



How Bosnia's Political Economy Holds It Back and What To Do About It

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Executive Summary

Twenty years after the Dayton agreements ended its devastating war, Bosnia and Herzegovina is mired in a corrupt political economy that feeds its political party bosses and their loyalists while leaving the country's economy in ruins, its governing institutions all but bankrupt and its citizenry in dire need. The first post-war decade (1996-2006) saw a spurt of assistance-driven economic growth and international intervention to create governing institutions, but little reform has been accomplished since. Stalled on the path to European Union membership, Bosnia and Herzegovina needs to find ways to limit the predation of its politicians, unburden its entrepreneurs, and prosper its people.

The required stimulus can no longer come from international intervention of the sort practiced in the first post-war decade by the High Representative. The European Union expects Bosnia and Herzegovina to meet its entry requirements by exercise of its own sovereignty and will rather than by imposition. The will does not exist today, because many of those in power expect to lose benefits and even fear going to prison if an independent judiciary, free media, energetic civil society and truly democratic processes were to hold corrupt parties accountable for exploiting the public trust for private gain.

As things stand now, the political economy in Bosnia and Herzegovina is unfavorable to reform. Its:

- political leadership and parties serve narrow interests,
- stalled economy is overburdened with public debt,
- complex business environment hampers recovery and growth,
- informal networks foster patronage, privilege and cronyism,
- state-owned enterprises generate mainly economic losses and political party revenue,
- judiciary is gradually moving under political party control,
- media and civil society are unfree and living in fear,

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- unemployment and poverty are on the rise, and
- captive state is unable to implement even reforms that are approved in legislation.

In order for Bosnia and Herzegovina to clear a way forward, the existing political economy has to change. This will require a multi-faceted effort, mainly implemented by Bosnians but supported by the European Union. Privatization, commercial law reform, internal democratization of political parties, a more independent judiciary, a vigorous civil society, an end to media subsidies from the government are all necessary, but none will suffice on its own.

We recommend that:

1. The High Representative continue to fade into the background, unless peace and security are threatened, and that the European Union requirements drive the reform effort.
2. The Bosnian authorities make a concerted effort to simplify their governing structures in accordance with the principle of subsidiarity.
3. The parliament require internal democracy in all political parties and end political appointment of executives in state-owned enterprises, which should conduct procurement and privatization as well as receive loans and subsidies only in accordance with European Union rules.
4. The parliament cut red tape and administrative costs, freeze government hiring and require that elected officials declare their assets and state-owned enterprises publish budgets and financial reports.
5. The European Union revive the dormant structured dialogue on justice, insist as a condition for assistance on implementation of its recommendations and verify that judges are appointed solely on the basis of professional qualifications.
6. The judiciary eliminate backlogs and focus its efforts on large-scale corruption cases, with assistance from the European Union.
7. The entity and state parliaments end media subsidies, require open competition for government advertising and any civil society funding, and strengthen the role of ombudspersons, auditors and regulatory agencies.

None of these reforms will be easy, because they will impinge on vested interests and deeply ingrained practices. But piecemeal reforms will not succeed without this kind of broader effort to change the political economy.



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Introduction – BiH the transition laggard and a post-conflict reconstruction disappointment

After two decades of an intense and robust state-building, Bosnia and Herzegovina (BiH) still exhibits characteristics of a failed state. The EU integration process is completely blocked. The country has not yet requested candidacy. It is last in the line among the Western Balkan countries for accession to the EU, with the exception of Kosovo.

The starting situation of the state-building process was complex. The Dayton peace accords (DPA) that ended the conflict in 1995 provided for a highly decentralized structure without some basic state functions at the central government level. The country was placed under international civilian and military supervision. Given the institutional discontinuity with the pre-war situation, absence of rule of law, and immense wartime violations of human rights, the establishment and building of institutions was fraught with great challenges. The state-building process was essential for BiH in the post-war period.

Starting in 1997, the international community, personified in the Office of the High Representative (OHR),² intervened directly in running the country with the help of other international or *ad hoc* institutions. During this top-down, internationally driven state-building phase, the OHR was mainly oriented towards stabilizing the country through eliminating obstructions to the implementation of the DPA and establishment of basic government functions. During that period the “Bonn” powers³ were used widely to dismiss elected and appointed officials the OHR believed were obstructing implementation of the DPA. Imposition of legislation in that period helped establish basic prerogatives of the state, such as the state symbols and a single currency, and secured freedom of movement throughout the country by removing internal checkpoints and imposing common license plates.

By 2000, with the EU gaining more influence over reforms in BiH, the country entered a mixed phase of both interventionist and membership-driven state-building. This is when the European Union (EU) introduced the first set of conditions and the mandate of the OHR was modified to include also the functions of the EU Special Representative (EUSR)⁴. From 2002 until 2011 the High Representative and the EUSR were the same person. In this phase key institutions at state

² Format of the international presence in BiH after the war was determined by the DPA, through establishment of the OHR as the “final authority in theatre to interpret the agreement”. Security Council Resolution 1031 of 15 December 1995 confirmed the position and authority of the OHR, provided for in the DPA.² The Peace Implementation Council (PIC), a group of 55 countries and international organizations that sponsor and lead the peace implementation process, later on elaborated this mandate further adding further powers to the the High Representative’s (HR) mandate. The aim of the London Peace Implementation Conference, held on 8 and 9 December 1995, was to mobilize international support for the implementation of the Agreement. The conference established the Steering Board of the PIC to work as the executive arm of the PIC.

³ As originally conceived, the main function of the OHR had been to supervise and co-ordinate the implementation of DPA. The role of the OHR was significantly augmented at a meeting of the PIC in Bonn in December 1997. The “Bonn powers”, agreed by the governments – members of the PIC, frustrated by the obstructionism of the Bosnian parties still in power, allowed the OHR to issue laws by decree and to remove officials and elected politicians from their jobs. No judicial institutions in Bosnia, not even the Constitutional Court, have the jurisdiction even to review the actions of the OHR.

⁴ The idea behind establishing of the European Union Special Representative (EUSR) presence in 2002 was “complementing the role of the HR with the tasks of the EUSR, thereby maximizing synergies. In other words, the ‘hard power’ of the Bonn powers was complemented by the ‘soft power’ of the EUSR, charged with accompanying the country towards the negotiations of the Stabilisation and Association Agreement (SAA) with the EU and to pursue the European destination of BiH [...], proclaimed by the European Council of Thessalonica in June 2003.” The EUSR has been in a personal union with the HR for more than 9 years.



level were established (state-level judiciary and law enforcement agencies) and the responsibilities and composition of the Council of Ministers were expanded, alongside independent agencies responsible for the conduct of elections, supervision and regulation of electronic broadcasting, etc. All these reforms were implemented primarily as a result of the imposition by the OHR.

International management of the state-building process created dependence of domestic political actors on the international community. They avoided painful reform measures that could cost them support at the polls. Irresponsible local political elites got used to waiting for the international community to take the necessary reform measures. Blame for the necessary pain involved would be apportioned to the international community, while credit for the few successfully implemented reforms would be claimed by the local political elites.

The role of the OHR has gradually declined, in parallel with the emergence of increasing opposition to intervention among key PIC member states regarding his purpose, in spite of the fact that the formal powers remained unchanged. Ever more extensive criticism of the OHR started also to come from international organizations. Thus, the Parliamentary Assembly of the Council of Europe expressed the following view: "... the Assembly considers it irreconcilable with democratic principles that the High Representative should be able to take enforceable decisions without being accountable for them or obliged to justify their validity and without there being a legal recourse".⁵ The Venice commission also concluded in its opinion from 2005 that it is "certainly not a normal situation that an unelected foreigner exercises such powers in a Council of Europe member state and the justification for these powers for the future merits not only political but also legal consideration [...] such an arrangement is fundamentally incompatible with the democratic character of the state and the sovereignty of BiH."⁶ It was in 2005 that the PIC first expressed its commitment to completely replace the OHR, with its wide Bonn powers, with the EUSR, who would have an exclusively European agenda based on voluntary acceptance of conditions.

Harsh criticism of the OHR's actions, the inability of the key PIC member countries to achieve agreement on its actions, as well as the inevitability of the OHR's closure ultimately led to a decision setting out the objectives and conditions to be met prior to the official termination of the High Representative's mandate (so called '5+2 Agenda').⁷

⁵ Parliamentary Assembly of the Council of Europe (2004).

⁶ European Commission for Democracy Through Law (2005).

⁷ Political Directors of the Peace Implementation Council Steering Board (PIC SB) at their meeting in Brussels on 26 and 27 February 2008 set out the requirements that need to be met by the BiH authorities prior to the closure of the OHR. These requirements are well established, approved by the PIC SB and have all been previously recognized by authorities in Bosnia and Herzegovina. The objectives that need to be delivered by the BiH authorities prior to OHR closure are:

- Acceptable and Sustainable Resolution of the Issue of Apportionment of Property between State and other levels of government;
- Acceptable and Sustainable Resolution of Defence Property;
- Completion of the Brčko Final Award;
- Fiscal Sustainability (promoted through an Agreement on a Permanent ITA Co-efficient methodology and establishment of a National Fiscal Council); and
- Entrenchment of the Rule of Law (demonstrated through Adoption of National War Crimes Strategy, passage of Law on Aliens and Asylum, and adoption of National Justice Sector Reform Strategy).

