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The impact of the economic crisis on local and regional authorities in Europe

Report¹

Committee on Social Affairs, Health and Sustainable Development
Rapporteur: Sir Alan MEALE, United Kingdom, Socialist Group

Summary

In the face of the economic crisis, the resources of local and regional authorities across Europe are affected by both diminishing tax revenues and intergovernmental transfers, whilst the demand for local services is on the increase. There is a need for comprehensive and innovative approaches to help local and regional authorities to overcome the crisis and make their finances more resilient to future crisis situations. Policies should be based on partnerships between public, private and associative stakeholders, and aimed at maintaining quality public services for all categories of society, in particular groups in need of special protection, such as children, the elderly or people with disabilities.

The Parliamentary Assembly should call upon member States to initiate relevant national reform processes and provide them with guidance concerning the principles to be followed. Through their legislative and fiscal frameworks, governments should ensure a certain discretion for local and regional authorities in setting local tax bases and rates, whilst maintaining a balanced mix in financing local budgets. The effectiveness and efficiency of local service provision should be improved. All relevant programmes at national level should be supported by a co-ordinated approach and regular exchanges of good practice at European level.

1. Reference to committee: [Doc. 11903](#), Reference 3623 of 20 November 2009.



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A. Draft resolution²

1. The current economic crisis is having a deep impact on local and regional authorities in Europe. Many of them are affected by important reductions in both direct revenue and resources made available through national budgets, while the demand for public services is growing with tight economic situations generating a loss of income and various related difficulties for households.
2. The Parliamentary Assembly is deeply concerned about the significant social problems caused by the crisis and the reduction of social welfare programmes, the impact on the provision of quality public services and lower investment levels in strategic policy areas, such as education and health and those social services which are linked to the well-being of vulnerable people.
3. The Assembly believes that local and regional authorities themselves need to be part of the contribution towards stimulating economic recovery, as a source for future revenue, and to be enabled to do so. In this context, the Assembly stresses the importance of partnerships between local government, businesses, educational and research institutions, as well as civil society organisations in countering social inequalities and caring for groups in need of special protection, such as children, the elderly and people with learning difficulties or disabilities.
4. Fundamental social rights need to be protected when deciding on local budget allocation or the intergovernmental transfer of resources to local and regional authorities. Moreover, local and regional budgets need to be adapted in times of economic crisis, when authorities face greater responsibilities in providing services and assistance to households in need, in accordance with Article 9 of the European Charter of Local Self-Government (ETS No. 122).
5. In view of the above, the Assembly calls on member States of the Council of Europe to ensure that national reforms for local and regional finances are developed in a transparent way and with the participation of the local and regional authorities themselves. Such reforms should pursue the following objectives in order to ensure sustainability of local and regional finances to enhance their ability to provide quality services to their citizens:
 - 5.1. as regards the legislative and fiscal framework:
 - 5.1.1. reducing the dependence of local budgets on highly volatile tax bases such as corporate profits and property transactions;
 - 5.1.2. where appropriate, extending access to taxes on personal income to create a more sustainable local tax base;
 - 5.1.3. enhancing local governments' discretion to set the bases and rates of local taxes and charges;
 - 5.1.4. avoiding disproportionate cuts in intergovernmental transfers to local authorities, and cuts undertaken at unreasonably short notice or concerning discretionary services such as community based organisations which are important for maintaining social cohesion;
 - 5.1.5. generally supporting the maintenance of a balanced mix of local taxes and intergovernmental transfers to finance local budgets;
 - 5.1.6. removing legal requirements which impose expensive service provision;
 - 5.2. as regards the effectiveness and efficiency of local service provision:
 - 5.2.1. promoting the targeting of social benefits to ensure that groups in need of special protection receive adequate assistance, including the possibility of means testing subsidies and benefits, and supporting community and home-based care for the sick and the elderly, so as to relieve some of the pressure on care institutions;
 - 5.2.2. supporting the reorganisation of authorities in charge of service provision with a view to maintaining services whilst reducing administrative expenditures;
 - 5.2.3. promoting inter-municipal co-operation, wherever appropriate, to make the delivery of local services more effective and efficient;

