

## EURASIA STATE OF DECENTRALISATION

Dialogue and capacity building of  
local and regional authorities  
in EU partner countries  
in the fields of development  
and local governance

2015



PLATFORMA

The European voice of **Local** and  
**Regional** authorities for development

EURASIA State of decentralisation

PLATFORMA – 2015  
SKL – 2015

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This document was prepared as a background document for the “Seminar for Dialogue and Capacity Building of Local and Regional Authorities in Eurasia in the Development and Local Governance Fields” held in Tbilisi, Georgia, 14-15 May 2014.

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# Table of Contents

|   |           |
|---|-----------|
| <b>1. GLOBAL TRENDS IN INTERGOVERNMENTAL FINANCE</b>  | <b>4</b>  |
| 1.1. European Charter of Local Self Government foundation for turn to decentralisation                        | 4         |
| 1.2. Sound intergovernmental fiscal relations critical for decentralized government                           | 5         |
| 1.3. Financing local governments primarily through own-revenues is an almost impossible task today            | 5         |
| 1.4. "Transfer dependency" driving new ways to get revenues and improve fiscal responsibility                 | 7         |
| 1.5. The Personal Income Tax as a source of local government revenue and means to foster economic development | 8         |
| 1.6. Anchoring Grant Pools and Property Devolution as Pillars of Local Government Success                     | 9         |
| <b>2. EURASIA 2014</b>  | <b>10</b> |
| 2.1. Formation, organisation and functioning of local self-governance   | 10        |
| 2.1.1. Political and legal status – fragmentation at its essence  | 10        |
| 2.1.2. Territorial and Organizational Structure of local government: political will or real need?             | 13        |
| 2.1.3. Organizational Structures of Local Governance: local governance vs. state governance                   | 15        |
| 2.1.4. Local government mandates – a call for clear designation   | 16        |
| 2.1.5. Service delivery – from structural change to consolidation and expansion                               | 17        |
| 2.2. Public Finance at the local level  | 29        |
| 2.2.1. Local budgets in national budget systems   | 29        |
| 2.2.2. Revenues, intergovernmental fiscal relations and fiscal autonomy of local budgets                      | 31        |
| 2.2.3. Weak public participation in the budget process but local signs of life                                | 33        |
| <b>3. CONCLUSIONS</b>   | <b>36</b> |
| <b>4. RECOMMENDATIONS</b>   | <b>37</b> |
| Administrative and Territorial Decentralisation   | 37        |
| Fiscal Decentralisation   | 37        |
| Improving multi-level governance  | 37        |
| Improvement of public participation, budget process and planning of services                                  | 38        |
| <b>BIBLIOGRAPHY</b>   | <b>39</b> |
| <b>APPENDIX</b>   | <b>42</b> |



# 1. GLOBAL TRENDS IN INTERGOVERNMENTAL FINANCE

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Recent trends in local government finance across suggest that municipal governments will remain heavily dependent on national government grants and transfers for the bulk of their revenues.

This dependency can be reduced by giving local governments the power to freely dispose of (non-essential) municipal property; by improving local property taxation; and perhaps most importantly by progressively giving them greater control over the taxation of personal income.

Even if this dependency can be substantially reduced, however, local governments are always part of single system of public finance and there will always be tensions between them and the national government over the rules which regulate their revenues and expenditure. These rules must be set by the national government. Worse, in decentralizing contexts not only are there no obvious technical answers to questions about what local governments should be doing, how they should pay for it, but whatever rules are decided upon will inevitably have to be adjusted and amended.

For these reasons, successful intergovernmental finance reform is probably more about institutionalizing and progressively enriching a substantive dialogue between local and national policy makers than it is about getting the “rules right.”



## 1.1 European Charter of Local Self Government foundation for turn to decentralisation

Over the last 25 years, an increasing number of countries have decentralized power and money to democratically-elected subnational governments – particularly municipalities. This trend has been driven by a variety of forces. Efforts to decentralize political power have been part of the broader wave of democratization that came with the collapse of communism in Eastern Europe and Eurasia, and of authoritarian regimes in parts of South America, Africa, and Asia. Decentralisation has also been encouraged by the globalization of trade and production which has shifted the location of “comparative advantage” from nation-states to regions and cities. And some national governments have clearly “dumped” responsibilities on local governments in order to reduce their own fiscal problems.<sup>1</sup>

But at the most general level, decentralisation has been driven by a set of wider convictions about the foundations of good governance. In short, national and international policy-makers increasingly agree that – as the preamble to the 1988 European Charter of Local Self Government puts it – “local authorities are one of the main foundations of any democratic regime” and that assigning them “real responsibilities can create a (public) administration that is both effective and close to the citizen.” Indeed, one measure of this “turn to decentralisation” is the fact that all 47 members of the Council of Europe have now signed the Charter which has also become the foundation of the United Nation Habitat’s “International Guidelines for Decentralisation and the Strengthening of Local Authorities”<sup>2</sup>.

<sup>1</sup> UCLG/World Bank, 2008.

<sup>2</sup> Himswoth, 2011, UN Habitatat 1998.



## 1.2 Sound intergovernmental fiscal relations critical for decentralized government

The Charter lays out the basic foundations of decentralized government. The eight short paragraphs of Article 9 address the critical questions associated with the Financial Resources of Local Governments<sup>3</sup>. They state that local governments should have;

1. diverse and buoyant revenues that are sufficient to cover their responsibilities
2. that they should have **real control** over at least some of these revenues
3. that there should be mechanisms that provide poorer jurisdictions, or jurisdictions with extraordinary expenditure needs additional – **equalizing** – funds
4. that most grants and transfers should be **freely disposable**
5. that local governments should have the **right to borrow** for investment purposes
6. and that they should be **consulted** about the way grants are allocated to them.

These basic principles are extremely important. Their practical realization, however is not only difficult, but differs substantially from country to country even when successful. In short, there is no simple model for good intergovernmental fiscal relations.

## 1.3 Financing local governments primarily through own-revenues is an almost impossible task today

In the following, we highlight some recent trends in intergovernmental finance. We begin by recalling the central idea of the literature on “Fiscal Federalism” because this literature often informs the way Ministries of Finance think about how the principles expressed in the Charter should be realized in practice. The central idea of this literature is that decentralisation will deepen democracy and make government more efficient if the jurisdictions of local governments can be aligned with their tax powers and with the benefit areas of the services they provide. Or to put the matter a little differently, local governments will be effective and accountable if voters know what services they provide, and understand that it is their taxes that pay for those services. From a policy point view, this tax-based logic of accountability and efficiency will work itself out in practice if 1. the responsibilities of local government are clearly separated from those of the national government; 2. if the scope of their services are aligned with their territorial boundaries; and, most importantly, 3. if local governments pay for as much of their responsibilities as possible out of taxes they impose<sup>4</sup>.

### *The Problems of Property Taxation as the fundamental pillar of local government finance*

We cannot fully discuss here the emphasis that the fiscal federalism puts on the importance of local government taxation for good governance. But two points are worth making because they shed some light on why decentralisation has proved so difficult to “get right” as well as some recent trends in intergovernmental finance. The first point is that fiscal federalism took shape in the United States and Canada during the 1960s and 70s where municipal governments derived more than half their revenues from a very robust, market-based property tax. This tax, the fiscal federalists argued, was the single best source of local government revenue because unlike taxes on income and consumption people could not easily move its base to other jurisdictions in search of lower rates; because better local services would increase property values, creating a positive link between the quality of local government and taxation; and because there was no good reason why the tax couldn’t be effectively administered by local authorities<sup>5</sup>.

<sup>3</sup> see Appendix.

<sup>4</sup> Musgrave, 1957; Oates, 1993 & 2005; Ter-Minassian, 2007.

<sup>5</sup> Norregaard, 2007.



But whatever the theoretical virtues of local property taxation may be it is fair to say that in most the world the tax has proved a disappointment despite years of investment into it by national governments and donors<sup>6</sup>. To be sure, the property tax does generate local government revenue equal to between 2.5% and 3% of GDP in the US, Canada, and a few other (mainly) Anglo-Saxon countries. But the average for the European Union (EU) is only about 1.1%. More importantly, in the developing and transitional world the yield is often well under 0.5% of GDP<sup>7</sup>. In short, while there are good reasons to improve local property taxation in most countries, experience suggests that the tax cannot be made robust enough to serve as the anchor for municipal finances in a decentralized order.

### ***Centralization of public revenues caused by the VAT revolution***

The second point is that fiscal federalism took shape before Value Added Taxation (VAT) replaced point-of-sales taxation as the main means of taxing consumption around the world. In point-of-sales taxation only the end consumer pays the tax and thus the tax has a single point of origin. This makes it possible for the tax to be shared between lower and higher levels of government, or indeed for both levels of government to tax the same transaction. With VAT however, all intermediate purchasers of goods and services pay the tax on their inputs, and then remit to the government the difference between the amount of tax they have paid and the amount of tax they receive when they sell the new, higher value product - hence value added tax - to someone else. The chain nature of VAT radically improves compliance because intermediate producers must be able to demonstrate that they have paid VAT on their inputs in order to avoid having to remit to the government all of the VAT they collect when they sell their outputs. But this same chain nature of the tax means that for the government imposing it, VAT has no single point of origin. And while some large federal countries allow regional governments to impose their own VATs – and then have complicated systems to regulate inter-regional trade – it is technically impossible to have VATs at the sub-provincial level<sup>8</sup>.

As a result, the VAT revolution of the last 40 years has not only eliminated local sales taxation, but has made it impossible for local governments to impose taxes on general consumption, or for consumption taxes to be shared with them on an origin basis<sup>9</sup>. This stands in stark contrast to the situation in America – one of the few countries in the world without a VAT – where almost 30% of subnational revenue continues to come from origin-based sales taxes<sup>10</sup>.

The take home message here is that fiscal federalism's normative objective of making local governments as financially independent as possible grew up around two taxes that are of limited or no importance in most of the world today: An exceptionally robust market-based property tax, and a point-of-sales consumption tax that has ceased to exist outside of the US. As a result, and as an empirical matter, municipalities in most countries derive well under 40% of their revenues from own-sources<sup>11</sup>. Or put another way, one the most important "trends" in intergovernmental fiscal relations is the often reluctant recognition by policy makers of just how difficult it is to decentralize power and responsibility to municipalities and still expect them to derive most of their revenues from own sources because there just are not that many robust taxes that can be reasonably assigned to them.

<sup>6</sup> Bird, 2010.

<sup>7</sup> NALAS 2013; Sepulveda & Martinez-Vasquez, 2011.

<sup>8</sup> Brazil, Canada, and India all have provincial VATs. They also all have complicated systems for dealing with inter -provincial trade (see McLure, 1987 & 2000). Nonetheless, the basic point holds at the sub-provincial level).

<sup>9</sup> The national government can earmark a percentage of the national yield of VAT for local governments. In this case, VAT is being "shared" with local governments but it is not being shared with them on an origin basis. Instead the "share" is really defining the size of a grant pool that is then being allocated to local governments on the basis of a formula and not by how much of the tax is generated in their jurisdictions – which in the case of VAT is impossible for the reasons we have discussed above. Nonetheless it is important to recognize the difference between these two types of tax sharing. For example, PIT can be shared with local governments on an origin basis and it can be shared by saying that percentage of the national yield of the tax will be allocated to them by formula.

<sup>10</sup> US Census Bureau, own calculations.

<sup>11</sup> Blochlinger and King 2006; Smoke 2008; UCLG, 2008 p. 297. In most countries a healthy portion of these own revenues typically come from non-fiscal sources, principally the sale or rental of municipal assets. We return to this point later.



## 1.4 "Transfer dependency" driving new ways to get revenues and improve fiscal responsibility

In a moment, we will discuss the Personal Income Tax (PIT) as a potential way to work around this general rule. But first it is important to consider the implications of this quasi-structural "transfer dependency" on how we think about intergovernmental finance systems. On the one hand, this dependency clearly weakens the tax-based logic of political accountability and economic efficiency that many advocates of decentralisation see as its central purpose: That by subjecting local governments to the political and economic discipline that comes from raising taxes, local officials will have to be both fiscally responsible and responsive to their electorates. On the other hand, and equally importantly this same transfer dependency seriously undermines the "financial independence" that local governments also often see as the central purpose of decentralisation. In short and whether we like it or not, local and national governments are tied together in a single system of public finance whose internal tensions cannot be made to disappear by miraculously transforming local governments into fiscally autonomous, self-financing units. Instead, the real challenge is to manage this mutual interdependence by developing an intergovernmental finance system that at once provides local governments with a firm financial platform for independent action while also fostering responsible economic behavior. This, however, is easier said than done.

The standard literature on public finance argues that defining this platform should begin by calculating the per capita costs of the service responsibilities – or "expenditure needs" – that have been assigned to local governments. These per capita costs should then be compared to the average per capita revenue raising capacity of all local governments. Any difference between the average per capita expenditure needs of local governments and their per capita revenue raising capacity is called a "vertical gap". And this gap, the literature argues should be filled by grants or shared taxes that allow local governments of average wealth and average expenditure needs to pay for the service responsibilities they have been assigned. Local governments with less than average revenue-raising capacity or higher than average expenditure needs<sup>12</sup> however should receive additional, equalizing grants to fill the so called "horizontal gap" between their financial situations and those of the average jurisdiction<sup>13</sup>.

