

**LESSONS LEARNED AND ANALYSIS UNIT
PRISTINA**

**Lessons from Bosnia for Kosovo
Part I**

Governance and development

**A real life story of private sector growth
in Bosnia and Herzegovina**

13 February 2002

LESSONS FROM BOSNIA FOR KOSOVO

A REAL LIFE STORY OF PRIVATE SECTOR GROWTH IN BOSNIA

EXECUTIVE SUMMARY

This report presents the results of a detailed study of the post-privatisation political economy in the municipality of Kalesija, one of Bosnia's least developed rural areas. It is part of an extended ESI study of patterns of local development in South Eastern Europe for the **Lessons Learned and Analysis Unit** of the European Union Pillar of UNMIK, tracing the evolution of key actors and institutions and examining the role of local government in the emergence of the new private sector.¹ By carrying out an exhaustive study of a particular locality, it is possible to assemble a picture of the economic transition process and draw lessons which may be generalisable across Bosnia and in other locations, particularly Kosovo.

For some time, international agencies in Bosnia and Herzegovina have spoken of the need for a change of paradigm: from reconstruction to development. What distinguishes effective development strategies from pure reconstruction is that they focus on developing local institutions and capacities. This requires knowledge of the institutional and political realities prevailing in the field, especially at local level. Only by understanding the strengths and weaknesses of existing structures is it possible to accomplish the lasting institutional change which is a precondition for sustained economic development. This paper is designed to demonstrate the kind of detailed knowledge needed for effective international development strategies.

The study presents findings in the following areas:

- Š With privatisation in Kalesija now substantially complete, employment in the former socially owned sector has contracted by two-thirds, and is likely to fall further. The primary benefit of the privatisation process has been to release assets from defunct businesses for new purposes.
- Š The new private sector has been the main engine of growth since the war, expanding from 5 to 42 percent of total official employment.
- Š The most immediate constraint on private-sector development is access to serviced land. New businesses have been forced to 'piggy-back' on the centres of socialist development in order to gain access to infrastructure, while most of the municipality remains closed to development.
- Š The collapse of the socially owned enterprises has forced local public-service providers to contract dramatically. Despite extensive foreign assistance with

¹ The Lessons Learned and Analysis Union is an initiative of the EU Pillar in Kosovo, supported by the Swedish government. It provides international and local policy makers in Kosovo with up-to-date analysis on key international programme areas. Reports are written independently by ESI and do not reflect EU Pillar views or policies.

infrastructure repair, there is no institutional basis for maintaining and developing municipal assets and services.

- Š In the absence of a municipal development strategy, local communities have shown remarkable initiative in mobilising their own resources to develop local infrastructure networks. However, this voluntaristic and haphazard process is inefficient and has caused confusion over the ownership of key assets.
- Š The municipality has considerable potential resources which could be used as a capital resource in support of private-sector development. However, it lacks both the managerial capacity and the legal framework to develop its assets effectively. Urban and commercial development is taking place without proper planning, generating significant long-term costs.

These findings suggest that strengthening municipal governance and the management of local public utilities is one of the key frontiers for economic development in Bosnia. It is at the local level that the most immediate constraints on private-sector development are encountered. Socialist self-management structures have collapsed, but have not yet been replaced by appropriate new forms of corporate governance. For as long as these problems remain, neither foreign development assistance nor local resources will be utilised effectively and the new private sector will remain hamstrung.

~ Table of contents ~

<i>Introduction.....</i>	<i>1</i>
<i>Privatising Kalesija's SOEs.....</i>	<i>3</i>
<i>The new private sector</i>	<i>6</i>
<i>Patterns of development.....</i>	<i>7</i>
<i>The municipality and its local communities</i>	<i>9</i>
<i>The remnants of Yugoslav self-management.....</i>	<i>10</i>
<i>The post-socialist utility crisis.....</i>	<i>11</i>
<i>Network expansion through private initiative.....</i>	<i>13</i>
<i>Municipal assets and dead capital.....</i>	<i>14</i>
<i>Some conclusions.....</i>	<i>15</i>
<i>Annex.....</i>	<i>18</i>

~ Table of figures ~

<i>Table 1: Reconstruction aid in Kalesija municipality per sector, 1996-1999.....</i>	<i>2</i>
<i>Table 2: Employment structure in post-privatisation Kalesija.....</i>	<i>5</i>
<i>Table 3: Registered full-time employment in Kalesija: 2000</i>	<i>6</i>
<i>Table 4: Employment in Kalesija by size of company</i>	<i>7</i>
<i>Table 5: Distribution of employment and unemployment in Kalesija according to mjesna zajednica.....</i>	<i>8</i>
<i>Table 6: Historic development of municipalities in the former Yugoslavia and Bosnia and Herzegovina.....</i>	<i>9</i>
<i>Table A1: The former SOE sector in Kalesija</i>	<i>18</i>
<i>Table A2: New companies in Kalesija employing more than 10 workers</i>	<i>18</i>

“Much of the important work in building institutions lies in modifying *those that already exist* to complement better other institutions and to recognise what not to build in a particular context, as much as what to build. “Best practice” in institutional design is a flawed concept.”²

World Bank Development Report 2002

“Development depends not so much on finding optimal combinations for given resources and factors of production as on *calling forth and enlisting* for development purposes resources and abilities that are hidden, scattered, or badly utilised.”

