

# SUPPORTING LOCAL ECONOMIC DEVELOPEMENT BY INFRASTRUCTURE DEBT FINANCING IN THE REPUBLIC OF SERBIA

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*The main goal of this paper is to establish grounds for a more efficient development of local communities taking into consideration their entire former development characterized by a pronounced polarization and territorial inequality of development exhibited among them in extreme proportions. In view of the insufficient and inadequate decentralization performed without a specific concept in the past, the authors aim to analyze the state of the local infrastructure within the framework of territorial organization offered by the latest regulations, as well as estimate the goals set in the last couple of years by the support programs related to the development of local infrastructure provided by the international institutions. The authors have a similar goal in that sense to provide sufficient argumentation for a quality distribution of local infrastructure and, accordingly, more efficient local development as a prerequisite for a more uniform regional development, especially in rural areas.*

**Key words:** territorial organization; local infrastructure; support program; regional arrangement.

## INTRODUCTION – TERRITORIAL ORGANIZATION AND STATUTORY BASIS OF OPERATION OF LOCAL GOVERNMENTS IN THE DOMAIN OF DEVELOPEMENT

The issues of local development have received their due attention in Serbia only in the past two years. The competencies of local governments and obligations transferred from the republic level have continuously expanded during that period, so that the problems of economic development, energy management and similar, are the subject of comprehensive work and interest in municipalities and cities in Serbia.

The Republic of Serbia<sup>1</sup> is statistically divided into two regions: North Serbia and South Serbia.<sup>2</sup> The first territory includes the Belgrade region and the region of Vojvodina with a total of eight areas, whereas the second territory covers three regions: Šumadija and West Serbia with eight areas, South and East Serbia with nine

areas and Kosovo and Metohija with five areas. The objects of this paper are 150 municipalities located on the territory of the so called Serbia proper and AP Vojvodina.

The Law defines the way municipalities are established and forms of competence the units of local government have at their disposal.<sup>3</sup> Planning of sustainable development, its implementation as well as welfare and prosperity of citizens is the main competence of the municipality.

It is therefore easy to conclude that the municipalities in Serbia are faced with no easy task. Besides all that, the local governments have to provide most of the assets for such activities by themselves. These assets are provided from original and assigned assets, transfers and by indebtedness. The law defines 16 forms of original revenue from which only few can be singled out as forming its total mass.<sup>4</sup>

## LOCAL ECONOMIC DEVELOPEMENT IN SERBIA

It is a notorious fact that the more centralized and concentrated the policy of development of a country at macro level, the more pronounced

are the development problems, particularly at regional level. Under such conditions the problems of local and regional development are often neglected, minimized and/or postponed for some future period. On the other hand, in a practical sense, the problem of local economic development in Serbia is a relatively new obligation. It was delegated to the level of local government only in the middle of the last decade. The local governments were supposed to establish LED (local economic development) offices accordingly. In case of smaller municipalities, such offices were either not established or, as a rule, they were established just symbolically and nominally and were put in charge of issues of local development. In reality these municipalities are still relying on higher decision making levels.

Under the altered circumstances, the development crisis and occasional episodes of enthusiasm and economic success, which is more an exception than a rule, which are related to the beginning of the 21<sup>st</sup> century, it is

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still impossible to provide a balance in acquisition and distribution, particularly a higher degree of investment, namely, financing the development. Hence, Serbia, as well as local governments to a smaller or greater degree, is more and more dependent on the inflow of foreign accumulation. It is not used just to finance the development, but also serves to a growing extent for maintenance of current balance. On the other hand, it is clear that without a higher degree and more efficient investment there is no achievement of development, especially not in a long run.

There has been a slight increase in investment in the past decades under the influence of inflow of accumulation from abroad based on privatization, and to a lesser degree, from direct foreign investments, and a conclusion can be drawn that the main investor is the state, which determines the character of investments. The state is investing in the development of capital infrastructure and makes less effort to stimulate the development of production capital and change of the economic structure. As a result the threat of the infrastructural limitation of development was eliminated to a significant extent. However, such positive events at macro level were not accompanied to a full extent by the local governments which are still neglected in smaller cities and municipalities, which results in the foreign investors being unable to materialize their investments.

## A LOCAL INFRASTRUCTURE SUPPORT PROJECT EXPERIENCE

At the end of 2008 the German development bank KfW began the execution of the project titled "Municipal infrastructure credit support project" <sup>5)</sup> consisting of two components: first, credit line in the initial value of up to 50 million € for financing the physical execution of the project in the domain of local infrastructure, and the second, providing technical-consulting support by experts for preparation of planning and execution of the project.