This methodology is both logical and technically challenging. Indeed, it is so challenging that it is extremely difficult to realize in most developing or transitional contexts. There are many reasons for this. On the expenditure side of the problem it is very difficult to price the services that have been assigned to local governments because there is often little reliable data about their costs; because what little data there is, often reflects less the real costs of these services than the fact that the national government was underfunding them prior to their decentralisation; and because attempts to estimate – in the absence of reliable historical data – what these services should cost almost always generates figures well in excess of the government's ability to finance them. And this is to say nothing of the additional problem of trying to determine which jurisdiction might have higher than average expenditure needs that might be compensated for through equalizing grants.

Meanwhile, on the revenue side of the equation the problems are only slightly less daunting. Typically, there is some data on the amount of own-source revenues that local governments actually collect. But actual collection is not a good measure of real revenue raising capacity because some local governments will make greater efforts than others to collect taxes. Indeed, building equalization systems off actual collection creates perverse incentives for local governments not to exert much tax effort. So what is really needed is some way to objectively measure the tax bases of local governments. Unfortunately, however, such measures are usually in short supply. For instance, developing countries never have fiscal cadasters that would allow national policy makers to compare the value of the property tax base across jurisdictions. And this in turn means that it is very difficult to construct equalization mechanisms that are built directly around the tax that is typically considered to be the best and most appropriate source of local tax revenue.

<sup>12</sup> By higher than average expenditure needs we mean objective factors which increase the cost of delivering public services in particular jurisdictions. Examples of such factors are low population density, higher than normal distributions of very young or old people, extreme topographical conditions, or higher than average wage rates in the local economy.

<sup>13</sup> Ahmad & Craig, 2007.

These difficulties do not mean that policy makers should not try to estimate what local government service responsibilities cost, or what their revenue raising capacities really are. On the contrary, it is critically important that national and local officials make continual efforts to improve the empirical basis upon which policy makers design and adjust intergovernmental finance systems. Nonetheless, the difficulties with the determining the size and allocation of the grants and transfers used to fill “vertical” and “horizontal” gaps means that in most developing and transitional countries these decisions have to be based on **politically constructed “guesstimates”**<sup>14</sup>. These guesstimates try to square the national governments limited revenues with local governments’ unbounded need for them. Indeed, it is fair to say that the relative success or failure of most intergovernmental finance systems is very much dependent on the quality of this discourse between national and local government officials.

Here policy makers have to strike an uneasy balance between defining rules that are stable enough to allow local governments to engage in at least medium term financial planning, and which also can be periodically revised and renegotiated as the decentralisation process unfolds, external conditions change, and/or new data becomes available. Increasingly, countries are trying to meet these challenges by legally requiring the creation of intergovernmental finance commissions. Typically, these commissions are composed in equal part of national government officials drawn from the ministries most engaged with local governments and representatives named by local government associations. In the most robust cases, these commissions are legally required to meet regularly and to give (non-binding) opinions and recommendations on all laws and ordinances that have material effect on the functioning and finances of local governments<sup>15</sup>. In less robust cases, they are empowered to make periodic reviews of the overall operation of the intergovernmental finance system and to make recommendations for its improvement. In all cases, it is not only important that these commissions have full access to all local government revenue and expenditure data, but that this data is easily available to the wider public so that interested third parties can weigh into the debate.

## 1.5 PIT as a source of local government revenue and means to foster economic development

There are also some interesting trends in the way some developing countries are trying to ensure that local governments have revenues that are adequate, equitable, and predictable enough to provide them with some real measure of financial independence. Here, the most promising trends are probably related to using the Personal Income Tax (PIT) to provide local governments with revenues. Where this is being done in the post-communist world, the process has usually started by giving local governments a share of the PIT generated in their jurisdictions<sup>16</sup>. A few countries have then gone a step further by allowing local governments to impose an additional local surcharge on the national rate, partially transforming the tax from shared tax into an own-revenue. And a few countries are currently considering giving local governments full control to set the rate of the tax up to a certain centrally imposed ceiling, a reform which would fully transform the tax into a true own revenue. Here, it is worth adding, that in Scandinavia – which includes some of the most decentralized countries in the world – local governments not only are responsible for setting PIT rates but get virtually all of the yield of the tax – though the national government continues to set the base of the tax and to collect it. Indeed, by giving local governments full control over this robust tax, Sweden, Denmark and Finland have – rather uniquely – been able to radically decentralize public services to municipal governments while sidestepping the problem of “transfer dependency.”

<sup>14</sup> In the phrase “politically constructed guesstimates” I use the word “politically” in its positive sense: as a consciously determined outcome that is meant to produce a reasonable and acceptable compromise between the interests of different social groups and sub-groups. Transfer systems can – and often are – “politically rigged” in order to produce outcomes that blatantly favor one group or another, be it jurisdictions controlled by one party or one ethnicity.

<sup>15</sup> Over the last ten years, Poland has developed an Intergovernmental Affairs Commission that is governed by special legislation, has a permanent committee structure; and meets every month. No legislation affecting local government revenues or expenditures can be submitted to parliament without prior consideration of the Commission.

<sup>16</sup> A prerequisite for origin based PIT sharing is the registration of PIT payments by tax payers’ place of residence and not the place of his or her employment (or worse, the headquarters of his or her employer). Among the post-communist countries that are sharing PIT on an origin basis with local governments are: Poland, Croatia, Serbia, Montenegro, Slovenia, Lithuania.





Nonetheless, even PIT sharing seems to have a number of virtues in many newly decentralizing states. The first is that the share of the tax going to local governments can be adjusted upwards as new functions are decentralized to local governments. The second is that sharing the tax provides direct budgetary incentives for local governments to promote economic development and job growth, as well as to work with the national government to legalize the gray economy. And the third, is that the tax can eventually be fully or partially transformed into a true own revenue – as we have already indicated.

PIT sharing however, also has at least one major problem: the yield of the share will differ substantially across local governments because of differences in employment, wages, and the relative size of the gray economy. Indeed, in some cases, the distribution of the tax may be so skewed that only a few local governments will actually benefit from the share. In cases where the base of the tax is concentrated in only a few large cities, it may make little sense to use origin based PIT sharing as a way to fill the vertical gap between the per capita expenditure needs and revenue raising capacity of the average jurisdiction. And in virtually all cases where PIT is used to provide local governments with substantial amounts of revenue some mechanism for fiscal equalization must be developed to provide additional funding to jurisdictions with low levels of (taxable) employment.

Here, it is important to note that at least in countries where the distribution of PIT is not extremely skewed toward a handful of big cities, PIT sharing itself provides a foundation for the development of a reasonably fair equalization system: Because the national government sets the base of the tax and administers it for the entire country, the per capita yield of PIT constitutes a reasonably objective measure of the relative wealth of local governments. This measure of relative wealth can then be used to design an equalization system that provides local governments whose per capita yield of PIT is below the national average with a (per capita) grant that brings their revenues from shared PIT and the grant closer to the national average. Moreover, local governments whose per capita PIT revenues substantially exceed the national average can be “taxed” to pay for some the cost of equalization<sup>17</sup>.

## 1.6 Anchoring Grant Pools and Property Devolution as Pillars of Local Government Success

In countries in which the distribution of PIT is so skewed that it make little sense to use the origin-based sharing of the tax as a means to fill vertical gaps, or as the foundation of an equalization system, then some other mechanism must be developed to provide local governments with general revenues. Here, the most positive trends are to be found in countries that stabilize grant pools by legally defining the amount of money that will be allocated to local governments as some percentage of the national governments total revenues, or some percentage of particular national government taxes. This ensures that local governments can be reasonably certain that their overall budgets will not fluctuate wildly from year to year and will grow (or contract) in line with the overall economy.

It is also worth adding that some of the most positive developments in local government finance can be seen in countries where local governments have been given ownership or effective control over large amounts of urban real-estate (e.g. Poland, China, Serbia). In these countries, local governments derive significant amounts of revenue from the sale or rental of land and buildings. Indeed, in China these non- fiscal revenues constitute the single most robust source of income for large urban jurisdictions. Equally importantly, control over land not only facilitates local governments’ ability to effectively plan their own development, but to enter into partnerships with the private sector to build housing or other public infrastructure.

<sup>17</sup> This sort of system exists in Germany and has been used with great effect in Poland. It is also worth adding that so long as PIT payments are registered by taxpayers’ place of residence, PIT yield can be used to construct indexes of the relative wealth of local governments even if the tax is not actually being shared with them.

## 2. EURASIA 2014

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There have certainly been decentralisation reforms in most countries of the Eurasia region (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan) and a development of local self-governance during the past 10-15 years. Yet decentralisation processes are frequently inspired by the wish to get rid of the excessive centralization inherited from Soviet times, rather than by an understanding of the advantages of a proper distribution of authority between various levels of power. As a result, many local authorities have had to assume the responsibilities without the relevant authority or resources required to fulfil them successfully.

And without having a strong financial basis, the vast majority of local governments have been constrained to recognizing collaterality of local governance prior to state government bodies. This recognition happened at official level (delegation of powers), and by an informal transfer of the right of decision-making to the regions.

In the Eurasian countries the dominating approach to local government is still not based on self-organization of citizens in a view of territorial development, its economy and the social sphere, but as a lower level of government to be “integrated” in the state administrative vertical.

We witness a constant and strong antagonism between tendencies of centralization and decentralisation in the development of local self-government in the Eurasian countries.

The aim of the present study is to bring the current trends in local government and development and processes of decentralisation in Eurasian countries to all interested parties in order to draw joint overall conclusions and elaborate recommendations that are pertinent for most of the countries of Eurasia region.



### 2.1 Formation, organisation and functioning of local self-governance

#### 2.1.1. Political and legal status – fragmentation at its essence

The constitutions of all Eurasian countries contain separate articles, sections or rules devoted to local self-government and to guarantees of its realization. They proclaim that the rights of citizens to local self-government may not be restricted. Constitutions regulate relationships between central and local governing bodies on principles such as:

- separation of state powers and powers of local self-government,
- organizational and functional independence of local self-government in the sphere of its competence,
- unity and integrity of state territory,
- combination of centralization and decentralisation in the execution of state power,
- balanced social and economic development of territories, and
- responsibility of organisational bodies and employees of local self-government to the state.

Some constitutions, including that of **Uzbekistan**, prescribe that relations between central and local governments shall be built on the basis of subordination and mutual cooperation.



However, the Constitution of **Moldova** does not contain any special reference related to the local self-governing, it states on public governance in the administrative-territorial units that is based on principles of local autonomy, decentralisation of community services, authorities election of local public government and public consultation in respect of issues of local significance.

In all Eurasian countries, special legislation has been adopted to define the legal status of local self-government. The principle of structural independence of the local self-government authorities against the state authorities is recognized in the most of the Eurasian countries that reflects an ascertain degree of the government decentralisation (**Armenia, Georgia, Kyrgyzstan, Russia, Ukraine and Moldova**). In these countries local self-government has certain autonomy and is separated from state government.

Nevertheless, the legislation of a number of Eurasian countries has no provisions related to the organizational disintegration of the local self-governments against the bodies of state power; In **Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan** the local self-government bodies are considered as sub-systems of the single state administrative mechanism, i.e. the local governance is executed through the representatives of the state's authorities at the local level. Consequently, the local self-government bodies are included into the state bodies system. In these countries local self-government plays a limited role and functions only at the lowest level; in small villages. It is nevertheless necessary to note that these countries are in the process of implementing reforms to increase the role of local self-governments and to enlarge their functions.

Another model of local self-government has been developed in **Belarus**. The Law "On Local Government and Self-Government in the Republic of Belarus" establishes a peculiar combination of different elements of central state government, local state government and local self-government. Local self-government, as opposed to the notion of a state-controlled local body, is defined as the organization and activities of citizens for independent solution of local issues, directly or through elected entities. This definition takes in to account the interests of the population, the development of administrative territorial units and the basis of own material and financial resources local government can generate or attract. But at each of the three levels (province, district or city with district rights, rural or urban municipality) executive powers are integrated in the system of the state executive power, even though they are, at the same time, bodies of local government. Local councils in **Belarus**, therefore, do not have their own executive powers.

At the present time is some Eurasian countries (**Georgia, Russia, Kazakhstan and Ukraine**) the changes in the long-held models of local government can be observed.

In **Georgia** a draft amended Organic Law of Self-Government has been prepared by the Ministry of Regional Development and Infrastructure (MRDI), the content of which is guided by "Basic Principles of Decentralisation and Self-Government for 2013-2015" endorsed by the Government of Georgia in February 2013. The principles guiding the proposed amendment are ambitious as they indicate a comprehensive reform and even more so given the time constraint. The main principles set out in this document are about:

- formation of public self-governments in each settlement
- territorial optimization and enhancement of local self-government (LSG)
- introduction of elements of self-government in the structure of regional authorities
- direct elections of mayors of cities and chiefs of municipalities

The proposed amendment to the Organic law is a clear statement of a political will to move decisions of importance for the daily life of citizens closer to them.

