Initial report for a joint CEMR – EPSU workshop: January 2012

Funding of Local and Regional Government: Key challenges, solutions to growth and alternatives

A very difficult economic context

Local and regional government in the European Union (EU) is operating in a very difficult economic and financial context and there is little prospect that this will improve in the short term.

With the exception of **Sweden**, the budget of every government in the EU is in deficit. The deficit for the whole of the EU, which was just 0.9% of GDP in 2007, had ballooned to 6.9% in 2009 and was still 6.6% in 2010. The latest forecast from the European Commission is that it will be 4.7% in 2011, 3.9% in 2012 and still 3.2% in 2013. Even by that year it is expected that 16 member states will have government deficits that exceed the 3.0% Maastricht threshold (see Table in Annex).

These high levels of deficit are to a large extent a consequence of the 2008 financial crisis and the recession it caused it. However, the banking crisis has been followed by a sovereign debt crisis, and, under pressure from financial markets, European governments have adopted policies which aim to eliminate government deficits as rapidly as possible.

This approach has been also been enshrined at European level by the majority of EU states as evidenced most recently by the "new fiscal compact" adopted by the Euro area leaders, as well as a number of other on 9 December 2011. This included a commitment that member states would incorporate into their "national legal systems at constitutional or equivalent level" a rule under which: *"General government budgets shall be balanced or in surplus; this principle shall be deemed respected if, as a rule, the annual structural deficit does not exceed 0.5% of nominal GDP."*

At same time, any hopes that it might be possible to balance budgets at their existing level by more rapid economic growth, seem to have disappeared. Instead, economic growth has stalled, as the European Commission points out in it latest economic forecast, published in November 2011:*"Real GDP growth in the EU is now expected to come to a standstill around the end of this year, turning negative in some Member States. Only after some quarters of zero or close-to-zero GDP growth, a gradual and feeble return of growth is projected in the second half of 2012."*[1]

This means that downward pressure on local and regional government expenditure as significant part of overall government expenditure (33.6% on average in 2010 on the basis of CEMR/Dexia figures[2]) will be ongoing.

But national differences in role

It is important to point out at this stage that the share of local and regional government in overall government expenditure varies widely between member states.

[1] *European Economic Forecast - Autumn 2011*, European Commission, November 2011
[2] This and subsequent figures on local and regional expenditure come from *EU subnational governments: 2010 key figures*, CEMR and Dexia, 2011

It is higher in countries with a strong federal structure, where important powers are devolved away from national governments: the CEMR/Dexia figures show that local and regional government accounts for 41.8% of total government expenditure in **Belgium**, 44.1% in **Germany** and 53.2% in **Spain**. In contrast in **Cyprus**, this level of government only accounts for 4.8% of total government spending; in **Greece**, the figure is 5.6%; in **Ireland** 10.3%; and in **Malta** 1.5%.

There are also important differences in tasks undertaken by local and regional government. In most countries, education is an important local and regional responsibility, accounting for 20.8% of total expenditure at this level. But local and regional spending on education is nil or miniscule in **Cyprus**, **Greece** and **Malta**, and well below average in **Italy** and **Portugal**. Health accounts for around a quarter of local and regional spending in **Denmark**, **Finland** and **Sweden**, as well as in **Austria** and **Spain**, and 44.2% in **Italy**, but in other states, including **France** ,**Germany** and the **UK**, local and regional government spending on health is very small or non-existent, as the responsibility lies elsewhere.

These differences should be borne in mind in any consideration of spending trends.

Local and regional government hit harder

There are indications that, in some countries, local and regional government has been more heavily affected by cuts than central government.