2. Draft resolution adopted by the committee on 25 April 2012.

- 5.2.4. promoting the use of various forms of partnerships, including public-private partnerships and involvement of the voluntary sector, to redesign public service provision and delivery without reducing the accountability of public authorities;
- 5.2.5. encouraging local authorities to optimise the effectiveness and efficiency of service provision, not least through relevant training of staff, whilst guaranteeing equal access for all sectors of the population;
- 5.2.6. promoting the efforts already made by many local governments to reduce employment costs by means other than redundancies;
- 5.2.7. promoting the principles of transparency and efficiency in public spending at all levels;
- 5.3. as regards European co-operation in this field:
 - 5.3.1. promoting further exchange of good practice at European level in order to share mutually beneficial expertise;
 - 5.3.2. making use of the “Kyiv Guidelines”, agreed by the Council of Europe Conference of Ministers responsible for Local and Regional Government at its 17th session in Kyiv in November 2011, as a central reference, and promoting their implementation among member States of the Council of Europe;
 - 5.3.3. at Council of Europe level, following a common agenda agreed between the Committee of Ministers and the Congress of Local and Regional Authorities, as proposed by the Spanish Minister of Territorial Policy and Public Administration, Mr Manuel Chaves, in his report to the Ministerial Conference in Kyiv.

B. Explanatory memorandum by Sir Alan Meale, rapporteur

1. Introduction

1. In 2009, at the peak of the economic crisis, real gross domestic product (GDP) in the European Union fell by 4.3%. The same year saw overall unemployment rise to an average level of 10.2%. According to Eurostat, a slow recovery pattern began to emerge in 2010 with GDP growth of 2% for the 27 countries of the European Union. However, the growth rate declined again to 1.5% in 2011 and was predicted to remain at 0% in 2012, with new real growth only expected for 2013.³ Unfortunately, whilst the financial and economic crisis began receding to a greater or lesser extent, it then turned into a so-called sovereign debt crisis, a situation which today still overshadows Europe's politics and economic development.

2. These developments have negative consequences for local and regional authorities' budgets and for the public services they are supposed to provide. For instance, the latter often align their local tax base too closely on the economic situation of local companies. Such practices can, in periods of slowdown, cause economic turmoil, especially when they occur at times of actual cuts in transfers of finances from national budgets, which often puts at risk the delivery of quality public services and strains social welfare budgets.

3. Important references in this respect are the revised European Social Charter (ETS No. 163), which includes provisions concerning social security and social welfare services, decent living standards, free primary and secondary education, or adequate housing, and the European Charter of Local Self-Government (ETS No. 122), which provides under Article 9 (paragraph 2) that local authorities shall be entitled to adequate financial resources of their own which shall be commensurate with the responsibilities provided for by the constitution and the law.

4. The precise effect of the economic crisis on local and regional finances in individual countries needs to be examined more closely. The question is what new methods or systems have been or can be introduced nationally and locally to first alleviate, then relieve, such fiscal stress, whilst, in the long term, strengthening the capacity of local authorities to respond to the crisis.⁴ This report focuses in particular on local authorities which are the government level closest to the citizen and which are responsible for the provision of various services.

2. Determinants of local budget situations

5. Local government revenues have declined in real terms in many European countries which provided data for 2009-10, for example by 19.7% in Bulgaria, 13.1% in Germany and 11.3% in Ireland.⁵ The different determinants of local budget situations are described in the following chapters. What form intergovernmental actions and decisions in response to the Europe-wide downturn will take is not yet known or fully understood. It is, however, certain that some of the austerity measures applied by European governments since 2009 have had an immediate impact on the budgetary situations of local and regional authorities, some of which are illustrated below. It is generally expected that the overall economic prospects will continue to put local and regional budgets under pressure, even more so under some of the governmental austerity policies which were pursued or even reinforced in 2011.⁶

6. Large parts of the following analysis and recommendations also apply to the situation of regional authorities which are as much affected by the economic crisis as the local level. However, their nature and role within national political and administrative systems vary greatly across Europe. Addressing the specific

3. Eurostat data: "Real GDP growth rate – Volume, percentage change on previous year" (data retrieved on 11 April 2012, last update on 2 April 2012), <http://epp.eurostat.ec.europa.eu>.

4. The rapporteur thanks in particular Mr Kenneth Davey, British expert on local government reform, former Professor of the School of Public Policy at the University of Birmingham and former associate and researcher of the Local Government Initiative (LGI), Open Society Institute (operational until December 2011), for his substantial contribution to the preparation of this report.

