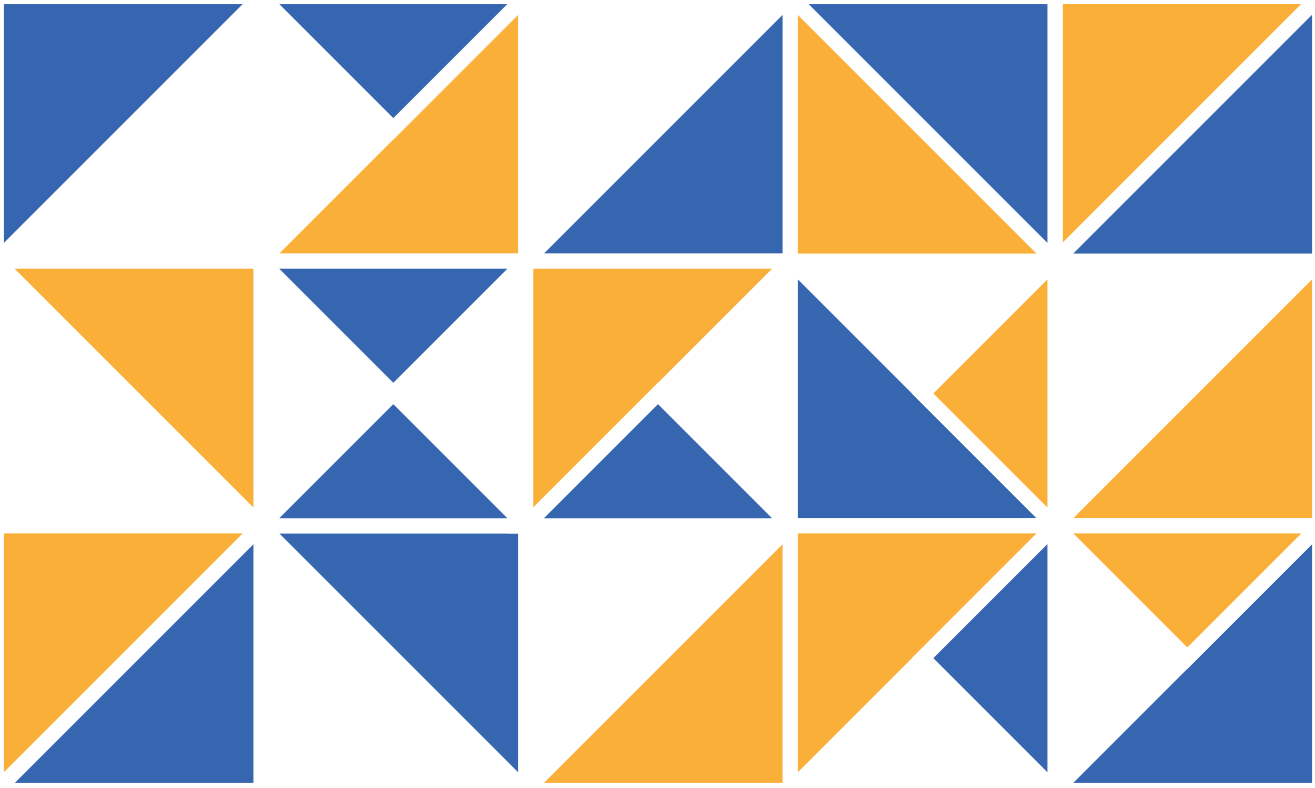
Good Governance
Vertical Dimension

Principles and approaches for the cooperation between the state and municipalities – lessons learned



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Introduction

The European Partnership with Municipalities Programme – EU PROGRES, is the largest area-based developmental programme in 2010-2014 Serbia, covering 25 municipalities in the South and South West of the country. It is the result of a continuous pledge of support from two major donors - the European Union and the Government of Switzerland to the Government of Serbia. The Programme is implemented by the United Nations Office for Project Services (UNOPS).

The main objective of EU PROGRES is to contribute to enhanced stability and socio-economic development in the beneficiary municipalities. Through a holistic approach, by addressing both the immediate infrastructure and other pressing needs, and by facilitating the creation of conditions for larger investments through, among others, preparation of technical documentation, by applying good governance principles and improving municipal and inter-municipal management capacity, and by promoting development potentials, EU PROGRES contributed to accelerated growth and improvement of the overall living conditions within the Programme area.

Any efforts to improve governance at the local level therefore also have to take into account the relationship between the municipalities and the central state (what we will refer to as vertical dimension). Municipalities do not function in isolation from the state. Of course, municipalities can and should invest in good governance at the local level, but the cornerstones of the system of local governance (the political structure of municipalities, their tasks and modes of financing the fulfilment of their tasks) are set out in the central state legislation. EU PROGRES has recognised, from the very beginning, the importance of the vertical dimension in all good governance activities. It has collected experience gathered throughout the implementation of several projects where the central state institutions/or legislation played a role.

