REPORT

Fiscal Decentralization Indicators for South-East Europe

Network of Associations
of Local Authorities
of South-East Europe
(NALAS)

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Fiscal Decentralization Indicators for South-East Europe: 2006-2011

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Network of Associations
of Local Authorities
of South East Europe

This report is a collaborative effort of the NALAS Task Force on Fiscal Decentralization (TF FD)

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THE REPORT IN BRIEF:

Decentralization in South-East Europe is still a work in progress: In no country in the region do local government revenues or expenditures reach the average for the EU, either as a percentage of GDP or of total public revenues.

Over the last five years there have been few major changes in the finances or service responsibilities of local governments across South-East Europe. This suggests that the policies designed to transfer power and money to local governments that began in the late 1990s have lost steam, and in some places ground to a halt.

Part of the explanation for this loss of momentum may be structural. On the one hand, **the low population density of local governments in most of South-East Europe makes delivering public services to dispersed settlements difficult and costly**. On the other hand, the **disproportionate concentration of people, wealth, and power in the region's capital cities has impeded the development of effective equalization systems. It has also made it harder to assign local governments robust sources of own revenues.**

Throughout most of the region, unconditional grants play a relatively modest role in the financing of local governments. This is significant because it is through unconditional grants that most countries provide poorer local governments with additional revenues. The underutilization of unconditional grants raises important questions about the equity of the region's intergovernmental finance systems.

In much of the region, local governments derive significant amounts of own-revenue from quasi-fiscal instruments imposed on real-estate transactions, new investment, and business operations. In a number of places, central governments are moving to constrain these practices in order to improve the "business enabling environment". As legitimate as these efforts may be, they will decrease the already limited financial autonomy of local governments unless ways are found to replace the lost revenues.

Nowhere in South-East Europe does the Property Tax produce revenue equal to 1% of GDP, the average for the EU and property tax collection needs to be improved everywhere. At the same time, it is unrealistic to expect the Property Tax to yield anything like the revenue it does in North America or (parts of) Scandinavia (2 -3% of GDP). Moreover, achieving EU norms will not radically improve the fiscal autonomy of the region's local governments. As a result, efforts to increase the tax powers of local governments should include giving them the right to impose surcharges on the Personal Income Tax - as is already done in Montenegro and Croatia.

Local government investment spending in a number of countries in the region is well below the average for the EU, and still further below the average for the eight formerly communist countries that joined the EU in 2004. This is particularly troubling given the neglected and underdeveloped state of the costly environmental and network infrastructure that local governments have everywhere been tasked with maintaining and in most places building for the first time.

In most of the region the financial position of local governments has deteriorated over the last five years and in many 2011 was characterized by further declines in both revenues and expenditures. In a few places, the trend has been more positive. These different financial trajectories however, cannot simply be explained by the different way the global recession of 2008/09 affected the economies of the region: While the effects of the global downturn have been far from uniform, central government policies both in response to it, and more generally with respect to local governments have also differed significantly across the region.

In most of South-East Europe, local governments have not been assigned significant social sector functions. **In Romania, Bulgaria, Moldova, Macedonia and Kosovo[1], however, local governments are fully responsible for financing pre-tertiary education, including paying teachers' wages. In all of them but particularly in Bulgaria and Macedonia - there is evidence that local governments and/or schools are underfunded.** Moreover, the "block" grants that local governments receive for pre-tertiary education in most countries do not function as block grants, and in most cases remain highly earmarked.

General government debt in South-East Europe is generally well below the limits established by the Maastricht Treaty. This is good news because it means that in most places local government borrowing can be expanded significantly without threatening the Maastricht limits. **Nowhere in the region does the total outstanding debt of local governments exceed 3% of GDP or 8.5% of total public debt.** There is some evidence that local governments in Montenegro, Romania, and Serbia have turned to the debt market to make up for revenues lost during the global recession.

Local governments in South-East Europe are spending higher proportions of their income on investment than their counterparts in the EU despite receiving significantly lower shares of total public revenue. Indeed, local government investment as a percentage of GDP has in much, if not all of the region been higher over the last six years than in the EU itself. This is good news, and means that municipalities in South-East Europe are working hard to make-up for the massive infrastructure deficits they inherited from the past. Nonetheless, invest spending in some places remains low, while in others it is being driven by the spending of a handful of wealthier jurisdictions.

[1] "This designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo declaration of independence."

INTRODUCTION

This report has been prepared by the Fiscal Decentralization Task Force of the Network of Associations of Local Authorities of South-East Europe (NALAS). It is the second edition of what NALAS expects to be an ongoing effort to provide national and local policy makers, researchers, and interested outside observers with reliable comparative data on municipal finances and intergovernmental fiscal relations in South-East Europe.

The first edition of the report was published in March 2011 and covered the years 2006-2010. This edition extends the period under review through 2011, and deepens certain aspects of the analysis. In particular, more analysis has been done on local government spending and on the effects of the global recession --now complicated by uncertainty about European Union's future—on the region.

Equally importantly, significant improvements have been made in the quality of the data. Data for virtually all members is now complete for almost all years under review and errors contained in the first edition have been corrected[2] . Nonetheless, the report, like its object of analysis, is still a work in progress and over time NALAS hopes to expand and deepen it in response to the needs of both its members and interested observers.

[2] The most important of these errors were that the Croatian data on local government revenues and expenditure did not include all jurisdictions; that the data on the investment spending of Bulgarian local governments did not include spending funded by EU structural funds; and that data on total public spending in Kosovo was for the central government, and not the general government.

In particular, we expect to expand the report to include the analysis of expenditures by function, as well as to examine the horizontal equity of the region's intergovernmental finance systems. Indeed, it is important remember when reviewing the indicators contained in the report that we are as yet unable to provide reliable data about the distribution of revenues and expenditures across local governments of different sizes and types. This is problematic because as we note there is good reason to believe that in many members of the group revenues and (investment) expenditures are heavily skewed toward a few large jurisdictions, particularly capital cities.

Nonetheless, the report provides a reliable snap shot of the structure, functions, and financing of local governments in South-East Europe today, as well as an overview of how intergovernmental financial relations have evolved over the economically turbulent period 2006-2011. It is our expectation that the report will be useful to NALAS' member associations, as well as to the more general policy community by providing all concerned with reliable data on the role of municipal governments in region, as well in comparison with their counterparts in the EU.

The report is divided into four sections. It begins with a brief discussion of the data and some of the methodological issues surrounding its use and interpretation. It then presents basic information about the size and structure of municipal governments in South-East Europe, as well a few key macro-economic indicators. The report continues by examining the composition of local government revenues and expenditures and concludes with a few observations about trends over the last six years.

1 DATA, TERMS, AND METHODOLOGICAL ISSUES

The data used in this report has been provided by NALAS member associations in response to a questionnaire. Member associations assembled the data from their respective Ministries of Finance, Central Banks and Statistical Agencies. The data was then checked for consistency and, where possible, compared with similar data from other sources including Eurostat, the statistical agency of the European Union; the IMF's data base on Government Finance Statistics, and the OECD's data base on tax revenues by level of government. Comparative data on local governments in EU member states has been drawn from Eurostat and from a series of publications put out by DEXIA bank.[3]

Comparing intergovernmental finance systems is never easy. The most important reason for this is that countries assign different public sector responsibilities and different public revenues to different levels of government. As a result, both what sub-sovereign governments do, and how they pay for it, varies substantially from country to country. Unfortunately, these differences cannot be easily distinguished simply by reading the relevant legislation. In part, this is because the regulatory regimes governing local governments are always complicated and idiosyncratic. And in part, it is because actual practice often differs substantially from what is specified in law. There is also still considerable variation in the accounting systems that national governments use to define and report public sector revenues and expenditures.

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Taken together, these problems mean that it is often difficult to be sure that apples are being compared to apples or that the rulers that are being used to measure performance are based on the same metrics. Finally, in many places the data itself is problematic. Below, we briefly outline some of these issues, while leaving others for greater discussion in what follows.

Levels of Government: In this report, we are primarily concerned with the lowest level of sub-sovereign governance, meaning democratically-elected municipal or communal governments. In virtually all of South-East Europe, democratically-elected municipal governments constitute the most important level of sub-sovereign governance, particularly when measured in fiscal terms[4] . For reasons of convenience we refer to both communal and municipal government as municipal governments or local governments, though this term masks the fact that many "municipal governments" are in fact villages of a few thousand souls. Unless otherwise indicated, all data used in the report refers to this lowest level (1st Tier) of democratically-elected governance.

[3] Local Government Finance in the fifteen countries of the European Union, Dexia (Brussels-Paris, 1997), "L'Europe locale et regional: les Chiffres Cles 2009", Dexia/CEMR (Brussels-Paris, edition 2010-2011) pp. 1-19. "Subnational public finance in the European Union", Dexia, July 2011 pp. 1-15; "Subnational public finance in the European Union", Dexia, Summer 2012 pp. 1-36

[4] The exception is Bosnia-Herzegovina.

What Municipal Governments Do: Throughout South-East Europe, municipal or communal governments bear primary responsibility for maintaining and improving local public infrastructure, including local streets, roads, bridges, and parks. Many are also responsible for school buildings. The vast majority of them finance and manage water supply and sewage treatment, garbage collection and disposal, public lighting, local public transport, and district heating. Most importantly, from a financial point of view, local governments must pay for the costs of building new (network) infrastructure, infrastructure that almost everywhere has been neglected or underfunded for decades. Indeed, in many places it has never existed[5].

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In some places, however services like water supply and sewage treatment are provided through commercialized entities that are "off-budget" and at least in theory support themselves through user fees and charges. In others, some or all of these services are provided by in-house municipal departments that also collect user fees and charges, but whose revenues and expenditures are considered part of municipal budgets. In most of the region, the sub-contracting of public services to private providers remains in its infancy, though there are exceptions in the areas of solid waste collection and local public transport.

With some important exceptions, most municipal governments are not responsible for financing or managing social sector services. The important exceptions concern places where local governments are responsible for some or all of pre-tertiary education and/or for the provision of primary health care services. Where this is the case, it is indicated in the discussion that follows.

Population: The population numbers used in this report are based on the last official census, or lacking an official census, the numbers used by the relevant statistical agencies. In a number of places (e.g. Albania, Kosovo[6]), censuses have recently been conducted but their results have yet to be finalized. In others, they are planned for the near future (e.g. BiH). The new censuses throughout SEE can be expected to produce technical challenges and political tensions. This is because there will be significant differences between the population numbers currently used to allocate intergovernmental grants and transfers and the ones that result from the new censuses.[7]

[5] In most of the countries of the region, the number of waste water treatment facilities and landfills capable of meeting EU norms can be counted on one hand.

[6] "This designation is without prejudice to positions on status, and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo declaration of independence."

[7] For example, the still to be finalized census in Kosovo suggests that the population is 15% to 20% less than is currently assumed and that a disproportionate share of the current overestimation is concentrated in Pristina. A similar phenomenon also seems to be characteristic of Albania and Tirana, where the results of the census also remain to be finalized.

GDP: The GDP numbers used in this report are those calculated by their respective Ministries of Finance according to the production method. They have been converted, where necessary, into Euro by using the average annual exchange rate for the year concerned. Tables and charts that compare trends over time across members of the group have been calculated on the basis of euro values using average exchange rates provided by the relevant Central Banks. In some cases, GDP and/or average exchange rate figures have been revised since the publication of the first edition of the report. We do not, however, discuss these revisions unless they substantially change the overall picture.

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Consolidated Public Revenue of the General Government: To compare the role of local governments in the public sectors of their respective national settings we have used their revenues as a share of the total revenues of the General Government. We have used revenues instead of expenditures because the data for these tend to be more available and more reliable. By General Government we mean the total revenues of the national government and its agencies, including the revenues of off-budget (social security) funds, as well as the revenues of subnational governments. In calculating total local government revenue we have excluded proceeds from borrowing, but included income from asset sales and carry-overs from previous years, despite the fact that in an ideal world they would be accounted for separately.

General Grants: In most of the South-East Europe local governments receive freely disposable general grants from their respective central governments. In some places, the size of unconditional grant pools are defined as percentages of particular central government tax revenues. On occasion, this has led to confusion about whether these revenues should be considered shared taxes or general grants. To the degree that these funds are allocated to subnational governments by formula – as opposed to being shared on the basis of their origin – we treat them as general grants.

Conditional and Block Grants: To compare the role of local governments in the public sectors of their respective national settings we have used their revenues as a share of the total revenues of the General Government. We have used revenues instead of expenditures because the data for these tend to be more available and more reliable. By General Government we mean the total revenues of the national government and its agencies, including the revenues of off-budget (social security) funds, as well as the revenues of subnational governments. In calculating total local government revenue we have excluded proceeds from borrowing, but included income from asset sales and carry-overs from previous years, despite the fact that in an ideal world they would be accounted for separately.

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Shared Taxes: In most of the region, local governments are legally entitled to a share of particular taxes generated in their jurisdictions but whose base, rates, and collection are controlled by higher-level governments. The most important tax shared with local governments in South-East Europe is the Personal Income Tax (PIT). The Property Transfer Tax, a tax imposed on the sale price of real-estate, is also often shared (in whole or in part) with local governments. In a few places, the recurrent Property Tax is also a shared with local governments, though in most it is a local government own-revenue.

The "block" function of block grants remains very limited

Own-Source Revenues: Throughout the world data on the own-source revenues of local governments is weak because countries often do a poor job collecting this information and because they classify it in different and inconsistent ways. This is particularly true in South-East Europe.

In theory, local own-source revenues consist of revenues from the sale or rental of municipal assets; income from fines, penalties, and interest; user fees and charges; permits and licenses; and local taxes. In practice, however, the lines between user fees and charges, licenses and permits, and local taxes are often blurry. In many places, local user fees and taxes --though collected by local governments-- are fully specified by higher level governments and really should be considered shared revenues.

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In others, *de facto*, if not necessarily *de jure* regulation of local fees and charges is weak, allowing local governments to use local fees, charges, permits and licenses as (poorly regulated) quasi-taxes. In a number of places, these practices are being challenged by higher level governments as part of larger efforts to improve the business enabling environment. These efforts could lead to significant declines in municipal own-source revenues over the coming years.

In a few places, higher level governments set and collect the Property Transfer Tax, but this tax is (incorrectly) considered own-source revenue because a 100% of its yield is returned to local governments on an origin basis. Finally, local governments in Montenegro and Croatia are allowed to impose local surcharges on the Personal Income Tax. The revenue from these surcharges should be considered as an own-revenue. Unfortunately, however, only Montenegro does this, while in Croatia - where the surcharge is more important revenue - it is reported with the income that local governments receive from the larger PIT sharing system.

2 GENERAL OVERVIEW OF LOCAL GOVERNMENTS IN SOUTH EAST EUROPE

Number and type of sub-sovereign levels of governance

Table 1 below presents the number and type of sub-sovereign governments where NALAS members operate. Bosnia-Hercegovina (BiH) has three levels of government: 1) two entities, Republika Srpska (RS of BIH) and the Federation of Bosnia-Herzegovina (FBiH of BiH) as well as the District of Brcko; 2) cantons in the FBiH (of BiH); and 3) municipalities in both FBiH and the RS. In FBiH (of BiH), cantons are responsible for many public services, and the entity government is relatively small.

In this report, the revenues and expenditures of canton level governments are not included in the revenue figures for *local governments* for either BiH or the Federation. They are however included in the figures for total public revenues and expenditure in both BiH and the Federation. As NALAS has member associations from both entities, the data for Bosnia and Herzegovina is analyzed separately for each entity. This approach provides both NALAS members with valuable information for their analytical and lobbying purposes.

TABLE 1

	NALAS MEMBER	LEVELS OF SUB-SOVEREIGN GOVERNMENT	TYPES OF SUB-SOVEREIGN GOVERNMENT	# OF 1ST TIER
ALBANIA	AAM	2	Counties; Municipalities/Communes	373
BOSNIA HERCEGOVINA		3	Entities; Cantons; Municipalities	143
FBIH	SOGFBIH	2	Cantons; Municipalities, (Neighborhood Units)	80
RS	ALVRS	1	Municipalities(Neighborhood Units)	63
BULGARIA	NAMRB	1	Municipalities/ Communes	264
CROATIA	UORH	2	Counties; Municipalities/Communes	556
KOSOVO*	AKM	1	Municipalities	38
MACEDONIA	ZELS	1	Municipalities (Neighborhood Units)	85
MOLDOVA	CALM	2	Raions/regions; Municipalities/Communes	898
MONTENEGRO	UMMo	1	Municipalities	21
ROMANIA	FALR, ACoR	2	Counties; Municipalities/ Communes	3181
SERBIA	STCM	2	Autonomous Provinces; Municipalities (Neighborhood Units)	145
SLOVENIA	SOG	1	Municipalities	211
TURKEY	UMMa	4	Special Provincial Administrations; Metropolitan municipalities; District municipalities; Communes	2854

Albania and Croatia both have county levels of government (Qarks; Zupanije). In Albania, the role of Qarks is extremely limited. In Croatia, Zupanije are somewhat more important, but still play a very limited role in the delivery of public services. Moldova has two levels of sub-sovereign government: raions/regions and communes/ municipalities. The heads of raions are appointed by the national government, and exercise significant control over the budgets of (democratically-elected) municipalities and communes. The power of the raion heads blurs the distinction of between first and second-tier governments in Moldova, as well as the distinction between local self-governments and territorial arms of the national government[9]. In the report, the financial data for local governments in Albania, Croatia, and Moldova includes the revenues and expenditures of second-tier of local governments. Serbia has two levels of sub-sovereign governance autonomous provinces and municipalities. The financial data in the report however is only for municipalities.

According to law, Romania has two levels of sub-sovereign government reons and communes on the one hand and towns and judets and big cities on the other. The second tier level plays a more important role in the delivery of public services than its counterparts in Albania or Croatia. Nonetheless, the more important level of sub-national government in both fiscal and public service terms remains municipalities, big cities and communes.

Turkey has four levels of sub-sovereign government. Three of them – communes, district municipalities, and metropolitan municipalities-- can be considered first tier local governments. There are, however, more significant differences in their rights and responsibilities. Turkey also has 81 democratically-elected Special Provincial Administrations, that exist alongside the territorial arms of the national government at regional level and which deliver some public services, particularly in rural areas. As with Albania, Croatia, and Moldova, the data in the report for Romania and Turkey includes the revenues and expenditures of these second tier local governments[10].

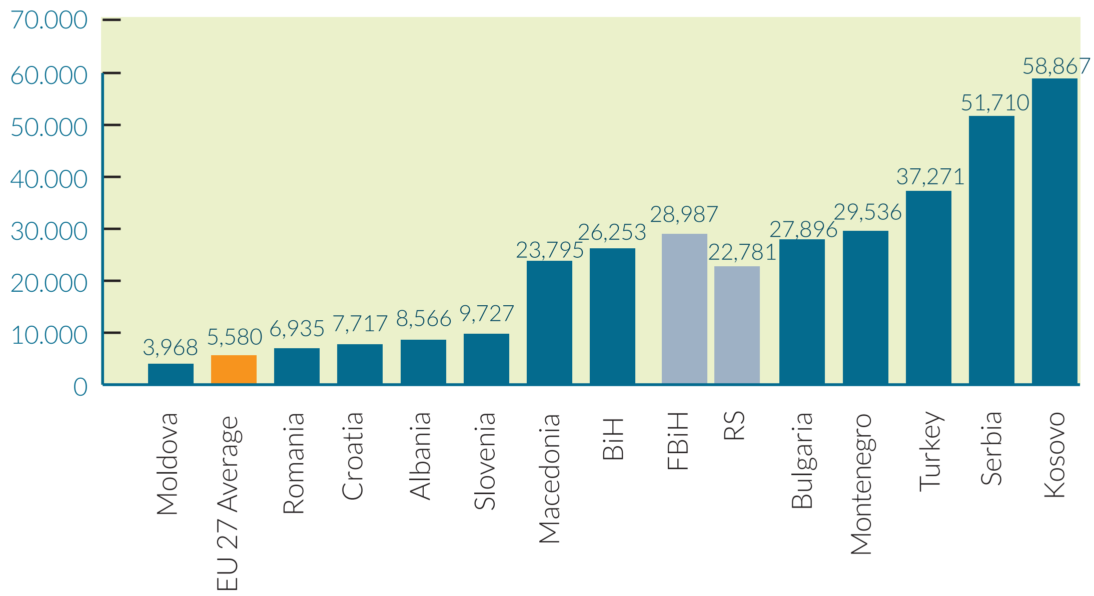
As can be seen from Chart 1, there is considerable variation in the average size of 1st Tier local governments across South-East Europe.

