

REPORT ON THE COMPLIANCE OF LOCAL SELF-GOVERNMENT FINANCING IN REPUBLIKA SRPSKA WITH THE EUROPEAN CHARTER OF LOCAL SELF- GOVERNMENT

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The aim of this report is to examine the level and structure of local finance and discuss the degree of compliance of local self-government financing in Republika Srpska with the European Charter of Local Self-Government, in line with the recommendations from the Congress Monitoring Report. The findings and recommendations are intended to support advocacy efforts undertaken by the Association of Municipalities and Cities of Republika Srpska.

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The views expressed in this report do not necessarily reflect the official position of the Congress of Local and Regional Authorities of the Council of Europe.

This report is available in English and the local language. In case of discrepancies between the English and local versions of the report, the local version shall prevail.

Report on the compliance of local self-government financing in Republika Srpska with the European Charter of Local Self-Government

Expert opinion

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1. Background information

The European Charter of Local Self-Government (*hereinafter referred to as „the Charter“*) is the international convention that lays down standards for protecting the rights of local authorities and requires the member states of the Council of Europe to comply with a number of principles. The Charter was opened for signature on 15 October 1985 and entered into force on 1 September 1988. It is ratified by all 46 member countries of the Council of Europe. The Charter projected standards for the most important segments of local self-government, such as legal framework, i.e. concept, organisation, control, financing, relationship with the central government, etc. The operationalisation of these standards involves the decentralisation of state authority, thereby strengthening local self-government. The Charter fundamentally understands local self-government as an element of decentralisation of power and democratisation of society.

The Charter does not contain a precise and universal, much less a unique model, but general principles of local self-government that are broad enough for the signatory countries to build nationally recognisable and specific models of local self-government, which will nevertheless respect the same democratic principles, i.e. to make lawful what is today considered the standard in this field.

Through a more thorough analysis of the Charter, the following principles of local self-government are shown: 1) principle of decentralisation; 2) principle of legality; 3) principle of subsidiarity; 4) principle of depoliticisation; 5) principle of autonomy; 6) principle of professionalisation; 7) principle of mutual co-operation between state and local governments; 8) principle of efficacy and work efficiency of local self-government bodies; 9) principle of equality; 10) principle of public work (transparency) and 11) principle of incompatibility of public functions.

Bosnia and Herzegovina ratified the Charter on 12 July 2022, and it became legally binding on 1 November 2002, thereby committing itself to its implementation.

2. Goal of the Report

The goal of the Report is to examine the level and structure of local finance and discuss the degree of compliance of local self-government financing in Republika Srpska with the European Charter of Local Self-Government, in line with the recommendations from the Congress Monitoring Report (2019).

3. European Charter of Local Self-Government – local self-government financing

The financing of local self-government bodies is defined in the Article 9 of the Charter. This is also the most extensive article of the Charter. It emphasizes that the resources of funds for local self-government should match up their responsibilities and authority defined by the constitution or law. Furthermore, resource funds should not be static but flexible and diverse and used efficiently through realistic assessment in the field. Furthermore, the Charter stipulates that LGUs should have their own sources of income, in form of local taxes and fees, for which the local authorities will determine the rate. The Charter stresses out that LGUs should independently manage their own income sources, in accordance with their authority. It also stipulates that the state will allocate certain funds to LGUs to alleviate unequal distribution of funds, that is, to protect those LGUs that are financially weaker. LGUs should be consulted on how these funds should be distributed. They, however, should not be earmarked funds that would prevent local self-governments to act within their authority. Also, the Charter defines the possibility of bank loans by LGUs.

In the last Report³ on the state of local and regional democracy in Bosnia and Herzegovina adopted by the Congress of Local and Regional Authorities in 2019, the following recommendations were made in the area of financing local self-government in Bosnia and Herzegovina, Republika Srpska:

- revise the legislation on local finances in order to ensure that local authorities have adequate and proportionate financial resources and enable the transfer of delegated responsibilities to lower levels of government to be accompanied by adequate financial resources;
- revise the current formula and allocation criteria in equalisation systems in order to adapt them to the rapidly changing context taking into account current demographic trends and
- increase the powers of local authorities to decide on the sources of local revenues in such a way as to diversify them (more different sources of revenues) in order to strengthen local fiscal autonomy, especially when it comes to smaller municipalities.

4. Organisation of local self-government in Republika Srpska

The organisation of local self-government in Republika Srpska is determined by the Law on Territorial Organisation of Republika Srpska. According to the same, the territory of Republika Srpska consists of municipalities and cities.⁴ A municipality is a basic territorial unit of local self-government in one part of populated place, for one for several populated places. Therefore, there are no quantitative criteria for municipalities (number of inhabitants, area, etc.).

On the other hand, a city has its own qualitative and quantitative characteristics. Thus, the Law on Local Self-Government stipulates that a city can be established by law in an urban area that forms a unique geographical, social, economic, historical and territorial entity with an appropriate level of development provided that: 1) it has more than 50,000 inhabitants and 2) it holds the status of a developed local self-government unit in the last three years by meeting the criteria for development of local self-government units. Exceptionally, a municipality can acquire the status of a city regardless of the number of inhabitants, if the employment rate on the territory of the municipality is above the national average index. Also, the territory for which the city is being formed represents a natural geographical entity, an economically connected area that has built-in communication between inhabited places with the seat of the city as the center of gravity.

