

CHAPTER 32.

ECONOMIC INTEGRATION AND DEVELOPMENT OF LOCAL PUBLIC SECTOR IN SERBIA¹

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Abstract:

In today societies the local public sector is getting increasingly important role in countries' sustainable development. The sustainable development assumes close interrelation and specific balance between economy, society and environment. It implies balanced development of the economy and society with simultaneous careful exploitation of limited natural resources and preservation of the environment. In such a general framework the local public sector is becoming one of the key agents of this complex process. Nowadays approach to the management of economic development is increasingly shifting from traditional and centralized to the local level. In the continuous struggle for economic resources needed for economic development, the market competition include variety of players: the businesses compete with other businesses, the central governments with other central governments, and in the same way in this process are including local governments which compete with other local governments. In the chapter are presented some of the most relevant experiences of the local public sector involvement in the economic development in the developed countries, and the analogy and comparison with the present situation in Serbia is made. In the last part of the chapter the major assumptions necessary to create efficient and effective local economic development are elaborated and the present situation regarding each of the specified assumptions is presented and evaluated.

Key words: *Sustainable Development, Local Economic Development, Local Public Sector, Centralized VS. Decentralized Economic Policy,*

¹This chapter is a part of research projects: 47009 (*European integrations and social and economic changes in Serbian economy on the way to the EU*) and 179015 (*Challenges and prospects of structural changes in Serbia: Strategic directions for economic development and harmonization with EU requirements*), financed by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

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INTRODUCTION

Nowadays the local public sector has an increasingly important role in the area of economic development. In the past it was implied that national economic development was a matter of concern of the state and the business sector. Other tiers of government were mostly considered passive participants in the process in which they primarily suffer the consequences of specific decisions adopted at the central level.

Today, however, the competitive market game, in addition to the central government and businesses, is joined, more and more actively, by the local public sector, that is, local communities institutionally organized as municipalities, cities or larger units - regions. Local communities defined this way become each other's fierce competitors at the national, but also at the international level. The governing structures of local governments, besides traditional social and administrative issues, are more frequently facing issues like efficiency of services they are providing to businesses located in their territories, the level of qualification and skills of the local labour force, the use of modern technologies, the dynamics of the local economic environment and the like.

THE RELEVENCE OF ECONOMIC DEVELOPMENT AT THE LOCAL LEVEL

The World Bank's documents define economic development as a „group of activities aimed at building capacities of local communities to improve their economic future and quality of life of their citizens“.⁴ Bryant and Cofsky in their definition of local economic development put emphasis on „activities conducted in a certain geographical area with the aim of achieving sustainable social-economic development“.⁵

Both of these definitions define the modern concept of the local economic development well, by expanding economic issues outside of the “economistic” understanding of this phenomenon. In the World Bank's definition, this fact is expressed by shifting the emphasis from narrow economic issues to the quality of

⁴ Swinburne G., *Local Economic Development – Quick Reference*, Urban Development Unit World Bank, Washington DS, 2006.

⁵ Bryant C. and Cofsky S., *Public Policy for Local Economic Development – An International Comparison of Approaches, programmes and Tools*, Economic Development Canada, Montreal, 2004.

life of people in its broadest sense. In the second definition, broader social issues and economic ones have been joined together.

Assessments of doing business and identification of companies' direct effects on local communities point to their deep multifold importance for the existence of local communities and particularly for the quality of life of their members. Empirical analyses have shown that companies in local communities do 80% of their transactions at the local level. These transactions produce direct financial effects such as, for instance, the payment of salaries to employees who live in a particular local community, the payment of local taxes and fees, contributions and other levies accompanying business activities in a certain area, as well as payments to local firms and suppliers.

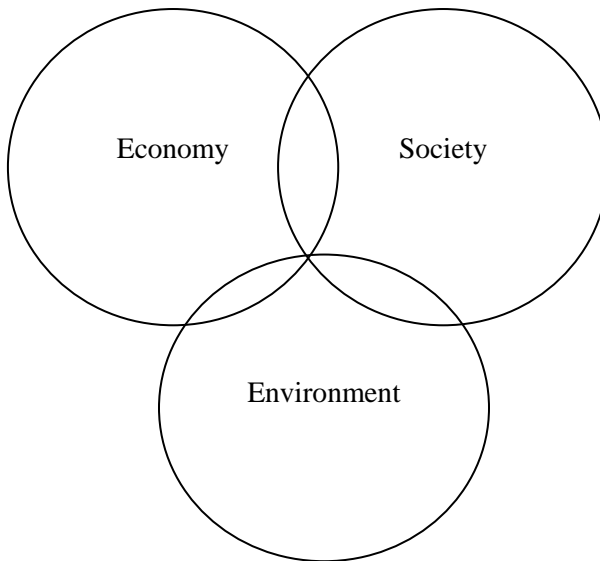
On top of these direct and easily perceived effects of doing business on the economic situation of local communities, business sometimes produces a whole array of indirect effects which are sometimes even more important to the local population of these communities than that of the direct, financial ones. They are reflected, amongst other things, in the following:

- Reduction of unemployment and along with it the number of those depending on social, financial, aid,
- Reduction of youth migration, especially highly qualified young people from less developed areas,
- Higher collection rate of dues to the state at lower, but, also at the central level,
- Expansion of the market and a potential basis of development for local businesses in the supply chain,
- Increase of demand for services due to larger consumption power which gives the service sector additional stimulus for development in the local community, etc.