Albert O. Hirschman, 1954

Introduction

This paper is part of a series of reports on local economic trends in post-privatisation Bosnia and Herzegovina. The objective is to understand the evolving political economy of post-war Bosnia and determine whether there are relevant lessons for economic policy, both in Bosnia and elsewhere, and particularly in Kosovo.

This case study focuses on the Bosnian municipality of Kalesija.³ Kalesija was selected because of the similarity of its pre-war economic and social structures to those prevalent in Kosovo. In 1990, Kalesija was the least industrialised municipality in Bosnia and Herzegovina, with socially owned enterprises (SOEs) dating back only to the 1970s. As in Kosovo, its SOEs were highly dependent on other public enterprises and declined rapidly following the collapse of the former Yugoslav economy.⁴

Damaged heavily during the war, Kalesija has received a significant flow of foreign reconstruction aid, particularly in the housing sector. Between 1996 and 1999, a total of DM 30 million in aid was spent in Kalesija. Municipal roads, water and electricity services are now better resourced than before the war. The DM 13.6 million spent on housing by foreign donors accounts for 35 percent of total repairs in the housing sector, the balance coming from private financing and remittances from abroad. The reconstruction aid helped to stimulate short-term economic activity, particularly in the local construction industry. However, the flow of reconstruction aid had mostly dried up by 1999.

Infrastructure development in Kalesija has traditionally come from external donations and higher political structures. Prior to the war the municipality never sought to develop an economic basis by which to further its own development. Following the war, its structures initially continued to be focused outwards towards international

² World Bank Development Report, “Building Institutions for Markets”, Oxford University Press, 2002, p. 4.

³ Kalesija lies close to the industrial centre of Tuzla in the north-west of the Federation of Bosnia and Herzegovina.

⁴ Forthcoming papers in this series, based on field research across Kosovo, will focus especially on the rural municipality of Orahovac/Rahovec and the industrial centre Pec/Peja.

donors. Beginning in 1997, however, citizens of the municipality have started to mobilise significant local resources in order to develop local telecommunications and road networks in rural areas neglected by socialist planners.

To understand how local resources were mobilised to support municipal development and, by extension, the emergence of the new private sector, it is critical to analyse local institutions and developments in municipal governance. This key dimension of economic transition has been largely overlooked by both Bosnian politicians at the state and entity level and by the international mission in Bosnia. Our analysis suggests that finding ways to support the ability of local institutions and new private entrepreneurs to generate local resources is central to helping Bosnia's private sector to emerge.

In post-privatisation Kalesija, we find that the former SOE sector has contracted dramatically. On the other hand, despite severe environmental constraints, the new private sector has already more than made up for the loss of jobs in the former SOEs.

We assess the impact of five years of international donations and the Bosnian privatisation process on Kalesija's economic structure. To analyse the emerging private sector, we examine the patterns of job creation, the constraints posed by poor access to infrastructure and the relationship between local and regional government and private business.

The objective is to discover elements and processes within the new Bosnian economic reality – “hidden rationalities” in the words of development thinker Albert O. Hirschman – which *do* work and could be supported through external assistance. The next steps would be to see if there exist similar rationalities elsewhere in the region and to shape long-term European assistance in this light.

Table 1: Reconstruction aid in Kalesija municipality per sector, 1996-1999

Sector	DM '000	%
Agriculture	960	3.2
Education	3,635	12.0
Energy	7,414	24.5
Health	1,402	4.6
Housing	13,662	45.2
Public buildings	192	0.6
Social support	557	1.8
Telecommunications	103	0.3
Transport	1,661	5.5
Water	626	2.1
Total	DM 30,212	100.0

Source: International Management Group

Privatising Kalesija's SOEs

Socialist development came late to Kalesija. Lacking Partisan connections after the Second World War, the area was considered politically suspect and ignored by the first generation of socialist planners. It was left to pursue largely small-scale, subsistence agriculture. From the 1950s onwards, land was nationalised in successive waves of collectivisation, creating the largest agro-company in Bosnia. Many citizens left Kalesija in search of employment in other parts of Bosnia or abroad. Roughly a third of Kalesija's working population is still employed outside the municipality and another third works abroad. Only in the 1970s did industrial investment commence, principally in metalworking. However, the period of planned development in Kalesija was brief, misdirected and ultimately superficial in result.

In 1990, Kalesija's economy consisted of six major SOEs and a number of smaller ones, including a warehouse, a motel and a few shops and restaurants. Employment in the municipality consisted of 1,750 jobs in SOEs, 659 jobs in public administration and 118 jobs in the private sector (excluding agricultural smallholdings).⁵ The principal SOEs in Kalesija were subsidiaries of other Yugoslav firms. Most of them sold their products to the parent company or another SOE under a long-term supply contract – a so-called *zatvoreni krug* or closed-circle business arrangement – obviating the need for them to engage in marketing or business development.

Privatisation in Kalesija is now substantially complete. Various methods of privatisation have been employed in Bosnia, including cash sales of small companies, public tenders, management and worker buy-out and mass voucher privatisation through investment funds.

By the end of 2001, the economic structure of Kalesija had been entirely transformed. Employment in the socially owned sector has been reduced to 40 percent of its pre-war level, while the private sector has begun gradually to expand. Looking at the fate of the six largest SOEs allows us to assess the impact of privatisation on the local economy.