Currently, Republika Srpska has 64 LGUs, of which 11 cities and 53 municipalities. All municipalities in Republika Srpska have the same legal status and position regardless of size, number of inhabitants and other criteria. Therefore, there are monotype municipalities with the same "omnibus" competences. Also, there is almost no difference in legal status between a municipality and a city. In terms of organisation, only the City of East Sarajevo has six municipalities: Pale, Sokolac, Trnovo, Istočno Novo Sarajevo, Istočna Ilidža and Istočni Stari Grad. Since there is almost no difference in the legal definition between municipalities and cities, and since municipalities and cities are the basic and only LGUs, that is, there is only one level of local organisation between the central and local authorities, we conclude that local self-government in Republika Srpska is single level monotype.

³ *Local and regional democracy in Bosnia and Herzegovina, Monitoring Report*, Congress of Local and Regional Authorities, 2019. <https://www.congress-monitoring.eu/en/44-pays.html>

⁴ *Article 2 of the Law on Territorial Organisation of Republika Srpska*, the Official Gazette of Republika Srpska, nos. 69/2009, 70/2012, 83/2014, 106/2015, 26/2019, 15/2021, 37/2022 and 32/2023.

5. Constitutional and legal framework of local self-government financing in Republika Srpska

The financing of local self-government in Republika Srpska is prescribed by the Constitution and the following laws: the Law on Local Self-Government⁵, the Law on the Budget System of Republika Srpska⁶, the Law on Concessions⁷, the Law on Real Estate⁸ Tax and the Law on Borrowing, Debt and Guarantees of Republika Srpska⁹. The budget system of Republika Srpska consists of the budget of the Republic, budgets of municipalities and cities, budgets-financial plans. According to the Constitution of Republika Srpska, "The city and the municipality are entitled to the revenues established by law and the funds for executing entrusted tasks."¹⁰ Also, the Constitution stipulates" that Republika Srpska and the municipality determine public revenues and public expenditures through the budget, and that the budget funds include charges, fees and other revenues established by the law".¹¹

According to the Law on Local Self-Government, the financial capacities of LGUs are proportional to their authority, and any new transfer or assignment of jurisdiction must be supported by allocated funds. Republika Srpska authorities are obliged to consult LGUs on all issues related to the provision and distribution of funds, as well as on all changes in the law that may affect the financial status of LGUs. The budget priorities in LGUs are aimed at financing primary responsibilities, i.e., the performance of the mandatory functions of local authorities. LGUs bodies and affairs under the jurisdiction of LGUs are financed from the budget of LGUs. When it comes to delegated work of LGUs, funds are allocated through the republic budget in accordance with the type, scope and complexity of entrusted work. Given that LGUs independently finance local bodies and institutions, they are expected to be efficient in their work.

According to the current Law on Local Self-Government, LGUs have the right to their own financial resources, which LGUs bodies can freely manage within their jurisdiction, in accordance with the law. In other words, LGUs have their own sources of income. This makes it easier for LGUs to plan their revenues and expenses. LGUs are also entitled to revenues from the national budget. The distribution of revenues between the Republic and the LGUs, in accordance with the level of development of the LGUs, is determined by law.

Revenues and incomes of LGUs according to Article 74 of the Law on Local Self-Government include:

- taxes (real estate tax; tax on income from agriculture and forestry; tax on profit from games of chance and other taxes established by law);
- charges (city, ie municipal administrative taxes; communal taxes and other taxes established by law);

⁵ *Law on Local Self-Government*, the Official Gazette of the Republika Srpska, nos. 97/2016, 36/2019 and 61/2021.

⁶ *Law on the Budget System of Republika Srpska*, the Official Gazette of Republika Srpska, nos. 121/2012, 52/2014, 103/2015 and 15/2016.

⁷ *Law on Concessions*, the Official Gazette of Republika Srpska, nos. 59/2013, 16/2018, 70/2020 and 111/202.

⁸ *Law on Real Estate Tax*, the Official Gazette of Republika Srpska, no. 91/15.

⁹ *Law on Borrowing, Debt and Guarantees of Republika Srpska*, the Official Gazette of Republika Srpska, nos. 71/2012, 52/2014, 114/2017, 131/2020, 28/2021 and 90/2021.

¹⁰ *Article 103 of the Constitution of Republika Srpska*, the Official Gazette of Republika Srpska, nos. 21/92 - revised text, 28/94, 8/96, 13/96, 15/96, 16/96, 21/96, 21/02, 26/02, 30/02, 31/02, 69/02, 31/03, 98/03, 115/05 and 117/05.

¹¹ *Ibid*, Article 62.

- fees (fees for the development of construction land; fees based on the natural and locational benefits of urban construction land and the benefits of already built communal infrastructure that may arise during the use of that land (rent); fees for the use of natural and other goods of general interest; fees for use facilities and devices of shared utility consumption (utility fee) and other fees);
- revenues and incomes from property (rental income; interest income and income from the sale of property, the sale of which does not jeopardise the performance of the competence of the city, that is, the municipality) and
- other income (income from self-contributions; income from fines imposed in misdemeanor proceedings, established by acts of the city or municipality and other income established by law).