In addition to these objectives, the PIC SB agreed that two conditions need to be fulfilled prior to OHR closure:

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While the use of interventionist state-building instruments helped establish key institutions needed for elementary functioning of the state, after the abandonment of such a model in practice, reforms came to a halt, jeopardizing everything that had been achieved in the state-building process. Following the abandonment of the use of the so-called Bonn powers, progress in meeting the EU requirements has been almost non-existent.

The country's executive serves its own narrow interests

Bosnia's institutional framework today is not viable. Following the reduction of the OHR's interventions, the institutions have become prey for political parties, which have used political appointments and fiscal blackmail to create a partitocracy. Institutions subordinated to political parties have been unable to significantly improve the quality of government, rule of law, and protection of fundamental human rights and freedoms. Effective governance is prevented by ethnic veto mechanism built into the legislative system, while abuse of constitutional mechanisms designed to ensure fair ethnic representation within state institutions has led to ethnically motivated behavior by elected officials. Furthermore, poor institutional capacities and inadequate coordination among numerous levels of government and between the institutions of individual governments leads to a lack of policy coherence. An indicator of efficiency of the Council of Ministers is that in the past eight years not once has the state budget been adopted by the annual legal deadline – 15 October.⁸

As a result, BiH has an oversized, ethnically divided and inept state apparatus which consumes around 50% of GDP⁹ and is burdened with administrative shortcomings and complex decision making processes, complicating the government's policymaking, public finance and human resource management.

The failure of the so-called 2006 April Package of Constitutional Reforms¹⁰, as noted by many analysts and commentators, was the milestone that marked the beginning of a permanent political crisis threatening to overturn the results achieved earlier in the state- and institution-building process. The Nations in Transit study shows that from that time the country has made no progress in the fundamental areas that are prerequisites for a functioning democracy: the rule of law and

-
- signing of the SAA; and
 - a positive assessment of the situation in BiH by the PIC SB based on full compliance with the Dayton Peace Agreement

⁸ Centre for Civic Initiatives (2015).

⁹ World Bank (2014).

¹⁰ The first comprehensive initiative to amend the Constitution of BiH came in 2005. The initiative was launched by the former Deputy High Representative Donald Hays (USA). The initiative was supported by the Department of State and the US Embassy organized direct negotiations between political leaders. After negotiations behind closed doors, the political leaders came up with an agreed proposal for constitutional changes in March 2006. The proposals envisaged the strengthening of the state-level government, with the formation of two new ministries (Agriculture and Technology), as well as strengthening of the state-level parliament along with increasing the number of MPs. Following the fine-tuning and approval by political leaders, the initiative was submitted to the parliament in April 2006, whereupon it came to be referred to as the April Package of Constitutional Reforms. The strongest opponent of the initiative was Haris Silajdžić's "Party for BiH" (SBiH), considering the envisaged reform insufficient and merely cosmetic, and leading to a definitive division of the country. The constitutional amendments failed to receive the necessary parliamentary majority because of the opposition coming from SBiH. The cables released by WikiLeaks later revealed that SBiH allegedly resorted to bribery and subterfuge to get the MPs to vote against the amendments.



protection of human rights. National democratic governance has even deteriorated since. The overall democracy score has slightly worsened compared to 2005.

Nations in Transit Ratings and Averaged Scores

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Electoral Process	3.25	3.00	3.00	3.00	3.00	3.25	3.25	3.25	3.25	3.25
Civil Society	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Independent Media	4.00	4.00	4.00	4.25	4.50	4.50	4.75	4.75	4.75	4.75
National Democratic Governance	4.75	4.75	4.75	5.00	5.00	5.25	5.25	5.50	5.50	5.75
Local Democratic Governance	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Judicial Framework and Independence	4.25	4.00	4.00	4.00	4.00	4.00	4.25	4.25	4.25	4.25
Corruption	4.50	4.25	4.25	4.25	4.50	4.50	4.50	4.50	4.75	4.75
Democracy Score	4.18	4.07	4.04	4.11	4.18	4.25	4.32	4.36	4.39	4.43

Table 1: Nations in Transit 2014, Freedom House (2014)¹¹

Another key characteristic of BiH is a large gap between the laws and practice, or lack of consistent implementation of the laws.¹² Thus, according to the Global Integrity Report 2011, BiH ranks among the countries with the lowest level of actual implementation of legislation.¹³ Arbitrary and inconsistent implementation of the law by the state administration is a result of insufficient institutional capacities and their subordination to political parties. Judicial institutions, suffering from unclear division of responsibilities, huge backlogs of cases and subordination to political power centers, fail to provide citizens with access to justice within a reasonable period, while acting protectively towards public officials by ignoring cases of high-profile political corruption, elaborated below.

The independence of the executive is weakened by the autocratic way in which political parties operate, with no internal party democracy and concentration of real power in the hands of their leaders. Thus, all important executive and legislative decisions (such as reform of the

¹¹ The ratings reflect the consensus of Freedom House, its academic advisers, and the author(s) of this report. The opinions expressed in this report are those of the author(s). The ratings are based on a scale of 1 to 7, with 1 representing the highest level of democratic progress and 7 the lowest. The Democracy Score is an average of ratings for the categories tracked in a given year.

¹² Transparency International BiH (2014b).

¹³ Global Integrity (2012). The survey ranks countries on a 0-100 scale, where 100 is the maximum score, measuring the quality of the legal framework and the level of its actual implementation. BiH's legal framework received a score of 92, and for the level of its actual implementation 35.



constitutional system and harmonization with the European Convention on Human Rights, issues related to state property, the census, and the distribution of managerial positions in state institutions) are made in the informal meetings between the political party leaders. These decisions are subsequently sent to parliaments for adoption merely to meet the form.¹⁴ An example of the aforementioned practice was the process of negotiations on constitutional reforms following the European Court for Human Rights' ruling in the so-called Sejdić-Finci case.¹⁵ After almost five years of informal negotiations the leaders failed to reach an agreement to the reform the Constitution and the Election Law in line with the European Court's ruling.

The bargaining process behind formation of the executive is best illustrated by the formation of the BiH Council of Minister and the FBiH Government following the 2010 general elections. In violation of the FBiH constitutional provisions and without a majority in the House of Peoples, the FBiH Government was elected in 2010 only to be dismissed in a no-confidence vote two years later. However, the Government continued to operate in a caretaker capacity because political leaders were unable to agree on the formation of a new government. The Council of Ministers was not formed until almost two years after the 2010 election. Even then, its composition (i.e. members of the coalition) changed twice in a very short period of time, and it remained effectively blocked for a largest part of its mandate.

Executive authorities often abuse the authority of the legislative branch. A 2014 example concerns the decision of the FBiH Government to transfer funds from the special-purpose disaster account to current budget spending, just days before the floods struck the country with devastating consequences. No one has ever been called to account for unauthorized spending of funds earmarked for flood protection and defense.

When it comes to the fight against corruption, a general conclusion stemming from the EU Progress Reports as well as reports of non-governmental organizations is that the government in BiH has so far failed to adequately come to grips with corruption. This is evidenced by the fact that only 10% of the legal and institutional measures envisaged under the 2009–2014 Anti-Corruption Strategy and Action Plan have been implemented in full.¹⁶ In recent years the executive has initiated changes to dilute important anticorruption laws, most notably the Conflict of Interest Law. Although the Law on the Agency for the Prevention of Corruption and Coordination of the Fight against Corruption was adopted in December 2009, it took Council of Ministers almost three years to adopt the Rules on the Agency's internal organization, thus delaying the start of the Agency's operations.

¹⁴ Al Jazeera Balkans (2012).

¹⁵ In December 2009 the European Court of Human Rights issued a decision ruling on the applications lodged by two prominent citizens of Bosnia and Herzegovina (Sejdić – Finci), complaining that the Constitution of BiH and the electoral law deny passive suffrage to the group of so-called "others", i.e. those who do not belong to the three constituent ethnic groups eligible to stand for election to the Presidency of BiH and House of Peoples of BiH. The Court's decision ordered that changes should be made to the relevant provisions of the Constitution and the laws that discriminate against "others" thus making them eligible to stand for election.

¹⁶ Transparency International BiH (2013).



Textbox 1: Abuse of public office: Our way or the highway

There are numerous examples of appointments to highest executive offices of persons who were convicted of or are under investigation for corruption.¹ Also, several ministers and other executive officeholders had been involved in the disruption of public peace and order, in physical confrontations in public places or drunk driving. Nepotism and clientelism is widespread, as demonstrated by the two Entity Prime Ministers who employed their closest relatives in public enterprises. Despite the fact that all the above cases were widely reported in the media, no one has ever been called to account.¹

Following elections in 2010 and establishment of the Government of FBiH, a total of 939 decisions regulating different personnel/staff positions, removals of management in public companies and institutions and subsequent new appointments were recorded. Prime Minister of FBiH Nermin Nikšić appointed his brother Mirsad Nikšić as the Executive Director for Maintenance in the public company FBiH Roads and Highways. Also, Ivan Šakota, son-in-law of Jerko Lijanović, Deputy Prime Minister and Minister of Agriculture of FBiH, was appointed the Executive Director for economic and financial matters in the same company.

