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System of Financing of Local Self-Government in the Republic of Srpska: Challenges and Contradictions

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Abstract: The purpose of the work is to analyse the system of financing of local self-government in the Republic of Srpska. The realization of the local self-government depends, among other things, on the financial autonomy of the units of local self-government. Financial autonomy is directly interconnected with the possibility of units of local self-government to exercise their competencies. The authors analyse the legal framework of the local self-government and the budgetary system of the Republic of Srpska to understand the contradictions, deficiencies, and possible solutions for improvement of the system of financing of the local self-government.

One of the main conclusions is that the constitutional provisions on local self-government are so general and poor that they enable the legislator to prescribe any system of local self-government as well as to increase or decrease the financial autonomy of the local communities. Another conclusion is that the units of local self-government are to a considerable extent under the direct or indirect control of the central authorities in two main ways. Firstly, the National Assembly can prescribe by law that some new taxes belong to the local communities or that some existing taxes cease to be their financial resource. Secondly, considerable part of local revenues are taxes which originally belong to the Republic of Srpska and which it shares with the local communities according to legally prescribed percentages. One can conclude that legal guarantees of the financial autonomy of the local communities are quite uncertain and under almost total control of the central authorities.

Keywords: Republika Srpska, the Republic of Srpska, local self-government, budgetary system, budget, financial autonomy.

INTRODUCTION

Local self-government (LSG) is one of the cornerstones of the modern constitutional systems. It is based on the notions that local self-government limits the state power and that it guarantees the institutional framework for the conducting of local affairs by the citizens themselves or their democratically elected institutions autonomous from the central power.

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For the realization of such a notion two main principles have to be prescribed and realized: the local authorities should have competencies which have to be entirely theirs, without interference from the central authorities; and financial autonomy has to be legally guaranteed. The problem arises when one figures out that the central power has the sole authority to legally prescribe the system of local self-government including the scope of the financial autonomy. The units of local self-government have no formal role in shaping the very system. The central power can widen or narrow the autonomy of the local communities.

The legal framework of the financial autonomy of the local self-government has to be analysed. It is quite complex and full of deficiencies, contradictions, and even unconstitutional solutions. It seems that the central power has tried to control the scope of the financial autonomy in a way it found necessary regardless of constitutionality of the legal solutions as well as their appropriateness.

CONSTITUTIONAL FOUNDATIONS OF THE LOCAL SELF-GOVERNMENT

Local self-government (LSG) is entirely under the authority of the entities (federal units) in Bosnia and Herzegovina. The latter does not have even the slightest competence in this area. Such a constitutional concept was a result of two facts. Firstly, the constitutional system was predominantly drafted and enacted by the US lawyers and political elites, whose role in the Dayton peace negotiations was dominant. Since the LSG was not and is not under the competence of the US federal authorities, the Constitution-maker thought it was not necessary in Bosnia and Herzegovina either. The second, and more important reason was that the negotiators had to reach an agreement at any cost, and they could not discuss the issues that were not of primary concern such as the issue of the LSG.

LSG has been prescribed by the Constitution of the Republic of Srpska from the very beginning, i.e. from the moment of its enactment. A particular part ("The Territorial Organization") has been dedicated to LSG. However, the constitutional provisions on LSG are quite poor. Some guarantees of LSG exist, but they have been prescribed in such a way that it was and still is possible for the legislator to enact any system of LSG. Practically, it depends on the political will of the parliamentary majority and on the relationship of political forces in the National Assembly of the Republic of Srpska which system of LSG would be enacted. The legislator can give wider rights to local communities and enact appropriate institutional, financial, and other means for their fulfilment. At the same time, the legislator could decide to do quite the opposite.

One can argue that a constitution has to be a general and short legal act, containing only fundamental legal and political principles. The system of LSG has to be prescribed in detail by law. Although there is some truth in this attitude, it is also harmful to the protection of LSG. Namely, if the legislator has almost total freedom to enact any system of LSG, which is the case in the Republic of Srpska, he can choose to narrow it.

Take for example Article 102 of the Constitution of the Republic of Srpska. It proclaims that the municipality enacts its budget. However, it adds that it does so following the law. What it means exactly and concretely is not easy to understand. It is not easy to understand the scope and consequences of this provision. Two interpretations are possible, as

we shall see later on, but it does not mean that both are correct. The first interpretation is that the enactment of the local budget is entirely the competence of a local representative body with no competence on the part of the central power to interfere. The second interpretation is that the local representative body enacts the budget but with certain interference from the central power.

Secondly, the constitutional provision in Article 62 prescribes that the law must prescribe the revenues of the city and municipality's revenues. This provision is even more dangerous than the previous one, if not followed with certain guarantees for the LSG units. It gives the authority to the central power to decide on the sources and amount of local revenues, which is a significant authority. Moreover, the Constitution does not limit this authority of the central power in any way. It means that the central power (i.e. the representative body) can broaden or reduce the revenues of LSG units.[3] By changing the law, the central power can enable the local communities to get more or less revenues. This can be done in two ways. Firstly, the central government can change the law on LSG, which originally defines the revenues of LSG units. Thus, some new revenues can be introduced, or some existing ones can be cut off. Secondly, by changing the law on the budgetary system, the central power can increase or decrease the percentages of the revenues originally belonging to the Republican budget which have to be transferred to some extent to the local budgets.