According to Article 11 of the Law on the Budget System of Republika Srpska, the budget revenues of municipalities and cities are:

- a) property tax, i.e., real estate;
- b) fines imposed in misdemeanor proceedings for misdemeanors determined by acts of cities, that is, municipalities;
- c) municipal administrative charges ;
- d) communal charges ;
- e) special water fees – fees for water protection;
- f) municipal fees for the use of natural and other goods of general interest;
- g) tax on winnings from games of chance;
- h) residence charges;
- i) concession fees for the assigned right for concessions granted by LGUs;
- j) concession fees for use for concessions granted by LGUs;
- k) other income, such as:
 - 1) income from grants, transfers and income that budget users achieve by performing regular and supplementary activities in accordance with the law, in the percentage determined by the decision on budget execution and
 - 2) other municipal revenues.

The distribution of income between republic and local authorities in Republika Srpska is prescribed by the Law on the Budget System of Republika Srpska. Revenues that are shared between the budget of Republika Srpska, the budget of municipalities and cities and other users are:

a) *revenues from indirect taxes¹², paid into the budget of the Republic from the Single account of the Indirect Tax Administration, which are, after allocating part of the funds for external debts of the Republic, divided as follows:*

- 1) the budget of the Republic 72%,
- 2) the budgets of municipalities and cities 24% and

¹² In Bosnia and Herzegovina, there are indirect and direct taxes. Indirect taxes include value-added tax (VAT), excises, road tolls, and customs duties. Direct taxes include corporate tax, income tax, and contributions (contributions for pension and disability insurance, health insurance, unemployment insurance, and child protection). Indirect taxes are under the exclusive jurisdiction of the state and are collected and distributed by the Indirect Taxation Authority BiH, while direct taxes are collected by the tax administrations of the entities and Brčko District of BiH.

3) PC "Roads of Republika Srpska" 4%.

Furthermore, the Law on the Budget System of Republika Srpska stipulates that the individual participation of LGUs in the distribution of revenues from indirect taxes is carried out in accordance with the following criteria:

- (a) 75% based on the number of inhabitants in the municipality and city
- (b) 15% based on the area of the municipality and city and
- (c) 10% based on the number of students in secondary schools¹³

b) revenues from income tax that include:

- 1) tax on income from self-employment, which is divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 75:25 and
- 2) tax on personal income, which is divided between the budget of the Republic and budgets of municipalities and cities in the ratio of 75:25;

c) *special distribution*, tax on income from self-employment and personal income tax is divided between the budget of Republika Srpska and the budget of areas of special concern of the Republic, which are determined as such by the law regulating the Solidarity Fund for the reconstruction of Republika Srpska, in the ratio of 50:50.

d) revenues from fees for changing the use of agricultural land, which are divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 30:70;

e) revenues from the rent of land owned by the Republic, which are divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 50:50;

f) concession fees, granted by the Government of Republika Srpska, are divided between the budget of the Republic and the budget of the municipalities and cities on the territory of which the concession activity is carried out in the ratio:

- 1) 30:70 for developed local self-government units;
- 2) 30:70 for medium-developed local self-government units;
- 3) 20:80 for underdeveloped local self-government units;
- 4) 10:90 for extremely underdeveloped local self-government units;

g) revenues from special water fees:

- 1) fees for the abstraction of surface and underground water, which are divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 70:30;

¹³ According to the Association, there is a need to redefine the current criteria and consider the possibility of including new ones that will take into account the development of LGUs measured by several different parameters of economic and social development such as: employment (especially employment of women and youth); percentage of young people in the overall age structure of the population; realised income in the area of LGUs; availability of health and social care services; the number of students enrolled in elementary schools, etc. Source: *Framework platform of the Association of Municipalities and Cities of Republika Srpska for advocating amendments to the Law on the Budget System of Republika Srpska, analytical background*, The Association of Municipalities and Cities of Republika Srpska, 2021, p. 14.

- 2) fees for the production of electricity obtained through the use of hydropower, which are divided between the budget of Republika Srpska and the budget of municipalities and cities in the ratio of 70:30;
- 3) fees for extracting material from watercourses, which are divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 70:30;
- 4) fees for water protection, which are divided between the budget of the Republic, the budget of municipalities and cities and the Environmental Protection Fund of Republika Srpska in the ratio of 55:30:15;

h) confiscated property benefit and funds obtained from the sale of confiscated items from the jurisdiction of the Republic Administration for Inspection Affairs, which is divided between the budget of the Republic and the budget of municipalities and cities in the ratio of 70:30¹⁴.

Funds allocated to municipalities and cities are considered general transfers, so municipalities and cities use them in accordance with their budgets. The essence of the distribution of funds is supplementing the budgets of local self-government units, so that they can adequately carry out their obligations. Source (own) revenues of LGUs in Republika Srpska account for 35% of their total revenues. „The composition of the own source revenues shows the domination of communal fees and charges (on advertisement, particular categories of entertainment, use of public space, parking, accommodation in hotels, and construction of buildings) making up 68% of the total in 2021. The revenues from property taxation remain low with 10% of the own source revenues in 2021, and among the lowest in South-East Europe.”¹⁵

According to the Network of Associations of Local Authorities in South-East Europe (NALAS) report from 2021¹⁶ public revenues and LGU revenues in Southeast Europe, presented in the graphs, indicate that Republika Srpska has a very low level of shared taxes (25% of the Personal Income Tax are defined as shared tax by the NALAS report) and a very high share of grants. Furthermore, the share of real estate taxes is low, the relevance of other local taxes is low, while the primary income contains mostly contributions and taxes. The table below shows public revenues and revenues of local self-governments in SE Europe in 2021.

