

FISCAL RULES AT THE LOCAL LEVEL ARE A CONDITION FOR STABLE PUBLIC FINANCES IN THE REPUBLIC OF SRPSKA

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Abstract: *The fiscal position of municipalities and cities has a great influence on the overall fiscal position of the Republic of Srpska. Bearing in mind that according to the Law on the Budget System, the budget system of the Republika Srpska consists of the budget of the Republic, the budget of municipalities and cities and the financial plans of the funds, then it is clear that the realization of the budget of municipalities and cities with a high budget deficit represents a great risk for excessive realization of the deficit at the level of the Republic. Republika Srpska does not have defined fiscal rules for local self-government units. However, bearing in mind that according to the Law on Fiscal Responsibility in the Republic of Srpska, the consolidated budget deficit is determined as the sum of consolidated budget deficits, the budget of the Republic, the budget of municipalities and cities, and the budget of funds, it is clear that the realization of an excessive deficit of municipalities and cities affects the fiscal rule on deficit at the level of Republika Srpska. The results of the analysis in this paper indicate the need to introduce fiscal rules for local self-government units. The fiscal stability of local self-government units has a positive effect on the overall fiscal stability of the Republic, especially if mechanisms are introduced to suppress the excessive deficit of local self-government units.*

Key words: *local self-government units, Republic of Srpska, deficit, fiscal rules.*

JEL classification: *H70, H72, H74*

1. INTRODUCTION

Stable public finances at the local level of Republika Srpska represent an important factor in creating fiscal stability of lower and higher levels of government. The local level of government plays a significant role in the political and economic development of many countries. Such a role is very important for the development of both local and state level (Klarić, M, 2017). Recently, the fiscal stability of the economy has been measured through prescribed fiscal rules. In 2015, the Republic of Srpska adopted a law that determines this area, namely the Law on Fiscal Responsibility.

For a strong fiscal policy of a country, it is necessary to continuously analyze the application of fiscal rules. The budget system of the Republic of Srpska includes the budget of the Republic, local level budget and financial plans of social security funds. That is why the high level of deficit of municipalities and cities represents a risk for the overall deficit of Republika Srpska.

The deficit analysis carried out by the Fiscal Council of the Republic of Srpska analyzes deficits as the sum of consolidated budget deficits, the budget of the Republic, the local level and the budget of social security funds (Act on Fiscal Responsibility in the RS, 2018). Therefore, it is necessary to analyze the impact of the local level deficit level on the violation of the fiscal rule on the deficit. The analysis of the use of fiscal rules

shows that a high deficit at the local level has a negative impact on the existing fiscal rule on the deficit of the Republic.

Republika Srpska consists of 64 administrations. Their budget is the basic instrument for financing public services in the local community. However, their budget represents much more than instruments with the help of which functioning is ensured. It is not only an instrument of continuous management of local funding. The budget at the local level should provide financing for development projects. Those projects are very important for the population in the local community, who cover the costs of the daily work of those administrative bodies with taxes and other levies charged within the budget of the local administration (Cilak and Copernicus, 2018). Precisely because of the possibility of increasing the budget as a development component, it is necessary to reduce the deficit to a level that does not endanger the functioning of municipalities and cities. Then there will be no risk of exceeding the fiscal deficit rule.

According to the Law on Fiscal Responsibility in the Republic of Srpska, general and special fiscal rules on deficit and debt are defined. General fiscal rules refer to the overall financial system of the Republic of Srpska and special fiscal rules represent binding, automatic measures if the indicators expressed in those rules reach one of the value thresholds defined by law (Law on Fiscal Responsibility in the Republic of Srpska, 2018).

The general fiscal rules are:

1. Rules on debt and
2. Consolidated budget deficit rules.

The debt rule limits that the public debt of Republika Srpska at the end of the fiscal year cannot exceed 55% of the realized GDP in that year. The rule of the consolidated budget deficit limits that the consolidated budget deficit at the end of the fiscal year cannot exceed 3% of the realized GDP in that year.

Special fiscal rules are:

1. debt limitation i
2. limit for the deficit of the consolidated budget.

The debt limit implies that the public debt at the end of the budget year should not exceed 50% of GDP. If this happens, it is necessary to plan the budget for the next fiscal year with a surplus.

The limit for the consolidated budget deficit implies that if the deficit of the consolidated budget at the end of the fiscal year reaches 2.5% of the realized GDP in that year, the budget for the following year must have a surplus in the budget (Law on Fiscal Responsibility in the Republic of Srpska).

Based on the defined fiscal rules, it is clear that endangering the deficit rule can consequently lead to the violation of the fiscal rule on debt. In addition, practice has shown that the deficit at the local level is solved with additional borrowing (Gojković B., Popović S., Đukić M., 2021). Servicing the deficit by borrowing can have a negative impact on the fiscal rule on debt. Because responsible fiscal management has multiple positive effects on the stability of the local level of the Republic, it is important to adequately manage the debt.

