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Fiscal Decentralisation and
Local Government Financing
in Serbia and Montenegro

Authors:
Sanja Kmezić
Katarina Đulić
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September 2016

Fiscal Decentralisation and Local Government Financing in Serbia and Montenegro

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Abstract This book focuses on the fiscal decentralisation processes and the systems of local government financing in Serbia and Montenegro in the period 2000-2015. The retrospective analysis of the decentralisation processes in both countries show that they have been moving back and forth between decentralisation and centralisation, constantly swinging the pendulum of *political* discourse and the *legal* framework on intergovernmental fiscal governance. During the observed period, the systems of local government financing in both countries have often undergone drastic changes. Thus, this study focuses on the *analysis of the impact of the legal framework* related to intergovernmental fiscal relations, fiscal decentralisation and local government financing in Serbia and Montenegro *on local government budgets*. By applying both normative and economic analyses, as well as both quantitative and qualitative research methods, the study *evaluates the legal quality and economic and factual effects* of relevant legislation on local government budgets and status in the period 2000-2015.

The study is divided into four parts: 1) Introduction; 2) Case Study: Serbia; 3) Case Study: Montenegro (both case studies include normative, economic and empirical analyses of the fiscal decentralisation process and the system of local government financing); 4) Comparative conclusions and recommendations.

Keywords: • Fiscal decentralisation • Local government financing • Intergovernmental fiscal relations • Serbia • Montenegro • Own-source revenues • Shared revenues • Transfers and grants

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Foreword

The book titled “Fiscal Decentralisation and Local Government Finance in Serbia and Montenegro” generally focuses on the analysis of an important question: how to transform societies in these two countries, which were heavily centralised during the last decade of the 20th century when the Yugoslav state was falling apart. The authors rightfully note that fiscal decentralisation and a stable local government finance system have not been featured among the strategic goals of the central governments of Montenegro and Serbia, even after the democratic changes that took place in 1997 and 2000, respectively. There was, truth be told, a period during the first decade of the 21st century, when laws were adopted in order to secure higher local government revenues. Nevertheless, those solutions were suspended with the onset of the global financial crisis, which constantly diminished local government revenues.

Faced with numerous challenges, the authors prepared a complex interdisciplinary and comparative analytical approach, which served as foundation for a multi-layered legal, economic and public policy analysis, encompassing both the revenue and the expenditure side of the budget. In their conclusion, they warn of detrimental consequences of abrupt U-turns in fiscal decentralisation policies, which cause volatility of local government revenue, jeopardise their liquidity, incite indebtedness and hinder long-term planning.

To summarise, the study entitled “Fiscal Decentralisation and Local Government Finance in Serbia and Montenegro”, by Sanja Kmezić, Katarina Đulić, Mijat Jocović and Jadranka Kaluđerović, presents not only a significant addition to the theory of fiscal federalism, fiscal decentralisation policy and tax legal science, but also a roadmap that Serbia and Montenegro could use in the period to come if they want to replace pseudo-decentralisation with a modern decentralised state model, one that would correspond to solutions applied in most EU states.

Prof. Dr Dejan Popović
University of Belgrade, Faculty of Law

This excellent book provides an original and comprehensive analysis of the processes of fiscal decentralisation in Serbia and Montenegro. It covers the changes made to the legal framework for fiscal decentralisation from the democratic transition of 2000 to the present day, and the fiscal effects of these changes on local government budgets. Using mixed qualitative and quantitative methods the book demonstrates how foreign donor influence initially drove policies of decentralisation with the laudable aim of bringing the financing and delivery of public services closer to their end-users. Following the

adverse impact of the global financial crisis of 2009 on central government budgets, policy turned to a re-centralisation of public finance in both countries. The piecemeal approaches adopted during this period and the unfortunate lack of coordination between central and local government levels created a chaotic situation in local government finances which disrupted public services at the local level. The book provides an in-depth and forensic examination of these changes. In doing so, it offers a unique insight into two previously under-researched examples of the complex processes of democratisation and economic transition in post-communist South East Europe.

Dr William Bartlett
LSEE Visiting Senior Fellow
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The structure of the book „Fiscal Decentralisation and Local Government Financing in Serbia and Montenegro“ is systematically developed through the explication of the research problem, research questions, and methodological approach in part I, as well as of the empirical case study of the fiscal decentralisation process, the system of local government financing, and the intergovernmental fiscal relations in Serbia beginning with the democratic changes in 2000 and up to 2015 in part II. The book also presents a similar empirical case study of the same processes in Montenegro from the beginning of the transition process to 2015 in part III and, finally, the comparative conclusions on the similarities and differences between the fiscal decentralisation processes in these two countries in part IV. The authors convincingly argue for the necessity of methodological pluralism based on the interdependence of normative and empirical approaches. The normative analysis of the legal sources for local government financing brings to the fore whether the contents of these legal sources are in line with the „principles“ of the theory of fiscal federalism, including decentralisation and the legal standards of the Council of Europe and the EU sources of law. This said, it becomes clear that the normative analysis correctly focuses on the teleological method of interpretation of these legal sources – in line with the overall functional approach. It needs to be emphasised that the authors of the book have undertaken a tremendous amount of work to compile and analyse the bulk of the literature, as well as to gather and systematically process all the data for the empirical analysis. In conclusion, this study is a theoretically and methodologically sound analytical exercise with important results for the future reform of Serbia’s and Montenegro’s fiscal systems, as can also be seen from the detailed policy recommendations the authors make.

Prof. Dr Joseph Marko
Institute for Public Law and Political Science
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Introduction

SANJA KMEZIĆ

Abstract The introduction explains the *context* – the lack of strategic commitments to fiscal decentralisation – that helps us gauge the *relevance of the study's subject matter* and set up an adequate *analytical framework*. Further, it outlines the major *research problem* and articulates the subject of the study and main *research questions*. The fundamental problem treated in the book is the fact that fiscal decentralisation and stable local finance systems are de facto not among strategic directions of Serbian and Montenegrin central governments. The study focuses on the following research questions: 1) What are the main features of fiscal decentralisation processes in Serbia and Montenegro?; 2) How have legal frameworks on local government financing changed over the last 15 years in Serbia and Montenegro?; 3) What is the fiscal effect of legislative changes on local government budgets?; 4) What are the main differences and similarities of fiscal decentralisation processes in these two countries? Finally, the Introduction presents the analytical approach and research methods used in the study.

Keywords: • fiscal decentralisation process • legal framework on local government financing • fiscal effects of legislative changes • comparative similarities and differences

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1 Explication of the context – lack of strategic commitment to decentralisation

Serbia and Montenegro embarked upon their post-communist political and economic transition processes more than two decades ago. However, these processes were hindered in the 1990s by the dissolution and armed conflicts in former Yugoslavia, which postponed fundamental reforms in Serbia and Montenegro for the next decade. Montenegro essentially began its reforms in 1997 by standing up to Milošević's policies and carrying out changes in the private and public sectors, which led to the country's independence in 2006. It was further awarded with the status of a candidate state in the process of EU accession in December 2010.¹ In Serbia, immediately upon the establishment of the democratic regime in late 2000 and early 2001, the process of political transformation, the economic transition, and the EU accession efforts resumed, culminating in the opening of membership negotiations in December 2015.

Until 1990, Serbia, as a country, and its system of financing subnational governments were quite decentralised. However, under the authoritarian regime of Slobodan Milošević, the Government of the Republic of Serbia initiated a rapid process of consolidation and centralisation of power by adopting a new Constitution of the Republic of Serbia in 1990, which abolished the existence of autonomous provinces and diminished the role and mandates of local governments dramatically.² The 1990 Constitution and the subsequent accompanying legislation abolished the fiscal autonomy of local authorities and deprived municipalities of having a role in providing any social services. The breakup of Yugoslavia, wars, the economic embargo and the hyperinflation of the early 1990s contributed to further fiscal limitations and additionally worsened local government finance.³ In the mid-1990s, the Milošević regime started losing its popularity. As the power of the opposition grew at the local level, the Republic's politics of centralisation became more aggressive and radical. For instance, in 1995, the National Assembly adopted the Law on Assets Owned by the Republic of Serbia,⁴ which "nationalised" all public property and established a centralised property management system. De facto, this meant that Serbian local governments were no longer authorised to manage and dispose of "public" property without obtaining the central government's permission. In other words, local governments in Serbia in the 1990s were basically deprived of both revenues and property assets, i.e., financial and development instruments.

Immediately after the Milošević regime was overthrown, the new Serbian government began intergovernmental fiscal reform by amending the Law on Public Revenue and Public Expenditure⁵ and the Law on Local Self-Government,⁶ aimed at increasing municipal revenues and devolving certain expenditure functions.⁷ In January 2002, a new Law on Local Self-Government⁸ was adopted that additionally increased the share of local revenues in total public revenues. To summarise, the 2001 and 2002 reforms led to a significant increase in municipal budgets, almost doubling municipal revenues

compared to 2000,⁹ that is, the period before the reforms. In its Public Administration Reform Strategy from November 2004,¹⁰ the Republic of Serbia opted for broader (fiscal) decentralisation and rendered it one of its basic public administration reform principles. Local government financing in Serbia was finally regulated by the adoption of a 'system' law in 2006 – the Law on Local Self-Government Finance.¹¹ Adoption of this Law seemed like a final step in the consolidation and the establishment of a stable intergovernmental fiscal system in Serbia, allowing multi-annual planning of both central and local finances.

However, during the period 2009-2015, the system has been repeatedly changed through amendments to the legal framework, and even by the suspension or abolition of certain provisions of the mentioned Law on Local Government Finance and other relevant regulations. Namely, in reaction to the economic crisis and an increasing budget deficit, the Government of Serbia adopted a reviewed budget in mid-2009 that drastically cut the volume of non-earmarked transfers (grants) to local governments. Over the three years during which the formula for the allocation of non-earmarked transfers was suspended, local governments incurred losses that amounted to a total of over 50 billion dinars, which at that time equalled half a billion euros.¹²

During these years, Serbian cities and municipalities reacted to this decrease by mobilising, increasing and improving the administration of their own-source revenues. After more than two years of suspension of the Law on Local Government Finance, local budgets temporarily recuperated, but this was not achieved by re-instating the existing legal system of non-earmarked transfers. Instead, the central government increased the share of local governments in the revenue from the wage tax from 40 % to 80 % (to 70 % in the City of Belgrade). Bučić and Spirić note that the total increase of revenue resulting from the increased share in the wage tax in the last trimester of 2011 and during the entire 2012 failed to fully compensate for the loss caused by the suspension of the non-earmarked transfer.¹³ At the time, they estimated that during the first three years of implementation of these legislative amendments, local governments would receive more than 40 billion dinars. Nonetheless, this solution, too, was short-lived, since as early as in 2013 the Republic decreased both the tax base and the tax rate of the wage tax, leaving municipalities with 20 billion dinars, instead of with the 40 billion they were expecting. In 2011 and 2013, the methodology for the calculation of transfers changed, additionally compromising the transparency of the system and reducing total funds received from this revenue. During 2012, certain local communal fees were abolished, while others were reduced due to calculation changes. Also, certain charges shared with local governments were also abolished. All these changes additionally decreased total local government revenues by some 5.5 billion dinars.¹⁴ During 2013, local governments were stripped of the revenue from the real estate rental income tax, which resulted in an additional decrease of 3 billion dinars.¹⁵ In late 2013, a new wave of reductions in non-earmarked transfers for 2014 ensued. They were decreased by 3.7 billion dinars, and stayed at the same, reduced level in 2015.¹⁶ As of

January 1, 2014, the construction land use charge ceased to exist and to be collected, causing municipalities to lose another 14 billion dinars, according to some estimates.¹⁷ In late 2014, the method for calculating the construction land development charge was changed, but the total loss in local government budgets will not be known until local governments adopt their annual statements for 2015.

Such practices cannot contribute to a stable fiscal decentralisation system or to the predictability of local government financing, and make it difficult to plan local budgets and policies. This particularly goes for development policies because the basic precondition for development planning is stable financial planning.

In Montenegro, in the period between 1993 and 2003, the organisation and financing of public administration were characterized by a high level of centralisation, low autonomy of local governments in decision making, and a unified system of financing the Republic and local government units as its organizational units. Starting in 1997, after the then ruling party underwent certain internal political changes and with substantial aid from international donors, Montenegro began its serious structural transformation in the areas of trade liberalisation, privatisation, financial sector reform, labour market reform and the reform of the entire business environment.¹⁸ One of the most important areas that required reform was public administration.¹⁹ Long-term unsustainability of the then centralised and cumbersome public administration, the certainty that international donations would eventually be reduced, the fact that further funding was conditioned upon achieving concrete reforms, and Montenegro's strategic commitment to EU membership all significantly contributed to the implementation of the public administration decentralisation process, particularly after 2000.²⁰ Even though Montenegro intensified reforms in many areas in the period after 1997, the system of local government financing did not change until 2003.

The decentralisation process in Montenegro formally began in 2003, with the adoption of the Law on Local Self-Government and the Law on Local Government Finance.²¹ The Law on Local Government Finance prescribes that municipalities should provide funds to finance their activities from four sources: 1. own-source revenues; 2. revenues shared by law; 3. the equalisation fund, and 4. the central budget. The application of the aforementioned regulatory framework in practice established a stable system of local government financing that enabled municipalities to regularly finance functions delegated to them by law.

Until 2008, there had not been any significant changes in the legal framework of the local government financing system. However, starting in 2008, the central government gradually began altering the system by adopting various regulations with one common goal – reducing local government revenue and curbing their autonomy in the administration of own-source revenues, which were at the time hindering economic development of the country according to policy makers in this area. However, the

abolition of own-source revenues of local governments was in no way coupled with an adequate compensation. The most significant changes in this period were the following: 1) the adoption and implementation of the Law on Local Communal Fees, which abolished local communal fees for the most profitable business activities – telecommunications, electricity distribution and the use of seashore land for business activities,²² 2) the adoption and implementation of the 2008 Law on Spatial Planning and Structure Development, which abolished the construction land use charge, and 3) the 2010 amendments to the Law on Local Government Finance, which abolished certain local government revenues – the consumption tax, the business sign or name tax, and the lottery and game of chance tax.²³ Simultaneously with the abolition of these own-source revenues, the 2010 amendments to the Law on Local Government Finance brought a significant increase in the percentages of shared revenues. Within the period these changes took place, local government finances were severely compromised and the consequences are still present today in the form of high levels of municipal arrears, the objective incapacity of municipalities to finance functions delegated to them by law, and the gradual collapse of the local business environment.

2 Explication of the Problem

Both Serbia and Montenegro have included (fiscal) decentralisation as one of the major goals in their public administration reform strategies. However, a retrospective analysis of the decentralisation process in the past 15 years shows that both countries have been moving back and forth between fiscal decentralisation and centralisation, constantly swinging the pendulum of political discourse and the legal framework on intergovernmental fiscal governance. As described earlier, the local government finance systems in Serbia and Montenegro have often undergone drastic changes during this period. The legal frameworks on intergovernmental fiscal relations and local government finance and functions have been changed frequently, leading to unpredictability and instability. Over the period 2008-2015 alone, the legal frameworks on the local government financing systems in both countries have been changed a number of times, often in the middle of the budgetary year. Such changes have often had an immediate effect and disrupted budgetary implementation and financial management at the local level. Under such circumstances, it is difficult for municipalities to plan and conduct fiscal and development policies. Finally, the changes in the legal framework ultimately led to a decrease of local government budgets and a crippled ability to perform their utility, investment and other municipal functions. In addition, local governments could not influence the policy-making and legislative processes. All this can be encompassed by the fundamental problem treated in this study - fiscal decentralisation and stable local finance systems are de facto not among strategic directions of Serbian and Montenegrin central governments.

There are many political and economic arguments in favour of fiscal decentralisation: 1) it improves political accountability and responsibility of local governments;²⁴ 2) it is a

good mechanism for the consolidation of democracy and political stability, because it provides higher political participation of citizens in the government at the lowest, grassroots level and better protection of citizens' rights;²⁵ 3) fiscally decentralised systems can provide services that are better adapted to needs of their citizens;²⁶ 4) decentralisation is considered to increase efficiency and improve the competitiveness of local governments, if there are mechanisms that prevents its destructive form ("race to the bottom");²⁷ 5) it increases effectiveness due to increased innovation and experimentation;²⁸ 6) local authorities may be better at mobilising the local tax base and more efficient in collecting some important public revenues (e.g. the property tax);²⁹ 7) if designed properly, decentralisation leads to better allocation of resources and can boost local economic development,³⁰ etc.

Following this line of argumentation, this study hypothesise that when adequately regulated, fiscal decentralisation ensures optimal conditions for stability and predictability of local revenues.³¹ This, in turn, enables municipalities to plan their fiscal and development policies, including providing services to citizens and businesses, financing capital investment, supporting economic development and employment, and thus, improving the standard and quality of life of citizens.

3 The subject of the study and the main research questions

This study focuses on the analysis of the impact of the legal framework related to intergovernmental fiscal relations, fiscal decentralisation and local government financing in Serbia and Montenegro on local government budgets. More precisely, it attempts to evaluate the legal quality and economic effects of relevant fiscal regulations on budgetary revenues and expenditures of local governments.

Thus, the subject matter of this study is the analysis of fiscal decentralisation, intergovernmental fiscal governance and local government financing systems in Serbia and Montenegro over the last 15 years. From this basic analytical framework, a subset of more concrete research questions will be addressed:

- 1) What are the main features of fiscal decentralisation processes in Serbia and Montenegro?
- 2) How have legal frameworks on local government financing changed over the last 15 years in Serbia and Montenegro?
- 3) What is the fiscal effect of legislative changes on local government budgets?
- 4) What are the main differences and similarities of fiscal decentralisation processes in these two countries?

The purpose of the study is to identify major obstacles to decentralisation and key weaknesses in intergovernmental fiscal relations and municipal financing. The study will provide recommendations for improving the quality of intergovernmental fiscal governance and the design of local government financing systems, as well as for

optimising fiscal decentralisation processes based on good examples and policies in the European Union, the Council of Europe and the case study countries.

4 The analytical approach and research methodology

The problem is complex and it requires an inter-disciplinary and comparative analytical approach, i.e., integrating and combining legal, economic and empirical analyses, and using qualitative and quantitative research methods. It is a multilevel legal, policy and economic study since it evaluates:

1. National policies and legal frameworks in Serbia and Montenegro in the area of intergovernmental fiscal relations and local government financing (assessed vis-à-vis the positive EU and CoE sources of law);
2. Municipal bylaws (ordinances) on local government budgets and financing;
3. Factual and economic effects of the said legal framework and policy measures on municipal revenues and expenditures and, thus, on final beneficiaries – citizens and businesses.

Hence, the analysis will focus on 3 dimensions:

1. The first dimension represents the design of fiscal decentralisation and the local government financing system, which is defined in national legal frameworks related to intergovernmental fiscal relations and municipal financing;
2. The second dimension represents the effects of the changes in the legal system on municipal budgets;
3. The third dimension is a comparative one and serves to formulate legal and policy recommendations based on good examples and practices.

Dimension I – In order to analyse and evaluate the design of fiscal decentralisation and the local government financing system in Serbia and Montenegro, the following research methods will be used:

1. Literature review, in order to support the arguments that fiscal decentralisation represents a good strategic commitment, as well as to present the concepts of optimal fiscal decentralisation design and an optimal system of local government financing.
2. Normative analysis of the content and quality of Serbian and Montenegrin legal frameworks related to intergovernmental fiscal relations and municipal financing, since the design of fiscal decentralisation is defined in national legal frameworks. The quality of norms is assessed vis-à-vis the frame of reference identified in the literature review and the positive EU and CoE sources of law. (Serbia and Montenegro are EU candidate countries, and as they are in the accession process, they tend to harmonize their laws and policies with the EU sources of law. In addition, both countries are members of the Council of Europe and have ratified the Council's Charter on Local Self-Government).

3. Semi-structured in-depth interviews with relevant stakeholders, in order to learn more about the institutional and factual aspects of policy-making, decision-making and legislative processes.

Dimension II – In order to assess the fiscal effects of the legal changes on municipal budgets in the period 2000-2014 in Serbia and 2007-2014 in Montenegro, the following research methods will be used:

1. Fiscal analysis of municipal revenues and expenditures in the observed period. Due to the lack of availability of data in Serbia, the detailed analysis focuses only on two local governments - the City of Belgrade and the Municipality of Paraćin – as they were the only ones willing to share their budgetary data.³² However, the analysis in the Montenegrin case study includes all 21 local governments.³³
2. Review of Serbian studies on fiscal decentralisation and local government financing, in order to present the information and data on fiscal effects of certain legal changes on municipalities not covered by our in-depth analysis.
3. Semi-structured in-depth interviews with relevant representatives of central and local governments and the association of local governments, in order to complement the analysis and learn more about the factual implications of legal changes on municipal budgets.

Dimension III – This dimension focuses on a comparative analysis in order to formulate policy recommendations based on good examples and practices.

1. Comparative normative analysis of national legal frameworks with specific sources of law of the EU and the CoE on intergovernmental fiscal relations and subnational financing;
2. Comparative policy and normative analysis of Serbian and Montenegrin fiscal decentralisation processes and legal frameworks on local government financing.

5 The structure of the study

The study is divided into four chapters: 1) Introduction; 2) Case Study: Serbia; 3) Case Study: Montenegro (both case studies include normative, economic and empirical analyses of the fiscal decentralisation process and the system of local government financing); 4) Comparative conclusions and recommendations.

The introduction explains the context that helps us gauge the relevance of the study's subject matter and set up an adequate analytical framework. Further, it outlines the major research problem and articulates the subject of the study and main research questions. Finally, it presents the analytical approach and research methods used in this study.

The case studies on Serbia and Montenegro include normative, economic and empirical analyses of fiscal decentralisation and local government financing. These chapters cover: 1) an examination of the fiscal decentralisation process and intergovernmental

fiscal relations from 2000 to 2015; 2) an in-depth analysis of the positive legal framework on local government financing; 3) the institutional role of local governments in the fiscal decentralisation process; 4) an analysis of fiscal effects of legal changes on municipal budgets; 5) conclusions and policy recommendations.

The final chapter presents comparative conclusions and findings.

Notes:

¹ Izvještaj o tranziciji u Srbiji i Crnoj Gori. (Report on Transition in Montenegro) (n.d.). In A. Jovanović & V. Vukotić (eds.), *Izvještaj o tranziciji u Srbiji i Crnoj Gori* (pp. 287-291). Beograd: G17, ISSP.

² The Constitution of the Republic of Serbia, Official Gazette of the Republic of Serbia, No. 1/90.

³ Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

⁴ Law on Assets Owned by the Republic of Serbia, Official Gazette of the Republic of Serbia, 53/95, 3/96, 54/96, and 32/97.

⁵ Law on Public Revenue and Public Expenditure, Official Gazette of the Republic of Serbia, No. 76/91, 18/93, 22/93, 37/93, 67/93, 45/94, 42/98, 54/99, 22/2001 and 33/2004.

⁶ Law on Local Self-Government, Official Gazette of the Republic of Serbia, No. 49/99 and 27/2001.

⁷ Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

⁸ Law on Local Self-Government, Official Gazette of the Republic of Serbia, No. 9/2002, 33/2004 and 135/2004.

⁹ Stipanović, B. (2006). *Local Government Finance System and Fiscal Equalization in the Republic of Serbia*. The Fiscal Decentralization Initiative for Central and Eastern Europe. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf and Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

¹⁰ For more details, see: *Strategija reforme državne uprave Republike Srbije (2004)*. (Strategy on Public Administration Reform in the Republic of Serbia). Retrieved from <http://www.gs.gov.rs/lat/strategije-vs.html> and <http://socijalnoukljucivanje.gov.rs/rs/category/dokumenta/>.

¹¹ Law on Local Self-Government Finance, Official Gazette of the Republic of Serbia, No. 62/2006, 47/2011 and 93/2012.

¹² Spirić, D., & Bučić, A. (2012). *Ka stabilnom i održivom sistemu finansiranja lokalne samouprave u Republici Srbiji* (Towards a stable and sustainable local government finance system in the Republic of Serbia). *Polis Magazine*, 1.

¹³ *Ibid.*

¹⁴ Interview with Aleksandar Bučić, quote.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ Izvještaj o tranziciji u Srbiji i Crnoj Gori. (Report on Transition in Montenegro) (n.d.). In A. Jovanović & V. Vukotić (eds.), *Izvještaj o tranziciji u Srbiji i Crnoj Gori* (pp. 287-291). Beograd: G17, ISSP.

¹⁹World Bank. (2006). Republic of Montenegro: Public expenditure and institutional review (Report No.36533), pp.3-4. Retrieved from website: <http://www.mf.gov.me/files/1165507662.pdf>.

²⁰ World Bank. (2003). Republic of Montenegro: Public expenditure and institutional review (Report No. 23689), pp.18-19. Retrieved from website: <http://datatopics.worldbank.org/hnp/files/edstats/SRBper03.pdf>

²¹ The Law on Local Self-Government, "Official Gazette of the Republic of Montenegro," 42/03, 28/04, 75/05, 13/06 and "Official Gazette of Montenegro," 88/09, 3/10 and the Law on Local Government Finance, "Official Gazette of the Republic of Montenegro," 42/03, 44/03.

²² The Law on Local Communal Fees, "Official Gazette of the Republic of Montenegro," 27/06.

²³ The Law on Spatial Planning and Structure Development, "Official Gazette of Montenegro," 51/08 and the Law on Local Government Finance, "Official Gazette of Montenegro," 74/2010.

²⁴ Faguet, J. (2011). Decentralization and governance. *Economic Organisation and Public Policy Discussion Papers*, 027. ; Hillman, A. L. (2009). *Fiscal federalism. In Public Finance and Public Policy – Responsibilities and Limitations of Government*. Cambridge, UK: Cambridge University Press.; Oates, W. E. (2005). Toward a second-generation theory of fiscal federalism. *International Tax and Public Finance*, 12, p. 349-373.; Brennan, G., & Buchanan, J. M. (1980). *The power to tax: Analytical foundations of a fiscal constitution*. Cambridge, UK: Cambridge University Press.

²⁵ Palermo, F., & Wilson, A. (2013). *The Dynamics of Decentralization in Italy: Towards a Federal Solution?* *European Diversity and Autonomy Papers*. EDAP, 04(2013).; Choudhry, S., & Perrin, B. (2007). The legal architecture of intergovernmental transfers: A comparative examination. In R. Boadway & A. Shah (eds.), *Intergovernmental Fiscal Transfers – Principles and Practice*. Washington, DC: The World Bank, Public Sector Governance and Accountability Series.; Kristić, Mr S. (2006). *Izvorni prihodi u sistemu finansiranja lokalne samouprave u Republici Srbiji*. Beograd: PALGO Centar i Stalna konferencija gradova i opština, donatora: SLGRP/USAID.

²⁶ Oates, W. E. (1999). An essay on fiscal federalism. *Journal of Economic Literature by American Economic Association*, 37(3), p. 1120-1149.; Oates, W. E. (1972). *Fiscal federalism*. New York, NY: Harcourt Brace Jovanovich.; Tiebout, C. M. (1956). A pure theory of local expenditures. *The Journal of Political Economy*, The University of Chicago Press, 63(5), p. 416-424.

²⁷ Choudhry, S., & Perrin, B. (2007). The legal architecture of intergovernmental transfers: A comparative examination. In R. Boadway & A. Shah (eds.), *Intergovernmental Fiscal Transfers – Principles and Practice*. Washington, DC: The World Bank, Public Sector Governance and Accountability Series.; Ulbrich, H. H. (2003,2011). *Public finance in theory and practice*. (2nd ed.). New York, NY: Routledge.; Oates, W. E. (1999). An essay on fiscal federalism. *Journal of Economic Literature by American Economic Association*, 37(3), p. 1120-1149.; Qian, Y., & Weingast, B. R. (1997). Federalism as a commitment to preserving market incentives. *The Journal of Economic Perspectives*, 11(4), p. 83-92.; Shah, A. (1994). The reform of intergovernmental fiscal relations in developing and emerging market economies. In *Policy and Research Series 23*. Washington, DC: World Bank.; Shah, A. (1991). *Perspectives on the design of intergovernmental fiscal relations*. In Working Paper WPS 726. Washington, DC: World Bank; Oates, W. E. (1972). *Fiscal federalism*. New York, NY: Harcourt Brace Jovanovich.; Tiebout, C. M. (1956). A pure theory of local expenditures. *The Journal of Political Economy*, The University of Chicago Press, 63(5), p. 416-424.

- ²⁸ Strumpf, K. (2002). Does Government Decentralization Increase Policy Innovation? *Journal of Public Economic Theory*, 4(2), 207-241.; Oates, W. (2007). On the Theory and Practice of Fiscal Decentralization. CREI Working Papers, 1(2007). Retrieved from http://host.uniroma3.it/centri/crei/publicazioni/workingpapers2007/CREI_01_2007.pdf;
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- ³¹ Oplotnik, Z. & Brezovnik, B. (2004) Financing Local Government in Slovenia. *Post-Communist Economies*, 16(4), p. 483-497.
- ³² For a detailed description and explanation, see the introductory chapter of the Case Study Serbia.
- ³³ Currently, there are 23 municipalities in Montenegro. Two municipalities were formed in 2013 (Petnjica) and 2014 (Gusinje), so the data for these two did not exist for the observed period.

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Legal and Institutional Analysis of the Fiscal Decentralisation Process and the System of Local Government Financing in Serbia from 2000 to 2015

SANJA KMEZIĆ

Abstract This portion of the book focuses on the legal and institutional analysis of the fiscal decentralisation process in the period 2000-2015. The author reviews the first two research questions – the main features of this process and the changes that occurred in the legal framework on local government finance. At the beginning the study explores the first fiscal decentralisation initiatives (2000-2006) and the role of various stakeholders. Second, it examines the next phase (2006-2008), during which major pieces of legislation were adopted and the new system of financing municipal functions established. The following chapter covers the period after the onset of the economic crisis (2009-2015) and analyses each individual source of municipal revenue and the legal changes that affected them. In addition, the chapter explores the political processes behind the measures implemented in this period. The last chapter assesses the existing institutional mechanisms of intergovernmental fiscal governance and the role of municipalities in the legislative and policy-making processes. The author finds that poor governance has discredited the decentralisation process, while a low quality legal framework has hampered Serbia from reaping potential benefits of fiscal decentralisation.

Keywords: fiscal decentralisation • intergovernmental fiscal governance • municipal financing • own-source revenues • shared revenues • grants • Serbia

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1 Introduction and some methodological notes

Over the past 15 years, the local government finance system in the Republic of Serbia has undergone frequent changes and reforms, at times for the better, but more often for the worse. The first phase was characterised by positive trends that led to an improvement in the fiscal autonomy of local authorities and wider decentralisation, and, most importantly, to the establishment of a stable and objective system of financing cities and municipalities. In the second phase, frequent ad hoc changes of regulations resulted in the collapse of local finance, instability, a lack of predictability and transparency of the system, as well as partisan politicisation of intergovernmental fiscal relations. This in turn resulted in legal and institutional uncertainty, which substantially compromised cities and municipalities' abilities to plan and implement development and other local policies, perform their mandates efficiently, and provide services to citizens and businesses. For that reason, this section of the study uses an in-depth normative and empirical analysis to explore: the process of fiscal decentralisation in Serbia from the democratic changes that took place in 2001 onwards, the existing legal framework for local government financing, the effects that specific legal changes had on local government budgets, as well as the institutional role that Serbian cities and municipalities have in creating public policies and regulations that can affect their finances and functioning.

Therefore, these topics and the matter at hand require a comprehensive analysis and a combination of various methodological approaches:

1. Normative - in order to analyse the content of laws and regulations and their 'quality' and to produce recommendations for their improvement. Namely, the analysis focuses on the regulations that govern local government finance and mandates – the Constitution of the Republic of Serbia, a number of so-called systemic and sectoral laws, as well as secondary legislation that includes central government bylaws and local government ordinances. The content and 'quality' of legal framework are evaluated vis-à-vis generally accepted positions and principles of the theory of fiscal federalism and decentralisation, as well as vis-à-vis the standards and values formulated by certain sources of law of the European Union and the Council of Europe.
2. Empirical - in order to analyse the implementation and practical effects of regulations. The collected empirical material includes:
 - a) A series of in-depth, semi-structured interviews with relevant stakeholders, such as policy- and decision-makers involved in the process of decentralisation and in designing local finance-related policies. Interviews were conducted with representatives of the central government, cities, municipalities, local government associations, as well as with the representatives of international donor organisations and the academic community.

b) An analysis of the fiscal effects that legislative changes have had on local government budgets. Due to a lack of transparency of national authorities and a limited access to local government budgetary data, a precise analysis of fiscal effects covers only two local governments – the City of Belgrade and the Municipality of Paraćin. Namely, as unofficial sources have informed me that national authorities possess all local government budgetary revenue and expenditure data, I simultaneously submitted requests to access the data to the Ministry of Finance, the Treasury Administration of the Ministry of Finance, and the City of Belgrade for the purpose of this analysis, all in accordance with Article 15 of the Law on Free Access to Information of Public Importance.¹

The Decision No. 4-00-45/2015 of the Ministry of Finance² stated that the Ministry did not possess the requested information and instructed me to submit the request to the Treasury Administration (that is, an authority integral to the Ministry of Finance itself), which is in charge of tracking and recording the data on local government revenue and expenditure. At the same time, the Ministry forwarded the request to the Commissioner for Information of Public Importance and Personal Data Protection, pursuant to Article 19 of the aforementioned Law.³

The Treasury Administration of the Ministry of Finance, “having considered the request in question, and having investigated the issue,” established that “the data requested cover extensive materials, requiring a disproportionately large effort by the authority in question, which would substantially compromise its regular functioning in terms of performing tasks related to state administration.”⁴ The Treasury Administration also issued a decision stating that, based on Article 13 of the aforementioned Law, the request is denied due to the fact that the volume of data requested is too large.⁵ This is the justification the Treasury Administration gave for refusing to issue the requested information, which included budgetary data for the period 2006-2014, for both the first request that encompassed all 145 local government units in the Republic of Serbia and for the second request that referred only to a stratified random sample of 12 local governments.⁶ In addition to the aforementioned explanation, the Treasury Administration’s decision regarding the second request, which concerned only a sample of municipalities, stated that it did not possess the relevant data and instructed me to request the information from the Ministry of Finance and the local government units themselves. Finally, the Treasury Administration also instructed me to file a complaint with the Commissioner for Information of Public Importance.⁷

Due to the fact that only the City of Belgrade positively responded to my request to access information of public importance and released its budgetary data for the period 2000-2014, this study analyses only the capital city’s budget revenue and expenditure; revenue is analysed on a subanalytical level and includes both own-sources city revenue and shared revenue, as well as national level grants and transfers in the period between

2000 and 2014, while expenditure is analysed on a synthetic level for the identical period.⁸

On the other hand, a majority of sampled local governments failed to respond to multiple e-mails and enquiries, which raises the question of whether, when and in what format they would respond to 'official' requests sent by regular mail. These were the exact reasons why the official request was submitted to national authorities. The idea was to receive uniform digital datasets from one single and centralised source in a quick and efficient manner.

However, ever since the Law on Local Government Finance was amended in 2011,⁹ the capital has not received funds calculated as the total non-earmarked transfer for the City of Belgrade. Instead, this amount became a solidarity transfer, which is divided among all other local government units in Serbia according to set criteria. Also, since the 2011 amendments, the City of Belgrade has been receiving 70% of the revenue generated through income tax collection from employees on its territory, whereas all other local governments receive 80% of the revenue generated by this tax.¹⁰ As a result, it was necessary to analyse also budgetary data of some other local government. Ideally, such a municipality would have been categorized as average in terms of the size of its territory, population and development level. Given the fact that the Municipality of Paraćin was willing to issue the data on budgetary revenue and expenditure for the 2006-2014 period, and that it also fulfilled the mentioned criteria,¹¹ this local government was included in the analysis in addition to the capital city.

3. Institutional - in order to analyse the role of local governments in the process of designing policies and legislation relevant for their finances and functioning. In addition to presenting the legal arrangement for relevant institutions in terms of their status, organisational structure and mandates, the study also analyses their practical functioning and behaviour in order to gain a clearer picture of the existing institutional mechanisms for intergovernmental fiscal governance and the possibilities for institutional change.

Fiscal decentralisation and local government financing in Serbia from 2001 to 2015

An examination of intergovernmental fiscal governance and local government financing over the last 15 years shows that Serbia has been continually swinging the pendulum of its political and legal discourse between fiscal decentralisation and centralisation. Even though the Republic of Serbia opted in its 2004 Public Administration Reform Strategy¹² for a higher level of (fiscal) decentralisation and included it in its basic reform principles, over the years that ensued it demonstrated in practice a non-strategic approach characterised by a lack of planning, consistency and intergovernmental co-

ordination, as well as by completely different trends and results in political, functional and financial decentralisation. These issues will be tackled in the sections to come.

We can notice two dominant trends in intergovernmental fiscal governance in Serbia since 2001:¹³

1) The trend of fiscal decentralisation, spanning the period between 2001 and 2008, was the phase during which two laws of utmost importance for local governments were adopted – the Law on Local Self-Government (2002 and 2007)¹⁴ and the Law on Local Government Finance (2006);¹⁵ the current Constitution of the Republic of Serbia was also adopted during this period (2006).¹⁶ In the course of this phase, the role of cities and municipalities, as well as their fiscal autonomy, was strengthened through the continuous transfer of new mandates and revenues, or sources of revenues, to fund those mandates.

2) The trend of fiscal centralisation and pseudo-decentralisation, prevalent in the period between 2009 and 2015, was characterised by an extended suspension of the Law on Local Government Finance and frequent changes of regulations, resulting in the collapse of the local finance system and a substantial decrease in municipal and city budgets. This phase featured:

- a) Frequent ad hoc repeals, cuts or changes to local government revenues, including to own-source municipal revenue, shared revenues and transfers from the national level;
- b) Frequent ad hoc transfers of new mandates, expenditures and costs without the transfer of the necessary funds;
- c) Vertical imbalance between revenue and expenditure, which was created by a poorly, non-strategically managed transfer of mandates and funds needed to finance these new mandates.

The following chapters present and analyse the aforementioned trends in the financing of local government mandates, as well as the relevant current legislation.

2 Local government financing in Serbia from 2001 to 2006 – the phase of fiscal decentralisation

2.1 General overview

After the fall of Slobodan Milošević's regime in 2001, Serbia embarked on a process of democratisation and socio-economic transition. As part of the comprehensive public administration and public finance system reform, the process of fiscal decentralisation was initiated in order to strengthen the position of local governments weakened during the 1990s. As mentioned earlier,¹⁷ prior to 1990 the governance of public affairs in Serbia, as in the entire former Yugoslavia, had been rather decentralised, which particularly applied to intergovernmental fiscal relations. However, with the adoption of

the 1990 Constitution,¹⁸ the Milošević regime centralised power and put local government in a position of constant financial dependance.¹⁹ After a decade of authoritarian and centralist governance, one of the first reform processes to be initiated was decentralisation in the context of increasing citizen participation in local public affairs and bringing local government services closer to the needs and preferences of the local population. In Serbia, decentralisation primarily meant return and devolution of fundamental competences to local governments, that is, establishment of financial preconditions and instruments that would enable local governments to deliver local public goods and services. Nevertheless, it is important to note that in 1994 fundamental bases of the Serbian intergovernmental fiscal system were established, which, although with significant changes, remained in place until the adoption of the 2006 Law on Local Government Finance, while some of the basic elements remained valid even in the new system.²⁰

Local government revenue was increased as early as March 2001, with the adoption of the Law Amending the Law on Public Revenue and Public Expenditure²¹ and the Law Amending the Law on Local Self-Government.²² At that point, local governments were given not only an increased share in certain types of revenue – such as an increased share in property tax from 25% to 100%, an increased sojourn fee share from 80% to 100%, and greater revenue on account of the increased real estate transfer tax rate (from 3% to 5%) – but were also allowed to impose a payroll tax at a rate of up to 3.5%.²³

Local government revenue and mandates continued to increase with the adoption of the new Law on Local Self-Government in 2002,²⁴ which transferred additional revenue sources and new mandates to local governments. Article 77 of this Law set forth that local government budget funds are to be generated through own-source and shared public revenue. Own-source revenue did not include any taxes, but only certain fees and charges, self-contribution, and revenue generated by leasing out real estate and selling movable property,²⁵ by earning interest and by performing local government activities (sale of goods and services). The law divided fees into: a) municipal administrative fees, b) local communal fees²⁶ and c) sojourn fees, and sets forth the following types of own-source charges: a) construction land use charge, b) construction land development charge, c) environmental protection and improvement charge, and d) charges raised through concessions (for communal activities and affairs). Article 98 of the Law regulating shared public revenue additionally increased total local government revenue. Namely, it regulated that:

- The Republic was to share with local governments 100% of tax revenue collected for the following types of personal income: agriculture and forest exploitation, self-employment, real estate leasing, personal property leasing, games of chance, and personal insurance;
- Cities' and municipalities' shares in revenue generated from the then consumption tax form – the sales tax on goods and services generated within a local government

unit – were to be increased. The municipality share was increased from 5% to 8%, the city share (Niš, Novi Sad and Kragujevac) went up to 10%, whereas the City of Belgrade’s share increased to 15%.²⁷

In addition, it was reaffirmed that the Republic was to share 100% of revenues generated by the payroll tax,²⁸ property tax, inheritance and gift tax, and real estate transfer tax. The Republic was also to share a portion of charges coming from the use of common goods and natural resources, more precisely, charges concerning: mineral raw materials exploitation; materials extracted from water; forest exploitation; agricultural land conversion; construction, maintenance and use of local roads; and environmental pollution. Finally, shared revenue also included the local governments’ share of funds acquired in the privatisation process (5%).

The fact that local government budgets doubled in the first two years of legislative reforms speaks to how poor the financial situation was in Serbian cities and municipalities in 2000. This can be seen in Table 1.

Table 1. Increase of local government revenue in 2004 prices (x 1000 dinars)²⁹

Year	Nominal value of total local government (LG) revenue	Real value of total LG revenue (in 2004 prices)	Growth rate (compared to the base year 2000)	GDP	Total local revenues as a % of GDP
2000.	13,341.4	36,743.3	/	355,168.0	3.8
2001.	30,433.5	44,370.6	120.8%	708,442.5	4.3
2002.	55,319.3	67,661.8	184.1%	919,230.5	6.0
2003.	68,195.7	74,674.3	203.2%	1,088,000.0	6.3
2004.*	81,420.6	81,420.6	221.6%	1,284,100.0	6.3

A large portion of local government revenue in that period was generated by sales tax, which could be shared based on the territory where the consumption occurred. Local government share in sales tax amounted to on average one half of the total shared revenue, that is, 30% of the total revenue of cities and municipalities.³⁰ At that time, however, the central government was preparing to introduce a type of consumption tax that is generally accepted in the European Union (and beyond) – the value added tax (VAT). The VAT is far more complicated to administer than the sales tax. Namely, it is not possible to share VAT in the same way sales tax is shared – based on the territory where consumption occurred. The VAT is calculated based on the value added at each of the stages in the process of trading goods and services, which can occur in multiple locations, while the taxpayer does not have to be registered at the place where the consumption took place. Thus, the main issue during the first half of the 2000’s was

how local governments were going to be compensated for the revenue lost once value added tax was introduced.³¹

In 2004, two major changes in the local government finance system took place. First, the Law on Payroll Tax from 2001 was repealed,³² which deprived local governments of 20% of their revenue. However, the annual Law on Budget³³ compensated for this loss by increasing the share in income tax from 5% to 30%. Finally, simultaneously with the repeal of the aforementioned Law, the Law on Value Added Tax was adopted,³⁴ and its implementation started on January 1st 2005. Most of the cities and municipalities were compensated for loss incurred as a result of this new form of taxation with the new increase in the share of income tax (from 30% to 40%), while the rest of the local governments acquired the remaining necessary funds through compensatory grants.³⁵

However, compensation for revenue lost due to the abandonment of the sales tax was not enough to overcome the shortcomings of the system. As Levitas concludes in his analysis,³⁶ the need for systemic reform was also brought on by: the lack of transparency and predictability of the allocation of funds from the shared revenue pool, which created serious difficulties in municipal budgetary planning;³⁷ substantial horizontal inequality due to an invalid formula for equalising revenue per capita; inefficiency of the central property tax administration, given that the collection rate was around 30%; and the absence of certain types of grants to finance concrete tasks and investment programmes. Also, it was necessary to establish an institutional mechanism for monitoring and reforming local government finance that would involve both representatives of the central government and those from (the association of) local governments. The period between 2004 and 2006 was primarily focused on preparing a draft law on local government finance aimed at consolidating and stabilising the system, as well as on advocating and lobbying for the adoption of proposed systemic solutions. The following chapters will analyse the role of relevant individual stakeholders in this process and in the initial period of fiscal decentralisation.

2.2 The role of the donor community

As early as 1990, programmes of the international donor organisations and development agencies aimed at supporting (fiscal) decentralisation had become active and widespread as part of comprehensive technical assistance focused on socio-economic reforms in countries in transition and developing countries. Those programmes were primarily based on economic arguments in favour of decentralisation, claiming that decentralisation improves efficiency in resource allocation and local public service provision. Furthermore, decentralisation would also supposedly improve local political accountability by increasing citizen participation in the local decision-making process. Therefore, programme goals were predominantly focused on improving public service provision and governance by enhancing intergovernmental fiscal relations,

strengthening administrative capacities and increasing the accountability of subnational authorities.³⁸

Given that Serbia (as well as most of the countries that emerged after the break-up of Yugoslavia) started the transition process an entire decade later, due to armed conflicts and economic sanctions, the first programmes focused on fiscal decentralisation appeared in early 2001. One such programme was the Fiscal Decentralisation Initiative – a common endeavour of the World Bank Institute, Open Society Institute, USAID, UNDP, Council of Europe, OECD and the Governments of Denmark, Switzerland and the Czech Republic – aimed at analysing the situation and providing recommendations for the improvement of intergovernmental fiscal relations. The analysis of the then legal, political and socio-economic environment led to the conclusion that the local government system needed comprehensive reforms, as the existing legislation put cities and municipalities in a completely financially dependent position. Thus, fiscal decentralisation was deemed as a precondition “sine qua non for true and real local governance and democracy.”³⁹ During those initial years of fiscal decentralisation, the role of the donor community would prove to be very, if not the most, significant. Among the donors, USAID played a decisive part, which can be seen from the way the process evolved. Most of the local political leaders at the time were interested only in getting more funds from the Republic and not in the the source of the money itself. USAID, on the other hand, perceived the process of fiscal decentralisation to be an effort towards consolidation and stabilisation of the local finance system, towards depoliticisation, objectivity and predictability of the grant and transfer system, as well as towards the devolution of wider fiscal competences to local governments.⁴⁰ When it came to the decentralisation of functions, USAID activities were mainly focused on reinstating the rights of property ownership and disposition to local governments and on giving them authority to manage their local economic development.⁴¹ Therefore, it can be concluded that the main goal of the USAID’s approach was to provide cities and municipalities with basic instruments to manage their development policies and projects. It is also important to note that, starting in 2001, USAID and other donors provided significant technical and financial support to the Serbian local government association – the Standing Conference of Towns and Municipalities (SCTM) – aimed at building and strengthening internal capacities in order to formulate local government interests and advocate for them in the process of decentralisation.

The objectives and support of the European Union (hereinafter: EU) in the decentralisation process differed from, but were not entirely opposed to, the USAID approach. During the initial phase of the decentralisation, the EU’s attention was primarily focused on setting up regional structures in Serbia that would be in charge of planning and implementing projects financed by pre-accession, cohesion and other European funds available to (potential) EU membership candidates. In Serbia, these needs were met by forming regional development agencies and, later on, by establishing

statistical (so-called NUTS 2) regions⁴² through the adoption of the Law on Regional Development.⁴³ These regions do not represent subnational levels of government in the political or institutional sense, they are not administrative territorial units and they have no legal personality. They are exclusively statistical functional territorial units established for the purpose of regional development policy implementation.⁴⁴ Later on in the process, the EU would focus its programmes on cities and municipalities, primarily on increasing their capacities to plan, prepare and implement capital investment projects.

The Council of Europe also played an important role during the initial years of fiscal decentralisation. Activities of the Council of Europe were directed towards assessing the existing legal and institutional framework, as well as towards providing technical assistance in drafting new legislation, especially the Law on Local Government Finance, in order to have it harmonised with the standards of the European Charter of Local Self-Government and accompanying recommendations on local finance. In 2005, Serbia signed the Charter and in 2007 it adopted the Law on Ratification of the European Charter of Local Self-Government.⁴⁵ Thus, the Charter became an integral part of Serbia's national legislation. Serbia accepted Article 9 of the Charter in its entirety, which regulates financial resources of local authorities. One of the main tasks of the Council of Europe's Congress of Local and Regional Authorities is to monitor the implementation of the Charter in countries that have ratified it.⁴⁶ The first, and so far the only, monitoring mission of the Congress visited Serbia in 2010 in order to prepare a report on the state of local and regional democracy.⁴⁷ Certain local decision makers, who were simultaneously Serbian representatives at the Congress of Local and Regional Authorities of the Council of Europe, are under the impression that the interest of this organisation in matters of decentralisation and intergovernmental fiscal governance in Serbia has declined over the last few years.⁴⁸ A similar impression persists when it comes to the EU, whose activities in Serbia today are predominantly focused on stabilising the national public finances and measures to reduce deficit and debt. According to local stakeholders who have been interviewed, even though these European organisations played significant roles in initiating the process of decentralisation, they have in the meantime stopped focusing on intergovernmental fiscal relations, ceased the monitoring of intergovernmental fiscal governance, and stopped encouraging the country to take the decentralisation path.

2.3 The role of the central government

Serbia experienced progress and high economic growth in the early 2000s. From today's perspective of the economic crisis, this period can be characterised as one of abundance, given that international donors provided great financial support and that Serbia obtained significant resources in its extensive privatisation process. The substantial increase in local government income between 2001 and 2003 demonstrates that the Government of Serbia generally wanted to strengthen local governments. However, this tendency was partly the result of a solid national budget. On the other hand, the central government had a responsibility to 'repay' both the local political leaders for their significant contribution in overthrowing the previous regime on October 5th and the citizens living in impoverished local communities for their fight for democracy.⁴⁹ One thing is certain – the substantial transfer of funds to the local level was not the result of a planned decentralization process. There was no state strategy that would: a) based on the subsidiarity principle, clearly define what mandates the central government should transfer to local governments in order to improve citizens' lives; b) contain an analysis that would estimate how much those mandates would cost, define (local) public service delivery standards, and determine the minimum quality of a public service or good delivery; c) outline a plan and the dynamics for transferring revenues or sources of funding needed to finance the expenditures in question. It is understandable that decentralisation could not have been among the top priorities, given the plethora of problems and challenges that the Government had after coming into power in 2001. Also, decentralisation was a politically sensitive topic due to issues regarding provinces and the territorial and administrative organisation of the state. Thus, the economic rationale for transferring functions onto lower levels was not even discussed.

However, the Ministry of Public Administration and Local Self-Government adopted the Strategy of Serbian Public Administration Reform in 2004 as part of one of the many donor-funded projects aimed at public administration reform. Taking into account comparative experience in transition countries, authors of the Strategy found that "there are certain obvious and unavoidable trends." These trends included the "deconcentration of the central state administration, the delegation of power from the central onto lower levels, and the devolution of mandates to lower levels, all in order to make public services more accessible to citizens." A further trend involved "fiscal decentralisation, as one of the guarantees that lower levels will be capable of performing tasks that were delegated or assigned to them."⁵⁰ Also, decentralisation was one of the five basic principles the Government of Serbia would pursue in "building a democratic state founded on the rule of law, accountability, transparency, efficiency and citizen-oriented public administration, which is capable of providing citizens and businesses with quality services at a reasonable price."⁵¹ The Strategy concludes that the so-called combined model of delegation and devolution of power, which was applied in the 2002 Law on Local Self-Government, is a good basis for the process of decentralisation.

Finally, the Strategy's Action Plan set the following goals for 2006: the amendment of the mentioned Law based on local government performance; the amendment of 'sectoral' laws in order to allow further transfer of mandates to local governments; and the adoption and amendment of regulations within the fiscal decentralisation process. Again, all these activities were to be implemented with substantial financial and technical assistance from international donors.

However, actual developments confirmed that there was a lack of a true strategic commitment to decentralisation. On the one hand, substantial progress was achieved in the financial and functional decentralisation during 2006 and 2007, which will be elaborated later on in this study. On the other hand, during the same period, a big step back was taken in political decentralisation. Namely, the 2002 Law on Local Self-Government introduced direct election of mayors, a system that had significant advantages in Serbia when compared to the system of indirect election.⁵² However, this solution was abandoned as early as 2006, when the new Constitution was adopted.⁵³ In practice, the transfer of mandates and finances to the local level was much more a haphazard than a planned process, given that concrete solutions did not come as result of comprehensive analyses, expert discussion and public hearings. Instead, solutions depended on the personalities in the ministries and the ministers' personal positions on decentralisation.⁵⁴ A good example of such practice was the manner in which the Draft Law on Local Government Finance was reached. Namely, during the first half of 2000s, positions of the administrators and officials of the Ministry of Finance were predominantly centralistic. Such viewpoints were not due to partisan differences, as was the case in the 1990s, because the same parties were in power on both the central level and in the majority of cities and municipalities. Those centralistic positions were justified, essentially, with two arguments: 1) local governments and their employees do not have the capacity to perform the tasks at hand, which was particularly underlined in cases of smaller and poorer municipalities, and 2) corruption thrives and costs more on the local level.⁵⁵

It is interesting to note one local official's observation that there is a natural tension between the central and local government.⁵⁶ Namely, while they fight for votes at the grassroots level, all parties advocate for decentralisation, promising citizens they will take better care of local community needs. But, when those parties win elections, they swiftly change their political priorities and start centralisation processes in order to retain as much power and financial resources at the national level as possible. This is exactly the point when they start perceiving local officials and administrators as "corrupt and incapable." Thus, it is no surprise that local government representatives coming from different political parties relatively quickly form common positions within the Standing Conference of Towns and Municipalities when they need to negotiate and advocate for their own interests with the central government.

On the other hand, the local government's perception is that the national government, while preparing the said law (as well as during other processes that ensued), was only willing to transfer those mandates it felt were a burden or from which it did not stand to benefit. It appears that these were the exact reasons why the national government agreed to decentralise administration of the property tax through the Law on Local Government Finance.⁵⁷ Finally, SCTM had had a ready draft of that law, containing solutions recommended by USAID consultants.⁵⁸ Once the Minister expressed his intention to pursue the process, those solutions were accepted and the Draft was prepared for the legislative procedure. The Law was adopted in July 2006, and its implementation started on January 1st 2007. The local government finance system that was set up by this Law will be the focus of the following chapters.

2.4 The role of the local government

It has already been said that local political leaders played a major part in overthrowing Milošević's regime in 2000, which enabled them to maintain significant political influence and power in the years to come. Large local governments with influential leaders managed to realise their interests mainly through direct contacts in the ministries. Therefore, they did not get too involved in efforts to establish an objective and transparent system of revenue-sharing from the central level. On the other hand, the reform of the system of transfers and local government finance was primarily the interest of smaller and poorer municipalities.⁵⁹ They supported suggestions and solutions presented by USAID, the Council of Europe and other donor organisations, formulating their final positions through SCTM bodies.⁶⁰ The Association would then advocate for the positions and interests of their members before the national authorities and, as has already been noted, act as the voice of cities and municipalities in the process of lobbying for the Law.⁶¹

Finally, an important fact is that up until 2011 public officials were allowed to hold more than one public function. So, for example, most members of the National Parliament were at the same time mayors, chairmen of local assemblies or held another executive function. This fact had a major influence on the legislative procedure in the period between 2000 and 2008, that is, on the content and quality of laws that affect local governments, as the representatives protected the interests of their cities and municipalities. Amendments adopted in 2008 and 2010 made it more difficult⁶² for public officials to hold multiple positions, while the Ruling of the Constitutional Court of the Republic of Serbia in 2011⁶³ finally prohibited this altogether. The decision was justified with the right reasoning - to prevent a conflict of interest of public officials. However, instead of being advocates of their voters' interests, members of parliament have now become representatives of partisan interests to an even greater extent. Given that most members of the parliament work in Belgrade, they have become estranged

from the communities from which they come. It can no longer be said that they represent their local government interests either.⁶⁴

2.5 Conclusions

Even though fiscal decentralisation and local government finance reform in Serbia were entirely necessary and economically justified, these processes were not initiated as part of a strategic commitment of the central government, nor were they initiated by local governments in order to attain more authority and an objective, foreseeable and transparent financial system. The main advocate of the fiscal decentralisation process in the period between 2001 and 2006 was the international donor community, which provided local stakeholders with expert and financial support necessary for implementation. This fact has had a major impact on how the decentralisation process evolved, especially when intergovernmental fiscal governance fell out of focus of donor programmes and when the years of economic crisis ensued.

3 Positive legal framework for financing local government mandates in Serbia – fiscal decentralisation in the period between 2006 and 2008

3.1 General overview

During 2006 and 2007, the Republic of Serbia adopted a new legal framework of key importance for the local government system. In addition to the new Constitution of the Republic of Serbia, two other core pieces of legislation were adopted – the Law on Local Self-Government⁶⁵ and the Law on Local Government Finance.⁶⁶ The former regulates the matter of mandates (competences, powers, functions, tasks) of local governments, which may be original (own) municipal mandates and mandates delegated by the Republic of Serbia or the Autonomous Province. The latter regulates the provision of funds (finance, revenue) to local governments, which they use for performing their original and delegated mandates. These are own-source revenues of local governments, shared revenues, intergovernmental transfers (grants) and other types of revenue. However, the list of functions and sources of financing given in these two laws is not numerus clausus. The matter of mandates and resources of local governments, in particular of delegated mandates and shared revenues, is regulated by a series of sectoral laws and other legal acts, which will be presented in detail later on.

In July 2006, the Republic of Serbia adopted the Law on Local Government Finance. The Law regulates the issue of funds cities and municipalities may use to perform their mandates. Its implementation began on January 1, 2007. After that, the Constitution of the Republic of Serbia was adopted in November 2006.⁶⁷ The Constitution contains provisions on local government that regulate the basic principles and the issues of status, mandates, municipal legal acts and bodies, supervision over local government, as

well as protection of local governments. Finally, in December 2007, a new Law on Local Self-Government was adopted. This law regulates the criteria for establishing local government units, local government bodies and mandates, the supervision of municipal acts and work, the protection of local governments, as well as other important issues. The primary goal of the new Law was to adapt the provisions valid at the time to the new constitutional solutions regarding local government bodies, but it also served to introduce a number of new mandates for cities and municipalities. As was already mentioned, the Constitution prescribes that the Assembly is to be the highest body of a local government unit,⁶⁸ that municipal bodies are “municipal assembly and other bodies defined by the municipal charter, in accordance with the law,” as well as that “municipal assembly elects and appoints municipal executive bodies, pursuant to the law and the charter.”⁶⁹ This abolished the possibility of the direct election of mayors, which was introduced by the previous 2002 Law on Local Self-Government.

This whole subject matter is rather broad, complex and regulated by a plethora of laws and other legal acts. In order to present the matter in a clear and structured way, the study will first outline constitutional and legal mandates of local governments, and then it will focus on the Law on Local Government Finance and other legal acts regulating municipal finance.

3.2 City and municipal mandates – the Constitution of the Republic of Serbia (2006) and the Law on Local Self-Government (2007)

The right of citizens to local self-government is set forth as one of the basic constitutional principles.⁷⁰ The Constitution of the Republic of Serbia prescribes that local governments are competent in matters that can effectually be realised within local government units, pursuant to the law.⁷¹ As will be shown further on, no other law defines more precisely the term and criteria of effectualness in this sense. In addition, the Constitution prescribes that the Republic of Serbia (or the Autonomous Province) can delegate some of its own mandates to local government units by law (or, in case of the Autonomous Province, by ordinance). The Republic of Serbia, or the Autonomous Province, provides funds⁷² necessary to perform those mandates.

In the Republic of Serbia, local government units are municipalities, cities and the City of Belgrade.⁷³ The Constitution delegates certain mandates to basic local government units – municipalities – whereas the law may delegate other, broader mandates to cities and the City of Belgrade.⁷⁴ Municipalities, as basic local government units, perform the following (original) mandates:

- regulation, provision and development of communal activities (utility and some other communal affairs);
- regulation and management of construction land and business premises;

- construction, reconstruction, maintenance and management of local roads, streets and other public structures of municipal importance; regulation and provision of local transportation;
- assurance that citizens' needs in the sectors of education, culture, healthcare, social protection, child protection, sports and physical culture will be met;
- development and improvement of tourism, the hospitality industry, crafts and trade;
- environmental protection, emergency and disaster management; protection of cultural heritage of importance for the municipality;
- protection, development and use of agricultural land;
- other tasks prescribed by law.

In addition, the municipality is to perform the following, in accordance with the law: adopt its own budget and an annual statement of accounts, adopt its urban development plan and municipal development programme, and independently manage municipal property. Also, the municipality is to define its symbols and their use thereof, to safeguard the exercise, protection and improvement of human and minority rights, to provide public information, and to prescribe misdemeanour penalties for breaches of municipal regulations.

Article 20 of the Law on Local Self-Government enumerates over 38 original municipal mandates. One may summarise them in the following way:

- Adopting a budget and an annual statement of accounts; setting municipal own-source revenue rates and defining criteria for setting local fees and charges;
- Adopting development programmes, including adopting and implementing local economic development programmes and projects; improving the overall business environment within the local government unit;
- Adopting urban development plans, construction land development and use programmes, determining charge for construction land development and use;
- Managing agricultural land;
- Managing municipal property, use of public assets, safeguarding and increasing public property; defining manners and criteria for the use of business premises managed by the local government unit;
- Regulating, providing and developing communal activities and utility services (purification and distribution of water; purification and disposal of atmospheric precipitation and sewage; production and distribution of steam and hot water; urban and suburban passenger transportation; maintenance of cleanliness in cities and neighbourhoods; maintenance of landfills; management, development and use of green markets, parks, green areas, recreation areas and other public areas; management of public parking; public lighting; regulation, management and development of cemeteries and burials grounds, etc.), as well as organisational, material and other preconditions for the performance thereof;

- Maintaining residential buildings and ensuring their safety;
- Establishing institutions and organisations in the areas of elementary education, child protection (kindergartens), primary healthcare, social protection, culture, sports and tourism, and providing for the functioning thereof;
- Developing and regulating the hospitality industry, crafts, trade, cooperatives, tourism; determining the sojourn fee;
- Adopting and implementing environmental protection programmes in accordance with the law and strategic plans and determining the charge for environmental protection and improvement;
- Managing emergencies and disasters;
- Constructing, maintaining and managing local and non-categorised roads and streets;
- Regulating transportation, taxi transport, water transport, and watercourse use within the municipal territory;
- Managing water resources and activities related to water management;
- Managing areas with natural healing properties;
- Providing self-help and solidarity for persons with special needs; providing legal assistance to citizens;
- Setting up commodity reserves necessary for the local population;
- Protecting human rights and individual and collective national and ethnic minority rights; ensuring the use of local ethnic minority language and script within the local government unit territory; informing citizens about issues of local importance via local public media; specifying municipal symbols;
- Safeguarding cultural assets of local importance, ensuring conditions and funds for (co)financing cultural programmes, projects and institutions;
- Establishing bodies, organisations and services required for municipal functioning and regulating their scope of work; organising inspection services and supervising the application of municipal regulations; prescribing misdemeanours penalties for breaching municipal regulations;
- Performing other activities of direct interest to citizens, in accordance with the Constitution, law and municipal charter.⁷⁵

Therefore, although rather comprehensive, this list of municipal original mandates is far from exhaustive. Formally legally speaking, the 2007 Law added several new original mandates to local governments, compared to the purview of original mandates defined by the 2002 Law.⁷⁶ First, the 2007 Law confirms the right of local governments to set the rates of their own-source taxes and to set the criteria for determining local fees and charges. Second, it confirms that cities and municipalities have the right to manage their own property.⁷⁷ Third, cities and municipalities acquired the right to develop and manage local economic development programmes and projects. Fourth, the Law delegates to local governments substantial tasks in the areas of social protection and assistance to persons with special needs and citizens in vulnerable social positions.

Fifth, in addition to safeguarding individual and collective human rights, local governments have been tasked with providing local public media services of local importance, which includes information in ethnic minority languages. Finally, the new list of original mandates includes financing local cultural policy and programmes. It is important to note that, even though many mandates in the social sector were formally included in the purview of original municipal mandates by the 2002 or the 2007 Law on Local Self-Government, they became local functions only later with the adoption of sectoral laws.

Article 21 of the Law regulates delegated mandates, i.e. the delegation of public mandates to local governments. Namely, certain state administration tasks may be delegated to all or some local government units by law, if it is “in the interest of more efficient and rational exercise of citizens’ rights and obligations and of satisfying their needs that have direct impact on their lives and work” Funds required to perform these delegated tasks are to be provided in the Budget of the Republic of Serbia in accordance with the nature and the volume of the task. This legal provision is especially significant and requires additional interpretation. Over the last several years, the central government has frequently delegated additional tasks and financial obligations by bylaws (for instance, by Government decrees, ministries’ rulebooks, collective agreements, as well as by Government conclusions that are often not published in the Official Gazette of the Republic of Serbia) to local governments, effectively changing certain elements that have had direct impact on the methodology used in calculating the costs related to already delegated functions. This raises the question of what exactly are public administration tasks, as set forth in Article 21. The Law on State Administration reads that certain public administration tasks may be delegated to autonomous provinces, municipalities, cities, and the City of Belgrade, as well as to other public authorities,⁷⁸ and goes on to specify tasks as: 1) participating in shaping Government policies in terms of preparing draft laws, regulations and other legal acts for the Government, and proposing development strategies and other measures to shape Government policies;⁷⁹ 2) monitoring, which includes assessing the situation in specific fields in their purview, examining the implications and effects of the assessed situation and proposing or undertaking measures;⁸⁰ 3) enforcing laws and other legal acts, including adopting bylaws, deciding in administrative matters, keeping public records, issuing public documents and undertaking administrative actions;⁸¹ 4) supervision of the implementation of laws and other legislation by direct examination of the management and actions of natural persons and legal entities, and, depending on the inspection results, pronouncing necessary measures;⁸² 5) ensuring public services;⁸³ 6) taking part in development tasks, including encouraging and steering development policies within their scope, in accordance with the Government policies;⁸⁴ 7) accomplishing other expert tasks, including collecting and analysing data within their scope, preparing analyses, reports, information and other materials, and performing other expert tasks to contribute to the development of areas within their scope.⁸⁵ However, even though the

Law on State Administration enumerates the types of public administration tasks, it fails to define the very terms “task” or “mandate.” According to Milosavljević’s interpretation, a “mandate is and has always been the right and duty to perform certain government tasks, meaning that a mandate encompasses the right and duty of a government body or government level to perform government functions. It is comprised of both authority and duty and the terminology in this case varies considerably. Some use the terms “right,” “functions” or “tasks” instead of “authority,” whereas instead of duty, they often refer to “obligations,” “tasks,” “responsibilities,” etc.”⁸⁶ Delegating any new cost and expenditure to the local government implies nothing less than delegating additional tasks and obligations, which can only be done in accordance with the law, and not by means of bylaws. Furthermore, additional expenditures were at times delegated to local governments not in order to ensure effectual performance of public functions, as required by the Constitution, and not in order to ensure the interest defined by the Law - efficient and rational exercise of citizens’ rights and obligations and the satisfaction of their needs that have a direct impact on their lives and work. Namely, the Republic has often delegated certain tasks to municipalities in order to reduce and hide its own expenses.⁸⁷ Additionally, the central government has frequently delegated new or additional financial obligations to the local level without providing funds from its own budget to cover those expenses. Instead, contrary to the Law, the burden was placed on the budgets of the local governments. The chapters to come will elaborate on the ways the central government has delegated new mandates to cities and municipalities and managed intergovernmental fiscal relations in recent years.

Tasks delegated to local governments are regulated by a number of sectoral laws that cover diverse areas, from general administration, the social sector, culture and sports, urban development planning, and environmental protection to traffic, transport and economic services. Based on Milenković’s December 2013 analysis, one may conclude that no less than 27 sectoral laws and an entire myriad of bylaws define and specify local government tasks.⁸⁸ Most of these laws were adopted prior to 2007, but a considerable number of them were passed in the period after 2007, thus delegating additional or completely new expenditures to the local level. In addition, in the last several years there has been a lack of mechanisms that would monitor the delegation of new tasks and obligations to local governments, as well as a lack of necessary accompanying funds for financing the new mandates. The institutions authorised to monitor the delegation of mandates and funds have been inactive, while consultations between the central and local governments have been scarce or non-existent.⁸⁹ All local government tasks, both original and delegated, are shown in Table 2 titled “Local Government Tasks in the Republic of Serbia.” This table is based on Milenković’s 2013 matrix showing the intergovernmental division of mandates in the Republic of Serbia, and it has been complemented with information collected during the interviews conducted as part of this study.⁹⁰

Table 2: Local government tasks in the Republic of Serbia⁹¹

<p>1. GENERAL ADMINISTRATION:</p> <ul style="list-style-type: none"> ➤ safety and civil protection ➤ communal police* ➤ fire protection ➤ citizen certificates ➤ electoral registers ➤ official statistics 	<p>5. URBAN PLANNING AND HOUSING</p> <ul style="list-style-type: none"> ➤ spatial and urban planning ➤ other tasks related to urban planning and construction ➤ housing, general* ➤ social housing* 	<p>7. CULTURE, ENTERTAINMENT AND SPORTS</p> <ul style="list-style-type: none"> ➤ culture (general framework) ➤ theatres and cultural events ➤ museums and libraries ➤ sports ➤ green areas and parks
<p>2. EDUCATION</p> <ul style="list-style-type: none"> ➤ education, general framework ➤ preschool education* ➤ elementary school /elementary education ➤ high school education 	<p>6. ENVIRONMENTAL PROTECTION AND SANITARY CONDITIONS</p> <ul style="list-style-type: none"> ➤ environmental protection (general) ➤ environmental protection (specific) • strategic impact assessment • project impact assessment • integrated prevention and control • protection of nature • air protection • water protection • waste and packaging waste management • non-ionising radiation • noise protection • chemicals ➤ municipal waste* ➤ cemeteries and burial services* ➤ consumer protection (inspector supervision) 	<p>8. TRAFFIC AND TRANSPORTATION</p> <ul style="list-style-type: none"> ➤ roads ➤ urban traffic* ➤ other forms of transportation and traffic * ➤ airports
<p>3. HEALTHCARE</p> <ul style="list-style-type: none"> ➤ healthcare protection (general) ➤ primary healthcare protection ➤ tertiary healthcare protection 		<p>9. ECONOMIC SERVICES</p> <ul style="list-style-type: none"> ➤ water supply* ➤ steam heating and hot water ➤ agriculture ➤ electrical energy ➤ economic promotion ➤ trade ➤ tourism ➤ other economic services
<p>4. SOCIAL SECURITY</p> <ul style="list-style-type: none"> ➤ social security, general ➤ homes and shelters* ➤ domiciliary care 		

The following chapters will focus more on the manner in which the central government delegated mandates to local governments in the period between 2009 and 2015.

3.3 Financing the mandates of cities and municipalities – the Law on Local Government Finance (LLGF) (2006)

The Law on Local Government Finance (LLGF) was adopted in July 2006⁹² and it introduced a number of novelties into the system, with the aim of consolidating and creating an objective, stable, predictable and fair framework for financing cities and municipalities. First and foremost, the Law established a system of transfers and grants based on objective formulas guaranteeing both vertical balance – so that delegated mandates would be accompanied by adequate financial funds – and horizontal equalisation – to reduce drastic divergence between per capita revenue in rich and poor municipalities by transferring additional financial funds to local governments of lesser fiscal capacity. Prior to January 1, 2007 when the new Law came into force, annual budget laws determined the amount of transfers and grants the central government appropriate for local governments. Given that transfers were in no direct relation to the GDP, total public revenues or the budget of the Republic, and that they were calculated using complicated formulas that left plenty of room for arbitrary decisions, local governments were facing completely unpredictable amounts that varied from one year to another.⁹³ The second most important legal novelty was property tax decentralisation. Local governments were granted the right to autonomously determine the rate of this tax within the range set forth by the Law on Property Taxes.⁹⁴ They also acquired the right to administer the tax themselves.

The following paragraphs will present the local finance system established by the 2006 Law on Local Government Finance, which was – in its originally adopted form – in force only from January 1, 2007 to May 2009. After that, from the middle of 2009 to the end of 2015, the local government finance system underwent frequent and dramatic changes from one year to another. Namely, almost every single source of revenue, within all three categories of local government revenues, was changed significantly, mostly to the detriment of cities and municipalities. For that reason, this chapter will only present the local finance structure as envisaged by the 2006 legal solutions, whereas individual types of revenue will be elaborated on and analysed in detail in the following chapter dedicated to current legal solutions and the waves of centralisation and pseudo-decentralisation between 2009 and 2015.

Therefore, according to the solutions established by the LLGF in 2006, funds put at disposal of cities and municipalities for performing original and delegated mandates may be divided into three main categories: own-source revenues, shared revenues, and transfers.

Local government own-source revenues

Own-source revenues are revenues for which the local government has the right to autonomously decide on the tax rate, that is, on the method and criteria for determining the fees and charges within the range prescribed by law.⁹⁵ During the first years of LLGF implementation, between 2007 and 2009, the share of own-source revenues in total local revenues was on average between 37% (2007) and 40% (2009).⁹⁶

According to the 2006 legal solutions,⁹⁷ own-source revenues included the following:

- property tax (the so-called “statistic” property tax), excluding the real estate transfer tax and the inheritance and gift tax (the so-called “dynamic” property taxes) that represent shared revenues;
- three groups of fees: local administrative fees, local communal fees and the sojourn fee;
- four types of own-source charges: the construction land use charge, the construction land development charge, the environmental protection and improvement charge, and the concession charge revenues (based on concession contracts concluded by local governments for the provision of utility services and other concessionary affairs);
- other revenues: self-contribution, proceeds from fines issued in misdemeanour cases for breaching local government ordinances, confiscated property in said misdemeanour cases, revenue from leasing out real estate and selling movable property owned by the state and managed by the local government, revenue generated by local governments by performing their regular activities, revenue from interest and revenue from donations.

Local government shared revenues

In the case of shared revenues, the Republic (central government) sets the tax base and the tax rate, that is, the method and criteria for determining the fees and charges. The central government also administers these revenues, but the yield generated on the territory of the local government unit is shared fully or partially with that local government.⁹⁸ During the first years of the implementation of the Law on Local Government Finance, between 2007 and 2009, shared revenues were on average between 38% (2007) and 40% (2009) of total local revenues.⁹⁹

According to the 2006 legal solutions,¹⁰⁰ shared revenues were:

- 1) The revenues from the following shared taxes:
 - a. Personal income tax generated on the territory of the local government, including:
 - 40% of the wage tax paid according to the employee’s place of residence,

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- total amount (100%) of the agriculture and forestry tax, self-employment tax, real estate lease tax, movables lease tax and personal insurance tax;
 - b. total amount of real estate transfer tax;
 - c. total amount of inheritance and gift tax.
- 2) Revenues from nine different shared charges generated on the territory of the local government unit, with percentages prescribed by separate sectoral laws. These were: the annual charge for motor vehicles, tractors and trailers, the charge for pollution, the charge for the use of mineral production materials, the charge for the material taken from river beds, the charge for the use of forests, the charge for the use of waters, the charge for the conversion of agricultural land, the charge for the use of natural healing factors, the tourism charge, and other charges in accordance with the law.¹⁰¹ The drawback of this normative formulation is that it does not confirm and ‘fix’ the local government share in the shared charges (set forth in the sectoral laws), even though one of the major goals of the LLGF was to comprehensively enumerate revenue sources and round out the framework for local government financing. Insight into the methodology of calculating the said charges and the method of sharing these with local governments requires special analysis of at least eight sectoral laws. The majority of these laws have undergone changes in the period between 2007 and 2015. The changes were almost always to the detriment of local governments, as many of the shared charges were abolished or significantly amended.

Transfers (grants)

As was already mentioned, the most significant novelty introduced by the LLGF was the establishment of a predictable and fair system of transfers and grants. In the period between 2007 and 2009, the share of transfers in total local revenue was between 18% (2007) and 21% (2009) on average.¹⁰² The law divided transfers into non-earmarked and earmarked (or non-categorical and categorical).¹⁰³

The total annual non-earmarked transfer amounted to 1.7% of generated GDP according to the latest data published by the Statistical Office of the Republic of Serbia. It represented a sum of four transfers:¹⁰⁴

1. The equalisation transfer is prioritised within the total non-earmarked transfer. This transfer is granted to the local governments of lesser fiscal capacity, which have revenue from shared taxes assessed as less than 90% of the average revenue from shared taxes in all Serbian municipalities, cities excluded. The amount of the equalisation transfer is in fact the calculated difference between the evaluated per capita revenue from shared taxes in a local government and 90% of the average revenue from shared taxes in all local governments. This method of horizontal equalisation, which considers only per capita shared revenues, managed to evaluate municipal fiscal capacity objectively. This provision ensured that

municipalities inefficient in collecting their own-source revenue could not “free ride” and that the tax burden would not spill over to taxpayers of other municipalities.¹⁰⁵

2. A general transfer was distributed to all local government units according to the following criteria, which is based on the assessment of real costs incurred by local governments:
 - 65.0% according to the population;
 - 19.3% according to the territory;
 - 4.56% according to the number of classes in elementary schools;
 - 1.14% according to the number of elementary school buildings;
 - 2.0% according to the number of classes in secondary schools;
 - 0.5% according to the number of secondary school buildings;
 - 6.0% according to the number of children included in the child care program (preschool education);
 - 1.5% according to the number of preschool buildings.¹⁰⁶
3. A compensation transfer is part of the total non-earmarked transfer that compensates for the revenue lost due to changes in the national legislation.¹⁰⁷
4. A transition transfer - its purpose was to gradually adjust those local budgets that experienced reduction exceeding the prescribed amount as a result of the new methodology for calculating transfers.¹⁰⁸

The following transfers were set forth as earmarked transfers:

1. Functional (block) transfer for financing expenditures within a certain function. It was calculated based on data on total costs of performing a certain function in the year preceding its delegation to the local level.¹⁰⁹
2. Earmarked transfer in the narrow sense for financing a specific purpose or type of expenditure within the scope of original or delegated functions. The amount, criteria and dynamics of appropriation of earmarked transfers are defined by a relevant ministry.¹¹⁰

In his note from 2010, Levitas shows that LLGF increased local government revenues between 2006 and 2007 by almost 10%. This was primarily due to the new transfer system that substantially reduced differences between rich and poor local governments.¹¹¹ In just a year of the implementation of the Law, total per capita revenues of the poorest municipalities (from the two of the poorest quartiles of municipalities) were increased by 126% and 119% respectively, whereas per capita revenues of the two richest cities – Belgrade and Novi Sad – were increased by a mere 7%.¹¹² Thus, the difference between the richest and the poorest local government units was decreased from 5.6:1 to 4.8:1. At the same time, the total revenue of all local government units resulting from general transfers between 2006 and 2007 was increased by as much as 154% – from 24.6 billion to 41.6 billion dinars.¹¹³ Also, property tax revenue increased significantly; from 2007 to 2009, revenue increased from 7.9 to 9.1

billion dinars, which is a 15% increase.¹¹⁴ This 1.2 billion dinar increase is mostly ascribed to increased property tax collection from natural persons, as methods of legal entity taxation were still not reformed in the period in question.¹¹⁵ Arsić et al. show that the total increase in property tax revenue during the first year of its decentralisation (2007) did not exceed a modest 1.31%, and they identify the adjustment of local governments to the newly delegated mandate – administration of the tax – as the most probable cause for this.¹¹⁶ A real increase in yield from the property tax occurred as early as in 2008, when revenues went up by 12.23% compared to the previous year.¹¹⁷

Unfortunately, the positive effects and success of the Law on Local Government Finance were short-lived. The period of growth of local budgets was interrupted as early as 2008, when revenues generated by cities and municipalities started dropping as a result of the effect of the global economic crisis on Serbia. The greatest decrease was evident in the revenues directly related to construction development and the real estate market – the charge for construction land development and the real estate transfer tax. Soon thereafter, the central government put an official end to the wave of fiscal decentralisation by deciding to suspend the implementation of certain provisions of the LLGF in the middle of 2009.

The following table presents a concise overview of the sources of local government financing in the period between 2006 and 2008, summarising the structure of local government revenue according to the 2006 LLGF.

TYPE OF REVENUE	2006 LAW ON LOCAL GOVERNMENT FINANCE
OWN-SOURCE REVENUE	
Taxes	1. Property tax
Fees	1. Local administrative fees 2. Local communal fees (16 types) ¹¹⁸ 3. Sojourn fee
Charges	1. Construction land use charge 2. Construction land development charge 3. Environmental protection and improvement charge 4. Charges for concessions - utility services and other concessionary affairs
Other revenues:	1. Self-contribution 2. Leasing out state-owned real estate managed by local government unit (LGU) 3. Leasing out movable property managed by LGU 4. Donations 5. Interests on LGU budget funds

	<ol style="list-style-type: none"> 6. Revenue from LGU activities 7. Fines for breaching LGU ordinances, and confiscated property
SHARED REVENUE	
Taxes	Personal income tax: <ol style="list-style-type: none"> 1. Wages (40%) 2. Self-employment (100%) 3. Agriculture and forestry (100%) 4. Real estate lease (100%) 5. Leasing out movables (100%) 6. Personal insurance (100%)
	Inheritance and gift tax
	Real estate transfer tax
Charges	<ol style="list-style-type: none"> 1. Annual charge on motor vehicles, tractors and trailers; 2. Pollution charge; 3. Charge for use of mineral production materials; 4. Charge for the material taken out of river beds; 5. Charge for use of forests; 6. Charge for water use; 7. Charge for conversion of agricultural land; 8. Charge for use of the natural healing factors; 9. Tourism charge; 10. Other charges in accordance with the law.
TRANSFERS:	
Total non-earmarked transfers = 1.7% of GDP according to the most recent data published by the Statistical Office	Equalisation transfer
	General transfer
	Compensation transfer
	Transition transfer
Earmarked transfer	Functional transfer
	Earmarked transfer in the narrow sense

4 Local government financing between 2009 and 2015 – Centralisation and pseudo-decentralisation phase

4.1 General overview

The wave of fiscal decentralisation was formally ended in 2009. Namely, due to the crisis, increasing budget deficit, and the International Monetary Fund's request to decrease public expenditure, the Government of Serbia decided to suspend the implementation of certain provision of the Law on Local Government Finance (LLGF) and to drastically reduce the volume of non-earmarked transfers in late April 2009.¹¹⁹ Even though this reduction in total non-earmarked transfers would have ensued automatically given that it is determined as a percentage of the GDP (1.7%), the central government decided to make the necessary cost cuts in its public expenditure by significantly reducing funds transferred to local governments, assuming that resistance would be the weakest in this part of the public sector. The central government made this decision in the middle of the budget year, without any previous announcement or consultation with local governments, and without any type of new methodology for the calculation of non-earmarked transfers.

Exactly this non-strategic and unpredictable manner of intergovernmental fiscal governance would characterise the period between 2009 and 2015. This phase featured the dominant trends of fiscal centralisation and pseudo-decentralisation. Namely, the central government frequently made decisions that were detrimental to local governments and that implied transferring money from the local treasury to the central one. Therefore, increasing central revenues meant reducing local revenues, and reducing central expenditures in turn meant imposing certain costs onto local governments. An additional problem was the fact that new expenditures taken over by municipalities were not coupled with the provision of adequate sources of financing. However, the largest issue with these decisions is that they were made without a plan and without analyses of financial costs and benefits, without announcement, without consultation with local governments and without public hearing, often at the very last minute (from the perspective of the central government), in the middle of the budget year and with immediate effect. It is interesting to note that, during the same period, the central government also took some sudden ad hoc steps towards decentralisation, resulting in a substantial increase of local government revenue, probably in order to alleviate their revolt. However, such measures were usually short-lived, since the central government would soon suspend its own decentralistic solutions in order to consolidate the national budget. That is why this phase may be called the centralisation and pseudo-decentralisation wave.

To summarise, the period between 2009 and 2015 is characterised by the continuous suspension of certain provisions of the Law on Local Government Finance, as well as

by frequent changes of this and other relevant regulations, which all led to the collapse of the local finance system, a substantial decrease in cities' and municipalities' budgets and the inability to plan local financial, development and other policies. Features of this phase include:

- Frequent ad hoc suspensions, reductions or changes to local government revenues, including both own-source municipal revenues and shared revenues and transfers from the national level;
- Frequent ad hoc transfers of new tasks, expenditures and costs, without providing adequate resources for the financing thereof;
- Vertical imbalance between local government revenues and expenditures caused by poor and non-strategic management of the process of transferring mandates and the necessary funding.

In order to more easily comprehend all the changes in legislation and other developments of importance for the local government within the given period, the following chapters will first present the new mandates and expenditures the Republic delegated to municipalities. Then, the chapters that follow will present a chronological overview of changes in local revenues caused by amendments to national regulations, with an in-depth analysis of all types of revenues.

4.2 Manner of transferring mandates to cities and municipalities in the period between 2009 and 2015

Fiscal decentralisation as a term is often perceived incorrectly in Serbia, not only by the interested portion of the public and media when addressing local government finance, but also by the professionals and experts, policymakers and decision makers. Fiscal decentralisation is often mistaken for decentralisation of revenues. Certain stakeholders in decision-making processes of importance for local governments went as far as to demand the "suspension of fiscal decentralisation"¹²⁰ when they wanted to say that it was necessary to reduce the local government share in certain revenues of the Republic. The other, equally important aspect of decentralisation is often disregarded, and that is the decentralisation of expenditures, or mandates. Therefore, when we talk about fiscal decentralisation, we need to start from the functions and the expenditures transferred to local governments, and then go on to talk about revenues.

In Serbia, there never was a plan and an intergovernmental agreement on public services and assets that need to be decentralised. From the standpoint of economic efficiency, and taking into consideration the economy of scales and potential externalities, the main goal of decentralisation is to secure better accessibility, higher quality and lower costs of public services to citizens, as local governments are more familiar with their populations' preferences and can therefore adjust their services more adequately. So, the basic guiding principle in organising public services performed in a country should take

into account the wellbeing of citizens. The goal should be to provide the best possible public service and, according to the subsidiarity principle, to secure access to decision-making processes as much as possible. As has been mentioned before, the Law on Local Self-Government is also governed by the interest of “exercising rights and obligations of the citizens, and fulfilling their immediate needs in a more efficient and rational manner.”¹²¹ It is these principles that need to be our starting point when discussing decentralisation of individual tasks – from education, healthcare, social contributions, road maintenance, communal and traffic police, inspection, misdemeanour control, managing property and economic development, to the administration of local public revenues. Within this context, one should first focus on functional decentralisation and then on creating financial preconditions and local government capacities necessary to perform mandates delegated by law. Therefore, the main shortcoming of the system is reflected as early as in the first step, and that is the lack of a strategic plan of delegating mandates to cities and municipalities.

Individual ministries mostly have internal plans for the adoption of new regulations, but no one knows in advance which tasks and expenditures will be delegated to local governments, since there is no institutionalised central authority that would plan decentralisation in a strategic way, coordinate the work of relevant ministries and supervise the transfer of new functions and necessary financial resources to the local level.¹²² Therefore, new expenditures are transferred to municipalities each year pursuant to ad hoc decisions. An additional problem is the fact that the central government delegated new tasks and financial obligations to local governments by means of various legal instruments. Instead of laws, the bases for such transfers were often government decrees, ministry rulebooks, collective agreements and even government decisions, which are rarely published in the Official Gazette of the Republic of Serbia.

An analysis of how much (local) public functions cost, that is, how much money local governments need to perform tasks defined by law as original and delegated mandates, has never been conducted. Local government representatives believe this to be the essential question that should be asked when transferring mandates and finances.¹²³ Such an analysis would make it possible to conceive an agreement on the minimal or standard quality of provision of a certain public service or good that all citizens of Serbia can expect to receive, as well as on how much such a service or good should cost per unit. At the moment, there is no standard measurement of whether sufficient funds are secured to perform local functions. It is necessary to conduct an analysis of how much individual mandates currently cost, how much they should cost, and how much they cost when they were financed by the Republic. An agreement on and regulation of sources of funding for local government mandates can come about only after this standard is defined.

Article 21 of the Law on Local Self-Government¹²⁴ prescribes that resources for financing delegated tasks should be provided by the Budget of the Republic of Serbia in accordance with the type and scope of the task. However, the Republic often ignores this provision of the Law, and national authorities rarely analyse fiscal effects of future laws, especially fiscal impacts on the local level. Transitional and final provisions of new legislations very often feature the following normative provision: “implementation of this Law does not require additional budget funds“. First, one may say that implementation of any legislation requires certain financial resources. Second, if implementation of a law does not require funds from the Budget of the Republic, then it most probably requires funds from the provincial or local budgets. In this context, it is necessary to mention one of the introductory provisions and basic principles of the Law on Local Government Finance. Article 3, which defines the guarantee of revenue sufficiency, states: “An obligation of the Republic is to provide adequate funds, that is, financial resources for carrying out new functions that are transferred, or delegated to local government units.“¹²⁵ Also, Articles 44 to 46 of this Law define earmarked transfers that should be allocated when transferring new functions to the local level or in cases when local governments are to perform additional tasks within their original or delegated domains. These articles also prescribe that the amount and criteria for allocation of earmarked transfers are to be set by relevant ministries. Practice has shown that earmarked transfers leave a substantial margin for arbitrary decision-making, which is not founded in realistic needs and objective criteria. This will be further discussed in later chapters.

The central government’s manner of transferring mandates to the local level without transferring the necessary financial resources, and also transferring resources without delegating additional tasks, shows that the local government finance system in Serbia is characterised by a vertical imbalance and other serious distortions. Alleviating or solving the aforementioned problems is beyond the scope of an economic analysis and cannot be achieved by a financial evaluation and the transfer of sufficient funds to cover the costs of local functions. It is aggravated by political and social factors, since there is a substantial surplus and an irrational and imbalanced distribution of employees in individual subsectors and functions within the public sector in Serbia.

The transfer of mandates to the local level should be coupled with the transfer of all financial and material assets the Republic utilised to perform the function in question. It is questionable whether the central government does in fact transfer all necessary resources to municipalities. Also, it is questionable whether hiring new people to perform newly delegated functions locally will automatically mean the reduction of employees on the central level. Namely, transferring employees from the central to the local level is limited by numerous factors, with public sector union resistance being just one of them.¹²⁶ Decentralisation of certain mandates would probably mean the loss of jobs, reduced salaries or lost benefits for some employees at the central level.

The decentralisation of the education system is an interesting example in this sense. School-related expenditures are enormous, employee salaries are financed from the national budget, education unions are strong and centralised structures, and the role of the relevant ministry is substantial.¹²⁷ The Ministry of Education is in charge of: a) planning educational and upbringing-related programmes, their implementation and further development, b) supervising the work of educational institutions, c) maintaining employee registries and issuing licences to teachers, pre-school teachers, expert associates and principals, as well as planning, coordinating and organising professional development programmes, d) other important functions necessary to secure equal quality and access to the service. Salaries, benefits, social contributions and severance funds for elementary and secondary school employees are financed from the budget of the Republic of Serbia. This budget also finances the professional development of employees, development programmes and institutional projects, pupil competitions, preparatory programmes for preschool children in the year preceding the first year of school, programmes for children with developmental impairments and children receiving treatment in hospitals, among other functions. Pursuant to the 2003 Law on Fundamentals of the Education System¹²⁸ and its later versions and amendments,¹²⁹ local governments were given major mandates in the domain of pre-school and elementary education. Local assemblies adopt ordinances on networks of pre-school institutions and elementary schools, that is, on their establishment, suspension, number and geographical coverage. Local governments also have substantial expenditures related to education, having to provide funds for:

- Entire pre-school education, amounting to 80% of the economic price per child, as well as salaries, benefits, social contributions, assistance and severance for pre-school employees, and other current expenditures;
- Current expenditure related to elementary and secondary schools (excluding salaries and certain employee-related expenditures);
- Capital investments in elementary and secondary schools;
- Protection and safety of children, in accordance with the law;
- Transport of pre-school and elementary school children under certain circumstances;
- Transport of employees;
- Professional development of employees;
- Jubilee awards and assistance to elementary and secondary school employees.¹³⁰

It is interesting to note how certain benefits of elementary and secondary school employees became legal obligations of local governments, with all other employee-related issues being mandates of the central government. Namely, education trade unions negotiate with the relevant ministry regarding salaries, benefits and other employment-related questions. The ministry has neglected to include local governments in any of the collective bargaining. When the 2004 negotiations on employee benefits were blocked, the solution was found in transferring the obligation of paying jubilee

awards for elementary and secondary school employees to local governments – a party that was in no way part of the negotiations.¹³¹ The expenditures transferred to some cities and municipalities were substantial, but local governments did not get any additional revenues, i.e. transfers from the Republic. It is interesting to note that this is a benefit only for employees in education, and not those in healthcare¹³² or the local government administration. In cases when employees press charges due to unpaid jubilee awards, courts often block school accounts, which the local governments cannot allow because they need to be able to pay current expenditures (electricity, heating, etc.). Local governments are thus forced to pay jubilee awards. Also, in certain municipalities, there were problems with financing the transport of pre-school and elementary school children.¹³³

A similar example of collective bargaining that excluded local government representatives can be found in the sector of culture. Namely, employees of cultural institutions negotiate their salaries with the relevant ministry. This often results in an increase in salaries, which is in turn regulated by the Decree on Coefficients for the Calculation and Payment of Salaries in the Public Sector.¹³⁴ Even though any increase in the coefficient comes with the increase of the total salary fund and expenditures in local government budgets, that is, items related to locally employed employees of cultural institutions, representatives of cities and municipalities were in no way allowed any influence on the aforementioned decision and Decree.

Salaries of employees in pre-school institutions, which are almost entirely within the mandate of local governments, were increased in a similar way. The Republic decided to increase salaries of pre-school teachers twice. First, it equalised them with teachers' salaries,¹³⁵ and then it increased their salaries' coefficients by the aforementioned Decree.¹³⁶ Certain municipalities invested in the construction of new kindergartens, which includes hiring new pre-school teachers, without being able to predict that the expenditures related to the total salaries fund would be increased at the time when they conducted the financial planning of the investments. When representatives of the Ministry of Education began negotiating with pre-school unions, municipalities requested to be included in the process. However, there was no response from the Ministry and local governments were excluded from the bargaining and the decision-making processes that resulted in increased salaries.¹³⁷ It should also be mentioned that expenditures related to kindergartens and pre-school education constitute the largest single expenditure of local governments. Levitas notes that the growth of pre-school education expenditures in the period between 2007 and 2009 was surprisingly fast, adding that the pre-school system was not under the direct control of local governments at the time, but governed by independent pre-school institutions. In just two years, these expenditures increased by 28%.¹³⁸ Since then, expenditures related to this function have been growing steadily.

