

**THE POLITICAL ECONOMY OF SUB-STATE DEVELOPMENT**  
**IN POST-CONFLICT BOSNIA AND HERZEGOVINA**  
*An Assessment of the Entities*

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## ABSTRACT

While post-war development in Bosnia and Herzegovina (BiH) has received excellent attention at the state level, there has yet to be a systematic comparison of the economic experience of the entities. This study contributes to the literature on post-war BiH firstly by filling this gap, and secondly by drawing on relevant theoretical insights to explain the trends. It observes that RS initially lagged behind FBH in reconstruction and reform, but caught up early in the present decade. In recent years, RS has conducted an active reform agenda surpassing FBH, but the quality of these reforms is questionable. FBH has exhibited a more consistent pace, typified by deadlock. These findings are explained by the political competition theory of post-communist transition in conjunction with ethnic politics scholarship, under a general rubric of the ethnicities and growth literature from economics. Consociational arrangements have minimized political competition and reinforced ethnic cleavages to the detriment of economic reform. In RS, a centralized structure has enabled reform, but the minimal political competition inherent to consociational guarantees produces a lack of accountability resulting in a reform process benefiting insiders who now prefer a rigged game to one of uncertain political and economic outcomes. In FBH, the lack of accountability has meant that when the consociational deadlock is broken, it remains difficult to ensure transparent reforms that foster market competition. Throughout the post-war period, external lobby actors have often played a role in shaping bargaining dynamics.

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## LIST OF ACRONYMS

AV	Alternative Vote
BiH	Bosnia and Herzegovina
CLI	Cumulative Liberalization Index
CoM	Council of Ministers
DM	Deutsche Mark
DPA	Dayton Peace Accords
EBRD	European Bank for Reconstruction and Development
EIU	Economist Intelligence Unit
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HDZ BiH	Croatian Democratic Union of Bosnia and Herzegovina
HDZ 1990	Croatian Democratic Union 1990
IFI	International Financial Institution
IMF	International Monetary Fund
ITA	Indirect Tax Authority
KM (BAM)	Konvertible Mark (international currency code)
FBH	Federation of Bosnia and Herzegovina
FRY	Federal Republic of Yugoslavia (Serbia and Montenegro)
OHR	Office of the High Representative
PIC	Peace Implementation Council
SDA	Party of Democratic Action
SDP	Social Democratic Party
SDS	Serbian Democratic Party
SME	Small and Medium sized Enterprises
SNSD	Party of Independent Social Democrats
SzBiH	Party for Bosnia and Herzegovina
RS	Republika Srpska
USAID	U.S. Agency for International Development
VAT	Value-Added Tax
WB	World Bank

## I. INTRODUCTION

Amongst developing and post-communist countries, Bosnia and Herzegovina (BiH) has the dubious distinction of being the only country to enter war as a province of a centrally planned economy, and conclude peace within the early stages of a transition to a market democracy. The Dayton Peace Accords (DPA), which forged this peace, did so by providing a decentralized consociational structure. The state itself held very narrow competencies in the immediate post-war period. Most power, including all economic policy, has instead been exercised by the two entities, Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBH). While the former is a centralized structure with a majority Bosnian Serb population, FBH is itself a consociational arrangement of Bosniaks and Bosnian Croats, with further territorial decentralization amongst ten cantons.<sup>1</sup>

Given the reality that the entities have conducted most economic policy, including the post-communist restructuring, it is not surprisingly that RS and FBH have also exhibited different patterns of development during the post-war era. RS has recently won plaudits for aggressively pursuing restructuring at a faster pace than FBH. Of late, RS has gained particular attention for privatization as well as passing high profile legislation easing the regulatory burden on business. FBH, on the other hand, lags behind on key measures of transition, though it still exceeds RS in terms of the overall size of its economy. Yet this narrative is far from constant across the post-conflict period. RS delayed the initial phases of reconstruction, and was plagued with poor policy and higher inflation. After a change of leadership, reforms began in the late 90s, leading RS to pull even with FBH early in the twenty-first century. While on the surface RS has recently pushed ahead in restructuring, however, the quality of those reforms has been dubious, with signs that many reforms have

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<sup>1</sup> Hereafter, referred to simply as Bosniaks, Croats, and Serbs.

primarily benefited insiders. RS remains to achieve full market status, and it is thus an open question as to whether a truly open system will be allowed to challenge elite dominance.

While the post-war development has received excellent attention at the state level,<sup>2</sup> there has yet to be a systematic comparison of these passing observations. Though this neglect partially reflects the well-intended goal of the donor community to see BiH develop as a single economic space, its altruism neglects the facts of post-war development. Furthermore, BiH has largely been left out of the post-communist transitions literature due to the difficulties posed by poor data, a delayed start to the transition, and the unique complexities resulting from civil war. The political situation has received far greater attention, particularly amongst scholars focusing on ethnic polarization, but these studies do not consider economic implications of entity dynamics. By conducting the first sub-national evaluation of reconstruction and reform, this study contributes to the literature firstly by filling this gap, and secondly by drawing on relevant theoretical insights to interpret observations.

In so doing, this work applies literature on ethnic polarization and political competition theory to explain reform variation. Drawing on recent insights from integrationist scholarship, FBH serves as an illustration of the deadlock that can result from consociational structures, while both entities show centrifugal tendencies. The simpler structure of RS, in contrast, removes the constraints of ethnic consensus that exist in FBH. As a result, once begun, RS has generally proceeded quicker with reforms. Ethnic political structures, however, still work to minimize political competition, thereby explaining challenges RS faces in moving beyond a state of partial reform. There is some evidence that periods of heightened competition produced greater openness.

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<sup>2</sup> For an in-depth study, see Timothy Donais, *The Political Economy of Peacebuilding in Post-Dayton Bosnia*, (New York: Routledge, 2005). For a shorter overview, see Michael Pugh, "Transformation in the political economy of Bosnia since Dayton," *International Peacekeeping*, 12 No. 3 (Sep. 2005), 448-62.

These findings contradict conventional wisdom. Neo-liberalism predicts that initial reforms should produce market actors, who will form a critical mass behind further reform. Instead, both entities remain only partial market democracies. Fourteen years after beginning, BiH remains in a position comparable to the Central East European states circa 1994. Meanwhile, consociational scholarship predicts that its prescriptions should help mitigate polarization, but instead, the politics surrounding economic reform remain as contentious as ever. Applying political competition theory in conjunction with integrationist insights offers an explanation of these trends. One of the key effects of consociational arrangements is to reduce risk of ethnic strife by minimizing the uncertainty inherent to democratic competition. Consociational arrangements have thus minimized political competition. The overall result is a lack of accountability producing a reform process benefiting insiders, who now prefer a rigged game to one of open and uncertain political-economic competition. In FBH, the consociational structure is even more rigid, leading to frequent deadlock. When the consociational deadlock is broken, the lack of competition means it remains difficult to ensure transparent reforms that foster market competition. These trends have occurred despite a strong international mission.

