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Local Government in critical times: policies for crisis, recovery and sustainable future

LOCAL GOVERNMENT IN CRITICAL TIMES: POLICIES FOR CRISIS, RECOVERY AND SUSTAINABLE FUTURE

REPORT

Prepared by the European Committee on Local and Regional Democracy (CDLR), supported by a partnership with the Open Society Foundations (OSF) and input from the Council of European Municipalities and Regions (CEMR)

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OVERVIEW: LIVING WITH UNCERTAINTY

An age of heightened uncertainty

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

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

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

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

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

- When economic growth will resume. A weak recovery in 2010 has been halted in much of Europe during 2011 by the expansion of the sovereign debt crisis and threats to the Euro; even German growth halted in the second quarter.

- Future trends in commodity prices and their impacts on local budget revenues and expenditures.

- Impacts of the crisis and its aftermath on governance, including the ability of individual governments to sustain austerity measures and possible extension of EU influence on national and local fiscal management.

- Effects on society and their incidence on different groups.

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

Living with uncertainty

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

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

- *Acclaim* the resilience of local government since Utrecht, and

- *Proclaim* the need for adherence to robust strategies which can withstand fluctuating economic fortunes.

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

- stabilising revenue bases;

- making the most of limited resources; and

- developing partnerships to meet long term challenges.

Stabilising Revenue Bases

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

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

- Local budgets should not rely too heavily on volatile revenues which overreact to economic fluctuations. Taxes based on corporate profits or property transactions are the prime examples. There is good argument for municipal access to these bases, but not for major dependence on them. The German *Gewerbesteuer,* assessed on corporate profits, for example, constitutes 30% of municipal tax revenue. Before the crisis taxes on property sales contributed 56% of municipal tax revenue in Bulgaria which shrank in 2009-10 by 55%.

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

- Revenue from local budget shares of personal income taxation has inevitably suffered from reductions in employment, hours, salaries etc, but less dramatically than that of corporate income. It remains the most effective alternative to over-dependence on transfers and should be protected (or introduced, where it does not exist).

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

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

Making the most of limited resources

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

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

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

Developing partnerships to meet long term challenges

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

- *keep local economies ahead of the game*. We can no longer assume that recovery from the current recession can be based on strategies like attracting inward investment and urban regeneration which were so successful in the 80s and 90s. Global competition is greater and the property market weaker. Partnership with other local actors will be crucial in identifying contemporary opportunities, promoting technological research and innovation, education to improve the local skill base and providing the planning and infrastructural framework (including information and communication technology).

- *cope with climate change.* Making municipal assets more energy efficient, increasing the use of renewable energy, reforming transportation, increasing the capacity of storm water drainage are all key tasks for local government, requiring partnerships with utility and transport companies, "green" technology companies and any other suitable actors with capabilities and commitment. Planning frameworks, for example, are often based on producing, assembling and distributing goods in multiple locations, scattered round the world despite transportation and environmental costs. The sustainability of these is likely to come under increasing pressure.

- *support the vulnerable, with special attention to children and the elderly*. Supporting increasing numbers of elderly people will depend on strategies to encourage community care and assist family members and others providing informal care. Services such as early childhood development which contribute greatly to the human rights of vulnerable groups should be safeguarded in times of austerity. Benefits may have to be targeted to the most needy households more restrictively.

Conclusion

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

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

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

CHAPTER II_

REVENUE: PERFORMANCE AND POLICIES

A. Revenue performance of local budgets in crisis

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

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

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

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

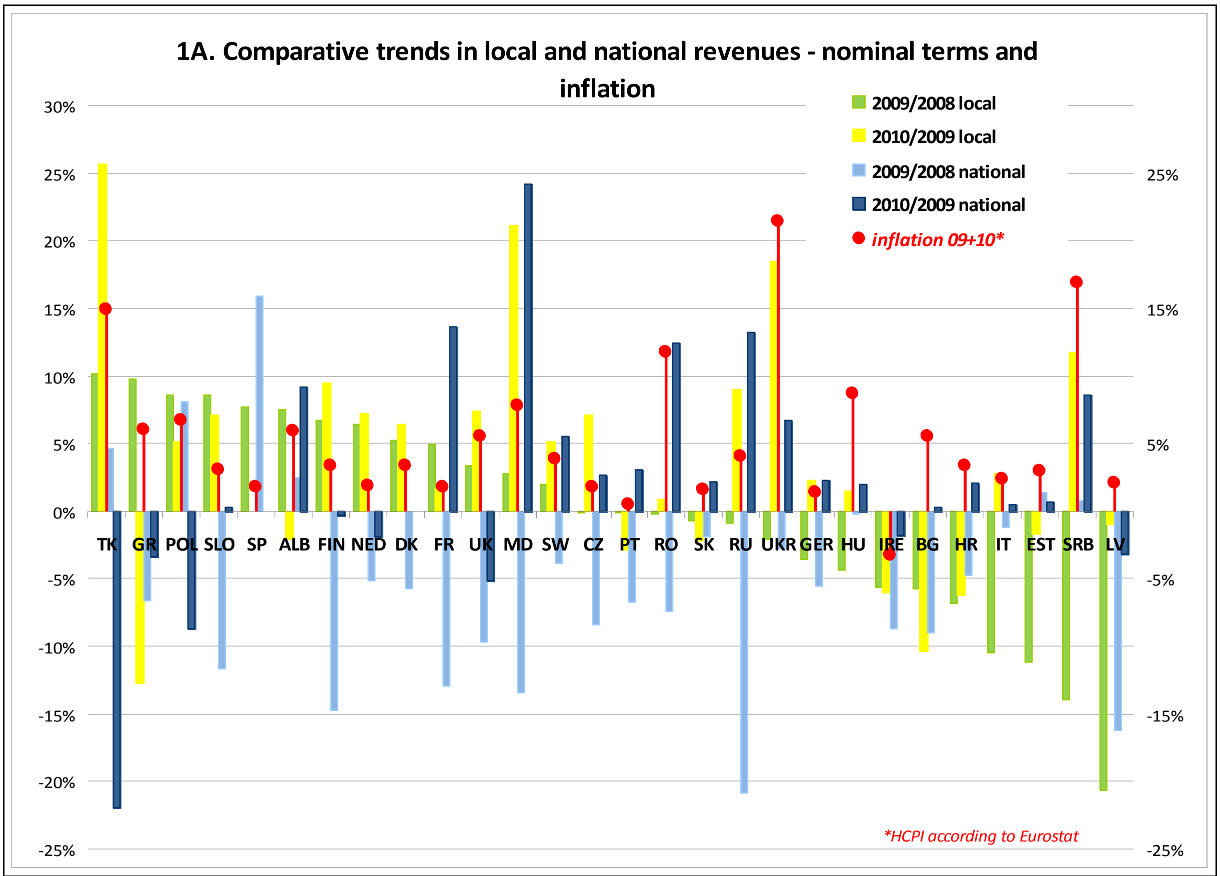
- The moment and severity of the economic downturn was different: more than one year separate the peak of the crisis in the Baltic states from that in Greece;
- The capacity of the state administrative machine to implement policies in adverse circumstances, as well as the fiscal space for manoeuvre,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