¹⁴ *Law on the Budget System of Republika Srpska, the Official Gazette of Republika Srpska*, nos. 121/2012, 52/2014, 103/2015 and 15/2016.

¹⁵ *Fiscal Decentralisation Indicator for SEE Report, ninth edition, NALAS, 2024*, <https://mail.google.com/mail/u/0/#inbox/WhctKKZWmmTrVnRncJjvbkJfBWtxcchvFqPLKzQwVlzMzjJmbxlqLwczsnsjTbfCkvGJlPb?projector=1&messagePartId=0.1>, 1 May 2024, page 114

¹⁶ *Fiscal Decentralisation Indicator for SEE Report, ninth edition, NALAS, 2024*, <https://mail.google.com/mail/u/0/#inbox/WhctKKZWmmTrVnRncJjvbkJfBWtxcchvFqPLKzQwVlzMzjJmbxlqLwczsnsjTbfCkvGJlPb?projector=1&messagePartId=0.1>, 1 May 2024.

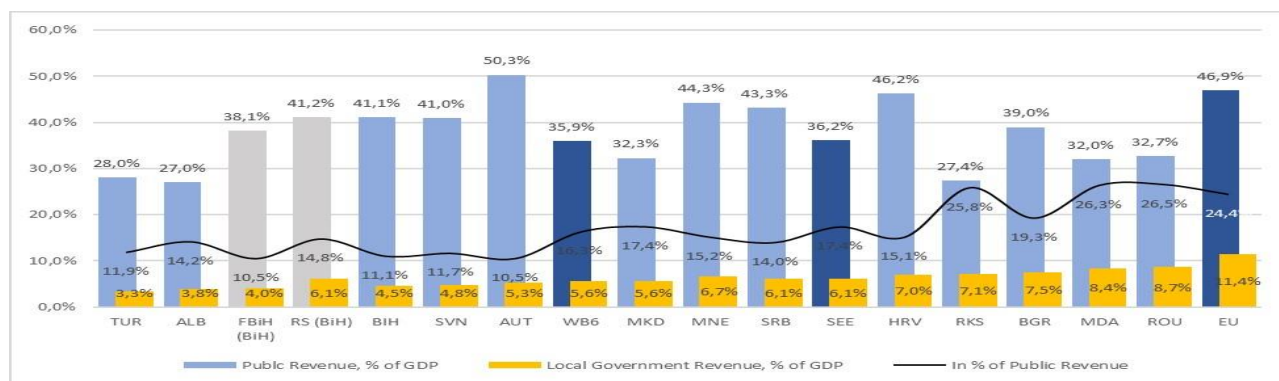


Table 1: Public revenues and local self-government revenues in Southeast Europe, 2021