Since 2012, EU PROGRES has organised a range of consultation workshops with representatives of towns and municipalities (heads of municipal administrations, finances and social issues) and representatives of ministries, who contributed with their knowledge and experience. Findings from these workshops were analysed and consolidated in one document prepared by Professor Snežana Đorđević (Faculty of Political Sciences, University of Belgrade), and are available on EU PROGRES website www.euprogres.org/biblioteka. The next step was discussion about the collected findings and results with the Standing Conference of Towns and Municipalities (SCTM) and the Swiss Agency for Development and Cooperation (SDC), which provided backstopping to the programme on good governance, held in January 2014.

This booklet draws general conclusions regarding improvements of the vertical dimension, underpinning them with examples from the Serbian context. We hope to ensure awareness, among all stakeholders, of issues regarding the vertical dimension, and to contribute to the discussion between municipalities and the state on how to improve this dimension of good governance.

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Important Principles: Subsidiarity, Fiscal Equivalence, Accountability

Decentralisation, i.e. the vertical distribution of power (decisive power, resources, political legitimisation) among the different levels of a state, allows democratic governance by those who are closest to a problem and can solve it according to their own needs, which will lead to efficient and broadly accepted solutions[1]. However, decentralisation can only keep these promises under certain minimal conditions. The three basic principles of a good decentralised state organisation will be explained in the following:

1. Municipalities must have their own legally secured[2] scope of action. The principle of subsidiarity shows which tasks (areas) shall reasonably be allocated to the local level[3]. This principle states that a task shall only be assigned to a higher level if the lower level is unable to fulfil the task completely and appropriately.

2. Municipalities must be enabled to accomplish the allocated tasks, which according to the principle of subsidiarity are best carried out at the local level.

↖ Municipalities especially need financial resources (or, at least regarding local wishes, to have a possibility of generating their own means, e.g. by collecting local fees)[4]. With regard to the accomplishment of funding task, the principle of fiscal equivalence shall be applied. This principle states that those who order a state service should, as much as possible, be the same as those who use the service and those who finance it. In the vertical dimension (central state - municipality),

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1 Cf. the preamble of the European Charter of Local Self-Government (Charter) on the advantages of decentralised state organisation.
2 Cf. Charter Art. 11 on legal protection
3 The principle of subsidiarity in Charter, Art. 4 par. 3
4 Cf. Charter Art. 9; Financial resources of local authorities

this principle especially means that the central state, when setting certain requirements for the municipalities, must contribute to the financing of said requirements. The stricter central state requirements are, the higher their financial contribution to the completion of the state tasks should be.

- Furthermore, municipalities must have the necessary capacity to accomplish their tasks (or they must be able to empower themselves, which again requires the necessary means)[5].

3. The accomplishment of municipal tasks must be accounted for (accountability). A municipality is not an end in itself, but always acts in the name of the central state and/or the local population. The "mandating" entity (the central state or local population) can thereby be considered as the principal, the municipality as their agent. A system that takes a municipality's accountability seriously, must guarantee that:

- Responsibilities are clearly allocated (e.g. it must be clear which level is responsible for what).

- It is clear whom the municipalities are accountable to (the local citizens or the central state). The underlying principles are as follows:

  - Decisions by and at the local level are to be accounted for to the local citizens; suitable structures and processes should be available. The central state shall define (and implement) cornerstones that guarantee local accountability, but leave the internal organisation (structures and processes) to the municipalities[6]. The central state shall not meddle with the local realm; otherwise local accountability will be impossible[7].

  - The central state has the responsibility to make sure that the municipalities act within the given legal framework, and that municipal tasks are accomplished according to the requirements of the central state. According to the principle of subsidiarity, these requirements shall be limited to bare essentials. Supervision by the central state shall, in other words, be restricted to ensuring compliance with the law and shall never be disproportionate[8].

- The principle (either the central state or the local citizens, depending on the situation) shall dispose of the necessary mechanisms to hold the agents (municipality, its organs or individual employees) accountable. The following are required:

  - Transparency mechanisms, so that the principal has the necessary information to judge if municipal tasks have been completed satisfactorily; and

  - Sanctioning mechanisms, i.e. intervention instruments if the municipality has completed its tasks poorly.

5 *Cf. Charter Art. 6, par. 1*
6 *Cf. Charter Art. 3, par. 2 on the accountability towards local citizens.*
7 *Cf. Charter Art. 8 on the administrative supervision of local authorities' activities.*
8 *Cf. Charter Art. 8 on the administrative supervision of local authorities' activities.*

Principles in the Serbian Context

Although not less decentralised than the neighbouring countries, Serbia is conceptually still organised as a central state, which is moving more and more towards decentralisation. Compared to other countries, local governments in Serbia (municipalities and cities) are rather big with approximately 50,000 inhabitants on average[9]. Therefore, they potentially have good capacities to procure a good set of services to their communities. In order to improve the decentralisation process, Serbia is planning to develop Decentralisation Strategy in the period to come.

