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Challenges and the Need for a New Approach

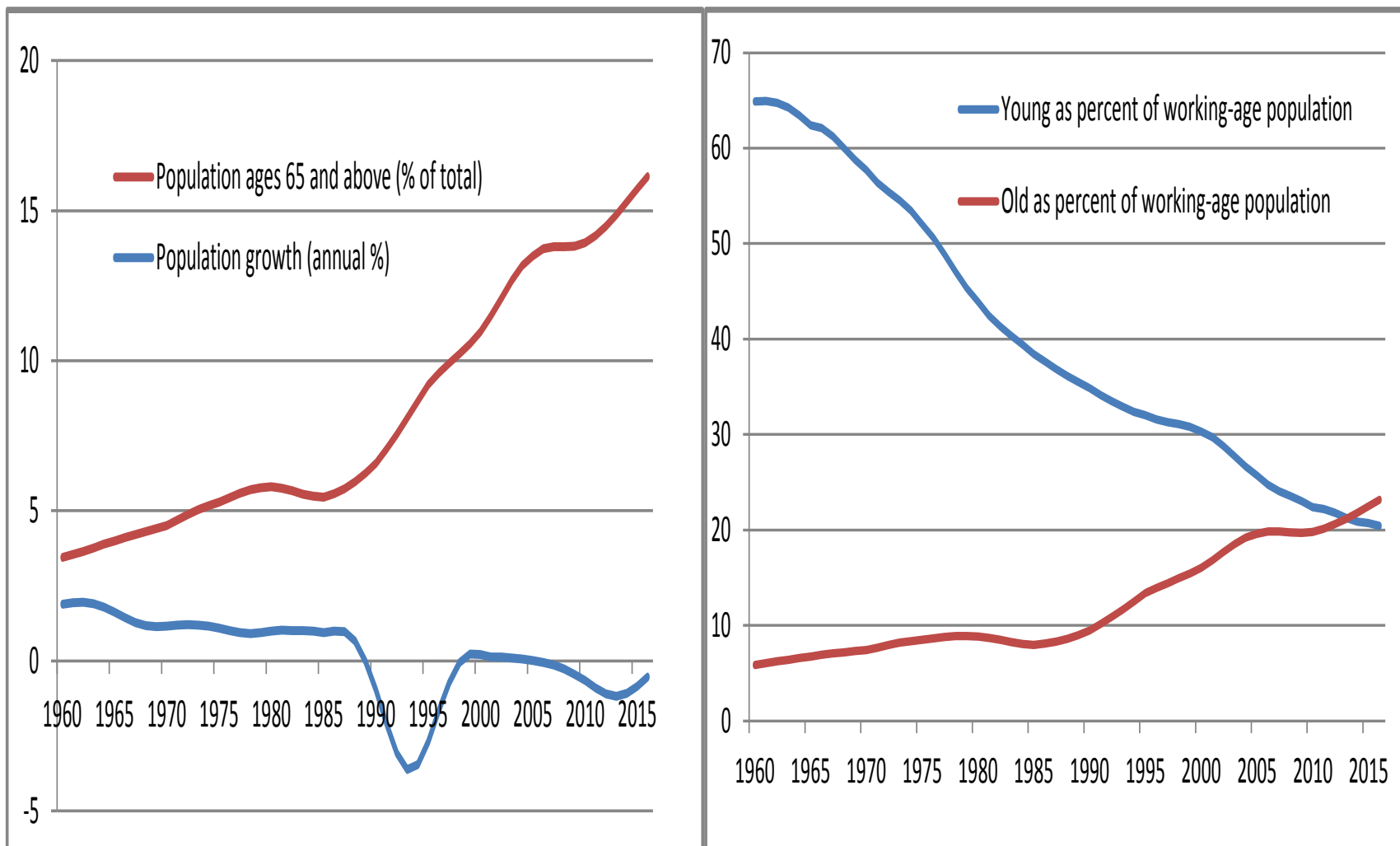
Gary O'Callaghan, Senior Advisor to the EUSR