While the limited scope of the project prevents drawing strong generalizations from the results, these findings nevertheless have important implications for the future of BiH and other countries wracked by ethnic conflict. In BiH, it has been common in recent years for the IMF to draw the conclusion that recent trends reveal the need for FBH to accelerate its reform agenda along the lines of RS. This work, however, reveals that the present constitutional environment produces political realities that cannot continue to be ignored if such advice is to be implemented for the benefit of sustainable development. Failing to do so may have dire implications for the survival of the BiH state. At a theoretical level, the study



draws on the unique position of BiH at the nexus of post-communist transitions and ethnic politics to merge these two literatures, providing insights that could yield rich innovations.

This work proceeds by first laying out the research design and scope of the findings. It then reviews the theory of consociationalism and an alternate approach offered by integrationist logic, as well as the contrast between neo-liberal versus political competition theory predictions regarding reform. The former is situated within the ethnicities and growth literature, and the latter within the broader field of post-communist transitions. By considering competing potential explanations, a robust theoretical framework is ensured. The fourth chapter presents empirical findings, which are followed by an analysis. The final section concludes.

## II. METHODOLOGY

This work approaches development and transition (the dependent variables) in BiH from a sub-national perspective, with the primary goal to detail and understand differences in performance between the entities. As such, the cases are conducted as interpretive studies, and employ competing theories of political economy to facilitate analysis.<sup>3</sup> The cases are treated as two separate studies, but integrated in order to facilitate controlled-comparison. Comparison is motivated by the lack of scholarly attention to the entities' divergence, and cases were not selected to test rigorously the theories employed.<sup>4</sup> Nevertheless, by examining the sub-national level, many variables are held constant across the cases.

Analytical application of theories is conducted primarily through detailed process tracing. Competing explanative theories are reviewed in the following section, for which signatures are hypothesized. These intervening variables are then sought in the case studies to determine which theories best explain the trends observed, and which can be eliminated.<sup>5</sup> Secondly, wherever possible, multiple within-case observations are sought of key figures and pillars of reform. The quality of data in Bosnia regrettably prevents the more rigorous periodizing necessary for a full longitudinal analysis; thus, this technique is used to complement the primary method of process tracing.

In addition to qualitative and quantitative sources, nine expert interviews were conducted by the author. Due to the nature of enquiry and situation in BiH, no one form of data is sufficient for the present purposes, and thus the different varieties are employed jointly (see Appendix: Data and Sources).

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<sup>3</sup> Arend Lijphart, "Comparative Politics and the Comparative Method," *The American Political Science Review* 65, no. 3 (Sep., 1971), 682-693.

<sup>4</sup> Clearly, the number of potential explanatory variable far exceeds the observations. While comparative in nature, therefore, the scope of the conclusions is limited to that of a single interpretive case.

<sup>5</sup> Alexander George and Andrew Bennett, "Process Tracing and Historical Explanation," *Case Studies and Theory Development in the Social Sciences* (Cambridge, Mass: MIT Press, 2005), 205-232.

Though the scope of the findings are limited to that of an analytical study, the study does offer theoretical insights.<sup>6</sup> Theory-testing is facilitated by the comparison of the two cases, and the consideration of competing theoretical explanations, which assists in avoiding confirmation bias. The cases hold potential to provide evidence in support of previous theories, reveal shortcomings in predicted causal mechanisms, and integrate previously distinct literatures, thereby facilitating future theory-building. Thus, though the theoretical conclusions may not be universalized beyond BiH, the findings do, therefore, have important implications beyond interpretation.<sup>7</sup>

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<sup>6</sup> George and Bennett (2005), 217.

<sup>7</sup> *ibid.*, 213-216.

### III. LITERATURE REVIEW

There is a wide body of literature that offers potential insights into development in BiH, a natural result of its specific post-Yugoslav legacy. The unique confluence of challenges this legacy presents include transition from central planning in an ethnically polarized society. As such, BiH constitutes a bridge between normally distinct literatures. This review lays out the broad contours of each, including alternate theories to those that will be applied in subsequent analysis. This chapter first introduces the general framework of neo-institutional political economy before moving on to review the role of ethnicity in development and politics, and theories of post-communist transition. Along the way, it details markers that would indicate the utility of particular theories if observed in the subsequent cases.

#### **The neo-institutional approach to development**

In order to understand the continued failure of many states to develop during the past half century, political economists have recently argued that institutions must be incorporated into development studies.<sup>8</sup> While Douglas North's definition of institutions as the formal and informal institutions that constrain humans and shape interaction<sup>9</sup> has now become standard, however, there is far less agreement as to which institutions matter most.

The rule of law is a general prerequisite for the development of a functioning financial sector, which, in turn, is a key component underpinning growth.<sup>10</sup> More broadly, other indicators of governance quality including stability, accountability, effectiveness, regulatory

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<sup>8</sup> See Kenneth Dam, *The Law-Growth Nexus: the Rule of Law and Economic Development*, (Washington, D.C.: Brookings Institution Press, 2008) 1-55.

<sup>9</sup> Douglas North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press 1990) 4.

<sup>10</sup> Dam (2008), 163-220.

quality, and control of corruption are also necessary factors to achieve full growth potential.<sup>11</sup> Considering these factors has been criticized on the basis that they rely on subjective survey data. While data obtained from surveys certainly is subjective, however, it is individual and firm level perceptions that influence decisions; thus, such perceptions clearly matter. This perspective informs the basis of much current thinking on development regarding the need for liberal institutional frameworks.

Strong debate remains, however, as to how best to achieve these institutions, as well as the proper mix of liberal institutions. Many of the theories below provide competing answers to these questions, but there has yet to be significant interaction across the two concentrations examined. At their core, however, the following theories build upon the central neo-institutional thrust elaborated here.

## **Ethnicity and Growth, Economic Policy, and Politics**

There is a wide body economic scholarship asserting that ethnic diversity has a detrimental impact on growth and overall economic development. Given the ethnic composition of BiH, this literature is highly applicable to the cases under consideration. Easterly and Levine's seminal work catalyzed this field in finding a strong connection between higher ethnic fractionalization and lower development.<sup>12</sup> In sub-Saharan Africa, poor economic policies are found to be indicative of societies with higher ethnic fractionalization. "High ethnic diversity is closely associated with low schooling, underdeveloped financial systems, distorted foreign exchange markets, and insufficient

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<sup>11</sup> Daniel Kaufmann, "Rethinking Governance: Empirical Lessons Challenge Orthodoxy," World Bank working paper (March 2003). Kaufmann leads the Governance Indicators Dataset, an ongoing WB project monitoring these six factors.

<sup>12</sup> This literature builds on earlier work arguing that polarized societies will exhibit worse economic policy. William Easterly and Ross Levine, "Africa's Growth Tragedy: Policies and Ethnic Divisions," *The Quarterly Journal of Economics*, 112, No. 4 (Nov., 1997), 1203-1250.

infrastructure.”<sup>13</sup> These policies, in turn, explain a significant portion of the low growth in sub-Saharan Africa.

