

CAUSES OF SLOW AND INEFFICIENT TRANSITION OF ECONOMY OF BOSNIA AND HERZEGOVINA AND POSSIBILITIES FOR ITS IMPROVEMENT

*Rajko Tomaš*¹

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Summary

In this paper, we are investigating the causes of slow and inefficient transition in BiH as well as possibilities for its improvement. In the past seventeen years, the international community has been the strongest integrative power of BiH. Although democratization and market economy are generally emphasized as peace strengthening factors, the market has not succeeded in absorbing resources nor has it provided economic self-sustainability, and democracy has not established institutions to match economic, social and political problems in BiH. This has led to the failure of the fundamental concept of transition set by the international community. The international community should demonstrate its readiness to let domestic politicians take responsibility for the current state of affairs in BiH. Only when domestic politicians have completely taken over responsibility can they become aware of all advantages and all shortcomings of the relationships in BiH established by the Dayton Accord and establish the needed political consensus about the future of BiH. This consensus is the imperative precondition for achieving the functionality of BiH, redrafting the Constitution, establishing a new economic system, conducting a new cycle of economic reforms and accelerating transition.

Key words: transition, market economy, democratization, economic reforms, new economic system.

¹ Rajko Tomaš, Ph.D., Full Professor, University of Banja Luka, Faculty of Economics, Bosnia and Herzegovina. E-mail: rajko.tomas@efbl.org

1. INTRODUCTION

Compared with the postwar circumstances, initial changes towards the establishment of a market economy and democratic institutions have been made in Bosnia and Herzegovina (BiH) in the past sixteen years. Assessments of BiH's postwar development, made by the academic community and politicians, have been unbalanced, and sometimes contradictory and confusing (Fischer, 2006). By comparing different indicators for transition countries, it is easy to notice that transition in BiH has been slower in almost all fields. What causes most concern is the slow progress in the improvement of public administration, the elimination of systemic corruption, the increase in efficiency of macroeconomic policy, the improvement of microeconomic policy, the establishment of rule of law and spreading economic freedoms (Freedom House, 2011). Therefore, the following question is justifiable: Why has BiH not achieved better results in the economic sphere, especially because, as a small transition country, it has been privileged to receive significant international economic and technical aid? Has the Dayton Peace Accord² been economically efficient in the past 17 years? Has the wave of transition only "splashed against" BiH in passing at the end of the transition paradigm (Carothers, 2002)? Can transition in BiH be accelerated and improved?

Transition in BiH, initiated in late 1980's, was thwarted by the war that was the result of disintegration of the socialist Yugoslavia. The privatization process was stopped and social property was "turned into state-owned". However, the freedom of entrepreneurship, established in late 1980's, was not suspended. For the duration of the war (1992-1995), the administrative and political control of the economy was stepped up. When the war ended (in November 1995), BiH demonstrated an empowered concept of state entrepreneurship established on the grounds of the totality of state-owned property in enterprises and banks, and, frequently, with non-transparent ties with private companies which were most developed in the trade and service sectors. State ownership became the basis for bureaucratic and voluntaristic management of the economy, politicization and socialization of economic relations, political and bureaucratic reapportionment between the economy and the state as well as within the economy, inefficiency in using resources, unattractiveness for expanding the economic partnership, limiting entrepreneurial and economic freedoms and so on. Resources were seized and isolated from the impact of the market system by national bureaucracies, group-ownership interests, corrupted political lobbies, criminal cartels and the inertia of the socialist system (Tomaš, 2008). In connection with this, both market and regulatory institutions were insufficiently developed, and were subordinated to the interests of resource controlling centers.

² *The General Framework Agreement for Peace in Bosnia and Herzegovina* is more recognized in public as the *Dayton Peace Accord*. It was signed in the Wright Patterson Air Force Base near Dayton, American state of Ohio, on 21st November 1995. The Accord was officially signed in Paris, on 14th December 1995. Its signing formally ended the war waged in Bosnia and Herzegovina (1992-1995).

Dayton Peace Accord was an effort to establish the fundamental parameters of the transition process in BiH and, on that basis, to eliminate, isolate or transform contradictions that had provoked the war. It includes the establishment of a market economy with a uniform BiH market. This is reflected throughout the following provisions: the freedom of movement of people, capital, goods and services (Article 1 of the Constitution); uniform currency and uniform monetary policy (Article 7 of the Constitution); centralized foreign trade policy (Article 3 of the Constitution); centralized customs policy (Article 3 of the Constitution); centralized balance of payments (Article 3 of the Constitution)³.

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Exposed to strong pressures made by the international community, BiH formally opted for the development of modern market institutions, privatization and ownership protection, as well as the execution of contractual obligations. It also opted for accepting risks of doing business, business morale and discipline. The goal was to accelerate movement towards a market economy through (WB, EC&EBRD, 1996): (a) the establishment of a stimulating business environment for existing private businesses and new ones, (b) the privatization of state capital in enterprises and banks, (c) the development of a disciplined and competitive financial sector, and (d) the liberalization of the market and opening up to economic cooperation and integrations.

Irrespective of any differences in BiH, a consensus has been established that market economy and strong private sector are preconditions for a fast economic recovery and continuous growth. Together with significant international support, BiH has made progress in all fields in the past 17 years. However, progress is far below expectations of the population and their real needs.

2. UNSATISFACTORY RESULTS OF TRANSITION IN BOSNIA AND HERZEGOVINA

BiH's economy is burdened with serious structural problems in the economy and the lack of strategy and policy of using resources, which is directly manifested in the creation of a small social product, very low efficiency in using resources and an uneconomic valuation of the contribution of resources to GDP generation. The net labor price⁴ is low; however, by means of relatively high tax and salary contributions rates⁵, it has artificially been raised to a higher level in relation to labor demand and offer on the market. Because of differences in their social, pension and educational

³ The Dayton Peace Accord includes the Constitution of Bosnia and Herzegovina as its integral part, which is not a usual practice in international peace accords.

