Governance structures in BiH

Capacity, ownership, EU integration, functioning state
“Of course, I am happy here! It is gorgeous here! Especially when I do not have any other alternative”

– *The Snow Leopard*
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Introduction

BiH today is suffering from an acute case of virtual statehood. A dangerous delusion continues to affect local as well as international officials, who refuse, for various reasons, to understand or acknowledge that Annexes 4 and 7 of the Dayton Peace Agreement go hand-in-hand – the establishment and functioning of the Dayton governance structure has been and continues to be dependent on international intervention. OHR breathed life into BiH state institutions, and, somewhat paradoxically, continues to be their life support machine. Bosnia and Herzegovina has now come to an important crossroads, where its political elites, as well as the international community, must ensure that some minimal institutional safeguards are in place to give the state a fighting chance of survival.

There will be no more Dayton or Washington negotiations, no high-profile diplomatic gatherings under the umbrella and heavy pressure of major powers. BiH is not a threat to international peace, nor a high international priority.
However, the time has come for BiH to become important to its own politicians. Those of them who count on hidden agendas, who think that the international community will transform BiH out of a feeling of guilt, frustration or fatigue, have made a serious miscalculation.

The current dysfunctional system, dependent on international intervention, can be made more operational and autonomous, but only if there is agreement in BiH that a secure, minimally autonomous and credible state-level is a reasonable and desirable common goal. Local political leaders, with the support of the international community, need to agree on a minimum package of constitutional, legal and political measures required to give the BiH state basic levels of autonomy and credibility prior to the closure of OHR. Two principles should guide this process:

1. **Give state more autonomy vis a vis other levels of government**
   - No weighted quorum in state-level institutions
   - No entity-based parliamentary voting on exclusive state competencies
   - Reduce definition of Vital National Interest
   - Normalise competencies of state government

2. **Where state and entities share competencies vertically, aim to establish clear legislative hierarchy and clarify the role of each level.** Set a general rule that state has exclusive legislative power in matters of shared competencies. Entities retain the implementation role, but no longer legislate on shared matters. However, entity voting in House of Reps on shared competencies would be retained.

### Objective and Approach

The aim of the research is to present a status report on efforts to reform governance structures in Bosnia and Herzegovina (BiH), particularly the state-building reforms that have formed a core part of the international community’s post-conflict engagement in the country and whose implementation (or lack thereof) will impact on BiH’s capacity to take on full governing responsibilities after the closure of the Office of the High Representative (OHR). Despite the relatively high amount of international political capital and resources that have been spent on establishing the new state institutions, we lack a proper analysis of the impact of these efforts on the consolidation of the weak Dayton state and reform of BiH’s sprawling public administration. Partly as a result of this, we have reached a moment when neither local nor international stakeholders seem to know how to deal with this post-post-conflict (and still pre-transitional) system. This is particularly worrying as BiH today finds itself at a multiple crossroads, the navigation of which will have massive impact on the country’s future. On the one hand, the closure of OHR is delayed, but imminent. The signature of the Stabilisation and Association Agreement with the EU is close – providing that domestic agreement on police reform can be overcome – and the EUSR waits to assume a more prominent, though yet to be defined role. At the same time, political tensions within the country and a destabilising regional environment have prolonged the extension of the OHR’s mandate, and political division in the country, though mostly rhetorical, seems to be dangerously high. In this environment of institutional and political uncertainty, it is easy to divert attention from the nitty gritty of day-to-day governance with polemic debates and counter debates. The impeding departure of OHR should, however, be provoking a much more serious discussion about the capacity of the BiH state structures to assume full governing responsibilities.

OHR, above all others, is the institution that breathed life into the BiH state institutions and it continues, in one form or another, to act as their life support machine. As the OHR prepares to close down, an honest and open assessment of the governing capacity of BiH state institutions is required. This report focuses on the issues that are – or should be – critical to shaping both domestic and international policy as BiH attempts a potentially painful transition from post-conflict quasi-protectorate to a candidate country that can enter negotiations with the EU as a serious counterpart. Both domestic and international audiences must confront the reality of BiH’s governance failures head on if there is to be progress towards consolidating the state in the short to medium term. The research assesses the extent to which the BiH state has taken – or is capable of taking – ownership of the decision-making process. The continuing role of the international community in propping up the state institutions is also assessed, as well as the balance of power between the state institutions, the entities and other formal and informal institutions that dominate political life in the country. From the assessment, a candid account of the extent of domestic ‘ownership’ has emerged with important conclusions for the development of a wider public administration reform strategy.
The report is intended to open a discussion on the measures that must be taken to create a minimally functional state apparatus in BiH prior to the departure of OHR. Our aim is more modest than most. We are attempting to find a way forward that will make the state institutions that have been established so far function. Although we focus on (the more realistic aim of) making the present system function, rather than redrawing internal or external borders, without urgent reform of this kind, we believe that BiH’s chances of becoming a credible candidate for EU membership will remain an unrealistic dream. Our findings show that further transfer of partial and incomplete powers to the state, on the basis of a complex and inefficient sharing of competencies, will only reinforce the ‘virtual’ nature of the BiH state. Rather we argue that the only way out of the present impasse is to deepen implementation of competencies that are currently held, in whole or in part, by the state and to put in place institutional mechanisms to guarantee that the state has more independent room for manoeuvre. We present an agenda for deepening not widening the responsibilities of the BiH state.

Deepening rather than widening the Functions of the State Institutions

Our proposals work within the constraints of the current territorial division of BiH. They do not necessarily require redrawing entity borders, or even the transfer of whole new sectors to the state. Rather we focus on measures that must be taken to deepen current reforms to the point where the state has the actual authority and resources to implement its obligations, as any other central state in a decentralised system. For better or worse, we believe BiH will never have a huge state apparatus capable of implementing ‘big government’ projects, such as comprehensive welfare state programmes. However, at minimum, it can and must have the authority to legislate and implement its modest list of competencies and to lead the process of EU integration with credibility. Otherwise the system has little chance of working without international interference. We believe these basic reforms should be politically acceptable and sellable to electorates in both entities. The status quo satisfies no one. Politicians can no longer afford to treat politics as a zero-sum game; a functional and efficient central state apparatus, which continues to guarantee fundamental protections for each constituent people, is not a threat but rather a common good that can provide its constituent parts with better services, a fairer and more efficient distribution of public funds and the consultation, coordination and cooperation mechanisms that are a prerequisite if a complex and multi-layered state like BiH is to work.

These recommendations are directed primarily at BiH decision-makers. Many of them talk the talk of domestic ownership and bitterly complain about the continued interference of the international community in BiH affairs. At the same time, the very same politicians preside over and represent a governance system that is a joke (funny for some, distasteful for others) in domestic, regional and international circles. For better or worse, the international community is fed-up with BiH, and political and financial interest in the country is drying up. BiH politicians will take over increasing responsibility for governance and, unless blockage of the system is their aim, systemic change is urgently required. The recommendations are also directed in part to the international community. The state-building agenda in BiH has been developed, pushed through and sustained by the international community, particularly the Office of the High Representative. Our findings show that the system as presently constructed relies on international intervention for survival. If the international community is to complete a successful handover of responsibilities to the BiH authorities, reform of the present system is a prerequisite. This needs to be taken into consideration in the process of defining the remaining tasks of the OHR and the emerging mandate of the Office of the EU Special Representative. We also argue that EU conditionality has been instrumental in promoting domestic adoption of state-building legislation. Without detailed, prescriptive conditions, it is doubtful that there would have been any voluntary transfer of competencies to the state from the entities. While the present system is unsatisfactory, its reform will continue to require robust conditionality and assistance from the EU. BiH is not just another country in transition. The international community has an obligation, and compelling pragmatic reasons, to guide the state-building process they crafted to a more satisfactory and functional conclusion.

Above all, we try to avoid here the promotion of unrealistic solutions to problems. There are many ‘ills’ in BiH that are present elsewhere in transition countries which can only be addressed in the long-run and through increasing integration in European structures. Moreover, there are many European models of government and it is misleading to argue that there is one centralized model that should be transplanted in BiH. However, this study exposes basic problems in BiH, stemming both from lack of political will and bad institutional design, that can and must be addressed if the protectorate is to emerge as a viable sovereign state.
Main Findings

1. The BiH state lacks the independence enjoyed by central government in other decentralised states and thus cannot perform basic state functions. (a) Ethno-territorial veto points at state-level accompanied by (b) a complicated division of shared competencies between the state and entities which require high levels of cooperation to function, seriously constrain the ability of the state institutions to perform their functions.

2. The number of BiH state institutions exercising exclusive competencies is small. In other areas, state-building has generally entailed the transfer of only partial competencies to the central state, leaving in place a complex system of shared competencies that relies on the goodwill of several different layers of government to operate. In these areas, the state by default usually remains seriously marginalised. In particular, although the state has a role in policy-setting particularly as regards inter-entity harmonisation of standards and compliance with international obligations, the entities continue to have legislative power in all shared competencies, often ignoring or undermining the requirements of state law.
Both in individual sectors and on broader issues of cross-sector planning and strategy (for example, European integration) there is little consultation, coordination or cooperation between different levels of government. In fact, information is often deliberately withheld. This obstruction is both political and administrative and both entities display disregard for the authority of the state.

State institutions tend to function most effectively where competencies are held exclusively by the state, the need for cooperation with the entity level is minimised and if international efforts have focused not simply on adoption of legislation but also on the development of implementation plans with international support for medium-term institutional development.

On the contrary, where the state legislates (framework legislation) and the entities retain the power to legislate and implement, there is little or no entity compliance unless as a result of aggressive international intervention. Similarly, where coordination or cooperation with the entities is built into state-level institutional design, the result is at best inefficient and at worst unworkable due to decision-making deadlock.

Much of the post-war ‘state-building’ process in BiH has been based on the principle of ‘institutional layering’, in which pre-war, wartime and post-war institutions have been allowed to coexist, with serious mandate and authority overlaps. In order to function, this web of interconnected and interdependent authorities would require a high level of political will and consensus and a relatively sophisticated civil service capable of managing delicate inter-governmental relations and institutions.

In the absence of each of these criteria in BiH, the international community has been the glue holding the system – to some extent – together.

Both international officials and domestic politicians have generally failed to grasp, or choose to ignore, the fact that a functional public administration is a critical segment of the state building process. Various efforts at public administration reform in BiH have thus failed to complement the requirements of the state-building agenda.
9. Public administration reform in BiH has no political support and has failed to empower the state institutions. Efforts to reform the public administration have failed to address the acute problems of the administration, which include inadequate human resources, overlapping competencies, lack of coordination between and across levels of government, the marked absence of a consensual, cooperative administrative culture and common-place political interference in the hiring and management of civil servants which exacerbates 'ethnic' cleavages within the public administration.

10. As such, the unreformed status quo in public administration is seriously jeopardizing the functionality and credibility of the state institutions.

11. The current fiscal set-up in BiH both mirrors and exacerbates the problems of a complex and inefficient governance structure. Without appropriate reform of the fiscal system, the state building process can only ever be partially successful.

12. The fiscal system is characterised by the following deficiencies:

- The state has no redistributive competencies and cannot promote more even development within the country as a whole.
- Formal fiscal coordination mechanisms are incomplete and there is little or no formal coordination in practice between different levels of government.
- There are fiscal disparities and overlaps in fiscal responsibilities.
- The inefficient direct tax system is not harmonised across the country and results in numerous tax law loopholes and weak revenue collection at all levels.
- The Ministries of Finance lack capacity.
- The public sector applies different accounting methods, making analysis of the public sector and its effect on the economy more difficult.

13. In the absence of domestic political will and institutional coordination mechanisms, the international community has been holding an unsustainable system of public finances together. As the role of the international community diminishes, macroeconomic stability in BiH will be put at risk if – at minimum – domestic capacity for coordination and implementation of fiscal policy is not significantly strengthened.
14. The middle level of government in BiH (the entities, cantons and Brcko District) benefit from the highest revenues, as their functions carry the highest levels of expenditures (education, police and judiciary). These functions are becoming ever more expensive given that their management and implementation is carried out separately, with little coordination and with no regard for pooling certain resources in the interests of efficiency.

15. The fulfilment of BiH’s EU ambitions is dependent on the functioning of cooperative governance mechanisms, if the EU’s highly technical requirements are to be implemented across the country. Based on experience so far, without considerable structural changes, this goal will be unattainable.
Conclusions / Recommendations

Virtual State-Building?

Twelve years after the Washington Agreement and eleven years after the Dayton Peace Agreement were signed, the BiH state and its population are still hostage to a cumbersome governance structure, in which numerous levels of government, wielding both legislative and executive powers and served by thousands of civil servants, operate largely in isolation from each other. The system is cumbersome, inefficient, expensive, and constrained by constitutional provisions designed to prevent common government at state-level rather than to enable it. Recent attempts to modify the BiH constitutional framework were aimed at addressing some of these deficiencies. Unfortunately, these attempts not only failed, but also exposed some of the inherent weaknesses in the existing system, including the fact that many people in BiH do not identify with the state and have not yet come to terms with Dayton’s version of statehood – for reasons more unitarian or separatist in nature.
This study attempts to take a step back and examine the way in which state-building from Dayton has proceeded and the institutional legacy it has left behind. We find an institutional paradox at the heart of the system: on one hand, the number of state institutions has grown to a degree unimaginable in 1995, but, on the other hand, the way the system has been built has made it a political bargaining and hostage to a continuing lack of political will. This cooperative system is dysfunctional and unmanageable. Its intentions and effects are a paradox. The system rewards those who continue to obstruct and refuse to cooperate. The international sponsors of the state hold the system together, presiding in many respects over a ‘virtual’ state-building process. One of the central questions that arise from this study is whether there is a “minimum of stateness” that can be achieved that could at minimum ensure the irreversibility of the state-building process to date.

Ownership Vacuum

BiH cannot be included in the category of ownership societies. In BiH, the political elite does not control the present, nor has it proved willing or capable of enabling BiH to become an ownership society in the near future. Instead, for the past ten years, ownership has been wielded by the international community. Domestic institutions do not have the capacity to follow the pace of internationally imposed reforms. In the absence of functioning domestic institutions, OHR became both a substitute and sponsor for the failing state bureaucracy. By insisting on the adoption of a large number of reforms but failing in many areas to see them institutionalised, OHR created an institutional illusion and devalued the meaning of ‘ownership’. This imaginary or virtual success in state-building has been used to justify requests for a decrease of the High Representative’s powers and a transfer of full responsibilities to the domestic institutions. This ignores the critical lack of institutional capacity and sustainability in the present BiH state, and the fact that any sudden transfer of reform processes to local institutions could cause a bureaucratic implosion.

Capacity to Absorb Ownership

As the International Crisis Group stated in August 2002, “BiH still is not a competent state, let alone one that inspires or enjoys the loyalty of all its citizens...”. Nationalism continues to be a dominant force, which is a “major factor impeding the introduction and consolidation of democracy”. This creates a vicious circle in which the functioning of the already unstable state is further obstructed by insistence on the ethnic principle. Public perceptions gathered through this research demonstrate that “institutionalisation of ethnic power-sharing on state level” prevails over any sense of overarching feeling of belonging to a single state or even a common state identity, so that almost every aspect of state governance is seen through “the ethnic lens”.

Abuse of constitutional mechanisms designed to ensure fair ethnic representation in the state institutions translates into an ethno-cratic imperative, where national and often nationalistic affiliations dominate the public administration. This has created a new caste of Bosniacs, Croats and Serbs who are suitable for key positions in the civil service, and excludes those who choose not to stick close to the ethno-cratic centres of political power. The abuse of constitutional principles of ethnic representation and the elevation of staffing policy to the pedestal of

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2 We can say that an ownership society is a society whose elite is capable of making strategic decisions in response to societal problems, which is responsible for those decisions, as well as independent from external impositions in the planning stage, and whose activities create or maintain a free and prosperous society of individuals.
7 Ibid.
Conclusions / Recommendations

doctrine have contributed to a functional implosion in the state civil service, which Brussels terms the ‘immaturity of domestic institutions’.

A central argument of this paper is that Public Administration Reform (PAR) cannot be considered in isolation as a benign technocratic process. Rather, it is a highly political project that will require the commitment of both international actors and BiH politicians if it is to be successful. This is true of governance reform processes in any country, but even more so in BiH where administrative downsizing and streamlining is intertwined with questions of ethnic group and territorial autonomy. Partly because of this, the development of a formal PAR strategy has been ostensibly ignored or sidelined not just by BiH politicians but also by the important players in the IC.

Lack of Coordination

This study will attempt to show that BiH continues to be a dysfunctional and unmanageable system in large part because there has been a critical lack of coordination and common vision of the state-building process, both domestically and internationally. We will focus on the three main elements required to build adequate governance structures in BiH, political, financial and administrative. Rather than forming the basis of an integrated state-building strategy, these elements have been ‘reformed’ in different directions, with little regard for each other. Efforts to increase the competencies of the state have largely not been accompanied by attempts to build a complementary fiscal and financial framework. On the contrary, the bulk of competencies and public funds remain concentrated at mid-levels of government. Likewise, efforts to reform the public administration have not been designed to complement the state-building process, but rather with the fuzzy aim of making the existing unmanageable and dysfunctional system more ‘professional and accountable’.

The fourth factor, which could serve as a framework for building a more coherent institutional system, is the EU Stabilisation and Association process, which has built-in many ‘state-building’ features. However, as this study will attempt to show, lack of coordination and consistency between different reform processes also affects this process.

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1. Defining the Principle for Change

The governance system in BiH today allocates both exclusive and shared competencies to the state and entities. The combination of systems is not in and of itself a problem, although overlaps in responsibility and inefficiencies are built into the system. What is highly problematic and, in present form, unsustainable, is the way in which:

1. the continued functioning of the state institutions and the exercise of exclusive state competencies can be seriously undermined by entity/constituent people-based quorum and voting rules, and
2. competencies shared between the state and entities are configured such that there are inadequate mechanisms to ensure entity compliance with state or joint policy.

If the system is to be capable of functioning after the closure of OHR, there needs to be urgent change of the first condition. Moreover, if BiH is to progress further towards EU integration – i.e. if the state is, at minimum, to be capable of setting standards and ensuring the compliance of lower levels of government with the requirements of the *acquis* – the state requires supremacy and enforcement powers. Experience demonstrates that these matters cannot be left to informal cooperation and coordination in BiH.

The focus of all international and domestic efforts should be on deepening rather than widening state-building reforms. This solution offers a political trade-off that should appeal to pragmatic BiH politicians: a stronger, more efficient state with a limited number of competencies can exist alongside and, indeed, improve the functioning of the entities.

However, if the modest and balanced arguments set out in this report do not convince reluctant BiH politicians of the pressing need for change, international supporters of BiH, keen to declare mission accomplished, must insist – through conditionality and the strategic use of financial incentives and sanctions – full sovereignty will be returned to BiH subject to a trade-off: secure entities can only be tolerated alongside a secure state. The state of BiH today is far from secure.

2. Specific Measures

I. Constitutional / Governance Structures

1. Decision-making

- Streamline parliamentary process in spirit of April 2006 proposed changes:
  - reform or abolish weighted quorum requirements
  - scale down House of Peoples to consider only issues of VNI
  - abolish or reduce instances where there is entity voting in the House of Representatives, for example, apply entity voting only on matters of shared competencies (see below).
- Transfer legislative responsibilities to the state on matters of shared competencies, with entities retaining the bulk of implementation responsibilities. In these legislative matters, entity voting mechanisms would be retained in the House of Representatives.
- Normalise the functioning of Council of Ministers, abolish quorum requirements and equip government with classic executive powers and coordination functions of centre of government in federal states.

2. Competencies

Review present division of competencies, with the following aims:

- Clarify the responsibilities of the state and entities.
- Aim, where possible, to untangle competencies, reducing interdependence between levels of government, and reducing the need for vertical cooperation.
Where competencies cannot be separated out and cooperation is a requirement (e.g., in areas that will be impacted by the requirements of European integration) put in place enforcement mechanisms (see below) and arenas in which coordination is compulsory, not occasional and voluntary.

In all areas, clearly define the hierarchy of legislative, executive, and implementation competences between the state and entities.

3. Enforcement

- Review enforcement mechanisms and consider the legal, administrative, and financial tools that the state requires to ensure implementation of state legislation and policy where legislative or implementation competences are shared with other levels of government. These options include:
  - State directly legislates on matters of shared competencies (possibly with entity voting in HoR retained, see above); entities retain responsibility for implementation
  - Constitutional supremacy clause specifying that state law prevails over inconsistent entity legislation
  - Judicial and administrative mechanisms to enforce state decisions, including BiH Constitutional Court
  - Fiscal federal mechanisms that empower the state to make conditional transfers to other levels of government to promote implementation of state-level decisions

II Public Administration

The PAR strategy should be reworked to identify areas for immediate attention.

1. Improve capacity to manage the administration

- Consolidate existing services at the centres of governments into unified structures providing key services to the state and entity prime ministers and other line ministries. Give priority to appropriate long term and annual planning, policy appraisal including Regulatory Impact Assessment, monitoring and evaluation;
- Develop and regulate methods of coordination and cooperation between the state and entity governments, with particular focus on sectors that require high levels of state-entity coordination and cooperation during the process of EU integration;
- Develop and regulate mechanisms for regular horizontal consultation within the Council of Ministers and other government agencies at all levels.
- Establish a ‘home’ or unit within each line ministry that has a clear responsibility (legal and institutional recognition) for policy, strategic planning and evaluation, which will become a key counterpart of the centres of government in terms of horizontal coordination and with lower level ministries in terms of vertical coordination. The units should be placed relatively high in the internal structure of the ministry, perhaps in the cabinet of the Secretary of the ministry;
- Develop capacity to ensure that planning and budget units collaborate and that planning and budget processes are aligned in terms of timing and inputs. This process should be continuous throughout the year;
- Develop capacity to translate overall government priorities into ministries’ priorities and cascade agreed objectives throughout government.

2. Professionalize the civil service

- Develop a detailed set of guidelines and recommendations that will guide the recruitment of civil servants to newly-established Policy and Planning Units within the Ministries with aim of attracting highly qualified people capable of accelerating change; examine ways of making the positions attractive and competitive;
- In cooperation with audit offices, develop a unified system of performance audit across the civil service;
- Develop training programmes for senior civil service managers in order to promote basic managerial skills such as planning and coordination, leadership, capacity to lead change, and human resource management;
- Following the completion of in-service training, open all positions of Secretaries of Ministries and Assistant Ministers posts for reappointment;
• Review budgetary space in order to decompress salaries and raise rates so that remuneration packages can attract and retain quality staff in the public service.
• Strengthen human resource management capacity in each institution in order to provide timely and efficient human resource management planning;
• Review provisions that would encourage mobility of civil servants between the state and entity levels
• Continue technical assistance support to the Civil Service agencies;

3. Pass and implement single law on administrative procedure to ensure uniform standards of service through the country

• Develop harmonized administrative procedures by adopting a single law on administrative procedure in BiH with a view to developing transparent and accountable administrative practice.

4. Longer Term Measures to make the overall Environment more Supportive of PAR

• Ensure that PAR is closely linked to the BiH’s European Integration agenda and that these processes are mutually reinforcing.
• Improve parliamentary oversight of PAR
• Improve beneficiary demand for efficient and accountable public administration.
• To donors: Ensure that donors and other international actors do not undermine long-term public administration reform.
  - Work through government processes and procedures, particularly the budget process.
  - Consider whether overall development approach and activities across sectors are undermining PAR efforts.
  - In the provision of technical assistance, give priority to recruitment of international consultants working in complex constitutional environments similar to BiH.
  - A programmatic approach to PAR should be considered, with a shift away from individual donor projects toward a multi-donor trust fund.
  - Maintain long timeframes, and make long-term funding commitments.

III – Public Finances

1. Establish a fiscal policy unit within the BiH Ministry of Finance and Treasury

Given that the ITA Governing Board has proved an inefficient mechanism for reaching policy consensus, it is proposed that responsibility for proposing indirect taxation and revenue allocation are transferred to the BiH Ministry of Finance and Treasury.

As its activities and tasks are a more natural fit within the structure of a Ministry of Finance, and since these functions already exist at the State level, we propose to transfer the Macroeconomic Analysis Unit to the Ministry, to form the nucleus of a Fiscal policy/Macroeconomic analysis department, with full transfer of all activities and staff.

2. Establish strong vertical coordination through the Fiscal council

We propose that the activities of the Fiscal Council are focussed on a limited number of critical areas, in particular functions that will constitute international obligations following the signing of the Stabilization and Association Agreement. Other functions should, as far as possible, be transferred to the BiH Ministry of Finance and Treasury.

3. Address the issue of direct taxation

There are two alternative methods of addressing this serious problem. The first, more radical proposal, entails moving direct tax policy decision making to the state level and providing a single legislative solution for direct taxes at the state level. Considering the success achieved with a single administration for the collection of indirect
taxes, it is plausible to assume that a single administration might also generate better results in the collection of direct taxes.

The second best option is to develop a strong mechanism for harmonizing direct tax policy.

4. Putting the middle on a diet

14 separate administrations are responsible for the most expensive functions in BiH (police, education and judiciary). Therefore, rationalizing the costs of the middle level of government will not be effective unless some common competencies in these areas are transferred to upper levels of government.

**IV – Reforming Governance Structures to meet Basic Requirements of EU Integration**

- Adopt the draft constitutional amendment proposed in April 2006 which would give the BiH state legislative authority to meet the requirements of EU integration. Adoption of this amendment should be considered a precondition for continuation of the SaP and accession process.
- Develop BiH matching funds for implementation of the National Development Plan (NDP) that will complement the National Fund for IPA (pre-accession instrument) resources. Create a line in the BiH budget for matching funds.
- Authorize (if necessary through constitutional amendment) the National Fund and BiH matching fund to administer financial support for the implementation of projects co/financed by IPA which might target areas in which responsibilities are shared between the state and lower levels of government (transport, agriculture, education, science).
- Empower the Ministry of Finance and Treasury to assume necessary authority and capacity to assist in this process.
- Build political will and institutional mechanisms necessary for EU integration, defining the maximum executive power of the entities and minimum executive power of BiH State, having in mind the subsidiarity principle for effective implementation of the *acquis communautaire.*
“The [constitutional] negotiations were very difficult, very delicate and in the end, we arrived at a consensus, not a painful or rotten compromise, but a credible compromise which at the end of the day does not destroy the character of the entities in BiH. The functionality of the institutions of the state of BiH has been improved and we have enumerated the basis for normal interaction between the state and the entities. The Serb people, like all other constituent peoples, have equal rights to govern BiH. If we make efforts to improve the functionality of the state of BiH, it does not mean that we destroy RS. I do not think that by weakening the institutions of BiH we are doing something positive for the RS, quite the opposite, this would be counterproductive and would bring into question, especially in international circles, whether the constitutional structure of BiH is hindering regional stability”.

(Dragan Cavic, former RS President and leader of SDS, describes the 2006 negotiations on constitutional change, interview with Nezavisne Novine, 7 April 2006).
Introduction

“It is obvious that the responsibilities of the State of Bosnia and Herzegovina cannot be compared with the powers enjoyed by European federal states such as Switzerland, Belgium, Austria, Germany or Russia. In these countries legislative powers are mainly concentrated at the federal level, there is a strong federal executive, financial resources are mainly controlled by the federal level and federal courts ensure respect for federal law. None of the applies in BiH”. (European Commission for Democracy Through Law (Venice Commission) Opinion on the Constitutional Situation in Bosnia and Herzegovina and the Powers of the High Representative, Venice, 11 March 2005).

The BiH central state works in nobody’s interests. Despite significant international investment in post-war ‘state-building’, the balance of power has tipped only marginally towards the BiH state, which continues to lack basic levels of autonomy, authority and credibility. Politicians from both entities ignore and undermine the present state. Federation politicians tend to view it as a temporary system, hardly worthy of their attention, that will be ditched sooner or later in favour of a ‘normal’ unitary European state, with sub-units organised on ‘functional’ lines. Their counterparts in the RS view the current state as a minor obstacle to their autonomist ambitions which is easily undermined and marginalised. For their part, the international community has sought to take a middle path, leaving the territorial integrity of the entities intact, while gradually taking competencies from them and reassigning them – in part – to the state. In practice, this process of gradual, step-by-step state-building has had the advantage of allowing the state to acquire some ‘normal’ functions of statehood without requiring the politically impossible, i.e. explicit constitutional change. However, the trade-off for this has been that the already weak Dayton structures are now the shaky foundations on top of which a range of state institutions perilously sit. The weakest of these state institutions are those that share competencies with the entities. Most are the result of political compromise and are built around a complex system of overlapping and unclear divisions of responsibility and authority that allows state, entity and other institutions to coexist and overlap without any clear hierarchy. The system of state governance barely functions with strong international pressure and is in danger of paralysis without it. This state cannot fulfill BiH’s present international obligations let alone future commitments to the EU and NATO.

