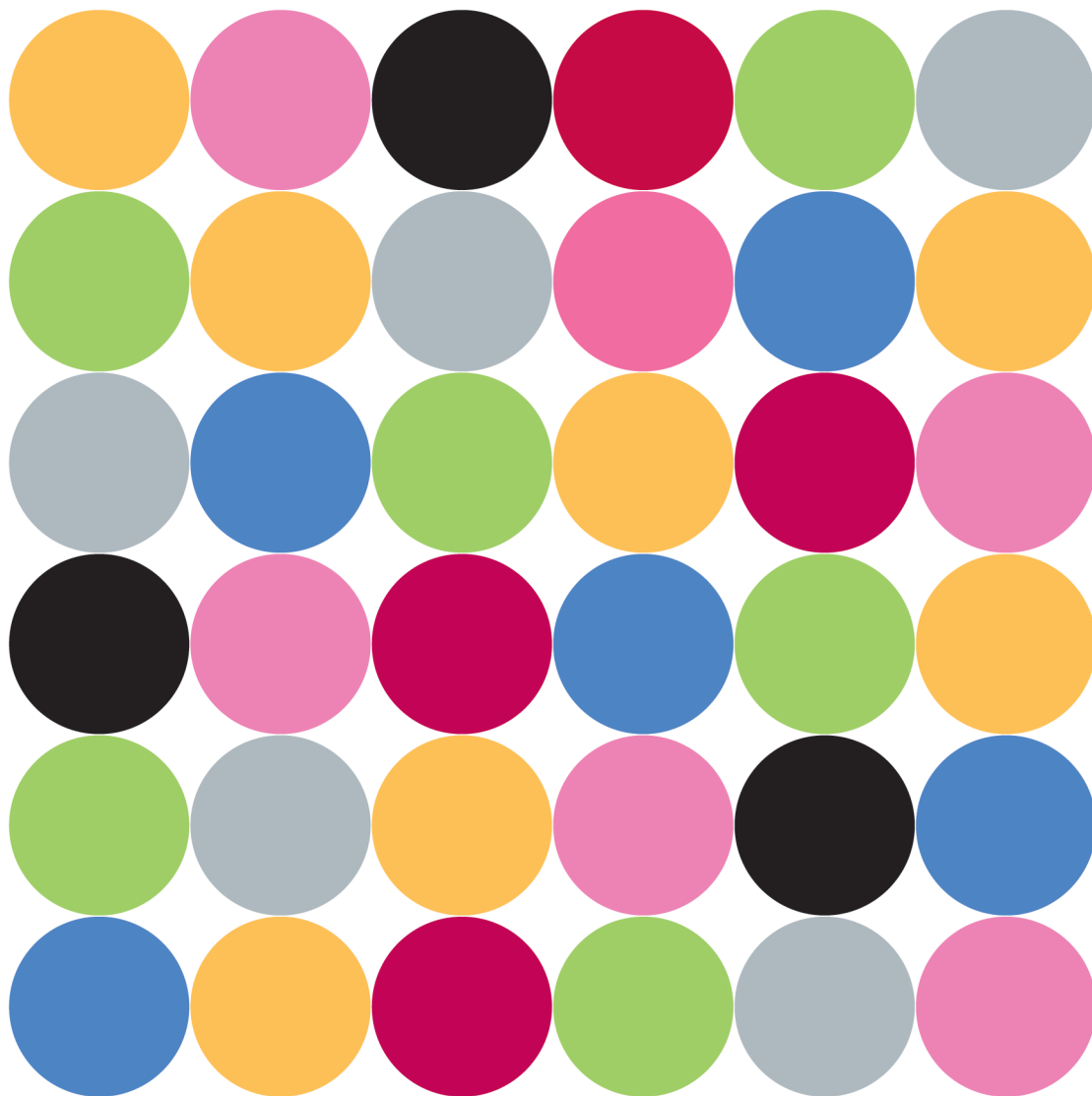


National Human Development Report 2005



BETTER LOCAL GOVERNANCE

in Bosnia and Herzegovina

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*The views expressed herein are those of the authors and do not necessarily reflect the views of the United Nations Development Programme.*

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## Foreword: Better Local Governance in BiH

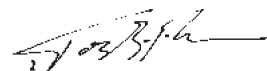
This is the fifth National Human Development Report produced for Bosnia and Herzegovina, and the second to take a distinct sectoral theme - that of local governance reform. It breaks new ground in a number of respects: by offering for the first time, BiH estimates for the Human Poverty Index and the Gender Empowerment Measure; by tracking developmental performance at the sub-national level; by engaging directly with practical policymaking; and through making use of new national thinkers as its contributing authors.

The more sophisticated picture of human development we are able to offer this year, yields somewhat conflicting messages. It is pleasing that in aggregate terms BiH continues to make progress; the Human Development Index has improved by some 5.1% on the previous year; the HPI at 14% of the population, suggests capability poverty (educational and health deprivation) is less severe than income poverty: and the gender measures show a relative equity between men and women. Yet inter-country comparisons suggest that BiH continues to be out-performed by its neighbours. More troublingly, the sub-national picture is disquieting, with entity, cantonal and municipal disaggregations revealing stark inequities in socio-economic and public service performance. This confirms anecdotal and qualitative evidence pointing to the emergence of a divide between wealthier areas of the country, particularly Sarajevo, and more peripheral regions.

This pattern provides both a critique of the failings of the current system of local governance and a rationale for their urgent reform. The capacity of many local governments within in BiH, and especially those outside the major cities, remains weak and hamstrung by the system within which they operate. But in turn, local administrations are necessarily closer to the people and therefore inherently better suited to addressing performance failures in key services like schooling and healthcare. The authors of the report go further still - arguing that the local level, where decision making is more immediate, and where nationalistic grandstanding counts for less, offers a means of changing the entire nature of politics in BiH.

Sadly, both local governance and the public services in BiH have a long way to go before this potential can be realized. Radical and brave reforms are required to secure the devolution of power, real accountability and the rights of all citizens to access services and articulate concerns.

This report makes strong recommendations for systemic and sectoral reforms. These include among others, the full implementation of the local self governance statutes developed by the Entity governments, the adoption of a functional fiscal equalization system, the devolution of schools and healthcare provision to the local level, and the rationalization of local public utilities. This is a demanding agenda and one which this report argues must be addressed if BiH is to enhance human development, and take its rightful place among the European Family of nations.



Jens Toyberg-Frandzen  
Resident Representative





# NHDR 2005;

## EXECUTIVE SUMMARY

Local government is a natural choice for this year's national human development report. This is not merely because local services have the ability to directly affect the life choices and opportunities of citizens, but because municipalities have an enormous potential for affecting more fundamental change. In the following we argue that this potential extends well beyond the parameters of the locality, presenting possibilities for driving long lasting social and political renewal at all levels.

### Human Development in BiH

Like past years' NHDRs, this report provides an up to date analysis of the state of human development in BiH today. This shows that BiH's Human Development Index (HDI), a combined measure reflecting longevity, educational performance and material living standards, has improved by some 5.4% on the previous year to a figure of 0.784. This change is driven by an improvement in educational performance and higher per capita incomes. Were this value to be applied globally, it would place BiH at the upper end of the medium human development band, and 64th among 171 reporting nations. The Gender development Index (GDI) which adjusts the figures in the light of inequity between men and women shows a similar improvement of 5.5%.

For the first time results are also presented for the Human Poverty Index (HPI) and the Gender Empowerment Measure (GEM), and most innovatively the level of human development within BiH's regions. The HPI and GDI reveal a similar developmental situation to the HDI, with some 14% of the population suffering from capability poverty and a GEM which is in the mid range of values.

Overall, what we can take from these values is a country which has made strong progress since the war, but has still not fully recovered the near-western European standards of human development it once enjoyed. Moreover, in recent years the rate of improvement has slowed and BiH is now being out-performed by many of its neighbours.

The regional disaggregation exercise undertaken by this study reveals considerable inequities between different parts of BiH. The pattern of variation is confirmed by a number of methodologies, and shows that the Greater Sarajevo and Herzegovina areas are outstripping others. This is driven predominantly by economic conditions but health and educational outcomes do play some role. Notably, these analyses also show that, in contrast to conventional wisdom, the Republika Srpska is not necessarily less developed than parts of the Federation. Developmental inequity is therefore a nuanced phenomenon in modern BiH.

## The State of Local Government

The report finds much wrong with local governance - both at the systemic level and in terms of performance on the ground. Bosnia's complex and often sclerotic administrative structures come in for much criticism, serving to cement the difficult legacy of the conflict which continues to blight the emergence of a productive and cooperative political culture. Local governments are imprisoned by a constitutional framework which tends to favour Entity and Cantonal governments and limits local competences and capabilities. Equally, the current system of fiscal relations deprives many municipalities of the necessary funds to meet local needs and expand opportunities. Under such conditions duplication, waste and non-transparency thrive, promoting poor performance and permitting the abuse of power. Most disturbingly, there are cases where the latter has been often severe enough to constitute the outright denial of basic rights. The variation in resources between different areas is equally disturbing - with some analyses suggesting the funding differential could be as high as a factor of five to one.

But it is important not to be overly pessimistic. Legal reform is underway and the acceptance of the Law on Local Self Governance in the Republika Srpska and progress towards a similar law in the FBiH marks a particular milestone. Equally, there are vestiges of a fiscal equalization system in both Entities which might be further developed.

We argue that if local government is to realize its full potential these reforms must be accelerated. The outcome at minimum must be: a new legal basis which guarantees and promotes local autonomy: an effective fiscal system which empowers and compensates for variations in needs and resources: and a scheme of ongoing decentralization, whereby local governments secure a larger responsibility for the services which shape the well-being of communities.

## Delivering and Enabling

The picture within the service domains also gives grounds for concern. Major local public services, including schooling and healthcare, are unresponsive to users and antithetical to social and economic progress. In turn, public utilities are desperately inefficient and suffer both from a lack of investment and weak management. Significant improvement will require a sea change in financial and management practices and workplace culture.

In relation to the human services, this report argues foremost for giving local governments a greater say in their administration coupled with a redefinition of the role of the public sector. Attention should be given to clarifying the responsibilities between different tiers of govern-



ment, and how differential needs might be compensated for. It is disquieting that locally delivered services, and especially schooling, are dominated by higher level governments, driven by divisive political agendas. Decentralization will contribute towards refocusing attention on the real public service objectives. To be fully successful this should be accompanied by transparency guarantees and the replacement of inputs-based funding arrangements with rational systems of output-led resourcing.

Turning to local public utilities, where BiH local governments already hold considerable service responsibilities, the report highlights a similar catalogue of failures. Yet in addition to political interference and managerial weaknesses, there is a chronic lack of investment and deficient maintenance. The report concludes reforms must address the fundamental question of the relationship between provider and consumer. Furthermore, that local utilities must adopt a distinctly commercial approach, rationalizing charges to reflect consumption and clearly defining the roles of politicians vis à vis managers. This route not merely offers benefits to public enterprises and their municipal owners, but will also motivate rational and more productive behaviours among consumers.

The report also considers the more contemporary concept of 'enabling' and community leadership as core municipal responsibilities. Enabling refers not to direct service delivery but activities which shape and motivate the behaviours of others - be they citizens, entrepreneurs or consumers. Taking the two key areas of economic development and environmental protection, we find that there is considerable scope for BiH municipalities to play a more proactive role in enriching community life, through both promoting a better business climate alongside heightened environmental awareness. The report recognizes there are strong connections between these areas and local government regulatory functions, it concludes the two need not be mutually antagonistic, and with imagination, can be supportive of each other.

## Managing and Consulting

The report closes by examining the quality of managerial practices at the strategic level within local governments. Like enabling functions this is an indirect area of activity, but one which is pivotal to success in all other domains. Effective planning and oversight is fundamental to effective implementation. Yet sadly, as the report reveals, little attention is given to these questions within most municipal administrations in BiH. All too often, corporate plans are incidental to the real decision making processes at work and have little 'traction' on budget allocations and service activities. Worse still, apparently consultative planning processes are merely window-dressing

exercises, orchestrated for public consumption or to satisfy international donors. Few local governments engage in genuine consultation and as a result decision making is both ineffective and lacks legitimacy.

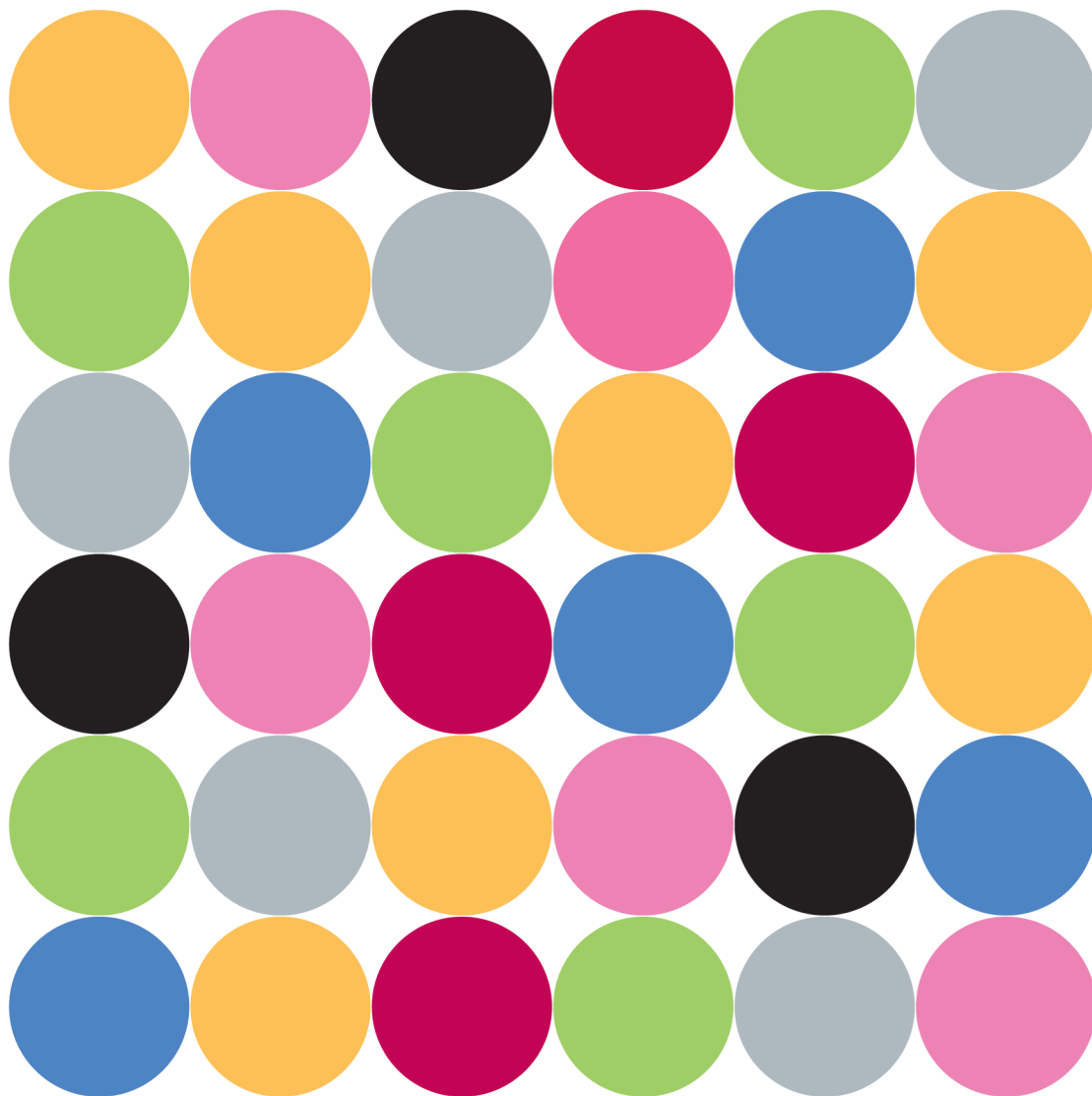
Yet it is important to recognize that there are positive signs of renewal and innovation. Traditional forms of local consultation, such as Mjesne Zajednice (community councils), are now being actively promoted. Similarly, some progressive local governments have engaged in effective strategic planning exercises. The report commends these efforts and argues for the cross-fertilization of these ideas across the span of local government in BiH.

## Unlocking Latent Potential

Whilst this report charts much that is wrong with municipal government in BiH and the system within which it operates, it remains positive about its future. The local level, where politics is necessarily more real, offers a spring board for lasting and substantial change. What is required is a mixture of systemic and downstream reforms which mutually reinforce each other.

We acknowledge that decentralization is a fundamentally political question as it involves the re-distribution of power and resources, and we are realistic about the extent of the difficulties and challenges faced. But change can be initiated at both the local and national level, through step-by-step measures. Of the two, change from within communities offers the most powerful driver for progress. This report purposefully seeks both to support local politicians and opinion formers as much as it does those at higher levels. We believe firmly that a local renaissance which drags politics closer to genuine public concerns - the substance of human development in BiH - has the potential in time, to bring about a new dawn for Bosnia and Herzegovina.

## CHAPTER ONE



## INTRODUCTION AND CONTEXT



# Chapter One: Introduction and context

Human development is about expanding the choices open to people to lead full and valuable lives. First articulated in the 1980s, the approach provides a means of understanding and tracking economic and social progress which is rooted in the real-world experiences of ordinary people. Human development concerns itself with furthering individuals' capacities (their 'capabilities') to access those states of being (or 'functionings') that define the quality of life. These include: being able to secure a decent education, being in good health, having the economic wherewithal to participate in the economy, and articulating a political voice by which outcomes can be affected.

The approach grew out of 'Basic Needs' thinking which re-defined development objectives away from a small number of macroeconomic indicators, chiefly growth in per capita incomes, and brought in notions of securing entitlements, such as nourishment, warmth and shelter. Human development goes conceptually further, not by merely identifying a wider and more sophisticated set of needs, but expressing well-being in terms of securing the freedom to make positive choices, and so enable individuals to realize their full potential.

Both the global Human Development Reports (HDRs) and those produced at the national level (NHDRs) by UNDP Country Offices working with domestic authors, seek to examine substantive well-being and the sustainability of the development process. They set out in practical terms, what can be done locally to improve conditions within a given field of public policy making.

## **The condition of human development in Bosnia and Herzegovina (BiH)**

The state of human development in BiH today gives grounds for concern. Per capita incomes remain low, health indicators are at best static and educational performance shows only weak improvement. Most problematic of all, BiH citizens still face a raft of discriminatory practices which circumscribe access to basic services and weaken the wider democratic process. Year by year BiH is falling behind others in Eastern Europe.

But to be clear, what we observe is a relative decline and a failure to progress. Much has been achieved since the end of the war and what BiH faces today is more of a failure to realize its very considerable potential than a socio-economic crisis. Broad measures of health and educational outcomes are high by global standards and economic growth remains positive.

We also have to bear in mind that objective data sources are hard to come by, and a large informal sector has developed. Anecdotal and some qualitative evidence, lends support to widely-shared views that official economic data paints a misleadingly negative picture. However, other parts of the country, especially those settlements which suffered during the war, endure severe deprivation. This apparent paradox is indicative of growing inequality in the distribution of income, wealth and opportunities.

Still more worrying is the routine disregard and patchy application of the rule of law. Citizens are deprived of legal certainty and equal treatment in the enforcement of regulations and administrative decisions. Portions of the population are denied



# Better Local Governance in BiH

decent educational and employment opportunities<sup>1</sup> and access to a variety of other entitlements is often limited. This situation both threatens to undermine BiH's human development inheritance, and the political settlement upon which peace was secured in 1995.

Running alongside this, an increasing number of non-poor BiH citizens perceive themselves being at risk of deprivation.<sup>2</sup> As institutions fail to mediate threats and create opportunities, people have lost their trust in government, and are losing hope for the future as well.<sup>3</sup> This process is troubling and may lead to an exodus of the BiH's capable younger generation and threatens to feed a vicious cycle.

The post-war reconstruction efforts and the technical support provided by the international community enabled considerable initial progress to be made. Nevertheless, it seems that the political and administrative framework created by the Dayton Peace Agreement has in time, failed to bring effective solutions in many domains. BiH is still a fragmented country split along ethnic lines and burdened with a huge and ineffective public administration system. Equally, the political space is dominated by dogmatically nationalistic political interests.

Wide international experience shows that the basic modus operandi of a market economy is more quickly established than the rules which underpin effective and functional public institutions. Moreover, in time the latter will circumscribe the progress of the former.<sup>4</sup> During the last one and half decades we have witnessed this progression in post-socialist Europe. After the initial political transition, it was easier to create the right economic conditions than it was functioning democracies, and

in turn, the freedoms and choices which characterize sustainable human development. This is especially true for countries where the transition process was directed from above and by an incumbent leadership whose culture was shaped under the tutelage of the past autocratic regimes.<sup>5</sup>

These phenomena should not be surprising. New institutions rarely take real shape in international treaties or on the initiative of the incumbent leaderships, but in the constructive tension of citizens, intellectual elites and civil society. Substantial social and political change requires locally-driven demands based on mass participation. The general political apathy of citizens and the dominance of ethnically-based politics unfortunately have allowed the status quo and the unproductive feudal nature of public life to prevail (for an example of this see Box 1 on 'Language').<sup>6</sup>

The key challenge facing BiH citizens today is the reconstruction of the social fabric. Better opportunities for people can only be created through the reform of formal and informal institutions and the establishment of a constructive public life that effectively reforms, and then checks, those reshaped institutions. Our key objective in this report is to explain how local governance might be utilized and revitalized so as to contribute to this pressing task.

## Local governance and human development

We see local governance as a primary means for securing higher levels of human development. The activities of municipalities can improve both public service delivery and the quality of democracy. Local governments, being closer to inhabitants, are in the

<sup>1</sup> World Bank/ UNDP Living Standards Measurement Survey (2003)

<sup>2</sup> HDR 2002

<sup>3</sup> UNDP Bosnia and Herzegovina, Early Warning System 2002 onward

<sup>4</sup> Fukuyama: State-building: Governance and World Order in the 21st Century, Cornell UP, 2004

<sup>5</sup> Presentation by Ivan Szelenyi on 'Transition Models' at the Institute for Political Science of the Hungarian Academy of Science, Budapest, 2004

<sup>6</sup> ESI (European Stability Initiative): Governance and Democracy in BiH: Post-Industrial Society and the Authoritarian Temptation, 2004

best position to assess local processes, problems, demands, expectations and potentials. They can mobilize local stakeholders to develop shared goals and to envision adequate strategies to set community development on a positive trajectory.

Equally, government failures are less likely in decentralized systems. Localities better match taxation levels with spending decisions, the democratic pressures are stronger and their inherently more attuned local knowledge helps to exploit revenue sources and identify needs more effectively. As a result, public services are delivered more efficiently and the policy process is more accountable. Field knowledge is key to extending access to services. The smaller government is, the more directly connected it is to communities, and able to reach out to the vulnerable and excluded. Indeed, for the most vulnerable, the mere availability of public provision alone does not necessarily guarantee take-up. Delivering public services to all citizens is a major component of building a more inclusive society and furthering human development.

By the same token, local governments can make a particular contribution to strengthening those local services (education, health and communal services) that are central to the human development agenda. Ordinary citizens are best placed to formulate opinions on the quality of delivery - and if decision makers are close and accessible, citizens possess incentives to actively represent their opinions and interests. Under the right conditions of transparency and openness, local government has the potential to become an instrument of communication and change. Moreover, as municipalities are the first line of the public administration system, their reform directly initiates learning and dialogue,

and it has the potential in BiH to initiate a process of re-building trust in all public institutions.

## Our objectives

The primary purpose of this report is to give an unbiased assessment of the condition of local governance in BiH, to suggest new roles for municipalities and how they might be empowered to work better. The central question is how can local governments become effective agents in improving the capabilities and opportunities of citizens?

Since the establishment of the post-war public administration system there has been no systematic attempt to analyse the conditions and performance of local administrations. Our report is a first attempt that includes both a horizontal analysis of the governance system and a vertical analysis of the various local services and 'enabling' duties municipalities undertake. One of our objectives is to assist supporters of democratic change by developing a wider understanding of the issues, offering priority-based analysis of the problems and makes proposals for improvement. Reliable analysis can assist policy champions to build clear arguments, and enable them to become more effective managers of the reform process. In addition to shaping the reform agenda, we seek also to inform the design of future UNDP interventions.

## Structure of this report

This report includes five further chapters. However, a full understanding of the nature of the challenges faced within BiH requires an appreciation of its political geography and the complex constitutional arrangements currently in place. Therefore in the second part of this introductory

# Better Local Governance in BiH

chapter we provide the necessary background material. Those who are familiar with these issues may choose to skip this section - for others it will prove essential preparation.

The second chapter assesses the conditions of Human Development in BiH, identifying the main threats and the key national and local policy challenges. The third chapter offers an analysis of the governance system at the strategic level, identifying the areas for reform. The fourth and fifth chapters provide a detailed analysis of the activities undertaken out by local governments. These are reviewed in terms of key services delivered, followed by the wider enabling functions and management competencies held. These three chapters represent the mainstay of our work and include proposals both to improve local service delivery and the overarching intergovernmental framework.

The sixth and closing chapter recaptures earlier conclusions and recommendations and highlights unifying themes.

## Working arrangements

It was decided early on in the preparation of this report that it should be researched and compiled by a group of young professionals to bring new ideas and fresh contributions to this debate. This decision can be taken as symbolic. It signals trust in change and we have purposefully aimed to empower future agents through exposure to serious policy work. This choice of UNDP underlines a deep belief in the importance of the process, and the vitality of BiH's emerging new thinkers. It is crucial that BiH nurtures the fresh ideas of motivated young intellectuals. In time new thinking should spawn genuine policy formulation circles, both inside government and

the independent sector, with the potential to become a major resource for a locally-driven reform processes.

## The limits of analysis

We emphasize at the outset that this report is a first attempt to systematically analyze BiH local governance in depth. Our report is both strong and weak. We have tried to bring new insights, creative ideas and build sound arguments. We sought to get away from emotions, activism and biased perceptions, and offer an objective commentary. However the often non-availability of reliable data and information presented serious obstacles to this approach, and we have been forced to deploy various methods to fill any information gaps. Yet nevertheless, we are confident that our analysis is much more than merely proximate. Most of the time we were able fill the gaps entirely satisfactorily, where not we have been obliged rely on supportive cases and qualitative material. We are aware of the dangers of this, and where evidence is particularly limited we have moderated our conclusions, and cautioned readers.

## Post-war political context

It is impossible to properly understand the condition of local governance in Bosnia and Herzegovina and the challenges faced without a familiarity with the current constitutional and administrative framework. Modern BiH is a confederal state of two parts: the Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH). This arrangement is further complicated by the presence of ten cantons in the Federation, with wide competences and constitutional recognition. These arrangements, which



stem from the Dayton Peace Accords (DPA), seek to mediate ethno-political differences (see map in Chart 1.1).

*Chart 1.1: Bosnia and Herzegovina, the Republika Srpska and the Federation*



## The Dayton Peace Accords (DPA)

The General Framework for Peace, by which the DPA is also known, created the framework of the BiH nation state. DPA is essentially a peace treaty, whose main aim was to end the conflict and thus resulted from protracted negotiations aimed at meeting the mostly conflicting political agendas of the principal parties. The Accords defined BiH as a state of three constituent peoples - Bosniaks (Muslims), Serbs and Croats. Two ethnically-based Entities were established - Republika Spska in the north with a serb majority, and the Federation (FBiH) in the South shared between the Croats and Bosniaks. Following further arbitration, the District

of Brcko was created under international supervision, as a single administrative unit of local self-government existing under the sovereignty of BiH. The Entities divide the country almost in half holding 49% and 51% of the territory respectively.

Many believe this territorial division codified the results of war gains and widespread ethnic cleansing, particularly as the new boundaries did not correspond to any pre-war historic or ethnic divisions. The main rationale behind the protection of national or 'ethnic' interests, through entrenching collective rights, was an attempt to establish the principle of equal representations at all levels of government.

The importance of establishing mechanisms to protect and preserve cultural identities should not be underestimated in post-war BiH (for example, see Box 1 on Language). However, the codification of collective rights has effectively resulted in splitting the country into three separate political spaces, one for each of the three constituent peoples.

The DPA comprises a total of eleven annexes, and mandated various international agencies to take the lead in aspects of the agreement. Annex 10 established the new position of High Representative as the final authority regarding interpretation of the DPA on the civilian implementation of the peace settlement, supported by the Office of the High Representative (OHR) - which is effectively a secretariat. Implementation of the peace agreement became the overall responsibility of the 52 nations and organizations who attended the Lancaster House Conference when the Peace Accords were signed, known as the Peace Implementation Council (PIC). A PIC Steering Board chaired by the High Representative was also set up, composed of representatives of Canada, France, Germany, Italy,

# Better Local Governance in BiH

Japan, Russia, the United Kingdom, the United States, the Presidency of the European Union, the European Commission. Its task was defined as providing political guidance and support in the peace implementation process. Two years later, at a PIC meeting in Bonn, in the face of political obstruction, the powers of the High Representative were extended to include the ability to dismiss or suspend officials for 'Anti-Dayton activities', and impose legislation. These became known as the 'Bonn Powers'.

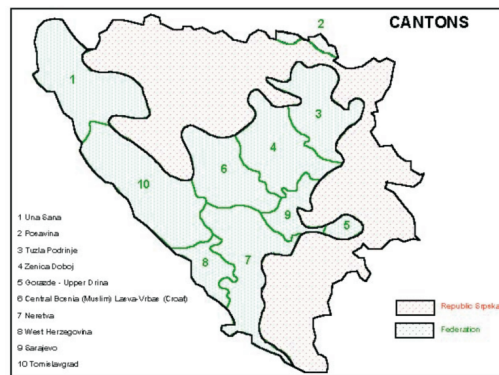
Over the past two years, in line with the requirements for entry into the EU Stabilization and Association Agreement (SAA), some modifications have been made within the Dayton Structure, notably the creation of additional State-level ministries. In addition, a State-level police agency (SIPA) and intelligence agency (OSA) have been set up.

## Constitutions

The constitution of BiH is set out in Annex 4 of the DPA. This has a highly complex and decentralized structure, establishing in effect, two separate political and territorial entities. The RS has a centralized structure with a central government and 64 municipalities, whereas FBiH has ten cantons and 82 municipal governments (see Chart 1.2). This fragmented arrangement is further burdened by the fact that competencies of the State-level government as outlined in the Constitutions are limited. Both Entities have their own constitutions. In the Federation, competencies are further devolved and this operates under a cascading principle: any power not granted to the federal government rests with the ten cantons. Consequently, in the RS it is the Entity government, and in the Federation it is

the Cantons, that have the strongest potential for power accumulation. The constitutional settlement has thus created a system that establishes governance by multiple sub-national authorities.

Chart 1.2: The FBiH's ten cantons



The Entity constitutions each determine the establishment of local governments within their territories.<sup>7</sup> Their regulation is further specified by local government laws passed by the Entities and the cantons in BiH. This functionally separate regulation inevitably produces considerable difference in local competence and capabilities.

## Governance structure

On the State-level, there is a bicameral parliament and a Council of Ministers. At the Entity level, there are parliaments (RS National Assembly and FBiH Parliament) and their respective governments. Within the FBiH, there are in addition, ten bicameral cantonal parliaments and cantonal governments. At municipal level in both Entities there are assemblies and mayors. Finally, Brcko District has an assembly, a government and a mayor. Thus, there are min-

<sup>7</sup> In this report the term 'local government' is used to mean municipal and city governments. Entities and cantons are not local governments, as they function as superior levels of government in BiH.

istries established on State, Entity and cantonal level - and as a result, in most cases 13 separate ministries, regulate each and every sector of responsibility. In all, the weak Bosnian economy and its people of less than 4 million, have to support 14 governments, 150 ministries, 200 ministers and 146 local governments. This administrative structure results in a high level of complexity and a huge redundant bureaucracy. Complexity leads to organizational and functional failures and high administrative costs. The impact is to cloud accountability, confuse citizens and 'crowd-out' non-administrative expenditures.

### **The resulting conditions**

#### **The administrative system**

BiH has one of the highest numbers of administrative workers per capita in the region, yet at the same time the public sector does not provide a sufficient or effective service to citizens. Indeed quite the opposite - citizens finance an extremely large bureaucracy for low quality services. The complexity of the system limits the ability of the average voter to properly appraise political performance, whilst the inherent lack of transparency, presents a huge barrier to effective democratization.

The size and complexity of the public administration system also creates internal incoherencies. The weak central state is unable to create a regulatory framework that is capable of implementing consistency or harmonizing operational policies and downstream processes. The laws and regulations produced by various sub-national units with strongly differing interests, increase the inherent disjunctures and the complexity of planning and imple-

mentation. This is a heavy burden that citizens and the economy, confront on a daily basis.

In principle such a complex system could still function if it were underlain by wide agreement on goals, a sophisticated web of intergovernmental relations and a sound democratic culture. Unfortunately, aside from the shared imperative of accession to the European Union (EU), none of these conditions can be assumed in BiH. The lack of data and technical capacity limits policy development. Discretionary administrative culture is an obstacle to predictable intergovernmental relations and citizen apathy permits the situation to persist.

#### **Weakness of the nation state**

The weak and ineffective central state is not capable of fulfilling its necessary functions. It cannot establish universal standards, nor access to basic services, and a minimum level of social protection. This limits the freedom of movement of citizens and leads to all manner of inequities. The weak state also fails to establish unified regulatory and common practices that might bring together the disparate economic, administrative and political spaces. The real and perceived ineffectiveness of institutions provide a fertile ground for the survival of outmoded ideologies and manipulative politics (see Box 1 on Language).

The weaknesses at the state level are also a huge obstacle to decentralization. In a decentralized administrative structure, the central state has a function that cannot be neglected. It must regulate and harmonize, creating incentives that coordinate and rationalize the activities of the parts of the whole. As Prud'homme puts it, (decentralization) 'is

# Better Local Governance in BiH

like polyphonic music that must be concerted and directed'.<sup>8</sup>

## **Territorial fragmentation and the economy**

The division of territorial units on the basis of ethnic lines has created functionally unnatural boundaries. Cities and regions that were logically connected economically and geographically have ceased to cooperate. In the long term, this can only result in negative economic and societal performances. In spite of much activity and some genuine progress by a number of agents, including the OHR, BiH's economy still can only partly be said to function as a 'single economic space'.<sup>9</sup>

## **Ethnic dominance**

BiH is atypical amongst multi-national states, as territorial units were ethnically mixed before the conflict. The war has completely altered the ethnic demography of the country. As none of the ethnic groups could achieve hegemony at the state-level, they have established a restricted dominance at a territorial level. Sadly, the fragmented governance system offers ample scope for such endeavours.

The two BiH Entities, established on the basis of ethnic principles, have entrenched the ethnic-based institutional structure of the country. The RS, the Serb Entity, and the FBiH, as the Entity of the Croats and Bosniaks and ten, again ethnically-based, cantons, have proved to be bastions of protection for so-called 'national interests' of their respective majority peoples. They remain for the most part, mutually antagonistic and socially and politically distant. In spite of a landmark ruling by the BiH Constitutional Court which confirmed the constitutionality of all three peoples in the whole of

the territory of BiH (a ruling which divided Constitutional court on ethnic lines), the situation did not improve significantly. Entity institutions still remain strongly marked by ethnic politics and are perceived as institutions of one of the respective peoples.

Rights and entitlements at the lower levels of public administration - the ones that relate to the daily life of average citizens - are even more vulnerable. Local consociational derogations give ample room for ethnic domination and the attendant negative consequences (including discrimination, loss of diversity, ideological leadership, and ineffective decision making). Indeed, most territorial units are split along ethnic lines. Members of minority ethnicities are still reported to be subject to human rights violations and be denied access to the same economic and social opportunities enjoyed by members of the dominant group.

As long as the constitutional and legal arrangements allow space for the exploitation of ethnic identities for dominant political control, the loss of ethnic diversity will continue. This tendency also reinforces the various divides by creating rational personal interests to declare belonging to a specific ethnic group and ensures choices are dictated by ethnic considerations in place of merit and rationality. Ethnic fault lines thus also limit the creation of efficient systems of service delivery and local management.

After this gloomy evaluation of the legal and administrative structure of BiH the reader must raise the logical question: why has this situation not changed for the better in the post Dayton period? The most generally given answer is that stakeholders in the process have diverging interests and have

<sup>8</sup> Prud' homme, R., On the Dangers of Decentralisation, World Bank Infrastructure and Urban Development Department, 1992

<sup>9</sup> An early goal of the International Community: whilst a single currency and common monetary policy operate the free movement of capital and labour between the Entities, the hallmark of an intergrated economy, are still limited.

as yet been unable to find a consensus. Part of the problem is rooted in the DPA and the supervision arrangements that it has spawned, but the underlying causes are rooted in the nature of the political arena. Incumbent political forces are motivated, and have developed, strategies to preserve this steady-state. Changing these dynamics carries very consid-

erable risks and has few certain payoffs - and even fewer political actors are prepared to contemplate such change. As long as citizen apathy paralyzes voters and civil society in pushing for change, the situation is unlikely to change substantially.

### Box 1: Language

One of the most manipulated issues in BiH has been the articulation of separate local languages. This process began in Croatia, took hold in Serbia and has continued throughout the former Yugoslavia. Before the war, the main official language was Serbo-Croatian, the only real differences being that Serb traditions held to writing the language in Cyrillic.

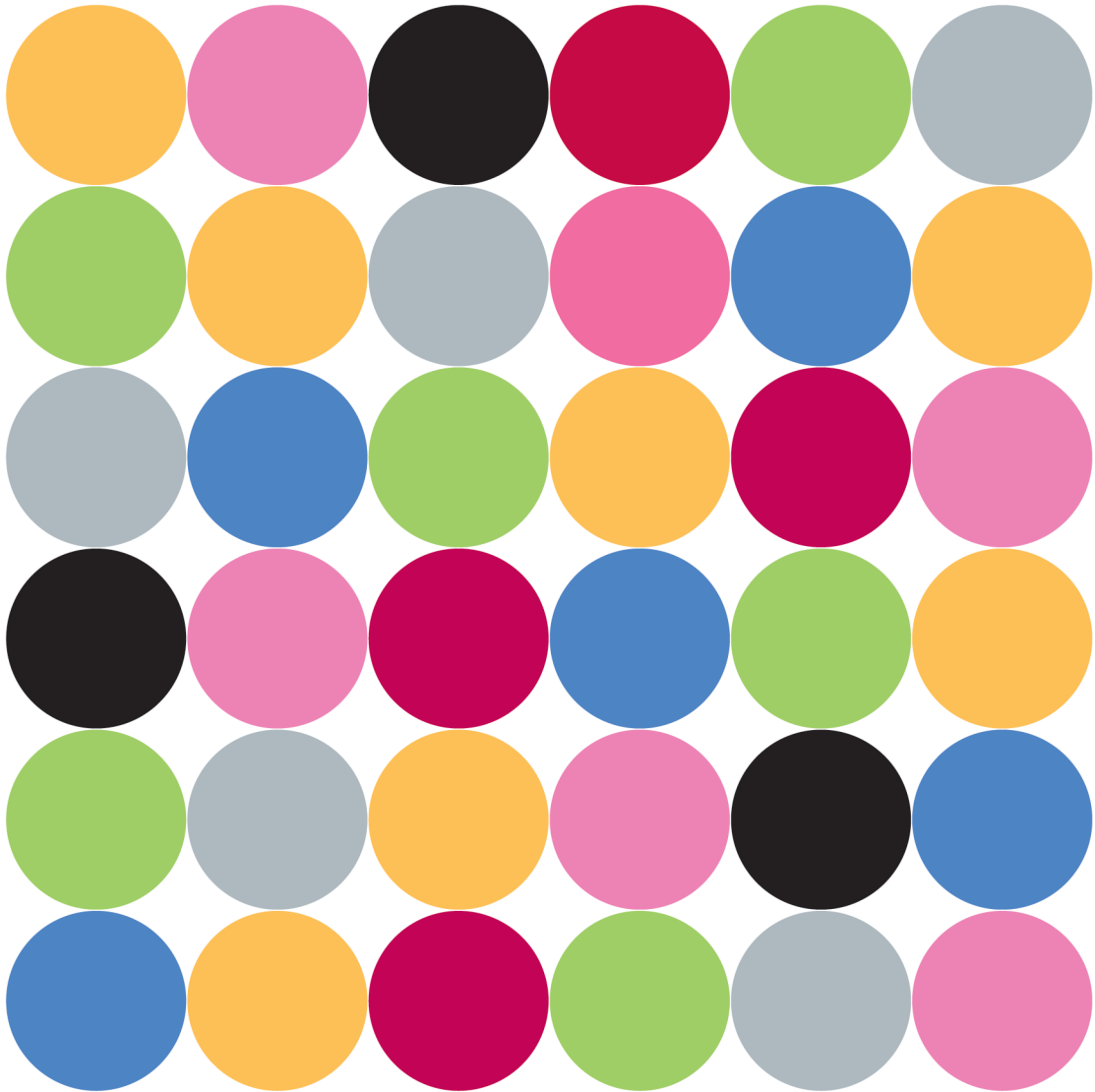
After secession, politics intervened heavily. As a part of the Croatian nation building process, Croats proclaimed their language as distinct and embarked on a process of distinguishing the Croatian lexicon. This effort involved large numbers of linguists and rested on codifying regional differences in both vocabulary and grammatical forms. In BiH's, multi-ethnic but monolingual community, this process has assumed a level of absurdity since Croats, Serbs and Bosniaks had lived together using the same language for centuries. Following the Croat and Serb efforts, Bosniaks also felt obliged to define a Bosnian language that is again some combination of rarefied differences between Serbian and Croatian. Nevertheless, obviously all three ethnic groups perfectly understand each other, and irrespective of these efforts, their languages are difficult to differentiate.

The language issue has had a detrimental impact on various facets of everyday life in BiH and especially so on the quality of political discourse. At the Dayton talks, representatives of the three peoples argued strongly that each had the right to use their own language, so this too became a defining principle enshrined within the accords. The International Community has been obliged to accept the existence of three different languages, and large sums of money are expended on translating from one to another in all manner of public documents and correspondence. Serb politicians have begun to adopt the Ekavica (traditional) pronunciation used in Serbia, but never in BiH. Equally, Croatian officials make incredible efforts to learn the new vocabulary advocated by nationalist interests in Zagreb.

This issue is far from trivial and minor differences in a common language are being exploited for the purpose of differentiation in the education system, in the arts and society at large. As with other disputes rooted in nationalistic politics, this debate remains highly politicized and divisive.



## CHAPTER TWO



## HUMAN DEVELOPMENT IN BOSNIA AND HERZEGOVINA TODAY





# Human Development in Bosnia and Herzegovina today

*"People are the real wealth of a nation. The basic objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives. This may appear a simple truth, but it is often forgotten in the immediate concern with the accumulation of commodities and financial wealth."*

*Global Human Development Report (1990)*

The objective of this chapter of the report is to appraise the conditions of human development prevailing in Bosnia and Herzegovina today and in particular to highlight those aspects where local governance reform might make a positive contribution. First, we look at the national level picture. Our review includes commentary on: the overall trends, health and education outcomes, economic conditions, poverty and employment, gender dimensions, and the quality of political participation. We also present the latest standard human development indices for BiH. Second, we examine regional and local disparities, presenting for the first time, disaggregated human development for the Entities and regions. We conclude by summarising the key human development challenges to be addressed by local governance reform.

## Overall Trends

Like other European transitional nations, BiH enjoys high levels of human development relative to its economic standing. The former Yugoslavia was one of the most economically advanced nations of Eastern Europe, and pre-war BiH represented a sophisticated post-industrial society. Its inheritance therefore included educational and health outcomes approaching or equivalent to, first-world standards.

The conflict and its protracted fallout served first to severely retrench, and then retard performance. Yet human development is a stock rather than a flow, and capacities are established over long term periods. Educational and health standards in particular, held up well, and have since recovered to their pre-war levels. Yet, the rest of the world and especially the emergent democracies of Eastern Europe, have powered ahead in that time. In addition, BiH's initially strong progress has stalled in recent years - economic conditions, although markedly better than the mid-1990s, remain fragile. This inevitably also has implications for the incidence of poverty and the standard of livelihoods.

Charting these changes empirically is difficult, since the quality of the data and measurement methodologies have varied over the post-war years. Table 2.1 reports the results for the Human Development Index for BiH, and the four data series which drive the index for the consecutive years from 2000. According to our calculations, BiH has an HDI of 0.784<sup>10</sup>, giving it a global ranking of 64th out of 171<sup>11</sup> countries. This figure places it at the upper bound of the medium human development category, and only marginally below the 'high human development' threshold (a value of 0.800). BiH is thus doing well in global terms but problematically, it is not doing well relative to its potential, and its performance across-the-board is disappointing when compared against others in the region.

<sup>10</sup> Using standard conventions this is based on 2002 data.

<sup>11</sup> This is arrived at by substituting locally calculated data into the 2004 (global) Human Development Report Method.



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Table 2.1: HDI components 2000 to 2002

Year	Life Expectancy in years (change on previous year)	Combined Enrolment Rate (change on previous year)	Adult Literacy (change on previous year)	PPP GDP per (change on previous year)	HDI (change on previous year)
2000	73.3 (n/a)	64.1 (n/a)	85.9 (n/a)	2,857 (n/a)	0.718 (n/a)
2001	73.8 (+0.6%)	67.3 (5.1%)	88.9 (+3.5%)	3,949 (+38.2%)	0.744 (+3.6%)
2002	74.0 (+0.2%)	67.3 (0.0%)	94.3 (+6.0%)	5,970 (+51.2%)	0.784 (+5.4%)

Source: NHDR team estimates (see Annex 1)

The picture below the surface is still more interesting. The most striking facet of the results above is the dramatic improvement in per capita GDP and literacy rates in recent years, whilst the other components have seen much weaker growth. Problematically, very serious questions can be asked about the validity of these improvements, and there are convincing methodological explanations which suggest the level of change is spurious. First, BiH's apparent economic strength owes much to ongoing revisions in the purchasing power parity estimation methodology used to adjust the crude figures. The 51% growth in the per capita income figure in 2002 compares to a mere 3.5% change in unadjusted GDP per capita<sup>12</sup>. Second the ongoing improvements in literacy can more than partly be ascribed to a new means of measurement rather than genuine change. Indeed, as a variable, adult literacy typically shows very small incremental changes.

