



**Local Governance Assessment
and
Policy Recommendations**

November, 2003

Executive Summary of Key Policy Recommendations

There is widespread acknowledgement that structures of governance as developed in BiH since 1995 are not efficient, do not reflect subsidiarity and may not be sustainable in the long run. The level of government closest to citizens, municipalities receive only 8% of all public revenues in both entities, despite a growing list of responsibilities and unmet citizen demands. These demands include the need for major capital investments in infrastructure required for economic and social development that are not being met by current revenue distribution. Even seemingly own-source revenues such as the property tax are regulated by higher levels, collected by entity tax offices, and in the Federation, shared with the cantons. On the other hand, municipalities are often held accountable by citizens for services that are actually the responsibility of higher units of government.

This paper proposes that the introduction of the VAT, and possible other tax reforms at the State and Entity level, be used as opportunities to address some of the systemic problems regarding the assignment of tasks and revenues to municipalities in both entities. (Such redesign is taking place in Serbia as a consequence of VAT being introduced in 2004). VAT will eliminate, not replace, the sales tax in 2006 as a significant source of municipal shared revenue in both entities, therefore discussions surrounding VAT should be broadened to consider the following policy changes:

- a) Move supervision and regulation of municipalities in the Federation back to the entity level in a revised Federation local government law;
- b) Reassign functions to municipalities in both entities based upon efficiency/accountability analysis and principles of subsidiarity, and align local and transferred resources to reflect the true cost of municipal mandates (both organic and delegated), guaranteeing relative equality in access and level of services throughout BiH. Cantons should not have the power to determine revenue sharing formulae.
- c) Take measures to strengthen the rule of law and observance of the constitutional and legal rights of municipalities already in force.

Both entities, the RS in its constitution (Article 103), and the Federation in its current local government law (Article 14) guarantee the availability of funds and resources

to carry out mandatory and delegated tasks on the municipal level. Both are routinely violated.

The enactment of a revised law on local government for the Federation that calls for the direct election of mayor, moves supervision of, and more importantly, the allocation of functions and revenues of the municipalities up from the cantons is critical for the financial and political sustainability of public administration and local government services. Article 18 of the current law should be removed as it gives cantons almost abusive powers over municipalities in municipal legislation, annual tax sharing and budget laws. The Federation Constitution does not mandate cantonal supervision over municipalities, instead assigns cantons regional public service duties, as well as all other powers that the Federation does not explicitly reserve for itself.

Policymakers should examine the use of the State-level Constitutional Court as a final court of appeals in inter-governmental disputes that cannot be resolved by either entity's own Constitutional Court. This includes making explicit in the relevant Constitutions and local government laws the right of municipalities in both entities to appeal in first instance directly to the entity Constitutional Court.

Clarifying the rights, powers and funding sources of municipalities also means imposing service standards, standardizing forms, making ownership and control over property unambiguous, thus enabling municipalities to manage public property as genuine, accountable owners.

Finally, because of widespread cynicism, passivity, and the entrenched nature of the status quo, the international community needs to play an active and constructive role in both advocating policy changes leading to more accountable and efficient public administration, as well in providing concrete assistance to municipalities in Bosnia-Herzegovina.

Purpose and Approach

This local governance assessment advises USAID and informs other donors and policy makers on the current situation facing municipal governments, and recommends program and policy approaches for the next three-year period.

Over a three week period in October, 2003, the assessment team¹ visited a total of seven cantons and sixteen municipalities in the Federation, as well nine municipalities in the Republika Srpska (RS). Interviews were conducted with mayors and their professional staff members, such as finance and budget directors. In the case of cantons, Finance Ministers were interviewed along with a sampling of their professional staff. On the Entity level, interviews were conducted with the Finance Ministries of both the RS and the Federation, as well as with the Ministry of Justice (Federation) and the Ministry of Local Self-Government (RS). Other stakeholders such as international donors, USAID implementing partners and contractors, local NGOs, municipal associations in both Entities, as well as members of the international community also provided valuable insights to the assessment team. The team also collected information on the unique situation in Brcko District as well as examining the prospects for a unified City of Mostar.

The assessment team decided it is not necessary to repeat the empirical research done recently by The World Bank (June 2003) and other donors. The team decided to make its policy recommendations unambiguous, underlining that the Dayton Agreement did not mandate all features of the structures of governance that by 2003, are in dire need of rethinking and reform. Dramatic examples will be highlighted later in this report.

The team collected evidence based by evaluating proposed and current legislation, surveying current literature on the state of local governance in BiH², as well as by asking

¹ Consisting of Marc Ellingstad and Marinko Sakic, Democracy Office, USAID Sarajevo, Ted Priftis, USAID Washington, and Charles Jokay, consultant.

² This assessment will not provide a general description of the local government system in BiH. See the following for more information:

Bosnia Herzegovina, From Aid Dependence to Fiscal Self Reliance, A Public Expenditure and Institutional Review, The World Bank, 2002

Bosnia and Herzegovina: Creating an Efficient Decentralized Fiscal System, The World Bank, June 2003 (World Bank, 2003)

Bosnia and Herzegovina Local Development Project – Legal and Regulatory Framework, Michael DeAngelis and George Peterson, The Urban Institute, 2001

Advisory Note on Regulatory Framework and Institutional Issues: Municipal Borrowing in Bosnia and Herzegovina, Glasser and Jokay, RTI International, 2000. <http://www.rti.org/pubs/mun-borr-bh-mdg.pdf>

Brief Analysis of Local Government Jurisdiction and Practice in Bosnia and Herzegovina, USAID, 2000 <http://206.118.253.100/usaaid-bih/information/sheets/analysis.doc>

interviewees a standard set of questions related to the following issues: the nature of municipal-higher level relationships (canton and Federation, or RS), tax sharing (revenue and task assignment), opinion and views on the planned introduction of VAT, the question of municipal property ownership and management rights, capital budgeting (investment needs and plans), and well as views on respective municipal associations. Cantonal, Federation or RS Ministry representatives were also asked similar questions.

Findings

The assessment team covered a diverse set of municipalities and cantons with widely varying levels of political and economic development. They all face problems associated with restoring physical infrastructure, dealing with returnees, and addressing the consequences of both unemployment and the magnitude of the gray, untaxed economy. The team discovered that in both entities, despite formalized political loyalties and similarities among elites at the lower and the next higher level of government, a surprising level of mistrust and open animosity exist between the municipality and the canton, or municipality and the RS government. In extreme cases, municipal leaders considered the next level of government to be an “enemy” of local democracy, calling into question the current practice of having an interlocutor between the municipal level and the state or entity level. This general mistrust and apprehension was repeated to varying degrees in all RS municipalities covered by the team, as well as throughout the Federation, regardless of the ethnic composition of either the canton or municipality concerned. These attitudes appear to be unrelated to their level of development or distance from the regional (cantonal) or entity center.

