

## THE URBAN POLICY CONTEXT IN MEDIUM-SIZED EUROPEAN METROPOLITAN AREAS

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### SUMMARY

In the aftermath of communism, the road to democratization has been a bumpy one for the Central and Eastern European cities of Tbilisi, Budapest, Zagreb and Belgrade. Once heavily focused on manufacturing under former communist regimes, these cities must now make a successful transition to democracy and attract investors by diversifying to a service-based economy and developing their IT sectors, green tourism and agriculture. Some of this work is well underway; yet, political instability and the rise of populism, for example in Hungary, risk turning investors' attention to safer geopolitical areas.

The economy in Central and Eastern Europe grew quickly in the first years after communism ended. Wages rose, and people were keen to adopt Western lifestyles and culture. However, shifting the paradigm from a centralized economy to one in which municipal governments have far more say in their governance and budgetary decisions hasn't been without its pitfalls. Hobbling the march toward democracy, for example, are leftover traditions from the communist era, such as the prevalence of corruption, along with the fallout from communist methods of rule, in which top-down political decisions, rather than local economic power, determined urban growth in Eastern Europe. On the plus side, the communist regimes have left a legacy of a highly educated and skilled workforce.

While Hungary was the first to introduce political and economic reforms after communism fell, a right-wing political resurgence has the European Union and investors now looking askance at the country. Georgia, too, has been under an increasingly nationalist influence since elections just over two years ago. Foreign

direct investment in these countries has also led to unstable governments indulging in spending sprees rather than in prudent fiscal management. Higher wages have translated into a loss of competitiveness in manufacturing and agriculture for Croatia, Serbia, Hungary and Georgia, resulting in a slowdown of GDP growth. Nor have any of these countries reached a point where they can compete in global markets of high added-value goods.

The four cities examined in this report are all making job creation a priority, along with the provision of services for companies looking to investing in them. These cities have also striven to become more livable for their residents by making commute times shorter with improved transportation infrastructure, and by ensuring adequate green space.

Higher wages, however, have been a two-edged blessing. While a rise in income has spawned a desire for better living accommodations, this has meant a flow of people away from city centres and the subsequent creation of urban sprawl. Compounding the problem is the fact that this flight started before local land use and building regulations were developed. Thus, these four cities must walk a tightrope between managing the economic impact of the flight from downtown and keeping up a certain level of fiscal resources and income to provide services to the growing neighbourhoods. This situation has put these municipal governments in a bind because house prices in the city centres have dropped due to the exodus and so have property tax revenues.

Struggling to balance their customary Eastern traditions with a new Western political, economic and social reality, the four cities face many challenges in providing housing and health care for their growing populations - which include refugees and immigrants - diversifying their economies, maintaining a secure economic foundation and improving their ability to generate revenue. The jury will be out for a while yet on well they've managed to achieve all this.

## **THE LEGACY OF THE EAST – URBANIZATION UNDER CENTRAL PLANNING**

Urban development is driven by such factors as economic relations, governance, institutional development and politics. Under communism, the growth of cities in Eastern Europe was, in many respects, determined by top-down political decisions rather than through the economic power of the settlement. Accordingly, small towns and villages that were at the bottom of the settlement hierarchy were often deprived of development funds. As a rule, central development plans tended only to consider industrial or sectoral perspectives and to ignore regional differences. The nature and organization of local government was such that larger municipalities enjoyed and exercised more rights and political power. After the fall of communism, along with the loss of some of their political power, these former urban areas began to lose some of their population, too. It is likely that this demographic shift is a natural correction in response to decades of central economic planning and to the impact of the 2008 economic downturn. A result was the rising demand for housing in areas adjacent to or near cities at a time when there was no clearly defined regulation on land use and building, and city master plans had not yet been fully developed.

## **BUDAPEST, ZAGREB, TBILISI AND BELGRADE**

One would expect similarities in the development of the four cities: they have similar geographical locations, they are melting pots of Central and East European cultures, religions and traditions, and they share comparable histories. During communism, all four cities were at the top of a political and economic hierarchy as they were the seats and focal points of executive power. After 1990, the transition from planned to market economy, from one party to multi-party and democratically accountable political systems resulted in important changes in these four capitals (Golubchikov 2016). As a rule, their development was determined by two factors, namely their past and the influence of the Western democracies (Fuchs and Offe 2008). Offe (1996) defines the past (East) as the historical legacy in the Eastern countries and the West as the external, supranational socio-economic and political influence of the above democracies.

Despite the many similarities between the cities and their respective countries, the process of transition was neither predetermined nor identical. Underlying conditions, such as economic development at the time of transition, the pre-existing institutional legacy, and in the case of the Balkans, a war of independence, also influenced development paths (Carothers 2002, 8; Herrschel 2007). Differences in development are also attributable to the availability of European Union funding, as full access to such funding is only possible once full EU membership is achieved. Budapest (Hungary) and Zagreb (Croatia) are cities in EU member states. Belgrade is the capital of Serbia, a candidate country for EU membership. Tbilisi is the capital of Georgia, a country in the Eastern Partnership agreement (EaP).

The EU grant system for urban and regional development, education and urban mobility is designed to encourage municipalities to follow a “European” path of development.

Under Europe 2020, the targets for European cities over the coming decades are: (i) increasing employment, (ii) research and development, (iii) reaching climate goals, (iv) social inclusion and (v) poverty reduction (Europe 2020). Urbanization has its economic and social advantages: a city's density often correlates with the number of patents registered, which is a measure of innovation (Carlino et al. 2006). Today, in adapting to the changing needs of their citizens, the welfare systems of these cities are being challenged. European cities must create and maintain housing, and provide health services to accommodate a large population, as refugees and immigrants arrive in Europe. They must also maintain and secure their economic base and improve their income-generating ability.