Many competences have been devolved during the last decade from the centre, either directly to municipalities or to public enterprises that are set up by municipalities.

Fiscal decentralisation implies transfer of public functions and public revenues from upper to lower authorities. Fiscal original revenues of local self-government (LSG) are:

- Municipal administrative fees
- Local communal fees
- Tourist fee
- Charges for the regulation of municipal construction land
- Charges for the use of municipal construction land.

Non-fiscal original revenues of LSG are:

- Revenue tax
- Revenues from concession for communal activity.

The National Assembly of the Republic of Serbia ratified the European Charter of Local Self-Government in 2007. The Charter came into force in Serbia on 1 January 2008. However, in agreement with the Charter's Article 12, which allows for some articles not to be ratified, the Parliament did not ratify several paragraphs:

> *Serbia formulated reservations on Article 4, paragraphs 3 and 5, Article 6, Article 7, paragraph 2, Article 8, paragraph 3 of the Charter concerning, in particular, local authorities' exercise of public responsibility and their scope of competence (the principle of subsidiarity[10]), appropriate structures and administrative means that correspond to the local authorities' mission (the principle of fiscal equivalence), financial compensation of elected representatives and the principle of proportionality in the context of administrative supervision (the principle of accountability).*

The relevant ministries worked with experts, discussing certain issues and harmonising Serbian system with the European Charter, including the consideration of non-ratified articles of the Charter. Some experts observed that the full ratification of the Charter is not possible due to certain provisions of the Constitution of the Republic of Serbia. This issue will be the subject of further discussions amongst relevant institutions and experts.

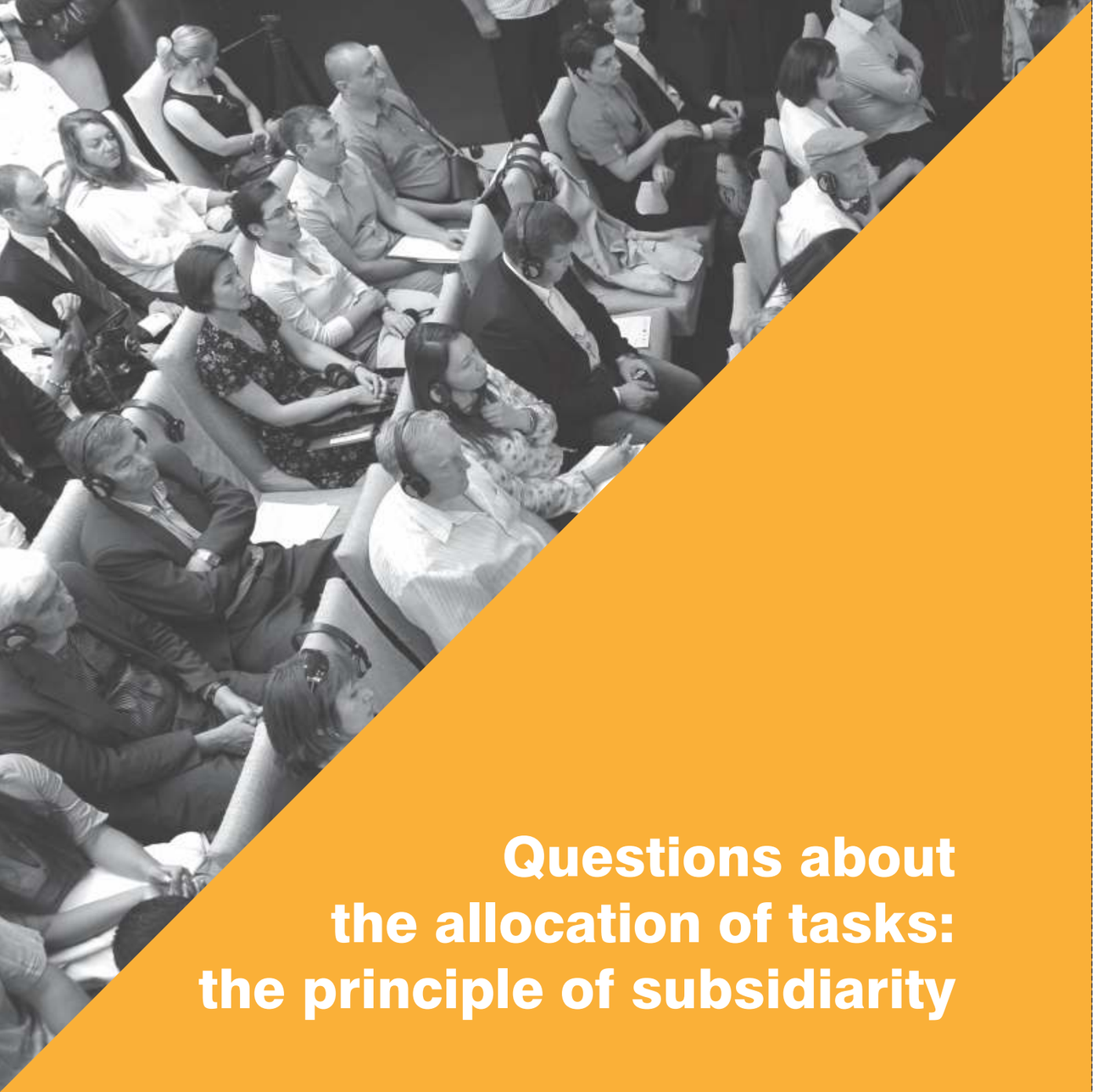
9 *Municipalities (without cities) still have app 40,000 inhabitants on average.*