⁴ The average net salary in BiH paid in December 2012 was 831 KM (425 Euros) (Source: The Agency for Statistics of B&H, Communiqué No. 12, as of 21th February 2013).

⁵ In the BiH Federation, the total rate of the contribution to the gross salary is 41.5%, and in the Republic of Srpska 33%.

systems, the entities⁶ have not established a uniform labor market (Stojanov, 2009:16). Unemployment is high.⁷ Salaries are increasing faster than labor productivity. The real interest rate on loans is higher than in the eurozone, loan insurances are frequently more rigorous, and borrowing procedures are more complicated... The prices and costs of doing business in BiH are growing faster than in the eurozone although the convertible mark is fixedly pegged to the euro.⁸ The Central Bank of BiH functions as the currency board⁹, providing stable prices. However, in conditions of a high and continuous deficit in the balance of payments, the real foreign exchange rate of the domestic currency is overestimated and discourages export. Trade liberalization, without the implementation of appropriate regulations and incentives for domestic production, has additionally destroyed domestic production and degraded available resources. The subsistence of the population has become dependent on imports. Trade balance deficit has a high share in GDP¹⁰, which makes social and economic sustainability increasingly dependent on imports. The balance of payments current account deficit is high¹¹. Poverty rate is one of the highest in South-East Europe,¹² and chances of eliminating poverty are very small. The purchasing power of the population in BiH represents no more than just around 30% of the European Union's average. Public spending has a high share in total GDP.¹³ Public debt is growing at a quick pace¹⁴. Net direct foreign investments in BiH are in a continuous fall¹⁵, thus influencing reduced spending. There are 90 pensioners and 77 unemployed persons for every 100 employed

⁶ The Dayton Peace Accord established a new political and legal organization of BiH. BiH kept the status of an internationally acknowledged state comprising two entities: the Federation of Bosnia and Herzegovina (51% of the territory), and the Republic of Srpska (49% of the territory).

⁷ In December 2011, the number of unemployed persons in BiH was 536,728. In November 2011, the unemployment rate in BiH, according to the ILO definition, was 27.6%. (Source: Survey on Workforce, Thematic Bulletin No. 10, Agency for Statistics of B&H, p. 25).

⁸ The annual inflation rate in BiH in 2011 was 3.1%, and in the Euro zone 2.7%. (Source: Communiqué of the Agency for Statistics of BiH, No. 12, 25th January 2012, and Euroindicators 30/2012, Eurostat, 29th February 2012).

⁹ The "convertible mark" domestic currency is legally bound to the euro at a fixed rate: 1 euro = 1.95583 convertible marks.

¹⁰ A high trade balance deficit has been maintained throughout BiH's independence. In late 2011, the trade balance deficit was -7.3 billion KM or around 28.9% of GDP. However, because of a decrease in spending, imports contracted. (Source: Statistics of Commodity Exchange with Foreign Countries, Communiqué No. 12, 25th January 2012, Agency for Statistics of BiH).

¹¹ Because of reduction in imports and spending under the influence of the crisis, there is a decrease in the relative significance of the current account deficit. In 2008, the current account deficit represented 14.4% of GDP, and in 2011, it was around 5.5%. (*IMF Country Report No. 10/348*).

¹² There are no official assessments of the extent of poverty in BiH. According to the assessments of the World Bank for 2011, 18% of BiH's population are below the poverty line (less than 2.5 US\$ per day), and even 48% of the population are on the brim of poverty (between 2.5 and 5 US\$).

¹³ The consolidated public expenses of BiH represent on average around 50% of the gross domestic product in the time period from 2008 to 2011. According to the findings of the IMF, the budget of the general government of BiH generated a deficit of around 4.5% of the gross domestic product in 2011 (*IMF Country Report No. 10/348*).

¹⁴ According to the estimation of the IMF, the public debt of BiH in the year 2012 will reach 60% of GDP, whereas it was 48% in 2008. (*IMF Country Report No. 10/348*).

¹⁵ The value of net direct foreign investments in BiH was 12.94% of GDP in 2007, only to fall to only 0.1% of GDP in 2010 (*Financial Sector Benchmarking System, Bosnia and Herzegovina High Level Financial Sector Overview, Partners for Financial Stability, October 2011*).

workers. The GDP per capita was 3392 euro in 2011, and, according to the purchasing power parity, it is the lowest in South-East Europe. Social policy has been imposed on enterprises as a parameter of doing business, which is not typical for a large number of countries. This significantly decreases the competitiveness of an enterprise.

During the war, and partly after the war, the rule of law was devastated in BiH. It is obvious that the authorities did not want to consolidate the rule of law, because of their own interests. Because of its inefficiency, BiH is widely perceived as a country of corruption, crime, gray economy, unprotected economic freedoms, human rights breaches, limitations to the freedom of the media.

