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FISCAL DECENTRALIZATION AND LOCAL PUBLIC INVESTMENT POLICY IN THE REPUBLIC OF SERBIA

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This paper analyses the level of fiscal decentralization and structural characteristics of local public finances in Republic of Serbia with focus on local public investments. Share of central government expenditures in consolidated government spending of 83%, indicates relatively high degree of fiscal centralization. In spite of significant rise in local public revenues in the last decade public investments remained low - amounting to 1% of GDP, which is significantly below EU and Central and Eastern Europe average (1.4 and 1.5% GDP, respectively). Our results indicate large variation in relative size of public investments across LSGs. Most local public investments are focused on roads maintenance administrative infrastructure, while investments in environment and education are low. To tackle local disparities in terms of quality of local infrastructure and to foster economic convergence, development of planning and implementation capacities and introduction of systemic incentives for local public investments should be considered.

Keywords: fiscal decentralization, local self-government, public finance, local-level public investments

JEL Classification: H70, H71, H72, H74

INTRODUCTION

The territorial and political organization of the state are largely determined by the way it has been formed, its cultural heritage, as well as the socio-political and economic characteristics of society. In this regard, one of the relevant issues in the domain of fiscal federalism refers to the optimal level of distribution of functions and resources by the levels of government and the impact of fiscal decentralization intensity on the overall economic performance of the state - primarily on long-term economic growth. Except for European transition economies, the levels of decentralization are relatively stable over time, revenue collection being relatively more centralized than expenditures (Dziobek, Mangas & Kufa, 2011). Theoretical arguments in support of fiscal decentralization are based on the so-called Tiebaut's model, which suggests that the existence of more political units (e.g. local governments) allows people to relocate in order to choose the one that best reflects their preferences, in

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terms of the quality of local public goods and services, and the amount and structure of taxes (Tiebaut, 1956). Therefore, it is considered that the existence of a larger number of local governments enables the adjustment of their policies to the preferences of their inhabitants, which has a positive effect on the overall social welfare (Stigler, 1957). This would indicate that fiscal competition between local governments leads to efficient resource allocation, which positively affects overall economic efficiency (Oates, 1972). These theoretical views are supported by some empirical research, which shows that the existence of a larger number of local governments per 100 thousand inhabitants, has a positive impact on local economic development (Akai & Sakata, 2002; Stansel, 2005). On the other hand, there is also a relatively large body of empirical studies that suggests a negative link between fiscal decentralization and economic growth (Martinez-Vazkues & McNab, 2003; Bodman, 2011; Baskaran & Feld, 2013).

The results of theoretical and empirical analyses also indicate that the link between fiscal decentralization and economic growth is not linear, but rather depends on the degree of decentralization, transparency of public finance, design of incentives created by the financing system, and the efficiency of use of public resources at the sub-central levels of government (Bird, 2000). Recent empirical research indicates that one of the main reasons for the relatively slow growth of the the economy of Republic of Serbia in the past two decades (compared to the growth achieved by, for example, Asian countries when they were at the same level of development), is the low level of investment - public investment, as well as domestic private investment (Arsić, Ranđelović and Nojković, 2019). Insufficient level of consolidated government public investment is a consequence of low investments of the central as well as the local government. At the same time, in the past few years, public investments at the central level of government have increased significantly, while local public investments have remained relatively low, despite the additional decentralization of public revenues (Ranđelović, 2020). Considering relatively significant size of fiscal multipliers with public investment in emerging European economies, found in empirical studies (Petrović, Arsić & Nojković, 2021), low public investment triggers significant losses in terms of the foregone future economic growth. Therefore, in order to encourage long-term economic growth, in addition to numerous other preconditions, it is necessary to improve institutional mechanisms that would provide a relatively high level of public investment at all levels of the state, the implementation of which would be transparent and efficient.

This paper is dealing with the evaluation of the state of fiscal decentralization in Republic of Serbia, the performances of local self-government (LSG) financing system, and the characteristics of local public expenditure policy, with the focus on LSG public investment policy.

In that respect, we test two main hypotheses:

H1: Local public investment in the Republic of Serbia are low.

H2: Revenue decentralization, without introduction of systematic incentives, does not trigger automatic rise in local public investment.

The aim of these analyses is to provide well-grounded evaluation characteristics of institutional arrangement related to LSG financing in Republic of Serbia and to identify areas for improvement of LSG financing mechanisms, aimed at promoting local public investment policy and fostering local economic development. The analysis in this paper is conducted using the methods of descriptive statistics, applied to the aggregated (macro-level) data available in the Public Finance Bulletin, for the period 2010-2019[i]. Evaluation of variation in structural features of local public finance policy is done using the LSG-level data for 27 sample cities and municipalities, for which the data on budget realization were collected by the authors. Sample LSGs account for 52% of total population in Republic of Serbia, 59% of total expenditures of LSGs and 62% of total revenues of LSGs.

The remaining of the paper is structured as follows. Section 2 provides insight into the key facts on the territorial organization and fiscal decentralization in

Republic of Serbia. Section 3 discusses LSG financing instruments and performances, while section 4 is dealing with the analysis of the state, structure and dynamics of LSG public expenditure policy, with the special focus on local public investment policy. Section 5 evaluates the institutional framework and performances in terms of fiscal balance and debt of LSGs, while the section 6 concludes.

TERRITORIAL ORGANIZATION AND FISCAL DECENTRALIZATION IN REPUBLIC OF SERBIA

Republic of Serbia is organized as unitary country, with dominant central government level and sub-central government levels consisting of local self-governments and autonomous provinces. Local self-governments can take the form of municipalities (normally above 10 thousand citizens) and cities (with more than 100 thousand citizens). These limits for formation of municipalities and cities can be alleviated for economic, geographical and historical reasons, which means that municipalities and cities may be formed even if the total population is less than 10 and 100 thousand respectively. According to the Law of Territorial Organization of the Republic of Serbia (2007), the territory of Republic of Serbia consists of 145 LSGs: 117 municipalities, 27 cities and the capital city (Belgrade). In addition to that, in Republic of Serbia there are 24 districts, which are defined as administrative units, without real functions and effective budgets.