5. Based on a specific European survey amongst Council of Europe member States undertaken by the intergovernmental sector of the Council of Europe with the assistance of the expert mentioned in the previous footnote. The results of this survey have, amongst others, been edited under: "Local government in critical times – Policies for crisis, recovery and a sustainable future", Council of Europe texts 2011, edited by Kenneth Davey, Strasbourg, February 2012.

6. The rapporteur also thanks Mr André Boulanger, Director of the Research Department, and Ms Isabelle Chatrue, Head of the International Studies Unit, of Dexia Crédit Local for a very fruitful exchange of views on 23 March 2012 in Paris.

situation of different regional authorities would therefore exceed the limits of the current report. Nevertheless, according to a survey undertaken by the Assembly of European Regions (AER), regional authorities consider themselves as being of “great importance for European countries in fighting the economic crisis”.⁷

7. In February 2012, the European Commission President, Mr José Manuel Barroso, speaking to the Committee of the Regions (CoR), stressed the importance of involving regions and cities in current European Union initiatives, such as those in favour of youth employment and the development of small and medium-sized enterprises (SME), and called on national governments to define tailored approaches with regional and local authorities.⁸ It can certainly be said that any action undertaken by regional governments in favour of economic recovery and growth could also have positive effects on the situation of local governments.

2.1. Revenue assignment

8. According to figures provided by Dexia in 2011, own-source and shared tax revenue, being the second largest source of revenue for the sub-national public sector, continued to drop by 1.5%, after a previous drop of 4.3% in 2009, a year in which the economic crisis and counter-cyclical tax measures made their full impact felt. In 2010, revenues continued to slightly decline by 0.8%, and drops were in particular recorded in several European Union countries, such as Germany, Luxembourg, Spain and the United Kingdom, whilst only few countries saw a rise in tax revenue (such as Belgium, Denmark, Italy, Finland and France).⁹

9. The recession has heightened ongoing concerns about the impact of local taxes on business enterprises. This has a number of facets. For instance, if any local authority had based its charges on business profits or turnover, it may have been highly vulnerable to the general economic downturn, causing volatility to budgets, which retain the role of funding recurrent commitments such as teachers' salaries or road maintenance. It is therefore important to realise that under such economic conditions, businesses may consider such fiscal charges and obligations as being intolerable burdens imposed by local politicians without consideration of the consequences.

10. Such views have long followed the French *taxe professionnelle*, the country's largest local tax source. It was therefore inevitable that the current recession renewed business pressure for its repeal and the end of a tax charge based primarily upon asset rental values. In this case, it ultimately led to its substitution by the *cotisation économique territoriale* (CET), which incorporated value added into its assessment base. This change caused a fundamental shift in power away from local government, with the result of business rates now being set nationally. This represents yet another significant change in local budget situations at a time when social cohesion costs rapidly increased.

11. There are many other local taxes on businesses which have been effectively abolished or restricted to ease fiscal burdens to allow them to survive during the recessionary period. For example, local taxes on sales periods and other products such as boats will disappear in Estonia by 2012. Similarly, Irish municipalities have largely observed national pleas for restraint in property rates. The powers of Slovak municipalities to set business property tax rates have been severely restricted, as have Albanian local authorities' powers to vary rates of small business taxation.

12. Set against this, there have, of course, been some increases in local revenue sources during this recessionary period. For example, in Finland, municipal shares of corporate tax yields have risen to 32%. Moldova's motor vehicle tax rate has risen by 30%. Some 54 Croatian local authorities have used enhanced powers to surcharge personal income tax. A municipal property tax is soon to be levied in Ukraine. Irish councils have been given the right to tax second homes and a general property tax was introduced in January 2012. Finally, the United Kingdom Government has announced its intention to restore the right of local authorities to retain a portion of the property tax they collect from businesses, which at present is merely redistributed on a national per capita basis.

13. Generally speaking, the only local revenue that has seen an overall increase by 2% in 2010 is the one linked to local public service provision, representing a share of 12% of local authorities' revenues, thanks to the increase of service tariffs and the creation of new charges.¹⁰

7. Assembly of European Regions (AER): “European regions: a trump in tackling the economic crisis”, the Fribourg Declaration, adopted by the AER Bureau on 15 May 2009, www.aer.org.