## **HISTORY, DEVELOPMENT, DEMOGRAPHY**

Migration has influenced the urban history and urban/land development of Zagreb, Budapest, Tbilisi and Belgrade in many ways. The cities are located on or near rivers that connect Europe with Asia, and the Mediterranean with northern Europe. Their location was in no small degree a key factor in their economic growth, which began before the Middle Ages. Over the centuries, they were adversely affected by war and they suffered significant destruction as a result of conflict in the 20<sup>th</sup> century. As is the case for other cities, the population of these capitals has increased markedly over the past 200 years. Such growth has slowed, however, over the past 20 years.

*Tbilisi*<sup>1</sup>: Tbilisi is in a valley and is built on both banks of the Mtkvari (Kura) River. It is surrounded by mountains on three sides. Originally, the Old City of Tbilisi was located for strategic reasons at the narrowest point of the valley and, as late as the 19<sup>th</sup> century, it still had its medieval city walls. Today, only a few buildings from the medieval period survive, but the medieval street plan remains intact. Tbilisi underwent various periods of growth and stagnation as a result of wars. Until the Soviet period, it remained small, but from the 1920s onwards it underwent a period of expansion. This development was in the city's northern, western and southeastern areas, and topographical constraints have resulted today in a city that is 35 kilometres long and five kilometres wide. A 2014 census recorded a population of 1,118,035 people, which is around one-third of the country's population. This is 5.2 percentage points higher than the figure recorded in the previous census. This growth in population is due to changing the city's borders as it expanded into the adjoining rural areas (EU 2012).

*Belgrade*: Belgrade is in the Balkans, in southeastern Europe, and lies at the confluence of the Sava and Danube rivers. The city is surrounded by water on three sides and is often referred to as the "Gateway to the Balkans" and the "Door to Europe". Belgrade is at the intersection of the old trade routes from Western Europe to the Aegean Sea, and from Western Europe to the Middle East and Asia. The Danube River is a transport route that connects Western Europe with southeastern Europe and the Black Sea to the North Sea. There is a record of a fort (Singidunum) at the site of today's Belgrade, which dates from 279 BC. The settlement gained municipal rights in the second century AD.

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<sup>1</sup> I would like to thank Zviad Archuadze for his help in accessing data regarding Tbilisi.

The city that developed from this suffered frequent attacks, was destroyed and later rebuilt and named Beograd (Belgrade). Over the centuries, Belgrade changed hands a number of times as a result of conflict and wars. During the First World War, it sustained more damage than any other town or city in Serbia. After recovering during the interwar period, it was bombed once more during the Second World War. After the war, as the capital of Yugoslavia, Belgrade developed rapidly. In 1991, Yugoslavia disintegrated and during the course of a number of separate conflicts, new countries came into being. During this time, approximately 230,000 refugees fled to Belgrade from Croatia, Bosnia, Kosovo and Metohija, adding pressure to the city's housing market. This led to an increase in illegally built housing and increasing urban sprawl (Rasevic and Penev 2006). The population has not changed significantly since 2002 (1,274,000 and 1,377,000 in 2002 and 2015 respectively (UN data)). In 2003, Belgrade became the capital of the newly formed State Union of Serbia and Montenegro (following an agreement brokered by the EU), and since May 2006 – following the Montenegro referendum for independence – Belgrade has been the capital of the Republic of Serbia.

*Zagreb*<sup>2</sup>: Zagreb is bordered by the Medvednica massif to the north and the river Sava to the south. The first record of the name Zagreb is in connection with the foundation of the Roman Catholic bishopric of Zagreb in 1093. In 1242, King Bela IV issued a charter proclaiming it a free city. The city developed in an east-west direction until a bridge was built over the Sava in 1786, allowing the city to spread to the south (Cavrić and Nedović-Budić 2007). The modern city centre was built in the mid-19<sup>th</sup> century. In 1937, Zagreb adopted a city plan based on Le Corbusier's ideas of the modern city (Cavrić and Nedović-Budić 2007). In 1991, Croatia's declaration of independence was followed by a war for independence, during which Zagreb was bombed for the first time in its modern history. In 2003, the city adopted a new master plan, which prioritized areas for development and reconstruction (the city centre and some of the outskirts).

*Budapest*<sup>3</sup>: As early as 2000 BC, there were settlements on both sides of the Danube in the area now occupied by Budapest. A Roman fort was erected in the first and second centuries (Óbuda). A thousand years later, merchants from the western part of Europe settled here. Following a period of conflict during the Middle Ages, Buda became the royal residence in the 15<sup>th</sup> century. In the 16<sup>th</sup> century, the Turks brought their language and culture, built bath houses and fortified the castle. The Chain Bridge, the first permanent bridge built over the Danube connecting Buda with Pest, was completed in 1849. Budapest underwent a period of rebuilding in the 19<sup>th</sup> century, which saw the construction of grandiose buildings, the laying out of wide boulevards and the construction of an underground railway system – the first on the European mainland. During the Second World War, Budapest was heavily bombed and in the postwar period, parts of the city had to be rebuilt. Today, Budapest is a cultural hub in Central Europe and is home to almost two million people, one-fifth of Hungary's population.

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<sup>2</sup> I would like to thank Karlo Kostanjevec for his help in accessing data regarding Zagreb.

<sup>3</sup> I would like to thank Peter Szegvari for his help in accessing data on Budapest.

