



STABILITY PACT  
FOR SOUTH EASTERN EUROPE



PROCEEDINGS OF THE  
SOUTH-EASTERN EUROPE REGIONAL  
MINISTERIAL CONFERENCE  
ZAGREB, CROATIA, 25-26 OCTOBER 2004

# EFFECTIVE DEMOCRATIC GOVERNANCE AT LOCAL AND REGIONAL LEVEL

*With reports on*

The State of Local and Regional Democracy in South-Eastern Europe

*and*

Fiscal Decentralisation in South-Eastern Europe

*Jointly organised by*

THE COUNCIL OF EUROPE

THE STABILITY PACT FOR SOUTH EASTERN EUROPE

THE GOVERNMENT OF CROATIA



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## FOREWORD

It is a great pleasure for us to present the proceedings of the South-Eastern Europe Regional Ministerial Conference on “Effective democratic governance at local and regional level”, which was held in Zagreb from 25–26 October 2004 and organised jointly by the Council of Europe, the Stability Pact for South Eastern Europe and the Government of Croatia.

The purpose of this Conference was to review the current state of local government in the Stability Pact beneficiary countries, to elicit commitments to promoting local democracy, decentralisation and capacity-building, and to encourage partnerships between state authorities at the central and local levels and the respective associations of local authorities.

For many countries in South-Eastern Europe, the first priority after the collapse of totalitarian regimes was to build strong and effective democratic states at the central level. Local self-government was only introduced—or ‘re-introduced’—later but, perhaps contrary to expectations, it proved to be a long process rather than an instant, ‘big-bang’ type of event. The transfer of competences, staff and resources from the state budgets to local budgets, fiscal decentralisation, the reform of territorial boundaries and the introduction of new tiers of government were slow, sometimes painful and controversial. This brought with it the risk that citizens would lose faith in democracy.

The Council of Europe’s Charter of Local Self-Government proved invaluable in identifying the main features of democratic local government and setting a framework for the implementation of European standards of local democracy. However, what was still needed was sufficient political will and a clear acknowledgment that local self-government is not an ‘optional’ feature of democratic states but an essential component of effective democratic governance.

The Zagreb Conference provided precisely that: a recognition by both central governments and local authorities that while the former must create the environment in which local authorities can carry out their responsibilities effectively, the latter also have to be strong enough to push forward the economic, social and environmental development of their communities.

In the run-up to the conference, special attention was paid to the dialogue between ministries and associations of local authorities in order to agree on common platforms for local government reform. The Congress of Local and Regional

Authorities of the Council of Europe and the Network of Associations of Local Authorities of South-East Europe (NALAS) played a very constructive role in this respect. At the conference itself, ministers, associations of local authorities and the donor community engaged in a dialogue leading to the signature by the ministers of a Memorandum of Understanding on commitments to local government reform. Based on a common template, Work Programmes for Better Local Government—drafts of which were presented to the conference—will set out objectives and priorities for action at national level. At regional level, these Programmes will provide a useful tool for assessing common needs and inspiring concerted action by both governments and the international community.

We believe that the Zagreb Conference was a remarkable opportunity for the countries concerned and the international community to fully gauge the importance of democratic local government for the stability and prosperity of the region, and therefore for the stability of Europe as a whole. The fact that a stocktaking conference will be held in Skopje in 2006 confirms the seriousness of the commitment of governments and associations alike for local government reform and its practical implementation to be the centrepiece of the democratic consolidation of South-Eastern Europe. In this way the states of the region will also be complying with the undertakings they made when they joined the Council of Europe.

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## POLICY ENVIRONMENT

### Local Democracy—But Only So Far

It is right that, in the early phases of transition, the emphasis is on the creation of a strong national government. This is necessary not only to build the appropriate organs of State in a new political, economic and social environment but also to manage the pressures for and against change. Early priorities must be to establish the rule of law, judicial reform, effective public administration, human rights and an effective Parliament.

But once the national government is established, the development of local democracy is essential to avoid tendencies to authoritarianism and to better meet the real needs of local people. Effective, democratic local government both delivers better local public services and gives local people a real say in the services they receive and in the way they are governed. It means that people in power locally become accountable to the people they serve, rather than to central government.

However, in a number of transition countries, the development of local democracy has only gone so far. Competences have been transferred, but in some cases not sufficiently or without sufficient resources. Public services are being provided, but not always to the standards to which local people are entitled. Local leadership is there, but not always sensitive to the needs of local people. Local people may vote, but they may not do much more than that.

### A Vision of Local Democracy

The development of effective, democratic local government is a fundamental change from the old ways of governing. To go down this path, people need a vision of what real local democracy might be.

Local democracy means that local authorities provide effective leadership for their communities. They work with civil society to introduce joint projects, to develop longer term plans for their community, to meet the challenges of the future. They focus on delivering results that improve the quality of life for local people. They provide public services that meet recognised standards and respond to the needs of local people.

Local democracy means that local people are engaged with their local authority not only through elections but in the setting of priorities, in the design of public services and in the decisions that affect those services. Local people understand their local authority's plans and celebrate their achievements. They are able to hold the local authority to account in the delivery of those plans and in the use of resources.

Local democracy means that local people need to be represented by men and women who themselves aspire to this vision, who understand how national and local government work, who care about the needs of the people who elect them, who communicate well and who encourage wider democratic participation.

Local authorities need to be staffed by professional men and women who take pride in their work of public service, who are trained to do a competent job and who look to an attractive career in the public sector.

Ministers and civil servants also need to share this vision. Their will and their competence determine the quality of the legislative framework and the constructiveness of their working relationship with local authorities and their associations.

This vision of local democracy should be set out in a strategy to which the government and its partners are seriously committed.

## Role of the International Community

How does the international community help member states bring this vision about? The Council of Europe is well known for establishing the standards agreed by the member states. The European Charter of Local Self-Government sets out the principles that underpin local democracy. There are numerous Council of Europe Ministerial recommendations that establish complementary standards.

But the journey from these principles and standards to the full flowering of local democracy is long and beset with difficulty. The Council of Europe is developing programmes to help member states and national associations of local authorities to move along this road.

Many international and national organisations have provided assistance in their own way. Each of them in their turn has moved the development of local democracy forward. They have helped strengthen local authorities; they have introduced programmes that have brought improvement to local public services; they have created examples of excellence.

The challenge is to build on what these organisations have achieved, to learn from good practice, to develop standardised approaches, to reach out to all local authorities and to ensure longer-term sustainability when external funding is reduced.

## Legislative Framework

The Council of Europe and other organisations have assisted member states with the development of the necessary local government legislation. The Congress of Local and Regional Authorities has monitored the implementation of the European Charter and other standards.

Reports of the Congress and other organisations have helped identify the issues, but this has not necessarily led to their resolution.

In some member states, the legislation is good but falls short on implementation. In other member states, advice from the Council of Europe may have been ignored for one reason or another, and the legislation remains weak or incomplete. The will and capacity of governments and their parliaments to fully transfer competences and resources to local government has fallen short of the expectations of the international community.

## Capacity-building

But there is another dimension to creating the necessary framework for effective, democratic local government. The will and capacity of central government may be there. But that is not enough.

A frequent reason given for the delay in transferring competences and resources, even when the legislation is in place, is the inability of local authorities to manage such responsibilities. Where are the trained staff to do the work? How well do the national associations help local authorities strengthen their own capacities to deliver good public services? How well do national associations stand up for strong local government in the national debate?

Central government concerns about the lack of local capacity may be justified. They need the confidence that local government will work well. They need to be sure that basic standards will be achieved, that public money will be properly accounted for. For that reason, capacity-building programmes are essential. They are the other side of the coin to the legislative framework.

National associations need the capacity to deliver effective support to their members.

Local authorities need the capacity to attract committed elected representatives and a cadre of competent staff and train them to deliver good local public services, to become organisations that foster good leadership and management, that engage local people and that meet high standards of public service.

## Two Sides of the Same Coin

Legislation sets the framework for local government; capacity-building programmes build the institutions needed for effective local government. There can be good legislation but, without capacity-building programmes, poor local government. But capacity-building programmes cannot make up for weak legislation. Legislation and capacity-building programmes are two sides of the same coin.

Training is a key part of capacity-building programmes. But if local authorities do not have the legal competences or public resources to deliver local services properly, training will be without purpose. If staff fear they will lose their job when the next mayor is elected because they have no legal protection, training will be inefficient. If staff are recruited without sufficient basic understanding and skills because there are no proper entry requirements into the public service, training will be wasted.

Other capacity-building programmes can complement training. Local public services can be improved by learning from best practice and by using techniques like fundamental performance reviews. Local leadership can be improved through peer assessment against a leadership benchmark. Community participation can be improved through networking. Performance management programmes can be used to introduce the discipline of continuous improvement in service delivery.

Good legislation and capacity-building together are key elements in the way ministries of local government and the national associations can support the local authorities themselves and their elected representatives and staff.

Ministries can ensure that the legislation reflects the principles of the European Charter of Local Self-Government and the standards of the Council of Europe. They can work with other ministries to ensure the proper transfer of competences and resources and in the development of good legislation on public service.

National associations can seek to ensure that the legislation responds to the needs of local authorities; they can also provide a wide range of capacity-building programmes to local authorities to help them deliver local leadership and local public services to high standards.

With such support, local authorities themselves—their staff and elected representatives—will develop their own capacities to provide good local government and make best use of the services provided by national associations and other national and international organisations.

## A Shared Endeavour Over Time ...

The development of effective, democratic local government is not something done by governments alone. It is a shared endeavour. It is about national governments and national associations of local authorities working to plan and implement the process together. It is about other national and international organisations supporting this endeavour.

The development of local democracy is not something done in one go. It takes time; it evolves. Further competences can be devolved as local authority capacity develops. Whereas a typical member state in SE Europe might now be spending around 5 per cent of its total public expenditure through local authorities, other member states of the Council of Europe may be spending 25 per cent.

Nor does the development of local democracy mean that the central government no longer has a stake in local government. Central government will have an interest in a number of local authority functions, such as the standards achieved by children at school. They will want to express that interest by establishing standards and targets and by monitoring performance and encouraging improvement.

## ...with Immediate Priorities...

The development of effective, democratic local government may take time, but there are always immediate priorities. In post-conflict areas, for example, community groups need to both live and work together. Local democracy means that all groups participate in community affairs. Women and young people have key roles to play. Where they are excluded, local democracy is less democratic.

Working together is much more difficult where there may be unemployment levels reaching 50 per cent. Unemployed people feel they have no function in modern society. There is little income for the family. Anti-social behaviour feeds on bored young people. Unemployed people lose confidence in the authorities.

But it does not have to be like that. Creating jobs can be a real priority.

Governments and local authorities—with international support as necessary—can focus on local economic development programmes. Business training, micro-credit and other local initiatives allow people to get a foot on, or move up, the enterprise ladder. Cross-border co-operation increases the size of the local market and the opportunities for trading. Municipal development programmes allow local authorities to exploit local job opportunities. Public works programmes provide low cost jobs and create community benefit. Programmes that attract inward investment introduce new ideas and increase both job opportunities and levels of confidence.

To promote such programmes, central and local authorities need to work together in partnership. Central authorities need to review their spending priorities to assess how effectively they are meeting the real needs of their people. They need to remove administrative and legal ‘red tape’ so that they can respond promptly to such needs and release the necessary resources. They need to give local authorities powers to develop their own resource base.

Local government needs the capacity to act as an effective partner to central government, to design and implement local economic development programmes, to harness support from local organisations and to bring the various groups in the community together in a common endeavour. Where this happens, this is local democracy ‘made good’.

### **...Based on Understanding and Professionalism**

The development of effective, democratic local government starts with a clear understanding of the value of local democracy. Strong local government is not a threat to central government. Rather it reinforces central government by enabling local people to participate more closely in government and by providing local public services more efficiently and effectively. It allows central government to focus on its priorities, while local authorities focus on what they do best.

To do this, central governments need to understand that local authorities need the competences, staff, finance and assets to be effective.

National associations need to be strong enough to work in partnership with central government and to provide valued services to local authorities. Local authorities need to build their capacity so that they can properly carry out the tasks entrusted to them. Elected members need to have sufficient vision and competence to fully serve the needs of local people. Local authority staff need a professional structure so that public service becomes an attractive career, and they develop the motivation, understanding and skills to deliver high quality local public services.

THE STATE  
OF LOCAL AND REGIONAL  
DEMOCRACY  
IN SOUTH-EASTERN EUROPE\*

› *Gérard Marcou* ›

\* Prepared by Professor Gérard Marcou, Professor at the University Paris 1 Panthéon-Sorbonne, Director of GRALE (Groupement de Recherches sur l'Administration locale en Europe) at the request of the Council of Europe.

The opinions expressed in this Report are those of the author and do not necessarily represent the views of the Council of Europe, the Open Society Institute, the Stability Pact for South Eastern Europe or the contributors of the country studies.



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## INTRODUCTION

This report deals with the situation of local and regional democracy in the “Stability Pact Countries” of South-Eastern Europe: Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Moldova, Romania, the State Union of Serbia and Montenegro and “the former Yugoslav Republic of Macedonia”.

This group of countries is characteristically heterogeneous. Each country was subject to socialist rule until the 1990s; each is oriented toward European integration—first, into the Council of Europe, and later, upon fulfilling accession conditions, into the European Union. Summarised as such, it would appear as though members of this group do not differ dramatically from the most recent enlargement countries, now new member states of the European Union (EU).

However, this comparison is valid only for two of the Stability Pact Countries (hereinafter, SPCs): Bulgaria and Romania. Both countries were involved in the same accession process as the eight Central European states recently admitted to the EU. However, their membership was delayed, owing to their slower and more difficult reform course. These two countries existed before, during and after state socialism, maintaining the same territory (though with significant border changes for Romania in 1945).

The situations of the six other countries of South-Eastern Europe are far more complex.

Four were components of the former Socialist Federative Republic of Yugoslavia (fSFRY). With the collapse of the fSFRY, and in response to a series of wars that erupted for the purpose of forming political communities based on ethnic homogeneity, these states sought independence. The late intervention of the international community imposed peace; yet, this intervention to a large extent recognised the ethnicisation of state building, based on the ethnicisation of settlements.

This is reflected in the international agreements that still provide the framework for domestic constitutional rules.<sup>1</sup> As such, the major issue facing these countries

<sup>1</sup> e.g.: The Constitution of Bosnia and Herzegovina, part of the Dayton Agreement; Serbia, where Kosovo is still under UN administration; and “the former Yugoslav Republic of Macedonia”, although to a lesser extent, with the Ohrid Peace Framework Agreement of August 2001. Furthermore, Croatia is also affected by the Dayton Agreement, regarding the return of refugees and judicial co-operation with the Hague war crimes tribunal.

is state building. Some of the most significant problems observed concerning the implementation of local self-government stem from the present organisation of the state, which itself is a consequence of arrangements guaranteed by the international community.

Nevertheless, it must be stressed that local self-government is always linked to international arrangements, and progress made in local self-government in terms of new state structures may be attributable to international guarantees. As well, dissimilarities among these countries appear to be increasing. It is expected that the current rate of progress in Croatia should enable the country to join the accession agenda predicted for Bulgaria and Romania between 2007 and 2009. Prospects seem less favourable, however, for the other three countries.

Since before state socialism, the territory of Albania has remained unchanged. Thus, its current situation basically resembles that of Bulgaria and Romania. Sizeable populations of Albanian origin, however, reside in neighbouring countries of the region.

Lastly, Moldova struggles with numerous difficulties. A republic of the former Soviet Union, it is now a small country squeezed between Ukraine and Romania. Moldova is a new state on the international scene: an independent Moldovan state ceased to exist after the sixteenth century; from the 1880s, Romania shared the province with the Russian Empire—and later, the USSR. In part of the territory, the authority of the central government continues to be challenged.

We can infer from these different backgrounds that local government issues must be handled in light of the state building needs of at least five of the SPCs; particular attention should be paid to local self-government to help consolidate new democratic state structures.

Another factor to be considered is the sizes of the SPCs, as these countries differ in terms of area and population. Population and area should be taken into account when discussing territorial reforms.

When taking stock of the current situations of the states of the region, and particularly in regard to local government, we must depart from any political or ideological approach on democracy and autonomy.

First, local or regional democracy should not be misunderstood. It is not a special type of democracy: democracy is a complex network of institutions, rights and behaviours implemented at all levels of government. Democracy at the local level cannot be isolated from its realisation at the national level. A key challenge in building constitutional democracy in the SPCs is to recompose the need to ensure citizens' rights, which are individual in nature, with the protection of minorities' rights, at the national and local levels. Local self-government has a special relevance to confronting this challenge.

Second, local self-government must be considered as part of the entire government system. It is necessary for developing better government, increased democracy, greater accountability and more responsiveness in managing public affairs. It should not, meanwhile, be in opposition to central or national government. The central government should consider decentralisation as an option in different public policies; as the purpose of government is to serve civil society and citizens, the distribution of responsibilities and powers among different government levels must strive toward meeting functional needs. These functional needs may differ—not only from country to country, but also within a country, from region to region and according to public policies and time periods.

In the last few years, most countries have adopted numerous pieces of legislation, and ongoing reforms are often prepared with international support. Generally speaking, the countries of the region are striving to implement the standards expressed in the European Charter of Local Self-Government, which they all have ratified. All Constitutions recognise and guarantee local self-government at least at the municipal level, and the basic legislation on institutions and responsibilities has been adopted in line with the requirements of the European Charter of Local Self-Government.

However, some significant problems arise in connection with the implementation of local self-government. In view of this, we will focus on the following three issues: (1) territorial reform and the government levels; (2) relationships between government levels and the distribution of responsibilities; and (3) the level of democracy in local institutions.

# I.

## TERRITORIAL PATTERNS AND GOVERNMENT LEVELS

A first necessary step of the analysis is to take stock of the present territorial pattern in the SPCs. Subsequently, reforms and reform projects regarding the municipal and 'regional' levels must be scrutinized. Lastly, cross-border co-operation should be considered as an opportunity to rebuild links between and among neighbours.

### A Review of Territorial Patterns

The following table will try to summarise the number and types of territorial units, and to distinguish local self-government services from central government local services (deconcentration). Territorial units are referred to by the area and population of a country; when necessary, the international status is also noted.

The classification of the table is based not on geographical but legal criteria. Column 2 presents those countries that are comprised of a loose association of quasi-state governments (Bosnia and Herzegovina; Serbia and Montenegro). Column 3 lists federal entities or regional autonomies, identified by the devolution of legislative power. Column 4 is for wider meso-level units; the fifth column shows supra-municipal units with a functional character; and the final column presents municipalities and their institutions for co-operation or local participation.

Central governments and local self-governments are listed in bold letters, local agencies of central government (deconcentrated authorities) are in ordinary letters, and co-operative efforts between local self-governments and infra-municipal institutions are in italics. Where the capital city has the status of a territorial unit of the upper level, this is mentioned in the corresponding column. Data on municipal self-governments reflect the distinctions made by domestic law among several categories of municipal self-governments.

Table 1: Territorial Organisation of Stability Pact Countries

1. Country data (population and size)	2. Union states	3. Federal entities/ autonomous regions	4. Wider meso level governments	5. Lower (supra municipal) meso governments	6. Municipal self-governments (with co-operations and infra-municipal entities)
Albania Pop. 3.32 m. 28,748 km <sup>2</sup>	—	—	12 regions 12 prefects	Tirana (11 boroughs)	65 municipalities divided into <i>sections</i> 309 communes (± 3,000 villages)
Bosnia and Herzegovina Pop. 3.8 m.	• Federation of Bosnia and Herzegovina (FBiH)	—	—	—	• Breko District : entity directly under the authority of State of BiH
Dayton Agreement	• Federation of Bosnia and Herzegovina (FBiH); Pop. < 2.3 m.	• FBiH: 10 cantons	—	—	• FBiH: 80 municipalities
UN High Representative	• Republika Srpska (RS); Pop. 1.5 m.	—	—	—	• RS: 63 municipalities
Inter-Entity Boundary Line endorsed by Croatia and fSFYR					

Table 1: Territorial Organisation of Stability Pact Countries (continued)

1. Country data (population and size)	2. Union states	3. Federal entities/ autonomous regions	4. Wider meso level governments	5. Lower (supra municipal) meso governments	6. Municipal self-governments (with co-operations and infra-municipal entities)
<b>Bulgaria</b> Pop. 7.9 m. 110,971 km <sup>2</sup>	—	—	<ul style="list-style-type: none"> <li>• 28 oblasts with governor (incl. Sofia) and regional development council</li> <li>• distributed into 6 regional units of the Ministry for Regional Development (NUTS II), with Committee of Economic and Social Cohesion</li> </ul>	—	<ul style="list-style-type: none"> <li>• 264 municipalities incl. 2,896 settlements with directly elected mayor in settlements pop. &gt; 250</li> <li>• among which 3 cities (incl. Sofia) with 35 urban districts</li> </ul>
<b>Croatia</b> Pop. 4.4 m., 56,532 km <sup>2</sup> Committed by parts of Dayton Agreement (borderlines, regional stabilisation)	—	—	<ul style="list-style-type: none"> <li>• 21 counties (županije) incl. Zagreb</li> <li>• 20 prefects</li> </ul>	—	<ul style="list-style-type: none"> <li>• 123 cities</li> <li>• 427 municipalities</li> </ul>

1. Country data (population and size)	2. Union states	3. Federal entities/ autonomous regions	4. Wider meso level governments	5. Lower (supra municipal) meso governments	6. Municipal self-governments (with co-operations and infra-municipal entities)
<b>Moldova</b> Pop. 4.3 m. 33,700 km <sup>2</sup>	—	<ul style="list-style-type: none"> <li>Region with special status: Gagaouzi, Pop. 175,000 1,848 km<sup>2</sup></li> <li>Area with <i>de facto</i> autonomy: Transdnestr Pop. 700,000</li> </ul>	—	32 districts + Chisinau Balti	<p>1) in the 32 districts: municipalities (towns and villages)</p> <p>2) Gagaouzia: 3 towns, 29 villages</p>
<b>Romania</b> Pop. 22.8 m., 238,000 km <sup>2</sup>	—	—	<p>1) Bucharest (municipe) 41 judete (departments) 42 prefects</p> <p>2) 8 regional development councils (NUTS II)</p>	8 Territorial Offices of State Chancellery (supervision) Local offices of government dpts. at district level or for several districts	<p>2,957 municipal self-governments, among which:</p> <ul style="list-style-type: none"> <li>80 municipalities, incl. Bucharest;</li> <li>183 towns</li> <li>6 urban districts of Bucharest</li> <li>2,688 rural municipalities</li> </ul>

Table 1: Territorial Organisation of Stability Pact Countries (continued)

1. Country data (population and size)	2. Union states	3. Federal entities/ autonomous regions	4. Wider meso level governments	5. Lower (supra municipal) meso governments	6. Municipal self-governments (with co-operations and infra-municipal entities)
Serbia and Montenegro Pop. 8.35m. 91,824 km <sup>2</sup>	Serbia Pop. 9.7 m.	Serbia in which Vojvodina: Pop. 2.0 m. 21,506 km <sup>2</sup>	Serbia 1) Belgrade 2) 25 districts, among which: – Vojvodina: 7	—	Serbia 160 municipalities <i>mesna zajednica with own council within municipalities</i> among which: – Vojvodina: 45
	Montenegro Pop. 0.65 m.	—	—	—	Montenegro 21 municipalities
	Kosovo Pop. < 2 m. 10,849 km <sup>2</sup>	—	5 districts	—	Kosovo 30 municipalities, <i>with mesna zajednica</i>
	—	—	—	34 state territorial offices Skopje	123 municipalities • 7 Skopje municipalities • <i>neighbourhood councils may be elected</i>
Pop. 2.1 m., 25,713 km <sup>2</sup>	—	—	—	—	—
Ohrid Agreement	—	—	—	—	—

These territorial patterns are partly attributable to the former regimes, and partly the result of reforms introduced or changes that have occurred during the last few years. The table makes it possible to draw out several basic features of local government across these countries.

First, no country suffers from excessive municipal fragmentation, compared with the average situation elsewhere in Europe (and especially in Western Europe). This holds even when France, which has the highest number of small municipalities in Europe, is excluded from the comparison. Certainly, this does not mean that no reform should be made; rather, reforms cannot be justified only on the basis of municipality size, and the purpose of any territorial reform must be clearly stated.

Second, a federalist state structure and autonomous regions exist largely as a result of the wars that have followed the collapse of the fSFRY, the ensuing international agreements and ethnic divisions (Moldova). Other countries have kept unitary state structures, which have determined the type of regional level they implement.

Third, territorial authorities exist at the meso level<sup>2</sup> in all countries except for Montenegro and Republika Srpska. In the Federation of Bosnia and Herzegovina, cantons, as very small federative entities, present a very particular type of meso level. Elsewhere, in Albania, Bulgaria, Croatia, Moldova, Romania, Serbia and “the former Yugoslav Republic of Macedonia”, there is a deconcentrated state authority and, at the same level, a local self-government, with the exception of Bulgaria, Serbia and “the former Yugoslav Republic of Macedonia”. In Moldova, the meso level is organised into rather small units (on average, 1,100 km<sup>2</sup>): districts, designed for services and functions, which need to be organised on an inter-municipal basis. These districts closely resemble the former *raion*. In “the former Yugoslav Republic of Macedonia”, the meso level corresponds to the former municipalities. The capital city may be subject to a special law.

Fourth, there is little or no co-operation between neighbouring local governments within the respective countries, or between cantons within the Federation of Bosnia and Herzegovina. The exaggerated devolution of powers to the cantons in the Federation of Bosnia and Herzegovina has fostered economic fragmentation, making the development of initiatives more difficult.<sup>3</sup>

<sup>2</sup> Meso level: Jim Sharpe uses the expression “meso-government” to designate institutions at the intermediate (meso) level of territorial government organisation, beyond their differences. He distinguishes between institutions subordinated to central government and those vested with some autonomy. He considers that the rise of the meso-government is based on the development of the latter. J.L. Sharpe, “The European Meso: An Appraisal”, *The rise of meso-government in Europe*, London: Sage, 1993, pp.1 and sq.

<sup>3</sup> See the speech of the High Representative Paddy Ashdown on 14 June 2002 in Banja Luka for “a single economic space” in Bosnia and Herzegovina: “successful decentralised countries (...) never confuse political devolution with economic fragmentation”.

## Reforms at the Municipal Level

Among SPCs, Croatia and “the former Yugoslav Republic of Macedonia” are the only countries where the municipal territorial pattern has changed drastically. As in Slovenia, post-socialist transition has led to the division of the large municipalities, characteristic of the previous regime.

In Croatia, reforms multiplied the number of municipalities fivefold (101 municipalities with uniform status in 1989; 547 municipal entities currently). Municipalities still have uniform status since the implementation of the local government act of 2001 (No. 33), and the qualification as “city” is of no legal consequence. The Constitution enables larger cities to have conferred on them the authority of a county by law (art. 133), but no application has been made to date of this provision.

In “the former Yugoslav Republic of Macedonia”, the present organisation—with 123 municipalities and the city of Skopje—was established under the reform of 1996. Previously, there existed only 34 municipalities, and these constituencies still exist for state territorial offices. The territorial reform adopted on 12 August 2004, following the Ohrid Agreement of 2001, provides for larger municipalities (80). As a consequence, it also provides for power sharing with the minority Albanians at the local level, with special rights (use of the native language, etc.) for community members when their portion of the population exceeds 20 per cent. Expectedly, this reform faces strong opposition. Local elections, held in November 2004, should establish the councils of the new municipalities; new laws on Skopje and on financing municipalities should be adopted during the same session.