Unis Tok in Kalesija town was a branch of Pretis, Vogosca, which belonged to Unis Sarajevo. Unis Tok employed 100 workers in the production of railway bearings and buffers, a business which did not survive the war. The company has been bought by a local entrepreneur (*Magnat company*), who has moved his own business – the production of windows and doors – into the Unis Tok premises. The private business subsidises the remaining 72 workers from the former SOE. The company's main attraction to the investor were its idle assets, which include cisterns for gas, diesel and hydraulic oil, reserve water tanks and a thermo-block power station. The investor has no capital available to restart the metalworking business, and no other investor has expressed any interest in doing so.

⁵ JP Zavod za izgradnju i prostorno uredjenje Kalesija, Strategija razvoja opštine Kalesija, Kalesija 1996, p. 45.

- €# **Moda/Kaletex** in Kalesija town was founded in 1987 as a textile factory producing heavy-duty clothing for foreign markets with 330 workers, but went bankrupt in 1990. During the war, the machinery was salvaged and used to produce military uniforms. After the conflict, the company was re-established with a supply contract to the Bosnian army, employing 78 employees. During tender privatisation, four offers were received, including one from a Kalesijan émigré in Switzerland. The contract was awarded to a local businessman, but the tender was successfully challenged in court and must be repeated.
- €# **Kartonaza Tojsici** was founded in 1978 by the Tuzla-based Univerzal company, providing packaging material on long-term supply contracts to Tuzla's chemical giant, Sodaso (of which it eventually became a part), and employing 80 workers. With Sodaso's future uncertain, the company is working at a fraction of its former capacity. It has 49 people on the payroll, half in administration. The company has been bought by a local Kalesija businessman, who hopes to invest in new packaging units for cigarette companies.
- €# **Remont Montaza Tojsici** was a branch of the Tuzla-based company, Remont Montaza, engaged in metal construction across Yugoslavia, particularly in the construction of thermal power stations. The Tojsici branch produced heat exchangers, employing 80 to 120 workers before the war. Remont Montaza has now been bought out by its workers and management, and 50 full-time and 30 occasional workers are employed in the Tojsici plant.
- €# **Plastikal** in Kalesija town was established to produce plastic folders, bottles and canisters for a Yugoslavia-wide market. After the war, it recommenced production but failed to recapture its former markets. In 2000, the company entered into a joint venture with a German company, *Büscherhoff*, using part of Plastikal's facilities to produce specialised packaging for export. The new company, *Plastikal-Büscherhoff*, employs all 85 staff from the old company, and has recently engaged a further 20 part-time workers following the transfer of production from Germany to Kalesija. This has been one of few successful foreign investments in Tuzla canton in the post-war period.
- €# **Spreca** is an agricultural company (*poljoprivredno preduzece*) established with land nationalised in the 1950s and 1960s. With user rights to a total of 3,760 hectares of land (2,300 in Kalesija), it was the largest company of its kind in Bosnia before the war, producing wheat, corn and alfalfa as feed for a herd of 2,000 dairy cattle and employing 300 people. The milk was sold under a long-term supply contract to a dairy in Tuzla for pasteurisation and processing. By the time of privatisation, the company employed 180 workers, although much of its land was uncultivated. The company's assets (although without the land, which remained with the canton) was bought by several privatisation investment funds (PIFs), led by 'Eurofunds' in Tuzla, which plans to reduce the workforce by paying off workers through the sale

of assets while maintaining the most valuable agricultural land in its possession through a concession agreement with the canton.

Privatisation in Kalesija is therefore almost complete. There has been only one successful foreign investment in Kalesija, generating 20 part-time jobs. Employment in former SOEs has been reduced to 637, a loss of more than 60 percent since 1990. The future of a number of these companies continues to be in doubt. Although the purchasers in tender privatisation are obliged by contract to retain or even increase the workforce over three years, they are likely to shed more staff in the future.

Table 2: Employment structure in post-privatisation Kalesija

Population	39,169 ⁶
Working age population	26,385 ⁷
Jobs in present/former SOEs in 1989	1,750
Jobs in present/former SOEs in 2000	637 ⁸
Registered unemployed	4,589 ⁹

A number of SOEs have been purchased merely to secure control of their assets, rather than continue their core business. The primary interest of most of the investors was to obtain land serviced by infrastructure. A former motel, Kosuta, which had been destroyed during the war, was bought by an emigrant worker returning from Switzerland who constructed a new, larger building. In the case of the metal-processing company Unis Tok, a cash payment of less than DM 100,000 secured a space of more than 30,000 m², including gas and water cisterns and a small power station. With the land itself worth DM 20 per square metre, this was enough of a bargain to be worth the cost of maintaining the workforce for three years under the terms of the privatisation contract. The same is true for the agricultural company Spreca, which includes valuable land and buildings near the airport and close to Tuzla. It was not the businesses, but the assets – and particularly the land – which proved of value to the new private sector.

There remains considerable lack of clarity, however, over certain assets, particularly concerning ownership of infrastructure on the land of privatised SOEs. Whereas private companies had to finance their own infrastructure, the infrastructure needs of SOEs were met through development funds and municipal grants. An OHR decree of May 2000 protects land used by SOEs from potential restitution claims from pre-nationalisation owners.¹⁰ However, it remains unclear whether *infrastructure* on that land is owned by the company, the municipality or the utility company.