This chapter examines the short-comings of the present governance system and identifies where and how the system is dependent on international intervention and which areas must be reformed prior to the departure of OHR. We assume that political will is in short supply in BiH and focus on the institutional reforms that must be in place to promote the participation of politicians from both entities and all constituent peoples in common government at the state-level.

State-building: A Brief History

The governance system put in place at Dayton was part of a peace package that the obvious and undeniable advantage of ending the armed conflict. Few, however, believed the state it envisaged would be capable of functioning. Dayton established a system of government at state level that was not designed to produce strong or effective government but to prevent the majority from taking decisions that adversely affect other groups. “In the BiH Constitution, there are many provisions ensuring the protection of the interests of the constituent peoples... The combined effect of these provisions makes effective government extremely difficult, if not impossible. Hitherto the system has more or less functioned due to the paramount role of the High Representative. This role is however, not sustainable.” It is also well-known that much of the present dysfunctionality in state governance is a direct or indirect result of lack of political will. Without adequate political will in both entities, the complex system of vertical and horizontal power-sharing in BiH is bound to fail. Political agreement and cooperation has been notoriously difficult to broker in post-war BiH, and state-building has been shaped by political compromise. This partly explains the emergence of a complicated governance system in which competencies are formally transferred to the state but real power remains elsewhere. The entities have been allowed to retain competencies and financial control, while the state has expanded, on paper at least.

International efforts were directed towards classical post-conflict measures in the early days of Dayton implementation, including stabilising the military situation and reconstructing damaged infrastructure. Political energy was

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expended on getting politicians from both entities to simply attend sessions of the state institutions, but obstruction of the state institutions met with few real international threats, neither political nor financial. Efforts to reintegrate the divided population in BiH, through economic reform and, for example, to reform the nationalist-dominated media, met with continued obstruction and lead the Peace Implementation Council to confer the so-called Bonn Powers of imposition and removal on the High Representative. These powers were used initially to legislate for and introduce basic tenets of statehood (common currency, vehicle license plate, passport), the adoption of which had been stalled by political deadlock. State-building in the form of state institution-building began in earnest with the PIC declaration in May 2000 which called for the state institutions to be strengthened, including the introduction of own revenue-raising capacity and a state Treasury; restructuring public utilities and state-level regulation of the system; establishment of a professional merit-based civil service at state-level; establishment of a state court to review executive decisions; and measures to open up single economic space. Many of these measures were contained in the EU Roadmap as conditions for further EU integration. In practice, the Roadmap proved to be a weak carrot and the High Representative intervened on many occasions in the face of political obstruction to impose legislation setting up the numerous state agencies and institutions envisaged in the 2000 PIC declaration.

Ashdown and the European assent

Paddy Ashdown’s mandate as High Representative brought in a new era of state-building in BiH in two key respects. First, responsibilities that are held by central government in other states, but which the BiH entities had retained firm control of at Dayton (defence, revenue-raising, intelligence services), were to be transferred to or assumed by the BiH state. Previous state-building reforms had been based on existing (but unrealised) BiH constitutional competencies. Ashdown’s state-building agenda required the explicit transfer of competencies from the entities to the state in several areas (i.e. de facto if not de jure constitutional change). The second major change in state-building methodology during Ashdown’s mandate was the shift in responsibility for adopting state-building legislation from the High Representative to the BiH authorities. This change from High Representative imposition to domestic adoption of state-building reforms came about for two reasons. First, many of the changes required were viewed by OHR as going beyond Dayton, as competencies had to be transferred to the state from the entities, and were therefore considered beyond the powers of the High Representative to impose. Second, Ashdown stated that he would not impose conditions that were part of the EU stabilisation and association process. While Ashdown and his predecessor had imposed many of the measures in the EU Roadmap, the EU backed Ashdown’s approach and stated that to be in compliance with the SAA conditions, the BiH authorities had to legislate and implement the requirements themselves. NATO echoed this approach on the adoption and implementation of conditions for Partnership for Peace (PfP) membership. A combination of the ‘pull’ of Brussels and a significant ‘push’ from OHR, which negotiated and developed the reforms and continued – explicitly and implicitly – to threaten sanctions (against individuals, political parties and entity structures), proved effective in securing formal domestic compliance with the state-building reforms required for opening the SAA and PfP membership.

By any measure, domestic adoption of many of these state-building reforms was a significant achievement. The entities have formally relinquished competencies to the state in sensitive areas that many thought impossible just months before adoption. However, the price for formal compliance has been high. The following sections will describe the weaknesses of the state-level governance system that has been emerged since Dayton, in terms of both systemic failures and implementation problems, including some of the ways in which the international community has undermined the very state-building reforms they have sponsored.

The Dependent BiH State

Much has been said and written about the dysfunctional aspects of the Dayton constitution. BiH is routinely compared to other European states and found to be unlike any other. Here we do not compare BiH with other unitary states where there are few or insignificant national or ethnic divisions. Rather we make a fairer comparison with other states that are divided on federal or ‘consociational’ lines, often reflecting national or ethnic divisions. Even this comparison demonstrates that the governance system in BiH is unlike any other comparable European state. Despite the assumption of many competencies over the last twelve years, the BiH central state bears little resemblance even to the centre in federal or decentralised states. It remains handicapped by (a) a weak executive, (b) a parliamentary decision-making process in which there are multiple veto points including de facto entity vetoes on state matters, (c) limited competencies that are often shared with other levels of government with no clear hier-
archy of functions or enforcement capacity at state-level, (d) an inadequate public administration in terms of both quality and quantity, and (e) continued reliance on international intervention in day-to-day governance.

The flaws of the decision-making procedures at state-level are well-known. It is no exaggeration to say that the state constitution agreed at Dayton put in place procedures that were designed to prevent state government rather than to enable it. The state is governed by a weak executive and a legislative process in which representatives elected by, or loyal to the entities (which more or less equates to constituent peoples) effectively wield veto powers. In the absence of political consensus on basic issues of governance, successive High Representatives have intervened to unblock the system. The constitutional changes proposed in April 2006 would have gone some way towards streamlining the decision-making process. We argue, however, that unless the weighted quorum and voting requirements in the Council of Ministers and the state parliament are reformed, the BiH decision-making process can be brought to a halt, based on the unilateral decision of one entity/constituent people. We also argue that state-building efforts since Dayton have shared competencies between the state and other levels of government in an unsustainable and unworkable manner. In the face of significant obstruction, state-building has generally entailed the transfer of only partial sectors and competencies to the central state, leaving in place a complex system of shared authorities that relies on the goodwill of several different layers of government to operate. There is no clear hierarchy of decision-making powers, resulting in an inefficient and opaque system in which most state institutions exercise only a virtual role. A virtual state yields virtual politics. Without meaningful competencies and enforcement powers, politicians from both entities ostensibly ignore the state and continue to use lower levels of government and other informal institutions as their power bases and arenas for real political negotiation and action. There are few mechanisms or incentives to lock political ‘elites’ into the system. In the face of continued political obstruction and indifference, the state’s weak, fragmented public administration stands little chance. It is ill-equipped for basic governance tasks, divided and control-led on ethno-political lines and barely manages to guarantee the formal integrity of the state institutions.

The conduct of politics and governance in BiH will never resemble practice in more centralised, established democracies. In a complex, post-conflict environment where there are low levels of trust, powerful sub-state entities and in-built guarantees for all groups at the central level, politics will always be about group balancing and achieving solutions that are based more on inter-group bargaining and compromise than economies of scale and efficiency criteria. However, the basic problem in today’s BiH state is not about less than optimal public policy outcomes at state-level. At the most basic level, there is currently little incentive for political leaders to participate and conduct politics in the state institutions in any meaningful sense. The institutions of the state of BiH quite simply do not have the authority and autonomy required to force politicians to take them seriously. Ultimately, institutions that can be undermined to the point of complete paralysis by representatives of (or loyal to) lower levels of government are not serious fora in which to conduct politics. This situation is enabled by institutional design (the systemic problem) which the state government and parliament can be paralysed by entity-based or constituent peoples’ boycotts and decision-making blocked by voting on state-level matters.

1. Systematic Problems

A. Federalism: A Disclaimer

There is controversy over applying the term ‘federal’ to BiH, largely because of assumptions made in BiH about the status of federal units within a federal state. At one end of the political spectrum, federalism is criticized as inapplicable to BiH as it is thought to imply that the federal units are self-determining and ultimately have a right of secession. This interpretation comes from the constitution of Yugoslavia which explicitly granted the right of secession to federal units. In fact, there is no right to unilateral secession in most federal constitutions, nor is there such a right in international law. Champions of the entities are suspicious of the term federalism for precisely the opposite reason: that its application to BiH undermines the autonomy of the entities by supposing that they are subordinate to a hierarchical federal centre. These political and terminological arguments aside, we argue that, in practice, BiH today displays several features of a federal state. The federal lens is therefore an appropriate tool through which (i) to examine the ways in which competencies have been divided between the BiH state and the entities since Dayton,
and (ii) to explore institutional mechanisms that would make the division of power in BiH more functional. The Dayton agreement put in place a highly weak federal (verging on confederal) structure. State-building efforts since have sought to build on these by strengthening the central state. In fact, this process has (a) failed to give the central state the competencies and enforcement tools typical of federal centres and (b) shared competencies between the state and entities without effective mechanisms to enforce agreed policy and to promote cooperation. Learning from other federal systems can only contribute positively to the reform of governance structures in BiH.

**B. BIH: A Hybrid of Different ‘Federal’ Systems**

Two ‘ideal types’ of federalism exist: coordinate or dual systems, where the federal level and the federal units hold and exercise separate responsibilities, largely independently of each other, and cooperative systems, where responsibilities are shared between the federal centre and federal units. Germany is usually cited as the closest example of cooperative federalism. Most competencies in the German system are shared. The central state makes the laws and the states – ‘länder’ – are responsible for implementing them. The länder are compensated for their lack of legislative power through strong participation in the federal decision-making process, most notably in the upper house of the federal Parliament. Shared competencies are accompanied by a shared taxation system in which the federal government and federal units share the most important tax revenues and resources are redistributed between the länder in order to benefit poorer states. By contrast, the US comes closest to a dual or coordinate federal system. In the US system, each government level has, in principle, an autonomous sphere of competencies. In each policy sector, one level of government holds both legislative and executive powers. Given the separation of responsibilities, the federal units are represented much more weakly at the federal centre. The taxation system reflects the divided nature of federal and state responsibilities. The federal level has its own sources of revenue and the federal units have fiscal autonomy and function largely without the financial intervention from the central level.

BiH seems to have acquired the worst and little of the best of both federal types. The system of competencies that has emerged as a result of the Dayton agreement and the subsequent state-building process, has put in place a hybrid mix of both exclusive and shared competencies. However, in each case, the conditions required to implement the different ‘federal’ models are missing in BiH (see Figure 1). In the face of a marked lack of cooperative political or administrative ‘culture’ in post-war BiH, there are few institutional mechanisms or even incentives to make the current division of responsibilities function.

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**Figure 1**

<table>
<thead>
<tr>
<th>Dual/coordinate responsibilities</th>
<th>Cooperative/shared responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Typical features of dual system</strong></td>
<td><strong>BiH system of dual responsibilities</strong></td>
</tr>
<tr>
<td>Federal level and federal units legislate and implement own competencies</td>
<td>Yes</td>
</tr>
<tr>
<td>Federal unit representation in federal-level decision-making weak</td>
<td>No, strong entity role in state-level decisions</td>
</tr>
<tr>
<td>Taxes raised separately and spent by each level</td>
<td>No, state raises indirect taxation which is divided with entities</td>
</tr>
<tr>
<td>Little fiscal redistribution between centre and federal units</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Typical features of cooperative system</strong></td>
<td><strong>BiH system of shared responsibilities</strong></td>
</tr>
<tr>
<td>Federal level legislates, federal units implement</td>
<td>No, entities continue to legislate and implement; no state-level enforcement mechanisms</td>
</tr>
<tr>
<td>Federal unit representation in Federal level decision-making strong</td>
<td>Yes</td>
</tr>
<tr>
<td>Shared taxation system</td>
<td>Partly, on indirect taxation only</td>
</tr>
<tr>
<td>Fiscal federalism</td>
<td>No</td>
</tr>
</tbody>
</table>
Exclusive responsibilities

Although the original Dayton constitution assigned only a small number of classical state competencies to the BiH government, the system envisaged a more or less clear separation of competencies between the state and entities (conforming, in terms of distribution of competencies, to a dual or coordinate model). However, the conditions that enable dual federal systems to function were absent in the Dayton settlement. Rather than ensuring a high degree of independence for the state in decision-making, representatives appointed by the entities are strongly represented in BiH-level decision-making, effectively wielding a veto over decisions within the state’s modest list of responsibilities. Entity representation and weighted voting is present in different forms in both houses of the state Parliament, which is highly unusual even in a highly cooperative federal system. Second, Dayton gave the state no revenue-raising powers, making it reliant on entity transfers to finance its institutions. Again, this bottom-up financing system resembles a weak confederal arrangement rather than a functional federation. Dayton therefore gave the state the worst of all federal models: the small number of exclusive competencies given to the state are exercised only with the consent of representatives elected by, or loyal to, the entities and has no independence in fiscal matters. Unlike cooperative systems, there is no trade-off for strong representation of the federal units in central decision-making in the form of state-level involvement in entity responsibilities: on the contrary, the entities are granted complete autonomy in most sectors of governance, subject to general guiding principles in the BiH constitution.

Shared responsibilities

Since Dayton, the separation of competencies between the BiH state and entities has become less clear. Part of the state-building process has involved assigning partial responsibilities to the state in matters that were previously generally in the exclusive domain of the entities, requiring cooperation in many areas. This state-level involvement in residual entity competencies broadly takes four forms: (i) state framework legislation, with or without state bodies to monitor and enforce compliance (ii) state-level regulation of public utilities and sectors (iii) state-level coordination of the legal and technical requirements of international obligations, particularly EU integration (iv) hybrid ‘cooperative’ executive bodies which bring the state and entity executives together in certain sectors for the purposes of policy-making.

Figure 2: Examples of shared competencies in BiH

<table>
<thead>
<tr>
<th>State-level regulatory bodies</th>
<th>Framework legislation</th>
<th>Hybrid state-entity executive bodies</th>
<th>State-level vertical coordination bodies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Telecommunication Regulatory Agency (Law on Telecommunications OG 24/98)</td>
<td>Framework Law on Registration of Business Entities in BiH (OG 42/04)</td>
<td>Governing Board of the Indirect Taxation Authority (OG 18/03)</td>
<td>Directorate for European Integration (Law on CoM BiH OG 38/02)</td>
</tr>
<tr>
<td>Communications Regulatory Agency (CRA) (Law on Communications OG 82/03)</td>
<td>Framework Law on Primary and Secondary Education in BiH OG 18/03</td>
<td>Commission for Refugees and Displaced persons (Law on refugees from BiH and Displaced persons in BiH - OG 23/99)</td>
<td>Co-ordination Committee of the Supreme Audit Institution (Law on Auditing of Financial Operation of BiH Institutions OG 17/99)</td>
</tr>
</tbody>
</table>

10 Some of these regulatory functions were specifically allocated to the state in the BiH constitution, such as Establishment and operation of common and international communications facilities; Regulation of inter-Entity transportation; and Air traffic control, and some derive from international obligations.

11 Competencies for defining the basic conditions for the provision of international telecommunication services; regulation of Common Facilities; coordination of the use of the radio spectrum; representation of Bosnia and Herzegovina in international fora concerned with telecommunications, harmonisation of Public Telecommunication Services.

12 Competencies for regulation of telecommunications and electronic media in BiH.

13 Competencies for establishing audit standards and representation in international bodies.
<table>
<thead>
<tr>
<th>State-level regulatory bodies</th>
<th>Framework legislation</th>
<th>Hybrid state-entity executive bodies</th>
<th>State-level vertical coordination bodies</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Electricity Regulatory Commission (DERK) (Law on Transfer, Regulator, and Operator of Electric Energy in BiH OG 13/03)</td>
<td>Framework Law on Privatization of Enterprises and Banks in BiH (OG 14/98)</td>
<td></td>
<td>The Standards and Assessment Agency established (Framework law on Primary and Secondary Education in BiH OГ 18/03) 14</td>
</tr>
<tr>
<td>Commission on Concessions of Bosnia and Herzegovina (BiH Law on Concessions OG 32/02) 15</td>
<td>Framework Law on Cooperatives (OG 18/03)</td>
<td></td>
<td>The Curriculum Agency (Framework law on Primary and Secondary Education in BiH OГ 18/03) 16</td>
</tr>
<tr>
<td>Special Joint Commission on Concessions (BiH Law on Concessions OG 32/02) 17</td>
<td>Framework Law on Pledges (OG 28/04)</td>
<td>BiH Accounting and Auditing commission 18</td>
<td></td>
</tr>
<tr>
<td>The Railway Regulatory Board (BiH Law on Railways OG 52/05) 19</td>
<td>Law on Classification (OG 76/06)</td>
<td></td>
<td>Demining Commission and Mine Action Centre 20</td>
</tr>
<tr>
<td>Agency for Post traffic (BiH Law on Posts OG 33/05) 21</td>
<td>Law on Road Traffic Safety (OG 6/06) (Corrigendum OG 75/06) Gender Equality Law (OG 16/03)</td>
<td></td>
<td>Agency for Labor and Employment of Bosnia and Herzegovina (OG 21/03) 22</td>
</tr>
<tr>
<td>Central Bank of BiH</td>
<td>Law on Conflict of Interest in the Governmental Institutions of BiH (OG 16/02)*</td>
<td>Central bank of BiH (Law on Central Bank (OG 1/97) 23</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Law on Protection of Rights of National Minorities (OG 12/03)</td>
<td>Fiscal Council</td>
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<td></td>
<td>Law on Freedom of Religion and the Legal Position of Religious Communities and Churches in BiH (OG 5/04)</td>
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<td></td>
<td>Law on Consumer Protection (OG 17/02)</td>
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<td></td>
<td>Law on Statistics (OG 26/04)</td>
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</tbody>
</table>

14 Competencies for establishing and implementing standards of students’ achievement and of assessment of the degree of their accomplishment; conducting assessment research, advising the competent educational authorities dealing with the prescribed standards and their implementation; establishment and maintenance of mechanisms of reporting on the situation in schools in the territory of BiH; coordination with international bodies that have similar functions; assisting in recognition of domestic certificates and diplomas in other countries.

15 Independent regulatory body with exclusive competencies related to the awarding of concessions in BiH

16 Responsible for implementing, follow-up evaluation, improvement and development of the common core curriculum for all levels of education implementation

17 Shared competencies with Entities in relation to concession awarding in case when concession goods extend to the FBiH and RS.

18 Competencies for administering the accounting and auditing standards and monitoring implementation of these standards.

19 Responsible for issuance, compliance and revocation of Licenses, Safety Certificates and Permits.

20 Competencies for representation of BiH abroad, approving of the Demining standards, approval of internal acts for the Mine Action Centre (BiH MAC), cooperation with the Entities through the BH MAC.

21 Responsible for issuing and confiscation of licences of post operators establishes single tariff policy, monitoring of the implementation of the post policy principles and other regulatory functions.

22 Competencies for international representation and cooperation with international organizations and execution of international obligations from the area of labor and employment; coordination of the activities with entity governments and entity employment institutes, monitoring of the implementation of conventions of the International Labor Organization and international standards in the area of labor and employment.

23 Competent for formulation, adoption and control the Monetary policy of Bosnia and Herzegovina and its execution, coordination of the activities of the agencies responsible for bank licensing and supervision in the Entities.
However, once again, the institutional mechanisms that make this sort of federalism function are generally absent in BiH. The most problematic systemic failure is the lack of a clear hierarchy in decision-making. The state generally lacks effective means of enforcing its own or even jointly-agreed decisions at lower levels of government. Where the state sets framework legislation, for example, the entities have retained the right to legislate as well as to implement. Despite legislative clauses requiring the entities to amend their legislation in conformity with the framework law set by the state, this rarely happens in practice, unless significant international pressure is brought to bear. The position of the state is even weaker in terms of its policy coordination role. While EU integration represents the only area of public policy in BiH that commands political support across the spectrum, both the horizontal and especially the vertical coordination functions of the centre are routinely undermined or flouted. In other areas, the BiH state shares formal policy-making competencies with the entities in the form of joint state-entity executive bodies. These attempts at formal policy cooperation are also hampered by lack of clear lines of authority, inadequate enforcement mechanisms, veto points and overlapping competencies in terms of both legislative and implementation competencies.

The following section sets out some of the main systemic problems in the system of state-level governance. These systemic problems manage to give BiH the worst of both federal worlds: the state is rendered both (a) dependent on the entities in executing competencies that are within the state’s own list of responsibilities, and (b) unable to enforce its authority in matters shared with the entities.

C. State competencies held hostage by the entities: weighted voting, quorum and threat of boycott

In federal systems where the central level legislates and the federal units implement federal legislation, the trade-off for the sub-units is their representation in the central decision-making process, usually primarily through the upper house of Parliament. In systems where there is a clear division of responsibilities between the centre and the federal units, such that each level raises its own revenues and in the main legislates and executes its own programmes, the federal units are generally not granted strong representation at the federal level. In BiH, where the state has only a few exclusive competencies and generally fails to ensure implementation of policy at lower levels of government, the state parliament and government are nonetheless governed by rules that enable representatives from one entity or constituent people not only to block decision-making on single items of policy and legislation but to completely paralyse the work of the executive and legislature, through the tool of boycott. These provisions have the effect of seriously undermining the autonomy of the state and can in the future be used by one entity or constituent people to undermine the very legitimacy of the state of BiH. The Bonn powers have reduced the impact of the boycott in the past, but it is not at all clear that the softer carrot of Euroatlantic integration will have the same effect in the future.

The ease with which the BiH institutions can be paralysed by the representatives of one entity or constituent people is striking. In the Council of Ministers and House of Peoples, two thirds of the members of each constituent people must be present in order to convene a session (in the House of Peoples, representatives of the constituent peoples are appointed by the entity parliaments). The House of Representatives has no formal entity or constituent people-based quorum requirements (a simple majority of members constitute a quorum) but the requirement that each majority vote in the House includes at least one-third of the votes of members from the territory of each Entity means that entity-based boycotts can easily paralyse the house, particularly as representatives from the RS tend to vote as a block on most state-level matters. In these circumstances, the one third requirement is sufficient to ensure that the boycott is a powerful tool. The state institutions have been the victim of the boycott on several occasions since 1996, even in the face of strong international pressure and threat of sanction against boycotting parties.

During 1996 and 1997, RS representatives in the state level institutions generally refused to attend sessions of all

24 Article 16 of the BiH Law on the Council of Ministers provides that the Council of Ministers may hold a session and adopt decisions if a session is attended by more than one half of the members of the Council of Ministers, provided that there are at least two members from each constituent people present. The CoM currently comprises 9 Ministers and the Chair, meaning that generally 2/3 of the members of each constituent people must be present to ensure a quorum. Article IV(1)(b) of the BiH constitution regulates that nine members of the House of Peoples shall comprise a quorum, provided that at least three Bosniac, three Croat, and three Serb Delegates are present. Again, in practice this means that 2/3 of the representatives of each constituent people must be present in order for the House to function. The House of Representatives has no formal entity or constituent people-based quorum requirements (Article IV(2)(b) of the BiH Constitution provides that a majority of all members elected to the House of Representatives shall comprise a quorum) but the requirement that each majority vote in the House includes at least one-third of the votes of Delegates or Members from the territory of each Entity.

25 The actual number of boycotts (or threatened boycotts) is difficult to calculate precisely given that parties frequently boycotted parliamentary votes despite their attendance at the Parliamentary sessions, or given that the Chair of the CoM is often unlikely to schedule a session of the CoM if there is no quorum.
state institutions, and were persuaded to do so only after the robust intervention of the international community (in particular IFOR and OHR). In March 1999, RS representatives withdrew from all state institutions following the adoption of a resolution by the RS National Assembly rejecting the arbitration on Brcko.26 The boycott ceased only after the High Representative imposed a Decision ordering that a session of the BiH Presidency be convened.27 In March 2000, RS representatives boycotted a session of the House of Representatives in reaction to the alleged use of inflammatory language by the SDA President in a pre-election speech. The longest boycott was the HDZ boycott of Parliament, which lasted from 3 March 2001 until 6 October 2001, following OHR/OSCE sanctions imposed on the party for their attempts to hold a referendum on establishing a third entity at the time of the 2000 general elections.28 In March 2002, Serb Representatives walked out of the inaugural session of the BiH House of Representatives in protest against the High Representative’s imposition of changes to the Law on Council of Ministers that increased the number of state ministries and streamlined decision-making in the government. Sporadic boycotts of state institutions have continued, though the frequency and length of boycott has reduced significantly since the early days of Dayton implementation. This reduction shows that there has been some degree of institutional maturing and a higher acceptance of the legitimacy of the state institutions on the part of politicians from both entities. However, the exercise and threatened exercise of the boycott is still real, and was used by RS members of Parliament as recently as May 2006 for a almost one month in response to the failure of the Council of Ministers to establish a Commission for investigating crimes allegedly carried out in Sarajevo during the war.29 Bosniak members recently boycotted sessions of the Council of Ministers, in an attempt to prevent the adoption of amendments to a decision on the quality of liquid petroleum fuels, pushed by the RS government.30 Therefore, the boycott has been used to block the work of the BiH institutions at a time when BiH is required to adopt and implement a heavy legislative agenda – which all parties have supported – in order to open negotiations on an SAA with the EU. Neither the carrot of EU integration nor the continuing threat of OHR sanctions was sufficient to prevent these boycotts and heavy international pressure has had to be applied in order to end them.

I BELIEVE THAT IT IS IN THEIR INTERESTS TO PRODUCE CRISES, BECAUSE THAT KEEPS THEM IN THEIR POSITIONS.
– Zenica, male

The Council of Ministers

Some of the ‘consociational’ or power-sharing features built into the system of state-level decision-making have been partly reformed since Dayton, normalising, to some extent, the appearance of the state government. Successive changes to the Law on Council of Ministers have improved the formal status of Council of Ministers. The most significant changes, imposed in 2002, abolished rotation among the Chair and Co-Chairs of the Council, in favour of a single Chair with responsibility for developing government policy, reduced the number of deputies Ministers to one per Ministry in an attempt to reduce ethnic and political reporting lines, increased the number of state Ministries by breaking up existing Ministries (e.g. the Ministry of Civil Affairs and Communications was split) and adding new Ministries to reflect newly acquired state responsibilities (e.g. the Ministry of Security), and created a Directorate for European Integration, directly responsible to the Chair of the Council of Ministers, tasked with co-
ordinating and supervising implementation of EU integration requirements across BiH.\textsuperscript{31} While these changes have certainly improved both the image and functionality of the Council of Ministers, some key flaws remain.

**Quorum and boycott**

As outlined above, the state government can be held hostage by the non-attendance of Ministers from one constituent people. The Law on the Council of Ministers provides that the government may only hold a session and adopt decisions if more than half of the members of the Council of Ministers are present, provided that there are at least two members from each constituent people present. The Council of Ministers currently comprises 9 Ministers and the Chair, meaning that generally 2/3 of the members of each constituent people must be present to ensure a quorum.

**Consensus decision-making**

Changes to the Law on Council of Ministers imposed by the High Representative in 2002 formally removed the requirement of consensus voting in the government. The changes allow for majority voting on all government decisions that are subsequently passed to the BiH Parliament for final decision, including draft legislation. On all other issues and, in particular, on regulations, nominations and appointments, as well as on the Rules of Procedure and their interpretation, the consensus requirement is retained, with the proviso that if consensus is not reached, the decision can be taken after a consultation period by qualified majority, providing the majority includes the votes of at least two members of each constituent people.\textsuperscript{32} In practice, because members of each constituent people tend to vote as a block, there is de facto a requirement of consensus on all final decisions made in the government.