In Italy, for example, the deficit reduction plans announced in 2010 and 2011 provided that "more than half of the expenditure reduction in 2011–2012 is to be delivered by sub-national governments,"[3] while the CEMR/Dexia figures show that they account for only 31.3% of total public spending. In the UK, the latest figures for public sector employment show that in the 12 months from the third quarter of 2010 to the third quarter of 2011, employment in local government fell by 195,000 or 6.7%, employment in central government, including the health service, fell by 49,000 (1.7%).[4]

A study by a Council of Europe body, the European Committee on Local and Regional Democracy, found indications that this was a general trend, although it looked at a wider range of countries than EU member states. It concluded that, "in more than half of the countries for which we have data, local budgets dropped more on aggregate than the corresponding central ones, at least in one of the two years of the crisis." It went on to point out that, "in a number of these countries [Central and Eastern European countries as well as some old member states] there is evidence that the central governments have deliberately applied pressure on local budgets in order to create fiscal space at the centre in order to deal with the effects of the crisis, either by cutting transfers and local borrowing or forcing local governments to run surpluses". [5]

Impact on social dialogue

Efforts to cut spending have directly affected employees through pay cuts and pay freezes, as well as in dealing with other issues, such as pensions. These changes in terms and conditions go to the heart of issues which ideally should be resolved through social dialogue, as do the cuts in employment which have implemented in many states.

[3] IMF Country Report No. 11/173: Italy, IMF, July 2011
[4] *Public Sector Employment - Q3 2011*, Office for National statistics, 2011
[5] *Local government: responses to recession across Europe*, European Committee on Local and Regional Democracy (CDLR), August 2011

Since 2008, 11 of the 27 EU states have directly cut public sector pay, sometimes more than once. The level of the reductions has varied from country to country, as has the way they have been imposed — sometime hitting basic pay, sometimes pay additions and sometimes both. The countries where pay has been cut are the **Czech Republic**, **Estonia**, **Greece**, **Hungary**, **Ireland**, **Latvia**, **Lithuania**, **Portugal**, **Romania**, **Slovakia** and **Spain**, and the situation in each one is set out in Table 2 in the Annex.

Seven further countries have frozen public sector pay, or significant elements of it, for at least a period since 2008. These are: **Bulgaria**, **Cyprus**, **France**, **Italy**, **Poland**, **Slovenia** and the **UK**. As with pay cuts there are variations in how this has been done. In **Poland**, for example, teachers are excluded — their pay has gone up. In **France**, it is the pay scales that have been frozen, while other elements of pay have improved for some public sector employees. In the **UK**, those earning less than £21,000 a year (about €25,000) got a small increase (although not in local government). A common feature in many countries is that pay freezes are set to last for a considerable time. In **Italy**, for example, public sector pay is being frozen from 2011 until the end of 2014. In **Cyprus**, the pay freeze announced in 2011 will last for three years, and in **France**, **Poland** and the **UK** pay freezes are planned for a two-year period.

The negative impact that these decisions have had on social dialogue has been intensified by the fact that in most cases pay cuts and freezes have not been negotiated between the social partners, but imposed, generally by central government. In some cases governments were under pressure to react quickly to pressure from the markets; in other the cuts were required by external funders (sometimes the International Monetary Fund alone, sometime in conjunction with the European Commission and the European Central Bank). However, whatever the reasons, unions and generally local and regional authorities themselves were not consulted beforehand.

There are some examples where agreements have been reached with the social partners, frequently after initial disputes. In **Ireland** in March 2010 the so-called Croke Park agreement guaranteed: that there would be no further pay reductions over the lifetime of the agreement – from 2010 to 2014; that there would be no compulsory redundancies; and that the 2010 pay reductions would be disregarded for the purposed of calculating pensions for those retiring in 2010 and 2011. In return the unions agreed to cooperate fully in redeployment within the public services as part of a modernisation of the public services allowing staff numbers to be reduced.[6] In **Lithuania** discussions between the government, the unions and the employers led to the signing of a national agreement on 28 October 2009. As well as covering a wide range of issues, this confirmed the average 10% cut in pay for state officials and civil servants and the average 8% pay cut for those employed in other publicly funded bodes. In return, the government promised that, during the period of the national agreement, there would be no further reduction in the basic salary level in the civil service. In **Slovenia** in December 2011 the government and the unions agreed to extend a freeze on pay in the public sector into 2012. The initial plan was for it to continue to be frozen throughout the whole of this year. However, following discussions with the unions, a compromise was reached limiting the freeze to the first six months. Finally in **Spain** unions signed a wide ranging agreement with the government and the employers in February 2011. The deal did not deal with public sector pay but did introduce major changes in Spain's pension system, increasing the normal retirement age from 65 to 67.

