



Intergovernmental Financial Relations in South East Europe in the light of the Global Economic Crisis

Dubrovnik Declaration

of NALAS Local Government Associations

Dubrovnik, 11-12 July 2009

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Over the course of the last eight months, the global economic crisis has begun to hit local governments throughout South-East Europe (SEE) with increasing intensity. The finances of local governments have been badly affected as some national governments decided to cut grants and transfers to local governments in an effort to reduce public spending and to prevent higher budget deficits; real economic activity fell, leading to lower local government revenues from shared taxes and own sources; and now, as unemployment rises, increasing the pressure on local governments to provide social services and various forms of relief.

NALAS has been monitoring and analysing the situation in SEE since the beginning of the crisis. At the NALAS General Assembly in Tirana in November 2008, we agreed on recommendations for central and local governments, most of which are still highly relevant today¹. Nonetheless, the overall situation has continued to deteriorate and it is now clear that the crisis will be deeper and longer than initially anticipated. Equally importantly, it will probably take years to repair the social, fiscal, and economic damage that it will leave behind.

We, the Associations of Local Governments of South East Europe, fully understand that there are no easy or quick solutions to the problems that this crisis is creating. We are also aware that reasonable strategies for mitigating the crisis will differ from country to country. At the same time, we are united in the belief that certain basic principles should govern the relationship between local governments and national governments; that national associations must intensify their efforts to help their members; and that local governments must adjust their policies to meet long-term challenges posed by the crisis and its aftermath.

Therefore, We urge national governments of South East Europe to:

- 1. Consult with local government associations prior to any adverse changes in the intergovernmental finance systems, and avoid in-year reductions in planned financial transfers.**

National governments should take all possible measures to avoid modifying intergovernmental finance systems in ways that reduce local government revenues. The consequences of all policy changes on

¹ Policy Brief: Local Governments of South East Europe Respond to Global Economic Crisis, NALAS Recommendations, November 2008: http://www.nalas.eu/ga/NALAS_Policy_Brief_Global%20Crisis_LGs_inSEE.pdf

local government finances should be clearly assessed before any anti-crisis measures are adopted. In many of our countries local governments remain underfunded and further reductions will only lead to the deterioration of public services and/or an increase in payment arrears. Sudden in-year reductions in planned transfers are particularly damaging, since local governments usually have very little leeway to make short term adjustments, and because since this completely undermines financial planning.

2. Inasmuch as the national government is negotiating with the **IMF or the EU** about **general budget support**, the role of local governments in mitigating the crisis should be recognised and the **existing levels of grants and transfers should be maintained**.

We also appeal to IMF, EU and other similar organisations to make any budgetary support conditional on at least maintaining existing levels of intergovernmental transfers.

3. **Discuss the crisis regularly with the associations**, insure access to information² and involve them in designing and implementing proposed responses.

As already recommended in NALAS Policy Brief of November 2008, it is of utmost importance that the dialogue between national and local governments is further intensified and better institutionalised. There should be frequent and regular meetings between representatives of the national governments and local governments.

For these meetings to be productive and constructive, our national governments must be prepared to provide local governments not only with information about all policy measures that are being considered, but also with the data needed to assess them, including more general data on the overall economic situation. In particular, local governments need to know how public revenues are performing on a month-to-month basis, what is happening on their local and regional labour markets and where major capital investment projects have been ramped-up or scaled back.

4. Make the **best possible use of all investment funds earmarked for local infrastructure development**, and intensify efforts designed to streamline and **improve the efficiency of EU and donor** supported investment programs.

The first casualty of revenue losses at the local government level is likely to be investment spending. This is particularly unfortunate because all of our countries are facing years of underinvestment in municipal infrastructure, and because local investment spending can have powerful counter-cyclical effects.

As capital funding is often scattered across various ministries and donor agencies, we urge our governments to consolidate information on available funds; clarify the procedures for accessing them; and where appropriate, consider redirecting them to “shovel ready” investment projects at the local level. Similarly, we urge the EU and our national governments to work with us to ensure that IPA and Structural Funds can be effectively

² CEMR's Code of Good Practice in Consultation, Paris, December 2008. Article 7: Access to Information.

accessed by all local governments, including those that have difficulties in preparing the necessary feasibility studies, and those that have difficulties funding investments before being reimbursed for these costs³.

5. Additionally, we urge national governments in SEE to complete or improve the **regulatory framework for decentralization** in those areas that are particularly important for helping local governments cope with the crisis, such as:

- **Increase local powers** to determine local taxes and utility charges, as well as the opportunities for more flexible local fiscal policy.