[9] Moldova also has an autonomous province –Gaugazia.

[10] At the time of this writing, Turkey was considering substantially increasing the number of metropolitan municipalities.

Chart 1

Average Population of 1st Tier Local Governments



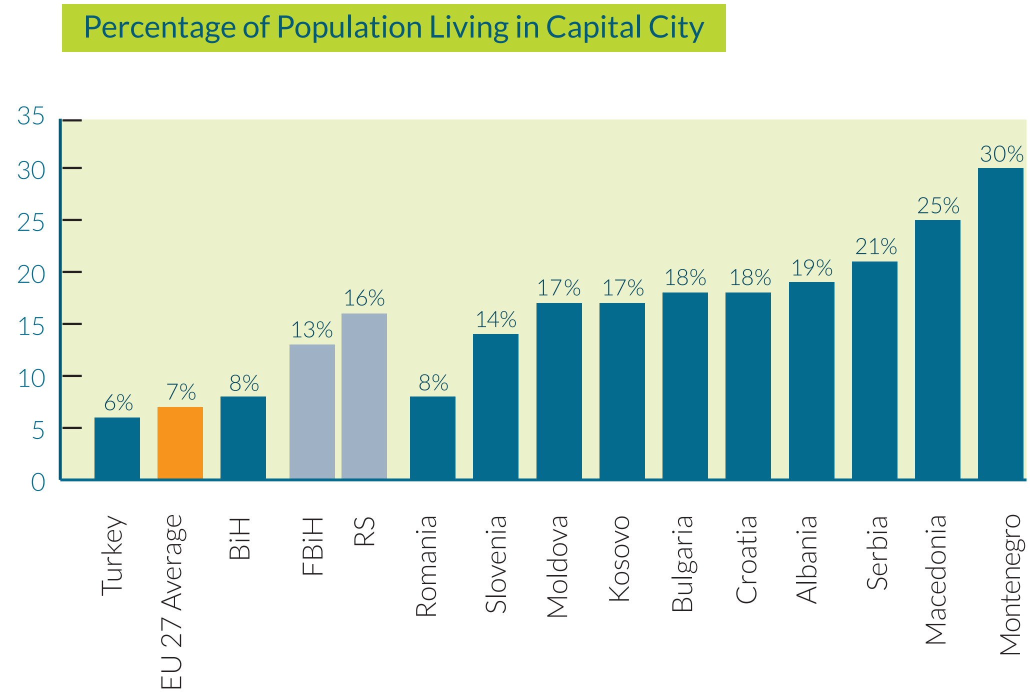
Moldova has the most fragmented system of 1st tier local governments with an average population of less than 4000 inhabitants. Municipal governments in Romania, Croatia, Albania and Slovenia are also relatively small, averaging less than 10,000 inhabitants. The small size of first tier local governments in these places presents obstacles to decentralization because small jurisdictions often have weak tax bases and lack the human capital necessary to reasonably support major public services. Nonetheless, what is unusual about the Chart is the relatively large size of local governments in the region when compared to those in the EU. Indeed, Macedonia, BiH, Bulgaria, Montenegro, Turkey, Serbia and Kosovo all have municipal governments with average populations of greater than 20,000 inhabitants whereas within the EU only 9 (of 27) countries (including Bulgaria) have municipal governments that are similarly large (Denmark 56,345; Greece –since 2010—34,650; Ireland, 39,190; Lithuania, 55,655; Netherlands, 38,435; Portugal, 34,520; Sweden, 32,210; UK, 152,200)[11].

One reason for the relatively large size of municipal governments in South-East Europe is the high percentage of people living in capital cities. As can be seen from Chart 2 below, most members of the group have significantly higher shares of their populations living in their capital cities than is the average for the EU. Indeed, within the EU only 7 countries have capital cities whose population represent more than 15% of their total populations (Vienna, 21%; Sophia, 17%; Nicosia, 22%; Tallinn, 34%; Budapest, 17%; Riga, 32%; and Vilnius, 17%).

[11] Dexia 2009

Population Distribution and Density

Chart 2



The relatively large size of capital cities In South-East Europe means that tax bases tend to be skewed toward one major urban area. This can create technical and political impediments to decentralization. Technically, it can be difficult to assign local governments robust own-revenues or to create good equalization mechanisms when so much of the economy is concentrated around one major metropolitan center. Politically, it can make the implementation of equalization measures difficult because they frequently create conflicts between the capital city and all other jurisdictions.

Chart 3 shows the average population densities of first-tier local governments in the region, while Chart 4 shows their average area in square kilometers. With the exception of Kosovo (whose population density is on par with Italy's), all members of the group have population densities below the EU average. At the same time, the average area of local governments is significantly larger than in the EU. Thus, municipal governments in South-East Europe have, on average, higher populations (Chart 1) and larger areas than their European

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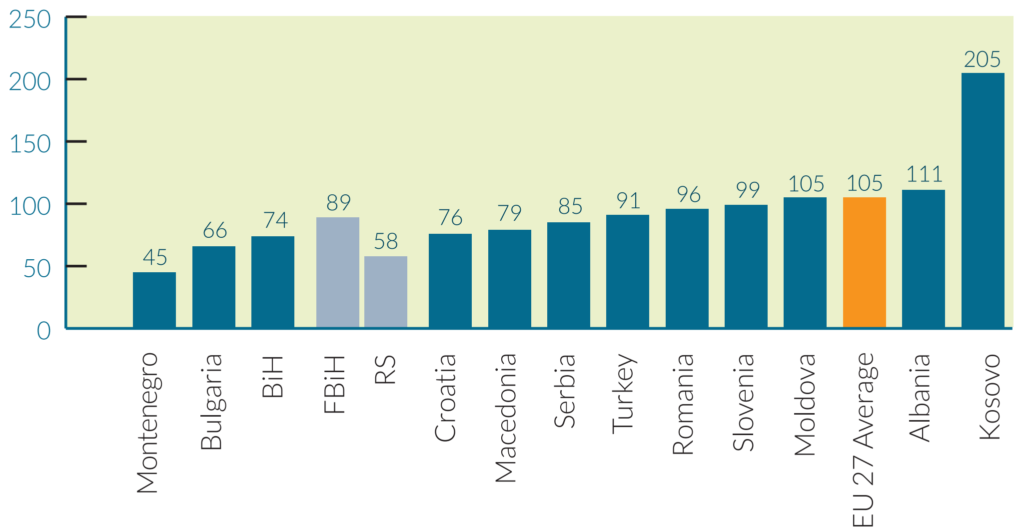
counterparts, but lower population densities. Low population densities mean that municipalities have to provide public services to populations that are dispersed over wider areas[12]. This can also complicate decentralization efforts because delivering public services to dispersed populations is harder and more costly than delivering them to populations living in concentrated settlements.

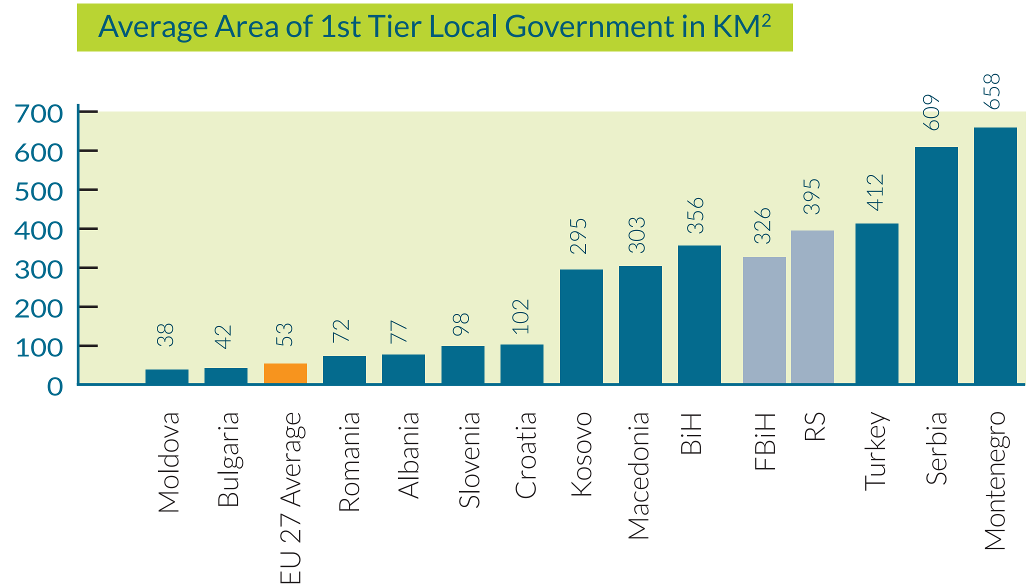
Chart 3

Population Density per KM



[12] It is possible to have highly concentrated settlements within jurisdictions that have large territories and thus low population densities. This, however, is not generally the case.

Chart 4



The Dynamics of the Gross Domestic Product

Chart 5 presents the GDP per capita for all members of the group in 2010. As can be seen from the Chart, there are very significant variations in the relative wealth of the members of the group. Slovenia is by far the richest, with GDP per capita of 17,363 euro. It is followed by Croatia (10,894), Turkey (7,519) and then Romania (5,995). Moldova is the poorest of the group with a capita GDP under 1500 euro. It is followed by Kosovo whose GDP per capita just broke the 2000 euro this year. All other members of the group have per capita GDPs of between c. 3000 and 5,300 euro.

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Chart 5

GDP Per Capita in Euro in 2011

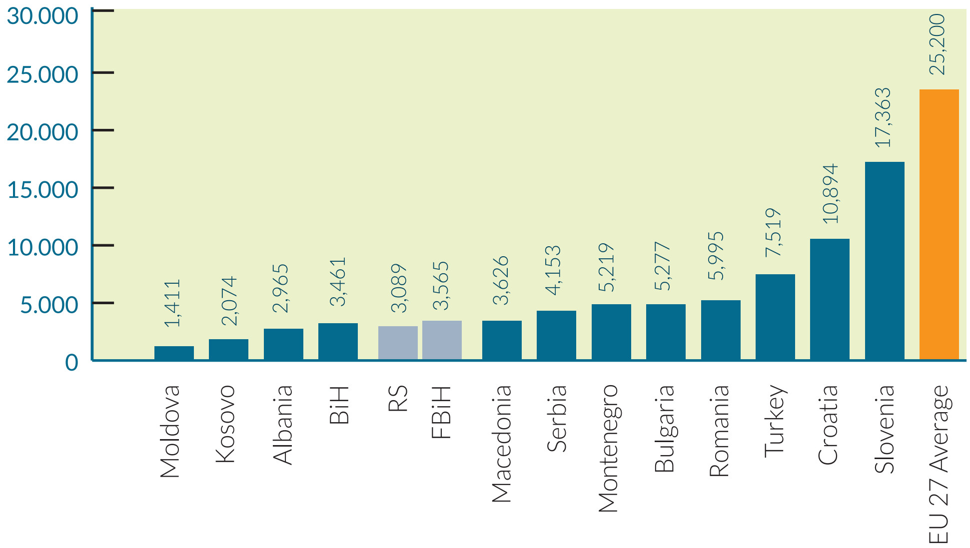
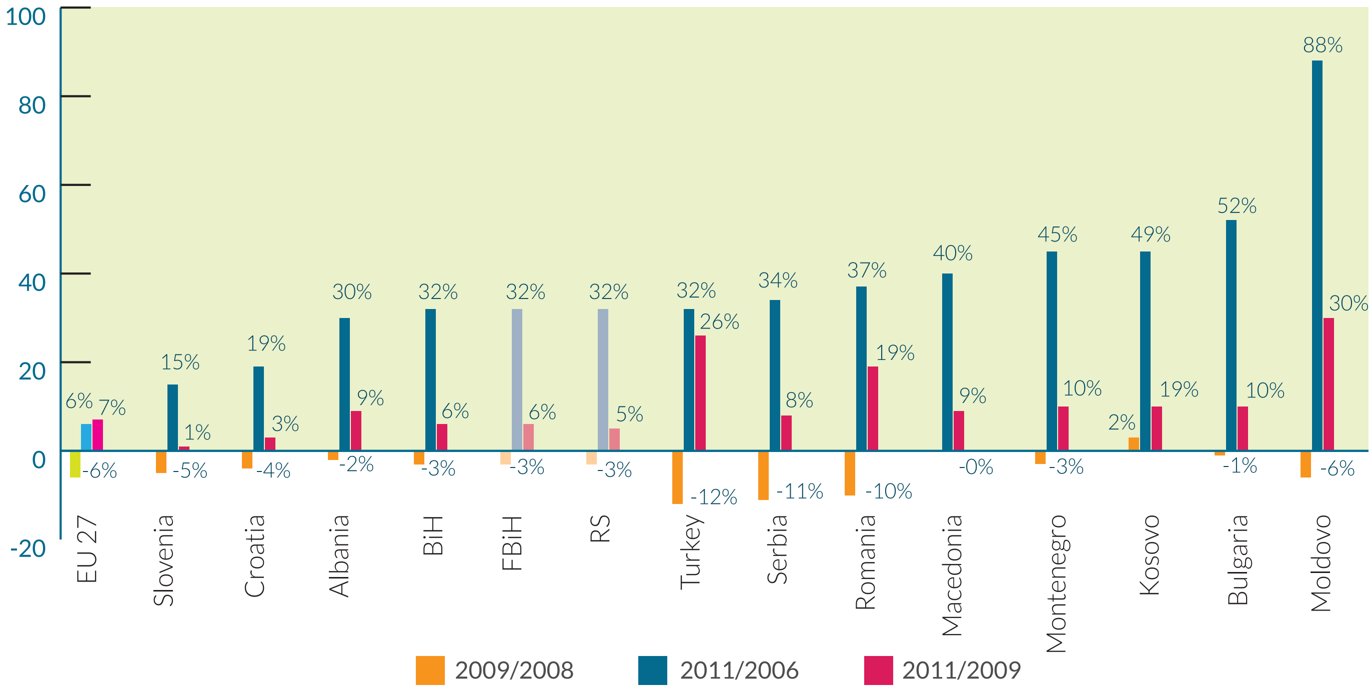


Chart 6, shows the growth of GDP per capita (in euro terms) between 2006 and 2011, the effect of 2009 global recession and the relative strength of the recovery since 2009. GDP growth has been fastest in Moldova. But this growth has come off a very low base. Bulgaria, Kosovo, Montenegro, and Macedonia have all grown 40% or more over the last six years, in part because they experienced relatively mild downturns in 2009, and in part because growth since has been relatively robust. Meanwhile, Albania, Bosnia- Herzegovina, Turkey, Serbia, and Romania all grew by between 30 and 40% over the last six years. Finally, the growth rates of Slovenia and Croatia were well under half those of the rest of the group, but more than double those for the EU as a whole.

Chart 6

GDP Growth 2006-2011; the 2009 Recession; and Recovery



As can be seen from the Chart, the 2009 recession had very different effects on the economies of different members of the group. Kosovo, Macedonia and Bulgaria felt the crisis least. Indeed, Kosovo actually grew in 2009. But Croatia and Slovenia experienced contractions larger than 3% and the economies of Turkey, Serbia and Romania all shrunk by 10% or more. The Turkish, Romanian and Moldovan economies, however all rebounded vigorously in 2010 and 2011 while the economies of Slovenia and Croatia have recovered the least quickly, expanding at rates well under those for the EU. In short, while there is some evidence for saying that many of the countries in the region seemed to have been spared the full brunt of the crisis precisely because of their lack of integration in the world economy, their different trajectories both before and after underscore the fact that economically speaking we are dealing with a quite heterogeneous group.

Basic Indicators of Fiscal Decentralization

The share of local public revenues (or expenditures) in a country's GDP is the single most telling indicator of fiscal decentralization because it expresses the size of the local government sector in relation to a country's total economic activity. The second most important indicator of fiscal decentralization is the share of local public revenues (or expenditures) in the consolidated public revenues (or expenditures) of the General Government. This indicator tells us how large a role local governments play in the overall governance structure of a country.

To put these indicators in comparative perspective we also need to know how large the total public sector is in relation to the GDP, as well as something about what public services local governments are responsible for. If the size of the total public sector in a country is small, it is unlikely that local government revenues will represent a significant share of the GDP. They may, however, represent a substantial share of total public revenues. Such a situation would suggest that all levels of government have trouble collecting taxes, but that the national government is treating local governments relatively fairly. Conversely, a situation in which the public sector is large, but local government revenues are low in relation to both the GDP and total public revenues would suggest that local governments are not taken very seriously by higher-level governments as partners in the delivery of public services.

To make reasonable comparative judgments about the status of local governments in South-East Europe we also need to understand what public services they are legally responsible for delivering. Fully inventorying these functions however is difficult. In part, this is because the legal regimes governing local governments across the region are both different and complex. In part, it is because in practice service responsibilities can differ quite substantially from what is specified in the law. And in part it is because many local governments may not have the revenues to provide the services they are responsible for.

Nonetheless, when looking at local government revenues (or expenditures) in relationship to the GDP, or to the size of the total public sector, some service responsibilities are so large that they become "game changers" if they have been assigned to local governments. Here we have in mind social sector services such as health, education, and social welfare. Of particular importance in this respect is whether local governments are responsible for paying teachers wages. The reason for this is because the wages of primary and secondary school teachers typically constitute one of a country's largest public expenditures, amounting to 3-5% of GDP.

Table 2 presents an overview of the social sector functions that have been assigned to local governments in the region. As can be seen from the Table, Romania, Kosovo, Macedonia, Bulgaria and Moldova are fully responsible for all the costs of pre-tertiary education, including the cost of teacher's wages. In Kosovo local governments also maintain primary health care clinics and pay the wages of the doctors and nurses who work in them. Meanwhile in Romania, local governments are responsible for the non-wage costs of primary and secondary health care. By all rights, local governments that have been assigned these social sector functions should have higher revenues both as a share of GDP and of total public revenues, than other members of the group.

TABLE 2 Social Sector Functions of 1st Tier Local Governments

	PRESCHOOLS		PRIMARY SCHOOLS		SECONDARY SCHOOLS		PRIMARY HEALTH		SECONDARY HEALTH	
	Buildings	Wages	Buildings	Wages	Buildings	Wages	Buildings	Wages	Buildings	Wages
KOSOVO	X	X	X	X	X	X	X	X		
ROMANIA	X	X	X	X	X	X	X		X	
MACEDONIA	X	X	X	X	X	X				
BULGARIA	X	X	X	X	X	X				
MOLDOVA	X	X	X	X	X	X				
SERBIA	X	X	X		X		X			
SLOVENIA	X	X	X				X			
CROATIA	X	X								
ALBANIA	X		X		X		X			
FBIH (BIH)	X		X							
RS (BIH)					X		X			
MONTENEGRO										
TURKEY										

At the other end of the spectrum, local governments in Albania, FBiH (of BiH), RS (of BIH), Montenegro and Turkey do not pay the wage costs of any social sector employees. Indeed, in Montenegro and Turkey they have no responsibilities in either health or education. So by all rights, local government revenues as both a share of GDP and of total public revenues should be lower here than elsewhere.

