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Adequate financial resources for local authorities

Governance Committee
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Summary

The right of local authorities to adequate financial resources is a key principle of the European Charter of Local Self-Government (Article 9, paragraphs 1 to 4). Nevertheless, the failure of national and regional authorities to respect this principle is a frequent complaint of local authorities. In December 2013, in the framework of its dialogue with the Committee of Ministers, the Congress Bureau identified the lack of adequate financial resources as one of the “recurring issues” it encountered in the course of its monitoring activities.

To assist all levels of government to better understand and more effectively apply this principle, the Congress makes a series of proposals and recommendations, notably that there be regular reviews of the correlation of resources to competences and that an explicit and detailed consultation procedure be agreed to govern the necessary negotiations concerning local authority grants and taxation powers.

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

Adequate financial resources for local authorities

RESOLUTION 372(2014)²

1. Effective local self-government requires adequate financial resources in order to manage a substantial share of public affairs under their own responsibility in a meaningful manner. That is to say, financial resources which are commensurate with the responsibilities attributed to local authorities by national and regional governments, whether in the constitution or by-laws and government decisions. The principle of connectivity -“who orders pays”- should, if possible, be anchored in national or federal state constitutions. The constitutional incorporation of that principle is the most powerful legal instrument to protect municipal interests.”Article 9 of the European Charter of Local Self-Government protects the right for local authorities to have their own resources, which the Congress believes is a prerequisite to effective and accountable local governance.

2. The Congress has noted, through its country reports on the implementation of the Charter in member states and complaints received from national associations, that many local authorities are facing increasing difficulties to cover their mandatory tasks and functions and few have the power to raise their own revenues, through charges and local taxes, or to determine their expenditure priorities.

3. A fundamental duty of local elected representatives is to make political choices in weighing the benefits of local authority activities against the cost to the local taxpayers and service users. These activities include the provision of local public services, as well as a range of other local authority responsibilities such as cultural activities and activities in favour of integration and social cohesion. Although overall spending limits may be set at a national level, it should be borne in mind that local authorities are accountable first and foremost to their electorates for the services that they provide.

4. The Congress is concerned that in some member states the balance of central transfers has changed, with earmarked or ring-fenced transfers becoming increasingly dominant at the expense of general grants, which are at the discretion of the local authority to decide where the money is spent. The result is that local authorities have too little discretion in developing their policies and activities.

5. The Congress is also concerned about the tendency in some countries to recentralise competences and the related financial resources in the name of austerity and rationalisation programmes.

6. The Congress, aware of the need to ensure that local financial resources are spent efficiently and effectively on local priority needs, welcomes improvements in financial methods and techniques to ensure value for money in the delivery of public services and functions and resolves to encourage innovation, training and sharing of good practice in local financial management.

7. In December 2013, in the framework of its dialogue with the Committee of Ministers, the Congress identified the lack of adequate financial resources as one of the “recurring issues” it encountered in the course of its monitoring activities.

8. The Congress asks:

a. its Monitoring Committee to continue to bring to the attention of the Congress those countries which are in non-compliance with their commitments under Article 9 of the Charter and to undertake, where possible, post-monitoring and cooperation activities to improve the situation;

b. 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, and to use the results of this exercise as the basis of discussions with the Committee of Ministers, in order to raise

² Debated and approved by the Chamber of Local Authorities on 14 October 2014 and adopted by the Congress on 15 October 2014, 2nd sitting (see Document CPL(27)2FINAL, explanatory memorandum), rapporteur : Gilbert ROGER, France (L, SOC).

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;

c. its Governance Committee to present good examples of local authorities' involvement and consultation in the procedures and processes of the distribution of tax revenues according to their responsibilities, as well as endowing local authorities with their own resources.

9. The Congress asks national associations of local authorities and the national delegations to:

a. continue to defend and explain the needs of local and regional authorities during national and regional budget negotiations and ensure that regular reviews are conducted of the actual costs of mandatory tasks;

b. in those countries where it does not yet exist, to continue to lobby for transparent and public publication of the criteria and methods used to calculate central transfers and financial equalisation.

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RECOMMENDATION 362 (2014)³

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

2. However, recent Congress monitoring visits in the framework of the application of the European Charter of Local Self-Government have highlighted serious problems in some member states concerning the financial resources of local authorities, which are not limited to the effects of the financial crisis.

3. The Congress is also receiving an increasing number of complaints from national associations of local authorities concerning restrictions to local financial autonomy and resources.

4. A survey conducted by the Group of Independent Experts on the European Charter of Local Self-Government in 2013 reveals that, in a number of member states, the revenues of local authorities are so low that they are unable to finance their mandatory tasks and functions, suggesting that the national authorities in question are not respecting the commitments that they entered into in ratifying Article 9 of the Charter.

5. The Congress is aware that the Committee of Ministers, in its reply⁴ to Congress Recommendation 79 (2000)⁴, shares its view that a proper balance needs to be found between the delegation of responsibilities to local authorities and the financial resources available to these authorities, whether through grants or taxation.

6. The Congress point out that:

a. Member States party to the European Charter of Local Self-Government have undertaken to provide local authorities with financial resources which are adequate and match the competences that they have been attributed; these financial resources should come partly from local taxes and charges, of which, within the limits of the law, they have the power to determine the rate;

b. local authorities should be consulted on the way in which redistributed resources are allocated to them;

c. the legal authority and responsibility to perform certain functions is meaningless if local and regional authorities are deprived of financial resources to carry them out;

d. Member States have considerable freedom to find a way to ensure adequate resources for local authorities; central grants; share of central taxes; charges and fees for public services; local taxes amongst others;

e. most member States do not restrict how local authorities spend their financial resources, in theory, but in practice the majority of local revenues are spent on their own and delegated "mandatory tasks" and functions leaving little left for own-decision spending priorities.

³ See footnote 2.

⁴ [CM/Cong\(2001\)Rec79final](#)

7. The Congress is concerned that:

- a. in many member States, local and regional authorities still do not have the power to determine the rate of local taxes or charges, within the limits of statute;
- b. local authorities in some member states do not have enough financial resources to cover the mandatory tasks and functions allocated to them by national and regional authorities;
- c. there is a tendency in some countries to recentralise tasks and finances in the name of austerity and rationalisation programmes, removing decisions from the level closest to the citizens;
- d. there are still member States which transfer competencies to the local and regional level without the commensurate transfer of funds;

8. Bearing in mind:

- a. Congress Recommendation 79 (2000) on the financial resources of local authorities in relation to their responsibilities: a litmus test for subsidiarity and the Deputies' reply of 14 March 2001 which states that "the Committee of Ministers shares the view of the Congress that the right balance should be found between the implementation of decentralisation of responsibilities and the financial resources of local authorities.";
- b. Committee of Ministers' Recommendation Rec (2005) 1 on the financial resources of local and regional authorities which contains guidelines for central authorities, and underlines the fact that local self-government implies a degree of financial autonomy;
- c. Congress Recommendation 340 (2013) on local and regional authorities responding to the economic crisis;
- d. the Kyiv declaration and Kyiv Guidelines, adopted by the Ministers Responsible for Local and Regional Government at their Conference in Kyiv (Ukraine) in 2011, calling for joint action by national governments and local and regional authorities in responding to the economic crisis;
- e. Parliamentary Assembly Resolution 1886 (2012) on the impact of the economic crisis on local and regional authorities in Europe, and Resolution 1884 (2012) on austerity measures;
- f. The overview of "recurrent issues" encountered by the Congress in the course of its monitoring activities, submitted by the Congress President to the Committee of Ministers on 13 December 2013;

