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Serbia – A country study

Description of the Country

Serbia (official: Republic of Serbia) is a landlocked European country situated on the Balkans peninsula. After a period of a relatively strong medieval kingdom, Serbia was occupied by the Ottoman Empire in the 15th Century. In the 19th Century, Serbs fought two revolutions against the Ottomans and finally in 1878, the modern Serbian state was internationally recognized on the Berlin Congress. The period of Ottoman rule, however, left a huge mark in the country's folklore, literature, as well as the influence of local governments which preserved Serbian culture during this long and dark period (Milosavljević 2005: 52). Serbia had a big role in the First World War, in which it suffered vast casualties, after which the *first* Yugoslavia was formed. During the Second World War, Serbia was occupied and the communist *partisans* organized a resistance movement, fighting the Nazis as well as collaborators, which led to an outbreak of a civil war which lasted in parallel with the Nazi terror. In 1945, the second Yugoslavia was formed as a federal socialist state and lasted up until the outbreak of a fratricidal war in the 1990s. The third Yugoslavia was comprised of Serbia and Montenegro and it was marked by president Milosević's authoritarian rule. After the Milosević's regime was brought down in 2000, it became a democratic, parliamentarian republic. In 2006, Montenegro left the union and Serbia became an independent country. In 2008, its Southern province Kosovo unilaterally declared independence, which is still not officially recognized by the United Nations.

Population of Serbia is 7,186,862 (excl. Kosovo), most of which are Serbs (83.3%). The most common religious domination is Orthodox Christianity. Nominal GDP of Serbia in 2013 was \$42.648 billion (IMF, 2014), and is expected to grow in 2014 at rate of 1% (IMF, 2014). Economy of Serbia is service oriented, as services account for up to 60% of GDP. Its main industries are motor vehicles manufacturing, oil and natural gas, furniture and food processing. Inflation in 2013 was normal (2.2%), while deficit remained high at 4.88% of GDP as well as public debt which passed the 60% threshold (IMF 2014). One of the main problems of the Serbian economy is unemployment which is at 22%, as well as corruption, shadow economy and over-bureaucratization, accounting for the country's low ranking on the *ease of doing business* list

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(91st in the World; World Bank Group 2014). Serbia is a member state of the Council of Europe and CEFTA and an official candidate for the European Union.

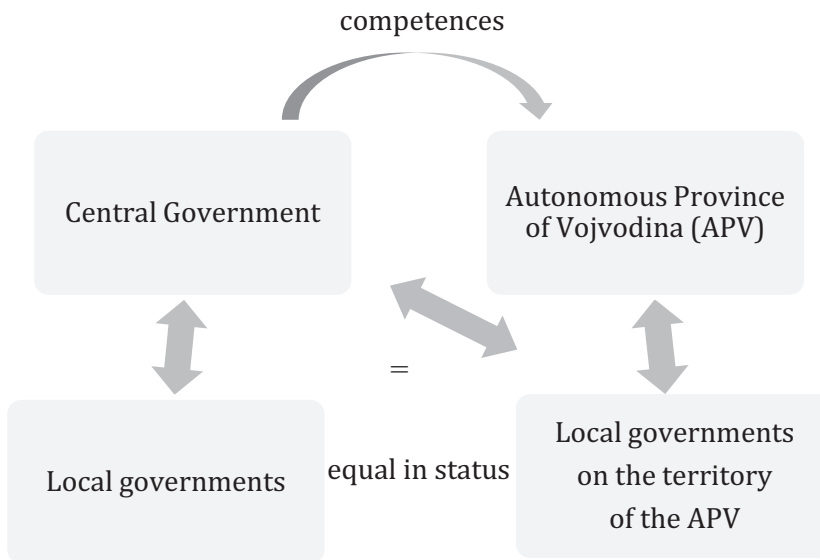
Multi-level governance in Serbia

Introduction

Serbia is a decentralized, unitary state. It has two levels of governance: the central government and local governments. The Constitution of 2006 also defines two autonomous provinces: *Vojvodina* in the north part of the country; and *Kosovo i Metohija* in the South, which is under rule of EULEX meaning that its local administration system is not under jurisdiction of the Republic of Serbia. The decentralization of the system is reflected in the number of government services being provided at the local level, as well as the level of revenues, which will be thoroughly explained in the following chapters.

There are two important reasons which can help understand why the decentralized nature of the public administration system in Serbia developed. Firstly, the current system has developed as a reaction to its opposite, fully centralised system from the 1990s. The cities and municipalities according to the 1990 Constitution, as well as the 1995 Law on State Ownership, had a very narrow scope of competences, without the ability of ownership or a decent level of revenues (Vasiljevic 2008: 183). The key year for this period is 1996, when the local elections were held, on which the democratic parties opposing Milosevic's leadership won in many local governments. This was the way in which many future leaders of the next decade had their first governance experience. After the revolution of October 2000, a democratic central government was formed, but the links with the local administrations remained and their influence rose (Ljuboja 2013: 17). Already in 2002, a new law on local self-government was enacted, passing many competences to the local level.