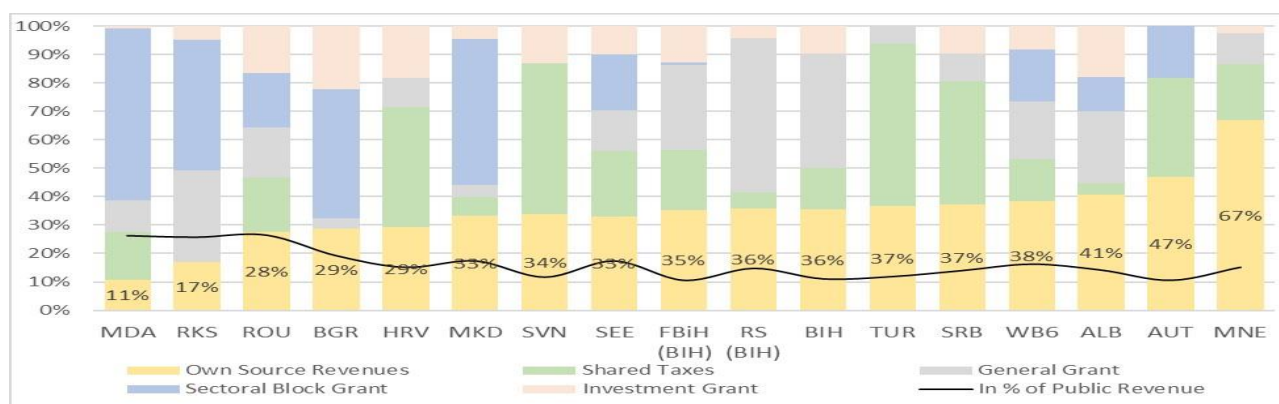


Table 2: Structure of local self-government income in 2021

The Association of Municipalities and Cities of Republika Srpska (hereinafter: AMCRS) considers that the system of distribution of revenues from indirect taxes, which takes into account the external debt of Bosnia and Herzegovina, is unacceptable because the external debt does not relate to financing of the needs and projects of LGUs. Based on this, and according to the AMCRS projection, LGUs in Republika Srpska remain deprived of funds of about 44 million BAM per year.¹⁷ Furthermore, AMCRS believes that the ratios of income distribution from personal income tax and income tax from self-employment should be redefined. The proposal is to adopt a 70:30 ratio between the RS budget and the LGUs budget instead of the current 75:25. Also, the distribution of income from special water revenues should be in the ratio of 50:50 instead of the current 70:30. Furthermore, the revenue from the public road fees from the registration of motor vehicles and trailers and the distribution of tolls, which is currently 100% of the income to the RS budget, should be, according to the AMCRS proposal, distributed in a ratio of 70:30 between the budget of the RS and the budget of LGUs. Finally, the AMCRS proposal is to change the distribution of revenue from fees for changing the use of agricultural land (the current ratio of 30:70 between the RS budget and the LGUs budget) to a ratio of 100% to the LGUs budget and for uses under the LGUs programme.¹⁸ The cited analysis does not clarify the merits of these proposals, but the intention is clear to strengthen the financial stability of LGUs in Republika Srpska.

¹⁷ Framework platform of the Association of Municipalities and Cities of Republika Srpska for advocating amendments to the Law on the Budget System of Republika Srpska, analytical background, The Association of Municipalities and Cities of Republika Srpska, 2021, p. 7.

¹⁸ Ibid, pp. 8-11.

According to the Law on Borrowing, Debt and Guarantees of Republika Srpska, LGUs can borrow long-term and short-term. Article 59 of the mentioned Law stipulates that the limit of long-term borrowing cannot be higher than 18% for the following year in relation to the realised regular income in the previous fiscal year. In the case of short-term borrowing, at no time can the debt exceed 5% of regular income in the previous fiscal year. All debts of local self-government units represent their absolute and unconditional obligation.

This borrowing limit, which is equally projected for all LGUs, is met with disapproval by individual LGUs, taking into account their different economic power, budget size, and borrowing needs. In the case of redefining these limits, it is necessary to obtain the views of international financial institutions (International Monetary Fund, World Bank and others).

Regarding the financing of LGUs, distribution of income, borrowing and support for underdeveloped and extremely underdeveloped LGUs, interviews were held with representatives of local authorities, the Association, and the line Ministry.¹⁹ In general, there are no significant objections to the existing system of financing LGUs in Republika Srpska. Everyone is unanimous in the opinion that underdeveloped and extremely underdeveloped LGUs should be helped. They believe that LGUs borrowing should not be linearly prescribed, but that limits should be differentiated when it comes to long-term borrowing and that the limit can be higher for economically stronger LGUs. At the same time, loan repayment periods must be taken into consideration, since current methodology allows one management structure to become indebted, at the possible expense of the next one. Also, they are satisfied with the co-operation with the central authorities, the Ministry of Administration and Local Self-Government and the Ministry of Finance. Regarding the approval of local budgets by the Ministry of Finance, monitoring is considered justified, but under the condition that the approvals should have an analytical dimension and that the central authorities, when approving the budget, should also provide income guarantees that they control and determine for LGUs. They also point out that the data related to the number of inhabitants and the number of students enrolled in secondary schools, which constitute the criteria for the distribution of revenues from indirect taxes, should be regularly updated by the Government, because the up-to-date data implies the amounts of individually allocated revenues. Equally, they are of the opinion that the central authorities must have up-to-date real estate registers, which is important for collecting taxes. There is an opinion that a larger percentage of the concession revenue of tax should belong to LGUs. Also, the revenue as a measure of fire protection should go to LGUs in a larger percentage and LGUs should have sovereign control over them. Opinions are divided regarding the legal possibility for cities to independently collect income from real estate taxes. The arguments are that the cities do not have mechanisms of forced collection, on the one hand, while on the other hand, the arguments that it would be more expedient and efficient to transfer it to the cities stand out.²⁰ City representatives do not see that a special law on LGUs financing would bring changes and progress to the LGUs financing system in Republika Srpska. However, there are also views that all countries in the region should have the same law and that an economic analysis of the justification of such a legal solution should be made, providing a more concrete point of view.²¹ Finally, they are of the opinion that it should be precisely prescribed what all LGUs can finance with the support of the central authorities so that individual projects do not jeopardise the long-term development of LGUs.

¹⁹ List of the interviewees can be found in the Appendix.

²⁰ According to the Local Self-Government Law in Republika Srpska, only cities have the authority to organise the collection of real estate taxes. Currently, the Tax Administration of Republika Srpska collects these taxes instead.

²¹ Comparatively, Serbia, Montenegro, Croatia, North Macedonia and Serbia have such laws.

6. The state of development of LGUs in Republika Srpska and the support of the central authorities

For a long time in Republika Srpska, there has been a debate on the criteria for classifying LGUs in terms of their development. All respondents agree that there are no ideal solutions.

The classification of LGUs according to the degree of development is done not only for statistical needs, but also for reasons of state intervention and directing support and aid funds, including prioritising economic and investment projects in these areas.