9. The Congress therefore asks the Committee of Ministers to invite member states:

a. to ensure that :

- i. decisions taken on a national and/or regional level concerning the allocation of financial resources to the local level are done so in a public and transparent manner;
- ii. the balance between mandatory tasks and functions and the resources available to local authorities is regularly reviewed and discussed between the different levels of government concerned;
- iii. effective consultation mechanisms are established to ensure the views of local authorities are taken into account during budget planning;

b. to provide local authorities, within the national economic policy with;

- i. adequate finances to meet mandatory tasks and functions;
- ii. the powers to raise their own revenues, to match their responsibilities with respect to expenditure;
- iii. the freedom to decide on expenditure priorities;

10. The Congress asks the Committee of Ministers:

a. to invite those member states which have not done so to consider ratifying Article 9.5 of the European Charter of Local-Self Government, which provides for the protection of weaker local authorities through the use of financial equalisation measures, to enable local authorities to provide a consistent level of public services;

b. to include, in its political dialogue with the Congress on the situation of local and regional democracy in Europe, the issue of adequate financial resources for local authorities, at least once during every Congress mandate (every four years).

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EXPLANATORY MEMORANDUM

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1. Introduction

1. The purpose of this report is to examine the implementation of Article 9, paragraphs 1-4 of the European Charter of Local Self-Government (CETS No.122) and to compare the current situation in the Council of Europe member states.

2. On this basis, the main objectives of this report are:

- to review the different financial systems on which resources available to local authorities are based;
- to assess whether they are sufficiently diversified and buoyant in the face of the world financial crisis beginning in 2008; and
- to look at how the principle of 'adequate resources' is defined within the national economic policy.

3. It is doubtful whether a comprehensive objective comparison can be made between Council of Europe member states in relation to the Article 9 of the Charter, not only because the Charter uses general and abstract concepts such as 'adequate financial resources', 'commensurability' of finance and tasks or 'local taxes', but because of the great differences between local government financial systems in the various countries. Furthermore, any assessment of whether the financial means available to local authorities are 'adequate' to their tasks and functions largely depends on the national circumstances of each state. Consequently, any conclusion drawn in a particular member state can only be of limited validity and relevance for other countries. Nevertheless, the major objective of this report is not to compare the situation of the member states by evaluating whether local government

funds are adequate in them, but rather, to examine how the adequacy principle is recognised in law and in practice.

4. This report is based on the 29 country reports⁵ which were prepared by members of the Group of Independent Experts on the Charter⁶ in response to a questionnaire drafted by Prof. Zoltán Szente on the situation in member states of the Council of Europe.

2. Local revenues and the freedom of local authorities to use them

Article 9, paragraph 1: Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

2.1 Definition and types of local (or 'own') revenues

5. Article 9, paragraph 1 of the Charter contains two basic requirements for local government finance. Firstly, local authorities must have their so-called 'own resources', these resources must be sufficient for fulfilling their tasks and functions. It does not mean that local governments should finance all their responsibilities from their own revenues. In a number of countries, a substantial part of local revenues comes from central grants and subsidies. However, local authorities must be entitled to resources of their own, and they must have the power to raise revenue on the basis of their own decisions.

6. Secondly, the Charter requires that local authorities should have financial autonomy in spending their revenues. This means that local authorities should be able to complete their other revenues, and to have financial capacity to set expenditure priorities in an autonomous way. This requirement is connected to the previous one, because, logically, local authorities can only have a margin of appreciation, if they have adequate financial resources.

7. To monitor the implementation of these requirements, the definition of 'own resources', and their differentiation from other revenues is essential. The Group of Independent Experts (GIE) has defined the term 'own resources' as follows:⁷

a. Local taxes are taxes that – within the limits of law – are levied by the representative body of local government, which is also entitled to determine the tax rate. In this term, the so-called 'shared taxes' (taxes that are levied by another authority, of which the local authority receives a share) do not belong to the 'local' revenues. Local authorities might have other taxation responsibilities (e.g. to determine their share in a central tax, or to run tax authorities);

b. Fees and charges are the revenues that are paid by users for public services delivered by the local government;

c. Revenues from using local government property or from other economic activities of local authorities.

8. This definition disregards all local government revenues that are transferred from any other authority or organisation because the scope of Article 9 paragraph 1 does not cover central grants, local governments' share in national taxes, credits and loans or any other transfers from public bodies or private organisations.

9. Although local authorities in most member states have all these potential resources, they sometimes use different terms to describe them. In many cases, as will be shown in point 2.1 below, some taxes are classified as 'local taxes', even if local authorities do not have any influence on their imposition and rate. For example, in Ireland a new 'local property tax was introduced on residential

⁵ The questionnaire was answered by experts from the following countries: Albania, Armenia, Austria, Azerbaijan, Croatia, Cyprus, Finland, France, Georgia, Germany, Greece, Hungary, Ireland, Latvia, Liechtenstein, Lithuania, the Republic of Moldova, Norway, Poland, Portugal, Romania, Serbia, Slovakia, Slovenia, Spain, Sweden, the Former Yugoslav Republic of Macedonia, Turkey, United Kingdom.

⁶ Information on the Group of Independent Experts on the European Charter of Local Self-Government can be found on the Congress website: www.coe.int/t/congress/Fonctionnement/WorkingGroups/default_en.asp?mytabsmenu=2

⁷ 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.

properties in 2013, though the revenue from this tax is transferred to a central fund to provide central grants to local authorities (which is normally to be considered as central transfers rather than local revenues). Moreover, in the various national accounting systems, the revenue structure can be quite complex and fragmented; thus, all specified resources are separated items, and are grouped into different clusters, such as revenues from 'fines, 'administrative charges and fees' and so on. Nevertheless, our definition of local or own revenues seems to be the appropriate analytical framework to compare various local government financial systems as well as to examine the implementation of the related provisions of the Charter.

10. The legal recognition of the local authorities' right to their own revenues varies in member states. In some countries, such as Croatia and Hungary, the national constitution guarantees this right of local governments, sometimes enumerating the most important local resources. More frequently, national constitutions contain the principle of adequate finance, without specified provisions or a particular reference to the own revenues of local authorities. In most member states, this right is acknowledged by national legislation, whereas in Ireland and the United Kingdom no relevant law has been enacted.

11. Only a few national experts reported on the share of own resources in local government budgets, so we have only sporadic data about the significance of these revenues. The rate is very high in Sweden, (approximately 82 percent in the municipalities and 78 percent in the counties), while at the other end of the scale is Azerbaijan, where the municipalities are in an extremely weak financial position. In this country the average per capita municipal income amounts to five euros per year. Total local government revenues are less than 0.14 percent of the consolidated state budget. Other countries shares of local revenues in local government budget fall in the middle of the scale: Croatia 11-12%, Latvia 14-15%, Poland 45 %, Spain 48% (20% in the provinces).

