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EFFECTIVE MANAGEMENT OF LOCAL FINANCES AS A ELEMENT IN IMPROVING LOCAL ECONOMIC DEVELOPMENT

Abstract

For normal functioning and development of local self-government, it is necessary to secure financial resources from various funding sources. The basic sources of financing for local self-government are local tax revenues. However, during a period of crisis, local governments cannot rely only on their revenues. To provide the most favourable source of financing, the local government has the task of establishing and implementing an effective debt management policy with the control of its indebtedness capacities. It is by determining this capacity, through various indicators of indebtedness, that it is possible to know what kind of financial health the local self-government has. The paper aims to show the degree of impact of the Pandemic crisis on the indebtedness of local self-governments in 2020. In addition, the paper presents key priority areas for financing local governments during the crisis period.

Keywords: local economic stability, local self-government units, Covid-19, local finance, debt management.

JEL classification: G31, H70, Q56

ЕФИКАСНО УПРАВЉАЊЕ ЛОКАЛНИМ ФИНАНСИЈАМА КАО ЕЛЕМЕНТ УНАПРЕЂЕЊА ЛОКАЛНОГ ЕКОНОМСКОГ РАЗВОЈА

Апстракт

За нормално функционисање и развој једне локалне самоуправе неопходно је обезбедити финансијска средства из различитих извора финансирања. Основи извори финансирања једне локалне самоуправе јесу локални порески приходи. Међутим, током кризног периода локалне самоуправе не могу се ослонити само на сопствене приходе. Да би обезбедила што повољнији извор финансирања, на локалној самоуправи је задатак успостављања и примене ефикасне политике управљања дугом уз контролу сопствених капацитета задужености. Управо утврђивањем овог капацитета, преко различитих показатеља задужености, могуће је спознати са каквим фискалним здрављем

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располаже локална самоуправа. У раду се жели приказати степен утицаја пандемијске кризе на задуженост локалних самоуправа у току 2020. године. Поред тога, у раду се приказују кључне приоритетне области финансирања локалних самоуправа током кризног периода.

Кључне речи: *локална привредна стабилност, јединице локалне самоуправа, Ковид19, локалне финансије, управљање дугом.*

Introduction

Local economic development can be viewed as a continuous process that requires the definition and implementation of strategies and plans for local sustainable development, with the establishment of close cooperation between the local government and business entities, and other non-governmental sectors. In that process, the focus should not be based only on certain sectors of the economy, but it should encompass the entire economy at the local and regional levels. Exactly because of those reasons, it is up to the local self-governments to conduct efficient local policy that creates optimal infrastructure, which nowadays is the basis of attracting foreign direct investments and development. Within that policy, special attention should be brought to local tax policy and debt management policy. Local self-government should approach the aforementioned policies strategically. Both policies must be defined to meet the key needs of the local community. To approach these policies strategically, it is necessary to determine the indebtedness capacity of local self-government through key indebtedness parameters such as the debt repayment ratio, public debt per capita, and the ratio of total debt to the value of taxable property.

The paper points out the importance of achieving continuous economic prosperity in a municipality and the basic instruments that can be used to promote it. Also, in the continuation of the paper, the author highlights the importance of a well-defined policy of economic development. The basic factors that must be taken into consideration when defining the mentioned policy are highlighted. In the last part of the manuscript, the author wants to show how the pandemic affected the parameters of the local government's responsibility. In the focus of observation are two indicators whose value is analysed in the period from 2018 to 2020. The indicators are observed for nine local governments, classified by different development groups. Also, in this part of the paper, it is shown which areas were defined by local self-governments as a priority for financing during the coronavirus pandemic.

2. Key elements of local economic development incentives

Setting economic development as a separate goal is absolutely a wrong move for the local government (Blakely & Brandshaw, 2002, p. 29). Economic development should be seen as a means by which it is possible to reach an appropriate level of well-being within a local community, taking into account the cultural characteristics associated with

the local population (Bryant & Cofsky, 2004, p. 24). Economic growth must be achieved continuously, emphasizing the increase in the level of employment and living standards of the population (Lee & Johnson, 2013). This leads us to the conclusion that the local self-government has the task of implementing a wide range of social policies to maintain economic growth in continuity (Cypher & Dietz, 2004).