The poor relative performance is exposed when comparisons are made against other nations. As shown in Table 2.2 below, BiH ranks as one of the weaker performers within South and Eastern Europe, with an HDI some 14% lower than Slovenia, the most advanced former Yugoslavian Republic,

and 6% lower than Croatia, a country also severely affected by the Balkan conflict. The underlying figures show the key problem areas remain: a weak economy, with BiH's adjusted GDP per capita being close to bottom to the league (and remember this tends to overplay the strength of the economic position): and poor educational enrolment, with BiH's combined rate in line with Albania's and around thirteen percentage points below Macedonia's.

The underlying pattern remains a weakly improving economy on a very low baseline, with high but almost static health outcomes, and relatively low but marginally improving educational ones. Such a position is troubling. Economic indicators typically react quickly to changing circumstances, whilst socio-economic variables, which although they better reflect the state of human development, have an inertial quality and take time to reflect changing circumstances. But the two are connected and causation runs in both directions. Over the longer run, a weak economy will ultimately undermine social progress. Equally, low educational enrolment will retard economic performance. What we face is not a collapse of human development in BiH, but an ongoing failure to capitalize on potential.

<sup>12</sup> Working out a credible figure for the per capita level of income in BiH is far more difficult than might be imagined. First, within BiH we face the problem of not knowing exactly how large the population is. (See Box 2 on Census) Second, for HDI purposes we adjust crude GDP to reflect its Purchasing Power Parity (PPP). Calculating this factor accurately is difficult, and particularly so in a post-conflict economy with a large informal sector. The PPP factor for BiH has grown substantially and now stands at a 440% uplift on US prices.

## Chapter two: Human Development in Bosnia and Herzegovina today

Table 2.2: HDI in Eastern Europe 2004

Central and Eastern European Nations (Alphabetical order)	Life Expectancy (years)	Combined Education Enrolment Rates (%)	Adult literacy Rate (%)	GDP per capita (PPP US\$)	HDI	HDI Rank <sup>13</sup>
Albania	73.6	69	98.7	4,830	0.781	66 <sup>14</sup>
Bulgaria	70.9	76	98.6	7,130	0.796	56
Bosnia and Herzegovina	74.0	67	94.3	5,970	0.784	64 <sup>15</sup>
Croatia	74.1	73	98.1	10,240	0.830	48
Czech Republic	75.3	78	99.9	15,780	0.868	32
Slovakia	73.6	74	99.7	12,840	0.842	42
Hungary	71.7	86	99.3	13,400	0.848	38
Macedonia (FYROM)	73.5	70	96.0	6,470	0.793	60
Poland	73.8	90	99.7	10,560	0.850	37
Romania	70.5	68	97.3	6,560	0.778	69
Slovenia	76.2	90	99.7	18,540	0.895	27
CEE& CIS Average	69.5	79	99.3	7,192	0.796	-
Medium HD Average	67.2	64	80.4	4,269	0.695	-

Source: UNDP Global HDR (2004) with adjusted BiH Data.

Underlying these problems is the legacy of the conflict. This has had two very distinct effects on the level of human development in BiH. First, there was inevitably an initial severe impact associated with the destruction of a variety of capacities, ranging from the physical - infrastructure, public provisioning and so forth, to the quality of individual and community relations - what we might call 'social capital'. The second and perhaps more pervasive, is an ongoing failure to make more vigorous progress, and this is defined by a series of interlocking problems ranging from governance weaknesses, a heavy international presence and difficult local com-

munity relations. The result is a path of economic underperformance, stagnation of public services and poor governance.

The better performance of comparable, though initially weaker, nations suggests this second effect has become the more significant. Structures, institutions and modes of conduct are in effect 'dead-weights' on the economy and society at large. This is a difficult challenge which must be resolved, and one which accords special prominence to the need for comprehensive governance reform. We argue that local decentralization is an essential part of this.

<sup>13</sup> Ranking is not as recorded in UNDP Global HDR (2004) as the BiH value has been revised upward

<sup>14</sup> Ditto

<sup>15</sup> Ditto

# Better Local Governance in BiH

## Education and Health Outcomes

Living a long, healthy and creative life is the very substance of human development. Yet securing sound educational and health outcomes is also the instrument through which the wider development agenda - economic to environmental - can be secured. Extensive discussions are devoted to these matters in the following chapters. Below we summarize current conditions in BiH, and how they affect the choices and capabilities of ordinary citizens.

In line with our broad assessment, educational performance is weak historically and regionally. The post-war improvement in several key areas has slowed. Enrolment in secondary and tertiary education remains disappointing: too few Bosnian young people stay on and there is evidence of a growing social stratification at the tertiary level. Moreover, the admittedly high, literacy test results tell us little in a European context. The tests and definitions of reading and writing ability are very basic, and contrast from the far stiffer functional literacy test employed by OECD nations. There is now a body of anecdotal evidence that education in BiH is failing to meet the demands of the new market economy, and it would be catastrophic if a skills gap thwarted much needed economic progress.

The education chapter documents the issues in far greater detail. But chiefly, the authors point to an educational system being stifled by a managerial and structural sclerosis, where institutions and education bureaucracies are inefficient and ineffective. Schooling is only weakly informed by the demands and needs of pupils, parents and employers.

The situation in relation to health outcomes is still less encouraging with little change in life

expectancy recorded at the State level in recent years and growing levels of morbidity coupled with a post-war history of physical disabilities and psychiatric conditions. Added to this must be the usual litany of lifestyle diseases of modern times - including carcinomas and heart disease. Like other Europeans, BiH citizens smoke too much, fail to take enough exercise and have unbalanced diets - yet unlike other European nations, positive changes in lifestyles have been slow to emerge.

Both authoritative studies and anecdotal evidence point to a maladapted and unresponsive health care sector as being a key contributory factor. As in the case of education, its rehabilitation is limited as much by the inefficiencies and inadequacies of current governance structures (including inadequate and confused local decentralization), as the weak economic and fiscal position of the BiH Governments. These issues are also returned to in the later chapter on local service delivery.

In all, the above paints a disquieting picture. However, it is important to keep a sense of perspective. BiH enjoys a strong social inheritance from the former Yugoslavia and moreover, its relative weakness is at least partly a function of slower economic progress. Given the ferocity of the conflict and the levels of dislocation, BiH has indeed made much progress and is far from the desperate situation in which it found itself in the mid 1990s.

## Livelihoods and Economic Conditions

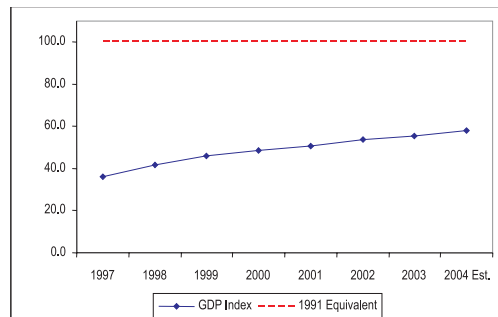
BiH's immediate post-war economy was in ruins and its three constituent peoples emerged destitute from the conflict. Moreover, a series of further challenges had to be faced, ranging from the

## Chapter two: Human Development in Bosnia and Herzegovina today

destruction of vital infrastructure to huge population dislocations, which affected up to half of BiH's citizens. The economic position today and the livelihoods of ordinary people is vastly improved but as we noted above, the recovery is far from complete and progress has slowed. GDP per capita in 2002 stood in nominal terms at a mere US\$1,362, whilst as is noted the purchasing power figure, which reflects global variations in the cost of living, is now a healthier US\$ 5,970. Economic growth remains positive but the level of income is still low by European standards.

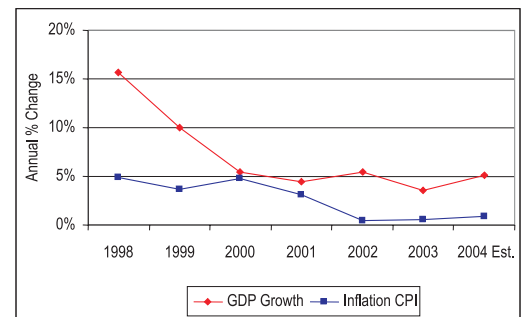
BiH's post-war growth trajectory was characterized by an initial rapid recovery followed by a steady-state performance. Problematically, the economy has settled back into this position well before reaching pre-war output levels. Following the cessation of hostilities in late 1995, the economy made enormous strides with annual growth averaging 25%. Yet as Charts 2.1 and 2.2 illustrate, growth has tailed off to around 5% per annum, and the current level of GDP is estimated to be in real terms roughly 60% of what it was in 1991. Without a considerable improvement, the pre-war benchmark will not be surpassed for some years.

Chart 2.1: Output (GDP) post 1997 versus the pre-war level



Source: Bulletin 1, 2004, Central Bank of Bosnia and Herzegovina (2004)

Chart 2.2: Growth and inflation



Competing explanations for the retrenchment in economic performance are offered by two distinct and increasingly partisan groups of commentators. The controversy lies between those who cite governance and institutional policy failures of national politicians, and those who lay the blame at the door of internationally-driven macroeconomic policy choices.<sup>16</sup>

Despite the failure to reach pre-war levels of prosperity, it is clear that economic recovery has continued to take place and this has fed positive dynamics within BiH bringing optimism to a variety of political and social processes. Securing greater levels of growth must be a prime policy objective. Moreover, as Chart 2.2 underlines, the economy exhibits a remarkable degree of price stability with inflation now running at less than 1%. The control of inflation is a key economic policy success and is attributed to the operation of a currency board arrangement by the Central Bank of Bosnia and Herzegovina (CBBiH), and the maintenance of strong monetary discipline. Whether policy remains

<sup>16</sup> Mainstream (and typically international) commentators posit the lack of a series of pro-market reforms and poor governance as being at the heart of the failure to translate stability into prosperity, these include further liberalization and privatization. Opposing this, national and heterodox thinkers blame an over-emphasis on macroeconomic stability and the lack of state intervention. Commonly, their analyses emphasize the lack of productive investment and the unavailability of credit as the key limiting factors.

# Better Local Governance in BiH

too tight some eight years after the conflict is a matter of conjecture. Inflation figures and other summary macro data are given in Table 2.3 below. However, it is important to emphasise here, that official figures are necessarily compromised by the pervasiveness of informal sector activity within BiH. Various authoritative sources offer contrasting estimates of the size of the grey economy, but the most reliable<sup>17</sup> suggest it accounts for figure of around 25% of GDP<sup>18</sup>.

Table 2.3 also shows that BiH's external position is unambiguously disquieting. The balance of payments statistics present evidence of chronic imbalances, which point to deep structural problems. Moreover, despite of reductions in official assistance targeted on reconstruction in the early post-war period and a slowing trade deficit, the overall current account deficit appears to be growing. BiH continues to suck in imports without developing compensating export capacities.

Table 2.3: Summary Macroeconomic Indicators

Year	Index 1991=100	Real GDP Change	Inflation (CPI)	Trade Balance (% of GDP)	Current Account ( % of GDP)	ODA (% of GDP)
1999	46.0	10.0%	3.7%	-67.3	-22.4	17.1
2000	48.6	5.5%	4.8%	-55.4	-18.6	13.7
2001	50.8	4.5%	3.1%	-59.0	-24.3	12.4
2002	53.5	5.4%	0.4%	-59.2	-30.9	8.9
2003	55.4	3.5%	0.6%	-55.7	-29.6	5.0
2004 Est.	58.2	5.1%	0.9%	n/a	n/a	n/a

Source: CBBiH Bulletin 1 for 2004, (CBBiH, 2004)

Equally, whilst it would be wrong to argue that there has been no change in the structure of the economy, the rate of change is much slower than in other post-socialist European countries and new activity is unevenly distributed. Without the rehabilitation of the pre-war industrial base, or the creation of new value-added activities, the prospects for accelerated growth and external balance in the medium term seem bleak.

The presence of considerable regional variations in economic performance adds more complexity to the mix and the level of variation suggests consid-

erable internal segmentation. GDP per capita is markedly lower in the Republika Srpska, but there are even more considerable variations in economic performance within the Entities themselves. Underpinning growing regional inequality is the nature of the re-orientation of the economy. Many of the large ex-socialist production facilities, particularly those delivering the highest value manufactures, are in a state of severe dilapidation. There is evidence that the post-war and post-industrial prosperity is chiefly associated with the informal sector, which is clustered around trading activities

<sup>17</sup> The Central Bank estimates GDP including the Non-Observed Sector (NOE) to be some 32% higher than official data suggests (CBBiH, 2004)

<sup>18</sup> The presence of such a substantial under-reporting of GDP is problematic in a number of respects ranging from the inadequacy of all GDP denominated figures to measures of economic participation and poverty. Further, we cannot assume that informal sector activity is evenly distributed.

and agricultural outputs. Opportunities for growth centre on those areas along the frontiers where paralegal trading activity is possible, at major interchanges and in the cities which provide a substantial domestic marketplace and benefit from the large international presence. In some other places, pockets of extreme deprivation remain and these are associated with ethnic and political frictions in specific locations. In areas like Srebrenica, problematic political and community relations continue to further blight economic and social renewal.<sup>19</sup>

The fundamental problem these inequities produce is that the impact on livelihoods from the ongoing growth is likely to be very unevenly distributed, and without structural change, will favour particular areas and high-earner groups. Political entrenchment and a lack of effective decentralization will tend to cement these inequities.

### Poverty and Unemployment

Poverty and unemployment data for BiH paints an equally complex picture. The most comprehensive poverty survey yet carried out for BiH, the jointly-funded UNDP and World Bank, Living Standards Measurement Survey (LSMS, 2003), found that the poverty headcount measure<sup>20</sup> was significant but not catastrophic at 19.5% of the overall population. The survey also concluded that only a negligible (and therefore non-measurable) percentage was living in extreme deprivation. The figures for the depth and severity indicators were mild by regional and international standards, reflecting both a clustering of consumption levels around the poverty line and homogeneity amongst the poor.

Official unemployment statistics give more grounds for concern with data reported by the

Entity employment bureaux showing jobless rates as high as 40% of the working population. More rigorous analysis based on ILO definitions produces figures which are considerably lower, at around 16%, yet even this lower result is difficult to square with the marked absence of severe poverty as given by the LSMS. A factor which is crucial in explaining this apparent contradiction is again the size of the informal sector. Anecdotal evidence and data from LSMS suggest that grey-economy participation amounts to significantly more than subsistence activities, and extends into trading, self-employment and paralegal commercial undertakings.

Yet as elsewhere in the transitional world, poverty is a nuanced social phenomenon that cannot adequately be captured by aggregate measures. Indeed, it is defined by comparisons with past and proximate consumption levels (especially against those enjoyed in the former Yugoslavia) and by prevailing societal perceptions. It is telling therefore, that data from the UNDP's Early Warning System (EWS, 2004) still shows a very much more substantial proportion of the population define themselves as poor. Moreover, there is a clear cross-community difference with Serbs seeing themselves as significantly more impoverished than their Bosniak and Croat neighbours. It is also an interesting phenomenon that perceived levels of poverty are strikingly stable regardless of the overall improvements in economic conditions. Indeed, further qualitative data available from successive waves of the EWS survey show that economic perceptions are generally worse than the empirical data.

More importantly, it has to be recognized that defining poverty wholly in reference to income is inadequate and we require wider evidence of wel-

<sup>19</sup> Sadly very little regional economic data is available to test these intuitive points. However it is useful to note the generally supportive picture provided by value added data for the cantons within the Federation and the RS at entity level. These data unambiguously underline the growing level of regional inequality, with Sarajevo and the southern Herzegovinian cantons standing out as the best performers.

<sup>20</sup> The Po measure reflects the percentage of the population below the poverty line

# Better Local Governance in BiH

fare levels. The human development approach has much to offer here. Indeed, we can speak of poverty as a form of capability-deprivation, where to be poor means to be denied the attributes of well-being - good health, education and opportunities. The approach also provides us with a ready-made metric, the Human Poverty Index (HPI) which records the proportion of the population living in capability-poverty based on the average of four

capability poverty 'hurdles' (see Table 2.4)<sup>21</sup>. This is the first year in which it has been possible to provide reliable estimates for BiH's HPI and we make use of a variant of the HPI2 specification, which is the format appropriate for industrialized nations. However, we are forced to offer two different versions owing the discrepancy between official unemployment data and the LSMS figures. Version A, based on the LSMS data, is the more reliable of the two.

Table 2.4: HPI Figures for BiH 2002

HPI and components	Version A Based on LSMS unemployment data	Version B Based on official unemployment data
Probability of not surviving beyond age 60 (% of population)	13.7	13.7
Adult functional illiteracy rate, (% of population) <sup>22</sup>	5.7	5.7
People living below the income poverty line (% of the population)	19.5	19.5
Long Term Unemployment (% of the workforce)	9.5	23.1
HPI	14.0%	17.8%

Source: NHDR team calculations see Annex 1

The results show a significant minority (between 14.0 and 17.8%) of the population are living in conditions of capability deprivation. It is interesting to note that both methods yield poverty proportions below the income poverty figure given by the LSMS (19.5 %). Thus, regardless of the debate over which measure of unemployment should be chosen, it is apparent that income poverty is considerably worse than the main capability components of the HPI. This again points to an imbalance between the eco-

nomic standing of BiH citizens and their relatively high human development inheritance.

Unfortunately regional comparisons are not possible, as only the most advanced OECD nations currently make available reliable HPI data. However, it is possible to make a useful comparison on certain subcomponents, notably the probability of not reaching age 60 and this is better in BiH than other comparable countries including those with higher HDI scores such as Croatia. It is also worth nothing that BiH's HPI suggests a certain level of equality

<sup>21</sup> These effectively serve as poverty lines delineating those deprived of adequate capabilities: life expectancy, literacy, income and employment opportunities.

<sup>22</sup> This refers to functional illiteracy and represents a higher benchmark than that used in the HDI.



## Chapter two: Human Development in Bosnia and Herzegovina today

amongst the population, even though the aggregate level of income is not high. This is backed up by estimates of the Gini coefficient for BiH, which suggest that income inequality is low in BiH. One negative and one positive implication follows from this: First, it indicates a large proportion of the population are clustered around the poverty line and are thus vulnerable to deprivation: but second it implies that the poverty-reducing effect of economic growth is likely to be substantial<sup>23</sup>.

### The quality of gender relations

Our analytical framework offers two indices which track equity between men and women and the quality of gender relations - the Gender-related Development Index (GDI) and the Gender Empowerment Measure (GEM). The results for BiH are provided in Table 2.5 below.

The GDI represents a gender-adjusted version of HDI. It is calculated by splitting the data set then separately calculating the sub-indices for gender, and standardising the overall result. Thus GDI varies against HDI where there is gender bias, whereas if gender equity exists the result closely matches the HDI figure. BiH's GDI is less than 1% below national HDI - which is very favourable. GDI scores for ex-socialist societies are generally high and can reflect an enforced equity, which tends to evaporate as the transition progresses. It is gratifying for BiH therefore, that the results show a distinct improvement on 2001, driven primarily by more equal sub-indices for educational performance and incomes.

Table 2.5: GDI, HDI and Annual Change

Index/ Component	2002	2001	Change
GDI	0.777	0.731	+5.5%
HDI	0.784	0.744	n/a
GDI variation against HDI	-0.9%	-1.7%	n/a

Source: NHDR team calculations see Annex for details.

The GEM in contrast, focuses on the empowerment of women and has been designed as a stand-alone index of women's political economic and social emancipation. The data requirements of the index are substantial and until this year it has not been available for BiH. The overall result for BiH is given as 0.471, which were it included in the global rankings, would yield a mid-range placement of 54th within 79 reporting nations. A review of the components reveals that a particular area of concern is the ratio of male to female earnings, and inequality in the representation of women in executive and public positions. This highlights that despite a high level of equity on the more generic GDI index, women lack power in the economic and political spheres. Like elsewhere in the world, gender is a complex issue in BiH and something which we return to in the section below on regional and other disparities.

### Participation

Without access to the democratic process, citizens are denied the ability to exercise the most basic capability of all, that of free expression. Voicing political concerns and exercising effective control over the public domain is inherent to human development approaches. In latter day BiH this key capability is circumscribed in many ways. This is

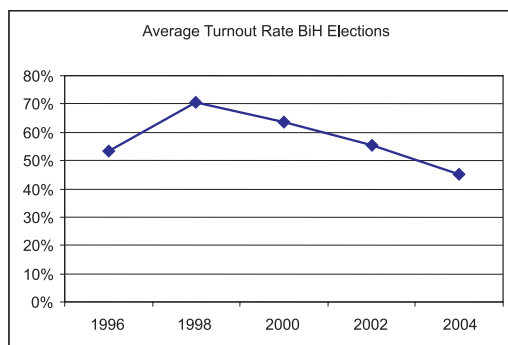
<sup>23</sup> Income inequality (as given by the Gini) is the primary factor in determining the extent to which economic growth will be pro-poor.

# Better Local Governance in BiH

chiefly through the failures and idiosyncrasies of the political system, but also the dominance of ethnically-based politics, and its often naked expression within areas of community stress.

Almost ten years after the Dayton Accords, the main political discourse is still ethnically-driven. Voters are sidetracked from real-world concerns and this has greatly limited the democratisation and reform process. The outcome is an absence of democratic pressures that would effectively control political performance, and an ongoing democratic deficit. The complexities of the system and its unresponsiveness are part and parcel of this. It is difficult to measure the extent or quality of participation, political or otherwise, in latter day BiH, but there are worrying indications of a high and growing level of apathy and alienation. One potential indicator is the turnout rates at elections and as Chart 2.3 illustrates these have been declining.

Chart 2.3: Average Voter Turnout Rates



Source: IDEA and OSCE BiH. Figures for 2004 are for local elections only

The immediate post-war 1996 elections confirmed the ethnic division of the country, and the political control of parties that governed during the war. There were logical reasons for holding demo-

cratic elections right after peace had been established. Nevertheless, there is a debate within BiH as to whether these elections were held too soon, and that the latter-day division of the political space was cemented at that time. It is clear that democratization was in its infancy at then, it was the beginning of the process, and hard to expect that voters would recognize any other political allegiance. The highest ranking politicians were mostly wartime leaders who had little in the way of shared vision. Governance in the early years was uncoordinated and obstructive.

In this somewhat unique political environment, the OHR and international interests (notably the European Union) have felt obliged intervene frequently, and the High Representative now assumes a strong political presence in BiH. Whilst there are some very positive impacts of these interventions there is still a clear need for reforms to be followed through, and OHR runs the risk of alienating citizens and supplying excuses for ineffective local political elites. It is also unlikely that genuine political change will emerge and become self-sustaining under the current level of supervision. OHR has however, played an important role in strengthening state level institutions and in transferring responsibilities to BiH central government, and has encouraged often antagonistic parties into relatively stable coalitions. These efforts have resulted in some unifying tendencies, yet it is still difficult to recognize one single political space in BiH.

The political arena at the municipal level is also unfortunately ethnically-based. Most people consider municipalities as governing units of the ruling ethnic group. But positive change is evident here too. Indeed, in 2004, the first local election to be

wholly organized by national agencies, there was a new emphasis on local real-world politics, and a move away from the 'big-picture' agenda which concerns itself with demands for high level and often irreconcilable political and constitutional changes. This is a welcome development. The local level, where the politics is necessarily more related to every life concerns, offers a genuine opportunity for building a new political consensus and *modus operandi*.

Democratisation represents a challenging process, where it is necessary to work on improving the framework for governance, and at the same time create the conditions that would stimulate public awareness and the mobilization of a vibrant civil society. Local governance can play a leading role acting as a catalyst for the learning of a new political culture and practices.

### Regional and local disparities

A key objective of this section of the report is to provide meaningful analysis and comment at the sub-national level. The following attempts to disaggregate human development outcomes and the indices, and through this, investigate the nature of local disparities. At the outset however, a note of caution is necessary. BiH is a territory beset by disjuncture and all manner of boundaries, and variations are often only perceptible through qualitative and discursive evaluation. Moreover, data sources are necessarily weak, thus apparently 'scientific' results need necessarily to be viewed with caution.

As a result of the data limitations, a comprehensive disaggregation is not possible, and instead three partial analyses are provided:

First, Entity-level figures: these are the most robust and complete estimates possible. All the main indices quoted are given and it has been possible to vary almost all the subcomponents. Second, a split based on the Federation Cantons plus the RS as a single region. This can only be done for the HDI, and somewhat partially at that, as we are only able to fully vary the GDP sub-index.

Third, a sampled HDI and HPI 'snap-shot' for 13 municipalities. This is perhaps the most problematic estimation available, and we present the results in ordinal form only. However, this does provide considerable insights, and permits a fuller disaggregation of the various subcomponents<sup>24</sup>.

### The Entities

The division between the two Dayton-created Entities marks a profound boundary within BiH. Each is effectively sovereign in the field of social policy and both have considerable scope to influence economic performance through their regulatory and institutional frameworks. As Table 2.6 illustrates, the variation in human development indices is striking, with the RS performing substantially worse on the HDI and HPI headline indicators and the various component datasets. This should perhaps not be surprising given the level of autonomy and the varying resource and competitive advantages. But it is also telling that on the two social components, are far less substantial and the difference is most acute in relation to the economy - with adjusted incomes estimated to be some 34% higher in the FBiH.

Various reasons can be advanced for the weaker economic performance of the RS. Unsurprisingly there is a debate over these matters with two polar-

<sup>24</sup> This draws on analysis carried out by Sarajevo Economics Institute which grouped a sample to form regional clusters, but in the light of peer reviews, we present individual municipalities' results, see Annex 2 for details.

# Better Local Governance in BiH

ized explanations. The first holds that the RS has simply not enjoyed the external support and resources directed at the FBiH. This ranges from lower levels of infrastructure rehabilitation to the local multiplier effect enjoyed by the Greater Sarajevo region as a result of the heavy international presence. Other perspectives cite governance and institutional failures in the economic sphere as a drag on prosperity, along with weak policymaking.

Actors like the International Financial Institutions (IFIs)<sup>25</sup> directly criticize the RS Government for running shy of reforms and necessary liberalization measures, such as privatization and the removal of market distorting subsidies and supply restrictions. There are also a complimentary set of arguments that point to the more favourable trading conditions enjoyed by the Federation and its better integration into regional and international markets.

Table 2.6: Inter-Entity Comparisons

Indicator	FBiH	RS	RS Variation on FBiH*
HDI	0.796	0.758	- 4.8%
Life expectancy <sup>26</sup>	74.4 years	73.4 years	-1.3%
Combined education enrolment rates	99.1 %	98.4%	-0.7%
Adult literacy rates	94.9%	93.3%	-1.7%
GDP per capita (PPP\$)	\$6,719	\$4,430	-34.1%
HPI <sup>27</sup>	17.4 %	19.0 %	- 13.8%
GDI	0.786	0.756	- 3.8%
GDI variation on HDI	1.1%	0.5%	n/a
GEM	0.509	0.517	+ 1.6%

Source: NHDR Team for calculation details see Annex 2  
 '-' means worse than FBiH, '+' means better than FBiH

Which of these positions has the greater explanatory power is a matter for speculation, and it seems likely that both have some substance. However, as is outlined below, further evidence suggests the level of variation is equally strong within and between the regions of the two Entities, somewhat debunking the common assumption of the FBiH's higher level of development.

The results for the gender indices also make interesting reading. Here, in contrast to the previ-

ous pattern, the Federation performs somewhat worse than the RS. Although the FBiH records a higher GDI, the variation against its HDI is greater, pointing to the presence of larger inequities between women and men. Equally, the GEM for the Federation is lower, indicating weaker levels of empowerment. Yet this should be kept in perspective - the variations are small and may be incidental.

<sup>25</sup> Meaning the World Bank and IMF

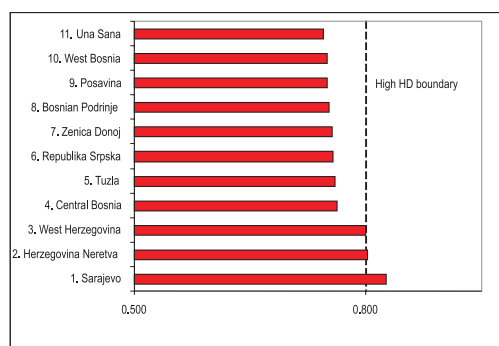
<sup>26</sup> Life Expectancy data is not available separately for the FBiH and therefore the above is based on a figure interpolated from RS and state-level data.

<sup>27</sup> Based on Method A (LSMS sourced data)

## Cantonal Disparities within the FBiH

Chart 2.4 illustrates the results of our first regional HDI disaggregation option, which retains the Entity level data for the RS and breaks the FBiH data down into the ten constituent cantons. This option makes use of fully disaggregated economic data but only partially varied health and education measures<sup>28</sup>. The resulting level of variation in the HDI is sizeable, and a distinct regional pattern emerges, the variation is over 5% either side of the national value.

Chart 2.4: Cantonal and RS HDIs



Source: NHDR team calculations (see Annex 2 for details).

Several interesting insights can be made which are also supported by qualitative evidence:

- First, it is apparent that genuine regional variations exist within the Federation, and that these are substantial enough to challenge the presumption that the FBiH is wealthier and enjoys higher across-the-board human development outcomes than the RS. Indeed, if we were to treat the RS as a single region (albeit an unrealistic assumption) it would rank in the middle of the distribution.

- Some individual results are particularly impressive with three cantons scoring within the high human development category (scores of 0.800 and above). Whilst the performance of Sarajevo is likely to be a capital city effect, it is important to note that the Herzegovina cantons also record HDI scores within this category.

Inevitably given the methodology, the main factor driving the figures are the economic disparities between the Cantons, and thus the quality of the results might be questioned on grounds of completeness. Yet it is worth noting that other evidence suggests that social components vary far less dramatically across BiH, thus even if perfect data were available, regional variations may well be found to be economic in nature.

## A BiH-wide Disaggregation

The third option prepared for this report aimed to provide a more thorough-going disaggregation enabling both the education and the GDP index to be fully flexed. To do this, it drew on unpublished research carried out by the Economics Institute in Sarajevo, which developed a database for 13 sampled localities to calculate a municipal-level HDI and a modified HPI<sup>29</sup>. Sadly, this exercise was necessarily partial and the data coverage is far from comprehensive. The results can therefore only claim to be illustrative rather than scientifically representative. Given this, the indices themselves are not provided, but rather the ordering of the municipalities, according to their HDI and HPI scores. To provide further insight, Table 2.7 separately includes the ratio between the individual HDI scores and the highest value (for Vitez).

<sup>28</sup> The Education and Life Expectancy components are only variable between Entities.

<sup>29</sup> In its original form this approach specified 6 regional clusters of municipalities. As the representativeness of the selection and clustering is debatable we present the municipal data only.

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Table 2.7: Sample Based HDI and HPI Analysis

HDI Rank	Municipality	Region	HDI as % of highest	HPI Rank
1	Vitez	Central Bosnia, FBiH	100.0%	5
2	Š.Brijeg	West Herzegovina, FBiH	99.7%	12
3	Travnik	Central Bosnia, FBiH	96.3%	6
4	Zenica	Zenica Doboј, FBiH	95.7%	1
5	Ljubuški	West Herzegovina, FBiH	94.3%	10
6	Trebinje	Trebinje, RS	93.5%	2
7	Tešanj	Zenica Doboј, FBiH	93.0%	13
8	Bosanski Novi	Banja Luka, RS	92.8%	3
9	Posušje	West Herzegovina, FBiH	92.5%	11
10	Prijedor	Banja Luka, RS	92.0%	8
11	Ključ	Una Sana, FBiH	91.8%	7
12	Sanski Most	Una Sana, FBiH	89.7%	9
13	Gacko	Trebinje, RS	89.3%	4

Source: Sarajevo Economics Institute (unpublished), again see Annex 2

The HDI results reveal a pattern of still more intricate regional variations, but the magnitude of the disparities is greatly reduced on the first disaggregation option. This is likely to be a result of excluding Sarajevo from the exercise<sup>30</sup>. Equally, by permitting a greater variation in the Education sub-index, the wealthier areas' 'premium' declines considerably. Indeed, the level of countervailing variation between the two sub-indices is surprisingly high. As a result, it is difficult to identify a distinct pattern, although the central and southern cantons in the FBiH appear to perform better<sup>31</sup>. The RS municipalities reveal a perplexing picture, providing few genuine insights into the level of variation between

them. By any measure the Federation municipalities in the Una Sana Canton score poorly.

A review of the component indices (see Annex 2) reveals that two different dynamics are at work in securing higher values for the central and southern regions. The central municipalities score well on education and the Herzegovina areas on the economy.

The results for the municipal level HPI and its lack of correspondence with the HDI also make for interesting reading. Indeed there is evidence of a counter-intuitive relationship between better human development and worse poverty, and this is particularly the case for the Herzegovina municipalities. This implies that where development is taking place it is not necessarily benefiting all inhabitants equi-

<sup>30</sup> On the grounds that Sarajevo is a statistical outlier.

<sup>31</sup> Central Bosnia: Vitez, Travnik and West Herzegovina: Š.Brijeg, Ljubuški and Posušje

tably. It must be noted however, that the data used suffers from statistical weaknesses and the researchers were forced to use a substantially modified specification of the index<sup>32</sup>. It is apparent that the key factor driving this variation is the poor state of water supply in the wealthier Herzegovinan municipalities and correspondingly better provision in the comparatively poorer areas.

### Summary and conclusions

Foremost, it is important to recognize that in human development terms BiH has made enormous strides since the end of the conflict - and this applies to a variety of capabilities. GDP has partially recovered, and educational and health care facilities are functioning at close to pre-war levels. Moreover, in aggregate BiH has an HDI of 0.784 which demonstrates a consolidation on previous years. Equally, the HPI, which suggests that 14% of the population is living in material deprivation, is far from catastrophic, and highlights that BiH enjoys considerable social equity. Similarly, the gender indices, and especially the GDI and GEM paint a relatively favourable picture of gender relations and the position of women.

However, four issues must be borne in mind alongside these conclusions:

- First that the data sources which underpin these findings are evidentially weak, and as has been explained, much of the improvement in HDI in recent years owes to much methodological changes. It should always be borne in mind that the indices are only a guide to the level of human development.
- Second, although there has undoubtedly been recovery and progress in the post-war period, BiH now lags behind its former Yugoslavian

partners, and the rate of improvement has levelled off in many dimensions. This is particularly pertinent in examining the education and health sub-indices. There is always a natural drift upwards in health measures, given improving technology and living conditions. The same is true in education, as literacy is weakest amongst the elderly population. Yet in spite of these upward pressures it seems that there is some form of 'deadweight' which continues to act as a drag on economic and social progress.

- Third, that below the state level there are growing disparities, between and within the two Entities. Moreover, these do not necessarily follow BiH's political fractures. The evidence increasingly points a pattern of inequity being rooted in other dynamics, including economic and specific locational factors (such as inadequate infrastructure, remoteness, sparsity and lack of natural resource endowments).
- Fourth, it is also important to have regard for the civil and human rights dimension of human development which cannot be directly reflected in the standard indices. In spite of progressively less fractious ethnic politics, BiH's polity and the public space is still compromised by ethnically-driven parties with disparate agendas. This acts to thwart political voice and empowerment.

In this context, local governance reform has a real primacy, since it has a very clear contribution to make. The benefits of more decentralized administration and decision making in terms of economy, efficiency and effectiveness are well-trailed in public administration theory, but are all the more evident in the empirical environment given by latter

<sup>32</sup> The HPI specification used effectively falls somewhere in between the HPI1 (developing) and HPI2 (developed world) methods - and for example includes access to safe water as a lead indicator.

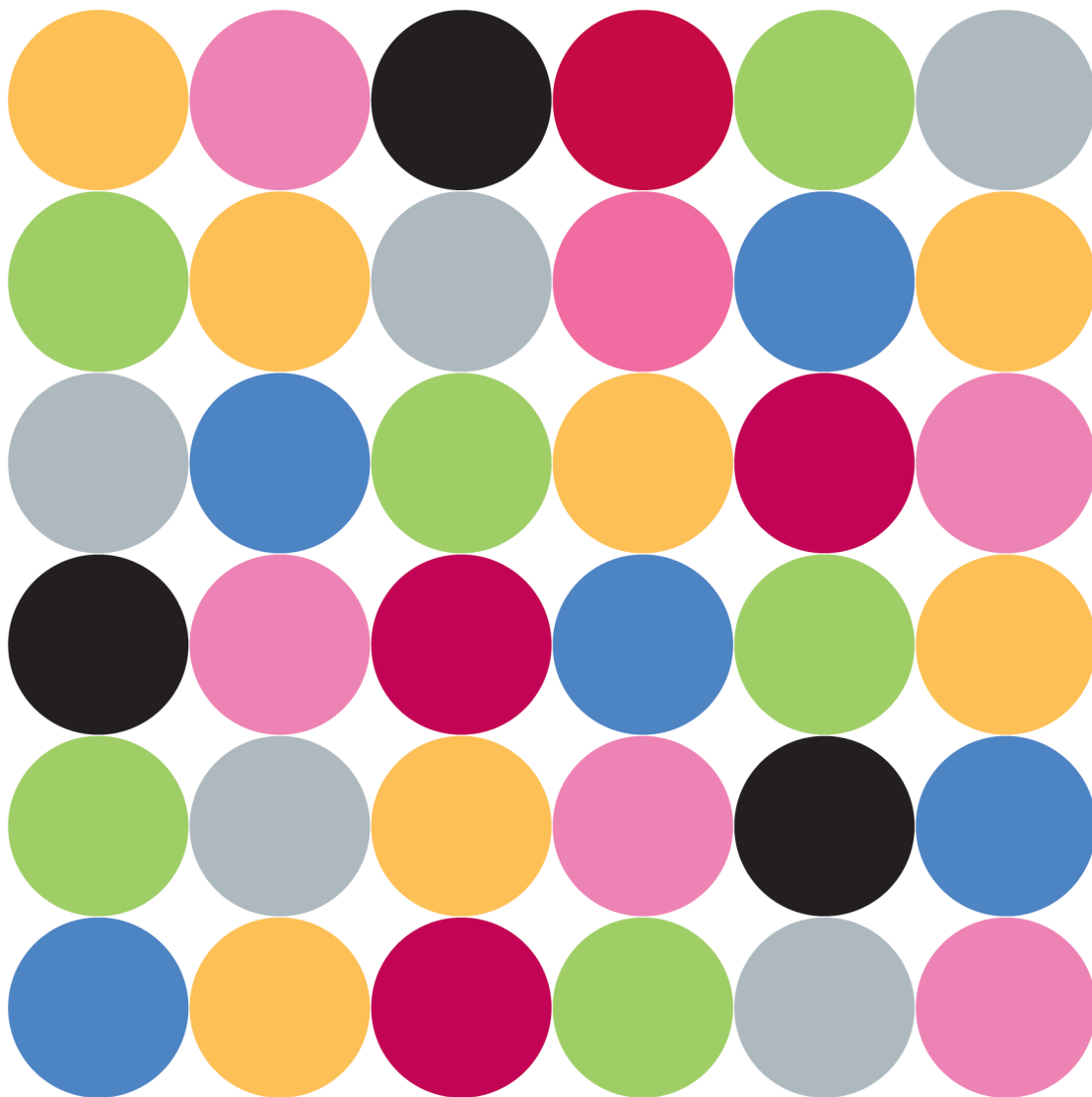
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day BiH. Most of all the discussion above underlines the fact that the real-world development issues - the quality of education, the standard of healthcare provision and the unresponsiveness of public decision making process - do not follow the political fractures. Rather, they affect and limit the potentials of each of the three constituent peoples of BiH. In a sense, decentralization offers the possibility of addressing the developmental agenda by sidestepping the dysfunctional national political space. Local empowerment may also serve to rekindle and build trust in public institutions, which might in time positively affect high-level structures.

Yet the past and politics do matter. The conflict has served to poison many things, perhaps most notably a willingness to share and balance burdens, a principle which runs to the heart of modern systems of local governance. Moreover, it would be naïve to think that the ethnic dimension or allegiances can be wished away or abolished by edict. Indeed, to do so would itself contradict with the right to cultural diversity which is also central to human development thinking. These issues must be resolved through the building of respect and a rights-based system of governance. Independent and strong local authority, regulated by appropriate constitutional guarantees, lies at the centre of such a system. Local governments are not merely more efficient and effective in service delivery but, the world, over serve a key function in representing and mediating difference.



## CHAPTER THREE



BUILDING A RESPONSIVE AND ACCOUNTABLE  
LOCAL GOVERNANCE SYSTEM



## Chapter Three: Building a responsive and accountable local governance system

The drive towards decentralization has become a world-wide phenomenon in recent decades. This process has been led by the conviction that representative government works better the closer it is to the people it serves. Effective decentralization rests on three pillars: the localization of service delivery responsibilities, local determination of resources (both spending and revenue rising), and the devolution of wider decision-making powers.

Decentralization is fundamentally different to de-concentration. The latter refers only to the delivery of functions via smaller units, with policies and decisions still made by central authorities. In contrast, decentralization requires the allocation of powers among the various tiers, based on guaranteed local freedoms. For decentralization to work as means of strengthening democracy and improving the quality of life enjoyed by citizens, some basic conditions have to be established. Local governments must have an adequate set of competencies and capacities that allow them to shape civic life in their communities. Furthermore, the framework should supply the right sort of incentives for local leaders, focussing their attention on goals and longer time horizons. Sadly, the system in BiH today is far from meeting such expectations.

The core problems in BiH have a systemic character. Both the state level and local governments are weak. The former has only residual power and cannot fulfil its necessary regulatory and distributive functions, whilst municipalities operate in a complex and often hideous web of intergovernmental relations. In most cases they are merely the implementing agents of upper-level governments, and it is they who make the important decisions. Municipalities lack resources, professional capacity and are often

'captured' by local elites. There can be no doubting that BiH is in need of administrative reform.

Some leading opinion makers in BiH have argued that decentralization can only follow centralization - that localization incurs risks and strengthening the state level is a pre-requisite. Yet we see no reason to delay decentralization. Strengthening the state and local levels are not conflicting goals. There should be no political and administrative reform envisioned first, and then decentralized after. The public administration reform process itself should be a genuinely decentralizing movement.

As Amartya Sen, the Nobel laureate and 'father' of human development thinking commented:

*"In earlier times, there were lengthy discussions on whether one country or another was yet 'fit for democracy', for example, the British discussed it regularly in denying India independence. That changed only quite recently, with the recognition that the question itself was wrong-headed: a country does not have to be judged to be fit for democracy; rather it has to become fit through democracy."*<sup>33</sup>

We believe these sentiments are as pertinent to local democracy: power must be decentralized so that local leaders and local governments become important engines of democratization, renewal and development. In this chapter we identify the major systemic obstacles within the current framework and set out plans for change.

We will focus on the potential of stronger local democracy for supplying better opportunities for communities. Our proposals are not limited by current local capacities, and we make recommenda-

<sup>33</sup> Excerpt from a presentation by Sen on Democracy and Social Justice, delivered at the Democracy, Market Economy and Development Conference, Seoul, Korea, February 1999.



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tions to create the system BiH requires if performance and the quality of democracy are to be improved. First, we will describe the administrative and legal system in which local governments operate, then we look at the fiscal framework. This is followed by an appraisal of the quality of democracy. In the closing section we summarize the main challenges confronting the local government system and set out possible remedies.

## Legal and administrative framework

This section picks up where our general discussion, in the Introduction, on the BiH constitution left off. Here we provide an overview of the definition of local competencies, the distribution of power and the quality of independent self-governance. We begin by discussing the current situation in each of the Entities, this is followed by proposals for reform.

### Legal framework in the Federation of BiH

In the Federation there are entity and cantonal regulatory frameworks.<sup>34</sup> At the entity level, the

key statute is the law on local self-government dating from 1995, which provides a very general framework for intergovernmental relations: the cantonal laws are the more significant in regulating the nature of local self-government. The FBiH law provides general principles, defining the main competencies of municipalities, their financing, and the forms of direct participation in decision-making. Elections are also regulated through laws made at entity level. In the FBiH both parties and individuals can compete for elected positions. Up until 2004, Mayors were elected by assemblies of representatives, they are now directly elected.

A review of the competencies enumerated in the federal law reveals a sizeable level of duplication between the competencies of local and cantonal governments (see Table 2.1 below). As demonstrated in the analysis of the various local services and activities in Chapters 3 and 4, this overlap is more than merely wasteful but counterproductive. It effectively ensures that many of the services which localities are permitted to perform represent merely de-concentrated, agency-type functions in the key service areas.

<sup>34</sup> Cantonal laws on local government further elaborate Entity laws and specify: the competencies assigned to municipalities; methods of direct participation in decision-making processes (local assemblies, citizens' initiatives and referendums); procedural arrangements; and rules for establishing Mjesne Zajednice (MZs)

Table 3.1: Definition of local government competencies in FBiH

ENTITY CONSTITUTION	LAW ON LOCAL GOVERNMENT
<ul style="list-style-type: none"> <li>• Stipulates that local self-government is to be implemented in municipalities, which will have statutes in accordance with the FBiH constitution, cantonal constitutions and laws.</li> <li>• Defines municipal administration, by outlining the main competencies of municipal assemblies, mayors and municipal courts.</li> </ul> <p>(Article 2 (VI) of the FBiH Constitution)</p>	<ul style="list-style-type: none"> <li>• Protects human rights and fundamental freedoms;</li> <li>• Duty to satisfy local needs of citizens in the fields of child care, education, work and employment, social care, culture, physical culture and sports, etc.;</li> <li>• Conduct urban and housing policy relevant for the municipality;</li> <li>• Manage municipal property;</li> <li>• Perform communal and other service activities, and those of local infrastructure;</li> <li>• Take care of tourist resources of the municipality;</li> <li>• Ensure utilisation and management of the local construction land;</li> <li>• Ensure public peace and order, etc.</li> </ul> <p>(Article 8 of the FBiH Law on bases of local self-government).</p>

In general the legislative practice of cantonal governments does not give due recognition to the status of local government, and local autonomy is extremely limited. It is also apparent that the federal authorities exercise little power in protecting localities from the cantonal governments, and little harmonization takes place. Thus the quality and standards of local self-governance vary greatly throughout the FBiH.

