



USAID | **SERBIA**
FROM THE AMERICAN PEOPLE

ASSESSMENT OF FUTURE ASSISTANCE GAPS AND NEEDS TO SUPPORT ECONOMIC DEVELOPMENT IN SERBIA

May 2010

This publication is a modified version of the publication produced by Mendez, England and Associates for the United States Agency for International Development, copyright 2009

CONTENTS

1.	EXECUTIVE SUMMARY	3
2.	INTRODUCTION	5
2.1.	PURPOSE.....	5
2.2.	METHODOLOGY	5
3.	BEYOND MEGA	5
4.	CHALLENGES AT THE LOCAL LEVEL	6
4.1.	NEW REVENUE COLLECTION RESPONSIBILITIES	6
4.2.	NON-DECENTRALIZATION	7
4.3.	INSUFFICIENT NON-DONOR TECHNICAL SUPPORT	7
4.4.	THE DOMINANCE OF PARTY POLITICS	7
4.5.	DIVERGENT VIEWS OF REGIONAL STRUCTURES	7
4.6.	LITTLE ACCESS TO CAPITAL FINANCING.....	7
4.7.	LOCAL GOVERNMENTS AND THE DIRECTORATES	8
4.8.	UTILITIES AND LAND DIRECTORATES.....	8
4.9.	LACK OF ACCOUNTABILITY TO ASSEMBLIES	9
4.10.	MUNICIPAL STAFFING AND COSTS	9
4.11.	MUNICIPAL FINANCE AND REVENUE	9
5.	MACRO CHALLENGES	10
5.1.	ECONOMIC CRISIS	10
5.2.	RURAL DEPOPULATION.....	10
5.3.	ELECTIONS.....	10
6.	ANTICIPATED CHANGES DURING THE PERIOD 2010-2015	11
6.1.	LEGISLATION.....	11
6.2.	FINANCIAL CRISIS.....	13
6.3.	CAPITAL FINANCE SOURCES	13
6.4.	UTILITY REFORM	14
7.	PROPOSED OBJECTIVES	14
8.	PROPOSED AREAS FOR ENGAGEMENT	17
8.1.	CAPITAL INVESTMENT PLANNING AND ACCESS TO FINANCE.....	17
8.2.	MUNICIPAL FINANCE AND REVENUE	18
8.3.	PUBLIC PROPERTY AND ASSET MANAGEMENT	18
8.4.	LED OFFICE AND RDA SUPPORT	19
8.5.	WORKFORCE DEVELOPMENT	20
8.6.	IMPROVING UTILITY PERFORMANCE	21
8.7.	MUNICIPALITY HUMAN RESOURCES	22
8.8.	MUNICIPAL LEVEL POLICY MAKING	22
9.	APPROACHES	24
10.	OTHER DONORS AND AGENCIES' RELATED ACTIVITIES	26

1. EXECUTIVE SUMMARY

This report is an assessment of the economic landscape at the local level in Serbia. It includes local and national challenges, expected changes in that landscape, and gaps and opportunities in the assistance field for the period 2011 through 2015. It makes recommendations on areas of intervention where USAID's support would be most appropriate along with possible approaches, some of which depart from past USAID local economic activities.

Municipalities are currently facing a number of challenges in relation to their efforts to promote economic development. However, they also have some opportunities for strengthening their position. Surveys indicate that:

- Municipalities are newly responsible for collecting property taxes. The administrative costs are significantly outweighed by the opportunity to increase rates of collection and contributions to municipal revenue.
- Ownership of property may soon be devolved to municipalities, increasing requirements for asset management, but creating opportunities for more flexible and cost effective utilization.
- The slow pace of decentralization and a lack of will in central government to progress on necessary secondary legislation, mean that local governments are in a limbo situation with regard to some key responsibilities.
- Politics and political parties dominate the management of local government to the detriment of competence and accountability. A proposed new law on local elections may reduce the parties' influence in favor of a more constituency-based system.
- The creation of regional development agencies is diverging in two directions, with some supporting the establishment of centralized NUTS 2 level agencies, and others supporting smaller, lower level NUTS 3 agencies.
- There are enormous needs for infrastructure investment; however, municipalities have few options for access to capital financing.
- Accountability of municipal institutions such as land directorates and utilities is weak and investment planning is uncoordinated. Therefore, performance and value for money suffer.
- Municipalities tend to be over-staffed, lack appropriate skills, and are under-motivated. Reforms are difficult because of central government restrictions and low levels of knowledge of human resource management approaches.
- Municipal revenues will decline in 2009 and 2010 because of the financial crisis and the requirement to reduce transfers from central government.
- Most technical assistance to municipalities is funded by donors, not by municipalities themselves. An expected donor withdrawal before EU accession would mean an end to accessible support services.
- In addition to local challenges, some macro-level trends will affect any new program of work to tackle local economic development.
- The global economic crisis is affecting new investment, existing firms are facing credit squeezes, and there will be bankruptcies and higher unemployment later in 2009.
- A long term trend of migration away from rural areas and low birth rates makes investment necessary but unattractive outside the big cities. Depopulation and the remaining ageing population will significantly affect municipal revenues, social costs and infrastructure maintenance costs.
- Strained ethnic relations in south and south-west Serbia have resulted in increased populations in minority areas; with higher birth rates, there is high youth

unemployment and significant strain on municipal resources.

- At least one set of local elections will be held during the forecast period; this will disrupt program implementation and impact.

Based on the above indications and an assessment of government strategy, as well as other donors' proposed programs, this report proposes that a new program aim towards the following objectives:

1. Improving municipalities' capital investment programs, including strengthening their abilities to plan and raise funds for capital investment projects that improve the business environment
2. Improving municipalities' capacities and effectiveness in raising and collecting own revenue taxes, including good business-friendly tax policies
3. Improving municipalities' abilities to manage property and other assets for the benefit of their community, and to realize maximum utilization
4. Supporting Local Economic Development (LED) Offices and Regional Development Agencies (RDAs) to promote conditions for investment and business growth
5. Supporting the development of a workforce that has more appropriate skills to meet the strategies and requirements of municipalities and regions
6. Improving the delivery of public utility services provided by and under the control of the Municipal Assemblies
7. Improving the ability of municipal organizations to motivate and develop their staff for improved service performance
8. Support municipal assemblies to improve the quality of policy-making and provide them with the tools to improve accountability of public services

These objectives would be achieved by specifically designed activities in conjunction with an overall strategic approach that would have the following key features:

- Competitive selection of municipalities and RDAs to participate in the program
- Regional hubs, in which 'hub' municipalities and RDAs work together to provide support to smaller poorer municipalities in the region
- Locating in the regional towns rather than big cities or remote rural areas (e. g. Zaječar, Užice, Prijepolje, Vranje). Towns with minority populations should also be targeted (Novi Pazar, Bujanovac)
- Intensive work with Assemblies, which are the key to all change at municipal level
- Working with civil society, local media and the public to maintain momentum for reform
- Tailoring support to each municipality and RDA, based on needs, capacities and the availability of other support programs. Defined exit criteria identify when support will no longer be needed.
- Support the use of private/non-profit sectors services providers, and support municipalities to develop their willingness and capacities to engage them
- Engage with and support central government policy

With these objectives and approaches, a program of work costing around USD 15 million over 5 years could significantly improve the conditions for local economic development in around 20 municipalities *and* their surrounding areas. Further, it would enable these municipalities to continue their development trajectory, by positioning them with the right skills and resources to access further support from EU accession funds and the structural funds that will come from EU membership.

2. INTRODUCTION

2.1. Purpose

This report is prepared in response to RFP No. 169-09-015 (4/24/2009). It has been prepared after extensive discussions with large and small municipalities, national ministries, as well as various organizations and individuals associated with local and national economic growth activities in Serbia.