Various instruments can be used to encourage local economic development (Batrik, 2003, p. 6; Balaguer-Coll, Prior & Tortosa-Ausina, 2016, p. 518). We can define about three basic instruments available to local self-governments (Đorđević, 2016, p. 95):

1. Instruments of legal nature – improving the quality of the administrative network, increasing the quality-of-service provision, implementing management on a strategic basis);
2. Instruments of financial nature – reduction of tax obligations, provision of loan guarantees, provision of local credit arrangements, etc.
3. Instruments of complex legal form (formations of free zones, equipping an industrial zone, the establishment of private-public partnerships).

When it comes to the available legal instruments, the main purpose of their application is to try to improve the operations of the local administration (reducing excessive administrative procedures, removing unnecessary permits, etc.). By improving the operations of the administrative local network, it is possible to create a more favourable business environment. In this way, it is possible to influence the entire business, i.e., the economic sector. Attracting investments is a very common financial instrument used by local self-governments (Kriz & Wang, 2013). In such situations, local self-governments apply fiscal-type incentives, such as low prices for communal services, assignment of construction land, or provision of certain construction facilities on favourable terms.

The goal of applying financial instruments should be to provide financial resources to economic entities that are the pillars and carriers of local economic development (Žikić & Mak, 2010). A credit guarantee given by the local government is one of the typical examples of this type of financial instrument. With such guarantees, the risk is assumed, that is, the local self-government guarantees with its resources that the loan granted to the business entity will be repaid. In return, the business entity's credit power and the possibility of greater economic activity, and therefore competitiveness, are increased. Providing financial assistance in crises and situations of economic instability can enable them to survive in the market without the need to reduce their activities and the number of employees.

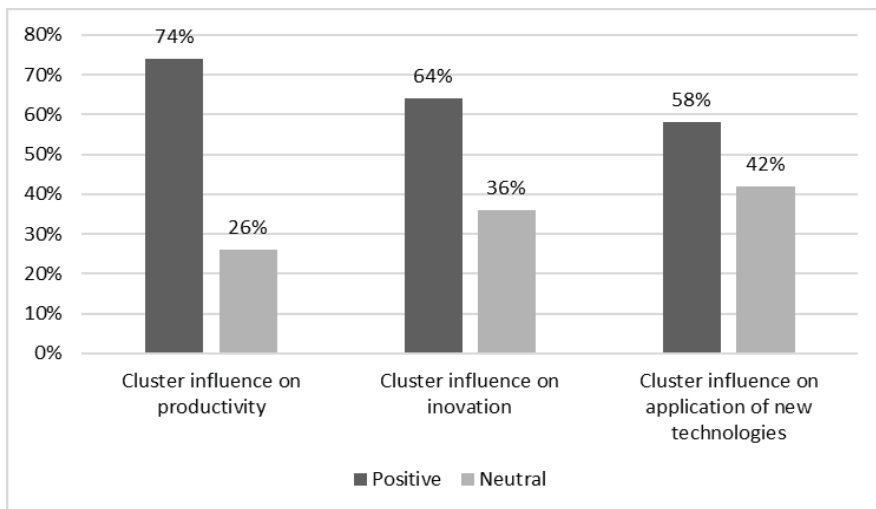
When it comes to complex incentive instruments available to local self-governments, public-private partnerships aimed at improving business-type infrastructure are most often applied. Vasiljević (2012) defines a public-private partnership as: “a long-term contractual relationship (10-30 years) established between entities of a public and private nature to ensure the construction of special purpose facilities and the provision of services under the jurisdiction of the public sector”.