ECONOMIC VS SOCIAL AND SUSTANABLE DEVELOPMENT

Inclusion of the local public sector (in Serbia it is represented by municipalities and cities) in developmental, integration processes implies that their leaders, together with leaders from the business sector, recognize realistic possibilities for development and create effective tools for its implementation. It is necessary to identify available resources, define development priorities and mechanisms which will be used to increase competitiveness of the local government. After this, it is necessary to use scarce financial and human resources to define priorities and then to monitor and control how the planned process is carried out.

Figure 1: Development model called „The Ring“⁶



The manner in which the local public sector will start this process depends on the circumstances and preferences of local leaders. They may focus on attracting new domestic and foreign direct investments, but also on supporting existing businesses. Also, measures may be defined in such way as to encourage entrepreneurship and self-employment and the development of small and medium enterprises. These decisions are directly connected with strategic choices and their results may pertain to the increase of employment, strengthened economic structure and general improvement of the quality of life in local communities.

As the above mentioned definitions of local economic development point out, economic development may no longer be seen as an autonomous component of development without any significant connections with other aspects of life in national and local communities. On the contrary, economic development today is seen as perhaps the most important, but still only one component of the long term and sustainable functioning of social communities.

In modern times sustainable development is defined as a specific interaction of three key areas of life: economy, society and environment. The specific relationship of these components may be presented by comparative analysis of

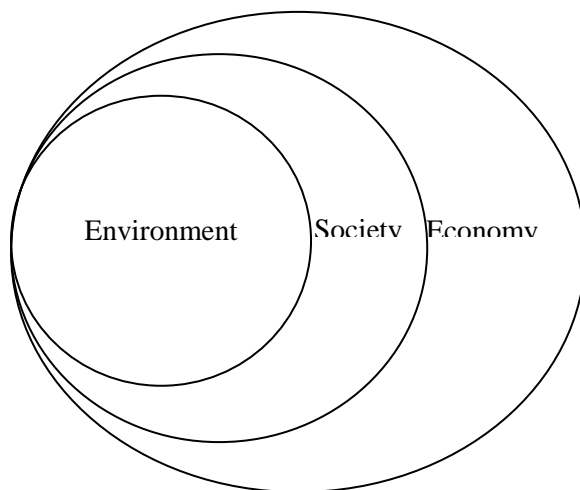
⁶ Methodology for Sustainable Development Strategic Planning, SCTM Exchange 2, Belgrade, 2009.

two development models: one which may be called the “ring” model (Figure 1) and the other called „Matryshka“(Figure 2).

As shown in Figure 1 (the “ring” model), elements of the economy, society and environment are partially and randomly intertwined. On the other hand, the “Matryoshka” model shows connections between these three elements but they are made in a different manner. This model shows that these spheres absorb each other and the connections between them are systematic and complete, therefore it would be practically impossible to develop activities in any of them without producing larger or smaller consequences on the other two.

The area that includes all others is the environment. In it the area of society encompasses the third one – the economy. This means that sustainable development implies balanced development of the economy and society with simultaneous careful exploitation of limited natural resources and preservation of the environment.

Figure 2: „Matryshka“Development Model⁷



The “Matryshka” development model points to another important aspect of the relationship between these three elements – in it a central role belongs to economic development. It is part of the societal and environmental rings and they form a framework for it to move, but on the other hand it is the basis for development of these two elements. Therefore it is not possible to expect that

⁷ Ibid.

society and environmental protection will develop without appropriate economic development.

Research conducted in Serbia in 2008 examined criteria that foreign investors in Serbia take into account when they are making their investment decisions.⁸ It showed that the business community very explicitly includes in their decision making process both economic and non-economic criteria. Thus it was stated that investment decisions are influenced by factors such as the quality of labour force, political stability, the quality and accessibility of infrastructure, the quality of life, simplicity of administrative procedures, etc.

On the other hand, factors which deter investors and have a negative impact on their investment decisions are as follows: high level of water, soil and air pollution; few cultural and social events; poor education options; underdeveloped road and utility infrastructure; inadequate housing conditions, political instability, etc.