Mean population per LSG in Republic of Serbia is close to 48 thousand, which is by 37% higher than the European Union (EU) or the Western Balkans (WB) average. On the other hand, mean land area of Serbian LSG is 534km^2, which is close to the EU average and somewhat higher than the WB average (Figure 1). These data indicate that LSGs in Republic of Serbia are rather large, especially in terms of population, in comparison with the prevailing European practice.

Territorial organization may shape to some extent the fiscal decentralization of a country. Fiscal

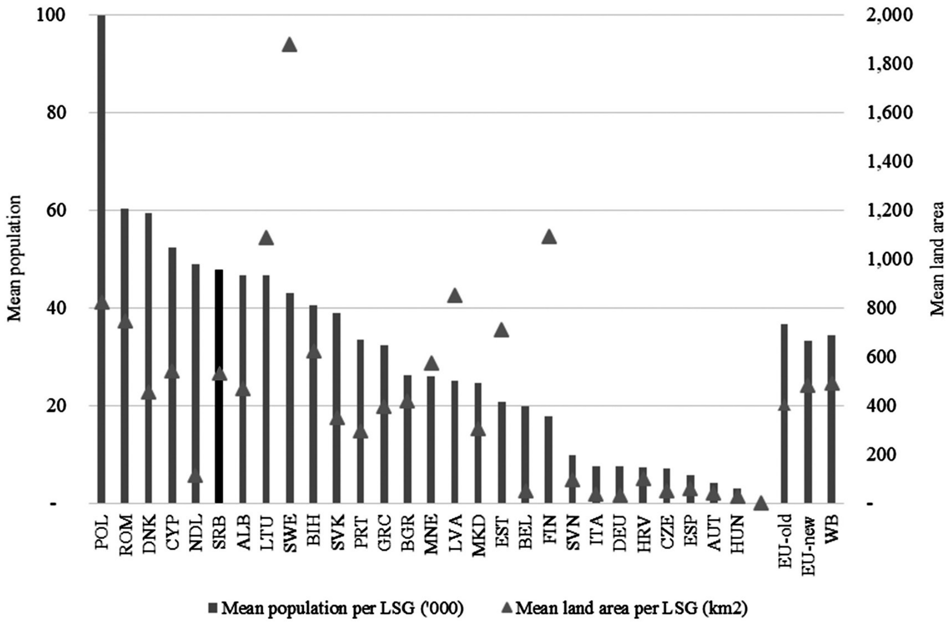

Figure 1 Mean population per LSG (‘000) and mean land area per LSG (km^2) in Europe

Source: Authors

decentralization can be measured in different ways, the coefficient of centralization - the share of central government expenditures in consolidated government expenditures, being one of the common indicators (Rosen & Gayer, 2014). Due to unitary character of the government, 83 percent of consolidated government expenditures in Republic of Serbia are attributed to central government (budget of Republic of Serbia, social security institutions, etc.), which is above the EU-27 and the Western Balkans average (Figure 2). The data presented in Figure 2 suggest stronger fiscal decentralization in developed European countries than in emerging Europe. This is in line with the findings in other empirical studies based on the more sophisticated methodology that takes into account not only the budget allocation across the levels of government, but also the effective fiscal autonomy, in terms of functions and powers (Aristovnik, 2012; Molnar, 2014).

LOCAL SELF-GOVERNMENTS' FINANCING

Institutional framework

Financing of LSGs in Republic of Serbia is regulated by the Law on Local-Government Financing. Pursuant to the article 2 of that law, there are three groups of LSG financing instruments: own-source revenues, assigned revenues and central-government grants. Own-source revenues are revenue-raising instruments that are designed, imposed and collected by a LSG, which means that LSG is relatively free to decide on its characteristics, parameters and amounts. These are: recurring property tax, local administrative and communal taxes, tourist fees, public goods usage fees, concession fees, some fines and penalties, income from rental of assets owned by LSG, self-contribution, grants, etc. Assigned revenues are instruments designed, imposed and collected by the central government and then assigned to LSGs based on the statutory criteria. There are several types

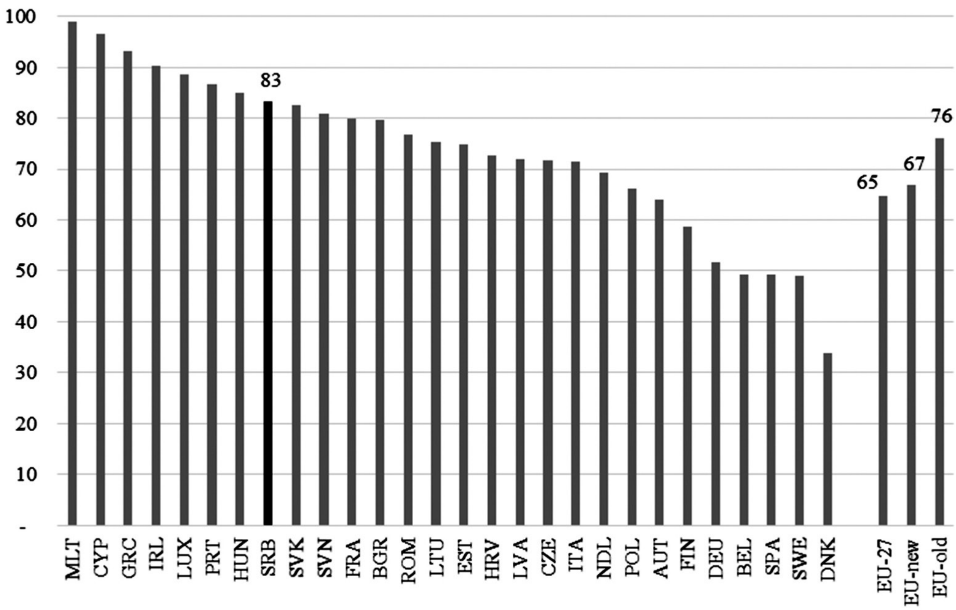

Figure 2 Coefficient of centralization in Europe in 2019 (%)

Source: Authors

of assigned revenues: 74% of wage tax revenues, full amount of other personal income taxes, inheritance and gifts tax and property transfer tax.

