

# LOCAL SELF-GOVERNMENT IN CENTRAL AND EASTERN EUROPE - A STRONG AND INDEPENDENT LOCAL-LEVEL MANAGEMENT TOOL OR JUST A PAPER TIGER?

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## *Abstract*

The onset of the independence process in Central and Eastern European (CEE) countries during the 1990s was marked by tremendous optimism and a declared wish for stronger fiscal decentralisation and the transfer of powers, responsibilities and resources to the units of local and regional self-government that were supposed to be closest to citizens in resolving their daily problems. However, this has not happened in these countries, at least not according to the basic financial decentralisation indicators, and this is the main thesis of this work. Despite numerous adjustments made in the local self-government organisation in the observed countries, an optimum level of local and regional self-government organisation has still not been achieved. The units of local and regional self-government are still heavily dependent on, or rather restricted by, the strong central governments, which reduces their autonomy and their influence on the local social and economic development.

*Key words: local self-government, fiscal decentralisation, Central and Eastern Europe*

## **1 Introduction**

Before the 1990s and the onset of democratic changes in CEE countries<sup>2</sup> local self-government was pronouncedly non-democratic and highly centralised, its role being far

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from significant. The communist parties played a leading role at the local level, and their powers ranged from the election of self-government bodies to the control of local elections, which were more a matter of form and a demonstration of loyalty to the ruling party than the reflection of the voters' will. Local council members and officials were usually members of the communist party whose appointments were almost always subject to approval and recognition of certain Party bodies. The local self-government bodies had access to very limited economic and financial resources (government grants accounted for the largest share of local revenues). Goods and services were in state ownership, while private ownership was generally neglected. In short, the real decision-making power at the local level was in the hands of the communist party bureaucracy, which also controlled the local self-government bodies.

In the early 1990s as the old communist regimes collapsed, these countries started their independence processes accompanied by economic and political transition from the strictly centralised socialist system of planned economy to the market-economy regimes. They also adopted new institutional, legislative and organisational frameworks and introduced a new local self-government organisation and new models of financing. Among other things, the 'changes from the 1990s' included the emergence of a multiparty system, as well as the transformation and an increasingly clear positioning of political parties. Along with the strengthening of the private sector, various new civil society organisations came into existence. This resulted in an increasingly active participation of citizens in the political life. In addition, the changes involved regular local and national elections and the transformation of the local financing system and local economy. As a result of these reforms, a new system and organisation of the local self-government was introduced and the local self-government was separate from the control of the central government. Numerous local government bodies were set up and their powers were redefined and extended, and new legislation governing the sources of local self-government financing was introduced. A new local financing system and the reintroduction and consolidation of local ownership were key prerequisites for local autonomy. However, even nowadays the local self-government bodies are largely incapable of influencing tax rates and introducing any type of local tax, because these matters fall within the competence of central government authorities (for further details, see: Baldersheim and Illner, 1996:1-41).

The local self-government, neglected by then, became increasingly important. However, it is highly questionable whether it really got its rightful place. More specifically, the development of the local self-government and fiscal decentralisation systems was supposed to be a key component of the entire transformation and democratisation process in these countries. But the transformation process was neither simple nor fast, nor has it ended in most of these countries, as they still have not set up optimum systems of local self-government or organised their efficient operation. Consequently, a great majority of these countries are still in search for adequate local self-government financing systems, which threatens their normal functioning. This is best indicated by numerous and frequent reforms carried out so far that have shown some minor or major shortcomings in the meantime, and a need for further transformation. The shortcoming primarily consisted in the non-functioning and inefficiency of certain initial solutions for the organisation and functioning of local self-government systems, particularly as concerns their financing.

The following parts give an explanation of similarities and differences in the development of local self-government and of the models of territorial organisation of local self-government in the observed post-communist countries in Central and Eastern Europe. The fourth part provides a description of the local self-government financing systems.

## **2 Similarities and Differences in the Development of Local Self-government among Central and East European Countries**

The considerable organisational and territorial changes in the local self-government have shown certain similarities but also differences among CEE countries. The key similarities relate to the holding of regular local elections, adoption of new constitutions and setting up of legal frameworks regulating the organisation and competences of local self-governments, as well as to the strong dependence on the financial aid from the central government. The basic differences among the observed countries consist in different local self-government structures, models of local administration organisation and models of financing the local self-government activities.

### ***2.1 Similarities in the Development of Local Self-government***

Similarities in the development of local self-government among most CEE countries relate to the re-establishment of the local self-government after democratic elections, the dependence of local self-government units on central government transfers, the constitution-based legal framework for the development of local self-government, and a large number of lower-level local government units, primarily municipalities.