A development policy that is often applied in more developed countries is the policy of business connection through clusters (Skowronek, 2019). Clusters, in addition to having the function of improving cooperation between economic entities, fulfil their role by influencing the growth of exports and the internationalization of the region (Vukotić, Cvijanović & Aničić, 2014, p. 233). The benefits that related companies can

achieve are reflected through the improvement and application of new technologies, the introduction of innovative solutions, the improvement of quality standards, the opening of new markets, and the achievement of economies of scale (Ilić, 2006, p. 81). In addition, companies are enabled to better communicate and exchange information, experiences, and knowledge. Achieving this interaction enables companies to achieve defined strategic goals more efficiently (Pongsiri, 2002, p. 491). In the economies of countries in transition, the implementation of economic policy is based on centralized decision-making without real support for the development of healthy economic competition. In such situations, business entities lose confidence in government systems due to not receiving the right support (Sexton, 2006). In such a state of economic development, donor support for cluster development can be crucial (Ketels, Lindquist & Solvell, 2006).

Research conducted in 2011 showed that clusters can bring great benefits to business entities. It was shown that based on 74 respondents (local self-governments), more than 70% believe that clusters have a positive impact on productivity growth (Figure 1).

Figure 1: Indicators of cluster influence on elements of competitiveness



Source: Author's presentation based on: Vukotić, Ančić & Laketa, 2014

3. Factors of importance for the continuous development of a local self-government

To identify the true effects of economic policy, it is necessary to know the factors that are of the greatest importance for the success of local economic development. According to many authors, the location stands out as a key factor in improving local economic development (Paunović & Zipovski, 2013, p. 75). The importance of this factor depends primarily on the nature of the investment (especially when it comes to new investments) (Adžić, 2013). When considering the decision to embark on an

investment project, investors evaluate the location conditions that are characteristic of the potential investment region (proximity to customers, proximity to suppliers, labour market situation, road infrastructure).

Creating good conditions for the further development of the private sector is another important factor for successful local economic development. Local self-government, through the reduction of tax duties, can encourage the formation of various funds that would help in further local development. The entrepreneurial orientation of public companies founded by local self-government significantly contributes to the creation of a better economic environment at the regional and local levels (Gogić, 2021). This type of orientation implies close cooperation of the public sector with business entities (establishment of public-private partnerships, establishment of business incubators, and other types of cooperation). In this way, it is possible to encourage the establishment of new successful business entities.

In addition to the factors of importance already mentioned, in the literature dealing with local economic development we can also find some of the following factors (Clark, Huxely & Mountford, 2010, p. 23):

1. Natural resources;
2. The inherited state of the economy;
3. Political affiliation;
4. Personnel capacities.

The application of an effective economic policy significantly affects the establishment of sustainable local economic development, the basic concept of which is based on even and continuous economic growth (Pokrajac, 2009, p. 26). Ristić (2014), believes that when achieving sustainable economic development, it is necessary to take care of environmental protection and ecosystem preservation for future generations. The previous definition indicates the need to establish an optimal balance between economic growth, full employment, and environmental protection.

4. Financing of local self-governments on the territory of the Republic of Serbia

The decision on how to finance certain projects of importance to the local population depends on the debt capacity of the same population and the efficiency of the local tax policy. In this regard, the local self-government should provide answers as to whether the local budget is sufficient for the realization of projects of economic importance, or whether they still have to rely on other available sources of financing.

Due to the process of accelerated urbanization and the need for continuous improvement of the level of development of local self-government, the original revenues become insufficient to finance all important projects. For these reasons, local self-government is forced to use secondary sources of financing. By those sources, we mean relying on (Chen, He & Liu, 2017, p. 54): 1. bank loans; 2. financing through the issue of municipal bonds.

It is specific for local self-governments in countries in transition that they predominantly opt for credit debt, which is not the case for local self-governments