These examples show that it is possible for social dialogue to deliver results. However, they remain the exceptions.

[6] Public Service Agreement 2010-2014

Funding solutions

Facing these funding difficulties and operating within a defined legislative framework, local and regional authorities have only a limited number of possible responses to make savings without reducing services. (It is beyond the scope of this report to look at the complex and very varied systems of the public financing of local and regional authorities through taxation and transfers from central government, or to look at authorities' capital spending plans.)

As well as cutting costs through reducing the pay of their employees (see above), their main options are primarily to:

- increase revenue from other sources, such as charging for services;
- make savings through rationalisation and general efficiency;
- reduce costs by making greater use of technology;
- make savings through cooperation with other local and regional authorities;
- work with the private sector through public private partnerships; and
- work more closely with voluntary organisations – the third sector.

The survey undertaken jointly by European Committee on Local and Regional Democracy and CEMR in the summer of 2011, although not complete, provides an indication of the actions taken by regional and local authorities under these headings.[7]

Higher charges

The survey indicates that in a number of countries charges for services have increased but that there are often limits on how much can be raised. The response from **Estonia** for example notes that, "*There have been some cases of the water tariff going up, bus tickets becoming more expensive, or the garbage collection fee rising, but these are rather exceptional cases, this not a general trend*". As the response from **Finland** notes some charges are "*defined quite narrowly by legislation and municipalities have limited possibilities of increasing them*," a position echoed by the response from **Slovakia**. However, higher energy charges have been passed on in **Finland**, and this also seems likely to happen in **Slovenia**.

Rationalisation and efficiencies

Here much more has been done, although often the process started before the current crisis. In **Bulgaria**, a programme of schools restructuring (closing or merging some and creating new larger schools with better conditions for students) began in 2007. In **Denmark** merging schools is part of an efficiency drive, which cut costs by some 1.3 billion DKK (€175m) in 2010 and an expected 2.2 billion DKK (€295m) in 2011. This also involves amalgamating day-care centres and centres for the elderly, joint municipal partnerships around shopping areas, digitalisation and benchmarking. In Latvia, many hospitals have been closed: in 2006 there were 106 hospitals, in 2010 only 39 are left. In **Romania**, "*the school and hospital networks are in full process of rationalisation, which means closing down or merging facilities*," although the closure of hospitals or their downgrading to social care facilities, with a consequent loss of funding has produced local protests. Benchmarking as a way of reducing costs is also used in **Sweden** and **Slovenia**.

More generalised approaches have been taken in **Greece**, where an Auditing Service, specialised in municipalities and regions has been created to keep a tight control on local

[7] https://wcd.coe.int/ViewDoc.jsp?Ref=Qu/2011/fin&Language=lanEnglish&Site=DG1-CDLR&BackColorInternet=B9BDEE&BackColorIntranet=FFCD4F&BackColorLogged=FFC679

and regional government spending, and in **Ireland**, where an Efficiency Review Group was established in February 2010 to address efficiency advances in the local government sector. Its report in July 2010 makes recommendations for efficiencies and savings of €511m (11% of 2010 current expenditure).