## GOVERNANCE

Croatia, Serbia, Georgia and Hungary were under communist regimes for most of the 20<sup>th</sup> century. This entailed an extreme form of centralization in the political, economic and institutional sphere. Central development plans were drawn up almost exclusively on a sectoral or industrial basis, while regional differences were ignored. The plans focused on urban development and were based on the assumption that towns as centres of development would have a positive effect on their rural surroundings. Accordingly, small towns and villages were deprived of development funds. With the fall of the Berlin Wall and the collapse of the Soviet Union, the end of the 20<sup>th</sup> century witnessed, in all four countries, the beginning of a slow and often painful shift from an authoritarian system of governance to a modern, democratic system of governance.

After the Second World War, Croatia and Serbia were states within the Socialist Federal Republic of Yugoslavia (SFRY). Despite a high degree of centralization,<sup>4</sup> each republic and province had its own constitution, supreme court, parliament, president and prime minister. There was a greater degree of individual freedom in SFRY than elsewhere in the socialist bloc.

*Croatia:* Croatia declared its independence in 1991 and then fought a war of independence from 1991 to 1995. Reconstruction began in 1996, facilitated through the injection of substantial foreign aid. In the following years, Croatia restored diplomatic relations with Yugoslavia and joined the Council of Europe.

While it had been part of Yugoslavia, Croatia had comprised 100 communes and one city – Zagreb. The administrative reorganization that followed independence resulted in the establishment of 21 regional counties, 418 communes and 69 cities (later these numbers grew to 428 and 127 respectively).

Officially, Croatia has a three-tier form of government. In practice, however, local and regional government has a very limited field of competence. Zagreb (owing to its status as the country's capital), and a number of specific areas (on account of economic hardship endured following the war) have been declared areas of "special concern". The country has been a member of NATO since 2008 and a member state of the European Union since 2013.

*Serbia:* With the collapse of SFRY, Serbia and Montenegro created a union that became the Federal Republic of Yugoslavia. (FRY) In 2006, Montenegro declared independence from FRY, marking the beginning of the final stage in separation of the original six republics constituting SFRY.

Serbia is a unitary state with a two-tier, decentralized form of government. Vojvodina is an autonomous province. Kosovo declared its independence from Serbia in 2008. Serbia did not recognize this declaration of independence, which resulted in a deterioration in the relations between the two states. In 2013, Serbia and Kosovo signed an agreement that opened the door to a normalization of relations.

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<sup>4</sup> The most powerful person was Josip Tito, who was named president for life and remained in office until 1980.

Before 1996, Serbia had a fully centralized system. Cities and municipalities had narrow competences and were not entitled to own property or raise revenue (Vasiljevic 2008). In 1996, the opposition parties won the local elections. In October 2000, a democratically elected central government was formed. The new constitution in 2006 and the new Law on Local Self-Government in 2007 laid the foundation of the current local government system. Today, there are 145 local government bodies in Serbia, responsible for an average population of 50,000.

Belgrade, the capital city, is divided into 17 administrative districts. In addition to the constitution (2006) and the Law on Local Government, numerous laws regulate operation and governance at the local level. A separate law concerns Belgrade only. Municipalities are responsible for providing basic public services, such as water and sewage treatment.

*Georgia:* On Nov. 18, 1989, Georgia – a state within the USSR – declared its sovereignty. On Nov. 15, 1990, the first democratic elections were held and the nation was renamed the Republic of Georgia. It officially declared independence on April 9, 1991, but remained unrecognized by the Soviet Union. However, the subsequent disintegration of the Soviet Union in December 1991 led to greater legal clarity on the issue. After 1991, the Georgian economy suffered a downturn, with hyperinflation peaking at 7,487.9 per cent in the period 1992-1993 and at 6,473 per cent in the period 1993-1994 (Wang 1999). The underlying problems facing the country – dysfunctional Soviet institutions, the gaps in property law and a fragile political system – resulted in endemic corruption and a difficulty in finding effective ways in which to tackle those problems. In 2003, the Rose Revolution led to the overthrow of the old regime, changes to the law and anti-corruption measures. In the period 2004-2012, the first phase of decentralization, Georgia consolidated its local government system. The government carried out a successful anti-corruption campaign, set up a functioning equalization grant system, granted powers to local government, improved infrastructure and made it possible for local authorities to raise revenue. Today, Georgia's demographic and settlement pattern is characterized predominantly by small cities, towns and villages. In 2005, with the adoption of the Georgian Law of Local Self Government, the powers of local government bodies were consolidated, and given property rights. One of the most important changes the law introduced concerns the direct election of mayors. The number of local governments was reduced from 1,110 to 69.