The elements of social development considered to be elements of comprehensive sustainable development are, amongst other, the following:

<p>Social development</p> <ul style="list-style-type: none"> • Improving the social climate • Promoting citizen participation • Reducing crime • Etc.
<p>Cultural development</p> <ul style="list-style-type: none"> • Preserving cultural tradition • Enriching artistic contents • Etc.
<p>Political development</p> <ul style="list-style-type: none"> • Preserving democratic principles • Increasing transparency of decision-making • Raising the political culture level • Etc.

The important fact about this approach is that the economic development must be connected with the process of widest possible societal development in such a way as to ensure its sustainability. Resources should be used in the future for activities that will produce new resources which will be then redirected into different areas

⁸ USAID, Municipal Economic Growth Activity, *Istraživanje: Investiciona klima u Srbiji – perspektiva stranih investicija*, 2008

of action and this way a continuous and unobstructed development cycle will be provided.

LOCAL VS TRADITIONAL CENTRAL ECONOMIC DEVELOPMENT APPROACH

Modern societies' approach to the management of economic development is more and more shifting from traditional and centralized to the local level. Basically, every investment and development that follows it is always more or less local. Even the largest world companies, promoters of a wider (sometimes global) societal-economic development, in their endeavours, at the end, are always facing a local administration, local regulations that they need to observe, local labour force, etc. Factors that contribute to this are numerous and amongst them, the most important are the following:

- **In the struggle for economic resources needed for economic development, states compete with each other while local communities compete with other local communities** – macroeconomic and monetary policy are created by states and they affect local communities. National legislation, tax and other legal systems impact the business climate, which may help or hinder local economic development goals. Simultaneously, however, the local administration and local policies are factors that, equally importantly, influence the climate for local economic development. They are critical for availability or lack of telecommunications, technical or drinking water, sewer, developed construction land and other issues that companies take into consideration when they decide on investing in a country and then doing business in it for a considerable length of time. Local governments, also, create procedures that companies must go through before they begin investing, they influence housing conditions, the quality of educational and health care services, availability of the labour force, public transport, etc. State governments, therefore, impact the competitiveness of states and, simultaneously, local governments impact the level of competitiveness of local communities.
- **Perceptions of citizens and businesses** – Independently from actual competencies of different tiers of government, citizens and businesses, as a rule, think that the final responsibility for living conditions and conditions for doing business rests with the local administration.
- **Legislation regulating competencies of local government units for economic development** – in Serbia, the Law on Local Government (Art 20.) has defined that, “municipalities, through their organs, in line with the Constitution and law, shall adopt programs and implement projects of local

economic development and are responsible for the improvement of a general framework for doing business at the local level.”

- **General practice and trends in the modern world** – It might be said that in modern times local governments have no choice but to join the process of local economic development. If they would fail to do so they would be condemned to defeat in international competition with other communities even before its start.

Changes in approaches to economic policies moving towards strengthening the role of the local level have produced changes of their most important traits. Comparative preview of traits of central and local economic policies are presented in the below overview mentioned.

In the traditional, centralized model, decisions are made at the top, and the emphasis is put on a sectorial approach (individual industries and activities are considered as priorities), development is promoted through large capital projects, and the support to the main stakeholders of development is provided by means of financial vehicles.

*Centralized VS Decentralized Approach to the Implementation of Economic Policy*⁹

Approaches to the implementation of economic policy	
Centralized „Top Down“ Approach	Decentralized „Bottom Up“ Approach
Centralized decision-making and interventionism	Promotion of all parts of a community
Management from the centre	Vertical cooperation of different tiers of government and horizontal cooperation with businesses
Sectorial approach to development	Territorial approach to development
Development of large industrial projects as mechanisms of stimulation for other economic aspects	Maximizing the development potential of all regions Adapting local systems to changes of economic climate
Financial support, incentives and subsidies as instruments of economic activity	Creating prerequisites for economic activity–improving local economic climate

⁹ Rodriguez-Pose, Andreas, *Making Case for Local Economic Development*, Inter-agency Conference on Local Economic Development, ILO, Turin, 2008.

On the other hand, modern approaches promote decentralization and the role of autonomous parts of the system; functions have been vertically delegated to different tiers of government, and cooperation with businesses has been horizontally developed. Instead of industries the emphasis is put on balanced territorial development; and finally, in addition to financial incentives, due attention is made to a comprehensive improvement of the local societal-economic climate.

LOCAL PUBLIC SECTOR EXPERIENCES AND PERSPECTIVE IN THE AREA OF ECONOMIC DEVELOPMENT

In developed European countries, in municipalities which started promoting economic development at the beginning of the 1960's, the focus has shifted over the years. One of the first economic axioms in the formulation of economic development policy at the national, but also at the local level, was investing in so-called basic infrastructure. Although it is obvious today that the road, water, rail networks and other infrastructure has a large impact on the economic development, beginning of the 1960's this discovery caused expansion of investments in infrastructure.