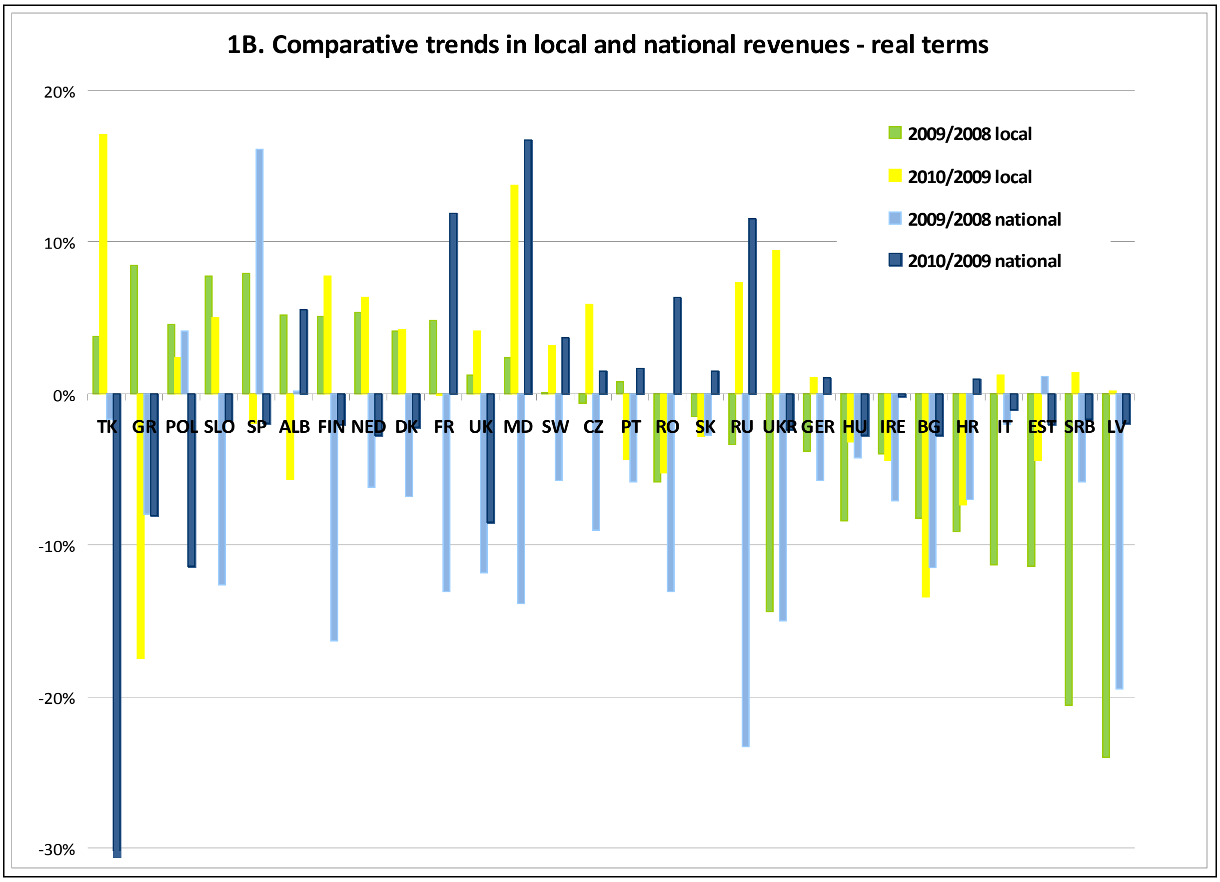
- The size, functions and scope for decision making in sub-national governments vary widely, from substantial in the Scandinavian countries (40-60% of the public spending) to modest in Greece, Cyprus, Ireland, Turkey or Portugal (around 10% or less).

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

Comparative trends in local and national revenues

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





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

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

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

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

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

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

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

Figure 2.1 Local government debt

Local government debt as % of total local revenues (all tiers combined)

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

Source: country observers

Figure 2.2 Local government debt as % of GDP

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

Source: Eurostat

The indebtedness of local governments has gone up across the board, with just a few exceptions: the Scandinavian group and a few other countries such as Croatia or the Czech Republic. However there is a large disparity between old EU member states or Turkey, where municipal debt is over 100% of the total local revenues, and the Scandinavian countries and the new EU member states where it is still much lower (Figure 2.1).

Other countries with recent public debt problems for which we have only inconsistent direct information from our country operators can be analyzed using the Eurostat data (Figure 2.2). The two sets of data – ours, and Eurostat – show by and large similar patterns, with the observation that the latter figures must be interpreted having in mind the very different size of the local government sector in terms of % GDP in each country. On average, the core Euro area displays a small rise of the sub-national debt, mostly in the first year of the crisis (9%); and the larger EU a somewhat higher, but still moderate rise.

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

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

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

Surplus in executing local government budgets

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

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

Figure 3. Surplus in executing the local government budgets (all tiers combined)

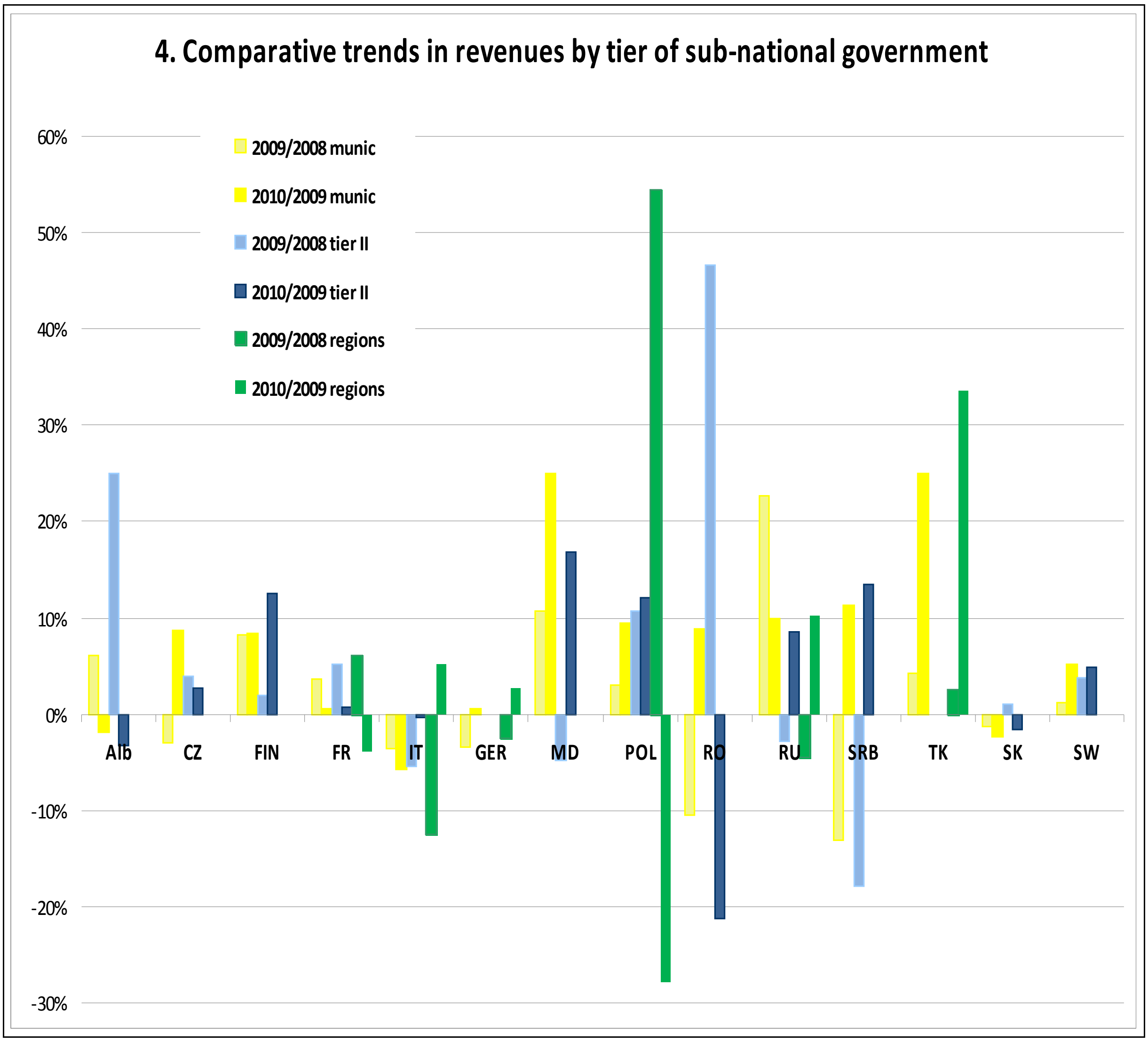
	2008	**2009**	**2010**
Bulgaria	9.4%	8.0%	7.2%
Armenia	-7.6%	6.1%	2.7%
Romania	3.3%	3.3%	6.2%
Finland	-1.1%	1.8%	4.8%
Denmark	1.0%	1.0%	0.3%
Spain	-1.2%	0.8%	
Sweden	-0.5%	-1.2%	0.2%
Ukraine	-1.2%	-1.3%	-0.2%
Albania	-1.4%	-1.7%	-1.6%
Russia	-0.5%	-2.2%	-0.4%
Hungary	0.5%	-2.6%	-7.3%
Moldova	-5.2%	-3.8%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