The Decision on determining the criteria and methods for evaluating the level of development of local self-government units in Republika Srpska²² defined the following criteria for evaluating the level of development of local self-government units: 1) total revenues of registered business entities in the previous year at the level of the local self-government unit per inhabitant; 2) total budget revenues (tax and non-tax) in the previous year at the level of the local self-government unit per inhabitant; 3) unemployment rate – the percent of unemployed persons in the total labor force at the level of the local self-government unit; 4) population density; 5) the total number of registered vehicles in the area of the local self-government unit in relation to the total number of registered vehicles in Republika Srpska; 6) the number of students attending primary school in relation to the number of inhabitants at the level of the local self-government unit; 7) the general rate of natural increase at the level of the local self-government unit (growth rate population); 8) the number of business entities at the level of the local self-government unit in relation to the total number of business entities in Republika Srpska and 9) the value of works by the type of constructed facilities and residential construction at the level of the local self-government unit in relation to the total value in Republika Srpska.

The degree of development of LGUs according to the above criteria is determined by the I-distance method. The I-distance method represents a difference that is defined as the discriminating effect of some characteristic for the observed pairs of data. On the basis of the above criteria, the Government of Republika Srpska determines the level of development of local self-government units for the following year by September 30 of the current year, in accordance with the Law on Local Self-Government, and with the previously obtained opinion of the Committee for Economy and the Committee for Local Self-Government of the National Assembly of Republika Srpska.

The Decision on the level of development of local self-government units in Republika Srpska for 2024 determined the level of development of local self-government units in Republika Srpska for 2024.²³ According to the Decision, 19 LGUs are in the developed category. There are 10 LGUs in the medium-developed category, while 15 LGUs belong to the underdeveloped category. Finally, there are 20 of them in the category of extremely underdeveloped LGUs.

As emphasized earlier, the problem lies in the fact that more than half (as many as 35) of LGUs fall into the category of underdeveloped and extremely underdeveloped. This situation is a kind of alarm to the central authorities that something comprehensive should be undertaken in order to economically strengthen local self-government in Republika Srpska and to develop special programmes to reduce the number of municipalities that are severely underdeveloped or poor.

²² *Decision on criteria for evaluating the level of development of local self-government units in Republika Srpska*, the Official Gazette of Republika Srpska, no. 56/2023.

²³ *Decision on the level of development of local self-government units in Republika Srpska for the year 2024*, the Official Gazette of Republika Srpska, no. 93/2023.

The AMCRS believe that these criteria need to be redefined. Based on the conclusions of the Presidency, the AMCRS initiated the review process of the current criteria for evaluating the level of development of LGUs, prepared a proposal for new criteria and performed simulations on all LGUs. Nevertheless, the Ministry of Administration and Local Self-Government of Republika Srpska decided to retain the current criteria. The document entitled *Criteria for evaluating the level of development of LGUs of Republika Srpska*, prepared by the AMCRS, specifies the following five criteria: 1) income tax revenue per inhabitant (X1), which is calculated as the ratio of the total amount of collected taxes paid by taxpayers during one fiscal year, natural persons with residence or habitual residence in the area of the LGUs unit for which the calculation is made of the number of inhabitants living in the area of the LGUs; 2) the level of unemployment (X2), which is calculated as the ratio of the total number of unemployed persons in the area of LGUs and the labor force, in the year for which the development index is made; 3) population movement (X3), which is calculated as the ratio of the estimated number of inhabitants in the area of LGUs in the year for which the index is calculated and the number of inhabitants according to the results of the last official population census; 4) the share of the young population in the total population (X4), which is calculated as the ratio of the number of inhabitants aged 0 to 35 in the area of the LGUs and the estimated total number of residents of the LGUs for which the development index is made, and 5) the level of education (X5), which calculated as the ratio of the number of inhabitants with secondary school and higher education and the labor force (employed and unemployed) at the LGUs level in the year for which the development index is made. Weights by indicators are: income tax: 20%; unemployment rate: 30%; population movement: 30%; percent of the young population in the total population: 10% and level of education: 10%.²⁴

Every year, within the budget of Republika Srpska (more specifically, the budget of the Ministry of Administration and Local Self-Government), the central authorities project transfers for the co-financing of projects to underdeveloped and significantly underdeveloped LGUs in the amount of 300,000 BAM,²⁵ the distribution of which is carried out in accordance with the Rulebook on co-financing of underdeveloped and significantly underdeveloped projects local self-government units in Republika Srpska²⁶ and the Decision of the Government of Republika Srpska on the co-financing of projects of underdeveloped and significantly underdeveloped municipalities. Furthermore, within the mentioned budget, there are also transfers to underdeveloped and extremely underdeveloped LGUs and they are shown in the amount of 3,000,000 BAM. These transfers are granted in accordance with the Decision on the level of development of local self-government units in Republika Srpska and the criteria established in the Rulebook on the criteria and procedure for the allocation of financial resources to underdeveloped and markedly underdeveloped local self-government units.²⁷ In addition to the mentioned funds, the Government of Republika Srpska, through the Ministry of Administration and Local self-government, transfers financial assistance to LGUs at their request from budget reserve funds, through various relocations and different sources. Based on the above, in 2022 a total of 16 projects were co-financed at the request of 13 local self-government units in the amount of 2,600,000 BAM.²⁸

²⁴ *Criteria for evaluating the level of development of LGUs of Republika Srpska*, AMCRS, 25 November 2022.