Ethnically diverse cities in the U.S. have been shown to exhibit lower quality public spending. Core public goods that are necessary for expansion, such as education and roads, are underprovided, while goods less beneficial to growth, including police, are overprovided. The same cities have higher overall levels of public spending and debt per capita, financed through intergovernmental transfers.<sup>14</sup> In situations voting is strongly divided along ethnic cleavages, ethnicity increases corruption by reducing the quality of politicians.<sup>15</sup> A number of subsequent studies have replicated these findings.<sup>16</sup>

Segregation of ethnic groups has been found to have an additionally detrimental effect on the quality of government, an effect which is even stronger in democracies.<sup>17</sup> Sparber echoes this thesis, finding an even more direct link on growth by showing that ‘variation in diversity across regions’ (*i.e.* segregation) decreases national output per worker. Higher costs of cross-group communication compound this effect.<sup>18</sup> In BiH, segregation varies along with fractionalization, making it difficult to determine which dynamic is at play. This difficulty is compounded by an underdeveloped causal chain explaining the link from segregation to poorer policy or productivity. Alesina and Zhuravskaya provide four potential explanations, though none is conclusive. Segregation could reflect higher levels of animosity and thus result in more policy disagreement, it could encourage the ethnic voting shown to be

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<sup>13</sup> *ibid.*, 1241.

<sup>14</sup> Alberto Alesina, Reza Baqir, William Easterly, “Public Goods and Ethnic Divisions,” *The Quarterly Journal of Economics*, 114, No. 4 (Nov., 1999), 1243-1284.

<sup>15</sup> Abhijit Banerjee and Rohini Pande, “Parochial Politics: Ethnic Preferences and Politician Corruption,” *Faculty Research Working Papers Series*, (July 2007). Paolo Mauro, “Corruption and Growth,” *Quarterly Journal of Economics*, (1995), 681-712.

<sup>16</sup> The effects are shown to be robust to the specific measure of ethnic fractionalization. Alberto Alesina, Arnaud Devleeschauwer, William Easterly, Sergia Kurlat, and Romain Wacziarg, “Fractionalization,” *Journal of Economic Growth* 8 (2003), 155-194. Alberto Alesina and Eliana La Ferrara, “Ethnic Diversity and Economic Performance,” *Journal of Economic Literature* 43, no. 3 (Sep., 2005), 762-800.

<sup>17</sup> Quality of government is captured by the six measures in the Governance Indicators Dataset. Alberto Alesina and Ekaterina Zhuravskaya, “Segregation and the Quality of Government in a Cross-Section of Countries,” Centre for Economic Policy Research, Discussion Paper 6943 (Aug. 2008).

<sup>18</sup> Chad Sparber, “A Theory of Racial Diversity, Segregation, and Productivity,” *Journal of Development Economics* 87 (2008), 210-226.

detrimental above, it could provoke threats of secession thereby destabilizing policy, or it could exacerbate an unequal allocation of public goods across regions. As these possibilities share similarities with the causal process predicted by earlier theories of ethnic fractionalization and growth, however, it is difficult to differentiate between signatures of segregation as compared to those of fractionalization.

Economic policy plays a central role throughout these theories, forming the channel through which diversity depresses economic prospects. A central assumption of this work, therefore, is that worse economic policy and provision of public goods will result in worse economic performance. Poor economic policy could be driven by a number of different motivations. The most obvious is a simple divergence in policy preferences between groups. Poor public spending can also reflect attempts to prevent public spending that is perceived as a wealth transfer from one group to another, an effect that is particularly pronounced when ethnic cleavages coincide with socio-economic cleavages.<sup>19</sup> Alesina and Drazen, meanwhile, demonstrate that ethnic fractionalization acts as a brake on the policy reform process by presenting additional hurdle to be overcome in the political process.<sup>20</sup>

Consequently, this approach hypothesizes a specific causal process: underdevelopment is caused by poor government policy and provision of public goods, which in turn is the result of ethnic polarization. A gap remains in the particular areas of policy given attention. Focus is primarily on public goods, but other key aspects of governance quality, *i.e.* regulatory quality, remain neglected.<sup>21</sup> If ethnic fractionalization has a negative effect of public investment and spending, it might be suspected to have a similar effect on these other policy areas. The present study offers an opportunity to consider these additional factors. A corresponding causal chain would be expected.

<sup>19</sup> Alesina, Baqir, and Easterly (1999), 1244.

<sup>20</sup> Alberto Alesina and Allen Drazen, "Why Are Stabilizations Delayed?" *American Economic Review*, (1991), 1170-1188.

<sup>21</sup> All six of the Kaufmann indicators are included in the segregation study by Alesina and Zhuravskaya study, though not all are found to be significant.

Common to the empirics of this literature is that it does not actually measure the degree of polarization between ethnic groups; instead, data constraints force a more standard measure of ethnic fractionalization.<sup>22</sup> The implicit assumption is that ethnic diversity inherently causes poor policy. If this assumption were to hold, however, ethnically diverse countries would be expected to be consistently amongst the least developed. Instead, a few obvious cases demonstrate that ethnic fractionalization does not universally stunt development. In BiH, the entity with greater ethnic diversity (FBH) would be expected to exhibit poorer policy across the observed period, but as noted in the introduction, this is not the case. This naturally begs the question of what factors might moderate the negative trends associated with polarization.

Paul Collier provides insight, arguing that ethnic diversity must interact with another variable to produce negative effects. Logically, political factors are particularly important, with democracy mitigating ethnic fractionalization's negative economic effects.<sup>23</sup> Clearly, and logically, then, it is not ethnicity alone that results in poorer economic policy, but rather ethnicity plus the political institutions through which policy is forged. This naturally begs the question, however, as to which institutional arrangements produce which effect. To answer this question, it is necessary to move beyond the economics literature and examine the substantial body of comparative work dealing with ethnic politics.

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<sup>22</sup> It is captured using a Herfindahl concentration index of Ethno-Linguistic Fractionalization (ELF), which measures the probability that two randomly drawn individuals are from a different group, such that:

$$ELF = 1 - \sum_{i=1}^N s_i^2 \quad \text{where } s_i \text{ is the share of group } i \text{ (} i = 1, \dots, N \text{)}$$

For an overview, see Daniel Posner, "Measuring Ethnic Fractionalization in Africa," *American Journal of Political Science*, 48, no. 4 (2004) 849-863.

<sup>23</sup> Paul Collier, "Ethnicity, Politics, and Economic Performance," *Economics and Politics* 12, No. 3 (Nov. 2000), 225-245. In other work, Collier distinguishes between the effects of dominance, in which a single ethnic group dominates all others, and fractionalization, in which many different groups are present, none of which possesses a majority. The study again finds that democracy ameliorates the problems of either situation, and does not find evidence that ethnic diversity alone leads to unambiguously worse economic performance. Paul Collier, "Ethnic Diversity: an Economic Analysis," *Economic Policy* (2001) 128-166.



## *Consociational Democracy*

In the study of ethnic politics, the conventional wisdom has long advocated power sharing, or consociational democracy in order to mitigate ethnic tensions. International relations scholars frequently see power sharing as a means of achieving peace after conflict, whereas democracy theorists see power sharing arrangements as a means by which to promote democracy itself.<sup>24</sup> Arend Lijphart, perhaps the single most influential figure in this discourse, argues that power sharing, or government by an 'elite cartel,' helps facilitate democracy in fragmented societies, thereby improving stability and the chances that democracy survives.<sup>25</sup> Cooperation yields a socializing effect, embedding traits such as tolerance and compromise that are necessary in democracy.<sup>26</sup>

Consociational arrangements typically involve certain key elements, including grand coalitions, veto rights, and territorial decentralization. Proportional representation in political representation and civil service are other common elements, and along with closed party lists can facilitate the elite cooperation necessary to avoid the disintegrative tendencies of polarized ethnic democracies by guaranteeing representation to major groups.<sup>27</sup>

The risks of further political fragmentation if a consociational structure is not adopted include polarization, deadlock, instability, and potentially the breakdown of the political system altogether. Drawing on the economic studies above, polarization is expected to impair efficient economic policy. Consociational scholars expect power-sharing arrangements to help a country navigate its ethnic tensions; this intuitively includes facilitating policy decisions, which by extension should include economic policy. Thus,

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<sup>24</sup> The two strains of political science define power sharing differently. International relations scholars consider both formal and informal institutions facilitating peace under its rubric, and it may occupy the political, military, economic, or cultural sphere. Comparative political scientists, on the other hand, tend to restrict analysis more narrowly to those formal political institutions for power sharing. This work follows the latter convention.