The analysis of public finances of local level shows that reductions in the budget revenues of the local level are not correlated with the reduction in spending (Fiscal Council of the RS, 2023). That is why some of local self-government units of Republic of Srpska realize a high level of deficit compared to their own revenues.

Some analyzes show that adequate functioning of public finances at the local level is conditioned by adequate servicing of own obligations and provision of services defined by law (Hendrick, 2004). This is very important in crisis years like 2008 or 2020 (Kieviet & McCubbins, 2014). A number of studies have been conducted on the topic of analyzing the impact of fiscal rules on the fiscal deficit. Alesina and Parotti believe that the accelerated growth of the deficit is a consequence of fiscal irresponsibility and the lack of limits. Those limitations refer to the existence of fiscal rules. In addition, there are studies that say that strict fiscal rules are a condition for achieving a smaller deficit (Luechinger & Schaltegger, 2013). Because there are no fiscal rules for municipalities and cities in the Republic of Srpska, this paper provides basic indicators that indicate that the creation of fiscal rules for this level would have positive effects on the overall fiscal position of the Republic of Srpska.

The aim of this research is to prove how the fiscal stability of the municipalities of the Republic affects the stability of the overall public finances of the Republic. In this way, it is shown what is the main risk for the fiscal stability of the local and

national level. This is proven by the analysis of the impact of the realization of the deficit at the local level on the overall level of the deficit of the Republic. In this way, it is determined how much the deficit created in municipalities and cities affects the exceeding of the fiscal rule on the deficit in the Republic.

Although in 2022 the deficit of municipalities and cities amounted to only 6.1% of the total realized deficit, the fact is that the realization of that level of deficit has a negative reflection on the execution of legally defined functions and certain development projects at the local level, especially if they are taken into account previous years (2017, 2019). This paper presents the quantification of the impact of the deficit of municipalities and cities in the Republic of Srpska on the fiscal rule of the Republic of Srpska.

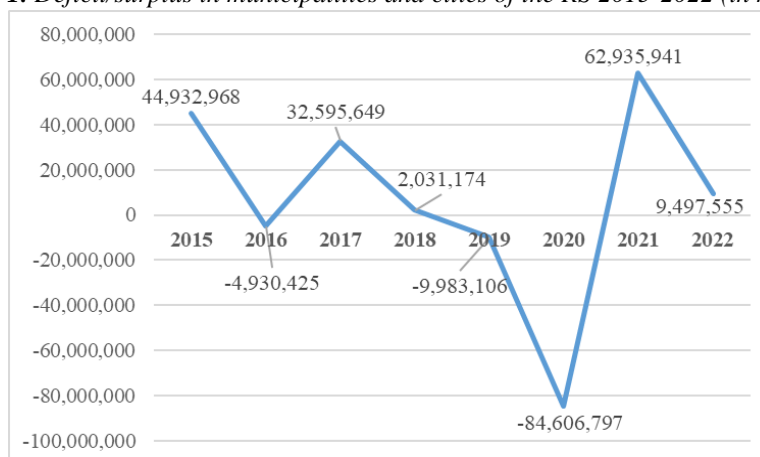
For this type of research, a descriptive analysis was sufficient in order to reach clear conclusions about the analyzed topic. The statistical basis for this research is the data of the Ministry of Finance of the Republic of Srpska. In the first part of the

research, the budget result and the level and dynamics of changes in the deficit of local self-government units of the Republic of Srpska in the period were analyzed. In the second part of the paper, the influence of the deficit of municipalities and cities on the overall deficit of the budget system and the dynamics and changes in the structure depending on the level of the deficit are considered.

2. ANALYSIS OF THE INFLUENCE OF DEFICIT LEVELS OF MUNICIPALITIES AND CITIES ON THE VIOLATION OF FISCAL RULES OF THE REPUBLIC OF SRPSKA

The deficit of the local self-government units during the 2015-2022 period shows a growing tendency, as shown in Graph 1, from 4.9 million in 2016 to almost 10 million in 2019, and then, finally, to 2020, when the total deficit of local self-government units amounted to 84.6 million. Since then, the local self-government units of the Republika Srpska, as can be seen in the following graph, have recorded an exit from the deficit zone.

Graph 1. Deficit/surplus in municipalities and cities of the RS 2015-2022 (in millions)



Source: Author's analysis

Despite the fact that in the last two years the municipalities and cities of the Republika Srpska did not record a consolidated deficit, the risk for public finances is represented by a high level of deficit in some municipalities and cities of the Republika Srpska.

