LOCAL ECONOMIC DEVELOPMENT AND MODERNIZATION OF LOCAL GOVERNANCE IN BOSNIA AND HERZEGOVINA

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Abstract

The purpose of this paper is to show the correlation between reform of governance in 72 BIH municipalities and local socio-economic and infrastructure development. The paper is a synthesis of eight years of monitoring of impacts the multi-faceted municipal reforms had on the communities undertaking the reforms. The examining period is from 2004 to 2012. The municipalities that are subject of this study are geographically, politically and in terms of size and stage of development equally spread throughout Bosnia and Herzegovina. In the paper we first provide a theoretical basis for understanding of the factors of the local economic development and we discuss several LED indicators. Main avenues of the municipal reform are discussed in the second, analytical section, as follows: modernization of the municipal services, urban permitting and spatial planning, municipal budget and finance and managing the development planning and infrastructure development. In the third section of the paper, we put the described reforms in a correlation with the empirical evidence on socio-economic development, from which we draw conclusions on the reforms’ impact on LED and intensity of its correlation to the selected indicators.

Keywords: Municipal governance, (Indicators of) local economic development, Modernization of municipal services, Own-source revenues, Participatory planning, Political stability.

Indicators of local economic development: a theoretical outlook

It is a prevailing opinion among the theoreticians that local economic development (LED) is a paradigm of future development of the municipalities. Hadžić states that by employing their internal capacities, above all human capital and material and intellectual potentials, the municipalities are able to attract the prominent businesses which will invest and thus create new jobs and utilize material resources (Hadžić 2010 : 18). In order to examine the effects the modernization of services has on the municipal development, it is necessary to first identify the indicators of the intensity and success of LED. This is where we come to the first stumbling block. There is a lack of theoretical knowledge on the indicators of LED, due to fact that the social and economic sciences have not paid sufficient attention to the problem.

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Umihanić states that “in Bosnia and Herzegovina there does not exist a specific institutional nor legal framework which would define and regulate the area of local economic development, and that includes the issue of functioning organizations for LED” (Umihanić 2012 : 29). “There are, however, several projects and studies, such as the USAID’s program of certification of the municipalities ‘NALED’, which has developed a methodology for evaluation of the quality of the development-conducive environment in the local communities.” The said program is using the following criteria for certification of the municipalities for their “business friendliness”: 1. A strategic approach to local economic development, 2. Organizational capacity to support businesses, 3. Business participation in local government (Economic Council), 4. Efficient building permits issuance system, 5. Availability of business relevant information, 6. Applying marketing for the purpose of investment promotion, 7. Creditworthiness and financial stability, 8. Employment and human resources promotion, 9. Encouraging public-private partnerships, 10. Adequate infrastructure and reliable utility services, 11. Transparent local fees, taxes and incentives policy, 12. Applying information technologies (NALED 2012 : 3). There are additional significant indicators of the municipality’s potential for LED, such as the existence of industrial parks, business incubators, local policies for supporting growth of small and medium enterprises (incubators, load-guarantee funds), efficiency of local government in providing services and participatory planning mechanisms. In short – we could call this group of business-friendliness or “micro” indicators of LED.

There is a group of substantial indicators – we shall call them “macro” indicators – which indicate the stage of local development. Hadžić states several of them, such as total GDP per capita, amount of investments per capita, unemployment rate, number of newly started businesses, number of businesses discontinued, use of energy, number of pupils, number of schools, number of innovations and registered patents, situation and increase of road infrastructure (Hadžić 2010 : 36). For simplicity, we use only two of the mentioned indicators for this study: GDP per capita and unemployment rate.

Macro indicators of LED

**GDP per capita**

GDP is measure of the total flow of goods and services produced by the economy over a specified time period, normally a year or a quarter. It is obtained by valuing the outputs of goods and services at market prices and then aggregating (Bannock et al. 1992 : 186). Ruffin and Gregory introduce a somewhat more detailed definition, stating that GDP is about market value of all final goods and services produced by the factors of production located in the country during a period of one year (Ruffin and Gregory 1993 : 121). To be able to compare individual municipalities’ GDP, it is necessary to calculate GDP per capita using the following equation, as used by the Federal Agency for Programming of Development: number of the employed persons
in a municipality, average salary in a municipality / number of the employed persons in an Entity, average salary in the Entity. The estimated GDP is then divided with the estimated number of inhabitants of a municipality. One should bear in mind that such a GDP per capita is an estimation because not all the factors influencing the real GDP were taken into account and because of lack of most current data on the number of inhabitants because census has not been held in Bosnia and Herzegovina since 1991.

Unemployment rate

According to the “Dictionary of Economics”, unemployment is defined as the existence of a section of the labour force able and willing to work, but unable to find gainful employment. Unemployment is measured as a percentage of total labour force out of work (Bannock et al. 1992 : 432). The theoreticians identify four distinct causes of unemployment: 1) Frictional unemployment, caused by people taking time out of work, being between jobs or looking for a job, 2) Classical unemployment, caused by excessively high wages, 3) Structural unemployment, as a mismatch of job vacancies with the supply of labour available and caused by shifts in the structure of the economy and 4) “Keynesian” unemployment, resulting from the existence of a deficiency of aggregate demand which is simply not great enough to support full employment. It is not subject of this paper to identify prevailing causes of unemployment in Bosnia and we are aware that a variety of factors, other than LED, have influence on the unemployment rate in a municipality. However, employment remains as one of leitmotifs of every municipality’s development policy and thus we use it as a relevant secondary indicator for identifying any correlation between the local reform and LED.