Political parties – the corruption generator

Following the war, during the period of interventionist state-building, virtually all social and state institutions in the country underwent seemingly ambitious reform processes, with the exception of political parties. There is still no comprehensive law on organizing or funding political parties at the state level, so they are all established and registered separately in each Entity, according to the relevant Entity's law, which limits their activity to that Entity.¹⁷

Meanwhile, mafia-like political parties have seized substantial control over social, public and economic resources in the country. The vast majority of party bosses have held the leader's position for more than 15 years. Over that time, their wealth skyrocketed. Some estimations from news media¹⁸ say that the most powerful political leaders secretly accumulated wealth worth hundreds of millions.

The current political elites in the country emerged in the early 1990s, with the introduction of the multiparty system in BiH, consolidating power during the war and the post-war ethnic frictions. The internal party election process is fraudulent. Senior party leaders appoint their loyal supporters as delegates to the election conventions or assemblies. These in turn vote for the leaders who appointed them, helping them get re-elected. Lists of candidates for the general elections are drawn up in a similar manner. Loyal party supporters get appointed into managerial positions in public enterprises or political offices in local governments. Once appointed to these positions by the party leaders they are expected to provide party funding. The appointments

¹⁷ The Entities' Laws on Political Organizations provide for different founding thresholds: in FBiH, the 1991 Law on Political Organizations (Official Gazette of the Socialist Republic of Bosnia and Herzegovina 27/91) provides that a political party may be founded by at least 50 citizens (Article 11, FBiH LPO); in RS, Article 11 of the RS LPO (Official Gazette of Republika Srpska 15/96 and 17/02) request at least 500 citizens for the establishment of a party, while in Brčko 300 citizens are necessary (BD LPO, Official Gazette of the Brčko District 12/02 and 19/07).

¹⁸ A leading source is imovinapoliticara.cin.ba - investigative journalist portal on wealth of politicians, Center for Investigative Journalism.



within a party are never merit or competence based, but rather contingent on loyalty to the party leadership.¹⁹

Textbox 2: Political party *modus operandi*

It is common practice for political parties to receive donations from companies doing business with the executive authorities. This is in clear violation of the Law on Financing of Political Parties. The Center for Investigative Reporting in Sarajevo (CIN) has found that six leading political parties took nearly 210,000 KM between 2006 and the end of 2010 from 70 private businesses that had contracts with the government. The ruling political parties also received donations from 39 companies that held contracts with government-controlled public companies. While the law prohibits accepting donations from companies that have done business with government, the same does not apply to doing business with public companies.

When it comes to direct transfers from the budget, in 2012, out of 21 million KM in agricultural subsidies that the FBiH Ministry of Agriculture provided, at least 2.7 million KM went to firms that applied with non-existent businesses or were owned by party colleagues and the minister's family, according to the same report.

CIN also reported that at least 20 firms owned by officeholders or candidates running for the upcoming elections have concluded at least 166 contracts with public companies and agencies worth at least 13.7 million KM between 2007 and August 2010. The amounts on some of the contracts were impossible to determine as the contracts available to the public are insufficiently specific.

Many political parties have gone so far as to include the name of their party leader in their official name.²⁰ 77% of the population perceive political parties to be the country's most corrupt institution.²¹

Textbox 3: Embedded networks – example of Milorad Dodik

When Milorad Dodik, the leader of Independent Social Democrats (SNSD), a party that also carries his name as a suffix, was on trial for misuse of public funds in 2005, the chair of judge panel was Milorad Novković, and the prosecutors Milan Tegeltija and Zoran Lipovac. The court acquitted Dodik of the criminal charges and ever since the careers of the prosecutors and chief judge progressed considerably. Milorad Novković was appointed President of the High Judicial and Prosecutorial Council (HJPC) of BiH, Milan Tegeltija has been appointed the President of Banja Luka Court. After Novaković's mandate expired, he was appointed the President of the HJPC, while Zoran Lipovac held a ministerial position, after which he was appointed a Constitutional Court judge.

A similar case was appointment of the BiH Ombudsman, who is legally expected to be independent and non-partisan. Ljubomir Sandić, one of the SNSD leaders, was appointed Ombudsman. Another instance was the Supreme Audit Institution (SAI) RS. Duško Šnjegota, previously Deputy Finance Minister and a close affiliate of SNSD, was appointed the Head of SAI RS. Džerard Selman, who had been a member of the Steering committee of SNDS, was appointed Chief Justice of the Constitutional Court of the RS, even though the related law explicitly requires that person not to have any political affiliation.

¹⁹ Bertelsmann Stiftung (2014).

²⁰ Official name of the Alliance of Independent Social Democrats include the name of party leader Milorad Dodik, also the name of Democratic front include the name of party leader Željko Komšić.

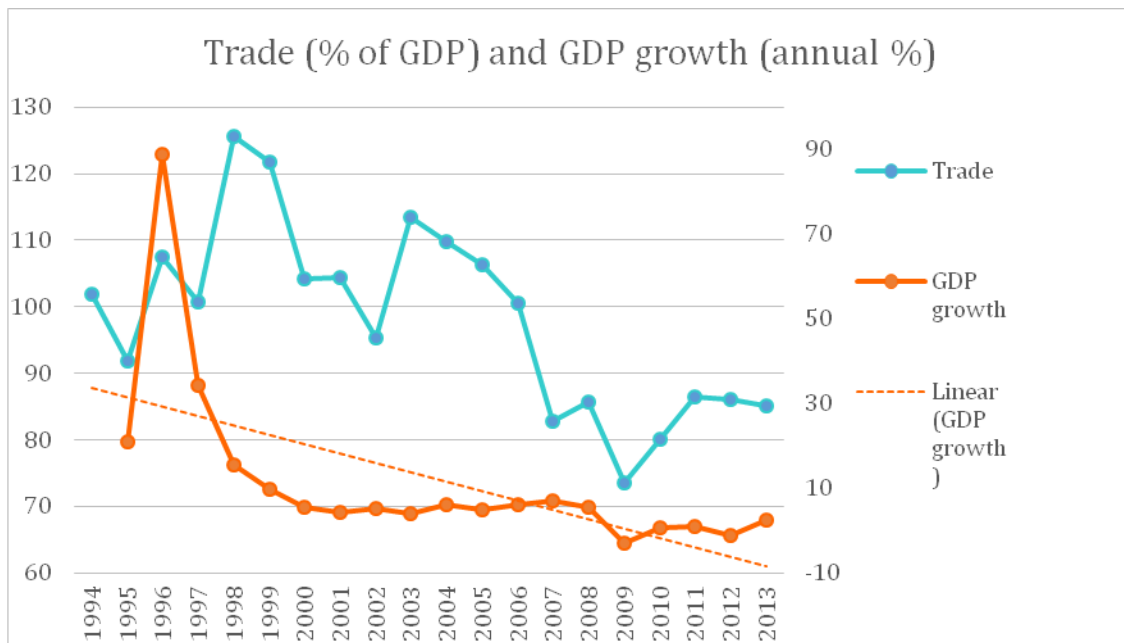
²¹ Transparency International (2013).



Following a short post-conflict surge the economy quickly went flat

BiH has progressed only slowly on the economic recovery and reform path. Much of the immediate post-war assistance of donor funds resulted in restart of some manufacturing capacities and the service industry, but that quickly subsided, as the national authorities attempted to take over the reform agenda. Growing disengagement of the international community and strengthening of the national grip over the economy led in fact to a reversal of many reforms and prolonged suffering of the economy and the real sector.

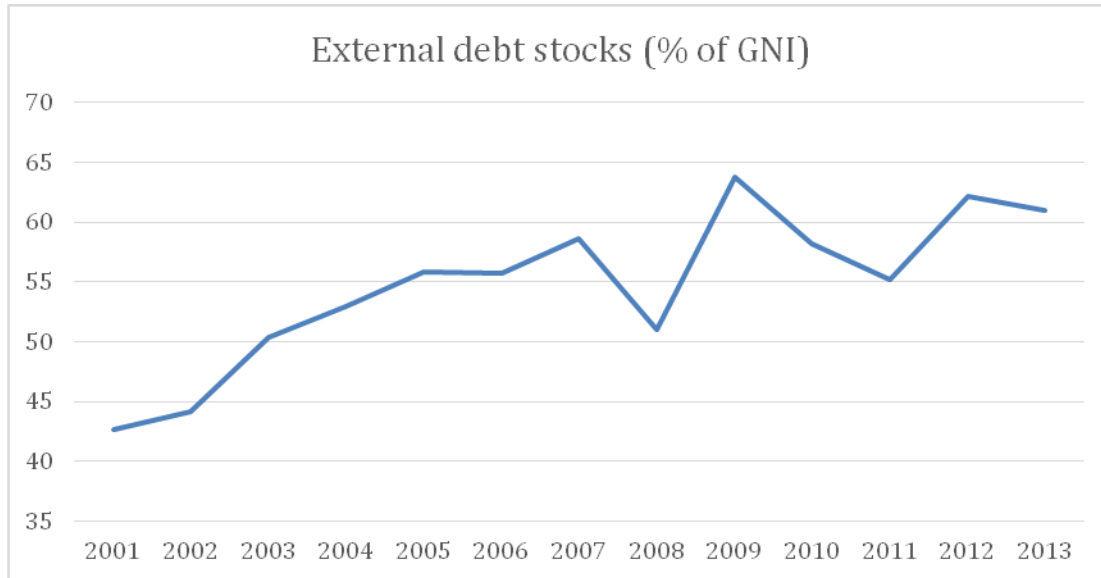
This is best illustrated by the GDP growth as well as the trade data.