It specifically addresses the goals of the Assistance Objective 1 as set forth in the SOW “Market Economy Strengthened” and its two intermediate results (“Enabling Environment for Enterprises Improved” and “Local Business Climate Improved”).

In preparation for the development of a new five-year strategy (2011-2015), USAID Serbia contracted with Mendez England & Associates (ME&A), Inc. for a three-person team to conduct an assessment of the economic growth environment in Serbia. The purpose of this assessment was to make specific recommendations about whether USAID should continue its current course of technical assistance or whether a different course might need to be considered.

2.2. Methodology

The assessment team was comprised of William J. Althaus, Team Leader, and J. Hugh Nichols and Richard Allen. All the team members had significant experience in the Balkans and on local economic development issues. The team assembled in Belgrade on May 25, 2009 and completed its work on June 19, 2009. The team interviewed over 100 individuals including USAID representatives, MEGA staff, officials of 18 municipalities, representatives of relevant government ministries and agencies, regional development agencies, the private sector, non-governmental organizations relevant to local economic growth activities and the European Commission and other international donors. Numerous documents and reports were reviewed. The field work occupied three weeks and reached every geographic region of Serbia. The final draft report was submitted prior to departure from Serbia.

3. BEYOND MEGA

USAID’s Municipal Economic Growth Activity (MEGA) will complete its five-year tenure in September 2010. MEGA’s principal areas of activity have included the establishment of 32 local economic development offices, support for Citizen Assistance Centers (CACs), asset management capacity-building, policy advocacy concerning laws related to local economic empowerment, municipal financial management training and capital investment planning. The assessment team’s necessarily-limited review found that in each of these areas MEGA has or will have accomplished all the results that the landscape permitted. Further work in most of these areas is indicated, sometimes adjusted for new realities. The rationale for the following observations is described elsewhere in this report.

Local Economic Development Offices

The emphasis should be on raising the capacity of many, if not all, existing LED offices. New ones should be considered only if strong candidates are identified, resources permit, or for reasons related to US Government policy objectives. As described elsewhere, the hub

concept should be used to bring together municipalities in a region to plan and implement projects necessary for a healthy economic growth environment.

Citizen Assistance Centres

We do not recommend any further work on this activity. The concept is sound and we understand that many are performing very well. However a CAC is not central enough to the economic goals to justify allocation of diminishing resources.

Asset Management

This activity will be incomplete as of September 2010 but only because of the non-enactment of the Law on Public Property. The great likelihood of such a law makes this an activity that should be pursued vigorously.

Policy Advocacy

Significant success was realized on the Law on Local Finance but there are other equally critical laws to come and this work should be continued.

Municipal Financial Management

Progress has been made within the scope of available time and resources but the need for better management in order to access credit makes the continuation of financial management support most important.

Capital Investment Planning (CIP)

This activity should support CIPs in municipalities where they have not been completed but should focus mainly on regional CIPs using the LED hub approach.

4. CHALLENGES AT THE LOCAL LEVEL

4.1. New Revenue Collection Responsibilities

Beginning in 2008, local governments in Serbia are responsible for collecting property taxes which had previously been a function of the central government. Because the revenues were for the use of local governments, the central authorities made little effort to develop and maintain reliable databases or collect revenues efficiently. Property taxes could be, as almost everywhere else, the principal own-source revenue for local governments. In the local economic development context, a local government's ability to create a positive business environment depends upon having sufficient revenues to provide needed services and infrastructure.

However, municipalities have not yet developed the capacity or the tax rolls to achieve worthwhile results. Technical assistance, hardware and software will all be needed by many of the smaller municipalities before this revenue source reaches its potential. It may well be that, building upon regional networks discussed later in this report, tax administration might be a candidate for a cooperative approach by establishing regional tax bureaus to service a group of municipalities.

4.2. Non-Decentralization

Serbia retains probably the most centralized governmental system in the region. While some of the primary legislation has been passed, the secondary laws needed for implementation have not. The Council of Europe has been doing work in this area. Discussions with the ministries of finance and local government indicate that the Government has no intention of moving toward a more decentralized system any time soon. This is a serious impediment to local efforts to foster economic growth. Just as revenues are essential, so is the authority to act.

4.3. Insufficient Non-Donor Technical Support

There is an apparent absence of a private market of technical assistance to local governments on a variety of issues such as project preparation, economic promotion and basic municipal management. This is unfortunate because the marketplace is where such services should be bought and sold. It would contribute to both the economy and the intellectual capital of the country. Paradoxically, this problem is caused, in part, by the generosity of the donors. It would be most difficult to succeed as a small consulting firm in competition with international entities that provide expertise, both foreign and local, at no charge. But within a few years the bi-lateral donors will begin to depart Serbia and there needs to be a private market to fill the gap.

4.4. The Dominance of Party Politics

This problem is, of course, not unique to Serbia. However, because of the use of a party-list system for local assembly elections, it may be worse at the local level than elsewhere. In a direct constituent-based electoral system, good government can equal good politics but not so where candidates and officeholders owe their positions to party strength, not their own performance on behalf of the citizens. The effects are most acute with regard to the directorates and utilities whose leaders are chosen for party loyalty, not competence. The pending new Law on Local Elections could improve matters but that seems unlikely. Engagement with local assembly members is a possible way to effect some movement.

4.5. Divergent Views of Regional Structures

The European Commission delivers much of its assistance to transitioning countries through regional structures known as NUTS, from a French acronym. NUTS 1 is a national delineation not relevant here. NUTS 2 is planned to consist of seven large regions. It is at this level that most projects will be implemented. Under the draft Law on Regional Development, now in the parliamentary process, these regions would be created and controlled by the Ministry of Economy and Regional Development. It is a top-down approach that appears not to invite or even accommodate any significant local input in the process for deciding the application of hundreds of millions of Euros in EC support.

Because local governments need input into these processes and have none, there have arisen several NUTS 3 level regional agencies (RDAs). Some have been established by municipalities on their own initiative and some with donor leadership including, curiously, the European Commission. Because of the government's indifference (at best), these small regional entities can be seen as endangered although their survival could be critically important to local governments in their efforts to influence the development process.

4.6. Little Access to Capital Financing

In the face of enormous needs for infrastructure investment, municipalities have very little access to any capital markets. Because of their size and lack of capacity and resources, it can be expected that most municipalities will not be able, in the foreseeable future, to obtain capital through the issuance of bonds. Lack of ownership of the public property renders them unable to collateralize loans from private banks; likewise inadequate and uncertain revenue streams in the utilities rule out revenue bond issues for most as well. Thus most local

governments are left in the posture of supplicants awaiting the largesse of the international community, particularly the IPA funds from the EC. Since the quality of proposals drives access to funding, the small municipalities with less capacity stand to fare badly.

4.7. Local Governments and the Directorates

As discussed above, heads of the directorates for construction and land are appointed by the municipal assembly on the basis of party affiliation rather than competence. Once appointed, they are largely free of de facto accountability to the assembly. Since these entities perform many critical development functions, such as capital planning and project design, their unaccountability and questionable capacity cause serious problems for local economic development. The utilities themselves do not control their own capital budgets.

4.8. Utilities and Land Directorates

The Land or Construction Directorates are basically carryovers from the pre-Serbia government when they planned and managed almost all of the major municipal investments. Their duties ranged from the traditional functions of water supply, sewage, solid waste disposal to more mundane tasks of removing dead animals and, in some instances, human burials. To perform these utilitarian functions, they collect both land use fees and development fees. They are basically the equivalent of the local governments Department of Public Works in the United States.