Central-government grants are transfers provided from the central government budget to LSGs budgets, in the form of Non-targeted or Targeted grants. Non-targeted grants are divided into: Equalization grant, General grant, Compensating grant and Solidarity grant. The total amount of Non-targeted grants is set out by the Law on Local Self-Government Financing (2006), at 1.7% of GDP. This amount is primarily used to finance Equalization grant that is aimed to assist LSGs, which underperform in terms of assigned revenues, due to underdevelopment. Equalization grant is paid to LSGs that have *per capita* assigned revenues below 90% of the average *per capita* assigned revenues in all LSGs in Republic of Serbia. Compensating grant is designed to compensate LSGs which lost revenues due to change in tax legislation, imposed by the central government. This grant should compensate LSGs for a fraction of foregone (assigned) tax revenues, so that the relative decline in the central and local governments' tax revenues is the same. General grant is provided to all LSGs. The maximum amount of the General grant is derived by subtracting Equalization and Compensating grants from the total amount of Non-targeted grants. According to the art 42 of the Law on Local Self-Government Financing (2006), there are several criteria based on which the amount of the General grant per LSG is calculated: LSG population (65% of the General grant), total land area of LSG (19.3%), number of classes in the primary schools (4.56%), number of primary schools (1.14%), number of classes in the secondary schools (2%), number of secondary schools (0.5%), number of children entitled to childcare service (6%), number of childcare institutions (1.5%). The amount of Equalization, Compensating and General grants for each LSG are corrected by the development coefficient that ranges from 0.5 to 1, in order to protect underdeveloped LSGs and to foster their economic growth. The amount of Equalization, General and Compensating grants, intended for the City of Belgrade is used to create fund for the Solidarity grant, which is disbursed to other LSGs based on their level of development.

Targeted grants can take the form of Functional and Strictly-targeted grant. Functional grant is aimed to provide funds to LSG needed to finance additional expenditures incurred by a LSG, due to shift of functions of powers from the central government to LSG. In a similar way, the central government may provide Strictly-targeted grant to LSGs, requiring from them to use that grant solely for delivery of a specific function as set out by the law. To ensure transparency of disbursement, data on Non-targeted grants provided to each LSG need to be disclosed in the Fiscal Strategy. However, in practice these data are not publically disclosed on a regular basis.

Description of the LSG financing scheme suggest that size of the LSG budget depends on its size, level of development, functions, features of public services, etc. while the efficiency of expenditure size of the budget (structure of expenditures) and local tax revenue-raising efforts have no direct impact on revenue allocation by LSGs. This means that the LSG financing scheme creates no systemic (positive) incentives in terms of (own-source) revenue raising as well as in terms of productive allocation of resources (Arsić, Ranđelović, Bućić and Vasiljević, 2012).

Revenue performances

Total revenues of LSGs in Republic of Serbia (including central government grants) in 2019, amounted to EUR 2.7 billion, which is equivalent to 5.9% of GDP. In relative terms, LSG revenues in Republic of Serbia are considerably below the EU average (9.9% of GDP). However, when benchmarked against the countries from the new EU member states from the Central and Eastern Europe (CEE), which are more comparable to Republic of Serbia, the difference is notably smaller (Figure 3). LSG revenues in Republic of Serbia account for 14% of consolidated government revenues, which is significantly below the EU-27 average (22%) and the new EU member states average (20.7%). This is the consequence of variation in territorial organization as well as vertical allocation of government functions. As a result of changes in LSG financing regulations and revenue collection efforts, the total LSG revenues in Republic of Serbia in 2019 rose by 15% in real terms, comparing to 2010, mostly due to increase in wage tax and property tax revenues, while the central government grants remained almost unchanged.

Public health crisis caused by the COVID-19 pandemic has had considerable negative impact on economic trends in the most of the world. Many countries, including Republic of Serbia reacted through massive fiscal stimuli, which included the offer to corporate sector to defer payment of taxes, which has considerably dampened pandemic recession (Ranđelović, 2021). However, the data of the Ministry of Finance show that in 2020 tax revenues of LSGs in Republic of Serbia posted mild nominal growth (while in real terms they stagnated), while the total revenues of LSG posted mild nominal decline of 2.8% (Ministry of Finance, 2020). This is, *inter alia* because large part of LSG tax revenues comes from the taxes with the stable tax base (e.g. property taxes). As government subsidies prevented massive rise in unemployment, wage tax revenues have been stable as well. At the same time, LSGs adjusted their public expenditures, which in total decline by 3.4% in comparison with 2019. Revenues from personal income tax account for 40% total LSG revenues, more than 4/5 of these revenues being related to wage taxes. The second largest financing instruments are recurrent property taxes, followed by the central government grants. These three financing instruments account for more than 70% of LSGs revenues, while the remaining part of revenues comes from inheritance and gifts tax, property transfer tax, signboard tax, other local communal and administrative taxes and fees, as well as other non-tax revenues.

Revenue structure (Figure 4) also indicates dominance of assigned revenues and grants, while the share of revenues that are parametrized and raised by the LSGs is relatively low, which to certain extent limits their autonomy. This is the consequence of the design of the public finance system, lack of incentives, and the relatively low revenue-raising efforts of LSGs.

According to municipal level data, average *per capita* revenues in the sample of 27 LSGs, amount to RSD 50,600. Distribution of *per capita* revenues across LSGs indicate relatively high inequality in terms of