The second reason is less political and more logical in nature. Simply, as there is no regional level of government, many government services had to be left to the local level, such as the supply of water, electricity, promoting employment and growth at the local level, etc. Let us not be confused by the existence of the autonomous province of Vojvodina's assembly and government, as its competences reflect the national level competences in the defined areas (illustrated in *Figure 1* below). The competences given to the Autonomous Province of Vojvodina will not be a subject of this work

Figure 1: *Administrative-territorial organization of Serbia*

Blöchliger (2013: 7–12) in an OECD study finds correlation between decentralization levels and GDP per capita levels. However, the example of Serbia shows how decentralization does not necessarily bring good governance. The main problem with the multi-level governance system in Serbia is its *politicization*, understood: (1) as the high level of connection between local governments and top-level politics; (2) as the lack of meritocracy and influence of politics in hiring technocratic staff. This issue will be the *leitmotif* of the following chapters which will explain the system of multilevel governance in Serbia and its shortcomings connected with the problem of politicization.

Laws and regulations on local governments

The foundation for the present local government system was enacted in the 2006 Constitution. It introduced two important changes. The first is related to the aforementioned politicization. Namely, the 2006 Constitution regulated that the unit's president or mayor is to be chosen by the municipal assembly and not on direct elections. This gives more power to the ruling parties to exert control over the mayors and presidents, than if they were chosen by the citizens directly. Furthermore, the Constitution introduced the proportional electoral system on the local level. These solutions, among other, laid ground for the domination of political parties over the system of local governments. The fact that this policy is enshrined in the Constitution implies that it can be changed only by referendum. In order to organize a referendum, a support

of two-third majority of MPs is needed, following a 50% plus one positive votes, and from this we can infer that this political solution was made to stay. The second important change which needs to be pointed out is the introduction of the category of municipal property, which did not previously exist.

In 2007 the National Assembly of Serbia enacted the following set of laws reforming local administration: Law on Local Self-Government (changing the one from 2002), Law on Territorial Organisation, Law on the Capital City and the Law on Local elections. Finally, in 2011, the Law on Financing Local Self-Government was passed and the current system was completed.

Basic regulations

The Law on Local Self-Government defines *Municipalities*, *Cities* and the *City of Belgrade* as types of units of self-government. According to the Law, a municipality is a basic territorial unit with at least 10.000 inhabitants (article 18); and a city is an economic, administrative, geographical and culture centre of a wider area with at least 100.000 inhabitants (article 23). However, even the territorial units which do not meet the respective 10.000/100.000 inhabitants boundaries can be defined municipalities or cities by the central government, if there are sufficient economic, administrative, geographical and cultural reasons. This regulation also leaves space for political influence. From the total of 122 municipalities, six have less than 10.000 and from 22 cities (excluding Belgrade), ten have less than 100.000 inhabitants (Vasiljevic 2008: 89).

Table 1: *The number of units according to the number of inhabitants*

The number of units according to the number of inhabitants	
Below 10.000	6
10.001–20.000	49
20.001–30.000	29
30.001–50.000	28
50.001–70.000	11
70.001–100.000	9
Above 100.000	13

Source: Vasiljević (2008: 184)

In total, there are 145 units of local self-government in Serbia, with 50,000 inhabitants and 610 km² on average. Comparatively, the units of self-government of Serbia are among largest in Europe, implying that the local governments are more detached from the citizens in these areas.

Institutions and elections

The Law also establishes the main institutions of local self-governance. In municipalities these are the Municipal Assembly, the Municipal Administration, the Municipal Council and the Municipal President. In cities and the City of Belgrade which is granted special status, the respective institutions are the City Assembly, the City Administration, the City Council and the City Mayor. Other institutions on the local level are the local ombudsman, public attorney and in case of cities, the city manager. The mandate of the members of the Municipal Assemblies is four years and depending on the size of the municipality there can be between 19 and 75 members. In the case of the City Assemblies, there can be maximum 90 members, elected for the equal period of four years. In case of City of Belgrade, there can be 110 members. The Municipal Presidents are elected by the Municipal Assembly which also elects the President and the vice-President of the Municipal Assembly and the members of the Municipal Council. The Municipal President, the President and vice-President of the Municipal Assembly are also members of the Municipal Council. The same system is at work in the cities and the City of Belgrade.