The experience of USA in this area confirms that there was a direct connection between infrastructure development and economic development. It has been noticed that there was a connection between increases of the number of the employed in geographical areas which has been crisscrossed by interstate roads. During the 1970's and 1980's more than three thousand kilometres of interstate roads were built in the USA and employment increased exactly in the areas where this network was built.¹⁰

In the next phase (the 1980's and the 1990's) the USA, and also other developed countries, started shifting their focus to secondary infrastructure and general improvement of the quality of life, considering that the requirement related to primary infrastructure had already been achieved in the previous period. The importance of infrastructure for economic development has remained unquestionable, therefore, in all market-oriented countries, all state, regional and local agencies put emphasis on infrastructure development, but this time with different infrastructure in mind. From primary the emphasis has been moved to secondary infrastructure.

The above mentioned development is presented in the table below:

¹⁰ USAID, Municipal Economic Growth Activity, *Lokalni ekonomski razvoj, priručnik za praktičare*, Belgrade, B2010

Three Waves of Local Economic Development¹¹

Waves	Focuses	Tools
First: 1960s to early 1980s	During the first wave the focus was on the attraction of: <ul style="list-style-type: none"> • mobile manufacturing investment, attracting outside investment, especially the attraction of foreign direct investment; • hard infrastructure investments. 	To achieve this cities used: <ul style="list-style-type: none"> • massive grants; • subsidized loans usually aimed at inward investing manufacturers; • tax breaks; • subsidized hard infrastructure investment; • expensive "low road" industrial recruitment techniques.
Second: 1980s to mid-1990s	During the second wave the focus moved towards: <ul style="list-style-type: none"> • the retention and growing of existing local businesses; • still with an emphasis on inward investment attraction, but usually this was becoming more targeted to specific sectors or from certain geographic areas. 	To achieve this cities provided: <ul style="list-style-type: none"> • direct payments to individual businesses; • business incubators/workspace; • advice and training for small- and medium-sized firms; • technical support; • business start-up support; • some hard and soft infrastructure investment.
Third : Late 1990s onwards	The focus then shifted from individual direct firm financial transfers to making the entire business environment more conducive to business. During this third (and current) wave of LED, more focus is placed on: <ul style="list-style-type: none"> • soft infrastructure investments; • public/private partnerships; • networking and the 	To achieve this cities are: <ul style="list-style-type: none"> • developing a holistic strategy aimed at growing local firms; • providing a competitive local investment climate; • supporting and encouraging networking and collaboration; • encouraging the development of business clusters; • encouraging workforce development and education; • closely targeting inward

¹¹ Work Bank LED Guidebook,<http://www.worldbank.org/urban/local/toolkit/pages/history.htm>.

Waves	Focuses	Tools
	leveraging of private sector investments for the public good; <ul style="list-style-type: none"> • highly targeted inward investment attraction to add to the competitive advantages of local areas. 	investment to support cluster growth; <ul style="list-style-type: none"> • supporting quality of life improvements.

For Serbia, it is clear that, for the most part, local government perceived the importance of primary infrastructure in the first phase of economic development, therefore a number of municipalities and cities began building local infrastructure in order to attract prospects to their communities. Unfortunately, without international road networks and inter-municipal roads and infrastructure, such endeavours, while satisfying local infrastructure needs, remain disconnected from each other and do not create preconditions for effective functioning of businesses in their territories.

In the past, economic development in Eastern European countries was run from the central level with direct state interventions which were most frequently implemented through large public enterprises. In recent decades, however, the experience of developed countries has shown that the focus is shifting away from the centre towards the local level.

ASSUMPTIONS FOR SUCCESFUL LOCAL ECONOMIC DEVELOPMENT IMPLEMENTATION

Successful implementation of the above described local economic development process implies several important assumptions to be met, and amongst them the most important ones are as follows:

- **Developing a system and process for strategic management of local economic development** - The base line assumption of active inclusion of the local public sector in the economic development process is establishment and then activation of a strategic management system. The result of this would be a long term strategy for local economic development which enables a local community to focus its financial, material and human resources to selected priorities; to formulate ways to implement or achieve these priorities, and, finally, to systematically monitor, control and, if need be, correct spending of these resources and reaching the desired effects of all these efforts.
- **Designing a capital investment plan based on priorities defined in the strategic management process** – In this step the strategic plan is

operationalized by formulation of capital investment plans with specific projects through which previously defined priorities can be implemented or achieved. A capital investment plan includes a list of specific project ranked by the order of their priority, or, rather the order of their implementation, with sources of finance and implementation methods.

- **Building a consistent local government finance system** – A segment with particular importance for sustainable local economic development is the local government finance system. It defines all available sources of local government finance, as well as their duties and usual spending areas.
- **Building an effective institutional framework for management and implementation of development projects** – Finally, it should be noted that an organizational-institutional framework is very important for jump-starting a sustainable local economic development because it defines the subject- the stakeholder who is responsible for undertaking all these activities. Given such wide purview of local governments and their heterogeneous activities which are carried out simultaneously it is important to have an organizational unit-subject which will be exclusively responsible for this area.