The land use fee is a thinly veiled version of a property tax based up on the amount of land that a structure occupies and the purpose for which the structure is used. Theoretically, the fee is set by the directorate to build and maintain the infrastructure for which it is responsible and, again, theoretically, set at a level relating to the amount of infrastructure a person or business is or will be using. But since the direct taxing, or charging, of individuals is distasteful, the fee (which is administered like a tax) is set low for individuals. Businesses are the primary target of the land use fee and may have fees set five or more times higher. In neither case does the cost of the infrastructure directly relate to the fee being paid (in some cases this may be a factor in new business start-ups or relocation thus affecting economic growth.)

The development fee is a one-time charge which is, theoretically, for the purpose of funding the investment cost to provide the increased infrastructure of the facility (residential or commercial) being constructed. Therefore, like the land use fee, it takes into consideration the square meters of any structure, the location of the structure, and the economic purpose for the structure. Like the land use fee, the development fee is also theoretically set to; at least, partially pay for the construction of the necessary infrastructure. Therefore, this is a fee on new investments that may be waived or reduced as an incentive as an economic growth incentive.

Theoretically, the pricing of utility products/services is set at the cost of operation because, historically, the utilities were not permitted to include the investment costs in the fee charged for products/services. This creates two problems: 1) the planning of; and 2) the payment for, construction. This has a twofold impact: The utility has little input into the location and service capability of the infrastructure because it is designed and constructed by the Directorate which must provide for the costs from its revenue sources. Therefore the utility does not include the investment costs in its pricing determinations. The situation is further aggravated by central government caps on permitted annual price increases

Utility rates are set by the assembly within limits prescribed by law. Unfortunately, it seems that many choose to opt for short term political safety instead of a business-friendly policy by setting rates higher for businesses than individuals. Whatever the rates, there are serious collection problems since enforcement by denial of service is usually impossible, e. g. shutting off heating to a building with 40 families because 10 are not paying. Because many

municipalities must provide operating subsidies to their utilities the motivation to set rates, collect them and perform efficiently is diminished.

4.9. Lack of Accountability to Assemblies

Assemblies have some potential authority over utilities, directorates and other municipal offices but this is severely limited by the political positions of the heads of those entities and also by the lack of capacity, will and staff of the assembly. Utilities files annual reports which are little more than lists of activities carried out, but Assembly members lack the understanding to evaluate, as well as the political clout to discipline them for inadequate performance.

4.10. Municipal Staffing and Costs

Many municipalities have far too many staff, often untrained and unmotivated. However the cost under law to make an employee redundant is so severe that local governments usually have no alternative but to keep them. This is particularly unfortunate when a local government must hire new staff with skills for a certain position, such as LED director. In that case they must pay for the qualified staffer but also keep paying for old ones whom they don't need. The Ministry of Public Administration and Local Government announced a plan to help municipalities with the costs of cutting staff. However, in the current economic situation, the plan was withdrawn and it is unclear when or if it might be resurrected.

4.11. Municipal Finance and Revenue

In recent budgets, the municipalities receive a large proportion of its revenue by transfer from central government. In general terms the government is projecting that the amounts of transfers will drop significantly in 2009 because of the international economic crisis.

This will be critical for municipalities that must fund the remainder of their operating budgets from the property tax, pay the investment costs of any shortfall in Land Directorate infrastructure costs, and make up the difference between the utility pricing caps and the actual cost of the utility services. The evidence is that not all property has been registered for property tax, and collection to date [by the central government agency] has been insufficiently rigorous. Taking on responsibility for property tax collection will provide some undetermined, yet probably insufficient, increase in property tax revenue. Given the reduction in transfers from the central government and the likely insufficiency of existing property tax revenues starting in 2009, a review and possible consolidation of all municipal revenue resources needs to be undertaken. This could be done and accounted for without any immediate reassignment of resources among the municipal authorities and provide a central auditable accounting mechanism.

The land use fee collected and managed by the Land Directorate is essentially a property tax and could be included as such, either separately specified as revenue dedicated to the Directorate, or folded into the general property tax revenue account and apportioned as needed and approved for utility use. As the public property devolution process is expedited and the properties are sold or developed, there is a potential for increased property tax revenue.

There is also a development fee for infrastructure that is discussed further under "Utilities and Land Directorates." This fee is charged for both commercial and residential development of land and is generally collected and administered by the Construction Directorate

The intergovernmental and policy relationships between the finance and revenue activities of the municipality and the investment/operational activities of the utilities and land directorates continues to create conflict and uncertainty in the delivery of and accountability for municipal services

5. MACRO CHALLENGES

5.1. Economic Crisis

Interviewees in banks and small businesses suggested that later this year there would be a serious downturn in the financial and business situation in Serbia. Businesses in Serbia generally do not borrow from banks for debt financing; there are terms of credit to suppliers and buyers of up to 180 days. Many of the large state-owned businesses are not paying their bills to suppliers. This will have a severe knock-on effect when the terms of credit expire. The large state owned businesses will not be allowed to fail, but their smaller private suppliers will. As suppliers fail to be paid, their suppliers in turn will suffer. By fall, many businesses are expected to fail and bring down others in turn. The slow processes in bankruptcy courts will exacerbate the crisis, preventing creditors from accessing any compensation for some time.

Inflexibility in the economy and labor markets will mean that from the end of 2009 Serbia is likely to enter a severe downturn from which it will take a long time to recover. Swift and decisive action, greater decentralization, and liberalization of the economy is needed from government. However, the track record of the government is relatively weak and these things are hard to do without strong and clear-sighted leadership.

5.2. Rural Depopulation

Rural areas have been severely depopulated in recent years. Municipalities are facing up to 10% decreases in population over a ten year period, with no signs of slowing. Depopulation is a factor of declining birth-rates, ageing populations and migration to cities and abroad. This causes a number of significant problems for municipalities. First, it is hard to find sufficiently qualified people to work in the public sector; there is a big shortage of teachers and specialists for municipal administration are hard to find. Second, municipal infrastructure is underutilized, leading to higher fixed costs and less money for services. Third, and perhaps most importantly, depopulation will decrease the tax base, leading to lower municipal incomes. This has not been evident in recent years because of changes to the way in which government transfers have been calculated, favoring poorer, rural areas. In the longer term, however, this may become a significant factor. Decreasing revenues may then accelerate the spiral of decline.

Interviewees suggested that little could be done about the extreme rural areas, and that investment in education and jobs should be made in rural towns which are likely to be 'hubs' for the areas around them. This would reduce the likelihood of the worst case scenario in which migration occurs only to the largest cities or abroad.

5.3. Elections

The next scheduled date for national and local elections in Serbia is 2012. The elections in 2008 proved extremely disruptive to the process of local government, and to all the reform programs in process, delaying progress by at least 6 months. There are three basic scenarios for the patterns of disruption by future elections, depending on the timing of national and local elections.

1. A national election is held early, local elections follow in 2012. This is the least disruptive scenario; national elections absorb the time and energy of local politicians, but the local assemblies continue to function. In a subsequent local election, the national coalitions are already established, and local ones can follow the national pattern. The subsequent local election may not be held until 2016.
2. National and local elections are held simultaneously in 2012. This is more disruptive, because prior to elections campaigning is more intense, absorbs more

time of elected officials and slows decision-making. After elections, local parties have to wait until national level coalitions are formed before beginning to negotiate their own coalitions. The subsequent election would be held in 2016, if the government coalition is stable.

3. National and local elections are held early before 2011. This is the most disruptive scenario from the USAID perspective, because it would mean two elections, both national and local, during the implementation period of the program; a subsequent election would have to be held by 2015. This could lose around a year of implementation time, plus the added disruption of changes to elected officials.

Programming for the period 2011 to 2015 must therefore take into account at least one, possibility two local elections, together with their consequent negative effects on implementation of reforms.