At the same time, the National Association of Municipalities of Georgia (NALAG) has decided to present its own proposal for revisions to the Organic Law to Parliament. Unlike the MRDI draft, the NALAG proposal is to a large extent building on the existing territorial divide but includes a concept for improved integration between municipalities and

villages through a Consultative Council composed of village representatives and several reforms related to governance of municipalities such including a rebalancing of the role of the council chairperson and the mayor.

The draft law "On Local Governance" presented by the Government of Georgia was amended in the process of parliamentary discussions. In particular, the proposal to create public self-governance bodies in each settlement was not supported. Instead, the Government was tasked to develop by the end of 2014 an independent draft law on improving the mechanisms of participatory self-governance. At this stage, efforts aimed at territorial optimization have been limited to an increase in the number of self-governed cities: 7 more cities were added to the already existing group of 5 self-governed cities. At the regional level, a Consultative Council under the governor was established (staffed with senior municipal officials) to replace the Regional Council – a representative body with broad mandate, the establishment of which was envisaged by the original draft law.

In **Kazakhstan** "The Concept on Local Government development" was approved by the President decree at the end of the 2012. The first stage (2013-2014) of Concept implementation envisages:

- enhancement of the role of the population in managing the issues of local significance by meetings and rural gatherings at the level of auls (villages), settlements, the cities of regional sub ordinance;
- establishment and development of mechanisms of active involvement of urban population in process of administrative decisions-making;
- extension of financial autonomy of the lower level of local governance.

According to the Concept it is proposed to be formalized in legislation with the following main provisions:

- definition of powers of local governments and their responsibility;
- regulation of procedures for holding of inhabitants meetings and rural gatherings;
- introducing an obligation of compulsory discussion the matters of financing issues of local significance by the inhabitants meetings;
- providing for the executive bodies of local governance (akims) of lower level the rights on establishing of own revenues.

Currently, in **Kazakhstan** the reform on delineation of powers between levels of state local governance regarding optimization of system state governance by redistribution of powers and authority vertically down "the republic (center) – region – raion (district) – city and rural settlements" is carried out. It is expected, that the effective scheme of interaction of the central government and local executive bodies will be elaborated.

In April 2014, **Ukraine** approved the Concept of Decentralisation of Power, envisaging the local governance reform with regard to changing the system of governance at the oblast (regional) and raion (district) level and expanding the mandates of communities. It is recommended that the Concept should be implemented in two stages. At the first stage (through October 2014), the necessary legislative framework should be created in full, and at the second stage, an institutional restructuring of local self-governance bodies and local executive bodies should be completed, and local elections should be held.

The reform provides further enlargement of competences of local authorities, as well as territorial changes at the local level, including merging of municipalities on a voluntary basis.

In **Moldova** the fiscal decentralisation reform launched in 2012 is expected to have a large impact on budgets and financial organization of local and regional authorities. This new reform introduces fixed quotas of shared taxes, separates transfers with special and general destinations, separates transfers to 2<sup>nd</sup> and 1<sup>st</sup> tier local governments, and liberalises the fiscal efforts of local authorities. At the same time, a heavy issue of financing the newly delegated competencies has surfaced, as the government is trying to cancel funding of a large majority of previously centrally financed competencies.



A huge impact on the pace of local government establishment in Eurasia has been made by international assistance projects. External support for decentralisation and local government reform provided by the World Bank, USAID, UNDP, EBRD, EU and other international organizations included both consultative and financial assistance.

### 2.1.2. Territorial and Organizational Structure of local government: political will or real need?

#### *Diversified territorial structures in the region*

Although the Eurasian countries originally had a uniform administrative and territorial division, later, in the course of decentralisation, they preferred different forms for territorial organization of local self-government. As a rule, these forms are highly diversified. In a number of countries territorial reforms resulted in the enlargement of regional territorial units (**Kazakhstan** and **Ukraine**). In other countries territorial reform was called upon to move the processes of public power closer to the general population (**Azerbaijan**, **Armenia**, **Russia** and **Uzbekistan**).

Most countries have introduced or allowed autonomous territorial units in recognition of ethnic or regional distinctiveness, sometimes with a dimension of conflict: **Azerbaijan** (Nakhichevan and Nagorno-Karabakh), **Georgia** (Abkhaz and Adjara republics), **Moldova** (Gagauz Eri, "Predniestrovye Republic"), **Tajikistan** (Nagorno-Badakhstan) and **Uzbekistan** (Karakalpakstan).

**Russia** is the only federal country in this region. However, several countries have an intermediate level of government on a rather broad scale, distinct from the local or municipal level of government. It is generally called oblast (region) and it is found in **Armenia**, **Belarus**, **Kazakhstan**, **Kyrgyz Republic**, **Tajikistan**, **Turkmenistan**, **Ukraine** and **Uzbekistan**. **Georgia** also has such a territorial level (mkhare). The capital city and other main cities may have separate legal status; that is, they are directly subject to the central government.

Usually the local government level (municipal level) is organized in two tiers. The most important is the district level, which is a rather small constituency, embracing a lot of villages but also some cities. Many municipal functions for small and mid-size cities are the realm of district-level powers; large cities are independent of the district level authorities. Usually, the lower municipal level is much less significant with respect to its functions.

A two-level municipal organization can be seen in **Azerbaijan**, **Belarus**, **Kazakhstan**, **Kyrgyz Republic**, **Moldova**, **Russia**, **Tajikistan** and **Ukraine**. At the same time, it is noteworthy that a number of countries are going through the process of the enlargement of low-level municipalities. As a result, the number of municipalities in Azerbaijan has decreased by more than 300 (from 2,000 to 1,700), and this trend persists.

Only one municipal level, although it may be differentiated, exists in **Armenia**, **Georgia** and **Uzbekistan**. In **Turkmenistan**, local government institutions exist only at the district level.





The level of local government autonomy varies considerably, even among similar countries<sup>18</sup>.

| Country    | Regional level   | Intermediate level   | Local level   |
|------------|--|--|---|
| Armenia    | 10 marzers<br>(administrative regions without budget rights)   |  | City of Yerevan ( <i>capital</i> )<br>48 urban and 866 rural communities                    |
| Belarus    | 6 oblasts<br>City of Minsk ( <i>capital</i> )  | 118 raions<br>10 cities of oblast subordination  | 1 193 rural municipal units<br>(cities/towns of raion subordination, villages, settlements) |
| Georgia    | 9 Administrative Regions (administrative regions without budget rights) Autonomous republics of Abkhazia and Adjara  | 5 cities: Tbilisi ( <i>capital</i> ), Batumi, Rustavi, Poti, Kutaisi<br>4 communities: (Eredvi, Kurta, Tighvi and Azhara)<br>60 raions |   |
| Kazakhstan | 14 oblasts<br>2 special status territories: Astana ( <i>capital</i> ) and Amaty  | 160 raions<br>39 cities  | 45 cities and towns<br>about 2,500 rural settlements without budget rights                  |
| Kyrgyzstan | 7 oblasts<br>(administrative regions without budget rights)<br>2 special status territories: Bishkek ( <i>capital</i> ) and Osh                                  | 40 raions<br>12 cities of oblast subordination   | 17 cities of raion subordination<br>453 settlements (auls)                                  |
| Moldova    | 1 autonomous territorial unit Gagauzia (Gagauz Eri)  | 32 raions<br>2 municipium (Chisinau and Balti)   | 3 municipium (Comrat, Bender and Tiraspol)<br>51 towns<br>847 villages (communes)           |
| Russia     | 83 subjects of RF:<br>21 republics, 46 oblasts, 9 krais, 4 autonomous okrugs,<br>1 autonomous oblast, 2 federal cities: Moscow ( <i>capital</i> ), St.Petersburg | 1,799 raions<br>521 cities ("gorodskoi okrug")   | 21,595 (1,734 urban and 19,861 rural) settlements   |
| Ukraine    | 25 regions:<br>24 oblasts<br>1 special status territory: Kiev ( <i>capital</i> )   | 488 raions<br>176 cities   | 243 towns<br>657 settlements<br>10,222 villages   |

The analysis of the territorial aspects of organization of the local self-government allows a conclusion that four organizational levels of local government are formed in the Eurasian countries: communal, rural, township and urban. In many of the Eurasian countries an original public management system has been formed in which the local self-governance is executed at the level of village, community, settlement or town and the local government is functioning in the rayon and the cities that are not under the rayon's sub ordinance (**Armenia, Belarus, Kazakhstan, Kyrgyzstan, Ukraine, Uzbekistan and Tajikistan**). Accordingly, the state authorities' influence in the rayons and cities is higher than in the other municipalities.

It must be stressed that the territorial basis of local self-government in a number of the Eurasian countries is developing not only "upward" aiming at the establishment of larger territorial units but also "downward" – toward establishment of smaller ones. First of all, this is connected with the resolution of the problems related to specific settlements: the municipal reforms aimed at strengthening of municipalities have led to the fact that a number of small settlements may enter into the single municipal unit in most of the Eurasian countries. Secondly, presumably due to strengthening of a tendency towards democratization and decentralisation within the latest decades, the demand for real development of self-government at the level of single village, community, urban districts has appeared.

<sup>18</sup> GOLD II.



Herewith, the ground for optimization of the municipal-territorial division shall be a criterion of the authority's accessibility and real social and economic relevancy, but not the potential possibility of improvement of the territorial governability.

Specifically, on the basis of this objective factor – an ability of the area to manage all matters of local significance effectively – division of the territory into municipalities shall be implemented. However, this ability is complicated, it is defined not only by such formal parameters as population number and density, and not only by the artificially created circumstances such as administrative-territorial structure or transport accessibility, but also by the number of others, more scaled factors, including following: natural resources availability, geography of the economic capacities, demographic trends, migration flows, service infrastructure etc.

### 2.1.3. Organizational Structures of Local Governance: local governance vs. state governance

An analysis of the local government legislation in all Eurasian countries confirms that it is the mandate of the assemblies of elected representatives in the respective countries to execute local self-governance. This confirms that the municipal council or assembly that is the main form of local community representation.

For instance, in **Armenia** the local self-government bodies – avagani – are elected in a community with the aim to execute the public powers and to deal with the municipal issues.

In **Belarus** the local self-government system consists of local councils of deputies and the territorial public self-government bodies. The later includes councils and committees of micro-districts, housing complexes, as well as the residents, sub-districts, neighbourhoods, settlements and rural committees. Local government is exercised by executive committees which are accountable to the state and the executive committees of a higher rank.

In **Kazakhstan** the inhabitants' representative body in the rayon, town, settlement, village (aoul) is maslikhat, which is local body of state governance acting with due account for the state interests.

In **Kyrgyzstan** the local kenesh (ail, town/city, rayon councils) form the system of representatives body of local self-government.

In **Uzbekistan** the Councils of People's Deputies lead by khokims are the local self-government bodies. It should be noted that the hokim of an oblast, district or city is the senior official therein and is also the head of the representative and executive authority therein. Hokim is subordinate and accountable only to the President and respective Kehgesh. There is no delimitation of powers at the foregoing levels of state governance since we can see an amalgamation of executive and legislative authorities there. Local self-governance in Uzbekistan is implemented in townships, kishlaks, auls and mahali, and, accordingly, the local governance bodies there are the gatherings of citizens.

The representative local self-government body in **Ukraine** is the council (rural, settlement, town/city, regional and rayon).

Representative municipal authorities in **Turkmenistan** are maskakhats, and executive authorities – hyakimy (the latter perform the function of local representatives of the President of Turkmenistan). They are appointed and dismissed by the President and are fully accountable to him. Hyakimy administer the activities of local governance bodies.

The representative agency as being an important part of municipal governance, as a rule, is elected by the public living in an appropriate administrative unit via direct voting (**Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Russia, Ukraine, Uzbekistan and Tajikistan**). In all Eurasian countries the quantitative representation of the local council depends on a number of inhabitants of specific administrative unit.

An analysis of the legal status of the municipal councils in the Eurasian countries suggests that elements of decentralisations are present even in the countries where the local self-government is an unequivocal subsystem of the single state-administrative mechanism (**Belarus** and **Kazakhstan**).

A mixed system of local governance has been formed in **Azerbaijan, Uzbekistan, Kazakhstan, Tajikistan, Kyrgyzstan** and **Ukraine** where the state agencies in situ act at the levels of region, rayon and town/city and the local self-government is executed by both direct and representative forms of grass-roots democracy.

For proper functioning of an integrated system of public power involving the state and municipal bodies, not only the development of legal mechanism of their cooperation is important but also the state influence upon local self-government. The key problem of implementation of any reform of the self-government is an identification of concordant balance between centralization and decentralisation. At present, there is rather a misbalance than balance, in the municipal systems in respect of interrelationship between the state agencies and local self-government bodies, which is expressed in strong state impact on local government bodies, which has a negative impact on development of the democracy principles in the Eurasian countries. Administrative control over the local government bodies activities is becoming a tendency almost in all Eurasian countries.

#### 2.1.4. Local government mandates – a call for clear designation

The national legislation of the Eurasian countries in respect of an integrated part of the local self-governance competences refer to:

- matters of local significance;
- delegated powers (**Armenia, Azerbaijan, Georgia, Russia** and **Ukraine**).