Micro indicators of LED

Strategic and participatory planning

Participatory planning is the essence of the local economic development and we are not much mistaken to put the equation mark between the two terms. Existence of a strategic plan (strategy) for LED, which was created in a participatory manner, with inputs from all relevant stakeholders taken into consideration, may serve as the first, albeit not the only important, indicator of a community’s potentials for LED. Today it is almost impossible to find a municipality without some sort of a development strategy. However, we must agree with the prevailing opinion by both, scholars and the municipal decision-makers, that most of the strategic documents were not successfully and fully implemented in practice. The reason most often stated, among other, is that the strategies often were not the products of thorough analysis and true partnership of main local economic and societal stakeholders. Recognizing this problem, many of the Bosnian municipalities, assisted by the foreign donors and
experts, such as UNDP, are currently in a process of participatory development of the local LED strategies, as well as the process of systemic implementation of the priorities already defined within their existing strategies.

Equally relevant for this study is the capital improvement planning process, which has been adopted in 72 Bosnian municipalities as a methodology of participatory planning of the capital projects of utmost importance for the local communities, mostly involving the infrastructure projects. Introduction of a five-year Capital Improvement Plan starts with establishment of a municipal team, consisting of relevant representatives of the main segments of the community (businesses, municipal government, youth, NGOs, local communities, underrepresented gender, etc). The team conducts a public survey for the community priorities and then analyzes the findings and creates the priority list. By doing this, “the municipalities develop municipal government capacity in project cycle management and capital improvement planning to ensure well administered programs and increase the knowledge needed to access EU pre-accession and other funding mechanisms and to improve the quality of municipal governance through better management of capital projects.” (GAP 2013 : 25).

Business parks

As a product of what scholars refer to as “close union between urbanization and development” (Todaro and Smith 2006 : 302), the business parks (or “business zones”, as they are commonly referred to in Bosnian language) are “separate and structured business establishments in which at one location, well connected with other locations, the various types of manufacturing and service activities are developed, on the basis of cluster-like organization principles and by using of the well-developed infrastructure and the accompanying services which are of specific industrial features” (REZ 2007 : 37). Beside the location and clustered position, the parks also provide favourable rents, delayed payment, tax benefits, access to venture-capital, organized marketing approach, assistance in export. Business park is established and managed by local government and various quasi-governmental and other organizations and it has a private status or some other form of organization (REDAH 2008 : 4). Despite their relative widespread presence throughout Bosnia, it is evident that thus far neither relevant governmental agencies nor scholarly community have produced a systemic and thorough analysis on fruitfulness of the business parks in Bosnia. That is why we shall take as an LED indicator only the fact of a park’s existence and not their true impact in a municipality.

Loan-guarantee Fund

Principle no. 6 of the Small Business Act for Europe sets forth: “Facilitate SMEs’ access to finance and develop a legal and business environment supportive to timely payments in commercial transactions.” (EC 2008 : 4). Loan-guarantee fund is
a guarantee scheme with a goal to secure guarantees to its members for the loans which the members want to take in the bank which is a signee of the agreement. Being a novelty, municipal loan-guarantee funds are still rather under-used tool for fostering local development. In RS there is one entity-level guarantee fund, while in the Federation of BIH the funds exist at the regional and local level.

**Business incubators**

Business incubator is another tool for fostering LED for which the municipality’s capacity and support of the local actors is of critical importance. It is defined as a “suitable” space where potential entrepreneurs start their business, or where the new (less than six months old) micro-, mini- or medium-sized enterprises continue their business. It features favourable conditions of use of the business premises, advisory services and the assistance provided by the incubator’s management (NBR 2008 : 3). According to the existing Strategy for Development of the Incubators in BIH, there is a total of 27,000 square meters of business space in the form of business incubators existing in Bosnia today, and they operate under various legal arrangements: as a project, as a department within an association, as a separate unit in the local government, public enterprise or a fund registered at the level of BIH.

**Municipal governance**

One of the principles of the EU’s “Small Business Act” is devoted to public administration and is aimed to “make public administrations responsive to SMEs’ needs, making life as simple as possible for SMEs, notably by promoting government and one-stop-shop solutions. Modern and responsive public administrations can make a major contribution to the success and growth of SMEs by saving them time and money and hence freeing resources for innovation and job creation. E-government and one-stop shops, in particular, have the potential to help improve service and reduce costs” (EC 2008 : 9). In the spirit of this EU principle, we introduce efficiency of delivery of municipal administrative services as a variable and an important feature which affects municipality’s business-friendliness and citizen and business satisfaction with the same.