While a certain level of intergovernmental friction is to be expected in all situations, the universality of mistrust formed through experience - seemingly regardless of political affiliation - by the municipal level vis-à-vis the next higher level government convinced the team that besides acknowledging the measurable fiscal imbalances and uneven distribution of resources, the stakeholders need to address the distributive and oversight legitimacy of the cantons, as well as aspects of the RS government that do not follow principles of subsidiarity and fiscal decentralization. This does not mean that the cantons, or some form of regional government in the RS, could not have roles as service providers were they demonstratively the most efficient and accountable unit to provide certain services.

Specific Findings and Explanations

Finding One: Disconnect between Functions and Financing

The assessment team's approach was to analyze the question of revenue and task assignment primarily from the perspective of municipal leaderships. Given the current structure of intergovernmental fiscal relations in BiH, the team concluded that municipalities in both entities lack the ability to influence neither the size nor the quality of the tax base used for both shared taxes (income tax and sales tax) and local taxes such as the property tax and the property transfer tax. Municipalities are subject to annually changing arbitrary sharing of revenues by the cantons and by the RS. The RS has a system of sharing rates adjusted to ratings of economic development. Mayors questioned the legitimacy of these ratings that contain arguably subjective elements, as well as indicators that may not necessarily reveal levels of economic development. The RS's attempt at equalization may be commendable; however, in practice it removes incentives for increasing local tax bases, and is relatively unpredictable.

In Bosnia-Herzegovina only 8% of all public revenues accrue to municipalities in both entities. In the Federation, the cantons and the entity keep 92% of public revenues, while in the RS, the entity keeps 92% of public revenues.³ A significant aspect of this situation is that the distribution of functions, and the administrative autonomy necessary, is not adjusted to the capabilities of the municipalities, and does not reflect true demand for services imposed by the population. Municipalities cannot adequately fund mandatory services from shared and own-source revenues, cannot reject delegated tasks from the entity or the canton, nor can they decide upon the most efficient and accountable form of delivering their services. Entity local government laws, as well as cantonal local government laws, were not designed taking into account which services could be optimally performed at each level of public administration, and the funding necessary for an optimal, or even for the current construct, is clearly inadequate, and beyond the control of the municipal level.

The number of delegated functions varies canton by canton, as do the sharing formulae and the tax bases. In neither entity is there an explicitly logical connection

³ For more data see World Bank (2003).

between the cost of mandated and delegated tasks, the sharing formulae, and the use and availability of local taxes and non-tax revenues. Entity tax offices do not make adequate efforts to collect taxes from state-owned enterprises which have tax arrears, and often engage in tax bargaining that reduces municipal revenue without any consultation with the municipality. Tax sharing on a derivation basis also reinforces existing differences in levels of development and tax capacity, while assigned and delegated functions are not adjusted to the divergent fiscal capacities of municipalities.

All taxes, even local taxes on property and transfers, are collected by entity-level revenue offices. In the RS, the entity sets property taxes imposed on the municipal level, collects and redistributes these taxes back to the municipalities. In that scenario, municipal management has no influence over tax rates, collections and enforcement. In the Federation, the canton sets municipal property tax rates, the entity collects the funds, and the canton keeps 20% of the municipality's local property and transfer tax funds. Even property taxes are not genuine own-source revenues in BiH, thus the connection between local services, property values, and the level of taxation or tax yields is completely broken. These revenue offices, mayors complain, do not provide adequate information for revenue planning, nor do they release information on local tax compliance so that municipalities could assist in collections and enforcement. This inability to obtain information on business taxpayers, and a general lack of instruments to improve the size and quality of the tax base through economic development, hinders the performance of even mandatory functions due to under funding and revenue sharing unrelated to actual costs.

The untaxed economy imposes demand-driven costs on municipal services that cannot be recovered through better tax compliance and collections at the local level. The entity-controlled tax offices have little concrete incentive to increase collections of the property tax and transfer tax, both of which could be significant municipal own-source revenues. An additional problem with the property and property transfer tax is that in the Federation it is not an exclusively municipal source of revenue as the cantons take on average 20% of these collections. The World Bank asserted that restoring the property tax as an exclusive local tax source is a “*conditio sine qua non* for restoring the fiscal autonomy and creditworthiness of local governments.”⁴ Municipalities, in both entities,

⁴ *ibid.*, p. 52

do not have the instruments to increase collections of property tax, nor to expand the size of the tax base used by the entity to collect sales and income taxes. In other words, local services and economic development are not funded out of local taxes, as these by any definition are rare.

Some mayors and municipal finance officials went as far as to assert that they did not trust the figures generated by the treasury, and one municipality recalled that the estimated tax sharing from the single greatest taxpayer in their community alone was more than was returned to that community in total shared taxes in any given year. In other words, the largest taxpayer's revenues alone generated estimated taxes whose shared portion was larger than what was returned in total. In communities that do not have large taxpayers whose revenues may be known to a municipality, it is difficult to determine the accuracy of tax collection reports compiled by the entity treasury and revenue office. Those tax collection reports, unverifiable by municipal officials, feed the revenue sharing system driven by the formula set by the canton or RS respectively.

State-owned firms were identified by municipal finance directors and mayors in both entities as having significant arrears in taxes of all types, including social contributions, payroll taxes, property taxes, and other taxes that form a municipality's tax base for revenue sharing. Obviously, a municipality cannot do much to force a state-owned enterprise to pay taxes to the entity tax office if the two organs of the state come to an agreement on tax compensation, tax subsidies or other arrangements that lead to the reduction of taxes actually collected on a municipality's territory.

Certain mandated and delegated services are not being provided or are grossly under-funded as a consequence of the lack of information and influence over local and shared revenues (in this case ignoring the arbitrary nature of cantonal distribution of shared taxes). Capital spending varied between 1-10% of cantonal budgets (direct investment by cantons amounted to no more than 5% of budgets according to World Bank estimates), and at the municipal level, certain mayors claimed capital spending took up to 30% of their budgets. In addition to the dearth of capital spending in both entities at the municipal level, the team encountered a confused legal and regulatory environment associated with capital borrowing by municipalities in both entities. That environment will be largely clarified by passage of the proposed Debt Law for the State and Entities. The lack of capital spending by cantons and municipalities means a visible decay of the

very infrastructure that is required to deliver services mandated by entity and/or cantonal laws and regulations.

Finding Two: Inadequate Definition of Responsibilities and Intergovernmental Relations

Certain public functions are unnecessarily split between municipalities and the next higher unit of government. In many respects, municipalities lack autonomy in organizing and delivering core services. Aspects of permitting and urban land use are shared between cantons and municipalities, preventing municipalities from influencing their own development, while making permit applicants hostage to the whims of a distant cantonal official. (Sarajevo Canton routinely issues construction permits for projects in Sarajevo's Center Municipality without even consulting the municipality). In both entities, social service and education functions are divided among the municipalities and the higher level in that teacher' salaries are paid by the higher unit, while maintenance and material costs are assumed by the municipality.