in developed countries (they often use the issuance of various securities as a source of financing) (Nedić, Cvetanovic & Subotic, 2017). Most often, municipal bonds are used. The emission of the mentioned bonds is carried out with a longer maturity period (from 7 to 15 years) and with an open option of possible revocation and additional insurance (Lee, Johnson, & Joyce, 2013). We can talk about different types of municipal bonds. The so-called green municipal bonds can have special importance for local self-government. Green municipal bonds represent a specific type of securities based on which local governments can finance environmental and social challenges that are extremely important for sustainable economic development (Candace & Medda, 2020). The issuance of the mentioned bonds provides funds for the financing of ecologically acceptable and responsible projects (Mihelja & Tica, 2021). It is a financial instrument that first appeared on the securities market in 2007, which soon became an attractive way to finance projects that leave a positive impact on the environment (Partridge & Medda, 2020). The inconsistency of the regulatory framework in countries in transition is one of the main reasons for the insufficient implementation of the aforementioned securities by their local governments (Chen & Zhao, 2021, p. 27). A similar problem was present in the market of the Republic of Serbia. Legal restrictions were removed only at the end of 2007. For these reasons, it was only in 2008 that Novi Sad, as the first city in Serbia, decided to issue municipal bonds.

5. Consequences of the pandemic crisis on local finances and local economic development

Before deciding on the way to finance certain projects, the local self-government must consider its financial capacities. Debt capacity can be viewed as an expression of the total financial resources that local self-government can obtain through various forms of debt, without questioning the effective management of local tax policy (Kriz & Wang, 2013). By analysing the indebtedness capacity, the fiscal state of public finances can be determined.

Papcunova, Hudakova, Stubanova, and Urbanikova (2020) point out that: “the availability and level of the potential borrowing capacity of a local self-government can be viewed from the aspect of assessing the indebtedness capacity of the local self-government itself, i.e., assessing the indebtedness capacity of the entire local community”. To make the mentioned assessments, it is necessary to use and observe some of the following criteria (Wang, 2015):

1. The ratio of total debt to the value of the taxable property - if we consider that local budgets are primarily financed from different types of taxes, then the fact is imposed that debt repayment depends on the amount of income generated from taxes;
2. The number of total debts per capita - a parameter that assesses the debt repayment capacities available to the local self-government;
3. The degree of debt repayment - is an indicator that considers the level of the annual amount of liabilities received and the income that the local self-government achieves. When calculating this ratio, it is possible to put special

categories of income of the local self-government unit available for debt repayment into the ratio.

The first two indicators tell us about the financial capacity of the entire local community, while the last one assesses the indebtedness capacity of the local self-government, determining its ability to fulfil obligations within the legally defined term.

When analyzing these two parameters, it is necessary to observe the values in one of the following ways (Kriz & Wang, 2013; Pest, 2015):

1. Analysis of the movement of the values of the observed parameters in the previous period;
2. Comparison of parameters for local self-government units and the same level of development;
3. Comparison of parameters based on the same credit ranks determined by rating agencies.

In this regard, in the further part of the paper, we will consider how the Covid-19 pandemic affected the second and third-mentioned parameters of indebtedness. The analysis covers the period from 2018 to 2020, for nine local self-government. Local governments are divided into groups according to the level of development. By looking at the value of the indebtedness indicator, we can determine the degree of impact of the pandemic on individual local governments.

Table 1: Debt repayment rate for the period from 2018 to 2020 (%)

<i>Development level</i>	<i>Local self-government</i>	<i>2018</i>	<i>2019</i>	<i>2020</i>
First level	Valjevo	6.5	5.4	9.8
	Subotica	13.2	13.3	14.2
	Užice	3.9	2.4	2.5
Second	Ruma	1.9	4.5	4.2
	Jagodina	23.4	21.7	25.2
	Zrenjanin	7.5	11.7	9.9
Third level	Loznica	4.4	3.8	3.9
	Bajina Bašta	11.6	7.1	7.6
	Leskovac	16.2	14.7	11.4

Source: Author's presentation based on PPSRS² data, 2022

The debt repayment indicator is an important indicator when looking at the level of indebtedness of local self-government. The value of this indicator can be influenced by various instruments available to the local self-government (revenue collection based on the level of tax rates and making a decision on the level of indebtedness). The value of the mentioned indicator should be below 10% (Wang, 2015). By analysing Table 1, we can see that in 2020 the value of this parameter is higher than the recommended one

² Public Policy Secretariat of the Republic of Serbia

(in Subotica, Jagodina, and Leskovac). An interesting fact is that all three local self-governments belong to different levels of development, with Jagodina having the highest value of this parameter (25.2%) in 2020. Of the nine analysed local self-governments, value growth in 2020 was recorded in six local governments (Valjevo, Subotica, Užice, Jagodina, Loznica, Bajina Bašta). Growth in the value of the observed indicator in the mentioned year was recorded in all three local governments that belong to the first group of development levels. The highest growth in the value of the ratio in 2020 was recorded in Valjevo (4.4%).