This lack of recognition of local governance and the vague and overlapping definitions of competences is felt through serious management and service delivery failures. Cantonal governments

regularly interfere in municipal competencies, violating their property rights, failing to provide adequate financing for the implementation of public services, and effectively undermining the functioning of municipalities in the Federation.<sup>35</sup> In addition, federal law does not provide for any legal mechanism to enable local governments to assert their rights or arbitrate decisions of the parent governments. There is a prima facie case not only for amending the existing laws, but for changing the whole approach to the regulation of local self-governance. This is pertinent to securing better coordination between local governments, their effective

<sup>35</sup> Statement of the Commission on local self-government of the FBiH Parliament

# Better Local Governance in BiH

independence, and as we will see, their financial sustainability.<sup>36</sup>

BiH's accession to the Council of Europe (CoE) has had an important influence on the development of law in this area. A post-accession requirement was the reform of relevant legislation to comply with the European Charter on local government. The FBiH Parliament is currently making amendments to establish a better definition of local self-governance. Yet according to an assessment published by the CoE, the draft law still remains too open to discretion on the part of the Cantons and thus lacks procedures for ensuring harmonization.<sup>37</sup>

More specifically, the CoE raised questions about the legal distinction between the three types of local authorities (cities, municipalities and city-municipalities), territorial organization, scope and procedures of administrative supervision, local government resources and finances, and the status of local elected representatives and staff.<sup>38</sup> Given the nature of these objections and their essentially negative appraisal, it was decided that the statute would not be further developed. Instead, a working group consisting of relevant experts and local

government representatives has been tasked with preparing a new version. This development signals a significant delay. It also has to be remembered that legal reform in the FBiH requires not only the adoption of an adequate framework on the federal level, but also subsequent harmonization of all cantonal provisions.

## **Legal framework in Republika Srpska**

In the RS, regulation of local self-government rests with the Entity government. The law allows local representatives to be elected both as individuals and from party lists, and for mayors to be directly elected. The current law was adopted in November 2004 and has been in effect since the beginning of 2005. Representatives from local government have participated in the drafting of the law, alongside experts from the CoE, with the aim of ensuring complete compliance with the European Charter. In contrast to the FBiH findings, assessments from the CoE are generally positive<sup>39</sup>. The innovations arising from the newly adopted law are given in Table 3.2, alongside those granted under the constitution and the pre-existing legislation.

<sup>36</sup> The FBiH Constitution, as well as the constitutions of some cantons, obliges cantons to transfer certain competencies, which relate to education, culture, tourism, local business, humanitarian activities, TV and radio to a municipality within its territory, in cases when the majority of population in that municipality is of another nationality than the canton as a whole. Although there are two areas where this has been proposed (Drvar and Žepče), implementation has not taken place.

<sup>37</sup> Legal Appraisal - Law of the FBiH on local Self-government and amendments (CoE, CDLR, Programmes Democratic Stability) March 2004, pp.1.

<sup>38</sup> Ibid. p. 2

<sup>39</sup> For example, the suggestion by the CoE that the local authorities should have the right to set the rates of revenues was accepted for local taxes and fees (Article 6 of the Draft law on local self-government).

Table 3.2: Definition of local government competencies in the RS

ENTITY CONSTITUTION	PAST LOCAL GOVERNMENT LEGAL PROVISIONS	INNOVATIONS FROM NEW LOCAL GOVERNMENT LAW
<ul style="list-style-type: none"> <li>• Design of local development programmes;</li> <li>• Adoption of the urban plan and budget;</li> <li>• Regulation and implementation of communal services;</li> <li>• Regulation of municipal land and construction;</li> <li>• Maintenance and use of local roads, streets and public buildings;</li> <li>• Satisfaction of citizens' needs in areas of culture, education, health, social protection, sport, information, and tourism;</li> <li>• Protection of the environment and other areas;</li> <li>• Establishment of municipal public institutions, organizations and services.</li> </ul> <p>(Article 102 of the RS Constitution).</p>	<ul style="list-style-type: none"> <li>• Adoption of a development programme;</li> <li>• Adoption of development, urban and implementation plans;</li> <li>• Managing and ensuring the best use of construction land and business premises;</li> <li>• Organization of communal police and other inspection bodies;</li> <li>• Organization of delivery of utility services;</li> <li>• Construction, maintenance and use of local roads, streets, and other public buildings;</li> <li>• Satisfying the local needs of citizens in culture, education, sports, health and social protection, information, tourism;</li> <li>• Undertaking measures for the protection of the environment.</li> </ul> <p>(Article 5 of the pre-existing RS Law on Local Self-government)</p>	<ul style="list-style-type: none"> <li>• Regulatory actions and municipal administration (including adoption of municipality development programmes, urban plans, issuing permits, establishment of communal police and other inspection authorities, inspections);</li> <li>• Service provision (specific functions in the area of culture, education, sports, health, social care, civil protection, information, tourism, environmental protection; organization and performance of utility services);</li> <li>• Legal services;</li> <li>• Public information;</li> <li>• Protection of citizens and material goods from natural disasters.</li> </ul> <p>(Articles 12-28 of the newly adopted RS Law on Local Self-government)</p>

Compared with the FBiH legislation, the RS legislation is more elaborate. It sets out in detail the competencies of municipalities and cities: 17 articles are devoted to competencies of municipalities, it lists six different types of local revenues and six methods of citizens' participation. In addition, the

authorities are currently undertaking major reforms in sectoral legislation, which once completed will affect the division of competencies and is likely to add to local government functions.<sup>40</sup>

It is worth spelling out some of the key changes in the RS law:

<sup>40</sup> CoE, Appraisal of the Draft Law of the RS on Local Self-government, Strasbourg, 2003.

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- The new provisions define local self-government as "the right of citizens to participate directly and through their freely and democratically-elected representatives in the achievement of the common interests of... the local community, as well as the right and ability of local self-government authorities to regulate and manage, within the limits of the law, public affairs under their responsibility, in the interest of local citizens."<sup>41</sup>
- The law now makes a clear distinction between municipality and city governments<sup>42</sup> and their respective competencies.
- The legislation provides an adequately elaborated list of responsibilities and makes a distinction between different local government units in assigning competencies.<sup>43</sup>
- Municipalities will henceforth only be assigned additional responsibilities following consultations with local governments, in accordance with criteria, and in parallel to the allocation of adequate resources<sup>44</sup>.
- The municipal authorities are given a general competence to deal with matters that have not been awarded to another body (or excluded from the area of their responsibility).
- Although revenue sharing remains derivation based, the law does specify that the categorization of development status, which governs the level of redistribution, will be based on objective, transparent and verifiable criteria<sup>45</sup>.
- The law is much more precise with regard to locally raised revenues. It specifies seven different sources and provides that local gov-

ernments alone have the power to set local tax rates and service fees<sup>46</sup>

- In cases of dispute between the RS government and local governments related to the level of resources for additional competencies, a mechanism of arbitration will be applied. Arbitration will comprise an equal number of representatives of local authorities and the RS government. If it fails, the dispute will be resolved by the higher courts.
- Unlike the former RS law<sup>47</sup>, the current provisions also allow for a court procedure for cases of violation of the rights of local governments.<sup>48</sup>

## Recommended next steps

This short analysis shows that the RS local government law is now much more advanced than the proposals which still remain at the development stage in the FBiH. The main benefits are a new framework and regulatory standards.

However, it has to be appreciated that the law alone cannot create local autonomy. Reform of fiscal and functional decentralization must also advance, with the devolution of further resources and competencies, in order to create effective local service delivery. We consider the law provides an adequate skeleton, which must be added to by the devolution of various functions and the necessary resources along with adequate means of supervision.

The innovations in RS law noted above should also be incorporated into the law still to be elaborated within the Federation. However, the challenge of reshaping FBiH legislation is much more significant, as the regulation of local government is essentially in the hands of the cantonal govern-

<sup>41</sup> Article 2 of the RS Law on Local Self-government - Unofficial translation

<sup>42</sup> The following definitions are given: A municipality is a fundamental territorial unit of local self-government, established for a part of inhabited area, for one inhabited area or more than one inhabited area. A city may be established for urban areas, that represent a coherent geographical, social, economic, historical and territorial unit, with an appropriate level of development.

<sup>43</sup> More clarity does not necessarily mean a rational division of roles among levels - see discussion in Chapter 4.

<sup>44</sup> Ibid. Article 28.

<sup>45</sup> Ibid. Article 67.

<sup>46</sup> Ibid. Article 66.

<sup>47</sup> It devotes five articles to the relationship between local government units and entity institutions, in a way that it prescribes their cooperation and procedures in cases of non-cooperation.

<sup>48</sup> Articles 96 and 97 of the RS Law on Local Self-government



ments. Change can only be implemented through a more complex procedure, which requires more time, resources and not least, the collective political will of both entity and cantonal legislators.

The logical end-game for the local government legislative framework in BiH would be the harmonization of RS and FBiH legislation to the greatest extent possible. This should ensure that the same standards and possibilities of development are afforded throughout the country. Ideally, this should be carried out at the same time or soon after the adoption of the new law in the FBiH.

However, the adoption of revised legal arrangements is only part of the challenge faced in both the RS and FBiH. For the system to function properly, many other measures will also have to be implemented. Reform of the fiscal system (the topic of the next section) is of the utmost importance. Moreover, sectoral reforms will be discussed in Chapters four and five. These proposals will have important implications for specific local responsibilities, and thus will also result in changes in the main local government statutes. Some of these reforms will most likely take place in parallel and in an ad hoc manner. The adoption of a proper framework law in both entities will accelerate progress on all of these matters. Throughout the process there will be a need to phase and regulate change, ensuring resources and capacities are paced appropriately.

### **The Intergovernmental Fiscal System**

The weakness of BiH's inter-governmental fiscal framework lies at the heart of many of the issues and challenges raised by this report. A lack of

resources and their maldistribution both severely constrains the scope for improvements in service delivery and limits the revitalization of local governance. An effective system of fiscal decentralisation, by which we mean the transparent and fair assignment of spending competences alongside resources and local discretion, is an absolute prerequisite for lasting change.

This section therefore examines the quality of inter-governmental fiscal relations in BiH. We begin by discussing the considerations which mark out effective decentralisation systems, we then review the arrangements currently in place in BiH, and we end by offering analysis alongside proposals for reform.

### **Principles of Fiscal Decentralization**

Sub-national public finance systems typically reflect constitutional structures and are thus extremely varied in character. The more progressive, however, explicitly recognize the value of local governments both in providing local services and in promoting a healthy democracy. Two issues stand out when describing the quality of central-local fiscal relations in a given country; the division of spending responsibilities and their sources of funding between different tiers; and the amount of decision-making discretion permitted to localities.

Best practice the world over provides us with three mutually supporting principles:

- First, it is argued that accountabilities are strengthened where spending competencies and tax raising powers held by the various tiers of government are commensurate. This is termed the correspondence principle.

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- Second, there is the subsidiarity principle which we have already referred to. This is the presumption that decisions are best exercised as close as possible to the people, and it calls for the general devolution of powers to the lowest appropriate level of government.
- Third, the equity principle demands that fiscal arrangements address sub-national variations in needs as well as revenue sources. This requires that fiscal transfers or allowances should be made between the centre and the locality, and between individual localities themselves.

Modern fiscal decentralization systems can accommodate the three principles simultaneously by empowering local governments, allowing them to raise their own revenues and by maintaining equalization mechanisms through tax sharing arrangements or central grants. The matching of resources to needs is referred to as equalization. This takes two forms: vertical equalization - the allocation of resources to different tiers of government to meet spending responsibilities; and horizontal equalization - the compensation of variations in needs between similar units of local government.

Vertical equalization implies local governments should be given sufficient revenue raising powers to cover the costs of their own competences. This can be achieved either by way of a dedicated share of a national or regional tax or by granting sufficient direct tax raising powers. The more challenging question of horizontal equalization requires the design of a needs versus resources determination mechanism. This is generally made up of a funding formula and a system of grants. The more complex of these arrangements include allowances for all

manner of expenditures incurred by local governments and the socio-economic characteristics of their areas, whereas the simplest rely on per capita allocations supported by weightings for special needs.

Equalization is rarely uncontroversial in even the most mature of democracies, since such arrangements require the differential treatment of areas, and inevitably the reassignment of taxes raised in one area for the benefit of another. Indeed, this not only raises issues of competing claims, but also systemic and managerial questions. Fiscal transfers between one group (the payers) and another (the recipients), potentially weaken and distort incentives - and 'cloud' tax and spending accountabilities. Mechanisms need to be found, which compensate whilst also holding local decision makers and managers responsible for their actions. Equalization transfers should be transparent, rules-based and self-limiting.

A further dimension of fiscal decentralization is the ability of local governments to borrow. Borrowing powers are vital if localities are to take the lead in financing capital investment. Yet the exercise of such powers is generally regulated by the centre, as it incurs national macroeconomic risks.

Thus the challenge for any nation is to achieve internal equity through matching diverse needs with resources, whilst also ensuring systems secure efficiency and accountability. Being successful in these endeavours is no small achievement and the policy options available are plagued with debate, but the potential 'pay-offs' far exceed the pitfalls.

### The BiH Context

The sub-national fiscal framework in BiH reflects the complexities of the Dayton constitutional arrangements. With separate systems operating within the RS, each of the ten Cantons in the Federation and Brčko District<sup>49</sup>, BiH effectively has 13 distinct fiscal frameworks. This is unprecedented in a nation of less than four million people.

Practically all taxes are set and raised by the Entity and Canton governments leaving only minor taxes<sup>50</sup> and fees levied by the State (for items such as national passports) and municipalities (property taxes and fees for local licences). By and large, municipalities function with very limited fiscal autonomy throughout BiH: in both the RS and the Federation they have no substantive revenue raising powers of their own, and receive the greater share of their resources by way of tax sharing and transfer arrangements with their respective 'parent' governments. The shares received are for the most part within 'the gift' of these higher level governments, and they can be varied at will and arbitrarily.

Moreover, the aggregate level of public expenditure disbursed at the local level (i.e. after application of the tax sharing arrangements) is strikingly low, at only 7.9% of total public spending in the FBiH and 8.1% in the RS<sup>51</sup>. This represents approximately 5% of Entity and national GDP. In spite of this, much service delivery does take place at the local level, but is resourced via direct Canton and Entity monies funnelled to institutions and other service delivery units via extra-budgetary funds which never formally touch municipal budgets.

The tax shares received by municipalities in both the RS and in the FBiH are calculated on a derivation basis (i.e. they are a fixed share of revenues

collected within their respective boundaries) and the level of resources available to individual local governments varies hugely. As a result there is a high level of inequity, particularly within the Federation. A proper examination requires we analyze the position at the sub-national level.

### National Value Added Tax (VAT)

However, before this, it is important to note that the proposed introduction of a state-level VAT and the abolition of Entity and cantonal sales taxes will radically reshape the fiscal landscape. Beyond broad agreement on the Entity-level shares, the precise means of allocating VAT revenues to sub-national and local governments have not yet been resolved. Moreover, the very nature of VAT, with its multi-stage incidence and collection, makes it a difficult tax to apply the current derivation-based sharing arrangements to. The national VAT system is planned to come on stream in January 2006, and this provides a further and urgent impetus for reform.

### The Federation

The ten cantons of the Federation each have an operationally separate fiscal decentralization system. The FBiH constitution operates via a 'cascading principle' by which all powers and competences not granted to the Federation accrue to the cantonal governments and all remaining powers to the municipalities. Although superficially decentralizing, this principle favours the Cantons. These administrations effectively determine the fiscal environment within which local governments operate.

As is apparent from Table 3.3, which summarizes the distribution of the main revenue raising powers, the only revenues set and raised locally are fees

<sup>49</sup> As the District of Brčko is a specific case, in the following sections we focus on the two Entities.

<sup>50</sup> The only exceptions are customs taxes which are set at the state-level but accrue to the Entities

<sup>51</sup> See World Bank (2002)

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and charges and a number of de minimis taxes delegated by the Cantonal authorities. The most significant of these is the property tax, but several

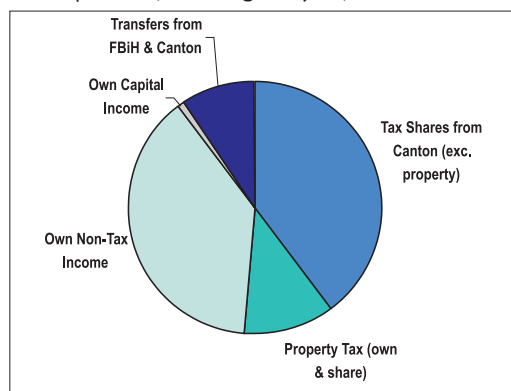
Cantons appear even to set the property tax rate and merely delegate 100% of the proceeds to localities.

Table 3.3: Distribution of FBiH Revenue Sources

Federation BiH	Canton	Municipal
<ul style="list-style-type: none"> <li>• Profit taxes (large enterprises)</li> <li>• Custom duties</li> <li>• Excises</li> <li>• Federation administrative fees</li> <li>• Federation courts' fees</li> <li>• Fines under federation regulations</li> <li>• Revenues from natural resources</li> </ul>	<ul style="list-style-type: none"> <li>• Other revenues to Federation</li> <li>• Enterprises' profit tax (SMEs)</li> <li>• Payroll tax</li> <li>• Fines under cantonal regulations</li> <li>• Sales taxes</li> <li>• Ad hoc fees and charges</li> </ul>	<ul style="list-style-type: none"> <li>• Fees and Charges for licences, utilities &amp; so forth</li> <li>• Delegated taxes (usually local property tax)</li> </ul>

The balance of funding generally favours the centre. Around half of municipal monies come from higher level governments (either as shared taxes or direct transfers from the Federation<sup>52</sup> or Cantons<sup>53</sup>): a further 15% or so is raised from property taxes (which can be either determined locally or set by the Cantons): thus only around 30% is genuinely locally generated (predominantly fees and charges). Charts 1 and 2, depict the funding breakdown for 2003. The first illustrates the shares without the data for Sarajevo, which has no formal tax sharing arrangement and supports its municipalities with a large cantonal grant. A sample of FBiH municipalities for 2003 confirmed these shares, but also revealed a considerable variance amongst respondents<sup>54</sup>.

Chart 3.1: Revenue Sources for FBiH Municipalities (excluding Sarajevo)

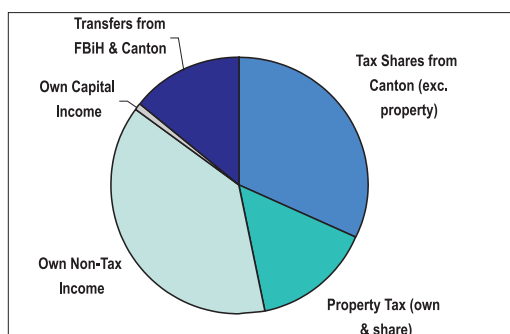


<sup>52</sup> These are ad hoc and made intermittently to 4 to 5 'weak' municipalities: the total level of support in 2003 was less than 1 million KM (Federal Finance Ministry).

<sup>53</sup> In 2003 cantonal grants were 44 million KM in total, but of this 23 million related to the Sarajevo central grants, which operate in place of tax sharing.

<sup>54</sup> 16 representative municipalities within the FBiH: Cazin, Bihac, Gradačac, Tuzla, Ključ, Žepče, Zivinice, Kladanj, Visoko, Ilidža, Novi Grad Sarajevo, Pale FBiH, Široki, Brijeg, Foča FBiH, Neum, Stolac

Chart 3.2: Revenue Sources for FBiH Municipalities (including Sarajevo)



Of the taxes shared with the Cantons the most significant is the sales tax, which in 2003 was estimated to have accounted for 45% of municipal spending.<sup>55</sup> This underlines the relevance of the introduction of VAT, which will replace sales taxes. The other principal shared taxes (income or salary taxes and taxes on profits) accounted for the bulk of the remaining transfers. These revenue proportions are not unusual in the European context, and superficially at least, appear fairly healthy. However, the allocation system and process is far from ideal, and various weaknesses serve to limit local competence over the budget and contribute to some fairly severe inequities.

Two particular issues stand out. The first is the derivation-basis of the system coupled with the power of the cantonal governments to vary tax shares, without the agreement of municipalities or any external check. This is exemplified by the variety and complexity of sharing arrangements in place. A summary of the different provisions is provided in Table 3.4 below. Although allocations do vary between cantons, they generally do not vary

between municipalities within a canton. But there are even exceptions to this:

- Most significantly, as noted, Sarajevo Canton's municipalities receive subjectively determined grants.
- In Tuzla Canton, different percentages are applied to municipalities. Most receive a standard share but five (Klandj, Celic, Doboj-East, Sapana, and Teocak) are allowed to retain a considerably higher share. It is not clear what underpins this.
- Similar arrangements are in place in Neretva Canton for the Mostar city municipalities which receive lower shares. The apparent rationale is their higher taxable capacity.
- Finally, in the Zenica-Doboj Canton, Zepce municipality receives a further transfer equivalent to a 10% addition to the average received by the other municipalities. This is the result of an OHR imposition associated with the unification of the municipality.

<sup>55</sup> Per sampled data and based on the OSCE municipal database.

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Table 3.4: Summary of Cantonal Tax Sharing Arrangements<sup>56</sup>

Canton	Tax Sharing	% of principal taxes	Delegated Taxes?	Notes/ Exceptions
1. Una Sana	Yes	Sales 20%, Profits 50%	Partial	None
2. Posavina	Yes	Sales 20%, Profits 30%, Salaries 20%	No	Even property tax is subject to sharing
3. Tuzla	Yes	Large range	Limited	Highly complex system: affords five municipalities considerably greater shares
4. Zenica Dobož	Yes	One municipality receives more	Yes	Transfer shares are based on a temporary order. Zepce municipality receives a further 10%. Delegation scheme allows for municipal tax setting.
5. Podrina	Yes	Sales 10-20%, Profits 50%, Salaries 20%	Partial	Not clear whether delegation allows for local determination of 100% delegated taxes
6. Central Bosnia	Yes	Sales 25%, Payroll 25%	Yes	Full discretion allowed for residence tax
7. Neretva	Yes	Mostar excluded	Partial	Complex and non-transparent arrangements applied to Mostar City Municipalities and the Mostar City authority.
8. West Herzegovina	Yes	Sales 20%, Salaries 50%, profits 20-50%	Yes	Most comprehensive segregation of tax competencies within the Cantons - the tax code specifies the taxes accruing to each level.
9. Sarajevo	No	Not applicable	None	Possesses no sharing arrangements, municipalities are funded by cantonal grants.
10. Hercegovina	Yes	Sales 25%, Salaries 40%, profits 20%	Limited	Operates highly complex system. Has the most comprehensive set of specified tax shares - even prescribing property taxes to be shared.

The second issue is the lack of any systematic attention to meeting individual spending needs by way of fiscal transfers from the centre (i.e. the Federal Budget) or between the municipalities themselves. There is some variation in the tax shares applied within cantons and several ad hoc federal and cantonal grants, but the basis of these arrangements is non-transparent, and they have no clear compensatory rationale. Indeed, most appear to be made to cover budgetary deficits and are negotiated on an individual basis with the recipients.

In the language of fiscal decentralisation, there is no effective horizontal equalization. The system both perpetuates and tolerates inequities. An analysis undertaken by the World Bank suggests that per capita municipal expenditures vary by a factor of three to one. The sample of municipalities taken to support this survey indicates that the variation is even larger, reaching a factor of five to one<sup>57</sup>. This is a very sizeable variance given the homogeneity of socio-economic conditions outside the capital city (both the World Bank and our sample specifically exclude municipalities in Sarajevo Canton).

Running in parallel with the complex fiscal arrangements is a considerable level of concurrent service provision, particularly in the social sector. The most significant functions are education and health services, where the Canton typically meets the salary and some operating costs of both schools and local health centres, whilst the municipality meets capital costs (buildings and equipment) and basic running expenses (maintenance, heating and lighting).

The precise picture is difficult to discern and is subject to many exceptions but the formal management of these facilities hangs on who is considered

the founder of the institution. In the main this is considered to be the municipality, and yet regardless, cantonal resources rarely come under the executive control of municipal managements, and do not enter the municipal budget<sup>58</sup>. For the most part staffs are paid directly by the cantonal budget and other monies are expended by the institution concerned as a cost centre within the cantonal budget. These arrangements, like the tax sharing mechanisms described above, are completely opaque and vary between areas. As a result the system serves to compromise political accountabilities. Moreover, they circumscribe incentives to contain costs and secure service improvements.

Finally, it is worth noting that the borrowing powers of municipalities are also constrained and poorly matched to needs. Under FBiH law, local governments are prohibited from borrowing commercially and this is enforced via banking regulations<sup>59</sup>. Municipalities can therefore only borrow from official sources (Federation, canton, other municipalities and accredited international institutions). They can borrow for both current and capital purposes but at any one time the outstanding debt cannot exceed 20% of the revenue budget. The majority of credits are granted by the federal and cantonal authorities, likewise borrowing from international institutions has also to be agreed by the federal authorities - whilst other municipalities generally only lend-on monies to meet short term cash needs.

Thus capital expenditure, and hence investment, is hemmed in by two considerations - the size of the local revenue budgets (itself a product of inequity) and the willingness of higher level governments to grant credits. This raises further equity questions

<sup>57</sup> The World Bank's sample (see PEIR 2002) included 11 municipalities: our survey based on OSCE data contained 16 municipalities.

<sup>58</sup> There are exceptions to this, depending on the canton, in which case these further transfers would be counted as 'other' revenue sources.

<sup>59</sup> Effectively, any such loan would be illegal and therefore non-recoverable by the lending bank.

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and limits the room for manoeuvre enjoyed by poorer municipalities: the borrowing control regime in essence cements the unfairness inherent in the distribution of revenue expenditure.

## Republika Srpska

Although many of the inadequacies observed in Federation also apply in the RS, the position has a different character, being more favourable in some areas and less so in others.

On the positive side, it is firstly clear that transparency is improved by the relative simplicity of RS

government structures. Entity-level tax sharing arrangements apply and local governments are assigned certain taxes by right. Second, the tax sharing percentages are varied on the basis of a systematic method rooted in an assessment of needs. Details of the allocation and assignment of individual taxes within the RS are given in Table 3.5. Again this is a partial listing - the Entity government also collects many minor taxes.

Table 3.5: Tax assignments in the RS

RS Revenues	RS Shared Revenues	Municipal revenues
<ul style="list-style-type: none"> <li>• Customs duties</li> <li>• Excises (except for oil derivatives)</li> <li>• Company Profit taxes</li> <li>• Income taxes (on non-salary income - royalties, patents and technical improvements,</li> <li>• Capital Gains Tax</li> <li>• Tax on movable property</li> <li>• Special tax on railway traffic</li> <li>• Taxes on gaming</li> <li>• Fees, duties, charges, and fines</li> <li>• Revenues from confiscated property and profits (courts revenue - entity level jurisdiction)</li> <li>• Other revenues to RS</li> </ul>	<ul style="list-style-type: none"> <li>• Sales tax on goods and services</li> <li>• Excise on oil derivatives</li> <li>• Road fees</li> <li>• Income tax (on salaries, personal self-employment)</li> <li>• Charges for use of farming land</li> <li>• Charges for extraction of mineral raw materials</li> <li>• Confiscated property and proceeds obtained by sale of confiscated objects, (falling under jurisdiction of the entity market inspection).</li> </ul>	<ul style="list-style-type: none"> <li>• Property tax</li> <li>• Income tax (agriculture and forestry)</li> <li>• Fines imposed in minor offence procedures for offences regulated by municipal enactments</li> <li>• Municipal administrative fees</li> <li>• Utility fees</li> <li>• Municipal fees for use of natural and other resources of general interest</li> <li>• Tax on income from lottery games</li> <li>• Other municipal revenues</li> </ul>



Whilst the RS also maintains the derivation basis, unlike the Federation local percentage shares of the principal tax revenues<sup>60</sup> (the sales tax and the local income tax) are varied according to the municipal 'development status'. This is appraised and assigned by the RS government every three years and is reported to take account of local taxable capacity and quality of the built infrastructure. The various categories and associated shares are<sup>61</sup>:

- Fully developed municipalities (70% central, 30% local)
- Medium-development (60%, 40%)
- Underdeveloped (50%, 50%)
- Exceptionally underdeveloped (40%, 60%)

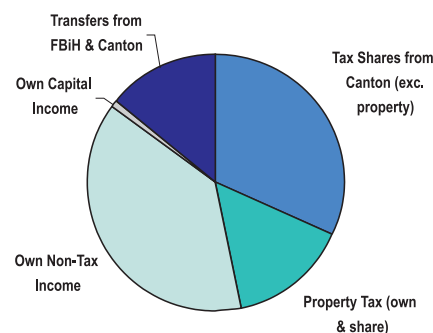
Clearly, this is a very positive development and represents an embryonic form of vertical equalization, which recognises the need for poorer municipalities to retain more of their own revenues. The number of categories specified and the variations in the shares ensures the scheme is fairly progressive.

However, on the negative side, it remains the case that the assignment of municipalities to a particular category lies wholly within the prerogative of the RS government, decisions are subjective and the criteria undisclosed. Thus accountability and transparency are enhanced but remain far from guaranteed. It is also reported that the RS Assembly has arbitrarily varied the percentages received in-year<sup>62</sup>.

More importantly within the RS the share of expenditure directly raised by local governments is very much lower than the Federation - and this somewhat offsets the impact of the clearer assignment basis used. Indeed, as Chart 3 (which is based on World Bank data) illustrates, tax sharing arrangements account for almost 75% of revenues<sup>63</sup>. In

addition, as a further sample drawn for this study shows, there is a considerable degree of inequality between individual local government respondents, but this is less pronounced compared with the FBiH.

Chart 3.3: Estimated Revenue Source Shares for RS Municipalities



Like the Federation, the RS also suffers from the same complex concurrent service delivery arrangements in the education and health sectors. Additionally, RS municipalities face a similarly unfair and restrictive allocation of borrowing competences. Given the lower levels of income and the weaker availability of donor aid, the pressures on capital expenditure within poorer localities are likely to be still more severe.

## Commentary and proposals

It is clear from our appraisal that the current decentralization system across BiH is weak, and that it both breaches principles of equity and compromises the efficient delivery of local services.

Most serious is the inherently low level of fiscal freedom given to municipalities throughout BiH. It must be recognised that both the RS and the Federation represent essentially centralized gover-

<sup>60</sup> The remaining shared revenues are allocated without regard to local development status.

<sup>61</sup> Note: Between the Entity and the Banja Luka city authority, these taxes are shared in the ratio 65 to 35.

<sup>62</sup> As reported by the Srebrenica Office of UNDP.

<sup>63</sup> 9 RS areas sampled: Derventa, Modriča, B.Luka, Ugljevik, Vlasenica, Novo Sarajevo, Pale, Nevesinje, Bileća

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nance structures. Within the RS this position is nakedly clear, whereas within the Federation, it is disguised by the presence of the Cantons. Nevertheless, local spending barely represents 5% of GDP in either Entity, and is a mere 8% of total public spending.

A close second is the alarming level of variation in resourcing levels between local governments of similar sizes and socio-economic conditions. It is of particular concern, that within the Federation, there has been no substantive progress in addressing these imbalances. Local government accountabilities are compromised and transparency is weak. Furthermore, as we will see from analysis of sectoral financing mechanisms in chapter four, the fiscal system provides few incentives for managers and politicians to contain costs.

Two particular factors lie at the heart of the equalization problem: the derivation basis of the tax sharing schemes, which preclude revenue reapportionments from other areas, and BiH's disparate governance structures, which limit the scope of further fiscal adjustments. Both are problematic and are rooted in politics. The derivation principle is far from unusual in Eastern Europe, where transfers between areas were achieved through non-transparent ad hoc arrangements made within bureaucracies. Indeed, their 'uncloaking' contributed to the controversy and instabilities which consumed the former Yugoslavia. The subsequent conflict has served to limit both the public's and politicians' appetite for fiscal solidarity. The Dayton structures, and particularly the cantonal structure within the Federation, further compromise the position by confining the resource sharing potential to small and often economically homogenous areas. It is

unsurprising therefore that the embryonic equalization arrangements adopted in the RS are more advanced.

Resolving these issues will require a political response and the building of a new consensus. This will not be easy, but the developmental payoffs, not least the economic ones, are likely to be sizeable. The gains to be had from genuine devolution - the granting of revenue-raising powers and the establishment of cross-municipality, cross-canton and in time and with consent, cross-entity equalization, need to be strongly advocated.

Two unrelated developments may assist this process. The first is the introduction of a health solidarity fund within the Federation that equalizes provision between cantonal health insurance funds, which provides a template for action. The second is the growing prominence of state level reforms, and in particular the introduction of the state-level VAT. Indeed, paradoxically, the central BiH state has much to offer the debate over central-local relations; it could act as the facilitator of change and a neutral arbiter in the process of reassigning greater revenues to, and between, municipalities. The introduction of VAT will necessarily require the redesign of the current tax sharing arrangements, and thus provides an opportunity for wholesale reform. It is recognised however, that the development of a fully fledged equalization system will have to be built progressively and with the consent of the three constituent peoples. Moreover, reforms will have to be accompanied by an adequate means of regulation and the building of municipal financial and managerial capacities.

There are four immediate steps which can be taken to begin this progress and deal with the con-

fused accountabilities and inefficiencies which are currently evident:

- Both Entity governments should give attention to the very low share of resources spent and raised locally, examine the scope for fully devolving taxes to municipalities and enable them to more effectively exploit their existing revenue-raising competences. The obvious candidate for full devolution is the local property tax. Within the FBiH cantonal governments should be encouraged to replicate the approach adopted by the RS in setting systematic tax sharing percentages, which benefit economically weaker and poorer areas. The RS should, at the same time, rationalize and publish the criteria by which the categorisation scheme operates and justify where deviations have occurred. In addition, it should institutionalize procedures for consultation with municipalities, permit appeals and operate damping arrangements for changes in status.
- Higher level governments and donor organizations should be encouraged to conduct reviews of the current distribution of functions and revenues and link improved service-delivery with the realignment of revenue competences. In keeping with recommendations made elsewhere in this report, this should be on the basis of expanding local provision (for example in health and education sectors), ensuring that funding keeps pace with changes.
- Third, high level attention should be given to the capital expenditure needs of local governments and how this might be accomplished in line with good managerial practice and within

macroeconomic limits. A review sponsored by the International Financial Institutions and a leading state agency may be the best vehicle for this.

- Fourth, statistical resources should be deployed to support a future equalization mechanism and debate initiated on possible models. Implementation of a fully functional system will most likely require demographic data which can only be established from a population census (see Box 2). Equally, a municipal recording system will be required to map budget allocations and the key cost drivers. This requires a mammoth effort, not merely on the part of statistical agencies, but also to improve the quality of administrative data collected by line ministries.

The preparations described above can begin now. With adequate sequencing and management, there are no reasons why these reforms, which underpin a myriad of other issues, should not be successful.

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## **Box 2: Census**

The war in BiH produced large movements of people and resulted in significant changes in the distribution of the three constituent peoples. Yet almost a decade after the war there is no reliable estimate of BiH's population. The last census took place before the war, and today there remain only broad estimates ranging between 3.4 and 3.9 million people. Without basic data, accurate measurement of development performance or the implementation of planning and distribution mechanisms (for example a fiscal equalization system) are utterly compromised. Return of refugees and displaced persons has all but practically been completed. However, external and internal political forces are still hesitant to carry out a full census.

### **Last census in 1991**

The 1991 census presented BiH as a multi-ethnic society, with only few territories where a single majority predominated. It also showed a growing number of people that declared their ethnic belonging as 'Yugoslavian', rather than one of the three national groups. The pre-war census also has a political primacy, as it remains the basis for deciding the proportionality enshrined in the Dayton Accords. Thus any new census threatens to unravel the political settlement.

### **War gains and population estimates**

The Dayton Accords obliged each side to permit and facilitate the full return of refugees to their pre-war homes. The key component, the return of property, was for the most part obstructed by local leaderships, and was implemented only when the International Community took control. However, the obstruction was long enough to discourage large numbers from returning. They instead sold their properties on, often at financial loss, and moved elsewhere. After these changes, without objective measurement, it is difficult to estimate the ethnic structure of different localities. This situation gives ample room for the use of conflicting estimates to serve political interests.

### **Political dimensions**

Discussion over the need for a new census is attracting growing national attention and has been debated at the state level. The International Community is reticent but supportive of a census taking place during the next international round which begins in 2010. There remains concern that the results might hinder national consolidation. Equally though, the lack of a census muddies the waters on the success of many initiatives, especially the returns process.

The motivations of political forces remain somewhat in conflict. The 1991 results serve a variety of official purposes - notably for voters' lists and the calculation of proportional representation shares. Yet these percentages likely bear little correspondence with reality. Serb political parties are arguing hard for a census as they predict Serbs represent a greater majority in the RS. Bosniak parties are cautious,

fearing the results might legitimize ethnic cleansing. Croats have similar doubts and fear the effect of migration. It is thus difficult to envisage how a consensus might emerge.

### **Potential steps**

BiH faces a difficult dilemma: the results of a new census might endanger stability, but it is impossible to plan and implement reform without reliable information. The solution might be to make the process as technical as possible and avoid the direct measurement of the ethnicity. Yet this is potentially neither a cost effective nor technically adequate solution. Measurement of ethnic belonging will have to take place sooner or later, and residence will practically confirm BiH's ethnic composition. It seems genuine political compromise and leadership is required. Growing European integration offers the most promising motivating force, since a census will prove a near essential statistical asset for EU accession.

## **Democratic accountability and participation**

Having examined the legal framework and inter-governmental fiscal relations, it is logical to take a closer look at the local political environment. The political context and culture of the localities in BiH very strongly affect what can be achieved. Here we comment on the local political stakeholders and then the quality of democracy. Sketching the web of interests and relations will also help to understand local government performance in later chapters.

First, however, we have to make a major proviso. It is inevitably difficult to support statements in this domain with hard facts and precise data. Little positive research has been made into this subject in BiH. The Rights Based Municipal Assessment Project (RMAP) programme of UNDP has provided a wide array of municipal case studies that can be used to support our review, but this research is far from a systematic analysis. As cases are only of illustrative strength, we list them within the footnotes and strongly suggest readers also review these in order to obtain a deeper understanding of the issues at stake.

## **Stakeholders in the local political arena**

There can be no doubting that even at the local level BiH's atypical political situation calls for specialized administrative structures. It is highly questionable however whether the current arrangements are up to the job.

### **Political parties**

During and after the war, the three nationalistic parties controlled the majority of municipalities in BiH and by and large, governed in the interests of the respective dominant majorities. In many municipalities distant from larger centres, local leaderships have not changed since the end of the war, and ethnic power-groups often gathered around private economic interests, established complete control over municipal affairs. In larger centres, discrimination and the misuse of power was less marked. This was due to a higher International Community presence, a stronger civil society and media scrutiny. Moreover, in those areas where multi-ethnic parties (essentially the SDP) were able to take power, they often purposefully appointed

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mayors that were from minority ethnic groups within the given municipalities. These decisions sent important messages regarding the possibility of political influence and participation regardless of ethnic identity. Sadly, it is unlikely this practice will continue under the current system of directly elected mayors as the majority of BiH voters still tend to vote on ethnic lines<sup>64</sup>.

Single-party domination of local politics has a detrimental effect on local policy making. First and foremost this makes politics non-rival - decision-makers no longer need the support of grass-roots voters, as they are effectively guaranteed power by their 'party machines'. Within political party hierarchies, divergent opinions and initiatives are not welcome. Within the hierarchies themselves, small interest groups are formed by sub-elites further distributing power in a non-transparent manner. Even though opposition parties can present some threat to this system, in reality these challenges are more often than not, clashes of competing power-groups than evidence-based. These processes are far from those which build democracy.

New political forces and strengthened political competition is necessary to break up this structure. The possibilities for breaking with the past are far greater at the local level where entry is less costly. Change within localities, can make an important contribution to the wider democratization process and this would be supported by open candidate lists and direct elections.

## Local leaders and representatives

There is a clear local accountability problem in BiH. Most local politicians are elected through the lists of the dominant nationalistic parties. Consequently, they owe their allegiance to party

headquarters rather than to their constituencies. Electoral law reform might offer opportunities to other political forces as well. Candidates who run independently, or are supported by coalition of less powerful parties, or issue-motivated NGOs, can be key drivers for change and the emergence of a more transparent political competition based on concrete and locally-relevant programmes. These candidates are generally more inclined to take account of the local arena and can provide a higher level of community participation in politics. However, these alternatives<sup>65</sup> have a far harder time succeeding in elections - they have less money and fewer media contacts. Political visibility and voter motivation is difficult. In order to afford better chances to non-affiliated candidates and open up political competition, new instruments of support and campaign regulations should be adopted.

Another condition that impacts negatively on local decision making is the absence of municipal assembly members representing geographic wards<sup>66</sup>. Assembly members reporting to constituencies are more likely to communicate with their electorates better. This includes channelling information to key groups, increasing local communities' understanding of municipal policy choices, and the assembly's understanding of local priorities. This is the heart of the community representation function, and a cornerstone of a functioning local democracy.

From 2004, mayors in both Entities have been directly elected. This development, although it has some potential to solidify nationalistic identities, is in general to be welcomed. It represents an attempt to reduce the influence of dogmatic political parties and to curb some the power of local strongmen

<sup>64</sup> This statement can be supported by analysis of party candidates for 2004 elections. The current mayor of the Centar Sarajevo, Ljubisa Markovic, a Serb, decided not to run. In spite of impressive results, it is unrealistic to expect that the majority would vote for a candidate of a minority group.

<sup>65</sup> It is promising that 180 independent candidates registered for the local elections this year. Some municipalities, such as Bihać, have more than 5 independent candidates.

<sup>66</sup> Previously MZ delegates were present at assembly meetings bringing in the perspective of local communities.

who accumulated influence during and since the war.<sup>67</sup> Whatever the context, direct mayoral elections increase accountability. However, two important factors can still limit their power. One is external; under current conditions decisions made at higher levels of government can strongly limit the scope for local action. The other is internal; the responsibilities of the mayor and his/ her relations with the municipal council are often regulated by municipal statutes.<sup>68</sup> These statutes can create both 'strong' and 'weak' mayoral positions. In municipalities captured by interest groups, the mayor's power can be limited in order to maintain the status of the ruling group. It is legitimate to surmise that in party strongholds, the 'weak' mayoral position is likely to emerge. It is likely that in such situations, a stronger position might only be secured by legal limitation of local statutes.

### Local bureaucracy

The civil service laws in place in both Entities create very weak incentives for local governments to apply merit-based human resource management practices. Indeed, within particular localities the opposite is often true - political and economic forces create an environment supportive of malpractice, favouritism, nepotism and outright corruption. As a result civil servants do not necessarily have adequate professional or personal qualifications. Moreover, the political environment also places pressure on local leaders to utilize the nominations process and public resources to strengthen political and ethnic alliances. Dependence on party, nationalist, ethnic and personal links diverts the attention of those responsible for public services away from performance. The same sorts of biases are evident in decision making on the allocation

of subsidies. The result is a very low level of trust in local governments and civil servants generally. To break this tradition, oversight and professional education of local public servants and political reforms should be evolved in parallel.

### Citizens

The average citizen in BiH perceives local governments as weak and unable to solve their problems. To an extent this is true, but a supply-side marked out by poor performance is only part of the problem. On the demand side, citizens simply do not understand the competencies or for that matter, the potential of municipalities. In turn civic leaders fail to communicate effectively with citizens, and this leads to them being blamed for problems where the solution lies with other levels of government or in the private domain. In practice both legitimate and misjudged claims feed citizen dissatisfaction.

In cases where municipalities are dominated by particular ethnic groups, the selection of leaders and staff through discriminatory practices also stoke the frustrations and disaffection of national minorities. But equally, majority citizens suffer from the same low quality of service delivered by ethno-politicized local governments. Moreover, in many BiH municipalities, a pervasive perception, real or false, of corruption on the part of local officials adds to a general disillusionment.

Whilst the level of public dissatisfaction is palpable, there is a general reluctance to make use of the available mechanisms for complaint and representation. Part of the explanation for this is citizens' apathy and a disbelief in the effectiveness of official channels of redress. The problem is especially pertinent in smaller municipalities where the municipal administration is a major source of employment,

<sup>67</sup> Smaller municipalities are most susceptible to the stranglehold of local strongmen. In Milici municipality, for example, opposition voices were repressed by all means necessary (RMAP reports on human rights).

<sup>68</sup> The RS Local Self-government law provides that a mayor holds executive power while the municipal council serves as the legislative body. In the FBiH this is left solely to cantonal legislation, and in turn cantons largely devolve this to municipal statutes. This will have to be amended given

recent amendments to the FBiH Constitution and adoption of the law on direct election of mayors.

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and is usually closely connected to other public and private employers. Since citizens are afraid of being singled out as 'troublemakers' they hesitate to make official complaints. The perceived repercussions include forms of victimization ranging from discrimination in employment, to denial of basic services.

## Businesses

The political behaviour of the business sector is similar to that of citizens. Unfortunately personal connections and relations are still often safer and more effective solutions for achieving commercial goals than following the rules. The old culture of mutual favours between businesses and bureaucracies has built strong local alliances and works against the emergence of a democratic culture of transparency and inclusion. Moreover, cases reported from the field often indicate that small business owners are hesitant in representing their opinions and interests because of the fear of a backlash from local 'strongmen'. Businesses are in most cases only contacted by municipal officials for financial contributions, and they are rarely consulted, or involved in community affairs. Nevertheless, there are also some promising cases studies which show that the setting up of inclusive goal setting process-

es can be an important step in breaking down the alliances between vested interests and thus reducing the room for bias and corruption<sup>69</sup>.

## Mjesne Zajednice (MZs)

MZs are a form of community governance which might play a positive future role in building participation and grass-roots local democracy. MZs are semi-official community associations established on a voluntary basis. They are a less formal variant of the French Communes or British Parish Councils. MZs have their roots in the former Yugoslavia and the majority of municipalities in BiH have decided to preserve these arrangements and use MZs as a tool for citizens' participation. (See Box 3 on MZs).

Their most important role is in rural areas where communities recognize and respect the MZ model as a means of solving problems. The MZs generally work with local government support but they also function where none is available, and tend to develop a sense of self-reliance. As MZs have proved themselves as effective in mobilizing citizens to take part in decision making and joint activities, many commentators believe they might provide a source of democratic pressure for change. We return again to their use in the section on local government management in Chapter 5.<sup>70</sup>

<sup>69</sup> Drvar Municipality has engaged a good number of SMEs in drafting economic development plans.

<sup>70</sup> Sevarlije MZ represents Bosniaks in Doboj municipality. The MZ existed prior to 1992. During the war the representatives kept in contact while in exile. After returning to their destroyed village all reconstruction efforts were directed by the MZ.