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

Impact by tiers of sub-national government

The visible pattern on chart 4 is that the revenues were much more volatile on the upper levels of sub-national government (regions, counties) than at the lower (municipal levels). This is true both in countries where such intermediary tiers play an important role (Italy, France, Poland, Germany) or a relatively minor one (Serbia, Turkey).

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



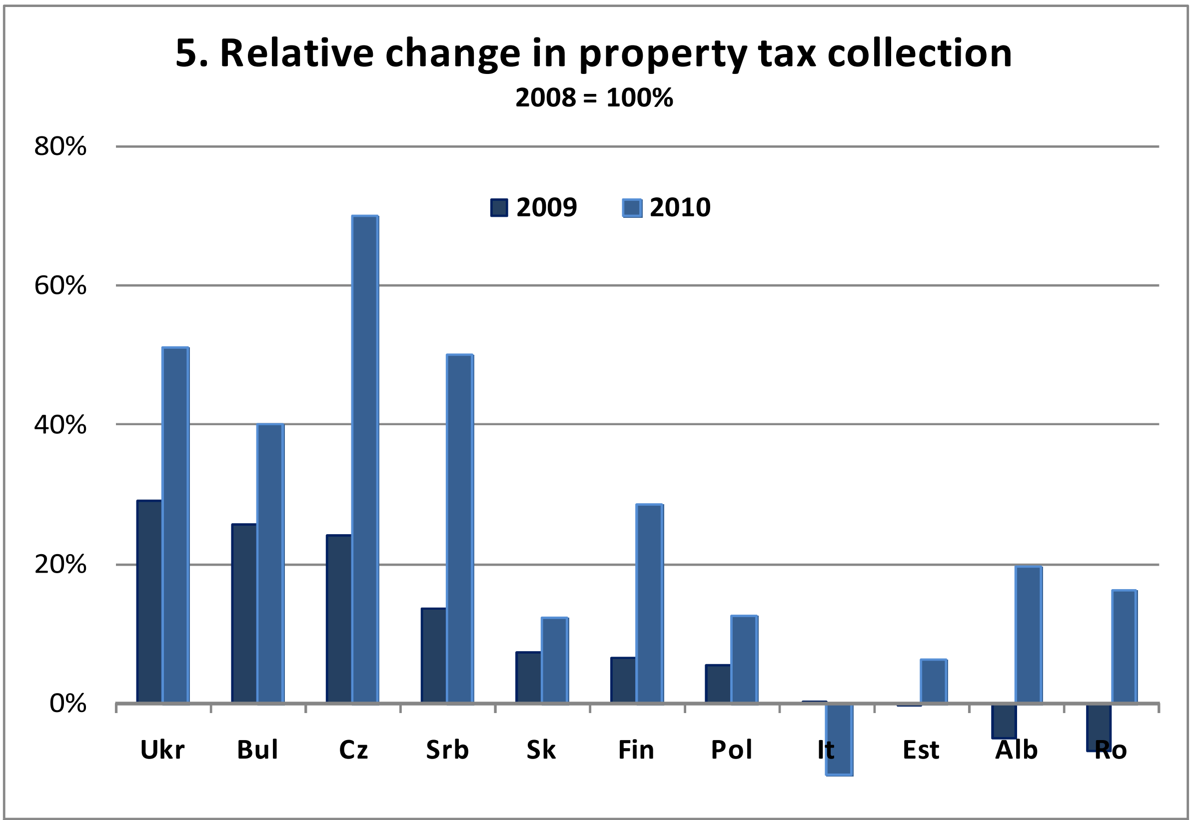
Trends by types of revenues

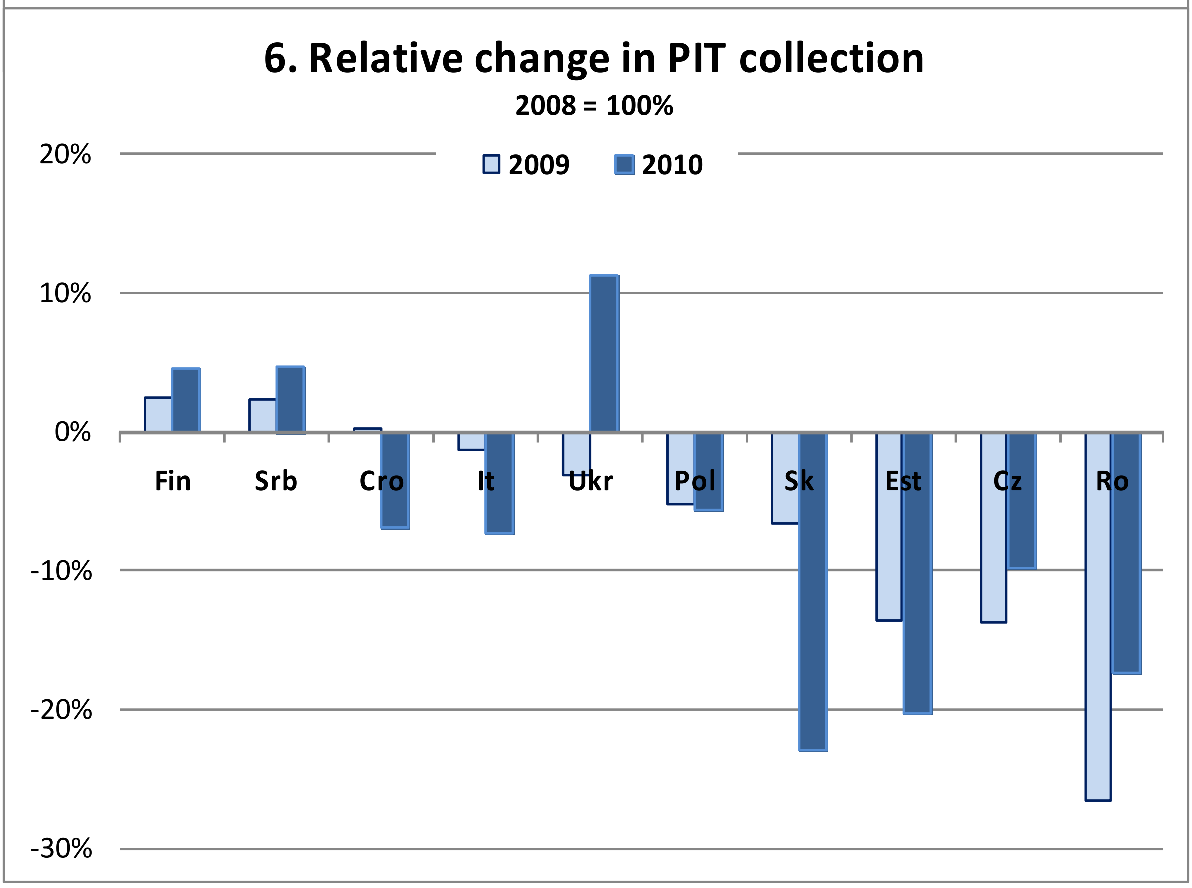
On the main types of revenues, the data we have at hand is not sufficient for drawing robust conclusions. Most of this fiscal information comes from the Central-Eastern European countries, with Italy as the only the large old EU member state included in analysis. Anecdotal evidence indicate that Spain may follow the same trends as Italy in local tax collection.