The majority of the reform processes in BiH were initiated, implemented and financed by different international organizations. Also, a lot of reform processes were created in order to fulfill the conditions for joining CEFTA, the EU and NATO. There is almost no authentic reform initiated and implemented by the BiH authorities. The international community has a vast, if not decisive, influence on political and economic issues in BiH (Donais and Pickel, 2003:6). Such a manner of reforming the economic and social system in BiH has not created sufficient responsibility on the part of domestic authorities for the implementation of reforms and monitoring their results. Also, those processes have often lacked harmonized solutions and coordinated implementation, thus bringing into surface unequal conditions in the functioning of the economy and implementation of human rights. BiH had one of the most expensive transition processes. However, the assessment of relevant international institutions is that the reached level of reform implementation in the economy and society is still not satisfactory to term its transition successful. According to the ease of conducting business operations, BiH was ranked 125th country out of 183 in 2012 (WB&IFC, 2011). According to the value of the economic freedom index in 2012, BiH is the 104th country among 184, and belongs to the group of countries with a prevalently limited economic freedom (The Heritage Foundation, 2011). In 2011-2012, according to the global competitiveness index, BiH was ranked 100th country among 142 (World Economic Forum, 2011). In late 2011, the international agency Standard & Poor's lowered BiH's sovereign credit rating from "B+" to "B" with a negative outlook. BiH also has the "B2" credit rating with negative prospects, according to Moody's Investors Service. Out of 183 analyzed countries, BiH was 91st according to the corruption perception index (Transparency International's, 2011). For years, it has been a country with the highest corruption perception in South-East Europe.

In all countries of the Western Balkans, transition has been slow. According to some economists, it has been very unsuccessful (B. Horvat, 2002; M. Kovačević, 2011). According to respectable world institutions engaged in researching the rank of countries as per different criteria and whose results serve as guidance for foreign investors, BiH frequently has the worst rank among the countries of the Western Balkans¹⁶, which unambiguously confirms its unsuccessful, slow and very costly transition.

¹⁶ For example: *Doing Business in a more transparent world 2012*, The World Bank and IFC, 2011; *The Global Competitiveness Report 2011-2012*, World Economics Forum, 2011; *Highlights of the 2012 Index of Economic Freedoms*, The Heritage Foundation, 2011; *Nations in Transit 2011*, Freedom House, 2011, Credit Rating of BiH, Standard and Poor's 2011; Moody's Investors Service 2011.

Slow and inconsistent reforms reduce the efficiency of using available resources, the inflow of foreign capital and the transfer of modern technology. Without these, there is no improved competitiveness, increase in employment, nor improvement in standard. BiH is one of the rare transition countries that have still not reached the real level of the GDP of 1990¹⁷. Its GDP in 2011 represented around 80% of the GDP expressed in prices in 1990. In the first five years since the beginning of transition, the majority of transition countries reached the GDP level they had prior to transition.

The spreading of the global economic crisis onto BiH threatens its already modest results of transition. The authorities, the business, the union and the non-government sector have not responded to the appearance of the crisis in a manner similar groups responded to it in other countries. Unfortunately, BiH has been experiencing different forms of the crisis for years now. Population here is used to hard life, uncertainty, low standard, isolation, political instability, bad quality of public services, poor infrastructure, corruption, inefficiency of the rule of law, breach of rights, limitation of freedoms, loss of property, loss of jobs... Under the impact of these factors for many years, the motivation of ordinary people has importantly modified when compared to the motivation of people in developed western countries hit by the crisis. Because of that, reactions to the expansion of the crisis have been of weaker intensity here. In BiH, the crisis has become an ambience people live in, an ambience creating one's view of the world, the reforms and the future.

3. CAUSES OF SLOW AND INEFFICIENT TRANSITION IN BIH

3.1. Limitations to institutional framework for transition in BiH

The development of BiH in the postwar period has pointed to an interdependent and simultaneous conduct of several forms of transition: (1) from socialism into capitalism; (2) from the war economy into the market one; (3) from totalitarianism into democracy; (4) from war exclusiveness into tolerance. The Dayton Accord ensured the institutional framework for making decisions on key issues regarding the functioning and development of BiH. However, the inertia of the conflict caused the consensus about fundamental reform projects to be reached very slowly. Critics of the establishment of two entities in BiH accused the Dayton Accord of being an unsatisfactory framework for the country's transition and progress. According to political options aspiring to the centralization and unitarianism of the country, the institutional framework produced by the Dayton Accord is insufficient and dysfunctional. At the same time, they forget that it was exactly the creation of entities that was the most significant argument for establishing and maintaining peace in BiH. "...By creating new states or autonomous regions - has been more successful in stopping ethnic civil wars than has the strategy of attempting efforts to reconcile warring parties un-

¹⁷ IMF - *World Economic Outlook*, October 2010, United Nations Statistics Division – National Accounts Statistics database

der a common state” (Paris, 1997: 80). Also, it is frequently forgotten that the Dayton Accord stipulates that the entities can reach an agreement on anything not directly written down in the Accord (Article III of the Constitution of BiH). According to the institutional framework designed by the Dayton Accord, everything can be changed in BiH, including the Accord itself, but neither nation, or entity, can impose their own will on the other nation or entity. That formula has established and strengthened peace in BiH.

The institutional setup created by the Dayton Accord in BiH prescribes democratic relations in the society and a market economy in doing business. Unfortunately, in a country such as BiH, the development of democratic and market institutions has been long and hard. The implementation of the Dayton Accord in the past 17 years has been least efficient in the economic field. The use of the Dayton Accord in the economic sphere was not an appropriate tool for transition in BiH. There are relevant explanations for this.

