

BRCKO:
A comprehensive solution

Table of Contents

EXECUTIVE SUMMARY	I
I. INTRODUCTION	1
II. THE FINAL STATUS OF BRCKO	2
II. PARTY CONTROL OF FINANCIAL STRUCTURES	3
A. PAYMENTS BUREAUX: ZPP, ZAP, SPP	3
B. BANKING.....	5
C. TAX ADMINISTRATION	6
D. STATE SECTOR COMPANIES.....	7
IV. PARTY CONTROL OF THE ECONOMY	9
A. BUSINESS REGISTRATION	9
B. BUSINESS RE-REGISTRATION.....	10
C. BUSINESS REGULATIONS	11
D. TAX RATES	12
E. INTER-ENTITY TRADE	13
V. CIVIL ADMINISTRATION	14
A. LOCAL AUTHORITIES.....	14
B. POLICE	15
C. JUDICIARY.....	16
D. EDUCATION.....	16
E. UTILITIES	16
F. HOUSING	16
G. MEDIA	17
VI. ELECTION SYSTEM	18
VII. CONCLUSION	19

ANNEXES:

ABOUT THE INTERNATIONAL CRISIS GROUP

SELECTED BALKANS PROJECT REPORTS



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EXECUTIVE SUMMARY

The Arbitral Tribunal on Brcko meets this month, and may or may not this time make its final decision, after postponements in 1997 and 1998. An award to either the Federation or Republika Srpska would provoke an extreme reaction: ICG advocates that a final decision should be made now, and that Brcko municipality should be reunited and made an autonomous district under the constitutional jurisdiction of the central government of Bosnia and Herzegovina.

Whatever the Tribunal decides, Brcko will remain under international administration for some time to come: this paper examines reforms which could be carried out in a future District of Brcko, in a way that would make a real difference and provide a testing-ground for possible models for Bosnia as a whole.

Different parts of Brcko are controlled by each of Bosnia's three main ethnic groups. Integrating their three sets of parallel institutions has failed so far because the primary levers of power and money are still in the hands of political forces whose influence is divisive rather than conciliatory. These levers include the financial infrastructure (control of money flows via Payments Bureaux), the economic infrastructure and public administration (police, local government, judiciary, media etc).

Assuming the Tribunal does settle the final status of Brcko, as a District of Bosnia and Herzegovina, ICG recommends that the Brcko Supervisor implements a series of simultaneous radical reforms over a 60-day period in the fields of finance, business and civil administration, including:

- Abolition of Payments Bureaux (ZPP, ZAP, SPP) and transfer of all payment functions to private banks;
- The establishment of strict banking criteria by an inter-entity task force from the USAID-supervised Banking agencies of both entities;
- The creation of a new local tax collection agency using former PB controllers;
- New three-man boards to run state- and socially-owned companies;
- Streamlining the business registration process to two days and automatic harmonisation of all business registrations at no cost to businesses;
- Reduction of the regulatory burden on business;
- Replacement of all current business taxes with an 8% VAT tax;

- Appointment of interim international supervisors with executive budget authority over all municipal departments;
- Unification of all three police forces under an international Commissioner;
- Unification of the judiciary;
- Creation of new education, housing and other administrations;
- Unification of all three power companies.

By reforming these control structures, the Supervisor will create effective and lasting changes in the Brcko municipality. These changes will encourage economic growth, foreign investment, employment, and increased inter-ethnic and inter-entity co-operation and trade. They will establish the rule of law and present a pattern for successful inter-ethnic co-operation throughout Bosnia and Herzegovina. They will create lasting institutions, which will enable the Bosnians to successfully govern themselves in an economically viable municipality when the international community finally leaves. All of this will encourage people of all ethnic groups who left Brcko during the war to return to their homes. But without these reforms, Brcko will be simply one more international failure.

Sarajevo, 08 February 1999

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I. INTRODUCTION

The town of Brcko occupies a unique strategic point in Bosnia: it lies in a narrow passage which provides the only direct communication between the eastern and western parts of the Republika Srpska (RS); and that same narrow passage stands between the Federation and eastern Croatia. It is such a key location that the Dayton Peace Accords gave it neither to Republika Srpska nor the Federation. Rather, an Arbitral Tribunal would decide its final status at a later date (originally December 1996). The US lawyer Roberts Owen was appointed Presiding Arbitrator. The Tribunal met in February 1997 but failed to reach a final decision; so too in February/March 1998. Now the Tribunal is meeting again, and it is still not clear whether a final decision will be made. For now Brcko is governed by an international supervisor, Ambassador Robert Farrand, with extensive powers.