⁶ Includes 5,733 displaced persons from Republika Srpska (1998 figures).

⁷ Population between 14 and 65, figures from 1998.

⁸ ESI figures from 2000, following SOE privatisation.

⁹ Registered unemployed, end 1999.

¹⁰ “Decision amending the Framework Law on Privatisation of Enterprises and Banks in BiH by introducing a clause protecting investors”, 11 May 2000: www.ohr.int.

The new private sector

While the formerly socially owned sector is unlikely to generate new growth, the fledgling private sector in Kalesija has already created some 1,200 jobs, more than compensating for jobs lost by SOEs. Another 422 are employed in private agriculture, with another few thousand seasonal agricultural workers.

Table 3: Registered full-time employment in Kalesija: 2000

Sector	No. employed	%
Former SOEs	637	21
New private companies	1,200	40
Private agriculture	422	14
Public administration	661	22
Public utilities	96	3
Total	3,016	100

This is a dramatic change in the structure of the local economy. New private businesses now account for 40 percent of official employment in Kalesija, up from 5 percent before the war.

The private sector in Kalesija, as in all of Bosnia, began from a very low base. In the former Yugoslavia, the scope for small private enterprise (*mala privreda*) was severely limited. Republican laws limited the size of private companies in terms of space, number of workers and permitted activities, as well as through prohibitive tax regimes. In tourism, laws defined the number of tables permitted in cafes and restaurants. Car mechanics workshops were limited to eight employees. No private retail outlets were permitted until the late 1980s.

Six years after the war, despite the limited availability of investment capital, the private sector has become the core of Kalesija's new economy, beginning in construction and services and now branching out into production. There are 10 new private companies employing more than 10 workers, including a sawmill, two construction companies, a wholesaler of construction materials, a petrol station, bars and restaurants. These ten companies employ a total of 170 people. In addition, there are a further 626 smaller companies with a total of 1,030 registered workers. The new private sector is therefore double the size of the recently privatised sector. In addition, although exact numbers are not known, estimates suggest that there continue to be several thousand people engaged in private agriculture and itinerant work in the construction industry.

One of the constraints on the new private sector is the pattern of vocational training in Kalesija inherited from the socialist period. Before the war, the local technical school focused on metalworking and agriculture, leaving the local population deficient in the skills required for the new economy. According to the statistics of the local employment bureau, of a total of 4,469 individuals looking for work within the municipality, 2,073 have no qualification and 1,592 have vocational training, with more than 500 in areas such as metalworking. It is notable that there are no local

agro-processing businesses in this rural municipality with a large agricultural sector. Local know-how in this area, especially in product marketing, has never been developed.

Table 4: Employment in Kalesija by size of company

Company employees	No. of enterprises	No. employed
1	461	458
2 - 5	141	408
6 - 10	28	211
11 - 20	9	132
21 - 50	7	210
over 50	4	299
Total	650	1,718

Growth of the private sector in Kalesija is still modest in absolute terms, but sufficient to make up for the loss of employment in the former socially owned sector. It suggests that the common perception of rural Bosnia as a wasteland in terms of private-sector development is not grounded in fact.

Patterns of development

In the former Yugoslavia, the central planning of infrastructure development was conducted purely to favour the SOE sector. There was no tradition of investing in infrastructure to develop rural areas, and certainly not to encourage private-sector growth.

Privatisation has made assets from the SOE sector available to new private enterprise. However, it has not changed the basic problem of lack of access to infrastructure across most of Kalesija. Today, 70 percent of all employment in the municipality is concentrated in just two of the 18 local districts (*mjesne zajednice*), Kalesija town and Tojsici. The cost of serviced land in these areas has risen sharply, up to DM 20 per square metre. The new private sector in Kalesija has been obliged to piggy-back on areas of socialist development in order to gain access to infrastructure.

However, the rest of Kalesija has little or no infrastructural development. There are only two main paved roads, one running from Tuzla to Zvornik (*magistrala*) and the other from Zivinice through Tuzla airport at Dubrave. In much of the municipality, there is no access to a stable supply of clean water. Without these basic services, the costs of establishing new production facilities are prohibitive. Unless the pattern of development becomes more even, these underdeveloped rural areas will continue to generate substantial labour migration.

Table 5: Distribution of employment and unemployment in Kalesija according to mjesna zajednica

Mjesna zajednica	Employed ¹¹ (all sectors)	Unemployed ¹²
Bulatovci	25	95
Dubnica	14	66
Gojcin	46	68
Hrasno Donje	32	222
Jajici	8	142
Jeginov Lug	2	89
Kalesija Centar	1,287	202
Kalesija Gornja	67	312
Kikaci	46	173
Memici	194	329
Miljanovci	82	197
Prnjavor	80	130
Rainci Donje	68	269
Rainci Gornje	185	523
Seljublje	22	137
Tojsici	555	657
Vukovije Donje	206	475
Vukovije Gornje	97	457
Zelina	0	26
Zolje	0	20
Total	3,016	4,589

The recent history of the new private sector in former Yugoslavia is the history of the struggle for access to appropriate business space. As legal restrictions on the private sector were gradually eased in the late 1980s, there was a marked shortage of suitable premises available for private business. As small shops and business began to appear, the private sector rapidly ran out of space.