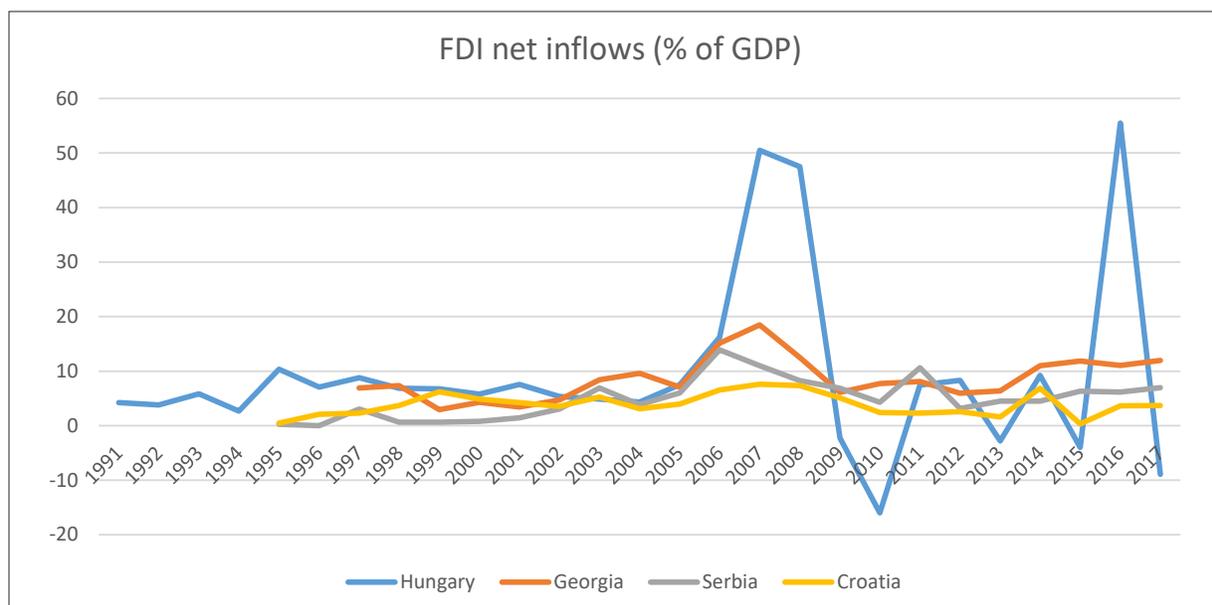
Rural areas in Georgia are a lot less developed than urban areas. In rural municipalities, the provision of services was poor in quality to the extent that waterborne diseases were not uncommon even at the beginning of the century (UNDP-SDC-ADA 2013a and 2013b). In 2014, 14 new municipalities were formed as a result of the subdivision of larger municipalities, and seven of them were merged again in October 2017. The Code on Local Self Governments gave a special status to and regulates Tbilisi, the capital of Georgia, a city serving a third of the population. Decentralization within the country was implemented at one level only. The country is a one-tier decentralization, but Tbilisi is further divided into 10 districts.

*Hungary* was under a communist regime between 1945 and 1990. After the fall of the Iron Curtain in 1991, municipalities were given the power to form their own local governments with elected mayors, to co-operate at a regional level on development issues and to collect taxes and fees. In the years that followed, Hungary became a rapidly developing, open and democratic country with a fragmented government system, comprising 3,200 local governments, 19 counties and seven regions. After 2010, in response to the economic difficulties facing the country, the government started recentralizing the public administration system and public finances. The state took over debts at the local and county levels and, in exchange for this, local and county property was moved into state ownership (schools, hospital buildings). Today, Budapest is divided into 23 districts and has a dual self-government system. This means that, in addition to the Budapest Municipality, the 23 districts also administer their own district governments, with elected mayors and a body of representatives. The Budapest General Assembly and the bodies of representatives in the districts have equal rights. There is no hierarchical relationship in terms of vested power. The district mayors are also members of the capital's General Assembly.

## **ECONOMIC DEVELOPMENT AFTER THE TRANSITION**

In the early 1990s, foreign direct investment (FDI) started to flow into the four countries. Investors took advantage of low labour costs, the opening of borders and the lifting of trade barriers between Eastern Europe and Western Europe (cf. Clement et al. 2002; Barysch 2005, 2f. and Gliberman et al. 2006). FDI played a crucial part in Eastern Europe's economic development and provided the economic basis for the shift from a planned to a market economy. Owing to the legacy of imbalance in the priorities of different types of municipalities – a characteristic of public administration systems in communist countries – some cities, especially capitals, enjoyed access to more valuable assets during the transition and could offer better infrastructure. Accordingly, they were magnets for FDI and were able to increase their ability to raise revenue. Since the economy was FDI-driven in the countries in question and as FDI was concentrated in the capital regions, the capitals soon accounted for approximately 40- to 50 per cent of the respective countries' GDP. The disparities affected infrastructure development outside the capitals, creating a vicious cycle: a reduced capacity to absorb FDI places an additional brake on development possibilities outside capital regions. The FDI concentration led to further polarization within the countries, and even within the cities in question. This created new patterns of social and spatial segregation (inner city vs. outskirts).

