# ENCOURAGING SUSTAINABLE TOURISM DEVELOPMENT BY ISSUING MUNICIPAL BONDS - SUGGESTIONS TO LOCAL AUTHORITIES

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***Abstract:*** *Among the 17 sustainable development goals adopted by the United Nations in 2015 (UNDP 2015), the eleventh goal refers to the sustainable development of local communities. The issue of financing the sustainable development of tourism is especially challenging in transition economies. Accordingly, a research question is defined as follows: How can a local community encourage sustainable development of tourism? When it comes to this, two types of financing stand out, namely: public-private partnership (Fainstein 1990; UN 2015b; Pieterse 2008; Naoum 2003; Haugh 2005) and municipal bond issue (Chapple 2010; Stevanović and Grujić 2014; Radivojac and Grujić 2017; Chapple 2010; Mysak 2012; Ramsamy 2006). The aim of this paper is to link the municipal bond issue with the achievement of sustainable urban development, based on tourism. By answering the research question related to the dilemma of how to finance the development of local communities, possible solutions to the identified problem are indicated. The contribution of this paper is reflected in the following: the scope and possibilities of using the issue of debt securities are explained, as well as the way in which this financial instrument can be used for the achievement of sustainability tasks. It was concluded that the biggest advantage of the described method of financing is reflected in the specific methods of achieving sustainability goals.*
***Keywords****: sustainable development goals, municipal bonds; sustainable development.*

## INTRODUCTION

Sustainability implies a new approach and new methods for implementing programs and projects whose goals are related to sustainable development (Haugh 2005: 15). It is a political concept imbued with governance issues (Farrell et al. 2005: 143). Sustainable development is mainly observed at the national level and in that context includes all local communities, regardless of their typology.

Due to the growing spread of the phenomena of metropolises and rapid urbanization, the attention of the academic community is increasingly attracted by the segment of sustainable development related to urban communities. An urban area is a place where self-interested political and entrepreneurial individuals and interest groups engage constructively or are in conflict to build sustainable markets - some formal and others informal (Papadopoulos & Axenov 2006: 146). The concept of sustainable cities and sustainable urban development emerged in the early 1990s (UN 2013: 60). Almost 70% of the EU population lives in urban areas, and these areas generate more than two-thirds of the European Union's GDP (European Commisson 2014). The Global Report on Sustainable Development, prepared by the United Nations (UN 2015: 96), points to the factors of sustainable inclusive growth by looking at the factors of sustainable development and their interconnectedness. Le Blanc (2015) analyzes the interconnectedness of 17 sustainable development goals, categorizing each of them depending on the number of other goals that are directly or indirectly significantly affected. In his opinion, the eleventh goal - Sustainable Cities and Communities, belongs to the group of goals with a medium number of connections (between 6 and 8).

Cities are spatial concentrations of human activity and interaction. They are the engines of the European economy that provide jobs and services, but also serve as catalysts for creativity and innovation throughout the EU (European Commisson 2014). The contribution of cities to sustainable development can be multiplied if more countries are involved in advocating for these goals and if society equally accepts these concepts and is ready and willing to produce, consume, and manage their behavior in a sustainable way. This is equally true for urban communities in developed countries as well as those within transition and underdeveloped economies (European Commisson 2014; UN 2013, 68). Sustainable urban development has a wide range of activities, including the following: concepts of change and transformation of the city; climate and environmental change; spatial planning and urban design; sustainability financing; sustainable infrastructure (transport, utilities, etc.); efficient functioning of local self-government, etc.

The subject of this paper is related to the financing of sustainable development in a broader sense, and in a narrower sense to the financing of sustainable development in the field of tourism through municipal bonds. The problem of the research is to find the answer to the question: In what way is it possible and desirable to finance the growth and development of tourism by issuing municipal bonds? The relevance and topicality of the problem stem from numerous reports of international institutions and organizations that indicate the importance of achieving the goals of sustainable cities and communities (UN 2013; UN 2015b, European

Commission 2014), then research on local community funding that indicates opportunities and brings into context different financing models with sustainability goals (Potter 2003; Chapple 2010; Fainstein 1990; Pieterse 2008), and additionally and in detail describes their nature, advantages, and disadvantages (Radivojac and Grujić 2017; Bubaš 2012; Orsag 2011). However, it does not mention the special, sustainable development of local communities related to tourism.