The problem with this kind of constitutional regulation is that the scope of development of LSG fundamentally depends on the political will of the switchboard power. It is not just a matter of what and how much competence LSG units have. The issue is whether they can exercise those powers. Financial resources are needed for their implementation – finance follows function. They can be sufficient if the central government so decides. However, the reverse can also happen.

The question, however, is of a principled nature. Financial autonomy is an important characteristic of LSG (Marković, 2014: 408–409). If it is not there, LSG does not exist, even when its other characteristics are present. When financial autonomy is limited, LSG will be limited, because LSG units will not be able to exercise their responsibilities in their entirety, perhaps not even for the most part. In many countries, the financial autonomy of LSG units is low or threatened (Friedrich et al., 2003: 12), and LSG units are financially dependent to a considerable extent on the central government (Chandler, 2003: 9; Bowman & Kearney, 2011: 350). In Britain, for example, around 60% of local government revenue comes from central government (Elcock, 2005: 9).

"There are five perspectives on models of government and the roles and responsibilities of local government: traditional fiscal federalism, new public management (NPM), public choice, new institutional economics (NIE), and network forms of local governance. The federalism and the NPM perspectives are concerned primarily with market failures and how to deliver public goods efficiently and equitably. The public choice and NIE perspectives are concerned with government failures. The network forms of governance perspective are concerned with institutional arrangements to overcome both market and government failures" (Boadway & Shah, 2009: 246).

3 Local self-government units around the world face the problem of insufficient revenues. A comparative analysis shows that financial transfers account for as much as 75% of all revenues of local government units in Great Britain, 60% in Poland, but only 20% in Switzerland (Friedrich et al., 2003: 2).

Financial autonomy is limited mainly by law.[4] Even when at first glance it seems that the constitutional principles of LSG are impeccable, it does not have to be that way. They can be so general that they do not provide sufficient protection for LSG. Such is the case with the Constitution of the Republic of Srpska. It follows from the aforementioned constitutional norms that financial autonomy is guaranteed in the most general possible way. Not even for the sake of example are the original revenues of LSG units listed, nor those revenues that cannot be taken away from them. It is not prescribed that the republican government cannot reduce the achieved level of realized revenues of LSG units. Such constitutional norms would be necessary and represent the necessary guarantee of financial autonomy. LSG units are always in a need of higher revenues. This need may or may not be justified.

Reducing the revenues of LSG units reduces their financial autonomy. It can be justified from the point of view of the financial situation of the Republic. If the Republic finds itself in financial problems, its government will try to justify reducing the financial autonomy of LSG units with those problems. One can, however, ask whether it is justified to resort to reducing the financial autonomy of LSG units before taking other measures. Perhaps it would be possible and justified to first reduce the revenues (and expenditures) of the legislative and executive authorities, and only then the revenues of the LSG units. The National Assembly of the Republic of Srpska can decide otherwise and assess that it is justified for the revenues of LSG units to be reduced because there are objective and justified reasons for this.

Moreover, aside from the formal and obvious changes of the relevant laws, tax procedure and tax collection can make a significant difference in terms of effective influence of the central government to the LSG financing. For instance, if the centralised tax authority collects all the revenues, including those defined as the LSG revenues, due to operational and other difficulties that LSG unit could encounter if it collected revenues by itself, then the LSG would directly depend on the central tax authority's dynamic and priorities of revenue collection. Tax audit and control could be organised in such a way that the tax authority prioritises collection of taxes which are more important for the central government and which belong mostly or exclusively to the central government.

These possibilities point to the weaknesses of the LSG system that stem from the constitution itself. The main weakness is that LSG, although a constitutional category, is almost entirely regulated by law (Marković, 2021: 541–546). In this we see the weakness of the constitutional protection of LSG. It is true that the Constitution contains norms on the jurisdiction of the Constitutional Court of the Republic of Srpska on resolving conflicts of jurisdiction between republican and local authorities. Those norms are important, but their reach is limited. They are applied only when there is a conflict of jurisdiction. When there is no conflict of jurisdiction, the Constitutional Court cannot intervene. In addition, the Constitutional Court cannot do anything, even if it wanted to, in a situation where the National Assembly, on the initiative of the Government or another entity, adopts laws that reduce the financial autonomy of LSG units.

4 This limitation sometimes has to do with party conflicts between the central government and local governments that are controlled by the opposition. The history of local self-government is full of such examples, for example during the reign of Margaret Thatcher, when her government fought with local authorities under the control of Labour (Stoker, 1988: 153).

LOCAL SELF-GOVERNMENT FINANCES AND THE CONSTITUTIONAL PRINCIPLE OF LEGALITY – FROM SAFEGUARD TO BURDEN AND BACK

Two distinct constitutional constraints regarding LSG' finances stem from the same constitutional principle – the principle of legality. The first constraint affects the power to raise revenues – city and municipality shall be entitled to revenues as established by law. The second constraint is based on the rules of budgetary procedure – the budget of LSG units can be enacted in accordance with the law. This exactly reflects the history of constitutionalism and parliamentarism, where the role of the Parliament has mostly been to constrain, limit taxation and public expenditure – "constitutional government arises from the efforts of citizens to constrain an absolute monarch's tax-raising powers" (Xu, 2009: 516–517).