12. It is worth noting that in some cases local authorities do not receive revenue from each of these resources. Article 9, paragraph 3 specifies that local authorities should receive revenues from 'local taxes and charges' so non-compliance with this particular aspect of the Charter is examined further under the relevant section below.

13. Many authorities face the problem of extremely low or minimal share of local revenues. Although the Charter does not specify what percentage or share of local revenue should make-up government resources, it refers to the principle of the 'adequate financial resources'.

2.2 Limitations on local authorities' rights to freely dispose of their own resources

14. According to the Charter, local authorities should be able to dispose freely of their revenues. On the whole, local authorities in member states may freely decide how to use their own resources, as there are no specific legal limitations concerning their expenditure priorities and spending decisions. Nevertheless, in some countries indirect restrictions and informal constraints may exist which reduce the real financial autonomy of local authorities.

15. Nevertheless, some national experts reported that in reality the share of local revenues is so low that local authorities, even in the absence of formal restrictions, do not have wide discretionary power to spend their own resources. Many other experts expressed the view that even if the share of local revenues is significant, local authorities still lack funds to finance their mandatory tasks and functions, so the freedom to dispose of their own revenues does not mean that they can enjoy a real financial autonomy.

16. First and foremost, the function of the local revenues is to cover the costs of the fulfilment of mandatory tasks and functions of local authorities. They are public bodies serving the public interest, with often wide-ranging responsibilities for satisfying the needs of local population. The central grants, the shared taxes, and other contributions themselves are nowhere enough to carry out the compulsory tasks of local authorities. In fact, all local resources are target-bound revenues.

17. Therefore, although local authorities may enjoy considerable freedom in spending their own revenues in theory, it is actually a widespread principle in member states that the implementation of voluntary tasks cannot endanger the fulfilment of mandatory functions.

18. Moreover, in a situation where a targeted central grant does not cover the real costs of a delegated task, local authorities must supplement the missing resources from their own revenues.

19. Local authorities have to follow some general rules and to meet certain standards and requirements when spending their own revenues. There are basic requirements and quality standards for basic local public service provision in all countries which impose obligatory costs on local budgets. This means that in some areas, local authorities are obliged to observe statutorily prescribed standards and methods which might have serious financial implications. When all these requisite demands are fulfilled through the various sources of revenue available to local authorities (both local own resources and central grants) very little remains for discretionary spending.

20. Local authorities must also comply with general rules concerning their staff and administration. Staff members have to be paid according to national legislation on civil service or other employments.

21. There is a growing tendency to restrict local financial autonomy, which has developed mainly as a result of the world economic crises. In some countries, the central government has launched financial consolidation programmes in order to assist local authorities which have high debt burdens or find themselves in a detrimental financial situation. Such programmes exist in Greece and Germany, among others. Although local authorities may choose, or request, to join these programmes, the participation in such consolidation projects inevitably imposes some restrictions on the local authorities' financial autonomy, allowing stronger central control over their financial management.

22. Another consequence of the world economic crises is the new debt ceiling legislation that has been introduced in some member states over the past few years. According to new laws on economic and financial stability, for example in Austria, Hungary, and Spain, local authorities are obliged to pass a balanced annual budget. In some cases, the budgetary planning process is also constrained by other requirements, such as a transparent, efficient and comparable financial management reporting obligations. A balanced budget, debt ceiling limits or other budgetary discipline rules are real limitations when imposed on local governments, especially when the central government may sanction their non-compliance.

23. There are some examples of central government decrees which limit local authorities' ability to determine their spending priorities. This appears to be the practice in some Caucasus countries, such as Georgia or Azerbaijan, where participation in some national development projects is obligatory for local authorities.

24. In addition, in some countries there are particular limitations which operate in particular circumstances or regulatory conditions. In Britain, the *ultra vires* principle operates to restrict spending priorities. The principle means that local authorities can spend their revenues only in accordance with the *expressis verbis* provisions of law and thus for purposes authorised by statute. Furthermore, in this country, local authorities have an obligation to operate subject to statutory 'best value' rules. In Hungary, central legislation defines with what types of private corporations local authorities may contract for providing certain public services.

25. Finally, as some national experts highlighted, even if there are no legal restrictions on how local authorities can use their own revenues, in practice, the persistent lack of resources of municipalities makes local financial freedom illusory; it minimises the room for manoeuvre for local authorities to set their own policy preferences. All in all, if local authorities do not have enough money, it does not really matter which statutory obligation is fulfilled first.

3. Local taxes and charges

Article 9 paragraph 3: Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

26. According to this provision of the Charter, local authorities, within the limits of law, should have taxation powers, and the right to determine the rate of charges and fees for local public services.

3.1. Local taxes

27. The standard method in member states is that all types of local taxes are determined by law. The relevant legislation contains the conditions of these taxes, also frequently setting their maximum rates of imposition. The various municipalities are more or less free to choose which and how many taxes they may levy. This is sensible, as local councils are in a better position to decide what kind of taxes are the most suitable in the light of local conditions.

28. In some countries, there are mandatory local taxes. In Latvia, for example, the real estate tax, which is defined as a 'state tax' by law, seems to be the only local tax, as local authorities administer and collect it, and, since 2013, they have had the right to set its rate or provide tax relief within the limits of the law. In Armenia, two of the three local taxes, the property tax and land tax, are compulsorily levied by municipalities. In a strict sense, mandatory taxes are not local taxes, as their choice or imposition is not based on the local governments' own decisions, and they have no any influence on them. In Britain, business rates used to be paid to central government and then distributed to local authorities using a formula based on local needs. Under the new system, introduced in April 2013, a limited form of local retention of rates has been introduced, allowing authorities to retain 50% of any growth that exceeds the local rates that have been set. However, if the 50% retained is high, in proportion to the overall council budget, a further levy is applied, so in some authorities the level of retention can be as low as 25%. Whilst local authorities can gain from increased levels of business rates, they are also exposed to any loss if, for example, a large business in their area closes down.

29. The autonomy of municipalities usually includes the power to determine the rate of the local tax, within the limits of the relevant law. This is a general rule in member states, with only one or two exceptions. In the Republic of Moldova, a recent legislation abolished all tax ceilings, so local authorities have full power to set the tax rates. For a couple of years, there have been no limits for setting the rate of local property tax for municipalities in Slovakia either. This allowed the municipality of Bratislava to counterbalance the loss of central grants after 2005.

30. Exceptionally, some local authorities are enabled to 'invent' new forms of local taxes, without any breach of the taxation power of the central government. This is the case in Austria and Germany, where local authorities may impose new taxes not levied by the federal or state legislation.

31. Where a two-tier local government system exists, the regional (county, provincial, etc.) governments often levy other taxes than the municipalities, if they have any taxation power at all. Usually, the second-tier self-governments have less revenue from local taxes than the basic-level local authorities.

32. There is a great variety of the local taxes according to the tax base and the share of these taxes in local revenues. The relevant tax codes of the member states comprise, on average, between three and 15 types of local taxes. In practice, local authorities levy from three to five such taxes.

