

3.1.4 Decentralisation process

3.1.4.1. Legal Framework

The territorial organisation of each Entity is regulated by its own Constitution.

The Constitution of Republika Srpska presents the Republic as a unitary state (Art.2), vested with all state functions and powers but those explicitly allocated to BiH by the Constitution of BiH (Art.3).

Local self-government is one of the basic principles of the RS constitutional arrangements (Art.5), and for proportioning powers and responsibilities of republican bodies (Art.66, al.2); the electoral system has to ensure that all municipalities are appropriately represented in the RS National Assembly (Art.71, al.2). Part II is a lengthy catalogue of rights and freedoms, among which the right to take part in the conduct of public affairs and to have equal access to the public service (Art.33), and the freedom of profession and of “national affiliation” or to declare no national affiliation (Art.34).

The RS National Assembly has to determine the territorial organisation of the Republic, and to adopt a development plan and an urban plan (Art.70). There is only one level of self-government, the municipality; however, the law may entrust local government tasks to a city, uniting several municipalities (Art.102).

The Federation of Bosnia and Herzegovina, on the contrary, consists of “Federal Units”, or “Cantons” (Art.I.2). The number of Cantons and their boundaries were agreed in February 1994 in the context of the Washington Agreement (“*Confederation Agreement Between The Bosnian Government And Bosnian Croats*”) by R BiH Prime Minister (Haris Silajdzic), the Republic of Croatia Foreign Minister (Mate Granic), the Bosnian-Croat Representative (Kresimir Zubak). Following this agreement, each Canton has its own Constitution, with legislative and taxing powers.

The FBiH Constitution, reflecting the Washington Agreement, divides responsibilities between the Federation and the Cantons (chapter III) leaving most responsibilities to Cantons. The exclusive competence of the Federation is very limited: namely defence, energy policy, but also planning, reconstruction and land use at the federal level (Art.III.1). Some matters are a common responsibility, in particular health, social welfare policy and the use of natural resources (III.2), but there is no clear regulation about relationships between Federal and Cantonal laws.

Cantons have all responsibilities not expressly granted to the Federation, including police forces, education, culture, housing, zoning, radio and television, the implementation of the welfare policy and the provision of welfare services (III.4). Judges are also appointed by the President of the Canton (Art.V.11).

A Canton in turn, may delegate its responsibilities to a municipality or city; in particular it may delegate functions concerning education, culture, tourism, local business, radio and television, and “is obliged to do so if the majority of

population in the municipality or city is other than that of the Canton as a whole" (Art.V.2).

It seems that in the RS as well as in the FBiH, the main rationale of the institutional arrangements and of the division of responsibilities, and in particular of decentralisation, is to secure ethnically homogeneous government units.

Legal situation of municipalities is similar in the Entities

Regarding local self-government, the legal situation of municipalities is very similar in both Entities, in spite of different institutional arrangements in the FBiH.

In the RS, there is a *Law on Local Self-Management* of 1999 (Official Gazette 35/99, as modified 20 and 51/01). The municipal assembly and the head of municipality are directly elected by the citizens for a four years mandate. The head of municipality may be removed by the assembly, or by referendum based on an initiative of 20% of voters. Partly resuming the Yugoslav tradition, the law provides for the creation - by statute of the respective municipality - of local communities with their own elected assembly, and for local referenda, including on the creation of facilities and their financing (Art.77 and 78).

Supervising the activity of municipal bodies, the government may refer suspected illegal acts to the Constitutional Court of the RS, or take over a function in case of default of the competent municipal authority. In the case of violation of rights and liberties, the RS National Assembly may dissolve the municipal assembly. However, there is no specific court procedure to challenge such decisions. In practice, municipalities are in daily contact with the relevant ministries.

In the FBiH, a rather short federal law was passed in 1995, which provides the framework for Cantonal legislation, and regulates certain key procedures (e.g. the election of Mayors) as *ius cogens*. Other general principles on municipalities are given in the Constitutions of the Cantons.