Historically, as the monarchs' and rulers' finances suffered and lacked funding, the focus gradually shifted from domain-based finances (domanial incomes from the monarch's estates) towards tax-based finances (taxes and contributions from the provinces and nobility), which led to century long struggle between nobility and monarchs, and later on between the bourgeoisie and the state, which eventually led to *no taxation without representation*, or *Nullum tributum sine lege* principles. The revenue side of the budget was first to be regulated, and monarch's power to be restricted, and later on, the expenditure side was regulated (Pfeffer, 2020). Therefore, comparative modern constitutional law analysis reveals numerous examples of provisions proclaiming the principle of legality of taxation, such as the Constitution of France, Art. 34, the Constitution of the Italian Republic, Art. 23, the Belgian Constitution, Art. 170, the Federal Constitution of the Swiss Confederation, Art. 127, or the Constitution of the Republic of Serbia, Art. 91. This principle usually does not constitute a full monopoly of the central government with regard to raising revenue, but rather a guarantee that the most important elements of taxes and other revenues will be uniform and harmonized, or as the Federal Constitution of the Swiss Confederation states: "The main structural features of any tax, in particular those liable to pay tax, the object of the tax and its assessment, are regulated by law". There are, therefore, some features of tax that could be regulated on an LSG level. Tax law theory recognizes the principle of legality of taxation, and focuses on what the elements should be of any revenue that are reserved for the legislative or statutory (central) level, thereby leaving some elements to possible regulation at the local level (Popović, 2021: 55–55). That does not, however, change the fact that LSG units are highly dependent on the central government, or simply conditioned, when it comes to enacting tax or any revenue legislation.

Initially and originally meant to protect the citizens from raising the revenue unilaterally by the central government, and contrary to the will of the people, the principle of legality of taxation now holds LSG "hostage" to the central government policies. At the same time, LSG is now arguably the very embodiment of legitimate and representative government. The representation and the potential political participation of the citizens has traditionally been the highest not at the central level, but at the local level of government. It is, perhaps, the right time to reassess the justification of the traditional concept of legality of taxation with regard to the LSG units. In order to do so, it is necessary to analyse the effect of the above-mentioned constitutional foundations of LSG and limitations to financial autonomy of LSG. Only after that will it be possible to suggest *de lege ferenda* solutions.

Prior to the analysis of legal regulation of financial autonomy of LSG, one important effect of taxation should be taken into consideration – distortionary effect of taxes. Summarily,

taxes that affect and distort the efficiency of market allocation of resources are distortionary taxes. Government should, therefore, use taxes which are not distortionary, such as lump-sum taxes. However, government usually lacks, quite understandably, the sufficiently fine information about the agents populating the economy, which is needed for the use of lump-sum taxes, which in turn makes distortionary taxes almost unavoidable on the path towards efficient implementation of the desired level of redistribution (Grochulski, 2009). In the terms of constutional law theory, this is the problem of *foot voting*. Taxpayers could leave the territory of LSG unit with less favourable taxation in favour of the one with more favourable taxation. This problem has already been manifested on the inter-entity level of taxation in Bosnia and Herzegovina. The Republic of Srpska does not tax the income from dividends and shares in the profit of a company. The relief was prescribed after the Federation of Bosnia and Herzegovina had already exempted from income tax the dividends and other income earned from participation in capital of another taxpayer. This very reason, the *race to the bottom* problem, was cited during the drafting and enactment of the Republic of Srpska's Law on income tax. The *race to the bottom* is the problem of different tax jurisdictions fighting for the taxpayers with the means of ever more favourable taxation. As a consequence, tax rates plummet, or even effectively reach 0%, which is *bottom* indeed. Furthermore, the public goods provision suffers due to lack of funding, which again leads to less favourable conditions for taxpayers, further accentuating the race to the bottom. This is exactly why unlimited or any kind of greater autonomy of LSG is perilous. This is also the reason for limiting taxation powers of LSG. The constitutions usually reserve the most important elements of taxation to be prescribed within laws or statutes, and LSG units are left with the power to define only some of the tax elements, within the limits set already in the relevant law.

In order to offset the risks of *foot voting* or *race to the bottom*, the ideal local tax should be the one that cannot be easily affected with migration, or tax base thereof cannot easily be eroded. Property tax is often seen as such a tax – "the real-property tax is generally taken to be an ideal tax to assign to lower levels of government, especially municipal governments, given their immobile nature" (Boadway & Shah, 2009: 115). Considering the potential downfalls of LSG finances based on greater autonomy in taxation through the prism of these arguments, the constitutional and legal limitations of the LSG autonomy once again take shape of a safeguard rather than of a burden. That being said, a safeguard for the LSG finances should only be the guarantee of the minimum revenues needed, and not the obstacle on the path toward LSG development and financing of its competences, for which we will later offer solutions with practical implications.

LEGAL REGULATION AS A SOURCE OF LIMITATION OF FINANCIAL AUTONOMY OF LOCAL SELF-GOVERNMENT

For the topic we are dealing with, two laws are of primary importance: the Law on Local Self-Government of the Republic of Srpska (Zakon o lokalnoj samoupravi) and the Law on the Budget System of the Republic of Srpska (Zakon o budžetskom sistemu Republike Srpske). There are, however, other laws that directly or indirectly shape the financial autonomy of the LSG units, such as the Law on Fiscal Responsibility in the Republic of Srpska (Zakon o fiskalnoj odgovornosti), the Law on Territorial Organization of the Republic

of Srpska (Zakon o teritorijalnoj organizaciji Republike Srpske), the Law on Civil Servants and Employees in Local Self-Government Units (Zakon o službenicima i namještenicima u organima jedinice lokalne samouprave) and the Law on the Status of Local Self-Government Units Officials (Zakon o statusu funkcionera jedinica lokalne samouprave).