To address this problem, the ground floor of many socially owned apartment blocks were converted into shopping areas. Some towns developed so-called *zanatski centri* (centres for handicrafts) as shopping malls. Kalesija municipality permitted extensions to various public buildings, such as the cultural centre, which became surrounded by small shops.

Within two years of the war ending, the shortage of space once again became acute. The municipality began to rent out space belonging to SOEs which had not been revived. *Magnat*, a local manufacturer of windows and doors, rented the building of the SOE Somboled, a defunct branch of a Serbian company.

By 1998, the municipality had begun to sell user rights – it is still not legally permitted to sell ownership rights – to municipal land in its two industrial zones, Kalesija town and Tojsici, using the proceeds to develop roads and other

¹¹ All sectors refers to public utilities, former SOEs, private enterprises, administration and farming.

¹² Figures from bureau for unemployment, Kalesija, October 1999.

infrastructure. In both cases, water and electricity supply could be provided relatively easily by drawing on infrastructure which had been developed in socialist times for socially owned enterprises.

One of the keys to further private-sector development is therefore the effectiveness of municipal government in making available key inputs such as land and services. This requires effective co-operation with both the lower levels (local communities) and higher levels (cantonal, entity and state) of government.

The municipality and its local communities

In the former Yugoslavia, municipalities were the basic socio-political community, defined by Tito's chief ideologist Edvard Kardelj as "an integrated social and economic community of all the inhabitants and organisations (including enterprises) in its territory". They were responsible for the self-management of all public functions in their area. To enable them to carry out these functions effectively, the municipalities were progressively expanded in size from the 1950s onwards, until by 1991 they had an average of 42,000 inhabitants. By comparison, in Germany the average size of a municipality is 5,430, in Italy 7,120 and in Slovenia 10,360.

Table 6: Historic development of municipalities in the former Yugoslavia and Bosnia and Herzegovina

Year	Population	Municipalities	Population/ municipality
<i>Former Yugoslavia</i>			
1931	13,982,000	4,645	3,010
1948	15,640,000	8,063	1,940
1953	17,055,000	4,139	4,120
1961	18,613,000	774	24,047
1991	22,424,000	533	42,071
<i>Bosnia & Herzegovina</i>			
1991	4,377,000	109	40,156
2001	est. 3,700,000	149	24,832

Once municipalities had become so large, they were no longer able to play an effective local self-government role. Local functions were progressively assumed by local communities (*mjesne zajednice* - MZ), which exercised authority delegated by the municipality. Outside the major urban centres, the system of *mjesne zajednice* is essentially voluntaristic, with no real administrative capacity. Without fixed revenues or responsibilities, their effectiveness depends on the initiative of the local inhabitants, who might be highly energetic or entirely passive. As one Slovenian analyst commented shortly before the collapse of Yugoslavia: "The existing commune cannot function satisfactorily as a state apparatus, for it is too amateurish, too chaotic and voluntaristic, insufficiently co-ordinated with higher administration and not responsible enough for the execution of important duties."

Each MZ has a local council and is constituted as a legal entity, enabling it to hold user rights over municipal property. The MZs in Kalesija each have a small office, usually in the *citaonica* (reading room), used traditionally for communication between citizens. Every MZ has a *pecat* (stamp) and a statute adopted by the MZ council of 5 to 11 members, who are volunteers. The election of MZ councils is not regulated by municipal statute – some representatives are elected by a *zbor* (public meeting), others are appointed by the parties represented in the municipal council – and many important legal issues concerning their constitution are unresolved. MZ boundaries are determined by local referendum and written into municipal law. The municipality employs officials responsible for MZs.

For example, the local community of Tojsici on the north-western boundary of Kalesija consists of 2 *naselje* (populated places), 16 *zaseoci* (parts of *naselje*), an estimated 1,560 houses and 5,420 people, making it as large as a municipality in many West European countries. The municipality has transferred to MZ Tojsici the right to use certain buildings (a cultural centre, reading room and kindergarten) as well as to receive rent from the local market, yielding an annual income of approximately DM 100,000 which is spent on maintaining the local football club and in contributions to local road and water projects. Villages within the local community are represented in the council according to a formula which reflects the distribution of wealth and political power in the area.

The remnants of Yugoslav self-management

Across the former Yugoslavia, municipal services are provided by public companies (*javno preduzece*) or local administrative directorates (*javna uprava*), responsible for a range of state functions. In Kalesija, these services include a veterinary clinic, social centre, public library, management of public buildings and so on. Each municipal company is supervised by a management board (*upravni odbor*) of five representatives, who are political appointees.

In the socialist past, public services were provided through a complex system of bilateral agreements between suppliers and consumers. Institutions of the socialist state such as schools, hospitals, SOEs and local communities communicated with citizens through a unique institutional network known as “self-management interest communities” (*samoupravne interesne zajednice* – SIZ). SIZs were responsible for developing agreements regulating the supply of and payment for public services. Their influence came from control over funds used for the development of municipal services. Over time, the SIZs largely replaced the regulatory role of the state in these fields.