An even more interesting example of this practice can be found in the case of increasing the coefficient of salaries of nominated and appointed persons and local government employees by means of the Decree adopted by the Government of the Republic of Serbia.¹³⁹ This measure was also taken without consulting representatives of cities and municipalities, and it resulted in a substantial increase of the total local employee salary fund, and, in turn, total local budget expenditures (allegedly of as much as 50%),¹⁴⁰ without any provision of additional financial resources. The most striking detail in this case is the fact that, until recently, the base for the calculation and payment of salaries of all employees in public institutions and services was determined by Government decisions, which are bylaws that do not have to be published in the Official Gazette of the Republic of Serbia.¹⁴¹ Nevertheless, arbitrary decisions are now somewhat limited, since this area has recently been regulated by law. First, more recent provisions of the Law on the Budget System regulate annual salary equalisation pursuant to fiscal rules.¹⁴² Also, in October 2014, the Law on Temporary Regulation of Bases for Salary Calculation and Payment was adopted. This law regulates wages and other regular benefits of public sector employees.¹⁴³ Still, central government decisions regarding salaries and the number of employees in the public sector seem rather contradictory. On the one hand, there is a prohibition of employment and a rationalisation of the number of employees in the public sector, due to the necessity to reduce total public expenditure of the state. On the other hand, central government measures often increase the total salary fund in certain parts of the public sector. The problem of the massive surplus of employees in local governments and, in general, in public administration, as well the problem of their irrational functional distribution, are in fact important to point out, but they are beyond the focus of this study.¹⁴⁴ Based on the information provided by the Ministry for Public Administration and Local Self-Government¹⁴⁵ and the information acquired during interviews conducted as part of this study, it may be concluded that the Serbian public sector lacks educated and trained human resources in certain specific professions, while the surplus mostly comes from those employed in general administration. It is a known fact that the public sector employs party members or persons otherwise close to the ruling parties.¹⁴⁶ In that sense, it is interesting to note that public utility enterprises that manage, for instance, water supply and sewerage, employ hundreds of people in smaller municipalities,¹⁴⁷ while in larger cities, this number is around several thousand people; however, a professional workforce is lacking.¹⁴⁸

There is one more important issue that needs to be considered when analysing and regulating the transfer of mandates, one that requires a consensus and coordination between all levels of government. Namely, representatives of the central and local governments usually have different views on whether it would be better to deconcentrate or decentralise certain functions, that is, whether it is more efficient for some mandates to be managed by a dispatched, branch offices of the central government or by local governments themselves. The traffic police and certain inspection tasks are often given as examples for this dilemma. Advocates for deconcentration usually state

that the decentralised performance of such functions, especially those including supervision and control, would lead to more corruption, and that instruments of supervision and control should be coupled with the original mandate itself. On the other hand, those in favour of decentralisation believe that delegating such mandates would lead to higher efficiency, as rewarding and penalising local officials would help local governments manage these functions better. In that sense, representatives of cities and municipalities believe that labour inspection should be a decentralised function. Since local governments receive as much as 80% of revenue from the wage tax, their representatives believe that they would be much more motivated to curb grey economy and unregistered labour in their communities. Those who benefit from a certain mandate should also have the responsibility and authority. And vice versa – those who hold the responsibility and authority should be the ones to enjoy the benefits of performing a function.

The previous chapter mentions that the 2002 Law on Local Self-Government had de jure delegated social sector mandates to cities and municipalities, but it was not until later sectoral laws were adopted that they in fact became local functions. These are very costly mandates that come with substantial expenditures. We have already mentioned decentralisation in the area of education, which was brought forth by the Law on Fundamentals of the Education System. The second significant transfer of mandates took place in the domain of primary healthcare. The 2005 Law on Healthcare prescribed that local governments were to take over founding rights over healthcare centres and pharmacies starting in 2007. Municipalities that were unable to allocate funds in their budgets to do so were given a total of eight years to take over all legal obligations and complete the process of reorganising and decentralising healthcare facilities. The ministry in charge of healthcare adopts the human resource plan, which regulates the number of employees in healthcare institutions whose salaries are funded from the mandatory healthcare insurance organisation,¹⁴⁹ while the local governments are allowed to create more jobs in healthcare if they are financially equipped to do so.¹⁵⁰ Local governments finance capital investments, including the construction, maintenance and furnishing of healthcare facilities, current investments for the maintenance of premises, medical and non-medical equipment and vehicles, as well as other obligations prescribed by law.¹⁵¹ The problem is that both healthcare centres and pharmacies had massive debts when they were taken over by local government units, and some of these institutions had already been blocked.¹⁵² This situation burdened local governments with new, unexpected expenditures because they had to pay these debts in order to provide primary healthcare to their citizens.¹⁵³ Based on all these facts, it may be concluded that there are many open questions when it comes to the intergovernmental division of indirect, implicit and hidden expenditures, especially in the areas of healthcare and education, but also elsewhere, and that they are left to be resolved arbitrarily by ad hoc decisions.¹⁵⁴

The social security sector has not seen significant changes in the transfer of mandates and expenditures to the local level since 2011, when the Law on Social Security was adopted.¹⁵⁵ Certain functions are exclusively delegated to local governments, such as: establishing social security institutions (social work centres, daycare facilities, shelters, etc.), providing services at shelters, ensuring the safety of socially vulnerable persons, finding solutions in crisis situations, offering home care assistance, etc. However, certain functions are only performed if local governments have the necessary financial resources.¹⁵⁶ Thus, for instance, municipalities may expand their rights in the area of social security and introduce higher standards and new forms of assistance in the area of familial social security. Such a legal solution, allowing local governments the discretionary right to finance additional social benefits, has been criticised by experts, who argue that this solution allows the state to provide its citizens with unequal services in terms of social benefits.¹⁵⁷

The issue surrounding the manner in which the central government planned to decentralise the management of a number of roads caused many controversies. Pressured by the IMF to reduce public expenditures on the national level, the Government of Serbia decided to transfer the management of a part of state roads to local governments, assuming that cities and municipalities had surplus revenue in their budgets as a result of the 2011 increase in the share of the wage tax.¹⁵⁸ In February 2012, the Government adopted the Decree on the Categorisation of State Roads,¹⁵⁹ which excluded a certain group of roads from the network of state roads of the I and II order that are managed by the public enterprise “Roads of Serbia.” This, in fact, meant that local governments were now in charge of those roads. However, the maintenance of the transferred kilometres of roads required enormous financial assets. The public enterprise “Roads of Serbia” assessed that the maintenance of the network of some 6,500 kilometres of roads, which was supposed to be transferred to the local level, requires around 32.5 million euros (in dinars), and local governments were not able to secure this amount in their respective budgets. Also, the ex lege transfer is not sufficient for acquiring the right to manage roads. It takes many additional actions, such as changes in cadastral data on the authority in charge of the road.¹⁶⁰ For these reasons, road maintenance never in fact became part of local government mandates. Namely, in November 2013, the Government of Serbia adopted a new Decree on the Categorisation of State Roads,¹⁶¹ which reinstated the roads excluded in 2012 as state roads of the I and II order. During this legal and technical vacuum, in the period between February 2012 and November 2013, the roads in question were maintained by the same public enterprise. This fact points to the lack of informed decision making on the central level and the absence of a clear strategy and consistent planning concerning the transfer of mandates and finances.

When it comes to urban planning, spatial planning and housing, one can also find inconsistencies in solutions in terms of local revenue and expenditure. On the one hand,

the Law on the Legalisation of (illegally built; the author's note) Structures foresees the possibility of a reduction of the construction land development charge, and introduces incentives in the form of paying this charge in monthly instalments over a period extending to as many as 20 years.¹⁶² On the other hand, the Law on Planning and Construction changed the methodology for the calculation of the said charge (and it also renamed it "the construction land development contribution"). These reforms led to a substantial decrease in local government revenue from this charge, which is supposed to be used for costly investments in utility infrastructure, including:

- Preparation of construction land, which includes exploratory works, drawing up land surveys, geological and other layers, the preparation of planning and technical documents, the implementation of programs for land preparation, relocation, the demolition of structures, restoration of the terrain, and other works, and
- Development of land, which includes construction of utility infrastructure and the construction and development of public surfaces.¹⁶³

Since the changes in the calculation methodology were adopted on December 29, 2014,¹⁶⁴ when local governments had already adopted their budgets for the following year and prepared necessary ordinances and solutions, a precise overview of lost revenues will only be possible after cities and municipalities adopt their annual statements for 2015.

In the period between 2009 and 2015, local government units were also handed over other mandates that require additional financial assets. With the adoption of the Law on Emergency Situations in 2009,¹⁶⁵ municipalities have been obligated to set up protection and rescue systems and to establish civil protection units. Material costs were partly supposed to be financed from the national budget and partly from local government budgets. More precisely, the Law set forth that hiring civil protection personnel and the costs of their transport, accommodation and food during protection and rescue tasks are to be financed from the budget of the Republic of Serbia and local government budgets.¹⁶⁶ A separate budget line, established for emergency situations, should provide funding for the equipment, material and technical instruments for civil protection.¹⁶⁷ However, municipalities have so far not received earmarked transfers for such purposes. Material costs of purchasing and mounting emergency sirens and establishing local civil protection units have so far been incurred by local governments only.

The area of environmental protection has not seen any new mandates or substantial expenditures transferred to local governments in the observed period. However, certain ecological charges were abolished, which the Republic shared entirely or partially with local governments. This will be discussed in more detail in the chapters to come, which focus on city and municipal revenues.

There are also other examples of completely unplanned increases of local government expenditures that do not necessarily have to do with the adoption of new regulation. One such case is the increase of municipal financial obligations caused by the termination of the national Environment Protection Fund,¹⁶⁸ which co-financed certain environmental projects together with local governments. Creditors who pressed charges in order to collect outstanding claims incurred within co-financed projects were issued verdicts instructing local governments, and not the Republic, to pay outstanding debts.¹⁶⁹

An especially interesting example of a totally unforeseeable increase of financial obligations can be found in municipalities in which during the 1950s and 1960s agricultural cooperatives bought land from natural persons, according to laws valid at the time. There were cases when cooperatives failed to pay full prices to sellers. In the meantime, regulations changed and cooperatives ceased to exist, but their debts remained. Such cases were particularly present in the municipalities in the Mačva region. More precisely, in the Municipality of Mionica, the cost of covering debts according to court orders amounted to as much as 12% of the local budget.¹⁷⁰

4.2.1 Conclusions on manner of transferring mandates to cities and municipalities

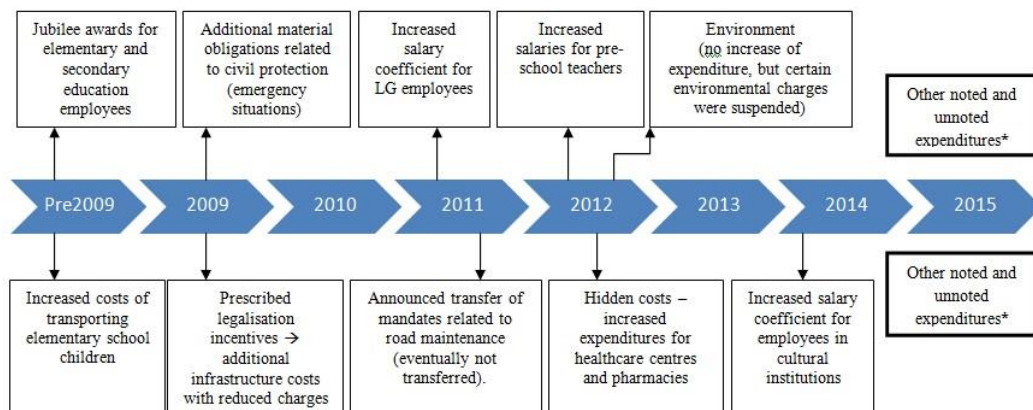
Based on this analysis and all the facts presented, it may be concluded that in the period between 2009 and 2015 (even though it has been shown that the problem persisted in the period preceding this one), the Republic delegated new mandates to local governments without a clear decentralisation strategy and a coordinated plan of transferring new functions and expenditures. Decisions made by the central government were often inconsistent, opportunistic and of an ad hoc character, and sometimes even non-transparent and non-methodical. In the process of preparing draft laws, there were no adequate analyses of costs pertaining to public services or analyses of proposed public policies and their fiscal impact on budgets on all levels of the government, which is not in line with the Council of Europe Recommendation on Financial and Budgetary Management at Local and Regional Levels.¹⁷¹ The discrepancy or, better yet, utter disconnectedness between delegating mandates and transferring resources for their financing has over the years resulted in a vertical imbalance in the local government finance system.¹⁷² This manner of governance is contrary to Articles 3, 39 and 44 of the Law on Local Government Finance,¹⁷³ to Item 2, Article 9 of the European Charter on Local Self-Government ratified by Serbia,¹⁷⁴ as well to the Council of Europe Recommendation on Financial and Budgetary Management at Local and Regional Levels¹⁷⁵ and on Financial Resources of Local and Regional Authorities.¹⁷⁶ As was pointed out earlier, at least 27 sectoral laws and a large number of bylaws regulate local government mandates.¹⁷⁷ Interviews and analyses conducted within this study identified another two dozens laws that regulate local government functions directly or indirectly.

Thus, the fact that local governments are for the most part excluded from policymaking and the process of adopting legislation causes great concern. There is a systemic lack of intergovernmental coordination and consultation, which is also contrary to the aforementioned Recommendations. In addition, there is insufficient horizontal coordination between relevant ministries and other national authorities. We may conclude that it is necessary to establish institutional mechanisms for the following:

- strategic planning of decentralisation;
- oversight of the process of delegating mandates to local governments, mutual coordination between national authorities and intergovernmental coordination and consultation;
- impact analysis of delegating new or additional mandates (and expenditures) to local budgets;
- setting up of a vertical balance in local finance, as it is necessary to ensure that local governments have (receive) sufficient assets to finance new or additional mandates (expenditures).
- The final part of this study will contain detailed recommendations on how the manner of delegating new mandates to local governments may be improved, including how the mandates may be financed.
- In order to more easily comprehend the analysed legislation changes noted in this chapter, the following table shows a chronological overview of the increase in local government expenditure due to new mandates delegated by the republic in the period between 2009 and 2015.

Chart 1.

Chronological overview of the increase in local government expenditure due to new mandates delegated by the Republic in the period between 2009 and 2015



*Within the observed period, local governments incurred costs of establishing youth offices, gender equality committees, as well as communal police in cities. Also, the new planning and construction law, adopted in 2009, obligated local governments to prepare new spatial and urban development plans within a given timeline. These expenditures were never reimbursed or covered by the Republic (Levitas, 2010).

5.3 Financing local government (mandates) in the period between 2009 and 2015

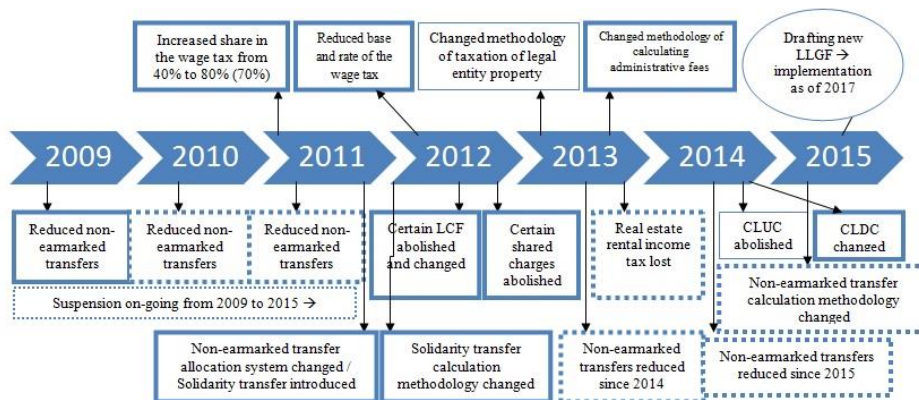
5.3.1 General overview

The previous chapter pointed to the fact that the 2006 Law on Local Government Finance (LLGF) was fully implemented only during 2007 and 2008. Its positive effects, however, and its contribution to strengthening the fiscal capacity of cities and municipalities were short-lived. The first effects of the economic crisis could be felt as early as 2008, since it inevitably led to the reduction of certain local revenues. In April 2009, the Government of Serbia suspended the implementation of certain provisions of the LLGF, thus arbitrarily reducing the amount of non-earmarked transfers.¹⁷⁸ Since that moment, as we will see, each year brought a new change in the system of local government financing. In the period between May 2009 and June 2011, Serbian cities and municipalities lost over 50 billion dinars (more than 500 million euros) as a result of the suspension of the calculation of non-earmarked transfers according to the formula set forth by law and the arbitrary reduction of the total amount local governments received from this revenue. During those years, cities and municipalities reacted to this reduction by mobilising, increasing and improving the administration of their own-source revenues. After two years of the LLGF suspension, local budgets temporarily recovered, but not due to the restoration of the existing legal system of transfers. Namely, the central government increased the local government share in the shared wage tax from 40% to 80% (70% in the case of the City of Belgrade). Bučić and Spirić state that the total increase of revenues due to the increased share in the wage tax during the last trimester of 2011 and all of 2012 failed to compensate for the loss caused by the reduction of non-earmarked transfers.¹⁷⁹ At the time, it was estimated that this change in the law would, during the first three years of its implementation, cause local governments to gain more than 40 billion dinars. However, this solution was short-lived too, since as early as 2013, the Republic reduced both the base and the rate of the wage tax, leaving local governments with only 20 billion instead of an additional 40 billion dinars from this revenue, according to some estimates. During 2011 and 2013, the methodology for calculating transfers was also changed, leading to even less transparency of the system and a greater decrease of this revenue.¹⁸⁰ In 2012, certain local communal fees were abolished, while others were reduced due to a change in the way they are calculated. Some charges shared with local governments were also abolished. These changes resulted in a further reduction of local government revenues by an additional 5.5 billion dinars.¹⁸¹ During 2013, local governments were stripped of the real estate rental income tax proceedings, which resulted in an additional decrease of 3 billion dinars.¹⁸² In late 2013, a new wave of reductions in non-earmarked transfers for 2014 ensued. They were decreased by 3.7 billion dinars and stayed at the same, reduced level in 2015.¹⁸³ As of January 1, 2014, the construction land use charge was abolished, which caused municipalities to lose another 14 billion dinars, according to

some estimates.¹⁸⁴ In late 2014, the methodology for the calculation of the construction land development charge was changed, but the total loss in local government budgets will not be known until local governments adopt their annual statements for 2015.

As can be seen in the previous paragraph, the last few years brought so many changes in the local government finance system that it is very difficult to keep track of them all. A conclusion may be drawn that, in such unpredictable circumstances, cities and municipalities cannot in fact focus on financial governance, but only on crisis management. In order for the reader to be presented with both a chronological overview of all the changes in the local government finance system and a detailed analysis of each and every group of revenues, the following chapters will focus first on transfers, then on shared revenues and, finally, on own-source revenues. Each group of revenue or individual revenue will first be presented with the existing legal solution prescribing it and a short retrospective of important events that have had an impact on it. This will be followed by an overview of shortcomings and issues and, finally, by recommendations on how the situation and the legal framework may be improved.

The following chart shows a chronological overview of changes in local government revenues due to legal changes in the period between 2009 and 2015. Unannounced changes in regulations that took place in the middle of the budget year, which came into force immediately upon adoption of the regulation, are framed with a bold blue line. Regulation changes that were somewhat expected and announced (although not planned and announced sufficiently in advance) and that came into force on January 1 of the following year are outlined with a broken blue line. Changes that were planned and announced are shown framed with a thin blue line. However, even for those changes, it cannot be said that local governments had had sufficient time to prepare and adjust. Finally, the draft of a new law on local government finance has been announced, and the new law is supposed to come into force on January 1, 2017 (in the chart, this future change is outlined with the blue ellipse). The task force entrusted with the preparation of the Draft Law on Local Government Finance was formed in early 2014, only to be suspended following the changes that took place in the Ministry of Finance in July 2014. The task force was reinstated a year later, in July 2015. Chart 2.

Chronological overview of changes in local government revenue due to changes in regulations in the period between 2009 and 2015**4.3.2 Transfers in the period between 2009 and 2015****4.3.2.1 Non-earmarked transfers**

It has already been mentioned more than once that in April 2009 the Government of Serbia, faced with the pressure of the global economic crisis and the need to consolidate the national budget, decided to reduce the total amount of non-earmarked transfers that local governments were supposed to receive.¹⁸⁵ Pursuant to the legal solutions valid at the time, the annual total of non-earmarked transfers to local governments equalled 1.7% of the realised GDP according to the data of the Statistical Office of the Republic of Serbia. The priority within the amount of the total non-earmarked transfer was the equalisation transfer.¹⁸⁶ Local governments with an estimated amount of shared revenues per capita below 90% of the national average of shared revenue per capita in all municipalities, cities excluded, were entitled to this transfer.¹⁸⁷ The next step would be to calculate the amount of the total transfer according to predefined criteria, such as the population, the total area, the number of children and facilities in the pre-school system, the number of classes and facilities in the elementary education system, and the number of classes and facilities in the secondary education system.¹⁸⁸ Even though the total non-earmarked transfer would have been reduced in any case, given that in 2009 the GDP started dropping rapidly, the central government decided to have additional savings in its public expenditures and to substantially reduce transfers (grants) to cities and municipalities. The problem lies in the fact that this decision was made in the middle of the budget year, by means of the budget review,¹⁸⁹ without any announcement or consultation with local governments and without any type of newly instated methodology for calculating the non-earmarked transfer. This decision of the central

government basically annulled one of the main goals of the 2006 Law on Local Government Finance, which is to establish an objective, transparent, predictable and fair transfer system.

In 2009, transfers were reduced by 36.8% compared to what local governments were entitled to by law, resulting in a total loss of around 15 billion dinars.¹⁹⁰ Levitas notes that in 2009, total local government revenue amounted to 30 billion dinars less than in 2007. Out of this total, half of the loss came as a result of reduced revenues caused by diminished business activities, whereas the other half came as a direct result of the suspension of the transfer system.¹⁹¹ The same measure remained in force in 2010, when the loss amounted to 21.8 billion dinars.¹⁹² During these two years, non-earmarked transfers were reduced by over 40%, that is, by 36.8 billion dinars. As was mentioned before, starting in 2009, local governments reacted to this reduction by increasing and improving the collection of their own-source revenues (the property tax, local communal fees, and the construction land use and development charges). In August 2010, the Government of Serbia issued its Memorandum on the Budget and Economic and Fiscal Policy for 2011 (including projections for 2012 and 2013), in which it announced that non-earmarked transfers would be increased by only 2 billion dinars in 2011. Realising that total losses may amount to over 58 billion dinars by the end of 2011, more than 150 local governments,¹⁹³ organised through the Standing Conference of Towns and Municipalities (SCTM), submitted a petition to the Government of Serbia in October 2010. Local governments demanded that, “after two difficult budget years during which this crisis management measure was implemented, and after the issuing of the official information that the Republic of Serbia is no longer stricken by the economic crisis,”¹⁹⁴ the Government of Serbia begin implementing the Law on Local Government Finance in its entirety, including reinstating the amounts of non-earmarked transfers to the levels prescribed by this law. The SCTM simultaneously addressed the Members of the Parliament, inviting them to support the petition to reinstate the amounts of non-earmarked transfers for 2011 to the levels prescribed by the Law. In that address, the SCTM emphasised that “no other part of the public sector suffered such drastic reductions of funds from the budget of Serbia” and pointed out that, in 2009, non-earmarked transfers comprised an average of 20% of total revenues of local governments (more than 50% of total revenues in certain poorer municipalities).¹⁹⁵ They also noted that, as a direct consequence of the reduction in transfers, levels of investments were drastically reduced, the quality of utility and other services suffered, and current debt pertaining to current expenditures and obligations towards creditors amounted to 17 billion dinars in 105 (out of 174) local governments.¹⁹⁶ Nevertheless, regardless of the appeals of the local authorities, austerity measures applied to non-earmarked transfers continued throughout 2011, when the total amount of non-earmarked transfers was almost 17 billion dinars less than what local governments would have been entitled to if the Law had been implemented. This uncertain situation seemed to end in mid-2011, when the National Assembly adopted legislation that made

a sudden shift towards decentralisation. Namely, the proposition was to increase the share of local governments in the shared wage tax from 40% to 80% (70% in the case of Belgrade). The Law on Amendments and Addenda to the Law on Local Government Finance was adopted in June 2011, and it standardised the proposed wage tax share increase, with the implementation scheduled to begin on October 1, 2011.¹⁹⁷ The reasons behind the central government's decision not to continue with the implementation of the provision of the law valid at the time, the positions of the local governments on the new concept of financing, as well as the consequences and effects of the new legal solutions on the national and local budgets will be elaborated on in detail in the following chapter, which will focus on shared revenues. To sum up, the total loss incurred by local governments due to the suspension of the legal framework pertaining to non-earmarked transfers in the period between 2009 and 2011 is calculated to be around 52 billion dinars.

In addition to the increased share of local governments in the wage tax prescribed by the Law,¹⁹⁸ significant changes in the transfer system were also introduced. Namely, the Law set forth that the annual amount of the total non-earmarked transfer is to represent a calculation category for the allocation of funds to local government units.¹⁹⁹ Even though Article 37 of the Law still reads that the non-earmarked transfer is to amount to 1.7% of the realised GDP according to the most recent data published by the Statistical Office of the Republic of Serbia, in effect, it amounts to around 1% of the GDP and has been fluctuating around this percentage for years now.²⁰⁰ Article 42a of the Law has introduced another important novelty: the sum of the equalisation transfer, the compensation transfer and the general transfer is to be multiplied by a certain coefficient, depending on the development level of the local government in question:

- Coefficient 1 for local government units in the 4th (lowest) development category;
- Coefficient 0.9 for local government units in the 3rd development category;
- Coefficient 0.7 for local government units in the 2nd development category;
- Coefficient 0.5 for local government units in the 1st (highest) development category.

The following paragraph clarifies that the development level is determined according to the unique local government development list determined for the year preceding the year for which transfers are calculated, pursuant to the law regulating regional development.²⁰¹ Furthermore, the transition transfer is abolished, and Article 43 replaces it with the solidarity transfer. At the moment of the adoption of these amendments to the Law and the increase of the share in the wage tax, almost one fourth of the employed population of the Republic of Serbia resided in the wealthiest local government – the City of Belgrade.²⁰² The wage tax is paid to the municipality on whose territory the employee resides. With this fact in mind, the Government passed a solution according to which the capital renounces its non-earmarked transfers for the benefit of all other local government units. It was, therefore, prescribed that the total

non-earmarked transfer for the City of Belgrade would in fact be calculated according to the aforementioned legal criteria, only to be redistributed amongst all other local government units, according to the following formula:

- 50% of the solidarity transfer allocated to local government units in the 4th (lowest) development category;
- 30% of the solidarity transfer allocated to local government units in the 3rd development category;
- 10% of the solidarity transfer allocated to local government units in the 2nd development category;
- 10% of the solidarity transfer allocated to local government units in the 1st (highest) development category.

The final paragraph of this Article set forth that the Government should elaborate on additional distribution criteria for local governments within the same development group by the means of a decree.²⁰³ This paragraph only remained valid for a year, as new amendments to the Law came as early as October 2012. This solution was then replaced with a complicated formula for the distribution of funds within the same development group, which took into consideration the number of local governments within a group and the development level of a local government as compared to the City of Belgrade.

The articles in question, which pertain to the formula for calculating the total non-earmarked transfer, require an additional analysis. First, all of the interviewed participants noted that formulas prescribed by law have not been implemented since 2009, and that the amounts of non-earmarked transfers are not set based on the previous year's GDP. Instead, the Ministry of Finance allocates funds by adjusting transfer amounts from the previous year. Second, the total volume of non-earmarked transfers does not amount to 1.7% of the GDP, but between 1% and 1.3%.²⁰⁴ Third, the GDP data published by the Statistical Office of the Republic of Serbia differ from the data issued by the IMF, the World Bank and other relevant institutions. Fourth, when calculating the amount of the total non-earmarked transfer, the central government should be using the same GDP data it uses when preparing the national budget and projections, which is not the case.²⁰⁵ Fifth, the approximate share of the equalisation transfer (which is determined as a priority) in the total amount of the non-earmarked transfer is unknown, as valid formulas are not being applied. At the moment, the total amount of transfers is distributed among local governments without a set formula, which leads to even less transparency, arbitrary decision-making and a politicised transfer allocation process. Local governments with higher political influence at a given moment receive more non-earmarked and earmarked transfers than other cities and municipalities.²⁰⁶ Finally, one novelty introduced by the Law was that the sum of the total non-earmarked transfers is to be multiplied by a certain coefficient, depending on the development level of the local government in question. This level of development of cities and municipalities is

determined by the Government's Decree on Establishing the Uniform List of Regions and Local Government Units According to Their Development Levels,²⁰⁷ which categorised local governments into 4 development groups according to the criteria also set by the same Decree.²⁰⁸ According to the Decree on Setting the Methodology for Calculating the Levels of Development of Regions and Local Government Units valid at the time,²⁰⁹ the main indicator used to measure the economic development level is the sum of all salaries, pensions and local government unit budget revenues.²¹⁰ The basic flaw in this methodology is the fact that it takes into account total revenues of a city or municipality without considering the local government's efficiency in the administration of its own-source revenues. Thus, local governments are encouraged in the worst possible way; those with low efficiency and a low own-source revenue (e.g., the property tax) collection rate are rewarded with additional transfer funds, and vice versa, local governments with efficient tax administration are, in fact, being punished. For example, the Municipality of Arilje was, according to the aforementioned methodology, categorised among the wealthiest local governments in Serbia, whereas the criteria applied by the Standing Conference of Towns and Municipalities placed it among the poorest municipalities in Serbia.²¹¹ Taking total budget revenues into consideration when calculating the general transfer is contrary to the criterion that is taken into account when calculating the equalisation transfer, which is the assessed per capita shared tax revenue in a local government. Namely, the general transfer should take into consideration the functions of cities and municipalities, that is, real expenditures local governments have for carrying out their delegated mandates, especially those pertaining to the social sector. This system basically penalises highly developed municipalities when it comes to determining the general transfer, even though they have dozens of facilities and hundreds of classes in the elementary and secondary education systems, thousands of children and numerous facilities in the pre-school system, thousands of vehicles in the public transportation system, etc. All these shortcomings in the transfer system should be addressed when new amendments to the Law are prepared.

Total non-earmarked local government transfers were reduced once again in late 2013. In order to reduce the public debt and to secure fiscal sustainability, the Minister of Finance, in his Instruction for the Preparation of the Decision on the Local Government Budget for 2014 (and Projections for 2015 and 2016), ordered an additional reduction of non-earmarked transfers, which was once again contrary to the legal provisions on the criteria for the allocation of these funds. Namely, in line with the austerity policy and the goal to "reduce subsidy-related expenditures on all tiers of government in 2014,"²¹² the Minister demanded that local governments plan to reduce their subsidy expenditures by 30% compared to the amount planned in the 2013 Budget Decision. He also demanded that local governments should plan for a 30% reduction in the central government's allocation of non-earmarked transfers for 2014.²¹³ This measure reduced total non-earmarked transfers allocated for 70 cities and municipalities by 3.7 billion

dinars. Certain local governments addressed the Ministry of Finance, objecting to this measure²¹⁴ and pointing out the fact that it constitutes an incorrect interpretation of the term “subsidy” by equating the accounting category with financial support to public utility companies that are managed irrationally and inefficiently. The way Paunović sees it, this interpretation of the Ministry basically punishes municipalities that finance their capital projects through their utility companies, while it does not punish those that spend enormous funds to pay the salaries of redundant employees in the administration and register this expenditure as a current general budget expenditure. Such municipalities were even rewarded with multiple increases in transfers.²¹⁵ Namely, according to the Rulebook on the Standard Classification Framework and the Budget System Chart of Accounts,²¹⁶ multiple subsidy groups are classified under account 450000: 1) subsidies to public non-financial enterprises and organisations; 2) subsidies to private financial institutions; 3) subsidies to public financial institutions; and 4) subsidies to private companies. There are two sub-groups within the first group of subsidies: 1) current subsidies to public non-financial enterprises and organisations, which include analytical accounts where current subsidies for public transportation, railway transportation, water management, and other non-financial enterprises and organisations are recorded; and 2) capital subsidies to public non-financial enterprises and organisations, which include analytical accounts where capital subsidies for public transportation, railway transportation, water management, agriculture, and other public non-financial enterprises and organisations are recorded. The opinion of local governments is that the provision of certain public services must be managed through public utility enterprises, and these tasks must be financed from the general budget of the local government.²¹⁷ The absurd fact is that, by having these expenditures recorded under different accounts, local governments could have either had a smaller reduction in non-earmarked transfers or avoided such a reduction altogether.

Upon adoption of the 2014 budget, representatives of the Ministry of Finance attended a session of the Assembly of the Standing Conference of Towns and Municipalities and explained that the Ministry, in fact, interpreted the accounting category “subsidy” incorrectly, and that the transfer funds were reduced without any grounds. Nevertheless, this mistake was never rectified and local governments never received the money to which they were entitled. Moreover, the Ministry of Finance, this time headed by a new Minister of Finance, repeated the same mistake in 2015. Namely, the Instruction for the Preparation of the Decision on the Local Government Budget for 2015 (and Projections for 2016 and 2017) no longer relates the amount of revenues from non-earmarked transfers from the Republic to the reduction of expenditures incurred by local governments pertaining to subsidies.²¹⁸ However, the Law on the Budget of the Republic of Serbia for 2015²¹⁹ maintains the identical, reduced amount of non-earmarked transfers for the same group of 70 cities and municipalities, as was done in 2014. Their loss due to reduced revenues from the transfers is once again 3.7 billion dinars.²²⁰

4.3.2.2 Earmarked transfers

The chapter that presented the structure of the 2006 Law on Local Government Finance also pointed out that transfers are divided into non-earmarked and earmarked transfers. There were no changes in the Law with impact on earmarked transfers in the previous period. As a reminder, earmarked transfers are used to finance specific functions and expenditures, and they are further divided into:

- Functional transfers – These are used to finance expenditures within one particular function and are calculated based on the data on the total costs of performing the function in question during the last year before it was delegated to the local government level;²²¹
- Earmarked transfers in the narrow sense – The central government may allocate a transfer to a local government so that it performs specific tasks within its original or delegated scope. Such a transfer is used to finance a specific purpose, that is, the task in question, while the responsible ministry determines its amount and distribution criteria.²²²

The distribution of earmarked transfers to cities and municipalities is almost impossible to track. Annual laws on the budget of the Republic of Serbia only contain information about the distribution of total non-earmarked transfers per local government unit. As can be surmised from the provision of the LLGF regulating earmarked transfers in the narrower sense, the manoeuvring space for the discretionary and non-transparent allocation of this type of fund is enormous. On the one hand, non-earmarked transfer funds are reduced each year more and more. The way the Law on Local Government Finance has been implemented, or better yet not implemented, by the Ministry of Finance leads us to a conclusion that local governments are facing utter uncertainty regarding the central government's next move. As a direct consequence, local governments are faced with unpredictability and the inability to plan not only multiannual capital projects, but also current revenues and expenditures. On the other hand, it is a well-known fact that politically privileged local governments receive substantial funds through earmarked transfers.²²³ The redistribution of funds from the pool reserved for non-earmarked transfers, to which local governments are entitled by law, into the pool for earmarked transfers, which are allocated without any methodology and criteria, derogates one of the basic reasons for the adoption of the Law on Local Government Finance. Namely, the main goal of the LLGF was to establish a depoliticised, objective, transparent and fair transfer system. Most municipal officials believe that earmarked transfers in the narrower sense should be abolished as a category.²²⁴

4.3.2.3 Conclusions on transfers

One of the first questions raised during the analysis of the developments and the aforementioned legal solutions in the context of the transfer system is: Why did not the Republic reach a consensus with local governments in 2009 on how the burden of the crisis would be shared, and why did not it set up a new methodology for calculating non-earmarked transfers? A follow-up question focuses on the central government's reasons for deciding to dramatically change the way local governments are financed in 2011. Why did the central government increase the share of cities and municipalities in the wage tax (with only a temporary impact on local budgets), instead of reinstating the existing legal solutions, which were still valid at the time? After gaining a comprehensive insight into how the central government delegated mandates and determined the amounts of transferred funds in the period between 2009 and 2015, we can conclude that the answer lies in the absence of a systemic and institutional focus on the issues of decentralisation and the financing of local government mandates. This is coupled with a lack of a strategy and plan concerning the state's intergovernmental fiscal governance.

Institutional aspects will be analysed in detail in the chapters to come. However, it is important to point out the fact that, ever since 2009, the central government has not even once consulted the Intergovernmental Finance Commission on any issue of importance for the financing of cities and municipalities.²²⁵ This institution was established in accordance with the LLGF, in order to secure the implementation of "the principles of fairness, efficiency and transparency of the local government finance system, and to offer recommendations for its improvement," as well as to monitor the system's vertical and horizontal equalisation.²²⁶ Since the onset of the crisis, the central government has governed intergovernmental fiscal relations in a non-systemic and illegal way. When it comes to calculating and allocating the transfers (grants), it might be said that the period between 2009 and 2015 has been characterised by a continuous breach of the LLGF and the de facto derogation of this Law by means of annual national budget laws.²²⁷ Such governance, coupled with an inadequate set-up of the transfer system, is contrary to the obligations the Republic accepted by ratifying the European Charter on Local Self-Government, as well as by incorporating provisions of Article 9 on financial resources of local authorities into the country's internal legislation.²²⁸ Such governance is also contrary to the Council of Europe Recommendations on Financial and Budget Management and on Financial Resources of Local and Regional Authorities.²²⁹

4.3.2.4 Recommendations

It is necessary to define a new total annual amount of non-earmarked transfers. First, since the onset of the economic crisis in 2009, the overall fiscal frameworks have changed in the country, and it is clear that local governments should take on a part of the burden brought on by the crisis by undertaking necessary reforms. Second, during the observed period, the central government has continuously delegated new expenditures to local governments. According to the calculations prepared for the purpose of this study, the total amount of the non-earmarked transfer never reached 1.7% of the GDP, and since 2009, it has rarely hit the 1% mark. Nevertheless, local government financial obligations have not been simultaneously reduced. Instead, they increased while their revenues continuously decreased. When setting a new general transfer amount, particular attention should be paid to expenditure growth in the social services sector, so as not to jeopardise the functioning of kindergartens and the implementation of pre-school programmes, the functioning of elementary and secondary schools, as well as of the primary healthcare of citizens. Third, one should keep in mind that, during the three-year suspension of the non-transfer provisions of the LLGF, local governments accumulated substantial arrears, which they still have not been able to return. Therefore, the central government should review the effects of the way intergovernmental fiscal relations have been governed so far, that is, the impact such governance can have on the country's consolidated balance sheet, economic development and business environment, as well as on the quality of life of its citizens.

When calculating total non-earmarked transfer amounts for local governments, the central government should base its calculations on the same GDP data it uses to prepare the national budget and macroeconomic projections.

The solidarity transfer should be abolished as a category, since it is calculated based on criteria that do not evaluate a local government's fiscal capacity in an objective way. Own-source revenues are not a good indicator of how developed or undeveloped a local government unit is, as cities and municipalities differ greatly in terms of property value, the number and type of businesses and the volume of investments made on their territories, which are bases for the property tax, local communal fees and the construction land development contribution, respectively.

When determining the percentage threshold for qualifying for the equalisation transfer, it should be kept in mind that, in the meantime, some rather poor local governments have been awarded the status of a city. Therefore, the evaluation of the average revenue per capita from shared taxes in the Republic should include cities, but it should exclude those that substantially surpass a defined amount or percentage, (such as Belgrade, Novi Sad and other wealthier local government units). Between two censuses, in the period between 2002 and 2011, over one hundred local governments experienced a substantial

decrease in population. The disparity between poor municipalities and the richest ones is continuously increasing. That is why it is necessary for the future equalisation transfer system to have the per capita revenue from the shared income tax as its most significant criterion when assessing the fiscal capacity of a local government. The formula should be conceived in such a way that would allow a quick redistribution and that would mitigate the differences between the wealthiest and the two poorest quartiles of municipalities. Unless the fiscal capacities of poorer municipalities are strengthened and the necessary conditions are provided in order for them to invest more in their economic development, they will continue to lose both their population and businesses, and the regional disparity will grow larger. The mitigation of drastic differences in wealth between local governments in Serbia cannot be achieved by the strengthening of own-source revenues, or by increasing shares in shared revenues. This process must primarily be financed by redistribution, that is, by the horizontal equalisation transfer funds.

Non-earmarked compensation transfers should be kept as a category in the future law because their purpose is clear – to compensate for the revenues local governments lost due to changes in the national legal framework, in case they were not compensated by other types of revenue. Even though the Republic did nothing to compensate local governments for the losses incurred due to changes in national regulation in the observed period, omitting this provision would mean depriving local governments of their right to be compensated in this way, as well as legitimising the central government's faulty practice so far.

Functional transfers should also be kept in the future law. The valid provision of the law sets forth that these transfers are to be calculated based on the data on total expenditures incurred by performing the function in question during the last year before it was delegated to the local level. In addition, the central government authorities that delegate a function to local governments should be legally obligated to prepare a report containing data on: a) the total funds used to perform the task during the last five years before it was delegated to the local level, with all funds and sources specified; b) the total expenditures pertaining to the function during the last five years before it was delegated to the local level, with every expenditure specified. Such a report should be prepared by every single authority that participated directly or indirectly in performing each and every task within a particular mandate and submitted for review to the Intergovernmental Finance Commission, the National Decentralisation Council and the Standing Conference of Towns and Municipalities at least 13 months before the planned delegation of the mandate is to take place. Given that functional transfers are temporary, it is necessary to obligate the Ministry of Finance and the Intergovernmental Finance Commission to adjust the formula for allocating non-earmarked transfers for the amount necessary to perform the newly delegated function within the prescribed one-year period. In the forthcoming period, during the EU accession process and the

harmonisation of the national legislation with the EU regulations, there will be instances when both central and local governments will receive a new mandate at the same time. In such cases, we would not have the usual process of delegating mandates from the central to the local level. That is why it is necessary to obligate the central government to prepare an elaborate report on the total evaluated direct and indirect expenditures pertaining to a mandate, keeping in mind both horizontal and vertical coordination and task distribution.

Finally, the earmarked transfer in the narrower sense should be abolished. Special, transparent rules and criteria for allocating funds for financing and co-financing capital investment projects should be defined.

TRANSFERS	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TOTAL NON-EARMARKED TRANSFERS (TNT)	TNT amounts to 1.7% of the realised GDP according to the most recent data published by the Statistical Office of the Republic of Serbia	<p>TNT represents a calculation category for the allocation of funds to local government units (LGU) and amounts to 1.7% of the realised GDP according to the most recent data published by the Statistical Office of the Republic of Serbia (2011).</p> <p>The amount of the non-earmarked transfer per LGU is calculated by multiplying the sum of the equalisation, compensation and general transfers by the development coefficient of the LGU in question (2011).</p>	<p>Suspension of TNT provisions in May 2009, in the middle of the budget year, which had an immediate effect. Suspension extended until July 2011.</p> <p>Amendments to the LLGF in 2011, in the middle of the budget year (June 29, 2011), came into force on October 1, 2011:</p> <ul style="list-style-type: none"> - TNT is a calculation category; - Non-earmarked transfer per LGU is multiplied by the LGU's development coefficient; - Solidarity transfer introduced. <p>Amendments to the LLGF in 2012, in the middle of the budget year (September 8, 2012), came into</p>
	Equalisation transfer	The same	
	Compensation transfer	The same	

	Transition transfer	Abolished	force on October 1, 2012: - Formula introduced for the redistribution of funds to LGUs within one development group, together with additional rules for the redistribution of funds among LGUs within the 1 st and 2 nd development category.
	General transfer	The same	
		Solidarity transfer – non-earmarked transfer for the City of Belgrade is abolished and its funds are redistributed to other LGU, where percentages depend on the development level of the LGU (2011, 2012).	
EARMARKED TRANSFERS	Functional transfer	The same	The LLGF suspended once again in late 2013, which came into force on January 1, 2014. (The Law on the Budget of the Republic of Serbia for 2014): - Tying the non-earmarked transfer funds to the subsidy level in the LGU and a reduction by 30%. 2014 transfer amounts kept in 2015 (The Law on the Budget of the Republic of Serbia for 2015).
	Earmarked transfer in the narrower sense	The same	

4.3.3 Shared revenues in the period between 2009 and 2015

4.3.3.1 Shared revenues from the personal income tax

In the observed period, the category of shared revenues also underwent a major transformation. When it comes to the personal income tax, the following changes were made: first, the way in which the revenue from the wage tax was distributed changed, which was followed by a change in the way its base and rate were calculated; second, the way in which revenue from the real estate rental income tax was distributed also changed. Apart from these, significant changes occurred in the domain of shared charges, as well.

After more than two years of the suspension of the Law on Local Government Finance (LLGF), local budgets recovered partly and temporarily due to the changes made in July 2011. At that time, the share in revenues from the shared wage tax was increased from 40% to 80%, that is, to 70% in the case of the City of Belgrade. How did this sudden change of direction in the local government finance system come about, and why did the Government of Serbia, whose policy until that moment had been one of reducing national expenditures and transfer funds allocated to local governments, decide to increase local budgets without even announcing it beforehand? In May 2011, the United Regions of Serbia (URS) parliamentary group submitted a petition signed by more than half a million citizens and proposed to the National Parliament a set of amendments and addenda to laws regulating local government.²³⁰ This set of amendments included the Draft Law on Amendments and Addenda to the Law on Local Government Finance, which set forth the increased share in revenues from the wage tax. At SCTM meetings, most mayors stood against this solution, predicting that it would not be long-lasting because it was unsustainable from the perspective of the national budget.²³¹ Local government representatives believed that the current LLGF needed no changes as long as its non-earmarked transfer provisions were implemented.²³² However, from the point of view of the leadership of the City of Belgrade, and its already three-year struggle to manage the capital's enormous expenditures without a predictable budgetary framework, the proposed solution was too enticing to refuse.²³³ Namely, almost every fourth employee of the Republic of Serbia works and resides in Belgrade, and the wage tax is paid according to the employee's residence.²³⁴ Representatives of Belgrade believed that the increased share in the wage tax would represent a more stable and reliable revenue compared to the non-earmarked transfer, which depended on the central government's willingness and the state of national finance at the moment the annual budget is prepared.²³⁵ Keeping in mind that the difference between the City of Belgrade and the rest of Serbian local governments is substantial in terms of the number of employed and the amount of their salaries, the URS proposed that the aforementioned solidarity transfer be established.

During the period when these amendments to the LLGF were proposed, the authority appointed by law to provide recommendations and opinions – the Intergovernmental Finance Commission – did not convene even once. However, the Fiscal Council of the Republic of Serbia conducted an analysis of fiscal effects of the proposed legal solutions and concluded that the increase in the share of local governments in the wage tax from 40% to 80% would cause the national deficit to increase by 1.1% of the GDP (equalling almost 40 billion dinars) in 2012. The Council's opinion was that the adoption of the proposed model would require substantial fiscal adjustments on the national level, as fiscal sustainability and macroeconomic stability would otherwise be jeopardised.²³⁶ The Fiscal Council, together with local government financial experts, pointed out that comparative practice shows few examples of the central government sharing such a high percentage of the wage tax with local governments, and that only wealthy local governments would benefit from such a model.²³⁷ They also warned that differences between underdeveloped local governments would only grow larger because there would not be sufficient funds for equalisation transfers, as well as that the proposed changes in the transfer system are worse than the valid legal solutions since they leave plenty of manoeuvring space for arbitrary decision-making. According to their opinion, the proposed model, which included both an increase in the share of the wage tax and a total non-earmarked transfer of 1.7% of the realised GDP, is fiscally unsustainable and cannot be implemented in practice.²³⁸ Delegating additional funds to the local level would require the decentralisation of certain public functions, and the proposal of the URS parliamentary group included no plan whatsoever of delegating additional mandates to municipalities. It is interesting to note that the URS, in its proposal, stated that the implementation of the said legal solution did not require additional funds from the budget of the Republic of Serbia, even though as early as 2012 it was necessary to secure no less than 40 billion dinars.²³⁹ Still, regardless of the Fiscal Council's warning, the Law on Amendments and Addenda to the Law on Local Government Finance was adopted in June 2011, and it came into force on October 1, 2011.²⁴⁰

In June 2012, Arsić and Randelović analysed the first effects of the amendments to the LLGF. Already in the first trimester of 2012, the total fiscal deficit of the Republic of Serbia was increased by almost 12 billion dinars. Fiscal deficit growth contributed to the growth of the foreign trade deficit and, indirectly, to the creation of inflation pressure.²⁴¹ By analysing the structure of local government expenditures, they found that local subsidies increased by 55%, that expenditures for procurement of goods and services increased by 30%, that social welfare went up by 25% and that salaries increased by 10%. In their opinion, this presents evidence of the increased unproductive spending of funds.²⁴² During the first trimester, the central government increased its expenditures by 10%, whereas local governments' expenditures grew by 18%. Based on these facts, the authors conclude that it is necessary to return the vertical distribution to

the sustainable levels that existed between 2006 and 2008, in order to keep the temporary increase in local expenditures from becoming permanent.²⁴³

It is necessary to make several remarks at this point. Namely, in order to reach a valid conclusion on whether the said increase in expenditures was counterproductive, it is insufficient to conduct an analysis of expenditures based on the economic classification alone and to compare the difference in expenditures between the final trimesters of 2010 and 2011 and the difference between the first trimesters of 2011 and 2012.²⁴⁴ In this case, it would be necessary to conduct an analysis of functionally classified expenditures over a longer time series.²⁴⁵ This way it would be possible to see exactly which expenditures increased and decreased compared to the base year of 2008. In the previous chapters, it was pointed out that after non-earmarked transfers were reduced in 2009, outstanding arrears accumulated on the local level. In addition, it was explained that the accounting category of subsidies does not represent only the “bad” subsidies, as that particular account records capital subsidies for local utility enterprises as well. It was also noted that, in the period after 2009, expenditures for salaries paid by local governments increased without the local government having any impact on this increase. In order to draw a valid conclusion on how local governments spent the additional influx of money, as well as on how many local governments used it to hire new employees, it would be necessary to conduct an in-depth multiannual analysis of local government expenditures.

Just as the experts predicted, the new Minister of Finance,²⁴⁶ who was behind the proposition to increase the local governments’ share in the wage tax and to amend the LLGF, made the first steps towards centralism already in September 2012. The Ministry of Finance then proposed the suspension and limitation of certain own-source revenues, such as the local communal fees, as well as the suspension of certain shared charges on using common goods and natural resources. These revenues were deemed to have increased drastically in the period between 2009 and 2012. They were also deemed to represent a heavy “parafiscal” burden on businesses, and they, therefore, needed to be abolished or reduced in order to improve the business environment.²⁴⁷ It does not come as a surprise that certain local communal fees were, in fact, substantially increased during the period in question, given that local governments focused on mobilising and improving the administration of their own-source revenues in order to compensate for the losses incurred as a result of the reduction of non-earmarked transfers. These new amendments and addenda to the LLGF again came into force in the middle of the budget year – in October 2012.²⁴⁸ The following chapters will analyse these changes in detail.

In May 2013, the Ministry of Finance took the next expected centralist step and proposed the reduction of the wage tax base from 12% to 10%, which was coupled with the increase of the non-taxable part of the base. The SCTM presidency warned the

representatives of the central government that the changes in the taxation of wages would cause a new problem in local government finances, given that, at the time, revenues from this shared tax made up for 40% of local revenues on average. The SCTM demanded that the Government approach the reform of local government financing in a systemic and comprehensive way because partial changes have detrimental effects on local budgets.²⁴⁹ Nevertheless, the proposed amendments to the Law on the Personal Income Tax came into force on May 30, 2013, once again in the middle of the budget year.²⁵⁰ Instead of the announced additional 40 billion dinars, local governments received half of that amount – 20 million dinars, according to some estimates – during the first 18 months of implementation.²⁵¹ Since 2013, there have not been any new amendments in the distribution or calculation of the wage tax. Still, there is a continuous uncertainty about whether the local governments' share in this tax will be reduced, given that the existing solution is fiscally unsustainable from the perspective of the national budget.

In addition to the changes concerning the distribution of revenues and the calculation of the wage tax, another important change took place in 2013 and it had to do with shared revenues from the personal income tax. Local governments were stripped of revenues they received from the real estate rental income tax. Article 35 of the LLGF, which regulates local government revenues from shared personal income taxes, prescribes that municipalities are to receive the entire (100%) amount of revenue from the real estate rental income tax realised on their territories, among other revenues. However, in May 2013, the Ministry of Finance decided to redirect funds generated from this tax into the budget of the Republic of Serbia by re-categorising them as proceeds from capital. According to the opinion of the representatives of the Ministry of Finance, revenues from the real estate rental income tax are, in fact, proceeds generated by capital, and revenue generated by taxing proceeds from capital belongs to the Republic entirely. It is interesting to note that all other revenues from taxing real estate represent local government revenues in their entirety and are paid to the local government where the real estate is located. These are revenues from the (own-source) property tax and revenues from the (shared) real estate transfer tax paid upon the sale-purchase transaction, that is, upon the transfer of absolute rights over real estate.²⁵² This is why the explanation that revenue from the real estate rental income tax is revenue of the central government is surprising. Article 35 provisions of the LLGF were practically derogated on May 29, 2013 with the adoption of the Law on Amendments and Addenda to the Law on the Personal Income Tax, which lists revenues from the real estate rental income tax as revenues from the tax on proceeds from capital in Article 61.²⁵³ Even though it was planned for new legal provisions to come into force on January 1, 2014, the Ministry of Finance began implementing them – retroactively even – as early as August 1, 2013, immediately after the adoption of the review of the national budget.²⁵⁴ Namely, the Ministry withdrew money paid to local governments after June 1, 2013 from the bank account for revenues from the real estate rental income tax. After a

month-long intensive discussion between local government representatives and the Minister of Finance, the money was returned to cities' and municipalities' accounts, and the implementation of the new legal solutions was postponed to the original date, that is, the beginning of the following budget year.²⁵⁵ This measure represents a fine example of continued unpredictability and fiscal uncertainty that cities and municipalities have been facing. This central government measure alone cost local governments around 3 billion dinars annually, 50% of which was the loss incurred by the City of Belgrade (around 1.5 billion dinars).

4.3.3.2 Shared revenues from charges on using common goods and natural resources

In the chapter on the current legal framework of financing local government mandates, it was pointed out that the matter of shared revenues is dispersed throughout a variety of sectoral laws. This is particularly true of revenues from shared charges. Charges are public non-tax revenues charged to natural persons and legal entities for using common goods – a) natural resources, b) goods of common interest and c) public goods.²⁵⁶ According to the Law on Public Property, natural resources include water, watercourses and their springs, mineral resources, ground water resources, geothermal and other geological resources, raw mineral reserves and other natural resources.²⁵⁷ Goods of common interest include agricultural land, forests and forestry land, water land, water facilities, protected natural assets, cultural assets, etc.²⁵⁸ Public goods include public roads, public railways, bridges and tunnels on a public road, railway or street, streets, squares, public parks, border crossings, etc.²⁵⁹ A separate set of laws focusing on issues pertaining to the exploitation and management of common goods regulates how these charges are determined and distributed between different government tiers.

According to the IMF GSF classification, public revenue generated from leasing out or allowing exploitation of land, underground resources and other natural resources is considered to be rent. Public authorities may issue licences for the use of mineral, fossil and other underground resources, and receive compensation – rent – in return over a certain period of time. When the owner of the exhaustible mineral, fossil and other resources is the state, payments are categorised as rent, whereas, when the owner of such resources is a natural person or, in some cases, another state, the payment is called “severance” and is categorised as tax, not rent. Other rents include those for deforestation, the use of uncultivated land, and the exploitation of water for recreational and commercial purposes, etc.²⁶⁰

According to the SNA classification, rent is the income that the owner of a natural resource (the lessor or landlord) may receive for putting the natural resource at the disposal of another institutional unit (a lessee or tenant) for the use of the natural resource in production. Two particular cases of resource rent are considered: rent on

land and rent on subsoil resources. Resource rent on other natural resources follows the pattern laid out by these two instances.²⁶¹

Charges for the use of common goods identified in Serbian legislation can be categorised as public-law (derivative, fiscal) revenues or as private-law (original, non-fiscal) revenues, depending on whether the public- or private-law element is predominant.²⁶² If the public-law element is dominant, and if the relation between the amount of charge and the use of the asset is negligible, international revenue classifications usually place such charges among taxes on use of goods, and rarely among fees. However, if the “price” element for the use of the good is predominant, such a charge will be classified as private-law revenue, that is, as revenue from leasing out non-produced property (rent) or revenue from selling goods and services (price). Another criterion to distinguish public- from private-law charges is to consider who is administering it. If a charge represents general revenue of the budget of the central (or lower-tier) government and is administered by the tax administration, then it is of a public-law nature. If, on the other hand, a charge is revenue of a public enterprise (or another public organisation) that manages the good and administers the setting of the price and the collection of the revenue, meaning that the revenue is paid into a separate account, it will be considered private-law revenue. All this leads to the conclusion that, in practice, charges (and frequently fees, too) come in various hybrid forms and that their legal nature is not always completely clear. This can lead to all sorts of misuse, manipulation and the proliferation of these non-tax revenues. That is why it is important to identify the relation between the amount of levy and the benefit it provides in the case of each and every type of non-tax revenue.²⁶³

Therefore, the term charge in the Serbian legislation denotes a levy paid to use all types of common goods – natural resources, public goods and goods of common interest – and as such has a wider meaning than the term rent. In practice, its nature may often be that of a tax, fee or price for the provided good or service. That is why we will use the most comprehensive term charge.

One version of Article 36 of the 2006 Law on Local Government Finance²⁶⁴ contained a list of nine charges the Republic was to share with local government units, in line with the territory where the revenue is generated. The 2012 version of this LLGF article contains a general provision, reading that the Republic shall share revenues from charges with the local government where those charges are paid, pursuant to the Law, without being precise as to which charges this concerns.²⁶⁵ A rough analysis shows that in the observed period, between 2009 and 2015, more than 15 sectoral laws regulated over 30 different types of charges recorded as either shared or own-source revenue of local governments.²⁶⁶ At the time of the present analysis, there are eight actively applicable laws regulating 16 charges the Republic shares with local governments. This study will not analyse the way in which the amount of each and every charge on the use of common goods is determined. Such an analysis would require specific technical and

technological expertise about the good, its scarcity, as well as the different possible effects, consequences and externalities, depending on the manner in which the good is used and exploited. Here, only an overview of laws regulating shared charges will be presented, since the respective legislation underwent a large number of changes within the observed period, often to the detriment of local governments. The following table provides a summary of charges the Republic shares or shared with local governments, the laws that regulate them, and the changes that occurred in the observed period. Charges were identified using data from the study titled “System of Charges for the Use of Natural Resources and Intergovernmental Revenue Distribution” by Milica Bisić²⁶⁷ and the Parafiscal Registry prepared by NALED.²⁶⁸

Table 5: Charges the Republic shares or shared with local governments in the period between 2009 and 2015

SHARED CHARGES				
TYPE OF CHARGE	VALID SHARED CHARGES AND % SHARED WITH LOCAL GOVERNMENT UNIT (LGU)	ABOLISHED SHARED CHARGES	LAWS REGULATING CHARGES	NOTE
1. ENVIRONMENTAL CHARGES (6 valid; 1 abolished)	1. Environmental pollution (general) – 40% 2. Environmental pollution in areas of special national environmental interest – 20% 3. Individual pollution source emission – 40% general, 20% in special areas 4. Produced or disposed waste – 40% general, 20% in special areas 5. Substances detrimental to the ozone layer – 40% general, 20% in special areas	Part of environmental pollution charge pertaining to motor vehicles. ²⁶⁹	The Law on Environmental Protection (Official Gazette of the Republic of Serbia, 135/2004 and 36/2009)	- The charge was abolished by the amendments to the Law from September 25, 2012, which came into force immediately upon adoption of the regulation. Apart from the Law on Environmental Protection, there are five more laws regulating

	6. Polyethylene shopping bags – 40% general, 20% in special areas.			around twenty environment-related charges that belong to the republic and the Province (APV), as well as two laws that do not prescribe charges, but that regulate LGU mandates pertaining to the environment. 270
2. AGRICULTURAL LAND CHARGES (2 valid)	1. Arable agricultural land conversion – 40% 2. Reduced value of multiannual crops – 40%		The Law on Agricultural Land (Official Gazette of the Republic of Serbia, 62/2006 and 41/2009)	
3. FOREST CHARGES (1 valid)	1. Use of forests and forestry land – 30%		The Law on Forests (Official Gazette of the Republic of Serbia, 30/2010 and 93/2012)	
4. ROAD CHARGES (4 valid, 5 abolished)	1. Annual charge on using commercial premises with access to municipal roads and streets, if LGU authority is in charge of the road (according to the LGU ordinance on local public roads, pursuant to the Law) – 100%	1. Annual charge on motor vehicles, tractors and towed vehicles – 100% 2. Annual charge on other motor vehicles –	The Law on Public Roads (Official Gazette of the Republic of Serbia, 101/2005, 123/2007, 101/2011, 93/2012 and 104/2013)	- Charges were abolished by amendments to the Law from September 25, 2012, and they came into force on October 1, 2012.

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	<p>2. Special charge on the use of municipal roads and streets, their part or section, if LGU authority is in charge of the road (“toll”) – 100%</p> <p>3. For structures and advertising/information in the area of municipal roads and streets, if LGU authority is in charge of the road (charge on billboards, advertising panels, visual or audio information devices) – 100%</p> <p>4. For construction of the water supply, sewerage, electricity, telephone and telegraph poles, etc. in the area of public roads – 100%</p>	<p>100%</p> <p>3. Construction of commercial premises with access to municipal roads, if LGU authority is in charge of the road – 100%</p> <p>4. Excessive use of municipal roads and streets, their part or section, if LGU authority is in charge of the road – 100%</p> <p>5. Connection of access roads to municipal roads and streets, if LGU authority is in charge of the road – 100%</p>		
<p>5. MINING AND MINERAL CHARGES (1 valid, but 9 types depending on the raw mineral)</p>	<p>1. Exploitation of raw materials – 9 types depending on the raw mineral – 40% goes to the LGU where the mining is done and the raw mineral is exploited.</p>		<p>The Law on Mining and Geological Research (Official Gazette of the Republic of Serbia,</p>	

			88/2011)	
6. ENERGY CHARGES (2 valid)	<p>1. Using general interest assets for the production of electrical energy, petrol and gas – 100%</p> <p>2. Issuing licences for performing energy-related business activities – this charge is not shared. The subject of the LGU authority ordinance pays the charge on the licence directly to the LGU – 100%</p>		<p>1. The Law on Paying and Directing Revenue from the Charge on Using General Interest Assets for the Production of Electrical Energy, Petrol and Gas (Official Gazette of the Republic of Serbia, 16/90)</p> <p>2. The Law on Energetics (Official Gazette of the Republic of Serbia, 145/2014)</p>	
7. WATER CHARGES (0 valid, 3 abolished)	Currently there are no water charges shared with local governments.	<p>1. Charge on drained water</p> <p>According to the previous Law on Waters, valid between 1991 and 2010, there were two water charges that were LGU shared revenues:</p> <p>2. Charge on water use (shared charge according to</p>	<p>1. The Law on Waters (Official Gazette of the Republic of Serbia, 30/2010, 93/2012)</p> <p>2. Previous Law on Waters (Official Gazette of the Republic of Serbia, 46/91, 53/93 and 54/96):</p> <p>A. Charge on water use</p> <p>B. The charge on material</p>	According to the 2010 Law on Waters, there were 6 groups of water charges. The first five groups include 18 charges of which 100% belongs to the Republic or the APV. Those groups of charges are: <p>1. for the use of water resources,</p> <p>2. for</p>

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		<p>Article 36 of the 2006 version of the LLGF) – 10% shared with the LGU where exploitation of mineral water takes place. According to the 2010 Law on Waters, it is kept entirely by the Republic or the APV.</p> <p>3. Charge on material exploited from watercourses (shared charge according to Article 36 of the 2006 version of the LLGF) – 40%. According to the 2010 Law on Waters, the charge on using water land is kept entirely by the Republic or the APV.</p>	<p>exploited from watercourses stopped being shared revenue of LGU immediately after the new Law on Waters came into force.</p>	<p>disposed water, 3. for water pollution, 4. for irrigation (~4 types), 5. for the use of water facilities and systems. None of those charges that belong to the Republic and/or the APV were abolished. The 6th group – the charge on drained water – that belonged entirely to the LGU was abolished by the amendments to the Law from September 25, 2012, which came into force on October 1, 2012.</p> <p>Serbian legislation prescribes the necessity for, but is yet to adopt regulation for water pollution.</p>
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<p>8. TOURISM AND SPA CHARGES (1 abolished, 1 never implemented)</p>	<p>1. Charge on the use of natural healing factors (thermal and mineral water, gas, medicinal mud)</p>	<p>2. Tourism charge – 80%</p>	<p>1. The Law on Spas (Official Gazette of the Republic of Serbia, 80/92)</p> <p>2. The Law on Tourism (Official Gazette of the Republic of Serbia, 36/2009, 88/2010 and 93/2012)</p>	<p>1. According to the Law on Spas, the National Parliament is supposed to set the amount of the charge, which never happened, and the charge was never implemented.</p> <p>2. The tourism charge was abolished by the amendments to the Law from September 25, 2012, which came into force on October 1, 2012.</p>
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Table 5 shows that, in the period between 2009 and 2015, the Republic abolished or stopped sharing as many as ten out of the total 27 shared charges with local governments. In addition, the charge on the use of natural healing factors has in fact never been implemented because the National Parliament has since 1992 been unable to adopt a law that would set up this charge and regulate its distribution between tiers of government. Out of these ten charges, two water charges became exclusive revenues of the national budget after the 2010 Law on Waters was adopted. The remaining eight charges were abolished in September 2012. At the time, the Ministry of Finance proposed changes in sectoral laws, abolishing around 130 various “parafiscal” impositions (fees, charges and other non-tax revenues) in order to reduce the burden on businesses and improve the business environment. Most of those impositions were one-time obligations and were not paid by all categories of businesses, but mainly by those that would ask for a certain right, service, good or administrative action from public authorities. Amendments to the law came into force immediately upon adoption on October 1, again in the middle of the budget year. It is interesting to note that the Parliament simultaneously adopted the proposed amendments to the Law on the Value Added Tax and the Law on Excises, which impact (almost) all natural persons and legal entities. The goal of these measures was to increase the base and the scope of products

that are subject to the tax and excises in order to increase national budget revenues.²⁷¹ The suspension of certain fees, such as some road charges and the tourism charge, seems perfectly justified. However, these changes resulted in the further reduction of budgets of local governments, which were not compensated for the losses. Also, abolishing those charges impacted the capacity of local governments to finance the management of common goods, that is, their maintenance, improvement and protection.

4.3.3.3 Conclusions

When it comes to local government shared revenues, it may be concluded that the 2011 changes to the distribution of revenue from the wage tax proved to be detrimental for both the central budget and local government budgets, which is exactly what the Fiscal Council and public finance experts predicted could happen. This measure jeopardised the country's fiscal sustainability and triggered a series of ad hoc changes that led to complete instability of the system of local government financing. Those changes include re-categorising the revenue from the real estate rental income tax, which used to be local government revenue, as the tax on proceeds from capital, which is national budget revenue. The changes also included the suspension of ten charges the republic shared with local governments.

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4.3.3.4 Recommendations

The share of local governments in the wage tax should be reduced to the level that was valid before the 2011 amendments and addenda to the LLGF. At the same time, reform of the non-earmarked transfer system should be conducted in order to compensate for the revenues that would be lost by the reduced wage tax share, as well as in order to set up a better formula for the redistribution of revenues between wealthier and poorer local governments.

The real estate rental income tax should once again be revenue that the Republic shares with local governments entirely.

Given that the previous period brought on sudden legal changes concerning charges on the use of common goods, it may be assumed that the entire system of charges requires comprehensive reform. Since a large number of sectoral regulations regulates the issues of using common goods and the charges paid for those purposes, it would be necessary for the future LLGF to list and “confirm” what charges are shared and the shares (percentages) to which local governments are entitled.

The use of common goods has substantial effects on the local community, but those effects and consequences often spill over to the neighbouring municipalities and the entire country. Therefore, it is important for the central government, together with lower tiers of government, to consistently regulate the issues of common good exploitation, environmental impact assessment and externalities, as well as the distribution of revenues generated by charges. If the resource exploited is of an exceptional importance for the country and/or such exploitation produces significant externalities, the Republic’s share should be considerably larger than the local government share (e.g., 75% to 25% or 70% to 30% for the Republic). If the resource in question is of local importance and/or such exploitation predominantly impacts the local community, the share of the central government and the local governments in revenues from such a charge should be equal (50% to 50%).

Local governments are currently not entitled to any water charges, and the charge on the use of natural healing factors was never implemented. Even though they would not represent a significant source of local budget revenue, it is necessary for cities and municipalities to receive a part of these charges in order to cover for expenditures pertaining to the maintenance of exploited resources and the repair of any possible damages resulting from the misuse of the good in the local community.

Table 6 presents a summary of legal changes in the area of shared revenues in the period between 2009 and 2015:

SHARED REVENUES	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TAXES	Personal income tax: 1. Wages (40%) 2. Income from individual business activity (100%) 3. Income from agriculture and forestry (100%) 4. Real estate rental income (100%) 5. Proceeds from	Personal income tax: 1. Wages (80%, 70% for the City of Belgrade) 2. Income from individual business activity – the same 3. Income from agriculture and forestry re-categorised as income from	Amendments to the LLGF that increased the share of local governments in the wage tax were adopted on June 29, 2011, and came into force on October 1, 2011. Amendments to the

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	<p>leasing out movables (100%) 6. Proceeds from personal insurance (100%)</p>	<p>individual business activity 4. Real estate rental income tax re-categorised as proceeds from capital, thus becoming national budget revenue 5. Proceeds from leasing out movables – the same 6. Proceeds from personal insurance re-categorised as wages.</p>	<p>Law on the Personal Income Tax, which deprived local governments of revenues generated by the tax on real estate rental income, were adopted on May 29, 2013, and came into force on August 1, 2013 (retroactively from June 1, 2013, instead of from January 1, 2014). After a public discussion, money was returned to local governments and the implementation started when it should have – on January 1, 2014.</p>
	Tax on inheritance and gifts	The same	
	Tax on the real estate transfer	The same	
CHARGES	<p>Article 36 of the LLGF: 1. Annual charge on motor vehicles, tractors and towed vehicles; 2. Charge on environmental pollution; 3. Charge on using raw minerals; 4. Charge on material exploited from watercourses; 5. Charge on the exploitation of forests; 6. Charge on the exploitation of waters; 7. Charge on</p>	<p>Article 36 of the LLGF, amended in 2012, reads: “The Republic shares with local government units revenues generated on the territory of local government units, according to the Law.”</p>	<p>Amendments to sectoral laws abolished the following charges in 2010 and 2012: 1. Annual charge on motor vehicles, tractors and towed vehicles; 2. Part of the environmental pollution charge pertaining to motor vehicles; 3. Charge on material exploited from watercourses; 4. Charge on the exploitation of waters; 5. Tourism charge;</p>

	agricultural land conversion; 8. Charge on the use of the natural healing factors; 9. Tourism charge; 10. Other charges in line with the Law.		6. Annual charge on other motor vehicles; 7. Charge on the construction of commercial premises with access to municipal roads, if LGU authority is in charge of the road; 8. Charge on the excessive use of municipal roads and streets, their part or section, if LGU authority is in charge of the road; 9. Charge on the connection of access roads to municipal roads and streets, if LGU authority is in charge of the road; 10. Charge on drained water. 11. The charge on the use of the natural healing factors was never implemented.
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4.3.4 Local government own-source revenues in the period between 2009 and 2015

4.3.4.1 General overview

One of the most important novelties in the local government finance system introduced by the 2006 Law on Local Government Finance (LLGF) was decentralization of the property tax. Local government units were given the authority to set tax rates within the limits prescribed by the Law on Property Taxes,²⁷² as well as to administer this tax themselves together with other own-source revenues. From December 1, 2006, cities and municipalities started establishing local tax administrations and taking over functions, employees, equipment and work instruments from the Tax Administration of the Republic of Serbia. In addition to the property tax, own-source revenues include local administrative fees, local communal fees, the sojourn fee, various types of own-source charges, self-contribution, monetary fines in proceedings pertaining to

misdeemeanours regulated by local ordinances, as well as other types of revenue (from selling or leasing out real estate and movables owned by local governments, local government activities, interests, donations, etc.). Local government units define the method and criteria for setting own-source fees and charges autonomously, but the Republic may set the highest and the lowest amounts of these revenues through law.²⁷³ Local government (that is, the city assembly or the municipal assembly) ordinance on establishing the method and criteria for the amount of fees and charges may only be changed once a year, within the process of adopting the budget for the following year.²⁷⁴

In the observed period, significant changes occurred in the area of own-source revenues. In order to better view and understand those changes, this chapter will first focus on own-source fees, since certain communal fees were abolished or modified at the same time as the aforementioned shared charges analysed in the previous chapter. After that, this section will present the changes that have affected own-source charges. Finally, the closing paragraphs will contain an analysis of the property tax and the reforms that affected it in the previous period.

4.3.4.2 Fees as local government own-source revenue

According to the LLGF, own-source fees include local administrative fees, local communal fees and the sojourn fee. Before going into the specifics of each of these groups of fees, it is necessary to present how the Serbian legislation defines the term fee. The Law on the Budget System defines fees as non-tax revenues paid for the direct provision of a certain public service or for the carrying out of procedure or action by the relevant public authority.²⁷⁵ The amount of the fee must be proportionate to the costs of providing the public service or the conducted procedure or activity. The fee has to be set as an absolute amount for the following year and cannot be increased during the year.²⁷⁶ The Minister of Finance defines the methodology and the criteria for setting the costs for the provision of services (by the rulebook)²⁷⁷. In case the amount of a fee is not prescribed through law, it shall be regulated by an act adopted by a national or local authority. A decision of the state authority on the amount of the charge requires consent from the Ministry of Finance, whereas the local authority needs to acquire consent from the local government authority in charge of financial matters.²⁷⁸ Pursuant to Article 9 of the LLGF,²⁷⁹ the local government may impose administrative fees for documents and administrative tasks and as part of other original mandate tasks, except for those documents and tasks for which administrative fees already exist on the state level.²⁸⁰

In February 2013, the Minister of Finance adopted the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services,²⁸¹ which is applied whenever a fee is not regulated and defined by law.²⁸² The Rulebook regulates the methodology, elements and formula for setting the amount of fees charged for the direct provision of public services or for carrying out procedures or actions by the relevant

public authority.²⁸³ The methodology is based on the principle of actual costs, which means presenting all relevant authority costs – for all activities and processes in the course of providing services, as well as for all cost-payers - in order to encompass all expenditures that occur.²⁸⁴ The second principle of the methodology is the principle of accessibility of a public service to beneficiaries.²⁸⁵ The amount of a fee is determined by multiplying the sum of the cost of labour and other costs of providing a public service with the accessibility coefficient. Costs of labour are determined by multiplying the effective time spent providing the service on an annual basis with the price of labour of an employee per hour. The accessibility coefficient is set by the authority in charge, based on the evaluated impact of the amount of a fee on the accessibility of a public service, and it can range between 0.1 and 1.²⁸⁶ The Rulebook also requires the relevant authority to keep a record of data on the public services provided, including data on costs, the number (volume) of public services provided, and data on the fees collected.²⁸⁷ The positive side of this methodology is the fact that it is completely in line with the World Bank recommendations on the methods of determining administrative fees,²⁸⁸ as well as with the EU Directive on Services in the Internal Market, which is based on the principle of cost recovery, according to the EU Directive.²⁸⁹ The Ministry chose one of the two most frequently applied methods of cost identification – the method of calculating the average total cost.²⁹⁰ Unfortunately, the Methodology, i.e. the Rulebook is hardly ever applied.²⁹¹

According to the GSF classification of the IMF, administrative fees are imposed for issuing permits and for the sale of other public authority services. If the amount of a fee is obviously higher than the costs of providing the service, it is classified as a tax on the use of goods and on the permission to use goods or perform activities.²⁹² According to the SNA classification of the UN, fees are imposed for special permits issued by public authorities for using certain assets and performing certain activities. If issuing the permit does not require considerable activity on the part of the public authority, but rather an automatised activity where the amount of a levy exceeds the costs of providing a service, the process is a way to collect additional revenue, and the fee is, in fact, a tax. If the public authority does perform its regulatory function and charges a “price” for it in order to recover service costs, then this imposition is a fee.²⁹³

When it comes to communal fees, Article 11 of the LLGF prescribes that local governments may impose communal fees for using rights, objects and services and that they cannot impose a special charge for the same purposes. Pursuant to the 2006 version of the LLGF, there were 16 different grounds for imposing local communal fees, whereas according to the existing legal solution, there are eight.

Table 7 contains an overview of changes in the local communal fee system in the observed period.

LOCAL COMMUNAL FEES**2006 LLGF****CURRENT LLGF SOLUTION**

1. Business sign display on business premises;	- Fee amount is capped;
2. Business sign displays and inscriptions outside business premises on facilities and areas owned by the LGU (roadways, pavements, green areas, poles, etc.);	Using advertising billboards, including business sign displays and inscriptions outside business premises on facilities and areas owned by the LGU (roadways, pavements, green areas, poles, etc.);
3. Keeping road motor vehicles and trailers, excluding agricultural vehicles and machinery;	- Fee amount is capped;
4. Using glass showcases to display goods outside the business premises;	- Fee amount is capped;
5. Keeping and using navigable equipment and vessels, and other facilities on rivers and lakes, excluding wharves used in border river traffic;	- Abolished in 2012;
6. Keeping and using boats and floating platforms, excluding the boats used by organisations engaged in waterway maintenance and marking;	- Abolished in 2012;
7. Restaurants and other catering and entertainment facilities on rivers and lakes;	- Abolished in 2012;
8. Keeping domestic and exotic animals;	- Abolished in 2012;
9. Utilisation of space in public areas or in front of business premises for business purposes, except for the sale of newspapers, books, and other publications, old and artistic handicrafts and folk handicraft;	- The same;
10. Games of chance equipment (“entertainment games”);	- The same;
11. Keeping musical equipment and live music in restaurants;	- Abolished in 2012;
12. Using advertising billboards;	- Merged with communal fee No. 2 in 2012;
13. Using parking spaces for road motor vehicles and trailers on appropriately fitted and marked areas;	- The same;
14. Using available areas for camping, setting up tents or other facilities for temporary use;	- The same;
15. Using waterfront areas for business and any other purposes;	- Abolished in 2012;
16. Using public space for keeping construction material and carrying out construction.	- The same.

After an in-depth look into both the old and the new list of communal fees, it may be concluded that, unlike administrative fees, communal fees are – by nature – not fees, but taxes or charges on using public communal goods. The division into local administrative and local communal fees represents a relic of the socialist public

administration system. In the former system, in which the regime of taxing the property of natural persons, legal entities and enterprises was fundamentally different and in which local governments were not authorised to impose taxes, local communal fees made much more sense. Nevertheless, the system of communal fees lives on even three decades later, after having mutated into a system of quasi-taxes and quasi-charges. Most provisions featured in the former Law on Communal Fees and Charges from 1992, which were also present in previous versions of the law,²⁹⁴ were simply copied into the 2002 Law on Local Self-Government and then into the 2006 Law on Local Government Finance, as the fundamental basis of financing cities and municipalities. The final paragraph of Article 15 of the LLGF prescribes that the Government is to set the maximum amount of: 1) the fee for business sign displays on business premises (hereinafter: display fee), 2) the fee for business sign displays and inscriptions outside business premises on facilities and areas owned by the local government unit (on communal goods), and 3) the fee for keeping motor vehicles. However, the Government has never set these amounts. Changes to the aforementioned fees did not occur until September 2012 when the LLGF was amended. After a campaign led by the USAID program titled “Business Enabling Project” and NALED,²⁹⁵ which was aimed at abolishing a large number of “parafiscal” impositions in order to reduce the fiscal burden on businesses and to improve the business environment, the then Minister of Finance proposed the abolition of 130 various levies.²⁹⁶ This included the abolition of eight communal fees and a change in the method of determining the amounts of the three mentioned fees. It cannot be denied that the domain of communal fees was in need of reform, but changing the way in which they were determined was supposed to be a part of comprehensive reform of the local government finance system. The problem is that this decision of the central government was, in fact, just one more partial ad hoc change that affected local government revenues in an already unstable local government finance system. This measure too was passed without any analysis of its impact on local budgets and without compensating for lost revenues, and it also came into force in the middle of the budget year. Eventually, even though only 17 out of the 130 abolished impositions were local revenues (10 shared charges and 7 local communal fees), the 2012 measures of the Ministry of Finance affected local budgets far more than the national budget. In addition to the abolition of 17 levies, three of the most important local communal fees were capped. The overall local budget reduction amounted to around 6 billion dinars, whereas the budget of the City of Belgrade was reduced by almost 3 billion dinars (4% of the 2011 City revenues). The total impact of the abolished local revenues on local budgets surpassed the share of abolished central government revenues in the budget of the Republic.²⁹⁷ As was already mentioned, the central government managed to compensate for the losses in the national budget by increasing the VAT and excises, but it neglected to do the same for local governments that lost revenues due to the abolition of shared charges and communal fees.

This study will not deal with the analysis of how each individual local communal fee is determined, especially because most of those revenues have little impact on municipal budgets. However, particular attention must be paid to the fiscally most significant and most frequently questioned display fee. Even though the LLGF refers to it as a communal fee, it is, in fact, a local quasi-tax on business activity. This fee has always presented a significant source of local budget revenue, and it continues to do so today, even though it amounted to no more than 4 billion dinars at the level of the consolidated balance sheet of the state,²⁹⁸ which is 0.27% of the 1,500 billion dinars of total public revenues of the state in 2013,²⁹⁹ In the same year, revenues from the corporate income tax made up around 3.6%, VAT revenues (for both natural persons and legal entities) contributed with around 25.4%, whereas social insurance contributions (which are roughly an equally split burden between the employees and the employers) made up around 32.6% of total public revenues of the Republic. Based on this, it may be concluded that the display fee was not that much of a burden to businesses. Nevertheless, it was not regulated well. Since the Government had not adopted the necessary bylaws as prescribed by the LLGF, local governments were allowed great freedom when determining the method and criteria for setting the amount of this fee. Municipalities discriminated against fee-payers based on their business activities, arbitrarily evaluating their financial capacities once a year. Thus, services were often “punished” compared to manufacturing activities. Within service activities, particularly high amounts of the fee were paid by financial and insurance organisations, betting establishments and casinos, telecommunication companies,³⁰⁰ electricity distribution enterprises, companies producing and trading with petrol, petrol derivatives, cement, etc. The methodology and criteria for determining display fees were not rational in most municipalities, but the amounts themselves were not an enormous fiscal burden, except in a few extreme cases that caused certain distortions.³⁰¹ Levitas states that, despite frequent complaints about the abuse of the display fee, revenues generated by this fee were not increased during the first two years of the economic crisis (2008 and 2009).³⁰² The examples of the City of Belgrade and the Municipality of Paraćin show that these two local governments did not increase the amount of the display fee and other communal fees until 2010. It may be assumed that other local governments acted in a similar way, after realising that the reduction of non-earmarked transfers would continue throughout 2010. Many municipalities changed their tariffs in 2010 for the first time after many years, causing the increase of fee-generated revenues to appear huge when expressed in percentages, even though the absolute amounts of fees were not dramatically high.³⁰³ This is confirmed by the examples of the City of Belgrade and the Municipality of Paraćin, where the increase of revenues from the display fee was negligible until 2010.

New legal solutions limited the amount of the display fee, in order to reduce the fiscal burden on businesses; however, the problem lies in the fact that these solutions were formulated without conducting any serious analysis on how much the display fee really

contributes to the fiscal burden on businesses and without taking into account interests of local governments whatsoever. Article 15a of the LLGF exempts entrepreneurs and legal entities categorised by accounting laws as small businesses, whose annual revenue does not exceed 50 million dinars, from paying this fee. Medium businesses, as well as entrepreneurs and small businesses with annual revenue exceeding 50 million dinars, have to pay the display fee in the amount not exceeding two average salaries, whereas large businesses must pay it in the amount not exceeding three average salaries. A special category includes legal entities that perform activities in the domains of banking, insurance, mobile and telephone services, electricity distribution, production and trading of petrol and petrol derivatives, tobacco products and cement, as well as casinos, betting establishments and night clubs. These legal entities are to pay the display fee in the amount not exceeding 10 average salaries. The average salary is considered to be the average salary on the territory of the local government unit in question earned during the first eight months of the year preceding the year for which the display fee is determined.³⁰⁴ However, average salaries differ greatly from one local government to another, so the main objection municipalities have is that the LLGF did not prescribe the national average as the base for this calculation.

When the Ministry of Finance presented its proposal of future legal solutions, local governments, through the SCTM, requested a series of changes pertaining mostly to the way the display fee and motor vehicle fee were supposed to be determined. Municipalities also pleaded with the central government for the measures to come into force at the beginning of the new budget year, instead of on October 1. The reasons for that were many: local governments had already planned and implemented their budgets according to plans; they had already completed all initiated public procurement procedures and concluded contracts with contractors; construction works were already on-going, or had been completed, meaning that local governments were expected to meet their obligations towards creditors; failing to meet those obligations would additionally compromise the liquidity of businesses; municipalities would accumulate more and more outstanding arrears, causing a deficit in the current year; local governments would have additional administrative obligations, since all existing ordinances and decisions would have to be annulled and new ones prepared and adopted, etc. However, in spite of these pleas, the Ministry of Finance still proposed and the Parliament adopted the legal solutions that came into force on October 1, 2012.

4.3.4.2.1 Conclusion on own-source fees

When it comes to own-source fees, it may be concluded that the existing division into local administrative and local communal fees is part of the heritage from the socialist era. Local administrative fees are, by their legal nature, fees. However, local communal fees are not fees by nature, but rather taxes or charges on the use of public communal goods. In September 2012, seven local communal fees were abolished, and the three

most important local communal fees were capped. In total, this measure caused local budgets in Serbia to lose around 6 billion dinars. Local communal fee reform was definitely necessary. The problem is that this decision of the central government was, in fact, just one more partial ad hoc change that affected local government revenues in an already unstable local government finance system. An additional problem is that this measure, like others preceding it, was passed without any analysis of its impact on local budgets and without compensating for lost revenues, and it also came into force in the middle of the budget year.

4.3.4.2 Recommendations on own-source fees

The Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services is in line with the World Bank recommendations on criteria for determining administrative fees, as well as with the EU Directive on Services in the Internal Market. However, the Rulebook is seldom applied, and it is, therefore, necessary to regulate the methodology of determining the amounts of administrative fees by law. The law should regulate the methodology for setting all types of fees for the provision of public services, that is, for carrying out procedures and tasks, and it should apply to all public authorities imposing and setting these fees. All types of fees should also be listed and categorised, in order to avoid overlapping and doubling administrative fees imposed by different authorities.

The future LLGF should define and classify local government own-source revenues in a more careful way. Local administrative fees are by their legal nature, and by the GSF and SNA public revenue classifications, fees. Local communal fees are not by their legal nature fees, but rather taxes and charges on using public communal goods. Literature on tax law states that one of the basic principles of fees is impersonality of the fee tariff, meaning that the tariff must remain uniform for a service, regardless of the fee-payer's economic ability.³⁰⁵ In practice, this is not the case with many local communal fees. Instead, payers are often discriminated against depending on their business activity and potential economic strength. That is why it is important for the new local government finance system to be stripped of all its quasi-tax forms, as well as to re-categorise communal fees as taxes or charges and to regulate them in detail according to principles of setting taxes and charges on using common goods. The future reform of communal fees should also make sure that there are no overlapping and doubled fiscalities, which used to occur until recently (e.g., the simultaneous tax on using, keeping and carrying assets that taxed the use of motor vehicles, the local communal fee on motor vehicles, and the (shared) annual charge on motor vehicles). In addition, focus should be placed on the purpose of the levy itself and the assessed amount it generates or should generate for all public authorities in order for them to be adequately funded to perform their mandates (maintaining roads and streets, for example).

Local governments in Serbia have a wide scope of mandates, both original and delegated, but they lack fiscal forms within own-source revenues to finance all expenditures of which they autonomously manage. When local tiers of government perform costlier tasks, such as communal and utility activities, maintaining traffic and other infrastructure, as well as social sector functions, they require more of substantial and adequate own-source revenues, particularly taxes. The property tax cannot be so sufficient to cover all or even most of the expenditures related to performing original local government mandates. Serbian local government needs a type of an own-source tax that would target business activities on its territory in a fair way. Depending on the assessment of potential revenues, accessibility of data to local governments, and the capacity of the local tax administration, alternatives could be found in the surtax on the corporate income tax,³⁰⁶ in one type of the business value tax,³⁰⁷ or in another form of the communal tax on business activity paid based on the enterprise's or entrepreneur's income, where local governments would be given the freedom to regulate rates within limits set by law.

4.3.4.3 Charges as local government own-source revenue

Pursuant to the valid Article 6 of the Law on Local Government Finance, which lists local government own-source revenues, local government units are entitled to revenues generated on their territories from the following original charges:

- From the charge on the use of common goods, pursuant to law
- From other charges, pursuant to law
- From concession charges

The previous legal solution contained a more precise provision, which included the following charges as own-source charges: the construction land use charge, the construction land development charge, the environmental protection and improvement charge, as well as revenues from concession charges on performing communal and utility services and other concessions concluded by local governments. In the meantime, the construction land use charge was abolished, that is incorporated into the property tax, while the construction land development charge was substantially altered and transformed into the construction land development contribution.

In the previous chapter, which focused on shared revenues, we pointed out the fact that, in the observed period, more than 15 sectoral laws regulated over 30 various charges. This number included the four laws that regulated five types of own-source charges. These are the Law on Planning and Construction,³⁰⁸ which regulated charges on the use and development of construction land, the Law on Environmental Protection,³⁰⁹ which regulates the environmental protection and improvement charge, the Law on the Public-Private Partnership and Concessions,³¹⁰ which regulates concession charges, and the

Law on Utility Services,³¹¹ which regulates communal charges. The following paragraphs will present these charges.

Construction land use charge

In addition to the property tax and rent charged for leasing out public land, the construction land use and development charges had represented the most high-yielding revenues of local governments for years.³¹² Both these charges were earmarked revenues of local budgets used to finance construction land development and the construction and maintenance of utility infrastructure structures. The charges were introduced during the socialist era and were kept as a fiscal form up until 2014. In the former system, these charges made much more sense because construction land was state or public property.³¹³ In such a system, the construction land use charge performed the function of the property tax. As noted by Arsić et al., in the meantime, it had become an overblown, parallel and primary property tax, as local governments were authorised to set criteria and methods for setting the amount of the charge autonomously,³¹⁴ while the property tax was capped by law. The criteria and methods differed from one municipality to another, but most of them included the size of the structure, the area of land, the location, the level of infrastructure development of land, the purpose of the structure, and often the type of business activity. Local governments did not only distinguished charge payers based on whether they were natural persons or legal entities. They also classified the purpose of structures and the type of business activities in a rather arbitrary way, in order to achieve differentiation between the various types of legal entities and business activities. That is why this charge, according to Arsić et al., had a triple function, as it represented: 1) the construction land use rent, 2) the para-tax on property, and 3) the tax on the supposed profitability of certain business activities.³¹⁵ In 2010, the Constitutional Court deemed illegal those ordinances of numerous local governments that based their criteria for setting the amount of the construction land use charge on the type of business activity.³¹⁶

The abolition of the construction land use charge had been announced for a while, but it presupposed a thorough reform of the property tax imposed on both natural persons and legal entities, as well as efforts to identify possible alternative revenue sources that would compensate for the loss caused by the abolition of the charge. As far as natural persons as charge-payers are concerned, the charge finally became meaningless once local governments took over the setting of rates and the administering of the property tax in 2006. However, one obstacle to the abolition of the construction land use charge concerned the taxation of property of legal entities. The 2009 Law on Planning and Construction stipulated in its final and transitional provisions that the construction land use charge was to be paid until it was integrated with the property tax, and the amendments to the Law adopted in April 2011 made this provision more precise, prescribing that this process had to be completed by December 31, 2013.³¹⁷ Even though the public discussion among experts about the abolition of the charge and its

integration into the property tax lasted for over a decade,³¹⁸ and the said Law formally prescribed it in 2009, the reform of the taxation of property of legal entities was not initiated until mid-2013. Until then, the property tax base for taxpayers with accounting books was the value of real estate recorded in their accounting books.³¹⁹ The Law on Amendments and Addenda to the Law on Property Taxes, adopted in May 2013, introduced new ways of setting the property tax base for legal entities: the base for a tax-payer with accounting books shall be the fair value of real estate according to international accounting standards,³²⁰ and the base for a tax-payer without accounting books shall be the value of real estate calculated according to the average price of a square meter in the zone in question.³²¹ The property tax will be in focus in the following sections. Here, we want to get an overview of the effects of the abolition of the construction land use charge and changes in the property tax for legal entities.

Table 8. Revenues from the property tax and the construction land use charge in the City of Belgrade and the Municipality of Paraćin in the period between 2012 and 2014 (in revalued Serbian dinars, in 2014 prices).

Belgrade	2012	2013	2014
Property tax on natural persons	3,365,414,469	3,531,350,135	5,669,897,000
Property tax on legal entities	2,635,628,048	2,293,989,687	5,542,565,000
Charge on the use of construction land	9,169,347,551	8,704,982,494	1,201,589,000
Paraćin	2012	2013	2014
Property tax on natural persons	51,101,268	60,133,699	101,345,139
Property tax on legal entities	46,771,832	60,413,110	61,353,764
Charge on the use of construction land	74,298,436	133,454,163	17,364,752

In the City of Belgrade, revenue from the natural person property tax increased by 60%, and revenue from the legal entity property tax increased by as much as 241% in 2014 compared to the previous year. Nevertheless, Belgrade failed to fully compensate for lost revenues, losing a total of 2.1 billion dinars after the construction land use charge was abolished. Local government budgets do not have separate accounts to distinguish between the construction land use charge paid by natural persons and the charge paid by legal entities. Regardless of the absence of this information, it is known that most municipalities did not incur losses from natural persons because the property tax had for the most part already replaced the construction land use charge. This charge was predominantly paid by legal entities, as revenues from them made up over 85% of the total amount of the collected charge in the whole country.³²² When this percentage is applied to the City of Belgrade, a rough estimation may lead to the conclusion that the total loss pertaining to legal entities exceeded 3.1 billions dinars. This, in turn, means that lost revenues previously generated by the charge paid by legal entities were mostly

compensated through increasing the property tax burden on citizens. It is also important to note that the City of Belgrade did not increase revenues from the natural person property tax by expanding the scope of taxable property (by registering real estate property that is not in the registries), by expanding the base or by increasing the property tax collection rate. The increase of revenue from the property tax on natural persons came as a result of increasing the burden on existing taxpayers by reassessing property values and, thus, increasing the tax base.³²³

The Municipality of Paraćin suffered a total loss of around 73.9 million dinars once the construction land use charge was abolished. In 2014, the property tax on legal entities generated only 1.5% more revenues, whereas the increase related to the property tax on natural persons reached 68.5% compared to 2013. Total revenue from the property tax on natural persons increased by 41.2 million dinars, meaning that even this local government did not manage to completely compensate its losses that had occurred due to the abolition of the construction land use charge. The Municipality partially compensated the loss, but exclusively by increasing the tax burden on citizens. The Municipality of Paraćin is, in fact, one of the most efficient local governments in terms of property tax administration. As early as 2009 and 2010, it managed to reach almost the maximum values when it came to both the capture of taxable property and the collection rate.³²⁴ This leads to the conclusion that the Municipality of Paraćin also increased the tax burden on citizens (natural persons) either by increasing the tax base or the tax rate.

The loss of revenues of all local governments in Serbia that resulted from the abolition of the construction land use charge (without taking into account the increase of revenues from the property tax) amounted to around 14 billion dinars.³²⁵ From the perspective of fairness and economic efficiency, the abolition of the charge was never questionable. The problem is that the difference in local government revenues, which resulted from the changes made to the said laws, was not compensated. Also, this was only one in a series of partial changes in the way cities and municipalities are financed that led to reduced local government budgets. After the charge was effectively abolished on January 1, 2014, pursuant to the Law on Amendments and Addenda to the Law on Planning and Construction³²⁶ adopted in April 2011, the Law on Utility Services (passed in November 2011) introduced *the communal charge*.³²⁷ This will be elaborated later on. The goal was, among other things, to set up a revenue source that would compensate for the revenues lost after the charge on construction land use was abolished. However, the Government of Serbia has never adopted bylaws that would enable this new charge to be introduced in practice.