33. One of the most widespread types of local taxes is the (local) business tax, levying the turnover of the local corporations or other business activities. This kind of local tax is quite popular, as it provides a stable and predictable revenue for municipalities. Moreover, the power of levying business tax, at least in well-developed urban areas means also gives a competitive advantage to municipalities, as they may attract new investments by tax exemptions or low-level tax rates. Nonetheless, the amount of this tax is highly dependent on the economic development of the various communities therefore local communities in poor regions cannot raise sufficient revenue from this resource.

34. Another widespread local tax is property tax. This type of local taxation has several different sub-types, as commercial properties can be taxed as well as residential or non-residential real estate in the administrative area of the municipality. The rate of property tax, within the limits of the law can be a lump sum, or can be based on a specified valuation of each residence. In some member states, local residents have to pay local tax only for their second residential property or other non-residential premises.

35. Other possible local taxes are levied on possessions, such as motor vehicles, boats, pets, or certain activities, such as tourism, entertainment, advertisement, etc. Consumption-based taxes are rarely used as local taxes, and when they emerge, like in Turkey for electricity and coal gas

consumption, they replace fees and charges for certain local public services. Sometimes special or unusual kinds of local taxes are applied, for example, the tax for 'using local symbols' in the Republic of Moldova. Certainly, in all cases the basis for tax liability is that the taxed property, activity or consumption is, or takes place in, the administrative area of the particular local authority.

36. Of course, the difference between levied taxes can be quite substantial. It is quite usual that a special kind of corporate tax is by far the most important, and some other taxes are imposed on special or luxury properties, like motor vehicles, boats, or activities, like hunting or fishing. Even the same tax might have extremely different importance depending on the location, wealth or other conditions of the various municipalities. Apparently, in holiday resorts, the municipalities have much more tax revenue from tourism than in rural areas, as the economic development has also a decisive role in tax revenues in general.

37. It is to be noted that in some countries, such as Germany and Hungary, the central government has proposed the abolishment of local business taxes as an instrument for economic recovery or development, but these plans have not been realised at the time of this report.

38. As to the share of local taxes in local revenues, their percentage as part of the local government budget is only an informative indicator of the state local finances, as the various local authorities may have extremely different revenues from these sources. Apparently, in undeveloped areas or in poor towns, local companies pay a much lower amount of business tax than in well-developed urban areas. Additionally, in some countries, there are no strict boundaries between local taxes as defined above, and 'shared taxes' such as VAT or personal income tax which are centrally levied and collected, but of which local authorities have regular revenues from a fixed percentage. In Austria, for example, the money from shared federal and *Land* taxes constitute about one-third of the total local revenues. Notwithstanding, local authorities do not have any real influence on the amount of their revenues from these shared taxes, which are imposed and determined by national legislation, even if their share is usually fixed by law.

39. In theory, the higher the local tax revenues, the better the income structure of local authorities, because other local or 'own' resources provide fewer opportunities to raise revenues or just keep their level. The percentage of local taxes in 'own revenues' varies between 10 and 90 percent in member states (the highest can be found in Poland).

40. In some countries, local taxes are collected by central tax authorities, for example in Georgia, but it is only the administrative method of tax collection, the local character of the tax does not change.

41. As a matter of fact, the regulation and practice of local taxation can lead to a violation of the Charter. In some member states, the power of local government to levy taxes is recognised neither in legal, nor in practical terms. The Lithuanian legal system does not have a concept of local taxes. Although the municipalities have some revenue from taxes, they have only weak rights of reducing the tax rates or providing exemptions from them. So the problem is bigger than what to call certain taxes of which municipalities have a share, because they cannot decide what kind of local taxes could be the most appropriate under the local circumstances. There is a similar situation in Latvia, at least in legal terms, as the legal system recognises only 'state taxes'. However, municipalities receive their entire revenue from the real estate tax, which is levied and collected by the central government. Local authorities may determine the tax rate, and may decide on the tax relief, within the limits of the law, of course.

42. As mentioned above, in Azerbaijan, local authorities only have a minimal amount of local revenues, so it is not surprising that the municipalities do not receive sufficient resources from local taxes either. Although the national tax code recognises two local taxes (land tax and property tax), and their share is very high (89 % in 2012) of local government revenues, when you look at the average five Euro amount of annual central support for local authorities, it does not really matter what the rate of these tax revenues is.

43. In Spain and in Hungary (and presumably, in some other countries) the regional authorities (i.e. the Spanish provinces and the Hungarian counties) do not have any taxation power, even if they can get some revenue indirectly from municipal taxes. Thus, in Spain, the provinces do not have any taxation power, they have only a surcharge on the municipal tax on economic activities. (However, the three provinces of the Basque Country enjoy large taxation powers, since they may impose personal and corporate income taxes.)

3.2. Fees, charges and other local revenues

44. Local authorities can also raise their own revenues from fees and charges for the public services they provide for the local population. These can vary: social housing rents; parking fees; charges for the use of public spaces; water, gas or electricity; fees for libraries and other local public institutions. The terminology for the 'fee' that the users have to pay varies, with other terms frequently occurring, such as 'duties' and 'contributions'.

45. The rate of fees and charges can be determined by different methods, depending on the nature of the public service or the central legislation. More often than not, the amount of public service provided is set by the local government, in particular in those cases when the service is provided by its own institutions. Besides that, the public service fee can be limited by law, setting the lower and upper limit of the service price. And finally, especially in case of public utilities, the fees are exactly defined by law, not leaving any discretionary power for the local authorities. This can be disadvantageous for municipalities, because the centralised pricing authority can hardly be susceptible to local conditions and needs.⁸

46. Most commonly, the basic principle is that the fees and charges should cover the real costs of public service delivery, but in certain cases, mainly in cultural or communal (water supply, gas, electricity) services, this requirement cannot be met.

47. Local authorities may have incomes from the sale or utility of their own real estate property, i.e. local government companies, council flats or lands. Certainly, local authorities have only limited sources for utilisation, and the primary function of their property is to enable the municipalities to carry out their mandatory tasks. In addition, the presence of such resources varies enormously in the various municipalities.

48. In a number of countries the local authorities, or their institutions, within the limits of the law, may engage in business activities to raise additional financial resources. This can take several different forms, from owning business-like organisations to participating in financial transactions. In fact, smaller municipalities or poorer local communities do not have appropriate property or capacity for doing business, but such revenues are often insignificant even in the bigger and richer municipal governments.

4. The commensurability principle in local government finance

Article 9 paragraph 2: Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.

4.1. Recognition of the 'commensurability' principle in national legal systems

49. This article of the Charter contains a general requirement of commensurability between the financial resources and the tasks and functions of local authorities, regardless of the sources of local government revenues. The Charter requires a balance between the total revenue of local authorities and the mandatory responsibilities, determined by law.

50. Clearly, it is extremely difficult to assess whether there is such a balance. Nevertheless, this requirement sets some conditions for transferring tasks to local authorities. Thus, any assessment requires a clear definition of the competences allocated to 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.