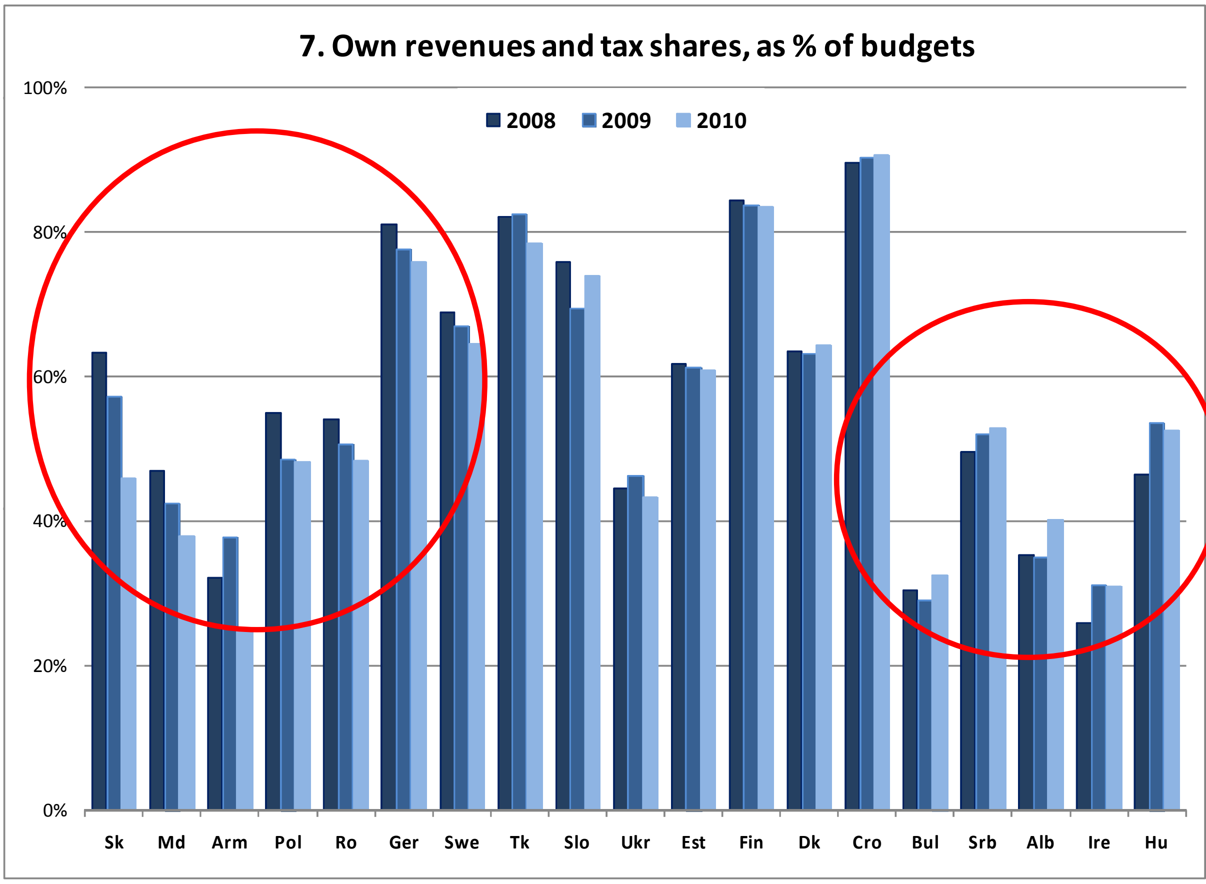
Charts 5 and 6 show that indeed the property tax was much more robust in crisis, at least when compared with the Personal Income Tax (PIT): except in Albania and Romania in the first crisis year, and Italy in the second, the yield from taxing property grew in all ten countries for which data is available. By contrast, the PIT has witnessed a drop in collection in the majority of countries – even in Poland, where technically there was no recession.

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

On PIT, it may be that not all the decline in revenues shown on chart 6 was "natural": at least in Romania the governments have cut the PIT share allocated to local governments in order to bolster the central budget.


5. Relative change in property tax collection
2008 = 100%
80%
60%
40%
20%
0%
2009
2010
Ukr
Bul
Cz
Srb
Sk
Fin
Pol
It
Est
Alb
Ro


6. Relative change in PIT collection
2008 = 100%
20%
10%
0%
-10%
-20%
-30%
2009
2010
Fin
Srb
Cro
It
Ukr
Pol
Sk
Est
Cz
Ro


7. Own revenues and tax shares, as % of budgets
100%
80%
60%
40%
20%
0%
2008
2009
2010
Sk
Md
Arm
Pol
Ro
Ger
Swe
Tk
Slo
Ukr
Est
Fin
Dk
Cro
Bul
Srb
Alb
Ire
Hu

Overall, it does not seem to matter much for the stability of the local budgets in crisis if the index on chart 7 has a high or low value. What is important is to ensure a broad and diverse basis of own revenues, avoiding over-reliance on a single major tax, and put in place transfer mechanisms with automatic stabilizers incorporated, such as those used in Northern Europe to finance the social services.

B. Revenue policies

Assignment

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

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

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

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

By contrast there have been some increases in local revenue sources. Finnish municipal shares of corporate income tax yields have temporarily increased to 32%, until 2011. Moldova's motor vehicle tax rate has risen by 30%. 54 Croatian authorities have used enhanced powers to surcharge personal income tax. A municipal property tax will be levied in Ukraine from 2012. Irish municipalities have been given the right to tax second homes and a general residential property tax has now been reintroduced. The British Government has announced its intention to restore the right of local governments to retain some portion of the property tax they collect from business tax payers; at present it is all redistributed on a national per capita basis.

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

Box 1

Intergovernmental Co-operation in Finland

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

These measures included:

- A temporary increase in the municipal share of corporate tax from 22.03 % to 32,03 % .
- Reduction of the municipal share of National Pension Insurance Contribution in 2009 and total abolition from 2010.
- Legislation change to allow municipalities to raise their real estate taxes within redefined limits
- Municipalities were also given special assistance in certain sectors and received relevant rises to State grants.

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

Tax Autonomy

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

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

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

Property Tax Assessment

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

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

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

Volatility

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

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

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

Intergovernmental Transfers

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

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

It is a temptation which some governments have been unable to resist. In 2010 the Serbian Parliament amended the legislation indexing block grants to the national budget so that municipalities with above average per capita revenues obtained less than they would otherwise have received, at least for one year. Also last year the Bulgarian Government withheld 15% of the grant for delegated functions half way through the year. British Government grants were cut in 2010/11 by £1.16 billion (2.1%).

Most governments have been more sympathetic to local budgets. In 2009 several countries including Austria, Germany, Norway, Spain and UK provided short term funding for small scale "shovel ready" investments designed to keep the construction industry in business. In the same year several countries, including Albania, Denmark, Finland Norway, Poland, Slovakia and Sweden increased general purpose transfers temporarily to compensate local authorities for declines in tax revenue.

Most of these were ad hoc responses, with some repetition in 2010. From this year, 2011 however, serious doubts over the ability to service or roll over sovereign debt have led to grant restraint in countries such as Greece, Ireland, Italy, Portugal and Spain. Deliberate and longer-term reductions in transfers are being made in some other countries, such as Romania and the UK in serious efforts to reduce structural public finance deficits. In the UK these represent phased cuts in grants reaching 12% p.a. by 2015. This is bearing out the OECD's finding that the financial consequences of recession are felt most severely by local budgets once economic recovery has begun and national governments try to repair the damage to public finance overall.