The GDP growth rate dropped significantly following the immediate aftermath of the conflict, with a negative trend overall. By 2000 this had stabilized just below 6% until 2009, which is when GDP reached a negative or a barely positive balance. This is mirrored in the trade figures, which have recorded mostly a downward trend since the late 90s. As the economy went through a surge in the late 90s, the trade volume followed suit. The relatively stable mid-2000s saw another expansion in trade, chiefly also because the internal market began to prosper while the GDP growth stabilized. However the downward trend began again before the global economic crisis and the BiH economy has not recovered since.

Instead, the economy is dependent on external borrowing and remittances coming from the large and expanding migration, which no longer consists of genuine asylum seekers but rather is economic in nature.²²

²² Source (chart data): World Bank (2015).



Foreign debt rose steadily since the early 2000s and more recently exceeded 60% of GNI, becoming a key source of revenues for the budget. Looking at the expenditure side, it is mostly invested in unproductive items. Over 60% of the RS and FBiH entity budgets finance public sector salaries and the social safety network, on top of which there is a significant portion for foreign debt servicing in each entity budget or another 30% on average²³. That percentage relative to the entire budget, but also the absolute payments for salaries and social benefits have been steadily rising from one year to another, which led to further foreign and domestic borrowing as well as tax increases (VAT, income, corporate etc.). The budget deficit still stands at -3.6% of GDP²⁴. This imbalance in turn led to social instability, unrest and riots in early 2014.

Political instability as the biggest obstacle to the national economy was reported by 25.1 per cent of BiH firms in 2009, which rose to a staggering 31.4 by 2013. By comparison, that same year only 10.8 per cent of firms globally reported political instability as an issue (13.5 in the Central and Eastern Europe region according to World Bank Enterprise Surveys data).

Because of large migration outflows during the war period in 1990s, BiH is the sixth leading country in terms of receiving remittances as a percentage of GDP (ranging between 13 and 23 per cent during 2006-2010). Annual inflows of international remittances, through the banking system only, are estimated at US\$ 2.228 billion by the World Bank²⁵ in 2010, which represents a staggering **45.5 percent** of the US\$ 4.9 billion worth of total exports of goods and services of the country in that same year (in current prices)²⁶. But the World Network of Bosnian Diaspora estimates the remittance inflows to be almost double, as the majority of remittances are sent as

²³ Budgets: Republika Srpska (2015) and Federation BiH (2015).

²⁴ 2014 est., CIA (2015).

²⁵ World Bank (2011).

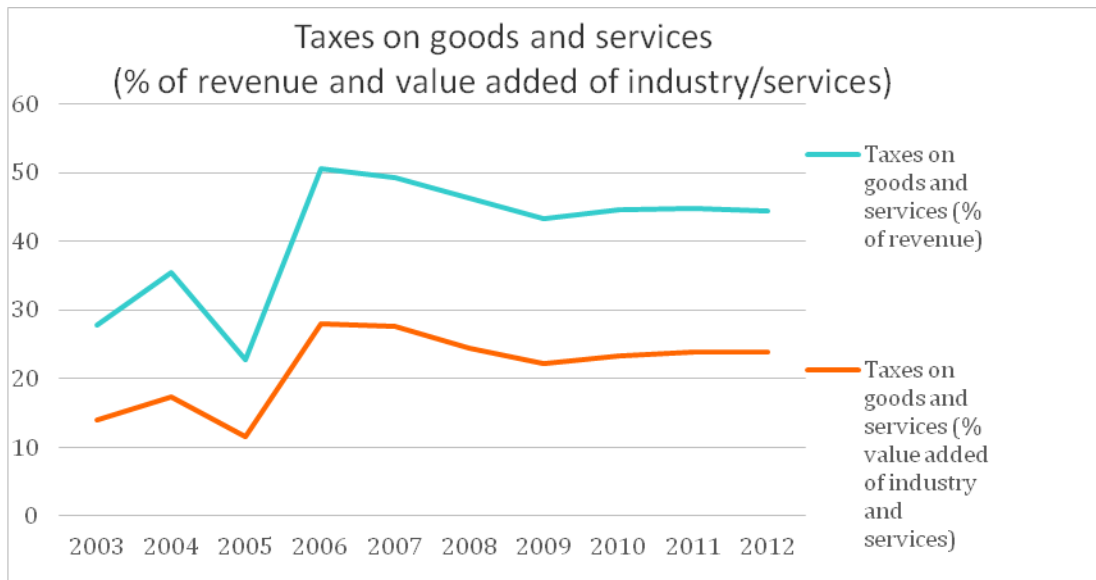
²⁶ Source: World Bank (2015).



cash transfers through informal channels²⁷ and support household consumption, thus keeping the system from collapsing altogether.

Complex business environment hampers recovery and growth

Meanwhile, the unstructured, fragile economy continues to underperform: in the composition of GDP by end use, exports of goods and services account for 29%, while imports come to -52.4%²⁸. Thus exports are disappointingly low, while imports remain high, causing the lasting negative net trade balance and outflow of capital. The real sector is overburdened with taxes that are being pumped into the unproductive public sector.



This key source of government income recorded a significant rise in mid-2000s and remains more than 50% higher than in the post-war years. The World Bank's Enterprise survey²⁹ also reflects this movement: in 2005 companies did not consider taxes too large a problem, but by 2009 it was. It remains one of the key problems the private sector identifies, though rising concern about instability has reduced its relative saliency.

Percentage of firms identifying tax rates as a major constraint (through WB Enterprise Survey (2013))³⁰:

2005	2009	2013
15.7	37.8	20.3

²⁷ Oruc (2011).

²⁸ CIA (2015).

²⁹ World Bank (2013).

³⁰ This should also be observed in relative terms: as the aforementioned fear of political instability rises, the other issues in relation drop, given the response criteria in the survey.



Enterprise ownership and legal incorporation structure in the non-agricultural, formal private economy reveals another worrying trend:

Economy	Year	Proportion of private domestic ownership in a firm (%)	Proportion of private foreign ownership in a firm (%)	Proportion of a firm held by the largest owner(s) (%)	Percent of firms with legal status of publicly listed company	Percent of firms with legal status of privately held Limited Liability Company	Percent of firms with legal status of Sole Proprietors hip
All Countries		87.7	9.2	83.1	3.1	39.1	40.0
Eastern Europe & Central Asia		93.7	4.9	85.1	1.7	85.2	9.8
Bosnia and Herzegovina	2002	42.8	10.2	66.2	17.6	16.0	0.0
Bosnia and Herzegovina	2005	79.7	13.0	78.9	7.5	16.4	0.0
Bosnia and Herzegovina	2009	89.4	5.2	92.0	13.8	56.7	26.5
Bosnia and Herzegovina	2013	93.4	5.4	88.1	3.3	96.7	0.0

There has been a steady change of ownership structure, with foreign capital fleeing the country. While BiH took pride in the early 2000s in having a greater presence of foreign capital than the average CEE country, this figure now reaches only about 1/3 of the peak foreign investment. From a high of \$2.1 billion in 2007, foreign direct investment (FDI) totaled \$392 million in 2012³¹. Meanwhile, capital was changing hands and concentrating in the hands of a few (88-92% of firm capital held by the largest owners). The same goes for legal incorporation: while public listing was popular in 2000s, it drops four-fold by 2013 and switches largely to the much less transparent and very concentrated limited liability company. At that same time, sole entrepreneurship and small crafts are being butchered by bureaucracy and the resulting management costs, so they diminished to the point of disappearance from the economic landscape of the country. Capital is being concentrated among a few powerful people, while well-intended business-oriented individuals are leaving the private sector.

Informal networks: story of patronage, privilege and cronyism

The country is confronted with systemic and rampant corruption – a problem that is not only an obstacle to the implementation of reforms, but also poses a serious threat to everything that has been achieved so far in terms of state- and institution-building. TI BiH analyses indicate widespread political corruption in the country as well as “state capture,” which denotes a situation in which the regulatory framework is tailored to suit the interests of particular economic agents.

³¹ US State Department (2014).