In accordance with the above, an analysis and synthesis of scientific research on the topic of internal entrepreneurship (Stevenson, Roberts & Irving Grousbeck 1994; Petković & Berberović 2013; Katz & Shepherd 2004), and entrepreneurship in the public sector was performed (Zerbinati & Souitaris 2005; Leyden & Link 2015), which is brought into context with sustainable urban development (Haugh 2005; Farrell et al. 2005; UN 2013; UN 2015b; European Commission 2014). The purpose of this paper is to bring the topic of sustainable development closer to the professional and general public and to point out the possibilities of financing, as well as the advantages and disadvantages of financing using certain financial instruments. In accordance with the above, a hypothesis is defined which reads: "To finance sustainable development, local governments can effectively use municipal bonds that ensure they can raise the necessary funds on their own."

The scientific goal of this paper is to link municipal bond issues with achieving the goals of sustainable urban development. The pragmatic goal is to confirm the hypothesis by presenting, analyzing, and describing funding methods that serve the described purpose, in order to give suggestions to local authorities, while leaving room for future research that would deal with additional methods. By achieving the set pragmatic goal, the authors made a contribution that is reflected in the existence of clear recommendations, the implementation of which would reduce the problems and negative consequences of the identified problem, which are reflected in the failure to meet sustainability goals due to insufficient funding.

## LITERATURE REVIEW

The development of local communities inevitably means an increase in the population as inhabitants of the same community, while it often points to geographical expansion. Rodwin (1981: 127) describes three main problems in this regard, namely the provision of the necessary infrastructure, finances, as well as the experience of local authorities in solving complex problems that arise during the growth of a particular community.

The government, i.e. public administration, with all its levels forms the foundation of sustainable development, whether at the national or local level. Accordingly, it has the greatest impact on the three fundamental pillars of sustainable development that comprise: society, economy, and ecology. Given that the term sustainable urban development is well known, it is necessary to draw the reader's attention to what is meant by "entrepreneurially driven sustainable urban development." The authors under this term mainly refer to the type of sustainable urban development that promotes, but also develops, different types of entrepreneurship. In other words, it is a model in which local authorities apply the concepts of internal entrepreneurship (Petković & Berberović 2013; Katz & Shepherd 2004) in their functioning, while at the same time stimulating the development of the entrepreneurial environment in which the private sector could develop. This type of sustainable urban development implies the implementation of a series of entrepreneurial projects with the aim of not only meeting the current needs of local communities, but also those that affect development and prosperity, and which directly target one of the pillars of sustainability. Therefore, the focus is on the implementation of projects in the field of social entrepreneurship, green entrepreneurship, and entrepreneurship of micro, small and medium enterprises. Local government, as such, is the main determinant of the development of the mentioned three pillars, as well as the achievement of sustainable urban development in general. Therefore, the action of local government has significant consequences in terms of encouraging or stifling sustainable development.

When it comes to developing countries, the generally accepted view is that public administration is the main reason for failure to achieve sustainability goals (IMF 2016). According to the earlier claims of numerous authors (Ostrom 1964; Wagner 1966), but also of international institutions, the dimensions and inadequate management system not only prevent public administration from developing but also "stifle" the private sector. Accordingly, this paper discusses such a model of functioning of public administration that respects all the principles of entrepreneurship in the public sector. This concept of entrepreneurship belongs to the so-called intrapreneurship which numerous authors recognize and confirm its advantages (Stevenson et. al 1994; Petković & Berberović, 2013; Katz & Shepherd 2004). Also, many researchers have written about the existence of a positive correlation between the application of entrepreneurship in the public sector, ie between entrepreneurship in the public sector and its performance (Zerbinati & Souitaris 2005; Leyden & Link 2015). However, practice shows that internal entrepreneurship is not sufficiently applied in institutions and government bodies, including public administration, as a result of which systems at the aggregate level do not function efficiently.