8. Committee of the Regions: “Barroso: out of the crisis through solidarity and responsibility, together with the European regions”, press release, 17 February 2012, www.cor.europa.eu.

9. Dexia Crédit Local: “Subnational public finance in the European Union”, Paris, July 2011.

10. Dexia Crédit Local: “Finances locales en France – Grandes tendances 2011” [Local finances in France – General trends 2011], Paris, November 2011.

2.2. Expenditure assignments

14. Whilst the recession has not given rise to comparable changes in expenditure assignments, Romania has proved the exception, where responsibility for the large majority of their hospitals has been devolved. The State has, however, in contrast, taken over complete funding of social assistance payments. Yet another exception is Iceland, where municipalities have recently taken over the care of its disabled population.

2.3. Intergovernmental transfers

15. In almost all countries, national government revenues have been affected more severely than local authorities; this period quickly worsened with many governments continuing to find themselves unable to either service or even roll over sovereign debt or adequately fund local authorities. Once again, figures gathered by Dexia indicate that grants and subsidies, being the leading source of revenue for the sub-national public sector, dropped by 1% in 2010. This represented a turnaround from 2009 where governments had set up substantial aid measures for local authorities as part of stimulus plans. In 2010, budget-cutting measures taken by central governments motivated by the public finance crisis led many of them to reduce or freeze their transfers to the sub-national sector.¹¹

16. In addition, some governments found themselves unable to resist the temptation to reduce transfers. One example of this being Serbia, where in 2010 the parliament amended legislation indexing grants to their national budget so that municipalities with above average per capita revenues received less than they would otherwise have been due, for at least one year. Also last year, the Bulgarian Government withheld 15% of the grant for delegated functions halfway through the year. For the rapporteur's own country, the United Kingdom, the government's efforts to reduce their structural public finance deficits are said to represent in some cases cuts in grants which would reach 12% per annum by 2015.

17. In contrast, some other governments have been more sympathetic to local budgets, with Austria, Germany, Norway and Spain all providing short-term funding for small-scale investments designed in particular to keep their construction industries in business. Several countries, including Albania, Denmark, Finland, Norway, Poland, the Slovak Republic and Sweden increased general purpose transfers temporarily to compensate local authorities for the decline in their tax revenues.

18. However, by 2011, serious doubts developed over a number of nations' ability to service or roll over sovereign debt, which led to grant restraint in countries such as Greece, Ireland, Italy, Portugal and Spain. Thus causing deliberate and longer term reductions in transfers in some other countries, such as Romania and the United Kingdom, which made serious efforts to reduce their structural public finance deficits. In the United Kingdom, these represented, in some cases, cuts in grants which will reach 12% per annum by 2015. Thus bearing out the Organisation for Economic Co-operation and Development's (OECD) findings that the financial consequences of recession are felt most severely by local budgets once economic recovery has begun, when national governments try to repair the damage to their overall public finances.

2.4. Revenue performance

19. The effect of the recession on local budgets reflects at least four factors:

- the severity of the downturn;
- the parallel fortunes and responses of national government;
- time lags due to the taxation system;
- the nature of the local revenue base and its vulnerability to economic change.

20. According to the OECD, revenue from property taxes has been the least affected by previous economic downturns, personal income taxes moderately vulnerable, taxation of business turnover more responsive, with corporate profits being the worst affected.

21. Dramatic falls in housing values might have been expected to affect revenues from local taxes on property, it being the most common local tax source in Europe. However, in most European countries, property taxation is generally based on formula valuations that are updated very infrequently, which subsequently robs the tax of buoyancy when times are good, but provides welcome stability during economic downturns.

11. Dexia Crédit Local: "Subnational public finance in the European Union", Paris, July 2011.

22. For instance, in the United Kingdom, revenue from the residential property Council Tax has continued to rise by £1 billion in each of the last four years, and most other countries also report a rise in property and land tax yields (for example, in 2009, 25% in Ukraine, 28% in Russia and 23% in the Czech Republic).

23. Property tax receipts are particularly vulnerable in times of recession, which cause negative pressures, particularly from business owners. For instance, default reduced Greek yields by 19.5% in 2009, rural municipalities in Poland granted 32% more individual rate concessions in 2009. However, in both France and the United Kingdom, incapacity to pay the tax is effectively compensated by the government's hidden subsidies as a response to economic distress.