Another institution of local governance defined by the Law on local self-government is the Municipal (or City) Administration. The Municipal (or City) Administration is led by the Chief of Administration, elected by the Council for a period of five years. Although the longer period of mandate is given to secure political independence of this technocratic function, the Law on local self-government gave the Council the discretionary power to elect another Chief of Administration anytime during its mandate, which again opened the door for politicization. The following *Table 2* illustrates the roles of different institutions in the system of local governance in Serbia.

Elections for the Municipal or City Assembly are held according to the proportional electoral system. This implies that on the local elections, citizens do not vote directly for the Municipal President or City Mayor, but for the lists made by the political parties. This is why the issues of top-level politics are often dominating the agenda of local elections in Serbia, instead of the local communities' issues. Furthermore, coalitions which are made at the local level very often have to reflect the coalitions made on the central level. If there are elections for the National Assembly in between the local elections, and the coalition in the government changes, the local coalitions often follow to reflect the central government coalition, or the new local elections are held.

Table 2: Roles of the local government institutions in Serbia

Municipal or City Assembly	Municipal or City Council	Municipal President or the City Mayor	Municipal or City Administration
1. Elects the Municipal President or City Mayor.	1. Elects the Chief of Administration.	1. Represents and acts in name of the unit.	1. Drafting of regulations.
2. Adopts the statute, budget and the annual balance sheet.	2. Proposes the statute, budget and other acts of the assembly.	2. Proposes solutions to the unit Assembly.	2. Executes acts of Assembly, President (or Mayor) and Council.
3. Determines the rate of direct revenues, local taxes as well as the land use fee.	3. Executes the acts of the assembly.	3. Giving orders for the execution of the budget	3. Solves in the first instance administrative procedure.
4. Establishes public enterprises and promulgates administrative boards.	4. Monitors the work of the administration.	4. Guides the work of the municipal administration.	4. Performs administrative supervision over the implementation of the acts of Assembly.
5. Adopts the act on public debit note.	5. Executes temporary financing in case the budget is not timely adopted.	5. Other duties defined by Law and Statute.	5. Performs tasks delegated to the municipality or city.
6. Adopt regulations and other general acts.	6. Solves in the second instance administrative procedure.		6. Other tasks as may be determined by other local institutions.
7. Other duties defined by Law and Statute.			

Source: The law on local self-government (2007)

Another problem regards the ability given by the Law on local self-government to the central government to dissolve the Municipal Assembly in case: (1) it does not sit for more than three months; (2) it does not elect the Municipal President or Municipal Council within a period of one month since the constitution of the Assembly; (3) it does not timely adopt the statute or budget. However, ever since this solution was adopted in 2002 (confirmed in law of 2007), there were many instances of arbitrary implementation of this regulation by the central government. The strictness of the regulation depends on the fact whether the local government is composed of the same parties which are in rule on the central level.

Competences of local governments

The competences of cities and municipalities are divided into two groups: delegated and original competences. The central government has the right to delegate tasks to a unit of self-government and to transfer the financial and other means for its execution. These tasks are not listed in any of the laws, but are regulated by a general clause of the Law on local self-government, stating that the units of self-government can administer the tasks of the central government only if the tasks are strictly delegated by a law enacted in the National Assembly.

The original tasks of the units of self-government are enshrined in the Constitution and the Law on local self-government. They are defined as public affairs of direct, common and local interest of

the community and listed in 8 competences in the Constitution and additional 39 competences in the Law enacted in 2007. The summary of the competences is in the following table:

Table 3: Competences of local governments

2006 Constitution	2007 Law on local self-government, summary
<ol style="list-style-type: none"> 1. Utility services. 2. Regulates the use of construction sites and business premises. 3. Construction and maintenance of local roads. 4. Meeting the needs of citizens in the areas of culture, education, health and social protection and sport. 5. Development and promotion of tourism and trade. 6. Taking care of protection of the environment and cultural goods. 7. Development of agricultural land. 8. Other duties as defined by law. 	<ol style="list-style-type: none"> 1. Development and local economy Adopting the local development programs and urban planning; promotes tourism and sets the residence tax; sets working hours and conditions for various businesses; determines the commodity reserves with approval of the Ministry; manages the unit's property. 2. Local finances Adopting the budget and the balance sheet; determines the rate of direct revenues of the unit, the local taxes and fees. 3. Utility services Water, public transport, sanitation, parks, markets, public lighting, etc. 4. Construction and rent Setting the fees, controlling the use of construction sites and business premises; building and maintaining local roads and river routes. 5. Agriculture and environment Taking care of the environment and adopting environmental programs; setting the fee for environment protection; organizes the protection from natural disasters; adopts the principles of protection of agricultural land and water sources. 6. Social welfare and culture Establishing public enterprises and organizes activities in these areas; providing legal aid services for citizens. 7. Human rights Taking care of respect of human rights and collective rights of minorities; promoting and helping solidarity projects; gives official status to minority languages and scripts; the provision of public information. 8. Legal affairs Organizes the legal protection of its interests; establishes agencies, departments and inspections; defines penalties for violations of municipal regulations; regulates and controls the use of unit's symbols. <p>Other duties of direct interest of citizens, in accordance with the Constitution, Laws and Statute.</p>

Financing of local governments

Basic regulations

The Law on financing local self-government was adopted in 2006 and amended in 2011. The law defines that the budget of units of self-government consists of *original* and *transferred* incomes, *transfers*, *income based on debt* and *other* incomes as regulated by laws.

