

CONGRESS OF LOCAL AND REGIONAL AUTHORITIES OF EUROPE

Recommendation 90 (2001)¹ on financial relations between state, regional and local authorities in federal states Conclusions of the Moscow International Conference (5-7 October 2000)

The Congress,

1. Bearing in mind,

- Conclusions of monitoring visits to the Russian Federation in 1999 (CG/Bur (5) 145);
 - Recommendation 64 (1999) on the situation of local finances in the Federal Republic of Germany;
 - Final Declaration of the Ancona Conference on responsibilities and finances of local and regional authorities;
 - Recommendation 79 (2000) and the fourth general report on application of the European Charter of Local Self-government in the member states of the Council of Europe “The financial resources of local authorities in relations to their responsibilities: a litmus test for subsidiarity”;
 - Recommendation Rec(2000)14 of the Committee of Ministers to the member states on local taxation, financial equalisation and grants to local authorities;
2. Taking into account the report CG (8) 7 on financial relations between state, regions and municipalities presented by Dr Gerhard Engel (Germany, L) at the 8th Plenary Session of the Congress (29-31 May 2001);
3. Welcomes the initiative to hold, for the first time ever, a conference on financial relations between state, regions and municipalities;
4. Reiterates its commitment to promoting the subsidiarity principle laid down in Article 4, paragraph 3, of the Charter, in particular with regard to financial autonomy of local and regional authorities;
5. Believes that allocation of responsibilities for local and regional authorities should be done by a clear definition of the responsibilities of each tier of public authorities and with reference to the subsidiarity principle and the principle of adequacy of resources;
6. Calls upon federal and regional governments of member states to study to what extent the principle of

concomitant financing implemented in some European federal states (and which requires that where functions are imposed on municipalities by federal or regional legislation, and on regions by federal legislation they must be accompanied by the transfer of resources necessary to finance the corresponding expenditure) could be implemented in their states;

7. Urges federal and regional legislative bodies and governments of member states to guarantee for local authorities’ unions the right to be consulted when the federal or regional budget is being drawn up as far as local authorities’ responsibilities are concerned;

8. Urges federal and regional legislative bodies to guarantee for local authorities the right to be protected by the courts if their financial rights have been infringed;

9. Urges federal and regional governments of member states to study carefully the conclusions of the Final Declaration of the Moscow Conference and in particular its paragraph 11 (see Appendix).

Appendix

Final Declaration of the International Conference on Financial Relations between State, Regional and Local Authorities in Federal States

adopted on 7 October 2000
(5-7 October 2000, Moscow, Russian Federation)

The participants in the conference – local and regional elected representatives and government officers, national associations of local and regional authorities and federal and regional ministries and experts – thanked:

– the Congress of Local and Regional Authorities of Europe (hereinafter the CLRAE or the Congress) and the Directorate of co-operation for local and regional democracy of the Council of Europe for inviting them to the conference, thus giving them the opportunity to take part in the debate on financial relations between federal government and regional and local authorities in European federal states;

– the Congress of Municipalities of the Russian Federation, the Ministry of Federal Affairs, Nationalities and Immigration Policy of the Russian Federation and the Government of the City of Moscow for perfect conference arrangements and their generous hospitality.

The conference enlarged and furthered thinking on financial relations in federal, quasi-federal and highly regionalised countries in Europe as a continuation of the work which the CLRAE began in 1999 with monitoring visits to the Russian Federation, the Ancona Conference on Responsibilities and Finances of Local and Regional

Authorities, and CLRAE adoption of Recommendation 64 (1999) (and the report) on the state of local finances in Germany and Recommendation 79 (2000) (and the report)

“The financial resources of local authorities in relation to their responsibilities: a litmus test for subsidiarity”.

After hearing the reports on financial relations between the various tiers of local government in federal states (Austria, Belgium, Germany, the Russian Federation and Switzerland) and in highly regionalised countries (Italy and Spain) as well as in some of the regions of these countries, the participants, while noting that there had been some progress, pointed out substantial difficulties over transparency and maintaining a balance in financial relations between the three tiers, in particular, though not only, between the regions and the municipalities.