24. In contrast, local taxes on property sales in many countries have fallen instantly and dramatically. Previously worth over €8 billion annually in France, their decline has been a particular blow to the *départements* (who are also faced with the major costs of social assistance).

25. Access by local government to personal income taxation varies across Europe, as does its mechanisms – whether by sharing with national government or local surcharge, assigned by origin (place of residence or employment) or by formula. However, regardless of method, where such access exists the revenue is highly significant to local budgets (70% of total local revenue in Ukraine, 50% in Estonia). Personal income tax is also a major resource for large local governments in the Nordic countries, central Europe and Switzerland.

26. Rising unemployment obviously hits personal income tax revenues, and those still in a job may earn less through cuts in hours, bonuses or even wage rates. For example, Slovakian local government revenue from personal income tax grew by 47% over the four years preceding the crisis, but declined by 25% in real terms in 2009 and 2010. Some countries have also reduced rates in an attempt to boost consumption; maximum rates in Poland had already fallen from 40% to 32%, and taxable income thresholds have been raised in Hungary. Most dramatically in Ukraine, where personal income tax accrues entirely to *oblast*, city and *rayon* budgets, revenues have fallen over the last year by over 20% in real terms largely due to wage arrears.

27. Similarly, local taxes on business profits or turnover are isolated and idiosyncratic, with victims often accused of distorting competition in a global marketplace. These taxes are also highly vulnerable to economic recession. German local governments are reporting major declines in the *Gewerbesteuer* (a local tax based on company profits), losses reflected in major increases in municipal overdrafts with local savings banks. Similarly, the Hungarian Business Tax, levied retrospectively on turnover, has shown the effects of downturn mainly in 2010. Czech municipalities experienced a 27% fall in corporate profits tax shares in 2009. Polish regions received 14.3% less than in 2009. Portugal reports a reduction in municipal contributions (a surcharge on corporate profits tax). Russian regions also suffered the biggest drop in corporate profits tax revenues in 2009, amounting to 70%.

28. Value added taxation is widely shared with local governments in South-Eastern Europe as compensation for the abolition of the local sales taxes, prevalent in the former Yugoslavia. Its yields are directly related to volumes and values of production and commerce, and are therefore highly vulnerable to their decline. Such shares represent half of the municipal revenue in Bosnia and yields declined by 17.5% in 2009 in Republika Srpska.

29. On the other hand, impacts on revenue from fees and charges are less clear since they are divided between the budgets of local authorities and their utility companies. Reductions of income from building permits and other development charges have been widely reported, particularly in the United Kingdom. Falls in water supply, sewerage, heating and refuse collection charges have been reported in Latvia, while in Ukraine only 60% of households are actually meeting utility charges.

2.5. Revenue balance

30. Fiscal federalists (predominantly North American) often attribute great advantage to local fiscal autonomy measured by the degree of local budget reliance on revenues levied and collected by local governments themselves. This has not been borne out by recent European experience. Local budgets financed principally by either local taxes or intergovernmental transfers have suffered considerably greater losses than those funded by a balanced mix of these sources. The vulnerability of individual taxes and transfers both to economic shocks and changing policies varies so much from State to State and source to source, that a balanced mix is often much safer.

31. Needless to say the recession has provoked debate in many countries on the necessity of reform of local tax on business profits. In some countries, the decisions were taken to abolish local taxes on some businesses to ease fiscal burdens. Nevertheless, in some European countries there have been increases in local revenue sources. As national government revenues were affected at first by the crisis, many countries reduced transfers to municipalities. The European experience has shown that a balanced mix of financing of local budgets by local taxes and intergovernmental transfers is much more reliable during the crisis period.

3. Cutting costs

32. Making the most of more limited resources is an ongoing challenge. Reports reveal many attempts to improve the efficiency and effectiveness of local government expenditure.

33. Comprehensive approaches – top-down, bottom-up – have been undertaken by two of the countries most severely affected by the recession, Ireland and Iceland. The Irish Government has orchestrated root and branch reforms including scale economies through reallocation and sharing of service provision and administrative processes, efficiency savings based on benchmarking worth €500 million, wage cuts, recruitment freezes, and crackdowns on tax evasion. The City of Reykjavik, faced with a 20% revenue loss over two years, imposed progressive wage cuts on senior staff, a recruitment freeze, 300 efficiency improvements based on Internet suggestions by staff, and co-operation with commercial and voluntary bodies.