<sup>25</sup> Arend Lijphart, "Consociational Democracy," *World Politics* 21, No. 2 (1969) 207-225.

<sup>26</sup> Arend Lijphart, "Democracies: Forms, Performance, and Electoral Engineering," *European Journal of Political Research* 25, no. 1 (1994) 1-17.

<sup>27</sup> Arend Lijphart, *Patterns of Democracy: Government Forms and Performance in Thirty-Six Countries*, (New Haven: Yale University Press, 1999) 144-150.

applying the theory of consociational democracy, one would expect power sharing arrangements in BiH to mitigate the effects ethnicity has upon economic policy.

### ***The Integrationist Approach for Divided Societies***

An alternate theory that may be termed the integrationist approach has levied heavy criticism against the ability of consociational prescriptions to mitigate ethnic tension. Dominant criticisms have focused on the fact that over the long term, consociational democracy does not necessarily provide the stability that it proffers.<sup>28</sup> In fact, power sharing prescriptions can have the exact opposite of the intended affect, serving to diminish the relevance of all cleavages other than the ethnic cleavage, thereby guaranteeing that political competition will continue to be pursued along ethnic lines. The result of consociational institutions will be centrifugal politics, due to a system rewarding the appeals of extremists over moderates.<sup>29</sup> Instead of attempting to facilitate politics by removing risk perceptions through a reduction in political competition (accomplished by guaranteeing seats at a fixed rate according to a common consociational prescription), integrationists advocate an institutional design that rewards the moderates.<sup>30</sup> The result is centripetal, instead of centrifugal, politics. Electoral systems are an important mechanism by which to engineer such outcomes. In particular, Reilly advocates preferential vote systems such as the Alternative Vote (AV), and open party lists.<sup>31</sup>

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<sup>28</sup> This does not necessarily mean that power sharing loses its utility in ending conflict. Rothschild and Roeder, for example, distinguish between the initiation and the consolidation phase of democracy. Donald Rothschild and Philip Roeder, "Dilemmas of State-Building in Divided Societies," and "Power Sharing as an Impediment to Peace and Democracy," in *Sustainable Peace: Power and Democracy after Civil Wars*, Philip Roeder and Donald Rothchild, eds., (Ithaca: Cornell University Press, 2005) 1-50.

<sup>29</sup> Benjamin Reilly, *Democracy in Divided Societies: Electoral Engineering for Conflict Management*, (Cambridge: Cambridge University Press, 2001).

<sup>30</sup> It is important to emphasize that the disagreement is not regarding the necessity of joint rule; rather, the integrationist-consociational discourse considers the most productive way to include groups in government. Anna Jarstad, "Dilemmas of War-to-democracy Transitions: Theories and Concepts," in *From War to Democracy: Dilemmas of Peacebuilding*, Anna Jarstad and Timothy Sisk, eds., (Cambridge: Cambridge University Press, 2008) 17-36.

<sup>31</sup> Reilly (2001), 18-24. Benjamin Reilly, "Does the Choice of Electoral System Promote Democracy? The Gap between Theory and Practice," in *Sustainable Peace: Power and Democracy after Civil War*, Philip Roeder and

A few important insights from the integrationist logic might be observed in BiH. With regard to consociational arrangements, integrationist works predict that chances of increased political tension are heightened, and that ethnic cleavages should remain dominant. Furthermore, consociational democracy is unlikely to function without the presence of a strong international power with some executive powers. The approach further directs attention to the importance of slight variations in electoral systems, which can either mitigate or exacerbate polarization. As with the theory of consociational democracy, any effect mitigating polarization would be expected to benefit of economic policy.

### ***External Lobby Actors and Ethnic Bargaining***

A final piece of theory that is extremely relevant to BiH concerns the role of external state sponsors of ethnic minorities. Such a situation develops when an ethnic minority finds itself separated from its corresponding nation state, typically located just over the border. Erin Jenne posits that minority claims are largely a product of perceptions of relative bargaining leverage. Within such a framework, intervention by an external lobby actor on behalf of 'its' ethnic minority can increase the leverage of the minority, thereby leading to a radicalization of demands. This posturing may represent an attempt to extract side payments from the government.<sup>32</sup>

In contrast to those political theories above, which consider structural institutional arrangements, Jenne thus provides a dynamic theory of bargaining dynamics (though certainly structural factors interact with the dynamics). While the theory of ethnic bargaining is formally modeled to explain "the extremity of collective demands that minority representatives advance against the center,"<sup>33</sup> there is no reason, *a priori*, why the actions of

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Donald Rothschild, eds., (Ithaca: Cornell University Press, 2005) 159-172. Donald Horowitz, *Ethnic Groups in Conflict*, (Berkeley: University of California Press, 1985).

<sup>32</sup> Erin Jenne, *Ethnic Bargaining: The Paradox of Minority Empowerment*, (Ithaca: Cornell University Press, 2008) 2-14.

<sup>33</sup> Jenne (2008), 40.

an external lobby actor will not have similar effects on intra-governmental policy making as well, at least in environments where policy making resembles strategic bargaining. By extension, therefore, moves by an external lobby actor that alter perceptions of group leverage hold the potential to play a critical role during the forging of economic policy.

### ***Ethnic Politics and BiH***

This section has outlined a general theory of ethnicity and growth, as well as a number of theories regarding factors affecting the hypothesized intervening political dynamics. In the subsequent case studies, particular attention will be given to economic policy. In particular, the quality of fiscal policy will be considered, both in terms of spending priorities and budgeting ability. The role of governing institutional structures will also be followed closely. Dayton initially provided BiH with a thoroughly consociational structure (elaborated below), but this structure has been adjusted over time. Close attention is also given to the positioning of the two key external lobby actors in BiH, Serbia and Croatia. There is the potential that a shift in any of these variables might produce different outcomes, ranging from poor to excellent policy, or alternately, deadlock.