The transition from a strongly centralised system began with democratic elections at both the national and local levels, which were the main prerequisites for decentralisation and the establishment of the local self-government legal system. However, the first free and democratic elections hardly led to any substantial changes in the local organisation, as the 'new old' political parties continued to dominate the political systems at the local level, and mayors and regional representatives were usually elected indirectly by their respective councils (Peteri, 2001). Furthermore, according to Bennet (1997), the development of local autonomy at the regional and district levels in most post-socialist countries was strongly influenced by the central government. Consequently, the newly established democratic governments of these countries had to renew the concept of local self-government, develop the necessary technical know-how, staff and political skills to promote local autonomy. It was also necessary to win enough political and public support to continue the development of the local self-government system and to get rid of the former USSR heritage concerning local self-government.

The analysis of basic financial indicators shows that local units in all of these countries were, and largely still are, financially dependent on the central government transfers (grants). The decision-making power concerning the financial aspects of the local self-government was concentrated at the central government level. Specifically, local government fiscal revenues in all the observed countries mostly came from taxes which were imposed, assessed, and collected by the central government. The local self-government bodies

had little or no discretion to decide on the rates, bases and amounts of taxes. Lower-level local self-governments in the observed countries were normally financed from tax-sharing, which made the bulk of local budget revenues, and from own local taxes and budget transfers (grants). While the rates, amounts and bases of local taxes were left to the discretion of the local self-government bodies, these taxes usually accounted for just a minor share in total local revenues.

There are also some other similarities in the transition processes among the observed post-communist countries in Central and Eastern Europe. For example, all of them were under the communist regime for many years, and the decision-making instruments were exclusively controlled by the communist party. In all these countries, the local self-government was legally based on the constitution, which theoretically provided for autonomy and prescribed the methods for the territorial distribution of government administration, as well as the interrelationship between the central government authorities and local self-government bodies.

Table 1 shows some basic common characteristics of the reforms of local self-government and territorial organisation in CEE countries.

New laws on local self-government were enacted during 1990 in Poland, Czech Republic, Hungary and Slovakia and by end-1993 in other observed countries. Slovenia was the last to introduce a new law on local self-government in 1993. The independence process was soon accompanied by elections at both the national and local levels. The first free democratic local elections were held after the adoption of the first laws on local self-government, i.e. in the period from 1990 to 1994. This was followed by a gradual introduction of a new territorial organisation or a territorial fragmentation of local self-government units, and new models of their financing were developed. Moreover, the capitals of all the countries were given a different organisational form and a special administrative status relative to other local units.

One of the key features of the local autonomy development in the post-socialist era was the reestablishment of the lowest levels of local self-government – local communities, municipalities or communes. However, in all the countries there is currently a large number of newly established small municipalities whose viability is questionable. Despite this, the re-establishment of this lowest level of local self-government and its increasingly important role resulted in its growing influence on making decisions on all significant local matters. The time has shown that such fragmentation and the excessive number of municipalities of questionable financial sustainability and low fiscal capacity results in the need for a permanent change of the local self-government organisation. Owing to this, the process of establishing new, increasingly smaller municipalities continued in most of the countries, but with less intensity than at the outset of the reform process in the 1990s.

## ***2.2 Differences in the Development of Local Self-government***

Differences in the development of local self-governments in most CEE countries relate to the structure of local self-government, the organisation of local administration (one-level to three-level organisation) and fiscal aspects of the local self-government's operation.

*Table 1 Basic Characteristics of Local Self-government Reforms and Territorial Organisation in CEE Countries since 1990*

Country	New Act on Local Self-government	Introduction of a new system of local finance	First free and democratic local elections	Current territorial organisation
Bulgaria	September 1991, Official Journal No. 77/91	during 1991	October 1991	The local self-government comprises municipalities (264) and regions or districts (28), in which the government authority is exercised at the local level. Below the municipal level there are town districts and local communities.
Czech Republic	September 1990, Official Journal No. 367/90	January 1993	November 1990	The local self-government level (6250 municipalities) and, since 1997, the intermediate, i.e. regional government level (14 regions and the City of Prague).
Croatia	December 1992, No. 90/92	December 1993	February 1993	The local self-government level comprises municipalities (429) and cities (127), and the regional self-government consists of counties (20 and the City of Zagreb).
Hungary	August 1990, Official Journal No. LXV/90	gradually, since 1986	October 1990	The local self-government (municipalities) and regional self-government (19 districts and the City of Budapest). Exemptions are the so-called towns with the rights of districts (22 of them).
Poland	March 1990	January 1991	May 1990	A three-level system comprising two local self-government levels and an intermediate level. The lower, local level comprises municipalities (2489), and the higher regional level comprises the districts (376 of them, consisting of village districts and towns with the rights of districts); the third, intermediate level comprises the provinces or duchies (16 of them).
Romania	1991, Official Journal No. 69/91	during 1994	February 1992	Two levels of local self-government: the higher level comprising districts or counties (42, including the municipality of Bucharest), and the lower level comprising towns (262) and municipalities (2686).
Slovakia	September 1990, Official Journal No. 369/90	January 1993	November 1990	The local self-government (2891 municipalities) and regional self-government (8 regions and 79 districts)
Slovenia	1993, Official Journal 72/93	during 1994	December 1994	One-level local self-government, comprising 210 municipalities, 11 of which have the status of 'urban/city municipality.