Chapter VI of the Law on Local Self-Government is devoted to property and financing of LSG units. Article 73 stipulates that the financial resources of LSG units are proportional to their competences.[5] This is quite expected and normal, because the exercise of competence does not make sense if it is not accompanied by the necessary and sufficient financial resources. This legal norm can represent a certain guarantee of the position of LSG units and the protection of their financial autonomy. Nevertheless, it is of a programmatic character, it is completely principled, so LSG units can hardly use it against the arbitrariness of the state government, except by proving that the state government, by reducing their financial autonomy, violates this legal principle. It is not insignificant, but it does not represent a precise legal foothold for the protection of financial autonomy. Rather, we would say that it is a legal standard ("proportionality"), which the government can interpret in different ways. It is enough for it to present any reasons and arguments that they would try to prove that the financial resources of the LSG units are commensurate with their competences.

Among the LSG units' sources of revenue are certain taxes and fees. The question, however, is whether these revenues are properly chosen and listed, especially if we take into account the share of these revenues in the total revenues of the budgetary system. A different solution can also be advocated, i.e. the one that would include some other taxes and fees as the source revenues of LSG units.[6] Such a decision, however, can always be revoked, that is, changed by the National Assembly amending the Law on Local Self-Government. Therefore, LSG units have no guarantee that the achieved financial autonomy will survive.

An alternative solution would be to explicitly state the most important sources of public revenue in the Constitution of the Republic of Srpska (for example, to explicitly state the taxes that are the source of revenue of LSG units). Such a solution would certainly be criticized as unusual and as turning a legal matter into a constitutional matter. The critics of this solution would consider that an impractical solution was adopted that would prevent reforms of the LSG system.

These criticisms are not unfounded. The constitutional text should be unburdened and short, principled and open to "experimentation" with different systems of LSG, including systems of its financing. Nevertheless, one should notice the weaknesses of the LSG system and try to limit or avoid them. One of the biggest weaknesses is that the state government unilaterally determines the degree of financial autonomy of LSG units. This statement can

5 A similar solution is contained in the Constitution of the Republic of Croatia: "The revenues of local and regional self-government units must be proportionate to their powers as envisaged by the Constitution and law" (Art. 131, paragraph 2).

6 When it comes to taxes, the independent sources of income of local self-government units are: real estate tax, tax on income from agriculture and forestry, tax on profit from games of chance, other taxes established by law (Article 74, paragraph 1, point 1 of the Law on Local Self-Government). Comparatively, independent sources of income are determined in different ways. In Poland, property tax is the most important local tax and accounts for more than half of municipalities' own revenues (Crnković, 2010: 1075). In Italy, the most important local taxes are property tax and business tax (Manojlović, 2008: 1096). The literature points out that the property tax is the most important local tax (Scharff, 2016: 296). In Serbia, among the taxes, the source income of local self-government units includes the property tax, apart from the tax on the transfer of absolute rights and inheritance and gift taxes.

be answered that it should be so because the state power is sovereign. It is simply a *state,* while local government is not. There is a hierarchical relationship between them.

This argument is valid. However, the state power, although it is higher than the local one, must strive for its own limitations. It adopts the constitution and laws, so in the constitutional and legislative procedure it should take into account the realization and protection of LSG, which is one of the constitutional principles, guaranteed by Article 5 of the Constitution. This principle can be interpreted in different ways. The state government could claim that LSG is protected by the fact that LSG units have been given their own sources of revenue by law. The very fact that these sources of revenue exist and that the state government does not encroach on them is proof that LSG autonomy is guaranteed.

This statement is correct at the level of a principle. However, there are no guarantees that LSG will not be substantially limited by reducing financial autonomy. It follows that constitutional principles and legal norms are not a sufficient guarantee. State power should limit itself in a more effective way. Therefore, we believe that it is justified that the financing of LSG units be partially regulated by the Constitution of the Republic of Srpska. If there were organic laws, the problem could be elegantly solved by having this issue regulated by organic law.

The constitution could, for example, specify taxes that must represent the original revenue of LSG units, which would establish a lower limit of financial autonomy. In the Constitution, a norm could be found that would prescribe that the level of financial autonomy achieved cannot be reduced, either by certain taxes and other sources of revenue ceasing to be original revenue, or by reducing the amount of funds that would represent the original revenues of LSG units. In the end, the right to protect LSG should be explicitly established as a competence of the Constitutional Court of the Republic of Srpska, not only in cases of conflicts between the competences of republican and local authorities, but also in other cases when competent authorities of LSG units consider that the right to LSG is threatened.

When it comes to taxes that represent the source income of LSG units, the Law on Local Self-Government stipulates that their amount is determined by law. This is expected and logical, but at the same time it indicates a potential limitation of LSG. Since the National Assembly of the Republic of Srpska passes laws, it can influence the implementation of LSG by amending laws that change the tax rate.