In both 1997 and 1998 ICG urged an immediate final decision, and a status for Brcko which gave it neither to the Federation nor to Republika Srpska¹. ICG still believes, for the third year running, that a final decision is necessary.

The cost of leaving Brcko as it is for yet another year would be a lost chance to make rapid changes for the better in at least one part of Bosnia, at a time when progress across most of the peace process is incremental at best. The International Community (IC) has so far failed to create the lasting structures necessary to implement the Dayton agreement and create a sustainable multiethnic society anywhere in Bosnia. After three years of hard work and the expenditure of billions of dollars in international aid, the IC has not changed a single major aspect of Bosnia's pre-war, Communist economic system - a system designed to ensure complete control by the ruling party over all economic, social, and political activity. Brcko offers an ideal laboratory for such change.

If the IC is to succeed in its mission in Brcko, and in Bosnia as a whole, it will have to free the economy and the flow of money from party control. Only then can it begin working with Bosnians in building the structures of a civil society and healthy economy which will survive its departure.

Brcko can be a beacon for the rest of Bosnia: this paper suggests how. Focusing first on the final territorial and legal status of Brcko, it then examines the financial sector (Payments Bureaux, banks, tax collection) and specific economic reforms (tax policy, business regulations, public sector firms), which will enable Brcko to attract foreign and domestic investment, while creating sustainable economic and job growth. Finally, it proposes integrating various municipal functions (police, courts, education, pensions, health care) into an effective, multi-ethnic unified administration, which will eliminate parallel institutions.

¹ See ICG reports *Brcko Arbitration: Proposal for Peace* of 22 January 1997 and *Brcko: What Bosnia could be* of 10 February 1998.

II. THE FINAL STATUS OF BRCKO

The goal of Dayton was to create a state in which all citizens could live, secure in the knowledge that their rights and liberties as individuals are respected, regardless of ethnic or religious background. In Brcko that goal has been realised no better than anywhere else in Bosnia. As a result, even ethnic majority residents of both entities continue to live in constant insecurity, uncertain whether the police, judiciary, and civil service of their own ethnic group will protect their most basic human rights. For ethnic minorities, the sad certainty is that they will not be protected at all.

In many ways, Brcko is a microcosm of the IC's task in Bosnia. It is controlled by three ethnic groups who dominate in different areas: Croats control Ravne/Brcko; the Bosniacs Brka; and the Serbs Brcko town and immediate surrounding areas. As in the rest of the country, the IC has achieved only minor success in creating a multi-ethnic administration and police force, and minority refugee returns have been few (though more than most municipalities). As in the rest of BiH, the IC successes in Brcko have been minor and ephemeral: if the IC left tomorrow ethnic strife would soon break out.

Minority returns within the boundaries of the pre-war Brcko municipality have mostly been limited to the Zone of Separation (ZOS), or areas where the returnees are not in the minority (Bosniacs to Brka, Croats to Ravne/Brcko). Almost no Bosniacs or Croats have returned to the town of Brcko itself. The town police force and administration have been nominally integrated, but in fact they remain under the control of the local ruling Serb political party (SDS). Because of this single ethnic party control, the administration and police are unresponsive to Supervisor Farrand's directives and continue to go their own way. As a result, they foster an environment that discourages minority return and cements the results of ethnic cleansing.

In order to create a workable, multi-ethnic Brcko, the arbitration decision must take into account the likely outcome of an award to either entity. The press in both entities frequently carries veiled threats of war if the arbitration process awards Brcko to the other side, and both Milorad Dodik and Alija Izetbegovic have threatened to resign in such a case. If awarded to either RS or the Federation, Brcko will serve as a rallying point. And the moment an arbitration award is made, the entity that receives Brcko will begin a program of ethnic consolidation and exclusion at the expense of the other nationalities. Given the overall strategic, political, and economic importance of Brcko, the question is not *whether* war will ensue, but rather *when*. Therefore, when making an arbitration decision, the International Arbitrator must take a creative course and award Brcko to neither RS nor the Federation.

Recommendations:

- The entire pre-war municipality of Brcko should be made a special, autonomous district, its territory being part of neither RS nor the Federation, but under the constitutional jurisdiction of BiH central institutions;
- The district will be autonomous in all internal matters, including taxes, laws, regulations, civil service, police, customs duties, and judiciary;
- Until the BiH central institutions are ready to take it over, the district will remain under a Supervisor from the International Community, who will enjoy executive and budgetary authority over the district.

III. PARTY CONTROL OF FINANCIAL STRUCTURES

Communism left behind a financial system designed to centralise control over money-flows. All public and private financial activities, including payment transactions, savings, tax collection, tax distribution, treasury functions, and private and public expenditures are controlled through a single institution known as a Payments Bureau (PB). In order to remove this control from party hands, the financial structure of Brcko must be transformed so that all three parallel PBs are eliminated, and a viable commercial banking system emerges to take its place. In addition, a unified Brcko municipal government must revitalise the currently under-utilised tax collection system. This section examines these problems in detail and suggests possible reforms.