51. In the framework of this report, the terms 'commensurability' and 'adequacy' refer to the requirement under the Charter that local authorities receive sufficient financial resources to enable them to carry out their tasks and functions. As a matter of fact, there is not a more precise definition of

⁸ For example, in Hungary, when the central government, without any prior consultation, decided to reduce uniformly the housing costs by 10 percent (reducing public utility bills), and announced a following reduction before the end of 2013, a number of local authorities suffered a great drop in their incomes.

'adequacy' in this area; the question relates to the meaning of this concept within the different national legal systems.

52. A vital issue is the manner in which local governments are guaranteed access to adequate financial resources and the kind of constitutional and legal rules that exist in the member states to ensure this.

53. From the analysis of the national reports, it is clear that this principle is recognised by the constitution and the relevant law(s) in most member states. The principle of adequate finance of local authorities is constitutionally acknowledged in some way in Armenia, France, Georgia, Greece, Hungary, Poland, Serbia, Spain, Slovenia, Sweden, and Turkey, while in Germany, the jurisprudence of the Federal Constitutional Court recognises it as a constitutional requirement. Most relevant constitutional provisions contain the principle in a clear and unambiguous way, referring to the 'adequate', 'sufficient', 'corresponding' or 'proportional' finance as a condition of transferring new responsibilities.

54. In France, a 2003 constitutional amendment introduced a new provision declaring that 'the tax revenue and other own resources of the territorial units' should represent 'a decisive share of their resources'. Sometimes, the principle is formulated as a negative requirement or as a prohibition, stating that no mandatory tasks may be transferred to local authorities without the parallel provision of sufficient resources. In Austria, this requirement can be deduced from a federal constitutional law stipulating that in the course of the financial equalisation process, the administrative burden imposed on territorial tiers as well as their capacity limits must be considered. Understandably, national constitutions nowhere define either the criteria of 'adequacy' or 'commensurability', or any other specified (e.g. procedural) rules for its implementation. Apparently, it is the function of statutory rules in all countries, so the constitutional recognition is usually repeated or specified by the ordinary legislation.

55. There are some countries where the principle is defined by one or more laws, without an explicit constitutional recognition. This is the case in Latvia, where the Law on Local Governments prescribes that in the law transferring new functions to local authorities, the same legislation must determine new sources of revenue for them. In some countries, such as Lithuania, the relevant laws go beyond the simple declaration of this principle, and specify also the methodology of calculation of the central transfers (or of the planning procedure).

56. And finally, in the United Kingdom, Ireland, Lithuania, Norway and Portugal there is no explicit reference to the 'commensurability principle' at all. However, this does not mean that it is an unknown principle or practice. In England, for example, the assessment of the overall level of local government spending is developed in the annual determination of levels of central grants and the division of them between local authorities. Similarly, in Scotland, in setting the total level of local government support, the ongoing responsibilities and any new burdens or transfers of responsibility are also considered. However, in Ireland, the commensurability principle emerges neither in the legislation on local government, their finance or in framework legislation, nor in government policies and programmes for the reform of local authorities.

57. In certain countries, such as the Republic of Moldova, parliamentary legislation recognises the commensurability principle not only in general terms, but it also specifically defines the compulsory as well as delegated state administrative tasks.

58. In Austria, Germany and Slovenia, the relevant legislation also includes procedural rules for negotiating or determining the level of adequate finance. Thus in Slovenia, a law has stipulated since 2007 that Government should sign an agreement with local government associations on the amount of the appropriate average per capita expenditure before the budget proposal for next fiscal year is submitted to the Parliament.

59. Some experts indicated that the implementation of the adequacy principle is often doubted by local authorities or their associations, like in Hungary, Latvia or Poland. In Germany and Austria, the alleged shortfall of the sufficient finance is sometimes the subject of constitutional complaints launched by municipalities.

4.2. The requirement of commensurability between the mandatory tasks of local governments and the correspondent financial resources

60. The 'adequacy principle' has two major dimensions. Firstly, local authorities should have enough financial resources to carry out their mandatory and voluntary tasks and functions. Secondly, commensurability of local resources can also be examined in relation to the specific tasks local governments perform.

61. By all appearances, while the costs of individual public services are estimated using more or less objective criteria, the calculation of the total budget of local authorities is an extremely complex issue.

62. A comparative analysis is very difficult, as there is such a large diversity between various local government systems. In Georgia, for example, there is no general or block grant, or, more exactly, there is only an 'equalisation grant', while in most countries the financial equalisation system has a special function of equalising the economic and financial differences of local authorities, in addition to the general grants. These technical or terminological distinctions should not be given too much importance, as the basic question is how to provide a fair balance between the tasks and the financial resources of local authorities in general terms.

63. According to some national reports, there is no practical method of implementing the commensurability principle; it prevails neither in budgetary planning, nor in actual funding. Primarily, this seems to be a feature of some Caucasian countries, but some other experts expressed also their doubt whether such a methodology exists in practice. For one expert, the principle is only an 'illusion, without any legal or institutional guarantee to be ensured' (Croatia); for another, it is only 'a formal declaration' (Republic of Moldova).

64. However, the lack of accurate, systematically elaborated criteria for calculating costs of the fulfilment of the various responsibilities does not mean that the principle of sufficient finance is completely neglected. It might be a plausible view that the commensurability principle is such a broad guideline that it cannot be fully satisfied at a general level.

65. As some experts refer to it, the whole process falls within the scope of responsibility of one or more ministries or other units of central government. Unfortunately, there is no available information about these processes.

66. Where we have some knowledge about the way central budgetary planning works, the reports mention two main methods. Accordingly, the cornerstones of the annual budget are determined either on the basis of a national-level estimation of needs or on the local level using the previous year's amounts (or indicators).

67. In some countries there are consultations between the central government and local government associations concerning the levels of adequate finance. In Spain or Norway, for example, the national association of municipalities represents the interests of local authorities, and lobbies for adequate financial resources.

68. Although sporadically there are some efforts to establish a system for a more precise planning for local government budgets, taking into account the real costs of the mandatory tasks, they have not yet produced satisfactory results. Thus, in Slovakia, according to a law, municipalities have to implement a so-called 'programme budgeting', rendering objective and measurable indicators of service delivery and cost assessment. Twice a year, local authorities have to monitor whether the goals have been achieved. But, according to the Slovakian report, this 'is just fiction' and the local authorities do not have access to sufficient financial instruments to achieve their 'programmes'.

69. It is also worth noting that the examination of commensurability between the tasks and the resources is used in calculating particular central transfers rather than in the planning process of the total local government budget (see the next point).

4.3. Guarantees of adequate finance in central transfers

70. In terms of this report, 'block' or 'general' grant usually means a large sum 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 must be spent only (and exclusively) on the determined targets. Both the block and the specific grants⁹ may be transferred as a lump sum (i.e. a single payment), or as periodic (e.g. monthly) payments to local authorities. Since this categorisation is rather a technical one, this classification is not used in this report.

71. As to the calculation method for block or general grants, there is a difference between the practices of the member states, whether the amount of these subsidies is estimated at central level for all local authorities, or whether they are estimated separately for each municipality.