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

Indebtedness

Outstanding sub national debt grew in the EU by 9.9% in 2009 and a lower rate of 6% in 2010 and represents 13% of the total public sector deficit.

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

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

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

CHAPTER III

MAKING THE MOST OF MORE LIMITED RESOURCES

Budget Squeeze

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

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

The Irish Government has orchestrated root and branch reforms including:

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

The City of Reykjavik, faced with a 20% revenue loss over two years, imposed:

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

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

Territorial re-organisation

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

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

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

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

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

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

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

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

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

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

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

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

Rationalising service provision

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

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

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

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

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

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

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

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

Employment

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

Some outright retrenchment has been adopted. Irish local authorities have shed 6,600 jobs over the last three years. Municipal establishments in Denmark were cut by 2.6% in 2009 and in Albania by 3% in 2010. The Ukrainian Government has set a target of cutting public sector employment by 20% overall.

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

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

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

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

Public/private partnership

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

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

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

The crisis is, however, posing a threat to existing third sector participation, particularly in the provision of social welfare to vulnerable groups. British charities claim that they have lost £100 million in reduced local authority grants in 2011, although the Government claims to have provided an additional £1 billion for social care over the period to 2014.

Cost control

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

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

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

- Benchmarking individual service and administrative service costs carried out in Bulgaria by the Open Society Institute in collaboration with the Resource Centre for Decentralization and Municipal Development and Club Economika 2000;

- Performance standards measured by the Benchmarking Club of Hungarian water company managers, with the consultant help of the Regional Centre for Energy Policy Research at the Corvinus University of Budapest and based on comparing a range of technical and management issues.

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

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

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

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

Performance audit

In 2006 LGI surveyed the audit of local government in 12 eastern and south-eastern European states. It found that most states had an adequate legislative framework, much of it newly enacted with EU assistance, but so far implementation had been weak.

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

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

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

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

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

Box 2

Surveys of user satisfaction with local public services in Denmark.

Municipalities

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

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

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

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

Regions

In the regions surveys of patient satisfaction with hospitals (including private hospitals and out-of-hospital clinics) are made annually and the results are published on the web for each hospital (together with information on waiting time and other measures of service quality). The surveys are made voluntarily by the regions which have chosen to survey quite a large population of 250.000 inpatients and outpatients (the number is equivalent to about 5 pct. of the national population). The surveys are so complete that that the results also reveal differences in satisfaction for departments of the hospitals. The regions now find the surveys indispensable instruments for controlling the quality of outputs from their different institutions.

Transparency

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

Box 3
Electronic auctions in Slovakia

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

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

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

CHAPTER IV:

SOCIAL CONSEQUENCES OF THE CRISIS

Shared Social Responsibilities

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

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

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

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

Societal impacts of the economic downturn

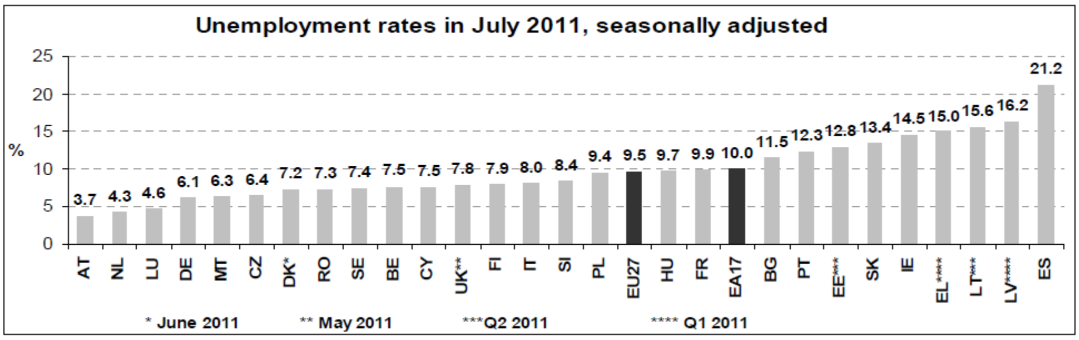
The consequences of the crisis hit the various social strata in different ways, with the poorest segment the most seriously affected. Statistical data illustrating these impacts demonstrate the following trends:

- Increases in unemployment (Figure 1);

- Material deprivation, particularly of children and the elderly, affecting at least 10% of the population in 22 countries and above 20% in 11 of them (Figure 2);

- Increasing household costs, aggravated by rising utility tariffs in 18 countries (Armenia, Austria, Bulgaria, Bosnia, Croatia, Estonia, Finland, Georgia, Greece, Hungary, Iceland, Latvia, Moldova, Romania, Serbia, Slovakia, Spain, and Ukraine). These have a specially negative impact on the household budget in those countries, where there are no targeted housing benefits (Figure 3).

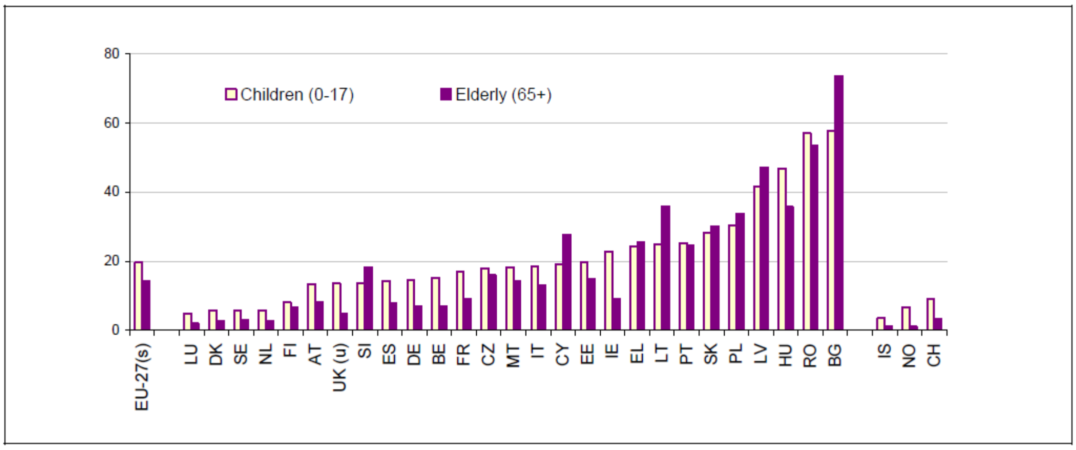
Figure 1.[3]



Source: EUROSTAT

Figure 2

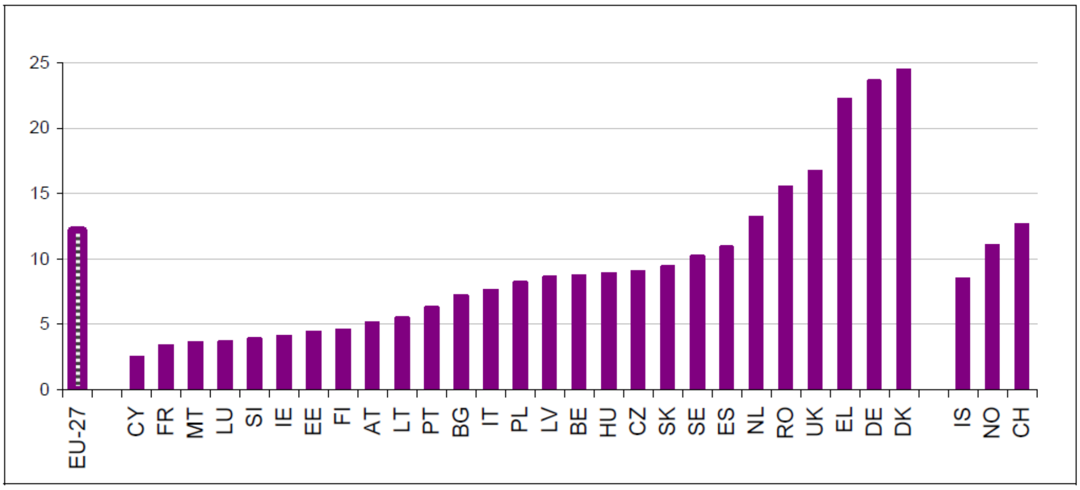
Figure 14-2: Material deprivation rate by age group (%), 2009