Several countries have adopted special legislation for the capital city, due to its demographic weight and to its functions: Tirana, Sofia, Zagreb, Bucharest, Belgrade and lastly Skopje. Such legislation is currently under discussion in Montenegro. These subdivisions are vested with local self-government institutions; however, in Sofia, district mayors are elected by the municipal council.

In the State of Bosnia and Herzegovina, the Inter-Entity Boundary Line, established after the cease-fire and following several adjustments, raises very difficult problems of government. Namely, a significant part of the Federation of Bosnia and Herzegovina separates the north and south of Republika Srpska. Numerous municipalities are also divided by this line. Numerous small municipalities have formed as a result, especially in Republika Srpska. Co-operation between municipalities on both sides is impeded by distrust, and there is still a tendency to divide cities along ethnic lines. In the case of Mostar, the High Representative has been obliged to support the unity of the city administration; yet, the city is divided into several municipalities of different ethnic majorities. In Sarajevo, with four very autonomous municipalities, the situation is similar.

To sum up, the governments of the region pursued or are contemplating very different policies. Croatia and “the former Yugoslav Republic of Macedonia” have split large municipalities inherited from the Yugoslav period into smaller entities, while Serbia has not. Municipalities remain in Montenegro, Kosovo and Bosnia and Herzegovina, but according to the Inter-Entity Boundary Line. Albania is contemplating merging smaller municipalities into larger ones; “the former Yugoslav Republic of Macedonia” is considering rebuilding larger municipalities as well. Bulgaria has kept large municipalities, but has increased inner-municipality decentralisation.

These observations suggest two general comments. First, merging or splitting municipalities should not be the only remedies to respond to functional difficulties or democratic demands. Second, general reorganisation brings about administrative costs and political tensions; therefore, reforms must be well founded and well prepared, in order for central governments to undertake them.

Other reform possibilities could be explored. Territorial reorganisation involving the merging of municipalities could be limited to situations in which excessive fragmentation results in the lack of financial and human resources. It could also be pursued step by step, on the basis of local considerations (for instance, the experience of the Netherlands). Co-operation between municipalities might be a response to functional needs through the delegation of competences to the inter-municipal level (by law or/and inter-municipal agreement); smaller communities could then remain as long as enjoy support from the people (for instance, as practised in France, with positive results). Meanwhile, inner-municipal decentralisation, with elected organs and responsibilities delegated upon them, could respond to democratic demands of the population, while keeping the functional advantage of larger municipalities. Several countries of the region have developed infra-municipal decentralisation: in 2003, Bulgaria increased the number of settlements (with a minimum of 250 inhabitants) governed by an elected mayor. Other countries have followed this path as well, including Croatia, Serbia, Portugal and Poland.

## Reforms at the Meso Level

There is much confusion over the meaning of “meso level”, especially with the increasing use of the term “region” to distinguish it. In fact, institutional and political realities vary tremendously from one country to another. In the case of the SPCs, the notion “meso level” appears to be especially inadequate. However, the organisation of this level is under discussion in most of these countries.

For the purpose of clarification, it is essential to parse out various interpretations of “region”.

The most general interpretation refers to an intermediate level of government with an elected council and self-government rights. The region is thus understood as an extension of self-government to the upper level of the territorial organisation of the state.

A more restricted interpretation refers to the increasing importance of territorial economic patterns in light of ongoing economic reforms—in particular, regarding openness. This interpretation supports the claim for stronger institutions, capable of implementing their own development policies. This vision is supported by the European Union regional policy, which is part of its economic and social cohesion policy.

A third vision of “region” is based on the revival of identities based on history, local languages and ethnicity; it mobilises in this way political loyalties rooted in “the region”, as opposed to the state or central government. This vision, therefore, has more to do with regionalism as a form of nationalism, rather than regionalisation as a functional adaptation of state structures to new challenges.

As it appears, although the word “region” is often understood as suggesting a wide geographical area with relatively large autonomous powers, what is called a “region” is neither necessarily wide nor inevitably vested with large autonomous powers. However, size is relevant with regard to the type of functions to be performed at that level. Furthermore, some countries have adopted forms of administrative regionalisation, whereby authority at the regional level is appointed by the central government, with the duty to implement a regional development policy involving municipalities (for example, Portugal, Greece, Bulgaria and Lithuania).

Turning to the SPCs, it is apparent that the meso level is a major issue for state building, for democracy and for development. Different situations must be distinguished and considered.

In Bulgaria, Serbia and “the former Yugoslav Republic of Macedonia”, the meso level consists solely of a state authority. In “the former Yugoslav Republic of Macedonia”, the state territorial offices have kept numerous tasks considered to be within the state competence at the seat of the former larger socialist municipalities (as in Slovenia). In Bulgaria, the *oblast* (region) is a rather small, multifunctional level, which is traditional. Additionally, there are six regional units of the Ministry for Regional Development (NUTS II level), with a committee of economic and social cohesion. While districts did not exist in the fSFRY, they were created in Serbia in 1992, instead of regions (*regioni*) that had been constituencies of co-operation between municipalities. These districts took over a number of tasks previously carried out by municipalities. By contrast, Montenegro has no meso level.

In Albania, Croatia, Moldova and Romania, local self-government institutions exist at the meso level. Their basic role is to perform administrative functions of

a rather local scope, but of a far broader scope than at the municipal level. Other functions are performed directly by central government field services covering more or less the same territory. Previously, Moldova was divided into 10 *judete*, according to the Romanian example in the reform of 1998. Law No. 764-XV of 27 December 2001 restored a form of territorial organisation closer to that of the former Soviet Union—with 32 districts (*raioni*) and two cities with district rights (Chisinau and Balti). Local state functions are performed in 25 territorial offices of government (following Government Decision No. 735 of 16 June 2003). In Romania, there are wider territorial units that may be compared to French departments, with an elected council, executive and prefect appointed by the central government.

The structure of the State of Bosnia and Herzegovina and of the State Union of Serbia and Montenegro cannot be analysed in terms of meso level institutions. These states are loose unions of political entities vested with main state prerogatives, except for international personality. The Constitution of the State of Bosnia and Herzegovina reserves very limited powers to the central authority, and the entities have their own armies (Constitution of the Federation of Bosnia and Herzegovina, art. III.1; Constitution of Republika Srpska: art. 68, 104–107). In the Federal Republic of Yugoslavia, Montenegro grew increasingly autonomous of Belgrade; this was recognised by the Constitutional Charter of 2003.

In the Republic of Serbia and in Moldova, there are regional self-governments (respectively, Vojvodina and Gagaouzia), which reflect the third meaning of “region” mentioned earlier, although according to specific conditions.

In Serbia, the Constitution provides for autonomous provinces based on national, cultural and other characteristics. As Kosovo remains under the jurisdiction of UNMIK, its future status is open and will be decided by the United Nations Security Council.

The constitutional status of “autonomous province” is applicable to Vojvodina. The new draft statute prepared by the provincial assembly is indeed a proposal for wider autonomy, with its own legislative power, and with the competence to organise a judiciary. Furthermore, the draft provides for a parliament with two chambers, one of which should be elected by the respective ethnic communities. This house would participate in elections of the government.

In Moldova, the Constitution was amended in 2002 to consolidate and guarantee the autonomy of Gagaouzia. Gagaouzia qualifies as an “autonomous entity,” with a special status established by an organic law adopted by at least three-fifths of the members of Parliament of the Republic (art. 111-1). Furthermore, according to new constitutional provisions, “specific forms and conditions of autonomy may be granted” to localities of the left bank of the Dniestr, according to a special organic law (art. 110). The *de facto* autonomy of the area called Transdnistria is based much

less on ethnic division than on economic interest; the area can now be organised on the basis of the Constitution and integrated into the territorial organisation of Moldova.

Discussions on the regional level are currently underway in several SPCs, especially in those countries which are close to accession to the EU. In Bulgaria, the government is committed to further decentralisation to a second level of self-government. In Croatia, the reinforcement of counties (*županije*) by a revision of the territorial structure was contemplated; at present, the government position is to keep the current territorial structure. In Romania, in addition to the professionalisation of prefects, the reform of the second level on the basis of existing *judete* or through the creation of a new regional level is being debated. In Albania, the focus is on the election and the responsibilities of the recently created regions.

Such reforms will have to take into account the need to guarantee the stability of the state and to preserve the self-government rights of municipalities. In smaller countries, it is doubtful that regional development policies call for a new regional authority; central government in these countries is in fact on the scale of regional governments in larger European countries.

## Cross-Border Co-operation

In all countries, cross-border co-operation has become part of the European dimension of local self-government. For several South-Eastern European countries, the issue of cross-border co-operation is a consequence of newly drawn international boundaries between countries that belonged previously to the same state. In a number of cases, new borders have divided existing municipalities. In this context, cross-border co-operation may be a way to restore links and trust between communities by the realisation of mutually beneficial projects.

At present, however, cross-border co-operation is very limited at the city level, which is precisely where its impact might be most noticeable. In a number of countries, this is the consequence not only of distrust, but also of the limits of local self-government itself: little autonomy with regard to the centre, lack of resources, and unclear responsibilities. The progress of decentralisation should naturally support co-operation among municipalities of neighbouring countries.

A more general impediment to cross-border co-operation is the lack of a legal framework. The Madrid Convention of the Council of Europe on cross-border co-operation developed such a framework; however, several countries of the region yet to ratify this convention ("the former Yugoslav Republic of Macedonia", the Union of Serbia and Montenegro and Bosnia and Herzegovina).

The development of Euroregions has been successful, involving institutions as well as representatives of civil society. There exist at least 10 Euroregions in which SPCs are involved. These regions have been created as a response by local authorities to the lack of co-operation between neighbouring countries. Euroregions have no legal power and are limited by the scope of the competence of their members, but they can promote common projects to improve living conditions in the fields of health, education and training, transport, tourism and co-operation in the case of natural disaster. Their levels of activity range widely, with some limited to consultations, and others able to carry out concrete projects.

According to the report of the Congress of Local and Regional Authorities of the Council of Europe on local democracy in the region, a limit to the development of cross-border co-operation results from the fear that this opportunity will be misused to establish co-operation based (solely) on ethnicity or kinship. A response to overcome this obstacle would be to develop agreements between the states concerned, which would specify the matters and the purpose of cross-border co-operation between local self-governments.<sup>4</sup>

4 Stefan Sofianski (Rapporteur), Les enjeux de la démocratie locale en Europe du Sud-est, Congrès des Pouvoirs locaux et régionaux, 11e session, CG(11)7, partie II, 28 Avril 2004.

## II.

RELATIONSHIPS BETWEEN GOVERNMENT LEVELS  
AND THE DISTRIBUTION OF RESPONSIBILITIES

The development of local self-government and the decentralisation of responsibilities require a central government strategy and dialogue with representatives of self-governments. In general, necessary institutions (local government associations) do exist. However, they must be established in some countries and their co-operation often must be improved.

Regarding the decentralisation of responsibilities to local self-governments, different models are possible, as reflected by the SPCs. In recent years, several countries of the region have improved their legislation. However, much remains to be done to achieve a clear and sound distribution of responsibilities, and to assign the necessary resources to local self-governments.

### Central Government Support to Decentralisation and Associations of Self-Government Units

In Albania, Bulgaria, Croatia, Romania and Serbia, there is a central government department (rather recently created, in some) in charge of local government and decentralisation. For example, in Croatia, the responsibility for local and regional administration was transferred at the end of 2003 from the Department of Justice to a newly created Central State Office for Public Administration, in charge of the local government reform. Serbia has also a Ministry for State Administration and Local Self-Government. In Romania, the Ministry of Administration and the Interior is in charge of local government matters. Albania and “the former Yugoslav Republic of Macedonia” maintain a Ministry for Local Self-Government. In Moldova, however, there is no central government organisation in charge of local government and decentralisation; these issues are handled directly by the government and the head of the government. In the State of Bosnia and Herzegovina, local government is the responsibility of the government of Republika Srpska (there is a Ministry of Local Self-Government); in the Federation of Bosnia and Herzegovina, it is a responsibility shared by cantons and the Ministry of Justice.

In all countries of the region, local self-governments and councillors are free to create associations to represent their interests. In “the former Yugoslav Republic of Macedonia”, municipalities must be members of the national association; such an obligation is controversial with regard to article 10 of the European Charter of Local Self-Government. Local government associations have developed in all SPCs, and consultation with the central government is a common practice. Usually, distinct associations exist for the respective local government levels. In Romania, the four associations of local self-governments have decided to organise one common association. In Moldova, meanwhile, there are two associations of councillors (one for municipalities and one for districts) and an association of local and regional powers, representing municipalities, districts and so forth.

Local government representatives are involved in major policy choices regarding local government. In Serbia, although there is a Standing Conference of cities and municipalities (an association of local self-governments), apparently no consultation has taken place since March 2004 on current issues. Moreover, the Standing Conference has not yet been heard in preparatory works for the future Constitution of Serbia. In Moldova, “there is a continuing lack of an effective and institutionalised dialogue between central and local authorities”.<sup>5</sup> In the State of Bosnia and Herzegovina, sufficient information on present practices does not exist. Elsewhere, regular consultations on major issues, legislation and finance regarding local self-government are reported. These practices include participation in working groups for the drafting of reforms and formal consultations for government projects. In some countries, the rights of associations of local self-governments are established in legislation on local government (Bulgaria, Romania).

At the same time, associations must develop their independent activities *vis-à-vis* their members, in order not only to consolidate their representativeness, but also to cope with their tasks. Some associations are already very active in this regard.

## Different Models of Responsibility Assignment

A first distinction should be made between general competence to deal with public affairs of local scope and assigned responsibilities.

The general competence to deal with public affairs of local scope is a general European standard, reflected in article 4.2 of the European Charter of Local Self-

<sup>5</sup> V. Popa and V. Furdui, General report on the situation of local autonomy in the Republic of Moldova, Conseil de l'Europe, Institute for Development and Social Initiatives “Viitorul”, Chisinau, June 2004, p.16.

Government. It is important as a self-government right for local councils. Surprisingly, this right is not clearly recognised in the SPC's legislation, except in Romania and "the former Yugoslav Republic of Macedonia". In Serbia, the law can be read in favour of this right, but the application of the law is based on the interpretation that local authorities may perform only the tasks devolved to them by law. The legislation should evolve in this respect to be more in line with European standards.

Regarding assigned responsibilities, a great diversity of systems is possible. However, responsibilities of local government cannot be analysed without reference to the past, which was marked by a distinction between the Soviet model and the Yugoslav model. In the Soviet system, local councils were organs of state power. As such, they performed numerous administrative tasks, but were not in charge of local interests; as such, there was no concept of local self-government. The situation was similar in socialist Albania. In Yugoslavia, however, municipalities performed a wide range of duties with their own resources and with extensive managerial autonomy, as an expression of the self-management ideology, but again without any distinction between state and local government functions.

Conversely, local self-government, as practised in European countries and as reflected in the European Charter, is based on a distinction between state (or central) and local government. The latter is supposed to promote local interests within the framework of the law. This implies defining and implementing a concept of local self-government responsibilities.

Regarding the present state of the law in the SPCs on the distribution of responsibilities, and without going into the details of the countries surveyed, several common issues exist beyond legitimate differences of approach. The idea of "own responsibilities" remains unclear. There is a discrepancy between the local government legislation and sectoral legislation, the result of which is to impede local self-government in the exercise of its responsibilities. There are difficulties in defining the functions of the meso level with respect to the state and to the municipal level.

The idea of "own responsibilities" means that a number of tasks are performed by local authorities under their own (primary or sole) responsibility and, as a consequence, with some discretion, within the framework of the law. This does not preclude the possibility that they also perform delegated tasks—such as tasks carried out by local authorities as agents of the central government.

However, the conditions under which certain tasks are discharged are not always taken into account in their characterisation as 'own' or 'delegated' responsibility. As a consequence, local authorities may have very limited discretion, if any, within the scope of their so-called 'own' competences. Examples of this are provided below, as well as some clarifications recently introduced in legislation.

The first example concerns the management of education personnel. Often, this is considered a local responsibility. However, the development of education on which

the personnel structure depends cannot be decided locally, and salary norms are fixed by the central government. The local authority, in such instances, is actually an agent of the central government; education is not its own responsibility.

In Albania, for instance, wages in education and healthcare were previously part of the conditional budget. Now, they are financed through ministry budgets, although they are serviced by local governments. Education and health in this instance are considered as “joint functions” in the Local Government Act No. 8652 of 31 July 2000. However, the responsibility may be considered as ‘delegated’ in relation to personnel matters, and a Law on the State Budget for 2003 redefined educational facilities and primary healthcare as delegated functions.

This explains why in Bulgaria, an increasing part of education expenditure is carried out directly by the state and social assistance and healthcare are direct responsibilities of the state, whereas until 2003, they were financed through municipal budgets. In other SPCs, teachers’ salaries are usually paid directly by the state budget (known as the “entity budget” in the State of Bosnia and Herzegovina).

The new law of Moldova on municipal public administration (Law No. 123-XV of 18 March 2003) is based on a clear distinction between own and delegated responsibilities, for both the municipal and district levels of self-government, even though the qualification of some responsibilities may raise doubt. Both categories of responsibilities are subject to different supervisory regimes: limited supervision for the legality of own responsibilities, and extended supervision for delegated responsibilities.

The differentiation between state and local government functions is essential, and results in a more limited scope of local government own responsibilities. It is proper that these responsibilities confer a certain amount of discretion on local self-government for policy making and management choices, albeit within the framework established by law. But, this differentiation is also essential for political accountability: for delegated functions, accountability is attributed to central government, whereas for own functions, it is attributed to the local authority.

Another issue is the relationship between general local government legislation and sectoral legislation. Usually, local government legislation provides lists of matters falling within the responsibilities of local authorities. However, sectoral laws regulate a variety of functions, and may give a very narrow interpretation of a local government responsibility, or even ignore the distribution of responsibilities.

An extreme case of such a discrepancy can be observed in “the former Yugoslav Republic of Macedonia”. According to the Local Government Act of 2002, the responsibilities of the municipalities newly established by the territorial reform of 1996 are fairly comprehensive, and include social welfare services, education, healthcare, urban planning and so on. Municipalities historically did not perform

these functions. As such, these broad-ranging responsibilities have had to be devolved by numerous specific laws (more than 80) that are still pending. As a result, municipal responsibilities are quite limited in reality, and they comprise only urban planning and the maintenance of some local services and infrastructure (local roads, drinking water, parks and so on). Other devolved functions are in fact performed by the current state administration at the district level. In February 2003, the government adopted the Operational Programme of Decentralisation for 2003–2004, and the transfer of responsibilities should take place together with fiscal decentralisation by the beginning of 2005.

In other countries, sectoral legislation has been recently adopted in order to give substance and an adequate legal framework to the devolved responsibilities. For example, from 2003 to 2004, Albania adopted a new law on the local police, and policy papers were approved on water supply and sewerage, on primary and secondary education, on healthcare services, and on social services and assistance. In Romania, new laws were adopted on urban and spatial planning (Law No. 350/2001), on local public services (Law No. 326/2001), on hospitals (Law No. 270/2003), and on public healthcare units of local and *judete* interest (Law No. 99/2004), among others. In Croatia, numerous recent laws regulate the responsibilities of local self-government units in the fields of environment protection (*Narodne novine*, Law No. 128/1999), waste management (Law No. 151/2003), physical planning (Law No. 32/2002), publicly funded housing (Law No. 82/2004), municipal services (Law No. 26/2003, consolidated text), roads (Law No. 65/2002) and waterway ports (Law No. 65/2002), or transfer new tasks to them in the fields of healthcare (Law No. 121/2003), primary and secondary education (Law No. 59/2001), agricultural land (Laws No. 66/2001 and No. 87/2002). Of course, these pieces of legislation should be assessed with respect to the objective of consolidating local self-government.

A last general issue, influenced by the size of the SPCs, concerns the functions of the meso level.

Uncertainties persist as to which tasks the central government should transfer to the meso level, and how the latter should relate to the municipal level. A first option is to keep a purely state authority, subordinated to the central government (Bulgaria, “the former Yugoslav Republic of Macedonia”, Serbia). If this solution is adopted, it is essential for the state authority to be staffed by civil service professionals (career civil servants), and for the municipal level to be given stronger powers to perform local government tasks, including through co-operation. Otherwise, there would be an imbalance between the requirements of central government policies and the representation of legitimate local interests, which is a *raison d'être* of local self-government.

Other countries have established local self-government at the meso level. This is the case in Albania, Croatia, Moldova and Romania, although state authority is

maintained. This option has the advantage of enabling the further decentralisation of functions that clearly exceed municipal capacities, and which are clearly related to a particular territory. Efficient co-operation among municipalities, meanwhile, is enhanced through state authority and through the territorial concentration of administrative capacities. In small countries, functions delegated to the meso level are necessarily limited, since otherwise they would infringe upon municipal responsibilities.

The provisions adopted in Albania and Moldova contrast strongly. In Albania, no single, clear responsibility has been assigned to the new regions: the law is drafted in general terms. For instance, mention is made of the “construction and implementation of regional policies”, but the purpose of such policies is not specified; new regions are assigned “every other function given by the law”, broadly including functions delegated by constituent municipalities and by central governments (Local Government Act, art. 13).

In the case of Moldova, on the contrary, there are precise lists of responsibilities for both levels. However, one matter can be listed for both levels, without specification of how it is shared: this is the case for social assistance (art. 10[1]e and 11[1]e). Furthermore, the district budget includes municipal budgets and must fix the share of the constituent municipalities from state revenues and from the share of the property tax allocated to local government (see Law on Local Public Finance, No. 397-XV of 16 October 2003, art. 2[1] and 21[2]). This means that district councils have a leading role in relation to municipalities, since they are responsible for adapting their resources to estimated needs.

However, examples from other small countries suggest that local self-government at the meso level may be useful when specialised. Among functions that can be appropriate for that level, the experience of these small countries displays: planning functions; public transport within the regional area; healthcare services available for a wider population basin; specific training and cultural institutions of a similar nature; and support to smaller municipalities in discharging their own responsibilities.

In sum, the transfer of service provision tasks to a meso level self-government is justified when it allows for overcoming spillover effects and internalising costs. As a result, a functional analysis has to be made before planning the devolution of responsibilities. The experience of the meso level in countries such as the Netherlands, Denmark or Hungary would be relevant for most SPCs.

A different case is the claiming of responsibilities on the basis of a regional autonomy programme. As illustrated by the case of Gagaouzia or by claims formulated in Vojvodina, the purpose is not functional, but political. Claiming responsibilities in this way can lead to difficulties of another kind, in relation to state governability and solidarity within the state, by bringing about a fragmentation of major state functions.

In the SPCs, regionalisation should take place in the state building process. Political claims should be balanced by a functional approach deemed to improve the provision of services to the population. This approach must use available resources efficiently, and move beyond the inward-looking claims of communities.

## Financing Local Government Responsibilities

Local government finance is a major issue in the relationships between central and local government. There is no decentralisation without adequate funding. Whereas it is generally admitted in the SPCs that delegated tasks must be financed in totality by resources transferred from the central budget (at least in principle), the conception of the financing of other tasks is not so clear. There are also ambiguities regarding the characterisation of a range of resources, as is the case for the various types of expenditure (cf. supra).

The major observation regarding financing can be summarised as follows: with the exception of Serbia, financial decentralisation is limited. Local budgets are usually funded from tax shares and direct budgetary transfers, and local councils have little influence over their current revenues. Municipal property still must be established or protected in several countries; however, recent reforms have improved the financial situation of local governments.

“The former Yugoslav Republic of Macedonia” certainly has the lowest level of financial decentralisation, with a level of local municipal expenditure below two per cent of GDP, and a system of capping when more local resources are collected than planned.

In other countries, municipal budgets are dependent on the budget of the higher level. In Albania, pass-through transfers for the payment of wages in the pre-university education and primary healthcare sectors and for social benefits to poor families represent close to 50 per cent of local government budgets (2003). This is, however, a major improvement in local self-government compared to the situation before 2000. At that time, the “conditional budget” formed more than 90 per cent of the local government budget, as an aggregate of expenditures included in the budgets of several ministries. Currently, only pass-through transfers are included in respective ministries’ budgets, but increasing discretion has been given to local governments since 2000. Local councils dispose freely of about 50 per cent of the total local budget, and the share of own tax revenues jumped from three per cent of total local government revenues in 2002 to 12.2 per cent in 2003.

In Moldova, financial decentralisation is based on the district level. Municipal budgets depend to a large extent on the district budget, which decides on their

participation in the share of general state revenues allocated to the district, and on their share in the property tax, including additionally own budgetary transfers to municipal budgets (Law No. 397-XV of 16 October 2003, art. 4). In Moldova, financial decentralisation seems to be limited at the district level.

In 2003, Bulgaria introduced a new financial system (in 2002, several amendments were made to the 1998 law on municipal budgets and to the 1997 law on local taxes and fees), similar to that implemented in Albania. Tasks delegated by the state are financed through resources allocated by the state: a percentage of the local yield of the personal income tax and a state grant to equalise revenues to meet expenditure needs. Local tasks, however, are financed by local revenues. The main difficulty of the new system is that the potential of local resources is not in line with the dynamics of expenditure, termed “expenditure standards”. As well, for many municipalities, the equalisation grant is too small to compensate for the low level of own resources. However, several functions considered to be of national scope have been taken over by the state budget (in the fields of health, social assistance and education). As a result, the share of local government expenditure has decreased (8.1 per cent GDP in 2000; 6.5 per cent in 2003). Local revenues now represent 32.1 per cent of the total municipal revenues, of which local taxes and local fees represented 21.1 per cent in 2003—compared to 11 per cent in 2000.

In Romania, the level of municipal expenditure increased significantly from 4.1 per cent GDP in 1999 to 8.5 per cent in 2003. Most budget-funded tasks are covered directly by the state budget and by tax shares. It is reported that following recent reforms the degree of financial autonomy of local authorities increased from 20 per cent to 50 per cent. Indeed, a major reform has been the introduction of a general personal income tax in 2000, the main part of which (63 per cent and later on 100 per cent) is assigned to municipal and *judete* budgets. However, there is no local tax power on the personal income tax. Tax collection has been transferred to local authorities as well, with the result that the tax collection rate has increased. This is only a temporary gain; on the whole, genuine own revenues can be raised from numerous taxes (namely, a property tax, which is increasing) and fees, upon which local governments wield rate-setting power.

Not surprisingly, the financial systems of the State of Bosnia and Herzegovina, Croatia, the State Union of Serbia and Montenegro and “the former Yugoslav Republic of Macedonia” remain quite similar. Although these systems are diverging, the basis of municipal finance in each is a basket of shared taxes. Grants play a very small role.