After hearing the report and conclusions on budgetary relations between the regions and the municipalities in the Russian Federation, drafted by Professor Gérard Marcou as part of the Adacs Local Authorities Programme, the participants invite the Russian authorities to carefully consider the resulting recommendations.

At the end of two and a half days' work, the participants reached the following conclusions:

1. The European Charter of Local Self-Government (hereafter referred to as the ECLSG or the Charter) is still the only European treaty which gives (Article 9) local authorities guarantees of adequate financial resources. Council of Europe member states which have signed or ratified the ECLSG must fully apply the provisions set out in Article 9 of the Charter in the development of financial relations with local and regional authorities. States which have not ratified the Charter should nonetheless apply its general principles.
2. Power to perform certain functions is meaningless if local authorities are deprived of the financial resources to carry them out. Article 9 of the Charter, while safeguarding local authorities' financial autonomy, also places a legal obligation on federal states which sign the Charter to transpose these principles into their federal and regional legislation.

The participants more especially:

3. Congratulate the Congress of Local and Regional Authorities of Europe (hereafter referred to as the CLRAE or the Congress) on the fourth report on Charter-application supervision named “The financial resources of local authorities in relation to their responsibilities: a litmus test for subsidiarity”, which is a significant step forward in supervising application of the Charter and clarifies its concept of financial autonomy of local and regional authorities.

Welcome furthermore the adoption of the Recommendation Rec(2000)14 of the Committee of Ministers to the member states of the Council of Europe on local taxation, financial equalisation and grants to local authorities.

4. Point out that the first legal recognition of the subsidiarity principle is to be found in Article 4,

paragraph 3, of the ECLSG (“Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy”).

5. Note that federal states have specific institutional features not shared by decentralised non-federal states in that legislative powers, including those concerning financial resources, are divided between two tiers of government (federal and regional). As the various CLRAE reports on financing systems have shown, this type of institutional arrangement can add to the financial difficulties of local authorities and lead to role confusion if respective responsibilities are not clearly and precisely laid down in federal and regional legislation.

6. Believe that the principle of adequate resources, like the subsidiarity principle, must be fully applied in the apportionment of powers. Adequacy here is the adequacy of financial resources to the responsibilities conferred on local authorities. The Charter (Article 9, paragraph 2) stipulates: “Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.” The principle of adequacy of resources cannot be applied without a clear definition of the responsibilities of each tier of authority.

7. Take the view that, notwithstanding the undeniable diversity of institutional systems in the various countries discussed at the conference, it is possible to pinpoint a number of common features and make various recommendations for taking better account of local and regional authorities' interests.

8. Note that, in addition to being affected by problems of institutional relations, municipalities' financial situation has deteriorated in countries with economic difficulties.

9. As far as financial resources of communes are concerned, the participants underline that certain trends listed below may present a negative impact on local autonomy:

- 9.1. reducing specifically local taxes and federal or regional authorities' tendency to replacethem by transfers;
- 9.2. a substantial weight of transfers over own resources and of grants as opposed to block allocations;
- 9.3. the attribution to local authorities of unproductive local taxes;
- 9.4. the lack in some federal states, at both federal and regional levels, of a limited number of established and objective criteria governing the methods and aims of financial equalisation, and the discretionary nature of the transfers made by some federal or regional authorities. This makes it quite impossible for municipalities to carry out the medium or long-term planning necessary to meet the community's needs and also causes inequalities in the treatment of local authorities, and consequently of the people. These equalisation criteria must therefore be based on needs and not on costs;

9.5. over-supervision in particular by regional authorities of local authority spending, sometimes amounting to disguised prior review of the expediency of local authority decisions, in breach of the Charter.