In the following lines each of the above mentioned assumptions needed for successful implementation of the economic development at the local level is elaborated in more details. At the same time the current situation in these areas in Serbia is presented and the perspective of their development in future assessed.

Strategic management in local government

Strategic management as a specific advanced management tool has originated in the business corporate environment during the sixties of the last century in the developed countries. In the course of time its application encompassed other organizations and institutions outside business sector, characterized by complexity and dynamics such as local governments. Local governments today are very complex systems, with very heterogeneous organizational structure, wide range and variety of competencies pertaining on respectable geographic area with a significant number of residents.

The local governments (municipalities and cities) in Serbia are characterized by organizational and economic sustainability: their population varies from around 10 to over 100 thousand people¹² with budgets ranging from several to 20 million Euros. Thanks to reforms initiated in 2002, the Law on Local Self- government

¹² The only bigger local government is Belgrade with almost 2 million inhabitants and over 600-million Euro budget. It should be noted that the City of Belgrade comprises 17 municipalities.

and a number of related laws (especially the Law on Budgetary System) and other legal documents - local government competencies has been considerably extended in Serbia, causing increase of available budgetary resources at the same time.

Such organized local governments present an environment, in which strategic planning and management has gained a very important role and application. Strategic management and planning process is, by its definition, a very complex and demanding both, in respect to its technical characteristics (methods, techniques, necessary information base, etc.) and its internal and external political characteristics (relations among participants in the process).

Strategic management in local governments' specific environment may be defined as a systematic process, in which local authority, together with local economic subjects, as well as subjects from other society's segments, and citizens – identify important issues and set up realistic objectives, tasks and strategies for their realization.

It is therefore necessary, in order to make planning process successful, to provide fulfilment of some basic preconditions. They will differ in some details among certain local governments depending on their specific characteristics. Planning process managers at local level have to be flexible in dealing and resolving certain issues since altered issues may occur as a result of the process, based on different interests of participants. In terms of this, any process should be adjusted to a local level in all its crucial aspects: technical, political and cultural. This particularly refers to the following factors:¹³

- *Technical capacities* - Not only expert knowledge need to be taken into consideration, but knowledge and awareness of all local participants regarding their role and place in a planning process. Current planning models imply inclusion of a number of entities into the process, and unless they are prepared to do it in an adequate way, results may be very poor despite all efforts;
- *Realistic approach* - Starting from specific characteristics of the local government and particularly availability of resources, expected results of the process should be realistic and achievable. Should expectations be excessive and goals set above realistically achievable ones, very soon the whole process might turn into a failure which will cause ineffective spending of scarce resources, and discarded the concept of strategic planning ad-acta as an expensive, unnecessary and useless exercise.
- *Connection with other management processes* – Strategic planning process in a local government should be incorporated in and directly related with other

¹³ Brnjas Z., Stošić I., Erić D., Strategic Management Planning as a Tool in Advanced Local Governments in The New Economy: Challenges, Opportunities and Choices, Indo-American Books, Delhi (India), 2009

planning-related processes, i.e. its result (strategic plan) would have to be a realistic base for all other plans, in the first place the budget plan, followed by capital investments plan, development plan for certain local community functions (culture, education, etc.).

Strategic management and planning techniques are part of managerial practice of numerous local governments in developed and in less developed countries. Its practical application, naturally, differs in certain aspects depending on specific characteristics of concrete community, such as their size, current legal framework, i.e. division of competencies among various governmental levels, community dynamics (whether it is, socially and economically speaking, prosperous community, or it is a declining community), up to subjective characteristics of authorities and decision-makers (aspiration level, personal management style, etc.).

Developing local government program of capital investments

A local government capital investment program (CIP) is usually defined as a multi-year plan for the investment of local government funds in infrastructure, public buildings, and equipment. Detailed project descriptions, dedicated revenue forecasts, and expenditure summaries are all accounted for in the multi-year project plan and the multi-year financial plan.

Working on the CIP will enable good planning while financing capital investment projects requires effective leadership, including a wide circle of local stakeholders, budget organizations and local public enterprises and their mutual cooperation. A well prepared CIP yields multifold benefits and its role can be particularly emphasized when it comes to the following:

- Balancing capital needs and operating budget;
- Improving the credit rating of local governments, controlling fiscal revenues and avoiding sudden attacks to local budgets due to changes in debt service dues;
- Identification of economically most needed capital projects;
- Increase of chances for obtaining external financial support;
- Using public resources and connecting them with other public and private development plans;
- Keeping the public better informed about future needs and projects;
- Promoting project planning which will help avoid expensive mistakes and aid local government to achieve their desired goals.