The original incomes are incomes which the self-government unit generates on its territory, which are:

- property tax, except the tax on transfer of rights and tax on inheritance and gifts
- local administrative tax

- local utility fees
- residence fee
- fees for the use of public space
- concession fees
- other local fees in accordance with the law
- revenue from fines imposed in misdemeanour proceedings as well as seized assets in this process
- income from rent
- income generated by the local public enterprises
- income on interest
- income from donations
- income from voluntary contributions.

The rates of the fees and taxes are defined by the unit's bodies, however, the central government can set upper and lower limits. According to a 2009 OECD study this approach, named “piggy-backing”, still gives significant power over taxation to the units of self-government (Blöchliger – Rabesona 2009). There is also a legal obligation to organize a public debate when determining the draft decisions on local government income. The decision on the rate of taxes and fees can be changed once a year, and exceptionally one more time if the law regulating the original incomes of the local self-government is changed.

Regarding the property tax base, since mid-2013, it is calculated by the local self-government's administration in accordance with the market value, and not book value which was the case before. According to a comparative study of 100 countries by Almy (2014: 19), property tax base is in most cases calculated by the central government. It is believed that the central government is usually less biased in this task due to its distance and its wider capacities. On the other hand, the local governments have a larger incentive to keep the valuations up to date and have greater knowledge of the nuances of the local property markets.

From the central government level, the local governments receive the assigned revenues and transfers. Assigned revenues are comprised of the assigned state taxes and fees. The transfers on the other hand are transferred from state budget to a local government budget and can be *earmarked* and *non-earmarked* transfers. Earmarked transfers are used for financing specified tasks and functions and can be *functional transfers* – used for a specified function of local self-government; and an *earmarked transfer in the narrow sense* – for a specific task defined by the central government.

Non-earmarked transfers are:

- Equalization transfer: given to units of self-government in which income per capita is below average.
- General transfer: given to all units of self-government according to the specified criteria.
- Compensation transfer: transfer that refunds part of the lost revenue resulting from changes in Republic tax legislation.
- Solidarity transfer: given to all units of self-government, excluding Belgrade, according to the specified criteria. The criteria for allocation are defined by the central government, which leaves space for political influence.

There are three very important legal solutions of the Law on financing local self government that need to be pointed out:

- According to the law of 2007, all the local governments got 60% of income tax collected from their territory. In 2011 the law was amended giving the local government 80% of the income tax, which became their main source of income.
- The amount of funds dedicated to general transfer is defined as 1,7% of the previous year's national GDP.
- According to the formula for the equalisation transfer, all of the local governments in which *per capita* income is less than 90% of the national average, receive the amount needed to meet the 90% of the national average *per capita* income (Cvijović, 2013). However, as previously noted, the criteria for the solidarity tax can be fine-tuned in a way that the local governments which are formed in the same way as the central government get more funds than other local governments which are economically in a similar position.

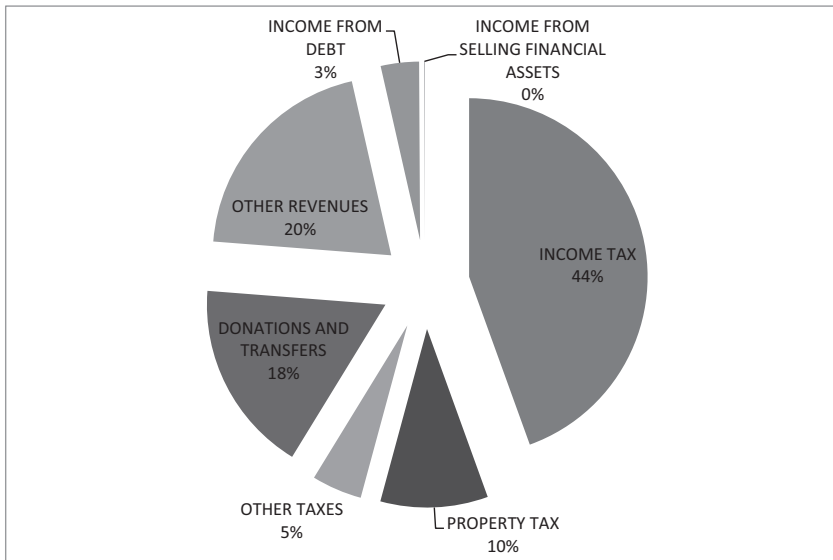
Local government revenues and expenditures

In the first part of this sub-chapter, the size of the local governments' revenues and expenditures will be analysed. Further on, the respective amounts will be compared with the total government expenditures and revenues in a time-scale to find how fiscally decentralised Serbia is. This will be an introduction to the next part, covering local government debt as well as the effects of economic downturn. Finally, a graph showing the number of employees in local government in time perspective will be elaborated.