Source: *Baldersheim et al. (1996b:24)*; adapted by the author.

Peteri (2001) suggests that, unlike the countries in Central Europe, Southeast European countries like Croatia, Bulgaria and Romania still combat the problems of the central government reform and decentralisation, and of adjusting various local self-government models to their own needs. The history of these countries shows the prevailing tendency towards centralisation, because they were established as national states later than the Central European countries.

The elected local bodies are limited in their functions and responsibilities and the authority for public functions and services is still in many different ways divided between them and the central government. Centralised distribution of public functions and strict control of public services exercised by the central government often coincides with a shortage of local units' own revenues. The distribution of revenues does exist, but it is largely discretionary. However, this is also differently arranged in the observed countries. For example, unlike Croatia which is in the process of general decentralisation, other countries plan to reform specific parts of their local self-government system, like Bulgaria, which is about to carry out revenue decentralisation, or Romania, which plans to redefine the role of majors. The need for further fiscal decentralisation is particularly pronounced in Slovakia, because, given low local revenues and strong dependence on government transfers, there are many municipalities with unsustainable financial systems. On the other hand, in Slovenia there is a strong need for giving wider decision-making powers to local bodies, because the municipal administrations cannot independently impose any new taxes, and are most frequently not entitled to increase tax rates or fees in order to provide for additional revenues.

A major difference among CEE countries consists in different structures of the local self-government, which can include one to three levels. The activities and functions of the existing public administration bodies and of the new local-level administrations have undergone constant changes in all of these countries. While the role of the intermediate level of government is the key issue in most new EU Member States (e.g. Czech Republic, Hungary and Poland), in Slovenia this level of government has not even been introduced. (for more details see Peteri, 2001:15-18).

Furthermore, Zakošek (2003:81) points to considerable differences among the units of local self-government in most CEE countries with respect to their size, economic and financial power and development. Therefore it is necessary to introduce elaborate fiscal equalisation mechanisms, based on various criteria (like in the Slovenian case), in order to support underdeveloped areas or areas with special (and greater) needs. The equalisation transfers may on no account depend on political criteria. In addition, the property owned by local self-government units in the region has not been adequately used so far. It is therefore necessary to develop more efficient local asset management administrations in order to increase the local budget revenues.

The following part outlines the history of the territorial organisation in the observed CEE countries, from the democratic changes in the 1990s to date.

### **3 Territorial Organisation of Local Self-government in Central and East European Countries**

The territorial organisation of local self-government in the observed countries is not uniform, but it has been developed in accordance with the specific needs of individual countries. As a result, from the beginning of its transformation, local self-government in

CEE countries has been organised at one, two or sometimes even three levels. The text below provides a description of the territorial organisation and the analysis of the number of local and regional self-government units.

After the collapse of communism, the local self-government in most of the observed countries (Hungary, Czech Republic, Slovakia and Poland) was organised at the municipality or local community level. "Hungary was the country with a most advanced local self-government reform which introduced a two-level organisation of local governance, the municipality level and district level. Similar reforms were introduced in Poland and Slovakia in 1999 and 2001 respectively, although Slovakia introduced a kind of a regional administrative division as early as 1996<sup>3</sup> (Majcherkiewicz, 2000).

Most countries have two-level local self-governments (a lower level and a higher level), with the exemption of major cities or capitals. Major cities in certain countries are organised in different ways. Their territorial scopes and jurisdictions, as well as their special organisation and financial status are regulated by special laws.

Municipalities and local communities constitute the lower-level local self-government<sup>4</sup>. In most countries, the lower level self-government is administered at the level of municipalities, but there are differences in their organisation. For example, some muni-

*Table 2 Territorial Organisation of the Intermediate Level of Government and of the Units of Local and Regional Self-government in CEE Countries Before and After their Independence*

Country	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Slovenia	Croatia
Provinces/regions (1993)	-	-	19	(49)*	41	-	-	-
Districts/counties (1993)	-	453	-	267	-	40	-	20+1
Total number of local communities (communes) and municipalities in 1993	4217	6196	3149	2468	2955	2851	147 (1994)	419 (1992)
Number of local communities (communes) in 1989	279	4092	1610	2375	2942	2725	62 (1991)	102 (1991)
Increase in the number of local communities (communes) from 1989 to 1993 (%)	93.4	34.0	48.9	3.9	0.11	0.4	57.8	75.7

<sup>a</sup> Source: Bennet (1997:10); the data on Slovenia and Croatia were adapted by the author and they represent the increase in the number of municipalities, being the lowest-level local self-government units in these countries at that time.

\*Note: The reform data on the number of provinces in Poland are in brackets, because provinces were not introduced until 1993.

<sup>3</sup> In 1996, Slovakia introduced a two-level system of general government administration offices, the regional and district levels, whereas the central government administration offices at the local level were abolished.