10 *During 2013 a project was implemented in Serbia in order to identify space for upgrading the scope of competencies for local governments and stimulating cooperation and partnership between the state and local governments. A mapping of competencies between the state, the Autonomous Province of Vojvodina, cities and municipalities, for each field of social policies was made, as well as a research about which competencies local governments could take as their original competencies (see the Ministry of Regional Development and Local Self-Government, Implementation of Subsidiarity Principle in Serbia, Profid. 2013)*

Key Questions and Possible Answers

Many important questions in the vertical dimension can be answered with the help of the three principles described above. They are valid everywhere, i.e. whenever a state has decentralised structures. EU PROGRES has organised several workshops dedicated to the challenges the municipalities encounter in their everyday work with regard to their relation to the central state. The results of these workshops are shown in a paper elaborated by Professor Snežana Đorđević[11]. Some of the mentioned challenges are being used in the following matrix to illustrate the important challenges in the vertical dimension in the Serbian context.

11 Accessible at www.euprogres.org/biblioteka



Questions about the allocation of tasks: the principle of subsidiarity

Questions	Solutions
Which tasks should be completed by the state (municipalities included)?	↖ The state (municipalities) is active whenever a market cannot satisfy the demand for certain services (with pricing according to the offer and demand). ↖ The state or municipal employment is basically welcome. From the point of view of the national economy, the state should carry out its services as economically as possible, to keep the fiscal burden of the population and the economy feasible, and to achieve the best possible results with the means at hand. ↖ It cannot be a municipality's task to create or maintain employment as an end in itself. **Example:** ↖ The idea that a municipality has to create jobs through the employment of public (local government) officials is still widespread in the Serbian context.
Who decides if a task should be completed by the state or by municipalities?	↖ The power of legislation lies with the central state, which should decide the assignment of tasks. ↖ If the state does not stipulate the allocation of a certain task, the municipalities must decide if they will take it on. **Example:** ↖ The original tasks of the municipalities in Serbia are stipulated in the Constitution (Article 97), but only in a very general manner. It is of great importance that the legal framework defines more clearly the scope and limits of municipal competencies. According to the Constitution

(Article 177), the state remains responsible for all issues that are not set out as a municipal task. This conception (declaring the state as competent for all matters that are not explicitly in the competence of municipalities) is in sharp contrast to the principle of subsidiarity.

Allocation of tasks: Either – or?

- When allocating tasks to the central state and the municipalities, it would certainly be easiest if either the central state or the municipalities were responsible.
- In many policy areas, however, such a rigid allocation of tasks would not be useful.
- Joint tasks that are carried out by the state and municipalities are successful if and when the roles (and responsibilities) of different levels are clarified and mechanisms allow a good cooperation.

Example:

- The Serbian system makes a difference between the original competencies for local governments, shared competencies between the state and local government and delegated competencies. It is of great importance, especially in the area of shared competencies, that the laws clearly stipulate the responsibilities of each tier involved in the fulfilment of a specific task.

What does the principle of subsidiarity mean in practical terms?

- As long as municipalities are capable of completing a task, the central state shall undertake this task.
- In other words: it is presumed that the responsibility for completing a given task lies with the municipality; the completion of a task by the central state requires justification.
- The often-heard claim of the central state that municipalities are not capable of completing certain services must be rejected. A well-organised municipality, where accountability is functioning, is capable of solving even complex problems. It is, however, necessary that much is invested into training and further education of those in charge.