Abolishing the consensus requirement on decisions that go to the BiH Parliament has had a positive impact on the conduct of government business, which is generally expedited more efficiently. Although decisions and draft legislation adopted without the support of ministers of all constituent peoples may sometimes fail in Parliament, some draft laws that were adopted by majority vote in the Council of Ministers have since passed the qualified voting system in the Parliament, albeit often under strong international pressure. This is partly because the parliamentary decision-making process is more transparent and subject to scrutiny compared to the executive’s deliberations. On the other hand, where the consensus requirement is retained in Council of Ministers decision-making, there has been significant blockage in the government, particularly in the area of government appointments. In the 2002-2006 mandate, the Council of Ministers failed on several occasions to reach agreement on appointments to key positions, including in sectors identified as critical for future EU integration.\textsuperscript{33} The government often failed to make appointments to institutions whose establishment and functioning were key Feasibility Study conditions. The appointment of management of the BiH Veterinary Agency, for example, was held up for months despite both public and private condemnation of the government by the EU, OHR and others. On more than one occasion, the High Representative stepped in to make appointments on behalf of the authorities. Examples include, the imposition of the Director and Deputy Directors of the State Investigation and Protection Agency (SIPA) in October 2002, three months after the legal deadline for appointing the positions had expired,\textsuperscript{34} and the imposition of the Director, Deputy Director and Assistant Director of the State Border Service (SBS) in September 2005, five months after the legal deadline for filling these positions had expired.\textsuperscript{35}

In summary, despite some degree of normalisation in the functioning of the Council of Ministers, there remain problems in the design and conduct of government at the state level in BiH. The most elementary of these is that the work of the state government and parliament can be paralysed if members of one constituent people decide not to show-up: under the present system, it only takes more than one third of the members of one constituent people in the government and upper house of parliament to stay away in order to shut-up the institutions. Despite

\textsuperscript{31} The Law on Council of Ministers of Bosnia and Herzegovina was imposed by the High Representative Decision, No. 79/02 and published in the Official Gazette of Bosnia and Herzegovina, No. 38/02. The law was subsequently adopted by BiH Parliamentary Assembly and published in the Official Gazette of Bosnia and Herzegovina 30/03.

\textsuperscript{32} Article 18 of the Law on Council of Ministers of BiH (BiH Official Gazette 38/02)

\textsuperscript{33} These disputes were most often caused by failure to agree on which constituent people the candidate should come from. In other cases, there was disagreement about individual candidates, though more often than not, a ‘gentleman’s’ agreement is honoured between the parties whereby each constituent people has more or less carte blanche to select whom they wish for certain positions, without the interference of others.

\textsuperscript{34} Decision Appointing a Director and Deputy Directors of the Agency of Bosnia and Herzegovina for Information and Protection, 7 October 2002, www.ohr.int

\textsuperscript{35} The new Law on the State Border Service entered into force on 17 November 2004 (OGBiH, 50/04) and stipulated that the procedure of appointment of managerial staff of the State Border Service, including its Director, Deputy Director and Assistant Director should be finalized no later than six months from the day of entry into force of said Law. See OHR Decision On Appointment of the Director of the State Border Service, September 9 2005.
the strong arm presence of the OHR and the constant threat of removals and sanctions against both individuals and parties, the boycott has been used and threatened on several occasions. If the weighted quorum and voting provisions remain unreformed and in place after the Bonn powers are phased out, it is quite likely that the state of BiH will be held hostage (i.e. shut down) by narrow entity interests for varying lengths of time, and that the threat of boycott may be used to undermine the effective implementation of state regulations in one entity or another. With the departure of OHR, politicians in BiH will certainly be forced to find ways of resolving inter-entity disputes and disagreements without the constant intervention of the international community. However, leaving mechanisms in place that enable one group to paralyse the state through the use of a sustained boycott means that there is every chance that the very integrity of the BiH state will be called into question in the (post-OHR) future.

...PRIOR TO ELECTIONS THEY PROMISE US MANY THINGS, THEY TELL NICE STORIES UNTIL THEY GET THEIR POSITIONS. WHEN THE POSITIONS ARE ALLOCATED, ORDINARY PEOPLE ARE FORGOTTEN.
– Zenica, male

D. Lack of State enforcement capacity in areas of shared competencies

The previous section describes how the BiH constitution fails at a fundamental level to guarantee the autonomy and independence of the state institutions, given that they can be held hostage by the simple non-attendance of members of one entity/constituent people. While Dayton envisaged a system of largely separate dual competencies between the state and entities, it gave entity representatives an effective veto in the state decision-making process over matters in the state’s nominally exclusive competencies. At the same time, there was no explicit trade-off envisaged in terms of granting the state explicit constitutional involvement in entity matters. The state-building agenda since Dayton has, though, chipped away at the exclusive responsibilities of the entities. As well as a small number of recent ‘clean’ and whole transfers of competencies to the state (most notably in defence and intelligence affairs), the state has been given partial responsibilities over policy-making and legislation (and in some isolated cases implementation) in matters which were previously conducted as exclusive entities (or cantonal) competencies. This section describes some of the different ways in which responsibilities have been shared between the state and the entities. What emerges is a system that shares competencies between levels of government without putting in place the institutional mechanisms (institutions, rules) to encourage or require cooperation.

WE HAVE TRANSFERRED A LOT OF COMPETENCIES TO THE ENTITIES FROM THE STATE, AND THAT IS NOT FUNCTIONING, NOT AT ALL...
– Doboj, male

[i] Framework legislation

There is no explicit reference in the BiH constitution to the sharing of competencies between the state and the entities. State framework legislation was first introduced in 1998, when High Representative Carlos Westerndorp
imposed the Framework Law on Privatisation of Enterprises and Banks in BiH.\textsuperscript{36} Since then, framework legislation has been introduced primarily in two areas: to establish a single economic space and to ensure the uniform and fair protection of human and civil rights across BiH. The BiH Constitutional Court supported the introduction of framework legislation at the level of the state, ruling that the state institutions are endowed with more than the limited list of responsibilities explicitly enumerated in article III.1 of the BiH constitution. The Court ruled that “Article II.3… gives a general competence to the common institutions of Bosnia and Herzegovina to regulate all matters enumerated in the catalogue of human rights which cannot exclusively be left to the Entities since the protection has to be guaranteed to “all persons within the territory of BiH”.”\textsuperscript{37} The Court also interpreted Article 1.4 of the constitution in a similar manner, which provides for freedom of movement throughout Bosnia and Herzegovina and places a requirement on the Entities not to impede the movement of persons, goods, services, and capital throughout the country. The state was therefore taken to hold the responsibility to regulate matters in which only state-wide standards could ensure the respect of human rights and the creation and functioning of an integrated economic space. The Court also stated that for a functioning market economy based on these principles, both the state and the entities are responsible for maintaining an appropriate legal framework. The stage was thus set for the state and entities to share legislative responsibilities in several areas.

In practice, framework legislation has been adopted in several sectors in an effort to establish uniform country-wide standards. Several state laws have also been adopted which, while not \textit{de jure} framework laws, establish integrated state-entity systems that require the entities to harmonise legislation in line with state legislation, for example, in the areas of public broadcasting and statistics. However, given that the entities retain legislative powers in areas where the state sets standards and that the state lacks enforcement mechanisms, a significant number of state framework laws remain paper tigers, as the entities fail or refuse to adjust legislation in line with the state framework (see figure 2). In the absence of both political consensus and formal cooperation and enforcement mechanisms, the state lacks the tools that are used in other cooperative federal systems to require or even promote entity compliance. Therefore, the provisions set out in state framework legislation often simply do not enter into force in the non-compliant entity. The international community, in particular, has invested much time and political effort on drafting and pushing for the adoption of state framework legislation only to discover that lack of entity compliance and implementation render their efforts null and void. In serious cases of non-compliance High Representative impositions have been a quick fix to the problem, harmonising entity legislation with state requirements. Indeed, the implementation of framework legislation has largely become dependent on international intervention. This provides a short-term solution to the problem, but there is no guarantee that the entities will not unilaterally unharmonise legislation in the future that was imposed or adopted under international pressure. Nor is there any institutional guarantee at present that framework laws adopted in the future will be applied in the entities and cantons. Apart from wasted effort, failure to harmonise entity legislation with the requirements of state framework legislation, may result in serious obstacles to the creation of a single economic space, human rights violations and a failure to meet BiH’s international obligations. Harmonisation of domestic legislation with the EC \textit{acquis} will require uniform standards and thus state-level framework legislation in several areas of entity competencies. The dismal implementation of framework legislation to date does not inspire confidence that BiH is capable of taking on even the administrative obligations of EU integration. Some current examples (among many) of entity non-compliance with state framework laws and the consequences of this are discussed below.

\textsuperscript{36} BiH Official Gazette (14/98).
\textsuperscript{37} BiH Official Gazette (17/00)
### Figure 3

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[^38]: High Representative Decision transferring responsibilities for implementation from the Payment Bureau of the FBiH to the Agency for Privatization in the FBiH, 20 December 2000

[^39]: De jure this is not a framework law, but the Entities were required to harmonize their legislation with the state level law within 60 days of this Law coming into effect.

[^40]: In 2003 BiH Ministry of Civil Affairs and Communications transferred the responsibility for monitoring of implementation to the Ministry of Human Rights and Refugees (Law on Amendments of the Law on Refugees and Displaced Persons in BiH (OG 21/03)

[^41]: Three FBiH Cantons failed to harmonise relevant legislation, leading to High Representative impositions of necessary legislative changes in Canton 10, Central Bosnia Canton and West Herzegovina Canton, on 7 July 2004. Due to a lack of capacity within the Ministry of Civil Affairs and lack of enforcement mechanisms, monitoring of implementation of these laws is weak.

[^42]: De jure this is not a framework law, but the Entities and District were required to harmonize their legislation with the provisions of this Law within 3 months of coming into effect.

[^43]: Establishing method of registration of business entities in the Entities and Brcko District and harmonization of laws of entities and Brcko District with the state level law. The law determines uniformed procedure of registration of business entities in the territory of Bosnia and Herzegovina, and is therefore applicable to all business entities established in BiH.

[^44]: Not de jure a framework law, but Entities were required to harmonize their legislation within 60 days of the law coming into effect. Although RTRS Law was adopted on time, FTV Law is yet pending before the FBiH Parliament due to Croat Caucus’s challenge before the FBiH Constitutional Court

[^45]: Not de jure a framework law, but the Entities were required to harmonize legislation with the state level law within 90 days of this Law coming into effect.
Examples of non-compliance with state legislative harmonisation requirements

**Education** The Framework Law on Primary and Secondary Education in BiH came into effect on 1 July 2003 (OG 18/3). It defines basic principles and standards for the organisation and functioning of pre-school, primary and secondary education in BiH. The Department for Education, Science, Culture and Sport within the BiH Ministry of Civil Affairs is responsible for education and one of its key functions is to supervise implementation of the Framework Law on Primary and Secondary Education. The framework law commanded the rare support of all political parties in the BiH Parliament, and as such, unlike much imposed legislation, reflected a genuine domestic political compromise. Moreover, both entities and cantonal ministries had participated in the development and drafting of the legislation, albeit under the supervision and at the insistence of the international community (OSCE, Council of Europe and OHR). All these factors should have contributed to relatively unproblematic harmonisation processes at entity and canton level. In practice, most of the Croat-majority and one mixed Bosniak-Croat canton refused to bring their legislation in line with the Framework Law. In response, the High Representative froze financing to the offending HDZ and SDA parties. However, neither international stick nor carrot could persuade three cantons to harmonise legislation in time for the start of the new school year in 2004. In the face of continuing obstruction, the High Representative imposed changes to the laws on primary and secondary education in three cantons. As one close observer of the process of education reform notes, experience with the non-implementation of the Framework Law on Primary and Secondary Education should be a salutary lesson for those tasked with developing a framework for Higher Education reform, or indeed, any other framework legislation in BiH. She notes that the goals of the Bologna Process could probably be achieved informally without any legislative framework and enforcement mechanisms whatsoever in a country in which policy objectives were shared across the political spectrum and a culture of cooperation existed. However, experience shows that only explicit state-level legislation with an appropriate enforcement mechanism and a degree of state-level financing will lead to the enforcement of uniform standards across BiH.

**Refugee return** In 2004, the BiH authorities assumed responsibility for promoting and implementing refugee return in BiH. Management of this sensitive sector had been heavily dominated by the international community, at the centre of which was the OHR-lead inter-agency Refugee Return Taskforce (RRTF) established in 1997 to tackle return and reconstruction issues in an integrated manner. With RRTF’s closure at the end of 2003, OHR and other international donors urged the BiH authorities to put in place a domestic structure capable of taking on many of the tasks that had previously been managed by the RRTF. A complex system of state and entity policy-setting and implementation mechanisms was put in place to take over these tasks (the design and functioning of which will be discussed in the following section). The legislative framework for the new system was passed at state-level. As well as providing for the establishment of new state bodies, the 2003 Law on Refugees from BiH and Displaced Persons in BiH establishes a framework with general principles regulating the status and rights of refugees and displaced persons in BiH. It requires the entities to harmonise legislation with the state law. Despite both the urgency of legislative harmonisation, given the closure of the RRTF, and continued international pressure, the relevant RS legislation was not harmonised with the result that important provisions of the state-level law simply did not apply in the RS for some time. In the meantime, and in the context of other changes, OHR took the opportunity to impose changes to the Federation law, which brought it in line with the state framework law. Even with the development in 2005 of new draft entity laws, under international coordination and with continued international pressure, inconsistencies remain between the state framework law and entity legislation in force. This failure to harmonise legislation in the return sector is a serious indictment of the system of shared competencies in BiH. Unlike in most other sectors, the state and entity Ministers responsible for refugee return meet regularly in institutionalised forums which exist to promote cooperation and policy coordination. Despite the existence of institutionalised cooperation forums between the state and entities and strong international pressure promoting compliance, without enforcement mechanisms, harmonised standards could not be achieved.

These two instances of failed state-level legislation concern sectors which the international community has deemed priority areas. Powerful carrots and sticks have been used in an effort to promote compliance. Despite this, domestic legislative compliance has been patchy and implementation flawed. In the face of the continuing failure

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46 See the Decisions Enacting the Laws of Primary and Secondary Education, 8 July 2004, at www.ohr.int
47 Daria Dulovic, Bologna Process vs. ‘Vital National Interest’: Higher education reform and Euro-integration of BiH Sarajevo 2005, written with the support of the Open Society Institute BiH
48 For details, see Functional review of the Return Sector in BiH, funded by European Commission, Sarajevo, 2005
of several cantons to bring their legislation in line with the state framework law on Primary and Secondary Education, the then High Representative stated that: “failure to bring cantonal law into line with State law represents a grave violation of the Rule of Law... If those involved do not address this matter urgently, and uphold the laws of the State of BiH, they are in effect challenging the statehood of BiH itself”. By this measure, BiH’s statehood is routinely and widely challenged by lower levels of government every day. In this situation, rather than relying on the executive powers of the High Representative or the mantra of European integration, there must be enforcement mechanisms to ensure compliance. Otherwise, where laws are not automatically binding for lower levels of government, there is little prospect that harmonised and uniform standards can be applied consistently in all areas throughout the country.

(ii) Formal Cooperation mechanisms: or how not to cooperate

The gradual and partial allocation of competencies to the BiH state in areas that were previously monopolised by the entities, has entailed the creation of some important decision-making bodies that are nominally BiH institutions but which involve the entities, and in some cases Brcko, in the formulation and execution of policy. These systems have been put in place as compromise solutions, and sometimes with the expectation that they transition eventually into purer state-level bodies, in the interest of securing political support for the transfer of new competencies to the state. In the face of political disagreement, the international sponsors of these reforms believed that securing partial state competencies in certain fields was better than ending up with none. In theory, one could argue that systems based on formal power-sharing between the state and entities represent a positive attempt to introduce formal cooperative systems into the fragmented BiH governance structure. However, in practice the functioning of many of these hybrid bodies is flawed. The outcome for the state and general governance effectiveness can be summarised as the worst of both worlds: on the one hand, most competencies remain with the entities and there is no hard requirement for them to coordinate let alone cooperate with the state; on the other hand, in matters of shared competencies, the entities retain the power to block common decision-making and thus impair the ability of the state of BiH to enforce and implement policy effectively.

This section looks in more detail at two systems that have been established as neither state nor entity bodies, but a hybrid cooperative mix. The Governing Board of the Indirect Taxation Authority (ITA) was established to set policy on indirect taxation and oversee the operations of the newly established BiH indirect tax collection body. The state and entity finance Ministers are members of the board, as well as government experts from each level with reduced voting rights and, at present, an international Chair with casting vote. A second example is the State Commission for Displaced Peoples and Refugees (SCDPR) which was recently strengthened as part of measures put in place to hand over responsibility for the return process from international agencies to the BiH authorities. The state and entity Ministers of Refugees are members of the Commission. The SCDPR seems to typify a cooperative (or, more accurately, uncooperative) system that is bound to fail from the outset. The ITA Governing Board encapsulates some genuinely cooperative features while also giving the state autonomy in fiscal matters. Despite this, lack of agreement between the two entities is blocking the work of the governing board with serious consequences for the overall fiscal situation in the country.

State Commission for Displaced Peoples and Refugees and Return Fund

The organisational structure put in place to equip the BiH authorities with the tools required to continue and complete the process of refugee return following the closure of the OHR-led RRTF, represent a complex sharing of competencies that adds a state-regional-municipality project implementation axis to the existing entity-canton structures. In theory, at the top of the structure is a State Commission which was originally established in 2000 by a decision of the BiH Presidency to ‘provide follow-up on coordination and inter-Entity consultations’ on refugee and return issues. With the establishment of the joint BiH Return Fund in 2004, which was initially envisaged as a tool for implementing joint IC-state-entity projects, the Commission has also became responsible for authorising and supervising the implementation of projects by the Return Fund.

Both the Commission and the Fund are examples of cooperative systems: the state and entity ministers for refugees are members of the Commission and determine policy jointly, while all three levels of government contribute to the joint Fund. There are three major structural problems with the design of these cooperative

49 Violation of the Rule of Law a Challenge to the Statehood of BiH, Press Release, OHR Sarajevo, 26 May 2004
bodies. (1) The State Return Fund relies on the voluntary contribution of the entities to function. Contributions are only pledged into the start of each budget year and are subject to the signing of an ad hoc Memorandum of Understanding each time. In practice, it has been difficult to solicit adequate funding from the entities, which continue to spend the majority of their return budgets themselves, rather than allocating to the joint state fund. This financing system mirrors the uncertainties and inefficiencies of the old system of entity funding to the BiH institutions. (2) While the system formally subordinates the state to the policy-setting authority of the Commission, which determines the scope of projects implemented by the state, there are no reciprocal enforcement mechanisms to ensure that the entities comply with policy set by the Commission. The Commission decides on the municipalities that will receive assistance from the state. By contrast, the entities which municipalities should be assisted to the entity parliaments. The coordination competencies of the Commission via a vis the entities are also weak. As the EC functional review of the sector notes: ‘The nature of the decisions and conclusions reached by the SCDRR is not defined in the law, which negatively affects its effectiveness. Its members, in particular the entity representatives, often meet difficulties in implementing the conclusions of the Commission, because of opposition faced at entity level, which does not necessarily consider the conclusions of the SCDPR as binding…’

On more than on occasion, one or the other entity has failed to implement decisions of the SCDPR. (3) Third, policy-setting and implementation tasks are duplicated as two parallel systems for domestic project implementation in refugee return have emerged – the new state-regional-municipality axis, which gives significant implementation competencies to the municipalities, was introduced on top of the existing entity-canton system, with no clear division of responsibilities between them.

As well failing to prevent parallel state and entity systems and thus wasting the dwindling domestic resources available for refugee return projects, the state Commission and Fund have also failed to fulfil another key objective of their mandate which was to act as a reliable domestic mechanism through which international funds would be channelled and return projects jointly implemented. This has not happened. The fund has been able to attract Council of Europe Development Bank and OPEC funding, but only after intense international lobbying on their behalf. Bilateral and other donors in the refugee return sector have not channelled funds through the Fund. As the functional review of the sector notes, ‘Donors still need convincing that the Return Fund’s procurement and payment procedures and sufficiently solid’ (Functional Review, page 21). Another unfulfilled aim of the reform, typical of many other internationally-sponsored state-building projects in BiH, is the streamlining and clarification of policy-setting and implementation responsibilities between and across different government levels. The Annex VII strategy drafted to define the remaining priorities in the refugee return sector envisages both state and entities withdrawing from actual reconstruction project implementation, leaving this to municipalities. It was in this context of reduced entity implementation that the entities were given a seat on the State Commission, giving them a significant role in policy formation. In fact, the entities have assumed this significant role in state-level policy while continuing to implement their own policies and projects at entity level unilaterally.

**ITA Governing Board** Reform of the system of indirect taxation in BiH has had important institutional consequences at state-level. For the first time since Dayton, the state’s precarious reliance on a confederal transfer of funds from the entities to fund its activities has been replaced by a system in which indirect taxation and customs are collected by a state-level agency and revenues are first allocated to the state, in the amount of the adopted state budget, and only then to the entities, based on a shifting coefficient. In addition to the state finance minister and one state-level expert, the entity finance ministers and two entity experts sit on an inter-state-entity governing board, enabling in entity input/veto in policy-making. Brcko District has the status of observer. Some of the original competencies of the governing board were watered down in parliamentary procedure. The board, initially a quasi-executive body with policy-setting competencies, was clearly subordinated to the Council of Ministers during parliamentary procedure and reduced to a proponent of policy to the Council which remains ultimately responsible for adopting policy. Nevertheless, in practice, the governing board must reach agreement on policy before it is proposed to the Council of Ministers, leaving room for the significant hold ups if policy consensus cannot be reached. At present, deadlock can, in theory, be broken by the casting vote of the international chair of the governing board, though consensus is usually sought in the interests of political stability. In 2006, for example, arguments over revenue allocation stalled the work of the governing board for months. This did not directly affect the state, as state revenue is automatically allocated in the amount of the state budget. However, lack of cooperation between the entities has a damaging impact on overall fiscal situation in BiH. Moreover, the mandate of the international chair is unlikely to be renewed past the closure of OHR, thus opening up the potential for even more
prolonged obstruction of the Governing Board’s work. The flaws of this cooperative system will be discussed in more detail in Chapter 3.

2. Implementation problems

The serious shortcomings of the formal system of governance in BiH are striking. However, even highly complex systems of power-sharing can work in practice if certain norms prevail, such as a common commitment to maintaining the system, a cooperative culture etc. In BiH, in addition to a cumbersome and inefficient institutional structure, the state institutions are also the victim of other types of obstruction and short-sighted politics. This section will examine three types of ‘implementation’ problem that undermine the state: (i) political and administrative obstruction, (ii) lack of basic domestic capacity and dependence on the IC, and (ii) lack of coherent and consistent international support for state-building.

A. Political and administrative obstruction

Political consensus is a rare commodity in BiH. The lack of political will has a much greater impact on governance in BiH than in other states, as the system requires a high degree of consensus to function. Both state-level decision-making and the shared competencies that the state has acquired since Dayton leave ample room for easy and effective political and administrative obstruction. As we have seen, if representatives appointed or elected from one entity simply do not show up in sufficient numbers, they can have a paralysing effect on the state institutions. It is well known and documented that RS representatives in the state institutions and the RS government obstruct state business. Representatives elected from the RS have boycotted the state institutions on more occasions than each of the other constituent peoples put together. The transfer of competencies to the state from the RS has been slow, reluctant and successful only under immense international pressure. While competencies have been formally assumed by the state, the RS is responsible for failing to implement state directive within its entity, and its state level representatives continue to do more to block government rather than to enable it. RS obstruction is relatively obvious and clear. Less, however, is known about the ways in which the Federation undermines the state institutions. Federation obstruction is often a result of administrative incompetence, oversight or simply bad communication, rather than political obstruction. However, more explicit political obstruction of state building is also evident in the Federation (FBiH). Despite much rhetorical support for state building, in reality, the FBiH, its government, parliament and the political parties that dominate them, show much disregard for the authority and integrity of the state. We will focus here on just two recent examples of the way in which both entities obstruct state-building reforms and undermine the general authority of the state.

The Federation obstructs too

Indirect taxation reform Reform of the indirect taxation system is a key requirement of the EU SAA and one of the most important state-building measures conducted since Dayton, as it provides the state of BiH with a secure source of own revenue with which to fund its institutions and obligations. Despite this, the introduction of the reform has been subject to political obstruction in both entities. We have examined the way in which RS representatives on the Governing Board of the Indirect Taxation Authority have blocked the work of the body. The FBiH too, has been responsible for undermining the reform and the authority of the state, most notably in 2004, when the Federation Parliament passed amendments to legislation on indirect taxation, which was in direct violation of the new state level system of uniform indirect taxation. The state Law on the Indirect Taxation System in BiH provides that the consent of the Governing Board of the ITA is required for the introduction of any additional indirect taxes in BiH. The FBiH Parliament ignored this despite repeated warnings from the ITA Governing Board and the FBiH government that the Parliament could no longer unilaterally enact changes to indirect taxation policy. Following the adoption of the legislation in the Parliament, the Chair of the Council of Ministers submitted a request

51 Provision of articles 1 and 2 of the FBiH Law on Amendments to the Law on Turnover Tax on Goods and Services and the provisions of articles 1 and 2 of the FBiH Law on Amendments to the Law on Special Tax on Non-Alcoholic Drinks.
to the BiH Constitutional Court asking the court to freeze the provisions of the FBiH law and rule on the constitutionality of the changes in view of the FBiH Parliament’s prior transfer of competencies on indirect taxation to the state of BiH and the subsequent passage of legislation governing indirect taxation at the state-level. The Constitutional Court upheld the request of the Chair, freezing the law’s application and requiring that the FBiH change the legislation accordingly. For its part, the FBiH Parliament did not even answer the Constitutional Court’s request to submit reasoning for their adoption of the legislation. This points to a general lack of accountability and responsibility in the institution and a fundamental disregard for the authority of the BiH state and its highest court.

**Defence reform** The creation of a single defence establishment in BiH is another landmark state-building reform, which has entailed the transfer of an entire responsibility to the state, including the political, bureaucratic and operational structures from both entities. Even in the FBiH, where there is widespread support for the reform – within the defence establishment, political circles and the wider public – it is no surprise that ambitious restructuring of the sector and merging of the entity authorities has been difficult and complicated by several vested institutional interests. However, the institutional vacuum that has emerged as the defence structures transition from entity-level to a unified state-level structure, is being exploited by the entities in order to retain control over as many resources as possible before the state ‘takes over’ in real terms. Despite the formal abolishment of the entity Ministries of Defence and the assumption of all formal defence responsibilities by the state, the entities have rushed to dispose of as much moveable and immovable property as they can before the state structures begin to function in earnest. The FBiH has been just as keen to deprive the new state defence establishment of key assets as the RS, transferring Ministry of Defence property into the ownership of the municipalities and cantons, both in violation of the spirit of the Defence Law and in direct violation of a ban on the sale or transfer of state property at all levels which was imposed in 2003 and repeatedly extended by High Representative decision. The FBiH has also failed to facilitate the work of the joint commission chaired by the Council of Ministers, which is tasked with proposing legislation to clarify which level of government owns what in BiH, in an effort to ensure that the state of BiH gains a fairer distribution of property which has been in the control of the entities since Dayton.

Both entities, therefore, routinely obstruct state-building and state business through political and administrative means. RS obstruction is certainly easier to identify and its political causes are clearer. However, the FBiH also displays little regard for the authority of the state in many areas, and can often hide their guilt by sitting back and free-riding on the back of the RS’s faster and more explicit obstruction.

**B. Lack of basic domestic capacity and dependence on the IC**

The problem of ‘ownership’ and the paradoxes of international interference in governance in BiH have been widely discussed. At the most fundamental level, the system of governance put in place at Dayton is said to be reliant on international intervention to function. Without the exercise and threat of the Bonn Powers, the BiH system provides few institutional incentives for BiH politicians to cooperate. We have also argued that continuing international intervention has the dangerous effect of making the system appear to function, while disguising systemic problems and seriously flawed rules that could jeopardize the viability of the state once OHR is closed. The international community is also routinely accused of undermining domestic governing institutions – including the very state institutions it has fought hard to establish – by continuing to over-ride the domestic decision-making process in terms of policy development and adoption, and failing to ensure that institutions established on paper have the means to actually implement envisaged responsibilities. These policies have both exacerbated and covered up the flaws of an ethnically divided, understaffed and inadequate state public administration.

...I don’t have faith in those who work in the civil service, nor those who have been elected, because highly educated young people are leaving this country. What we are left with is not a good choice.
– Brčko, male
i. Lack of domestic capacity

(a) Ethnic parallelism

The next chapter looks in greater depth at problems affecting reform of the public administration in BiH, including the acute problem of inappropriately qualified personnel in the state institutions. This situation is the result of many factors, including a politicised recruitment process, particularly at the managerial level, which reinforces ethnic divisions in the civil service and seriously hampers effective management in state ministries and agencies. The worst excesses of ethnic/entity-based parallelism in state bodies have been formally eradicated. For example, until 2000, the accounts of many state Ministries were literally divided in three, reflecting the de facto existence of three parallel ethnic administrations ‘under one ministerial roof’.