A. Payments Bureaux: ZPP, ZAP, SPP

Founded in the mid-1950s as the SDK (*sluzba drustvenog knjigovodstva*), the PB acted under the direction of the League of Communists of Yugoslavia as a monopoly bank, conducting all payments transactions, collecting taxes, and controlling the cash flows of all companies, both private and public.

All told, the SDK carried out the following functions:

- 1) Treasury to government;
- 2) Treasury to public and private businesses;
- 3) Tax collection;
- 4) Payment transfers (banking);
- 5) Central Bank;
- 6) Collection of statistics;
- 7) Accounting service to all private and public enterprises.

During the war the SDK in Bosnia split into three separate organisations. The Sarajevo-based Bosniac organisation (ZPP), the West-Mostar-based Croat organisation (ZAP), and the Banja-Luka-based Serb organisation (SPP) all maintain similar operating procedures and perform similar functions.

The PBs' day to day activities remain essentially unchanged from the pre-war era. They collect all taxes and tax returns, conduct all public and private payments transactions, hold all private and public cash reserves, manage all governmental financial transactions, and collect all customs' duties. In essence, the PBs monopolise and control all financial assets in the country, including bank assets, which are also deposited at the PBs.

On a national level, businesses report high levels of corruption and fraud in the system. In addition, the PBs charge high fees, restrict a company's access to its funds on deposit, and work too slowly. Available evidence suggests that the PB system drives a substantial proportion of business activity underground so as to avoid government control over their cash flows and high government taxes. Private businessmen and military intelligence analysts now place the level of illegal (black) economic activity within the territory of the pre-war Brcko municipality at nearly 90% of total economic activity.

Today, elected political parties have replaced Communist party control, and so enjoy complete power over the PBs. The bureaux can be manipulated to do their bidding, launder their money, and fund their activities from profits and

money taken from state-owned companies. They are above the law of the land and regularly disregard court orders at party instruction. They answer to the ruling party and are not publicly accountable. In addition, freelance fraud, corruption, and cronyism exist within the bureaux themselves.

Control over the PBs means control over the budgets and expenditures of the police, pension fund, health care, education, state-run enterprises, and private businesses. As long as the ruling parties control the economic system and the finances of the municipal administration through the PBs, it will be impossible to effect systemic changes.

Recommendations:

The PBs must be dismantled rapidly! Any and all subsequent reforms depend on their elimination! The international supervisor should eliminate the PBs over a 60-day period according to the following time schedule:

D – 30

- Parallel PBs notified of impending closure;
- Controllers told of new jobs with tax agency (see page 6);
- International liquidator appointed to supervise shut-down of the three parallel PBs.

D DAY

- PBs lose monopoly on payments processing;
- Businesses have 30 days to shift their accounts from a PB to a private bank.

D + 30

- PBs close doors;
- PB property privatised.

Benefits:

- Some black market business will become legitimate, increasing the tax base;
- Incentive for businesses to locate in Brcko;
- Destroys the ability of parallel institutions to raise and collect taxes, and to fund themselves;
- Strengthens the commercial banking sector;
- Breaks stranglehold of political parties on governmental organisations;
- Breaks stranglehold of political parties on the economy;
- PB property can be privatised and sold to banks.

B. Banking

In the current system, banks are not allowed to conduct payment transactions. Neither are they permitted to mediate consumer cash deposits. Rather, this role is reserved to the PBs. At the end of the day, all banks are required to deposit their day's receipts at the PBs. This robs banks of their primary source of cash deposits, reducing the amount of working capital available to the economy. It also dramatically lowers banking income, causing many banks to hover on the brink of illiquidity.

Under the proposed reform scenario, banks will take over the role of payment transfers from the PBs. Unfortunately, the recent history of banks in BiH and SFRY demonstrates how the government(s) plundered the private hard currency savings of private depositors. In addition, many banks in BiH are technically insolvent, while many are unable technically to handle payment transactions.

In order to prevent the establishment of insolvent or shaky banks in the municipality, and to prevent the wholesale plundering that has occurred to date, a review panel must be created from the USAID-supervised Bank Supervision Agencies (*Agencija za Bankarstvo*) of both entities. This panel will create a set of regulations and criteria which must be met by all banks which wish to operate in the Brcko municipality. The hope is that the relaxed banking environment will attract fiscally sound banks from both entities, such as *Kristal Banka* and *Banja Lucka Banka* from the RS, and *Market Banka*, *Central Profit Banka*, *Gospodarska Banka*, and *Ziraat Banka* from the Federation. No doubt each of these banks will at first attract business only from members of the ethnic group associated with the bank, but at least conditions will have been established for a genuine competitive market to develop.