Example:

- In many areas local governments claim more competencies from the central state (i.e. areas of trade, agriculture, forestry and water management, tourist inspection).
- Local governments are in dire need of well-trained local officials. The status of local officials has to be clarified and training possibilities should be evaluated; the state should at least not impede efforts of local governments to invest in the quality of their staff; recruitment based on merits should be made possible and the vertical as well as horizontal mobility should be introduced in the system. For example, the fact that salaries of local officials are determined by the state is detrimental for local officials' incentives to invest in their career.

? Questions

Solutions

- Note that Serbia has not ratified Article 6 of the European Charter of Local Self-Government, which declares that the conditions of service of local government employees shall be such as to permit the recruitment of high quality staff on the basis of merit and competence; to this end, adequate training opportunities, remuneration and career prospects shall be provided.

What are the limits of decentralisation?

- In many areas, the responsibility naturally lies with the central state (foreign affairs, defence, monetary policy, etc.)
- The same is true for policies that offer services within a large perimeter (universities, cutting-edge medicine, national heritage, etc.)
- In many areas it is favourable if tasks are allocated to the municipalities.

What role, in general, does the central state play at the municipal task-solving level?

The central state cannot just devolve tasks to the municipalities and then abandon them. It is responsible for:

- Providing basic organisational standards to guarantee due process, transparency and an effective and economical completion of tasks by the municipalities
- Providing requirements for the municipal accountability (political rights, an organisation that respects division of powers, responsibilities)
- Protecting minorities and disadvantaged groups of society

? Questions

Solutions

- Limiting its supervision to checking for lawful (and unlawful) actions of municipalities
- Sanctioning a municipality in case of unlawful actions after the municipality has been warned and has not been prepared to remedy the situation on its own accord
- Protecting the citizens and the economy from unlawful municipal actions, and protecting the municipalities from unlawful central state actions.

Example:

- In Serbia the state generally provides for too many organisational standards (e.g. the questions whether the mayor should be elected by the citizens or the municipal assembly; fixing the salaries of public officials; a number of details in the area of utility services provision, e.g. which tasks are to be performed by the municipal public utility companies (PUCs) and how they are organised, instead of leaving organisational freedom to municipalities).
- The protection of minorities and disadvantaged groups is - due to a lack of the state regulation - often put at the discretion of the municipalities (e.g. Roma, Internally Displaced Persons).
- The supervision is (by the Constitution) limited to checking the legality (only in the area of the original tasks of municipalities), but a proportionality of sanctions is not ensured (the Parliament did not ratify Article 8 of the European Charter of Local Self-Government which is dedicated to the proportionality of administrative supervision).

Questions

Solutions

What role does the central state play at the municipal task-solving level in various areas?

- The central state sets certain parameters to ensure the nationwide implementation of certain policies, and to guarantee the equitable treatment of its people.
- The central state, however, must give municipalities leeway in completing these tasks, because only then can the municipalities bring their resources into play, consider the local particularities and their citizens' particular needs.
- If needed, the central state must provide policy-specific requirements, especially if a uniform implementation of a national policy is essential.
- The central state must ensure that municipalities meet the requirements, the local bodies take up their responsibilities and the municipalities are accountable to the central state within those requirements.
- Through the contacts with the municipalities, the central state must carry out continuous reflection of its national policy and adapt it constantly according to the lessons learned.
- It must provide the necessary knowledge to advise the municipalities in case of difficult, individual questions and to ensure the needed support.

Example:

- The area of spatial planning might be considered as a complex one for the assignment of tasks to different levels. In Serbia the central state is responsible for the Spatial Plan of the Republic of Serbia. This plan should be elaborated in close cooperation with municipalities and should be restricted to strategic issues, thereby leaving room for municipalities to develop their own plans, in accordance with their local needs.

Questions

Solutions

- Cooperation between municipalities and the state in general must be improved (partnership).
- All policies affecting local governments must be prepared in close cooperation between the SCTM and the state. This is relevant not only when a law is being adopted but also when ordinances or general policies/strategies are being developed.
- The state should better prepare/support the municipalities in complex areas or in areas that are under reform. For example:
  - The municipalities would welcome a consolidated handbook with detailed explanation of the procedure for issuing building permits (notably for solar and wind parks, mini hydropower plants and similar facilities)
  - Better support is needed in the area of production / distribution and use of energy