The issue of distribution of powers between public authorities and local government, and also between local governments of different levels are insufficiently regulated in the legislation of the Eurasian countries. The legislation of specific Eurasian countries lacks the provisions related to inherent and delegated powers (**Belarus, Uzbekistan** and **Kazakhstan**). In **Kyrgyzstan** in addition to basic Law on “Local self-government” that establishes a list of matters of local significances and also a list of delegated powers, there is a separate Law on “Procedures for delegating specific state authorities to local self-government bodies”.

The first group of issues is an inherent competence of local self-governance. Usually, the local self-governance’ obligatory and voluntary (optional) competences are specified in its structure. The list of matters of local significance as provided for by the legislation of this or that country does not differ significantly in each specific case. The local significance issues are basic, paramount and integrated part of the local self-governance that delimits independency and competences of local self-governance against the state sovereignty.

The second group of powers is delegated (by the state) competence of local self-governance. The powers’ delegation as a rule is stipulated in the national legislation, and its implementation is executed under the state control. The exercise of delegated powers, as contrasted with the local significance matters, is based on finances and facilities specially transferred by the State.





In the legislation on local governance of the Eurasian countries the following issues of local significance are quite often stipulated:

| Country      | Urban planning | Pre-school education | Secondary education | Social services | Public health | Water and power supply, municipal transport | Economic development |
|--------------|----------------|----------------------|---------------------|-----------------|---------------|---|----------------------|
| Armenia      | x              | x                    |                     | x               | x             |   | x                    |
| Azerbaijan   |                | x                    |                     |                 | x             |   | x                    |
| Belarus      |                |                      |                     |                 |               | x   | x                    |
| Kazakhstan   | x              |                      |                     | x               | x             | x   | x                    |
| Kyrgyzstan   | x              |                      |                     |                 |               | x   | x                    |
| Russia       | x              |                      | x                   | x               |               | x   | x                    |
| Tajikistan   | x              | x                    |                     | x               | x             | x   |                      |
| Turkmenistan | x              |                      |                     |                 |               |   |                      |
| Ukraine      |                | x                    |                     | x               |               | x   | x                    |
| Uzbekistan   | x              | x                    |                     |                 | x             | x   |                      |

The issues of social and economic development of the municipalities have the high priority for the local self-government in **Belarus** and the **Central Asian** countries. The problem of delimitation of issues of state and local significance is most distinct in these countries. This is due to the hierarchical centralization which is demonstrated through the impact of the state authorities on the local self-government bodies. Therefore, the central authorities are endowed with the regulatory functions, and the local self-governments and local state agencies are entrusted with the organizational functions.

## 2.1.5. Service delivery – from structural change to consolidation and expansion

### *Social Services*

#### \* Education

In the majority of Eurasian countries responsibility for public education is divided between local state government and local self-government. The latter, as a rule, is entitled to deal with preschool and school education. Nevertheless, central state government establishes general regulations in this sphere, and local self-governments put these regulations into practice. In **Uzbekistan**, education is centralized. For pre-school and basic education, central state bodies approve standards, provide resources and supervise the execution of laws, while other levels are engaged in providing services and deploying resources. In **Tajikistan**, local self-government is responsible for pre-school and elementary school institutions, while cities and districts handle secondary schools and colleges. In **Ukraine**, there is no strict separation of functions in education, which results in a confusion of powers between local state government and local self-government.

In **Moldova** the current reform on local self-government calls for a change in the division of competences in the area of education, which in the future would be managed by the regional level (2<sup>nd</sup> tier) instead of the municipalities. The objective of this reform is to introduce important savings into a fairly expensive education system and to ensure equal access to education. However, local authorities point out the heavy departing from subsidiarity principle, the centralisation of the competence, and the political dependence of the 2<sup>nd</sup> tier of local public administration from central government.<sup>19</sup>

<sup>19</sup> CEMR, 2013.

In **Kyrgyzstan** education is centralized and local self-governments are only responsible for maintaining municipal buildings that used for schools and kindergartens.

In **Russia** the power in providing preschool services is distributed among regions and municipalities. Regions are empowered to assure the availability of services, and, in addition, to finance main costs of such services, including payroll.

### Reform of institutions system in Russia

In the mid-2000s, the search for optimum models of public sector management with the mixed budget/population financing of services provided by institutions was launched in Russia. In 2006- 2010, the reform of institutions targeted to enhance their independence took place. This reform covered all central government and municipal institutions of all levels of public authority.

Prior to the reform there was only one type of central government/municipal institutions with no budget of their own. At the discretion of the region or the municipality that founded this institution revenues from extra services (non-budget revenues) were either retained by this institution or transferred to the budget of its founder. Under this reform each institution was classified based on three categories: budgetary, governmental or autonomous, differentiated by the level of their independence in decision-making and use of funds and assets. The reform was rather conservative – irrespective of enhancement of institution independence, the founder still retained the rigid control in all categories of institutions.

The reform outcome is different for various social sectors and regions. In some areas actual capabilities and efficiency of institutions remained the same. At the same time the reform was rather successful in some sectors. It especially refers to preschool institutions. The sizeable part of preschool institutions managed to use the benefits of increased independence, namely, to increase the share of paid services provided in excess to the basic preschool program. In this way the reform enhanced the efficiency of this type of institutions, increased their motivation and linked it to volumes and quality of provided non-budgetary services.



### \* Public health

Nearly all Eurasian countries have divided the responsibility for public health between state (national and regional) government and local self-government. In a number of Eurasian countries, local authorities are responsible for providing medical first- aid, organizing medical aid in the “zone of first contact” with patients in hospitals, ambulances and medical posts, and organizing preventive medical services. In **Russia**, in 2012, the responsibility for health care services was transferred to the regional level, local authorities are responsible only for ambulances and organizing medical aid in the “zone of first contact” with patients in hospitals in case of emergency. Under the existing system of local self-government and health care this decision should be viewed as the «second best». Obviously, the situation when most of cities with millions of residents cannot impact there health care system is not normal; however, the transfer to the more efficient system is not feasible without complex restructuring of health care and local self-governments.

According to the laws of **Armenia**, heads of municipalities are responsible for organizing and managing municipal health-care institutions. They promote improvement of sanitation and implement sanitary, hygienic, anti-epidemic and quarantine measures. In **Kazakhstan**, local state authorities administer public health. They assist local hospitals and general polyclinics, specialized clinics, tuberculosis hospitals, diagnostic centres and rural medical posts. They are also responsible for the prevention and treatment of dangerous infections. In **Uzbekistan**, public health is handled mainly by the state. Local self-government is responsible for organizing and maintaining medical posts. As with education, health care in **Kyrgyzstan** is centralised and local governments are only responsible for maintaining municipal buildings that used for health care.





### \* Social protection

The majority of Eurasian countries have a multi-level system for financing social protection services. As a rule, local state authorities and local self-governments do not have adequate financial resources for maintaining public services in the fields of education, public health and social aid, though total budgets grow constantly. In **Tajikistan**, public health and social protection services are not handled by local governments. However, local budgets finance 7% and 8% of expenditure on social aid and education. Another model exists in **Uzbekistan**: 100% of expenditure on social insurance is covered by local budgets. Meanwhile, social aid, public health and education costs are financed as follows: about 20% by the state, approximately 50% by regional budgets, and 20% to 30% by district budgets.

In **Russia** the municipal functions in social protection and support starting from 2008 were totally transferred to the regional level. In practice some functions are frequently transferred to municipalities for implementation but the extent of such transfer is rather limited. The withdrawal of local self-governments from provision of social protection functions is unjustified and contradicts the essence of local self-government. The efficient decentralisation of functions in this sphere requires the implementation of a more flexible model of functions transfer. Otherwise, a considerable part of municipalities will be unable to provide services of appropriate quality.

In **Kyrgyzstan** social services are state responsibility but as part of delegated state authorities local self-governments assist to territorial departments of state agency to define low income households as well as to define indigence level so they could receive state monthly allowances.

It may be concluded, that delineation of powers between the state government authorities and the local self-government bodies in the most of the Eurasian countries is established based on a model of the state functions centralization. It is understood that it is rather difficult to pick out purely local functions, as the most of them being executed by the local self-government bodies are pursuant to the tasks formulated by the central authority. The powers enforcement has a local significance only as it is executed within specific area by the relevant subject.

Delineation of powers shall be established based on decentralisation of the state functions but not by vesting the local self-government bodies' powers from the system of powers of the state authorities. The issues of development of the "joint competence" institute requires more detailed examination in all Eurasian countries, as an instrument of close cooperation (synergy) of these agencies activities without sacrificing their constitutionally entrenched self-governance.

### ***Approaches in provision of social services***

The major scope of social services is provided by public and municipal institutions in Eurasia. The use of non- government and non-municipal providers of social services in Eurasia region is rather limited. Most of private institutions are funded through provision of paid services. Only some services make an exception. No less than a quarter of home care services granted to the population is rendered mainly by non-commercial organizations under federal and municipal procurement programs. However, these exceptions are not widely spread. There is no official statistics on this issue. In Eurasia the use of private providers is not viewed as a separate objective but as the way to enhance the capability of services rendering (first of all it is relevant for preschool education experiencing the shortage of vacant places) and as the tool for making the system more flexible.

In **Russia** at the federal level the use of private providers for social services was defined as a task of the social policy only in the early 2010s, while this task failed to gain a top priority for the system development. The experience of using private providers of services showed that it is relatively efficient in provision of certain services of higher quality (elite educational institutions) as well as services not requiring considerable funding (home care, supply of foodstuff for subsidised categories of population, etc.). As for other social services the use of non-government (non-municipal) providers led to unacceptable level of expenses of respective budgets for services provision and administration, while the use of private providers on the local level is more complicated than on the regional one due to the fact that under highly centralised management of the public sector municipalities have less freedom in their operation.

### *Public Participation in Social Service Delivery*

All countries in the region have developed, to different degrees, a legal framework to ensure public participation in the process of decision-making on issues of service provision. They have also ratified various international conventions obligating them to build public awareness and participation in decision-making.

But despite the presence of certain favorable factors and mechanisms for citizens' participation in almost all countries – as local referendums, initiatives, consultations with the public and etc., general civil participation level is lower than the established democratic standards provided in the European Charter of Local Self-Government. Current situation with regards to citizens' participation in these countries is characterised with certain problems from both points of view – legislative system, as well as practical application of mechanisms, forms and procedures of citizens' participation in local governance.

Quite frequently, countries understand “public participation” as the right of the local community to have access to information about various processes, rather than any further public participation in decision-making. Population of the Eurasian countries is more or less informed on the actions of local governments and on their own rights. At the same time, the level of this awareness is insufficient for the formation and development of participatory local democracy. With this purpose, some bodies of local governance, local self-government leaders, donors and local NGOs carry out efforts achieving certain positive results. A positive example can be found in Ukraine.



### **Improvement of local policy in the area of out-of-school education in the city of Kherson (Ukraine)<sup>20</sup>**

According to the legislation of the country, among own responsibilities of local self-government are issues regarding organisation of out-of-school education. In other words, this is a type of additional extra-curricular, non-mandatory education, when children, through a network of various art schools, clubs, children's sports schools, etc. in their neighbourhood, are able to show their art and sports abilities, and usefully spend their leisure time.

Local territorial community, represented by the Mayor Office and the Department of Education, should create all conditions for the operation of such extra-curricular facilities, ensure their financing, and create maximally favourable conditions for children, so that they can attend various sections, groups, educational classes, etc.

Civil society organisations of the city decided to carry out a public assessment of quality of such extra-curricular education, learn parents' opinions regarding local policies in the area of out-of-school activities, collect their suggestions on the prospects of the development of this area and, based on the obtained results, propose to the city Council to adopt a new extra-curricular education program.

For the implementation of this idea, a coalition of local civil society organisations used citizens' participation mechanisms that were stipulated in the City Charter: public hearings and submission of public initiatives to the local self-government.

<sup>20</sup> The Center of Strategic Research and Development of Georgia (CSR DG). Citizen Participation in Local Self-Governance in the Eastern Partnership Countries: Comparative Analysis. 2012.



### Description of the participation process

With the efforts of a youth civil organisation “New Initiative”, a survey of parents having schoolchildren was carried out regarding the conditions of extra-curricular education, and quality of services provided by out-of-school facilities. Citizen Report Cards method was used for this purpose. As a result of the study, main problems of the network of extra-curricular educational facilities were identified, and a quite high level of dissatisfaction with quality of work of such facilities was revealed.

Afterwards, a series of public consultations was held on the directions of the development of extra-curricular activities. This way, the final document - suggestions to the city Council - was developed. At the next stage, an initiative group of citizens' was created to collect 300 signatures requesting city authorities to hold thematic public hearings. This procedure was determined by Kherson Charter. According to the procedure, if 300 residents of the city submit a request to hold thematic public hearings, the Mayor is obliged to hold such hearings, and the results should necessarily be discussed in the city Council session. Public hearings on the issue were held, where citizens' expressed their final suggestions to the city Council regarding the ways of developing of extra-curricular education activities. Representatives of the city authorities also expressed their views of the local policy on the issue. Public hearing participants passed a resolution which was submitted for consideration to the city Council members. The resolution was reviewed on an assembly of the City Council, with participation of members of the initiative group.