Banks from throughout BiH will attempt to move into Brcko due to the absence of the PBs. So too will foreign banks. The lack of PBs will open up profitable financial service sectors, which the banks will want to take advantage of. So too, the ability of private businesses to use commercial banks to carry out their financial transactions will create an incentive.

Because 80 to 90% of all economic activity in Brcko takes place in the "black" economy, any disruption to commerce during the transition from a PB system to a banking system will be minimal.

Recommendations:

The international supervisor should take the following steps to create a viable commercial banking sector in Brcko according to the following 60 day schedule. These reforms must be carried out simultaneously with the PB reforms.

D - 30

- Banks notified of changes and new criteria;
- Banks allowed to register in Brcko;
- Banking criteria supplied by review panel of USAID-supervised RS and Federation Banking Agencies;

D DAY

- Banks continue to move in to Brcko municipality.

D + 25

- Revenue collection accounts of all parallel institutions unified into commercial bank accounts controlled by international arbitrator;
- Government accounts move from PBs to commercial banks;
- All revenue (tax and customs) collecting accounts move to commercial banks.

D + 30

- Banks now handle all financial transactions;
- Banks handle all tax accounts.

Benefits:

- Strengthen BiH commercial banking sector;
- Incentive for foreign banks to locate in Brcko;
- Incentive for businesses to locate in Brcko;
- Increases amount of working capital available to business;
- Recycled PB employees find work in the Banking sector.

C. Tax Administration

One of the functions of the PBs is the collection and distribution of all government revenues and expenditures through the PB account system. When the PBs close, the government of the Brcko municipality must find an alternative method to collect and distribute revenues. Otherwise it will soon go bankrupt.

The present tax system relies on each enterprise calculating, reporting, and paying its own taxes through the PB, so businesses are accustomed to administering their own taxes. The abolition of the PBs will create a gap in regard only to the deposit of revenues.

Under a unified system, the Brcko municipality will keep its assets on deposit in commercial banks. Tax-payers will make their payments directly to the government agency or through a commercial bank. The government agency will hold its accounts at commercial banks, and not the PBs. Funds will then be distributed for government treasury purposes through normal commercial banking channels, as in the West.

Under the current BiH administrative framework, a tax administration exists. This agency has grossly under-utilised manpower, as it relies heavily on the PBs to do much of its work. Under a unified system, the current tax collectors will be driven from the coffee houses, and put to work doing their jobs. In

addition, the account controllers from the PBs will be hired to supervise tax collection. Each controller has an intimate knowledge of the companies in his portfolio, including cash flows, revenues, previous tax returns and payments, etc. Hiring them to work in the tax administration will enable their knowledge and skills to serve the unified administration for tax collection.

Recommendations:

The three parallel tax administrations should be disbanded in concert with the PBs, and a new multi-ethnic Tax Administration should be formed by hiring the best of the old employees, along with former PB account controllers. The Tax Administration will open revenue collecting accounts at commercial banks. An international supervisor should initially exercise budgetary control over this organisation and supervise its three member multi-ethnic board. The 60 day time line would be:

D minus 30

- Parallel tax administrations notified of impending changes.

D DAY (implementation)

- Creation of new Tax Administration;
- Training begins for new tax collectors;
- All parallel Tax Administrations disbanded;
- New Tax Administration begins to function;
- All parallel revenue collecting accounts shut down at PBs, funds transferred to unified accounts at commercial banks.

D + 30

- Aggressive tax collection begins;
- Banks handle all revenue collection accounts.

Benefits:

- Brcko civil administration controls its own finances and revenue flows;
- Political parties no longer control government finances;
- Greater control over black market activity.

D. State Sector Companies

Under the present system the political parties appoint the directors of all state-owned firms. This makes it easy for the parties to use the assets of these firms in their own interest. For example, several directors of state-run firms in one part of Bosnia have reported that in late 1998 they were instructed to empty the

companies' holiday funds into party accounts to help fund that party's election expenses.

In addition, state-run companies control (own) much of the housing and commercial property stock. They decide who gets housing, and who has access to prime commercial space and under what conditions. In an all-too common scenario, politically appointed directors of state-run companies deny employment to minority returnees. They can also deny returnees access to housing, unemployment and health care benefits, and commercial space.

With privatisation approaching, directors of state-run firms are also in a position of power. Should the Brcko Supervisor adopt a privatisation plan which includes vouchers, they will decide which workers receive such vouchers. Once again, an opportunity for discrimination presents itself.