Construction land development contribution (charge)

The construction land development charge, like the charge discussed previously, is a relic from the socialist times, when municipal construction land was a good owned by the state or society. At the time, local governments performed the tasks of planning, constructing and maintaining communal infrastructure through their construction directorates. The construction land use and development charges used to be direct own-source revenues of these utility enterprises, not of the general local government budgets.³²⁸ Revenues from these charges were earmarked revenues, used exclusively for financing infrastructure projects. Given that communal infrastructure was also considered to be a public or communal good, using existing infrastructure and the construction of new infrastructure required paying a charge.

Amendments and addenda to the Law on Planning and Construction altered the construction land development charge and transformed it into the so-called construction land development contribution. As was prescribed in earlier versions of this Law, the charge, now named contribution, kept its earmarked character. It is used to finance the development of construction land, the acquisition of public property construction land, as well as the construction and maintenance of communal and utility infrastructure.³²⁹ Construction land development includes construction land preparation and furnishing.³³⁰ Preparation consists of exploratory works, producing geodetic, geological and other layers, producing plans and technical documentation, land development programmes, resettlement, tearing down structures, land treatment, etc. Furnishing includes the construction of communal and utility infrastructure and the construction and the furnishing of public areas.³³¹

Until recently, the charge amount was set by contracts signed between investors and local governments, that is, the public enterprise in charge of construction. Such a contract would regulate mutual relations pertaining to construction land development – the scope, structure and execution of construction works, as well as the amount of the charge, payment dynamics, etc.³³² The amount of the charge was determined based on the level of infrastructure development of the location, the annual land development programmes implemented by the local government, the urban planning zone, the purpose and the size of the structure. The law envisaged the following purposes: housing, commercial activity, production activity, and other purposes. The local government unit itself would prescribe criteria for setting the amount of the charge.³³³ All this leads to the conclusion that local governments had rather wide discretionary authority when it came to setting the amount of the charge. The differences between the amounts of the charge within the territory of one local government were vast, irrational and often inexcusable. For instance, in the City of Belgrade, the amount of the construction land development charge paid for the construction of business (commercial) premises in the extra zone was as much as 70 times higher than the charge

paid for the construction of a structure of the same size, only with the “least expensive” purpose in a zone farthest away from the centre.³³⁴

One of the main motives for initiating the reform of the method for setting the amounts of the construction land development charge – or contribution – was part of an effort to reduce informal construction (particularly outside urban zones), which has reached dramatic proportions over the last two decades.³³⁵ Representatives of the central government believed that, in addition to the complicated and lengthy procedure of issuing construction permits, the construction land development charge was one of the main factors contributing to illegal construction.³³⁶ However, this claim is questionable for more than one reason. In spite of the fact that both national and municipal planning and construction regulations have for years prescribed substantial discounts of the construction land development charge, as well as various other incentives (payment in instalments, reduction of the charge, etc.), in order to encourage the legalisation of illegally built structures, a large percentage of residential structures is yet to be legalised.³³⁷ Serbia has been facing the problem of informal construction for decades, which began long before the large amounts of the construction land development charge in urban city zones even became an issue. Žerjav claims that the causes of informal construction must first be sought in the inefficient and inadequate housing policy, tolerance for informal activities, opportunist behaviour and speculative trading on the real estate market, etc.³³⁸ The list of causes can be expanded by adding a lack of local spatial plans, as well as corruption. Petovar notes that there are two basic groups of peoples’ motives for informal construction: 1) the satisfaction of basic needs in terms of housing and access to local public services, and 2) opportunist behavioural practices and profit generation through the abuse of public goods.³³⁹

Article 97 of the Law stipulates that the amount of the contribution is established by multiplying the base, which is the average price of square metre of a newly constructed residential unit in the local government unit, with the total net area of the structure under construction, as well as with the zone coefficient and the purpose coefficient. It is interesting to note that the lawmakers chose the data on the average price of a square metre published by the Statistical Office of the Republic of Serbia, and not the data on the average price of square metre published by local tax administrations, which are used when calculating the property tax base. The zone coefficient cannot exceed 0.1, and the purpose coefficient cannot exceed 0.15. Finally, the amount of the contribution is no longer subject to contracts between investors and the local utility enterprise in charge of construction. Instead, the amount is set by the decision issued within the administrative procedure of issuing building permits.³⁴⁰ This was the policymakers’ way to try to curb arbitrariness of local governments in the process of setting the amount of the contribution, but without defining the widest possible range of amounts paid for structures of the same size in different zones and/or with different purposes. It is important to mention that Article 97 of the Law on Planning and Construction contains

a provision exempting, among others, production facilities and warehousing structures from paying the construction land development contribution. It is interesting that experts in this area often criticised local governments for categorising businesses into different groups based on their activities and industry sectors and thus charging the businesses different amounts of fees and charges. Previous sections pointed to the difference in the treatment of service-oriented compared to production-oriented businesses, as well as to the difference in the treatment of service-oriented businesses themselves depending on the supposed economic strength of payers in the processes of setting the amounts of the business sign display fee and the construction land use charge. On the other hand, proponents of the Law on Planning and Construction (i.e., lawmakers) that reformed the method of setting the construction land development charge did the exact same thing by exempting production-oriented businesses from paying the contribution. It is not completely clear why the authors of the law chose this approach. Construction of production facilities often requires much larger investments in the infrastructure equipment of land than is the case with structures that will be occupied by service-oriented businesses. If the lawmakers' motive was to encourage investments, thus helping create new jobs, it is still not clear why the service sector businesses would be discriminated against in this context. It can easily be supposed that newly constructed and opened facilities that house businesses in the sub-sectors of retail, hospitality and so on can create more new jobs than a production facility or a warehouse. Finally, the draft law did not contain a single analysis that could help assess the fiscal effects of the proposed new legal solutions on local government revenues. On two occasions during late 2014, the National Parliament amended the Law on Planning and Construction, both times modifying the provisions on the construction land development contribution. The Parliament first passed the Law on Amendments and Addenda to the Law on Planning and Construction³⁴¹ on December 9, 2014, which came into force on December 17, 2014. In this version of the Law, Article 97 prescribed that the amount of the contribution for structures of the same size in the most expensive zone, with the most expensive purpose cannot exceed the amount of the contribution for those in the least expensive zone and with the least expensive purpose more than tenfold. At the very end of the year, when local governments were finalising their local budget preparation and adoption processes and passing ordinances on own-source revenues for the following year, the National Parliament of the Republic of Serbia adopted another set of amendments and addenda to the Law on Planning and Construction on December 29, 2014.³⁴² The Law came into force the following day. In its final version, Article 97 does not stipulate the aforementioned limitation of the contribution range (1:10), but it continues to cap the zone coefficient at 0.1 and the purpose coefficient at 0.15. It is difficult to predict the effects of the amended Law on Planning and Construction and the changed criteria for setting the amount of the construction land development contribution. The effects of the Law will not be suitable for analysis and review until local governments adopt their final statements for 2015.

To sum up, the contribution, as it is today, essentially represents a one-time tax on construction. Even though costs of infrastructure equipment of construction land may be known in advance, the construction land development contribution (charge) is not, and it never was the price of construction or the extension of necessary infrastructure. It has been considered a charge for investments in utility infrastructure as a communal good – in its construction and further development and maintenance.³⁴³ Tax-payers, i.e., payers of the construction land use and development charges, have for decades invested in the construction of communal and utility infrastructure. These funds were mostly used to construct primary utility infrastructure (main roads, water supply and sewerage networks in settlements, etc.), while during the previous decades, they were also used to build secondary infrastructure (infrastructure branches and connections to the construction lot itself). Therefore, any future reform should be directed at transforming the contribution into a form of the communal infrastructure tax, instead of into the price of construction or extension of existing infrastructure. Žerjav recommends, as a fair and economically justified solution, to develop a fiscal instrument to finance infrastructure land development primarily through the value added capture of land and real estate.³⁴⁴ Such an instrument would exist in three varieties, depending on where exactly this added value is created: a) the capture in new settlements, b) the capture in informal settlements, and c) the capture in built-up urban areas. In the first two cases, not all citizens would pay this tax because they should not be the ones financing the infrastructure of new urban areas. Citizens and investors whose investments generate this added value of land and structures would be the ones to pay it³⁴⁵ Today, in addition to the construction land development contribution, the following sources of funding are also used for the development of land: assets generated from selling or leasing out construction land, assets generated from the conversion of the rental right to the right of ownership over construction land, as well as other funds (loans, bonds, etc.).³⁴⁶

Environmental protection charge

The Law on Environmental Protection prescribed that local governments may introduce the environmental protection and improvement charge on three completely different grounds.³⁴⁷ According to this Law, local governments determine the amount, deadlines, payers, the method of payment and subsidies for certain categories of payers, all pursuant to criteria set by the Government. They are also obligated to acquire approval of their charge-related ordinances from the Ministry for the Environment.

The first ground has to do with using residential buildings and apartments for housing, and with using commercial buildings, premises and land for the purpose of business activities. In this case, payers will be owners or lessees of property, and the amount is set according to the area of the property and paid monthly, up to the amount set by law. The Government prescribed that the basic criteria for determining the amount of this charge is the used area within the residential building or business premises, as well as

that the maximum amount of the charge is 1, 3, or 0.5 dinars per square metre, depending on the type of structure.

The second ground deals with performing certain activities with impact on the environment, as defined by the Government. The charge is to be paid by legal entities and entrepreneurs that perform certain activities. The Government prescribed that the basic criterion for setting the amount of this charge is the income generated from activities with impact on the environment, that is from selling raw materials, semi-finished products and finished products. The highest amount of the charge in this case may not exceed 0.4% of the annual generated income.

The third ground is the transport of petrol, petrol derivatives, raw materials, finished and semi-finished products made of chemicals and other hazardous industrial materials on the territory of a local government with the status of a protected environmental area. Payers will be owners of freight vehicles and natural persons and legal entities involved in transport. The basic criteria for setting the amount of the charge in this case are the bearing capacity of the transport vehicle exceeding 5 tons and the weight of transported goods, while the maximum amount of the charge may not exceed 100 dinars per ton.³⁴⁸

If one natural person or legal entity is obligated to pay the charge on multiple grounds, the maximum amount of the charge must not exceed 0.4% of the annual generated income. Revenues from this charge are earmarked and are to be used exclusively for environmental protection and improvement programmes, in accordance with strategic and action plans.

As can be seen from the grounds and criteria for determining the charge, the legal nature of this charge, in the first case, is a form of a property tax. In the second case, it is essentially a type of income tax, whereas only in the third case can it be said that this is in fact a charge on exploitation, or the protection of public goods. That is why every sub-category of this charge should be reformed differently. First, a part of the charge can be integrated into the property tax by increasing the tax rate, thus covering the amount generated on the first ground. Second, the part of the charge generated according to the second ground may be integrated with some future form of a local tax on business activity. Third, the part of revenue generated based on the third ground may be integrated into the shared environmental pollution charge by increasing the local government share in this charge from 40% to 50%.

Communal charge

The 2011 Law on Utility Services³⁴⁹ prescribes in Article 24 that funds for financing utility services are to be, among other sources, provided by the communal charge. The purpose of this charge is to provide funds to finance utility services in cases where end users cannot be identified. When this Law was drafted, local governments requested the establishment of revenue that would enable them to finance utility services from which either the entire community or some parts of it benefit (e.g., villages or settlements), such as zoo-hygiene services, the maintenance of parks and green areas, public lighting, etc.³⁵⁰ The experiences of cities and municipalities have shown that citizens often demand that the scope of these services be expanded and that they are willing to pay more for them, but there is no legal ground to allow local governments to charge for such expanded services.³⁵¹ General budget funds are often insufficient to cover the financing of these services, especially if these are additional services, exceeding standards and plans, and/or services that are not provided to the entire community, but only to certain parts. Such utility services cannot be financed from the standard price because prices target specific end users of a certain utility service. Article 27 of the Law on Utility Services stipulated that the Government decision outlines the payers in detail, the grounds for the calculation of the amount, the criteria for setting the amount and the highest amounts of the charge, as well as the collection, exemptions and other important issues pertaining to the communal charge. This article also sets forth that local government units are to adopt ordinances defining zones, the coefficient and other issues of significance to setting the charge and its collection. However, the Government never adopted the necessary bylaws to define the communal charge in detail, so it never came into force.

Concession charge

The Law on Local Government Finance prescribes that revenue from concession charges is also one of the local governments' own-source revenues. This issue is more closely regulated by Article 43 of the Law on the Public-Private Partnership and Concessions,³⁵² which stipulates that the concessionaire, that is the concedent (grantor), is obligated to pay a charge for the concession in the amount and manner defined by the public concession contract, unless paying the concession charge is economically unjustified. The concession charge includes the charge on the use of the common good in question, which is set pursuant to the specific law regulating the use of that particular good. However, given that concession contracts are almost non-existent in practice,³⁵³ local governments do not generate revenue from concession charges. This is confirmed by data from the budgets of the City of Belgrade and the Municipality of Paraćin.

4.3.4.3.1 Conclusions and recommendations on own-source charges

Analyses of each specific own-source charge (with the exception of the concession charge) point to similar conclusions – almost none of these are, in fact, charges on the use of common goods. Due to fairness and economic efficiency, it would be better to replace these charges with certain types of communal taxes. More precisely, those could be communal surtaxes on the property tax or on the business activity tax, which would enable local governments to finance specific mandates. The first such tax would be a communal tax on infrastructure or a surtax on the property tax in order to achieve added land and real estate value capture in various cases: a) the construction of new settlements, b) informal settlements, c) the already built-up urban areas. The second tax could be a communal business activity tax, with a surtax to target activities with a negative impact on the environment. The third form could be a special surtax on the property tax, which could finance specific utility services where end users cannot be identified precisely (public lighting, zoo-hygiene, the maintenance of parks and green areas, etc.), with a limitation that such a surtax can only be imposed by local governments in specific settlements and parts of the community where there is an expressed demand for additional utility services.

Table 9 contains an overview of changes in the local government own-source charges system in the observed period.

OWN-SOURCE CHARGES		
2006 LLGF	Current LLGF Solution	Note
<ul style="list-style-type: none"> - Environmental protection and improvement (EPIC) - Construction land use (CLUC) - Construction land development (CLDC) - Revenues from the concession charge on performing utility services and other concessionary activities 	<ul style="list-style-type: none"> - Public asset use charges, pursuant to law - Other charges, pursuant to law - Concession charge 	<ul style="list-style-type: none"> - The construction land use charge was abolished on January 1, 2014. - The construction land development charge was transformed into a “contribution” and the criteria for setting the amount were changed on January 1, 2015. - The communal charge was never imposed, since the Government failed to adopt bylaws necessary for determining the amount of the charge. - The concession charge is almost non-existent in practice.

4.3.4.4 Property tax

Decentralisation of the property tax occurred in 2006, when the Law on Local Government Finance included the property tax in own-source revenues of local governments and delegated the right to determine, collect and control the tax in its entirety to local authorities.³⁵⁴ Cities and municipalities were granted the right to set the tax base autonomously, that is, to determine the value of real estate, in the manner set forth by the Law on Property Taxes and relevant bylaws, as well as the property tax rate within the limits stipulated by the Law.³⁵⁵ Upon the adoption of the LLGF, local governments focused their activities on establishing local tax administrations, forming new databases of property tax payers, improving control and the enforced collection of the tax, etc.³⁵⁶

Arsić et al. note that, in the period between 2006 and 2011, revenues from the property tax increased by 46%, while their share in the total revenues of local governments in the same period increased from 4.79% to 7.42%.³⁵⁷ The impact of the property tax on local budgets increased in particular after 2009, when cities and municipalities resorted to mobilising and improving the administration of this own-source revenue due to the economic crisis and the unpredictable intergovernmental fiscal policy of the central government. In the previous sections, we showed that after January 1, 2014, that is, after the abolition of the construction land use charge, the relevance of the property tax increased drastically. As the analysis has shown, revenues generated by the natural person property tax increased in Belgrade by 60%, whereas revenues from the legal entity property tax increased by as much as 241% compared to 2013. In Paraćin, revenues from the natural person property tax increased by 68.5%, but in the case of the legal entity property tax, revenues increased by only 1.5% compared to 2013.

When it comes to this tax, it is important to note a few key aspects and shortcomings in existing legal solutions. The first has to do with the tax base. Namely, for taxpayers who do not keep accounting books, the tax base is equal to the value of real estate determined by the local government authority.³⁵⁸ Real estate value is calculated by multiplying the useful area of the structure or land with the average price of a square meter of comparable real estate in the same zone. Local governments must define at least two zones within their territories, and zoning is done according to the type of settlement, the infrastructure development of land, , traffic infrastructure and other public structures and facilities in zones. The local government authority sets the average price of comparable real estate per zone based on prices reached on the market within the year in question.³⁵⁹ The Law kept the concept of amortisation in the calculation of the tax base. Real estate value may be decreased on account of amortisation at the annual rate of 1%, but not by more than 40% compared to the year of construction or the most recent reconstruction of the structure.³⁶⁰ Arsić et al. recommend the total abolition of amortisation, so that the tax base can be as close as possible to the market

value of real estate. In case there were less than three transactions of comparable real estate within one year, the price would be based on the average prices reached in bordering zones with at least three transactions of comparable real estate (regardless of where these zones are located).³⁶¹ However, in numerous local governments, there was the issue of determining the base and price in zones, as no real estate was bought/sold in the municipality in question or in any of the neighbouring municipalities. Within the same context, a particular problem was determining the prices for business premises and other non-residential real estate.³⁶² Such cases require more detailed legal regulation for determining the base and the value of real estate and for weighting the principles for the calculation of the average price.

The second important aspect is related to taxation of legal entities. Amendments to the Law on Property Taxes adopted in 2013 introduced one significant novelty. The property tax base for tax payers with accounting books is no longer any accounting value of real estate (which underestimated the base drastically). Instead, the accounting value can be the property tax base only if a tax payer assesses the property in the books according to the fair (market) value, in line with international accounting standards.³⁶³ According to this new model, taxpayers themselves state the amount of their tax obligations and submit their tax returns to local governments. In addition, legal entities that assess their property according to the fair value are obligated to check the value of their real estate annually, in order to receive an annual audit report. If legal entities assess their property in the books according to the cost method, they calculate their tax base by using the average values, which natural persons use when calculating their property tax. Companies take this checked value of real estate and apply the tax rate, thus conducting self-taxing. Since 2014 was the first year that this new legal entity taxation model was applied, the first effects of the implementation of the Law will not be seen before 2016. Therefore, the newly established system does not discriminate against natural persons compared to legal entities when it comes to the tax base. However, when it comes to the tax rate, it is still not equal for natural persons and legal entities. Namely, natural persons pay higher property tax rates than legal entities. Taxpayers who keep accounting books pay a tax rate of up to 0.4% for their real estate, whereas those without accounting books pay a tax rate of up to 0.3% for the land. When it comes to other types of real estate, i.e. structures on the land, taxpayers without accounting books (including natural persons) pay a progressive tax rate: up to 0.4%, up to 0.6%, up to 1% and up to 2%, depending on the value of real estate. It remains unknown how policymakers chose this solution and why rates imposed on businesses differ so much from those paid by citizens. It is interesting to note that all other levies that represent a heavier burden on businesses than on citizens are subject to constant pressure to be equalised and to reduce the burden on businesses, in order to improve the business environment. When it comes to property tax rates, there is no such tendency, since such a measure would mean an additional burden on businesses, given that it is

unrealistic to imagine a situation where the rate of the natural person property tax would be decreased.

4.3.4.4.1 Conclusions and recommendations on property tax

Regarding the property tax, it is important to point out several facts pertaining to its potential. Even without changing the existing legal framework, there is substantial manoeuvring space to improve the administration of this tax in at least two aspects:

- First, many local governments are yet to improve and update their records on real estate and taxpayers,³⁶⁴ meaning that registering unregistered real estate (expanding the base) can result in increasing the capture of taxable property;
- Second, local governments need to improve control and to maximise the collection rate of this tax.

Improving legal solutions that regulate the calculation of the base, the expansion of the taxable property capture, and the equalisation of the natural person and legal entity tax rates would, of course, lead to further growth of revenue generated by this tax. However, even though the property tax potential is exceptional, it cannot replace or incorporate in itself all other revenues and enable the financing of the implementation of all or most (original) mandates of Serbian cities and municipalities. This is particularly impossible with the costly mandates and functions of local governments, such as pre-school education, certain mandates pertaining to elementary and secondary education, and primary healthcare. With such a distribution of functions between the central and local governments, it is necessary to develop a stable system of transfers and alternative adequate own-source revenues.³⁶⁵

4.3.4.5 General conclusions on own-source revenues

As is the case with transfers and shared revenues, the domain of own-source revenues underwent substantial changes in terms of its legal framework in the period between 2009 and 2015, mostly without the participation or significant impact of local governments on the legislative and policy-making processes that directly compromise their fiscal autonomy. Measures taken by the central government were mostly of an ad hoc character. They treated certain types of local government own-source revenues partially, without a comprehensive overview of the impact such measures may have on city and municipal budgets and without adequately compensating for lost or reduced revenues.

The total losses that local budgets incurred due to the abolition or reform of certain communal fees (and certain shared charges) in September 2012 amounted to around 6 billion dinars in the whole country. The property tax underwent significant reform in 2013, but not in a way that would compensate for the losses that resulted from the

abolition of the construction land use charge. The charge was abolished on January 1, 2014. According to some estimates, the total loss of all local governments in Serbia (excluding increased revenues from the property tax) amounted to around 14 billion dinars, which is the value that had not been netted. After that, on January 1, 2015, the construction land development charge was significantly changed. The total effects of this change will not be visible before 2016. The communal charge, which was supposed to partially compensate for losses incurred due to the abolition of the construction land use charge, never really gained momentum.

Table 10 summarises the changes that took place between 2009 and 2015 in the area of own-source revenues.

OWN-SOURCE REVENUES	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TAXES	Property tax	The same	Amendments to the Law on Property Taxes from May 2013 considerably improved the way the tax base is calculated (real estate value) for both payers who do not have accounting books (including natural persons) and payers who have accounting books.
FEES	- Local administrative fees	- The same	- The Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services was adopted in 2013, but it is rarely applied.
	-Local communal fees (LCF) Article 15 set forth 16 types of LCFs.	- Article 15 sets forth 8 types of LCFs.	- The LLGF was amended on September 28, 2012 and came into force on October 1, 2012. - Seven LCFs were abolished, two were merged into one, and three LCFs were substantially reformed (maximum amounts of fees were capped).
CHARGES	Article 6: - Environmental protection and improvement (EPIC)	Article 6: - Public asset use charges, pursuant to law - Other charges, pursuant	- The construction land use charge was abolished on January 1, 2014.

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	<ul style="list-style-type: none"> - Construction land use (CLUC) - Construction land development (CLDC) - Revenues from the concession charge on performing utility services and other concessionary activities 	<p>to law</p> <ul style="list-style-type: none"> - Concession charge 	<ul style="list-style-type: none"> - The construction land development charge was transformed into a “contribution” and the criteria for setting the amounts were changed on January 1, 2015. - The communal charge was never introduced because the Government never adopted the necessary bylaws for determining the amounts of the charge. - The concession charge is almost non-existent in practice..
OTHER REVENUES	<ul style="list-style-type: none"> - Self-contribution - From leasing out state-owned real estate used by local government units (LGU) - From selling movable property used by LGU - From donations - From interests on LGU budget assets - Revenues generated by LGU activities - From monetary fines for misdemeanours regulated by LGU ordinances, as well as confiscated property 	<ul style="list-style-type: none"> - Self-contribution - From leasing out state-owned real estate or movable property used by local government units (LGU) - From leasing out LGU-owned real estate and movable property used by local government units (LGU) - From donations - From interests on LGU budget assets - Revenues generated by selling services of LGU budget users - From monetary fines for misdemeanours regulated by LGU ordinances, as well as confiscated property 	<ul style="list-style-type: none"> - It is unclear why the new provisions do not include revenue from the sale of property owned by the LGU, among other revenues.

Finally, Table 11 presents a summary of all legal changes that have occurred in the local government finance system since the adoption of the LLGF in 2006 until today (December 2015):

OWN-SOURCE REVENUES	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TAXES	Property tax	-The same	-Amendments to the Law on Property Taxes from May 2013 considerably improved the way the tax base is calculated (real estate value) for both payers who do not have accounting books (including natural persons) and payers who have accounting books.
FEES	-Local administrative fees	-The same	-The Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services was adopted in 2013, but it is rarely applied
	- Local communal fees (LCF) Article 15 set forth 16 types of LCFs.	- Article 15 sets forth 8 types of LCFs	- The LLGF was amended on September 28, 2012 and came into force on October 1, 2012. - Seven LCFs were abolished, two were merged into one, and three LCFs were substantially reformed (maximum amounts of fees were capped).
CHARGES	Article 6: - Environmental protection and improvement (EPIC) - Construction land use (CLUC) - Construction land development (CLDC) - Revenues from the concession charge on performing utility services and other concessionary activities	Article 6: - Public asset use charges, pursuant to law - Other charges, pursuant to law - Concession charge	- The construction land use charge was abolished on January 1, 2014. - The construction land development charge was transformed into a "contribution" and the criteria for setting the amounts were changed on January 1, 2015. - The communal charge was never introduced because the Government never

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			<p>adopted the necessary bylaws for determining the amounts of the charge.</p> <ul style="list-style-type: none"> - The concession charge is almost non-existent in practice.
OTHER REVENUES	<ul style="list-style-type: none"> - Self-contribution - From leasing out state-owned real estate used by local government units (LGU) - From selling movable property used by LGU - From donations - From interests on LGU budget assets - Revenues generated by LGU activities - From monetary fines for misdemeanours regulated by LGU ordinances, as well as confiscated property 	<ul style="list-style-type: none"> - Self-contribution - From leasing out state-owned real estate or movable property used by local government units (LGU) - From leasing out LGU-owned real estate and movable property used by local government units (LGU) - From donations - From interests on LGU budget assets - Revenues generated by selling services of LGU budget users - From monetary fines for misdemeanours regulated by LGU ordinances, as well as confiscated property. 	<p>-- It is unclear why the new provisions do not include revenue from the sale of property owned by the LGU, among other revenues.</p>
SHARED REVENUES	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TAXES	<p>Personal income tax:</p> <ol style="list-style-type: none"> 1. Wages (40%) 2. Income from individual business activity (100%) 3. Income from agriculture and forestry (100%) 4. Real estate rental income (100%) 5. Proceeds from leasing out movables (100%) 6. Proceeds from personal insurance (100%) 	<p>Personal income tax:</p> <ol style="list-style-type: none"> 7. Wages (80%, 70% for the City of Belgrade) 8. Income from individual business activity – the same 9. Income from agriculture and forestry re-categorised as income from individual business activity 10. Real estate rental income tax re-categorised as proceeds from capital, thus becoming national budget revenue 11. Proceeds from leasing out movables – the same 	<ul style="list-style-type: none"> - Amendments to the LLGF that increased the share of local governments in the wage tax were adopted on June 29, 2011, and came into force on October 1, 2011. - Amendments to the Law on the Personal Income Tax, which deprived local governments of revenues generated by the tax on real estate rental income, were adopted on May 29, 2013, and came into force on August 1, 2013 (retroactively)

		12. Proceeds from personal insurance re-categorised as wages	from June 1, 2013, instead of from January 1, 2014). After a public discussion, money was returned to local governments and the implementation started when it should have – on January 1, 2014.
	Tax on inheritance and gifts	-The same	
	Tax on the real estate transfer	-The same	
CHARGES	Article 36 of the LLGF: 1. Annual charge on motor vehicles, tractors and towed vehicles; 2. Charge on environmental pollution; 3. Charge on using raw minerals; 4. Charge on material exploited from watercourses; 5. Charge on the exploitation of forests; 6. Charge on the exploitation of waters; 7. Charge on agricultural land conversion; 8. Charge on the use of the natural healing factors; 9. Tourism charge; 10. Other charges in line with the Law.	Article 36 of the LLGF, amended in 2012, reads: “The Republic shares with local government units revenues generated on the territory of local government units, according to the Law.”	Amendments to sectoral laws abolished the following charges in 2010 and 2012: 1. Annual charge on motor vehicles, tractors and towed vehicles; 2. Part of the environmental pollution charge pertaining to motor vehicles; 3. Charge on material exploited from watercourses; 4. Charge on the exploitation of waters; 5. Tourism charge; 6. Annual charge on other motor vehicles; 7. Charge on the construction of commercial premises with access to municipal roads, if LGU authority is in charge of the road; 8. Charge on the excessive use of municipal roads and streets, their part or section, if LGU authority is in charge of the road; 9. Charge on the connection of access roads to municipal roads and streets, if LGU authority is in charge of the road;

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			10. Charge on drained water. 11. The charge on the use of the natural healing factors was never implemented.
TRANSFERS	LEGAL SOLUTION FROM 2006	CURRENT LEGAL SOLUTION	NOTE
TOTAL NON-EARMARKED TRANSFERS (TNT)	TNT amounts to 1.7% of the realised GDP according to the most recent data published by the Statistical Office of the Republic of Serbia	TNT represents a calculation category for the allocation of funds to local government units (LGU) and amounts to 1.7% of the realised GDP according to the most recent data published by the Statistical Office of the Republic of Serbia (2011). The amount of the non-earmarked transfer per LGU is calculated by multiplying the sum of the equalisation, compensation and general transfers by the development coefficient of the LGU in question (2011).	Suspension of TNT provisions in May 2009, in the middle of the budget year, which had an immediate effect. Suspension extended until July 2011. Amendments to the LLGF in 2011, in the middle of the budget year (June 29, 2011), came into force on October 1, 2011: - TNT is a calculation category; - Non-earmarked transfer per LGU is multiplied by the LGU's development coefficient; - Solidarity transfer introduced.
	Equalisation transfer	-The same	Amendments to the LLGF in 2012, in the middle of the budget year (September 8, 2012), came into force on October 1, 2012: - Formula introduced for the redistribution of funds to LGUs within one development group, together with additional rules for the redistribution of funds among LGUs within the 1 st and 2 nd development category. The LLGF suspended
	Compensation transfer	-The same	
	Transition transfer	-Abolished	
	General transfer	-The same	
		Solidarity transfer – non-earmarked transfer for the City of Belgrade is abolished and its funds are redistributed to other LGU, where percentages depend on the development	

		level of the LGU (2011, 2012)	
EARMARKED TRANSFERS	Functional transfer	-The same	once again in late 2013, which came into force on January 1, 2014. (The Law on the Budget of the Republic of Serbia for 2014): - Tying the non-earmarked transfer funds to the subsidy level in the LGU and a reduction by 30%. 2014 transfer amounts kept in 2015 (The Law on the Budget of the Republic of Serbia for 2015).
	Earmarked transfer in the narrower sense	-The same	

5 Institutional aspects

5.1 General overview

In order to achieve a more comprehensive understanding of fiscal decentralisation and local government financing in Serbia, it is important to analyse the existing institutional mechanisms of intergovernmental fiscal governance. In particular, it is necessary to analyse the role of local governments in the legislative and policy-making processes relevant to their financing and operation. In addition, it is essential to study the legal regulation of individual institutions and organisations, as well as their practical actions and behaviour. This will provide a complete picture of how the functional and financial decentralisation process is managed, allowing us to study the obstacles and opportunities for institutional change.

In the first chapter of the Serbia Case Study, we demonstrated that the main driver of fiscal decentralisation between 2001 and 2006 was the international donor community and not the central or local governments. The first crisis showed that fiscal decentralisation is not a strategic orientation of the state, as the central government drastically reduced the total amount of non-earmarked transfers to local governments in the first year of the economic crisis. The analysis pointed to several key deficiencies in the process of transferring competences and finances to the local level. First, the central government made decisions without a clear decentralisation strategy and a coordinated plan for the transfer of new functions and expenditures, making such decisions inconsistent, opportunistic, ad hoc and dictated by current political interests. Second, the central government's approaches to formulating policies and drafting legislation were mainly superficial. There are no adequate databases, records or integrated systems that would provide analytical support for decision-making, and these are mostly non-transparent even when they actually exist. So far, republic authorities have not

conducted adequate analyses of the costs of performing public functions³⁶⁶ or examined the fiscal impact of proposed regulations on the budgets of all government levels. Hence, there is a total absence of coherence between the transfer of competences and the funds necessary for their financing, leading to a vertical imbalance in the local government finance system. Third, there is a systemic lack of horizontal and vertical coordination in making public policies and preparing legislation relevant for local governments. Throughout this analysis, some 50 laws and a series of bylaws were identified that directly or indirectly regulate local government functions. According to estimates of the Standing Conference of Towns and Municipalities (SCTM), local governments will apply two-thirds of EU regulations from the 35 negotiating chapters, and it is estimated that in any legal system, about three-quarters of the regulations are to some extent implemented at the local level.³⁶⁷ However, the participation of local governments or associations of cities and municipalities in the legislative process now depends exclusively on the will and initiative of the state authorities. In the legal and institutional analysis of horizontal and vertical coordination in the decision-making process of importance for local government in 2010, Jerinić and Pavlović-Križanić concluded that: 1) the process of adopting strategic documents and regulations does not provide for a separate mandatory step involving the consideration of issues essential for local government; 2) there is no body at the central level to coordinate the adoption of documents and regulations of relevance to cities and municipalities. The Ministry of Public Administration and Local Government exclusively follows regulations within its purview, which are mainly related to the system of local government, but not to the delegation of functions and issues concerning finance. Jerinić and Pavlović-Križanić also concluded that 3) at the central level, there is no institutionalised method for the mandatory inclusion of local governments in the process of drafting regulations and decisions, while the involvement of local authorities is based on ad hoc practices of relevant ministries.³⁶⁸ Consequently, the authors maintain that this approach results in unenforceable regulations of insufficient quality, which cause implementation and enforcement problems in practice.³⁶⁹ The issue of bylaws can be particularly problematic. Namely, it regularly happens that the central government does not adopt the necessary bylaws that would regulate in more details the issues relevant for the practical implementation of laws. In addition, the process of adopting government decrees and other bylaws (rulebooks, instructions, etc.) does not require the organisation of public consultations or a regulatory impact analysis.³⁷⁰ Although Article 79 of the Law on Local Self-Government stipulates that local governments are to take part either independently or through their associations in the preparation of regulations relevant for their functioning,³⁷¹ this provision is not operationalised in other regulations that govern the legislative process and the procedures of adopting strategies and other important documents.³⁷²

This study did not examine the actual role and capacities of individual organisational units inside the Ministry of Public Administration and Local Government (MPALSG),

specifically the Department of Local Government, or the de facto role and capacities of individual organisational units inside the Ministry of Finance, in particular, the Unit for the System of Local Government Financing within the Department of the Budget.³⁷³ However, it is important to explain precisely what activities these organisational units perform according to the internal regulations of the Ministries.

In line with the Rulebook on Internal Organisation and Workplace Classification of MPALSG,³⁷⁴ the purview of the Department of Local Government includes participation in the preparation of the Decentralisation Strategy of the Republic of Serbia and monitoring national legislation of relevance for decentralisation. Inside this Department, the Division for Analytics provides opinions on laws and other regulations proposed by other government bodies, oversees the implementation of regulations, drafts analyses of the current state concerning a specific issue and so on, while the Unit for Decentralisation Coordination and Local Government Capacity Building, as indicated by its name, draws up the Decentralisation Strategy and coordinates the decentralisation activities, monitors the implementation of relevant legislation, and works on local government capacity building.

According to the Information Booklet on the Ministry of Finance,³⁷⁵ the Unit for the System of Local Government Financing, which is within the Department of the Budget, performs the following: conducts normative and analytical activities in the process of drafting legislation on local government financing; establishes transfers and additional funds from the national budget to local governments; analyses revenues and expenditures of local budgets; analyses municipal and city applications for additional funds from the national budget; analyses the local government ordinances on the budget, as well as the execution of local budgets; prepares instructions for bodies that implement regulations in the field of local government financing; coordinates activities of the Intergovernmental Finance Commission.

The purview of the Department of Local Government of the MPALSG and the Unit for the System of Local Government Financing shows that precisely these two organisational units are responsible for coordinating and managing the decentralisation of mandates (expenditures) and finances (revenue) to the local level. In addition, in the Republic of Serbia, there is a separate body tasked with supervising the decentralisation process - the National Decentralisation Council. There is also a body tasked with supervising the local government financing system - the Intergovernmental Finance Commission. European Commission progress reports for Serbia in 2012, 2013 and 2014 conclude that both institutions are inactive and that the state does not have a mechanism to monitor the transfer of functions and the necessary finances to municipalities or to assess the financial and other capacities of local governments.³⁷⁶ In the following paragraphs, we analyse these two separate bodies, as well as other institutions and organisations that play or may play a role in the fiscal decentralisation process.

5.2 National Decentralisation Council

Developments connected to the National Decentralisation Council are a typical example of the lack of a strategic orientation towards decentralisation and the shifting of the pendulum of political and legal discourse from decentralisation to centralisation and vice versa.

In March 2009, the Government of Serbia established the National Decentralisation Council,³⁷⁷ which is tasked with participating in the drafting of the Decentralisation Strategy of the Republic of Serbia in cooperation with the Ministry of Public Administration and Local Self-Government. According to the idea formulated by the Decision establishing this Council, the Council “takes part in preparing and drafting the Decentralisation Strategy of the Republic of Serbia in accordance with European standards and the experiences of developed European countries, as well as with the need to continue democratisation of Serbia through the decentralisation process.”³⁷⁸ In addition, the Council is tasked with studying the experience of other countries in the decentralisation process, examining the legislation of the Republic of Serbia that is essential for decentralisation, cooperating with international institutions and raising public awareness about the essence and benefits of decentralisation.³⁷⁹ Council members were mostly ministers and other officials, but the Council also had an Expert Working Group made up of professors and other decentralisation and local government experts. The Council, according to the Decision, should meet at least once a month. However, the European Commission progress reports for Serbia in 2012 and 2013 present the Council as a completely inactive body.

In October 2012, the Government of Serbia abolished the Council, only to re-establish it in May 2013.³⁸⁰ According to the new Decision, the Council coordinates and directs the preparation of the draft Decentralisation Strategy of the Republic of Serbia, as well as the activities connected to the preparation and implementation of the Decentralisation Strategy, by giving opinions, issuing recommendations, monitoring their enforcement and initiating the establishment of working groups for individual Decentralisation Strategy chapters.³⁸¹ In line with the new solutions, the Council has more members than under the earlier provisions – a higher number of ministers and more representatives of the Standing Conference of Towns and Municipalities. This Decision did not appoint members of the Expert Working Group. Instead, the minister responsible for local government issues is the one who appoints these members.³⁸² Also, according to the new provisions, the Council should convene at least once every three months. However, the European Commission progress reports for Serbia from 2013 and 2014 indicate that this body still remains inactive and that there is no institutional mechanism at the central level to monitor the decentralisation process of competences and finances.

5.3 Intergovernmental Finance Commission

The Intergovernmental Finance Commission was established in 2006 by the Law on Local Government Finance (LLGF) to ensure fairness, efficiency and transparency of the city and municipal financing system and to make recommendations for its improvement.³⁸³ The Commission has ten members appointed for a period of five years; the Government appoints five members,³⁸⁴ while the Standing Conference of Towns and Municipalities (SCTM) appoints the other five. The Chairman of the Commission should convene a meeting at least once every three months. The Ministry of Finance performs technical and administrative tasks for the Commission, while it also has an obligation to submit local government revenue and expenditure data from the previous year to the Commission and the SCTM no later than April 30th of the current year. In addition, relevant ministries and other public bodies have an obligation to deliver data on all transfers made to local governments, which should be broken down by purpose and local government unit, to the Ministry and the Commission no later than April 30th.³⁸⁵

The LLGF lays down the precise tasks of the Commission. Thus, it should:

- Analyse the system of establishing and awarding non-earmarked and earmarked transfers;
- Monitor the vertical and horizontal uniformity of the system, as well as the local governments' debt levels, and prepare annual reports about these issues no later than May 30th for the previous fiscal year;
- Draft proposals to amend and improve the system of local government financing.

As one may guess, a disadvantage of this solution is that the Intergovernmental Finance Commission is only a consultative body whose decisions are solely of an advisory character. It makes recommendations and drafts proposals for improving the system of municipal financing. Another problem is that the Commission has yet to convene, although there has been a strong need for cooperation between the Ministry of Finance and local governments. Even when there was dialogue between the central and local government, it took place through the association of local governments (SCTM), rather than through the institutions established to deal with local government financing issues. According to some representatives of cities and municipalities, the central government did not have any interest in making the Commission operational and there was always a tendency to circumvent it.³⁸⁶ The Commission's activities have long been stalled due to frequent changes in the organisational structure of the Ministry of Finance. Hence, the Commission has been without a chairman for a long time and it has not performed its planned tasks. From 2009, when cities and municipalities began having financial problems, until 2015, the Commission convened only five times.³⁸⁷ Thus, it did not have the opportunity to take part in the drafting of laws and bylaws. The government and the Ministry of Finance have never consulted the Commission when preparing amendments

to the laws vital for municipal and city finance. Due to a lack of institutional dialogue, local governments have fought for their own interests through the association of local governments (SCTM) in situations when their financial stability was threatened.³⁸⁸

5.4 Fiscal Council

Under the Law on Budget System, the Fiscal Council was established as an independent state body accountable to the National Assembly.³⁸⁹ Among other things, the Fiscal Council: checks the macroeconomic and fiscal assumptions used to draft the Government Fiscal Strategy; provides an independent and credible assessment of economic policy measures proposed by the Government aimed at achieving quantitative fiscal targets set by the Government; assesses the basic fiscal risks and the likelihood that the Government will meet its fiscal targets in the future; provides its opinion to the draft of the Fiscal Strategy; produces and submits analyses of the draft budget laws of the Republic of Serbia to the National Assembly, which also include proposals for budget revisions, as well as amendments submitted during parliamentary debates; produces and submits analyses of the laws on the annual financial statement of the Republic of Serbia, as well as the consolidated balance sheet of the general government to the National Assembly; prepares and submits estimates of fiscal impacts of other draft laws and amendments submitted during parliamentary debates to the National Assembly.³⁹⁰

Of particular importance is the provision of the Law on Budget System that establishes the right of the Fiscal Council to request information and data from ministers and all public sector entities (including public enterprises) that is needed for economic and fiscal analyses and forecasting. In the event that the above entities fail to submit the requested information, the chairman of the Fiscal Council notifies the National Assembly about this failure.³⁹¹

The Intergovernmental Finance Commission and the Fiscal Council do not have any legal-institutional relationship, and they have never had any informal consultations with each other. The Fiscal Council has on several occasions dealt with issues concerning local government finances. First, in June 2011, the Council prepared the Analysis of the fiscal effects of the decentralisation model, which the parliamentary group United Regions of Serbia proposed to the National Assembly. In it, the Council analysed the fiscal effects of the proposed amendments to the Law on Local Government Finance, Law on Agricultural Land and the Law on Property Taxes.³⁹² This analysis was discussed in the section that dealt with shared revenues. Second, in March 2013, the Council prepared an Assessment of the situation and the prospects of fiscal decentralisation in 2013, with the aim of finding an optimal solution for the deficit in the budget of the Republic.³⁹³ Third, in May 2013, the Fiscal Council assessed the effects of tax legislation on individual local government revenue in its public finances

stabilisation proposal, showing aggregate projections of local government revenues from wage taxes and non-earmarked transfers from the budget of the Republic.³⁹⁴ In its analyses, the Fiscal Council dealt with issues of local finances primarily from the perspective of the national budget, looking for ways to save in order to reduce the national budget deficit. Given that fiscal rules also apply to local governments, the Fiscal Council might be an appropriate institution to supervise the financing system of local government mandates and to monitor vertical and horizontal balances in local budgets. This would mean that the Fiscal Council would need to take over the functions and responsibilities of the Intergovernmental Finance Commission.

5.5 Standing Conference of Towns and Municipalities

The Standing Conference of Towns and Municipalities (SCTM) is an association of local authorities founded more than 60 years ago.³⁹⁵ When the international donor community launched the first fiscal decentralisation initiatives after 2000, it recognised the SCTM as an adequate partner in this process. With extensive technical and financial support of international donors, this association has become stronger institutionally, building significant internal capacities for formulating and representing the interests of local governments in the decentralisation process. This organisation has managed to unite all local governments in Serbia, regardless of their size, financial capacity and development level, geographical position, demographic and ethnic structure, and the political affiliation of their leadership. Local government representatives recognised the SCTM as an organisation whose bodies facilitate the formulation of common positions on all issues of importance to local governments. The SCTM also advocates for and represents the interests of its members in the central government.

Article 89 of the Law on Local Self-Government³⁹⁶ states that local governments may establish their associations to promote the development of the local government, its protection and the achievement of common interests. Local government associations represent the interests of their members before state bodies, especially in the process of preparing laws and other acts essential for the protection, promotion, financing and realisation of activities of local governments. However, the Law on Local Self-Government does not contain any specific criteria on the representativeness of local government associations or any special rights and obligations of these associations. Therefore, the Law does not recognise the SCTM as a representative association. On the other hand, the Law on Local Government Finance recognises the SCTM as a relevant player, since the provisions on the Intergovernmental Finance Commission state that the SCTM is to appoint five out of the ten members of the Commission. Moreover, Article 54 of this Law obligates the Ministry of Finance to submit local government revenue and expenditure data to this association.³⁹⁷ The involvement of the SCTM in drafting laws and documents of the Government depends solely on the initiative and the willingness of state bodies to ensure the participation of this association in a given

process. When it comes to laws, particularly laws of special importance for the local government system, the relevant ministries generally actively include the association in the preparation of these regulations. However, when it comes to bylaws, the participation of the SCTM in the drafting process is generally not ensured.³⁹⁸ Therefore, it is necessary for the Law on Local Self-Government to include specific criteria for the representativeness of local government associations and to also institutionalise representative associations, including their rights and obligations. The Law should also establish an obligation for state bodies to deliver the draft versions of laws and bylaws to these associations. Furthermore, provisions on the participation of representative local government associations should also be present in other regulations that govern the legislative and the policy-making process, including the adoption of strategic and other documents of state bodies.

5.6 Parliamentary Committees

The National Assembly of the Republic of Serbia has permanent working groups whose role is to consider draft laws and other acts, guide the Government's policies, monitor the enforcement of laws and other general acts of the Government and other state bodies, as well as discuss other important issues in the competence of the National Assembly.³⁹⁹ There are two relevant bodies of importance to local government issues:

The Committee on Justice, Public Administration and Local Government, which primarily deals with constitutional and administrative matters, i.e., issues of importance to the local government system;

The Committee on Finance, the Budget of the Republic and the Control of Public Spending is, as the name suggests, tasked with supervising public finances and assessing draft laws and other acts related to local public finances. Within this committee, in June 2015, a Working Group tasked with introducing and developing the Public Finance Supervision Portal was formed, whose goal is to strengthen the supervisory functions of the Parliament and to increase the transparency and accountability of public spending.⁴⁰⁰ The development of the Portal involves linking it with the system and databases of the Treasury Department of the Ministry of Finance.

An examination of the actual role of these committees in the legislative process would require a separate analysis of the reports on their activities related to the assessment of draft laws and other acts significant for local government issues.

5.7 Conclusions and recommendations

Following the analysis of legal regulations, institutional mechanisms and governance in the field of delegating mandates and financing local governments, it may be concluded

that there is a systemic lack of horizontal and vertical coordination in the policy-making and legislative processes in Serbia. Therefore, the central government authorities, together with the lower levels of government, should establish functional institutional mechanisms for:

- Strategic planning and implementation of the decentralisation of mandates and finances, and the oversight of this process;
- Analysis of the impact of delegating new or additional mandates (expenditures) to local budgets;
- Establishing a vertical balance inside the local finance system in order to ensure that local governments have (receive) necessary resources to fund new or additional mandates (expenditures).⁴⁰¹

To ensure this, it is necessary to establish appropriate databases and records, as well as to upgrade and integrate the existing (local) public revenue and expenditure systems and to make them transparent. These databases should serve as analytical support for making informed decisions. Based on these data, the responsible bodies should analyse the costs of performing public functions and the fiscal impact of proposed regulations on the budgets at all government levels. Furthermore, the decisions of these bodies should be binding, not advisory. Regulations that govern the process of policy- and decision-making (the preparation of strategies, laws, bylaws and other acts) should operationalise the participation of these institutions and the lower levels of government in these processes. This would make hasty ad hoc solutions that are not based on regulatory impact analyses impossible and ensure that professional bodies provide quality opinions on the proposed regulations and decisions in a timely manner.

However, the question is how to strengthen the role of the Intergovernmental Finance Commission, if there is no political will and interest in having this kind of body perform analytical tasks (for which it would need to obtain necessary data from relevant bodies), supervise the municipal and city financial system, and assist the Ministry of Finance in making decisions. If the finance ministers are not interested in having a professional body that enables institutionalised dialogue between the central and local government, as well as a systematic way of monitoring local public finances, the question is whether, in such a context, any other institutional mechanism could be operational. Similarly, if there is no continuous, joint pressure of local governments on the central government to ensure the functioning of institutions and the enforcement of law, then it may be concluded that the system is characterised by a complete absence of political will. Therefore, we can conclude that the reason for non-functional institutions is apparently the lack of the rule of law.⁴⁰² On the one side, there is a lack of political will to enforce the law, and on the other side, there is the absence of political will to raise the issue of responsibility of those who flout or violate laws. This also means that local governments find alternative, non-institutional means of materialising their interests. One mechanism is of a bilateral nature and is realised through direct partisan contacts of

local governments with central government representatives. Another mechanism is advocacy and lobbying for local government interests through the association of local governments– the SCTM. Therefore, the Law on Local Self-Government should contain specific criteria for the representativeness of local government associations, together with special provisions on the rights and obligations of such associations. The law should institutionalise representative associations and establish an obligation of state bodies to submit drafts laws, regulations and other documents in a timely manner to these associations before submitting any regulation or document further. These provisions must also exist in other regulations that govern the legislative and policy-making processes or the adoption of strategic and other documents of state bodies.

An independent body outside the system of state administration, which would answer directly to the National Assembly, should take over the functions and tasks of the Intergovernmental Finance Commission. The Fiscal Council could be an adequate institution to supervise the system of financing local government mandates and to monitor the vertical and horizontal balances inside the system of local public finance, as an integral part of the state system of public finance. Under this arrangement, the Fiscal Council should have a legal and institutional liaison with the SCTM.

The MPALSG should take over the role of the national decentralisation process coordinator. This ministry would be responsible for the preparation of the decentralisation strategy and the annual action plans for delegating mandates and funding to the lower levels of government, together with the Ministry of Finance, other ministries and central government bodies, the SCTM and the Fiscal Council (in the role of the Intergovernmental Finance Commission), as well as for the coordination and supervision of the entire decentralisation process.

6 Conclusions

This study focused on the analysis of the Serbian legal framework regulating fiscal decentralisation, intergovernmental fiscal governance and local government financing in the period between 2005 and 2015, as well as on the analysis of the impact that certain regulatory changes have had on local government budgets. The study evaluated the legal quality of relevant fiscal regulations and the economic effects of these regulations on city and municipal budgetary revenues and expenditures.

The study identified the main obstacles in the decentralisation process and crucial shortcomings in both institutional mechanisms for intergovernmental fiscal governance and the very setup of local government financing. The study has showed that the Republic of Serbia has renounced the idea of fiscal decentralisation. Its manner of governing the local government financing system resulted in the collapse of local finance and a dramatic decrease of both the budgets and the significance of cities and

municipalities. The study also offered specific recommendations for improving the quality of intergovernmental fiscal governance and the model of local government financing.

Based on the detailed analysis conducted as part of this study, a series of relevant conclusions can be made.

First, we may conclude that we can clearly identify two phases of financing local government mandates in Serbia:

- The first phase of fiscal decentralisation lasted from 2001 to 2008, during which the Republic adopted regulations of key importance for local governments. During this period, the role of cities and municipalities grew more significant, as did their fiscal autonomy. The Republic delegated a number of important mandates to local governments, including public functions in the social sector, while there were also many increases in local budgets.
- The second phase was the fiscal centralisation and pseudo-decentralisation phase, which lasted from 2009 to 2015. It is characterised by the continuous suspension of certain provisions of the crucial law regulating local government finance, as well as frequent changes of this and other regulations, all leading to the collapse of the system of local government financing and substantial decreases of local budgets. Certain measures of the central government were in line with decentralisation processes, but they were soon annulled by new centralistic solutions. Poor, nonstrategic and disconnected governance of functional and financial decentralisation led to a vertical imbalance between local revenues and expenditures.

Second, the legal framework of the local government financing system in Serbia is characterised by a complete absence of stability, predictability and legal and financial certainty. The legal analysis showed that legal changes were very frequent, which had rather radical and immediate effects. Such ad hoc decision making of the central government resulted in drastic changes in the framework within which local governments in Serbia operate, particularly when it comes to financing capital investments. In fact, financial management at the local level became management of crises.

Third, the very same ad hoc character of decentralisation and the system of financing cities and municipalities confirms that the state has no strategic plan and systematic approach to decentralisation. In other words, decentralisation and the reform of local government financing have not been perceived as one of the state's strategic and political priorities. As soon as the first wave of the crisis set in, the Republic gave up on the idea of fiscal decentralisation and jeopardised the financial stability of local governments. Given that the state has been faced with serious financial hardships since

2009, its focus has been on the national budget. The Republic, in fact, sometimes fails to recognise local government budgets as an integral part of the public finance system, and it resorts to using them in order to achieve balance in the national budget. This testifies to a lack of political awareness of the importance and role of local governments, which are often treated as parastatal bodies, instead of as an integral part of the state. We can also conclude that the Republic's commitment to the concept of decentralisation is to an extent formal. The final effect of the entire process is an even higher level of centralisation and a compromised process of fiscal decentralisation in Serbia.

Fourth, the central government's lack of planning in managing local government financing, coupled with legal uncertainty and unpredictability, resulted in a vertical imbalance between local budgets' revenues and expenditures. On the revenue side, changes of the legal framework in the period between 2009 and 2015 had been so frequent that they are too difficult to even track. Our research identified 11 significant changes impacting the revenue side, all resulting in reductions in local budgets. When it comes to the expenditure side, that is, to delegating mandates and new costs to the local government level, decisions of the central government have been characterised by inconsistency and opportunism, and they have been uninformed, without any foundation in financial analyses. In the legislative and public policy-making processes that affect local governments, the central government had never prepared analyses of the fiscal impacts these decisions would have on local government budgets. An utter lack of consistency between the policy of transferring mandates (expenditures) and the policy of transferring resources necessary for financing these mandates (revenues) has, over the last years, led to a vertical imbalance in the local government finance system. It is particularly important to note that this manner of governing functional and fiscal decentralisation, that is, of transferring mandates and finances, is contrary to the laws of the Republic of Serbia, to the European Charter of Local Self-Government, which Serbia ratified, as well as to the Council of Europe's Recommendations on Financial and Budgetary Management at Local and Regional Levels and on Financial Resources of Local and Regional Authorities.

Fifth, the absence of a systematic approach to local government financing is also reflected in the low-quality and excessive legal framework regulating the matter of local finance and mandates, as well as in the inadequate approach to drafting regulations and making policies. The matter of finance, i.e. local government revenue, is regulated by dozens of regulations. The fact that this matter is addressed in a plethora of laws and bylaws, the unsystematic and partial approach to regulating the local public revenue system, and the conflicting different laws led to complete legal uncertainty and non-transparency of the system. When it comes to local government mandates, the analysis showed that some 50 sectoral laws, together with a number of bylaws, regulate functions of the local government. In addition, one of the major flaws in the system is

the fact that local governments are excluded from the processes of creating policies and legislation.

Sixth, the absence of a national strategic approach to the issue of local government financing, coupled with the instability and unpredictability of the legal framework and the reduction of local revenues, has resulted in other negative effects and consequences reflected in local government budgets and policies. Concretely, these include: substantial volatility of city and municipal revenues and expenditures; frequent liquidity problems; compromised capital projects and decreased investments; increased current expenses; accumulated arrears and debts to creditors; reduced creditworthiness and borrowing capacity; compromised delivery of local public services to citizens; and, finally, inability to focus on any kind of long-term planning. Examples presented in the analysis illustrate that such a practice of the central government also jeopardised local economic development, as it forced local governments to consider capital investments in a rather restrictive way and, in fact, reduce their capital budgets drastically. The central government sought justification for most of its measures in the need to reduce the fiscal burden on businesses in times of crisis, completely disregarding local government interests. On the one hand, the central government suspended and reduced local revenues, while on the other hand, it kept increasing national budget revenues – the VAT and excises – that represent a much bigger tax burden. Reducing local government revenues has actually been detrimental to the economy, the business environment and citizens' quality of life, since this impacted infrastructure development in cities and municipalities, utility systems and the provision of local public services.

Seventh, intergovernmental fiscal governance practices indicate insufficient intergovernmental coordination and consultation and a lack of institutional mechanisms for monitoring the process of decentralisation and the system of local government mandate financing. Such a manner of governance is also contrary to the aforementioned recommendations of the Council of Europe. Specifically, there are no institutional mechanisms for the strategic planning of decentralisation, for monitoring and the horizontal and vertical coordination in the process of transferring mandates to the local level, for analysing the fiscal impact (expenditures and costs) of transferring new mandates, and for providing adequate resources to finance these new mandates and establishing a vertical balance in the local finance system. In other words, there is no institutional intergovernmental dialogue, or a systemic practice of monitoring local public finance. In this domain, it is necessary to change the laws that regulate the matter of local government associations, the institutions in charge of fiscal decentralisation and the local government financing system, as well as the very legislative and policy-making processes. A non-strategic approach to the decentralisation process and local government functioning led to the very idea that fiscal decentralisation has been compromised and its significance misunderstood.

Eighth, policies and decisions are not informed and based on evidence, due to the fact that databases are non-transparent, inadequate, unused, or non-existent. Intergovernmental fiscal governance and the manner in which the central government has been making decisions relevant for local government finance are not supported in financial analyses, simulations and projections. There is no practice of doing ex ante or ex post fiscal analyses of different measures and their effects, which restricts the establishment of an optimal local government financing model. Non-transparency and the inexistence of adequate databases also hinder expert or scientific analysis, as well as oversight and control over the financial system by other public authorities, the interested public and tax-payers. The failure to publish fiscal and budgetary data is contrary to certain pieces of the so-called “Six-pack” and “Two-pack” EU legislation. Specifically, it is contrary to the Directive on the Requirements for Budgetary Frameworks of the Member States,⁴⁰³ the Regulation on the effective enforcement of budgetary surveillance in the euro area,⁴⁰⁴ and the Regulation on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area.⁴⁰⁵

Finally, the study presented an in-depth legal analysis of all revenue groups and almost all individual sources of local government funding, as well as the effects of regulatory changes on local budgets. Also, the analysis of local government revenues in the period between 2009 and 2015 presents concrete conclusions and recommendations for each revenue group – transfers, shared revenues, and own-source revenues – and the concrete types of revenues within these groups. However, it is important to emphasise that the system of non-earmarked transfers set by the Law on Local Government Finance was suspended and collapsed in mid-2009. Since then, there has been non-transparency and unpredictability of non-earmarked transfers, while the formula used to calculate this type of transfer is not adequate or based on objective criteria. A lack of transparency is also one of the features of earmarked transfers. When it comes to shared revenues, the way in which the wage tax is distributed between the central and local governments has proven to be unsustainable because it jeopardised the fiscal stability of the country and triggered a series of ad hoc regulatory changes that led to instability and the collapse of the local government finance system. These changes include, among others, reducing the wage tax basis and rate, suspending the municipal right to collect revenue yielded by the real estate rental income tax, suspending ten charges that had previously been shared by the Republic, and suspending seven and capping three of the most significant local communal fees. The central government did not provide any compensation for the local government revenues it suspended or reduced. Local governments did not have any influence over the legislative changes, even though these changes interfered directly with their fiscal autonomy. When it comes to own-source revenues, the analysis showed that the current local government financing policy relies to an excessive extent, or even entirely, on the property tax. Although the potential of this tax is significant, the property tax cannot secure financing for all or the majority of local government

mandates, due to the fact that they include some rather costly functions, such as pre-school education, partial mandates in elementary and secondary education, primary healthcare, maintenance of roads and utility and communal activities. With such an intergovernmental distribution of functions, it is necessary to establish: 1) a new system of transfers, 2) a balanced distribution of the personal income tax and charges on the use of common goods, as well as 3) a new own-source revenue system, which would, in addition to the property tax, include some form of a local business activity tax and a different system of communal fees and charges.

To sum up, this analysis has confirmed that the Republic of Serbia is not anymore strategically committed to fiscal decentralisation and the establishment of a stable, predictable and transparent system of financing cities and municipalities. Consequently, the manner in which the central government transferred public functions to the local level and governed fiscal relations and public finances in the state led to the deterioration of the local finance system, reductions in local budgets and capital investments, and compromised provision of local public services to citizens. With all this in mind, it would be useful to conduct new research, which would include an in-depth analysis of local revenues and expenditures in all local government units in Serbia in the period 2009-2015. Such a study would represent a solid foundation for developing a future model of financing cities and municipalities. Also, it would be beneficial to conduct a study that would evaluate the impact that regulatory changes have had on local economic development in the same period.

Notes

¹ Article 15 of the Law on Free Access to Information of Public Importance (Official Gazette of the Republic of Serbia, No. 120/2004, 54/2007, 104/2009 and 36/2010) regulates requests for information, access, copies and referall within the framework of the procedure concerning the relevant authority.

² Decision of the Ministry of Finance of the Republic of Serbia, 19 No.: 4-00-45/2015, April 30th 2015.

³ Article 19 of the same Law (Official Gazette of the Republic of Serbia, No. 120/2004, 54/2007, 104/2009 and 36/2010) reads that “in the event that the authority does not possess the document containing the requested information, the authority shall forward the request to the Commissioner and shall inform the Commissioner and the requestor which authority, to their knowledge, possess the document.”

⁴ Decision of the Treasury Administration of the Ministry of Finance of the Republic of Serbia No.: 401-00-315/2015-001-007, April 2nd 2015 and No.: 401-00-438/2015-001-007, May 7th 2015.

⁵ Article 13 of the Law on Free Access to Information of Public Importance (Official Gazette of the Republic of Serbia, No. 120/2004, 54/2007, 104/2009 and 36/2010) regulates abuse of free access to public information, reading that “the authority may deny the requestor the right to access to information of public importance if the requestor abuses the right to access to information of public importance, in particular, if the request is unreasonable, frequent, repetitive

in terms of already issued or identical information, or if the volume of information requested is too large.“

⁶ The Treasury Administration of the Ministry of Finance does possess the requested information, which is proven by the fact that the Administration's data was used to support analyses in the following publications: 1) On certain own-source types of revenue: Arsić, M., Randelović, S., Bučić, A., & Vasiljević, D. (2012). *Reforme poreza na imovinu u Srbiji: Rezultati i perspektive* (p. 23). Beograd: FREN.; Arsić, M., Vasiljević, D., Bučić, A., & Randelović, S. (2014). *Analiza mogućnosti za kompenzaciju prihoda od naknade za korišćenje građevinskog zemljišta kroz porez na imovinu*. Belgrade: FREN.; 2) On shared revenue and transfers: *Analiza fiskalnih efekata modela decentralizacije koji je Narodnoj skupštini predložila poslanička grupa Ujedinjeni regioni Srbije*. (2011). Beograd: Fiskalni savet Republike Srbije; *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena*. (2013). In *Ocena seta poreskih zakona*. Belgrade: Fiskalni savet Republike Srbije.; 3) On expenditure: Arsić, M., & Randelović, S. (2012). *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena*. *Kvartalni Monitor* (28). Beograd: FREN; and numerous others. Representatives of the Standing Conference of Towns and Municipalities and the Fiscal Council informed me that the data they used in their analyses had come from the Treasury Administration.

⁷ Upon receipt of my request, administrators in the Office of the Commissioner for Information of Public Importance informed me that the complaint procedures against decisions in which authorities state that they do not possess the requested information are in practice unsuccessful. Namely, the Commissioner does not have an inspectorate that could monitor and establish whether the authority in question possesses the requested data or not (see Articles 19 and 20 of the Law on Free Access to Information of Public Importance). Also, any further procedure would be uncertain, complicated and time consuming, which would jeopardise the completion of this study.

⁸ Even though I explicitly stated in my request that I need the data in excel or another electronic format that allows data processing, the City of Belgrade issued requested revenue information in hard copy, instructing me to look for expenditure data in budgetary tables published in the Official Gazettes of the City of Belgrade in pdf form.

⁹ See Articles 37-43 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia 62/2006, 47/2011 and 93/2012).

¹⁰ See Article 35 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia 62/2006, 47/2011 and 93/2012).

¹¹ According to the 2002 data, an average municipality in Serbia would have ca. 54,000 inhabitants on a territory of around 500 square kilometers. The population of the Municipality of Paraćin was around 58,000, and its territory covered ca. 540 square kilometers. See page 7 in: Stipanović, B. (2006). *Local Government Finance System and Fiscal Equalization in the Republic of Serbia*. The Fiscal Decentralization Initiative for Central and Eastern Europe. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf and the Official presentation of the Municipality of Paraćin. (n.d.). Retrieved from

http://www.parcin.rs/index.php?option=com_content&task=view&id=10193&Itemid=206.

According to development level, the Municipality of Paraćin belongs to the (third) group of local governments, with a development level between 60% and 80% of the national average of GDP per capita. The first group consists of local governments with development level above the national average of GDP per capita. The second group consists of local governments with development levels ranging between 80% and 100% of the national average, the fourth group is made up of those with development levels below 60% of the national average, while

municipalities with development levels below 50% of the national average are categorised as devastated. See the Decree on Establishing the Uniform List of Regions and Local Governments According to Their Development Levels for 2014 (Official Gazette of the Republic of Serbia, 104/2014).

¹² For more details, see the Strategy on Public Administration Reform in the Republic of Serbia. (2004). Retrieved from <http://www.gs.gov.rs/lat/strategije-vs.html> and <http://socijalnoukljuivanje.gov.rs/rs/category/dokumenta/>

¹³ It is interesting to emphasise that the very same trends are also evident in Montenegro. For details see: Kmezić, S., Kaluderović, J., Jocović, M., & Đulić, K. (2016). Fiscal decentralisation and local government financing in Montenegro from 2002 to 2015. *Lex Localis - Journal of Local Self-Government*, 14(3), p. 431-450.

¹⁴ With the adoption of the current Law on Local Self-Government in 2007 (Official Gazette of the RoS, No. 129/2007), the 2002 Law was repealed (Official Gazette of RoS No. 9/2002, 33/2004, 135/2004 and 62/2006).

¹⁵ Law on Local Government Finance (Official Gazette of RoS No. 62/2006, 47/2011 and 93/2012).

¹⁶ The Constitution of the Republic of Serbia (Official Gazette of RoS No. 98/2006).

¹⁷ See Part I. Introduction.

¹⁸ The Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, No. 1/90)

¹⁹ For more details, see: Inicijativa za fiskalnu decentralizaciju: Prilozi za konferenciju - The Fiscal Decentralization Initiative: Conference Proceedings, November 9-10, 2001. (2002). The Fiscal Decentralization Initiative for Central and Eastern Europe and PALGO Center; Milosavljević, P. (2015). *Dva veka lokalne samouprave: Razvoj zakonodavstva 1804-2014*. Belgrade: Stalna konferencija gradova i opština, Beograd.

²⁰ Stipanović, B. (2006). Local Government Finance System and Fiscal Equalization in the Republic of Serbia. The Fiscal Decentralization Initiative for Central and Eastern Europe. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnack279.pdf

²¹ Law Amending the Law on Public Revenue and Public Expenditure (Official Gazette of the Republic of Serbia, No. 76/91, 18/ 93, 22/93, 37/93, 67/93, 45/94, 42/98, 54/99, 22/2001 and 33/2004).

²² Law Amending the Law on Local Self-Government (Official Gazette of RoS, No. 49/99 and 27/2001)

²³ For more details, see: Stipanović, B. (2006). Local Government Finance System and Fiscal Equalization in the Republic of Serbia. The Fiscal Decentralization Initiative for Central and Eastern Europe. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnack279.pdf

²⁴ Law on Local Self-Government (Official Gazette of RoS, No. 9/2002, 33/2004 and 135/2004)

²⁵ It has already been noted in Introduction that between 1995 and 2009 local government units had not been entitled to sell construction land, but had only been able to lease it out or lend it for usage. This hinderance, created by the Law on Assets Owned by the Republic of Serbia (Official Gazette of the Republic of Serbia, No. 53/95, 3/96, 54/96, and 32/97) was removed when the Law on Planning and Construction (Official Gazette of the Republic of Serbia, No. 72/2009, 81/2009, 24/2011, 121/2012, 42/2013, 50/2013, 98/2013, 132/2014, 145/2014) was adopted in 2009. When it comes to selling other real estate, the Law on Public Property (Official Gazette of the Republic of Serbia, No. 72/2011, 88/2013 i 105/2014) of 2011 established the legal grounds for disposal.

²⁶ Pursuant to Articles 79 and 83 of the 2002 Law on Local Self-Government, local communal fees may be imposed for the usage of rights, objects and services based on 16 different grounds.

The 2006 Law on Local Self-Government Finance (Official Gazette of the Republic of Serbia, No. 62/2006, 47/2011 and 93/2012) will retain the same classifications of these fees, which will be discussed later on.

²⁷ For more details, see Article 98 of the 2002 Law on Local Self-Government (Official Gazette of the Republic of Serbia No. 9/2002, 33/2004 and 135/2004)

²⁸ Even though the Law classifies it as a shared revenue, payroll tax might be considered a local government own-source revenue because decisions on the introduction of the tax and the tax rate (between 0% and 3.5%) were made by local assemblies. All local government units decided to exercise this right in its entirety. For more details, see: Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

²⁹ The table is taken from p. 9 of the publication: Stipanović, B. (2006). *Local Government Finance System and Fiscal Equalization in the Republic of Serbia. The Fiscal Decentralization Initiative for Central and Eastern Europe*. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf. For 2004 Stipanovic used the data on planned revenue.

³⁰ For more details, see: Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

³¹ For more details, see: Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

³² Law on the Repeal of the Law on Payroll Tax (Official Gazette of the Republic of Serbia, No. 33/2004).

³³ Law on the Budget of the Republic of Serbia for 2004 (Official Gazette of the Republic of Serbia, No. 33/2004 and 115/2004).

³⁴ Law on Value Added Tax (Official Gazette of the Republic of Serbia, No. 84/2004, 86/2004, 61/2005, 61/2007, 93/2012, 108/2013, 68/2014, 142/2014).

³⁵ For more details, see: Stipanović, B. (2006). *Local Government Finance System and Fiscal Equalization in the Republic of Serbia. The Fiscal Decentralization Initiative for Central and Eastern Europe*. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf

³⁶ For more details, see: Levitas, A. (2004). *Reforma sistema finansiranja lokalne samouprave u Srbiji*. In *Reforma sistema finansiranja lokalne samouprave*. Beograd: PALGO Centar, Čigoja.

³⁷ As will be presented further on in the analysis, the manner of coming up with ad hoc, last minute solutions and non-transparent changes in local government financing was reinstated only two years after the Law on Local Government Finance was adopted. In the last several years, national laws that regulate local government finance can change a few times a year, whereas their implementation is often set to begin immediately upon the adoption, even if the law is enacted in the middle of the budget year.

³⁸ For instance, see the evaluation of the World Bank fiscal decentralization programmes in the period 1990-2007 *Decentralization in Client Countries – A Evaluation of World Bank Support 1990-2007* by Independent Evaluation Group IEG. (2008). Washington DC: The World Bank.

³⁹ *Inicijativa za fiskalnu decentralizaciju: Prilozi za konferenciju - The Fiscal Decentralization Initiative: Conference Proceedings, November 9-10, 2001*. (2002). The Fiscal Decentralization Initiative for Central and Eastern Europe and PALGO Center, p. 161.

⁴⁰ Interview with Dušan Vasiljević, consultant to USAID (2001-2015) Serbian local government reform project (SLGRP), consultant to the Council of Europe, and a member of working groups preparing the Draft Law on Local Government Finance and the Draft Law on Property Tax, Belgrade, August 2014.

⁴¹ Local economic development became a local government mandate in 2007.

⁴² For a more detailed description of the approach the EU took in the process of decentralization, see: Avlijaš, S., & Bartlett, W. (2011). *The Political Economy of Decentralisation and Regional Policy in Serbia: Choices and Outcomes*. LSEE Papers on Decentralisation and Regional Policy.

⁴³ Law on Regional Development (Official Gazette of the Republic of Serbia, No. 51/2009 and 30/2010)

⁴⁴ For more details, see Article 176 of the Constitution of the Republic of Serbia, Article 2 of the Law on Territorial Organisation of the Republic of Serbia (Official Gazette of the Republic of Serbia, No. 129/2007) and Article 4 of the Law on Regional Development (Official Gazette of the Republic of Serbia, No. 51/2009 and 30/2010)

⁴⁵ Law on Ratification of the European Charter of Local Self-Government (Official Gazette of the Republic of Serbia, No. 70/2007).

⁴⁶ For more details, see the web page of the Council of Europe (n.d.). Retrieved November 19, 2015, from http://www.coe.int/t/congress/Activities/Monitoring/default_en.asp?mytabsmenu=3

⁴⁷ Local and Regional Democracy in Serbia. Council Of Europe. (2011). Retrieved from https://wcd.coe.int/ViewDoc.jsp?id=1846217&Site=Congress#P40_2498

⁴⁸ Interview with Mr. Zoran Alimpić, former Deputy Chairman of the City Assembly (2004-2007, 2008-2013), former Chairman of the City Assembly and Acting Mayor of the City of Belgrade (2007-2008), former Member of the National Parliament of the Republic of Serbia (2004-2007), and former member of the Committee of the Congress of Local and Regional Authorities of the Council of Europe (2004-2010), Belgrade, March 2015; Interview with Mr. Saša Paunović, the Mayor of Paraćin and former Chairman of the Standing Conference of Towns and Municipalities, November 2014.

⁴⁹ Interview with Mr. Dušan Vasiljević, quote.

⁵⁰ Strategy on Public Administration Reform in the Republic of Serbia. (2004). Retrieved from <http://www.gs.gov.rs/lat/strategije-vs.html> and <http://sociojlnoukljucivanje.gov.rs/rs/category/dokumenta/>, p. 4

⁵¹ Strategy on Public Administration Reform in the Republic of Serbia. (2004). Retrieved from <http://www.gs.gov.rs/lat/strategije-vs.html> and <http://sociojlnoukljucivanje.gov.rs/rs/category/dokumenta/>, p. 24

⁵² The indirect appointment of mayors results in local coalitions that reflect the ruling coalition at the central level. Whenever the national government would change, local governments would change coalition partners based on the partisan instructions. Also, the accountability and freedom of decision-making of the local executive leadership is substantially reduced.

⁵³ Article 191 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, No. 98/2006).

⁵⁴ Interview with Mr. Dušan Vasiljević, quote.

⁵⁵ Insight of one of the interviewees, Mr. Dušan Vasiljević. Some official argued that higher decentralisation leads to more corruption, that corruption in a decentralised system causes more damage and higher costs than corruption in a centralised system, etc., even though numerous studies disproved this thesis and proved the opposite – higher decentralisation results in reduced corruption. For details see: Za detalje pogledati: Huther, J., & Shah, A. (1996). A simple measure of good governance and its application to the debate on the appropriate level of fiscal decentralization. Washington, DC: World Bank; Huther, J. and A. Shah (1998). Applying a Simple Measure of Good Governance to the Debate on Fiscal Decentralization. Policy Research Working Paper Number 1894. World Bank, Washington DC; Fisman, R., & Gatti, R. (2002). Decentralization and corruption: Evidence across countries. *Journal of Public Economics*, 83, p.

325-345; Oates, W. E. (2002). Fiscal federalism and European Union: Some reflections. In *Società Italiana di Economia Pubblica, Dipartimento di Economia Pubblica e Territoriale. Università di Pavia*; Fan, C., Lin, C., & Treisman, D. (2008). Political decentralization and corruption. Retrieved from http://www.sscnet.ucla.edu/polisci/faculty/treisman/Papers/pol_dec_and_corruption.pdf; Treisman, D. (2000). Decentralization and the Quality of Government. Department of Political Science Working Paper. University of California; Ivanyna, M., & Shah, A. (2011). Decentralization and corruption: new cross-country evidence. *Environment and Planning C: Government and Policy*, 29, 344-362.

⁵⁶ Interview with Mr. Zoran Alimpić, quote.

⁵⁷ Up until that point, this tax was administered by the national tax administration, and rather poorly (collection hardly reached 30%). As revenue from this tax was fully shared with local governments, the national government had no interest in retaining its administration.

⁵⁸ Interview with Mr. Dušan Vasiljević, quote.

⁵⁹ These are the insights of one of the interviewees, Mr. Dušan Vasiljević, quote.

⁶⁰ *Ibid.*

⁶¹ The institutional role of this association will be further analysed in this Part in Chapter 5.

⁶² An official was required to get consent from the Anti-Corruption Agency, which decided whether holding multiple functions was in fact a conflict of interest. For more details, see Article 28 of the basic text of the Law on the Anti-Corruption Agency (Official Gazette of the Republic of Serbia, No. 97/2008, 53/2010, 66/2011, 67/2013 and 8/2015), as well as later amendments to this article.

⁶³ The Ruling was published in the Official Gazette of the Republic of Serbia, 66/2011. See the Law on the Anti-Corruption Agency (Official Gazette of the Republic of Serbia, No. 97/2008, 53/2010, 66/2011, 67/2013 and 8/2015)

⁶⁴ Interview with Mr. Zoran Alimpić, quote.

⁶⁵ The Law on Local Self-Government (Official Gazette of the Republic of Serbia, 129/2007)

⁶⁶ The Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

⁶⁷ Articles 188-193 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁶⁸ Article 180 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁶⁹ Paragraphs 3 and 4, Article 191 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁷⁰ Article 12 of the Constitution of the Republic of Serbia reads that “state government is limited by the citizens’ right to provincial autonomy and local self-government.” This study does not focus on the organisation, mandates and finances of provincial autonomy.

⁷¹ Article 177 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁷² Article 178 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁷³ Article 188 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 98/2006).

⁷⁴ See Article 189 of the Constitution of the Republic of Serbia, Articles 23-26 of the Law on Local Self-Government, and Article 8 of the Law on the Capital City (Official Gazette of the Republic of Serbia, 129/2007) specifying additional mandates delegated to the City of Belgrade.

⁷⁵ Articles 20 of the Law on Local Self-Government (Official Gazette of the Republic of Serbia, 129/2007).

⁷⁶ Compare with Article 18. of the 2002 Law on Local Self-Government (Official Gazette of the Republic of Serbia, 9/2002, 33/2004 and 135/2004).

⁷⁷ Article 86 of the Constitution of the Republic of Serbia introduces the term “public property” and sets forth that this property can be owned by the state, by an autonomous province and by local governments. Paragraph 1, Article 87 of the Constitution defines that natural resources, public interest goods, property used by bodies of the Republic of Serbia, as well as other objects and rights specified by law, represent “state property.” Paragraph 4 of this Article prescribes that property owned by autonomous provinces and local governments, as well as the manner of disposal thereof, will be regulated by law.

⁷⁸ Article 4 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁷⁹ Article 12 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸⁰ Article 13 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸¹ Article 14 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸² Article 18 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸³ Article 19 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸⁴ Article 20 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸⁵ Article 21 of the Law on State Administration (Official Gazette of the Republic of Serbia, 79/2005, 101/2007, 95/2010 and 99/2014).

⁸⁶ See: Milosavljević, B. (2013). *Primena principa supsidijarnosti u Republici Srbiji (izlaganje na konferenciji, Palata Srbija, Beograd, 19.11.2013)* (Applying Subsidiarity Principles in the Republic of Serbia (conference exposition in Serbia Palace, Belgrade, November 19, 2013) in: Đorđević, S., Milenković, D., Prokopijević, M. (2013). *Studija o primeni načela supsidijarnosti u Republici Srbiji*. Beograd: Ministarstvo regionalnog razvoja i lokalne samouprave. (Study on the Application of Subsidiarity Principles in the Republic of Serbia. Belgrade: Ministry of Regional Development and Local Self-Government); p. 19.

⁸⁷ It appears that the Republic was spilling over its deficit onto the local level in order for its expenditures to appear smaller during negotiations on arrangements with the IMF. Manipulating statistical data and spilling over the deficit from the central to local level was possible due to a lack of an integrated system that would consolidate all data on debt incurred by all levels of government, as well as due to a lack of uniform accounting and unique analytical records on the central level.

⁸⁸ For more details, see: Milenković, D. (2013). *Distribucija nadležnosti u najznačajnijim oblastima između centralne i lokalne vlasti u Republici Srbiji* (Intergovernmental Distribution of Mandates in the Most Significant Areas in the Republic of Serbia), in Đorđević, S., Milenković, D., Prokopijević, M. (2013). *Studija o primeni načela supsidijarnosti u Republici Srbiji*. Beograd: Ministarstvo regionalnog razvoja i lokalne samouprave (Study on the Application of Subsidiarity Principles in the Republic of Serbia. Belgrade: Ministry of Regional Development and Local Self-Government), p. 10-83.

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⁸⁹ These conclusions were also presented in European Commission reports on the progress of Serbia in the European integration processes for 2014, 2013 and 2012, as well as in the Analytical Report of the European Commission from 2011. For more details, see: (2014). Serbia 2014 progress report: Communication from the Commission to the European Parliament and the Council (COM (2014)700 final). Retrieved from the European Commission website: http://ec.europa.eu/enlargement/pdf/key_documents/2014/20140108-serbia-progress-report_en.pdf ; (2013). Serbia 2013 progress report: Communication from the Commission to the European Parliament and the Council (SWD(2013) 412 final). Retrieved from the European Commission website: http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/sr_rapport_2013.pdf ; (2012). Serbia 2012 progress report: Communication from the Commission to the European Parliament and the Council (SWD(2012) 333 final). Retrieved from the European Commission website: http://ec.europa.eu/enlargement/pdf/key_documents/2012/package/sr_rapport_2012_en.pdf ; (2011). Serbia 2011 Analytical report: Communication from the Commission to the European Parliament and the Council (SEC(2011) 1208). Retrieved from the European Commission website: http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/sr_analytical_rapport_2011_en.pdf

⁹⁰ “Table of the Intergovernmental Division of Mandates in the Republic of Serbia” is produced in accordance with the Council of Europe methodology; Milenković, D. (2013). Intergovernmental Distribution of Mandates in the Most Significant Areas in the Republic of Serbia in: Đorđević, S., Milenković, D., Prokopijević, M. (2013). Studija o primeni načela supsidijarnosti u Republici Srbiji. Beograd: Ministarstvo regionalnog razvoja i lokalne samouprave. (Study on the Application of Subsidiarity Principles in the Republic of Serbia. Belgrade: Ministry of Regional Development and Local Self-Government), p. 80-83. During the interviews conducted as part of this study, certain local government mandates have been identified that were not encompassed by Milenković’s analysis.

⁹¹ The asterisk marks areas where local government units perform tasks in their entirety, while the central government still remains in charge of the relevant legal framework. Italics mark tasks performed only by certain cities.

⁹² Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

⁹³ Stipanović, B. (2006). Local Government Finance System and Fiscal Equalization in the Republic of Serbia. The Fiscal Decentralization Initiative for Central and Eastern Europe. Retrieved from: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf

⁹⁴ Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011, 47/2013 and 68/2014).

⁹⁵ More recent amendments to the Law on Property Taxes granted local governments the right to set the property tax base as well (see Article 5 of the Law on Property Taxes, Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011, 47/2013 and 68/2014), which in turn broadens the very definition of own-source revenue contained in Article 2 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

⁹⁶ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behavior of Local Governments: 2007-2009. A policy

note for the roundtable on “Sharing the Burden of Intergovernmental Reform.”.Belgrade, Serbia: USAID/MEGA.

⁹⁷ Article 2 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

⁹⁸ Article 2 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

⁹⁹ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behavior of Local Governments: 2007-2009. A policy note for the roundtable on “Sharing the Burden of Intergovernmental Reform.”.Belgrade, Serbia: USAID/MEGA.

¹⁰⁰ Article 35 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰¹ Article 36 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰² Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behavior of Local Governments: 2007-2009. A policy note for the roundtable on “Sharing the Burden of Intergovernmental Reform.”.Belgrade, Serbia: USAID/MEGA.

¹⁰³ Article 2 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁴ Article 37 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁵ Article 38 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁶ Articles 41-43 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁷ Article 39 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁸ Article 40 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁰⁹ Article 44 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹¹⁰ Article 45 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹¹¹ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behavior of Local Governments: 2007-2009. A policy note for the roundtable on “Sharing the Burden of Intergovernmental Reform.”.Belgrade, Serbia: USAID/MEGA, p. 3.

¹¹² Ibid. p. 5.

¹¹³ Ibid. p. 5. Amounts are shown in dinar values adjusted to the 2009 inflation rate.

¹¹⁴ Amounts are shown in dinar values adjusted to the 2009 inflation rate.

¹¹⁵ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behavior of Local Governments: 2007-2009. A policy note for the roundtable on “Sharing the Burden of Intergovernmental Reform.”.Belgrade, Serbia: USAID/MEGA, p. 8.

¹¹⁶ Arsić, M., Randelović, S., Bučić, A., & Vasiljević, D. (2012). Reforme poreza na imovinu u Srbiji: Rezultati i perspektive. Beograd: FREN. p. 23.

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¹¹⁷ *Ibid.*

¹¹⁸ Article 15 of the original version of the 2006 Law on Local Government Finance stipulated that local communal fees may be imposed on 16 different grounds: 1) business sign display on business premises; 2) business sign display outside business premises on structures belonging to the local government unit (roads and streets, sidewalks, green areas, utility poles, etc.); 3) keeping road motor vehicles and trailers, excluding agricultural vehicles and machines; 4) using glass cases to display goods outside business premises; 5) keeping and using navigable equipment and vessels, and other facilities in rivers and lakes, excluding wharves used in border river traffic; 6) keeping and using boats and floating platforms, excluding boats used by organisations engaged in waterway maintenance; 7) restaurants and other catering and entertainment facilities on rivers and lakes; 8) keeping domestic and exotic animals; 9) utilisation of space in public areas or in front of business premises for business purposes, except for the sale of newspapers, books, and other publications, as well as of old and artistic handicrafts and folk handicraft; 10) keeping equipment for games of chance (“entertainment games”); 11) keeping musical equipment and live music in restaurants; 12) using advertising billboards; 13) using parking spaces for road motor vehicles and trailers on appropriately arranged and marked area; 14) using available area for camping, setting up tents or other facilities for temporary use; 15) using waterfront areas for business and any other purposes; 16) using public space for keeping construction material and carrying out construction works. Paragraph 2, Article 15 prescribed that the Government shall set the maximum amount of local communal fees listed as 1, 2 and 3 “upon proposal of the Ministry of Finance that has previously obtained the opinion of the Intergovernmental Finance Commission,” which never actually happened. Maximum amounts were only set by the 2012 Amendments to the Law.

¹¹⁹ Spirić, D., & Bučić, A. (2012). *Ka stabilnom i održivom sistemu finansiranja lokalne samouprave u Republici Srbiji (Towards a stable and sustainable local government finance system in the Republic of Serbia)*. Polis Magazine, 1.

¹²⁰ Radulović, S. (2012, September 9). *Nemojte povećavati PDV*. Web Log Post. Retrieved from <http://blog.b92.net/text/21029/Nemojte-povecavati-PDV/> and Radulović, S. (2013, June 6). *Koje ekonomske mere nam trebaju?*. Web log post. Retrieved from <http://blog.b92.net/text/22527/Koje-ekonomske-mere-nam-trebaju/>

¹²¹ Article 21 of the Law on Local Self-Government (Official Gazette of the Republic of Serbia, 129/2007).

¹²² As will be shown later on, this role should at least partly be held by the Intergovernmental Finance Commission, which has remained inactive for a number of years. In fact, it has never really been fully active, nor has it performed its task in full capacity.

¹²³ Interviews with S. Paunović and Z. Alimpić, quote.

¹²⁴ Paragraph 2, Article 21 of the Law on Local Self-Government (Official Gazette of the Republic of Serbia, 129/2007).

¹²⁵ Article 3 of the Law on Local Government Finance. (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

¹²⁶ Insight of Dušan Vasiljević, one of the interviewees.

¹²⁷ *Ibid.*

¹²⁸ The Law on Fundamentals of the Education System (Official Gazette of the Republic of Serbia, 62/2003, 64/2003, 58/2004 and 62/2004)

¹²⁹ The Law on Fundamentals of the Education System (Official Gazette of the Republic of Serbia, 72/2009, 52/2011, 55/2013 and 68/2015)

¹³⁰ Article 157 of the Law on Fundamentals of the Education System (Official Gazette of the Republic of Serbia, 72/2009, 52/2011, 55/2013 and 68/2015).

¹³¹ Insights of Dušan Vasiljević and Saša Paunović.

¹³² The sole reason for why employees in education were allowed this kind of benefit is found in the force of their unions and the willingness of the ministry in charge of education to transfer this cost to local governments. One of the interviewees pointed out that neither the National Healthcare Fund nor local governments themselves have sufficient assets to pay similar benefits to their employees. (Interview with Aleksandar Bučić, the secretary of the local government finance committee within the Serbian association of local governments – the Standing Conference of Towns and Municipalities – and former member of the Užice City Council, responsible for finances and the budget.)

¹³³ For instance, the Municipality of Vranje.

¹³⁴ Decree on Coefficients for the Calculation and Payment of Salaries in the Public Sector (Official Gazette of the Republic of Serbia, 44/2001... 58/2014)

¹³⁵ Information acquired during interview with Saša Paunović.

¹³⁶ This measure alone, for instance, cost the Municipality of Paraćin around 1% of its budget. An additional limitation in financing child protection services and pre-school education is the fact that parent participation in kindergarten costs is limited to 20% of the economic price. Also, rulebooks issued by the relevant ministry in charge of education prescribe the criteria and standards related to carrying out pre-school programmes. These rulebooks determine the number of employees within each function in pre-school institutions. See, for instance, the Rulebook on General Fundamentals of Pre-school Programmes (Official Gazette of the Republic of Serbia – Education Gazette, 14/2006). In fact, rulebooks are public administration bylaws used to elaborate on certain provision of laws and regulations adopted by the Government. Local government representatives almost never have a say in what these legal documents will prescribe. On the one hand, there is a standing prohibition to hire new public sector employees, and on the other, standards like these present a problem that local governments need to solve.

¹³⁷ Interview with Saša Paunović, quote.

¹³⁸ Levitas, A. (2010). The Effects of the Suspension of Serbia's Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. Note presented at the round table "Central and Local Finance – Distributing the Weight of Reforms." Belgrade, Serbia: USAID/MEGA, p. 13.

¹³⁹ Article 1 of the 2012 Decree on the Coefficient of Salaries of Nominated and Appointed Persons and Public Sector Employees. (Official Gazette of the Republic of Serbia, 44/2008 and 2/2012).

¹⁴⁰ Interviews with Zoran Alimpić and Saša Paunović, quote.

¹⁴¹ One of the interviewees, Dušan Vasiljević, pointed out that the base used to be determined by Government decisions, which are not published in the Official Gazette. Instead, they would be sent by fax to local government units. Using decisions as legal instruments to govern important issues is not new. The problem is that these issues sometimes require legal grounds and full transparency. Otherwise, this kind of governance undermines the rule of law.

¹⁴² See Article 27e of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015).

¹⁴³ The Law on Temporary Regulation of Bases for Salary Calculation and Payment, or Wages and Other Regular Benefits for Public Sector Employees (Official Gazette of the Republic of Serbia, 116/2014).

¹⁴⁴ The number of required employees in the public sector has not been the subject of a serious analysis by relevant institutions until recently. Even today, upon preliminary analyses conducted

by the central government, recommendations start with the current situation. One of the proposed solutions is a linear reduction of the number of civil servants. If this solution is to be implemented, the authorities and organisations that were responsible and rational in terms of new employment could be worse off than those that indulged in over-employment. The linear reduction of the number of employees means that those that were rational would be the ones that are actually penalised.

¹⁴⁵ Ministry of Public Administration and Local Self-Government. (n.d.). Retrieved from <http://www.mduls.gov.rs/dokumenta-ostalo.php> <http://www.mduls.gov.rs/dokumenta-ostalo.php>

¹⁴⁶ Partijska knjžica 'jača' od diplome. (2014, January 19). Aljazeera. Retrieved from <http://balkans.aljazeera.net/vijesti/partijska-knjzica-jaca-od-diplome>

¹⁴⁷ Still, the better part of the municipality is not connected to the sewerage network. (Interview with Milica Bisić, professor of public finance and former deputy minister and advisor to the ministers of finance (interviewed as a representative of the academic community and a participant in the decentralisation process on the side of the central government, i.e. of the Ministry of Finance.)

¹⁴⁸ Interview with Milica Bisić, quote.

¹⁴⁹ Article 173a of the Law on Healthcare (Official Gazette of the Republic of Serbia, 107/2005, 88/2010, 99/2010, 57/2011, 119/2012 and 93/2014).

¹⁵⁰ Paragraph 7, Article 13 of the Law on Healthcare (Official Gazette of the Republic of Serbia, 107/2005, 88/2010, 99/2010, 57/2011, 119/2012 and 93/2014).

¹⁵¹ Paragraph 5, Article 13 of the Law on Healthcare (Official Gazette of the Republic of Serbia, 107/2005, 88/2010, 99/2010, 57/2011, 119/2012 and 93/2014).

¹⁵² Saša Paunović had an interesting viewpoint on the decentralisation of pharmacies. When these healthcare institutions were transferred to the mandate of local governments, many were already deep in debt, while local government units had to maintain the number of employees and their salaries that were agreed upon with the national Healthcare Insurance Fund. Also, the Republic abolished the monopoly of state-owned pharmacies concerning the sale of prescribed medicines, which made them even less competitive compared to private pharmacies. In addition, unlike private pharmacies, state-owned pharmacies have to go through public procurement procedures when buying drugs and pharmaceuticals, meaning that they have to wait for months in order to sign the contracts and purchase the drugs. Each one of these factors compromises state-owned (or “public”) pharmacies’ competitiveness and financial sustainability.

¹⁵³ The Municipality of Paraćin needed to allocate 4% of its budget to cover debts and costs of healthcare centres, and an additional 4% for pharmacies. In the Municipality of Čuprija, healthcare centres have been blocked and employees are not being paid because the Municipality failed to take adequate measures.

¹⁵⁴ An interesting example is found in the way mandates and expenditures were divided between the central and local governments concerning all activities around the catastrophic floods that hit the region in May 2014. Decisions were made ad hoc on who should conclude contracts and pay the persons hired during and after the floods, as well as on who should incur material costs, who would take care of public procurement, which sources would secure the funds to cover all those expenditures, etc. At the time, local governments allocated substantial additional funds, and the issue of earmarked transfers was not regulated in a consistent way.

¹⁵⁵ The Law on Social Security (Official Gazette of the Republic of Serbia, 24/2011).

¹⁵⁶ Milenković, D. (2013). Distribucija nadležnosti u najznačajnijim oblastima između centralne i lokalne vlasti u Republici Srbiji (Intergovernmental Distribution of Mandates in the Most Significant Areas in the Republic of Serbia), u Đorđević, S., Milenković, D., Prokopijević, M.

(2013). *Studija o primeni načela supsidijarnosti u Republici Srbiji*. Beograd: Ministarstvo regionalnog razvoja i lokalne samouprave (Study on the Application of Subsidiarity Principles in the Republic of Serbia. Belgrade: Ministry of Regional Development and Local Self-Government), p. 10-83.

¹⁵⁷ Interview with Milica Bisić, quote.

¹⁵⁸ The increase of the share in the wage tax from 40% to 80% (70% in the City of Belgrade) was proposed as a solution to the problem that was caused by the suspension of non-earmarked transfer provisions in the period between 2009 and 2011. Since in this period local governments received substantially lower amounts of non-earmarked transfers than prescribed by law, and they faced a decrease in revenue due to the economic crisis, they accumulated large debts and arrears. These changes in legislation will be analysed in detail in the chapters to come, which focus on the revenue side of local budgets. Keeping in mind the aforementioned changes in revenues of local budgets, it appears that decentralisation of a number of roads was nothing but a way to transfer expenditure from one level of government to another. Given that road maintenance requires huge assets, decentralisation would in fact lead to the accumulation of new debts or to inadequate road network maintenance.

