

Intergovernmental Fiscal Relations in Central and Eastern Europe

A sourcebook and reference guide

Francis J. Conway
Brien Desilets
Peter Epstein
Juliana H. Pigey
Graeme Frelick
Fred Rosensweig



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INTERGOVERNMENTAL FISCAL RELATIONS IN CENTRAL AND EASTERN EUROPE

A SOURCEBOOK AND REFERENCE GUIDE

CD-ROM INCLUDED (INSTRUCTIONS ON PAGE 6)

Prepared by

Francis J. Conway
Brien Desilets
Peter Epstein
Juliana H. Pigey
The Urban Institute

Graeme Frelick
Fred Rosensweig
Training Resources Group

Produced by

The Urban Institute
www.urban.org/international



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The United States Agency for International Development

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FOREWORD

The fall of communism launched an era of reform throughout Central and Eastern Europe. Countries that are labeled as transition economies have created institutions to function as pluralistic and democratic societies. Key among these reforms has been the process of decentralization: the devolution of fiscal power and responsibility from central to local governments.

The challenge these countries are facing is how to design efficient intergovernmental fiscal systems that can effectively enlist the resources of the state, civil society, and the private sector to provide better public services to their citizens. The implications of decentralizing the public management system is far-reaching, and the manner in which public resources and responsibilities are allocated among different levels of government will affect a nation's overall economic and fiscal performance. Thus the intergovernmental reform challenge is to design a system of governance that will (a) influence the efficiency with which public resources can be mobilized and utilized, (b) achieve fiscal equity, and (c) promote macroeconomic stability.

The U.S. Agency for International Development and the World Bank Institute present this sourcebook in response to requests for promoting active dialog on intergovernmental finance issues in the region. The sourcebook is part of a broader donor initiative that facilitates discussions among academics, policy analysts, and government officials involved in the decentralization process. It facilitates direct access to the wealth of knowledge and information on government finance issues in Eastern Europe by providing electronic links to a large number of documents on the subject included on the CD included with this volume.

This important sourcebook, produced by the Urban Institute under a contract with the U.S. Agency for International Development, enriches the dialog on intergovernmental finance issues in Eastern Europe. We are pleased to make this volume available to all those interested in the topic.

Frannie A. Léautier
Vice President
World Bank Institute



ACKNOWLEDGMENTS

The United States Agency for International Development (USAID) and the World Bank Institute (WBI) are pleased to present this sourcebook on intergovernmental fiscal relations in Central and Eastern Europe. The Urban Institute produced the sourcebook under contract to the USAID and WBI, in response to requests for better access to information on fiscal decentralization by participants at a one-week course in Budapest in April 2000. The course was sponsored by the USAID, WBI, and the Council of Europe.

The sourcebook is part of a broader WBI initiative that seeks to educate academics, policy analysts, and trainers in the expectation that they will disseminate and apply the main lessons of fiscal decentralization in their countries. The Budapest participants agreed with the objectives of this initiative, but indicated that to facilitate their own efforts they needed better access to information on fiscal decentralization in general, and on its history and current status in Central and Eastern Europe in particular. The sourcebook facilitates direct access to the wealth of existing knowledge and information on intergovernmental finance issues in Central and Eastern Europe by providing direct electronic links to a large number of documents on the subject.

The sourcebook is also part of a broader initiative by the USAID and other donors to support and promote the development of a vibrant and sustainable local democracy throughout Central and Eastern Europe. A strong system of local finances is an essential component of that process. Given its importance, the USAID and other donors have provided technical assistance and training to national authorities and individual local governments in each country. These efforts have helped these entities assess their early experience in fiscal decentralization and learn from it. They have also helped local elected officials and their staff develop, learn, and apply new financial management methods and techniques, a continuing effort that is not yet complete. In addition, these efforts have produced many of the case studies, data, and other background materials included in the sourcebook.

The USAID and WBI are grateful to the Organisation for Economic Co-operation and Development and the Local Government Association of England and Wales for their generous provision, through this sourcebook, of excellent documents on the subject of intergovernmental finance in Europe. We believe the collection of source materials on intergovernmental finance included with this sourcebook is a valuable and unique resource for the many people and institutions interested in promoting an active dialog on intergovernmental finance issues and improving the understanding of these issues in the region and beyond.

PART I – ABOUT THIS SOURCEBOOK



1. PURPOSE AND USE OF THIS SOURCEBOOK

PURPOSE

The primary purpose of this sourcebook is to enrich and inform the dialog on intergovernmental finance issues in Central and Eastern Europe.

The sourcebook facilitates direct access to the wealth of knowledge and information on intergovernmental finance issues in Central and Eastern Europe by providing direct electronic links to a large number of documents on the subject (included on the CD provided with this book). The documents discuss the basic concepts and principles of intergovernmental finance and describe the evolution of intergovernmental finance in the countries of Central and Eastern Europe. The sourcebook serves as a roadmap to help readers explore the documents and find relevant materials on specific intergovernmental finance issues.

The sourcebook also provides suggestions on how to present the knowledge and information to others either as participants in a policy dialog or as students and trainees in a course. In doing so, it provides direct electronic links to relevant training and educational materials, which are also included on the CD.

USERS

This sourcebook is intended for people interested in intergovernmental finance issues in Central and Eastern Europe. It will be especially useful and relevant to policy analysts and trainers interested in promoting an active dialog and improving the understanding of these issues in their respective countries.

RESULTS

After completing the guide, readers should be able to

- Describe the full range of intergovernmental finance issues affecting the countries of Central and Eastern Europe
- Structure multiday events to present and discuss these issues
- Find and use relevant materials from among the documents on the CD to improve their own understanding of intergovernmental finance issues in Central and Eastern Europe and to help them present and discuss these issues with others.

COUNTRIES COVERED BY THIS SOURCEBOOK

The following countries are covered extensively:

- Albania

- Bulgaria
- Czech Republic
- Hungary
- Latvia
- Macedonia
- Poland
- Romania

Those listed below are covered partially or are referred to as examples, and are not necessarily located in Central and Eastern Europe:

- Austria
- Bosnia-Herzegovina
- Denmark
- Estonia
- France
- Germany
- Lithuania
- Morocco
- Norway
- Russia
- Sweden
- Ukraine
- United Kingdom
- United States

LIMITATIONS

The design of the sourcebook assumes that readers have some prior knowledge of intergovernmental finance in general, and of intergovernmental finance in Central and Eastern Europe specifically, and can use and apply the content without additional guidance and support.

This sourcebook is not a textbook on intergovernmental finance. Rather, it links readers to documents that present basic concepts and principles in the field. While the printed version of the sourcebook does not analyze and describe the evolution of intergovernmental finance in Central and Eastern Europe, the accompanying CD links readers to a wealth of information on the topic, as well as to reports on recent developments in the various countries in the region.

This sourcebook is not intended as a manual for policy analysts and trainers. Rather, it is a guide and a resource to help them develop their own applications.



2. HOW TO USE THIS SOURCEBOOK

PRINTED AND ELECTRONIC VERSIONS

The printed version of the sourcebook comes with a CD that includes an electronic version of the sourcebook as well as of many documents that the U.S. Agency for International Development (USAID), the World Bank Institute, the Organisation for Economic Co-operation and Development (OECD), the Local Government Association of England and Wales, and the Fiscal Decentralization Initiative for Central and Eastern Europe have made available.

If you are viewing the file on a computer, as you read through the various sections of the sourcebook you will find underlined text that appears in blue: [Blue](#). This indicates a hyperlink, that is, an electronic link to some other part of the sourcebook or to relevant source documents included on the CD.

The links shown in underlined text—[Blue](#)—in the printed version of the sourcebook are illustrative only, that is, they are inactive. *To explore the sourcebook and source materials using the active links you must be using the electronic version of the sourcebook that is on the CD. This is the most effective way to use this sourcebook.* Working from the CD, you will be able to move back and forth easily between the sourcebook and the source materials (this is explained further later on in this chapter).

STRUCTURE OF THE SOURCEBOOK

The sourcebook is organized in five parts as follows:

- *Part I: About This Sourcebook.* You are now reading part I. It explains the purpose of the sourcebook and provides instructions on how to use it
- *Part II: Content Guide.* Part II is organized in three chapters, each of which describes key intergovernmental finance issues of current interest in Central and Eastern Europe, that is, local governments' functions and responsibilities, financial resources of local governments, and general intergovernmental finance issues that do not fit neatly into the first two chapters. The discussion of issues is descriptive, not analytical. It is somewhat like a checklist on all the topics to consider under the heading of intergovernmental finance in Central and Eastern Europe.
- *Part III: Applications Guide.* Part III provides suggestions on how to present the issues described in the Content Guide to others, either as participants in a policy dialog or as students and trainees in a course. The organization of part III tracks that of part II, with modules on local governments' functions and responsibilities, financial resources of local governments, and general intergovernmental finance issues. Each module contains a proposed design for a multiday workshop to present and discuss the issues. Part III also includes a link to a five-day course that combines the three modules, as well as a section on an academic course.

- *Part IV: Source Materials.* Part IV is organized in four chapters, each covering one of the categories of links used in the Content and Applications guides: principles, technical, legal, and comparative. The material in each chapter follows the organization of the Content Guide. Under each heading you will see a short summary of what you will find on that issue in the documents on the CD. This part of the sourcebook is of limited use in the printed version. To get the full benefit of part IV you need to be using the electronic version of the sourcebook.
- *Part V: Bibliography.* The bibliography provides a complete list of all the documents included in the CD. It is organized in three chapters. The first chapter lists technical and comparative source materials in alphabetical order by the name of the author. The second chapter lists legal source materials grouped by country in alphabetical order by country. The third chapter lists training materials in alphabetical order by the name of the author.

USING THE ELECTRONIC VERSION OF THE SOURCEBOOK

HARDWARE AND SOFTWARE REQUIREMENTS

To use the electronic version of the sourcebook and the documents included on the CD, you must have access to a computer with the following:

- A CD drive
- Acrobat Reader and an Internet browser (Netscape or Explorer, for instance) if you want to use those features of the CD that run automatically
- Microsoft (MS) Word and MS PowerPoint (version 97 or later) if you want to use only the source documents available on the CD.

ACCESSING THE ELECTRONIC VERSION OF THE SOURCEBOOK

When you insert the CD into your CD drive, a graphic title page will automatically open in your default Internet browser ([special note for AOL users](#)). Click the title page to launch the Sourcebook Start Page in Microsoft Word.

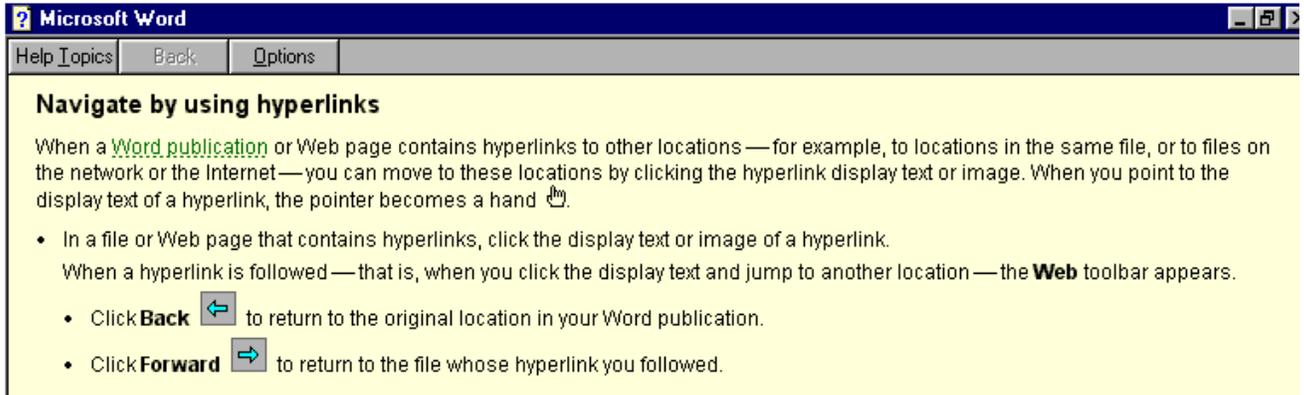
The Start Page provides links to all the contents of the CD, including the Content Guide, Applications Guide, Source Materials, and Bibliography, as well as these instructions. It also provides links to other useful resources available on the Internet. To use the latter you must have an active Internet connection on your computer, otherwise the Start Page functions as a normal MS Word document.

You also can access the electronic version of the sourcebook directly from MS Word. Insert the CD in the appropriate drive and open the Start Page, which is filed as “start.doc” in the sourcebook folder on the CD. For example, if the E drive is the one designated for CDs on your computer, the document will appear as E:\Sourcebook\start.doc. This is true of all the other documents included on the CD. You can access each of them by opening the corresponding file following the usual procedures either in MS Word or PowerPoint, as appropriate.



NAVIGATING THE SOURCEBOOK USING THE HYPERLINKS

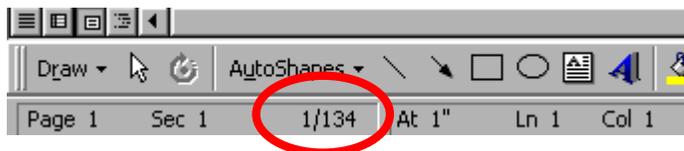
As you read through the sections of the sourcebook on your computer, you will find underlined text that appears in blue: [Blue](#). This indicates a hyperlink, that is, an electronic link to some other part of the sourcebook or to relevant parts of the source documents included on the CD. You can move to these locations, or “navigate” the sourcebook, by clicking the hyperlink display text or image, as follows:



The web toolbar has many features that are useful for navigating the sourcebook CD. Most important, the forward and back arrows on the left end of the bar allow you to return easily to the Source Guide and Content Guide after viewing source materials. The back arrow will return you to the previously viewed document, even from the end of a PowerPoint slide presentation. If you want to return to a document that was viewed prior to the previously viewed document, use the Go menu, which lists all the documents viewed since the beginning of the session.



When navigating, be sure to give each document sufficient time to load. You will know that a document is fully loaded when it stops calculating pages on the bottom-left of the document window.



When you are using the electronic version of the sourcebook, the hyperlinks ([Blue](#)) serve as a roadmap to the related materials in the sourcebook and the source

documents included on the CD. Each part of the sourcebook contributes to this roadmap in a different way.

CONTENT GUIDE (PART II)

This will help you explore the many source materials included on the CD. The hyperlinks will take you to the relevant part IV summary of what you can find on the

specific subject in the source materials on the CD. Additional links in part IV will take you to the actual text in each document or presentation that discusses the specific issue you have been reading about in part II. Thus you will not have to read each document completely to find the relevant references for each issue.

The wording of the text underlined in blue under each topic in part II will tell you what type of reference material is available in part IV on the specific issue you are reading about:

- [Principles](#) links in part II link to the appropriate principle or principles of the European Charter of Local Self-Government adopted by the Council of Europe that apply to the issue. The link also will include any relevant explanatory notes on the principles.
- [Technical](#) links in part II link to one or more documents that describe general economic theory and concepts related to the issue.
- [Legal](#) links in part II link to the specific article in one or more laws relating to the issue. The laws are all from the countries of Central and Eastern Europe.
- [Comparative](#) links in part II link to the specific section of one or more documents that describe and/or analyze the experience in another country relevant to the issue. The documents include comparative material mostly on the countries of Central and Eastern Europe, but some material on Western Europe is also provided.

APPLICATIONS GUIDE (PART III)

The descriptions of the issues contain underlined text in blue: [Applications](#). This indicates that materials in one or more of the documents on the CD can help in the presentation of the issues. These are materials such as slide presentations, a course syllabus, or speakers' notes.

SOURCE MATERIALS (PART IV)

This part provides a quick and simple way to access and explore the source materials by using the hyperlink in [Blue](#). Double click on a link to go to the relevant text in a source document. If you are interested only in specific types of source materials, using this part of the sourcebook is quick and easy.

BIBLIOGRAPHY (PART V)

This provides another way to access and explore the source materials. Double click on a [Blue](#) hyperlink to go to the beginning of each document listed in the bibliography. You should use these links if you are interested in reviewing an entire document.

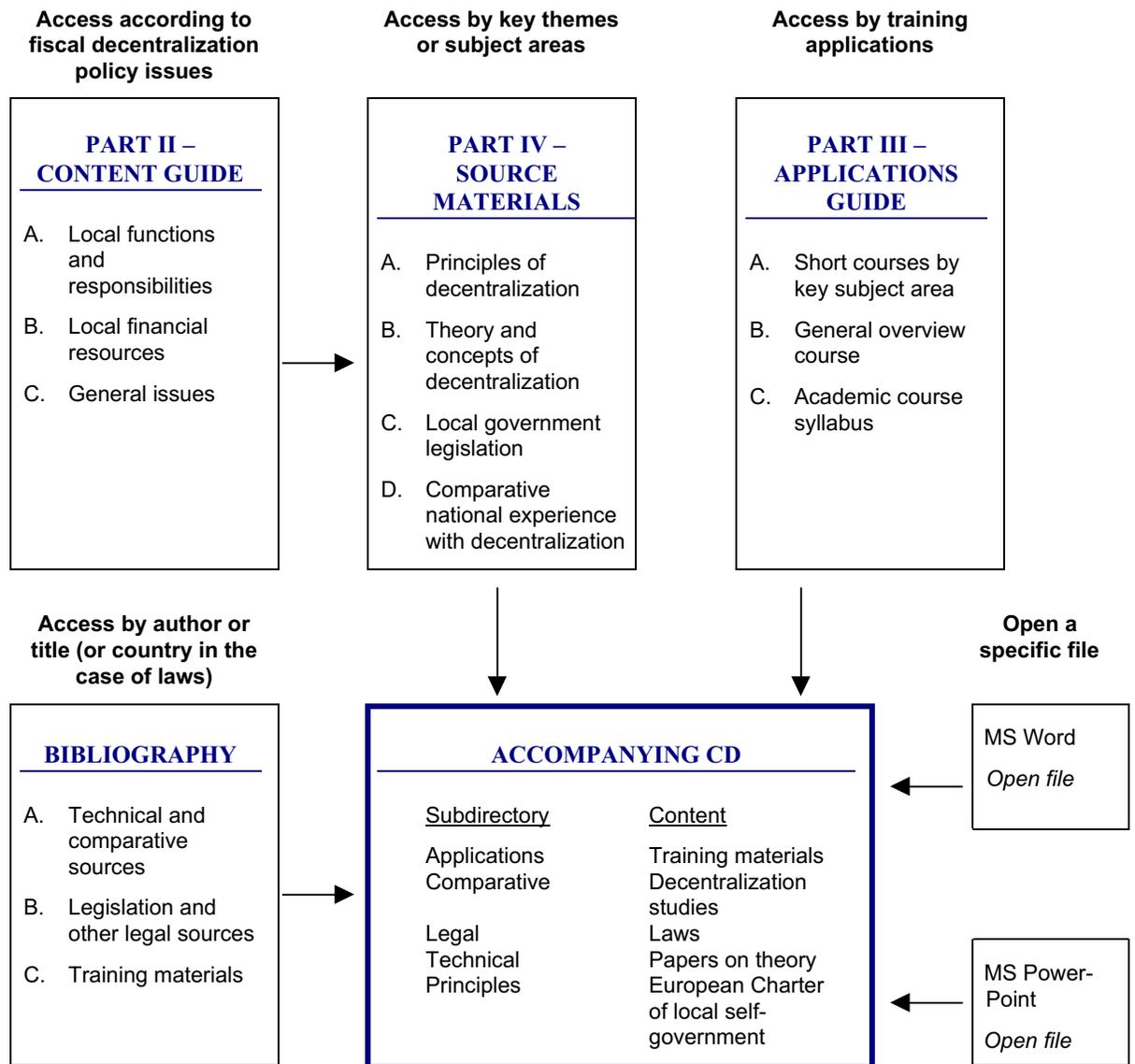
DIRECT ACCESS

Note also that you can access the documents stored on the CD following the normal procedure for opening a file through MS Word or MS PowerPoint, depending on the type of file.



Figure 2.1 shows graphically how the various sections of the sourcebook provide access to the source documents on the accompanying CD.

FIGURE 2.1. A ROADMAP TO DOCUMENTS ON DECENTRALIZATION



TIPS ON USING THE SOURCEBOOK DOCUMENTS IN MS WORD

The documents are easiest to read when they are in Page Layout (if not already in this view, choose Page Layout from the View menu). Adjusting documents to 75 percent of their actual size may also be helpful. If a document appears at a larger or smaller scale, you can adjust it by selecting Zoom from the View menu. You also may want to turn off the spelling and grammar checkers in MS Word by selecting Options from the Tools menu, then Spelling and Grammar and deselecting both “check spelling

as you type” and “check grammar as you type.” This will be especially useful if MS Word on your computer is set to a language other than English (United States).

We have linked the documents using bookmarks, which appear as large Is. These bookmarks should not appear in any of the documents, but if they do, you can hide them by selecting from the Tools menu Options...View and deselecting Bookmarks.

PROBLEMS NAVIGATING THE SOURCEBOOK

- **What do I do if the CD does not start automatically?**
Using MS Word, open the file Sourcebook\start.doc from the CD (usually the E or G drive on your computer).
- **How do I return to the document I just viewed?**
Click the back arrow on the web toolbar.
- **How do I return to the document I viewed before the last two documents I looked at?**
Select the file name from the Go menu on the web toolbar.
- **The arrows in the web toolbar are not active. What should I do to continue using the Sourcebook CD? How do I find the title of the document I am viewing?**
Scroll to the top, or first page, of the document.
- **How do I open individual documents on the CD (for printing, modifying, and so on)?**
Use the bibliography. Each entry in the bibliography is linked to the appropriate file, whether a Word document, PowerPoint presentation, or Acrobat file.
- **What do I do if my default internet browser is AOL?**
Temporarily change your default browser. First, close AOL if it has automatically opened. Then launch an Internet browser (Netscape or Explorer, for instance), which will automatically ask if you would like to change it to your default browser. Answer yes, then return to the sourcebook.

You are now ready to begin using the electronic version of the sourcebook. If you have any problems while using the sourcebook, try accessing the section on [frequently asked questions](#) under Comments and Questions on the start page. Also, do not hesitate to contact us at iac@ui.urban.org with your questions and comments.

PART II – CONTENT GUIDE



3. FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

OBJECTIVE

This chapter describes the intergovernmental fiscal policy issues that the countries of Central and Eastern Europe should consider in deciding what functions and responsibilities to assign to local governments. The chapter also indicates where the European Charter of Local Self-Government provides related guidance (Charter).

BACKGROUND

Decentralization of the responsibility and authority to provide or regulate services and to manage and/or promote local development can lead to better services and improved local conditions. The expectation is that placing authority and responsibility for certain public services in the hands of local elected officials will lead to decisions about the quantity, quality, and mix of services that most closely match the preferences of local service beneficiaries. Expanded local authority to manage urban growth or to promote local economic development can have a similar effect. [Technical](#), [Application](#)

Not all functions are equally suited to decentralization. Certain political and technical issues are common to all countries engaged in deciding what functions to assign to local governments. The structure of local functions and responsibilities varies by country. This section presents these issues and the related principles from the charter as they apply specifically to Central and Eastern Europe.