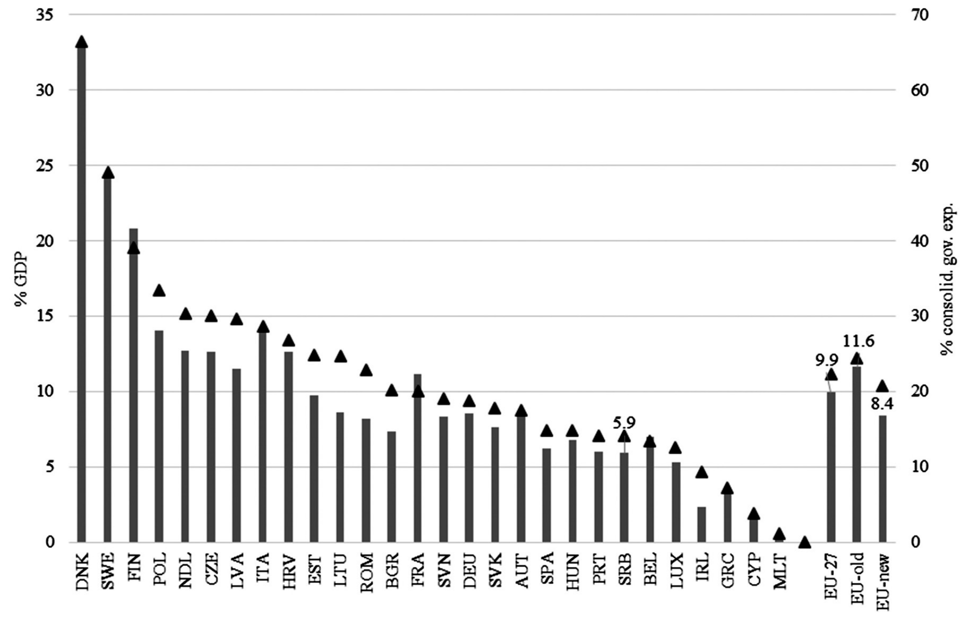

Figure 3 LSG public revenues in Republic of Serbia and Europe

Source: Authors

revenue allocation. Average coefficient of variation in the sample of 27 LSGs amount to 37 (Figure 5), which is the consequence of the design of LSG financing system and regional inequalities in terms of economic development. Inequality in revenue distribution is then translated into inequality in expenditures distribution, including inequality in local public investment (Figure 10), with adverse impact on local and regional disparities in terms of economic development.

LOCAL SELF-GOVERNMENTS' EXPENDITURE POLICY

Institutional framework

Functions and operations of LSGs in Republic of Serbia are regulated by the Law on Local Self-Government (2007). In overall terms, functions of LSGs in Republic of Serbia are similar to the roles assigned to LSGs in many other European countries:

- to make local economic development plans and facilitate doing business condition and inflow of investment;
- to provide local/communal services (e.g. waste and water management, heating, etc.), public transportation and to use construction land and business premises;
- to develop, maintain and manage local roads and other public infrastructure;
- to assist provision of services in education (pre-school, primary and secondary), primarily in terms of development and maintenance of education infrastructure (school buildings and equipment);
- to facilitate provision of services in research and innovation, culture, healthcare (maintenance and development of primary healthcare infrastructure), social protection and sports;
- to foster development of tourism, handcraft industry, trade and hospitality;

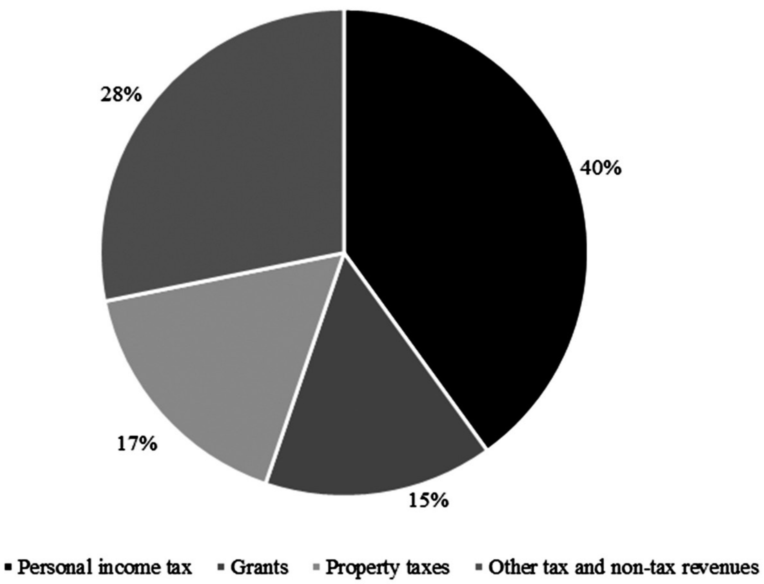

Figure 4 Composition of LSG revenues in Republic of Serbia in 2019 (%)

Source: Authors

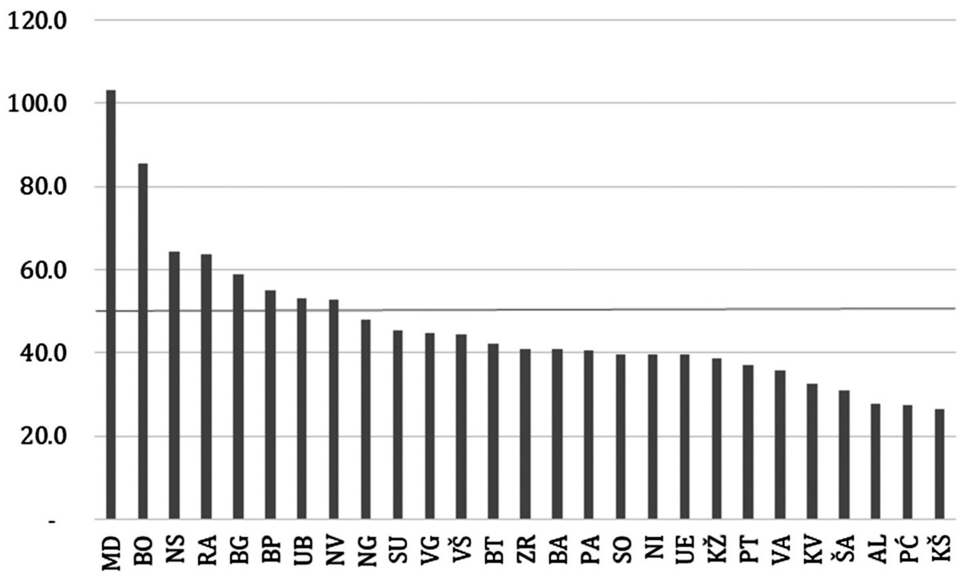

Figure 5 LSG revenues *per capita* in 2019 (RSD thousand)[ii]

Source: Authors

- to provide other services which are important for local development (construction permitting, firework protection, etc.).

Regulation and oversight of LSGs operations are done by the Government of the Republic of Republic of Serbia - Ministry of Public Administration and Local Self-Governments.

Expenditure composition and trends

The total expenditures of LSGs in Republic of Serbia in 2019, amounted to 6% of GDP, i.e. 14.1% of the consolidated government expenditures. Expenditures on goods and services represent the single largest expenditure item, with the share of 36% in the total spending, followed by other outlays - mostly related to social protection (22% of total spending) and wages (19% of total spending), while capital expenditures accounted for around one sixth of the total LSG spending (Figure 6).