A special risk is the method of calculating the deficit according to the Law on Fiscal Responsibility in the Republic of Srpska, where the consolidated budget deficit is determined as the sum of the consolidated budget deficits, the budget of the Republic, the budget of municipalities and

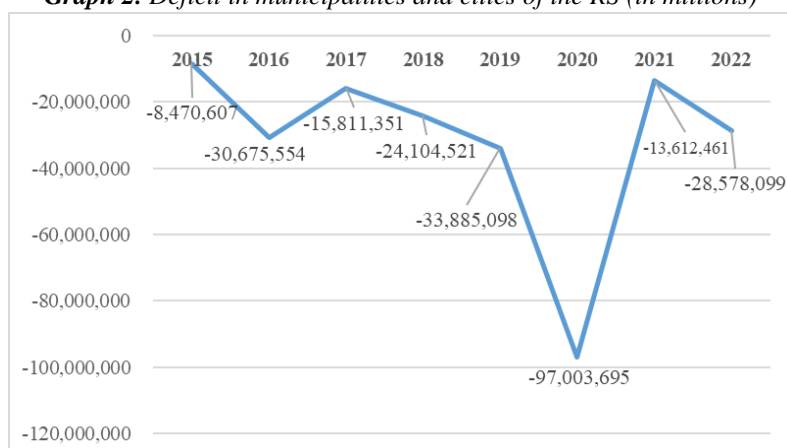
cities, and the budget of funds. Therefore, in addition to the deficit of the Republic and the funds, the fiscal rule on the deficit is also affected by the realized deficit realized at the local level.

Therefore, the high level of deficit in the the local self-government units of the Republika Srpska has a very negative effect on the fiscal rule on the deficit at the level of the Republic of Srpska. As can be seen from Graph 2, the deficit calculated according to the Law on Fiscal Responsibility in the Republic of Srpska had been rising from 2015 to 2020.

According to the deficit shown on the graph, it is clearly visible the risk that its realization has on the fiscal rule on the deficit. The uncontrolled growth of the deficit in the local level aims to threaten the limit for the consolidated deficit, as

well as the normal functioning of the local self-government units. That is why it is very important to consolidate public finances. The risk of deficit growth at the local level can be seen more clearly in the following graph.

Graph 2. Deficit in municipalities and cities of the RS (in millions)



Source: Author's analysis

Although the public finances of the local level of the Republic represent 15% of the public finances of the Republic, we should not forget that it is precisely in them that it is important to provide an adequate life for the population (Gojković B., Popović S., Đukić M., 2021). That is why it is very important to create an environment for adequate financial management and the realization of the necessary legal obligations in the local level. The realization of obligations defined by law should be the basis for normal functioning at the local level.

Therefore, it is very important to reduce the negative impact on the development of the local community. That negative impact can be solved by reducing the deficit. This is necessary because of the future development of the local level and because of the negative impact on the existing fiscal deficit rule. This is especially important when analyzing the participation of the local level deficit in the total deficit of the Republic, for which there are limits.

Table 1. Share of the deficit of local level in the total deficit of the RS

Years	Consolidated result of the Republic, in millions	Deficit Funds, in millions	The deficit of local self-government units of the RS	% of deficit of local self-government units in the total consolidated result	Total consolidated deficit, in millions
	1	2	3	4(3/5)	5(1+2+3)
2011	-116.74	-1.57	-29.2	19.8	-147.51
2012	-39.22	-62.35	-85.48	45.7	-187.05
2013	22.46	-44.36	-25.46	36.5	-69.82
2014	-192.06	-45.01	-24.82	9.5	-261.89
2015	17.55	-75.06	-8.47	10.1	-83.53
2016	-45.62	-39.39	-30.68	26.5	-115.69
2017	135.89	-4.47	-15.81	78	-20.28
2018	-45.32	0	-24.1	34.7	-69.42
2019	1.95	0	-33.89	100	-33.89
2020	-521.08	-15.58	-97	15.3	-633.66
2021	-74.77	-8.45	-13.61	14.1	-96.83
2022	-416.39	-21.56	-28.58	6.1	-466.53

Source: Data from the Government of the RS

The high percentage of realized deficit affects the adequate development of the local level, especially if the level of outstanding obligations is also taken into account. In the period from 2011 to 2022, a high level of local level deficit was recorded in the total deficit. In 2017, the local level comprised 78% of the total deficit, and in 2019, 100%. On average for the observed period, 50% of the deficit refers to the deficit of units of local self-government of the Republic. That percentage represents a huge risk for adequate functioning, fulfillment of legally deficient competences and certain development projects. Finally, a high level of deficit at the local level tends to threaten the fiscal rule on the deficit, and consequently the public debt. Deficit reduction in units of local self-government of the Republic is possible by introducing and applying fiscal rules at the local level. This would have a positive effect on increasing fiscal stability and fiscal responsibility

at the local and national level. The creation of fiscal rules at the local level would have positive effects on the fiscal sustainability of especially small and underdeveloped local self-government units.