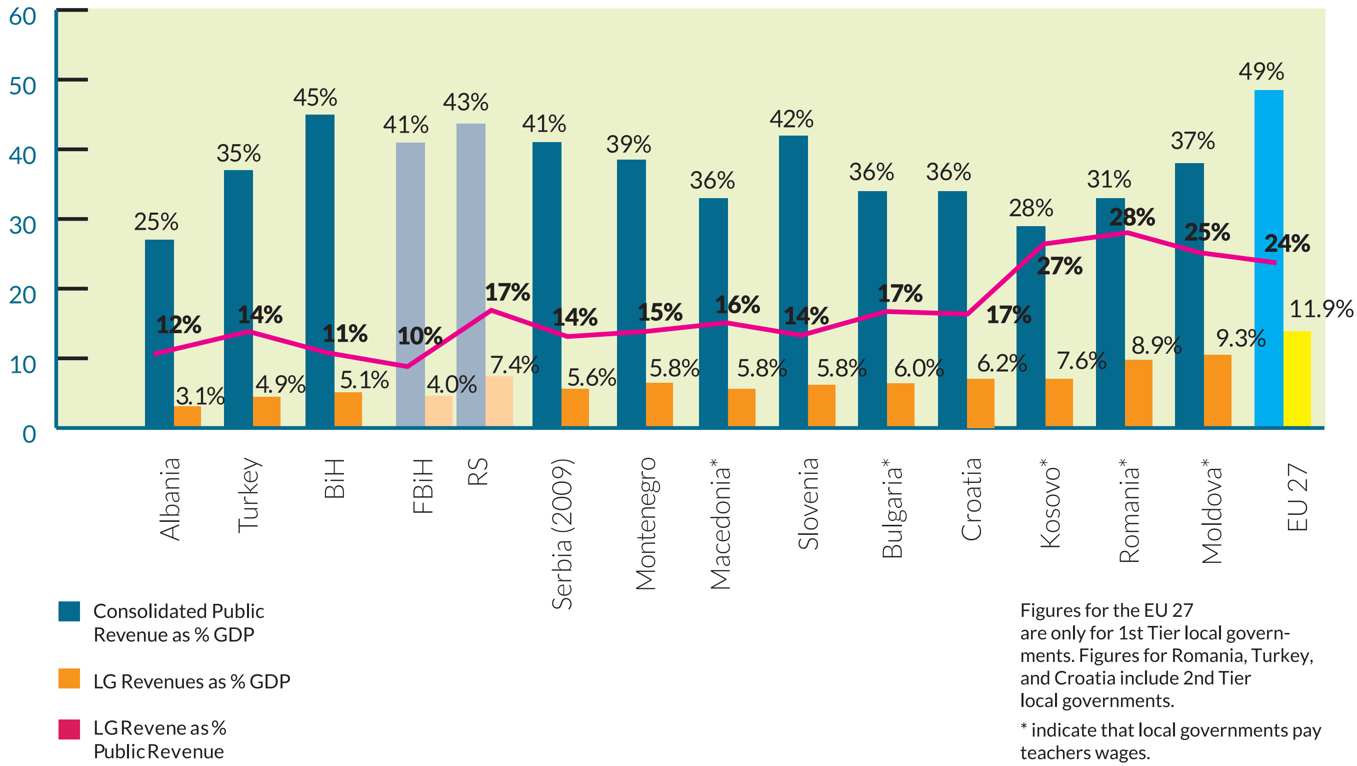
Local Governments Revenues in South-East Europe

With these conditions in mind we can now turn to Chart 7, which shows local government revenues as a share of both total public revenues and as GDP for all members of the group, as well as the average for the EU. Here, it should be noted that the figures for the EU are only for first-tier local governments while the figures for Romania, Turkey, Moldova, and Croatia, include second-tier governments. The most important thing that can be seen from the Chart is that on average local governments in the EU play a much more substantial role in their respective public sectors than do local governments within the NALAS group. Indeed, it is fair to say that in most of South-East Europe decentralization is still very much a work in progress.

In most of South-East Europe decentralization is still a work in progress

It should also be clear that the size of the public sector as a percentage of GDP in virtually all members of the group is substantially below the average for the EU. Indeed, in a number of places total public revenues represent less than 35% of GDP, suggesting both weak economies and poor tax collection.

Chart 7 Local Government Revenue as Share of GDP and Total Public Revenue in 2011



Figures for the EU 27 are only for 1st Tier local governments. Figures for Romania, Turkey, and Croatia include 2nd Tier local governments.

* indicate that local governments pay teachers wages.

Here, local government revenues as a percentage of GDP are likely to be lower than one might expect simply because the entire public sector has difficulties in collecting the taxes needed to pay for public services.

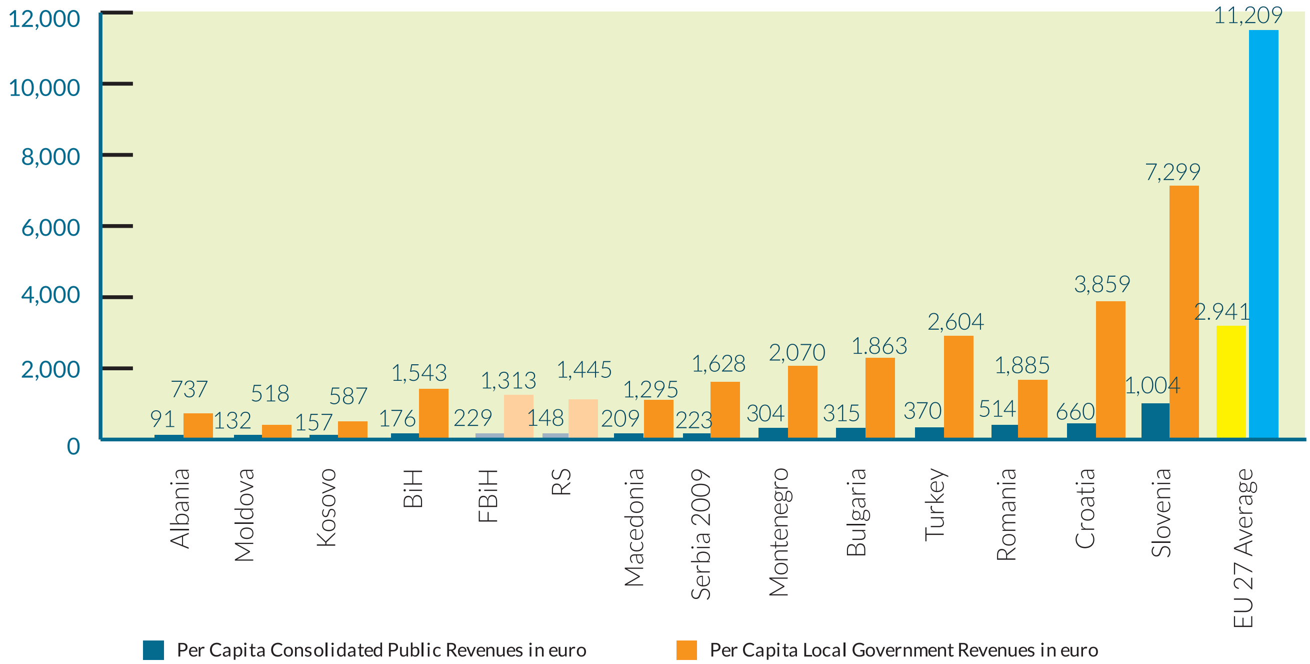
Even more surprising is that Macedonia, Bulgaria, Kosovo, Romania and Moldova do not look radically different from other members of the group despite the fact that their local governments pay for the full costs of pre-tertiary education. Moreover, in Kosovo and Romania they also pay for much of the costs of the health care system as well. Macedonia and Bulgaria are particularly surprising in this respect: total local government revenues are respectively 5.8% and 6.0% of GDP, levels similar to many others in the group despite the fact that about half of these shares go to teacher wages. As a result, it appears that in Macedonia and Bulgaria local governments and/or pre-tertiary education is seriously underfunded. Conversely, local governments in the RS (of BiH) seem to be getting a relatively high share of GDP (7.4%) when one considers the fact that they are responsible for virtually no social sector functions.

As can be seen from the Chart, all members of the group have public sectors that are significantly smaller than the average for the EU as a whole, and that in many total public revenues are equal to well under 40% of the GDP. This suggests tax collection is weak throughout the region. But despite this general weakness, some central governments are treating their local governments better than others. For example, the size of the total public sectors of Macedonia, Bulgaria, Kosovo, Romania and Moldova are similar, and in all local governments are responsible for paying teachers wages. Nonetheless, local governments in Romania, Kosovo and Moldova all receive just under 30% of total public revenue (close to EU norms), while in Bulgaria and Macedonia they get well under 20%. This suggests that the central governments of Romania, Moldova and Kosovo are trying harder than their counterparts in Bulgaria and Macedonia to provide municipalities with the revenues they need to support the functions they have been assigned.

Another surprising result is the relatively small share of both GDP and total public revenues that local governments in the three wealthiest countries of the group -Slovenia, Croatia, and Turkey - receive. Here, decentralization has not progressed very far despite the relative wealth of these countries.

Chart 8 shows the per capita revenues of the consolidated public sector and of local governments in euro in 2010. The Chart is a useful reminder of how profoundly the resources available to the public sector differ both within the group and when compared with the countries of the European Union.

Chart 8 Consolidated Public Revenue and Local Government Revenue Per capita in Euro in 2011



Indeed, it is striking that local governments in Moldova, Kosovo and Macedonia -three of the poorest in the group-- are not only paying for basic services with per capita revenue of less than 200 euros but also teacher wages. So if decentralization has not progressed very far among the relatively wealthy, it has been pushed farthest among the poorest. This suggest that at least in some cases, decentralization has been driven less by a desire to empower local governments to deliver public service of reasonable quality, than by the desire of central governments to relieve themselves of the responsibility for reasonably financing them.

If decentralization has not progressed very far among the relatively wealthy, it has been pushed farthest among the poorest. This suggests that at least in some cases decentralization has been driven less by a desire to empower local governments to deliver public services, than by the desire of central governments to relieve themselves of the responsibility to reasonably finance them.

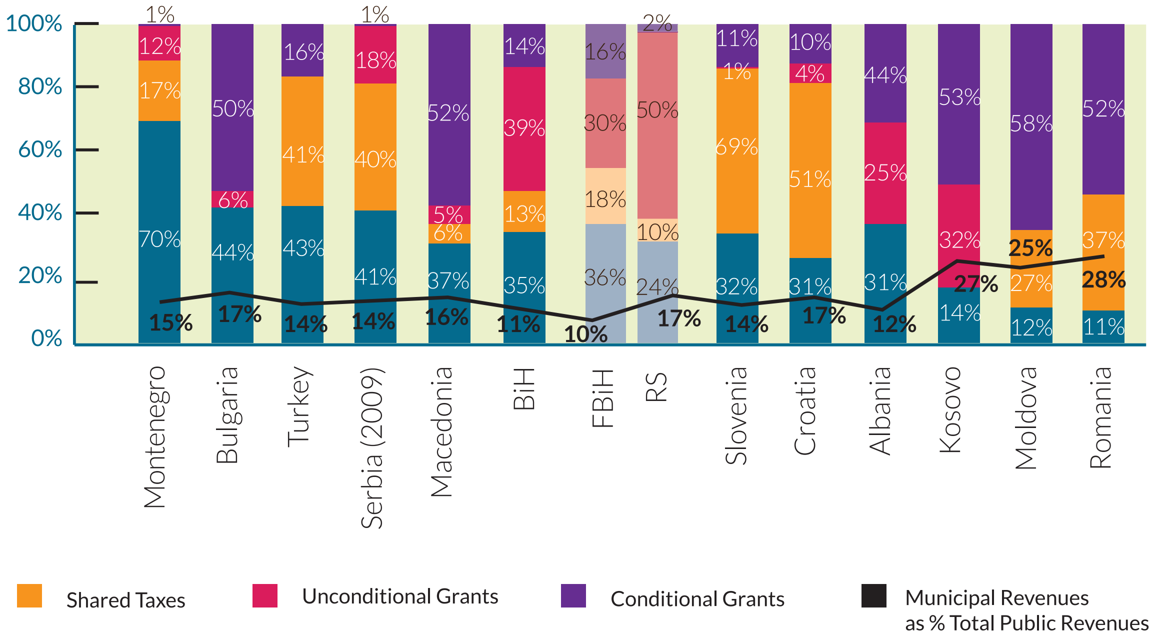
The Chart is also useful when read in conjunction with Chart 7. For example, Bulgarian local governments have per capita revenues similar to those of their Montenegrin counterparts. But they pay teachers' wage while the Montenegrins do not. Meanwhile, municipalities in the RS (BIH) have significantly higher per capita revenues than their counterparts in FBiH (BiH) despite the fact that both sets of local governments are responsible for the same functions and total public revenues per capita in FBiH (BiH) are higher than in the RS (BIH).

Basic Composition of Local Government Revenues

Chart 9 shows the basic composition of local government revenues for members of the group in 2011. Unfortunately, it is difficult to get comparable information for EU countries as a whole. One reason for this is that the data often presents shared taxes as own-revenues or grants. Sometimes, however, the opposite is true, and own-revenues from local surcharges on PIT are presented as shared taxes. In fact, both problems –as well as others—create problems for interpreting the data for the region.

Chart 9

Composition of Local Government Revenues in 2011



For example, in Turkey a number of shared taxes are pooled and returned to local governments in part on an origin basis, and in part as an unconditional grant that is allocated by formula. But one cannot determine from the data how much of the shared taxes are really grants. Similarly, the equalization system in Slovenia gives additional increments of PIT to poorer jurisdictions. The revenue from these additional PIT increments functions like equalization "grants", but again cannot be distinguished from shared taxes. Conversely, in Croatia, local governments are allowed to impose local surcharges on PIT. These revenues should be considered own-revenues and not --as shown in the Chart-- shared taxes. Finally, as we have discussed earlier, many of the revenues that are typically considered own-revenues are in fact fees and charges set by higher-level governments (and sometimes collected by them) but whose yield goes entirely to local governments and are thus considered (incorrectly) as local government own-revenue.

Financial Independence of Local Governments

Nonetheless, the Chart does provide some basic information about how much financial independence local governments have. For example, in Bulgaria, Kosovo, Macedonia, Moldova and Romania the financial autonomy of local governments is limited because they receive more than 50% of their revenues from conditional grants. This can be explained by the fact that here municipalities are responsible for delivering social sector services and their central governments want to insure that money intended for education actually gets spent on it. In Albania however, the situation is more problematic. Here, local governments get close to 45% of their revenues in conditional grants, despite the fact that they provide no social sector services.

Conversely, local governments in Montenegro receive virtually no conditional grants from the central government, and have very high levels of own-revenue. Indeed, the share of own-revenue in Montenegro is about double what the average for EU countries would probably look like if we had reliable data. This is possible in Montenegro because local governments have been collecting very significant own-revenues from asset sales and rentals, and from land development fees. As in Croatia, they also have the right to impose a local surcharge on PIT. Unlike in Croatia however, revenue from this source is (correctly) accounted for not as a shared tax, but as an own-revenue.

More generally, it is interesting to note that only **Albania, Kosovo, and Bulgaria make no use of PIT sharing, while Macedonia makes extremely limited use of it. This is surprising since the origin based sharing of PIT is not only clearly popular in the region, but has formed a critical pillar of the intergovernmental finance systems of virtually all the post-communist countries that joined the EU in 2004**. Perhaps more importantly, local governments in Turkey, Slovenia, Croatia, Moldova, and Romania receive no income from unconditional grants while in Macedonia, Montenegro, and Bulgaria they account for less than 10% of total revenue. The low share of unconditional grants in total revenue raises questions about the equity of these intergovernmental finances systems because it is generally through unconditional grants that central governments provide additional revenues to poorer jurisdictions. Nonetheless, unconditional grants can be allocated in many ways and their simple existence in a system should not be taken to mean that they are being used to redistribute national income. Moreover, and as we have already mentioned both Turkey and Slovenia do at least some equalization through other mechanisms.

The low share of unconditional grants in total revenue raises questions about the equity of these intergovernmental finances systems because it is generally through unconditional grants that central governments provide additional revenues to poorer jurisdictions.

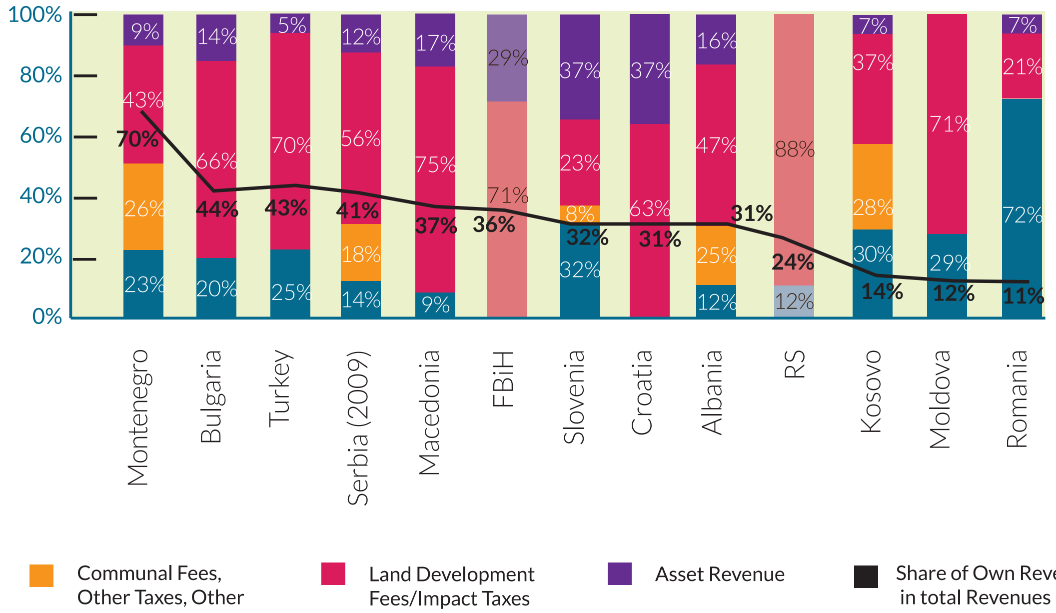
Table 3 simplifies the information presented in Chart 9 by showing the share of own source revenues in total revenues for members of the group who pay teachers wages and those who don't.

TABLE 3 Ratio of Own-Source Revenue to Total Revenue (2011)

PAY TEACHERS WAGES	**Bulgaria**	**Macedonia**	**Moldova**	**Kosovo**	**Romania**				
	0.43	0.31	0.10	0.18	0.10				
DO NOT PAY TEACHERS WAGES	**Montenegro**	**Turkey**	**Serbia**	**BiH**	**FBiH**	**RS**	**Albania**	**Slovenia**	**Croatia**
	0.79	0.43	0.41	0.35	0.37	0.31	0.37	0.34	0.27

Chart 10 below presents the composition of own-revenues, as well as their share in total revenues for local government throughout the region. Unfortunately, the way own-source revenues are accounted for differs radically from country to country - including within the EU. In some cases, the reporting is quite detailed and contains many more categories than are presented in the Chart. In others, only two or three categories are used and it is difficult to say what these categories really contain. For example, in Macedonia, FBiH (of BiH) and the RS (of BIH), local governments derive significant revenues from Land Development Fees, Land Use Fees and Construction permits, but they are all recorded as Communal Fees. Similarly, revenues from the sale or rental of municipal assets are frequently presented as Communal Fees.