Due to rise in revenues and inflation, LSG expenditures in Republic of Serbia rose in nominal terms by 71.7% from 2010 to 2019, while real growth (inflation-adjusted) amounted to 19.2% (Figure 7). This has been to large extent driven by the rise in spending on goods and services (which rose by 90% in real terms over that period). Increase in unproductive expenditures has been encouraged by buoyant inflow of revenues (due to reform of wage tax allocation in 2011), as well as by rather low level of accountability in terms of local public finance management and the fact that over that period there was a hiring freeze in the public sector, which is why many LSGs have started to outsource services that used to be provided internally.

Local public investment policy

Since 2011, capital expenditures (i.e. public investment in local infrastructure) have been on decline until 2015, in spite of inflow of additional tax revenues due to the reforms legislated in 2011 and 2014. LSG public investment started picking-up yet in 2015 and since then they are rising steadily. However, in 2019 LSG public investment amounted to approx. EUR 450 million, thus still being lower, by 13% in real terms, than in 2010. In relative terms, LSG public

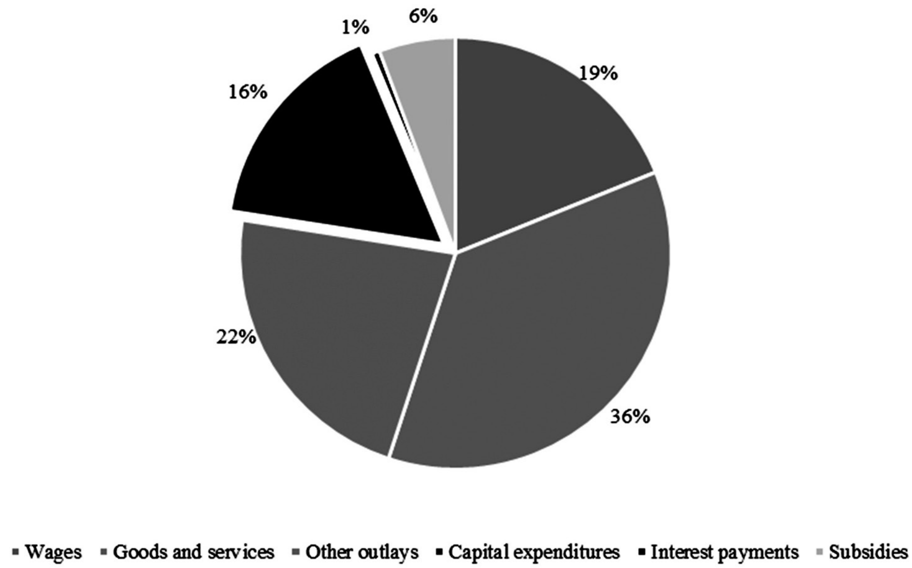

Figure 6 Composition of LSG expenditures in Republic of Serbia in 2019 (%)

Source: Authors

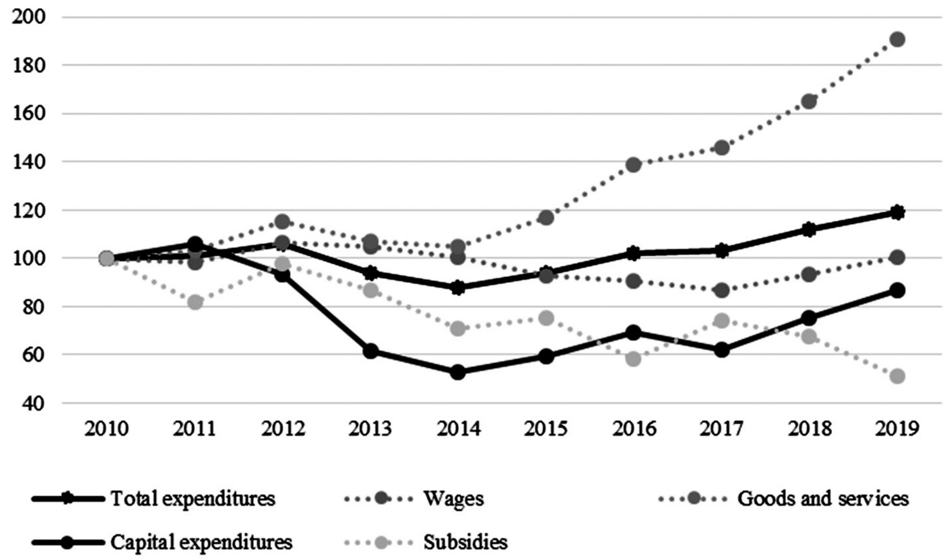

Figure 7 Index of real trends in LSG expenditures (2010=100)

Source: Authors

investment in 2019 (Figure 8) amounted to 1% of GDP, thus accounting for only one fifth of the consolidated government public investment.

Although starting from 2015 the LSG public investment have been on the rise (both in nominal and in real terms), they rose at the slower pace than the central government investment, which is why the share of LSG public investment in the consolidated government public investment was on a continuous decline since 2011. Thus in 2011, LSG public investment accounted for 40% of the total consolidated government public investment, while by 2019 that share has been halved (Figure 9).

In comparison with the other European countries, the total LSG public investment in Republic of Serbia are significantly below the EU-27 average (1.4% of GDP) and the CEE average (1.5% of GDP). New EU members from CEE tend to invest more from LSG budgets, than the developed European countries, in order to converge in terms of development of local infrastructure. Relatively low LSG public investment in Republic of Serbia in comparison with the other CEE countries may be, to some extent, explained by the lower local-level public spending. However, the data suggest that Republic of Serbia underperforms also in terms of the share of public investment in the total LSG expenditures. Low public investments of LSGs in Republic of Serbia can be explained by limited decentralization of revenues, by the weak local-level public finance policy, and lack of capacities to plan and deliver infrastructure projects.