**CHART 1 FDI NET INFLOWS IN CROATIA, HUNGARY, SERBIA AND GEORGIA**

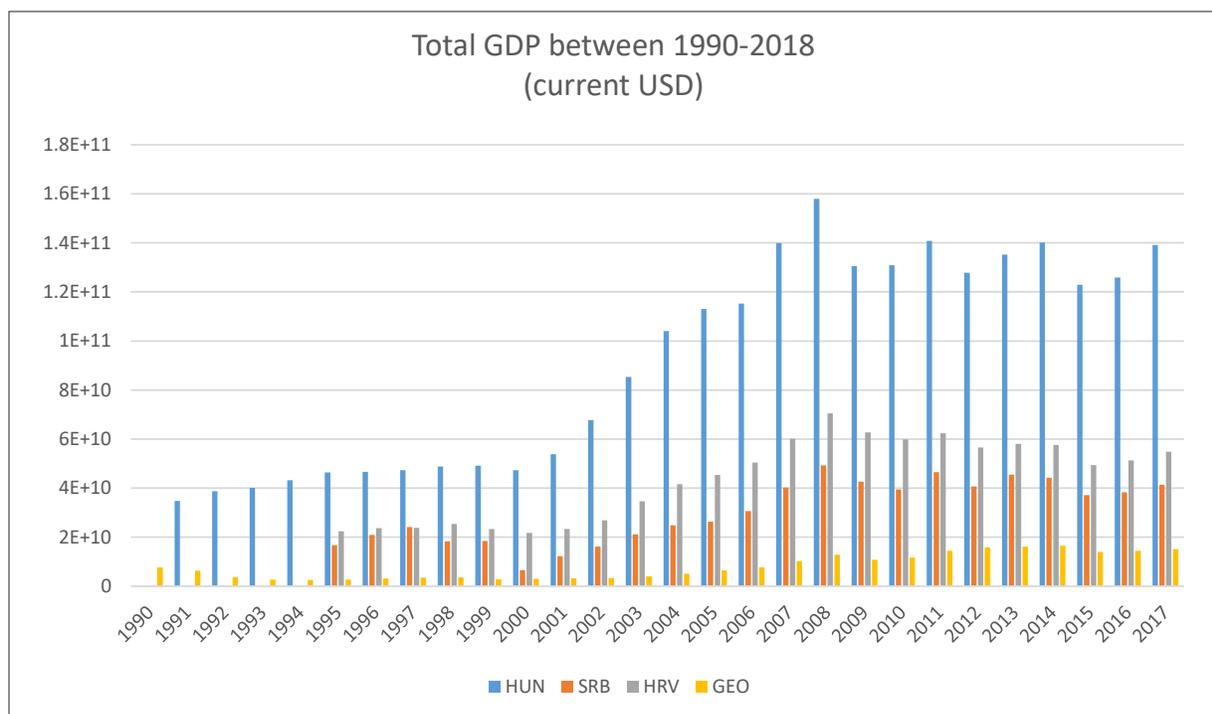


Source: World Bank World Development Indicators: Global Private Financial Flows, 2018

The economic crisis of 2007-2008 aggravated this situation, as the economic downturn had different effects in Western and Eastern Europe. The social consequences of the crisis in the new EU and pre-accession member states were more severe than in the EU12. Western European companies decreased their investment in Eastern European companies (a sharp decline in FDI after 2007). Employment levels in Eastern Europe fell rapidly after 2008 and many skilled workers faced cuts in wages and spending power.

Today, Croatia is a high-income country. Serbia and Hungary are upper middle-income countries, while Georgia is a lower middle-income country. The World Bank's *Global Economic Prospects* publication forecasts that GDP growth will slow by 1.2 per cent in Hungary by 2021 (from 4.3 per cent in 2017 to 3.5 per cent), while in the other three countries, the prognosis is moderate GDP growth, from three to four per cent, four to five per cent and 2.6 to 2.8 per cent in Serbia, Georgia and Croatia respectively.

**CHART 2 GDP IN HUNGARY, GEORGIA, SERBIA AND CROATIA BETWEEN 1990-2018**



Source: World Bank national accounts data, and OECD national accounts data files.

Tbilisi generates almost 48 per cent of the country's US\$15.2 billion GDP (World Bank Statistics 2018). Tbilisi's economy has been growing at an average rate of 10.45 per cent annually over the past few years. However, compared to other Central and Eastern European/southeastern European capitals, this economic output is still relatively modest and even several smaller regional CEE cities (such as Krakow, Poland) have comparable economic output. Employment growth is slow, and the city suffers from a persistently high unemployment rate of around 22.5 per cent. Overall, the investment environment in Georgia and Tbilisi is developing favourably and the level of FDI is increasing to levels above US\$1 billion annually. The dominant sector of Tbilisi's economy is trade.

Belgrade, whose economy is dominated by manufacturing and trade, was badly hit by the economic crisis. Between 2008 and 2013, the number of employed people in the capital area fell by 16 per cent and almost half of small businesses closed. The per capita GDP in Belgrade is €6,749 and the city holds approximately 65,000 business entities. The unemployment rate in 2012 was 15.3 per cent.

Zagreb is the economic centre of Croatia. Its €14.4 billion GDP accounts for approximately 30 per cent of the country's GDP (€43.5 billion). The capital dominates the country's information and communication, financial and insurance sectors. Moreover, it is the headquarters of many leading companies in information technology, telecommunications, trade, the pharmaceutical industry and science. In 2014, the unemployment rate in Croatia stood at 17.3 per cent. The figure for Zagreb was 11.2 per cent.

Budapest accounts for approximately 40 per cent of Hungary's GDP (KSH database), and its per capita GDP is more than double the national average. At the beginning of the 1990s, many industrial parks were built in Budapest to support economic development. Economic

restructuring was rapid in Hungary. One of the city's main projects – and a key part of its integrated urban development strategy over the coming years – is the development of tourism and improvement of airport-city transport links. Plans include the development of a railway connection between the airport and the city centre. Today, Budapest is one of Hungary's most important tourist destinations and dominates its economy.

## **MUNICIPAL FINANCES**

Public finances – like everything else – were centralized under communism. During the transition years, one of the first steps towards fiscal decentralization involved the allocation of property and revenue resources to local government bodies that were needed for providing services. To efficiently organize these services, capacity building at the local level was both institutional and personal. This also helped to achieve the prudent fiscal management that was expected from local decision-makers. While the degree of municipal fiscal independence still varies among the countries in question, they all passed fiscal responsibility laws at some point so as to better regulate local finances and debt. Often, as local revenue rose, municipalities started to increase spending, sometimes without any adequate budgetary control. This raised concerns about overspending, especially in Hungarian and Serbian municipalities.

In Georgia, the Organic Law of Georgia on Local Self Governments aims to establish the independence of local budgets and to regulate budgetary procedure. Municipalities collect property tax and non-tax revenue (rents, fines, penalties and income generated from the sale of goods and services). Individuals and businesses pay property taxes, but the central government sets the rate. The threshold for individual property tax is (i) an annual income of GEL40,000 or (ii) owning at least five hectares of land bought after 2004. Given that the average monthly salary in 2013 was GEL773.1 (GEOSTAT 2014), and the fact that land can be divided and shared among family members, very few people fall into this category. Corporate property tax also falls under specific regulation and raises questions over transparency and accountability. If a company pays more VAT than it should, the excess amount can be deducted as an overpayment from the property tax levied, transferring local income to the central budget.