The tripartite governance of Ministries and many state agencies, which in the case of the latter often extended to absurd rotation among the Head and Deputy Heads of technical agencies, has also been progressively reduced. However, despite these advances, sources in several different state institutions confirm that in many of them, ethnic reporting lines are still dominant, over-riding functional division of responsibilities and maintaining parallel reporting systems. This is generally true of positions from senior management down but is most pronounced in management positions where political reporting lines (and in BiH this translates into ethnic reporting lines) are usually dominant, setting the tone for the (mis)management of each institution. The division of positions in the administration along ethnic lines is justified by a provision of the BiH constitution that states that officials appointed to positions in the institutions of Bosnia and Herzegovina shall be generally representative of the peoples of Bosnia and Herzegovina.

In practice, this clause is interpreted in a three-way division of management positions, a practice that is also mirrored to a large extent in recruitment to lower-level positions throughout the state institutions. As well as compounding ethnic parallelism, this system also frequently results in the best candidates for positions being overlooked in favour of candidates further down shortlists who are chosen in the interests of ethnic balance. The intentions of senior management and Ministers are often known in advance, discouraging candidates of another ethnicity from even applying for positions. There is clearly no quick fix solution to the problem of ethnic division in the state institutions, which has become accepted institutional practice across much of the state. It is likely that considerations of fair representation of ethnic groups will (and arguably should, for various reasons) remain a guiding principle in the state administration. However, maintaining a fair ethnic balance should not translate into an ethnification of the structures of government if BiH is to transition towards a more functional system of government which is capable of abiding by international commitments, especially the arduous process of compliance with EU law. Various institutional reforms since Dayton have been able to lessen the problem of ethnic parallelism in the state institutions, and these could be built on in the future, given sufficient political will.

...AND THOSE WHO HAVE BEEN EMPLOYED, WE ALL KNOW WHICH KEY AND CRITERIA WERE USED IN THEIR SELECTION.
– Tuzla, male

(b) Lack of staff

As well as inadequately qualified personnel, the state institutions have a more basic problem: there are still whole sectors of state responsibility that have not even been staffed yet. On one estimate, the state institutions are 40% short of full-staffing levels, as defined in the rulebooks of different institutions.

This lack of staff affects all state institutions, but is particularly marked in new sectors that have recently been assumed by the state, where some

52 The short-lived Alliance government of 2000-2002 was able to unify the accounts of each state Ministry, which had previously been divided in three. For an account of the changes see particularly the 2001 Annual Reports of the BiH Audit Office at www.revizija.gov.ba.

53 Changes to the Law on Council of Ministries in 2002, abolished the second deputy Minister positions in an effort to reduce the tripartite governance of state Ministries. Abuse of civil service procedures, however, allowed the political parties to install candidates of a third ethnicity in the position of Secretary in many of the BiH Ministries.

54 Article IX.3 of the BiH Constitution

55 Interview with senior official, Council of Ministers of BiH, February 2007.
whole sectors are next to empty. For example, the Department for Education, Science, Culture and Sport within the BiH Ministry of Civil Affairs is exclusively responsible for education matters at state-level. These responsibilities include supervising implementation of the Framework Law on Primary and Secondary Education in BiH, and overseeing the development of the Law on Higher Education, not to mention a host of other (theoretical) responsibilities. Incredibly, the Department has only one full-time employee responsible for education, at the level of Assistant Minister. The international community has entrusted the BiH Ministry for Refugees and Human Rights, and four regional centres under its authority, with taking over responsibility for coordinating policy and implementing projects to facilitate refugee return in BiH. The OHR extolled that “the launch of the regional centres marks the start of an implementation program that will set in place a comprehensive nationwide structure through which the Ministry for Human Rights and Refugees can discharge its responsibilities effectively.”56 This ‘comprehensive nationwide structure’ currently employs two full-time employees per regional centre. Although the regional centres employ some temporary staff on a project-to-project basis implementation, the staffing levels fall seriously short of the intentions of the reform’s international sponsors. Here, again, the BiH state remains firmly in the world of virtual reality.

(c) Inadequate capacity-building

International attempts to build capacity in the state institutions have had mixed results. The next chapter examines key failures of civil service reform in BiH. This internationally-sponsored ‘cornerstone reform’ was intended, more than any other, to breath life into the ethnically divided, patronage-soaked BiH public administration and to develop the human capacity necessary for BiH to take over full governing responsibilities. As we discuss in the next chapter, in reality, the reform has fallen far short of expectations. In other areas, even where there has been effective capacity-building, subsequent policy has undermined this. A prime example is the work of CAFAO, which was active in strengthening the entity customs and taxation administrations since 1997, through relatively intensive and detailed mentoring and on-the-job peer trainings. With the merger of the entity indirect taxation administrations and the establishment of a single Indirect Taxation Authority in 2004, many of the staff trained by CAFAO found themselves unemployed, the victims of internal ‘restructuring’. That some officials must loose their jobs in the process of merger and ‘right’ sizing is not a surprise. However, it is alleged in several cases that political parties interfered in the internal restructuring process in the new ITA, favouring political cronies for positions over individuals with a track record of exposing corruption and tax fraud. Having trained these individuals over a number of years, CAFAO was unable to prevent their marginalisation and sometimes elimination from the new state authority. In other areas, the international community has simply substituted for the state institutions because their capacity is low or sometimes non-existent.

ii. The substitution effect

(a) Political negotiations

In the face of a weak, divided and politicised state administration, the international community has often decided simply to over-ride domestic structures rather than to work with them, or allow them to take responsibility for reforms. While this policy has undoubtedly produced faster and, in some ways, better formal short-term results, the implications for the longer-term sustainability of IC-sponsored reforms are less optimistic. The worst excesses of international ‘substitution’ are no longer in evidence. Gone are the days when entire pieces of legislation were drafted in OHR and imposed, sometimes without even the pretence of parliamentary discussion. International organisations and domestic interest groups no longer direct pleas for reform and legislative change to the High Representative, but are forced to work with the BiH institutions, albeit with mixed results. Moreover, some joint policy making, though negotiated with international mediation and assisted by international technical expertise, can produce genuinely cooperative projects that domestic stakeholders feel ownership of. However, serious problems of international ‘substitution’ remain. The most obvious and difficult of these habits to break is international facilitation of negotiations between the BiH parties on key reforms. Recent reports of the failed talks on police reform are instructive, as they place as much, if not more responsibility on OHR for failing to broker an agreement between the parties, as they do on BiH political leaders. This reflects a reality in which OHR has facilitated negotiations between the parties on every state-building reform since Dayton. The extent of international, particularly

OHR involvement in the promotion of domestic compliance with international obligations and conditions, particularly EU and NATO requirements, is often underestimated. The OHR has employed a catalogue of formal and informal threats and incentives to urge the parties towards agreement. Just one example is defence reform, where, in addition to detailed NATO Partnership for Peace membership conditions (the carrot), at least three scandals of international proportions were used by OHR to solicit RS support for defence reform. OHR used RS complicity in these scandals to pose credible threats against individuals, parties and institutions of the RS, in the case of non-compliance with international conditions. First, the ‘Orao’ affair in 2003-4 exposed the involvement of an RS government owned company in the illegal sale of arms and spare parts to Iraq, in breach of the UN Security Council resolution. Second, the 2004 report of the Srebrenica Commission, formally established by the RS government, exposed the role of the RS army (VRS) and other organs of the RS government in the 1995 genocide. Third, the continuing failure of the RS to arrest ICTY indictees and evidence that the RS army was continuing to provide support to indicted war criminals, repeatedly held up BiH’s PfP membership. Each of these events were used at various points by the High Representative to launch, speed up and solicit domestic support for defence reform, and were accompanied by mass High Representative removals of RS public figures and various punitive measures including bans on party financing to the governing SDS party and visa bans on individuals. Given the difficulty with which OHR has solicited RS support for state-building, despite credible threats and incentives (particularly EU and NATO membership), the capacity and willingness of the RS parties to engage in sensitive state-building reforms, or even sustain those adopted so far, in a future without the Bonn Powers is a critical and open question.

(b) Policy setting

There are other, less obvious, but important, areas in which international intervention continues to dominate the conduct of governance in BiH. Policy-setting is one such area. International organisations have conceptualised and drafted all common state policy documents since Dayton, with the partial exception of the Poverty Reduction Strategy. From Justice and Jobs to the SAA conditions, all documents that have received the support of the BiH government and parliament are international creations. While these agendas have succeeded in soliciting domestic and international support for several state-building reforms, international policy that has been developed largely in isolation has actually undermined the implementation of many reforms. In addition to plain political obstruction, reforms often fit awkwardly into domestic structures, including the budgetary landscape, and usually lack genuine domestic institutional support and understanding. The unfortunate combination of little or no domestic policy planning capacity, paired with international planning that fails to look beyond the immediate priority of establishing institutions, has contributed to and reinforced the virtual aspects of BiH governance. One indication of this can be seen in the type of legislative activities undertaken by the BiH Parliament. Over a three year period, between the end of 2002 and beginning of 2006, 50% of the entire legislative activity of the BiH Parliament was spent on amending existing laws. Given the small number of laws adopted at the state level, this means that a high proportion of all BiH laws have been changed, sometimes repeatedly and by the same Parliament that originally adopted them. This is certainly less a reflection of policy innovation and more an indication of poor initial planning. The impact of OHR’s withdrawal from many aspects of the policy planning process is only now becoming obvious, given the present High Representative’s policy of intervening less in domestic governance. What emerges is both a lack of political will at state level to develop and execute common policies and a critical lack of technical expertise in the state Ministries to assist in this process.

We have discussed the lack of sufficient and appropriate staffing in the BiH institutions, the impact of international ‘substitution’ and the cycle of dependence this has created. It is clear that insufficient international attention has been directed to capacity-building in its most basic form, given the number of state-level institutions that continue to be seriously under-staffed. As international organisations continue to set policy, coordinate legislative drafting and supervise implementation in many sectors, there is often little pressure brought to bear on the authorities even simply to staff institutions. This also applies to the development of domestic fora and mechanisms for inter-governmental cooperation and coordination. In their absence, international-sponsored working groups have coordinated state-entity consultations in several different sectors, and ensured that joint policy is implemented at lower levels of government. Continued international intervention draws attention away from the need for domestic mechanisms to facilitate state-entity interaction. As the international community progressively withdraws from different policy areas, the need for these mechanisms will become increasingly obvious and urgent.

57 Legislation adopted between 3 December 2002 and 21 February 2006; source Information and Documentation Service of the Parliamentary Assembly of BiH
C. Lack of joined-up IC policy

Systemic and implementation problems aside, the international community’s formal commitment since Dayton to creating a stronger and more functional state administration may, in retrospect, seem clear and consistent. However, in reality, the international agenda is less coherent and cohesive. Some international policies have seriously undermined state-building, pitting one international organisation directly against another. In other ways, and sometimes with the best of intentions, the international presence in BiH has undermined the very state institutions they have fought to establish. As an example of this, we examine the disconnect between international state-building efforts and international financial policy in BiH.

Financial leverage

If money is power, the BiH state’s lack of it and the international community’s failure to use vast amounts of post-war financial assistance to promote state-building, have resulted in several missed opportunities for strengthening the state. Bilateral and multilateral sponsors of peace implementation have generally failed to use economic sanctions and positive financial conditionality to promote state-building. Perhaps more seriously, international organisations have applied financial conditionality that actually contradicts and undermines the state-building agenda, effectively promoting entity-building instead. The International Monetary Fund (IMF) has been the most obvious offender in the regard. In their disbursement of the Stand-by, the IMF negotiated bilaterally with the entities, treating them as essentially sovereign counterparts and, until relatively recently, their dealings with the puny state were a mere after-thought. When the state began to acquire more competencies and institutions from 2000 onwards, rather than insisting that the overall cost of public administration should be cut across the country, by, for example, cutting out overlapping functions at entity level – a policy which would have been in line with the aims of the state-building agenda and the public administration reform process – the IMF instead continued to view the operation of the state and entities separately and tended simply to insist on the containment of the growth of the state institutions. In 2004, for example, as a condition of the Stand-by, the IMF insisted on a reduction in state-level salaries, ignoring arguments that competitive salaries were necessary to attract candidates to the civil service from across BiH. To insist that state salaries (a very small percentage of overall public administration costs in BiH) be cut rather than encouraging or requiring the elimination of duplicative and overlapping functions and positions at entity-level typifies a critical lack of coordination and joined policy-making in the international community. The IMF’s entity-centric approach was also reflected in their strong opposition to the introduction of a single Value Added Tax for BiH. Until strong international pressure was brought to bear on the IMF, the organisation lobbied hard for the retention of indirect taxation at entity level and offered no other solution for guaranteeing own revenues for the state of BiH.

As well as directing much financial assistance, and thus political power, to the entities, until the transfer of indirect taxation matters to the BiH state in 2004, the international community did little to support the state’s acquisition of independent financial means. Although the May 2000 PIC declaration called for the establishment of a BiH treasury and urged international funds to be channelled through the treasury, the latter has not happened. Even recent attempts, sponsored by the international community, to set up a Return Fund at state-level through which international donations would be channelled, has failed to attract international donor interest. This has deprived the state of a valuable tool which would have enabled it to assert greater levels of authority and autonomy, forcing more serious and committed participation in the state decision-making process from both entities. If international funds had been channelled through the state, disbursement of funds to lower levels of government could, for example, have been conditioned on their compliance in other areas of state activity.

58 Over-reliance on the High Representative to legislate in place of the domestic authorities and to use powers of sanction to remove obstructers, partly explain the failure to use classic tools of sanction and incentive in BiH. Much has been written about how the use of High Representative legislative powers disincentives domestic compromise but the High Representative’s Bonn Powers have created a distorted incentive structure for both BiH politicians and international organisations. The international community became just as addicted to the use and threatened use of the Bonn Powers by the High Representative as domestic authorities, choosing to lobby for the ‘quick fix’ of High Representative imposition, rather than engaging in the more difficult process of soliciting domestic agreement. One of the most striking of these was the imposition of the entire 2003 FBiH annual budget, which was imposed to meet the IMF Stand-by conditions.
3. Chinks of light: examples of successful state-building

Despite the significant challenges facing the BiH state, there have been some successful advances in ‘normalising’ its functioning since Dayton. Broadly three factors have contributed to the relative success of these state-building reforms: (i) clear division of competencies (ii) effective state enforcement capacity (iii) targeted international assistance. In summary, state institutions tend to function most effectively where competencies are held exclusively by the state, the need for cooperation with the entity level is minimised and if international efforts have focused not simply on adoption of legislation but on institutional development with targeted international support. This indicates that there is nothing inherently unviable about governance at the state-level in BiH. The legacy of the war does not mean that common inter-ethnic structures at state level are doomed to lack popular legitimacy. Rather, state institutions can function effectively if certain conditions are in place.

A. Clear division of competencies

The competencies of one level of government cannot be hermetically sealed from another. This is especially true in BiH, where even many of the state’s ‘exclusive’ competencies require inter-entity coordination and close state cooperation with entity structures, for example, in inter-entity criminal law enforcement and inter-entity transport. However, state institutions tend to function best where the need for cooperation with the entities in minimised and the state’s independent room for manoeuvre is greatest. Although the state continues to be saddled with cumbersome decision-making procedures and a public administration divided on ethnic lines, some state institutions which hold clear competencies in both policy-making and implementation are functioning as well, if not better, than entity institutions.

It is premature to produce a comprehensive assessment of the functioning of new state institutions such as the Independent Taxation Authority (ITA). However, initial indications show that some of the main arguments used to oppose the transfer of indirect taxation matters to the state have proved to have little basis in reality. Both officials from the RS and some international organisations claimed, for example, that levels of inter-entity and inter-ethnic trust were so low in BiH that there would be much lower compliance and tax collection rates under a common system. In fact, per head, each officer in new ITA collects eight times more revenue than the entity services did. Accounting for statistical effects, this is in practice means around five times more revenue is collected per employee than under the old system. Although the increase in revenue is partly to do with the fact that a VAT system yields more than the old sales tax, large efficiency gains have undoubtedly been made through having a more efficient and united single system.

The inherent difficulties of sharing responsibilities in one sector between the state and entities are also evident in the area of defence reform. The cooperative system of defence sector management in BiH was abolished in favour of a single state-level structure after it became clear that the entity defence structures were unable or unwilling to implement state-level directives and policy. Justifying a move to a single system under the control of one BiH Ministry of Defence, the report of the Defence Reform Commission critiqued the way in which formal state-level control and policy-setting was undermined in practice by entity structures: “Control over the day-to-day running of the armed forces… remained at the entity level, which retained the majority of personnel, logistics, and training functions. The state’s authority in administrative areas was limited to setting standards, and by the end of 2004 it had become clear that attempts to exercise even this limited authority were meeting considerable institutional inertia. This situation, coupled with unrelated evidence that elements of the operational administrative chains of command were not fully under wither state or entity control, resulted in the Defence Reform Commission’s current mandate to consolidate the two chains of command under full state-level control.”59 While the incorporation of entity Ministries into a single structure is on-going, and there has been entity-level institutional blockage of the restructuring process, some initial signs are encouraging. For example, there have been significantly more applications from soldiers to join units that cross the inter-entity boundary line rather than those that remain within entity boundaries. While this is undoubtedly largely due to the fact that remuneration packages are more attractive in units that cross the IEBL, it nonetheless demonstrates that a single state structure with the right incentives in place can create the basis for functional integration of even the most antagonistic and divided of entity structures in BiH.

B. Effective state enforcement capacity

The second condition that seems to be critical to the proper functioning of state institutions is effective enforcement capacity. As we have seen, enforcement is generally worst where the state shares competencies with the entities and there are no formal mechanisms at state-level to require compliance (the poor record on framework law harmonisation and implementation at entity level is one example of this). On the other hand, where the authority of the state has been established early with international support, and does not depend on sharing policy and implementation tasks with the entities, there is generally a high degree of institutional credibility, with high compliance rates with state decisions across the country. Examples of such institutions include the BiH Election Commission, which is responsible for implementing the BiH Election Law directly (with municipal authorities and only minimal input from entity Election Commissions) and has sole responsibility for implementing the Laws on Party Financing and Conflict of Interest across the country. Other examples include the Communications Regulatory Agency, the High Judicial and Prosecutorial Council and the CIPS project, all of which successfully implement policy across the country with little or no requirement of cooperation with the entities. It is no coincidence that each of these institutions either started life under international or quasi-international management (CRA, HJPC, Election Commission), or with significant international backing and assistance (CIPS) (the following section assesses the role of international assistance in developing effective state institutions).

Effective enforcement of matters within the state’s competencies is also facilitated where there are effective judicial mechanisms in place to uphold state-level decisions. Decisions of the CRA and BiH Election Commission have been upheld frequently by various courts in BiH, and are generally complied with following the completion of judicial proceedings. The BiH government has also referred some cases of entity non-compliance to the Constitutional Court of BiH, which has ruled on the legality of entity legislation that infringes on the competency of the state. This resulted in the important Constitutional Court decision described above, which ruled that FBiH legislation on indirect taxation matters was in direct violation of the state’s competencies, given the earlier transfer of competencies from the entities to the state on indirect taxation matters and the adoption of the Law on the ITA.

The Constitutional Court is able to place an interim freeze on the application of legislation at any level of government in BiH that may be in violation with the BiH constitution, until a final ruling had been made. If the Court rules that a piece of legislation violates the BiH constitution, a freeze on its application is extended until such time as the offending entity has changed its legislation in accordance with the Court’s decision. The Chair of the Council of Ministers submitted the FBiH violation in 2004 to the Constitutional Court at the suggestion of OHR, and although the constitutional court could be called upon more frequently to rule on the legality of entity legislation that fails to conform to state legislation, the BiH authorities rarely use this mechanism, whether for political reasons or as a result of general inertia. More frequent use of the Constitutional Court would certainly place a heavy burden on the institution, and therefore it is arguable that other judicial and enforcement mechanisms should be exhausted first before the Constitutional Court is called upon.

C. Effective International Assistance

A third factor that has contributed to deeper and more effective institutionalisation of competencies at state level is targeted international assistance, in terms of both political and technical support. The international community has been widely criticised for contributing to the virtual nature of the BiH state, both in terms of its habit of substituting for the BiH authorities and a more general failure to assist the state in acquiring and developing the institutional means to implement policy effectively. There are, however, examples of international intervention in BiH that have been effective in gradually strengthening and empowering domestic institutions to take over meaningful governing responsibilities. Just as international assistance is only of minor assistance if the formal division of competencies between the state and entities lacks a clear hierarchy and division of tasks, using High Representative powers or pressure to establish the legislative basis for new institutions has generally been effective only if legislation is accompanied by institutional development plans with continued and targeted international assistance. The institutions mentioned above – Election Commission, CRA, HJPC and CIPS – were in whole or part managed by the international community, with mainly BiH staffs, in their early years and have now transitioned fully into

60 The Law on Conflict of Interest (OG 16/02) was envisaged as a framework law. However, in practice, implementation has been considered an exclusive competency of the BiH Election Commission, with support of the international community. This has created a relatively functional system which applies uniform standards on public officials throughout the country.

61 BiH Constitutional Court Case No. U-14/04
BiH institutions, budgeted for and responsible to the Council of Ministers. The transition from international to domestic status has not been without problems and has exposed, for example, the difficulty of transposing international organisations with significantly higher budgets and salaries, for example, into the domestic system where institutional and budgetary constraints are high. The effective insulation of many of these organisations from political control and pressure during their status as (quasi) international bodies has also been problematic. That these organisations must give up some aspects of control and independence to the system of domestic checks and balances is desirable: they must become accountable and responsible to BiH institutions. However, it remains to be seen whether these institutions can maintain relatively high levels of professionalism and impartiality once their international sponsors leave BiH. What the functioning of these institutions undoubtedly demonstrates is that professional, merit-based recruitment of BiH administrators coupled with initial international support and development, makes for effective institutional functioning. Significantly, these state institutions are not plagued by ethnic division and parallel reporting lines, but generally function as effective, integrated institutions.

Effective international support is thus important for institutional development and credibility. However all the international support in the world will not solve the basic problem of many state institutions which are hampered by bad institutional design and unclear lines of state responsibility vis a vis other levels of government. In these cases, where implementation appears to be effective, international assistance is often the only thing holding the system together.
“The BiH administration remains fragmented, poorly equipped, the personnel lacks professional qualifications and are still often politically nominated. There are administrative overlaps and coordination between the different levels of administrations still lacking. The respective legal framework remains incompatible across the different levels”\(^{62}\).

1. Introduction

The general view of public administration in Bosnia and Herzegovina is that it is cumbersome, inefficient and expensive. This report will not repeat the findings of several recent analyses of the dire state of public administration in the country. Rather, we will look in detail at a critical but neglected area: namely, the way in which various

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efforts at public administration reform in BiH have failed to complement the requirements of the state-building agenda, and the ways in which the unreformed status quo is seriously jeopardizing the credibility of the state institutions. International officials and domestic politicians have generally failed to grasp, or choose to ignore, the fact that a functional public administration is a critical segment of the state building process. The complex constitutional and political systems in post-Dayton Bosnia have a direct and negative impact on the public administration, and vice versa. The BiH institutions remain fragile and weak, contributing to the general lack of credibility and legitimacy of the state. The intensive state building agenda sponsored by OHR and the international community has often been the subject of heavy political trade-offs and political concessions, resulting in a complex system of ‘institutional layering’ in which pre-war, wartime and post-war institutions have been allowed to coexist, with serious mandate and authority overlaps. Streamlining these authorities has generally not been a pressing international or domestic political priority. In order to function, this web of interconnected and interdependent authorities would require a high level of political will and consensus, an accountable political and administrative leadership and a sophisticated civil service capable of managing delicate inter-governmental relations and institutions. In the absence of each if these criteria in BiH, the international community has been the glue holding the system – to some extent – together.

A functioning, streamlined public administration is a prerequisite for effective governance and economic growth in BiH. However, politicians tend to regard improvements in the public administration as just one on a list of EU integration requirements (and not even a particularly high priority on the list), rather than condicio sine qua non for the country’s development beyond the status of de facto international protectorate. The deficiencies of the public administration are glaringly obvious and it is well-known that the complex administration sucks up funds which could otherwise be directed to pensions, education, health and other social benefits. However, instead of mounting public pressure for change, there seems to be ever growing passivism among the general public. Citizens’ trust in the effectiveness and impartiality of public administration in BiH is so low that often entitlements and requests are not even pursued. In this apathetic environment, public administration reform efforts are lead, albeit half-heartedly, by international organizations rather than BiH decision-makers. The divided and aid-dependent post-conflict environment sustains and promotes this charade.

This chapter explores some of these contradictions at the heart of public administration reform efforts in BiH, evaluates achievements and problems to date and examines possible ways forward, including measures that may strengthen the environment in which PAR takes place. We draw heavily on in-depth interviews with key decision-makers in the BiH public administration and international community, as well as the findings of the many technical reviews commissioned to date on PAR.

2. Public administration reform in Bosnia and Herzegovina: how the process became disconnected from pressing priorities

A. PAR: a brief history

The formal structured process of Public Administration Reform in BiH was launched in March 2003 with the publication of the so-called Public Administration Reform Commitments. This document was formally presented by the then Chair of the Council of Ministers, Adnan Terzic, to the March 2003 meeting of the Peace Implementation Council. However, the document was largely drafted in OHR, with some input from other international organizations, and almost no input from the BiH authorities. With international pressure, and amidst tension between the OHR and EC on how the process should be taken forward, OHR translated the PAR commitments into an organizational framework headed by a PAR coordinator, formally responsible to the BiH Minister of Justice,
that included a number of mixed domestic and international working groups tasked with developing a comprehensive PAR strategy, aimed at producing an efficient, effective and transparent public administration. The working groups were tasked to address the following problems:

- The fragmentation of government structures, with many overlapping functions and a lack of coordination between agencies;
- The disconnect between 13 parallel jurisdictions in Bosnia and Herzegovina;
- The unclear lines of accountability with weak reinforcement mechanisms;
- The very poor policy development and coordination management capacity;
- The lack of experienced professional staff with the necessary skills;
- The lack of robust procedures for recruitment and appointment on merit, which has led to a high level of patronage-based appointments;
- Slow and outdated administrative systems.
- The need for a pay and grading structure which attracts, retains and motivates civil servants;
- The need to develop sound HR policies and system of performance management.

Having written the PAR commitments and organized a web of working groups with international and domestic participation to draft a PAR strategy, the OHR quickly, and largely unexpectedly, withdrew from the PAR process it had created. At root, there was insufficient commitment within OHR to deal with the complex problems of the public administration and skepticism that this was a task that OHR either could or should take on given constraints of time, resources and mandate. The launch of an ambitious state-building agenda, which was to include defence and intelligence reform, and the introduction of VAT as an own source of state revenue, was considered of much more pressing importance. In addition, the EC was opposed to the OHR-lead PAR structure and insisted that it overlapped with the series of functional reviews of vertical and horizontal government functions that the EC would launch in 2003/2004. The PAR process established by OHR thus ground to a halt and actions were put on hold pending the outcome of the EC functional reviews in 2004/5.

This inauspicious start to the PAR process points to three basic problems which continue to hamper reform efforts. First, the reform was born on desks at OHR with little or no input from the BiH authorities. Secondly, the process was divided and weakened from the outset by competing short-term visions of the process in the international community and basic reluctance on the part of donors to coordinate their activities. Thirdly, neither OHR nor the BiH authorities considered PAR an essential part of the state-building process. One donor representative characterizing the period stated that “it was worst of bad practice... there was no desire nor time to think about the long term goals, nor patience to understand what was already there, what could work, what was the starting point or assessment of capacity we were working with”.

Bosnia and Herzegovina and its Entities entered the public administration process less than half-heartedly, making empty commitments that were written for them in OHR, with no clear idea of the issues at stake nor what they wanted to achieve from the reform. Lack of domestic clarity was mirrored in the international community. Donors funded programs without regard for their strategic importance, particularly in relation to state-building. There was no agreed strategic framework within which programs could be developed and coordinated in order to achieve a common set of goals. Only recently, with the adoption of the Public Administration Reform Strategy in the summer of 2006, has a meaningful and coherent framework for PAR been established, on paper at least.