According to Article 3 of the Law on the Budget System of the Republic of Srpska, the budgets of municipalities and cities are part of the budgetary system of the Republic of Srpska. Article 9 of this law determines the revenues that are shared between the budget of the Republic of Srpska, the budget of municipalities and cities, and other beneficiaries. Among them are: 1) revenues from indirect taxes (whereby 72% belongs to the Republic and 24% to local self-government units, while the rest belongs to the Public Enterprise "The Roads of Srpska"); 2) income from income tax; 3) income from fees. The ratio in which these revenues belong to the Republic or LSG units has been determined.[7]

7 According to the opinion of the Congress of Local and Regional Authorities, the lack of a legal solution is that the low percentage of distribution of income from indirect taxes is prescribed and that the financing system of local self-government units relies too much on grants. Municipalities significantly depend on indirect taxes, which make up about 50% of budget revenues in the Republic of Srpska (Congress of Local and Regional Authorities, 2019: 23).

The law prescribed the criteria on the basis of which LSG units participate in the distribution of revenue: 1) number of inhabitants (75%); 2) area (15%); 3) number of students in secondary schools (10%). It is interesting that the level of development is not included among the criteria, which, in our opinion, should be included. The purpose of the allocation of budget funds should, among other things, be the provision of financial resources that LSG units need to exercise their competences. It is expected that the criteria prescribed by the Law affect the possibility of exercising the independent competences of LSG units and that they are directly related to the sources and amounts of their own revenues. However, the degree of development is also significant because it also affects the (in)ability of exercising independent competences. Moreover, this measure could be made more concrete and precise in such a way that the BDP per capita or other adequate indicator in each LSG unit would be taken into account, since the degree of development in itself is not a concrete enough indicator.

The law stipulates that LSG units must secure the consent of the competent ministry before adopting their budget (Law on the Budgetary System of the Republic of Srpska, Article 28, Law on Fiscal Responsibility in the Republic of Srpska, Article 9, para. 2.). The head of the municipality, i.e. the mayor, cannot submit the draft budget to the local assembly before sending it to the competent ministry, which should make recommendations. When preparing the final version of the draft budget, the head of the municipality, i.e. the mayor, takes into account the recommendations of the ministry. After the local assembly adopts the draft budget with the input recommendations of the ministry, the budget proposal is submitted to the ministry for approval. After receiving the consent of the Ministry, the local assembly adopts the budget proposal. Therefore, the budget cannot be adopted before the ministry gives its consent.

It is justified to question the expediency, even the constitutionality, of this solution. This solution is, on the one hand, expedient, if we take into account the unity of the budgetary system of the Republic of Srpska, as well as the fact that the funds shared between the Republic and LSG units are organised within the Treasury of the Republic and paid from the public revenue account (Article 7, para. 1 of the Law). On the other hand, the budget resources that fully belong to the budget of a municipality or a city, and which represent their original revenues, are from the public revenue account of the municipality, i.e. the city. Therefore, it is logical that the Republic wants to control the outflows from its own Treasury accounts.

However, the expediency of this solution can be challenged on two grounds, which, in our opinion, prevail. First, the LSG revenues that are part of shared revenues held at the public revenue account come under the category of one's own (source) revenues of municipalities and cities because they are used to exercise their *independent* competences. It is just a matter of the Treasury technique and accounting that these revenues are held together with the revenues of the central government. It is not to be confused with the financial resources that the Republic transfers to LSG units for the exercise of *transferred* competences, which we do not write about here. As soon as the LSG unit has to obtain the approval of the ministry for its budget, it may happen that it will not have enough funds to exercise its independent powers. This means that the exercise of independent competences can be indirectly limited because the LSG unit cannot exercise certain competences (or cannot do so to the full extent) if the ministry does not agree with the planned financial means

for their exercise. It follows that the Law on the Budget System enables the Republic's control over the exercise of independent competences of LSG units. Although control is done indirectly, it is still possible. Second, the financial autonomy of LSG units is achieved, first of all, by independent decision-making by LSG units on the adoption of the budget. By definition, it is limited by the fact that the budget cannot be adopted without the consent of the ministry.

We believe that the question of the constitutionality of the legal norms regulating the procedure for adopting local budgets can be raised. When adopting this law, the National Assembly of the Republic of Srpska started from the relative vagueness of the constitutional norms, which are of a principled and programmatic nature. Article 102, paragraph 1, point 1 of the Constitution of Republic of Srpska prescribes that the municipality adopts the budget through its organs in accordance with the law. At first glance, it seems that the budget adoption procedure, prescribed by the Law on the Budget System, is constitutional. The budget is adopted by the municipal authority, i.e. assembly, at the proposal of the executive body, i.e. the mayor of the municipality. Passing the budget is in accordance with the Constitution, because the Budget System Law prescribes the procedure for passing the budget, which the Constitution not only allows but also prescribes. The Constitution guarantees LSG, but it does not define that guarantee, just as it does not define the scope and content of LSG. Moreover, the Constitution expressly stipulates in Article 102, paragraph 2 that the system of LSG is regulated by law.

The procedure for adopting the budget is regulated by law. On that side, the constitutional norm was formally respected. The budget is adopted by the municipal assembly, that is, the city assembly. The Constitution was respected from that side as well. Only the local assembly passes the budget. No one else participates in the decision-making process. Here we come to the problem. This conclusion is correct if we analyse the budget adoption procedure within the LSG system. In other words, when we observe how the LSG system functions, we come to the conclusion that the budget is decided by the bodies of the LSG units. That conclusion, however, is only correct at first glance, if we look at the problem from the point of view of who adopts the budget. Both laws that we mention in this text correspond to the fact that the budget is adopted by the assemblies of LSG units. The question arises, however, what if the competent ministry does not agree with the proposed budget. Can such a budget proposal be adopted? The law suggests a negative answer to this question. Therefore, the municipal assembly can adopt the budget only if the ministry agrees with it. Making a decision on the budget is not an independent competence of the municipal assembly, but it is a joint competence with the ministry. We believe that this is contrary to the purpose and goal of the constitutional norm, which can only be interpreted as giving the authority to the municipal assembly to pass the budget independently. The participation of the ministry could only be advisory, that is, such that it gives an opinion or recommendations, and not consent without which the budget cannot be adopted.