3.1.1. Dayton Accord almost does not have an economic dimension

The Dayton Accord mentions only a few points of reference of the basic elements of the economic system, which have not been sufficient to inspire the authorities in BiH to reach a consensus about a modern economic system. In the economic field, BiH had very difficult tasks to accomplish in the postwar period:

3.1.2. Reconstruction of demolished infrastructure and devastated production capacities, as precondition for economic sustainability

Thanks to international financial aid and favorable loans, best results have been achieved in the reconstruction of infrastructure (electric power supplies, water supplies, reconstruction of roads, bridges, telecommunications, and communal infrastructure in settlements). Enterprises and banks were left to the market, i.e. they were about to be renewed and brought back to function after privatization. Privatization was justified by the need to depoliticize economic life and establish the foundations of economic recovery and growth. However, it was soon realized that in BiH the privatization process “failed on both counts” (Donais, 2002: 2). Unfortunately, the slow, bureaucratic and criminalized process of privatization was not efficient and has not yet been brought to an end. A package of transition measures almost identical to the one offered to other transition countries was applied to the reconstruction and postwar development of BiH (WB, EC&EBRD, 1996). WB and IMF proposed structural changes starting from a presumption that western models of market economy and democracy were optimal, and that they complemented each other (Paris, 1997:62). On the basis of the first experiences in postwar reconstruction, doubts emerged that a conceptual approach to reconstruction was an inadequate response to economic problems originating in the socialist and war past (Fischer, 2006: 447) or that it was wrong as well (Stojanov, 2001).

3.1.3. *Transition to market economy*

In order to conduct a successful transition in a country such as BiH, which, simultaneously with transition, had to solve problems of postwar reconstruction, political integration and international reconciliation problems, much stronger institutions had to have been established in BiH instead of the existing ones. Because of the lack of political unity, the strong inertia of socialism and the war economy, and substantially because of the international community's obtrusiveness, BiH was not capable of defining a consistent model to pursue through transition. Only partly was the model determined by the Dayton Accord. It was unclearly interpreted, and to a large extent, it was upgraded through the postwar influence of the international community. International organizations in BiH applied the model of economic transition derived from the neoliberal ideology of aggressive capitalism (Pugh, 2005). It used to be believed that BiH was crying out for a market economy and that free entrepreneurship would very soon soften the majority of contradictions in BiH. A uniform market, uniform currency and the freedom of entrepreneurship, accompanied by a strong financial support received from the international community, should have led to economic integration and progress of the country. "The equation *"Democratization + Market Economy = Peace"*, which has been the guiding principle of international intervention, did not match Bosnian reality" (Fischer, 2006: 447). BiH's experience demonstrated that political divisions in the country were much deeper than it had been previously believed, and that the consensus about the need of transition to a market economy and a democratic society was not the highest priority of political structures in the country.

3.1.4. *Necessity of structural changes*

Change in economic structure, adoption of a new technology, change in the entrepreneurial concept and increase in the competitiveness of domestic enterprises are preconditions for economic development and economic sustainability of BiH. In BiH, there was no political will to achieve a consensus about the institutional framework and policy of structural changes. Therefore, there is no single institution in BiH which could take the responsibility for structural adjustments in the economy. This is left to spontaneous flows in the market. However, inefficient privatization, poorly managed system of foreign investments, undefined economic system, inadequate foreign-trade policy and lack of vision of development led to the collapse of entire areas of production. Spontaneous structural adjustments proved to be the most expensive form of adaptation, accompanied by serious consequences in social and political spheres.

3.1.5. *Focal point of Dayton Accord was not economic but political efficiency*

Establishment of peace was expected to encourage domestic authorities to precipitate building of a democratic system with a strong economy founded on the mar-

ket. This expectation has not been achieved. The country has been preoccupied with dealing with the past for the last 17 years. At the same time, it has lost its future. The population is still obsessed with fear and interethnic mistrust, which is manifested in supporting radical nationalists in the elections (Fischer, 2006: 442). The predominant method of functioning of BiH in the past 17 years has on the one hand been the strong will and police coercion of international peace forces, and attractive economic aid on the other. Many a reform solution has been subordinated to the maintenance of peace and campaigns related to peace reinforcement (return of refugees, regaining the possession of property and so on), which has been unfavorable for economic consistency and efficiency. International economic aid should have compensated for lower efficiency and thus should have made the system sustainable in its entirety. However, institutional and entrepreneurial initiative for the development of the economy failed to occur. Therefore, the reduction in international aid in recent years has increasingly been indicative of the fact that economic sustainability of BiH is a precondition for its entire sustainability as a country.

3.1.6. Very important role of the international community

The important role of international institutions based in BiH, often with arbitrary and supervisory authorizations, has led to its lagging behind in development and to the passivity of domestic institutions. It is often the case that the attitude of the international community regarding a problem in BiH is more important than the interest and potential agreed upon attitude of domestic interested parties. The Office of the High Representative (OHR)¹⁸ for BiH has become almost the highest legislative and judicial authority in BiH because the OHR has been empowered to impose laws and, without any legal proceeding whatsoever, suspend democratically elected representatives of the citizens if he has assessed that their behavior represents an obstacle to the implementation of the Dayton Accord. In such circumstances, elected political leaders have felt greater responsibility towards the OHR than towards the citizens. Therefore, a special form of moral hazard has been introduced to the political system of BiH. Elected politicians have not taken responsibility for what is going on in the country, making excuses and claiming that they have been limited in doing so by the international community. This has additionally slowed down the process of reaching a consensus about important issues and slowed down creating necessary institutions and establishing the needed level of their efficiency.

The slow and inefficient transition in BiH is not exclusively the consequence of institutional limitations caused by the implementation of the Dayton Peace Accord. BiH's economy is burdened by its heritage of socialism and war. Postwar inefficiency of the economy and institutions in the implementation of reforms should just be added to these factors..

¹⁸ The OHR is an international *ad hoc* body established by the Dayton Accord, with a mandate to supervise the implementation of the civilian aspects of the Peace Accord.