The greater use of technology

Here, the main focus seems to have been in cutting energy costs **Austria**, **Cyprus**, the **Czech Republic**, **Denmark** and **Slovakia** all refer to this in their responses to the survey. The Danish reply points out that, "*Several municipalities are leaders in the cleantech race for technological advancement and job creation. Every year the Danish Ministry of Climate and Energy gives out an award to the municipality who does the most to mitigate climate change and promote cleantech. So there is fierce but friendly competition between the municipalities to receive this award.*"

Cooperation with other local and regional authorities

This is also an area where a number of countries have been active. In **Austria**, a new model of regional cooperation is being introduced in Styria. In the **Czech Republic**, local governments are free to co-operate among themselves and also to form partnerships with the private sector. However, the number of associations between municipalities has declined slightly recently from 779 in 209 to 766 in 2011.They mostly cover water supply and waste water treatment, communal services, collection of household waste, local road construction and maintenance and territorial planning. **Danish** municipalities have a long tradition of inter-municipal cooperation in a number of different policy fields. The technical sector has the most institutionalised cooperation through joint legal and economic entities dealing with waste handling, energy supplies and water supply; the transport sector also has a long tradition for cooperation. In **Finland**, the Ministry of Finance has introduced a cooperation network of several big and middle-sized cities aiming to increase efficiency through cooperation, with the IT sector seen as the most fruitful area for savings. In **France** new legislation, adopted in December 2010 makes cooperation between local authorities easier. They can now share services and responsibilities. In **Ireland** local authorities are now sharing services in areas such as regional waste management strategies, water services and the collection of rents, rates, fees and fines on behalf of the town authorities. The larger local authorities are also processing salaries and wages and planning applications on behalf of smaller local authorities within their area. One particularly interesting development in Ireland is the online annual quotation solution (www.laquotes.ie) to make it easier for local authorities to obtain quotations from suppliers in plant hire, haulage, tool hire and supplies and services. Suppliers can now submit a quotation online to all participating authorities rather than submitting paper based quotations individually to each local authority. In **Portugal**, there is a general stimulus for municipalities to cooperate in order to make economies of scale. In **Slovenia**, the Local self-government Act provides several forms of inter-municipal cooperation, some of which are also subsidised by the government. Municipalities can merge, organise associations of municipalities or set up joint management bodies. In the **UK**, a number of local authorities are seeking to merge their back-office functions.

Working with the private sector through public private partnerships

The responses to the survey indicate that this option has been taken up in some countries. These include: **Denmark**, where local authorities have a joint agreement with central government with a target of increasing the level of competition and use of private suppliers,

France, where longer term public private contracts are being developed, **Latvia**, where it is considered necessary "*to stimulate projects implemented by public and private partnership, because in the future it will reduce maintenance costs of local governments*", but currently this is not being done properly, and **Slovenia**, where a Public Private Act was adopted in 2006, regulating partnership between public and private sector. This legislation provides for transparency between the public and private sector and the Slovenian Ministry of Finance provides professional advice to municipalities preparing to cooperate with private sector and manages a list of PPP cases. In the **UK** too public private partnerships have been widely used for many major capital projects. However, they remain controversial.[8]

Working more closely with voluntary organisations – the third sector

The survey provides little evidence that this option is being widely taken up, although the response from **Slovenia** specifically mentions the possibility. However, in the **UK** voluntary organisations and local authorities have worked closely together for some time in the provision of services, although there are some indications that cuts in budgets are putting that relationship under strain. There are also union fears that voluntary organisations are being used to undercut the pay and conditions of existing employees and in some cases replacing them.

The way forward

These developments indicate that local and regional authorities are taking a range of measures to improve their financial position at a time when the demand for their services is growing. However, as CEMR and EPSU pointed out in a joint statement in October 2011, the policy of austerity has "only contributed to the negative developments in growth and employment", while "risking a race to the bottom" in the provision of quality local public services. The way forward is for government and European institutions to "take a long-term perspective" and it is clear social dialogue is vital for successful long-term planning and innovative ways of cooperation.