Despite the relatively late introduction of a formal PAR process in 2003, there were some significant ongoing attempts to improve the effectiveness of the public administration before this. Civil Service reform was the most ambitious and potentially far-reaching of these measures. Despite ambitious hopes, however, the process has been characterized by a series of missed opportunities.

### B. Civil Service reform

Reform of the civil service, an integral part of wider public administration reform, began in BiH in 2002. The overall aim of the reform was to create a professional, merit-based civil service at the state and entity levels. The first phase of the reform envisaged the development of a legal framework for the civil service, a personnel management system and robust training program for all civil servants. In 2002, Civil Service Laws were adopted by the
Governance structures in Bosnia and Herzegovina

RS and imposed by the OHR at state level. The Federation Civil Service Law was adopted in 2003. Three Civil Service Agencies were created and charged with central management of the civil service at their respective levels of government. It was anticipated that the legal frameworks put in place would help to protect civil servants from political pressure, secure the tenure of civil servants, rid the administration of incompetent officials through a review process, attract young and competent professionals into the civil service and recruit more suitable candidates to key posts in the civil service.

Almost immediately upon launch, establishment of both the BiH Civil Service Agency (BiH CSA) and the PAR coordinator’s office — the key institutions responsible for the reform process — ran into difficulties. Implementation of both projects was slower and more difficult than anticipated. Before implementation could commence, it took more than a year to recruit senior management staff and fill key positions in the CSA and PAR coordinator’s office. The progress of implementation was even slower in most ministries, as it was difficult for senior staff to understand procedures and establish teams with the right competencies.

Although no policy document was produced that defined the overall aims of the reform, the initial intention of the drafters was to create a so-called position-based civil service system, with some limited characteristics of a career based system65. By opening vacant civil service positions to candidates outside the civil service, the intention was to create a wider pool of candidates with specialist skills for advertised positions, promoting competition and a higher quality of applicant. The rational behind this was that the BiH administration could not afford to wait for a new generation of civil servants to emerge through a career based system. On the contrary, the administration, particularly the senior management level, urgently needed the injection of fresh blood and modern managerial solutions in order to shake up a passive and reactive administrative culture and increase efficiency and effectiveness. However, in order for this system to realize its potential, several conditions had to be in place.

a) There must be an adequate pool of potential candidates in the market to recruit from;  
b) Salary scale and benefits package should be sufficiently competitive to attract qualified new blood into the civil service;  
c) The most pressing needs of the civil service must be carefully assessed and known in order to seek candidates of an appropriate profile;  
d) There must be sufficient number of key posts in key institutions which can absorb new professionals; and  
e) The selection of candidates should be conducted through a transparent and merit based procedure.

Unfortunately, these criteria were not in place prior to the adoption of the Civil Service laws, and little attempt was made to create and promote these conditions during the process of implementation. Indeed, sometimes, directly contradictory conditions prevailed that were exacerbated, intentionally or unintentionally, by way in which legislation was implemented.

(a) and (b) The potential pool of skilled candidates for civil service positions has been seriously reduced given the heavy presence of international organizations in BiH which distorts the labour market for younger, qualified professionals. Civil service careers, even at the marginally better paid state-level, are not competitive in this context, and will remain so as long as there is little space in the budget to increase salaries so as to attract or retain appropriate people. Notwithstanding these budgetary constraints, there has been no trace of creative thinking about alternative ways of making civil service careers more attractive that might potentially compensate for salary levels. On the contrary, the conduct of the recruitment process lead many qualified individuals to conclude that civil service reform had done little to introduce merit-based recruitment and that the ‘old guard’ were still firmly in control.

(c) No staffing plan was developed to reflect even the immediate needs of the public administration. The Civil Service agencies are entrusted with the potentially powerful authority to evaluate and comment on the systematization of civil service positions, both new and existing posts. This valuable tool could have been used not only to improve the profile of candidates for vacant posts, but also to develop a sound system of performance appraisal – based on informed and objective performance and skills-based criteria – for civil servants already in post. However, the civil service agencies have generally carried out this task in a very formalistic manner, without proper regard for the content of responsibilities enumerated in each position and their relationship to key problems in individual

65 For example, there are provisions in the law which allow internal transfer to replace the open competition in cases where suitable candidates can be identified within the administration.
institutions and across the administration. For example, one would expect that the skills required of a senior civil servant holding a position in a state level ministry which has exclusive jurisdiction over a particular matter, may be different from those required of a manager serving a ministry which shares powers with entity and cantonal levels. Also, the requirements of positions in a ministry may require different skills and competencies compared to those required by executive agencies, for example.

Most European countries which have position based systems have paid close attention to the reform of senior civil service positions and their proper design, given that getting this echelon of the public administration right will have far reaching impact on all other aspects of the reform. The review and revalidation of senior civil servants in BiH was carried out by the civil service agencies in the absence of any guidelines as to what each of the posts require in terms of professional skills. No human resources policies were in place to guide the revalidation process and it was undertaken without regard for a wider needs assessment. Therefore, in many cases there is a serious mismatch between the actual requirements of posts and the professional suitability of the individuals serving in them.

(d) The position based system in BiH has been further prevented from fulfilling its potential given that there is an insufficient number of vacant civil service posts to absorb new professionals. Given the highly politicized process of recruitment prior to the adoption of the new legislation – particularly in key managerial posts – one aim of the new legislation was to discredit inappropriate appointments and open up key posts to open competition. However, in practice, the opposite happened. The vast majority of previous appointments were validated and incumbents granted security of tenure in their positions. The decision to conduct the review of all civil service posts immediately after the adoption of the law caused several problems. First, the young, weakly institutionalized civil service agencies did not have the capacity to conduct a comprehensive review. A proper review, in the spirit of the law and the position-based system, should have had a much wider scope than simply evaluating the procedural grounds of appointment and compatibility with the rules in force. The review should also have evaluated each candidate’s profile and performance against a set of values and skills appropriate to each post. However, the young agencies interpreted the law very narrowly and looked only for procedural inconsistencies and compatibility with basic benchmarks. The result of the review process was that very few civil servants were disqualified from their positions and, as a result, only a very limited number of key managerial posts became available for open competition.

(e) Following the review, most senior managers remained in position, many of whom had close links to the governing political parties. Therefore a valuable opportunity to break ethnic and political reporting lines and loyalties in the institutions was lost. The recruitment process for new positions has also been subject to much criticism. There are continuing and widespread claims that the recruitment process for vacant positions run by the civil service agencies is subject to political manipulation, particularly in the case of managerial positions. Indeed, in the aftermath of the 2002 general election, the Council of Ministers knowingly subverted the civil service law and appointed individuals to the positions of Secretaries of the Ministries without the involvement of the BiH civil service agency. Following international pressure, the appointments were withdrawn and an ‘open’ competition launched for the same positions. Following a lengthy process, almost exactly the same candidates emerged through the nominally open and merit-based civil service recruitment process and were once again – only this time ‘legally’ – appointed to the same positions. Although it is difficult to substantiate claims of political interference in the recruitment process for lower level positions, both sources within the domestic institutions and the international community stated that there is a strong belief in the administration that questions for written exams are given in advance to “preferred candidates” placing them in a favorable position relative to other competitors. It is also evident that ethnicity, which in the BiH context generally translates into political affiliation, generally overrides considerations of merit. This is especially true in the case of managerial appointments. Party politics

NATIONAL TENSION IS EVERYWHERE, IT’S UNBELIEVABLE. AND THAT STRUCTURE COMES FROM NATIONALISM; THE SITUATION IS UNSUSTAINABLE.
– Doboj, male
therefore continues to play a large role in the civil service. In this environment, management of the institutions is generally conducted according to party and ethnic affiliation, rather than on functional lines, and there is significant political resistance to efforts designed to effect improvements in the management of institutions.

C. Capacity-building, or lack of it

Following the completion of the review process, the civil service agencies were expected to assist in the design of training programs for civil servants. However, the same problems that affected the review process have undermined the effectiveness of training provided. No strategic assessment of training needs has been conducted that attempts to identify, let alone address the acute problems of the public administration. Training programs have been neither strategically focused nor fully demand driven and civil servants see little incentive to participate in them, particularly at senior levels. Inertia is widespread. The vast majority of civil servants were revalidated through the review process and now have security of tenure. They see little need to improve their skills. Continued political and ethnic patronage in managerial posts results in opaque, informal lines of reporting and makes meaningful implementation of performance appraisal mechanisms difficult. Numerous bilateral and multilateral donor programs and trainings have been inserted into this chaotic mix. Much of this assistance has been overlapping and designed on the basis of universal best practice rather than to stimulate solutions tailored for the specifics of the BiH situation.

More generally, institutional accountability and incentives for institutional improvement within the civil service have also been weakened by the very international organizations that have supported the formal development of the civil service. As the genesis of the PAR process demonstrates, the vast majority of policy priorities and legislative projects in post-war BiH have been triggered, developed and even in part implemented by the international community. Not only BiH politicians, but the entire state administration has been over-ridden by the international community which has managed, coordinated and even in part implemented the majority of reform programs. One consequence of this is that domestic institutions have little room – or indeed need – to develop the competencies and technical expertise to develop, coordinate, implement and assess policy. The public administration at state level in particular, has become accustomed to and in many ways dependent on international intervention, and the administration’s weaknesses have been in part disguised by the substitution of internationals.

In conclusion, during this period, civil service reform and wider PAR efforts were characterized by piecemeal initiatives and paper reforms that generally failed to grasp and deal with the real and acute problems of the public administration in BiH.

D. Functional reviews

So-called ‘functional reviews’ of eight vertical and six horizontal sectors or functions of government in BiH were launched in 2004 by the European Commission, in formal partnership with the BiH authorities at all levels. These reviews were to be used as a basis for simplifying and streamlining functions, improving coordination among various levels of government, and improving strategy and policy making processes and separating them from implementation and operational functions. The findings and recommendations of the reviews were to create the foundations of the future PAR Strategy. In retrospect, it is clear that these reviews should have constituted the first phase and point of departure of the entire PAR process.

Functional reviews are one valuable tool that is commonly used in the PAR processes in order to provide an analytical basis and guide for the reform. They have the following primary functions:

a) Redefinition of the roles, missions and tasks of different level of administration;

b) Establishing the appropriate role for the government in any particular sector or function, at different levels, that includes identifying:
   • redundant functions;
   • duplication between and within the institutions at various level;
   • missing functions;
   • functions that could be rationalized from numerous units to a single unit.

c) Identification of inconsistencies and omissions in the legal framework that units from performing their functions;

66 Public Administration Reform, Practice note, UNDP www.undp.org/policy/praticenotes.htm
d) Review of the match between the functions and the staff engaged in performing it;
e) Proposing areas for improving horizontal coordination between units with complementary or dependent functions.

This review analysis provides the basis for exploring higher-level policy options, such as:

a) Opportunities for improving the policy making process and separating policy making from implementation;
b) Gains that could be realized through introducing elements of competition and performance management in service delivery;
c) Areas for effective gains through a reduced role of the various levels of government and opportunities for staff reductions, etc.

The functional and system reviews have reconfirmed the existence of well-known deficiencies in the BiH public administration. The main findings which are found in all the reviews and are of particular relevance to this study are the following:

- There is significant overlap, redundancy, and duplication among various levels of government and there are some key functions that are completely missing. Many formal government functions are not performed by staff due to lack of knowledge and capacity.
- Planning and coordination, legislative drafting, as well as some basic managerial techniques which are vital for better institutional performance are seriously underdeveloped.
- There is an evident lack of domestic responsibility and capacity to undertake policy development. A serious challenge remains creating incentives for the State and Entity governments to assume a coordinated policy-setting role.
- In all federal systems, appropriate mechanisms must be in place through which the policy, plans and resources of various levels of governments are linked together. These functions can be provided by centres of government. In BiH centres of government are weak, disintegrated and often made up of a large number of offices that barely coordinate among themselves let alone horizontally or vertically.
- Professionalism, accountability and efficiency in the civil service is seriously undermined by a complex structure and overlapping responsibilities, outdated legislation on Administrative Procedures, and the absence of adequate professional development programs. Merit base recruitment is still undermined by the constitutional obligations of proportional representation and ethnic balance. There is a salary discrepancy which hampers development of a cohesive civil service across the country with mobility between its parts.
- Management of the Civil Service is still hampered by weak Civil Service Agencies. Central human resource management units represent a novelty in local administrative culture therefore more time and efforts need to be invested in their strengthening in order to prove their usefulness.
- Public expenditure management still remains a key deficiency directly impacting on the efficiency and effectiveness of the administration and seriously undermining economic growth. The institutional/constitutional setting is very complex and ineffective. Long term financial planning is absent, and the budget is in not well linked to policy making nor is it used as a priority-setting tool. Most ministries lack staff qualified to improve the situation.

3. Public Administration Reform Strategy

In 2006, the PAR process was redesigned to take on board lessons learnt. The state and entity governments adopted a revised PAR strategy in the summer of 2006, launching a new phase in the reform process. The strategy aims to improve the functioning of the Public Administration in BiH over the next decade. The strategy acknowledges that reform is a condition for future EU integration and that its implementation will be closely monitored by responsible authorities. This PAR strategy has been organized in five pillars, each of which represent core administrative competencies necessary for good governance. A brief description of the key pillars is provided below:

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67 Id.
Policy-Making and Coordination Capacities
A major priority in the administrative reform process is to develop central policymaking and coordination capacities on all levels, in order to ensure coherence and consistency among various policies and informed decision-making. The reform of central policy capacity will require new organizational arrangements, procedures, staffing, and development of coordination capacity for the government Secretariats. Moreover, in the context of BiH – with its complex constitutional set-up and multiple layers of governments – there is a strong need to rely on well-developed capacities for linkages and coordination between different levels of government. The reform of central policy capacity needs to proceed in parallel with increasing policy capacity in ministries; ministries are the bodies that primarily develop policies and legislation within their areas of competence. They need to improve the capacity to take sufficient account of government priorities, especially priorities related to harmonization with EU legislation, develop policy proposals, consult and assess possible impacts, and draft high quality legal acts.

Public Finance
Public Finance is an area that is closely linked to EU requirements, on the budget process, and on the principles, standards and methods of public internal financial control (PIFC). In the past years the area of Public Finance has been subject to various reforms. However, the reforms were not entered into in a strategic and overarching manner. In order to promote a public administration that is open, efficient, effective and accountable, it is necessary to consolidate and further existing efforts in the PF sector, establish an efficient financial management system, and strengthen the control environment within which the administration operates.

Human Resource Management
Human resources are the most important capital in public administration. Achievement of the highest quality in the area of human resources management is the biggest challenge. The goal is to develop a professional, politically impartial, ethical, stable and officiating public service, which is respected and able to deliver effective services to both Governments and citizens. The most important objective is to ensure the continued harmonization and development and modernization of human resources policy for both the immediate and longer term. The key element is strengthening the policy role of the CSAs and Brcko HR Unit to create effective bodies that are responsible for HRM policymaking, defining general objectives and priorities in HR development, securing specialized HRM capacity in individual institutions, and developing understanding of managers of modern HRM policies so that they are more actively involved in the development and motivation of staff, introducing and implementing procedures for effective HR planning in and across institutions to enable efficient delivery of institutional and Government priorities; investing in personnel with appropriate knowledge and skills on the basis of efficient, transparent recruitment procedures; development planning based on regular identification of needs for training and development; changing the salary structure across BiH so as to make it more attractive for existing and prospective employees and ensuring single common approach across BiH enabling both transfers and harmonization of salary. The reform will accelerate the efficiency of public administration on the basis of greater affiliation, motivation, and competitiveness of employees. This is a key component of meeting the challenge to which membership in the European Union presents.

Administrative Procedure
The reform of administrative decision-making is central to ensuring efficiency, effectiveness, and predictability of public administration in delivering public services to the society. The main pillar of the reform is administrative simplification, which requires legislative, organizational, IT, and capacity-building measures.

Institutional Communication
Institutional communication is geared towards enhancing the accountability of government to citizens – implying two-way dialogues that permit the public to influence and contribute to government policy. The objective of the reform is to strengthen public relations capacities in public institutions, gain public support, create positive attitudes towards public institutions, and encourage active public participation in the decision-making process.

Information Technologies
IT is increasingly transforming not only how governments conduct their business but also what they do and how they relate to citizens and society. BiH will increase IT utilization in public administration in order to make government more accountable, transparent and effective. The important anticipated changes relate to: policy; organization and human resources; IT infrastructure including security; and automation of public administration, business processes, including fundamental registries, and e-services.

Implementation of the strategy was supposed to start immediately, according to the PAR Action plan. The first year of implementation is reserved for improving the basic administrative system, with the aim of strengthening and harmonizing capacities such that there is a ‘generic ability’ across the public administration to adopt the requirements of the EU acquis. Two more cycles are envisaged - medium term 2008-2010, and the long term 2010-2014. The Office of the Public Administration Coordinator, which as of 2004 sits under the Chairman of
the Council of Ministers, is mandated to coordinate the preparation and implementation of the PAR strategy, at all levels of government. As such this office has to cooperate closely with the Entity and Brcko District PAR coordinators and with the Directorate for the European Integration of the Council of Ministers, as the PAR process is one of the key prerequisites for future EU integration.

The PAR Strategy provides a single strategic framework for reform across the entire country. However, despite formal endorsement, the content of the strategy is not the product of political consensus across governments in BiH. The PAR strategy consists of the consolidated findings and recommendations of the system review translated into strategy. It is neither clear that the strategy and its priorities correspond to the views of the political leadership in BiH nor to the priorities of the general public. There has been no debate on the strategy at the parliamentary level nor in any other public forums. Thus, a key deficiency of the PAR process remains that it commands weak levels of political support and commitment and little understanding among the general public. The following section will address these deficiencies and assess the conditions that should be in place to bring the PAR process to life.

4. Elements required for PAR effectiveness and sustainability

Many of the problems that have been encountered in developing and executing the PAR process in BiH are by no means unique to this country. There is a plentiful literature on PAR in developed and developing countries that chronicles the failures of many PAR programmes. As one analyst observes:

Most reforms in government fail. They do not fail because, once implemented, they yield unsatisfactory outcomes. They fail because they never get past the implementation stage at all. They are blocked outright or put into effect only in tokenistic, half-hearted fashion.69

It is therefore useful to review other countries’ experiences with PAR and identify conditions that have helped promote successful reform elsewhere. Despite widely different contexts, international experience suggests that six elements are needed for PAR to have any chance of success. These areas are identified below and evaluated in terms of the BiH experience.

A. Domestic political leadership

The fundamental importance of political commitment to a successful PAR is highlighted repeatedly in various studies. One reviewer notes:

It is a truism, but one important to restate, that any system in public administration which does not have the support and political commitment of the governing elite is unlikely to make much progress ... the key to the whole process of public administration reform is political commitment.70

The tendency for reform initiatives to be hosted by various special units or commissions can undermine success, because these administrative bodies often have relatively little power in the face of ministries (and ministers) who may object to reform.

Ultimately only manifest backing for reform on the part of political leaders [can] ensure that the various ministries and departments make reform a priority. Put bluntly, officials are more likely to pick up the baton of reform and run with it if the head of the government is breathing down their necks (and the necks of their respective ministries).71

As we have noted, domestic political commitment in Bosnia and Herzegovina to PAR remains very weak. There have been some attempts to give the process much-needed political leadership, including the 2004 reallocation of the Office of the PAR Coordinator in the Office of the Chairman of the BiH Council of Ministers. However, in the fragmented BiH political landscape, this move is certainly not enough to ensure even limited political commitment to the process. As things stand at present, the PAR process is critically low on the political list of priorities.

Political commitment is a concept that cannot easily be measured, since it is multidimensional and therefore cannot be measured through a single quantitative indicator. Various levels of political commitment are possible.

71 Polidano, C., 2001, Why Civil Service Reforms Fail, p.14
Political leaders who speak out publicly about the importance of PAR are expressing commitment to the issue and creating a climate for change. But for an effective reform process, words must be followed by actions. These include enabling policies, support programs, adequate funding, the appointment of good people to key positions, promoting accountability and participation in frequent program reviews and evaluations. Political commitment might be tested by measuring any of these aspects. In this section we will evaluate some of these aspects in the BiH context.

Supportive public statements made by political leaders are a basic indicator of political commitment, though the sincerity of these statements can always be drawn into question. The web site of the Office of PAR coordinator in BiH has a special section which monitors media coverage of PAR and collects relevant press statements by key political figures in the country. The proportion of statements made by international officials relative to BiH leaders is striking. The overwhelming proportion of statements are made by EC and other international officials who keep reminding the BiH public and their politicians about the importance of the PAR process for the country. There is only one isolated “domestic” speech recorded, that of former Prime Minister Adnan Terzic, at the official adoption and launch of the PAR Strategy in July 2006. Apart from the PAR launch, it is difficult to trace any record of public debate in the media or in the BiH parliaments on PAR. Considering the complexity but also the importance of the issue, one would expect that the PAR priorities would have been widely debated, especially by those parties which continuously speak about the need for strengthening the state institutions. However, the PAR strategy was not even put before domestic parliaments for approval or discussion. If the government wants to demonstrate its commitment to a delicate reform like PAR, it needs to commit funds, people, and time to the cause but for this, it ultimately needs parliamentary backing. Parliamentary support enhances political commitment, and enables domestic funds and resources to be allocated to the reform agenda.

In BiH, the only time when there is public debate about the performance and output of the public administration seems to around the time of municipal elections, when politicians seek to win votes by promising better service delivery. That there is pre-elections debate around the provision of municipal services is not surprising. However, while municipal services are certainly closest to the citizen, the complex, inefficient and opaque system of public administration across all levels of government in BiH has a much more damaging impact on service delivery than the record of individual municipalities.

This lack of rhetorical support for PAR is accompanied by grossly inadequate actions on the side of BiH politicians. Actions speak louder than pro forma words. As we have pointed out, political leaders show no commitment to improving the transparency of recruitment and reporting lines within ministries and administrative bodies and top ministerial and government posts are still reserved for those of party affiliation rather than individuals qualified for the posts. The PAR priorities are not reflected in the BiH budgets, and there is a continuing passive reliance on international donor agencies to support the process. Lack of domestic funding seriously undermines both politicians’ commitment to the process and their accountability towards it. Ultimately, no domestic politician is accountable for money spent for the purposes of PAR reform, as international funding continues to stop gap. Not a single state or entity level ministry has made any connection to the PAR priorities in their annual plans. The priorities of the new BiH government, expressed in the recent expose of Prime Minister Nikola Sprič to the Parliamentary Assembly of Bosnia and Herzegovina, give little attention to PAR, reflecting once again the widespread attitude that PAR is just another EU integration condition which needs to be formally ‘adopted’, rather than a set of cultural and institutional rules that require sustained political commitment over a longer period to be successful.

Lack of political commitment also stems in part from the highly divided and fragmented nature of the political environment in BiH. In the absence of agreement on what the governance structure of the state should look like in the immediate or even medium-term, it is unlikely that there can be unified political commitment to a far-reaching PAR. What is common to all political options is a fundamental lack of understanding or openness to any change that undermines the current power base of the various political elites. Politicians who advocate strengthening the state institutions of BiH usually mean simply increasing the responsibilities of the state institutions on the expense of the entities, while those who speak about strengthening the entity institutions mean retaining responsibilities at entity-level with little regard for their performance.

72 See www.parco.gov.ba
B. Support from the civil service

In addition to political commitment, a crucial element in successful PAR processes is a supportive civil service, familiar with and sympathetic to the aims of the reform. The benefits of the reform must be both understood and promoted by a wider circle than simply central agencies and senior leaders. Civil servants are among those most directly affected by PAR and its benefits must be familiar to them. Otherwise, institutional obstruction of reforms is inevitable.

At this moment, the level of understanding of PAR among BiH civil servants is minimal, and largely negative. Interviews conducted with randomly selected civil servants from various line ministries at the three highest levels of government in BiH indicate a complete lack of knowledge among interviewees about key elements of the reform and its ultimate goals. None of 12 civil servants interviewed could specify priority areas in the PAR strategy nor expected results. Moreover, there was a marked attitude of fear and resentment among the civil servants when PAR was discussed. Most fear that PAR could ultimately negatively affect their job security and salaries.

In July 2006, the EC project supporting the PAR Coordinator’s Office commissioned an analysis of perceptions of the PAR process among several focus groups, including civil servants. The results of the civil service focus group show that in general, public servants are concerned and anxious about what reform will bring about. They are aware that each reform requires further cuts on the expenditure side and that this may result in job losses. Although they recognize that performance standards need to be improved, civil servants fear that each new reform is aimed only towards job cuts and organizational restructuring.73 The wider benefits of PAR are barely discussed.

C. Popular Demand

A third observation in studies of PAR processes is that public expectations are crucial in providing momentum for change. PAR has historically been most successful in countries where citizens have had the opportunity to make their voices heard and hold public officials accountable. This condition is admittedly very difficult to achieve; even developed countries have seen a lack of popular demand for and understanding of PAR.

Popular demand in BiH in terms of PAR is naturally centered on the issues that are most visible and immediately relevant to the average citizen. Most citizens interviewed in the focus group on perceptions of PAR, expressed the expectation that reform will affect the quality of services that are traditionally delivered by municipal authorities.74 The BiH PAR Strategy addresses horizontal administrative processes that aim to improve the way services are produced. But, even with a high degree of political and institutional commitment, these improvements cannot be delivered over night but rather require a long period of continuous effort for change to be visible. The fact the PAR does not produce ‘quick fix’ solutions may undermine both the commitment of politicians to it, and the level of public support it commands. Lack of public pressure reduces oversight over the process which is detrimental for the sustainability of reform. The content of an effective PAR strategy can never correspond neatly to popular demand. It is in many ways a technocratic process that will never be of huge political interest. However, in order to maximize political and popular support, the PAR strategy can be repackaged and made more relevant to the areas that are of pressing priority to the average citizen. In BiH, this is not a demanding process, given that the layers of inefficient and overlapping bureaucracy in the country are obvious and PAT streamlining can have a real and significant long-term impact on economic growth and the delivery of better services.

D. Norm or values: institutional change

Formal rules can be relatively easily changed, but cultural norms and values take much longer to change. While better training, more qualified staff and organisational restructuring can improve organizational capacity, broader institutional reform is necessary for sustainable improvements to be made. As one analyst comments:

It has been learnt that even what are technically “first-best” solutions are unlikely to work in highly politicised environments, where the informal rules of the game (rent-seeking, extortion, whatever) dominate the formal rules of the game75.

74 Ibid.
The literature shows that the process of institutional change is very slow, and requires a carefully targeted approach, with strong political support, and a commitment from donors to do no harm. In an overview of PAR processes in the Balkans, Sigma, puts special emphasis on the importance of realism and moderate expectations in regards to PAR:

PAR must be understood as a sociological process in which time is measured in generations, not as a one, two or five-year project within aid programming cycles. Possibly because it is donor-driven, PAR in the region is too often conceived as a project rather than a process, with exaggerated, unrealistic expectations about what can be achieved. The type of change required in the region is systemic and cultural, and is not merely a matter of working procedures or organisations. Change should be designed to influence values in both administrative and political spheres.

The practice in the region of passing law, often under pressure from donors, without considering its connection to life and society or its interaction with other laws, also applies to PAR projects. Although law is often a necessary first step in reform, too often PAR projects focus only on formal legal aspects, without regard to implementation or to the necessary internalisation of values or policies that a piece of legislation is meant to promote. Law is also seen as the main means of communication about reforms both within the public sector and in society at large. It certainly is that, but administrative reform requires an adequately resourced communication strategy designed to address and sustain the support of key actors.

These conclusions point to several problems that are inherent in PAR process, and indeed apply to many other reform processes, in BiH. There has been insufficient attention paid to implementing, rather than just adopting legislation and action plans. Domestic authorities have been shut out of the planning process by the international community, whose priorities for reform often ignore the cultural and societal context and hard constraints such as budget. We fully agree that unrealistic expectations have been placed on the PAR process in BiH. However, this does not simply boil down to inhospitable domestic cultural ‘norms’ and clumsy international policies. BiH politicians at various points in the process have obstructed the advance of a viable PAR strategy because it directly threatens their power base. PAR is both feared and undermined at the political for that reason. In order to implement a successful PAR process in BiH there has to be a trade-off between seeking compromises that will command the political support necessary to ensure implementation, and pushing bolder policies, with public support, that are likely to undermine political power bases and the stagnant status quo.

E. Donor behavior

International donors provide much of the funding for reform initiatives in Bosnia and Herzegovina. Financial power, coupled with domestic apathy have led donor agencies to take centre stage in the selection and definition of many reform projects. In theory donors respond to the needs identified by client governments. In practice they often identify clients’ needs for them.

