Failure to Devolve: Azerbaijan Avoids Promised Devolution of Power to Municipalities by Merging Them Instead

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Azerbaijan has long been expected to take concrete steps towards decentralization and strengthening local governments (municipalities). However, in April of this year, the government opted to centralize municipalities further. On 16 April 2024, the president signed decrees amending the Law on the *Joint Activities, Merger, Splitting, or Dissolution of Municipalities* and the Law on the *Status of Municipalities*. The government already had the right to forcibly merge local governments, yet initiatives to merge municipalities were legally voluntary (in practice they were not) prior to these amendments. Thus, according to the amendments, municipalities with a population of less than 3,000 people or households of less than 1,000 units will be merged with other municipalities by a decision of parliament, taking into account their socio-economic situation, history and other local peculiarities. The name of the merged municipality will be determined in accordance with the name of the municipality with the largest population. A number of municipalities, including Khınalıq, Lahıj and Ivanovka will be impacted by the amalgamation due to local peculiarities.

Another important point in the amendments is related to the start date of the merger process. The annex to Article 1 of the law states that the merger will take place in the latter 2 years of the 4 year period following the last nationwide municipal election. Since the amendments came into effect in

April 2024, the process should start after the upcoming municipal election, which will be held in the last month of this year. However, Siyavush Novruzov, Chairman of the Milli Məclis's Regional Affairs Committee, clarified that the intention of the law is that it be applied before the upcoming elections. According to him, as soon as the law is passed, the amalgamation process will begin. The process should be completed by December before the elections. There is no precise information about a set number to which the number of municipalities should be reduced. Some reviews note the number to be 700, while others have pointed to 1/3 of the current number. If the process is successful, the number of municipalities can be expected to drop to 500-600 from 1.606.

Some questions inevitably arise regarding the consolidation mechanism, especially in the period before it is submitted to parliament for review. How will the merger of municipalities take place? Who, and which institution, will deal with this process? Will municipalities take the initiative, or will the process be managed by a state body, such as the Center for Work with Municipalities at the Ministry of Justice? Which criterion for the merger will apply? On what principle is it to be determined that municipality A should merge not with municipality B, but with municipality C?

The practice of merging municipalities is not new for Azerbaijan: Mass merges have taken place twice since independence. The first amalgamation measure was launched in 2009. Thelaws on the *Creation of New Municipalities through the Merger of Municipalities in the Republic of Azerbaijan* dated 29 May 2009 and the *Creation of New Municipalities through the Merger of Municipalities in the Nakhchivan Autonomous Republic* dated 19 June 2009 reduced the number of municipalities by 38%, from 2.757 to 1.718. At that time, the legislation envisaged a voluntary merger of municipalities, yet the process was carried out administratively. As a result of unofficial tasks given to the municipalities, they *voluntarily* held meetings and decided to merge. As a result of

this initiative, there has been a sharp decrease in the number of small municipalities with populations of less than 1.000 people. If before the merger 46% of municipalities had a population of less than 1.000, their share decreased to 18,3% after the merger.[1] The second merger took place in 2014. The Law of 30 May 2014 on the *Creation of New Municipalities through the Merger of Municipalities in the Republic of Azerbaijan*, created 94 municipalities by amalgamating 211 municipalities, and the total number of municipalites was reduced to 1.606. The previous *legally voluntary* mechanism was also applied to the second merger.

When launched in 1999, municipalities numbered 2 667. In the period up to 2009, there was an upward trend in the number of municipalities and their number rose to 2 757. As a result of amalgamation measures, their number plunged to the current limit of 1 606 in subsequent periods.

So how have these previous amalgamations improved municipalities and what does the upcoming one promise to do? Has or will muncipalities' efficiency improve?

Parliamentary discussions elicited a number of reasons for the merger of municipalities. During the parliamentary debate on the draft law, Siyavush Novruzov stated that the move is aimed at ensuring that local self-governance becomes more efficient. The main arguments in the parliamentary discussions surrounded the size of municipalities, their weak financial capacity, their dependence on the state budget , and examples of successful municipal mergers around the world.