According to the Framework law (Art.18), Cantonal legislation has to regulate details on municipal functions, municipal organs, municipal property, local taxes, direct citizen participation and other issues not covered by federal legislation. Between 1995 and 1999, all Cantons passed local self-government legislation. Despite a considerable degree of similarity, the Canton's local self-government laws vary in particular regarding the distribution of functions and resources; these differences in the legal framework are reinforced by different implementation practices. Such differences between municipalities may hamper economic development.

It is said that the Canton Governments are in daily contact with their respective municipalities; by contrast, the Federation has very little contact with municipalities, and there is no Ministry specifically responsible for local government issues or the coordination of such issues.

Ethnic dimension puts stress on local

The ethnic dimension puts additional stress on local government

*government
management*

management in all BiH, since political appointments as well as staff compositions have to be ethnically balanced. This requirement makes deputies, to a certain degree, equal partners of the head; however, on the political level, deputies may not replace their superiors in voting as that is seen as a distortion of the ethnic equilibrium. The preparation and implementation of the budget may also be affected by ethnic bargaining. In some municipalities, there are said to be three budgets, the official one, and two that are informally agreed between dominant ethnic groups. Recourse to such informal adjustments may increase if refugee return intensifies.

3.1.4.2. Institutional framework

The Inter-Entity Boundary Line (IEBL) broadly follows the cease-fire line. The resulting division of the territory causes difficult governance problems.

Numerous municipalities of RS have difficult physical access to the Government in Banja Luka. In addition, the IEBL divides areas which were closely linked in the past. Cross-“border” co-operation is not yet established.

There are at present 80 municipalities in the 10 cantons of the FBiH, and 63 municipalities in the RS, with no middle tier (the idea to create 6 or 8 regions has been abandoned). The Final Award on Brčko creates a Special District for the entire pre-war Opština whose territory belongs to both Entities. The Brčko District (44,500 inhabitants) is under direct international supervision (by a Deputy High Representative).

*Cantons are very
different in size*

The number of inhabitants in the FBiH Cantons varies widely: from 41,000 inhabitants for Bosnia-Podrinje to 609,000 for Tuzla; four cantons have less than 100,000 inhabitants; the others have more than 200,000.

Municipalities tend to be large, which is a legacy of the former Yugoslavia. But the division of settlements by the IEBL has resulted in a number of tiny municipalities, especially in the RS. Only 6 municipalities of the FBiH have less than 10,000 inhabitants, but 21 in the RS, among which 3 have less than 1,000.

In both Entities, cities are local government units formed by two or more municipalities that are territorially and economically linked (Const. FBiH: Art.VI.A, *Local Government Law* of the RS: Art. 3). There are two cities in the FBiH -- Mostar (104,000 inhabitants.) and Sarajevo (270,000 inhabitants, divided into 4 autonomous municipalities); and one city in the RS -- Banja Luka (208,000 inhabitants.). The city level is rather weak, and depends on transfers from constituent municipalities.

The distribution of expenditure across all levels of government in BiH shows that the level of Cantons and RS are most important.

As can be seen from the following table, the share of expenditure by municipalities is relatively low by comparison to that of the Entities themselves and, in the FBiH, of Cantons.

BOSNIA AND HERZEGOVINA

DECENTRALISATION PROCESS

<i>Government levels</i>	<i>FBiH (in %)</i>	<i>RS (in %)</i>
Entity level	25.2	60.4
Cantons	34.2	--
Municipalities	7.9	8.0
Public funds (pensions, unemployment ins. health ins.,)	32.6	31.6
TOTAL	100	100

(Source: World Bank, "Bosnia and Herzegovina: creating an efficient decentralized fiscal system", June 2003).

A major difference between the FBiH and the RS is that the RS has a comprehensive competence for education, health and social protection, whereas these matters (including higher education) are assigned to Cantons in the FBiH.

Tasks assigned to municipalities are rather large and often under-funded

In both Entities, municipalities are only in charge of assigned responsibilities; there is no general competence of local self-government for local affairs. Responsibilities of municipalities include child care, primary and secondary school buildings, employment agencies, social care, culture, sports; housing and urban planning; municipal utilities (sanitation, sewage treatment, water supply) usually performed by own enterprises; public order; tourism; management of municipal properties.