As importantly, municipality’s management of scarce budget resources is of direct relevance to LED. Depending on how efficient and responsible management of budget and finances is – i.e. generation of own source revenues or ratio of capital versus operational outlays – a municipality will have a potential to more successfully foster LED. Non-tax revenues are the only source of income a municipality can directly collect and control, resulting from the municipality’s own-source revenue generation. As Osborne and Geabler point out, perhaps the safest way to raise non-tax revenue is simply to charge fees to those who use public services. User fees have
become ever more popular as resistance to tax increases has mounted (Osborne and Geabler 1993). It is assumed that reforms of the municipal services and, especially, the municipal budget and finance management, will lead to an increase of municipal own revenue generation, as measured in total own-revenues as adjusted for inflation. Management and technological innovations assist the municipality to better plan, collect, analyze and store information on the collected fees and their sources, the existing and the prospective ones. Another potential and desirable impact the municipal reforms have in the socio-economic area is increase in the ratio of capital outlays to operating expenses. In other words, as a percentage of total expenditures, municipalities will devote less to their own operations and more than before to capital investments including infrastructure for enabling the business and societal prosperity.

**Political stability**

We believe that political stability is of a significant importance to LED. Potential investors prefer a predictable, harmonious socio-political environment for their business endeavours. That is why, in order to complete our landscape for studying potential impact the reforms have on local development, we shall add one indicator of a political nature to the group of the mostly economic micro-indicators. Since 2004, there were three direct elections of Mayors in Bosnia and Herzegovina, which gives us sufficient evidence from which to draw the conclusions whether any change occurred in the local voters’ motivation. In order to test this, we shall analyze the electoral success of the Mayors or their parties in 72 municipalities in which reforms of governance took place.

Political actors’ responsibility to the voters is in the essence of modern understanding of political democracy as a “system of governance in which rulers are held accountable for their actions in the public realm by citizens, acting indirectly through the competition and cooperation of their elected representatives” (Schmitter and Karl 1991 : 2). This is a broader understanding than the classical Schumpeterian definition of democracy as “regime in which government offices are filled as a consequence of contested elections” (Schumpeter 1947 : 296). We deem that administration is one of the main tools at disposal of the political actors which enable them to fulfill promises to the voters and make the mentioned sense of “responsibility” work. That is a rationale behind one of our hypotheses that direct correlation exists between modernization of administration and the success of the political actors leading the reforms.

It is, however, important to note that the stated sense of responsibility (“accountability”) can be established only in a consolidated democracy, in a society in which democracy is, as Linz and Stepan point out, “the only game in town.” According to these authors, a democratic regime in a territory is consolidated when (...) a strong
majority of public opinion holds the belief that democratic procedures and institutions are the most appropriate way to govern collective life in a society such as theirs and when the support for anti-system alternatives is quite small or more or less isolated from the pro-democratic forces (and) when governmental and nongovernmental forces alike, throughout the territory of the state, become subjected to, and habituated to, the resolution of conflict within the specific laws, procedures and institutions sanctioned by the new democratic process (Linz and Stepan 1993 : 6).

Modernization of local governance

In the first section of this paper we analyzed several indicators for measuring the success of LED. Purpose of discussion on the indicators is to enable us to measure what impact modernization of governance may have on municipal development. In this second section we discuss in more detail the reform endeavours that took place in 72 Bosnian municipalities from 2004 to end of the last year (2012) as part of one of the biggest and most systemic donor-funded projects in local governance – USAID/Sida/EKN Governance Accountability Project (GAP).

Theoretical overview

Modernization of administration and the role the reforms have in fostering of local development can be viewed as an outcome of the one of general tendencies in development of public administration to which Pusić refers as “tendency towards decrease in coercion in governance”. Increase of technical capability of administration is one of critical features of the mentioned tendency. Pusić states that “rise of technical capacity of administration consists of introduction of more and more administrative procedures, which requires high skill, specifically, the procedures which imply lex artis, and not the power of force. More comprehensive societal division of labour leads to creation of new administrative services which do not rely on coercion. All new administrative operations stemming from the urban way of life – i.e. city lights, sanitation, transport, sewage, heating, gas, urban planning and many other – in principle, do not presuppose coercion as a principle for their existence” (Pusić 2002 : 104).

Ivanović points out that for a successful application of the information technologies not only a technological maturity is needed, but also an entrepreneurial one; a willingness for reshaping of the whole mode of operations. That is of special relevance for the public administration system and the other public services in which influence of the external factors, which could push the process of application of the information technologies forward, is not clearly defined (Ivanović 2003 : 336). However, Ivanović states, “although we cannot dispute that public administration is still far less than business sector prone to the external demands and risks stemming from
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Anticipation of these demands, we are witnessing that the public demands are becoming recently more and more prominent and binding for the administration too, because the public is measuring efficiency of the government by the benefits they are bringing. (...) These pressures, which come in the form of ever higher expectations by the citizens, are taking place at the same time as the requests for adoption of the new technological skills and modes of operation. These two sources of demand for adjustment are intertwined and interdependent, thus creating a need and drive for changing of the old ways of doing things” (Ivanović 2003 : 343).