Based on this, we can determine that the majority of local self-governments experienced a drop in income or new types of indebtedness. The economic measures that were taken during 2020, to mitigate the coronavirus pandemic, included the reduction of tax rates for local business entities and entrepreneurs who suffered the most negative consequences. In addition, other socioeconomic measures were implemented to help the local population. This fact can be taken as one of the reasons for the increase in the value of the observed indicator in the analysed local governments. Based on this, it is concluded that the Pandemic crisis has increased the level of indebtedness of local self-government.

Table 2: Public debt per capita for the period from 2018 to 2020

Development level	Local self-government	2018	2019	2020
First level	Valjevo	32.894	36.339	35.061
	Subotica	41.350	46.969	49.862
	Užice	37.499	41.643	44.721
Second level	Ruma	38.433	35.776	37.675
	Jagodina	35.160	42.235	37.491
	Zrenjanin	34.593	40.322	41.403
Third level	Loznica	26.580	28.192	29.788
	Bajina Bašta	33.428	34.926	35.389
	Leskovac	29.048	28.710	30.949

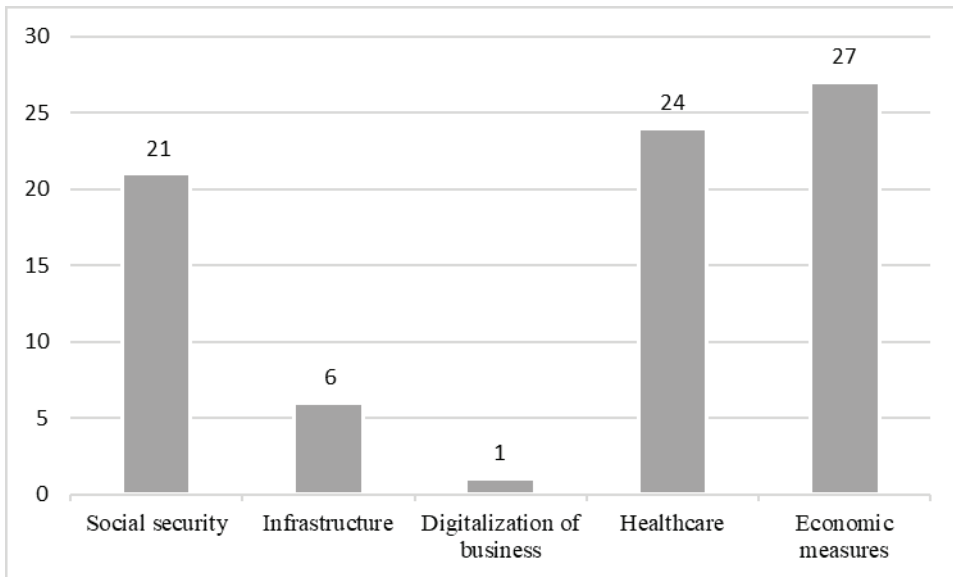
Source: Author's presentation based on PPSRS data, 2022

The total debt per capita is an indicator that can be used to assess the financial resources of the local community. The data from the previous table tells us how the debt per capita of nine local governments moved in the period from 2018 to 2020. In 2020, the growth of this indicator was recorded in seven local governments (Subotica, Užice, Ruma, Zrenjanin, Loznica, Bajina Bašta, and Leskovac).

Specifically, Jagodina recorded a decrease in the value of this indicator in 2020, in contrast to the previously analysed indicator. This fact leads us to the conclusion that the local self-government decided to reduce its obligations due to the drop in income, which caused an increase in the value of the debt repayment indicator. In addition to Jagodina, the decrease in the value of debt per capita was also recorded in Valjevo. The

largest increase in this indicator in 2020 was recorded in the city of Užice. Based on the analysis, we can conclude that the pandemic affected the growth of the obligations of local governments. This fact is to some extent expected, considering the difficulties faced by the local economy and the need to support it through funds from the local budget.