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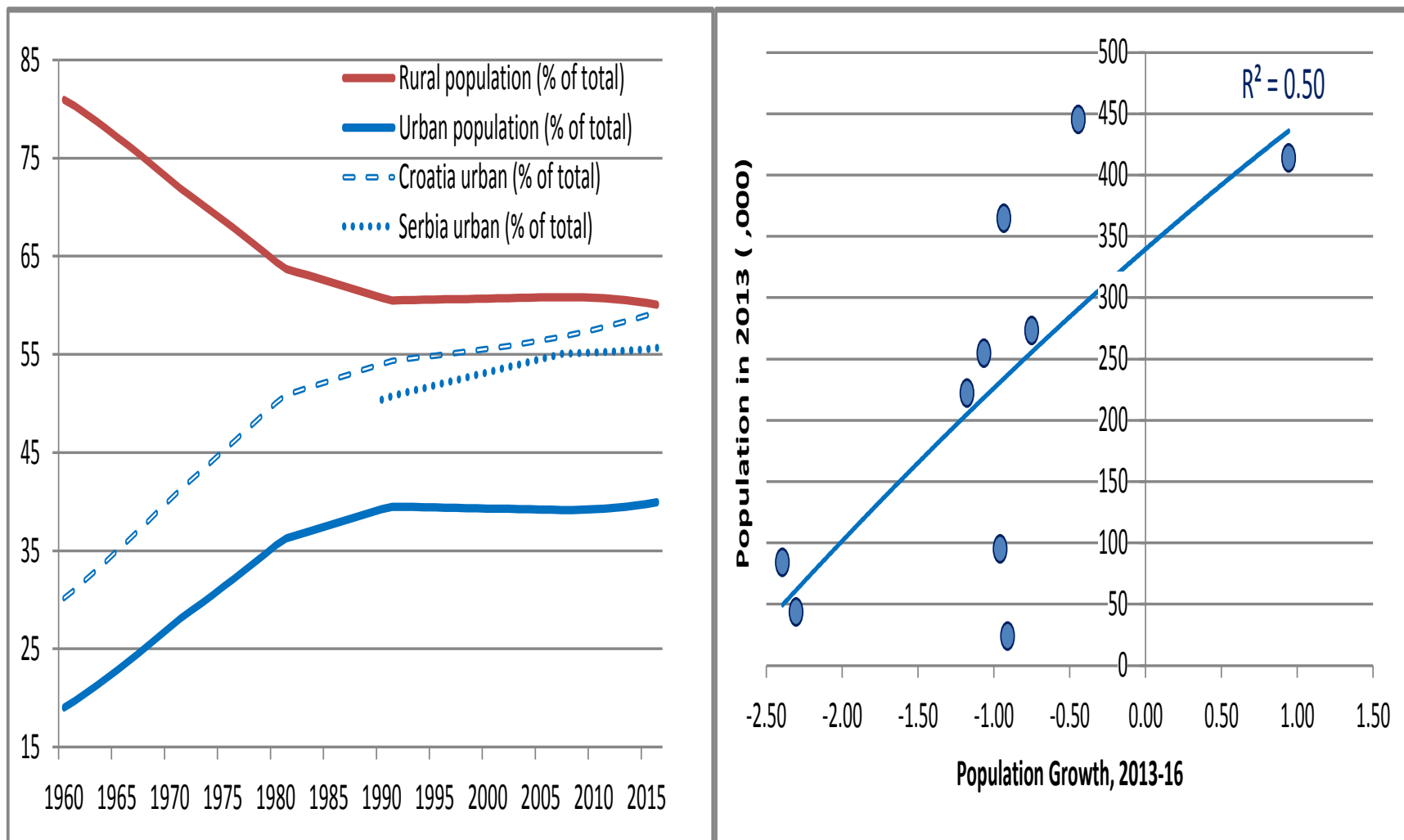
1. Common Challenges

- Common challenges / systemic problems.
- Local government is fragmented and often costly and, as a result, there are insufficient resources available for local economic development and, especially, social care.
- The population is falling and aging and this is putting an increasing strain on resources.
- Secondary cities are in decline and there is a growing divide between the capacities of smaller municipalities and larger cities.