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

Figure 3.[4]

Figure 14-6: Housing cost overburden rate (%), 2009



Source: EU-SILC

[3] Statistical Portraits of the Social Situation 2010 (2011) European Commission Eurostat Directorate General for Employment, Social Affairs and Inclusion
http://ec.europa.eu/social/keyDocuments.jsp?type=0&policyArea=0&subCategory=0&country=0&year=0&advSearchKey=ssr2010&mode=advancedSubmit&langId=en

[4] Idem

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

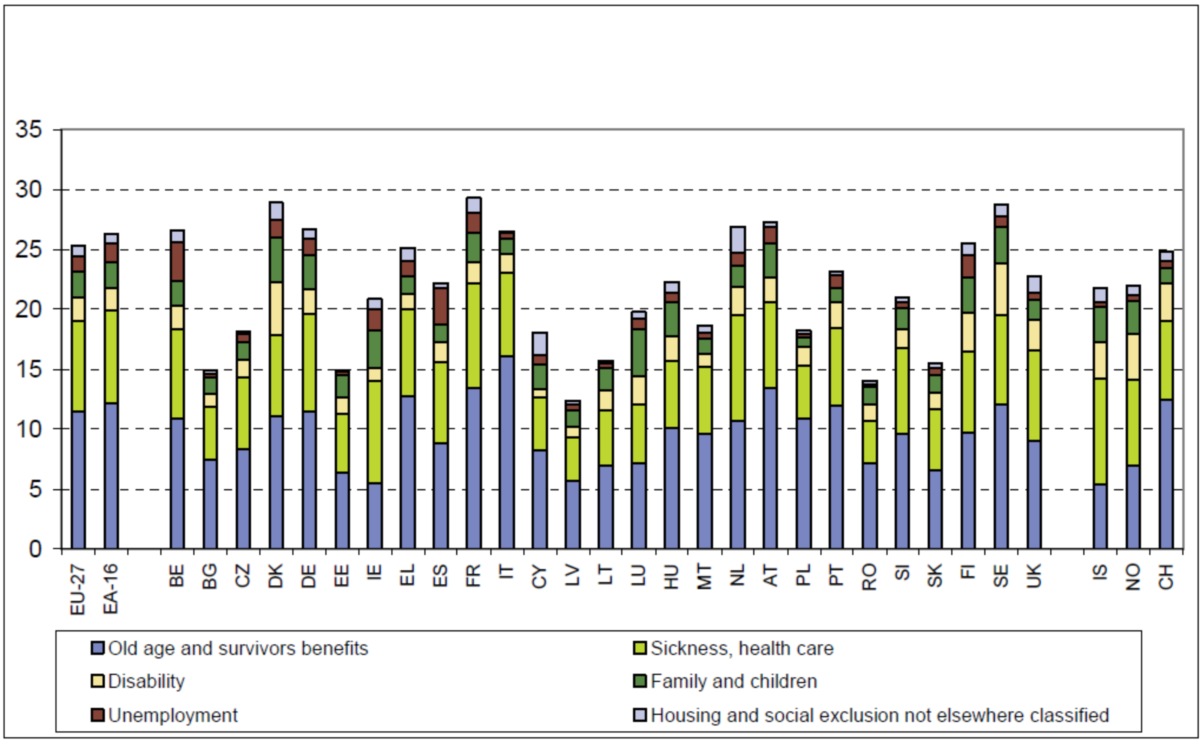
As far as the long-term prospects of the European countries are concerned, the situation of those countries is especially worrying, where children are more seriously hit by poverty and deprivation than other age cohorts.

The National Context

Although official documents generally refer to the European social model, and the welfare state, actually there are differing social protection systems. The variations are manifested, among others, in the level of social security financed from public resources; in the variations of the sources of benefits, in the division of responsibilities between the different tiers of government, the market and the non-governmental sector; in the mandated and non-mandatory services and cash benefits. The impact of the economic downturn was presumably deeper in some of these types of the systems while others proved to be more resistant. (Figure 4)

Figure 4

Figure 10-4: Social benefits as % of GDP by groups of functions, 2008



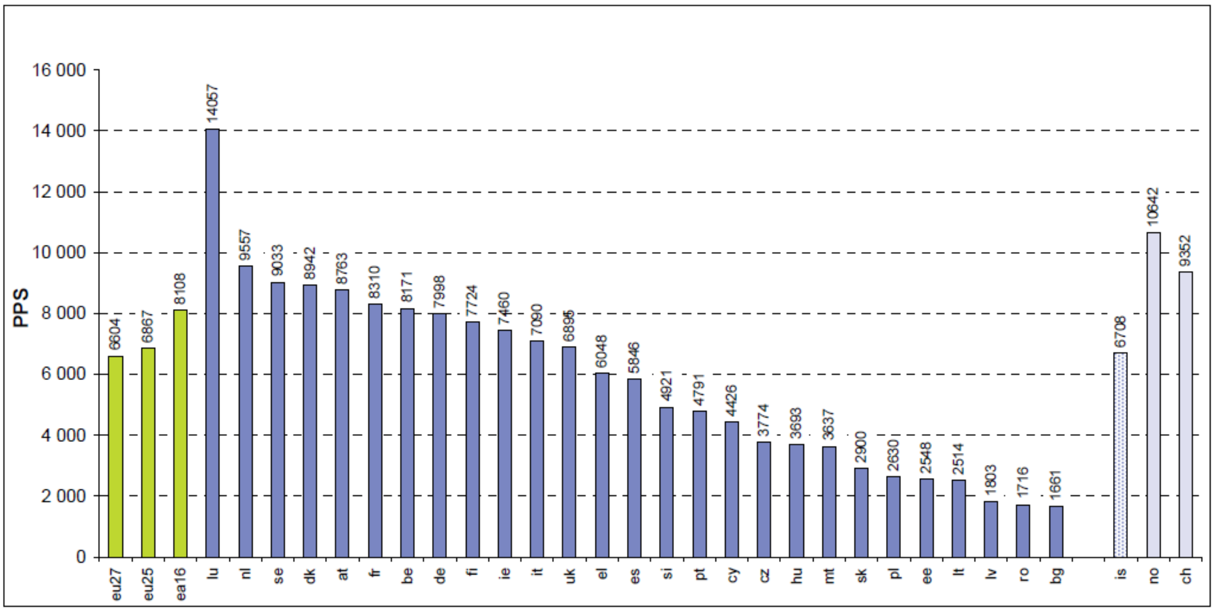
Source: Eurostat — European System of integrated Social Protection Statistics (ESSPROS)

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

Sharper differences are manifested if the expenditure on social protection in PPS per head of population is also taken into consideration. Compared to the EU-27 average (6604) the value was in 2008 in Luxemburg 14057, in the Netherland 9557, while in Romania 1716, in Bulgaria 1661 (Figure 5).

Figure 5

Figure 10-2: Expenditure on social protection in PPS per head of population, 2008



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

Social Responsibilities and Local Budgets

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

- Housing and utility allowances (because of falling household incomes or slower reimbursement by central government);

- Safety net payments to the long term unemployed and others eligible for minimum income guarantees;

- Emergency aid to families in advance of awards of state benefits;

- Care for a growing population of elderly and disabled people;

- Protection for an increasing number of children from distressed families.