Recommendations:

Anticipating problems from the state-owned sector, the Supervisor should:

- Remove the current directors of public sector firms;
- Seek nominations from all local ruling political parties for each of three directors of each state-run company in the territory of the pre-war Brcko municipality using the following system: parties A and B agree on a nominee from ethnic group C. If A and B fail to agree in any or all cases, the Supervisor should himself appoint any missing nominees;
- Create a three-man board for each company consisting of these three nominees;
- Give this three man board complete financial control over each company;
- Give the board authority to hire, fire, and assign housing and other benefits;
- Give the board complete authority over each company's assets;
- Make the three-man board answerable to the Supervisor, and not the political parties.

Benefits:

- Minimises the chances of inter-ethnic stonewalling;
- Encourages minority return and employment;
- Encourages fair disposition of state-owned resources.

IV. PARTY CONTROL OF THE ECONOMY

Structural reforms of the current system need to be made if the economy is to flourish. Yet with such reforms it should be possible to create an economic zone conducive to business activity, a sort of Bosnian Hong Kong. Precedent exists within the former Yugoslavia for such a model. During the Markovic-era economic reforms (1989-1990), several Yugoslav municipalities took advantage of the new laws and reduced the regulations and taxes imposed on business. The few municipalities that did so attracted business investment from throughout the former Yugoslavia and the diaspora abroad: they enjoyed increased employment, higher tax revenues (at lower tax rates), and less business activity in the "black" economy. One of these municipalities was Laktasi (north of Banja Luka) under the guidance of its reform-minded mayor Milorad Dodik.

In order to create an economically attractive zone in Brcko, reforms are needed in business registration, business regulations, inter-entity trade, and the tax rates.

A. Business Registration

The current business registration process can take from six to twelve months, depending on the level of corruption and obstruction in the system. In the Federation, for example, registration requires approval from the Cantonal Court, Ministry of Defence, Ministry of Foreign Trade, Ministry of Finance, Statistical Association, PB and municipal government. A similar process is in place in RS.

This process is expensive, time-consuming and intimidating, even to a local resident who is a member of the majority ethnic group. For a minority returnee, it can be manipulated and prolonged, effectively denying him the opportunity to open his own business and earn a living. For potential returnees abroad, the expense of travelling repeatedly to Bosnia over a period of several months simply to register a business can be overwhelming. When entrepreneurial potential returnees see the level of bureaucratic obstruction in the local administration, this alone gives them good reason to stay away.

Registering a business also requires a detailed description of code numbers for the various business activities. It is common for a typical business to attach eight or nine pages of detailed business activities to its registration document. This requires the added cost of engaging a lawyer. In addition, there are no standardised forms or guidelines available to assist a potential businessman in registering his company. He must always engage a lawyer, at added expense.

Following the registration procedure, current laws require each business to maintain detailed documentation - as part of its registration documentation - regarding company administration, etc. The required paperwork strangles small companies and forces them to engage a lawyer.

Recommendations:

The Brcko Supervisor should change the current system of business registration. The new system should have the following characteristics:

- Timely (two days);
- Transparent;

- Inexpensive (less than 400 DM in administrative costs);
- Place the burden for refusing a license on the bureaucrat;
- Standardised paperwork (forms) to be filled in when applying for a business license;
- Abolish the requirement to declare all areas of business activity to the smallest detail;
- Abolish the requirement for detailed company statutes.

Benefits:

- Incentive for business investment from other areas of the former Yugoslavia and BiH;
- Returnees can engage in start-up activities quicker.

B. Business Re-Registration

Experience with other reintegrating municipalities (Zepce, Travnik, Novi Travnik) demonstrates that the majority ethnic group will discriminate against the minority group by imposing administrative procedures for business re-registration, with high financial and bureaucratic costs attached. The local administration will require that an existing company “harmonise” its documents with existing laws. This amounts to a requirement that each minority-area company re-register. While waiting for the new registration documents, companies are not permitted to operate. As a result, many companies are forced out of business due to intentional bureaucratic delays in approving paperwork.

If the Brcko Supervisor exercises competence over a unified Brcko which includes areas currently under Bosniac and Croat control, business registrations will have to be harmonised and centralised at a central municipal court.

Recommendations:

In order to prevent the Brcko economy shutting down due to administrative delays with company re-registrations, the re-registration process should have the following characteristics:

- Transparent;
- Fast (two days);
- Automatic re-registration for all companies with valid registration documents in Ravne/Brcko, Brcko, and Brka;
- 30 day time framework for re-registration;
- Business should bear no financial burden for re-registering;
- All other criteria similar to the above-recommended registration procedures.