### Box 3: Mjesne Zajednice (MZs)

Before the war in Bosnia and Herzegovina, Mjesne Zajednice were a traditional means of community governance. Established on a territorial basis and focused on local issues, MZs were represented within decision making processes and crucially helped plan and implement local infrastructure projects (particularly local roads and water supplies). MZ representatives served as an intermediary between citizens and municipal administrations and were especially important in rural areas, where they represented the main tool for communicating and addressing citizens' needs. They had their heyday in the 1970s, rapidly developing throughout the former Yugoslavia.

During the period after the war MZs were neglected both by local leaders and donor programmes. Most of the efforts to foster local democracy which were led by the international community, focused on the development of new non-governmental organizations (NGOs). Two years ago, donors turned their interest towards local governance, and MZs presented themselves as a possible mechanism for increasing citizen participation. The current legal framework is permissive in both the FBiH and RS, but does not purposefully encourage their formation. The new self-local governance laws assign the regulation of MZ activities to local statutes. In post-war BiH, MZs by and large, do not have legal personality and have not maintained the importance they once had. In addition, a large number of rural areas were abandoned and economically devastated - this is one of the major reasons for a lack of 'bottom-up' pressure to reinstate the MZ as an mechanism of grass-roots governance.

Nevertheless, a large number of municipalities in BiH have decided to revive and build on the MZ tradition, using them as forums for citizens' participation.

### NGOs

After the war many NGOs were established through donor programmes. Unfortunately most have remained weak. The ones that have survived and prospered are those that are issue-based, like Ostanak (Stay in place)<sup>71</sup>, or Majke Srebrenice (Mothers of Srebrenica)<sup>72</sup>. The key attribute which makes these groups stand out is their commitment to their communities and causes. Yet even these NGOs are at risk. Their dependence on declining international donor funds leaves them at the mercy of local governments. Often, municipalities do not have the funds or the political will to support the voluntary sector. Clearly, a more balanced 'palette' of NGOs would not only assist local service deliv-

ery, but might also result in balancing problematic political influences. Fair and transparent procedures for the allocation of funds along local strategies would reduce their exploitation by special interests.

### The quality of local democracy

Capture of local governments by parties and local interest groups, distorted accountabilities, professionally weak leaderships and bureaucracies, citizen and business apathy, clearly wont provide the foundations for a promising environment for political participation. The first minimal step towards stakeholder participation in community affairs should be securing improvements in the transparency of the public policymaking and management processes.

<sup>71</sup> Ostanak (the remainders) is the biggest NGO in BiH and represents Bosnian Serbs who wish to remain in the municipalities from which they were displaced.

<sup>72</sup> Majke Srebrenice is an NGO representing women who lost family members in the genocide.

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Yet as long as accountabilities are not directed towards constituents there is no clear motivation for local leaders to provide greater transparency, since this would inevitably reveal the biases and the exploitation of public resources for special interests. Equally, citizens too, do not play their part in promoting open and effective government. For instance, in spite of the fact that BiH has a law on access to public information, citizens are often unaware of its existence, or are hesitant to use it. Yet equally, when individual citizens or groups of citizens have asked for public information, officials often obstructed their requests.<sup>73</sup> There are however, a few cases as well when pro-active citizens have successfully fought for their rights. This underlines the importance of a vigorous and motivated civil society and local public space.<sup>74</sup>

Unfortunately the media is not yet an effective force in pushing for democratic minimum standards. It does not play an active role in fact finding, exposing failures, nor in presenting arguments for change. It cannot currently claim to be an advocate, let alone a watchdog, for democracy. Since the end of the war, a large amount of donor assistance has been allocated to the development of an independent media. These programmes have included both support to organizations as well as the education of journalists. At the same time, the strong control exercised by the political parties over parts of the media, and its inherent partisanship, has remained unchallenged. In this context, it is a difficult task to develop quality, independent print and electronic media. In BiH today, there are very few non-aligned and investigative media outlets. The most effective are entity-based magazines and newspapers local equivalents simply do not exist.

Although transparency and communication with citizens are neither part of the traditional culture of bureaucracies, nor part of the motivations driving the major political forces in BiH, it is possible to envisage how participatory practices might infiltrate the body politic. Existing and upcoming laws give ample room for municipalities to improve participation. Moreover, some positive examples of successful municipal efforts and involvement have already emerged. Certain local governments have made important steps in sharing information with citizens. Some have established information centres (Prijedor and Bugojno), some publish guides for citizens (Sanski Most), and in others citizens are encouraged to attend and given speaking rights at municipal assembly meetings (e.g. Trebinje).<sup>75</sup> Besides these examples, larger municipal governments are taking positive steps using PR techniques to communicate with local populations.<sup>76</sup>

Still more positive examples of local action are provided by those municipalities participating in the Rights Based Municipal Assessment and Planning Project (RMAP). This is a joint intervention between UN agencies, the Ministry of Human Rights and Refugees and selected local authorities (See Box 4). The project's primary objective is to secure adherence to human rights standards and principles throughout governance and administrative practices. Importantly, the project has designed participatory processes that seek to avoid capture of local decision making by a single party and special interest groups. This includes the setting up of Municipal Partnership Groups which act as consultative forums between municipal staffs, the general population, the business community, leading NGOs and vulnerable groups.

<sup>73</sup> For example, in Drvar citizens were not given information on the privatization of shops, or the amount of taxes collected at the municipal level. In Dobo, and Derventa large allocations of privately owned land were made for housing displaced persons without properly informing citizens.

<sup>74</sup> For example, citizens in Kotorako, where massive land allocations were made, have petitioned the district court and managed to halt construction on the disputed land.

<sup>75</sup> The Trebinje Citizens Guide explains that the public can be excluded from the sessions of the local assembly when important issues are on the agenda and councillors are obliged to keep the discussions secret.

<sup>76</sup> Centar Sarajevo publishes a newsletter for all citizens and a web-site.

#### **Box 4: The Rights-Based Municipal Assessment Project (RMAP)**

RMAP began as a pilot project between UNDP and the UNOHCHR to examine whether basic human rights were being respected within local governance and administrative practices. Following the initial assessment phase the project moved to support the adoption of rights-based methodologies within local planning and decision making.

Following a comprehensive rights assessment at local level, RMAP teams are presently assisting with the production of municipal development plans. Local ownership, capacity building, awareness raising and inclusion of marginalized groups form essential components of their work. A parallel aim is to empower local civil society to critically and independently contribute to the planning process. The current challenge is to institutionalize the approach within local statutes and operational practices. The following priorities will be addressed in coming years:

- Further refinement and improvement in the coverage of rights-based methodologies;
- Encouragement of linkages to existing planning and budgeting processes in order to avoid duplication and to facilitate access for the identified priorities to other funding opportunities;
- Awareness raising and capacity building of national, entity and municipal staffs;
- Strengthening of citizens and civil society organisations participation;
- Identification of a legal means of anchoring rights-based processes.

#### **Commentary and recommendations**

The overall picture of players in the local policy environment is not a positive one. As is outlined in the Introduction, like the national political arena, the local governance system does not adequately keep in check tendencies for ethnic domination, and the prioritization of special interests to the detriment of community goals. Furthermore, the analysis above has shown that transparency and participation are directly opposed by such group interests, and that party dominance has a detrimental impact both on the motivation of local leaders and the quality of local bureaucrats. In many localities, stakeholder apathy permits the status quo to reassert itself, whilst the poor performance of municipalities only serves to reinforce civic inactivi-

ty. In addition, there is more than a passing connection between the political environment and the quality of municipal management and service delivery. We return to these issues in the next two chapters.

Experience in BiH municipalities is far from wholly negative however, and our review has presented some promising case studies, new initiatives and some significant opportunities for new political leaders. Nevertheless, these positive signs do not change the fact that the current context and the system do not produce fair competition and adequate incentives for local leaders. The challenge facing reform, democratic forces in BiH is to break the political capture of local governments. This is a difficult task because the incumbents are powerful. Yet there are several avenues through which participation might be enhanced and these are addressed below.

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## **Building on rights-based approaches**

Much has been gained from the RMAP initiative in promoting participation and developing a rights-based orientation within the participating local governments. Efforts are now being made to institutionalize the approach within local legal frameworks and to secure a range of funding opportunities for rights-based activities.

Another demanding challenge is the dissemination of these methodologies to other municipalities and wider local government practices. RMAP has provided a useful model, particularly as a means of carrying-out a dispassionate assessment of conditions and the creation of standing consultative frameworks for constructively dealing with shortcomings. The sharing of these activities might be achieved through example and advocacy or ultimately via regulation by higher levels of government.

## **Access to Information**

Public communications strategies are essential. As the analysis of stakeholders showed, citizens'

apathy and a lack of understanding of local governance are also part of the problem. Citizen information and education on local governance, on the tasks, duties and services of municipalities could make an important contribution enabling stakeholders to make informed choices. In practice most municipalities provide some information about their activities through a municipality gazette or via the local media. Some also organize public debates about important issues. Besides these, certain mayors hold surgeries, where citizens can meet and petition them directly.

However, there are also many municipalities where even minimal efforts to provide citizens with useful information are absent. There are many cases where existing official procedures completely neglect existing regulations on access to public information. (See Box 5: Access to public information). These basic requirements need strengthening and enforcing.

## **Box 5: Access to public information**

Between 2000 and 2002, BiH enacted comprehensive legal reforms on public access to information at both the State and Entity levels. Underpinning these laws is the recognition that officially-held information is a public good - and that access promotes transparency, increases accountability and strengthens democratic practices. The law grants individuals the right to freely obtain information, and places an obligation on public institutions to provide access on request. The law also requires the publication of certain information on a regular basis. The State and Entity Ombudsmen's offices are tasked with monitoring implementation.

Initial assessments of the laws have been very positive. They are in line with European standards, and provide for clear and well-defined procedures. Nevertheless, some critics have argued that their usefulness and real impact is questionable - given BiH's weakly developed political culture, the poor quality of public administration and the inadequacies of public law. Indeed, the potential re-interpretation of legal provisions and the extent of exceptions which might be granted by the courts have attracted particular

criticism. As with other administrative reforms, the force of freedom of information legislation lies in its effective implementation.

In addition to supply-side issues there is also a demand-side challenge. Citizens and civil society have remained generally passive and have as yet, failed to fully exercise the access to information rights they have been granted. Two factors may underpin this. Firstly, they have not been adequately informed about these rights, and secondly, they are not confident about the official response to such requests. Both of these issues need to be addressed, if the full potential of these kinds of reforms is to be realized.

### Consultations with MZs and NGOs

As a form of community governance with traditional roots, MZs offer an ideal vehicle for gaining citizens' participation. Several localities have moved to exploit this potential, two innovative examples are:

- In Brcko District, MZs have been registered as NGOs, giving them legal personality and hence, the ability to implement projects, and own property.
- In Novi Grad Sarajevo, formal consultations are undertaken between municipal officials MZs on budgetary planning and implementation.

These encouraging pilot arrangements have been assisted by a fairly permissive legal framework. However, some local experiments have encountered financial and organizational impediments<sup>77</sup>. It would be advantageous if the legal arrangements for municipal-MZ relations were formally codified.

Similarly, formal consultation mechanisms with NGOs could offer real pay-offs. Sadly as we have noted, the NGO sector is heavily dependent on diminishing international donor funding and citizens often view NGOs as 'quasi-businesses'. There are however, some promising case studies of NGO based consultation and joint working:

- The NGO Forum in Derventa successfully lobbied the municipal administration to adopt a

transparent set of criteria for the allocation of funds to the independent sector.

- Novi Grad Sarajevo municipality provides support for NGOs and is keen to coordinate common objectives. They commissioned a local NGO to develop better communication links with citizens and to support volunteerism.<sup>78</sup>

Fair and transparent procedures for allocating municipal grants to NGOs, according to the recipients' contributions to public goals are crucial. These serve to ensure NGOs ongoing involvement in the local public space is maintained, and prevent the exploitation of funds for particular interests. The planning and decision making process would be enhanced by direct consultation with groups affected by a particular decision or action. This might extend to regulating for consultations with key groups such as business interests and labour unions.

### Promoting volunteerism

Volunteerism is an expression of commitment on the part of individuals, and a reflection at community level of social solidarity and reciprocity. Volunteering to serve in local services or the municipal administration offers a means of boosting participation and stimulating interest in local governance within the wider community. Rooted in trust,

<sup>77</sup> For Example, the NGO approach used in Brcko, is not without problems. The law requires that three or more physical or legal persons found an NGO. On the one hand this ensures the involvement of designated citizens in the MZ, whereas on the other, it leaves open to question how others (i.e. non-founders), might be involved.

<sup>78</sup> NGOs are obliged to prepare reports on relevant activities for Municipal authorities. Novi Grad municipality also provides NGOs with lists of citizens to be included within their programmes.

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voluntary action can connect local governments to community networks and offer a pool of untapped skills. As volunteers are often drawn from key client groups, responsiveness and accountability are enhanced.

Active promotion of volunteerism therefore contributes to the quality of local services and builds public participation. But harnessing this potential also requires management and commitment on the part of municipalities themselves. The most useful device for this is developing a scheme partnership with national NGOs or established volunteers organizations. Within BiH, United Nations Volunteers (UNV) works with selected local governments to support and resource volunteers in a wide range of placements. With a distinct focus on young adults, UNV BiH also works alongside NGOs to promote broad community development. This involvement extends to decision making processes. A noteworthy activity has been the organization of events to mediate between youth branches of the disparate political parties.

## Summary and conclusions

In this closing section, we first provide a summary of the key points of the chapter, set out the potential mission of local governments and list the required reforms.

### Key points from the discussion

The first section made clear that BiH local governments sit within a massive and often dysfunctional administrative system that is highly politicized and weakly coordinated. This leads to the paradoxical situation that citizens finance an extremely large administration in return for low quality services. Moreover, this complex web of institutions, loaded

with overlapping functions, is non-transparent and disorients citizens. For the average voter it is impossible to understand what can be expected and from which component of the 'melange' of governments and institutions. Under such conditions it is near impossible to judge specific professional and political performances. Nevertheless, the widely shared perception remains that the overall performance is very poor. This compounds citizen apathy, providing a further obstacle to democratization of the country.

The system of public administration is clearly in need of reform. Whilst this statement is accepted in principle by all of the societal and political forces, their interests are in conflict. In any reform scenario two components must be necessarily included. One is the consolidation of the system by extending the regulatory and distributive functions of the state level, the other is the shift towards a more rules-based system through clear definitions of tasks, rights and allocation rules and transparent and strong enforcement. Unfortunately both of these goals are perceived by most of the actors in power as undesirable. The nationalist parties which dearly guard all means of control over their respective territorial units feel threatened by such changes. In the short term, the party interest will be against such changes. Only popular pressure is likely to result in change. Without an active civil society it remains unclear how in-country ownership can be built behind the reforms.

Our analysis of the conditions and performance of local governments provided a clear operational rationale for decentralization reform in BiH. At present the definition of local governments' rights and responsibilities are so fluid as to allow too wide a

discretion to higher level governments. This results in unpredictability and a loss of accountability. The environment is strongly politicized with administrations being captured by political and other interest groups. As a consequence of this political intrusion, municipal governments cannot be expected to make rational choices in the interests of the citizens. Employment decisions, project selection and financial allocations can easily become prey to these distortions. Local leaderships are effectively beholden to ruling political interests rather than their constituents. Thus the basic building blocks of good governance - fiduciary responsibility, transparency, participation, equal treatment of citizens - are often completely neglected.

Reform is needed at all levels of government. Sadly, it seems that the most committed party to this task is the international community. A recent study of governance in BiH arrived at the conclusion that "the most striking feature of government in BiH is its passivity in the face of a growing social and economic crisis".<sup>79</sup> Yet international leadership is fundamentally at odds with the sustainability of reforms.

### **The importance of local governance reform**

Experience from elsewhere in the world, shows that genuine change in political culture can take place at the local level much more rapidly. The political messages face less inertia as local services are visible to each and every citizen, and directly connected to the quality of everyday life. Deficiencies are difficult to cover-up with ideologies and falsehoods. If recent and future changes in the rules that govern local elections can liberate local politicians from their political ties, their accountabil-

ities can be refocused on constituents and concrete local issues. Changes in the political arena might also give rise to changes in existing political practices, opening-up the possibility of issue-based coalitions, and bringing in non-political organizations. Such a process would allow additional space for the participation of civil society, since securing popular support will assume a higher importance. An issue-based political agenda would be fundamentally more accountable and productive.

International experience also tells us that in addition to accelerated change, local innovation can also initiate wider reform. Our explicit rationale in examining local governance in this year's NHDR is precisely to unleash change capable of infiltrating all levels of governance in BiH. As is already seen in some parts of the country, committed local leaders have succeeded in building citizen commitment and customer-oriented local services. These reforms have frequently transformed the political space, and offer a vision of BiH's potential for developing domestically-owned and directed governance reform.

### **Key practical reforms**

Local politicians can be important 'agents of change' but they also need to be supported by a set of systemic changes enacted from above. The success of local leaders is necessarily dependent on the creation of a permissive framework. This requires the establishment of the key components of the decentralization system and our findings can be condensed into four key goals:

<sup>79</sup> ESI (European Stability Initiative): *Governance and Democracy in BiH: Post-Industrialist Society and the Authoritarian Temptation*, 2004



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## **One: Improve coordination and fiscal equalization**

Decentralization reform presupposes a national coordination mechanism that can set standards and rules that unite the administrative space of the country. This relates to both strategic coordination and the intergovernmental fiscal system. Resource pooling must secure appropriate compensation for those municipalities with weaker revenue bases and greater needs. Equalization is inseparable from the decentralization of revenue sources. BiH should strive over time to establish a state-level system that systemically compensates for variations and inequities. However, it is recognized that the administrative and political context of BiH precludes this, but as outlined above, a series of practical innovations can be made within the existing framework.

## **Two: Improve accountabilities and the correspondence of functions and finances**

Decentralization reforms must lead to a more predictable and stable management environment for local governments. This means not merely clearer definitions of tasks and financial allocation rules, to help local governments plan their activities, but also a different division of responsibilities that limits duplication. Responsibility and resources for individual functions should be grouped at one specific governmental level, so that specific administrations can be held accountable for their given service responsibilities.

## **Three: Secure a professional and neutral local civil service**

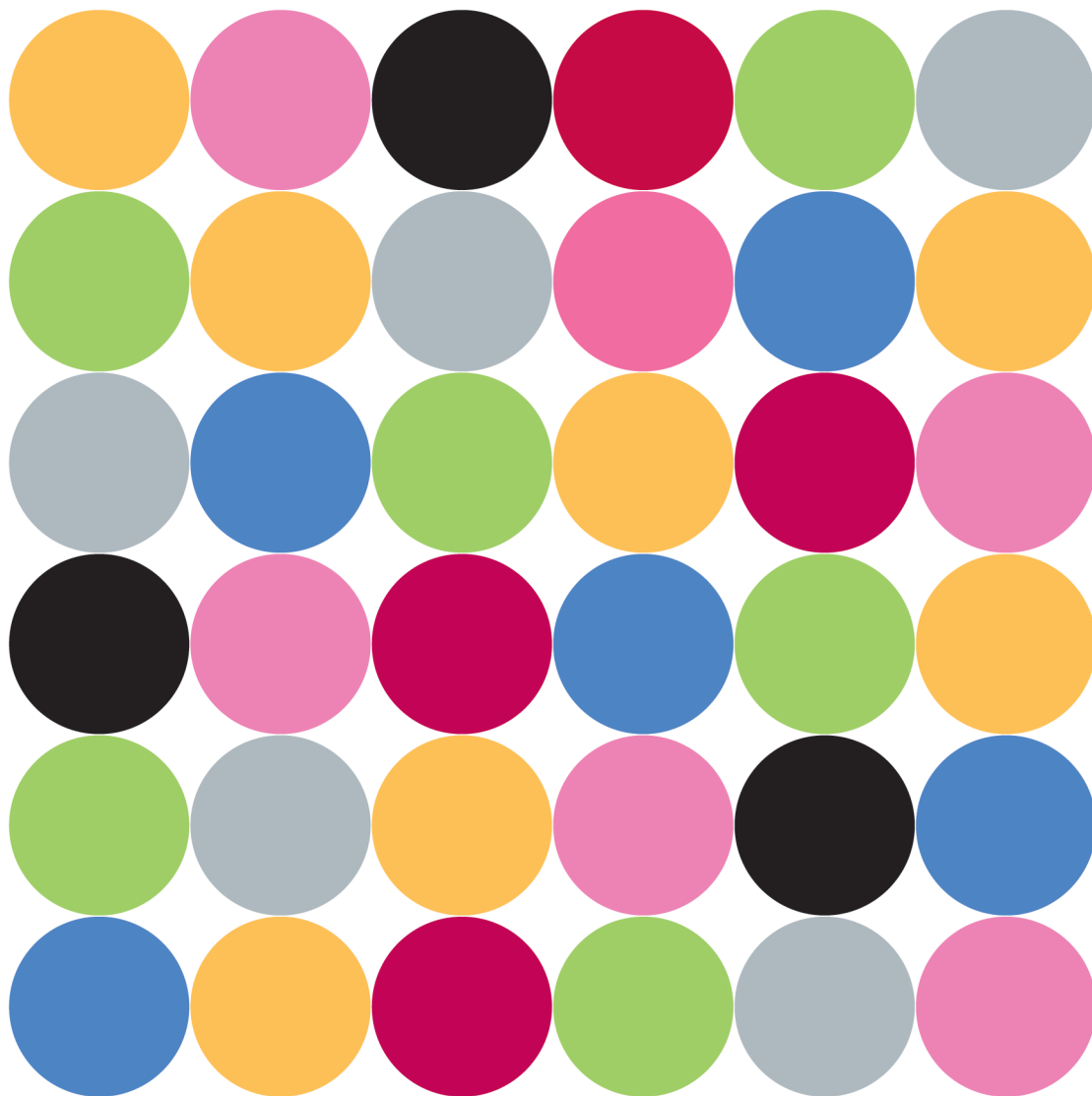
The professionalism of civil servants is a necessary condition for more effective service delivery. The development of a strong technocracy would not only improve service delivery, but would also support the reform process. It would be the task of the national framework to establish civil service education and training, so that local officials could gain modern public management skills in an organized manner. This must necessarily include the establishment of a strong public service ethic that emphasises neutrality and respect for basic human rights.

## **Four: Strengthen local accountability, rights-based approaches and participation**

Last but not least, good local governance needs strong accountability guarantees. The system should produce the very rational incentives that make those who govern exclusively accountable to their local constituencies. These incentives should be embedded in the system of local politics. This should be regulated via: local election rules and regulations; a fair system of campaign support; prior definitions of legislative and executive relations; an institutionalized guarantee of basic rights; freedom of information statutes; and effective consultation with civil society actors and community governments.



## CHAPTER FOUR



QUALITY AND ACCESS  
IN LOCAL PUBLIC SERVICES



## Chapter Four:

# Quality and access in local public services

From this point onward the report embarks on an analysis of the services and activities undertaken by local governments. This chapter reviews the public services provided by municipalities, whilst the following chapter focuses on 'enabling' or indirect functions.

Here we are concerned with operational matters, and we investigate in detail those local services which have the greatest impact on the quality of people's lives, and hence human development outcomes. We cover in turn: education and schooling, primary health care, social services, and lastly, the public utilities. The questions raised include: how can better access and improved quality be secured: and how might services be delivered more efficiently? Throughout the analysis the reference points are the goals of human development: choice, equity and opportunity. As elsewhere in the report, each section includes positive recommendations for change. Given the weak level of decentralization in BiH, we have drawn our scope of enquiry widely, bringing into consideration all local public services, not merely those where local governments already have important roles. Indeed, our agenda is in part, to advocate for municipalities to play a defining role in each of the domains reviewed.

### Education and basic schooling

There is probably no other area of human life and activity that connects and influences so many others as education. It is through education that we create and reproduce our culture, values, habits, attitudes, knowledge and skills and pass them on from one generation to another. Today education represents one of the most important factors in securing well being. Often quoted as a 'silver bullet' for a variety of socio-economic ills, educational

programmes can help address all manner of disparities and inequities. It is also via education that we directly shape the conditions of the cultural and economic strength of the country. Educational performance, unsurprisingly, has a centrality within human development thinking.

International experience shows that education systems work best when all government levels make appropriate contributions. State institutions are in the best position to broker a country-wide agreement on core goals and values to be embedded and promoted by schools and colleges. State-level regulation and support (financial and technical/ professional) create the necessary conditions for universal access to quality services and their coordination. At the same time, lower level governments are better placed to adjust the nature and level of provision to meet the needs and demands of citizens.

Recent policy pronouncements in BiH signal that authorities and stakeholders have now arrived at a consensus on basic principles. The white paper "*A Shared Modernization Strategy on Primary and General Secondary Education in Bosnia and Herzegovina*," adopted in 2003, sets this agreement out, covering the substantive issues to be addressed by all actors, extending well beyond synchronising state and entity level activities, into the realm of schooling and learning curricula.

Our inquiry will make a complementary contribution to the emerging reform agenda. We will review this strategy from the perspective of local governments and how their greater involvement might further the process of change. After a short outline of the current condition of the education service and the white paper, we will discuss the potential municipal involvement offers and how this might



# Better Local Governance in BiH

best be implemented. In this chapter, our analysis is concerned with traditional local functions, specifically pre-school and primary education<sup>80</sup>. In Chapter Five we refer to vocational training in the context of local economic development.

## Current conditions

### Educational heritage and recent changes

BiH's pre-war educational indicators were above average for the region, and its education system was inclusive and strong. Virtually all children completed eight years of primary schooling, most completed four years of secondary schooling and many went on to study at university. Whilst primary school enrolment has declined in the initial post-war period, it has recovered in recent years and is satisfactory at about 94% of the eligible population.<sup>81</sup> Yet for a modern European country even this high watermark is disappointing. Moreover, there is dispute about the correct rate of enrolment: significantly more pessimistic figures published by the Ministry of Civil Affairs suggest the effective enrolment rate could be as low as 85%<sup>82</sup>. Differences between urban and rural schools and between the access enjoyed by different populations are evident in statistical returns<sup>83</sup>. (See Box 4: Ethnic-based education).

It has been argued by many commentators that the quality of education has declined in recent years.<sup>84</sup> A key part of the case made concerns teacher training: specifically that teachers receive pre-service training which has not been updated in over ten years. Courses remain theoretical and neglect the professional skills that make for a good teacher. Teaching in BiH for the most part focuses on the

transmission of factual information instead of learning outcomes.<sup>85</sup> Moreover, many qualified teachers have left the profession, and on average 20% of the teaching staff do not hold basic qualifications.

At the same time, the level of in-service training support is inadequate.<sup>86</sup> In the FBiH only one of the ten cantons<sup>87</sup> makes such provision, and whilst the situation is slightly better in the RS, where the Pedagogical Institute offers mandatory in-service programmes, coverage is not wholly comprehensive.

Second, in contrast with the tradition of general education in BiH, the pre-primary sector has never really been developed. Whilst in other socialist countries pre-schooling was widely available, in BiH little less than 10 % of children were enrolled in such institutions before the war.<sup>88</sup> Enrolment today has dropped to a depressing 4% of those eligible, and this underlines the effective non-availability of this service. This has a particular impact on life chances and capabilities of children within poor and vulnerable families. Studies show that early schooling both helps socialize children with difficult family circumstances, and enables their adult carers (principally parents) to participate in the labour market, so helping secure their families' livelihoods.

## Governance and management

As elsewhere within BiH public services, management of the education sector is asymmetric and sclerotic. Education is regulated by Entity law in the RS and directed by the RS Ministry of Education and Culture, and at the cantonal level in the FBiH. The Federation Ministry of Education has only a coordinating role. Thus in BiH there are 14 responsible ministries, with over forty regulatory statutes, plus

<sup>80</sup> Primary schooling in BiH ran from age 6 to 14, reforms then extended this to 9 years.

<sup>81</sup> Variations occur as data on net enrolment rates, which would be a better indicator, are unavailable. The gross rates may contain large numbers of repeaters.

<sup>82</sup> Education Development in BiH, National Report, Ministry of Civil Affairs of BiH, August, 2004

<sup>83</sup> Refer to analysis supporting regional HDI calculations in Chapter 2 and Annex 2.

<sup>84</sup> Very few quantity indicators are available and there has not been adequate quality monitoring.

<sup>85</sup> Teaching methods, pedagogy, classroom control, didactic education and teaching practice amount to only about 10 % of the pre-service teacher training, compared to about 50% in EU countries (WB/ CoE report).

<sup>86</sup> Excluding programmes offered by different NGOs and the IC.

<sup>87</sup> Tuzla Canton is the only exception to this.

<sup>88</sup> In another part of the FYR (Vojvodina) enrolment was approximately 90 %.

a raft of secondary legal instruments which also apply to education institutions.<sup>89</sup>

Whilst fragmentation has increased, in the individual units, management practices have not changed since the socialist times. The RS, the ten cantons within FBiH and the District of Brcko, all operate highly centralized systems within their respective boundaries. Each ministry has full responsibility for passing legislation, controlling cur-

riculum content and resource allocations. This gives rise to enormous variations in outputs and dramatic inequities in access. Little has genuinely been decentralized to municipalities. Save for pre-school provision, the RS Entity and FBiH cantons are entirely responsible for education policy and delivery. However, some cantons are gradually involving municipalities in the running of ancillary services, albeit often to decrease their own expenditures.

#### Box 4: Ethnic bias in education

Since the collapse of the FYR, education has been used for propagating and sustaining separate ethnic spaces, including three separate religions, histories, languages and cultures - indeed everything but a tool for the development of a common BiH identity. In the absence of a state-level curriculum, nationalist groups and their political factions have invested heavily in creating separate educational canons.

The regulation of education is devolved to the Entity level in the RS and (largely) to the cantons in the FBiH. This division of responsibilities has tended to reinforce the ethno-nationalistic agenda in schooling. Most telling has been the importation of teaching materials from abroad. Croat politicians have argued for books and learning kits to be brought in from Croatia, similarly the practice in the RS has been to import from Serbia. In some contexts the use of imported educational materials can be a logical choice to keep costs down, but in BiH the rationale has been entirely different. In this over-politicized environment, imported educational materials serve to further differentiate the already fragmented educational system, strengthening the ethnic divide and discrimination whilst also increasing the cost of the system.

The introduction of a core curriculum in 2004 is an important element in the re-unification of an ethnically divided school system. The curriculum aims to counteract discrimination and segregation in schools and ensure the mobility of students and teachers throughout the country. It especially seeks to address the so called 'national' groups of subjects (history, languages and literature and even geography), which have largely been appropriated by nationalist forces in the post-war period.

Clearly, it is not merely the curriculum which can and has been used to promote the exclusive values of dominant groups. The presence of national and religious symbols in school buildings is still a custom. Extra curricular religious education in most cases is offered only for children of the dominant religious group. Moreover, action to prevent obviously discriminative practices by the International Community and others has been met with opposing arguments which cite the right to be educated in mother-tongue languages and national cultural norms.

This is a highly problematic issue in latter day BiH. Schooling and wider education has the potential to be either a brake on reform or a means for its acceleration. Yet regardless of these agendas, the right of all to a quality education cannot be compromised.

<sup>89</sup> In cantons with a Bosniak majority and sizable Croat minorities, there is a parallel Croat structure of institutions further increasing fragmentation and inefficiency.

# Better Local Governance in BiH

## Institutional structure

Throughout BiH the average size of schools and classes are small. Moreover, as Table 4.1 shows schools in the RS are smaller still. It seems absurd

that while schools have serious material<sup>90</sup> and financial problems they have very rich teacher-pupil ratios. This also attests to a poor rationalized and weakly managed pattern of provision.

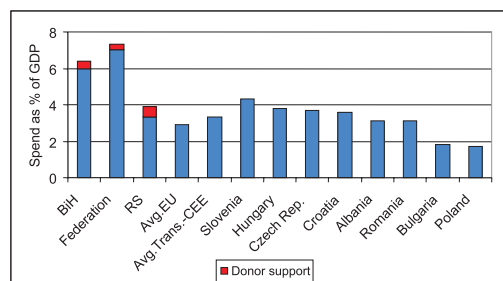
Table 4.1: School and Pupil Numbers

		1996	1997	1998	1999	2000	2001
Federataion	Pupils (1000s)	252	260	268	277	276	259
	Schools	898	973	976	1,103	1,029	1,086
	Pupils per Sch	281	267	275	251	268	238
RS	Pupils (1000s)	126	131	128	126	na	124
	Schools	657	734	737	750	na	na
	Pupils per Sch	192	178	174	168	na	na
Total	Pupils(1000s)	379	390	396	403	na	383
	Schools	1,555	1,677	1,713	1,763	na	na
	Pupils per Sch	244	233	231	229	na	na

## Resourcing

Public spending on education stands at around 7% of GDP<sup>91</sup>. This is a relatively high proportion compared to other transitional or EU countries (illustrated in chart 3.1). However, due to BiH's low GDP, the cash sum expended is low.

Chart 4.1: Comparative Spending on Education



In addition, the financing mechanisms employed are ineffective and inequitable. Funding is deriva-

tion based and so limited by the local tax take with- in either the respective Entity or canton. This is compounded by the use of input-based methods (past staffing levels and so forth) for allocating monies to individual schools<sup>92</sup>. The funding arrange- ments have two principle negative effects. First, they serve to 'lock-in' inequities with the poorest regions receiving the lowest schools funding. Second, they produce extremely weak incentives for school management and teaching staff to operate either efficiently or effectively<sup>93</sup> as the inputs- based systems motivate rational managements to aggrandize their budget and neglect the quality of outputs.

The fragmented education system in BiH is expensive, inefficient in translating inputs into out- puts, and ineffective in delivering quality improve- ments. The high administrative expenses also serve to 'crowd-out' resources<sup>94</sup> from teaching activities.

<sup>90</sup> As a consequence of limited useable space students learn in two or three shifts in some places.

<sup>91</sup> "Public Expenditure and Institutions Review in BiH", The World Bank, Sarajevo, 2002

<sup>92</sup> The complex formula reflects standardized inputs and dates to socialist times.

<sup>93</sup> A primary school teacher in Sarajevo (FBiH, Canton Sarajevo) earns almost twice as much as a colleague in Srpsko Sarajevo (RS) (300 versus 150 Euro/ per month) whilst they might work only one street away.

<sup>94</sup> The proportion of the budget spent on wages and salaries varies from about 75% in Sarajevo to 93% in Una-Sana. "Education in Bosnia and Herzegovina: Governance, Finance and Administration", CoE/WB report, 1999

Expenditure on salaries and wages takes the dominant part of the resources leaving very little for material expenses, maintenance and the development of facilities<sup>95</sup>. Nevertheless, by regional standards teaching salaries remain low, arrears often build up, and teachers' working conditions have deteriorated. This can only lead in the long run, to the breakdown of the system. Recent industrial unrest, including teaching staff strikes, is an alarming indication of the pressures which exist.

### Policies and decisions

The system faces both old and new poor practices. On the one hand, in the regulatory and financ-

ing spheres, command economy methods have survived. This is apparent from the maintenance of rigid equalized pay scales and the control exercised by ministerial bureaucracies. On the other hand, the post-war fragmentation of BiH plays itself out by embedding resource variations and a variety of unfairnesses. Practically all strategic decisions on resources are concentrated at the Entity and cantonal levels and very little room is left for municipalities and schools who are in daily contact with parents and students.

Table 4.2: Resourcing levels in FBiH Cantons

Canton	Total Edn. Expend. KM mln	Expend. per capita KM	Expend. as a % of GDP	Expend. as % of Budget
Sarajevo	107	285	6.0	21
West Herzegovina	18	226	7.2	31
Herzegovina- Neretva	39	183	5.6	25
Central Bosnia	38	165	7.7	28
Una-Sava	49	165	11.3	33
Tuzla	87	163	9.5	26
Posavina	7	155	8.5	22
Zenica-Doboj	60	155	9.3	26
West Bosnia	11	134	8.2	24
Gorazde	3	99	6.5	16

### Recent developments

In the complicated constitutional framework of BiH it is very difficult to advance serious systemic change. Yet education stands out as an area where reform, and the desire for reform, is evident:

- In November 2002, education was identified as a national priority area alongside the economy and the judicial system:
- A wide consultation process was initiated to establish shared principles and goals and to build a consensus on reform strategies<sup>96</sup>:

<sup>95</sup> Over 95% of reconstruction and new schools were financed through international donations.

<sup>96</sup> Shared Modernization Strategy on Primary and General Secondary Education in Bosnia and Herzegovina adopted in 2003.

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- State level coordination functions were established when the Ministry of Civil Affairs was given an oversight role<sup>97</sup>:
- A new state-level framework law<sup>98</sup> was adopted for primary and secondary education:
- A similar law for pre-school education is also in preparation.

The white paper itself gives an excellent summary of the agreements that should be taken-up following its adoption:

- Goals and duties should be based on the implementation of human rights, and should lead to compliance with European educational standards.
- The new system should offer equal opportunities to mandatory primary education, based on principles of decentralization, democratization and de-politicization.
- Teaching should focus on learning outcomes related to knowledge, competences, and skills as regulated by the core curricula<sup>99</sup>. Amongst these outcomes, respect for human rights and social values, critical thinking, communication skills and national history are equally pertinent as IT skills, languages, and mathematics.
- New methods of objective testing of students and external quality control of teaching.
- Establishment of a new system of professional training for teachers and school managements to support modernization and development of education.
- Finally, with reference to financing, the White Paper advocates the rationalization of budgetary methods (including the introduction of per student funding and rolling budgeting),

fairer public finance allocations and the delegation of financial authority to schools.

The document sets out a framework for a modern, European-style education system, based on a unified structure with a single core curriculum. This will require the standardization of awards, joint issuing of certificates and allowing teachers and students to move freely between institutions. A key strategic goal will be the establishment of new financing methods. A supporting development is the newly drafted BiH Federation Constitution which, if enacted, will grant responsibility for the 'establishment and functioning of pre-school and primary education institutions' to the municipal level<sup>100</sup>.

## Proposals for change

### Connecting administrative changes to financing reform

In spite of the fragmentation and inefficiencies there are some positive developments. The importance of the state-level ministry assuming a coordination role cannot be overemphasized as a first step to modernization. However, this achievement must be followed up by real systemic changes which reinforce the implementation process, including both new financial mechanisms and increased accountability. Thus far, few advances have been made in these two complementary areas. Without effective and fair resource allocation rules, accountability will not be improved.

### Rationalizing expenditures

As a starting point we have to recognize that the public resources available for education are likely to increase at a level well-below the growth rate of the overall economy<sup>101</sup>. Therefore, minds should be focused on how to manage resources better and

<sup>97</sup> The role of the MoCA in the area of education does not extend beyond coordination and cooperation. This can be instrumental in areas such as development and adoption of state-level legislation, but the Ministry has neither the authority nor personnel to deal with other much needed reforms.

<sup>98</sup> Framework Law on Primary and Secondary education in Bosnia and Herzegovina, 2003

<sup>99</sup> Curriculum regulation means that a common core curriculum is defined for each subject taught in schools. The share of obligatory elements varies from 70 % in so called 'national' subjects to 90 % in 'non-national' subjects.

<sup>100</sup> Also in the working version of the FBiH law on local self-governance

<sup>101</sup> The PRSP strategy goes further and commits BiH to freeze education expenditure as a % of GDP



get more from the same. One obvious answer is to reduce fragmentation and increase school sizes, and so gain economies of scale. However, the current input-based financing system produces few real incentives for rationalization. Indeed, the system provides perverse incentives - schools are effectively rewarded for the more staff they employ and the more resources they use. A financing scheme that adjusts allocations according to the teaching services provided and/or the number of students taught in the school would create a very different set of incentives. It would allow and motivate managements to better organize their affairs and make cost-savings. The introduction of open-enrolment would also give incentives for schools to compete for students, thus spurring improvements in teaching quality.

Efficient management would necessitate rationalization and upfront investment. It must be recognized that this would have short-term resource consequences, which might also give rise to conflict. It is likely that the availability of funds would, in addition, mitigate the extent of opposition encountered. Yet within the current system, which barely reimburses schools for necessary daily expenses, there is no means of finding resources for investment. Supplementary grants made available to schools that demonstrate a commitment to rationalize, would strongly facilitate the process of reform.

Gaining control of salaries and wages expenditure will inevitably require that difficult decisions be taken. Yet succeeding here presents managers with a double-edged challenge, since poor teaching salaries also stand in the way of quality improvement. These objectives are not easily reconciled, but there is evidence to suggest that better management may release resources which might be

used to reward, retain and attract staff. Studies of schools' cost structures show that savings might be made from the huge share of the budget devoted to part-time teachers<sup>102</sup> and the excessive expenditure on non-teaching staff. Moreover, the systems in place in both the FBiH and the RS, pay teachers according to a strict pay scale that takes only their work experience and work-load into consideration. Little discretion is allowed for schools to create their own incentives. This effectively functions against rationalization of staff, rewarding the best performers or encouraging new applicants.

### **Increasing local discretion and accountability**

Within the current system only ministry bureaucrats, who sit far from the field and know little of actual conditions, are able to exercise real managerial authority. Municipalities and school managers, who have intricate knowledge of the context, have little decision-making power. The new draft constitution of the FBiH is an important step in devolving power to local governments but this must be accompanied by the provision of financial incentives and the right accountability mechanisms. More financial discretion at the local level and output-based financing schemes would supply better incentives not merely to managers, but also to encourage policymakers to incur the necessary political costs in affecting full decentralisation.

Unit-based funding is crucial because it would enable high-level policy makers to disengage from the managerial process, leaving this for operational managers.

In the RS, pre-school and primary education are already effectively deconcentrated functions. In some senses this is a more advanced position than

<sup>102</sup> WB PEIR, 2001

# Better Local Governance in BiH

that observed in the Federation, but RS schools and local governments still lack effective managerial power. Here the next step must be full administrative decentralization running in parallel to the financial reforms discussed above. It is logical that a reformed financing scheme for schools be coupled with the harmonization of local rights and responsibilities.

## **Equalization of resources**

A related challenge is the introduction of an equalization scheme tailored to the needs of BiH schools. There are huge differences in the level of education expenditure amongst administrative units (Cantons and the RS). These differences work against the uniform application of human rights and the modernization agenda. Equalization is unavoidable if BiH wants, as is claimed in the Education Reform Strategy, to address equity in the access to education. The preferred method would be a funding scheme at state level, but it is recognized that the prospects for this are limited. Therefore, in line with the reform strategy, we recommend a solidarity fund be set up for the compensation of extreme disparities. Such a solution is far from perfect and its establishment is also dependent on the contribution and allocation formulae being accepted by all financing authorities within BiH. Reaching agreement will most likely entail a long struggle, as solidarity and willingness to redistribute amongst nationalistic governments is minimal. Yet realizing a functional solidarity fund is still far more achievable in the medium term, than a full equalization system.

## **Maintenance and investment in school facilities**

Whilst the strategy given in the White Paper includes many positive proposals in relation to

strategic issues, it says little about renewing and maintaining the educational capital stock - other than identifying investment as a policy objective. What remains in school budgets after wages and salaries are paid, can often cover only minimal supplies and utility costs. As a result capital investment financed from domestic sources is virtually non-existent. Over 95% of the construction of new schools and renewal of existing provision, in the post-war period has been financed by international donors. To date, donor aid has contributed to the rehabilitation of over 60% of BiH's schools. Yet the focus of development assistance is increasingly being shifted away from physical rehabilitation towards institution-building. Few governmental actors, central, entity or local have stepped in to fill this void. Moreover, the dilapidation of the building stock and equipment is one of the few absolutely universal problems facing the BiH educational system. The ongoing deferral of investment cannot go on for long without serious risks to the already problematic quality of education, let alone the danger of structural failure.

In order to facilitate capital investment, some form of intergovernmental support mechanism will have to be established. These costs cannot be afforded at the local level and it would also be unjust as the severity of the condition of facilities varies greatly. The most favoured system would be a centrally administered capital grants framework but regulated borrowing (as discussed in Chapter 3) for institutions in good financial health should not be precluded. Capital investment grants exist in countries with less dilapidated infrastructure and larger local spending capacities. Such a capital grant regime should be functionally separate from the revenue financing arrangements proposed above.

### **Coordinating education and decentralization reform**

An overarching issue must also be addressed. Education sector reforms (strengthening of the state-level and the unification of standards and access) have unfolded parallel to the debates on decentralization. Some stakeholders in the education sector have argued that the specific decentralization of the education service should only take place once other education reforms have been completed, and the consistency of the system adequately secured. They assert that otherwise the localization of the service would simply bring more entropy into the system.

Two important counter-arguments can be made. The first is systemic - education is part of the public administration system of BiH. The country has now an historic opportunity for public administration reform. Centralizing then decentralizing as separate stages in two consecutive rounds has little chance of success. The second argument is political. Reforms are costly; intellectual and political efforts and are burdensome both for bureaucracies and politicians. After a long reform process of centralizing services and creating a workable system, it would be practically impossible to build sufficient support for a second round of reforms for decentralization. Moreover, if a centralized system were to be created it would inevitably strengthen a State (or worse a new Entity) level power structure that would resist further change.

### **The contribution of local governments**

Whilst the formulation and coordination of education policy rests at the higher levels of government,

municipalities remain the most appropriate vehicle for field decision making and delivery. As we have argued, localities have informational advantages and are more directly accountable to local citizens. In principle, such an arrangement contributes to services being adjusted to customer needs and the improvement of effectiveness, whilst also helping to secure national goals.

BiH's dense population structure means that the efficient catchment areas of pre-school and primary education are small, operationally favouring the decentralization of these services. Moreover these two levels of education have the strongest social welfare dimension, proving a further rationale for locating responsibility for them as close to their consumers as possible. For larger municipalities with sufficient human, financial and institutional capacities, consideration should also be given to their taking on responsibilities for secondary schools and potentially, tertiary education institutions.

The priority placed on social inclusion within national planning frameworks, notably the PRSP, adds yet a further argument in favour. BiH has set itself a basic goal of including all children in primary education by 2007. Securing access does not necessarily secure inclusion. Addressing the needs of the vulnerable and excluded requires that these communities actively be sought out. Local governments are best placed to do this - especially given the specific conditions of post-war BiH and the varied challenges presented by returnees, minorities and the poor. The solutions to this require a matrix of social policies be deployed in order to bring all children into the school system. Municipalities are the only agencies within BiH able to orchestrate the necessary response.