The discussion begins by addressing issues related to the assignment of local functions and responsibilities, followed by those regarding the nature and extent of local authority to perform those functions.

MEANING OF TERMS

The dialog on local functions and responsibilities is complicated by the lack of uniformity in the use of key terms from country to country. This confusion also exists in the literature and statistics. There is no simple solution to this problem, except to be aware of the fact and to take it into account when applying the terms. In the context of policy analysis or dialog or of training, defining each term in advance precisely as it will be used in the specific instance in question is prudent and useful. [Application](#)

Decentralization is often used with different meanings. It can be a generic term that refers to all forms of sharing or transferring authority or responsibility between the national government and any other level of government, including local or regional offices of the national government itself as well as local governments. An alternative, narrower use of the term covers only the transfer of authority for certain functions from the national to local governments and excludes the transfer of authority within a given national institution. The latter is the meaning used in this document. [Technical](#)

Deconcentration usually refers only to the service authority or responsibility assigned to a lower-level unit within a larger organization, for example, a local or regional office of a national ministry. This is the meaning used in this document. Because this term is not used in many countries, deconcentration as defined here may be referred to by another term that includes other, different forms of sharing or assigning service authority and responsibility. This leads to confusion.

Delegation usually refers only to cases in which one government institution relies on another to perform some or all of its functions and responsibilities. No transfer of functions takes place. The originating organization retains overall authority and responsibility, and has the right to take back the delegated functions. While delegation may include all aspects of a function, usually it includes only selected administrative aspects. For example, the Ministry of Education may delegate the payment of salaries for local teachers to a local government. The local government has no authority over the teachers. It merely acts as the ministry's agent in paying them. This document uses delegation to signify circumstances such as these.

Confusion with this term often stems from the failure to apply it uniformly in a specific country in a way that describes circumstances that are clearly different from those described by the other terms. For example, in practice in a given country there may be little difference between "decentralization" and "delegation" of service responsibility. The term may also be used with other meanings.

Devolution may have a generic meaning that refers to the process of transferring authority and responsibility for certain functions from the national to local governments. The term may also have a narrow meaning that refers only to the full transfer of authority and responsibility to lower levels of government. In this sense it excludes other, more limited forms of transfer, such as delegation. This document uses this narrower meaning. Sometimes devolution may refer to cases in which the national government sets the priorities for services otherwise performed by local governments. Thus even devolution can conflict with true local self-governance.

Mandated or obligatory services refer to those that a national government requires local governments to fund in each budget year, for example, local education expenditures. This term appears in several Central and Eastern European laws. Confusion occurs when this term is combined with others, such as decentralization or devolution, that imply a certain level of local autonomy or discretion in making decisions about services. In this case, one term seems to contradict the other. This document does not use the term mandated services.

A frequent variation in the use of the term refers to instances when the national government imposes an obligation on subnational governments to perform a service, but fails to provide funding to cover the costs. A typical case involves subsidies authorized by the national government, such as for water consumption or transportation. The national government establishes the parameters of the subsidy, and then instructs local governments to pay the subsidies from their own budgets without providing additional funds. These are called unfunded mandates. This document uses this narrower term.



ASSIGNMENT OF FUNCTIONS TO LOCAL GOVERNMENTS

Comparative, Application

What functions should be assigned to local governments? The literature on decentralization raises many questions regarding the assignment of functions that do not have clear or simple answers. The underlying issues are fundamental to the success of the decentralization process, and trying to address them explicitly, even if imperfectly, is important. Response to issues will vary by type of function, thus the analysis must address each one separately. The issues also interact, so the responses by different countries will differ. Finally, the response in many cases will vary over time, depending on such variables as the evolution of the national political system and the economy.

Technical, Comparative

ECONOMIC CRITERIA FOR ASSIGNING FUNCTIONS

The economic literature provides useful guidance when making choices about what functions to assign to local governments. Common problems in applying this guidance derive from poor or inadequate data specific to a country. Comparative

- *Type of function.* Economic theory attributes certain functions to the public sector, including the production of so-called public or quasi-public goods, such as streets or education and health services. Another function attributed to the public sector is redistribution, that is, activities such as social assistance that distribute wealth from one part of the population to another. Not all functions attributed to the public sector are equally well suited for decentralization. In general, the assignment of responsibility for producing public goods follows the principle of subsidiarity, that is, the best results occur when these functions are assigned to the lowest level of government capable of performing them. This is not an absolute rule. Other criteria discussed later have an impact on the allocation of the production function. The redistribution functions are generally seen as national, but this too is subject to different views. Principle, Technical
- *Service or benefit area.* A fundamental issue is the extent to which the geographic boundaries of local governments coincide with the area of service costs and benefits. Greater coincidence or overlap of the two argues for decentralizing the service. Less overlap argues for maintaining greater regional or central policy authority or financing responsibility. Wastewater treatment or solid waste disposal are cases where the costs will often spill over the boundaries of individual local governments. If a local government treats wastewater inadequately or not at all, but dumps it into a river, the downstream population, including areas served by different local governments, will be affected. The first local government has little, if any, incentive to fix a problem suffered by the residents of another area. This suggests the need for some regional or national role. Important considerations are the extent and quality of specific country data on service costs and benefits, whom they affect, and where they reside. Technical
- *Scale.* The issue here is efficiency, that is, the extent to which the provision of a service on a smaller or larger scale affects its cost. This issue is often tied to the choice of production technology, which may vary over time. Frequently

important considerations are the extent and quality of country data on service costs at different scales of production, particularly for social services, whose costs are difficult to allocate. Issues of scale often affect the assignment of responsibility for infrastructure services, such as water provision.

OTHER CRITERIA FOR ASSIGNING FUNCTIONS

Other issues that are perhaps less objective, but equally important, also affect the choice of what functions to assign to local governments, namely: [Comparative](#)

- *Cultural values.* These have to do with subjective considerations of what is fair or just. Countries that place a high value on ensuring universal access to certain services, such as education, may be less inclined to decentralize those services than countries that place a higher value on local choice or control. [Comparative](#)
- *Size and diversity.* The size of the country and local conditions, such as population density or the fiscal capacity of local governments, also come into play. The assignment of service responsibilities in a larger country with a dispersed population may differ from that in a smaller, more compact country. For example, this may affect the assignment of responsibility for services that rely on a physical network, such as water systems. In a small country there may be an argument for maintaining more centralized control over such services than in a larger country where the population is more dispersed or where distances between population centers are greater. [Technical](#)

ASSIGNMENT OF LOCAL AUTHORITY TO PROMOTE AND MANAGE DEVELOPMENT

Not all the functions and responsibilities of local governments necessarily involve local public services. They could include managing urban growth or local economic development. The issues related to the assignment of such functions are far less clear than those for public services. Some concerns arise about the nature and extent of possible competition among local governments that may lead to the inefficient allocation of risks or investments. [Comparative](#)

LEGAL DEFINITION OF LOCAL FUNCTIONS

The legal definition of the functions and responsibilities assigned to local governments determines the extent to which they are explicit, clear, and stable. [Technical](#)

Treatment in the Legislation

The first issue is whether legislation addresses the question of local functions in general, by specific function, or not at all. Equally important is whether the legislation addresses the nature and extent of local governments' authority over the functions assigned to them. This includes policy, administrative, and regulatory authority, as discussed in the next section. Issues of clarity often concern the relationship between local government laws and laws dealing with specific services or sectors, such as education or urban planning. They also concern whether the legislation uses



unambiguous terminology or relies on catchall phrases, such as “in accordance with the law.” [Principle](#), [Technical](#), [Legal](#), [Comparative](#)

Stability of Assignment of Responsibilities

A separate issue is how easy (or not) it is to redefine local functions and responsibilities. This applies whether or not the legislation is clear and explicit about the nature and extent of local authority over services. The questions are what does the legislation say or established practice show about how and how often local functions and responsibilities can change? A related issue is where the authority to make these changes resides and whether or not consulting with local governments as part of the process is customary or obligatory. [Technical](#)

NATURE AND EXTENT OF AUTHORITY TO PERFORM LOCAL FUNCTIONS

This section covers a wide range of issues that determine the extent of local discretionary authority over functions assigned to local governments. The answer to specific questions may differ in a given country by type of service. For example, local governments may have more discretion over certain basic infrastructure services than over local social services. [Principle](#), [Technical](#), [Legal](#), [Comparative](#), [Application](#)

AUTHORITY TO MANAGE SERVICES

Various factors determine the extent of local discretion and autonomy in making decisions about services as follows: [Comparative](#)

- *Authority to determine whether or not a service is required.* The analysis of local service authority begins with the question of who decides what services to provide in a given community. Who decides that a local problem or need requires a public response? Who determines the appropriate response? These questions are often ignored, because the attention is on existing or ongoing services. This leaves out consideration of local authorities initiating new public services or discontinuing or curtailing a service that is not a local priority. Conversely, the notion of mandatory or obligatory services (see earlier definition of terms) is a negative version of this form of authority. In effect, national legislation takes away local discretion not to provide a given service.
- *Authority to determine service policy and standards.*
 - In terms of policy, who has the authority to determine the quantity, quality, and cost of the service; the eligibility criteria (if not universal); or the form of financing (direct charge through fees or indirect through general revenues)? For example, if local governments are responsible for heating and transportation services, can they also decide that they will sacrifice the quality of transportation services by having fewer buses that run less often in order to improve the quality of heating services by investing to upgrade the system? As seen in the discussion on standards, local governments may appear to have

policy authority, only to find that it is undermined by national service standards. [Technical](#), [Comparative](#)

- The nature and extent of national standards regarding local services are frequent and often contentious issues. They also produce confusion that tends to limit local discretion over service quality, quantity, and cost. The issue is not just who sets the standards, but also what the standards cover (minimum national concerns versus detailed service conditions, inputs versus outcomes), how clear and objective they are, and how much local discretion they allow. For example, national standards for water systems might specify detailed technical specifications for treatment facilities (inputs) or minimum standards for the quality of water to minimize health risks (outcomes). In the first case, the standards tell local governments how to do their job. In the second, the standards describe a minimum condition local governments must achieve that is clearly of national interest (health), but leave it up to them to decide how. [Technical](#)
- The nature and extent of procedural standards are also frequent and contentious issues. The standards include rules governing public procurement or contracting and worker safety rules. The issues in this case are similar to those regarding service standards. They include who sets the standards, what they cover, and how much local discretion they allow.
- *Authority to organize service delivery.* Separate from the content and scope of services, other issues concern how a service is organized and who the service providers will be. The general issue is whether local governments have the authority to decide whether to provide a service directly or to make arrangements to have others provide it. Each choice raises new issues.

[Principle](#)

- Direct service provision by a local government raises issues about local discretion and autonomy either to establish its own internal organization or to create corporate entities to perform services, and to decide between the two. Other issues have to do with the authority to decide the best way to produce the goods or services. This relates back to issues of national standards, particularly when those standards apply to the inputs of production, namely, people, technology, or methodology. [Legal](#)
- Cooperation among local governments in service provision raises issues about local discretion and authority to purchase a service from another local government or to form a joint organization for service provision. This authority is especially relevant when local governments are the only service providers (for example, compulsory primary education) and many of them are too small to warrant setting up their own facilities. [Principle](#), [Legal](#), [Comparative](#)
- Delivery of services jointly with the private sector or exclusively through private firms raises issues about the rules that apply and the extent of involvement by national authorities. Issues about the rules include the scope of what can be contracted out, requirements for



competitive bidding versus direct negotiation, and maximum duration of contracts. Issues regarding the role of national authorities include prior approvals and the extent of their participation in the bidding and contracting process and in subsequent monitoring. Delivery of services jointly with or through nongovernmental organizations (NGOs) raises many of the same issues. [Technical](#), [Legal](#), [Comparative](#)

- *Ownership of assets.* In the transition from a centralized to a decentralized form of government, issues arise about the nature and extent of local ownership of and control over assets. If local ownership does not follow automatically with the assignment of functions and responsibilities, it can become an obstacle to local governments' full exercise of their service authority. For example, if local governments are responsible for school investments and major repairs, who owns the school buildings? In the case of services provided by separate corporate entities, such as utilities, who will acquire ownership of the assets, the local government or the corporate entity? Together with any restriction on the alienation of assets, this has important implications for the joint production or the privatization of services. [Legal](#), [Comparative](#)

DELEGATION OF AUTHORITY

The delegation of authority is a special form of assigning local functions and responsibilities. All the issues discussed earlier apply in the context of a delegation of authority. In addition, the following issues are unique to this process:

- *How the delegation takes place.* The first important issue is whether delegation occurs through new or amended legislation, such as the annual state budget law, or whether the national government may initiate a delegation to local governments on its own authority. Other process issues include whether or not local governments must be consulted in advance of any delegation and have the option to accept the delegated functions, and whether delegations must apply equally to all local governments or may be applied selectively. [Principle](#), [Legal](#)
- *The degree of discretion in managing delegated services.* Also an important issue, by definition, policy control will remain with the entity originating the delegation. Local discretion to manage delegated services will depend largely on local governments' authority to decide the best way to produce the goods or services, that is, to make choices about the inputs of production, namely, people, technology, or methodology. [Principle](#), [Technical](#), [Comparative](#)
- *Who finances the cost of delegated functions.* This is extremely important. If local governments are expected to finance these costs from their own revenues, then this is more a case of an unfunded mandate than a delegation of functions. This would be the case, for example, of a subsidy authorized by the national government that must be paid from the local budget. [Legal](#), [Comparative](#)

NATURE AND EXTENT OF LOCAL REGULATORY AUTHORITY

Regulatory authority provides the means for local governments to influence or direct those services and activities of local interest provided or performed by others, including citizens, NGOs, and private firms. This authority is particularly important and relevant when local governments have been assigned the responsibility to manage urban growth or to promote local economic development. The following questions arise:

- *Legal basis for local regulatory authority.* A fundamental question, analogous to who decides that a new service may be required, is whether or not local governments have a general authority to regulate matters of local interest. The opposite would be that authority is limited to specific areas defined by law. Making a careful distinction between the responsibility to prepare plans, such as urban plans, and the authority to regulate related activities, such as land development and new construction, is also important. [Legal](#)
- *Other issues.* To whom does local regulatory authority apply? What methods of enforcement are available to local governments? The first question looks at the nature and extent of local authority to regulate the activities of citizens, private firms, and/or NGOs (for instance, sports or cultural clubs). The second question looks at the extent of local discretion and autonomy in determining sanctions or penalties or in having recourse to action in the courts. [Legal](#)



4. FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

OBJECTIVE

This chapter describes the intergovernmental fiscal policy issues that the countries of Central and Eastern Europe should consider in deciding the best way to provide for the financing of local governments. [Application](#) The chapter also indicates where the European Charter of Local Self-Government (Charter) provides related guidance.

BACKGROUND

The need to ensure adequate financial resources for local governments is a fundamental principle of decentralization. [Principle](#) In practice and by principle, the financial resources available to local governments will come from varied sources. Confusion arises in the use of the terms used to identify these different sources (see “Meaning of Terms”). This sourcebook uses the following classification of local government resources:

- Own financial resources, including
 - Local taxes and fees
 - Debt
 - Other local sources of financing, such as donations or sale of assets
- Transfers, including
 - Grants
 - Shared national tax revenues.

All countries deciding on the best way to finance their system of local government using a combination of these sources face similar political and technical issues. The structure varies by country. This section presents the issues and the related principles from the charter as they apply specifically to Central and Eastern Europe. [Technical](#), [Comparative](#), [Application](#)

MEANING OF TERMS

As with local functions and responsibilities, the dialog on local financial resources is complicated by a lack of uniformity in the use of key terms from country to country.

Own resources. Legislation and analytical and statistical reports on local governments use this term with very different meanings. A frequent distinction comes from whether it applies to all the financial resources available exclusively to local governments or only to those over which local elected officials have some authority to vary the amount of revenues raised from a particular source. Because it follows practice in the region most closely, this document uses the term own resources to refer broadly to all types of financial resources a local government receives directly from people or

firms, whether or not the local government has the authority to vary the amount received from these sources. This is not the accepted usage in most of Western Europe, where “own” tends to connote some authority to vary the amount of revenues by “own” rate and/or tax base changes. [Comparative](#)

Local taxes. This term appears frequently in the legislation and analytical and statistical reports. The difference in the use of the term usually revolves around the same point as with own resources, that is, the degree of local discretion or authority to vary the amount of the tax. This document uses “local” taxes in the broadest sense to encompass all instances of the use of this term in Central and Eastern Europe.

Fees, user charges, and tariffs. These terms all refer to a payment made in exchange for a service received by the person or firm making the payment. The confusion usually derives from the use of any one of the terms to include the others and from the appropriation of one of the terms in a given country. This document uses “fee” as a general term that encompasses user charges and tariffs.

Transfers, grants, and shared revenues. These are different terms used to describe financial resources provided to local governments from the national government, regional governments (in countries with multiple tiers of government), or other local governments. The confusion usually derives from the use of any one of the terms to include the others and from the appropriation of one of the terms in a given country. This document uses transfers as a general term that includes all financial resources provided to local governments by another unit of government.

OWN SOURCES OF FINANCIAL RESOURCES [Principle](#), [Comparative](#), [Technical](#), [Legal](#), [Application](#)

LOCAL TAXES AND FEES

Local taxes and fees are fundamental building blocks of local finances. To a large degree, how these taxes and fees are treated in law and in practice determines the extent to which local governments decide the cost of the services they provide. [Technical](#), [Comparative](#)

EXTENT AND NATURE OF LOCAL AUTHORITY OVER TAXES AND FEES

The responses to specific issues of local discretionary authority may differ in a given country by type of tax or fee. For example, the treatment of local administrative fees (for example, for permits) may differ from the handling of fees for basic services (for instance, water supply or solid waste collection). [Principle](#)

- *Legal definition of local taxes and fees.* This has to do with specific language in laws or regulations. The options range from general language that provides local governments with broad authority to impose local taxes and fees, consistent with their functions and responsibilities, to specific language that limits them to specific taxes and fees. [Legal](#), [Comparative](#)
- *Authority to decide how to use revenues from local taxes and fees.* This has to do with restrictions or mandates in the legislation or in national regulations. For example, the legislation may limit the revenues from fees to the payment



- of costs incurred in the production and delivery of the goods or services paid for through the fees. [Legal](#)
- *Authority to set tax rates and adjust the tax base.* Should local governments simply receive the revenues from certain taxes that are controlled fully by national authorities, or is there some local discretion in determining the tax liability or assessment? This may involve some authority to set the tax base, the tax rate, or both. These are largely procedural issues that are usually defined in a law or regulation. [Legal](#), [Comparative](#)
 - The issues regarding the tax base include how it is defined, how it is revalued, and who revalues. In inflationary environments in particular, revaluation becomes an important issue.
 - The issues regarding the tax rate are more varied. Is a national tax rate applicable to all local governments? Is there a maximum tax rate or a range from which each local government can determine the rate to be applied in its jurisdiction?
 - *Authority to set fees.* If a single method for calculating specific local fees is applied uniformly, does it allow for local discretion to make adjustments to reflect local conditions? Are local governments given authority to determine the method of calculation and the amount for specific local fees? Are local decisions subject to review by an outside body, such as a ministry or a regulatory commission? [Legal](#), [Comparative](#)
 - *Authority to administer own taxes and fees.* Issues related to the administration of local taxes and fees include such questions as who identifies the tax or fee payers, who collects the funds, who enforces the law in case of nonpayment, and who imposes and collects penalties. [Legal](#), [Comparative](#)
 - *Other issues of local tax and fee authority.* Do local governments have the right to establish local exemptions and/or deductions for hardship cases or special local interests? Is a referendum or other form of local public consultation required prior to adopting or amending certain taxes and fees?

ECONOMIC AND TECHNICAL FACTORS IN THE ASSIGNMENT OF LOCAL TAXES

Economic and technical factors refer to the types of taxes that should be available to local governments. Some types of taxes are ill-suited or inappropriate for local governments. Effectively, the following are the criteria for choosing what taxes to assign to local governments. The underlying issues grow in importance with local governments' actual or intended degree of discretionary authority to vary the parameters of a given tax. [Technical](#)

- *What to tax.* The options include personal or corporate income (wage or profit taxes), goods and services (sales or value added taxes), personal or corporate property and assets (buildings and land, vehicles, pets). Further choices are available within each option, for example, the type of income, service, or property to tax. [Comparative](#)

- *Who pays.* Do only local residents and firms pay the tax or can it be “exported” to people or firms in other jurisdictions? This also includes considerations about the tax’s equity and efficiency in economic terms.
- *Competition.* This exists among local authorities (raising or lowering taxes) and between national, regional, and local levels (all of which are competing for revenues from the same tax base).

OTHER ECONOMIC OR TECHNICAL ISSUES AFFECTING LOCAL TAXES OR FEES [Technical](#)

Generally, a good local revenue system would generate a revenue stream that is relatively productive and stable over time, is relatively neutral with regard to its impact on private economic decisions, is simple and predictable, and is equitable. Relative to other potential sources of local tax revenues, property tax and local fees score well on all these criteria.

- *Value versus replacement cost basis for property taxes.* In all countries of Central and Eastern Europe property taxes have been assessed based on the estimated replacement cost of the property. Usually this is calculated based on a fixed cost per square meter of land and/or construction, with some variations by type of construction. A recurring question has been whether, and if so when and how, to convert to a property tax system that uses market value as the basis for assessment. [Comparative](#)
- *Choice of methodology to determine the amount of fees.* The method used to calculate a fee is important, with different considerations to be taken into account depending on the purpose of the fee.