Although it has been argued that fiscal decentralization on the revenue side is needed in order to foster local level public investment, the data (Figure 7 and 8) show that providing additional funding is not likely to result in the rise in public investment, without change in the institutional arrangement and capacities and introduction of systemic incentives. Without introduction of link between revenue allocation and the structure of LSG spending (e.g. by means of the pro-growth incentives and well-defined performance indicators), there is a risk revenue decentralization will be used to finance expenditures items that yield

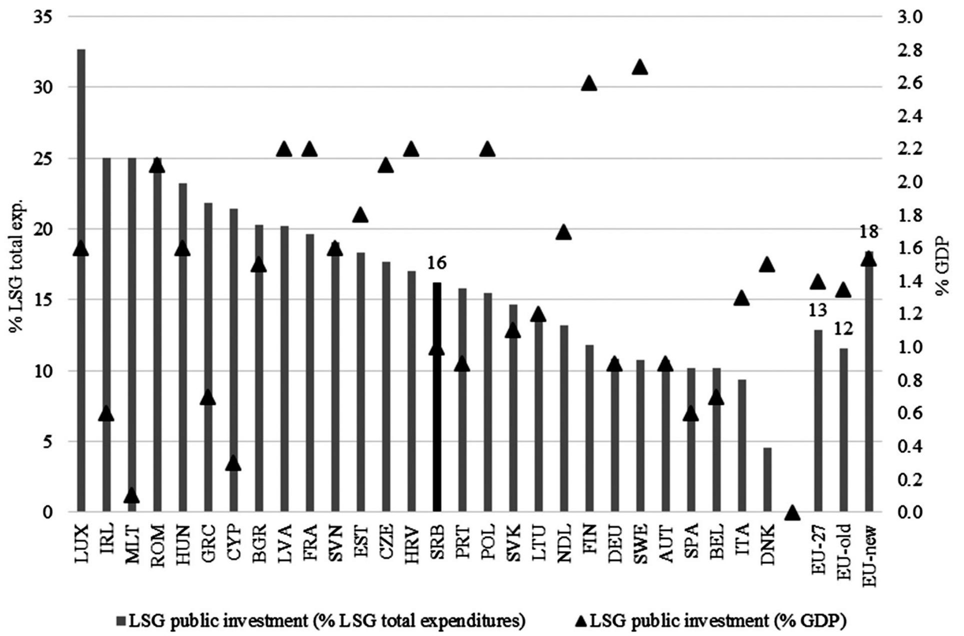

Figure 8 LSG public investment in 2019: Republic of Serbia *versus* Europe

Source: Authors

short-run political dividend, rather than focusing on development of prerequisites for the long-run growth. This is illustrated by the declining share of LSG public investment in the total expenditures of LSG - from 22% in 2010 to 16% in 2019 (Figure 9).

Analysis based on 2018 micro data for 27 sample LSGs also indicates strong variation in the relative amount of public investment across LSGs (Figure 10). The average share of public investment in the total expenditures stood at 13.7%, with the coefficient of variation equals 44.6%. Large variation in the local public investment may be caused by the lack of the systemic link between the LSG financing instruments and LSG's expenditure policy. However, the sample LSG data indicate that on average execution of public investment is lower by 20% than the amount disclosed in the projected annual budget while very close to collected revenues. This indicates that LSGs in general are systematically overestimating budgets to compensate for uncertainty in revenue collection and unforeseen efficiency in terms of project management.

Data on 27 sample LSGs also indicate that the LSG public investments are mostly focused on community development (29%)[iii] and traditional street reconstruction and maintenance (26.9%). Investments in education, culture and sports infrastructure account for close to 13%, while investments in green infrastructure (environment, waste management, water supply and water waste management) account for less than 6% of the total local governments' public investment (Figure 11). On the other hand, large chunk of public investment of LSGs (18.9%) goes to acquisition and development of the other types of infrastructure, required for provision of administrative and general services.

Considering relatively low quality of local level roads infrastructure, lack of appropriate waste management, water supply or waste water management system and low quality of air, it would be expected to see higher share of investment in these types of infrastructure, in the overall amount of capital expenditures. Presented data may suggest that it is not the case, *inter alia* due to a lack of systemic framework that would foster productive investment and potentially contribute to reconstruction and maintenance of critical infrastructure. Government of Republic of Serbia has

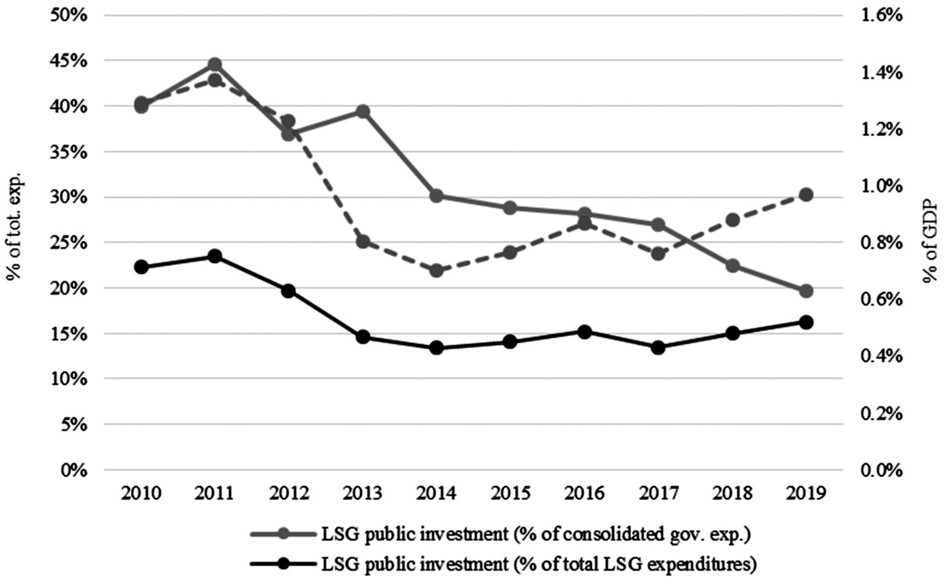

Figure 9 LSG public investment trends

Source: Authors

announced long-term public investment plan "Serbia 2025", in which investment in local infrastructure is seen as one of the priorities. Considering that it is the role of LSG to invest and maintain communal infrastructure, it may be advised to use the investment plan to introduce systemic incentives for LSGs to increase their efforts in developing and rehabilitating long neglected local infrastructure, rather than having the central government directly engaged in development of communal infrastructure. Having a clear plan and targets should revert from supply to demand driven mindset and enable LSGs to plan on medium and long term.