The current Budget System Law (and the laws related to this one) in Serbia do not envisaged separation of capital from operational budget, even there are a number

of differences between operating and capital budgeting. The main is that the annual operating budget supports the routine costs associated with service delivery such as salaries, materials, office supplies, and fuel, while in contrast, the capital budget provides funding for non-routine and nonrecurring investments infrastructure, public assets, public equipment, and land, etc. In addition to basic these differences between capital and operating budget, there are few which are very important during their execution phase. A few of the reasons are listed below:

- *High cost of capital projects* - it is a common situation for local budgets that there is never enough money for financing all projects. Due to the high cost of individual capital project investments, this is especially true with capital budgeting. As a result, it is impossible to meet the needs in a single year and therefore it is critical that municipalities create and conduct a special process to understand and prioritize the capital needs and develop a multi-year funding program.
- *Uneven clusters of projects* - On an annual basis, operating expenditures for things like salaries, materials, and office supplies are recurring expenses and tend to fluctuate in fairly smooth patterns. In contrast, capital needs are non-recurring expenses and spending often fluctuates significantly on an annual basis. The combination of high individual project costs and uneven clusters of capital project needs further increase the municipality's problems in providing finance needed for projects implementation. As a result, a single year budget horizon is not adequate and it is necessary to involve a multi-year project planning and multi-year financing approaches.
- *Careful planning and coordination* - Capital projects are commonly complex projects that take time to plan, design, coordinate, and implement. In some cases, the process from careful design through meticulous execution and implementation takes years. Due to the high cost of investment and the fact that the projects last for many years, errors in capital planning and coordination can only be corrected at extremely high costs.
- *Consistent source of revenues* - Because of the high costs of capital projects, special financing with dedicated revenues is sometimes required for successful implementation of a multi-year capital program. If debt financing is used to support a capital program, linking specific revenue sources for debt service payments is a basic prerequisite. Separating capital funding sources from operating revenues is especially important because public officials, who are focused on day to day concerns and problems, are often inclined to resolve immediate needs regarding grants to organizations or beneficiaries and trade off longer term issues and investments in infrastructure and public assets. An independent approach is therefore needed to address capital program issues.

As a result of these specific characteristic it is necessary that local governments pursue capital programming as a separate and independent budget development process and document.

Well prepared local government capital investment program need to consist of the following three components:

- *The project plan* - The final project plan is the complete schedule of individual projects that have been included in the multi-year capital plan. There are several steps that need to be completed in order to develop the final project plan including the following: inventory and assess all major public assets and ongoing projects; identify and develop new capital needs and projects with detailed project proposals; create program priorities; prioritize and rank all projects; coordinate and summarize all projects. The final product of the project plan is the implementation and expenditure schedule for all of the individual projects included in the multi-year program horizon.
- *The financial plan* - The financial plan is the schedule of funding that supports the capital project investments over the planned period. Because it is a multi-year plan, the fiscal health of the municipality needs to be considered over the necessary time period and individual revenues need to be identified, forecast, and dedicated to achieving the project program. The financial plan should also include policies for financing that address issues such as the ratio between debt versus cash financing and the level of debt burden that the municipality will incur. The final product of the financial plan is the summary funding schedule that supports each project in the respective capital program.
- *The capital investment program summary* - This component brings the final project plan together with the forecasting realities of the financial plan. Specifically, it integrates the expenditure schedule from the project plan with the financing schedule from the financial plan into a single program for making capital investments over a multi-year period. The program summary information is combined with individual summaries for each project to produce the CIP summary. Each of the project summaries contains information on the purpose, benefits, location, and expenditure schedule, financing, and operating impact for individual project. The capital improvement program summary allows all main local stakeholders (the mayor, council members, department heads, businesses, investors, citizens, and taxpayers) to understand the local government plans to improve the infrastructure, public buildings, and service equipment for the benefit of the community.

Local Government Finance in Serbia

Local government in Serbia (LG) has been defined as the right of citizens to perform functions of public interest in the unit where they reside either directly

and/or through their elected representatives. The basic territorial units within which they exercise these rights in Serbia are municipalities and cities.¹⁴ The law recognizes local government's original functions and functions that are delegated to them by the higher government authorities (Republic and Province). The structure of their finances (both revenues and expenditures) has been harmonized with these functions.

The local budget revenues

Funds needed for original and delegated functions are provided by local government budgets. The legal framework for local budgets and their functioning has been defined with several laws out of which the most important are the Local Government Finance Law (2006), Law on Local Government (2007) and the Budget System Law (2009).¹⁵ For delegated or shared functions higher tiers of government provide and transfers funds to local governments, while for original functions LGs secure funding through their own or original revenues.

According to the above mentioned laws sources of revenues of local budgets are so-called "original" (or own) and revenues transferred from higher tiers of government – shared revenues and transfers. In addition to revenues, there are local budget proceeds which include proceeds based on borrowing and based on sale of local financial and nonfinancial assets.