Tbilisi's yearly income is approximately GEL800 million (US\$300 million). Like other Georgian cities, Tbilisi is largely dependent on the central government for revenue. If the city requires extra resources from the government, the amount is usually granted. This does not necessarily promote fiscal prudence.

In Serbia, the 2006 constitution provided for the concept of municipal property. In 2011, the amended Law on Financing Local Self-Government completed the wave of reforms promoting decentralized government. As is the case for other post-communist countries, municipalities are given a wide range of competences including responsibility for utility services, dealing with construction permits, and building and maintaining local roads, as well as promoting local tourism and culture, etc. Serbian local government bodies may collect property tax and local administrative tax, levy fees and raise revenue from rent, as well as collect income generated by local public enterprises. Even so, the share of own-source revenue in the local budget is low. Local government bodies set tax rates, but do

not have the right to introduce new taxes or fees. They are, however, entitled to draw on 80 per cent of the income tax generated within the area they are responsible for (before 2011, the figure was 60 per cent).

Belgrade enjoys a special status in the country. Local taxes and fees account for 22 per cent and asset revenue for 15 per cent of the budget. The share of own-source revenue in the budget has been growing steadily over the past few years. After the economic crisis, Belgrade needed to increase social transfers and subsidies for public companies within its budget. At the same time, its debt servicing increased by more than 50 per cent.

In Croatia, public finances are centralized. However, Zagreb is different, as more than two-thirds of Zagreb's revenue (71 per cent) comes from income tax and surtax. Communal and utility charges and fees account for 14 per cent of Zagreb's revenue. The third significant source of income derives from property tax. Borrowing in Zagreb is centralized, and subnational units need approval from the central government to take on new debt.

Hungarian public finances were very centralized in the early 1990s (and today, after a decade of decentralization, they have been centralized again), and municipalities have access to only limited resources. Hungarian municipalities have some financial resources – such as local tax revenue and fees on services – that are independent of centralized decision-making. Own-source revenue represents less than one-third of the local budget. According to the local tax law – *Act C* on local taxes that came into force in 1991 and has been amended by the Parliament almost every year since – local governments exercise discretion over the levying of local taxes and over the tax rate. A general rule is that current expenses should not be financed from investment income. However, this does sometimes happen in practice as municipalities may sell assets through off-budget institutions, or issue general-purpose bonds and use the income to finance operations. State subsidies and shared taxes may not be used to repay loans. Many municipalities in Hungary are in a very difficult financial situation and they operate with a deficit. In this respect, Budapest is no exception. The city's income was HUF256.3 billion in 2017, yet expenditures stood at HUF381.4 billion. The deficit was financed by loans, raising questions about the lack of prudent fiscal management.

## **LAND USE ISSUES**

The Charter of European Cities and Towns Towards Sustainability (the Aalborg Charter 1994) sets out several action areas. Planning and Design (Action Area 5) concerns land use policies in cities. Land use planning as an integral part of urban planning helps deliver better environmental, social and economic results and avoids urban sprawl. In CEE countries, laws usually define two types of property. The first category consists of assets (buildings, land, etc.) that are needed to provide the requisite public services and which are thus protected and cannot be sold. The second category comprises assets that the municipality may sell. Municipalities may regroup assets if they ensure that the provision of public services will not be jeopardized.