LOCAL SELF-GOVERNMENTS' FISCAL BALANCE

According to the Budget System Law (2009), LSG may run fiscal deficit only for the purpose of financing local public investment. Fiscal deficit of local self-government, however cannot be higher than 10% of its public revenues in the respective year. In case of implementation of large investment project, a LSG may request from the Ministry of Finance a permission to run fiscal deficit higher than this limit, while the decision of the Ministry of Finance shall depend on justification of the request and the general fiscal framework.

LSG deficit may be financed by means of lending. Art 33 of the Law on Public Debt (2005) allows LSGs to borrow money at the market, with a written consent of the Ministry of Finance. The total debt raised to fund current liquidity cannot exceed 5% of its total revenues in the last year. On the other hand, long-term borrowing is allowed only for the purpose of financing public investment project or repayment of debts, with the following limits:

- long-term debt may not exceed 50% of budget of LSG in the previous year;
- expenditures for payment of interest and repayment of debt may not exceed 15% of current revenues of LSG in the respective year.

LSGs are not allowed to issue guarantees. The LSG

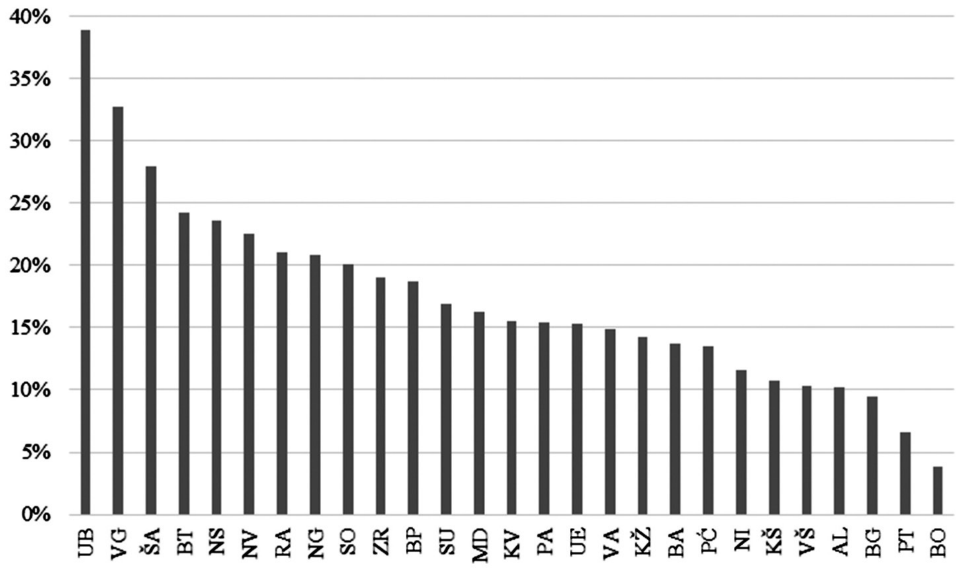

Figure 10 Share of public investment in the total local expenditures, by LSGs (%)

Source: Authors

fiscal rules set out by the Budget System Law (2009) are in line with the debt issuance provisions, provided by the Law on Public Debt (2005).

In the last decade (2020-2019) LSGs in Republic of Serbia have mostly been running fiscal surplus, while deficit has been posted only in 2012, 2013 and 2019. The average fiscal balance of LSGs in Republic of Serbia from 2010 to 2019 was close to RSD 5.5 bn (surplus), which is equivalent to 2.8% of their total revenues (Figure 12). This is considerably below the deficit ceiling (10% of public revenues), as set out by the Budget System Law (2009). Over the same timeline, the total expenditures for payment of interest and outlays related to repayment of debt in LSGs in Republic of Serbia amounted to RSD 12 bn (close to EUR 100 million) per year, which was equivalent to 5.5-6% of their revenues, thus also being far below the statutory limit (15% of revenues).

CONCLUSION

Empirical studies show that in the last two decades LSGs in Republic of Serbia posted convergence within two clusters, while Belgrade district shows no signs of convergence with any of the other clubs (Barrios et al, 2020). In spite of the club-convergence, there are still substantial local and regional disparities, which foster migrations of productive population towards more developed regions, thus undermining the convergence chances of underdeveloped areas. Results of empirical studies show that even relatively small changes in economic inequalities can have large effects on migration volumes (Denett, 2014). In this paper, we have evaluated the degree of fiscal decentralization in Republic of Serbia and features of local public finance policies, with the focus on local-level public investment policy, as strategic, green and growth oriented development of local infrastructure is one of the key reconditions for economic development.

Our results presented in this paper, imply several scientific and practical insights. First, it is concluded that LSGs in Republic of Serbia are rather sizeable, especially in terms of mean population, in comparison with the European practice. Second, the degree of fiscal decentralization in Republic of Serbia is below the European average. LSG public revenues and expenditures (relative to GDP) in Republic of Serbia

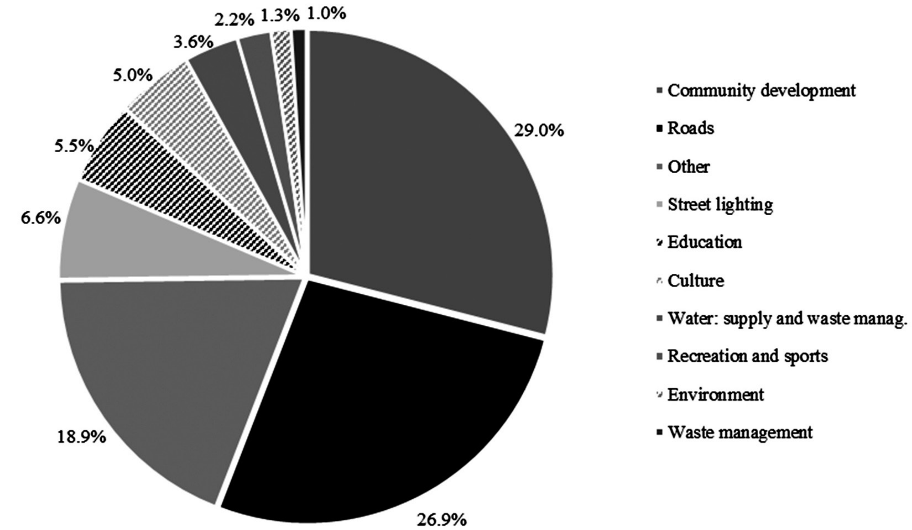

Figure 11 Structure of LSG public investment (%)