Original revenues (Article 6 of the Law on Local Government Finance) are taxes, fees and charges whose base and rate are set by municipalities and cities, where taxes could be raised only up to the ceiling defined by law. Those can be taxes, fees, charges, revenues from property lease, from sale of movables, local government services, interests, voluntary (self)-contribution fees and donations.

Shared revenues are taxes and charges whose base and rate are specified by the Republic and the revenue itself is shared between the Republic and a city/municipality. Revenues generated entirely in the territory of a local government are shared entirely or partially with local government units. According to Article 35 of the Law on Local Government Finance these revenues may be revenues from shared taxes or revenues from shared charges.

Specific revenues that are transferred from the Republic budget to cities and municipalities may be: (i) non-earmarked – specified annually as 1.7% gross

¹⁴ Law on Local Self-Government (2007)

¹⁵ The mentioned acts are the most important ones; however, the local government finance system in Serbia has been, in addition, directly or indirectly regulated by a series of other laws, such as the Public Debt Law (2009), the Public Procurement Act (2008); etc.

GDP¹⁶, and distributed to all local government units according to the criteria specified in the law; LGs independently decide how to spend these funds; and (ii) earmarked funds which are used for funding of the previously specified functions and expenditures.

The structure of local budget expenditures

All Serbian municipalities are spending their budget predominantly within the following three areas: (i) financing work of local government administration and governmental bodies (municipal council, Mayor office, etc.); (ii) financing social functions that are under local governments competency (education, sport, culture, etc.) which is performing through transferring funds to the local budget beneficiaries; and (iii) investments, mostly in local infrastructure.

According the Serbian Budget Law(s) there are no specific types of budget expenditures that are prescribed to the local governments. Serbian municipalities are generally obliged to perform certain social functions like to provide to their citizens communal services, to cover material costs to the educational institutions (primary and secondary schools), to provide cultural and sport activities in the local communities, etc. The way (quantity and quality of services) in which they will fulfil these obligations is left to the LGs to decides in accordance to their preferences and funds available. So, formally looking it could be said that all local budget expenditures are discretionally, i.e. that LGs are deciding about level of its financing.

Having this in mind it is understandable that shares of certain expenditures are varied in different Serbian Municipalities. According the experiential standard in average Serbian municipalities are spending around 1/3 out of total budget for each of the group of expenditures. This varies in each specific case: some of less developed municipalities are devoting just a few percentages (5% to 10%) of its total budget, while the more developed municipalities are spending around or even over 50% of their total budgets. The main problem of this approach is that it could and it does create considerable differences among municipalities in a level of services offering to their citizens.

¹⁶ This provision of the Law was in force for only 2 years (2007 and 2008), when due to the financial crisis and sudden reduction in proceeds and revenues of the national budget its effects were practically suspended.

Institutional framework for local economic development management

As already mentioned, the *Law of Local Self Government* differentiates local government's original scope of responsibilities from the ones which are delegated to them by Republic level of government. For the purpose of performing their functions prescribed by Law, the local government units are establishing enterprises, institutions and other organizations engaged in providing different public services.

The mentioned Law has listed more than 30 activities within the original scope of LGs responsibilities and they could be summarized within the following groups of activities:

- Providing number of communal services such as water supply, road traffic, cleaning, maintenance of landfills, spatial planning and utilization of green markets, parks, green, leisure and other public areas, public parking spaces, public illumination, maintenance of cemeteries and burials, etc. This group of activities, among other, includes the activities referring to implementation most of the local government capital investment projects.
- Establishing institutions and organizations and monitoring and providing conditions for their functioning in the field of primary education, culture, primary health care, physical culture, sports, child and social welfare, tourism, etc.
- Regulating and providing conditions for various local communities and citizen activities.

For performing all these activities, local governments are establishing a network of institutions and organizations which are according the Serbian legislation eligible for using local budget funds, and those are the following:

- *The Direct Budget Beneficiaries (DBB)* - DBB in Serbian local governmental system represent parts (executive bodies, organizational divisions) of the LG administrations which are in charge of performing certain LG's functions. From the point of their financing it should be noted that they are completely financed through local budgets and (what differentiated them from indirect beneficiaries is that) they have direct financial relation with the budget. The flow of budgets funds goes to them without any intermediary entity. Some of Direct BBs have an important role in, financially and operationally, managing groups of indirect budget beneficiaries (Indirect BBs) which are delegated to perform some of the LGs functions.
- *The Indirect Budget Beneficiaries (IBB)* – IBB are financed as well by local budgets but their budget funds are transferring to them through Direct BB; the other specifics of these institutions (comparing to Direct BB) is that they

could obtain funds additional to the budget (for example through selling the services to clients in the market).

- *The Budget Funds Users (BFU)* – BFU are other organizations which are partially financing through local budget. Unlike DBB and IDB which represent relatively stable structure of entities financing through local budget, the list of Budget Fund Users could vary from year to year. These entities could be organizations and institutions, but very often they are just a single specific project or activity.