Three principles of the improved governance

It is often heard that the organizational and technological improvements of governance are bringing more transparency, customer orientation and efficiency. As these three principles are so closely associated with the modernization of governance and administrative service delivery, we shall discuss them in larger detail.

Transparency

Principle of transparency is very often mentioned while discussing the reforms of governance, to the point that its true meaning and importance are inflated. Transparency is one of the goals, and also one of the tools in bringing about the change in governance. To best explain this broadly used term, let us refer to Osborne and Gaebler, two theoreticians who were among the first to conceive the term in the 70s and 80s of the last century, in the eve of the doctrine of “entrepreneurial” government in the US. They point out: “Think of our public systems as an infrastructure – like sewers, water pipes, and electrical lines – and the idea of transparency becomes clear. Customers do not care how infrastructure systems work; they do not want to know what goes on underground. They just want the lights and faucet and phone to work. User friendly, transparent systems are designed to hide the underground pipes and wiring, but to give customers all the information they need about the lights and faucet and phone” (Osborne and Gaebler 1993 : 192).

Customer orientation

Customer orientation is the second principle we discuss in this section. Again returning to the roots of its usage, we refer to an example about which we learn from Osborne and Gaebler. Distinguishing the government which is customer-oriented, and not self-oriented they refer to the slogan “Serve people not the budget lines!”, which was an underlying principle behind the rationalization of the New York Employment Bureau, a success story of a customer-oriented public administration. However, the same authors point out that transformation of public administration
towards the customer orientation specific of private sector remains a challenging and complex task, for the simple reason that public administration, unlike private sector, does not get the funds from their immediate customers. That is why they conclude that “most American governments are customer-blind, while McDonald’s and Frito Lay are customer-driven. This may be the ultimate indictment of bureaucratic government” (Osborne and Gaebler 1992 : 167).

Efficiency

Modernization cannot in itself be an indicator of development of administration, or even a reliable indicator of its productivity. While in manufacturing a direct and clear connection can be drawn between technological progress and increase in productivity, in the administration the case is different. As Ivanović points out, in the information-intensive activities, especially in public administration, the productivity is nowadays hardly any higher than it was forty years ago. Despite all the huge investments in the information technologies and office equipment, the civil servants, as staff who process and make the administrative decisions, as well as IT experts of various kinds, are processing approximately a same amount of information and create as much new content per unit of investment, as did their colleagues of previous generations (Ivanović 2003 : 334). That is why we shall search for the impact of modernization in the indicators beyond general measurement of productivity, immanent to the private sector, and rather seek to establish correlations between modernization and the indicators of LED.

Reform of the local governance in Bosnia and Herzegovina

Leading Bosnian scholar of local self-government, Mirko Pejanović, states that reform of the local government in Bosnia and Herzegovina is built on three pillars: First, the institutional reform, establishing a unified and clear legal and institutional framework for defining local and regional governments’ powers, determining the financial and technical resources for the execution of powers and establishing the instruments of cooperation with the higher tiers of government. Second is the functional segment of the reform, consisting of reform of the municipal governance and functioning of the communal services and services to the citizens. Third pillar, according to Pejanović, is the territorial reform, dealing with the necessary alternations of the territorial organization of the municipalities (Pejanović 2006).

The institutional and territorial segments of the reforms have been to a large extent either completed or defined in the Constitution. The third pillar of the reform of local government – functional reform – is continuing to be in focus of the government, citizens as well as international donors. A significant number of municipalities in Bosnia and Herzegovina have undertaken, in the last seven to ten years, the reforms of the municipal administrative services, financial management and planning.
investing in technological and organizational innovation, municipalities are becoming more oriented towards the end-user, the citizens and the business and local governments are undertaking “incremental changes in the administrative personnel and elected representatives’ approach towards the citizens and many municipalities put the efficient services to the clients increasingly in the centre of their interest. The old model of local governance as a labyrinth of rules and regulations, and discretionary rights of the clerks, makes way for more open and accessible model of service delivery” (Leskovac 2009 : 351). These developments are in line with the trends existing in Europe since the 70s for bigger devolution of political and administrative powers in the developed as well as in the developing countries and the prevailing doctrine of the “new public management” according to which “local governments, similarly to the business firms in a market arena, shall fight for their citizens’ trust” (Rondinelli 1990 : 10).

**Improvement of the municipal services**

The World Bank is measuring business-friendly environment by using the following indicators: 1) Starting a business, 2) Dealing with construction permits, 3) Getting electricity, 4) Registering property, 5) Paying taxes, 6) Trading across borders, 7) Getting credit, 8) Protecting investors, 9) Enforcing contracts, 10) Resolving insolvency, 11) Employing workers (World Bank 2013 : 17). As can be seen, top five of them are directly within the scope of municipal governance. That is why improving the direct service delivery from the municipality to the customers, including the business, is of the highest importance.