1. Common Challenges



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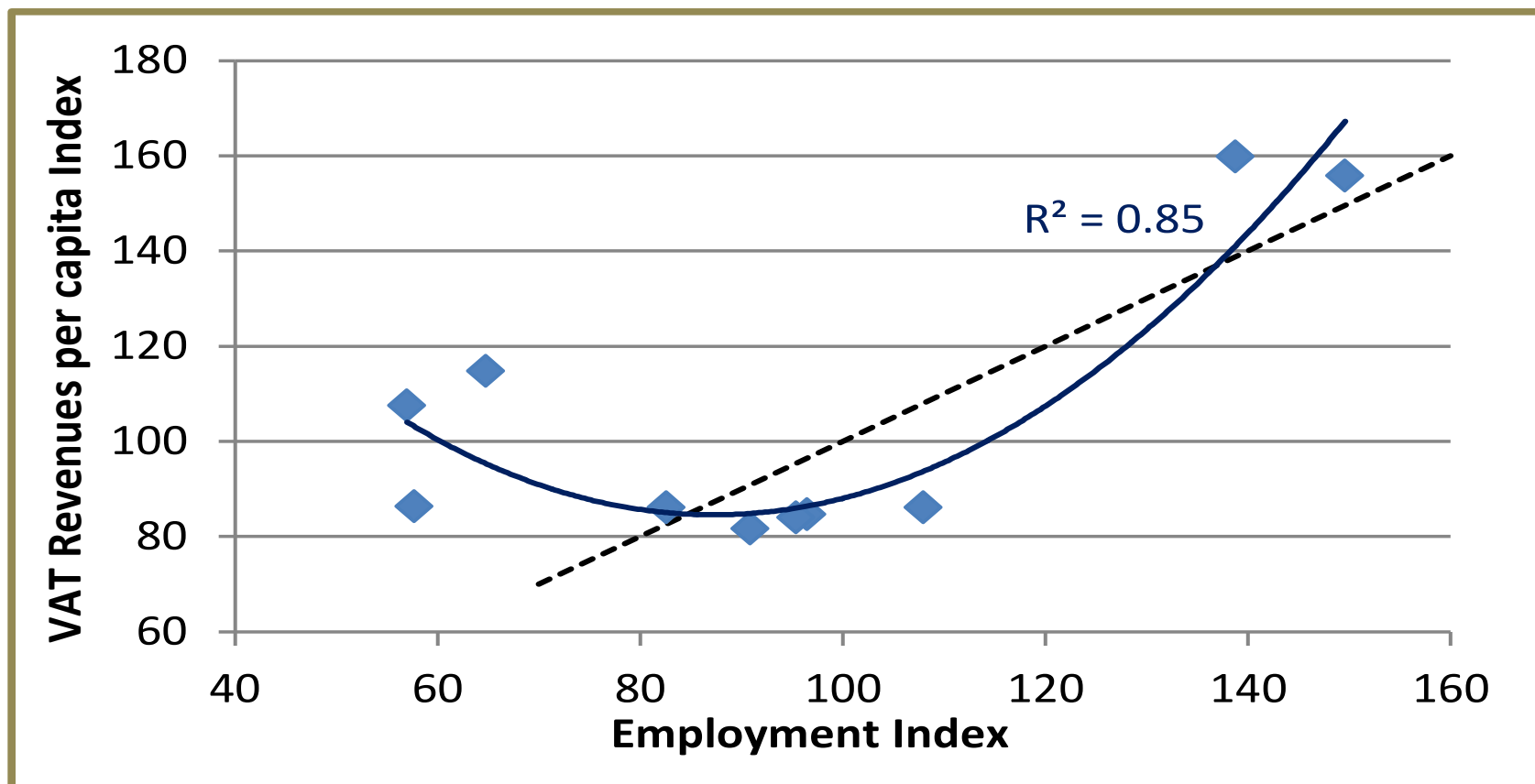
Source: World Bank and BiH Statistics.

1. Common Challenges

- The vertical allocation of resources (and external debt payment) is viewed as unsatisfactory by almost all municipalities.
- Management/sharing of natural resources is often inefficient and undermines the sustainable development of resources.
- The horizontal allocation of resources is controversial—especially for cantons—and there is no FBiH consensus on a balance between keeping/sharing local resources.