3.2. Burdensome economic heritage and inconsistent reforms

3.2.1. Economic structure was formed by using bureaucratic and not market methods

In the economic structure of BiH, as opposed to other parts of former Yugoslavia, it is possible to recognize traces of bureaucratic modeling of the economic structure. This process lasted for almost half a century and employed the largest part of resources found on the territory of BiH. It was replaced by the war economy formed by three national entities. In order to enable the free market to remodel the economic structure of BiH, it is necessary to eliminate the heritage of socialism and war, as well as to have institutions strong enough to establish and protect the freedom of the market.

3.2.2. War consequences are much more serious than previously considered

The condition of resources in BiH and possibilities for their market utilization is much worse than it was thought immediately after the war. Human and material resources were damaged immeasurably and invisibly. Figures cannot provide us with the real state of affairs. A large number of people went through different traumas, and their capabilities cannot be compared with those before the war. A large number of refugees from BiH, primarily highly educated ones, have stayed in developed countries permanently because of better living conditions, a more advanced system of education and a more substantial social aid (Eastmond, 2006). The changed political structure of the country and the change in territorial jurisdiction of institutions had an impact on the change in the organization and business contacts of a large number of enterprises. The disintegration of the Yugoslav market had serious consequences for the economy of BiH. Technological lagging behind of BiH's economy was more prominent when compared to other transition countries, and this reinforced the lagging behind of labor productivity and the loss of market.

3.2.3. BiH is not fully politically stable

Although the Dayton Peace Accord was efficient in stopping the war, the institutions established by the Accord did not ensure full political stability. Based on political requests frequently presented on different sides in BiH, it can be concluded that the opposed war goals of the national communities did not disappear once the peace accord was concluded. To the contrary, attempts were made to achieve these goals by means of other methods. This primarily refers to political forces leading the nations and stressing their national interests in the past war. They are still active in the political life of BiH and present themselves as legitimate representatives of national interests in the implementation of the Dayton Peace Accord as well as partners of the international community in the process. To justify their *raison d'être*, national political structures frequently reaffirm different theses regarding endangered national interests, the unequal position of the nations in BiH, the injustices inherent

in the Dayton Peace Treaty and similar issues. All this contributes to political instability of relations in BiH and slows down the development of democratic institutions. The Dayton Peace Accord was a good political basis to stop the war. However, it has become evident that a sufficiently strong political will that would establish an institutional framework representing a higher level of political stability necessary as a general framework for the development of the economy and a democratic society simply does not exist. Exactly for this reason there are centralistic, hegemonic, separatist and nationalist political tendencies in BiH. Their emergence brings BiH back to the beginning; the key elements of its political and legal constitution and existence are brought into question. The worst damage generated by such conditions is evident in the sphere of economy.

3.2.4. Formal reform of the society

A plethora of reforms have been initiated in BiH. Unfortunately, international institutions have been the most frequent initiators of reform and proposal-makers for reform projects. Such reforms have often been conducted partially without necessary coordination and synchronization, and as a precondition for the approval of financial aid. Also, “imposition of solutions” of the international community by the OHR in BiH has been a significant factor in conducting reforms. Such solutions, especially in the economic sphere, have not brought about needed motivation with investors, especially foreign. Domestic institutions have frequently attempted reforms only formally and in a superficial manner. They have most frequently reformed the system only to the point directly required by the international community. Because of this, the system would very often continue to function as it did before in a number of fields, and it would already be certain that a new cycle of reforms would need to be conducted in order to enable BiH to develop.

3.2.5. Inefficient and expensive government structure has been established

In order to reconcile political contradictions, a government structure was established, and it was spending a big portion of the domestic product, especially in the Federation of BiH, at the same time offering a very modest range of public services and goods. Unfortunately, reforming such a government structure is a very slow process with a lot of political limitations, while consumption of the institutions continued to grow. The high price of political compromise in BiH is paid by its citizens. About one half of the GDP is spent by BiH’s public institutions. BiH has become the most bureaucratized country in South-East Europe, spending around 13% of its GDP only for the purpose of salaries paid to those employed in the administration (WB, 2012). The state level of government has no responsibility at all for the development of the country or social conditions in it. Entities are in charge of these issues. The state budget is fixed and has priority in being financed from the uniform account of public incomes. Therefore, the state budget is not exposed to the risk of deterioration of economic conditions in the country and the reduced possibility of collecting

public income. Because of this form of financing the state budget, yet another form of moral hazard and fiscal paradox has made its way to BiH. The security of income for the state budget frees the state institutions and those employed in them from being responsible for the condition in the country. On the other hand, the entities have the entire public income of the country at their disposal but only have an overall responsibility for development and the social condition.

3.2.6. Broadly corrupted society

During the war and the postwar period, BiH has become a territory of illegal trade of many goods, including trafficking. The specificity of the war in BiH, where national armies had blocked supplies of elementary foodstuffs needed for the subsistence of cities and entire regions, is that “national businessmen” emerged, and they became “heroes” because they succeeded in providing large amounts of goods in difficult times. Of course, prices were several times higher than ordinary market prices. This is how those privileged “suppliers” acquired their wealth. In very difficult times they had money, and money in their hands meant power. War entrepreneurs adapted themselves well to the post-Dayton time period (Pugh and Cooper, 2004:146). They became sponsors, donors and “benefactors” of many institutions, including political parties as well. To live without them playing a role seemed impossible. As trade became more liberalized in the postwar period, the prices of the war period decreased for a large number of goods. At the same time, various cartels and lobbies for trading deficient goods were established and the corrupted structure of government was brought to light. High profits were generated thanks to customs duties and tax evasion, rather than because of high productivity (Tomaš, 2010). The “start-up funds” of the new elite were created during the war. However, wealth continued to accumulate but it was not necessarily dependent on the continuation of the war (Andreas, 2009:41). Corrupted politicians enabled war profiteers to continue to accumulate their wealth in peace as well.