Lack of local ownership is a critical issue in many countries. Donors recognize this, but often do not consider themselves guilty of undermining the authority and autonomy of recipient governments. Instead, lack of ownership tends to be viewed as a technical problem of project management which can be solved by appropriate measures: for example, consultation meetings with local officials, and a public commitment to reform by political leaders. Even where donors do not explicitly aim to push their pet ideas onto governments, their power of the purse can distort decision-making as governments adopt initiatives that are likely to bring in the most aid money rather than those that are the most necessary. Aid donor organizations make vital technical and financial inputs into public sector reform in developing countries. They can also play an important gatekeeping role against badly-designed or inappropriate initiatives. Gatekeeping is one thing, however; originating proposals for reform and foisting them onto client governments is another. This can destroy any sense of local ownership of reform and undermine donors’ own efforts to bring about change.

As we have indicated in earlier sections, the role of the donor community in terms of supporting PAR in BiH has been problematic. Almost all of the key international donors have been involved in PAR. The EC, UNDP, DFID, USAID, Sida, OSCE, WB/IMF have all implemented projects related to PAR. In the marked absence of basic domestic political agreement, let alone a well-developed strategy and identified priorities for reform, donors have literally foisted projects and programs on apathetic and disinterested governments in BiH. The international donors

76 Sigma, Public Administration in the Balkans: Overview, pp.15
have also been guilty of the very same crime that BiH governments are so often accused of: lack of coordination and cooperation.

Some international donors have recently proposed the creation of a joint PAR fund to support programs from the national PAR strategy. The creation of a joint fund has the potential to maximize the benefits and minimize the bureaucracy usually associated with international assistance. At this moment DFID, Sida, EC Delegation in BiH and the Netherlands have agreed to establish the joint PAR Fund, and there is potential that other interested donors may use this joint mechanism to dispatch funds. Other donor organizations that are unable contractually to commit funds to a joint pool, are discussing the establishment of a joint forum where funding programs would be coordinated to avoid overlapping initiatives. The Fund would probably be managed through the BiH Treasury and held in a ring-fenced budget line for expenditure on approved projects only. Donors have agreed that BiH Law on Procurement will form the basis for the financial management of the fund. There are still doubts at present as to whether the Office of the PAR Coordinator is capable of taking on day to day management responsibilities for the fund. The Office would be responsible for drafting project specifications, conducting initial evaluations of projects and monitoring their implementation. Lack of technical expertise can be overcome. However, continued lack of political support to the PAR Office and its functions may lead international donors to question the readiness of the BiH institutions to manage international funds.

The disbursement of international funds through the BiH institutions would be a significant departure from international practice to date and, if managed properly, has the potential to shake up the meagre levels of accountability and commitment domestic politicians have so far shown towards the PAR process. Now more than ever the BiH authorities must demonstrate that they have the commitment and capacity to use donor funds in an effective manner.

International experience suggests that the preconditions for successful public administration reform are lacking in Bosnia and Herzegovina. Political commitment to the reform process is weak, and the overall context is not conducive to successful reform. The level of progress to date has been low. Much of this is acknowledged by the donors leading the reform effort. However, despite PAR's problems to date, discontinuing the process is not an option: BiH's overall development demands that the PAR process is elevated to a more serious position in the government.
1. Introduction: Fiscal pluralism in BiH, a weak state and fiscally sovereign entities

Reform of the indirect taxation system in BiH has been applauded as a key state-building reform. The unification of indirect revenue collection systems in BiH (VAT, excise and customs) has built a more efficient collection system and one that allocates the state a secure source of revenue for the first time since Dayton. However, despite these important advances, the BiH state still lacks basic fiscal prerogatives that are exercised by central government in all other states, including federal countries. The BiH state is responsible only for parts of fiscal policy that deal with indirect tax collection and distribution mechanisms. Even this responsibility is diluted as the state cannot set policy without the approval...
Governance structures in Bosnia and Herzegovina

of the entities who sit on the Governing Board of the Indirect Taxation Authority (ITA). The state has little or no input in defining overall fiscal policy in BiH; this continues to be determined autonomously by the two entities, Brcko District, and partly by the cantons in the FBiH, with little or no coordination between them. Allocation of fiscal burden, general budget policy, and all other elements of fiscal policy that have an impact on the macroeconomic stability of the country are developed either outside the BiH state’s remit or, in the best case, are shared between the state, entities and Brcko District, and coordinated only under international pressure.

2. State-Level financing in BiH

Dayton failed to provide the state of BiH with a basic tenant of statehood: the means to raise revenues to finance the conduct of government. As the state assumed more competencies, it was able to raise some relatively minor revenues from fees and charges (for example, passport issuance fee) and revenues from the activities of certain budget users (for example, revenues from regulatory agencies), but the state continued to rely overwhelmingly on entity transfers to meet its budgetary needs (1/3 from RS, 2/3 from FBiH), amounting to a quasi ‘confederal’ model of financing. Not only did this model render the state dependent on the entities, it was also dysfunctional, as the entities frequently failed to transfer funds to the state in a timely manner. Lack of fiscal and budget discipline in both entities and additional political obstruction from the RS resulted in an unreliable and unsustainable method of state financing. As a result, the international community was forced repeatedly to coax the entities into meeting their obligations towards the state and one of the conditions set out in the earlier IMF Stand-by arrangements was the timely transfer of funds by the entities.

In view of this acute problem of state dependence on the entities, the international community, particularly OHR and the European Commission, used the introduction of VAT to advocate a system of collection and distribution that would address the issue of state-level financing. Following lengthy negotiations coordinated by OHR, with clear conditionality set by the EC following the 6th Directive, the entity parliaments ratified agreements to transfer competencies on indirect taxation matters to the BiH state, paving the way for the adoption of the BiH Law on the Indirect Taxation System (OG 44/03). This legislation provided a basis for the preparation of VAT introduction by establishing a state-wide institution that would implement VAT and would be responsible for other indirect taxes. Crucially, the legislation also normalised financing of the state-level institutions by specifying that funds from the single account, where all the revenues from indirect taxes are collected, are first to be allocated for state financing in the amount of the approved state budget.

Following the introduction of the new system of indirect taxation in BiH, revenues from indirect taxes are regulated at state level and shared across all levels of government, the entity share being subject to the approval of entity representatives on the Governing Board of the ITA, while direct taxes remain entity revenues of entities (Annex A). The state level has no other revenues from taxation. Indirect taxes (Value Added Tax, customs and excise tax) are collected by the BiH Indirect Taxation Authority in a Single Account from which they are disbursed on a daily basis. In accordance with the Law on Indirect Taxation system in Bosnia and Herzegovina the state is first to receive funds (in the amount of its adopted budget plan for Single Account revenues). The remainder is divided among the entities and Brcko District, in accordance with shares (expressed in percentages) agreed upon by the Governing Board of the Indirect Tax Administration, and following the Law on Payments to the Single account and Distribution of Revenues (BiH OG 126/04). From these shares, external debt obligations are deducted for each entity and paid through the state budget. After the repayment of external debt, the funds are transferred to the entities and Brcko District.

Thus, in 2005, a year before VAT was introduced, the state of BiH began to receive funds directly from tax revenues for the first time in its post-war history, and the system of entity transfers was stopped. This change clearly represents a vast improvement for state independence and autonomy. However, the state remains dependent on the entities, given that the state budget is subject to annual approval by a parliament that is strongly divided along entity lines. Budget allocations for state institutions can be cut if parliamentarians deem these institutions a threat to the entities, or if they feel the overall size of the budget threatens the entity budgets, which receive funds after the state takes its share under the new model. Moreover, unlike in other federal contexts, the state has no power to
make ‘equalisation transfers’ to lower levels of government, either conditional or unconditional, to correct horizontal revenue imbalances between different parts of the country. And, as we will discuss in the next section, the state has only a marginal role in coordinating overall fiscal affairs in the country.

I believe that VAT is useful and yes we can feel that in substantial terms, our municipalities are richer and that something has been done. You can see roads built from our money. In my perception, the things that are common, joint, they function properly, and since VAT is a joint thing it means there is one joint wallet.
– Zenica, female

3. Revenue framework in BiH

In 2005, a Fiscal Council was established in BiH, with responsibility for coordinating fiscal policy within the country. The Fiscal Council was established through an agreement signed by the Prime Ministers of the BiH state, entities and Brcko District and composes the heads of governments and Ministers of Finance of the BiH institutions and the entities, with observer status granted to the Mayor of Brcko District and the Governor of the Central Bank. The agreement grants the Fiscal Council authority to set overall deficit targets and their apportionment across levels of government, and to agree on revenue projections. A draft Law on the Fiscal Council has been prepared, which elaborates on the functioning of the body, and allows for the establishment of a secretariat and technical expertise unit to serve it. The draft law has yet to be adopted and despite the formal establishment of the Fiscal Council, in practice, the body is not functioning. The Council failed to issue guidance to governments in BiH during preparation of the 2007 budget. One of the body’s main tasks is to set overall deficit limits and revenue projections to be respected in the process of budget preparation at each level of government in BiH.

The absence of an operational Fiscal Council is particularly detrimental as the international community’s coordination role in fiscal matters in BiH has been greatly reduced. While IMF involvement is clearly not a desirable or feasible long-term substitute for proper internal fiscal coordination between the disparate levels of government in BiH, the organisation was active in determining revenue projections and deficit targets for each level of government in BiH through the provision of annual Stand-by assistance, providing some form of coordination and common fiscal envelope in the fragmented BiH fiscal system. The country no longer has a Stand-by arrangement with the IMF, and its absence has exposed inherent weaknesses in BiH’s management and coordination of public finances. Given lack of coordination and weaker IMF impact, the governments in BiH provided relatively optimistic revenue projections in 2007. These isolated projections could ultimately endanger fiscal stability in the country. This situation once again underlines the way in which international intervention has sustained public administration in its present form in BiH, effectively substituting for sustainable domestic mechanisms. The state of BiH lacks fiscal tools to maintain macroeconomic stability within the country. In the absence of clear state competencies, there is not even an operational domestic coordination process which could at least determine a common fiscal envelope within which the multitude of governments in BiH would be bound to operate.
Organization of public finance in BiH (two sides of the same coin – revenues and expenditures in BiH)?

In Table 1 comparative data for the portion of public spending in GDP as well as total amount of public spending on all government levels for centralized and federal states is presented. Comparative data for BiH is not included since data on consolidated budgets is not available. Information regarding BiH is provided in the following section. Overall, it is evident that BiH allocates a much smaller percentage of its total public spending on the central government level compared to the countries with strong fiscal federalism.

Table 1. Fiscal federalism models

<table>
<thead>
<tr>
<th>Country</th>
<th>Portion of public spending in GDP (%)</th>
<th>Total amount of public spending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Central government Federals Local</td>
</tr>
<tr>
<td></td>
<td></td>
<td>government units government</td>
</tr>
<tr>
<td>Countries with the highest spending of central government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>34.0</td>
<td>94.6</td>
</tr>
<tr>
<td>Kenya</td>
<td>29.3</td>
<td>94.3</td>
</tr>
<tr>
<td>Chile</td>
<td>32.3</td>
<td>93.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>21.2</td>
<td>92.3</td>
</tr>
<tr>
<td>Mexico</td>
<td>30.2</td>
<td>90.1</td>
</tr>
<tr>
<td>Israel</td>
<td>62.9</td>
<td>90.8</td>
</tr>
<tr>
<td>Countries with the lowest spending of central government</td>
<td>46.0</td>
<td>41.3</td>
</tr>
<tr>
<td>Denmark</td>
<td>57.6</td>
<td>47.1</td>
</tr>
<tr>
<td>India</td>
<td>22.6</td>
<td>47.5</td>
</tr>
<tr>
<td>Switzerland</td>
<td>37.4</td>
<td>47.5</td>
</tr>
<tr>
<td>Australia</td>
<td>39.1</td>
<td>52.8</td>
</tr>
<tr>
<td>Finland</td>
<td>43.0</td>
<td>54.7</td>
</tr>
</tbody>
</table>


A. Public revenues in BiH: facts and figures

The tables and charts presented here attempt to give an overview of the workings of the revenue allocation system for each level of government in BiH. The differences in public revenues and expenditures are presented not only in absolute amounts, but also on a per capita basis in order to present a clearer comparison of actual expenditures on public administration and the impact that public administration has on its ‘consumers.’

It is worth highlighting at the outset that the BiH level of government, even with the full security of revenues provided by the Single account, is still relatively poor in funds. It has only recently managed to catch up with Brcko District, which, rather absurdly, had a bigger budget than the state for years. Catching up with other government levels would necessitate the transfer of additional functions to the BiH level, which will be discussed in more detail later in this paper.

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77 While cash donations and projects running directly through an institution are reflected in budgets at all levels of government, donor funding of specific projects or even equipment donations are usually not reflected. An exception to the rule are the World Bank funds for projects in the entities. However, they are not an integral part of the budget, but are presented in an annex, and are usually not available on web-sites of entity institutions. Privatization receipts, following an agreement with the IMF in 2002, are kept on escrow accounts, and reserved for settlement of internal debt at different levels of government.
Moreover, unlike in other federal states, BiH has significantly less funds for state functions, when compared to other countries that apply the principle of fiscal federalism. In BiH, the bulk of funds, and the main power centres are actually located at the “middle” layer of government, which includes the entities, Brcko District and the Cantons in FBiH. The bulk of revenues are concentrated at these levels of government, to the detriment of the state and local government. Municipalities are poorly funded, even though they are deemed closest to citizens and perform the bulk of direct services (for example, urban infrastructure and communal services).

The most expensive public administration in the world is Dayton’s ugly baby. That is our state structure.
– Zenica, male

The structure is complex, especially in the Federation. There is plenty of administration, three layers of it. We are not financially capable of sustaining that... we are simply destroying the country from inside. We are falling apart from within.
– Doboj, male

Table 2 presents a comparison between revenues of different levels of government separated by type of revenue, for revenues collected in 2005. Grants received from other levels of government are excluded from this comparison. Contributions are also not included as they are directly linked to health care and pension funds.

**Table 2 – revenues collected in 2005 (in 000 KM)**

<table>
<thead>
<tr>
<th>Type of revenue</th>
<th>BiH</th>
<th>FBiH</th>
<th>RS</th>
<th>Brcko District</th>
<th>Cantons FBiH</th>
<th>LGs FBiH</th>
<th>LGs RS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax</td>
<td>251,500</td>
<td>792,946</td>
<td>889,700</td>
<td>140,310</td>
<td>1,203,590</td>
<td>211,972</td>
<td>276,435</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>94,205</td>
<td>201,792</td>
<td>127,900</td>
<td>51,790</td>
<td>191,758</td>
<td>161,475</td>
<td>123,230</td>
</tr>
<tr>
<td>Capital revenues</td>
<td>4,947</td>
<td>40,333</td>
<td>15,100</td>
<td>0</td>
<td>50,515</td>
<td>11,661</td>
<td>4,306</td>
</tr>
<tr>
<td>Grants</td>
<td>30,013</td>
<td>9,670</td>
<td>0</td>
<td>860</td>
<td>2,815</td>
<td>1,883</td>
<td>1,072</td>
</tr>
<tr>
<td>Financing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>9,645</td>
<td>4,359</td>
</tr>
<tr>
<td>Carry over surplus from 2004</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>34,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>380,665</td>
<td>1,044,741</td>
<td>1,032,700</td>
<td>226,960</td>
<td>1,448,678</td>
<td>396,636</td>
<td>409,402</td>
</tr>
</tbody>
</table>
Chart 1 shows the revenues side of budgets by level of government in percentages, presenting and comparing the structure of revenues for each government level in BiH.

![Chart 1 - Structure of revenues by government level in BiH (% values)](image)

Chart 2 compares public revenues by level of government in BiH in absolute amounts. It can be seen that the State revenues are the second lowest when comparing the absolute amount of revenues collected for each budget.

![Chart 2 - Revenues by government level in BiH in 000 KM](image)

Chart 3 compares revenues making a distinction between three levels of government – upper level (state) middle (entities, cantons and Brcko District) and lower level (local governments). The comparison is made in absolute amounts, and total revenues are used. Here the observation is simple – the State (upper level) has the lowest share of public revenues as compared to other levels.

![Chart 3](image)
Chart 4 showcases the revenues of different government levels per capita. It should be noted here that the revenues of the BiH level are divided across all citizens of BiH, while the revenues of lower government levels are divided by respective population numbers.

Note: data on population numbers for RS, FBiH and Brcko District do not correspond with the total number of BiH citizens given by the BiH Statistics Agency. The methodologies used to make estimates differ by around 30,000 citizens. The BiH Statistics Agency does not have estimates for population numbers in the entities, but only the country as a whole, thus the data provided by the Entity Statistics Institutes was relied upon.

Brcko District collects the highest revenues per capita. This data should be read with caution, however, as the District government also collects electricity usage fees, which are significant, and which are form part of the rev-
The data in Chart 4, option 2 is presented without Brcko District, as observations about other government revenues per capita were distorted by Brcko District results. Since Brcko District accounts for the smallest share of public revenues and population, the total is not altered much. However, the differences and disparities between levels of government can now be observed. Most revenues are collected for funding the RS government, with Cantons running a close second. The State emerges with the lowest revenues, when observed per capita.

If we consider the entities in consolidated form, FBiH has significantly higher revenues than RS. The disparity in revenues between different levels of government, when observing them in a per capita form, are striking.

The disparities in revenues are even more striking when considering only one level of government and comparing the revenues of this level of government horizontally. In the Graph below the tax revenues of local governments within two Cantons of FBiH are compared with a view to presenting revenues, and thus also underlying development disparities. These disparities are striking both in terms of local governments in RS or the Cantons in FBiH.
B. Public expenditures within Bosnia and Herzegovina

It is generally acknowledged that spending on public administration in BiH is excessive when considered as a share of GDP. It is also accepted that a disproportionately high amount of public money is spent on upkeep of the administration itself and, in particular, on the salaries of public administration employees. This is in large part due to the legacy of Dayton and the subsequent state-building process which has left in place a web of overlapping competencies, and in part due to a general inefficiency in the delivery of services in the country, particularly acute in the Federation, which is governed by three levels of more or less dysfunctional government. The state has assumed several new responsibilities from the entities since Dayton, including indirect taxation, intelligence, defence and partial competencies in several other sectors. It has also taken on responsibility for funding some state bodies that were originally funded by the international community, including elections, the Communications Regulatory Agency, and the High Judicial and Prosecutorial Council. Despite these increases in responsibilities, however, state level spending is still relatively low.

The tables below present the expenditures of different government levels in BiH, divided by economic classification. In this analysis, we again exclude off budget funds that are financed from contributions, as their specific nature and absolute link to one function only (pensions, health and unemployment) would function more or less similarly without structural reform whichever level of government it is being provided from.
Table 3 - Comparison of expenditures in 2005 in 000 KM

<table>
<thead>
<tr>
<th>Expenditures</th>
<th>BiH</th>
<th>FBiH</th>
<th>RS</th>
<th>Brcko District</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Entity</td>
<td>Cantons</td>
<td>LGs</td>
<td>Total</td>
<td>Entity</td>
</tr>
<tr>
<td>Salaries</td>
<td>197,061</td>
<td>267,123</td>
<td>747,455</td>
<td>1,150,706</td>
<td>365,900</td>
</tr>
<tr>
<td>Operating costs</td>
<td>120,759</td>
<td>78,115</td>
<td>199,506</td>
<td>360,672</td>
<td>82,300</td>
</tr>
<tr>
<td>Transfers</td>
<td>30</td>
<td>512,632</td>
<td>355,351</td>
<td>97,979</td>
<td>965,962</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>13,990</td>
<td>61,661</td>
<td>148,696</td>
<td>319,049</td>
<td>35,200</td>
</tr>
<tr>
<td>Other expenditures</td>
<td>7,663</td>
<td>38,597</td>
<td>12,806</td>
<td>7,600</td>
<td>59,003</td>
</tr>
<tr>
<td>Total</td>
<td>339,503</td>
<td>958,128</td>
<td>1,463,814</td>
<td>433,450</td>
<td>2,855,392</td>
</tr>
</tbody>
</table>

Notes:
Brcko District groups together material expenditures and current transfers. Debt repayment is not included in this comparison.

Table 4 takes the absolute amounts presented in Table 3 and gives percentage values of participation of each type of expenditure in total expenditures for each level of government.

Table 4 - budget expenditures in 2005 (% values)

<table>
<thead>
<tr>
<th>Expenditures</th>
<th>BiH</th>
<th>FBiH</th>
<th>RS</th>
<th>Brcko District</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>FBIH</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries</td>
<td>58.0%</td>
<td>27.9%</td>
<td>51.1%</td>
<td>31.4%</td>
<td>39.3%</td>
</tr>
<tr>
<td>Operating costs</td>
<td>35.6%</td>
<td>8.2%</td>
<td>13.6%</td>
<td>19.2%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Transfers</td>
<td>0.0%</td>
<td>53.5%</td>
<td>24.3%</td>
<td>22.6%</td>
<td>40.9%</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>4.1%</td>
<td>6.4%</td>
<td>10.2%</td>
<td>25.1%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Other expenditures</td>
<td>2.3%</td>
<td>4.0%</td>
<td>0.9%</td>
<td>1.8%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
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The following graphs are a visual representation of the spending disparities by level of government in BiH, which follows the current allocation of functions within BiH. It should be noted that the data available was for year 2005, and as such did not include the transfer of defense responsibilities to the State level, which marginally improves the state position in the overall expenditures structure.
Observing public expenditures, the same conclusions can be drawn as when observing revenues – the state level government is the second smallest level in terms of expenditures, i.e. its total expenditures are 4.3 times lower than the expenditure of the Cantons (the biggest spender) on public administration needs.
Graph 8 demonstrates that the most costly level of public administration in BiH, when observed in consolidated form, is within the FBiH, given that 10 additional cantonal administrations are maintained within that entity.

**Frankly I have no knowledge about tax collection and allocation of public money. But what I can see with my own eyes is that there is money, in the municipality and the canton and so on, and that money is spent, but I would not say for the right purposes.**

– Tuzla, male

When expenditures are compared per capita, i.e. per citizen by level of government (see graphs 9-11), it can be seen that the state level spends the least amount on citizens. Again, we should note here that division per capita is made using the number of citizens a certain government level is considered responsible for, thus the BiH level has the largest base, and Brcko District the smallest.
Graph 9 presents the expenditures per capita by each government level. As with revenues, Brcko District spends the highest amount of funds per capita. Looking at the structure, it can also be said that Brcko District and local governments are spending the least on salaries of employees and the most on capital investments. The State, on the other hand, is spending such a minor amount per capita that its expenditures are just small lines on the graph.

Graph 10 compares the structure of expenditures by government level. The BiH state spends most funds on salaries and operating costs. It has no social welfare facet, and as such transfers are almost non-existent. The servicing of foreign debt is not included in this overview as the state only funnels funds received from the entities for foreign debt servicing. These funds are included in the entity budgets.

The entities, FBiH cantons and Brcko district spend the bulk of their funds on salaries (including education, judiciary and police salaries) and on transfers, which in most budgets are geared toward the social welfare function which draws the majority of transfer funds in both entities. In the RS, the central government budget covers all major expenditures within the entity (education, police, judiciary, etc) and as such, carries the larger proportion of public revenues within the entity.
The FBiH central government budget deficit is financed out of international concession loans. The cantonal deficit cannot be financed by international or domestic borrowing which means that each misbalance between revenues and expenditures generally results in accumulation of arrears and a progressive potential decrease in expenditures. This clearly can have a detrimental impact on the provision of adequate services in the FBiH. Extreme imbalances in the revenue allocation system within FBiH also contributes to the entity’s financial problems – origin-based tax-sharing has led to poorer Cantons only sinking in troubles while the well-off areas could indulge in excessive spending.

The most “balanced” budgets in the sense of expenditures structure are local government expenditures. This is largely due to the fact that municipalities are mainly responsible for infrastructure maintenance, and even when they are not directly responsible, they try to fill gaps left by higher levels of government (for the most part salaries and social transfers) as opposed to capital investment.

It should be noted here that each level of government has a similar set of expenditures for executive and legislative branches, while the judicial branch is not funded at the local government level.

When considering both entities and Brcko District in consolidated form, we observe a disbalance in expenditures per capita. This is a direct result of the fact that the BiH state has no redistributive competency and cannot promote more even development within the country as a whole. The state also lacks the competencies and tools required to stimulate economic development in the country. In fact, no level of government in BiH devotes itself to economic development and the limited funds that are available for functions other than administrative expenses, tend to be tied up in social welfare provisions.

The division of functions at lower levels of government directly impacts on the state budget. The most expensive functions in BiH are education, judiciary and the police. While the state has some responsibilities in judicial affairs and policing (State Border Service, SIPA, HJPC, the BiH Court, Prosecutor, etc.) the bulk of spending on these functions is located at the entity level in RS, and at the level of the cantons in FBiH. These functions are becoming ever more expensive given that their management and implementation is carried out separately at each level, with little coordination or regard for pooling certain resources in the interests of efficiency. The worst offender in this regard is the FBiH, which acts as a mini (dysfunctional) state within its territory; it has a coordinating role, but no real direct responsibilities in many areas, sustaining a relatively large public administration that exercises few competencies. Even where FBiH has a direct responsibility for policy setting, it has tolerated non-compliance from the cantons and has failed to exercise even a coordination role. Two recent exceptions to this rule are in the areas of regulation of social welfare funds for civil victims of war and revenue allocation within FBiH. In these cases, it was the FBiH Parliament that insisted that the FBiH exercise its responsibilities, and not the executive or the administration itself.
While the entities and cantons continue to raise and spend the vast majority of public funds, the proper functioning of state institutions has been hampered by budget constraints. In several sectors affected by EU integration, the state has been required to assume a coordinating role or responsibility for setting standards. This has entailed the establishment of several institutions, such as the Veterinary Agency and Phytosanitary Agency, an expanded and stronger Statistics Agency, and bodies to implement refugee and asylum policy and grants management etc. The proper development of each of these bodies and functions has been stunted partly by lack of available funds. In the absence of properly equipped state institutions, responsibility in these areas has in practice been usurped by the entities. Once again, the international community has failed to insist that institutions established in law are actually given the funds to enable them to function. As many of the EC functional reviews have pointed out, the transfer of capacity and funds from the entity level to the state would at once solve the problem of lack of state funds and eliminate many overlapping functions at entity level. Instead of this, we have seen a proliferation in the number of state institutions, few of which are operational in a meaningful sense. Notable exceptions to this general rule are the “full reforms” such as defence, intelligence and the ITA, where entity bodies were merged and right sized in the process of creating united state institutions. In these areas, initial indicators are positive. The new ITA, for example, has proven itself to be more efficient than the autonomous entity services. VAT collection has resulted in large revenue increases in 2006. When compared with 2005, revenues from VAT and late sales tax payments have risen by 48.69%\(^78\). A single administration, well funded and with strong technical support has managed to deliver tangible results in a relatively short time. There have also been clear efficiency gains as a result of defence reform and implementation of a single state border service.

C. Direct Taxation

The existing set of taxation laws and procedures in BiH do not constitute a ‘system’, but rather more closely resembles a state of chaos. The status quo benefits only those who are keen to abuse the rules. Their efforts are facilitated by an abundance of complicated tax legislation, obsolete taxation forms, sub-standard entity tax administrations, as well as a generally “low level of tax consciousness” on the part of tax payers. This has contributed to an almost universal lack of tax discipline and worryingly poor collection rates since Dayton.

BiH is currently divided into three separate and independent tax territories: FBiH, RS, and Brcko District. Within each of these areas, there are a number of obsolete, complicated and ineffective taxation systems, including various income taxes on various bases (in FBiH), obsolete property tax, and so on (see Annex B). There is a high level of tax evasion and obvious “holes” in tax legislation that are taken advantage of, both legally and illegally. Profit tax revenues are almost nonexistent as profit is hidden by high levels of tax deductions. Income tax, wage tax and contributions are endangered by high official unemployment levels and a dominant “grey economy”. A yearly tax on the total income of citizens is hardly ever reported. Tax legislation is not harmonized within BiH. There are various rates applied on taxes and contributions, and up until recently, there were even different customs tariffs applied. Other problems remain, such as double taxation on profit tax.

Under international pressure, there have been efforts to work on tax harmonization in the last few years. However, these efforts have mainly been directed towards regulating indirect taxes at the state level. Some efforts have been invested in reform of direct taxes in the entities. As a result, RS introduced new legislation on income tax and profit tax. However, FBiH is lags behind and it is uncertain whether reform in each entity will actually bring about a harmonized tax space within BiH. Tax-control procedures are an undisputed competency of the entity tax administrations. As well as the harmonization of tax legislation, the past couple of years have marked some success in the area of fostering cooperation between the entity tax administrations. However, efforts invested in cooperation cannot compensate for the fact that there are three independent tax administrations working along the inter-entity border-line.