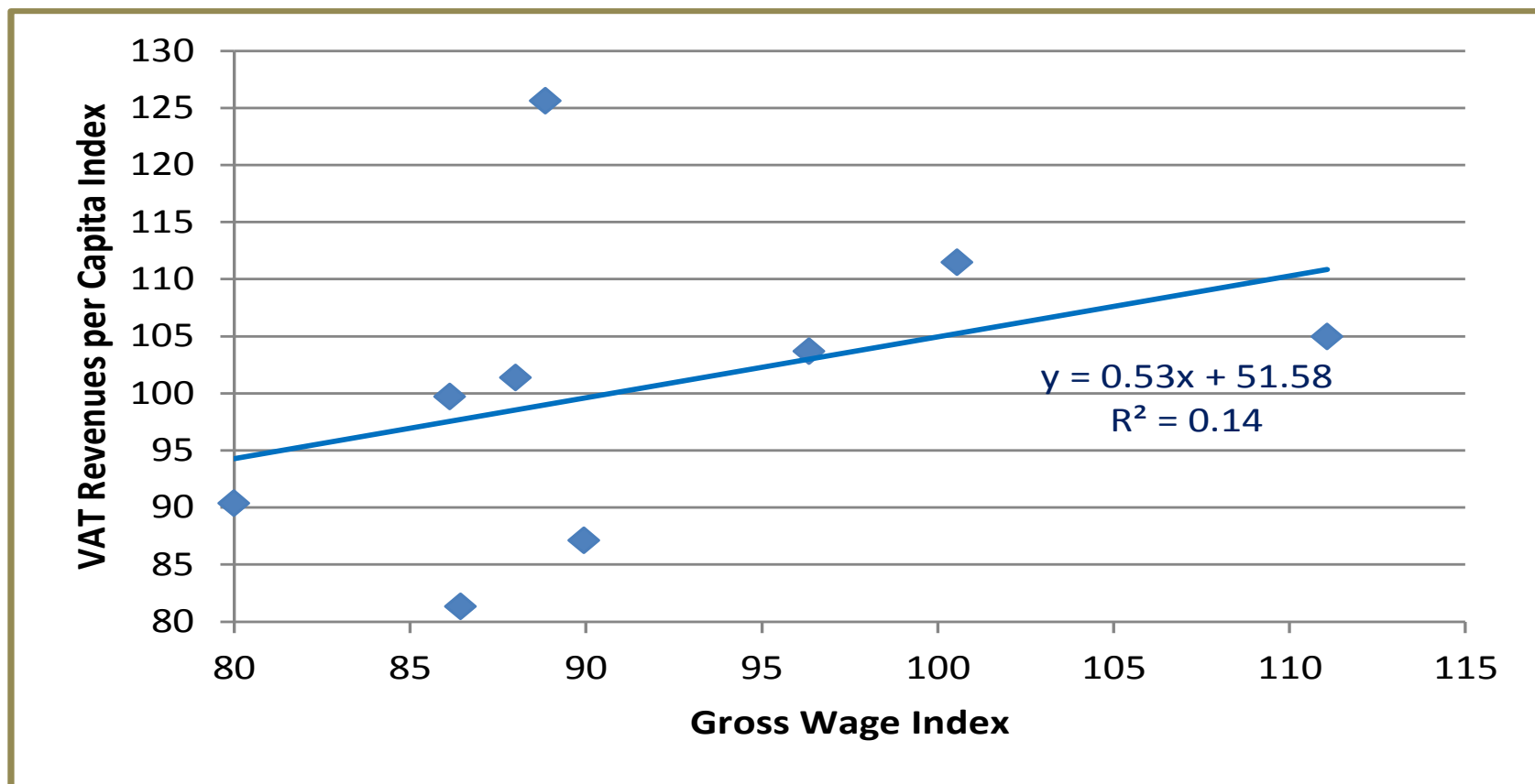
1. Common Challenges—Horizontal Allocation