DEBT

Even in the most affluent countries, local governments cannot (and economic efficiency argues that they should not) pay for essential capital investment projects solely from their current revenues. As a rule, they look to borrow much of the money for providing needed infrastructure and facilities. In so doing, they also share the burden of paying for a major capital project among all those who will benefit from it over its useful life (until the debt is repaid). Access to borrowed funds will become increasingly important for local governments in Central and Eastern Europe as they look to finance the massive investment in environmental improvement required for European Union (EU) accession. [Principle](#), [Technical](#)

EXTENT AND NATURE OF LOCAL AUTHORITY TO BORROW

In the interests of public debt management and consumer protection, certain restrictions may be placed on local governments’ use of credit, but these may still allow them a measure of local decisionmaking authority. Key questions include the following: [Technical](#), [Comparative](#)

- *Basic authority to borrow.* For what purposes may local governments borrow? What distinctions, if any, should there be in the use of long-term versus short-term debt? Should the law set borrowing or debt service limits? [Legal](#)



- *Process of borrowing.* What is the local approval process for issuing debt? To what extent must the local community be consulted in advance of borrowing? What approvals are required from other levels of government and what are their scope and content? What is the extent of regulation of the type of local debt instruments or the characteristics of local debt (interest rates, form of amortization)? Are special disclosure requirements needed for local borrowing? [Technical](#), [Legal](#)

OTHER FINANCIAL AND TECHNICAL ISSUES [Comparative](#)

- *Local creditworthiness.* This set of issues looks at the extent to which local governments are able to meet debt service payments over time and the effect on private lenders' and investors' perceptions of local creditworthiness. Key questions include: Are local governments able to generate a stable and predictable surplus of revenues over expenditures in their annual operating budgets? Are local governments restricted in how they use such a surplus? Will the growth in autonomous own-source revenues keep up with inflation and the costs of services? [Comparative](#)
- *Relations with lenders and investors.* Key questions include: How will local debt be secured? Is this matter to be resolved by law or through negotiations between the borrower and lender? What are the lenders' remedies in the event of default? Does the central government have a legitimate role in monitoring local government debt or in intervening if repayment problems arise? [Technical](#), [Comparative](#)
- *Borrowing for jointly provided services.* Local capital projects are often financed through locally controlled enterprises or authorities, organized to operate on business principles, with borrowing often secured by pledges of revenues from fees charged their customers and excluded from calculations of subsovereign debt. Special issues arise in connection to both nurturing and regulating this activity, which can necessitate attention to the array of sector-specific policies and laws (in connection with, for example, water supply, wastewater handling, public transportation, solid waste management) that govern the operations of such entities. [Comparative](#)

OTHER LOCAL SOURCES OF FINANCING

Other sources of financial resources might be available to local governments, each of which raises a unique set of issues. All these other sources tend to raise questions about appropriate uses of local resources and assets, about the relationship of local governments with the for-profit sector, and about risk and accountability. Key sources and questions include the following:

- *Income from local property.* This can include, for example, the use of local property to raise revenue through leasing, renting, or sale. Does this authority apply to all local property or does the law exclude certain types of properties? What are the legal requirements on the use of such authority? In many countries these and other related issues are addressed in a separate law on public property. [Legal](#), [Comparative](#)

- *Financial income.* Are local governments authorized to make loans to individuals or firms as a source of revenue? Are local governments authorized to keep surplus cash in interest-bearing accounts to generate additional revenues? (Note: This latter question is related to overall local cash management and to the use of a single public treasury. The question is part of a broader discussion of local financial management and administration issues that is not included in this sourcebook.)
- *Income from business activities.* Are local governments allowed to participate in commercial ventures and derive income from the profits? Can they participate in business ventures with private firms? (Note: This is different from the question of local authority to work with and through the private or nonprofit sectors to deliver services. For that question, refer to the discussion of local functions and responsibilities.) [Legal](#)
- *Gifts and foreign grants.* Can local governments receive gifts from public and private sources? Can they receive grants from foreign governments? What are the legal requirements, if any, on the use of such gifts or grants? [Legal](#), [Comparative](#)

TRANSFERS

All countries in Central and Eastern Europe rely on transfers from the national government to provide a significant share of local governments' financial resources. This will continue for the foreseeable future. The following discussion also considers the possibility of transfers from regional to local governments or between local governments. [Technical](#), [Comparative](#), [Application](#)

GRANTS

Grants include all forms of local government financial resources provided through the budget of another level of government without any requirement that the local governments give anything in return. Depending on what other financial resources have been assigned to local governments, grants may be provided for different reasons. The nature and extent of grant conditions and the manner in which grants are administered can reinforce or constrain local governments' authority to manage their own finances. [Principle](#), [Legal](#), [Comparative](#)

NATURE AND EXTENT OF GRANT CONDITIONS [Technical](#)

- *Limitations on local governments' use of grants.* Can local governments use the funds for any public purpose consistent with their functions and responsibilities? Is use of the funds limited to specific sectors (for example, education), institutions (a particular school), types of expenditures (maintenance of school buildings), or projects (construction of a new school)? [Legal](#), [Comparative](#)
- *Limitations on who receives grants.* Are all local governments eligible to receive grants or are they limited? If limitations apply, are they related to classes of local governments (for instance, location or size), to the use of the grants (for example, technical criteria for projects or activities), or to how local



governments develop proposals for use of grants (for example, a comprehensive plan or consultation with local residents)? [Legal](#)

- *Financial conditions.* Is there a matching requirement? That is, are local governments required to provide a certain level of funding for a specific use or project as a condition for receiving the grant? Are there requirements regarding how the funds are treated in local budgets and financial reports? Do grant funds that have not been used by some specified time, such as the end of the budget year, revert to the grantor? [Comparative](#)

NATIONAL POLICY CONSIDERATIONS

The nature and extent of conditions governing grants and the process of allocating and administering them should vary according to the purpose of the grants. In general the key questions will be: What national and/or regional objectives will the conditions address? Given the objectives, is any condition required or warranted? How do the conditions achieve the underlying national and/or regional objectives? Is the extent of the conditions consistent with the relative importance of the objectives?

EQUALIZATION [Comparative](#)

The equalization transfer system is a fundamental part of the fiscal arrangements in a country. Equalization transfers allow countries to reap the advantages of a decentralized delivery of public services while ensuring that the design of public services conforms to general notions of efficiency and equity. A well-functioning intergovernmental system should provide all necessary public services to all citizens at comparable tax rates, that is, people in different parts of a country should have equal access to public services, and the tax burden they are asked to bear should be uniform across jurisdictions.

- *Objectives of equalization.* This set of questions looks at whether a clear statement of objectives regarding equalization is in place and how well that definition works. For example: Is the equalization objective expressed in terms that are measurable? How well quantified are the differences that the grants seek to remedy? Can the grants' success be measured after the fact? Are these measurements included in procedures for managing equalization grants? [Principle](#), [Technical](#), [Comparative](#)
- *Existing conditions versus performance.* This set of questions considers whether equalization grants seek to address problems within or outside the scope of local government management control. Do the grants compensate for differences in fiscal capacity or fiscal performance? That is, by design and in practice, do they help communities with a lower tax base or those that do a poor job of collecting taxes? Do the grants compensate for service needs or actual expenditures; that is, do they help communities that have greater needs or those that are spending more? What sorts of incentives do equalization grants provide to local governments to collect taxes and control costs? [Comparative](#)

METHOD OF ALLOCATING GRANTS

- *Criteria for allocating grants.* How is the amount that each local government will receive determined? Is a quantitative formula used or are general criteria applied? Who applies the criteria or controls the formula? In either case, is the method consistent with the purpose of the grants? [Principle](#), [Comparative](#)
- *Grant allocation formula.* Is the information used in the formula readily available so that any interested party, including local governments, can perform their own calculations? Are the rules governing grant allocations subject to modification each year as part of the national budget process? [Technical](#), [Comparative](#)
- *Other procedural issues.* What information do local governments have on the levels and types of grants they will receive when preparing their budgets? Is the information available before they prepare the initial budget? Who administers the grants, approves applications, and monitors the use of the funds? What kinds of procurement rules must local governments follow? [Comparative](#)

SHARED REVENUES [Technical](#), [Legal](#), [Comparative](#)

Given the lack of suitable sources of local taxes sufficient to meet local governments' financing needs, some countries in Central and Eastern Europe are turning to shared revenues from national taxes as an additional financing source for local governments. The key policy issues regarding shared national taxes include the following:

- *Annual or continuing appropriation.* From a legal perspective, the key issue is how revenue sharing has been authorized. Is it in a separate law on local finances or is it authorized each year as part of the national budget? This may have an impact on the stability of revenue sharing. [Comparative](#)
- *Allocation/assignment of specific taxes for revenue sharing.* These issues are similar to those regarding the assignment of authority for specific local taxes discussed earlier. In the case of revenue sharing, the distribution of tax revenues among local governments may also depend on the allocation formula. For example, if the shares will be based on the location of taxpayers, then a consideration of their geographic distribution is important. If taxpayers are concentrated in a few locations, only a few local governments will benefit from the shared tax revenues. [Comparative](#)
- *Formulas for sharing.* Several questions are relevant in this context. Is the local share based on where the tax is collected or on some other formula, such as per capita allocations of the total amount collected nationally? Do data limitations influence the formula? Are revenue-sharing rules subject to modification each year as part of the national budget process? Are local governments that receive larger revenue shares required to give part of the revenues to other local governments? If so, how is this measured and on what basis does the redistribution occur? [Comparative](#)



5. GENERAL INTERGOVERNMENTAL FINANCE ISSUES

OBJECTIVE

This chapter describes general intergovernmental finance issues that were not addressed in the two previous chapters. One set of issues derives from the impact of the ongoing reforms in the countries of Central and Eastern Europe on intergovernmental fiscal relations. A second set of issues arises in the context of the annual budget cycle of national and local governments. [Application](#)

ONGOING TRANSITION AND REFORMS [Comparative](#), [Application](#)

The process of establishing a viable system of finances for local governments in Central and Eastern Europe is taking place in the broader context of the transition from centrally planned to market economies and from autocratic to democratic systems of governance. The process is also occurring in the context of economic and fiscal problems, at times severe, that have accompanied this transition. Finally, in managing the transition, the countries are motivated and guided by their desire to achieve accession to the EU. These three events—political and economic transition, accompanying economic and fiscal problems, and EU accession—provide the overall context for the policy dialog on intergovernmental fiscal relations in Central and Eastern Europe and have a profound impact on that dialog.

First, the very notion of a transition means that the established way of doing things must change. What does not change will probably remain largely as it was before. This means that the policy dialog on intergovernmental fiscal relations and the decisions on a new system of local finances cannot focus exclusively on what is new, but must also focus on changing the system that is in place, otherwise the combination of the new and the old may have unintended consequences and produce results different than those anticipated.

Second, the transition is an evolutionary process that progresses unevenly across a wide range of issues that affect intergovernmental fiscal relations and the local finance system. This means that the policy dialog on intergovernmental fiscal relations must constantly adapt and readapt to new circumstances, otherwise it will lose relevance and become ineffective.

Third, the devolution of greater fiscal authority to local governments acquires special significance when considered in light of the complex and difficult decisions that the national executive and legislative authorities must make in the context of the broader transition and of the process of EU accession. National authorities and the donors that support them may be reluctant to surrender fiscal authority to local governments if they perceive this as leaving them without the tools they need to address broader national reforms. This means that the policy dialog on intergovernmental fiscal relations must focus carefully on the timing and phasing of reforms, otherwise the process of decentralization may conflict with the larger process of change and lose support.

Finally, the importance of meeting the requirements for accession to the EU provides special meaning to the European Charter of Local Self-Government of the Council of Europe (Charter). This is the standard, and the dialog on intergovernmental fiscal relations needs to remain attentive to the charter's principles. This is a key consideration in gaining and maintaining broad support for the process of fiscal decentralization in the region.

The next section looks at the ongoing transition and related reforms specifically as they affect the dialog on local functions and responsibilities and local financial resources.

ECONOMIC AND FISCAL POLICY REFORM ISSUES [Comparative](#), [Legal](#)

The key reforms have a significant impact on decisions regarding the financial resources of local governments in Central and Eastern Europe.

FISCAL STABILIZATION

The region's countries face continuing fiscal and economic problems as they strive to reduce and redefine the role of government and to adjust to the new market economy. The fiscal stabilization programs adopted in response to these problems include numerous provisions that have a direct impact on decisions about local financial resources. [Technical](#), [Comparative](#)

- *Budget deficit targets.* Fiscal stabilization has involved some combination of increases in public revenues and decreases in public expenditures to reduce the overall budget deficit to some target, usually expressed as a share of gross domestic product. It has also included limits on overall debt exposure and debt service targets. What is the impact of these measures on local government revenues and expenditures? What impact do they have on local governments' ability to borrow or raise capital to finance investments? Are local changes considered comprehensively in advance, or is the process more ad hoc, characterized by separate, unrelated decisions whose overall impact is not clear? Is there a sense of the extent to which any adverse impact is shared proportionally between the national and local governments? [Technical](#)
- *Financial administration.* Fiscal stabilization also includes measures to maintain tight control over public expenditures and manage the government's overall cash position. A common measure involves establishing a single treasury with jurisdiction over all public funds, including those of local governments. Are local governments required to keep all their cash with this treasury? What is the nature and extent of treasury controls over local revenues and expenditures? How efficient and timely are treasury services to local governments? How timely and complete is the flow of information from the treasury to local governments on the transactions and balances in their accounts? [Comparative](#)

TAX REFORM

In general, Central and Eastern European countries have faced the need to implement broad reform of taxes to reduce the high tax rates, broaden the tax base, and modernize and strengthen tax administration.

- *Impact on local revenues.* Key questions are whether and how the reforms affect the specific taxes assigned to local governments, either as local or as shared taxes. Some of these taxes may be eliminated as part of the reforms, while others may be restructured, for example, the wage tax may be folded into a general income tax. What impact do the reforms have on the volume of revenues that local governments receive from these taxes? If local tax revenues increase or decrease, are other local sources of revenues, such as transfers, adjusted as well? What is the net impact on total local revenues? How does this affect the vertical balance between the two levels of government? (See the discussion of this last issue in the section on the “National Budget Cycle” later in this chapter.)
- *Impact on local tax administration.* What impact, if any, do tax administration reforms have on local governments? Is local authority to administer taxes affected in any way? If so, does it increase or decrease? What about the flow of information to local governments on taxes administered by the national government on their behalf? Do local governments receive more or less complete and timely information as a result of the reforms?

PUBLIC ADMINISTRATION REFORM

Civil service reform is an important part of the changes taking place in public administration throughout Central and Eastern Europe. How these reforms are structured can have a significant impact on local finances. [Principle](#)

- *Cost of local staff.* Key issues are the extent to which new civil service system rules apply to local governments and how they affect local personnel costs. Will a single, national personnel classification and compensation system apply to local governments? Is the size of local government staff subject to national review and/or approval?
- *Transfers of functions.* In the case of national functions that are transferred to local governments, are the rules regarding civil servants clearly spelled out? If so, do the rules take the interests of local governments into account? For example, if a function might be overstaffed, does a local government have the authority to set its own staff levels at the time of the transfer? What happens to the current civil servants? If compensation is to be provided for those who are not retained, who pays? If the existing civil service legislation does not address this issue, who has the authority to decide?

CAPITAL MARKETS REFORM

In many respects the use of debt as a financial resource for local governments is intertwined with the development of the overall capital market. Policies and legal frameworks for capital markets have direct impacts on local governments' ability to access these markets and to compete on equal terms with other borrowers.

- *Legal framework.* Are tax laws neutral as they affect local borrowing (as opposed to other forms of borrowing) or the sale of local government bonds versus direct bank lending to local governments? Do regulations pertaining to securities markets and financial institutions (banks, pension funds, insurance companies) discriminate against the local government sector? To what extent does the legal framework facilitate equity versus debt financing? What is the relative role of commercial lending versus bonds?
- *Role of government.* Do national grant and loan programs that fund local government investments strengthen or compete with the development of a private market for local government credit? Beyond ensuring a level playing field, should the national government intervene actively to support local credit market development by authorizing state transfer intercepts or other forms of credit enhancement? Should a municipal development bank be in place along with other forms of credit intermediaries? [Technical](#), [Comparative](#)

SOCIAL SECTOR REFORM

In most Central and Eastern European countries, ongoing or planned reforms for financing health services, social assistance, and consumer subsidies have significant implications for intergovernmental finances.

- *Local functions.* The first issue is whether and how these reforms affect the assignment of functions to local governments. In many cases, local governments have been responsible for some part of existing social service programs. Is their role being considered as part of the reforms? Are issues of local service authority being considered?
- *Cost of subsidies.* Subsidies on the consumption of public services, such as heating or transport, and income support programs can have a large impact on local budgets. They can become a bigger burden as a result of measures to increase the prices of such services or to address the social impact of economic and other reforms. What are the nature and extent of local authority and involvement in this area? Is the impact on local budgets of price increases and/or changes in subsidy policies being considered? Are local governments authorized to implement their own subsidy programs for those services assigned to them?

STATE ENTERPRISE REFORM

Many services typically assigned to local governments were previously performed by state enterprises. In all countries in the region, these enterprises are going through a profound transformation, which can have a significant impact on intergovernmental finances. Key issues include the short-term impact on local expenditures, the longer-term issue of who controls the enterprises and how this affects local governments' ability to compete for the provision of certain local services through privatization or other means. Who is responsible and accountable for subsidizing the enterprises if they do not operate on a break-even or profit basis? What is the enterprise's legal relationship with the local government? What is the nature and extent of local authority over the enterprises? In the case of infrastructure enterprises, who owns the assets required to provide the services? (See the following discussion of



property issues.) Does existing legislation protect any of the enterprises from competition? [Comparative](#)

LAND OWNERSHIP AND PROPERTY MARKET REFORMS

The legal status of local public property is an important issue in Central and Eastern Europe and other transition economies where establishing a legal regime for public ownership of property has been necessary. A number of issues surround the new local public property legislation, including the process and timing of transferring ownership to local governments. Is the process of allocating property between the national and local governments transparent and are local interests considered? How long does it take? What is the nature and extent of legislative restrictions on the right to alienate public property? How are the restrictions expressed in the law? How are they imposed and by whom? How are they lifted and by whom? The more general question is whether implementation of the law results in the transfer to local governments of all the public property they need to perform the functions assigned to them. What share, if any, of public property that is not immediately related to a specific purpose is made available to local governments?

DECISIONMAKING PROCESS

Is the impact of reforms on local governments, particularly on their finances, considered in planning the reforms, and if so, by whom? Is the analysis of the local impact sufficiently refined to determine whether or not the changes affect all local governments equally? Are local governments consulted in advance? If not, when and how are they advised of the changes? Do local governments have adequate information and time to prepare and adjust for any changes? Are any changes or compensating measures included to mitigate any adverse impact on local governments? [Principle](#)

EUROPEAN UNION ACCESSION ISSUES [Principle](#)

The requirements for accession to the EU also raise issues that affect decisions about the financial resources of local governments.

FINANCING THROUGH REGIONS

Much of the assistance that the EU will provide as part of the accession process will be disbursed through a regional structure. This raises a number of important questions about the relationship between these new regional structures and intergovernmental finances in Central and Eastern Europe.

- *Nature of the regions.* What will be the nature of the new regions? Are they administrative bodies or will they become a new tier of local government? If the latter, how will they be financed? Will this detract from the financial resources of existing local governments? What will the functions of the new regional governments be and how will this affect the functions currently assigned to local governments? If the new regional bodies are only administrative (appointed, not elected), what will be their role in the flow of funds from the national to local budgets? What will be the role of local elected officials in these regional administrative bodies? [Comparative](#)

- *Flow of funds through the regions.* Will the EU grants follow the same process as transfers from the national budget, or will separate mechanisms and procedures be put in place? What will be the impact on local authority to make spending decisions?

NEW STANDARDS

The process of accession will bring other requirements that may affect intergovernmental finances. Many of these will concern new standards for functions for which local governments have the primary responsibility, such as air or water quality.

- *Impact on local finances.* How the standards are managed may affect the level of authority of local governments. The standards, in turn, may have an impact on local expenditures. Will extensive new investments be needed to bring local facilities and equipment up to the new standards? Will local service expenditures be affected? The issues will be the same as those discussed in chapter 3, “Functions and Responsibilities of Local Governments.” How will this funding be handled? Will additional EU funding for these investments be provided? If so, how will this funding flow? (See the foregoing discussion of regions.) [Comparative](#)
- *Nature and extent of local participation.* How the discussions on EU accession are managed within each country may determine the extent to which the impact on intergovernmental finance is considered at the time that decisions and commitments are made. The key issue is what role, if any, will local governments have in this process.

MAASTRICHT CRITERIA

These eventual requirements for all countries seeking accession to the European monetary union refer to targets on overall public deficits and debt. Maastricht criteria do not distinguish between national, municipal, or regional debts or those of national funds and institutions. This will bring local government debt under greater scrutiny and may lead to additional reporting requirements. [Comparative](#)

THE ANNUAL BUDGET CYCLE

The process of preparing and adopting national and local budgets raises a specific set of issues when the functions, responsibilities, and financial resources of local governments are considered together. Key decisions regarding local revenues and expenditures in the context of the national budget must also be made. The dynamics of the budget process itself has an impact on local decisions about both revenues and expenditures. [Application](#)

THE NATIONAL BUDGET CYCLE

A central question in intergovernmental fiscal relations concerns vertical equalization, that is, whether the sum of resources available to local governments from their own and national sources is adequate to meet local needs. As revenues from local taxes and fees are usually insufficient, the key issue is the share of national fiscal revenues and other national sources of financing that local governments should receive.



The process of preparing and adopting the annual national budget leads to decisions about total national financial resources available in any given year to all local governments. Important policy and procedural issues relate to the management of this pool of national financial resources available to local governments. [Principle](#), [Technical](#), [Comparative](#)

- *Decisionmaking process.* The first issue is whether this decision is made explicitly, that is, whether the size of the pool is identified as a specific decision in the annual national budget process. Often, it is not. In this case, the questions are: Is the impact of the size of the pool on local finances taken into account? What has been the impact? In cases where explicit discussion of the issue takes place, who decides? Is the national legislature made aware of the decision? Do associations representing local governments have an opportunity to comment on the proposed size of the pool of national resources they are to receive as a group? [Principle](#), [Legal](#), [Comparative](#)
- *Criteria and methodology.* Sorting out the financial needs of local governments raises the same methodological issues that are involved in making decisions about equalization grants, namely, how to define local fiscal capacity and local expenditure needs (see chapter 4). Assuming that developing such an estimate is possible, the next issue is how to determine the local share of national financial resources. This is especially difficult when the entire government is facing financial stress because of the transition process, as some argue is the case in most Central and Eastern European countries. The issue at that point becomes how to share the scarcity of resources. This, in turn, raises issues of relative priority of national versus local public expenditures. The division of resources is also complicated by changes in local revenue and expenditure assignment and by ongoing national reforms that affect both. Given the methodological difficulties, how much analysis is possible and necessary? Whatever the method, to what extent are local governments aware of the calculations and do they have an opportunity to comment?

THE LOCAL BUDGET CYCLE [Legal](#), [Comparative](#)

How is the local budget prepared? This affects both the revenue and expenditure sides of the budget. The local budget is only as good as the information that goes into its preparation. When local governments lack the information they need, or when they are forced to accept estimates provided or mandated by others, the budget loses much of its value as a financial management tool. Under these circumstances, holding local officials accountable for their management of the budget is also difficult. [Legal](#), [Comparative](#)

- *Revenue estimates.* Revenue issues concern the extent to which local governments have access to sufficient information to forecast all their financial resources. For local taxes and fees the result often depends on who has responsibility for administration. If it is not the local government, then the responsible entity must provide the information to the local government. In the case of financial resources provided from national sources, the result depends largely on the transparency and stability of the rules governing revenue sharing and transfers. [Legal](#), [Comparative](#)

- *Expenditure estimates.* Expenditure issues concern the degree of local control over service policy and standards; the extent to which the assignment of local functions changes from year to year; and how much advance information, if any, local governments have about these changes.
[Comparative](#)
- *Interaction with the national budget process.* Adequate and appropriate procedural norms are important in any financial management system. Budgeting and financial management procedures are simply the accounting manifestation of public policy. Proper public financial management must control the total level of revenue and expenditure adequately, allocate public resources among sectors and programs appropriately, and ensure that governmental institutions operate as efficiently as possible.
- *Budget preparation and approval.* To what extent are the local and national budget cycles related? Is there a uniform budget format that all local governments must use? Who establishes that format? Are local budgets subject to review by national authorities? What is the nature, purpose, and timing of the review? Do individual local governments receive any type of spending or revenue ceiling as a result of the review? Is there any relationship between the timing of approval of local and national budgets? If so, what happens if the new budget year begins before the budgets have been approved? Are spending limits in effect, and if so, what law, regulation, or institution establishes these limits? Is the impact of any changes to local revenues and expenditures included in the national budget retroactive to the beginning of the budget year? [Legal](#), [Comparative](#)
- *Budget execution.* Is it clear who has the authority to implement the local budget? To what extent is implementation of local budgets subject to national rules and supervision? Are limits placed on the level of local reserves, for example? Can local revenues be taken back or frozen in the course of the year? Are local governments allowed to retain and carry forward any surplus of revenues over expenditures? Who has the authority to approve expenditures under the budget? Do national authorities play any role in approving expenditures? If so, what happens if a disagreement occurs? [Legal](#), [Comparative](#)
- *Financial accounting, reporting, and audits.* What are the financial accounting and reporting requirements? Who establishes them? Are they uniform and mandatory for all local governments or are they optional? Are local government financial and accounting staff subject to technical supervision or oversight by an outside institution? Are local revenues and expenditures subject to external audits, and if so, by what institution? Is it clear who is accountable for local budget implementation decisions? Do audit standards exist, and if so, who authorizes them? Are these standards clear? Are they published so local officials can learn of them in advance? [Technical](#), [Legal](#), [Comparative](#)

PART III – APPLICATIONS GUIDE



6. OVERVIEW OF THE APPLICATIONS GUIDE

TYPES OF APPLICATIONS

This guide covers three types of applications. Each is described in the following subsections.