72. For the first method, a 'basis approach' is used also in many countries, when the total expenditure of the previous year is taken as a basis, and is modified by certain factors (e.g. by the rate of inflation) for calculating the general operational costs of the local authorities. This means that the average or the particular (specified for the individual municipalities) costs of the various mandatory tasks are not assessed every year, but the preceding figures are taken as a reference for the next budget.

73. In certain countries, like in Hungary from 2013, a so-called 'task-based' approach is used, based on a general assessment of the real costs of each responsibility, often corrected by different variables for the various types of municipalities.

74. In the course of such a calculation, it is usual that the planning authorities take into account various data and information. Most frequently:

- the size of population;
- the level or amount of 'own revenues';
- the local authorities share of central (or regional) taxes;
- the average cost of the particular tasks and functions;

are taken into consideration. More often than not, this data is corrected by other indicators, such as the administrative status of the municipalities or their special geographical conditions. Corrective mechanisms are also used when a local authority does not reach a national or average level of revenues from the various sources. Thus, the calculation process is usually a highly complicated mechanism, applying a number of indicators and arithmetic operations. Obviously, these are not entirely accurate assessments, but their accuracy depends on the particular tasks. For example, the central grants for teachers' salaries can be precisely calculated if statutorily defined salary rates are used. In other cases, the estimation of the real costs is not so clear-cut, as the provision of the same public service might have significantly different prices in the various regions, or simply, because some variables are not known in advance.

75. Technically, the calculation methods used for allocating sufficient resources, in most cases, cover both the estimation of local needs and resources. Optimally, the level of budgetary support is the difference between these two rates, but in reality, as some reports stress, other financial considerations often override this method.

76. Despite the complexity of data and the methodological difficulties, in some countries, the average costs of the statutory tasks and functions are estimated each year, for each municipality. In Slovenia, the calculation is based on the real costs of service delivery in the previous two years, corrected by objective criteria set by law. In Ireland, the approach known as the 'Needs and Resources' model is used to determine general purpose grants assessing the expenditure needs of each local authority.

77. As for calculating the local governments' percentage of the so-called shared taxes, the transparency and predictability of these resources is highly important, as in many countries local authorities have greater revenue from these taxes than from central grants. From this aspect, the adequacy principle prevails in the same way as calculating central grants; whereas in some countries

⁹ These central supports are called 'conditional' and 'unconditional' grants in some countries.

the share of local authorities is a percentage fixed for many years, in other countries it is redefined from year to year.

78. In general, more sophisticated methods are used for allocating specific ('targeted' or 'earmarked') grants. It is simply much easier to count the real cost of a particular service delivery for which the central support has been provided. Even more precise mechanisms are used for some capital expenditure, when the implementation of an investment needs a refined planning process. In this way, the financial supports of EU funds, for instance, are guaranteed by individual agreements and/or central government decisions. Since EU funding has accurate and strict rules, presumably the adequacy principle prevails in this area.

79. Complicated formulas are used for allocating equalisation funds in most countries. True, in some of them the precise method, if there is any, is unknown to local authorities, even if the financial equalisation has a crucial role in equalising the regional discrepancies and the different economic capacity of municipalities and regional governments. As far as technical information is available concerning the calculation methodology, it can be said that similar data are used in the member states. Nevertheless, the internal logic of the redistribution differs from that of other central transfers, as the equalisation systems concentrate on the immediate financial needs of the local authorities which are in financially detrimental situations, rather than on the balance of statutory tasks and financial resources.

4.4. The implementation of the principle of adequate finance of local authorities in the member states – problems and challenges

80. The questionnaire asked every national expert to give their opinion and evaluate how the principle of sufficient finance of local authorities is implemented in their country. Of course, it is hard to provide a general assessment of the implementation of this principle even in a particular country, since local authorities might be in extremely different situations. The financial situation of the large cities cannot be compared to those of the small ones, even if they have formally the same competences, as is the case in many countries. Thus only certain trends can be noted here.

81. First of all, it is a frequent view in the national reports that there is no balance between the responsibilities of local authorities and the respective financial resources. According to some experts, this relationship is 'unbalanced', the local authorities are 'chronically underfinanced', local finance is a 'funding gap', while others think that the principle of sufficient finance is 'illusory' or is only an empty idea. The last opinion has merit as, apart from rare examples, the content of the principle, even if it is recognised by the constitution or the laws, is not clarified by lower-level regulation.

82. The national experts cited many reasons for this situation: municipalities provide some non-mandatory tasks (as voluntary or involuntary commitments) for which central government does not allocate any resources; the general and/or earmarked grants do not cover the real costs of service delivery; when delegating tasks and functions the central government fails to provide corresponding finance for local authorities, etc. As some experts underlined, economic mismanagement and unaccountable financial strategies of local authorities can also account for insufficient financial resources, at least in some cases.

83. Only a few experts have reported a balance between the financial instruments of local authorities and their duties. This is the situation in some well-developed countries which were not deeply affected by the world financial crisis, such as Liechtenstein or Sweden.

84. No doubt the lack of a transparent and secure planning process places local authorities in a vulnerable position, because they have no guarantee that they will get sufficient resources for their operations in the future, which can cause difficulties for local governments to make their own operational and investment plans.

85. Certainly, it is in itself a problem if there is no transparent method of calculation to provide adequate financing, because in such cases local authorities have no say in the decision-making process, which can so deeply affect their interests and operations. Under these conditions, the real needs of local authorities can easily become only secondary considerations in the planning process, referring to the poor resources 'which are available' in the state budget.

86. One of the most frequently mentioned problems of finance is that both the central estimation of local government needs, and the so-called 'basis approach' ignore the regional differences and the resulting fiscal capacities of local authorities. Another difficulty stems from the fact that sometimes 'historical' data are taken as a basis for calculating needs and costs, as the Spanish report supposes. In Hungary, for example, a real cost analysis of the several different mandatory functions was made back in 1991; ever since then, the figures of the preceding year have served as a basis for the new calculation.

87. Another recurring problem is that, even if there is an elaborated mechanism for the planning process in central government, local authorities or their associations are not consulted, or even informed about it, thereby the latter do not have any influence on the whole procedure. Without such consultations, the central government is presumably more insensitive to local needs, as well as the lack of actual information might cause difficulties. Other dangers might also arise, such as using central transfers for political purposes (e.g. in campaign periods).

88. The most frequent problem raised in the national reports is that the central transfers, regardless of how they are calculated, do not cover the real costs of the performance of the mandatory tasks. Sometimes there is no consensus about what kind of costs should be taken into consideration, because local authorities claim for the full costs of the fulfilment of mandatory functions, while the central government expects the municipalities to use their own revenues as well.

89. As a rule, if the central government delegates its own tasks (frequently called a delegation of 'state administrative tasks and functions') to local authorities, it simultaneously has to ensure the transfer of sufficient resources necessary for their fulfilment. Nevertheless, a lot of national reports refer to the recurring complaint of local authorities that it is not the case in practice. Although the costs of a particular delegated task can in theory be determined easily, some experts reported that no relevant legislation or specific techniques are known in this area. Furthermore, even if proper statutory guarantees can be found in a legal system prescribing proportionate or adequate financial resources for the newly delegated central government tasks, experience shows that the financial means transferred in parallel with the delegation of tasks are frequently insufficient, so they do not cover the real costs of the fulfilment of these tasks. Except for Austria and Germany, where local authorities may submit constitutional complaints against the inadequate finance, local governments (or other stakeholders) do not have any instruments to enforce those safeguards, so the principle of adequate finance may easily become a dead letter.