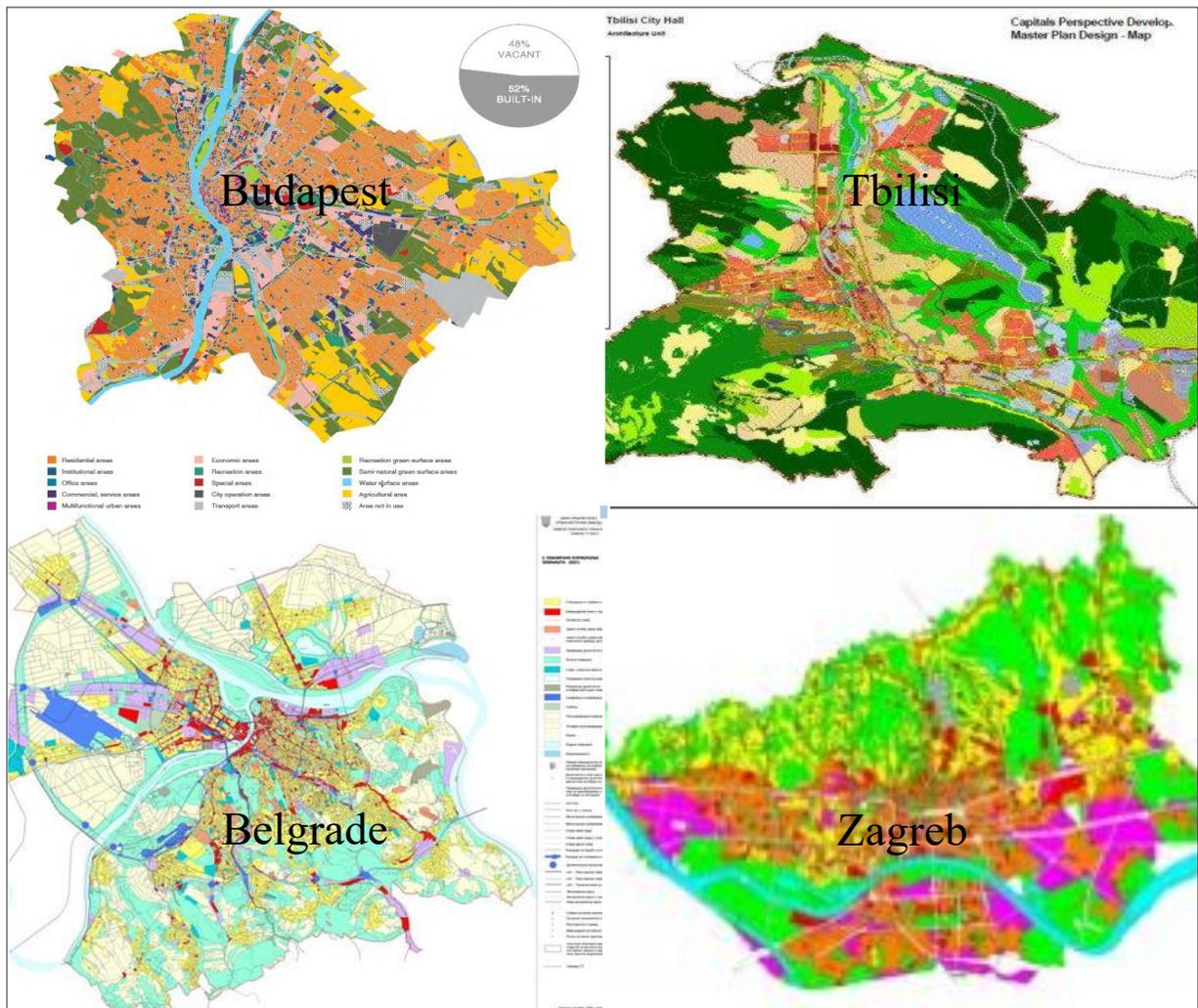
In Georgia, the Organic Law on LSGs distinguishes between the basic and additional property of the municipality. The basic property may not be sold. Municipalities may also obtain other property if they apply to the relevant ministry and request an ownership transfer. Transferring property is thus an ongoing process in Georgia. Georgian municipalities, including Tbilisi, recently started implementing land use and asset management plans with considerable help from international aid organizations. The valuation of property only happens if the municipality considers selling it. Tbilisi created its first master plan in 2017. Its vision – to create a place where people want to move to – resonates with the Aalborg Charter’s content. Today, only a little more than half of the city’s land is being used. The rest is still vacant. To reduce population density in the most populated districts, the plan provides for the re-zoning and development of residential areas with green and public spaces.

Belgrade adopted a master plan in 2016 that, in the wake of the Yugoslav wars, focuses on urban renewal and on expanding urban (re)building while also preserving the quality of the natural environment. Further goals include the sustainable use of land and the protection of water resources; the maintenance, refurbishment, improvement and promotion of cultural goods; the modernization and development of transport, infrastructure capacities and utilities; more efficient building use, rehabilitation and the re-urbanization of former industrial and municipal zones.

Zagreb’s new master plan aims at decreasing the area of new land used for housing by reclassifying brownfield areas and redeveloping the city centre. The city is suffering from pressures on land use as a result of the building of new houses. At the same time, there is much scope for redeveloping abandoned industrial areas: with careful planning, these could be turned into residential districts. The centre is currently losing its population as people move out to the suburbs, with the result that the suburbs now almost completely encircle the city centre. Zagreb planners believe that the transformation of abandoned industrial zones into housing developments increases the quality of life in the city and promotes the integration of these districts into city life (Cavrić and Nedović-Budić 2007). They believe that such transformation will result in better access to human services and improved infrastructure in the surrounding municipalities.

Budapest planners divided the city into an Inner Zone, a Transitional Zone, a Suburban Zone, the Buda Hills and the Danube Zone. The Inner Zone consists of the city’s historic section and has a high population density. The Transitional Zone is heterogeneous and comprises residential areas, railway lines and other landmarks. The Suburban Zone’s residential areas typically have a low-density population. This zone is characterized by single-family houses or Soviet-type panel housing/communal housing. The Danube Zone is diverse and includes industrial areas, green areas and a protected World Heritage Site (the old city centre). Green areas account for approximately 30 per cent of the city’s area. In recent years, as is the case for Zagreb and Belgrade, people have been moving away from the centre of Budapest and out into the suburbs.

**CHART 3 CITY MASTER PLANS IN BUDAPEST, ZAGREB, TBILISI AND BELGRADE**



Sources: Budapest City Council, Tbilisi City Council, City of Zagreb and City of Belgrade