WORKSHOP MODULES

The workshop modules are based on the three substantive areas covered in “Part II–Content Guide,” that is:

- Functions and responsibilities of local governments
- Financial resources of local governments
- General intergovernmental finance issues.

The first two modules are for two-day courses and the third is for one-and-a-half days. The modules are not complete training guides, but offer a fairly specific outline for the course, including detailed guidance about what needs to be developed. Instructors will need to develop the complete course, including participant materials. Links are provided to help develop the courses and the participant materials.

This approach allows maximum flexibility to instructors to adapt the modules to specific situations (for example, more time for a more in-depth treatment).

Each module is structured in a similar way: a short introduction, learning objectives, schedule, and detailed session outlines. Each module is subdivided into sessions with suggested time frames.

A link is provided to a [Five-Day Course on Intergovernmental Fiscal Relations](#) that combines the above three modules. The substantive session outlines are the same, but the introduction and application sessions are specific to this course. A course setting the context for the three modules is also provided. For a two-day course that combines the modules on functions and responsibilities of local governments and financial resources of local governments, see the [Workshop Design](#) for Fiscal Decentralization in Macedonia.

THREE-DAY COURSE ON INTERGOVERNMENTAL FISCAL RELATIONS

This course is an overview aimed at an audience that needs to learn more about the subject matter, but does not need an in-depth understanding. The audience may include people with policy responsibilities or involved in program planning and oversight who need to be conversant enough with the topic to make informed choices and to make good use of people with expertise in the subject matter. The course covers the main concepts of intergovernmental fiscal relations. It combines lectures and small group work to maximize participant learning. The format of each module is similar to that of the workshop modules.

The course can be delivered in a single-country or multiple-country setting. Either variation will require some adaptation, especially in the analysis of country-specific case information and in the application of course content.

The instructors should have a firm grasp of the subject matter, as well as experience in organizing and facilitating training programs using active, participatory, adult learning methods. The course uses interactive lectures, facilitated discussions, case studies, and small group work.

ACADEMIC CURRICULA

This chapter contains sample academic curricula for intergovernmental finance from Georgia State University in the United States and the University of Fribourg in Switzerland. The curricula include extensive reading lists. This chapter is provided for those interested in applying the sourcebook themes to an academic setting.

PLANNING THE EVENTS

Several actions are recommended in planning an event (workshop or course).

- *Read the relevant sections of the sourcebook.* Make sure you are clear about all the content and the instructions for conducting the event. Read each step in the workshop and course design.
- *Adapt the designs for your needs.* This may mean shortening or expanding specific sessions or modifying the goals.
- *Prepare the participant materials.* The sourcebook provides many links that should help you prepare the materials.
- *Prepare for the event with your co-trainer.* Meet for at least one day of preparation to review all materials, clarify your understanding of the event overall, and divide responsibility for the parts of the event.
- *Review the list of materials.* During the event you will need to distribute some handouts, so copy them before the session. You will also need to prepare flipcharts and/or slides you will use during the session.
- *Set up the room.* Before the event starts, arrange the seating either in a semicircle where everyone can see each other or at tables where they can participate in small group discussions. Place flipchart stands at the front of the room. Hang the prepared flipcharts in the order of your presentation. Put a folder with plain paper and pen or pencil at each participant's place.

For more information on adapting material for instructional use please refer to the [Application of Course Materials](#) guide.



7. MODULE ONE: FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

OUTLINE FOR A TWO-DAY COURSE

This course outline is intended for audiences ranging from policymakers to policy analysts interested in improving or clarifying the functions and responsibilities of local governments. It assumes that participants are familiar with the European Charter of Local Self-Government (Charter), particularly as it applies to local functions and responsibilities. If this is not the case, you may have to add a lecture and discussion explaining the charter, which may result in extending the course to a very full two days.

This course outline is one of three in the sourcebook. The others are “Financial Resources of Local Governments” and “General Intergovernmental Finance Issues.” The content of this course can be incorporated into a longer one that includes other topics, or it can be shortened by omitting one or more of the sessions or modules.

Any reference to [Country X] refers to the country or countries represented by participants in the course. It requires that instructors have on hand information from [Country X] pertaining to local functions and responsibilities.

LEARNING OBJECTIVES

By the end of the course participants will be able to:

- Define the key terms for a dialog on local functions and responsibilities
- Describe the issues and factors that relate to the assignment of functions to local governments, including
 - Criteria for assigning functions
 - Legal definitions
- Identify the nature and extent of authority to perform local functions in selected Central and Eastern European countries for
 - Authority to manage services
 - Delegation of authority
 - Nature and extent of local regulatory authority
- Suggest ways in which the functions and responsibilities of local governments might be modified in [Country X] to align more closely with the Charter of Local Self-Government.

COURSE SCHEDULE

DAY ONE

1. Course Overview

- Introductions
- Objectives and Agenda

2. Key Terms

- Lecture and Discussion

3. Assignment of Functions

- Lecture and Discussion
- Exercise

Lunch

4. Authority to Perform Local Functions

- Lecture and Discussion
- Case Study: Comparison of Two Countries
- Report Out of Small Group Work and Discussion

DAY TWO

5. Modifying Functions of Local Governments

- Information Presentation
- Individual Work
- Small Group Work
- Work in Pairs or Threes
- Report Out, Identify Areas of Agreement
- Summary

Lunch

6. Application and Next Steps

- Individual Work
- Plenary Discussion

SESSION OUTLINES

SESSION 1: COURSE OVERVIEW

Session 1 is left up to the instructor's discretion. If this is a stand-alone course, then the session will include introductions, presentation of the course's objectives and agenda, and probably a welcome speech, not necessarily in that order.

SESSION 2: KEY TERMS

(Total time: 45 minutes)

LECTURE

25 minutes

Adapt the material from the [Meaning of Terms](#) section.

You should acknowledge that people may have different definitions for these terms. The intention behind these definitions is to provide a common framework for discussions and to avoid the confusion that can result from different interpretations of the words. Ask participants to accept them in this spirit.

One approach is to explain the terms in a presentation format. Another approach is to list the terms without descriptions and ask participants to define them. Solicit one or two examples for each term, and then give the meaning from the sourcebook. Avoid debating the examples given by participants; instead recognize that the terms have different interpretations. This option will take more time, but it may be worthwhile as a way to encourage more participation and to identify possible areas of confusion.

**DISCUSSION***20 minutes*

Provide time for clarification questions before moving on to the next topic. Avoid getting into an in-depth discussion, because the following sessions will elaborate on a number of the definitions.

SESSION 3: ASSIGNMENT OF FUNCTIONS TO LOCAL GOVERNMENTS*(Total time: 2 hours)***LECTURE***40 minutes*

Adapt the material from the sections on [Criteria for Assigning Functions to Local Governments](#) and [Legal Definition of Local Functions](#). Training materials that might be useful in preparing and presenting this session are also available, including a [presentation](#) on expenditure assignments, a report on [Revenue and Expenditure Assignments](#), and a report focusing on [Expenditure Assignments](#). One exercise allows participants to analyze the [Assignment of Expenditures in Kazakhstan](#) and describe the [Assignment of Expenditures of Their Own Countries](#).

Another set of resources refers to the [Charter of Local Self-Government](#) and its relevance to the [assignment](#) and [implementation](#) of functions and responsibilities. If participants are not familiar with the charter, you should consider either including the sections as resource materials or making a separate presentation. A separate presentation would lengthen the course.

Make sure to give examples of the difference between legislation and actual practice. The legislation may dictate other assignments of functions well in line with the charter, but actual practice may differ from the legislation in important ways.

EXERCISE—SMALL GROUP WORK*45 minutes*

Ask participants to work in small groups to identify two or three examples of functions assigned to local governments in [Country X] and answer the following questions:

- What assignment criteria do you think have been applied?
- What does the legislation address?
- What are the actual practices?
- Why do you think those differences exist?

Ask participants to share any information they may have regarding the assignment of local authority to promote and manage development.

EXERCISE—REPORT OUT*35 minutes*

Ask each group to give an example of a function and the criteria they think were applied for assigning local functions. Make sure they differentiate between actual practices and the legislation. Discuss their responses.

SESSION 4: AUTHORITY TO PERFORM LOCAL FUNCTIONS

(Total time: 3 hours)

LECTURE

45 minutes

Adapt the material from the section on [Nature and Extent of Authority to Perform Local Functions](#). A source with useful examples of a country situation is a presentation on [Issues of Transition in Hungary](#).

Another source that may be of interest is a presentation on [Alternative Forms of Service Delivery in Municipal Services](#). This topic is a subset of the issue of services and would involve taking more time, or even an entire session.

CASE STUDY

2 hours 15 minutes

INDIVIDUAL WORK

30 minutes

Ask participants to read selections describing the assignment of functions either in [Albania](#) or [Macedonia](#). A study of both countries is also possible, but will take longer. To stay within the allotted time, studying one country or assigning each country to different groups of participants may be better. Ask them to take notes and respond to the following questions:

- What authority does this country give local governments to manage services?
- How do they organize service delivery?
- What is the nature and extent of local regulatory authority?
- What are some changes that this country might consider regarding the nature and extent of authority to perform local functions in order to be more closely aligned with the Charter on Local Self-Government?

SMALL GROUP WORK

1 hour

Once they have completed the individual analysis, ask participants to form groups of four to six people to discuss their responses. Ask them to identify points of agreement.

REPORT OUT

45 minutes

Ask each group to report on a different question to distribute the time evenly between groups. Discuss the responses.

SESSION 5: ANALYSIS OF COUNTRY SITUATION TO EXPLORE MODIFYING THE FUNCTIONS OF LOCAL GOVERNMENTS

(Total time: 4 hours)

This session may be shortened or deleted depending on the amount of time available and the possibility of working with information about the country or countries represented.

**PRESENTATION OF COUNTRY INFORMATION SUMMARY***30 minutes*

Refer to the objective that reads: Suggest ways in which functions and responsibilities of local governments might be modified in [Country X] to align more closely with the Charter of Local Self-Government.

Present information about the functions and responsibilities of local governments in the country where the course is being held. You need to assemble this information prior to the course. Give participants time to read over the information and to ask clarifying questions.

ANALYSIS EXERCISE—SMALL GROUPS*1 hour*

Ask participants to respond to the following questions. Some of them may have been answered in the earlier part of the course. If so, they can concentrate more on the last question:

- What authority does [Country X] give local governments to manage services?
- How do they organize service delivery?
- What is the nature and extent of local regulatory authority?
- What are some changes that [Country X] might consider regarding the nature and extent of authority to perform local functions to be better aligned with the Charter on Local Self-Government?

Ask the groups to record their responses on flipchart paper so that all may see and refer to these for discussion purposes and for the following activity.

REPORT OUT*30 minutes*

Ask each group to report out on a different question to distribute the time evenly. Discuss the responses. Link them to the following activity, in which they will explore their suggestions and recommendations in greater depth. Write on the flipchart the list of changes based on their suggestions and identify five or six that would lend themselves to further elaboration.

WORK IN PAIRS OR THREES USING ANALYSIS OUTCOMES¹*45 minutes*

Make sure everyone is prepared to engage in this activity. If necessary, modify the tasks as appropriate.

Assign each suggested change to a pair or threesome. Ask them to do the following:

- Review the suggested change. Identify the advantages and disadvantages.
- Make refinements as appropriate and be prepared to present them to the plenary. Record the group's work (on the flipchart, on a whiteboard, or in PowerPoint).

¹ The smaller groupings are both to vary the methodology and to allow more in-depth discussion of the issues.

REPORT OUT*45 minutes*

Ask each small group to report out. Identify areas of agreement and those that either deserve further analysis or represent disagreement. For this activity to fit in this time frame, do not push too hard for consensus. For consensus you will need much more time, as much as a half-day or a day depending on your audience.

SUMMARY*30 minutes*

Review the suggestions and recommendations and how they have been organized to verify that they have been summarized accurately and understood by everyone. Link to the next session, in which individuals will identify how they plan to follow up on these items.

SESSION 6: APPLICATION AND NEXT STEPS*(Total time: 1 hour)***INDIVIDUAL WORK***20 minutes*

The wording and timing of this task will vary depending on the type of audience. An example of wording might be

- Review the notes from the previous sessions.
- Identify the most important insights or lessons you have gained from this course and write them down.
- Review the summary of suggestions and recommendations and identify two or three things you might do in the next two weeks to follow up on these items. Write them down.

PLENARY DISCUSSION²*1 hour 10 minutes*

Ask for examples of participants' insights or lessons. Write them on a flipchart if possible so that everyone can benefit. Then ask for examples of how people plan to follow up on the suggestions and recommendations. Writing these down for all to see may also be useful. This part of the course can serve as a planning session and can be extended if participants are policymakers, for example.

You may wish to conduct a course evaluation at this point. Make sure to allot enough time for people to fill out the evaluation form.

² You may conduct this activity in small groups, especially if subgroups of participants who work together outside the course are present.



8. MODULE TWO: FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

OUTLINE FOR A TWO-DAY COURSE

This course outline is intended for policymakers and policy analysts interested in improving the system for financing local governments. It assumes that participants are familiar with the European Charter of Local Self-Government (Charter), particularly as it applies to local functions and responsibilities. If not, then you may need to add a lecture and discussion explaining the charter, which may result in extending the course to a very full two days.

The content of this course can be incorporated into a longer one that includes one of the others in the sourcebook (Financial Resources of Local Governments and General Intergovernmental Finance Issues), or it can be shortened by omitting one or more of the sessions or modules.

Any reference to [Country X] refers to the country or countries represented by participants in the course. It requires that instructors have on hand data from [Country X] pertaining to local financial resources.

LEARNING OBJECTIVES

By the end of the course participants will be able to

- Identify the different types of financial resources potentially available to local governments, using a common definition for each type of resource
- Describe the issues associated with local governments using the following “own” sources of financing:
 - Local taxes and fees
 - Debt
 - Other local sources
- Describe the issues faced when using intergovernmental transfers, including
 - Grants
 - Shared revenues
- Analyze the current situation in [Country X] regarding the financial resources available to local governments
- Identify changes needed to the current system of local government financial resources in [Country X].

COURSE SCHEDULE

DAY ONE

1. Course Overview

- Introductions
- Objectives and Agenda

2. Financial Resources and Common Definitions

- Lecture and Discussion

3. Own Sources of Financing

- Lecture and Discussion
- Case Study Part One
- Individual Work on the Case Study

Lunch

Own Sources of Financing (continued)

- Small Group Work on the Case Study
- Report Out of Small Group Work and Discussion

4. Intergovernmental Transfers

- Lecture and Discussion
- Case Study Part Two
- Individual and Small Group Work on the Case Study

DAY TWO

Intergovernmental Transfers (continued)

- Report Out of Small Group Work and Discussion

5. Analysis of Country Situation Regarding Financial Resources

- Presentation of Data Summary
- Analysis Exercise in Small Groups
- Report Out

Lunch

6. Identifying Changes to the Current System

- Work in Pairs Using Analysis Outcomes
- Report Out, Identify Areas of Agreement
- Summary

7. Application and Next Steps

- Individual Work
- Plenary Discussion

SESSION OUTLINES

SESSION 1: COURSE OVERVIEW

Session 1 is left up to the instructor's discretion. If this is a stand-alone course, then the session will include introductions, presentation of the course objectives and agenda, and probably a welcome speech, not necessarily in that order.

SESSION 2: FINANCIAL RESOURCES AND COMMON DEFINITIONS

(Total time: 45 minutes)

BRIEF LECTURE

20 minutes

Adapt the material from the section on [Background](#) on Financial Resources of Local Governments. Referring to the lecture slides on [Principles of the European Charter: Assignment of Revenues and Resources](#) may be useful.

The lecture should not last more than 20 minutes. It will last about 40 minutes if you spend time on the Principles of the European Charter.

**DISCUSSION***25 minutes*

After the lecture ask questions to stimulate discussion and understanding of the terms. Writing the participants' answers on the flipchart and then categorizing them according to each term would also be useful. Here are some proposed questions:

- What types of financial resources are available in [Country X]?
- Which of these resources fit into the category of
 - Own resources
 - Local taxes
 - Fees, charges, and tariffs
 - Transfers, grants, and shared revenues?

For a complete course on debt, see the [Foundation Course](#) for Local Credit in Romania.

SESSION 3: OWN SOURCES OF FINANCING*(Total time: 3 hours)***LECTURE***45 minutes*

Adapt the material from the section on [Own Sources of Financial Resources](#). You might find that [existing training materials](#) are also useful in preparing and presenting this session.

To promote greater understanding, participation, and discussion, ask for examples from the country or countries represented in the audience as the lecture proceeds.

CASE STUDY*1 hour 30 minutes***INDIVIDUAL WORK***30 minutes*

Training materials are available that might be useful in preparing and presenting a relevant case study. The materials include profiles of two fictitious countries, [A](#) and [B](#), based on a mix of actual information from several Central and Eastern European countries, and case study questions designed to make use of one of the country profiles. The case study includes national-level policy related to the financial resources of local governments, as well as details on functions and responsibilities, including revenue sources.

The questions listed below are intended as a substitute for the case study questions in the reference materials. You would need to study [Country Profile A](#) and determine whether you wish to use it in its entirety or make modifications. Reducing the amount of information in the country profile may be worthwhile, particularly if time is short.

Ask participants to review [Country Profile A](#) and to answer the following questions:

- What is the structure for local taxes and fees in Country A?
- How much autonomy does it provide to local governments?
- What are the implications of this structure if a local government wishes to borrow money?

- What other local sources might be available to local governments?
- What policy changes might be needed for local governments to have greater access to financial resources?

SMALL GROUP WORK

1 hour

Once they have completed the individual analysis of the case, ask participants to form groups of four to six people to discuss their responses. Ask them to identify points of agreement.

REPORT OUT

45 minutes

Ask each group to report out on a different question to distribute the time evenly between groups. Discuss their responses.

SESSION 4: INTERGOVERNMENTAL TRANSFERS

(Total time: 3 hours)

LECTURE

45 minutes

For the lecture refer to the presentation on [National Payments to Subnational Governments](#). For further information refer to the paper on [Intergovernmental Transfers in Developing and Transition Countries: Principles and Practice](#).

To promote greater understanding, participation, and discussion, ask for examples from the country or countries represented in the audience as the lecture proceeds.

CASE STUDY

2 hours 15 minutes

INDIVIDUAL WORK

30 minutes

Ask participants to work on a comparison of the intergovernmental transfer situation between [Country A](#), studied in the previous session, and [Country B](#), which they will now read for the first time. Ask them to note their answers to the following questions:

- In your opinion, which of the two countries appears to have the most effective system for
 - Ensuring the vertical balance of the fiscal system
 - Ensuring the horizontal balance of the system of local governments
 - Influencing the allocation of resources by local governments
 - Reimbursing local governments for the costs of performing agency functions
- What recommendations would you make to either country to improve its system of intergovernmental transfers?¹

¹ This question will take more time and assumes a more advanced level of knowledge and experience by participants, therefore you may wish to omit it for certain audiences.

**SMALL GROUP WORK***1 hour*

Once they have completed the individual analysis of the case, ask participants to form groups of four to six people to discuss their responses. Ask them to identify points of agreement.

REPORT OUT*45 minutes*

Ask each group to report on a different question to distribute the time evenly between groups. Discuss their responses.

SESSION 5: ANALYSIS OF COUNTRY SITUATION REGARDING FINANCIAL RESOURCES*(Total time: 2 hours)***PRESENTATION OF COUNTRY DATA SUMMARY***30 minutes*

Present data from the country where the course is held, including both policy and revenue information (you can model this using categories from Country A or B above). You will need to assemble data prior to the course.

Give participants time to read over the data and to ask clarifying questions.

ANALYSIS EXERCISE—SMALL GROUPS*1 hour*

Depending on the time available and the number of participants, you may wish to assign the two series of questions below to different groups:

Own Sources of Financing

- What is the structure for local taxes and fees in this country?
- How much autonomy does it provide to local governments?
- What are the implications of this structure if a local government wishes to borrow money?
- What other local sources might be available to local governments?
- What policy changes might be needed for local governments to have greater access to financial resources?

Intergovernmental Transfers

Assess how effective you feel this country's system is for

- Ensuring the vertical balance of the fiscal system
- Ensuring the horizontal balance of the system of local governments
- Influencing the allocation of resources by local governments
- Reimbursing local governments for their costs of performing agency functions.

Identify one or two recommendations you would make to this country to improve the system of intergovernmental transfers.

Ask the groups to record their responses on the flipchart, and refer to the responses for discussion and for the following activity.

REPORT OUT*30 minutes*

Ask each group to report on a different question to distribute the time evenly between groups. Discuss the responses. Link to the following session, in which they will explore their suggestions and recommendations in greater depth.

Plan enough of a break between this and the next session, probably an extended lunch, for the organizers to identify and classify the different suggestions or recommendations so that each one may be assigned to a different group in the following activity. This task may involve selecting appropriate items that lend themselves to the course context and time available.

SESSION 6: IDENTIFYING CHANGES TO THE CURRENT SYSTEM*(Total time: 2 hours)***WORK IN PAIRS OR THREES USING ANALYSIS OUTCOMES²***45 minutes*

Refer to the session objective: “Identify changes needed to the current system of local government financial resources in [Country X].” Make sure everyone is prepared to engage in this activity. If necessary, modify the tasks as appropriate.

Assign each recommendation or category of suggestion to a pair or a threesome. Ask them to do the following:

- Review the suggestion or recommendation
- Identify the advantages and disadvantages
- Make refinements or changes as appropriate and be prepared to present them to the plenary
- Record the group’s work (on a flipchart or in PowerPoint).

REPORT OUT*45 minutes*

Ask each small group to report out. Identify areas of agreement and areas that either deserve further analysis or represent areas of disagreement. For this activity to fit in this time frame, do not push too hard for consensus. For consensus you will need more time, as much as a half-day or a day depending on the audience.

SUMMARY*30 minutes*

Review the suggestions and recommendations and how they have been organized to verify that they have been summarized accurately and understood by everyone. Link to the next session, in which individuals will identify how they plan to follow up on these items.