The financial system of Croatia differs most dramatically—first, because of the creation of counties, for which resources are necessary. Most tax revenues stem from tax shares, and the transfer of new responsibilities to cities has been financed by the

concession of an additional share of the local yield of the income tax. As a result, the share of central government in personal income tax revenues has decreased from 60 per cent down to 25.6 per cent. Local taxes and other own revenues provide only a small part of local government revenues. However, municipalities do have the possibility to levy a surtax on the income tax, a possibility that is initially reserved to larger cities; 12 cities used this possibility up to the end of 2003. Nevertheless, the very unequal financial situation of municipalities, cities and counties suggests that the equalisation is not sufficiently developed. At present, it is based on annual decisions about minimum financial standards for each decentralised function, and a government decision on the mode of calculation of the amounts of equalisation functions for the coming year. A more stable system with clear criteria set out by law is desirable.

Tax and financial systems in the State of Bosnia and Herzegovina differ between the Federation of Bosnia and Herzegovina and Republika Srpska. Financial data reflect the weak position of the state: only 1.3 per cent of the total expenditure is financed by contributions from the Entities. In the Federation of Bosnia and Herzegovina, there is a federal law on the allocation of public revenues among cantons, and each canton must adopt a law on the allocation of public revenues among municipalities. Otherwise, the financing of local governments is very similar in the Federation of Bosnia and Herzegovina and in Republika Srpska. The whole allocation system is based on tax sharing applied to a basket of taxes, with a specific tax share for each tax. There is no grant system, and sharing rates are subject to discretionary variations in both entities and in each canton of the Federation of Bosnia and Herzegovina. There are a few local taxes, over which municipalities have some discretionary powers, representing on average 10 per cent of municipal revenues. Non-tax revenues may be significant in urban areas. As a result, the system does not allow municipalities to make forecasts regarding the development of their revenues, and there are considerable fiscal disparities between municipalities in both Entities. With the introduction of VAT, planned in 2006, and the replacement of the sales tax, the derivation system will no longer be maintainable, and the whole finance system will require reconsideration.

In Serbia, the budget of Vojvodina is financed by transfers based on the cost of the services transferred from the state to the province (10.4 billion dinars in 2003), and by tax shares (income tax and property tax, 3.1 billion dinars); there are no own revenues. As regards municipalities, the local finance system of Serbia seems to be quite sound compared to other SPCs. The level of municipal expenditure, at 5.6 per cent GDP, seems to be adequate for their tasks, considering the expenditures directly financed by the central budget (teachers' salaries, primary healthcare). Municipalities also have an unusual rate of investment expenditure (24 per cent

of the total expenditure of municipalities). With the reform introduced in 2002, municipal revenues increased considerably across Serbia: from 34.3 billion dinars in 2000 to 66.6 billion dinars in 2003 (revised budget of the Republic in 2002, 217.7 billion dinars). Until recently, the level of financial decentralisation in Serbia was also unusually high, with municipalities receiving 41 per cent of their total revenues (without debt) from their own revenues. These revenues consisted mainly of their own taxes, over which municipal councils had the power to vary rates. The reform of 2001–2002 gave municipalities greater control over fee rates. Municipalities may use the self-imposed contribution, which is a tax that municipalities may impose on their citizens through referendums, for specific investment programmes. This is widely used (71 per cent of municipalities in 2002), although the total yield is under two per cent of the total revenue of municipalities. Additionally, municipalities are financed by tax shares from a tax basket (43 per cent of the total municipal revenue). Municipalities receive the remainder of their revenues from the so-called “limited shared taxes”, which are additional tax shares allocated yearly on the basis of needs criteria, and which are designed to achieve a certain equalisation. There is no grant system in Serbia, and equalisation is controversial because of the lack of clarity of the needs criteria. Local government finance in Serbia as it existed until 2003 shows that a certain fiscal decentralisation is also possible in difficult economic conditions.

This system is now under review because of radical changes to the tax system. With the introduction of VAT, which replaces the sales tax, the tax share of the sales tax will be replaced by a state grant based on 2002 revenues with corrections. Voting on this law was scheduled for July 2004. More importantly, the payroll tax, paid by companies at a rate voted by municipalities, was abolished on 1 July 2004 by a state budget law of 2004. (All municipalities voted for the maximum rate of 3.5 per cent; the yield was expected to be 20 per cent of the total municipal revenue in 2003). The tax will be replaced by an increased share allocated to municipalities of the local income tax yield. This means that a local tax is replaced by a tax share, and it points to less fiscal decentralisation. However, the property tax revenues remain at a very low level, and reforms could increase the tax capacity of municipalities.

The situation in Montenegro is, in broad terms, rather similar to Serbia, with a high proportion of own revenues. A new local finance law provides for increased own tax revenues from 2004 (a surtax up to 13 per cent on the personal income tax), but fewer self-imposed contributions and tax shares.

Local finance of Kosovo is now quite distinct from Serbia. Municipalities are funded by transfers managed by UNMIK. However, since 2000, municipalities receive own revenues from licenses and fees, and from 2003, following a pilot programme, UNMIK has introduced a property tax (UNMIK regulation 2003/29). Tariffs for local public utilities are voted by municipal councils. As a whole, own

revenues represent 20 per cent of the municipal budgets on average.

This review of the key features of local finance in the SPCs shows that financial decentralisation needs to be improved in several countries, in order to support self-government. The experience of some countries shows also that it is possible even in particularly difficult situations. Municipal self-government cannot develop without a certain level of financial autonomy.

Municipal self-government also requires municipal property. This poses a challenge for the SPCs, since properties need to be identified before being transferred. However, the property right of municipalities is now recognised in the law of all SPCs, with the exception of Serbia. In this country, a law of 1995 transferred to the Republic all municipal properties, including municipal enterprises. In turn, municipalities possess only the right to use, manage and lease these properties, including the right to sell this *usus* right. This law must be repealed to comply with the European Charter of Local Self-Government. According to the government of Serbia, a new law will follow the adoption of the new Constitution of Serbia.

In the State of Bosnia and Herzegovina, no such law was passed, and municipalities should still possess their traditional property rights. The situation is unclear in “the former Yugoslav Republic of Macedonia” after the territorial reform of 1996 and in Croatia for the same reason, although municipal property continues to be recognised. The situation of local government property is unclear in Moldova, as well. According to the Constitution, public property belongs to the state or to “administrative/territorial units” (art. 127). Municipal councils manage municipal properties, whereas such a competence cannot be found in the law on district councils (Law No. 123-XV of 18 March 2003, art. 18(2)x, and art. 49). Provisions on local revenues suggest that only municipalities (territorial administrative units of the first level) are entitled to public properties (see Law No. 397-XV of 16 October 2003, art. 4).

Other countries have adopted one or several laws deemed to solve property issues for municipalities: Albania (Laws No. 8743/2001 and No. 8744/2001); Bulgaria (Law of 1 June 1996, largely modified, with a new law pending, aimed at facilitating investments); and Romania (Laws No. 213/1998 on public property and No. 3/2003 on public services providing administration for the public and private domain). However, the main difficulty in this matter regards implementation; effective monitoring must be organised.

### III. DEMOCRACY IN LOCAL INSTITUTIONS

By themselves, decentralisation and self-government are not sufficient to guarantee greater democracy, but democracy requires decentralisation and self-government. The progress of democracy depends on institutions and on political behaviour. The latter is particularly difficult to attain and requires time. Nevertheless, institutions have a responsibility to support the progress of democratic consciousness.

As regards political behaviour, it is beyond the limits of this report to assess whether or not it is in line with the new institutions. What can be concluded is that good laws are not sufficient for elections to run fairly (but, they are necessary), and that it is not enough to have fairly run elections (but, again, they are necessary) to confer political legitimacy on political elites.

This report focuses on observations that can be made from the analysis of the legislation and from information on institutions. A summary of the results follows.

Generally speaking, all SPCs have adopted legislation establishing democratic institutions of local self-government and procedures of citizen participation. Legislation at times needs to be improved in order to guarantee self-government rights; as this is largely technical issue, it does not receive elaboration here. As well, the neutrality of the public service requires reinforcement. Above all, in some countries, ethnic divisions negatively affect the functioning of local institutions.

#### **Elected Bodies**

In all SPCs, a directly elected council rules each local government; in some countries, an indirect election exists only at the meso level. In Albania, members of regional councils are delegated by local councils in proportion to the population, and include all mayors (Constitution, art. 108–110). In Romania, Law No. 151/1998 on Regional Development established regional development councils; presently, there are eight development regions. The councils comprise of four representatives for each *judete*, including representatives for each category of municipality. Representatives are appointed for four years. However, the regional development council is not a local authority; it is supported by the regional development agency.

As regards the executive, legislation is more diverse. In Albania, Bulgaria, Moldova, Romania, “the former Yugoslav Republic of Macedonia”, Serbia and Montenegro and the Republika Srpska, mayors are elected directly. In the Federation of Bosnia and Herzegovina (according to the federal law on local government), Kosovo and Croatia, mayors are elected by councils. At the meso level, the president of the *judete* in Romania, the president of the district in Moldova and the governor of the county (*župan*) in Croatia are elected by the council. The mayor (or the president) is assisted by a board or deputies, elected by the council or appointed by the mayor (the president).

Regarding electoral turnout, rates in the SPCs resemble European averages, according to a recent survey commissioned by the CDLR on strengthening of participation at local level.<sup>6</sup> In a survey of 25 countries, including Bulgaria, Moldova and Romania, 13 countries reported electoral turnout of between 40 and 59.99 per cent during the last three elections. Bulgaria, Moldova and Romania all fall into the brackets; this is also the case for Albania. Nevertheless, there is no reason to be satisfied with such a rate. Improving transparency and the quality of decision-making would contribute to restoring confidence and increasing turnout.

The situation of elected local government officials is still a concern in a number of countries, and cases of forced dismissals of mayors remain. For example, on 23 March 2004, the Assembly of Gagaouzia dismissed the mayor of Comrat. The Supreme Court of Gagaouzia rejected the claim to allow the law of the Republic of Moldova to prevail, confirming the dismissal on the grounds that the mayor was an official.<sup>7</sup> In short, this case points to the need to distinguish clearly between the situation of a public servant and the situation of an elected official holding a political mandate. The situations of both require the protection of the law, but in different ways, as each serves a particular purpose: the former, the neutrality and the professionalism of the public service; the latter, the representative quality of the elected official holding a political mandate.

Democratic legitimacy, however, is not the only issue to consider. Governability of the local government unit is also important. It would be a major problem if, due to separate elections, a directly elected leader lacked a stable majority in the council—even more so if the council had its own chairman as a political leader. Much depends on the degree of fragmentation of political forces; the electoral system may aggravate the situation.

<sup>6</sup> CDLR, Committee of Experts on Democratic Participation at Local and Regional Level, Experiences of member states with policies for the strengthening of participation at local level, Council of Europe, LR-DP (2004) 13 rev., 10 September 2004.

<sup>7</sup> V. Popa and V. Furdui, General report on the situation of local autonomy in the Republic of Moldova, Conseil de l'Europe, Institute for Development and Social Initiatives “Viitorul”, Chisinau, June 2004, p.7.

## Citizen Participation

Much has been done regarding legislation to favour the direct participation of citizens in decision-making. In all countries of the region, legislation provides for local referendums and initiatives; differences relate to the possible subjects of such procedures, the conditions of initiative, and the conditions of validity. However, referenda are only consultative in Moldova; in Kosovo, they are currently restricted under the international administration.

Although information on practice is lacking, thus making it difficult to assess the impact of the above-mentioned legislation, the direct participation of citizens is rather common practice inherited from the former Yugoslavia. In “the former Yugoslav Republic of Macedonia”, for instance, the population was consulted on amalgamating municipalities; in Serbia, municipalities intended to raise the self-imposed contribution. Examples in Western Europe show that the development of such procedures changes the practice of representative bodies, since citizens may challenge their decisions. Negative side-effects might include making the promotion of change more difficult, or facilitating emotional mobilisation on an ethnic basis. Nevertheless, and insofar as the main concern is to increase the legitimacy of institutions, procedures of direct democracy may help to offset low turnout at local elections.

Institutions of community self-government within municipalities (sub-municipal units) are typical for several countries of the region—namely, directly elected settlement mayors in Bulgaria, and elected community councils in Serbia. In Bulgaria, a new law of 2003 on the territorial administrative division lowered the threshold for a settlement to elect its mayor from 500 to 250 inhabitants; as a result, the number of such mayors increased to 2,896. In Serbia, the *mesna zajednica*, which is a local community council upon which some administrative tasks may be delegated, must not be confused with urban districts, or inner municipality local self-governments. These institutions facilitate proximity with citizens, offer them a collective representation with regard to the municipality and guarantee the sustainability of wider municipalities. In Kosovo, it has been proposed to restore them as an alternative to splitting up municipalities. It has also been suggested to introduce a territorial element in elections to the municipal assembly, in order to create a linkage between councillors and the areas of the territory they represent.<sup>8</sup>

Other forms of citizen participation or protection may be provided by the legislation of a particular country. Furthermore, according to the survey on strengthening of participation at local level, 21 out of the 26 countries reviewed have a general

<sup>8</sup> Working group on local government, Framework for the reform of local self-government in Kosovo, July 2004.

policy framework for promoting citizen participation locally. Bulgaria and Romania have such a framework; Moldova does not.

However, much has still to be done to enliven democracy at the local level. In April 2004, the Congress of Local and Regional Authorities of the Council of Europe took stock of local democracy in South-Eastern Europe,<sup>9</sup> listing the main obstacles to the development of citizen participation as:

- (i) the lack of transparency and accountability, local government often following the low standards of the central government, the lack of legislation on free access to official documents (with the exception of Bulgaria and Romania), the lack of regulations on the publication of basic documents, such as budgetary documents;
- (ii) the low level of citizen participation in decision-making, with particular concern for members of national minorities and displaced persons, the need for reconciliation processes to overcome inter-community tensions; and
- (iii) the passivity of NGOs with respect to public administrations, and the (low) level of media contributions to supporting democratic processes.

### Neutrality of the Public Service

Neutrality of the public service is essential for guaranteeing equal treatment to all citizens, and for avoiding political bias in decisions. Merit-based recruitment therefore must be guaranteed by law. An emphasis on merit contributes to the attractiveness of the local public service and to improving recruitment. However, not all countries have yet adopted legal provisions for establishing such guarantees.

Among the SPCs, only Albania, Bulgaria and Romania have a public service law that can be applied to applicants for, or the personnel of, local government administrations regarding competitive examinations for recruitment. The implementation of examination procedures still must be reviewed. For the remaining SCPs, it is urgent to establish an adequate legal framework that would hold local public servants to high standards in performing their tasks, and thus inspire the trust of citizens.

In countries with a deconcentrated state administration, public service rules must be developed and upheld. The heads of relevant agencies should be senior

<sup>9</sup> Stefan Sofianski, *Les enjeux de la démocratie locale en Europe du Sud-Est*, Congress of Local and Regional Authorities of the Council of Europe, Chamber of Local Authorities, CG(11)7 Part II, 11th Plenary session, 28 April 2004.

civil servants—not politicians—insofar as they have real powers, and not only a representative role. Current reforms in Romania to professionalise the prefects are a step in this direction.

## **The Impact on Local Democracy of Distrust among Communities**

Distrust between communities negatively impacts the functioning of local institutions and public administration as a whole.

Distrust has provoked the fracturing of municipalities along ethnic lines, resulting in inchoate entities and border changes. This has happened along the Inter-Entity Border Line in the State of Bosnia and Herzegovina, between municipalities in the Federation of Bosnia and Herzegovina, and in “the former Yugoslav Republic of Macedonia”. Issues of interethnic discord have also hampered decentralisation in Kosovo; in “the former Yugoslav Republic of Macedonia”, they present obstacles to new territorial reforms, which are considered necessary for better management. In the Federation of Bosnia and Herzegovina and in Republika Srpska, the predominant rationale of institutional arrangements has been to decentralise powers to the smallest, ethnically homogeneous constituency.

As stated in the report on local and regional democracy in Bosnia and Herzegovina, presented in 2000 to the Congress of Local and Regional Authorities of the Council of Europe, “it is unacceptable that new municipalities should be founded on ethnic grounds”.<sup>10</sup>

The Constitutional Court of the State of Bosnia and Herzegovina issued an important sentence of 1 July 2000, delineating between ethnic collective rights and segregation in a multiethnic state.

In a number of cases, particularly in the Federation of Bosnia and Herzegovina, the ethnic dimension hampers local government management. Not only must personnel be ethnically balanced, but also deputies of the head of the municipality are, in fact, equal partners with him or her as representatives of particular groups. Ethnic bargaining also affects the budget. In some municipalities, three budgets exist: the official budget and two informally agreed upon by the dominant ethnic groups. The significant influence of ethnic political parties extends from the institutions over social and economic matters. Other countries are not immune to such bias.

<sup>10</sup> Congress of Local and Regional Authorities of the Council of Europe, Report by Claude Haegi and Gianfranco Martini, CG/CP(6)29 rev., p.15.

## CONCLUSIONS

Several conclusions and recommendations can be drawn from this review, on the basis of the general principles and values expressed in the conventions of the Council of Europe, and in particular from the European Charter of Local Self-Government.

### General

- Local self-government must be considered as part of the whole government system; it is necessary for better government, more democracy, greater accountability and more responsiveness in managing public affairs. Central government should consider decentralisation as an option in different public policies. The distribution of responsibilities and powers among government levels has to be adequate to functional needs, as the purpose of government is to serve civil society and citizens. These functional needs may differ, not only from country to country, but also within a country and from region to region, according to public policies and time periods. Doing this, the government must pay close attention to the constitutional framework, to historical legacies and to existing communities.
- In the central government, an authority should be dedicated specifically to supporting the implementation of local self-government and its consideration by sectoral departments. Local government representatives have to be involved in the determination and the implementation of this policy, through their associations.

### Territorial Reform at the Local Level

- With reference to the European average, no country suffers from excessive municipal fragmentation. Nevertheless, territorial reform may be justified for reasons other than the average size of existing municipalities. General reorganisation, however, brings about administrative costs and political tensions. Therefore, such reforms must be particularly well founded and well prepared, to justify

their undertaking by the central government. In particular, amalgamation has to be based on common perspectives.

- If a territorial reform is justified, merging or splitting municipalities should not be the only (sole) remedies to respond to functional difficulties or democratic demands. Territorial reorganisation through the merging of municipalities may be limited to local situations in which an excessive fragmentation results in the lack of financial and human resources. It can also be pursued step by step on the basis of local considerations. Co-operation between municipalities could be a response to functional needs through the delegation of competences to the inter-municipal level (by law or/and inter-municipal agreement); smaller communities could remain while supported by the people. Conversely, inner-municipal decentralisation, with elected organs and responsibilities delegated upon them, could respond to the democratic demands of the population, while keeping the functional advantage of larger municipalities.
- More generally, there is too little inter-municipal co-operation; this detracts from finding solutions to key development issues. Municipalities should be encouraged to cooperate by adequate legislative and financial provisions. This also would help to bring communities closer to each other.

## The Regional Level

- The creation of a regional level of government is difficult. It depends on the size and complexity of the country. Regional government should be functional.
- Deconcentrated state government administration/agencies and local self-government need to be able to work together in a way that protects the integrity of the state, while recognising the rights of local authorities. Regional levels of government may not be viable in smaller countries.
- The establishment (or reinforcement) of local self-government at the regional level should seek to enable the further decentralisation of tasks that are in excess of municipal capacities. It should be aimed at improving services to citizens.
- Regional self-government must be clearly related to territory and to policy areas where efficient and effective co-operation between municipalities might be difficult to achieve. Regional functions should not encroach upon municipal responsibilities; on the contrary, they can be useful in supporting municipalities, particularly where they are specialised (e.g. land use planning, public transport, healthcare, training and culture).

- Where regional autonomy appears unavoidable due to recent events, it should be balanced by a functional approach aimed at improving services to citizens in a way that goes beyond the inward-looking representations of communities.

## Cross-border Co-operation

- Cross-border co-operation is part of the European dimension of local self-government; it is also an opportunity to restore links and trust among communities by the realisation of mutually beneficial projects.
- Cross-border co-operation among local self-governments (municipalities, regions or others) must be supported by governments, as well as by the EU.
- All countries should ratify the Madrid Convention on transfrontier co-operation between territorial communities or authorities.
- International agreements between the countries of the region should promote and facilitate cross-border co-operation.

## Distribution of Responsibilities and Powers

- Decentralisation must be seen in the context of a distribution of responsibilities and powers among different government levels. Tasks should be based on an adequate level of resources and clear responsibilities.
- Much remains to be done to establish a sound distribution of responsibilities and to assign the necessary resources to local government. This goes beyond legitimate differences in approach. Practice falls short of the European standard: the European Charter (article 3) refers to "... a substantial part of public affairs...". There are inconsistencies between "delegated responsibilities" and "own responsibilities". The latter needs to be more clearly established. There is no real "own responsibility" where there is no sufficient discretion for local policy choices.
- The general competence of local authorities to rule local affairs, other than responsibilities assigned by the law, should be clearly recognised in legislation.
- There are discrepancies between local government legislation and sectoral legislation, reflecting a reluctance to decentralise powers and thus impeding local authorities in the exercise of their responsibilities.

## Financial Decentralisation

- Despite progress made in several countries, financial decentralisation is limited. Local authorities have little influence over current revenues. They should be granted more tax power within the framework set by law.
- Sufficient discretion in expenditure should be secured.
- Municipal property must be recognised and guaranteed where it is not. Properties related to local government functions should be transferred into municipal ownership.

## Ethnic Division

- Local government is well situated to build trust and overcome ethnic conflict. This applies in particular to larger multiethnic municipalities.
- Ethnic divisions can negatively impact local government and the management of local affairs. Some municipalities are split along ethnic lines, hampering effective administration and the sustainability of the municipality. The design of municipalities must avoid consolidating ethnic divisions, and promote the equal treatment of citizens. Specific decision-making and control procedures can secure the rights of minority members, as long as it is necessary.

## Citizen Participation

- Citizen rights are individual and equal, and do not depend on membership to any community.
- There is legislation in all countries establishing democratic institutions and mechanisms for citizen participation (e.g. local referenda). However, this legislation should be supplemented by effective measures to reinforce transparency in decision-making, free access to official information, and accountability of councillors and public officials. NGOs and the media must play a more important role for these purposes.
- Care should be taken to ensure that democratic legitimacy is not pursued at the cost of governability, especially where the fragmentation of political forces and the use of particular electoral systems make a stable majority in a local authority difficult to achieve.

- Low electoral turnout may be offset by more direct democracy. Democracy may be served by the use of directly elected settlement mayors or local community councils. These institutions facilitate close contact with citizens, improve representation, and support the sustainability of the municipality.

## Local Public Service

- A neutral local public service requires merit-based recruitment guaranteed by law. Merit-based recruitment can make a local public service career attractive and improve recruitment. It will also increase trust between local government and citizens. More needs to be done in order to develop the necessary legal provisions.

## APPENDIX COUNTRY PROFILES

*Although every care has been taken to ensure the accuracy of the information contained in these appendices, the Council of Europe accepts no responsibility for factual errors or omissions.*

### ALBANIA

#### General Context and Constitutional Framework

According to the Constitution of November 1998, Albania is a “unitary and indivisible state” (art. 1) in which local government is based on the “principle of decentralisation” and exercised according to the “principle of local autonomy” (art. 13). The coexistence of Albanians with national minorities is integral to the basis of the state, which has the duty to protect all inhabitants (art. 3). Members of national minorities have the right to express and preserve their culture; in particular, they have the right to be taught in their mother tongue (art. 20). Greek-speaking representatives may hold the majority of seats in some communes. Albania signed the European Charter of Local Self-Government in May 1998. Reforms are rooted in three pieces of legislation (31 July 2000): the new local government act; the act on the special organisation of Tirana; and the act on the territorial division of the territory.

Part 6 of the Constitution is devoted to local government. Units of local government are municipalities or communes and regions (*qarqe*); others may be created by law. Communes and municipalities are the basic units of local government; they perform all self-government duties, except those devolved by law upon other local government units. Self-government is exercised in the local government units by representative organs and by referenda. Whereas representative organs and the mayors are directly elected in communes and municipalities for three years, members of regional councils are delegated by local councils, in proportion to their population, and include all mayors of the region (art. 108–110).

Organs of local government may refer to the Constitutional Court on competence conflicts between central and local government, and to assess the compatibility with the constitution of normative acts of central or local organs (art. 131 and 133).

Furthermore, the government appoints a prefect in each region (art. 114). He/she supervises the legality of regulations and decisions adopted by local government units, and must co-ordinate local offices of central government ministries (Law No. 8927 of 25 July 2002). Regional branches of the State Supreme Audit Institution (SSAI) are subordinated to the prefect.

## Territorial Organisation, Local Institutions and Responsibilities

Albania is divided into 12 regions (corresponding to the 12 prefectures) and 373 basic units of local government, among which there are 65 municipalities and 309 communes, plus Tirana.

Communes are *de facto* federations of villages, although villages are by law subdivisions of communes. Municipalities are local government units of urban areas; they are subdivided into sections (*lagje*), and may also include villages. Only villages elect their own representatives; in so-called sections, there is a public officer appointed by the mayor. As a whole, there are more than 3,000 settlements. The population of Tirana has grown rapidly in recent years, from 350,000 inhabitants in 1992 to over 600,000 at present. Tirana is divided into 11 boroughs, each with an elected council and mayor. The capital city has no special responsibility in law, but the law on Tirana provides for the distribution of functions between the city and the boroughs.

Regions are the “units in which regional policies are constructed and implemented”, and “harmonised with the state policy” (Constitution, art. 110).

The law distinguishes among own functions (art. 10), joint functions (art. 11) and delegated functions (art. 12), and defines and lists areas for each category.

Some new own functions were previously performed by the district (water supply, local roads), or as agency functions for central government (cemeteries and burial services, nurseries and shelters); others are completely new (local economic development programmes, public markets and commercial networks, supporting small businesses). Urban planning, land management and housing are also own functions.

Joint functions are shared with central government, which must secure sufficient material and financial support when communes and municipalities are required to perform the said functions or to achieve the standard set by the central government. Social care, public order and environmental protection are listed as joint functions; others may be added by law.

For delegated functions, all costs have to be borne by central government. Educational facilities below the university level and primary healthcare are qualified as delegated functions.

Several local governments may join together for one or several functions, including the creation of a new corporate body funded by the parties (art. 14).

Own functions of regions are: (i) “the construction and implementation of regional policies and their harmonisation with state policies at the level of the region”; (ii) “every other function given by the law”; and (iii) functions delegated by constituent local governments or by central government.

## Local Finance

Since the Local Government Act of 31 July 2000 (art. 19), municipal budgets include all incomes and all expenses, together with loan payments. As a result, the budget practice surrendered the distinction between the so-called “conditional budget” and “independent budget”. The former was delegated by central government, as an aggregate of expenditures included in the budgets of the various ministries. The law retains the distinction between conditional and unconditional transfers. Among conditional grants, so-called “pass-through” transfers are as high as half the total local government revenues. These transfers are for the payment of wages in pre-university education and primary health sectors, and for the payment of social benefits to poor households. However, for national accounts, they are ascribed to the respective ministry budgets. This means that the payment of these wages by local governments is a pure agency function.

Nevertheless, the scope of local government discretion in financial matters has increased significantly during the last few years, especially after the Local Government Act of 2000 and the financial package laws of 2002. Major changes include:

- the introduction of an unconditional transfer in 2001, which has increased every year by substituting former conditional transfers, and has been based on a distribution formula since 2002. This has had an equalisation impact since the local tax reform implemented in 2003;
- earmarked grants are maintained for capital expenditures, but still raise transparency and equity problems; and
- according to three laws of 12 December 2002, full authority of local governments turned into local taxes (as of 2003) for fees, rate setting authority of local governments (within  $\pm 30$  per cent of an indicative tax rate) for the property tax on buildings, the agriculture and land tax, and the local small business tax. The full

revenues of other taxes are allocated to local governments with spending discretion (simplified profit tax, vehicle registration tax, immovable property transfer tax).