The main reason for the failure of current systems is the fact that their authorities do not consider sustainability in the second term, but act guided by imperatives for economic growth and the need to respond to the short-term interests of elected politicians (Espinosa & Walker 2011: 25). Although the central, i.e., state-level authorities, play a major role in determining the structure and form of development of the welfare state, and its finances, when it comes to implementation, this level of government is of minor importance. It is the local authorities that ensure the primary delivery of services and goods to their citizens (Parkinson 1990: 92). It is the long-term orientation that would be achieved by redirecting to the previously described entrepreneurial leadership. Namely, entrepreneurship in itself implies achieving independence and sustainability of both individuals and legal entities, and by promoting such leadership, local authorities would strive for sustainability in the long run. The problem that arises is reflected in the financing of such entrepreneurial projects which, due to their nature, require significant financial resources, which are usually not available to local levels of government. Hisrich et. al (2016) analyze the case of Macedonia, however, the key segments identified are applicable to other transition economies as well. These authors consider investments to be a significant driver of entrepreneurship development. In accordance with the inexhaustible importance of investments in achieving sustainability goals, further in this paper, we will talk about the ways and possibilities of obtaining funds for investments in capital and development projects.

## WAYS AND POSSIBILITIES OF FINANCING SUSTAINABLE URBAN DEVELOPMENT

The definition of sustainability in the nonprofit sector is quite different from that in the for-profit sector. In short, the reason lies in the fact that "in the second, organizations have sustainable finances, while in the first this is not the case" (Urban 2010: 136). Economic growth and development of local communities rely mostly on local institutions, so it largely depends on their abilities how they will organize programs and strategies for development and provide finance accordingly. Potter (2003: 165) states that there are numerous possibilities for implementing programs for revitalization and economic growth of cities, but the authorities most often use: expropriation, spatial planning, loans, and taxes, issuing bonds for development projects, and the like. If cities want to strengthen development patterns, they must raise their own taxes, issue bonds, and build large-scale infrastructure (Chapple 2010: 27). The road to building sustainable cities involves two types of investment. The first type refers to investments in infrastructure and capacity development to close social development deficiencies. This means providing access to quality public transport, water, electricity, energy services, and sanitation, as well as education, health, and housing. The second type refers to the so-called. investing in urban "resilience", which includes investments such as those in the industrial transformation towards the use of renewable energy sources, creating decent employment in "green" production activities, and adopting strategies to adapt and mitigate negative impacts (UN 2013: 69).

Although local financing systems differ from case to case, what is common to all cities is the need to rely as much as possible on the funds they collect themselves (Fainstein 1990: 126), i.e., to generate as many financial resources as possible on their own. Creating a policy framework to respond effectively to the challenge of financing the city's sustainability requires multi-layered cooperation between local, national, and global communities, including the development of partnerships for the use of public and private resources (UN 2015b: 78). In order to provide the necessary resources to finance sustainable growth and development, cities need to respect several facts. First, creditworthiness in terms of solvency and transparency of the local community are key. Second, it is necessary to establish capacities for the development of reliable projects. Third, a public-private partnership can be beneficial, but only if it is well structured (UN: 2015a). Unlike the financing of current needs, for which the necessary finances are mainly provided from regular, mainly fiscal revenues of local authorities, and borrowings, either from commercial banks or some other creditor, development projects should be financed from independently generated funds and exclusively for that purpose, because otherwise the projects will either not be sustainable or will not have the characteristics of entrepreneurial ventures, which is the goal. Accordingly, two financing models have been identified, which stand out in particular, and are underused in the local communities of transition countries. These are public-private partnerships and the issuance of debt securities.