Benefits:

- Uninterrupted functioning of the Brcko economy;
- Confidence-building measure among local ethnic groups.

C. Business Regulations

Current business regulations are cumbersome and designed to provide maximum state control over firms. The typical company is visited by an endless parade of various inspectors, demanding bribes and kick-backs². Many of these inspectors are vested with sweeping powers, including the right to shut down a company on the spot or seize goods. Companies are left with little legal recourse since due process, including a right of judicial appeal, does not function.

Many laws are restrictive of and destructive to businesses. For example, current laws require that there be a minimum number of employees in each type of firm. In the Federation, a minimum of two employees must be registered for each company, whether or not the company is even functioning. This requires the payment of all employment taxes for these employees. In the construction sector the number of minimum employees is much higher, typically around twelve. This means a construction company is forced to pay wages and payroll taxes during the slow winter months. These employment laws discriminate against small firms and favour state-owned enterprises.

No small claims court exists, forcing business to wait for years as any legal suit winds its way through the regular court system. Upon the suit reaching court, the opposing party often bribes the judge. Many other regulations are confusing, contradictory, and open to interpretation by inspectors.

Recommendation:

The regulatory burden on business needs to be reduced by the following reforms:

- Create a multi-ethnic panel of local businessmen to review all existing economic regulations and propose changes;
- Curb the power of inspectors by removing their power to seize goods on the spot and shut down firms without due process;
- Create a cheap court system to handle small claims;
- Abolish laws on minimum number of employees.

Benefits:

- Business-friendly environment will increase economic activity and employment;
- Increased employment will accelerate refugee returns;

² e.g. sanitation, market, safety, environmental, customs, financial...

- Businesses can free up valuable assets to invest in productive activities;
- Corruption will decline dramatically.

D. Tax Rates

Current business tax rates are among the highest in Europe. In the Federation these include:

- 10% tax on services;
- 10% tax on margin;
- 5% tax on cash deposits (retail sales);
- 87% tax on employees net salary;
- 36% tax on profits;
- Annual business registration taxes;
- Miscellaneous municipal taxes and levies, often retroactive.

Because most BiH companies operate with a thin 20-25% margin (compared to 50-100% margins in the West), these taxes quickly wipe out any profit. A company operating within the law and declaring all of its income will typically have a 3% year end profit margin. Given such low potential earnings, it makes more sense to deposit one's funds in a German bank and get a 4% to 5% annual return.

These high tax rates drive most businesses to operate at least partially in the underground economy. In the Brcko region it is estimated that as much as 80% to 90% of all economic activity is underground. Many workers remain unregistered, due to the high employment taxes. This deprives the municipal government of needed tax revenues. Given the current tax policies, Brcko will not recover economically unless the entire system is fundamentally altered.

Recommendations:

A wise tax policy is crucial to the economic growth of Brcko, as well as vital to the revenues of the municipality. A revamped tax system should:

- Abolish all current business taxes;
- Institute a VAT tax of 8% on all business transactions (as the economy strengthens this may be raised slightly higher);
- Lower the level of payroll contributions to 47% of net salaries;
- Offer a two year tax holiday to all new investment in Brcko.

Benefits:

- Attract new business investment to Brcko;

- Create job growth;
- Increase the number of legally registered workers;
- Increase the level of legal economic activity;
- Increase overall government revenues;
- Create long-term economic prosperity;
- Create suitable conditions for refugee return.

E. Inter-Entity Trade

Because of its unique position astride the two entities, Brcko will become a hub for inter-entity trade. In spite of international community efforts to the contrary, both the RS and the Federation have erected numerous regulatory barriers to inter-entity trade. As a result, almost all cross-boundary trade occurs illegally.

Recommendations:

- A multi-ethnic panel should be appointed to prepare a report within 30 days on all barriers to inter-entity trade;
- Upon receiving this report, the Brcko Supervisor, in concert with the High Representative, should impose a new law removing inter-entity trade barriers.

Benefits:

- Increased inter-entity trade;
- Increased inter-entity economic co-operation;
- Increased inter-entity interaction on all levels.

V. CIVIL ADMINISTRATION

On the face of it, the International Community has extensive powers and leverage over the ruling parties and their respective administrations at all levels. Through political pressure and threats of cutting off humanitarian aid, the IC has been able to coerce the parties into passing adequate property legislation in both the Federation and Republika Srpska.

Unfortunately, as in the case of property laws, the legislation is rarely implemented effectively by local bureaucracies, judiciaries, and police forces. This is because the parties continue to exercise control over local administrations, and will not allow them to implement laws deemed harmful to the party's interest. Under the current system, police, judges, and all municipal employees serve at the pleasure of the local party. A judge who rules against party policy, such as a ban on evictions, or the policeman who enforces the judge's decision is at risk of losing his job. The local bureaucrat who follows legal procedures and gives documentation or title to a home to a minority returnee will face the displeasure of the party which controls the funds that pay his salary.