Nationalist elites that have gradually tightened “state capture,” prioritizing their own over the public interest (see textbox 4). “While most types of corruption are directed toward changing how existing laws, rules, or regulations are implemented with respect to the bribe payer, state capture refers to corrupt efforts to influence how those laws, rules, and regulations are formed.”³²

Another aspect of patronage, privilege and cronyism concerns the management of public enterprises, which have been overtly integrated into political parties as their informal subdivisions. Their principal reporting line is towards the political parties, whose prominent cadres are the formal management. A vital aspect of corruption is public procurement, where many forms of embezzlement are tolerated – from addition of innumerable annexes altering the contract value after the signing, to failing to deliver on the prepaid contract etc. For the system to function with impunity, political parties exert control of law enforcement agencies and the judiciary in order to avoid prosecution. This is often managed under the umbrella of ethnic divisions in law enforcement and judiciary that enables their effective party control. Media are extensively used to back such operations.³³

Textbox 5: Blurred line between state budget and private pockets

Evidence exists of executive officeholders using direct budget transfers as subsidy payments to their own private firms or firms owned by their closest relatives. During Minister Vahid Hećo’s term of office (2006–2010) as the Ministry of Energy of FBiH, he distributed nearly KM 15 million worth of subsidies to private businesses in FBiH and Brčko District. Journalists of the Centre for Investigative Journalism (CIN) found that at least KM 4 million of that amount had been allocated to companies whose owners or directors were members of or donors to the ruling parties in FBiH. Similarly, the RS Investment and Development Bank (IDB), which is run by the Government of RS, provided capital injections or gave soft loans to companies owned by high-ranking officials and their relatives. “Fruit Eco” is a private company for production and distribution of fruit and vegetables from Gradiska in which Igor Dodik, son of RS Prime Minister/President Milorad Dodik, owns 50% of the shares. The firm was established in 2007, by Igor Dodik and Mirko Dobric, another Dodik close relative, with the minimum founding capital of 2,000 KM (1,000 Euros) – 1,000 KM from each. In July 2008, the Credit Committee of the RS IDB, which was then presided over by Prime Minister Milorad Dodik, decided to award a 3,000,000 KM loan with mostly concessionary terms to “Fruit Eco” company, with a repayment period of 15 years and a grace period of 3 years.

State-owned enterprises as a key generator of economic losses and party revenue

The concentration of capital is fueled through direct fiscal transfers to state-owned companies (SOEs), run by the political cronies of the parties in power.

Some of these formerly successful SOEs have accrued significant debts from unpaid health and pension contributions. Potential investors are required to assume these debts and maintain the existing workforce by the inflexible privatization agreements offered to them. This too contributed to the significant shrinking of foreign investment in the last several years. Artificially employed labor remains a budgetary liability and further subsidies are being poured into these

³² Hellman, Kaufmann (2001).

³³ Over the last 15 years, TI BiH, Center for Investigative Journalism and other organizations and media have exposed numerous corruption affairs, that caused loss of hundreds of millions euros. Not a single of them has been prosecuted.

Center for Transatlantic Relations

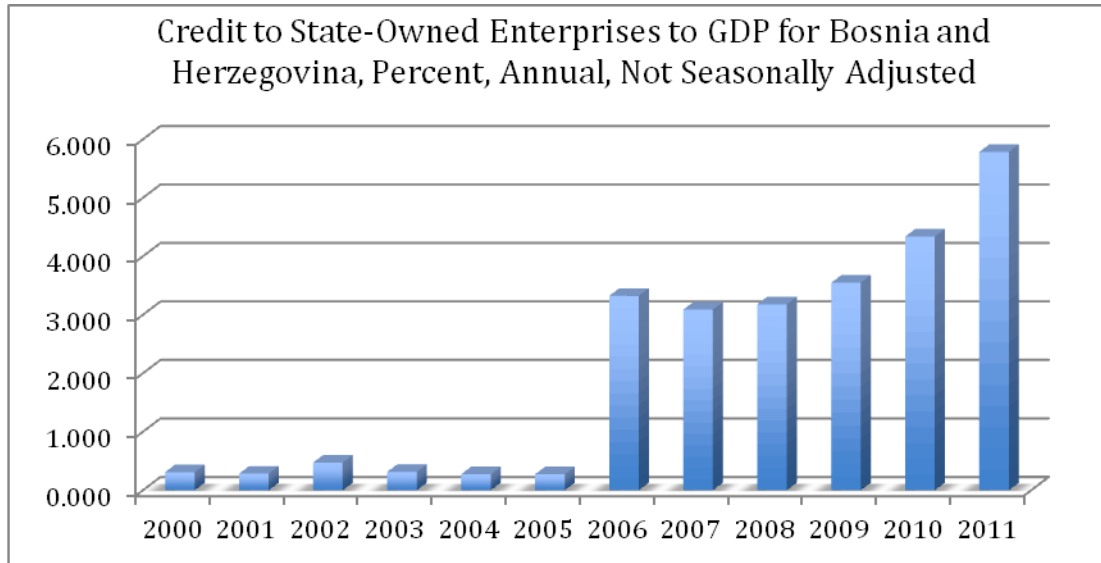
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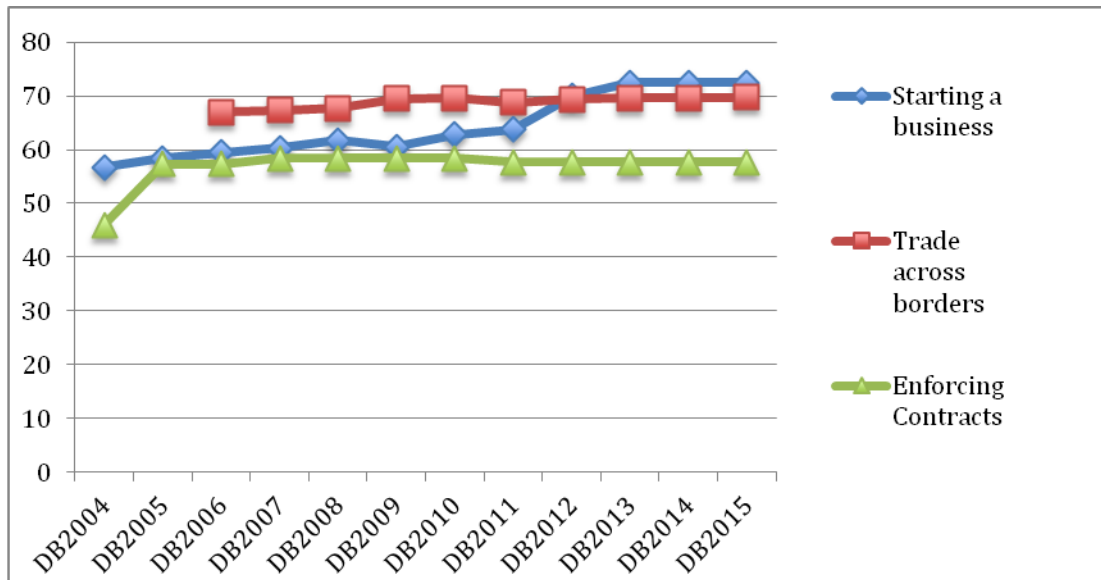
transatlantic-sais@jhu.edu – (202) 663-5880



SOEs in order to maintain social stability and preserve peace, at the expense of the shrinking real sector and expanded borrowing, both domestic and foreign.



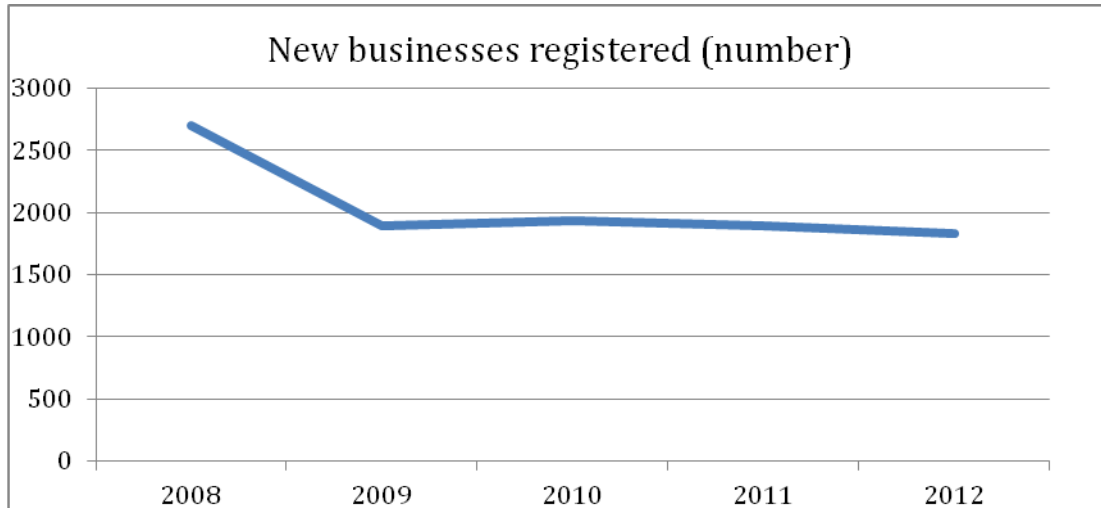
Meanwhile, the governments at all levels did very little or nothing to improve the business environment and remove the mounting non-tariff barriers as the distance to frontier for the selected key investment climate indicators in the Doing Business demonstrates for BiH over years.



There has been almost no progress reforming the business environment in over a decade, as bureaucracy does little to let go of the status quo and its privileges in the form of official fees and sometimes related informal payments associated with issuance of licenses, permits (especially in the construction sector). This leaves the BiH economy with a hugely oversized state-owned sector that keeps accumulating arrears and debts. The environment for the real sector is anything but a level playing field. High barriers to entry, concentration of power, lack of access to capital for



unconnected entrepreneurs, and difficult conditions for managing a business mean few businesses dare to enter the market. The number of start-ups annually has fallen by about a 1000 to 1828³⁴ and showed no sign of post-global crisis recovery.