### Participation results

Based on the held public hearings, the city Council considered all suggestions of the citizens' and made a decision about the development of a new extra-curricular education program. At the same time, a decision was made to take practically all suggestions (75%) expressed during the public hearings as a basis of the new program. Thus, citizens' opinions were taken into consideration and a new local policy on extra-curricular education was being developed considering the interests of schoolchildren's parents, as well as children themselves.

### Public Services

In most countries of the Eurasia region, local governments are responsible for the for the management and provision of water supply and sanitation services, as well as for the development of local water supply and sanitation infrastructure (with the exception of **Armenia** and **Georgia**), district heat supply (with the exception of **Moldova** and **Tajikistan**), solid waste management, and intra-urban passenger transportation services.

Despite these local responsibilities, in most countries, almost all regulation around basic services is the domain of central government (with the exception of the haulage and disposal of solid waste and passenger transportation services in some countries). State or regional public authorities, and especially established national regulatory bodies, tackle the development of tariff policies for basic services.

A positive example is **Kyrgyzstan**, where state powers related to water and heat supply provision and tariffs have been delegated to local governments since 2011, in accordance with the law on local self-government.

As for urban transportation all issues relating to the quality of services, issuing of permits, and financing of city transport development are tackled at local level. As a rule, central or regional authorities do not interfere with the handling of city transport services, except for two aspects: putting a ceiling on maximum fares, and implementing mandates with regard to the licensing of individual types of passenger transportation (city, rural and inter-city transportation).

### \* Water Supply and Sanitation

Access to water and sanitation services varies greatly across the region. More than 75% of the urban population in Russia, Belarus, Armenia, Kazakhstan, Uzbekistan, and Ukraine has access to water and sanitation services. The highest proportion of the urban and rural population with access to a centralized water supply and sanitation is found in Russia, at 100% in cities and 96% in small towns with less 10,000 residents. But even here only 31% of rural settlements have access to piped water. Piped sanitation services are provided to 100% of cities, 82% in small towns and 6% of rural settlements.

The bulk of the population in **Kyrgyzstan** and **Uzbekistan** lack access to reliable sources of drinking water, and a major part of the urban and rural population gets water according to a fixed schedule (whether delivered or supplied via pipelines). In **Georgia**, most settlements also suffer from interrupted water supplies. Inadequate access to drinking water is a significant problem in **Moldova** and **Tajikistan**, especially for poor and rural populations. The access of the population of the Central Asian countries to improved sanitation (sewerage or clean toilets either with slab-covered pit latrines or connected to septic tanks) is insufficient.

### \* Heat Supply

District heat supply systems, drawing on piped steam or hot water from centralized plants, are widely used in **Russia, Ukraine, Belarus, Kazakhstan, Uzbekistan** and **Kyrgyzstan**. Over 70% of housing stock relies on these systems in **Russia**, over 60% in **Ukraine**, and above 50% in **Belarus** and **Kazakhstan**. According to national policies, the countries plan to gradually increase the proportion of the urban population with access to district heating by constructing thermal power plants and introducing innovative high performance technologies.

Quite a different situation prevails in **Armenia, Georgia, Moldova** and **Tajikistan**, where the district heat supply systems have either collapsed, or are at the point of doing so, as a result of insufficient investment and poor maintenance over a prolonged period. In **Tajikistan**, district heating is provided only in the centre of Dushanbe, the capital of the country. Even in Dushanbe, the Dushanbinskaya combined heat-and- power plant services the needs of less than 10% of the city population and only for 3-4 months during the winter.

At present, in **Armenia**, as well as in **Georgia**, homes are heated mainly by individual heating units using electricity and natural fuel. **Moldova** faces the same situation.

### District heating in Moldova

At the beginning of the 1990ies, the bulk of the population in Moldova had access to district heating. Multiple increases in imported energy resources caused the unavailability of district heating services for the consumers, which resulted in mass non- payments and change over to autonomous heating.

By the end of 2011, centralized heat supply remained only in 7 out of 35 cities. In fact 97.7% of apartment buildings relying on centralized heat supply were in two major Moldavian cities – Chisinau and Balti. Today individual (per apartment) heat systems or individual built-in/attached boilers are installed almost in every newly constructed building in the Republic, while new connections to centralized heat systems are rare.



The following factors have contributed to the degradation of district heat supply in above mentioned countries: lack of investment in the heat supply systems; unsatisfactory technical servicing; outdated technologies; high prices for imported heat carriers (gas and fuel oil); low level of payments for services by consumers.

#### \* Public Transport Services

In all countries of the region, except for **Kazakhstan**, there has been a decline in the quality and use of public transportation as a result of such factors as fare increases, deteriorating service and higher levels of car ownership. Over the past two decades, the only type of transport to have experienced a slight increase in investment and construction is underground railways. Several new underground stations were commissioned in **Armenia** and **Georgia**. On December 1, 2011, the first ever underground line was opened in the city of Almaty (Kazakhstan).

The number of journeys by public transport over the recent years across the Eurasia region decreased by more than half, although in **Russia**, **Ukraine** and **Belarus** the decline was not so sharp. In many cities, the state and municipal transport of high passenger capacity (buses, trolleybuses, and trams) was replaced by privately-owned micro-buses of lower capacity that work the same routes as the state transport.

#### \* Solid Waste Management

Waste management in Eurasia, as a rule, is limited to collection and transportation of waste to be dumped in landfills. Waste is not “managed” in the modern sense of this term. Delays in collection, non-sanctioned landfills and illegal dumping are common problems for most countries in the region.

The legal regulation of waste management in the Eurasian region is targeted mainly at environmental pollution, rather than the reuse and recycling of solid waste. Most countries, lack a system of separate collection for different kinds of waste. However, there are emerging approaches to waste recycling in a number of cities of **Russia**, **Ukraine**, **Kazakhstan**, **Belarus** and **Uzbekistan**, involving selective collection, sorting, and recycling.

### *Approaches in provision of public services*

#### \* Management models

In Eurasia, there are positive trends in the evolution of management models, and most local authorities select the models they find appropriate for managing the enterprises that provide basic services.

In almost every country in the region, **water supply** and **sanitation facilities** are the property of municipalities or higher-tier governments. In **Kyrgyzstan**, **Tajikistan**, **Ukraine**, **Belarus** and **Russia**, most water companies are state- or municipally-run public companies. In **Armenia** and **Georgia**, the water supply and sanitation systems are managed by private operators. In **Russia**, about 25% of the population is provided with water and sanitation by private operators under public-private partnerships (PPP) contracts.

The **heat supply** situation varies across Eurasian countries. In **Russia**, **Kazakhstan**, **Uzbekistan**, **Ukraine** and **Kyrgyzstan**, the heating market is patchy, with segments under the control of various owners, including joint stock companies (private or with a stake held by state) which own large combined heat and power sources and heating pipes from combined heat and power plants, and state or municipally owned utilities which, generally, hold low-power heat sources (municipal boiler houses) and heat distribution networks. In **Belarus** and **Tajikistan**, the practice of vertically integrated heat providers continues to exist, though there are fewer than in the Soviet era.



The models applied for managing the utilities engaged in **solid waste collection**, haulage and disposal vary across the countries. In **Uzbekistan** and **Kyrgyzstan** these services are provided by municipal agencies or utilities authorized by local governments. In some cities, primarily in **Uzbekistan, Russia, Ukraine, Kazakhstan, Armenia** and **Georgia**, local governments use private operators for the collection and removal of solid waste.

In the sphere of **public transportation** services, the proportion of municipally owned transport is minor.

### Turning to private minibus service in Uzbekistan

Since 1991, Uzbekistan has been facing a sharp deterioration in the performance of its passenger transportation system. Within only a few years, the country witnessed a many-fold reduction in the number of urban passenger routes and journeys while the performance of passenger transportation services became substandard, failing to meet even basic standards of comfort and safety.

Despite this deterioration, demand for urban passenger transportation services remained, and municipal and state-run transport operators were unable to satisfy it. This paved the way for the arrival of private transport operators.

A rapid growth in private passenger transportation services was driven by the launch (in 1995) of a Daewoo Damas minibus production line at a local automobile plant UzDaewoo. The unprecedented low cost for these vehicles (4-6 thousand euros, depending on the vehicle configuration), as well as the opportunity for installment purchasing made the minibus essential for passenger transportation across the republic. In fact, in the second half of the past decade, more than five thousand such minibuses were running in Samarkand, the second largest city of Uzbekistan, where they accounted for over 90% of all intra-urban passenger transportation.

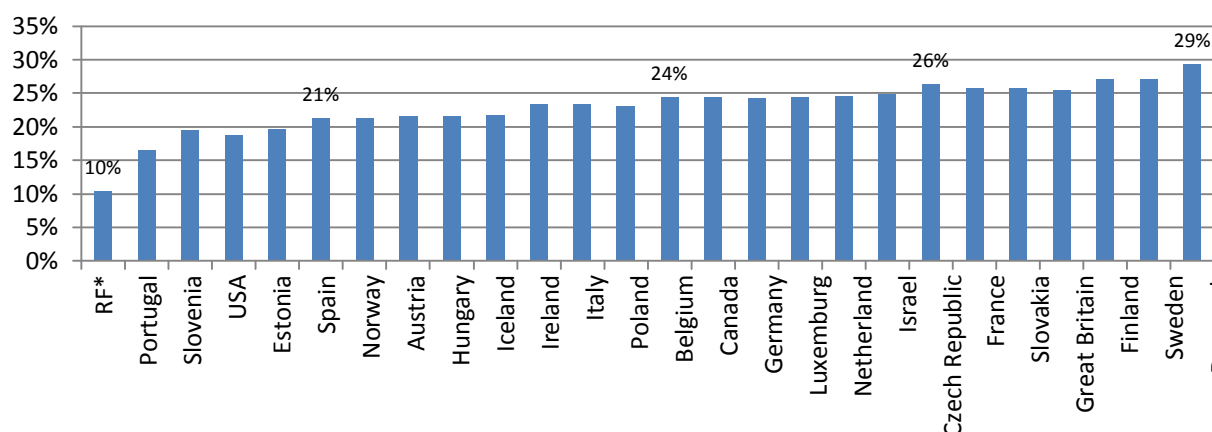
Private operators dominate the market of taxi and bus transportation services. Municipal governments typically seek to encourage a wider private involvement in provision of passenger transportation services with a view to a revitalized competitive environment and incentive- based service provision.

Regardless of the form of management (state, municipal or private), most of the enterprises providing public services in the countries of the Eurasian region have to face the problem of a shortage of funds. Most Eurasian utilities engaged in water supply, sanitation and heating face underfinancing, with insufficient funds not only for upgrading systems but also for covering their operating costs. This is accounted for by politically driven tariff regulation based on a principle of “socially acceptable tariff rates”. Gaps between costs and tariffs for water, sanitation and heating for households are covered by budget subsidies or cross-subsidizing. The highest level of cross-subsidizing in the region is found in **Tajikistan**, where the tariff for heat supply to industrial consumers in 2010 was 28 times higher than the tariff for households (20 and 0.7 Euro/Gcal respectively). Tariffs for households are kept at an artificially low level, so enterprises lack money to invest.

Financial problems suffered by providers of water supply, sanitation and heating services in **Moldova, Tajikistan, Kyrgyzstan, Armenia** and **Georgia**, stem mainly from mass non-payments of tariffs due to the high poverty levels in these countries. State policy-makers in the region agree that it would be politically unacceptable to increase tariffs for basic services to the levels required to cover costs.

In **Russia**, recent years are characterized by the stringent federal policy of curbing utility tariffs. Advocates of such policy claim that Russia’s residents spend a considerable share of their income on utility payments, which considerably exceeds the one in industrialized countries. This argument cannot be supported by analytical survey data.





*The share of utility payments in household expenses in EU and Russia in 2012, %*

*Source: OECD Statistics, RF Statistic Reporting*

In 2013, average household spending in Russia on housing and utilities was below 9% of average household income. Russian households spend less than 1% of their budget on water supply and sewerage.

Deficits in funds on the part of Eurasian public utilities are mainly compensated for by central and municipal governments. Private financing of the sector is scarce. The mobilization of loans from national commercial banks is constrained by the low credit-worthiness of the enterprises. Debt financing for infrastructure projects is rare, due to the unavailability of long-term rates and the considerable political risks of raising tariffs. Another important factor is as follows: one part of revenues of municipal enterprises is generated by budget allocations, because some people enjoy benefits with regard to utility payments, and in some cities one part of the cost of services is also subsidized from the budget, which results in the dependence of enterprises on availability of funds in the city budget, which, in its turn, increases potential credit risks.

Policies pursued in the Eurasia region thus result in most countries resorting to financing from external sources, including international organizations, for the implementation of projects oriented toward improving the performance of piped water supply, sanitation, heat supply services and also towards developing the market of public services and the energy sector as a whole.

### ***Private participation in basic service delivery***

Private operators are being attracted to the utility sector in the Eurasian region, and various models of public-private partnerships (PPP) are in operation. This approach is practiced primarily in **Russia, Ukraine and Armenia**. Over the recent years, both the legal and institutional conditions necessary for the implementation of PPP projects have been established. The legislation of **Kazakhstan** is also geared to the development of PPP mechanisms, but in **Kazakhstan** PPP mechanisms primarily are implemented in the rail-way transportation, education and medical care.