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## Access to basic health services

As was argued in the chapter on the state of human development, at the macro-level there has been little improvement in material health conditions during recent years. Life expectancy rates have remained static and morbidity is growing. Moreover, public opinion polls consistently show that access to basic health care is a key issue. We can summarily conclude therefore that there are serious problems with the supply of healthcare, and the responsiveness of the responsible agencies. People complain about the quality of equipment, the competence of medical staff and basic accessibility. Indeed, a variety of obstacles, geographical and administrative, restrict service provision. According to a recent World Bank study, only 28% of the rural population has access to basic health care.<sup>103</sup>

It is important however, to retain a sense of perspective. Huge advances have also been made since the end of the war, a large proportion of health sector institutions, facilities and equipment have been rehabilitated and reform programmes are underway. Notably, important steps have been made in rationalizing finance and improving access. Health sector reform is a work in progress, and in many respects, is ahead of other areas.

Our focus in this section is the contribution of local governments to health care and the potential to enhance health outcomes as a key dimension of human development. To understand the role played by municipalities, we will first give a short review of the structure and financing of the system and its quality and accessibility. Second, we discuss the current duties assigned to local governments. Finally, we examine what local governments can do to improve the situation and positively influence the well-being of citizens.

## Overview of the system

### Health conditions

Inevitably, the war had a very negative impact on the health conditions of the population. The legacy of ill-health, felt both directly and indirectly, continues to shape priorities. Hundreds of thousands were wounded, and according to estimates, some 25,000 people were left with permanent physical disabilities. Psychological traumas are difficult to quantify but present an ongoing challenge. Their latter day indications within BiH include a high incidence of suicide and all manner of addictions, domestic violence and family-stress. In addition, both environmental problems and unhealthy lifestyles have contributed to health risks and generally deteriorating conditions.<sup>104</sup>

### The legal and administrative framework

Before the war BiH had a centralized health system based on compulsory insurance and risk sharing at the Yugoslavian republic level. After the war the system was split in two parts, and within the FBiH, further decentralized to cantonal level. Brcko District has also established its own health sub-system. Today in BiH the state level has no mandate for health policy, health care provision or financing and 13 ministries of health make these decisions in a geographically small country containing (at most) four million people. But it is worth noting administrative duplication is strongest in the Federation where, in addition to the cantonal authorities, the Federal Ministry also exercises a coordinating role.

Each of the subsystems operates a binary provision and financing structure: care is delivered by healthcare institutions largely under the control of the Ministries whilst financing is carried out by 13

parallel Health Insurance Funds (HIFs). The Funds are nominally independent but are effectively organs of the host jurisdiction and they often have to be supplemented by cash transfers from the respective Entity or cantonal budget.

### **System of service delivery**

The system retains an extensive network of providers resting on two main pillars: community health institutions established for primary care, and various types of hospitals and institutes supplying secondary and tertiary care. During the war 30% of facilities were destroyed or heavily damaged and an estimated 30% of health professionals were killed or left BiH. Post-war reconstruction rehabilitated health institutions, but of course the unified system has subsequently been split into 13 component parts. This has seriously fragmented service delivery. Entities and individual cantons have become operationally separate, governed by different statutes and overseen by different authorities. Yet in spite of this, little innovation has emerged, and practices and procedures rely on the pre-existing Yugoslavian model. Each authority has effectively established a 'carbon copy' of the former system, and as a result the bureaucratic management practices of the past have continued and been duplicated.

The types and roles of service delivery institutions have not changed either. In both entities primary care is supplied by community health centres (Domovi Zdravlje - referred to as CHCs) and smaller outreach health stations (Ambulante - referred to as HSs). CHCs are out-patient clinics providing basic care and some specialized services. Their role is to provide first contact care, preventive services and direct patients to specialists if needed. The CHCs are mainly staffed by general practitioners (GPs) and

nurses, but some specialists are on hand, alongside dentists, and sometimes, optometrists. The HS branches are localized out-patient clinics. Secondary and tertiary care is a more heterogeneous ranging from general hospitals to specialized clinics. Private providers present the only new component of the system. They are largely profit making bodies and receive very little government support.

### **Financing of services**

Public expenditure on healthcare amounts to 7.6% of BiH's GDP, while private health sector and out-of-pocket payments make-up an additional 4.7%<sup>105</sup>. In total, expenditure in BiH approximates to 12.3 % of GDP, which is very high in relative terms. HIFs are responsible for financing health care services. They collect revenues from obligatory employees' and employers' contributions and, in theory, from government for the coverage of certain vulnerable and other groups unable to contribute (those serving in the armed forces and the unemployed for example). Contributions are between 15 to 18% of salaries in both entities. Yet in spite of these high contribution rates, the Funds are financially weak as a result of serious collection problems. Low collection results only partly from citizens' inability to pay. The larger problem lies in an inability to enforce collection<sup>106</sup> and government agencies (notably the armed forces) failing to meet their contributions.

The 13 HIFs have considerably different revenue bases and financing remains mostly derivation based.<sup>107</sup> This results in the usual resource inequities and is most acute in the Federation as a result of the cantonal system. Moves have been made to form a Solidarity Fund to compensate for variations and boost inter-jurisdiction cooperation.<sup>108</sup>

<sup>105</sup> "BiH: Poverty Reduction Strategy Paper", IMF Country Report No. 04/114, April 2004, page 165.

<sup>106</sup> Private sector contribution to the HIF is only around 3 %. Health resource accounts, BiH. Know How Fund and Health and Life Partnership, 1999

<sup>107</sup> Allocations to institutions strongly depend on the amount collected a given area.

<sup>108</sup> This fund is not yet fully operational, as political pressures have continued to block its progress.

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Cantonal HIFs are required to contribute 8% of their annual revenues and the Federal Government makes a matching transfer, for reallocation amongst the weaker Funds. The importance of the establishment of this arrangement should be recognized not only for the functional improvement it has brought, but also because it marks a political milestone in the development of wider solidarity and risk sharing.

As in the education sector, the financing of institutions themselves is largely based on input based criteria<sup>109</sup> calculating transfers on the basis of number and qualification of employees, equipment and running costs. This system again does not motivate managers to make savings or improve services as funds received are not dependent on efficiency or performance. Instead, the system supplies incentives for the employment of more staff and padding of budgets.

To mitigate this incentive problem in the RS an important reform has been initiated in the form of a fee-for-service payment system. Yet this intervention was poorly crafted without standard cost limits and almost succeeded in bankrupting the entire system. Subsequently, a price list was defined and institutions are contracted by the RS HIF on the basis of this list. The important paradigm-shift is reflected not only in the pricing logic but also in the fact that the rules allow provider to sue the Fund if not reimbursed for services provided. The system has imperfections and is potentially subject to abuse, yet these teething problems should not downplay its importance.

As in the education sector, the salaries scales of the medical staff working in the public sector are flat. They are driven by formal educational qualifications and practice years, and are unrelated to per-

formance. Salary-for-service payments are used only in private facilities. The best rewarded employees are specialists, but even their salaries do not stand out within the generally truncated pay scales.

## Citizens' access to services

Formally access is governed by HIF payment status: employed and self-employed citizens have access to public health care if their health insurance contributions are paid. In both Entities the unemployed, children and people aged over 65 are entitled to free health care. The FBiH regulations specify that all family members of the insured are entitled to coverage. The RS also affords free care to pregnant women. Emergency services are available for all citizens from and in both entities. This is one of the only secure cross-boundary entitlements, an issue which is returned to below.

The health insurance coverage of the population varies significantly across cantons and regions, and these variations are even more drastic across municipalities.<sup>110</sup> It is estimated that about 26 percent of the entire population living in BiH (17% in FBiH and 35% in RS)<sup>111</sup> is not covered by any health insurance.<sup>112</sup> The situation is mostly caused by the fact that employers, and especially informal sector employers (and employees) fail to contribute to the HIFs.

Yet in spite of this, the law requires that all insured citizens are entitled to access a Basic Benefit Package (BBP) of services, irrespective of the funds available in the HIFs. In RS the BBP was adopted in 2000, and here politicians faced a difficult trade off - the universally covered services comprise a smaller package than that which was offered previously but the most that could be afforded. This was the price of extending a more viable set of services to a greater number of benefi-

<sup>109</sup> There is little difference between the formulas used in the Entities: the RS uses a simple input basis, while the FBiH has an input-related historical formula (a combination of two out-dated approaches from socialist times).

<sup>110</sup> For example in Teslic, the estimated number of uninsured individuals is 20,000 people. No more than 50% of the population in Milici has health insurance, the rest have to pay full fees. Source: RMAP, 2004.

<sup>111</sup> Social Insurance Technical Assistance Project (SITAP), Report No. 25672, World Bank, May 12, 2003, p. 11.

<sup>112</sup> According to estimates around 20% of the population in BiH is not covered by any health insurance scheme. Health Insurance and Reinsurance Fund FBiH, 2004



ciaries. Nevertheless, low collection rates (especially compared to entitlements) still leads to implicit rationing that limits access to legally guaranteed service levels.

For services not covered by the BBP citizens must pay contributions. There are three types of out-of-pocket payments: statutory contributions for public health services, fees for private services and informal 'under-the-table' payments. The FBiH cantons and the RS decide on the level of legal co-payment for services delivered in public health institutions. Prices are dependent on socio-economic status and available resources. When patients turn to private doctors the fees are clearly market-based. In both cases, access to services is limited by the ability to pay. For this reason out-of-pocket payments are criticized, although they are a logical consequence of limited health budgets. Yet a viable BBP, coupled with transparent legally-defined out-of-pocket payments for additional services (i.e. ending practice of illicit payments), seems to be an acceptable compromise.

In addition to the financial constraint, access presents a major problem. This is largely rooted in administrative failures. As the network is split into parts, often the hospitals of other health care providers are much closer than citizens 'own' hospitals.<sup>113</sup> In spite of claimed inter-entity and cantonal agreements, entitlements are practically not valid outside the jurisdiction of residence. Often the closest institutions are accessible for citizens only on a full payment basis.<sup>114</sup> The problematic political geography of BIH also hinders access to basic care. According to estimates only 28% of the rural population has access to CHCs or their subsidiary health stations. Accessibility is thus exceptionally difficult

for disabled persons as transport to medical centres is often not available<sup>115</sup>. If portability of insurance could be ensured, travel constraints would be eased considerably.

Although access problems appear severe on first analysis, it is apparent that a considerable level of 'informal solidarity' takes place. Whilst it is clear that large segments of the population would be excluded due to non-payment, cases of absolute denial are very rare. In reality, providers simply do not enforce the entitlement rules strictly<sup>116</sup>. This allows doctors and institutions to admit the non-eligible who are in real need - a fairly typical occurrence in transitional countries whereby the weaknesses of formal mechanisms allow professionals to mitigate systemic failures.

## Major weaknesses and commentary

The fact that the health care system in BIH has been split into many parts should not be an insurmountable obstacle for effective service delivery. The fragmentation failures are a product of two factors - a lack of political will to cooperate and limited capacity to coordinate. Perhaps the most glaring example of lack of political will is the poor functioning of the Inter-Entity Health Agreement. Cross-border referrals are a rarity and instead of finding a resolution, politicians and bureaucrats engage in endless debates about compensation mechanisms<sup>117</sup>. The non-portability of entitlements is also an issue between the FBiH cantonal funds. Uncooperative politics has also had an impact on professional practices. Fragmented training, licensing and recruitment practices limit their ability to find the best opportunities for learning and working. Moreover, weak equalization amongst territorial units creates huge differences in salaries.

<sup>113</sup> For example the nearest hospital for residents of Sanski Most is Prijedor, only 30 km away, and Banja Luka, about 50 km away, while the Cantonal Hospital in Bihac is 130 km distance.

<sup>114</sup> If patients from Sanski Most (FBiH) wish to receive medical treatment in Prijedor (RS), they are required to pay the full price and wait for reimbursement from the Federation HIF. Similarly returnees to Sanski Most without FBiH health care entitlements are required to pay for medical services from the local CHC...

<sup>115</sup> For example transport problems in Orašje affect the rural elderly population and disabled people in particular. Few can afford to make the long-distance trip to the nearest medical facilities (RMAP, 2004).

<sup>116</sup> Interview with Ms Snjezana Bodnaruk, Assistant Minister of Health (FBiH), October, 2004.

<sup>117</sup> Specific HIFs have different price lists and dispute cost estimates. The FBiH has offered a price list that is roughly 60% of the rates charged between cantonal funds, but the RS fund considers prices too high.

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Turning to the key problem of weak coordination, managing a decentralized system requires very different rules and skills than directing a centralized network. Abrupt decentralization in BiH without development and reorganization of the networks has created incentives for duplication and introduced dis-economies of scale.

A very expensive and ineffective system has developed with problems of equity, access and finance. Equally, the new solidarity mechanisms only address part of the problem. Real improvements in delivery and access can only be expected if risk pooling and regulation is established at the state level thereby harmonizing entitlements. Efficiency and effectiveness within institutions will only be secured through well-executed decentralization.

## The current role of local governments

### Competencies

At present, local governments within both Entities have established CHCs and their branch clinics - although within the FBiH it is an option, whereas in the RS it is an obligation. Municipalities across BiH are also permitted to set up home care services, rehabilitation centres and even some specialized hospitals.

In the Federation local governments typically elect to establish CHCs including ancillary services, like pharmacies and dentists, but also local spas or even small hospitals. Where the municipality is the 'founder', it owns the buildings and equipment, and appoints the board and the director of the centre in consultation with the cantonal authorities. As we will discuss later the CHC receives a revenue

budget allocation from the relevant HIF for operational costs (salaries and expenses).

In the RS the system functions in much the same way, except that:

- The Entity level ministry is the relevant overseeing authority:
- The mandatory nature of the function affords local governments a stronger position, CHCs are autonomous and the ministry has no direct managerial control. The municipality alone appoints the governing council, the director and staff:
- Following a recent innovation, consultative forums have also been established at the local level. Local Health Councils now bring practitioners and stakeholders together to guide health service decisions.

### Financing arrangements

The running costs of CHCs (including salaries) are financed by the respective HIF. Municipalities contribute by funding the facility costs and some of the equipment. In addition, a large portion of capital outlays are met with capital grants from cantonal and the Federation budgets. The traditional financing method, as noted, is input-based and therefore neither provides the right managerial incentives, nor reflects service delivery needs.

Reform of the primary care financing arrangements is a long term objective and is strongly supported by the international community<sup>118</sup>. Alternatives include use of population data (i.e. a capitation method), GP lists or health indicators. In general, reform strategies opt for a capitation funding as it provides the most transparent and rational system. In time these might be developed to a needs-based allocation formula. It is worth noting

<sup>118</sup> This is top of the WHO's agenda, it is being targeted by the World Bank's BHP (Basic Healthcare Project) and SITAP (Social Insurance Technical Assistance Project).



that the RS has already begun to move in this direction, with the use of a patient numbers based allocation system for secondary care. For now, however in both Entities, budget allocations from HIFs to CHCs largely reflect the staffing structures of each centre. The commissioning system is also similar. The HIFs effectively sign contracts (a form of block-service level agreement) with local providers on the basis of the established running-cost allocations.<sup>119</sup> This modality has some benefits but is non-transparent, and allocations are largely the product of a 'bargaining' process.

The lack of clarity and inequity is heightened in the Federation, as this process is non-uniform across the ten jurisdictions. Yet as the Federal ministry has already prepared a list of prices for medical visits and specific treatments for the purpose of inter-entity payments, these could also easily be used for fee based payments. They are already used for financing services provided by private providers. The few private sector contracts made by HIFs are as a result, market-based and more rigorous.

### **Service delivery**

In the FBiH 70% of CHCs are operated by municipalities. CHCs cover an average population of 30-50 thousand whilst HSs are located in smaller districts of 2-10 thousand people. The CHC employs general practitioners, nurses and some specialized doctors to provide basic services. Some CHCs have also developed some specialized services. The geographical distribution of the existing institutional network is sub-optimal. As municipalities make decisions on the establishment of CHCs and branches, in theory they could improve their distribution. However, in practice, the size of the necessary investment would make the restructuring of supply a long process.

<sup>119</sup> Contracts are made mainly with CHCs but also for some private provision.

### **Recent developments regarding local primary care**

Some recent donor interventions have had significant implications for local service delivery. One is the World Bank-funded Second Public Finance Structural Adjustment Credit. This included a condition that Health Fund allocations for primary care should reach 40% of total health spending, and this has largely been met.

The World Bank financed Basic Health Programme has also brought about support for positive changes. This programme gives support to the establishment of an effective family care system. The service is based on family care teams delivering comprehensive services for families - not only treatment but also education, preventive, detection and rehabilitation services. It is intended these family health teams (based in CHCs) should serve as 'gatekeepers' to the rest of the system. In the new RS Law on Health Care and Health Insurance, these sorts of reforms are also envisaged, and in practice such a system is already operational in Banja Luka and Doboj. The Basic Health Programme will establish a wider base for such practices at other pilot sites throughout BiH. In addition, it includes systemic reforms covering management training, capacity building, accreditation, performance standards evaluation and financing schemes. The project's use of a BiH-wide approach is also supportive of unifying healthcare provision.

### **Incentives and decisions at the local level**

A key failing of the current system is a lack of local ownership and hence local leadership. Healthcare issues are amongst the top priority con-

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cerns of citizens, yet municipalities simply do not see health as an important part of their work. There are various factors contributing to this. The most significant is the financial constraint - CHCs have to compete with other and more powerful budgetary pressures. Another factor relates to the funding system - so long as operating support is wired directly from HIFs, municipal contributions to capital costs can and will be deferred. Equally, within the current arrangements there is very little room for local innovation, since these go completely unrewarded. As we have argued, input-based financing produces only one incentive - generally to aggrandize the budget without necessarily serving more clients or extending access. Whilst there is an obvious need for institutional reform, this is only likely to be secured when municipalities assume control within their own budgets.

The salary structures also feed perverse incentives. Instead of sound performance, climbing the official ladder is rewarded, and this not necessarily achieved by being productive. As long as salaries are not objectively based there is little incentive for staff to work more efficiently. Moreover, while salaries remain low and career opportunities are limited, doctors are motivated to take specialist positions and leave the primary care sector.

## Recommendations for change

Healthcare reform strategies the world over, prioritize the primary care sector. This is rightly so, since reform in this area has the highest health, and hence human development pay-offs. Modern approaches also emphasize prevention and detection in a wider sense, sparing the population from

painful and debilitating conditions and relieving the mainstream health budget of expensive treatments.

As we have argued, motivated and empowered local government involvement in primary services can make a big difference to this agenda. Local authorities are able to better match services to local needs, and possess inherent informational advantages. These make for more effective and cost efficient treatments. Locally-driven systems of care are more fitted to where populations live. In addition, access, especially for excluded groups, is enhanced. Yet municipal involvement cannot solve the basic coordination problems ubiquitous in BiH. Issues like standards and financial transfer mechanisms are clearly the role of upper level governments. Therefore our first set of recommendations is directed at higher level authorities:

- The portability of care requires considerable improvement. Some movement has already taken place, but more is required. This includes the resolution of the problems associated with the inter-entity agreement, and more effective transferability of entitlements within the FBiH;
- Co-ordination to improve quality is also required: this includes standards of care, training, inspection and certification;
- As in other sectors, resource equalization questions and inequities must be addressed. The establishment of a solidarity fund in the FBiH shows that reform is possible and this process is underway. We believe these arrangements should be expanded;
- Finally, the allocation system which governs the sums directed to individual CHC areas should be reformed to reflect outputs and

needs. This is probably best achieved by moving first to per capita based financing of health services, perhaps with appropriate allowances for specific needs.

We turn now to local delivery. The reforms mapped out in the Basic Healthcare Programme chart a credible way forward, and local administration of the primary care system sits well with this. Thus we argue for more devolution than allowed under the current de-concentrated arrangements. Municipalities should assume greater responsibility, but they themselves also need to exercise more ownership of the service. It is not clear what underpins their timidity, but the current financing methods probably play a role, and output-based allocations should offer some resolution for this. Municipalities should also be encouraged to innovate.

The clearest value that municipal service delivery can add is that local governments are better at matching needs and preferences. As restructuring of the delivery network is a challenge that lies ahead of BiH, the informational advantage of local governments can hardly be underestimated. It must be recognized though, that restructuring of the institutional network will be costly, and access to capital, possibly via intergovernmental capital grants, will also be required.

The second substantial benefit lies in municipalities' ability to more effectively promote access. Whilst insurance entitlements grant recipients the right to access health services, this is no guarantee of take-up. As we have shown, there are large groups within BiH who simply do not exploit these entitlements. This is especially true for vulnerable groups who require a tailored and integrated social and health service for improving their quality of life.

A customer oriented approach to service delivery, is vital to reducing the 'disconnect' between the vulnerable and service provision. This is sometimes best organized on a small scale at community level.

Moreover, municipalities are also in a position to create specialized care packages for specific groups facing particular health challenges. The social exclusion agenda is particularly pertinent here - and often social and health assistance are best combined with educational services to meet the needs of the ultra-poor and excluded minorities. The outreach capacity of ministries to these groups is minimal and higher government levels can only create a permissive framework for such activities. The effectiveness of assistance is highly dependent on the awareness and communication skills of local health and social workers. This in turn, can only be shaped through the institutional connections at the level of local CHCs and, as we discuss in the following section, the Centres for Social Work.

## Access to social services

BiH undoubtedly has very serious social problems. Less than a decade has passed since the war and the economy although growing, remains weak. The dramatic initial decline in GDP, due to economic devastation and the slow recovery, has led to some serious, and often highly localized, problems of poverty and unemployment. A sizeable minority of the population and some key minority groups feel, and are, deprived and excluded.

At the same time the most authoritative research recently conducted on poverty<sup>120</sup> suggests that the biggest problem is not severe poverty, but that a large proportion of the population subsists just above the general poverty line and therefore a size-

<sup>120</sup> LSMS, conducted in 2001 by Statistical Institutes in BiH, with support from UNDP, WB and DFID

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able proportion of the population is constantly at risk. These people need active policy measures, like better employment training and a raft of other labour market measures. Long term prosperity, however, can only be based on increased competitiveness and the associated employment stability and higher wages.

The focus of the next section is social assistance - the direct application of assistance to the poor and needy and the role to be played by local governments. In the following we first provide a short overview of the system of social protection in BiH, we then analyze the current and potential function of local governments, and conclude with recommendations for change.

## Social welfare policies

According to the Living Standard Measurement Survey (LSMS) published in 2003, which remains the reliable analysis of poverty in BiH, a considerable proportion, 19.5%, of the population finds itself below the poverty line<sup>121</sup>. According to the UNDP-supported EWS series, close to 30% of the total population regard themselves poor and around 45% see themselves as being below the average.<sup>122</sup> In addition, official BiH statistics suggest that the unemployment rate is as high as 40%. These facts have led some experts to argue that two-thirds of BiH's population require some form of social protection and that the number is growing. Yet to any informed observer, it is clear that securing social support for two-thirds of the population by the better-off one third is an impossible mission. This problem has to be framed differently.

Contrary to official figures, research by local authors and estimates published by international organizations, suggest that the real rate of unem-

ployment<sup>123</sup> is probably below 20%, but clearly there are large regional variations and some serious pockets of unemployment. Analysts also say that the key problem is rather the emergence of a 'new poverty' than an extreme deprivation of the wider population. As a result of the relatively high level of entitlements guaranteed under the former SFRY, citizens tend to perceive poverty as being more dramatic than it actually is. From this we can restate the problem - as the UNDP's MDG Update Report puts it:

*"The point is not that poverty does not exist, but rather the situation is more complex and nuanced than is often suggested. BiH faces less a severe deprivation of the few and more a vulnerability of the many".<sup>124</sup>*

Mitigating the risks of those at the margin of falling into poverty necessitates a complex set of developmental policies. The Poverty Reduction Strategy Programme (PRSP)<sup>125</sup>, agreed in mid-2004 sets out to achieve this by creating the conditions for sustainable and balanced economic development and accelerated EU integration. These policies have a wide application, social protection policies in contrast, must focus on the neediest. Direct cash benefits and access to social services should be targeted at the socially excluded and the most vulnerable.

Without such targeting social assistance loses its effectiveness. Yet in BiH the old welfare system, with its wide entitlements offered to a large part of society, survives intact. Veterans' benefits for example are given independently of social need and take huge amounts of the available resources<sup>126</sup>. Additionally, a weak definition of rules permits 'double dipping' (drawing a double benefit) and provides scope for abuse. The shrewd, the savvy and often the least disadvantaged, can easily crowd-out

<sup>121</sup> LSMS, conducted in 2001 by Statistical Institutes in BiH, with support from UNDP, WB and DFID

<sup>122</sup> EWS, 2003

<sup>123</sup> As in the rate conforming to ILO definitions.

<sup>124</sup> MDG Update Report, UNDP, 2004

<sup>125</sup> The PRSP seeks to: raise employment levels by strengthening the private sector, establish a sustainable social security system, and secure EU membership.

<sup>126</sup> In FBiH the budget spent on veterans is 13 times larger than the SWCP expenditure: in the RS it is twice as big. PEIR, WB, 2002, p. 78.

the weakest. Moreover, the fragmented financing system, again derivation based, allocates money in an inverse proportion to need.

Decision makers must face the problem of adjusting objectives to potentially available resources so that the impacts can become effective. There are three key challenges for social protection: a redefinition of the beneficiaries, revision of entitlements, and the pooling of resources to larger areas - possibly the entire country.

## Overview of the system

### Legal and administrative framework

There is no unified system of social welfare and child protection (later SWCP) in BiH. Social assistance and care is the responsibility of Entities, yet the relevant ministries in both have very extensive portfolios<sup>127</sup> which dilute their capacity and create a series of perverse incentives.

The Federation's cantonal structure complicates matters by sharing responsibilities three ways. The federal level sets the legislative framework, whilst implementation and financing remains largely with the Cantons<sup>128</sup>, but most cantonal authorities opt to devolve delivery to the local level.<sup>129</sup> In practice, all municipalities supply both general social and child protection services through their CHCs or local Centres for Social Welfare<sup>130</sup> (CSWs). Financing of

child protection is a local duty everywhere, whilst other social services are financed by Cantons using a variety of mechanisms. In the RS, SWCP is shared between Entity and local governments. For both child and social protection, the Entity government is responsible for policy while financing and implementation are decentralized. However, child support is financed from a separate free-standing fund.

Neither of the arrangements adopted at entity-level functions effectively, and a confused set of mandates and misdirection of resources is apparent. It is instructive to note the comments of the World Bank on the system: "In general, the present SWCP structure, whereby policies are set at a government level that is different from the level which finances and implements them, combined with poor co-ordination amongst governments, has resulted in the creation of significant un-funded mandates for many local authorities."<sup>131</sup>

### Beneficiaries

Beneficiaries are generally classified into two basic age groups (minors and adults) although within this there are further subgroups. The total number of social protection beneficiaries in for BiH overall was just over 240,000 people in 2002. The table below provides a summary disaggregated by Entity and age. It is worth noting that these figures include 23,252 refugees and disabled persons, who represent the neediest sub-groups.

<sup>127</sup> In the FBiH social/ child protection and the benefits of civil war victims are the responsibility of the Ministry of Social Affairs, Displaced Persons and Refugees yet there is also an Office of Social and Child Protection at Entity level. In the RS, the Ministry of Health and Social Protection is responsible for social protection and child care, and the Ministry of Veterans, War Casualties and Labour is responsible for the civil victims of war.

<sup>128</sup> There are Cantons that have not adopted the necessary legislation proposed by the Entity Law.

<sup>129</sup> Law on Social Welfare Protection of Civilian War Victims and Families with Children, Official Gazette of FBiH No. 36, (1999)

<sup>130</sup> Different terms are used in different municipalities. Not all municipalities have CSWs (RMAP 2004).

<sup>131</sup> Public Expenditure and Institutional review, WB, 2002 p.80

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Table 4.3: Social Protection Beneficiaries

Recipients	Children	Child/ Adult %	Entity %	Adults	Child/ Adult %	Entity %	Total
Federation of BiH	12,794	13%	68%	84,157	87%	38%	96,961
Republika Srpska	5,990	4%	32%	138,266	96%	62%	144,256
Total BiH	18,784	8%	100%	222,423	92%	100%	241,217

Social assistance recipients make up roughly 2% of the total population, but as the Table makes clear, the adult incidence rate is far higher in the RS. In addition, beneficiaries are highly geographically clustered with a small number of municipalities accounting for 20% of the total. Given that cash resources are largely constrained by the derivation basis of financing, services and cash benefits are inevitably rationed. The number of potential beneficiaries and the value of claims<sup>132</sup> are much higher than the number which can be covered. As the framework laws do not define the criteria for rationing, ample room exists for misdirection and abuse.

## System of service delivery

There are two pillars of the delivery system - the CSWs, whose support activities include both the provision of cash benefits and social services, and different forms of institutionalized care.

CSWs are responsible for implementing the social and child protection programmes and provide various services under one roof. These include: the provision of permanent and temporary cash benefits for rehabilitation; counselling and temporary assistance to families under stress; provision of various retraining programmes for adults; and even, summer vacations for children.<sup>133</sup> The CSWs are themselves responsible for identifying beneficiar-

ies, and services are largely provided free at the point of use.

In addition to the CSWs, BiH has a complex patchwork of social care facilities. Various levels of government have continued to maintain these pre-war institutions and donor programmes have filled a number of gaps. Estimating the total supply of institutional care, resources or their efficiency is practically impossible due to the various uncoordinated channels and the lack of data.

## Financing of services

Spending on social services is low - in 2000 it was 0.3% percent of GDP, and roughly 0.6% of public spending<sup>134</sup>. Again, the sources and application of funds is derivation based. This along with various regulations within administrative units, results in huge disparities in per capita spending and considerable variations of effective coverage. While the expenditure of cantons on social welfare varies between 0.2 and 1.2 % of total expenditure (1999), in the RS it accounted for 1.7% of the consolidated budget and 5.1 % of municipal spending in the same year<sup>135</sup>. There are also weaknesses in the local use of resources. The share of administrative costs within the total spending of CSWs is very high: according to 1999 figures in FBiH it varies between 37 and 87 % and in the RS between 37 and 90%<sup>136</sup>.

<sup>132</sup> Figures should be treated with caution due to double counting and reporting weaknesses. PEIR, WB, 2002

<sup>133</sup> The list is not exhaustive only indicative of the wide range of activities.

<sup>134</sup> PEIR, WB, 2002, p.83

<sup>135</sup> Ibid p.85

<sup>136</sup> Ibid pp.81-84

### Major weaknesses and commentary

The fragmented social welfare system limits the county's capacity to restore the social safety net, to develop an integrated social policy, and to set up an equitable allocation mechanism for social benefits. The current regulations establish entitlements that are disproportionate to financing capacities. In addition, the system whereby one government level makes policy, whilst another level provides the finances, leads to irresponsible decisions. Invariably, political leaderships are unwilling to incur the political cost to cut entitlements which result in implicit rationing and often, the crowding-out of the most vulnerable. The thorniest issue remains the remuneration of veterans.

The lack of reliable data also limits policy development. A redefinition of entitlements and restructuring schemes to match financing, would be near impossible without consolidated and reliable estimates of real need. Neither the CSWs nor other institutions undertake systematic collection of information on potential beneficiaries, and both lack basic information technology<sup>137</sup>. Entitlements are not only impossibly wide but also vaguely defined. The absence of clear criteria for the selection of beneficiaries<sup>138</sup> can easily be exploited for subjective decision making. Some municipalities have exhibited a tendency to direct money according to political benefits or with an ethnic bias.<sup>139</sup>

### Conclusions

The resolution of the key problems in this area is well beyond the scope of our enquiries and cannot be achieved solely through improved decentralization. Nevertheless, our concern is with the contribution that local governments can make, and below, we review what can be done within the cur-

rent system and present some ideas about the wider range of potential contributions and the conditions necessary to support them.

### Local service delivery

CSWs are the basic institutions undertaking social services provision in BiH. Those in the RS are in large part financed from municipal budgets, alongside minimal donations by domestic donors or foreign charity organizations. In most of the FBiH Cantons, the running costs and salaries of CSWs' employees are mainly covered by the municipal budgets, whilst social assistance disbursements are provided from cantonal budgets<sup>140</sup>. Apart from aid distribution, the employees of CSWs provide practical and psychological help such as supportive counselling and home visits. However, the CSWs usually lack professional staff, such as social workers and psychologists, skilled in dealing with the problems that arise. As a result, most service delivery is effectively bought in.

Besides the CSWs there are other types of institutions involved in the delivery of social services. People with serious trauma-related problems and mental disorders who need specialized treatment are directed to the Community Mental Health Centres (CMHC). These aim to provide clinical services for the mentally-ill, and psychosocial rehabilitation. CMHCs are usually staffed by a psychiatrist, a psychologist and social workers. Sadly, there is evidence of CMHCs refusing to accept clients referred by particular CSWs, because of past unpaid debts. According to data from 2002, there are also 11 centres for the daily care of mentally retarded persons in the FBiH and 25 other social protection institutions.

In the RS, besides the CSWs, there are 10 institutions that provide care for elderly and for children.

<sup>137</sup> RMAP 2004: examples could be found within all municipalities reported.

<sup>138</sup> RMAP research cites many such cases e.g. the CSW Odzak has no criteria for the selection of beneficiaries.

<sup>139</sup> RMAP 2004, see Derventa Report

<sup>140</sup> Bugojno municipality allocates resources for the local CSW's running costs and some limited resources for vulnerable groups, including medication. All other costs are covered from cantonal funds (RMAP, 2004).



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Roughly 1,600 persons live in these institutions<sup>141</sup>. However, CSWs often cannot afford to pay for places in these homes and lack the ability to treat those needing care themselves. In areas where this is the case, people are left to be looked after by their families or to fend for themselves<sup>142</sup>.

In addition to these public institutions there are many NGOs, domestic and foreign, engaged in providing social services for vulnerable groups. They are considered to be valuable partners especially where CSWs are unable meet local needs<sup>143</sup>. The Red Cross, for example, distributes aid and provides homecare to returnees and others<sup>144</sup>.

## Demand and supply of assistance at the local level

As municipal institutions disburse social assistance, citizens perceive that municipalities are responsible for social protection. However, in reality, the Entity in the RS and the Cantons in the FBiH determine policy. The RS Law on Social Welfare regulates the standards of service and the level of disbursements, whilst municipalities are obliged to provide the funds for covering entitlements. Yet municipalities often do not have sufficient resources to meet the benefits of eligible persons on a regular basis. In the FBiH, various cantonal laws regulate forms of assistance. Under-funding and resource rationing is commonplace in both jurisdictions.

Moreover, there seems little political or institutional willingness to pool the resources available for social protection or to create any kind of equalization mechanism. The situation is exacerbated by the clustering of exceptional needs in areas where revenues are the weakest. This creates huge differences in allocations and service provision. More detailed statements about the consequences are

difficult to support with data for various reasons. But it is clear that some social benefits and services prescribed by the Entity laws are simply not provided in a number of localities.

Two conclusions can however be drawn without any risk. Firstly, that the social care offered by municipalities generally does not meet the population's needs, neither in terms of quantity nor quality. Secondly, that local governments are restricted in their competence and financial capacities - thus, they are not currently able to offer any real added-value.

## Recommendations for change

Local governments play an important function in social services delivery in many other countries and there are good reasons for BiH to adhere to a similar model. It is abundantly clear, however, that the current system which includes a high level of functional decentralization is dysfunctional. This is chiefly because the system pushes almost the whole burden of implementing and funding social assistance onto local governments without support. This is at odds with both the correspondence and the subsidiarity principles.

Cash benefits should clearly be regulated and financed at the state level and social services budgets should be strongly equalized. Only under such conditions can local governments play a more constructive role in social services, as the main provider or commissioning agent of care. Models of delivery vary - under a minimalist approach, local governments could be assigned extended agency functions, under which they could act as an interlocutor between higher level governments and citizens. They could also be charged with monitoring and collecting data on social status and needs.

<sup>141</sup> Federal Ministry of Work and Social Welfare, Ministry of Health and Social Policies of the RS

<sup>142</sup> Due to the large debts that the Prijedor CSW accumulated individuals who had been hospitalized in various institutions throughout BiH are now being sent back to the municipality (RMAP, 2004)

<sup>143</sup> Owing to a lack of resources, Una-Sana Canton did not set aside any money for the CSW in Sanski Most for 5 years. The Centre was able to

begin distributing funds in 2003. In Trebinje, the municipal budget covers only 60% of the needs of social welfare sector (RMAP reports, 2004).

<sup>144</sup> In Milici Municipality cooperation takes place with the local branch of the Red Cross, the "Zora" Women's Association, and the "Život je lijep" youth organization.



With a more developed role, localities could effectively share information about opportunities with citizens and seek to reach out to the most isolated members of society enabling access and social re-integration. Under this more courageous model a larger degree of discretion could be devolved to local governments (within a margin determined by law) to adjust benefits and services. Obviously such discretion can only work if coupled with locally- disbursed finance. The current range of local services provision is clearly a de-concentrated agency function (and not a decentralized service), but the system is still far from the minimalist approach mentioned above. Many CSWs are forced to fight for their daily survival.

Few Centres even have the capacity to disseminate relevant information to potential beneficiaries<sup>145</sup>. This is an important systems failure, since ordinary people are not aware of their rights and are not familiar with the eligibility criteria for social assistance. As a consequence, there is a large portion of the vulnerable who are left outside the local social support network<sup>146</sup>. Particular additional efforts must be made in order to reach rural populations that live in distant areas. In the case of groups where information alone is not enough, active social work is needed to enable them to use the available opportunities.

The network would work better if it were financed differently. If per capita allocations could be determined for certain types of beneficiaries, these allocations could be drawn from centralized budgets by the institution treating clients. If money followed the client, beneficiaries would be less dependent on local financing capacities and less often excluded from care. Such arrangements

would also supply incentives for institutions to perform better and be more customer-oriented.

An integrated database on actual and potential beneficiaries would be needed regardless of the particular delivery model adopted. A reliable and regularly updated database is necessary both for scaling national policies and for adequate implementation at local level.

Clearly, there is ample room for improvements even within the current de-concentrated system. At the same time, it is also apparent that local governments could usefully do a lot more within a decentralized framework, if some policy making role were also devolved to them. They could define the adequate 'mix' of client services and share of resources. They are also in better position to establish and run 'third-way' services that could keep old and disabled people in their own homes, instead of institutions, through the better coordination of the work of NGOs, volunteers and private providers. As noted previously, if freedom of manoeuvre is given to them, municipalities are best-placed to build purposeful linkages between social care, health, education and other local services.

## Public utilities

The management and delivery of local utility services (water supply, waste disposal, heating and energy) is one of the key functions in which local governments in BiH already play a very substantial role. This is in contrast to their limited competencies in other areas. In spite of their rather prosaic nature, these services are vital for well-being and human development. Gaps and weaknesses in supply undermine living conditions, public health, environmental protection, and seriously impede local eco-

<sup>145</sup> For example, in spite of legal commitments to the visually impaired, and absence of clients, Odžak CSW has no plans to inform citizens about this entitlement (RMAP reports, 2004)

<sup>146</sup> The vast majority of returnees who live in the rural areas of Milici municipality do not register with the local CSW (RMAP reports, 2004).

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conomic development. Without sound utility services neither environmental nor social sustainability can be secured.

The war caused overwhelming devastation to BiH's physical infrastructure. In the post-war period most of the essential services have been restored with the support of the international community<sup>147</sup>. Nevertheless, a tremendous need remains for maintenance and the provision of new infrastructure. It is estimated that over 50 % of BiH citizens are deprived of the right to access a safe and secure water supply, sanitation and solid waste disposal. This is far from a phenomenon of remoteness alone: the infrastructure in some major urban areas remains underdeveloped. There is huge need for investment, and the financing gap was estimated, by a World Bank team in 2003 to be around US\$ 1.2 billion.<sup>148</sup>

Locally run utilities also suffer from poor management. Pricing schemes and collection practices are outdated, and thus collection rates are very low while company management and working culture has not changed since socialist times. Nor are sector strategies or urban development plans in place which might be used to guide service renewal.

Improved provision can play a key role in improving the living standards and promoting economic growth. In contrast with other sectors, these challenges can be addressed now by municipalities within their existing competences. As in previous sections, we begin with a short overview of the general conditions of service delivery. Then we analyze solutions before making final conclusions and recommendations.

## General context and condition of services

### Legal framework and local competencies

The legal and administrative framework governing utility services in BiH is as complex as the regulation of the social functions we have already reviewed. Territorial planning of utilities, and their financing and organization are undertaken at entity and cantonal level creating, again, 12 different delivery regimes. Whilst the relevant body of law is vast, there are also important gaps in the current regulations especially those covering basic quality and safety standards.

In both Entities local governments are responsible for water supply and sanitation<sup>149</sup>, solid waste management and district heating.<sup>150</sup> In principle<sup>151</sup> municipalities own the assets, determine service development priorities and have the right to set charges. In addition, they are allowed to contract-out the services, and in some cases to award concessions. Yet full privatization requires the approval of higher level governments.<sup>152</sup>

### Environmental standards

There is currently a lack of state level authority for the protection of natural resources and the environment. An Inter-Entity Environmental Steering Committee was established in 1998, but its mandate is restricted to the coordination of policy and harmonization of environment laws. The presence of multiple ministries at various levels still results in a fragmented system and often conflicting rules. In addition, all levels of government suffer from a lack of adequate institutional infrastructure (monitoring and regulatory agencies, research and planning institutes, and so forth).

<sup>147</sup> Projects financed by WB: Mostar water supply and sanitation project; BH Sanitation and solid waste urgent works project. Other relevant donors are providing technical assistance projects.

<sup>148</sup> Infrastructure and Energy Business Plan, World Bank, 2003

<sup>149</sup> The only exception is the City of Sarajevo where the Canton is responsible for these services.

<sup>150</sup> By communal services we mean public hygiene and cleanliness, public lightning, etc.

<sup>151</sup> In both the RS and FBiH duties are not clearly defined and therefore allow for different interpretations.

<sup>152</sup> For utility asset privatization, local authorities need to seek approval from the relevant Privatization Agency. Local authorities can award concessions for solid waste, but not for water sector related services.

### Management practices

Services are mostly delivered by public enterprises, which are owned by municipalities<sup>153</sup>. Enterprises operate as autonomous entities having independent management teams, but their revenue capacity is dependent on municipal decisions on tariffs and subsidies. Private partners have been involved in utility companies, but they do not hold controlling interests. There is also some, although limited, involvement by the private sector, largely as subcontractors. Typically, local authorities lack resources, knowledge and competences to prepare and implement effective Urban Development Plans, which is a precondition for improved utility service coverage and quality enhancement. In the absence of such strategies, ad hoc measures define the course of infrastructure decisions, resulting in low investment efficiency and limited effectiveness.

There is little transparency or predictability in municipal-company relations. Pricing formulas are practically not used: both rate setting and subsidy decisions are made in most cases by highly subjective decisions. Utilities are still often treated more as social services than financially self-sustainable public enterprises, and municipalities try to avoid price increases. As a result most utility companies are perpetually in deficit. The financial difficulties are also a result of low collection rates (between 40% and 60%<sup>154</sup>) and huge arrears. There are few incentives to pay amongst private users, but the largest defaulters often are other public institutions and companies. There are no adequate legal mechanisms in place against defaulters and many consumers rationally chose to 'free-ride'. If subsidies do not cover outlays, utility companies often balance the losses by withholding payments due to

private or governmental creditors.<sup>155</sup> These practices result in a complex web of debts, which works to further thwart efforts to resolve them.

### Access and quality of services

Lack of investment resources, absence of strategy and outdated company management practices serve to worsen the infrastructure failures inherited from the war. In spite of rehabilitation efforts, the current condition of urban infrastructure is generally poor. There is no reliable data regarding service coverage. However, it is estimated that only 53% of the total population has access to the mains public water supply and only 45 % have continuous service. Water rationing is common, especially in summer. About 40% of the population is connected to sewerage system, but only 10% of the collected waste water is treated.<sup>156</sup> The situation is worse in the solid waste management sector, where, according to estimates, less than 40% of the population is covered by organized collection and only five land-fill sites are properly engineered. In addition to generally low standards, there are also huge differences between regions, and in some municipalities, there are serious supply failures<sup>157</sup>. Rural-urban disparities are particularly evident. Access to the public water supply in rural areas is as low as 32%, whilst access to the public sewerage system runs at 24.5%<sup>158</sup> of households. Rural and remote areas of the country rarely have access to public waste collection services, and where the service is available, it is of extremely low quality.

There are also serious problems with service quality. The piped network is in a terrible condition and 50-80% of pipes need replacement<sup>159</sup> and even more need rehabilitation. The gaps in waste water services and unprotected dumping sites result in

<sup>153</sup> There are various groupings of services in companies. In larger places often water and waste water services are provided by one company, heating services by another, while solid waste management and other communal services are supplied by a third company. In smaller municipalities one or two public enterprises handle all three.

<sup>154</sup> Project Appraisal Document for an Urban Infrastructure and Service Delivery Project, WB, 2004

<sup>155</sup> Ibid

<sup>156</sup> Study on water supply provision within FBiH Sarajevo, BiH

<sup>157</sup> At the extremes there are municipalities like Zivinice, Tuzla Canton FBiH, with about 51.6 thousands inhabitants out of which only 4 thousands (9.5%) have access sewerage system

<sup>158</sup> Living Standard Measurement Survey in BH (LSMS), 2003

<sup>159</sup> Water sector institutional strengthening project in RS and FBH, Phare 1999

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permanent environmental damage. The lack of protection of water sources compromises water quality, whilst water loss is a big problem across the network, and amounts to 50 to 70% of the water retrieved at source. A large part of the losses stem from leakages, but in addition a large portion of illegal consumption is taking place which remains unrecorded.<sup>160</sup> These conditions are not supportive of environmental sustainability, and more significantly, present serious health risks.

Unsurprisingly, citizens perceive that utility services have deteriorated since the war. Opinion surveys overwhelming register their dissatisfaction: 36.1% consider water supply and sewage systems to be of very low quality.<sup>161</sup>

## Commentary and recommendations by sub-sector

### Water and wastewater sub-sector

Drinking water supply services cover only 56% of FBiH and 48% of RS inhabitants, compared with over 90% in Europe. Households consume 75% of the water produced. As most laboratories were devastated during the conflict, water quality and quality control varies enormously between settlements. Water supply is also very costly in many parts of BiH. A major reason is the topography; in a large number of localities water needs to be piped uphill to reservoirs before it is distributed. The other is a maladapted system, which is a legacy of socialist planning practices. The third and most important reason is the devastation visited on the network during the conflict. Inefficient company management is the final ingredient.