Source: Authors

are lower than the EU and CEE average. Three largest revenue raising instruments for LSGs are personal income tax, property taxes and grants from the central government, accounting for almost ¾ of the total revenues. More than half of LSG revenues are assigned or transferred by the central governments, indicating low degree of fiscal autonomy. Third, mentioned indicators show that local public investments in the Republic of Serbia have been low, while their variation across LSGS was high. Thus, on the spending side, the main items are purchase of goods and services and wages, accounting for 55% of total expenditures, while the share of public investment in total LSG outlays is yet 16% (i.e. one fifth of the consolidated government public investment). Relative size of LSG public investment in Republic of Serbia (1% of GDP) is considerably below the CEE average (1.4% of GDP). Fourth, decentralization of public revenues, implemented at the beginning of last decade has not led to rise in local public investments, which have been on decline for long time. Fifth, LSG public investment in Republic of Serbia are mostly oriented to community development and traditional streets reconstruction and maintenance, while investment in education, culture and sports infrastructure as well as in environmental infrastructure are rather low. In spite of rise in the total revenues (e.g. wage tax revenue decentralization) over the last decade, LSG public investment posted a real decline. Sixth, the fact that a significant number of LSGs had low public investments even in periods when they were running a budget surplus indicates that in addition to fiscal constraints, some of them also face limitations in terms of their capacity for planning and implementation of investment projects. The low level of local public investment and the fact that it has not increased even when revenues have risen, signal that LSGs lack mid and long term planning capacities and that institutional design of LSG financing system lacks systematic incentives for pro-growth investment local public finance policy and clear performance indicators. This is because the amount of revenues that local governments generate, as well as the grants they receive from the central government, do not depend on the quality and efficiency of their fiscal policy. Recent changes to planning legislation, requiring preparation of development plans (7 years) and mid term plans (3 years) could be an anchor to improve planning capacities provided properly prepared and monitored.

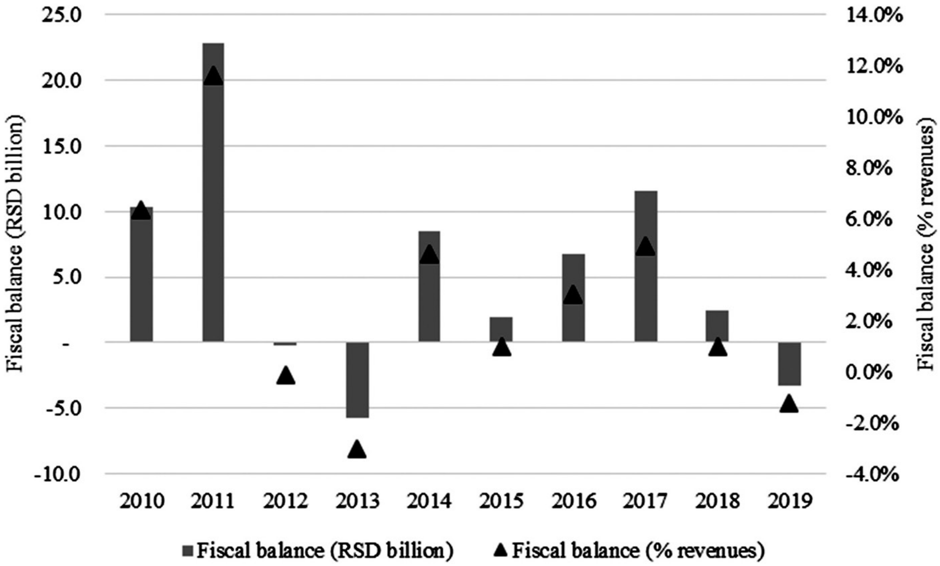

Figure 12 LSG fiscal balance dynamics, 2010-2019

Source: Authors

Lessons from comparative (international) practice suggest that for a more permanent and sustainable increase in the local growth and green oriented public investments introduction of systemic incentives can be effective. Those are the incentives that reward LSGs, which direct more of their public expenditures to productive purposes. In addition to that, systemic approach to public administration reform that would result in improvement of their administrative, technical, and planning capacities, may also contribute to enhancement of the overall efficiency of local public investment policy.

According to the above mentioned, the scientific relevance of the obtained results refers to the evaluation of the relationship between fiscal decentralization and public investment, and especially to the relationship between the dynamics of public revenues and the amount of local public investment, in the absence of systemic incentives for investment. In addition, the obtained results provide relevant insights for policy makers, since the paper, in addition to analysing the situation, identifies the causes of low local public investment, as well as key institutional barriers to their increase. The analysis in this paper is based on the methods of descriptive statistical analysis. To provide additional robust insights into the relationship between the level of fiscal decentralization and the level of local public investment, it would be necessary to apply relevant methods of econometric analysis, in order to control for the impact of other factors. In addition to the relationship between fiscal decentralization and local public investment, the issue of the impact of the level and structure of local public investment on local economic development is relevant, which may be an interesting issue for further research.

ENDNOTES

[i] As economic and fiscal trends in 2020 may have been affected by extraordinary processes caused by the COVID-19 pandemic, discussion of structural characteristics of local public finance policy based on 2020 data may be misleading, which is why the sample is restricted to the period until 2019. The data on Serbia, disclosed in this study refer to the territory of the Republic of Serbia without Kosovo and Metohija*, as according to the UN Security Council Resolution 1244 it is formally the area under administration of the UN since 1999.

[ii] Data are related to the year 2019. Data on expenditure *per capita*, per LSG, presented in the Figure 10, are related to the year 2018, which is the latest year for which expenditure data per municipality are available.

[iii] According to the official COFOG classification, Community Development includes: administration of community development affairs and services - administration of zoning laws and land-use and building regulations, planning of new communities or of rehabilitated communities, planning the improvement and development of facilities such as housing, industry, public utilities, health, education, culture, recreation, etc. for communities; preparation of schemes for financing planned developments; production and dissemination of general information, technical documentation and statistics on community development affairs and services.

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