6. ANTICIPATED CHANGES DURING THE PERIOD 2010-2015

The hazards of predicting the future are well known. Attempting to do so in Serbia, a country with a tendency toward the unpredictable, is doubly hazardous. Nevertheless, there are some indications at the time of writing of some of the trends and events that will have an impact on local economic growth between 2010 and 2015.

6.1. Legislation

New laws in Serbia are regularly announced, and their proponent ministries are usually confident of them passing through government and parliamentary procedure swiftly. Events, however, often conspire to slow their progress, or even remove them entirely from collective memory (e. g. the NGO law). The following are laws that are predicted and are in draft. They will have fundamental effects on local economic development, although because they are not yet finalized, the precise impact cannot be known.

Law on Regional Development

The draft law on regional development proposes institutional arrangements for managing the pre-accession and post-accession EU funds earmarked for regional development. The law would establish seven NUTS 2 regions for statistical purposes, each of which will have an agency charged with a key role in disbursement and management of funds. Vojvodina and Belgrade will each be regions with an element of democratic control through the provincial and city governments respectively. The other four regions in Serbia proper will be accountable only to the Ministry responsible (likely to be the Ministry for Economy and Regional Development) and a National Council for Regional Development.

Under the draft law, a fund for regional development will be established, although the criteria and mechanisms for disbursement are undefined. The law only says that the fund will be for *loans* for regional development purposes.

Regardless of the specificities of the coming law, it looks as though there will be two tiers of regional agencies, at both NUTS 2 and NUTS 3 levels. The NUTS 2 agencies will be, in effect, deconcentrated agencies of the Ministry of Economy and Regional Development, over which the Ministry will have substantial influence. These will cover the whole country, albeit at a level somewhat removed from the municipalities they will support.

The NUTS 3 agencies will be voluntary, in the sense that they are not mandated to exist. Rather, they can be created at the initiative of municipalities or NGOs. They will need to be accredited by the National Agency for Regional Development, but the criteria for accreditation have yet to be specified or agreed. There are currently around 9 NUTS 3

agencies in Serbia, most of which were created with the support of EC programs or bilateral donors. They will require substantial level of success in order to demonstrate their legitimacy, and to maintain a sustainable level of funding and support from the municipalities for which they work.

The NUTS 3 agencies would typically support from 3 to 13 municipalities, and are therefore appropriately sized to be able to provide effective support to municipalities on a range of development activities. In particular, the authors of this report suggest that the NUTS 3 agencies could be appropriate institutional vehicles for providing technical support in proposals and project management to smaller, more rural municipalities which do not have viable capacity for such skills. However, significant work needs to be done to bring the regional agencies closer to their member municipalities in terms of understanding, and to see municipalities as their customers rather than as subjects.

The competence of the NUTS 3 agencies becomes crucial in the coming years, not just for their ability to support their municipalities, but also for their ability to advocate with NUTS 2 agencies and the national agency for regional development for the interests of their municipalities. Further, their implementation capacity and ability to develop good quality project designs will be a factor in national and regional decisions about how to allocate funds. Areas with strong NUTS 3 agencies are therefore likely to obtain more regional funding support than those with weak or non-existent agencies.

Law on Public Property

Formal ownership of municipalities' property was transferred to central government in the 1990s. Since then, there has been an intense lobbying campaign to have this decision reversed. A law on public property is in the pipeline which would do just that, and some in government are saying that it could be passed this year. This is a law that is not without controversy, however. It has been linked to the problems of property restitution, which are still unresolved, and central government has fears of returning this responsibility to municipalities for financial reasons and concerns about possible corruption.

If the law is passed, however, it would be a major fillip to local economic growth. Municipalities would be able to use returned property as collateral for loans, and they would also be able to offer ownership of property as incentives for potential investors. Currently use of municipal property can only be given on a 99 year lease agreement, and leases cannot be traded.

The consequence of the law would also be to increase the responsibilities of municipalities for asset management. They would no longer have to accept the maintenance responsibility of property that is no longer, or only partly in use, and could sell unnecessary property to finance further capital investment. There are risks, however, that sale of property is used to finance current deficits, or worse. Many municipalities would require development of their asset management capacities. There is also speculation that the property restitution question could be linked. Return of property to municipalities could mean that liabilities for compensation and restitution are also transferred to municipalities. Claims for property restitution were submitted to central government by 2006, but these are not currently available to the public. This means that the extent of government liabilities is not known. Transfer of property to municipalities could also mean that the balance sheet liabilities presented by the restitution issue are also transferred to municipalities.

The property transfer story is likely to continue during the project period, and therefore support from USAID for advocacy if the law is not passed, and for assistance with asset management if the law is passed, would be highly beneficial.

Law on Local Elections

A new draft law on local elections appears to be an experiment to reintroduce some form of constituency or ward-based accountability at the local level. According to CeSID, the draft law proposes a mixture of the party list system and the constituency system, under which

elected officials would represent a part of the territory of the municipality. This represents a potential increase in the degree of accountability individual elected officials have to their constituents, and a commensurate reduction in their obligations to follow party diktat (although they would still have to be loyal to their parties in order to be placed on the party list in the first place).

It could present an opportunity for USAID to provide assistance to elected officials in terms of their ability to deliver on their constituents' wishes. This could be done, for example, by introducing assembly members to tools and techniques for setting service level objectives for the utilities and other municipal companies, and for holding the directors to account if they fail to meet objectives.

Law on Spatial Planning

A new law on spatial planning is currently in draft, and it is expected to be passed in 2009. It should help to ease the bureaucratic requirements for obtaining building permits in the long term, but much work will need to be done to prepare national, regional and local spatial plans in order to make this happen.

6.2. Financial Crisis

As discussed above, the current financial crisis is expected to worsen later in 2009, with severe consequences for local economic development. The closure of manufacturing and processing companies and consequent increase in unemployment will mean increased social costs for central and local government. There will be a knock-on effect to local services companies too. At the same time, central government transfers to local government are being reduced at the initiative of the IMF; this is most likely to happen in both 2009 and 2010. We are already seeing a significant reduction in the value of inward investment, and new investments generally as a result of the crisis. This is likely to continue to 2010 at least.

Municipalities will face a squeeze on their budgets that may have positive consequences. Their budgets are considered adequate for their current activities, but high costs mean their expenditure is limited. The financial crisis may put extra pressure to reduce costs through shedding staff and making other efficiency savings. This would be more likely if the Ministry of Public Administration and Local Self Government reintroduces its proposed package of support for redundancies and early retirement. Municipalities are already seeing an increase in their own revenues from property taxes since January 2009 when they were obliged to take responsibility for collection from the state-level body. Further pressure on budgets may see more efforts being made to ensure registration for, and payment of, local taxes. If, as expected, the financial crisis severely harms the prospects for inward investment in the medium term, the role of the LED offices may have to shift somewhat away from investment promotion. Instead, the LED office could focus on preparing the ground for future investment, such as workforce development and ensuring necessary infrastructure is in place. It would also be essential in assisting existing companies to survive and access new markets. One other effect of the financial crisis may be an accelerated depopulation of young and educated people away from rural areas, severely limiting prospects for recovery. Investment in training and opportunities for young people would be necessary even during the downturn.

6.3. Capital Finance Sources

Capital finance is at present very limited for municipalities. The majority of municipalities use budget funds for investments, which limits the size of the infrastructure projects they can fund each year. Loans are limited to 20% of the previous year's budget by law, and can be subject to fluctuations in exchange rates. The future of capital finance is not looking bright. Municipal bonds are one possibility, but these will be available only to the larger municipalities with more stringent standards of financial accountability, and only if there are

changes in the law to allow a bond market to flourish. The National Investment Plan is significantly depleted, having been spent in what some consider to be an uncoordinated and un-strategic manner. The European Union's Instrument for Pre-accession Assistance, IPA, is being eroded by the financial crisis; half of the funds for 2009 are being used as government budget support, leaving only around €100 million for IPA projects. The government is currently searching for other sources of capital finance, including in Russia and China. These may be channeled into funds such as the proposed Regional Development Fund, a revolving loan fund envisaged by the Law on Regional Development.