Allocation of VAT Revenues to Cantons
(per capita index, average = 100), 2016



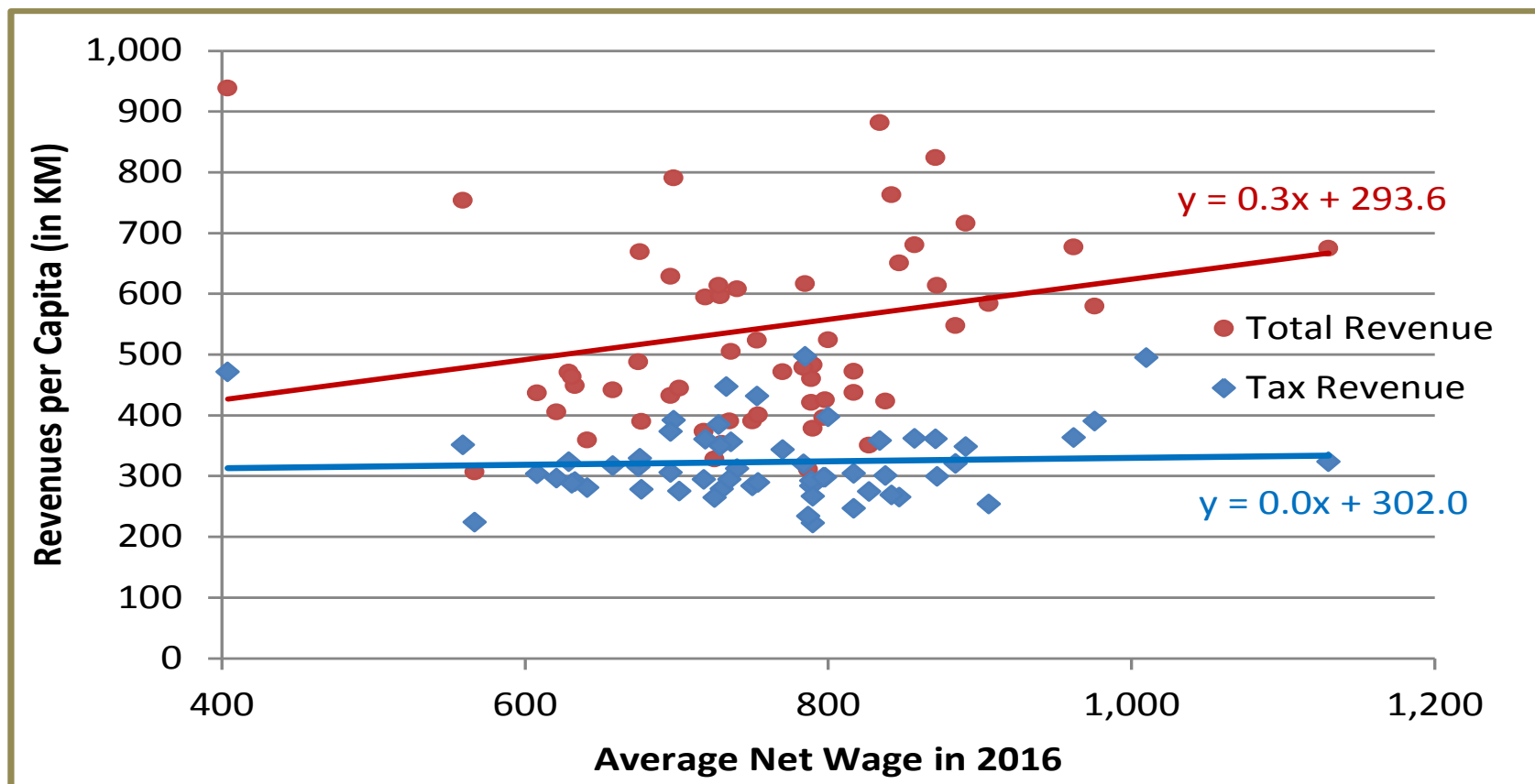
1. Common Challenges—Horizontal Allocation

Allocation of VAT Revenues to FBiH Municipalities by Canton
(per capita index, average = 100), 2015



1. Common Challenges—Horizontal Allocation

Municipal Revenues per Capita in RS
(Total and Tax Revenues), 2017



2. A Networked Approach

- No scope for aggregate tax increases—but sharing of resources could be re-examined.
- Need to significantly improve cooperation and collaboration to save resources.
- Cooperative actions need to be formalised in joint networks (institutions) that would:
 - Range across areas/regions that are large enough to deliver economies of scale.
 - Have the necessary organisational features to preserve local autonomy.

2. A Networked Approach

- Same approach—different structures:
 - In FBiH, canton is the logical unit to anchor a networked approach (that needs to be agreed with municipalities). Reforms need to be tailored (locally) to specific cantons (that vary in size by a factor of 20/1).
 - Cantons could make significant savings through improved cooperation—especially in health care and public order and safety.
 - The RS proposes multi-type municipalities (to replace mono-type). This could lead to networked service delivery around larger cities.

2. A Networked Approach

- Same approach—different institutions:
 - A hub-and-spoke system for single-access services (health): consumer goes to the provider & institutions are part of a system;
 - A collaborative system for pure-networked services (water): a common product is provided on demand and institutions share infrastructure;
 - An associated approach to the provision of grouped-network services (economic development): agencies/institutions are jointly owned and pursue a common goal.