Questions about finance

? Questions	Solutions
How can municipal tasks be financed?	↖ For financing local tasks through taxes there are two basic procedures: • On the one hand, taxation (income and wealth tax of natural and legal persons) by the central state, and allocation of funds to the municipalities for the completion of their tasks. • On the other hand, the central state and municipalities both raise taxes to cover their own financial needs (fiscal decentralisation). ↖ From an economic point of view, it is important that taxation, regardless of the tax system, remains reasonable to allow for a positive development of the economy. ↖ If the central state allows municipalities to raise taxes for funding their tasks, it should lower the central taxes to prevent the overall rise in taxation. ↖ Apart from funding through taxes there are fees that are claimed by the municipalities to finance certain local tasks. **Example:** ↖ In Serbia, a reform in the financial sector was made possible by the Law on Local Finance (2006) which prescribes financial and fiscal autonomy to local governments. It defined precisely which percentage of GDP and budget should be transferred to local governments. ↖ The Law identified the redistribution formula for general grants and financial equalisation grants. The Law was created by the SCTM with active participation of small, medium and big municipalities and cities (heads of

administrations or representatives from various policy fields), with a number of key ministries (finance, education, social affairs). Local governments have original taxes (on property) and a number of fees (ecological, on pets, on firms, on using municipal facilities, on building materials: sand, water etc.). This Law also enabled local governments to establish their own tax offices.

- In a short period of time local budgets grew up rapidly, a large number of local governments established their own tax offices, and a substantial number of local governments used some form of public debate on the budget. Local budgets were still not very user-friendly (too formal and bureaucratic), but local governments debated at least some important questions with their citizens in all wards (community offices - mesna zajednica), asking them to help in the process of establishing priorities).

- The Law allowed local governments to easily calculate their growth of budget from the beginning of the budget year and to plan their activities.

- Reduction of non-earmarked transfers (since 2009) has been regulated through the Law on Budget, which actually derogated the Law on the Financing of Local Self Governments.

- The main problem in this process is that local governments became highly financially dependent. The state again established voluntarism in distribution, and local governments lost certainty and possibility to plan their finance during a year.

- In this period, justifying its behaviour by the crisis, the state took a great part of the money from local governments and a number of smaller and poorer municipalities found themselves on the verge of bankruptcy (2010).

- The state now pays greater attention to local needs but still the Law does not allow for financial and fiscal independency of local governments: there is a lack of stability and possibility to plan their activities.

- For fiscal decentralisation to make sense, it is of utmost importance that there are clear criteria for the distribution of state transfers to municipalities (both tied and untied transfers).

What are the advantages of fiscal decentralisation?

- If the political bodies of a municipality can define both the quality and the quantity of local tasks, they should also be accountable for the tax charge of the local citizens.

- The principle of the fiscal equivalence is being applied: whoever places the order pays the bill. This constant pressure usually guarantees a certain degree of modesty when placing orders, and an economical completion of tasks.

- Municipalities are autonomous in financing their tasks and do not have to rely on the transfer by the central state.

- Tax competition between municipalities keeps them fit.

Questions

Solutions

What are the disadvantages of fiscal decentralisation?

- If the central state delegates tasks to municipalities without contributing to their funding in relation to its order, municipalities need to raise taxes for the tasks they are not responsible for. The principle of fiscal equivalence is thus flouted.
- Municipalities must base their taxation on national tax laws, and can only define the local tax rates. Changes by the central state to its tax regulation have an impact on municipalities, and could have significant consequences on the local budgets.
- The financial power (tax return per capita) is not the same in every municipality; there might be large differences between urban and rural municipalities. Even though experience shows that per-capita expenditure by 'poor' municipalities is lower than in 'rich' municipalities, the poorer ones will barely be able to finance their expenditure through the tax revenue. Therefore, centrally regulated compensation schemes (equalisation of finances and burdens) should be put into place.

Is a combination of different financing schemes possible and useful?

- Various financing schemes can be combined in practically any way.
- Tasks that lie in the sole responsibility of either the central state or a municipality should also be financed, to follow the rule of the fiscal equivalence, by either the central state's or the municipality's tax revenue.
- With joint tasks, the financial contribution should reflect each state level's possibility of shaping the task. If the central state sets only few conditions and municipalities are free to shape the task at their discretion, they should also carry the responsibility for financing the task. If, however, the central state sets clear and rather strict conditions, then it should carry the major load of financing its order.

Questions

Solutions

- Finally, tasks that are financed separately must also be considered: certain areas are financed by the beneficiary (fees/charges - in contrast to financing by taxes, where the tax payer cannot demand a specific service from the state in return). Examples are, namely, water, sewage, waste removal and power supply. This financing system, the fees, is complementary to financing by taxes. From a socio-political point of view, it is important to remember that taxes are usually based on the economic potential of a tax payer, whereas fees are owed by all users regardless of their financial situation.

Example:

- In Serbia the assignment of tasks and the process for fiscal decentralisation are not harmonised. First, many competences were decentralised to municipalities without adequate finances. In the next turn, the fiscal system was changed in favour of municipalities, but the changes were, to a large extent, taken back by real politics during the financial crisis. Under these conditions the advantages of decentralisation cannot come into play.
- One recent example of delegating tasks to municipalities without respective finances is the transfer of the maintenance of the national roads by way of a simple order in 2013. These new competencies, together with local governments' original competence for maintenance of the local roads, start being too heavy a burden to local governments. Some of them refused to do so (Zrenjanin, Kraljevo, Paraćin, etc.) and they were excused, but this obligation stays for the others.