The idea of merging municipal government units in Azerbaijan was first put forward in 2007 by experts from the Center for Support for Economic Initiatives representing the civil society sector. As a result of advocacy measures carried out in 2007-2009, the government took this step in 2009. The assessments[2] conducted after the completion of the mergers showed that the amalgamation not only did not have the desired

effect, but even created additional problems. These included issues such as incomplete representation of the local population in the amalgamated municipalities, the challenge of citizens' re-registration, the new municipalities' limited capacity for financial transactions, and sharp differences in size between the amalgamated municipalities.

Between 2008 and 2023, the revenues of municipalities that underwent two amalgamations increased by 26,5% across the country. This means that municipalities managed to increase their revenues by an average of about 1,5% per year over 16 years. However, the rate of revenue growth has been volatile over this period. Decreases occurred in 2009 (-38%), in 2015 (-37.2%), in 2018 (-0,3%), and in 2020 (-3,9%), and were mainly due to global crises. From 2008 to 2009, municipal revenues were negatively affected by the global financial crisis, and in 2015 by the devaluation. The recession in 2020 was caused by the global pandemic. In only 4 of the last 16 years, municipal budget revenues have been above the 2008 level. In 2023, budget revenues rose to a record 54,5 million AZN.

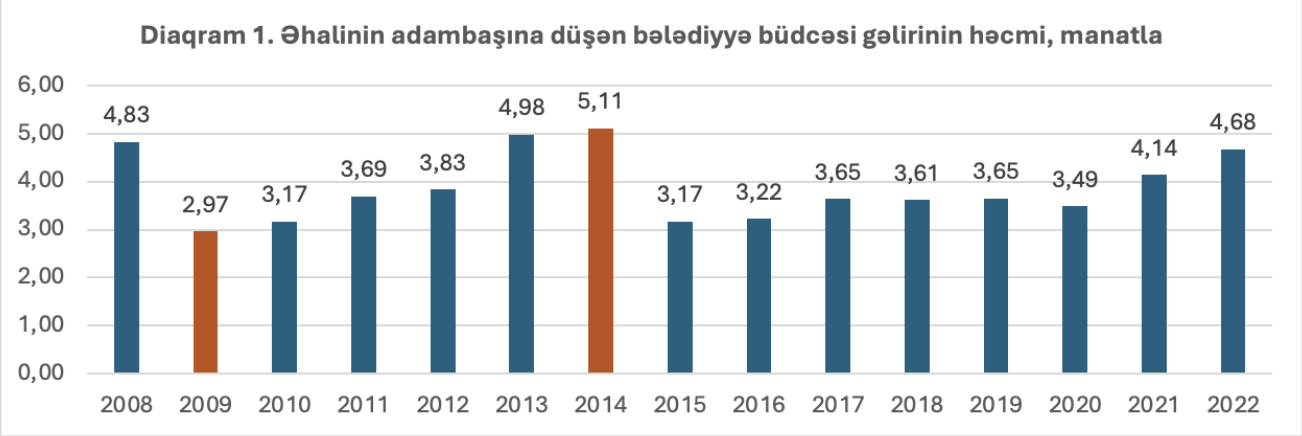
The question arises: What is the role of municipal governments in the growth of local budget revenues from their direct activities between 2008 and 2023? What is the contribution of municipal amalgamation to this growth? An analysis of the composition of local budget revenues shows that the main drivers of revenue growth were *personal property taxes* (increased by 5,5 times) and *subsidies and subventions from the state budget* (increased by 2 times). The increase in these sources is mainly a result of a central government decision to change the taxable base of personal property tax in 2014. Because of that change municipalities made significant progress in collecting revenue from this source (3,4 times). Currently, 41% of local budget revenues are contributed by these two sources.

The greatest growth in resources directly dependent on the

activities of municipalities was recorded in the payments for sanatorium-resort, hotel and tourist services (increased 8,8 times) and stationary or mobile trade, catering and other services on lands specially allocated by municipalities (increased by 4,3 times). These sources account for only 4% of local budget revenues. As can be seen, the amalgamation is not responsible for significant growth in municipal revenues.

Let's take a look at another indicator. Amid the 26,5% growth of municipal budget revenues, the volume of local budget per capita revenues decreased. Between 2008 and 2022, the volume of local budget per capita revenues decreased from AZN 4,83 to AZN 4,68 (See Figure 1).