These unclear and shared functions and responsibilities are often blamed on the Dayton Peace Accords, yet any suggestion that the status quo be modified raises fears that the very basis of those Accords is threatened. The assessment team agrees with many analysts' conclusions that fiscal decentralization was not properly addressed by the Accords, and that the situation as it evolved is far removed from the intentions of the framers and signatories to that Accord

For example, a routine complaint of mayors is that cantons do not discharge their social welfare functions (examples include Zenica, Bugojno, Jajce among others), leaving municipal staffs and budgets unsupported in their efforts to address social issues that are not municipal responsibilities legally, but in practical terms, the municipality has to answer to the affected population directly. The assessment team encountered a protest march on the municipal building by pensioners in Zvornik who were angry about late payments and the low amounts paid in retirement benefits. This, again, is not a municipal responsibility, but the mayor and his staff are caught between the obligations of a distant higher level of government, i.e. the RS government, and the immediate accountability demanded by citizens. In Prnjavor (RS), veterans' benefits such as housing and welfare payments take up 8% of the local budget as a result of this entity responsibility not being

adequately funded. Similarly, the Municipality of Caplina in the Federation complained of its obligation to house and feed veterans and their families without an adequate transfer of resources from the canton and entity levels.⁵

Split responsibilities in the educational sector means that parents complain to municipal governments about cold, dark and dilapidated schools, and are hence forced to fund improvements and operating expenses out of their own budgets, budgets which for many reasons are inadequate to cover even mandatory functions. Capital expenses of certain types are also involuntarily assumed by municipal offices facing public pressure.

In this system, those officials at the RS or cantonal levels who are legally responsible for certain public services are not held accountable by citizens at the local level, while municipal officials, who lack the authority and wherewithal to address the problem, are held directly accountable to the public. This paradox illustrates that the inherent basic accountability that exists at the municipal level is fundamentally more vibrant today than at higher levels of government. As a generic guiding principal of modern public administration, service provision should occur at that level which provides the optimum balance between efficiency and democratic accountability.

Finding Three: Lack of Political Weight for Municipalities

A universal complaint of mayors is that the revenue sharing formulae used in both entities are arbitrary, do not reflect the cost of service, and are not fair to those municipalities with weak tax bases which could perhaps never produce sufficient revenues to be shared and returned to cover the costs of mandated services. Revenue sharing practices appear to result from calculations of political strength and opportunity and have little to do with actual needs or costs. Cantonal finance ministers claimed that the “division of responsibilities” justified the canton taking 65-80% of the shared revenues. As to why this high share was needed by the canton, or why the lower share was enough at the municipal level, was never justified nor explained by cantonal representatives. Cantons spend on average 80% of their budgets on salaries and benefits, and certainly, at least in the seven cantonal offices the team visited, canton governments possess office

⁵ For more data see World Bank (2003).

facilities, luxury vehicles and the trappings of wealth that are seldom seen at the municipal level. (Cantonal usage of municipal buildings without any compensation will be covered in a later finding).

Causes of municipal weakness are many. In the Federation, the municipal association is viewed as weak and ineffective both as a lobbying tool as well as a mechanism for professional development. Individual municipalities divided among ten cantonal jurisdictions have very little collective power to question the tasks and revenues assigned to them by the canton. Because cantonal parliaments set revenue and task allocation, and many cantonal constitutions and local government laws can challenge municipal ordinances, and have methods to remove mayors, the need for effective municipal political advocacy at the Federation level is striking.

The political structure of the Federation offers no municipal advocate at a ministry or entity government level. If in the future were a municipal association in the Federation ever strong enough to engage in real interest representation, as structures currently stand it would have no audience at the Federation level, and would instead be faced with ten different cantonal governors, ministers, legislatures, and bureaucracies as counterparts to any negotiation or discussion. In effect, currently the Federation municipal association can only speak on behalf of those several municipalities actually located in a given canton. As demonstrated later in this assessment, the Federation has in effect “washed its hands” of responsibility for municipalities, thus a Federation-based municipal association literally has no counterpart in the executive and legislative branch of the Federation government where potential new municipal legislation could be proposed, argued for and eventually passed and implemented.

In the RS, mayors questioned the legitimacy of the “economic development” criteria used to determine the share of sales and income taxes to be returned to a municipality, and considered being rated as “more developed” catastrophic for their budgetary revenues. (This is especially true in areas with a high level of gray market activity and untaxed consumption, since an area may “appear” prosperous, without any tax increment going to any level of government). This rating and classification system was questioned by nearly all mayors interviewed by the assessment team, with some questioning openly whether potential changes represent just another scheme to claim more revenue for the Entity. Those with the highest level of development receive only 20% of

the sales and income tax collected on their territories, and saw little hope for increasing their revenues given the lack of control and oversight over the tax base, and the disinterest of the RS tax office in collecting municipal taxes such as the property tax. Those municipalities with “less developed” ratings enjoyed a higher share of taxes returned, albeit supported by a smaller tax base. Some underdeveloped municipalities allegedly receive extra compensation grants based upon the political affiliations of the mayors and the minister considered. Such arbitrariness pervades the seemingly “objective” system of revenue sharing adjusted to the general level of economic development. RS municipalities rated as being undeveloped earnestly feared being “upgraded” since some of the indicators used to determine a locality’s level of development were not appropriate and gave false readings. An example: Nevesinje, one of the poorest municipalities in the Eastern RS, reported fears about being upgraded given the large number of mobile phones in their community. As in other countries in transitioning Europe, mobile networks expanded rapidly since fixed line systems were antiquated and still do not provide adequate penetration. (Many people could buy cheap pre-paid phones even in poor areas, instead of waiting for the privatization and recapitalization of the old state monopoly telephone company. So the high proportion of the population having mobile phones does not necessarily indicate a high level of development, in some cases, it is a proxy solution for the unavailability of modern fixed line service.) Moving from enjoying 40% of shared taxes to 30%, for example, means a 25% drop in shared revenues on a constant nominal basis. Being upgraded by the RS government means in a static sense losing 10-20% of the share of revenue enjoyed a year before, without enjoying a proportionate expansion in the tax base used to collect and share such taxes.

In general, the team detected a universal sentiment in both entities that collective action given current circumstances is futile, that municipalities are alone in their struggle to deliver services and to obtain funds that they control. Some cited a level of inconsistency on the part of the International Community regarding the role and powers of the municipal level. Others opined that the IC has in general ignored the concerns of the municipal level by either creating fully-empowered cantons, removing responsibility from the Federation through constitutional and other mechanisms, or by too fully entrusting municipal affairs to the RS entity government. Both municipal associations were deemed as being relatively dysfunctional and powerless by their constituents. However, on a positive note, RS mayors did recognize the role that their municipal association played in

deflecting certain negative aspects of the entity treasury and in commenting upon the draft revisions to the local government law in the RS. The team's impression was that in the Federation the association may as well not even exist from the perspective of its potential constituency, and in the RS, the strong leadership and personal influence of several key mayors have made the difference, but this capacity is not institutional in nature. Policy analysis capacity is sorely missing in both associations, as is an awareness of the need for membership services and feedback.