Different types of partnerships between the state and the business sector, or state and civil society organizations, can be useful in implementing various projects aimed at urbanizing the poor, as well as responding to the imperatives of sustainable urban development (Pieterse 2008: 36). City authorities can work with civil society organizations to promote sustainable urban development (Pieterse 2008: 43). Public-private partnerships (PPPs) occur when two or more organizations from the public and private sectors come together and start a collaboration based on mutual trust, rather than on a strict hierarchical structure (Naoum 2003). It does not always have to be based on the exclusive placement of funds from one side to the other. PPPs can serve as a sustainable fundraising instrument for financing infrastructure projects, especially in developing countries, where access to long-term lending is limited (UN 2015b, 78-79). In the context of sustainable development, Haugh (2005) discusses social entrepreneurship that can be developed in the way that PPP projects are implemented, among other things, and in the way that a private sector partner provides consulting services to the public sector. However, this type of obtaining the necessary finances also has certain disadvantages. In the case of transition economies, which are given special attention in this paper, the biggest problem is finding a sufficiently "good" (in terms of financial stability, profitability, etc.) investors from the domestic private sector who would have the will and desire to participate in such projects. Those who are financially strong enough, most often (as is the case with foreign investors from the private sector), do not show enough interest for the simple reason that the return on investment is not as fast, nor the premium as high, as is the case in their regular business activities. Thus Rodwin (1981: 103) cites cases where large private investors gave up projects halfway through their realization, seeing that they would not achieve a high enough profit. Above all, the fact that such a model most often requires placements of a large amount of money by all participants in the project, low premiums are simply not sufficient compensation for high risk.

Another, interesting type of financing in the context of the subject of research of this paper is the issue of debt securities. The most common reason for issuing securities is the intention of the state or its decentralized levels of government, which is to cover the budget deficit or raise funds to finance development projects or current needs. In the role of the issuer, the authorities can appear at different levels - from local, to central, i.e., republic or state. Government bonds, treasury bills, savings bonds, etc. are mostly issued. which differ in maturity, interest, method of interest payment, and other parameters (Radivojac and Grujić 2017: 156). Cities must access the capital market in order to invest in urbanization and thus plan or direct growth and development.

The cost of delaying investment in planned urban development is huge, and the "mortgage" is in that case the future (UN 2015a). Municipal bonds appear as an efficient model for issuing debt securities. Municipal bonds represent debt arrears of value, which oblige the issuer, which in this case is represented by the local level of government, i.e., municipality or city, to pay the invested money to the buyers, together with the corresponding interest, after a certain period of time. In terms of time, municipal bonds are generally issued for a longer period, and the related interest is calculated at a fixed or variable interest rate for capital projects, with local authorities being able to issue such bonds for a shorter period, which includes several months. In that case, when the securities are issued for a shorter period of one year, they are called notes and, as in the case of treasury bills, they are issued for the purpose of obtaining funds to cover irregular fund flows or budget deficits (Orsag 2011). According to Bubaš (2002), municipal bonds are considered less risky than other types of investments, especially from the corporate securities market. Local authorities try to make issues of these securities as attractive as possible by investing in bonds, i.e., to bond buyers, offer different types of tax exemptions (Radivojac and Grujić, 2017: 172). By issuing municipal bonds, in addition to providing cheaper sources of financing, issuers have the opportunity to adjust the conditions of their indebtedness in terms of the manner of allocating funds for project implementation, choosing the interest rate and length, i.e., the manner of repaying borrowed funds (Radivojac and Grujić, 2017: 244). The money raised by issuing municipal bonds can be used for various public investments or to improve public goods (Chapple 2010: 124). In addition, they are crucial for financing development (Chapple 2010: 125). Ramsamy (2006: 182) analyzing the example of the United States, suggests that the issuance of municipal bonds can be used as an effective instrument for financing various programs in developing countries. Furthermore, he points out that this type of financing can assist local authorities in financing the necessary infrastructure without borrowing funds from the central government. Mysak (2012) goes further and points out industrial development bonds that local communities can issue in order to finance projects in the field of industry, related to infrastructure, etc. In addition, the same author cites case studies in which the mentioned financial instrument led to impressive results.

On the other hand, experience shows that the secondary municipal bond market is significantly more passive and less liquid compared to the stock market or government bond market (Van Horne & Wachowicz 2014), which to some extent may be a disadvantage of this financial instrument. In addition, the fact that this financial instrument is underdeveloped in terms of the market, and that the procedure for obtaining money for the issuer is significantly longer compared to a bank loan, is stated as a pronounced demerit and danger of obtaining money through the issue of municipal bonds. In this regard, analyzing the possibility of issuing bonds as an alternative to classic credit borrowing, Stevanović and Grujić (2014) found that from the day of the decision on borrowing to the announcement of the decision to accept bonds on the official stock market, even several months pass.