The following table summarises the present situation of local finance in Albania (in millions of leks).

	2000	2001	2002	2003
Total local expenditures (TLE)	32,846	38,177	40,724	46,654
Total local expenditures ( per cent GDP)	6.19	6.25	6.01	6.24
Total local government current revenues without conditional pass-through transfers and earmarked grants	10,199	12,289	15,834	19,425
Conditional pass-through transfers ( per cent TLE)	59.6	61.0	56.1	49.7
Earmarked grants ( per cent TLE)	31.1	11.8	7.6	9.6
General purpose grant ( per cent TLE)	0.0	18.0	25.7	17.0
Own taxes (rates set by LG) ( per cent TLE)	2.5	3.2	3.0	12.2
Shared taxes ( per cent TLE)	0.1	0.1	0.1	5.6
User charges and fees ( per cent TLE)	2.7	3.1	3.9	2.6
Other revenues ( per cent TLE)	4.0	2.8	3.6	3.3

*Source:* Based on data provided by A. Hoxha (with J.H. Pigey), *Fiscal decentralisation in SEE countries. Case of Albania*, Stability Pact Conference, September 2004.

The transfer of properties to local government is based on two laws of 2001. According to these laws, immovable properties serving for the execution of own local responsibilities will be transferred in full ownership to the respective local governments. Those related to delegated tasks will be used by the respective local governments without charge, while remaining in state ownership. However, the initial inventory, which is necessary to carry out the transfers, is far from complete. In 2002, city halls were transferred, and from 2003, properties related to local government own functions began being registered, thus permitting their transfer.

## BOSNIA AND HERZEGOVINA

### General Context and Constitutional Framework

Bosnia and Herzegovina (BiH) is a case of ethnic decentralisation in a state, which was organised as result of a peace settlement. This settlement has been imposed and guaranteed by the international community.

### *The International Guaranty*

BiH consists of two Entities, the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS), which are separated by the Inter-Entity Boundary Line (IEBL). The Constitution of BiH and the IEBL are parts of the Dayton Agreement of 14 December 1995. The High Representative monitors the implementation of the peace settlement, in line with UN Security Council resolutions; since March 2002, he/she is appointed by the Council of the European Union.

### *The Constitution of BiH*

The Constitution of BiH establishes only central institutions with very limited competences. However, it also establishes a Constitutional Court (art. VI), with three judges appointed by the President of the European Court of Human Rights. All government functions and powers not expressly assigned to the institutions of BiH are those of the Entities. The Constitution allows for the transfer of further responsibilities to BiH, but only subject to agreement of the Entities (art. III). Remarkably, BiH has no defence capabilities; only the Entities have the responsibility to organise the defence of their territory and maintain their own armies (Constitution of the Federation of Bosnia and Herzegovina, art. III.1; Constitution of Republika Srpska: art. 68, 1°, 2° and 3°, art. 104–107).

As a result, most domestic matters are within the competences of the Entities, subject to the basic rights guaranteed by the Constitution of BiH. These include the right for refugees and displaced persons to return to their homes of origin, and to have their properties restored to them or to be compensated for the loss thereof, in accordance with Annex 7. There is no reference to the internal organisation of either Entity.

### *State Structure in the Entities*

The territorial organisation of each Entity is regulated by its own Constitution.

The Constitution of Republika Srpska presents the Republic as a unitary state (art. 2), vested with all state functions and powers apart from those explicitly transferred to BiH by the Constitution of BiH (art. 3). Local self-government is one of the basic principles of the constitutional arrangements (art. 5). The National Assembly must determine the territorial organisation of the Republic, and adopt development and urban plans (art. 70). There is only one level of self-government: the municipality. However, the law may entrust local government tasks to a city, uniting several municipalities (art. 102).

The Federation of Bosnia and Herzegovina (Constitution of 1994), on the contrary, consists of federal units or “cantons” (art. I.2), which are supposed to result from the exercise of their sovereign rights by the “constituent peoples” of BiH in the territories of the Federation (Preamble). There are 10 cantons, each with its own Constitution, and with legislative and taxing powers.

Again, the Constitution divides responsibilities between the Federation and the cantons (chapter III), leaving most responsibilities to cantons. The exclusive competence of the Federation is very limited—namely, defence and energy policy, and also planning, reconstruction and land use at the federal level (art. III.1). Some matters are a common responsibility—in particular, health, social welfare policy and the use of natural resources (III.2). There is no clear regulation about relationships between republican and cantonal laws. Each canton is responsible for those functions not granted to the Federation, such as those pertaining to police forces, education, culture, housing, zoning, radio and television, the implementation of welfare policy and the provision of welfare services (III.4). Judges are also appointed by the president of each canton (art. V.11). In fact, most capacities and responsibilities seem to be in cantons’ hands.

A canton may confer its responsibilities to a municipality or city in its territory. In particular, it may delegate functions concerning education, culture, tourism, local business, charitable activities, and radio and television. It is “obliged to do so if the majority of the population in the municipality or city is other than that of the Canton as a whole” (art. V.2).

### *The Ethnic Issue*

In the RS, as in the FBiH, the only rationale behind current institutional arrangements and the division of responsibilities is to secure ethnically homogeneous government units. There is a tendency to decentralise to the smallest ethnically homogeneous constituency, a demonstration *ad absurdum* of subsidiarity.

The Constitutional Court of BiH issued a sentence (1 July 2000, “constituent peoples’ decision”) that declares that only BiH is a sovereign state. This sentence delimits between ethnic collective rights and segregation in a multiethnic state; at the same time, it serves to consolidate the ethnicisation of institutions.

The sentence led to an agreement under the auspices of the High Representative for its implementation (27 March 2002). The agreement secures an equal representation of ethnic groups for safeguarding their respective “vital interests” in the legislature, in parliamentary procedure, and in the distribution of key political functions. Equal representation is also required among public authorities, including courts, in the FBiH and Republika Srpska (IV).

## Territorial Organisation and the Distribution of Responsibilities

### *Territorial Structure and Institutions of Local Self-government*

The Inter-Entity Boundary Line, which, after some adjustment, follows the cease-fire lines, raises rather difficult issues of government. Numerous municipalities of RS are isolated from their government (in Banja Luka), and areas are divided by the IEBL into isolated municipalities. Distrust now prevents them from seeking co-operation.

As of 1999, BiH had 3.8 million inhabitants, compared to 4.5 before the onset of conflict. Of these, 60 per cent lived in the FBiH, and 40 per cent in RS; nearby 3 million people were forced to leave their homes during the war. According to estimates, 21 per cent of the population in the FBiH and 31 per cent in RS are displaced persons.

There are at present 80 municipalities in the 10 cantons of the FBiH, and 63 municipalities in RS, with no middle tier; the idea to create six or eight regions has been abandoned. The Brcko District (44,500 inhabitants) is now an autonomous local government unit of BiH, instead of a municipality.

The delimitation of cantons displays striking disparities: from 41,000 inhabitants in Bosnia-Podrinje to 609,000 in Tuzla. Four cantons have less than 100,000 inhabitants; others have more than 200,000.

As regards municipalities, the legacy of rather larger municipalities (characteristic of the former Yugoslavia) remains, with the exception of the division of settlements by war.

In both Entities, cities are local government units formed by two or more municipalities that are territorially and economically linked (Constitution of the FBiH, art. VI.A; Local Government Law of Republika Srpska, art. 3). There are two cities in the FBiH: Mostar (104,000 inhabitants) and Sarajevo (270,000 inhabitants with 4 very autonomous municipalities), and one city in RS: Banja Luka, the capital city (208,000 inhabitants). The city level is rather weak, and dependent on transfers from constituent municipalities.

In RS, there is a new law on local self-management as of 1999 (*Official Gazette*, Law No. 35/99, as modified 20 and 51/01). Citizens directly elect their municipal assembly and the municipality head for a four-year mandate. The head of the municipality may be removed by the assembly or by referendum, with 20 per cent voter support. Partly resuming the Yugoslav tradition, the law provides for the creation of local communities with their own elected assembly by the statute of the municipality,

and for local referendums, including the building of facilities and their financing (art. 77 and 78). Supervising the activity of municipal bodies, the government may refer illegal acts to the Constitutional Court of the RS, or take over a function in the case of default of the competent municipal authority. In case of violation of rights and liberties, the National Assembly may dissolve a municipal assembly. However, there is no specific court procedure to challenge such government decisions. In practice, municipalities are in daily contact with the relevant ministries.

In the FBiH, there are provisions on municipalities in canton constitutions. A rather short federal law was passed in 1995, as a framework for canton legislations. A new local government law is being prepared, with more detailed provisions. Between 1995 and 2000, all cantons passed their own local self-government legislation; there is much variation in the distribution of functions and of resources, and even more variation in practices. Generalising is thus extremely difficult. However, on the basis of the present federal law, mayors are not elected directly, but by the municipal assembly. In practice, the canton government is in daily contact with municipalities; by contrast, the Federation has little contact with municipalities, and the Ministry of Justice is specifically responsible for local government.

From 2000, the organisation of elections passed to national and local authorities. The general elections of 2002 were organised and run by BiH authorities; the municipal elections of October 2004 were to be totally organised and funded by BiH.

The ethnic dimension impacts local government management significantly. Since the staff must be ethnically balanced, deputies of the head of the municipality are, in fact, equal partners with him or her as representatives of particular groups. Ethnic bargaining also affects the budget. In some municipalities, three budgets exist: the official budget, and two informally agreed upon by the dominant ethnic groups. The influence of ethnicity will likely increase in RS in the near future.

### *The Distribution of Responsibilities*

Although the situation is rather confused in legal terms, because of discrepancies among cantonal laws in the FBiH and due to unclear legal provisions, the distribution of expenditure (2000) shows that the level of cantons and RS are most important. In the consolidated budget of BiH, central government counts for only 1.3 per cent of the total expenditure. Such a weak central government has no equivalent in the world. Thus, the FBiH represents 71.0 per cent, RS 27.3 per cent and Brcko 0.4 per cent.

If we consider the distribution of expenditure among government levels in both Entities, it appears that municipalities show a rather low level of expenditure.

Government levels	Federation of Bosnia and Herzegovina (in %)	Republika Srpska (in %)
Entity level	25.2	60.4
Cantons	34.2	—
Municipalities	7.9	8.0
Public funds (pensions, health insurance, unemployment insurance)	32.6	31.6
<b>TOTAL</b>	<b>100</b>	<b>100</b>

*Source:* World Bank, “Bosnia and Herzegovina: Creating an Efficient Decentralized Fiscal System”, June 2003.

A major difference between the FBiH and RS is that in the latter, the Entity has a comprehensive competence for education, health and social protection, whereas these matters (including higher education) are assigned to cantons in the FBiH.

In both Entities, municipalities are only in charge of assigned responsibilities; there is no general competence of local self-government for local affairs. In general terms, responsibilities of municipalities can be summarized as follows: child care, primary and secondary school buildings, employment agencies, social care, culture, sports (“local needs of citizens”); housing and urban planning; municipal utilities (sanitation, sewage treatment, water supply), usually performed by own enterprises; public order; tourism; and the management of municipal properties.

Most institutions with substantial personnel expenses are financed and run by the canton, or central government in RS. A common difficulty with public utilities is recovering charges; this results in an invisible debt.

Existing laws do not determine clearly the responsibilities of cities with respect to constituent municipalities. It is up to the statute of the city, adopted by the city assembly, to divide tasks. In reality, decisions, as well as revenues, of city authorities are very much dependent on the constituent municipalities.

There are important regional disparities between cantons and municipalities in both Entities, especially regarding key functions like education, social assistance and housing.

## Local Finance

Typical for BiH is that the State only has the power to legislate on custom duties, whereas all other tax powers rest with the Entities. Customs revenues are assigned

also to the Entities. The Federation of Bosnia and Herzegovina and Republika Srpska maintain two distinct tax and finance systems.

Both Entities contribute to financing the state: two-thirds from the FBiH; and one-third from RS. In both Entities, lower government levels have very limited taxing powers.

In the FBiH, cantons legislate on a few own and municipal taxes (property tax, property transfer tax, some fees), and on tax sharing with their respective municipalities. However, cantons have no control over rates and bases of the most important taxes (sales tax, personal income taxes, profit tax), which are subject to federal legislation.

In the FBiH, tax sharing between cantons and municipalities is based on: (average sharing rates in parentheses, canton/municipalities): payroll tax (place of work, 80/20); citizen income tax (place of residence, 20/80); sales tax (on turnover, 70-80/30-20); property tax (20/80); property transfer tax (20/80); and road tax (motor vehicles; 55/45). Cantons have the power to regulate the two property taxes and, in part, the citizen income tax.

In RS, tax sharing between the Republic and municipalities is based on (sharing rates in parentheses, Republic/municipalities): payroll tax (74/26); citizen income tax (74/26); sales tax (74/26); property tax (0/100); and property transfer tax (0/100).

The yield of property taxes is low in both Entities, as there is no regular assessment of property values, and there is a low level of enforcement.

Additionally, there are several local taxes over which local authorities wield some discretionary powers, representing in average 10 per cent of municipal revenues. Local non-tax revenues may be significant in urban areas (rents, concession fees, fines, charges and registration fees on vehicles). In general, these revenue sources are regulated by the cantons or by the Republic; municipalities also have some powers on their level. Part of the revenue is assigned to cities.

As a whole, tax shares represent 82.9 per cent of municipal revenues in the FBiH, and 80.9 per cent in RS. The main source of revenues is the personal income tax in municipalities of the FBiH (43.2 per cent) and the sales tax in municipalities of RS (55.5 per cent).

There are large horizontal fiscal disparities between municipalities in both Entities. By contrast, there is no stable system of transfers either in the FBiH or in RS. Sharing rates have been subject to discretionary variations.

There is an agreement between policy makers and the international community to introduce VAT in BiH in 2006. At that time, the sales tax will be suppressed. Since it is not possible to maintain a tax derivation system for local budgets with the VAT, the finance system of Entities, cantons and municipalities will have to be reconsidered.

## BULGARIA

### General Context and Constitutional Framework

According to the Constitution of 1991, Bulgaria is a unitary state of local self-government; however, autonomous territories are ruled out (art. 2). Self-government rights are guaranteed by the Constitution. Municipal councils may refer to the Constitutional Court (art. 150.1).

All citizens are entitled to study their mother tongue if it is not Bulgarian, and to develop their own culture (art. 36 and 54).

The territory is divided into municipalities (*obshtina*) and regions (*oblast*) (art. 135.1). However, only municipalities are self-governments, as the basic territorial administrative unit (art. 136.1); the region is only a central government constituency (art. 142), but the regional administration is a legal person.

### Territorial Organisation and Local Institutions

Bulgaria has a relatively small number of large municipalities, comprising of one or usually several settlements. There are 264 municipalities, with an average of 30,000 inhabitants. The basic legislation is the Law on Local Self-Government and on Local Administration of 17 September 1991, as revised in 1995 and modified several times subsequently. Council and mayors are directly elected.

Municipalities are divided into administrative units with their own elected organs, ensuring inner municipal decentralisation. Three larger cities are divided into urban districts (Sofia, Plovdiv, Varna). Settlements with more than 250 inhabitants (as a result of a law of 2003) elect their own mayor (in total 2,896). Voter turnout is highest for the election of settlement mayors. A new law on local elections (2003) is aimed at facilitating participation among young people and those having difficulties moving.

The territory is additionally divided into 28 regions (on average, with 285,000 inhabitants). Regional administrations are charged with the regional development policy and the local implementation of the state policy. These administrations are headed by a governor, appointed by the government, who is at the level of an undersecretary of state. As such, he/she is invited to the Council of Ministers. The governor must co-ordinate all state field services in the region.

A law of 1999 on regional development has established a development council in each region, to assist the governor as an advisory body. Members are mayors and one representative of each municipal council; the governor has the chair.

## The Distribution of Responsibilities

Most services to the population are provided by municipalities either as own responsibilities or as delegated responsibilities financed by the state. The distinction is not always clear, but it has been a leading principle of the local finance reform since 2001. Delegated functions are funded from the local share of the personal income tax, an equalisation state grant as a revenue supplement with respect to expenditure needs where income tax revenues are too low, and targeted grants for delegated functions. Local tasks are funded from own revenues and an equalisation grant.

During the last few years, the state has taken over several tasks, which have exceeded the scope of municipal responsibility. These include social care, healthcare and teachers' salaries, now funded from the central budget. Conversely, the state budget decreased its participation in housing and municipal services. As a result, the share of local budgets in the GDP dropped from 8.1 per cent in 2000 to 6.5 per cent in 2003; their share in the consolidated public expenditure decreased from 19.2 to 16.8 per cent.

Municipalities carry out the following tasks: civil register; local public order; pre-school, elementary and secondary education, part of vocational education; sport and leisure, primary healthcare and local hospitals; social welfare and the management of most social institutions; local cultural institutions; water supply, sewerage, waste disposal; local roads; heating; subsidies to local public transport and local public enterprises; town planning; social housing; oversight of retail trade; and delivering some licenses.

State administrations and subordinated bodies or enterprises at the regional level perform the following functions: security and fire protection; road security; higher education and part of vocational education; regional and specialised hospitals; some social institutions; job insurance; national heritage; state enterprises for water supply and sewerage, electricity and gas supply; airports.

### Local Finance

Municipal budgets have become less dependent on resources assigned by the state—namely, tax shares and state grants. State transfers dropped from 75.3 per cent of the total municipal revenues in 2000 to 58.4 per cent in 2004 (forecast), mainly because of the suppression of some tax transfers. Conversely, the share of own resources has increased, but along with a diminishing trend in municipal expenditure. Own resources are expected to reach 39.4 per cent in 2004 (17.5 per cent in 2000).

Primary local taxes are the property tax, inheritance duties and property transfer taxes (10.1 per cent in 2004). Charges and fees are expected to yield 14.8 per cent, and others (such as property revenues), 14.5 per cent.

## CROATIA

### General Context and Constitutional Framework

According to its Constitution, Croatia “is a unitary and indivisible democratic and social state” (art. 1). The right of citizens to local self-government was recognised (art. 128). With its revision in 1997, the Constitution provided for two levels of self-government: (1) municipalities (*općine*) and districts or cities (*gradovi*); and (2) counties (*županije*). With the revision of 2000, the new article entitles citizens to “local and regional (*područnoj*) self-government”. Laws on local government have to be voted by the majority of members of Parliament (art. 82).

Self-government rights are guaranteed by the right of any local authority to challenge any government or legislative act violating self-government rights established by the Constitution (art. 128). According to the constitutional revision of 2000, counties are defined as “units of regional self-government”; the state administration must be organised by law on the basis of the new article 116 of the Constitution. Regional self-government refers only to functional requirements: the management of affairs of regional significance, taking in account efficiency and economy (art. 134). Additionally, the Constitution provides for a special status for the capital city, Zagreb (art. 133).

Article 15 of the Constitution guarantees minorities equal rights, including the right to express their nationality, to use their language and script, to express cultural autonomy, and to a distinct representation in Parliament and in local assemblies.

The legislative bases of local self-government were established by several laws of 29 December 1992. Amendments in 1996 to a law on the elections of local councils provide for proportional representation of ethnic or national minority groups in the council, when group constituents surpass 8 per cent of local voters or, in accordance with the local statute, when they represent more than 8 per cent of the population at the national level. The first election of representatives of minority groups to local councils took place on 18 May 2003.

Although the European Charter of Local Self-Government was ratified in 1997, decentralisation remained rather formal during Tudjman’s rule. Following parliamentary elections of January 2000, the government has undertaken local government reforms, and several pieces of legislation were adopted in 2001. The government programme of 2000–2004 provides for extensive decentralisation among its strategic priorities; it is planned to be carried out before the next local elections in May 2005.

## Territorial Organisation and Local Institutions

Croatia is divided into 20 counties plus Zagreb (which has the rank of a county) and, at the lower level, 123 cities and 427 municipalities. Additionally, a prefect is appointed by the central government in each county; he/she is in charge of supervising local government acts. The average population of a county is 240,000 inhabitants; for a city, 20,353; and for a municipality, 3,627. Zagreb has about 900,000 inhabitants. Self-government is organised on the basis of the same model at the first and second levels. The council or assembly (*skupština*) is directly elected by the citizens for a four-year term, according to the proportional representation ballot system. The council elects a mayor (a governor, *župan*) and, according to the number of inhabitants, deputy mayors (deputy governor) and members of a board (*poglavartstvo*), vested with executive functions. The executive may be recalled by the council. A direct election is now contemplated. As in other countries of the former Yugoslavia, transition gave rise to dividing the large socialist municipalities, thereby multiplying the number of municipalities fivefold (101 municipalities with uniform status in Croatia in 1989).

A reform introduced by the Local Government Act of 1999 has been to separate the prefect, as a state representative appointed by central government, and the governor, as an executive of the county, for the purpose of regional self-government.

The review of individual administrative acts is subject to the law on general administrative procedure, and administrative courts may review second instance decisions.

Zagreb, the capital city, is subject to a special law provided by the Constitution. Since the law of 1999, the mayor of Zagreb is exclusively elected by the city council, and city offices are accountable to the mayor. Furthermore, the new Act on the City of Zagreb of 11 August 2001 provides that the structure of city offices is decided by the municipal assembly. The heads of these offices are appointed by the executive board of the city when they are in charge of self-government matters, but with the agreement of the competent minister when they are in charge of state delegated matters (art. 13 and 14). The law on Zagreb provides for city districts as a form of local self-government, but these are not self-government units, and the city management remains centralised.

The new article 134 of the Constitution offers an open definition of the responsibilities of local and regional self-governments based on the principle of subsidiarity. However, there is no general competence of self-governments within their jurisdictions. The performance of delegated state duties by local or regional self-governments is possible on the basis of article 116 of the Constitution.

These provisions are the basis for the devolution of new responsibilities in the competence of local and regional self-governments laid down by the Local Govern-

ment Act of 33/2001. Self-government responsibilities at the municipal level are those which respond directly to citizens' needs: civil registry; area and urban planning; municipal activities (infrastructures provided to the population by the municipality, such as public lighting, water supply, sewerage, street maintenance); child care; primary healthcare; pre-school and primary education; cultural and sporting activities; consumer protection; environment protection; fire protection; and civil defence. Self-government responsibilities of counties are: education; health service; area and urban planning; economic development; traffic and traffic infrastructure and the development of networks of educational, health, social and cultural institutions (not transferred). In both cases, the sector legislation sets out the tasks to be carried out by municipalities and cities, and by counties. Cities over 30,000 inhabitants are allowed to take over the responsibilities of counties, with the exception of the development of the network of educational, health, social and cultural institutions (art. 21). Additionally, municipalities (cities) and counties may perform state tasks delegated by central government, only with state budget funding (art. 23).

Cities, municipalities and counties are free to co-operate with local and regional self-governments of other countries within the field of their competence and under usual supervision. Local government units may establish common organs or services to perform jointly some self-government tasks on their territories (Local Government Act of 1999, art. 54); their co-operation and the delegation of certain tasks may also be contractual (art. 67). The implementation of the reform started on 1 July 2001, with cities having the fiscal capacity necessary to support the new tasks. Transfers cover: elementary and secondary education; social care centres and homes; and hospital investment maintenance. To 32 city budgets, these transfers cover elementary education.

## Local Finance

Article 137 of the Constitution lays down the basis of the financial autonomy of local and regional self-governments and of an equalisation between them. Units of local and regional self-government have the right to their own revenues, which they can dispose of freely in their jurisdiction. Revenues must be proportional to their responsibilities provided by the Constitution and by law. The state should assist financially weaker units of local and regional self-government in conformity with law. Before the 2001 reform, local government expenditure was about six per cent of GDP and 10.4 per cent of the general consolidated government budget; it should reach 7.5 per cent of GDP after the reform. Local finance is regulated by Act on Financing Local Government of 117/1993, several times amended, and lastly by Act

59/2001 to adjust local finance to the transfer of new responsibilities on counties and cities. A new budget act, passed in 2003, introduced public expenditure planning programmes.

Local finance is based mainly on tax sharing and various non-tax revenues; the share of grants is relatively low. Pursuant to the provision from that law, a unit of local self-government collects revenues from: own revenue sources (revenue from its own assets, county and municipal taxes, fines, charges and fees), shared taxes (income tax, profit tax, tax on real-estate transactions, gambling tax) and grants. Unfortunately, recent disaggregated data are not available.

Own tax revenues are negligible. As an exception, bigger cities have the possibility to levy a surtax on the personal income tax (rate: from 10 per cent in municipalities up to 18 per cent in Zagreb). However, only 12 cities have used this option. It is contemplated to introduce a property tax as an own municipal revenue source.

The equalisation grant has been replaced by targeted grants from an equalisation fund, supporting the transfer of new responsibilities, and by special support to backward areas. To finance transfers resulting from the Local Government Act of 2001, legislation provides for additional shares from the personal income tax yield. Additionally, equalisation grants have been allocated to counties and cities that could not cover additional expenses with the additional personal income tax share. In total, the expenditure increase of circa 1,500 million kunas has been covered by 693 million kunas from additional personal income tax shares, and 819 million kunas from equalisation grants. Furthermore, in special state care areas, municipalities receive up to 90 per cent of the local personal tax yield (and even 100 per cent in islands), and up to 90 per cent of the local profit tax yield.

## MOLDOVA

### General Context and Constitutional Framework

A former republic of the USSR, Moldova became an independent state on 27 August 1991.

According to the Constitution of 29 July 1994, Moldova is a “unitary and indivisible state” (art. 1), and its territory is “inalienable” (art. 3). The Republic is the commonwealth of all citizens, but the state recognises and guarantees the citizens’ right to express and develop their ethnic, cultural or religious originality (*samobytnost*) as well as their own language (art. 10). Article 13 distinguishes among the state

language (Moldovan), Russian and other languages used on the territory of the Republic, which are recognised and protected by the state.

The Constitution recognises two autonomies: Gagaouzia, and parts of the east bank of the Dniestr. Although the regional autonomy of Gagaouzia had already been recognised by the Constitution, revisions of 25 July 2003 gave a clear base for both. Both have different characters. Gagaouzia is a distinct region where the population, speaking a Turkish dialect, has been claiming autonomy from the time of Moldovan independence. The east bank of the Dniestr is predominately Russian, industrialised and home to several military units. There has been *de facto* autonomy (and *de facto* government) for many years on the east bank of the Dniestr.

Article 111 is devoted to the “autonomous territorial formation” Gagaouzia, with own status established by an organic law. This is qualified as a form of self-determination of the Gagaouzes, and at the same time “an inalienable component” of the Republic. Through its representative organs, it rules all political, economical and cultural matters within the limits of its competences. It possesses its own budget, but it is not vested with legislative power. However, Gagaouzia is entitled to legislative initiative (art. 73). Natural resources comprise the basis of the development of the territory, although they remain under the Republic’s ownership. The organic law<sup>11</sup> on the special status of Gagaouzia was adopted on 23 December 1994, and the basic law of Gagaouzia was adopted by its parliament in 1998.