Finding Four: Rule of Law Concerns

Mayors in the Federation complained universally of bullying behavior on the part of cantonal officials. Examples include simply not abiding by agreements, court decisions, cantonal laws and other commitments, or arbitrary interference in municipal regulations and administrative decisions. The totality of anecdotal evidence convinces the assessment team that in many ways the readiness of cantons to rule arbitrarily along the vertical axis of power is reminiscent of the excesses of the communist era.

While not explicitly identified as such, mayors and other municipal officials interviewed express serious doubts about the ability of municipalities in either entity to seek legal redress or an independent review of their complaint against arbitrary actions by the RS level or by a canton. In the Federation Constitution, cantons have the right to challenge municipal laws in the Constitutional Court, but municipalities do not have an explicit constitutional right to challenge the laws and decisions of the canton, or any other part of the state. In the RS, "any citizen" may appeal to the Constitutional Court, but municipalities are not given this right explicitly.

Significant inconsistencies were identified between cantons regarding revenue sharing, and among municipalities in the RS. For example, in April, 2002, Tomislavgrad municipality discovered that the property tax and transfer tax revenue that the canton shared with 80% to the municipality had been rearranged by a new cantonal regulation which kept 75% of property tax revenues for the canton, leaving the remainder for the municipality. That canton seems to be upsetting the convention that property tax revenue is organic to the municipality, as it is entirely in the RS, and elsewhere in the world where property taxes are imposed. In this case as in many others, those municipalities have no legal recourse. Categorization in the RS seemed in many instances to be arbitrary, as well

as the revenue allocation formula in any canton. What is common in these complaints is that there is no higher forum to address grievances against the canton or against the RS government.

For example, some cantons and RS agencies use municipal property without paying any rent or compensation for utility and maintenance expenses. Despite court orders in some cases, the higher level of government is seemingly free in BiH to abuse its power over the municipal sector. Examples of arbitrary actions on the part of higher units of government abound. There are problems related to the extraction of natural resources such as wood and minerals, where municipalities are entitled to “usage of natural resources” fees, but these fees are not shared by the canton, if they are imposed and collected at all.

One of the most egregious examples of arbitrary and arguably illegal action on the part of a higher unit of government was discovered in the RS, in the Municipality of Modrica. According to the mayor, the town’s water system was privatized without consultation, consent, let alone compensation. A mandatory municipal function, water service, was sold, including the pipes in the ground that were in part constructed with local taxes and self-contributions. Modrica municipality is accountable and responsible for clean water, and for setting water prices, yet it cannot influence the new private owner’s actions. Who will be at fault if service is unreliable or unhealthy is unclear. To the best of the Mayor’s knowledge, the RS government did not sign any performance agreement with the new owner, nor did it extract any commitment to expand and improve service. The RS Law on the Privatization of State Capital⁶ deems water and other environmental services as being “strategic,” hence their privatization is under the direct control of the privatization agency at the RS level. The law refers to a special decree on strategic assets that has not yet been formulated. It is questionable whether such a privatization is legal at all. Certainly the procedure and the result question the very role of municipalities in delivering services mandated by the Local Self-Government Law. In a similar situation, communal services such as water provision, street cleaning and waste removal were

⁶ Article 7 of the RS Law on the Privatization of State Capital in Enterprises (“Official Gazette” of Republika Srpska, 24/98, 62/02) states the following: “*In enterprises of strategic importance within the area of production and distribution of electricity, railway traffic, telecommunications, water supply, mining and forestry, public media, games of chances, production of arms, military equipment and other enterprises defined by the Government Republika Srpska, state capital will be privatized based on this law according to Special privatization programs of the Government, and in exceptional cases even according special decisions of the Government*” (OHR translation).

partially privatized in Zvornik, again without municipal consent. The mayor questioned the legality of the move by the RS government, and expressed grave concern over how the municipality is to deliver a mandatory service if the assets needed to deliver the service were taken away, and with the municipality lacking a legal instrument to hold the new owners accountable. Neither mayor could identify a court or other forum where he could seek redress or at least file a protest.

Though most mayors felt that they had legal control, i.e., full ownership (including the right to sell and reshuffle real estate) of their core assets such as streets, public buildings, parks, schools etc., many ambiguities remain regarding the separation of municipal, cantonal and entity property, since ownership claims are justified with references to pre-1990 Yugoslavia, as well as with claims of ownership based upon current possession. The latter is especially common in cases where canton offices simply occupied municipal buildings as the cantons never existed before, and needed the space traditionally used and owned by the municipalities. Clear-cut definitions of state, entity, cantonal and municipal property are still missing in BiH, and property ownership does not follow function based upon the principle of subsidiarity.

Finding Five: Wide Disparities in Skills and Knowledge at the Municipal Level

This finding, based upon gained knowledge and impressions of the physical and human resource capacities of the municipalities encountered by the team is not unique to BiH, as any transformation country has similar characteristics. However, given the intensity of the problems defined in the first four findings, the variation of skills, and on average, the stunted ability to deal with the problems described, the municipal skill question has deeper implications for political stability, and the viability of democratically-elected local government in BiH.

Mayors in both entities complained about “inheriting” large numbers of staff from the previous regime or during the war period. These staff members often do not have the skills, professionalism and willingness to work in a modern public administration system. Yet mayors fear firing such staff for political and economic reasons, i.e., it is difficult to fire a public servant, and expensive in terms of severance costs. Furthermore, the cost of bloated and unqualified staff includes the inability to hire appropriate people, especially in the IT and finance areas, both of which are critical to any reform process.

With no on-going BiH-wide education of municipal officials, elected and professional, as well as a dearth of professional information channels, this situation needs immediate attention. From training of local legislators to professional certification of finance officers and others, major human capital deficits were detected in all parts of the country. At the same time, the team was able to identify many municipalities with dedicated, professional mayors and staff who seemed to well understand both their jobs and the environment they work in..

General Characteristics of Findings:

The status quo described above provides incentives for systemic under- and unfunded mandates, virtual mandates, as well as burden shifting from higher levels of government to the local level.

Unfunded, underfunded and virtual mandates:

By *underfunded and unfunded* mandates we mean legislation from the canton or RS level that defines municipal responsibilities without proper financing. For example, municipalities are responsible for transporting students to schools, yet there is no separate funding for the full costs of these tasks. In the case of veterans' housing, in both entities municipalities were made responsible without any additional funds. In the case of social safety net questions, additional unemployment caused by privatization and/or restructuring of state-owned firms increases the municipalities' burdens to care for the newly unemployed, yet no line item exists for this new task. In both entities, municipalities are responsible for the maintenance and material costs of elementary schools. Yet if the electric or heating costs exceed the resources the municipality has available from various local and shared taxes, it has no choice but to cover the additional costs, or else the parents will protest to the mayor, not at the appropriate higher level of government.