² The smaller groupings are both to vary the methodology and to allow more in-depth discussion of the issues.



SESSION 7: APPLICATION AND NEXT STEPS

(Total time: 1 hour)

INDIVIDUAL WORK

20 minutes

The wording and timing of this task will vary depending on the type of audience. An example of wording might be as follows:

- Review the notes from the sessions in this course.
- Identify your most important insights or lessons from this.
- Review the summary of suggestions and recommendations and identify two or three things you might do in the next two weeks to follow up on these items.
- Write them down.

PLENARY DISCUSSION³

1 hour 10 minutes

Ask for examples of participants' insights or lessons. Write them on the flipchart if possible so that everyone can benefit. Then ask for examples of how people plan to follow up on the suggestions and recommendations. Writing them down for all to see may also be useful. This part of the course can serve as a planning session and can be extended if the participants are policymakers, for example.

You may wish to conduct a course evaluation at this point. Make sure you have allotted enough allotted for people to fill out the evaluation form.

³ This activity may be conducted in small groups, especially if subgroups of participants who work together outside the course are present.



9. MODULE THREE: GENERAL INTERGOVERNMENTAL FINANCE ISSUES

OUTLINE FOR A ONE-AND-A-HALF DAY COURSE

This course is intended for policymakers and policy analysts interested in improving the system for financing local governments in a given country or in a set of countries in Central and Eastern Europe. It is assumed that the instructors are familiar with intergovernmental finance issues in Central and Eastern Europe in general, including the requirements for accession to the EU.

The content of this course can be incorporated into one of others in the sourcebook (Financial Resources of Local Governments and Functions and Responsibilities of Local Governments), or it can be shortened, using one or more of the sessions or modules.

Any reference to [Country X] as shown in brackets refers to the country or countries represented by the participants. It also requires that instructors have information from [Country X] on ongoing transition and reforms as well as in-depth understanding of the national and local governments' annual budget processes.

LEARNING OBJECTIVES

By the end of the course participants will be able to:

- Describe how the broader context of the economic and political transition in Central and Eastern Europe affects policy discussions on intergovernmental fiscal relations
- Analyze how this broader context is affecting the current situation in [Country X] especially regarding economic and fiscal policy and EU accession
- Describe how the process of preparing and adapting national and local budgets in [Country X] has an impact on expenditures and the resources available to local governments
- Identify potential changes in the annual national and local budget process that will better meet objectives.

COURSE SCHEDULE

DAY ONE

1. Course Overview

- Introductions
- Objectives and Agenda

2. Impact on Intergovernmental Fiscal Relations of Ongoing Transition and Reforms

- Lecture and Discussion

3. Analysis of Impact

- Small Group Task
- Report Out
- Summary

Lunch

4. Effect of the National and Local Government Budget Processes

- Lecture and Discussion

DAY TWO

5. Potential Changes in National and Local Budget Processes

- Individual Work
- Small Group Work
- Report Out, Identify Areas of Agreement
- Summary

6. Application and Next Steps

- Individual Work
- Plenary Discussion

Lunch

SESSION OUTLINES

SESSION 1: COURSE OVERVIEW

Session 1 is left up to the instructor's discretion. If this is a stand-alone course, then the session will include introductions, presentation of the course objectives and agenda, and probably a welcome speech, not necessarily in that order.

SESSION 2: IMPACT OF ONGOING TRANSITIONS AND REFORMS ON INTERGOVERNMENTAL FISCAL RELATIONS

(Total time: 2 hours)

LECTURE

45 minutes

Adapt the material from the [Ongoing Transition and Reforms](#) section to construct a lecture. Another useful source is an existing presentation on [Fiscal Decentralization](#).

This lecture should provide an overview of transition and reform issues in (1) economic and fiscal policy, and (2) the annual budget cycle for national and local government, and their links to intergovernmental fiscal relations. The focus of this lecture is on helping the participants understand these links and not on analyzing the situation in [Country X], which is the focus of the next session.

You can deliver the lecture in several ways. One way is a 45-minute presentation based on the material in the sourcebook followed by a plenary discussion. A more interactive way to engage the participants is the following:



- Divide the lecture into its two components: transition and reform issues and the annual budget cycle.
- At the beginning of each component, list the major subheads in part II of the sourcebook on the flipchart. For example, transitions and reforms would include fiscal stabilization, taxes, public administration, capital markets, the social sector, state enterprises, land ownership and property markets, and the decisionmaking process.
- For each of these topics, ask how these issues affect intergovernmental fiscal relations.
- Supplement the participants' comments, making sure you cover the major points.

This second approach would in effect combine the lecture and discussion time.

DISCUSSION

45 minutes

If you took the first approach, allow adequate time for questions. In either case, the discussion should focus primarily on understanding the issues and their links to intergovernmental finance and not on their application to the specific country situation. That is covered in the next session.

SESSION 3: ANALYSIS OF IMPACT IN [COUNTRY X]

(Total time: 90 minutes)

This session is aimed at relating the issues discussed in the previous session to the actual situation in a specific country. This session consists of small group work followed by reports from the group and discussion.

Divide the participants into three small groups, each discussing one of the following themes:

- Economic and fiscal policy reform (fiscal stabilization; reform of taxes, public administration, and capital markets)
- Economic and fiscal policy reform (social sector, state enterprises, land ownership and property markets, decisionmaking process)
- EU accession.

EXERCISE—SMALL GROUP WORK

45 minutes

Ask each group to answer the following questions (pertaining to the themes assigned to the group):

- How have the issues affected intergovernmental fiscal relations in [Country X]?
- Which issues continue to pose the greatest difficulties in creating an equitable and rational system of intergovernmental finance? Why?
- Which issues are the most important to resolve? Why?
- What can be done to address the most important issues?

REPORT OUT*35 minutes*

Ask each group to summarize its findings to the full group. Make sure the group focuses on the impact of the issues on [Country X].

SUMMARY*10 minutes*

After all the groups report out, lead a discussion with the full group on which reforms are the most critical to address to strengthen intergovernmental fiscal relations.

SESSION 4: EFFECT OF THE NATIONAL AND LOCAL GOVERNMENT BUDGET PROCESSES*(Total time: 60 minutes)***LECTURE***30 minutes*

Adapt the material from the [Annual Budget Cycle](#) section. The lecture should discuss both the national and local budget cycles and their interaction.

The following links may also provide additional information for this lecture:

- [Fiscal Decentralization in Former Socialist Economies: Progress and Prospects](#)
- [Fiscal Decentralization and Local Government Finance in Hungary 1989–1999](#)
- [Fiscal Decentralization in Transition Countries](#).

Another possibility is to refer to the country profiles in [Financial Management A](#) and [Financial Management B](#), which contain descriptions of the budget process and structure for the two fictitious countries used in earlier sessions.

DISCUSSION*30 minutes*

Ask participants for clarification questions to make sure they understand the lecture. The focus of this discussion is on understanding the way budget cycles affect intergovernmental finance. The next session will focus on the application of these principles to [Country X.]

SESSION 5: POTENTIAL CHANGES IN NATIONAL AND LOCAL BUDGET PROCESSES IN [COUNTRY X]*(Total time: 105 minutes)***INDIVIDUAL WORK***10 minutes*

Ask participants to do the following:

- Make a list of potential changes to local and national budget processes that would have a positive effect on intergovernmental fiscal issues.
- Identify changes that would be especially difficult to make.

SMALL GROUP WORK*50 minutes*

Divide the participants into groups of six and ask them to do the following, making sure to discuss the local and national government budget processes separately:



- Share the responses to the individual tasks.
- Agree on the most critical changes that need to be made.
- Discuss why those changes are the most critical ones.

REPORT OUT*45 minutes*

Ask each group to report its findings on the local government budget process and then on the national government budget process.

Identify areas of agreement and record them on the flipchart. Tell the group that the next session will include identifying concrete action on the critical issues related to the budget process.

SESSION 6: APPLICATION AND NEXT STEPS*(Total time: 1 hour and 15 minutes)***INDIVIDUAL WORK***15 minutes*

The wording and timing of this task will vary depending on the type of audience. An example might be

- Review the notes from this course.
- Identify your most important insights.
- Review your suggestions and recommendations and identify two or three things you might do in the next few weeks to follow up on these items.

PLENARY DISCUSSION*60 minutes*

Ask for examples of participants' insights or lessons. Write them on flipchart if possible so that everyone can benefit. Ask for examples of how people plan to follow up on the suggestions and recommendations. Writing them down for all to see may be useful.

Approximately 30 minutes of this discussion is intended for detailed discussion of follow-up on a few critical items. Expecting the participants to have identified a few key issues of particular importance is reasonable, and discussing follow-up actions in some depth will be a productive use of workshop time.

You may wish to conduct a course evaluation at this point. Make sure you have allotted enough time for participants to fill out the evaluation form.



10. THREE-DAY COURSE ON INTERGOVERNMENTAL FISCAL RELATIONS

This three-day course outline was originally designed for USAID and World Bank staff with varying levels of experience and involvement in the subject matter. The goal of the course was to help participants be better informed when involved in either program design or management related to fiscal decentralization. The approach and content are adaptable to a wide variety of audiences. Unlike the previous courses in the sourcebook it is not intended to develop a high level of expertise.

Depending on their backgrounds, as a result of this course participants should be able to develop scopes of work for consultants working in fiscal decentralization and be effective managers of the products that the consultants deliver. Participants in this course should also be able to contribute to policy discussions and program design teams.

LEARNING OBJECTIVES

By the end of the course participants will be able to

- Provide a conceptual framework and understanding of the theory of intergovernmental fiscal relations, decentralization, and local autonomy and their relationship to local government and democratic governance
- Provide “lessons learned” from and specific experiences of the reform of intergovernmental fiscal relations and decentralization in the transition economies of Eastern Europe
- Demonstrate how the theory and practice can be applied to resolving specific transitional issues in the participant countries, taking regional realities and priorities into consideration
- Improve the effectiveness of program design and management by enabling participants to address fiscal decentralization issues (optional).

The following table shows how each of the proposed sessions of the course address and/or reinforce these three objectives (the fourth objective is optional). As the table shows, three sessions emphasize the basic theory and concepts of decentralization and the lessons learned about the process in the transition countries. A further three sessions look at how to apply these concepts and lessons learned in solving practical problems that typically arise during the process of decentralization in transition countries. These same sessions also look at the corresponding program design issues. The last session, listed on the schedule as optional depending on the audience, looks specifically at the program design implications of all the material presented in the course. If you choose not to conduct this session you can either shorten the course to two-and-a-half days or add another session related to the application of the material in the course tailored to the needs of your specific audience.

SUMMARY OF OBJECTIVES BY SESSION

Session number/main theme	Concepts and theory	Lessons learned	Solving problems	Program design
2. Overview	✓	✓		
3. Building blocks	✓	✓		
4. Access to credit	✓	✓		
5. Country experience	✓	✓		
6. National/local interests	◆	◆	✓	✓
7. Phasing of reforms	◆	◆	✓	✓
8. Legislative reforms	◆	◆	✓	✓
9. Program design	◆	◆	◆	✓

- ✓ Main focus of the session.
 ◆ Reinforces prior themes.

SCHEDULE

The following schedule shows how the topics can be arranged over a full three-day period.

Day	Time	Session Topic	Description
ONE	1 hour 15 minutes	1. Welcome and Overview	<ul style="list-style-type: none"> • Welcome • Participant introductions • Start-up activity • Objectives/agenda/working norms
	45 minutes	2. Overview of Decentralization: Basic Objective and Global Patterns, Trends and Lessons Learned	<ul style="list-style-type: none"> • Basic concepts and theory of decentralization • Key lessons learned about decentralization in transition countries • Presentation and discussion
	15 minutes	Break	
	1 hour 15 minutes	3. Building Blocks of Decentralization	<ul style="list-style-type: none"> • Building blocks of decentralization • Key lessons learned about these building blocks in transition countries • Presentation and discussion
	1 hour	Lunch	
	1 hour	4. Infrastructure Finance and the Role of Debt, Borrowing, and Creditworthiness	<ul style="list-style-type: none"> • Basic concepts and theory of local borrowing • Key lessons learned about local borrowing in transition economies • Presentation and discussion



Day	Time	Session Topic	Description
	1 hour 15 minutes	5. Country Experiences with Decentralization	<ul style="list-style-type: none">• How concepts of fiscal decentralization and local borrowing and how the lessons learned regarding fiscal decentralization in transition countries may apply specifically in countries where participants work▪ Small group work
	15 minutes	Break	
	1 hour	Country Experiences (continued)	<ul style="list-style-type: none">• Groups report to plenary discussion
<u>TWO</u>	1 hour 15 minutes	6. Balancing Overlapping Local and National Interests	<ul style="list-style-type: none">• How the failure to balance overlapping local and national interests in the process of fiscal decentralization can create unintended problems for local governments and why that can lead to instability in the assignment of functions to local governments• Ways in which to balance overlapping local and national interests in the process of fiscal decentralization in the design or implementation of donor programs that support decentralization or have an impact on the process• Presentations and case study
	15 minutes	Break	
	2 hours	6. Balancing Overlapping Local and National Interests (continued)	<ul style="list-style-type: none">• Case study: work in small groups• Groups report out in plenary
	1 hour	Lunch	
	1 hour 15 minutes	7. Phasing and Sequencing of Fiscal Decentralization	<ul style="list-style-type: none">• How the failure to coordinate the phasing and sequencing of fiscal decentralization can create unintended problems for local governments• Why the rush to decentralize functions may not always lead to effective local control or adequate funding of the new functions• Some of the ways in which to address the phasing and sequencing of fiscal decentralization in the design or implementation of donor programs that support decentralization or have an impact on the process• Presentations and case study

Day	Time	Session Topic	Description
	15 minutes	Break	
	2 hours	7. Phasing and Sequencing of Fiscal Decentralization (continued)	<ul style="list-style-type: none"> • Case study: work in small groups • Small groups report out in plenary
<u>THREE</u>	1 hour 15 minutes	8. Impact and Limitations of Local Government Legislative Reforms	<ul style="list-style-type: none"> • How the failure to take the impact and limitations of local government legislative reforms into account can create unintended problems for local governments, and why legal reforms often lead to limited change in the way national and local governments work • Some of the ways in which to consider the impact and limitations of local government legislative reforms in the design or implementation of donor programs that support decentralization or have an impact on the process • Presentations and case study
	15 minutes	Break	
	2 hours	8. Impact and Limitations of Local Government Legislative Reforms (continued)	<ul style="list-style-type: none"> • Case study: work in small groups • Small groups report out in plenary
	1 hour	Lunch	
	1 hour 15 minutes	9. How to Design, Manage, and Monitor Activities to Support Decentralization (optional)	<ul style="list-style-type: none"> • Some of the ways in which the theory, concepts, and lessons learned introduced in course can help improve the design and management of donor support for decentralization • Presentation and small group work
	15 minutes	Break	
	1 hour	9. How to Design, Manage, and Support Activities That Support Decentralization (continued)	<ul style="list-style-type: none"> • Small groups report out to plenary
	1 hour	10. Wrap-Up and Course Evaluation	<ul style="list-style-type: none"> • Written course evaluation and postcourse application plan • Closing comments



SESSION OUTLINES

DAY ONE

SESSION 1: INTRODUCTORY SESSION

(Total time: 1 hour and 15 minutes)

Welcome the participants to the course. Ask the participants to briefly introduce themselves to the full group.

Here are two options for a start-up activity:

Option One

If you do not have much advance knowledge of the participants' expectations of the course, do the following:

- Divide the participants into groups of four to six people and ask them to agree on their four or five most important expectations from the workshop. Ask all the groups to report out when they have finished. Making major changes to the course program may not be possible at this point, but having an idea of what the participants feel they need is helpful. Your response can be to clarify what the course is intended to cover and what it is not going to cover to forestall any misunderstandings. An additional response is to look at the sessions and make adjustments by covering some material in greater depth so as to respond to what a significant number of participants expressed as expectations.

Option Two

This option is a bit more fun, because it creates a climate for active participation and for people to express their feelings about decentralization, a major theme of the course. It can be a valuable source of information for instructors about where participants stand on the issue and how they have experienced it in their professional, and even in their personal lives:

- Write the following task on a flipchart at the front of the room: "In my work experience, the process of decentralization in transition countries feels like...."
- Have flipcharts on the wall around the room with some of the following statements: "being left alone at the altar," "turning the Titanic," "planting crops during a drought," "getting a loan with no credit history," "driving on a stormy night with no headlights," "building a house with an unreliable contractor." You may add or substitute other statements that you prefer. Post the charts far enough from one another so that a group may stand around each one.
- Provide the following task on another flipchart: "Go stand next to the statement that best completes the sentence for you, based on your experience. Try to have a maximum of five people per statement. Discuss with the others making the same choice why they selected the statement. Then have one person be prepared to make a summary of the discussion."

- Once members of each group have discussed their reasons with one another for about 10 minutes, ask the participants to remain next to the statements they selected while a representative from each group reports out. Summarize briefly, linking the statements to the course themes. Then thank them and have them return to their tables.

Present the [objectives](#) and the agenda for the course, pointing to themes related either to expectations if you choose option one, or to the summaries of the discussions about decentralization if you choose option two. Discussing [working norms](#) that will create the most productive learning environment for all the participants is also recommended.

If you decide to conduct a pre- and postcourse self-assessment of knowledge about intergovernmental fiscal relations and you were unable to distribute it to the participants prior to the course, you may wish to add about 20 minutes to have them fill out the [precourse self assessment](#). This is an evaluation tool that can help determine how much participants have learned during the course. It is not a test, and the questionnaire can therefore be anonymous. If people choose not to write down their names, then they should use a symbol that they will use again for the postcourse self-assessment.

SESSION 2: OVERVIEW OF DECENTRALIZATION: BASIC OBJECTIVE OF DECENTRALIZATION AND GLOBAL PATTERNS/TRENDS/LESSONS LEARNED

(Total time: 45 minutes)

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- List the basic concepts and theory of decentralization
- Describe the key lessons learned about decentralization in transition countries.

Introductory Lecture

20 minutes

The [introductory lecture](#) gives a basic definition of fiscal decentralization and the arguments for it, including how local governments can capture its benefits, how revenues should be assigned, and some rules and approaches for decentralization.

Lecture on Key Lessons in Transition Countries

25 minutes

The [lessons learned lecture](#) focuses on structure and competencies of fiscal decentralization using Hungary's intergovernmental relations model. It then turns to local expenditure and general government expenditure and revenue examples from 24 European countries; the challenges created by government restrictions on borrowing; and weaknesses in local legal, institutional, and organizational frameworks.



SESSION 3. BUILDING BLOCKS OF DECENTRALIZATION

(Total time: 1 hour 15 minutes)

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- Describe the building blocks of fiscal decentralization
- Identify the key lessons learned about these building blocks in transition countries.

Lecture

1 hour

This [lecture on the building blocks of fiscal decentralization](#) encourages people who work on decentralization to remember the relatively simple concept that local decisions will lead to the quantity, quality, cost, and mix of services that most closely match local needs and preferences, and to return to this concept when caught in technical details or when unsure of what action to take. The key building blocks in the lecture are assignment of functions, revenue assignment, property, and budget.

The lecture underscores important implications about decentralization for transition countries. Decentralization implies profound change in almost every aspect of what government does and the way it conducts its business, and it transforms intergovernmental relations. Some of the lessons learned are that no single correct model is available. Finally, the lecture looks at how national reforms affect decentralization.

Open Questions from the Participants

15 minutes

This part of the session is devoted to clarifying questions that the participants may have. To forestall lengthier discussions in the interest of effective course time management, reminding the participants that this is one of the sessions building up to sessions 5 through 9, where they will be working in small groups to explore the subject matter in greater detail, may be useful, and they will have much more time for discussion during those sessions.

SESSION 4. INFRASTRUCTURE FINANCE AND THE ROLE OF DEBT, BORROWING, AND CREDITWORTHINESS

(Total time: 1 hour)

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- Describe the basic concepts and theory of local borrowing
- Identify the key lessons learned about local borrowing in transition economies.

Lecture

45 minutes

The [lecture on infrastructure finance and the role of debt, borrowing, and creditworthiness](#) starts with the infrastructure implications of decentralization, the investment implications of infrastructure transfer, and how to finance infrastructure. It then moves to the issue of borrowing and of conditions for creditworthiness, authority to borrow, guarantees, rules, and default. The key lessons learned are that no single model for municipal credit is available, that external requirements drive many of the rules (EU, International Monetary Fund), and that local and national investment priorities can be different, leading to potential conflicts.

Open Questions from the Participants

15 minutes

Here again the participants have an opportunity to ask questions.

SESSION 5. COUNTRY EXPERIENCES WITH DECENTRALIZATION*(Total time: 2 hours 15 minutes)***Recommended Advance Preparation**

In anticipation of the tasks in this session, the practical nature of the discussion will be greatly enhanced if you ask each participant to obtain the information specific to a given country before coming to the course. The selection of the country or countries will depend on their responsibilities and interests. Ask them to find the following information:

- What are the key functions and sources of revenue of local government in the country or countries that you would like to study in this course? Try to find out why the participants selected these specific functions and sources of revenues.
- How does the local budget process work?
- What is the status of local ownership of assets and of local property rights?
- Identify one national-level reform or transition process that has affected the process of decentralization. How and to what extent have local governments handled the impact of this reform?
- What have been the key steps in the process of decentralization to date? Focus on key legislation and on the measures to implement that legislation.

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objective: By the end of the session participants will be able to

- Describe how concepts of fiscal decentralization and local borrowing may apply specifically in the country or countries they would like to study during the course.

This session builds on the material in sessions 2, 3, and 4 and on any information that the participants have been able to obtain prior to the course. For those who do not have this information, reports are available in this sourcebook that describe local government systems in several countries of Central and Eastern Europe.

**Work in Small Groups***1 hour 15 minutes*

Ask participants to work in groups of no more than six people, preferably working on the same country or group of countries. They should select a facilitator and a recorder and be prepared to report out on the following task.

The [instructions for the small group discussion](#) provide guidance on the questions to discuss and on how to structure the group discussions.

Small Groups Report to Plenary*1 hour*

A representative of each small group will have five minutes to make a presentation on the main points identified by the group. After all small groups have reported out you should have some 30 minutes left for a facilitated plenary discussion.

Advance Preparation

To prepare for Session 6 the next day encourage each participant to read the Session 6 [case study](#), which typifies the issues that arise from overlapping local and national interests in the process of fiscal decentralization. Make sure they also have the [Case Study Resource Document](#), which contains a composite of laws on local self-government. It is not required reading at this point, though it is highly recommended reading at the end of Day Two.

DAY TWO**SESSION 6. BALANCING OVERLAPPING LOCAL AND NATIONAL INTERESTS***(Total time: 3 hours 15 minutes)***Advance Preparation**

In anticipation of the tasks in this session, ask each participant to read the Session 6 [case study](#), which typifies the issues that arise from overlapping local and national interests in the process of fiscal decentralization.

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- Explain how the failure to balance overlapping local and national interests in the process of fiscal decentralization can create unintended problems for local governments and why that can lead to instability in the assignment of functions to local governments
- Identify some of the ways in which to balance overlapping local and national interests in the process of fiscal decentralization in the design or implementation of donor programs that support decentralization or have an impact on the process.