Meanwhile, the situation of the east bank of the Dniestr still requires clarification. According to article 110.2 of the Constitution, “special forms and conditions of autonomy may be granted to settlements (*naselenyj punkt*) of the left bank of the Dniestr, though a particular status established by organic law”. It may be inferred from the reference to an organic law that the type of autonomy would be similar to that of Gagaouzia, but its geographical extent is unclear. The terminology does not refer to specific administrative units, and the formulation does not imply that the totality of the territory of the left bank would be concerned. This formulation has been taken over from the local government law of 1998. The organic law has not been adopted yet.

Lastly, the Constitution determines the basic principles of local self-government: local autonomy; decentralisation of public services; election of local government organs; and participation of citizens in the management of local public affairs. Autonomy is referred to as the organisation and activity of local government organs and to the settlement of the community’s affairs; it may not damage the unitary character of the state (art. 109).

<sup>11</sup> Must be adopted by the majority of the elected members of the parliament, after two readings at least (Constitution, art. 74).

## Territorial Organisation, Local Institutions and Responsibilities

Moldova has a two level local self-government system: the municipal level and the district (*raion*) level. Gagaouzia is divided into municipalities only, and is at the same level as a district from a territorial viewpoint. The capital city, Chisinau, is subject to an organic law, and is vested with district rights. Another city, Balti, is also assimilated to a district. A new law on local government has recently been adopted (Law No.123-XV of 18 March 2003).

Moldova has 443 municipalities. Legislation distinguishes between towns and villages, but this distinction has no legal consequence for the institutions, the responsibilities or the budget. They all form the first level of territorial-administrative units.

The second level of territorial administrative units are the 32 districts (without Chisinau and Balti). The present administrative division of the country is determined by a law on the administrative territorial structure (Law No. 764-XV of 27 December 2001). This law revoked the territorial reform of 12 November 1998, which had divided the country into 10 counties (*judete*), according to the Romanian model.

A draft law on the capital city has been prepared; it should divide the capital city into smaller municipalities, and curtail the powers of the mayor.

Councils at both levels are directly elected; mayors are also directly elected, whereas district presidents are elected by district councils.

Deconcentrated field services of the ministries are established at the district level, or for several districts. There are eight chancellery offices for the supervision of local government acts (art. 70).

The local government law of 18 March 2003 sets out lists of responsibilities for both levels, distinguishing own and delegated competences. Own competences are subject only to legality oversight; delegated competences are subject also to supervision on the merits of decisions (art. 69). Legality oversight is obligatory only on local government acts within the field of delegated competences and for a limited list of local government acts in the field of own competences (art. 71-72). Within the framework of the legality oversight, if the local authority does not comply with representations made by the chancellery office, the latter must refer to the administrative court (art. 75).

Own competences of municipalities include (art. 10): local economic development and town planning; local roads; and municipal services including local public transport, social assistance, social housing, schools, cultural institutions, libraries, markets and fairs, sport, green areas, environment protection and estate allotments.

Delegated competences include (art. 12): social protection, public hygiene and public order.

For districts, own competences include (art. 11): local economic development and regional planning; regional roads; building of health and school premises of district importance; upper secondary schools; social welfare; maintenance of social and health institutions; public transport at district level; municipal services at district level; and cultural and sport institutions at district level.

Delegated competences of districts include (art. 13): social protection; healthcare; public order; vocational education; and specialised education.

Competences can be modified only by law (art. 14).

## Local Finance

Local finance is governed by Law No. 397-XV of 16 October 2003.

Financial decentralisation is based on the district level. Municipal budgets depend to a large extent on the district budget, which decides on their participation in the share of general state revenues allocated to the district, and on their share in the property tax. Districts also decide upon own additional budgetary transfers to municipal budgets (art. 4). In Moldova, financial decentralisation seems to be limited at the district level.

Municipal budgets are further financed by some local taxes, fees and revenues from municipal properties, duties for delivering certain licenses or patents for enterprises. In addition, they receive a share of the income tax revenue from households and legal persons.

Despite Law No. 523/1999 on public property, the inventory of goods belonging to the state must be completed in order to make possible property transfers from the state to districts and municipalities.

## ROMANIA

### Constitutional Framework and Territorial Structure

The Constitution of 8 December 1991 was revised by the Constitutional Law of 19 October 2003, approved by referendum. This revision provides for the accession to the European Union (new art. 148) and to the North-Atlantic Treaty (new art. 149).

In particular, the revision strengthened the formulation of democratic principles in several new provisions. Romania is a unitary state (art. 1), but the “Romanian”

character of the state has been replaced by the “unity of the Romanian people” and the solidarity of their citizens (art. 4.1).

However, the evolution of Romanian legislation has increasingly emphasised ethnic links, partly to comply with international expectations to guarantee national minority rights. While the Romanian language is the official language (art. 13), national minority rights are recognised (art. 6). In territorial-administrative units where at least 20 per cent of the inhabitants belong to a national minority, these groups are entitled to use their mother tongue in their relations with local government administration (Law No. 215/2001 on Local Government, art. 17). Recent constitutional revisions refer to the “significant weight” of citizens belonging to a national minority (new article 119.2). Furthermore, the electoral law of 68/1992 guarantees a seat in the National Assembly and in the Senate for any representative organisation (or groups of organisations), which has obtained five per cent of ballots. As a result, organisations claiming minority rights are multiplying: of 18 registered organisations in 2000, 15 were represented in Parliament. Magyar-speaking people are the most significant (7.1 per cent of the population), followed by the “Roms” with two per cent, and all others with less than one per cent.

The Constitution recognises the principle of local self-government. According to article 119.1, as revised in 2003: “public administration is based in territorial administrative units on the principles of decentralisation, of local self-government and of deconcentration of public services”.

The territory is divided into municipalities (*comune*) or towns (*oras*), some of which may be declared cities (*municipe*) (art. 3.3); the latter may be subdivided into urban districts (art. 120.3, and Law No. 215/2001, art. 18). At a higher level, the territory is also divided into 41 counties (*judete*) outside of Bucharest, as stipulated in Law No. 2/1968. The *judet* is both a local self-government unit and a constituency of the state administration.

Bucharest is subject to special provisions of Law No. 215/2001; it is a *municipe* divided into six sectors. It is also vested with the rights and the responsibilities of a *judet*.

The notion of region has appeared recently in relation with the regional development policy and the support received from the EU. According to Law No. 151/1998, eight regions have been delimited by a series of agreements between county councils. They are neither new territorial administrative units nor legal persons. They correspond to the level NUTS II for the EU. Regions are linked to a regional development agency for programme implementation.

## Institutions and Distribution of Responsibilities

### *Institutions*

Regarding institutions, three levels must be distinguished: the municipal level, the *judete* and the regions.

At the municipal level, councils and mayors are directly elected. County councils are also directly elected, but council presidents and his/her deputies are elected by the council. Councils are elected by proportional representation. Local elections are regulated by the new Law No. 67/2004.

Local co-operation is provided by Law No. 215/2001, but collaboration is rare. Local councils may decide to co-operate or join with other legal persons in Romania or abroad to perform services or carry out common projects, or with other local government units to promote common interests. County councils can also co-operate with municipal councils. This includes cross-border co-operation and participation in international associations.

In each *judete*, the government appoints a prefect, who represents the government, has authority upon deconcentrated field services of central government and carries out the supervision of local governments. A prefect may refer an act to the court, if he/she thinks it is unlawful; this claim suspends the act's execution. After three annulling judgments within six months, the prefect may propose to the government to dissolve the council. The constitutional revision of 2003 established article 122: to assert the authority of the prefects over deconcentrated field services; to refer the powers of the prefect to an organic law; and to emphasise that there is no subordination between the prefect on the one hand, and the municipal and county councils, mayors and county council presidents on the other. A new law on prefects is being prepared with the purpose to strengthen the professionalisation of prefects as civil servants. This aim is also increase their capacity to lead deconcentrated state services and to co-operate with local self-governments.

In each county, there is an advisory commission chaired by the prefect, a president of the county council, mayors and heads of deconcentrated services. The commission is consulted on the yearly economic development programme.

A new framework law on decentralisation is also being prepared.

At the regional level, there is a regional development council with four representatives for each *judet*: the president of the county council, and one representative for each category of municipality. The chairman and his/her deputies are elected for one year; they cannot represent the same county.

### *Distribution of Responsibilities*

According to the Constitution, local councils are vested with a general competence to rule local affairs (art. 121.1). Furthermore, county councils must coordinate municipal councils, insofar as some municipal services are also of interest to the whole county.

Municipalities are in charge of: gas and water supply; sewerage; heating; public transport; local roads; housing; waste disposal; green areas; education (including teachers); primary healthcare; town planning and building permits; various licenses; and civil register (Law No. 215/2001, art. 38).

Counties maintain: water supply; sewerage; public transport; county roads; child care; regional development and planning; services and enterprises at county level; and support to municipalities (Law No. 215/2001, art. 104).

Since the Law on Regional Development of 1998, responsibilities regarding regional development are to be exercised within newly created regions, especially as regards investments and infrastructures.

Furthermore, Law No. 270/2003 on hospitals and Law No. 99/2004 on public medical units of local and county interest have increased the competence of local government in these fields.

The development programme of each county is submitted to the advisory commission by the prefect.

As it appears, the delimitation of responsibilities by government level and by self-government tasks and state functions is not quite clear.

### **Local Finance**

The level of municipal expenditure has increased significantly in the last few years (about four per cent GDP in 2000; 8.5 per cent in 2003); half is carried out by towns. Most budget-funded tasks are covered directly by the state budget, but most local revenues of local budgets are under state control.

It is reported that following recent reforms, the degree of financial autonomy of local authorities increased from 20 per cent to 50 per cent. Indeed, a major reform was the introduction of a general personal income tax in 2000, 63 per cent of which (and recently the totality) was assigned to municipal and *judete* budgets. Tax collection was transferred to local authorities as well, thus increasing the tax collection rate. However, this is only a temporary gain; on the whole, there is no local tax power on the personal income tax.

Real own revenues can be raised from numerous taxes (in first place a property tax) and fees, but for a rather small part of the total revenue (15 per cent in 2000).

Equalisation is based on the income tax revenue; 29 per cent of the personal income tax is assigned to the equalisation fund.

Municipalities receive targeted grants for heating, and a number of subsidies for specific purposes. In particular, these specific purposes are: for investments partially funded through external loans; for child care and disabled persons; for general urban planning; for housing; for local roads; and for water supply.

## SERBIA AND MONTENEGRO

NB: No statement of this profile can be interpreted as a position regarding the future of Kosovo.

### General Context and Constitutional Framework

#### *Constitutional Developments with Regard to Local Government and Territorial Organisation*

The State Union of Serbia and Montenegro, proclaimed on 4 February 2003, is a successor to the former truncate Federal Republic of Yugoslavia of 1992. It is based on a Constitutional Charter, leaving nearly all domestic affairs in the jurisdiction of member states (Serbia and Montenegro). Human and minority rights are guaranteed at the union level.

In Serbia, the Constitution of 1990 still prevails; a new Constitution is being elaborated. Serbia includes two autonomous provinces, which were recognised by the Federal Constitution of 1974 (art. 2): Kosovo and Vojvodina. In the federal organs of the former Yugoslavia, these provinces enjoyed practically the same rights as the member republics. This autonomy was removed in 1989. According to the Constitution of 1990, both autonomous provinces are “forms of territorial autonomy” included in the Republic of Serbia (art. 6). They no longer participate in decision-making at the federal level (see art. 80 of the Federal Constitution of 1992).

As a result of war, Kosovo (full name: Kosovo and Metohia) is under UN interim administration in application of Resolution 1244 of the Security Council of 10 June 1999 (see below).

War in Kosovo gave rise to claims for more autonomy in Vojvodina as well; these claims were reflected in a declaration of 29 January 1997. Parties and groups based

in Vojvodina (68 of 120 seats) later won the majority of seats in provincial elections. However, the population of the province is mainly Serbian (more than 1.3 million inhabitants of a total population of 2 million); there is also a significant Magyar population (approximately 300,000).

Regarding local government, in the former Socialist Federative Republic of Yugoslavia, local government was based on very large municipalities vested with general competence. The dissolution of Yugoslavia resulted in strong centralisation in Serbia and Montenegro as in other newly independent republics, but by contrast, there was no proliferation of local government jurisdictions. Rather, the territorial pattern has remained unchanged. One aspect of this centralisation process has been the division of the entire territory of the Republic of Serbia into 29 districts by government decree in 1992, and the creation of a district state administration. This administration has taken over a number of tasks previously carried out by municipalities, and supervises municipalities. (See Law on the Territorial Division of Serbia, *Official Gazette of Serbia*, No. 47/1991, with subsequent modifications; and Law on the State Administration, *ibid.* No. 20/1992, with subsequent modifications.)

This centralisation process removed the republics from the socialist conception of self-government and brought local government closer to West European standards as laid down in the European Charter of Local Self-Government. A decentralisation reform has been undertaken recently both in Serbia and in Montenegro.

### *The Republic of Serbia*

In the Republican Constitution of 1990, chapter 6 deals with territorial organisation.

Autonomous provinces (*autonomne pokrajine*) are formed in accordance with particular national, cultural and other characteristics of their area, and their territory is determined by law.

The Statute of Vojvodina, adopted in 1991, as the highest legal act of the province, determines the competences and the organs of the province; it is subject to approval by the National Assembly. The province possesses rule-making power to perform its responsibilities, but no legislative power in devolved matters (art. 109). A law on particular responsibilities of the autonomous province of Vojvodina (*Official Gazette*, No. 6 of 7 February 2002) details and extends (as made possible by art. 109) the responsibilities of the province and its right to regulate them by ordinances in a series of matters. Several responsibilities shall be performed as delegated responsibilities. The province has no competence on the organisation of local government but the right to be consulted before any change in territorial organisation (law of 2002, art.

59). This territorial autonomy can be qualified as a form of regional decentralisation, which can be compared (from a legal view point) with Wales.

However, a new statute, significantly called a “basic law”, is being prepared by the provincial assembly. On 23 October 2003, the assembly decided to submit a draft to the public. This draft is indeed a claim for much larger autonomy: the provincial assembly should have legislative power (art. 3) and organise the judiciary (art. 119 sq); the competence of the province would include practically all domestic affairs (art. 80 sq), including the organisation of the social security (under republican law, however) and local government (art. 145 sq). Furthermore, the provincial assembly would include two houses. One house would be a council of communities, the members of which would be elected by respective ethnic communities (thus requiring citizens to be registered as members of ethnic communities); the other would be elected by all citizens. Only the latter would exercise legislative powers, but the government would be elected by a common session of both houses.

Chapter 6 applied to Kosovo, which is at present under the authority of UNMIK.

According to article 7 of the Serbian Constitution, “the municipality is a territorial unit in which local self-government is exercised”, and Belgrade is a separate territorial entity. Article 113 determines matters of municipal competence, and refers to the law and the statute of the municipality for other affairs. It is unusual for a Constitution to determine the competence of local government, and even more to refer to the statute of the municipality. According to article 115, the statute may include “other questions of interest to the municipality”. The law may establish a municipality as a city when its territory includes several municipalities or towns (art. 117). Article 118 provides for the status of the City of Belgrade, which includes city district municipalities, to which part of the responsibilities of the city are assigned by the city statute.

Whereas local government laws of 1991 and 1999 aimed at centralisation, the new local government act of 14 February 2002 entails a new course, oriented towards decentralisation, and is generally in line with the European Charter of Local Self-Government. Municipalities are governed by a municipal assembly, as the representative body, and a president, as the executive body. Both are directly elected for a four-year term. The assembly elects a municipal council, the function of which is to co-ordinate its activity with the president and to supervise the municipal administration; the president appoints a deputy (art. 30, 40, 43). The law resumes the institution of *mesna zajednica* from the former Yugoslavia, as the lowest level of local self-government (for a village, a city district or neighbourhood) (art. 73–76). The municipal assembly may delegate assets and functions to *mesna zajednica*, which may be the owner of assets funded by voluntary contributions of its inhabitants approved by a local referendum (art. 73). The law provides for the representation of

communities in ethnically mixed municipalities (art. 63), and organises the direct participation of citizens in decision-making (citizens' initiative, referendum, meeting, art. 65–69). However, by a law of 1995, municipalities are deprived of properties; all properties were transferred to the Republic, except for the *usus*.

Lastly, the law provides for the oversight of municipalities (art. 105–112) and the guarantee of self-government rights (including with damages) by courts: the Constitutional Court or the Administrative Court, to be established in 2004. Until the latter is functioning, and depending on the case, the Supreme Court is consulted (art. 122–124). The new law is to be applied upon the next local elections (art. 130).

### *The Republic of Montenegro*

The Republic of Montenegro adopted a new Constitution on 12 October 1992.

As in Serbia, municipalities are the sole level of self-government; government districts were not introduced in Montenegro. The territorial division of the Republic has remained unchanged since the law of 1990 on the division of the Republic into municipalities.

Local government reforms have only recently been adopted: laws on Local Self-Government (*Official Gazette*, Law No. 42/2003 and Law No. 28/2004), on Financing Local Self-Government (Law No. 42/2003), and on the Election of Mayors (Law No. 42/2003). A law on the territorial division of the Republic is still pending. The local government act closely resembles the Serbian law, but displays some noteworthy differences. It details the substance and the legal regime of different types of municipal properties; there is no municipal council between the municipal assembly and the mayor; municipal institutions are based on the principle of a strict division of authorities between the assembly and the mayor (both directly elected); and the mayor may appoint deputy mayors with the approval of the assembly. A chief administrator is appointed as a professional by the mayor with the approval of the assembly. The Constitutional Court concentrates the judicial review of decisions or enactments violating self-government rights. The bill on territorial division is a step toward facilitating the division of existing municipalities.

## **Territorial Organisation and Local Government Tasks**

Regarding territorial organisation, Serbia and Montenegro still have much in common. Therefore, it is convenient to present separately the territorial organisation and the tasks.

### *The Territorial Organisation*

The following table summarises the territorial organisation for the whole of Serbia and Montenegro.

Republics and provinces	Population (millions)	Size (km <sup>2</sup> )	Number of districts	Number of municipalities
Serbia (2002)	7.8	88,361	30	190
<i>of which Vojvodina (2002)</i>	<i>2.0</i>	<i>21,506</i>	<i>7</i>	<i>45</i>
Montenegro	0.65	13,812	—	21

With the creation of districts, regions (*regioni*) were suppressed. They were the constituency of co-operation between municipalities.

Generally, municipalities are rather large units: on average more than 50,000 inhabitants in Serbia (but only 45,000 in Vojvodina), only 31,000 in Montenegro. By the late 1990s, there were 10 municipalities with fewer than 10,000 inhabitants in the entire Yugoslav Federation, four of which were in Montenegro.

Belgrade also performs the functions of a district; the capital city has 1.6 million inhabitants, and is divided into 16 city municipalities. Each municipality possesses its own assembly, tasks and budget. Niš, Novi Sad, and Kragujevac are the largest urban areas; the first two each comprise individual municipalities, and are cities according to the new local government act. Inner city municipalities must not be confused with *mesna zajednica*, which is a form of local self-government below the municipal level (for example, there are 66 in Kragujevac).

In Montenegro, a law of 1993 transferred the capital to Cetinje, a small historical city of about 20,000 inhabitants; Podgorica, with more than 150,000 inhabitants (previously Titograd) is the only sizeable significant urban area. By law, Podgorica is the main city (*glavni grad*), whereas Cetinje is the capital (*prestonica*); additionally, there are 19 municipalities. Local government law is generally applicable to the capital and to the main city; a new law is being discussed for the latter.

### *Local Government Tasks*

According to the new local government act, the main responsibilities of municipalities (as own tasks) in Serbia are: housing (building and maintenance); local public utilities (heating, public transport, water supply, sewerage, waste collection and disposal, green areas, public lighting); town planning; pre-school education; local roads and streets; culture and sport infrastructure of local scope; primary healthcare subject to

further legislation; and building maintenance. Municipalities are also responsible for the costs of running primary and secondary schools, although salaries are paid by the state. The same sharing of responsibilities prevails for social care, but municipalities may add to the legal obligations at their own cost. Altogether, this should represent 5.6 per cent of GDP. This appears to be a quite good level, considering that salaries for education and social care are paid by the state budget, and that primary healthcare has not actually been transferred. According to data for the first semester 2003, the investment expenditure is slightly in excess of 24 per cent of the total expenditure of municipalities; 14 per cent is through subsidies to various organisations.

The implementation of the law of 2002 on particular competences of the autonomous province of Vojvodina resulted in the effective transfer of a number of tasks from districts to the province, especially for education and healthcare, distinguishing between those devolved in the own competence of the province, and those only delegated by the Republic to the provincial authorities. In 2003, from a total expenditure of 14.1 billion dinars, more than 10 billion was devoted to all degrees of education, from primary education to university level, including personnel expenses. The second budget line is the development fund of the province, nearing 1.8 billion dinars. The province has no authority over municipalities. The application of the law of 2002 raises the question of the future of the districts in this province.

Lastly, in Montenegro, the tasks of the municipality were regulated by the local government act of 1995 and the law of 1992 on the transfer of public service affairs to municipalities. The latter delegated a number of tasks from the Republic to municipalities, on a per ministry basis, and provided for further transfers by subsequent laws. The new local government act of 2003 offers a revised list of responsibilities. This makes it necessary to update numerous sectoral laws of the last few years, which are not always in accordance with the new scope of local government responsibility. A major novelty is the introduction in the law of the principle of the general clause. Otherwise, there is little difference between Serbia and Montenegro in the material competence of municipalities.

## Local Finance

As regards local finance, Serbia and Montenegro are not at the same stage. Serbia has a working system of local finance, although some elements must be improved; in Montenegro, local finance is waiting for a reform.

### *The Republic of Serbia*

Attention must first be paid to the autonomous province of Vojvodina. According to the law of 2002 on particular competences of the autonomous province, the assets and personnel (taken from district offices) necessary to the competences transferred or delegated to the province were transferred under the authority of the province from the end of 2002. There is still no regulation on revenues of the province. The budget is funded mainly by transfers from the Republic, based on the cost of the functions transferred. On total revenues of 14.1 billion dinars, more than 10.4 are from transfers from the Republic. The estimate of own revenues is less than 3.2 billion dinars, which come mainly from a share of the income tax (2.6 billion dinars) and from a share of the property tax (0.5 billion dinars); they are not really own revenues.

Regarding municipal revenues (including municipalities of Vojvodina), a major reform has been introduced from 2002 by the new law on public revenues and expenditures (late 2001), the new local government act and the new law on budget (both of 26 February 2002). As a result, municipal revenues increased from 34.3 billion dinars in 2000 to 63.1 in 2002 and 66.6 in 2003 (modified budget of the Republic in 2002: 217.7 billion dinars).

Municipal finance will be heavily affected by the tax reform introduced in 2004, the implementation of VAT and income tax reform. These will curtail the financial autonomy of municipalities.

“Original” (own) revenues comprise about 41 per cent of the total revenues (without debt) in 2003. Original revenues consist of own taxes, including the power of the municipal assembly to vary rates. This level of financial autonomy based on own tax revenues is an exception, and not only in transition countries. The most important change has been the local payroll tax paid by enterprises on their salary fund, at a maximum rate of 3.5 per cent. All municipalities immediately voted for the highest rate, and the yield was expected to provide 20 per cent of total revenues in 2003. The next largest own revenues in order of importance are: fees for the use of construction land; fees for the development of construction land; and incomes from the lease of property in the disposition of municipal governments (although the owner is the Republic). Self-imposed contributions (under two per cent of total revenues) are taxes that local governments can impose on their citizens through referendums for specific programmes and investments. These contributions are entirely free from national government limits and are widely used by Serbian local governments (71 per cent of municipalities in 2002), almost every year.

Additionally municipalities receive a share of several taxes collected on their territory but controlled by the state, for an amount equal to 43 per cent of total

revenues (“unlimited shared taxes”). Municipalities receive eight per cent of the sales tax (cities receive eight per cent and Belgrade, 15 per cent) and, since 2002, 100 per cent of several taxes on income. Reforms have also increased the local government shares of a number of other taxes. Namely, the local government share of the property tax grew from 25 per cent to 100 per cent and the share of the tourist tax increased from 80 per cent to 100 per cent. As well, shares of the agricultural tax, the property transfer tax (with a higher tax rate, collected on the transfer of any valuable property, not only immovable) the gift and inheritance taxes, and the tax on income earned from the leasing of property all grew from 50 to 100 per cent.

Lastly, so-called “limited shared taxes” are tax shares determined yearly by a special law and allocated to municipalities on the basis of need. This has amounted to between 12 per cent and 18 per cent of total municipal revenues from 2000 to 2003 (16 per cent). Resources are a share of the tax on wages, and an additional share of the sales tax.

With the introduction of VAT, the sales tax, which yielded about 30 per cent of municipal revenue through different channels, disappeared on 1 January 2004. As VAT cannot be shared on the basis of the local yield, the revenue is replaced by state budgetary transfers. Then, the government abolished the payroll tax paid by enterprises (20 per cent of municipal revenues in 2003) and this revenue source was replaced by an increased share (30 per cent) in the newly reformed income tax.

The property tax, although assigned to municipal budgets in full, is controlled by the Republic and is under-collected (only 40 per cent according to estimates).

Equalisation has not worked well, due to the lack of clarity applying legal criteria in the distribution of limited shared taxes. The introduction of grants to compensate the loss of the sales tax and the increased share in the income tax should offer opportunities to improve equalisation.

### *The Republic of Montenegro*

The new law on financing local self-government (*Official Gazette*, Law No. 42/2003) provides an own tax basis to municipalities.

From this year, basic competences of municipalities are funded through three main sources: own tax revenues, tax shares and an equalisation grant. Own tax revenues yield 15.9 million Euro from 24.6 million Euro (first semester 2004), shared or ceded revenues yield 4.9 million Euro and the equalisation grant, 3.8 million Euro.

Own taxes are: the surtax on the personal income tax (close to 29 per cent of own tax revenues, first semester 2004); the real estate tax (close to 14 per cent); local taxes

(close to 13 per cent); various compensations related to land use, land development and road building (for a total of 29 per cent); and various small other taxes.

Shared and ceded tax incomes are primarily the share from the personal income tax: 78 per cent of these revenues, with 10 per cent of the total local yield of this tax for municipalities and the capital city, and 15 per cent for cultural and historical centres. Next are the tax on property transfers (20 per cent, 50 per cent of the yield) and some other small receipts.

The equalisation fund receives 10 per cent of the total yield of the personal income tax and provides grants divided into two parts. The first (90 per cent) is allocated on the basis of equalisation criteria weighted by the law; the second is targeted at “stimulating” municipalities. A special committee (with five representatives of municipalities among seven members) is responsible for the allocation of grants from the equalisation fund.

Additionally, municipalities receive transfers from the budget of the Republic for tasks imposed upon municipalities.

## KOSOVO

### **The Province of Kosovo under UN Interim Administration**

On the basis of Resolution 1244, the Secretary General of the UN established an interim administration in Kosovo (UNMIK), headed by a standing representative (SRSG).

From 2000, UNMIK undertook to establish self-government institutions of the province. The main step was the promulgation of the “Constitutional Framework for Provisional Self-Government” (UNMIK 2001/9 of 15 May 2001). This framework recognises collective rights of ethnic communities (chapter 4). It provides for a legislative assembly, a president and a government (Provisional Institutions of Self-Government, PISG). The assembly was elected at the end of 2001. A multiethnic government, headed by an Albanian leader and with Serbian members, was inaugurated on 12 June 2002. Subsequent general elections are to be held late in 2004.