34. In many countries, a strong decrease in local investment (representing about 15% of local expenses) was observed in 2010, notably concerning subsidies to third parties and expenses linked to local equipment: direct investment in particular, representing more than 60% of public investment at local level, fell by 7.2% whilst it had still been stimulated in 2009 for the purpose of fostering economic recovery.¹² Nevertheless, despite a context of continuous economic crisis and budgetary constraints, the first positive signs could be seen in 2011 when local investment started increasing again. This evolution is much welcomed by many experts who consider that local authorities, even in uncertain economic situations, must continue to make investments which are important for the long-term development of their communities.

35. Other methods of tightening belts have been widespread, but sporadic and rarely strategic. Some of them are categorised below.

3.1. Employment

36. The recession has meant some drastic reductions in staff and salaries. Irish local authorities have shed 6 000 jobs over the last three years; Danish municipal establishments were cut by 2.6% in 2009. The Ukrainian Government has set a target of cutting public sector employment by 20% overall. In many countries, these trends affect women more heavily than men, given that they account for higher percentages of public sector employment (two thirds in the United Kingdom) and also rely to a greater extent on public services and financial assistance. Because they are poorer and live longer than men, women will also be disproportionately affected by reductions in services to the elderly.¹³

37. Since 2009, recruitment freezes have been widespread. For instance, Serbia legislated to impose a ceiling of four municipal staff per 1 000 inhabitants; a number of municipalities have evaded this by making staff redundant and then outsourcing their former duties to them.

38. Many other States or individual authorities have tried to avoid redundancies, partly because of the cost of compensation and partly to avoid making the recession worse. Alternatives of pay freezes or cuts have been widely adopted. Pay in Estonia and Latvia is down by 15%, and in Spain by 5%. The Greek Government has cut both pay and bonuses, while Hungary withheld 13th month payments in both 2009 and 2010, except for the lowest paid staff. The same progressive approach has been adopted in Portugal where cuts have been imposed on all staff earning more than €1 500, the size of the cut rising with salary up to a maximum of 10%. Czech municipalities were also set a financial target for retrenchment with the option of cutting pay or numbers. Latvia has not cut numbers but has instead reduced the working week to four days, while Icelandic municipalities have cut both hours and overtime.

12. Dexia Crédit Local: "Finances locales en France – Grandes tendances 2011" [Local finances in France – General trends 2011], Paris, November 2011.

13. Beth Gardiner: "British women bearing the brunt. Cuts in public services and benefits hit them disproportionately hard", *International Herald Tribune*, 7 March 2012.

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

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

3.2. Cost control

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

42. Such temporary or one-off savings do not greatly affect longer term efficiency, which require more fundamental examination of the practical ways in which services are run, the subject of "value for money" approaches and performance audit systems developed over the last three decades being examples of this.

43. The Council of Europe has for some time been helping to develop performance management capacity in a number of countries such as Bulgaria, the Russian Federation and Serbia, and in particular has encouraged the development of French initiatives.

44. A key to many service cost savings has been computerisation. For example, from 2012 public applications to Danish municipalities will have to be online. A further example is the United Kingdom, where public library users record books borrowed and returned on the library terminal.

45. A less formal approach to curbing excessive costs has been adopted by a variety of local governments from Greece to the United Kingdom, which publish details of all items of expenditure over a fixed limit on the Internet for scrutiny by zealous media. Slovak municipalities are also now compelled to conduct procurement by online auctioning (which have resulted in price reductions estimated at 50%).

46. The economic crisis has forced all countries to tighten their belts using different methods of cost cutting: from reduction of staff and salaries to pay freezes. The revision of pension rights with the aim of increasing the level of contribution to pension funds and the age of retirement has also been considered in many countries as a way to save costs for public budgets. The current financial downturn also emphasises the need for the development of performance management capacity. Many local administrations have now started to use computerisation for cost savings of local budgets.

47. Finally, the mechanisms of financial monitoring, the obligation for transparency and communication, as well as the standards for budgetary discipline which are imposed on local authorities in a given national context, are expected to be reinforced across Europe. In this respect, a modern governance of public finances must better co-ordinate national and local policies and associate local authorities wherever they are concerned by national reform programmes or austerity measures.¹⁴

4. Social responsibilities

48. Local government's social responsibilities are under both short and long-term pressure, which has been estimated as an area of expenditure which will keep on growing.