In view of the fact that the long lasting devastation of infrastructure at local level has brought most of the municipalities and cities to the brink of ruin and caving in of the system, that due to a long period of lack of serious investments in that area the communal systems are mostly inadequate to meet the requirements of the population and particularly of the industry and business, initiation of such a project would mean a significant positive shift.

a) Typical situation in small and medium size municipalities in the sphere of water supply and

sewerage, waste water treatment, is as follows:

- losses in the potable water system at the level of 45-50% (including all types of losses – from leaking pipelines, illegal connecting, to unsettled dues for supplied water),
- a majority of rural settlements is not connected to the potable water supply system or the quality of this connection is such as to make a normal supply impossible,
- untrained personnel and/or lack of equipment and assets for quality sampling and checking of potable water quality, which is then often used only as "service" water,
- underdevelopment of the sewer system, particularly outside the central city core, which leads to the problems of overflowing of septic tanks and possible broader environmental pollution,
- local governments in Serbia with a developed and functional waste water treatment system are an exception, whereas as a rule investment in this area is postponed for the future (unfortunately the situation is not much better even in the largest cities, including Belgrade, Novi Sad and others).

b) The situation is very different in the domain of electric power, gas supply and telecommunications, depending on the development of certain regions. The border areas, especially towards Romania and Bulgaria have a serious problem with quality electric power supply (low voltage, power outages, etc.), and particularly no access to the gas network and often not even modern telecommunications (lack of network). On the contrary, the areas along the main traffic corridors (such as, e.g. from Belgrade to Subotica, Niš and Šid) have a perfectly good access to such infrastructural services, which makes them attractive partners for foreign investors from the start. No wonder that the majority of foreign investments is concentrated primarily in larger urban areas and second, on the routes of the subject corridors or in their close vicinity.

c) The situation is utterly different in the district heating system and supply of heat energy in the largest cities (Belgrade, Novi Sad,

Kragujevac and Niš) and in other local governments. Namely, large cities were the object of interest and investment of significant assets by foreign donors (in strengthening the institutional capacities, as well as in the actual infrastructure), whereas smaller and particularly remote municipalities are often neglected and forgotten, left to fend for themselves and solve problems in this area. The characteristics of their systems are typically as follows:

- the heat energy production facilities and distribution of heat energy are obsolete, their declared useful life has expired long ago, and in most of the cases they were sized according to the standards in force in EU some 35-40 years ago, in other word, before the first and the second oil crisis,
- total losses in the systems are extremely high (cracked heat conduits, lack of maintenance of the network, illegal putting up/extending of connections) which has a disastrous impact on the operation of utility companies,
- difficulties in collection of dues for the provided services to the consumers with continuous pressure by local government on the management of public utility companies to postpone the collection from households "for social reasons", because of the importance of employment and economy budget.

d) The urban local infrastructure such as modern streets (with pavements, efficient and energy saving public illumination) parks and green areas, communal waste collection and disposal systems etc. is also very obsolete, with a low level of investment in maintenance and inability of many local governments to finance, from their own budget assets, its modernization independently.

The above situation has caused to a great extent a very high demand for loans from MICLP which are provided through domestic banks. The "hunger" for investment credits has led to placement of over 77 million € instead of the planned 50 million €, in more than three years, through 110 entered credit agreements (Tables 1 and 2).

Table 1: Placed credit amounts according to years in mill. €

Withdrawal/repayment	2009	2010	2011	Total
Contracted	21,975,357	21,492,696	33,782,554	77,250,607
Drawn	21,975,357	21,403,876	21,271,753	64,650,986
Paid	3,066,013	2,021,614		10,472,721
Unsettled	18,909,344	19,382,262	21,271,753	54,178,266
Balance for withdrawal	-	0.088	12,510,801	12,599,621

Source: MICLP internal material – Report on execution of the project

Table 2: Review of approved credits by year 2009–2011.