### **Post-communist Transformation**

Many of the economic challenges faced by BiH fall within the literature examining the move from central planning to market democracy. Amongst others, the host of reforms this transition involves includes deregulation, price liberalization, abolishment of state trading bureaus, and privatization. Explanations economic performance have tended to group around three set of independent variables: initial conditions, liberalization policies, and institutional variables. These explanations do not so much reflect rigid schools, but are rather differences in degree. De Melo, Denizer, and Gelb provide a comprehensive index measuring liberalization on the core components of post-communist reforms, finding a strong correlation

between liberalization and macroeconomic stability, which in turn has a positive impact on growth rates.<sup>34</sup> Based on this, the authors conclude that to the extent governments have discretion in choosing the speed of liberalization, a faster policy will be superior.<sup>35</sup> Initial conditions, in particular those indicating greater integration with the communist block, are also found to have long-term negative effects.<sup>36</sup>

One of the most controversial questions in this discourse has been whether a policy of shock therapy or gradualism contributes more to transitional growth.<sup>37</sup> The studies above that conclude in favor of the former have been criticized for this conclusion because despite a method of enquiry designed to measure the *level* of liberalization, the conclusions frequently make normative statements regarding the proper *speed* of liberalization, (*i.e.*, faster). While it is certainly logical that liberalization improves growth, the subsequent conclusion that faster liberalization is therefore unambiguously better proves questionable. Heybey and Murrell argue that this conclusion “glosses over the distinction between policy and policy changes.”<sup>38</sup>

<sup>34</sup> In the mid-nineties, it was not taken for granted that stabilization was a prerequisite for growth. Many argued that transition economies were fundamentally different from fully developed market economies, and thus needed loose monetary policy in order to finance growth during transition. Those advocating gradualism based on this logic should be differentiated from the neo-institutional argument for gradualism considered below.

<sup>35</sup> Martha de Melo, Cevdet Denizer and Alan Gelb, “Patterns of Transition from Plan to Market,” *World Bank Economic Review*, 10 no. 3 (Sep. 1996), 397-424. Fischer, Sahay, and Vegh, show similar results while additionally controlling for fiscal deficit, official development assistance, inflation, and fixed/flexible exchange rates. Stanley Fischer, Ratna Sahay, and Carlos Vegh, “Economies in Transition: the Beginnings of Growth,” *The American Economic Review*, 86, No. 2 (May, 1996), 229-233 and Stanley Fischer, Ratna Sahay, and Carlos Vegh, “Stabilization and Growth in Transition Economies: the Early Experience,” *The Journal of Economic Perspectives*, 10, No. 2 (Spring, 1996), 45-66. Selowsky and Martin correct for underreported private sector activity and the occurrence of war, and come to similar conclusions. Marcelo Selowsky and Ricardo Martin, “Policy Performance and Output Growth in the Transition Economies,” *The American Economic Review*, 87, No. 2, (May, 1997), 349-353.

<sup>36</sup> Martha de Melo, Cevdet Denizer, Alan Gelb, and Stoyan Tenev find these variables to have an effect in addition to the policies of liberalization described above. “Circumstance and Choice: the Role of Initial Conditions and Policies in Transition Economies,” *World Bank Working Papers*, No. 1866 (1997). Aslund, Boone, and Johnson confirm the importance of initial conditions, but find that after including dummy variables for former ruble zone and war torn countries, the effects of liberalization policy as constructed by de Melo et al. vanish. Anders Aslund, Peter Boone and Simon Johnson, “How to Stabilize: Lessons from Post-communist Countries,” *Brookings Papers on Economic Activity*, 1 (1996), 217-313.

<sup>37</sup> While shock therapy often refers to bringing hyperinflation under control, in the context of the transitions literature, the phrase refers to the broader process of economic restructuring.

<sup>38</sup> The authors find that initial conditions are far more important in determining initial economic performance during transition, while the speed of liberalization is insignificant. Furthermore, initial conditions are important predictors of the speed of liberalization, a potential indication of endogeneity problems within these models. Berta Heybey and Peter Murrell, “The Relationship between Economic Growth and the Speed of Liberalization During Transition,” *Journal of Policy Reform*, 3, no. 2 (1999), 6.

Popov echoes this critique, further finding that institutional quality is also important. He concludes that “liberalization alone, when it is not complemented with strong institutions, can not ensure good performance.”<sup>39</sup> Other studies have found institutional variables to play a role in predicting FDI as well as growth.<sup>40</sup> This finding of joint necessity accords with the neo-institutional arguments presented above. The overwhelming lesson of this literature has been that development requires an institutional framework with a self-restraining state, in which property rights are guaranteed against arbitrary expropriation.<sup>41</sup>

Thus, a general consensus is emerging that both institutions and liberal policies matter. Havrylyshyn and Rooden, for example, write that solid macroeconomic policy is a necessary but not sufficient condition for growth.<sup>42</sup> Recent work has also found that over a longer period of time, the impact of initial conditions diminishes, an intuitively logical finding.<sup>43</sup> Without the key institutions comprising a state restrained from arbitrarily expropriating wealth, liberal policy alone cannot cause growth, but neither will the proper institutions be sufficient if the state does not reform. While a consensus is forming around the importance of institutions, however, economics offers little insight as to how these liberal institutions are attained. To account for this variation, it is necessary to turn to comparative political studies on post-communist transitions. The following subsections consider the

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<sup>39</sup> Vladimir Popov, “Shock Therapy versus Gradualism: the End of the Debate (explaining the magnitude of the transformational recession),” *Comparative Economic Studies*, 42, no. 1 (Spring 2000), 44.

<sup>40</sup> Aymo Brunetti, Gregory Kisunko and Beatrice Weder, “Institutions in Transition: Reliability of Rules and Economic Performance in Former Socialist Countries,” World Bank Working Paper No. 1809, (1997).

<sup>41</sup> Douglas North and Barry Weingast, “Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England,” *Journal of Economic History* 49, no. 4 (1989) 803-832. Mancur Olson, “Dictatorship, Democracy, and Development,” *American Political Science Review* 87 (1993) 567-576.

<sup>42</sup> Oleh Havrylyshyn and Donald McGettigan, “Institutions Matter, but so do Policies,” International Monetary Fund, Working Paper WP/00/70 (2000).

<sup>43</sup> Sergio Godoy and Joseph Stiglitz, “Growth, Initial Conditions, Law and Speed of Privatization in Transition Countries: 11 Years Later,” National Bureau of Economic Research, Working Paper 11992 (January 2006).

traditional neo-liberal prescription creating a restrained state, followed by a recent challenge articulated by political competition theory.<sup>44</sup>

### ***The Neo-liberal Approach to Market Reform***

The conventional wisdom, reflected in the neo-liberal Washington Consensus, provides a straightforward and simple prescription for creating the institutions that facilitate market exchange. Expecting private market agents to demand the rule of law and protection of property rights, neo-liberals prescribe an agenda emphasizing the fast creation of these market agents for the post-communist space. One of the most important steps in this process is the privatization process.

Compromising on quality by allowing some rent-seeking during the reform process may be necessary to avoid alienating economic insiders to the degree where they ‘walk-out’ on the reform agenda.<sup>45</sup> If this results in a corrupt mode of privatization, this result may be tolerated with the knowledge that new private owners will seek to make a profit from their industries.<sup>46</sup> Attempting to pursue profits, in turn, will lead these new market agents demand continued reform to limit the suffocating reach of the state. Thus, even if new owners acquired their assets through ill means, the new entrepreneurial class will demand the consolidation of a market democracy in order to protect these assets.<sup>47</sup> Over time, insiders’ power will be diluted as markets facilitate the trade of shares.<sup>48</sup> Combining these

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<sup>44</sup> For excellent literature reviews on the topic, see Milada Vachudova, *Europe Undivided: Democracy, Leverage, and Integration after Communism* (Oxford: Oxford University Press, 2005) 11-24, and John Gould and Carl Sickner, “Making Market Democracies? The Contingent Loyalties of Post-privatization Elites in Azerbaijan, Georgia and Serbia,” *Review of International Political Economy* 15, no. 5 (2008) 742-748.