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

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

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

Local government capacity to meet these growing responsibilities is limited by the revenue shrinkages already discussed in chapter 2, and by reductions in staffing described in Chapter III. (Observers' reports refer to reductions in the numbers and remuneration of staff in 20 countries). Strategies for bridging this gap between rising demands and shrinking resources include:

- Improved targeting of welfare benefits;

- Promoting community rather than residential care, particularly for the elderly;

- Increasing co-operation with other local governments, with private and social enterprises and with voluntary organisations.

These are discussed in turn.

Targeting social assistance

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

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

Community Care

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

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

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

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

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

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

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

Care for the elderly is increasingly a mixed economy. 80% of residential care in Spain is provided by the private sector, with religious bodies particularly specialising in mental health care. The Orthodox Church is expanding provision of residential care in Romania. Home carers in Bulgaria are funded by co-operation between municipalities, the Red Cross and UniCredit Bank.

Inter-municipal co-operation

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

Shared Social Responsibility

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

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

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

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

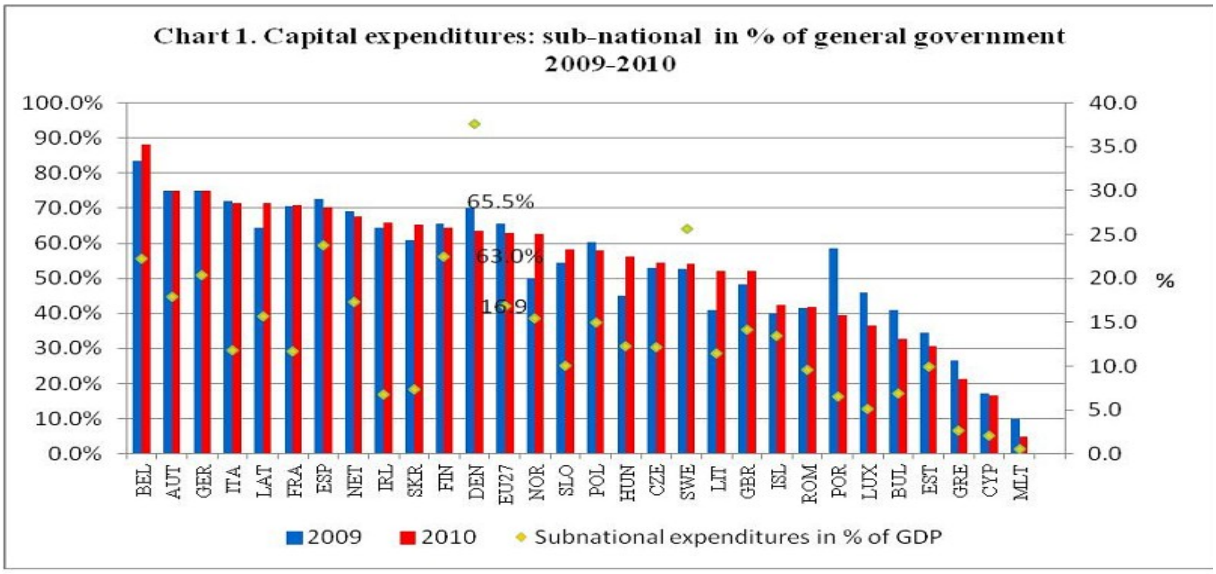
CHAPTER V :

SUSTAINABLE ECONOMIC DEVELOPMENT: LOCAL GOVERNMENT'S ROLE

Financing local capital investments

Local governments manage a significant portion of general government capital expenditures. In the average of the 27 European Union countries, sub-national governments' share is almost two-thirds of the total government gross capital formation[5] (Chart 1: 63% in 2010). So in the period of economic downturn the capacity of local governments to finance and to implement capital investments is critical. They can contribute to economic recovery by maintaining the level of public investments and launching new projects when private investments slow down. However, the local governments' relatively high share and the dependency on external resources, such as national budget capital grants, makes capital investments an easy target of restrictions and consequently a rather vulnerable item of the public budget.

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



Source: Eurostat

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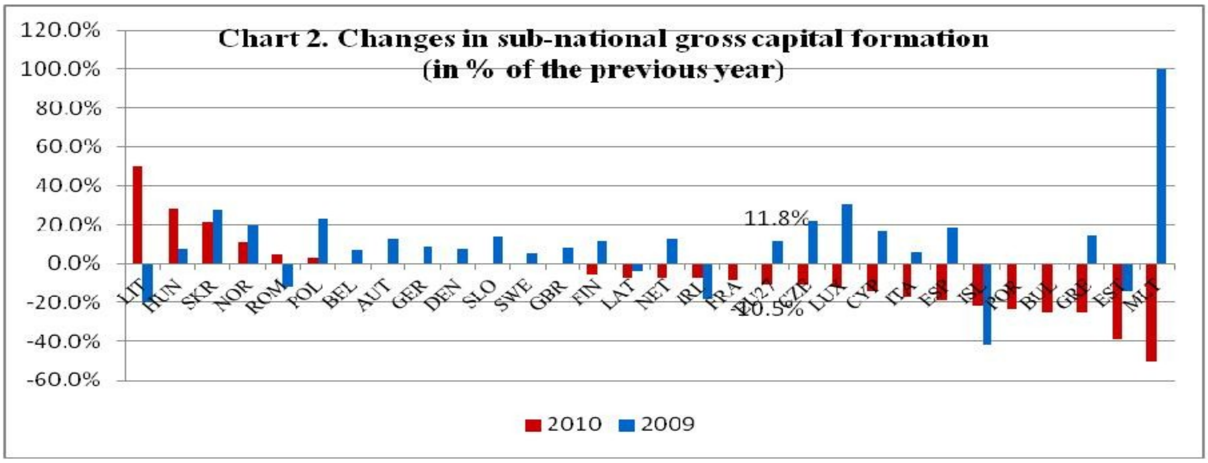
[5] Gross capital formation is measured by the total value of the gross fixed capital formation, changes in inventories and acquisitions less disposals of valuables.

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

In the EU27 countries the sub-national government's capital expenditures decreased by 10.5% in 2010 compared to the previous year. (Chart 2). Only six countries were able to increase the local gross capital formation: among them five are new member states, which benefit mainly from the EU grants (Lithuania, Hungary, Slovakia, Romania, Poland). All the others either kept capital expenditures at the same level or decreased them. Beyond the least decentralised countries (Malta, Bulgaria, Cyprus), the countries mostly hit by the crisis belong to this group: Greece, Portugal, Spain, Italy.

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



Source: Eurostat

Sources of financing local capital investments

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

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

So in the period of overall restrictions local governments will not be able to continue capital spending at the earlier level and probably the funding schemes should be changed, as well. In the coming years the estimated level of general government debt will increase both in the Euro zone and in the OECD countries (Table 1). On the average gross financial liabilities are equal to the GDP and there are rather huge variations by countries.