Under this system, municipal services were funded not through taxation and public spending, but through ‘voluntary’ contributions from socially owned enterprises, agreed in direct negotiations and written into legally enforceable contracts. This mechanism for municipal service delivery, which lasted for almost two decades, in fact required constant political intervention in order to function. It tended to multiply the layers of bureaucracy and distort municipal budgets, rendering co-ordination

impossible and ultimately leading to stagnation in the development of municipal services.

In Kalesija before the war six SIZs were active:

1. *SIZ for health protection*: responsible for the public health of workers, pensioners, teachers and farmers, and on a voluntary basis with private craftsmen and workers abroad.
2. *SIZ for flats and public services, land development and local roads*: responsible for the maintenance of the social housing funds, waste management and cleaning of public spaces in the municipality, urban planning and the control of available land for development, as well as the maintenance of local and uncategorized roads in the municipality.
3. *SIZ for culture and sports*: managed cultural institutions such as libraries and cinemas, and arranged official and cultural events, including theatre performances. This SIZ also supervised sports clubs in the municipality.
4. *SIZ for employment*: responsible for the registration of the unemployed and employment services with local companies.. This SIZ has been transformed into a local office of the cantonal service for employment, under the Federation Employment Bureau.
5. *SIZ for social care and child protection*: dealt with orphans, handicapped children, other vulnerable groups and the elderly, as well as with victims of war, working closely with the communal social centre. The SIZ no longer exists, but the communal centre for social work and care of vulnerable individuals still operates. Those employed by the centre are paid from the municipal budget, whereas the needs of social care recipients are financed from the cantonal budget.
6. *SIZ for pension and invalids insurance*: this SIZ has become the local office for Federation pensions and invalids insurance.

Shortly before the war, the SIZs were abolished and united in a municipal fund. During the war the fund was stripped of its reputedly considerable resources and collapsed.

The post-socialist utility crisis

Because SOEs were traditionally the main source of contributions to the “self-management interest communities”, they were able to direct infrastructure investment. Once the SOE sector began to collapse, the municipal service providers were starved of funds and forced to reduce their services drastically.

Within this system, there was no capacity to develop municipal infrastructure in order to service a new private sector, to redistribute resources in favour of underdeveloped

areas, or to manage municipal assets as a capital resource. These limitations have not yet been overcome.

The problems of the municipal company *Komunalac* are illustrative. *Komunalac* is responsible for a range of municipal services, including waste disposal, cleaning and gardening of public spaces, maintaining a small central heating unit in Kalesija town, and servicing the water network and an old sewage treatment plant. It performs these tasks in a basic and haphazard way, with little mechanisation. Despite being the only waste-disposal company in the municipality, it is only paid for its services by 800 of the municipality's 10,000 households. Not surprisingly, Kalesija suffers from a growing problem of unplanned garbage dumps.

With appropriate attention to cost recovery and enhancing services, the waste management situation could be improved. But since the dissolution of the responsible SIZ, no reliable system of collecting fees from the company's customers has emerged. There is no legal obligation for households or enterprises to conclude service contracts with *Komunalac*. During the summer of 2001, the company was partly privatised in a public offering of shares. The municipality of Kalesija retained 51 percent, six individuals from Kalesija (including the present mayor) took 23 percent and a privatisation investment fund from Sarajevo bought 26 percent. The public offering of shares did not provide any fresh capital to the company. As a result, the corporate or institutional basis for resolving the waste-disposal problem is yet to be established.

Kalesija has similar problems with other public services. The municipality lacks a reliable water network for much of its territory, and outside the two local networks in Tojsici and Kalesija, the citizens supply themselves from wells and open water. A new network was built in Kalesija town just before the war, but was damaged beyond the scope of *Komunalac* to repair.

In 1999-2000, the Norwegian government carried out a water project in the municipality valued at DM 3.6 million. Water pipes were laid to service the major population centres in the municipality, but 5,000 individual households still need to be connected. There is also a serious problem with water purity. The main water source in the area is at the lowest point of the valley, close to the Spreca river. Untreated sewage is being released straight into the river, and risks polluting the drinking water.

Leakage from old and dilapidated sections of the water network causes interruptions to the water supply. This causes constraints on the development of any form of production relying on the steady supply of clean water, such as agro-processing or textile industries.

In the past, a Tuzla-based engineering company was responsible for planning, developing and building water networks, *Komunalac* carried out maintenance, the municipality 'owned' the networks and the SIZ was responsible for fee collection. Today, fewer than half of the connected households pay their water bills regularly. In its present condition, the municipality is unable to cover even the recurrent costs of the water system, let alone pay for its repair and expansion.

In order to avoid taking on the debt, excess workforce and managerial weaknesses of Komunalac, the municipal council of Kalesija has recently established a new municipal waterworks company, *J.P. Vodovod i kanalizacija*, drawing on the Norwegian donation. In Germany, for example, water and waste fees are set by the municipality, which in turn controls the prices which private service providers are permitted to charge. The collection of fees is guaranteed by the municipality from its own budget.

Network expansion through private initiative

In addition to the maintenance of assets and the provision of public services, the municipality faces the challenge of funding the construction and expansion of its infrastructure. To provide a long-term economic basis for infrastructure development, it needs to generate resources and capital from its own citizens .