As in all transition countries, in theory at least, laws "guarantee" sufficient resources to carry out mandated and delegated duties. In the Federation, Article 14 of the Federation Law on Local Self-Government, states that municipalities are "entitled to...appropriate sources of financing" over which they can "freely dispose of", as well as

funds to perform tasks delegated by the cantons.⁷ Neither guarantee is enforceable nor adhered to, nor does the Federation's local government law identify any forum for redress. (The Federation Constitution does not give municipalities the explicit right to appeal to the Constitutional Court against cantonal or federation laws and rules). This legal right of the municipal sector to adequate funding is clearly denied in cantonal legislation and practice, but municipalities also lack the accounting and technical skills to effectively demonstrate the true cost of services they are mandated to deliver, and what types of additional resources Article 14 of the Federation Local Government Law entitles them to have.

Virtual mandates are those that are not legally or explicitly required of a municipality. If the public function is to be carried out to the satisfaction of the local population, despite a lack of direct funding and responsibility for tasks to be financed by a higher level, municipalities must often step in.. Examples abound in the fields of education, social welfare, and public housing. Municipalities, not faced with any legal or explicit mandate, are often forced into the role of bandaging a broken welfare state, usually on an ad hoc basis. While demonstrating that municipal leaders can be both responsive and entrepreneurial, the failings of higher levels of government cause particular pressure on municipal budgets.

Burden shifting: hiding the true cost of the public sector

Burden shifting in short can be defined as forgone incomes and incurred opportunity costs at the municipal level, combined with increased operational, maintenance and utilities outlays, combined with a crumbling physical infrastructure, that is, depreciation expense.

Burden shifting by higher levels of government underreports and hides the true cost of the public sector in BiH in several ways. Firstly, when a higher level unit of government uses municipal facilities without paying rent or other forms of compensation, no unpaid accounts payable accumulates in the public sector accounting system. A higher unit of government uses public assets for "free," while the municipality also does not record its uncollected accounts receivable. There is no direct measure of the rents unpaid,

⁷ See Law on the Bases of Local Self-Government (Official Journal of the Federation BH, November 8, 1995).

or incomes forgone in the public sector. In either case, refusal by the users of municipal property to pay rent and the inability to collect or record such foregone income shifts the burden of running the public sector down to the municipal level. At a macro level, contingent liabilities and incomes accumulate, while the municipalities take losses in one unrecorded, and two very visible ways. Firstly they forgo significant rental income. Secondly, they assume the utility, maintenance and other overhead costs of buildings used by other units of government and these uncompensated expenses show up in their budgets. Thirdly, these buildings used by other units of government depreciate in a physical manner, and the municipality is not capable of preserving the value of these buildings for future use, and thus takes a significant loss on a theoretical balance sheet.

Burden shifting, though hard to measure, deserves serious consideration by all stakeholders as the full cost of running the state, entities, cantons, and municipalities should be made explicit. Examples of burden shifting abound. Canton, Federation and RS units of government and public administration, cantonal courts, cantonal police forces, etc. use municipal buildings throughout BiH without paying any rent or compensation. In the RS, the tax office uses municipal office space in many situations where the office space could earn significant rental income from commercial users, but the tax office does not pay rent to municipalities. In the cantons where the formerly municipal functions like the police were moved up, or new functions such as cantonal courts and administration were added, municipal buildings were simply appropriated or occupied. Instead of assuming full responsibility for maintenance and utility costs as “new” owners should, the cantons simply use municipal facilities free of charge, and occasionally at full cost to the municipality, which again has no legal recourse to collect rents and utility charges. Municipalities use the modest share of taxes collected on their territory to essentially subsidize the cantons that in extreme cases take 80% of the shared taxes generated within a given municipality.

The true cost of public administration and governance in Bosnia is not fully recorded or measured. Those aspects of burden shifting that are observable, however, are borne fully by the municipal sector.

This situation is not a direct result of the Dayton Accords but rather the cumulative effect of improper and inefficient intergovernmental relations allowed to become precedent and therefore define the status quo. The IC does bear some degree of

responsibility for not recognizing and challenging in a timely enough manner what has grown into an abusive and inefficient system of intergovernmental relations in Bosnia and Herzegovina.

Brcko District and Mostar City

The assessment team spent a significant amount of time interviewing stakeholders, both local and international, involved in Brcko District and Mostar. Brcko District seems to attract the envy of mayors throughout BiH, who see it as an example of what can be done at the municipal level if both autonomy and adequate financing are present. On the other hand, these same mayors in both entities report that Brcko is home to rampant smuggling and tax evasion, as well as completely legal tax shifting. In other words, residents of jurisdictions close to Brcko suffer losses of both sales and income taxes as consumers and businesses route transactions through the District that has lower tax rates than surrounding areas.

Brcko District demonstrates that a relatively small municipality, formerly consisting of ethnically-based municipalities, can be consolidated and reformed based upon service delivery criteria. The unpopular consolidation of public institutions and offices did cause unemployment in the District, yet these reforms demonstrated that municipalities can be reorganized with independent tax and finance authorities and other functions not available outside of Brcko. Unfortunately, the ability of Brcko reforms to serve as a model for other BiH municipalities is limited by a widespread feeling that “Brcko is different”.

On the future of Brcko District, the assessment team believes it important to point out that a number of important policy questions remain open. These questions have implications not just for Brcko District, but also impact neighboring regions, future VAT implementation, and the overall structure of public administration in BiH.

The case of Mostar’s potential consolidation into one city with one municipal government requires first of all political will on the part of all existing municipalities and stakeholders. However, beyond the considerable political obstacles to unification, the assessment team believes it important not to neglect technical aspects to implementation

should a political accord be reached. The Brcko experience demonstrates that with sufficient political will, international pressure and support, as well as with appropriate technical skills, a unified, efficient multi-ethnic city can be created out of divided and subdivided municipalities. At the same time political will, in and of itself, may not be enough. The assessment team believes that the technical aspects to the Brcko experience can be mined for insights and implementation strategies should Mostar embark upon a unification course.

Policy Recommendations

In light of the findings above, the assessment team proposes that the impending imposition of the value added tax (VAT) in BiH be used as an opportunity to reconsider the roles and resources of local government. A consensus is developing among stakeholders at nearly all levels that the current public administration system is not efficient, does not reflect subsidiarity, and is not sustainable in the long run. The introduction of VAT will necessarily require a substantial restructuring of the current system of intergovernmental finance. The assessment team strongly recommends that both sides of the equation – revenue collection and expenditure assignments – be reshaped as Bosnia-Herzegovina prepares for VAT implementation.