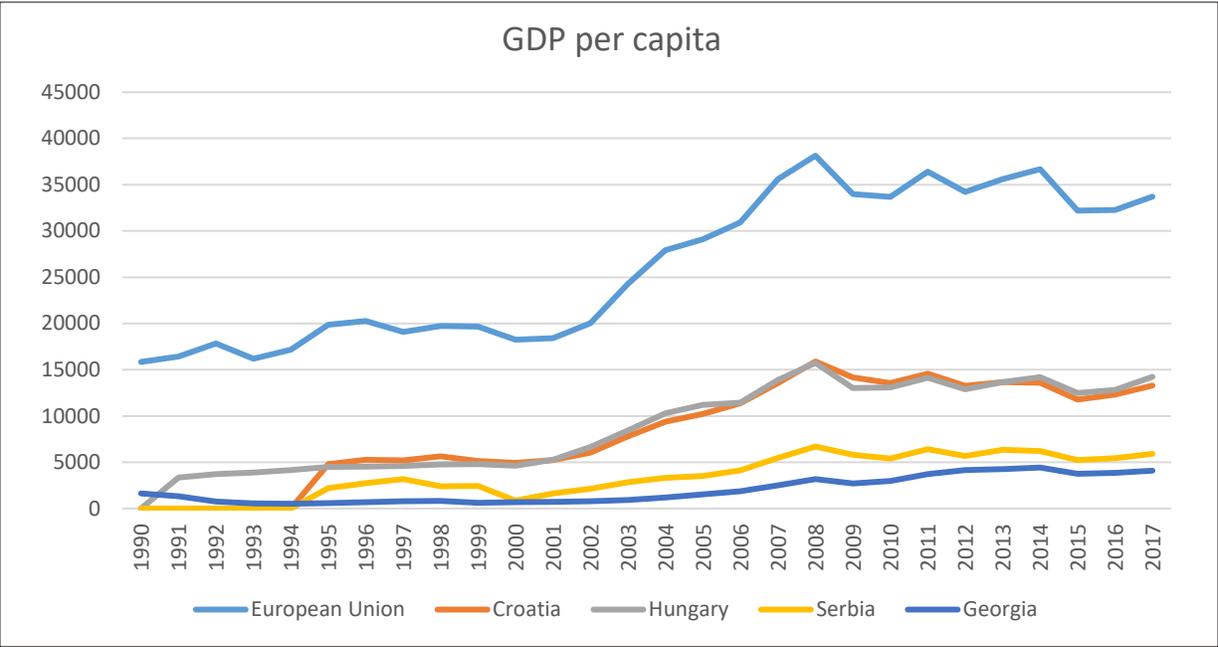
## **THE CHALLENGES FACING POST-COMMUNIST CITIES - LESSONS LEARNED**

Development in Croatia, Georgia, Serbia and Hungary and in their capitals is driven by economic factors. Their future urban development should be understood and assessed in the context of future economic development scenarios.

The economy in Central and Eastern Europe grew fast in the early transition years. This period saw a rise in wage levels and the adoption of Western culture and lifestyles, which many people in these countries had wanted for decades.

According to the World Bank's data, GDP per capita in the countries in question stood at around 20- to 25 per cent of the EU average by the mid-1990s (except in Georgia, where this figure was markedly lower. See chart below). For a number of years, the difference continued to become less pronounced. However, since the early 2000s, the gap has started to slowly widen again.

**CHART 4 PER CAPITA GDP IN THE EU, CROATIA, HUNGARY, SERBIA AND GEORGIA**



Owing to increasing labour costs, CEE countries have been losing their competitiveness in manufacturing and labour-intensive agriculture. This has contributed to a slowdown in GDP growth. At the same time, these countries have not yet been able to compete in the markets of high added-value goods. As a result, investors have been divesting and shifting their focus to regions with cheaper resources. This tendency has become more pronounced since the 2008 economic crisis.

**CHART 5 WAGES IN HUNGARY 1995-2017**



In order to gain a better understanding of what is happening, we need to draw on the arguments developed to describe the “resource curse”. When the rule of law is weak, a solid institutional framework is absent, administrative capacity is inadequate and corruption levels are high, a windfall of natural resources can lead to negative outcomes in terms of democracy, social equality and economic performance. The FDI net inflow, sometimes as high as 10- to 20 per cent of GDP in the countries in question – and boosted by EU and other international subsidies – can be categorized as a natural resource.

Sustaining growth in resource-rich regions is challenging as resources are only available for a fixed time period. For this reason, income should be spent on restructuring the economy so as to increase competitiveness even when natural resources run dry. Accordingly, with a view to escaping the middle-income trap, CEE countries need to invest in education and innovation-based goods, in green energy and in IT. This is in line with the Aalborg Charter’s recommendations.

The extent to which these countries perform in this regard varies. In Hungary, where the focus of the economy is still on agriculture and manufacturing, large numbers of workers have been leaving the country in search of better working conditions and higher wages abroad. The government’s anti-immigration policies have compounded this situation, which has meant that car manufacturers – major investors in Hungary – have been less willing to maintain their manufacturing operations within the country. The government has responded by implementing tax cuts, by providing direct subsidies and by amending employment laws so as to enable employers to compel employees to work an additional 400 hours per year.

Croatia managed to shift the focus of its economy towards IT and services, and Serbia and Georgia are also currently making the necessary adjustments by focusing on developing their IT, green tourism and agricultural sectors.

Economic difficulties have had a substantial effect on governance in these countries, too. Hungary was the first of the four countries to reform its political regime after 1990, but it is currently undergoing an experiment in democratic regression. At the same time, political instability and economic uncertainty have deterred investors and the country’s relationship with the EU has become fraught with difficulty. In Croatia and Serbia, political and economic reforms came a decade later than those in Hungary. In the 2016 October elections, Georgia also experienced the right wing’s growing influence.

In general, scholars agree that the shared common communist past has played a critical role in political and economic developments in these countries (Dolenecz 2008; Vachudova 2005). Political illiberalism usually goes hand in hand with administrative and economic centralization and has an impact on municipalities, including country capitals. The cities in question find themselves in a fiscal trap. Whether they can be winners in the longer term depends on the degree to which they can manage the impact of the demographic exodus from their centres and the growing urban sprawl in their green belts, as well as maintain the level of fiscal resources and income. As people move away from urban centres, house prices fall, which leads to a fall in property tax income for municipal budgets.

All four cities - Zagreb, Tbilisi, Belgrade and Budapest - have addressed the challenges facing them by prioritizing job creation and providing services for companies interested in investing in them. To varying degrees, the cities have endeavoured, too, to create a livable environment, preserving green areas and improving commuter transport infrastructure.

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