Chart 10 Composition of Own Revenues 2011



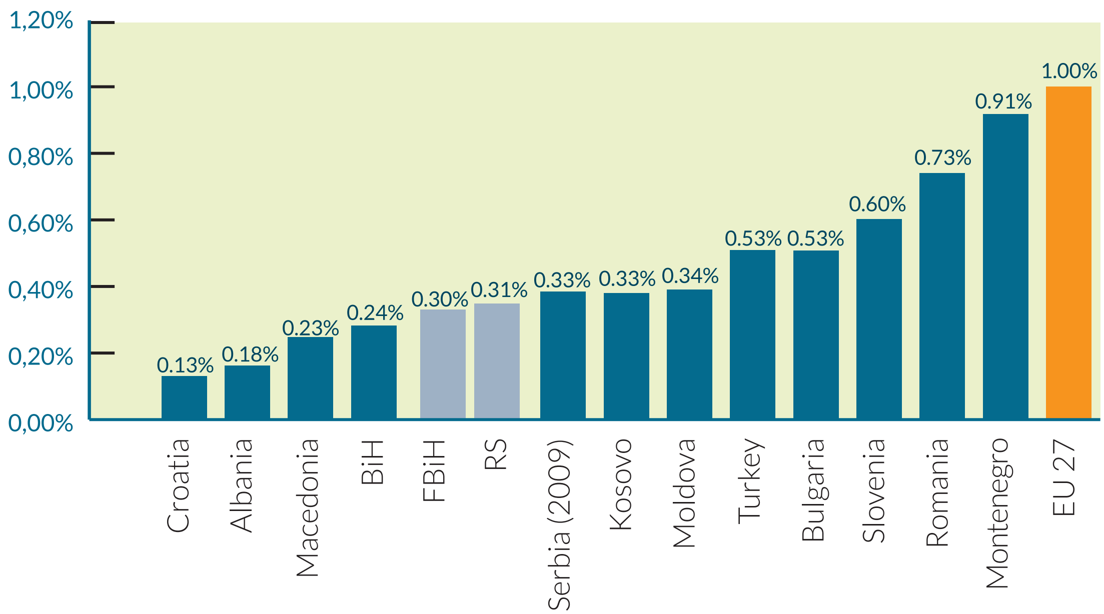
Because of these difficulties it is hard to come to any general conclusions about the composition of own-revenues in the group or about the relationship between the composition of own-revenues and their share in total local government revenues. What can be said is that in most places the data on own-revenues is poor and that there does not seem to be a strong relationship between the composition of own-revenues and their share in total local government revenues. Or to put the matter another way, there is no obvious relationship between the composition of own revenues and the financial autonomy of local governments. It is however worth adding, that throughout the region own-source revenues are disproportionally concentrated in capital cities and typically tied very strongly –through land development fees, construction permits, and the Property Transfer Tax—to the real-estate market.

Own-source revenues are disproportionally concentrated in capital cities and typically tied very strongly –through land development fees, construction permits, and the Property Transfer Tax—to the real-estate market.

Chart 11 shows revenues from the Property Tax as a percentage of GDP in 2011 for all members of the group as well as the average for the EU. As can be seen from the Chart, only Romania and Montenegro approach the EU average of 1% of GDP. This, in turn, is low when compared to North America, Australia, France, and some of the Nordic countries where the property tax accounts for between 2 and 3% of GDP.

Chart 11

Property Taxes as % of GDP (2011)



It should also be noted that in many EU countries –as well as in some members of the group— the yield of the recurrent Property Tax is recorded with the yield of the Property Transfer Tax. This tax is imposed on the sale price of land and buildings and typically must be paid before the buyer can receive official title to the property he has bought. Thus compliance tends to be high and in many places the yield of this tax is higher than that of the recurrent property tax. This despite the fact that Property Transfer Tax is imposed only on properties that have been sold during the year. For example, in Montenegro –the member of the group whose property tax yields the most as a percentage of GDP and where the two taxes are reported separately-- the yield of the Transfer Tax has exceeded the yield of the Property Tax in two of the last six years.

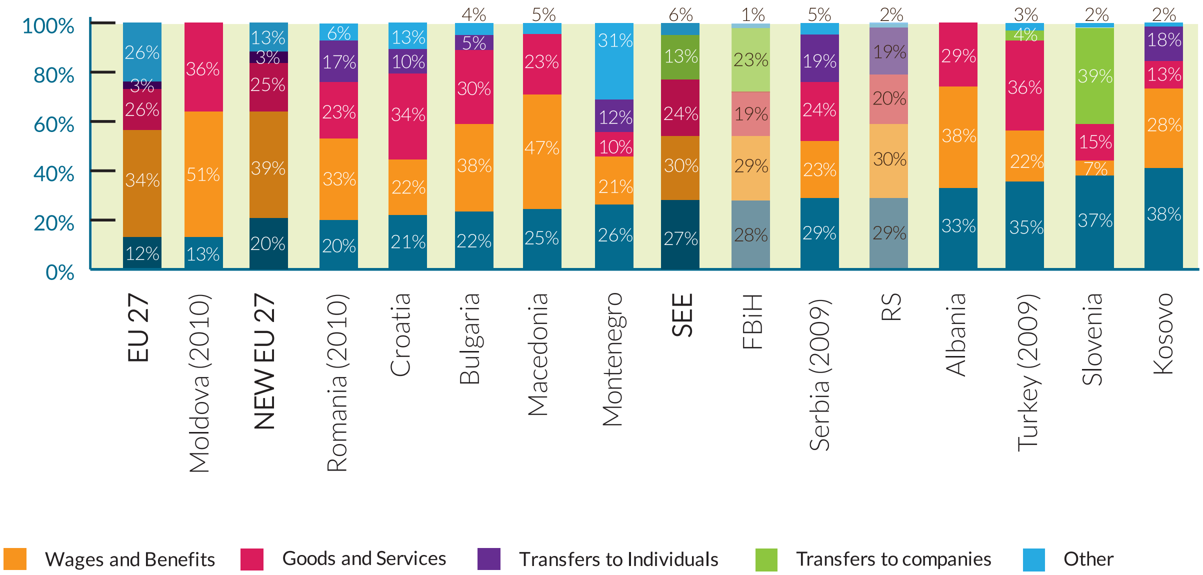
Given the evident difficulties across much of the EU (and beyond) in making the ad valorem property tax a robust source of local government revenue, it is probably fair to say that it is unrealistic to expect the tax to provide the foundation for the financial independence of local governments in South-East Europe.

Local Government Expenditures

Chart 12 shows the composition of local government expenditures by economic type for each of the members of the group, as well as the average for the group as a whole (SEE); the average for the EU (EU 27); and the average for the seven post-communist countries that joined the EU in 2004 (NEW EU7)[13].

The data should be treated with caution because there are significant differences in the way expenditures are reported across countries as well as problems with extracting fully comparable data from EuroStat. For example, within the region some places treat capital transfers to public utilities as investment expenditures while others record them as subsidies to legal entities. Meanwhile, in the EU capital transfers are not considered subsidies and in the Chart below are included in the category "Other" while the category for Subsidies includes only operating transfers to public utilities. More generally, and again within the region, there seems to be a tendency to overstate investment spending by considering many routine repairs as well as the purchase of all new equipment (e.g. computers) as investment. In some places there also seems to be a tendency to wage spending by recording it as the purchase of goods and services.

Chart 12 Composition of Local Government Expenditures 2011



[13] Czech, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia.

For the RS (BIH) transfers to individuals and to firms are not distinguished. For Serbia, investment includes capital subsidies to public companies and "neighborhood units", for Montenegro "other" includes substantial amounts of debt service payments, for EU 27 and NEW EU 7 transfers include only operating subsidies to public utilities.

Nonetheless, the most striking feature of the Chart is that investment spending by local governments in most of South-East Europe is significantly higher than that of the their counterparts within the EU and even that of the seven post-communist countries that joined the EU 2004. Indeed, the differences in the average investment rates for the three groups (SEE, E27, and EU7) has been remarkable consistent over the last 5 years. This is remarkable and suggests that local government in South-East Europe, like those of the seven countries that joined the EU in 2004 are playing an extraordinary game of catch-up and spending as much they can on investments to modernize the run-down or non-existent infrastructure they inherited from the past. Or to put the matter another way: Local governments in South-East Europe are working harder than their counterparts in most of the EU to build new infrastructure because they are spending higher proportions of their income on investment, despite receiving significantly lower shares of public revenue –measured either as a percentage of GDP or of total public revenues (Chart 7).

All over the world, local authorities are faced with greater pressure in providing additional public services and new infrastructure together with limited financial resources to cover these needs. Investments decisions in infrastructure require large sums of financial resources and are hard by definition. Therefore local governments should be allowed to use flexible composition of resources and methods to follow the investment needs in the community. Beside the basic institutional framework of financial decentralization, the design of efficient financial management for local government investment should introduce new and flexible concepts of capital expenditure management. In providing the funds for financing public infrastructure with respect to the resources available, the three different forms of funding typically used are the current budget revenues, the debt financing (comprises the coverage of financial resources for infrastructure by issue of securities or loan raising in the capital market) and public-private partnership (contractual co-operation or even privatization, involving private sector funds in the provision of public infrastructure).

Local governments in South-East Europe are working harder than their counterparts in most of the EU to build new infrastructure because they are spending higher proportions of their income on investment, despite receiving significantly lower shares of public revenue –measured either as a percentage of GDP or of total public revenues (Chart 7).

Taking in consideration the low amounts of local government investment expenditure in most of CEE countries, the decline of local government investment after 2009 due to the financial and economic crisis and the condition of the existing infrastructure, we can detect the huge need of expanding the available investment funds at local level. In transition countries local governments are faced with additional problems of underdeveloped infrastructure with both high pressure for renovation and the request to ensure compliance with EU norms on the one side. On the other side they are faced with low budget financial possibilities for funding capital public investment and with the non developed capital market.

Knowing that local governments are the main bearer of the care on providing local public infrastructure, we can understand the importance of local public investment capacity for the development of the entire community and its long-term economic health and social cohesion. The decisions on providing the infrastructure are among the most important that local government make. These decisions result in good transport facilities, streets and public parks, schools and kinder-gardens, water and waste-water facilities, waste disposal, sport halls and recreation areas, libraries and city halls, fire protection, health care ambulances, elderly social care provision and other public facilities. This decisions have been very important in recent years and will be still of particularly importance in the future development.

Going into comparisons across members of the group, the first thing that should be noted is that the share of investment spending is lowest, and the share of wage expenditures is highest in Bulgaria, Macedonia, Moldova and Romania. This is understandable because these four (with Kosovo) are responsible for paying the wages of all pre-university teachers. Like them, Kosovo municipal governments spend a very high percentage of their budgets on wages. But unlike them, Kosovo municipalities have a high investment rate. Why this is the case is not perfectly clear. But part of the explanation certainly lies in the comparative robustness of Kosovo's intergovernmental finance system (see Chart 7).

Conversely, it should be noted that for the last few years over 40% of all local government investment in Bulgaria has been financed by EU structural funds. These funds are also important in Romania and Slovenia. Indeed, without these funds investment spending in all three countries would be significantly lower. But the problem is deeper in Bulgaria. This is because the share of total public revenues that local governments in Bulgaria receive is (given their social sector responsibilities) low in relationship to the GDP (see Chart 7). **As such, it seems that EU funds are in some sense allowing Bulgarian policy makers to avoid dealing with the more general weakness of the country's intergovernmental finance system.** Meanwhile, it is particularly remarkable that Macedonian local governments are investing as much as they seem to be given how poorly they are being treated by the national government (again Chart 7). Finally, the combination of an extremely low share of investment spending combined with an extremely high share of spending on wages should be of particular concern to both national and local government policy makers in Moldova.

The relatively low level of investment spending of Croatian local governments is surprising. But this appears to be a temporary by-product of the recession and the slow recovery because prior to the crisis investment accounted more than for 30% of all local government spending in Croatia. Moreover, the Croatian intergovernmental finance system appears to be one of the more robust in the region. Here again, however we say "appears" because without being able to analyze the distribution of revenues and expenditures across local governments it is hard to say how much of the high rate is accounted for by the investment spending of Zagreb and a few other large cities. In other words, while investment rates in the region are generally high, what we don't know is how much these rates are being driven-up by a few wealthier jurisdictions and by the (likely) imbalances in the region's intergovernmental finance systems. Meanwhile local government investment spending Montenegro has fallen even more dramatically than in Croatia and similar things could be said for Slovenia.

Charts 13 and 14 below throw further light on the situation. Chart 13 presents the average share of local government investment as percentage of GDP for all members of the group for the last six years; for the 15 members of the EU before the 2004 expansion; and for the seven post-communist countries that joined the union that year. Chart 14 presents average municipal investment levels in per capita euro terms over the same period and for the same groups as Chart 13. For both Charts, the average for Serbia is based only on data for 2007 and 2009, while the average for Moldova is based on the period 2005-2010, and not 2006-2011.

The first thing that should be note from these Charts is that a high share of total municipal spending on investment does not necessarily translate into a high share of municipal investment as a share of GDP or in high levels of per capita spending measured in euro. Local governments in Albania, for example, have been devoting more than 30% of their expenditures to investments (funded in large part by conditional grants --see Chart 9). Despite this high rate of investment spending, Albania has the lowest level of municipal investment as a percentage of GDP and –less surprisingly-- one of the lowest levels of per capita investment spending in euro. Conversely, Moldova has a low municipal investment rate and the lowest spending per capita in euro, but nonetheless exceeds the average for the "original" 15 members of the EU with respect to local government investment as share of GDP.

> In other words, while investment rates in the region are generally high, what we don't know is how much these rates are being driven-up by a few wealthier jurisdictions and by the (likely) imbalances in the region's intergovernmental finance systems.

Chart 13 **Local Government Investment as share of GDP (average 2006-2011)**

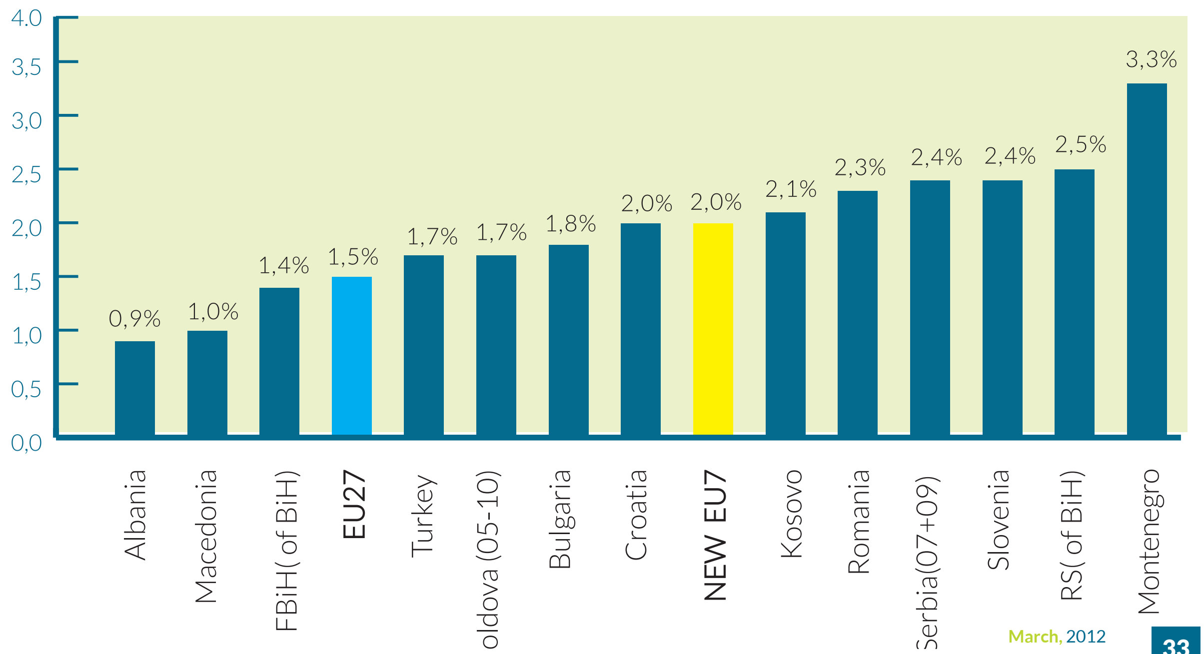
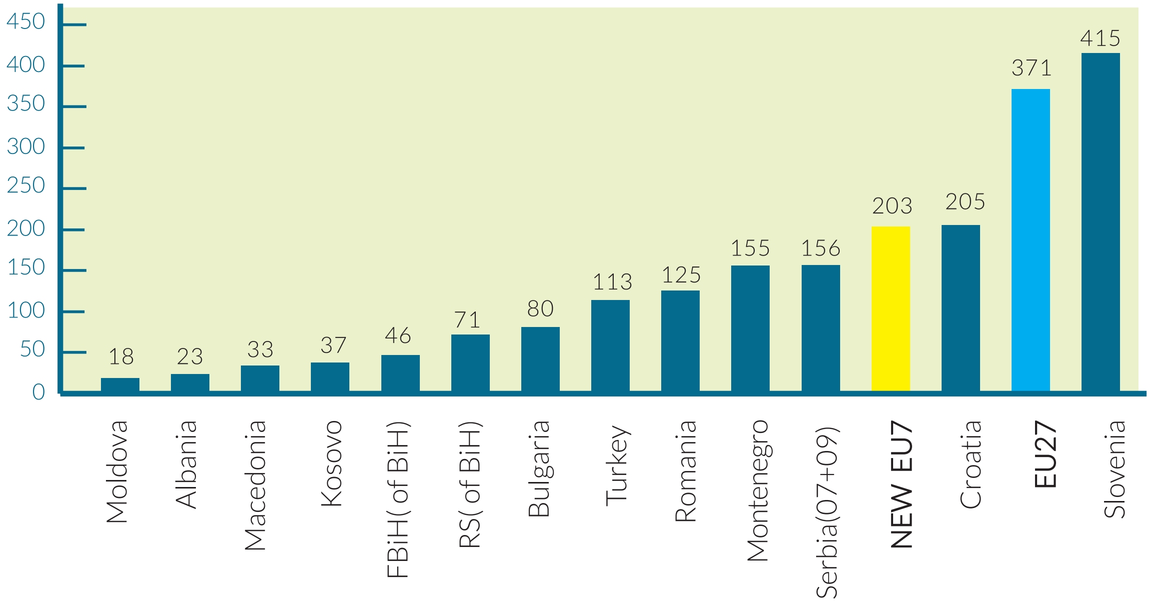


Chart 14 Local Government Investments Per Capita in Euro (average 2006-2011)

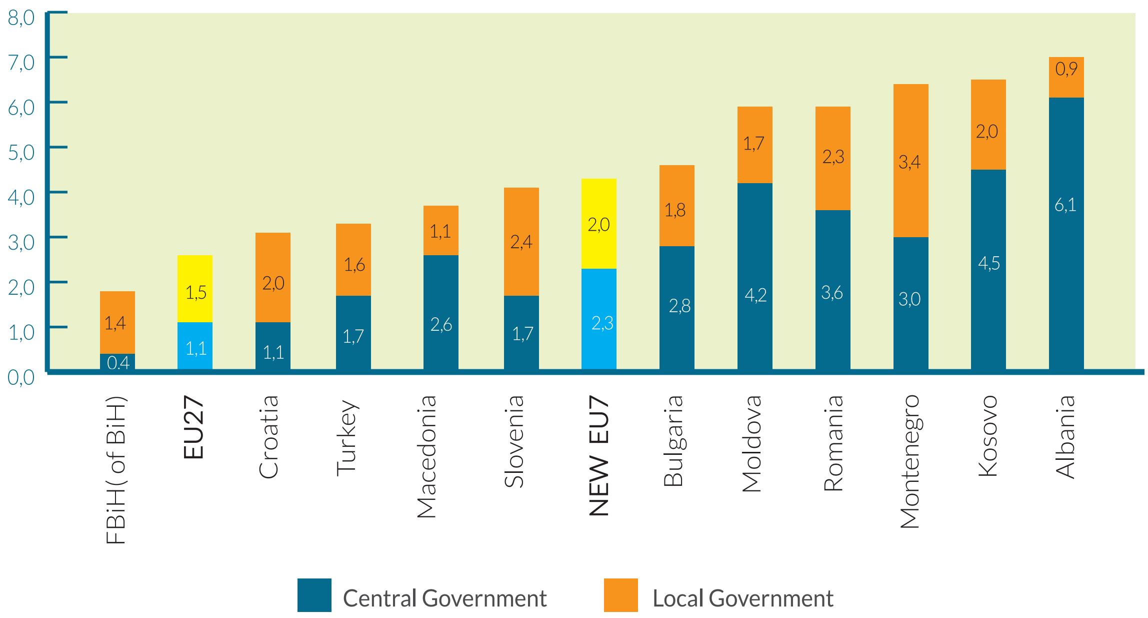


That said, the second thing to be noted is that *in general* the higher municipal investment rates that we saw in the region (as well as for the EU7) (Chart 14) have been accompanied by higher levels of municipal investment as a share of GDP when compared with the average for the EU. Indeed, local government investment as a share of GDP has exceed not only average for the EU27 but of the EU7 in Montenegro, RS (of BiH), Slovenia, Romania and Kosovo. Moreover, local government investment per capita in Slovakia has been higher than the average for the EU for the last six years, while Croatia has achieved per capita spending levels equal to those of the EU7. These are impressive achievements which hopefully will be sustained over the next decade.