The entities which are of specific importance for carrying out activities related to local economic development are the two following group of entities:

- The specific department (or specific units within departments) entitled for performing urban and land use planning, planning and building local infrastructure and related activities. This organizational unit is very often called *Directorate* (for development, investment, planning and alike). Their role is especially important in preparing the development plans, designing specific projects and taking part in its implementations as a monitoring body. This entity has a status of DBB meaning that it is financed directly from local budget funds.
- Next important group of entities which play one of the crucial roles in performing activities related to local economic development are local *Public Utility Companies (PUCs)*. While the role of Directorates is to plan and prepare projects, PUCs role is to implement the project related to communal infrastructure, put them into the function and to operate the systems. From the point of their status they could be considered as budget funds users (BFU). PUCs are formally out of budget finance system: their accounts are not within the local treasury system, but within the commercial banking sector, and they are functioning within the regime of business sector (account system, legal system, etc.). Anyhow, since LGs are founders of these PUCs they do have managerial as well as financial relations with them.
- In addition to these two entities, from the mid of the last decade, some of the LGs in Serbia has begun to introduce a new specific entity specifically entitled to carry out the activities. Those units are usually called Office for Local Economic Development and their dominant scope of work include planning and implementing various activities referring to local economic development like develop specific economic plans, developing specific local economic policy, negotiating with interested investors, initiating local business incubators, industrial and free trade zones, technological parks, etc.

Creating the whole elaborated network of all described entities and providing their synchronized functioning is a one of the crucial prerequisite for initiating

effective process of sustainable economic development in any specific local government.

CONCLUSION

The role of the local public sector in promoting economic development has become very significant in modern times both in developed and somewhat less developed countries. A traditional centralistic approach in which the state, or the central level, is entirely competent and responsible for creating the climate and for creating the policy of economic development of the country has been largely outdated, or more accurately, upgraded by including local government in the process. In that context, in modern times, participants in global market competitions are proliferating, and relationships between them more and more complex and interdependent. In addition to businesses, then those who represent or originate from the central authorities (various government agencies and public institutions), the process includes local public sector representatives (specialized local agencies, local government bodies, representatives of local authorities, etc.). Entities from this level of government are joining the market game, competing against each other but also with other tiers of government for resources, for attracting domestic and foreign direct investment and, in general, for creating local development pools.

For this purpose local government is developing a whole set of tools to get into this competition. It is being done by infrastructure development, by forming special urban zones serviced in line with the needs and expectations of clients (primarily prospects), by developing local human resources and by forming and guiding education programs, by developing and promoting service sector and, in general, by building a societal climate which will be attractive for these clients. In Serbia the local public sector is formed by local government units (municipalities and cities). There are 145 of them where the average size is around 50-ish thousand inhabitants¹⁷. This indicates that a relatively significant degree of population concentration in urban areas in Serbia is an important prerequisite for building potential for sustainable (especially economic) development of local government units.

Still, active inclusion of the local public sector in Serbia in the processes of creating and promoting economic development is a relatively recent phenomenon.

¹⁷ One should note that the average also includes the city of Belgrade with around 2 million people. Still, this does not change the conclusion that Serbian LGs have relatively significant degree of conglomeration.

It's worth noting that LGs in Serbia began assuming responsibility for the economic development in their territories only mid last decade.

In this period LGs in Serbia began establishing some necessary assumptions of effective economic development management at the local level:

- Most LGs in Serbia today have a more or less developed strategic management system at the local level, and as a result of it, elements (or in some cases full documents) of development strategies for their local communities;
- A large number of LGs have further operationalized their strategic plans by defining capital investment plans by specific priority investment projects, by potential sources of finance, and by potential implementers;
- The local government finance system in Serbia has been relatively well defined by a set of appropriate laws. It should have provided stability and predictability for local government sources of finance, and within it a source of finance for capital investment projects. One should, however, take into consideration that, first of all; due to the financial crisis a good part of the legislation has lost its effects on actual processes.
- Finally, most LGs began building an appropriate organizational-institutional framework for managing the local economic development. A number of LGs rely on the traditional solution in which these issues are addressed by specific parts of the local governments. Those are usually departments of utility-urban planning affairs which are often separated into special organizational units – so-called Directorates of Development. A certain number of LGs have established special organizational units –so-called Local Economic Development Offices which are simultaneously under the local government roof and independent from it, and that autonomy enables them to follow other (market and economic principles) compared to typical administration.

In conclusion it could be said that the local public sector in Serbia is gaining new competencies in the area of economic development in a more significant and explicit manner, taking them away from the central authorities, which is in line with trends which have been going on in the developed, market oriented countries for several decades. In that respect, several LGs have already appeared on the “global competition map” and it may be said that they have achieved some results. Still, a large number of LGs are yet to finish important tasks in order to use their local development potential to the fullest and thus contribute to the complete sustainable development of their local communities and society as a whole.

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