10. With regard to the need for local authority spending power to match responsibilities, the participants noted that:

10.1. local authorities have to cope with substantially increased welfare expenditure in fields such as education, health, housing, care for the elderly and disabled, deprived families and asylum seekers;

10.2. the indispensability, or even compulsoriness, of such expenditure often leads to a large decrease in local-government investment whereas, in European countries, local authorities have traditionally been responsible for a significant proportion of public investment expenditure and are best placed to match such investment to real needs since they are closest to the citizens;

10.3. the rise in municipal debt, when municipalities already have very little financial room for manoeuvre, substantially increases local authorities' financial burden and often makes them dependent on the regional authorities. It goes without saying that municipal debt will probably place a strain on local budgets for many years to come;

10.4. the tendency to assign a large number of responsibilities to regional and local authorities without adequate financial compensation, often referred to as "decentralisation of problems", lies at the heart of a number of political conflicts between different tiers of authority in federal states. This tendency is exacerbated in some federal states by the fact that the principle of matching resources to responsibilities is not clearly set out in federal and/or regional legislation, with the result that application of the law concerning powers and responsibilities depends on the goodwill of the regional or federal authorities.

In delegating new tasks to the municipalities, the federal and regional authorities must be guided by the principle of concomitant financing, which requires that where competences are imposed on municipalities by legislation, be it federal or regional, they must be accompanied by the transfer of the resources necessary to finance the corresponding expenditure. When the principle is incorporated into law, the municipalities must be able, if necessary, to have their right to compensation enforced by the courts.

11. Bearing all the above in mind, the conference participants urge federal and regional authorities of federal or quasi-federal states to take into account and be guided by the following recommendations in the development of budgetary relations:

11.1. consider reorganising regional and local taxation so as to establish, or in some cases restore, a reliable system of local taxation based on flexible, productive, non-obsolete taxes. Such reorganisation should also provide taxes that correspond to local and regional authorities' tasks;

11.2. establish by law, at both federal and regional level, an apportionment of and a strict and rigorous separation between own powers exercised by each tier of government and delegated powers, whereby the concept of own powers implies freedom of appraisal and policy making within the framework of the law;

11.3. organise the allocation of powers under the concept of joint powers, as used in some federal law, through the adoption of federal and regional framework legislation that must simply lay down general principles. Such legislation should also stipulate how joint powers are to be financed;

11.4. in those countries whose area and population justify the existence of several levels of local government, ensure that each level enjoys appropriate conditions of financial autonomy;

11.5. noting that in some countries the principle of concomitant financing is laid down in regional constitutions so that local authorities receive financial compensation for the implementation of regional laws, or where necessary can obtain it through the courts, the participants recommend that states consider introducing the principle of concomitant financing into their federal and regional constitutions where appropriate, drawing on existing models.

In relations between federation and regions, the federal state could give undertakings to the federal entities as regards finances where federal law requires them to carry out various tasks.

In relations between regions and municipalities, and where local autonomy is not a matter solely for the regions, the federal state could give similar undertakings to the municipalities as regards the implementation of federal laws. Where local self-government is entirely a matter for the regions, it is recommended that the regions give a similar undertaking to their municipalities.

The participants accordingly welcome the existence of the principle of concomitant financing in the constitutions of Austria and the *Länder* of Baden-Württemberg, Thuringia, Schleswig-Holstein and Brandenburg in the Federal Republic of Germany, which explicitly provide for financial compensation "matching" or "adequate" to new tasks delegated to local authorities;

11.6. machinery for evaluating the actual implementation cost of federal and regional legislation must be devised in collaboration with local and regional elected representatives and must be based on rigorous, objective criteria enabling regional and local authorities both to undertake negotiations (if the criteria are reviewable at regular intervals) and make planning arrangements, taking account of local economic and social development programmes;

11.7. as a rule, local and regional authorities' own resources must be sufficiently diversified and stable to enable better multiannual programming of spatial development and investment policies. It must also be

possible to develop and adapt these resources to take account of the economic climate, growth and new needs;

11.8. in federal states, local and regional authorities' own resources must be defined by means of a formal legal instrument, that is the national constitution or a federal act or a regional constitution or a regional act. This type of official legal commitment provides local and regional authorities with the necessary guarantees and any alteration to it will require an act of equal legal force;

11.9. it is obvious to the conference that, in keeping with the European Charter of Local Self-Government, local authorities must derive a substantial proportion of their resources from their own taxation revenue and from charges the rates of which they must be free to set. It is by levying their own taxes so as to finance a large part of the local and regional policies drawn up by local and regional elected representatives that local and regional authorities can be truly self-governing within the context of national economic development policy.