Sewage service provision covers only about 40% of the population and this proportion has fallen

from about 70% during the pre-war period. Only 70% of households in urban areas and larger settlements are connected, whilst in smaller settlements this percentage does not exceed 10%. Due to the lack of wastewater treatment plants<sup>162</sup>, 90% of the wastewater is released into the watercourses causing serious contamination of both natural waters and soil. Such a dismal condition of water services imposes a serious threat to public health conditions.<sup>163</sup> Improving access and the quality of water services must be an absolute priority in the future in BiH.

Limited financial resources mean that municipalities are forced to trade-off priorities against one another. In most cases they decide in favour of rehabilitation of the existing network and push service expansion aside. Through this strategy some municipalities have been able to invest and plan steady maintenance, but others have had to limit their activities to emergency interventions, like the repair of major leakages. Municipalities alone will not be capable of meeting the dual challenges of improving both quality and access.

### Utility company-consumer relations

As political and not commercial considerations drive decisions on charges, operating costs and investment needs are rarely covered by revenues<sup>164</sup>. Commercial considerations do not often figure and political pressures ensure that local providers are supported with non-transparent general subsidies to meet social objectives<sup>165</sup>.

Non-rational rate setting processes are a major source of company deficits but low collection rates, at between 40 and 70%, are as significant. Municipalities frequently make ad hoc transfers to utility companies to cover for losses incurred, but this is dependent on the resources available in the

<sup>160</sup> For example Sarajevo Canton Water Utility produces 85 million m<sup>3</sup> of water on a yearly basis, while it registers only 32 million m<sup>3</sup> of actual consumption, implying water loss equivalent to 63%. It is clear that not only leakage, but illegal water consumption, also contributes to the reported loss.

<sup>161</sup> BiH Local Level Institutions and Social Capital Study, June 2002, World Bank, ECSSD, p. 33 - Table2

<sup>162</sup> Only seven cities in Bosnia and Herzegovina had treatment systems

before the war. Yet two, Sarajevo and Trnovo are still not functioning due to war damage. But a treatment plant has been constructed in Srebrenik.

<sup>163</sup> Poor water quality resulted in hepatitis outbreak in the Bihac in 2002.

<sup>164</sup> Cost is estimated on historic basis, aiming to cover energy consumption, administration, costs of working capital, emergency maintenance but excluding depreciation costs.

<sup>165</sup> The household water tariff in Sarajevo is 0.7 KM/m<sup>3</sup>, in Banja Luka 0.25 KM/m<sup>3</sup>, and in Lukavac 1.11KM/m<sup>3</sup>.

municipal budget. Subsidy setting is therefore utterly non-transparent. Levels of support have no objective basis and are a product of a bargaining process between the municipality and the company. It is often the case that the effective municipal subsidies range between 10% and 20% of utility companies' total reported losses.<sup>166</sup> These figures reveal the extent of the bargaining game whereby both parties connive to withhold information from each other.<sup>167</sup> It is no wonder that the system does not produce data for analysis, let alone policy or managerial reform.

Consumer-company relationships are as irrational as company-municipality relationships. For the most part, flat average charge rates are used. Where consumer metering does exist it often does not measure individual consumption, but the aggregate consumption of blocks of apartments. Neither of the two methods promotes accountability. The picture is somewhat better in the commercial sector where metering of business usage has progressed more rapidly. Yet equally, supply is also plagued by perverse subsidy schemes which offer free or discounted supply above a set level of consumption. As a result, pricing cannot be used to rationalize consumption and nor does it supply information on demand.

While the system is prodigious in granting general subsidies, paradoxically, there are no targeted household subsidies. There are also no effective legal means for enforcing payment by defaulting consumers. Rate setting, collection and subsidy practices are at odds with the principles of both universal access to quality services and supporting a sustainable environment.

Clearly, outdated management practices produce a very expensive system, and result in huge gaps in access, a low quality service and in many places an ongoing gradual deterioration of the network. The politicization of management and workplace culture harks back to the socialist period. However, as we have seen above, there are technical obstacles as well, and furthermore, the system does not produce information which could be used to make future strategic choices.

### **Improving pricing and subsidy mechanisms**

Pricing reform is a possible solution to this trap. If local governments were to accept the absolute need for full cost recovery and move towards efficient pricing mechanisms, which are transparent, predictable and affordable, then financial discipline would constrain both companies and municipal leaderships. Municipal leaders would be under pressure to cover the costs of supply and reduce the subsidies. Cost recovery-based prices would also close the door to the subsidy bargaining process that diverts attention away from reducing water losses and improving collection performance. The implications of tariff reform would generally be beneficial. Yet, some conditions must be in place if these benefits are to be fully exploited:

- Municipalities will require technical assistance to design adequate pricing schemes. This includes expertise that is as yet unavailable within the sector;
- Legal changes should create a means for companies to force users (both private and public) to meet their obligations;

<sup>166</sup> Public utilities yearly business reports (2003) for Sarajevo, Banja Luka, Mostar

<sup>167</sup> For example Sarajevo's water utility reported a net loss of 23.1 KM million (equivalent to 58.9% of revenues) in 2003, but only 3.6 KM million were transferred from the cantonal budget to cover priorities.

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- Targeted subsidies should be created for the needy to secure their access to service (we return to this below).

New pricing schemes can also have very positive implications for consumer-provider relationships. If cost recovery-based pricing were coupled with individual metering, the system would initiate a process which would work to rationalize consumer behaviour. More market-driven relationships would equally tend to increase company accountability. However, here again we face a technical problem. Installing meters at each consumer's location represents a huge up-front investment, and one that is often crowded out by other urgent expenditure needs. In a number of countries, giving private consumers the option to install meters at their own expense, or offering part-grants, has assisted this process.

Yet we also need to have realistic expectations about what tariff reform can achieve. First, it is unlikely to generate sufficient revenues to offset the accumulated failures of the past, and provide for rehabilitation and extension. Capital grants should therefore also be considered as a policy option for making good the deferred works, especially within those areas with weak revenue capacities.

Second, it must be recognised that new tariffs, however constructed, will not alter the fact that if revenues are to rise, then so too must prices. As in other post transition countries, user charges are well-below cost coverage and considerably lower than European levels (see Table 4.4). Estimates show that some tariff increases could be as high as 100% if BiH's water utilities are to break even. Although clearly, the level of increase will vary depending on local conditions and in particular, the extent of the efficiency gains which can be reaped from changed managerial and working practices.

Table 4.4: Average Water and Wastewater Tariffs

Parameter (KM/m <sup>3</sup> )	RS	FBiH	Hungary	Estonia	EU average
Water price	0.20	0.40	0.8	0.63	2.0
Wastewater price	0.09	0.20	0.8	0.81	1.5
Total	0.29	0.60	1.6	1.44	3.5

Finally, price rises necessarily impose a political challenge and it is likely that tariffs could only gradually be made compliant with cost-recovery principles. Moreover, even mild increases are potentially problematic for the poor, and the appropriate targeted subsidy schemes already recommended are vital. The costs and scope of such schemes should not, however, be overestimated, and the financial consequences of providing targeted support are almost certainly cheaper than current levels of general subsidies.

## The need for investment grants

Pricing reform is only part of the solution as the backlog of deferred maintenance and development cannot be fully charged to users - because their general capacity to pay is simply inadequate. Moreover, access to borrowing is limited, and in any case, it would not be equitable to raise investment needs wholly from current consumers due to the huge disparity in initial endowments. Municipalities are likely to need a long period of support for network development and rehabilitation. Capital grants would be especially important for those municipalities where there are major gaps in infrastructure which limit human and economic development.

There is already some investment grant funding available in BiH, but the amount is well below cur-



rent needs. Furthermore, decisions on allocations are discretionary and often politically biased. Transparent procedures should be set up for grant allocations which could secure fair competition. Putting such procedures in place would increase the potential for leveraging in other resources.

#### **The potential contribution of privatization and regionalization**

International experience shows that the involvement of private partners can increase company efficiency and bring in additional resources to finance investment. At the same time, experience also shows that poorly executed privatization has served to pass lucrative businesses to private interests and incur huge losses for citizens and customers. In the field of water and wastewater services most municipalities in BiH are almost certainly not in a position to embark on full-blown privatization. They need technical assistance to reform pricing, secure adequate levels of transparency for company management and finance, and clarify local strategies before beginning this process.

The regionalization of utility services is another issue often raised in BiH. Efficient network planning of both water and wastewater systems is dependent on hydrology and topography. Municipal boundaries are often not coterminous with drainage catchments and therefore are unable to fully exploit the available economies of scale. In many cases, there is some potential for clusters of cooperating municipalities to establish more cost-effective services which might better facilitate access. The aggregation of water companies would also serve to enhance the network's resilience and reliability. Such regional companies could also better exploit financial resources. A similar, regional approach

could be taken for wastewater in cases of smaller settlements. However, savings should not be taken for granted - costs are context dependent and should be analyzed thoroughly prior to any decisions being taken.

#### **Solid waste management sub-sector**

Sustainable waste management implies provision of facilities that minimize adverse environmental impacts and ensure that the living conditions of future generations are not compromised. It involves all levels of authorities but also the broader public. Increased awareness amongst citizens is the key underpinning of such sustainable approaches.

#### **Supply and revenue collection**

After the war, waste collection was literally paralyzed due to a severe lack of equipment. This situation has abated. But the small number of sanitary landfills or incineration facilities, coupled with a non eco-friendly culture, has led to a form of municipalized fly-tipping<sup>168</sup>. In rural areas where organized waste collection largely does not exist, illegal dumping has become rampant. Waste is often thrown in rivers or simply on the roadsides. Inappropriately disposed waste can be carried away by animals or blown by the wind from open dumpsites. This presents real dangers to public health and the environmental amenity of the countryside. Infiltration and soil contamination can affect drinking water sources, amplifying the potential adverse impacts. Therefore, improving waste management has been recognized as a priority by both local and international authorities in BiH. Nevertheless, there is still no accepted strategy for this sub-sector.

<sup>168</sup> It is estimated that there are over 1,200 non-managed landfills in BiH. As local authorities do not receive financial or technical support from higher-level structures, they often resort to operating provisional local dumpsites. Interview with Professor Milasinovic, Faculty of Civil Engineering, Sarajevo, August 2004

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A future strategy has to face two challenges: increase both service coverage and deposition standards. Currently, only approximately 60% of the population is covered by regular waste collection, while the norm outside the cities is below 40%. Where the service exists, it is provided by a local utility company. In most areas, waste is collected in 1100-litre bins, which are placed alongside the road and there are no means of checking who deposits waste in these communal containers.

## Rate setting and cost coverage

Tariff setting is the responsibility of local authorities. Most citizens do not pay the amounts charged and enforcement is difficult. If sued in court, the process is usually lengthy and could cost more money than the utility might recoup. The average collection rate is low at 25% in the RS and 35% in the FBiH<sup>169</sup>. Low collection rates and revenues present a huge obstacle to service extension and quality improvement.

Rate setting, at least in principle, seeks to estimate the costs of collection and deposition on the basis of projected waste volumes. Unfortunately, in practice the estimated costs are based on the volume per person, yet charges are made according to floor area. Moreover, political discretion plays a substantial role. Rates vary greatly among municipalities and the ratio between highest and lowest is six to one.<sup>170</sup>

Most companies complain that tariffs are artificially low, do not cover operating and maintenance costs and undermine future capital investment. According to some expert estimates tariffs should be raised by an average of 230% to ensure cost coverage. It has also been argued that the cost burden is being exacerbated by weak realization of

potential economies of scale. According to (admittedly) partial data, annual waste collection and disposal costs per person range between 27.4 KM per person in Banja Luka and 153.5 KM per person in Bosansko Grahovo.<sup>171</sup> This underlines the very real potential for cost savings.

Tariffs should therefore be raised gradually over the medium term, so that the cost burden can be shifted to consumers. As with the water supply sector, reaching full cost coverage is both politically difficult but also rewarding for those leaders that are prepared to embark on such reforms. Although the relative burden on household expenditures of waste tariffs is usually the lowest of the utilities, discontent will still be felt. Nevertheless, if costs can be covered by tariffs, then this obstacle to service expansion can be overcome quickly as entrepreneurs are likely to then enter the market. Such policies might therefore be 'sold' to the public as they are capable of producing fairly rapid and visible changes. Of course, cost-recovery based prices will still not be affordable for all. Thus parallel to the increase in tariffs, properly designed and targeted household subsidies will also have to be introduced.

## Involvement of private providers

Some municipalities, like Zenica, Dobož and Tuzla, have already started to contract out<sup>172</sup> solid waste collection and disposal services. Generally, the authorities are relatively satisfied with the results, as service quality has improved, whilst costs have decreased as a result of market competition. However, substantial improvements in terms of service coverage and frequencies of collection have not taken place due to lack of funds. As up front investment in collection equipment is not prohibi-

<sup>169</sup> Revenue collection by public utilities is extremely low ranging between 15% to 80%, FBiH Draft Strategy for Solid Waste Management, Cost Assessment, p. 23, Faculty of Civil Engineering, Sarajevo, August, 2000

<sup>170</sup> Knezevo 0.1 KM/m<sup>2</sup>; Banja Luka 0.6 KM/m<sup>2</sup>; Sarajevo 0.1 KM/m<sup>2</sup>; Ibid

<sup>171</sup> Ibid

<sup>172</sup> The services are contracted on an annual basis. This solution might exploit the pressure from frequent competition to discipline providers, yet this probably won't provide sufficient rationale for investment.



tively high, cost-recovering based prices could rapidly secure service expansion. Contractor competition (if real and well managed) can also help in price setting as it breaks through the asymmetric information problem inherent in company-municipal relations.

### **Regional landfills**

Whilst local collection capacity can be expanded through pricing policy change, the establishment of landfill or incineration facilities according to modern environmental standards would require a sizeable investment. Such an investment is beyond the financial capacities of most municipalities and domestic investors in BiH. Moreover, it would not be economical either to establish and manage many small landfills - thus inherent economies of scale call for cooperation between municipalities. After the initial proposals put by international agencies, local authorities have rapidly recognized the benefits of such regional dumpsites. The World Bank has invested in five regional landfill locations, each serving 150,000 inhabitants plus.<sup>173</sup> One of these, the "DREKA" landfill site, will ultimately include 11 municipalities and will solve the long-term problem of waste collection and disposal for about a quarter of BiH's population.<sup>174</sup> The respective municipalities' have already established an inter-municipal board responsible for the coordination of technical work and cross-entity cooperation. We recommend that other municipalities examine this model.

### **District Heating**

District heating is a specialized form of utility provision that harks back to the centrally planned economy. However, it has also operated very successfully in several market-based economies

(notably in Scandinavia). The maintenance of this form of heating supply is central to the well-being of a large proportion of the population in BiH. Unfortunately, the technology adopted in the former Yugoslavia presents particular challenges.

BiH has about 20 district heating systems, which are operational in every major settlement including Sarajevo, Doboј, Zenica, Tuzla and Banja Luka. Before the war, these sorts of systems covered about half of the nation's inhabitants - today that number has fallen to a little over 32% of the population.<sup>175</sup> After the war only the Sarajevo plant was fully rehabilitated and others are still in need of considerable reconstruction. Neglected maintenance and chronic underinvestment have caused increasing inefficiencies resulting in energy losses averaging a staggering 60% of inputs.

Responsibility for providing this service rests with local authorities, yet it is delivered by the public utility companies. Production is mostly coal-based, although natural gas is used in Sarajevo and partially in Zvornik and Zenica. The use of low grade 'brown' coal is both inefficient and release pollutants. Indeed, contemporary thinking has swung away from the net environmental benefits of district heating, noting that the inadequacies of the technology more than offset the production gains.

These arguments are particularly pertinent to BiH, where the network design is primitive, does not allow for individual consumption metering, nor heating volume adjustments. Allowing the households to make choices about whether to access the system, adjust heating consumption and the installation of metering would require prohibitively high investments. However, without such upgrading it is hard to see how either the quality of service or the

<sup>173</sup> More distant settlements and towns would have their own transfer stations, where recyclables would be first separated, and then the rest transferred to the regional landfill at the most efficient time intervals.

<sup>174</sup> Especially in Doboј, Magla, Teslic, Tesanj, Zepce, Zavidovici, Orasje, Derventa, Brod, and Tuzla

<sup>175</sup> Living Standards Measurement Survey in BiH (LSMS), Agency for Statistics BiH (2003)

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system's efficiency might be improved. In the absence of individual metering, the tariff has to be set according to estimated square metre costs. Moreover, it is impossible to cut household supply to reduce the high level of outstanding arrears. Indeed, it estimated that collection rates in Zenica are as low as 30% of the total amount due.

Cost-recovery pricing under these conditions is precluded by the very high production costs, weak ability to pay and the impossibility of direct enforcement. The most that can be achieved in this area is the containment of deficits and hence of subsidy levels, through all possible means. Reducing losses through technological improvements is the most urgent intervention required, and this would also upgrade the service quality and reduce negative environmental impacts. Practices of other post-socialist cities should be examined, as the problems associated with district heating system are common within Eastern Europe. Interventions, although costly, are vital; without them there is a risk that systems will suffer major failures.

## Other Municipal Services

Finally, within this section we examine two further areas of service delivery - local roads and communal services.

### Local roads

The construction and maintenance of local roads are also municipal responsibilities in both Entities. There are two major problems with the network of local roads:

- Firstly, in some areas there is a degree of underdevelopment, whereby access to settlements is not secured year round;

- Secondly, there is a general quality problem. Due to war devastation and a lack of maintenance, local roads are invariably in a poor condition, and require substantial investment.

World Bank studies have found that 74.1% of the public believe that local roads are of low quality, and operational assessments suggest that more than two-thirds of local roads are in need of repair.<sup>176</sup> Poor roads are a serious impediment to citizens' freedom of movement, their access to other services and wider economic growth.

In general, local authorities realize the importance of infrastructure to local development and when finances permit, make large efforts to improve its quality. Those that are better-off have made continuous investments. Yet others with perpetual financial problems are unable to make any useful impact. In some places, for example in Trebinje, cooperation with newly established MZs might offer some room for improvement.<sup>177</sup> Indeed, there is a tradition of infrastructure development in close collaboration with MZs. In recent years the old practice of capital cost sharing has been revived and this has led in particular, to the upgrading and extension of the rural road network.

Recent legal changes are also expected to increase the resources available for local roads and positively impact on the size and quality of the network over the medium term. The new legal provisions allow the introduction of road investment fees and maintenance payable upon car registration. The estimated revenues to be collected from these fees could amount to 20%-35% of total non-tax revenues within local budgets.

<sup>176</sup> Sabina Basic (2002), *The role of local authorities in promoting private sector growth: Issues & Challenges in BiH* (2002). Conference on Local Development, Faculty of Economics, Charles University

<sup>177</sup> Based on interviews with local administrators

## Communal services

These services include the maintenance of public areas, green spaces and public lighting. Responsibility for these activities normally rests with municipalities and services are normally undertaken by local enterprises controlled and financed by the municipalities. Local governments are invariably required to meet the costs of provision from their own often restricted budgets and are not allowed to charge fees. Given their relatively low political priority, the quality of service is very dependent on local fiscal capacity. The general picture of many cities is grim. Opinion surveys show that 58% of respondents across BiH are generally dissatisfied, and especially with the quality of green and public spaces.<sup>178</sup>

The level of resources available is the key problem, but weaknesses in the management of provision should not be overlooked. In many cases one municipal company is responsible for a variety of services. The company often also holds responsibilities for solid waste management, for which it is able to charge. Communal services are therefore often seen as ancillary and unimportant add-ons. It would be more effective if park maintenance, public cleanliness, and so forth, were financed by municipal transfers made under quasi-contractual terms. Indeed, it may also be worth considering outsourcing or subdividing municipal companies along functional lines.

In addition to the work carried-out by municipal enterprises, the public's willingness to undertake volunteer collective activities can also make a big difference to the quality of the local environment. In many places positive attempts have been made to improve local living conditions via joint community

efforts, such as collective cleaning and green space actions. These can be financially supported by municipalities but undertaken by community based associations. These initiatives also have a wider external role in fostering civic responsibility and community cohesion.

## Summary and Conclusions

Within this chapter we have discussed the local services provided, or at least facilitated, by municipalities in BiH. They are the very substance of local government's mission and major contributors to the quality of lives and hence, human development. We have made a series of recommendations and although many of the problems are dependent on the characteristics and the context of delivery, there are common themes.

Overall, our appraisal reveals a set of functional but highly challenged systems that are failing to live up to their potential and are in some cases, increasingly moribund. Alongside this, and especially within the education and social welfare sectors, there is also evidence of ongoing political biases, ethnic domination and poor targeting of assistance.

The overall lack of resources and the political situation are important drivers of the sectoral challenges we have reviewed. But management, oversight and coordination are also pressing constraints. Moreover, in the medium term resources are necessarily limited, and equally political change is likely to proceed slowly. We believe that effective decentralization offers the best hope of squaring the circle of improving provision both in terms of access and quality within existing financial limits. As we have argued repeatedly, local governments are best placed to match provision with needs and

<sup>178</sup> Local level institutions and social capital study, World Bank, 2001, p.33

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bring rationality to the current fragmentation and dislocation which plagues BiH.

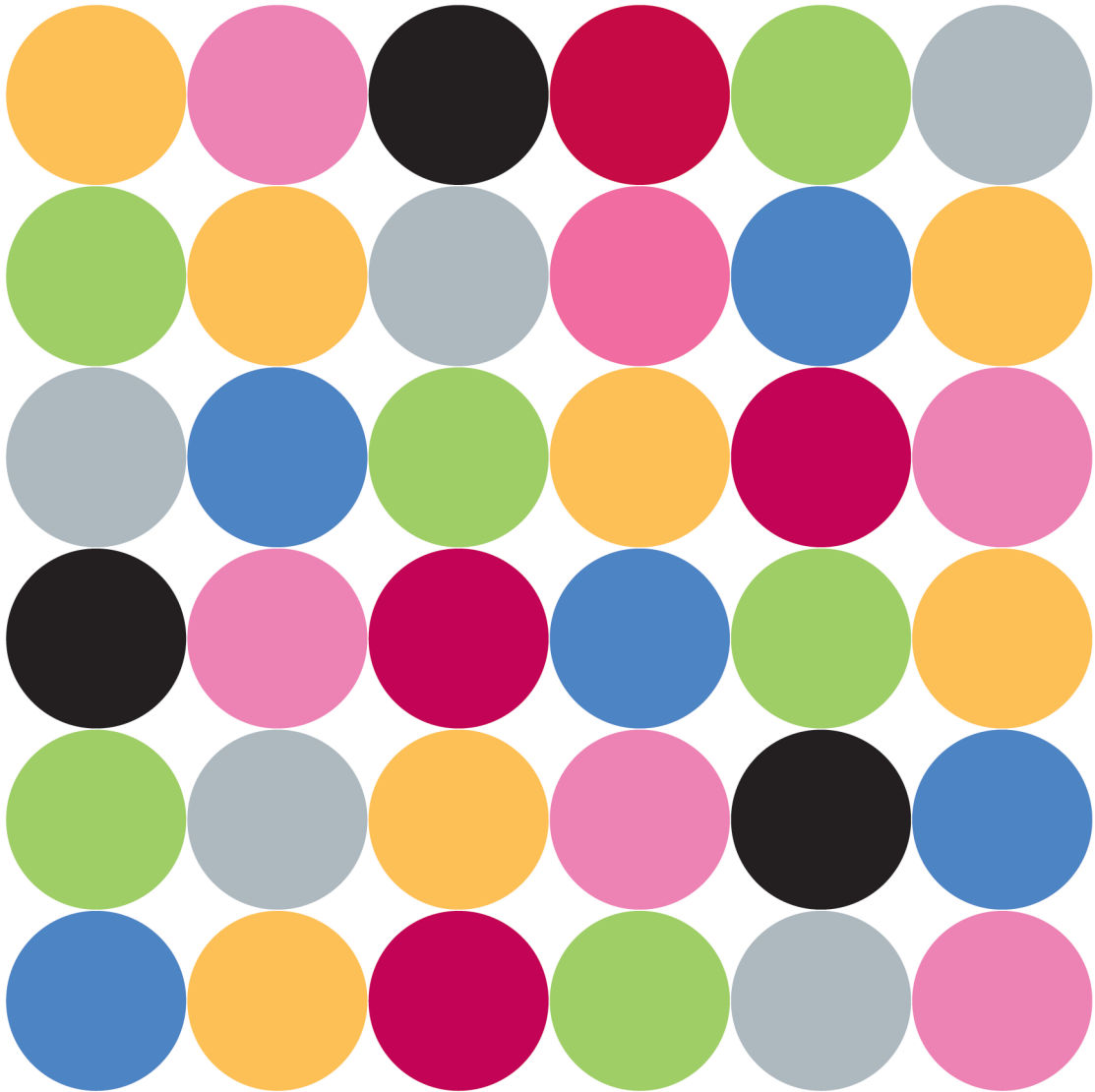
However, this cannot be done without support from above and systemic change is required, particularly in financing and coordination mechanisms. As argued in Chapter 3, equalization of resources has a very high priority. In the health, education and social welfare systems, huge inequities are present, and we judge that although welcome, current moves towards the establishment of solidarity funding arrangements will prove inadequate. Indeed, the current unfairness in provision, in some cases, amounts to a denial of basic rights. Allied to this is a need to rationalize responsibilities ensuring transparency and accountability. The centre needs also to step into areas of delivery and policy which are rightfully its domain. The most striking example of this is the provision of social welfare benefits.

Equally, capital financing questions will have to be addressed if reforms are to be initiated. Across each of these frontline delivery sectors, investment is required to renew worn out plant (especially the utilities sector) and facilitate change (for example with regard to staffing levels and remuneration in the social sectors). These needs cannot be borne locally, and various centrally coordinated financing mechanisms will be required.

Additional finance might also be generated internally by managerial changes. Two types of reform are pertinent to this. First, there are huge efficiency gains to be had by addressing poor management practices, training and workplace culture; and secondly, via the replacement of existing inputs-based resource systems. These will serve to improve targeting, revealing waste and disciplining the wasteful and undeserving. The introduction of output or outcome based funding in the social sector will also be a spur to quality improvement. These targeting systems have a corollary in the utilities sector in the form of pricing reforms. Through cost-based recovery charging, behaviours and decision making are modified. Prices come to assume a signalling function, encouraging consumers to use outputs more efficiently; and managers to make more productive decisions; and freeing politicians from involvement in operational matters.

In sum, our recommendations and proposals amount to a radical modernization agenda. This is one of direct performance improvement that encompasses better targeting, greater transparency, and necessarily, genuine devolution to the local level.

## CHAPTER FIVE



MAKING IT HAPPEN -  
ENABLING AND MANAGING



## Chapter Five:

# Making it happen - enabling and managing

This chapter continues our examination of municipal activities but broadens it beyond service delivery to take in those functions which 'shape' rather than directly affect local conditions and community well-being. Here we refer in turn to community leadership 'enabling' duties undertaken by modern local governments, and to the quality of local management.

The chapter has three parts. In the first and second we examine the two primary enabling responsibilities - securing environmental sustainability and local economic development. In the third, we examine municipal management, both at the corporate level and in terms of key support services.

### **Enabling as a public service concept<sup>179</sup>**

Before we begin however, it is important to be clear about what we mean by 'enabling' as a public service concept. In its broadest sense, the term refers to an approach to meeting public responsibilities through shaping conditions and encouraging public, private and independent actors to secure desired outcomes. Enabling can be applied to the broad ambit of local government responsibilities - including service delivery. For example a local government might 'enable' various NGOs to provide advice service through grant-in-aid, rather than maintaining its own welfare rights service. Yet the enabling principle is clearest in relation to community leadership functions which are ill-suited to traditional service delivery approaches.

### **Sustainable environmental management**

The quality of the natural environment directly impacts on the quality of peoples' lives, their health and their capabilities. Sustainable development

policies therefore lie at the heart of the human development approach. Neglect, carelessness and greed can contribute to the pollution of surface and ground waters, soil, and air. Through regular and everyday activities, and especially through the pursuit of narrow economic gain, communities can put their environments at risk. Our challenge here is to examine what local governments can do to regulate pollution and make behaviours more environmentally aware.

A growing body of evidence suggests that current day BiH is suffering from uncontrolled and excessive exploitation of its natural resources<sup>180</sup> in parallel to a dangerous contamination of its natural environment. Moreover, that the weak economy limits regulatory activity and leads to maladapted incentives operating on both enterprises and private individuals.

Although environmental legislation recently adopted in BiH conforms to EU standards, enforcement is almost non-existent. The accession process will increase the pressure on local authorities to solve environmental problems without hindering economic growth. Sadly, these issues, have so far, assumed no real political weight. Attitudes remain complacent and ill-informed, and for the most part, BiH's once pristine environment is seen simply as a resource to be exploited.

At the outset however, it has to be recognized that most environmental challenges are beyond the scope of local government action alone. Whilst a complete resolution of these issues lies at the state and even the supranational level, municipalities can make a contribution. First, via a variety of local services - utilities, physical planning and so forth: they can address the symptoms of environmental degra-

<sup>179</sup> Enabling emerged as a public service concept in the 1990s; it refers to indirect governmental actions to promote socially beneficial outcomes, which might be better achieved by means other than direct provision. It draws on the social capital framework promoted by Putnam (1995, 2000) and others.

<sup>180</sup> It is estimated that due to the construction of housing, industrial and infrastructure facilities in recent years, BiH has been lost over 20,000 hectares of agricultural land & the annual volume of tree felling is around 3.7 million m<sup>3</sup>.



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dation and facilitate more eco-friendly behaviours. Second, local governments can play a role in environmental monitoring and education, exercise leadership to improve awareness and so directly challenge problematic attitudes.

## **The legal and institutional framework**

According to the BiH constitution, environmental protection is the responsibility of the Entity governments. Each has its own environmental ministries and legal frameworks. However, the latter were made more consistent in 2003 and secondary legislation is currently being developed<sup>181</sup>. The major issue to be tackled remains enforcement. At the state level, there is no single responsible authority, but instead coordination takes place via the Environmental Steering Committee (ESC), which comprises representatives of the two ministries and seconded experts. Within this framework a large number of responsibilities, especially within the fields of monitoring and enforcement, are delegated to municipalities.

A major challenge arises from the fact that environmental problems do not respect boundaries, and this is made more difficult by BiH's administrative fractures. Indeed, it is telling that the inter-entity boundary and the coterminous areas are subject to particular environmental damage, including illegal deforestation and the disposal of bulky and hazardous waste. The need for harmonized legislation and the establishment of a state-level enforcement agency is vital. It is also a basic requirement for BiH's accession to various international and European environmental treaties and conventions.

At the local level also, environmental protection is rarely the responsibility of a dedicated agency. Typically it is combined with physical planning or

infrastructure related services such as utilities. Moreover, local authorities invariably hold the weakest mandates within the overall framework. As a result, there is much duplication and inter-agency conflicts of interest are frequent.

## **The key environmental pressures**

The main sources of air pollution in BiH are industrial: they include coal-fired power plants and outdated heavy industry. As a result of inefficient technologies, pre-war atmospheric emissions were very high despite the relatively low level of urbanization. Although the war resulted in the destruction of many of these industries and has thus brought about lower environmental pollution (now approximately 35% of the pre-war level), the earlier contamination and ongoing pressures are still evident.

New industrial plants and processes in BiH make use of newer, more environmentally friendly technologies imported from overseas. Yet these are few and far between. Extremely high investment was required in order restart production, and for the most part BiH's industrial plant has not been rehabilitated. Currently operational plants are legally required to create a compliance plan to meet new EU standards by 2008, though it remains an open question whether this will be achieved.

Transportation represents the second largest environmental pressure. Pollution results from both the increased number of vehicles and the relatively high emissions of older vehicles. There are limited options for substituting road traffic with (electrified) rail transit, as construction costs in BiH's mountainous terrain are prohibitive. It is possible, however, to promote some increase in railway



and inland water transport in accordance with the BiH Transport Master Plan<sup>182</sup>. Furthermore, it might also be possible to reduce these pressures to a minimum by actively working towards European standards on fuel emissions and limiting (or banning) the movement of vehicles without exhaust control and other environment-friendly devices. This process must of course, be gradual and paced to ensure there is no detrimental effect on the relatively weak economy.

### **Local responses**

Two distinct roles can be identified for local governments. The first has to do with adapting local service provision to environmental outcomes, whilst the second involves a much more difficult challenge, that of advocacy and community leadership to reshape attitudes and behaviours. Each is reviewed in turn.

## **Environmental impact of local services and activities**

### **Spatial planning and air quality**

In the pre-war period, industrial facilities were poorly located due to the lack of appropriate spatial planning. Many facilities were sited next to settlements, and as a result air quality for heavily populated areas was, and remains, poor. Application of air quality management techniques in BiH is not well known. Spatial and urban planners do not use emission cadastres and atmospheric distribution models to the extent that is necessary. There is a general need to update the methodologies in use for monitoring and reporting. Although current practices take into account local specificities (fuel quality and

data collection capabilities) they require sophistication. The introduction of modern methodologies, as prescribed by international organizations should also be accelerated.

### **Enforcement of building codes**

Illegal construction without regard to quality or planning rules, results in the loss of important agricultural land and suboptimal settlement structures. There are two parallel reasons for illegal construction - the lengthy and costly planning permissions procedures, and weak enforcement. In both of these areas local governments could make an important contribution.

### **Water resources and water supply**

BiH's territory lies within the catchments of the Black Sea (76% of the total area) and the Adriatic (24% of the total). Within these, there are seven river catchment areas. The annual precipitation of BiH is high when compared with the European average, but it is unevenly distributed, with a good proportion falling in the winter months. Although the rivers are characterized by relatively high runoff there is a great variation in flow. In spite of this apparent wealth of water resources, the spatial and time variations result in areas that experience heavy flooding in winter months and suffer from drought in summer.

Flood protection and irrigation are important issues which should be handled at the local level by the municipalities located on each of the major watercourses. Successful international practice shows that these activities need to receive support from the State or Entity authorities as flood defence has a high capital cost and strategic character, but

<sup>182</sup> Japan International Cooperation Agency (JICA): Study for Transport Master Plan in Bosnia and Herzegovina, Final Report (Executive Summary), March 2001

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ought to be locally managed. Delivery models might also include groups of local authorities acting together.

According to figures given within the National Environmental Action Plan (NEAP), drinking water supply covers only 56% of population in FBiH and 48% in the RS, and losses in the water supply network are high.<sup>183</sup> Moreover, sources for drinking water supply are inadequately protected from physical, chemical or biological pollution. This is a particular problem in Karsts (porous limestone-like rock) areas of the country<sup>184</sup>. Due to the solubility of these rock types sources are interlinked through complex underground systems, where pollutants can easily find their way across long distances. It is absurd that a country with abundant and clean upland drainage faces a drinking water supply problem.

## Wastewater management

Prior to the war, industry generated 80% of wastewater in BiH. Although, detailed monitoring exercises have not taken place since that time, it can safely be assumed that household wastewater discharges have remained about the same, whilst industrial releases have fallen-off dramatically. Yet the average share of household connections to the sewage system is low (at 38%<sup>185</sup>) and clearly a large proportion of wastewater is discharged directly to the ground. Moreover, of the collected discharge, very little is treated and 90% is released into water-courses.<sup>186</sup>

As noted previously, there are only six wastewater treatment plants in BiH, and even these operate irregularly due to high operational and maintenance costs. Industrial concerns are required by the law<sup>187</sup> to control their emissions. However, due to weak enforcement, illegal discharges are estimated to be

considerable. As a result of these pressures the majority of the rivers in BiH are heavily polluted, with many falling into the lowest class of river quality - the Bosna and Vrbas rivers being the most polluted<sup>188</sup>.

## Solid waste management

The prevailing attitude towards refuse in BiH is to dispose of it in any manner possible. As a result there are countless fly-tips filled with household waste, used cars, construction waste and animal carcasses. As discussed in the previous chapter, even in settlements and cities with organized waste collection systems, the final disposal of the waste is made via municipal dumpsites which are often unprotected, allowing run-off to enter the soil and groundwater, the wind to disperse waste, and disease vectors such as flies and rodents, to thrive at the disposal site.

In addition to the problems of local communal waste management, there are regulatory and enforcement weakness. One is the lack of adequate regulation and treatment of hazardous and industrial waste. There are no specific disposal facilities for such wastes. Whilst the most hazardous types, including contaminated medical refuse, are often simply sent to landfill. One possible solution is exportation to specialized disposal providers, but this is a costly and lengthy process, and most likely beyond BiH's means.

Equally, industrial waste is frequently dumped at the same sites as regular municipal refuse. Some industries, including mining and thermal power plants, have their own disposal facilities. But again regulation of these is weak. The only relevant protocol in development is the Basel Convention, which is still only in the initial phases of application.

<sup>183</sup> The average value of water losses is estimated to be between 50% and 70%, while the losses due to the poor state of the system amounts to 30% of the total water production.

<sup>184</sup> Karst geology refers to the presence of soluble rock types (such as limestone and dolomite).

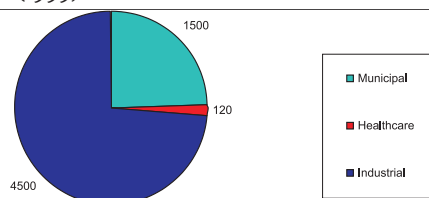
<sup>185</sup> For settlements with a population of more than 10,000, the extent of coverage rises to 72% whilst for smaller settlements it falls to about 10%.

<sup>186</sup> Certain rivers such as Bosna or Neretva, the levels of bacteria are high, especially in the summer when the water levels are lowest, and temperatures rise. In some rivers, like the Zeljeznica, or parts of Bosna, health warnings are issued to discourage bathing during the summer.

<sup>187</sup> Law on Environmental Protection and the requirements of the Water Management Accord

<sup>188</sup> Water resources management basis BH, Institute for Water Resources Management in Sarajevo (1984-88)

Chart 5.1: Composition of Daily Waste Generation in BiH (1999)



### Separate waste collections and recycling

In BiH very little has happened in the field of recycling. The absence of industries that could recycle certain types of waste (except for paper) has stifled efforts for selective collections. Waste which might be recycled or reused is discarded. A recycling programme would not only save landfill space and conserve natural resources, but could also increase the level of environmental awareness within the population. Even though some municipalities, like Sarajevo and Siroki Brijeg<sup>189</sup>, have organized collections in urban areas, the lack of recycling capacity limits these activities. The lack of a domestic market for recyclables (except for paper<sup>190</sup>) ensures that most of the collected material is exported through the means of intermediary firms.

Equally, segregated collection and recycling is beyond the capacities of most local governments. Nevertheless, municipalities could conduct public awareness campaigns to facilitate collections by NGOs and communities. Moreover, as the costs of recycling on a small scale basis are prohibitively high, localities should be examining how they might cooperate on this issue.

### Local Environmental Action Plans

Though local governments cannot exercise complete control over their natural environments, they

need to identify environmental protection priorities within their jurisdictions. This can be done through Local Environmental Action Plans (LEAPs) which bring a strategic focus to their work. The Regional Environmental Centre for South Eastern Europe is currently supporting the development of such plans under the auspices of the Swedish International Development Agency (SIDA) with a number of municipalities<sup>191</sup>. Each of the participating localities is being assisted by one NGO to organize the participatory processes necessary for priority setting and accessing donor funding.

### Monitoring and changing attitudes

Wider environmental management includes planning and monitoring activities, and the re-education of the local population and key stakeholders. Current practice within BiH at all levels is weak on these key activities.

### Environmental monitoring

Monitoring activities are rarely conducted, and even when they are, it is difficult to obtain the relevant results. Agencies for statistics, at the national or entity level, do not have this type of data, whilst the agencies that undertake monitoring are typically public enterprises. As quasi-governmental bodies they are often reluctant to provide information. Hence, there is a need for a more transparent system for informing the public and especially local governments. Dissemination and sharing of data at international level is also required to meet different conventions and obligations. Although the Law on Access to Public Information is in force and would bind authorities to share information, specific protocols are also needed to regulate and encourage this process.

<sup>189</sup> The EU Cards programme has initiated a Waste Recycling Pilot Project, whilst the large public utility 'Rad' in Sarajevo has started its own recycling pilot project that involves separate collection of recyclables in a few residential areas such as Luzani in Ilidza and in schools. Some of the other public utility companies, such as Komos in Mostar have conducted sporadic attempts at recycling waste from landfills or disposal sites. There are also a number of smaller entrepreneurs that deal with retail of recyclables.

<sup>190</sup> Via the Natron Maglaj paper factory

<sup>191</sup> Dobo, Živinice, Sanski Most, Prijedor, Maglaj and Novi Grad Sarajevo

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Monitoring and proper environmental management would facilitate data tracking, identify threats and priorities and inform the public about key issues. Monitoring programmes are more effective when conducted by local authorities as they have a constant presence in a location, rather than more remote State authorities. However, in order to ensure the quality of monitoring programmes, it is necessary for the local participants to be guided by Entity or state-level organizations. Organization of the overarching system has to be the responsibility of the Entity or State governments.

One of the major shortcomings in BiH generally, and in the environmental protection sector in particular, is the lack of information flows. Different institutions share little information with others, and there is very little coordination. As a result, redundancies and overlaps occur amongst and within projects. The use of available resources is far from optimal. A clear obligation of the Entity or State governments should be to create a database, which would allow for updates and provide sufficient information. The task of the local authorities would be to feed and make use of these systems, either individually or working in concert.

## **Environmental public awareness and participation**

Traditionally, environmental public awareness has assumed a very low priority in BiH. It is, however, encouraging that there is increased interest in nature and ecology as evidenced by the number of citizens associations and organizations actively engaged in environmental protection. Yet public awareness is still hampered by the inconsistent and inadequate amount of information disseminated. In order to harness rising public interest, complex

issues need to be expressed in clear understandable terms and disseminated. Local governments can play a key role as an advocate for eco-friendly behaviours and attitudes.

New environmental legislation, framed in accordance with EU requirements, has assigned a significant role to public participation. For projects that require environmental permits an Environmental Impact Assessment (EIA) must be carried out and discussed in a public forum. In recent months a number of these have been organized, with significant participation from the affected stakeholders. The EIA and the already discussed LEAP processes are important steps in strengthening awareness and participation in BiH.

## **Local economic development**

A vibrant private sector is vital for the prosperity of localities. Local enterprises, large and small, make investments, create employment opportunities and pay the taxes which help fund local services. Thus municipal support for the development of an effective private sector is central to boosting incomes, offering affordable goods and achieving lasting poverty reduction - objectives which are central to the human development agenda.

Unfortunately, the conditions under which businesses operate and public perceptions of the private sector are not positive in current day BiH. Companies have to cope with poor infrastructure, a complicated regulatory framework, unpredictable and non-transparent governance practices and weak human capital. Moreover, public officials whose agenda should be the improvement of the regulatory environment, often do not understand the importance of private business within the local economy

and their own role in promoting a more hospitable environment. Making the shift from a planning and directing function, to an enabling role in the economy, is a huge challenge for decision makers and bureaucrats. This is not merely procedural but extends to the culture of government (including municipalities) and the mindset of individuals.

The promotion of local economic development (LED) is a very specialized field of local government activity. It is made up of a set of strategic activities aimed at assisting independent economic actors, chiefly business and entrepreneurs, to bring goods and services to the market place, and in turn, expand local employment and prosperity. These activities are about establishing an environment which nurtures local businesses and attracts in others, particularly investors, from outside the area. LED is very place dependant, and the context will determine needs, whilst activities are diverse, ranging from the provision of physical infrastructures to modifying the behaviour of local officials.

## **The current situation**

### **Conditions**

The economic situation in the majority of municipalities in BiH is characterized by high levels of official unemployment alongside a more vibrant but variable informal sector. Indeed, anecdotal evidence and theory suggest that the grey economy is far from evenly dispersed, and is concentrated along frontiers, transport nodes and urban centres. Although supportive of incomes, the informal sector has few sustainable developmental advantages. The large enterprises which characterized the pattern of employment in the SFRY are dilapidated - and even where they continue to operate, are

underutilizing their capacity. Moreover, they are often propped up by direct subsidies, or indirectly through the non-payment of creditors, especially utility companies and tax authorities. The crucial SME sector, which might soak up underemployed labour, remains challenged both by difficult trading conditions (not least the level of taxation and poor government), but also the preponderance of informal sector competitors. Local economies also suffer enormously from the inefficient, slow and often non-transparent privatization processes, within which local communities have largely been denied a voice.

Disappointingly, many local authorities remain in denial about their local economies, believing that the redundant factories will somehow grow back to their full potential. The reality is very different and communities must therefore seek other ways to revitalize their prospects. This perceptual problem is perhaps the gravest challenge to be faced. Officials often lack a basic understanding of the economy: they do not see that attracting new investors and supporting the development of new activities are vital for economic transformation and growth<sup>192</sup>. Instead, they nurture fake beliefs that conditions will improve without any intervention.

### **Obstacles faced by business**

Nearly ten years after the war, and despite progress on a number of fronts, BiH has not succeeded in creating a fully unified economic space which is supportive of business. Procedures for setting up and running businesses remain complicated and time consuming. Equally, the corporate tax burden is among the highest in Europe.<sup>193</sup> Weakness in law enforcement and protection of property rights are key operational risks that busi-

<sup>192</sup> Small and Medium Enterprises Interventions and Gap Analysis, page 28, USAID, June 2004.

<sup>193</sup> "Commission report to the Council regarding BiH's readiness to start negotiating with the EU about the SAA" (Feasibility Study), Brussels, 18th November 2003.

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nesses face. Corruption and an ineffective judiciary in resolving disputes add yet further dimensions.<sup>194</sup>

The size of the informal sector (conservatively estimated to be 25% of GDP)<sup>195</sup> is both a reflection of poor economic governance and an impediment in itself. Entrepreneurs often claim that competition forces firms to move into the informal sector in order to keep their heads above water.

Further problems are caused by poorly managed unregulated inspection arrangements. As mandates and standards of inspection<sup>196</sup> are not defined, inspectors frequently 'gold-plate' requirements imposing additional and unnecessary burdens<sup>197</sup>. There is a general impression that inspectors also deliberately target particular companies as a means of exerting political pressure. Local planning practices and regulations also present obstacles to investment. Municipalities either do not have spatial and zoning plans in place, or if they do, they are not adjusted to reflect commercial and LED needs. This makes it almost impossible to plan and deliver land and infrastructure projects. This is especially true when it comes to securing green-field investments, since the time and costs related to land acquisition and obtaining different licenses and permits are often unacceptably high and very unpredictable.<sup>198</sup> General administrative failures and incompetence serve to further discourage many potential investors.