90. It is more difficult to assess the implementation of the commensurability between the delegated tasks and the financial resources allocated for their fulfilment where the local government functions and the delegated responsibilities are not clearly separated, and this issue does not make sense at all where such kind of delegation does not occur. In Albania, for example, the concept of 'shared responsibilities' of the central and local governments is 'unclear and misleading', while the category of 'delegated tasks' is not recognised in UK practice.

91. The lack of real guarantees of sufficient finance is even more conspicuous when statutory regulations prohibit local authorities to adopt annual budgets with deficit, or if the legislation punishes them if they exceed their planned expenditure, or do not respect the budget planning guidelines, as is the situation in some countries, such as Serbia.

92. In extreme cases, as in the Republic of Moldova, in the case of newly delegated state tasks, the issue of the corresponding finance does not usually arise.

5. The effects of the financial crisis on local government economic autonomy

Article 9 paragraph 4: The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

93. Article 9 paragraph 4 of the Charter establishes a requirement according to which local government finance should be flexible enough 'to keep pace' with the rise of costs of carrying out their tasks. This must extend to the capacity of local authorities to increase their revenues in order to be able to react to the changing economic and social circumstances.

94. In theory at least, local authorities have some opportunities to raise their own revenues. Nonetheless, almost all replies stressed that most of these possibilities are limited. Obviously, there are some 'natural' differences between municipalities in their capacity to increase their revenues depending on their size, number of inhabitants, economic development, and so on.

95. As described above, local authorities usually have the power, within the limits of law, to raise local tax rates, to widen the tax base, or even to introduce new local taxes. This means that local taxation powers could provide some possibilities for local authorities to increase their revenues. However, owing to the economic effects of the world economic crises and the longstanding restrictive economic policy of the central government in many countries, municipalities must consider the general tax burden of the local population, taking account of the impacts of the national taxes. Under these conditions, the great majority of local communities can draw the conclusion that the local population cannot be burdened by higher or new local taxes. Furthermore, when the rate of local corporate/business tax is set, local authorities, in particular in big cities or more developed regions, have to create a competitive economic environment, and this interest has tax-reducing effects. Finally, local authorities might have conflicting interests, if, for example, greater local tax revenues lead to less central funding.

96. Similarly, municipalities may increase local fees and charges paid by public service users. They may raise the amount of these charges, or sometimes may impose new ones (by extending the borders of pay parking zones, for example). Many large cities do that more or less on a regular basis. These opportunities also have their limits: in many countries, the prices of certain basic public services (e.g. electricity, gas, water) are centrally or legally fixed. Besides, a lot of public services cannot be delivered in a market-based way (like public transport, or cultural services).

97. Some experts also noted certain administrative revenues from penalties or procedural fees and charges (e.g. for issuing permissions). But all activities like sanctioning certain behaviours or exercising legal authority are strictly regulated, so these tools are available only to a limited extent for increasing revenues.

98. Another possible way of raising funds is utilising municipal property, that is selling or letting out local government properties (lands, council flats, companies). In most countries, local authorities may engage or participate in economic activity in a direct or indirect way (through municipal companies, for instance). However, the range of usable or profitable municipal property is limited, and local authorities have usually only limited capacity to do extensive profitable activities.

99. It is much more important that local authorities may issue bonds, or borrow credits and loans in the financial markets. In fact, these are not strictly speaker 'local revenues', since municipalities are using the money of others, but in this way they may get additional financial resources by their own decisions. Moreover, since the beginning of the world economic and financial crisis, stricter conditions and rules have been introduced in a number of countries for borrowing or other financial market transactions by local authorities. As a result, several different restrictions were placed on taking up loans or issuing bonds by local governments for community objectives. It is a widespread restriction that borrowing is confined to capital spending (i.e. it is prohibited for current expenditure). In the Republic of Moldova, local borrowing cannot exceed five per cent of the approved budget of the respective local authority, while in Hungary, Ireland and Slovenia all borrowing require central government approval. In Georgia, local governments are not allowed to borrow money in financial markets at all, while in Armenia it is not even a possibility for the municipalities.

100. Interestingly, some national replies expressed the view that local authorities may realistically expect a higher revenue only from a more rationalised and effective financial management, without receiving extra money from external sources

101. Finally, the questionnaire also addressed the effects of the world financial crisis on local government finance, and the capacity of local authorities to raise their revenues. It is not surprising that the crisis has affected the financial situation of local authorities in a negative way in almost all member states. Nonetheless, there have been quite different effects in the various countries, and some Council of Europe member states, such as Turkey or Azerbaijan have not been affected as much as the others.

102. But in most countries both local revenues and central transfers have decreased. The continuous loss of these revenues without any compensation or additional financial transfers contributed significantly to the budgetary imbalance of a number of local authorities.

103. Another tendency is that in some countries, strict regulations have been adopted to curb local government debts, so their capacity to borrow or receive loans is more restricted than before. In some countries, the structure of central transfers has also changed, and the specific or earmarked grants (which must be spent on specific targets) have become dominant at the expense of the block or general grants (which are more beneficial for local authorities, because they are free to decide how to spend them). In many cases, these measures and restrictions were elements of state-level economic recovery/stability/efficiency programmes, for example in Austria, Greece, Hungary, Latvia, Portugal and Spain. These measures frequently affected local authorities directly, reducing the number of local councillors or putting constraints on local government financial management (e.g. prohibition of planning deficit).

104. In particular, many experts reported that the capital expenditure of local governments has significantly dropped since the beginning of the world crisis. Local authorities have suffered from decreasing resources in indirect ways too. Thus, as a consequence of the world financial crisis, the overall revenue from personal income tax has decreased in almost every country, so the share of local governments in these revenues has also reduced. The narrowing of the tax base (from the rate of business profits to the household income) has been a general phenomenon since 2008.

105. The aggregate impacts of these restrictive tendencies can be seen, to varying degrees in the respective countries, in the dangerous increase of deficit in local budgets, the indebtedness of municipalities, and an overall imbalance in local finances. It should also be taken into account that in parallel with these financial losses, and linked to the world crisis, the needs of the local population for social benefits and assistance has exponentially grown, increasing further the financial pressure on local authorities.

106. It is worth noting that in some countries there have recently been dramatic changes in local government finance, for example, in Hungary, the share of local governments in GDP has fallen from 12% to 8–8.5% within a year. Behind these statistics, is a massive loss of local government responsibilities. Removing competences from municipalities can also be observed in other countries as well. Although the world financial crisis was frequently given as the reason for this recentralisation, this can be questioned. The danger is that some central governments are using the financial crisis as an excuse to gain more and more control and influence over local authorities.

107. In some countries, the consequences of the economic downturn has also led to the introduction of new techniques and methods of financial management, such as performance budgeting or 'task-based' finance, and to various administrative reforms rationalising public service delivery or other areas of local administration.