<sup>45</sup> Valerie Bunce, “Rethinking Recent Democratization: Lessons from the Postcommunist Experience,” *World Politics* 55, no. 2 (2003) 187. Andrei Shleifer and Daniel Treisman, *Without a Map: Political Tactics and Economic Reforms in Russia*, (Cambridge: The MIT Press, 2000) 34-38.

<sup>46</sup> This implies they will conduct the enterprise restructuring necessary to make the industry profitable, as well as seeking to limit the role of the state. Shleifer and Treisman (2000), 36. For evidence from Russia, see Maxim Boycko, Andrei Shleifer, and Robert Vishny, *Privatizing Russia*, (Cambridge: The MIT Press, 1995).

<sup>47</sup> On the general demand of entrepreneurs for such institutions, see Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

<sup>48</sup> Wing Thy Woo, “Improving Enterprise Performance in Transition Economies,” In *Economies in Transition*, eds. Wing Thy Woo, Stephen Parker, and Jeffrey Sachs (Cambridge: The MIT Press, 1997) 299-323.

expectations provides a clear policy prescription favoring privatization despite the odds. If the causal process follows the chain predicted by neo-liberal market reformers, even a corrupt process will facilitate the consolidation of a market democracy over the long-term.

### ***Political Competition Theory***

Recent evidence from the post-communist space has called into question the prescription of privatizing at all costs. Political competition theory argues that in the absence of robust mechanisms ensuring political competition, elites are likely to rig reform processes to their own benefit. Contrary to the predictions immediately above, however, these insiders often benefit from continued market dysfunction, thereby leaving little incentive to push for the consolidation of an open market democracy. The result is a stalled ‘partial reform equilibrium.’<sup>49</sup> In the resulting environment is one in which it is difficult to distinguish between political and economic elite; state capture enables continued rent seeking so long as accountability remains limited.<sup>50</sup>

Political competition, however, holds the potential to mitigate the effects of rigged reforms. At its core, this requires mechanisms by which populations can hold elites accountable. The vertical accountability exercised by voters is a key component facilitating reform. Alternation in ruling parties or coalitions brings reassessments of economic policy, thereby preventing poor policy from compounding and preventing the entrenchment of special interests.<sup>51</sup> Strong competition between political parties leads ruling elites to anticipate the consequences of reform failure and moderate attempts to benefit themselves.<sup>52</sup> Horizontal accountability further helps lead rational elites to consider the costs of improper

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<sup>49</sup> Joel Hellman, “Winners Take all: The Politics of Partial Reform in Postcommunist Transitions,” *World Politics* 50, no. 2 (Jan., 1998) 203-234.

<sup>50</sup> Joel Hellman and Daniel Kaufmann, “Confronting the Challenge of State Capture in Transition Economies,” *Finance and Development* 38, no. 3 (2001) 31-35.

<sup>51</sup> Mitchell Orenstein, *Out of the Red: Building Capitalism and Democracy in Post-Communist Europe* (Ann Arbor: University of Michigan Press 2001), 96-127.

<sup>52</sup> Anna Grzmala-Buisse, “The Discreet Charm of Formal Institutions: Postcommunist Party Competition and State Oversight,” *Comparative Political Studies* 39, no. 3 (2006) 271-300.



action.<sup>53</sup> Identity politics, however, may impede this process. In Slovakia during the early 90s, a discourse centered on creating a sovereign Slovak state allowed managers to slow the privatization process by framing goals in the language of national identity.<sup>54</sup> Playing on victimization, managers articulated a need to maintain control over industries in order support the fledgling state's independence.<sup>55</sup>

### ***Post-communist Transformation and BiH***

This section has considered a number of aspects inherent to post-communist reform that will be examined in the cases below. The subsequent chapter will give specific attention to privatization and deregulation, and the relationship between the conduct of the reforms and further transformation. It will also observe levels of political competition, considering mechanisms of vertical accountability in particular.

Finally, while transition naturally indicates movement, many states described as 'transitioning' have actually become stalled in various stages of semi-authoritarianism. Continuing to consider such states within a framework of transition can obscure more than it can reveal.<sup>56</sup> This warning against teleological assumptions must borne in mind. Fourteen years after the war, it would be specious to assume that BiH is necessarily still transitioning. Stasis is a reasonable possibility.

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<sup>53</sup> Guillermo O'Donnell, "Delegative Democracy," *Journal of Democracy* 5, no. 1 (1994) 55-69.

<sup>54</sup> Hilary Appel and John Gould, "Identity Politics and Economic Reform: Examining Industry-State Relations in the Czech and Slovak Republics," *Europe-Asia Studies* 52 no. 1 (2000), 111-131. John Gould, "Out of the Blue? Democracy and Privatization in Postcommunist Europe," *Comparative European Politics* 1 (2003) 277-311.

<sup>55</sup> Appel and Gould (2000), 125.

<sup>56</sup> Thomas Carothers, "The End of the Transition Paradigm?" *Journal of Democracy* 13, no. 1 (2002) 5-21. For a response, see Jordan Gans-Mors, "Searching for Transitologists: Contemporary Theories of Post-Communist Transitions and the Myth of a Dominant Paradigm," *Post-Soviet Affairs* 20, no. 4 (2004) 320-349. See also Larry Diamond, "Thinking about Hybrid Regimes," *Journal of Democracy* 13, no. 2 (2002) 21-35 and Steven Levitsky and Lucan Way, "The Rise of Competitive Authoritarianism," *Journal of Democracy* 13, no. 2 (2002) 51-65.

## Conclusion

This literature review has surveyed a broad range of theories. Because of BiH's position at the nexus of these processes, each holds analytical potential to elucidate understanding of development at the sub-state level. These broad concentrations are not mutually exclusive, although certainly some theories within these concentrations predict contradictory outcomes. This unique nexus also makes the cases of theoretical interest, and allows for potential generation of new hypotheses. To the author's knowledge, for example, the ethnicity and growth literature, while important to development in general, has yet to be integrated with theories of post-communist transitions. Additionally, BiH is generally excluded from the body of post-communist transitions, as it naturally tends to provoke a different set of questions. In this respect, theory testing can help fill an empirical hole in the survey of post-communist states. With these potentials in mind, it is now possible to consider post-war development of the entities.

## IV. CASE STUDIES

### Dayton and the Initial Governing Structure

As the acclaimed Bosnian writer Semezdin Mehmedinovic has noted, various ethnic groups were so intertwined in BiH that any attempt to separate them out could not help but be a wrenching process.<sup>57</sup> Four years of fighting along ethnic lines attempted to achieve this disentanglement, resulting in a high degree of polarization amongst groups that had previously lived in a highly integrated society. In addition to its extreme toll in human terms, the 1992-1995 war wreaked economic and political havoc on the emerging state, decimating the nation's infrastructure and delaying the start of the transition to a market economy. Political institutions with roots in the socialist era were twisted to the war's purposes, divided along ethnic lines, and were thus ill-suited to building a democracy. Having been necessary to fund the war effort, economic institutions faced a similar division, and operated in a shadowy unofficial criminal sphere connected to the political leadership.