Figure 2: Local self-governments priorities in 2021



Source: Author's presentation based on: Mirić, 2021

The pandemic crisis has affected all spheres of social life. The process of financing projects of importance for further local economic development is difficult for a local self-government. There was a need to provide financial assistance through funds provided by the European Union funds. Through the IPA II funds, the European Union allocated funds of 93 million euros in March 2020 (Mirić, 2021, p. 15). The largest part of the funds was directed towards the achievement of medium-term economic recovery, while 15 million euros was directly intended for emergency humanitarian aid (medical equipment and materials).

In 2021, an examination of local self-governments was carried out regarding priority areas of financing. Answers were received from 59 local self-governments³ (Figure 2). The majority of local self-governments declared that in 2021, their main

³ Belgrade region (Voždovac, Zvezdara, Zemun, Rakovica, Stari Grad, Surčin), Vojvodina region (Sombor, Odžaci, Pančevo, Bela Crkva, Novi Sad, Beočin, Vrbas, Srbobran, Sremski Karlovci, Titel, Kanjiža, Mali Idoš), Šumadije and West Serbia Region (Užice, Sevojno, Nova Varoš, Požega, Prijepolje, Ljig, Mionica, Šabac, Krupanj, Despotovac, Paraćin, Varvarin, Trstenik, Čičevac, Kraljevo, Vrnjačka Banja, Novi Pazar, Raška, Knić, Lapovo, Topola), South and East Serbia region (Majdanpek, Kostolac, Veliko Gradište, Žagubica, Malo Crniće, Petrovac na Mlavi, Boljevac, Sokobanja, Lebane, Pantelejev, Gadžin Han, Merošina, Svrlijig, Pirot, Babušnica, Bela Palanka, Smederevo, Surdulica, Prokuplje, Kuršumljaja).

priority was the successful implementation of economic measures to preserve the local economy (27 local self-government). In addition, many local self-governments declared that the financing of healthcare and social security services is a high priority for them, in contrast to the implementation of infrastructure projects and the implementation of digitization of business.

Conclusion

The majority of local self-governments are forced to use secondary sources of financing during the realization of the most important capital projects. By these sources of financing, we mean credit debt or financing through the issue of municipal securities. In addition, the option of withdrawing funds from various European Union funds is also opened. All these sources can be characterized as long-term debts. Most of the funds provided in this way are necessary for the further economic development of the local community. The way local finances are managed, i.e. debt management, can significantly determine the profitability of planned investments. For the aforementioned reasons, the paper highlights the importance of a well-defined local finance management policy, i.e. debt management.

The paper shows how the Covid-19 pandemic affected the parameters of the responsibility of various local governments. All observed local governments are located on the territory of the Republic of Serbia. The analysed local governments belong to different levels of development. The results of the research indicate the negative impact of the Pandemic on the level of indebtedness of the observed local governments. The reason for the negative trends of the analysed parameters in 2020 can be found in the growth of total debts, i.e., the decline in the income of local self-governments. In local self-government of the first level of development, the negative trends of the mentioned parameters are more noticeable. This fact does not have to exclusively mean that this local self-government led to a bad local finance policy during the pandemic. There is a possibility that local self-governments, through the implementation of various economic measures, consciously renounced a part of their income to improve economic activity. This can lead us to the conclusion that municipalities with a higher level of development have allocated more funds for the remediation of negative consequences in 2020. In the mentioned year, local self-governments pointed out that the priorities for which the most financial resources should be directed are the increase of health capacities and the implementation of economic measures. A significant place was occupied by social security, while the financing of infrastructure projects was not defined as a priority. Based on that, we can conclude that in times of crisis, infrastructure and capital projects do not gain importance. The financing of measures that directly affect the preservation of the existing social and economic situation is in the foreground, while the financing of projects that can further improve economic development is placed in the background.

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