Questions	Solutions
	↖ Another example is the requirement that all local self-government units build asylum for animals set by the Veterinary Law without providing funds for this task. ↖ The modes for financing several delegated tasks need to be revised, e.g. in the areas of education (municipalities claim for funding per pupil instead of funding per class[12]), health, culture.
Should the central state even out the disparate potential of the municipalities?	↖ The more a municipality has to pay for its tasks with its own tax revenue, the greater the disparity becomes between municipalities regarding their financial potential. ↖ It is practically impossible to completely eradicate this fiscal disparity. However, in order to guarantee a minimum level of public services in all municipalities, state-monitored levelling out would appear necessary and useful. ↖ A compensation for the potential financial gap (reducing disparity, ensuring minimal standards) can either be achieved vertically (allocation from the central state to the poorer municipalities), or horizontally (transfer from the richer to the poorer municipalities). A legal foundation on the national level is a prerequisite for either compensation system. ↖ Any compensation will be made according to the objective, transparent criteria; the extent of the compensation, however, will have to be defined on the political level.

12 *Potentially, a combination of both systems could make sense, bearing in mind that funding per pupils creates incentives for an effective management of schools in densely populated areas, but at the same time it can be a big challenge for rural areas with small classes.*

Questions	Solutions
Does the central state have to even out the burdens due to disparities of the municipalities?	↖ Compensation must also be considered in the event that some municipalities have extremely high burdens which they can barely finance on their own. ↖ Such burdens can roughly be put into two categories: They can be burdens due to extent (e.g. very scattered settling; long ways for public infrastructure, etc.); in these cases, a topographical-geographical compensation will be useful. On the other hand, some municipalities may be confronted with above-average social burdens (e.g. many social welfare cases); in these cases, a socio-demographic compensation will be useful. ↖ Equalisation of finances or burdens is unconditional.
Are subsidies useful?	↖ If the state wants to encourage certain services in municipalities, subsidies can be an important incentive. ↖ The state can offer subsidies when a municipality offers certain services and takes on part of the financing (i.e. Setting up child care facilities). ↖ These contributions are not unconditional, but are only transferred when the municipality offers certain (tangible) services.

Questions about accountability

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Does the central state leave municipalities room for manoeuvre?	↖ Municipalities need room for manoeuvre to accomplish their tasks effectively. ↖ They need to be able to organise their work, within the frame set by the central state, in such a way that they can meet local needs. ↖ They also need to be able to decide if they will accomplish a task themselves, together with a third party or if they want to buy services from a third party altogether.

Example:

In Serbia the state provides a lot of organisational issues instead of leaving operational freedom to municipalities. For example:

- Regarding the internal organisation of a municipality (election of Mayor, job profile of the head of administration, staff salary , maximum number of staff, etc.)
- Which services to perform through PUCs and how to organise PUCs instead of leaving the decision to municipalities whether to perform a task through own company in whatever legal form, or to buy it (e.g. from another municipality or on the market).
- Serbia has not ratified Article 6 of the European Charter of Local Self-Government, which declares that without prejudice to more general statutory provisions, local authorities shall be able to determine their own internal administrative structures in order to adapt them to local needs and ensure effective management.

? Questions | Solutions

When should the central state set requirements?

The following incomplete list of examples will illustrate areas where the central state requirements are useful:

- Political structure of municipalities: the central state must guarantee that all municipalities observe the separation of powers, and that the voters' true intentions are expressed in the elections and referenda
- In the interest of consistent order and for safeguarding certain principles (e.g. minority protection), the state can pass certain parameters for the political structure and election procedures.
- Transparency: it is essential that the central state requires that any decision of a municipal body is duly documented and made available to the municipality's supervisory body. It should also be stipulated which decisions must be made public.
- Acquisition law: the central state must define the rules for public acquisitions.
- Duty of withdrawal: the central state must provide rules in case of a conflict of interest of an individual working in or serving a municipality.
- Accounting: the central state needs to provide rather strict and detailed rules for municipal accounting; thus allowing for harmonised statements across all municipalities and ensuring complete transparency.

? Questions | Solutions

Should the central state participate in the operational decisions of the municipality?

- Basically, the state should limit its interaction with the municipalities to regulating requirements or conditions.
- If the state's participation in municipal affairs (e.g. approval) is necessary, it should be limited to assessing the lawfulness.
- By no means should the state intervene in questions of municipal practicability or usefulness. The democratically organised municipality has its own accountability system which ensures that all bodies carry out their tasks correctly and according to local needs. If the central state can contribute to municipal affairs at its discretion, responsibilities will be diluted and municipalities will become completely unmotivated.