The Dayton Accords did not call for the current status quo of municipal functions and revenues in the entities and cantons. The Accords included as an annex the proposed and eventually adopted Constitution of Bosnia and Herzegovina. That State Constitution does not mention municipalities, and delegates all powers not specifically assigned to the State to the two entities.

The Federation Constitution offers very few specifics on the rights, obligations and roles of municipalities, and in fact, in Section I, Article 2, mentions only cantons as the units that constitute the Federation. While cantonal functions are specifically identified, all powers not specifically allocated to the Federation by law or in the Constitution (III, Article 4) belong exclusively to the cantons. These are the clauses that seem to enable cantons to do as they will vis-à-vis municipalities. The Federation Constitution identifies the differences between Federation and cantonal duties, and specifically authorizes cantons to both “confer” and to “delegate” (V, 1, Article 2) its own responsibilities to the municipality. Cantons may even “confer” responsibilities to the Federation (!) but no municipality may reject tasks either delegated or conferred by the canton, or confer responsibilities it cannot discharge back to the canton. There are no requirements that the canton also transfer resources to fund those conferred and delegated responsibilities. The Federation Constitution’s section on municipalities (VI, Article 2) states specifically that municipalities may exercise self-rule, but at the same time must have local statutes that are consistent with Federation and cantonal constitutions and laws. This seems reasonable and prudent and this does not authorize cantons to write independent laws governing

municipalities. Unfortunately, in the Federation Constitution there is no explicit mention of the responsibilities and rights of municipalities, nor does the Federation Constitution define a municipality's right to own property.

Despite these features, the Federation Constitution does not *specifically* empower cantons to write their own local government laws, nor to essentially rule over the municipalities without any form of judicial or constitutional redress. While the assessment team did not have specialized legal expertise, the team concluded that instead of Dayton or the Federation Constitution, the Federation Local Government Law, also passed in late 1995, is the legal instrument that simply requires and empowers cantons in Article 18 (“cantons shall regulate”) to write their local government laws regulating a long list of issues. That Federation law, written and passed under duress in late 1995 as the Dayton Accords were approved, should be changed given eight years of clear policy failure. The Federation should take back its power to set the legal framework for municipalities, and hence this power will be explicitly the competence of the Federation, still leaving other “unregulated matters” in the hands of the cantons. As Dayton, the State and Federation Constitutions give essentially sovereign powers to the entities, the Federation may chose to regulate municipalities directly, in other words that power by the current Federation Constitution will not de facto belong to the cantons, and the Federation still has the right to revise its current Local Government Law that unfortunately gives unchecked power over municipalities to the cantons.

Therefore, it is not the Dayton Peace Accords, nor the Constitution of the Federation that is responsible for this untenable power grab by the cantons, rather it is the Federation Local Government Law that simply absolves the Federation of any responsibility, oversight and power over the municipalities.

The status quo developed in a power vacuum with canton legislatures using loopholes and ambiguities in Federation law, as described above, to do as they pleased with municipalities. The status quo was created neither by external pressure nor by logic, but rather by the simple calculus of political weight. This problem was aggravated and indeed cemented since the International Community largely ignored the plight of the municipal sector, or conveniently advocated “decentralizing” responsibility to the (entity) cantonal or RS level without adequately taking into account revenue and task assignment, the issue of property, efficiency and accountability. To be fair to the IC, public

administration efficiency and accountability were understandably not the number one priority immediately following the war.

Recommendation One: Examine the Current Assignment of Functions and Responsibilities with the Intention of Maximizing the Principle of Subsidiarity

The implementation of VAT needs to go forward in 2006 in conjunction with a systemic review and realignment of functions and corresponding revenues, and property where appropriate. The fast track implementation of VAT must take into account the effect of the removal of the sales tax as a source of shared revenue for the municipalities and cantons in 2005. According to our information, the VAT will go into effect across BiH in 2006, and will be distributed to the two entities in line with the collections of sales tax established in 2005. The VAT, paid into a state-level account, will be partially used to fund the international debt obligations of both entities, to finance the state budget, and finally, the entities and Brcko are to receive the balance based upon final consumption as determined by VAT returns. This is a potential danger to the viability of local governments in that though VAT is expected to be a more robust tax than the sales tax, the entities and Brcko, as well as the state, have priority in access to these funds. What is left for redistribution, if any, is entirely at the discretion of the entities, and given the municipalities' extremely limited bargaining power and the lack of municipal knowledge and awareness of municipal problems at the Federation level, the assessment team is not convinced that what remains after initial VAT distributions will *at a minimum* replace the amounts that sales taxes represent as a source of municipal financing.

Implementing legislation proposed for the State and Entity levels, to our best knowledge, will simply empower the two entities to consider further uses and potential distribution of the VAT. Both entities, the RS in its Constitution (Article 103), and the Federation in its local government law (Article 14) guarantee the availability of funds and resources to carry out both mandatory and delegated (by the RS or the cantons) tasks on the municipal level. The VAT discussion should include options for finally complying with the RS Constitution and with the current local government law in the Federation by undergoing a thorough examination of the costs of mandated and delegated services.

In our view to only focus on the revenue-collection side of VAT would be missing a significant opportunity to encourage a necessary review (including reconsideration of the

distributive role of cantons in the Federation) of revenue and task assignments. The cantons should not serve any distributive function in VAT revenue sharing. Revenue should be passed from the entity directly to the municipality by formula if it were to form a shared tax. The cantons were not empowered nor intended by the Dayton accords to be distributors of resources to the municipal sector and their potential as regional service providers in functions requiring scale economies is certainly ignored. Cantons created on primarily ethnic criteria should not be obstacles to the creation of inter-cantonal, inter-entity and inter-municipal service provision areas in health, education and environmental infrastructure that follow economic, technical, hydrological and other objective factors in delineation, rather than boundaries hammered out during ceasefire and peace negotiations.⁸

Functions should be assigned on an exclusive basis, removing overlapping and divided responsibilities (salaries from above, maintenance and utilities from below).

The assessment team is concerned that when the sales tax is removed as a source of shared revenue for the municipalities, the entities (cantons) will not, of their own accord and volition, voluntarily develop a fairer, more uniform and more efficient source of funding for municipalities. The pattern may be repeated with other direct (such as a potential unitary income tax) and indirect taxes as those too are modernized without a functional examination of the role of municipalities in delivering services. Given the inability of the municipal sector to lobby for its own interests in either entity, it is simply not fair, wise, nor realistic on the part of VAT advocates (both domestic and international) to assume that the entity governments will “work out” the VAT distribution issue on their own without further damaging legitimate municipal interests and violating principles of subsidiarity.