<sup>4</sup> In Bulgaria, for example, local self-government is only organised at the municipality level, whereas the intermediate level (the regions) is responsible for law enforcement and the performance and control of executive functions transferred by the central government to the lower government levels.

icipalities in Slovenia and Slovakia have city municipality status, whereas some cities in Hungary also have the powers of a higher level of local self-government, i.e. of the district. Similarly, it is impossible to make a comparison of the size of municipalities between, e.g. Poland and Slovenia.

Districts or counties<sup>5</sup> represent the higher level of local or regional self-government, which is responsible for coordination of the activities of municipalities and communities in a certain area, promotion of local interests and organisation of public services in a broader area. In most countries, the higher level of local self-government is represented by local or regional self-government, because its bodies are elected at local elections and it is responsible for the execution of tasks at the local level.

Some countries also have an intermediate level of governance or territorial organisation represented by regions or provinces. In Poland, for example, this intermediate level includes 16 duchies (provinces).

An important issue is also the efficiency of a huge (and inadequate) number of the lowest-level self-government units – municipalities and communes, whose financial viability is questionable. Table 2 gives a comparison between the numbers of local self-government units in the observed countries before and after they gained independence (up to 1993).

The increase in the number of newly established units of local and regional self-government, primarily the local communities (communes) and municipalities as the basic and lowest-level local self-government units, at the very beginning of the territorial fragmentation differs from country to country. The increase in communes in that period was the highest in Bulgaria (as high as 93%), and the lowest in Romania. In certain countries, the process of establishing new local communities and municipalities is still going on. Specifically, despite a boost in the number of municipalities in Croatia in the 1991-1992 period (of about 76%), the number of newly established municipalities continued to grow even after this period. Since 2005, Croatia has had as many as 429 municipalities, mostly established for political reasons and without an adequate economic analysis. As a result of this, the financial viability of such units is questionable.

Even after 1993, most of the observed countries (except Slovenia which only saw a rise in the number of municipalities) went through many radical changes in their territorial organisation, as shown in Table 3.

An intermediate level of government at the level of regions or provinces has been introduced in Bulgaria, Czech Republic, Poland and Slovakia. Other countries still have no regions, but the functions transferred by the central government to the local level, which are usually discharged by regions, are performed at the higher level of local self-government, i.e. in districts or counties. In Romania, for example, the activities of the local self-government are carried out at a higher level of self-government i.e. in districts (42 districts together with Budapest which has dual status of both district and municipality), and at a lower level of local self-government, in cities and numerous local communities.

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<sup>5</sup> For more details, see Kandeveva, 2001:24-28.

With some exceptions<sup>6</sup>, Hungary has a two-level system of local self-government with districts as higher-level units of local self-government and cities and local communities as lower-level units of local self-government. During 1994, 8 regions were abolished and their functions were delegated to the districts. Poland has the most sophisticated three-level system of public administration.

*Table 3 Territorial Organisation of the Intermediate Level of Government and of the Units of Local and Regional Self-government in CEE Countries, till 2006<sup>7</sup>*

Country	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Slovenia	Croatia
<i>Intermediate level</i>								
Provinces/ regions	28 (1998)	14 (2001)	–	16 (1997)	–	8 (1996)	–	–
<i>Higher level of local self-government</i>								
Districts/ counties	–	–	19 (1994)	376 (1997)	42 (2001)	79 (1996)	–	20+1
<i>Lower level of local self-government</i>								
Cities/city municipalities	–	–	169	–	179 (2001)	–	11 of 210 <sup>b</sup>	126 (2006)
Municipalities	264 (2005)	6.250 (2003)	–	2.489	83 (2001)	2.891 (2005) <sup>b</sup>	210 (2006)	429 (2006)
Local communities/ communes/ villages	–	–	2.913	–	2.688	–	–	–

*Note: <sup>a</sup>In 2005, 138 municipalities in Slovakia had city status, while in Slovenia, 11 municipalities of a total of 210 had city municipality status.*

*Source: The author's research.*

According to Baldersheim et al. (1996b;25-28), the basic unit of local self-government in Czech Republic, Hungary, Slovenia and Poland is the municipality or commune. Municipalities in Poland are relatively large, while in other CEE countries they are rather small in size.

Table 4 presents the organisation and scope of higher-levels of local and regional self-government, and of the intermediate level in the observed countries.

<sup>6</sup> In Hungary there are the so-called cities with the rights of districts (22 of them together with Budapest), which also perform the functions of districts, and the capital, Budapest, divided into 23 districts.

<sup>7</sup> Different levels of government have different names in particular countries. In some of them, for example, higher (intermediate) levels of government are called provinces (or regions), and in others they are called districts or counties). Similarly, the lowest-level local self-government units are known as municipalities in some countries and local communities in others.