Table 1. General government gross financial liabilities as a percentage of GDP

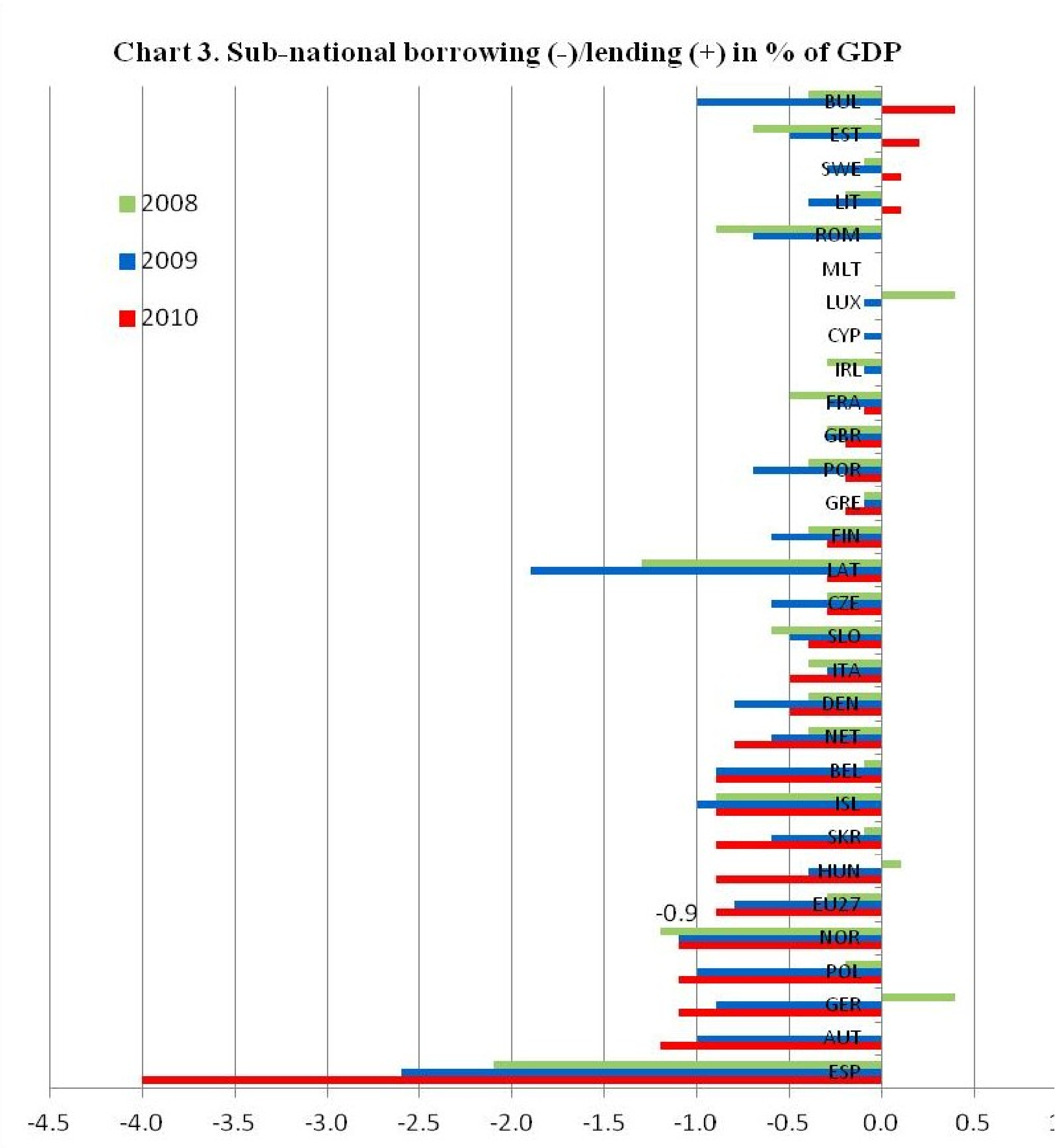
	Financial liabilities in % of GDP	
	Euro area (14 countries)	***OECD-Total***
2007	71,7	73,1
2008	76,7	79,3
2009	87,0	90,9
2010	92,8	97,6
2011	95,7	102,4
2012	96,6	105,4

Source: OECD

The already high and increasing level of public debt constrained the local scope of borrowing. (Chart 3). Sub-national borrowing declined in most of the countries in 2010 compared to the previous years. Again the Central European new EU member states (without the Baltic states), some of the more decentralised countries (e.g. Netherlands) and the federal states, including Spain were able to issue more debt in 2010. The most indebted countries have already further limited local government loans either by discouraging municipal borrowing or temporarily lowering the limits on local debt (e.g. Spain).

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

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



Source: Eurostat

Responses on the high public debt were formulated at all levels of government, including the European Commission. The European Stabilisation Mechanism provides financial assistance to countries with serious economic problems through a loan scheme. The European Commission borrows on the capital market and the debt is repaid by the beneficiary Member State[7]. Alternative sources are provided by the European Financial Stability Fund (EFSF) endowed with € 440 billion, of which € 250 billion is available in loans[8]. It is available for the Euro zone countries as loans to countries with financial difficulties. The 16 member countries guarantee the debt issued by the Fund.

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

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

Partnering with the private sector

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

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

[8] http://www.efsf.europa.eu/about/index.htm

However, the general public attitude towards private provision of public services has changed recently. The contracting-out and PPP schemes are rejected because the projects became more complex and sophisticated, so the municipal administration has not always been able to negotiate the deals with the large, multinational companies. The usual arguments against any form of private sector participation are the increased costs of services due to profit gained by the private service organisations and the negative consequences of rigid contractual arrangements. PFI costs in UK are also heavily increased by the higher interest rates paid by private investors. During the past decades the public actors (the clients, the regulators) are inclined to keep these services under direct control, as they have learnt a lot from the businesses in funding and managing municipal services. There is an increasing hostility towards foreign operators as the domestic utility companies became more experienced and prepared for taking back the service management.

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

(i) private delivery of public services; and

(ii) joint local actions of public entities and businesses.

Private provision of local services

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

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[9] In the coming 2 - 3 years municipalities should make a decision on 12,000 concession agreements in Germany, whether to extend the present concessions or to take over the network operation by a municipal company. The amendment of the energy regulations is already under discussion to limit the litigation, securing the information for the municipalities. (Information sheets provided by the CoE/LGI project national observer). These new trends are discussed by Wollman, H.-Marcou, G. (2010): The provision of public services in Europe. Edward Elgar Publishing Ltd., Cheltenham, UK

Service companies are often criticised once the first private investments improve the service performance and the tariffs are increased or user charges just kept at a higher level. In some cases populist actions led to re-municipalisation of services when in a decentralised environment local governments have limited regulatory capacities. In these cases, when re-communalisation happens before the service agreements actually expire, the private partners should be compensated for terminating long-term concessions or operating contracts, which will obviously cause one-time expenditures for the local governments[10].

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

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

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

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

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

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

Promoting local economic development

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

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

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

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

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

Box 3.
Poles of competitiveness in France

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

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

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

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

The creation of a pole must come from an initiative of a group of entrepreneurs, mostly with support of LSG, who submits a project after the Agency has issued an invitation to tender. A limited number of poles are accepted. Originally it was meant to be quite low (10 to 15) and of world dimension (space, cars of future, chemistry, pharmacy…) but 66 have been accepted in 2005 and 5 more were added in 2007, covering nearly all economic sectors. An international evaluation made in 2008 concluded that 13 were weak and finally accreditation of 6 poles with low output was withdrawn. But in 2010 six new ones were created, dedicated to eco-technologies (water, energy, waste…). The total number is still 71. Their legal status is private law, mostly a non-profit association, which offers greatest flexibility.

National competitive biddings are published for specific programmes with indication of the amount of money available, the general priorities and procedure information. From 2005 to mid-2011, 1051 projects have been selected and received support. The 2011 September call for tenders was the 11th. The public money comes from central State ministries depending on the nature of the projects; from local governments, mostly regions but also other LSG bodies, and from European Union (FEDER).

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

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

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[12] More info at: http://territoires.gouv.fr/poles-de-competitivite

[13] Barca, F. 2009: AN AGENDA FOR A REFORMED COHESION POLICY. A place-based approach to meeting European Union challenges and expectations. Independent Report prepared for Danuta Hübner, Commissioner for Regional Policy.

[14] `Clark, G., 2009: Recession, recovery and reinvestment: The role of local economic leadership in a global crisis. OECD LEED

[15] Romanik, C, 2011: A new definition of local development. http://www.developmentandtransition.net/

[16] The Work Foundation, 2009: Recession and Recovery: How UK Cities can respond and drive the recovery. London

Energy efficiency

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

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

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

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

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

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

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