This would directly affect the strengthening of fiscal stability and fiscal sustainability. At the same time, it would enable efficient management and long-term stability of the overall public finances of the Republic of Srpska. In this way, it is possible to adequately perform the competences of the local self-government units provided for by law without negative consequences on the overall fiscal stability.

The following table shows the groups of local self-government units of the Republika Srpska according to the level of deficit in relation to the total revenues of the local self-government units of the Republika Srpska from 2018-2022. years.

Table 1. Groups of local level (deficit level in relation to total revenues of local level in 2018-2022)

BUDGET DEFICIT OF LSGURS					
Groups of local self-government units of the Republika Srpska (LSGURS) by level of deficit in relation to total revenues of LSGURS	% of the total number (64) of local self-government units of the Republic of Srpska				
	2018	2019	2020	2021	2022
up to 5%	15.63	10.94	14.06	9.38	12.5
from 5% to 10%	17.19	4.69	6.25	6.25	6.25
over 10%	15.63	23.44	43.75	6.25	15.63
from 10% to 20%	6.25	15.63	14.06	3.13	10.94
from 20% to 30%	4.69	7.81	12.5	1.56	4.69
from 30% to 50%	4.69	0.0	12.5	1.56	0.0
over 50%	0.0	0.0	4.69	0.0	0.0
LSGURS with a surplus	51.56	60.94	35.94	78.13	65.63
TOTAL	100.0	100.0	100.0	100.0	100.0

Source: Data from the Government of the RS

Based on the analysis of certain groups of municipalities and cities of Republika Srpska in relation to their incomes, it is concluded that it is necessary to establish rules to reduce the growth of expenditures. The highest percentage of local level with a realized deficit was recorded in 2020, as much as 64.06% of local level. In 2022, the percentage of local level units running a deficit will decrease to 34.38%. The risk for local finances is the structure of the deficit in relation to their revenues. The table shows that in 2018, 15.63% of local level had a deficit of more than 10% of their total revenues. The following year, the percentage of local self-government units that generate a deficit of more than 10% of revenue increased to 23.44%, and in 2020 to 43.75%. The devastating fact is that in 2020, 12.5% of local

self-government units realized a deficit between 20-30% and between 30-50% in relation to income. Due to the crisis caused by the corona virus in 2020, a higher level of deficit is expected in that year. However, what is worrying and gives the impression of the fiscal vulnerability of some municipalities of the Republika Srpska is the tendency of the deficit to grow in 2022. Considering the global economic situation, it is necessary to strictly establish fiscal rules for the local level. This will strengthen fiscal stability in Republika Srpska at the local level. Starting from the assumption that fiscal instability at the local level can also threaten the fiscal stability of the Republic of Srpska, it is necessary to limit the expenditures of the level. Because the share of source revenues of local self-government units of

the Republika Srpska in their budget is low, it is not realistic to expect a significant increase in revenues at the local level. That is why it is necessary to carry out the procedure of fiscal consolidation at the local level. This consolidation should preferably be done by reducing consumption.

CONCLUSION

In addition to the creation and introduction of fiscal rules in the local level. For a stable fiscal policy at the local level, it is necessary to strengthen fiscal responsibility and the transparency of spending financial resources. In addition, it is necessary to ensure responsible planning and more efficient management of public finances at the local level. Because the fiscal policy at the local level affects the result at the level of the Republic, it is necessary to work on raising the quality of budget decisions. In this way, the creation of new obligations would be harmonized with the fiscal capacity of the local level.

Based on the analysis, it is concluded that the consolidation of public finances of the municipalities and cities of the Republika Srpska is a condition for a stable fiscal policy at both the local and national level. A condition for a stable fiscal policy at the local level is the creation of fiscal rules for the municipalities and cities of the Republic of Srpska. The analysis confirmed that the high level of deficit of certain local self-government units of the Republika Srpska negatively affects the fiscal rule on the deficit in the Republika Srpska. According to the Law on Fiscal Responsibility in the Republic of Srpska, the consolidated budget deficit represents the total deficit of the budget system of the Republic of Srpska. It includes the sum of the consolidated budget deficits of all budget beneficiaries in the Republic of Srpska. Therefore, it is clear that the high level of deficit in the local self-government units of the Republika Srpska has a negative effect on the fiscal rule on the deficit at the level of the Republika Srpska.

Based on this research, it is concluded that stable public finances of municipalities and cities in Republika Srpska are a condition for stable public finances of Republika Srpska. That is why it is necessary to create fiscal rules for local self-government units of the Republic of Srpska.

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