[8] See *EPSU Briefing on Public-Private Partnerships (PPPs), "10 facts about public-private partnerships (PPPs)"*, November 2011

Annex

Table 1: Net government lending (+) or borrowing (-) as percentage of GDP

	5-year averages							Autumn 2011 forecast			Spring 2011 forecast	
	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013	2011	2012
Belgium	-5.4	-0.7	-0.6	-0.3	-1.3	-5.8	-4.1	**-3.6**	**-4.6**	**-4.5**	*-3.7*	*-4.2*
Germany	-3.0	-1.7	-3.3	0.2	-0.1	-3.2	-4.3	**-1.3**	**-1.0**	**-0.7**	*-2.0*	*-1.2*
Estonia	:	-0.5	1.5	2.4	-2.9	-2.0	0.2	**0.8**	**-1.8**	**-0.8**	*-0.6*	*-2.4*
Ireland	-1.7	2.4	1.2	0.1	-7.3	-14.2	-31.3	**-10.3**	**-8.6**	**-7.8**	*-10.5*	*-8.8*
Greece	-9.7	-4.2	-5.9	-6.5	-9.8	-15.8	-10.6	**-8.9**	**-7.0**	**-6.8**	*-9.5*	*-9.3*
Spain	-5.8	-1.9	0.6	1.9	-4.5	-11.2	-9.3	**-6.6**	**-5.9**	**-5.3**	*-6.3*	*-5.3*
France	-4.9	-2.2	-3.2	-2.7	-3.3	-7.5	-7.1	**-5.8**	**-5.3**	**-5.1**	*-5.8*	*-5.3*
Italy	-8.3	-2.3	-3.6	-1.6	-2.7	-5.4	-4.6	**-4.0**	**-2.3**	**-1.2**	*-4.0*	*-3.2*
Cyprus	:	-3.6	-3.7	3.5	0.9	-6.1	-5.3	**-6.7**	**-4.9**	**-4.7**	*-5.1*	*-4.9*
Luxembourg	1.6	4.5	0.6	3.7	3.0	-0.9	-1.1	**-0.6**	**-1.1**	**-0.9**	*-1.0*	*-1.1*
Malta	:	-7.5	-5.1	-2.4	-4.6	-3.7	-3.6	**-3.0**	**-3.5**	**-3.6**	*-3.0*	*-3.0*
Netherlands	-3.3	0.0	-1.3	0.2	0.5	-5.6	-5.1	**-4.3**	**-3.1**	**-2.7**	*-3.7*	*-2.3*
Austria	-4.1	-1.6	-2.0	-0.9	-0.9	-4.1	-4.4	**-3.4**	**-3.1**	**-2.9**	*-3.7*	*-3.3*
Portugal	-4.6	-3.3	-3.9	-3.1	-3.6	-10.1	-9.8	**-5.8**	**-4.5**	**-3.2**	*-5.9*	*-4.5*
Slovenia	:	-3.1	-2.0	0.0	-1.9	-6.1	-5.8	**-5.7**	**-5.3**	**-5.7**	*-5.8*	*-5.0*
Slovakia	:	-7.6	-3.9	-1.8	-2.1	-8.0	-7.7	**-5.8**	**-4.9**	**-5.0**	*-5.1*	*-4.6*
Finland	-5.8	2.7	3.1	5.3	4.3	-2.5	-2.5	**-1.0**	**-0.7**	**-0.7**	*-1.0*	*-0.7*
Euro area	-5.0	-1.7	-2.5	-0.7	-2.1	-6.4	-6.2	**-4.1**	**-3.4**	**-3.0**	*-4.3*	*-3.5*
Bulgaria	:	0.5	0.6	1.2	1.7	-4.3	-3.1	**-2.5**	**-1.7**	**-1.3**	*-2.7*	*-1.6*
Czech Republic	:	-4.2	-4.3	-0.7	-2.2	-5.8	-4.8	**-4.1**	**-3.8**	**-4.0**	*-4.4*	*-4.1*
Denmark	-2.5	0.9	2.6	4.8	3.2	-2.7	-2.6	**-4.0**	**-4.5**	**-2.1**	*-4.1*	*-3.2*
Latvia	:	-1.4	-1.2	-0.4	-4.2	-9.7	-8.3	**-4.2**	**-3.3**	**-3.2**	*-4.5*	*-3.8*
Lithuania	:	-4.8	-1.1	-1.0	-3.3	-9.5	-7.0	**-5.0**	**-3.0**	**-3.4**	*-5.5*	*-4.8*
Hungary	:	-5.3	-8.0	-5.1	-3.7	-4.6	-4.2	**3.6**	**-2.8**	**-3.7**	*1.6*	*-3.3*
Poland	:	-3.9	-4.9	-1.9	-3.7	-7.3	-7.8	**-5.6**	**-4.0**	**-3.1**	*-5.8*	*-3.6*
Romania	:	-4.0	-1.6	-2.9	-5.7	-9.0	-6.9	**-4.9**	**-3.7**	**-2.9**	*-4.7*	*-3.6*
Sweden	-7.7	1.0	0.6	3.6	2.2	-0.7	0.2	**0.9**	**0.7**	**0.9**	*0.9*	*2.0*
United Kingdom	-6.1	0.5	-3.0	-2.7	-5.0	-11.5	-10.3	**-9.4**	**-7.8**	**-5.8**	*-8.6*	*-7.0*
EU	:	-1.4	-2.5	-0.9	-2.4	-6.9	-6.6	**-4.7**	**-3.9**	**-3.2**	*-4.7*	*-3.8*