For those that continue to operate in the market, the sources of funding have become scarcer. The economy in the immediate post-war period saw fast growth financed mostly through sales. In more recent years firms increasingly borrow to keep the workforce employed and thus preserve social stability. Some of that funding comes from the banks that are state-owned or are subject to party interests, which enables unsound borrowing. Around two-thirds of BiH firms now borrow capital from banks or other financial intermediaries, which is higher than the global or CEE average, which is just above 1/3 of all businesses³⁵. Many of these loans are channeled through the highly political entity-level development banks. Subsidies to the SOEs and politically connected private sector have thus surged to the dramatic new highs. The entity budgets for 2015 envisage the following: the RS budget foresees KM 99,844,500 for subsidies (27,320,000 to SOEs and 60,000,000 to private enterprises and agriculture); while the FBiH subsidies total KM 130,097,311: 57,933,599 to SOEs (2014 ended with subsidies to SOEs of: 112,373,908) and 72,163,712 to private enterprises and agriculture. Together that represents almost KM 230 million, which is approximately one-third of FBiH total borrowing or 1/2 of RS borrowing in foreign and domestic markets.

The mere existence of 13 different privatization laws for 13 different constituencies (10 cantonal, FBiH, RS and Brcko) has led to several different models of privatization implemented by 13 agencies. To date the results of the process have been impossible to measure and the ownership structure of the privatized entities remains unclear.

The costs of such a poor management of the public sector and particularly the SOEs are borne entirely by the real sector and the citizens: through borrowing, now and in the future. Taxes are

³⁴ 2012 figures, World Bank (2015).

³⁵ WB Enterprise Surveys (2009) and (2013).



being diverted to subsidies that cover negative enterprise balances. These taxes are collected from the few that produce new value to fund those that produce nothing or even negative value. Additionally, SOEs and the public sector engage in non-transparent and often corrupt public procurement practices, which is another expense picked up by the citizens, who have no access to the proceeds that could have been raised through sale of state property. This represents an additional opportunity cost resulting in lack of fresh capital, new technologies and new employment. As the private sector shrinks and foreign investment leaves, entrepreneurship is on the verge of collapse.

The only ones to profit from the perseverance of the large state-owned sector and particularly the large infrastructure and utility monopolies are the political cronies who launder public money through their accounts and syphon them into the private or party coffers (through illicit procurement, ghost workers in pay-lists, fictitious expenditures, etc). This has provided the incentive to renationalize some of the already privatized companies. The RS Government approved debt-equity swaps (increasing the share owned by the state sector) from 2013 by means of a law (Law on Special Tax Debt settlements³⁶), Art.5 of which states that “accrued tax arrears can also be serviced by means of [...] (b) conversion of tax debt into ownership (equity) in the society”. The entity governments and particularly RS has since rapidly been increasing the share of SOE employees in the economy, preserving for the time being social peace and indebting public finances even further (due to growing subsidies). At the same time, renationalization helps the internal party cadre policies by creating employment opportunities for loyal cronies.

The politicians continue to appoint leaderships of SOEs that in turn engage in reducing the equity of the enterprises and increasing liabilities, through debt creation. Any change in government, particularly in FBiH, leads to a large scale replacement of SOE management from new party ranks. These individuals have their hefty salaries secured through the entity and cantonal budgets irrespective of their performance. Political appointees are also pushed into the boards of directors or supervisory boards, which enjoy large honoraria for their political rubber stamping of management decisions.

Procurement of goods and services also occurs in the same political circles that appointed the management, benefiting only selected firms and individuals. As such procurement is subsidized through the budget, there is no reason to rationalize or select the lowest bidder, but typically an expensive politically appropriate one. This is a racket the SOE managers use to pay back those who hired them and who politically and financially continue to sponsor their work. Some of the private sector also participates in such rackets, but in the form of paid ads in the political party bulletins and controlled media, as several NGOs have been reporting³⁷. SOEs’ debts are often written off and again transferred to the real sector through external borrowing. These are

³⁶ Zakon o posebnim načinima izmirenja poreskog duga (2013)

³⁷ According to a 2011 survey 81% of BiH private business owners believe that the political interference in the operations of business sector is very strong, and 61.1% of them report to have met with political demands in their work (Transparency International BiH (2014b)).



examples of the ‘embedded networks’ that saw their predecessors in similar forms during the Alberto Fujimori regime in Peru or that of Slobodan Milosevic in Serbia during the 1990s.³⁸

Reports of the public sector supreme audit institutions (SAIs) have consistently identified systemic problems in relation to how budgets are spent, but the executive has not demonstrated genuine willingness to act on the audit report recommendations. SAIs of both FBiH and RS have attested to large-scale mismanagement in performance audits of the utility companies, such as electricity and railroads. Supreme auditors used to be extremely critical in the 2000s, which led to a ‘hostile takeover’ of those institutions in the current decade, largely ensuring political compliance and far more positive reporting. Even so, all of the above continues to be highlighted in the SAIs’ reports.³⁹

The structural damage is perhaps even more far-reaching than the immediate damage. The playing field is not level and there are permanent attempts to hamper the unconnected private sector in efforts to compete with the SOEs and crony businesses. The image of BiH abroad is disastrous, which keeps any fresh FDI at a safe distance, targeting successful transition economies and reformers. Political and economic power concentrates with the selected few and corruption levels increase. Social protection trickles down in order to avoid civil unrest. Foreign borrowing is the key means to maintain the minimum required, but it simply reprograms the current financial crisis to tomorrow at a premium price. There have been no serious attempts to address the budget deficit through reductions in expenditure on salaries in the public sector, as these are steadily growing each year. So the problem is left to the coming generations who get born with an unsustainable debt. In parallel, the remnants of the authentic private sector are maneuvering their way out of tax compliance in order to stay in business and maintain minimum employment.

The direct and indirect damage from the ‘embedded networks’ running the economy are manifold. The example of the Brod oil refinery illustrates all too well what proportions this can take.

³⁸ ‘Embedded networks,’ term used by Transparency International to illustrate groups connected through governing structures that operate on the grounds of conflict of interest and favoritism to benefit the group or their parts, and by fostering individual interest, they act against the public ones of the citizens.

³⁹ Examples from the Audit Reports of the Telekom a.d. Banja Luka (2005) and of Elektroprivreda BiH d.d. Sarajevo (2005) both public enterprises.



Textbox 6 – Brod Oil Refinery

Transparency International BiH in 2009 published an extensive report on privatization in BiH which included a detailed analysis of the Agreement on privatization of the oil industry of Republika Srpska (NIRS). Not only did the report show that financially there are no positive effects of that transfer, but in fact losses and liabilities were calculated for the public finances for a long period to come. Using a conservative approach when analyzing the agreement, initially concealed by the authorities, approximately a billion KM (half a billion euros) in the first years of operations were transferred to the RS public debt when the refinery was awarded to an unknown, Russian entity with secretive management structure – Nyeftegazinkor. Examples of the direct costs are the non-concessional loans provided by the Russian firm to the Oil Refinery in Brod, i.e. to itself as a new owner. The value estimate of the industry following the sale was so low that it immediately caused the stock price of the business to slump at the Banja Luka Stock Exchange to a fraction of the pre-sale level (a drop of over 90%). The price agreed was never paid in full and only about half was paid into the RS Budget.

Meanwhile the losses continue to accumulate beyond TI BiH's conservative prediction. In 2010 alone the Oil Refinery added KM 372 in losses and failed to pay KM 133 million in tax arrears. In 2011 the RS Government extended the grace period for collection of the arrears to 2019. However the losses continued in hundreds of millions per annum, chiefly borrowing from the mother company at very uncompetitive terms. Production was halted several times.⁴⁰

The citizens of BiH were meanwhile subjected to a higher than market price for fuel that came via the refinery as a means of domestic industry protection, through high levies on the imported oil derivatives. Today the refinery owes scores of monthly salaries to its labor, resells oil derivatives of dubious quality at a premium price to the end users, and continues to accumulate debt that has long surpassed any market value of the industry. It now would cost far more to shut down than to continue production.⁴¹

Judiciary gradually moving under party control

The judicial reform that has been implemented over the last ten years with major support from international institutions failed to ensure an efficient and independent judiciary able to tackle the challenge of corruption. The EU 2014 Progress Report as well as Transparency International B&H reports notes that BiH is still far from effective prosecution of corruption. Only very few low-ranking officials are prosecuted.⁴² The recent TI BiH report *Monitoring the Prosecution of Corruption in the Courts and Prosecutors' Offices in BiH (2012–2013)*⁴³ indicates a continued downward trend. The report notes the country's worst performance in prosecuting corruption in the last 5 years, with the number of verdicts and investigations for corruption offences dropping several fold.

In 2013 the Court of BiH delivered only three verdicts for corruption offences, one of which was a guilty verdict. Prosecution of corruption by courts in the Federation of BiH has also seen a decline compared to the previous four years – in 2013 a total of 78 verdicts were delivered for corruption offences, compared to 124 verdicts in 2012 and 113 verdicts in 2011. A decline is also observed in the number of guilty verdicts: only 60 guilty verdicts were delivered in FBiH in 2013, fewer than in the preceding years. Similarly, in RS in 2013 a total of 60 corruption cases were

⁴⁰ (Vaskovic blogspot: <http://slobodanvaskovic.blogspot.com/2014/12/rafinerija-brod-prestala-s-proizvodnjom.html>).