3.2.7. Highest portion of resources under control of a small number of people

The war accumulation of capital, corrupted authorities, economic and political lobbies – they all led to the establishment of direct or indirect control over the largest portion of resources by a relatively small number of people (Tomaš, 2004). This control limited the efficiency of reforms and discouraged foreign investors from coming to the country. Various lobbies and cartels became stronger than state institutions. Frequently, their will was crucial for the efficiency of a measure introduced by the authorities. In the same manner, either by accident or on purpose, certain decisions reached by the authorities favored them. Unfortunately, a large number of people controlling the resources did not gain control through normal market competition but through institutional privileges, control of the corrupted authorities and criminal acts. They were not capable of developing competitiveness and were incapable of being good partners to foreign investors. Their activities and success would be un-

imaginable in normal market conditions and a country governed by the rule of law. A Bosnian variant of “bandit capitalism” was established. Both they and politicians under their control did not need a better system. In a normally arranged economic system, they would go bankrupt under the pressure of the competition, and their political partners would be defeated in a normal democratic system. Martina Fischer was right to notice that the war did not only produce “losers” but also “winners” who developed an interest in the continuation of the conflict (Fischer, 2006: 450).

3.2.8. Widely present “gray economy”

Low standard of living of the population, corrupted authorities and high unemployment rate has had an impact on the creation of the sector of “gray economy”. Because of stunted development and low economic efficiency, the “gray economy” has become a “social program”. Avoiding any responsibility for the socio-economic conditions and absence of economic development, the authorities accepted the “gray economy” as a necessity and became very tolerant to its expansion. Of course, the “gray economy” is very “efficient” in connecting poverty, corruption and crime, on the one hand, and, in discouraging legal business on the other. Research of the relation between “gray economy” and corruption has shown that “gray economy” generates corruption to a higher degree, rather than vice versa. (Buehn and Schneider, 2009: 27). This is especially obvious in BiH. Corruption has become a sort of taxation of the “gray economy” (Tomaš, 2010: 131).

3.2.9. Inefficient macroeconomic policy

In BiH, a uniform and coordinated macroeconomic policy does not exist. Some international institutions, such as the IMF or the WB, have a greater influence on the macroeconomic policy than domestic authorities. Partly, macroeconomic policy is implemented by the authorities of the entities. However, sufficient and efficient coordination does not exist. Furthermore, international institutions frequently initiate and conduct the needed coordination of policies among and between the authorities of the entities.

4. HOW TO IMPROVE TRANSITION IN BOSNIA AND HERZEGOVINA

By establishing two entities and by introducing the equality of the three nations, the Dayton Accord established peace in BiH. Also, possibility was left for all issues not regulated by the Dayton Accord to be agreed upon by the entities through BiH’s institutions. From this aspect, BiH should be capable of creating an institutional framework that is ready to be used in solving any problem it encounters. However, the experience of the past 16 years has shown that the mechanism has functioned in a rather limited manner, and had an impact on slow and inefficient transition. Unsat-

isfactory results of the transition, difficult socio-economic conditions, political instability, corruption, weak rule of law, moral hazard in the behavior of politicians, moral hazard in state-owned institutions' spending and a series of negative phenomena in the postwar functioning of BiH – these are the factors that repeatedly showed that it was necessary to search for solutions that would change the existing situation.

4.1. Political and institutional presumptions

4.1.1. Political consensus about the future of BiH

The experience in the implementation of the Dayton Accord in the past 17 years has demonstrated that the past is a burden when expanding the institutional framework for efficient transition. The future requires peace as the starting point, as the highest of all BiH values. The Dayton Accord should not be discarded; on the contrary, its strength should be used to shape the future. It is not an ideal peace accord. However, it is the most what BiH can accept in order to live in peace. The Dayton Accord is the foundation of the existence of today's BiH and its entities, i.e. the compromise which reconciled contradictions between the nations and enabled them to live in peace. Without the political platform established by the Dayton Accord, BiH would not be sustainable. The consensus should not be changed. It is necessary to establish a consensus about the future and about the way to create an institutional framework which will encourage economic and democratic development.

The political consensus about the future should be an expression of the entities', nations' and citizens' will, i.e. their vision of their own future in BiH. The consensus must arise from BiH's entities', nations' and citizens' honest and direct acceptance of each other the way they are, and not the way they are imagined by international institutions. Every consensus in BiH in the past 17 years has been reached through direct intermediation by international institutions, or has been initiated by them. It is necessary that a political consensus about the future be established without the intermediation of the international community. The consensus should represent the set of common interests that provide security, dignity and prosperity for all. Such an approach exists in BiH. However, it should be recognized and formulated. If BiH, its entities and nations currently possess clearly formulated common interests with neighboring countries, with the European Union as well as other countries throughout the world, it is logical that such interests must exist inside BiH as well. The mutual respect of nations and the entities in conditions of equality- the Dayton Accord - is the starting point for formulating common interests in the future. Reaching a political consensus about the future should begin with domestic politicians taking full and complete responsibility for overall conditions and development of the country as well as with the international community's readiness to relinquish responsibility and hand it over to them. In BiH, a semi-protectorate of the international community still exists. According to some authors, this was an understandable postwar response to the insupportable conditions of conflict (Fischer, 2006: 446), but which could be unlimited regarding its duration and competences (Ehrke 2003:126).