Example:

- In different areas approvals from the line ministries prevent local room for manoeuvre (e.g. issuance of permits: acquisition of fire protection consent without respecting the deadlines and often being practiced as an overall assessment of the main project although it should be restricted to fire protection); selection of the directors of institutions in the fields of education, culture, health, and even in the areas of original municipal competence such as sports/recreation).
- The state is entitled, by the LSG, to check not only legality but also appropriateness of local government actions (normative, but also decisions), in the area of delegated competencies.

Questions

Solutions

Is central-state supervision necessary?

- Ultimately, the central state is also accountable for municipal actions. It would however be wrong to infer that the central state should have a strong influence in operational matters to meet its responsibility.
- There must be an effective supervision of the central state over municipalities. The supervision must be limited to judging the lawfulness of municipal acts; it would not be appropriate if the supervision was extended to usefulness.
- The nature of the central-state supervision must acknowledge the fact that, first and foremost, municipalities ensure lawfulness of their actions through their own supervisory bodies (audit, examination by local parliament).
- The central state must be given the most pertinent information and can make random on-site supervision visits.
- The supervision of accounting is especially significant. While a municipality is responsible for the audit (within the scope provided by the central state), the central state must know all significant financial parameters to allow for early detection of problematic issues. It must be able to assess permanently if municipal budget is balanced or going completely off track. A mid-term prognosis is thereby of major importance.

Example:

In several areas the state does not intervene even if municipalities do not perform their tasks according to the legal requirements. For example:

- Although the competence for educational inspectorates was handed over to the municipalities and at least 30 municipalities still have not established their inspectorate, the state has not intervened in order to obey the line Law.

Questions

Solutions

- 98% of municipalities have adopted their spatial plans, with small delays, while the preparation of obligatory urban plans is in progress. The main reasons for not fulfilling these tasks were inadequate financial and human capacities in the local governments. The proper intervention of the central level in this case should have been provision of adequate support to the municipalities.

Should the central state be allowed to punish deviant municipalities?

- The initial assumption is always that a municipality can correct recognised deviance within the scope of its own accountability mechanisms.
- The central state should only intervene if a municipality will not or cannot rectify the situation.
- The central state must give a municipality the opportunity to pronounce itself in the matter, and can then decide on relevant and appropriate sanctions. In the event of serious mistakes the central state can take on the operational responsibility for a certain amount of time and hold the erroneous municipal bodies accountable.

Example:

- The Law does provide for mechanisms of the central state to punish deviant municipalities, after having warned them. A proportionality of the sanctions is, however, not ensured (Serbia has not ratified Article 8, paragraph 3 of the European Charter of Local Self-Government that reads: “Administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended to protect”.

Questions	Solutions
Should a municipality be able to legally resist the central state?	↖ Citizens shall not be subjected to state actions without the possibility of defending themselves; they must be able to resist within a legally stipulated defence and recovery system. ↖ The same is true for municipalities: by the Law, the central state may infringe on practically any aspect of municipal organisation and its completion of tasks. However, municipalities may not be subjected to the mercy of the central state's operational decisions; they must be able to defend themselves, in impartial courts, against the central state's unlawful decisions. **Example:** ↖ Judicial protection is foreseen in the legal framework, but in practice it is still very difficult for the individuals who are confronted with unlawful actions of a municipality, but also for the municipalities confronted with unlawful behaviour of the state, to find effective means of legal redress.

5 Perspectives

It can be concluded that improving the vertical dimension cannot be done once and for all. It is an ongoing process and adjustments need to be made from time to time, depending on the prevailing political attitudes.

Nevertheless, it is important that the discussion about the vertical dimension is oriented towards accomplishing the cited principles of subsidiarity, fiscal equivalence and accountability.

The following lessons learned are important for this discussion:

- The discussion regarding financing of sectoral tasks must always be combined with the overall system of municipal finance and of equalisation (these topics are Siamese twins!).
- It is better to reduce central state provisions to a minimum but to enforce them.
- It is important to be clear who can represent the municipal interests vis-à-vis the central state: it is neither a single municipality (nor a group of municipalities) nor a donor. The Standing Conference of Towns and Municipalities is the legitimate representative of municipalities.
- Experience gained from projects that relate to the vertical dimension can and should be collected and communicated to the Standing Conference of Towns and Municipalities. These lessons learned can be an important and useful basis for drawing conclusions.
- Projects dealing with the assignment of tasks and finances are successful when municipalities and the central state together, as partners, develop the conceptual approach and models. Moreover, the constant exchange between science and practitioners is very important.
- And finally: decentralisation makes sense only if municipalities do possess the necessary capacities. It is therefore imperative that the political bodies and the administration at the municipal level be enabled to implement their tasks in a correct and effective manner.

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