Negotiated in November of 1995, the Dayton Peace Accords brought an end to hostilities. The agreement specified a new state structure, subsequently modified by successive laws. The structures detailed in this introduction refer to the initial arrangements, with revisions noted as appropriate in the case studies. To reassure the polarized ethnic groups, the DPA specify decentralized and consociational structures. As a result, the state is a loose confederation with minimal powers. Most functions are exercised by the level immediately below the state, the entity governments (RS and FBH). The awkward structure was a necessary concession for peace, but did enable BiH to retain its pre-war boundaries. Dayton also envisaged an active initial role for the international community in order to guide

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<sup>57</sup> Semezdin Mehmedinovic, "Stocking Hat," *Sarajevo Blues*, Translated by Ammiel Alcalay, (San Francisco: City Lights, 2003), 21.

the state-building process, overseen by the Peace Implementation Council (PIC), a group of fifty-five countries and organizations.

At the state level, government structures ensure each ethnic group equal representation and veto over issues of ‘vital national interest.’ The awkwardness this entails is readily on display in the state presidency, a three member body with a rotating chairmanship. The parliament is a bicameral body. Bosniak and Croat members of these bodies are elected by FBH voters, while the Serb members are chosen in RS. While voters of any ethnicity are in theory eligible to vote in both entities, this has not been the practice. Members of the presidency must formally declare themselves to be of the group they compete to represent. In the parliaments, the ethnically constituted parties work to naturally ensure that representatives belong to their constituent group.<sup>58</sup> Finally, the Council of Ministers (CoM) forms the semblance of the state cabinet.

Each entity further possesses a full set of governing institutions. RS initially had a unicameral National Assembly with a Prime Minister (PM) and a directly elected president. In contrast to this centralized structure, FBH further replicates the decentralized consociational arrangements of the state level. A bicameral parliament with a PM again stipulates proportionality to ensure both groups an equal role. Below the entity level, FBH is further split into ten cantons, each with its own parliament and PM. At the lowest level, each entity is further divided into municipalities.

While revenue in RS is collected by its government and then transferred to municipalities, FBH consistently reflects the principle of subsidiarity in order to accommodate the two ethnic groups (largely separated across the cantons). Consequently, any function not explicitly assigned to the FBH government is devolved to the cantons, which further delegate significant responsibility to the municipalities. The overall result of this

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<sup>58</sup> For more on the disenfranchising effects of this institutional structure, see Donais (2005).

structure is that BiH, a country of roughly four million people, possesses thirteen parliaments and as many PMs. The majority of this redundancy, however, is concentrated in the Federation. While the RS is primarily comprised of Serbs and the FBH is shared between Bosniaks and Croats, in the eyes of the international community, the entities were not *in theory* to belong to any ethnic group.

The PIC is represented in BiH by the Office of the High Representative (OHR), initially an ambassador with little true power. The Organization for Security and Cooperation in Europe (OSCE) was responsible for elections. Economic matters were under the authority of a collection of International Financial Institutions (IFIs), many of which had seats on the PIC. The World Bank took the leading coordination role, with the U.S. Agency for International Development (USAID), IMF, and the European Bank for Reconstruction and Development (EBRD) directing portfolios of key projects.

Under this initial structure, the entities exercised exclusive authority for economic and social sector policies, resettlement and reconstruction, justice, and the collection of tax and customs duties. The state had formal authority over monetary policy, customs law, and inter-entity infrastructure, though it took time to control even these minimal competencies. The state possessed no independent sources of revenue, and was dependent upon transfers from the entities.<sup>59</sup> Despite this fact, the state was the sole guarantor of the sovereign debt. In FBH, the cantons were responsible for sales, income and property taxes, as well as local user fees.<sup>60</sup> As a result of this structure, all economic policy operated at the entity level.

As a result, the political economy must be understood as highly segregated along ethnic lines. With most economic power exercised at the entity level, it quickly became a realm for contestation rather than mutual positive-sum cooperation. Such a trend has been noted by the International Crisis Group, which recently found that “Since the end of the war,

<sup>59</sup> Elizabeth Cousens and Charles Cater, *Toward Peace in Bosnia: Implementing the Dayton Accords*, (Boulder: Lynne Rienner, 2001) 88.

<sup>60</sup> World Bank, “Country Assistance Strategy for Bosnia and Herzegovina (FY00-FY02),” (June 2000), 9.

economics have often divided Bosnia's entities, rather than encouraged cooperation."<sup>61</sup> This was the institutional setting in which reconstruction began.

## **The Post-war Reconstruction Phase: 1996 – 2000**

For the first four years after the war, primary focus was given to baseline repairs. At the end of 1995, approximately half the population was displaced. Estimates of devastation, though widely varied, concurred in the need to rebuild the economy almost entirely from scratch. GDP per capita was placed between \$250 and just under \$500,<sup>62</sup> around 20% of pre-war levels.<sup>63</sup> Estimates of the overall size of the economy ranged between 5 to 10% of prewar levels.<sup>64</sup> Nearly half of the industrial capacity was destroyed, and industrial production was a mere 7% of the 1990 level.<sup>65</sup> This extreme underutilization reflected the devastation of infrastructure.<sup>66</sup> Wartime damage was much more extensive in FBH than in RS, but pre-war development had also been higher in FBH, which possessed four out of five of the major urban centers in BiH.

Monetary policy was highly complicated, with four currencies in use, but none universally accepted. The FRY Dinar was prominent in RS, the Croatian Kuna in Croat regions, the BiH Dinar (pegged to the Deutsche Mark) in circulation amongst Bosniaks, and the Deutsche Mark (DM) the only semblance of a state-wide currency. The government held \$5b of debt, of which \$2.5b was owed to foreign creditors and \$2.3b to citizens.<sup>67</sup>

In economic terms, this meant that 1996-2000 was considered under the special circumstances of reconstruction as compared to post-socialist transition. In practice, this

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<sup>61</sup> International Crisis Group, "Ensuring Bosnia's Future: a New International Engagement Strategy," Europe Report No. 180 (15 February 2007).

<sup>62</sup> EIU (March 1996), 8-9.

<sup>63</sup> Zlatko Hurtic, Amela Sapcanin, and Susan Woodward, "Bosnia and Herzegovina," in *Good Intentions: Pledges for Aid for Postconflict Recovery*, Shepard Forman and Stewart Patrick eds., (Boulder: Lynne Rienner, 2000) 316-17.

<sup>64</sup> EIU (June 1996), 11.

<sup>65</sup> *ibid.*, 11.

<sup>66</sup> EIU (March 1996), 9.

<sup>67</sup> EIU (June 1996), 11.

connoted a particular emphasis on rebuilding infrastructure, financed by substantial foreign aid. It also excepted BiH from economic (but not political) conditionality, and meant work on economic transformation would primarily be preparatory. Political restructuring was central to the reconstruction. RS emerged relatively quickly, not surprising given its wartime legacy, and the blurry line dividing it and the Federal Republic of Yugoslavia (FRY).<sup>68</sup> The FBH, on the other hand, despite having formally been forged in the Washington Agreement more than a year before the war's end, was a fiction at the start of reconstruction. In reality, Bosniaks exercised their authorities at the state level, and Croats administered their regions through the illegal para-state of Herzeg-Bosna. Consequently, BiH started its reconstruction more as three states than two entities.