The question of over-indebtedness of LSG units could arise, which also exists in comparative law (Chandler, 2003: 85). However, it cannot be solved in the previously described way of passing the local budget, both because of the inexpediency and even more because of the unconstitutionality, especially since the problem of indebtedness of the LSG units cannot be equated with the adoption of the local budget. When it comes to borrowing, comparative law knows the solution according to which the law determines the cases in

which it is allowed (Manojlović, 2008: 1097), that is, the solution according to which the law regulates in detail the prevention of constant or repeated over-indebtedness of municipalities (Lentner & Hegedűs, 2019: 64–68).

RECENT LIMITATIONS TO LOCAL SELF-GOVERNANCE AUTONOMY

The following controversial case is quite new. The National Assembly of the Republic of Srpska adopted the Law on Amendments to the Law on the Budget System in December 2024. It entered into force on 1 January 2025. Article 3 prescribes the public revenue distribution for three years, by which the revenue from indirect taxes otherwise appointed to LSG units with more than 100,000 inhabitants will be reduced and distributed to LSG units with less than 50,000 inhabitants. The further distribution of this amount is done in such a way that 65% belongs to LSG units that in the previous year generated the revenue from indirect taxes of less than five million KM, while the remaining amount of 35% is distributed to LSG units that in the previous year generated the revenue from indirect taxes greater than five million KM. This type of financing is limited to a period of three years. Comparative law knows the solution according to which the state helps financially the underdeveloped municipalities, which is also an acceptable solution, because in that way it helps the realization of LSG (Dubajić, 2010: 477).

The question of the constitutionality and expediency of this decision arose. According to one opinion, the legal norm is unconstitutional because it contradicts Article 66 of the Constitution of the Republic of Srpska, which guarantees equality before the law, which is the measure and basis of the authority and responsibility of the republic's authorities. However, the important question is whether the solution to the problem can be found in Article 66 (and then in the possible interpretation of the Constitutional Court of Republic of Srpska that this article is violated). At first glance, it seems that the principle of equality before the law has been violated because the legal norm implicitly stipulates that only two cities, Bijeljina and Banja Luka, should remain without a part of the revenue. Other cities, since they have less than 100,000 inhabitants, will not be financially deprived, nor will this be the case with the municipalities that have the status of developed municipalities.

Equality before the law is violated because financial resources are taken away only from two LSG units and not from others, which, both in terms of the number of inhabitants and in terms of economic strength and budget size, are perhaps quite close to Bijeljina and Banja Luka. A separate question is why the measure of the number of inhabitants would be valid, if one takes into account the fact that that measure, if considered separately from other measures, is not sufficient to answer the question of whether cities are so economically strong that it would be justified to reduce their revenues. Would it, for example, be justified to reduce the public revenues of a city with less than 100,000 inhabitants, whose per capita revenue is perhaps higher or close to the per capita revenue of Bijeljina and Banja Luka?

The foregoing indicates that the criterion for reducing the revenues of Bijeljina and Banja Luka is arbitrary. It is difficult to justify that the revenues are reduced only for these cities if you take into account the fact that the principle of solidarity should be applied in the widest possible way and that it should cover all cities, in proportion to their financial strength,

but also all or at least some developed municipalities. There is no reason to "impose" solidarity only on the cities with more than 100,000 inhabitants. On the contrary, one could argue that these cities deserve support, since they reduce expenses – if these cities were reorganised and divided into four smaller cities, each with far less than 100,000 inhabitants, instead of the existing two, it would lead to almost double the size of administration and double the local public expenditure for the same area and population. This is due to the fact that there are certain fixed expenses for each LSG unit (municipality or city). If there were four instead of two local governments, the expenses would be significantly higher, and at the same time these four newly formed LSG units would be far below the 100,000-inhabitant threshold.

On the other hand, "smaller local self-government units (5.000–20.000 inhabitants) are not necessarily poor, in particular, if they have the possibility to exploit natural resources (mining, water, forest), which permits budgetary stability, together with other resources. A high share of population still resides in these rural areas (around 60%)" (Congress of Local and Regional Authorities, 2019: 123. 3 c). Moreover, unlike smaller LSG units, larger LSG units often face the problem of public goods congestion, which prompts investments and additional public expenditure.

So far, we have talked about the expediency of the accepted solution. Its unconstitutionality is difficult to prove. Equality before the law means that everyone should have the same rights and obligations. If this principle is interpreted in this way, then it seems that it has been violated by the aforementioned legal solution. However, equality before the law does not mean mere equalization of rights and obligations. Equality will not necessarily be violated if there is no equality of rights and obligations, provided that it can be considered justified and rational, and that such a solution also withstands the test of proportionality. There is no doubt that the goal officially declared, which is to help the underdeveloped and significantly underdeveloped municipalities, could be achieved in other ways, for example by reducing some expenses of legislative, executive or judicial institutions. This goal could also be achieved by greater tax discipline.