At the same time, it is necessary to recognize that the situation elsewhere in the region is not so happy. Local government investment spending as a percentage of GDP is extremely low in Albania and Macedonia where it is well below the average for the EU. This should be of profound concern to policy makers in these countries. Similarly, while the picture is better in FBiH, Bulgaria, Turkey and Moldova, local government investment as a share of GDP remains lower than the average for the EU7 and thus below what one might reasonably hope to see given the catch-up game that local governments in South-East Europe must play.

Finally it is worth looking briefly at composition of public investment by level of government. This is shown in Chart 15 below which shows total public investment as a share of GDP, as well as how much of that investment each level of government is responsible for. As in the previous charts, the figures are averages for the years 2006-2011[14].

Chart 15 Public Investment as a Percentage of GDP by Level of Government (average 2006-2011)



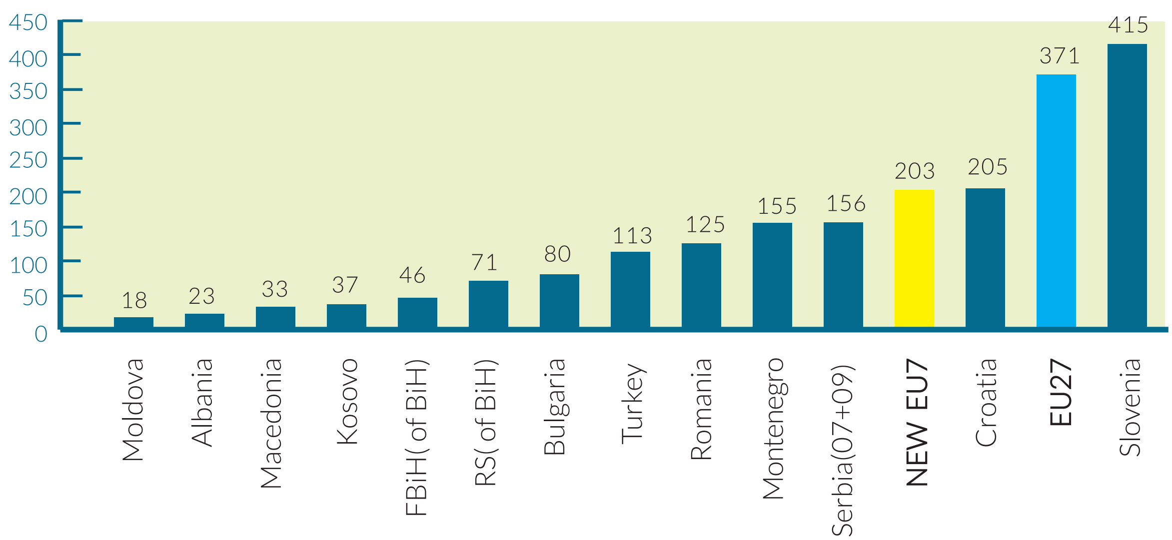
As can be seen from the Chart, both the level of total public investment and its composition differs significantly both with region, and between the region and our two groups of EU members. Indeed, there is so much variation that it is hard to draw any firm conclusion about patterns or trends. The one thing that does seem clear is that the need for public sector investment –at least as percentage of GDP—seems to be significantly smaller within the original 15 members of the EU, and that public sector investment tends to fall as economies mature. It also seems that there is a tendency for the share of local government spending on investment to rise in relation to the total public spending as countries get richer. There also seems to be something of an inverse relationship between total public investment and the ability of governments to collect taxes, though this is probably another way of saying that the need for public sector investment as whole falls as economies mature.

[14] Small differences between the charts with respect to local government investment as a percentage of GDP are the result of discrepancies in the sources of data on total public investment.

Local Government Borrowing

In most of South-East Europe, local government borrowing is still a very new phenomenon. This can be seen from Chart 16 below. The Chart presents data on the total outstanding debt of local governments in per capita euro for all members of the group for which we have reliable data, as well as for the EU as a whole[15]. Local governments across South-East Europe have not been immune from the challenging economic environment and the volatile credit market conditions. The severity of the economic slowdown has put a strain on local governments' finances affecting their budgetary performance. Some local governments have also been affected by liquidity stress and face higher costs of funding. Others have seen their access to the market restricted by central government policy. On the other side, the demand for commercial credit has been constrained by access to diverse sources of apparently cheaper funding, including soft loans and grants from state-owned agencies and international aid programs and amortizing debentures is offsetting the effects of the adverse credit market situation.

Chart 16 Outstanding Local Government Debt Per Capita in Euro



[15] Kosovo, FBiH of BiH, and BiH are excluded for lack of data. But while there has been some local government borrowing in FBiH, the amount in Kosovo has been negligible.

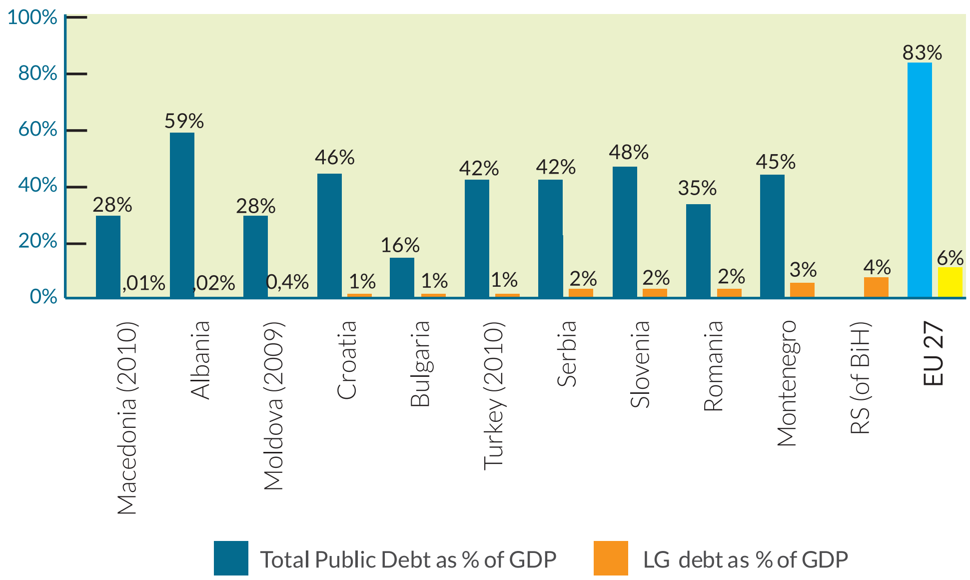
As can be seen from the Chart 16, the outstanding per capita debt of local governments in the EU is close to five times greater than that of Slovenia[16], the country with the highest level of outstanding debt in the group. Meanwhile, at the other end of the spectrum, local government borrowing in Moldova, Albania, and Macedonia is clearly in its infancy while elsewhere in the region it remains underdeveloped.

The comparatively low level of general government debt in South-East Europe is, at least in theory, good news for local governments in the region because it means that local government borrowing can be expanded very dramatically without pushing general government debt much closer to, or over the Maastricht norms. There are however one important exception: Albania.

Chart 17 below adds crucial details to this picture. It shows the amount of public sector debt --both of local governments and of the general government-- as a percentage of GDP. General Government debt in most of the region is well below the average for the EU. And the average for the EU is now significantly higher than the limit of 60% of GDP set by the Maastricht Treaty of 1992. Some of this "excess" debt has been generated by national governments borrowing to repair their financial systems and/or to stimulate their economies after the crisis of 2008. But well before 2008, general government borrowing in the EU was –on average-- exceeding the Maastricht limit.

Chart 17

General Government and Local Government Debt as % of GDP



[16] The data does not include unpaid liabilities to private contractors or to other government agencies. In Turkey, such data is available, and unpaid liabilities are significant, equaling 3-4 times the amount of official commercial debt. Unfortunately, reliable data on unpaid liabilities is unavailable for other countries, but it has been significant in Macedonia and may be an issue in Moldova, Serbia, and other members of the group.

In 2011, Romania's public debt amounted to only 37% of GDP. Local government borrowing however, has doubled from 1.2% of GDP in 2006 to 2.4% of GDP in 2011. As a result, total outstanding local government debt increased to 27% of local government revenue in 2011 and rose in nominal terms from 12.9 billion lei in 2010 (26% of own revenues) to 13.8 billion lei in 2011. Local governments in Romania, however, are exposed to some foreign currency risk since around 40% of their debt is denominated in euro (2011)[17].

The total outstanding debt of local governments in Slovenia and Bulgaria has been on upward trend over the past few years. In Slovenia, it reached a manageable 29% of total local government revenue at the end of 2010 from 15% in 2007, while in Bulgaria local debt grew to a still moderate 18.6% in 2010 from 8.8% of total revenue in 2007. Although at slower pace, a further increase has happened in both countries in 2011 with total outstanding debt close to 33% and 21% of total local government revenue respectively.

In 2011, adjustments on the capital side of local governments' budgets played a major role in maintaining the good financial performance of Slovenian and Bulgarian local governments because both reduced investments as revenues fell. In Slovenia, capital spending decreased from to 37% of total expenditures, down from 43% for period 2006-2010. In Bulgaria, investment declined to 22% of total spending in 2011, down from 28% in 2010. This indicates high capital expenditure flexibility, as some projects can be delayed or abandoned if required.

The local governments' debt has been relatively stable in Croatia and since 2008 as stood at around 10% of local government revenue. The low level of borrowing reflects the central government's restrictive approach to local debt. However, it is worth mentioning that through 2010 local government debt steadily increased in absolute terms. In 2011, however, it fell by 8.8% as local governments reduced both borrowing and capital expenditure in response to lower revenues. Indeed, capital expenditure fell by 11 percentage points to reach a historic low of 21% of total expenditure at the end of 2011.

The growth of local government debt in Slovenia, Bulgaria, Romania and Croatia has increased because of pressure to meet EU standards for environmental infrastructure following their entry into the EU (Croatia will join in July 2013)[18]. However, budgetary pressure and the potential depletion of cash reserves combined with the requirements to co-finance EU supported investments projects are likely to prove challenging going forward. The current need for significant budget cuts on the back of materially declining revenue will test local governments' ability to respond adequately to adverse economic and financial conditions.

[17] It is worth adding that there is significant amount of exchange rate risk associated with local government debt in other countries. In Serbia, for example, virtually all local government debt is in euro and a good case can be made the exchange rate risk is underappreciated at both the national and local level.

[18] Much of the EU's assistance to new member states comes in the form of grant monies for the construction of new public infrastructure, particularly water sewage treatment facilities and solid waste dumps. These grants, however, have to be co-financed by end-users. Local governments in the new member states of the EU have used debt to meet these co-financing requirements. It should also be noted, that EU grant monies are only released after the end-user has paid for the project the grant monies are meant to support. This means that local governments need bridge loans to make effective use of EU funds. This problem has led to the development of special programs or special rules in a number of new member states. In Poland, for instance, debt incurred for the financing of EU funded projects is exempt from local debt limits while in Bulgaria the Association of Local Governments and the National Government worked together to create a bridge financing facility called FLAG.

In Montenegro, the outstanding debt grew significantly between 2008 and 2011, from 28 million to 98.5 million euro. Measured against total local government revenue, debt grew from 8% to 52% over the same period. Up until 2008, local governments paid for the vast majority of their investments with capital revenue and donor funds. The use of debt and the sharp increase of debt stock is also attributable to the deterioration in the self-financing capacity of local governments and the lower cash reserves. The local governments, however, remain well within the national borrowing limits, according to which debt service payment should not exceed 10% of the preceding year operating revenue. It is worth noting that between 2010 and 2011 --and as revenues fell-- local governments in Montenegro reduced capital spending from 83 million euro to 51 million euro (down from 166 million in 2008). This demonstrates the capacity of local governments to adjust their budgets in case of economic downturn.

Serbian municipal debt has grown steadily over the past few years reaching 42% of total local government revenue at the end of 2011 up from 31% in 2008. This increase was in part the result of the first municipal bond issue in the country. The bonds have been being issued by the City of Novi Sad in three tranches for a total of 35 million euro. The first tranche was sold in October 2011 for 15 million euro and marked a significant step forward in the development of the countries credit market. The redemption of the bonds is spread across 10 years, with a two year grace period[19]. According to forecasts for 2012 the capital spending of Serbian municipalities will remain at their 2011 level of 23% of total expenditures. Local government debt is also expected to fall to 37% of total revenue in 2013.

Municipal debt in Macedonia is still negligible reflecting (i) recently removed ban on municipal borrowings (2008); (ii) local governments' reliance on funding from the central government, and (iii) new funding opportunities for capital investments (sale/lease of construction land).

Although the total outstanding debt of local governments in Macedonia grew significantly from MKD36 million in 2010 to MKD 467 million at year-end 2011, it still represents only 2% of local government revenue. Substantial 73% of local debt came from the first on-lending program Municipal Services Improvement Project (MSIP I), supporting municipal investments with revenue-generating or cost-saving potential. The debt-to-revenue ratio of the municipal sector is expected to gradually increase over the next 2-3 years given the new loan agreement (MSIP II) signed between the Government of Macedonia and the World Bank, which will provide additional EUR37.2 million for scaling-up capital investments at local level. Both programs aim to stimulate the Macedonian local economy by providing funds that enable municipalities to undertake an ambitious investment pipeline, key for their economic development. When counting the new funding opportunities for Macedonian municipalities, the stock of debt relative to total revenue is expected to increase to approximately 15%.

As can be seen from the Chart 17, Albania is at risk of exceeding the Maastricht limit for total public debt of 60% of GDP. As a result, the country is under considerable external pressure to restrain public borrowing. At the same time, local government borrowing has really yet to begin, and local governments are not responsible for Albania's problems with Maastricht. Nonetheless, the national government is afraid that any increase in local government debt could push the country over the line and thus has effectively blocked municipalities from borrowing.

[19] The issue was facilitated by USAID which provided guarantees on the third tranche of 6 million euro through its Development Credit Authority.

Worse, it is not clear how this problem should be addressed. The obvious answer is for the national government to reduce its own obligations and thus create some space for local borrowing. Unfortunately, however, experience from other countries suggests that national governments rarely constrain their own borrowing in order to facilitate it for local governments. Indeed, much of the current discourse in Albania is not about excess national government debt but on all the reasons why local government borrowing is premature and dangerous.

Between 2009 and 2011 capital expenditure accounted for a significant proportion of the local governments' total expenditure in Albania – 37% on annual average – reflecting the need for upgrading major infrastructures. The aggregated debt-to-total local government revenue ratio of Albanian local governments is expected to gradually grow going forward given the newly adopted regulation on local government borrowing, giving the authorities more room for debt issue.

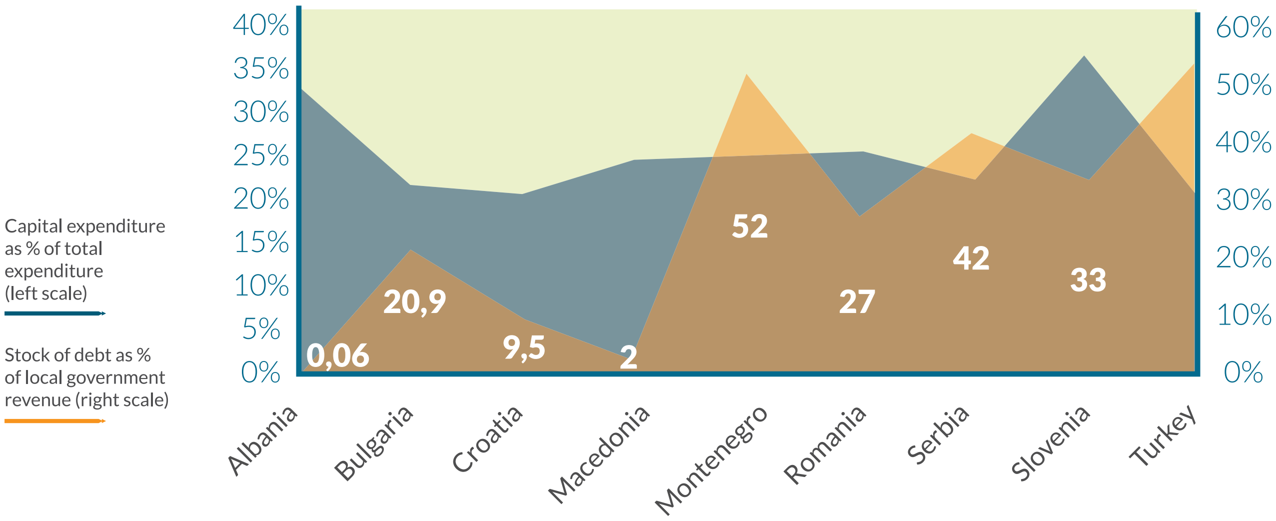
TABLE 4 Outstanding debt as % of local government revenue

	2007	2008	2009	2010	2011
ALBANIA	-	-	-	0.3	0.6
BULGARIA	8.8	8.2	12.8	18.6	20.9
CROATIA	7	7.5	8.9	10	9.5
MACEDONIA	-	-	-	0.1	2
MONTENEGRO*	7	8.5	29.4	44	52.3
ROMANIA	19.3	21.1	25.1	26	26.8
SERBIA	33.8	30.7	37.8	37.4	42
SLOVENIA	15	18.9	25.7	28.7	33.2
TURKEY*	CALM	79.6	82.1	N/A	53.8

*including unpaid liabilities

Chart 18

Stock of Debt and Capital Spending in 2011



The budgetary performance of the local governments has been challenging in the last few years with some entities recording consecutive deficits. This has been driven mainly by attempts to continue high levels of capital spending, with little or no reduction of operating expenditures. But looking across the region, what is striking is that most local governments seem to have responded to the recession by constraining operating costs and cutting investments, demonstrating the flexibility necessary to adjust to a tough environment. Moreover, most have managed to return to balanced budgets and have thus prevented major dislocations in local public finances. In order to stay resilient to external circumstances in the next period they will have to continue to be willing and able to prudently manage capital spending and to maintain adequate operating balances in a manner consistent with the weaker revenue inflows.

No group of local governments in South-East Europe is borrowing at anything like the level of their counterparts in the EU (Chart 16): Only in Montenegro, Romania, and Slovenia is local government borrowing near or above 2% of GDP while in most other places it remains well below these already meager levels. Moreover, in many countries a disproportionate amount of total local government debt is debt incurred by capital cities. For example, in Serbia close to half of the 580 million euro in total local government debt comes from Belgrade.

As such, it should be clear that local government borrowing in the region remains extremely undeveloped and that one of the major challenges of the coming period will be to figure out how to expand it prudently. In most places this will require some combination of at least two broad types of policy interventions.

First, in many (if not all) places the overall adequacy and predictability of local governments revenues will have to be increased if municipalities are to have the resources against which to prudently incur debt. This will require local governments to do a better job collecting own-revenues, particularly with respect to setting higher user fees and charges, and then forcing their utilities to collect them. But it will also require central governments to improve the robustness of their intergovernmental transfer systems and to anchor these systems in rules that give both borrowers and lenders confidence that revenue streams will not change dramatically from year to year. Moreover, in many places, equalization systems will have to be strengthened if second and third tier municipalities are to be able to make prudent use of debt, and if local government borrowing is move beyond its current concentration in capital cities.

Second, and equally importantly, local governments will have to radically improve their ability to prepare, plan, and cost-out complex, multiyear investment projects --particularly in the water and solid waste sectors. Without the thorough preparation and costing-out of such projects it is impossible to make good use of debt capital, even if creditors are willing to lend. This sort of planning, however, requires both money and time, and unfortunately many local governments in the region are unwilling to devote either to the effort.