*Table 4 Organisation and Scope of Intermediate and Higher Levels of Local Self-government in CEE Countries*

Country	Higher level of governance	Scope
Bulgaria	28 regions	Decentralised administrative and territorial units in which the government authority is exercised at the local level. They also implement regional policy and harmonize the national and local interests.
Czech Republic	14 regions (together with the capital)	Responsible for the planning of economic and social development in their respective territories.
Croatia	20 counties and the City of Zagreb having the status of city and county	Performing the functions of regional significance aimed at promoting balanced economic and social development of the units of local self-government in their territories.
Hungary	19 districts	Responsible for government administration activities which they carry out at public administration offices, and for providing services or regional significance.
Poland	16 regions or provinces and 376 districts	The districts, together with municipalities, perform the functions of the local self-government, whereas the regions carry out the activities of government administration and are responsible for high education and spatial development.
Slovakia	8 regions and 79 districts	Responsible for government administration activities at the intermediate level of government, as well as for the economic and social development within regions or districts.
Slovenia	-	-
Romania	42 districts (counties)	Units of local self-government and bodies responsible for government administration activities.

*Source: The author's research.*

The intermediate level of governance is differently organised in CEE countries. In some of them (e.g. Hungary), higher-level units of local self-government, i.e. districts, constitute the intermediate level of regional governance performing the tasks similar to the tasks executed by regions or provinces in other countries. Only Slovenia has not yet developed such level of governance. However, the territorial organisation reform in this country is primarily aimed at establishing the regions. The current administrative organisation of Slovenia consists of central government authorities and municipal or city government. The establishing of regions or provinces is necessary, primarily for the purpose of utilising the money from EU funds earmarked for European regions, but also for interregional cooperation<sup>8</sup>.

<sup>8</sup> On 27 June 2006, the Slovenian Parliament passed a constitutional law (Official Gazette, 68/06) amending those Articles of the Constitution which provide a basis for the enactment of laws in the Government procedure. Provinces are to be established in 2008, so that both provincial and parliamentary elections would be held concurrently. The provincial government would consist of the provincial council, the president of the province and various provincial bodies (e.g. the committee at the president of the province, a municipality conference as an advisory body to the council, to the president, etc.). The provinces should start to function on 1 January 2009. The 12 statistical regions and 14 development regions would most probably constitute the territorial framework for provinces as new administrative and territorial units in Slovenia. For more details, see IFIMES (2006).

Similarly, the capitals of most of the observed countries were recognised special status, as briefly shown in Table 5.

*Table 5 Status and Organisation of Capital Cities in CEE countries*

Country	Capital	Number of administrative units	Capital city status
Bulgaria	Sofia	24 administrative units	Special status; Sofia is given the powers to provide public services falling within the scope of local self-government and government administration.
Czech Republic	Prague	57 municipal districts and 22 administrative units performing the government administration functions	Special dual status of the capital which performs the functions of the local self-government and government administration; Prague has both the local self-government and regional centre status.
Croatia	Zagreb	17 town districts	Dual status of city and county; it is given the powers to perform the functions and tasks of both local and regional self-government.
Hungary	Budapest	23 administrative units	Special legal status of city self-government and self-governments of 23 districts.
Poland	Warsaw	11 administrative units	Special dual status of municipality and urban district; it is divided into 11 municipalities among which only the Warsaw-Centre municipality has 7 municipal districts.
Slovakia	Bratislava	17 administrative units (districts)	The municipality status, like its other districts which also have their own self-government bodies and own budgets.
Slovenia	Ljubljana	Divided into town district communities	The status of urban municipality, like the other 10 major Slovenian cities.
Romania	Bucharest	7 administrative units (districts).	Dual status of municipality and district.

*Source: The author's research.*

«The described development of the local self-government system in CEE countries had numerous consequences. First, most municipalities were too small, and, given their inadequate sources of financing, they were unable to provide enough staff for the local self-government bodies. Secondly, the small size of municipalities posed an obstacle to further decentralisation of powers and responsibilities in providing services and to an autonomous functioning of the local self-government. Thirdly, the small-sized municipalities led to the strengthening of a higher level of governance (already established in Hungary and Romania before 1993), or to an increase in the administrative power of regions or provinces controlled by central government authorities. Fourthly, the growing independence of municipalities slowed down their mutual cooperation and association in coping with certain difficulties arising from their small size.» (For more details see Balderheim and Illner, 1996).

Briefly put, as a result of territorial organisation reforms, local self-government is exercised at the municipality level in most of the observed countries (with the exception of Poland where it is also exercised at the district level), whereas government administration functions are performed at a higher level of local governance, i.e. by districts, or at an intermediate level, by regions.

#### **4 The System of Local Self-government Financing in Central and East European Countries**

During the communism, lower levels of local self-government had little or no authority over their expenditures. Their budgets were approved by the central government and transfers of revenues from the central government to the local government level were subject to negotiations. However, economic reforms introduced in CEE countries after they gained their independence changed the role of self-government in these countries, though still insufficiently, which is discussed in greater detail in the following part.

As from the 1990s, the parliaments in a number of transition countries adopted the laws on local self-government, local taxation and the right to association, as well as the laws on election reforms. Most of the laws on local self-government were based of the European Charter of Local Self-government. The key feature of these laws was the division of powers to decide on revenues among different levels of government. However, the extent to which these laws were applied differed from country to country, so that the lower-level local self-governments in most countries are still institutionally incapable of assuming the new responsibilities. (Raičević i Ilić-Popov, 2002:29).