¹⁵⁹ The Decree on the Categorisation of State Roads (Official Gazette of the Republic of Serbia, 14/2012).

¹⁶⁰ Due to the lack of an integrated system with updated public road data, this action could not be routinely and automatically performed. Instead, it would require extensive fieldwork and the processing of data on some 6,000 km of roads.

¹⁶¹ The Decree on the Categorisation of State Roads (Official Gazette of the Republic of Serbia, 105/2013 and 119/2013).

¹⁶² Articles 29-31 of the Law on the Legalisation of (illegally built; the author's note) Structures (Official Gazette of the Republic of Serbia, 95/2013 and 117/2014).

¹⁶³ Article 93 of the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 72/2009, 81/2009, 64/2010, 24/2011, 121/2012, 42/2013, 50/2013, 98/2013, 132/2014 and 145/2013).

¹⁶⁴ The Law on Amendments to the Law on Planning and Construction from December 29, 2014. (Official Gazette of the Republic of Serbia, 145/2014).

¹⁶⁵ The Law on Emergency Situations (Official Gazette of the Republic of Serbia, 111/2009, 92/2011 and 93/2012).

¹⁶⁶ Article 28 of the Law on Emergency Situations (Official Gazette of the Republic of Serbia, 111/2009, 92/2011 and 93/2012).

¹⁶⁷ Article 136 of the Law on Emergency Situations (Official Gazette of the Republic of Serbia, 111/2009, 92/2011 and 93/2012).

¹⁶⁸ The Law on the Suspension of the Law on the Environment Protection Fund (Official Gazette of the Republic of Serbia, 93/2012).

¹⁶⁹ Although the said Law in its Article 2 reads that the rights and obligations of the Fund will be taken over by the Republic of Serbia, local government representatives had to step in and cover the Republic's obligations. Interview with Aleksandar Bučić, quote.

¹⁷⁰ Interview with Aleksandar Bučić, quote.

¹⁷¹ The Council of Europe Recommendation of the Committee of Ministers to Member States on Financial and Budgetary Management at Local and Regional Levels (Recommendation Rec (2004)1 adopted by the Committee of Ministers on January 8th, 2004) advises member states to regularly prepare financial evaluations of costs in lower tiers of government, to publish them and update them. The formula for this financial evaluation needs to be transparent, objective, stable

and fair. When transferring new expenditures, higher tiers of government must also transfer sources of financing. For more details, see: <https://wcd.coe.int/ViewDoc.jsp?id=103899>

¹⁷² Even though experts have stated that local governments had either a surplus or insufficient funds in their budgets, an exact evaluation of the vertical (im)balance between revenues and expenditures would require a serious analysis of direct and indirect expenditures pertaining to each and every decentralised function.

¹⁷³ Article 3 regulates the principle of guaranteeing revenue sufficiency – meaning that the Republic is obligated to provide resources for performing functions every time it transfers or delegates a function to local governments. Article 39 regulates compensation transfers and Article 44 regulates functional transfers. They will be analysed in detail later on. The Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁷⁴ The Republic of Serbia ratified and incorporated the Charter into its internal national legislation by adopting the Law on the Ratification of the European Charter on Local Self-Government (Official Gazette of the Republic of Serbia, 70/2007), and it also adopted the provisions of Article 9, pertaining to financial assets of local governments (See: European Charter of Local Self-Government, CETS No. 122, Strasbourg, 1985. <http://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/122>)

¹⁷⁵ The Council of Europe Recommendation of the Committee of Ministers to Member States on Financial and Budgetary Management at Local and Regional Levels (Recommendation Rec (2004)1 adopted by the Committee of Ministers on January 8th, 2004) <https://wcd.coe.int/ViewDoc.jsp?id=103899>

¹⁷⁶ The Council of Europe Recommendation of the Committee of Ministers to Member States on the Financial Resources of Local and Regional Authorities (Recommendation Rec (2005)1 adopted by the Committee of Ministers on January 19th, 2005) <https://wcd.coe.int/ViewDoc.jsp?id=812131>

¹⁷⁷ Milenković, D. (2013). Distribucija nadležnosti u najznačajnijim oblastima između centralne i lokalne vlasti u Republici Srbiji (Intergovernmental Distribution of Mandates in the Most Significant Areas in the Republic of Serbia), in Đorđević, S., Milenković, D., Prokopijević, M. (2013). Studija o primeni načela supsidijarnosti u Republici Srbiji. Beograd: Ministarstvo regionalnog razvoja i lokalne samouprave (Study on the Application of Subsidiarity Principles in the Republic of Serbia. Belgrade: Ministry of Regional Development and Local Self-Government), p. 10-83.

¹⁷⁸ More precisely, the reviewed budget was adopted by means of the Law on Amendments and Addenda to the 2009 Law on the Budget of the Republic of Serbia (Official Gazette of the Republic of Serbia, 31/2009), which reduced the total amount of non-earmarked transfers by 15 billion dinars (36.8%). For more details, see: Spirić, D., & Bučić, A. (2012). Ka stabilnom i održivom sistemu finansiranja lokalne samouprave u Republici Srbiji (Towards a stable and sustainable local government finance system in the Republic of Serbia). Polis Magazine, 1.

¹⁷⁹ Spirić, D., & Bučić, A. (2012). Ka stabilnom i održivom sistemu finansiranja lokalne samouprave u Republici Srbiji (Towards a stable and sustainable local government finance system in the Republic of Serbia). Polis Magazine, 1.

¹⁸⁰ This opinion is shared by all of the interviewed participants.

¹⁸¹ Interview with Aleksandar Bučić, quote.

¹⁸² Interview with Aleksandar Bučić, quote.

¹⁸³ Interview with Aleksandar Bučić, quote.

¹⁸⁴ Ibid.

¹⁸⁵ Due to a lack of political will to solve structural budget deficit issues in a different way, the Government of Serbia arbitrarily decided to reduce one of the largest expenditure items in the national budget. At the time, reducing transfer funds intended for cities and municipalities was, politically speaking, the easiest decision to make.

¹⁸⁶ According to the then valid LLGF, after the equalisation fund, the compensation and transition transfers were to be calculated if necessary. See Articles 37-43 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006).

¹⁸⁷ The status of “city” was awarded to 19 additional local governments in 2009, increasing the total number of cities in Serbia to 23. At the time, it lowered the national per capita average of shared revenue from 5,400 to 4,600 dinars, as most new cities were wealthier than an average local government. It is unknown whether the Ministry ever redesigned the calculation method that would take into consideration the new number of cities, that is, the new average. Levitas wrote about this in his 2010 note. He pointed out that the result of a new calculation methodology would be that 28 out of 88 local governments would no longer be entitled to the equalisation transfer and that its total amount would be reduced from 2.8 to 1.4 billion dinars. See Levitas, A. (2010). The effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A Note presented at the round table “Sharing the burden of intergovernmental reforms.” Belgrade, Serbia: USAID/MEGA.

¹⁸⁸ See Articles 37-43 of the 2006 Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006). Identical criteria were kept in the more recent versions of the Law, albeit complemented with additional criteria pertaining to local government development levels. (Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)). The interviewees expressed doubt that the Ministry of Finance possesses all (correct) data on the number of children, classes and facilities in the education system that are necessary to calculate the non-earmarked transfer.

¹⁸⁹ The Law on Amendments and Addenda to the Law on the Budget of the Republic of Serbia for 2009 (Official Gazette of the Republic of Serbia, 31/2009)

¹⁹⁰ According to the Law, the amount of transfers for 2009 should have been calculated based on the 2008 GDP data, when the GDP still recorded growth (5.3% compared to 2007). For more details, see: Spirić, D., & Bučić, A. (2012). Ka stabilnom i održivom sistemu finansiranja lokalne samouprave u Republici Srbiji (Towards a stable and sustainable local government finance system in the Republic of Serbia). Polis Magazine, 1.

¹⁹¹ Levitas, A. (2010). The effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A Note presented at the round table “Sharing the burden of intergovernmental reforms.” Belgrade, Serbia: USAID/MEGA, p. 6.

¹⁹² Petition to return non-earmarked transfers for 2011 to the levels prescribed by the Law on Local Government Finance. (n.d.). Retrieved from <http://www.skgo.org/pages/display/313/Peticija+za+vracanje+nenamenskih+transfera+u+2011.+g+odini+na+nivo+predviden+Zakonom+o+finansiranju+lokalne+samouprave>

¹⁹³ Out of the total of 174 local government units in the Republic of Serbia.

¹⁹⁴ The request of cities and municipalities submitted to the Government of the Republic of Serbia to return non-earmarked transfers in 2011 to the levels prescribed by the Law on Local Government Finance. (2010, October 7). Retrieved from http://www.skgo.org/upload/files/Zahtev_SKGO_Vladi_RS_vracanje_transfera_746_1.pdf

¹⁹⁵ These are outstanding debts owed to national public enterprises (heating, electricity, etc.), but also arrears owed to suppliers in realised public procurement procedures, contractors, hired

personnel, etc. Public address to Members of Parliament to support the reinstatement of non-earmarked transfers to local governments in 2011 to the levels prescribed by the Law on Local Government Finance. (2010, October 7). Retrieved from <http://skgo.org/files/fck/File/zastupanje/Poziv%20narodnim%20poslanicama%20da%20podrže%20Ozaktev%20SKGO.pdf>

¹⁹⁶ Ibid.

¹⁹⁷ The Law on Amendments and Addenda to the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 47/2011).

¹⁹⁸ Article 35 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

¹⁹⁹ Article 37 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

²⁰⁰ Interviewed representatives of the SCTM state that this amount varies between 1% and 1.3% of the GDP according to their data.

²⁰¹ Article 42a of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

²⁰² Workforce Poll, 2011. (2012). (Bulletin 550). Retrieved from

http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/61/71/SB_550_ARS2011_SAJT.pdf

²⁰³ Article 9 of the Law on Amendments and Addenda to the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 47/2011).

²⁰⁴ Information acquired during interviews with Milica Bisić and Aleksandar Bučić.

²⁰⁵ Information acquired during an interview with Milica Bisić.

²⁰⁶ All interviewed participants gave the example of the Municipality of Jagodina, which constantly receives some type of financial support from the Republic, either transfers or funds from the current budget reserve, even though its revenues per capita are higher than in many other municipalities that did not receive those funds.

²⁰⁷ The Decree on Establishing the Uniform List of Regions and Local Governments According to Their Development Levels for 2011 (Official Gazette of the Republic of Serbia, 51/2010; 69/2011; 107/2012; 62/2013; 104/2014)

²⁰⁸ Article 8 of the Law on Regional Development (Official Gazette of the Republic of Serbia, 51/2009 and 30/2010) reads that the Methodology for Calculating the Levels of Development of Regions and Local Government Units is to be adopted by the Government upon the proposition of the ministry in charge of regional development.

²⁰⁹ The Decree on Setting the Methodology for Calculating the Levels of Development of Regions and Local Government Units (Official Gazette of the Republic of Serbia, 68/2011). The new decree was adopted in July 2015 and it prescribes different criteria (Official Gazette of the Republic of Serbia, br. 62/2015). The criteria that are now taken into account are the unemployment rate, the income per resident, own-source revenues per resident, the education level and the population growth or decline rate. Still, own-source revenues per resident cannot be considered a good indicator of a local government's development level, given that cities and municipalities differ significantly with regards to the value of property, the number and type of businesses and the volume of investments on their territory for which they may impose the property tax, local communal fees or the construction land development contribution.

²¹⁰ This sum excludes funds received by local governments for the elimination of consequences of emergency situations. For more details, see Article 3 of the Decree.

²¹¹ Interview with Saša Paunović, quote.

²¹² Page 9 of the Instruction for the Preparation of the Decision on the Local Government Budget for 2014 (and Projections for 2015 and 2016).

²¹³ The Instruction contains the formula for calculating planned non-earmarked transfer funds, which takes into consideration certain annual adjustments and corrections. For more details, see page 10 of the Instruction for the Preparation of the Decision on the Local Government Budget for 2014 (and Projections for 2015 and 2016).

²¹⁴ Political circumstances were substantially different in 2013 in comparison with 2010, when a large number of local governments submitted a petition through the Standing Conference of Towns and Municipalities to the Government of Serbia to return non-earmarked transfers in 2011 to the levels prescribed by the Law on Local Government Finance. This time, a large number of cities and municipalities did not make such a joint request. Certain local governments submitted individual objections to this solution, requesting that transfers be returned to levels prescribed by law. For more details, see, for example, the memo of the Mayor of Paraćin, Saša Paunović, to the Minister of Finance, Lazar Krstić, from December 2013:

Paunović, S., @paunovicsasa. (2013, December 29). Dopisivanje sa MinFin – prvi deo, o raspadu sistema finansiranja lokalne samouprave <http://fb.me/2CMRGSdzb> [Twitter post]. Retrieved from: <https://twitter.com/paunovicsasa/status/417399428996403200> and Paunović, S., Dopisivanje sa MinFin – prvi deo, o raspadu sistema finansiranja lokalne. [Web Log Post]. Retrieved from

<https://paunovicsasa.wordpress.com/2014/01/11/%D0%B4%D0%BE%D0%BF%D0%B8%D1%81%D0%B8%D0%B2%D0%B0%D1%9A%D0%B5-%D1%81%D0%B0-%D0%BC%D0%B8%D0%BD%D1%84%D0%B8%D0%BD-%D0%BF%D1%80%D0%B2%D0%B8-%D0%B4%D0%B5%D0%BE-%D0%BE-%D1%80%D0%B0%D1%81%D0%BF%D0%B0/>

²¹⁵ Paunović, S., @paunovicsasa. (2013, December 29). Dopisivanje sa MinFin – prvi deo, o raspadu sistema finansiranja lokalne samouprave <http://fb.me/2CMRGSdzb> [Twitter post]. Retrieved from

<https://twitter.com/paunovicsasa/status/417399428996403200>

²¹⁶ Rulebook on the Standard Classification Framework and the Budget System Chart of Accounts (Official Gazette of the Republic of Serbia, 103/2011...63/2015).

²¹⁷ An example of this is zoo-hygiene, whose services cannot be charged as the price of services of a local public enterprise. Also, there are examples of municipalities whose entire capital investment plans are recorded as subsidies to local public enterprises in charge of the roads.

²¹⁸ Page 14 of the Instruction for the Preparation of the Decision on the Local Government Budget for 2015 (and Projections for 2016 and 2017): <http://www.mfin.gov.rs/pages/issue.php?id=8452>

²¹⁹ Official Gazette of the Republic of Serbia, 14/2014.

²²⁰ The Mayor of Paraćin, Saša Paunović, wrote a complaint to the Minister of Finance this time as well, demanding that local governments be reimbursed and compensated for their losses. His opinion is that the transfer funds were not reduced out of political reasons, as the reduction hit both local governments ruled by opposition parties and those where the ruling coalition is in power. Paunović believes that this was a case of the central government being disinterested and unfamiliar with how local governments function. For more details, see: Paunović, S., Šta je Krstić razrušio, Vujović ravna buldožerom – nastavak razaranja sistema finansiranja opština i gradova, još jedno pismo za MinFin. [Web Log Post]. Retrieves from <https://paunovicsasa.wordpress.com/2015/01/08/%D0%BC%D0%B8%D0%BD%D0%B8%D1%81%D1%82%D0%B0%D1%80%D1%81%D1%82%D0%B2%D1%83-%D1%84%D0%B8%D0%BD%D0%B0%D0%BD%D1%81%D0%B8%D1%98%D0%B0/>

²²¹ Articles 2 and 44 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

²²² Articles 2 and 45 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

²²³ All interviewees share this opinion. The Republic's habit to allocate earmarked transfers to local governments that are important to the central government politically can be seen in the annual laws on the budget of the Republic of Serbia. The earmarked transfer of 2 billion dinars from the budget reserve to the City of Belgrade in December 2014 presents a recent example of this practice. On the one hand, the Ministry of Finance demands that local governments reduce their subsidies by 30%, and it reduces their non-earmarked transfer by the same percentage. On the other hand, the Government takes 2 billion dinars from the budget to subsidise a local utility company in Belgrade, the wealthiest local government in Serbia. Often, the example of the Municipality of Jagodina is mentioned, too. Over the last several years, Jagodina received more funds in earmarked than in non-earmarked transfers. Finally, it is also important to consider information about local governments that are relieved of their debts to national public enterprises by decisions of the central government. This issue requires a special, complex analysis. (The question is whether such an analysis would be possible.) It is a known fact that the Municipality of Novi Pazar has on multiple occasions been relieved of its debt. (Information acquired during interviews).

²²⁴ Interview with Aleksandar Bučić, quote.

²²⁵ Interview with Saša Paunović, quote.

²²⁶ Article 50 of the Law on Local Government Finance (official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

²²⁷ Not only does the central government breach the non-earmarked transfer provision of the Law on Local Government Finance, but it also breaches the financial autonomy of the Province, which is guaranteed by the Constitution. Namely, Article 184 of the Constitution of the Republic of Serbia defines that the budget of the Autonomous Province of Vojvodina (APV) shall amount to no less than 7% of the budget of the republic of Serbia. (Official Gazette of the Republic of Serbia, 98/2006). In the same way that local governments never really received 1.7% of the GDP, the budget of the APV also never reached 7% of the national budget. Political and partisan negotiations and deals make the maintenance of such an unconstitutional arrangement possible. (Interview with Zoran Alimpić, quote.)

²²⁸ The Law on the Ratification of the European Charter on Local Self-Government (Official Gazette of the Republic of Serbia, 70/2007).

²²⁹ The Recommendation of the Committee of Ministers of the Council of Europe to Member-States on Financial and Budget Management on Local and Regional Levels from 2004 and the Recommendation of the Committee of Ministers of the Council of Europe to Member-States on Financial Resources of Local and Regional Authorities from 2005 contain important provisions on the necessity of an adequate transfer system set-up. The latter recommendation focuses on a fair, transparent and predictable transfer (grant) policy. Fairness implies that transfer allocation rules are universal, non-discriminatory, stable, non-arbitrary, and that they are not changed in an ad hoc manner. The recommendation also insists on transparency of information pertaining to transfers and the payment calendar, as it is of a key importance for the local governments' financial governance.

²³⁰ URS was a political party founded in 2010 by Mlađan Dinkić, the then Vice-President of the Government and the Minister of Economy and Regional Development. He continued to perform these functions through February 2011. In early 2011, as the President of a newly founded party,

URS, Dinkić began his election campaign based on a programme of regionalisation and decentralisation of Serbia. The party was dissolved after it failed to pass the election census and enter the Parliament in 2014. See in: Dinkić predao parlamentu peticiju o decentralizaciji. (2011, May 30). Blic. Retrieved from <http://www.blic.rs/Vesti/Politika/256964/Dinkic-predao-parlamentu-peticiju-o-decentralizaciji> and *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena.* (2013). In *Ocena seta poreskih zakona.* Belgrade: Fiskalni savet Republike Srbije.

²³¹ Interview with Dušan Vasiljević, quote.

²³² Interview with Zoran Alimpić, quote.

²³³ URS reached a political agreement with the then Mayor of Belgrade and representatives of the Democratic Party regarding support of the new legal solution in the National Parliament of Serbia. As will become clear later on, the decision that the representatives of Belgrade made was wrong, and the newly-adopted legal solutions were short-lived. Again, the implementation of the new model of local government financing depended on the willingness of the central government and the situation in the national budget.

²³⁴ *Anketa o radnoj snazi, 2011. godine.* (2012). Bilten, 550. Retrieved from http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/61/71/SB_550_ARS2011_SAJT.pdf.

²³⁵ Interview with Zoran Alimpić, quote.

²³⁶ *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena.* (2013). In *Ocena seta poreskih zakona.* Belgrade: Fiskalni savet Republike Srbije. p. 3.

²³⁷ *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena.* (2013). In *Ocena seta poreskih zakona.* Belgrade: Fiskalni savet Republike Srbije. p.3. And interview with Tony Levitas, quote.

²³⁸ Ibid.

²³⁹ Ibid.

²⁴⁰ Law on Amendments and Addenda to the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 47/2011).

²⁴¹ Arsić, M., & Randelović, S. (2012). *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena.* Kvartalni Monitor (28). Beograd: FREN.

²⁴² Ibid. p. 58.

²⁴³ Ibid. p. 60.

²⁴⁴ According to Article 3 of the Rulebook on the Standard Classification Framework and the Budget System Chart of Accounts (Official Gazette of the Republic of Serbia, 103/2011...63/2015), the economic classification of expenditures and costs presents individual goods and services and paid transfers.

²⁴⁵ According to Article 7 of the Rulebook on the Standard Classification Framework and the Budget System Chart of Accounts (Official Gazette of the Republic of Serbia, 103/2011...63/2015), and pursuant to the function classification of the United Nations Statistical Department, the functional classification presents expenditures according to their functional purpose, regardless of the organisation implementing them.

²⁴⁶ The new Minister of finance was President of the URS, Mladan Dinkić. He performed this function from July 2012 until September 2013 in the government of the Prime Minister Ivica Dačić.

²⁴⁷ According to the definition of the National Alliance for Local Economic Development (NALED) and the USAID-funded programme titled Business Enabling Project (BEP), which in 2012 prepared a study on parafiscal impositions in Serbia, parafiscalities include "all forms of

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payment, regardless of the term (fee, charge, or other), that to a certain extent represent a financial and/or administrative burden on business, for which they: a) do not receive any right, service or asset, or b) receive right, service or asset for which the objective value is considerably smaller than the amount of the imposition.” Mostovi i ćuprije – sistem neporeskih i parafiskalnih formi u Republici Srbiji (p. 4). (2012). Belgrade: USAID BEP, NALED.

²⁴⁸ The Law on Amendments and Addenda to the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 93/2012).

²⁴⁹ Lokalna samouprava, 62. (2013). Retrieved from <http://www.skgo.org/publications/download/475> p. 4

²⁵⁰ For more details, see Articles 11 and 12 of the Law on Amendments and Addenda to the Law on the Personal Income Tax (Official Gazette of the Republic of Serbia, 47/2013) and Articles 15 and 16 of the Law on the Personal Income Tax (Official Gazette of the Republic of Serbia, 24/2001...57/2014).

²⁵¹ Interview with Aleksandar Bućić and Saša Paunović, quote. On the one hand, the Government of Serbia reduced the taxable base and the rate of the wage tax, justifying this decision by saying that it is a measure aimed at lessening the burden on businesses. However, the gross amounts of wages were not reduced, as the Government of Serbia increased the retirement and disability insurance employee contributions by the same amount, which are revenues completely collected by the Retirement and Disability Contribution Fund of the Republic of Serbia. (See the Law on Amendments and Addenda to the Law on Mandatory Social Contributions (Official Gazette of the Republic of Serbia, 47/2013) and the B92 News: Poreske izmene "naše nasušne" (2013, May 23). B92. Retrieved from

http://www.b92.net/biz/vesti/srbija.php?yyyy=2013&mm=05&dd=23&nav_id=716498)

²⁵² According to Article 23 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001...68/2014), the real estate transfer tax is paid when ownership is transferred with compensation for real estate, intellectual property, motor vehicles and the usage of construction land.

²⁵³ Articles 3 and 61 of the Law on Amendments and Addenda to the Law on the Personal Income Tax (Official Gazette of the Republic of Serbia, 47/2013, from May 29, 2013).

²⁵⁴ The Law on Amendments and Addenda to the Law on the Budget of the Republic of Serbia for 2013 (Official Gazette of the Republic of Serbia, 59/2013, from July 5, 2013).

²⁵⁵ Dinkić: Đilas je u pravu. (2013, August 23). B92. Retrieved from http://www.b92.net/biz/vesti/srbija.php?yyyy=2013&mm=08&dd=23&nav_id=745749 and Đilas piše Nebojši Stefanoviću. (2013, August 23). B92. Retrieved from http://www.b92.net/biz/vesti/srbija.php?yyyy=2013&mm=08&dd=23&nav_id=745600

²⁵⁶ Articles 2 and 18 of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015).

²⁵⁷ Article 9 of the Law on Public Property (Official Gazette of the Republic of Serbia, 72/2011, 88/2013 and 105/2014).

²⁵⁸ Article 10 of the Law on Public Property (Official Gazette of the Republic of Serbia, 72/2011, 88/2013 and 105/2014).

²⁵⁹ Article 10 of the Law on Public Property (Official Gazette of the Republic of Serbia, 72/2011, 88/2013 and 105/2014).

²⁶⁰ International Monetary Fund. (2001). Government finance statistics manual 2001 (GSFM 2001). DOI: <http://www.imf.org/external/pubs/ft/gfs/manual/>

²⁶¹ United Nations Statistical Commission (UNSC). (2008). System of national accounts 2008 (2008 SNA). Retrieved from <http://unstats.un.org/unsd/nationalaccount/sna2008.asp>

²⁶² Raičević, B. (2002). Lokalni nefiskalni javni prihodi. In Inicijativa za fiskalnu decentralizaciju. Beograd: Prilozi za konferenciju, Čigoja, Magna Agenda.

²⁶³ Popović, D. (2011). Poresko pravo. Beograd: Pravni fakultet Univerziteta u Beogradu. Kristić, Mr S. (2006). Izvorni prihodi u sistemu finansiranja lokalne samouprave u Republici Srbiji. Beograd: PALGO Centar i Stalna konferencija gradova i opština, donatora: SLGRP/USAID.

²⁶⁴ Article 36 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006).

²⁶⁵ Article 36 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011, 93/2012).

²⁶⁶ This number includes the four laws that regulate or regulated five types of own-source local government charges – the Law on Planning and Construction (Article 96) (Official Gazette of the Republic of Serbia, 72/2009... 145/2014), the Law on Environmental Protection (Article 87) (Official Gazette of the Republic of Serbia, 135/2004 and 36/2009), the Law on Utility Services (Articles 24 and 27) (Official Gazette of the Republic of Serbia, 88/2011) and the Law on the Public-Private Partnership and Concessions (Article 43) (Official Gazette of the Republic of Serbia, 88/2011). Own-source charges will be analysed in detail in the following chapter, which will focus on local government own-source revenues.

²⁶⁷ Bisić, M. (2011). Sistem naknada za korišćenje prirodnih bogatstava i raspodela prihoda između centralnog i lokalnih nivoa vlasti (System of Charges for the Use of Natural Resources and Intergovernmental Revenue Distribution). Beograd: Stalna konferencija gradova i opština.

²⁶⁸ Registar neporeskih i parafiskalnih nameta (Parafiscal Registry). (n.d.). Retrieved from <http://www.naled-serbia.org/sr/parafiscals/index/Registar-neporeskih-i-parafiskalnih-nameta> 40

²⁶⁹ List of charges abolished in September 2012, The Ministry of Finance (n.d.). Retrieved from http://www.mfin.gov.rs/UserFiles/File/dokumenti/2013/Spisak_naknada_14_9_2012_.pdf.

²⁷⁰ These are: the Law on Environmental Protection (Official Gazette of the Republic of Serbia, 36/2009, 88/2010 and 91/2010), which regulates the charge on the use of protected areas; the Law on Protection and Sustainable Exploitation of Fish Stocks (Official Gazette of the Republic of Serbia, 128/2014), which regulates the charge on the exploitation of fishing areas; the Law on Game and Hunting (Official Gazette of the Republic of Serbia, br. 18/2010), which regulates the charge on the exploitation of game protected by the close of a season and the charge on hunting permits; the Law on Waste Management (Official Gazette of the Republic of Serbia, 36/2009 and 88/2010), which regulates charges for products that become special waste flow after use; the Law on Packaging and Packaging Waste (Official Gazette of the Republic of Serbia, 36/2009), which regulates the charge on packaging trading; the Law on Chemicals (Official Gazette of the Republic of Serbia, 36/2009, 88/2010, 92/2011, 93/2012 and 25/2015), which regulates the charge on checking data from files on chemicals and other administrative tasks. The Law on Environmental Protection from Noise (Official Gazette of the Republic of Serbia, 36/2009 and 88/2010) and the Law on Air Protection (Official Gazette of the Republic of Serbia, 36/2009 and 10/2013) do not prescribe charges, but they do prescribe local government mandates pertaining to environmental protection and improvement. For more details, see: Bisić, M. (2011). Sistem naknada za korišćenje prirodnih bogatstava i raspodela prihoda između centralnog i lokalnih nivoa vlasti (System of Charges for the Use of Natural Resources and Intergovernmental Revenue Distribution). Beograd: Stalna konferencija gradova i opština.

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²⁷¹ These are amendments to the Law on the Value Added Tax from September 28, 2012 (Official Gazette of the Republic of Serbia, 84/2004...93/2012, 108/2013, 68/2014 and 142/2014), which increased the rate from 18% to 20%, as well as amendments to the Law on Excises from September 28, 2012 (Official Gazette of the Republic of Serbia, 22/2001...93/2012...55/2015), which increased rates and expanded the scope of excised products. Another VAT increase occurred on December 7, 2013, when the rate for trading certain goods and services was increased from 8% to 10%.

²⁷² The Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011, 47/2013 and 68/2014)

²⁷³ Item 1, Article 2 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

²⁷⁴ Paragraph 2, Article 7 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

²⁷⁵ Item 18, Article 2 and Paragraph 2, Article 17 of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

²⁷⁶ Paragraphs 4 and 6, Article 17 of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

²⁷⁷ Paragraph 5, Article 17 of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

²⁷⁸ Paragraph 8, Article 17 of the Law on the Budget System (Official Gazette of the Republic of Serbia, 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

²⁷⁹ Article 9 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

²⁸⁰ Pursuant to the Law on Republic Administrative Fees, fees are paid for documents and administrative tasks, as well as for other documents and tasks of which the national authorities are in charge. Fees are paid by persons requesting authorities to initiate administrative or other tasks. Articles 2 and 3 of the Law on Republic Administrative Fees (Official Gazette of the Republic of Serbia, 43/2003...93/2012)

²⁸¹ Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 i 99/2013)

²⁸² Most probably, the law in question is the Law on Republic Administrative Fees (Official Gazette of the Republic of Serbia, 43/2003...93/2012)

²⁸³ Article 2 of the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 and 99/2013)

²⁸⁴ Article 3 of the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 and 99/2013)

²⁸⁵ In addition to the two mentioned principles, the methodology is also based on the principle of data confidentiality. This principle allows the responsible authority, which gives consent to the act of determining the amount of a fee, to gain insight into adequate documents and data in order to ensure that the fee is aligned with the methodology. For more details, see Article 3 of the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 and 99/2013)

²⁸⁶ Exactly how this public service accessibility coefficient is applied is yet to be fully clarified, but we suppose that this coefficient is the same for each and every payer of the fee in question. From the perspective of fee principles, it is important for the fee to be characterised by impersonality, meaning that the tariff should be identical for each and every fee payer, regardless of his or her ability to pay. Articles 5 and 6 of the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 and 99/2013)

²⁸⁷ Article 8 of the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services (Official Gazette of the Republic of Serbia, 14/2013, 25/2013 and 99/2013)

²⁸⁸ Investment Climate Advisory Services of the World Bank Group. (2011). Avoiding the fiscal pitfalls of subnational regulation – how to optimize local regulatory fees to encourage growth. Washington, DC: IFC, The World Bank, MIGA.

²⁸⁹ Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on Services in the Internal Market, Official Journal of the European Union, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:376:0036:0068:en:PDF>

²⁹⁰ The second most recommended method is the method of marginal cost calculation. For more details, see: Investment Climate Advisory Services of the World Bank Group. (2011). Avoiding the fiscal pitfalls of subnational regulation – how to optimize local regulatory fees to encourage growth. Washington, DC: IFC, The World Bank, MIGA.

²⁹¹ Information acquired during interview with Milica Bisić, quote. For instance, the Public notary tariff (Official Gazette of the Republic of Serbia, 91/2014, 103/2014 and 138/2014) did not apply the methodology from the Rulebook. Instead, it prescribes “rewards” for public notaries, which are in no way aligned with the public service accessibility principle, nor are they proportionate to the service provided. Public notaries charge up to 600,000 dinars (around 5,000 euros) for the authentication of real estate transfer contracts. The Ministry of Justice never requested consent from the Ministry of Finance, as is prescribed by the Law on the the Budget System and the Rulebook on the Methodology and Criteria for Determining Costs of Providing Public Services. Also, according to the information shared by Aleksandar Bučić and Saša Paunović, the methodology is not applied on the local level either.

²⁹² “Government Finance Statistics Manual 2001 (GSFM 2001),” International Monetary Fund, 2001, <http://www.imf.org/external/pubs/ft/gfs/manual/>

²⁹³ “System of National Accounts 2008 (2008 SNA),” United Nations Statistical Commission (UNSC), 2008, <http://unstats.un.org/unsd/nationalaccount/sna2008.asp>

²⁹⁴ For more details, see: The Law on Communal Fees and Charges (Official Gazette of the Republic of Serbia, 11/92...25/2000)

²⁹⁵ It is necessary to emphasise here that these are non-tax, and not parafiscal impositions. Most of the identified and abolished impositions were in fact fiscal, levy-type, public-law revenues (fees and charges), while some were non-fiscal, original, private-law revenues of public-law subjects (certain types of charges with prevailing private-law elements, and other revenues). The USAID Business Enabling Project (BEP). (n.d.). Retrieved from http://www.bep.rs/english/index_en.php and the National Alliance for Local Economic Development, NALED (n.d.). Retrieved from <http://www.naled-serbia.org/en/page/63/Para-fiscal-registry>

²⁹⁶ The USAID BEP and NALED study identified 370 non-tax levies, 180 of which were “parafiscal” impositions for which businesses received no right, service or asset in return. The costs incurred by authorities in charge were significantly smaller than the amount of the imposition. It was also established that the Republic was in charge of more than three-quarters of those impositions. See in: Mostovi i ćuprije – sistem neporeskih i parafiskalnih formi u Republici

Srbii (Bridges and Traverses – Non-Tax and Parafiscal System in the Republic of Serbia – List, Impacts and Reform Recommendations) (p. 4). (2012). Belgrade: USAID BEP, NALED.

²⁹⁷ Information acquired during interviews with Zoran Alimpić and Aleksandar Bučić.

²⁹⁸ This refers to 2013. Interview with Aleksandar Bučić, quote.

²⁹⁹ Public Finance Bulletin, The Ministry of Finance of the Republic of Serbia, 125. (2015).

³⁰⁰ Some local governments charged sign display fees even for base stations or antennae poles used by mobile operators. Telecommunication companies need to place their business signs on their antennae for insurance reasons. Antennae poles are their basic work instruments, not their business premises or branch offices. The Ministry of Finance issued a conclusion (number 434-06-00046/2011-06 from November 16, 2011), stating that telecommunication companies had already paid for the special licence issued by the state to perform electronic communication activities and to use and maintain the public telecommunication network. Base stations are an integral part of that network. Therefore, placing the business name on the base station cannot be construed as placing a business sign outside of business premises.

³⁰¹ According to the information provided by Dušan Vasiljević during an interview, certain companies that had multiple business units on the territory of one local government had to close some of their branch offices because of high sign display fees.

³⁰² Levitas, A. (2010). The effects of the Suspension of Serbia's Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A Note presented at the round table "Sharing the burden of intergovernmental reforms." Belgrade, Serbia. USAID/MEGA, p. 9.

³⁰³ Information acquired during interviews with Zoran Alimpić and Aleksandar Bučić.

³⁰⁴ For more details, see Article 15a of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012)

³⁰⁵ For more details, see: Popović, D. (2011). Poresko pravo. Beograd: Pravni fakultet Univerziteta u Beogradu.; Lovčević, J. (1991). Institucije javnih finansija. Službeni list SFRJ.

³⁰⁶ Opponents to this solution emphasise their arguments that profit is affected by various factors, that it is not determined transparently and objectively in all cases, and that the rate of evasion is tremendous. It is also not possible to divide one company's profit based on the local government territory, so the distribution of money would become an issue. The corporate income tax is paid according to the seat of the company, so, if surtaxes were to be imposed, vast differences between local governments would occur. Therefore, it would be more beneficial to structure the future communal tax in a way that allows the base to be determined in relation to the location of the company's branch offices, instead of to the seat of the company itself.

³⁰⁷ Business Value Tax (BVT) was conceived by Richard Bird. The BVT has three features that distinguish it as better than all other forms of business taxes: 1. It is a form of the income tax, meaning that both profit and salaries are taxed; 2. Since it is in fact a tax on production, it is determined according to the place of origin, instead of according to the final destination; 3. It is calculated based on accounting reports and data, not based on each individual transaction, and it is calculated on an annual basis. This way, investments are much less discriminated against than it appears at first sight, and definitely less than other business activity taxes. The BVT is a more stable and secure revenue source for lower tier governments than any other business tax. Given that the BVT comes with a rather wide tax base, it is feasible to determine lower rates. This renders its distortion effects minimal, especially so if subnational governments are allowed to impose a single rate on all types of businesses. This prevents discrimination against one group of business subjects compared to others. In a way, the BVT is similar to the value added tax (VAT), but the essential difference is that the VAT targets the destination, whereas the BVT targets the

source of revenue. Bird, R. M. (2010, October). Subnational taxation in developing countries – a review of the literature. The World Bank, Poverty Reduction and Economic Management Network, Economic Policy and Debt Department, Policy Research Working Paper 5450; Martinez-Vazquez, J. (2008). Revenue assignments in the practice of fiscal decentralization. In N. Bosch & J. Duran (eds.), *Fiscal Federalism and Political Decentralization*. UK: Edward Elgar Publishing LTD; Bird, R. M. (2006). Local and regional revenues: Realities and prospects. In R. Bird & F. Vaillancourt (eds.), *Perspectives on Fiscal Federalism*. Washington, DC: WBI Learning Resources Series, WBI; Bird, R. M. (2003, May). A new look at local business taxes. *Tax Notes International*, (30), p. 695-711.; Bird, R. M., McKenzie, K. J. (2001, November). Taxing business: A provincial affair?. *Commentary*, C.D. Howe Institute, Toronto, Canada, 154.; Bird, R. M., Mintz, J. M. (2000). Tax assignment in Canada: A modest proposal. In H. Lazar (Ed.), *The State of the Federation, 2000-01: Toward a New Mission Statement for Canadian Fiscal Federalism* (pp. 263-292). Montreal, Canada: McGill-Queen's University Press for School of Policy Studies, Queen's University; Bird, R. M. (1991). *More Taxing than Taxes? The Taxlike Effects of Nontax Policies in LDCs*. San Francisco, CA: ICS Press.

³⁰⁸ The Law on Planning and Construction, Article 96 (Official Gazette of the Republic of Serbia, 72/2009... 145/2014)

³⁰⁹ The Law on Environmental Protection, Article 87 (Official Gazette of the Republic of Serbia, 135/2004 and 36/2009)

³¹⁰ The Law on the Public-Private Partnership and Concessions, Article 43 (Official Gazette of the Republic of Serbia, 88/2011)

³¹¹ The Law on Utility Services, Articles 24 and 27 (Official Gazette of the Republic of Serbia, 88/2011)

³¹² Levitas, T. (2008). *Izvorni prihodi, ekonomski razvoj i finansiranje infrastrukture u Srbiji danas i sutra. (Own-source Revenues, Economic Development and Infrastructure Finance in Serbia Today and Tomorrow)*. USAID MEGA.

³¹³ Article 60 of the Constitution of the Republic of Serbia (Official Gazette of the Republic of Serbia, 1/90)

³¹⁴ Arsić, M., Vasiljević, D., Bučić, A., & Randelović, S. (2014). *Analiza mogućnosti za kompenzaciju prihoda od naknade za korišćenje građevinskog zemljišta kroz porez na imovinu. (Analysis of Possibilities of the Compensation for Revenues from the Construction Land Use Charge by Means of the Property Tax)*. Belgrade: FREN.

³¹⁵ Arsić, M., Vasiljević, D., Bučić, A., & Randelović, S. (2014). *Analiza mogućnosti za kompenzaciju prihoda od naknade za korišćenje građevinskog zemljišta kroz porez na imovinu. (Analysis of Possibilities of the Compensation for Revenues from the Construction Land Use Charge by Means of the Property Tax)*. Belgrade: FREN, p. 9 and 11.

³¹⁶ The Constitutional Court also ruled illegitimate the criteria pertaining to the purpose of the structure, the maximum construction area index, incentives and exemptions from the charge payment, and the official seat of the charge payer. For more details, see: ³¹⁶ Arsić, M., Vasiljević, D., Bučić, A., & Randelović, S. (2014). *Analiza mogućnosti za kompenzaciju prihoda od naknade za korišćenje građevinskog zemljišta kroz porez na imovinu. (Analysis of Possibilities of the Compensation for Revenues from the Construction Land Use Charge by Means of the Property Tax)*. Belgrade: FREN, p. 11.

³¹⁷ Article 89 of the Law on Amendments and Addenda to the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 24/2011).

³¹⁸ See CLSD publications from the early 2000s, such as: Begović, B., Bisić, M., & Mijatović, B. (2005). *Neka pitanja lokalnih finansija (Some Local Finance Issues)*. Retrieved from

http://www.clds.rs/newsite/publikacije_studije.html and Levitas, A. (2003). Intergovernmental Fiscal Reform in Serbia. Belgrade, Serbia: USAID/SLGRP.

³¹⁹ The Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011 (except for 47/2013 and 68/2014)).

³²⁰ Article 7 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011, 47/2013 and 68/2014).

³²¹ Article 6 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001, 80/2002, 135/2004, 61/2007, 5/2009, 101/2010, 24/2011, 78/2011, 47/2013 and 68/2014).

³²² This estimation was found in Arsić, M., Vasiljević, D., Bučić, A., & Randelović, S. (2014). Analiza mogućnosti za kompenzaciju prihoda od naknade za korišćenje građevinskog zemljišta kroz porez na imovinu. (Analysis of Possibilities of the Compensation for Revenues from the Construction Land Use Charge by Means of the Property Tax). Belgrade: FREN, p. 43.

³²³ This conclusion may be deduced from citizens' tax reports from 2014, which show an increase of 80% compared to 2013.

³²⁴ Source: Baza znanja (USAID/MEGA Knowledge Base). (2010). Retrieved from http://www.skgo.org/pages/display/330/Baza_znanja

³²⁵ Information acquired during an interview with Aleksandar Bučić.

³²⁶ The Law on Amendments and Addenda to the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 24/2011).

³²⁷ The Law on Utility Services (Official Gazette of the Republic of Serbia, 88/2011)

³²⁸ Levitas, T. (2008). Izvorni prihodi, ekonomski razvoj i finansiranje infrastrukture u Srbiji danas i sutra (Own-source Revenues, Economic Development and Infrastructure Finance in Serbia Today and Tomorrow). USAID MEGA.

³²⁹ Article 96 of the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 72/2009, 81/2009, 64/2010, 121/2012, 132/2014 and 145/2014)

³³⁰ Article 93 of the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 72/2009, 81/2009, 64/2010, 121/2012, 132/2014 and 145/2014)

³³¹ Ibid.

³³² Article 93 of the 2009 version of the Law (Official Gazette of the Republic of Serbia, 72/2009)

³³³ Article 93 of the 2009 version of the Law (Official Gazette of the Republic of Serbia, 72/2009)

³³⁴ Interview with Dušan Vasiljević, quote. For more details, see also: Mijatović, B., Begović, B., & Paunović, M. (2007). Reforma naknade za uređenje građevinskog zemljišta (Reform of the Construction Land Development Charge). Belgrade: Centar za liberalno-demokratske studije (CLDS).

³³⁵ Interview with Dušan Vasiljević, quote.

³³⁶ Explanation of the Draft Law on Amendments and Addenda to the Law on Planning and Construction, Ministry of Civil Engineering, Traffic and Infrastructure, Belgrade, July 2014.

³³⁷ The number of informal structures in the City of Belgrade increased by 50,000 in the period between 2003 and 2009. The percentage of legalised family residential structures was around 10%, while the legalisation of commercial structures was much more successful. Žerjav, B. (2013). Studija o mogućnostima finansiranja urbane infrastrukture kroz zahvatanje dodatne vrednosti nekretnina (value capture) u Srbiji: Pregled i pouke internacionalnih iskustava (Study on Possibilities to Finance Urban Infrastructure by Means of Additional Real Estate Value Capture in Serbia: International Experience Overview and Lessons) (pp. 14-15). Belgrade: SKGO. Due to a lack of most recent data, it cannot be said with certainty how many informal structures have been legalised up to 2015, especially because informal (illegal) construction is still an on-going process.

- ³³⁸ Žerjav, B. (2013). Studija o mogućnostima finansiranja urbane infrastrukture kroz zahvatanje dodatne vrednosti nekretnina (value capture) u Srbiji: Pregled i pouke internacionalnih iskustava (Study on Possibilities to Finance Urban Infrastructure by Means of Additional Real Estate Value Capture in Serbia: International Experience Overview and Lessons) (pp. 11). Belgrade: SKGO.
- ³³⁹ Petovar, K. (2003). Urbana sociologija: Naši gradovi između države i građanina. Geografski fakultet Univerziteta u Beogradu.
- ³⁴⁰ Article 97 of the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 72/2009, 81/2009, 64/2010, 121/2012, 132/2014 and 145/2014).
- ³⁴¹ Law on Amendments and Addenda to the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 132/2014).
- ³⁴² Law on Amendments and Addenda to the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 145/2014).
- ³⁴³ Kaganova, O., Govorusic, S. & Markovic, D. (2012). Guidebook on Packaging and Marketing Municipal Land to Investors. Washington, DC: The Urban Institute. <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412532-Guidebook-on-Packaging-and-Marketing-Municipal-Land-to-Investors.PDF>; Kaganova, O., Govorusic, S., Markovic, D., Vasiljevic, D., Bojovic, J., Popovic, O., Hyde, E. (2009). Land allocation and land-related fees and subsidies at local governments in light of the new law on planning and construction: Policy and implementation issues. Washington, DC: United States Agency for International Development – Municipal Economic Growth Activity, The Urban Institute. Retrieved from <http://www.skgo.org/bz/data/1%20Policy%20Notes%20-%20Preporuke/ENG/Land%20Allocation.pdf>
- ³⁴⁴ Žerjav, B. (2013). Studija o mogućnostima finansiranja urbane infrastrukture kroz zahvatanje dodatne vrednosti nekretnina (value capture) u Srbiji: Pregled i pouke internacionalnih iskustava (Study on Possibilities to Finance Urban Infrastructure by Means of Additional Real Estate Value Capture in Serbia: International Experience Overview and Lessons) (pp. 19). Belgrade: SKGO.
- ³⁴⁵ Ibid.
- ³⁴⁶ Article 95 of the Law on Planning and Construction (Official Gazette of the Republic of Serbia, 72/2009, 81/2009, 24/2011, 121/2012, 132/2014 and 145/2014)
- ³⁴⁷ Article 87 of the Law on Environmental Protection (Official Gazette of the Republic of Serbia, 135/2004 and 36/2009)
- ³⁴⁸ The criteria for setting the charge and the maximum amounts are regulated by the Decree on Criteria for Setting and the Maximum Amounts of the Environmental Protection and Improvement Charge (Official Gazette of the Republic of Serbia, 111/2009).
- ³⁴⁹ The Law on Utility Services (Official Gazette of the Republic of Serbia, 88/2011).
- ³⁵⁰ Interview with Saša Paunović, quote.
- ³⁵¹ Ibid.
- ³⁵² The Law on the Public-Private Partnership and Concessions (Official Gazette of the Republic of Serbia, 88/2011).
- ³⁵³ Lawyers in one of the most prominent law offices in Serbia have never had a cases of concession contracts in their practices.
- ³⁵⁴ See Articles 6 and 60-63 of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012). As was explained before, other property taxes (the so-called taxes on dynamic property) – the tax on real estate transfer and the tax on inheritance and gifts – are shared local government revenues that the Republic determines and administers, only to share them entirely with local governments.

³⁵⁵ Articles 5-7a and Article 11 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013)

³⁵⁶ Arsić, M., Randelović, S., Bučić, A., & Vasiljević, D. (2012). *Reforme poreza na imovinu u Srbiji: Rezultati i perspektive* (Property Tax Reform in Serbia: Results and Perspectives). Beograd: FREN.

³⁵⁷ Arsić, M., Randelović, S., Bučić, A., & Vasiljević, D. (2012). *Reforme poreza na imovinu u Srbiji: Rezultati i perspektive* (Property Tax Reform in Serbia: Results and Perspectives). Beograd: FREN.

³⁵⁸ Article 5 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013).

³⁵⁹ More precisely, between January 1 and September 30 of the year preceding the year for which the property tax is determined. For more details, see Article 6 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013).

³⁶⁰ For more details, see Article 5 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013).

³⁶¹ Article 6 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013).

³⁶² Interview with Milica Bisić, quote.

³⁶³ Article 7 of the Law on Property Taxes (Official Gazette of the Republic of Serbia, 26/2001... 47/2013).

³⁶⁴ Arsić, M., Randelović, S., Bučić, A., & Vasiljević, D. (2012). *Reforme poreza na imovinu u Srbiji: Rezultati i perspektive* (Property Tax Reform in Serbia: Results and Perspectives). Beograd: FREN. Slack, E. (2010, June 14-15).

³⁶⁵ Roy Bahl in: Investment Climate Advisory Services of the World Bank Group. (2011). *Avoiding the fiscal pitfalls of subnational regulation – how to optimize local regulatory fees to encourage growth*. Washington, DC: IFC, The World Bank, MIGA; Slack, E. (2010, June 14-15). *The Property Tax in Theory and Practice*. Lecture presented at The 6th Symposium on Fiscal Federalism on Financing Local Governments, Barcelona.; Bird, R. M. (2010, October). *Subnational taxation in developing countries – a review of the literature*. The World Bank, Poverty Reduction and Economic Management Network, Economic Policy and Debt Department, Policy Research Working Paper 5450.; Bird, R. M. (2006). *Local and regional revenues: Realities and prospects*. In R. Bird & F. Vaillancourt (eds.), *Perspectives on Fiscal Federalism*. Washington, DC: WBI Learning Resources Series, WBI.

³⁶⁶ One exception is the analysis of state functions conducted in mid-2015 by the Ministry of Public Administration and Local Self-Government.

³⁶⁷ *Lokalne vlasti ne smeju biti samo posmatrač u pregovorima sa EU*. (2014, December 24). EurActiv. Retrieved from [³⁶⁸ Jerinić, J., & Pavlović-Križanić, T. \(2011\). *Horizontalna i vertikalna koordinacija u postupku donošenja odluka od značaja za lokalnu samoupravu u Srbiji \(Horizontal and Vertical Coordination in the Process of Making Decisions of Importance for the Local Government in Serbia\)*. Belgrade: PALGO.](http://www.euractiv.rs/srbija-i-eu/8189-lokalne-ne-smeju-biti-samo-posmatra-u-pregovorima-sa-eu- andi Jerinić, J., & Pavlović-Križanić, T. (2011). Horizontalna i vertikalna koordinacija u postupku donošenja odluka od značaja za lokalnu samoupravu u Srbiji (Horizontal and Vertical Coordination in the Process of Making Decisions of Importance for the Local Government in Serbia). Belgrade: PALGO.</p></div><div data-bbox=)

³⁶⁹ Ibid.

³⁷⁰ Ibid.

³⁷¹ Article 79 of the Law on Local Self-Government (Official Gazette RS, No. 129/2007)

³⁷² Jerinić, J., & Pavlović-Križanić, T. (2011). Horizontalna i vertikalna koordinacija u postupku donošenja odluka od značaja za lokalnu samoupravu u Srbiji (Horizontal and Vertical Coordination in the Process of Making Decisions of Importance for the Local Government in Serbia). Belgrade: PALGO.

³⁷³ Informator o radu Ministarstva finansija Republike Srbije (Information Booklet of the Ministry of Finance of the Republic of Serbia). (2015). Retrieved from [http://www.mfin.gov.rs/UserFiles/File/o_ministarstvu/2015/Informator_o_radu_avgust_2015\(1\).pdf](http://www.mfin.gov.rs/UserFiles/File/o_ministarstvu/2015/Informator_o_radu_avgust_2015(1).pdf)

³⁷⁴ Rulebook on Internal Organisation and Workplace Classification at the Ministry of Public Administration and Local Self-Government of the Republic of Serbia, 2014. <http://www.mduls.gov.rs/doc/PRAVILNIK%20Ministarstva%20Odrzavne%20uprave%20i%20lokalne%20samouprave%20-%20JUL%202014%20%2013082014.pdf>

³⁷⁵ Information Booklet of the Ministry of Finance of the Republic of Serbia, August 2015. [http://www.mfin.gov.rs/UserFiles/File/o%20ministarstvu/2015/Informator%20o%20radu%20avgust%202015\(1\).pdf](http://www.mfin.gov.rs/UserFiles/File/o%20ministarstvu/2015/Informator%20o%20radu%20avgust%202015(1).pdf)

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³⁷⁷ Decision on the National Decentralisation Council of the Republic of Serbia (Official Gazette RS, No. 21/2009)

³⁷⁸ Article 3 of the Decision on the National Decentralisation Council of the Republic of Serbia (Official Gazette RS, No. 21/2009)

³⁷⁹ Ibid.

³⁸⁰ Decision on the National Decentralisation Council of the Republic of Serbia (Official Gazette RS, No. 21/2009, 46/2013 and 92/2013)

³⁸¹ Article 3 of the Decision on the National Decentralisation Council of the Republic of Serbia (Official Gazette RS, No. 21/2009, 46/2013 and 92/2013)

³⁸² Ibid.

³⁸³ Article 50 of the Law on Local Government Finance (Official Gazette RS, No. 62/2006, 47/2011 and 93/2012)

³⁸⁴ The Commission consists of representatives of the five relevant ministries (finance, public administration and local government, education, social protection, environment). The Commission does not have an established relationship with other ministries.

³⁸⁵ See Articles 50-52 of the Law on Local Government Finance (Official Gazette RS, No. 62/2006, 47/2011 and 93/2012)

³⁸⁶ Interview with Zoran Alimpić, who believes that there is a constant political conflict in two directions. The first one is the division between the ruling parties and the opposition, and the second one is the division between the central and local policy.

³⁸⁷ The meetings of the old Commission were held on 4 May 2009 and 18 May 2009, while the meetings of the new Commission were held on 13 December 2010, 13 September 2011 and 24 April 2016. Information obtained from the SCTM.

³⁸⁸ Information obtained through interviews with Saša Paunović and Aleksandar Bučić.

³⁸⁹ Article 92a of the Law on Budget System (Official Gazette RS, No. 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

³⁹⁰ Articles 92e and 92ž of the Law on Budget System (Official Gazette RS, No. 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

³⁹¹ Article 92i of the Law on Budget System (Official Gazette RS, No. 54/2009, 73/2010, 101/2010, 101/2011, 93/2012, 62/2013, 63/2013, 108/2013, 142/2014 and 68/2015)

³⁹² *Izmene Zakona o finansiranju lokalnih samouprava: Analiza dosadašnjih rezultata i predlog promena.* (2013). In *Ocena seta poreskih zakona*. Belgrade: Fiskalni savet Republike Srbije

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³⁹⁴ The Fiscal Council Report only shows the trend of the two mentioned revenues without going into an in-depth analysis of the trends of other local revenues or analysing local budgets expenditures. *Ostvarenje budžeta, ocena mera Vlade i predlog Fiskalnog saveta za stabilizaciju javnih finansija.* (2013). Retrieved from

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³⁹⁵ The Founding Assembly of the SCTM was held in 1953. *History of the SCTM.* (n.d.). Retrieved from http://www.skgo.org/pages/display/4/Istorija_SKGO

³⁹⁶ Law on Local Self-Government (Official Gazette RS, No. 129/2007)

³⁹⁷ Article 54 of the Law on Local Government Finance (Official Gazette RS, No. 62/2006, 47/2011 and 93/2012).

³⁹⁸ Interview with Aleksandar Bučić, quote.

³⁹⁹ Articles 46-67 of the Rules of Procedure of the National Assembly (Official Gazette RS, No. 52/2010 and 13/2011) regulate the composition, mandates and operation of the committees. The National Assembly of the Republic of Serbia. (n.d.). Retrieved from: <http://www.parlament.gov.rs/narodna-skupstina-/organizacija-i-strucna-sluzba/radna-tela-narodne-skupstine-.2178.html>

⁴⁰⁰ Working Group tasked with introducing and developing the Public Finance Supervision Portal. (n.d.). Retrieved from <http://www.parlament.gov.rs/akti-vnosti/narodna-skupstina/radna-tela/odbori,-pododbori,-radne-grupe/radna-grupa-za-uvodjenje-i-razvoj-portala-za-nadzor-nad-javnim-finansijama.2853.html>

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⁴⁰⁴ Regulation No. 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0001:0007:EN:PDF>

⁴⁰⁵ Regulation (EU) No. 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0473&from=EN>

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Empirical Analysis of the Fiscal Decentralisation Process and the System of Local Government Financing in Serbia from 2000 to 2014

KATARINA ĐULIĆ

Abstract This portion of the study focuses on the third research question - what are the fiscal effects of changes in legislation from 2000 to 2015 on local government budgets in Serbia? The chapter focuses on an in-depth analysis of legal changes on budgetary revenues and expenditures of two local governments – the Capital City of Belgrade and the Municipality of Paraćin. In addition, the analysis measures the level of fiscal decentralisation in Serbia over the observed period, based on the aggregate data for all local governments in the country. The findings show that frequent legal changes implemented by the central government led to volatility of local revenues, which resulted in liquidity problems and accumulation of arrears, jeopardised capital investment and, finally, the inability to make any long-term financial and development plans. The findings also show that ten years of reforms in the area of fiscal decentralisation made the Serbian public finance system less decentralised than it was before reforms began.

Keywords: fiscal analysis of legislative changes • Serbia • local government budgets • municipal revenue • municipal expenditure

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1 Empirical Analysis – Subject, Analytical Approach and Research Methods

After completing the normative analysis, we continue with an empirical analysis. This portion of the study focuses on the research question: what are the fiscal effects of changes in legislation on local government budgets in Serbia? At the very beginning, it is necessary to provide a few important remarks on the subject of this empirical analysis, methodologies used and the analytical approach itself. Also, the structure (map) of the empirical analysis will be presented here, in order to facilitate its flow and conclusions.

As already mentioned, the authors' initial intention was for the subject of the analysis to be budget data for all 145 local government units in Serbia in the period 2006-2014. Alternatively, a stratified sample of 12 local governments was formed (spanning the same period), in case securing access to the requested data for all municipalities proved to be too difficult a task for the Treasury Administration of the Ministry of Finance – the institution that is supposed to possess the data in question. Unfortunately, the Treasury Administration denied both requests, stating that the first request requires “disproportionately large efforts by the line authority, which would render its regular activities substantially more difficult.” The second request was rejected with the explanation that the Administration does not possess the requested data.¹ Every effort to secure the data through direct contact with local governments within the defined sample also ended in failure.

The only local government that responded positively to the authors' request to access budget data was the City of Belgrade, and the budget data spanning the period between 2000 and 2014 were submitted to the authors. The limited access to data led the authors to redefine the research subject and, consequently, the analytical approach. Instead of a sample analysis, the empirical analysis essentially became a case study. However, given that the City of Belgrade is the largest local government unit in Serbia, that the 2012 budget of the City of Belgrade made up approximately 27.4% of all local government budgets in the Republic of Serbia,² and that all changes in legislation that impact local government mandates and finance affected the budget of the City of Belgrade directly, the empirical analysis itself did not become inadequate due to this change. Besides, a case study, compared to an aggregate analysis, allows for more depth in research, a greater focus on details and, in turn, more nuanced conclusions.

Nevertheless, the City of Belgrade is somewhat specific, and the conclusions of an analysis that focused on the capital alone could not easily be generalised and applied to the rest of Serbia. For instance, as was already mentioned, the amount of funds calculated as the total non-earmarked transfer for Belgrade is not paid to the capital. Instead, it is distributed among all other local government units in the form of a solidarity transfer. Further, the share of revenue from the tax on wages of employees

with residence on the territory of the local government is not the same in Belgrade as in other municipalities and cities in Serbia. These specific features of Belgrade required, due to the complexity of the analysis and possible generalisation, for at least one more municipality, which would grant access to its budget data, to be included as a subject. This municipality should be, to the largest extent possible, “an average Serbian municipality.” The chapter on methodology states that a viable candidate was identified in the Municipality of Paraćin, which became the second, parallel case study within our empirical analysis.

In order to acquire the best quality and comprehensiveness of answers, a complementary set of research methods have been used:

- Fiscal analysis of revenue and expenditure of Belgrade and Paraćin in the observed period; this is the most important part of the empirical analysis as it seeks to identify the effect of all relevant regulations on revenues and expenditures of local governments. In order to present realistic condition of fiscal capacity of municipalities, revenues and expenditures are given in EUR according to the median exchange rate on January 1st of the year following the year budget items refer to. (Data on the median exchange rate of the euro are taken from the official website of the National Bank of Serbia.) Given that revenues and expenditures from local government balance sheets concluded on December 31st of the previous year, we believe that this currency date is adequate. Keeping in mind that the Serbian economy is to a large extent “euroised,” we think that it would not be necessary to include additional inflation corrections, since the consistency in calculating the real purchasing power is largely achieved by applying currency fluctuations, that is, different currency dates. If the euro amounts were corrected by the Serbian inflation rate, the purchasing power of budgets that have already been corrected by currency fluctuations would be undervalued. On the other hand, inflation of the euro (in the Eurozone) differs from one country to another, with each country featuring an economic situation different to that of Serbia. The same can be said of average values, regardless of whether we discuss the European Union as a whole or the Eurozone. Therefore, the authors believe that euro inflation would not be an adequate corrective factor to determine local budgets’ purchasing power. Due to data accessibility, the analysis covers the period from 2000 to 2014 for Belgrade and the period from 2006 to 2014 for Paraćin. Since the process of fiscal decentralisation in the normative analysis section of the study is observed in the period between 2000 to today, the empirical analysis in the example of the City of Belgrade will try to evaluate the effect of changes within the same period. A comparative analysis is only possible for the period 2006-2014. Budget data for both cities in the comparative analysis are presented per capita, using data on the population of these two local government units retrieved from the census, which was conducted in the Republic of Serbia in 2011.³

- Detailed examination of national studies on fiscal decentralisation and local government finance from various years in the observed period; some analysed studies contain aggregate budget data for all or for some local governments in the Republic of Serbia in different stages of the observed period. Data from these studies will be used in the effort to both bridge the lack of data for the rest of the Republic of Serbia and to provide context to the case studies and complement the analysis.
- Semi-structured detailed interviews with key stakeholders in Belgrade and Paraćin, as well as in other relevant institutions, who took an active part in fiscal decentralisation processes in Serbia; specifically and most importantly, Mr Zoran Alimpić and Mr Saša Paunović⁴ were interviewed. Mr Zoran Alimpić is the former Deputy Chairman of the City Assembly (2004-2007, 2008-2013), the former Chairman of the City Assembly and acting Mayor of Belgrade (2007-2008), the former Member of the Parliament of the Republic of Serbia (2004-2007) and the former Member of the Committee of the Congress of Local and Regional Authorities of the Council of Europe (2004-2010). Mr Saša Paunović is the Mayor of Paraćin and the former Chairman of the Standing Conference of Towns and Municipalities. These interviews enabled the authors to gain invaluable insight into political, sociological and other processes that transpired in the background of the observed legal and economic changes and that have largely shaped them.

This empirical analysis is chronological and structured around local government budget items. Revenue is analysed in detail first, followed by an analysis of expenditure. The revenue analysis begins with total public assets at the local governments' disposal. These include total current revenue, proceeds from the sale of non-financial assets, as well as proceeds from borrowing and the sale of financial assets. After analysing total public assets and sources thereof, we shall focus on total current revenue, which includes local government own-source revenue, revenue shared by the Republic and transfers made by the Republic, in order to evaluate the fiscal capacity and creditworthiness of a local government. After that, the analysis will further examine the most important individual revenues. The criteria for the selection of these individual types of revenue to be analysed were (i) volume of the revenue itself (i.e., its relevance) and (ii) its sensitivity to legislative changes in the period under observation. During the course of the analysis, revenues were categorised according to their groups (own-source revenues, shared revenues, and transfers), as well as by their nature (taxes, fees, and charges). On the expenditure side, the analysis is somewhat more concise and for the most part follows the manner in which individual funds are used: (i) for current expenditure, and/or (ii) for capital investments. Each individual revenue and expenditure was analysed within the time period under observation, first for the budget of the City of Belgrade, and then for the budget of the Municipality of Paraćin; the two cases were then compared in order to identify possible similarities. During the analysis, particular attention was paid to the main course of legal and institutional changes (the

decentralisation wave – 2000-2008 and the centralisation and pseudo-decentralisation wave – 2009-2014).

As will be shown in the chapters to come, the empirical analysis supports the conclusions presented thus far to a substantial extent. We arrived at these conclusions through the normative analysis of content and the quality of legislation that regulates intergovernmental fiscal relations in the Republic of Serbia.

2 Revenues

Within the period under observation (2000-2014), we can discern two waves of fiscal reforms – one dominated by the central government’s commitment to fiscal decentralisation (the period between 2000 and 2008) and one where centralistic processes prevailed (the period between 2009 and 2014). Notably, the decentralisation period coincided with the period of economic boom, whereas the onset of the economic crisis was the turning point in the intergovernmental fiscal relations. A very similar trend can be identified in Montenegro. In the first phase – from 2003 until 2008 – the Republic of Montenegro adopted the legislation that strengthened the role and fiscal autonomy of local governments. In the second phase – during the period from 2008 until 2015 – a number of the national government’s centralistic policies came into force.⁵

The analysis will be conducted for individual items of the budgets of the City of Belgrade and the Municipality of Paraćin, or more precisely for certain accounts. Article 9 of the Rulebook on the Standard Classification Framework and the Chart of Accounts for the Budget System⁶ stipulates that the Chart of Accounts is comprised of classes, categories, groups, synthetic accounts, analytic accounts and sub-analytic accounts. The Standard Classification Framework and Chart of Accounts are meant to provide the basis for organising and recording all financial transactions made by budget users,⁷ including local government revenues and expenditures.

To begin with, we can observe the general overview of basic trends by taking a look at the graph presenting fluctuations in total public assets of the City of Belgrade in the 2000-2014 period. “Total public assets” encompass (from the Chart of Accounts) class 700,000 (Current revenues), class 800,000 (Proceeds from the sale of non-financial assets) and class 900,000 (Proceeds from borrowing and the sale of financial assets). In fact, these assets represent the total of the budget at the disposal of the City of Belgrade to perform all functions. As was already noted, for reasons of a more objective overview, we present total public assets in thousands of euros.

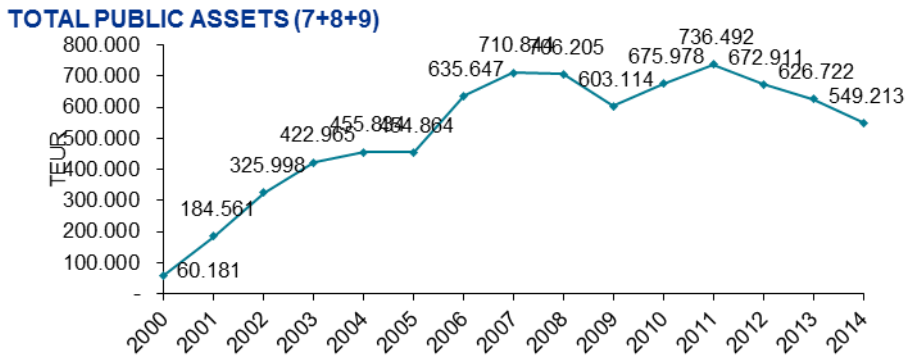


Chart 1. Total public assets – Belgrade

2.1 Decentralisation wave (2000-2008)

The chart clearly shows that, at the very beginning of the decentralisation process, the effects on the City's budget were quite significant. In 2002, total public assets increased 5.4 times compared to the base year of 2000. This drastic increase can to an extent be explained by a relatively low budget volume in the base year, the fact that the country started to recuperate economically, but also by regulatory changes that took place at the very beginning of the transition. Namely, the first wave of decentralisation was started in 2001⁸ with the adoption of the Law on Amendments to the Law on Public Revenue and Public Expenditure⁹ and the Law on Addenda and Amendments to the Law on Local Government.¹⁰ Immediately after that, in January 2002, the process continued with the passing of the Law on Local Government.¹¹ It is important to mention that the 2001-2002 reforms resulted in a radical increase in local government revenue, without the delegation of new functions and tasks.¹² The authors who analysed the period in question conclude that these reforms actually doubled local government revenue. For instance, Levitas states that the growth of local government revenue (in constant 2003 prices) amounted to 21% in 2001 compared to 2000, 52% in 2002 compared to 2001, which is 94% compared to 2000.¹³ Our analysis shows that, in the case of the City of Belgrade, the effects were far more evident. This was probably due to the fact that Belgrade, with much more vital economic activity, gained more from strengthened fiscal autonomy as compared to the rest of Serbia. Although at a slower rate, the growth continued into 2003. The following table clearly shows the increase in total public assets and in the budget of the City of Belgrade during the first years of reforms, compared to the base year of 2000.

Table 1: Budget of the City of Belgrade 2000-2003.

Budget of Belgrade				
TEUR	2000	2001	2002	2003
Total public assets	60,181	184,561	325,998	422,965
Change %	100%	307%	542%	703%

Still, it is necessary to emphasise that fiscal decentralisation and the substantial increase in local government revenue in the observed period were most certainly underpinned by overall positive economic trends in Serbia. GDP growth in 2002 was at 6%, which is substantially higher than the 3.8% in 2000.¹⁴

The period between 2004 and 2006 was a transition period between the system set up by the 2001-2002 reforms and the system that was to be introduced with the new Law on Local Government Finance¹⁵ in 2006. During this analytic period, local government revenues were reduced as a result of the suspension of two major tax sources. First, in July 2004, municipal revenue from the wages fund tax was suspended, after which local governments lost their share in the sales tax starting on January 1, 2005. This came as a serious blow to local government budgets, with some evaluations claiming that they were halved.¹⁶

According to the data on the City of Belgrade, the wage fund tax made up 14.4% of the total budget of the City in 2003, while the sales tax made up 27.3%. Therefore, these two types of revenue aggregately made up a substantial 41.7% of the budget. Starting in July 2004, the City lost its share of the wage fund tax, which can be seen in the relevant account showing an approximately 50% decrease in this revenue in 2004 compared to 2003. In 2004, the sales tax made up almost 30% of the budget of the City of Belgrade.

In order to compensate for this loss, the state first shared 30% of the wage tax with local governments, only to increase their share to 40% in 2006. This increase first became visible in the 2004 budget of the City of Belgrade (when the annual Law on Budget increased the local government share to 30% starting in July), and it became even more remarkable in 2005 (see Table 2). In 2004, this type of revenue of the City of Belgrade increased 3.5 times compared to 2003. In 2005, it was 2.5 times higher, although it amounted to much more in absolute values compared to 2004. Namely, the tax on wages made up almost 30% of the annual budget in 2005, whereas in 2003, it amounted to no more than 4% of the budget.

Table 2: Most significant changes in the budget of the City of Belgrade in the 2004-2006 period

Budget of Belgrade				
TEUR	2003	2004	2005	2006
Tax on salary fund	61,008	31,114	1,400	1,701
Share in public assets	14.4%	6.8%	0.3%	0.3%
Sales tax	115,297	134,843	-	-
Share in public assets	27.3%	30%	0%	0%
Total	176,305	165,957	1,400	1,701
Tax on wages	15,118	53,076	132,858	177,370
Share in public assets	4%	12%	29%	28%
Compensation transfer	-	-	54,089	51,188
Share in public assets	0%	0%	12%	8%
Total	15,118	53,076	186,946	228,559
Total public assets	422,965	455,834	454,864	635,647

From the observed data one can conclude that in 2004 and 2005 the City of Belgrade was compensated for the loss of shared revenues mainly by an increased share in the tax on wages, and much less by the compensation transfer. Nevertheless, the compensation transfer made up a substantial 12% of the budget of the City of Belgrade in 2005 and 8% in 2006.

Chart 1 shows that in 2005 total public assets of the City of Belgrade were decreased slightly to 99.8% of the 2004 budget, only to increase drastically by 39.7%, in 2006. Chart 2, which presents the structure of Belgrade's total public assets, additionally illustrates the aggregate quality of these changes, showing that the share of shared revenues (the category within which the changes took place) fell from 70% in 2004 to 51% in 2006. Also, what is indicative is the trend of compensation transfers in the same period.

Chart 2: Structure of total public assets – Belgrade.

Structure of total public assets - Belgrade

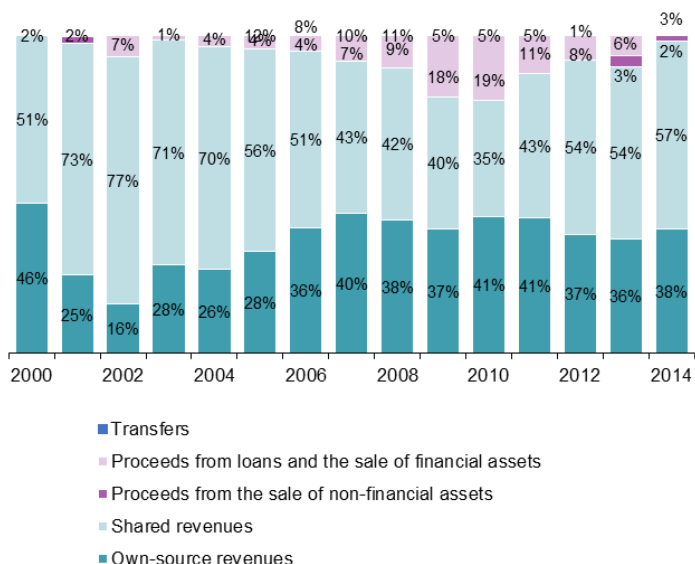


Table 3 shows the macro-image of the effects that the 2004-2005 changes had on the budget of the City compared to the base year of 2000, which is when the decentralisation wave began.

Table 3: Budget of the City of Belgrade 2000-2006.

Budget of Belgrade	2000	2001	2002	2003	2004	2005	2006
TEUR	60,181	184,561	325,998	422,965	455,834	454,864	635,647
Change%	100%	307%	542%	703%	757%	756%	1056%

The last analytic period within the decentralisation wave extends from 2007 to 2008. It was simultaneously the final stage preceding the global economic crisis in 2008. The analysis of the impact of changes introduced by the 2006 Law on Local Government Finance,¹⁷ which became visible in local government budgets starting in 2007, will include the Municipality of Paraćin, since the data for this municipality are available

from 2006 onward. This enables us to draw comparisons between changes and generalise our conclusions more precisely.

Chart 3: Total public assets – Paraćin

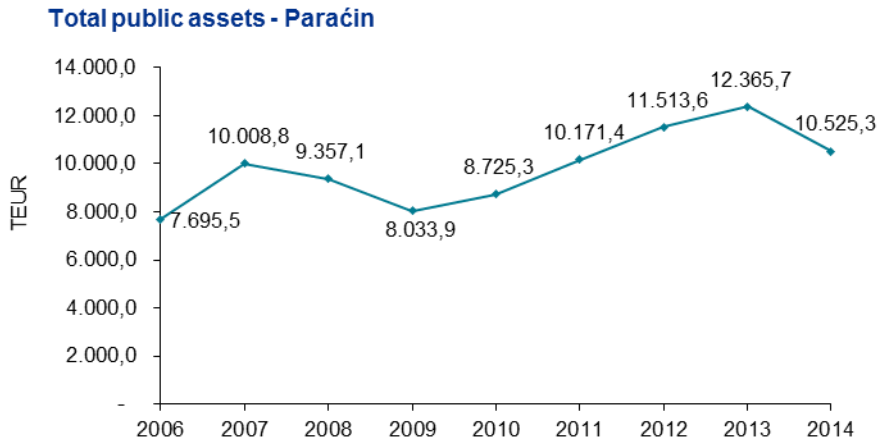
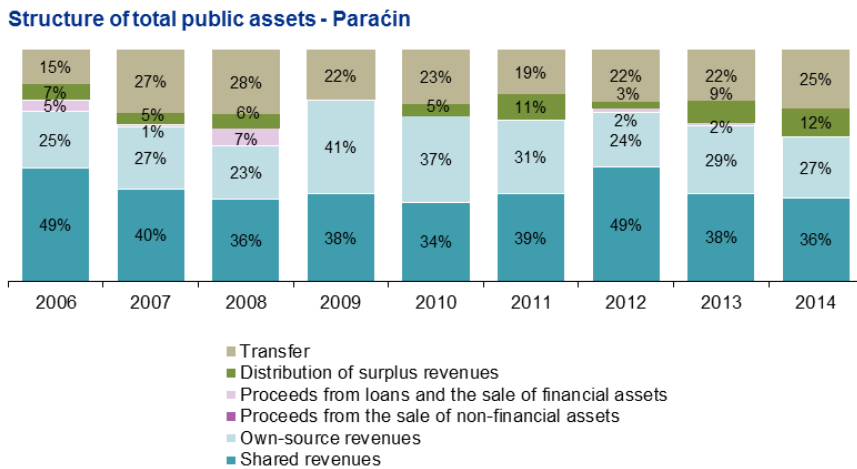


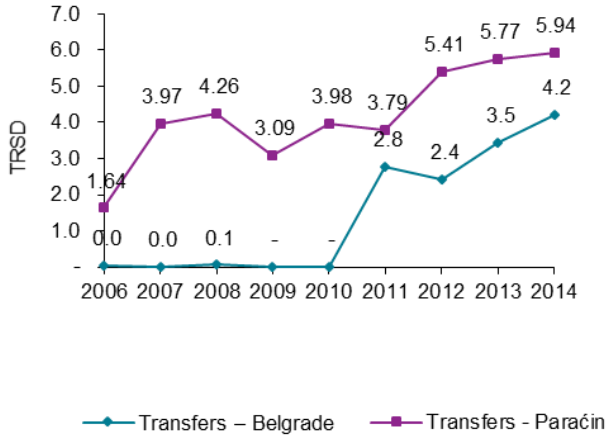
Chart 4: Structure of total public assets – Paraćin.



The said Law introduced the following significant changes to the local government finance system in 2006: (i) all local governments received a 40% share of the income tax; (ii) the total non-earmarked (general) transfer that the Republic divides between local governments was defined as 1.7% of the value of the GDP, as presented by the latest published data of the Statistical Office; (iii) when calculating the general transfer, the key factor was the amount of the equalisation fund (which the City of Belgrade did not receive), even though compensation transfers were also taken into consideration (used to compensate part of revenue lost due to changes in legislation); and (iv) the property tax was declared own-source revenue of local governments. Regarding the last item, it is important to note that local governments were given the authority to set the tax rate themselves within boundaries set as maximum by the central government. Also, the entire administration of this tax was delegated to local governments.¹⁸

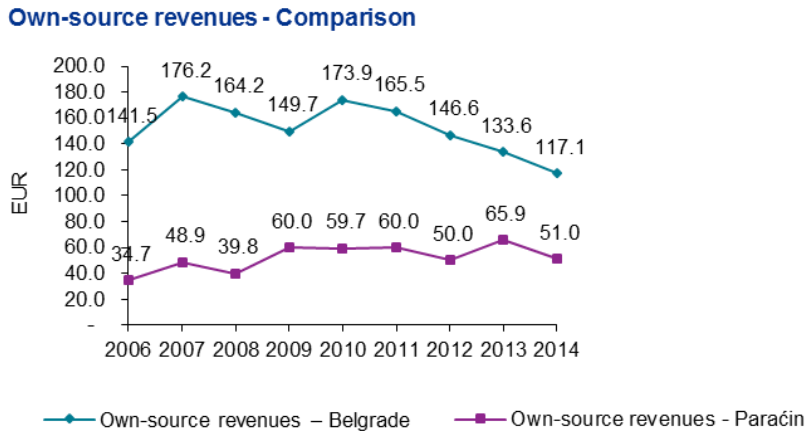
The first analyses showed that total local government revenues increased by 9% in real amounts, compared to 2007. During the first year of implementation of the Law, this growth was for the most part the result of the growth of the general transfer, which impacted poorer municipalities' budgets more than the budget of the capital. Therefore, certain authors state that the growth reached in 2007 improved the fairness of the local government finance system in Serbia.¹⁹

Our data analyses confirm these hypotheses, since in 2007 they show real growth by 11.8% in the case of the budget of the City of Belgrade and 30% in the budget of the Municipality of Paraćin (see Charts 1 and 3). Also, in the budget of the City of Belgrade in 2007, transfers made up for 10% of total public assets, whereas in the Municipality of Paraćin, they reach as high as 27% (see Charts 2 and 4). Chart 5 shows transfers per capita in these two local governments. In 2008, both local governments experienced a minor decrease in revenue, which probably hinted at the impending global economic crisis.

Chart 5: Total transfers – Comparison.**Total transfers – Comparison**

Tendencies of own-source revenues in Belgrade and Paraćin in this period require a special analysis. Namely, after the changes that impacted shared revenues, it was no surprise that local governments reacted by mobilising all their fiscal capacities in an effort to compensate for the loss of shared revenues by better administering their own-source revenues. It appears that in 2007 Belgrade had considerable success in this area, but a further analysis would be necessary to establish how this increase was achieved exactly.

Chart 6: Own-source revenues – Comparison.



Let us first observe the trends of the property tax. Given that our goal is to direct this analysis towards Belgrade’s capacity to generate revenue, focus should be placed on total current revenues. They are more realistic as a measure of a local government’s fiscal capacity than total public assets, which also include proceeds from the sale of non-financial assets (class 8000) and proceeds from loans and the sale of financial assets (class 9000). It follows that the share of the property tax in total current revenues of Belgrade did not change significantly in the said period. In 2006, when this tax was still a shared revenue, it amounted to 4.6% of total current revenues of the City. The change was not great in 2007, when it dropped to 4.2% of total current revenues of the City of Belgrade, only to grow by one per cent, reaching 5.2% of total current revenues in 2008. At the same time, own-source revenues of the City increased significantly in 2007, amounting to some 57.6 million euros more (around 8.4% of total current revenues of Belgrade in 2007). Then, the question is: which own-source revenue is the most instrumental to the increase in Belgrade’s budget? Our analysis shows that the increase must first be attributed to the construction land development charge, which brought in some 47 million euros more in 2007 (the property tax showed an increase of only 27.6 thousand euros). This particular charge made up for 51.4% of own-source revenues in 2006, 57.4% in 2007, and 54% in 2008. In 2008, total current revenues started dropping with the onset of the global crisis.

Table 4: Analysis of selected revenues of the City of Belgrade, 2006-2008.

Analysis of selected revenues of the City of Belgrade			
TEUR	2006	2007	2008
Taxes	321,203.27	309,553.24	302,699.09
Income tax	234,734.31	227,994.51	238,984.02
Real estate transfer tax	83,422.34	79,444.47	62,203.22
Tax on salary fund	1,701.20	795.16	523.19
Other	1,345.41	1,319.10	988.66
Charges	10,455.48	7,858.72	4,924.68
Transfer	51,188.15	72,362.76	79,176.95
Shared revenues (with transfer)	382,846.90	389,774.72	386,800.72
Shared revenues (without transfer)	331,659	317,412	307,624
Taxes	28,384.93	28,412.57	34,330.04
Property tax	28,384.93	28,412.57	34,330.04
Fees	16,915.44	15,834.99	17,277.20
Local communal fees	14,820.72	13,492.14	14,951.61
Other	2,094.72	2,342.86	2,325.59
Charges	162,645.71	213,089.11	192,977.08
Construction land use charge	39,845.40	43,049.15	43,790.77
Construction land development charge	120,670.60	167,760.32	146,912.34
Other	2,129.71	2,279.64	2,273.97
Other revenues	26,899.55	35,131.34	27,818.17
Own-source revenues	234,845.62	292,468.01	272,402.49
Total current revenues	617,692.52	682,242.73	659,203.21
Proceeds from the sale of non-financial assets	-	-	19.35
CURRENT REVENUES AND PROCEEDS FROM THE SALE OF NON-FINANCIAL ASSETS (7+8)	617,693	682,243	659,223

Table 5: Analysis of selected revenues of the City of Belgrade, 2006-2008 (%).

Share – Belgrade	2006	2007	2008
Property tax			
% of total current revenues	4.6%	4.2%	5.2%
% of total public assets	4.5%	4.0%	4.9%
Business sign display fee			
% of total current revenues	1.3%	1.0%	1.2%
% of local communal fees	53.4%	48.3%	54.5%
% of total own-source revenues	3.4%	2.2%	3.0%
Construction land development charge			
% of total current revenues	19.5%	24.6%	22.3%
% of total public assets	51.4%	57.4%	53.9%
Income tax			
% of total current revenues	38.0%	33.4%	36.3%
Own-source revenues			
% of total current revenues	38%	43%	41%
% of total public assets	37%	41%	39%
Shared revenues			
% of total current revenues	54%	47%	47%
% of total public assets	52%	45%	44%
Transfers			
% of total current revenues	8.3%	10.6%	12.0%
% of total public assets	8.1%	10.2%	11.2%

When it comes to Paraćin, in the observed period, both the total budget and own-source revenues experienced substantial growth in 2007 compared to 2006, whereas in 2008, we see a slight decrease in total public assets. In 2006 in the Municipality of Paraćin, own-source revenues made up 33% of total current revenues, while in 2007, they reached 40%. Further analysis shows that this increase was not the result of a significant increase of the property tax, even though it grew from 7.5% of total current revenues in 2007 to as much as 11.2% of total current revenues in 2008. In 2007, a large single jump in revenue from leasing out construction land is recorded, which was accompanied by relatively balanced growth in other own-source revenues, including the property tax.

Table 6: Analysis of selected revenues of the Municipality of Paraćin, 2006-2008.

Analysis of selected revenues of the Municipality of Paraćin			
TEUR	2006	2007	2008
Taxes	3,442.2	3,594.0	3,034.0
Income tax	2,450.9	2,364.4	2,402.4
Real estate transfer tax	734.3	487.2	304.9
Inheritance and gift tax	253	736	326
Other	3.6	6.6	1.0
Fines	0.1	4.6	0.2
Charges	326	402	304
Transfer	1,124.7	2,721.4	2,607.5
Shared revenues (with transfer)	4,895.3	6,724.0	5,948.2
Shared revenues (without transfer)	3,770.6	4,002.6	3,340.7
Taxes	424	542	617
Property tax	424	542	617
Fees	423	501	484
Local communal fees	422	482	452
Other	1.0	19.4	31.2
Charges	763	749	809
Construction land use charge	142.7	140.2	126.4
Environment protection and improvement charge	299.6	315.6	311.5
Construction land development charge	320.6	293.2	371.3
Other and miscellaneous revenues	273.1	860.9	245.5

Own-source revenues	1,883.4	2,652.9	2,156.8
Total current revenues	6,778.7	9,376.9	8,105.0
(Total current revenues – Transfer)	5,654.1	6,655.6	5,497.5
Proceeds from the sale of non-financial assets	0.5	-	-
Total current revenues and proceeds from the sale of non-financial assets	6,779.3	9,376.9	8,105.0
Proceeds from loans and the sale of financial assets	380	129	684
Total public assets	7,695.5	10,008.8	9,357.1
Distribution of surplus revenue	536.1	502.9	567.8
Transfer	1,124.7	2,721.4	2,607.5

Table 7: Analysis of selected revenues of the Municipality of Paraćin, 2006-2008 (%).

Share – Paraćin	2006	2007	2008
Property tax			
% of total current revenues	6.3%	5.8%	7.6%
% of total public assets	5.5%	5.4%	6.6%
Business sign display fee			
% of total current revenues	4.5%	3.7%	3.6%
% of local communal fees	71.5%	72.2%	64.0%
% of total own-source revenues	16%	13%	13%
Construction land development charge			
% of total current revenues	4.7%	3.1%	4.6%
% of total own-source revenues	17.0%	11.1%	17.2%
Income tax			
% of total current revenues	36.2%	25.2%	29.6%
Own-source revenues			
% of total current revenues	28%	28%	27%

% of total public assets	24%	27%	23%
Shared revenues			
% of total current revenues	56%	43%	41%
% of total public assets	49%	40%	36%
Transfers			
% of total current revenues	16.6%	29.0%	32.2%
% of total public assets	14.6%	27.2%	27.9%

We conclude that, in the observed period from 2006 to 2007, both local governments realised growth in their budgets in 2007, followed by a slight drop in 2008. This budget increase was mainly the result of growth in own-source revenues. In the case of Belgrade, this was primarily due to the construction land development charge, whereas in Paraćin, this growth was more balanced, even though it was mostly achieved by a one-time increase in revenues from leasing construction land and a moderate increase of the property tax, which account for more than a half of own-source revenue growth.

2.2 Centralisation wave (2009-2014)

Unfortunately, the wave of decentralisation was abruptly ended with the onset of the global economic crisis in 2008. As early as April 29, 2009, through the amendment to the 2009 budget, the Republic of Serbia decided – due to the impact of the crisis on the budget of the Republic – to suspend the implementation of certain provisions of the Law on Local Government Finance and, consequently, to reduce transfers by 15 billion dinars.²⁰ This decision was made suddenly, in the middle of the budget year, without giving local governments the time or manoeuvring space to adjust. Levitas shows that, aggregately observed, the decrease in total revenues of local governments in Serbia in the 2007-2009 period was great – around 15%. According to his calculations, 45% of the 30 billion dinar loss in these two years came as a direct consequence of the suspension of implementation of the transfer system, whereas the rest of the loss may be ascribed to the global economic crisis.²¹ This reduction continued into 2010 and 2011.

Which local government revenues received the hardest blow during the first years of the crisis? Levitas aggregately analysed the first effects of the global economic crisis on all local government revenues in Serbia, so his analysis represents a useful reference framework for the study of Belgrade and Paraćin.²² He states that the decrease was the largest in revenues from non-earmarked transfers. Also, own-source revenues were significantly lowered (by 10% in 2009, compared to 2007), although not all of them by the same dynamic. Revenues from the construction land development charge decreased the most (aggregately as much as by 39%, amounting to almost 6% of total local government revenues in 2009), followed by the sale and lease of local government

assets (a 25% drop, or around 1.5% of budgets of all local governments).²³ As for shared revenues, a substantial decrease was recorded in revenue from the real estate transfer tax. All this leads to a conclusion that taxes closely related to the real estate market were the first victims of the global economic crisis, with Levitas concluding that wealthier local governments were affected more than the poorer ones.²⁴ It is interesting to note that the revenue from the shared tax on wages recorded the smallest decrease, indicating that at the very beginning of the recession employers had not yet begun laying off employees.²⁵

How did local governments react to these challenges? One logical answer is their attempt to more aggressively mobilise their fiscal capacities pursuant to the 2006 Law on Local Government Finance. Levitas' analysis shows that, aggregately observed, the highest increase was in the land use charge (18%), followed by the property tax (15%), and certain local communal fees (11%). He also states that Belgrade and Novi Sad resorted to borrowing to a greater extent than other municipalities. Namely, revenues from loans and the sale of assets in these two cities increased by as much as 86% in 2009, compared to 2007. He concludes that the 2009 changes had a disproportionately bigger impact on Belgrade and other more developed cities because they were mostly hit by both the sudden reduction of transfers and the collapse of the real estate market.²⁶

Let us now put Levitas' conclusions to a test, in particular those regarding the general situation in Serbia, by comparing them to our analysed local governments – the City of Belgrade and the Municipality of Paraćin. We will first analyse the City of Belgrade in detail, and then focus on the Municipality of Paraćin.

In 2009, the City of Belgrade shows a substantial drop in total current revenues of as much as 116.895 million euros. However, the decrease of the total budget (i.e., total public assets) was somewhat smaller - 103.091 million euros. Chart 8 and Table 8 indicate the nature of restructuring that took place in the City's budget. It is apparent that the significant decrease in revenues was primarily the result of the reduction of transfers and the drop of revenues from the construction land development charge. A detailed analysis of budget accounts confirms Levitas' data analysis on the level of the whole of Serbia – revenues from the real estate transfer tax dropped significantly, by as much as 48%, compared to 2008. One alleviating factor was the fact that, at the time, this tax had little importance for the balance of the budget of Belgrade. At the same time, in 2009, a large portion of the total loss was compensated by loans and moderate, but not aggressive, mobilisation of own-source revenues. Also, contrary to predictions, both the tax on wages and the revenue from the lease of real estate recorded growth. Let us observe these changes in more detail.

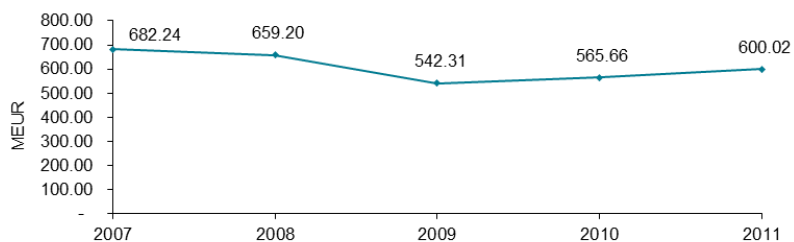
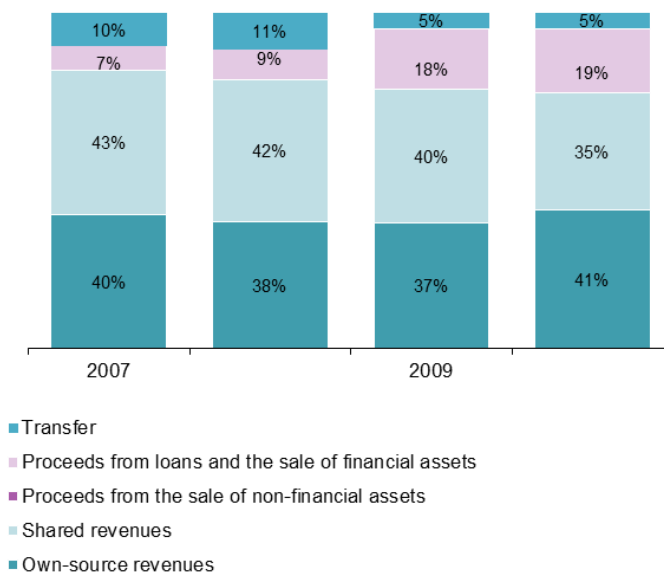
Chart 7: Total current revenues (transfers included) Belgrade, 2007-2011.**Total Current Revenue****Chart 8:** Structure of total public assets – Belgrade, 2007-2010.**Structure of total public assets - Belgrade**

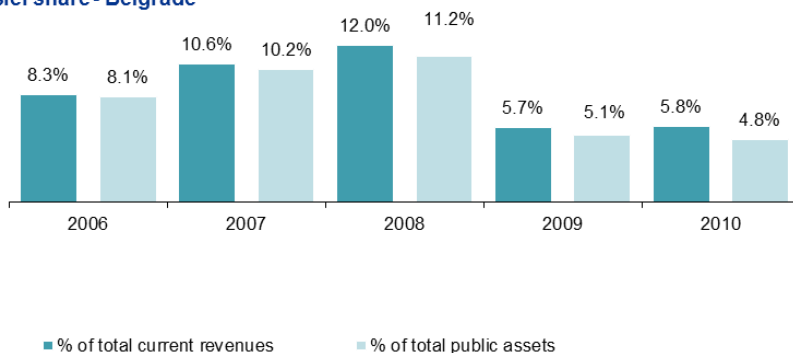
Table 8: Analysis of selected revenues of the City of Belgrade, 2008-2010 (%).