## DISCUSSION

To prove the hypothesis, we used the analysis methods of the available literature on the topic of relevant concepts in this paper, then the analysis of case studies and research conducted by the authors from the referenced literature, to finally reach certain conclusions by the method of synthesis. To this are added the findings of a case study of the functioning of the City Administration of the City of Banja Luka, including the application of entrepreneurship as well as the financing of development projects made on the basis of field research on the spot.

The case study proves the positive experiences in the issuance of municipal bonds. Analyzing the way of financing development projects within the case study of Banja Luka, it was found that local authorities mainly rely on regular budgets, and on assistance and co-financing by international institutions and organizations, which are usually approved at relatively high prices or rigorous conditions, and credit indebtedness. According to the authors, as long as local authorities rely on funds they receive from the "other side", even when it comes to the central government, one cannot talk about long-term sustainability. Namely, for such a situation, a certain degree of autonomy and independence is needed, which can only be achieved by collecting and "creating" the necessary resources by the local government.

In the case of the issue of debt securities of value, ie. municipal bonds, the local government takes over the acquisition of the necessary funds into its own hands. Success in this will largely depend on the reputation and reputation that the local government enjoys in public. In addition, it is understood that municipal bonds are issued for the purposes of development projects, which would be primarily in the field of entrepreneurship of micro, small and medium enterprises or projects that generate positive cash flow such as roads, tolls, parking spaces, public garages, maps for skiing, etc. With this approach, by separating each specific project, citizens and legal entities as the primary target group, have the opportunity to indirectly participate and influence the development of their cities.

Issuance of municipal bonds has certain advantages over classical borrowing from commercial banks. In the first place, it is about increasing the responsibility of the local government. Namely, due to the transparency of issuing this type of securities, they are indirectly "forced" to take more care and to pay more attention to the implementation of projects. This is mostly due to increased control by the public, which entails the aforementioned transparency of broadcasting. Furthermore, this type of financing of sustainable development projects enables citizens to participate in it, by purchasing their bonds, and as a result to act more responsibly, conscientiously, and carefully in connection with projects financed from these funds, and to have a greater motive for the projects to be successfully realized. This way increases the social responsibility of the local community.

Apart from the fact that municipal bonds could be placed on the domestic market, the same could be done on the international market. However, despite the benefits of gaining international creditworthiness and credibility, as well as attracting new sources of money, it is impossible to ignore the unfavorable reputation that developing countries "enjoy" at the international level. Negative “publicity” at the state, cantonal, county or entity level is transmitted in parallel to lower territorial units. Accordingly, it is not to be expected that these municipal bonds will attract significant interest in the international market. The same is true for other transition countries with similar levels of economic and social development. Therefore, the proposal to local authorities, in this case, is to focus on the domestic population (i.e., domestic individuals and legal entities - insurance companies, banks, pension funds, and broker-dealer companies) and build trust between them, as potential investors. Also, a good approach would be to rely on investors from neighboring countries, with whom special relations of cooperation are developed and cultivated. Periodic meetings with a large number of potential institutional investors and the creation of an indicative calendar of debt securities issues to help investors adjust their cash flows to market issues can also be helpful. This move is desirable both for issuers of debt securities and for investments in them.

## CONCLUSION

The paper confirms the hypothesis that local authorities can effectively use financial instruments that provide them with the opportunity to raise the necessary funds. Issuing municipal bonds is an efficient way of obtaining the necessary financial resources for local authorities that want to achieve the sustainability of the urban community and encourage the development of tourism in the long run. The positive sides of municipal bond issues are certainly reflected in the multiplier effects that are achieved in a way that the state has direct benefits, especially in terms of reducing expenditures that would otherwise have to be allocated to finance sustainable development projects. Of course, it is necessary to keep in mind the demerits of this method of financing, which is reflected in much greater uncertainty than, for example, the case with bank loans.

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