O'Sullivan (2002:171) argues that in almost all transition countries, the finances of the lower-level local self-governments have a decisive role in improving economic efficiency and achieving macroeconomic stability, as well as in providing the social security network. In addition, in countries with a shorter history of local self-government, the development of efficient local and political institutions may be the key to establishing a modern state. In this process, the development of a transparent, functional and efficient system of interrelations between various levels of governance and an efficient decentralisation of powers and responsibilities can be crucial for the achievement of most reform goals.

In other words, the decentralisation of powers and establishment of efficient local self-government proved to be the key factors of transformation in CEE countries (Baldersheim et al., 1996b:23-43). Bird, Ebel and Wallich (1995) note that the "decentralisation in transition countries proved to be one of the key institutional steps in the transition to market economy and the establishment of a political system based on democratic decision-making."

In this way, the development of local self-government in CEE countries was most closely correlated with the achieving of an optimum degree of fiscal federalism, i.e. the division of fiscal powers and responsibilities among different levels of government. Moreover, the development of local self-government in these countries was closely related to the fiscal decentralisation process, i.e. the transfer of responsibilities for the planning, managing, taking over and distribution of resources from the central government to the lowest level of local self-government.

The following part presents an analysis of certain financial indicators in order to highlight the financial importance of previous fiscal decentralisation processes in the observed CEE countries. But before this, let it be mentioned that the fiscal decentralisation process in these countries was exceptionally complicated. In this region, the decentralisation process is inseparable from the transition to the market economy and establishment of democratic political institutions. The first important steps towards fiscal decentralisation were taken in Hungary and Poland during 1971 and 1983 respectively, by enacting new local self-government legislation. However, this legislation did not introduce any material changes into the local self-government within the communist systems, nor did they reduce the dominance of the communist parties in local decision-making. In other words, these minor and limited changes made but a small contribution to the strengthening of local democracy and efficient functioning of local self-government bodies.

Jurlina Alibegović (2007) notes that a centralised state exists when the central government or public authorities are vested with a larger number of powers to make public decisions. The degree of centralisation is one of the common measures of the level of centralisation in a country, representing the share of the central government revenues/expenditures in the total general government revenues/expenditures. The degree of centralisation is also measured by the share of the central government in gross domestic product (GDP). The degree of decentralisation is the measure of the decentralisation level in a country showing the extent to which the local self-government bodies participate in the total revenues and expenditures of the general government and in GDP. A motive for increasing the degree of decentralisation should be (but is very often not) to improve the efficiency of the public sector and the quality of satisfying the public needs of citizens, in accordance with their affinities and needs for public goods and services. The fiscal theory clearly suggests that the decentralisation of fiscal authorities is more efficient in countries with fully determined legal aspects of the local self-government organisation and financing and in which the local self-government bodies exercise adequate public revenues and expenditures control and in which the local administration possesses the appropriate knowledge and skills. If this is not achieved, the results of decentralised decision-making in discharging public functions and utilisation of public resources are unsatisfactory.

Most of the observed countries have still not achieved an optimum level of fiscal decentralisation, nor have they provided sufficient revenues to finance the tasks transferred from central government authorities to the local level of government. For that very reason, these countries have to introduce fiscal equalisation mechanisms in the form of transfers based on various criteria, aimed at providing aid to underdeveloped areas or areas with special needs.

The degree of (de)centralisation in certain CEE countries can be measured by a number of indicators. We have selected the following: the share of total revenues and expenditures of local and regional self-governments in GDP, the share of total revenues and expenditures of units of local and regional self-government in total general budget revenues and expenditures, the share of central government transfers in the total revenues of units of local and regional self-government and the share of tax and non-tax revenues in the total revenues of units of local and regional self-government.

Tables 6, 7 and 8 show some decentralisation indicators for CEE countries.

*Table 6 Total Revenues and Expenditures of Units of Local and Regional Self-government in CEE Countries (as % of GDP)*

	Share of total revenues of units of local and regional self-government in GDP		Share of total expenditures of units of local and regional self-government in GDP	
	2000	2005	2000	2005
Bulgaria	7.3	5.7	7.0	5.3
Czech Republic	8.6 (1999)	10.9	7.9	8.8
Croatia*	7.4 (2002)*	5.3	6.5 (2002)*	7.7
Hungary	11.1 (1999)	12.5	10.4	13.1
Poland	12.0 (1999)	12.6	12.1	11.9
Romania	4.4	-	3.4	-
Slovakia	2.4	6.7	2.7	5.9
Slovenia	5.3	8.9	5.3	7.5
Average (for 2005, excluding Romania)	7.3**	9.0	6.9**	8.6

Sources: for 2000, Human Dynamics Consortium (2007:9); for 2005, the author's calculation based on IMF data (2006a; 2006b).