Introductory Lecture*30 minutes*

This [lecture on balancing overlapping local and national interests](#) looks at the impact on local governments of reforms in public administration, such as in civil service or procurement; of reforms in the sectors that have been or might be decentralized, such as education, water, health care, and social services; and of fiscal or macroeconomic reforms.

Lectures on Relevant Country Experiences*45 minutes*

The country example of Hungary is included in two lectures, one on [Hungarian Public Sector Reform in the 90's](#) and the other on [Overlapping Local and National Interests in Decentralization](#). Hungary's recent experience includes both decentralization reforms that worked well and some that did not. Hungary has successfully provided genuine authority and discretion to local governments in the area of education without causing conflicts with the overall national education system. Conversely, during the fiscal adjustment in the 1990s the government did not always give careful consideration to local governments' interests, causing financial problems at the local level.

Work in Small Groups*60 minutes*

Review some of the concepts from the previous sessions. They are in the preface to the [Case Study Questions](#).

Answer any clarification questions the participants may have regarding the case study before proceeding to small group work. Then have participants return to the same groups in which they worked earlier to respond to the case study questions.

Small Groups Report Out*60 minutes*

A representative of each small group will have five minutes to make a presentation on the main points identified by the group. After all small groups have reported out you will have about 30 minutes left for a facilitated plenary discussion.

SESSION 7. PHASING AND SEQUENCING OF FISCAL DECENTRALIZATION*(Total time: 3 hours 15 minutes)***Introduction**

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- Assess how the failure to coordinate the phasing and sequencing of fiscal decentralization can create unintended problems for local governments
- Explain why the rush to decentralize functions may not always lead to effective local control or adequate funding of the new functions
- Identify some of the ways in which to address the phasing and sequencing of fiscal decentralization in the design or implementation of donor programs that support decentralization or affect the process.

**Introductory Lecture***60 minutes*

This [lecture on issues related to phasing and sequencing of decentralization](#) builds on the issues of balancing of overlapping local and national interests in Session 6. The lecture underscores the need to account for other ongoing events when working through decentralization reform and highlights ways to address the conflicting interests of stakeholders. The lecture encourages people to recognize and commit to a long-term, multiyear process that requires a consistent approach; a common vision of what decentralization will look like; and a sustained effort that includes information provision, consultation, lobbying, analysis of procedures that impede implementation, and attention to other reforms that could affect local government.

Lecture on Relevant Country Experience*30 minutes*

The country example of [Decentralization in Albania](#) provides some history and analyzes the qualities of and problems inherent in current decentralization reform. The analysis includes technical issues and what is needed for a long-term vision and a sustained approach.

Work in Small Groups*1 hour 15 minutes*

[Introduce the case study](#) and review some of the concepts from the previous sessions. Give participants time to read the Session 7 [Case Study](#) and answer any clarification questions they may have prior to proceeding to their small group work. Then have the participants return to the same groups in which they worked earlier to respond to the case study questions.

Small Groups Report Out*60 minutes*

A representative of each small group will have five minutes to make a presentation on the main points identified by the group. After all small groups have reported out you will have about 30 minutes left for a facilitated plenary discussion.

Advance Preparation

In preparation for the next day encourage the participants to read the [Resource Document for the Case Study](#) with the Organic Law of the Republic of Transecon, a fictitious country that has adopted a law that is a composite of those adopted in a number of transition countries.

DAY THREE**SESSION 8. IMPACT AND LIMITATIONS OF LOCAL GOVERNMENT
LEGISLATIVE REFORMS***(Total time: 3 hours 15 minutes)***Introduction**

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objectives: By the end of the session participants will be able to

- Assess how the failure to take the impact and limitations of local government legislative reforms into account can create unintended problems for local

governments, and why legal reforms often lead to limited change in the way national and local governments work

- Identify some of the ways in which to consider the impact and limitations of local government legislative reforms in the design or implementation of donor programs that support decentralization or affect the process.

Introductory Lecture

20 minutes

This lecture on [Local Government Legislative Reforms](#) highlights lessons learned about the impact and limitations of local government legislative reforms. A major point is that “big picture” reforms are essential, but they do not work unless accompanied by administrative reforms. The lecture explores reforms that prove difficult, problems with the new laws, and what to do. The recommendation is that those involved develop their own model; devise a shared strategy, including a shared vocabulary and broad participation; and write clear legislation that pays attention to details.

Lectures on Relevant Country Experiences

40 minutes

Romania provides clear examples of the lessons learned. The first brief lecture on [Fiscal Decentralization in Romania](#) provides background on the need for reform and on the content and process of drafting and debating a law on local public finance. The second lecture focuses on [Achievements and Shortcomings of the 1998–99 Reform](#). In 1998 Romania adopted the new Law on Local Public Finance, which appeared to give local governments considerable discretionary control over all aspects of their finances. The results have been mixed, falling short of expectations. The best results have come in the areas where administrative procedures were adapted to the provisions of the law, such as in the administration of local taxes. The lack of progress partly reflects the impact of other laws that have diluted or reversed some of the changes intended in the Law on Local Public Finance. It also reflects a narrow interpretation of key language in the law that was vague or unclear. The nature of these problems is such that they are likely to recur in other countries that attempt similar reforms.

Work in Small Groups

1 hour 15 minutes

Give participants time to read the [Session 8 Case Study](#) and answer any clarification questions they may have prior to proceeding to their small group work. Then have the participants return to the same groups in which they worked earlier to respond to the case study questions.

Small Groups Report Out

60 minutes

A representative of each small group will have five minutes to make a presentation on the main points identified by the group. After all the small groups have reported you will have about 20 minutes left for a facilitated plenary discussion.

Conclude with a 10-minute [wrap-up lecture](#) that sums up key points about authority to perform functions and explores the question of who decides about: revenues, property/budget, administrative issues, services, investment, regulatory issues, and revenues. This lecture returns to the building blocks and to the question: why decentralize?



SESSION 9. HOW TO DESIGN, MANAGE, AND MONITOR ACTIVITIES TO SUPPORT DECENTRALIZATION (OPTIONAL)

(Total time: 2 hours 15 minutes)

Introduction

Introduce the session by referring to the session objectives and their link to the course objectives.

Session objective: By the end of the session participants will be able to

- Identify some of the ways in which the theory, concepts, and lessons learned during the course can help improve the design and management of donor support for decentralization.

Introductory Presentation

30 minutes

This session works well when a person or a panel of two people with experience in program design and management make a brief presentation on the [Role of Staff in the Design and Management of Activities in the Support of Decentralization](#). First distribute the document to participants and have them read the issues listed. Then discuss the issues from the perspective of the person or persons on the panel.

Individual Task

15 minutes

In preparation for working in small groups, ask all the participants to think of a situation in the institution where they work (activity, program, and so on) that could have benefited or that could benefit from attention to the issues listed in the document on the Role of Staff in the Design and Management of Activities in the Support of Decentralization. Referring to the issues in the document, ask them to

- Identify what is not being done (or what was not done)
- Suggest what their institution should do more of or less of to attend to these issues.

Work in Small Groups

30 minutes

If possible divide the participants into small groups by institution and/or region to build on the individual task and do the following:

- Share their situations and analyses
- Discuss some things that their institutions should realistically do more of or less of to ensure more effective support of decentralization in the countries where they have activities or programs
- Be prepared to share an example with the larger group during the plenary discussion.

Plenary Discussion

60 minutes

Ask each group to contribute its perspective on what participants' institutions should do to ensure more effective support of decentralization in the countries in which they have activities or programs. After all the small groups have reported out you will have about 30 minutes left for a facilitated plenary discussion.

SESSION 10. WRAP-UP AND COURSE EVALUATION

(Total time: 30 minutes)

Postcourse Application Plan

Ask the participants to build upon the discussion in the previous session and think about the actions they plan to undertake on the job over the next six months to apply what they have learned during the course. Distribute the [Postcourse Application Plan](#). If appropriate, collecting and copying the plans and returning the originals to each person is useful if you plan to follow up with the participants six to eight months after the course to ask them how they have progressed in carrying out their plans, and perhaps what additional learning needs they might have identified. This approach can help determine the utility of the course for postcourse evaluation purposes as well as for determining future training needs.

Course Evaluation and Self-Assessment

Distribute the course evaluation form to elicit feedback on the participants' reactions to the course, including what they felt was beneficial and the degree to which they feel the objectives were met.

Then distribute the postcourse self-assessment form, which contains the same items as the precourse assessment form, to determine how much more participants know about fiscal decentralization as a result of the course. This questionnaire can also serve as a summary for the participants of the key points they learned during the course, pulling all the concepts together. Remind them to use their name or the same symbol they used for the precourse questionnaire so that you can chart overall progress as well as individual progress.

Closing Comments

The closing comments consist of a brief statement thanking the participants, either by the trainers and/or course sponsors and encouraging them in their ongoing work. In some cultural contexts the participants may elect a representative to make some closing comments as well.



11. ACADEMIC CURRICULUM

One of the applications of the sourcebook is for a semester or year-long academic course. For this type of application the sourcebook is a rich source of information.

The Andrew Young School of Policy Studies at [Georgia State University](#) and the [University of Fribourg](#) have provided examples of curricula on intergovernmental finance. Each offers an overview of the course and extensive reading lists.

PART IV - SOURCE MATERIALS

12. REFERENCES TO THE EUROPEAN CHARTER OF LOCAL SELF-GOVERNMENT

FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

ASSIGNMENT OF FUNCTIONS TO LOCAL GOVERNMENTS

CRITERIA FOR ASSIGNING FUNCTIONS

Economic Criteria

Types of Functions

The charter states a preference that functions be performed by the [authorities that are closest to the citizens \(explanation\)](#). It accompanies this with a clear statement that local governments are expected to [manage a substantial share of public affairs](#) for which they are responsible.

LEGAL DEFINITION OF LOCAL FUNCTIONS

Treatment in the Legislation

The charter states that a country's [law or constitution \(explanation\)](#) should prescribe local government responsibilities without preventing the attribution of other responsibilities. The charter also stipulates the need for judicial recourse for local governments to secure [freedom in fulfilling their responsibilities \(explanation\)](#).

NATURE AND EXTENT OF AUTHORITY TO PERFORM LOCAL FUNCTIONS

The charter states a preference for local government authority to be [full, exclusive, and unfettered \(explanation\)](#). In addition, the charter gives local governments [full discretion to exercise their initiative \(explanation\)](#) with regard to any matter that is not excluded from their competence or assigned to any other authority. [Supervision of local government should be limited \(explanation\)](#) by law.

Authority to Manage Services

Authority to Organize Service Delivery

Local governments should be able to [determine their own internal administrative structures](#).

Cooperation among Local Governments

The charter states that local governments should be [free to associate in executing their tasks \(explanation\)](#).

Delegations of Authority

How the Delegation Takes Place

Local governments should be [consulted \(explanation\)](#) to the extent possible in matters that concern them directly.

Degree of Discretion in Management of Delegated Services

Local governments should be able to [adapt delegated functions \(explanation\)](#) to local conditions. Supervision of local governments should normally be limited to compliance, but [may be exercised to increase the expediency \(explanation\)](#) of delegated functions.

FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

BACKGROUND

Resources available to local government should be [sufficient \(explanation\)](#) to enable them to keep pace with changes in the costs of their functions and should [match their responsibilities \(explanation\)](#).

OWN SOURCES OF FINANCIAL RESOURCES

Local governments should be entitled to [own resources to be freely disposed of \(explanation\)](#).

LOCAL TAXES AND FEES

Extent and Nature of Local Authority

Local governments should have access to local taxes and fees and have the [authority to set their rates \(explanation\)](#).

DEBT

Local governments should have [access to national capital markets \(explanation\)](#).

TRANSFERS

GRANTS

Grants to local governments [should not be earmarked \(explanation\)](#).

Equalization

Objectives of Equalization

Financially weaker local governments should be [protected by equalization](#) procedures that do not diminish local government discretion.

*Method of Allocating Grants*

Local governments should be [consulted on the distribution \(explanation\)](#) of resources among them.

GENERAL INTERGOVERNMENTAL FINANCE ISSUES

ONGOING TRANSITION AND REFORMS

ECONOMIC AND FISCAL POLICY REFORM ISSUES

Public Administration Reform

The charter anticipates that local governments will have [access to high-quality staff](#).

Decisionmaking Process

Local governments should be [consulted on all matters that concern them \(explanation\)](#).

EU ACCESSION ISSUES

The explanatory notes to the charter specifically address the [potential impact of EU directives on the authority of local governments](#).

THE ANNUAL BUDGET CYCLE

THE NATIONAL BUDGET CYCLE

Vertical Equalization

Local government resources should [match their responsibilities \(explanation\)](#).

Decisionmaking Process

Local governments should be consulted on the allocation of [redistributed resources \(explanation\)](#).

13. REFERENCES TO GENERAL CONCEPTS AND THEORY

FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

BACKGROUND

The [benefits of fiscal decentralization](#) in terms of improved services have been clearly described in the literature.

MEANING OF TERMS

[The meaning of fiscal decentralization](#) is understood differently by different people.

CRITERIA FOR ASSIGNING FUNCTIONS

Functional assignments must conform to local preferences and conditions; [there is no universally best assignment](#). However, several [principles](#) and [recommendations](#) should be considered in assigning functions.

Conceptual basis of expenditure assignment ([table](#)).

ECONOMIC CRITERIA

Functional assignments should aim to achieve [efficient allocation, redistribution and stability](#). [Fiscal equivalency](#) should determine the assignment of functions.

Service or Benefit Area

Responsibility for services should be granted to the level of government whose jurisdiction is [most closely aligned with the benefit area](#) associated with those services. For [example](#), local governments should be responsible for public utilities and central governments should be responsible for national defense.

Expenditures to stabilize the economy, such as unemployment programs, are [best provided by the central government](#).

OTHER ASSIGNMENT CRITERIA

Size and Diversity

The [size and economic power of provinces and/or counties](#) should be considered in the assignment of functions.

ASSIGNMENT OF LOCAL AUTHORITY TO PROMOTE AND MANAGE DEVELOPMENT

Legal Definition of Local Functions

Local government autonomy [should not be granted if it depends on central judgments](#) about its correction.

Treatment in the Legislation

A clear, legal [definition of expenditures](#) is central to systems of intergovernmental relations. The lack of a clear definition can become a [source of conflict](#) between central and local governments.

STABILITY OF ASSIGNMENT OF RESPONSIBILITIES

The [lack of formal and stable expenditure assignments](#) can destabilize intergovernmental relations.

NATURE AND EXTENT OF AUTHORITY TO PERFORM LOCAL FUNCTIONS

A large share of local government expenditure in total government expenditures [does not necessarily indicate](#) a high degree of local control or responsibility. Shared or [fragmented responsibilities are likely to cause inefficiencies](#), including deferred maintenance.

AUTHORITY TO MANAGE SERVICES

Authority to Determine Service Policy and Standards

In Terms of Policy

Local governments should control capital investments so they are more likely to [serve the needs and preferences](#) of taxpayers.

Nature and Extent of National Standards Regarding Local Services

The best way to [ensure that local governments provide minimum desired service levels](#) is a combination of reimbursements and lump sum grants. [National standards](#) may be required in education, social services, and environmental protection.

Authority to Organize Service Delivery

Delivery of Services Jointly with the Private Sector

[Privatization](#) offers efficiency gains to local governments.

DELEGATION OF AUTHORITY

Degree of Discretion in Management of Delegated Services

Since the enforcement of [detailed expenditure mandates](#) is at a minimum costly, and sometimes impossible, such mandates are best kept simple and reasonable.

FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

BACKGROUND

Efficient assignment and planning for revenues requires an understanding of the expenditures to be financed; [finance follows function](#).



Whether local governments have [sufficient resources to fulfill their responsibilities](#) is difficult to determine.

OWN SOURCES OF FINANCIAL RESOURCES

The fact that local revenues constitute a large share of total revenues nationwide [does not necessarily indicate](#) a large degree of local autonomy.

LOCAL TAXES AND FEES

Successful fiscal decentralization requires [significant local government taxing powers](#). Permitting local governments to levy fees offers [benefits and disadvantages](#).

Economic and Technical Factors in the Assignment of Local Taxes

In selecting what types of taxes to assign to local governments it is important to recognize that [not all types of taxes are equally well suited](#).

Other Economic or Technical Issues

Taxes designed to [influence behavior instead of raise revenue](#) increase administrative costs.

Local tax structures should [permit adjustment](#) to local economic structures.

DEBT

Borrowing permits local governments to [fairly distribute](#) investment costs.

Large local governments should be [encouraged to borrow](#), especially as most [will be unable to make long-term investments using current savings](#). Most local governments in transition [will not borrow using bonds](#) because of the lack of capital markets.

Public utilities should be permitted to issue [revenue bonds](#) to finance service improvements.

EXTENT AND NATURE OF LOCAL AUTHORITY TO BORROW

Borrowing by local governments requires an appropriate [legal framework](#).

Several [design questions](#) should be considered in relation to local autonomy over borrowing.

Process of Borrowing

Having an appropriate [regulatory framework for borrowing](#) by local governments is important. In this context, it may be advisable for the [finance ministry to supervise](#) local government bond issuance, and sometimes to create an insurance fund for such issuance.

OTHER FINANCIAL AND TECHNICAL ISSUES

Relations with Lenders and Investors

Allowing local governments to [pledge municipal assets](#) may not always be a good practice.

TRANSFERS

Many types of transfer programs are available, but [all have two dimensions](#): the size of the pool of funds available and its distribution.

GRANTS

Grants include all forms of financial resources provided to local governments.

Nature and Extent of Grant Conditions

Conditional [grants that require monitoring](#) increase administrative costs.

Equalization

Objectives of Equalization

There are several [methods for measuring horizontal imbalances](#).

Method of Allocating Grants

Grant Allocation Formulas

Allocation [formulas that depend on unavailable data](#) can increase administrative costs and erode confidence.

Grants commissions should review allocations and [recommend changes every few years](#) to provide a mix of stability and flexibility.

SHARED REVENUES

Revenues should be shared among levels of government [only under certain circumstances](#), because sharing revenues [decreases accountability](#).

GENERAL INTERGOVERNMENTAL FINANCE ISSUES

ECONOMIC AND FISCAL POLICY REFORM ISSUES

FISCAL STABILIZATION

Macroeconomic control and stability ~~is one of~~ are the reasons why [decentralization has not been implemented](#), even where it has been discussed and praised.



Budget Deficit Targets

Local government [fiscal autonomy requires a hard budget constraint](#) to guard against paternalistic central governments.

Capital Market Reform

One alternative to local governments directly issuing bonds is to create a financial intermediation program ([box](#)), but this involves [various risks](#).

THE ANNUAL BUDGET CYCLE

THE NATIONAL BUDGET CYCLE

Vertical Equalization

There are two conventional [methods for measuring vertical imbalances](#).

Many central governments prefer to begin the year with vertical imbalances between local government expenditure needs and revenue authorities to [foster dependence](#) on their decisions and allocations.

THE LOCAL BUDGET CYCLE

Financial Accounting, Reporting, and Audits

Successful decentralization requires [strong monitoring and evaluation](#) of finances.

14. REFERENCES TO CURRENT LEGISLATION

FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

LEGAL DEFINITION OF LOCAL FUNCTIONS

TREATMENT IN THE LEGISLATION

The Local Government Law in Albania, adopted in July 2000, provides [exclusive jurisdiction](#) to local governments over a wide range of functions.

Bulgarian law gives local governments rights to “[resolve on issues](#)” relating to social services, local finance, public property and enterprises, and so on, and assigns [obligatory authority](#) for a list of specific activities.

Czech local governments have [independent jurisdiction](#) over local issues, such as social services, water supply, wastewater and refuse removal, and other local services, except those of state administration.

Hungarian local governments are assigned [jurisdiction](#) for providing services of local importance. Hungarian law divides jurisdiction within the capital city of Budapest among [metropolitan and district](#) local governments. [County](#) local governments are assigned obligatory and discretionary functions.

Macedonian local governments are assigned [independent jurisdiction](#) over many specific activities.

Romanian [local](#) and [county](#) governments are responsible for several specific activities. These functions are defined in an annex to the Law on Local Public Finances that is amended annually as part of the State Budget Law.

NATURE AND EXTENT OF AUTHORITY TO PERFORM LOCAL FUNCTIONS

Albanian legislation defines clearly the [competencies](#) of local governments in relation to their exclusive functions and responsibilities, including administrative, service, investment, and regulatory authority.

Hungarian law defines the [municipal rights](#) of local governments to act independently in public affairs of local interest.

[Hungarian](#) and [Macedonian](#) local governments have jurisdiction over activities of local importance over which the central government does not have jurisdiction.

Macedonian local governments are [autonomous](#) in accordance with laws.

AUTHORITY TO MANAGE SERVICES

Direct Service Provision

Albanian local governments have broad authority to establish administrative structures to [carry out their functions](#).

Bulgarian municipal councils have rights to manage [municipal enterprises](#). Bulgarian local governments are free to [finance municipal and private enterprises](#) whose operations serve community needs.

Czech municipal councils are also authorized to establish, manage, and terminate [state companies](#).

Hungarian local governments have rights to establish and manage [municipal enterprises](#).

Romanian local governments are permitted to [directly administer and to delegate](#) service provision.

Cooperation among Local Governments

Local governments in Albania may exercise any competence given to them [jointly](#) with other local governments or with the central government under diverse forms of collaboration.

Czech local governments are permitted to [associate](#) for certain purposes and are free to assign financial and physical assets.

Hungarian local governments have rights to [associate](#) and [establish institutions](#) to jointly provide services.

Macedonian local governments have the right to [associate in the provision of services](#).

Macedonia required agreements [between old and new](#) local governments and [between local governments and municipal enterprises](#) on the joint provision of public services. Municipal enterprises were required to serve the territories of [both](#) old and new local governments.

Romanian local governments are permitted to [jointly provide](#) public works and services.

Delivery of Services Jointly with the Private Sector

Romanian local governments are permitted to [participate with capital stocks or assets](#) in commercial enterprises.

Ownership of Assets

[Albanian](#) local governments have broad rights to own, purchase, and sell their own property.

[Bulgarian](#) and [Hungarian](#) ([reaffirmed](#); [again](#)) local governments have rights to manage municipal property. Hungarian local governments have rights to their municipal properties.

Czech local governments have independent jurisdiction over [disposal](#) ([reaffirmed](#)), [acquisition, and assignment](#) of municipal assets. Czech local governments are free to [pledge](#) municipal assets.

Macedonian mayors are entrusted to [manage](#) municipal property. Macedonian local governments are guaranteed jurisdiction over [management](#) of municipal property.



Macedonia required a division of assets between the [central and local](#) governments within six months of the passage of its regulations on local governments and a subsequent division of assets between [former and new](#) local governments.

DELEGATIONS OF AUTHORITY

How the Delegation Takes Place

In [Albania delegations](#) may be mandatory or nonmandatory (optional). Mandatory delegations must be authorized by law.

Who Finances the Cost

[Bulgarian](#) ([reaffirmed](#)), [Czech](#) ([reaffirmed](#)), [Hungarian](#), and [Romanian](#) local governments are protected from central government unfunded mandates.

NATURE AND EXTENT OF LOCAL REGULATORY AUTHORITY

Legal Basis

The new local government law in Albania provides a clear and complete definition of the [regulatory authority](#) of local governments that encompasses all [their exclusive functions](#).