BiH can claim with certainty that the nations and citizens of BiH want a European future. Their perception of their belonging to the European community of nations is an extremely valuable fact for creating a more advanced future for BiH: the basic direction to follow is already known¹⁹. This fact is the focus of decisions on the future of BiH and the prosperity of its nations and citizens on the territory of BiH. The European way of life, European standards regarding the rights of nations and citizens must be created in BiH, they must be an expression of awareness, will and desire to reach them. It is in one's own country that one becomes a citizen of Europe. BiH should become a territory where rights and freedoms we aspire to through European integrations are really achieved. The strengthening of the economy is the precondition of all rights and freedoms. Therefore, the establishment of a more efficient economic system in BiH is an inevitable topic to be discussed when remodeling the future of BiH.

A political consensus about the future of BiH should clearly define the position of the nations and citizens, the political structure and regulation of BiH, institutions, the hierarchy of institutions, institutions' competences and the way of governing and protecting the rights and freedom of the nations and citizens. BiH should be defined as a decentralized democratic country. The hierarchy of institutions and sharing powers between different levels of government should be regulated so that each level of government has the needed level of functionality. It should be clear from the political platform that the responsibility for the future of the country depends on nations and citizens, i.e. their democratically elected representatives. The role of the international community should be reduced to an ordinary level as the one present in all other internationally recognized countries. A political consensus about the future would signify the end of the international protectorate in BiH.

The attitude towards changing the Constitution should also be an integral part of the political consensus about the future of BiH. After reaching a political consensus about the future, changing the Constitution would be a technical issue. The new Constitution should define rather precisely the division of competences between institutions of different levels of government. Institutions would have to be professional, transparent, rationally organized and serve the citizens. Democratically elected representatives of the nations and citizens should shape the institutions and establish their operations in compliance with the Constitution and laws.

By reaching a political consensus about the future of BiH and changes of the Constitution in compliance with determinants of the future, some very significant limitations in the functioning of the entire system would be overcome: (a) political stability of BiH would be increased; (b) professional functioning of institutions would be established; (c) the allocation of competences in exercising authority would

¹⁹ In BiH, there is not a single serious political party whose program opposes the accession of BiH to the European Union. To tell the truth, there are attitudes in political circles according to which "membership in the European Union should not be accepted at all costs". They are usually pointed out when there is disagreement over initiatives for changing the political structure of BiH (for example, ideas about abolishing the entity-based system of BiH).

be defined and clear; (d) a better public image of labor would be enabled and citizens' oversight and control of the work of institutions would be increased; (e) disproportion between necessary reforms and the development of functionality of the institutions would be reduced, and this would speed up reforms and increase their efficiency.

4.1.2. New economic system

Political consensus about the future and changes in the regulatory framework based on a new political platform should enable the establishment of a new economic system. The bases of a new economic system would also have to find their place in a political platform about the future of BiH and in the new Constitution. They should then be elaborated in legislation and institutions should be established to implement them. The new economic system in BiH should be based on:

4.1.3. Freedom of entrepreneurship

Precisely because of its political specificity, the economy of BiH should rely more on free entrepreneurship and less on institutional entrepreneurship. In the long run, we should tend to establish an entrepreneurial society. Relations built on free entrepreneurship are founded on competition and objective regulations, thus offering a lower degree of conflict than is the case with state controlled entrepreneurship. BiH should institutionally encourage the freedom of entrepreneurship and design methods for it to verify, and also to develop the circumstances of taking business risks.

4.1.4. Legal security of doing business

The rule of law in BiH must protect the conduct of business, i.e. ensure the freedom of entering into business relations as well as the obligation of executing contractual obligations. Failure to execute obligations must be very risky and consequences for failure to do so should have far-reaching consequences for business operations and assets of an enterprise. It is impermissible, as is the case now, for the state to implement its "social policy" through failing to stick to contracts or tacitly tolerating it. In the long run, the absence of the rule of law in business leads to the collapse of the economy. Loan-takers terrorizing creditors and slow and inconsistent administration of justice discourage serious investors who would like to set up long-term business activity in BiH, and lead the country to even more corruption and to the collapse of its economy.

4.1.5. Uniform economic area

Even the existing Constitution of BiH indicates a uniform area, although it is imprecisely determined which measures and instruments are used to ensure it. Through a series of laws at different levels of the legislature, full freedom of exchange of goods, investment of capital, employment, and service provision should be ensured

in the entire territory of BiH. It also indicates that there are economic subsystems whose functioning ensures the uniformity of the economic area. The following must be uniform: currency, monetary policy, import regime, export regime, protection of competition etc.

4.1.6. Uniform system of macroeconomic coordination

The existence of a uniform economic area also suggests uniform macroeconomic coordination and macroeconomic policy. There is also the need to synchronize policies used to achieve goals in different sectors. It is not easy to reconcile all economic and political differences in BiH; however, this is the precondition for the efficient functioning of the economic system. Therefore, an institutional framework of macroeconomic coordination needs to be established. Its functioning would be founded on the affirmation of advantages such coordination brings to the economy of BiH, and not on a centralized concept of managing the economy.

4.1.7. Synchronized economic policy

The future BiH should be a decentralized country. According to the current balance of political forces in BiH, a political consensus about the future of BiH and a new Constitution based on it could probably be based on a federal state structure with a clear demarcation of competences among institutions on different levels of government. In such circumstances, conducting the economic policy at different levels of government would be possible. In order to achieve common macroeconomic goals, mechanisms of synchronization of the economic policy should be established according to sectoral and institutional principles.

New administrative and economic institutions, established on the basis of a political consensus about the future and the new Constitution, should initiate a new cycle of economic reforms. The economic effects of those reforms will confirm the efficiency or the inefficiency of constitutional and systemic changes. Reforms within the new economic system should lead to changed flows of resources in the economic area of BiH, as well as to the establishment of true competition, the elimination of voluntarism and its influence on the economy, to the collapse of “bandit capitalism” and to the establishment of new relative price relations based on more competitiveness. Changes in the economic system should also reveal the unproductivity of some of the current solutions applied to the economic system, and how much time and money has been spent on quasi reforms that have produced very poor results or no results at all. This could be a good reason for the public and investors to support a new economic concept.