Total income of all the units of self-government in Serbia in 2013 was 241 billion RSD, which is around 2 billion EUR. Most of the income came in through taxes: 142 billion RSD (income tax: 107 billion RSD, property tax: 23 billion RSD) followed by transfers and donations:

42 billion RSD (17.4%). The following *Figure 2* shows the structure of local government income in 2013. It can be observed that most of income is received from the central level, as the income tax is collected by the central government.

Figure 2: Local government revenues, 2013



Source: Own study of Bulletin of public finances, 2014

Total revenues of all the units of self-government in Serbia in 2013 was 237 billion RSD, a bit less than 2 billion EUR. Most of the spending was for purchasing of goods and services: 59 billion RSD and expenses for employees: 54 billion RSD (Bulletin of public finances 2014: 35).

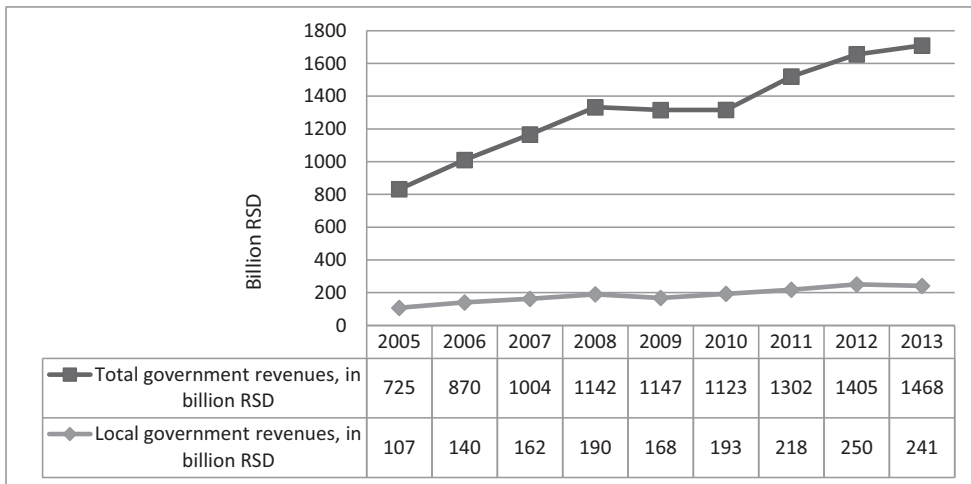
The *Figure 3* (next page) shows the data on local government revenues in billions RSD from 2005 to 2013, comparing them to the total government revenues in the same period:

What can be *prima facie* observed from the graph is the trend of a rise of revenues on both local and central government level in the period analysed. There is a fall in 2009 on the local level due to the impact of the crisis, as the main source of income of the local governments are income and property taxes.

However, the data from the graph shows the values in Serbian Dinar and not Euro. If we were to convert the values into Euro, we would get results that show how the revenues of the governments did not rise as much as it seems. To illustrate, the middle exchange rate RSD:EUR on 1st of January 2006 was 85:1 and on the 1st of January 2013 it was 113:1 (Narodna Banka Srbije 2014). Hence, the main objective of the graph above is to show the ratio between the

local and total government revenues, and not to provide a full picture of their size and rise over time. The *Table 4* shows the same data in more depth.

Figure 3: Local and total government revenues, 2005–2013



Source: Own study of Bulletin of public finances, 2014

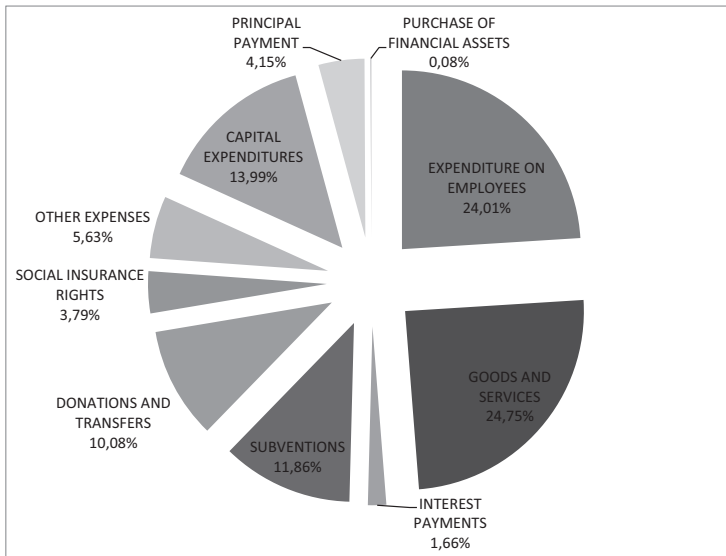
Table 4: The share of local government revenues in total government revenues, 2005–2013