²⁵ The AMCRS proposal is that this amount should be a minimum of 500,000 BAM instead of the current 300,000 BAM.

²⁶ *The Official Gazette of Republika Srpska*, nos. 29/18, 21/19 and 52/20.

²⁷ *The Official Gazette of Republika Srpska*, no. 1/23.

²⁸ *The Official Gazette of Republika Srpska* no. 48/15.

7. Strategic framework for improving the financing of local self-government units in Republika Srpska

Local Self-Government Development Strategy in Republika Srpska for the period 2023-2029 recognised the importance of local finances, so the Strategy projected the strategic goal “Improved local self-government financing system” which will be realised through the following three priorities: 1) Systemic increase of local self-government revenues; 2) More efficient and transparent management of budget funds in LGUs and 3) More efficient management of LGUs assets and sustainable management of local resources.²⁹ Furthermore, the Strategy foresees that the priorities will be realised through the following 11 activities: 1) increase of source revenue of local self-government; 2) increasing the share of LGUs in the distribution of direct taxes and benefits; 3) more efficient collection of non-tax revenues of LGUs; 4) more active attraction and use of grants (grants, project funds) from LGUs; 5) strengthening the role of the Financial Mechanism for financing integrated and sustainable local development projects in Republika Srpska; 6) improving financial management and building a system of internal financial controls in the public sector at the local level; 7) increasing the effectiveness and transparency of the programme of awarding incentives, grants and subsidies from LGUs; 8) strengthening orientation towards capital investments and projects in LGUs; 9) support for the establishment of digitised management of LGUs assets; 10) ensuring the equal participation of LGUs in deciding on concessions and other types of use of natural resources on their territory and 11) piloting and expanding programmes for village revitalisation.³⁰ The Strategy envisages an increase in the share of LGUs revenues in the total revenues of Republika Srpska by about 4% until 2029, which would increase the value of the local autonomy index for the *financial autonomy* dimension from seven (aggregated) to at least eight in 2009 (out of possible 12). To be noted, Bosnia and Herzegovina belongs to the group of countries with a medium level of local autonomy (from 50 to 60 points) together with 14 other countries, including Slovenia, Croatia, North Macedonia and Montenegro. The strategy points out that BiH receives a small number of points in the domain of financial autonomy due to the fact that the degree of fiscal autonomy and financial sustainability of LGUs in the Federation of BiH is lower than in Republika Srpska.³¹

Financing of development projects in LGUs is also carried out through the Investment and Development Bank of Republika Srpska. More specifically, in March 2014, a Memorandum of Understanding was signed between the Ministry of Finance, the Ministry of Administration and Local Self-Government, the Swiss Agency for Development and Cooperation (SDC), the United Nations Development Program and the Investment and Development Bank of Republika Srpska, which established the Financial Mechanism for the financing of projects of integrated and sustainable local development, in the area of improving the availability and quality of public services and stimulating the rural development of local communities in Republika Srpska. Since the signing in 2014, through seven annual financing cycles, 64 projects have been implemented in local self-government units throughout Republika Srpska. Their total value is 8,100,000 BAM, of which 5,100,000 BAM was allocated through the Financial mechanism. The remaining amount was secured by the users through

²⁹ Report on the financial audit of the Ministry of Administration and Local Self-Government of Republika Srpska for the period 1 January- 31 December 2022, Main Service for Auditing the Public Sector of Republika Srpska, Banja Luka, 23 March 2023, p. 12-13. Available at: https://gsr-rs.org/wp-content/uploads/2023/04/RV010-23_Lat.pdf, 13 April 2024.

³⁰ Local Self-Government Development Strategy in Republika Srpska for the period 2023-2029, Government of Republika Srpska, Banja Luka, 2023, p. 59.

³¹ *Ibid*, p. 25.

the co-financing of project activities. In addition to the above, in the period from 2020 to mid 2022, the legal framework governing the financial sector was significantly improved in order to affirm alternative forms of financing of companies and investment opportunities, further development of the capital market of Republika Srpska, easier access to financing for entrepreneurs and economic entities, and a more attractive business environment for investors, which ultimately contributes to better local development.³²

8. Conclusion

The implementation of principles of the European Charter of Local Self-Government in Republika Srpska by the Congress of Local and Regional Authorities of the Council of Europe was rated quite high.³³ Financing of local self-government in Republika Srpska is for the most part in accordance with the Charter.

Local self-government units have their own source revenues which they manage independently. However, the sustainability and diversity of those revenues poses a challenge.

Also, the central authorities have a strong influence the distribution of income, and the projection of the distribution is met with objections from the local authorities that consider it disproportionate and inadequate. The objection of LGUs also refers to the limitation of borrowing in view of the linear borrowing limit set by the central authorities, valid for all LGUs, regardless of their economic power and the size of the budget.

Financial analysis of NALAS point to a low level of shared taxes and a very high share of grants in the financing of local self-government, which deviates from the principles of the Charter.

Central authorities still do not have strong and sustainable resources for both regular and project support to local self-government units.

The problem is also the inadequate criteria for evaluating the level of development of local self-government units, which give an unrealistic picture of development. As the level of development is a parameter for financial support, wrong criteria give a potentially inaccurate picture of development, and therefore an inadequate allocation of support funds.