Figure 1. Total municipal budget per capita revenues, in AZN



Note: The figure is based on data provided by the State Statistics Committee.

One of the indicators that would demonstrate an improvement in municipalities' efficiency would be a reduction of the administrative burden. The analysis of local budget expenditures, contrary to expectations, shows an increase in administrative costs. The maintenance costs of municipalities surged by 112,2%, while local budget expenditures increased by 11,2% between 2008 and 2023. At the same time, the share of local government expenditure in budget spending increased from 35,1% to 67%. Clearly the amalgamation only increased the administrative burden.

Today, all around the world there is an increasing trend of reducing the number of local governments through amalgamations. The Council of Europe member states have a great deal of experience in this field. For example, the number of municipalities in Albania was reduced from 373 to 61 in 2015; in Denmark from 271 to 98 in 2007; in Finland from 431 to 320 between 2009 and 2013; in Switzerland from 3.021 to 2.495 between 1990 and 2012; and in Greece from 1.034 to 325 in 2011.

The number of municipalities varies in countries with roughly the same size and population as Azerbaijan. There are more municipalities in Austria (2.357), Hungary (3.175) and the Czech Republic (6.250) than in Azerbaijan. There are 589 municipalities in Belgium, an area one-third the size of Azerbaijan, and 484 in Cyprus, 9 times smaller than Azerbaijan. The number of municipalities in Greece, which has the same population as Azerbaijan, is 325. There are 98 municipalities in Denmark, the area and population of which are 2 times smaller, and 418 municipalities in the Netherlands, which has around the same area as Azerbaijan and whose population is twice Azerbaijan's.

In spite of all the practices with regard to municipal amalgamations, it has not been possible to find an optimal size of municipalities to date. The main reason for reducing the number of municipalities is to improve economic efficiency. It is believed that reducing the number of municipalities reduces several costs, including administrative costs, and improves the quality of services provided by local governments. However, merger has not been fruitful across many countries. For example, an analysis of the results of the 2007 municipal amalgamation conducted in Denmark showed that the costs of other sectors began to increase despite decreasing administrative costs. Danish local government reforms failed to yield any cost savings in the delivery of public services such as schools, roads and infrastructure. A comparison of 82 amalgamated municipalities in Finland between 1970 and 1981

with 82 unamalgamated municipalities found that municipal mergers were not conducive to lower per capita spending. In most spending categories, the per capita expenditure increased more in the merged municipalities than in the comparison group. In Sweden, the 1952 amalgamation reform had a negative impact on expenditures for municipalities under a critical size, but lower expenditure growth was only observed in cases of the amalgamation of highly fragmented municipalities of equal size and not when a large municipality amalgamated with a smaller one.

In Azerbaijan, municipal amalgamation has also failed its ostensible goals. The mergers resulted neither in a reduction of administrative expenditures nor growth of economic potential. The main reason for this is that amalgamated municipalities did not receive further responsibilities and powers as expected. The central government not only failed to entrust these responsibilities and powers after the merger, but rather limited municipalities' financial capacity. 2016 amendments to the Tax Code (Articles 206.1-1 and 206.3) transferred a portion of revenues from the individual land tax away from municipalities to the state budget. When the Tax Code of 3 December 2021 was amended, one of the 4 sources of municipal taxes—*the tax on construction materials of local importance*—was also transferred from municipalities to the state. Total revenues from the local construction materials extraction tax for 2021 amounted to 1,24 million AZN, accounting for 3% of the country's local budget revenues.

Recommendations regarding the monitoring report prepared through an intermediary of the Monitoring Group of the Congress of Local and Regional Authorities of the Council of Europe in 2003 (Recommendation 126), in 2012 (Recommendation 326) and in 2021 (Recommendation 461) emphasize the 1) increasing the powers of municipalities; 2) expanding their financial opportunities; and 3) recognizing municipalities as a state institution that exercises state power as part of the general state administration.. Local think tanks and experts

support these Council of Europe recommendations. But, unfortunately, the central government is in no hurry to take concrete action in this direction.

Notes and references:

[1] Opinion on the current state of local authorities in Azerbaijan. NGO Alliance for the Development of Municipalities, Baku, 2011

[2] Ibid.