In part, this is because many local governments remain reluctant to pay for the intangible expertise that is a prerequisite for planning the construction of good physical infrastructure. In part, it is because while the region is generally rich in engineers, financial planning skills are harder to come by and the linkages between the two often weak. And in part, it is because electoral cycles are shorter than what is required to plan and build new environmental infrastructure. As a result, scarce investment funds tend to be spent on pay-as-you-build road projects and not on debt-financed, pay-as-you-use environmental facilities like waste water treatment plants because, planning roads is simpler; construction can be delayed if money runs out; and because the benefits are more likely to be visible to voters before the next election.

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Deepening the planning skills of local governments and making intergovernmental finance systems more robust and predictable will not be easy. But it can be done if central government policy makers work constructively with local government associations, domestic and multilateral creditors and development organizations, and the agencies of the EU interested in promoting the effective absorption of grant monies. After all, there is no shortage of good models for better project preparation; for enhancing municipal creditworthiness; or indeed for strengthening transfer systems. What is generally lacking, however, is the recognition among national policy makers that municipal governments play an absolutely fundamental role in modernizing the region's public infrastructure and that without strong municipal governments this infrastructure will not get built.

Table 4 below presents a crude estimation of the potential gains of better policy development and coordination. It shows the amount of new investment that would be made if local government borrowing was increased throughout the region to 4% of GDP. This is obviously an ambitious target, particularly in the current period of fiscal restraint. Indeed, it is probably an unrealistic one. But if it was achieved today, it would produce more than 23 billion euro in new infrastructure.

Local Government Outstanding Debt Today and at 4% of GDP **TABLE 5**

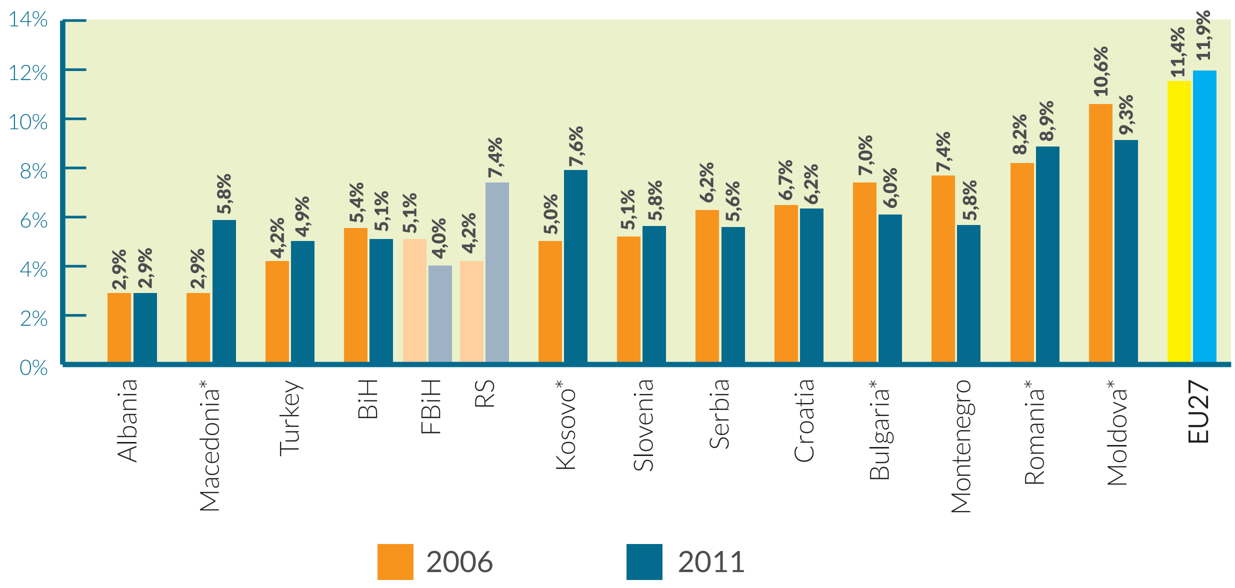
	CURRENT % OF GDP	OUTSTANDING DEBT (MILLION EURO)	SIMULATED AT 4% OF GDP	OUTSTANDING DEBT (MILLION EURO)	INCREASE IN INVESTMENT
MACEDONIA (2010)	0.01%	59	4%	293	235
ALBANIA	0.02%	1.5	4%	375	373
MOLDOVA (2009)	0.04%	16	4%	201	185
CROATIA	0.06%	269	4%	1.870	1.600
BULGARIA	1.2%	480	4%	1.537	1.057
TURKEY (2010)	1.2%	6.643	4%	22.173	15.530
SERBIA	1.6%	582	4%	1.246	664
SLOVENIA	1.9%	685	4%	1.426	741
ROMANIA	2.4%	3.200	4%	5.458	2.258
MONTENGERO	3.0%	96	4%	131	35
RS (BiH)	3.9%	174	4%	177	3
AVARAGE/TOTAL	1.48%	12.031	4%	34.886	22.855

3 FISCAL DECENTRALIZATION 2006-2011

In this section we present select indicators for South-East Europe for the period 2006-2010. Chart 18 shows local government revenues as a percentage of GDP in 2006 and in 2011. As can be seen from the chart, the financial position of local governments in Croatia, FBiH (BiH), Serbia, Bulgaria, Montenegro, Moldova have all weakened over the last half of the decade. The most significant declines have come in Montenegro, Bulgaria and FBiH. In Montenegro, where local governments rely extremely heavily on own revenues in general, and from revenues associated with the real-estate market in particular, the decline can be attributed to the collapse of the real-estate boom that characterized the middle years of the decade. The situation in Bulgaria and FBiH is less clear, but whatever is driving the decline policy makers in both places should be concerned, particularly in FBiH which doesn't have the luxury of using EU structural funds to compensate for the weakness of its intergovernmental finance system. Meanwhile, Albanian local government revenues remain at the same (low) level as they were in 2006

In contrast, local government revenues as a percentage of GDP have increased modestly in Turkey, Slovenia, and Romania. Here there have been no major changes in in expenditure responsibilities. Local government revenues have risen much more dramatically in RS (of BiH), Macedonia, and Kosovo. In Kosovo this has been driven by an increase in the conditionals grant that local governments receive for teachers' wages and the wages of primary care health workers. In RS (of BiH) the growth has been driven by changes in the transfer system introduced in 2007. Here, however, there has been no significant increase in local government expenditure responsibilities and local governments do not pay teachers wages. This is in contrast to Macedonia where local governments began to enter the so-called second phase of decentralization in 2007, and have been progressively assuming responsibility for pre-tertiary education. These new responsibilities are financed almost entirely be a heavily regulated "block grant" that is essentially earmarked for teachers wages.

Chart 19 Change in the Share of Local Government Revenues as a Percentage of GDP (2005-2010)



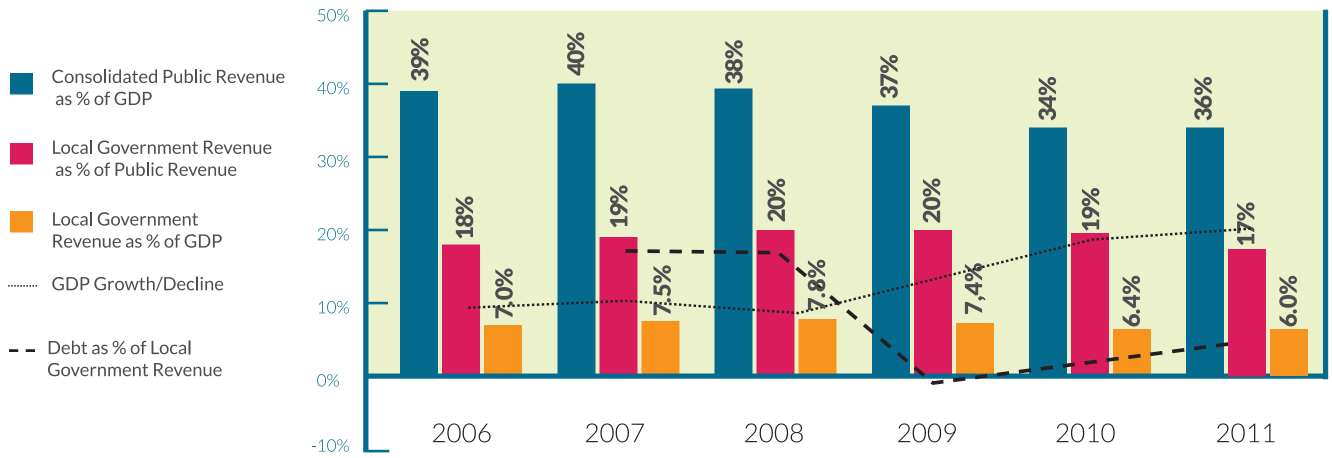
For Macedonia and Kosovo 2007 and not 2006 is used as the base year

Trends for local governments that pay teachers' wages

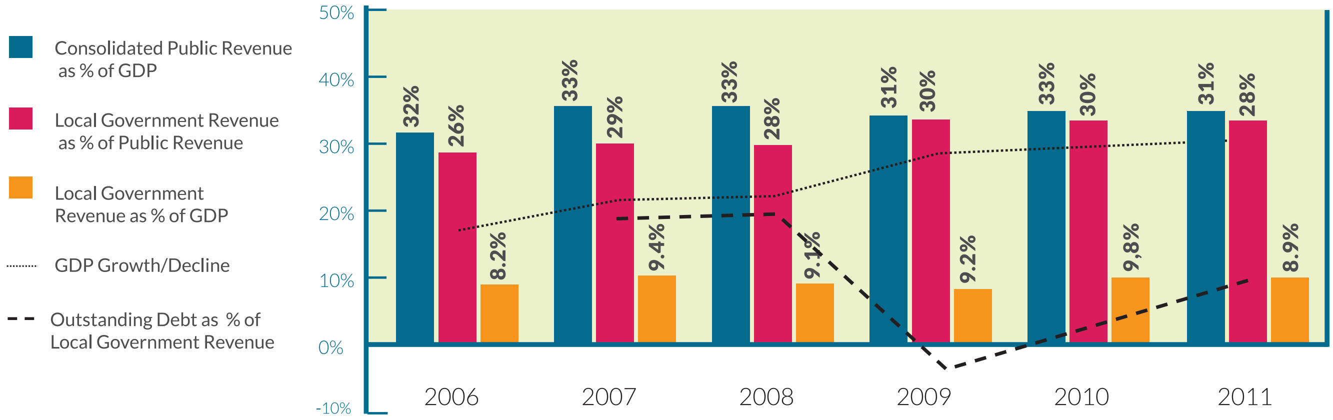
The next set of charts looks at trends over time in the five members of the group in which local governments pay teachers wages (Bulgaria, Romania, Macedonia, Kosovo and Moldova). Here, we present the revenues of the consolidated general government as a percentage of GDP; the revenues of local governments as a percentage of GDP and of total public revenues; the growth or decline of the GDP in euro; and where possible, outstanding local government debt as a percentage (of annual) local government revenues. For the members of this group, the following trends are worth noting:

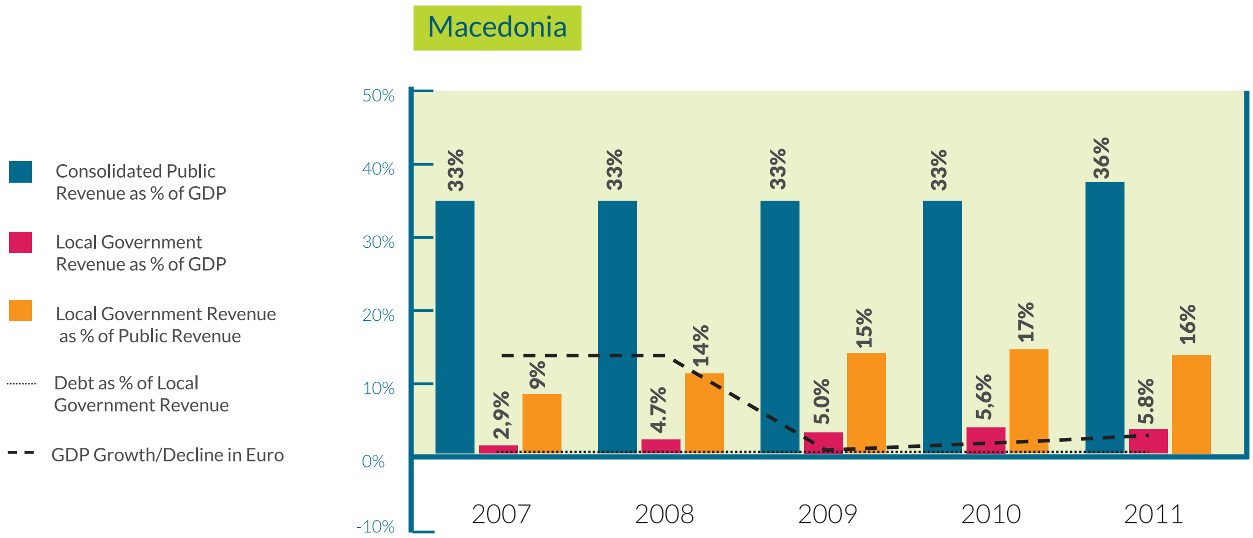
- All members of the group have public sectors that represent broadly similar shares of the GDP (30-40% of GDP), and in all local governments perform similar functions. The share of public revenues going to local governments however differs significantly: In Bulgaria and Macedonia local governments receive less than 20% of all public revenues while in Kosovo, Romania and Moldova it is between 25 and 30%.
- Between 2006 and 2010, Macedonia underwent the most structural change. Local government revenues increased from 2.2% to 5.8% of GDP as local governments progressively assumed responsibility for financing pre-tertiary education and other functions.
- Given the fact that local governments in Macedonia and Bulgaria pay teachers wages and at the same time have revenues equal to less than 7% of the GDP and 20% of total public expenditures, it seems that local governments and/or pre-tertiary education is being underfunded.
- Of the group, the 2009 global economic downturn hit Romania the hardest. The national government, however, appears to have tried to protect local governments from the downturn because neither local government revenue as a share of GDP or as a share of public revenues declined.
- In Kosovo and Macedonia the global economic downturn did not lead to a decline in the GDP, though it did stop growing. In both countries local government revenues as a share of both GDP and of total public revenues have increased between 2009 and 2011 without any new major changes in expenditure responsibilities.
- In Bulgaria, the GDP did decline, but significantly less than in Romania. In both countries however, local government revenues have fallen between 2009 and 2011, though the decline in Romania was delayed until last year and seems to have been accompanied by a slight increase in local government borrowing.
- Local government borrowing has yet to begin in Kosovo, and is just starting in Macedonia. In Bulgaria it remains modest. In Romania, total outstanding debt is now equal to about 28% of annual local government revenues and seems to have increased following the global recession.

Bulgaria

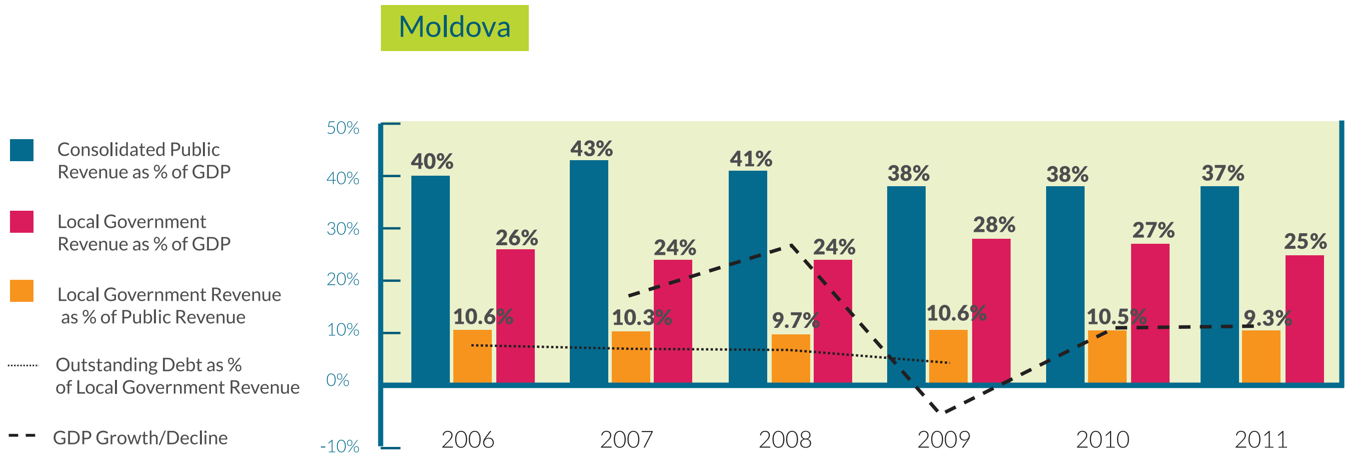


Romania

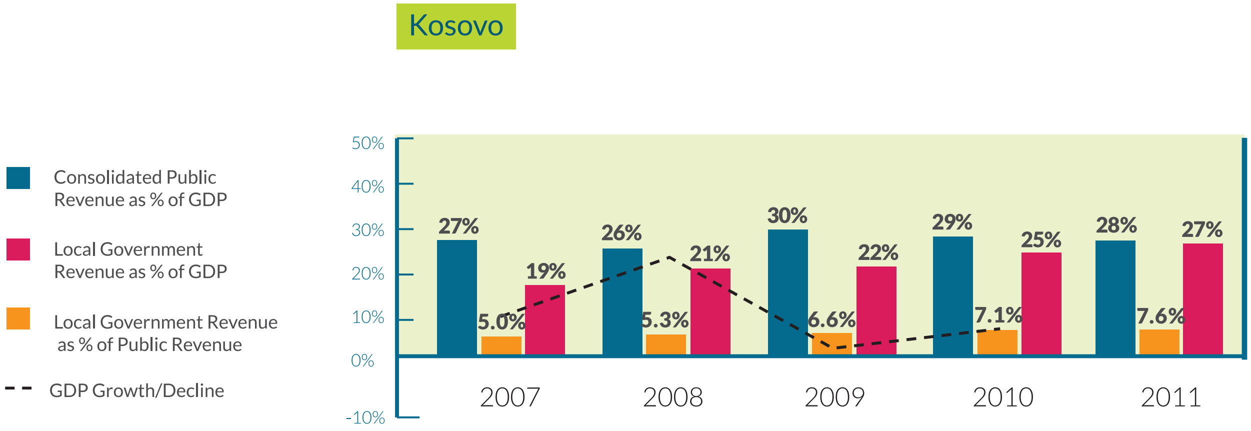




Macedonia
Consolidated Public Revenue as % of GDP
Local Government Revenue as % of GDP
Local Government Revenue as % of Public Revenue
Debt as % of Local Government Revenue
GDP Growth/Decline in Euro
50%
40%
30%
20%
10%
0%
-10%
33%
2,9%
9%
33%
4.7%
14%
33%
5.0%
15%
33%
5,6%
17%
36%
5.8%
16%
2007
2008
2009
2010
2011



Moldova
Consolidated Public Revenue as % of GDP
Local Government Revenue as % of GDP
Local Government Revenue as % of Public Revenue
Outstanding Debt as % of Local Government Revenue
GDP Growth/Decline
50%
40%
30%
20%
10%
0%
-10%
40%
10.6%
26%
43%
10.3%
24%
41%
9.7%
24%
38%
10.6%
28%
38%
10.5%
27%
37%
9.3%
25%
2006
2007
2008
2009
2010
2011



Trends for local governments that do not pay teacher's wages or the costs of primary health care

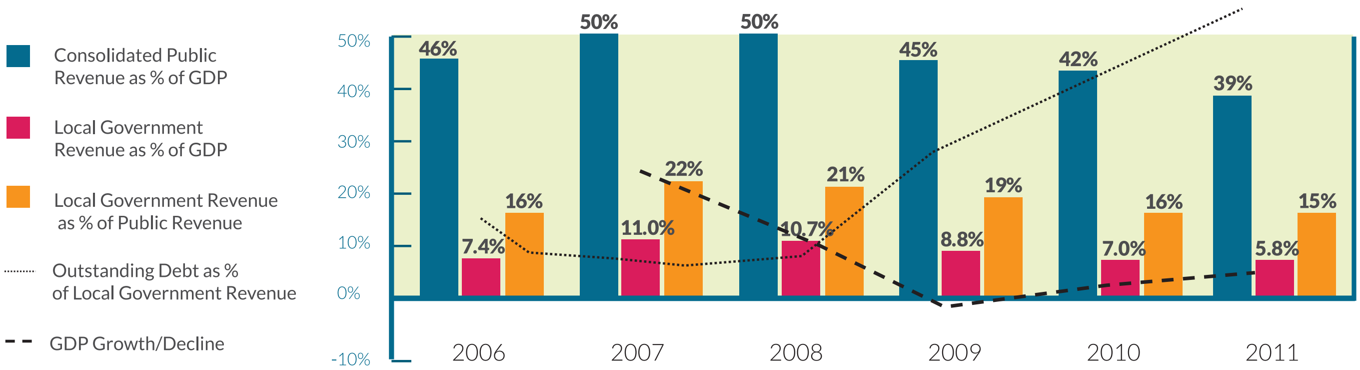
The next set of charts looks at local governments in Montenegro, Slovenia, RS (of BiH), FBiH (of BiH), Turkey, Serbia and Croatia. Here municipalities do not pay the wages of primary or secondary school teachers, nor do they provide primary health care services. Slovenian, Croatian and Serbian local governments, however, do pay the wages of preschool teachers.