2005	2006	2007	2008	2009	2010	2011	2012	2013
15%	16%	16%	17%	15%	17%	17%	18%	16%

Source: Own study of Bulletin of public finances, 2014

We can observe a more or less constant level of the share of local revenues in total government revenues. This might seem odd as the competences of local governments grew with the new laws and amendments adopted in 2007 and 2011, which regard financing as well. However, this can be explained as most of the revenues still come from the central level: from the income tax and transfers from the central level. Furthermore, the central government has used borrowing to fill its budget much more than the local governments, although some of the units of local government have been borrowing a lot as well, as the next sub-chapter will show.

Expenditure on the local government level was more or less constantly in line with the revenues; local self governments did not run large deficits. In the following *Figure 4*, the structure of local government expenditures in 2013 can be observed.

Figure 4: Local government expenditures, 2013

Source: Own study of Bulletin of public finances, 2014

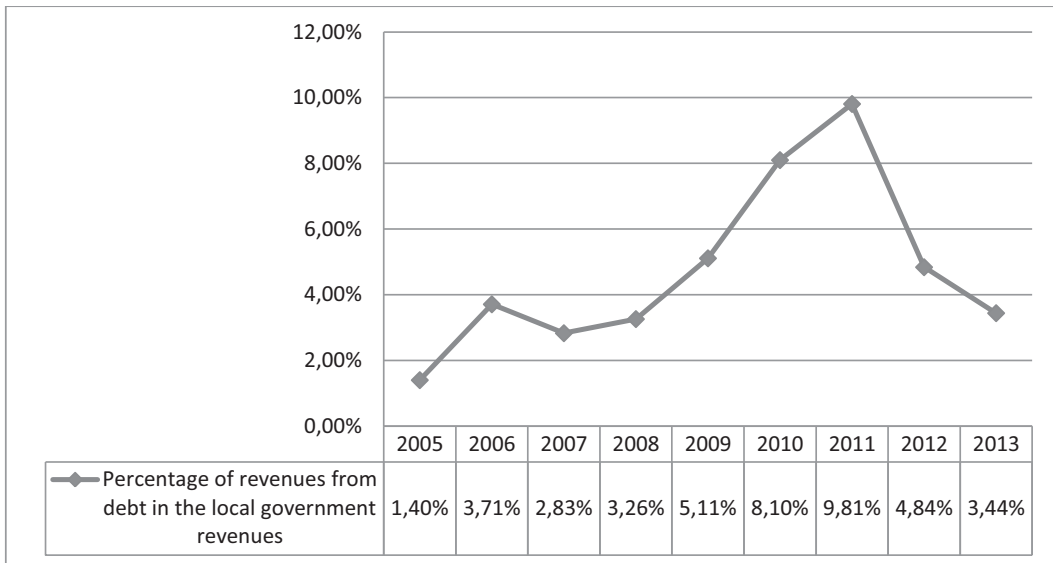
Local government debt

The law which regulates local government debt is the Law on public debt, which was adopted in 2005, amended in 2009 and 2011. The main solutions of this law according to Brnjas et al. (2013: 14–5) are the following:

- Independence of the units of self-government on borrowing
- Ability to borrow from abroad
- Ability to take short-term loans to solve liquidity problems:
 - which cannot be refinanced or moved for the next fiscal year
 - which cannot cross 5% of the last year's revenues
- Ability to take long-term loans for investments:
 - which cannot cross 50% of the last year's revenues
 - if maturing principal and interests do not cross 15% of the last year's revenues
- Ability to emit municipal bonds
- Ability to issue guarantees
- Central government can bail-out a local government by providing counter-guarantees for their debt
- Ability of placing the free funds available
- Obligation to inform the Ministry of Finance every six months.

According to the World Bank (2013), the stock of local government debt at the end of 2012 was only 2% of total GDP. This does not appear large in terms of the municipalities' ability to pay (p. 55). The same conclusion can be implied from the *Figure 5*, which shows the percentage of annual revenues from debt in the annual revenues of the units of self-government (aggregate):

Figure 5: Revenues from debt as part of local government revenues, 2005–2013



Source: Own study of Bulletin of public finances, 2014

Around half of the municipal debt is owed to international financial institutions, mainly European Bank for Regional Development and European Investment Bank, which offer more favourable terms than the commercial banks. However, debt to local commercial banks is rising as well, and in addition the municipalities are now slowly entering the bond market (World Bank, 2013: 55).