During the socialist period, revenue for construction could be raised by imposing ‘voluntary contributions’ on the workers in SOEs, deducted directly from their salaries. Individuals working abroad were obliged to pay the fees on their return visits, or else face confiscation of their passports. These local contributions were nonetheless insufficient to finance large-scale infrastructure development. The contributions were therefore collected in republican or federal development funds, from which they were distributed for projects on the basis of priorities – in a manner not unlike the distribution of international reconstruction and development aid today. It was left up to the SOEs to apply for these funds. As development concentrated on urban areas, and within those on social housing projects and SOEs, most of the population across the former Yugoslavia was left without any co-ordinated development schemes for water, telephone and, in the case of remote areas, even electricity networks.

With these socialist mechanisms now inoperative, municipalities are obliged to use their own initiative to identify new sources of development funds. In 1999, the municipality of Kalesija undertook a project to improve the road network by linking villages to the main roads and, for the first time in Kalesija’s history, providing paved roads within the city. Of the original anticipated cost of DM 1 million, half would be covered by a loan from Tuzla Canton and the other half through voluntary contributions from citizens. Following a crisis in the cantonal budget, only DM 200,000 was made available from the Canton. However, interest from citizens in the project was so high that the local communities were able in a short time to raise more than DM 1.8 million in voluntary contributions, *without using any formal revenue-raising powers*. The municipality covered the remaining costs through the lease of municipal land, credits and from its annual budget. By mobilising local resources, a total of DM 3.7 million was invested in a total of 44 km of improved roads.

Another example of effective local resource use was the expansion of the local telephone network. In 1997, three MZs in Kalesija – Hrasno, Kikaci and Seljublje – began to collect money from their citizens, hired a construction company and rebuilt

and extended their local telephone network. To launch this initiative, the MZ presidents called a *zbor gradjana* (citizens assembly). People were invited seven days before the event by posters and letters delivered to every house, as foreseen in the statutes of the MZs. After approving the project, the telecommunications company PTT provided the technical plans. The *zbor* elected a *gradevinski odbor* (construction board), and the project was implemented by a private company without the assistance of the municipality or any investment by PTT.

The local communities also determined the contributions from different categories of people. Of the total cost of DM 601,200, an ordinary family paid DM 590 for connection, together with a tax of DM 154 to the PTT. War invalids and families of fallen soldiers paid a lower contribution of DM 400, without the connection tax. In addition, each family was expected to pay for or carry out the digging of 50 meters of trench for laying cables.

The success of this project attracted the interest of other local communities and the municipality became involved in co-ordinating the process. In the second phase, another 1,377 new connections and 888 reconnections were completed, at a total cost of DM 878,340.

As the network expanded, the telephone exchange in Tojsici proved to be outdated. The mayor requested PTT to upgrade the facility, but without success. In the end, only his threat to turn to the Banja Luka PTT for assistance – a credible threat given Kalesija's position on the inter-entity boundary line – spurred PTT Sarajevo into action.

At one level, this method of local infrastructure development has been remarkably successful, illustrating that there is both considerable initiative and significant resources available at local level. On other hand, the process has left some crucial issues unresolved, particularly concerning ownership of assets. PTT Sarajevo has claimed ownership of the locally-funded network, while the mayor has offered to sell it to PTT on behalf of the citizens. Local telephone exchanges are located in the public reading room in Vukovije Donje, in a private house in Memici and in the youth centre in Rainic Gornje, but there is no formal arrangement for the use of these premises. Clearly, these are some basic issues in need of resolution.

Municipal assets and dead capital

Local infrastructure is not the only area in need of better governance and clearer property title. The municipality has other potentially valuable assets, such as land and forests, which are essential to economic development.

Kalesija recently carried out an inventory of its land and was surprised to find that it owned 810 hectares of land, or 4 percent of the municipality. In 2000, lease of land and commercial premises raised DM 830,000, or a third of the municipal budget.

The municipality has the potential to generate capital for its development by developing its land and selling or leasing it at a premium. However, it is hindered by

the pre-war legal framework governing socially owned land, which allows it to allocate only user rights to private companies and for certain public purposes. The legislation governing land use is in urgent need of reform.

The municipality has only recently begun to plan effectively for urban and commercial development, which is not well regulated. Because of this, up to 50 percent of all new housing construction is illegal, straining infrastructure and increasing the cost of future integration by extending urban development into unplanned areas.

The 480 hectares of forest owned by the municipality are also a potentially valuable resources. At the turn of the 20th century, the Austrians had built forest roads, narrow-gauge railways and cable cars to facilitate logging of highland forests, but these fell into disuse during the communist period. Without these access routes, it is impossible to manage the forests in a profitable and environmentally sustainable fashion. Strategic investment in forestry could generate further municipal revenues. However, it is a cantonal company that holds the user rights to state forests and is responsible for their care and exploitation. The municipality therefore has little scope to develop this resource, even if the cantonal forestry company fails to do so.

Some conclusions

This study of economic processes underway in Kalesija indicates the key role which local government must play in economic development. To overcome the chronic underdevelopment typical of rural regions in Bosnia, municipalities must learn to use their resources to generate capital investment in the infrastructure and local services required by the new private sector. They must also play an active role in assessing and anticipating private-sector needs, so as to plan adequately for land use and infrastructure development.