Since 2005, there were 72 modern municipal Citizen Services Centres (also known as One-Stop-Shops) opened in Bosnia and Herzegovina. In the Centres, citizens and businesses obtain the administrative services in a more efficient and transparent manner. Additionally, in the Centre an administrative procedure for more complex administrative matters is initiated and the information on the status of the administrative process obtained. In order to achieve a transparent and efficient service to the end-users, a wide range of improvements is required, ranging from the new, bright and pleasant premises, user-friendly design of the premises and processes, staff trained in customer-orientation skills and the high-end computer equipment, software and communication systems. A very important segment of the reforms is “hidden” from the eyes of an average citizen or a businessperson. By this we mean a complex and demanding preparatory work which takes place in the “back offices”, which is where the administrative cases are processed and the administrative decisions made. This preparatory work consists of various complex and sensitive organizational changes and changes in the management process, leading to a complete re-engineering of the administrative processes. In addition, introduction is needed of the new systems for electronic processing and flow of documents and information – namely, data-processing (registry) software, document-tracking software and information-desk software. Finally, all the administrative data previously available
and stored only on paper needed to be digitized and fed into databases. For example, in order to digitize the registry records (i.e. on birth, death, marriage) the mentioned 72 municipalities performed over 8 million entries. But this tedious and labour intensive work is highly rewarding and in the case of the mentioned municipalities the reform has resulted in reduction of duration of the registry services from average half an hour to few seconds.

**Urban permitting and spatial planning**

As every municipal Mayor will prove, the municipal land is the most important resource of the municipal revenues. Reliability and efficiency in urban permitting and spatial planning is of utmost relevance to attracting of investments, opening of the work places and is becoming ultimately a driver of municipal development. However, due to outdated spatial plans and complex and slow procedures as determined by the existing rules and regulations, urban permitting and spatial planning have been an impediment instead of driver of the local development. To remedy this, several municipalities pioneered in introduction of the zoning methodology as a system of application of more flexible principles in urban planning. Staying within the existing legal framework, this new system, with its simplicity and streamlined permitting process, lessens the administrative burden on the end-users, in this case, mostly the businesses.

As in the case of the registry services, streamlining of urban permitting and planning is very demanding and requires complex preparations, one of the most complex being creating the organizational and institutional arrangements for a continuous and smooth cooperation between various stakeholders relevant to the permitting process. Laying down necessary infrastructure for data collection, analysis and sharing has proved to be as challenging. Thousands of hours of training, counselling and practical coaching, and hundreds of software licenses and hardware units (scanners, computers, GPS equipment etc.) was needed for the process of permitting in a GIS surroundings to be put into function. “In Banja Luka, the issuance of a Regulatory Plan Excerpt for areas covered digitally takes only five minutes, whereas before the procedures in the permit centre took twenty-five days on average. Although baseline measurements are not available, reliable analysis indicates that the urban permitting process has been shortened by approximately thirty to sixty business days and efficiency of permitting was significantly increased” (GAP 2007 : 80).

**New Budget and Finance System**

There can be no efficiency in services provision or development of the communities without an efficient and transparent budget and finance management. That is why – in parallel with the technological and organizational improvements, which
were predominantly *outside-oriented* and aimed towards the users of the municipal services – it is necessary to address the *internal* functioning of the municipal government. Over the last few years, more than 50 municipalities have introduced an integrated accounting and budget system, in order to achieve greater transparency, efficiency and discipline in their budget and accounting management. The backbone of the system is a sophisticated multi-modular software which enables all the financial transactions and other operations relevant to budget and finance to be processed through the “general ledger”, the core module of the software. Consequently, all the aspects of financial management are now integrated, which means that the financial transactions are automatically posted from other modules into the general ledger as soon as they are entered into the system. Given that the software is consistently and continuously used by all the involved stakeholders (i.e. all municipal departments generating or allocating revenue or tracking the expenses) the system improves the municipal financial management practices significantly. Among other benefits, it has helped the mayor develop informed policies and make decisions on budget planning, collection and execution. As for the personnel working in the accounting and finance, the system has allowed swift reporting and information sharing and improved their daily operations immensely.

*Structures for managing development and community planning*

According to the recent study produced by the LEDnet Project (IPA-funded Bosnian network of the LED-related organizations) the organizations dealing with LED are widespread with around 30 of such organizations existing throughout Bosnia. “They were formed either as the municipal ‘executive’ agencies, the associations of businesspeople and entrepreneurs or the independent experts’ associations to deal with the challenges of the economical transition through enabling and streamlining of the process of LED and serving as link to the local economic endeavours, especially by providing support to development of the small and medium entrepreneurs or initiating or supporting the implementation of local development projects” (Umihanić 2012 : 22).

These organizations take a special role in supporting the implementation of the LED strategies which were adopted in line with the modern MiPRO methodology (...) this methodology is fully in line with the existing legal framework which defines the development planning at the local level, stipulating that the municipal administration has a leading role in preparation and implementation of the development strategies (EDA 2011 : 8).

