

# **Fiscal Federalism in Bosnia and Herzegovina**

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**Abstract.** The following paper deals with the fiscal federalism in Bosnia and Herzegovina (BiH). It provides a detailed description of the development of the fiscal federalism in BiH since the Dayton peace process, illustrates how the public finance system in BiH is designed, and identifies the main differences between the Republika Srpska and the BiH Federation. We analyze the revenue disparities between the cantons and their respective municipalities which are boosted by the origin, or rather, the derivation principle in tax collection, and present an equalization system based on the VAT which can minimize the fiscal gaps mainly in the Federation of Bosnia and Herzegovina (FBiH). This paper highlights the successful process and the unsolved problems of the recently introduced Value Added Tax in BiH.

**JEL Classification:** H7; H2; H1

**Keywords:** Fiscal Federalism, Grants, VAT introduction, Bosnia and Herzegovina

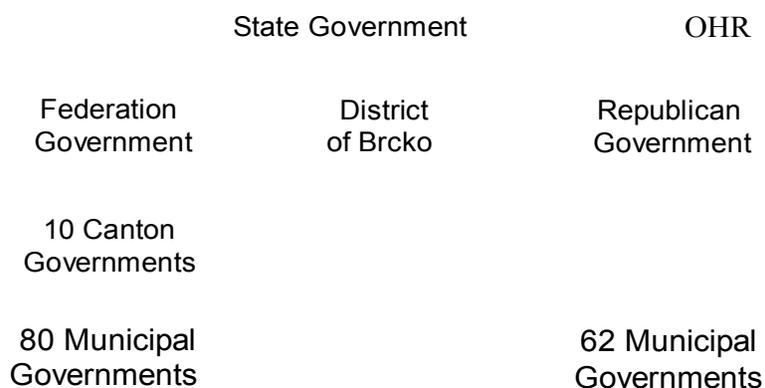
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## **1. Introduction**

After almost four years of bloody conflict between the three ethnic groups, the political leaders of the Bosnian Serbs, Croats and Moslems agreed on a peace agreement at Wright-Patterson Airbase in Dayton, USA, on November 21, 1995. The General Framework Agreement for Peace (GFAP), also known as the Dayton Peace Agreement (DPA), was signed by all the political parties in Paris on December 14, 1995. The DPA became the basis for peace in Bosnia and Herzegovina and ended the civil wars, in which more than 300,000 people were killed and nearly two million people became refugees.

The Dayton peace agreement created Bosnia and Herzegovina (BiH) as a single sovereign state composed of two Entities - the BiH Federation and the Republika Srpska - and the small District of Brcko. While the BiH Federation itself with a federal government in Sarajevo, ten cantons and 73 municipalities is structured as a three-tier fiscal system, the Republika Srpska consists of the Republican government which is located in Banja Luka, and 62 municipalities only as a two-tier administrative body. Moreover, due to the Dayton peace agreement, the Office of the High Representative (OHR) exists in BiH which is the supreme authority for enacting laws and a huge number of political decisions. Therefore BiH is “*de jure*” not a complete sovereign country because it is still under the supervision of the OHR of the United Nations.<sup>2</sup>

The following figure describes the actual political conception of BiH:



Source: own illustration

Another feature of the BiH fiscal federalism is that the central government does not exert a huge political influence, because the Entities have enacted their own constitutions and are politically, administratively and fiscally autonomous. For example, the whole revenues of the central government amounted to only €171 million in 2004<sup>3</sup>, while in the same fiscal year the Republika Srpska had €778 million and the Federation of BiH had revenues in the amount of €1,904 million at its disposal.<sup>4</sup> A similar situation between the central government and the two Entities can be observed in terms of the expenditure assignment. Table 1 shows the distribution of accountability for some areas of expenditure between the different tiers of government:

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