The combined impact of each of the above factors is a dismal tax revenue collection rate from all sources in BiH, which adversely affects each entity and all budget users in BiH.

Macroeconomic and fiscal conditions for economic growth in BiH

BiH is already suffering from the consequences of much reduced international financial assistance. Further reduction of dependency on foreign aid in the coming years will pose the following challenges to the BiH state:

1. The number of functions and responsibilities which the state government will have to take over continues to increase (state border police, veterinary services, army, and other new state agencies necessary for the exercise of regulatory functions).

2. Once the process of reconstruction is over, international aid will significantly diminish. The need for high economic growth will continue and BiH will have to finance high current deficits. BiH should not expect funds from international financial markets. Therefore, it is extremely important to control public finances at all levels and focus domestic savings on domestic investments while improving the business atmosphere for investment.

Currently there is no institution responsible for building a stable macroeconomic environment necessary to modify the fiscal system. Heavy budgetary responsibilities are evident and yet there is no strategic plan for modifying the fiscal system at state, entity and sub-entity levels. The inadequacies of the current situation present a danger for the successful functioning of monetary and fiscal policy and the Currency Board in BiH. Clearly, international financial institutions cannot take over the responsibility for sustainable macroeconomic environment in BiH. BiH-driven reform is the only option. The current fiscal system is inadequate and inefficient and most entrepreneurs face double taxation and various administrative barriers. BiH needs to develop a positive business atmosphere which can contribute to increases in employment and improvement in the collection of revenues.

4. Conclusions

- The fiscal system in BiH is characterised by the following deficiencies:
  - The state has no redistributive competencies and cannot promote more even development within the country as a whole.
  - Formal fiscal coordination mechanisms are incomplete and there is little or no formal coordination in practice between different levels of government.
  - There are fiscal disparities and overlaps in fiscal responsibilities.
  - The inefficient direct tax system is not harmonised across the country and results in numerous tax law loopholes and weak revenue collection at all levels.
  - The Ministries of Finance lack capacity.
  - The public sector applies different accounting methods, making analysis of the public sector and its effect on the economy more difficult.

In the absence of domestic political will and institutional coordination mechanisms, the international community has been holding an unsustainable system of public finances together. As the role of the international community diminishes, macroeconomic stability in BiH will be put at risk if – at minimum – domestic capacity for coordination and implementation of fiscal policy is not significantly strengthened.

The middle level of government in BiH (the entities, cantons and Brcko District) benefit from the highest revenues, as their functions carry the highest levels of expenditures (education, police and judiciary). These functions are becoming ever more expensive given that their management and implementation is carried out separately, with little coordination and with no regard for pooling certain resources in the interests of efficiency.

Resources are not only scarce in financial terms; in any field they are scarce in the terms of human resources and adequate staff. The number of institutions that need to be staffed fully numbers more than a dozen in each functional area, which leads to a lack of capacity in each and every one of them.

A severe obstacle to the establishment of single economic space in the field of fiscal policy is the existence of three profit tax areas in the country. Companies are either double-taxed or must pick which entity/district it will limit its activities to. Many simply break the law.

VAT introduction has given the State a secure source of revenues. However, it represents a missed opportunity in some respects, as the process has not been coordinated with reform of the public administration or the state-
building agenda, and the state institutions continue to function virtually in many areas. The fact that the state is not fully and/or efficiently using the resources it now has at its disposal, could in the medium-term undermine its financial security, if sufficient outrage is felt over “misspending of funds” by the state.

5. Recommendations

A. Establish a fiscal policy unit within the BiH Ministry of Finance and Treasury

Reason 1 – Governing Board of ITA

As underlined earlier in the report, the set-up of the Governing Board of the Indirect Tax Authority leaves room for significant hold-ups. As in other similar quasi-entity state institutions, the breaking of deadlock in the body is largely dependent on the intervention of an international arbiter. The mandate of the International Chair of the ITA Governing Board is unlikely to be extended beyond 2007, leaving behind the potential for institutional deadlock.

Given the dysfunctional set-up of the ITA Governing Board, it has been unable to move beyond one of its basic functions, namely determining coefficients for revenue allocation between the entities and Brcko District. Its primary function, the setting of tax policy has been relegated to the sidelines.

The RS has questioned the very legitimacy of the ITA Governing Board as it has been “over voted” on the issue of revenue allocation, one of the critical issues the Governing Board was set up to resolve. As the Governing Board has proved an inefficient mechanism for obtaining policy consensus, it is proposed that the drafting of indirect tax policy and revenues allocation formulas are transferred to the BiH Ministry of Finance and Treasury.

It is proposed that the Ministry be responsible for the technical side of revenue allocation and indirect tax policy, proposing draft decisions to the Council of Ministers and BiH Parliament for adoption. Entity interests would be protected under this system through the retention of entity-weighted voting in the BiH House of Representatives.

Though this proposal may appear radical, it is a pragmatic and workable alternative to the present system that relies on international intervention to function. The solution would make the setting of indirect tax policy more efficient, and would not require constitutional change.

Reason 2 – fiscal disbalance

The analysis of current expenditures and revenues within the country illustrates the existence of significant fiscal disbalances within the country, which are necessarily accompanied by disbalances in economic development within BiH.

This is caused by the fact that the BiH state has no redistributive competencies, and cannot promote more even development within the country as a whole.

These fiscal disbalances cannot be fixed without a strong technical base and analytical support.

We thus propose the creation of a new unit within the BiH Ministry of Finance and Treasury to provide technical analysis of the existing problem, and to propose viable solutions to the Council of Ministers.

The solution

The Macroeconomic Unit of the Governing Board of the Indirect Tax Authority already performs functions related to fiscal policy issues in BiH. The draft Law on Fiscal Council (see below) is proposes to incorporate this body into the Fiscal Council.

As its activities and tasks are a more natural fit within the structure of a Ministry of Finance, and since these functions already exist at the State level, we propose to transfer the Macroeconomic Analysis Unit to the Ministry, to form the nucleus of a Fiscal policy/Macroeconomic analysis department, with full transfer of all activities and staff.
B. Establish strong coordination through the Fiscal council

Bosnia and Herzegovina needs a permanent and efficient solution to two burning issues: (i) determining the fiscal envelope for the multitude of governments in BiH, and (ii) setting the primary deficit / surplus targets for BiH governments bearing in mind the Maastricht criteria that will become binding for BiH if the process of further EU integration is successful.

The mechanism that is currently being developed to address these issues is the Fiscal Council. Although the draft Law on the Fiscal Council envisages a stronger legal basis for the body’s work and a clearer outline of its tasks, the adoption process has been stalled sine mid-2006 because of concerns over its constitutional basis and due to the intervening elections.

There are weaknesses, and potential weaknesses, in the way the Fiscal Council functions, that need to be addressed, including:

- It has been difficult to organize meetings as the attendance of three Prime Ministers was required. Meetings have had to cancelled / postponed due to the inability of one / several members to attend.
- Meetings have been used to discuss issues that, while important, do not have a direct bearing on key functions of the Fiscal Council, making meetings less productive and more politicised.
- The draft Law mandates the Fiscal council to take decisions and coordinate on nine particular and weighty issues.
- There is no deadlock breaking mechanism. The solution to deadlock is that pending resolution of disagreement, all governments do not adopt budgets but survive on temporary financing decisions until an agreement is reached.

We propose that the activities of the Fiscal Council are focussed on a limited number of critical areas, in particular functions that will constitute international obligations following the signing of the Stabilization and Association Agreement. Other functions should, as far as possible, be transferred to the BiH Ministry of Finance and Treasury.

We propose streamlining and re-focussing Fiscal Council functions given that previous meetings have been burdened by a multitude of issues that have made meetings difficult to organise and manage.

Finally, the decision making processes envisaged in the draft Law (where a vote must include 5 of the 6 members, including the votes of each constituent people) is likely to lead to blockage of decision-making unless mechanisms are put in place to break deadlock.

C. Address the issue of direct taxation

Failure to reform the system of direct taxation has emerged as one of the most problematic obstacles to the creation of a Single Economic Space.

There are two alternative methods of addressing this serious problem. The first, more radical proposal, entails moving direct tax policy decision making to the state level and providing a single legislative solution for direct taxes at the state level.

Considering the success achieved with a single administration for the collection of indirect taxes, it is plausible to assume that a single administration might also generate better results in the collection of direct taxes.

However, given likely political opposition to this proposal in the RS at least, the second best option is to develop a strong mechanism for harmonizing direct tax policy.

The burden of compliance with the complicated system that would emerge (especially in the sense of determining the place/entity where the tax revenues are to be collected and allocated) should not be placed on businesses, making operations in BiH even more expensive than they are now, but resolved within the administration itself.

While working on the direct tax policy reform, Social Funds contributions and their harmonization should also be considered.

D. Putting the middle on a diet

We have shown that the state spends significantly lower amounts of revenue relative to the “middle” layers of government (entities, Brcko District and cantons), which perform functions requiring the largest expenditures,
with little regard for coordination let alone cooperation. The current vertical and horizontal fragmentation of functions adds to administrative costs and makes it impossible to achieve economies of scale.

14 separate administrations are responsible for the most expensive government functions (police, education and judiciary). Therefore, rationalizing the costs of the middle level of government will not be effective unless some common competencies are transferred to upper levels of government. Even in less costly areas, we can observe a proliferation of administrative bodies, which carry significant costs – for example, FBiH has established a Ministry of Environment, while at the same time a State Fund for the Environment has not been established, although this is a precondition for continuation of EC projects in the environmental field.
1. Defining the problem

In this chapter, we focus on the technical and functional requirements that will be placed on BiH when the Stabilisation and Association Agreement (SAA) is signed, and the country’s capacity to take on these responsibilities. Although significant political conditions are yet to be fulfilled (adoption of the Public Broadcasting Law, police reform, arrest of war criminals and cooperation with ICTY), the technical round of the SAA is complete. However, even if BiH were to meet outstanding political conditions and sign the SAA today, the country would still face a number of challenges and difficulties that arise from the nature and substance of the Agreement. Most critically, the voluntary nature of the current process becomes obligatory after the agreement is signed, which is in essence a contract with the EC, and agreed articles of that contract become binding and subject to strict screening by the EC. Many domestic politicians
seem to have failed to grasp this and continue to view BiH’s European future as essentially voluntary and negotiable. Here we outline the main steps that must be taken by the BiH authorities from the day the SAA is signed.

2. Signing the SAA: the process

The interim agreement will be enforced two to three months after signing the Agreement and it will initiate all transitional deadlines concerning the economic parts of the SAA, i.e. 90% of the Agreement. The SAA itself (in full capacity) will become operational two years after all 27 EU countries ratify the SAA with BiH. In practice, BiH will need to start to comply with the rules three months after the SAA is signed, but it will not become eligible for the benefits of integration for at least another two years.

As this report has outlined, BiH’s constitutional set-up and dysfunctional cooperative governance system, means that obligations from the SAA will be very difficult to implement. There is a real danger that BiH could thus lag behind in the process of EU integration and that the country’s overall development will be harmed, not only because of a lack of political will, but also because the country is not prepared in terms of organizational capacity for the obligations and opportunities that come with EU integration.

Political will to meet the requirements of EU integration is only evident on the surface of political dialogue and discussion in BiH. In practice, many of the conditions required to fulfil the Feasibility Study were forced through government and parliament by international players. Implementation of many of the conditions is patchy at best, reflecting a lack of understanding and interest in the process on the part of BiH politicians and the administration more generally. There is no clear or common view on the part of political stakeholders about which reforms should be prioritised and implemented. In the face of either indifference or political obstruction, BiH could face huge political, structural, sociological and economic problems in the coming period. Where is BiH likely to find itself in five, ten or fifteen years from now? Encircled by Europe and its neighbours, whose European agendas will move forward while BiH remains trapped in stagnation? The country’s future and ability to find a way out of the present vicious circle will depend on efforts undertaken in the coming period to develop structures that are capable of exercising real domestic ownership as the international presence withdraws.

Based on experience so far, and reflecting arguments made elsewhere in this report, the most obvious institutional deficiencies, overlaps and functional conflicts in implementation of the SAA will appear in the following areas:

- the state’s ability to comply with the EU integration process will be seriously challenged by the existing constitutional arrangement in which economic policy is concentrated at entity and partly cantonal level, while the state has only a limited “coordination” role, mostly through the Ministry Of Foreign Trade and Economic Relations;
- the existence of parallel institutions at different levels of government resulting from shared and overlapping competencies, e.g. civil service agencies, directorates for roads, agriculture, health, industry;
- a continued increase in the scope of administration at state level, which is not followed by reductions in functions, budgets and personnel at entity and cantonal levels.
- lack of autonomous and adequate financial distribution mechanisms supportive of the state building process:
  - entities continue to exert significant influence in allocation of revenues collected by the state;
  - the vertical financial framework is still egg shaped and heavy in the middle;
- inept administration, which does not see the big picture and is ill-prepared to cope with the necessary changes:
  - The Directorate for European Integration and Ministry of Foreign Affairs will not implement the SAA;
  - outside the Directorate for European Integrations, Ministry of Foreign Affairs and a few individuals in some other institutions, the administration is generally unacquainted with the SAA requirements that will be required of BiH institutions at all levels;
  - ministries and institutions at entity and cantonal level exercise, by dint of BiH’s odd constitution, several responsibilities which are usually competencies of the state, so they will be subject to EC screening, if not directly than indirectly;
  - most of SAA will need to be implemented by the administrations at entity and cantonal level, who are still uneducated and uninformed about EU integration and SAA requirements;
Chapter IV
Governance structures in BiH in the context of EU integration

- lack of knowledge of foreign languages coupled with vast computer illiteracy and general absence of knowledge of the requirements of EU integration make for a recipe for disaster in this area.

- Moreover without capacity to absorb EU funds through the Instrument for Pre-accession Assistance (IPA) – which started in 2007 and is supposed to be the main and priority-focused financial injection for development outside the regular budgets of all BiH government levels – the country will face a situation in which it is unable to absorb financial resources offered by the EU. BiH still does not have a National Development Plan that could serve as a guide to the utilization of the IPA resources available to BiH. This is a precondition and benchmark to assess the ability of a potential/candidate country to use IPA funds. Since the active, coherent, strategic and coordinated involvement of BiH and entity institutions is a requirement to gain access to those funds, BiH will need to develop a whole new mechanism that can support this exercise, a so called Decentralized Implementation System (DIS), which will entail:
  - creation of necessary institutions;
  - people who will identify areas for intervention and development, will be able to write projects, civil servants who will process them, lobby, monitor, liaise, and set, account and evaluate projects in the ministries;
  - coordination among all those involved in the process;
  - cooperative and entrepreneurship spirit and mind set.

3. Virtual treatment of the consequences – what about the causes?

Bosnia and Herzegovina is thus not prepared to take further steps towards EU integration. Numerous EC projects have provided policy, technical and capacity-building assistance to BiH institutions, and the more successful of them have pushed at the limits of institutional inventiveness in order to find a way around the constraints of the country’s dysfunctional constitutional set up. However, as we have pointed out earlier in the report, much of what has been created at state-level are simply framework laws and ‘coordinating’ state institutions that cannot enforce state-level policy.

The entities, as the main stakeholders in the BiH governance system, act as mini-states using their constitutional responsibilities to create and execute developmental, economic, social and other policies. So far, the BiH state institutions have been unsuccessful coordinators of entity activities. Where there has been streamlining, the international community invariably leads the process. Unless this coordination evolves into policy creation and real responsibility over competencies that are normally in the remit of the central state, BiH as a country will not be able to fulfill any of the EU conditions and criteria. At present, both entities have a clear constitutional and legal right to do things on their own, while the state institutions can only hope that some departments in state ministries will coordinate as part of a ‘technical’ harmonisation process.

The April 2006 package of proposed constitutional changes contained a valuable mechanism that would have contributed to unblocking this deadlock, mainly through one, broadly neglected, amendment – to bring all necessary responsibilities in EU integration from the entity level to BiH Parliament and Council of Ministers. We believe that this amendment was the perhaps the most important aspect of the entire April package. Although there would undoubtedly have been disagreement over its interpretation, it would have had a huge impact on the development of governance structures, contributing to the creation of capable BiH institutions, which are constitutionally empowered to undertake reforms.

Thus far, the programming and implementation of all EU assistance to BiH has been centralized through the EC Delegation with minimal involvement of the beneficiary institutions. As BiH moves to the status of potential candidate country, new models of pre-accession assistance require the more strategic and active involvement of BiH institutions. Going on present indicators, this requirement will expose the severe shortcomings of the present systems and the ability of BiH’s institutions to perform in new, more serious circumstances. The time has come to take the virtual reality helmets off the heads of both the EC and local stakeholders.
4. Instrument for Pre-accession Assistance (IPA) and its requirements.

EU candidate countries and potential candidate countries receive financial assistance through pre-accession funds in order to create capacity required to utilise EU funds available for member states. The new pre-accession instrument – IPA – makes a clear distinction between candidate and potential candidate countries (Annex C). Access to pre-accession funds involves complicated technical procedures in the implementation of funded programs and complex and transparent project management.

IPA will be an accession driven instrument, aimed to support the fulfillment of all the requirements from the accession process. The major EC objective when designing the IPA was to streamline “all pre-accession assistance into a single framework and to unite under the same instrument both candidate and potential candidate countries therefore facilitating the transfer from one status to another”. The IPA\(^{79}\) will thus consist of five components: Transition Assistance and institution Building, Cross-Border Cooperation, Regional Development, Human Resources Development and Rural Development.

A. IPA and NDP in the context of public finances in BiH

The aim of IPA fund is to support the realization of each country’s National Development Plan (NDP). Since the creation and implementation of a NDP has a strong economic impact, and therefore macroeconomic and financial impact as well, its creation has to be coordinated among the responsible authorities at many levels of government in BiH. It is not necessarily one document but rather a comprehensive and coordinated set of documents with clear vision and defined priorities in the key areas. Nevertheless, to create this plan, a high level of political will and consensus as well as common vision is of paramount importance.

Furthermore, by signing the SAA and getting access to IPA, Bosnia and Herzegovina and the EU become partners in the development of the country. The partnership relation requires matching funds from the BiH side in the implementation of NDP. Problems will certainly arise as 14 parallel budgets finance responsibilities and many of these are shared among two or more levels (for example, transport, agriculture, education, science).

The Maastricht criteria represent another critical issue that BiH will need to comply with in a more effective way. At present, the state’s limited authority in fiscal affairs and the problematic functioning of the Fiscal Council demonstrates the insecurities and fragility of cooperative institutions in which entity-voting is retained.

B. Institutional requirements for IPA absorption

IPA implementation modalities are not defined yet. It is expected that IPA implementation modalities will partially unify the processes of management, implementation, programming and monitoring of the components available to candidate countries.

A Decentralised Implementation System (DIS) envisages a partial transfer of responsibilities from the EC to the recipient state in areas of a) procurement and grant allocation procedures and b) transfer of payments to end users.\(^{80}\) The transition from a centralised to decentralised system of implementation is part of a potential candidate country’s gradual preparation to manage the pre-accession funds.\(^{82}\) A key misunderstanding is that introduction of a DIS model represents the development of pre-accession funds absorption capacities.

Using EU terminology, the main elements of a DIS are a National Fund (NF), Central Financing and Contracting Unit (CFCU), National Aid Coordinator (NAC) and Senior Programme Officers (SPO).\(^{82}\)

The National Fund is a channel for transfer of EC funds headed by the National Authorising Officer (NAO), usually an Assistant to the Minister or a State Secretary appointed by the Government. NF and NAO are usually

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\(^{82}\) Ibid.
linked to finance management. The role of the National Authorising Officer is to submit requests for funds and manage pre-accession funds, as well as to appoint PAO (Project Authorization Officer) in cooperation with NAC.

The Central Financing and Contracting Unit (CFCU) is an agency for implementation which cooperates with other ministries and agencies (project beneficiaries). The CFCU’s responsibility include organising public procurement notices/tenders, contracting, budget creation and payment of Community funds. CFCU is headed by a PAO who is responsible for efficient realisation of the programmes, economic and efficient spending, or ensuring sound financial management, including tendering procedures and contracting procedures, as well as project monitoring. This is the most technical institution to be created which must work according to EU financial and contracting practices.

The National Aid Coordinator (NAC) is responsible for coordination of programming, including project formulation and monitoring and appraisal of pre-accession funds. In cooperation with NAO, relevant ministries and the EC, NAC is also responsible for programming through drafting and coordination of annual financial memoranda. The NAC is a member of JMC and the main associate of the EC Delegation throughout the project cycle, ensures coordination with the BiH Ministries and acts as a liaison between the Delegation and Ministries. This role should be taken on by the most experienced institution in EU integration in the country, which has capacity for coordination and knowledge of EU programming.

Senior Programme Officers (SPO) are located in line ministries. The responsibility to manage and technically implement project activities within ministries lies entirely with them. It is important to stress once again that the CFCU is responsible for the administrative and financial aspect of project realisation, while SPOs deal with the actual implementation. The EU communicates through state ministries and institutions only. Therefore, SPOs are established in the BiH state ministries which are to coordinate but not implement projects. BiH’s track record so far in coordinating projects is poor, and BiH ministries that have proved largely incapable of performing an efficient coordination role to date will be responsible for the technical coordination of significant EU related projects. About 70% of SPOs will be located in MOFTER, the international community’s favoured economic coordination ministry, followed by Ministry for Civil Affairs of BiH as the ministry responsible for the coordination of most other issues that are within the responsibility of the state.

Working groups (European Integration units) are to be established among entity ministries, and in some cases within ministries, if there is a multitude of projects. EU funding is treated within aid coordination groups at entity level along with other donor programmes. The main problem outlined several times in the report is that fact that the constitutional set up in BiH does not provide for clear vertical subordination between levels of government. A recent ACIPS study rightfully identifies that “Federation of BiH and the RS have different challenges in this area... FBiH’s main problem, as in other areas, is coordination with lower levels of government, due to a complicated nature of intergovernmental relations. The situation in the RS is almost the opposite since RS has created a parallel system inside of its own government which directly deals with RS municipalities, when necessary. The main issue is lack of effective coordination between the state ministries and the RS government.”

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83 Other NAO duties are signing financial agreements with the CFCU; ensuring regular updates on the system for submitting of financial reports for CARDS funds and corresponding steps on the reporting to CFCU; transfer of funds to CFCU in line with the mechanisms defined in the Financing Agreement; participation in the common monitoring board along with the representatives of the European Commission, PAO and NAC; return of the unutilised funds in the CFCU at the end of CARDS programme.

84 www.deltur.cec.eu.int/default.asp?lang=1&sprId=7&prnId=5&hnd=1&cod=4&docId=580&fop=0

85 Also, with EDC, CFCU makes appraisals of the budgets of draft project contracts, signs contracts before forwarding them to EDC to screen, and makes payments of EU financial contributions for project realisation.

86 PAO’s main duties are ensuring the setting up of corresponding structures for programme realisation and its successful realisation; design, realisation, and monitoring of projects, in line with the tender control procedures and contracts envisaged in the Memorandum on Financing; ensuring respect of DIS rules during awarding of contracts and project realisation; ensuring transparency in usage of programme funds and policy of open information sharing for all stakeholders; signing of contracts and authorisation of payments; intermediary function between contractors and beneficiaries in cases of obstacles in project realisation; setting up and functioning of efficient accounting system, in line with the DIS rules on financial management and reporting; regular reporting on the status of projects and funds; naming of the commission for appraisal of project success; participation in the Joint Monitoring Committee (JMC).

87 Also, NAC provides guidance for priority areas from the Country Strategy Paper (CSP) and multi-year state programme, ensures coordination of programming, alongside other donor programmes, and provides comments and guidance on project ideas, and forwards them to the EC for oversight.

88 ACIPS Center for Policy Research study envisage DEI as NAC.


However, BiH needs to show an ability to plan strategy and define priorities for development that might lead to more competitiveness. Therefore, "standard benchmark for the measurement of the ability to properly plan the absorption is contained in the National Development Plan (NDP). I order to produce a quality, comprehensive strategy for the proper use of the EU pre-accession aid instruments, or the NDP, BiH needs to start building relevant capacities now. Timing is crucial factor." To cut a complicated story short, in parallel with a comprehensive development strategy (not a political wish list), BiH needs to create six kinds of institutions which must be highly cooperative in order to provide minimal assistance absorption, no matter what they are called. The following should also be defined in the NDP:

- Managing Authority, responsible for the implementation of NDP and setting up necessary implementing, monitoring, evaluation and control systems.
- Paying Authority, designated to draft and submit payment applications to EC, receiving them from EC and processing towards the final beneficiary.
- Intermediate Bodies, responsible for the implementation of priorities and implementation of measures.
- Final Beneficiary, Bodies which grant the aid: state authorities (in wider sense) and foundations acting/; under state control.
- Priority/Measure Workgroups, carrying out the monitoring of the application on Priority/Measure level, real implementation.
- Auditing Authority, established by the Parliament to MA, PA, IBs and final beneficiaries or relevant ministries.

Programming quality will largely depend on local incentive as the best motivator and guarantor of successful programming and implementation. "The local stakeholders have to be involved at all stages of the project, not just through the internet or seminars because of the better organisation and information dissemination and also because the larger involvement builds the ownership feeling and goes a long way in creating a risk taking and pro-active attitude as well as independent initiative mentality." If the project is written by a central authority, without it, it is likely that the implementation of such project will not be successful. Therefore, the opportunities for partnerships and co-financing should be explored at the local level. Even where there are insufficient funds the end users need to adopt the mentality of “helping themselves” as much as possible.

Indeed, local / municipal authorities, as well as NGOs and the local business community, need to identify the priority actions at their level that would help boost their capacity, and feed these into the preparation of projects, taking advantage of co-financing possibilities and independent reflecting these in budgetary planning. Mechanisms of consultation used at the local level also impact on chances of receiving funds.

Finally, although DIS is a requirement, its full implementation is not in itself sufficient to create optimal absorption capacities. The new IPA will mainly initially cover the sectors of Rural Development/ Agriculture, Transportation and Environmental Infrastructure/ Regional Development, Human Resources Development and Institutional Building Measures. Therefore, the development of absorption capacities takes place predominantly in the institutions that govern these sectors and non-state actors interested in the process. This includes introduction of proper horizontal and vertical institutional organisations and a strategy required to manage, programme, implement and monitor the process.

92 Ibid.
93 Ibid. pg. 37
94 Ibid. pg. 37
95 As noted in ACIPS Study, full implementation of DIS is a precondition for the creation of absorption capacities. DIS covers procurement and grant allocation procedures; transfer of payments to the end users and limited programming elements.
5. Conclusion

Bosnia and Herzegovina’s road towards EU has no viable alternative, yet it remains a highly politicized issue. The fulfilment of this goal, which is supported by most BiH citizens, is dependent on the functioning of highly cooperative governance mechanisms in order to ensure the proper application of increasing numbers of technical requirements across the country. As we have shown, cooperative mechanisms generally do not function in BiH, thus the country’s road to Europe is likely to provoke huge political, structural, sociological and economic problems.

Besides an absence of political will to render the system functional, BiH is also plagued by an incompetent, inefficient and ill-informed public administration that has been protected by the Laws on Civil Service at state and entity levels. Even if or when political consensus is reached, the inert public administration will seriously hamper BiH’s future chances of successful EU integration. Reform in this area is as important as realignment of the governance structure. Otherwise, BiH will be unable to take advantage of IPA funds, prioritize development areas and upgrade its competitiveness.

6. Recommendations

- Adopt the draft constitutional amendment proposed in April 2006 which would give the BiH state legislative authority to meet the requirements of EU integration. Adoption of this amendment should be considered a precondition for continuation of the SAP and accession process.
- Develop BiH matching funds for implementation of the National Development Plan (NDP) that will complement the National Fund for IPA (pre-accession instrument) resources. Create a line in the BiH budget for matching funds.
- Authorize (if necessary through constitutional amendment) the National Fund and BiH matching fund to administer financial support for the implementation of projects co/financed by IPA which might target areas in which responsibilities are shared between the state and lower levels of government (transport, agriculture, education, science).
- Empower the Ministry of Finance and Treasury to assume necessary authority and capacity to assist in this process.
- Build political will and institutional mechanisms necessary for EU integration, defining the maximum executive power of the entities and minimum executive power of BiH State, having in mind the subsidiarity principle for effective implementation of the *acquis communitaire*.
In the course of this study, nine focus groups were conducted in five locations throughout BiH during February 2007, to gauge public perceptions of the structure and conduct of governance in BiH. The groups reflected a cross-section of the public with regard for age, gender and national balance. Although there are variations in the participants’ responses in some areas, the common denominator for all, regardless of gender, nationality, religious background etc. is a perception that the authorities in BiH make decisions on behalf of citizens, excluding them from participating in the process. Most participants firmly believe that the views of ordinary people do not count and that they are there simply to be used by politicians prior to elections; elections are not about substantial

96 Interviews with focus groups were conducted in Tuzla (1 Feb 2007), Zenica (11 Feb 2007), Doboj (16 Feb 2007), Brecko (17 Feb 2007), and Mostar (West) (25 Feb 2007). The groups were generally divided into two, based on gender, with the exception of Mostar (West) where one focus group representing both genders was formed.
democratic issues and processes, but rather a tactical trick played on the public by corrupt political elites.