The most widely used forms of private sector participation in the utility sector in the region are lease contracts. In this model, a lessee assumes responsibility not only for the system management, but also for the collection of payments for the provided services. Authorities remain responsible for investments, which can be made, partially or fully, using lease payments. There are cases when the operator is also responsible for investments under a lease contract.

In terms of PPP development, the Eurasian countries can be divided into four groups<sup>21</sup>:

1. **Armenia and Russia:** The involvement of privately owned enterprises in the utility sector is common in these countries. Despite different forms of cooperation between businesses and authorities, PPPs have generally been rather successful in these countries.
2. **Georgia, Kazakhstan and Ukraine:** Recently, these countries have been doing a lot to try to attract privately owned enterprises to the utility sector. However, the involvement of private companies in this sector is still rare, with only a few examples.
3. **Kyrgyzstan, Moldova, Tajikistan and Uzbekistan:** In these countries, the participation of private sector in basic services provision is either non-existent or very modest. However, there is a sound basis for private involvement due to the decentralisation of utility management according to which central government transfers associated responsibilities to regional or local authorities.
4. **Belarus:** This country has a centralized national system that manages the utility sector. All responsibilities in the sector rest with the state authority. Privately owned companies are not involved in the public services provision and, moreover, it would be impossible to attract them without radical institutional changes.

It should be noted that expectations of the inflow of private investments under public-private partnership agreements virtually did not come true in all Eurasian countries, even in the countries with developed legislation and PPPs mechanism. It was caused mainly by the lack of long-term tariffs and intense political motivation of tariff-setting (especially in **Russia**). The public-private partnership model supposes that private investments attracted for the development of utility facilities will be paid off through the sale of goods and services produced by such facilities, i.e. business operations. But future revenues from such operations depend at what price (tariff) such products will be sold. When tariffs are unpredictable, there are a lot of risks in assessment of required investments and payback period.

### *Public Participation in public service delivery*

Virtually no country in region has a high level of citizen participation in public service delivery. The role of local government in most cases amounts to providing a number of social services established by law to citizens; these services are subsidized from the state budget, rather than being self-organized and self-financed. The amount of public service financing is determined by state, rather than local, and frequently depends on the funds allocated by the central bodies of power. In this situation, potential forms of citizen engagement in the process of exercising power at the local level, as provided by law, are losing their significance. Instead, they give rise to incredulity at the possibility of influencing decisions taken at the local level.

Nevertheless, the population of all countries of the Eurasian region participates to some degree in the process of rendering public services.

#### **\* Water supply and sanitation**

**Kazakhstan and Georgia** have laws which provide for active public involvement in decision-making around water supply and sanitation. In **Kazakhstan**, prior to adopting new tariffs for water and sanitation, territorial bodies of the Agency for Natural Monopolies' Regulation have been organizing, on mandatory basis, public hearings to discuss issues relating to the operations of water and sanitation companies, the level of technical and commercial losses of water, enterprises' expenditures, and changes to tariffs. Various public organizations and representatives of local communities are invited to such hearings.

<sup>21</sup> Organization for Economic Co-operation and Development (OECD)/Institute for Urban Economics. *Status paper on key trends in private sector participation in water supply and sanitation in the EECCA region*. OECD, 2010.



Democratization in **Georgia** has led to an intensification of the activity of different community organizations, which represent the best-organized and most conscientious part of the society. Due to the fact that water and sanitation problems directly influence levels of wellbeing, public health and the environment, various social organizations actively contribute in tackling these problems. A wide range of tools and procedures for public participation in the process of decision-making in the area of water and sanitation are incorporated into both national legislation and international conventions. In **Armenia**, community organizations are also involved in the processes of setting tariffs for water.

**Ukrainian** legislation recommends the engagement of representatives of community organizations and owners of multi-family buildings in verifying the conformity of water and sanitation services with the standards, norms and rules established for their provision. Laws of **Uzbekistan** and **Kyrgyzstan** also encourage voluntary public participation in the renovation, repair and maintenance of the water, sanitation, and heat supply networks, as well as in the creation of local partnerships engaged in public service provision. Kyrgyzstan's Taza Suu programme envisaged the participation of local communities in the renovation of water supply infrastructure. Their involvement entails the borrowing and repayment of loans, the maintenance of the water supply systems and tariff setting.

### Local volunteers build toilets in Tajikistan

In Tajikistan, the inhabitants of many settlements are making efforts toward creating their own models of organization for water supply and sanitation. Specifically, the practice of establishing public committees of water users with local administrations is widely used. A water committee consists of 10-12 people, elected by the community. These committees are entitled to make decisions on every issue relating to the organization of water supply and sanitation in a settlement. The committees accumulate funds through monthly payments in the amount of 1-2 somonis (USD 0.2) made by each household. The accumulated funds are then used to finance the maintenance and operation of water supply and sanitation systems. In Muminabadskiy Rayon, Temurmaliyskiy Rayon, and Beshkentckiy Rayon of Tajikistan's Khatlonskaya Oblast, all the locals voluntarily participate in building toilets, and cleaning water pipes and reservoirs. In some settlements community involvement has built school toilets, cleaned reservoirs for drinking water, and organized the co-financing of a water network construction project. The water committee of Shibonai settlement, whose inhabitants have long suffered from high incidence of malaria because of a weedy collecting ditch, together with religious leaders of the community hired a power shovel and paid for its driver's services with money collected from the inhabitants. As a result, the problem has been solved, and the water committee now supervises the maintenance and operation of the collecting ditch.

Sources: Bukhoriev (2010); PARASTOR (2011); Khovar, (<http://www.khovar.tj/rus/>)

### \* Heat supply

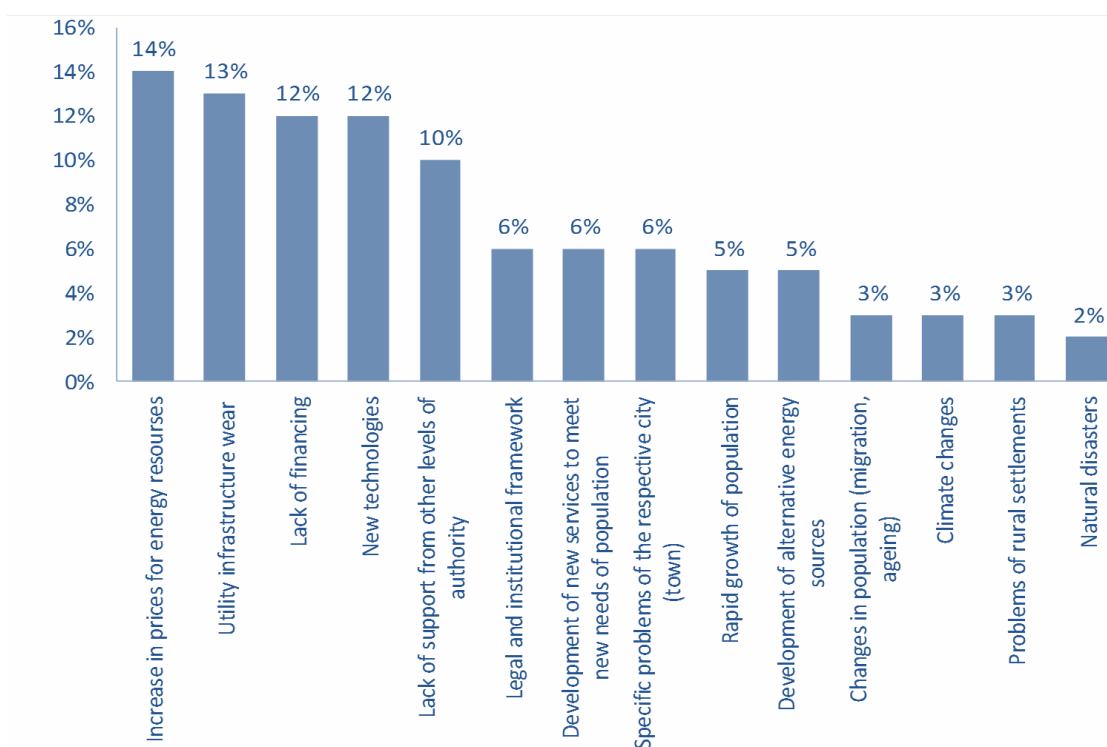
In some parts of **Moldova** and **Armenia**, homeowners' associations are involved in organizing and/or managing heat supply systems. There have been successful pilot projects in the sphere of heat supply implemented in the Armenian cities of Yerevan, Gyumri, and Spitak. The experience gained in these cities proves that cooperatives may be effective in organizing rehabilitation/renovation and in managing heat supply systems via raising loan funds.<sup>22</sup>

<sup>22</sup> UNDP/GEF (2010).

### Existing and emerging challenges

Basic service provision in the Eurasia region has shown some improvements over the last decade but performance remains generally unsatisfactory, with negative impacts on the population, the environment and the economy as a whole. Countries have progressed at different paces and there are some examples of successes, but in most cases, where improvements in performance have been observed they have usually remained at a limited scale. The development of public service provision in the Eurasia region is held back by a number of factors. The results of a survey undertaken for this investigation specified a range of factors that affect the development of basic services and their relative significance. The rise of energy prices (14%) was found the most important, followed by utility infrastructure wear (13%). The affordability of new technologies and a lack of finance and support from other levels of authority received 12% each; and these were followed by other factors.

Factors mostly affecting the development of the sector of public services, according to the questionnaire survey of city representatives from some countries of Eurasia region:



<sup>11</sup> Euroregions or similar structures, founded under the Madrid Outline Convention (Council of Europe, 1980), European Groupings of Territorial Cooperation (EGTCs) at the internal and external borders of the EU, or Euroregional Groupings of Cooperation (EGC), created under the Third Additional Protocol to the Madrid Outline Convention.





## 2.2 Public finance at the local level

### 2.2.1. Local budgets in national budget systems

In the 1990s, Eurasian countries faced with the necessity of forming local-level authorities and local budgets, which did not exist in Soviet Union. Despite local finance problems in Eurasian countries over the last two decades, significant progress has been made in the following areas:

- explicit assignment of expenditures have been put into law in all these countries;
- meaningful revenue decentralisation has taken place;
- relatively transparent equalization transfer mechanisms have been developed.

Independently of the legal status of the local self-government, the municipal budgets are the part of the national budget system. The approaches and principles of the local finances management are determined at the national level in all Eurasian countries. It relates to both, revenues and expenditures commitments of the local budgets, and to the local finances management approaches.

The role of local budgets in the budget system is significant virtually in all Eurasian countries. At that, the share of municipal budgets in aggregate expenditures of the enlarged government differs significantly. In **Armenia** and **Russia** the local budgets role is quite low (accordingly, 8.8 and 13.8 per cent of the enlarged government expenditures within the recent years' data available for examination). In **Kyrgyzstan**, **Moldova** and **Ukraine** this index varies from 20 to 50 per cent, in **Belarus** and **Kazakhstan** it exceeds 50% (see Table 2). Evidently, that the local level position in the budget system derives from approaches to determination of the local level of public authority and the scale of the public sector presence in the economy.

The Size of Government Expenditures<sup>23</sup>

| Country,<br>years       | Total Expenditure of General<br>Government (% of GDP) |        | Expenditure of Local<br>Government (% of GDP) |        | Local Expenditures as a Share<br>of General Government (%) |        |
|-------------------------|---|--------|---|--------|--|--------|
|                         | year 1  | year 2 | year 1  | year 2 | year 1   | year 2 |
| Armenia (2008; 2011)    | 23.9  | 27.3   | 1.3   | 2.4    | 5.5  | 8.8    |
| Belarus (2008; 2013)    | 48.7  | 29.5   | 17.3  | 18.2   | 35.5   | 61.7   |
| Georgia (2007; 2011)    | 29.0  | 36.8   | 6.1   | 7.0    | 21.2   | 19.0   |
| Kazakhstan (2007; 2011) | 20.6  | 25.8   | 11.0  | 16.5   | 53.4   | 64.0   |
| Kyrgyzstan (2006; 2011) | 23.3  | 38.2   | 6.1   | 7.7    | 23.8   | 25.9   |
| Moldova (2008; 2012)    | 41.4  | 34.3   | 10.2  | 8.2    | 24.6   | 23.9   |
| Russia (2008; 2013)     | 42.9  | 37.4   | 7.8   | 5.1    | 18.3   | 13.8   |
| Ukraine (2008; 2012)    | 45.4  | 34.9   | 14.2  | 15.6   | 31.2   | 44.6   |

<sup>23</sup> Data sources for all the tables and diagrams in the «Local budgets in national budget systems» and «Revenues, intergovernmental fiscal relations and fiscal autonomy of local budgets» sections: Local Government Finance: The Challenges of the 21st Century (GOLD II), 2 010; Tumanyan D., Fiscal Decentralisation in Armenia: practice and challenges, 2013; Armenia Local Government Program –Phase 3. USAID, 2010; Local self-governance in Ukraine 2010-2012, USAID, 2013; Report on public finance of the Republic of Belarus, January -December 2013, Abdrakhmanov S., Benchmarking assessment of revenues and expenditures of the local budgets for 2008 -2014 (Kazakhstan); Bulletin of the Pridnestrovsky Republican Bank N.4'2013; National statistical resources, authors calculations.