³² *Ibid*, pp. 16-17.

³³ Compare: *Bosnia and Herzegovina - Monitoring Report*, <https://www.congress-monitoring.eu/en/44-pays.html> and <https://rm.coe.int/local-and-regional-democracy-in-bosnia-and-herzegovina-monitoring-comm/168098072a> 4 May 2024. Based on the Report, out of 30 ratified provisions, BiH has 20 aligned, five partially aligned, and five non-aligned provisions. For Republika Srpska, it is significantly better compared to the Federation of BiH, and the Report cites the key reason for this as the non-alignment of cantonal laws with the federal legislation on local self-government. For example, Croatia, as an EU member, has only 16 aligned provisions, Austria has 21, Hungary 12, Serbia 16, Greece 10, etc.

9. Recommendations

Recommendations to the National Assembly of Republika Srpska and the Government of Republika Srpska, the Ministry of Administration and Local Self-Government and the Ministry of Finance of Republika Srpska:

- 1)** Consider the possibility of passing the Law on Financing of Local Self-Government of Republika Srpska, which would comprehensively and thoroughly ensure the financing of local self-government units in Republika Srpska. Alternatively, amend and supplement the Law on the Budget System of Republika Srpska, which would redefine the ratio of distribution of certain types of income in accordance with the joint expert analyzes of the central authorities and LGUs in Republika Srpska.
- 2)** Consider the possibility of changing the criteria for the distribution of revenues from indirect taxes intended for local self-government units.
- 3)** Consider adopting new criteria for determining the level of development of local self-government units in Republika Srpska, which would contain indicators based on which the level of development of local self-government units in Republika Srpska could be more accurately and reliably assessed.
- 4)** Consider the possibility of a differentiated limit of long-term borrowing by LGUs.
- 5)** Consider the possibility of a systematic, unified, sustainable and comprehensive arrangement of support for financing projects of local self-government units in Republika Srpska, taking into account the best practices and experiences of countries in the region and the European Union (resource center, revolving fund, etc.).

10. Appendix – A structured interview³⁴

In order to prepare the "Report of the Compliance of local self-government financing in Republika Srpska with the European Charter on Local Self-Government", please answer the following questions:

1. The Law on the Budget System of Republika Srpska stipulates that the individual participation of LGUs in the distribution of revenues from indirect taxes is carried out in accordance with the following criteria:
 - a) 75% based on the number of inhabitants of the municipality and city
 - b) 15% based on the area of the municipality and city and
 - c) 10% based on the number of students in secondary schoolsWhat is your opinion about these criteria, are they adequate and if not, why not. Also, take a look at the question, does the RS Government regularly update the data under a) and c)?
2. Do you have any comments and suggestions for other parameters and ratios of revenues distribution (income tax, water fees, concession fees, rent, confiscated property, self-employment, etc.)
3. What is your position on the support of the central authorities to underdeveloped and extremely underdeveloped LGUs in the sense of whether it is sufficient, whether it is timely and adequate, and whether certain interventions need to be carried out in this regard?
4. What do you think about the current, now multi-year criteria for evaluating the level of development of LGUs in Republika Srpska, are they adequate, should they be changed and how?
5. Should Republika Srpska adopt the Law on Local Self-Government Financing? What would be achieved by this, bearing in mind that the existing Law on the Budget System of Republika Srpska prescribes the necessary parameters for the financing of local authorities? On the one hand, you have the independence of LGUs, and on the other, the regulation of their finances by the central authorities?
6. What do you think about the borrowing limits prescribed by the central authorities for LGUs in Republika Srpska, where the short-term limit is 5%, and the long-term limit is 18% of the budget? Should this limit be linear for all or should it be differentiated, how to arrange so that one set of authorities does not burden LGUs, which will be inherited by some future ones, etc. Should this be redefined and in what way?
7. What do you think about the obligation to approve the LGUs budget by the Ministry of Finance? Should it be only formal or essentially and analytically oriented in the sense that LGUs receive more instructions but also guarantees that the approved budget will contain funds for financing the work entrusted to LGUs by the central authorities?
8. Should the collection of real estate taxes be done by the cities (which they have the right to do by law) or should the Tax Administration of Republike Srpske continue to do it. Would the aforementioned affect the growth of collected revenues, considering that cities do not have the possibility of compulsory collection, at least not in the capacity that the Tax Administration has?
9. What do you think about the abolition of special revenues by the central authorities (such as communal charges for company name display)? Should LGUs introduce and/or redefine some new types of revenues?
10. In your opinion, what else needs to be done so LGUs have stable and sustainable funding resources they can manage independently, which is the key requirement of the European Charter of Local Self-Government?

³⁴ Interviews were held with Mr. Ljubiša Ćosić, Mayor of the City of Istočno Sarajevo and Chairman of the Association, Mr. Bojan Kresojević, City Manager of the City of Banja Luka, Mr. Darko Tomaš, Mayor of the City of Prnjavor, Mr. Đorđe Papak, Assistant Minister in the Department of Local Self-Government, Ministry of Administration and Local Self-Government, Government of Republika Srpska, Mr. Aco Pantić, Secretary General of the Association of Municipalities and Cities of Republika Srpska.