In the case of Kalesija, the present municipal leadership shows every willingness to take on these new responsibilities. However, their capacity remains limited. Planning for the private sector involves a major institutional shift for Bosnia's municipalities, from the role of largely passive recipient of investment which was characteristic of the old system, towards an active role which is responsive to the needs of the community. It means treating existing infrastructure and public land as a capital resource to fund development. It means overhauling the corporate governance of municipal services, allowing for effective cost recovery and re-investment. It also requires much more even-handed treatment of the entire territory and population of the municipality. Instead of following the tendency of socialist planners to pursue one or two islands of development, according to the needs of socially owned industry, it means giving the entire municipality the opportunity to participate in the process of development.

The starting point for this process of transition in Kalesija has been the production of a new area plan (*prostorni plan*) in late 2001 and early 2002. In the Federation, the production of area plans is a cantonal competence, while municipalities produce a smaller-scale urban plan (*urbanisticki plan*). Across the country, many of the existing area plans are twenty years or more out of date. In Kalesija, the municipality took the

initiative to produce a new version and to make it publicly available to its citizens. As there was no experience within the municipality to carry out such a planning exercise, the municipality received external assistance from the newly founded Technical University of Brandenburg in Cottbus, Germany.

Effective development planning at municipal level has the following features:

1. It abandons socialist-derived preconceptions about economic and urban development in favour of a thorough collection of information about the population and its needs, and specifically about the needs of the new private sector. An area plan must begin from a detailed study of the situation prevailing on the ground.
2. Planning begins from areas which are already populated and tried to maximise existing infrastructure. If this is done effectively, it reduces development costs.
3. It must make a realistic assessment of the construction needs in the municipality. Socialist planning in Kalesija only anticipated construction in the two principle settlements, Kalesija town and Tojsici. Because the needs of the rest of the population were not provided for, this encouraged 'wild construction'. This wild urbanisation spread along the main roads, causing uneconomic use of space, raising infrastructure costs and damaging both the ecological and agricultural profile of the rural areas. To prevent wild construction, area plans must allow citizens to satisfy their legitimate needs.
4. Effective planning is intimately connected with the quality of local democracy. In the past planning has been an inscrutable process, hidden from the public eye. To create an effective balance between urban needs, the agricultural economy and nature, there has to be a mechanism by which the needs of citizens can be expressed and aggregated.

Another vital element of the developmental process missing in Bosnia is a clear and effective system of private property rights. The combination of socialism and massive population displacement has left rural Bosnia with a nightmare of unclear, undocumented and contradictory property rights. The uncertain nature of user rights to formerly socially owned property, unresolved restitution claims by pre-nationalisation owners, the collapse of agro-industrial combines and agricultural co-operatives, the incomplete privatisation of socially-owned enterprises and a half century of informal and unregistered property transactions have created an effective legal vacuum in this vital area.

This gives rise to a whole series of complex problems.

- Š' First, in an environment of insecurity of land tenure, different authorities are competing to control land. The municipality and the canton are each making claims over the land of the state farm Spreca, while some of the land has been repossessed by pre-nationalisation owners and other parts remain idle. Legal

uncertainty has a negative effect on the quality of local governance, encouraging predatory behaviour.

- Š· Second, confusion over title artificially reduces the amount of land on the market, driving up prices.
- Š· Third, the failure to enforce the division between agricultural and urban land means that all land comes to be valued as potential construction land. This drives up the price, undermining the economic basis of agriculture.
- Š· Fourth, the question of the ownership of key elements of the public infrastructure networks remains unresolved, inhibiting development and cost recovery.
- Š· Fifth, until such time as the confusion over land is resolved and a proper registration system established, it will be impossible to implement an effective property tax, which is potentially the most important source of municipal revenue.

It is therefore essential to begin the process of documenting and resolving the problems of land title, a process which will involve both legislative reform at entity level and a great deal of hard work at local level.

*Annex**Table A1: The former SOE sector in Kalesija*

Company	Transformation	Employed 1990	Employed 2000
Plastikal	Joint venture with German company Büscherhoff; remainder yet to be privatised.	85	85
Unis TOK	Sold to a local entrepreneur through tender privatisation and converted to new business.	100	72
Kartonaza	Sold to a local entrepreneur through tender privatisation.	85	64
Remont Montaza	Management/worker buy-out through direct negotiations.	120	50 + 30 casual
Kaletex	Tender privatisation cancelled by court for unfairness; to be repeated.	330	78
Spreca p.p.	Bought by PIFs through public share-offering	300	180
ZZ Vocar	Converted to semi-private co-operative	35	17

Table A2: New companies in Kalesija employing more than 10 workers

Enterprise	Mjesna zajednica	No. of workers	Activity
Pilana Fati	Kikaci	12	Sawmill
Anker	Prnjavor	12	Construction
Kalesija Promet	Prnjavor	13	Wholesale and storage of construction material
Binder	Tuzla	15	Construction
Avdo Imamovi	Vukovije Donje	15	Bar, restaurant and guesthouse/nightclub
Polo	Tojsici	16	Petrol station
Magnat	Kalesija C.	20	Production of windows and doors
Bijeljevac-Tours Kalesija	Kalesija C.	22	Local bus transport
Zemljoradnicka Zadruga Vo ar	Kalesija C.	22	Private co-operative trading in fruit and vegetables
Polo Junior	Prnjavor	23	Petrol station, Car mechanic, restaurant and motel (expansion of Polo Tojsici)