Public-Private partnership is regularly touted as being a solution to capital investment needs. Municipalities we spoke to were reluctant to engage in this form of enterprise, mainly from a suspicion of private business. Many of the smaller municipalities will not have the necessary expertise in-house, and may not be able to afford the necessary fees for adequately qualified lawyers and other professionals.

The future of capital finance for municipalities is therefore mainly focused on access to donor funds. Those with the capacity to develop good quality proposals will be those which obtain funds, and those with lesser capacities will lose out; this will most likely exacerbate regional divides, rather than reducing them.

6.4. Utility Reform

Both GTZ and MEGA are engaged in programs of reform of municipal utilities. MEGA is supporting the development of a utility reform strategy. This will take shape by the end of 2009; if there is government support, it will most likely follow after some delay. During the period of the future program, however, it is likely that there will be some attempts to reform the ownership and structure of municipal utilities.

7. PROPOSED OBJECTIVES

Better Regional Capital Investment Planning

MEGA has done solid work in capital investment planning with individual municipalities but new realities are approaching. With or without a new law on regional development or the much-awaited IPA and structural funds from the EC, local governments in Serbia are just beginning to think and act regionally. Regional cooperation in planning and implementing projects is critical to accessing the EC funds but it is more than that. It is good government. This is the cornerstone of the local role in economic development. Most of the small, usually poor, municipalities in Serbia not only cannot undertake large projects such as wastewater plants or landfills by themselves, but, more importantly, they should not. A favorable climate for business requires services and infrastructure levels that are beyond the means of these localities when acting alone. The regional CIPs should be related to the regional strategies also arising from the process of collaboration.

If municipalities begin to plan together, the next logical step could be shared services, such as tax administration, waste hauling or road repair. But the first step should be creating a culture of regional planning and implementation at the NUTS 3 level. Nothing in the government-controlled NUTS 2 structures allows this kind of efficient cooperation.

Municipally-owned and Well-managed Public Property

At some time in the coming period, much public property will be devolved to municipal ownership. As that subject moves forward at the central level, the International Community should use its influence to see that the Government of Serbia resolves the matter of restitution

before the transfer of property. Failure to put in place a comprehensive nationally-funded restitution plan means that devolution will entail shifting a potential liability from the central government to local governments.

Land that is under the ownership and true control of a local government has two values. First, it can be sold for development based on the municipality's strategic plan. This brings revenue and moves the plan forward. Second, it can be used as collateral for market financing, something presently out of the reach of most Serbian local governments. But if local governments receive property with no resolution of the restitution issue, the land is essentially worthless for either of those purposes.

Without waiting for the actual transfer of public property, USAID should continue MEGA's work in addressing an often-stated need of local officials, that is, technical assistance to build asset management capacity. This could include software applications and training on valuation. Local governments need this capacity not only to manage public property yet to be devolved but also to practice good governance techniques in their daily operation with current assets.

Strong RDAs Supporting Municipalities

The regional system planned by the government will deconcentrate authority geographically but will in no way decentralize the development regime, thus leaving local governments in a powerless state where access to development resources will be determined by political and personal influence rather than merit. Regional municipal alliances can be built around NUTS 3 RDAs where they exist or can be developed through the hub system described *infra*. These regional structures, whether formal under RDAs or informal, will foster local economic development in two ways. First, they will give municipalities a voice loud enough to be heard at the government-controlled NUTS 2 RDA level. This will make the application of resources, EC/IPA or other, more responsive to the needs of local governments and citizens than any Belgrade-controlled system could. Secondly, regionally-coordinated, cooperating local government is good government. The majority of the small Serbia municipalities not only cannot support major infrastructure projects individually, but they should not. Landfills, wastewater plants, road planning programs and the like should all be prepared regionally by municipalities with common interests.

Workforce Skills Better Matched to Employer Needs

One of the most important factors in business location decisions is the availability of workers with the required skills for the enterprise. A working partnership should be established that includes LED offices, universities, businesses and business associations and, necessarily, the National Employment Service. Such an effort can be a major draw for foreign investors and also help existing businesses remain competitive.

A Private Training and Consultancy Market

Almost all capacity-building and consultancy for local governments in Serbia is presently provided by international donors. While this is understandable and somewhat inevitable, it is necessary to begin to create a private market. By the end of the period 2011 to 2015, it is likely that the majority of bi-lateral donors will have left or be planning to end their tenure in Serbia. It cannot be expected that the Government of Serbia will have either the capacity or the will to fill the vacuum in technical support. Nor would that be the best long term solution. Similarly, technical assistance by the European Commission would only be a short term approach. Healthy economies have private markets for such skills and it can be assumed that the skilled individuals are present in Serbia.

Two actions could help movement toward the goal of a private professional market in municipal management skills. First, a USAID project should offer a voucher program to selected municipalities to procure and use consultancy skills from private firms. This helps the municipality with procurement decisions, provides income to the private vendors and also

helps keep the resources and the individuals in Serbia. Secondly, other donors must be encouraged to support the approach by beginning to charge modest fees for assistance provided and indeed to work to steer the municipalities to private sources.

Accountability of Municipal Assemblies

Presently, assembly members see their allegiance as being to their party, not the public. While major changes are needed in the Law on Local Elections, there are changes that can be attempted at the local level. If municipal service delivery, transparency and costs are analyzed and reported to the citizens by carefully selected NGOs, great pressure can be brought to bear on the elected officials to improve their responsiveness and the service level of the local government.

8. PROPOSED AREAS FOR ENGAGEMENT

8.1. Capital Investment Planning and Access to Finance

The MEGA program has been assisting some municipalities with their capital investment planning, and this has proven to be a valuable and appreciated activity. In general, municipalities' capital investment plans are wish-lists, rather than carefully prioritized projects, with assessments of cost and benefit. They often do not link to the intentions established in their strategic plans, or regional strategic plans.

With the continued strengthening of the NUTS 3 level Regional Development Agencies, and general donor engagement in the preparation of strategic plans, many municipalities would benefit from considered and experienced assistance with capital investment planning.

Municipalities are also severely restricted in their abilities to raise capital finance to pay for infrastructure projects and other investments. Currently they are limited to borrowing up to 20% of the value of their previous year's budget, but bank borrowing is on unfavorable terms and denominated in foreign currency. This presents unacceptable risks for most municipalities. The only other alternative currently available is competitive funds, such as the National Investment Plan and the coming EU IPA (Instrument for Pre-accession Assistance) funds, and some other government sources such as lottery funds. Municipalities are currently being encouraged to lodge investment projects in the 'SLAP' pipeline, which is a database managed by the Standing Conference of Towns and Municipalities and supported by the EC-funded Municipal Infrastructure Support Project (MISP).

Municipal infrastructure is further hampered from investment by the unrealistically low pricing of utilities. Municipality assemblies are responsible for deciding annual increases of utility prices within a limit set by central government. For electoral reasons, municipal assemblies often do not increase utility charges to the maximum amount, but then provide subsidies to the utility companies from the local budget. This means that utility fees often do not cover the running and maintenance costs of utilities, still less any investments required. This hampers the ability of utilities to raise finance, (which is anyway mostly done by the land directorates), and has led to a vicious cycle of under-investment.

Additionally, the structure of local government does not support coordinated investment planning. The land directorates are primarily responsible for capital investment planning, but are independent of the municipal administration, and largely outside the control of the Mayor. The directorates are also independent of the utilities, so the only coordinating body is the Municipal Assembly. An overlay of political interest in the appointment of directors of these institutions means that consolidated capital investment planning is difficult.