National governments should act to increase the own revenue powers of local governments to enable them to respond to the crisis not just by cutting expenditures but, where politically and economically possible, by raising revenues. In this respect, the lifting of any caps on utility prices is of utmost importance. This is necessary because one of the few realistic ways for local governments to reduce the pressure on their budgets is to lower capital and operating subsidies to utilities.

Both national and local governments should put in place systems to monitor payment arrears at both the local government and utility levels. At the same time, however, new tax and rate powers should be designed to ensure that local governments do not discriminate between different types of taxpayers, and in particular that any new tax or fee burden is not concentrated on the business community.

- **Transfer state property** related to local public services and unused **urban construction land to local governments**.

In many of our countries, national governments have still not transferred to local governments either ownership of the assets they use to deliver public services, or of unused urban construction land. Control over these assets is important for local governments if they are to rationally manage their public services and to attract investment, which has become all the more critical given the nature and depth of the crisis.

- **Review** and, where appropriate, **reform** the criteria by which **grants and equalising transfers** are allocated to local governments, ensuring that those criteria are fair and objective.

This is particularly necessary in the current environment because the overall fall in public revenues means that policy makers must make every possible effort to ensure that existing funds are used as efficiently and effectively as possible and that grants are allocated on the basis of objective criteria of need.

6. Finally, we recall that all our national governments have ratified the **European Charter of Local Self-Government** of the Council of Europe, and are obligated to abide by the principles and provisions of the Charter. In particular, we ask that Article 9, - which requires that the financial resources of local governments be commensurate with their legal responsibilities, especially that a

³ The newly created Bulgarian “FLAG” fund which insures co-financing of EU funded municipal projects may prove a useful model for this kind of effort (<http://www.flag-bg.com>).

share of their own resources should keep the real evolution of the cost of carrying out their tasks (point 4 of the Charter) - be respected.

Given the severity of the crisis, and perhaps equally importantly the fact that public expenditure levels are likely to be under pressure long after the crisis itself ends, it is critically important that both our Associations and our constituent local governments intensify their efforts to find innovative responses policy solutions for both increasing own revenues, and improving the efficiency and effectiveness of local public services.

We commit to support local governments in South East Europe to:

1. Develop **benchmarks** and **disseminate good practice** of local financial and service management.

Local government associations should intensify their efforts to provide relevant policy advice and technical services to their members; set up or improve systems for disseminating best practices and develop benchmarking and performance measurement systems. In order to meet the challenges of the crisis local governments need to be able to compare their revenue collection efforts and the costs of their public services with other local governments of similar demographic and topographic characteristics.

2. **Improve collection of existing taxes and charges** before increasing them.

Local governments should not begin by raising fees and charges, but rather by making sure that all citizens pay their existing taxes and utility bills. Local governments must explain to citizens that in the name of fairness and equity, everybody should pay their local fees, charges and taxes.

3. **Exercise prudence in incurring new loans** and avoid borrowing in foreign currencies

Long-term debt should only be incurred for investment purposes and only by local governments that have stable and predictable operating surpluses. By its very nature, the current crisis makes it difficult to project operating surpluses and local government officials should therefore be particularly conservative in making these projections. Similarly, given the difficulties that many national governments are having in defending existing exchange rates, borrowing in foreign currencies should be avoided. In any case, local governments should under no circumstances enter into long-term debt to finance their current deficits.

4. Reinforce efforts for **restructuring** and **optimization** of the network of service facilities.

Local governments must find ways to deliver better public services at the same or lower levels of public expenditures. These efforts should start by reducing administrative overhead costs, including inessential staffing costs. But local governments should also consider closing underutilised public facilities; where

appropriate making greater use of local NGOs and firms to provide social services; and working to reform service standards that are simply too costly to be sustained.

5. Reinforce **internal controls** and **transparent procurement procedures**.

Local government associations and their constituent members must work to ensure that cost effective methods of internal control are developed and implemented, and that public procurement procedures are transparent, streamlined and correctly used.

6. Improve the **targeting of social assistance** to the most needy.

It is essential that the allocation of social assistance should give priority to the needs of poorer households and that they should not be denied access by legal and procedural obstacles.

7. Avoid incentives to high cost provision of health and social care, wherever possible.

It is desirable to review the administrative and financial arrangements for social and medical care to ensure that they do not create incentives for more expensive types of provision such as residential rather than domiciliary care for the elderly and hospital rather than ambulant treatment, unless in the best interests of the client.

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