Belgrade – Absolute amounts and shares			
TEUR	2008	2009	2010
Tax on wages	173,905	167,619	153,534
% of total current revenues	26%	31%	27%
Total transfers	79,177	30,873	32,715
% of total current revenues	12%	6%	6%
General non-earmarked transfers	79,177	28,631	31,334
% of total current revenues	12%	5%	6%
Own-source revenues	272,402	248,445	288,652
% of total current revenues	41%	46%	51%
Property tax	34,330	36,822	42,738
% of total current revenues	5%	7%	8%
Own-source fees	17,277	17,472	22,950
% of total current revenues	3%	3%	4%
Business sign display fee	8,145	7,870	11,059
% of total current revenues	1%	1%	2%
Motor vehicle fee	303	97	363
% of total current revenues	0.05%	0.02%	0.06%
Administrative fees	998	791	1,186
% of total current revenues	0.15%	0.15%	0.21%
Own-source charges	192,977	159,338	169,672
% of total current revenues	29%	29%	30%
Construction land use charge	43,791	56,052	88,175
% of total current revenues	7%	10%	16%
Construction land development charge	146,912	100,951	79,442
% of total current revenues	22%	19%	14%
Environment protection and improvement charge	2,274	2,336	2,055
% of total current revenues	0%	0%	0%
Total current revenues	659,203	542,308	565,660

Chart 9 clearly illustrates the effect of reducing the total non-earmarked transfer on the budget of the City in 2009. In 2009, in Belgrade, the share of transfers in total current revenues and the budget were halved. It is necessary to repeat the list of transfer categories here, in order for the changes to be more clearly visible and understood.

Chart 9: Share of transfers in total current revenues and total public assets, 2006-2010, Belgrade.

Transfershare - Belgrade



Namely, within the 733000 group (Intergovernmental transfers), the Chart of Accounts distinguishes between the synthetic account 733100 – current intergovernmental transfers – and the synthetic account 733200 – capital intergovernmental transfers.²⁷ The Law on Local Government Finance divides transfers into non-earmarked and earmarked.²⁸ Earmarked transfers, as their name suggests, address needs that are determined in advance. They are further divided into (i) earmarked transfers in the narrow sense, which are intended to perform tasks within the original and delegated domains,²⁹ and (ii) functional transfers, used to finance expenditures within a defined function.³⁰ According to the 2006 legislation, valid at the time of the aforementioned reduction, non-earmarked transfers included: (a) the transition transfer (the function of this transfer was short-term; it was later replaced by the solidarity transfer, distributed between all local governments with the exception of the City of Belgrade),³¹ (b) the compensation transfer (intended to compensate for part of the loss due to legislative changes),³² (c) the equalisation transfer (redistributed revenues towards poorer local governments)³³ and (d) the general transfer.³⁴

While capital transfers are one-time revenues and are related to a local investment supported financially by the Republic, current non-earmarked transfers are “regular” revenues, so local governments included them in their annual budget plans. Chart 10 clearly shows how important non-earmarked transfers were for the City of Belgrade,

given that it was the only type of transfer received by the capital. In that sense, the first major shock to the budget of Belgrade came with the drastic reduction of this transfer. It caused the loss of 50.546 million euros, which is 43.2% of the decrease in total current revenues in 2009. Let us now take a look at the changes in own-source revenues.

Chart 10: Transfer share and trends, 2008-2014, Belgrade.

Transfer share and trends - Belgrade

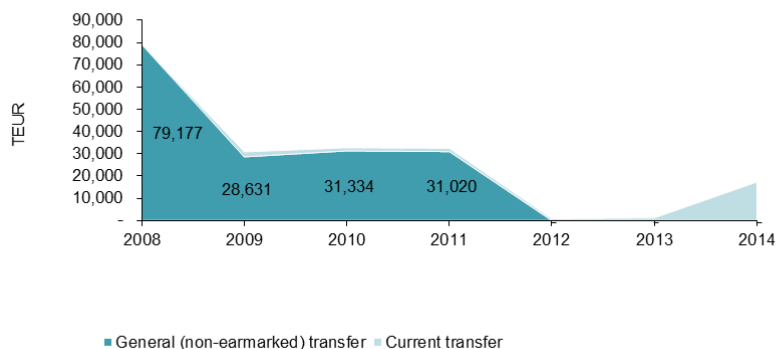


Table 9 shows that there was a drop of 9% in Belgrade’s own-source revenues in 2009, while the following chart shows changes in the structure of own-source revenues in the observed period.

Table 9: Own-source revenues, Belgrade, 2008-2010, (%).

Percentage change Belgrade	2008	2009	2010
%	2008	2009	2010
Own-source revenues	100%	91%	106%

Chart 11: Structure of own-source revenues, 2007-2010, Beograd.**Structure of own-source revenues**

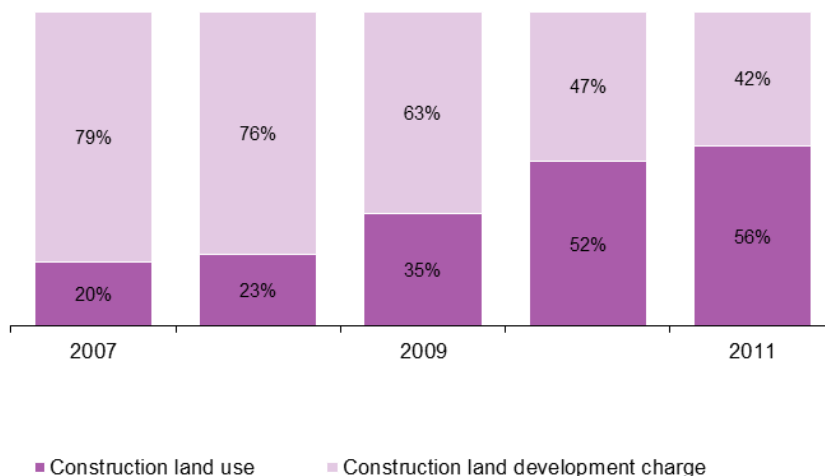
Chart 11 leads to the conclusion that, in 2009 in the City of Belgrade, the most significant changes occurred in the own-source charges category. Also, as already mentioned, there is a remarkable increase in loans (the category of other and miscellaneous revenues), as well as a discrete increase in shares of the property tax and the construction land use charge in own-source revenues. The following table focuses on own-source charges in the observed period.

Table 10: Own-source charges, Belgrade – changes, 2008-2010, (%).

Percentage change Belgrade	2008	2009	2010
%	2008	2009	2010
Construction land use charge	100%	128%	201%
Construction land development charge	100%	69%	54%
Environment protection and improvement charge	100%	103%	88%
Own-source charges	100%	83%	106%

Chart 12: Structure of own-source charges, 2007-2010, Belgrade.

Structure of own-source charges - Belgrade

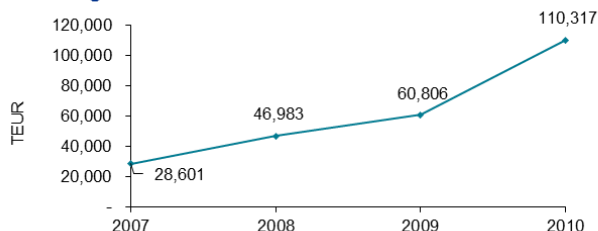


Tables 8 and 10, as well as Chart 12, confirm Levitas’ assumption that the largest decrease was recorded in the construction land development charge, and that this can for the most part explain the drop in own-source revenues in 2009. Most local governments compensated for this loss by increasing the construction land use charges. Therefore, we may conclude that out of the total current revenue loss in the City of Belgrade, which amounted to 116.895 million euros in 2009, as much as 96.507 million euros (or 82.6%) may be ascribed to:

- Reducing non-earmarked transfers (50.546 million euros) and
- Direct consequences of the crisis, reflected in the decrease of revenue from the construction land development charge (45.961 million euros).

As we have already said, the tax on wages and proceeds from leasing out real estate recorded a moderate increase in the same period.

Finally, Chart 13 confirms Levitas’ statement that, in 2009, Belgrade tried to compensate for a significant part of the sudden loss in the 2009 by taking out loans. The chart illustrates the major growth in loans in the period between 2007 and 2009, as Levitas concludes,³⁵ with a 30% increase in 2009, compared to 2008. It may be concluded that Belgrade did resort to loans in the observed period, but this effort was not sufficient to solve the problem of the unexpected deficit in the budget.

Chart 13: Loans, 2007-2010, Belgrade.**Loans - Belgrade**

Let us now turn our attention to the Municipality of Paraćin. Table 11 and Charts 14 and 15 clearly illustrate interesting changes that occurred in the Paraćin municipal budget in 2009. First, we notice that total current revenues have decreased negligibly. If we analyse the structure of total public assets (Chart 15), it is noticeable that the share of individual revenues in the total budget of the Municipality of Paraćin diminished more significantly.

Table 11: Analysis of selected revenues of the Municipality of Paraćin, 2008-2010, (%)

Paraćin – Absolute amounts and shares	2008	2009	2010
TEUR	2,020	1,822	1,689
Tax on wages	2,020	1,822	1,689
% of total current revenues	24.9%	22.7%	20.4%
Total transfers	2,608	1,747	2,046
% of total current revenues	32.2%	21.8%	24.7%
Own-source revenues	2,157	3,255	3,236
% of total current revenues	26.6%	40.5%	39.1%
Property tax	617	482	761
% of total current revenues	7.6%	6.0%	9.2%
Own-source fees	484	780	878
% of total current revenues	6.0%	9.7%	10.6%
Business sign display fee	289	343	426
% of total current revenues	3.6%	4.3%	5.1%
Motor vehicle fee	108	358	419
% of total current revenues	1.3%	4.5%	5.1%

Administrative fees	29	6	6
% of total current revenues	0.4%	0.1%	0.1%
Own-source charges	809	1,708	1,255
% of total current revenues	10.0%	21.3%	15.2%
Construction land use charge	126	404	586
% of total current revenues	1.6%	5.0%	7.1%
Construction land development charge	371	842	413
% of total current revenues	4.6%	10.5%	5.0%
Environment protection and improvement charge	312	462	256
% of total current revenues	3.8%	5.8%	3.1%
Total current revenues	8,105	8,030	8,268

Chart 14: Total current revenues, Paraćin, 2007-2011.

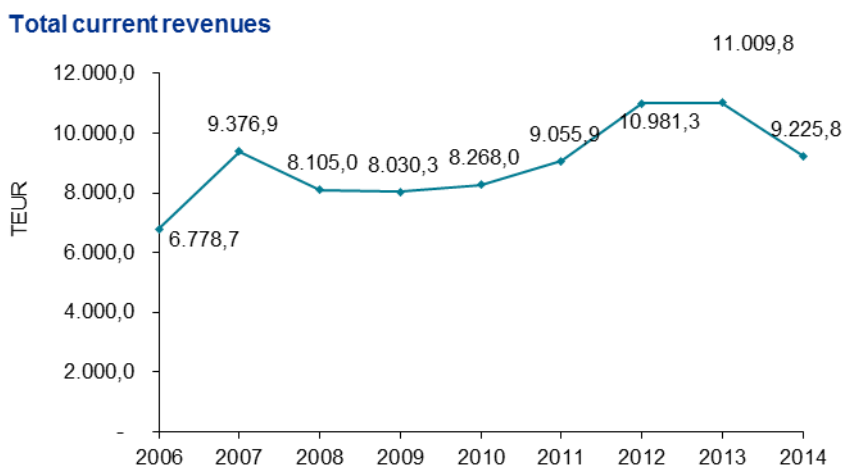
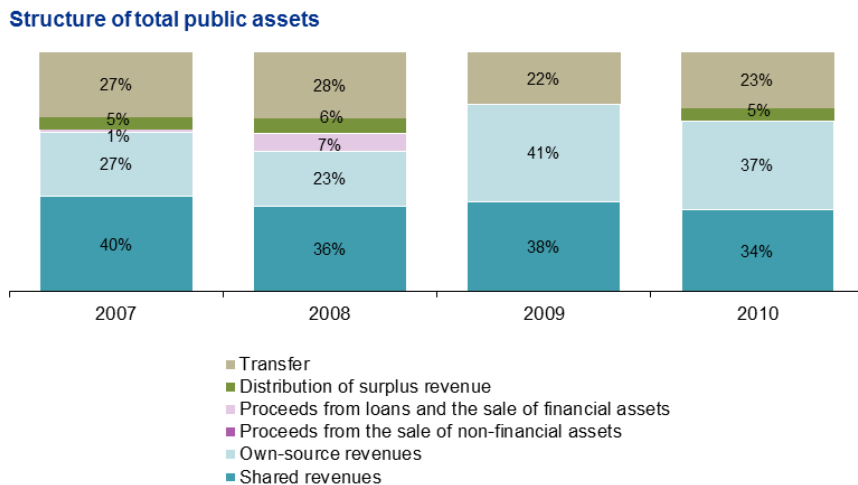


Chart 15: Structure of total public assets, Paraćin, 2007-2010.

Namely, the decrease in the share of transfers and the major increase of own-source revenues, which were almost doubled, are quite noticeable. Even though the decrease in transfers is significant for the budget, given that they represented almost one third of total current revenues in 2008, it appears that the drop was largely alleviated by the dramatic rise of own-source revenues. It is important to note that Paraćin chose not to solve the problem of the budget deficit by borrowing. Also, in 2009, the distribution of the surplus revenue does not appear on the chart, but this revenue category is of a lesser importance for this analysis.

Chart 16: Share of transfers in total current revenues and total public assets, 2006-2010, Paraćin.

Transfer share - Paraćin

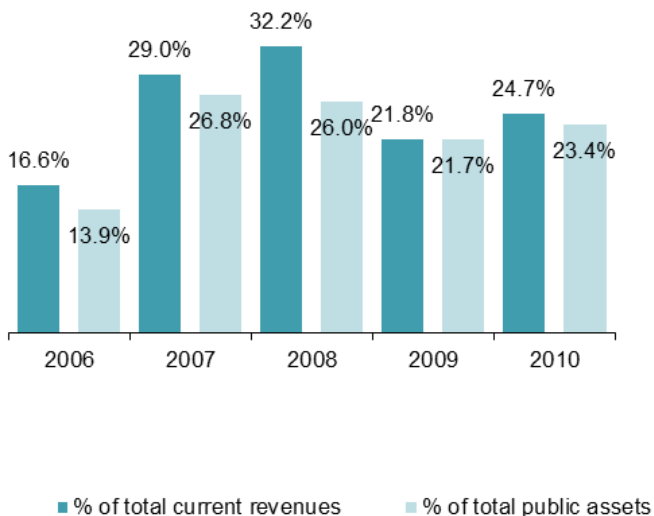
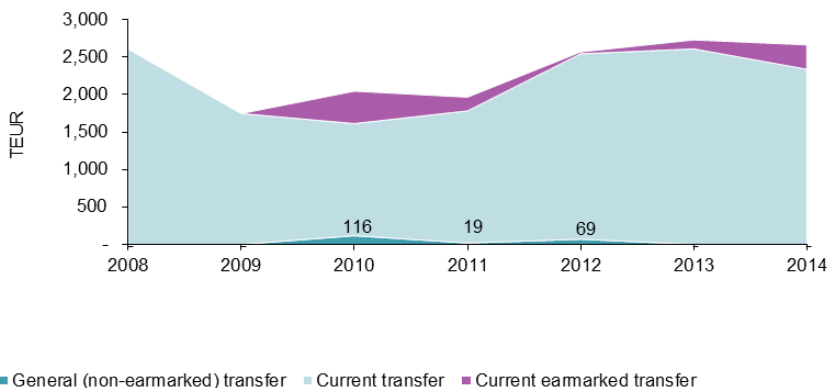


Chart 17: Transfer share and trends, 2008-2014, Paraćin.

Transfer shares and trends - Paraćin



In the case of Paraćin, it is necessary to make one more remark related to transfers, which is visible in Charts 16 and 17. In the municipal budget, the category of non-earmarked transfers is registered on two accounts – 733151 and 733152 – shown in Chart 17 in dark blue (733151) and light blue (733152), respectively. According to the Budget System Chart of Accounts,³⁶ account 733151 is used to record non-earmarked transfers from the central government to municipalities, whereas account 733152 shows other current intergovernmental transfers. However, the budget of the Municipality of Paraćin marks account 733151 as “current intergovernmental transfers” and account 733152 as “current intergovernmental transfers benefitting the municipality.” Regardless of this inconsistency, it is obvious that Charts 16 and 17 show that the municipality of Paraćin receives different categories of non-earmarked current transfers. The changes in the entire non-earmarked transfer affected Paraćin less than Belgrade because Paraćin was entitled to the equalisation transfer, which was not accessible to the City of Belgrade as it is the wealthiest local government in Serbia.

Table 12: Own-source revenues of the Municipality of Paraćin, 2008-2010, (%).

Percentage change Paraćin			
%	2008	2009	2010
Own-source revenues	100%	151%	150%

However, what is especially interesting is the growth of own-source revenues. Namely, in 2009, in spite of the first wave of the crisis, own-source revenues of the Municipality of Paraćin increased by 51% (see Table 12). It appears that this once again confirms Levitas’ theory that wealthier local governments were harder hit by the crisis and that they did not only suffer from the suspension of general non-earmarked transfers. Still, an additional explanation is also viable. Given the Municipality’s fiscal capacity compared to the City of Belgrade, borrowing was most probably a less attractive and less realistic option for Paraćin in 2009. It is possible that this fact caused the Municipality to more quickly and efficiently mobilise its potentials, which the 2006 Law on Local Government Finance made possible, and to try to compensate for the budget deficit through the better collection of own-source revenues.

Chart 18: Structure of own-source revenues, 2007-2010, Paraćin.

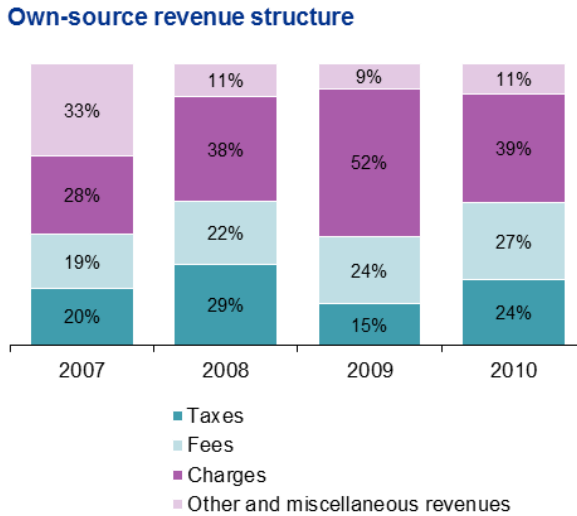


Chart 18 shows the structure of the Municipality’s own-source revenues in the analysed period. The chart clearly suggests that particular attention should be paid to the category of “charges,” which registered the highest growth.

Table 13: Own-source charges, Paraćin – Changes, 2008-2010, (%).

Percentage change Paraćin			
%	2008	2009	2010
Construction land use charge	100%	320%	145%
Construction land development charge	100%	227%	111%
Environmental protection and improvement charge	100%	148%	82%
Own-source charges	100%	211%	155%

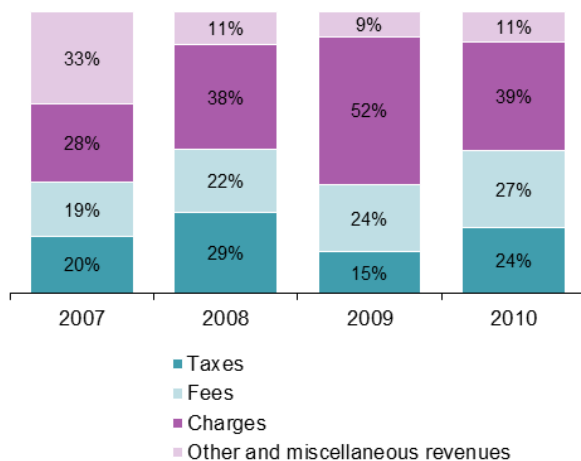
Chart 19: Structure of own-source charges, 2007-2010, Paraćin.**Own-source revenue structure**

Table 13 suggests that Paraćin reacted faster than Belgrade to the reduction in revenues caused by the crisis and the reduction of non-earmarked transfers by mobilising its own revenues in a more efficient way. Namely, revenues from the construction land use charge increased by as much as 320% in 2009 compared to 2008 that is by 145% in 2010 compared to the base year of 2008. Most probably, this is a cumulative effect of increasing the amount of this charge and of its improved collection. When it comes to the construction land development charge, which was the one-time revenue charged for developing and preparing land before the construction of structures, the reason for its sudden increase is probably the larger volume of investments compared to 2008,

coupled with the increase of its amount. In any case, Levitas' statement that wealthier cities were affected more by the crisis and the 2009 legislation changes is confirmed through the examples of the City of Belgrade and the Municipality of Paraćin.

Table 14: Tax on wages, Paraćin – Changes, 2008-2010, (%).

Percentage change Paraćin			
%	2008	2009	2010
Tax on wages	100%	90%	84%

Finally, as shown by Table 14, revenues from the tax on wages in Paraćin decreased during 2009 and 2010, which was probably caused by the onset of the crisis and the drop in the employment rate and wages. At the time, Belgrade was still not experiencing the decrease in revenues from this shared tax.

After the sudden centralist decision to reduce non-earmarked transfers in 2009, there came an unexpected shift in 2011, when the Ministry of Finance made two important decentralist steps. The first had to do with the tax on wages and the second with transfers. First, the Law on Local Government Finance was amended, increasing the local government share of revenues from the tax on wages from 40% to 80%. Due to the fact that a disproportionate number of the employed reside in the City of Belgrade, and that the tax on wages is paid according to the territory of the local government, it was decided that Belgrade would receive 70% of this tax. According to some authors' assessments, these changes caused a loss of some 45 billion dinars in the budget of the Republic of Serbia, which was 1.5% of the GDP of Serbia at the time.³⁷

Second, the decision was made to further reduce transfers to more developed municipalities. Namely, as already mentioned, certain provisions of the Law on Local Government Finance were suspended and non-earmarked transfers were decreased for all cities and municipalities in 2009. The suspension of the Law would remain in force in the years to come, and the 2011 amendments to the Law on Local Government Finance reduced total non-earmarked transfers to a "calculation category," which resulted in its effective decrease. Also, the so-called solidarity transfer was introduced as a form of redistribution of funds from Belgrade to other cities and municipalities in Serbia. The starting assumption was that Belgrade benefited the most from the new way in which revenues from the tax on wages were distributed. Therefore, for reasons of solidarity, funds calculated as the total non-earmarked transfer for the City of Belgrade were redistributed as a solidarity transfer to all other local governments, according to the formula set forth by the law.

The Fiscal Council of the Republic of Serbia³⁸ criticised these changes in 2011. The proposal was deemed unsustainable because it required major fiscal adjustments that did not happen. Further, the proposal that 80% of the revenues from the tax on wages should go to local governments was viewed as unfounded in modern fiscal practice, which only adds to differences between the developed and underdeveloped municipalities. Finally, even though changes in the transfer system were considered to be a step forward in the right direction in terms of addressing these differences, it was underlined that the changes were arbitrary and inferior to solutions introduced by the 2006 Law.³⁹ In spite of the opposition of the Fiscal Council, the proposed amendments were passed in mid-2011 and came into force on October 1, 2011.

Let us now turn our attention to the effects of the 2011 changes, first on the budget of the City of Belgrade and then on the budget of the Municipality of Paraćin.

Chart 20: Structure of total public assets, 2010-2014, Belgrade.

Structure of total public assets - Belgrade

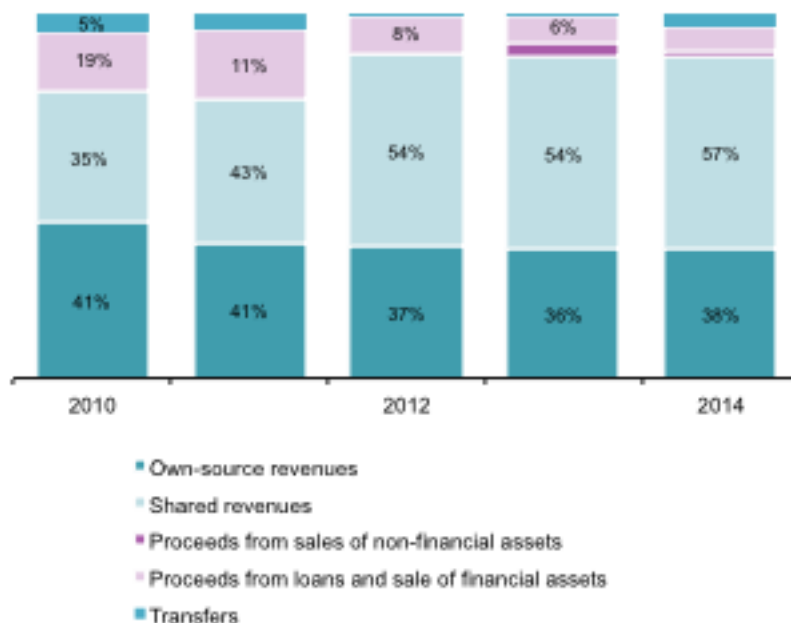


Chart 21: Transfer share, 2010-2014, Belgrade.

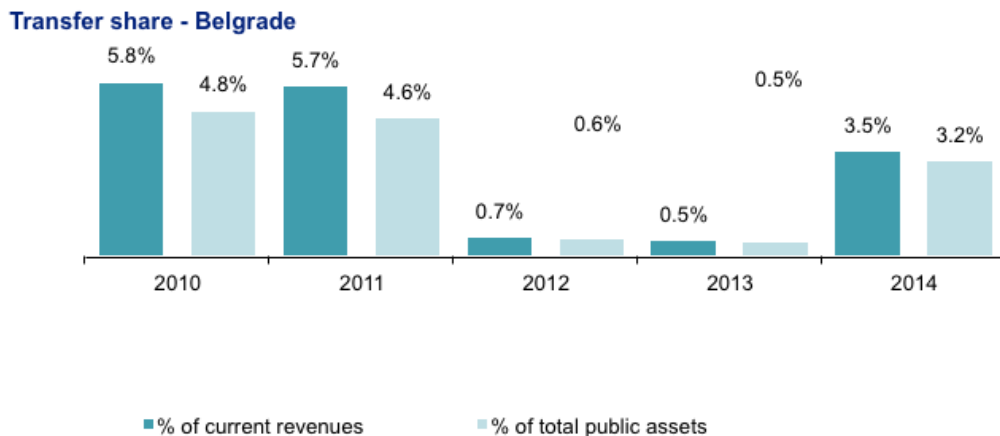


Chart 20 illustrates both of the significant changes that occurred in 2011. As was already mentioned, the described changes in the Law on Local Government Finance were adopted on June 29, 2011. They came into force eight days after being published in the Official Gazette and were implemented starting on October 1, 2011. That is why the full effect of the changes was not visible before 2012, even though the trend can be spotted as early as in the last trimester of 2011. Therefore, Chart 20 clearly shows the changes in the structure of total public assets. The trend of growth of shared revenues is registered, primarily caused by the increased share of the income tax, whereas in 2012, one perceives a substantial drop in transfers. Chart 21 confirms that the full effect of transfer-related changes is only visible in 2012, when the share of transfers in total current revenues drops from 5.7% to 0.7%. Table 15 analyses the changes illustrated by Charts 20 and 21 in more detail.

Table 15: Shared revenues, 2008-2014 period, Belgrade.

Analysis of shared revenues of the City of Belgrade	2008	2009	2010	2011	2012	2013	2014
TEUR							
Taxes	302,699.09	257,734.18	237,468.63	282,176.32	346,822.21	328,076.97	285,355.68
Income tax	238,984.02	226,146.91	208,190.30	252,333.80	321,130.93	304,488.24	263,090.88
Real estate							

transfer tax	62,203.22	30,046.49	28,176.89	27,702.27	23,678.09	21,770.90	20,753.99
Tax on salary fund	523.19	70.46	8.80	16.50	7.53	13.29	40.48
Other	988.66	1,470.33	1,092.65	2,123.76	2,005.65	1,804.54	1,470.33
Fines	-	149.27	1,908.05	2,058.84	1,866.76	1,814.15	1,829.16
Charges	4,924.68	5,106.85	4,916.89	7,179.58	6,304.80	1,907.02	4,779.68
Transfers	79,176.95	30,873.05	32,714.85	34,024.15	4,044.49	2,974.41	17,508.69
Shared revenues (with transfers)	386,800.72	293,863.35	277,008.42	325,438.89	359,038.26	334,772.56	309,473.22
Shared revenues (without transfers)	307,624	262,990	244,294	291,415	354,994	331,798	291,965

Table 15 shows that the most significant effect of the 2011 changes was related to the income tax. Data received from the Statistical Office of the Republic of Serbia explain why this is the case. Namely, the data show that in 2011 around 23% of all employed persons in the Republic of Serbia lived in the Belgrade region.⁴⁰ That is the reason why it was decided to share 70% of the income with Belgrade instead of 80% (which was the case with other local governments).

When it comes to this particular shared revenue, it is necessary to add that there are many categories of personal income. Therefore, this revenue is registered under many sub-analytic accounts in the budget of the City: account 711111 registers the most prolific revenue from the income tax – the tax on wages; account 711121 registers shared revenue from individual business activity paid based on actual generated net revenue; account 711122 registers shared revenue from individual business activity paid based on flat-rate net revenue; finally, account 711123 registers shared taxes on revenues from individual business activity paid based on self-taxation. Even though each of these types of income underwent changes, the most important change was registered for account 711111 and relates to wages. Chart 22 shows the growth of the income tax, whereas Table 16 illustrates the increase of the tax on wages.

The purpose of the 2011 changes was to compensate local governments for the losses they had in 2009. However, instead of simply implementing all provisions of the valid Law on Local Government Finance, thus reinstating solutions related to non-earmarked transfers, the then Minister of Finance resorted to a completely new decentralist measure. The City of Belgrade benefited very much from this new solution. At the time of the adoption of the new regulations in 2011, the number of the employed in Belgrade was 497,002, which, as already mentioned, made up for as much as 23% of the total number of the employed in the Republic of Serbia (2,166,656). Also, the average salary in Belgrade amounted to 68,315 dinars (706 euros) in June 2011, which is more than the national average of 54,616 dinars (564 euros).⁴¹ That explains the second part of the

reform, which included the introduction of the new horizontal equalisation system by establishing the solidarity transfer and redistributing a part of shared revenues from Belgrade to other local governments.

Chart 22: Income tax, 2009-2014, Belgrade.

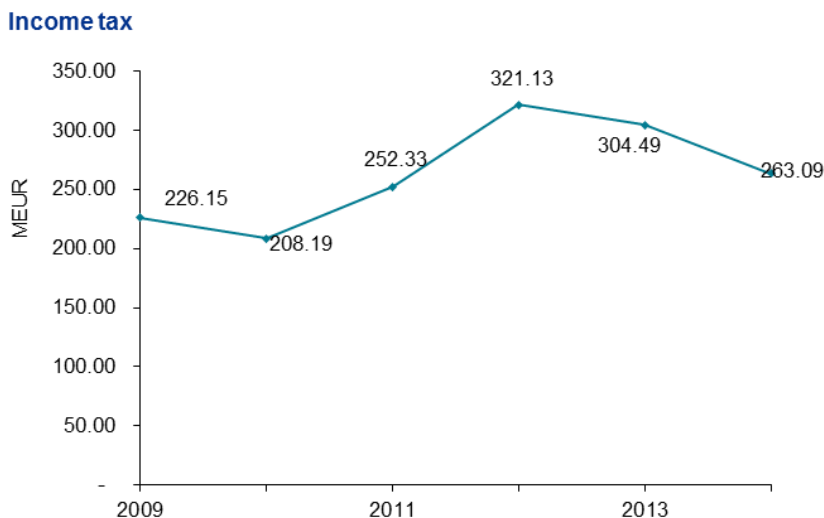


Table 16: Income tax, Belgrade – Changes, 2008-2014, (%).

Percentage change Belgrade	2008	2009	2010	2011	2012	2013	2014
%	100%	96%	88%	111%	152%	141%	124%
Income tax	100%	96%	88%	111%	152%	141%	124%

What was the impact of the 2011 changes on the Municipality of Paraćin? The analysis of the structure of total public assets shows substantial growth in the share of shared revenues in total public assets, as well as an increase of transfers. As a reminder, the changes related to transfers in 2011 did not hit Belgrade and other local governments to the same extent. All non-earmarked transfers were suspended for Belgrade. The solidarity transfer was introduced in order to achieve horizontal equalisation, flowing into all local government budgets, except into that of Belgrade. Chart 24 (and Table 17) register a decrease in transfers in Paraćin in 2011, which was the result of a change in the way non-earmarked transfers were calculated in the period between 2009 and 2011. Still, as already mentioned, it was not until 2012 that the effects of the 2011 changes in

the calculation of transfers were fully registered. Our data for the year clearly show an increase.

Chart 23: Structure of total public assets, 2010-2014, Paraćin.

Structure of total public assets

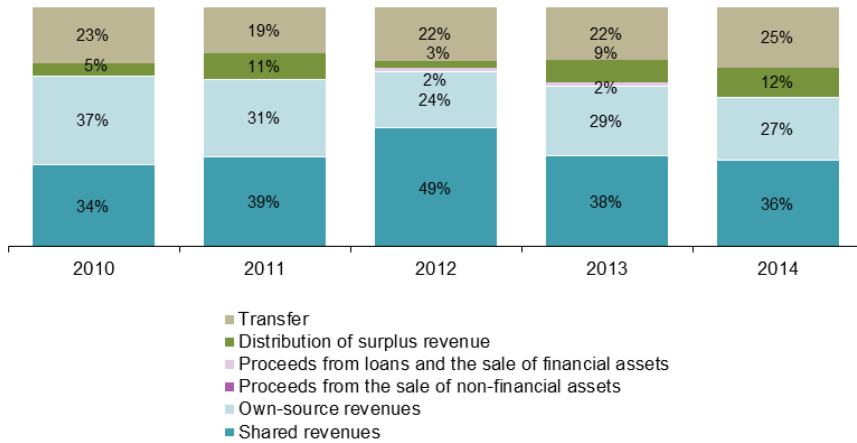
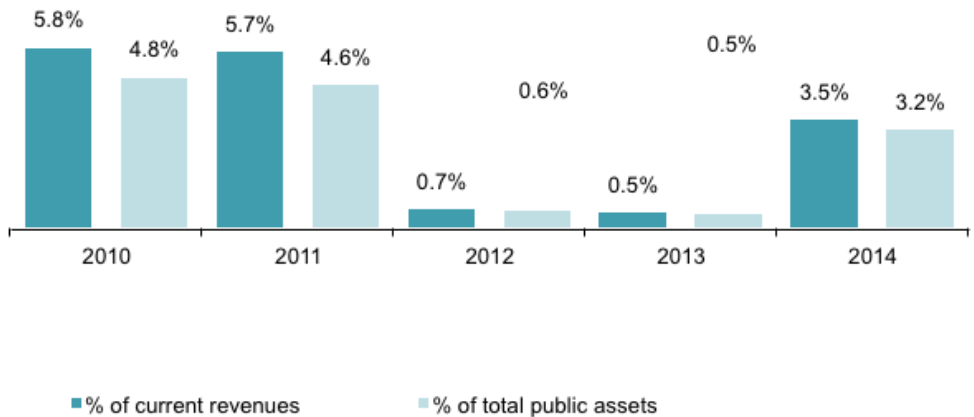


Chart 24: Transfer share, 2010-2014, Paraćin.

Transfer share - Belgrade



Comparing trends in per capita transfers in the City of Belgrade and the Municipality of Paraćin also illustrates the relatively higher significance (and amount) of transfers for a less developed Municipality of Paraćin, (see Chart 25). This is particularly clear when this insight is correlated with the trends in per capita total public assets in the same period in these two local governments (see Chart 26).

Chart 25: Transfer trends, 2010-2014, comparison – Belgrade and Paraćin.

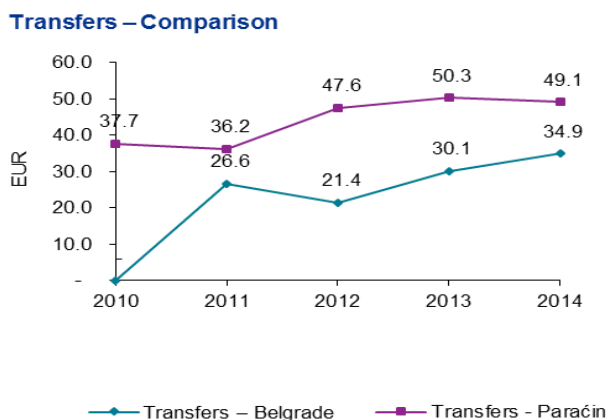
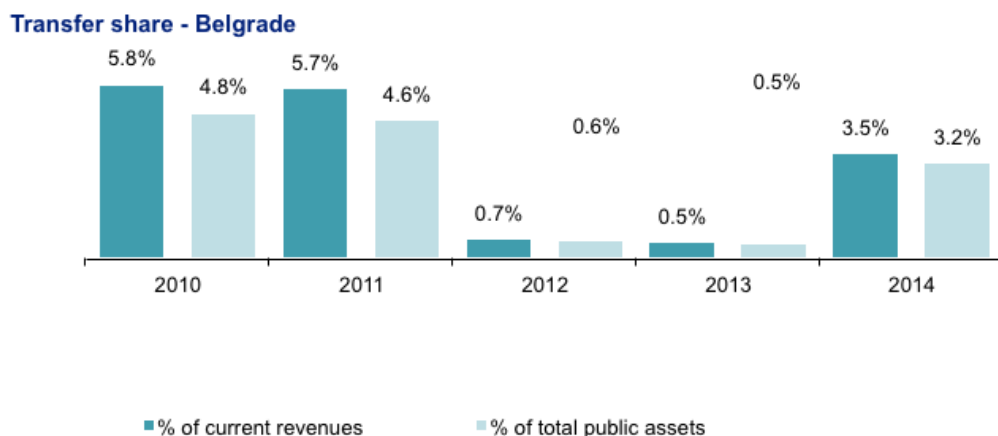


Chart 26: Total public revenue trends, 2010-2014, comparison – Belgrade and Paraćin.



Tables 17 and 18 and Charts 27 and 28 analyse shared revenues in Paraćin in detail and show trends present in the shared revenue from the income tax.

Table 17: Analysis of shared revenues, 2008-2014, the Municipality of Paraćin.

Analysis of shared revenues of the Municipality of Paraćin							
TEUR	2008	2009	2010	2011	2012	2013	2014
Taxes	3,034.0	2,750.0	2,674.7	3,515.1	5,347.2	4,516.0	3,603.9
Income tax	2,402.4	2,198.3	2,065.5	2,834.6	4,850.8	3,905.7	3,280.2
Real estate transfer tax	304.9	259.3	316.0	253.6	170.0	149.3	160.3
Inheritance and gift tax	326	297	294	425	325	460	160
Other	1.0	(4.4)	(1.2)	1.5	1.2	0.5	3.4
Fines	0.2	3.2	51.1	52.2	59.0	56.7	88.1
Charges	304	274	260	270	284	135	103
Transfers	2,607.5	1,746.9	2,045.6	1,965.2	2,580.0	2,729.9	2,663.7
Shared revenues (with transfers)	5,948.2	4,775.0	5,032.4	5,802.9	8,270.5	7,437.3	6,458.7
Shared revenues (without transfers)	3,340.7	3,028.1	2,986.8	3,837.6	5,690.5	4,707.4	3,795.0

In 2010, the income tax made up for 41% of shared revenues (with transfers) in the Municipality of Paraćin; in 2011, this share reached 49%, and in 2012 it went up to 58.6%. Although one would not expect Paraćin to profit from changes related to this tax to the same extent as Belgrade, Paraćin reaped considerable benefits. Namely, in 2012, shared revenues from the income tax per capita in Belgrade made up for 53.3% of total current revenues per capita, while in Paraćin this percentage was 44.71. The average salary in June 2011 in Paraćin amounted to 40,395 RSD (417 euros)⁴².

Regulations concerning the income tax, or the tax on wages, underwent one more significant change by the end of the analysed period. Namely, in 2013, the income tax rate was decreased from 12% to 10%, while the tax base was reduced by increasing its non-taxable portion. The effects of this new reduction again affected both local government budgets and are clearly shown in Charts 22 and 27 and Tables 16 and 18 for Belgrade and Paraćin, respectively.

Chart 27: Tax on wages, 2008-2014, the Municipality of Paraćin.

Tax on wages – Paraćin

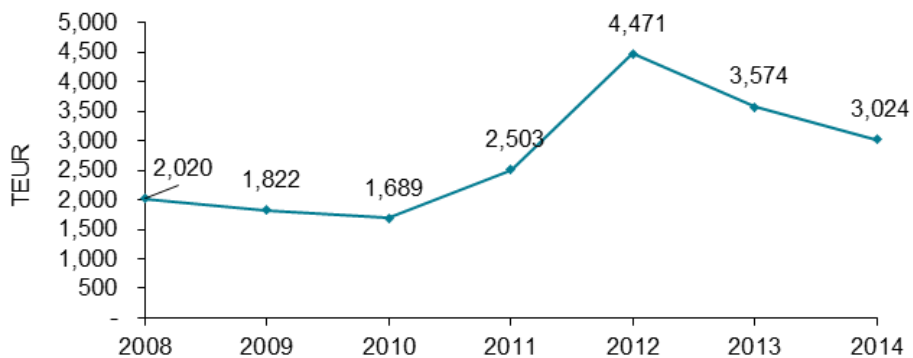
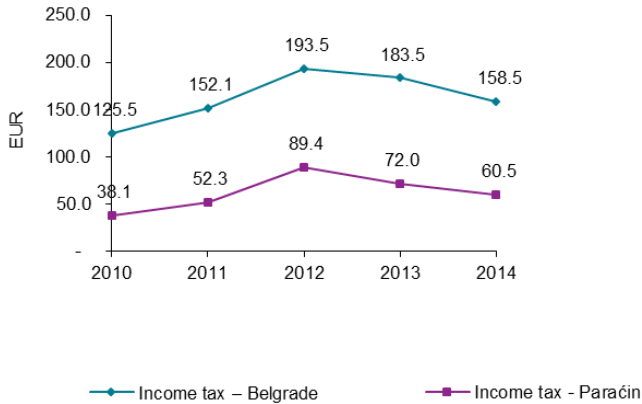


Table 18: Tax on wages, 2008-2014, the Municipality of Paraćin.

Percentage change Paraćin	2008	2009	2010	2011	2012	2013	2014
%	2008	2009	2010	2011	2012	2013	2014
Tax on wages	100%	90%	84%	124%	221%	177%	150%

Chart 28: Income tax, 2010-2014, comparison – Belgrade and Paraćin.**Income tax – Comparison**

In September 2012, certain types of own-source fees and shared charges were either suspended or substantially reformed. The goal of these changes, allegedly, was to reduce the burden on businesses. The central government concluded that local governments tried to compensate for shortages in their budgets, which resulted from the reduction of non-earmarked transfers, by additionally burdening businesses through imposing higher local fees and charges. Even before these measures were implemented, in 2010, the Republic had stopped sharing two types of charges with local governments.⁴³ Then, in 2012, the aforementioned measures were introduced. An entire range of local communal fees and shared charges was suspended. These changes came into force in the last trimester of 2012, so their effects can only partially be seen in local government budgets in that year. The full effect of these changes is clearly visible in budgets in 2013.

When it comes to shared charges, in 2012 six types of water charges that were local government shared revenues were suspended. For the purpose of comparison, not one water charge that was the Republic's revenue got suspended. Then, five types of shared road charges were also suspended, as well as one shared environmental charge (which was part of the environment pollution charge related to motor vehicles).

As for fees, national regulation changes meant the suspension of seven local fees, with an additional three undergoing significant changes.⁴⁴ The business sign display fee and the motor vehicle fee were changed. Namely, the maximum amount local governments may charge for these fees was set. Two fees were merged into one (business sign

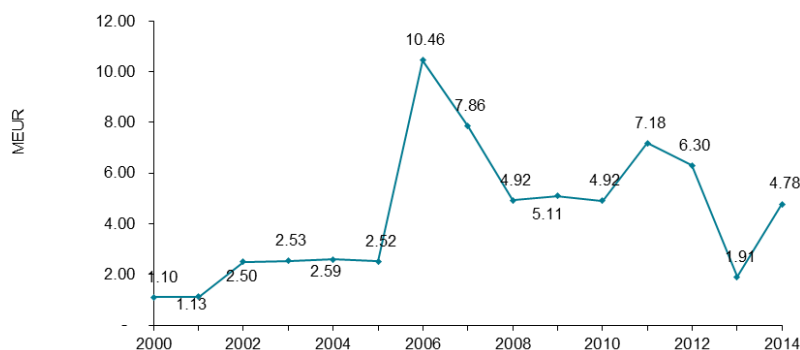
display outside business premises and using billboards), for which the central government also determined the maximum amount.

Given that these changes were analysed in detail in the part focusing on regulatory changes, let us now pay attention to the effect they had on the budgets of the City of Belgrade and the Municipality of Paraćin, respectively.

Chart 29 clearly shows a significant drop in shared charges as early as in 2012, and the decrease in 2013 is dramatic – in that year, this category of revenue dropped to 30.3% of its amount in the previous year.

Chart 29: Shared charges trends, 2000-2014, Belgrade.

Shared charges trends - Belgrade



Was the Republic correct to claim that own-source fees were (ab)used in order to increase own-source revenues and close the gaps in local governments’ budgets caused by regulation changes in 2009 and 2011? Table 19 shows that, in the case of Belgrade, this assumption might be correct. Namely, we have said that Belgrade failed to react as quickly as Paraćin, meaning that own-source revenue growth was not visible until 2010. Table 19 shows that own-source fees rose dramatically up until 2012, followed by a drop caused by the aforementioned changes. However, Table 20 shows that these types of revenue had little impact on the total budget of the City. Also, amounts shown in the table indicate that this burden on businesses was far from unbearable. On the other hand, it appears justified that local governments resorted to the authority the Law on Local Government Finance gave them and mobilised their fiscal capacities to cover budget deficits. Faced with abrupt and significant cuts in certain types of revenues mid-year (revenues they were legitimately counting on), Serbian local governments were

forced to react. Additional revenue could only be secured in two ways – additional taxation of either businesses or citizens. The choice they made, to increase fiscal impositions on businesses, seems justifiable. When, in the period to come, there were efforts to compensate for shortages in local budgets by increasing impositions paid by citizens by increasing the property tax, criticisms of local governments became even harsher.

Table 19: Own-source fees, 2008-2014, percentage change, compared to 2008, Belgrade.

Percentage Change Belgrade							
%	2008	2009	2010	2011	2012	2013	2014
Business sign display fee	100%	97%	136%	189%	161%	113%	106%
Motor vehicle fee	100%	32%	120%	280%	412%	251%	192%
Administrative fees	100%	79%	119%	116%	108%	107%	80%
Own-source fees	100%	101%	133%	187%	181%	125%	117%

Table 20: Own-source fees, 2008-2014, Belgrade.

Belgrade, Absolute amounts and shares							
TEUR	2008	2009	2010	2011	2012	2013	2014
Own-source fees	17,277	17,472	22,950	32,239	31,255	21,516	20,197
% of total current revenue	3%	3%	4%	5%	5%	4%	4%
Business sign display fee	8,145	7,870	11,059	15,432	13,092	9,204	8,651
% of total current revenue	1%	1%	2%	3%	2%	2%	2%
Motor vehicle fee	303	97	363	847	1,247	759	580
% of total current revenue	0.05%	0.02%	0.06%	0.14%	0.21%	0.14%	0.12%
Administrative fees	998	791	1,186	1,154	1,078	1,068	799
% of total current revenue	0.15%	0.15%	0.21%	0.19%	0.18%	0.19%	0.16%

When it comes to Paraćin, a drop in shared charges is also noticeable. In 2013, these charges were at 47.5% of their 2012 amounts (this decrease is, therefore, smaller than in Belgrade). Own-source fee growth is visible as of 2008. It is interesting to note that the highest increase was registered in 2009, while slightly more moderate growth was seen in 2010. After that, a decreasing trend is recorded until the end of the observed period. It is also interesting that, in the case of Paraćin, the motor vehicle fee shows the highest volatility (and spikes). One can also notice that own-source fees contribute much more significantly to the budget of the Municipality of Paraćin than to the budget of the City

of Belgrade. This is particularly valid in cases of the business display fee and the motor vehicle fee, which together generate almost all own-source fee revenues in the Municipality of Paraćin.

Chart 30: Shared charges trends, 2006-2014, Paraćin.

Shared charges – Paraćin

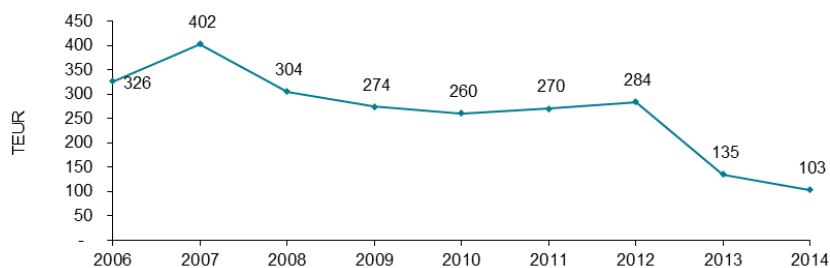


Table 21: Own-source fees, 2008-2014, percentage change compared to 2008, Paraćin.

Percentage change, Paraćin							
%	2008	2009	2010	2011	2012	2013	2014
Business sign display fee	100%	119%	147%	128%	104%	101%	89%
Motor vehicle fee	100%	330%	386%	381%	326%	183%	183%
Administrative fees	100%	22%	93%	107%	64%	125%	72%
Own-source fees	100%	161%	182%	167%	140%	104%	104%

Table 22: Own-source fees, 2008-2014, Paraćin.

Paraćin, Absolute amounts and shares							
TEUR	2008	2009	2010	2011	2012	2013	2014
Own-source fees	484	780	878	808	679	503	505
% of total current revenue	6.0%	9.7%	10.6%	8.9%	6.2%	4.6%	5.5%
Business sign display fee	289	343	426	371	300	292	257
% of total current revenue	3.6%	4.3%	5.1%	4.1%	2.7%	2.7%	2.8%

Motor vehicle fee	108	358	419	413	354	198	199
% of total current revenue	1.3%	4.5%	5.1%	4.6%	3.2%	1.8%	2.2%
Administrative fees	29	6	6	6	4	5	4
% of total current revenue	0.4%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%

The last wave of changes in the observed period took place in 2013 and 2014. Namely, in 2013, changes were introduced in the methodology of calculating business entities' property tax. A decision was made to take the fair property value for the base of this tax, instead of the accounting property value, which was the practice until then. Then, revenues from the tax on income generated by real estate, which was a 100% shared revenue according to the Law on Local Government Finance, became a type of revenue that the Republic received in its entirety. Most of these changes came as a response to the conclusion that the 2011 changes related to the tax on wages were introduced hastily, and that the effects of those changes had a disproportionately negative impact on the budget of the Republic.

What was the effect of these changes on our local governments' budgets? When it comes to the City of Belgrade, Chart 31 (and Table 23) clearly show a growth trend in the property tax. The dark blue colour marks the period when the Republic levied this tax and shared it with the capital, while the light blue shows the period when this tax was own-source revenue of the local government. It is noticeable that the tax was administered more efficiently when it became own-source revenue, as well as that after the 2013 changes, it increased by 91.3% (as compared to the previous year). Table 24 shows that this tax represents very significant revenue to the City. Concretely, in 2014, it amounts to as much as 18.5% of total current revenues of Belgrade, whereas in 2008 it contributed with a mere 5.2% of total current revenues. Table 24 also clearly illustrates the growing importance of the income tax in the City's budget. On the other hand, the construction land development charge and transfers gradually became less and less important for Belgrade.

Chart 31: Property tax, 2000-2014, Beograd.

Property tax – Belgrade

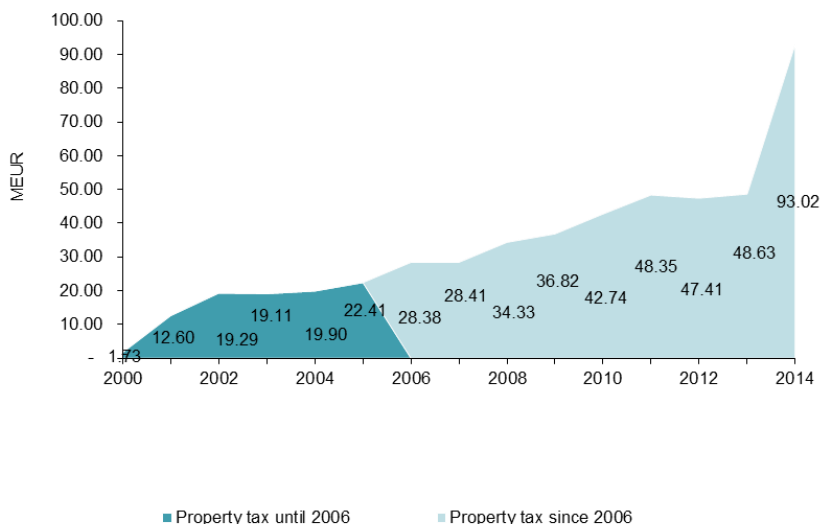


Table 23: Property tax, 2008-2014, percentage change, Belgrade.

Percentage change Belgrade	2008	2009	2010	2011	2012	2013	2014
%	2008	2009	2010	2011	2012	2013	2014
Property tax	100%	107%	124%	141%	138%	142%	271%

Table 24: Share of individual revenues in the budget of the City, 2008-2014, Belgrade.

Share of individual types of revenue in the budget of Belgrade	2008	2009	2010	2011	2012	2013	2014
Property tax							

% of total current revenue	5.2%	6.8%	7.6%	8.1%	7.9%	8.7%	18.5%
% of total public assets	4.9%	6.1%	6.3%	6.6%	7.0%	7.8%	16.9%
Business sign display fee							
% of total current revenue	1.2%	1.5%	2.0%	2.6%	2.2%	1.7%	1.7%
% of LCT	54.5%	51.1%	54.1%	52.0%	45.4%	48.3%	48.8%
% of total own-source revenues	3.0%	3.2%	3.8%	5.6%	5.4%	4.2%	4.5%
Construction land development fee							
% of total current revenue	22.3%	18.6%	14.0%	9.0%	8.3%	6.8%	6.2%
% of total own-source revenues	53.9%	40.6%	27.5%	19.6%	20.5%	17.1%	16.1%
Income tax							
% of total current revenue	36.3%	41.7%	36.8%	42.1%	53.3%	54.7%	52.2%
Own-source revenues							
% of total current revenue	41%	46%	51%	46%	40%	40%	39%
% of total public assets	39%	41%	43%	37%	36%	35%	35%
Shared revenues							
% of total current revenue	47%	48%	43%	49%	59%	60%	58%
% of total public assets	44%	44%	36%	40%	53%	53%	53%
Transfers							
% of total current revenue	12.0%	5.7%	5.8%	5.7%	0.7%	0.5%	3.5%
% of total public assets	11.2%	5.1%	4.8%	4.6%	0.6%	0.5%	3.2%

In the case of the Municipality of Paraćin, similar trends can be observed. Property tax growth was stable, yet less dramatic (see Chart 32 and Table 25). Chart 33 compares revenues generated by the property tax per capita in the two local governments. Up until 2013, this revenue had a greater share in Belgrade, but that difference was not large. In 2014, the property tax generated more than double the usual per capita revenue in the city of Belgrade than in the Municipality of Paraćin, which is logical given the value of real estate in these two locations.

Chart 32: Property tax, 2006-2014, Paraćin.

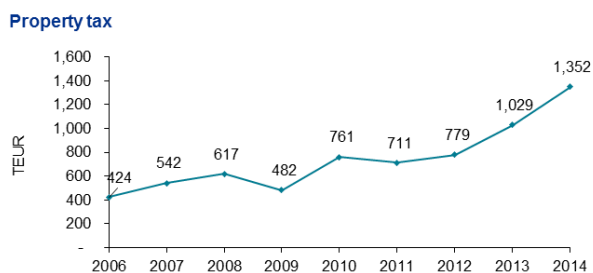


Table 25: Property tax, 2008-2014, percentage change, Paraćin.

Percentage change, Paraćin	2008	2009	2010	2011	2012	2013	2014
%	2008	2009	2010	2011	2012	2013	2014
Property tax	100%	78%	123%	115%	126%	167%	219%

Chart 33: Property tax, 2006-2014, comparison.**Property tax – Comparison**

When it comes to the share of individual revenues in the budget of the Municipality of Paraćin, it is noticeable that the property tax has a relatively similar weight in both local governments, with transfers and the business display fee being more important in Paraćin.

Table 26: Share of individual revenues in the budget of the Municipality, 2008-2014, Paraćin.

Share of individual types of revenue in the budget of Paraćin	2008	2009	2010	2011	2012	2013	2014
Property tax							
% of total current revenue	7.6%	6.0%	9.2%	7.9%	7.1%	9.3%	14.6%
% of total public assets	6.6%	6.0%	8.7%	7.0%	6.8%	8.3%	12.8%
Business sign display fee							
% of total current revenue	3.6%	4.3%	5.1%	4.1%	2.7%	2.7%	2.8%
% of LCT	64.0%	44.5%	49.1%	46.6%	44.6%	59.1%	51.8%

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% of total own-source revenues	13%	11%	13%	11%	11%	8%	9%
Construction land development fee							
% of total current revenue	4.6%	10.5%	5.0%	4.6%	2.3%	2.2%	2.7%
% of total own-source revenues	17.2%	25.9%	12.8%	12.7%	9.3%	6.9%	9.1%
Income tax							
% of total current revenue	29.6%	27.4%	25.0%	31.3%	44.2%	35.5%	35.6%
Own-source revenues							
% of total current revenue	27%	41%	39%	36%	25%	32%	30%
% of total public assets	23%	41%	37%	32%	24%	29%	26%
Shared revenues							
% of total current revenue	41%	38%	36%	42%	52%	43%	41%
% of total public assets	36%	38%	34%	38%	49%	38%	36%
Transfers							
% of total current revenue	32.2%	21.8%	24.7%	21.7%	23.5%	24.8%	28.9%
% of total public assets	27.9%	21.7%	23.4%	19.3%	22.4%	22.1%	25.3%

Finally, on January 1, 2014, the construction land use charge was suspended under the premise that the new formula for calculating the property tax would compensate for the losses incurred due to the suspension of this charge. In addition, the method of calculating the construction land development fee was significantly changed on January 1, 2015, but the effects of this change in the way infrastructural land development will be financed is yet to be observed in the years to come.

3 Expenditure

After an in-depth analysis of revenue, our focus will now shift to a more concise analysis of expenditure. The revenue analysis was more relevant to measure the effects of legal changes, as they directly influenced precisely this side of the budget. The expenditure analysis should just roughly demonstrate the spending structure of the studied local governments, as well as whether and to what extent it changes depending on the changes on the revenue side. Therefore, our expenditure study is focused only on the economic budget classification. This classification of expenses and expenditures shows the individual goods and services and executed transfer payments inside the Chart of Accounts.⁴⁵ Hence, this study does not deal with an exhaustive functional

budget classification that breaks down expenses by their functional purpose. As we do not analyse spending in detail, expenditure data will be observed only up to the double-digit account (i.e., up to the account category) because this is sufficient to understand general trends in certain types of costs and to clearly (although only at the macro level) recognise how local governments spend their funds. The analysis is informed by the data for the City of Belgrade for the period from 2002 to 2013, and for the Municipality of Paraćin from 2006 to 2014.

On the expenditure side, we recognise three important classes of accounts: class 400000 - current expenditure, class 500000 - non-financial assets expenses, and class 600000 - principal repayment and acquisition of financial assets expenses.⁴⁶ Our analysis will centre on each of these classes separately for each local government (both Belgrade and Paraćin) in order to determine trends within the observed period.

Under class 400000, our analysis will cover the following categories: category 410000 - employee expenditure, category 450000 - subsidies, category 460000 - donations, grants and transfers, and category 470000 - social insurance and social protection.

Category 410000 comprises eight groups of accounts relating to: employee wages financed by local government, social benefits paid by the employer, benefits in kind, social expenditure to employees, reimbursement of employee costs, awards to employees and other special expenditure, parliamentary allowance and judicial allowance. Although our data for category 410000 are only aggregates (i.e., we do not present the content of specific groups of synthetic accounts, analytic accounts and sub-analytic accounts), it is important to indicate what precisely is covered by this category. The reason for the separate analysis of this expenditure category is frequent criticism of local governments by the central government regarding their irrational spending of additional funds attained in the fiscal decentralisation process. Namely, this criticism first targeted local government employee wages expenditures, as the public openly speculated that additional funds received by the local government are primarily spent on excessive recruitment of new staff. An exact answer to this criticism is outside the scope of this expenditure analysis. To be precise, in order to gain a clearer picture of the merits of these allegations, it would be necessary to thoroughly analyse the expenditure data by their functional classification and individual costs. Such an analysis would demonstrate in which employee categories the wages grew and whether the local government influenced this or not. Our analysis of the expenses is not so exhaustive, and therefore cannot provide a final position on this matter. However, it may show expenditure trends under this account category throughout the studied period, thus contributing to a distinct understanding of these sensitive issues.

Category 450000 covers four groups of accounts: subsidies to public non-financial companies and organisations, subsidies to private financial institutions, subsidies to

public financial institutions, and subsidies to private companies. The study of synthetic accounts inside this group clearly indicates that category 450000 includes current and capital subsidies for each of these types of beneficiaries. In other words, subsidies are an on-going transfer of funds to recipients that incentivise production and the provision of services and that may be current and capital. Wages and subsidies alike are often criticised as the inefficient spending of the taxpayers' money on helping market players incapable of surviving market competition on their own. However, economically speaking, capital subsidies are less “malignant,” hence the final position about the type and quality of support provided by the observed local governments to companies and organisations on their respective territories would require a level of detail beyond the scope of our study. Yet, here we will be able to comment on the trend of subsidies inside the studied period.

Category 460000 (donations, grants and transfers) contains the following five groups: donations to foreign governments, grants to international organisations, transfers to other government levels, grants to mandatory social insurance organisations, and other grants and transfers. As shown by the normative analysis, certain types of costs that have the same economic essence may sometimes be booked as subsidies and sometimes as donations, grants or transfers. Experience has shown that the decision regarding the accounting treatment may influence the acceptability of an individual cost (donations, grants and transfers are generally rated more favourably than subsidies, while their economic essence could have been the same in some cases). Therefore, in order to get a complete picture, this expenditure category also needs to be examined.

Category 470000 (social insurance and social protection) contains only two groups of accounts: social insurance rights and social protection benefits from the budget. This category, however, covers a range of different social benefits types essential for the population. Thus, for example, group 472000 includes benefits paid from the budget in the case of illness and disability, for maternity benefits, for children and family benefits, for unemployment benefits, for old-age and survivors' pensions, for benefits from the budget in the event of death, for education, culture, science and sports benefits, for housing and living benefits, as well as for other social benefits. Keeping in mind that Serbia will have to face a demographic implosion sometime soon, this category of expenditures is becoming ever more salient.⁴⁷ In the section that dealt with the normative analysis, it was explained that one part of the activities in the field of social protection is optional for local governments, i.e., they are performed when funding is available. Our analysis of this expenditure category aims to determine whether the City of Belgrade and the Municipality of Paraćin used this discretion to provide quality services in the field of social protection to their citizens in times of abundance and whether they chose not to provide them with the same in times of austerity.

Class 500000 essentially refers to capital investments in fixed assets (buildings, machinery and equipment, other real estate, intangible assets, etc.), inventories (materials, unfinished and finished products), valuable objects, natural assets (land, mineral resources, forests and water), and non-financial assets financed from the funds earmarked for the national investment plan implementation. Economically speaking, this class of expenditures is vital for local economic development. Thus, it has been given special attention. Of particular interest to us is how this expenditure category was influenced by the changes in revenues that took place during the analysed period. To get a complete picture of the capital expenditure of local government in terms of the economic definition of capital investments, in addition to class 500000, trends in the two accounts belonging to class 400000 need to be examined. This covers two four-digit accounts: account 4632, where expenses for capital transfers to other government levels are booked, and account 4512, where expenses for capital subsidies are booked. As we lack data on expenditures at the synthetic level, our analysis of capital expenditure will only be limited to class 500000.

Finally, class 600000 comprises two groups: repayment of the principal and the acquisition of financial assets (acquisition of domestic securities and loans to various types of domestic beneficiaries). This class of expenditure says something about the behaviour of the local government on the financial market. Category 610000, which relates to the repayment of the principal, contains account groups where repayment to domestic and foreign creditors is booked, against guarantees, for financial leasing and the repayment guarantees for commercial transactions. Category 620000 relates to the acquisition of financial assets and contains a group of accounts where the acquisition of domestic and foreign financial assets and assets of the national investment plan is booked. Economically speaking, in question here are the acquisition of domestic and foreign securities and the lending to different financial market participants. Recent analyses of the capital budgeting practices of Serbian companies illustrate inefficiency and illiquidity of the Serbian capital market and, consequently, a limited supply of domestic financial assets.⁴⁸ An analysis of this account class allows us to get the full financial picture of the local governments.

Our analysis will begin by observing the general trend. Although we will observe this trend during the entire period, special attention will be devoted to the years that are crucial in the revenue analysis. Consequently, of particular interest for our expenditure analysis are years 2006, 2008 and 2011.

2006 was a year of essential decentralisation reforms, whose full effect is seen in local government budgets in 2007. Namely, let us recall that in this year after the new Local Government Financing Law was adopted,⁴⁹ all local governments received a share of 40% in the personal income tax, and that the total non-earmarked (general) transfer awarded by the Republic of Serbia to local governments was established, defined as

1.7% of the GDP according to the latest data published by the National Statistics Office. At the same time, the property tax became own-source revenue of the local government. Considering that effects of these changes were only visible in the fiscal year of 2007, we will treat 2006 as the base year in order to isolate the effects of these changes on the local governments' expenditure.

Another crucial year was 2008, and it was important for two reasons. First, the global economic crisis broke out, spilling over relatively quickly to Serbia. In addition, owing to some centralisation changes in the republic government in 2009, this year will be treated as the base year in the second part of this analysis, in which the effects of the suspension of individual provisions of the Local Government Financing Law are to be studied. It should be noted that in the middle of the 2009 budget year, the transfer system was discontinued, which triggered a large reduction in the revenues of local governments.

Finally, in 2011, we have two vital (pseudo) decentralisation moves. First, the share of the local government revenue in the revenue from wage taxes increased from 40% to 80% (for the City of Belgrade to 70%). Second, transfers to municipalities were further reduced, while non-earmarked transfers were discontinued for the City of Belgrade. These two changes came into force on October 1, 2011. For this reason, 2011 will be treated as the base year in this part of the analysis, as a way to isolate impacts of these changes on expenditure.

Chart 34 shows total public expenditure trends of the City of Belgrade between 2002 and 2013 in TEUR. This chart follows the expenditures of all three classes of accounts - 400000 (current expenditure), 50000 (capital expenditure) and 600000 (repayment of the principal and lending). As expected, the chart shows expenditure growth over the decentralisation period (up to 2008). However, contrary to expectations, expenditure for the City of Belgrade grew after the onset of the crisis and the 2009 reduction in transfers. After 2011, there was a decrease in expenditures despite significant inflows provided by the wage tax changes. As a result, trends of certain expenditure classes inside this period should be examined more carefully.

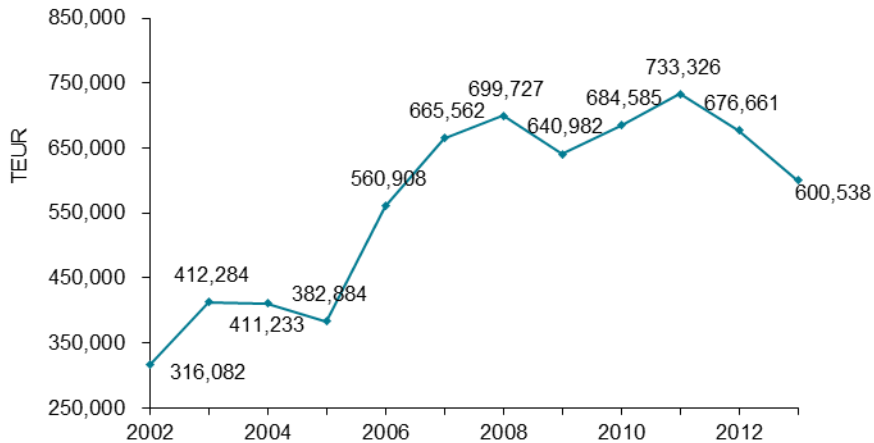
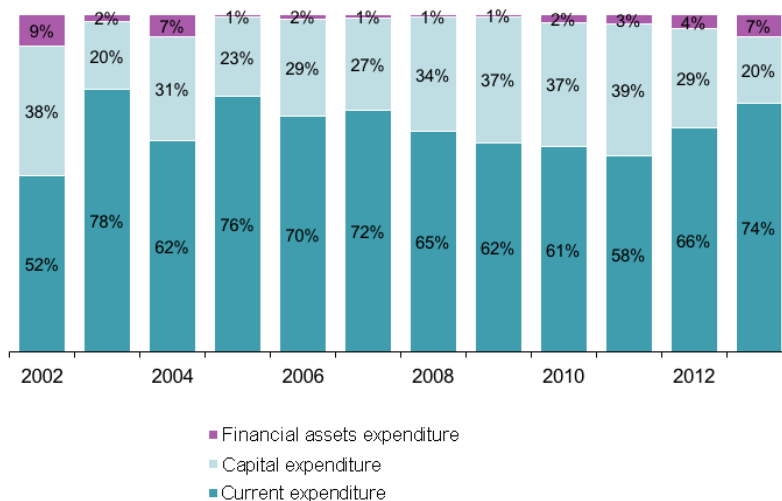
Chart 34: 2002 - 2013 total public expenditure, Belgrade.**Total public expenditure - Belgrade**

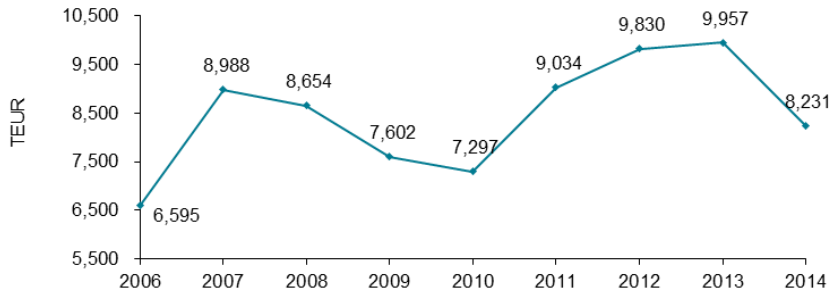
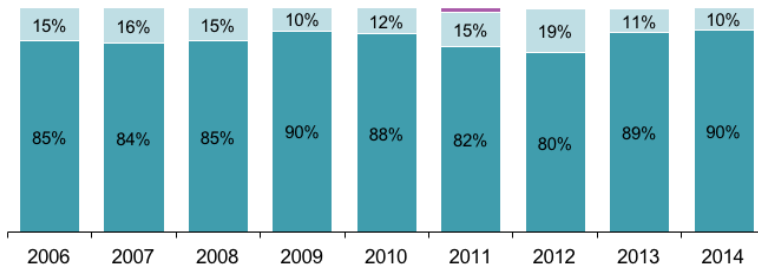
Chart 35 shows the share of different classes of expenditure in the budget of the City of Belgrade within the studied period. It demonstrates that the city managed to allocate considerable funds to capital expenditure during the entire period. What is particularly interesting is that capital expenditure was the highest in years when, due to the onset of the crisis and the 2009 reforms, the city's budget was under the greatest pressure. These capital expenditures are likely to be related to the Bridge on Ada, which was constructed between 2008 and 2011. After 2011, investments exhibited a steady downward trend.

Chart 35: Shares of different expenditure classes in the budget of the City of Belgrade, 2002 – 2013.

Structure of Total Financial Assets - Belgrade



On the other hand, the situation with the Municipality of Paraćin is somewhat different. As expected, expenditure of the Municipality of Paraćin is in a stronger positive correlation with reform changes on the revenue side. In fact, Chart 36 shows that the total public expenditure abruptly increased after decentralisation changes in 2006, that the economic crisis and the 2008 - 2009 transfer restrictions led to a severe decline on the expenditure side, and that the 2011 (pseudo) decentralisation changes caused expenditure growth. In contrast, Chart 37 shows that the Municipality of Paraćin spent a far larger portion of its budget on current expenditure than the City of Belgrade.

Chart 36: 2006 – 2014 total public expenditure, Paraćin.**Total public expenditure - Paraćin****Chart 37:** Shares of different expenditure classes in the budget of the Municipality of Paraćin, 2006 – 2014.**Structure of Total Financial Assets - Paraćin**

- Financial assets expenditure
- Capital expenditure
- Current expenditure

Tables 27 and 28 show the years in which the two local governments had a surplus or a deficit. It can be noticed that the City of Belgrade had a deficit from the start of the global economic crisis and that even the 2011 changes that led to revenue growth failed to cover the deficit. Given the level of capital expenditure, it may be concluded that in

Belgrade large investment ventures simply started at an unfortunate time. Considering that the Bridge on Ada construction had to be finished by the city, the deficit pushed the city to borrow more and to reduce costs wherever possible.

Table 27: City of Belgrade surplus/deficit between 2002 and 2013.

Belgrade												
TEUR	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Current revenue	325,809	401,875	451,468	439,579	617,693	682,243	659,203	542,308	565,660	600,017	602,385	556,488
Current expenditure	165,050	321,079	256,891	289,754	391,093	476,686	457,724	397,394	417,468	425,857	449,082	442,503
Net available budget funds (7-4)	160,759	80,796	194,577	149,825	226,599	205,557	201,479	144,914	148,192	174,159	153,303	113,985
Capital expenditure	121,463	82,133	127,573	89,576	161,345	181,689	235,661	238,472	250,378	285,180	198,395	117,961
Surplus / Deficit	39,297	(1,337)	67,004	60,249	65,254	23,868	(34,182)	(93,558)	(102,186)	(111,020)	(45,092)	(3,976)

On the other hand, the Municipality of Paraćin only had a deficit in 2008, when the crisis broke out, which points to a relatively good management of funds. Nonetheless, it should be noted that capital expenditure is significantly lower in Paraćin, and that there were no major investments within the analysed period.

Table 28: Municipality of Paraćin surplus/deficit between 2006 and 2014.

Paraćin									
TEUR	2006	2007	2008	2009	2010	2011	2012	2013	2014
Current revenue	6,779	9,377	8,105	8,030	8,268	9,056	10,981	11,010	9,226
Current expenditure	5,626	7,582	7,379	6,826	6,456	7,453	7,880	8,838	7,422
Net available budget funds (7-4)	1,153	1,795	726	1,205	1,812	1,603	3,101	2,172	1,803
Capital expenditure	969	1,406	1,275	776	841	1,384	1,906	1,097	783
Surplus / Deficit	184	389	(549)	428	971	219	1,196	1,075	1,021

Let us delve a little deeper into class 400000 – current expenditure - and its respective groups in both local governments.

Charts 38 and 39 show the trend and structure of current expenditures of the City of Belgrade during the entire analysed period. At the outset of our analysis, it was highlighted that special attention inside class 400000 (current expenditures) will be dedicated to the following categories: category 410000 – employee expenditure,

category 450000 - subsidies, category 460000 - donations, grants and transfers, and category 470000 - social insurance and social protection.

Chart 38: Current expenditure of the City of Belgrade, 2002 – 2013.

Current expenditure - Belgrade

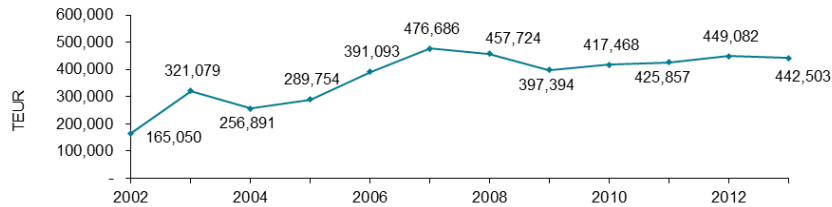


Chart 39: Current expenditure structure of the City of Belgrade, 2002 – 2013.

Current expenditure structure - Belgrade

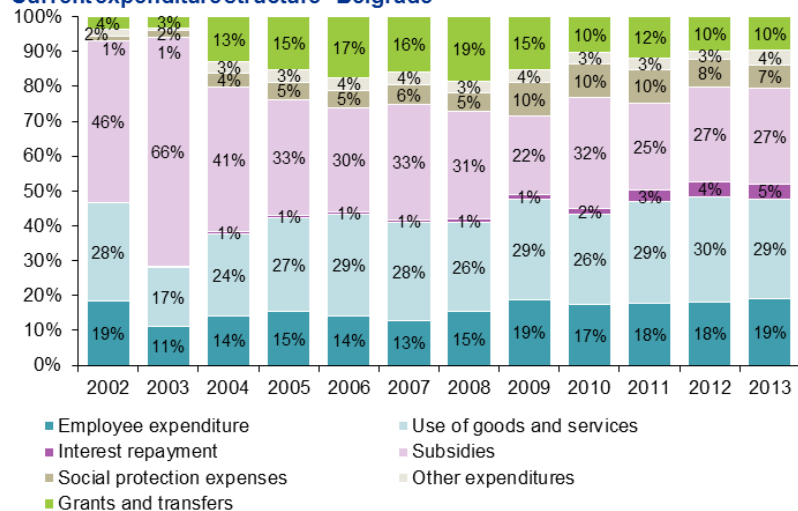


Chart 38 shows that current expenditure of the City of Belgrade, despite considerable reform changes on the revenue side, was quite balanced within the studied period.

However, its structure changed. What is noticeable is that the City of Belgrade did not spend ample funds on employees. Moreover, the share of these expenditures in current expenditures inside the analysed period is fairly balanced, varying only a few percentage points.

A closer look at Table 29 provides more detailed insights regarding the movement of absolute amounts of these expenditure types (in euros), with particular focus on the base years, as important reforms came afterwards.

Table 29: Employee expenditure trends according to the most important reform years, Belgrade.

Category 410000 (Employee expenditure)	2006	2007	2008	2009	2010	2011	2012	2013
TEUR	55,502	61,179	70,349	74,494	72,557	75,882	81,516	83,815
Absolute amount	55,502	61,179	70,349	74,494	72,557	75,882	81,516	83,815
Base 2006	100.0%	110.2%	126.8%	134.2%	130.7%	136.7%	146.9%	151.0%
Base 2008			100.0%	105.9%	103.1%	107.9%	115.9%	119.1%
Base 2011						100.0%	107.4%	110.5%

It is evident that the growth of these expenditures was constant (the only decrease was recorded in 2010), while the actual growth was rather moderate (year after year). As expected, growth was faster in the period before the crisis, only to be much slower between 2008 and 2011. After the inflow achieved by the 2011 reforms, growth of these expenditures in 2012 was slightly higher relative to other years inside the analysed period. This brief analysis still says plenty about the allegations related to the large increase in employee expenditure after additional inflows provided by the decentralisation process. In the case of Belgrade, these do not seem overly justified.

When it comes to subsidies, if we accept the common view that they are a negative phenomenon, the trends from Graph 39 may be assessed as healthy. In fact, the studied period was marked by a relative decline in these expenditure types. Nonetheless, this downward trend may be assessed as a constant with minor variations. Table 30, however, shows that the absolute amounts spent on subsidies are in constant decline. An abrupt increase in subsidies was recorded in 2007 (i.e., after positive decentralisation moves in 2006); however in 2008, a decline was recorded, which became drastic in 2009. By the end of the period, subsidies did not return to the absolute amount from 2008. Nevertheless, after the budget recovery brought on by the 2011 reform, subsidies started to grow moderately (in 2012 by 13%).⁵⁰ As a result, it may be concluded that the subsidies expenditure behaviour was much more in tune with the criticism forecasts

than the employee expenditure (they were rising at the time of decentralisation and falling at the time of crisis and centralisation reforms).

Table 30: Subsidies expenditure trends according to the most important reform years, Belgrade.

Category 450000 (Subsidies)								
TEUR	2006	2007	2008	2009	2010	2011	2012	2013
Absolute amount	117,044	158,107	141,222	88,775	132,538	107,267	121,841	120,753
Base 2006	100.0%	135.1%	120.7%	75.8%	113.2%	91.6%	104.1%	103.2%
Base 2008			100.0%	62.9%	93.9%	76.0%	86.3%	85.5%
Base 2011						100.0%	113.6%	112.6%

As already mentioned, donations, grants and transfers have a similar economic substance as subsidies at times (although not always). For the purpose of our analysis, it is sufficient to conclude that the costs of this category had the highest growth between 2006 and 2008, subsequently followed by a downward trend until the end of the period. The only exception is 2011, when there was a onetime increase in this cost category by some nine percentage points. However, this certainly did not change the general trend of grants, subsidies and transfers reductions in the last five years.

Table 31: Donations, grants and transfers expenditure trends according to the most important reform years, Belgrade.

Category 460000 (Donations and transfers)								
TEUR	2006	2007	2008	2009	2010	2011	2012	2013
Absolute amount	68,398	75,083	84,840	60,605	42,756	49,979	44,052	42,362
Base 2006	100.0%	109.8%	124.0%	88.6%	62.5%	73.1%	64.4%	61.9%
Base 2008			100.0%	71.4%	50.4%	58.9%	51.9%	49.9%
Base 2011						100.0%	88.1%	84.8%

In principle, unlike expenditure for employees and subsidies, allocation of additional tax revenue to social protection is considered as desirable if it is well targeted and if it does not represent political manipulation (e.g., an increase in these expenditures before elections).⁵¹ When the City of Belgrade is concerned, this expenditure category does not represent a large share of the city's budget; however, up until 2011, the social insurance

and social protection expenditure recorded steady growth (see Table 32). The rise was particularly abrupt in 2007 (39.1%) and, surprisingly, in 2009 (55.3%), following the onset of the crisis. In this respect, the downward trend in the last two years may be assessed as negative, as it seems that the city achieved some of the savings, perhaps necessary for the budget, at the expense of the most sensitive categories in the population.

Table 32: Social protection expenditure trends according to the most important reform years, Belgrade.

Category 470000 (Social protection and expenditure)								
TEUR	2006	2007	2008	2009	2010	2011	2012	2013
Absolute amount	19,681	27,370	24,881	38,647	41,075	40,854	34,793	29,899
Base 2006	100.0%	139.1%	126.4%	196.4%	208.7%	207.6%	176.8%	151.9%
Base 2008			100.0%	155.3%	165.1%	164.2%	139.8%	120.2%
Base 2011						100.0%	85.2%	73.2%

When it comes to the City of Belgrade, we can conclude that the current capital expenditure within the analysed period was fairly balanced and that it did not significantly increase at the expense of other expenditures throughout the decentralisation process. Similarly, when the city's current expenditure structure is concerned, it is noticeable that the employee expenditure was maintained at relatively low levels (between 11% and 19% of the total budget) without any significant increase. In contrast, subsidies represented a considerable portion of the city's budget, especially at the beginning of the period (46% in 2002, 66% in 2003 and 41% in 2004), but without any subsequent dramatic jumps. At the end of the period, subsidies amounted to 27% of the 2013 budget. The share of grants, subsidies and transfers saw slightly higher variations (between 4% at the beginning of the period, 19% in 2008 and 10% at the end of the period). This expenditure category reached its maximum between 2006 and 2008, with an evident downward trend afterwards. Finally, the category of social benefits had a considerably smaller share in the budget of Belgrade (below 10%). The city's largest allocations for social benefits occurred after the onset of the crisis, which is commendable. However, there is a marked decrease trend starting in 2012.

Now let us look at the current expenditures of the Municipality Paraćin between 2006 and 2014. Chart 40 provides a rough picture of the current expenditure trends within the analysed period. It is obvious that (in absolute terms) current expenditures recorded significant growth owing to the 2006 decentralisation wave, that from the beginning of

the crisis and the suspension of transfers in 2009 they dropped (as expected), that they grew from 2011 to 2013, and that a decline was registered in the last year, 2014. In this respect, it seems that the current expenditures of the Municipality of Paraćin were largely influenced by the revenue side developments that resulted from reforms. However, Chart 41 shows a relatively obvious positive correlation between revenue behaviour (per capita) in the two local governments.

Chart 40: Current expenditure of the Municipality of Paraćin, 2006 – 2014.

Current expenditure - Paraćin

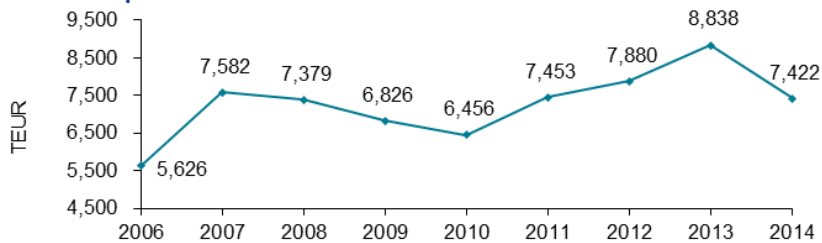
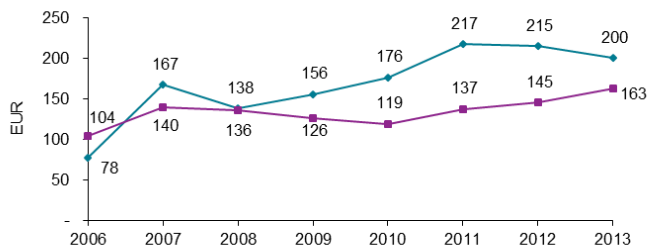


Chart 41: Comparison of current expenditure between Belgrade and Paraćin, 2006 – 2014.

Current expenditure trend - Comparison

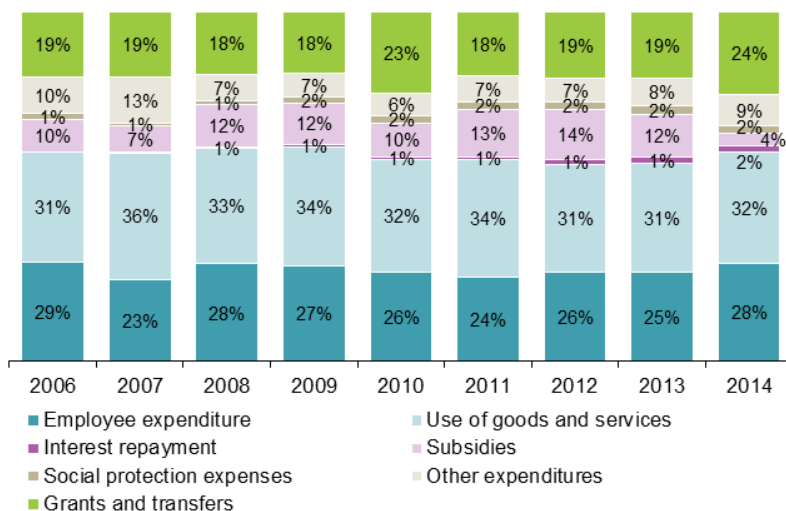


— Current expenditure - Belgrade — Current expenditure - Paraćin

Let us now examine the current expenditure structure and the behaviour of some current expenditure categories within the period of the study.

Chart 42: Municipality of Paraćin current expenditure structure, 2006 – 2014.

Current expenditure structure - Paraćin



Category 410000 (employee expenditure) represents an even more homogenous and essential item in the budget of the Municipality of Paraćin compared to the City of Belgrade. In the course of the analysed period, this expenditure accounted for between 23% and 29% of the municipal budget. The largest increase by this revenue category was achieved in 2008, although the entire period of 2006 – 2008 was characterised by significant growth year after year, which may be regarded as a negative phenomenon by decentralisation critics. After the onset of the crisis and the reduction of transfers in 2009, a decline in this expenditure category was registered, which recovered after 2011. Thus, it appears that employee expenditure in the Municipality of Paraćin exhibited relative resilience to the reforms, while its increase and decrease resulted from the Republic’s decentralisation and centralisation practices. This would require an exhaustive analysis of which functions saw an increase in the number of employees, as the Municipality of Paraćin was one of the few municipalities in Serbia with a shortage of employees (as much as 100)⁵² according to the analysis of the Ministry of Public Administration and Local Government from May 2015. Therefore, it may be assumed that this local government initially had a smaller number of employees compared to other municipalities. This could be the reason for the considerable growth from 2010 and 2011.

Table 33: Employee expenditure trends according to the most important reform years, Paraćin.

Category 410000 (Employee expenditure)									
TEUR	2006	2007	2008	2009	2010	2011	2012	2013	2014
Absolute amount	1,607	1,772	2,059	1,858	1,653	1,787	2,012	2,250	2,085
Base 2006	100.0%	110.3%	128.2%	115.7%	102.9%	111.2%	125.2%	140.0%	129.8%
Base 2008			100.0%	90.3%	80.3%	86.8%	97.7%	109.3%	101.2%
Base 2011						100.0%	112.6%	125.9%	116.6%

The subsidies category (450000) has far less importance in the budget of the Municipality of Paraćin than the same category in the budget of the City of Belgrade. However, given that other donations, grants and transfers (category 460000) have far greater importance, one should be careful when making final conclusions with regard to these two cost categories.

When it comes to subsidies, efforts by the municipality to curb subsidies are visible especially after the Republic initiated centralisation reforms. Their reduction in 2009 and 2010 is evident. The dramatic contraction of the subsidies expenditure in 2014 directly resulted from the measures introduced by the Ministry of Finance in December 2013, which requested that the municipality cut down the subsidies expenditure by 30% in 2014. At the end of the period, in 2014, subsidies made up 52% of the amount allocated for subsidies in absolute terms in 2006. However, decentralisation critics will notice that, in the case of this expenditure category, growth was recorded on the basis of decentralisation (growth of about 60% year after year in 2008, which is still treated as the decentralisation year since it preceded transfer cuts, just as in 2011). However, in 2014, the share of subsidies in the budget of the Municipality of Paraćin was only 4%.

Table 34: Subsidies expenditure trends according to the most important reform years, Paraćin.

Category 450000 (Subsidies)									
TEUR	2006	2007	2008	2009	2010	2011	2012	2013	2014
Absolute amount	543	552	881	801	631	1,002	1,108	1,102	284
Base 2006	100.0%	101.5%	162.2%	147.4%	116.1%	184.4%	204.0%	202.8%	52.2%
Base 2008			100.0%	90.9%	71.6%	113.7%	125.8%	125.0%	32.2%
Base 2011						100.0%	110.6%	109.9%	28.3%

Donations, grants and transfers (category 460000) represent a substantial item on Paraćin’s expenditure side. Additional research is probably needed to determine the specific subsidies and to better understand the differences in categories 450000 and 460000 in our two observed local governments. Here, we will only say that some 19 - 24% of the municipal budget was allocated to category 460000, which recorded a critical rise in 2007 (about 35%) and 2010 (26% year after year). After 2011, this expenditure category was poised for continued growth.

Table 35: Donations, grants and transfers expenditure trends according to the most important reform years, Paraćin.

Category 460000 (Donations and transfers)	2006	2007	2008	2009	2010	2011	2012	2013	2014
TEUR	1,048	1,416	1,323	1,197	1,508	1,369	1,491	1,657	1,746
Absolute amount	1,048	1,416	1,323	1,197	1,508	1,369	1,491	1,657	1,746
Base 2006	100.0%	135.1%	126.2%	114.2%	143.8%	130.6%	142.2%	158.1%	166.5%
Base 2008			100.0%	90.5%	113.9%	103.4%	112.7%	125.3%	131.9%
Base 2011						100.0%	108.9%	121.1%	127.5%

Finally, social protection and social expenditure (category 470000) represent a relatively small item in Paraćin’s budget (only 1 - 2%), which is far less not only absolutely, but also relatively when compared to the City of Belgrade. However, the municipality invested efforts to boost these expenditures, and they recorded substantial and consistent growth throughout the period. A considerable reduction in this type of expenditure occurred only in 2014 when it fell towards the 2010-2011 level.

Table 36: Social protection expenditure trends according to the most important reform years, Paraćin.

Category 470000 (Social protection and expenditure)	2006	2007	2008	2009	2010	2011	2012	2013	2014
TEUR	83	62	95	122	141	169	179	201	155
Absolute amount	83	62	95	122	141	169	179	201	155
Base 2006	100.0%	74.6%	114.9%	146.5%	169.1%	202.9%	215.2%	242.4%	186.3%
Base 2008			100.0%	127.5%	147.3%	176.7%	187.4%	211.1%	162.2%
Base 2011						100.0%	106.1%	119.5%	91.8%

It may be concluded that, compared to the City of Belgrade, the Municipality of Paraćin sets aside more for employees and less for social protection and social expenditure. A final judgement regarding subsidies, donations, grants and transfers is not possible, as

this would require a thorough analysis aimed at identifying specific expenditure and accounting treatments of the respective expenditure and similar economic phenomena. Moreover, it seems that the expenditure side of the Municipality of Paracin reflected the decentralisation and centralisation reforms of the Republic in a slightly more noticeable way.

Charts 43 and 44 provide some interesting insights. They illustrate that both local governments could have covered their current expenditure with their current revenues over the entire period without much difficulty.

Chart 43: Share of current expenditure in total revenues, 2002-2013, Belgrade.

Belgrade - Share of current expenditure in total revenues

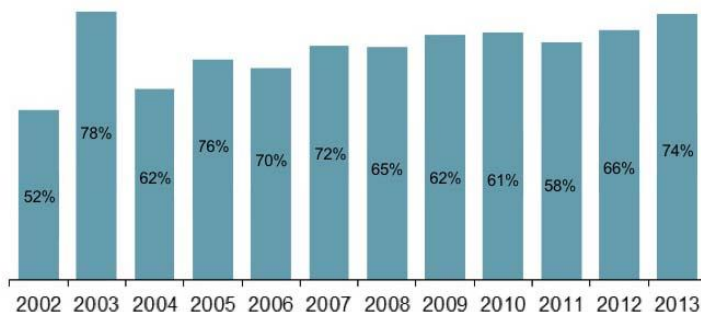
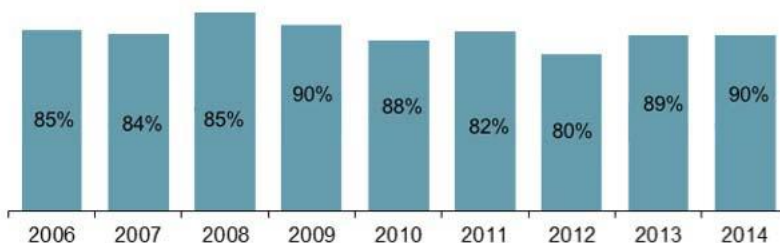
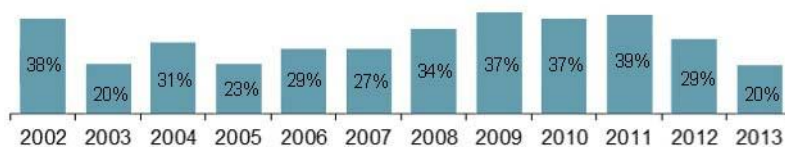


Chart 44: Share of current expenditure in total revenues, 2006-2014, Paraćin.**Paraćin - Share of current expenditure in total revenues**

Let us now turn to the very important category of capital expenditure in both observed local governments. It was said that, in economic terms, this expenditure class is vital because it is a determinant of local economic development. We have emphasised that the analysis will not be conclusive, as it does not include data from two four-digit accounts (4632 and 4512) where expenses for capital transfers to other government levels and expenses for capital subsidies are booked. However, class 500000 covers the most important capital expenditure and will provide us with a clear view of investment activities of our analysed local governments.

When it comes to Belgrade, Chart 45 shows that its capital investment activities within the studied period were not negligible. Although it is difficult to perceive the relative importance of these investment allocations from the city budget without available comparisons with other local governments in Serbia, it is clear that the allocation between 37% and 40% of the total public finances for capital investments (in 2002, 2009, 2010 and 2011) represents good governance. We know that between 2008 and 2011 the city financed the construction of the Bridge on Ada. Furthermore, we also noted that the investment was, unfortunately, launched at a very awkward moment - at the onset of the global economic crisis and centralising fiscal reforms. The city, however, completed this investment. Chart 45 obviously shows that both before and after the construction of the Bridge on Ada, the city's policy was to allocate a significant portion of the budget to investments, as much as 25 - 30%. The lowest budget level allocated to investments within the analysed period was 19% (2003 and 2013). Accordingly, it may be assessed that Belgrade gives relatively high importance to investments and economic development both in times of expansion and crisis.