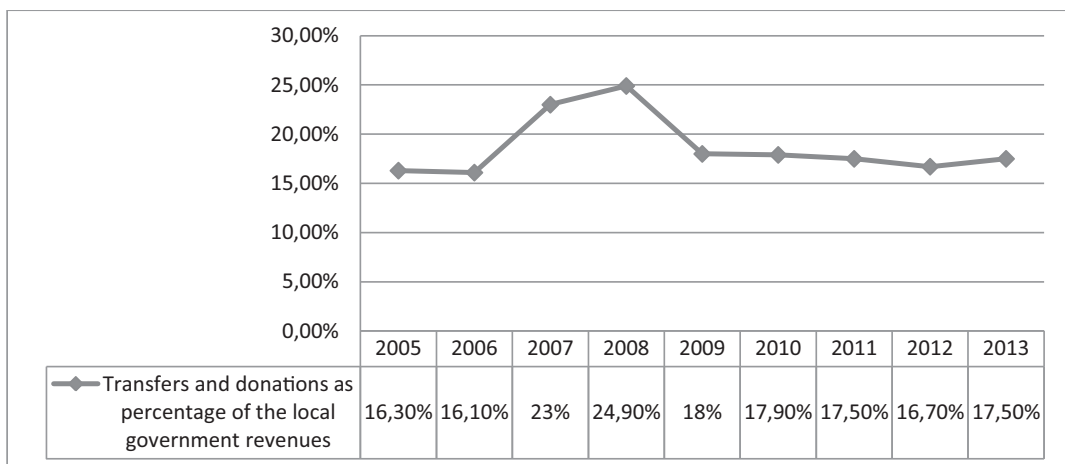
Even though it may seem that borrowing on aggregate level may not cause concern at this time, the main worrying development is the debt of the City of Belgrade. For instance, in 2010, the debt of the City of Belgrade alone accounted for 74.2% (in 2008 it was 62.3%) of the aggregate gross debt of the units of self-government (Brnjac et al. 2013: 18). In August 2013, total stock of debt of the City of Belgrade was RSD 45,580 million (Ministry of Finance 2014). Since the budget of the City of Belgrade for 2013 is RSD 71,120 million (City of Belgrade 2013), the total stock of debt accounts for 63% of the budget. According to the budget of 2014, debt service will total RSD 3,332 million, which is around 4.2% of the total expenditures (City of Belgrade 2014). Most of the debt was generated to finance large infrastructural projects, especially the new Sava Bridge.

According to the World Bank (2013: 57), “as grace periods expire, the debt service burden is likely to increase”, hence there are reasons to impose more strict debt regulations, especially since other municipalities may follow in the same direction, starting a *domino effect*.

Effects of the crisis

By solely observing the *Figure 5* presenting local government revenues in a time perspective, we can not conclude that, overall, there was a large effect of the economic crisis. Going more into detail, the three main effects of the crisis are the fall of transfers from the central level, the rise of debt in the period until 2011 and the fall of public enterprises profits.

Figure 6: Transfers and donations as percentage of the local government revenues, 2005–2013



Source: Own study of Bulletin of public finances, 2014

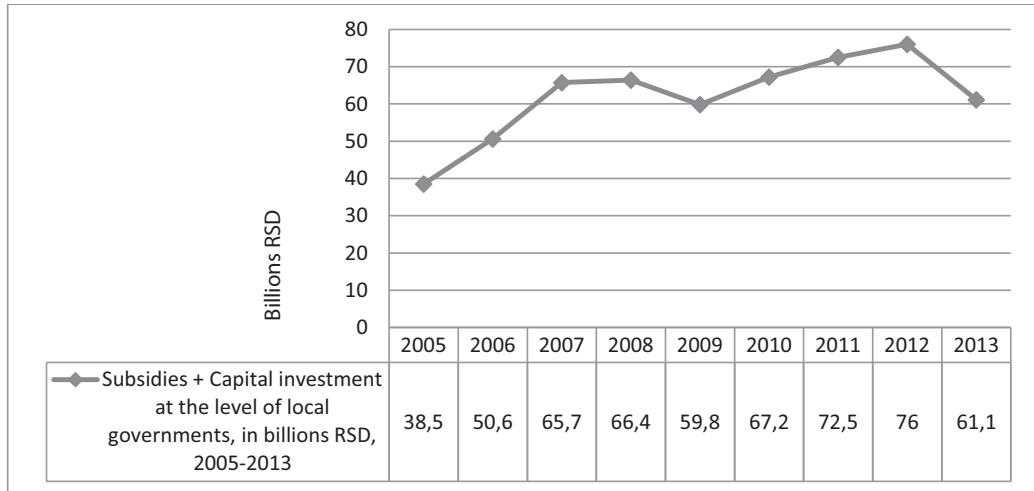
In the *Figure 6* we can observe how the level of state transfers (and donations, which are negligible) was rising for three years up until the 2009, when the effects of the crisis were felt at the central level, when this percentage dropped for around 5% and it did not come back at that level.