The following trends are worth noting:

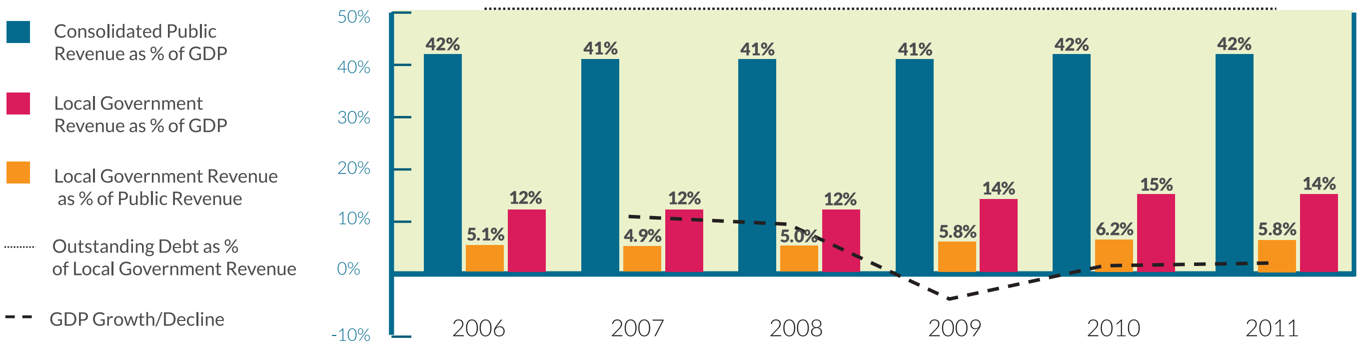
- In Montenegro, local government revenues peaked at over 10% of the GDP in 2007 and 2008, and have since fallen to under 6%. The peak was driven by a real-estate boom, and the decline has been caused by a contraction of both the real-estate market, and of total public revenues. Local governments seem to have responded to the contraction by expanding borrowing and Montenegrin local governments are making active use of the capital market, though as elsewhere there are probably significant differences in this use across richer and poorer jurisdictions.
- In Slovenia, local government revenue as a share of GDP and of total public revenue increased significantly in 2009 and 2010 despite a sharp decline in the GDP. This suggests that the national government tried to protect local governments from the impact of the crisis and/or an influx of EU funds has helped buffer local governments from the more general downturn. In 2011, however, local government revenues declined slightly. Local government borrowing has remained remarkably stable over the period, and outstanding debt amounts to just under 50% of annual revenues.

- The situation of local governments in FBiH (of BiH) improved between 2006 and 2008 with the adoption of a new revenue sharing system. Since then there has been a serious erosion of their financial position despite the relatively modes impact of the global crisis on the entities economy. Local governments have begun borrowing in FBiH but entity government is not actively tracking it, and aggregate data on outstanding debt is unavailable.
- In contrast to the trend in FBiH (of BiH), the financial position of local government in RS (of BiH) have improved continuously over the last six year. Indeed, local government revenues as percentage of GDP are now well above 7% and are arguably the highest in the region given the fact that RS (of BiH) municipalities are not responsible for social sector functions. There also seems to be a reasonably active local government capital market and the total outstanding debt of local government is now equal to a little over 50% of annual revenues.
- In Turkey, local government revenue as a share of GDP and of total public revenues has increased steadily over the entire period, including during the sharp economic downturn of 2009. Nonetheless, local government revenue remains low for a large country that has more than a dozen municipalities with over a million people, and which is rapidly urbanizing. Outstanding bank debt is now equal to about 30% of local government revenues. If however, all outstanding liabilities are considered the figure is closer to 80% of local government borrowing.
- In Croatia, local government revenue as a share of GDP and of total public revenue peaked in 2008 (7.3% and 19% respectively). Since 2008 both have declined and now stand at 6.2% and 17%. Nonetheless, local government revenue has contracted less than the total public sector. This suggests that the national government has made at least some effort to protect them. Outstanding municipal debt is low at about 16% of annual revenues and the local governments seem to be making less use of debt than most of their neighbors.
- In Albania, local government revenue is very low both as a share of GDP and of total public revenues. In part, this is due to the size of the public sector in relation to the GDP and to the difficulties all levels of government have in collecting taxes. In part, however it seems to be a direct result of government policy and a general turn away from the decentralization drive that marked the first half of the last decade. Though local government borrowing has begun in Albania it remains in its infancy.
- The situation of Serbian local government is currently unclear. Prior to 2009, local government revenues both as a percentage of GDP and total public revenues were at reasonably healthy levels (c 6.5% and 15% respectively) given that Serbian local governments do not pay the wages of primary and secondary school teachers. (They do however pay the wages of preschool teachers and these costs are significant because preschool attendance in Serbia is high). In 2009, the national government cut transfers to local governments in response to the crisis. Then in 2011, in the run up to new national elections the law governing local finance was rapidly changed in order to provide municipalities with new money. Data for the period after 2009 is hard to come by, and it is unclear what the changes in the law have actually done for local government finance. Despite the volatility of the overall intergovernmental finance system, larger local governments, and in particular Belgrade have begun to aggressively borrow for investment purposes.

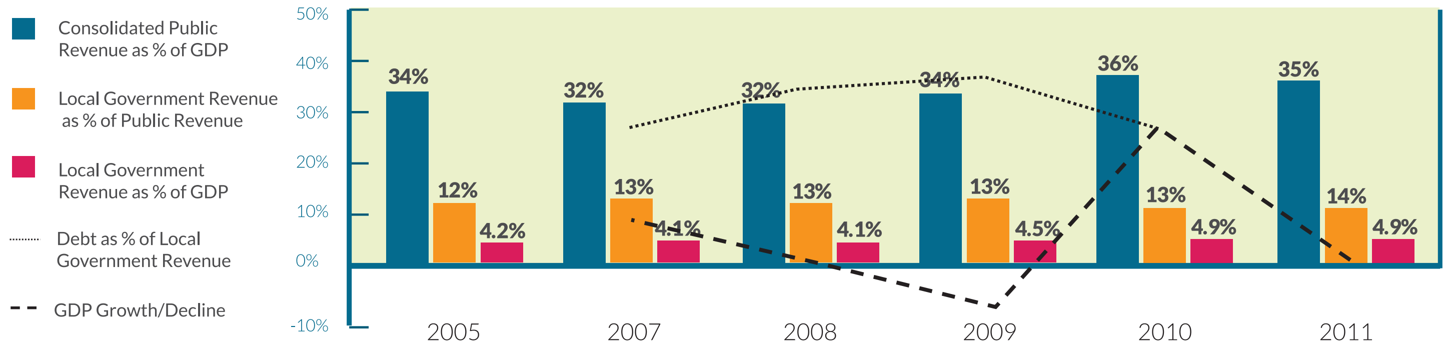
Montenegro



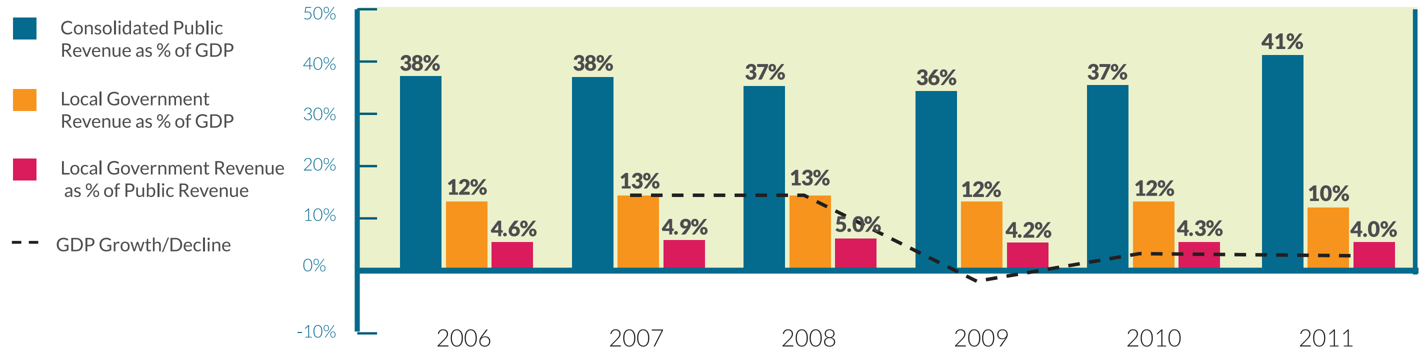
Slovenia



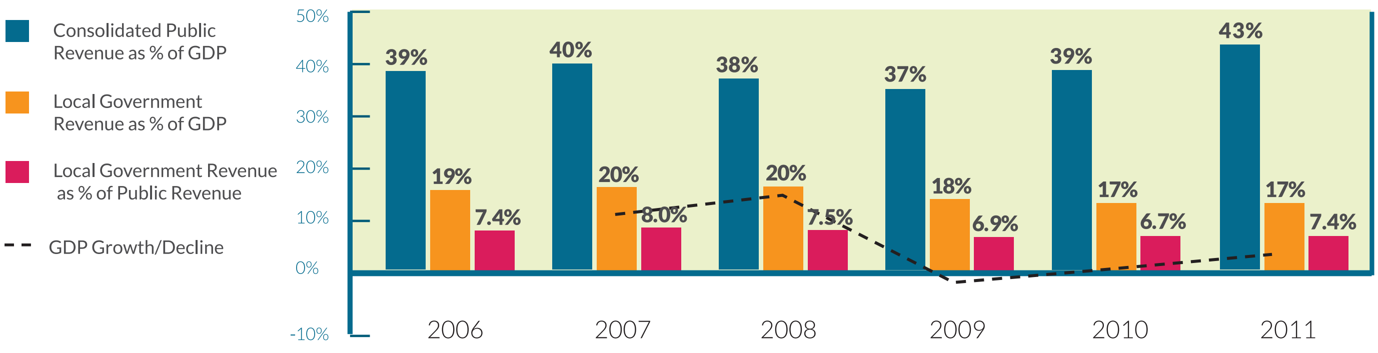
Turkey



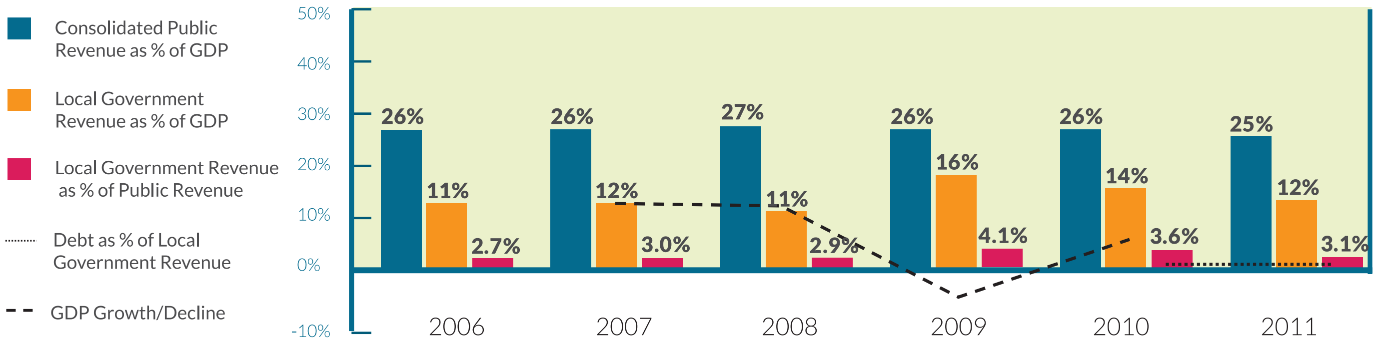
Federation of Bosnia Herzegovina (BiH)



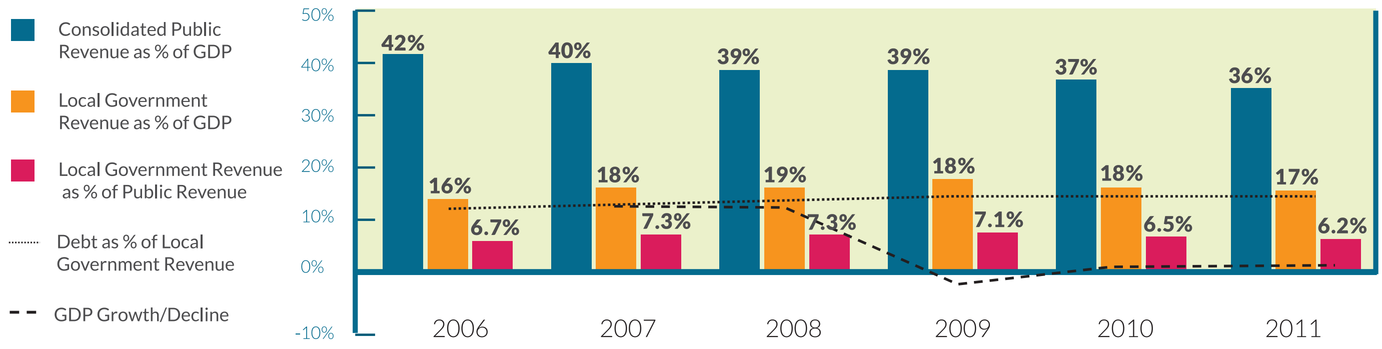
Republika Srpska (BiH)



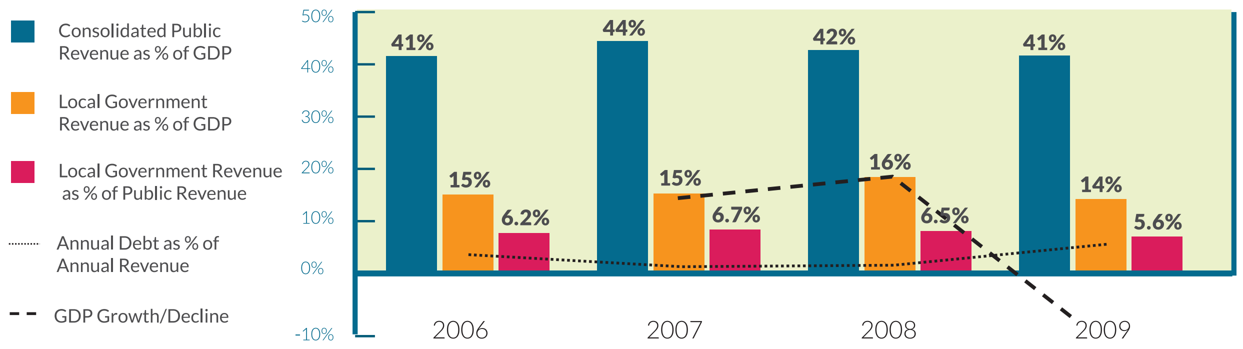
Albania



Croatia



Serbia

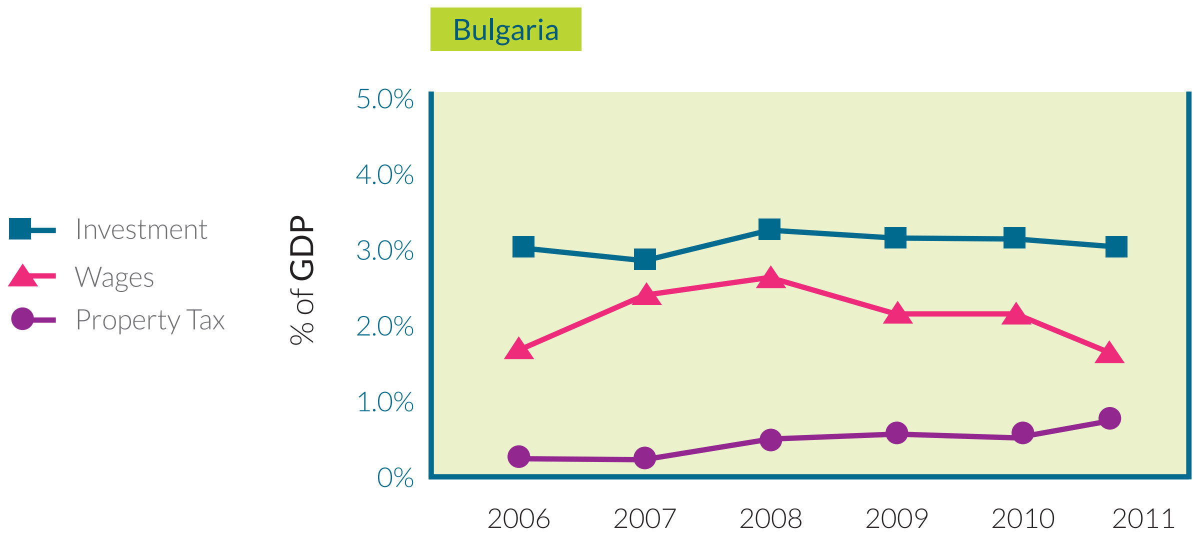


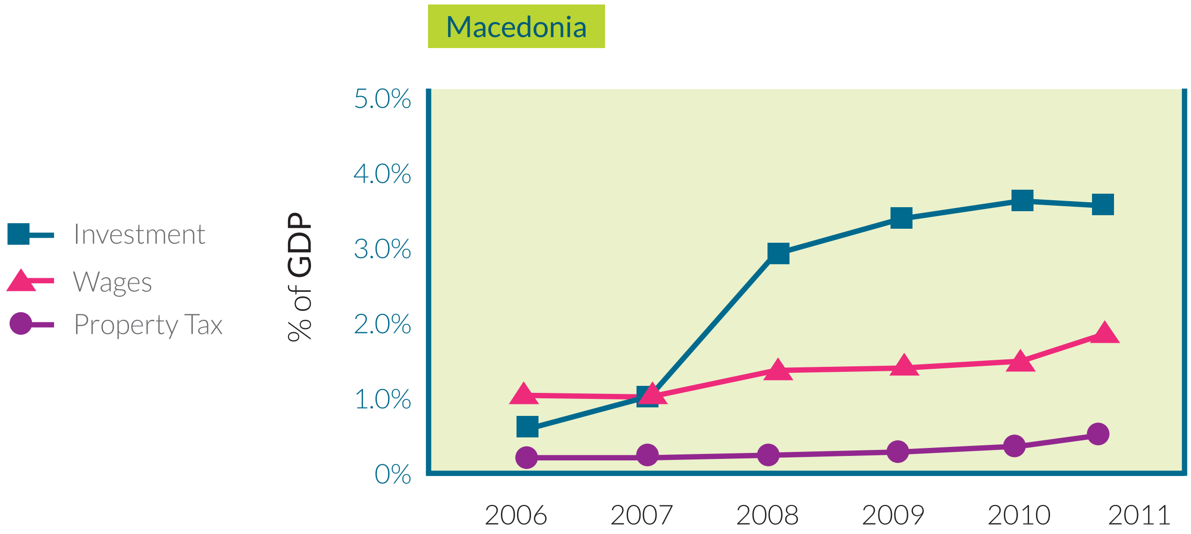
Trends for local government investment, wages and property taxes as a percentage of GDP

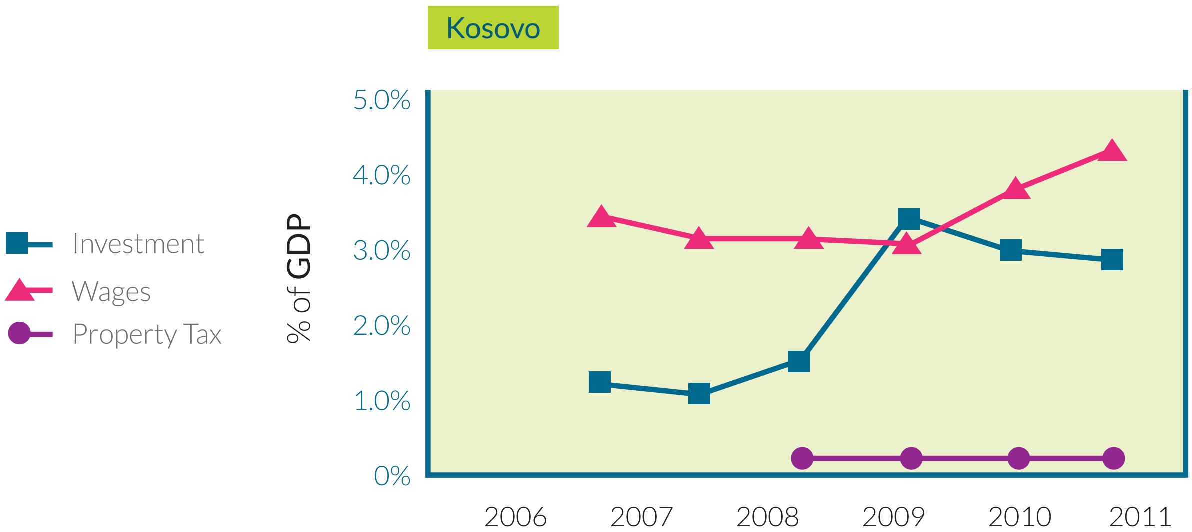
The next set of Charts present local government investment, wages and property taxes as a percentage of GDP. Again, we begin with the five members of the group that are fully responsible for pre-tertiary education. Here, the following trends are worth noting.