Chart 45: Share of capital expenditure in the budget of the City of Belgrade, 2002 - 2013.**Share of capital expenditure in total public assets - Belgrade**

However, Table 37 shows a disturbing trend. The 2011 reforms, which were supposed to bring significant revenue to the city through an increased share in the wage tax revenue, have not led to an increase in the investment budget. In addition, after the 2012 abolition of parafiscal impositions, i.e., certain shared charges and local communal fees, the 2013 fiscal year saw a dramatic decline in investments – below the levels of 2006. Therefore it seems that, after the Bridge on Ada was completed, the city still opted for a somewhat more restrictive investment policy (although still relatively generous compared to most local governments). Hence, it is justifiable to ask how much have volatile, unforeseeable and relatively non-transparent decision-making processes at the central government level, which directly influence the city's revenues, contributed to this restrictive approach in recent years.

Table 37: Capital expenditure trends according to the most important reform years, Belgrade.

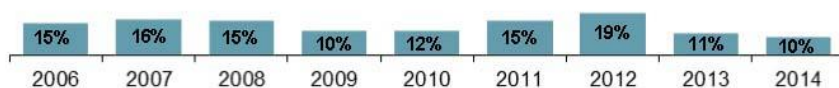
Class 500000 – Capital expenditure (non-financial assets expenses)							
2006	2007	2008	2009	2010	2011	2012	2013
161,345	181,689	235,661	238,472	250,378	285,180	198,395	117,961
100.0%	112.6%	146.1%	147.8%	155.2%	176.8%	123.0%	73.1%
		100.0%	101.2%	106.2%	121.0%	84.2%	50.1%
					100.0%	69.6%	41.4%

Finally, Table 38 shows that Belgrade could not finance all investments from the funds remaining in the city’s budget after current expenditures had been settled. The city had to borrow to cover the deficit. While the table obviously shows that the borrowing was associated with the beginning of the Bridge on Ada construction, and that it was the highest throughout the construction, it is evident that the city maintained solid investment levels in the last two years of the observed period. However, significantly lower investment levels had to be partly financed by Belgrade through further borrowing.

Table 38: Available investment funds, Belgrade.

Belgrade								
TEUR	2006	2007	2008	2009	2010	2011	2012	2013
Current revenue	617,693	682,243	659,203	542,308	565,660	600,017	602,385	556,488
Current expenditure	391,093	476,686	457,724	397,394	417,468	425,857	449,082	442,503
Net available budget funds (7-4)	226,599	205,557	201,479	144,914	148,192	174,159	153,303	113,985
Capital expenditure	161,345	181,689	235,661	238,472	250,378	285,180	198,395	117,961
Surplus / Deficit	65,254	23,868	(34,182)	(93,558)	(102,186)	(111,020)	(45,092)	(3,976)

In the case of Paraćin, on the other hand, it is notable that a much smaller portion of the budget was allocated to investments. Within the analysed period, this percentage ranged between 7% and 17%. This may be explained by either relatively higher current expenditure or relatively lower borrowing capacity, which created hard budgetary constraints for Paraćin when compared to Belgrade. It is also evident that the investments grew in periods when fiscal decentralisation measures had effects. Consequently, we have the highest investment levels in 2007, 2008, 2011 and 2012, when the results of the 2006 and 2011 decentralisation measures were most prominent. The fall in investments is present at the onset of the crisis and after the reduction of transfers (2009 and 2010), after the abolition of shared charges and local communal taxes in 2012, and lastly after further reduction in transfers in 2014. Thus, it may be concluded that the municipality of Paraćin responded constructively to the fiscal decentralisation process by increasing its investment budget, while saving during the period of centralisation reforms. However, Table 39 shows the investment budget reduction trend similar to Belgrade. It also shows that in 2014 the investment level of Paraćin was at 80.8% of the 2006 level, 61.4% of the 2008 level, and only 56.5% of the 2011 municipality investments level.

Chart 46: Share of capital expenditure in the budget of the Municipality of Paraćin, 2006 – 2014.**Share of capital expenditure in total public assets - Paraćin****Table 39:** Capital expenditure trends according to the most important reform years, Paraćin.

Class 500000 – Capital expenditure (non-financial assets expenses)									
TEUR	2006	2007	2008	2009	2010	2011	2012	2013	2014
Absolute amount	969	1,406	1,275	776	841	1,384	1,906	1,097	783
Base 2006	100.0%	145.1%	131.6%	80.1%	86.8%	142.8%	196.7%	113.2%	80.8%
Base 2008			100.0%	60.9%	66.0%	108.5%	149.4%	86.0%	61.4%
Base 2011						100.0%	137.7%	79.2%	56.5%

Table 40, on the other hand, suggests that the Municipality of Paraćin, with the exception of 2008, financed its investments from internally available resources instead of through borrowing. This may have resulted from hard budget constraints or simply from the municipality's preference to withdraw from investing if there are no available current revenues.

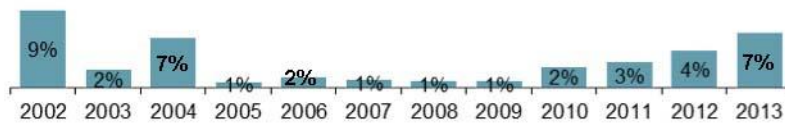
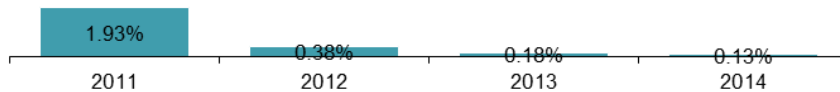
Table 40: Available funds, Paraćin.

Paraćin									
TEUR	2006	2007	2008	2009	2010	2011	2012	2013	2014
Current revenue	6,77 9	9,37 7	8,10 5	8,03 0	8,26 8	9,05 6	10,981	11,010	9,226
Current expenditure	5,62 6	7,58 2	7,37 9	6,82 6	6,45 6	7,45 3	7,880	8,838	7,422
Net available budget funds (7-4)	1,15 3	1,79 5	726	1,20 5	1,81 2	1,60 3	3,101	2,172	1,803
Capital expenditure	969	1,40 6	1,27 5	776	841	1,38 4	1,906	1,097	783
Surplus / Deficit	184	389	(549)	428	971	219	1,196	1,075	21

Finally, to finish up the expenditure story, we still need to examine class 600000, which includes principal repayments and the acquisition of financial assets. This class may offer some insight into the behaviour of the observed local governments on the capital market. Since our analysis only studies the trend of the entire class of accounts within the period under review, conclusions will be rather concise.

Specifically, Charts 47 and 48 essentially build on the picture presented in Tables 38 and 40. In fact, it is obvious that Belgrade is considerably more active than Paraćin on the capital market, which is logical given the different administrative and borrowing capacities of these two local governments. Chart 48 shows the entire analysed period for the Municipality of Paraćin, as the observed expenditure in other years was below 1%. However, as already highlighted, without a detailed analysis of the class 600000 structure and the borrowing conditions of the observed local governments (and/or their borrowing capacity), we cannot draw conclusions about the level of spending on principal repayment and lending, or about what the credit and administrative capacities of both local governments are today. These conclusions remain beyond the scope of our study. For us, it is enough to conclude that the capital city, within the legal limits, borrowed for capital investments to a much greater extent.

From the onset of the global economic crisis, real sector financing options of the Serbian banks became increasingly modest, while crediting of the Republic and municipalities was far more attractive. Namely, in spite of everything, the general rule of financing in Serbia is that the state (including the local government) is less risky than the economy. Despite this, and despite the readiness of Serbian banks to finance local governments, it seems, at least in the case of the Municipality of Paraćin, that the borrowing approach is conservative. While this may be a wise preference in times of crisis, the fact remains that the absence of borrowing entails a lack of investments and, at best, development stagnation.

Chart 47: Share of financial assets expenditure in the budget of the City of Belgrade, 2002 – 2014.**Share of financial assets expenditure in total public assets - Belgrade****Chart 48:** Share of financial assets expenditure in the budget of the Municipality of Paraćin, 2011 – 2014.**Share of financial assets expenditure in total public assets - Paraćin**

4 Conclusions

At the very end, we will attempt to summarise the main conclusions of our analysis. It was said that, during the observed period (2000-2014), the periods of decentralisation (2000-2008), centralisation and pseudo-decentralisation (2009-2015) may be clearly separated.

The adoption of the Local Government Financing Law in 2006 was the key reform of the decentralisation period.⁵³ This Law introduced important changes in local government funding, while the most important are listed here: (i) all local governments were given a 40% share in the personal income tax; (ii) the total non-earmarked (general) transfer was established, which is allocated by the Republic of Serbia to local governments and defined as 1.7% of the GDP according to the latest published data of the National Statistics Office; and (iii) the property tax became own-source revenue of the local government. This law was fully implemented only in 2007 and 2008, and its effects are visible in these fiscal years in the budgets of the analysed local governments.

Centralist and pseudo-decentralist reforms were more frequent; however, this conclusion will only focus on the most important ones. When it comes to centralist changes, the crucial years are 2009, 2012, 2013 and 2014. In 2009, the Republic of Serbia decided to suspend the application of individual provisions of the 2006 law in the middle of the budget year due to the onset of the global economic crisis and its impacts on the Republic budget. The key change was the drastic reduction in non-earmarked transfers. According to some estimates, cities and municipalities in Serbia lost some 50 billion dinars due to this reduction from May 2009 to June 2011.⁵⁴ In October 2012, reforms were targeted at the so-called parafiscal impositions with the aim to unburden the economy. Specifically, certain types of own-source fees and shared charges were eliminated or significantly reformed (effectively reduced) at that time. Our interviewed expert said that these changes reduced the budgets of local governments of Serbia by about 5.5 billion dinars.⁵⁵ In May 2013, local governments were deprived of important revenue from the property rental income tax (which was diverted to the Republic budget). This change became effective on 1 January 2014 and, according to the estimates of our interviewees, it has led to further reductions in the municipal budgets of about 3 billion dinars at the national level (50% of this loss was incurred by the City of Belgrade).⁵⁶ On this occasion in May 2013, the Republic also reduced the tax base by increasing the non-taxable portion and the wage tax rate (from 12% to 10%), which, as we know, is important shared revenue. These changes came into effect at the end of May, and therefore, in the middle of the budget year. Furthermore, although the process of reducing non-earmarked transfers was constant in the examined period (in 2011 and 2013, the methodology for calculating non-earmarked transfers changed, which resulted in its effective reduction), another large cut occurred in 2014 when non-earmarked transfers were reduced by about 30%. Lastly, at the beginning of 2014, the construction

land use charge was abolished again, costing the municipalities an additional 14 billion dinars, according to the estimates of our interviewees.⁵⁷

Finally, the Republic tried to facilitate the recovery of local government budgets in 2011. However, the government did not re-introduce the full implementation of the 2006 law. Instead, there was an increase in the share of local government revenues from the shared wage tax from 40% to 80%, i.e., to 70% for the City of Belgrade (this solution was applied on 1 October 2011). However, due to the above changes related to the base and tax rate on wages from 2013, the expected local government revenue from the decentralisation measures in 2011 fell from the expected 40 to only 20 billion dinars.⁵⁸ Owing to their aggregate effects, the paper assessed the wage tax-related reforms as pseudo-decentralist.

At the very end, in the conclusion we will:

- Summarise the effects of decentralisation waves on the most important budget items of the observed local governments,
- Outline the effects of the centralisation and pseudo-decentralisation waves on the affected items and the total budget of the studied local governments,
- Attempt to roughly quantify the decentralisation level by determining the share of local budgets in the Republic's budget and the share of local budgets in the consolidated budget of the Republic, and
- Try to answer through short and high-level analysis the question of whether the analysed local governments were actually compensated by the 2011 decentralisation measures for the losses they suffered in 2009.

In this part of the paper, we will not particularly concentrate on the transfer of competences and the expenditure side effects, given that these changes are related to the specific competences thoroughly analysed in the legal part of the study.

4.1 Revenue

Table 41 attempts to summarise the aggregate effects of all reform measures of the observed period on the revenue of the City of Belgrade. In the conclusion, revenue is expressed in revalued RSD (base year 2014),⁵⁹ and in this respect, it indicates a slightly different intensity of changes relative to the previous analysis where revenue was expressed in EUR.⁶⁰ However, the direction of change remains the same. This revenue table outlines the most important items on the revenue side - total current revenues and total public assets. As noted, the key reform years were 2006, 2009 and 2011. In order to measure the budget effects of the changes, these years were used as the base years. The only exception is 2009. For the 2009 reforms, the base year was 2008 primarily due to the onset of the economic crisis.

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The table shows that the decentralisation reforms of 2006 led to an increase in total current revenues of 4.5% and the growth of total public assets of 5.8% in 2007. This growth is lower than the registered revenue growth expressed in euros (9.2% growth in total public assets in 2007). However, both analytical approaches clearly show that decentralisation reforms had a positive effect on the budget of the City of Belgrade. The construction land development charge generated most of the revenue growth in Belgrade. In 2008, there was a slight decrease in the total budget, while the achieved growth of current revenue was cancelled. This effect was probably caused by the global economic crisis, which the capital city felt earlier than the smaller local governments with weaker economic activity.

Table 41: City of Belgrade revenue in revalued dinars during the observed period.

Belgrade Revenues	2006	2007	2008	2009	2010	2011	2012	2013	2014
KRSD	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total current revenue	87,582,594	91,490,628	87,984,087	72,466,083	78,380,129	74,225,965	75,473,789	65,264,264	60,937,513
	100.0%	104.5%	100.5%	82.7%	89.5%	84.7%	86.2%	74.5%	69.6%
			100.0%	82.4%	89.1%	84.4%	85.8%	74.2%	69.3%
						100.0%	101.7%	87.9%	82.1%
Revenue from the sale of non-financial assets	-	-	2,583	-	-	-	26,886	2,501,177	998,113
Revenue from borrowing and the sale of financial assets	2,545,737	3,835,514	6,270,808	8,125,210	15,286,017	16,882,894	8,809,310	5,735,786	4,496,298
Total public assets	90,128,332	95,326,142	94,257,478	80,591,293	93,666,146	91,108,859	84,309,986	73,501,226	66,431,924
	100.0%	105.8%	104.6%	89.4%	103.9%	101.1%	93.5%	81.6%	73.7%
			100.0%	85.5%	99.4%	96.7%	89.4%	78.0%	70.5%
						100.0%	92.5%	80.7%	72.9%

In 2009, one can notice large reductions in total current revenues (17.6% year after year) and total public assets (14.5%). Two key reasons for this revenue fall are: (i) the global economic crisis, which hit the real estate market the hardest and lowered revenue from the construction land development charge, and (ii) the suspension of the provisions on the total non-earmarked transfer in the middle of the budget year (2009), which had an immediate effect. In 2010, the city's revenues were recovering. However, this was a short-lived recovery since the 2011 reforms did not yield the desired results. Thus, Table 41 (Charts 49 and 50) shows that, in the case of Belgrade, the 2011 pseudo-decentralist changes related to the wage tax did not compensate the city for the losses it incurred due to the crisis and the reduction of total non-earmarked transfers. Specifically, in 2011 and 2012, the total amount of current revenues and total public

assets remains below the respective revenues in 2008. Such developments were later further confirmed by the wage tax changes (tax base and tax rate reduction in 2013) and the abolition and/or reduction of local communal fees in 2012. Furthermore, some shared charges were decreased and transfers were reduced even further. The result at the end of the period was rather discouraging. Total annual revenues were in freefall until the end of the period, and in 2014, they were at some 69% of the current revenue levels of 2006 and 2008. The situation was similar with total public assets, which at the end of the period (in 2014) represented only 73.7% of the city's 2006 budget.

Chart 49: Total public assets of the City of Belgrade in revalued dinars (base year 2014), 2006-2014.

Total public assets - Belgrade

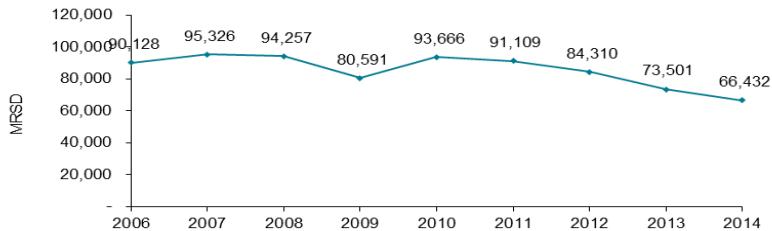
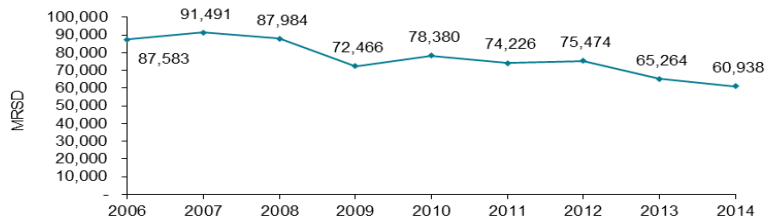


Chart 50: Total current revenue of the City of Belgrade in revalued dinars (base year 2014), 2006-2014.

Total current revenue - Belgrade



The situation with the municipality of Paraćin is slightly different. First, since the Municipality of Paraćin received relatively more transfers than the City of Belgrade, the rise in total current revenues and total public assets in 2007 was much higher (130.8% and 123.0% - the real budget growth expressed in euros was also high, equalling some 25.5%). However, own-source revenue and, in particular, the one-time increase of revenues for the lease of construction land and the moderate increase in the property tax greatly contributed to the growth in this year. In 2008, the crisis started to produce negative effects, yet, as was predicted, the pace of these effects was much slower in the case of smaller municipalities than in the case of the capital.

Table 42: Municipality of Paraćin revenue in revalued dinars during the observed period.

Paraćin Revenue	2006	2007	2008	2009	2010	2011	2012	2013	2014
TRSD									
Total current revenue	961,154	1,257,471	1,081,775	1,073,054	1,145,648	1,120,268	1,375,870	1,291,214	1,115,931
	100.0%	130.8%	112.5%	111.6%	119.2%	116.6%	143.1%	134.3%	116.1%
			100.0%	99.2%	105.9%	103.6%	127.2%	119.4%	103.2%
						100.0%	122.8%	115.3%	99.6%
Revenue from the sale of non-financial assets	76	-	-	-	-	-	717	12	3,753
Revenue from borrowing and the sale of financial assets	53,890	17,295	91,338	473	474	402	24,094	23,973	-
Total public assets	1,091,139	1,342,203	1,248,892	1,073,527	1,209,012	1,258,263	1,442,550	1,450,236	1,273,123
	100.0%	123.0%	114.5%	98.4%	110.8%	115.3%	132.2%	132.9%	116.7%
			100.0%	86.0%	96.8%	100.8%	115.5%	116.1%	101.9%
						100.0%	114.6%	115.3%	101.2%

Data from 2009 - 2011 show inconsistent findings, which creates the need for deeper analysis. Even though transfers fell in 2009, our analysis demonstrated that own-source revenue doubled (the construction land use charge rose abruptly by as much as 320% compared to 2008, while significant growth was also recorded in the construction land development charge). Therefore, the reduction in total current revenues in 2009 was not dramatic, while in 2010 we even have solid growth. A large decrease in the total budget is primarily the result of the absence of revenue from borrowing and the sale of financial assets, which were significant in 2008.

It seems that the 2011 reforms that were related to the personal income tax had a much stronger effect on the budget of the Municipality of Paraćin than on the budget of the City of Belgrade. In 2012, total current revenue increased by as much as 22.8%. We mentioned that the share of the personal income tax in the Municipality of Paraćin was 41% of the shared revenue in 2010, while in 2012 this percentage jumped to as much as 58.6%. In 2013, the wage tax was reduced considerably (down about 20% year after year) as a result of the tax base and the tax rate changes. This reduction continued in 2014.

After 2012, the Municipality of Paraćin recorded a revenue decrease, and it was even greater in 2014. Nonetheless, it seems that the reforms during this entire period affected Paraćin's budget far less than the budget of Belgrade. In 2014, the Municipality of Paraćin was more or less at its 2011 (or 2008) total current revenue level. When compared to 2006, the Municipality was in an even better situation. The same applies to the entire budget.

Chart 51: Total public assets of the Municipality of Paraćin in revalued dinars (base year 2014), 2006-2014.

Total Public Assets - Paraćin

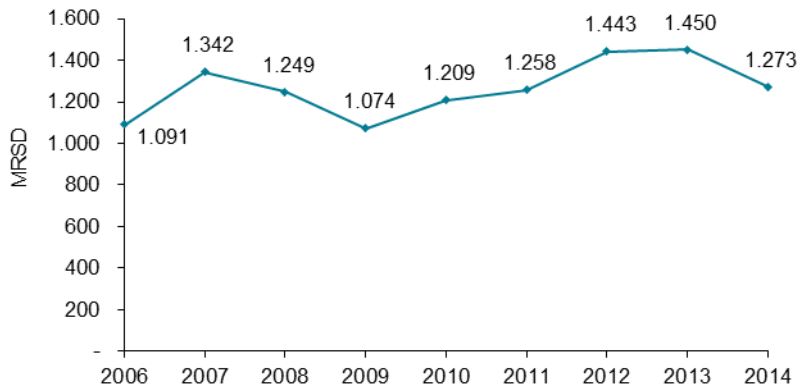
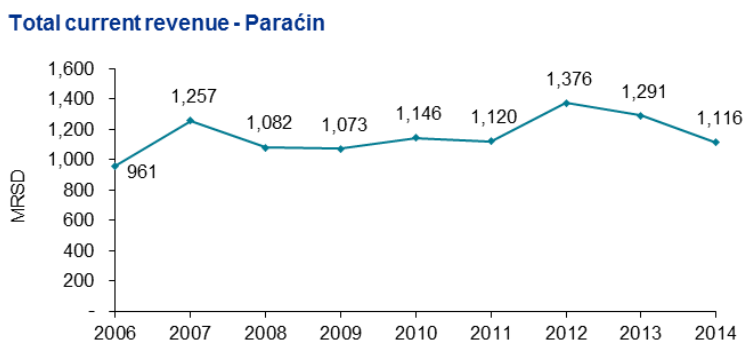


Chart 52: Total current revenue of the Municipality of Paraćin in revalued dinars (base year 2014), 2006-2014.



4.2 Expenditure

In the conclusion on expenditures, the data will be presented in the manner described below. To begin with, we will present a table containing expenditure of the City of Belgrade (followed by the Municipality of Paraćin) according to categories (current, capital, financial assets expenditure and total public expenditure), with special emphasis on the reform years, which will be treated as base years in order to recognise the reform effects on the budget. For the sake of clarity, we will then present the same information graphically to make the expenditure trend more prominent. Expenditure and revenue data were expressed in revalued RSD. The base year was 2014.

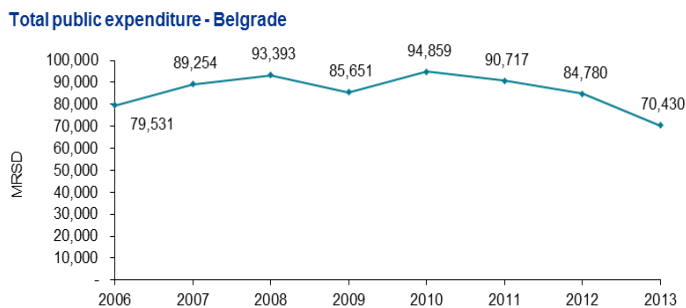
Table 43: City of Belgrade expenditure in revalued dinars during the observed period.

Belgrade Expenditure	2006	2007	2008	2009	2010	2011	2012	2013
TRSD	2006	2007	2008	2009	2010	2011	2012	2013
Current expenditure	55,453,120	63,924,890	61,092,585	53,101,870	57,846,036	52,681,328	56,266,225	51,896,274
	100.0%	115.3%	110.2%	95.8%	104.3%	95.0%	101.5%	93.6%
			100.0%	86.9%	94.7%	86.2%	92.1%	84.9%
						100.0%	106.8%	98.5%
Capital expenditure	22,877,073	24,365,007	31,453,790	31,865,906	34,693,344	35,278,591	24,857,230	13,834,315

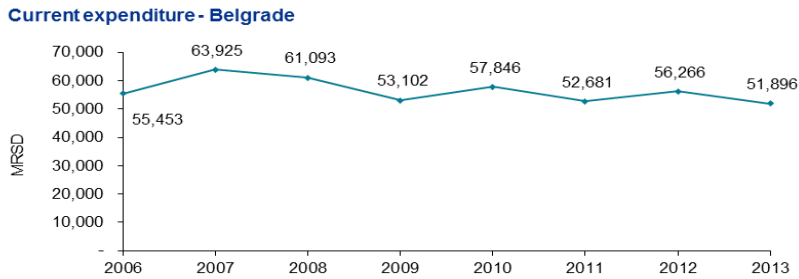
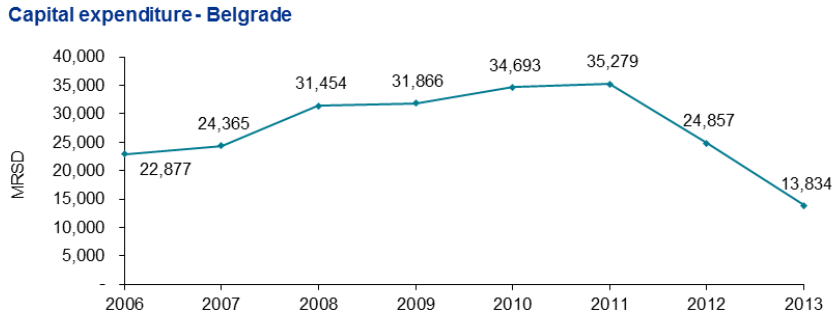
Financial assets expenditure	1,200,857	963,843	846,399	683,522	2,319,371	2,757,307	3,656,376	4,699,838
Total public expenditure	79,531,050	89,253,741	93,392,774	85,651,299	94,858,751	90,717,226	84,779,831	70,430,428
	100.0%	112.2%	117.4%	107.7%	119.3%	114.1%	106.6%	88.6%
			100.0%	91.7%	101.6%	97.1%	90.8%	75.4%
						100.0%	93.5%	77.6%

If we accept the initial assumptions of the study that decentralisation is a strategic commitment of the Republic and that significant competences have been transferred from the Republic to the local government in the period under review, one would expect the current expenditures to grow. Also, we know that it would be desirable to achieve growth of capital expenditures from the standpoint of economic development. Table 43, however, shows a slightly different picture. Namely, it presents expenditure behaviour and registers similar trends as Table 41 (for revenue). Nonetheless, it should be noted that the oscillations on the expenditure side are far less volatile than those on the revenue side. On the expenditure side, the analysis ends in 2013, the year in which the economy performed slightly better than in 2014, which was the last year of the revenue analysis. However, this does not alter the conclusion that, when it comes to current expenditure, oscillations are moderate. The largest increase of current expenditure was recorded in 2007 (15.3%), followed by 2010 (about 9%) and 2012 (6.8%). While expenditure growth in 2007 and 2012 was expected due to decentralisation measures from the previous years, the growth in 2010 requires a much more detailed analysis. The period ended with a noticeable decrease in overall public expenditure when compared to the beginning of the period, while current expenditure was maintained at the approximately same level.

Chart 53: Total public expenditure of the City of Belgrade in revalued dinars (base year 2014), 2006-2014.



Consequently, when it comes to the City of Belgrade, its current expenditure was uniform without any considerable variations in both the period of decentralisation and the period of pseudo-decentralisation reforms. Previous analyses have exhibited that, as far as the city’s current expenditure structure is concerned, all expenditure categories recorded moderate variation, as well as a discreet downward trend before the end of the period. Moreover, we noted that in the studied period, Belgrade managed to allocate significant funds to investments during the entire period (between 37% and 40% of its total public assets for investments in the years 2002, 2009, 2010 and 2011). Even the lowest budget level allocated to investments inside the examined period was relatively high (19% in 2003 and 2013). After 2011, the investments were in significant decline and this trend is worrying. The fall in capital expenditure may be explained by the relatively larger reduction in overall public expenditure relative to current expenditure at the end of the period.

Chart 54: Current expenditure of the City of Belgrade in revalued dinars (base year 2014), 2006-2014.**Chart 55:** Capital expenditure of the City of Belgrade in revalued dinars (base year 2014), 2006-2014.

The situation with Paraćin is somewhat different. To begin with, we have presented the 2014 data for Paraćin as well. Expenditure growth after the 2006 reforms was significantly higher in Paraćin (compared to Belgrade), and this level of expenditure was maintained in 2008 despite the crisis. The abolition of transfers led to the reduction of current expenditure (and total public expenditure) and, as expected, after the 2011 reforms, growth of current expenditure was registered in the next two years. As shown

in Chart 58, Paraćin abandoned investments during difficult times, thus causing a relatively larger decrease in total public expenditure than in current expenditure.

Table 44: Municipality of Paraćin expenditure in revalued dinars during the observed period.

Paraćin Expenditure	2006	2007	2008	2009	2010	2011	2012	2013	2014
TRSD	2006	2007	2008	2009	2010	2011	2012	2013	2014
Current expenditure	797,669	1,016,756	984,914	912,094	894,572	922,001	987,316	1,036,465	897,799
	100.0%	127.5%	123.5%	114.3%	112.1%	115.6%	123.8%	129.9%	112.6%
			100.0%	92.6%	90.8%	93.6%	100.2%	105.2%	91.2%
						100.0%	107.1%	112.4%	97.4%
Capital expenditure	137,398	188,582	170,203	103,702	116,552	171,228	238,754	128,629	94,665
Financial assets expenditure	-	-	-	-	-	24,348	5,552	2,608	1,614
Total public expenditure	935,067	1,205,338	1,155,117	1,015,796	1,011,124	1,117,576	1,231,622	1,167,702	995,571
	100.0%	128.9%	123.5%	108.6%	108.1%	119.5%	131.7%	124.9%	106.5%
			100.0%	87.9%	87.5%	96.8%	106.6%	101.1%	86.2%
						100.0%	110.2%	104.5%	89.1%

Chart 56: Total public expenditure of the Municipality of Paraćin in revalued dinars (base year 2014), 2006-2014.

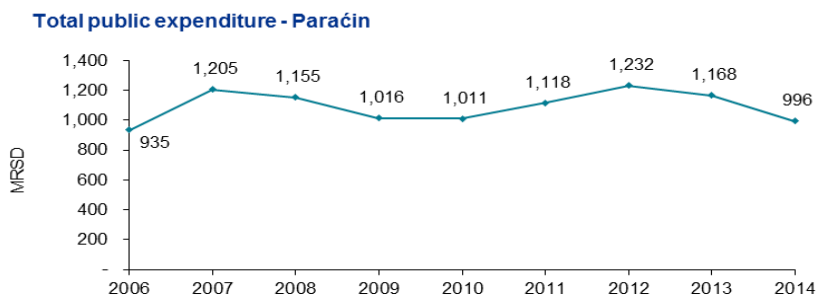
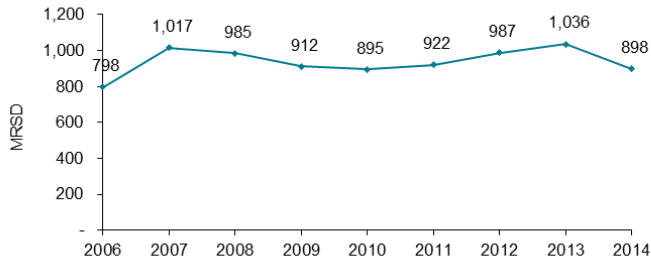
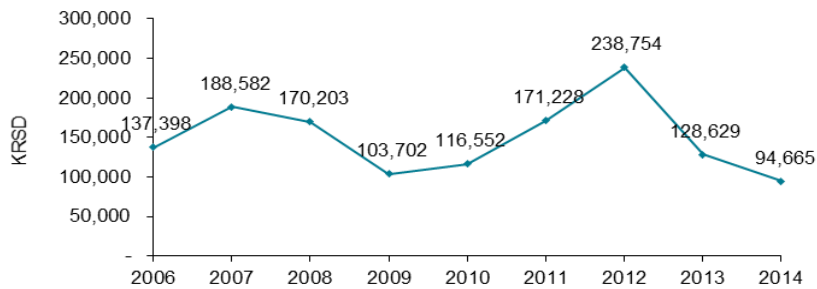


Chart 57: Current expenditure of the Municipality of Paraćin in revalued dinars (base year 2014), 2006-2014.**Current expenditure - Paraćin****Chart 58:** Capital expenditure of the Municipality of Paraćin in revalued dinars (base year 2014), 2006-2014.**Capital expenditure - Paraćin**

Thus, Municipality of Paraćin expenditures are in a stronger positive correlation with reform changes on the revenue side. Total public expenditure had jumped after the 2006 decentralisation measures, while the economic crisis and the 2008 - 2009 transfer restrictions led to severe decline on the expenditure side. The pseudo-decentralist

changes of 2011 brought on the re-growth of expenditure. Furthermore, the Municipality of Paraćin spent a far more significant portion of its budget on current expenditure than the City of Belgrade. In terms of the current expenditure structure, compared to the City of Belgrade, the Municipality of Paraćin set aside more for employees and less for social protection and social benefits. However, in the case of Paraćin, it is notable that a much smaller portion of the budget was allocated to investments. Inside the observed period, this percentage ranged between 7% and 17%. It is also evident that investments grew in periods when the fiscal decentralisation measures produced effects. However, similar to Belgrade, there is a declining trend in the investment budget. In 2014, the level of Paraćin's investments was at 80% of the 2006 level, 61.4% of the 2008 level and only 56.5% of the 2011 level of municipal investments.

4.3 Final remarks

After summarising the effects of the waves of decentralisation, centralisation and pseudo-decentralisation on vital budget items of the studied local governments (both the revenue and expenditure side), we will try to roughly quantify the level of fiscal decentralisation in Serbia inside the observed period. This will be done by identifying the share of local government budgets in the budget of the Republic of Serbia, as well as the share of local government budgets in the consolidated balance of the state and the gross domestic product (or GDP).

Table 45 uses data from the January 2015 Public Finances Bulletin.⁶¹ Since the Bulletin data are indicated in nominal terms (as confirmed by the authors of the analyses), we performed the revaluation by using inflation data from the International Monetary Fund database⁶² (base year 2014). For clarification purposes, in addition to the budget of the Republic of Serbia, the consolidated balance of the state (i.e., consolidated revenues of the Republic) includes the Pension Fund budget, the Republic Health Insurance Fund, the National Employment Service, the Military Personnel Social Insurance Fund, the PE Putevi Srbije and Koridori Srbije, the local government level, municipalities and the Autonomous Province of Vojvodina. Columns 4, 6 and 8 of Table 45 quantify the fiscal decentralisation level in Serbia by applying the common methodological approach involving the calculation of the revenue share of all local governments in the state in (i) the consolidated balance sheet of the state, (ii) the budget of the Republic of Serbia, and (iii) the gross domestic product. Hence, it should be noted that the key reform years are 2006, 2009 and 2011, as well as that the significant centralist reforms were introduced at the end of the observed period.

After 2006, there was an apparent increase in the share of local government revenues in the consolidated revenues of the state that amounted to 2.6%, while the growth in the budget and the GDP shares was far more modest. A decrease of the fiscal decentralisation parameters on all levels was recorded in 2009. The share of local

government revenues in the consolidated budget of the state fell by 2.1%. It also decreased by as much as 3.9% in the Republic budget and by 1.1% of the GDP. The 2011 decentralisation reforms that were related to the wage tax effectively gave rise to the growth of these decentralisation indices. Consequently, the growth of the share of local government revenues was at the level of 0.6% in the consolidated balance of the state and 1.5% in the budget of the Republic of Serbia, while their GDP share remained unchanged. It is obvious that the 2009 measures had swung the pendulum towards centralisation to a much greater extent, while the 2011 changes brought on very low levels of fiscal decentralisation (both sets of reforms were introduced during the budget year). In 2012, the values of the decentralisation parameters were the highest probably because the full effects of the 2011 wage tax reform were the most prominent in this year. In this respect, the increase of the local government revenue share in the consolidated budget of the state was 1.7% (year after year, and 2.3% compared to 2010). In the Republic budget, the increase was 3.8% (year after year, and even 5.3% when compared to 2010) and a whopping 1% of the GDP (year after year compared to 2010). The centralist measures at the end of the period prompted a decrease in the fiscal decentralisation parameters, and at the end of the period, all parameter values were lower than the corresponding parameters at the start of the fiscal reforms in 2006. These parameter values were lower only in 2009 (although not significantly lower), when the state introduced extremely centralist reforms. These data point towards the conclusion that the net effect of the changes initiated in 2006 was negative in terms of fiscal decentralisation, despite the fact that the Republic of Serbia declaratively opted for fiscal decentralisation in its strategic documents.

Table 45: Decentralisation level in Serbia during the observed period (revenue in revalued dinars).

Decentralisation level REVENUE							
TRSD	Consolidated revenue of the Republic	LG revenue	LG revenue share in consolidated revenue of RS	RS revenue	LG revenue share in revenue of RS	GDP	Local government revenue share in GDP
2006	1,626,893,632	239,297,291	14.7%	886,885,756.34	27.0%	3,521,547,183	6.8%
2007	1,534,805,313	265,521,077	17.3%	981,141,447	27.1%	3,855,261,416	6.9%
2008	1,797,856,438	275,366,724	15.3%	981,090,649	28.1%	4,009,167,286	6.9%
2009	1,673,334,457	221,470,419	13.2%	914,157,509	24.2%	3,790,554,436	5.8%
2010	1,679,127,475	232,325,489	13.8%	935,453,906	24.8%	3,785,146,287	6.1%
2011	1,610,914,694	231,621,054	14.4%	880,456,901	26.3%	3,793,231,708	6.1%
2012	1,621,937,141	261,641,746	16.1%	868,751,942	30.1%	3,689,488,649	7.1%
2013	1,573,429,037	238,605,441	15.2%	830,758,556	28.7%	3,701,385,046	6.4%
2014	1,620,752,100	225,503,100	13.9%	881,083,300	25.6%	3,878,020,000	5.8%

Table 46 presents very similar measurements on the expenditure side. What is evident from this table is that the expenditure data support all conclusions we reached about the degree of decentralisation by analysing revenue in the previous table. The year 2007 was marked by the growth of decentralisation parameters, in particular, the 1% growth of the local government expenditure share in the consolidated expenditure of the state, an increase of up to 3.2% in the expenditure of the Republic, and an increase of 0.5% in the GDP. The crisis in 2008 decreased these parameters. However, this reduction was higher in 2009, when a 1.2% decrease in the share of the local government expenditure in consolidated expenditures was recorded (year after year and a reduction of 2% compared to 2007), along with a 2.7% decrease in the share in the Republic expenditure (year after year and a decrease of as much as 5.3% compared to 2007). Furthermore, there was also a 0.4% reduction in the share of the GDP (0.8% compared to 2007). The years 2011 and 2012 exhibited modest growth of the decentralisation parameters on the expenditure side relative to the revenue side. This was followed by a reduction of the parameters that continued until the end of the period. At that time, the share of local government expenditures in the Republic expenditures was decreasing the fastest (4.8% compared to 2011), although the decrease in the share in the GDP was not trivial (1% compared to 2011, i.e., 1.5% compared to 2012). Overall, the reduction of the fiscal decentralisation parameters on the expenditure side was significant at the end of the period when compared to the beginning of the period. The share of local government expenditure in the consolidated expenditure of the state fell by 0.7%. This share was also reduced by as much as 6.1% in the expenditure of the Republic of Serbia and by 1.1% of the GDP. Therefore, the expenditure side parameters substantiate the conclusion that we reached by analysing comparable parameters on the revenue side. Namely, ten years of reforms in the area of fiscal decentralisation made the Serbian public finance system less decentralised than it was before reforms began.

Table 46: Decentralisation level in Serbia during the observed period (expenditure in revalued dinars).

Decentralisation level EXPENDITURE							
TRSD	Consolidated expenditure of the Republic	LG expenditure	Share of LG expenditure in consolidated expenditure of RS	RS expenditure	Share of LG expenditure in RS expenditure	GDP	Share of LG expenditure in GDP
2006	1,682,290,249	237,641,400	14.1%	938,436,456	25.3%	3,521,547,183	6.7%
2007	1,848,786,418	279,095,933	15.1%	980,065,238	28.5%	3,855,261,416	7.2%
2008	1,906,377,761	272,254,460	14.3%	1,052,642,907	25.9%	4,009,167,286	6.8%
2009	1,850,505,107	242,482,127	13.1%	1,043,262,338	23.2%	3,790,554,436	6.4%
2010	1,864,341,215	247,269,239	13.3%	1,070,636,023	23.1%	3,785,146,287	6.5%
2011	1,804,185,407	249,877,181	13.8%	1,041,006,675	24.0%	3,793,231,708	6.6%

2012	1,892,078,169	261,383,050	13.8%	1,103,567,438	23.7%	3,689,488,649	7.1%
2013	1,790,403,859	231,986,528	13.0%	1,036,296,852	22.4%	3,701,385,046	6.3%
2014	1,658,029,398	221,720,007	13.4%	1,153,887,428	19.2%	3,967,214,460	5.6%

Finally, the last part of our concluding remarks deals with the issue of whether the analysed local governments were actually compensated for the losses they suffered in 2009 by the decentralisation measures undertaken in 2011. In other words, we want to address whether it was better from the fiscal decentralisation perspective to fully apply the 2006 Law throughout the entire period or to indulge in the design of ad hoc corrections and adjustments. We focus on the two most important revenues that experienced the most dramatic changes - the total non-earmarked transfer and the shared wage tax. For the purposes of this analysis, we used available data on transfers and the wage tax from the actual budgets of both local governments. Our approach to formulating projections involved the following. In order to formulate the projections concerning the transfers that the observed local government should have received, we first calculated the total amount of the transfer, which under the 2006 Law should have been paid to all local governments (1.7% of the GDP for the previous year according to the Republic Statistics Office). Subsequently, we calculated the percentage of the total non-earmarked transfers paid to Belgrade and Paraćin for the years when the Law was fully implemented. The same percentage (average if there were differences between 2007 and 2008) was adopted in calculating the amount of the transfer, which should have been set aside had the 2006 Law remained in force in 2009 and until the end of the period. When it came to the wage tax, we formulated the projections in a similar manner, based on the assumption that local governments were supposed to receive 40% of the wage tax levied on the territory of the respective municipality. The projections were calculated for the year in which the application of the relevant provision of the 2006 Law was suspended. All amounts were revalued in a manner similar to the one used in the previous analyses of this conclusion (base year 2014, inflation data from the International Monetary Fund database). Tables 47 and 48 show the calculations. The yellow cells contain projected amounts. It should be noted that this is a very rough approximation that is only aimed at providing an indication about the extent and direction of the differences.

After performing the necessary calculations regarding the projected and actual transfers and the shared revenues from the wage taxes, we arrived at the conclusion that the City of Belgrade incurred a loss, while the Municipality of Paraćin had a gain. What is striking is that Belgrade's losses of 7,167,800 KRSD are far greater than Paraćin's gains of 114,009 KRSD. In other words, if the genuine objective of the Republic government was to decentralise the public finance system, this could have been accomplished more effectively had it continued the implementation of the 2006 Law instead of making the adjustments and corrections that were supposed to achieve the same objective more efficiently.

Table 47: Losses/gains for the City of Belgrade from the abolition of transfers and the wage tax increase.

Belgrade								
TRSD	2007	2008	2009	2010	2011	2012	2013	2014
Transfer	9,560,196	10,567,776	3,825,805	4,341,717	3,837,421	-	-	-
Projected			11,049,667	10,644,078	10,150,544	10,532,473	10,206,367	10,779,766
Wage tax	21,884,843	23,211,096	22,398,060	21,274,313	23,969,537	33,139,588	28,676,101	26,041,323
Projected					17,432,391	18,936,908	16,386,343	14,880,756
Losses/Gains			(7,223,862)	(6,302,361)	224,023	3,670,208	2,083,391	380,801

Therefore, our concluding observations indicate that the process of fiscal decentralisation in Serbia placed a series of challenges before local governments. Our legal analysis has clearly demonstrated that legal changes were very frequent, radical and sudden, as regulations were introduced without consultations and with an immediate effect. Similarly, the changes pushed the process in completely opposite directions, from decentralisation to centralisation and then to pseudo-decentralisation. This behaviour of the legislative authorities led to high volatility of local government revenues, which resulted in frequent liquidity problems, the endangerment of capital projects, the accumulation of debts and finally, the absence of meaningful long-term planning. The examples of Belgrade and Paraćin have revealed that such behaviour of the central government jeopardised local economic development as it compelled local governments to undertake a very restrictive approach to investments. Furthermore, data show that the formal commitment of the Republic to fiscal decentralisation was to some degree insincere. The final effect of the entire process is a greater degree of centralisation and a rather compromised process of fiscal decentralisation in Serbia.

Notes

¹ Decision of the Treasury Administration of the Ministry of Finance of the Republic of Serbia No.: 401-00-315/2015-001-007 from April 2, 2015 and No.: 401-00-438/2015-001-007 from May 7, 2015.

² Data on total local government revenues taken from Đorđević, S., Prokopijević, M., Milenković, D. (2013) “Study on Application of Subsidiarity Principles in the Republic of Serbia,” Ministry of Regional Development and Local Government, Belgrade, 2013, p. 97 and data on total current revenues of the City of Belgrade were taken from a database the authors received from the City of Belgrade.

³ According to the data, the relevant population of the City of Belgrade is 1,659,440, while the population of Paraćin is 54,242.

⁴ The interview with Mr Alimpić was published in March 2015. (Interview conducted by W. Bartlett, K. Đulić and S. Kmezić), and the interview with Mr Paunović was conducted in two rounds – in November 2014 and in March 2015 (interviews conducted by S. Kmezić).

⁵ Kmezić, S., Kaluderović, J., Jocović, M., & Đulić, K. (2016). Fiscal decentralisation and local government financing in Montenegro from 2002 to 2015. *Lex Localis - Journal of Local Self-Government*, 14(3), p. 431-450.

⁶ Rulebook on the Budget System Standard Classification Framework and the Chart of Accounts, (Official Gazette of the Republic of Serbia, 103/2011, 10/2012, 18/2012, 95/2012, 99/2012, 22/2013, 48/2013, 61/2013, 63/2013 – corr., 106/2013, 120/2013, 20/2014, 64/2014, 81/2014, 117/2014, 128/2014, 131/2014, 32/2015 and 59/2015).

⁷ *Ibid*, Article 4.

⁸ As was elaborated in detail in the chapter dedicated to the normative analysis, the first reforms towards decentralisation started in March 2001, when local governments received higher shares in some revenues on the one hand, and were allowed to impose the tax on the salary fund at a rate of up to 3.5% on the other. The increase in shares was not negligible – the property tax share was increased from 25% to 100%, the sojourn fee share was increased from 80% to 100%, and the raised real estate transfer tax share was increased from 3% to 5% of the value of the property exchanging owners.

⁹ Law on Amendments and Addenda to the Law on Public Revenues and Public Expenditures (Official Gazette of the Republic of Serbia, 76/91, 18/ 93, 22/93, 37/93, 67/93, 45/94, 42/98, 54/99, 22/2001 and 33/2004).

¹⁰ Law on Amendments and Addenda to the Law on Local Government (Official Gazette of the Republic of Serbia, 49/99 and 27/2001).

¹¹ Law on Local Government (Official Gazette of the Republic of Serbia, 9/2002, 33/2004 and 135/2004). Article 98 of this Law increased the sales tax share of municipalities from 5% to 8%, the share of cities (Niš, Novi Sad and Kragujevac) to 10%, and the share of the City of Belgrade to 15%. In addition, the same article delegated six taxes to local governments. Those were the following income taxes: (i) real estate, (ii) individual activity, (iii) leasing out movables, (iv) personal insurance, (v) other income and (vi) game of chance income. In order to address the problem of inequality between local governments, which became even more present with the strengthening of their fiscal autonomy, the so-called equalisation transfer was introduced. Unlike the general transfer distributed between all local governments, funds from the equalisation transfer were only received by those municipalities whose assessed revenue from shared taxes per capita was lower than 90% of the assessed average revenue from shared taxes per capita in all local governments in Serbia, cities excluded. See Article 38 of the original version of the Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006).

¹² Namely, Article 18 of the 2002 Law basically reduced local government tasks to communal functions. For more details, see: Levitas, A. (2003). Reform of the Local Government Finance System in Serbia. Belgrade, Serbia: USAID/SLGRP program, p. 234.

¹³ *Ibid*. Also, see Đorđević, S., Prokopijević, M., Milenković, D. (2013) “Study on Application of Subsidiarity Principles in the Republic of Serbia,” Ministry of Regional Development and Local Government, Belgrade, 2013, p. 94.

¹⁴ Stipanovic, B. (2006). Local Government Finance System and Fiscal Equalisation in the Republic of Serbia. The Fiscal Decentralisation Initiative for Central and Eastern Europe, p. 9. Available at: http://pdf.usaid.gov/pdf_docs/pnadk279.pdf

¹⁵ Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁶ Đorđević, S., Prokopijević, M., Milenković, D. (2013) “Study on Application of Subsidiarity Principles in the Republic of Serbia,” Ministry of Regional Development and Local Government, Belgrade, 2013, p. 94.

¹⁷ Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

¹⁸ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A note for round table “Central and local finance – How to Distribute the Burden of Reforms”. Belgrade, Serbia: USAID/MEGA, p. 4.

¹⁹ Ibid. p. 5.

²⁰ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A note for round table “Central and local finance – How to Distribute the Burden of Reforms.” Belgrade, Serbia: USAID/MEGA, p. 5.

²¹ Ibid. p. 6.

²² Ibid.

²³ Ibid p. 8.

²⁴ Ibid p. 8.

²⁵ Ibid p. 7.

²⁶ Ibid. p. 8.

²⁷ Chart of Accounts,

http://www.trezor.gov.rs/uploads/file/Pravilnici/06.04.2015_Pravilnik%20o%20standardnom%20klasifikacionom%20okviru%20i%20kontnom%20planu%20za%20budzetski%20sistem/Prilog%202%20-%20Kontni%20plan.pdf according to the Rulebook on the Budget System Standard Classification Framework and the Chart of Accounts, (Official Gazette of the Republic of Serbia, 103/2011, 10/2012, 18/2012, 95/2012, 99/2012, 22/2013, 48/2013, 61/2013, 63/2013 – corr., 106/2013, 120/2013, 20/2014, 64/2014, 81/2014, 117/2014, 128/2014, 131/2014, 32/2015 and 59/2015).

²⁸ Articles 38-48. Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012).

²⁹ Law on Local Government Finance (Official Gazette of the Republic of Serbia, 62/2006, 47/2011 and 93/2012), Article 45.

³⁰ Ibid. Article 44.

³¹ Ibid. Article 40.

³² Ibid. Article 39.

³³ Ibid. Article 38.

³⁴ Ibid. Articles 41-43.

³⁵ Levitas, A. (2010). The Effects of the Suspension of Serbia’s Law on Local Government Finance on the Revenue and Expenditure Behaviour of Local Governments: 2007-2009. A note for round table “Central and local finance – How to Distribute the Burden of Reforms,” Belgrade, Serbia: USAID/MEGA, p. 8.

³⁶ Chart of Accounts

http://www.trezor.gov.rs/uploads/file/Pravilnici/06.04.2015_Pravilnik%20o%20standardnom%20klasifikacionom%20okviru%20i%20kontnom%20planu%20za%20budzetski%20sistem/Prilog%202%20-%20Kontni%20plan.pdf according to the Rulebook on the Budget System Standard Classification Framework and the Chart of Accounts, (Official Gazette of the Republic of Serbia, 103/2011, 10/2012, 18/2012, 95/2012, 99/2012, 22/2013, 48/2013, 61/2013, 63/2013 – corr.,

106/2013, 120/2013, 20/2014, 64/2014, 81/2014, 117/2014, 128/2014, 131/2014, 32/2015 and 59/2015).

³⁷ Đorđević, S., Prokopijević, M., Milenković, D. (2013) "Study on Application of Subsidiarity Principles in the Republic of Serbia," Ministry of Regional Development and Local Government, Belgrade, 2013, p. 95.

³⁸ Analysis of Fiscal Effects of the Decentralisation Model Proposed to the Parliament of Serbia by the United Regions of Serbia Club. (2011). Belgrade: Fiscal Council of the Republic of Serbia.

³⁹ Ibid p. 3.

⁴⁰ Republic of Serbia, Statistical Office, (2012). Workforce Poll, 2011 (Bulletin 550). The document can be retrieved from the Statistical Office website: http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/61/71/SB_550_ARS2011_SAJT.pdf.

⁴¹ Ibid. For data on salaries, see Saopštenje ZP14 Republičkog zavoda za statistiku o zaradama po zaposlenom u Republici Srbiji po opštinama i gradovima iz juna 2011. godine. <http://pod2.stat.gov.rs/ObjavljenePublikacije/G2011/pdf/G20111208.pdf>

⁴² Saopštenje ZP14 Republičkog zavoda za statistiku o zaradama po zaposlenom u Republici Srbiji po opštinama i gradovima iz juna 2011. godine. <http://pod2.stat.gov.rs/ObjavljenePublikacije/G2011/pdf/G20111208.pdf>

⁴³ These are charges for the use of water and for the material taken out of riverbeds.

⁴⁴ The following fees were suspended: 1) using glass showcases to display goods outside business premises; 2) keeping and using navigable equipment and vessels and other facilities on rivers and lakes, excluding wharves used in border river traffic; 3) keeping and using boats and floating platforms, excluding boats used by organisations engaged in waterway maintenance and marking; 4) keeping restaurants and other catering and entertainment facilities on rivers and lakes; 5) keeping domestic and exotic animals; 6) keeping musical equipment and live music in restaurants; 7) using advertising billboards; and 8) using the waterfront area for business and any other purposes. Fee No. 7 was suspended as a separate fee and instead it was merged with the fee for "firm display and inscription outside the business premises on facilities and areas owned by the local government unit (roadways, pavements, green areas, poles, etc.).

⁴⁵ Article 3. Rulebook on the Budget System Standard Classification Framework and the Chart of Accounts, (Official Gazette RS № 103/2011, 10/2012, 18/2012, 95/2012, 99/2012, 22/2013, 48/2013, 61/2013, 63/2013 – corr., 106/2013, 120/2013, 20/2014, 64/2014, 81/2014, 117/2014, 128/2014, 131/2014, 32/2015 and 59/2015)

⁴⁶ Ibid. For more detailed information on specific classes, categories and groups, see the Rulebook.

⁴⁷ Djulic, K. i Kuzman, T. (2013), "Women on Corporate Boards in Bosnia and Herzegovina, FYR Macedonia and Serbia", *Serbia* (Washington, DC: IFC), available at: <http://www.ifc.org/wps/wcm/connect/c0e2ab804fb037b6ad8cef0098cb14b9/PublicationBalkansBD2013.pdf?MOD=AJPERES> (March 8, 2016)

⁴⁸ Barjaktarovic, L., Djulic, K., Pindzo, R. & Vjetrov, A. (2016) *Analysis of the Capital Budgeting Practices: Serbian Case, 2016/79* (Belgrade: Management), pp. 47-54.

⁴⁹ Local Government Financing Law (Official Gazette RS № 62/2006, 47/2011 and 93/2012)

⁵⁰ Although this increase may seem significant, some authors argue that local subsidies in the first quarter of 2012 increased by as much as 55% relative to the same period in the previous year, which is significantly higher than the growth of subsidies in Belgrade. See Arsić, M., & Randelović, S. (2012). Amendments to the Local Government Financing Law: Analysis of the Previous Results and the Proposed Changes. Quarterly Monitor (28). Belgrade: FREN

⁵¹ See Arsić, M., & Randelović, S. (2012). Amendments to the Local Government Financing Law: Analysis of the Previous Results and the Proposed Changes. *Quarterly Monitor* (28). Belgrade: FREN, p 60.

⁵² Overview of workplaces inside the state sector, Ministry of Public Administration and Local Government of the Republic of Serbia <http://www.mduls.gov.rs/latinica/index.php> and "Law solves the excess and deficiency of employees in municipalities" (27.7.2015), *Tanjug news*: <http://www.tanjug.rs/full-view.aspx?izb=191435>

⁵³ Local Government Financing Law (Official Gazette RS № 62/2006, 47/2011 and 93/2012).

⁵⁴ Spirić, D. & Bučić, A. (2012, October) Towards a stable and sustainable local government finance system in the Republic of Serbia, *Polis magazine*, 1

⁵⁵ Interview with Aleksandar Bučić.

⁵⁶ Interview with Aleksandar Bučić, Saša Paunović and Zoran Alimpić.

⁵⁷ Interview with Saša Paunović.

⁵⁸ Interview with Aleksandar Bučić and Saša Paunović

⁵⁹ Calculations were based on inflation rates from the International Monetary Fund (IMF) database, World Economic Outlook Database, available at <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/download.aspx>.

⁶⁰ Opinions on whether euros or revalued dinars better reflect the real value and the "purchasing power" of local governments are divided. For the purpose of the time series analysis, Serbian literature mainly expresses monetary amounts in revalued (formerly nominal) dinars. In this study, given that (i) Serbian and Montenegrin data are compared, (ii) the study itself is intended for international and not only local audiences, and (iii) the Serbian economy is deeply "euroized," it was decided to express the amounts in euros with the necessary corrections (exchange rates changes). However, in the conclusion, we expressed the analysed revenues and expenditures in revalued RSD (base year 2014) to make the analysis more useful to local authors, thus giving it an additional angle.

⁶¹ Republic of Serbia, Ministry of Finance, Public Finance Bulletin, № 125, January 2015.

⁶² IMF (International Monetary Fund), World Economic Outlook database, available at <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/download.aspx>.

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Analysis of the Legal Framework for Fiscal Decentralisation in Montenegro

MIJAT JOČOVIĆ

Abstract The author of this section focuses on the legal and institutional analysis of the fiscal decentralisation process in Montenegro in the period 2000-2015. The author examines the first and second research questions - the main features of the fiscal decentralisation process, and the changes in the legal framework on municipal functions and finance. At the beginning, the study explores the different stages of decentralisation shown through the prism of the legal changes. The analysis continues with a thorough study of the current legislation, examining all categories of revenues, as well as the different sources within each category. In the last chapter, the author discusses institutional cooperation between central and local governments in the fiscal decentralisation process. The analysis identifies two distinct phases of municipal financing. In the first phase (2003-2008), Montenegro adopted legislation that strengthened the role and fiscal autonomy of municipalities. During the second phase (2008-2015), the national government adopted a few centralistic policies that were coupled with the impact of the crisis. Although the changes were not too frequent, the overall effects deteriorated local public finance.

Keywords: Fiscal decentralisation • Local government finance • Own-source revenues • Shared revenues • Grants • Montenegro

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1 Introduction

The fiscal decentralisation process in Montenegro, much like in other transitional countries, needs to be observed and analysed within the overall context of public sector reforms undertaken over the past twenty years. In addition to improving democracy through the reform of a traditionally conservative and highly centralised public administration system, functional and fiscal decentralisation also achieved other goals, such as delegating responsibility for financing and managing specific public functions to the lowest levels of local government, improving service quality, increasing governance system efficiency, improving the quality of resource allocation, etc.¹ The preamble to the European Charter of Local Self-Government, ratified by Montenegro and other European transitional countries, states, amongst other things, that local authorities are one of the main foundations of any democratic regime and that the existence of local authorities with real responsibilities can provide an administration which is both effective and close to the citizen.² It is precisely these goals that served as motivation for initiating public administration reform and decentralisation in Montenegro.³

The suddenness of the changes to the entire political, economic and legal system, the lack of adequately established institutions and the overall system of values inherited from the past, together with the experience of a highly centralised federal state, all significantly hindered the process of implementing decentralisation in Montenegro. Furthermore, the delegation of public functions and responsibilities from the central to the local level, coupled with the strengthening of the functional and fiscal autonomy of local governments, meant that Montenegro needed to discontinue its longstanding practice of maintaining a highly centralised public administration system, in which the role and significance of local governments were marginalised. This process, initiated formally and effectively two decades ago, is still on-going and will undoubtedly remain in focus in the period to come.

The significance of fiscal decentralisation, the complexity of local government revenues, the diversity of their legal nature and economic effects, the sheer number of regulations applied in this area all require undivided attention in the process of conceiving and adopting laws and bylaws. The process also calls for substantial public debate and the avoidance of adopting laws in order to meet short-term goals without considering the long-term ones. Thus, one of the goals of this research is to identify certain weaknesses present in the regulatory framework for fiscal decentralisation and, simultaneously, to present recommendations for its improvement. This analysis brings forth criticism towards certain normative solutions regarding fiscal decentralisation issues and points out that some of the main prerequisites concerning the rule of law (predictability, legal certainty, law implementation efficiency, etc.) are significantly compromised as a result of the instability and volatility of the legal framework, as well as the lack of harmonisation among certain important laws. The analysis will draw

attention to numerous examples of how such legislation affects fiscal decentralisation issues. The overall objective of the analysis is to point out long-term negative effects of such a normative approach to policy makers in this area.

Fiscal decentralisation theories present several concrete reasons for why central governments may be reluctant in allowing local governments to take over partial control of finances. The first reason is a lack of administrative capacities. This position implies that the central government possesses a larger and better-qualified administration than do the lower tiers of government. The second reason is the central government's concern over its own finances. The third reason is rooted in the fear of losing macroeconomic stability. The fourth is derived from the concern over economic development. The fifth reason is related to the issue of accountability.⁴ Many of these reasons were, objectively speaking, justified, realistic and present in fiscal decentralisation practices in Montenegro. Therefore, it is logical and for the most part justifiable that this process was met with resistance. An additional problem in Montenegro was the fact that, in addition to public administration and local government reform, the country was also undergoing the process of establishing a newly independent state and its institutions, which are the basis for, among other things, a functional local government system. Nevertheless, there was always sufficient political will to implement this process, as policy makers understood that setting up an efficient and decentralised system was one of the key factors in establishing a modern state.

An important fact that needs to be emphasised in the analysis of the normative framework for fiscal decentralisation in Montenegro is that the local government system is relatively simply organised. Namely, the system of local government in Montenegro is comprised of 23 local government units, including the Capital City and the Old Royal Capital. Also, significant, complex and financially demanding functions (primary education and healthcare) are not part of the local government mandate. Due to all of the aforementioned reasons, the process of fiscal decentralisation in Montenegro appears to be simpler in comparison to numerous other transitional countries with more complex organisational structures of public administration and more mandates taken over by local governments. Still, the current state of local finance and the manner in which the fiscal decentralisation process is implemented imply that this is no simple issue.

Over the last few years, intergovernmental relations have become tense. The reasons for this are high municipal debt, the municipalities' objective incapacity to finance their functions, a low own-source revenue collection rate in certain local governments, issues with municipal property management, and the detrimental impact on the business environment brought on by high levies. Intergovernmental relations have also worsened due to the municipalities' position that they cannot finance their legally allocated functions with their current revenue and the state's lack of understanding of local government financial needs and difficulties. As a result, the general public scrutinises

any central government activity regarding local government finance. Unfortunately, the issue of fiscal decentralisation in Montenegro attracts public attention at a wrong time, just when the state is facing consequences of the economic crisis that had a negative impact on local government finance.

None of the stakeholders – the Government of Montenegro, local governments, the Union of Municipalities, representatives of local businesses and the non-governmental sector - are satisfied with the state of local government finance and the municipal governance of local fiscal policies. Still, the arguments presented often differ and contradict one another. Unfortunately, Montenegro lacks well-founded scientific research in this area, which could determine the causes of local public finance problems in a reliable and objective way and deliver concrete recommendations for their improvement.⁵ The European Commission, in its 2013 Report on the Progress of Montenegro, states that there were no changes in the area of local government rationalisation and efficiency over the past year and that additional efforts are needed to establish a transparent, efficient and accountable administration.⁶ All of the above leads to the conclusion that fiscal decentralisation is a complex issue that requires a multifaceted and methodologically-robust analysis of the causes of the current situation in local government finance.

The political will to reform local governments and implement fiscal decentralisation is present in all the strategic documents adopted by the Government of Montenegro that analyse the position of local governments. The Government's comprehensive analysis leads to an overall conclusion that decentralisation is the end objective, as well as that there is clear criticism of the results achieved so far. The current Montenegro Public Administration Reform Strategy (2011-2016) emphasises higher levels of functional and fiscal decentralisation as the most important goals pertaining to local government.⁷ The part of the Strategy that deals with local government points out the results achieved, but also focuses on shortcomings in the decentralisation processes in the following areas: lack of efficiency of local governments in own-source revenue collection; high levels of debt; inefficient spending and misuse of funds; inadequate local government financing system; inconsistency in the public service quality and approach to public service delivery from one municipality to another; inability of local governments to promote local economic development; non-stimulating functioning of the equalisation fund; complex and costly administrative procedures; cost inefficiency of certain local government bodies, etc.⁸

The document Analysis of Local Government Functioning, which was adopted by the Government of Montenegro in 2012, clearly states that it is necessary to keep improving the local government financing system. It goes on to offer specific recommendations to improve this area to both ministries and municipalities.⁹ It is particularly important to emphasise that this analysis also identifies certain issues that are related to the functioning of the normative framework for local government financing. Among the

issues related to improving the system of local government financing within the existing legal framework, priority is given to the need to regulate municipal short-term borrowing, the usage of the municipal budget reserve, the issue of the mandate of the Committee for Monitoring Development of the System of Fiscal Equalisation of Municipalities, etc.

The Information on the Financial Situation and the Number of Local Government Employees that was discussed by the Government of Montenegro in late 2014 states that municipal financial planning is unrealistic and that spending is disproportionate to the taxation capacities of businesses and the population. This created substantial problems in certain municipalities, including high levels of uncollected tax, debt and arrears towards banks and suppliers, surplus of employees, etc. This document also analyses and criticises the financial situation in local governments, with the main conclusions being that the situation with local government financing is unsustainable, that it undermines the entire financial system, and that it is necessary to take urgent steps to consolidate the system.¹⁰ All of the above points to the central government's critical position and dissatisfaction with the fiscal decentralisation process and the results achieved in the practical functioning of local governments.

On the other hand, local governments and their association (the Union of Municipalities of Montenegro) do not agree with the Government of Montenegro on many issues related to local government financing and municipal public finance. For example, the document *Analysis of Local Finance*, produced by the Union of Municipalities of Montenegro in 2013, identifies the global economic crisis, legislation changes, problems with implementation of certain regulations, inefficient administration, a surplus of employees and other issues as the main reasons that contributed to the current situation in local government finance. This analysis clearly states that the changes made in the normative framework during the previous period substantially diminished the fiscal capacity of municipalities and undermined their ability to finance their tasks. It is further emphasised that starting in 2008, the government began abolishing certain types of revenue without compensation, which has contributed to the gradual accumulation of municipal debt and significantly affected the municipalities' financial situation.¹¹

Local government financial problems culminated in late 2014 and early 2015. In November 2014, the Ministry of Finance initiated a meeting with local government representatives in order to define measures to resolve municipal financial difficulties. In December 2014, the Steering Committee of the Union of Municipalities adopted the Recommendation on measures to overcome the difficult financial situation in local government units.¹²

Successful fiscal decentralisation reform and a balanced functional and fiscal role of local governments contribute significantly to the affirmation of the idea of rule of law in the economy.¹³ Process of fiscal decentralisation in Montenegro is intrinsically

associated with attracting foreign investments and improving competitiveness of national economy.¹⁴ However, local business environment studies show that businesses in Montenegro are not content with local government fiscal policies and practices. So, for instance, the research conducted by the Union of Employers of Montenegro titled “Five Murderers of Business” clearly shows that participants perceive that local governments often set taxes, fees and charges (their own-source revenues) arbitrarily, without considering current economic circumstances for doing business on the local level.¹⁵ The Foreign Investors Council in Montenegro has for years drawn attention to certain shortcomings in local government functioning that burden businesses. They are primarily related to an unpredictable business environment where local governments introduce new financial impositions for businesses and lengthy permit issuance procedures.¹⁶ The Economic Policy Recommendations, issued by the Central Bank in 2014, identify certain problems in how local governments operate, which additionally affect the business environment. They relate to the following: 1) local hindrances reflected in too many communal fees and charges that are also frequently too high; 2) inconsistency in construction permit requirements and procedures in different municipalities, etc.¹⁷ Having analysed the above facts and various arguments presented by relevant stakeholders in Montenegro, one can conclude that fiscal decentralisation requires a systematic and comprehensive approach, with careful consideration of the two goals that must not contradict one another normatively or factually. These two goals are: 1) the improvement of the local business environment and 2) the implementation of optimal functional and fiscal decentralisation and the system of local government financing, which do not compromise the delivery of goods and services to businesses and citizens.

2 Stages of fiscal decentralisation as changes in the legal framework

In the period between 1993 and 2003, the organisation of the state administration in Montenegro was based on the 1992 Constitution, the Law on State Administration Organisation, and the Decree on the Organisation and Functioning of the State Administration.¹⁸ It could be said that public administration featured a high level of centralisation in this period. The most prominent centres of power were the ministries, while the municipalities had an extremely low level of autonomy in decision-making. Also, the state administration system in Montenegro was characterised by a large number of employees – according to the World Bank assessments, it was among the highest in Europe at the time, which had negative effects in terms of the economy and organisation.¹⁹ Apart from its size, the administration faced an additional problem in the form of insufficient capacities and an inadequate ratio between political and professional positions in the public administration system.²⁰ It is especially important to note that the reduction of financial aid after 2000 had a partial impact on the decision to speed up state administration reforms. Namely, after the democratic changes in Serbia, it was evident that this kind of aid directed at Montenegro will diminish substantially. More precisely, concrete results in reform implementation were conditional to receiving

further help.²¹ Also, during the same period, the European Union identified public sector reform as one of the main prerequisites for the initiation of negotiations on the conclusion of the Stabilisation and Association Agreement.

After 2003, Montenegro began to address both the issue of state administration reform and the fiscal decentralisation process. Up until that time, the state administration system had been extremely centralised, while municipalities and their roles – including financing their mandates – were completely marginalised. The first official (Government) strategy that focused on local government was adopted for the 2003 – 2009 period. Apart from addressing local government, the Strategy also outlined the need for reform in the sector of state administration and public services. It defined two major goals of state administration reform – enhanced efficiency of the administrative system and changes in administration directed at its inclusion in wider social reforms.²² In the part that related to local government, the Strategy clearly identified that there is a need to allocate and introduce new functions, which was a process that was to be accompanied by adequate local government finance reform.²³ Observed from today's perspective, this process was marked by strong internal resistance, caused by the fear of losing previous privileges.²⁴

Before the 2003 Law on Local Government Finance, local governments in Montenegro managed their finances in accordance with the Law on the Public Revenue System.²⁵ Under this law, public revenue included revenue used to finance rights and obligations of the Republic of Montenegro and local governments, as well as mandatory social security contributions. Therefore, until 2003, one single systemic law regulated financing of the Republic and local government units as its organisational parts. This legal act stated that local governments, pursuant to the law, may introduce the following types of revenue: local communal fees, local administrative fees, charges on the exploitation of public interest goods, and the construction land use charge. Also according to this Law, local revenue included revenue generated by local government bodies through their activities, as well as revenue generated by public institutions financed from local municipal budgets.²⁶

In terms of legislative initiatives in the domain of fiscal decentralisation in Montenegro, two distinct periods can be identified.²⁷ The first period spans from 2003 to 2008, and the other from 2008 to the present day. The first period of fiscal decentralisation is characterised by the completion of the regulatory framework for local government and fiscal decentralisation, as a significant portion of the framework had been inherited from the period when Montenegro was in the Union with Serbia.²⁸ With the adoption of the 2003 Law on Local Self-Government (“Official Gazette of the Republic of Montenegro,” 42/03, 28/04, 75/05, 13/06 and “Official Gazette of Montenegro,” 88/09 and 3/10), Montenegro formally initiated legislative reform in this area. The adoption of the Law came with the need to harmonise it with a number of other regulations inherited from the previous period of centralised functioning of the public administration. In fact,

over one hundred regulations that were not harmonised with the Law had still been valid at the time of its adoption.²⁹ This caused a substantial number of legal hindrances to its implementation and seriously jeopardised efficient functioning of the legal system in practice. The Law on Local Government applied the method of enumeration to identify more than 40 original mandates of local governments. In theory, such a position of lawmakers is justifiable due to the practice and interpretation that everything not prescribed by law is forbidden; as a result, local governments often arrived at an incorrect interpretation of their own mandates. Unfortunately, this problem persists in the practice of local government functioning to this very day.

One of the main issues within local government reform was local government financing. The success of reforms depended largely on how this problem was to be solved. The first Law on Local Government Finance from 2003 (“Official Gazette of the Republic of Montenegro,” 42/03 and 44/03) clearly states that funds for original municipal mandate financing are to be provided by local budgets and that municipalities have the autonomy to dispose of those funds. Compared to the previous local government financing system in Montenegro, key novelties introduced by this law were the following: 1) real estate tax became own-source revenue of local governments (previously, 50% of its amount had been a shared revenue); 2) new taxation forms were introduced as municipalities’ own source revenues: surtax on personal income tax, consumption tax, vacant construction land tax, business display tax, gift and inheritance tax and tax on games of chance; 3) shared revenue percentage allocated to municipalities was equalised for all municipalities – 10% of revenues generated within municipalities’ boundaries (exception is the Old Royal Capital, which got 15% of revenues generated within municipalities’ boundaries). The former solution defined a range spanning between 15 to 90% of generated revenues; 4) Equalisation Fund was introduced into local government financing system.

Comparing the 2003 solution to the current positive regulations, the following can be concluded. First, the concept of local government revenue has not changed because the previous law also set forth four types of sources of municipal revenue: own-source revenue, shared revenue, equalisation fund revenue, and the central budget. On the other hand, the content of the solution, in terms of individual types of revenue, underwent significant changes. Changes that actually reduced or cancelled certain municipal own-source revenues are especially evident.

Legislative activities aimed at diminishing local government autonomy in the areas of setting and collecting numerous own-source revenues characterise the second stage of the normative development of fiscal decentralisation, which started in 2008 and is still on-going today. In fact, policy makers had deemed this fiscal autonomy a hindrance to the country’s economic development. Therefore, the regulatory reform that took place in this period via the fiscal decentralisation reform was part of a wider government policy directed at foreign investment attraction and improving national economy

competitiveness.³⁰ If one is to observe these normative changes through the prism of the effects they had on local government finance, it may be concluded that this stage featured two types of legislative activities, both with equally detrimental effects on the functioning of the local government. The first legislative activity consists of creating conditions to reduce municipal own-source revenue. On the other hand, changes introduced by the new Law on Local Government Finance in the second stage of legislative activity focused on increasing shared revenues as pillars of local government financing. This in turn reduces political accountability at the local level.

The most significant changes made in the legal framework that impacted the fiscal decentralisation process and local government finance during the first stage are the following:

- Adoption and implementation of the Law on Local Communal Fees.³¹ This law abolished local communal fees for the most profitable economic activities – telecommunication, electricity transfer and business exploitation of the seashore. This fact had a substantial impact on local government revenues in this area. For example, in 2007, these types of revenues totalled 9,309,779.00 euros. In 2008, they were reduced by more than three million (6,079,575.00 euros). Experts believe this was a turning point in the fiscal decentralisation process in Montenegro.³² The reason for such a position is simple – this law was the first instance when the general rule that the abolition of one type of revenue must be adequately compensated was broken.
- The 2008 Law on Spatial Planning and the Construction of Structures.³³ The adoption and the consequent implementation of this law, starting on January 1, 2009, impacted municipal revenues the most. Namely, this law abolished the construction land use charge. In 2008, local government revenue totalled 29,013,631.00 euros from this charge. Chronologically, it was exactly at this point that local governments began experiencing problems with liquidity. These problems are still present today.
- The 2010 Amendments to the Law on Local Government Finance. These amendments abolished certain local government revenues, such as the consumption tax, the business name display tax, and the lottery and game of chance tax.³⁴

In addition to the positive effects these laws had on attracting investment, the solutions adopted also had ramifications for local government finance. In 2010, certain legal provisions were changed. Namely, the Law on Local Government Finance changed in the following manner:

- The percentage of the share of local governments in the personal income tax revenues earned on their territories was increased from 10% to 12% (that is, to 16% for the Old Royal Capital and to 13% for the Capital City);
- Local governments' share in the real estate transfer tax revenues was increased (from 50% to 80%);

- Local governments' share in the revenues from the concession and other charges on natural resource exploitation was increased (from 30% to 70%);
- Equalisation fund allocation criteria were significantly improved.

The main reasons given for amending the law were: the necessity to further improve the vertical balance between municipal revenues and expenditures; the need to harmonise this law and other laws regulating the system of local government with the European Charter of Local Self-Government; and the need to further improve the business environment by abolishing fiscal items with negligible net effects on municipal revenue. Also, the explanation for the 2010 amendments emphasises the fact that the Government of Montenegro, as the proposer of the solutions, considered both the stability of financial resources and the optimality of municipal expenditure, in order to secure long-term financial stability and regular servicing of municipal legal obligations.³⁵ Unfortunately, the practical implementation of this law and the current financial situation in local governments confute the majority of arguments presented as part of the explanation for the 2010 amendments to the legal framework for local government financing in Montenegro. Even though the end goal of lawmakers was to rectify the identified shortcomings and to secure smooth functioning of local governments by providing increased funds to municipalities, the described activities had negative legal effects. Their consequences were negative not only in the economic sense, but also in the context of the functioning of the legal system in this area.

Public finance theory and recommendations made by relevant international organisations in this area provide certain guidelines on the general principles on which intergovernmental relations should be founded. Some of the most significant suggestions are the following: adequate financing must be provided for the allocated functions; local governments should finance their functions from their own-source revenues as much as possible; the transfer system should be, to the largest extent possible, transparent and predictable. The position of the theory and the recommendations of international institutions in no way oblige policy makers; however, the fact that policy makers have frequently ignored key issues in the process of fiscal decentralisation reform in Montenegro, particularly after 2008, causes great concern. Namely, key actors completely ignored some of the aforementioned guidelines with the onset of the economic crisis. As an example, we refer to the general position presented in the Recommendation of the Council of Europe no. 21 (2005) that reads, among other things, that when higher levels of government decide to reduce the local government tax base, they should secure adequate compensation. In the process of fiscal decentralisation, especially after the economic crisis, there were numerous examples of certain revenues being abolished without any adequate compensation. In practice, this had a negative impact on the functioning of local governments, as well as detrimental consequences in terms of the entire process of fiscal and functional decentralisation.

Finally, we believe that it was precisely the absence of legislative initiative that became (and continues to be) a hindrance on the path towards public finance stabilisation on the local level. For example, the Law on the Legalisation of Informal Structures is yet to be adopted, having spent years in the form of a bill in the Parliament of Montenegro. The absence of this Law has multiple consequences, one of the most difficult ones being a shortage of funds in municipal budgets. In fact, proposers of this Law have calculated that the implementation of certain solutions proposed in this Law would be expected to increase the total revenues of local governments in Montenegro by 500 million euros.³⁶ This revenue would be generated by a) the transfer of ownership of state-owned land on which illegal structures are built, and whose legal owners are, in the majority of cases, local government units (Article 7), as well as by b) the collection of the construction land communal development charge, the regional water supply system construction charge and the legalisation charge.³⁷ Another example is the failure to adopt the Law on Communal Activities, which entered the legislative procedure in the Parliament in 2011. This Law would have a direct impact on the functional and fiscal role of local governments because it would define obligations and responsibilities of municipalities in the area of utility services. This regulatory act would be of great importance for local governments because it prescribes the introduction of the communal charge as one type of local government revenue. Namely, Article 52 of the proposed Law on Communal Activities regulates the introduction of the communal charge and defines those obligated to pay it.³⁸ We are particularly underlining numerous initiatives made by local government representatives and the Union of Municipalities to include the aforementioned laws in the agenda of the Parliament of Montenegro. Keeping in mind the current problems in local government finance, as well as the critical position of the Government of Montenegro towards local government activities in this area, it appears justified to pose the question of accountability for the delayed adoption of these laws. This fact also confirms that placing absolute responsibility for the poor situation in public finance on local governments speaks to the total lack of understanding of the overall environment in which local government finance functions.³⁹

3 Current legal framework on fiscal decentralisation and local government financing

Local government financing is, directly or indirectly, regulated by the Constitution, numerous legal regulations and bylaws adopted by the central or local government. The right to self-government is one of the basic human rights of the citizens of Montenegro prescribed by the Constitution within common provisions on human rights and freedoms.⁴⁰ On the other hand, provisions on local government financing are presented in the part titled "Organisation of Government." The Constitution of Montenegro is precise in dividing and standardising local government functions and financing. The right to local government belongs to citizens and local government bodies, and it encompasses the right to regulate and govern public and other affairs, based on own accountability and in the interest of the local population. A separate article, which

regulates municipal financing from own-source revenues and funds allocated from the central government, also regulates the issue of financing the local government. The same article prescribes the municipalities' right to their own budgets.⁴¹

By adopting the Law on the Confirmation of the European Charter of Local Self-Government ("Official Gazette of Montenegro – International Agreements," 5/08), Montenegro embedded into its legal system the basic principles of the most significant international document on local government. Montenegro ratified Article 9 in its entirety, which regulates financial resources of local governments.

In addition to ratifying the European Charter of Local Self-Government, which is the only legally binding document regulating local government and its financing, Montenegro has also taken into consideration all applicable Recommendations of the Council of Europe when adopting the legal framework on fiscal decentralisation, local finance and local government own-source revenue. The Explanation of the latest Amendments to the 2010 Law on Local Self-Government reads that one of the reasons for amending the law in question is the necessity to harmonise existing legal solutions with the European Charter of Local Self-Government and the Recommendations of the Committee of Ministers of the Council of Europe regarding local government finance.⁴² In continuing local government finance system reforms, one must also consider other recommendations issued by the Council of Europe in this area, which, although not binding, contribute substantially to the affirmation of the concept of local government decentralisation in practice. These are: the Recommendation of the Committee of Ministers to Member States on Financial and Budgetary Management at Local and Regional Levels (2004); the Recommendation of the Committee of Ministers to Member States on Financial Resources of Local and Regional Authorities (2005); and the Recommendation of the Committee of Ministers to Member States on Local and Regional Services (2007).

In its evaluation of the quality of the legal framework, the Council of Europe was clear in stating that the local government system established in Montenegro is to a significant extent harmonised with international documents and that local government has reached certain levels of commonly accepted standards.⁴³ However, one must also be careful when interpreting certain provisions of the European Charter of Local Self-Government and Recommendations of the Council of Europe because mere copying of the provisions does not necessarily imply that they are understood correctly, especially within a system as complex as the local government financing system in Montenegro.

The Law on Local Self-Government, as a systemic law regulating local government, also contains general norms on the manner of financing local governments. This legal act is important for local government finance issues because it defines the types and the scale of local government tasks. Some of the most important are:

- Performing and developing utility and other communal activities;

- Maintaining and safeguarding local and non-categorised roads;
- Regulating and providing passenger transportation in urban and suburban areas;
- Providing preconditions for entrepreneurial development;
- Environmental protection;
- Safeguarding local public interest (natural and common) goods;
- Managing watercourses, the surrounding land and structures of local importance;
- Cultural development and safeguarding cultural heritage, etc.⁴⁴

With regard to the authority of local governments in Montenegro, it is important to emphasise that the Law does not define municipal legal obligations in the education and healthcare systems, a fact that makes normative regulation and fiscal decentralisation processes easier to manage. Nevertheless, the Law on Local Self-Government prescribes that local government should, in accordance with its abilities, contribute to creating the necessary conditions and improving healthcare, education, social and child protection services, employment opportunities, and other areas of local public interest. The Law also sets forth the rights and obligations municipalities hold as founders of institutions established to provide the abovementioned services, in accordance with the law. In practice, this means that in some cases certain municipalities used their own financial resources to perform the aforementioned activities, even though that was not their legal obligation.

Based on the analysis of the normative framework for local government obligations, and on the conducted interviews, we can conclude that there is, in a number of cases, a legal and factual imbalance between functional and fiscal decentralisation in Montenegro. This means that tasks were allocated without the provision of adequate sources of funding. For example, the Draft Law on Healthcare introduces new obligations for municipalities in terms of secondary and tertiary healthcare without defining revenue to finance those obligations. The Law on Urgent Medical Help sets forth that, in cases when it becomes necessary to open urgent medical aid substations in areas where the number of people seeking medical aid has increased due to the frequent transit and sojourn of tourists, local governments are required to finance the operations of these temporary urgent medical help substations, including the salaries of the temporary staff. Also, several regulations allocate tasks to local governments, primarily of an administrative nature (such as issuing certain permits, keeping records, etc.; the Law on Rafting, the Law on Alcohol and Alcoholic Beverages, the Law on Wine, etc.), without defining sources of financing. Consequently, these tasks are financed by general local government revenue, even though they require hiring new employees.

The issue of financing local governments is directly regulated by Article 92 of the Law on Local Self-Government, which reads that municipalities generate funds to finance their tasks from the following sources: local taxes, fees and charges, shared taxes and charges in the amount defined by the relevant law, budget donations and other sources pursuant to current laws. Therefore, the lawmakers' intent was to have municipalities

finance their own tasks from revenues they regulate and collect themselves as much as possible. The central budget is to provide the funds needed for the financing of allocated and shared tasks. Finally, decentralisation is one of the basic principles recognised by this Law.

The Law on Local Government Finance regulates municipal finance in detail.⁴⁵ According to this Law, local governments have four sources of funding to finance their mandates: 1. own-source revenues; 2. revenues shared by law; 3. the equalisation fund, and 4. the central budget. The major innovation in the category of own-source revenues is that the Law defined the real estate tax as own-source revenue. Prior to the change in 2003, this tax was shared revenue and local governments were entitled to 50% of the generated revenue. The 2003 Law gave local governments the right to: determine the tax base by assessing the market value of the real estate, set the tax rate within the range from 0.1% to 1%, administer the control and collection of the tax revenue, and maintain the inventory of real estate on their territory. Further, the Law introduced the personal income surtax as own-source revenue. Municipalities got the right to the surtax on revenues generated from the personal income tax up to 10%, except for the Capital City and the Old Royal Capital, which could determine the surtax up to 13% and 16%, respectively. Finally, the 2003 Law also included the following taxes in the category of municipal own-source revenues: the local consumption tax with the rate of up to 3% (except for the Capital City and the Old Royal Capital, which could have a rate of up to 5%); the firm name display tax (hereinafter, the firm tax) of up to 300 euros annually per company; the tax on undeveloped construction land; and the tax on lottery and the games of chance.

When it comes to shared revenues, prior to the adoption of the new Law, all municipalities received different percentages of revenues from the personal income tax. The range spanned from 15% to 90%, depending on the municipal level of development. However, the 2003 Law equalised the share of local governments in the revenues generated from this tax. All municipalities got entitled to 10% of the generated revenues, except for the Old Royal Capital, which got entitled to 15%.

Finally, the last major innovation of the Law was the establishment of the Equalisation Fund. The earlier system did not have any transfer mechanism and the Republic allocated grants in a non-transparent manner. There were no specific criteria or procedures for the allocation of grants. The 2003 Equalisation Fund's revenues were secured from the personal income tax in the amount of 10% of the total revenues collected. The Law listed the following criteria for the use of funds: the municipal fiscal capacity index, the municipal budgetary spending index, and the local communal infrastructure development index.

The Law on the Budget and Fiscal Accountability regulates budget planning and execution, fiscal accountability, loans, guarantees and other questions of importance for

both the budget of Montenegro and the local government unit budgets.⁴⁶ This Law also regulates certain local government finance issues. The most important among these are the following: 1. the budgetary deficit of local government bodies within one year shall not exceed 10% of municipal revenue in the same year;⁴⁷ 2. prior to adopting the draft ordinance on the municipal budget, the relevant local authority shall receive comments from the Ministry of Finance regarding the level and structure of spending, the income policy, capital expenditure, sources of financing, and the levels of municipal budget cash surplus and deficit;⁴⁸ 3. local governments may take long-term loans and provide guarantees with prior consent of the Government, upon proposal by the Ministry of Finance;⁴⁹ 4. the relevant local government body keeps record of the current municipal debt, long-term and short-term loans and issued guarantees, and reports to the Ministry of Finance quarterly, no later than 30 days after the end of the trimester. The adoption and implementation of this law will significantly improve fiscal discipline and contribute to public finance stability.

Apart from the aforementioned regulations, the issue of local government finance is indirectly regulated by a set of other laws. The most significant are:

- The Law on the Real Estate Tax.⁵⁰
- The Law on the Real Estate Transfer Tax.⁵¹
- The Law on the Personal Income Tax.⁵²
- The Law on Local Communal Fees.⁵³
- The Law on Administrative Fees.⁵⁴
- The Law on Spatial Development and the Construction of Structures.⁵⁵
- The Law on Roads.⁵⁶
- The Law on State Property.⁵⁷
- The Decree on Selling and Leasing Out State Property.⁵⁸
- The Law on Concessions.⁵⁹
- The Law on Watercourses.⁶⁰
- The Law on Water Management Financing.⁶¹
- The Law on Tax Administration.⁶²
- The Law on Forests.⁶³
- The Law on Mining.⁶⁴
- The Law on Ports.⁶⁵
- The Law on Marine Resources.⁶⁶
- The Rulebook on the Allocation and Use of Equalisation Fund Assets.⁶⁷

Based on this, one can conclude that the legal framework on local government functioning – and its financing in particular – has been regulated by a series of regulations of various content and legal weight in Montenegro. These can be categorised according to various criteria. According to their legal power, we identify constitutional, legal and government regulations and bylaws on local government finance. On the other hand, within the category of laws regulating local government finance, it is important to note that there are two sub-categories of laws. The first group

is comprised of systemic laws that directly regulate the issues of local government mandates and financing, and these are the Law on Local Self-Government and the Law on Local Government Finance. The second group consists of laws that, by regulating other aspects as major issues, indirectly regulate the issue of local government financing. Additionally, the matter of local government finance is directly regulated by a series of bylaws – Government acts (decrees, conclusions) and ordinances of local governments. Such a normative situation is the result of the lawmakers' objective incapability to adopt one systemic (comprehensive) law that would regulate all local government revenues and the manner of their collection in detail. As a result, one can draw a general conclusion that the Law on Local Government Finance is the basic act that enumerates all local government financing sources, whereas particular laws and bylaws regulate individual revenues in detail.

3.1 Own-source revenues of local government units

Using the enumeration method, the Law on Local Government Finance is precise in regulating own-source revenue of local governments. Such revenue can be divided into four groups. The first group consists of taxes – the real estate tax and the surtax on the personal income tax. The second group of revenues are charges: the municipal roads use charge, the environmental protection charge, and the construction land development charge. The third group of revenues comprises fees – local administrative and local communal fees. Finally, the fourth group consists of other revenues, which vary in terms of their content and legal nature. These are:

- revenue from the sale and lease of municipal property,
- revenue from capital,
- fines issued in misdemeanour proceedings,
- revenue from concessions,
- revenue from municipal body activities, revenue from donations and subsidies, and other revenue.

Even though the Law identifies the aforementioned revenues and categorises them as own-source revenue, many of these do not belong in the own-source category based on their legal nature. For instance, fines issued in misdemeanour proceedings cannot constitute own-source revenue because municipalities do not have the discretionary right to impose or to affect the revenue generated by these sources.

3.1.1 Taxes as a type of local government own-source revenue

In line with the existing legal provisions and established objectives, the real estate tax became the main source of financing for local governments. The Law on the Real Estate Tax envisages that local government units should impose the real estate tax through their own regulation and that revenues belong to the local government on whose territory the property is located. The Law defines the tax rate range and it also provides

the basis for certain tax credits and exemptions. The range of tax rates on real estate, under the current legal provisions, ranges from 0.10% to 1.00% of the real estate market value established by the municipalities depending on the type, location, quality, date of construction, and use of the property. Certain types of real estate, such as agricultural land and construction land with illegally built structures, are subject to a higher tax rate.

Local government units' obligations concerning the administration of this tax present an important legal issue. In this regard, local government obligations are to: 1) determine the market value of the real estate; 2) set the tax rate on real estate; 3) control and collect taxes on real estate; 4) maintain the register of real estate subject to taxes; 5) regularly align their real estate register with the real estate register maintained by the state authority responsible for real estate; 6) submit data to the ministry relating to the assessment and collection of real estate taxes, if necessary, at least once a year. Hence, municipalities have a broad discretion when it comes to managing all phases of this tax – from setting the tax base by determining the market value of real estate to controlling and collecting the tax. We consider this legislative approach to be appropriate, and such a position is best supported by the respective increased revenue collection.

If we take into account the economic effects and the legal solutions related to this tax that have been discussed above, it can be concluded that the real estate tax is the most important source of municipal revenue in Montenegro. According to the Ministry of Finance, the 2013 real estate tax revenue amounted to 39.3 million euros, which, compared to 2012 (36.0 million euros), represents an increase of 9.11%.⁶⁸ The 2013 tax policy analysis lists the following arguments for increasing revenue on these grounds:

- Broadening the tax base,
- Defining special tax treatment for certain real estate categories – uncultivated agricultural land, secondary housing, illegal buildings, hospitality facilities located inside the priority tourist zone, and construction land not used in accordance with the planning documentation;
- More effective control of tax calculation and collection by the municipal tax authorities and better records of the real estate owners.⁶⁹

In order to improve collection of this tax, we believe that national policymakers and municipal authorities charged with implementing the law in question should focus their attention on several key areas in the future. It is particularly important to note that municipalities are unable to influence the majority of issues and their solutions. First, the state must create the legal preconditions that would help achieve the full application of the existing legal provisions at the level of individual taxpayers. For example, in practice there is no regulation that thoroughly defines the concept of agricultural land, despite the legal obligation of the administrative authority for agriculture to adopt a regulation detailing this term (Paragraph 3, Article 9a).⁷⁰ The second source of problems is connected to the functioning of the real estate cadastre, since in practice there is a substantial discrepancy between the on-site situation and the cadastral records data.

Municipalities cannot solve this problem because it is tied to the state administration – the Real Estate Administration. Third, the Law lacks penalties for failure to submit a tax return or for filing incorrect tax returns. Finally, the forced collection of the real estate tax is perhaps the main problem with regard to this revenue. According to the legislation, the forced collection of the real estate tax does not assume the immediate eviction from a property. It first assumes an administrative suspension and/or reduction of the salary or other income of the property owner. In practice, employers often ignore the conclusions concerning forced collection, while the legislation does not provide for sanctions against this practice.⁷¹ The Government of Montenegro has identified the above problems and devoted considerable attention to them through a number of recommendations made to relevant ministries, with the goal of improving the collection of this tax. The most important recommendations are as follows: a necessary amendment to the Tax Administration Law, primarily with regard to the shortening of the forced collection procedure and the introduction of sanctions against employers who do not apply the forced collection decisions; preparing amendments to the Law, with the aim of updating the database necessary to assess and collect real estate taxes; preparing amendments to legal solutions in order to define and shorten the forced collection procedure, particularly in regard to the employer's responsibility for not blocking an employee's salary, as well as establishing adequate sanctions, etc.⁷²

In December 2014, the Government of Montenegro adopted a Draft Law amending the Law on the Real Estate Tax and submitted it to the Parliament of Montenegro for deliberation and adoption. The text of the Law was adopted on February 17, 2015, while its enforcement was postponed for January 1, 2016. The Preamble of the Draft Law amending the Law on the Real Estate Tax states that its key goals are overcoming solvency issues of local government units, replenishing municipal lost revenues, as well as improving the fiscal policy by abolishing certain tax forms that have a distortionary effect on entrepreneurship. However, the academic community strongly criticised some provisions of the Draft Law, and in our opinion, such criticism was justified.

In comparison to the previous legal solutions, the most significant updates include the following:

- An increase of the tax rate threshold from 0.1% to 0.25% of the real estate market value;
- Tax exemptions for structures and special parts of residential buildings owned by investors that are referred to in business records as either investments in progress or finished products inventory, which are intended for resale;
- The introduction of tax exemptions for secondary structures that have a lease contract with a travel agency or a local tourism organisation and that have an average occupancy rate of at least 60 days per annum.
- The introduction of a potential tax rate increase for certain categories of structures.
- The introduction of sanctions for failure to submit data to local governments by various legal entities.