Alternative sources of capital finance being discussed, but so far not realized, include Municipal Bonds, and Public-Private Partnership. Municipalities consulted were for the most part skeptical and reluctant to consider these possibilities.

Many required investment projects are not contained within the boundaries of a single municipality. Central government and the EC is encouraging solid waste, waste water treatment and water supply infrastructure to be a shared between neighboring municipalities. Therefore, much capital investment planning needs to be carried out at the NUTS 3 regional level. This means that any future USAID engagement on capital investment planning take into consideration both municipal and NUTS 3 region needs.

We suggest, then, that USAID consider technical support to individual municipalities, together with their associated RDA, in the following:

- Continued support and mentoring in the preparation of project plans and project implementation
- Preparation of capital investment plans that prioritize investment projects on the basis of costs and benefits, and other criteria

- Assistance in identification of potential sources of capital finance
- Assistance with accessing capital finance (e. g. development of PPP agreements)
- Lobbying and support to reform in the structure of local government companies and directorates, in line with the forthcoming strategy for utility reform.

8.2. Municipal Finance and Revenue

MEGA has recently engaged on a program of support for municipalities in the area of finance and revenue. Municipalities' new revenue collection responsibilities have posed a challenge to many of the smaller municipalities which lack the resources to establish sound systems and data for reliable revenue collection. Municipalities valued this support, and voiced support for its continuation. Further progress in this area is likely to result in significantly increased revenues from property tax collection and a reduction in costs if there is consolidation of the revenue collection functions between municipal administrations and the land directorates.

USAID should consider providing continuing support to municipalities in this area. This might consist of:

- Technical advice and support in establishing levels of property tax for residential and business use to maximize both revenues and competitiveness
- Assistance with IT software required for making changes to the revenue collection systems, especially in terms of enabling the sharing of data between utilities, land directorates and the municipal administrations
- Support to reforming the revenue collection responsibilities of municipal institutions with a view to removing land use and land development fees in favor of a simpler system of property taxes and more realistic utility charges. This would require advocacy and support to central government as well as practical and technical support to municipalities
- Technical assistance with budgeting and identifying areas for cost reductions and efficiency savings.

While not explicitly ruled out, public budget hearings have not been a great success in Serbia; they work when supported by donor support, but tend not to be sustainable. The legally required hearings might be a way to exercise some public influence over the budget, but it would need to be associated with greater civil society awareness-raising and training on budget analysis, and understanding of the legal constraints within which municipalities operate.

8.3. Public Property and Asset Management

In the 1990s all municipal owned property was transferred to the ownership of the central state. This means that municipalities require the permission from the national government to change land use or to sell property. Often this permission can take some years to obtain. This restricts economic growth because potential investors can only obtain permission to use land for up to 99 years. These so-called 'leases' are not tradable, so cannot be used as security on loans.

There has been much lobbying in recent years to return property back to municipalities. Government representatives told the authors of this report that the Law on Public Property would be passed within the coming year, and that this law would, indeed, return ownership to municipalities. If this is the case, municipalities will have greater opportunities for rationalizing their property portfolios, attracting investment and raising capital finance. The greater opportunities for capital finance would come from sale of property, and also the increased possibilities of property as security for loans. These opportunities, however, come

at a cost. There would be increased administrative requirements, and new skills required in asset management. Municipalities would have to prepare or update their property inventories, and make decisions on use, restoration, and sale. It is anticipated that municipalities would need technical assistance with this task in order to ensure that their property portfolios contribute as far as possible to economic growth and the welfare of their citizens.

A possible downside to the new law on public property is the potential transfer of responsibility for restitution claims to municipalities. Restitution claims were filed to central government by 2006, although there has been no new information on what will happen with these claims. Because these claims are outstanding, and details of claims are not available to the public, the property market is affected; potential buyers are not able to find out if there is a claim on property they wish to purchase.

USAID could provide technical assistance to municipalities in the following areas:

- Property inventories, collecting information and verifying details of property ownership;
- Asset management; identification and costing of options for property use, including public consultation where appropriate
- Assisting assessment
- Options for sale, including auctions
- Lobbying for greater transparency in restitution claims; provision of technical support to the responsible ministry.

8.4. LED Office and RDA Support

The question has arisen repeatedly as to whether USAID should continue its support to the LED offices established under MEGA or move on to the creation of new LED offices in other, probably less developed municipalities. Even with limited resources this need not be an either/or proposition. We recommend that USAID adopt an approach that will advance both these goals as well as address several new factors that have arisen since the design of the MEGA program. The following are the elements of such an activity.

Customized Support for the MEGA LED Offices

MEGA supported the establishment of thirty-two LED offices in three sequential groups called cohorts. Obviously the first cohort received the most assistance, at least temporally. However it cannot be assumed that the duration of support correlates perfectly with the capacity levels achieved by the various LED offices. Many factors have contributed to the progress of each office including individual staff abilities, municipal (particularly mayoral) support and available local resources. While the assessment team's review of individual offices was necessarily limited, it may well be that there are Cohort Three offices with skills and successes equal to or greater than some Cohort One municipalities. At the same time, there are significant differences in the skills sets that the various offices will need. Issues such as tourism, cross-border cooperation, agriculture support, healthy-food promotion, urban traffic and marketing techniques will have varying degrees of relevance to different LED offices. Also, some will have a much greater role to play in regional activities than others, as discussed below. Therefore, in any future support activity, one size definitely does not fit all. We propose an activity that recognizes these differences and tailors its support accordingly.

The LED support activity starts with a baseline assessment of both the capabilities and needs of the 32 MEGA-supported offices. An important element will be the Strategic Plan, whether it has been completed and adopted by the Assembly and what was the level of stakeholder buy-in. New training modules are then developed that reflect the needs and capacity gaps identified in the assessment. From this menu and in consultation with the individual LED officer a training regime is designed for each LED office. The new modules might include

participatory capital improvement planning, project proposal preparation, marketing and promotion, agricultural business needs, an introduction to IPA rules and procedures and mentoring techniques for (new) smaller municipality LED offices that may be established.

Regional Hubs for Municipal Consensus

This start-up process should also include identifying a lead LED office in each NUTS 3-level region where the new project will have local partners. Factors in this determination would include population, geographic centrality, staff capacity and municipal resources. These leading LEDs would serve as hubs for interaction with the level 3 regional development agencies (RDAs). This hub structure would not eliminate the direct participation of the other LED offices in the region in activities of the RDA. The hub municipalities would receive guidance in leadership, Capital Improvement Planning, consensus-building and communication. All supported LEDs in a region would be expected to be supporting members of the RDA.

Regional Participatory Capital Investment Planning

Relatively little progress has been made in Capital Investment Planning (CIP) at the municipal level and probably less at the regional level. The hub would lead the municipalities in such a process, identifying, prioritizing and advocating regional or sub-regional projects and initiatives. This approach would include significant citizen participation and would produce results that are independent of the views or biases of the RDA staff, supporting donors or the Central Government. Thus CIP would become Participatory Capital Investment Planning, thereby broadening the support base for agreed-upon projects.

Supporting the Establishment of New LED offices

Depending upon the availability of resources, the coming USAID project can broaden its economic development reach by supporting new LED offices in the regions where it has existing local partners. Notwithstanding the fact that such new LED localities will often be smaller municipalities with less financial and human resources, a competitive selection method is still advisable, subject, of course, to any policy-based selections made by the Mission. It is, however, our view that a great many of the smaller municipalities lack the resources to support such offices by themselves and the hub/mentor approach will work best in most cases.

Since these new LED partners will require a higher level of support than their predecessors and this would be the other function of the hub LED offices. With their higher skill level and with training on mentoring techniques, these hubs can guide and support the new offices. Much can be learned by teaching and this process will build not only the capacity of the new partners but also the skills and confidence of the mentoring hub municipalities. As noted above, among the training subjects offered to these hub municipalities should be team-building and coalitions.