\* In Croatia, there is a problem of consolidation and the application of different methodologies in the observed years. Specifically, unlike in the previous years, from 2002 on, the GFS 2001 methodology was applied. In addition to this, since 2002, only 53 local units that assumed decentralised functions have been consolidated (20 counties, the City of Zagreb and 32 other towns), which accounts for 70 to 80% of total transactions. The Table presents exactly these data and they should be taken with caution. The official data provided by the Ministry of Finance of the Republic of Croatia were used. This note also applies to the Tables 7 and 8.

\*\* Given the difference in the years observed, this data should be taken with reservation.

The share of expenditures of the units of local and regional self-government in GDP is a reliable indicator of decentralisation. Table 6 shows that Slovakia (2.7%), Romania (3.4%) and Slovenia (5.3%) were the least decentralised countries in 2000. Croatia (7.7% in 2005) belongs to relatively centralised systems (Human Dynamics Consortium, 2007:71). However, even though Slovakia and Slovenia increased the shares of expenditures of their respective units of local and regional self-government in GDP in 2005, they still remain the least decentralised countries in the region, together with Bulgaria.

Looking at decentralisation in 2000 from the point of view of revenues, countries with centralised expenditures usually have centralised revenues, too. Croatia follows this general trend. In addition, the shares of total revenues of units of local and regional self-government in GDP are below the average for CEE countries which have become new members of the EU. There are considerable differences among the units of local and regional self-government in centralised EU Member States with respect to the reliance on various sources of revenues. Thus, new EU Member States rely more heavily on tax and

Table 7. *Shares of Total Revenues and Expenditures of Units of Local and Regional Self-government in GDP in CEE and Western European Countries*

	Share of total revenues of units of local and regional self-government in GDP	Share of total expenditures of units of local and regional self-government in GDP
<i>CEE countries</i>		
Bulgaria	5.7	5.3
Czech Republic	10.9	8.8
Croatia	5.3	7.7
Hungary	12.5	13.1
Poland	12.7	11.9
Romania	-	-
Slovakia	6.8	5.9
Slovenia	8.9	7.5
<i>Average (excluding Romania)</i>	<i>9.0</i>	<i>8.6</i>
<i>Western European Countries</i>		
Austria	8.1	8.0
Belgium	21.2	21.0
Denmark	32.6	33.3
France	10.9	10.2
Italy	14.7	14.7
The Netherlands	15.8	15.9
Norway	15.6	15.3
Germany	19.1	20.4
Spain	20.1	19.0
Sweden	25.5	23.9
UK	12.9	12.3
<i>Average</i>	<i>17.9</i>	<i>17.6</i>

Source: IMF (2006a; 2006b).

non-tax revenues. Less reliance on grants reduces the ability of the local self-government to ensure an equal level of local services, because local units have to rely on their own fiscal capacities (Human Dynamics Consortium, 2007:10).

In 2005, like in 1999, the largest shares of total revenues of the units of local and regional self-government in GDP were recorded in Hungary and Poland (over 12%).

Table 7 gives a comparison of the shares of total revenues and expenditures of units of local and regional self-government in GDP in 2005 between CEE and Western European countries.

The analysis of the shares of total revenues and expenditures of units of local and regional self-government in GDP listed in Table 7 shows that, according to financial indicators, the role of local and regional self-government in CEE countries is almost half as important as that in Western European countries. In other words, the role of local and regional self-government in the Western European countries (especially Denmark, Sweden and Belgium) is considerably more important than in CEE countries. As suggested

Table 8 Other Decentralisation Indicators for CEE Countries (in %)

	Share of revenues of units of local and regional self-government in total general government revenues		Share of expenditures of units of local and regional self-government in total general government expenditures		Share of tax revenues in total revenues of units of local and regional self-government		Share of non-tax revenues in total revenues of units of local and regional self-government		Share of grants (transfers) in total revenues of units of local and regional self-government	
	2000	2005	2000	2005	2000	2005	2000	2005	2000	2005
Bulgaria	16.9	13.6	20.6	14.9	46.3	19.4	13.8	11.1	42.7	69.6
Czech Republic	20.8 (1999)	27.3	26.1	21.5	47.7 (1999)	50.3	36.3 (1999)	12.3	25.3	37.4
Croatia	14.9	11.8	11.7	9.8	57.1	58.2	28.6	27.8	6.0	14.0
Hungary	26.7 (1999)	29.3	24.1	26.3	33.0 (1999)	35.1	17.0 (1999)	15.3	49.3 (1999)	49.4
Poland	28.8 (1999)	31.2	45.1	28.5	24.5 (1999)	32.7	24.2 (1999)	16.9	39.3	50.4
Romania (2002)	12.9	20.5 (2002)	12.0 (1999)	19.1	69.7	83.6	13.8	10.0	17.0 (1999)	6.4
Slovakia	5.6	18.5	7.4	15.4	67.1	49.2	20.9	15.1	18.6	35.7
Slovenia	12.4	19.3	13.2	16.7	58.5	33.8	18.1	18.3	23.8	47.8

Sources: IMF (2001, 2006a); Human Dynamics Consortium (2007) and the author's calculation.

by the basic financial indicators, the importance of local and regional self-government in Central and Eastern Europe is only comparable to that in Austria (about 8%) or France (about 10%). Nevertheless, the Western European countries have a much longer tradition of local democracy and the local self-government in these countries is much more efficient and stable.