Additionally, with aim to achieve durable and sustainable arrangements of inclusion of all relevant local stakeholders in the process of the community planning, 72 municipalities adopted the methodology of capital improvement planning (CIP). Based on decisions of the Municipal Assemblies / Municipal Councils to introduce
five-year Plans of Capital Improvements, the municipalities formed the coordination teams which conduct the public survey of priorities, assist the municipal management in deciding on the priorities for implementation and monitoring of the same. Often implemented in collaboration with the donors, but with a very significant cost-sharing by the municipalities, capital improvement projects’ importance is twofold. *First*, there is direct benefit for the citizen and direct or indirect benefit for the business-environment in the shape of the kilometres of road infrastructure, water supply systems and sewage, street lights, renovated civic centres and schools, etc. The *second* benefit is perhaps even greater. It is the introduction and putting into function of an institutionalized, sustainable and continuous practice of inclusion of all stakeholders into development process as well as mastering methodology of project management – which are tools of vital importance for applying for and implementing of the projects financed from EU pre-accession funds.

**Impact of the modernization – An empirical outlook**

In this section of the paper we shall bring into correlation the reform endeavours discussed in the second section with the indicators of LED introduced in the opening section of this paper, in order to draw conclusions about whether the local development is proportional to modernization of the municipal administration.

**Macro indicators of local economic development**

A direct connection between the municipal reform endeavours and the unemployment rate or its trends in the period in which the reforms took place (2005–2010) is difficult to establish. While according to www.mojemjesto.ba, the reform-oriented municipalities such as Banja Luka, Trebinje, Novo Sarajevo, Laktaši, Sarajevo-Centar and Tuzla are blessed with the lowest unemployment rate (25 to 35 per cent), some other municipalities, which also had a significant success in modernizing the administration and increasing citizen and business satisfaction, such as Foča, Gračanica, Gradačac and Cazin, have very unsatisfactory rate (from 55 – 60 per cent). Additionally, a recent study of quality of life in Bosnian municipalities revealed that “given the number of inhabitants, the best situation is in Novo Sarajevo where on three citizens there is one employed person. Banja Luka, Tuzla, Mostar, Trebinje and Široki Brijeg follow with one employed on every four citizens” (CCI 2013). On the other hand, according to the same study, the worst situation – one employed on every eight citizens – is recorded in Livno and Foča, as two municipalities which were among the best examples of success of the reforming efforts we discussed in the section 2 of this paper. Truthfully, since we operate with the data from the period 2005 to 2010, there is an assumption that the unemployment trend lines might have alternated since then – given the fact that the impact of the reform...
takes more time to be fully visible, as well as due to the fact that “labour market adjusts slower than any other market” (Bannock et al. 1992 : 432). The fact that the high unemployment rate diminished significantly from 2005 to 2010 in many of the reform-oriented municipalities, such as Gračanica, Gradačac, Travnik, Goražde, Široki Brijeg or Vogošća, supports this assumption. Ilidža is a leader in this group as a municipality in which unemployment rate fell from 53 to 37 per cent in the course of the five “reform” years. This, however, cannot be established as a rule because in various other “reformed” municipalities, such as Ljubuški, Jablanica, Mrkonjić Grad or Velika Kladuša an increase in unemployment rate was recorded, or as in the case of the reform-minded Bihać and Bosanska Krupa, a stagnation.

In the case of the second macro indicator of LED, GDP per capita, there is a similar case. Rate of success of the reforms does not guarantee any increase in GDP per capita. Similar to the unemployment rate, in the case of GDP it is the numerous other factors that influence the correlation between modernization and development. Although there are numerous examples of an accelerated increase of GDP in the “reformed” municipalities, such as Bugojno, Banja Luka, Bihać, Breza and Široki Brijeg, there is a prevailing trend of a very limited growth or stagnation in the municipalities, regardless of whether they were reforming or not. According to a recent study (CCI 2013), for two years in a row the reform-minded municipalities of Široki Brijeg, Banja Luka and Novo Sarajevo remain the municipalities with the highest index of quality of life, while the lowest index is recorded in Bihać, as we mentioned earlier, also a municipality which reformed its administration and services to business and citizens with highest enthusiasm. This confirms that the macro indicators to large extent depend on other factors and only in a limited or no extent depend on the subjective efforts of a municipality.

Micro indicators of local economic development

Efficiency of governance

The resources and time invested in the above mentioned reform endeavours resulted in significant strides in efficiency of the municipal operations. To illustrate this and to provide the empirical argumentation we shall point out to the findings of the monitoring and evaluation measurement performed by the GAP project. Three main tools were devised for the Project’s monitoring and evaluation system (M&E), as follows: a Municipal Capacity Index (MCI), which measures the capacity of municipalities according to their overall performance over time, Municipal Services Efficiency Index, which measures the level of efficiency in providing municipal services based upon the volume of services and average delivery time for these services over time, and annual attitudinal surveys. As we shall see, the M&E results are varying among the cohorts of the municipalities joining the project, depending on the duration of the reform.
As pointed out in the project’s Completion Report, published recently by the USAID (GAP2 2013), the municipalities significantly increased their efficiency in providing municipal services as measured by the Municipal Services Efficiency Index. In particular, 23 municipalities increased their efficiency by 300 percent, 18 municipalities (second group of municipalities which were the project’s partners for a shorter period of time) by 50 percent, 31 municipalities (two groups of partner-municipalities which joined the project the latest) increased their efficiency in providing the municipal services by 30 percent. Waiting times for the municipal services, such as issuing vital records, were reduced to four to five minutes on average compared to the baseline. At the same time, complaints about the municipal issues fell by 26 percent, while the percentage of complaints resolved increased from 26.2 to 57.9 percent, reflecting significantly improved accountability by local governance among the municipalities.