When it comes to the fiscal decentralisation process, the essential question is whether increasing the tax rate threshold to 0.25% of the real estate market price will increase municipal revenues. The proposal above is a logical consequence of the Government of Montenegro's earlier documents, which had proposed improving the business environment through the elimination of certain local government revenues and their replacement in this way.⁷³ Nevertheless, the question of long-term economic effects of these legal solutions still exists.

On the other hand, the introduction of tax exemptions for structures and special parts of structures owned by investors, which are referred to in business records as investments in progress or finished products inventory and which are intended for resale, creates preconditions for a considerable reduction in municipal revenues. The Union of Municipalities of Montenegro pointed this out in its Opinion on the Draft Law, noting that these solutions imply giving substantial benefits to construction companies and stimulating further construction, as well as that real estate is property that physically burdens the environment and that must be taxed as such.⁷⁴ From the perspective of legal permissibility, particularly controversial is the provision on tax exemption for secondary structures that have a lease contract with a travel agency or a local tourism organisation and that have an average occupancy rate of at least 60 days per annum; Article 6 of the Draft Law introduces this provision. The main reason for the aforementioned opinion is that it is legally disputed whether the details outlined in the Draft Law could form the basis for the real estate tax exemption or only for the tourist fee exemption. Moreover, the above solution opens the door to the abuse of the law by making it possible to conclude fictitious contracts in order to avoid taxes. Amendments submitted by the Union of the Municipalities of Montenegro to the Economy and Budget Committee of the Parliament of Montenegro assert that the local government is committed to tourism development at the local level and that the possibility to issue hospitality business permits to owners of secondary residential units (foreigners and non-residents in general) has removed barriers to using these facilities for tourism purposes.

The amendments also point out that, upon proposal of the Ministry of Sustainable Development and Tourism, local governments have exempted owners of such buildings from tourist fees, and thus have created a tax environment conducive to economic development.⁷⁵ Finally, the Union of Municipalities stressed that this solution discriminates against owners of secondary residential structures who do not have contracts with tourist organisations, especially owners of small and older properties inherited through inheritance proceedings. In examining this Draft Law, the introduction of sanctions emerges as an affirmative novelty. The lack of sanctions has been a factor that has reduced efficiency of administering this tax. The lack of sanctions excludes forced collection, which has in practice not been sufficiently developed in this area. The Draft Law introduces penal provisions for different types of entities, whose omission in the previous period was recognised by the lawmakers as one of the factors causing

lower enforcement efficiency. Furthermore, in relation to the sanctions prescribed by the Draft Law, one might also treat with caution the solution that establishes a fine for a taxpayer (natural person, entrepreneur or a legal person) who fails to pay his or her taxes in two equal instalments. The fine for this violation ranges from 250 to 2,000 euros (for natural persons) or from 2,000 to 20,000 euros for legal entities. Caution towards this solution stems from an objective risk that the economic situation and the inevitable increase in tax rates would render citizens and businesses unable to regularly pay the real estate tax. We highlight that the above solution runs the risk of a selective application of the law, or its non-application, which is an equally poor solution for legal certainty and the rule of law. Finally, a distinct intention of the Draft Law should be underlined. Namely, although the Draft Law increases the tax rate threshold, it also introduces legally illogical (but allowed) tax exemption solutions. We believe that this has negative effects on the decentralisation process and undermines the basic principles of the local government autonomy in this field.

In addition to the real estate tax, the Law on Local Government Finance provides a legal basis for municipalities to introduce a surtax on the already calculated personal income tax, which can be up to 13% of income in all municipalities except in the Capital City and the Old Royal Capital, which can determine a surtax of up to 15%. The said surtax is based on the personal income tax from various sources (personal income, self-employment, property and property rights, and capital). In practice, local governments adopt their own legal acts (ordinances) on the basis of this law, which detail the surtax rate rules and the rules surrounding the supervision of tax calculation and payment. Future revenue collection from this tax will depend on two factors: 1) the reduction of the grey economy, and 2) more efficient intergovernmental cooperation during the approval process of the deferred tax payment. The Union of Municipalities' analyses concerning this issue pointed out the following practical problems caused by the existing legal framework:

- Deferred personal income tax payments approved by a state authority cause delayed surtax payments without the consent of the municipality to which this revenue belongs;
- The practice of not filing tax returns for the surtax is frequent;⁷⁶
- According to the Ministry of Finance data, the realised revenues from the surtax on the personal income tax in 2013 amounted to 17.7 million euros. Compared to 2012 (15.0 million euros), this is an increase of 18.02%; this is the result of more efficient control of tax calculation and collection by the municipal tax authorities.⁷⁷

3.1.2 Fees as a type of local government own-source revenue

In theory, a fee implies any charge for a particular service provided by a state authority to the taxpayer. In comparative practice, legislators often make no distinction between fees and taxes. The main criterion for their distinction, as explained by Popović, is that a

fee is clearly associated with the cost of services provided by the state authority. If the relation is weak or if it does not exist, then a levy is not a fee, but a tax, regardless of the name used in a law.⁷⁸

In Montenegro, there are two types of fees – local communal and local administrative fees. The adoption of the Law on Local Communal Fees in 2006, which entered into force on January 1, 2008, was one of the first steps by which the Government of Montenegro began to reduce the own-source revenue of local governments. However, appropriate revenues in the positive law that would offset the negative effects of abolishing fees for certain categories of profitable entities were not introduced. The erroneous legislative approach of abolishing certain municipal communal fees continued in numerous other cases. The result was identical – local governments were left without revenue, while at the same time no legal basis was found to compensate for the adverse effects this had on their functioning. According to this Law, local governments levy communal fees on the basis of their regulation. The Law states that a communal fee may be introduced for: 1) the use of public space, except for the sale of newspapers, books and other publications, old and artistic crafts and handicrafts; 2) organising musical entertainment in hospitality facilities, excluding music played by mechanical devices (record player, tape recorder, radio, TV, etc.); 3) the use of billboards, except near the main roads and highways; 4) the use of parking spaces for motor vehicles and trailers, motorcycles and bicycles, on landscaped and marked places; 5) the use of open areas for camping, setting up tents or other temporary structures; 6) the use of showcases for displaying goods outside business premises; 7) operating floating facilities, floating devices and other structures on water; 8) operating sawmills, power saws and chainsaws for cutting material; 9) running restaurants and other hospitality and entertainment facilities on water; 10) operating asphalt concrete plants and stone crushing and processing and sand production plants; 11) the use of open areas for carting tracks, amusement parks and circuses; 12) the use of the coast, except the seashore, for business purposes. Consequently, the Law in question normatively defined a wide range of situations in which municipalities could impose the local communal fee payment obligation. The Law stipulates that municipalities may determine the amount of their local communal fees depending on the type of activity, area, location or zone in which the buildings or objects are located or in which services subject to the fee are performed. From a legal point of view, it is essential that municipalities have the authorisation to determine and collect this revenue, which leads to the conclusion that in their legal nature and under the existing legal solutions in Montenegro, communal fees are local government own-source revenue.

A Government document titled *Analysis of Fiscal Policy at the Local Level* shows that there is an inconsistency at the local level when it comes to implementation, administration and collection of local communal fees.⁷⁹ This inconsistency is a result of the vague regulatory framework. In the absence of alternative funds that would enable local governments to fund their functions and in a situation when they do not have

sufficient financial resources, local governments are forced to find mechanisms to increase their revenue through the application of the existing legal options, despite the fact that certain fees might have a negative impact on the business environment at the local level. As a result, the amount of the fee frequently exceeds the administrative costs of services, and the local governments presently charge different types of fees for the very same administrative activities. Lastly, it is important to note that the existing Law does not prescribe sanctions in cases of non-compliance, which also adversely affects revenue collection.

On the other hand, municipal administrative fees are levied and paid in accordance with the Law on Administrative Fees. Administrative fees are paid for documents and actions before state administration bodies, local government bodies and other legal entities having public authority. The law authorises municipalities to impose administrative fees for actions and documents before local government bodies. The level of administrative fees for actions and documents before the state administration is determined by the national fee tariff, while the level of local administrative fees for actions and documents conducted before local government bodies is determined by the local fee tariff. However, the law distinctly stipulates that the level of a local fee may not be greater than the amount of tax payable for similar documents and actions conducted before state administration bodies.

3.1.3 Charges as a type of local government own-source revenue

Charges are paid for the use of public assets – natural and common goods.⁸⁰ The Law on Local Government Finance recognises the following types of charges as part of local government own-source revenue:

- the construction land development charge;
- the municipal roads use charge;
- the environmental protection charge.

a) The construction land development charge. After suspending certain taxes, the Parliament suspended the construction land use charge starting in 2009. Our analysis will confirm that the suspension of the said charge without an adequate replacement in the local government revenue system created problems for the local government, such as causing municipalities to default on their obligations and to borrow more. After analysing the legal framework for urban construction land in Montenegro, we can conclude that the policy of the central government (and its relevant legislation) regarding the construction land ownership right in Montenegro influenced the further process of fiscal decentralisation and local government revenues.

When it comes to the urban construction land charges, there are two distinct phases in Montenegro. The first relates to the enforcement of the Law on Construction Land up until 2008, while the latter covers the period from 2008 to the present day and is linked

with the implementation of the Law on Spatial Planning and Construction. The 2000 Law on Construction Land allowed the private ownership of construction land in addition to state ownership. On the other hand, the Law also kept a usage right of construction land – a remnant from the socialist times when private entities were not allowed to own land. Consequently, municipalities were charging for the use of construction land. Revenue from these charges was significant and allowed for the smooth functioning of the local government, i.e., the fulfilment of legal obligations.

However, legislative policy and the approach to the construction land use charge in Montenegro changed in 2008 when the Law on Spatial Planning and Construction of Structures entered into force. Namely, private entities were permitted to acquire ownership rights over urban construction land, and the legal basis for the construction land use charge finally ceased to exist in 2009.⁸¹

Therefore, the only revenue of the local government from construction land that remained for local governments was the construction land development charge. The Law on Spatial Planning and Construction of Structures obligates investors to pay this charge for infrastructure development of land. However, other provisions of this Law directly affect the autonomy of local governments to freely administer this charge, which is their own-source revenue. First, the Law prescribes that the Government of Montenegro should give prior consent for the terms, manner, deadlines and procedure by which the charge is to be paid. Second, the Law states that revenues from this charge may be used by the local government units only for the preparation and development of the construction land in the area where a structure is being constructed. Third, this local government revenue will be reduced considerably in the future, as the Law defines numerous exceptions in which investors are not obligated to pay the construction land development charge.

In practice, local governments take the gross or net usable area of the structure being built or reconstructed as a criterion in calculating the charge. When arranging a legal relationship with investors, local governments are legally obligated to facilitate the payment of this charge in one of two possible ways: by providing an opportunity to pay the charge in instalments and by providing a discount for a one-time charge payment. The Union of Municipalities of Montenegro has also publicly expressed its criticism of these legal solutions, indicating that local governments will not be able to bear the burden of these construction land reforms and finance necessary infrastructure development of land.⁸²

This legislative approach affected local government financing and left local governments without important own-source revenues. In our opinion, this is one of the key moments in the fiscal decentralisation process because, in this case, the reduction of revenue was not accompanied by an equivalent replacement. By its legal nature, the revenue from the construction land development charge is own-source revenue of the

local government. However, the latest legal measures limit the ability of local governments to freely administer this revenue and empower the central government to give prior consent for the conditions, manner, deadlines and procedures of the construction land development charge payment, which directly affects the legal nature of this concept. In conclusion, it should be noted that by 2016, the Government of Montenegro plans to abolish this charge. According to the rationale and opinion of the Council for Improvement of the Business Environment, a more efficient real estate tax collection procedure in the future should provide compensation for the revenues from this charge.⁸³

b) The roads use charge. In addition to the construction land development charge, the municipal roads use charge is also one of the own-source revenues of local governments. The legal basis for the introduction and collection of this charge is the Law on Roads. The introduction of this fiscal charge and its inclusion in local government own-source revenues were justified by the authority and obligations of the local governments to manage and maintain municipal roads. Thus, the inclusion of this charge upheld the legislative principle that functions should be accompanied by appropriate financing. The Law lists different types of charges for the use of municipal roads that a municipality may introduce on its territory. Furthermore, municipalities may independently determine the amount of the charge, which is subject to prior approval of the Government of Montenegro. The Law prescribes the following types of municipal roads use charges: 1. the special transport charge; 2. the charge for setting up commercial signs on roads and next to roads; 3. the annual charge for the lease of road land; 4. the annual charge for the lease of other land belonging to the road administration; 5. the charge for connecting an access road to a public road; 6. the charge for routing pipelines, water supply, sewage, electrical, telephone and telegraph lines along public roads, etc.; 7. the annual charge for pipelines, water supply, sewage, electricity, telephone and telegraph lines, etc. installed along public roads; 8. the charge for the construction of commercial facilities with road access; 9. the annual charge for the use of commercial facilities with road access. Local governments determine the level of the roads use charges independently.

If one is to view the legal nature of own-source revenue from a theoretical angle, this charge is the own-source revenue of the local government both in normative and factual terms, considering that municipalities may determine its level at their own discretion. On the other hand, this Law is either in direct conflict or coincides with other laws governing local government revenues. First, in determining certain charges that may be introduced by the local government, there is an overlap or, to say the least, a concern about an overlap with other fiscal charges, such as the construction land development charge and other individual fees.⁸⁴ More specifically, according to the existing solutions, the investors might pay the same charges for construction and maintenance of roads on two separate grounds: 1) as part of the construction land development charge under the Law on Spatial Planning and Construction of Structures (Item 2, Paragraph 1,

Article 65), and 2) as special charges, pursuant to the Law on Roads (Paragraph 4, Article 22). The Government of Montenegro's document "Analysis of the Fiscal Charges on the Local Level" highlighted this legal inconsistency in particular. Second, there is an obvious duality in the existence of two fiscal charges of different legal natures paid on the same basis – the local communal fee for the use of billboards and the charge for setting up commercial signs on roads and next to roads.⁸⁵

c) The environmental charge. The position of policy-makers on fiscal decentralisation, and particularly on own-source revenues of the local government, may be illustrated through the approach taken towards the environmental charge. Namely, under the Law on Local Government Finance, the environmental charge was set forth as local government own-source revenue. The Law on Environmental Protection allows local government units to impose an environmental charge depending on their own needs and particularities. The Law has defined that this charge is earmarked revenue. Nonetheless, in practice this charge has not become operational. The reason for this lies in the fact that this Law and secondary legislation have not determined specific criteria and conditions that would allow municipalities to collect this charge; thus, this legal opportunity has not yet become part of the local government practice. Practice shows that the Republic sometimes adopts laws that introduce certain revenues without adopting accompanying bylaws, which are a necessary precondition for practical implementation of the legislation and, thus, for the collection of these local government revenues.

3.1.4 Other own-source revenues of local governments

Finally, the last group comprises the so-called non-fiscal revenues of local governments. This group includes different types of revenues, collected on different legal grounds. The Law on Local Government Finance outlines the following non-fiscal revenues of local governments: property revenues, revenue from concession charges, revenue from the operation of municipal bodies, services and organisations, revenue from donations and subsidies, as well as fines in misdemeanour proceedings and confiscated assets during misdemeanour proceedings.

We can distinguish between two types of property revenue stipulated by the Law on Local Government Finance:

- revenues from the sale and lease of municipal property and
- revenues from capital (interests, shares, etc.).

The legal framework of Montenegro, including the Constitution and a number of other laws and regulations, define the local government's right to own property. The issue of municipal property is regulated by the Law on Local Self-Government, the Law on State Property and the Decree on Selling and Leasing Out State Property. The Law on State Property has defined that certain state property-related authorisations are to be

exercised by municipalities. A separate part of the Law regulates the natural resources managed by municipalities, local common goods managed by municipalities, other local assets of public interest managed by municipalities, and other state assets at the disposal of municipalities. The responsible municipal body manages immovable and movable property and other state-owned assets for which the municipality has certain ownership authorisations. The Parliament of Montenegro (Article 29) decides on the disposal of all state-owned assets whose value exceeds 150,000,000 euros, upon Government's proposal. Assets owned by the Republic and municipalities may be leased under a contract for up to 30 years by a decision of the Government or a responsible municipal authority, and up to 90 years by a decision of the Parliament upon Government's proposal (Article 39). The issue of municipal property disposal is highly sensitive. In the past few years, there have been many legal disputes and criminal proceedings related to municipal property disposal.

After analysing the legislative framework and practices related to the disposal of municipal property, some general conclusions can be made. Revenue from the sale and lease of municipal property depends on many factors, such as the value of assets owned by the municipality, the investors' interest in the municipalities' assets, and the geographical position of the municipality, etc. As a result, revenues from the sale and lease of municipal property vary from one municipality to another and are tied to problems of uneven regional development.

3.2 Shared revenues

An examination of the amendments to the 2003 Law on Local Government Finance suggests that the basis of the shared revenues system has not changed in comparison to the original version of the Law. Precisely, the majority of shared revenues from the 2003 Law are still present in the valid Montenegrin legislation. However, the 2010 amendments to the Law clearly show that the intention of the policymakers was to ensure that local governments are predominantly financed from shared revenues. The Law substantially increased the percentage of the shared revenues that is transferred to local governments. Such a legislative position has multiple legal and economic consequences. First, local government cannot influence the level of revenue through its actions, so there is a lack of accountability for revenue collection. Second, this creates an obvious dependence of local governments on the efficiency and goodwill of the central authorities, which results in further fiscal centralisation.

In line with the Law, two groups of shared revenues may be discerned. The first group consists of shared revenues from personal income taxes and revenues from real estate sales taxes. The second group comprises shared revenues from the following charges: concessions and other charges shared by the state, the annual charge for motor vehicle, tractor and trailer registration, and the so-called environmental charge paid for the

registration of vehicles. It should be stressed that there is no revenue fully (100%) transferred to the local government.

a) Tax forms of shared revenues. The personal income tax is collected by the central government and subsequently redirected to the municipal budget according to predetermined percentages. Thus, municipalities are beneficiaries of this tax and have no legal mechanisms to influence its further increase by improving its collection rate. The 2010 amendments to the Law have slightly increased the local government share in the personal income tax revenue and have not significantly affected local government financing.⁸⁶ Under the current legal solutions, all municipalities receive 12% of revenues from personal income taxes levied within their territory, except for the Capital City, which receives 13% of collected revenues, and the Old Royal Capital, which receives 16% of collected personal income tax revenues.

After examining the existing legal solutions and identifying practical problems related to the application of regulations, it can be concluded that local governments are powerless to actively influence the increase of these revenues. However, based on the interviews and analysis of the normative framework, we can conclude that there is a legal inconsistency that considerably reduces the municipalities' revenues from the personal income tax. Namely, there is a conflict between the Law on Local Government Finance and the Decree regulating the format and content of the salary form that employers submitted to the tax authorities. The law states that the tax should be tied to the revenue generated on the territory of local government, while according to the Decree, the revenue is allocated based on an employee's identification number that is tied to his or her residence.

In the case of the real estate transfer tax, valid law prescribes that a municipality receives 80% of revenue from the taxes generated within its territory. Further, an additional 10% is transferred to the municipalities through the Equalisation Fund. The above legal solution suggests that a high percentage of revenue is transferred to municipalities; however, the solution's economic effects vary between local governments. Moreover, unlike in the case of the real estate tax, municipalities do not have autonomy in determining and collecting the real estate transfer tax. Instead, their revenues depend on the activity and efficiency of the central authorities. The above solution is deemed economically incorrect and legally illogical. Economic irregularity arises from the fact that the entity that receives 90% of the revenue has no authority to influence the efficiency of revenue administration. Also, there is a lack of consistency between the legal solutions regulating the real estate transfer tax and the general real estate tax. In the case of the latter, local governments determine and fully administer the tax revenues.

b) Concessions and other charges for using natural resources as shared revenues. Revenues from concessions and other charges for the use of natural resources granted

by the state include a set of different revenues that are transferred to local governments from the central government budget. Article 28 of the Law on Local Government Finance regulates the amount transferred to municipalities, while other regulations regulate specific issues related to a particular type of charge in more detail. Municipalities receive 70% of revenues from concessions and other charges for the use of natural resources. However, there are also two exceptions where the percentage of the shared revenue is lower, amounting to 20% of the revenue generated.

These include:

- Revenues from the concession charge for the use of ports;
- The charge for the use of the coastal zone.

In addition to the Law on Local Government Finance, the Law on Concessions exhaustively regulates the conditions and procedure for granting concessions. This Law allows a municipality to make a concession decision for the public assets it owns (Paragraph 2, Article 9 of the Law on Concessions).

The Law on Local Government Finance lists the natural resources and prescribes that local government receives revenues from charges on the use of natural resources. This term includes forests, water, watercourses, mineral resources, sand, gravel, stone and other natural resources. The Law on State Property more closely defines the very concept of natural resources.

The provision of the Law on Local Government Finance may be criticised for not accurately defining what specific charges for the use of natural resources the local government receives. In addition, the said article does not mention the concept of public (common) goods, which the Law on State Property both mentions and defines. On the other hand, the budgetary accounting guidelines – the Report on the Planned and Actual Budget Revenues (POP Form) - which indicates revenue items, separates these two concepts precisely by identifying special charges for the use of public (common) goods and special charges for the use of natural resources. In practice, local governments generate revenues through the following charges for the use of public (common) goods:

- the charge on the use of waters;
- the charge on material extracted from watercourses;
- the charge on water pollution;
- the charge on the use of the results of geological investigations.

Different laws and regulations govern the above charges, the method of their allocation, calculation and the performance of other administrative actions. For example, in addition to the Law on Local Government Finance, the share of local governments in charges on waters is regulated by the Law on Concessions, the Law on Waters, the Law on Water Management Financing, the Law on Tax Administration (the part related to collection), the Law on Inspection Oversight (the part related to supervision), and a

number of bylaws stemming from these laws. It is essential to note that these revenues are earmarked, since the Law on Water Management Financing states that funds belonging to local government budgets should only be used to finance water management operations, under the competence of local government bodies, according to the program adopted by the competent local government (Article 4). Furthermore, enforcement of legislation has numerous problems, which are ultimately manifested in the reduction of local government revenues in this area. For example, the Report of the State Audit Institution titled Budget Revenues from the Signed Concession Agreements in the field of water management makes a recommendation to the Water Administration as the competent authority to ensure continued control of the concessionaire's obligations and improve cooperation with the Tax Administration and the Inspection Administration in order to exchange data and improve the collection of the respective budget revenues.⁸⁷

The natural resources use charge comprises the following revenues:

- the forest use charge;
- the coastal zone use charge;
- the mineral resources use charge;
- the mineral raw materials use charge.

The legal framework in this area is complex and contains a large number of laws and bylaws regulating individual assets and issues. It includes the Law on Forests, the Law on Mining, the Law on Ports, the Law on the Coastal Zone and a number of bylaws. An analysis of the State Audit Institution has identified a number of problems in the use of natural resources. The most prominent ones are oversights in the concession procedure, the calculation and collection of concession charges, the supervision of the administrative body conducting the concession procedure by the relevant ministries, cooperation with the tax administration, inspection and supervision, as well as in the supervision of the execution of the concession agreement.⁸⁸

A critical overview of the concession system in Montenegro

The system of concessions in Montenegro is rather complex and problematic, which causes great damage to municipalities as it seriously affects their revenue. A review of concession legislation in Montenegro leads to the conclusion that local governments are the ones least able to influence their revenue in this respect. First, under the existing concessions solutions and practices in Montenegro, municipalities have no insight into the amount of the stipulated concession charges. Second, municipalities have no information about the amount of funds coming from concession charges to the state authorities, despite the fact that they are entitled to receive a share of these revenues under the Law on Local Government Finance. Third, the authorised representatives of municipalities are often not involved in the process of negotiating and signing contracts with concession receivers in some areas; state bodies hold a monopoly in this respect.

In the course of 2013, the Government of Montenegro adopted a report that presented how obligations under concession agreements are actually fulfilled and identified the key issues in this area. The principal ones are: 1. irregular concession charge payments; 2. poor coordination between the competent authorities and state and local governments; 3. lack of an electronic concessions register; 4. failure of the competent authorities to fulfil their own obligations and comply with Government orders and conclusions..⁸⁹

The last amendments to the Law on Local Government Finance introduced another local government revenue – revenue from the charge for the use of vehicles and their trailers. The Law stipulates that a municipality owns 30% of the revenues generated by these charges. However, the Regulation on the Level, Calculation and Payment Method of the Environmental Pollution Charge (Official Gazette of Montenegro, 49/12) suspended this charge. We emphasise that it is legally illogical for a lower-level regulation to annul a higher-level piece of legislation, which points to yet another drawback in the regulatory design of local government financing and fiscal decentralisation.

3.3 Equalisation fund revenues

The legal framework on local government financing in Montenegro also includes the concept of an Equalisation Fund, which is used for balancing horizontal differences in the fiscal capacities of municipalities. The Law on Local Government Finance defines precisely the source of revenue and the criteria for allocating equalisation fund resources. Under the said Law, the Fund's revenues are secured from the following sources:

- The personal income tax in the amount of 11% of total revenues;
- The real estate transfer tax in the amount of 10% of total revenues;
- Concession charges from games of chance in the amount of 40% of total revenues;
- The tax on the use of motor vehicles, vessels and aircrafts in the amount of 100% of total revenues.⁹⁰

The right to use the Fund's resources is conditioned upon a municipality's per capita fiscal capacity in the three fiscal years preceding the allocation year. Municipalities whose average per capita fiscal capacity is lower than the average capacity are entitled to the Fund's resources. Resources are awarded throughout the year in the form of monthly instalments, as well as at the end of the year as the final annual allocation. In both cases, 60% of the revenue is allocated based on fiscal capacity and the remaining 40% based on budgetary needs. The Decree on the Allocation and Use of the Equalisation Fund Resources regulates the method of identifying local government fiscal capacity, the method, elements and criteria for assessing municipal budgetary needs, along with the method of distributing and utilising Equalisation Fund resources that have not been allocated. Municipalities are not able to control and improve the administration and collection of revenue of the Fund in any way. They only exercise the

rights stipulated by the relevant legislation, meaning that they only receive the funds that are administered by the Republic.

Municipal fiscal equalisation system development is institutionally supported through a special body - the Municipal Fiscal Equalisation System Monitoring Commission. Policy-makers have rightly recognised the importance of the equalisation fund concept and thus, given the Commission authority to monitor criteria and recommend fiscal equalisation improvements, provide opinions on documents of the Ministry of Finance in this field, and report on municipal fiscal equalisation system development. The composition of this body also allows local governments to influence the fiscal equalisation system, since the Union of Municipalities appoints five representatives out of the seven members of this body. The Ministry of Finance and the Ministry responsible for local government each appoint one representative.

The issue of protection of financially weaker municipalities is regulated by the European Charter of Local Self-Government, which states that the protection of financially weaker local authorities calls for the institution of financial equalisation or equivalent measures that are designed to correct the effects of the unequal distribution of potential sources of finance. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own scope of responsibility.⁹¹ After analysing the provisions of the Equalisation Fund from a legal perspective, it may be generally concluded that, from the perspective of legal regulations and the definition of certain issues, Montenegro's equalisation fund system is not to be criticised, as the system is transparent, predictable and aligned with the principles of the European Charter of Local Self-Government. On the other hand, the Fund's revenues coming from the two largest sources – the personal income tax and the real estate transfer tax - are unstable. For this reason, possible future reforms could be oriented towards finding more stable revenue to finance the Equalisation Fund.⁹²

The 2010-2014 Regional Development Strategy of Montenegro identified the Equalisation Fund as the main instrument of regional development policy that should contribute to the reduction of regional disparities.⁹³ If we analyse revenue allocation to regions between 2004 and 2013, most of the equalisation fund resources were directed towards the local governments of the northern region - 69.58% of the total fund resources. In the same period, 25.6% of the total equalisation fund resources were allocated to local governments of the central region, while 4.8% of the resources were allocated to municipalities of the coastal region.⁹⁴ The legal definition of criteria and the Equalisation Fund revenue structure uphold the intention of policymakers in this field. However, the new 2014-2020 Regional Development Strategy of Montenegro does not identify the Equalisation Fund as the main mechanism for reducing regional disparities. Policymakers expect that by 2020, local government units, which are the beneficiaries of the Equalisation Fund, will develop and strengthen their fiscal capacity. This will increase their tax base and sources of revenues and thus, reduce the share of the

equalisation fund revenue in the total revenue of local governments.⁹⁵ If we take into account the existing problems in local government finances, we doubt that this is a realistic scenario.

3.4 Conditional budgetary grants

The Law on Local Government Finance stipulates that the state may allocate budget funds to municipalities for investment projects of particular local interest. The Law defines several preconditions for the exercise of this right. First, in order to receive state budget grants, a municipality must have a multi-year investment plan. Second, the grant amount is limited to 50% of the funds planned for the investment project. Third, the Government of Montenegro may adopt the grant decision upon the proposal of the Ministry of Finance.

4 Institutional cooperation between central and local governments on fiscal decentralisation

Quality cooperation between local governments and central government authorities is one of the key preconditions not only for improvement of the overall decentralisation process, but also for the fulfilment of the constitutional and other legal rights and mandates of local governments within the Montenegrin legal framework. In practice, intergovernmental cooperation is materialised in different ways – through the exchange of information, various policy initiatives, participation of local government representatives in the legislative drafting process or in various special working bodies and groups, etc. It should be noted that intergovernmental cooperation is also a legal obligation, which should additionally guarantee that the cooperation is implemented in practice.

Institutional cooperation between local governments and the central government in Montenegro is legally and factually achieved in two ways – through direct communication between local governments and state authorities, as well as through initiatives and activities that the Union of Municipalities of Montenegro launches and implements on behalf of local governments. A review of the previous legislative activities and practice show that the government treats intergovernmental cooperation as an important issue. Commitment to cooperation is evident in the stipulation of concrete rights and obligations regarding the implementation of intergovernmental cooperation, in various cooperation agreements and memoranda of understanding between different institutions, and in the preparation of numerous strategies and documents in which the Government of Montenegro holds a clear position that effective cooperation between local governments and state authorities is crucial for improving the decentralisation process.

Intergovernmental relations are regulated in a separate section of the Law on Local Self-Government. This Law establishes a general principle and a legal obligation of mutual cooperation between state authorities and local governments. The Law on Local Self-Government envisages that local governments have the authority to initiate three kinds of activities. They can: 1. propose activities to be done by the state authorities in the domain of local government development; 2. request opinions from the state authorities regarding the application of laws relevant for the functioning of local governments; 3. take part in the drafting of laws and bylaws that are relevant for the functioning and development of local governments (Article 121 of the Law on Local Self-Government). The Law also clearly defines the rights and obligations of state authorities in intergovernmental cooperation. In order to facilitate cooperation with the local government, state authorities need to implement the following actions: 1. inform local government bodies about the measures taken to enforce laws and the instances in which the laws were violated; 2. provide technical assistance to local government bodies; 3. request reports, information and data about activities under local government purview.

When it comes to the decentralisation process, a particularly important issue relates to the standardisation of the role of local government in the entire legislative process. Namely, there is a legal stipulation that ensures the active participation of local governments in the legislative process – the right of local government to provide a technical opinion on the proposals and draft legal documents relevant for the functioning of local governments. Article 122a of the Law on Local Self-Government stipulates that state administration is obligated to send draft laws and other acts to the municipalities for review. These can then present an opinion in the legislative process that tackles the status, rights and obligations of local governments. Local governments should have at least 15 days to provide an opinion about the drafted legal document. This legal framework forms a good basis for intergovernmental cooperation and the participation of local governments in the legislative process. However, conducted interviews and a detailed analysis of the practical implementation of these standards suggest that there is considerable room for improvement of the aforementioned norm. The Union of Municipalities to the Government of Montenegro has officially informed the Government of the problems local governments face in the legislative and policy-making processes, as a significant number of ministries and other state bodies do not involve local governments in the process or shorten the opinion submission deadlines to 3-5 days.⁹⁶ This is a direct violation of the local governments' legal right to provide their opinion to legislative initiatives of the central government.

In practice, intergovernmental cooperation is also realised through the organisation of expert round tables and various thematic sessions or through the submission of amendments to draft laws to appropriate parliamentary committees. A particularly important question is active participation of the local government representatives in the working groups and bodies that draft laws and bylaws relevant for the functioning of the local government. The Law on Local Self-Government does not regulate this issue. We

believe that further reforms of the legal framework in this area should require the participation of local government representatives in task forces entrusted with the drafting of laws, as the mere submission of opinions to the draft laws does not provide any considerable results in practice. The main reason behind this recommendation is the fact that long-term positive effects are better achieved through the direct influence on the drafting process, rather than through the provision of opinions on draft laws and bylaws or through proposing amendments. Opinions and amendments may affect the quality of individual solutions, but these actions cannot influence the general direction and intention of the legislators.

The Law on Local Self-Government authorises municipalities to establish associations. Strategic cooperation between local governments and the Government of Montenegro is realised through the Union of Municipalities of Montenegro. When it comes to fiscal decentralisation, the Government of Montenegro and the Union of Municipalities signed a cooperation agreement on fiscal decentralisation development and implementation in 2006. This legal act also determined areas of cooperation, including the municipal participation in the legislative drafting process, daily operational management issues, as well as other conditions important for the efficient functioning of the Union of Municipalities. Lastly, there are three mechanisms defined as necessary for the effective implementation of the agreement; at the political level, there is the cooperation between ministries and the Union of Municipalities managing board, at the technical level, there is the cooperation between departments of the Union of Municipalities and assistant ministers, and at the national level, cooperation between the Prime Minister and the president of the Union of Municipalities.⁹⁷ A review of activities of the Union of Municipalities, particularly those related to local government financing, shows that this institution is an active observer of the fiscal decentralisation process, as well as of the developments regarding municipal finance and implementation of laws and policies in practice. Activities of the Union of Municipalities include: 1. conducting in-depth analyses of the state of public finances in local governments; 2. providing concrete proposals for improving the existing situation in certain areas; 3. initiating a policy dialogue with representatives of the Government of Montenegro; 4. initiating legislative activities; 5. providing opinions on draft laws and other legal and policy documents, etc. Moreover, in practice, intergovernmental cooperation is realised when local government representatives take part in numerous working groups and bodies. Some of the most important are membership in the Coordinating Committee for Local Government Reform, the Committee monitoring the horizontal fiscal equalisation between municipalities, the Concessions Commission, the Council for Improving the Business Climate and Structural and Regulatory Reform, the National Council for Sustainable Development, the Privatisation Council, various working groups drafting legislation and so on. It should also be highlighted that the involvement of the local government representatives in most of the aforementioned bodies is stipulated as an obligation in the respective laws.

However, the analysis of the practical implementation of the legal solutions on intergovernmental cooperation shows that there is a substantial gap between what is stipulated as a legal obligation and the practical cooperation between the local governments and central government authorities. First, regardless of the physical participation of local government representatives in the legislative process, the position of the Union of Municipalities is not sufficiently respected in practice. As a result, various initiatives of the Union of Municipalities remain unanswered by the central government authorities. If this is examined in more detail, then from 2008 until today there has been a significant discrepancy between the attitudes of local governments and the Union of Municipalities of Montenegro on the one hand, and the official policy of the Government of Montenegro on the other. In the domain of local government financing, such differences in opinion are particularly pronounced in regard to the elimination of the construction land use charge and communal fees without adequate compensation, the central government restriction of the construction land development fee, different approaches to property taxation, different approaches to revenue sharing, etc.

Official documents of the Government of Montenegro contain different views on the quality of institutional intergovernmental cooperation. For example, the Public Administration Reform Strategy points to the necessity of improving cooperation and coordination between the Government, the Union of Municipalities and the local governments.⁹⁸ On the other hand, the document Analysis of Local Government Functioning highlights the existence of an appropriate level of cooperation and communication on all levels.⁹⁹ As a result, these different interpretations concerning the quality of cooperation reinforce the general view that we need to devote more attention to promoting cooperation in practice and ensuring the implementation of stipulated legal rights and obligations.

5 Conclusion

The analysis of the regulatory framework changes in the field of fiscal decentralisation in Montenegro from 2003 to 2015 demonstrates that reforms have indeed been taken seriously. However, the legal solutions have certain drawbacks. Despite the fact that changes in regulations have been substantially aligned with international standards, we can conclude that the entire legal framework in this area is complex, excessive, unstable, and in some instances not implementable.

The analysis of the legal framework on local government financing and the fiscal decentralisation process in Montenegro shows that there are two distinct periods. The first period is from 2003 to 2008, while the second spans from 2008 to present day (2015). During the first period, the Republic adopted the legal framework shaping the functional and fiscal decentralisation and established a stable basis for local government financing. This period coincided with the rapid economic development of the country

and an increase in foreign investments, which led to the growth of local government revenue. This revenue was primarily revenue from the construction land development charge, the real estate transfer tax, and the personal income tax.

The second stage of fiscal decentralisation covers the period from 2008 until today and is characterised by legislative activity aimed at reducing municipal autonomy in determining and collecting own-source revenue and at increasing the share of local governments in centrally-determined taxes and other revenues. This period coincides with the start of the economic crisis, which led to a decline in investment activity and the liquidity crisis of the domestic business sector. These developments negatively affected local government revenues.

Certain sections of this study clearly identify aspects of the legal framework that, in our opinion, negatively affect the practical achievement of the fiscal decentralisation objectives. The following developments were highlighted earlier: frequent changes of the relevant legislation, collision between laws, conflicts between laws and accompanying bylaws, failure to adopt the proposed legislative solutions, and failure to create preconditions for the application of the adopted legislation. Such a legal reality adversely influences the functioning of the local government, the achievement of general fiscal decentralisation objectives, and the improvement of the business environment.

A careful examination of the changes that have occurred in the regulatory framework on local government financing since 2003 reveals that functional and financial decentralisation have not been adequately managed. Local government competences have not been substantially changed since 2003, while many sources of revenue have been reduced without adequate compensation. In addition to the economic crisis, which automatically led to a reduction of local government revenues, the analysis has identified that, *inter alia*, changes to numerous regulations since 2009 had also adversely affected local government finances in the previous period.

Special emphasis should be given to the fact that local governments perform differently under the same regulatory framework, in terms of revenue mobilisation and administration. Therefore, it cannot be unilaterally concluded that changes in the regulatory framework in the past have been the sole reason for the current poor state of local government finances. Undoubtedly, the lack of efficiency of local governments in collecting their own revenues, irrational consumption, and a large number of local civil servants are also some of the reasons that have contributed significantly to the current situation. However, the aim of this study was to analyse the impact of regulatory changes on the fiscal decentralisation process.

The legal analysis points to these most common shortcomings of the regulatory framework:

- Valid legislation creates the risk of possible overlap, meaning that a single issue is often regulated in a different manner by two or more regulations of the same legal power (conflict of laws);
- The legal existence of a particular source of revenue does not necessarily guarantee its practical existence and administration, due to a lack of secondary legislation needed for the practical implementation of the respective legislation;
- There is a real risk that the Law on Local Government Finance (as the basic law) may become inapplicable or dependant on the application and adoption of other regulations;
- There is insufficient precision of legal solutions, which causes different interpretations by the authorities enforcing the law;
- Frequent changes to regulations do not contribute to the quality of the fiscal decentralisation process, but rather create the impression that there is a lack of a clear, strategic vision and legislative rationale of the Government;
- The delayed adoption and application of certain regulations have an adverse effect on the overall legal system and the rule of law and also directly reduce local government revenue. In addition to negatively contributing to the functioning of the legal system, the delayed adoption and application of regulations suggest that policymakers in this field have not been adequately monitoring the fiscal decentralisation process.

The analysis of how specific sources of local government revenue are regulated shows the following:

- There is a notable intention of the policymakers to make the real estate transfer tax the principal source of local government revenue in the future. In light of the recent legislative changes in this field that are to be effective from 2016, our opinion is that legal solutions will not improve the fiscal decentralisation process.
- Reforming the system of local communal fees has had a long-term negative impact on local government finances. The abolition of local communal fees for the most profitable activities – telecommunications, electricity transmission and the use of the coastline for business purposes - had a positive long-term effect in terms of reducing barriers and the burden for businesses; however, this was the first time that the abolition of a certain revenue was not accompanied by adequate compensation. This resulted in further inconsistencies in the implementation, administration and collection of local communal fees by the local governments.
- The regulation of charges as own-source revenues has certain drawbacks:
- By abolishing the construction land use charge without providing adequate compensation, the Government jeopardised the basic principles of fiscal decentralisation, substantially disrupting a previously stable local government financing system. The abolition of the said charge without the introduction of adequate compensation generated further problems in local government finances, gradually causing the accumulation of arrears and the need for increased borrowing. The analysis of Montenegrin legislation on urban construction land

shows that the new regime regarding the construction land ownership rights has had a considerable effect on the entire fiscal decentralisation process and land-related local government revenues.

- The construction land development charge has been substantially changed by the central government, although it is own-source revenue. By its legal nature, revenue from the construction land development charge is own-source local government revenue. However, recent legislation has limited the ability of local governments to regulate this revenue and empowered the central government by having it give prior consent for the municipal arrangement of conditions, methods, deadlines and procedures for paying the construction land development charge. This directly affects the very legal nature of this revenue, limiting autonomy of municipalities to regulate and freely administer their own (own-source) revenues.
- There is a need for more precise regulation of the roads charges. Analysis points to the fact that this charge overlaps with other local fiscal impositions, namely, with the construction land development charge and specific fees. Furthermore, there is an obvious duality of fiscal impositions that are to be paid for the same purpose, such as paying local communal fees for the use of billboards and paying a local charge for installing commercial signs on local roads.
- The Government should create conditions for the practical implementation of the laws regulating the environmental charges. The Law on Environmental Protection introduces a municipal environmental charge. However, neither this law, nor secondary legislation, have outlined specific criteria and conditions for municipalities to introduce this charge by their local ordinances. As such, this legal possibility has never been implemented and become operational in the practice of local governments.
- One of the questions vital for successful fiscal decentralisation is whether the existing model of local government financing, with increased shared revenues and lowered own-source revenues, will really lead to positive effects of fiscal decentralisation. This paper highlighted the negative opinion on the 2010 amendments of the Law on Local Government Finance, which introduced shared revenue as the predominant source of local government finance. These new solutions may decrease political accountability at the local level and fuel freeriding, and they reduce the autonomy of municipalities in controlling their finances. The paper places special emphasis on the issue of concessions and other charges for the use of natural resources. The existing model of concessions in Montenegro has certain system drawbacks and does not allow municipalities to utilise potentials of concessions and yield more revenues. Under the current legal framework, municipalities have no influence over or insight into the amount of the centrally-contracted concession charges or information about the amount of concession charges that central government received from the concessionaire. Furthermore, municipal representatives are often not included in the process of negotiating and concluding contracts with concessionaires. State authorities hold a monopoly in concession affairs. Taking into account the current share of these

revenues in the local government budgets, we believe that the future regulatory changes should improve the role of municipalities in concession affairs and, thus, the share of concession charges in the total municipal revenues.

- There is a need for a broader expert discussion about possible changes to the existing equalisation grant scheme. Although the existing legal provisions are in line with international standards, we believe that more stable sources of revenues should finance the equalisation fund. Its existing sources of funding are by their nature unstable and dependent on economic cycles.
- The legislative practice of introducing new functions or transferring new tasks to the local level without providing necessary funding for these tasks should be avoided. Through the examination of specific cases, the analysis showed that the Republic sometimes introduces new functions or transfers additional mandates to local governments without transferring the necessary sources of revenue. In our opinion, this approach is incorrect, particularly bearing in mind the already poor state of local government finance.
- There is a need for further affirmation of institutional cooperation between the central and local governments. An analysis of the existing legal framework on intergovernmental cooperation has shown that there is a significant gap between the legislation and the cooperation between local governments and state bodies in practice. Despite the fact that there is a clear set of legal obligations and that there is a cooperation agreement between the Government of Montenegro and the Union of Municipalities, the official opinions of local government representatives are often in conflict with policy and legal measures that the central government initiates and implements. This is particularly the case when it comes to the regulation of fiscal decentralisation and the financing of local government mandates.

Future regulatory activities in this area should focus special attention on the introductory provisions of the Law on Local Self-Government and the Law on Local Government Finance – the general principles. These principles should present the goals and the purpose of these laws. We believe that insufficient attention is currently paid to the general guiding principles of these laws. The Law on Local Self-Government prescribes that the right to local self-government should be grounded in the principles of democracy, decentralisation, de-politicisation, autonomy, legality, professionalism, efficiency of local government bodies, and mutual cooperation between the central government and the municipalities. However, when it comes to the practical implementation of these laws, these principles are rarely applied. In the case of the Law on Local Government Finance, although there is no list of specific guiding principles that would provide policy direction and rationale for the Law, there are introductory provisions that state that municipal funds must be commensurate with the expenditures for performing municipal mandates defined by the Constitution and the laws. An analysis of the past and the current legislation, as well as of the announced future regulatory policies, shows that the vertical balance principle is not sufficiently respected

and implemented in practice. The costs of performing municipal functions are often higher than the municipal revenues. Accordingly, in addition to the formal compliance with the international standards, which have already been substantially incorporated in the Montenegrin legal system, more attention should be paid to the interpretation and practical application of these standards in order to achieve the objectives of decentralisation.

Policymakers should be concerned by the fact that practical implementation of the Law on Local Government Finance has become dependent on the adoption or application of a number of other laws and bylaws. In practice, this fact negatively affects the implementation of fiscal decentralisation, as administration and the collection of concrete local government revenues are becoming trapped by sluggish legislative and administrative procedures. This also threatens another legal value - the efficiency in the creation and implementation of law - which further affects the rule of law and the business environment.

It is undeniable that the economic crisis has had a considerable negative influence on the fiscal decentralisation process in Montenegro. When certain resources were abolished, local governments began increasing other own-source revenues (primarily local communal fees), rapidly borrowing from commercial banks, delaying the payments to creditors, selling or leasing out municipal property without economically justified rationale, etc. All these activities have negatively affected the overall local business environment, especially small and medium-sized enterprises. This analysis also points to the increased public perception, which is wrongly becoming a widely accepted opinion, that local governments impede foreign investments and hinder the implementation of structural reforms. In a number of cases described and explained in this analysis, the fiscal decentralisation process was “sacrificed” for the sake of reducing business barriers. Comparative experience and expert analyses show that stable local government revenues enable local governments to perform their functions and deliver local public services, which are key prerequisites for attracting investments. The current situation suggests that priority is given to the improvement of the business climate without ensuring stable local government financing. We believe that fiscal decentralisation and the reform of the business environment are mutually dependent processes. Therefore, reducing the burden on businesses by abolishing local government revenues without the proper compensation is the first step towards the actual deterioration of the business environment. The future policy approach should take into account the accepted standards and principles, require careful fiscal analyses and improve the relationship between functional and fiscal decentralisation, while future legal solutions should focus on improving local government responsibility in promoting a business environment conducive to local economic development.

Notes

¹ Levitas, A., & Peteri, G. (2004). Intergovernmental Finance Reform in Central Europe. In Levitas & Peteri (eds.), *Local Government Finance Reform*. Bgrade: Palgo Centar, pp. 16-20.

²The European Charter on Local Self-Government, Strasbourg, October 15, 1985. <http://conventions.coe.int/Treaty/en/Treaties/Html/122.htm>.

³ See: Government of Montenegro. Ministry of Justice, (2002). *Administrative Reform Strategy in Montenegro 2002-2009*. Retrieved from website: www.mup.gov.me.

⁴ In more detail: Richard Bird. World Bank, Economic Policy and Debt Department, (2010). *Subnational taxation in developing countries: A review of the literature (5450)*. Washington: The World Bank. pp. 15 – 21.

⁵ This fact was identified in the Public Administration Reform Strategy, where it is precisely stated that the absence of organised and competent scientific institutions that would, from the perspective of a professional, scientific and methodological approach, monitor the process and provide logistical support to reform implementation proved to be one of the main hindrances to achieving public administration reform goals in the past. See: Government of Montenegro. (2011). *Public Administration Reform Strategy in Montenegro for the period 2011-2016*, pp. 9. Retrieved from website: www.gov.me.

⁶ See: European Commission. (2013). *Report on Progress of Montenegro for 2013*, pp.7-8. Retrieved from: www.mvpei.gov.me/.../FileDownload.aspx?...Prevod.

⁷ Government of Montenegro. (2011). *Public Administration Reform Strategy in Montenegro for the period 2011-2016*. Retrieved from website: www.gov.me.

⁸ *Ibid.* pp. 37-38.

⁹ The most significant recommendations, according to the ministries, are the following: improving cooperation between the ministries and municipalities in the process of adoption and implementation of legal acts (documents produced by ministries that introduce new municipal revenues often lack deadlines by which municipalities are to adopt their own documents and sanctions in case they fail to adopt them); harmonising bylaws of certain ministries with the umbrella Law on Local Government Finance; absence of ministry-level bylaws based on which municipalities would be able to introduce own-source revenues; a more timely reaction of ministries in situations that proved faulty; creating normative prerequisites to increase collection rates of certain revenues, etc. With the aim of consolidating local public finance, this document contains recommendations to municipalities that did not take the opportunity to introduce certain own-source revenues. These recommendations include to create normative preconditions for own-source revenue collection, to put in effort in terms of establishing more efficient collection of own-source revenues, to immediately start cooperating with the Ministry of Finance and come up with a reprogrammed payment plan for fiscal and non-fiscal debt if they have them, to prepare and plan their budgets in accordance with Government recommendations provided in the Macroeconomic and Fiscal Policy Guidelines, to continue with the activities aimed at reducing the number of employees in local administration bodies and public institutions and enterprises that are founded by local governments, to have those municipalities that signed the Agreement on Financial Restructuring with the Ministry of Finance follow the agreed dynamics of repayment of fiscal and non-fiscal debt: See: Government of Montenegro. Ministry of Interior. (2012). *Local Government Functioning Analysis*, pp.16-17. Retrieved from website: www.mup.gov.me.

¹⁰ As specific measures, this document recommends the following activities: 1. The Ministry is to form a task-force, comprised of the representatives of the Ministry, the Union of Municipalities and local governments, which will prepare to elaborate on the state of each municipality's debt, in order for the debt to be reprogrammed, and establish criteria for reprogramming (it is particularly recommended to consider the possibility to convert part of the municipal debt using functional

assets, which would, to an extent, relieve local government public finance); 2. Municipalities, public enterprises and institutions founded by local governments are to register all taxpayers by December 31, 2014; 3. Local government units with an identified surplus of employees are to take steps to optimise the number of employees and to keep it within defined standards in order to decrease expenditures. Tax Administration is especially required to apply legal measures in all municipalities and public enterprises and institutions founded by local governments that pay net salaries without taxes and contributions. See: Government of Montenegro. (2014). Information on the Situation in Finance and Number of Employees in Local Governments, pp. 15-16. Retrieved from: www.gov.me.

¹¹ See: The Union of Municipalities of Montenegro. (2013). Analysis of the Situation in Local Government Finance, pp. 1-16. Retrieved from: www.uom.co.me/.../2013/.../analiza-stanja-finansiranja.

¹² The most significant measures presented in this document are the following: 1. Maximum commitment of local government units and their tax administrations to achieving higher local public revenue collection rates; 2. Increased local work efficiency and rationalisation of costs (primarily by reducing the number of employees); 3. Considering the Ministry's help with solving the local surplus of employees; 4. Considering the possibility of partial or total debt write-off by the Government of Montenegro on account of unpaid taxes and contributions; 5. Solution for the problem of debt owed to local government units by the public authority, enterprises and other institutions; 6. Considering the possibility of the state assisting with parts of reprogramming of debt towards banks incurred by means of capital investment loans; 7. Starting the initiative to adopt the Law on Communal Activities, the Law on Amendments and Addenda to the Real Estate Tax, the Law on Amendments and Addenda to the Law on Local Government Finance (primarily by a possible increase of the Equalisation fund), etc. In more detail: The Union of Municipality of Montenegro. (2015). How to Overcome Financial Problems of Municipalities. "Our Union Bulletin." Retrieved from <http://www.uom.co.me/wp-content/uploads/2015/02/Bilten-18.pdf>.

¹³ In more detail, see: Vasiljević, M. (2011). Privreda i vladavina prava, *Pravo i privreda - časopis za privrednopravnu teoriju i praksu*, 48(4-6), pp. 17-43.

¹⁴ Jocovic M. (2013). A critical review of the legal framework of foreign direct investment in Montenegro. *The Macrotheme Review - A multidisciplinary journal of global macro trends*, 2(6), pp. 1-7.

¹⁵ See: The Union of Employers of Montenegro. (2012). Five Murderers of Business, pp. 5-6. Retrieved from: www.poslodavci.org.

¹⁶ Foreign Investors Council of Montenegro. (2013). White Book 2013: Looking Ahead, pp. 46-47. Retrieved from website: www.mfic.me/files/BijelaKnjiga.pdf.

¹⁷ Central Bank of Montenegro. (2014). Economic Policy Recommendations to the Government of Montenegro for 2014, pp. 8-9. Retrieved from website: <http://www.cb-mn.org>.

¹⁸ Constitution of Montenegro, "Official Gazette of the Republic of Montenegro," 48/92, the Law on State Administration Organisation, "Official Gazette of the Republic of Montenegro," 56/93, Decree on the Organisation and Functioning of State Administration, "Official Gazette of the Republic of Montenegro," 8/93,....9/03).

¹⁹ World Bank. Poverty Reduction and Economic Management Unit. (2003). Serbia and Montenegro – Public Expenditure and Institutional Review (Report. No. 23689-YU). Retrieved from website: <http://datatopics.worldbank.org/hnp/files/edstats/SRBper03.pdf>.

²⁰ Data on state administration size in that period show that public administration comprised of 15 ministries, 4 agencies, 10 administrations, 4 secretariats, 15 national organisations and 6 inspectorates. See: Vukotic, V. (2004). Report on Transition in Montenegro. In Jovanovic, A. &

Vukotic V. (eds.), Report on Transition in Serbia and Montenegro. Belgrade: G17, ISSP, pp. 287-291.

²¹ World Bank, Serbia and Montenegro – Public Expenditure and Institutional Review, Report. No. 23689-YU, pp.18-19.

²² Government of Montenegro. Ministry of Justice, (2002). Administrative Reform Strategy in Montenegro 2002-2009, pp. 14. Retrieved from website: www.mup.gov.me.

²³ Ibid pp. 28-29.

²⁴ Muk, S., Marović, J., Popovic, M., & Milošević, M. Institute of Alternatives. (2013). Public Administration Reform in Montenegro – Between Ambitious Plans and Realistic Possibilities. Retrieved from website: <http://media.institut-alternativa.org/2013/03/Reforma-drzavne-uprave-u-Crnj-Gori-3.pdf>.

²⁵ “Official Gazette of the Republic of Montenegro,” 30/93, 3/94, 42/94, 1/96, 13/96 and 45/98)

²⁶ During the implementation of this law, municipalities were financed from the following sources: local communal fees, local administrative fees, the public interest goods exploitation charge, the municipal construction land use charge, the construction charge, the maintenance of local roads and streets and other public interest structures, income from selling property and leasing out state-owned real estate used by local administration bodies, a part of the concession charges, a part of the public interest goods use charge, fines for misdemeanours prescribed by municipal ordinances as well as property confiscated in those processes, financial assets generated by selling state capital in public enterprises founded by the municipality, income generated by municipal bodies performing their activities, interest on municipal budget funds deposited with banks, donations and other revenue defined by law. All of these types of revenue can be classified as own-source revenues of local governments, although the law did not categorise them as such.

²⁷ Kmezić, S., Kaluđerović, J., Jocović, M., & Đulić, K. (2016). Fiscal decentralisation and local government financing in Montenegro from 2002 to 2015. *Lex Localis - Journal of Local Self-Government*, 14(3), 431-450.

²⁸ For example, the 1992 Law on Local Communal Fees was valid in Montenegro until 2006.

²⁹ Lepetic, J. (2008). Citizens and Local Government in Montenegro. *Foreign Legal Practice*, 2, pp.197-198.

³⁰ Jaćimović, D., & Jocović M., (2014). Foreign investment and trade in the Western Balkan – Focus on Economic and Legal System. *Journal of Advanced Management Science*, 2(4). pp. 301-306.

³¹ Law on Local Communal Fees, “Official Gazette of the Republic of Montenegro,” 27/06.

³² Interview with Žana Đukić, a secretary responsible for local government finance issues in the Union of Municipalities of Montenegro.

³³ Law on Spatial Planning and the Construction of Structures, “Official Gazette of the Republic of Montenegro,” 51/08.

³⁴ Law on Local Government Finance, “Official Gazette of the Republic of Montenegro,” 74/2010.

³⁵ See: Explanation of the Law on Amendments and Addenda to the 2010 Law on Local Government Finance 2010. Retrieved from website: <http://www.skupstina.me>.

³⁶ According to official data of the Real Estate Administration, there are some 40,000 informal structures in Montenegro. Even though there is no precise registry, the Ministry of Sustainable Development and Tourism states that there are some 100,000 illegally constructed structures – meaning those without necessary permits or those that have overstepped boundaries of their construction area. If we assume that legalisation costs are 50 euros per square meter and that, pursuant to provisions of the new Law on the Legalisation of Informal Structures, legalisation costs would be paid in long-term instalments (20 years maximum), the Ministry of Sustainable

Development and Tourism, after a detailed analysis, calculated that local governments could generate income totalling 500 million euros from legalisation, or 25 million euros a year over a 20 year period. This is more than 2 million euros per month. See: Government of Montenegro. Ministry of Sustainable Development and Tourism. (2013). Report on the Implementation of the Action Plan for Converting Informal Settlements into Formal Ones and Legalising Structures.

³⁷ Article 25 of the proposed Law on the Legalisation of Informal Structures prescribes that the charges on communal development of construction land and regional water supply system construction for informal residential structures are to be paid in not more than 240 equal monthly instalments. For other informal structures, these charges would be paid in not more than 120 equal monthly instalments.

³⁸ The proposed law prescribes that the communal charge is to be paid per real estate size unit by the owners of residential, commercial and garage spaces, as well as by the owners of land used for business activities (open space depots, car yards, etc.) and vacant construction land. The communal charge is set according to the zone where the real estate is located and its use, while the adequate methodology is to be defined by the Government. The communal charge base, within one defined zone and per measuring unit, is to be identical for all. This provision effectively equalises natural persons and legal entities in terms of these obligations.

³⁹ Official analyses of the Government of Montenegro also identify this problem. See: Government of Montenegro. Ministry of Interior – Coordination Board for Local Government Reform. (2014). Action Plan for Local Government Reform for 2014. pp. 8-9. Retrieved from: <http://www.mup.gov.me>.

⁴⁰ “The right to local self-government is guaranteed,” Constitution of Montenegro, Article 22.

⁴¹ See: Paragraphs 4 and 5, Article 116 of the Constitution of Montenegro.

⁴² See: Explanation of the Law on Amendments and Addenda to the 2010 Law on Local Government Finance. Retrieved from website: <http://www.skupstina.me>.

⁴³ Government of Montenegro. Ministry of Interior. (2012). Analysis of Local Government Functioning, pp.13-14. Retrieved from website: www.mup.gov.me.

⁴⁴ For more information, see: Article 32 of the Law on Local Self-Government.

⁴⁵ “Official Gazette of the Republic of Montenegro,” 42/03 and 44/03, and “Official Gazette of Montenegro,” 5/08 and 74/2010.

⁴⁶ The Law on the Budget and Fiscal Accountability, “Official Gazette of Montenegro,” 20/2014.

⁴⁷ The same article sets forth a separate provision, which states that, in the event that the budget deficit set for the year is exceeded without the consent of the Ministry of Finance, the Minister is required to stop the transfer of adequate funds from the central budget to the local government body in the amount equal to the amount by which the budget deficit is exceeded. See: Law on the Budget and Fiscal Accountability, Paragraphs 1 and 4, Article 27.

⁴⁸ In the event that the Ministry responds negatively, the municipal assembly may not adopt the Ordinance on the Budget. See: Law on the Budget and Fiscal Accountability, Paragraphs 1 and 3, Article 35.

⁴⁹ Companies and legal entities whose majority owner is the municipality may take long-term loans with prior consent of the Government, issued upon proposal by the Ministry of Finance. See: Law on the Budget and Fiscal Accountability.

⁵⁰ “Official Gazette of the Republic of Montenegro,” 65/01, 69/03, “Official Gazette of Montenegro,” 75/10.

⁵¹ “Official Gazette of Montenegro,” 36/13.

⁵² “Official Gazette of the Republic of Montenegro,” 65/01, 12/02, 37/04, 29/05, 78/06, 04/07, 86/09, 73/10, 40/11, 14/12, 06/13.

⁵³ “Official Gazette of the Republic of Montenegro,” 27/06.

- ⁵⁴ “Official Gazette of the Republic of Montenegro,” 55/03, 46/04, 81/05, 02/06, “Official Gazette of Montenegro,” 22/08, 77/08, 03/09, 40/10, 73/10, 20/11, 26/11.
- ⁵⁵ “Official Gazette of Montenegro,” 51/08, 40/10, 34/11, 40/11, 47/11, 35/13, 39/13.
- ⁵⁶ “Official Gazette of Montenegro,” 54/09, 40/10, 73/10, 36/11, 40/11.
- ⁵⁷ “Official Gazette of Montenegro,” 21/09.
- ⁵⁸ “Official Gazette of Montenegro,” 44/10.
- ⁵⁹ “Official Gazette of Montenegro,” 08/09.
- ⁶⁰ “Official Gazette of the Republic of Montenegro,” 27/2007.
- ⁶¹ “Official Gazette of Montenegro,” 65/08.
- ⁶² “Official Gazette of the Republic of Montenegro,” 65/01 and “Official Gazette of the Republic of Montenegro,” 20/11, 8/15.
- ⁶³ “Official Gazette of Montenegro,” 74/2010.
- ⁶⁴ “Official Gazette of Montenegro,” 65/2008.
- ⁶⁵ “Official Gazette of Montenegro,” 51/08.
- ⁶⁶ “Official Gazette of the Republic of Montenegro,” 14/92.
- ⁶⁷ “Official Gazette of Montenegro,” 50/11 and 50/12.
- ⁶⁸ See: Government of Montenegro. Ministry of Finance, (2013). 2013 Tax Policy Enforcement Analysis, pp. 25-26.
- ⁶⁹ Ibid.
- ⁷⁰ See: The Union of Municipalities of Montenegro. (2013). Local Government Finance State Analysis, pp 5-6. Retrieved from: www.uom.co.me/.../2013/.../analiza-stanja-finansiranja.
- ⁷¹ Ibid, pp 5-6.
- ⁷² See: Government of Montenegro (2012), Analysis of Local Government Functioning, pp. 15-16.
- ⁷³ The document titled Local Fiscal Charges Analysis calculated the average tax at the central level to be 0.25% of the market value. Nonetheless, the question is whether the taxpayers in underdeveloped municipalities, particularly in the north of the country, will be able to finance their obligations by increasing tax rates in this way.
- ⁷⁴ See: The Union of Municipalities of Montenegro. (2014). Opinion on the Draft Law amending the Real Estate Tax Law, pp.10-11. Retrieved from: <http://www.uom.co.me>.
- ⁷⁵ See: The Union of Municipalities of Montenegro. (2014). Amendments on the Draft Law amending the Real Estate Tax Law, pp. 4-5. Retrieved from: <http://www.uom.co.me>.
- ⁷⁶ See: The Union of Municipalities of Montenegro. (2014). Local Government Finance State Analysis, pp. 3-4. Retrieved from: www.uom.co.me/.../2013/.../analiza-stanja-finansiranja.
- ⁷⁷ See: Government of Montenegro. Ministry of Finance, (2013). 2013 Tax Policy Enforcement Analysis, pp. 24-25.
- ⁷⁸ Popović, D. (2011). Poresko pravo. Beograd: Pravni fakultet Univerziteta u Beogradu, pp. 6-7.
- ⁷⁹ See: Government of Montenegro. (2012). Analysis of Local Government Functioning, Podgorica, 89-90. Retrieved from website: www.mup.gov.me.
- ⁸⁰ Popović, D. (2011). Poresko pravo. Beograd: Pravni fakultet Univerziteta u Beogradu, pp.9-10.
- ⁸¹ See in more detail: Marković O. (2013). Aktuelni aspekti uređenja građevinskog zemljišta u Crnoj Gori. In K. Danilović (Ed.), *Finansiranje komunalnog opremanja građevinskog zemljišta u lokalnim samoupravama Hrvatske, Slovenije, Crne Gore i Njemačke – iskustva i preporuke za Srbiju*. (Current Aspects of Construction Land in Montenegro. In K. Danilović (Ed.), *Financing of the Construction Land Development in Local Governments of Croatia, Slovenia, Montenegro and Germany – Experience and Recommendations for Serbia*.) Retrieved from http://www.skgo.org/upload/files/Komunalno_opremanje_21052013_final_web.pdf.

⁸² See: The Union of Municipalities of Montenegro. (2014). Local Government Finance State Analysis, pp. 9-10. Retrieved from: www.uom.co.me/.../2013/.../analiza-stanja-finansiranja.

⁸³ See: Government of Montenegro. Council for Improvement of the Business Environment, Regulatory and Structural Reforms, (2013). 2013 Operation Report of the Council for Improvement of the Business Environment, Regulatory and Structural Reforms, pp. 8-9. Retrieved from website: www.gov.me/.../FileDownload.aspx?rId=162944..2.

⁸⁴ In this case, the views of the Government's Analysis and of the Union of Municipalities are completely different. Namely, the Board of the Union of Municipalities in its Opinion to the Council for Improvement of the Business Environment of March 27, 2013 pointed out that the road and road land use charge is necessary to maintain and protect existing roads due to their depreciation, while the construction land development charge is primarily utilised for road infrastructure development.

⁸⁵ In this case, the Government of Montenegro and the Union of the Municipalities have the same interpretation.

⁸⁶ According to the Ministry of Finance data, the 2013 personal income tax collection amounted to 124.9 million euros, which is, in comparison to the previous year (107.6 million euros), an increase of 16.1%. 95.6 million euros of the revenues collected from personal income taxes was allocated to the state budget, 15.6 million euros was allocated to municipal budgets, and 13.7 million euros was allocated to the Equalisation Fund. See: Government of Montenegro. Ministry of Finance, (2013). The 2013 Tax Policy Implementation Analysis.

⁸⁷ See: State Audit Institution. (2014). Audit Report – Budgetary Revenues of Montenegro based on Concession Agreements signed for the Use of Natural Resources, pp. 42-43. Retrieved from website: www.dri.co.me/.../Izvjestaj o reviziji.

⁸⁸ Ibid, pp. 7-64.

⁸⁹ See: Government of Montenegro. (2013). Concession Agreements Obligations Achievement Report, pp. 5-6.

⁹⁰ The Law on the Tax for the Use of Passenger Motor Vehicles, Vessels, Airplanes and Aircraft (Official Gazette of the Republic of Montenegro, 28/04 and 37/04 and Official Gazette of Montenegro, 86/09) introduced the tax on the use of passenger motor vehicles, vessels and aircraft, which has been in force from early May 2004. Subject to this tax are legal entities and individuals who own registered passenger cars, vessels, airplanes and aircraft, according to the prescribed tariff.

⁹¹ See: The European Charter on Local Self-Government, Article. 9 (5). Strasbourg, 15.X.1985. <http://conventions.coe.int/Treaty/en/Treaties/Html/122.htm>.

⁹² One of the conclusions of the Union of Municipalities management board in the document Proposed Measures to Overcome the Difficult Situation in Local Government Units was to amend the Law on Local Government Finance by introducing measures that would increase the equalisation fund resources. See more: Union of Municipalities of Montenegro. (2015). How to Overcome the Financial Problems of Municipalities. Naša Zajednica Bulletin. Retrieved from <http://www.uom.co.me/wp-content/uploads/2015/02/Bilten-18.pdf>.

⁹³ Government of Montenegro. Ministry of Economy, (2010). 2010-2014 Regional Development Strategy of Montenegro, pp. 36-38. Retrieved from website: www.mek.gov.me/.../FileDownload.aspx?...Strategija.

⁹⁴ Between 2004 and 2007, this Fund's resources were used by all local government units of Montenegro, while from 2008, the resources were not used by the Capital of Podgorica and the Municipalities of Bar, Budva, Kotor, Tivat and Herceg Novi. From 2011, resources were also not used by Pluzine due to its improved fiscal capacity. From the time of the creation of the

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Equalisation Fund in 2004 to the year 2013, local government units of Montenegro received 167,240,885 euros from this Fund.

⁹⁵ Government of Montenegro. Ministry of Economy, (2014). 2014-2020 Regional Development Strategy of Montenegro, pp. 76-78. Retrieved from website: www.mek.gov.me/./FileDownload.aspx?rid=166201.

⁹⁶ See in detail: <http://www.uom.co.me/?p=12884>.

⁹⁷ See: Cooperation Agreement between the Government of Montenegro and the Union of Municipalities signed in 2006. Retrieved from <http://www.uom.co.me/?p=683>.

⁹⁸ Further reform efforts in this area will particularly target better and more sustainable coordination between the Government, the Union of Municipalities and the local authorities. See: Government of Montenegro. (2011). Public Administration Reform Strategy in Montenegro for the period 2011-2016, pp. 38-39. Retrieved from website: www.gov.me.

⁹⁹ “The framework of cooperation of the Government and the Union of Municipalities provides conditions for achieving the objectives of cooperation defined by the said agreement. An appropriate level of cooperation and communication on all levels has been secured and represents a success story of cooperation in Southeast Europe.” See: Government of Montenegro. Ministry of Internal Affairs, (2012). Analysis of Local Government Functioning, pp.68-69. Retrieved from website: www.mup.gov.me.

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Analysis of the Fiscal Effects of Legal Framework Amendments on the Montenegrin Municipal Budgets

JADRANKA KALUĐEROVIĆ

Abstract The purpose of this book segment is to analyse the third research question - how the legislative changes in Montenegro have affected local government budgets in the period 2002-2013. The analysis covers the whole population of municipalities that existed at the time. First, the author examines how legal changes affected the revenue side of municipal budgets, dividing the period into three sub-phases: the growth trend, the plunge, and the period of stagnation. Then, the author examines the changes that occurred on the expenditure side. The findings show that several of the national government's centralistic policies, coupled with the effects of the economic crisis, deteriorated both local public finance and macroeconomic stability. As a consequence, municipalities experienced serious liquidity problems, an accumulation of outstanding bills and arrears, and unsustainable local public debt. This state of municipal finance in Montenegro endangered capital investment and hindered local economic development.

Keywords: • fiscal analysis of legislative changes • Montenegro • local government budgets • municipal revenue • municipal expenditure • macroeconomic instability • global economic crisis

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1 Subject, Analytical Approach and Research Methods

The purpose of the present segment of the analysis is to find if and how the analysed legislative changes, presented in the previous segment of the study, have affected local government budgets in Montenegro. Data from 21 out of the total 23 Montenegrin local governments have been analysed for this purpose. This analysis does not include the Municipality of Petnjica, established in 2013, and the Municipality of Gusinje, established in 2014. Data available for the aforementioned two municipalities are insufficient for the purpose of the study, which aims to cover a much longer time horizon.

The empirical analysis presented here is based on the municipal revenue and expenditure data provided by the Ministry of Finance of Montenegro for the period 2002 – 2013. Namely, according to the Law on Budget and Fiscal Accountability,¹ municipalities shall prepare quarterly and annual financial statements for the Ministry of Finance. The Rulebook on Preparation and Submission of Financial Statements by the Budgets, State Funds and Local Government Units² regulates the preparation and submission of these statements. The subject rulebook defines that municipalities shall prepare and submit to the Ministry six to seven types of reports (depending on whether they have public institutions or not), one of which is the cash flow statement as per the economic classification. Data from the aforementioned statement, the cash flow statement as per the economic classification, have been used as the base of empirical analysis. Note that data from 2005 and 2006 are not available in line with the classification and aggregation method suitable for the present analysis. Nevertheless, this will not impair the quality of analysis and conclusions, as we analyse years characterised by significant revenue growth by all budget categories. Therefore, special focus has been given to the revenue and expenditure analysis from 2007 – 2014, while data from 2002, 2003 and 2004 have been used as base data, i.e., benchmark data for gauging and analysing the changes. Also, it should be noted that all data are presented in nominal values as inflation in Montenegro was at a low level during the observed period and did not influence the analysed trends.

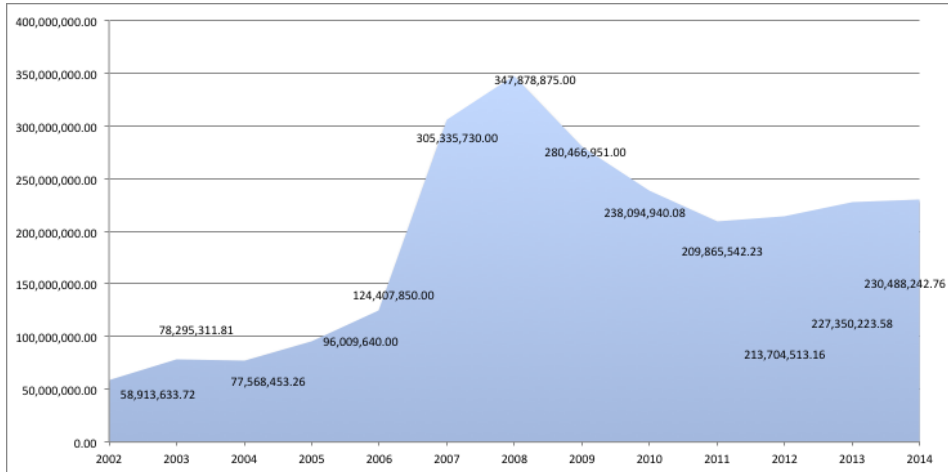
The initial idea of the author was to group local government units in this analysis by certain criteria (such as the level of development, deviations from average revenues per capita, or use of the equalisation fund) and to analyse differences between the groups. However, preliminary analysis showed that such grouping would not provide for detailed conclusions that could significantly contribute to a better understanding of the subject of analysis. As a result, the study conducts an analysis of the total data, i.e., data from all Montenegrin municipalities and the Capital City of Podgorica. Additionally, in conducting the analysis, the author has observed and analysed data from individual municipalities. Certain untypical trends or practices that deviated from the general conclusion have been underscored in the study.

There were two reasons to conduct a separate analysis of the Municipality of Podgorica. First, the aim was to methodologically adapt the analysis of Montenegro to the analysis of Serbia as much as possible for the purpose of having the most relevant comparison of the findings, as well as for further high quality work. Second, the Municipality of Podgorica is the biggest municipality in Montenegro by population (58% of the total population according to the 2011 census) and the share in the total budget (Podgorica's municipal budget was worth 22.4% of the total budget revenues of all Montenegrin municipalities in 2013). Additionally, the Municipality of Podgorica does not deviate significantly from the country average for budget revenues per capita.

The empirical analysis has been structured around the local government budget items. Municipal revenues are analysed first and are then followed by an analysis of expenditures. The revenue analysis begins with the total revenue analysis and then turns to revenue analysis for each revenue source, as follows: own-source revenues (local taxes, fees and charges), shared revenues (share of income tax, concessions and other), revenues from the equalisation fund, conditional grants and other local government revenues. Each of the subject groups has been analysed in detail in terms of the types of revenue. The types of revenue in the analysis have been selected on the basis of two criteria: 1) abundance of the revenue, i.e., share of the revenue in the total revenue or the observed revenue category, and 2) revenue sensitivity to legislative amendments implemented during the period of observation. The analysis of the municipal budget expenditures is somewhat more concise and based on how they are used: 1) for operational spending, and 2) capital expenses. As has already been mentioned, each analysed budget revenue or expenditure was analysed for all municipalities, and separately for the Municipality of Podgorica.

2 Revenues

The principal finding of the total municipal revenue analysis for the period covered, i.e., between 2002 and 2014, is that total local government revenues grew by 306%. Namely, total local government revenues in 2002 were 58.9 million euros or 4.3% of the GDP, while in 2014 they were 230.4 million euros or 6.8% of the GDP.

Chart 1: Total revenues (€) – all municipalities

Source: Ministry of Finance, Government of Montenegro

However, the total revenues trend during this twelve-year period was not always the same. An analysis of the trend indicates that there were three phases of total revenue tendencies during the period in question: the first from 2002 to 2008, characterised by the uptrend in total revenues, the second from 2008 to 2011, characterised by a drop, and the third from 2011 to 2014, characterised by relative stabilisation. The period of revenue growth concurs with the period of legal framework stability, which was identified in the analysis of the legislative aspect of fiscal decentralisation in Montenegro. On the other hand, the period of the revenue drop and stabilisation, i.e., 2008 – 2011, concurs with the period characterised by frequent legislative changes that directly or indirectly affected municipal finances. Additionally, two phases of the business cycle are evident in the period of analysis: the expansion phase characterised by positive economic trends, especially during the 2006 – 2008 period, and the recession phase, during which Montenegro dealt with the effects of the global financial crisis.³ Therefore, it is very important for the analysis to distinguish between the impacts of economic growth and legislative changes on budget revenues.

2.1 2004 – 2008 Period - Growth

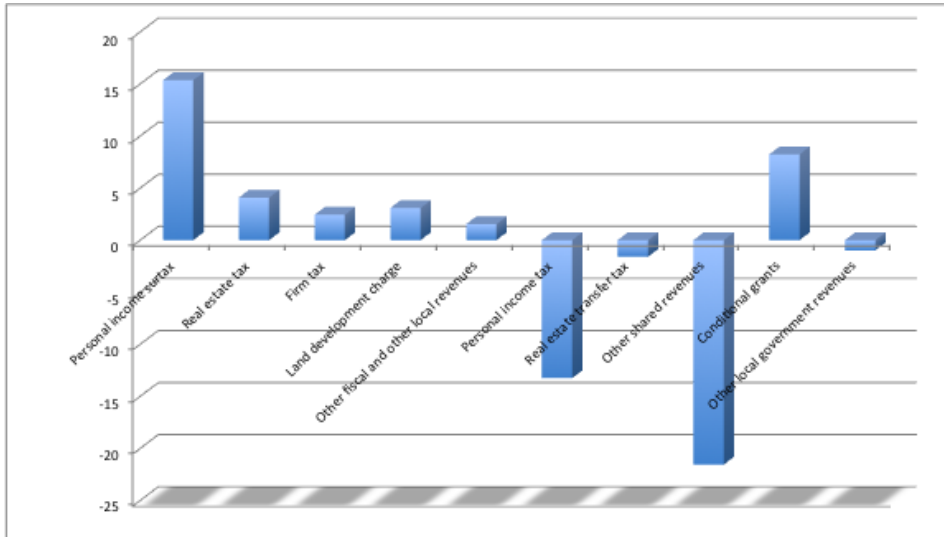
2004 was characterised by a period of growth and the adoption of the Law on Local Government Financing, which sought to achieve fiscal decentralisation or the introduction of a financing system under which municipalities could primarily focus on their own financial sources. In this year, total municipal revenues reduced slightly, by 0.7 million euros or 0.93%. The reduction was not observable in all municipalities. For

example, revenues of the Capital City of Podgorica dropped from 22.2 million euros in 2003 to 18.5 million euros in 2004. The Municipality of Bar also saw a reduction of 1.8 million euros, while the Municipality of Kolašin experienced a 0.7 million euro drop. The Municipality of Nikšić (with by far the biggest increase, from 4.8 to 8 million euros) and the municipalities of Budva and Herceg Novi were among those that registered revenue increases.

The main reason for the reduction of the total municipal revenues is the reduction of shared revenues (by 65.2%). This reduction was primarily the result of the reduction within the category “other shared revenues,” which decreased by 85% in only one year. Revenues from this category decreased primarily as a result of the Law on Local Government Financing, which abolished revenues obtained from the charge for the use of resources of general interest as a revenue source (these revenues amounted to 13 million euros in 2003). The observed reduction also occurred due to the fact that the personal income tax decreased by 51.6%. This reduction is the consequence of the amendments to the Law on Personal Income Tax that was adopted in 2001. The principal characteristic of this law was the re-levying of progressive income taxation;⁴ instead of a single rate of 19%, the law introduced 0%, 17%, 21% and 25% tax rates. The law was then amended in 2004, with a particular focus on the segment related to the tax rate. As of July 1, 2004, personal income tax rates were reduced to 0%, 15%, 19% and 23%. The amendment to the law decreased the previous effective income tax rate by 10%,⁵ thus significantly affecting revenues from this source, which can be observed in the present data.

On the other hand, local or own-source revenues grew in 2004 in comparison to the previous year (which amounted to around 20 million euros or 80%). The growth was primarily the result of revenues from the personal income surtax, consumption tax and firm tax. All aforementioned sources of financing were introduced through the Law on Local Government Financing, which was implemented as of January 1, 2004. Previous analyses indicate that in the case of the personal income surtax, all municipalities applied the maximum 13% rate allowed by law, while the Capital City of Podgorica and the Capital of Cetinje applied 15%. Similarly, municipalities levied the maximum 3% consumption tax rate allowed by the Law, with the exception of Cetinje and Podgorica, which applied the 5% rate.⁶ This confirms the importance of the level of tax rate and not only of the tax model.⁷ As indicated in the chart below, a major contribution to overall growth came from the growth of the real estate tax revenues. The Law on Real Estate Tax,⁸ which was adopted in late 2001 and put into force in January 2003,⁹ introduced real estate taxation. One may assume that the observed growth is probably the result of the application of the Law and more efficient tax collection.

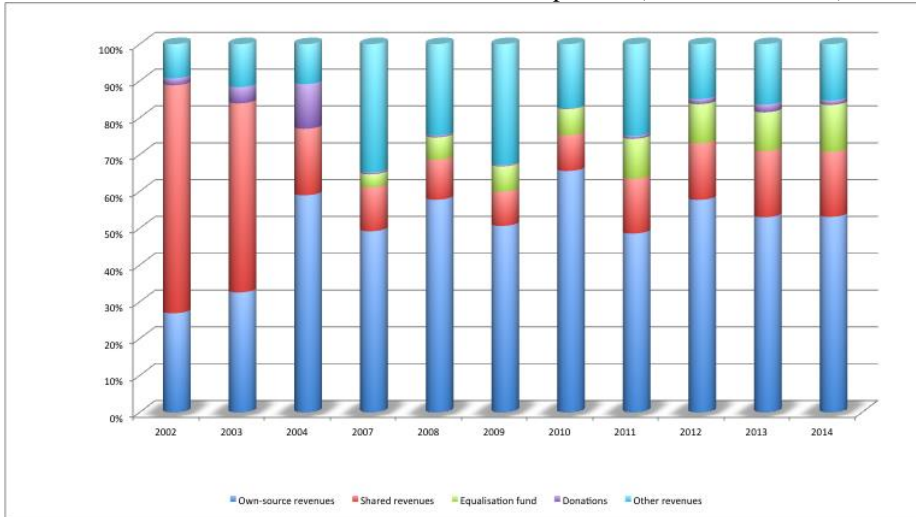
Chart 2: Contribution by individual categories to total revenue changes in 2004 (%) – all municipalities



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

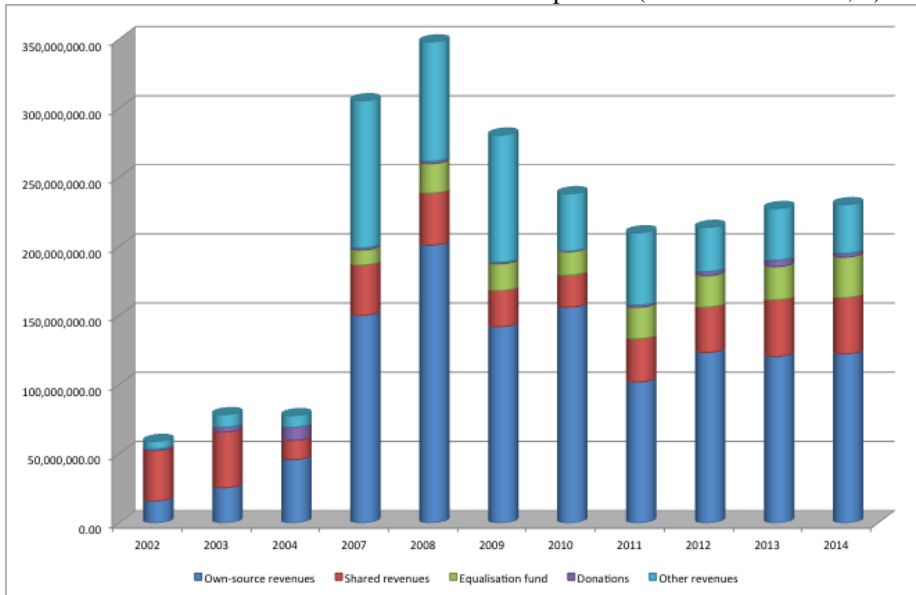
The structure of total revenues changed significantly already in 2004. In that year, local revenues accounted for around 60% of total revenues, while shared revenues accounted for only 18%. In the previous two years, shared revenues had been around 55% of total revenues and own-source revenues or local revenues had accounted for around 29%. Dominant in the total revenue for 2004 were revenues from the land development charge (15.8%), revenues from the personal income surtax (14.3%) and revenues from the personal income tax (11.6%).

Chart 3: Structure of total revenues – all municipalities (relative indicators)



Source: Ministry of Finance, Government of Montenegro

Chart 4: Structure of total revenues – all municipalities (absolute indicators, €)



Source: Ministry of Finance, Government of Montenegro

After a minor drop in total revenues, but significant structural changes in 2004, total revenues grew from 77.5 million euros to 347.3 million euros in 2004 – 2008 (the highest level of revenues the municipalities reached during the period of analysis). The biggest contribution (with around 60%) to this growth came from the growth of local or own-source revenues. Another significant contribution came from the growth of the “other revenues” category, which grew by as much as ten times during the period of analysis mainly due to growth in revenues from municipal asset sales.

Further analysis shows that the growth of own-source revenues, which was achieved between 2004 and 2008 and which is worth 155 million euros or 340%, is the consequence of the growth in all revenue categories composing local revenue. However, it is clear that the growth was primarily the consequence of the growth in revenues from the land development charge, which amount to an increase of around 80 million euros. In other words, somewhat more than half (52%) of the growth in total local revenue during the aforementioned period was the result of the increase in revenues from this charge. Also, the growth of revenues from the land use charge contributed to the overall growth of local revenue by around 16%. In 2004 – 2008, there were no legislative framework changes with significant effects on municipal revenues, so the growth achieved was primarily the consequence of improved economic activities.

Table 1: Growth of own-source revenues between 2004 and 2008

	Change in 2008 versus 2004 in €	Contribution to change of total own-source revenues
Personal income surtax	7,344,815.76	4.73%
Real estate tax	8,733,069.91	5.63%
Consumption tax	1,599,722.74	1.03%
Firm tax	715,794.50	0.46%
Local communal fee	1,928,946.71	1.24%
Land use charge	24,696,809.67	15.92%
Land development charge	80,747,340.45	52.05%
Municipal road use charge	3,756,934.00	2.42%
Other fiscal and other local revenues	25,617,752.68	16.51%
Total local revenue	155,141,186.4	

Source: Ministry of Finance, Government of Montenegro; Calculations: Author

The only legislative change carried out during the period under observation that is relevant for municipal financial analysis is the adoption of the Law on Local Communal Fees in 2006.¹⁰ Changes introduced by this Law, which concerned the elimination of

local communal fees for the most profitable business entities, came into force in early 2008.¹¹ Analysis shows that revenues from the local communal fee dropped by 34.6% in 2008, but that drop was insignificant in comparison to the growth generated by other revenue categories. Due to positive trends in other revenue categories, total local revenues grew by 33.7% from 2007 to 2008. Also, when taking into account the full 2004 – 2008 period, the contribution of revenues from the local communal fee to the growth of total own-source revenues was 1.24%.

Much like today, the number and amount of local communal fees during 2004 – 2008 varied from one municipality to the other. The only available example that gives insight into the levels of local communal fees is the Municipality of Plav.¹² This example is illustrative enough to help us show the level of fees by individual categories and the differences between certain categories. It is evident that fees for the installation of mobile telephone base stations, the installation of aerial, TV or radio receivers or the installation of the PTT box, as well as fees for games of chance, were the the highest. These fees were eliminated by the 2006 Law. In other words, by implementing this law, the Municipality of Plav was left without the most important of its local communal fees.

Table 2: Municipal communal fees in the Municipality of Plav in 2006

	Subject of the fee	Amount	Note
1	For statements, announcements and advertisements by means of radio stations and similar media	1€	
2	For organising live music in hospitality facilities	1.5€ daily	
3	Games of chance equipment and entertainment devices	17€ monthly	
	Raffle and betting	100€ monthly	
	Casino	100€ monthly	
4	Use of space for camping, tents and similar objects	0.70€ daily	
	For motor road vehicles and trailers per m2	0.50€po m ² daily	
5	For circuses	9€ per m ² monthly	
	For other movable shops	5€ per m ² monthly	
6	For public space use in front of commercial premises for business purposes		
	Plav and Gusinje – for hospitality business	20€ monthly per table	

	Plav and Gusinje – use of showcases for exhibition of goods	0.2 per m ²	private properties, 50% of the subject amount
	Murino and dwellings beyond MP - for hospitality business	15€ monthly per table	
	Murino and dwellings beyond MP - use of showcases for exhibition of goods	0.15€ per m ²	
7	Showcases for ice cream, popcorn, pancakes and similar	0,30€ daily	
8	Rent of automobiles and bicycles for children	0.50€ per piece daily	
9	For possession of motor vehicles and trailers		Paid at time of vehicle registration
	For cargo vehicles and trailers	10€ annually	
	For passenger vehicles	5€ annually	
	For motorcycles	3€ annually	
10	For advertisement panels in public places	40€ per m ² annually	
	For billboards and use of advertisement panels of foreign firms	350€ annually per side	
11	For parking cargo vehicles, trailers and buses	2€ daily	
	For parking passenger vehicles	1 daily	
12	For use of public and other space for commercial purposes		
	Installation of mobile telephone base stations	330€ monthly per station	
	Installation of aerial, TV or radio receivers	120€ monthly per receiver	
	Installation of PTT box	150€ annually	
13	For use of public and other space for concerts, plays, meetings, filming movies and advertisement videos	200€	
14	For use of public and other space for construction, disposal, excavation		
	For installing a protective fence for construction	0.10€ daily per m ²	
	For disposal of construction and other materials	0.10€ daily per m ²	
	For excavation of public space	0.50€ daily per m ²	
15	For restaurants on water and other hospitality facilities	5€ monthly per m ² of usable area	
16	Coast use for commercial purposes	4€ monthly per m ²	
17	For keeping animals as pets	15€ annually	

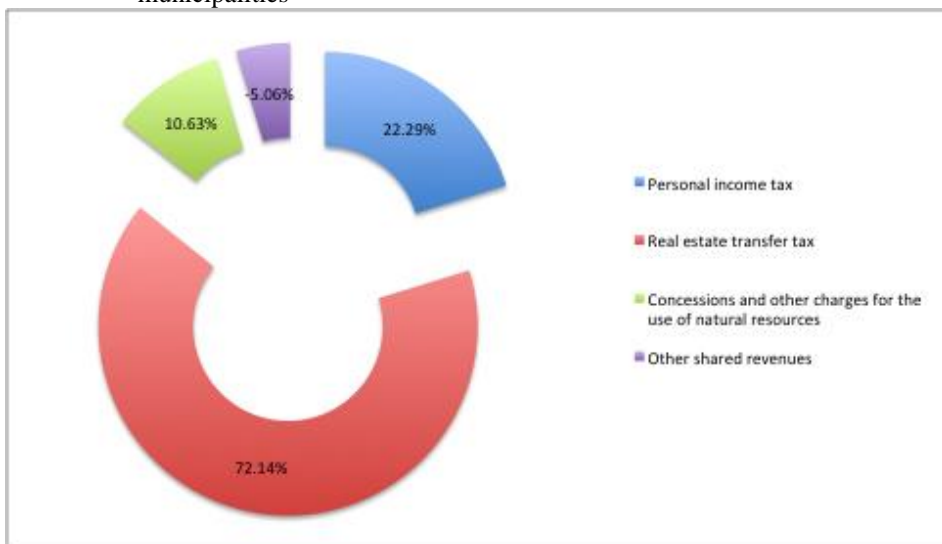
Source: Municipality of Plav

Although the effect of the 2008 legal change, which resulted in a significant drop in revenues from communal fees, was concealed by the growth in other categories, a further drop of revenues from this source will have much more significant effects on budget revenues in the coming years.

The same period (2004 to 2008) was characterised by an increase in shared revenues of 169%. This increase was mainly due to the growth of revenues from the real estate tax (contributing to the aforementioned change with 72.14%), which was not the result of a legislative change, but solely of improved economic activities. Namely, 2006, 2007 and 2008 were the years of high growth rates when the construction and real estate sectors generated around 20% of the GDP.

The increase in shared revenues was the result of the growth of revenues from the personal income tax, which contributed to the growth of shared revenues by 22.2%. From the moment of implementation of the Law on Personal Income Tax (2001), the law was amended several times in order to introduce improvements. One of the most important amendments was the introduction of rates of 0%, 15%, 19% and 23% were imposed. These rates were replaced by a single 17% rate in 2007.¹³ Considering that these amendments were imposed to reduce the tax burden on wages, it is obvious that the growth of revenues from this source is the result of improved economic activities.

Chart 5: Contribution to the change of shared revenues in 2004 - 2008 – all municipalities

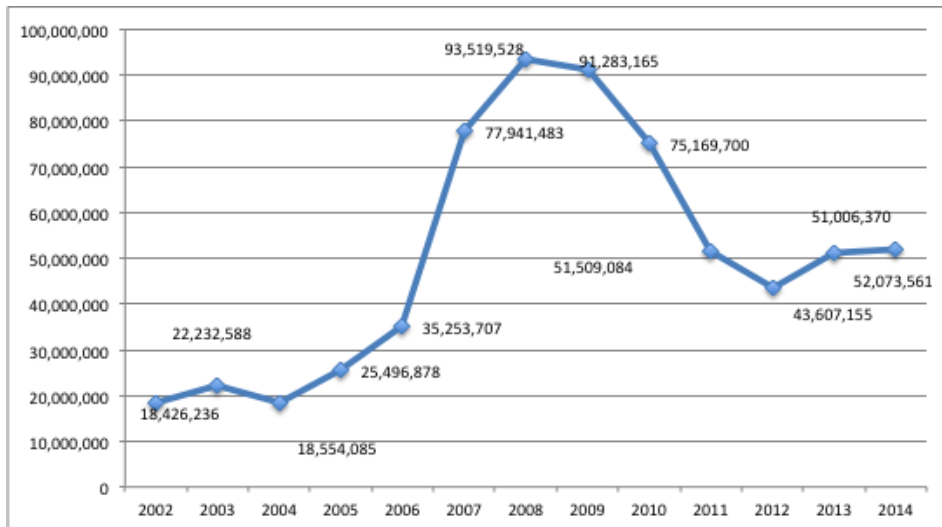


Source: Ministry of Finance, Government of Montenegro; Calculations: Author

Keeping in mind the analysed tendencies of both the level and structure of local government revenues, one may conclude that the Law on Local Government Financing served as a good foundation for municipal financial decentralisation. However, growth in the period 2004 – 2008 was only to a small extent a consequence of improved local government efficiency in public financial management. Instead, this was a consequence of improved economic activities, particularly in the construction sector and real estate sale transactions.

The trend identified by means of the total revenue analysis is also present in data for the Capital City of Podgorica. Namely, municipal revenues grew constantly between 2002 and 2008, with the biggest growth from 35.2 million to 77.9 million euros occurring in 2006 and 2007. After 2008, when revenues reached 93.5 million euros, there was a period of constant total revenue reduction, which reached 43.6 million euros in 2012 and which stabilised at 52.07 million euros in late 2014.