## Obstacles to reform

At a basic level, BiH's complex and ineffective administration presents a fundamental constraint. This alone however, is not a sufficient explanation for the very piecemeal approach to transition that has occurred. There is a clear unwillingness on the part of the ruling political forces to implement the

necessary reforms, as they perceive their interest lies in protecting the status quo.

During the past decade, important steps forward have taken place in the field of macroeconomic policies under international pressure, but very little has happened at the micro and meso levels to attract new investment and encourage the development of new domestic businesses. The need for immediate action from all levels of government in BiH is very apparent. These actions should establish an environment that enables and promotes economic growth. To date the performance of BiH governments in shaping policies towards this outcome have been disappointing<sup>199</sup>.

International development organizations<sup>200</sup> have long recommended the fostering of entrepreneurship and SMEs as a recipe for successful transformation and revitalization of the economy. Yet a report on SMEs produced by the Ministry for Foreign Trade and Economic Relations (MOFTER) confirms that almost nothing has been done in this area<sup>201</sup>. It argues for the inclusion of entrepreneurship within the school curriculum, the training of entrepreneurs, better access to finance through tailored interventions and schemes to affect technology transfer.

## Intervention strategies

Unfortunately, it seems that many of these issues which have a national or entity-level character are unlikely to be addressed as BiH governments take little ownership of the challenges faced by business, leaving the international community as the only sponsor of pro-private sector policies. This is disquieting, yet the BiH Medium Term Development Strategy (the PRSP), accepted by

<sup>194</sup> Page 25, BiH Enterprise Policy Performance Assessment, OECD, September 2003.

<sup>195</sup> BiH PRSP 2004-2007: March 2004

<sup>196</sup> Municipalities are responsible for three inspections: (i) Markets, (ii) Construction and (iii) Sanitation.

<sup>197</sup> Page 34., Small and Medium Enterprises Interventions and Gap Analysis, USAID, June 2004.

<sup>198</sup> BiH Enterprise Policy Performance Assessment, OECD, September 2003.

<sup>199</sup> EBRD (2002) places BiH among those countries that have improved their business climate, but still must resolve a number of issues before being considered attractive for domestic and foreign investment.

<sup>200</sup> BiH Enterprise Policy Performance Assessment, OECD, September 2003: Small and Medium Enterprises Interventions and Gap Analysis, USAID, (June 2004)

<sup>201</sup> Report on Implementation of European Charter on SMEs in Bosnia and Herzegovina, Ministry for Foreign Trade and Economic Relations of Bosnia and Herzegovina, (2003).



BiH, in 2004 signals a change of approach by specifically including a chapter on enhancing the business environment and supporting entrepreneurship. It remains to be seen whether this strategy will be followed by purposeful actions.

Our primary concern within this report lies with local governments and the following examines their potential contribution. The state-level government also has an obligation to facilitate local action by clearly assigning responsibilities and signalling goals and intentions. At present there is practically no indication of the LED functions envisaged for localities within the PRSP framework. Whilst municipalities can work on their own in supporting private sector development and engagement, the absence of higher-level governments' interest in their role weakens motivations and incentives.

### **Recommendations for the role of local governments**

Most municipal level LED activities are still in their infancy and generally are initiated through the technical assistance programmes of international development organizations. The absence of a national framework inevitably means that strategies focus on activities that can be implemented within currently limited authorities and resources. In addition, however, they also play some role in motivating key stakeholders to exert pressure on higher-level governments to dismantle the official constraints on business development.

Potential activities fall into two main categories. Firstly, local interventions to support the development of a business-friendly environment - especially investment promotion: and secondly, measures to promote entrepreneurship and SME development.

### **Building an enabling environment**

The creation of an enabling environment is one of the most significant goals to be achieved if a community, region or nation wants to improve the dynamics of its economy and overall competitiveness. Several standard interventions would support this - these can be summarised three ways:

- Better infrastructure, economic regulation and public services to reduce transaction costs and the risks of doing business. These enhance competitiveness and facilitate entry to a wider market place;
- Better overall governance to promote predictability and stability. This creates a level playing field and reduces the attractiveness of the informal sector and promotes inward investment;
- Targeted actions, such as resolving credit constraints, to overcome market failures, enabling private sector activity which would not have otherwise taken place.

### **Improving municipal operations**

Municipalities in BiH have only limited regulatory powers pertinent to their own jurisdictions. Nevertheless, the enforcement of local regulations, the quality of their public services and the transparency of administration plays a significant role in shaping the costs of doing business and local investment attractiveness. Municipalities, as we have shown, have much room for improvement. Most of all this requires the creation of client-oriented administrations. This is a large category but we discuss below two distinct interventions that are especially relevant.

Firstly, the introduction of quality management systems, such as those of the International

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Standards Organisation (ISO) can yield huge benefits. In BiH several municipalities<sup>202</sup> are in the process of, or have already completed, the introduction of ISO 9001:2000. This standard:

- Obliges the municipality to introduce clear internal administrative procedures: ISO establishes transparency, helps businesses understand municipal functions and builds trust in local decision making.
- Provides the basis for efficient management of resources that can lead to important cost savings, creating room for additional activities.
- Reduces business costs (both direct and indirect) in the jurisdiction, along with boosting predictability.

A second innovative approach is the One-Stop-Shop (OSS) concept. This involves the establishment of a single contact point for key customer groups (and especially businesses) thus avoiding the need to visit various parts of the administration to obtain services. There are various types of OSS that can be established. In BiH two models have been pursued - for citizens for general administrative services (documents, certification and so forth)<sup>203</sup> and exclusively for businesses. In such OSSs all services, permits and licenses are provided<sup>204</sup>.

As yet very few BiH municipalities<sup>205</sup> have introduced business OSSs. The key element within these operations is a competent information service providing business people and prospective investors with details of possibilities, land availability and infrastructure: whilst also being able to undertake key administrative procedures (for example acquisition of land, and issuing different permits and licenses). Access to information, enhanced pre-

dictability of the process and a new culture of customer orientation are the key benefits.

As these OSSs are in essence, a kind of front-office for municipal operations affecting businesses, their establishment encourages the rationalization of organizational structures and administrative procedures. For OSSs to supply reliable services, the responsibilities and obligations of municipal departments, deadlines and procedures have to be clearly regulated. This places accountability requirements on staff and constrains them to a new culture of work while the greater transparency decreases the possibilities for corruption.

It is worth recognizing that municipalities can make many improvements in their wider operations without such projects. Dismantling barriers to information, decreasing transacting time, professionalization of staff and improvements in public relations, all lead to a more productive operating environment for business.

## Improving land and infrastructure

The availability of development land and the provision of sound infrastructure are two key conditions for attracting investment. In both fields municipal policies play a key role. Municipal spatial plans and local regulations impact greatly on the potential value and the exploitation of local resources and business opportunities. As noted, BiH municipalities either do not have spatial and regulatory plans or they are maladapted for economic development purposes. Unclear land property rights represent a key risk factor, and increase the transactions cost of investment.

Providing necessary infrastructure is often a more significant problem as the cost of matching needs is far beyond the financial capacity of a

<sup>202</sup> Centar Sarajevo, Laktasi, Srebrenik, Derventa, Tesanj

<sup>203</sup> Financed and supported by USAID. Already 20 OSSs have been established and 40 more are being planned.

<sup>204</sup> Implemented by SEED (the South East Europe Enterprise Development) and SDC (Swiss Development cooperation).

<sup>205</sup> Prijedor and Doboj Istok municipalities



municipality. Moreover, the installation of key mains supplies has a long lead-in time, yet their absence acts a major deterrent to the location of new industry in disadvantaged areas.

Effective urban planning, provision of infrastructure and land-use regulation consistent with LED objectives, all make a contribution to private sector development. Dedicated industrial zones developed by municipalities offer a means of significantly decreasing the costs faced by investors and create an environment that is attractive for new businesses. The importance of cost rationalization is crucial since in BiH, even connection fees represent serious financial burdens for business start-ups. Nevertheless, it must also be added that sponsorship of industrial zones are risky investments given current municipal capacities.

### **Improving available human resources**

Unemployment data confirms that skilled and unskilled blue-collar workers represent vulnerable groups of the workforce accounting for 35% and 38% respectively of the unemployed in FBiH, and 39% and 29% in the RS.<sup>206</sup> Part of the cause of this phenomenon can be traced to the poor orientation of education and training provision. Reform of vocational education has only just started in BiH and has thus far brought few results. Equally, re-training programmes are scarce, although admittedly this situation has improved in recent years. These initiatives should be supported and expanded, and combined with incentive schemes that encourage employers to give opportunities to the unemployed who are undergoing retraining.

We recognize however, that vocational training and adult education are not currently municipal activities. But they have such a strong impact on the

local economy that municipalities should seek to establish relationships with training institutions. Local governments are in a position to supply information on the need for specific services and the institutions to adjust programmes to meet market needs. Larger municipalities, or possibly consortiums of smaller neighbouring municipalities, could also take an active part in developing or sponsoring badly needed programmes in their areas.

### **Reducing the businesses cost burden**

There is a wide range of fees that municipalities in BiH currently impose on businesses. A general lack of resources has forced municipalities to exploit this revenue potential more vigorously. Businesses often rightly complain that municipal fees and rents are high and that they are often forced to pay for substandard or non-delivered services.<sup>207</sup> While the case put by businesses is strong, deciding the appropriate level for fees and charges is a difficult issue. Progressive thinking on business-government relations does not necessarily advocate the absolute limitation of charges and definitely not, the cross-subsidization of businesses by other taxpayers. Instead, commentators consider pricing as an important tool to adjust supply and demand, in pursuit of securing value and fairness for all tax and fee payers. Clearly, there is a trade off to be faced by municipal decision makers - increasing revenues can improve service delivery, but increases can seriously damage the competitiveness of local businesses, the level of inward investment, and hence ultimately, local livelihoods.

All that can be required of decisions on pricing and service delivery levels is that they are carefully arrived at, taking account of equity, supply-costs and their contingent effects on the health of the

<sup>206</sup> Data according to Country Report on BiH, Economist Intelligence Unit, 2003 p.22

<sup>207</sup> Frequently businesses pay rents on construction land which is not even equipped with very basic infrastructures.

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local economy. Equally, the competitiveness of local businesses is not a one dimensional question. Enterprises benefit from a low cost environment but they also require quality public services. Addressing economy and efficiency within local government must therefore, run in parallel to improving service delivery.

## Enterprise development

Support to local enterprises, particularly nascent businesses, is another key branch of LED policies. SMEs have an especially important role to play in the local transition process as they have the potential to become local and domestic champions, supplying and supporting newly privatized state-owned firms. This process represents the most effective means of soaking up unemployed labour and securing poverty reduction. An especially useful function is fulfilled by micro enterprises. These often represent start-up firms of new entrepreneurs, and both reflect and promote growing dynamism and entrepreneurship.

Start-ups and SMEs encounter specific problems due to their size and experience: they lack and require information, management skills and financing. Banks also tend to overlook and neglect their needs because of their relatively small borrowing capacity, weak collateral and lack of creditworthiness. Governments can do much for SME development by easing some of the barriers that they confront by offering information on opportunities, technical equipment, access to professional services (especially legal and accounting) and access to financing mechanisms. Best practice shows that SME support is a multi-layered activity where national governments set out the overall strategy

and regional and local governments develop their own action plans adjusted to local conditions.

Entrepreneurs in BiH widely share the opinion that those in government, at all levels, have a limited understanding of their importance and have ineffective resources (financial and human) for promoting enterprise development.<sup>208</sup> Both the institutional framework and the capacities needed for this are underdeveloped at all levels<sup>209</sup>. New structures have been established at State and Entity level, but they have thus far proved weak.

## Business support organizations

Some municipalities have already made attempts to establish local development agencies and business development centres but development of these institutions has not yet moved beyond provision of work space and employment of a few key support staff members. These organizations, especially where they are not supported by international institutions, lack the resources for basic operations and do not have the capacity to develop the services needed to support SME development.

Excluding large urban centres, there are rarely any business service providers. The market is generally underdeveloped, and mainly provides accounting or legal services. Business consulting exists only in the form of individual consultants (mainly university professors). Business services to support start-ups are particularly weak. Management and entrepreneur training opportunities, for example, are only provided by international donor organizations. In survey after survey, private sector respondents express great dissatisfaction with the work of chambers of commerce and existing business associations. We conclude there is currently no association capable of providing effective

<sup>208</sup> Entrepreneurs, when asked to rate local and regional government capacities to promote SME development, rated them between very poor and poor. BiH Enterprise Policy Performance Assessment, OECD, 2003.

<sup>209</sup> The FBiH Ministry for Energy, Mining and Industry created the Department for Entrepreneurship; the RS Ministry for Industry and Technology created the Department of Private Entrepreneurship; the Council of Ministers adopted proposals for the creation of a Division for Development and Entrepreneurship.

tive services to enterprises or identifying problems and lobbying for business interests.

Attempts by international organizations to establish business service providers have in the main also failed to come to fruition<sup>210</sup>. The poor quality and narrowness of the services these organizations were able to offer prevented them from developing a sufficient private sector clientele and thus they floundered when the support ceased.

Entrepreneurs often expect municipalities to cover this gap and provide them with different types of information and basic business services. There are at least two important reasons why municipalities ought to cater for this demand. The first is economies of scale. Many local enterprises are too small and weak to finance sound professional advice on a permanent basis. Yet they need professional inputs if they are to optimize their market activities. The second more directly relates to the finances of the municipality. If support organizations are run well, their direct costs will, in the long run, be many times off-set by the indirect revenues accruing to the public sector from the increased economic activities they trigger and the decreased need for social expenditures.

The problem is that most municipalities are too small to establish these services at a scale and level that would make a real difference. It is preferable that professional support and financial incentives be established on a regional basis. This necessitates the involvement of higher levels of government or the creation of consortiums of municipalities. Donors might be lobbied to bridge gaps for a limited time, but the BiH governments have to take the long term responsibility.

### **Access to working capital and long term finance**

A major barrier to business start-ups is finding the initial working capital and securing ongoing finance. Municipalities' ability to address this key question is necessarily limited but there are three interventions that might be considered:

- First, consideration could be given to reducing local fees, charges and rents to new businesses. This runs somewhat against what is argued above, but start-ups present a special case and such subsidies should be self-limiting.
- Second, municipal business incubators provide an institutionalized and tailored solution. If possible, municipalities should consider the establishment of incubators providing premises, alongside administrative, technical and advisory services. These inputs can prove crucial in improving their chances of survival on initial entry to the market. In many cases, municipalities have available unused facilities which could be used for such business centres. At present in BiH only two incubators exist - in Gradacac and Mostar.
- Third, more innovative solutions might be considered for the capital constraints faced by SMEs. The most favoured option would be the organization and sponsorship of a credit guarantee association. Such an arrangement might bring together a variety of partners - member enterprises, business associations and a group of local governments to offer mutual guarantees for bank loans. Another option might be arms-length support for micro-finance institutions such as Credit

<sup>210</sup> Enterprise Development Agencies (EDAs) were established in Banja Luka, Livno, Mostar, Brcko and Bihac; along with three Regional Business Development Centres, Agency for Local Development Initiatives (ALDI), Tuzla Agency for Local Economic Development (TALDI), Central Bosnia Economic Development Agency (CeBeda).

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Unions. However, a note of caution must be sounded here. These ventures are risky and due to an acute lack of resources<sup>211</sup> most BiH local governments have no capacity to champion such approaches. Only the larger and wealthier should consider cooperation with local banks. It would generally be more fruitful to establish such schemes at the regional level and with the support of donors.

## Other activities

### Linkages with wider activities

It has been argued by some commentators that LED initiatives are often too narrowly focused, that they do not give enough attention to improving human capital and neglect the potential for harnessing LED to support social objectives. Linkages necessarily need to be drawn with improved education, social protection, health and other local services<sup>212</sup>. A useful way of resolving these issues is the development of holistic LED strategies, which explicitly include poverty reduction or other social objectives as policy goals.

International organizations have over time shifted the focus of their development programmes towards the local level<sup>213</sup> and many have assisted municipalities to develop such strategies<sup>214</sup> through participatory approaches which establish dialogue between public and private sectors and civil society. These schemes typically establish a formal team or department exclusively responsible for LED. Those that have gone down this path have also ensured that adequate financial resources are found from within the local budget. Presently municipalities state that they invest a minimum of 5% of their expenditure in LED, and this is surprisingly high.

We conclude therefore that there must be scope for gaining wider pay-offs from LED activities, and making local resources go further. The key to this is strategic planning. Local planning processes ought to include analysis of conditions and economic potentials, alongside the identification of actions and key partnerships with others, such as educational institutions, and higher level governments.

### Communication and trust building

Municipalities also have to significantly improve their communication with the private sector. A higher level of involvement and participation would increase transparency and accountability, and make municipalities more responsive to their needs. This would in turn, improve local services and better target actions. Municipalities must make an effort to move from formal compliance with legal obligations towards a more active role as a provider of information and an advocate.

Unfortunately, interaction between the two is sporadic or in some cases non-existent. Many municipalities avoid contact with the private sector since they think they have nothing to offer to them. Equally, the private sector often perceives that the solution to most of their problems lies with higher level governments, and thus they show little interest in dialogue. SME owners have responded that the only occasion when the municipal authorities contact them is to seek financial contributions for municipal projects. Nevertheless, there are also cases where municipalities are very active and have regular meetings with the local private sector<sup>215</sup>.

### Building alliances between local businesses and local governments

The low capacity of municipalities to implement development policies is additionally undermined by

<sup>211</sup> Many Municipalities lack financial resources for financing even the operational costs of basic services.

<sup>212</sup> Water, sanitation, etc.

<sup>213</sup> USAID, SIDA, OSCE, UNDP, OSI, etc.

<sup>214</sup> USAID, UNDP, OSCE.

<sup>215</sup> Communication and cooperation between public and private sectors in Gradacac and Gracanica are well-known. These two municipalities have vibrant local economies.

a lack of communication, cooperation and support from higher levels of government. Furthermore Entity and cantonal authorities rarely have a settled development policy or sufficient capacity themselves to implement economic development initiatives<sup>216</sup>. Regardless of positive intentions, little can be achieved at the local level without active involvement and support from above. Much good can come from local governments, businesses and other actors joining forces to lobby for change. An additional effort should also be made by the international community to put pressure on higher governments to provide more support to existing local initiatives.

### Local Government Management

In Chapter Three of this report we examined in systemic terms, how decentralization and hence local government stewardship might be improved. Our focus was the macro level, charting in several spheres where action might be taken by higher level governments to secure change. Similarly in the previous chapter which dealt with sectoral issues, we pointed out where systems and practices might be reformed within particular service areas. This section in contrast focuses on local governments themselves in relation to the general quality of how they conduct and organize their affairs. It is a natural concomitant to the enabling functions discussed above since it requires localities to shape their internal practices and how they relate to their citizens to maximise the value-added they deliver.

This area is vast, but we confine ourselves here to corporate management, the extent of consultation and quality of support services.

### Corporate Management

As in other spheres, strategic planning processes in BiH are regulated differently in the two Entities. In the RS municipalities are obliged to adopt and implement a municipal development programme and to agree the budget and annual financial statements<sup>217</sup>. Obligations in the FBiH are not spelt out that precisely. The federal law on local self-governance defines general functions whilst detailed regulation is undertaken by the Cantons or is specified by the municipal statutes. Yet regardless of these formal frameworks, municipal planning in practice is organized around the development and implementation of the annual budget.

All municipalities in BiH, generally prepare three types of plan:

- Mayor's annual plan and programme of work;
- Annual budget;
- Capital Investment Programme (CIP), which is also part of annual budget process.

In addition, many municipalities draft development strategies but the current position of these within the governance system is weak. Neither the resource base nor internal organization is conducive to their implementation. Such strategies are often general documents and are unsupported by financial plans and management arrangements. There is rarely therefore any formal feedback mechanism or monitoring.

### Mayor's Annual Plan

Preparation and submission of the Mayor's annual plan and programme of work is defined by the municipality statutes. This document is typically a rather vague, three-page statement, highlighting the mayor's priorities. In essence it is a list of ongoing activities which need to be completed in the com-

<sup>216</sup> Economic Development Strategy of Tuzla Canton

<sup>217</sup> Local Government in Bosnia and Herzegovina, Charles Jokay

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ing year and the Mayor's general commitments: it might include aspirations about working with the young or fostering better community relations.

## Capital Investment Programme (CIP)

Municipalities spend on average between 10% and 20% of their annual budgets on investment in local infrastructure and facilities. The CIP includes details of investments in the development and maintenance of infrastructure and facilities that are necessary for the provision of municipal services (e.g. roads, street lighting and other street furniture, educational facilities, health facilities). The programme is normally developed by departments in charge of spatial planning, reconstruction and utilities.

In the majority of cases the CIP is not a plan at all but a statement of intent. It does not specify in detail the various planned capital investments, instead it quotes only the overall amounts that are committed for various types of works for that specific year (e.g. asphaltting of a 10 km local road or construction of village water supply systems). The CIP is prepared on an annual basis and it is an obligatory part of the yearly budget cycle. However, the CIP it is not a multi-year plan, nor is it a capital budget and does not include forecasts or details of contingent costs.

## The Municipal Budget

This is the most important document that guides local government operations. Indeed, the entire planning system is focused and organized around the process of its development. Guidance for preparation is given by the Entity Laws on Budgeting<sup>218</sup> which prescribe the rules for enact-

ment of budgets at all government levels. These statutes specify that the document must contain:

- A detailed breakdown of all public revenues and expenditures;
- Proposals for allocation of the budget surplus or sources of financing of budget deficit;
- Functional classification of expenditures (subjective analysis);
- Revenues and expenditures of each budget beneficiary in accordance with the accounting classification (objective analysis).

The budget document must also contain matching data from the previous fiscal year, changes in forecasts for the ongoing fiscal year and predictions for the next. Budget documents must also contain an annual report about the planned investments which last for more than one year and referenced to the relevant enabling legislation. Once completed, the budget is publicly announced and presented. After expiration of a legally determined period, the document is submitted to the municipal assembly for adoption. In the FBiH, after the municipal budget is adopted, it must also be submitted to the respective cantonal Ministry of Finance.

## General commentary

Well managed municipalities typically prepare<sup>219</sup> the capital investment and NGO grant allocation sections in consultation with MZs and other civil society stakeholders. Although the budget development process encompasses these types of consultations, this does not necessarily mean that the needs and projects identified are accepted by the municipality. The allocation of resources often remains a reflection of power balance between the main political interests. These practices need to be improved upon.



Municipalities have argued that because of the existing financing system they are unable to develop reliable financial forecasts. Yet we found that this is not the case for the annual budgeting process. Our research shows in some 15 municipalities, implementation of the budget reached over 90% of the forecasted figures. However, it has to be recognized that projections are made only for the coming year and they are prepared after the main decisions on intergovernmental allocations have been taken. Municipalities do not produce multi-year predictions. This is the greatest weakness of current financial planning procedures. This is at least partly caused by the lack of predictability of revenues which remain within the 'gift' of higher level governments. The resolution to this therefore lies in the systemic reforms we recommend in Chapter 3.

Yet, defective planning also reflects a basic lack of capability and will within municipalities themselves. Indeed, the generally inefficient use of resources and weak coordination is rooted in absence of management interest underpinned by weak political commitment. It is not unusual to hear from municipal staff that a strategic plan was agreed but it has been misplaced and now cannot be found.

OSCE, in the course of its work with municipalities on the improvement of their financial management systems, has identified the following weaknesses of local budgeting, and we recommend each of these be addressed:

- Budgets are often not adopted within the legally prescribed timeline;
- Practices are non-transparent;

- Documentation does not include a narrative explaining budget lines nor discrepancies;
- Outstanding debt levels are not clearly stated;
- Only paid expenditures are recorded and committed sums are not;
- Budget planning and realization are not controlled by the municipal departments.

### **Strategic planning**

Above all, our analysis calls for local governments to devise genuine strategic plans for their organizations informed by local priorities and challenges. Encouragingly efforts have been made in this direction, but there remain serious failures in execution.

There are in essence two mechanisms by which municipalities in BiH devise strategic plans. The first is where the municipality commissions a strategy from an academic institution or from a single or group of university professors. These groups tend to develop strategies without any significant involvement from municipal staff or the community: equally they are often forced to rely on limited and unreliable statistical data. Such a process usually produces a long and poorly focussed document that is read by hardly anyone including those who commissioned it.

The second type of approach is given by projects supported by international development organizations. The processes adopted are radically more professional but unfortunately, again because of a lack of cooperation, municipalities often work with two or three donor agencies on strategic planning, which unnecessarily stretches scarce human resources, confuses citizens and results in the publication of several plans that have conflicting goals.

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One distinct advantage of such donor-driven projects is their strong adherence to best practice participatory approaches. These are new to both municipal staffs and communities. Making use of the knowledge of the local community about needs and problems is a diametrically different approach to expert-based processes. Yet, participatory-based planning is extremely demanding of all stakeholders and BiH municipalities often cannot make the commitment required. In turn, international development organizations often work to pre-determined project budgets and timetables. Limitations can result in plans that are of inadequate quality, superficial and unrealistic. Regretfully, as a consequence the strategies developed with participatory approaches in many cases share the fate of those prepared under the traditional approaches. It is also worth noting insufficient commitment on the part of the Mayor alone can prejudice the outcomes. If a municipality agrees to work on strategic development not because it is convinced of the benefits but rather because external forces (typically donors) offer support, and the local

authority does not want to be perceived as uncooperative, there is little chance for success.

International organizations counter this by arguing that even if implementation fails, much is achieved through the process itself, chiefly via the dialogue between public and private sectors and civil society. Moreover that such processes increase transparency and accountability by raising the expectations of those citizens who participate. Others paint a more pessimistic picture, arguing that stakeholders are made more apathetic if they witness a failure to follow through, and that this can cement perceptions of an inefficient and moribund municipal sector.

It is important however not to be too pessimistic and some genuine innovations are taking place within BiH local governments. A successful example of progressive consultative planning at the local level is given by the UNDP managed SUTRA returnee support project. The management arrangements it adopts provide a model for mainstream local government activities and donor interventions within localities (see Box 6: The SUTRA Model).



### Box 6: The SUTRA model

The UNDP's SUTRA project aims to facilitate the return of displaced persons to their rightful pre-war homes, in 12 prioritized municipalities (B. Brod, Doboj, Lukavac, Travnik and Tuzla, B. Krupa, B. Novi, Brcko District, Derventa, Drvar, Jajce, Kljuc, Maglaj, Mostar, Samac, Vares, V. Kladusa. The projects activities are diverse ranging from local economic development to infrastructure and housing reconstruction. But its particular value-added is the way it approaches this task through consultation and empowerment of local communities. SUTRA provides a consultative governance model - central to its work has been the establishment of a framework for the BiH authorities to engage in longer-term, community-driven development.

Community needs are to be developed through the participatory mechanisms provided by Local Action Groups based on the public-private partnership concept, in each of the targeted municipalities. SUTRA is designed to support local partners within LAGs, mainly municipal officials, civil society representatives and the business sector, to promote a wider enabling environment for sustainable community development.

SUTRA demonstrates that municipal development can be a powerful agent of change at the community level but also that reform is infinitely more effective when placed in a coherent policy framework provided by higher-level institutions. In the returns sector, which is a particularly challenging task, the policy framework is provided by the annual priority-setting process at the MHRR (Ministry for Human Rights and Refugees) and SCRDP (State Commission for Refugees and Displaced Persons). At the local level efforts are also made, in the economic development sphere to tie project activities in with the Regional Economic Development programmes supported by the EU. These devices provide the means of anchoring the work of the LAGs in the field, who in turn shape and tailor activities to the specific municipal context.

We conclude that the solution to these issues is not to abandon strategic planning or participatory practices, but instead to address the operational problems. We make the following recommendations;

- Participation should be maintained for the implementation period by involving stakeholders in follow-up monitoring and evaluation;
- Inputs from financial and assets management strategies should be also channelled into strategy development, ensuring that plans are realistic and resource based;
- Strategies, once developed, should be operationalized through technical and sectoral plans

which must be developed by respective departments and implementation should be adequately backed up with appropriate structures;

- Performance indicators and measurement systems should also be designed during the process alongside reporting mechanisms.

### Management Support Services

It is apparent that the public administration system in BiH is plagued by a poor workplace culture and ineffective management systems, which give rise to all manner of biases, perverse incentives and moral hazards. This is supported by widely held

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public opinions. UNDP's governance perception survey, for example, confirmed that a majority of citizens and businesses view public administration practices unfavourably<sup>220</sup>. Management weakness can be cited therefore as a key cause of poor performance in local government operations. In the following we examine three principal areas of management activity, and make proposals for change.

## **Financial management**

As outlined above, BiH municipalities rarely look beyond the annual budget cycle when making decisions. Equally, the budget process itself is simply focused on questions of how available resources can be spent. Issues of efficiency, economy and effectiveness are almost entirely neglected within the very narrow concept of financial management adopted.

In addition to a lack of multi-year planning, annual monitoring is very weak. Municipalities rarely make use of information that is not strictly required by budget statutes. Nor have they developed adequate internal reporting systems which would enable finance departments to accurately record expenditures, track the flows of municipal funds and provide adequate corporate information. Although municipal assemblies have budget oversight committees, they do not meet their obligations. In most cases, local governments function without a financial strategy capable of supporting decision making. Contingency planning is unusual and if resources fail to materialize due to unforeseeable events, common practice is to simply suspend the activity. This entails very substantial risks for public service providers and their clients.

The lack of fiscal autonomy is a major contribution to these weaknesses. It serves to both limit revenue sources and the incentives to establish a

decent planning mechanism, which might lead to cost savings. Yet it is also apparent that BiH municipalities themselves do not fully exploit their own potentials. Opportunities for increasing their own tax revenues and through better utilization of their assets and property in most cases remain untapped. Furthermore, there is a troubling lack of financial discipline.

Within this environment it is unsurprising that large numbers of municipalities face significant deficits. Financial sustainability cannot be counted on, and there is an urgent need for wholesale reform. We recommend therefore that:

- Finance departments are appropriately staffed and their position be strengthened within organizational structures;
- Financial discipline is promoted by better internal regulation and increased transparency;
- Municipalities consolidate their revenues by increased charging, exploiting untapped tax bases (especially local property tax) and dramatically improve revenue collection and debt recovery rates;
- Financial strategies based on multi-year perspectives should guide these reform objectives.

## **Asset management**

Municipalities are wholly responsible for the management of the assets they legally own or the institutions for which they 'founded'<sup>221</sup>. Most municipal assets are registered and recorded in inventories. However, these are often inaccurate and rarely contain information about status and condition of assets. This limits municipalities from planning and financing maintenance and replacement.

Perhaps predictably, municipal leadership typically blame growing obsolescence on the lack of

financial resources. While the impact of this should not be underestimated, negligence, outdated practices and workplace culture have also played a role in the level of deferred maintenance that has accumulated. We recommend that municipalities improve their asset management systems by:

- Creating regularly updated asset registers that accurately record inventories;
- Ensuring that the present status and conditions of assets be registered and appropriate depreciation rates be determined;
- Integrating asset management with the CIP and the financial management system in order to ensure more efficient allocation of capital investments.

A further asset management problem is the under-exploitation of revenue-generation potential. Often municipal assets are used by individuals and organizations free of charge. Municipalities recognize their inefficiency in collecting fees and rents, but have as yet, failed to respond to the incentives to improve on these practices.

### **Human Resources**

Human resource management practices within BiH local governments are in a parlous condition. Overstaffing, poorly qualified workers and very weak motivation and morale are commonplace. At the heart of these problems are two fundamentally wrong but widely used staffing practices. Firstly, municipal employment is often exploited for social policy reasons: decision makers typically attempt to offset the lack of employment opportunities elsewhere in the locality by employing people regardless of their skills. The second is that staffing is primarily driven by political and ethnic criteria, and not merit.

During interviews with BiH municipality staff, many confirmed that human resource management systems are virtually non-existent and moreover, that legal provisions relating to hiring, promotion and remuneration are rarely respected. A large proportion of staff are not employed through transparent procedures. Nor do municipalities have Human Resource Departments. There are no career development plans for employees nor is there any real employee training.

In municipalities with only very basic management systems, the evaluation of the staff entirely lays in discretion of departmental heads. This is inevitably done without clear criteria. The majority of municipal staff interviewed had never been informed of any criteria used for the evaluation of their performance. Most municipal employees perceive that, regardless whether they work or not, whether they perform well or not, their status is going to remain the same - they will neither be rewarded nor sanctioned. Within the present system it is almost impossible to fire an employee for poor performance.

We recommend vigorous local public service reforms be pursued, enabling local governments to establish adequate human resources management and provide better career opportunities. This includes setting-up human resources departments and developing personnel policies. Procedures should be transparent and clear and define:

- All key practices, including hiring, firing, redeployment and redundancy policies;
- Conduct and conflict of interest issues - sexual harassment, grievance processes, use of public property and so forth;

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- Remuneration and performance rules setting salary ranges, criteria for changes in salaries, promotion and demotion;
- Benefits policies such as annual leave, sick leave, maternity leave, and holidays;
- Training and development practices.

## Summary and conclusions

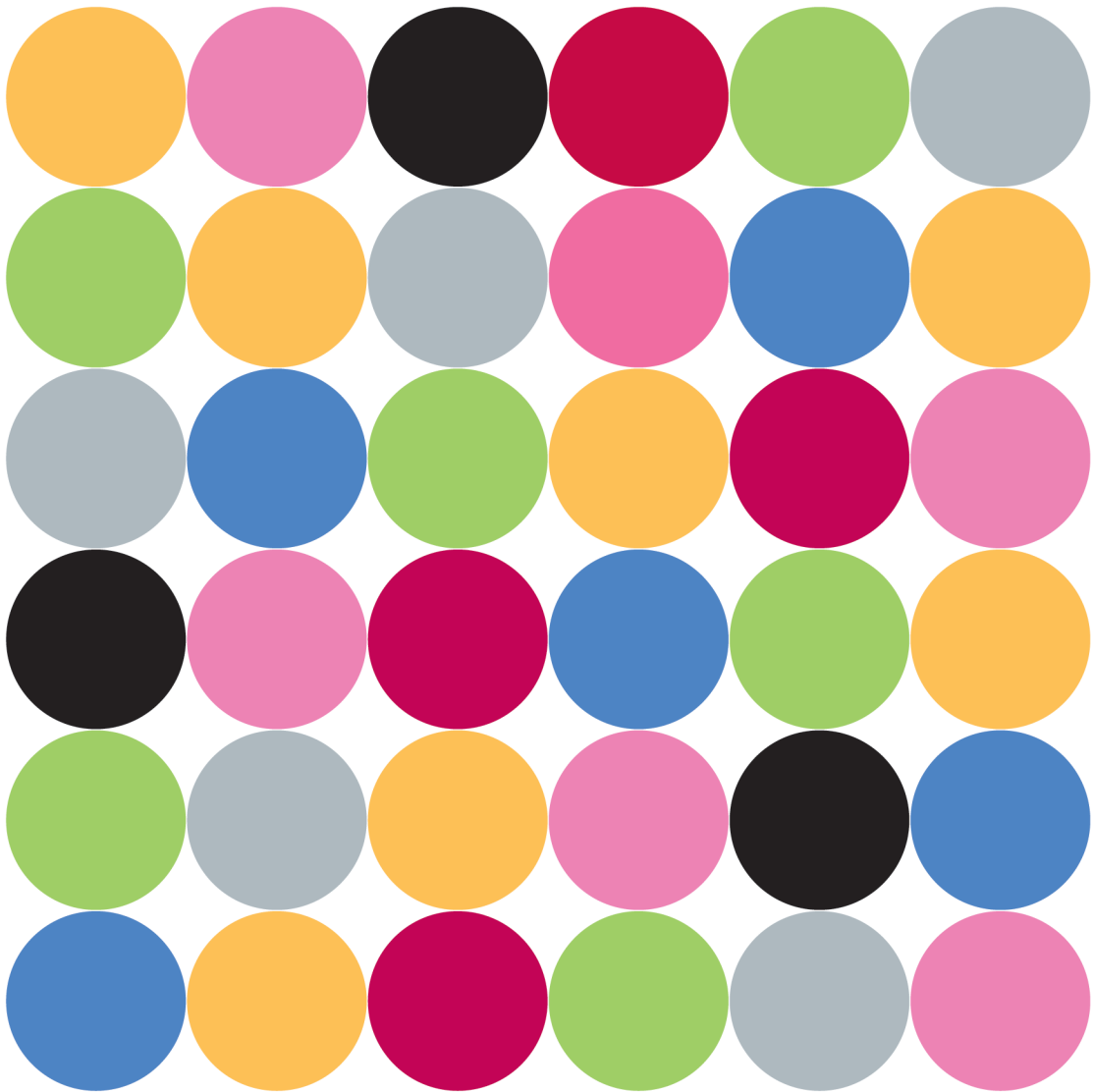
This chapter has addressed areas of activity that have tended to be neglected within BiH local government. Yet it is timely that municipalities address their wider enabling responsibilities and the quality of their organizational process and cultures.

Municipalities have always engaged with their operating environments and sought to lead their communities. The major difference in modern approaches to these questions is simply in the degree of emphasis. Our discussions on both the natural environment and local economic development made clear that being an effective 'enabler' involves traditional service delivery (for example as a pollution regulator or infrastructure provider) alongside becoming a community advocate and lobbyist. The extent of these roles will vary greatly according to area and conditions. The core of such enabling functions is about resolving market failures, such as a lack of SME finance, business service providers or the presence of pollution. This requires local governments themselves to shape delivery as they see fit, but it necessarily also

means local leaderships must come to appreciate their responsibilities more widely. Sadly, too many in local government dismiss these functions as beyond their remit or simply of little practical use. Yet the local environment and the vibrancy of the local economy directly impact on the lives of citizens - indeed as much as do the quality of schools or public utilities. Better economic and environmental conditions also have a direct feedback on the demand for local services and the ability of municipalities to raise revenues. Moreover, meeting enabling responsibilities typically requires very low resource inputs. One of the most valuable contributions of this report is to emphasize the importance of these functions to local leaders and their constituents.

Finally, the issues raised in the discussion on organizational management lie at the heart of the agenda to improve the broad span of local government activities. The quality of strategic choices and the local bureaucracy shapes the effectiveness of the entire municipal sector. Here our messages are clear. Firstly, that genuine strategic thinking and planning practices have to emerge. Secondly, that these are enhanced where real consultation takes place. Third, that across-the-board performance improvement is possible now and without major resource inputs. What organizational change requires most of all, is for local leaderships to tackle vested interests and outdated practices.

## CHAPTER SIX



TOWARDS A NEW LOCAL GOVERNANCE



## Chapter Six:

# Towards a new local governance

Our first goal in this final chapter is to recapture the conclusions and recommendations we have presented and offer a general assessment of the challenges facing local governance in BiH. Our second, is to map out a strategic vision of the reform agenda.

This endeavour immediately confronts some fundamental questions. Reform in BiH, as elsewhere in the world, is embedded in politics, yet our assessment of the potential for political change is pessimistic. The political elite have not shown a commitment to reform and ordinary citizens are apathetic and disenfranchised. Civil society is still weak and BiH lacks a genuine 'civil space'. Sadly, change continues solely to be driven by an increasingly assertive resident international community.

It is difficult to see therefore how the necessary reforms can ever come about. Our analysis also suggests a still more negative possibility; that the absence of strategies has not come about by chance or benign neglect, but is a direct consequence of dominant political forces' implicit opposition to change. It is a depressing prospect but the key obstacle to decentralization may not be systemic weaknesses, but outright political opposition.

Our response to this possibility must be both positive and assertive. Reform is never the exclusive game of those with power, but a challenge to be achieved by all stakeholders. Real lasting progress is rarely revolutionary in character but is instead made up of a myriad of small and practical steps, taken by all manner of groups. This report seeks to support such a process: its analysis, arguments and proposals form ammunition for all those

who are willing to fight for change. We also hold to the view that decentralization has a greater purpose in building the broad consensus that is necessary for comprehensive reform in modern day BiH.

### **Building a better local governance system**

#### **The governance framework and human development conditions**

Our analysis of the legal and administrative framework underlined the difficulties the disjunctures of BiH present for the quality of governance and the level of human development. These serve to effectively limit freedom of movement, access to basic public services and the provision of unified standards of service. The fragmented structure of government produces huge inefficiencies, with the middle tiers effectively 'crowding out' municipalities from raising their own revenue and exercising autonomy. The vague and overlapping definition of responsibilities and annually determined fiscal allocations result in uncertainty and dependency. The absence of any real resource pooling and fiscal equalization creates huge disparities between areas and hence, levels of local service provision. The outcomes are poor governance, weak public services and the undermining of local democracy.

Although it is difficult to draw direct connections, our review of the evidence suggests that BiH's intergovernmental arrangements contribute to its disappointing human development performance. The country is far from being in a developmental crisis, but the lack of governance reform, serves to retard performance in securing basic entitlements. Incomes are low, while health and educational outcomes have stagnated in recent years. As a result



# Better Local Governance in BiH

BiH's strong human development inheritance and its potential are under threat. In contrast, other initially weaker countries, which have proceeded with reforms, are performing better<sup>222</sup>. This is disquieting for a country seeking to join the European Union.

## Proposals for systemic change

The third chapter of this report offered the conclusion that decentralization and other reforms can play a very significant role in democratization and the public service improvement agenda. Our review indicated that actions must, however, be initiated at the systemic level to support changes in service sectors and within municipalities. Four specific areas for action were identified:

- The introduction of coordination and equalization mechanisms, to include fiscal arrangements to compensate for higher spending needs;
- Improvements in the definitions and correspondence of local functions and finances, within a general devolution of functions to localities;
- Securing the professionalism of the local civil service and the de-politicization of the environment in which they work;
- Strengthening local political accountability through electoral and managerial reforms.

The benefits of decentralized governance are maximised where local authorities are dynamic and innovative. This can be secured through a mixture of empowerment and competitive pressure within an appropriate framework. For this to prevail in BiH both the State and the local level must be strengthened. While the first proposed area requires action at the higher levels of government, the remaining

three are aimed at directly developing local capacity and capability.

The first series of actions would establish a country-wide framework providing standards, outputs and processes, including a fiscal equalization mechanism. The implementation of the second set would lead to a more predictable and stable operating environment for local governments. Achieving correspondence between responsibilities and resources is vital and local governments need clear definitions of the tasks and resource allocation rules which they face. This would enable them to build multi-year strategies and plan effectively. Accountability is also enhanced by grouping responsibilities and resources for specific functions at a single governmental level. The final two areas for reform are complementary and apply to the operational dimension. These support the improved delivery of frontline services and enabling functions, through improved management and political oversight.

## Service sectors, enabling functions and management

### Cross-cutting findings

In the fourth and fifth chapters we reviewed local governance from a vertical perspective, first looking at the direct services local governments currently provide and others they should provide, and second at the enabling functions expected of modern local governments. For each we examined the possibilities and incentives which affect service delivery, and the relationship between providers and consumers, evaluating both access and service quality. While the services reviewed were diverse, the challenges faced were remarkably similar.



Indeed these cross-cutting similarities reveal some of the most important dimensions of the governance transition challenge facing BiH.

A first and key problem faced is an outdated definition of public roles and private entitlements and the non-affordability of some of those entitlements. The socialist state took on wide responsibilities. Education and health were free and accessible to all, other services like culture and utilities were also widely available at essentially 'token prices'. We believe BiH needs not so much to make an absolute break with this tradition, but to redefine the social contract between state and citizens.

Whilst the public sector cannot cease to be responsible for the provision of public services, it cannot necessarily finance them all. Scarce resources oblige the authorities to make difficult choices. Certain services, like basic education, should continue to be available for all free at the point of use, yet in other areas, there is need for serious reconsideration. In the healthcare sector, for example, governments have already taken painful decisions to cut entitlements. The definition of the 'Basic Benefits Package' represented a huge step, as it allowed the extension of a minimal level of insurance to the vast majority of citizens. Yet in contrast, within the utilities, local governments are hesitant to cut general subsidies whilst it is obvious that without such cuts financial sustainability is impossible.

BiH has made only the first tentative moves in restructuring and redefining public roles and responsibilities. However, in so doing, it is important to recognise that throughout any revision of entitlements, attention must be paid to protecting the interests of the poor and vulnerable. This calls

for a radical rethink of how policymakers prioritize and target support.

The second cross-cutting problem is the huge inefficiencies in service delivery. This is mostly a consequence of the input-based financing mechanisms surviving from the socialist period. In this situation it is very difficult to judge whether the currently available resources could provide for a satisfactory level of service even if usage were rationalized. Unfortunately, the information currently produced by the BiH's public management systems is not sufficient to make such judgments. In each of our sector contributions we call for the reform of these mechanisms. Better prioritization, allocation and stewardship can produce strong incentives for more efficient and effective delivery.

The third and the last of our cross-cutting findings is that all sectors witness regional disparities that are due to the lack of resource pooling for redistribution among cantons and Entities. As resources do not cover minimal standards in many places there is an urgent need for resource equalization. This is a basic systemic challenge. Resolution of these problems requires more than a system of solidarity funds, but an explicit recognition that compensation is needed for both variations in revenues and divergent needs.

## **Sector conclusions and recommendations**

We summarise the specific sector challenges encountered in two ways. First by groups of sectors, and second in matrix form (see Table 6.1) to reflect that solutions necessarily require concerted actions from both higher and lower level governments.

# Better Local Governance in BiH

Taking the human service sectors first (the health, education and social services sectors) which have the most direct relationship with human development outcomes, we concluded that the institutional frameworks are wholly inadequate for delivering the required outcomes. Roles and responsibilities are confused and the systems are poorly rationalized. And specifically that:

- In primary education, the existence of large numbers of small schools results in a costly and weak service, and there is scope for rationalization.;
- In the health sector an ill-fitted geographical distribution of provision due to the large population shifts and Bosnia's problematic

administrative structure presents a huge challenge;

- In social services, poorly coordinated investment has resulted in network inefficiencies.

Part of the solution to these problems lies in coordination and equalization. Yet rendering the institutional networks more effective would necessitate large investments that are not available at the local level and nor would they be directed to the priority areas within the current system. Intergovernmental grants financed through aid or borrowings are therefore required to support municipalities to restructure and invest in public service delivery.