Source: European Economic Forecast – Autumn 2011: Statistical Annex, European Commission, October 2011

Table 2: Pay cuts in the public sector

Country	Pay cut
Czech Republic	Public sector paybill cut by 10% in 2011, with ministries deciding between job and pay cuts; teachers are exception; pay freeze until 2014
Estonia	Series of pay cuts starting in 2008; by the first quarter of 2011 average pay in central government was 8.0% lower than it had been in the fourth quarter of 2008, while in local government the drop was 14.6%
Greece	Series of pay cuts implemented in early 2010, involving 20% cuts in allowances and 13th and 14th month salary reduced, equivalent to 14% to 15% pay cut over year; in 2011 new pay system introduced, expected to result in further 17% pay cuts
Hungary	13th month salary abolished from 2010 and replaced it with lower payment; on going pay freeze and in March 2011government announced there will be no increase in public sector paybill before 2015
Ireland	Cut in pay of 6%-7% from January 2010; this hits highest paid harder but all lose at least 5%; in November 2010 government cuts pay for new entrants to the public sector by 10%
Latvia	15% cut in pay from January 2009 but low paid initially protected, increased to 20% for higher paid and 15% for lower paid in June; a revised overall pay system from 2010 cuts pay further
Lithuania	Major cuts in money available for salaries in 2009 results in cuts in additional payments as well as unpaid leave; further overall cut of 10% in July 2009: 5% cuts in basic pay, with supplements cut by more affecting higher paid more severely; pay freeze until end 2012
Portugal	5% pay cut from start of 2011; highest paid hit hardest with those on €1,500 to €2,000 losing 3.5% and those under €1,500 unaffected; from 2012 13th and 14th month pay abolished for those earning more than €1,000 and cut for those earning less; pay frozen until end of 2013
Romania	Cuts in additional payments and bonuses plus two weeks unpaid leave in 2009;

	followed by temporary 25% cut in pay from July 2010 until end of 2010; in January pay was increased by 15% but 13th month payments and many bonuses have been eliminated
Slovakia	Public sector paybill cut by 10% in 2011, with ministries deciding how the reduction should be made; teachers and some other groups are not affected
Spain	5% cut in public sector pay from 1 June 2010 and pay frozen until initially until end of 2011 but now 2012; all public sector employees to work 37.5-hour week (some previously worked less)