However, in a number of Cantons of the FBiH other tasks are assigned or devolved to municipalities: local roads, health care supplies; ambulance services. In several Cantons social welfare functions are left under-funded by the authorities of the Canton, shifting the burden onto municipalities in charge of the execution of these functions, on the assumption that those municipalities could raise resources to fill the gap. It is also usual that capital spending is left to municipalities.

In the new *Local Government Law* of the RS, the following tasks are added: health care, general and detailed land use planning; local roads and streets; regulating construction and business premises; other tasks as determined by laws and the statute of the municipality – this provision could authorize the municipality to extend its activities, provided that it would not infringe on the competence of other authorities. However a specific difficulty in the RS is the number of very small municipalities. The new *Local Government Law* provides that municipalities with under 1,000 inhabitants need not form an administration; the RS Government will designate a neighbouring municipality to discharge its administrative tasks (Art.28).

Utility charges are often not paid

Most institutions with heavy personnel expenses are financed and run by the Cantons in FBiH, or central government in the RS. A common difficulty with public utilities is recovering charges; this results in accumulation of invisible

debt.

The laws do not determine clearly the responsibilities of cities with respect to constituent municipalities. Tasks are assigned through a legal act, adopted by the City Assembly. In practice, the activities and revenues of cities depend on the decisions of the constituent municipalities.

Important regional disparities in the level of public services exist

In both Entities, there are significant disparities amongst municipalities, especially in their provision of key functions, such as education, social assistance and even more housing. In FBiH similar disparities exist amongst the Cantons.

3.1.4.3. Local financing

Tax legislation is the responsibility of the Entities

The State Level has only the power to legislate on custom duties, the revenue from which is assigned to the Entities. All other tax powers rest with the Entities. The FBiH and the RS have two distinct tax and finance systems.

No perequation of revenues between cantons or municipalities exists

Both Entities contribute to financing the State-level on the basis of 2/3 from the FBiH, and 1/3 from the RS. In both Entities, the tax administration is centralised; lower government levels have very limited taxing powers. However, FBiH tax revenue goes mainly to the Cantons; a mechanism to transfer resources from richer to poorer Cantons is not foreseen.

In the FBiH, Cantons legislate on a few cantonal taxes and municipal taxes (property tax, property transfer tax, some fees), and on tax-sharing with their respective municipalities. However, Cantons have control over neither rates nor bases of the most important taxes (sales tax, personal income taxes, profit tax), which are subject to Federal legislation.

In the FBiH, the tax sharing between Cantons and Municipalities is based on the following taxes (average sharing rates between brackets: canton/municipalities): payroll tax (place of work: 80/20), citizen income tax (place of residence: 20/80), sales tax (on turnover: 70-80/30-20), property tax (20/80), property transfer tax (20/80), road tax (motor vehicles: 55/45). Cantons have the power to regulate the two property taxes and partly the citizen income tax.

The tax sharing between RS and its municipalities is based on the following taxes (sharing rates between brackets: Republic/municipalities): payroll tax (74/26), citizen income tax (74/26), sales tax (74/26), property tax (0/100), property transfer tax (0/100).

According to the new RS *Local Government Act* (Art.68), city resources are derived from taxes, duties and fees assigned by the law to municipalities. A city receives 45% of the total revenue obtained by its component Municipalities. In the case of a city containing only one municipality (at present this concerns uniquely the City of Banja Luka) the city receives only 35% of this revenue.

The yield of property taxes is low in both Entities, because there is no regular assessment of property values, and there is a low level of enforcement.

Additionally, there are several local taxes on which local authorities have some discretionary powers, representing on average 10% of municipal revenues. Local non-tax revenues may be significant in urban areas (rents, concession fees, fines, charges, registration fees on vehicles...). In general these revenue sources are regulated by the Cantons or the Entity, but municipalities also have some powers.

As a whole, tax shares represent 82.9% of municipal revenues in the FBiH, and 80.9% in the RS. The main sources of revenues are personal income tax in municipalities of the FBiH (43.2%) and sales tax in municipalities of the RS (55.5%).