From 2000 and onwards the role of local budgets in the budget systems of the Eurasian countries has flattened out. As one can see from the table above, a certain decentralisation of funds took place in a number of countries that had been allocated into the economy as local budgets expenditures. **Georgia, Moldova** and **Russia** are exceptions. At the same time, the growth of funds invested into the economy as the municipal budgets expenditures was accompanied with a decrease of financial self-sufficiency of local budgets (see below) and autonomy of decision making by the local authorities, in whole.

The list of local expenditure responsibilities of local budgets is significantly impacted by the administrative – territorial division. Thus, the number of functions assigned to settlements is usually not large due to the diseconomies of scale and spill over effects. Typically settlements are assigned responsibility for housing and community amenities, pre-school education and recreation. If district budgets are included in the local government category, the list of responsibilities can include, in accordance with expenditure assignment criteria, general education and primary health care. If region budgets are regarded as local, expenditures on health care and education will constitute a large portion of total outlays, and will support many related responsibilities. Due to economies of scale, services provided at this level will be less expensive and will reach a greater portion of the population.

In some countries expenditure responsibilities are unclear: it is difficult to find out which level of government is responsible for what service. In **Georgia** local government “performs social-cultural activities and supports the activities of the relevant objects (educational and educative institutions, etc.) having local importance” and “establish preschool and other education institutions”. Following this arrangement, general education could be provided by local or central government (de facto it is provided by central government). In **Moldova** the legislation on local self-government assigns the same powers to local authorities of the first and second levels. The concept of issue of local significance (municipality competence) is defined in **Russia** but there is no clear answer in the legislation to the question: whether implementation of all issues of local significance is compulsory or it is just a right (possibility) of the municipality.

A significant problem of expenditure assignment in Eurasia arises from so called «unfunded mandates» that are the obligations for local governments to provide a service or perform a task without full or adequate funding from the upper-level governments that introduces the requirement or obligation. Unfunded mandates exist in **Armenia, Kyrgyzstan** and **Moldova**. In **Kazakhstan, Russia, Ukraine, Belarus** and **Georgia** unfunded mandates are formally forbidden but in practice some legislative decisions of higher levels of government do result in additional financial burdens to the local level.

Despite the formal delineation of authority, central governments often seek to retain control over local spending. One way to do so is to allow the central treasury to manage (meaning control) the allocation of public expenditures even though, on paper, the treasury is simply supposed to manage the internal control of funds and never decide on the priorities for the allocation of resources, it can, and often does, exert quite significant influence over these. For example, **Armenian** observers have noted that the treasury often intervenes in the financial operations of the local communities. Another method used by Federal or Central governments to exercise control over local expenditure is to regulate by law the number of local government and public sector employees. This can be found in **Belarus, Kazakhstan, Ukraine** and **Kyrgyzstan**.

The introduction of so-called program budget in specific Eurasian countries is a notable tendency in the field of fiscal management within the recent years. When going to the program's budget the main portion of expenditures is implemented based on the programs – documents incorporating objectives, tasks, activities, resources, terms and performance targets. This process is explicit in **Russia, Kazakhstan** and **Georgia**, and to a less degree – in **Ukraine**. In all these countries the programs have been put into practice at the national level, and at the next stage – in the regions and municipalities. The experiences of the countries that have started introduction of the program's budget show that this instrument can potentially increase an effectiveness and transparency of the budget expenditures, but its introduction at the local level shall be carried out with a great discretion.





The program budget requires serious investments of funds and time as well as an availability of qualified staff. Furthermore, if the results of its introduction in the large cities are surely positives, then at the level of small towns and rayons the positive effect is not obvious, and for most of the settlements the program is unjustifiably complicated and resources consuming instrument.

## 2.2.2. Revenues, intergovernmental fiscal relations and fiscal autonomy of local budgets

The search for stable revenue sources with an evenly distributed tax base represents a great challenge for the majority of Eurasian countries. Besides, the smaller the size of a municipality (settlement, village), the more difficult it is to find suitable revenue sources.

In Eurasia this task is complicated by underdevelopment of property taxes. In the USSR, the group of property taxes included the personal property tax, the legal entity property tax and the land tax. Volumes of all the taxes, especially personal property tax, were very small; therefore there is no tradition of real estate valuation in post-soviet countries. Currently, some Eurasian countries are still in the process of separating property taxes from land tax (**Russia** and **Armenia**), others have combined these revenue sources into a single tax. Also, in **Moldova** and **Russia** local authorities can vary the tax rate within the limits established by law (see Table 3). In all of these countries the tax base for property taxes is set by national legislation.

### The Structure of Local Tax Revenues

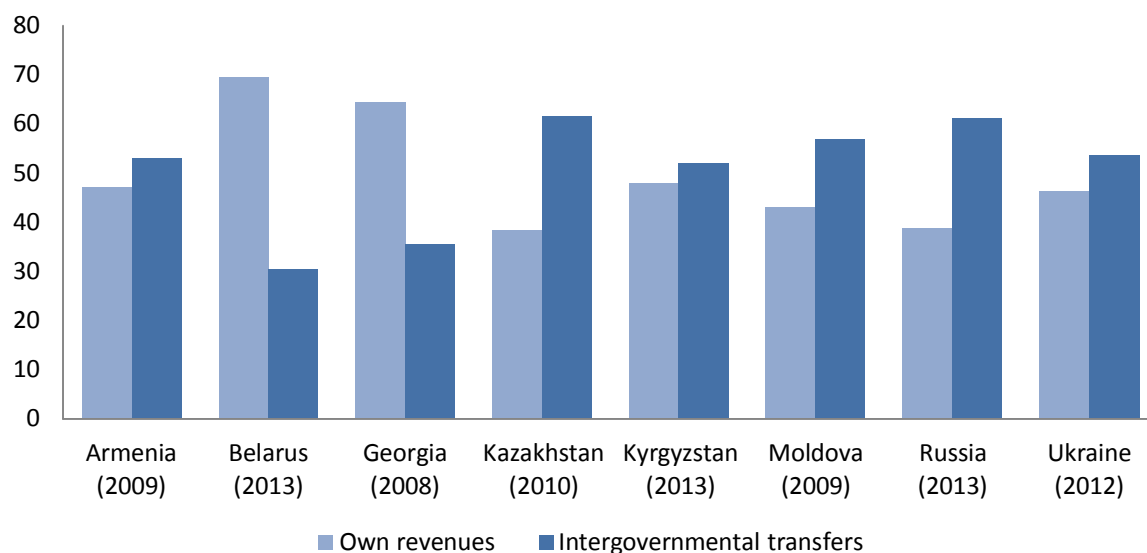
| Country, years    | Taxes on income, profits, and capital gains | Taxes on payroll and workforce | Taxes on property (incl. land tax) | Taxes on goods and services | Other taxes |
|-------------------|---|--------------------------------|------------------------------------|-----------------------------|-------------|
| Armenia (2009)    | 80.2%                                       | 0.0%                           | 0.0%                               | 0.0%                        | 19.8%       |
| Belarus (2013)    | 59.5%                                       | 0.0%                           | 10.1%                              | 29.7%                       | 0.0%        |
| Georgia (2008)    | 36.9%                                       | 0.0%                           | 62.5%                              | 0.0%                        | 0.6%        |
| Kazakhstan (2008) | 36.2%                                       | 34.0%                          | 14.0%                              | 6.6%                        | 9.1%        |
| Kyrgyzstan (2013) | 49.6%                                       | 0.0%                           | 17.6%                              | 31%                         | 1.8%        |
| Moldova (2012)    | 84.4%                                       | 0.0%                           | 6.2%                               | 0.0%                        | 9.4%        |
| Russia (2013)     | 82.4%                                       | 0.0%                           | 16.3%                              | 0,1%                        | 1.2%        |
| Ukraine (2012)    | 73.7%                                       | 0.0%                           | 5.0%                               | 0.0%                        | 21.3%       |

Therefore, experience shows that in circumstances where municipality plays a prominent part in public sector, in particular, in case of delivery of perceptible range of services in the spheres of education, medical care, social assistance and protection, the property taxes cannot provide for a sufficient income base.

Of the countries under consideration, in **Armenia**, **Moldova** and **Kyrgyzstan** collection of local taxes (duties) has been transferred or delegated to the local level. In **Armenia** local government monitors the tax base and controls the collection of land and property taxes. 75 inter-municipal inspections were created to fulfil this function. The delegation of property tax collection to the local level in 2003-2005 resulted in a 38 percent increase in collected tax revenue. The delegation of land tax collection in 2006 resulted in a 36 percent increase in collected tax revenue. Thus, the experience of these countries has shown that tax collections at local level increase tax compliance.

In fact, fiscal autonomy of local governments is restricted in most countries of the region. All countries under review have a closed list of local taxes, some countries (**Belarus**, **Kazakhstan** and **Kyrgyzstan**) set the sharing rates of shared taxes in the budget law. In Russia, district governments have a significant amount expenditure responsibilities assigned

to them but no taxes of their own. Besides, central (federal) governments can establish tax benefits (exemptions, etc.) for local taxes (**Georgia** and **Russia**).



### *The Structure of Local Revenues*

Intergovernmental transfers are used to reduce vertical and horizontal imbalances, to stimulate local governments to follow the central (or regional) government's policies, or to ensure equal access to public services for all citizens. Local governments in all the countries receive general purpose equalization transfers in addition to targeted transfers. The relatively low proportion of transfers in local budgets of **Belarus** (30.4) is not surprising as, given the political regime in this highly centralized structure, the centre is likely to be much less afraid that the decentralisation of revenues will lead to a loss of control over vertically aligned bodies of executive power. In addition, the central government has a legislative opportunity to withdraw revenue surpluses in the form of negative transfers.

At the same time in **Kazakhstan** the proportion of transfers is even higher than in **Russia** (61.6 percent of revenues) although Kazakhstan also uses sharing rates of taxes and negative transfers and this figure have been steadily increasing over 10 years as well as in Kazakhstan. For Russia and Kazakhstan it is typical not only the growth of transfers share in municipalities budget revenue, but the growth of targeted transfer share as well in the structure of transfers. In **Moldova** and **Ukraine**, the share of transfers in the structure of local budgets is also high (56.9 percent).

The current problem for the most of Eurasian countries is a **transparency and foreseeability** of the transfers. The laws that determine the structure and process of allocations of the transfers are frequently changing. Moreover, non-transparency in the methods of designation of the financial amounts for the transfers can be questioned, and there are examples of politically motivated transfers.

The ratios of fiscal charges from national taxes to local budgets should be established for a long term in order to improve the quality of local budgeting. Frequent and unpredictable changes of taxes, revenues of which are allocated to local budgets, preclude local bodies from long-term decisions in budget planning.



Thereby for local self-governments to become more autonomous it is necessary to enlarge the list of local taxes (specifically, in **Russia, Kyrgyzstan** and **Georgia**) and/or to assign for long periods those shared taxes whose sharing rates are currently established in annual budget laws (**Kazakhstan, Belarus** and **Moldova**). Local real estate tax should be introduced instead of separate taxes on land and property. In the countries with the highest portion in local revenue (**Kazakhstan, Moldova** and **Russia**) it can be recommended to make a comprehensive review on opportunities of substantial improvements of fiscal capacity of local budgets.

### 2.2.3. Weak public participation in the budget process but local signs of life

The precondition for public participation in the budgeting process is an openness of information related to the budget system. Most of the countries in the region are characterized by low and medium levels of openness of the budgeting system. Following to the International Budget Partnership assessment the level of openness of the budget systems in **Tajikistan** and **Kyrgyzstan** is markedly lower than the worldwide average level. The ratings of **Georgia, Kazakhstan** and **Ukraine** are just over than the worldwide average level. **Russia** significantly outweighs the worldwide average level with rating equal to 74 (10<sup>th</sup> rank among 100 countries in 2012).

Open Budget Index in selected Eurasia countries

| Country   | 2006 | 2008 | 2010 | 2012 |
|---|------|------|------|------|
| Georgia   | 34   | 53   | 55   | 55   |
| Kazakhstan  | n/a  | 35   | 38   | 48   |
| Kyrgyzstan  | n/a  | 8    | 15   | 20   |
| Russia  | 47   | 58   | 60   | 74   |
| Tajikistan  | n/a  | n/a  | n/a  | 17   |
| Ukraine   | n/a  | 55   | 62   | 54   |
| World average based on the sample of the research | 46   | 39   | 49   | 43   |

Data source: <http://internationalbudget.org/what-we-do/open-budget-survey/full-report/>

It can be assessed that the level of transparency of the budget system in **Belarus** is meeting approximately the worldwide average level. In **Armenia** and **Moldova** this index is a little bit lower than the worldwide average level, and in **Uzbekistan** – markedly lower.

The transparency of the public finances had increased recently. This increase was achieved due to the development of information technologies and the targeted state policy. The recent tendency is an introduction of specialized web-sites with systemized information on the budget for general public including comments and infographics. Presently such web-sites are not numerous and are created mostly at the national (**Moldova, Russia**) and regional levels. At the local level such web-sites are uncommon, but their number is increasing.