It is impossible to create an effective, professional civil service, police force or judiciary, which carries out its duties irrespective of citizens' ethnic or political stripe, while the ruling parties control the appointments and salaries. The International Community can monitor, advise and demand all it wants, but as long as it is the party that controls the salaries of the policeman, the judge, and the bureaucrat, they will follow the direction of the party.

A. Local Authorities

Local authorities need more genuine independence everywhere in Bosnia, but particularly in Brcko, since otherwise no single administration can function: it will be torn three ways.

Recommendations:

First, the three separate Bosniac, Croat, and Serb-dominated municipal administrations must be dissolved, and their employees vetted and, where appropriate, incorporated into the new administration. The International Supervisor should appoint an international administrator, who will hold executive and budgetary powers, to head each municipal department. This administrator will control budgets, salaries, policies and personnel practices.

The Supervisor should make clear to all municipal employees that their employment and salary levels are no longer contingent upon their loyalty or obedience to Banja Luka, West Mostar or Sarajevo. Rather, they will be evaluated on the basis of their proficiency in performing their duties, following the laws and administrative guidelines set down for them by the IC. It should also be made clear that failure to obey the rules will result in immediate dismissal. The new administration should be created according to the following schedule:

D-30

- International municipal department administrators appointed;
- IC begins a functional audit of each administration, determining how they work and who does what;
- Preliminary organisation of the new municipality begins;
- Hiring and training of new staff begins.

D-Day

- Parallel administrations cut off from funds and disbanded. Staff sent home on one month's paid leave;
- New administration begins operating.

B. Police

Little that the International Community wants to achieve in Brcko, be it economic reform, minority return, or development of a civil society, can be achieved without a loyal constabulary. Unless the police obey and enforce the law without preference for ethnicity or party affiliation, conditions will not exist for refugee return or economic development.

Today, the Brcko municipality is home to three separate police forces: Croat-controlled Ravne/Brcko, Muslim-controlled Brcko centred in Brka, and the current central Brcko police force, financed by the RS Ministry of Internal Affairs. Although this Serb-controlled police force has been nominally integrated, it remains under the control of the ruling local political party (SDS). Due to single ethnic party control, the administration and police are largely unresponsive to Supervisor Farrand's directives. The result is an environment that discourages minority return and cements the results of ethnic cleansing.

In order to create conditions conducive to refugee return, a multi-ethnic, unified police force must exist, under the supervision of an internationally-appointed police commissioner, independent of single-party control. Such a police force should understand that the international commissioner determines their employment and salaries, not the political parties. It should also be made clear that any complaints by citizens or the IPTF will be taken extremely seriously: if found to be true, the offending officer will be immediately dismissed.

Recommendations:

- The Supervisor should unify all three ethnically based police forces over a 30-day period using a common, equal pay scale;
- He should appoint an international police commissioner for Brcko, with executive and budgetary control over the newly unified force. The commissioner should be an experienced police officer with extensive administrative experience, and should work independently of the mandate of the IPTF;

- Following unification, the commissioner should rationalise the force structure, in line with security requirements and ethnic balance;
- The salaries of all remaining police should be increased significantly, to ensure their loyalty to the new authority.

C. Judiciary

A similar unification of the currently divided judiciary should take place simultaneously with that of the police. The Supervisor should appoint an international legal administrator, who will act as chief justice and appellate tribunal to oversee the work of the newly hired and rehired judges. The Supervisor would have executive authority to dismiss and promote judges based on their ability and probity. The judiciary should also set up commercial and small claims courts to provide swift decisions on business disputes. The Brcko judiciary will not be subject to the RS or Federation court system. Rather it will operate within a special, extra-entity jurisdiction, and all appeals will be made directly to the Supreme Court of BiH. Appropriate penal systems should be developed to address the special nature of the new municipality. The salaries of all of the newly-formed judiciary and its employees should be double the salaries of those in the highest-paid of the three municipalities.

D. Education

As with the other municipal departments, the school systems of the three municipalities should be unified. Teachers' and administrators' salaries will be paid by the new municipality. As in other departments, the education department should be given an international administrator with executive and financial control over the system. The administrator should also oversee a curriculum review in conjunction with local educators in order to develop a common curriculum for the following year. This curriculum would need to respect the legitimate identification of children and parents with their own ethnic group, but promote diversity rather than prejudice. Brcko can provide an experiment in good practice from which useful lessons could be drawn for the whole of Bosnia and Herzegovina.