14. Dexia Crédit Local: "Finances locales en France – Grandes tendances 2011" [Local finances in France – General trends 2011], Paris, November 2011.

49. Brought on by a mortgage market crisis, recession has left a legacy of unemployment, homelessness and declining household income. The demands these make on local budgets vary greatly between European States according to the distribution of responsibility between central government, social security funds and local authorities for safety-net benefits and housing subsidies. Depending on country systems, local government may bear some of the extra costs of:

- housing and utility allowances;
- safety-net payments to the long-term unemployed and others eligible for minimum income guarantees;
- emergency aid to families in advance of awards of State benefits.

50. In 2010, such costs to local budgets rose by 10% in Denmark, 22% in Hungary and 24.5% in the Slovak Republic.

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

4.1. Targeting benefits

52. Local government can mitigate such costs by targeting more of the benefits to low income households.

53. Currently, in many Council of Europe member States, social benefits are frequently distributed without regard to financial circumstances. For instance, all British pensioners automatically receive a winter fuel allowance of £200, without application. In Lithuania, 64% of social assistance expenditure is on universal benefits, notably child allowances. In the countries of the former Soviet Union, numerous allowances or free services are provided to various categories of “veteran” (of war, labour, natural catastrophes, etc.).

54. The current crisis has begun to promote efforts to target benefits more precisely. For instance, some Romanian cities, including Bucharest, have abolished subsidies to heating companies, replacing them with means-tested subsidies to individual consumers. Chişinău has started to means test public transport subsidies.

4.2. Community care

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

56. However, helping elderly people stay longer in their own homes requires greater support to family and voluntary carers. In several countries, the elderly are now eligible for cash allowances towards the costs of daily living, which are graduated by degrees of dependence, but can be flexibly used to buy support most needed from anyone able to provide it. Public funds can reimburse a range of financial costs from the loss of earnings by a relative who has to cut hours to provide care, to the petrol expenses of taking a neighbour to the clinic or supermarket.

4.3. Rationalising service provision

57. The present crisis has encouraged a cut in underutilised service institutions. Bulgaria, Hungary, the Republic of Moldova, Romania and the United Kingdom all report such measures, with small rural schools the most common target. In many cases, the recession has provided the opportunity to introduce changes provoked by demographic change.

58. For example, in a number of countries, such as Hungary and Ukraine, the responsibility for residential care for the elderly and infirm and hospital care lie with upper tiers of local government, while the municipalities provide domiciliary and primary health care. The funding of the upper tier service may well be based on formulae including the numbers housed or treated. These arrangements may well provide strong incentives to place social service clients in residential homes or patients in hospitals when it may be neither the most appropriate nor sympathetic response to their needs. In most cases, it is the more expensive solution.

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

60. Local authorities who would like to cut costs are frequently debarred by national regulation. This applies particularly in countries which distinguish between the “autonomous” and “delegated” tasks of local government and place the more expensive services like education, social services and health care in the latter category.

61. Delegated services are often regulated by detailed standards of provision and local government management is subject to close supervision by sectoral ministries. These norms typically govern inputs, rather than outcomes. Ukrainian local governments cannot close grossly underutilised schools or social and cultural institutions without the permission of national ministries, and this is frequently withheld. Such institutions may well no longer be frequented due to changes in population or public preference.

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

4.4. Shared social responsibility

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

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

65. This can be unfortunate if the principal beneficiaries of such services are the more vulnerable households. Early childhood development programmes prepare children from low income or migrant families for formal education. Kindergartens and after-school clubs enable low-income mothers to ensure their families' income. Third-sector partners provide a lot of care for the disabled. Giving priority to the support of public employees and mandatory services can have damaging repercussions for the needs of the most vulnerable and for social cohesion, dangers to which the Commissioner for Human Rights drew graphic attention at the International Conference on Local Government: Responses to Recession Across Europe (Strasbourg, 11 October 2010).

66. Local governments bear the main responsibility for providing social services, especially housing, health and childcare and aid to those on a low income. In a situation of recession, local governments should give increasing priority to targeting social benefits to the needs of the low-income population. It is important to avoid any cuts in local budget expenditures on early childhood development or support to community care. Partnership between local government, private and social enterprise and voluntary organisations is essential in addressing social deprivation and promoting social cohesion.