The National legislation of the Eurasian countries defines quite limited list of possibilities for direct participation of the citizens in the budget process.



The legal mechanisms for the general public participation in the budget process in the Eurasian countries as of 2014:

| Country    | Compulsory public hearing for the draft local budget | Compulsory public hearing for the draft report on local budget implementation | Availability of legal mechanism for targeted financing of the projects based on special charges to be paid by public |
|------------|--|---|--|
| Armenia    | no   | no  | no   |
| Belarus    | no   | no  | yes  |
| Kazakhstan | yes  | no  | partly   |
| Kyrgyzstan | no   | no  | partly   |
| Moldova    | no   | no  | no   |
| Russia     | yes  | yes   | partly   |
| Tajikistan | no   | no  | no   |
| Ukraine    | no   | yes   | yes  |
| Tajikistan | no   | no  | yes  |

Source: National legislation on local government and budget legislation

The national legislation of most of the countries lack requirements for obligatory public hearings on the draft budget and (or) on report of its implementation at the local level. The imperative norms of law regarding to obligation of holding the public hearings are established only in the **Russian** and **Kyrgyz** legislation. Nevertheless, the experience of holding of public hearings in Russia and Kyrgyzstan shows that the establishment of obligation of law does not ensure real participation of the general public in the budget process. In most cases the public hearings are hold formally, but their results are ei ther not properly recorded, or fully ignored by the local authorities while taking decisions.

## Public hearings on the local budgets experience in Kyrgyzstan

Public hearings on the local budget in Kyrgyzstan were launched within the framework of an international project. Local self-governance bodies of the city of Naryn were the first to initiate a broad discussion on the budget and its implementation during public hearings on the budget in 1999. Gradually this practice (of public hearings) was scaled up and successfully implemented in other cities and townships across the country. Currently, most local self-governance bodies have accumulated the experience of holding public hearings on the budget. Accordingly, the donor support, as well as the support of special-purpose projects in this area was cut down and re-targeted so as to ensure the attainment of qualitative rather than quantitative outputs.

Numerous examples of the positive impact of public hearings on local budgets can be observed in 29 rural municipalities of Djalal-Abad and Issyk-Kul oblasts (within the framework of the project “Vox populi and accountability of local self-governance bodies: budget process”, financed by the government of Switzerland and implemented by the Institute for Development Policy – Project). From November 2011 through 2013, 29 local self-governance bodies in these municipalities were assisted with holding 49 public hearings with 4,000 participants therein. During these events, 69 proposals were made with regard to making amendments and/or additions to local budgets, and 44 of those were adopted by local self-governance bodies and approved by local councils. The efficiency of public hearings is assessed during the competition “Actual contribution of citizens to the process of drawing up local budgets” (held under the same Project) aimed at selecting, encouraging and disseminating the most successful initiatives.



Therefore, even without specified regulations on public hearings in place, even small settlements with meagre budgets have a possibility to organize basic involvement of the general public in the budgeting process. In this case the key attention should be paid to the information accessibility and to the format of communication between the local authority and inhabitants as equitable partners.

The lack of obligation for the budget hearing does not mean that these hearings are not held at all. In fact, experiences of such hearing holding are available in all countries of the region. There are examples of effective cooperation with general public and consideration of the public opinion when taking financial and budgeting decisions in all countries of the region and in different municipalities from rural settlements to the large cities. However, these examples are not numerous and shall be considered as a merit of the local self-government bodies in the specific areas. Moreover, the role of the international donor organizations is significant in implementation of these projects.

As a whole, it can be said that there has been a visible increase of openness of the budget system in the Eurasian countries within the recent years, including at the local level, but not the actual possibility of the general public to **impact** on decisions making in respects of revenues and spendings of the municipal budgets.

Basically, only the legislation of **Belarus, Ukraine and Uzbekistan** contains legal arrangements of direct force allowing targeted financing of the projects funded by special household charges. In **Kazakhstan, Kyrgyzstan and Russia** such legal arrangements are introduced partly, i.e. the legislation of these countries contains a number of provisions allowing attracting inhabitants' funds, but it cannot be considered as complete. An example of incomplete regulation is a situation, when the mechanism of self-imposition is established, but the budget legislation do not provide for obligatory provisions on what targets these funds can be used. In practice, the proportion of self-imposition in all Eurasian countries is inconsiderable.

### Imposition of the inhabitants in the Kirov region (Russia)

Russian legislation stipulates that the decision on self-imposition introduction, i.e. targeted once-only payment from citizens can be adopted through a referendum (in settlements with electorate up to 100 people – at the citizens meeting).

The Kirov region is leading in Russia in respect of attracting self-imposed funds for the purpose of implementation of local initiatives at the settlements level. The regional program for supporting the citizens' self-imposition is ongoing from its start in 2008. The program envisages a support to activities aimed at the project selection in the settlements in Kirov region and carrying out referendums among the inhabitants regarding to the self-imposition. In case of positive decision at the referendum and on condition of a positive evaluation of the project feasibility, the budget of Kirov region participates in the projects implementation. The self-impositions funds are 60%, 40% are the budget funds. The self-impositions charges varies from EURO 0,5 to 12.

In 2008-2012 projects had been implemented in 227 settlements (in total there are 326 settlements in the region). Local initiatives have included: repair of local roads, improvement of the territory, reconstruction and upgrading of water supply and sanitation systems, reconstruction of a sports venue etc. A considerable part of the projects apart of the financial funds have involved citizens input in the form of volunteers' labour, gratuitously provided materials and other forms.

The project not only has allowed implementation of a considerable number of local projects but had a positive impact on relationships between the inhabitants and public authorities in the region.



### 3. CONCLUSIONS

The countries of Eurasia have achieved different stages in the development of local self-government. But despite all differences, they share several general tendencies and features.

Decentralisation in the countries of Eurasia has been a spontaneous process based on the trial-and-error that in turn led to changes in the status of administrative-territorial entities, municipality borderlines, and assignment of expenditure responsibilities and revenue sources. Although formal local self-governance in some countries is nearly 20 years old, the decentralisation process has not been completed. In all of the Eurasian countries, there is an increasing aspiration among local communities to decide social issues locally and independently through their own representative bodies. This movement is, however, constrained by long-standing traditions; in some countries decentralisation is prevented by unstable political and economic conditions. The general process of decentralisation and reinforcement of local self-government is also hindered by the chronic shortage of resources, including those needed to exercise real power by local governments. In all Eurasian countries, the development of local self-government is undermined by a weak financial base.

In all the countries expenditure responsibilities are assigned to different levels of government by legislation but the assignment is not always clear. Sometimes the same definitions occur among the responsibilities of authorities of different levels, also some responsibilities are still assigned according to the old method of institutional delineation (property ownership). Sometimes de facto assignment differs from that outlined in the legislation: local governments finance responsibilities that do not belong to the local government authority. Co-financing of expenditure from different levels of government is rare but still exists.

As for the region as a whole, a centralized approach still dominates in provision of the public and social services. The legal competence of the municipalities is limited with limited scope responsibilities on social services, health. The issue of delimitation state and local responsibilities is fundamental in Eurasian countries.

The municipal budgets are the part of the national budget system. The role of local budgets in the budget system is significant virtually in all Eurasian countries. However fiscal autonomy of local governments is restricted in most countries of the region. All countries under review have a closed list of local taxes, some set the sharing rates of shared taxes in the budget law.

All countries in the region have developed, to different degrees, a legal framework to ensure public participation in the process of decision-making on issues of local self-government development and services provision within the municipality. A visible increase of openness of the budget system in the Eurasian countries was achieved in the recent years, including at the local level. At the same time the actual possibility of the general public to impact on decisions making in respect of revenues and spending of the municipal budgets is still limited. Participation in decision-making is still rather rare, and more of an exception rather than a practice.

Most of Eurasian countries are making efforts aimed at local self-government development and improving the quality of services provision. Activities at the national level aimed at enhancing local self-government development and the level and quality of services provision should include decentralisation of powers and resources, an increase in the overall financing, an improvement in the investment climate, the adoption of national programmes and measures to ensure both financial and administrative incentives and support for local initiatives.





## 4. RECOMMENDATIONS

### Administrative and Territorial Decentralisation

At present, in most Eurasian countries, centralization processes are underway. On one hand, there are government statements about the legal decentralisation, but on the other hand, an increasing centralization of decisions is witnessed. Legal decentralisation should be reinforced by both administrative and financial mandates of local authorities; the delegated functions should be supported with adequate financial resources. The search for optimal size of municipalities, which is especially difficult in rural municipalities, is basically about striking a balance between the proximity to public decisions and service provision and the need to provide for capacity to deliver services.

- Delineation of powers between local and state governments should be clearly defined and based on decentralisation of the state functions but not by vesting the local self-government bodies' powers from the system of powers of the state authorities.
- Any territorial division should be based on the capability of the municipality to manage the matters of local significance in effective way, but not on the wish of the state or region to increase the level of a manageability of the territory.
- Well-balanced policies should be developed, based on the decentralisation of responsibilities and resources, with the parallel creation of national mechanisms to encourage the development of local governments through legislative frameworks and state programmes to support local reforms.

### Fiscal Decentralisation

Fiscal decentralisation is at the core of the division of powers. Administrative decentralisation and political decentralisation are closely connected with fiscal decentralisation and are mutually dependent. Decentralisation of expenditure can improve the governance balance, as public finances can be better tailored to subnational needs, leading to greater efficiency in expenditure.

- Local governments should have autonomy over local budgets: expenditure autonomy should be supported by revenue autonomy with sufficient revenue sources and clear assignment of expenditure responsibilities should be established.
- Unfunded mandates should be eliminated not only on paper but in the everyday practice, delegated functions must be supported with adequate financial resources.
- The ratios of fiscal charges from national taxes to local budgets should be established for a long term.
- Local authorities should be involved in administration of local taxes.
- Transfer allocations should be predictable and transparent.

### Improving multi-level governance

Although more practical attention should be given to subsidiarity and to the realization of the decentralisation objectives articulated by government, it is also important to bear in mind that many challenges in local self-government development and services provision are of both local and national concern. This involves such important issues as budget co-financing of the public and social services sector at the local level and tariff policies designed with due regard for people's ability to pay. The small scale of services provision at the local level and the poor competencies of local managerial staff should be addressed, not through the transfer of authority to "higher echelons of power", but rather by developing horizontal links in the form of inter-municipal cooperation and, eventually, private sector partnerships for better services provision. There are also functions that are more effectively located at higher levels. Genuine partnership is the goal here, and coordination between jurisdictions is essential.

- Both vertical and horizontal links can be encouraged to improve the effectiveness and efficiency of local services.
- More discretionary power should be given to local governments to adopt the models for provision that are most appropriate at local level.
- Development of public-private partnership tools and attraction of private investments in the sector of public services provision should be based on state policy and shifting away from the state administrative regulation.
- To improve the investment climate, it is necessary to create a system of incentives for service providers to cut expenses, modernize their operations and enhance the level and quality of services.
- Policy reforms also should be considered in order to facilitate cooperation among municipalities in enhancing of efficiency of basic services provision through supporting inter-municipal cooperation agreements which will allow local governments manage services jointly and undertake local development programmes.
- The public authorities should be cautious when introducing program budgeting at the local level, as the positive effect at the level of small towns and regions is not obvious, and for most of the settlements the programmes are unjustifiably complicated and a resource consuming tool.

### **Improvement of public participation, budget process and planning of services**

Sustainable urban development, minimizing conflict on use of urban areas, and balanced policy on providing high-quality basic services to the maximum number of people are all connected to the establishment of long-term systems of urban planning. Such urban regulation requires that local authorities adequately ensure the changing needs of citizens. An important tool for this purpose is the involvement of citizens in discussion and negotiation on the main issues related to local self-government, budget process and planning of services sector.

- Improvement of the legislation in the area of citizens' participation and passing of specific laws that will provide for applicable forms, effective mechanisms and procedures for citizens' participation, adoption by local authorities of respective regulations, additional legislative acts, more detailed and simple instructions.
- Introduction of programs on the advanced civil participation experience; support of the development of success stories on the ground and active encouragement and promotion of citizens' involvement on various stages of a political cycle and decision-making.
- Encouragement of partnership and campaigns for proactive citizenship, joint planning and management of local public wealth and finances
- For citizens' inclusion in decision-making processes on local levels, it is better to apply innovative instruments, communication means and technologies; creation of an interactive internet-platforms and application of hot-lines for processing citizens' suggestions or complaints regarding the operations of local authorities and local services.
- The constituents' involvement into the budgeting process will be able to improve quality of administrative decisions at the local level and to promote public confidence in the authorities. With an intent of public involvement in budget process, it is recommended to introduce obligations and mechanisms for the direct public relations in adopting the budgets (budgeting hearings), as well as the mechanisms of self-imposition in order to implement the local initiatives in the national legislation.
- Background for cooperation with the general public within the budgeting process is an access to the budget information presented in simple and intelligible form.







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## APPENDIX

### Article 9 of the European Charter of Local Self-Governments

#### Financial resources of local authorities

1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
4. The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
5. The protection of financially weaker local authorities calls for the institution of financial equalization procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.
6. Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.
7. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
8. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.









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