Under international pressure from the IMF and the EU, Serbia is also planning to introduce VAT sometime in 2004. The Ministry of Finance, partly due to municipal association lobbying, was forced to consider the consequences of removing sales tax as a major source of municipal revenue and revenue equalization. The experiences of Croatia with several years of VAT implementation, and Serbia preparing for VAT should be considered by stakeholders in BiH as the budget systems laws in all three were influenced

⁸ Interjurisdictional cooperation in service delivery is supported by the World Bank (2003) study, p. 14. Several mayors indicated that it was inevitable that they would need to cooperate with neighboring municipalities, crossing both entity and cantonal lines given the nature of watersheds and population centers.

by the same donor, the US Treasury, and the local government laws, based in part on Yugoslav tradition, show striking similarities as well.

The World Bank report on fiscal decentralization (June, 2003) supports the idea of redesigning the task and revenue allocation system⁹, but explains the problems and solutions in technical language only. We suggest that the World Bank report be circulated more widely among experts and perhaps in a shorter and simpler form for the local and international stakeholders. Both versions deserve broader consideration and debate among policymakers at all levels in BiH.

Recommendation Two: Standardize Legislation and Provide More Autonomy for Municipalities to Provide Efficient Public Services

The team's recommendations in this area include the following specific steps:

- A. Enactment of a revised law on Local Self-government for the Federation that moves supervision of, and more importantly, the allocation of functions and revenues of the municipalities up from the cantons.

In other words, the Federation needs one local government law, not ten separate cantonal local government laws. Article 18 of the current Federation law must be removed since it gives cantons almost abusive powers over municipalities in cantonal municipal laws and annual tax sharing and budget laws.

Article 18 of the Federation Local Government Law states: "A cantonal law on local self-government shall regulate in greater detail...the ..work of the municipality, direct participation in decision-making by citizens, organs of a unit of self-government, territorial self-government, property and financing of local self-government and **other issues** (sic!) relevant for the exercise of local self-government."¹⁰ The Constitution, in contrast, does not grant direct supervisory powers to the cantons over the municipalities, rather it assigns all functions not otherwise granted to the Federation as being the competence of the cantons. The assessment team argues that the cantons have used this Federation law provision rather liberally, essentially exceeding the spirit of this law, Dayton, and all principles of subsidiarity.

⁹ We fully support some of the Bank's recommendations concerning: "establishing the parameters of local revenue at the level of organic law," eliminating tax compensation, reassigning the property tax exclusively to the municipalities, allocating the sales tax and future VAT proportionately on a per capita basis, decentralize tax administration etc. See World Bank (2003) pp. 54-57.

¹⁰ (Official Journal Federation BH, 8 November, 1995)

There are documented contradictions between cantonal and Federation laws and constitutions that have not been addressed since 1995, and many of these contradictions stem from the arbitrariness of cantonal legislation governing municipalities. A new Federation LSG law is needed to eliminate the current ten systems of local government in the Federation, with varying revenue and task assignments, and no recourse to higher authorities. There is no justification for cantons to each have their own systems of municipal governance, when in the smallest cantons there may just over 30,000 citizens living in several municipal jurisdictions.

Furthermore, given expected declines in donor funding, and great needs for infrastructure at the municipal level, a unified credit market cannot emerge without great inefficiencies if lenders and bondholders have to become familiar with 10 different municipal systems. The lending market with such inefficiencies will add interest and transaction costs to potential borrowing by municipalities who are least in a position to avoid paying a systemic premium through no fault of their own. Interest articulation, training and education of elected and professional officials, as well as equal access to quality services by the local population are not possible in a system with ten different legal and financial frameworks for local governance.

The existing Federation Local Self-Government Law could, in our view, be amended, to offer unitary and equitable services to all citizens, regardless of where they live. The revised draft versions of the new RS Local Self-Government Law could serve as a basic model of a revised Federation-level law that removes all aspects of revenue and task assignment from the cantons. Cantons could continue as elected regional units of self-government, performing those tasks that regional units of government are usually assigned in other European countries, such as: (for illustrative purposes) secondary education, regional environmental infrastructure, regional roads, and perhaps police and justice. The role of the cantons would need to be explicitly addressed in relevant Federation legislation, perhaps with a law on cantons that derives their powers from what is contained in the Constitution, not from the powers the cantons asserted when the Federation Local Government Law took a “hands off” approach to municipal rights and duties.

- B. Rapid passage and implementation of a new law on public debt in both entities to establish a framework for municipal infrastructure borrowing.

The assessment team fully supports the public debt law being developed by the US Department of Treasury, and is convinced that such legislation would serve a vital role in promoting a viable municipal credit market. As donor resources decrease and the accumulated effects of deferred capital spending increase, a viable private-sector led municipal credit market is of utmost importance.

- C. Reexamine the RS Law on the Privatization of State Capital in Enterprises in regards to communal enterprises and local utilities. This includes reviewing any regulations or decrees that were issued regarding water sector utilities.
- D. Require increased sharing of, and access to, information between cantons/municipalities and the entity tax authorities to provide data for multiyear budget preparation, oversight of actual transfers and collections, and improvement of tax bases and collections.
- E. Examine the use of the State-level Constitutional Court as a final court of appeals in inter-governmental disputes that cannot be resolved by either entity's own Constitutional Court. This step could include making explicit the right of municipalities in both entities to appeal first directly to the entity Constitutional Court in the relevant Constitutions and local government laws of both entities, then to the State-Level Constitutional Court.

The current RS Law on Self-Government does not contain dispute resolution language as article 32 clearly states that conflicts between municipalities and the state will be settled by “the Government.” The RS Constitution allows “anyone” to appeal to the RS Constitutional Court; however there is no explicit court of redress for municipalities. Fortunately, a draft revision of the RS Local Self-Government Law contains a provision enabling municipalities to appeal directly to the RS Supreme Court in cases where the

municipality seeks to challenge the legality of a law, directive, and decision, etc., of a higher unit of government. Such a provision, with clear rules, could be a part of a proposed revision of the Federation Local Self-Government Law.¹¹

The Federation Local Government Law does not identify any redress procedure or court available to municipalities. The Federation Constitution identifies the Constitutional Court as the forum to resolve conflicts between and among levels of government, including between cantons and municipalities. Unfortunately, the Constitution declares that Federation laws, cantonal laws, Federation regulations, and municipal regulations may be submitted to the Constitutional Court by every level of elected authority except the municipal level. Cantonal Ministers and Presidents may submit cantonal or municipal laws to the Court. Mayors and elected bodies of municipalities are not listed as being authorized to submit questions regarding cantonal decisions. In other words, the canton may request judicial oversight over a municipal law or regulation, but a municipality cannot request judicial review of a cantonal decision that it feels violates its rights.¹²

Recommendation Three: Strengthen Municipal Internal Capacities

Given the weaknesses in local professional capacity, as well as systemic factors identified as hindering municipal government, the team has the following simple policy suggestions:

- A. Support direct election of mayors in the Federation, with appropriate changes to the Federation Constitution.