Table 6.1: Summary of key sector challenges

EDUCATION		HEALTH CARE	SOCIAL CARE	UTILITIES	LOCAL ECONOMIC DEVELOPMENT	ENVIRONMENTAL MANAGEMENT
Tasks and political costs of upper governments						
Redefinition of entitlements and public roles		Insurance coverage Benefit packages	Beneficiary groups according to need	Universal access	Enabler	Enabler and coordinator
New financing schemes	Per student	Capitation and fee for service	Money follows the patient	Cost coverage and metering	SME and start-up support	
Restructuring support	Facility improvement and network rationalization	Network rationalization and filling access gaps	Improve access and monitoring	Network extension and rehabilitation implementation	Active labour policy	Regulatory change
Political cost		Restrict benefits	Restrict beneficiaries			Economic implications for business

## Chapter Six: Towards a new local governance

	EDUCATION	HEALTH CARE	SOCIAL CARE	UTILITIES	LOCAL ECONOMIC DEVELOPMENT	ENVIRONMENTAL MANAGEMENT
Tasks and political costs of local governments						
Local public roles	Service provision	Service provision	Service provision	Policy Supply access Means tested subsidies	Enabler SME and start-up support	Enabler and advocate
Key components of local strategies	Improve and rationalize delivery and network	Improve and rationalize institutional network	Reach out to people in need	Financial sustainability Extension of access	Enabling environment SME and start-up support	Regulation and information dissemination
Political costs	Close school and fire staff			Increase price and collection		Economic implications for business

Second, with regard to utility services, BiH faces a classic transition challenge in reshaping perceptions, expectations and the mode of service delivery. In short, the utilities must be run on commercial lines: their costs should, as far as possible, be recovered from user charges. Any element of cross-subsidy should be explicit and justified in terms of the direct social benefits. Pricing schemes and the perceived entitlements of citizens must be changed to secure sustainability and a rational use of inputs. Utilities must cease to be a kind of direct social support. Charging can create important incentives for more rational behaviours on the part of decision makers, providers and consumers. Market-based incentives and social goals are not necessarily mutually exclusive - cost-recovery charging can assist in promoting access and universal coverage. Yet it also needs to be recognized that increasing prices and directing subsidies to the vulnerable alone, entails political risks for local leaders.

Third, referring to enabling functions, local governments need to modernize their approach and recognize they hold implicit duties that extend beyond mandated responsibilities. These activities, like local economic development and environmental improvement, are not ancillary to their missions but central to community development. This necessarily means taking these functions seriously and not shifting responsibility elsewhere. It has to be recognized that finances are necessarily scarce, and this calls for municipalities to find innovative ways of meeting these challenges through partnerships with others, higher level governments, neighbouring areas and the private sector, and through exploiting other non-financial resources to secure the desired outcomes.

Finally, in relation to strategic management and planning, we emphasize that reform is very much a matter of adopting best practice approaches common to complex businesses and public sector

# Better Local Governance in BiH

organizations the world over. These span finance, corporate planning and human resources disciplines, but this process will also require far more than simply 'cutting and pasting' innovative procedures. Developing the right work culture, incentives, performance discipline, and above all, managerial ambition will prove challenging. It must be recognized that fundamental change is not secured overnight and requires sustained commitment.

## Charting a way forward

Decentralization is an essentially political question, since it necessarily involves changing the distribution of power and resources. The systemic reforms that we have identified will therefore rank as the most difficult to realize. Effective progress will require leadership and a broadly based consensus. Moreover, to be sustainable, state-level change must have domestic backing strong enough to overcome vested and immovable interests.

Unilateral international imposition would almost certainly be self-defeating. But this should not preclude international sponsorship of discussions or the development of policy options. Support and encouragement is a valuable function which might be discharged both by donors and by the Dayton partners.

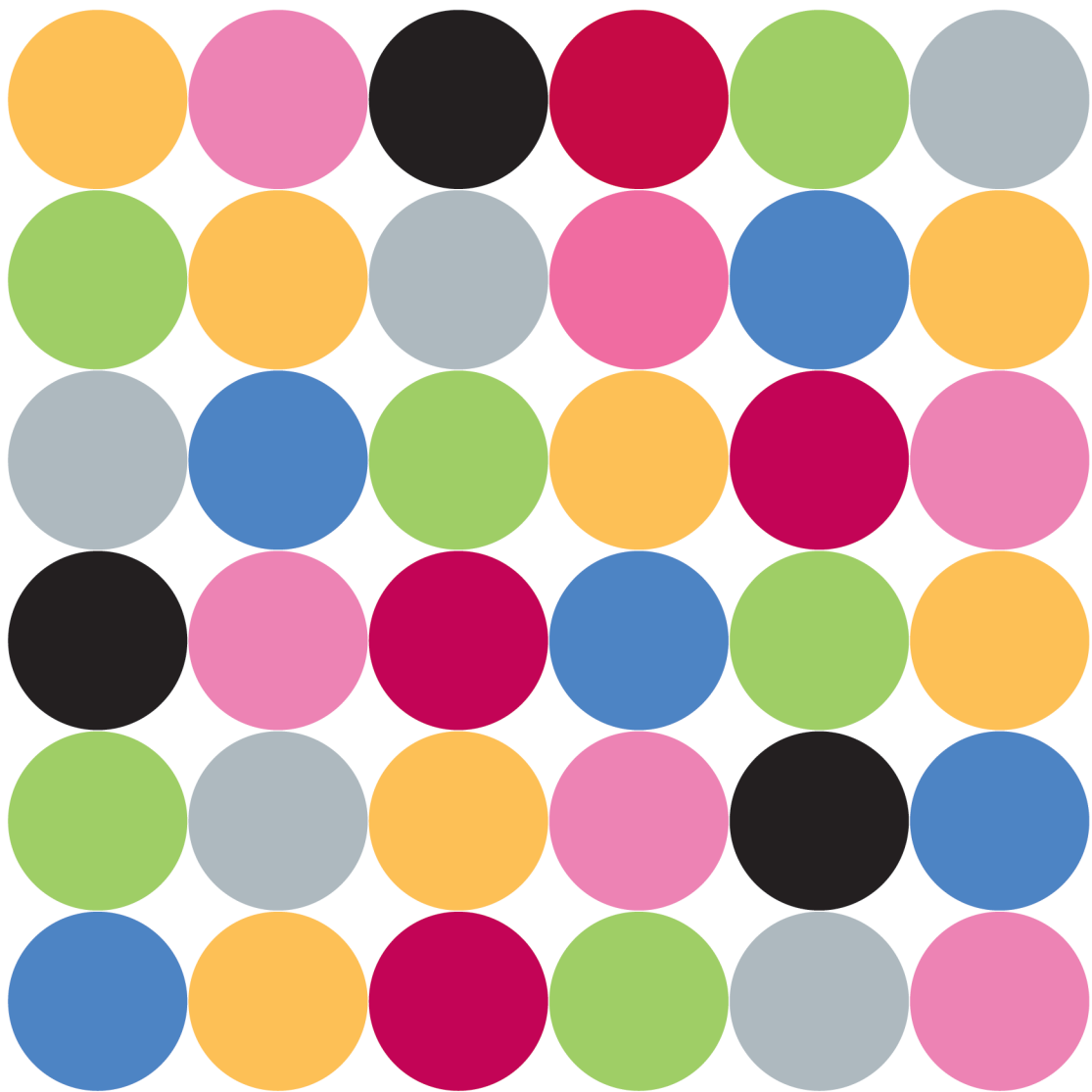
Equally, the extent of the challenges at the State-level does not mean that sectoral and less problematic systemic reforms should be shelved or made contingent on higher level reforms. Firstly, sectoral reforms themselves have a supportive 'soft' political role to play in shaping attitudes and thus the political climate. Furthermore, many simply make good sense in their own right and can be implemented now. For example the introduction of a

new pricing regime in the utilities has both a strong technical rationale and would directly work to modify incentives and behaviours. We emphasize that changes which result from operational interventions like this, are not merely limited to the consumers of local government services, but directly promote political room for manoeuvre.

Management of perceptions and expectations will also be important, and there is a difficult balancing act to be secured between this and maintaining sufficient ambition. Passivity and cynicism are already features of the political landscape in BiH. All partners in the process of change need to be schooled in the need for tenacity and determination. All positive contributions must be welcomed. It is possible and useful to diligently work on small practical reforms in various sectors. These incremental steps are key to setting the ball rolling. They both curtail the wasting of resources and contribute directly to quality of citizens' lives. This ultimately establishes a virtuous circle, building trust in public institutions, and breaking citizen apathy and deep-rooted opposition.

We close on both a cautionary and an optimistic note. It would be foolhardy not to underline that Bosnia and Herzegovina's recent history and political geography present a challenging environment for the programme we advocate. Yet, as we have argued previously, targeting the local arena, where the politics is more real and immediate, can unleash seismic forces capable of overcoming entrenched opposition and renewing the entire system of governance. This is precisely why local government reform is so central to the human development agenda in BiH.

TECHNICAL ANNEXES





## Annex 1:

# Human Development Indices

This annex provides the calculations to support the standard human development indices for Bosnia and Herzegovina, which are presented in Chapter 2 and referred to throughout the publication. It has two sections. The first provides a brief overview of the human development approach, the second describes the methods used to compile the indices.

### The Concept of Human Development

The human development approach provides a welfare-based means of thinking about, and tracking, economic and social progress. At its root, Human Development concerns itself with furthering individuals' capacities (their 'capabilities') to access those states of being (or 'functionings') that define the quality of life. These include being able to secure a decent education, being in good health, having the economic wherewithal to participate in the economy, and having a political voice by which outcomes can be affected. The approach grew out of Basic Needs thinking which re-defined development objectives away from a small number of macroeconomic indicators, chiefly growth in per capita incomes, and brought in notions of securing basic entitlements, such as nourishment, warmth and shelter. Human development goes conceptually further by expressing well-being in terms of securing the freedom to make positive choices and so enable individuals to realise their full potential.

In order to give effect to these values UNDP formulated a metric through which performance could be measured over time and between nation states. The Human Development Index (HDI), was first published in the global Human Development Report (HDR) in 1990, and has been calculated for each of

the UN member nations on an annual basis ever since. The HDI is a composite index made up of three equally weighted parts representing three key capabilities: life expectancy, educational performance (given by literacy and enrolment rates) and living standards (given by GDP per capita). While the HDI represents the principal indicator employed, further indices have been added over time and compilation methods have been sophisticated:

- The Human Development Index (HDI), as outlined above;
- The Human Poverty Index (HPI), a capability-based poverty measure;
- The Gender Development Index, a stylised form of HDI which adjusts the HDI components to reflect gender differences;
- The Gender Empowerment Measure (GEM), which explicitly measures the political and economic empowerment of women.

### Indices for BiH

The rubric and calculations for BiH for each indicator follow below. In general the methods replicate those in the global report. However, the calculations do attempt to offer more a comprehensive and reliable picture by using more up-to-date data, and by reporting indices (specifically the HPI and the GEM) which are not yet available internationally. Occasionally this has necessitated departing from the standard methods of compilation and this is disclosed where relevant. Although the analysis provided in Chapter 2 makes use of indices provided at Entity, and in some cases regional levels, the following reports only the national figures. Sub-national data necessarily relies on estimates and assumptions, and is therefore provisional.



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Details of how the sub-national figures were arrived at can be found separately in Annex 2.

## Human Development Index - HDI

The HDI is summary measure of human development. It measures average achievement across three basic dimensions:

- A long and healthy life, as measured by life expectancy;
- Knowledge, as measured by the adult literacy rate (two thirds weight) and the combined primary, secondary and tertiary gross enrolment ratio (one third weight);
- A decent standard of living, as measured by the logarithmic transformation of GDP per capita (in PPP US\$).

Before the HDI is compiled an index needs to be created for each of the dimensions. These indices are framed by minimum and maximum values, termed 'goal posts'. Performance in each dimension is expressed as a value between 0 and 1 by applying the formula:

$$\text{Index} = \frac{\text{Actual} - \text{Minimum Value}}{\text{Maximum} - \text{Minimum Value}}$$

The minimum and maximum values for the current year are:

	Max	Min
Life Expectancy	85	25
Adult Literacy	100	0
Combined enrolment	100	0
GDP per capita (PPPUS\$)	40,000	100

The HDI is then given as a simple average of the dimension indices. The Box provides details of the calculations for BiH.

## The HDI for Bosnia and Herzegovina

The approach outlined below entirely follows the standard UNDP methodology.

### (1) Calculating the Life Expectancy Index

This index measures the relative achievements of a country in longevity. For BiH with a life expectancy of 74 years the index is given as:

$$\text{Life Expectancy Index} = (74.0 - 25) / (85 - 25) = 0.817$$

### (2) The Education index

This index measures a country's relative achievement in both adult literacy and combined enrolment. Two subsidiary indices are calculated for each of these part-dimensions, and then combined with differential weights (two versus one third):

$$\text{Adult Literacy Index} = (94.3 - 0) / (100 - 0) = 0.943$$

$$\text{Gross Combined Enrolment Index} = (67.3 - 0) / (100 - 0) = 0.673$$

$$\text{Education Index} = \frac{2}{3} (0.943) + \frac{1}{3} (0.673) = 0.853$$

### (3) Calculating the GDP Index

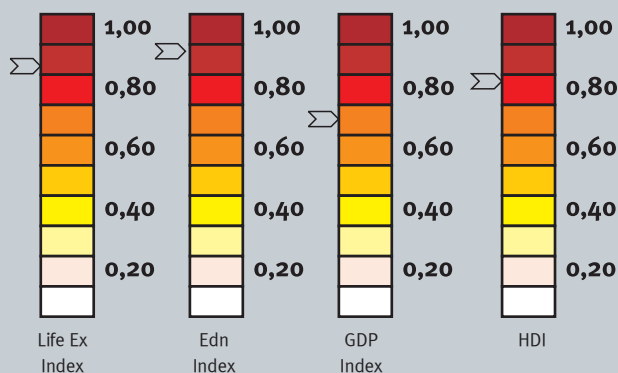
The GDP index is calculated using adjusted GDP per capita (in purchasing power dollars). Income serves as a surrogate for all dimensions of human development not reflected by longevity and knowledge. GDP per capita is adjusted using a log transformation because achieving a respectable level of human development does not require unlimited income and the associated welfare benefit declines progressively as more income is received. For BiH with a GDP per capita of PPPUS\$ 5,970 the index is given as:

$$\text{GDP Index} = \log(5970) - \log(100) / \log(40,000) - \log(100) = 0.683$$

### (4) Compiling the HDI

Once the dimension indices have been determined the HDI is the straight forward average of the three (see diagram also):

$$\begin{aligned} \text{HDI} &= \frac{1}{3} (\text{ILE}) + \frac{1}{3} (\text{IE}) + \frac{1}{3} (\text{IGDP}) \\ &= (0.817/3) + (0.853/3) + (0.683/3) = 0.784 \end{aligned}$$





## The Human Poverty Index - HPI

Whilst the HDI measures average achievement the HPI measures deprivation in the basic dimensions of human development. These are represented by the extent to which nations fail to reach specified thresholds (akin to human poverty lines). The scale of inequality within the world means that it is not possible to meaningfully apply a common index to all UN member nations and thus two variants are provided:

- HPI1 which is applied to the developing world;
- HPI2 which is reported for selected OECD countries, but is equally applicable to the former East European nations (and thus to BiH).

Each measures similar deprivations, but the HPI2 adopts higher thresholds and includes an unemployment variable to track social exclusion. A summary of each follows.

### HPI1

- Premature death, measured by the proportion of the population not reaching age 40.
- Exclusion from knowledge measured by adult illiteracy.
- Inadequate living standards given by the average of the proportions of those without access to safe water, and children who are underweight.

### HPI2

- Premature death measured by the proportion of the population not reaching age 60.
- Exclusion from knowledge measured by the level of functional literacy skills.
- Inadequate living standards measured by the proportion living below the income poverty line.
- Social exclusion represented by the long term unemployment rate.

Although the HPI2 specification is more relevant to the BiH context, data limitations have meant it is

not possible to follow the full formulation. Thus a hybrid HPI has been adopted (see box).

## The HPI for Bosnia and Herzegovina

### (1) BiH Specification

Data limitations have meant that the approach outlined below deviates somewhat from the HPI2 specification which is relevant to BiH.

The two variables we lack are the numbers of adults lacking functional literacy skills and the numbers below an income poverty line (defined as 50% of the median income). In their place we have substituted the total adult literacy rate and the consumption-based poverty measure given in the Living Standards Measurement Survey (UNDP/ World Bank, 2003).

### (2) Calculating the HPI for BiH

The hybrid formula we have adopted is closest to the HPI2 which fits best with BiH's developmental position:

$$\text{HPI2} = [\sqrt[4]{(P_1^a + P_2^a + P_3^a + P_4^a)}]^a$$

Where:

P1= Probability (at birth) of not surviving to age 60

P2= Adult illiteracy Rate

P3= Population below the consumption poverty line

P4= Long term unemployment (12 months and more)

a = 3 (as per standard)

Thus the calculation is:

$$= \sqrt[3]{\sqrt[4]{(13.7^3 + 5.7^3 + 19.5^3 + 9.5^3)}} = 14.0\%$$

This implies that a standardised 14 % of the population are living in human poverty.

### (3) Standardization and the parameter (a)

Note that unlike the HDI each component is expressed as a population percentage and therefore no standardisation is required prior to calculating the index.

The method of combination makes use of a power (a) which is currently given as the cubed value of each indicator. This ensures that the final result is more than proportionately affected by the lowest components. As a result HPI scores can best improved by action to address each and every of the deprivations measured, and the effect of trade-offs between the variables is muted.

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## The Gender-related Development Index - GDI

The GDI is a stylised form of HDI which adjusts the calculation to reflect inequities between men and women. The index is specified using the same methodology and dimensions, but yields gender-adjusted measures, termed equally distributed indices (EDIs). These are then averaged to produce the GDI.

There are three stages to the process. First, carry-out the standard HDI calculations but for men and women separately. Note this requires the use of gender-specific goalposts for life expectancy: with men having a minimum and maximum of 82.5 and 22.5 years, and women 87.5 and 27.5 years. Second, the gendered-indices are recombined to provide their equally distributed counterparts. Using the formula:

$$EDIs = \{ [ \text{Female population share (female index}^{1-e}) ] + [ \text{male population share (male index}^{1-e}) ] \}^{-1}$$

The parameter (e) represents the level of aversion to inequality. As it rises above 1 it places a greater penalty on inequalities within any of the dimensions. Within the current specification (e) is set at 2. Thus the square roots of the two shares are taken to produce the harmonic mean of the female and male indices.

$$EDIs = \{ [ \text{Female population share (female index}^{1-e}) ] + [ \text{male population share (male index}^{1-e}) ] \}^{-1}$$

Finally the GDI is calculated as a simple average of the three EDIs.

As the GDI represents an adjusted HDI it is useful to compare the result against the headline HDI. A large decline is suggestive of gender inequity whereas a value close to the HDI is indicative of equity. As the BiH data in box shows, the GDI varies only marginally, indicating, that at the macro level at least, gender equity prevails.

## The GDI for Bosnia and Herzegovina

Data sources are sufficiently robust as to allow the standard GDI methodology to be followed.

### (1) Calculating the Equally Distributed Life

Expectancy Index	FEMALE	MALE
Life expectancy =	77.0	71.0
Life expectancy index =	0.825	0.808
Population share =	51.6%	48.4%
Life Ex. EDI=	$\{ [0.516(0.825^2)] + [0.484(0.808^2)] \}^{-1} = 0.817$	

### (2) Calculating the Equally Distributed Education Index

First indices for the adult literacy rates and the combined gross enrolment ratios are calculated separately for men and women:

	FEMALE	MALE
Adult literacy rate =	90.4%	98.4%
Adult literacy index =	0.904	0.984
Gross enrolment ratio =	70.8%	63.9%
Gross enrolment index =	0.708	0.639

Second, the education index (two-thirds weight to adult literacy and one-third weight to the gross enrolment) is computed for each gender: Female = 0.838: Male = 0.869.

The gendered indices are combined to create the Education EDI:

$$\{ [0.516(0.838^2)] + [0.484(0.869^2)] \}^{-1} = 0.853$$

### (3) Calculating the Equally Distributed Income Index

First, estimates are developed for the level of male and female income in PPPUS\$. As in the HDI methodology per capita incomes are adjusted by taking the logarithm of the PPP figures and the income index is calculated for each gender using the standard formula: (log actual-log minimum / (log maximum- log minimum)):

	FEMALE	MALE
Per capita PPPUS\$ =	3,749	8,338
Logged income =	3.574	3.921
Income Index =	0.605	0.738

The Income EDI is arrived at by applying the standard treatment:

$$\{ [0.516(0.605^2)] + [0.484(0.738^2)] \}^{-1} = 0.663$$

### (4) Compiling the GDI

The GDI is simply the unweighted average of the three equally distributed dimension indices:

$$GDI = \frac{1}{3}(\text{Life Exp. EDI}) + \frac{1}{3}(\text{Edn. EDI}) + \frac{1}{3}(\text{Inc. EDI})$$

$$= \frac{1}{3}(0.817) + \frac{1}{3}(0.853) + \frac{1}{3}(0.663) = 0.777$$

### (5) Comparison with HDI

These results show that the GDI is less than 1% lower than the HDI (0.784), suggesting that gender inequity is not high.

## The Gender Empowerment Measure - GEM

Focusing on women's opportunities rather than their capacities, the GEM is calculated on the basis of three key dimensions:

- Political participation and decision making measured by women's and men's shares in the primary legislatures.
- Economic participation as measured by two indicators: the gender shares of decision making offices (legislators and senior public officials): and the gender share within professional and technical positions.
- Power over economic resources, as given by the ratio of men's and women's estimated earned income.

For each of these dimensions, an equally distributed equivalent percentage is calculated (EDEP) as a population weighted average according to the following general formula:

$$\text{EDEP} = \{[\text{female population share (female index)}^e] + [\text{male population share (male index)}^e]\}^{-1}$$

The parameter (e) measures aversion to inequality and values higher than 1 more than proportionately penalise inequities on individual components. As in the GDI the current UNDP specification sets e at 2, affording a moderate penalty to inequality between the genders. The formula is thus:

$$\text{EDEP} = \{[\text{female population share (female index)}^2] + [\text{male population share (male index)}^2]\}^{-1}$$

For political and economic participation the EDEPs are further adjusted by dividing by 50. The rationale being that in an equal society these authorities should be shared equally.

The income dimension ratio is calculated with reference to the standard HDI goalposts, but the unadjusted PPPUS\$ figures are taken in place of the logarithmic scale.

## Calculating the GEM for Bosnia and Herzegovina

Data sources are sufficiently robust to allow the standard UNDP methodology to be followed.

### (1) Calculate the EDEP for parliamentary representation (PR)

This measure reflects the relative empowerment of women in the political sphere. The formula is based on the relative shares of seats held by men and women in the national parliament, versus the population gender balance.

	FEMALE	MALE
Population share	0.516	0.484
Parliamentary share	14.3%	85.7%
PR EDEP = $\{[0.516 (14.3^2)] + [0.484 (85.7^2)]\}^{-1}$	= 23.97	
Indexed EDEP (divided by 50)	= 0.4794	

### (2) Calculating the EDEP for economic participation

This element reflects the representation of women and men in senior executive and decision making positions in the economy, again relative to the overall population share.

	FEMALE	MALE
Share of legislators/ senior Officials & managers (LSOM)	19.57	80.43
Share of technical & professional posts (TPP)	48.66	51.34
LSOM EDEP = $\{[0.516 (19.57^2)] + [0.484 (80.43^2)]\}^{-1}$	= 30.88	
Indexed EDEP (divided by 50)	= 0.6177	
TPP EDEP = $\{[0.516 (48.66^2)] + [0.484 (51.34^2)]\}^{-1}$	= 49.93	
Indexed EDEP (divided by 50)	= 0.9987	

### (3) Calculating the EDEP for income

The male and female earned income figures used for the GDI are re-used here, but are not adjusted using the logarithmic scale. The standard EDEP approach is then followed:

	FEMALE	MALE
Income (PPPUS\$)	3,742	8,338
Index $(x-100)/(40000-100)$	0.092	0.207
ESDEP for income (average of the 2)	= 0.1252	

### (4) Calculating the GEM

The final index is given by the simple average of the three components:

$$\text{GEM} = (0.479 + 0.808 + 0.125) / 3 = \mathbf{0.4709}$$

### (5) Female and Male Income Shares

Note that as in the global report the female income share is based on the ratio of male to female wages scaled by economic participation rates. For BiH it is assumed average female wage is 75% of the male wage.



## Annex 2:

# Regional Human Development Indices

Chapter 2 of this report provides a regional picture of Human Development in Bosnia and Herzegovina today. Our overall purpose was to better contextualize the environment in which local governments operate, and to show that local action is vital if material improvements in human development are to be secured.

Three separate disaggregation models are offered at various levels: the FBiH and RS Entities, the FBiH Cantons plus the RS, and one based on a clustered sample of municipalities across the whole of BiH. All of the options offer a disaggregation of the Human Development Index (HDI). The municipal sample also provides a modified Human Poverty Index (HPI), whilst the Entity-level model provides the complete set of indices.

This Annex explains the methodology employed to support these calculations and highlights the challenges and problems encountered. Whilst dis-

aggregations of this nature would present problems in any context, the position is more problematic in BiH, owing to the lack of statistical sources at all levels. Thus, it has to be noted that our estimates are at best proximate and provide an indication but not a definitive mapping of regional disparities within BiH.

### Entity Level

This first approach, which provides measures for each entity, is the most reliable sub-national disaggregation offered and permits the calculation of the full set of indicators (see table A1 below). But with only two units, it might be argued that it is of rather limited value. Indeed, as both anecdotal evidence and the later approaches show, there are quite considerable disparities within each Entity.

Table A1: Entity Level Human Development Indices

Indicator	FBiH	RS	State	FBiH Variance against State	RS Variance against State	Entity Variance (RS against FBiH)
HDI	0.796	0.758	0.784	+1.5%	-3.3%	-4.8%
- Life Expectancy Index	0.823	0.807	0.817	+0.7%	-1.2%	-1.9%
- Education Index	0.854	0.833	0.853	+0.1%	-2.3%	-2.5%
- Economic Index	0.703	0.633	0.683	+2.9%	-7.3%	-10.0%
HPI	12.5%	16.9%	14.0%	-10.7%	-20.7%	-35.2%
GDI	0.786	0.757	0.777	1.2%	-2.6%	-3.7%
GDI change on HDI	-1.3%	-0.1%	-0.9%	-44.4%	+88.8%	+92.3%
GEM	0.509	0.517	0.471	+8.1%	+9.8%	+1.6%



# Better Local Governance in BiH

The methodology employed was straight forward. The data sets used for each of the calculations were gained separately from the respective Entity's statistical institutes and where this was not possible, other official sources were used. Although the compilation rubric was essentially as described in Annex 1, there are two deviations from the standard approach:

- The first concerns the life expectancy (LE) index used in the HDI and GDI calculations. Owing to the absence of a comprehensive population census, national life expectancy data for BiH has since 1999 been based on UN estimates. At Entity level only the RS Institute has carried out an estimation exercise. Therefore the indices rely on quoted estimates for the State and RS and our own interpolated figure for the FBiH. The interpolation used was crude and assumed strict proportionality according to population size between the two Entities, i.e.

Life Expectancy (LE) FBiH = State LE - (RS LE x RS Popn. Share) / ffb BiH Popn. Share

- The second relates to the longevity indicator used within the HPI. As age specific mortality rates are not available for the FBiH or RS, the probability of surviving until age 60 component (P1), has been held constant for both entities.

It should also be noted that the HPI results vary dramatically according to how the Long Term Unemployment component is specified. Either official unemployment rates or the LSMS (ILO-based) definition can be used, and both are presented in the text. Although based on a sample survey and now rather dated, the LSMS approach remains

more accurate given the weaknesses associated with the official jobless count.

## FBiH Cantons plus the RS

This second approach provides a considerably more disaggregated picture of human development conditions across BiH, but does so at the expense of rigour and completeness.

The results are limited to the HDI alone, and it was possible to only fully vary the Economic (GDP) component. This is because there are no complete official or unofficial secondary sources for sub-entity life expectancy, educational enrolment or literacy. In addition, the GDP figures used also have their limitations as they are based on research carried out at Canton Sarajevo in 2000 (on 1999 data). As a result:

- The life expectancy and education indices were held constant at Entity-level values - respectively: 0.823 and 0.864 for the FBiH; and 0.807 and 0.833 for the RS;
- The economic index was derived by re-pricing per capita 1999 estimates taken from Canton Sarajevo research, using the published deflator series (a factor of 1.0613). These were then re-priced to international (US dollar) prices, using an imputed Purchasing Power Parity Factor (4.3833).

The non-availability of comparable data for any of the seven RS regions necessarily also limited the analysis to the Federation. Therefore we are effectively recognizing the RS as a single region. This is a problematic assumption as conditions within the RS, are likely to vary substantially. However, the analysis does usefully demonstrate that the RS is not universally less developed, and its placement

## Annex 2: Regional Human Development Indices

within the middle of the distribution underlines the weakness of such commonly held assumptions.

The results of the exercise are given in Table A2 below:

Table A2: HDI for FBiH Cantons and the RS

	Canton or RS (Rank Order)	Economic index	HDI	Variation from State level	Percentage difference on high HD level (0.800)
1.	Sarajevo	0.792	0.824	5.1%	3.2%
2.	Neretva	0.718	0.800	2.0%	0.3%
3.	West Herzegovina	0.712	0.798	1.8%	0.0%
4.	Republika Srpska	0.633	0.761	-2.9%	-4.8%
5.	Central Bosnia	0.600	0.760	-3.1%	-5.0%
6.	Tuzla	0.594	0.758	-3.3%	-5.3%
7.	Zenica Doboј	0.581	0.754	-3.8%	-5.5%
8.	Podrina	0.569	0.750	-4.3%	-6.0%
9.	Posavina	0.563	0.748	-4.6%	-6.3%
10.	Herceg Bosna	0.562	0.748	-4.6%	-6.3%
11.	Una Sana	0.548	0.743	-5.2%	-6.9%

The above show a reasonable level of variation with the highest value (Sarajevo) being 5.1% above the State-level figure and correspondingly the lowest value (Una Sana Canton) being a similar percentage below the State level. More interesting are the relativities to the High-Human Development interval which begins at a value of 0.800. This illustrates a distinct break in the data with three regions (Sarajevo plus the Herzegovina cantons) being within the category, and the others all around 5% below. Indeed, the level of variation outside the higher-scoring regions is very much reduced.

### Sample of Municipalities

The third approach relied on a sample of 13 municipalities scattered across BiH for which data

had been collected in 2000 for research undertaken by the Sarajevo Economics Institute. This exercise aimed to use pairs or groups of three municipalities, to represent the larger regions in which they are located and purposefully avoided using outliers such as Sarajevo and Banja Luka. The six regions and the constituent municipalities were:

- Region 1: Sanski Most, Kluć
- Region 2: Bosanski Novi, Prijedor
- Region 3: Travnik, Vitez
- Region 4: Zenica, Tesanj
- Region 5: Siroki Brijeg, Ljubski, Posuje
- Region 6: Trebinje, Gacko

The data compiled for each allowed the calculation of approximate HDIs and HPIs for each municipality and region (the aggregate of the two). Owing

# Better Local Governance in BiH

to data source difficulties, significant deviations from the standard methodology were necessary:

- In the case of HDI: As it was not possible to vary life expectancy data, this was held constant across the sample at the state level value. Educational information was sourced from municipalities themselves, whilst the income (GDP) data was arrived at via commonly accepted disaggregation methods (based on SNA data). Allowance was also made for unrecorded remittances from abroad and informal sector activity.
- In the case of HPI: Lack of adequate data meant the index specification had to be modified to a form somewhere between the HPI1 (used for developing countries) and the HPI2 (used for industrialized nations). The four components were as follows (with a description of how closely they match the HPI2 specification):
  - P1 - probability of not reaching age 60 (standard):
  - P2 - total unemployment (non-standard but conceptually closer to HPI2):
  - P3 - wastewater connection rates (non-standard and closer to HPI1):
  - P4 - illiteracy (non-standard measure used which is closer to HPI1).

In order to update this exercise for the relevant base year (2002), further adjustments were made to the calculations:

- The 2001 state-level life expectancy figures were replaced with the current Entity level figures (see above).
- The GDP index data was re-priced to 2002 prices using the GDP deflator series (a factor

of 1.0146) . This was followed by application of the PPP adjustment specified for 2001. Note that here we made use of the 2001 adjustment factor and not the derived 2002 adjustment, as the global HDR retained the per capita GDP for BiH at the 2001 value.

Finally also in relation to HPI: as it was impossible to replicate the data, no updating took place and the original 2001 estimates were simply rolled forward.

Given the limitations described we concluded that at best, the HPI dataset could only offer an ordinal and non-regional reflection of the disparities between the selected municipalities. This is explicitly recognised within the text of the report, and the raw data (which is given below in Table A3) is not reproduced.

Table A3: Sampled Municipalities HDI and HPI Data

Sampled Municipality	HDI Value	HPI Value
Sanski Most	0.707	11.5%
Ključ	0.723	7.5%
Bosanski Novi	0.731	5.0%
Prijedor	0.725	5.8%
Travnik	0.759	11.2%
Vitez	0.788	7.2%
Zenica	0.754	7.5%
Tešanj	0.733	13.5%
Š.Brijeg	0.786	10.5%
Ljubuški	0.743	7.9%
Posušje	0.729	13.8%
Trebinje	0.737	9.0%
Gacko	0.704	15.3%



## Annex 2: Regional Human Development Indices

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Several regional constructions of these results were reported to NHDR team members. The subsequent discussions revealed concerns about the selection of the original sample, how representative the municipalities are for their regions and the index modifications made. As a result, the final text describes these results as only being an illustrative reflection of likely regional pattern of human development and poverty. Although both HDI and HPI are presented in ordinal form, the relatively better quality of the HDI was recognized by expressing the results as a ratio of the highest figure.

In spite of serious weaknesses, it is apparent that the results have some correspondence with anecdotal evidence and the other more satisfactory approaches quoted. They broadly reveal a core-periphery pattern of disparities. It is also interesting to note that there is little relation between the HDI and HPI results at municipality level. Indeed, there is at least a suggestion of a negative relationship between the two and this is particularly so in the emergent wealthier regions of the Federation.



## Annex 3: Donor activities in the local governance arena

This annex offers an overview of current and recent international donor activity in the areas of decentralization and local government service reforms in BiH. It is intended to relate existing donor projects to the problems and constraints faced by local governments, as have been identified in this report. For each problematic issue, relevant donor programmes are grouped under a separate subheading and commented upon. The annex closes with an assessment as to whether specific problems are being tackled, and suggests gaps to be targeted by future donor assistance.

### Macro-level Problems related to the DPA and Entity Constitutions

Legal confusion and competency overlap. The rights and responsibilities of local government in BiH remain ill-defined. Higher authorities have been able to exploit this by delegating tasks to the municipal level while withholding the necessary resources. Subsidiarity is severely wanting in BiH. Municipalities have also suffered badly from not having the power to determine their fiscal revenues, thus being unable to undertake long-term planning and budgeting.

To a certain extent, this has been remedied through the passage of entity laws on local self-government. The Council of Europe (CoE) has taken the lead in addressing these issues, by lending legal support to lawmakers in both Entities. The European Charter on Local Self-Governance (ECLSG) has served as the base document: its implementation is one of CoE's post-accession criteria for BiH. Specifically, CoE has instigated and supported the following interventions:

- Launching a model cantonal law on local self-government (LSG);
- Supporting the amendments to the framework Law on LSG of the FBiH;
- Supporting the drafting amendments to the Constitution of FBiH;
- Supporting the drafting of a new Law on LSG for the RS.

Lack of formal municipal consultation and representation at canton/ entity/ state level: Although associations of municipalities exist to represent their interests at higher government levels, these have been ineffective. Strengthening of such associations vis-à-vis the Cantons and RS government, respectively, is crucial if municipalities are to have more say in public policymaking. An upcoming project by the Association of Netherlands Municipalities (VNG) and OSCE will focus on capacity building for both existing local government associations, the Union of Cities and Municipalities in the Federation, and the Union of Municipalities and Towns in the RS.

### Problems at the local level

Lack of capacity and capability on the part of mayors, lawmakers and senior managers: Internal mismanagement of municipalities is in part due to the lack of professional administrative skills of mayors and civil servants at the local level. In response to this a number of interventions are underway:

- OSCE runs a Local Government Programme with subcomponents on Public Ethics and Dissemination of Best Practice. The latter is based on the UK's 'Beacon Council' scheme, and awards local authorities demonstrating best practices in specific areas of service delivery and performance. It is run in associa-



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tion with CoE and the Local Government International Bureau;

- Also, an OSCE programme entitled 'strengthening internal good governance within local authorities' will provide training to incoming mayors and councillors following the 2004 municipal elections.

Transparency and accountability deficiencies, lack of planning and budgeting capacities. Modern administrative structures, with transparent budget prioritization and spending, and official accountability is still the exception in BiH. There have, however, been several donor initiatives in this area:

- The Friedrich Ebert Foundation assists the implementation of ISO standards in local administrations, a project conducive to BiH's future fulfillment of EU accession criteria;
- The Konrad-Adenauer-Foundation runs a permanent project for the general improvement of local self-governance in the city of Mostar;
- The OSCE assists municipalities in implementing the ECLSG and the Freedom of Access to Information Acts (at State and Entity levels). While the former provides for efficiency gains and is a step on the road to EU accession, the latter improves citizen access to local government decisions. A related programme entitled "Improving Local Government Outreach in the Community" assists local governments to improve communication and consultation with citizens. This is intended to encourage citizen participation in decision-making at the local level, thereby improving local government accountability;
- OSCE's flagship project on the local level is the Municipal Infrastructure and Finance

Programme (MIFI), which promotes best practice in budget management and consensus and community-building. Successful municipalities can 'graduate' from MIFI by fulfilling the objectives of the programme;

- USAID runs a number of projects to improve the efficiency and democratic credentials of BiH municipalities. The main tool through which this is achieved is the installation of one-stop-shops where municipal services are concentrated for easier citizen access and improved visibility of the local government;
- SIDA (the Swedish International Development Agency) and USAID will join forces on the 'Government Accountability Project', an ambitious effort aiming to improve all aspects of local government work in 40 municipalities. SIDA has also just finished a project rationalizing municipal administrative procedures by providing custom-tailored information technology and training to a number of municipalities;
- The World Bank runs a 'Community Development Project' targeting the poorest municipalities in the country. This aims to improve local governance and responsiveness to citizens' needs by forging partnerships and their use in investment decisions.

## *Political apathy of citizens*

Mayors and councillors in BiH are not yet scrutinized by their citizenry to the extent expected in a modern, liberal democracy. Thus the electoral system fails to affect adequate check. Some donors have sought to remedy this via the active political education of citizens at the local level:

- CoE has published a 'Guide for participatory democracy in Bosnia and Herzegovina and

Serbia and Montenegro', which is distributed widely;

- The 'Beacon' scheme by the OSCE and CoE singles out well-run municipalities, thus putting pressure on the under-performers. OSCE's 'Improving Local Government Outreach in the Community' aims to widen the spectrum of opportunities for citizen participation in municipal deliberations, such as budget formulation, strengthening the role of MZs, and municipal planning priorities;
- UNDP's Rights Based Municipal Assessment (RMAP) alerts citizens to the shortcomings of their municipalities, and their rights to participation and service provision.

*Dilapidated infrastructure:*

Poorly maintained roads, water and sewage, electricity, and telecoms impair local communities' prospects for economic development and the quality of life. Many municipalities' infrastructure remains in a desperate state, while funds for repairs and development are lacking. A number of donors have started to address this issue:

- USAID is about to launch a project with Volksbank BiH that will provide municipal loans for infrastructure improvements. USAID will give risk guarantees to Volksbank's loans, thus opening the commercial credit market to

municipalities for the first time. This comes at a crucial time, when international assistance is in decline;

- The World Bank is similarly working to create of a municipal credit market, connecting municipalities to commercial banks through its Local Development Project.

## **Analysis of Donor Interventions**

The following schedules provide an analysis of the donor programmes noted above and others. These detail the nature of the interventions, their location, their duration and where available the amounts committed.

The purpose of this analysis is to bring some 'hard facts' to the discussion above and to inform the commentary which follows in the final section. It should be noted that this information has been gathered from a number of sources including direct interviews, and in some areas is somewhat patchy.

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**Table A4;  
Donor Interventions - Who, Where, When, What and How Much?**

## **Legal confusion and competency overlap**

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
Council of Europe	FBiH	16 months: 1-Jan-2004 to 30-Apr-2005	Launching the drafting of a model Cantonal law on local self-government	Not available (n/a)
Council of Europe	FBiH	6 months: 1-Jan-2004 to 30-Jun-2004	Supporting the amendments to the framework Law on LSG of the FBiH	n/a
Council of Europe	FBiH	6 months: 1-Jan-2004 to 30-Jun-2004	Supporting the drafting amendments to the Constitution of FBiH	n/a
Council of Europe	RS	6 months: 1-Jan-2004 to 30-Jun-2004	Supporting the drafting of a new Law on LSG for the RS	n/a

## **Lack of municipal representation at canton/entity/state level**

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
VNG with OSCE	RS and FBiH	3 years: 15-Jun-2004 to 14-Jun-2007	Municipal Associations Capacity Improvement	USD 1.25 million

## **Lack of skills on the part of mayors and lawmakers**

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
OSCE with CoE and Local Government International Bureau	nationwide	Open-ended	Public Ethics and Dissemination of Best Practice	n/a

### Annex 3: Donor activities in the local governance arena

OSCE	nationwide	Open-ended	Training on the roles and responsibilities of elected officials	n/a
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#### Infrastructure

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
USAID and Volksbank BiH	Nationwide	Start in 2003, ongoing	Infrastructure loans to municipalities	USD 25 million, of which 1.5 million loan guarantee from USAID
World Bank	Nationwide	13-Apr-1999 to 31-May-2005	Assisting development of commercial credit market for municipalities	USD 17.8 million

#### Transparency and accountability deficiencies, lack of planning and budgeting capacity

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
Friedrich Ebert Foundation		8 months: 1-Jan-2004 to 31-Aug-2004	ISO Standard - Modern Management in LSG	n/a
Konrad Adenauer Foundation	Mostar	Indefinite	Permanent project on improvement of LSG in the City of Mostar	n/a
OSCE	Nationwide	15 months: 1-Oct-2003 to 31-Dec-2004	Implementation of Freedom of Access to Information Act	n/a
OSCE	Nationwide	16 months: 1-Sep-2003 to 31-Dec-2004	Implementing the ECLSG	
OSCE	Nationwide	6 years: 1-Jan-1998 to 31-Dec-2004	Municipal Infrastructure Finance and Implementation-MIFI 56 participating municipalities, of which 20+ have graduated	n/a

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USAID	Northern Bosnia	3 years: 1-Oct-2002 to 1-Oct-2005	Installation of one-stop-shop service facilities in 12 municipalities	USD 6.5 million
USAID	Central Bosnia	3 years: 26-Sep-2001 to 1-Oct-2004	Installation of one-stop-shop service facilities in 14 municipalities	USD 6 million
USAID	Nationwide	3 years: 1-Jan-2004 to 31-Dec-2006	Reform of Administrative and Legal Systems	USD 3 million
USAID with SIDA	Nationwide	39 months, starting summer /fall 2004	Government Accountability Project 40 municipalities to receive aid in setting up one-stop-shops	USD 20.45 million
SIDA	Nationwide	1999 to 30-Jun-2004	Strengthen municipal financial management in 40 municipalities	USD 2 million
World Bank	Nationwide	26-Jun-2001 to 31-Mar-2005	Improve basic services and facilities for low-income and poor areas.	USD 16.9 million

## Political Apathy of Citizens

Donor	Location	Duration	Objectives and outputs	Size of Project in USD
Council of Europe			Citizens' Guide for Participatory Democracy	n/a
OSCE and Council of Europe	Nationwide	Open-ended	'Beacon' scheme	n/a
OSCE	Nationwide	Open-ended	Improving local government outreach in the community	n/a
UNDP	Nationwide	2 1/2 years, starting 21-Oct-2002	Rights-based municipal assessment programme, 16 municipalities	USD 1.2 million



## Commentary

A review of the tables summarizing donor interventions above reveals that most if not all of the problems identified in this report, are at least being addressed in one way or another by the international community. However, whether the issues are being appropriately prioritized remains open to question - and it is clear that some issues attract greater attention and finance than others. By far the largest number of projects is aimed at improving municipal management and service delivery. This is, of course, an area where local governments' failures have been particularly evident, and where technical assistance can be most effective.

Two areas where success is more elusive are citizen apathy and relations between municipalities and higher levels of government. These should arguably attract more attention. Citizens' participation in the political process, and scrutiny of the authorities, are of the utmost importance if BiH is to become a European-style liberal democracy, and if

the development process is to respect the needs of the different sections of the population.

Legal reforms, as advocated by the Council of Europe, are an important component in the improvement of relations between the local and higher levels of government. Another is attitudes and norms of political behaviour. Respect from all parties for the rule of law and the subsidiarity principle, the emergence of skilled and professional mayors, and an active and open court system to settle constitutional disputes would help greatly to strengthen the position of municipalities.

Finally, municipal infrastructure badly needs investment. Two projects by the World Bank and USAID may pave the way for making commercial credit available to credit-worthy municipalities. But this can only be a start. Given what has been said about the centrality of municipalities in citizens' perceptions of governmental performance, BiH's progress in becoming a vibrant democracy may in no small part depends greatly on functional local infrastructure.



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**ERRATA SHEET**

Table A3: Sampled Municipalities HPI and HDI data (page 152)

Sampled Municipality	HDI Value	HPI Value
Sanski Most	0.707	24.1
Ključ	0.723	23.2
Bosanski Novi	0.731	17.2
Prijedor	0.725	24.0
Travnik	0.759	22.6
Vitez	0.788	20.8
Zenica	0.754	14.6
Tešanj	0.733	32.0
Š.Brijeg	0.786	30.0
Ljubuški	0.743	25.6
Posušje	0.729	28.7
Trebinje	0.737	16.5
Gacko	0.704	20.5

Note for ranking (used at Table 2.7): Highest rank is the most favourable value, highest HD, lowest HPI.