108. Although the world economic and financial crisis has had a number of negative effects on local government budgets, some experts reported on certain efforts and tendencies which are strengthening the financial autonomy of local authorities. In Poland, for example, there is a strong tendency to reduce central grants and subsidies in favour of raising the level of local tax revenues. In the Former Yugoslav Republic of Macedonia, a whole series of statutory measures has been taken with the purpose of strengthening the financial capacity of the municipalities. Such restructuring of local government finance might affect the economic freedom of local authorities in a positive manner, in so far as it does not result in a loss of local revenues. A similar trend can be observed in Slovenia since 2007.

109. While financial difficulties may encourage local authorities, in order for more effective service delivery, to cooperate with each other, the economic problems might raise, as a last resort, the issue of the reduction of municipalities; as has been the case in Cyprus.

6. Conclusions

110. As mentioned above, both the entitlement of local authorities to financial resources of their own, and the principle of commensurability between the mandatory tasks and their finance are legally recognised in the most countries. The Charter does not specify how these principles should be acknowledged by the national legal systems, it is sufficient if these requirements prevail in practice. At

the same time, it can mean a stronger guarantee for local authorities if these requirements are entrenched in the law, especially if such an enactment has legal sanctions (i.e. local governments have legal instruments to enforce the principle of adequate finance). However, since the achievement of the adequacy principle is an extremely complicated and difficult legal question in practice, a judicial remedy can only be recommended as the last resort.

111. Generally, local authorities are not restricted in how they spend their own resources, at least in a legal sense. So it could be concluded that the relevant principle of the Charter prevails in the member states. However, this is only a theoretical freedom because in reality the majority of local revenues are spent on mandatory tasks and functions. Nevertheless, it can be said that no serious legal limitations are imposed on local authorities in this field.

112. As the Charter does not determine the share or standard of own revenues in the total local government budget, it does not specify how much it should be. It is impossible to quantify what share of own resources would provide economic leeway for municipalities to meet the changing needs of the local population. Nevertheless, it can be noted that northern European countries generally find themselves in the best situation whereas Caucasian countries find themselves in the worst position.

113. With regard to the implementation of the Charter, some member states find themselves in a critical situation. In Armenia, revenues from local taxes are minimal, even if two taxes bear that name in that country. This seems to be clear a breach of the Charter. Another extreme case is Azerbaijan, where the share of local taxes in the tax revenues of the state budget is 0.25%. This means that even if municipalities have a right to levy local taxes, these revenues, for various reasons, do not have any significance. In some other countries, such as Hungary, the regional governments do not have any powers of local taxation, a practice which does not meet the explicit requirement of the Charter. In Cyprus, the annual budgets of the municipalities have to be approved by the Council of Ministers, which is a serious limitation of the financial autonomy of local authorities, even if 'in practice, the Council of Ministers is unwilling to disapprove the budgets or reject the local authorities' recommendations'.

114. From the national reports received, it can be concluded that the requirement to provide adequate financing to local authorities is much more than a guideline in the case of some particular central transfers. This means that while the commensurability principle is only an abstract standard for the overall local government finance, it is a more viable assumption when central transfers are calculated in the central budgetary planning processes.

115. The insufficient finance of local authorities cannot be measured exactly. The number of local government bankruptcies is not a suitable indicator, because municipalities may have a legal protection against bankruptcy. Besides, the economic capacities of local authorities vary even in the same country, and their financial situation depends significantly on their own policies and decisions.

116. In practice, the decisions concerning local authorities' share of national and/or regional budgets (i.e. the level of transfers) as well as concerning the amount or rate of particular grants are basically political decisions. These are made by national and/or regional parliaments and governments on the basis of the assessment of higher-level administrative agencies. The respective decisions can justifiably be influenced by political considerations, based, for example, on the financial situation of the given country. Article 9 paragraph 1 of the Charter itself emphasises that the entitlement of local authorities to adequate financial resources of their own should be provided 'within the national economic policy'. Therefore, the right to make the relevant final decisions on local government finance could hardly be removed from the national and/or regional authorities in the name of a general and abstract principle of the Charter.

117. There is a strong relationship between the first two Articles of the Charter, between the principle of adequate finance and the requirement of local governments' entitlement to 'own resources'. Local resources have a considerable role in supplementing central transfers, and in financing the general administrative and operational costs of local governments. At the same time, in some countries, like in Hungary, the costs of local government staff, building and equipment, both their current and capital expenditure are partly financed also by central transfers. Thus, the whole decision-making process can be an open-ended procedure in which the central government can justifiably count on the financial contribution of local authorities to the fulfilment of their obligatory tasks.

118. Nevertheless, member states have committed themselves to providing sufficient finance for local authorities, once they have transferred mandatory functions to them. This is an essential and well-emphasised criterion of local self-government in the Charter. As described above, this principle, in one way or another, is also a constitutional or legal requirement in the most countries, so national authorities are legally obliged to comply with it.

119. So it would not be plausible to say that this principle does not mean anything or that no real obligation can be deduced from it just because it has been expressed in an abstract form. It is a more appropriate view that the member states have considerable freedom in how they choose to provide adequate finance for local authorities.

120. 'Adequate finance' is a general guideline encouraging national and/or regional authorities to monitor continuously the adequacy of the finances of local authorities taking into account their mandatory tasks, to ensure that local authorities are able to raise their own revenues based on their own decisions, and to make efforts to provide proportionate financial support to a necessary degree. In other words, the balance between the mandatory tasks and available financial resources should be regularly reviewed by member states. Special procedures could be developed for monitoring the financial needs of local authorities and for ensuring a fair and reasonable balance between the tasks and resources.

121. Moreover, the adequacy principle should be used to provide legal protection for local governments in extreme cases, when the available resources are obviously not commensurate with the obligatory tasks of local authorities. In particular, the principle could be referred to when immediate and irrational changes in funding have been introduced. Thus, if the central government cuts central grants disproportionately and without any compensation, or deprives local authorities of their possibilities to raise local revenues, the principle of adequate finance should be applicable. In such case, the adequacy principle can function as a substantive requirement.

122. The difficulties mentioned above can open the way to an interpretation of Charter's provision of sufficient finance as a procedural principle. In this sense, the standard or common requirement should be to require member states to establish clear and transparent rules for central transfers and financial equalisation. During these processes, the central government should take into account criteria which are relevant to the assessment of adequacy. The criteria and the method of calculation used should be published and the decision-making process and the decisions themselves should also be public.

123. Additionally, an effective consultation mechanism should be established in order to ensure the representation of local authorities' interests and opinions in the process of budgetary planning. In order to promote the implementation of the adequate finance provision, member states should be encouraged to involve the national associations of local authorities in the parliamentary and governmental decision-making processes when local finance is planned and local resources are estimated.

124. While strict regulations against indebtedness of local authorities cannot be condemned, these processes and instruments also carry a serious risk, by giving higher levels of government direct and strong control over the financial management of local governments. It is therefore important to ensure that financial and legal restrictions on local government financial management are only provisional.

125. With regard to the well-known shortages of, as well as the new challenges to, local government funding, the Congress should follow-up the implementation of its recommendations relating to adequate finance on a regular basis, by paying special attention to these requirements during its visits to monitor local and regional democracy in member states.