Table 8 shows some other decentralisation indicators for CEE countries.

According to Jurlina Alibegović (2007:4), Croatia is a highly centralised country, compared with others, in which the central government accounts for the largest part of public revenue and for most of public expenditure. This means that the decisions on public money collected from all taxpayers and of its spending are mainly made at one place – in the central government, as confirmed by the data in Table 8.

Other decentralisation indicators suggest that, unlike in Poland, Hungary and Czech Republic, where the share of revenues of the units of local and regional self-government in total revenues of all levels of governance (i.e. in the general government budget) was relatively high in 2005 (more than 25%), in all other countries this participation was rather low. In other words, while the units of local and regional self-government in Poland, Hungary and Czech Republic generate more than one fourth of total public revenues, they also account for about one fourth of total public expenditures.

In 2005, the share of tax revenues in total revenues of units of local and regional self-government was the largest in Croatia and Czech Republic (there are no available data for Romania for all the years). The share of non-tax revenues in total revenues of the units of local and regional self-government was small in all CEE countries, and it is these revenues that the units of local and regional self-government decide upon independently.

Furthermore, an analysis could also be made of the importance of central government transfers for units of local and regional self-government in these countries. In 2005, the strongest dependence of the local self-government on central government transfers was observed in Bulgaria, Hungary, Poland and Slovenia. It is obvious that the financial systems of the local self-government in most of the observed countries, inherited from the 'central planning era' continue to be characterised by strong dependence of the lower levels of self-government on central government transfers and an almost complete absence of any substantial own sources of revenues. Consequently, the local self-governments in all the observed countries are faced with the same problem of insufficient funds, and their central governments have the exclusive control over the major sources of funds. In other words, the central government transfers to units of local and regional self-government are very important, primarily due to limited local taxes. The dependence on transfers and tax sharing in these countries shows that they expected their units of local and regional self-government to assume a more substantial role in the local social and economic development after they gained their independence and started the process of decentralisation. However, this has still not happened.

## **5 Conclusion**

The process of local self-government transformation after 1989 was not the same in all the CEE countries. However, what all CEE countries had in common was that the beginning of the transformation process coincided with the collapse of communist regimes and the establishment of new democratic governments. Moreover, all the countries subsequently ratified the European Charter of Local Self-government, so that the laws regulating self-government in most of these countries were based on the European Council recommendations. In addition to this, the main similarities in the development of local self-governance among the observed countries relate to the enactment of new laws on local self-government, setting up of a new territorial organisation of the local self-government system and the introduction and organisation of a new system of local finance. It turned out, however, that the new models of territorial organisation resulted in a large number of small municipalities with questionable viability. Furthermore, as the power to make decisions on financial aspects of local self-government was concentrated at the central government level, the units of local self-government in all the observed countries were, and for the most part still are, financially dependent on central government transfers (grants).

The differences in the development of the local self-government most often relate to the structure of local self-government, the organisation of local administration and the models of the local self-government's fiscal operation. The reforms often failed to solve the problems existing at the local level, e.g. the existence of extremely small municipalities, insufficient fiscal capacities of the lower levels of government, the lack of a clear-cut di-

vision of powers between the local and central government bodies or the issues of local ownership. In addition, local self-government bodies are often financially dependent on central government transfers (grants).

The local self-government is differently organised in the observed CEE countries, i.e. at one level, two levels or even three levels of governance. Most of the countries have one or two levels of local self-government. Exceptions are big cities and capitals with special statuses. In other words, the local self-government in CEE countries is territorially organised at a lower level- in municipalities and communes or local communities, and at a higher level – in districts or counties. In some countries there is also an intermediate level represented by provinces or regions.

The development of local self-government in CEE countries closely correlates with the allocation of fiscal powers and competences among different levels of governance and with the fiscal decentralisation process, i.e. with the transfer of responsibilities for planning, management, taking over and distribution of resources from the central government down to the lowest level of local self-government. However, the analysis of basic fiscal decentralisation indicators shows no significant improvement in the degree of fiscal decentralisation in most of the countries. Moreover, in most of them lower levels of local self-government are heavily dependent on central government budget transfers, while their own sources of revenues (primarily own tax and non-tax revenues) are insufficient to finance all functions of the local self-government. In other words, these countries are permanently faced with the need for stronger fiscal decentralisation, which poses new challenges, primarily with respect to optimum transfer of not only tasks and obligations, but also of financial resources, to the local level of governance. This would provide a basis for a real fiscal autonomy of local self-government units.

It is for this reason that further reforms of local finance have been an almost daily topic of numerous discussions across CEE countries. In the past, the transformation process was focussed on the fiscal relationships between different levels of governance, whereas today, the reforms are focused on finding the way to increase the share of independent sources of revenues of units of local self-government and thus strengthen their autonomy and their influence on the local social and economic development in CEE countries.

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