Far more worrying, the focus groups indicate that people in BiH are getting used to and almost accept a situation in which they are passive viewers of the political process, rather than active players in it. This does not simply reflect an absence of understanding of what democracy should be about. It points to a broader collective alienation from socio-political processes. The country’s recent experience of conflict and the peculiarities of post-conflict politics have contributed to this deep sense of alienation and inertia. Politics is seen as a game between self-interested political elites. The constitutional structure confirms and exacerbates this, reducing politics to an apparently zero-sum game between antagonistic national groups. There is a serious lack of communication and consultation between political elites in this system and the electorate, who are should to be their corrective.

1. Perceptions of the BiH state

Lack of communication and consultation with citizens is felt to be particularly acute at the level of the distant BiH state institutions. Psychologically, people find it difficult to identify with something that is weak, distant and apparently unsuccessful in serving their basic needs. The focus groups reconfirm that the state institutions are out of sight, complex, and above all disconnected from citizens. What could be a strength of the Dayton construction – that it equally represents and safeguards the interests of all the major ethnic or national groups in BiH – is not an attribute which is seen as a positive by citizens. Rather, politicians use the tripartite division to sustain parallel and competing power-bases, to promote disintegration and conceal their activities from the public. Policies that emerge from this system tend to be based on the lowest common denominator rather than on issues of efficiency, functionality, fairness etc. Thus, citizens’ primary identification remains religion, ethnic belonging and local patriotism, and identification with the state takes a more or less distant second place.

“I DO TRUST THE ENTITY GOVERNMENT..., BUT I DO NOT TRUST WHAT THE COUNCIL OF MINI- STERS OF BIH SAYS ... I DO NOT KNOW WHETHER PEOPLE FROM BIH FEDERATION TRUST THEM EITHER...”

– Doboj, male

State-level governance structures appear to be distant, unclear, virtual, and inefficient in the eyes of ordinary people. Respondents underlined that they have few practical links to the state institutions. They are quite aware that they do not pay taxes to the state, but rather to the entities and cantons. They have passports provided by the state, but they cannot travel freely and without a visa. The entities are responsible for social programs and healthcare and even higher education. The state institutions are still a pale imitation of the state-like entities, which citizens recognize, giving preference and loyalty to lower levels of government. These responses underline the finding that the Dayton-Washington constitutional framework is not a functional consociation, but is rather based preventing one group from dominating another, effectively preventing the government from functioning in the absence of large amounts of political will. Our focus groups confirm that this system generates and feeds off fear, creating a viscous circle that requires international intervention to break stalemate.

Interviewees pointed to the fact that citizens have grown tired of expecting any positive changes to happen.

“I WOULD SAY THAT OUR CITIZENS ARE TIRED AND THAT THE MAIN REASON FOR THIS PASSIVENESS IS THE FACT THAT NOTHING HAS CHANGED FOR A LONG TIME”.

– Mostar, female
Many participants portrayed Bosnia and Herzegovina today as a nightmare, which complicates rather than supports the lives of citizens. The main culprits identified are:

IC. The international community, whose mandate and authorities are perceived to be the greatest, tends to be seen as the undisputed governor of BiH. Political parties. Regardless of public perceptions of the power of the international community, most respondents consider political parties to be the main reason for political stalemate, which prevents the state from developing to the satisfaction of its citizens. There is a clear perception that BiH’s destiny has been left to the narrow interests of the governing political elites, which have been in place for years. Those elites govern, shape public opinion, and manipulate it in the way that suits their interests.

Elected representatives and civil servants. The majority of respondents do not have trust in elected representatives or civil servants. Lack of support is slightly greater in the case of elected representatives. Many consider that entering politics has become a profitable business and that the governing structures (elected representatives) deliberately produce crises in order to maintain the status quo and enjoy the privileges it offers.

Religious institutions. Some interviewees emphasize the strong influence of religious institutions on political and social affairs in BiH, stating that the leading nationalist parties have given religious communities the role of arbiter in some social spheres which are not their responsibility. Respondents believe that the opinion of religious authorities is taken into account even in the selection of individuals who are appointed to key political positions.

“Governing parties are under the great influence of religious institutions. Not only in policy-making, but in the appointment of key positions”.
– Zenica, male

Financial lobbies. Focus group participants stated that there are various lobbies in BiH (financial, or energy lobbies), which, with the support of political parties and religious institutions, are privatizing the country and shaping its destiny.

Some respondents feel that politicians have forced them into a kind of self-defensive lethargy against their will, but they see no way out of this cycle. They consider politicians and elected representatives to be morticians of the state, deliberately destroying its social, moral and economic cohesion. Respondents questioned whether they should trust people who are expected to build and develop the state, but easily give up their ideological affiliations for the privileges offered by political position.

Focus group participants acknowledge that they are citizens of BiH, but are generally distrustful of the BiH state, which seems to be akin to a new brand for them. Citizens are generally distrustful of the state and do not seem to want to get closer to it, because they perceive that it can give little or nothing in return. The state has failed to use this space for interaction, “selling its brand” in fields, for example, where the state institutions have a prominent role: including EU and NATO integration, public diplomacy, visa regime, foreign direct investments etc. Radical decentralization mitigates against the development of citizens’ loyalty to the state, as does the failure of politicians to harmonize differences, instead choosing to perpetuate them.

Respondents are not satisfied that political elites put their personal or party’ interests before state interests and use complex governmental structures as a cover for bad results. Some believe that the complex governmental structure need not be an obstacle to improving the functioning of the administration, if politicians were willing to cooperate in the implementation of objectives that are for the benefit of all citizens.

Most respondents are familiar with the basics of the governmental structure which was established by the Dayton Peace Agreement, and they are not satisfied with it. They label the structure complicated, irrational, inefficient and expensive, especially in FBiH. Numerous layers of government and models of political organization at each level create a large administration, which BiH is not capable of sustaining.

Respondents consider cantons an additional burden for BiH, and generally consider this level of government obsolete. They consider cantonal administrations large, incompetent and wielding competencies that additionally complicate the FBiH.

The majority of respondents expressed confidence in local government which is perceived as closest to the citizen and most willing to respond to their needs and effect instant results. They generally believe that local authori-
Governance structures in Bosnia and Herzegovina

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ties should be given more competencies, including management of economic development. Some stress that a new form of interaction should be built between local and central levels, and that it should start from the bottom where the identification and loyalty is the strongest. Local governance reform is considered generally successful and should continue to be supported because it has brought visible results97.

However the following should be born in mind:

- BiH citizens are looking for a more functional system, which will ease their fears about an uncertain future. Therefore, all political stakeholders in BiH need to do their utmost to give assurances to citizens and relax their fears about the impact of reforms. Since the 2006 election, political rhetoric has worked quite to the contrary.
- Most respondents feel that the state should be given more authority, but they disagree about the form of territorial organization below the state level.
- Most respondents, from all three national groups, agree that the structure of government in BiH, as defined in the Dayton Peace Agreement, should be improved, or reorganized in order to improve the functioning of government. But there is little consensus about what should be changed to improve the system. Opinions from respondents from different national groups were often diametrically different.

“... Do not touch RS... Let Sarajevo be the capital of the whole of BiH, but let Croats get some sort of federal unit...”

– Doboj, male

“...I would love it if our country was organized more simply with stronger municipalities, local governance and state institutions only...”

– Zenica, female

“...there is too much overlapping between FBiH, state and cantons. It has to be simplified”,

– Mostar, male

“...I have the least faith in the canton, because the canton is some institution... organizational form, which leads to nothing and helps no one”

– Zenica, male

97 Government Accountability Project (GAP) helped establishing more direct interaction between local authorities and citizens
2. Perceptions of process of constitutional change

The majority of respondents agree that BiH is not a functioning state, but their opinions are divided as to the cause of this. Some blame the complex governmental structure on the constitutional set up, others believe that the personal interests of individuals from the governing parties are the problem, as they manipulate national sentiment for their own ends, others blame the international community.

Many respondents could not say or it was not clear to them what the constitutional reforms proposed in April 2006 entailed. Some stated that they did not want to familiarize themselves with the proposals as they believed political parties involved in the process did not actually intend to pass these reforms.

Those who had some knowledge of the constitutional reforms understood them as delegation of competencies to the state level and a process which would have established more state ministries, including a Ministry of Agriculture at the state level. They also recognised that the proposals would give Bosnia and Herzegovina one president who would be elected from among representatives in the state parliament. Those who were familiar with the proposed reforms believed the package was generally positive.

Respondents had many objections to the way in which the process of attempted constitutional change was conducted. They believe the process had a negative outcome because both substantive changes and the management of the process were dictated by the international community, namely the embassies of the USA and UK, who avoided announcing and explaining their intentions to BiH citizens. The international community is blamed for failing to establish a constructive dialogue with local actors, applying ‘backroom’ pressure instead.

“A DISASTER – BECAUSE IT WAS CONDUCTED THE WRONG WAY. IT WAS DONE BY EU, IT WAS DONE BY THE BRITISH EMBASSY AND IT WAS DONE BY THE AMERICAN EMBASSY. AND THEN AS ONE POLITICIAN WAS COMING IN THEY TOLD HIM WHAT HE WANTED TO HEAR AND AVOIDED WHAT HE DID NOT WANT TO HEAR. AND THEN THEY TWISTED ARMS, REMOVED POLITICIANS AND IN THE END, THERE WAS NOTHING”.
– Mostar, male

“NOBODY EVER PRINTED OUT THE CONSTITUTIONAL REFORMS; THEY NEVER CAME OUT AS A CLEAR PROPOSAL. THEY WERE THE PROPOSAL OF ONE STATE, I.E. ONE EMBASSY PUT FORWARD A PROPOSAL WHICH IT NEVER WANTED TO ANNOUNCE IN PUBLIC OR TO PRINT OUT IN THE NEWSPAPERS SO WE COULD READ IT”.
– Mostar, male

The majority of respondents in focus groups consider that the biggest mistake of the process was the fact that its success was dependent on the will of political parties only. Respondents pointed out that these changes concern every citizen of BiH, not just parties, and they object that political negotiations were not transparent or subject to public scrutiny. Negotiations were conducted behind closed doors with no media access. This has contributed to
a sense of conspiracy in the minds of many respondents. Some respondents criticized the way in which politicians used the constitutional amendments to manipulate national feelings for their own political goals. That created confusion and suspicion among the public. Political parties of different ethnic orientations interpreted the changes in the way that suited them best. The international community had its own demands and subsequently their own interpretation of those reforms which created additional confusion in people's heads.

First, it was wrong that only the leading political parties were invited to these talks. Secondly, those talks were conducted secretly and no journalists were able to attend.

— Zenica, male

Wrong, because no one informed the public sufficiently... the process was kept private and no one clearly stated to the public what the constitutional changes involved. We had to find out from the media, to the extent that journalists were able to find out themselves.

— Brčko, male

One story was served to us and others served a different story to their people... and the international community served a third story.

— Brčko, male

...certain basic things were agreed on by a narrow group of people. And I wish that this had been subject to public discussion or something similar in order for citizens to have their say, to find out what broader public thinks about it, and then send it on for adoption... four men vote this out and then we live in a completely
DIFFERENT STATE AND WE HAVE NO CLUE WHAT WAS THIS WAS ALL ABOUT. WE SHOULD HAVE HAD THE CHANCE TO VOTE FOR THIS.

– Zenica, male

IN MY OPINION THEY STARTED WITH ALL THOSE SESSIONS IN THE WRONG PLACES LIKE THIS HOTEL, THAT MOUNTAIN... [THE PROCESS] WAS ALREADY MYSTIFIED.

– Brčko, female

The actions and public appearances of domestic politicians during the process are subject to heavy criticism as respondents believe that they did not attempt to deal with the real issues and problems affecting BiH during the constitutional negotiations.

IT WAS PITIFUL TO WATCH ON TV HOW POLITICIANS NEGOTIATE CONSTITUTIONAL CHANGES WITHOUT ANY KNOWLEDGE ABOUT THE ISSUES THEY ARE NEGOTIATING. SOME INTERPRETED THEM IN ONE WAY, OTHERS IN ANOTHER. THEY DID NOT KNOW THEMSELVES, NOT TO MENTION ORDINARY PEOPLE WHO ONLY READ ABOUT IT AFTER.

– Mostar, male
Revenue allocation in FBiH is regulated through the Law on allocation of public revenues in Federation of Bosnia and Herzegovina (FBiH OG 22/06) and through a range of cantonal laws and decisions regulating the allocation of revenues between each Canton and its municipalities. The FBiH Law on allocation of revenues defines the sharing of major tax revenues in FBiH, while Cantonal legislation regulates the sharing of cantonal taxes.

Direct tax revenues and contributions (health, pension, unemployment) in FBiH are collected by the FBiH Tax administration and shared across different levels of government in accordance with legislation. The fees and charges are collected by the Cantons and Local Governments themselves, but there is no particular body responsible for their collection.
FBiH main revenues are:

- 36.2 percent of the revenues received from the Single account
- 100 percent of the enterprises’ profit tax paid by banks and other financial institutions; agencies for insurance and reinsurance of property and persons; legal entities from electric power management; post and telecommunications; and legal entities whose sole activity is gambling;
- fees and charges, fines and penalties under Federation regulations;
- revenues from natural resources and property owned by the Federation;
- donations

Cantons revenues are:

- 51.48 percent of the revenues received from the Single account
- 100 percent of the profit tax paid by all enterprises whose revenues are not FBiH revenues,
- 71.5 percent of the Wage Tax collected in each Canton;
- percentage of revenues from taxes defined by Cantonal regulations (property tax, citizen taxes, etc)
- fees and charges, fines and penalties under Cantonal regulations;
- revenues from natural resources and property owned by Cantons;
- donations and categorical grants;
- other revenues defined by cantonal and FBiH regulations

Local governments’ revenues are:

- 8.42 percent of the revenues received from the Single account
- a minimum of 28.5 percent of the wage tax collected within each local self-government unit;
- 100 percent of the land use and the land development fees;
- percentage of revenues from taxes defined by Cantonal regulations (property tax, citizen taxes, etc)
- fees and charges, fines and penalties under local government regulations;
- revenues from natural resources and property owned by local governments;
- donations and categorical grants;
- other revenues determined by FBiH, cantonal and local government regulations

Republika Srpska revenue allocation is regulated by the RS Law on Budget System, which defines the sharing of all revenues within RS.

Direct tax revenues and contributions (health, pension, unemployment) in RS are collected by the RS Tax administration and shared across different levels of government in accordance with legislation. The fees and charges are collected by relevant Local Governments themselves, but there is no particular body responsible for their collection.

Republika Srpska revenues are:

- 72.5 percent of the revenues received from the Single account
- profit tax;
- personal income tax 75%
- tax on movable property
- special tax on regular and safe operation of railway traffic;
- tax on organization of lottery and gambling games;
- fees, duties, charges and fines
- revenues from illegally gained property and profits;
- other revenues in accordance with RS regulations
Revenues of Local governments in RS are:

- 24 percent of the revenues received from the Single account
- personal income tax 25%
- property tax,
- tax on income from lottery games
- fees, charges, and fines
- other municipal revenues

Republika Srpska adopted a new income tax law in August 2006, and it is expected that the Law on Budget System shall be changed to reflect the changes in the tax system.

Brcko District revenues are regulated by Brcko District Law on Revenue Agency, which is the body responsible for revenues collection in Brcko District. Brcko District revenues are:

- 100% of the SA revenues
- Profit tax
- Income tax
- Property tax
- Electricity use fees
- Other fees, charges, and fines
- Other revenues defined by Brcko District regulations
Income taxes

High levels of unemployment accompanied with low incomes and black market employment (grey economy) have negative effects on the volume of income tax collection. Furthermore, any citizen of BiH who wishes to work for an employer in a different entity can be defined as a foreigner.

There are three separate systems in the income tax area:

- Income tax in Brcko District based on the flat tax rate of 10%
- Income tax in RS with progressive tax rates of 0, 10 and 15%
- Extremely complicated system of income taxation based on federal and cantonal laws on taxation in FBiH

Different levels of payments for health, unemployment and pension benefits are evident in both entities. The level of benefit payments
Governance structures in Bosnia and Herzegovina

According to the federal law, wage tax in FBiH is 5% and tax for special service agreements rate is 32%. All other incomes are regulated by cantonal legislation with inevitable differences such as:

- Income tax on individual employment activity (from 20% to 30%),
- Property taxes (houses, apartments, cars, garages, buildings, etc.)
- Property income and property rights taxes (rent, income from participation in an entrepreneurial activity, usually 15%)
- Taxation of property rights, patents, and technical advances (5% to 20% depending on the source of income)
- Inheritance and gift taxes (3% to 10%)
- Lottery winning taxes (15% to 20%)
- Agricultural activity taxes
- Taxation of total individual annual income (from 10% to 20%).

Based on the aforementioned, FBiH has a two phased taxation of individual income:

1. Individual taxation of specific types of incomes: income, individual employment activity, property income, etc.
2. Double taxation of income thorough the application of total annual individual income tax on top of other income related taxes if a certain threshold is reached (this category has been fictional since very few individuals reported their annual income and control system is almost nonexistent).
3. FBiH is currently preparing for adoption of a new income tax law which should replace a slew of different income taxes with a single FBiH Law on Income Tax that will tax all sources of income under a single set of rules. While this will stabilize the tax space within FBiH, differences will remain on the national level due to specific entity tax laws.

Profit tax

Entities in BiH have adopted very different profit tax laws for companies. These tax laws differ in tax rate, number and size of tax deductions, and incentives.

Although the tax rate in FBiH is 30% and only 10% in RS, it does not necessarily mean that businesses in RS are in a privileged position. To be more specific, the high tax rate in FBiH is often annulled by high level of tax deductions and incentives which aim to promote, stimulate and develop domestic businesses. Unfortunately, this system has resulted only in businesses spending more on accountants who can help them find the deductions and incentives to apply and hide legitimate profits. The RS system is simpler for implementation and the low rate means there is less incentive for tax evasion.

Additional problem arises when businesses with home office in one entity acquire income from their offices in the other entity. All businesses from FBiH which acquire income in RS are to pay taxes according to RS laws. The same business must also pay taxes in FBiH which is a perfect example of double taxation or overlaps in tax laws.

Although new tax laws are expected to resolve the issue of double taxation there is still the issue of lack of direct tax laws on national level. For all businesses wishing to conduct their business in both entities continuing problem will still be the existence of several different profit tax laws. Having double taxation in one country is in direct contradiction to one of the most basic Constitution requirements and principles – the existence of single economic space in Bosnia and Herzegovina.
The CARDS programme came to an end in 2006 and has been replaced by a new instrument, the Instrument for Pre-Accession Assistance (IPA)\(^8\). This new instrument will also replace other pre-accession instruments (e.g. ISPA, SAPARD). In addition to economic and institutional dimensions, the IPA instrument has a clear social dimension. For instance, regional and rural development components are directly referred to the social inclusion of vulnerable groups and development of disadvantaged areas; human development component directly refers to the creation of capacity for programming and managing European Social Fund.

Since 2001 assistance to BiH was provided mainly through the CARDS instrument. The priority sectors for CARDS assistance to Bosnia and Herzegovina were:

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Refugee return
Support to institutions (tax and customs)
Local development and social cohesion
Policing, asylum and migration
Integrated border management
Environment and natural resources

The full financial envelope for 2000 - 2006 for CARDS was € 5.13 billion out of which Bosnia and Herzegovina received 502.8 million EURO or approximately 10%. 99

EU assistance absorption is framed by a number of fixed documents and processes.

First of all, the new IPA instrument and its different approach to candidate and potential candidate countries that will start on January 1st 2007. Moreover, its requests for new State institutions and procedures needed for assistance absorption make this frame even stronger.

Second, “Strategy for implementation of the Decentralised Implementation System (DIS) in BiH of 8 April 2005” represents the institutional framework around which a more concrete model of EU assistance absorption will have to be tailored.

Third, is the “European Partnership for Bosnia and Herzegovina” and “The Action plan” for its implementation based on a “Strategy for European Integration of Bosnia and Herzegovina”.

Fourth, is the very process of negotiation on a Stabilization and Association Agreement.

Fifth, and from the structural and organizational point of view the most important, is the Constitutional structure of BiH and the authorities of all levels of government set by the Constitution.

EU candidate countries and potential candidate countries receive financial assistance through pre-accession funds in order to create capacities for the use of the EU Structural, Cohesion and regional development funds, European Social Fund and other funds available for the member states. Pre-accession funds are also aiming to support the adoption of Acquis in the candidate countries. The new pre-accession instrument – IPA makes a clear difference between candidate and potential candidate countries. Candidate countries100 have access to all five components of IPA while potential candidate countries101 have access only to the first two.

The status of EU potential candidate country will allow Bosnia and Herzegovina to access partially the pre-accession funds. Access to funds does not imply that a candidate or potential candidate country will be able to use (absorb) these funds. Access to the pre-accession funds involves very complicated technical procedures in implementation of funded programmes and requires complex and transparent project management. In order to access the pre-accession funds and implement EU funded projects, it is necessary to develop absorption capacities (technical, human and financial capacities for the accession as well as the implementation, monitoring and reporting capacities) of domestic institutions, nongovernmental sector, and business community. It is debatable whether Bosnia and Herzegovina is prepared to manage new pre-accession assistance and to absorb those funds. From that point of view, any discussion about accessing all five IPA components or only two is premature. The experiences of the new EU member shows clearly show that development of absorption capacities is a long-term process. The average absorption of pre-accession funds is 20% of available funds in the first several years of availability, and after that the average increase of absorption is approximately up to 60%.

100 Croatia, Turkey and FYR Macedonia
101 Bosnia and Herzegovina, Albania, Serbia and Montenegro
IPA components

It is already obvious that the IPA will be an accession driven instrument, aimed to support the fulfilment of all the requirements from the accession process, notably in terms of priorities, monitoring and evaluation. IPA will therefore replace the current pre accession instruments:

- PHARE, the scope of which is support for the implementation of the acquis communautaire in the form of institution building and related investments, investments in economic and social cohesion and cross-border cooperation;
- ISPA, which is the precursor of the Cohesion Fund and deals with environment and transport infrastructure;
- SAPARD, the precursor of Rural Development plans, dealing with Common Agricultural Policy acquis and Rural development;
- Turkey pre-accession, with the same scope as Phare;
- CARDS, which covers the Western Balkans.

In line with the Commission’s aim of simplifying the procedures and coordination of external assistance, the major objective when designing the IPA was to streamline “all pre-accession assistance into a single framework and to unite under the same instrument both candidate and potential candidate countries therefore facilitating the transfer from one status to another”. The IPA102 will thus consist of five components:

1. Transition Assistance and institution Building Component as a first component shall assist the Western Balkan countries in the attainment of the objectives set out in Article 2. It may inter alia be used to finance capacity and institution building as well as investment as far as the latter is not covered by components 2 and 5.

2. Cross-Border Cooperation is second Component made to support the candidate and potential candidate countries in cross-border, and, where appropriate, trans-national and interregional cooperation among themselves and between them and EU Member States. The objective is fostering stability, security and prosperity in the mutual interest of all countries concerned, and of encouraging their harmonious, balanced and sustainable development. It is especially important that within the objectives of this article, this component may inter alia be used to finance capacity and institution building as well as investment.

3. Third component, the Regional Development Component shall support only candidate countries in policy development as well as preparation for the implementation and management of the Community’s cohesion policy, in particular in their preparation for the European Regional Development Fund and the Cohesion Fund. With this component differentiation begins between Anex I and II countries.

4. The Human Resources Development Component is the fourth component that should support again only candidate countries in policy development as well as preparation for the implementation and management of the Community’s cohesion policy, in particular in their preparation for the European Social Fund.

5. The Rural Development Component is the fifth and final component dedicated to support for candidate countries in policy development as well as preparation for the implementation and management of the Community’s common agricultural policy. It shall in particular contribute to the sustainable adaptation of the agricultural sector and rural areas and to the Candidate Countries’ preparation for the implementation of the acquis communautaire concerning the Common Agricultural Policy and related policies. Preparations for CAP are considered the most important task for new member states during their candidate status.

This short overview offers insight into what can be expected from the IPA instrument. By reading IPA Regulations more carefully, it is evident that 3-5 IPA components could be open in some areas for potential candidates under certain conditions. This gives reform oriented governments the opportunity to take advantage of all possible funds on the road to EU accession. However, there are no guarantees. Differentiation is there to make distinctions and to push potential candidates towards successfully implementing more reforms, reaching candidate status therefore opening the full IPA package to them.

Abbreviations

ACIPS  Alumni Association of the Centre for Interdisciplinary Postgraduate Studies
BD  Brcko District
BiH  Bosnia and Herzegovina
CAFAO  Customs and Fiscal Assistance Office
CARDS  Community Assistance for Reconstruction, Development and Stabilisation
CFCU  Central Financing and Contracting Unit
CIPS  Citizen Identification and Protection System
CoM  Council of Ministers
CRA  Communications Regulatory Agency
CSA  Civil Service Agency
DFID  Department for International Development
DIS  Decentralized Implementation System
EU  European Union
EUSR  European Union Special Representative
FBiH  Federation of Bosnia and Herzegovina
FTV  Federal Television
GAP  Government Accountability Project
GDP  Gross Domestic Product
HDZ  Croat Democratic Alliance (Hrvatska demokratska zajednica)
HJPC  High Judicial and Prosecutorial Council
HoR  House of Representatives
HR  Human Resources
HRM  Human Resource Management
IBs  Intermediate Bodies
IC  International Community
ICTY  International Criminal Tribunal for Yugoslavia
IDMP  Institute for Development Policy and Management
IEBL  Inter-Entity Boundary Line
IMF  International Monetary Fund
IPA  Instrument for Pre-Accession Assistance
Governance structures in Bosnia and Herzegovina

- ISPA: Instrument for Structural Policy for Pre-accession
- IT: Information Technologies
- ITA: Indirect Tax Authority
- JMC: Joint Monitoring Committee
- LGs: Local Governments
- MA: Managing Authority
- MOFTER: Ministry of Foreign Trade and Economic Relations
- NAC: National Aid Coordinator
- NAO: National Authorising Officer
- NATO: North Atlantic Treaty Organisation
- NDP: National Development Plan
- NF: National Fund
- NGOs: Non Governmental Organisations
- OHR: Office of the High Representative
- OPEC: Organisation of the Petroleum Exporting Countries
- OSCE: Organisation for Security and Co-operation in Europe
- PA: Public Administration
- PAO: Project Authorization Officer
- PAR: Public Administration Reform
- PF: Public Finance
- PfP: Partnership for Peace
- PHARE: Poland and Hungary Assistance with Reconstruction
- PIC: Peace Implementation Council
- PIFC: Public Internal Financial Control
- RRTF: Refugee Return Taskforce
- RS: Republic of Srpska
- RTRS: Radio and Television of Republic of Srpska
- SAA: Stabilisation and Association Agreement
- SAP: Stabilisation and Association Process
- SAPARD: Special Accession Program for Agriculture and Rural Development
- SBS: State Border Service
- SCDPR: State Commission for Displaced Peoples and Refugees
- SCDRR: State Commission for Displaced Peoples and Refugees and Return Fund
- SDA: Party of Democratic Action (Stranka demokratske akcije)
- SDS: Serb Democratic Party
- Sida: Swedish International Development Cooperation Agency
- SIPA: State Investigation and Protection Agency
- SPO: Senior Programme Officer
- UNDP: United Nations Development Program
- USAID: US Agency for International Development
- VAT: Value Added Tax
- VNI: Vital National Interest
- VPI BH/FPI BH: Foreign Policy Initiative BH
- VRS: Army of RS (Vojska Republike Srpske)
- WB: World Bank
Artist Nebojša Šerić Šoba: Monument to the International Community Sarajevo, City Center