⁴¹ (<http://www.nezavisne.com/posao/privreda/Zaduzenost-tri-puta-veca-od-kapitala-302514.html>).

⁴² European Commission (2014).

⁴³ Transparency International BiH (2014a).



processed, a decrease of almost 50% compared to 2012. The number of guilty verdicts for corruption offences in RS has been in continuing decline during the last five years with just 37 in 2013, a decrease of 40% compared to 2012. Overall, 147 verdicts for corruption offences were issued in 2013 at all levels in BiH, of which 102 were convictions, 36 were acquittals and 9 were verdicts of abandonment.

Numerous scandals and affairs, most of which received wide media exposure, have never seen a proper response by relevant institutions. Judicial reform has brought about few substantial changes in the functioning of the judicial system. One of the biggest problems continuing to limit the judiciary is the excessive backlog of cases and long court proceedings.⁴⁴ Citizens and legal entities have to wait a long time for courts to commence a case. The road to justice is time-consuming and expensive. According to World Bank's Doing Business 2014, it takes 595 days to resolve litigation in BiH.⁴⁵ According to the 2013 High Judicial and Prosecutorial Council (HJPC) Annual Report, as of 1 January 2013 there were 2,112,622 pending cases before the courts in BiH, of which 1,664,328 were the so-called "utility cases" (i.e. cases requiring the payment of the outstanding debts for public utility services).⁴⁶ Compared to 2011, the reduction in the backlog was negligible. This means that the backlog problem will, for a long time, continue to be a major impediment to expeditious court proceedings and the right of access to courts and justice within a reasonable period. A common practice is for political officeholders to publicly accuse and place pressure on judges and prosecutors, adding to their reluctance to rule on a case.

The fundamental problem besetting the judiciary still resides in the fact that the country has four nearly autonomous judicial systems – state level of Bosnia and Herzegovina, two entity systems (RS and FBiH), and Brčko District of BiH. These systems are virtually detached from each other in terms of their responsibilities (with some exceptions when cases of war crimes are concerned), as a consequence of the country's constitutional structure. The parliaments continue to pass laws governing the judicial system, despite significant efforts to harmonize specific pieces of legislation in terms of both substance and procedure. This has resulted in uneven judicial practices and unequal treatment of the same or similar factual and legal situations by different courts.

The financing of the courts and prosecutor's offices is even more complicated. The courts and prosecutors' offices are still financed from 14 different budgets, which makes the capacities and resources of the courts unstable and unbalanced. It also allows political influence to be exerted on the judiciary through budgeting.

Since 2006 EU progress reports have continuously warned of the lack of adequate progress in judicial reform.⁴⁷ Ever since the initial stages of the international community's engagement in the country, the establishment of an effective and independent judiciary has ranked high on the priority list and has been a condition in all stages of the accession process. Due to the continued

⁴⁴ Visoki sudski i tužilački savjet Bosne i Hercegovine (2013).

⁴⁵ World Bank (2015).

⁴⁶ Visoki sudski i tužilački savjet Bosne i Hercegovine (2013).

⁴⁷ Dick (2013).



lack of progress and the continuing political obstruction, the EU decided to open up a so-called structured dialogue on justice. This is a new tool of the EU, first established in BiH in 2011, aimed at supporting reforms of the justice system. So far, five thematic sessions have been held between representatives of the EU and BiH authorities on reforms that are necessary in the integration process.⁴⁸ Except for recommendations, there have been no concrete results of this dialogue as yet.

Media and civil society are not free and are operating in fear

Media freedom and civil society strength appear to have deteriorated further in recent years. The media are divided along ethnic and entity lines, so that they do not cover the entire social and political spectrum, but are oriented towards the particular ethnic segments. As the political centers of power and decision-making are key factors in the financial viability of media outlets, the media often become tools in the hands of the political elites for their mutual confrontations. Advertising, vital to media revenue, has been experiencing a continuing decline over the last five years. The value of this market is now about KM 50 million, which is almost 40% less than in 2009. One of the biggest advertisers is the government, i.e. institutions and enterprises under state control. The RS government over the last five years has also spent more than 10 million on direct subsidies to media close to the government.⁴⁹

Textbox 7: Media as government PR

Over the last few years the RS Government has introduced the practice of direct grant assistance to the media. Allocation of direct financial assistance to the media happens without clearly defined criteria and increases in value during election years. This has led to direct assistance allocated either to close contacts of the leaders of the ruling party in RS, or to the media that shortly after receiving support from the Government began to uncritically promote and advocate pro-government views. In 2009 a total of about KM 5 million in grants was awarded to privately-owned pro-government media outlets in RS, in 2010 KM another 5 million, and in 2011 the RS government allocated over KM 3.6 million for direct grant assistance to the media.

A number of media outlets in the country may not be under the direct control of the ruling political structures, but the most powerful and richest outlets find their interest in representing and promoting the views of the government. Media pluralism in BiH has not contributed to the democratization of society, or the media for that matter. Journalists and media outlets who criticize the current leaders (at any level of government) are publically counterattacked and exposed to pressure.⁵⁰ In the first six months of 2014, the Helpline for Journalists received 45 reports of direct pressure and threats against journalists.⁵¹ Particularly alarming are the frequent direct attacks on journalists by public authorities, such as a recent police raid in the Klix portal premises. International institutions have frequently condemned the practice.⁵²

⁴⁸ Delegation of the European Union to Bosnia and Herzegovina (2012).

⁴⁹ Friedrich Ebert Stiftung Bosnia and Herzegovina (2014).

⁵⁰ Transparency International BiH (2014b).

⁵¹ Friedrich Ebert Stiftung Bosnia and Herzegovina (2014).

⁵² OSCE (2014).



Critical and analytical assessment and evaluation of government's performance remains inadequate. Media outlets that are controlled by the government, or depend heavily on government entities for advertising, act largely as spokespersons of the ruling parties rather than objectively reporting on the work of government. There is also a tendency to ignore the most pressing problems in the society, in order to avoid reporting critically on the work of the government.⁵³

Civil society in BiH is heterogeneous; it includes various forms of association, ranging from informal communities and volunteers to religious and professional organizations. Some of these organizations are financed from budgets at some level of government (e.g. veterans' associations, trade unions, pensioners' associations) and are more likely to come under the governmental influence. On the other hand, foreign-financed CSOs through democracy promotions programs of EU, USAID and other Western European countries are typically found to be free from undue external interference to a significantly greater extent.⁵⁴

That said, intimidation and violence against activists and civil society organizations continues, mostly involving human rights advocates and activists investigating alleged corruption.⁵⁵ There have also been several cases of public pressure on CSOs by actors associated with religious communities⁵⁶ and the media in the country. Although the religious communities are supposed to be part of civil society, in BiH they have been repeatedly associated with the ethnic governments, especially in election periods.

Government media lead smear campaigns aimed at tarnishing the image and undermining the integrity of CSOs, promoting arrests of activists, and intimidating them. No authorities strive to protect civil society or human rights activists. What is sadly lacking is an appropriate response by the competent ministries, ombudspersons as well as courts and the police in denouncing threats and attacks. Nothing is done to create an environment in which it would be possible for citizens and their organizations to operate freely. According to official information, none of the above cases has been prosecuted.

Unemployment and poverty are on the rise

BiH is being driven further into poverty. The 2013 unemployment rate was estimated at 44.5%,⁵⁷ though many of these individuals may have been operating in the grey economy.

⁵³ Freedom House (2014).

⁵⁴ Ibid.

⁵⁵ European Commission (2014).

⁵⁶ Depo portal (2011).

⁵⁷ Labour and Employment Agency of BiH (2014).



	Q4 2009	Q4 2010	Q4 2011	Q4 2012	Q4 2013
BiH	510,580	522,052	536,781	550,574	553,580
FBiH	354,577	351,929	371,090	384,852	386,091
RS	145,396	145,620	153,535	153,458	154,998
Brčko Distr.	10,607	11,503	12,156	12,264	- - -

Source: Labor and Employment Agency of BiH (2012).

The table above demonstrates an increase in the number of unemployed at all levels in BiH, the total of which rose between 2009- 2013 by 31,414 persons, i.e. by 8.1 per cent.⁵⁸

Unemployment segmented by gender and youth is even more dramatic in FBiH:

	Employment rate (%) in FBiH			Unemployment rate (%) in FBiH		
	2009	2010	2011	2009	2010	2011
Total	30.9	30.4	29.8	44.24	45.09	45.47
Age 15-24	14.6	12.4	12.6	53.9	62.3	59.7
Women	20.7	20.6	20.3	27.9	32.3	32.1

Source: Labor and Employment Agency of FBiH⁵⁹

In order to get a job in the well-paid public administration or government sector, which is a budgetary priority and receives alone close to half of the public finances, it is critical to be networked. Nepotism and cronyism almost entirely dominate the hiring process, as a recent opinion poll demonstrates: 61.6% in 2012, as opposed to 54.3% in 2008, are convinced that connections or bribes buy your way into public sector hiring while about a third agree to some extent (34.0% as opposed to 19.5% in 2008).⁶⁰ The trend is downward towards worsening of the public administration, which is ruled by the interests of the few to whom new recruits later remain forever indebted and loyal.