If, on the other hand, the problem is viewed exclusively from the point of view of the position of LSG units and their equality, more precisely equality before the law, it can be said that it is justified to take part of the financial resources from the largest LSG units and redirect them to the underdeveloped and highly underdeveloped ones. The criterion that these are the cities with more than 100,000 inhabitants can be justified by the fact that these are the cities that generate the highest revenues, because they have the most taxpayers, the greatest economic power, the greatest turnover of goods and services, etc.

On the other hand, this solution can be criticized because it could be argued that this is a big burden for the cities with more than 100,000 inhabitants, while other cities are not burdened at all. If the other cities were also burdened proportionally, there would be less of a burden on the cities with more than 100,000 inhabitants, so they would be in a better position than according to the accepted solution. This, however, would put other cities in a disadvantageous position, which are not burdened at all now, but would be burdened by accepting a different legal solution. In any case, when the principle of solidarity is viewed from a narrow, local point of view, there would always be those who are dissatisfied and would claim that they are affected by that measure, even if the measure is unconstitutional, because it violates the principle of equality before the law. Just as the cities with

more than 100,000 inhabitants claim that their equality before the law is threatened, other cities (or even the most developed municipalities) would claim the same if their revenues were reduced, as is now being advocated for the reduction of the revenues of Banja Luka and Bijeljina, which the National Assembly has already adopted. Everything points to the conclusion that the claim about the justification and proportionality of the adopted legal solution is at the very limit of constitutionality.

THE IMPLEMENTATION OF THE EUROPEAN CHARTER OF LOCAL SELF-GOVERNMENT REGARDING LOCAL FINANCES IN THE REPUBLIC OF SRPSKA

The European Charter of Local Self-Government (ECLSG), drawn up within the Council of Europe, and opened to signature as a convention by the member states of the Council of Europe on 15 October 1985, commits the parties to applying basic rules guaranteeing the political, administrative and financial independence of local authorities. ECLSG entered into force in 1988. There are a few issues that should be discussed prior to the analysis of ECLSG effect on the constitutional and legal framework of LSG units in the Republic of Srpska. Most of these issues come down to the problem of the exact place of the ECLSG in the hierarchy of constitutions, laws and regulations in Bosnia and Herzegovina.

Unlike most of the federal units in comparative law, the entities in Bosnia and Herzegovina may enter into agreements with states and international organizations in two ways – with the consent of the Parliamentary Assembly of Bosnia and Herzegovina for each such agreement, or without it if the Parliamentary Assembly provided by law that certain types of agreements do not require such consent (Constitution of Bosnia and Herzegovina, Art. III 2 d). Parliamentary Assembly has never enacted such a law, which, at the moment, leaves only the first option (consent is required for each international agreement that entities may enter into, except for the right of the entities to establish special parallel relationships with neighbouring states which they have as long as special parallel relationship is consistent with the sovereignty and territorial integrity of Bosnia and Herzegovina).

Given the fact that the entities have the exclusive constitutional competence to regulate LSG, it would be expected that the entities have signed and ratified the ECLSG. However, Bosnia and Herzegovina joined the Council of Europe on 24 April 2002, signed and ratified the ECLSG in full (without reservations or declarations) on 12 July 2002. The Charter entered into force in respect of Bosnia and Herzegovina on 1 November 2002. Without delving any further into the analysis of this peculiarity or oversight, since there have already been attempts to do so on the similar grounds (Marilović, 2022: 419–428), we can recognize the necessity to apply the standards of ECLSG in the entities in Bosnia and Herzegovina.

The Congress of Local and Regional Authorities of the Council of Europe has recognized such a necessity: "the rapporteurs, aware of the specificity of the constitutional structure of Bosnia and Herzegovina, underline that the commitments entered into under the Charter legally bind the State, but it is also and primarily the responsibility of the two entities (Federation of Bosnia and Herzegovina and Republic of Srpska), and the cantons to ensure the Charter's implementation according to the distribution of competences regarding local

government. The recommendations will therefore be addressed to Bosnia and Herzegovina as a member State of the Council of Europe, but the implementation thereof will also be a matter for the entities and cantons" (Congress of Local and Regional Authorities, 2019: 2 d). It would be interesting, therefore, to analyse the relation between the Constitution of Republic of Srpska and the ECLSG, which is far beyond the scope of this article. We will, therefore, only show the comparative analysis by Articles 8 (Administrative supervision of local authorities activities) and 9 (Financial resources of local authorities) and selected countries, based on the website tools and the data from monitoring missions of the Congress of Local and Regional Authorities of the Council of Europe.

Table 1. *Comparative Analysis by Articles and Countries – Web Monitoring*
(Congress of Local and Regional Authorities, 2025)

COUNTRY	Article 8			Article 9							
	8.1	8.2	8.3	9.1	9.2	9.3	9.4	9.5	9.6	9.7	9.8
Bosnia and Herzegovina	C	C	C	NC	NC	PC	?	PC	C	C	C
Bulgaria	C	C	C	NC	NC	PC	PC	C	C	NC	C
Croatia	C	C	NC	NC	NC	NC	NC	PC	PC	NC	C
Hungary	C	C	NC	NC	NC	NC	NC	PC	NC	NC	PC
Montenegro	C	C	C*	PC	PC	PC	PC	C	NC	PC	PC
North Macedonia	?	?	?	?	?	?	?	?	?	?	NC
Romania	C	C	C	PC	PC	C	C	PC	C	PC	C
Serbia	NC	NC	?*	NC	NC	C	C	PC	C	PC	C
Slovenia	C	C	C	C	C	C	C	C	C	C	C

Note. C – compliance; PC – partial compliance; NC – non compliance; * – non ratified.