3. Political Challenges and Opportunities

- Reforms hampered by associated problems of political division and corruption. Static affiliations reduce public scrutiny and induce a lack of transparency and corruption.
- Grant schemes complicated and political—combine into a few block grants targeted to broad areas & allow full discretion to spend.
- Reform Agenda, renewed growth, EU path and new infrastructure offer opportunity.
- New approach has to facilitate and provide incentives for collaboration & cooperation.

4. Issues Specific to the FBiH: I Competences, Coordination & Financing

- Cantons think they have a coordinated approach with municipalities but there is significant confusion and frustration due to:
 - Joint and overlapping competences between the two layers of government (e.g. in local economic development and spatial planning);
 - A municipal perception that unfunded mandates are handed down to them (e.g. in social welfare and mental health); and
 - A failure to overcome latent inefficiencies in assignment of responsibilities (e.g. waste).

4. Issues Specific to the FBiH: I Competences, Coordination & Financing

- Cantons should lead local service delivery:
 - Agree (3-5 year) Public Service Development Agreements (**PSDAs**) that would clarify local responsibilities (e.g. social welfare, waste) and need to be co-signed by municipalities.
 - Draft cantonal **network plans** (e.g. health) that would adhere to a single entity methodology to link them with plans from other cantons.
 - Establish **functional agencies**—with joint municipal ownership—to oversee specialised functions (e.g. economic development).

4. Issues Specific to the FBiH: I Competences, Coordination & Financing

- Cantons should have incentives to improve local coordination and collaboration.
- PSDAs would include agreement on vertical allocation in cantons—including PIT and CIT.
- Clearer canton-specific identification of local responsibilities and roles.
- Servicing of external debt could be sole responsibility of entity—with corresponding reduction in VAT allocations at local level.

4. Issues Specific to the FBiH: II Horizontal Allocation of Resources

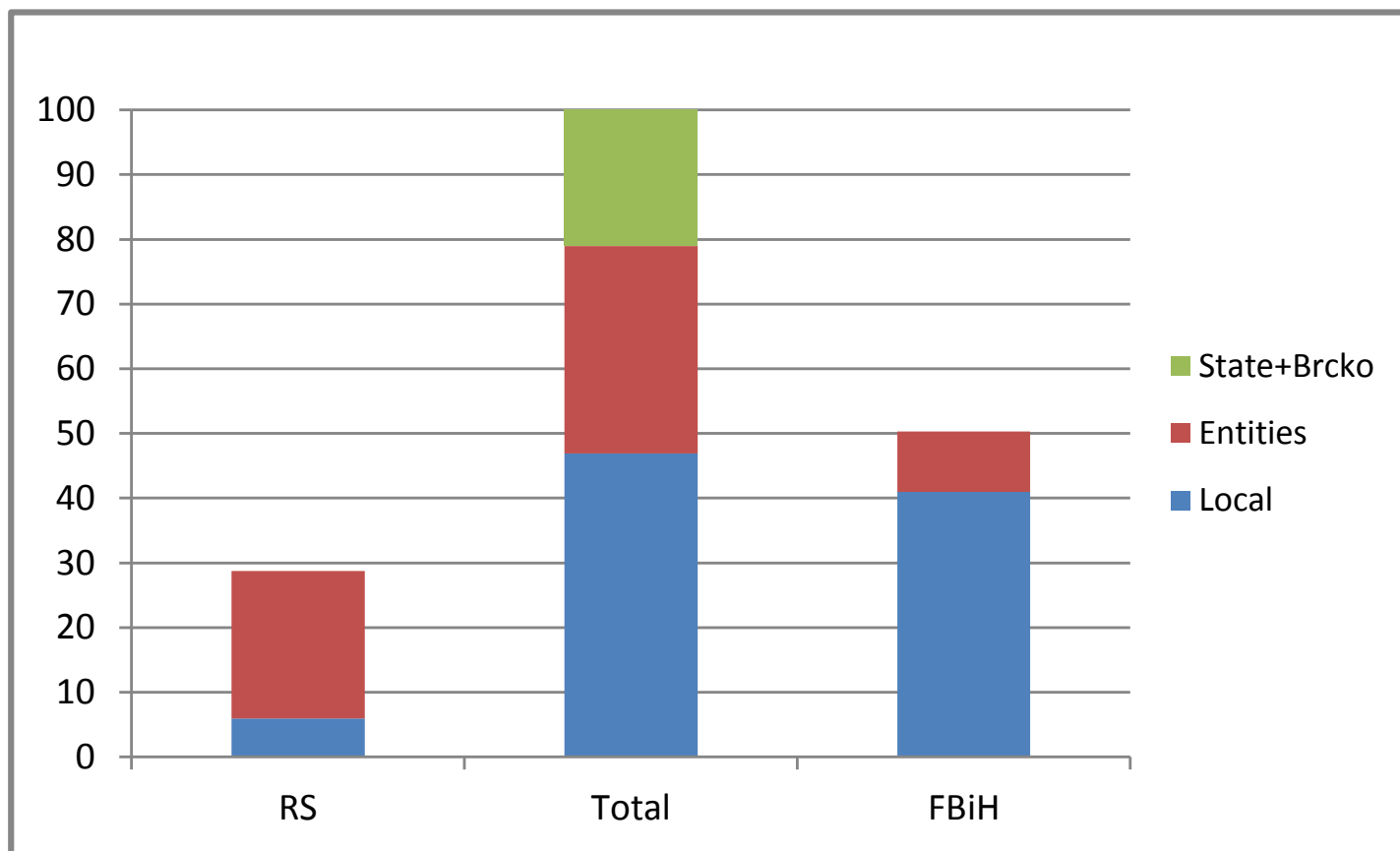
- Horizontal allocation of revenues suffers from a hybrid system that achieves none of its goals and is subject to near-universal resentment—especially from cantons.
- System should be reformed and simplified according to clearly-agreed principles.
- Report endorses a two-pillar approach proposed by the IMF to replace coefficients.
- Professor Brosio will elaborate on options.