5. Promoting economic recovery

67. If experience from recessions in the 1980s and 1990s encouraged expectations that local governments would lead effective partnerships with business and civil society in promoting economic recovery, it is not to be expected today.

68. Capital is harder to mobilise, with banks seeking to rebuild their own reserves and avoid risks. Budget squeezes have depleted the operating surplus with which many municipalities invested in new infrastructure. Neglect of technical education has frequently led to a shortage of relevant skills, such as the engineering capacity needed to develop renewable energy. In addition, competition is now global.

69. The property market boom which favoured urban regeneration projects has collapsed. Rising fuel prices are challenging the economics of moving everything from electronic components to Mother's Day flowers halfway around the world. Some Green movements argue that local strategies should focus on restoring self-sufficiency rather than on distribution "parks" close to motorways.

70. Not every aftermath of recession is negative. For example, interest rates are low and construction prices competitive. For new member States and candidate countries, the 2007-13 flow of European Union investment funds came on stream just when other sources were drying up. Difficulties in providing pre-finance and matching funds have been widely overcome.

6. Prospects

71. In view of the above, we may consider that local government faces four longer term challenges:

- the growing demand for care of the elderly;
- threats to social cohesion exacerbated by the recent recession;
- the costs of an over-elaborate structure;
- the need to rediscover and foster local economic advantage in an age of globalised competition and rising energy costs.

7. Conclusions and recommendations

7.1. Conclusions

72. The situation of local and regional authorities has become critical in recent years as they are directly in the front line on local issues, such as business closures, unemployment and social problems.

73. There are clearly several countries, chiefly in Scandinavia and central Europe, where economic recovery is well under way and local government finances are back on track. Sadly, this picture is far from universal. There are other States which are still in recession or desperate to sustain their sovereign debt and there is a third category of States like Romania and the United Kingdom with a strategic policy of achieving a long-term reduction in public sector deficits which involve cutting transfers.

74. Local self-government has been affected in conflicting ways. On the one hand, fiscal policy has generally reduced local determination of tax levels. On the other, national regulation of expenditures has been partially relaxed in many but not all countries, simply because national governments cannot fund new mandates and do not claim to know what is best for local authorities to do in times of financial hardship.

75. It must also be recognised that local and regional authorities act as seedbeds for job creation activities.

7.2. Recommendations

76. Accordingly, this report:

- recommends lessening the dependence of local budgets on highly volatile tax bases such as corporate profits and property transactions;
- welcomes the increased effort being made to assess and collect property taxes, and recommends giving local authorities discretion to set their rates where this is not currently the case;
- notes the greater resilience of local revenue bases with a balanced mix of local taxes and intergovernmental transfers;
- recommends that local governments be given a year or more's notice of any unavoidable reductions of intergovernmental transfers so that they are able to plan how they can best be absorbed. Cuts should be distributed by objective formulae to ensure their equity and political neutrality;
- urges that municipal budget autonomy should be exercised within regulated limits as regards borrowing, and procedures be put in place to manage cases of insolvency;
- endorses the efforts of many local governments to reduce employment costs by means other than redundancies;
- encourages the development of outsourcing local service provision to the private and voluntary sectors;

- underlines the importance of benchmarking and performance audit, improved accountability as well as transparent publication of financial accounts, and endorses the support being given to these processes by the Council of Europe's Centre of Expertise for Local Government Reform;
- notes that the crisis has encouraged the optimisation of local service networks, but recommends that these be accompanied by measures to avoid aggravating access by people living in rural areas and vulnerable groups;
- recommends that the administration of social benefits by local governments give increasing priority to the needs of low-income households;
- urges avoiding disproportionate cuts in local budget expenditure on discretionary services like early childhood development or support to community-based organisations which are important in maintaining social cohesion and protecting human rights;
- recommends removing administrative and financial incentives to providing institutional rather than community care for the sick and elderly, and strengthening support, both practical and financial, to those who care for them in their own homes;
- stresses the increasing importance of partnerships between local governments and businesses, educational and research institutions and civil society organisations in countering social deprivation, caring for the growing numbers of elderly people and identifying and promoting potential paths of economic recovery;
- encourages efforts to promote transparency and efficiency in all aspects of local governance.