E. Utilities

The three municipalities currently have three separate power grids purchasing electricity from three different providers. With the creation of the new municipality, the three current administrators should form the tripartite management of a unified power company which will be free to solicit competitive bids from the various power providers in the region. In addition, municipal employees should be free to purchase water, sewerage, and waste removal services from the lowest bidder.

F. Housing

The various units of the three administrations dealing with housing and property issues should be unified, and put under the control of an international administrator with executive control over employment and

personnel policies and the budget. The administrator will chair, and have the authority to take chairman's decisions over, the multiethnic housing committee. All property decisions, temporary and permanent, by previous administrations since 1991 should be suspended pending review by the new committee.

G. Media

The Brcko *opstina* is currently home to at least three separate municipality-funded radio stations, each of which represents a drain on the limited resources of each community. When the reform process begins, it will be essential that developments are covered by the local media with fair, objective reporting.

Therefore, the supervisor should order the merger of the various publicly funded stations and other media into a single, municipal public service broadcaster, employing a multiethnic staff under the supervision of an international administrator with executive and budgetary powers³. The technical resources of the various stations should also be merged.

Private radio stations should be encouraged but carefully monitored. The Supervisor should close down any station broadcasting material aimed at re-creating divisions in society.

³ Or possibly a three-man board selected as in section III(D) above.

VI. ELECTION SYSTEM

Elections do not need to be held immediately. The three elected authorities now existing within Brcko municipality could be merged, as an experiment in seeing whether they can co-operate. Anyway there is no reason to expect, if elections were held now, a result much different from the balance of forces now in place. Meanwhile the entire structure of Brcko will change around the incumbents.

However, sooner or later the Supervisor will need to call an election. Brcko should not simply follow the system used in all Bosnian elections to date, a system which plays on the voter's fear and dislike of perceived extremists in other ethnic groups and leads him to vote for a strong party of his own ethnic group as a defence. The result is familiar deadlock.

Instead, once again Brcko can lead the way for the rest of the country. By the standards of post-war Bosnia Brcko will be a mixed multiethnic community, and an ideal place to try out new ideas to produce a more generally-acceptable result than separation into polarised hostile camps⁴. A reasoned, creative approach to constructive democracy in Brcko could give valuable pointers to a way forward for Bosnia as a whole.

Recommendations:

- Existing elected office-holders should be given a chance to work together, and their progress carefully observed.
- If co-operation is not satisfactory, the Supervisor should work with OSCE and OHR to draw up an election system for Brcko whose explicit purpose would be to produce a local government within which parties would collaborate, rather than simply insult each other and block initiatives.

⁴ A process often described, sadly but all too accurately, as Balkanisation.

VII. CONCLUSION

Firstly the Arbitral Tribunal needs to come to a final decision about the future of Brcko. ICG believes that decision should be to establish Brcko as a District of Bosnia and Herzegovina, under the temporary government of the existing international Supervisor.

The Supervisor must then use his authority to make rapid and radical reforms to the financial, economic, and administrative infrastructure which supports the continued existence of party-controlled parallel institutions. Such restructuring will lay the foundation for a functional free-market economy, a solid tax base, and an environment conducive to refugee returns.

In order to achieve the above stated aims, ICG recommends the Supervisor undertake a series of simultaneous reforms over a 60-day period. These include:

- Abolition of Payments Bureaux (ZPP, ZAP, SPP) and transfer of all payment functions to private banks;
- The establishment of strict banking criteria by an inter-entity task force from the USAID-supervised Banking agencies of both entities;
- The creation of a new local tax collection agency using former PB controllers;
- New three-man boards to run state- and socially-owned companies;
- Streamlining the business registration process to two days and automatic harmonisation of all business registrations at no cost to businesses;
- Reduction of the regulatory burden on business;
- Replacement of all current business taxes with an 8% VAT tax;
- Appointment of interim international supervisors with executive budget authority over all municipal departments;
- Unification of all three police forces under an international Commissioner;
- Unification of the judiciary;
- Creation of new education, housing and other administrations;
- Unification of all three power companies.

By reforming these control structures, the Supervisor will create effective and lasting changes in the Brcko municipality. These changes will encourage economic growth, foreign investment, employment, and increased inter-ethnic and inter-entity co-operation and trade. They will establish the rule of law and present a blueprint for successful inter-ethnic co-operation throughout Bosnia and Herzegovina. They will create lasting institutions, which will enable the Bosnians to successfully govern themselves in an economically viable municipality following the withdrawal of the international community. All of this will encourage people of all ethnic groups who left Brcko during the war to return to their homes. But without these reforms, Brcko will be simply one more international failure.

Sarajevo, 08 February 1999