Summary of the Series Evaluation
“Tax systems and revenue authorities in developing and transition countries as an instrument of poverty reduction”
Field Study “Advice on the establishment of a standardised tax system for Bosnia and Herzegovina”

The opinions presented in this study are those of independent external experts
German development cooperation with Bosnia and Herzegovina

Summary of the evaluation

“Advice on the establishment of a standardised tax system for Bosnia and Herzegovina”

Summary

Under the Stability Pact for South-Eastern Europe, the Federal Republic of Germany has been helping Bosnia and Herzegovina with the reform of direct taxation since June 2000. The first phase will come to an end in June 2003. A subsequent phase is planned for a period up to June 2004. As the measure began at short notice, no detailed planning process took place before the project began. For this reason, planning activities and implementation activities took place in parallel right from the beginning and were interlinked.

The aim of the evaluation was to arrive at conclusions and recommendations on whether taxation systems and revenue authorities in developing and transition countries can be a useful focus for development co-operation. All development and sector-specific aspects of the project were therefore evaluated (classic evaluation). Given the political circumstances in Bosnia and Herzegovina (BiH), the project does, however, also offer a special chance to investigate whether the provision of advice on tax systems plays, or can play, a key role in the establishment of a new state in political entities that have emerged from the collapse of a former nation state. For this reason, the evaluation focused on the viability of the project concept in these special political circumstances.

Findings

The project operated within very difficult conditions. Seven years on from the Dayton Peace Agreement, the inhabitants of the two entities – the Bosniak-Croat Federation of Bosnia and Herzegovina and the Republika Srpska – still do not identify with the overall state. This is compounded by the tangled web of constitutional structures provided for under the Dayton accord. The result is a state of 4 million inhabitants with 14 different governments and parliaments. Added to these is the “Office of the High Representative” (OHR), established by the international community to oversee implementation of the Dayton agreement. The OHR has wide-ranging political and legislative powers, which it has indeed used in the past.

The business sector is facing the double challenge of transformation and repairing the damage done by war.

The project was to be implemented immediately as part of the Stability Pact for South-Eastern Europe. The task in June 2000 was to sketch out a project and begin implementing it straight away without any intensive preparation phase. Planning took place under the particular circumstances in BiH, with the reform agenda very much determined by the international community of nations and donors. The need for a project of this type was therefore first formulated by the OHR and the members of the international donor community involved in the field of taxation in Bosnia and Herzegovina. It was only at the second stage, so to speak, that the partners were involved, when planning workshops were held in autumn 2000. The planning process was only participatory to a very limited extent. Whilst the German side and the local level were agreed that assistance in the field of income tax reform was desirable, there is no real agreement on an expressly standardised taxation system. There is also resistance towards the specific taxation model proposed by the project.

Reform of the income tax system has always been the clear focus of the project. All other outcomes and activities were subordinate to this. Given the time at which the project was being launched and the positive experience gained with an earlier tax project in Croatia, the international donors, the partners and also the BMZ and GTZ decided right from the beginning
to adopt the taxation model drawn up by Prof. Manfred Rose (Heidelberg University). Using this as a basis, a working party made up of representatives from both entities was to start developing a uniform draft law. Yet it was not long until, in autumn 2001, the Republika Srpska implemented its own reform of the income tax system using a different model. Whilst the representatives of the Bosniak-Croat Federation remain in the working party, the staff from the Ministry of Finance who had been involved in the activities have not given their backing to the draft that has now been produced. In the light of this, the newly appointed Minister of Finance announced that he would be putting forward his own draft law by 1 July 2003. In the independent multi-ethnic district of Brcko (approximately 70,000 inhabitants), which became involved in the work in 2002, the draft is due to be introduced in 2003/2004.

Recommendations

The window of opportunity for reforming the income tax system in the Federation is likely to remain only until the end of 2003, since in 2004 capacities will be fully stretched by the introduction of the reform of value added tax, to which the OHR attaches priority, and the organisational input associated with it. If the Ministry of Finance’s announced draft is available by September at the latest, the project should support the process of implementation. If not, the project should be terminated.

If the Ministry so wishes, the project should support the development of the draft. If it becomes clear that the Ministry wishes to implement a taxation model other than the one that has so far been proposed, the project should give up the idea of this model and provide constructive support for the partner’s own plans, possibly bringing in a new short-term expert, provided these plans lead to an improvement in income tax law.

A plan of operation should be developed as quickly as possible with the partners in the Federation, the Republika Srpska (RS) and Brcko. Based on this, a sound system of monitoring and evaluation should be introduced that ties the next steps in the process to clear indicators. It should, however, be borne in mind that the project may possibly only run until mid-2004. The project should therefore concentrate initially within the Federation on improving communication with the Ministry of Finance, particularly at working level. So as to avoid any further communication problems, this should be done by the long-term expert himself rather than other project staff or short-term experts.

Should the district of Brcko conduct the reform of the income tax system in 2003 or at the beginning of 2004, the tax authority should be helped with the technical implementation of the legislation, if it so wishes.

Contact should also be established once more with RS on the issue of income tax and inquiries made as to the demand that exists. It may then emerge that the best option is to return to the original outcome of “improving communication with tax-payers”. It has been indicated that advice is needed in particular on a tax assessment model.

If a relevant draft law is produced in the Federation by mid-2003 and adopted in 2003, an assessment should be made as to whether the project should be extended beyond June 2004. The aim of a standardised taxation system should be dropped.

An additional factor is that the Federation’s decision is not entirely independent from the opinion of the OHR. If the project so wishes, the BMZ should use political channels to impress on the international community that Germany desires and actively supports this project.

Conclusions

Tax reform projects can certainly contribute to the process of consolidating the state. If, however, a project has no means of control over the actual implementation of the reform, account has to be taken of the environment in which the project is operating in terms of the political climate and civil society. For BiH this means that reforms should be aimed at entity level only, because state-level consolidation can only be supported indirectly by trying to
establish co-operation within working groups – as the project did – whilst at the same time accepting the different views of individual groups with regard to the reform of the taxation system, provided they represent a step in the right direction – something the project did not do. Consolidation of the state does not necessarily or solely mean harmonising and standardising a particular area of law. A legal framework that is diverse whilst also building on the existing historical legacy and successful experience and that can be easily communicated to the public and implemented can, at micro level, have a positive influence on the citizens’ attitude towards the state and strengthen their confidence in state structures.

For a number of reasons, it is advisable to put forward a model at the beginning of the project as a basis for discussion, thus cutting down the length of time needed for design and decision-making. Care should, at the same time, be taken to ensure that it is a plan that can be adapted to local wishes. In the field of income tax, there is a broad consensus as to what the features of taxation law should be. It would therefore appear sensible to develop a broad outline for a “consensus taxation model” and make it the general starting point of tax systems projects.

**Basic data:****

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<th>Description</th>
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<tr>
<td>End of phase 1:</td>
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<td>End of phase 2:</td>
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