Chart 6: Total revenues (€) – Capital City of Podgorica

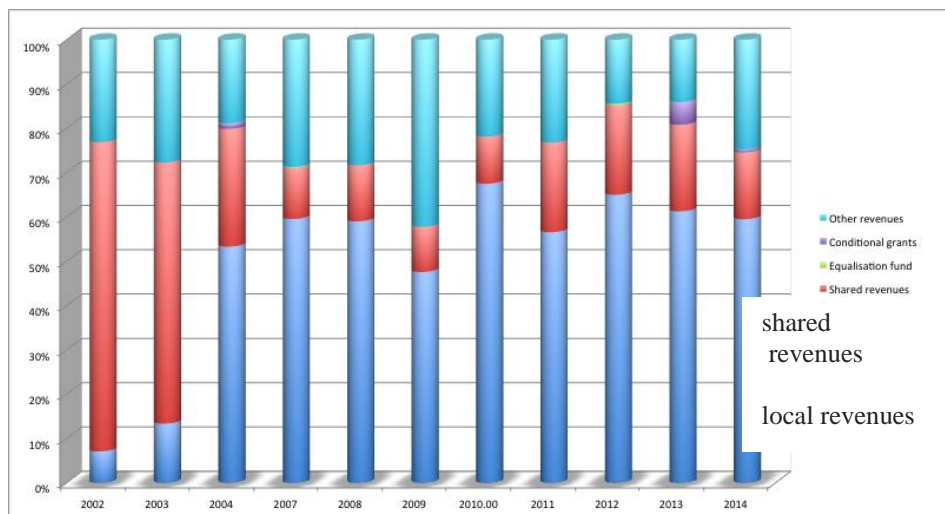


Source: Ministry of Finance, Government of Montenegro

The Capital City of Podgorica also had a total revenue drop in 2004, which saw revenues decrease by 14%. The same trend is also evident at the aggregate level. In 2004, own-source revenues of this municipality reached an annual growth rate of 243%. The growth was primarily the consequence of the new sources of financing, such as the personal income surtax (revenues from this source contributed with around 77% in total local revenue growth), the firm tax and consumption tax (total contribution was 7.5%).

Revenue growth from the real estate tax made up for 7.5% of the total local tax growth in the Municipality of Podgorica. On the other hand, shared revenues dropped by 61%, primarily due to the elimination of revenues from the charges related to the use of communal resources of general interest (worth 6 million euros), but also due to a drop in revenues from the personal income tax and the real estate transfer tax (worth in total around 2 million euros). These changes defined a completely new structure of total revenues of the Capital City in 2004. The share of local revenues grew from 7.1% in 2002 to 53.3% in 2004, and the share of shared revenues dropped from 69.7% to 26.6% during the same period.

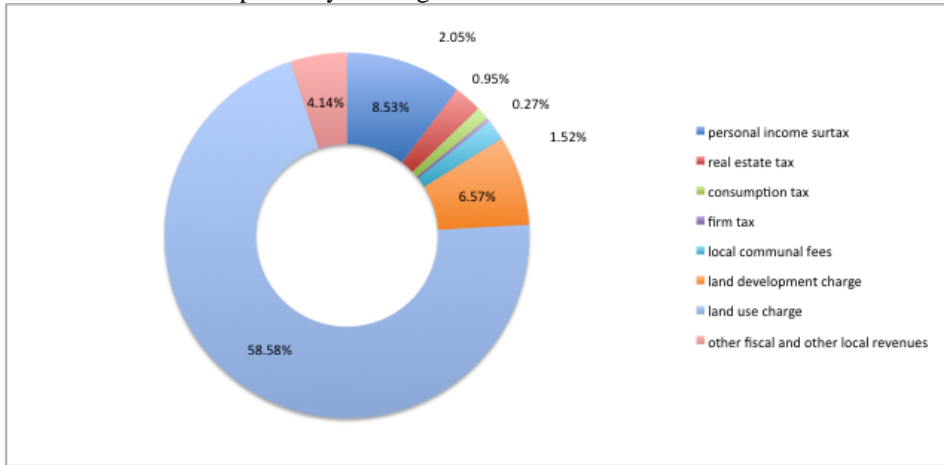
Chart 7: Structure of total revenues – Capital City of Podgorica



Source: Ministry of Finance, Government of Montenegro

The period of 2004 – 2008 was characterised by a constant growth of total revenues, which was primarily due to the growth of own-source revenues (by 60%) and the growth of the category “other local government revenues” (by 30%). The contribution of shared revenues to the overall growth was 9%.

Own-source revenue growth of the Capital City for the entire four-year period was 441%. The growth was primarily the consequence of an increase in revenue from the land development charge, which increased by 60% (contribution). The total growth was also due to an increase in revenue from the personal income surtax (contribution of 8.5%), land use charge (6.5%) and revenues from the real estate tax (4.1%). The individual contribution of different local revenue categories to the total growth is shown in the figure below.

Chart 8: Contribution to the overall growth of local/own-source revenues in 2004 - 2008 –Capital City of Podgorica

Source: Ministry of Finance, Government of Montenegro

Although revenues from the local communal fees contributed to the growth of total revenues by 0.92% in 2004 - 2008, the changes that resulted from the Law on Local Communal Fees led to a drop in these revenues by 36% only in 2008. In regard to the local administrative fees, they grew by 113% in this four-year period.

In the period 2004 – 2008, shared revenues grew by 76% as a result of revenue growth from the real estate transfer tax (from around 400,000 euros to 3.6 million euros), as well as the doubling of revenues from the personal income tax.

The “other local government revenues” category grew by 390%, and this is primarily the result of the growth of revenues from municipal asset sales. The Capital City of Podgorica generated revenues in the amount of 47.6 million euros only from municipal asset sales. The highest revenues were generated in 2006 and 2007, which were the years of the strongest economic growth and the real estate boom.

Table 3: Revenues from the municipal asset sales – Capital City of Podgorica

Year	Revenues from asset sales (€)	Share of total revenues
2008	6,156,629.81	6.58%
2007	19,382,649.90	24.87%
2006	13,054,883.58	37.03%
2005	5,633,393.32	22.09%
2004	3,452,463.61	18.06%
Total	47,680,020.22	

The trends described above contributed to the total Capital City revenue structure that consisted of 59% of own-source revenues, 12.6% of shared and 28.34% of other revenues in 2008. It is important to note that the other revenue structure analysis in 2008 shows that the revenues from borrowing in that year amounted to 8 million euros. It was planned that 22.8 million euros in revenues would come from the asset sales, but, as the table above shows, these revenues amounted to only 6 million euros. The data indicate that the Capital City of Podgorica expected further economic growth and high demand on the real estate market, something that never happened in reality. Planned revenues were significantly lower than the ones generated, and the municipality had to borrow money in order to fulfil its obligations. Thus, positive expectations were abruptly discontinued by negative tendencies in 2009.

2.2 2009 – 2011 Period - Plunge

In 2009, Montenegrin municipal revenues began to drop. Total revenues dropped by 19.37% in 2009, 15.10% in 2010 and 11.85% in 2011. As a consequence of these changes, total revenues decreased from 347.87 million euros to 209.86 million euros. Two processes that directly impacted municipal revenue tendencies characterised this period; the first one was a drop in economic activity, both globally and nationally, and the second one included the legislative changes that had a direct impact on local finances.

After several years of strong economic growth with an average annual rate of 8%, gross domestic product in 2009 reached a negative annual rate of – 5.7%. The drop in economic activity hit the majority of the economic sector, especially industry, construction and trade, i.e., those sector activities that had previously greatly affected the level of municipal revenues. The same year also marked the beginning of the application of the Law on Spatial Development and Construction of Structures,¹⁴ which eliminated the land use charge as one of the more important previous sources of municipal financing. This charge was actually rent for (lease of) state-owned land. The

revenue was eliminated principally because of the change in circumstances determined by new ownership relations, new state-owned land management, and, according to some people, ad hoc and inconsistent use of the charge to boost municipal revenues. Additionally, a further 40% drop in revenues from local communal fees during 2009 contributed to the general downtrend in revenues.

All the aforementioned factors contributed to a drop in revenues in 2009. This is also shown by data on the contribution to change by most significant revenue categories: revenues from the land development charge contributed to the drop by 40.79%, revenues from the land use charge by 37.76% and revenues from the real estate transfer tax by 15.07%.

In 2009, shared revenues dropped by 30.89% in comparison to the previous year, primarily due to a decrease in revenues from the real estate transfer tax that amounted to 10 million euros (87.27% of the total drop in shared revenues). The reduction only intensified pressure on local governments that was caused by a drop in revenues from the land development and land use charges. In the year under analysis, only revenues from the real estate tax grew and neutralised 7.4% of the total drop of Montenegrin municipal revenues. Also, one may notice the increase in revenues from the municipal roads use of around 0.8 million euros, the consumption tax of 0.1 million euros, and the firm tax of 0.3 million euros.

The table below is an overview of changes by all principal budget categories, as well as the contribution to the change of total and own-source revenues of Montenegrin municipalities.

Table 4: Total revenues – All municipalities

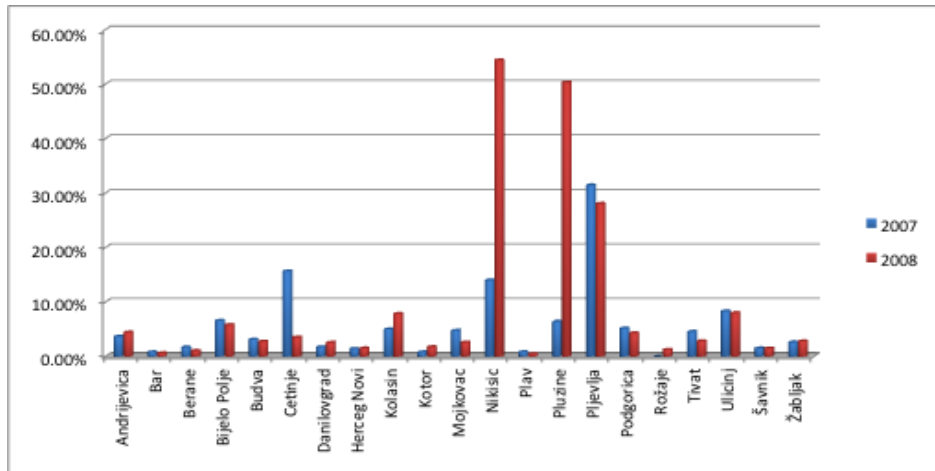
Type of revenue	Change in 2009 versus 2008 in €	Contribution to the change of total revenues	Contribution to the change of local/shared revenues
LOCAL REVENUES	-58,896,087.00	87.37%	
Personal income surtax	-2,857,675.00	4.24%	4.85%
Real estate tax	5,021,658.00	-7.45%	-8.53%
Consumption tax	189,388.00	-0.28%	-0.32%
Firm tax	341,433.00	-0.51%	-0.58%
Local communal fees	-2,441,078.00	3.62%	4.14%
Land use charges	-25,451,695.00	37.76%	43.21%
Land development charges	-27,499,681.00	40.79%	46.69%
Municipal road use charge	896,132.00	-1.33%	-1.52%

Other fiscal and other local revenues	-7,094,569.00	10.52%	12.05%
SHARED REVENUES	-11,642,252.00	17.27%	
Personal income tax	-1,436,100.00	2.13%	12.34%
Real estate transfer tax	-10,160,403.00	15.07%	87.27%
Concessions and other charges for use of natural resources	-120,612.00	0.18%	1.04%
Other shared revenues	74,863.00	-0.11%	-0.64%
EQUALISATION FUND	-1,882,550.00	2.79%	
CONDITIONAL GRANTS	-710,311.00	1.05%	
OTHER LOCAL GOVERNMENT REVENUES	5,719,276.00	-8.48%	
TOTAL (1+2+3+4+5)	-67,411,924.00		

The data and analysis presented lead to the conclusion that a significant revenue drop in 2009 is the consequence of both the changes in regulations (specifically, elimination of the land use charges) and the deceleration of economic activities that led to a decrease in revenues from taxes and land development charges. Budget reduction pressures of this nature led municipalities to rely more on own-source revenues and better collection. However, one may ask the following question: Have the effects of the drop in revenues from the land use charges affected all municipalities in the same manner?

According to data from 2007 and 2008, the average share of revenues from the land use charges in total revenues was 5.7%. However, a close analysis by cities showed that this share is vastly different from one municipality to the other, and that it was the biggest in the municipalities of Nikšić, Plužine, Pljevlja and Cetinje (according to 2007 data). The share of revenues from this source in other municipalities is below 10% and remained relatively stable during the period under observation.

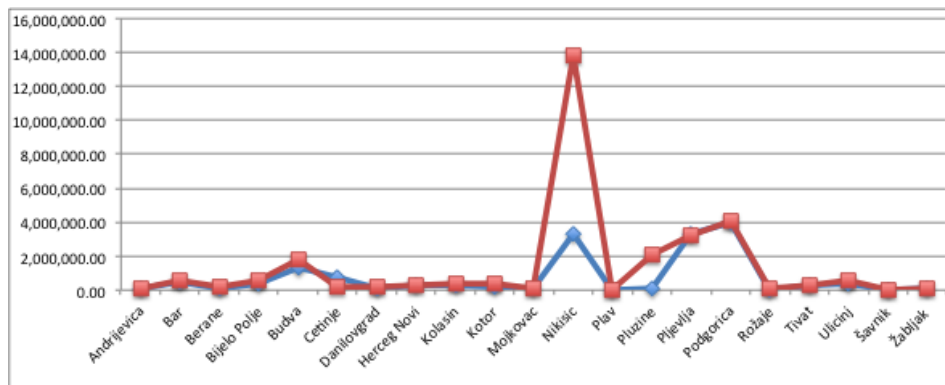
Anyway, the most interesting conclusion of the analysis of the data on revenues from the land use charges is shown in the following figure. Namely, an enormous growth of observed revenues is obvious in the municipalities of Nikšić and Plužine in 2008 in comparison to 2007.

Chart 9: Share of revenues from the land use charge in total revenues – by municipalities

Source: Ministry of Finance, Government of Montenegro

The Municipality of Nikšić saw growth from 3.3 to 13.8 million euros, while the Municipality of Plužine reached a 1453% increase from 0.1 to 2.0 million euros. These changes were the result of the collection of the land use charge from the Electric Power Company of MNE (EPCMNE) in 2007 in the Municipality of Nikšić and in 2008 in the Municipality of Plužine.¹⁵ Based on the increase, EPCMNE grew significantly in 2008, which led the company to request an increase in electric power tariffs from the Energy Agency; this request was approved.¹⁶ In other words, the growth of municipal revenues resulted in an increase of electric power prices, which was paid by all citizens and companies of Montenegro.

Chart 10: Revenues from the land use charge (€) – all municipalities



Source: Ministry of Finance, Government of Montenegro

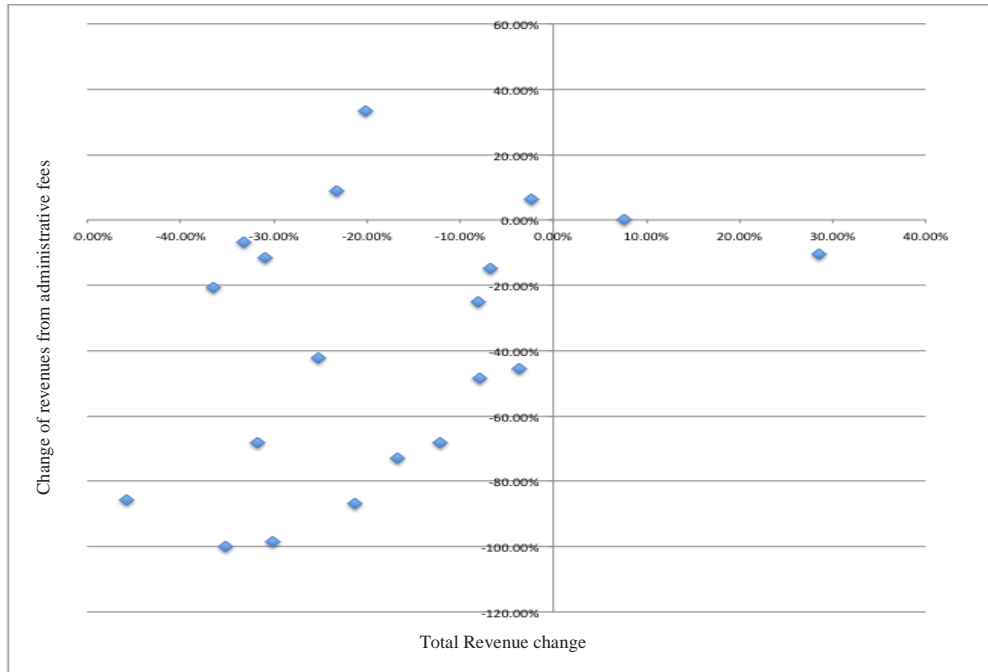
Therefore, if the municipalities of Nikšić and Pluzine are excluded from the analysis (as municipalities significantly deviating from the average), we may conclude that the elimination of the land use charge left municipalities in 2009 without 3.9% of their revenues (according to 2007 and 2008 data).

The decrease in total revenues continued during 2010, as a consequence of a drop in shared revenues by 11%. Own-source revenues, however, grew by 9.9%, primarily as a result of the growth of revenues from the real estate tax and “other fiscal and other local revenues” category, which grew due to additional municipal borrowing. The increase of these categories was significant and, thus, it covered the lack in revenues from the land use charge, land development charge, as well as the municipal road use charge. The drop in shared revenues was the result of lower revenues in all revenue categories, but above all, a 1.3 million euro decrease in revenues from the personal income tax. Also, the “other shared revenues” category dropped significantly due to a 0.5 million euro reduction of charges related to motor vehicles and a 0.2 million euro decrease of the forest use charge. The lowest contribution to the drop in shared revenues during this period came from concessions (around 8%).

Considering the observed revenue drop in 2009, which was significant in all Montenegrin municipalities, one should analyse if and to what extent the municipalities have tried to alleviate the decrease by increasing other revenues. The most frequent practice municipalities used to cover the drop in revenues is to increase local administrative and communal fees. Hence, we have analysed if there was a link between the level of the total revenue drop in 2009 and the level of revenue changes related to local communal and local administrative fees in 2010. The figures below show this relationship. The first figure shows the annual changes of total revenues in 2009 and the

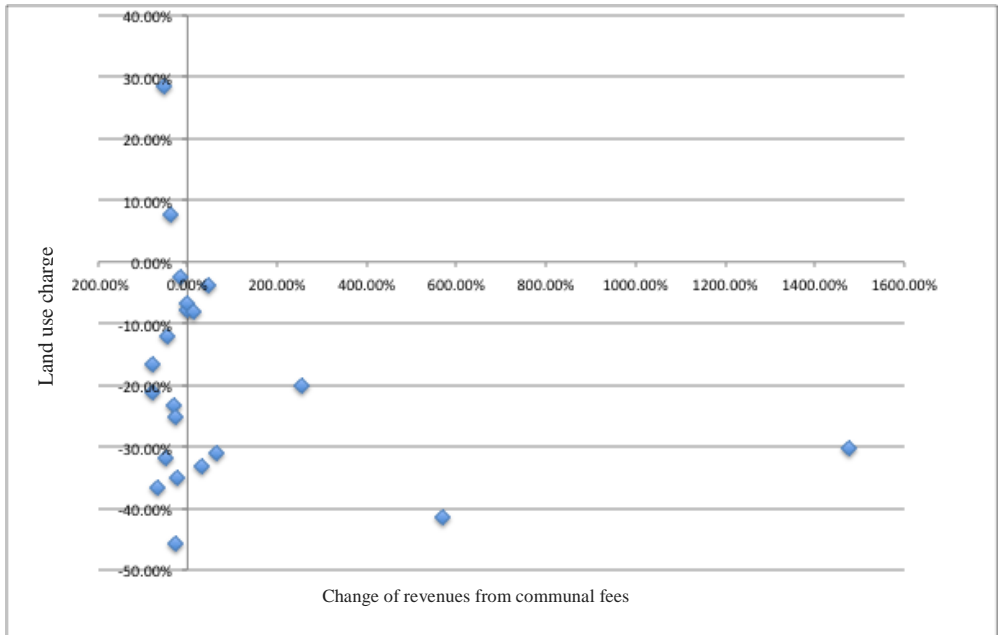
annual changes of revenues from administrative fees in 2010, while the second figure shows the annual changes of the total revenues in 2009, compared to the annual changes of revenues from communal fees in 2010.

Chart 11: Total revenue change (2009) and changes of revenues from administrative fees (2010) – individual municipalities

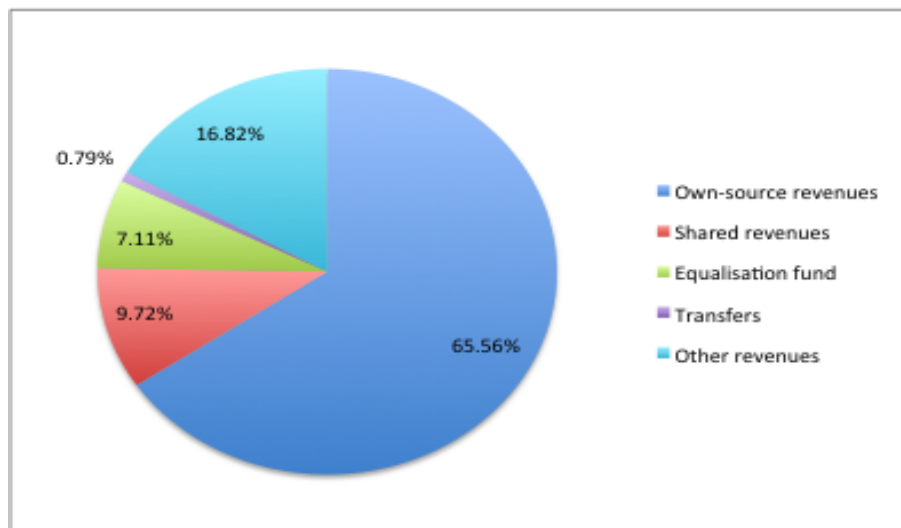


As indicated in the figure above, no link between the total revenue drop and revenue growth from administrative fees is observable. Moreover, in 2010, revenues from administrative fees decreased for the majority of municipalities, compared to the previous year, despite the fact that municipalities had faced a significant drop in revenue. Also, the following figure shows that the municipalities that experienced a significant drop in revenue in 2009 did not resort to increasing communal fees, i.e., did not have growth of revenues from this source.

Chart 12: Total revenue change (2009) versus changes of revenues from communal fees (2010) – individual municipalities



In 2010, there were no legislative changes that could have had possible consequences for municipal budgets, but there were some in 2011. In order to observe the effects of these changes on individual budget categories, we will analyse the revenue structure at the end of 2010. As shown in the following figure, the most significant source of revenues in the year under analysis was local/own-source revenues, which is a logical consequence of the seven-year implementation of the decentralisation process. However, the fact that revenue from other proceeds is at 16.82%, among which the majority are loans from domestic and foreign financial institutions, points to the conclusion that municipalities significantly increased their borrowing from the start of the crisis. Also, two years earlier (2008), the share of “other proceeds” category was 24%, yet major portions of this category were funds transferred from the previous years.

Chart 13: Structure of total local government revenues in 2010 – all municipalities

The table below is a representation of municipal revenues according to the classification that provides for a detailed analysis by individual budget category. It is clear that municipalities realised 10% of their revenues from asset sales in 2010. Also, one may notice that real estate taxes represented a significant revenue source of municipalities, with a share of 10.32%.

Table 5: Municipal revenues by individual budget category (in %)

Local taxes	18.73
Real estate tax	10.32
Games of chance and entertainment games tax	0.29
Consumption tax	0.84
Firm or business display tax	1.17
Personal income surtax	6.11
Local fees	2.41
Local administrative fees	0.86
Sojourn fees	0.02
Local communal fees	1.45
Charges	29.91

Land use charge	0.28
Land development charge	27.23
Municipal road use charge	1.16
Other charges	0.74
Other local revenues	5.14
Revenues from equity	0.93
Penalties and seizures of material gains	0.16
Revenues generated through activities of municipal authorities	2.06
Other revenues	1.99
Revenues from asset sales	9.37

Source: Ministry of Finance, Government of Montenegro

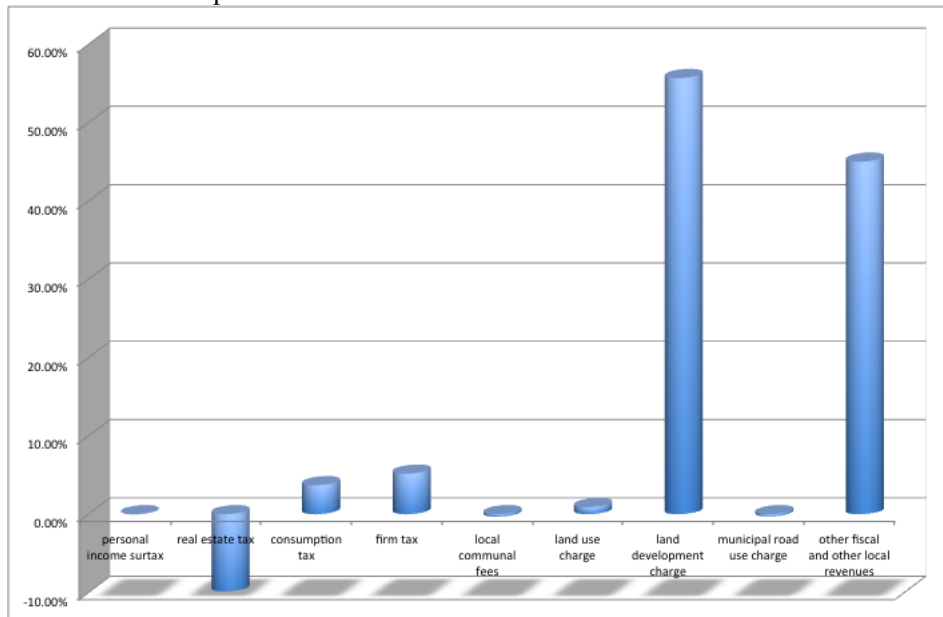
In the following year (2011), total revenues decreased by 11.8%, and several changes introduced by the Law on Local Government Financing were implemented.¹⁷ These changes were related to: a) the elimination of certain local government revenues, such as the consumption tax, firm or business display tax, games of chance and entertainment games tax; b) an increase in the percentage share of local government revenues from the personal income tax collected on municipal territory (from 10% to 12%, except for the Capital, which received 16%, and the Capital City, which received 13% of revenues generated); c) an increase in the percentage share of local government revenues from the real estate transfer tax (from 50% to 80%) and d) an increase in the percentage share of local government concessions for natural resources (from 30% to 70%, in comparison to the previous legal solution). Equalisation fund criteria were also significantly amended.

Additionally, the currently valid Law on Real Estate Tax¹⁸ was also implemented in 2011. This law increased the range of allowed tax rates from the previous 0.08% - 0.80% to 0.10% - 1.00% of the real estate market value set by municipalities depending on the type, location, quality, date of construction and purpose of the property. In 2011, total local/own-source revenues dropped by 34.7%, while total shared revenues grew by 35.2%.

The drop in local/own-source revenues was primarily the consequence of a drop in revenues from the land development charge, as well as the elimination of revenues from the firm tax and consumption tax. The elimination of the firm tax and consumption tax contributed to the overall decrease in own-source revenues of around 9% and left municipalities without 2.31% of total revenues. The contribution to the decrease of revenues from the land development charge was 55%. The share of “other fiscal and other local revenues” in total revenue was also reduced and decreased 45%, primarily

as a result of the drop in revenues from asset sales. Revenues from the real estate tax had a completely reversed trend and they grew by 21% in comparison to the previous year, thus neutralising the drop in municipal own-source revenues by around 10%.

Chart 14: Contribution of individual categories to local revenue drop in 2011 – all municipalities



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

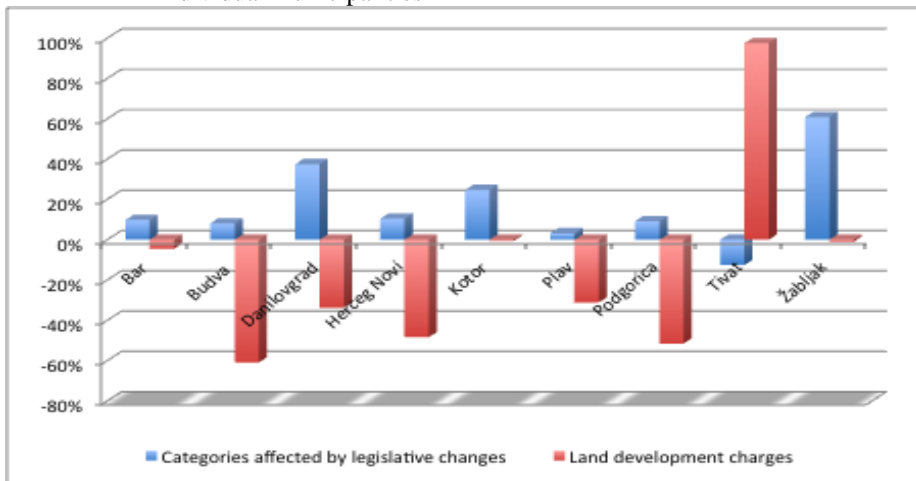
On the other hand, an increase in shared revenues was primarily the result of the growth of revenues from concessions (contribution of 38.56%) and revenues from the personal income tax (contribution of 22.69%). Also, a significant contribution of 20.23% came as a result of the growth of revenues from the real estate transfer tax.

The reduction in own-source revenues, which resulted from the application of the aforementioned reform (elimination of the firm tax, consumption tax and games of chance and entertainment games tax), amounted 5.4 million euros. On the other hand, growth realised from the revenues from concessions, revenues from the real estate transfer tax, personal income tax, and the real estate tax amounted 11.9 million euros. Also, it should be noted that the biggest drop in this year was in the category of revenues from the land development charge, which resulted solely from a decrease in economic activity in the country. Therefore, one may conclude that changes introduced in 2011 did not represent any significant threat to municipal budgets, but they surely

meant a step back in terms of financial/fiscal decentralisation by eliminating certain own-source revenues and increasing municipal dependence on shared revenues.¹⁹

It is interesting to see how regulatory changes affected revenues of individual municipalities. Out of the total 21 analysed Montenegrin municipalities, 9 faced a drop in total revenues in 2011 (those are presented in the Chart 15). The Municipality of Budva faced an annual drop of more than 40.6%, and the Capital City saw a decrease of 31.4%. All other municipalities had a growth of total revenues. The following figure shows the impact on the total change of municipal revenues from the land development charge (as a budget category not affected by legal changes, but only by economic activity) and revenues from all other categories (those related to the legal changes)²⁰ during 2011. As is clearly shown in the figure below, the total impact of categories affected by amendments to the law was positive in all municipalities; thus, the end result of these legislative changes was growth of revenues in these municipalities in 2011. One may conclude that by introducing the aforementioned changes, the Government provided for revenue reduction from one source to be replaced by revenue growth from another. Further analysis of the data indicates that the reduction of revenues from the land development charge had a significant impact on the reduction of total revenues, especially in certain municipalities, such as the municipalities of Budva, Danilovgrad, Plav, and in the Capital City of Podgorica.

Chart 15: Contribution of individual categories to local revenue plunge in 2011 (in %) – individual municipalities



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

In the 2009 – 2011 period, the Capital City of Podgorica experienced total revenue drops of 2.39% (2009), 17.64% (2010), and 31.47% (2011). In contrast to 2008, total own-source revenues decreased by 21.3% in 2009. This reduction was a consequence of a drop in revenues from the land use charge (contribution of 34.2%), and as such, a sole consequence of legislative changes imposed by the Law on Spatial Development and Construction of Structures. Expressed as a percentage of the total revenues generated by the Capital City in 2008, the drop in revenues is 4.1%. Therefore, the Capital City of Podgorica lost 4% of its total revenues as a result of the legislative change.

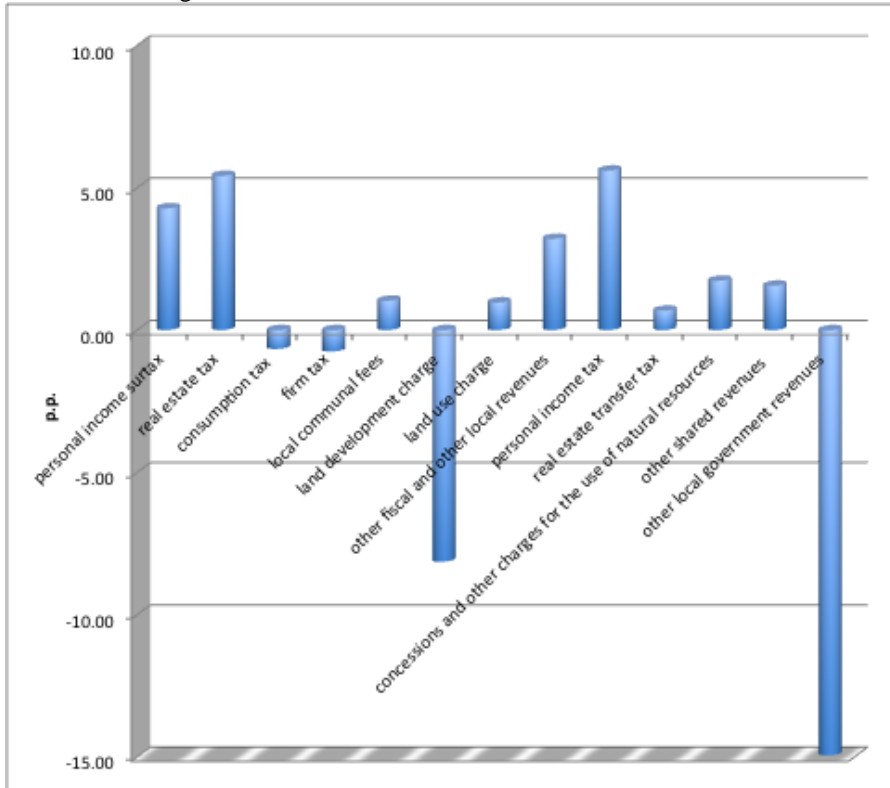
The drop in total local revenues is also the consequence of a 18.28% decrease in revenues from the land development charge. Since in the year under analysis there were no legislative changes affecting revenues on these grounds, one may assume that the revenue drop from the land development charge was a consequence of the deceleration of economic activity and a decreased interest among investors due to the effects of the global financial crisis. Also significant was the 8.96% drop in revenues from the personal income surtax. The elimination of local communal fees for the most profitable businesses resulted in a 5.5% drop in total local revenues. Also, it should be pointed out that a drop in other fiscal and other local revenues had a significant effect on the decrease in total local revenue of the Municipality of Podgorica. A drop in revenues from this category contributed to as much as a 36.1% reduction of total revenue.

Shared revenues of the Capital City also had a 21.1% decrease during 2009, primarily due to a 56% (annual) reduction of the revenues from the real estate transfer tax and a 6.1% drop in the personal income tax. Other revenues of the Capital City grew by 45% in 2009, primarily as a consequence of revenue growth from real estate sales (revenues from the sales were 6.1 million euros in 2008 and 19.3 million euros in 2009).

In 2010, both own-source (by 11.3%) and shared revenues (by 14%) decreased. All own-source revenue categories of the Capital City experienced a drop, except revenue from the real estate tax. The biggest drop was related to revenues from the land development charge (the annual growth rate of this category was -13.47%). Among the shared revenue categories, concession charges stand out, as they decreased by 96% during 2010.

As has already been mentioned, 2011 will be subjected to a somewhat detailed analysis due to significant legislative changes implemented during that year. Data indicate that total revenues of the Capital City in 2011 dropped by 31.47%, as a result of a 24% reduction in own-source revenues. Own-source revenues dropped primarily because of the drop in revenues from the land development charge and revenues from the category of other fiscal and other revenues. Revenues from the real estate tax grew by 8%. On the other hand, shared revenues had an annual growth rate of 30%, primarily due to revenue growth from concessions and revenues from the personal income tax.

Chart 16: Change of share in total revenue structure in 2011 and 2010, Capital City of Podgorica



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

These changes may also be observed by means of an analysis of the change in revenue structure in 2011 and 2010. The share of revenues from the real estate tax and personal income tax grew by around 5.5 percentage points. On the other hand, revenues from the land development charge dropped by 8.14 percentage points, while other local government revenues dropped by 15 percentage points. In 2011, the most significant share in the revenue structure of the Capital City was held by the following revenue categories: revenues from the land development charge (19.74%), personal income surtax (14.56%), personal income tax (13.78%) and the real estate tax (10.14%).

2.3 2012 – 2014 Period – Stagnation

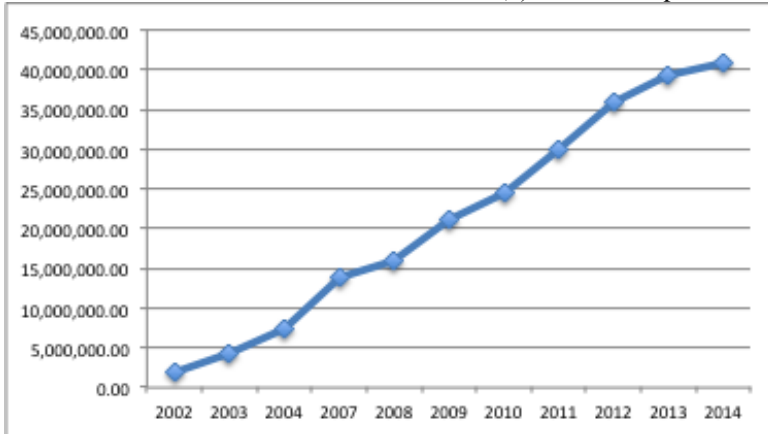
After several very difficult years for local governments, total revenues increased by 1.8% in 2012. This positive trend continued in the next two-year period when total revenues grew by 6.3% and 1.2%. All principal budget categories grew in the 2011 – 2014 period, except for the “other local government revenues” category, which had a 32% drop. Own-source local government revenues grew by 19%, primarily due to the growth of revenues from the real estate tax (contributed to the growth with around 54%), as well as the revenues from the personal income surtax and the land development charge. The growth of revenues from the real estate tax is the consequence of the implementation of the Law on Real Estate Tax provisions, which extended the range of tax rates as of 2011.²¹ During the same period, shared revenues grew by around 30%, primarily as a result of a 75% increase in revenues from concessions and a 25% increase in revenues from the personal income tax. In the last three years, municipal revenues stabilised as a result of improved economic activity and the tendency to make revenues from the real estate tax the most important source of local government financing.

The analysed changes led to a change in local government revenue structure. Thus, in 2014, the biggest shares in the total revenue structure were revenues from the real estate tax (17.7%), revenues from the land development charge (16.6%), other local government revenues (15%) and the equalisation fund (12%). This structure is vastly different from those in 2004, in which revenues from the land development charge (15.8%), revenues from the personal income surtax (14.3%), and revenues from the personal income tax (11.6%) were predominant. It is interesting to analyse the trend of different budget categories during the observed period.

Revenues from the Real Estate Tax

Revenue from real estate is revenue that existed in Montenegrin municipal budgets throughout the entire period under observation. Real estate taxation in the early part of this period was implemented as per the Law on Real Estate Tax,²² which was adopted in late 2001 and implemented in January 2003. According to this law, the tax rate ranged between 0.08% and 0.80% of the real estate market value. The law was not changed until 2011, when the tax rate range was amended to 0.10% - 1.00% of the real estate market value. During this same period of analysis, revenues from the real estate tax grew continuously from less than 5 million euros to more than 40 million euros, as shown in the figure below.

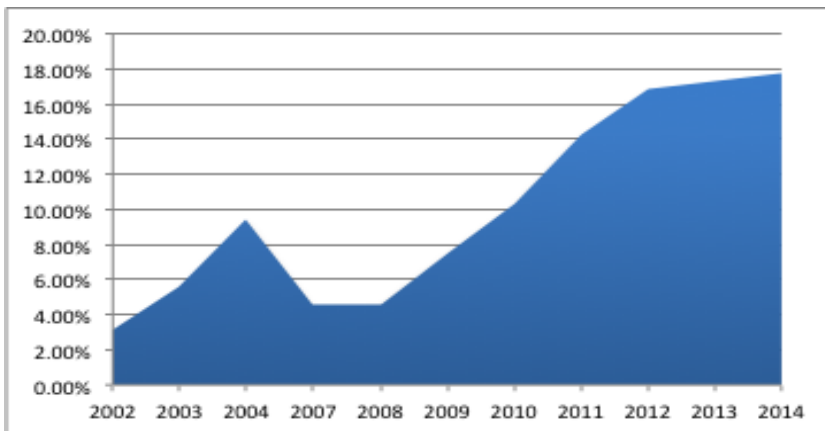
Chart 17: Revenues from the real estate tax (€) – all municipalities



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

The share in the structure also grew during the period under observation, but it is evident that the real estate tax was always among the most important revenues of the Montenegrin municipal budgets. Namely, revenues from the real estate tax on average made up 19.74% of own-source revenues and 10.11% of total local government revenues.

Chart 18: Share of revenues from the real estate tax – all municipalities



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

As was shown in the previous analysis, this revenue became particularly important after the elimination of the land use charge. It seems that this revenue was the crucial fiscal instrument municipalities used to substitute revenues lost due to the elimination of the land use charges. However, considering that the average real estate tax rate is 0.26% and that the base rate may be set within the 0.1% and 1.0% range of the real estate market value, it seems that local governments have only improved collection efficiency of this tax, but not used the option to increase the tax rate. Furthermore, although tax collection has improved (from 72% in 2011 to 76% in 2012), the collection rate is still very low, especially in certain municipalities. According to the information we obtained from municipalities, inaccurate and out-dated cadastre records present another aggravating circumstance of setting and collecting the real state tax in individual cases.

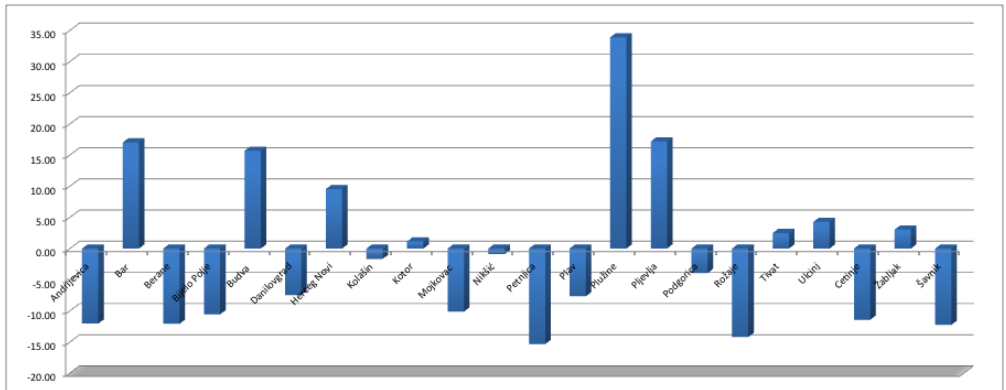
Table 6: Real estate tax collection rates and average tax rate in 2012

	% of collection	Average rate
Andrijevića	40.24	0.40
Bar	87.11	0.21
Berane	52.07	0.20
Bijelo Polje	56.49	0.26
Budva	70.24	0.21
Danilovgrad	63.69	0.29
Žabljak	64.36	0.25
Kolašin	58.36	0.24
Kotor	81.28	0.27
Mojkovac	44.75	0.19
Nikšić	83.87	0.31
Plav	38.47	0.26
Plužine	95.12	0.56
Pljevlja	139.80	0.26
Podgorica	65.40	0.28
Rožaje	38.76	0.22
Tivat	87.73	0.20
Ulcinj	57.67	0.18
H.Novi	70.87	0.21
Cetinje	113.24	0.25
Šavnik	103.38	0.25
TOTAL:	76.47	0.26

Source: Ministry of Finance of Montenegro (2013), Local Level Fiscalities Analysis

In the later part of the period under observation (2014), the average share of revenues from real estate in total revenues was 15.34%. A significantly higher share than the average was present in the municipalities of Bar, Budva, Herceg Novi, Plužine and Pljevlja. The Capital City of Podgorica had a lower share than the average with 11.42%.

Chart 19: Deviations from the average share of revenue from the real estate tax in total revenue

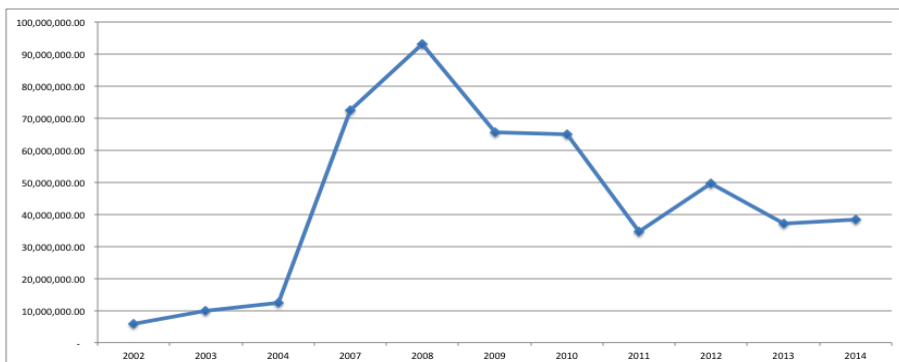


Source: Ministry of Finance, Government of Montenegro; Calculations: Author

Revenues from the Land Development Charge

Revenue from the land development charge is also one of the revenues that existed in the Montenegrin municipal budgets as of 2002 or at the start of the period under observation. After the elimination of the land use charge (2009), the land development charge was left as the only local government revenue from construction land. During the period in question, no legislative changes that could potentially affect these municipal revenues were effectuated. Thus, the tendencies of revenues from the land development charge were impacted solely by economic activity and the demand for land.

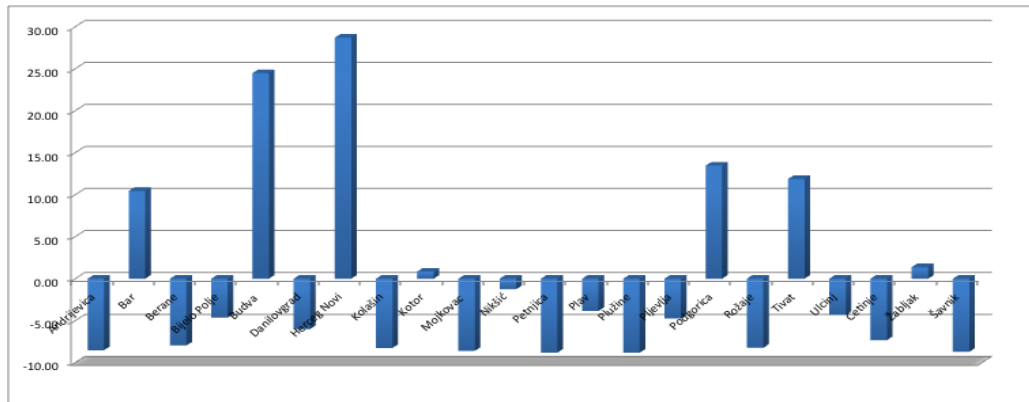
Chart 20: Revenues from the land development charge (€)



Source: Ministry of Finance, Government of Montenegro;

As shown in the previous figure, in 2002, revenues from this charge were below 10 million euros and reached their peak of around 90 million euros in 2008. At the end of 2014, revenues from this source amounted to 39 million euros. The share in the structure changed from 36.3% in 2002 to 48.3% in 2007 and 31.4% in 2014. In 2014, the average share from this revenue was 8.8%, and the municipalities that recorded higher than average shares are Bar, Budva, Herceg Novi, Podgorica and Tivat. These municipalities were interesting for new construction due to their attractive location on the coast, or, in case of the Capital City, because it is the administrative centre.

Chart 21: Deviations from average share of revenues from the land development charge in total revenue (in %)



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

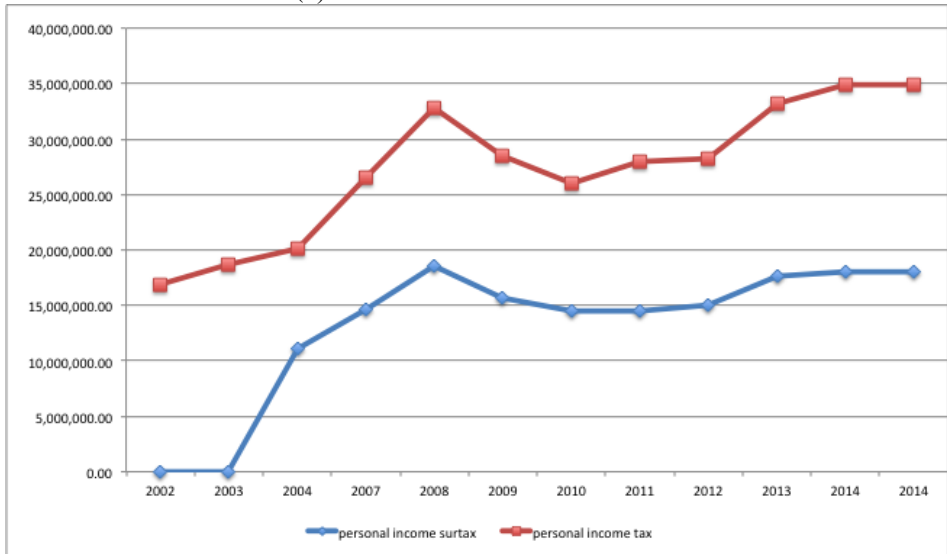
Revenues from the Personal Income Surtax and Personal Income Tax

Municipalities generate own-source revenues from the personal income surtax as per the Law on Local Government Financing adopted in 2003. According to this law, municipalities are allowed to impose a personal income surtax at the rate of up to 13% in municipalities, while the Capital City and the Capital may impose a rate of 15%.

Revenue from the personal income tax is shared revenue. The Law on Personal Income Tax set the tax rate, while the Law on Local Government Financing determined the percentage to be shared with municipalities. During the period under observation, the Law on Personal Income Tax (adopted in 2001) was amended twice: in 2004, when the tax rates were reduced to 0%, 15%, 19% and 23%, and in 2007, when a single 17% tax rate was introduced, which was then reduced to 12% in 2009 and 9% in 2010. In line with the amendments to the Law on Local Government Financing adopted in 2010, municipalities receive 12% of revenues from the personal income tax (PIT) generated

on their territories. Also, the Law on Local Government Financing defines that Cetinje receives 16% of the PIT revenue generated on its territory, while Podgorica receives 13% of the PIT revenue generated on its territory.

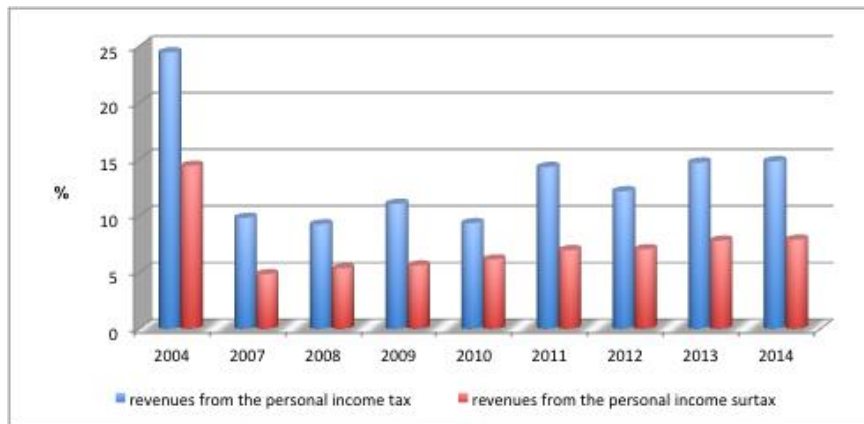
Chart 22: Revenues from the personal income tax and revenues from the personal income surtax (€)



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

As shown in the figure above, both revenues grew from 2004, and they were particularly impacted by the economic growth in 2007 and 2008. However, after the period of decline, revenues from the personal income surtax in 2014 once again reached the level from 2008, while the 2008 level of revenues from the personal income tax was even surpassed.

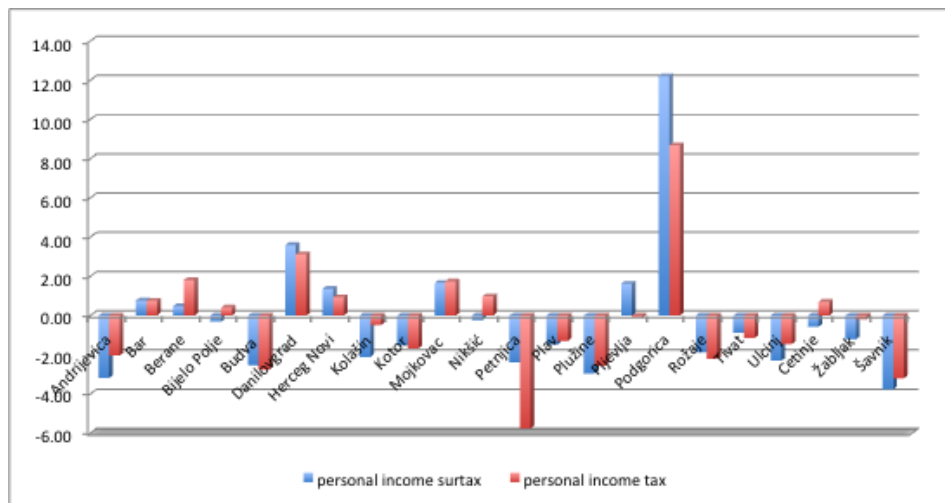
Chart 23: Share of revenues from the personal income tax and revenues from the personal income surtax in total revenues



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

The share in revenue structure from the personal income tax dropped by 10 percentage points in 10 years, from around 24% in 2004 to 14% in 2014. Revenue from the personal income surtax also decreased, from 14% in 2004 to 8% in 2014.

Chart 24: Deviations from the average share of revenues from the personal income surtax and personal income tax in total revenues



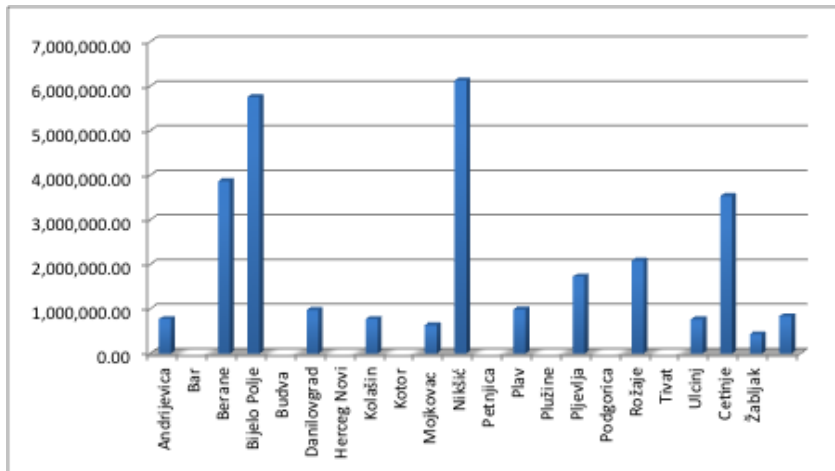
Source: Ministry of Finance, Government of Montenegro; Calculations: Author

In 2014, the average share of analysed revenue was 5.6% and 5.7%, respectively. As clearly shown in the figure above, the Capital City of Podgorica significantly deviates from the average with a share of 17.8% of the personal income surtax and 14.4% of the personal income tax.

Equalisation Fund

Revenue from the equalisation fund is used to equalise municipal financing. Municipalities with an average fiscal capacity per capita below the average capacity of all municipalities in the previous three years are entitled to use funds available in the equalisation fund. Funds are allocated during the year in the form of monthly advance payments, as well as after the final allocation at the end of the year, whereby 60% of revenues are allocated on the basis of fiscal capacity and the remaining 40% on the basis of budgetary needs.

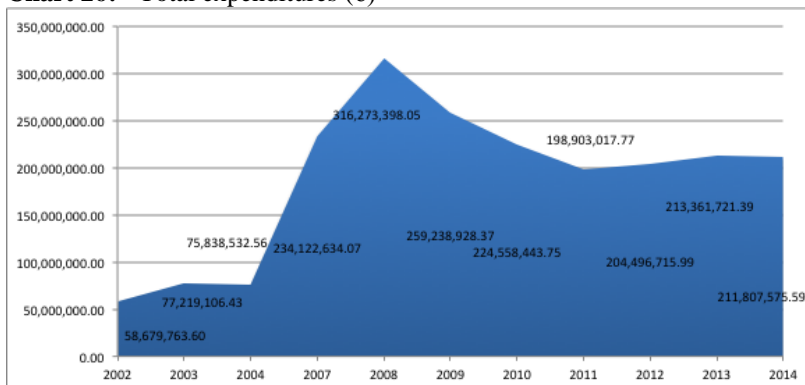
Data from 2014 show that the biggest user of the equalisation fund is the Municipality of Nikšić, which received 6 million euros from this source. The Municipalities of Bijelo Polje, Berane and the Capital of Cetinje also received significant amounts from the fund during 2014. Municipalities from the north region are obvious users of the equalisation fund, while municipalities in the south (with the exception of the Municipality of Ulcinj) receive no funds from this source.

Chart 25: Revenue from the equalisation fund in 2014 (€)

Source: Ministry of Finance, Government of Montenegro; Calculations: Author

3 Local Government Expenditures

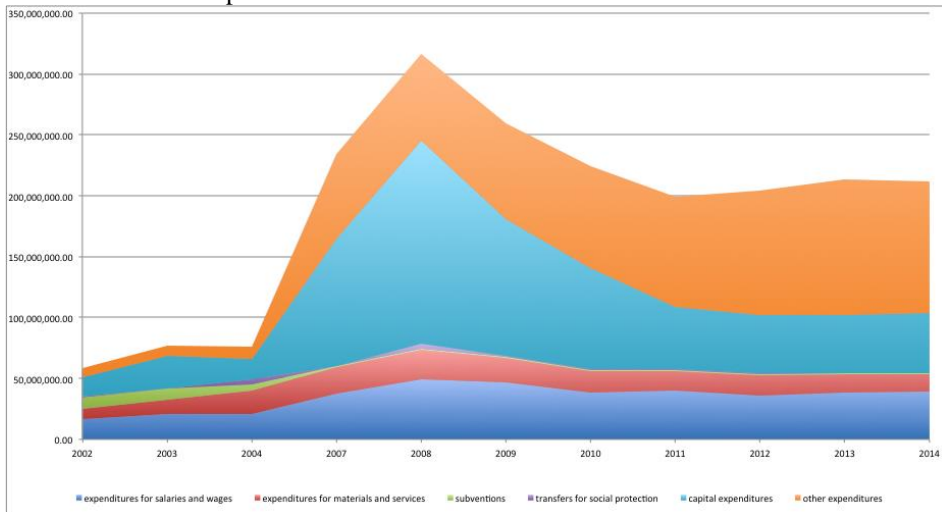
Much like revenues, total expenditures of local governments experienced strong growth until 2008, followed by a plunge of 4.4 percentage points of the GDP until 2011, and then stagnation until 2014. During the period under observation, expenditures grew from 58 million euros in 2002 to 211 million euros at the end of 2014. Local government expenditures reached their highest level in 2008, which amounted to 316.3 million euros or 515.5 million euros per capita.

Chart 26: Total expenditures (€)

Source: Ministry of Finance, Government of Montenegro

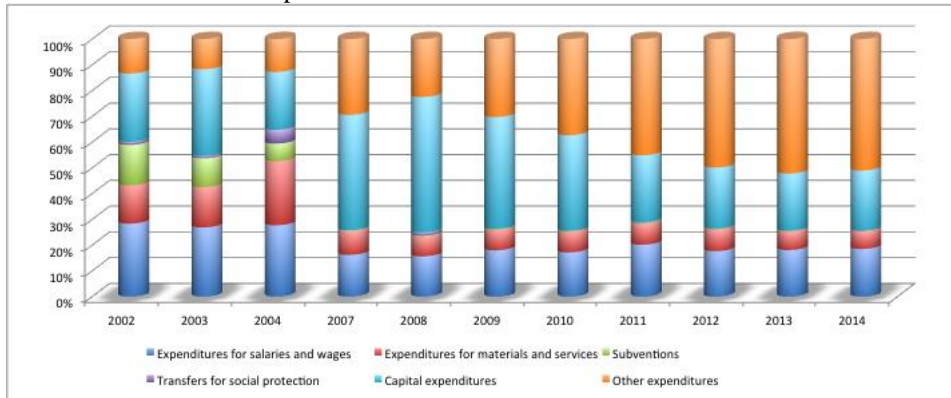
The structure of total local government expenditures experienced significant changes during the period under observation. Current expenses, which made up around 30% of total expenditures during the period in question, had a constant share in total local government expenditures. Capital expenses, which made up approximately 45% of total expenditures before the crisis, were reduced by approximately half and reached 23% of total expenditures in 2014. Social welfare related transfers are not a major expenditure item for local governments, while the share of transfers to institutions, individuals, NGOs and the public sector grew from 11.4% to 15% of the total revenue. What is evident is that the “other expenditures” category decreased steadily during the period under observation by way of increasing credits and loans and servicing debts from the previous period.

Chart 27: Total expenditure structure



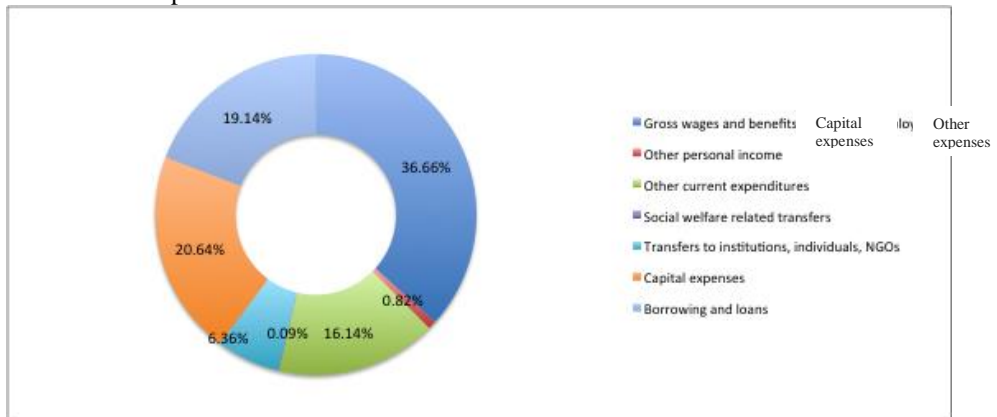
Source: Ministry of Finance, Government of Montenegro; Calculations: Author

The most important expenditure item in current expenditures is gross wages, making up 57% of current expenditures or 18% of total expenditures of all local governments in 2014. In comparison to 2007, the share of these expenditures in total current expenditures grew by 10 percentage points. On the other hand, a consequence of the revenue drop was a 5 percentage point reduction in expenditures for other personal income, as well as an approximately 7 percentage point reduction in expenditures for materials and services.

Chart 28: Total expenditure structure

Source: Ministry of Finance, Government of Montenegro; Calculations: Author

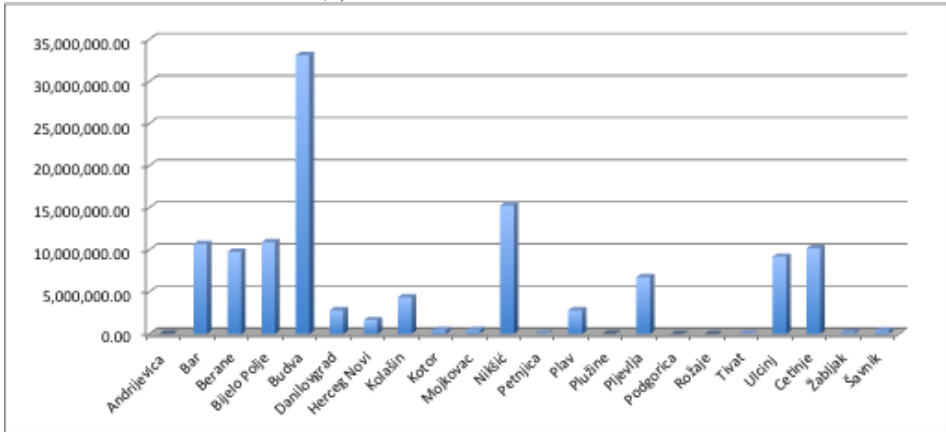
Regardless of the total expenditure structure and shares of individual categories in the total revenue, it is obvious that local governments are facing serious challenges in the form of piled up debt and unpaid bills. Outstanding bills of all municipalities at the end of 2014 amounted to 119 million euros. A major portion of unpaid bills is related to gross wages and benefits paid by the employer (around 36.6%) and capital expenses (20%).

Chart 29: Unpaid bills in 2014

Source: Ministry of Finance, Government of Montenegro; Calculations: Author

Observation shows that the Municipality of Budva is the leader in terms of unpaid bills, which amount to 34 million euros. The Municipality of Nikšić is second with 15 million euros.

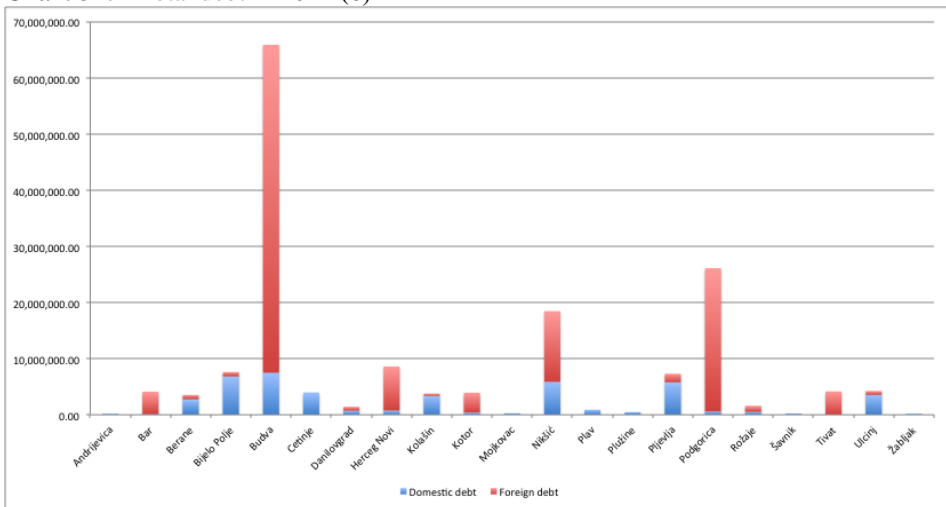
Chart 30: Arrears in 2014 (€)



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

The situation seems even more dramatic when we analyse the total municipal debt in Montenegro. Namely, total municipal debt is 166 million euros, out of which 121 million euros is foreign debt and only 44 million euros is domestic debt. The Municipality of Budva stands out from among the municipalities with a total debt of 65 million euros. The Capital City of Podgorica is indebted with 26 million euros, with almost all of the debt being owed to foreign creditors.

Chart 31: Total debt in 2014 (€)



Source: Ministry of Finance, Government of Montenegro; Calculations: Author

Analysed data indicate that Montenegrin municipalities directed their significant revenue growth completely to increasing expenditures. Municipalities also borrowed additionally to service growing liabilities. A major share of expenditures was directed to capital expenses. However, considering the fact that at the end of 2014 unpaid wages and taxes made up the biggest portion of the debt, it is clear that growing revenues were also used to increase these expenditures. However, this is not visible in the aggregate data.

4 Conclusion

Through the analysis of legislative solutions related to individual local government revenues and their effects on local government budgets, we can conclude the following:

- The 2003 Law on Local Government Financing changed the structure of local government financing sources swiftly and significantly for the benefit of own-source revenues;
- Changed sources of financing, together with economic growth up until 2008, provided for significant growth of municipal revenues. According to the available data, revenue growth was primarily directed to the growth of current and capital expenses;
- 2009 was a crucial year for local government budgets because revenues decreased significantly. The analysis indicates that the drop was mostly a consequence of a reduction in economic activity (contribution of around 55%) and legislative changes, which resulted in the elimination of revenues from the land use charge and communal fees (around 40%);
- The elimination of certain charges (for example, land use charge and local communal fees) led to a positive long-term effect in terms of eliminating existing business barriers and somewhat negative effects on budgetary revenues. This change was particularly important since this was the first time that the unwritten rule imposing that the elimination of one revenue item must be adequately substituted in the local government financing system was violated.
- The significant decrease in revenues, which municipalities faced especially as of 2009, improved municipal revenue collection efficiency of the real estate tax. This tax became one of the most important sources of local government financing.
- Amendments introduced in 2010 had no significant impact on municipal budgets. Nevertheless, they were definitely a step back in terms of the financial/fiscal decentralisation process since certain own-source revenues were eliminated, which consequently increased municipal dependence on shared revenues. This has significantly diminished political accountability at the local level, as well as local government influence in controlling local finances.
- Legislative solutions from 2010 narrowed the local government's capacity to direct revenues from the land development charge and gave the central government the authority to approve the criteria, methods, deadlines and

procedures related to the payment of this charge, thus directly influencing its legal nature.

- Although revenues generated by municipalities in 2014 were 300% higher than those generated in 2002, the current level of arrears of the local government is very high (119 million euros at the end of 2014). This problem requires the involvement of all tiers of government, local and national.
- Municipalities focus on sources of revenue that are easily collected, with only one payer. For example, the real estate tax requires significantly more effort from local authorities in setting and collecting revenue than the land development charge.
- A high level of arrears and high debt characterise the current situation of municipalities in Montenegro. This situation is primarily the consequence of the fact that municipalities increased their expenditures on the basis of revenue growth both generated and planned for the future. However, future growth did not take place due to a deceleration of economic activity.

Notes

¹ „Official Gazette of MNE,“ number 20/14

² „Official Gazette of MNE,“ number 23/14

³ Kaluđerović, J. (2002). Zbornik Radova Miločerskog Ekonomskog Foruma, Finansijska tržišta, korporativno upravljanje i koncentracija vlasništva (Business cycles. Collection of Papers from the Conference: Financial Markets, Corporate Management and Concentration of Ownership, Economic Forum in Milocer), pp. 143-155. ISBN 86907245-1-6.

⁴ The single tax rate system was introduced in 1999. The progressive taxation system was in force before that, with a 30% effective tax rate levied on gross wage.

⁵ Krsmanović, A., Vojinović, I. and Kaluđerović, J. (2006). Proporcionalni porez – akcelerator Ekonomskog Razvoja Crne Gore. ISSP Policy Analysis. Web. <http://issp.me/wp-content/uploads/2012/08/policy_paper-proporcionalna_stopa.pdf

⁶ By the Law on Local Government Financing

⁷ Kaluđerović, J. (2006). Teorijski pristup progresivnom oporezivanju. (Theoretical approaches to progressive taxation) MONET-Montenegrin Economic Trends, 87-87. ISSN: 1451-3617.

⁸ Official Gazette of MNE, no. 65/01

⁹ The tax rate was between 0.08% and 0.80% of the real estate market value

¹⁰ "Official Gazette of MNE," no. 27/06

¹¹ As indicated above, local communal fees for telecommunications, electric power transmission and the use of the seacoast for business purposes were eliminated.

¹² Institute for Strategic Studies and Prognoses, Montenegro; internal analyses.

¹³ Reduced to 12% in 2009 and 9% in 2010.

¹⁴ Official Gazette of MNE, no. 51/08, 40/10, 34/11, 40/11, 47/11, 35/13,39/13

¹⁵ As per the resolution of the Property Directorate of the MA of Nikšić UP/IO no. 01-23-U70/07 from May 24, 2007, EPCMNE was liable to pay for the land use charge to the budget of the Municipality of Nikšić a monthly amount of 485,433.93 euros, which was worth 5,825,207.16 euros in total in 2008. As per the resolution of the Secretariat of the Local Administration of the Municipality of Plužine, no.04-1774 from 09/10/2008, EPCMNE was liable to pay for the land

use charge to the budget of this municipality a monthly amount of 560,161.36 euros, as of 16/08/2008. As per the aforementioned, EPCMNE was laible to pay a total of 2,529,760.98 euros for August – December 2008.

¹⁶ Decision of the Energy Agency, number 08/379-32 OD 30/05/2008

¹⁷ For details see Part IV of this study on legal analysis of the fiscal decentralisation process and local government financing in Montenegro.

¹⁸ "Official Gazette of MNE," no. 65/01, 69/03, "Official Gazette of Montenegro," no. 75/10

¹⁹ Kmezić, S., Kaluđerović, J., Jocović, M., & Đulić, K. (2016). Fiscal decentralisation and local government financing in Montenegro from 2002 to 2015. *Lex Localis - Journal of Local Self-Government*, 14(3), p. 431-450.

²⁰ Real estate tax, games of chance and entertainment games tax, consumption tax, firm or business display tax, personal income surtax, personal income tax, real estate transfer tax and charge for the use of natural resources

²¹ Range was exetnded from 0.08% - 0.80% to 0.10% -1.00% of the real estate market value set by the municiplaities depending on the type, location, quality, date of construction and prupose of the property

²² "Official Gazette of MNE," no. 65/01

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- The World Bank Group (n.d.) *Fiscal Indicators* (Washington, DC: The World Bank), available at: <http://www1.worldbank.org/publicsector/decentralization/fiscalindicators.htm> (March 23, 2016).

Conclusions: Comparative Perspective – Similarities and Differences between the Fiscal Decentralisation Processes and Local Government Financing Systems in Serbia and Montenegro

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Abstract The final part of the book answers the fourth research question that aims at establishing basic similarities and differences between fiscal decentralisation processes in Serbia and Montenegro. The answer is provided through the prism of the first three research questions. The authors first compare *the basic features of the fiscal decentralisation processes* in two countries during the observed period. Then, the authors point out differences and similarities between *the legal frameworks on local government financing*, focusing on the quality of the current legislation on financing municipal mandates. Further, the authors compare the different phases of decentralisation in Serbia and Montenegro by presenting *the fiscal trends in municipal revenues and expenditures from 2000 to 2015*. The analyses of fiscal effects of specific legislative measures in Serbia and Montenegro show the similar pattern of re-centralisation of public finance in both countries. All aspects of the study – the policy, legal and economic analyses – show that the central governments in both Serbia and Montenegro have abandoned the idea and commitment to fiscal decentralisation after 2009, as a response to the global economic crisis.

Keywords: Serbia • Montenegro • Comparative Analysis • Fiscal Decentralisation • Local Government Finance • Centralisation • Global Economic Crisis

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This study focuses on the analysis of legal frameworks in Serbia and Montenegro on fiscal decentralisation, local government financing and intergovernmental fiscal relations, as well as on the analysis of fiscal effects that certain legal changes in this field have had on local government budgets. More specifically, this study evaluates changes and the quality of relevant regulations on local functions and finance, as well as the economic effects these regulations have had on budgetary revenues and expenditures of cities and municipalities. In addition, the study helps identify the main obstacles to the process of decentralisation in Serbia and Montenegro and points out key shortcomings in intergovernmental relations. Furthermore, the analysis sheds light on the main flaws in the existing system of financing local governments in both countries and offers specific recommendations for improving the local government finance system and enhancing the quality of managing intergovernmental fiscal relations.

In our study, we focus on the following research questions:

- What are the basic features of the fiscal decentralisation processes in Serbia and Montenegro?
- How did the legal framework for financing local government change in the period between 2000 and 2015?
- What were the fiscal effects on local government budgets resulting from legal regulation changes in the observed period?

Through the prism of the first three mentioned research questions, we will answer the final, fourth question that aims at establishing basic similarities and differences between fiscal decentralisation processes in Montenegro and Serbia. Based on our detailed legal and economic analysis, the following comparative conclusions can be drawn:

First, when it comes to basic characteristics of fiscal decentralisation processes (the first research question), both countries committed to this process at the same time, during the early 2000s, by adopting policies, that is, strategies and legal frameworks, aimed at achieving higher levels of fiscal autonomy of local government. On one hand, fiscal decentralisation came as an integral part of the “package” of the overall institutional and social transition that both countries initiated in the early 2000s, which included decentralisation as one aspect of public administration reform. On the other hand, fiscal decentralisation processes in both countries were initiated and, at least during the first years, predominantly led by the international donor community by means of various local government reform programs. This “projectisation” of public policy in the domain of local government finance resulted in both countries’ central governments failing to approach the process of decentralising functions and finance in a strategic and comprehensive way. At the very beginning, but also well into the process, what was absent was a decentralisation plan that would help central governments decide which of their mandates they wanted to delegate to the local level and that would address how they envisaged doing just that. Ideally, such a plan would contain a cost-benefit analysis

as well as arguments supporting the decentralised provision of a specific public good or service. Finally, such a plan would also include an adequate model of financing the newly delegated mandates and expenditures.

Both countries clearly display two phases or two different approaches to local government financing in the observed period. The first phase lasted from 2001 to 2008 in Serbia, and from 2003 to 2008 in Montenegro, and it predominantly featured the trend of fiscal decentralisation.¹ This period saw local governments gain a more significant role, revenues, and fiscal autonomy. However, there were important differences in terms of the scope of mandates. In Serbia, during this stage, local governments were delegated significant social functions, such as child protection (pre-school education), certain mandates from the domain of elementary and secondary education, as well as primary healthcare. The Republic of Montenegro did not decentralise these functions, meaning that local governments are not responsible for social services, although they may provide additional child protection services if they so choose. During this period, both countries completely decentralised property tax administration, delegating to local governments the right to set the base and the rate within the legally prescribed limits, as well as to administer and retain the entire revenue from the collected tax. Thus, property tax became the most significant own-source revenue of local governments in both Serbia and Montenegro. This was particularly valid in the case of the natural persons' property tax after the onset of the global economic crisis. Also, during the same period, both countries introduced new systems of transfers, aimed at making vertical and horizontal equalisation objective, depoliticised, stable, and predictable.

The second phase or approach to local government financing began in 2009 and was brought on by the economic crisis. However, the situation and measures taken in these two countries differ significantly. We may say that the period between 2009 and 2015 in Montenegro was marked by the trend of fiscal stabilisation of local finance, whereas in Serbia, it was characterised by the trend of fiscal centralisation. Namely, the policies of the Montenegrin central government after 2009 were aimed at stabilising compromised local government revenues, alleviating to some extent the effects of the fiscal crisis on local budgets, and compensating lost local government revenues. In Serbia, on the other hand, central government policies were predominantly oriented towards centralising public finance and reducing local revenues in order to redirect the assets and thus consolidate the compromised central budget. This caused progressive deterioration of the financial situation in local governments between 2009 and 2015. Therefore, the period from 2000 to 2008 in Serbia may be characterised as a period of fiscal decentralisation, while the period that ensued after 2009 centred on reinstating fiscal centralisation by reducing the fiscal autonomy of local governments, the drastic reduction of local budget revenue (which was not only due to the economic crisis, but

also in large part the policies of the central government), and compromised financial stability of cities and municipalities.

As a result of donor-funded projects aimed at regulatory reform, reducing administrative procedures and costs for businesses, as well as improving the business climate, the central governments in both countries abolished and/or reduced various fiscal impositions, particularly local ones, in order to reduce the tax and non-tax burden on businesses. These measures not only reduced local government budget revenue, but they also compromised municipal fiscal autonomy, since own-source revenues of local governments comprised the better part of the abolished fees, charges, and taxes. However, the aforementioned measures were introduced at a different time in Serbia and Montenegro, under different external circumstances, and they therefore had different consequences. The central government in Montenegro abolished certain municipal own-source revenues, which led to diminished fiscal autonomy, but it did so in two waves, in 2006 and in 2008, before the onset of the crisis, when local budget revenues were still experiencing significant growth. At that time, the Montenegrin central government abolished local communal fees imposed on the most profitable activities (telecommunications, electricity-related industries, and the use of the coastal zone for business purposes),² as well as the land use charge. This leads to the conclusion that fiscal policy reform was approached from the perspective of the needs of investors and businesses, and not from the perspective of local governments and their need to provide sufficient resources for the delivery of local public services. The authors of the study believe that reducing the fiscal burden on businesses by reducing local government revenues was a step towards deterioration, instead of improvement of the business climate. Municipal revenues dropped drastically, and the central government did not provide any sort of compensation or offer alternative sources of revenue to local governments, which resulted in lower quality of local public services. Once it became obvious that such measures compromised financing local government mandates, the central government reacted relatively promptly by amending the law in order to stabilise local finance.³ Revenues were then stabilised, albeit not by increasing municipal own-source revenues, but by increasing revenues that the Republic shares with local governments (“shared” revenues). Thus, this move still lowered local government fiscal autonomy. In Serbia, the central government abolished and/or capped local fees and charges in the period after the onset of the crisis, when municipal budget revenues had already been drastically diminished; however, it simultaneously increased taxes that comprised central budget revenue.⁴ In that sense, the real fiscal burden on businesses was not reduced. The trend of reducing and abolishing local revenues (both own-source local revenues and transfers and revenues that the Republic shares with local governments) began in 2009 in Serbia and continued throughout the observed period, until 2015. During those six years alone, the legal framework on local government

financing was changed more than 10 times, and all municipal revenues were abolished and reduced without the provision of adequate compensation.

When it comes to the institutional aspects of fiscal decentralisation, our study focuses primarily on the roles of various stakeholders and authorities in the process and manner in which intergovernmental cooperation took place. The analysis shows that in comparison to the legal framework in Serbia, the legal framework in Montenegro pays considerably more attention to the local governments' role in the legislative processes and policymaking.⁵ Nevertheless, regardless of the solid legal solutions in this field, Montenegrin municipalities pointed to the fact that the central government often fails to consult local governments regarding drafts and propositions of regulations, or that it fails to do so in a timely manner, as foreseen by the law.⁶ In Serbia, on the other hand, there is a clear absence of both horizontal cooperation between various central authorities and vertical intergovernmental cooperation in the process of delegating new and changing existing functions and revenue sources for financing local government. The entire process of functional and fiscal decentralisation in Serbia is characterised by a non-systematic approach, given that the central government adopts and introduces measures and policies in an ad hoc manner, without ex ante or ex post financial analyses, without adequate financial data – given that databases are either non-existent or inadequate – and without consulting local governments. Namely, what causes concern is the utter lack of political awareness within the central level of government regarding the significance and the role of local governments in providing public services, as well as regarding the effects that central government measures have on local budgets and, in turn, on the entire public finance system of the country. Finally, the total absence, inadequacy, and/or lack of transparency of fiscal data on budget revenues and expenditures in Serbia present a major obstacle for both scientific and expert analyses of local public finance and control of the system by interested public authorities and, generally speaking, by the public and taxpayers.⁷

The second research question focuses on the analysis of changes in the legal framework on local government financing in the period 2000-2015. Both countries tried to cover the issue of local government financing within one single comprehensive law. In Montenegro, the Law on Local Government Finance (LLGF) was adopted in 2003, whereas in Serbia this law was adopted in 2006. The analysis highlights the brief period of validity of legislation in both countries. In Montenegro, changes in the system of municipal financing were introduced only three years after the adoption of the LLGF, when communal fees for the most profitable business activities were abolished. The next set of changes ensued in 2008, with the abolition of the construction land use charge. These changes significantly diminished local government revenues, since the central government failed to compensate the abolished revenue sources with other funds, while keeping municipalities' mandates at the same level. In 2010, the Republic

of Montenegro adopted the amendments to the Law on Local Government Finance, introducing great changes in all three groups of local revenue (i.e. in own-source revenues of local governments, in revenues shared by the Republic, as well as in the equalisation fund) in order to stabilise local finance. In Serbia, on the other hand, the LLGF was in force for only two years. As early as 2009, the Government of the Republic of Serbia suspended implementation of certain provisions of this law by reducing non-earmarked transfers drastically, thus breaching the existing grant allocation formula without introducing a new one to replace it. This suspension lasted three years and it initiated a series of ad hoc changes in the way cities and municipalities were financed. In the period between 2009 and 2015, the Serbian system of local government financing underwent more than 10 considerable alterations, almost all of which included the abolition or limitation of local revenues and, in turn, the reduction of their budgets without any kind of compensation or alternative sources of revenues. In addition to being frequent and, for the most part, unannounced, these changes were often introduced in the middle of the budgetary year. Such legal unpredictability and insecurity jeopardised local governments' financial stability, while also disrupting financial planning and management, the budget cycle, public procurement processes, capital investments, etc. Even though the goal of the Law of Local Government Finance was to regulate the matter of local government finance in a systematic and comprehensive way, the aforementioned ad hoc changes to the legal framework led to a situation where, at the moment, a myriad of laws and bylaws partially regulate different local government revenue sources. In addition, during the same period, between 2009 and 2015, local governments in Serbia received new mandates – and some of these functions are financially very demanding (e.g. in the area of primary healthcare) – as well as additional expenditures within already transferred mandates. As a rule, the Republic delegated these new expenditures to the local level without providing municipalities with funds or adequate revenue sources. The problem is further aggravated by the fact that more than 50 laws and a plethora of bylaws regulate local government functions. The ministries and other central government authorities in charge of preparing legislation relevant for local governments should coordinate their legislative activities with the Ministry of Finance and with municipalities. Otherwise, the consequence could be further vertical imbalance between local revenues and expenditures.

It is also interesting to note that certain laws in both countries allow local governments to introduce certain types of non-tax revenues (e.g. communal and other charges),⁸ but their provisions prescribe that the methodology for the calculation of these revenues shall be regulated by central government bylaws. In practice, though, central governments have failed to adopt the necessary regulations, thus preventing local governments from exercising their right to impose and collect revenues to which they are legally entitled.

Our study contains a detailed analysis of all individual revenue sources within each category of local government revenues and offers specific recommendations to improve the systems of local government financing. It is obvious that the central governments in both Serbia and Montenegro significantly reduced the local governments' fiscal autonomy, particularly so in the period after the onset of the crisis, by abolishing certain municipal own-source revenues or by capping them in order to decrease the fiscal burden on businesses. One may say that, in terms of own-source revenue, the local governments' manoeuvring space for autonomous fiscal policy has been reduced to management and administration of the natural persons' property tax. Generally speaking, the system of financing cities and municipalities in both countries does indeed rely primarily on this tax form. Keeping in mind the current intergovernmental division of functions in Serbia, the existing local government financing system cannot provide sufficient funds to cover all local government mandates prescribed by law. It is necessary to establish a new system of own-source revenues – one that would include other forms of tax in addition to the property tax – as well as a new system of municipal fees and charges. In Serbia, the revenue sharing system also requires serious changes, given that the existing system, where 80% of revenue generated by the income tax is given to local government, is fiscally unsustainable. Finally, the third group of local government revenues in Serbia – the transfer (grant) system – requires an overhaul. The current model is not transparent and predictable, the transfer calculation formula is not based on adequate, objective, and transparent criteria, while the entire method of grant allocation (particularly earmarked grants) is seriously politicised. In Montenegro, the transfer (grant) system is rather simple, transparent, and predictable. It is structured as an equalisation fund formed by various revenue sources, but municipalities can in no way influence administration and collection of these revenues (e.g. the personal income tax is one of the fund's major sources, but municipalities have no formal instruments to curb informal economy and improve personal income tax collection).

Third, when it comes to fiscal effects of the legislative changes on local government budgets, it is important to once again review the two distinct phases that occurred within the observed period between 2000 and 2015. The first one, which stretches from 2000 to 2008, is characterised by fiscal decentralisation, strengthened local government fiscal autonomy, a drastic increase in municipal budgets, and overall economic growth in both countries. In Montenegro, in the period between 2002 and 2008, local government budgets increased nearly seven-fold. In Serbia, the budget of the capital city of Belgrade grew more than 1000% in the same period.

The second phase began simultaneously with the onset of the economic crisis. As early as late 2008 and early 2009, the effects of the measures taken by the Montenegrin central government in 2006 and 2008 became visible in local government budgets. Namely, the abolition of certain communal fees for the most profitable business

activities and the construction land use charge on one hand, and the drastic drop in the GDP rate on the other, led to a substantial decrease in local government revenue in the period between 2008 and 2011 (from approximately 350 million to around 210 million euros). The abolition of the aforementioned municipal sources of revenue without adequate compensation from alternative sources of revenue, coupled with the effects of the economic crisis and other inefficiencies in managing local public finance, caused long-term financial problems that local governments continue to face in Montenegro. It is in this period that municipalities began their practice of failing to meet their obligations towards their creditors and increasing indebtedness. As has already been mentioned, the ramifications of the 2006 and 2008 changes in legislation were an admonition to the central government, which then initiated further changes to the Law on Local Government Finance in 2010 in order to stabilise the financial situation in the municipalities. Even though local revenues were somewhat stabilised, the problem of unpaid loans remained unsolved. By the end of 2014, total outstanding bills and arrears of Montenegrin local governments passed 119 million euros, which made up more than 70% of the total municipal debt (167 million euros). In Serbia, the financial situation has evolved to an even more dramatic state since 2009. Both the Republic and local governments felt the first fiscal effects of the crisis and the considerable drop in the GDP as early as late 2008. Aiming at national budget consolidation, the central government breached the Law on Local Government Finance by significantly reducing municipal transfers. After that, the method of financing cities and municipalities underwent as many as 11 major changes between 2009 and 2015. These changes were characterised by the continuous abolition and reduction of local revenue sources without adequate compensation or provision of alternative sources of funding, which all eventually resulted in a drastic decrease in local budget revenue. Simultaneously, the constant delegation of new functions and expenditures without the transfer of the necessary sources of revenues led to vertical imbalance in municipal budgets. A lack of synchronisation between processes of functional and financial decentralisation and an utterly unpredictable and ad hoc central government policy in the domain of local government finance resulted in a series of detrimental consequences. Serbian municipalities frequently face problems pertaining to liquidity, accumulated arrears and outstanding bills, diminished borrowing capacity, and inability to plan long-term fiscal and development policies. Due to the continued reduction of revenues and the pressure to increase current expenditures, local capital investment budgets decreased drastically, whereas the provision of local public services (such as primary healthcare) and local economic development have been heavily jeopardised. The budget of the City of Belgrade, the largest and wealthiest local government in Serbia, and one with the highest economic activity rate, dropped by almost 25% in the period between 2010 and 2014 alone. Total budget revenues of the City of Belgrade were reduced by some 30% in 2014, compared to 2006, when the Law on Local Government Finance was adopted to strengthen fiscal autonomy and increase local government revenues. When it comes

to the aggregate data for the whole of Serbia, the share of local government revenue and expenditure in the GDP reached 7.1% at the peak of the fiscal decentralisation process. After the central government's aforementioned centralistic measures in 2015, the share of local government revenues dropped to 5.6% of the GDP, while the share of expenditures dropped to 5.7% of the GDP.

Our study suggests that both countries face a metaproblem - a lack of political awareness at the central level of government regarding the role of local governments in providing public services, the potential advantages of functional and financial decentralisation, and the effects that central government policies and measures have on municipal budgets and operations. Due to this profound lack of understanding, the commitment to fiscal decentralisation in both countries was compromised at the first test brought on by the financial crisis of 2008.

The reviewed literature suggests that, when adequately regulated, fiscal decentralisation ensures optimal conditions for macroeconomic stability, allocation of resources, and economic growth and development. However, if these preconditions are not fulfilled, fiscal decentralisation may disrupt macroeconomic stability. This is, at the same time, one of the most important theoretical arguments in favour of fiscal centralisation. It seems that similar argumentation was used as a rationale for some of the central governments' policies in the period between 2009 and 2015. The experience of many countries, particularly of developing ones, confirms that subnational authorities might contribute to aggravating macroeconomic problems by spending more money than they are able to collect through taxes. However, when decentralisation is based on precise and comprehensive rules that clearly list local competences, the resources available for their implementation, and the rules relating to hard budget constraints, then dangers to macroeconomic stability are kept in check.⁹

The second key argument in favour of fiscal centralisation claims that fiscal decentralisation can lead to reduced efficiency of public service provision and allocation of resources due to externalities and insufficient economies of scale. It is true that numerous "local" public services tend to have a spillover effect on neighbouring jurisdictions, either positive or negative. However, the central authorities: 1) may internalise negative effects of spillovers by special regulations and taxes and 2) may allocate additional grants to local jurisdictions in cases of positive externalities. In addition, local authorities may introduce special fees for public services for non-residents and internalise benefits this way. The second part of this argument points out that some public functions require large economies of scale, and the question is whether it would be cost effective for local governments to provide them. Again, such cases may be regulated by the central authorities, which can define clear criteria for the introduction and provision of a particular public service.¹⁰

The third important argument for fiscal centralisation concerns equality because decentralised public service provision may produce an imbalance in service provision to citizens of one and the same country. The advantage of centralisation is that it enables the same treatment for all persons and legal entities in the country, asking them to pay the same levies and providing them similar services regardless of their residence or business seat (a rich or a poor community, an urban centre or a suburb or a village).¹¹ This means that central authorities either provide local services by themselves or have a large impact on how these services are provided. However, the question is whether citizens really receive the same treatment.¹²

On the other hand, both theoretical studies and experiences of more developed countries have shown several serious arguments in favour of fiscal decentralisation: (1) it improves political accountability and responsibility of local governments;¹³ (2) it is a good mechanism for the consolidation of democracy and political stability, because it provides higher political participation of citizens in the government at the lowest, grassroots level and better protection of citizens' rights;¹⁴ (3) it can help local governments provide services that are better adapted to needs of their citizens;¹⁵ (4) it is considered to increase efficiency and improve the competitiveness of local governments, if there are mechanisms that prevent its destructive form ("race to the bottom");¹⁶ (5) it increases effectiveness due to increased innovation and experimentation;¹⁷ (6) it makes local authorities better at mobilising the local tax base and more efficient in collecting some important public revenues (e.g. the property tax);¹⁸ and 7) if designed properly, it leads to better allocation of resources, thus boosting local economic development.¹⁹

To conclude, all of the stated arguments for centralisation stem from the fear of the loss of macroeconomic or financial control, from insufficient willingness to regulate the system properly, and from the absence of commitment to invest in the capacities of local government authorities. When fiscal decentralisation is based on predictable, stable, and strict rules on local taxation and spending, the use of transfers (grants) and bail-out rules, local government borrowing and hard budget constraints, the problems of macroeconomic and financial instability can be avoided or alleviated.²⁰ The arguments in favour of fiscal decentralisation seem to be much more convincing and, thus, should be internalised by political and governing elites in both countries. However, our study shows that neither Montenegro nor Serbia can now benefit from fiscal decentralisation because of the current low-quality fiscal policy and legal framework. If the countries want to reap the benefits of fiscal decentralisation, their central governments have to be strategically and practically committed to a stable, predictable, transparent, and optimal system of local government financing.

Notes

¹ During this phase, the Republic of Serbia adopted the Public Administration Reform Strategy (2004), two of the most important local government laws – the Law on Local Self-Government (2002 and 2007) and the Law on Local Government Finance (2006), as well as the current Constitution of the Republic of Serbia (2006). The Republic of Montenegro adopted the Public Administrative Reform Strategy 2002-2009 in 2002, followed by the Law on Local Self-Government (2003), and the Law on Local Government Finance (2003).

² The Law on Local Communal Fees (2006) and the Law on Spatial Planning and Development (2008).

³ The Law on Amendments and Addenda to the Law on Local Government Finance (2010).

⁴ Even though Serbia changed the formula for distributing the income tax to the advantage of local governments in 2011, this measure initiated a series of ad hoc changes to laws that resulted in total instability of the local government finance system. Some of these changes include: abolishing ten charges the Republic used to share with local governments; abolishing and limiting a number of own-source local revenues – abolishing seven communal fees and capping three of the most significant communal fees; stripping local governments of the tax on revenue generated by the real estate rental income tax; abolishing the construction land use charge; changing the regime of the construction land development charge; as well as reducing transfers from the central level in order to decrease expenditures of the Republic. Simultaneously, the central government increased the VAT rate from 18% to 20% and increased excise rates, which are central budget revenue (amendments to the Law on the Value Added Tax (2012) and amendments to the Law on Excises (2012)).

⁵ See the Montenegrin Law on Local Self-Government (2003) and the Serbian Law on Local Self-Government (2007).

⁶ Interview with Žana Đukić, the Union of Municipalities of Montenegro.

⁷ The authors' insight after attempting to access information of public importance and budget data at the Treasury Administration and the Ministry of Finance of the Republic of Serbia.

⁸ For example, in Serbia, the Law on Utility Activities (2011).

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