Other Issues

Czech local governments have independent jurisdiction over the [assessment of penalties](#). They are free to impose duties to fund [responses to natural disasters](#) and to [levy fines](#) for failing to maintain land and other real property and for polluting municipal environments.

Macedonian local governments have independent jurisdiction over the application of [penalties](#) ([reaffirmed](#)).

FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

OWN SOURCES OF FINANCIAL RESOURCES

[Albanian](#), [Czech](#), [Hungarian](#), and [Macedonian](#) ([reaffirmed](#)) laws specifically list local government own resources. Czech law also lists [district](#) own resources. Macedonian law also lists revenue sources of [neighborhood self-governments](#). Romanian law lists specific [local](#) and [county](#) government own resources.

LOCAL TAXES AND FEES

Extent and Nature of Local Authority over Taxes and Fees

Legal Definition of Local Taxes and Fees

Albanian local governments have the right to receive revenues from a variety of [local taxes](#) and [fees](#).

Bulgarian local governments are guaranteed revenues from several specific [taxes](#) and [fees](#). Bulgarian law also requires that fees be paid to the [budget that secures the maintenance of activities](#) for which fees are paid.

The Macedonian local government law includes a limited list of [local taxes and fees](#).

Hungarian law provides general authority to [levy local taxes](#). This authority is defined further in a specialized [Act on Local Taxes](#).

Romanian local governments have a general authority to [establish local taxes and fees \(reaffirmed\)](#). This authority is defined further in a special [Law on Local Taxes and Fees](#).

Authority to Decide How to Use the Revenues from Local Taxes and Fees

Romanian local governments are required to collect fees exclusively from [the beneficiaries](#) of the activities on which fees are levied and to [isolate](#) those funds for the specific activity.

Authority to Set Tax Rates, Adjust Tax Base

Albanian local governments may determine local [tax](#) rates within limits set by law.

Bulgarian municipal councils have rights to set [local taxes within limits set by law](#) and are required to [publicize their decisions](#) on local taxes and fees.

Romanian local governments have the authority to set tax rates within limits specified by law by type of tax, such as on [buildings](#), [land](#), and [tourism](#). They also may adjust the [tax base](#) to account for inflation.

Authority to Set Fees

Albanian local governments may determine local [fees](#) within limits set by law.

Bulgarian municipal councils are authorized to [determine fees](#) for any services not identified by law. Bulgarian local tax legislation discusses in detail procedures and rates for specific fees, including those on [garbage](#), [public spaces use](#), [social services](#), [resorts](#), [quarry materials extraction](#), [technical services](#), [administrative services](#), [dogs](#), [grave plots](#), and [agricultural property protection](#).

Macedonian local governments are prohibited from charging citizens [different rates for the same activity](#). Specialized legislation regulates [communal fees](#) and fees for [new construction](#) and [land use](#).

Romanian local governments have general authority to establish [special fees to finance public services](#) and are required to assess and [recover](#) depreciation of their assets through tariffs. A special law determines fees on [means of transportation](#), [building permits](#), [advertisements](#), and other services.

Authority to Administer Own Taxes and Fees

Albanian local governments have the authority to collect and administer local [taxes](#) and [fees](#).

Bulgarian law is ambiguous about the authority of local governments to administer their own taxes. The general law states that [local governments collect their own revenues](#) unless otherwise provided by statute. The special law on local taxes and fees charges [central tax authorities with collecting local taxes](#) and local governments with collecting local fees. As of 2000, the Ministry of Finance still [administered all local taxes](#).

Romanian local governments assumed full responsibility for [tax collection and tracking](#) in January 2000.

DEBT

Extent and Nature of Local Authority to Borrow

Basic Authority to Borrow

Albanian local governments have the [authority to borrow](#), subject to a specialized law.

Bulgarian municipal councils have the general authority to decide on [bank borrowing and bond issuance](#). Bulgarian law specifically grants local governments the [rights to issue bonds](#) and prohibits them from [borrowing to finance general costs](#). It also permits local governments to borrow to [cover budget deficits](#), but limits such loans to [more than 10 percent](#) of their revenues for a given year and requires repayment within the same budget year. They may not use central budget resources to [repay](#) or [guarantee](#) loans.

Czech local governments are free to [pledge](#) municipal assets, [borrow](#) money, and [issue bonds](#). They are required to [publicize](#) their intentions to assign real property at least 30 days prior to discussion by municipal councils. Czech law includes [credits, loans, and financial assistance](#) among local government income sources.

Hungarian local government representative bodies are responsible for [borrowing and bond issuance \(reaffirmed\)](#), and are subject to [borrowing limits](#).

Macedonian local governments are permitted to [issue bonds and borrow money](#), but may [borrow exclusively from the central government to finance budget deficits](#).

Romanian local governments are permitted to borrow from [internal and external sources](#) and to issue bonds [directly or through specialized agencies](#). Romania local governments are [prohibited](#) from borrowing if their debt payments are greater than 20 percent of their total revenues. A recent amendment to the local finance legislation extended these same limits to any guarantees issued by a local government. They are permitted [limited borrowing](#) from the central government.

Process of Borrowing

Bulgarian law states that a [resolution of the municipal council](#) provides sufficient authorization to effect lawful transactions with banks and other financial institutions. No other action or approval is required.

Romanian local governments are permitted to borrow from domestic sources on their own authority, but must obtain approval from the [Commission for the Authorization of Loans](#) for all loans in the international markets or from foreign sources.

OTHER LOCAL SOURCES OF FINANCING

Albanian local governments have access to revenues from diverse [other sources](#).

Bulgarian local governments are free to [lend to each other](#).

Income from Local Property

Czech local governments are assigned [income](#) from municipal assets.

Macedonian local governments may retain the [proceeds](#) from the sale of their properties as well as any [income](#) from their operation.

Romanian local governments are entitled to revenues from the sale of [fixed public assets](#) and [public assets in the private domain](#), but are [required to invest](#) those revenues. They are also entitled to [lease public assets](#) and to retain the revenues from selling [confiscated goods](#).

Income from Business Activities

Czech local governments have independent authority to make [decisions on ownership interest in businesses](#).

Hungarian local governments may pursue [entrepreneurial activity](#) and may retain the [profits from their activities](#) as revenues.

Macedonian local governments are permitted to [conduct business](#) and other profit-making activities.

Gifts/Foreign Grants

Czech local governments have independent jurisdiction over the [provision and receipt of gifts](#).

The own resources of Macedonian local governments include [donations](#).

TRANSFERS

GRANTS

Albanian local governments may receive [unconditional](#) or [conditional](#) grants.

In Hungary, local governments receive a general or [normative](#) grant as well as earmarked transfers for [social subsidies](#) and [investments](#).

Poland has a similar structure that includes [general as well as earmarked subsidies](#), as does [Bulgaria](#).

Romania established a single [equalization grant](#) in 1999 and limited specific investment grants only to [investments funded by foreign loans](#) made directly to the national government.



Nature and Extent of Grant Conditions

Limitations on the Use of Grants by Local Governments

In Albania, to date [investment grants](#) from the central government have been restricted by the objectives of the respective ministries' policies, whereas local councils have been free to decide on the priorities for [operating grants](#).

Limitations on Who Receives Grants

Romanian legislation sets an [upper limit of 25 percent](#) on the share of the equalization grant that county governments may receive.

SHARED REVENUES

Under the new local government legislation in Albania, local governments have the right to receive revenues from [shared taxes](#), although this provision of the law has not yet been implemented.

In the Czech Republic local governments receive shares of both [personal and corporate income taxes](#).

In Hungary local governments receive only a [share of the personal income tax](#).

This is also the case in [Romania](#). The law in each of these countries also defines the method of allocation and the local share. In Hungary and Romania the local share percentage has been amended annually in the context of the State Budget Law.

GENERAL INTERGOVERNMENTAL FINANCE ISSUES

ECONOMIC AND FISCAL POLICY REFORM ISSUES

The new Albanian local government law includes [transitory provisions](#) that phase in the functions of local governments starting in [2001](#) and [2002](#). This is unique among similar legislation in the region. The intent of these provisions is to allow time to complete other reforms in Albania before transferring the corresponding functions to local governments.

THE NATIONAL BUDGET CYCLE

Decisionmaking Process

In Albania the government must [consult](#) with local governments on the adequacy and stability of transfers from the state budget.

The Bulgarian National Association of Municipalities has rights to [legally represent](#) its members before central government agencies, [propose amendments and improvements](#) to local government regulations, and [propose and opine on the national budget](#). The Ministry of Finance is [required](#) to consult with the National Association of Municipalities on the draft national budget.

THE LOCAL BUDGET CYCLE

In [Albania](#) the local budget cycle is tied by law to the national budget cycle.

[Bulgarian \(reaffirmed\)](#), [Czech](#), [Macedonian](#), and [Romanian](#) municipal budgets are concurrent with the calendar year.

Preparation of the Initial Budget

Bulgarian municipal budgets are [controlled by communities](#) through their municipal councils and are open to public scrutiny. They are prohibited from incurring [deficits that exceed 10 percent of their revenues](#). The legislation spells out in great detail the process for [drafting municipal budgets](#).

Czech local governments have independent jurisdiction over the [preparation and implementation of their budgets](#). They are required to give preference to financial [obligations](#) imposed by legal agreements.

Hungarian law requires local governments to [submit their budgetary concepts](#) by November 30 to mayors, and mayors must [submit draft budgets](#) by February 15 to their assemblies.

Revenue Estimates

The Bulgarian Ministry of Finance provides [revenue estimates](#) according to procedures established in the annual National Budget Act that serve as the basis for draft municipal budgets.

Interaction with the National Budget Process

Budget Preparation and Approval

Albanian local governments have the right to [adopt and execute](#) their own budgets.

Czech local governments [adopt their budgets](#) without having to submit them to review by outside authorities. They submit a [final report](#) for the previous calendar year to relevant district offices or auditors for review.

In [Bulgaria](#), [Macedonia](#), and [Romania](#), among others, the ministry of finance receives and reviews local government budgets prior to their passage by municipal councils. In Bulgaria local governments must also [submit their final budgets](#) to the National Audit Office and the Ministry of Finance within established time limits or face a possible [suspension of transfers](#).

Budget Execution

Territorial offices of the Romanian national Treasury manage [cash implementation](#) of local government budgets. Romanian local governments are permitted to create [reserve funds](#) up to 5 percent of total expenditures, but are [required](#) to use any budget surpluses first to reimburse loans and pay associated interest.

Czech local governments are permitted to establish [special purpose funds](#), and their budgetary [surpluses are secure](#) from forfeiture. They are also guaranteed [control](#) of their budgetary means.

Hungarian local governments are permitted to use [reserves](#) to substitute for revenues that failed to materialize and for extra expenditures. Hungarian mayors are permitted to collect revenues and execute budgets in response to [natural catastrophes and failures to approve budgets](#).



Financial Accounting, Reporting, and Audits

The new local government law in Albania includes clear requirements regarding the [archiving of financial records](#) and [internal](#) and [external](#) financial controls.

15. REFERENCES TO SPECIFIC COUNTRY EXPERIENCE

FUNCTIONS AND RESPONSIBILITIES OF LOCAL GOVERNMENTS

BACKGROUND

ASSIGNMENT OF FUNCTIONS TO LOCAL GOVERNMENTS

The assignment of local functions and responsibilities varies among the countries of Eastern Europe as shown by expenditure assignments in Bulgaria, the Czech and Slovak Republics, Hungary, Poland, Romania, and Russia ([table](#)); Estonia, Latvia, Lithuania, and Ukraine ([table](#)); and Denmark and Hungary ([table](#)). The same holds true for [Western Europe \(table\)](#). No single Western European model exists.

As a result, the share of local expenditures in total public spending ([table](#)), as well as the level of local expenditures by sector, including general public services ([table](#)), defense ([table](#)), public order and safety ([table](#)), education ([table](#)), health ([table](#)), social security and welfare ([table](#)), housing and community amenities ([table](#)), and recreation and culture ([table](#)), varies among European countries.

This is also true for other regions of the world, where expenditure assignments vary greatly from country to country ([table](#)) ([table2](#)).

Expenditure assignments in specific Central and Eastern European countries:

In [Albania](#), until recently the main law that defined local government organization and functioning since 1998 was not highly specific on the actual tasks of local governments.

The assignment of public functions in [Bosnia-Herzegovina](#) is different in many respects from that of other countries in the region ([table](#)).

In [Bulgaria](#) expenditure assignments by sector to [1997](#) did not necessarily convey actual authority to determine spending priorities. The annual State Budget Act defines [spending priorities](#).

In the [Czech Republic](#) expenditure assignments include extensive social service responsibilities ([details](#)).

In [Estonia](#) expenditure assignments include some social and welfare services, local infrastructure, and maintenance of health and education facilities.

In [Hungary](#) expenditure assignments include mandatory and discretionary functions. [County governments](#) lost many of their responsibilities during the transition. Hungarian local government expenditures by sector 1993–98 ([table](#)).

In [Latvia](#) expenditure assignments are quite extensive for all levels of local government. Large cities have the combined functions of both local and regional levels of government ([table](#)).

In [Lithuania](#) expenditure assignments include both own and shared functions ([table](#)).

In [Macedonia](#) expenditure assignments are established in both the Constitution and the Law on Local Government, but in practice the laws establishing the system of local self-government [limit the autonomy of municipalities](#).

In [Romania](#) the assignment of functions for county councils and local councils is outlined in an appendix to the Annual Budget Law and has tended to vary from year to year.

Criteria for Assigning Functions

[Four criteria](#) are used to assign expenditures in Bosnia-Herzegovina.

Scale

The size of local government populations has affected reform in [Hungary](#), which has the second smallest [average](#) population per municipality in the region. Hungary's Local Government Act provides the option of enacting additional legislation to [distribute competencies based on municipality size](#). To date, no such legislation has been enacted.

Other Assignment Criteria

[Politics and history](#) shape local government systems as much as the need for efficiency.

Cultural Values

Ethnic considerations contributed to the delineation of expenditure responsibilities in Bosnia-Herzegovina. Minorities that are economically better off favor service delivery at the lowest possible level, where [ethnicity and income are more likely homogeneous](#). Many people in Bosnia-Herzegovina are [not concerned with the delivery of public services to the entire country](#), just delivery to those within their groups.

Size and Diversity

Assignment of Local Authority to Promote and Manage Development

Macedonian local governments [share](#) jurisdiction over land use planning with the central government. The city architect has [nominal authority](#) over development planning in Macedonia, but in reality [shares](#) authority with the Ministry for Urban Planning, Construction, and the Environment.

LEGAL DEFINITION OF LOCAL FUNCTIONS

Treatment in the Legislation

The roles and responsibilities of local governments had [not been clearly defined](#) in the Albanian legislation as of July 2000.

In Bosnia-Herzegovina legal expenditure [assignments are unclear](#) and nearly silent regarding municipalities.

From 1990–95 Macedonian local governments [lacked](#) an adequate legal framework. The Constitution grants [nominal autonomy](#). However, various laws [limit](#) functions, and local governments do not have direct [operating authority](#). In general,



legislation [contradicts](#) Macedonian local governments' constitutional autonomy, limiting them to roles specifically assigned by the state. The inconsistent legal context will definitely [impact](#) the future development of local governments. Macedonian mayors complain that their efforts to reform municipal administrations are [hampered](#) by current legislation.

In a recent OECD survey, Hungary and Latvia reported several [outstanding problems](#) in defining expenditure assignments, whereas Denmark reports no problems.

NATURE AND EXTENT OF AUTHORITY TO PERFORM LOCAL FUNCTIONS

Differences between state and national averages and between actual and required expenditures among states in the United States indicate a [high degree of local authority](#) (see tables with data from [four states](#), [Alabama](#), [California](#), [Connecticut](#), and [Mississippi](#)).

In 1997 the [Constitutional Court](#) in Macedonia decided 13 cases directly related to the exercise of local government authority, and in each case it overturned the action of the municipality.

AUTHORITY TO MANAGE SERVICES

With decentralization and the transfer of responsibilities, municipalities in [Hungary](#) were given autonomy in determining forms of provision and management of municipal services. With the changes in methods of service organization and provision, the role of local governments is gradually evolving from direct service provider to purchaser of services and regulator of the quality and performance of services.

Authority to Determine Service Policy and Standards

Nature and Extent of National Standards Regarding Local Services

In Poland the Ministry of Finance determines [minimum education standards](#) and ensures their financing.

COOPERATION AMONG LOCAL GOVERNMENTS

[Intermunicipal cooperation](#) in Estonia is viewed as necessary, given the absence of regional governments. Local authorities have a constitutional right to form associations or establish joint institutions.

France has organized an extensive system of [intercommunal cooperation](#).

Hungarian local governments have [associated despite incentives](#) to jointly provide services.

DELIVERY OF SERVICES JOINTLY WITH THE PRIVATE SECTOR

Government size in Bosnia-Herzegovina needs to be reduced to [facilitate private sector operations](#).

Ownership of Assets

In [Bulgaria](#) the Municipal Property Act 1996, as amended, distinguishes between municipal public property and municipal private property. This is a distinction that also appears in local property legislation in Romania.

Macedonian local governments have rights to manage and operate property, “[in the public interest and good faith](#),” but the stability of their property ownership is unclear. A clear [distribution of former local governments’ properties](#) among new local governments is needed. Macedonia has not yet acted [to implement recommendations](#) by a commission established to propose a division of assets between the central and local governments.

DELEGATIONS OF AUTHORITY

Degree of Discretion in Management of Delegated Services

Macedonian local governments are subject to [supervision](#) by the central government, which is free to intervene in cases of [unconstitutional or illegal acts](#), [acts exceeding the scope of shared authority](#), and [acts exceeding the scope of entrusted authority](#).

Who Finances the Cost?

In 1996 central governments in Bosnia-Herzegovina did not finance required salary increases, leaving many cantons and municipalities with [insufficient resources](#).

The Hungarian legislature has [ignored](#) its own law prohibiting unfunded mandates.

FINANCIAL RESOURCES OF LOCAL GOVERNMENTS

BACKGROUND

Revenue assignment in Central and Eastern European countries:

In [Albania](#) revenues include transfers, shared revenues, and local taxes and fees. Transfers, which in Albania are totally earmarked, represent about 95 percent of total local government revenues ([Aggregate data to 1997](#)) ([Data on revenues 1996–97](#)).

The International Monetary Fund, World Bank, and central government [negotiated revenue assignments](#) for Bosnia-Herzegovina in 1996. Summary of suggested tax assignments for Bosnia-Herzegovina ([table](#)). Relative share of taxes by level of government ([table](#)).

In Bulgaria local government revenues include general transfers, shared taxes, and local taxes and fees ([data on revenues 1996–99](#)).

In [Latvia](#) local governments receive revenues from shared taxes, equalization and specific transfers, and both state and local fees.

In [Hungary](#) the three main categories of local government revenues defined in the Local Government Act are own revenues; shared central taxes; and transfers and subsidies from the central government, including normative, targeted, and other earmarked transfers.

Macedonia does not have a single local government finance law in Macedonia. [Several laws](#) must be cross-referenced to determine the local government finance system. Attempts have been made to create a [comprehensive statement](#) of local government revenues. Transfers account for [virtually all revenues](#) for local governments in Macedonia.

In [Poland](#) the law defines four categories of local government revenue: shared taxes, conditional grants, nonconditional fiscal transfers, and own revenues.

In [Romania](#) the new Local Public Finance Law assigns transfers, shared tax revenues, and local taxes and fees as the revenue sources of local governments ([data on revenues 1997–99](#)).

MEANING OF TERMS

OWN RESOURCES

Local government finance experts in Western Europe tend to limit the use of the term “own” sources exclusively to those cases where local authorities [set rates](#).

Own Sources of Financial Resources

The general trend in Western Europe has been to [strengthen own revenues](#). This is not a universal trend, as evidenced by [the United Kingdom](#).

In [Bulgaria](#) local revenue sources are defined in the Municipal Budgets Act and include local taxes and fees, shared revenues, and transfers.

In [Romania](#), according to the Law on Local Public Finance and the budget classification of the Ministry of Finance, own revenues include current fiscal and nonfiscal revenues, capital revenues, and revenues with special destinations.

In [Hungary](#) local governments have a diverse source of own revenues beyond simply local taxes and fees.

LOCAL TAXES AND FEES

Local taxes and fees assignment in Central and Eastern European countries:

[Albania](#) has 10 to 20 local taxes and fees. The most important ones for local governments are the solid waste fee, the business registration fee, the market tax, and the small business tax ([data on own revenue 1996–97](#)).

In [Bulgaria](#) municipalities currently receive only a small part of their revenues from local taxes and fees. There are constitutional and legislative restraints on municipal discretion to raise local taxes and fees and to introduce new sources of revenues.

In the [Czech Republic](#) taxes are essentially a national function, with limited local authority over taxes and fees.

In [Estonia](#) local governments have broad tax authority, including the authority to assess corporate income taxes.

[Latvia](#) does not have any local taxes.

In [Lithuania](#) local governments receive taxes from various sources, but have no real taxing authority ([table](#)).

In [Hungary](#), unlike in other countries of Eastern and Central Europe, municipalities were given an option of levying five types of local taxes, which were not obligatory. It is up to each local council to determine which local tax it wishes to levy. The number of local governments that levy at least one of them has [increased](#) each year. They have favored taxes on business ([total](#) and [business](#) tax revenue tables) over taxes on inhabitants ([details of local taxes](#)).

Even though the Law on Local Self-Government appeared to assign a wider base of revenues in [Macedonia](#), in reality many of these require further implementing laws, regulations, or decisions by the government and have remained hypothetical.

Classification of local taxes by tax base, percentage for Denmark, Hungary, and Latvia ([table](#)).

EXTENT AND NATURE OF LOCAL AUTHORITY OVER TAXES AND FEES

Legal Definition of Local Taxes and Fees

In [Albania](#), even though own local taxes and fees offer the greatest potential for full local autonomy, many elements of the framework that existed until new legislation was passed in September 2000 limited this potential.

In [Bulgaria](#) municipalities have no authority over local taxes, which include the property tax, inheritance tax, gift tax, and vehicle tax. Assessments, tax rates, and exemptions are defined in the Local Taxes and Fees Act.

In the [Czech Republic](#) the tax system does not currently have local taxes in the sense that elected municipal officials can establish their own tax bases, tax rates, exemptions, or tax relief.

In [Latvia](#) local governments have no right to set tax rates because the existing taxes are state taxes.

In Macedonian local governments depend significantly on revenues from fees assessed in a [law dating from 1979](#). Many other local fees remain [hypothetical](#) because implementing legislation has not been passed.

Authority to Decide How to Use the Revenues from Local Taxes and Fees

Macedonian local governments receive revenues from [land fees](#), the [gradska renta](#) (fees for the use of urban land), [communal fees](#), and the [fee for temporary stays](#) (tourist fees), but their use of these fees is mostly limited to expenditures for [urban development](#), [water and sanitation](#), and [tourism programs](#). Local governments are permitted to use up to half of the revenues from their *gradska renta* to fund [capital improvements](#) in municipal enterprises, which are [understated](#) in most local government accounting.