Municipal Capacity Index was measured in the group of “control municipalities” in which there were no recorded reform initiatives of similar scale. In the beginning, the MCI points were at approximately similar average level as in the municipalities in which reforms were undertaken. While over time the points steadily rose in the reform municipalities, the results in the control municipalities were flat, and in case of several municipalities even falling over time. Specifically, in the area of urban permitting improvement, the baseline values were established for the selected partner municipalities and the group of „control municipalities” in which there were no recorded reform initiatives of similar scale. The average baseline rating was 34.7 percent of the maximum number of points for the selected municipalities and 35 percent for the control municipalities. After one year of assistance, selected municipalities’ capacity had increased to 80 percent, while the control municipalities recorded no improvements (GAP 2013 : 21).

**Business parks, Business incubators, Loan guarantee funds**

The municipalities which improved their administration and services to the citizens are at the same time leaders in opening and supporting of the business parks, incubators or loan guarantee funds. In particular, out of eleven existing business incubators (Brčko, Jablanica, Mostar, Modrića/Gradačac, Prijedor, Sarajevo, Trebinje, Tuzla, Zavidovići, Zenica and Žepče, source: ED, 2013) and two which are in development (Bugojno and Ključ), ten are located in the municipalities which were the partners of GAP. Out of the four free business zones in BIH, three are located in the “GAP municipalities” (Mostar, Vogošća and Visoko). Out of 29 business parks and two entrepreneurial parks which, according to the records of the Federal Ministry of Entrepreneurship and Trade, operate in Bosnia (Tešanj, Usora, Doboj-Jug, Tomislavgrad, Ćitluk, Gračanica, Zenica, Livno, Ravno, Ćelić, Vogošća, Bihać, Gradačac, Bosanski Petrovac, Orašje, Domaljevac, Lukavac, Jablanica, Ljubuški,
Kakanj, Vitez, Sanski Most, Kupres, Žepče, Goražde, Odžak, Usora, Tešanj, Gračanica, and the entrepreneurial centres Mostar and Gradačac, source: Bejić, 2012), 21 of them are located in the municipalities which significantly improved their management and the services to the citizens. Finally, the practice of establishing of the loan-credit is also dominated by the “reformed municipalities”. In two regions we examined – Herzegovina and Northeast Bosnia, loan guarantee funds exist only in the municipalities which were subject to the reform of administration (Mostar, Livno, Prozor-Rama, Vlasenica, Tuzla and Kalesija). Thus, we are able to establish a firm connection between the modernization efforts and number and location of the business parks, business incubators and loan/guarantee funds, as indicators of development.

Non-tax revenues

The municipalities which undertook the reforms maintained steady increase of own source revenues. Analysis of the annual budget execution reports (from 2007 to 2011) of the municipalities which undertook the reforms of services and budget and finance management revealed that the non-tax revenues were steadily rising during the period of examination and by 2011 were nominally higher than the baseline by 24 percent (or eight percent, adjusted for inflation in the four years). This achievement is even more significant in the situation where total budget revenues and tax revenues were falling (and were in the end below the baseline) during the period in question, due to global financial crisis. Additionally, the percentage of non-tax revenues or municipal own source revenue generation as a share of total municipal revenues has risen continuously since the beginning of the reforms discussed here (since the beginning of 2005) and, even during the global financial crisis of 2008 onward, were 30 percent of total municipal revenues.

Capital outlays to operating expenses

With completion of the initial reform endeavours, the ratio of capital outlays versus operating expenses had moved in a desirable direction, rising steadily and at a noteworthy pace from 0.54 in 2005 to 1.06 in 2008. However, the effects of the global financial crisis had a significant impact on municipal budget revenues in BIH in 2009 and 2010. Consequently, the huge impact was recorded in relation to the expenditures, so the capital investments were the first to cut. Thus, after a very promising start, capital investments in all 72 GAP partner municipalities in 2010 were nominally on the same level as in 2009 and the baseline in 2007. In particular, during 2009, the ratio fell to 0.78 and fell further in 2010 (0.73) or below the baseline levels of 2007 as result of the financial crisis. As can be seen, the impact of the global financial crisis on municipal budgets was huge, although the majority of municipalities took
some recovery measures themselves which were combined with the positive effects of the reform endeavours discussed here. (GAP 2011 : 64)

**Participatory planning and infrastructure development**

The new municipal mechanisms for the participatory planning and multi-year capital planning had a significant impact on infrastructure development of the local communities in focus. The reforming municipalities, with support of GAP, implemented 179 community infrastructure development projects, worth 22.8 million dollars of which the municipalities contributed 13.4 million or fifty-eight per cent of the total investment. Public participation process and the resulting transparency ensured that all of these projects reflected the compelling local priorities, with the projects dealing with road infrastructure and water supply amounting more than fifty per cent of all the projects implemented. Benefit the infrastructure projects brought to the communities as well as willingness of local governments to share the costs further confirms the reforming municipalities as conducive to the local economic development. Furthermore, out of forty municipalities which currently undertake the most advanced model for participatory planning of LED (MiPRO, discussed earlier) the majority (25, or 62.6 per cent) are the municipalities which also significantly improved their municipal governance and participatory planning.