Direct election of mayors has been in place in the RS for several years, although other supporting laws were not explicitly defined. The Federation Parliament received and approved the initiative on the direct election of mayors five years ago, but it ended up in the drawers of Constitutional Commission of the Parliament that was to prepare appropriate amendments to the Constitution of FBiH. The adoption of these amendments

¹¹ Several cantonal local government laws enable “any citizen” to appeal to the Constitutional Court if the “citizens” right to self-government were denied. This language is not strong enough, and does not specifically give the municipality the right to directly appeal to the Constitutional Court.

¹² See Federation Constitution, IV-C-3, Article 10 on the functions of the Constitutional Court.

would help lay the groundwork for more accountability at the local government level in the Federation and diminish the ability of political parties to put their own interests above all. The mayor would be elected directly by citizens and not by the municipal council, replacing the practice of political parties to be more concerned with party representation at the mayoral and departmental level, rather than taking only professional qualities into account.

B. Municipal utilities, their ownership, oversight and management structures require urgent reforms and clarification of roles and responsibilities.

The situation in this field is complex as most utilities are semi-autonomous in FBiH and in the RS the entity government can manage its own and municipal assets. Municipalities serve as founders, appoint management boards and approve rates based upon utility company proposals, but also subsidize their operations and their budget in case of low collection rates or other infrastructure improvements. No significant efforts have been made in the privatization of public utility and infrastructure enterprises. In the RS, the assessment team was told about certain cases when entity government conducted the privatization of a communal utility company unilaterally without consulting the municipality. Privatization of public utilities should follow a strategic approach which takes community input into account, and should not be undertaken on an ad hoc basis to merely generate one-off revenues.

C. Local government documents and permits, as well as forms, etc., used for standard functions should ideally be universal throughout BiH, taking into account linguistic differences and the use of minority languages.

The situation in the Federation in this respect is much more complex than in the RS. Standardization efforts would bring more order into the current system, facilitate and simplify procedures, improve inter-governmental information sharing and communication, and help prevent forgery.

D. Develop concrete service standards for municipalities and their agencies.

Many municipalities in both the Republika Srpska and the Federation have undertaken substantial revisions of administrative regulations and procedures. While great gains have been made already in Brcko, municipalities in the two entities continue to face considerable challenges in amending regulations and policies while conforming to existing local governance laws. There are an increasing number of municipalities working to achieve ISO 9001/2000 certification or undertake other steps to achieve system quality management. Municipalities should be encouraged to strive to further improve concrete services to citizens.

USAID has financed the creation of 22 one-stop shops, essentially information and service centers where citizens can complete most of the paperwork and processes needed to obtain the routine municipal services, such as birth and death certificates, permits, payment of local taxes and fees, etc. These service centers operate more efficiently if combined with process reengineering workflow not just at the customer interface level, but within the municipal administration. These efforts have significantly cut waiting times for routine municipal services, and also enable citizens and municipal workers to track where exactly the paperwork is at any moment in time, greatly increasing accountability. More work is needed in this area, including identifying bottlenecks at the cantonal or entity level that essentially limit the extent of these reforms. Furthermore, while news of one-stop shops and other concrete administrative reforms is spreading, more formalized documentation and dissemination of methodologies and success stories needs to take place.

Program Recommendations

The assessment team offers the following recommendations to USAID as rough parameters around which to design future local government assistance projects.

Geographic scope: Some spread-effect of ongoing municipal projects in Northern and Central Bosnia was observed, with non-target municipalities demonstrating awareness of ongoing reform efforts. Because of the lack of previous large-scale municipal programming, the team recommends that the area south of Sarajevo, including both Eastern and Western Herzegovina be considered for direct municipal-level interventions. Policy work would largely have to be accomplished in both Sarajevo and Banja Luka.

Direct municipal interventions: USAID should continue to work directly with municipalities in improving service standards (through one-stop shops, process engineering, human resource management training, etc.), in promoting local economic development through increased cooperation with and awareness of the business community, in utility management/handover, and in budgeting and financial management. USAID should use experience already present in BiH (Brcko, previous target municipalities), or experiences from other countries in the former Yugoslavia.

Policy component: Given the critical importance of replacing the sales tax with a different source of municipal revenue, as well as the opportunity to truly reform revenue and task assignment, the new program should have a policy research and support component that addresses needs at the Federation Ministry of Finance (where there is little or no experience in working with municipalities), at the RS Ministry of Finance and Local Self Government Ministries, as well with appropriate municipal associations. The policy component should consider regional experiences, with an emphasis on the former Yugoslavia as well as other transition countries. The policy effort should also assist the efforts of the IC in this area, and could include a “public involvement/professional debate” component in conjunction with nascent local policy organizations.

Small-scale, community infrastructure grant component: If funding permits, this should be closely tied with other municipal-level interventions. This would be a modest component providing visible outputs to citizens in the very short-term, and creating a context for deeper municipality-community interaction in providing solutions for local needs.

Municipal association strengthening: This is a fundamental and largely unmet need in both entities. However, given the complex realities, including the absolute necessity for political will and the legacy of ongoing efforts, this component should be structured to allow enough flexibility so that contractor efforts would be conditioned on concrete progress in certain areas, with built-in periodic reviews to allow for a “go/no go” decision. Ideally, work with municipal associations would also include providing associations with the capacity to provide policy analysis and to fulfill an information/skills dissemination function.

Municipal loan packaging: A small, discrete component should be included which would provide demand-driven assistance in packaging potential municipal capital projects to be presented to banks active in the municipal credit market. Municipalities in BiH have little concrete experience in interacting with private banks in longer-term projects and are likely to require assistance in many cases for otherwise bankable projects to be approved.

List of Interviewees

International Community

The World Bank, Sarajevo Office
OHR Sarajevo
VNG Project Office, Sarajevo
OSCE Sarajevo Office
US Treasury—Public Sector Accounting Project
UNDP Sarajevo Office
UK Civil Service College Project Office, Banja Luka
OHR North, Brcko
EU Delegation, Sarajevo
OHR South, Mostar
US Treasury, Office of Technical Assistance, Sarajevo
Swiss Agency for International Development

Brcko District

Municipal officials (mayor, finance director, other professional staff)

Federation BiH

Ministry of Finance
Ministry of Justice

Municipal officials (mayor, finance director, other professional staff):

Mostar (City, Stari Grad, Jug)
Capljina
Ljubuski
Orasje
Tuzla
Sanski Most
Jajce
Bugojno
Livno
Tomislavgrad
Siroki Brijeg
Citluk
Jablanica
Maglaj
Zenica
Sarajevo Centar

Cantonal officials (Ministers of Finance, other professional staff):

Mostar Canton
Canton 8
Posavina Canton
Tuzla Canton
Central Bosnia Canton
Canton 10
Zenica Canton

Republika Srpska

Ministry of Finance
Ministry of Local Self-Government

Municipal officials (mayor, finance director, other professional staff):

Banja Luka
Prnjavor
Derвента
Modrica
Trebinje
Nevesinje
Zvornik
Bijeljina
Doboj