From *Figure 6* it can be observed how the percentage of revenues from debt grew from 1,4% in 2005 to 9,81% in 2011, due to the crisis. In 2012 and 2013 there is a declining trend in this regard and the situation on overall level is going back to normal.

The Law on local self-government, as previously explained, gives right to local self-governments to found and manage public enterprises. These public enterprises have their employees and managers, which are chosen on a public tender. However, the practice tells us how in most of the cases, the managers of public enterprises are in almost all of the cases people close to the

ruling parties on the local level. These enterprises usually finance their operating costs from user charges which they retain, hence spending financed from the budget consists of *capital investments* and *subsidies* (World Bank 2013: 66).

Figure 7: *Subsidies + Capital Investments at the level of local governments, 2005–2013*

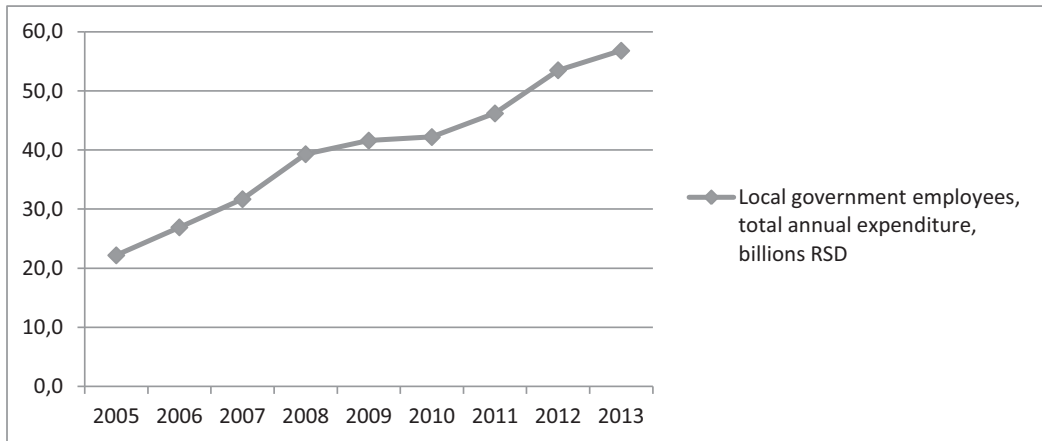


Source: Own study of Bulletin of public finances, 2014

In total, subsidies and capital investments in the period observed (*Figure 7*), accounted for, on overall, 34,2% of the local government's budgets. The World Bank (2012: 35) finds how the combined annual net losses of local publicly-owned companies only in 2012 was more than EUR 46 million. The situation is especially alarming in the case of the City of Belgrade. In the budget for 2014, subventions make up for 18,51% of the total revenues (around EUR 86,5 million).

The World Bank (2014: 27–34) points out how the main reasons for the bad functioning of the public enterprises owned by the local self-governments in Serbia are: (1) unresolved ownership and property issues related to the fixed assets; (2) highly politicized management; (3) high tariffs and economic regulation; (4) lack of private sector participation, such as public-private partnerships or contracting-out. In the same document, The World Bank (p. 35) finds how the combined annual net losses of local publicly-owned companies in 2012 was about EUR 46 million. Losses of public enterprises owned by the City of Belgrade accounted for around 70% of the total losses of the local government's enterprises.

Finally, the employees of local governments in Serbia have hardly felt the hardship of the world economic crisis. With time, both their number and their salaries grew, despite the austerity measures imposed on citizens (*Figure 7*).

Figure 8: Local government employees, total annual expenditure, 2005–2013

Source: Own study of Bulletin of public finances, 2014

There are, as of Q2 2014, around 163.000 employees in the local governments, with above-average salaries. A World Bank official recently stated (*Politika*, 12/07/2014) how “the salaries of the local government employees cannot be seen in the segment of the budget which relates to the annual expenditure on salaries. The municipalities and cities account them under services and in that way they blur the image of how much money goes on their employees”. The Government of Serbia has, as of 1st of January 2014, imposed a ban on employing in the public sector. However, only five municipalities have respected this ban. This tells a lot about the current state of the local government system in Serbia.

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