

Pristina Declaration on Renewing Commitment to Fiscal Decentralization in South East Europe

On the basis of recent analyses of local governance in South East Europe, including the NALAS report on *Fiscal Decentralization Indicators*, the DEXIA/CMR report on *Subnational Finance in Europe* and the Council of Europe report on *Local Governments in Critical Times*, we, the Associations of Local Governments of South East Europe hereby declare that:

The economic turbulence of the last five years has impacted the economies of South East Europe with different force and in different ways. In many places, the size of the public sector has gotten smaller, as governments reduce spending in response to falling tax revenues. In others, the overall size of the public sector has stayed stable or recovered after declines in 2009. In a few, there has been some growth.

In general, however, the period has not been a good one for local governments in the region. Indeed, the movement to decentralize the delivery of public services that was so visible in the between 1990 and 2005 seems to have lost momentum.

- With a few exceptions, major structural reforms in the area of local governance have stopped, and in about half the region local government budgets have actually decreased in relation to the GDP.
- Almost everywhere, local government investment as a share of GDP has fallen over the last five years, and in most places remains well below the average for the EU.

This is particularly disturbing given that local governments throughout South East Europe have been assigned primary responsibility for constructing long-neglected and extremely costly public infrastructure like water and solid waste systems.

The apparent erosion of the financial position of local governments in much of the region is complicated by long standing issues that remain to be resolved, as well as new challenges.

- Throughout the region, unconditional grants in general, and equalization grants in particular remain underutilized raising serious questions about the equity of intergovernmental financial arrangement.
- In many places, grants and tax shares are still negotiated on an annual basis, making it difficult for local governments to anticipate their revenues, effectively plan or realize investments, or borrow prudently.

Local governments that have been assigned responsibility for pre-university education are facing particular difficulties. On the one hand, the block grants they receive from their respective central governments are often too small to reasonably fund their school systems. On the other hand, and in practice, they are also highly earmarked, making it difficult or impossible for local governments to rationalize education spending.

In most of the South East Europe, local governments have limited revenue raising powers. Moreover, in many places some of these powers are being questioned: Across the region, central governments –often supported by donor agencies-- are taking steps to improve the overall business enabling environment and in many places this has entailed efforts to restrict the ability of local governments to impose fees, charges, and taxes on business. As justified as these initiatives may be, they risk precipitating further declines in the financial autonomy of local governments.

Meanwhile, property tax collection is poor and local governments throughout South East Europe remain reluctant to aggressively collect it. This needs to change and will require greater political will at the local level as well as significant reform of both national legislation and national land and titling systems. Even with reform, however, it is unlikely that in most places property tax collection will reach European norms in the immediate future. Indeed, even if they do, this will not lead to a radical strengthening of the financial position of local governments in most of the region.

Given the weakening of the overall impetus towards decentralization, the persistence of unresolved problems, and the emergence of new challenges, we hereby call on our members, their respective governments and the international community to recommit to decentralization in order to improve the daily lives of citizens, strengthen democratic institutions, and facilitate European integration.

In particular we call on NALAS members, their central governments, and the international community:

1. **To systematically review the operation and functioning of intergovernmental grant and transfer mechanisms.** In line with European Charter of Local Self-Government these mechanisms should be clearly defined in law and designed to yield predictable revenues that are adequate to fund the functions local governments have been assigned.
2. **To focus particular attention on improving equalization mechanisms which are weak in most of the region.** Here, efforts should concentrate on developing solutions which mitigate the intensity of the intra-municipal conflicts that inevitably arise in countries in whose wealth and populations are heavily concentrated in capital cities.

3. **To recognize that in most of the places where local governments have been assigned responsibility for financing pre-university education, the data suggests that the function is being underfunded.** Moreover, in these places local governments typically have extremely limited powers to spend the education funding they receive from the national government freely within the sector because of the de facto earmarking of block grants. The underfunding of education is imprudent, while the earmarking of block grants puts local governments in the impossible position of being held responsible for a service they cannot really manage.
4. **To appreciate that low and declining rates of municipal investments are rendering it difficult for local governments to make-up for the deficits in public infrastructure they have inherited from the past.** If allowed to continue they will also undermine the legitimacy of local democratic institutions because citizens will regard their municipal governments as ineffective. National governments should take steps to increase local government revenues and to their access to credit. The EU should work to ensure that pre and post accession funding is concentrated on building the environmental infrastructure that local governments are responsible for. And international donor should concentrate technical and financial assistance on improving financing and managing of public utilities.
5. **To understand that in countries in which tax bases are highly skewed towards capital cities and in which there is no tradition of ad valorem taxation it is very hard to give local governments robust sources of own revenues.** Thus while efforts to improve the property tax should be intensified throughout the region, it is unreasonable to expect that property tax alone will provide a strong foundation for the financial independence of municipal governments. In this respect, efforts should be made to expand the own revenue powers of local governments by giving them the power to impose local surcharges on the Personal Income Tax, as is done in some countries of the region.
6. **To appreciate the critical importance that property rights have in the development of viable and dynamic local governments and to take steps –where those steps have not been taken—to transfer to local governments local public land and buildings.**
7. **To examine the obstacles to the prudent expansion of municipal borrowing and to take steps to improve local governments’ access to debt capital.** Without access to debt financing it is unrealistic to expect local governments in the region to be able to build the costly (environmental) infrastructure they have been made responsible for.