Description	2009		2010		2011	
Total number of credits	24		31		55	
Local governments	16		20		28	
Public utility companies	8		11		26	
Other	0		0		1	
North	5		13		10	
South	5		5		4	
West	4		6		13	
East	2		2		8	
Central Serbia	8		5		20	
Number of credits (in € and RSD)	24	0	29	2	50	5
Largest credit	3,200,000	-	3,074,382	186,400,000	3,949,143	100,000,000
Smallest credit	33,727	-	23,307	172,720,000	22,979	20,162,260
Average credit amount	915,640	-	613,312	179,560,000	633,699	42,672,452
Interest rate in %						
- Variable	15		16		34	
In Euro*	15	4.87	14	4.47	29	3.71
In RSD**	0	-	2	1.70	5	1.82
- Fixed	9	6.75	15	6.40	21	6.50

Source: MICLP internal material – Report on execution of the project

\*Interest rate on credits with foreign exchange clause determined at 3-month Euribor level increased by the subject margin percentage

\*\*Interest rate on dinar credits determined at the level of Bellibor increased by the subject margin

According to local government and public utility companies the requirements are highly diverse: they range from minimum investment, most frequently procurement of missing machinery (garbage trucks, snow hauling machines, etc) to major investment interventions (as a rule these are construction of roads, development of industrial zones, waterworks and sewerage systems, district heating etc.). Most of the investments are centered in the regions of the north (AP Vojvodina) and centrally (Šumadija and Pomoravlje) where 58.8% of the total assets was invested, whereas the region of the south (Niš and everything southward) falls far behind with a total of 10.3% of total investments.

Regional distribution of approved credits according to the credit size is showing that Central part of Serbia is covering 31.1%, Northern part 27.7%, Southern 10.3%, Western 15.2% and Eastern 15.7%. From the analysis of taken credits it follows that the greatest requirements for investment were in the means of transportation (machinery, public transportation etc.) at the local level, including the construction and/or reconstruction of streets and squares, which most often implied complete works on infrastructure – waterworks and sewerage network, energy and telecommunication grid, public illumination and new carriageways/pavements.

Allocation of approved assets by locations according to credit size is showing that Belgrade is covering 5.5%, other towns 28.2% and Municipalities 66.4%.<sup>9)</sup>

Greatest investments were then made in the social infrastructure – construction/ reconstruction of kindergartens, health care centers, cultural centers and sports facilities (most often school gyms, but

also public sports halls).<sup>7)</sup>

It is characteristic that some projects that were deemed as priority, first of all because of their high profitability, such as, for example, in the sphere of energy efficiency, are not in the focus of investment by local governments. The most frequent explanation given by the leadership of the municipalities is that it is a question of “projects which are not (directly) visible to the citizens”, furthermore, that these projects require major investment and long period of return on the invested assets.

Most of the credit assets are orientated to *current maintenance* in main services of the local government – providing potable water, sewerage, garbage removal and supply of energy. Much less attention is paid to current maintenance of additional services (one could say “luxury”) such as sports facilities, parks, promenades, etc. Furthermore, much more attention is orientated to *investment activities* in basic services than in additional services. This shows that significant assets are still earmarked for maintenance of the local infrastructure systems already in use than to their development. Accordingly, it may be

claimed with certainty that the problem of investment in the development of local infrastructure in Serbia in the next 5–7 years, as a prerequisite for local economic development, will be in the focus.

The options for different ways of financing these activities have not been exhausted by far, because first attempts to secure finances by issuing the so called municipal bonds appeared only recently, more precisely in the middle of 2011, and these attempts are still in the initial phases of resolving issues through private-public partnerships.<sup>9)</sup> On the other hand, the options of taking on credits by local governments in Serbia have not been used within the existing legal possibilities. Thus, in the middle of 2011, the local governments had at their disposal a possibility to take on additional credit ranging around €450 mill. Compared to the realized revenue in the past year this is just somewhere above 21%, whereas compared to the unsettled liabilities under the credits it is just 28.8%. In that context it is interesting to make a review of indebtedness and possibility of indebtedness of local governments in Serbia, Table 3.

Table 3. Review of indebtedness and possibility of indebtedness of local governments in Serbia status on 30/6/2011 in RSD

Item	2011	2012	2013
Liabilities under existing credits	3,371,658,240	4,370,047,338	5,977,241,638
Total existing credit liabilities	72,777,654,512		
Unsettled credit liabilities	63,760,331,505		
Settled credit liabilities	9,017,323,006		
Available for new debts	46,711,230,338		
Realized current revenue of the local government in 2010	220,943,123,686		

Source: www.mfin.gov.rs used on 14/2/2012. Data of the Public Debt Administration

From these indicators it follows that the local government is much less in debt compared to the central level of government, indicating that part of the responsibility for the investment from the central level should be shifted to the local government authorities. A prerequisite for the realization of such approach is the need for the local governments to take the responsibility for their own development, and the realistic basis for this is the option to manage their own assets as well as legal security, namely institutional integration of the entire segment.