Large fiscal disparity between municipalities prevails

There are large horizontal fiscal disparities between municipalities in both Entities, with a coefficient of variation of the tax capacity indicator (including tax shares) as high as 2.22, with a maximum per capita in Sarajevo Centar of 15,383 KM and a minimum of 17 KM in Prozor-Rama (Canton of Herzeg-Neretva). Excluding Sarajevo, the coefficient of variation is 0.59.

By contrast, there is no stable system of transfers either in the Federation of BiH or in the RS and sharing rates have been subject to discretionary variations.

VAT will be introduced in 2006

There is an agreement between policy makers and the international community to discontinue the Sales Tax and introduce VAT in BiH instead in 2006.

It is impossible in a VAT regime to identify payments by geographical source. Therefore, the system for financing local budgets of Entities, Cantons and Municipalities will have to be urgently reconsidered.

In the RS, municipalities may borrow. According to article 12 of the Law on Local Government, the municipal assembly shall “decide on loans to be taken by the municipality” and “float public loans and voluntary contributions” (Art.47 for a city assembly). The municipality “may take credits needed to fulfil those obligations that cannot be fulfilled from anticipated revenues...” in the law, but not to provide “resources needed for the funding of municipal bodies” (meaning current expenditures for the functioning of these bodies) (Art.36; Art.69 for cities).

RS municipalities may only borrow for investment

According to the law on the budget of the RS (Official Gazette of RS, 4/00, Art.38 and 39), cities and municipalities may borrow only for investments. For that purpose, they may borrow locally and abroad, subject to special criteria, that have to be defined in a *Law on the Implementation of the Budget* of the RS: it has not proved possible to identify whether this law has been passed or not. The amount of the debt of the city or municipality is limited by the ability to meet the payment obligations from own-source revenues, while the total of the debt cannot exceed 20% of the total

budgetary revenue.

In FBiH borrowing rules differ from Canton to Canton

In the FBiH, Cantons and Municipalities are, according to the Organic Budget Law, free to borrow. But conditions differ from Canton to Canton according to the respective legislation on local self-government. For example, in some Cantons, the borrowing requests of Municipalities are submitted to the Parliament of the Canton for approval, whereas in others the decision belongs only to the Municipal Assembly (cantons of Zenica-Doboj and Sarajevo for example).

However, recent Federation budget execution laws have banned any type of commercial borrowing, due to the seriousness of the current financial situation (see, for example, Budget execution law of the FBiH 2000, Art.34). The *Organic Budget Law* limits indebtedness to 20% of total budgetary revenues (Art.37-39).

3.1.4.4. Conclusions

The Federation of Bosnia and Herzegovina and the Republika Srpska have two distinct financial, tax and economic systems. Economic development calls for a single economic space throughout BiH. At present the far reaching legislative competence of Entities and Cantons provokes tax and regulatory disparities that hamper investment and development and that cannot be justified in a small country.

1. It is necessary to develop and put in place co-ordination and consultation structures between State, Entities and Cantons, such as are common in other federal states, to ensure legal harmonisation and economic development for the whole country. The State Level of BiH should take the lead in this coordination and harmonisation process. The State Level should have some independent resources.
2. Within the remits of both the Dayton and Washington agreements, the legislation on local government and on local finance should be harmonised (if not identical) across all levels of government of BiH. This will require the development, in BiH, of dedicated institutionalised inter-governmental communication and coordination mechanisms.
3. Municipal financing has to be reconsidered, and the introduction of the VAT in 2006 offers the opportunity to do it. Instead of sharing taxes on the basis of the local tax yield, thus reflecting and maintaining tax base disparities, an equalization system should be introduced, including a per capita criterion. At the same time, municipal own-taxes should be developed. A first step would be to enforce the existing property taxes and to evaluate properties; another step would be to review existing local taxes, in order to use them as policy instruments for municipalities. Lastly, a grant system has to be introduced for local tasks for which national standards have to be met.
4. The European Union should support cooperation between Entities and cooperation between neighbour municipalities separated by the Inter-

Entity Border Line, in order to rebuild functional.