Laws adopted by the assembly must be promulgated by the SRSG. The legislative procedure includes a conciliation procedure at the initiative of representatives considering whether a provision to be adopted would violate vital interests of their community (section 9.1.39).

According to the constitutional framework, municipalities are “basic units of local self-government” (art. 1.3). The first local elections took place on 28 October 2000, with a turnout close to 80 per cent; Rugova’s party (DLK) won 21 municipalities of the 27 in which elections could be organised. The SRSG had promulgated a regulation on self-government in municipalities of Kosovo (UNMIK 2000/45 of 11 August 2000). This legislation is still in force. It is based on former Yugoslav legislation, with some significant differences. Municipalities are under the strict supervision of the SRSG (section 47), who has a representative in each municipality (section 48), with the municipal administrator appointed by him/her. Furthermore, municipal boundaries are a reserved competence of the SRSG. The first local elections were held for a two-year mandate (UNMIK 2000/39); the second were held for a four-year mandate (UNMIK 2000/45 and 2002/11) on 28 October 2002, but the turnout was much lower (54 per cent). UNMIK has worked to overcome ethnic divisions in municipalities; it succeeded in November 2002 to restore a unified municipal administration in Mitrovica.

Municipalities perform tasks set out by the UNMIK regulation. The central authority (e.g. the SRSG) may delegate other tasks and exercise supervision. He/she is also the appeal authority regarding claims against municipal decisions.

The municipal assembly is elected according to a proportional system. The assembly elects the president, as the executive authority, and his/her deputy from its members; communities who are not in the majority are entitled to another deputy. As in Serbia, the participation of lower local self-government entities of villages or city districts or neighbourhoods in the management of local government affairs, including the delegation of tasks to them, is recognised. However, there is no referendum, and citizens’ initiatives can only be petitions to the municipal assembly. Alternatively, the regulation provides for the creation of a community committee and a mediation committee: the first prevents discrimination; the second solves litigation disputes related to alleged discriminations. As well, a community office must be created in municipalities with a significant minority. It is under debate whether to create municipal sections with own organs, budgets and councils for minority communities.

The next step is the transfer of responsibilities from the UNMIK to local authorities. For this purpose, a joint council of UNMIK and of the Provisional Institutions of Self-Government of the province was established in March 2003. The Presidential Statement of the Security Council of 30 April 2004 called for “more effective local government through devolution of central non-reserved responsibilities to local authorities”. According to this orientation, a local government reform is being prepared by a Working Group on Local Government chaired jointly by UNMIK and the Provisional Institutions of Self-Government. According to the *Framework for the*

*Reform of Local Self-Government in Kosovo* published by this Working Group (July 2004), “the local government reform process is based on a firm commitment by all parties to a multiethnic Kosovo”. The *Framework* states that municipalities are too large, and favours either smaller municipalities or the delegation of competences to sub-municipal units; it provides for a wide array of responsibilities to be transferred. As a first step, it recommends to begin with “pilot projects”. The *Framework* also recommends amending the electoral system, in order to introduce a system of open lists, giving more influence to the inhabitants, and a territorial element to create a linkage between councillors and the areas that they represent.

However, ongoing violence still demonstrates the fragility of the recent institutional achievements. This “unilateral decentralisation” was also criticised in 2003 by the Minister of Justice of the Serbian Government.

## Municipal Boundaries and Tasks

In Kosovo, municipal territories and boundaries are a reserved responsibility of the SRSG. Villages, settlements and urban quarters are recognised by section 5 of Regulation 2000/45; tasks and resources may be delegated to them by the municipality. They are equivalent to *mesna zajednica* in Serbia. The *Framework for the Reform of Local Self-Government in Kosovo* proposes to strengthen these sub-municipal units.

In Kosovo, municipalities have more tasks, but these tasks are conditioned by central regulation and funding, and subject to sharing the responsibility with the municipal administrator appointed by the SRSG. In principle, the subject matters of municipal competence are very similar to those of Serbian municipalities. However, the personnel of education and primary healthcare are managed by the municipal authority, and salaries are recorded in municipal budgets. The *Framework for the Reform of Local Self-Government in Kosovo* (July 2004) provides for the devolution of numerous matters upon municipalities.

## Local Finance

Mainly budgetary transfers from the central authority finance municipal budgets. Nevertheless, some own resources do exist and UNMIK established the basis for a new local tax system.

Municipalities receive financial transfers based on objective criteria, including an assessment of financial needs, of expected resources and of spending priorities established by the central authority. Part of these transfers may be designated for

specific activities, and part should be undesignated (UNMIK Regulation 2000/4, section 38).

According to the same regulation, own revenues are limited to licenses and fees, income from municipal assets and fines (section 39). However, a property tax has been introduced; municipal assemblies must to vote upon the rate (between 0.01 and one per cent of the market value). The rate may vary according to the categories of property laid down by law (UNMIK 2003/29). The tariffs of local public utilities must be voted by the municipal assembly.

## ‘THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA’

### General Context and Constitutional Framework

The Constitution adopted in 1991 provides for the legal basis of local self-government. According to article 8 (par.1), local self-government is a citizen’s right. Local government units are municipalities (art. 114); Skopje, the capital city, is a separate unit of local government subject to a special law (art. 117). As well, neighbourhoods may be established by municipalities as a form of local self-government (art. 114). Municipalities are financed from own sources determined by law and revenues transferred by central government; in practice, these effectively do not exist. Local powers are subject to court revision, but local authorities are entitled to call for the Constitutional Court in order to protect their own rights.

The Ohrid Agreement of 13 August 2001 secured the representation of ethnic minorities in the institutions of the Republic, and brought about a revision of the Constitution, adopted in November. These amendments made all citizens of the Republic subjects of the sovereignty, whatever their ethnic origin, introduced a double majority vote on key issues in Parliament in order to secure minority rights, and provided for further decentralisation with the devolution of a wide array of responsibilities to municipalities (amendment XVII).

The Constitution has two features regarding local government which are distinct from other countries. First, a basic law on local government is provided and must be passed with a two-thirds majority of deputies in the National Assembly, including the majority of those belonging to communities which are not of the majority (art. 114). Secondly, article 115 determines the areas in which citizens participate in decision-making on matters of local importance: it is quite unusual to set out

the responsibilities of local government in the Constitution of a unitary state. As a result, changes are quite difficult to make due to the circumstances surrounding the adopting of the Constitution. Other responsibilities may be determined by law. The new Local Government Law of 2002 has extended the responsibilities of municipalities. According to the Constitution, municipalities perform their responsibilities independently, only subject to legality oversight. Central government tasks may be delegated, but in this case a law is not required.

According to data of 1997, Macedonians represented 66.4 per cent of the population and Albanians 23.1 per cent. Turks comprise fewer than four per cent, and other groups are even less numerous. New surveys will likely yield different results. The Constitution tries to cope with this diversity. According to article 7, Macedonian, written in the Cyrillic alphabet, is the official language. Minorities are entitled to use their language and alphabet for official communication with local government units, in which minority members are a majority.

On the basis of constitutional provisions, an important legislation package was passed in 1995–1996: on Local Self-Government, on Territorial Division of the Republic of Macedonia and Determining of the Territory of the Municipalities, on the City of Skopje, on Local Elections (in 1996), and a Law on Regulating the Relations between the New Units of Local Self-Government and the Units of Local Self-Government from Which They Derive. No local finance law has been passed, but some provisions in the Law on Budgets of 1993 and the local government law have been partly implemented.

The local government reform started with the *Strategy of Reform* adopted by the government in November 1999. However, reforms actually began with the Ohrid Agreement of August 2001, including provisions on the development of local self-government. A new local government law was adopted on 24 January 2002; other pieces of legislation, in particular the local finance law and the new territorial division law, were passed during the summer of 2004. The last of these is particularly important, since the IMF stated in its report of May 2002 that a new territorial division was a prerequisite for the finalisation of the new Law on Local Government Finance; fiscal decentralisation will not be introduced before that.

## Territorial Organisation, Local Institutions and Responsibilities

“The former Yugoslav Republic of Macedonia” is divided into 123 municipalities; Skopje is a special local government of seven municipalities. This is a one-tier system of local government. The Law on the Territorial Division of the Republic established

this territorial organisation from 1996. Previously, there existed only 34 large municipalities. These constituencies still exist as the seats of the territorial branches of various government administrations (state regional offices). This territorial reform was thought to be necessary to establish self-governed municipalities.

The territorial pattern is characterised by the significant size of Skopje (554,000 inhabitants, or a quarter of the total population), the existence of mountainous areas and striking differences between municipalities. Municipality populations vary from 500 to 120,000 inhabitants; 46 municipalities are under 5,000 inhabitants, and four are under 1,000 inhabitants. This territorial pattern has been heavily criticised, generally considered to be inadequate. A new law on territorial division, adopted on 12 August 2004, foresees that the number of municipalities will drop from 123 to 80 and then to 76 by 2008. Local elections of November 2004 are planned to establish new municipalities. The purpose of the reform is indeed to give minority Albanians more power in certain areas, with probably 16 municipalities under the control of minority Albanians. This law is also facing strong opposition; referendums on amalgamations held in January and February 2004 revealed that, in a number of cases, opposition to larger municipalities arose for ethnic reasons. Later on, the new law on Skopje will have to be adopted.

According to article 14 of the local government law, municipalities may establish joint administrative authorities, agencies and other administrative bodies. In addition to administrative co-operation, municipalities may also join funds in order to accomplish common interests and perform common tasks that fall within the municipal responsibilities.

According to article 82 of the above-mentioned law, neighbourhoods are sub-municipal self-governments established by the council. Certain tasks of direct interest to the local population may be delegated to neighbourhoods, with an elected decision-making body (art. 84 and 86). Local offices as a kind of one-stop information and delivery office can be established in neighbourhoods.

Each municipality is managed by a council, elected by way of proportional representation; mayors are also directly elected. However, in Skopje, some councillors (14 among 39) are delegated by the seven municipalities (subject to revision on the basis of the new law on Skopje).

According to article 20 of the law, municipalities have a general competence in all local matters. They have the right to perform in their territory activities of local scope that are not excluded from their competence or do not fall under the competence of state authorities. In accordance with amendment XVII to the Constitution, resulting from the Ohrid Agreement, the enumerative, comprehensive and detailed list of municipal responsibilities (art. 22) includes: social welfare services; child protection; education; healthcare; urban and rural planning; communal activities (comprising e.g.

water supply, drainage, public hygiene, waste administration, public transportation, construction and maintenance of local roads); local economic development; and sport and recreation.

However, municipalities do not yet have these broad-ranging responsibilities; these must be devolved to them by specific laws. According to the Operational Programme of the Government, more than 50 laws require adoption, among which more than 40 concern the transfer of competences. Some have already been adopted, others are in the process.

## Local Finance

As municipalities have no stable or proper financial basis, local finance presents a significant dilemma.

Municipalities receive taxes on property transfers, inheritance taxes, the property tax (real estate and immovable assets), and various other minor taxes, as well as fees. Although no precise detailed data is available, tax revenue is very weak. Furthermore, municipalities are entitled to a share of the VAT, a grant for delegated state tasks, subsidies for backward areas, investment subsidies. There is no equalisation scheme. Transfers are also very low. This results from fact that resources are allocated on the basis of expenditure estimates, and that expenditures are at a low level, since most responsibilities devolved to municipalities have not yet become a reality.

This predicament is expected to change with the implementation of reforms. A new law on financing municipalities is to be adopted in August 2004.



# FISCAL DECENTRALISATION IN SOUTH-EASTERN EUROPE

› *Kenneth Davey* ›

The opinions expressed in this Report are those of the author and do not necessarily represent the views of the Council of Europe, the Open Society Institute, the Stability Pact for South Eastern Europe or the contributors of the country studies.



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## I. INTRODUCTION

### The Issues

Decentralisation to regional and local levels of self government can contribute substantially to both political and economic stability. Politically, it is a method of diluting the concentration of power, providing some autonomy for disaffected minorities and improving the accountability of local public services.

Though less often discussed, decentralisation can also promote economic stability. By severing regional and local budgets from that of the State it becomes possible to introduce a hard budget constraint and effective financial discipline at all levels. It can also improve the efficiency of public expenditure, simply because it substitutes the local accountability of representative bodies for the very weak accountability of deconcentrated state agencies. It also provides incentives for the effective exploitation of local revenue sources, replacing the disincentives inherent in the former centralised and politically biased methods of local budget funding.

These advantages can only be realised, however, if political and administrative decentralisation is placed within an effective framework of fiscal decentralisation. How far this is the case in eight countries covered by the Stability Pact is the subject of this report, which summarises surveys of the individual states (Albania, Bulgaria, Croatia, Moldova, Montenegro, Romania, Serbia and “the former Yugoslav Republic of Macedonia”) commissioned by the Local Government and Public Service Reform Initiative of the Open Society Institute.

In particular the report covers the following aspects of fiscal decentralisation:

- (1) the extent to which regional and local authorities are assigned responsibility for significant proportions of public expenditure, and the adequacy of the resources allotted to them for this purpose
- (2) the effectiveness of the mechanisms for minimising the impacts of disparities between local resources upon the quality of local services
- (3) the degree of discretion conferred on regional and local authorities to determine their spending priorities and levels of revenue.

The findings of the survey in respect of these three dimensions will be reviewed in turn. Specific details in respect of individual countries are given in the Country Profiles at Part V.

Bosnia Herzegovina is omitted from this survey. It was not possible in the time available to secure sufficient information on its complex structure to include in this comparative framework, and legislation on a permanent framework of fiscal decentralisation is still under consideration.

## General Reforms

A number of the Stability Pact members have recently initiated general reforms of their fiscal decentralisation systems which are at various stages of implementation. These are mentioned here by way of introduction:

- *Albania*: National Strategy for Decentralisation, 2000, implemented by the Local Government Law of 2000.
- *Bulgaria*: publication of the Fiscal Decentralisation Conception in 2002, implemented through the 2002 Local Taxes and Charges Act and 2003 State Budget Law.
- *Croatia*: adoption of a fiscal decentralisation programme in 2001.
- *Moldova*: Law on Local Public Administration, 2003.
- *Montenegro*: Law on Financing Local Autonomy, 2003 (implemented in 2004).
- *Romania*: Law on Local Public Administration, 2001, and substantial amendments to the Law on Local Public Finance in 2002. Law of 2004 approving Government Ordinance 45 of 2003 on local public finances. 2004 Framework Law on Decentralisation.
- *Serbia*: 2004 legislation replacing sales tax with VAT which will necessitate major changes in local government finance.
- *“the former Yugoslav Republic of Macedonia”*: the Law on Local Government, 2002 and adoption in 2004 of new laws on Local Government Finance and Territorial Organisation. The latter two laws are due to come into force in 2005.

This survey is, therefore, looking at a rapidly changing scene. Most, though not all, the changes can be regarded as progressive, but few have reached maturity.

## II. EXPENDITURE AND REVENUE ASSIGNMENTS

### Assignments

Local government systems (including county and municipal levels in Croatia, Moldova and Romania) are generally responsible for local physical infrastructure, commonly known as “communal services” and including street maintenance, cleaning and lighting, refuse collection, parks, public transport, cemeteries and sports facilities, together with local regulatory tasks such as urban planning and civil registration. They manage what remains of the public housing stock. With the exception of Albania, they also generally own the major utility services, water supply and sewerage, heating and energy supply. The effect of the latter on local budgets is reduced by the fact that the utility services are largely funded by user charges or subsidised by social security benefits. In South Eastern Europe these competences are normally described as “own” or “autonomous” functions.

The biggest differences between local government systems, both worldwide and in the Stability Pact countries in particular, lie in their degree of responsibility for the personal social services: education, healthcare, and social security and welfare. The divisions of responsibility between state budgets, local budgets and insurance funds for teachers salaries, medical care and social benefits basically determine differences in the size of local budgets.

In South Eastern Europe these personal service competences are normally described as “delegated”, although some elements such as pre-school education and welfare services (as opposed to financial payments) may be classified as autonomous functions. Local governments in Bulgaria, Croatia, Moldova and Romania have extensive responsibilities for schools, healthcare and social welfare (including income support in Moldova and Romania). Such delegation is as yet small in Serbia (except for kindergartens and school building maintenance), Albania and Montenegro. The Macedonian Local Government Law assigns social sector responsibilities to local governments but subject to phased implementation under IMF conditionality. Assignment of these tasks in the basic local government legislation often requires amendment of sectoral laws for implementation, a process which may lead to delay and dilution.

## Adequacy of Funding

Clearly the assignment of public service and spending responsibilities to self government is only empowering if matched by allotment of adequate revenues. Adequacy is difficult to define and measure because it depends partly on what public policy regards as the legitimate balance between public and private sectors, but also overwhelmingly on what is affordable within current economic constraints.

Nevertheless adequacy can be measured by three tests

- (1) How do the resources allocated to local authorities to manage devolved or delegated services compare with previous levels of state budget expenditure on them?
- (2) Are the resources sufficient to meet the standards of service mandated by national laws and regulations?
- (3) How far do the resources assigned to local responsibilities benefit from upturns in the national economy and public revenues as a whole?

The eight country studies show the following significance of local government budgets in 2003:

*Table 1: Local and General Government Budgets*

Countries	Government expenditures in percentage of GDP	Local expenditures in percentage of GDP (%)	Local expenditures in percentage of general government expenditures (%)
Albania	27	6.7	23
Bulgaria	38	6.5	16
Croatia	49	7.5	15
Moldova	25	7.2	29
Montenegro	42	5.8	14
Romania	32	8.5	25
Serbia	25	5.6	25
“The former Yugoslav Republic of Macedonia”	27	1.8	7

Comparison can be made with the following EU member states (2000 DEXIA data):

*Table 2: European Union Comparisons*

Country	Government expenditures in percentage of GDP (%)	Local expenditures in percentage of GDP (%)	Local expenditures in percentage of general government expenditures (%)
Hungary (1998)	47.7	13.9	25
Poland (1999)	41.7	12.1	29
Denmark	52.3	30.6	58
France	52.8	10.0	19
Italy	46.1	13.5	29
Sweden	60.5	23.9	39

By these comparisons levels of local government funding in the Stability Pact countries look low in relation to both GDP and public expenditure as a whole, the disparity being greater in relation to GDP. There are a number of explanatory factors such as the role of health insurance funds in financing healthcare independent of local budgets, the payment of teachers salaries by the State Budget (Croatia), and the lower administrative costs resulting from the inheritance of relatively large jurisdictions from the former Yugoslavia, together with a single tier of local government in Albania, Bulgaria, Montenegro, Serbia and “the former Yugoslav Republic of Macedonia” and only two elsewhere.

More fundamentally the low ratios of total public expenditure to GDP in all but two of the states indicate the general effect of disorder and/or radical political and economic change on tax ratios and the overall funding of public services. Local governments may be underfunded but not necessarily more so than government as a whole. Aggregate funding of local government expenditure may be adequate but poorly distributed; it does not ensure that all local governments can perform their responsibilities; issues concerning the equity and transparency of local budget funding will be discussed in the next section.

The recent bout of local government legislation has stabilised local government funding to some extent and the country reports make less reference to “unfunded mandates” than may have been the case four or five years ago. Stabilising reforms have been of two kinds. The first consists of the assignment of substantial shares of personal income tax (PIT) to the funding of local delegated services (100 per cent in Bulgaria, Moldova and Romania); in “the former Yugoslav Republic of Macedonia” and Romania a share of Value Added Tax (VAT) has also been allocated to a central pool to augment local funding of these services. PIT is a relatively large, stable and buoyant revenue source although the equity of its assignment does depend upon allocation to the employee’s place of residence rather than work, not the case in a number of countries.

Secondly, a number of states have mechanisms for adjusting local budget revenues assigned for funding delegated services (chiefly PIT) to the estimated costs of these tasks according to centrally prescribed normatives. In the case of Bulgaria, Croatia and Moldova these adjustments are made by a State budget subsidy, in Romania by the general equalisation fund. These payments should ensure that local governments can at least operate the delegated services at nationally prescribed minimum standards, however high or low those may be. In Moldova and Romania this mechanism has been undermined in some cases by failures to adjust normatives to local cost disparities (e.g. the higher unit costs of rural education), to increase the cost estimates to take account of all rises mandated by the government, and by non-transparent distribution of the equalising funds by the upper tier of local government.

It is clear that responsibility for the social sector, for education and healthcare in particular, and to a lesser extent for social welfare, is both constrained and constraining. It is constrained by the inevitable intervention of national government in prescribing patterns and levels of local expenditure; nothing will stop ministers of education making pay deals with teachers' unions. It is constraining in that, however funded, the burden of regular current expenditure makes heavy demands on local budgets and robs them of much room for manoeuvre in coping with other community needs. Nevertheless local publics attach high priority to these services, schools in particular, and local accountability tends to favour and improve them.

Standards of "own" or "autonomous" functions, by contrast, gain little protection from intergovernmental fiscal arrangements and their quality and quantity depend largely on local taxes and charges which reflect differences in the size and prosperity of municipal jurisdictions. Strategies generally put faith in the eventual reform of property taxation for improvements in their support, but these are so far a matter of aspiration rather than achievement.

Although recent legislation has generally removed the worst inadequacies and instabilities of local government funding (or should do in "the former Yugoslav Republic of Macedonia" when implemented) many local governments are still encumbered by the debts incurred during the pre-reform period. This is particularly the case in Bulgaria and "the former Yugoslav Republic of Macedonia". How far new arrangements give them the budgetary latitude to clear these obligations is far from certain.

### III. CORRECTION OF DISPARITIES

#### Disparities

Taking South Eastern Europe as a whole, the distribution of revenue between local authorities is probably a greater problem than aggregate funding of local government. To the extent that local budgets are funded by local revenues or origin-based revenue shares (as opposed to other intergovernmental transfers), there are bound to be considerable disparities in potential expenditure on services due to differences in wealth and economic activity. These are particularly evident in countries where the capital city is economically dominant; Tirana receives 43 per cent, Skopje 50 per cent and Chisinau 60 per cent of local revenue raised within their respective states.

Even intergovernmental transfers may reflect historic inequalities in the geographical distribution of state budget resources. Moreover the costs of providing services are not uniform. Low population density can add significantly to the cost of a service like education, whereas large settlements may well incur higher per capita costs in the case of road and traffic management or refuse disposal. The relatively large local government jurisdictions can also pose accountability issues where diverse geographical and ethnic communities are combined.

The following table shows the range of per capita revenues before and after receipt of intergovernmental subsidies: (Montenegro is excluded as the revenue base is new in 2004).

*Table 3: Range of Local Government Revenues:  
Ratio of Highest to Lowest per Capita Incomes*

Country	From own sources and origin based revenue shares	From all sources
Albania	11 : 1	2 : 1
Bulgaria	20 : 1	7 : 1
Croatia	5 : 1	4 : 1
Moldova	Unknown	8 : 1
Romania	65 : 1	9 : 1
Serbia	5 : 1*	2 : 1*
“The former Yugoslav Republic of Macedonia”	50 : 1	Unknown

\* Refers to quartiles not individual authorities.

## Equalisation

These disparities emphasise the critical importance of equalisation systems. In the case of physical infrastructure there is often a convergence between high levels of economic activity leading to above average revenues on the one hand, and higher service costs. Some disparities between local budgets may well be reasonable and acceptable. This is less the case with the personal social services, however, where public policy (and often the national constitution) expects the public to enjoy more or less equal standards of service regardless of location and economic circumstances. A combination of serious local revenue and cost disparities and significant social service responsibilities demands an effective equalisation mechanism.

Equalisation may be achieved *vertically*, i.e. through the criteria for distribution of intergovernmental transfers, or *horizontally* through the partial redistribution of local revenues, or by some combination of the two. To some extent the old style matrix systems of financial relations between state, regional and local budgets which operated in most of the former Socialist states aimed at a combination of vertical and horizontal equalisation. It was seriously flawed, however, by an absence of normative calculation and its reliance on annual negotiation resulting in nepotism, inequity and severe disincentives to revenue mobilisation and budgetary discipline. Most of the former Socialist states are in various stages of progress away from this former framework of intergovernmental finance to a system which is more equitable, transparent and normative.

Among the Stability Pact members the personal social services, where delegated to local government, are basically financed by origin-based shares of PIT (plus shares of corporate income tax in Moldova). These are clearly unequal in their distribution, and legislation recognises the need to bring their yields up to the minimum costs of national standards of provision. This is attempted by way of a specific equalising subsidy in Bulgaria, Croatia and Moldova. In Romania teachers salaries and income support are subsidised by transfers from a dedicated portion of VAT receipts, while all municipal expenditures are supported by the distribution of an equalisation fund comprising 29 per cent of PIT.

There are much more varied approaches to equalising the funding of own or autonomous expenditures. Albania (with the lowest disparities in per capita revenue from all sources) applies two mechanisms, a block grant biased towards smaller and poorer jurisdictions and a horizontal redistribution from authorities with per capita revenues over 35 per cent of the national average to those more than 35 per cent below. Croatia also distributes a block grant according to spending need and fiscal capacity, while also awarding higher shares of PIT to Areas of Special National Concern (largely defined by war damage) and mountainous areas. The new Macedonian

Law assigns three per cent of VAT to an equalisation fund, but the formula for its distribution remains to be defined. Montenegro has allotted 10 per cent of PIT to an equalisation fund, 90 per cent of which is distributed according to spending need and fiscal potential, and 10 per cent to reward increases in collection of local taxes and charges. Romania has a general equalisation fund comprising 29 per cent of PIT, and Serbia allocates additional origin-based shares of Sales Tax for vertical and horizontal equalisation.

All countries practise some form of equalisation, although Bulgaria and Moldova restrict its coverage to delegated services. The efficacy of the varied arrangements is constrained by a number of factors, however. Firstly, there is a tendency to prescribe general distribution criteria without numerical weightings, leaving scope for non-transparent application, particularly where this is left to a higher level of elected government, as in Moldova and Romania. Any room for negotiation tends to dilute the equalising impact, because of the political pressure to give everyone a share whatever they qualify or not. Adjustment by giving differential tax shares as in Serbia is an imprecise instrument which can be undermined by differences between estimated and actual collections. Thirdly, measuring own revenue potential by actual collections leads to potential disincentives and distortions, but finding a more objective basis of calculation is technically challenging.

#### IV. LOCAL DISCRETION

For the political and economic benefits of decentralisation to be realised, three further conditions need to be met:

- (1) Self-governments need significant discretion to allocate expenditure in accordance with local preferences and priorities. The imposition of national standards and policy requirements should not be so strict as to preclude local initiative and judgment.
- (2) Self-governments should have freedom to vary the rates of the taxes and charges which accrue to their budgets. This may be restricted by ceilings but should nevertheless be sufficient to provide scope for varying levels of expenditure and enhance the sense of public accountability of local officials. Intergovernmental transfers should not be so dominant as to discourage the use of such discretion.
- (3) Intergovernmental transfers should be allocated by transparent and stable criteria which free recipients from political dependence on state officials or higher levels of local government for resources and encourage local care and foresight in their use.