Finally, there remains the issue of the efficiency of such functioning of the sector of public utility companies. First of all, the price policy determined by the central government determines linking of the public utility companies to the so called macroeconomic framework of the Government of the Republic of Serbia as the option of adjustment of the established level of prices. Secondly, without reaching the realistic price level of utility services that would cover the current operation plus the development of the system, there is a danger that providing these types of services to the population and the industry would be blocked as soon as midterm in many of the local governments. The price policy in the public utility companies is also the main cause of the absence of privatization in this sector. Foreign investors, although interested in many such companies, do not wish to make investments with an uncertain outcome of their profitability.

## FINAL DISCUSSION

The development of the Republic of Serbia, just like in the case of all the other countries that had used the concept of intensive industrialization in their development over a long period of time, is characterized by a pronounced polarization which brings significant limitations to the development from the aspect of regional development as a territorial concept, as observed also at the sector level. The lack of territorial uniformity is particularly emphasized at the level of local communities, especially in rural areas. It is also partly caused by inadequate decentralization and territorial organization that was implemented in the last couple of decades. Legal and institutional prerequisites for a more efficient development of local communities have been created only in the last couple of years. A conclusion may be drawn that from a practical aspect, the issue of local economic development is a relatively new obligation. In Serbia it has been delegated from a higher administrative level to the level of local governments only in the middle of the last decade.

Its dependence on foreign accumulation is

exhibited more and more under the changed circumstances, as well as the crisis of development that has overcome Serbia as well. It is used for financing not just the development requirements, but also to a growing extent for maintaining the current balance which significantly diminishes its development capacity and increases the public debt over a longer period of time. The state is the one that is the main investor, hence its greater orientation to the development of infrastructure. It creates conditions for the foreign investors to make their investments in the local communities that have inadequate utility and/or economic-social infrastructure. For this reason the program of support to the development of the local infrastructure is deemed an adequate means to overcome such limitations in the shortest possible time. The investigation of the effects of such a project indicates a significantly higher scope of placement than foreseen by the original project budget. Furthermore, observed according to the regional structure, the location as well as the purpose of investment, it can be concluded that there is a significant regional uniformity in the use of the assets. There is a significant presence of projects oriented to maintenance, but also in part to new investments. There is a specific problem of the efficiency of operation of public utility companies. It can be concluded that there is a need for further investment. However, it is related to the investment capacity of the municipalities and the reality of the prices of utility services that would cover the current operation plus the development of the system. Otherwise, there is a danger that as soon as midterm numerous local governments would be blocked from providing these types of services, not to mention further development.

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<sup>1)</sup> Due to non-existence of statistical data for the analyzed period in this paper the term Republic of Serbia treated in this paper implies the territory of AP Vojvodina and Serbia proper, without AP K&M.

<sup>2)</sup> According to Official Gazette of Serbia for 2010, page 19, Republic Institute of Statistics, Belgrade.

<sup>3)</sup> Municipalities have 39 competencies under this Law, “Off. Gazette RS”, 129/2007, Article 18.

<sup>4)</sup> Property tax and building land fees, together with local and administrative taxes are the greatest source of revenue, for sure. In less developed municipalities is the greatest source are transfers from the Republic levels (in numerous municipalities also over 75-80% of the total budget).

<sup>5)</sup> The MICLP project shall be completed by March 31, 2012.

<sup>6)</sup> Source: MICLP internal material – Report on execution of the project.

<sup>7)</sup> Drinking Water 11.1%, Waste Water 9.3%, Solid Waste 11.1%, Transport 29.4%, Energies 8.6%, Social 26.5% and Economics 3.9%. Source: MICLP internal material – Report on execution of the project.

<sup>8)</sup> Municipal bonds were until now issued by Novi Sad (successful, 43 million €) and Užice and Pančevo (unsuccessful), PPP is present in some municipalities for several years, however, as a rule, it is an investment only in solving the question of solid communal waste (noting that several such contracts have been terminated). The experience shows that PPP as a manner of financing of investments in Serbia is still the object of difference limitations, hence also the legal limitations. Furthermore, the foreign investments experienced in the attempts of beginning PPP in Serbia state the uncertainty of investment in priority partners which is intensified with each change of the local government.