5. CONCLUSION

The war in BiH ended when consensus was reached under the auspices of the international community, and not when the warring sides understood that peace was

a better option. The transition process was discouraged because of this during the entire postwar period, since neither side was fully satisfied with the Dayton Accord and there were frequent attempts to achieve the war goals in peacetime by other means.

Through the Dayton Accord, BiH was created as a decentralized state. This was supposed to be a starting point for the creation of efficient mechanisms of coordination and cooperation between different levels of government, in order to enable the realization of common development goals. BiH has serious problems in coordinating policies among different levels of government and in creating a market based economy of the state. Institutions on different levels of government in BiH are not characterized by a high level of efficiency. They slowly change the characteristics of the system, insufficiently protect the rights of citizens and of the business community, they do not provide quality public service and they spend a large portion of the GDP on their functioning. Common institutions have no general power. Not many common goals have been created there. They have not become a factor leading to the integration of the country, nor have they started development. Reduction in international economic aid, worsened conditions of borrowing abroad and the economic crisis have enhanced the political destabilization of BiH. It is increasingly obvious that the country's economic decline can endanger peace as well.

Because of generous international economic aid and bad shape of the domestic economy, BiH has become economically dependent on the international community. When the economic, social and political conditions in BiH are concerned, no one has taken full responsibility for them. The system of responsibility is partially regulated without clear and functional coordination. Therefore, democratic institutions could not have functioned at their full capacity. Even 17 years since the establishment of peace in BiH, the country has remained a divided society with an undefined integrative power. Expectations that the international community will opt for one side, or even make the final decision, encourage the development of damaging strategies that do not lead to the establishment of trust and an authentic consensus inside the country.

Although this analysis has demonstrated the fact that the international community's formula "*democratization + market economy = peace*" has not become fully functional in postwar BiH, it cannot be claimed that it is wrong. To be honest, there are serious problems with regard to both democracy and market economy. However, peace continues to be preserved. In BiH today, there is more democracy and more market economy than ever before. However, the power of democratic and market institutions is weaker than the power needed for changing relations in the society and reinforcing the economy. This analysis has identified two specific forms of moral hazard in BiH: (1) important role of the international community in all processes, as well the encouragement of the allegiance of domestic authorities to the international community which weakens the responsibility of the authorities towards those who have elected them and (2) spending of public administration in BiH is independent of economic conditions in the country. Democratization usually suggests transparency and a high level of responsibility, while market economy indicates taking economic

risks for reached decisions. In the postwar years, a lot has been done with regard to democratization and economic reform. However, not a single process has been completed: the allegiance to the international community and the acknowledgement of its political superiority in BiH has replaced democratic responsibility and, corruption, crime, the gray economy and voluntarism have flourished. In such conditions, transition in BiH could not have been more successful either. By eliminating moral hazard from the behavior of the authorities, interest in societal relations would be reinforced and motivation for a dialogue on contradictions would be improved. There are two possibilities that can result from such a dialogue: a consensus could be reached about the future of BiH - a consensus about the possibility or impossibility of the existence of BiH. No matter which consensus would be established, it would be a realistic picture of BiH as a product of real political, national, religious, social and economic relations. A consensus about the future could very quickly initiate changes and accelerate transition. Although BiH is burdened with a series of contradictions, a consensus about the future is still more probable than the disintegration of BiH. It is time for the international community to understand this and give domestic politicians a chance. Otherwise, the economic and social conditions in the country could destabilize the country relatively quickly and threaten the survival of everything that has so far been achieved during transition.

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UZROCI USPORENE I NEEFIKASNE TRANZICIJE EKONOMIJE BOSNE I HERCEGOVINE I MOGUĆNOSTI NJENOG POBOLJŠANJA

*Rajko Tomaš*²⁰

Sažetak

U ovom radu istražujemo uzroke usporene i neefikasne tranzicije u BiH, te mogućnosti njenog poboljšanja. Najsnažnija integrativna snaga BiH u proteklih sedamnaest godina bila je međunarodna zajednica. Iako se vjerovalo da će demokratizacija i tržišna ekonomija ojačati mir, tržište nije uspjelo apsorbirati resurse i obezbijediti ekonomsku samoodrživost, a demokratija nije uspostavila institucije po mjeri ekonomskih, socijalnih i političkih problema u BiH. Time je osnovni koncept tranzicije, postavljen od strane međunarodne zajednice, doživio neuspjeh. Međunarodna zajednica treba pokazati spremnost da prepusti odgovornost za stanje u BiH domaćim političarima. Tek potpunim preuzimanjem odgovornosti, domaći političari mogu spoznati sve prednosti i sve mane odnosa u BiH uspostavljenih Dejtonskim sporazumom i uspostaviti potrebni politički konsenzus o budućnosti BiH. Taj konsenzus je nužna pretpostavka za funkcionalnost BiH, promjenu Ustava, uspostavljanje novog ekonomskog sistema, provodjenje novog kruga ekonomskih reformi i ubrzavanje tranzicije.

Ključne riječi: *tranzicija, tržišna ekonomija, demokratizacija, ekonomske reforme, novi ekonomski sistem.*

JEL klasifikacija: *H77, P21, P27*

²⁰ Prof. dr. sc. Rajko Tomaš, redoviti profesor, Ekonomski fakultet, Sveučilište u Banja Luci, Bosna i Hercegovina, E-mail: rajko.tomas@efbl.org