## Discretion on Expenditure

Local government discretion over expenditure on the delegated services of education, healthcare and social welfare is squeezed between the standards and normatives stipulated by the State and the rights to self-management conferred by law on institutions such as hospitals and teachers (and, one might add, the ungovernable nature of doctors and teachers). Whether expenditure normatives actually govern local budgetary allocation or only the calculation of transfers varies from state to state. They are often taken to have more directive force than is legally the case. Such administrative powers as the appointment of school or hospital directors probably confer more local power over these tasks than financial discretion.

There are few restrictions on current spending on own or autonomous functions other than national stipulation of salary levels. Local discretion has been enhanced in countries like Albania where a variety of earmarked grants has been consolidated into block grants. Capital investment expenditure, on the other hand, is still widely dependent on project by project awards of grants by the State.

Although not strictly an issue of fiscal decentralisation, delay in some cases in transferring the ownership of property used by local public services to local government is a practical impediment to their effective management.

## Discretion on Revenue

The following table shows the percentage of local government revenues in 2003 over which the local authority had some discretion in defining the rates:

*Table 4: Percentage of Local Government Revenue Subject to Local Rate Setting*

Country	Per cent
Albania	14.8
Bulgaria	25.0
Croatia	38.0
Moldova	22.3
Montenegro	29.0
Romania	21.0
Serbia	21.2

These comparisons need to be treated with caution since the discretion may in some cases be subject to tight limits and the figures may include a small amount of revenue from nationally prescribed fees.

Croatian and Montenegrin local governments have the power to surcharge PIT (within limits); this right has provided the foundation of the highest degrees of fiscal decentralisation exercised within the European Union (plus Norway and Switzerland). PIT has proven to be the only tax base which is technically capable both of assignment to local government and of supporting a substantial percentage of local government expenditure including expensive personal services. Although modest in current contribution to local budgets (about 10 per cent in Croatia), such surcharging rights can always be enhanced in a fiscally neutral manner by substitution for existing PIT shares.

Bulgarian and Serbian local governments have no taxing powers (through constitutional limitation in Bulgaria). In the other six countries they have power to vary the rates of local taxes, usually within limits ( $\pm 30$  per cent of a norm in Albania,  $\pm 50$  per cent in Romania); these taxes are mainly on real estate or motor vehicles. They tend to comprise a minor portion of the local budget and have substantial yields only in the larger towns. There are declared hopes, however, in most countries of increasing local discretion over property taxation coupled with a major overhaul of its assessment base. Whether these will be achieved and, if so, to what extent and how soon, is a matter for speculation. It is worth noting that the highest yields of property taxation in central and eastern Europe are one per cent of GDP in Poland and 0.9 per cent in Romania; they are owed not to full-scale *ad valorem* assessment but to the freedom and encouragement given to municipalities to adjust tax rates annually slightly above the rate of inflation. More significant representation of inter-local variations in property values in the multipliers applied to square meterage could probably improve the assessment base substantially within existing frameworks without the costs and complexities of market value assessment.

Local governments generally enjoy substantial freedom to levy rates of fees and charges, though these are supposed to be anchored to costs. This discretion tends to be exercised energetically, particularly in cities and where the costs fall on businesses rather than on voters. A Serbian report has suggested that the number and scale of administrative fees is excessive and a disincentive to enterprise. Certainly local revenue generation can be predatory and should not be simplistically regarded as *ipso facto* beneficial.

## Stability and Transparency

The country profiles show progress in defining the revenue base of local governments in permanent rather than annual budget legislation. This has introduced a welcome element of stability and transparency. Year-on-year uncertainty is still attached to the

annual recalculation of expenditure normatives governing delegated service subsidies and equalisation.

Discretionary funding, where it remains, is a major threat to local autonomy, since having to beg for money from higher levels of government weakens the independence and authority of locally elected leadership. The non-transparency of equalisation fund distribution has already been highlighted.

The other major field for patronage remains the award of capital investment grants. Experience in central Europe suggests that this may be curtailed or mitigated by preparation for accession to the European Union and a growing role for its funds in this sphere. Subjecting the distribution of capital funds to objective criteria is technically more difficult than in the case of current transfers; the example of Bulgaria in allocating an overall investment grant quota to each local government subject to approval of its project application, is particularly interesting in this respect.

## V. COUNTRY PROFILES

### Albania

#### *Assignments*

Local governments are responsible for the customary range of communal services but the intended devolution to them of water utilities is at an early stage of implementation. Delegated functions in the fields of education, health and social welfare are largely of an agency nature, financed by earmarked payments from ministry budgets, but further devolution is under active preparation.

Major reforms in financing local expenditures have been introduced in 2003, the previous reliance on conditional grants being largely replaced by a combination of assigned taxes on property, small businesses and agricultural land, the full yields of state taxes on simplified profits and vehicle registration, and formula-based unconditional grants.

#### *Adequacy*

Over the decade 1993 to 2003 overall government expenditure in Albania declined from 50 to 27 per cent of GDP leaving all public services severely underfunded. Local government expenditures declined substantially from 1992 to a low of 18 per cent of state budget expenditure in 1998 and 6 per cent of GDP in 2002. However, recent reforms have reversed this decline with local budget expenditures reaching

23 per cent of public expenditure in 2003 and the prospect of further increases. The full effect of these will only be apparent in 2004 but provisional data indicate an upward trend in local budget revenue.

### *Equalisation*

The 2002–3 reforms introduced two equalisation mechanisms: firstly a more equitable formula system of allocating unconditional grants (benefiting smaller and poorer authorities in particular), and secondly an element of horizontal redistribution calculated on 35 per cent of the difference between per capita revenues from taxes on small business, simplified profit and vehicle registration and the national average.

### *Discretion*

Recent reforms have greatly increased local discretion and transparency. The contribution of earmarked grants to local budget revenue has been reduced from 85 per cent in 1998 to 20 per cent, replaced by a combination of unconditional grants, local taxes and revenue shares over which local governments have full spending discretion.

From 2003 local governments have had discretion to set the rates of taxes on agricultural land, property (buildings) and small business within a range of  $\pm 30$  per cent of an indicative rate.

Unconditional grants and revenue shares are distributed by transparent formulae. The volumes and formulae are still governed by annual state budget rather than permanent legislation, but have not so far been varied to local government detriment. Government ministries still exercise considerable discretion over the funding of the delegated services, education, healthcare, social welfare and public order, and the distribution of grants for capital investment.

*Key challenges* include the devolution of responsibility for personal social services.

## **Bulgaria**

### *Assignments*

Bulgarian municipalities have full responsibility for communal services and utilities, plus extensive responsibility for pre-school, primary and secondary education, social welfare and healthcare. Most educational expenditure is executed through normative transfers to schools, while healthcare is partially funded by compulsory health insurance.

The costs of the “delegated” functions (education, social assistance, healthcare and culture) are calculated by a normative formula and covered by assignment of

100 per cent of PIT by origin and a general complementary subsidy which covers any estimated shortfall. Estimated PIT revenue surplus to the delegated service costs reverts to the State Budget, but not yields in excess of the estimate. “Own” functions (communal services and utilities etc) are covered by local taxes on property, property transfers, inheritance and gifts, vehicles and road use, together with fees and charges. They also may attract State capital investment grants.

### *Adequacy*

The delegated functions are primarily funded by a reasonably stable and buoyant PIT, and the capacity to fund mandated standards should be ensured by the complementary subsidies, providing the normative costings are accurate. The adequacy of funding for autonomous functions depends on the vagaries of the local revenue basis and therefore varies widely. The National Association of Municipalities considers that these services are frequently underfunded.

### *Equalisation*

As already described, a complementary subsidy closes any gap between PIT and the estimated normative costs of the delegated tasks. There is no mechanism for correcting disparities in the basket of own revenues devoted to autonomous functions.

### *Discretion*

Municipalities have wide discretion in allocating expenditure on own functions; over 80 per cent of current budget transfers are unconditional. Tight constraints are applied, however, to funding schools; staffing levels are centrally prescribed as well as salaries and funds have to be handed over to individual school management under a set formula related to pupil numbers.

Local tax rates and liability for them are determined by national legislation since all taxing power is reserved to Parliament by the Constitution. Municipalities have no discretion in this respect, but the 2002 Local Taxes and Charges Act conferred wide powers on them in respect of fees and charges.

Revenue sharing and intergovernmental transfers are determined by permanent legislation, but the expenditure normatives governing the calculation of the complementary subsidy are defined in the annual state budget law, and therefore subject to frequent change. Investment subsidy quotas are allocated to individual local governments by formula, but their use requires project by project approval.

*Key challenges* include the legal ban on municipal discretion over local tax rates, and the disparities in the local revenues supporting autonomous functions.

## Croatia

### *Assignments*

Decentralised responsibilities have increased substantially since reforms in 2001. Local governments at either county or municipal level have added primary and secondary education, social welfare and healthcare to their existing responsibilities for communal services and utilities. Between 1999 and 2003 local government expenditure increased from 11.1 per cent to 15.2 per cent of general government expenditure and from 6.1 to 7.5 per cent of GDP. These increases have been limited by the fact that local governments have not assumed responsibility for the remuneration of school and healthcare staff..

Local government units taking over the newly devolved functions have received added percentage shares of PIT and are also eligible for equalisation fund payments that meet any gap between the income tax shares and the standard normative costs of the extra responsibilities. Autonomous functions are funded by basic shares (by origin) of personal and corporate income taxes, and a variety of taxes on real estate, consumption, gifts, inheritance and vehicles together with fees and charges.

### *Adequacy*

Linkage to income tax should ensure reasonably buoyant funding for these functions in relation to the growth of the national economy. Equalisation funds should ensure that mandated standards of delegated tasks can be financed. Overall local government balances have improved considerably since 2001 suggesting that the new funding basis for local government responsibilities has been adequate.

### *Equalisation*

As already explained, an equalisation fund evens out capacity to meet minimum spending targets in respect of education, healthcare and social welfare. For other types of expenditure there are two types of equalisation: firstly additional shares of personal and corporate profit taxes for Areas of Special National Concern and mountainous areas, and secondly, a current expenditure grant distributed according to mixed criteria relating to per capita revenues and spending needs. Grants reduce revenue disparities only to a very limited extent and their allocation only partially correlates with objective factors such as regional GDP or tax revenue. A number of reasons have been suggested in the country report including some generosity in the classification of Areas of Special National Concern and mountainous areas which receive extra tax shares, and the absence of any numerical formula for applying the statutory criteria governing the distribution of current grants.

### *Discretion*

Local government units have general freedom in allocating funds for current expenditure, despite the existence of spending norms for decentralised services. Grants for capital expenditure are earmarked by sectoral ministries for specific investments.

The bulk of local tax revenue consists of shares of national revenues specified by Parliament. However, authorities have, and increasingly exercise power to impose surcharges of up to 10 per cent on personal income tax. They are free to determine rates of charges for local utility services and some minor taxes on local property and consumption.

Rates of revenue sharing are prescribed by law and therefore transparent. However, the government has considerable discretion in designating Areas of Special National Concern which attract extra revenue shares and in allocating both the current and capital investment grants.

*Key challenges* include the development of more precise criteria for the distribution of equalisation funds.

## Moldova

### *Assignments*

By SEE standards, local governments (rayon and municipal) have wide responsibilities including education and social benefit payments. These account for the relatively high percentages of government expenditure and GDP. However, the demarcation of social sector tasks between rayon and municipal administrations is unclear and healthcare is partially funded by compulsory health insurance.

Delegated tasks are financed by the assignment of personal and corporate income taxes by origin to rayon and municipal budgets together with a grant to meet any shortfall estimated according to normative costs. “Own” functions have to be financed by assigned real-estate taxes, minor local taxes, fees and charges.

### *Adequacy*

The combination of assigned income taxes and equalising subsidies should provide a stable base for the delegated services. However, this depends on the accuracy of the normative costings; these have been unfair in not recognising the inevitably higher unit costs of rural schooling and have ignored extra costs imposed by governmental directives, notably a 20 per cent teaching salary increase in 2003. The adequacy of general municipal revenues has also declined as a result of the major cost implications

of the 2003 territorial reorganisation which re-established 33 rayons, and increased the number of municipalities by one-third. This was also accompanied by directives increasing municipal establishments. Reforms have also deprived local governments of the benefits of shared revenue yields exceeding the estimate, which provided both incentives and funds for capital works.

### *Equalisation*

As already mentioned, a subsidy is intended to cover the gap between assigned taxes on income and the normative cost of delegated services. The only equalisation of own revenues and expenditures relates to some horizontal redistribution of revenues which exceed the expenditure normatives by more than 20 per cent

### *Discretion*

Expenditure normatives in respect of the staffing of the delegated services severely constrain budgetary choice, particularly in smaller rural jurisdictions where education costs are dominant. A series of governmental decisions, particularly on territorial reorganisation and staffing has also imposed serious burdens on local budgets.

Local governments have discretion whether to levy local taxes and, if so at what rates. The largest of these optional taxes are on spatial improvements and business registration with potential mainly in Chisinau and other large towns.

The structure of revenue shares and transfers is determined by permanent laws, but expenditure normatives are defined by annual law. The distribution of the shared taxes and equalisation transfers for delegated functions is determined by the rayon administration annually involving considerable negotiation, particularly over the estimated yields of assigned taxes.

*Key challenges* include the separation of rayon and municipal budgets and removing rayon discretion over municipal entitlements to revenue shares and equalisation subsidies.

## Montenegro

### *Assignments*

Cities and municipalities are responsible for the normal range of communal services and utilities but not for the social sector services.

Under a new law effective in 2004 they receive taxes on real estate, alcoholic consumption, inheritance, gifts and visitors, plus 10 per cent of PIT (by origin) and 50 per

cent of property transfer tax. They also receive fees and charges and have the right to levy a surcharge of up to 13 per cent on PIT (15 per cent in two cities). They are eligible for grants from an Equalisation Fund comprising a further 10 per cent of PIT.

### *Adequacy*

There is no experience on which to judge the new funding base introduced in 2004. In the absence of delegated social sector responsibilities there is no normative element of spending need in the distribution of revenues, but the major role of PIT shares and surcharges should provide a stable and reasonably buoyant base barring major economic decline.

### *Equalisation*

As already mentioned 10 per cent of PIT is allocated to an equalisation fund from 2004. 90 per cent of this is to be allocated according to indices of fiscal efficiency and budget expenditure, details of which are not available, while the remaining 10 per cent will reward municipalities achieving the largest percentage increases in own revenue.

### *Discretion*

The new Law on Financing Local Autonomy appears to confer wide discretion on municipalities although this has not been tested by experience. They have complete freedom of budgetary allocation between their defined competences; these do, however, exclude what other countries in the region regard as delegated tasks.

From 2004 municipalities may levy and determine the rates of taxes on real estate, consumption of drinks, visitors, business registration, gifts and inheritance. Implementation is partially delayed by the absence of existing machinery for assessment and collection, but developing this is presumably a matter of time. Crucially, they may impose a surcharge of up to 13 per cent on PIT (15 per cent in two cities).

Rights to raise revenue and to receive tax shares are defined by permanent legislation. The remaining uncertainty attaches to the distribution of the equalisation fund, but its aggregate size has been defined (10 per cent of PIT) and allocation will be made by a Commission for Local Autonomy.

*Key challenges* will emerge from the current year's experience of implementing the new Law.

## Romania

### *Assignments*

Local authorities (*judets* and municipal) have a full range of local public service responsibilities including education, minimum income support and other social subsidies such as heating vouchers. Unusually, some utilities are operated at *judets* rather than municipal level.

They receive PIT (partly by origin and partly through equalisation), local taxes on real estate, vehicles, hotels and entertainment, fees and charges. They also receive grants towards teachers salaries and income support (partly financed by a share of VAT), and are eligible for state budget capital investment grants.

### *Adequacy*

The increasing allocation of PIT (now 100 per cent) and an approximately 25 per cent share of VAT to local government support, together with a full tranche of local taxes, fees and charges, has provided a buoyant base for local budget expenditure which has doubled as shares of public expenditure and GDP since 1999. This framework is adequate in aggregate, but its impact on individual local budgets is marred by unstable and arbitrary allocations of equalisation funding by *judets* to municipalities. Further weaknesses are the frequent changes in mandated expenditure and the highly discretionary distribution of capital investment funds.

### *Equalisation*

Twenty-nine per cent of PIT is allocated to an equalisation fund which is allocated by formula to *judets* for onward distribution to municipalities. No numerical weightings are attached to the distribution criteria, which are in any case frequently ignored by the *judets*; as a result the distribution is highly discretionary and the per capita disparities in municipal revenue in fact are enhanced rather than reduced by the equalisation funds.

### *Discretion*

Government directives govern the numbers and salary levels of administrative and teaching staff and the calculation of minimum income support. Otherwise local governments have substantial freedom to determine their expenditure, although this is frequently constrained by the cost implications of these directives.

Local government has power to set the rates of taxes on real estate, motor vehicles and hotels within 50 per cent above or below statutory norms and to adjust them annually for inflation. Annual adjustment has helped to push property tax yields to relatively high levels by CEE and SEE standards.

Revenue shares and the aggregate size of the equalisation fund (29 per cent of PIT) are defined in permanent legislation. However, the distribution of the equalisation fund between municipalities is determined by *judets* in a non-transparent manner. The allocation of government subsidies for investment is also highly discretionary. The frequency of changes in the directives over educational and social welfare expenditures also inhibits budgetary planning.

*Key challenges* include the elimination of discretion in the distribution of equalisation funds and improving the distribution of capital investment subsidies.

## Serbia

### *Assignments*

Cities and municipalities have wide responsibilities for communal services and utilities, but in the social sector only for pre-schools and the maintenance of primary and secondary school buildings.

Their largest revenues have been from shares by origin of Sales Tax (eight per cent in municipalities, 10 per cent in three cities and 15 per cent in Belgrade), additional shares of sales tax awarded annually for equalisation purposes, five per cent by origin of Wages Tax, various taxes on real estate, fees and charges.

### *Adequacy*

Given the slenderness of social sector responsibility, a 25 per cent share of public expenditure by local government units is substantial and buoyant. However, this is heavily weighted in favour of the cities by their disproportionate shares of sales tax, and smaller municipalities are less amply funded. Sales tax shares disappear in 2005 with the replacement of the tax by VAT; the government apparently intends to replace this revenue to local governments principally with an enhanced share of wages tax. The challenge will be to distribute this more equitably.

### *Equalisation*

Additional shares of Sales Tax have been awarded in the annual Tax Sharing Law for purposes of both vertical and horizontal equalisation. Although the cities get a lower percentage share than the poorer municipalities, it yields higher per capita sums when applied to their superior tax base, and may have the effect of increasing rather than diminishing the revenue disparities when yields significantly exceed the estimates.

### *Discretion*

Local government expenditure is subject to little prescription except for national control over salary levels. A major constraint, however, is the absence of municipal rights to ownership of the property they use for public services. Legislation is expected to grant such rights but is delayed by difficulties in defining its scope.

Local governments do not have power to set the rates of any tax, although exercising wide discretion over fees and charges. Legislation to reform property taxation is expected in the near future including local discretion over tax rates within prescribed limits.

Annual tax sharing laws determine the local government shares of sales and wages taxes. The basic shares remain reasonably stable, but the annual allocation of additional shares (nominally for equalisation purposes) is the result of a negotiated process of dubious equity. The abolition of sales tax presents an opportunity to substitute a more stable and transparent alternative.

*Key challenges* include the replacement of sales tax shares as the major local revenue source and the assignment to local governments of discretion over some local tax rates.

## “The former Yugoslav Republic of Macedonia”

### *Assignments*

Former systems of functional decentralisation were disrupted by the 1996 split of 34 local government units into 124 and by civil war. The 2002 Law on Local Government assigns a wide sphere of responsibility to local government including education and social welfare, but under IMF conditionality responsibility for services will be delegated in two stages, with staff emoluments last. Meanwhile the share of local budgets in public expenditure remains extremely low.

The new Law on Local Government Finance assigns the levy of various taxes on property to local government units together with three per cent of PIT (by origin) and access to an equalisation fund equal to three per cent of VAT. Delegated services will also attract sectoral block grants.

### *Adequacy*

Arbitrary distribution of revenue shares among the 34 former municipal areas and the current 124 authorities, together with vicarious public expenditure restrictions and reliance on earmarked sectoral transfers has, generated great instability for municipal finance. The news laws on territorial organisation and local government

finance should create a more a secure and buoyant framework, but the adequacy of funding of the delegated functions will depend on the calculation of sectoral block grants still in progress.

### *Equalisation*

“The former Yugoslav Republic of Macedonia” has no equalising mechanism at present, but the new Local Government Finance Law allocates three per cent of VAT to an equalisation fund. It requires the government to prepare a distribution formula in consultation with the local government association but stipulates that 50 per cent must be allocated purely according to population. It states that Skopje should be treated separately, but it is not clear how far this will exclude the city from benefit.

### *Discretion*

Municipalities are currently dependent to a substantial extent on earmarked grants from sectoral ministries. It is intended that these should be replaced by sectoral block grants which will increase spending discretion within, but not between sectors.

Under the new Law municipalities will gain the right to set the rates of property taxes within statutory limits, fees and charges.

At present municipal revenues are subject to unpredictable and non-transparent decisions over the distribution of tax shares within the previous 34 municipal areas, the allocation of shared tax yields in excess of previous public expenditure caps and the allocation of earmarked sectoral grants from national budgets and dedicated funds. Transparency and stability should be substantially improved by implementation of the new Law since rights to own and shared revenue are prescribed permanently together with the volume of equalisation funding. However, the formulae for calculating equalisation transfers and sectoral block grants remain to be defined and will also be important in securing stability and transparency.

*Key challenges* are presented by all aspects of implementing new legislation, in particular the calculation of sectoral block grants and the distribution of the equalisation fund.

## VI. RECOMMENDATIONS

The country studies on which this Report is based highlight encouraging progress in the promotion of fiscal decentralisation in South-Eastern Europe over the last four to five years. In several countries strategies have been adopted and implementation has, to varying degrees, taken place. More responsibility for local public services

has been devolved in most of the countries covered and progress has been made in making their funding more stable and transparent. Insofar as local services remain underfunded, the weakness applies to public expenditure as a whole and derives principally from wider economic circumstances.

Individual local governments do not necessarily benefit equally from improvements in the aggregate funding. Weaknesses remain, particularly in the distribution of equalisation funds whose importance is accentuated by the major role played by origin-based revenue sharing in the systems of intergovernmental transfers. Capital investment funding is another field in which greater regularity is much needed.

From a rapid survey and a brief report it would be inappropriate to formulate detailed recommendations of universal relevance. A major reform of local government funding will be needed in Serbia to replace local sharing of Sales Tax. Otherwise most effort is needed in most of the eight countries to implement legislation already in place.

A few generalised priorities can be suggested, however. These include:

- (1) complete budgetary separation both between national and local government and between tiers of local government; where this is not in force, intergovernmental transfers being distributed directly to each level
- (2) transparent and precise procedures for the distribution of equalisation funds
- (3) more transparent arrangements for the allocation of grants for capital investment
- (4) greater local discretion in the imposition of local taxation principally through extending powers to surcharge PIT (in substitution for shares) and local setting of property tax rates
- (5) care to ensure that fiscal assignments, whether of tax shares or subsidies, are promptly and fully adjusted to reflect any national policy decisions which impose major additional costs on local budgets
- (6) incorporating the system of intergovernmental transfers and the levels of revenue sharing in permanent legislation, where this is not already the case
- (7) assigning shares of PIT to local government jurisdictions where the payers live rather than work.

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THE CHALLENGES AND OBJECTIVES  
FOR THE DEVELOPMENT OF  
EFFECTIVE DEMOCRATIC  
LOCAL GOVERNMENT



**Challenge:** Understanding local government

The vision of what local government might be is often unclear to officials and elected representatives at national, regional and local levels, and to local people themselves. A shared vision is hard to find.

Reforms are not integrated in an agreed overall strategy.

Specific Objectives
<ul style="list-style-type: none"> <li>• Strong local government should be seen as a key element in the stability and sustainable development of the region and be recognised as such by all state bodies. A national debate on the benefit of decentralised governance should be stimulated.</li> <li>• A comprehensive strategy should be developed, based on a clear definition of the role of local and regional government shared by all stakeholders (government, parliament, local authorities...).</li> </ul>

**Challenge:** Assignment of competences

Experience shows that the most frequent shortcomings of basic legislation are related to the following situations:

*Responsibilities*

- Unclear distribution of responsibilities between central, regional and local government.
- Inadequate decentralisation of functions relating to policy implementation at local level.
- Undetermined and/or unrealistic scope of local government mandatory functions.

### Specific Objectives

Specific targets are set which should guide the drafting of new legislation, including the following:

#### *Responsibilities*

- Reduce overlapping responsibilities and, whenever possible, assign exclusive competences to the local authorities;
- Increase local government responsibilities in the provision of utilities and basic social services at the local level;
- Fix clear boundaries to mandatory tasks, avoiding long lists of ‘broad’ responsibilities which are assumed to be mandatory as a whole;
- Set clear standards in service provision, which should be consistent with the resources available.

**Challenge:**      Assignment of resources

Experience shows that the most frequent shortcomings of basic legislation are related to the following situations:

#### *Resources*

- Inadequate assignment of resources by central government to local government (including property, finance, staff) resulting in unachievable mandates and poor service delivery.
- Little room for manoeuvre both in raising own revenues at the local level and in allocating available resources.
- Imbalances between local authorities in different areas and insufficient equalisation (causing great disparities in development potential and accentuating migration trends).

Specific Objectives
<p>Specific targets are set which should guide the drafting of new legislation, including the following:</p> <p><i>Resources</i></p> <ul style="list-style-type: none"> <li>• Ensure that all properties needed for the delivery of local services are transferred to local government.</li> <li>• Increase the local government share of public expenditure, consistent with their responsibilities.</li> <li>• Improve the local taxation system, especially land/property taxation, which should become a pillar of this system, and ensure the conditions for its effective enforcement.</li> <li>• Consolidate, whenever possible, earmarked grants, to increase both the room for manoeuvre and the effectiveness in the allocation of resources.</li> <li>• Increase the level of equalisation to achieve a target level [at least 80 per cent] within a given timeframe.</li> </ul>

**Challenge:**      Implementing legislation

In some countries, important changes in basic laws on local government fall short of implementation or remain ineffective because there is insufficient will at the national level and because there are inconsistencies in the legal framework.

Specific Objectives
<ul style="list-style-type: none"> <li>• Conduct an in-depth analysis of the local government legal framework to identify possible internal inconsistencies and point to changes required in basic and sectoral legislation.</li> <li>• Plan legislative reforms in a rational and comprehensive manner and back them up with timely implementation measures.</li> </ul>

**Challenge:** Professional structure for elected and appointed officials

The legal status of local elected representatives does not encourage the emergence of a local political elite.

The legal status of local government staff does not encourage a professional career.

Specific Objectives
<ul style="list-style-type: none"> <li>• Enhance the status of local elected representatives and set out clearly what is expected of them.</li> <li>• Enhance the professional status of local government staff and set out standards for their recruitment, training and promotion.</li> </ul>

**Challenge:** Relationship between state authorities and local government

Deconcentrated state administration may not support in practice the development of local self-government.

Excessive administrative supervision by central government may leave insufficient scope for local initiative or for the development of local responsibility/accountability.