4. Issues Specific to the FBiH: III Oversight, Grants and Public Administration

- New system of horizontal allocation would include block grants to promote better coordination—to be approved by a combination of ministries.
- Ministry of Local Government could oversee reforms, coordination and grants.
- Need PFM Reform for vertical coordination.
- PAR needs to address overstaffing, lack of qualification and “rigid” Civil Service Laws.
- PAR needs to address “unsuitable” Public Procurement Laws & lack of PPP structure.

4. Issues Specific to the FBiH: III Oversight, Grants and Public Administration

Government Payroll in BiH



4. Issues Specific to the FBiH: IV Fragmentation in Health and Public Order

- **Health** financed by 10 cantonal insurance funds and a Federation Solidarity Fund (SF).
- Fragmented systems range in size from 443,000 to 23,500 people and per capita expenditures vary by a factor of 2.
- SF only used to purchase high-cost drugs.
- Wide variety of health-delivery systems undermines development of network plans.
- Hospitals accumulating significant arrears and stop-gap measures lead to strikes.
- Equalisation, portability & joint purchasing.

4. Issues Specific to the FBiH: IV Fragmentation in Health and Public Order

- 11 **law-enforcement** agencies & 11 MOIs—often leads to different readings of laws.
- All financed independently with little co-operation, leading to duplication of service & inefficiencies—policing very expensive.
- Recent floods and fires demonstrated an urgent need for improved cooperation.
- More coordination & communication between boards to reduce political interference and strengthen integrity.
- Joint purchasing & share special services.

5. Issues Specific to the RS: I Moving to a Multi-Type System of Government

- Strategy envisages a networked approach.
- Multi-type system would address the fact that smaller units cannot provide full range.
- Financing needs to adjust to broader perspective that promotes cooperation.
- Legal framework already established to facilitate municipal cooperation—both within the entity and across entities.
- Municipalities need to be more efficient and targets set to reduce overstaffing.
- PFM reforms will improve budget controls.

5. Issues Specific to the RS: II Financing, Sustainability and Local Autonomy

- Stage is set for a meaningful debate:
 - Vertical financing system could be reformed by allocating external debt to entity level.
 - Multi-type system could be enhanced by the introduction of a municipal surcharge on PIT.
 - Property tax system could be improved as its administration is devolved to municipalities.
 - There is general support for existing system of horizontal financing and giving assistance to less-developed and undeveloped areas.
 - Municipalities will need joint regional plans and new institutional vehicles (as proposed and described in the Report).