- In all members of the group except Moldova and Kosovo, wages are between 2.5 and 3.5% of GDP. Given that teachers' wages for pre-tertiary education typically account for the 2.5 - 3.0% of GDP, there is reason to believe that education in Macedonia, Bulgaria, and Romania is particularly underfunded. This does not mean the situation with education is good in Moldova or Kosovo. Only that teachers seem to be receiving higher share of the GDP than their counterparts elsewhere.
- In Macedonia, the sharp rise in wages as a percentage of GDP reflects the extension of the decentralization process to all local governments between 2006-2009. Since then, wage growth has stabilized and investments have begun to increase though from extremely low levels. Initial gains in property tax collection have not continued.
- In Moldova, local government wages have risen to close to 5% of the GDP. The high share of wages in local government budgets in part may be the result of relatively high teacher wages and/or overemployment in the sector. In part, it also reflects the administrative costs of maintaining a large number of very small local governments.
- In Bulgaria, local government investment as a percentage of GDP fell in 2011 despite an increase in EU structural funds. Wages, have also declined while property tax collection has increased. All of this suggest that local governments in Bulgaria under a fair amount of financial stress.
- In Montenegro, local government investment spending peaked in 2008 at over 5% of the GDP. It has since crashed to 2% of GDP. Expenditures on wages have also declined recently, while property tax collection continues to increase and is now close to EU averages. As in Bulgaria, this combination of trends suggest that Montenegrin local governments are under a fair degree of financial stress.
- Both local government wages and investments have risen fairly sharply in Kosovo over the last few years. Property tax collection has however decline slightly.
- In Slovenia, local government investment has fallen from a high of 3% of GDP in 2010 to 2% in 2011. Property tax collection has not improved and but remains relatively high for the region. For reasons that are hard to explain, spending on wages, are very low.

- Since 2009 investment spending in Croatia has fallen from over 2% of GDP to just over 1%. Expenditures on wages have stayed relative low and stable, while property tax collection remains very low for a relatively wealthy country with a lot of prime real-estate. Here it should be remembered that the property tax still has not been decentralized to local governments.
- In FBIH of BiH, investment spending has fallen to 1% of GDP while wage spending has remained at precisely the same 1% level for the entire period. Meanwhile property tax collection has declined marginally from already low levels.
- In RS of FBiH, investment spending exceeded 3% of GDP in 2008. They have however fallen to just under 2% since then. Meanwhile wages have remained flat at 2% of GDP since 2009. Property tax collection has fallen slightly.
- In Albania, investment spending peaked at just over 1% of GDP in 2009, and has since fallen. Wage spending is law at less than 1% of GDP and property tax collection has declined slightly over the last few years.
- In Turkey, local government investment spending has fallen slightly from about 2% of GDP in 2008 to 1.7% today. Wages are low and stable at 1% of GDP. Property tax collection is low and stable.




Macedonia
Investment
Wages
Property Tax
% of GDP
5.0%
4.0%
3.0%
2.0%
1.0%
0%
2006
2007
2008
2009
2010
2011


Kosovo
Investment
Wages
Property Tax
% of GDP
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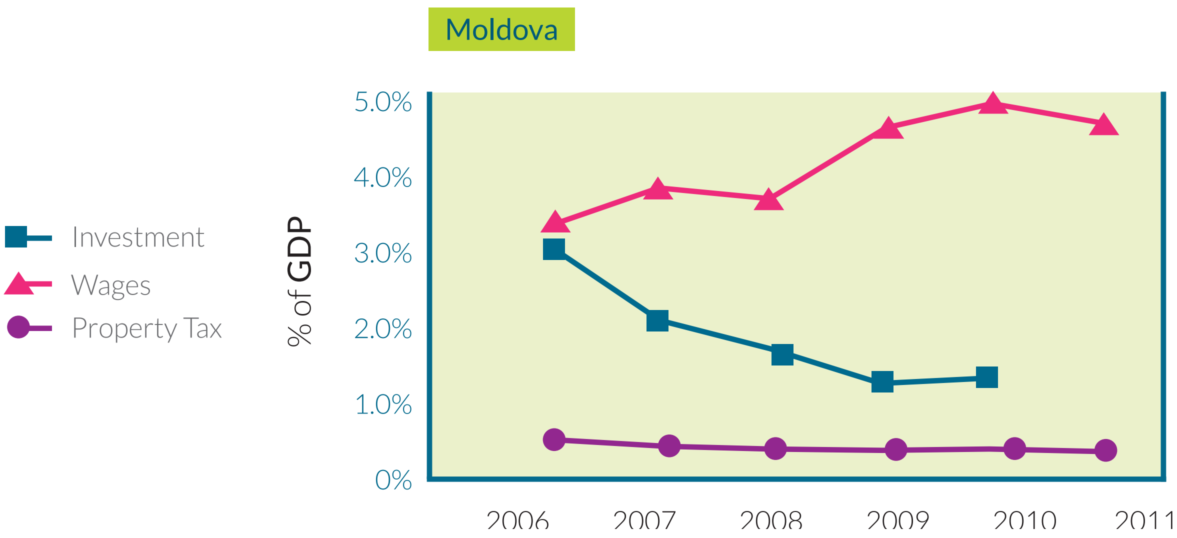
4.0%
3.0%
2.0%
1.0%
0%
2006
2007
2008
2009
2010
2011


Moldova
Investment
Wages
Property Tax
% of GDP
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3.0%
2.0%
1.0%
0%
2006
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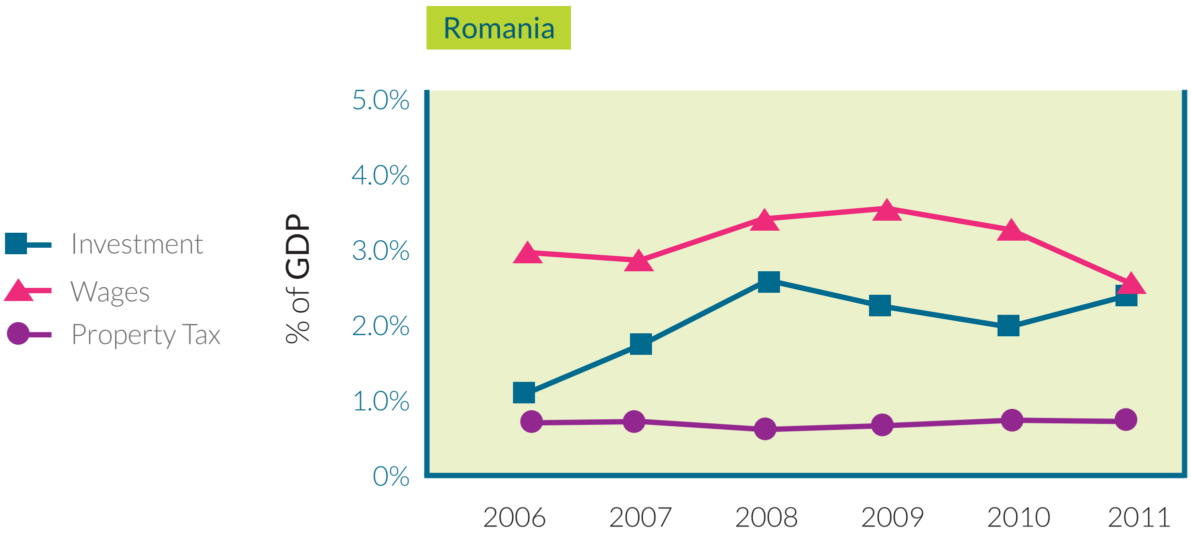
Romania
Investment
Wages
Property Tax
% of GDP
5.0%
4.0%
3.0%
2.0%
1.0%
0%
2006
2007
2008
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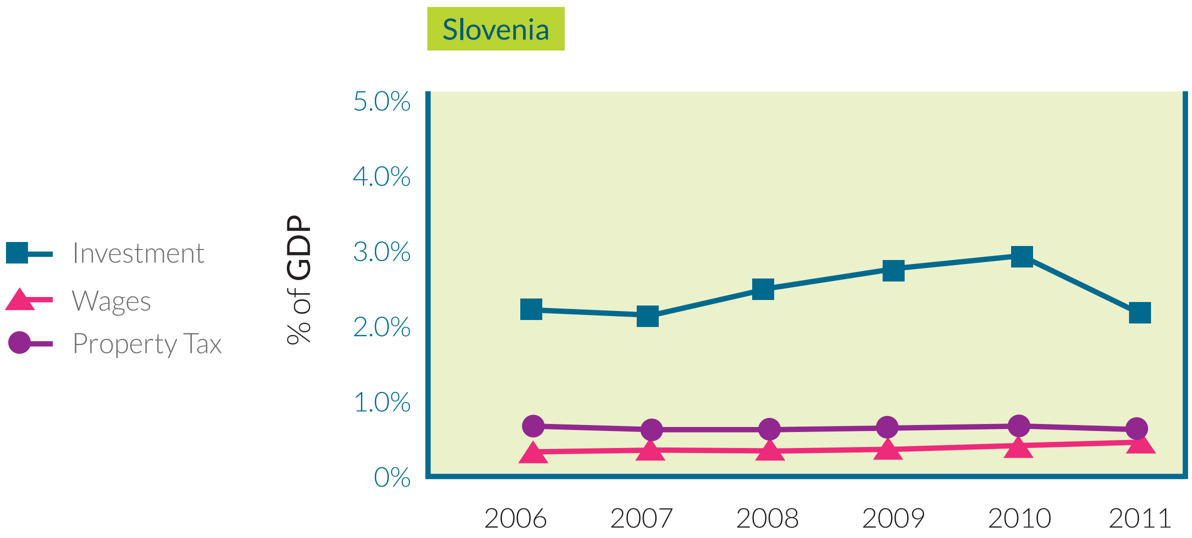
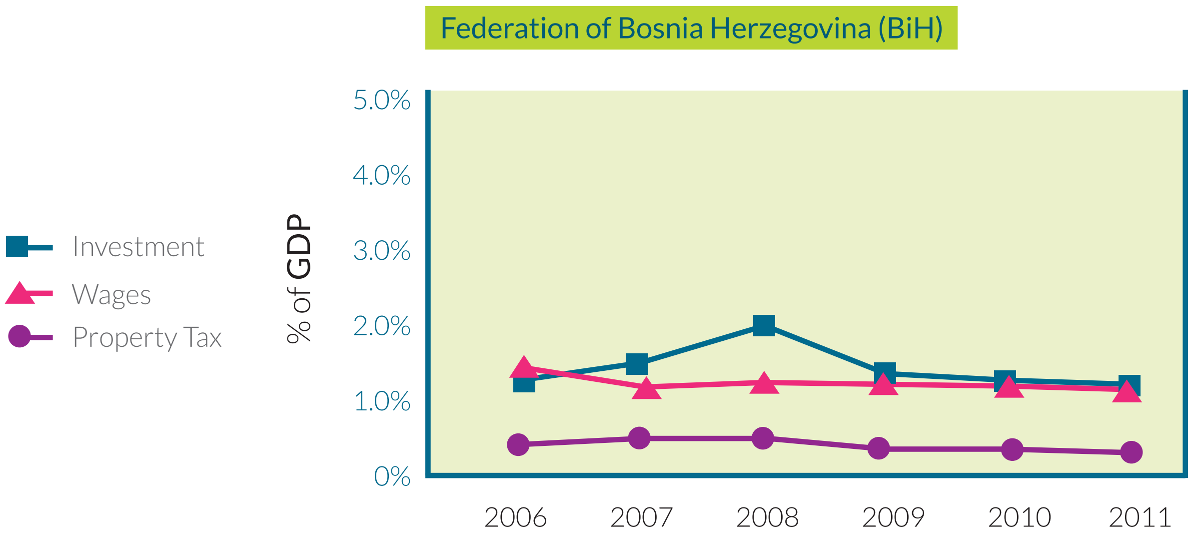
2010
2011



Slovenia
Investment
Wages
Property Tax
% of GDP
5.0%
4.0%
3.0%
2.0%
1.0%
0%
2006
2007
2008
2009
2010
2011

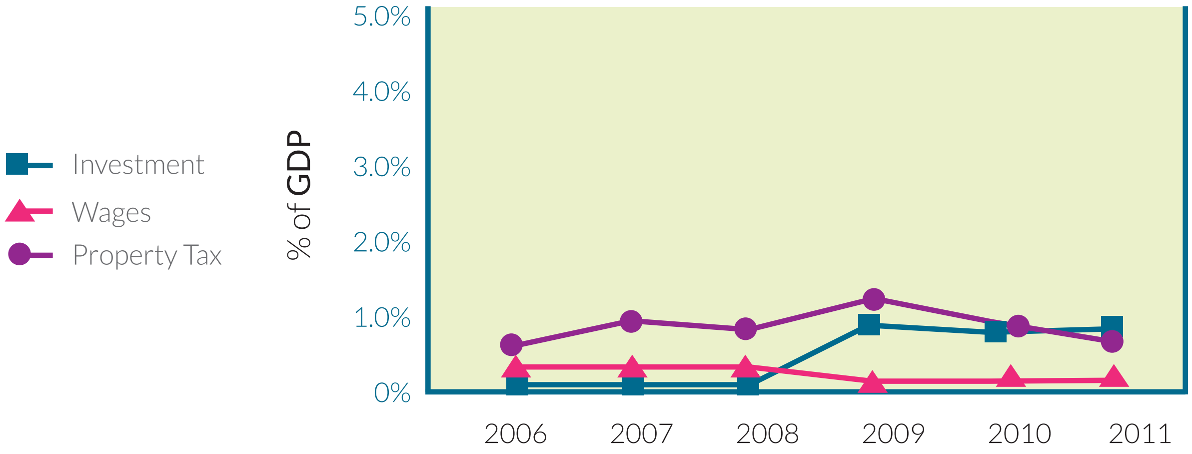


Federation of Bosnia Herzegovina (BiH)
Investment
Wages
Property Tax
% of GDP
5.0%
4.0%
3.0%
2.0%
1.0%
0%
2006
2007
2008
2009
2010
2011

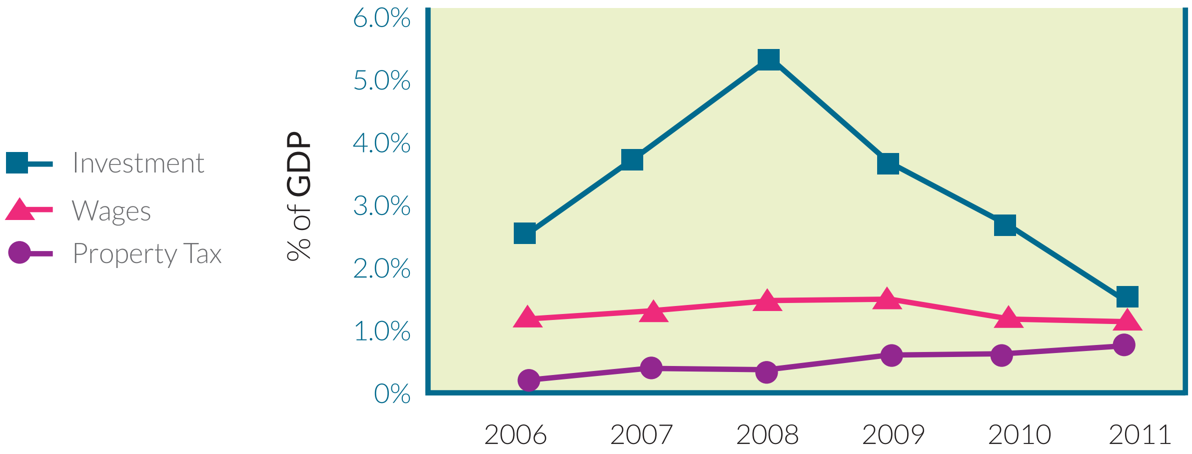
Republika Srpska (BiH)

Croatia

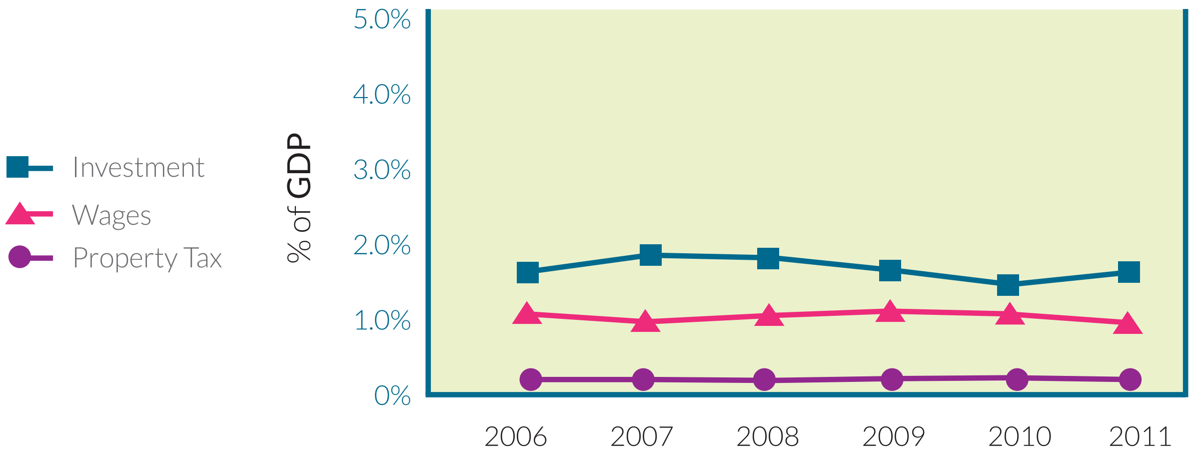
Albania



Montenegro



Turkey



Serbia

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