It is evident from the reports and the data in the chart that the Republic of Srpska and Bosnia and Herzegovina are not that different from the neighbouring and other countries in this part of Europe, and particularly Republic of Serbia (Hadži Stević, 2025), including some EU members, when it comes to the implementation of the ECLSG. However, some requirements of the Article 8 are not respected, which the rapporteurs have not considered. According to Article 8, paragraphs 1 and 2, any administrative supervision of the activities of local authorities has to be carried out according to pre-established procedures and can only aim at ensuring compliance with the law and constitutional principles. While it may seem that this is indeed respected, the proper analysis of financial laws and regulation proves the contrary. According to the Law on Civil Servants and Employees in Local Self-Government Units, Art. 64, "employment in the city or municipal administration can only be carried out in accordance with the employment plan adopted by the mayor or the head of the municipality, within 30 days from the date of entry into force of the decision on the adoption of the budget of the local self-government unit", while the Law

on the Status of Local Self-Government Units Officials, Art. 16, prescribes that "funds for salaries of officials are provided in the budget of the local self-government unit". We have already pointed out the constraints relating to LSG budgets in terms of the consent of the competent ministry needed prior to adopting LSG unit's budget. In combination with the employment and funding rules regarding LSG civil servants, employees and officials, this makes it possible for the central government to effectively control and condition the very functioning of the LSG in a way that is far beyond the scope of ensuring compliance with the law and constitutional principles. This may further support our findings on possible unconstitutionality of the analysed legal provisions on the financial autonomy of LSG.

A NEW-OLD SOLUTION TO THE PROBLEM: LOCAL SELF-CONTRIBUTIONS AS ULTIMATELY DEMOCRATIC AND EXCLUSIVELY LOCAL REVENUE

Defining a perfect local tax or revenue may be challenging, but there is a specific local tax that historically proved its usefulness, democratic characteristics and versatility. About half a century ago, the Socialist Republic Bosnia and Herzegovina (SRBiH), similarly to other republics in the Socialist Federal Republic of Yugoslavia (SFRY) enacted laws on local self-contributions (Zakon o mjesnom samodoprinosu; Zakon o samodoprinosu). This local, earmarked, extraordinary surcharge income tax was raised, following a ballot measure, and revenues were used for the development and investment in the matters of public utilities, local public goods and community infrastructure. At the time, decentralization did not end at the municipality level. Local communities within municipalities were competent for settlement planning, housing, communal facilities, social care for children, social protection, education, culture, physical culture, human environment protection, national defence, and social self-protection, and local self-contribution played a key role in financing these competences. Municipal ballot, needed for the adoption of decision to raise self-contribution, would not lead to the problems that are present at higher electoral levels, such as the problem of discrimination against citizens, based on the combination of ethnic and territorial requirements (Marković, 2023: 5–15).

Prescribed by special law, self-contributions were essentially different surcharge income tax with tax rates generally below 10%, and sometimes as low as 2%. It was locally introduced and administered, with the revenue locally deposited. It was characterized with high tax morale. Self-contributions had been earmarked, and specifically allocated for certain purposes such as repairing, building and expanding village roads, bridges, school buildings, etc.

Although no such law on self-contribution has ever been enacted in the Republic of Srpska, self-contributions still exist, at least formally, in the tax system of the Republic of Srpska. The Law on Local Self-Government of the Republic of Srpska, Art. 74, explicitly lists self-contribution as one of the "other municipal non-tax revenue", which is also given specific economic codes within the chart of accounts for users of the revenues of the budget of the Republic, municipalities, cities and funds (Pravilnik o budžetskim klasifikacijama, sadržini računa i primjeni kontnog plana za budžetske korisnike). Although the special law on self-contribution should be enacted in the Republic of Srpska, raising self-contri-

butions within LSG units, in our opinion, would be in line with the legality principle even based on the existing above-mentioned Law and Rules. In this case, until the new law on self-contributions is enacted, the pre-war, socialist period Law on Self-Contribution could be applied on the basis of the Constitutional Law for the Implementation of the Constitution of the Republic of Srpska (Ustavni zakon za provođenje Ustava Republike Srpske), in connection with the Constitution of Bosnia and Herzegovina (Ustav Bosne i Hercegovine), Annex II, Art. 2. This would enable LSG units to source their public goods provision with an additional means and full autonomy.

CONCLUSIONS

System of financing of local self-government in the Republic of Srpska faces several challenges and contradictions. The analysis of this system leads to several conclusions. Certain revenues, such as real-property tax and locally raised, administered and earmarked revenue such as self-contributions, should be included within *materia constitutionis* as exclusively locally raised revenue. The Constitution of the Republic of Srpska should provide guarantees not only regarding sources of financing, but also guarantees of the reached level of financing of the LSG. Only exceptionally, the differentiation of financing of different LSG units should be introduced, and only on the condition that it is based on well-defined, balanced and impartial criteria. Not only formal, but effective constraints to the fiscal autonomy as well, should be reassessed in accordance with the domestic law and international law and legal principles of local financing and local self-governance. In the meantime, local self-government units should utilize the existing but almost forgotten legal grounds for additional fully autonomous source of revenue in the form of self-contributions.

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