8.5. Workforce Development

An issue raised in field interviews by numerous individuals, both public and private, is that of adequate workforce training. Although the need for a supply of workers equipped with the right skills is fundamental to business attraction and retention, it would seem that in Serbia today the subject is addressed only by the National Employment Service (NES), an institution with uncertain capacities. To support its local economic development efforts, USAID should consider a set of activities that would address the partial vacuum in this critical area, including the following:

Workforce Development in Strategic Plans

A training module should be developed to help LED officers understand and begin to address the issue in their strategic plans. Strategic plans not yet completed could include the subject and, since all the plans should be updated periodically, existing ones can be amended to incorporate it. The same is true of regional plans, discussed *supra*. In this way local economic officers will be seen by business owners as responsive to their needs and will also help launch needed discussion of the question by various stakeholders.

Convening the Stakeholders

The next USAID project could serve as a convener of the principal parties who can affect the worker training system. This will take the form of a Workforce Skills Working Group that would include, at least, municipalities, business associations where available, public and private universities and the National Employment Service. To ensure its support, the NES could be invited to act as a co-convenor although this might lead to operational challenges. The objectives of the Working Group would include gathering accurate data about skills gaps, raising awareness of the problem among other groups such as the Ministries of Education and Local Government and the donor community, very particularly the European Commission in light of the future human resources component of IPA funding, discussed *infra*.

Preparing for IPA HR Funds

With USAID leadership and technical assistance, the Working Group can prepare a series of proposals for application of IPA funding under the HR component that will commence when Serbia achieves candidate status. These proposals would be designed to recognize the various regional, demographic and economic profiles that exist in Serbia. Since the timing of Serbia's designation as a candidate state cannot be known and may not have arrived by the time of the next project, these proposals should not be so EC-specific as to preclude implementation by others including the Government of Serbia, the donor community or private entities. The initiative thus becomes a logical candidate for USAID's Global Development Alliance (GDA), as below.

Public-Private Partnerships Using GDA

The possibility for participation in the workforce skills issue by private corporations and academic institutions suggests the use of USAID's GDA as a vehicle to advance the effort. Private businesses might base participation on a corporate social responsibility (CSR) rationale or they could gain either a profit or a source of skilled workers or both.

8.6. Improving Utility Performance

The availability and reliability of utilities is of great importance to firms considering investment in particular locations, and knowing that services are available and reliable assists in reassuring potential investors. At present, utilities are under-performing and under-investing. The key weakness is in their patronage relationship with municipal assemblies, and the insufficient. The accountability of utilities to municipalities (through the municipal Assemblies) is generally weak, as described above. Utilities are able to generate better information on their performance, but are generally not asked to do so by municipal administrations or Assemblies

We suggest that USAID could assist Utilities, Municipal Assemblies and Municipal Administrations to improve the performance of utility services in the following ways:

- Identify and test appropriate benchmarks and performance measurements for locally controlled utilities

- Support Assemblies and Administrations to establish performance agreements with utilities, incorporating performance measurements
- Support utilities to deliver on the required performance measurements
- This approach should probably be tested on a pilot basis before being rolled out to more municipalities.

8.7. Municipality Human Resources

Underpinning any capacity change in municipalities – the municipal administration and the municipal companies – is the ability to attract, motivate, and develop their staff. On the whole, municipalities have a great deal of difficulty doing this, especially in the poorer, more rural areas where finding appropriately skilled people can be hard.

In some municipalities where USAID has provided training and assistance (e.g. to the LED offices), the training is a step to another job and the well trained and motivated leave the municipality. Therefore, it is crucial that, if the impact of USAID assistance to municipalities is to be sustained, municipalities are able to manage their human resources better.

Problems of human resource management are compounded by two underlying factors. First is the restricted freedom municipalities have to set salaries and decide on the appropriate qualifications for specific jobs – these are set either by law or by the Ministry of Local Government and Public Administration. The second factor is the level of politicization of appointments. Key positions are often reserved for members of the ruling coalitions, and the former post-holders cannot be dismissed, but are sidelined. This leads to bloated and dysfunctional administrations.

Despite these limitations, there are ways in which human resource management can be improved. Initially this can be done by raising awareness through of some basic concepts, such as how to motivate staff, and job design. Subsequently, the application of these concepts would need to be supported and reinforced by mentoring and coaching.

USAID should consider supporting human resource management in the municipalities where it is working in order to protect its investment in the people that it has made until now. This can be done through training and mentoring, and in particular encouraging municipalities to establish improved systems and approaches to motivation and discipline. It might also consider establishing some form of certification scheme (a ‘people-friendly municipality’ award?) as an incentive to municipalities which display a more systematic approach to managing and investing in its people, and promoting good municipalities as an example to others.

8.8. Municipal Level Policy Making

While policy attention is usually focused on the national level, which is, in fact, of critical importance, there are also matters of locally-determined policy that need to be addressed. Despite the almost nonexistence of decentralization, local assemblies do have discretion in some matters.

Public Utilities and Directorates

One of the most important areas of local discretion in relation to the local economic development efforts of the municipality is the appointment of heads of the directorates and utilities. These bodies are responsible for delivery of most of basic municipal services such as water, waste, roads and other infrastructure. These services are crucial to a municipality’s ability to attract new investment and for its existing businesses to remain viable. Under the unfortunate party-list system of election of assembly members that presently exists, party affiliation and loyalty are of paramount importance. Therefore vital utilities are often headed

by persons without either the professional skills or sense of public accountability necessary for the position. While the real solution to this lies with party reform at the national level and major changes in the Law on Local Elections, there are some local interventions, discussed below, that could lessen the party influence on these vital positions.

The Assembly Role in Strategic Planning

The strategic plan that is a core element in a municipality's local economic development effort must, of course, be adopted by the Municipal Assembly. But more than that, the Assembly should be engaged throughout the process. Members should be informed, *ab initio*, of how the process works and why it is important. A strategic plan that the assembly does not "own" has far less chance of being implemented than one wherein assembly members have been stakeholders from the outset.

The Assembly's (limited) Discretion in Setting Tax Rates

Within limits prescribed by law (a subject for national reform) the municipal assembly can determine that rates for certain taxes and fees. Our field research suggests that assemblies often choose the short-term expedient of raising taxes on businesses rather than citizens. While it is arguable, at least, that there are other elements of a business climate more important than taxes, nonetheless taxes and the message they send do matter. A tax regime that may be seen as anti-business creates a perception with real consequences in a region where investors have so many venue choices.

Activities

To address these matters of municipally-set policy, we recommend that USAID consider the following types of intervention.

Municipal Assembly Capacity-building

It would be naïve to assume that most assembly members avidly desire instruction from a USAID project on their roles and responsibilities. However the effort can be invitational and inclusive rather than didactic and patronizing. There are indications that there would be a positive response. The general donor preoccupation with mayors has led many projects to neglect this critical institution. In Vranje, the Assembly Chairman hosted and participated fully in our LED discussions. He was most interested in further involvement, including training on the issues. In Novi Pazar, several assembly members expressed to our team their keen desire to learn more and become more engaged in economic development issues.

Strengthening Local Advocacy by Civil Society

At least in some instances, civil society organizations may be an effective ally to influence the decisions of the municipal assembly and officials. An initiative by an NGO in Zaječar, supported by USAID through the Institute for Sustainable Communities (ISC) has worked with SME associations and individuals to educate and lobby assembly members on business taxation policy and expects success on many of its key proposals. USAID should consider replicating this process in other localities throughout Serbia.