As a result, large parts of the population are considering leaving the country for an extended period of time or permanently. This sentiment also rose between 2008 and 2012.

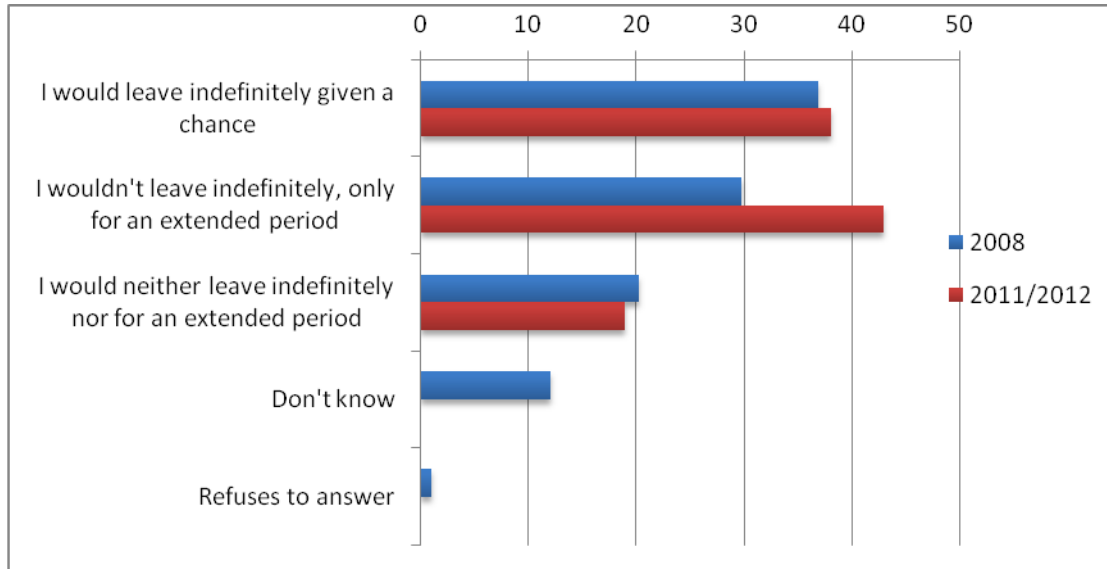
⁵⁸ Centre of Civil Initiatives (2013).

⁵⁹ Ibid.

⁶⁰ Ibid.



Chart: Would you leave the country for an extended period of time or indefinitely? (Comparison 2008 and 2011/12)



Source: Centre for Civic Initiatives (2013).

If the youth possessed the education or skills that are in greater demand abroad, these figures would have likely been even higher.

State capture suffocates the future

Complete deletion of boundaries between private and business interests of public officials and the public interest is a feature that characterizes all forms of state capture. In the state capture context, profits only have been privatized, while the losses are "socialized" (i.e., borne by society as a whole). During the period of institutional vacuum, absence of the rule of law and discontinuity of the state, the ethno-national elites were able to achieve full and effective control and influence over all key social institutions, putting up strong resistance to all reform initiatives, most of which came from the international community. It is often assumed that the political will for the EU accession and systemic reforms is there and that the problem lies solely in the lack of capacity.⁶¹ However developments since the failure of the April package of constitutional reforms in 2006 demonstrate genuine lack of the political will to implement the necessary institutional and economic reforms.

In the vast majority of reform processes, the matrix has largely been the same: after endless discussions and under strong pressure from the international community, even if the consensus on adoption of reform legislation has been reached, the implementation of this legislation is thwarted by failure to secure the necessary funding or by the inability to agree on the appointment of the management. Such was the case with the police reform and the establishment of state police

⁶¹ Pippidi (2011).



institutions, with the provision of funds for the functioning of the state judiciary, establishment of the state-level anti-corruption agency, etc.

As Fukuyama rightly pointed out all reforms are inherently political,⁶² therefore it is about generating political will for reforms and not only strengthening capacities of the institutions. Leveraging and articulating the public's deep mistrust in the government through citizens' active involvement in decision making should be prioritized in order to avoid another wave of destructive protests like those of 2014. Past experience shows that simply calling on leaders to undertake reforms and to take responsibility is insufficient. Generating a genuine and articulated "internal demand" for reforms is key to achieving sustainable progress toward integrating the country into the EU. When it comes to the EU engagement, "until now the EU's transformative power has proved effective in integrating established states; now it is confronted with the challenge of integrating contested states."⁶³

Recommendations – a way forward

Based on the detailed analysis provided above and in order to make case specific and actionable points, this paper makes the following recommendations:

1. **The High Representative**, whose intervention was vital to state-building progress in Bosnia and Herzegovina during the first ten years after Dayton agreements were signed, now has to take a back seat in a reform process driven by European Union requirements but executed by elected Bosnian authorities. The Office of the High Representative should continue to shrink and eventually move to Brussels, conserving the Bonn powers for use only in a situation where peace and security are threatened.
2. **Governance structures** in Bosnia and Herzegovina are over-complicated, duplicative and too distant from the citizens. A decentralized structure consistent with the EU principle of subsidiarity should be the goal, thus reducing bureaucracy and increasing accountability and transparency:
 - a) In cooperation with the EU, an independent commission appointed by the state government should map state, entity, cantonal and municipal institutions and determine at which level functions need to be carried out.
 - b) Following that and under EU expert guidance, the BiH authorities should decide which level most effectively deals with a regulatory issue and annul duplication at other levels. Where feasible and consistent with accountability and transparency, devolution to the municipal level should be a priority.
3. In order for this process to succeed, **the political economy** of Bosnia and Herzegovina has to undergo important changes whose overall effect will be to ensure that the country's executive authorities begin to serve the interests of the citizens who elect them rather than their own.

⁶² Fukuyama (2014).

⁶³ Rupnik (2011).



4. Particularly important will be the following **political party and economic reforms**:
 - a) A new law on political parties should require them to adopt procedures that allow the membership to choose their leaderships in an open and democratic process;
 - b) Political party nomination of SOE managers and staff should be eliminated in favor of a merit-based system;
 - c) Subsidies and loans to SOEs should be limited by direct implementation of the EU State Aid *acquis*.
 - d) Privatization at all levels should be pursued exclusively through internationally supervised processes.
 - e) Procurement by governments and SOEs should likewise be pursued exclusively through processes that meet international standards.
 - f) Red tape and administrative costs need to be cut dramatically. Public service hiring should be frozen to prevent further politicization.
 - g) Governments also need to be more open. Elected officials should be required to make annual statements of their assets; SOE budget and financial statements should be published.

5. The **justice system** needs to become far more independent and professional:
 - a) The EU/Bosnia structured dialogue on justice should be revived by making a portion of EU assistance to Bosnia conditional on implementation of its recommendations.
 - b) The High Judicial and Prosecutorial Council (HJPC) should be appointed free of political influence in a process fully open to public participation and CSO scrutiny, monitored and verified by the EUSR.
 - c) The HJPC should rely on international expertise and close collaboration with counterparts from the EU in verifying the qualifications of judges and prosecutors, retiring and replacing those who do not meet the highest ethical and professional standards.
 - d) The judiciary at all levels should adopt work plans that eliminate backlogs and provide for prosecution of corruption, with major cases tried at the state level.
 - e) With EU assistance, key cases of grand corruption involving political leaders should be identified (especially within the areas of public procurement, privatization and major infrastructure) and processed before national judicial institutions as a matter of priority.

6. **Independent institutions**
 - a) Government grants to **media** should be ended and government-sponsored advertising should be placed in accordance with openly competed tenders.
 - b) The government's ombudspople, regulatory agencies and auditors need strengthening.

Civil society has same rights to operate in the country, as does in any other EU member state, including to receive funding. State subsidies to NGOs are to be awarded publically, following public calls, transparent award criteria and results published in the press.



List of Abbreviations

BiH – Bosnia and Herzegovina
CEE – Central and Eastern Europe
CIA – Central Intelligence Agency
CIN – Centar za istraživačko novinarstvo (Center for Investigative Reporting)
CSO – Civil Society Organisation
DPA – Dayton Peace Accord
EU – European Union
EUSR – European Union’s Special Representative
FBiH – Federation of Bosnia and Herzegovina
FDI – Foreign Direct Investment
GDP – Gross Domestic Product
GNI – Gross National Income
HJPC – High Judicial and Prosecutorial Council
KM – Konvertibilna marka (convertible mark)
LPO – Law on Political Organisations
OHR – Office of the High Representative
OSCE – Organization for Security and Cooperation in Europe
PEFA – Public Expenditure and Financial Accountability Assessment
PIC – Peace Implementation Council
PIC SB - Peace Implementation Council Steering Board
RS – Republika Srpska
SAI – Supreme Audit Institution
SBiH – Stranka za BiH (Party for BiH)
SNSD – Stranka Nezavisnih Socijaldemokrata (Party of Independent Social Democrats)
SOE – State Owned Company
TI – Transparency International
USD (US\$) – United States dollar
VAT – Value Added Tax
WB – World Bank



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