**Citizen and business satisfaction**

Similar to the effects the reforms had in respect of the municipal efficiency, the reforms had a significant impact on citizen’s perceptions of the municipal government with a significant year-to-year increase recorded, as can be seen from the following M&E results. The final attitudinal survey that gauged the level of citizens’ satisfaction with municipal service delivery showed an increase of between 14 and 18 index points (depending on the duration the municipalities participated in the reforms) comparing to the baseline. From 80 to 90 per cent of citizens responded with “satisfied” or “very satisfied”. At the same time, in the control municipalities decrease of 10 index points was recorded.

Based upon interviews with thousands of citizens and the municipally registered businesses, before and after the implementation of the citizen service centres and other reform interventions, GAP2’s M&E found an aggregate increase in citizen satisfaction of 14.5 points and business satisfaction of 11.8 points. These measurements are recorded in “basis points”. The actual percentage increase in each case is significantly greater. Specifically, citizen satisfaction jumped from 69.3 basis points to 83.8 or an increase of twenty-one per cent. Likewise, the change in business satisfaction was from 40.5 basis points to 52.3 basis points or an increase of twenty-nine per cent.
In each case, the changes recorded in the control municipalities were substantially less, with an improvement of approximately seven per cent (GAP 2007 : 78).

**Political stability**

Studying the electoral success of the Mayors (or their political parties) in the two last consecutive municipal elections reveals that in 72 municipalities, there were 49 (68 per cent of those who ran for the office) of Mayors, or their parties, winning the elections following the significant improvements in functioning of the municipal government and large infrastructural development discussed above. This leads us to the conclusion that, among other factors, the improvements in the municipal governance has a significant influence on the voters’ opinion. However, if we analyze Mayors’ electoral success in the second group of municipalities – those in which significant interventions in improvement of the work of the municipal administration did not take place – we see that 72% of the Mayors who ran also won the elections, which is a few per cent higher percentage than in the first group of municipalities. From this result we could conclude that the improvement of the municipal services, internal management and capital investment does not have impact on sentiment and opinion of citizens in the local communities. However, we saw that it is not true because the previously discussed results of the citizen satisfaction survey showed a significant increase in the “reforming municipalities”, while at the same time in the “control” municipalities a decrease of citizen satisfaction was recorded. This clearly shows that the improvements in municipal administration do have an impact on the citizen satisfaction.

Which brings us to the second possible conclusion – that the citizen satisfaction with the municipal government does not have a fundamental impact on the political attitudes of the voters. This can be confirmed. In the selected number of the municipalities, in which there were no significant improvements in municipal services, the citizen satisfaction has fallen 10 index points in relation to the baseline results but despite of decrease in citizen satisfaction, there was a larger percent of the Mayors remaining in power than was the case in the reform-oriented municipalities (in which the citizen satisfaction increased). This can only lead us to a conclusion that other criteria – i.e. party politics at the higher tiers of government – are dominant in forming the voters’ opinion.

**Conclusion**

If the findings of our study of correlation between the governance reform and LED and infrastructure development are synthesized, it could be said that correlation is a multifaceted one and that its intensity diminishes gradually with distance between
the reform efforts and the variables of local development. In particular, the impact of the reforms is strongest in relation to the existence of the institutional arrangements of support to economic activity at the local level (business parks, incubators, loan-guarantee funds) and the features of the municipality’s business-friendliness such as efficiency of the municipal services delivery and citizens’ satisfaction – in other words, the variables which are most closely related to the results of the innovation.

In case of non-tax revenues, correlation is also distinguishable but of a lesser intensity; it is also more prone to the influence of the outside factors (such as economic crisis) which hampers the end-results, but still does not annul or reverse the effects. In the case of ratio of capital versus operational expenditures, a direct impact of the reforms can be detected but the correlation is interrupted easily and the results of reforms significantly undermined by the external factors, such as economic crisis.

In the case of the macro-indicators, we cannot establish a firm correlation with the reforms of the municipal administration. While the micro indicators stand undoubtedly in a correlation with municipality’s entrepreneurial spirit and its reform mindedness towards the LED, the macro indicators do not depend solely on the municipality’s own initiative. There is a myriad of other factors – such as geographical position, infrastructure, politics, tradition and historical heritage of a municipality, its people and the wider region – which affect the macro indicators of municipality’s economic and societal state of affairs.

Finally, correlation is of least significance in the case of political stability, from which we can conclude that local communities in Bosnia and Herzegovina still have a way to go in terms of establishing a sense of responsibility and accountability between the political actors and a median voter.

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