Benchmarking and Public Awareness

Given the host of problems, external and internal, confronting municipal service delivery, particularly from the utilities, the quality of services is quite low and, it is safe to assume, public expectations are similarly low. An activity could be designed, in collaboration with one or more NGOs, to gather accurate comparative data on municipal utility fees, staffing and service levels. Letting the public know, in effect, that they could have better service with better management might be a powerful persuasive tool against the current system based on party rather than performance.

9. APPROACHES

Working with Central Government

Central government support is the key to institutional sustainability of reforms at local level. According to government officials interviewed, previous USAID local government-level programs have not engaged sufficiently with central government, and this has had its effect on the appropriateness and sustainability of some local level interventions.

Any new USAID local economic development program must have strong and supportive relations with key Ministries, including the Ministry of Economy and Regional Development, the Ministry of Finance, and the Ministry of Local Self Government and Public Administration. In order to do this, USAID needs to consider the following approaches:

- Ensure that the three above ministries are engaged in the process of preparation of the new program, and are committed before completion
- Provide support to ministries – in the form of technical experts or similar – where requested in order to develop legislation or strategies relating to essential reforms covered in this report (e. g. reform of utility pricing, improving human resource management in municipal administrations, etc).
- Reinforce the message that USAID local economic development programs are supportive of national strategies and policies, and are able to adapt as policy changes.

Regional Hubs

Since most of the smaller municipalities lack the resources to mount separate LED efforts, the project should identify LED offices established under MEGA that show the potential to serve as regional leaders. Where there is a NUTS 3 level RDA, the supported LED office should act as liaison between the RDA and the surrounding municipalities. Technical assistance for an office in this posture would include team and coalition-building techniques. The hub LED would also play the leading role in convening and conducting a participatory regional strategic planning process in those areas where one has not been created at the time of project startup. This should include a capital investment program (CIP).

Where there is no small RDA, the same role can be performed by the hub in an informal way. We do not propose establishing new formal NUTS 3 RDAs where none exist. Those entities can and perhaps will be initiated by the municipalities in the region themselves. That would augur far better for sustainability than another donor-created institution.

Tailored LED Support

As described in the LED section of this report, support for LED offices should begin with a baseline assessment of the MEGA-supported LEDs. Both their needs and their level of growth will vary greatly among them. A variety of technical assistance modules would be created to reflect those variances. In consultation with each selected LED office, a custom-designed curriculum would then be agreed upon and launched.

Vouchers and the Private Sector Technical Assistance Market

The USAID project should establish from the beginning the principle that at least some technical assistance will no longer be provided with no cost to the beneficiaries. To make this possible, the project should make available to selected municipalities small grants in the form of vouchers that can be used in the marketplace to procure expert assistance from Serbian professionals. The project would assist in the procurement process. It will also be important for the Mission to use its influence to try to persuade other donors delivering local technical

assistance to agree to the idea that at least modest fees should be charged for many, if not all, training programs.

This approach will provide opportunities to Serbian professionals, many of whom experienced much growth through USAID and other donors' programs, and help to keep both the expertise and the money in Serbia.

Civil Society Monitoring, Benchmarks and Advocacy

Partnerships with appropriate civil society organizations interested in governance and economic growth matters could bring much needed attention to some of the issues involving local governments as they seek to develop a business climate. The initial activity would be monitoring utility performance, staffing levels and charges in different municipalities in a region, analyzing the data and preparing a clear, easily understood report. The USAID-supported NGO could then proceed in either of two ways. It could seek to begin a non-public dialogue with the assembly to raise their awareness and concern about utility performance. The other, more confrontational route would be to go directly to the public with the findings. This would ensure an antagonistic response from the assembly members and it is recommended that the first, more collaborative approach be tried first. Realistically, in most cases the response would be denial or disinterest and so the public presentation is likely in any event.

An appropriately interested and qualified NGO can also be supported to begin an advocacy campaign with the local assembly concerning its personnel and rate-setting practices as regards both the utilities and the municipal administration. This would require coalition with available local business groups along with patience and diplomacy. The Zaječar experience described to the assessment team suggests that, properly conducted, such an initiative might succeed to some degree.

Two needs identified, but which may be too ambitious for the scope of this project given entrenched political interests, are for stronger independent audit mechanisms for all municipalities, and for beginning a program of review and evaluation of public service effectiveness and value for money. Both these would increase accountability, and provide guidance for national and local level politicians who wish to improve services for their citizens. Advocacy on both these issues is needed, but may not yield a result in the short or medium term.

Standing Conference and NALED

In any country moving toward decentralized, more democratic government, however slowly, a strong, effective association of municipalities is a requisite. The Standing Conference of Towns and Municipalities appears not to have strong capacity or interest in performing its dual roles of advocacy before the central government on behalf of local governments and delivering services to members. It is not recommended that a new USAID project have, as a major component, an association development activity. However the importance of the Standing Conference can neither be denied nor ignored and the USAID project should remain engaged. An informal working group consisting of those donors who have and will support the Standing Conference should be convened to try to develop some guiding principles.

NALED lacks the official imprimatur of the Standing Conference but has a far broader constituent base. Therefore it can be an effective advocate on economic issues. The USAID supported regional hubs can be a conduit for providing data from the field to NALED. Conversely, NALED has a national visibility that can be of great value to the regions in gaining attention to their issues.

10. OTHER DONORS AND AGENCIES' RELATED ACTIVITIES

The area of local governance reform in Serbia has two other major players, aside from USAID.

The EU, through the European Commission is the largest, and has been investing in local government reform and regional development since 2000. Its programs for the future period include a large south and south-west Serbia program that is still in discussion. This would be a follow-on from the PRO program in south west Serbia, and is likely to include a heavy emphasis on regional infrastructure development. Details of the program are yet to be made public.

The EU is also financing a large multi-component Municipal Support Program, due to begin in 2009. This has, as an overall goal, the aim to support further decentralization of government functions, and the efficient delivery of these.

The proposed program for USAID's support to local economic growth complements these, and is distinct in two key ways. First, the focus is on local government reforms that are relevant to economic growth, not simply reforms for improved governance. Second, it recognizes that local level reforms are not only a product of municipal level civil servants, but are dependent on Assemblies and the opinions of the wider population. Further factors that differentiate the USAID approach are the requirement for municipalities to opt in, rather than simply being selected, and the emphasis on tailored support recognizing the varying capacities and needs of individual municipalities.

Funder (implementing agency)	programme name	Budget	Timeframe	Location	Major activities
Sweden, Switzerland, Norway (UN joint programme: UNDP, UNICEF, HABITAT, ILO, UNHCR)	South Serbia conflict mitigation	Approx USD 8m	Oct 2009 – Apr 2012	South Serbia (Pčinja & Jablanica districts)	Youth development Access to public services Local economic development Local media
European Commission/IPA 2007	Municipal Support Programme (MSP)	€22m	2009-2012	National	- good governance, planning & service delivery (€10m, inc €2m to Council of Europe) - Grant scheme for projects & skills transfer (Exchange 3) €10m - Direct award to SCTM (€2 million)
European Commission	Municipal Infrastructure Support Programme	€10m	2010 -	National	Enabling municipalities to develop infrastructure projects for SLAP pipeline

Funder (implementing agency)	programme name	Budget	Timeframe	Location	Major activities
European Commission/IPA 2007	Modernisation of VET system	€2.5m	2009-2011	National	Creation of national council for Vocational Education and Training, supporting reforms
European Commission/IPA 2008	Draft – support to south and south west Serbia	Not known	Est. 2010-2014	South and west Serbia	Not known – building on PRO and MIR2 programmes, support to municipalities and regional development agencies
GTZ	Municipal economic development in Danube Region	€4m	2010-2012	10 mun: Danube shore/East Serbia	Support to intermunicipal cooperation, and assistance with RDAs (NUTS 3)