Specific Objectives
<ul style="list-style-type: none"> <li>• Reassess and redesign the role of state representatives at local and regional level and the operation of state field agencies to foster joint action by public authorities and support the exercise of devolved powers by local government.</li> <li>• Ensure that supervisory mechanisms and procedures have a clear rationale and are established by law.</li> <li>• Reduce automatic control of local decisions which do not directly affect the national interest and do not entail sizeable costs.</li> </ul>

**Challenge:** Institutional dialogue

There is a lack of institutional dialogue and insufficient recognition of local government as a partner.

The national association of local authorities may not have sufficient capacity for effective dialogue with the government.

Specific Objectives
<ul style="list-style-type: none"> <li>• Facilitate the strengthening of independent national associations of local authorities.</li> <li>• Develop mechanisms of continuous dialogue to ensure full involvement of local government representatives in the reform process.</li> </ul>

**Challenge:** Transparency and accountability

Standards on transparency, accountability and public ethics are not developed.

Specific Objectives
<ul style="list-style-type: none"> <li>• Set minimum standards for transparency and communication with local communities by law.</li> <li>• Establish standards of public ethics at local level and processes for their enforcement.</li> <li>• Establish mechanisms for the participation of local people at critical points in the affairs of local authorities.</li> <li>• Develop national and local audit processes.</li> </ul>

**Challenge:** Local economic, social and environmental development

Local development affects the quality of life of local people. But local authorities may lack the necessary powers to take the action needed or they may fail to use existing powers. They may not have the vision or the initiative to see what is possible. They may lack specific expertise.

The challenge of local development requires a joint approach by the local authority and other stakeholders. But there may not be a culture of partnership.

Understanding local development begins with dialogue with local people and organisations about their needs. But communications with the local community may be weak.

### Specific Objectives

- Encourage local authorities to:
  - create local forums of senior representatives of the public, private and voluntary sectors to consider local development challenges and find shared solutions;
  - prepare local development policies and strategies, based on local needs analyses, to harness the energies of local stakeholders towards development programmes;
  - work with neighbouring local authorities and with district/regional authorities to prepare regional development strategies and programmes.
- Introduce provisions and funding mechanisms to enable local authorities to play a stronger role in local development.
- Commission guidance in local economic, social and environmental development for local authorities.
- Encourage best practice programmes and relevant training (e.g. project design and management) to help local authorities improve their approach to local development and learn from each other.
- Encourage better use of information and communications technology by local authorities to support local development.

**Challenge:** Leadership and strategic management

The longer-term vision of the community and of the role of the local authority is usually unclear.

Local officials and elected representatives are not fully engaged in the core work of their local authority.

The local authority fails to engage civil society in partnership in the development of the community.

The local authority fails to communicate effectively internally and externally.

The local authority fails to use training effectively to improve performance.

### Specific Objectives

- Work hand in hand with the national association and offer concrete political support, financial incentives and technical/logistical assistance to their initiatives designed to:
  - assess leadership and strategic management in each local authority against an agreed Benchmark as a platform for an Improvement Programme;
  - introduce a requirement that each local authority should draw up a 3–5 year Strategic Plan, and monitor its implementation through annual performance reports against annual plans;
  - Introduce models and standards for the effective management of the human resources and finance functions in every local authority;
  - Develop training and communications strategies in each local authority;
  - Facilitate the development of partnerships between local authorities and with civil society;
  - Support the development of information and communications technology in each local authority.

**Challenge:**      Service provision

The quality, quantity and accessibility of service provision vary considerably within and between countries.

Insufficient use is made of examples of good practice to promote widespread improvements.

There are few systematic programmes to deliver better performance.

National associations may not have the capacity themselves to introduce capacity-building programmes for local authorities.

### Specific Objectives

- Work hand in hand with the national association and offer concrete political support, financial incentives and technical/logistical assistance to their initiatives designed to:
  - introduce Best Practice Programmes in priority internal and external service areas;
  - explore the introduction of innovative approaches to service provision learnt from other countries;
  - introduce Fundamental Performance Reviews to identify strengths and weaknesses in particular services as a platform for service improvement;
  - introduce Performance Management Programmes for all main services with clear objectives, performance indicators and targets to guide service improvement.

#### Challenge: Training

Training is not sufficiently available to all staff and elected representatives.

Training is frequently of low quality, not focusing on priorities and failing to use interesting and interactive methodologies.

Much training investment is wasted by not making best use of existing capacity, by not building on examples of good training practice, by frequent turnover of staff, by lack of co-ordination and co-operation between training providers.

There are insufficient qualified trainers.

Training budgets are often insufficient to achieve impact.

Training is excessively supply-driven rather than demand-led.

Specific Objectives
<ul style="list-style-type: none"> <li>• Offer concrete political support, financial incentives and technical/logistical assistance to the National Association for the development of a National Training Strategy based on a comprehensive Training Needs Analysis in collaboration with all major stakeholders.</li> <li>• Contribute to the identification or establishment of the appropriate institutional arrangements for delivering the National Training Strategy.</li> <li>• Play an active role in ensuring that the National Training Strategy is used to:               <ul style="list-style-type: none"> <li>– Develop training priorities;</li> <li>– Develop standardised curricula in core topics;</li> <li>– Make arrangements for course accreditation where appropriate;</li> <li>– Assist training providers in raising their standards and co-ordinating their approach;</li> <li>– Ensure provision of sufficient qualified trainers;</li> <li>– Increase the range of training methodologies in use (e.g. use of media, best practice, etc);</li> <li>– Develop training capacity within each local authority;</li> <li>– Increase national and local resources devoted to training;</li> <li>– Ensure longer-term sustainability in the provision of training.</li> </ul> </li> </ul>

**Challenge:** Understanding of democracy and community participation

A deeper understanding of local democracy and community participation is needed among both local authorities and local people.

There are insufficient mechanisms for citizen participation and the role of civic society is undervalued.

A lack of clarity in the legislative framework and the over-regulation of certain procedures do not encourage local authorities to use existing mechanisms of community participation and hinder innovation and experimentation.

Local democracy and community participation at local level have not sufficient profile within the education programmes.

Social networks need to be developed.

The role of women and youth needs to be better recognised and enhanced.

Communication within multiethnic communities is often inadequate.

### Specific Objectives

- Prepare, in co-operation with the national association, publish and disseminate a Guide to Local Democracy, setting out the rights and obligations of local and central government and the opportunities for community participation.
- Support the organisation of local and regional forums to develop a common understanding of democratic participation among local authorities, political parties, NGOs and the media.
- Encourage local authorities to establish an active communication policy, tailored to the community's needs and expectations.
- Launch, in co-operation with the national association, targeted programmes for local authorities to promote "best practice" on citizen participation.
- Support the creation of "learning networks" of local authorities engaged in experimentation and innovation.
- Encourage local authorities to work with civil society to deliver more effective services for local people, and support those that launch initiatives to develop a common longer-term vision of the community.
- Promote civic education in schools and universities and through local cultural events in a way that fosters participation.
- Help develop and implement training programmes for citizens' groups.
- Support the more dynamic NGOs, especially those active in promoting the participation of women and youth in local politics and decision-making and in developing mutual understanding within multiethnic communities.

**Challenge:** Transfrontier co-operation

#### *Legal framework*

- The legal framework for cross-border co-operation between territorial communities or authorities is unclear or non-existent.
- The conclusion of cross-border agreements or the establishment of cross-border co-operation bodies is subject to previous authorisation by central government.
- Euroregions or similar forms of co-operation cannot work due to inadequate legal framework and funds.

*Capacity-building*

- Local authorities lack the necessary capacity for implementing cross-border co-operation initiatives and assessing their effectiveness.
- Cross-border co-operation is hampered by lack of funds for social and economic development.
- Prejudices and mutual indifference prevail between communities across the border.

*Practical arrangements*

Visa requirements and lack of adequate cross-border facilities limit the number of contacts, the volume of exchanges and the working opportunities for would-be cross-border commuters.

Specific Objectives
<ul style="list-style-type: none"> <li>• Ratify the Madrid Outline Convention on Transfrontier Co-operation.</li> <li>• Remove the legal and administrative obstacles to cross-border co-operation in accordance with the “check-list” of measures established by the Council of Europe.</li> <li>• Introduce domestic legislation to enable local authorities to conclude agreements with local authorities of neighbouring countries having similar competences and establish joint bodies, with adequate legal capacity.</li> <li>• Provide information, guidance and assistance to local authorities wishing to engage in cross-border co-operation.</li> <li>• Use National Training Strategies for local authorities’ staff and elected representatives to promote cross-border co-operation.</li> <li>• Ensure that local finance regulations and equalisation mechanisms cater for the specific needs of border areas.</li> <li>• Encourage schools, the media and youth movements to establish partnerships, exchange experiences, arrange mutual visits and present the “neighbour” in an objective way.</li> <li>• Promote the learning of the neighbour’s language in schools; enable local authorities’ staff and elected representatives to learn the neighbour’s language to help implement cross-border projects.</li> <li>• Negotiate bilateral and multilateral agreements aiming at the suppression of visas, the use of identity cards, the improvement of cross-border facilities, and the opening of the labour market to their neighbours.</li> </ul>



MEMORANDUM  
OF UNDERSTANDING

ON COMMITMENTS OF THE MINISTERS  
RESPONSIBLE FOR LOCAL GOVERNMENT  
OF SOUTH-EASTERN EUROPE



*We, the Ministers:*

- a. *Meeting in Zagreb, Croatia, on 25–26 October 2004 under the auspices of the Stability Pact for South-Eastern Europe and the Council of Europe,*
- b. *Having regard to the European Charter of Local Self-Government, opened for signature by Council of Europe member states on 15 October 1985, and to the European Outline Convention on Transfrontier Co-operation between Territorial Communities or Authorities, opened for signature by Council of Europe member states on 21 May 1980;*
- c. *Acknowledging the validity of the principle of subsidiarity, by which public responsibilities should be exercised—and public services delivered—at the level closest to the people where this is efficient and effective;*
- d. *Bearing in mind that central government has the right and the duty to create the proper framework for effective democratic local government, including (i) a sound legal basis and financial arrangements to empower local authorities, and (ii) a constructive relationship between the different levels of public authority;*
- e. *Recognising the importance of strengthening the capacity of both local and regional authorities in order that they may continually improve the leadership they give to their communities, the public services they provide to their citizens, and the opportunities they create for citizen participation in local government;*
- f. *Recalling that local people have the right to be informed, to be consulted, and to participate in decision-making in local affairs;*
- g. *Considering the critical value that civil society can bring to local governance;*
- h. *Understanding the role that local authorities can play in building bridges between communities separated by national borders;*
- i. *Recognising the diverse challenges that still face local government in South-Eastern Europe:*
  1. *Reaffirm the importance of, and our commitment to, fully implementing the principles of the European Charter of Local Self-Government;*
  2. *In order to achieve this objective, will establish Work Programmes for Better Local Government in our respective countries, preliminary drafts of which were presented at the Conference, based on the Council of Europe’s Template;*
  3. *Will finalise our respective draft Work Programmes in co-operation with the Council of Europe and other interested stakeholders, with a view to*

bringing them to the attention of the 14<sup>th</sup> Conference of European Ministers responsible for Local and Regional Government (Budapest, 24–25 February 2005), and commit ourselves to their implementation;

4. Affirm our will to work in partnership with our respective national Associations of local authorities in the implementation of our Work Programmes;
5. Agree to meet in order to assess the progress made in the implementation of our respective Work Programmes for Better Local Government in eighteen months, at a follow-up conference to be held in Skopje;
6. Welcome the assistance of national and international partners, and commit ourselves to contributing positively to any subsequent regional initiatives that promote active learning and mutual support.

Done at Zagreb, 26 October 2004

*Ben Blushi*

*Aleksandar Geštakovski*

*Borjano Krišto*

*Zoran Lončar*

*Antun Palarić*

*Slaven Pekić*

*Marius Constantin Profiroiu*

*Željko Šturanović*

*Pantelei Tiltu*

*Kristin Wambold-Liebling*

# FINAL DECLARATION



1. The Conference on “Effective Democratic Governance at Local and Regional Level” has met in Zagreb, Croatia, on 25–26 October 2004 at the invitation of the Foreign Minister of Croatia, under the auspices of the Stability Pact for South-Eastern Europe and the Council of Europe.
2. The purpose of the Conference has been to review the current state of local government in the Stability Pact beneficiary countries, to promote the drafting of Work Programmes for Better Local Government aimed at fostering local democracy, decentralisation and capacity-building, and to encourage partnership between state authorities at the central and decentralised levels and the respective associations of local authorities.
3. At the close of the Conference, the Ministers or State Secretaries responsible for Local Government of Albania, Croatia, the Federation of Bosnia and Herzegovina (Bosnia and Herzegovina), Moldova, the Republic of Montenegro (Serbia and Montenegro), the Republic of Serbia (Serbia and Montenegro), Republika Srpska (Bosnia and Herzegovina), Romania, “the former Yugoslav Republic of Macedonia” and the representative of UNMIK/ Kosovo have signed a Memorandum of Understanding committing themselves to the implementation of their respective Work Programmes for Better Local Government.
4. Representatives of States and International Organisations participating in the Stability Pact process have attended the Conference in order to express support for the reforms of local government institutions in South-Eastern Europe, reaffirm their commitment to the democratic development and further stabilisation of the region and take part in exchanges of experience and the launching of initiatives designed to sustain the reform and stabilisation process.
5. The Conference has enabled Ministers and other participants to enter into a dialogue with representatives of civil society, with the Association of Local Democracy Agencies (ALDA) and with associations of local authorities of South-Eastern European countries and their umbrella organisation, NALAS,<sup>1</sup> on their respective expectations and agendas for local government reform. The preparatory work and input of NALAS to the Conference has been highly appreciated.
6. At the close of the Conference, the participants:
  - (i) Reaffirm their belief that reinforcing democracy is a precondition for social, economic and environmental development in South-Eastern Europe;

<sup>1</sup> The Declaration presented by NALAS is appended.

- (ii) Underline that the efforts to create reliable democratic institutions must not be confined to the national level, and that democratic principles must be applied right down to the grass-roots level, taking account of the conclusions of the conference “Strengthening Local Government and Democratic Participation in a Changing World”, held in Oslo on 30 September–1 October 2004;
- (iii) Acknowledge the significant steps accomplished by all the Stability Pact beneficiary countries towards the establishment of a democratic system at local level, and the progress made towards endowing local authorities with adequate powers and resources;
- (iv) Are conscious that local government reform is an ongoing process for all countries, and that the sustainable development of effective local democratic institutions at local and regional level in South-Eastern Europe requires further efforts and renewed political commitment;
- (v) Recall the importance of transfrontier co-operation between territorial communities or authorities as a means of promoting mutual understanding and sustainable development and fostering reconciliation and stability, support already existing regional cross-border networks and welcome the proposal to establish an Adriatic Euroregion;
- (vi) Accordingly agree on the following criteria for local government reform:
  - a. The distribution of competences and resources between central, regional and local government, the relationship between the various tiers of government and the freedom of association of local authorities must conform to the principles and objectives of the European Charter of Local Self-Government, in particular providing local governments with substantial discretion in the management of local public services and an equitable distribution of the financial resources to support their effective delivery;
  - b. The development of strong institutions at national level, including representative associations of local and regional authorities, must be supported, so that they can better contribute to effective democratic local and regional government;
  - c. Dialogue and consultation between state, regional and local representatives must be institutionalised, so that the needs of local and regional government can be properly articulated and taken into account in the development of the policy, legislative and institutional framework;

- d. The capacity of the field agencies of the State to work together and collaborate with local authorities with a view to stimulating local development must be enhanced, and State representatives at local and regional level must be given a clear facilitating role to this end;
  - e. The capacity of both local and regional authorities must be developed so as to enable them to provide responsive leadership, ensure effective provision of services, promote community involvement in local and regional policy- and decision-making and engage in cross-border co-operation;
  - f. State and local authorities must engage civil society in actions aimed at developing local democracy, strengthening the cohesion and solidarity of local communities and creating a new administrative culture in the region;
- (vii) and welcome
- a. the signing by the Ministers responsible for Local Government in South-Eastern Europe of a Memorandum of Understanding with commitments to finalise and implement Work Programmes for Better Local Government;
  - b. the initiative of the associations of local authorities in the region to prepare complementary work plans designed to improve the capacity of local authorities to deliver effective democratic governance;
  - c. the intention expressed by a number of countries—through their national agencies for international development—and International Organisations to support the implementation of the Work Programmes for Better Local Government;
  - d. the readiness of the Secretary General of the Council of Europe to prepare regional initiatives that contribute to the effectiveness of the Work Programmes for Better Local Government;
- (viii) Request the Government of Croatia to report on the Zagreb Conference and the follow-up measures taken by States and International Agencies to the 14<sup>th</sup> Conference of European Ministers responsible for Local and Regional Government (Budapest, 24–25 February 2005) with a view to making the reform of local government in South-Eastern Europe a centrepiece of democratic transformation in Europe;
- (ix) Request the Stability Pact and the Council of Europe to further consider the idea of establishing regular review meetings with the participation of State, regional and local authorities;

- (x) Note the intention of “the former Yugoslav Republic of Macedonia” to convene at Skopje in eighteen months another conference to review the measures taken at both national and regional levels in order to implement the Work Programmes for Better Local Government and the regional initiatives arising out of them;
- (xi) Thank the Government of Croatia for the hospitality and excellent organisation of the Conference.

# NALAS—NETWORK OF ASSOCIATIONS OF LOCAL AUTHORITIES OF SOUTH-EAST EUROPE

*South-East Europe Regional Ministerial Conference  
Effective Democratic Governance at Local and Regional Level  
(Zagreb, 25–26 October 2004)*

## NALAS Declaration

We,  
the Associations of Local Authorities from South-East Europe gathered in the Network of Associations of Local Authorities of South-East Europe, committing ourselves to a better daily life for all citizens, a more balanced development respectful of the unity of our respective countries, and convinced that strong local government is needed for that purpose, have the honor to draw Governments' attention to the following issues regarding effective democratic governance at local level in South-East Europe (SEE):

### *Vision and Leadership*

There is a necessity for permanent dialogue between us and central governments, in order to gradually obtain a shared vision of what local government might be with the ultimate goal to promote strong local democracy.

This vision should develop into an overall and consistent strategy determining concrete actions and provisions in various fields (training, capacity building, resources, communications, partnerships, etc...).

The organisation of regular SEE Forums on local issues should be supported, with a view to developing a common understanding of local governance among central governments, political parties, local authorities, NGOs, media and other stakeholders.

NALAS proposes to receive from the governments gathered in Zagreb the mandate to explore the eventuality of writing a Guide Book to Local Democracy in South-East Europe.

### *Local Self-government*

There is a need to ensure a clear distribution of responsibilities between local, regional and national governments as well as an adequate assignment of resources.

National debates on the benefit of decentralised government should be stimulated; regular co-operation mechanisms between local and national stakeholders should be defined and organised.

We strongly encourage central governments to work hand in hand with Associations of Local Authorities and offer political support, financial incentives and technical assistance to their initiatives.

### *Legislation*

Legislation should be designed and implemented in close co-operation with the local government and their Associations in order to meet the standards contained in the European Charter of Local Self-Government. We call on all parties that have not yet signed and ratified the Charter to do so rapidly.

NALAS commits itself, under the framework of the Stability Pact for South-East Europe and of the Council of Europe, to collaborate with all central authorities involved to promote a set of regional standards of local services that can help local authorities drive up the quality of service delivery .

It is a high priority for NALAS to ensure coherent legislation regarding local self-government, to eliminate the existing inconsistencies and to clarify the competences of respective levels of government (from central to local), following the overall objective of reaching a higher degree and a better quality of decentralisation.

An improvement in decentralisation will be realised by expanding local authorities' competencies on all activities in which citizens have a direct interest and that can be efficiently dealt with at local level (principle of subsidiarity).

Local political systems, in particular local elections, should, as far as possible, not only allow citizens to elect their representatives, but also make the latter accountable to the former for their work in local parliament and government. Possibilities for local referendums, at the initiative of a group of citizens, should be expanded.

Legislation should be adequately designed to help municipalities run their community responsibly, cost-effectively, openly and in accordance with the will of the citizens. It will also have the goal to promote the participation of all citizens in local affairs including minorities or communities.

It is necessary to vest, whenever possible, the local authorities with exclusive tasks and to fix clear limits to mandatory tasks, all this being accompanied by adequate

financing distinguishing clearly respective activities and financial sources for local, regional and central authorities.

Law should enhance the status of local elected representatives and define clearly what is expected from them.

### *Transfrontier Co-operation*

Further to the existing cross border co-operation we believe that local democracy and transfrontier co-operation are strongly connected and therefore we encourage central and local governments to actively participate in relevant Programmes and we call on all parties that have not yet done so to sign and ratify the European Outline Convention on Transfrontier Co-operation between Territorial Communities or Authorities and its two Additional Protocols.

We welcome the initiative taken by the Congress and its President, to convene a meeting in Termoli on 8–9 November, with a view to creating a Euro Region of the Adriatic Sea. We also believe that such an initiative can also be taken in other geographical areas such as the Black Sea.

### *Resources*

It is important to pursue the objective of financial autonomy of local government through more fiscal decentralisation. It is thus a priority to accelerate local finance reform and fiscal decentralisation, so that municipalities can plan, implement and finance their activities on the basis of their own budget and financial resources.

Municipal ownership is obviously a big issue and it proves necessary to ensure that all properties needed for the delivery of local services are transferred to local authorities. It is essential to adapt the legislation on ownership to the standards of the European Charter of Local Self-Government.

It is the responsibility of the central government to reduce the imbalances between local governments and to improve financial equalisation.

### *Capacity*

NALAS should be backed by the International Community and donors to increase its capacity to be a qualified partner of the SEE national governments in the implementation of regional initiatives, responding to the needs of more than one country, in the field of local democratic governance.

Committing themselves to the development and implementation of their respective Work Programmes, the Associations of Local Authorities express their determination to increase their capacity to provide services to their members and to be efficient and reliable partners of their central government on local affairs, deserving both to be consulted and listened to.

National authorities should work hand in hand with independent associations of local governments, to contribute to an improvement in the quality of the services the Associations are providing to local authorities and citizens. This co-operation will benefit from adequate support, financial incentives and logistical assistance.

National authorities should co-operate with associations of local authorities in the development of a national strategy for the training of local civil servants and elected representatives, based on a careful and comprehensive evaluation of the needs in this field and incorporating extensive use of exchange of good practice as well as all possible forms of collaboration with all relevant stakeholders.

Central governments should ensure that sufficient resources are available for the training of local civil servants.

The associations of local authorities should not only be allowed to open and run their own training schools, but the certificates that these schools deliver should also be fully recognised by the national authorities.

Since it affects the quality of life of local people, local sustainable development should be considered as a national priority. In collaboration with the associations of local authorities, all possible measures and incentives should be examined to enhance the role of local authorities in local development and improve their relations with enterprises and potential investors.

NALAS commits itself to collaborating with all central authorities involved to promote a set of standards of local services that can help local authorities drive up the quality of service delivery .

### *Partnerships*

A comprehensive national decentralisation strategy should make all possible room for dynamic partnerships between all stakeholders (including local citizens/civil society), and be based on a clear definition of their respective roles.

Satisfying mechanisms of on-going dialogue should be developed between central government, local authorities and their associations in all matters dealing with local affairs and local reforms in accordance with article 4, paragraph 6 of the European Charter of Local Self Government .

It is up to local authorities to enhance citizens' participation, especially that of women and youth. The associations are fully committed to assisting them to perform

that task. It is up to the central authorities to establish the adequate framework and mechanisms to favour and develop citizens' participation.

### *Transparency*

Transparency and accountability should be core objectives of local government reform and fiscal decentralisation.

National law should set standards for transparency, communication and accountability. This effort of transparency will also concern the allocation of funds to the local authorities by the central government. Such allocation should correspond to a limited number of criteria clearly defined by national legislation.

Since it is also often a priority to fight corruption and increase transparency and accountability at local level, we underline the necessity of ensuring a real implementation of the European Code of Conduct on the political integrity of local and regional elected representatives, adopted by the Congress of Local and Regional Authorities of the Council of Europe in 1999.

Transparency requires equal treatment of all local authorities regardless of their political affiliation, and excludes political or financial pressure exerted on them based on discretionary power.

**We invite the Ministers responsible for Local Self-Government, who signed the Memorandum of Understanding at the Zagreb Ministerial Conference in Zagreb on 26 October, to closely co-operate with the Associations of Local Authorities in controlling and evaluating the implementation of the Work Programmes for Better Local Government and to adopt a 10 year Programme for decentralising public powers in SE Europe. This Programme should be implemented by each country and monitored by annual conferences jointly promoted by the Ministers and NALAS.**



## CONTRIBUTING AUTHORS

**Kenneth Davey** is the Chairman of the LGI Steering Committee. He is a Professor Emeritus in the School of Public Policy at the University of Birmingham, of which he was the first Head, having previously been Director of one of its constituents, the Institute of Local Government Studies.

He received his MA at the University of Oxford and served for fifteen years in the British Overseas Civil Service, specialising in local government finance. Since joining the University of Birmingham in 1972 he has worked as a consultant on local government finance and management in 25 countries for the World Bank, British technical assistance and other donors.

During the last decade Ken Davey has worked almost continuously on local government reform in central and eastern Europe, directing British Know How Fund programmes in Czech Republic, Hungary and Slovakia, and currently advising the Ukraine Government on fiscal decentralisation. He initiated the creation of the Local Government Policy Partnership, a comparative policy research programme which is jointly funded by LGI and the Know How Fund.

**G rard Marcou** is Professor in public law at the University Paris 1 Panth on-Sorbonne where he teaches law, local government and comparative public law. He is currently Director of GRALE (Groupement de Recherche sur l'administration locale en Europe) and former Director of CERAPS (Centre d'Etudes et de recherches administratives, politiques et sociales). In addition to his many other functions, he is a member of the scientific council of his university and the director of Pr p'ENA Sorbonne, a post-graduate training course to the entry examination of the Ecole Nationale d'Administration. He is also honorary Professor at the University of Birmingham (UK).

His expertise includes administrative and constitutional law, local authority budgetary and financial law, administrative science, European integration, regional planning and transfrontier co-operation. His work crosses international borders including Germany, the United Kingdom, Spain, Italy, central and eastern Europe (Poland, Czech Republic, Hungary, Slovakia, the Russian Federation and Ukraine). A prolific writer, G rard Marcou has written numerous articles and publications for the French government and major international organisations, including the United Nations, the World Bank, the European Commission, the OECD, the OSCE and the Council of Europe.





This publication contains the main reports and documents of the South-Eastern Europe Regional Ministerial Conference on Effective Democratic Governance at Local and Regional Level held in Zagreb, Croatia, on 25–26 October 2004. The Conference was a joint initiative of the Council of Europe and the Stability Pact for South-Eastern Europe, held at the invitation of the government of Croatia.

The Conference brought together the Ministers responsible for local government in the Stability Pact countries. Other countries, international agencies and organisations involved in the Stability Pact process also attended.

Its purpose was to review the current state of local government in the Stability Pact beneficiary countries, to promote the drafting of Work Programmes for Better Local Government aimed at fostering local democracy, decentralisation and capacity-building, and to encourage partnerships between state authorities at the central and decentralised levels and the respective associations of local authorities.

The Conference resulted in Ministerial commitments to local government reform based on Work Programmes setting out priorities for action. It also led to constructive dialogue between Ministries, Associations of Local Authorities and the donor community.



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