Authority to Set Tax Rates and Adjust the Tax Base

Local governments throughout Europe have broad authority to [set property tax rates](#). [France is unusual](#) in its restrictions.

Municipalities in the [Czech Republic](#) may set property tax rates within national limits.

Authority to Set Fees

In [Bulgaria](#) most fees (such as for marketplaces, kindergartens, resorts, and dog fees) are assigned a range of rates, with floor and ceiling limits, and the municipal council is responsible for setting the rate to be applied locally. Authority over fees for basic services varies by sector: [water](#), [heating](#), [solid waste disposal](#), and [public transport](#).

In the [Czech Republic](#) municipalities have mixed authority over fees, with the right to set some (air pollution) and with others determined nationally (garbage pickup, licenses, and permits).

In [Latvia](#) local governments have fairly broad authority to set local fees for public services and the use of public land.

The institutional framework for [local discretion in setting fees](#) varies somewhat between Denmark, Hungary, and Latvia.

Hungarian local governments are responsible for [setting utility prices](#) for water, wastewater, and solid waste services and district heat.

Macedonian local governments are authorized to [set utility rates](#).

AUTHORITY TO ADMINISTER OWN TAXES AND FEES

In [Bosnia-Herzegovina](#) cantons fear federation administration of taxes, the federation fears canton administration of taxes, and Bosnians are concerned about what might happen if the administration of taxes is centralized. Governments get [more revenue benefits from collecting taxes they retain for themselves](#) than from permitting another government to collect their taxes.

In [Estonia](#) local governments are the tax authorities for local taxes within their administrative territories.

In [Latvia](#) and [Lithuania](#) tax administration is centralized.

Hungarian local governments manage their own taxes. Local tax [administration costs](#) range from 2.8 to 8.7 percent of tax collections.

Macedonian municipal enterprises have made [little progress](#) in improving their [50 percent](#) collection rates on utility fees.

Economic and Technical Factors in the Assignment of Local Taxes*What to Tax*

Many Western European local governments have the [authority to tax personal income](#).

Local governments in every Western European country except Malta and Sweden are [authorized to tax property](#).

In 1997 the Joint Commission's Working Group on Municipal Finances in Poland recommended that *gminas* (lowest level of local self-governing communities) be authorized to enact their [own taxes on personal incomes](#).

Other Economic or Technical Issues

VALUE VERSUS REPLACEMENT COST BASIS FOR PROPERTY TAXES

Western European countries use [rental or market value](#) to determine property taxes.

The [Czech Republic](#) is considering whether to adopt the system of estimated market value of the property (that is, of both land and structures) as part of an overall local tax reform.

Only two Hungarian municipalities have opted to use [market value](#) for assessing property taxes.

DEBT

Municipal bond issuance in Hungary has been erratic ([table](#)).

EXTENT AND NATURE OF LOCAL AUTHORITY TO BORROW

Basic Authority to Borrow

In [Bulgaria](#) the current legal framework sets forth a clear, simple, and reasonable procedure for authorizing municipal debt at the local level. However, [borrowing has been limited](#) by the absence of a functioning credit market. There have been only a small number of municipal loans to date ([data on loans](#)).

In the Czech Republic municipalities have [broad authority to borrow](#). No limitations are placed as to where a municipality borrows, what it borrows for, under what terms and conditions it borrows, and so on.

Municipalities borrow from both local and foreign banks, issue municipal bonds, and accept loans from companies outside the financial sector ([local debt data](#)).

Local governments in [Estonia](#) have fairly broad authority to borrow.

Authority to borrow by local governments in [Latvia](#) and [Lithuania](#) is centralized.

Macedonian local governments have [authority to borrow](#) from the republic's budget. However, as no conditions or [plans for reimbursement](#) have been made for loans from the central government, these may be considered grants. Local governments are awaiting enabling legislation for borrowing from, and issuing bonds through, commercial banks, although at least [one bank has made loans](#) to local governments.

Process of Borrowing

In [Estonia](#) different debt limits pertain to loans obtained from the state and those from other sources. National controls on [subnational loans](#) are also in place.

In [Latvia](#) a supervisory board composed of central government institutions approves all local borrowing. Local governments are also limited in the [selection of lenders](#).

Local borrowing in [Lithuania](#) is subject to debt limits.

Hungary instituted [debt service limits](#) starting in 1990. Subsequently, the country adopted [municipal bond regulations](#) to place further limits on local government debt. The



1997 Securities Act requires the prospectus on local bonds to include [specific information](#).

Poland modified its [borrowing limits](#) to shift the base from expenditures to revenues.

OTHER FINANCIAL AND TECHNICAL ISSUES

[Imperfect information](#) is a major obstacle to the development of a fully competitive municipal credit market in Hungary. International [donors](#) focused on municipal credit market development in the early 1990s in Hungary and Poland.

Local Creditworthiness

Several indications suggest that Macedonian local governments are [not creditworthy](#).

Before the adoption of legal reforms in 1998, several factors constrained the [creditworthiness](#) of local governments in Romania, including the lack of clear ownership of local property, the inability to carry forward a surplus from one year to the next, and vague rules on the process of borrowing.

Relations with Lenders and Investors

After three small villages defaulted in 1995, Hungary adopted the [Municipal Debt Adjustment Act](#), which establishes a formal process for dealing with such circumstances. Local governments or creditors may initiate the [debt adjustment process](#). To date, Hungary is the only country in the region to have such a process.

Borrowing for Jointly Provided Services

In Poland, the central government pays 70 percent of the interest on [neighborhood association](#) loans.

OTHER LOCAL SOURCES OF FINANCING

INCOME FROM LOCAL PROPERTY

Local governments in Hungary have relied on asset sales to finance [investments](#) in a way that is not [sustainable](#).

Issues of [legal definition and documentation of ownership](#) must be resolved before Macedonian local governments can use their properties.

GIFTS/FOREIGN GRANTS

The amount of [donor assistance allocated to local governments](#) in Hungary is difficult to estimate.

TRANSFERS

The structure of transfers varies among the countries of [Western Europe](#). In several instances [regional governments also transfer funds](#) to local governments.

In [Bulgaria](#) transfers from the central government include the general transfer, a special transfer for social welfare expenditures instituted in 1999, and targeted grants for investment.

The [Czech Republic](#) limits transfers mainly to operating and investment subsidies.

In [Hungary](#) the largest transfer from the central government to municipalities for operating purposes is the normative subsidy. The share of this subsidy in local government budgets declined from 42 to 28 percent of current revenues between 1993 and 1998, but earmarked operating transfers have [increased](#). Central government [grant funding for local investments](#) has increased.

Transfers account for [virtually all revenues](#) for local governments in Macedonia.

In [Romania](#), with the adoption of new legislation in 1998, local budgets benefit from financial transfers that can be classified as revenue sharing of national taxes, general equalization grants, and earmarked transfers for investments financed through external loans guaranteed by the state.

GRANTS

The split between general and specific purpose grants varies by country, as illustrated by Denmark, Hungary, and Latvia ([table](#)).

[Estonia](#), [Latvia](#), and [Lithuania](#) have both general and specific purpose grants.

Beginning in the early 1980s, Western European countries [consolidated their numerous categorical grant programs](#) into single, general assistance grants. For example, the [general operating grant in France](#) is a composite program that has evolved since the early 1980s. It is the largest intergovernmental transfer allocated to French *departments* (as well as to municipalities and municipal associations). The [general decentralization grant in France](#) is designed to compensate local governments for centrally mandated services, but local governments determine its use.

Nature and Extent of Grant Conditions

Limitations on the Use of the Grants by Local Governments

France has three different grants targeted to [investment expenditures](#).

In Hungary the total of [earmarked transfers](#) from the state has increased over time. Their share in total revenues has ranged from 20 to 24 percent and in current revenues from 25 to 29 percent. Local governments in Hungary receive [centralized allocations](#), including ad hoc grants and matching grants, which have funded large severance payments in the education sector ([targeted subsidies detail—table](#)).

Many revenues for Macedonian local governments derive from [state funds](#) that are targeted to specific sectors.

FINANCIAL CONDITIONS

Although many subsidies in Hungary require matching funds, local governments have been able to play [fast and loose](#) with the uncoordinated system and the central government has responded with more [regulations](#).

Equalization

The equalization grants in [Latvia](#) address large cities, rural communities, and regions separately.

The French [Fund for the Correction of Regional Inequalities](#) provides a partially equalizing allocation for the country's poorest regions, whose per capita fiscal capacity is less than 15 percent of the national average (13 regions in 1994).

"Pure" equalization programs exist in [Sweden](#) and [Germany](#).

Large horizontal imbalances are expected in Bosnia-Herzegovina, and [grants are unlikely to offset](#) them.

Objectives of Equalization

In [Estonia](#) the equalization grants were initially set up to compensate for the drop-off in revenues from shared taxes.

General grants in [Lithuania](#) focus on horizontal revenue equalization.

Norway's general purpose grants aim to equalize differences in [revenue raising ability and expenditure needs](#).

[Polish equalization programs](#) serve to compensate local governments for mandated services and standards and to provide general revenue for poorer local governments.

In [Romania](#), according to Article 10(1) of the Law of Local Public Finance, the purpose of the equalization grant system is to achieve "budgetary balance." The equalization grant formula used in 1999 introduces a fiscal capacity criterion, but the larger weight (70 percent) still goes to proxies for operating costs.

Existing Conditions Versus Performance

Some countries use proxy measures of relative tax bases to [prevent local governments from reducing their own tax rates to qualify for larger equalization funds](#) from the central government.

Method of Allocating Grants

Method of Allocating the Grants

Hungarian centralized allocations are [determined by central government or parliamentary priorities](#) for local government. Deficit grants are based on revenue and expenditure [estimates by municipalities](#).

Macedonia has separate procedures for allocating money from the [Road Fund](#), [Agency for Underdeveloped Regions](#), [grants for water and wastewater investments](#), and the [Fund for Environment and Nature Protection and Promotion](#).

The Polish Law on Municipal Finance fixes the education subsidy to a [percentage of national budget revenues](#), to be distributed in accordance with a complex formula.

Grant Allocation Formulas

Formulas for grant allocation vary among the countries of Western Europe. [Age and social factors](#) determine the allocation of Denmark's grants. The Municipal Fund in the Netherlands uses an [exhaustive approach](#) for calculating local government expenditure needs. In the United Kingdom expenditure needs are expressed in [standard spending assessments](#) that determine grant distribution. Standard spending assessments are different for secondary education ([table](#)), social services ([table](#)), and roads ([table](#)).

Transparent and [objectively determined grants](#) are necessitated by lingering distrust among groups in Bosnia-Herzegovina.

[Estonia](#) uses a quantitative formula for equalization that focuses on revenues per capita as the key variable.

[Latvia](#) uses a wide variety of expenditure and revenue factors to allocate equalization grants.

The Polish [foundation grant](#) for education is allocated according to a set formula.

Other Procedural Issues

Combining the allocation processes for normative grants and the normative share of the personal income tax would [simplify the system](#) of municipal finance in Hungary. Hungary does not clearly require local governments to prove [project feasibility](#).

SHARED REVENUES

[Shared revenue is unimportant](#) in the intergovernmental fiscal systems of Western Europe.

In [Bulgaria](#) the two main national taxes shared with local governments are the personal income tax and the corporate income tax. The share of the personal income tax allotted to local governments is defined each year in the State Budget Act.

In the [Czech Republic](#) one of the key goals of local budgets reform was to replace the high proportion of national subsidies in municipal budgets by other revenue sources. Instead of introducing local taxes as a substantial part of municipal revenues, a shared tax system was chosen. The [lessons from the experience](#) of the Czech Republic are clear. Revenue sharing of the wage tax can promote local autonomy and economic efficiency. However, revenue sharing by origin can exacerbate existing differences in local fiscal capacity, and can even create inefficiencies as localities compete for residency of businesses ([details](#)).

[Estonia](#) shares revenues from taxes on personal income, land, and gambling with local governments.

[Latvia](#) shares revenues from the personal income tax with local governments.

Hungarian local governments share revenues from [two types](#) of taxes with the central government. There are [two main lessons](#) to be learned from Hungary's experience. The first is to resist the temptation to constantly change the share of the wage tax to be distributed among local governments. The second is to resist the temptation to try to create a perfect equalizing system, which can never be achieved, but



in the process will confuse local government recipients with its complicated formulas and criteria ([personal income tax distribution table](#)).

One of the [lessons from Poland](#) is that a transition period may be necessary when the government wants to institute major changes in the transfer system. If revenue sharing by origin is the goal, then local governments should be made aware of this goal and be given a schedule by which this goal will be achieved. Another lesson from Poland is that the central government will be more committed to equalization where there is a clear equalization target that all local governments understand.

Annual or Continuing Appropriation

Arrangements for sharing revenues from the personal income tax annually have been [modified](#) in the State Budget Law in Hungary.

Allocation/Assignment of Specific Taxes for Revenue Sharing

Revenues from [personal and corporate incomes and the value added tax](#) are distributed among three levels of government in Germany.

Formula for Sharing

Population, territorial size, and other factors determine the [distribution of shared revenues in Austria](#). Five indicators and weights determine the [distribution of the Provinces Fund in the Netherlands](#).

The process for allocating the personal income tax in Hungary has become extremely complicated ([box](#)).

[Macedonian budget revenues](#) were distributed on the basis of population in 1997, but under a new formula beginning in 1998.

Tax revenue shared with *gminas* in Poland has been unstable, because the distribution is [determined by the central government](#). The Law on Large Cities permits supplementary distribution of personal income tax revenues [on the basis of the U coefficient](#).

GENERAL INTERGOVERNMENTAL FINANCE ISSUES

ONGOING TRANSITION AND REFORMS

A recent OECD survey concluded that economies in transition need methods to [monitor and evaluate their reforms](#) of government finance.

Among Warsaw Pact countries in 1989, [Hungary](#) was the best prepared for reform, largely because the process of reform dates to the [1980s](#). As a result, Hungary was the [first](#) country in the region (with Poland) to attempt decentralization.

In part because of a long-running tradition of local government in the Czech Republic, the reestablishment of local democracy in 1990 after a hiatus of 50 years reopened the [debate on financing local government](#).

The process of decentralization during the transition in [Poland](#) was also characterized by intense political debate.

Understanding the current system of local government in Macedonia is impossible without first trying to understand [local self-government](#) as it existed and was practiced in the country in the late 1980s, before independence from Yugoslavia. This was followed by a [transition period from 1990 to 1995](#) that is the basis for the current system of local government.

The [legacy of Yugoslavia](#) also has significant relevance for the design of Bosnia's intergovernmental fiscal system as it exists today.

ECONOMIC AND FISCAL POLICY REFORM ISSUES

Throughout the region, local government expenditures account for a range of 0.5 percent of gross domestic product in [Macedonia](#) to as high as 15 percent in [other European countries](#).

Fiscal Stabilization

In March 1995 Hungary instituted its first [fiscal stabilization program](#) since the beginning of the transition. This program resulted in new limits on local debt and an attempt to bring local governments into the new state treasury system.

The [decline of the Romanian economy](#) between 1997 and 1999 resulted in a reduction of aggregate transfers to local public administrations that strained local budgets.

Financial Administration

Financial administration reform in Hungary included an attempt to incorporate local governments into the new [state treasury system](#) that did not fare well. Otherwise, the financial administration reforms have [focused on the central government](#) and ignored local governments, even though their problems are similar.

In 1995 Macedonian local governments were required to [shift their deposits](#) from the banking system to the National Bank of Macedonia, thereby [denying them regular account management services](#). Local governments are not required to deposit [off-budget resources](#), including programs and funds, in the National Bank. Local governments have been [left out](#) of the national treasury system.

Capital Markets Reform

Role of Government

Competition in the Hungarian municipal credit market has been [impeded](#) by the legacy of the National Savings Bank's monopoly.

State Enterprise Reform

The evolution of the relationship between local governments and the old state enterprises responsible for service provision has varied across the region.

The transformation of utility enterprises into municipally-owned companies or private companies operating at the municipal level has proceeded slowly in [Bulgaria](#). The extent of municipal control and involvement varies by sector, with a greater role in garbage collection, a mixed role in water provision, and relatively less involvement in heating and transport.

Local public enterprises played a crucial role in providing public services under the former system of local government in [Macedonia](#). They continue to play the same role, but their relationship with the municipalities has not been fully resolved. Based on the various enabling acts now in effect, the municipalities should be able to exercise [oversight and control](#) over the affairs and the finances of the enterprises. However, such factors as lack of clarity concerning the ownership of assets and limited staff capacity in the municipalities [constrain their ability to provide adequate oversight](#).

EU ACCESSION ISSUES

Financing through Regions

Nature of the Regions

In [preparation for receipt](#) of EU accession funds, Hungary enacted the Act on Regional Development and Regional Planning in 1996. This has generated intense debate over the nature of the region as an administrative unit or as a new tier of elected local government. It also has raised questions about the financing of the new regional structures.

This same debate is taking place in the [Czech Republic](#).

New Standards

Impact on Local Finances

Hungary will have to change the public chart of accounts [to comply with EU standards](#).

Maastricht Criteria

The recent experience of the [Czech Republic](#), [Hungary](#), and [Poland](#) shows that compliance with the Maastricht criteria will lead to expanded reporting on local debt, and perhaps to additional limits on the extent of that debt.

THE ANNUAL BUDGET CYCLE

THE NATIONAL BUDGET CYCLE

Vertical Equalization

There are at least two ways to determine [vertical fiscal imbalance](#), neither of which is an accurate indicator of local autonomy, as expressed by a recent OECD survey of Denmark, Hungary, and Latvia.

Revenue assignments in Bosnia-Herzegovina were [designed to create vertical balance](#), but several cantons are estimated to have deficits.

Expenditures by subnational governments in Hungary greatly exceed own-source revenues, leading to financial [dependence](#) on grants from and tax sharing with the central government. A central government tendency to “push-down” (unfunded mandates) spending responsibilities has exacerbated the problem.

Conversely, an analysis of budget trends from 1997 to 1999 in Romania makes it difficult to argue that the [vertical balance](#) has shifted in favor of the central government and against the local governments.

Decisionmaking Process

A recent OECD survey of Denmark, Hungary, and Latvia found [formal mechanisms for budget dialog](#) in all three countries. However, the lack of coordination among local governments [obstructs](#) communication between the central and local governments in Hungary.

In 1995 [Latvia](#) established a local government equalization board to discuss matters of local government finance and equalization, including state grants. The [process of consultation](#) is repeated annually in advance of budget preparation.

The [Joint Commission for Intergovernmental Affairs](#) in Poland is a consultative body composed in equal part of ministers and representatives of local government associations. It must be consulted on all matters relating to changes in local government finances and competencies.

LOCAL BUDGET CYCLE

Municipalities in the Czech Republic have considerable freedom to manage their budgets. Some have argued that they have too much freedom, and suggest the need for additional [financial controls](#).

Local governments in [Estonia](#), [Latvia](#), and [Lithuania](#) have independent budget authority.

The Public Finance Act in [Hungary](#) defines the budget cycle and the information and reporting requirements to the government and to the local council or county assembly. Once these basic requirements and procedures are met, local governments are free to proceed as best they see fit in relation to their own internal budget and financial reporting and management. However, [constant changes in the rules](#), particularly regarding transfers from the state budget, have impeded municipal financial planning. Hungarian local government budget calendar ([box](#)).

The State Budget Law is the [primary regulation](#) for local government budgets in Macedonia. The law includes [specific provisions](#) for local governments and the city of Skopje, but is somewhat [ambiguous](#) in other areas. Local revenues and expenditures are presented in several documents, including [budgets](#), [programs](#), and [funds](#), that are not consolidated in a single budget document.

Local governments in Albania have limited control over their budgets. [Two laws](#) govern local government budgets and produce a budget structure that is unique in the region. It divides the local budget into a conditional and independent budget that run on two [different fiscal years](#). The Ministry of Finance prepares [guidelines for operating cost estimates](#) and line ministries can [override](#) local budget estimates.

Preparation of the Initial Budget

Local governments in [Romania](#) must prepare their initial budgets each year without having a clear picture of either their revenues or expenditures for the next year. This creates obstacles to sound management of local finances.



Revenue Estimates

Macedonian local governments have [no role](#) on the revenue side of the budget.

Expenditure Estimates

The annual Law on Limiting Public Expenditures [establishes ceilings](#) for each unit of local government in Macedonia that become the [basis for that part of the local budget](#). Macedonian reporting systems [do not fully acknowledge](#) the expenditures of local governments.

Interaction with the National Budget Process

Budget Preparation and Approval

The Albanian finance minister submits [local budgets as part of the national budget](#) to the Council of Ministers. Final conditional budgets are [often unapproved](#) at the end of the budget year, requiring the central government to begin transfers at rates of 1/12th of the previous year's total transfers.

The national government controls local budgets in [Estonia](#) and [Lithuania](#) through the revenue side.

Hungarian annual local government budgets [depend on parliamentary decisions](#) about subsidies, grants, and transfers. Annual regulations list [specific items](#) to be included in local government budgets.

The Macedonian Ministry of Finance must [opine](#) on local government budgets before municipal councils pass them. All local governments use the [Finance Ministry's regional offices](#) to help prepare their budgets.

Budget Execution

Albanian local government funds are available from [local offices of the national treasury](#) on a bimonthly basis throughout the year. Local governments must receive ministerial approval before spending excess revenues.

The Hungarian Treasury's shift to [net financing](#) has negatively affected local government finances, provoking the establishment of the "[Small Treasury](#)" system that improved ([box](#)) local financial management.

The section of the Macedonian State Budget Law that addresses budget execution does not mention local governments, but Ministry of Finance officials have stated that [this section does apply](#) to local government budget execution.

Throughout the year, the Ministry of Finance unsystematically and somewhat arbitrarily allocates [additional revenues](#) that sometimes cause local governments to [exceed](#) their public expenditure limits.

Financial Accounting, Reporting, and Audits

[Reporting](#) on local finances in the Czech Republic is standardized and is purely for statistical purposes.

Estonia also has standardized [reporting requirements](#) and began external audits in 2001.

Local governments in Latvia [report](#) on their budget execution and net loans on a monthly and annual basis.

Hungarian legislation ignores the form and content of draft budgets, but has many [requirements](#) for local budgetary decrees. The financial reporting requirements of Hungary's Public Finance Act are the principal means for central government data collection. The act includes requirements for [internal reporting](#), [reporting to the central government](#), [reporting to constituents](#), and [reporting on debt](#). Hungarian local governments are also required to institute [audits by the state](#), [audits by outside auditors](#), and [internal financial controls](#). In general, budgeting, reporting, and auditing procedures [do not promote accountability](#).

In Macedonia the Ministry of Finance reviews [accounting records](#) of local government revenues and expenditures and the State Audit Office reviews the [use and spending](#) of local government revenues. The Ministry of Finance reviews only local government budgets, which [do not include full accounts](#) of revenues and expenditures, leaving a [major gap in financial accountability](#) of local governments.

All accounting by local governments in Macedonia is on a [cash basis](#), and local government financial data is [inadequate](#) and [fragmented](#). Attempts have been made to develop a comprehensive financial statement ([table](#)) of local government revenues and expenditures.

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THE WORLD BANK

**1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.**

**Telephone: 202 477 1234
Facsimile: 202 477 6391
Internet: www.worldbank.org
E-mail: feedback@worldbank.org**



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