Similarly, as stated in CLRAE Recommendation 79 (2000), local authorities must have the right to vary the rates of the taxes they levy. The rates can be set within pre-established limits or by act of parliament after annual negotiations involving the three tiers of authority. Empowering local and regional councils to set rates is a guarantee of genuine autonomy in the performance of their function of implementing public policies at local or regional level;

11.10. the right to vary rates of taxation must not affect the right to receive transfers, and such transfers should preferably take the form of general grants. Such transfers should not impair the stability of local budgets and the possibility to plan them over a reasonable period;

11.11. the freedom to levy taxes should not preclude solidarity measures and economic policies at federal or regional level, without which economic and social imbalances could arise nationally or regionally.

The solidarity measures should be implemented by an appropriate combination of vertical and horizontal equalisation.

Vertical equalisation is effected by transfers from central government according to objective criteria aimed at reducing inequalities in the financial capacity of local authorities. It is the most appropriate method in situations of major inequality.

Nevertheless, it would be a mistake to bring in equalisation schemes that discouraged wealthier local authorities from making additional tax-raising efforts they saw as merely raising finance for transfer to other authorities. Nor must equalisation discourage the poorer local authorities from making the most of what fiscal capacity they have. Financial equalisation must apply at both levels – federal (between the federate entities) and regional (between the local authorities of a region). Clear, stable equalisation

criteria must be set, following consultation with the local and regional authorities. At regional level, the local authorities should be able to voice opinions through their associations. The criteria laid down by law should at no stage be modified unilaterally or without prior consultation with the associations representing the local authorities;

11.11.bis. the freedom to levy taxes must be subject to reasonable limits and constraints in order to avoid uncontrolled competition among local authorities, with the risk of accentuating imbalances between public bodies;

11.12. the procedure for drawing up regional and local budgets and the preceding discussions on financial priorities must be fully transparent;

11.13. also to guarantee transparency, the conference recommends that federal and regional authorities enshrine local authorities' right to consultation in their legislation. The CLRAE has already had occasion (Recommendation 64 (1999), paragraph F1) to note with approval that in the Federal Republic of Germany the right of consultation is explicitly written into the constitutions of a number of *Länder* (Saxony, Brandenburg, Baden-Württemberg and Thuringia). These examples should be followed with a view to open dialogue between regional and local authorities on the apportionment of financial resources. The right to be consulted should also be guaranteed – as in Austria – at federal level (even in cases where there is, in principle, no direct hierarchical connection between the federation and the municipalities), given that it is the local authorities that implement various federal legislation. The federal and regional authorities could set up, on an institutional basis, joint committees on which local authorities were represented, which would regularly assess the balance between resources and obligations. The CLRAE has already advocated this method in Recommendations 64 (1999) and 79 (2000);

11.14. local authorities must also have the protection of the courts, to which they must be able to apply if they believe their financial rights have been infringed. In the Russian Federation, disputes concerning financial relations could be examined by administrative courts, which have yet to be set up.

12. The participants invite the Council of Europe and in particular the CLRAE, as the body representing the interests of local and regional authorities in the forty-one Council of Europe member states, to monitor budgetary relations in the federal states and take regular stock of the situation.

13. With regard to the situation of local government finance in the Russian Federation, the Council of Europe should:

– look to the functioning of local democracy not only in large and medium-sized cities, but also in small towns and rural communities and take appropriate initiatives to that end;

– assist the Russian authorities in the necessary task of re-establishing an acceptable minimum level of local financial autonomy by the implementation of local taxation reforms (local taxes, joint and shared taxes);

– consider with the Russian authorities the possibility of reinforcing the programme for the training and exchange of local and regional elected representatives and officials in the field of administrative and financial management, management of local and regional public services and the development of the local economy in model regions

selected within each of the seven recently created federal districts;

– support the measures recently taken by the Russian authorities to make the system of federal and regional financial transfers more objective and transparent.

1. Debated by the Congress and adopted on 30 May 2001, 2nd Sitting (see Doc. CG (8) 7, draft recommendation presented by Dr G. Engel, rapporteur).