### **1996**

The first post-war donor's conference in Brussels netted initial pledges of \$1.2b for BiH. RS, however, was not present, which combined with refusal to implement Dayton, resulted in almost the entirety of these funds being directed toward FBH. Yet while FBH received substantial aid pledges, it still needed to establish basic entity-level structures before it would prove capable of spending these funds. The major impediment to this, in turn, was the continued operation of Herzeg-Bosnia, which itself was a result of continued external sponsorship from Croatia. The Croatian Democratic Union of BiH (HDZ BiH), the dominant Croat party and effective government of Croat areas, was itself merely a branch of the HDZ in Croatia, where it was also the ruling party. An agreement was reached under heavy international pressure in August, detailing a simultaneous transfer of powers from Herzeg-Bosnia and the Muslim dominated state institutions to the Federation. In a telling sign of Zagreb's role in FBH politics, it was Croatian President Franjo Tudjman who signed the

<sup>68</sup> At the time, FRY consisted of Serbia and Montenegro, but the key power center with respect to the BiH political economy was Belgrade, the center of Serbian politics. For this reason, FRY and Serbia shall be used interchangeably. The secession of Montenegro in 2006 finally dissolved the last remnants of the Yugoslav state, meaning after this point the term Serbia is used exclusively.

agreement. In a parallel sign of the importance of external lobby actors, Radovan Karadzic was persuaded to step down as President of RS under pressure from Serbian President Milosevic.<sup>69</sup> He was replaced by the Vice President of RS, Biljana Plavsic, also a member of the extreme Serb Democratic Party (SDS).

The first elections for state and entity parliaments were held in September. The results widely confirmed the dominant position of the ruling ethno-nationalist parties, the SDA, HDZ, and SDS. As the EIU noted, these results produced the ironic situation in which “The three parties who were previously engaged in military conflict now have the task...to govern a loosely united country.”<sup>70</sup> Though opposition parties made inroads, it remained clear that power was entrenched in the parties.<sup>71</sup>

Nevertheless, by the end of the year, the first outlines of institutional structures along the lines envisaged by Dayton could be discerned. In September, the state established the BiH Central Bank under the stipulations of the DPA.<sup>72</sup> Though multiple currencies continued to circulate, a new payment transaction system helped facilitate commercial trade between the entities. FBH began exercising limited competencies, and managed to collect its first revenues through customs. Roughly \$700b in aid was distributed in 1996,<sup>73</sup> but only 2% went toward RS.<sup>74</sup> WB estimates put growth at 35% for the year, almost entirely associated with reconstruction work. As RS received little aid, however, growth was almost entirely in FBH. In a sign of the stagnation in RS, average monthly wages there were just DM40, as compared to DM235 in FBH, though the latter figure marks a sharp difference between Croats and Bosniaks, with the former earning significantly more.

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<sup>69</sup> EIU (August 1996), 9.

<sup>70</sup> EIU (December 1996), 6.

<sup>71</sup> *ibid.*, 10.

<sup>72</sup> Annex 4, Article VII.

<sup>73</sup> EIU (February 1997), 3.

<sup>74</sup> EIU (December 1996), 12.



**1997**

Forming governments from the September elections was an extremely drawn-out process, despite the clear mandates. FBH took until February to form its government, largely due to Croat tactics of boycotting parliament. Heightened tensions were further displayed when the Bosniak PM Edhem Bicakcic (SDA) accused his deputy and Finance Minister Drago Bilandzija (HDZ) of depriving the FBH of DM23m worth of revenue by allowing a Croat company's imports to cross into Western Herzegovina tax-free.<sup>75</sup>

Ultimately, the three ethnic parties dominated coalitions, but the delay at a time of pressing reform highlights the role of polarization causing delays. The deadlock delayed a package of reforms required by the international community before another donor's conference would be held. The reforms constituted the baseline legislation needed to establish a functioning political and economic sphere, including agreements required for the central bank to start functioning, adopting budgetary laws, resolving the foreign debt, and forging customs, trade, and foreign investment policies – in short, central issues of economic policy.<sup>76</sup> The reforms required substantial entity consensus.

RS, meanwhile, continued to show greater ties with FRY than the central state. In February, the SDS signed a special agreement on ties with FRY, covering such areas as economic cooperation and the mutual border. The importance of Serbia's external sponsorship was further demonstrated when it assisted in reopening limited production at the Bosanski Brod oil refinery, the largest refinery in BiH.<sup>77</sup>

At the same time, the RS leadership broke into an open power struggle that took on a decidedly economic connotation when RS President Plavsic attempted to open an investigation into corruption. The move threatened a powerful circle of Bosnian Serbs,

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<sup>75</sup> Though the FBH continued to draw most funding from foreign aid, the lost revenue was significant at a time when the government's obligations already equaled ten years worth of tax revenues. EIU Q1 1997 10-12. "Finance Minister Dismisses Accusations of Financial Wrongdoing," BBC, 27 January 1997.

<sup>76</sup> EIU (May 1997).

<sup>77</sup> EIU (July 1997), 14.

including the Serb member of the State Presidency, Momcilo Krajisnik, and Radovan Karadzic. Karadzic and Krajisnik were both speculated to benefit heavily from continued operations of wartime criminal-business operations. Plavsic, ostensibly outside this network, claimed that such activities deprived the state of significant revenues and throttled economic recovery in the RS.<sup>78</sup> She received backing from economic reformers, while Krajisnik's powerbase, included many powerful SDS figures and much of the wartime leadership. The international community, though aware of Plavsic's former ties to Karadzic and her own hardline views, nevertheless supported her in the struggle, perceiving her greater willingness to cooperate for economic benefits. This crack in the Serb leadership represents the first opening of political competition in RS, and as such is a key event.

With discord between Croats and Bosniaks blocking all work in the FBH, and an ongoing power struggle in the RS, reconstruction funds dropped off in the first half of 1997, leading growth to slow. The delay was even more painful for RS, which had yet to begin see economic benefit. The quick deceleration demonstrates the degree to which growth continued to be almost entirely aid dependent and based on short-term projects.<sup>79</sup>

Over the summer, however, the situation began to markedly reverse. Compromise on necessary reforms was finally reached in June, allowing the donor's conference to go forward.<sup>80</sup> Work also began to move forward on a key pillar of transition, when entities proposed initial privatization plans. The RS submitted the first plan, but it received heavy criticism, particularly from the WB, which was concerned over a scheme that seemed designed to benefit insiders. Western governments advised the RS start over. FBH received a warmer reception, though it forged the plan in close consultation with Western experts.

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<sup>78</sup> Particularly problematic for the RS was fuel, cigarette, alcohol, and coffee smuggling, as customs were a primary source of entity revenue. As EIU noted, "Private businesses complain that firms with powerful political connections are enjoying monopolies on trade in key goods, stifling economic development." EIU (May 1997), 11-12.

<sup>79</sup> EIU (February 1997), 12.

<sup>80</sup> EIU (November 1997), 13.

The plan began with small enterprises, and included vouchers, auctions, and public tenders, the latter two being equally open to foreign and domestic investors. Implementation of the plan, however, met delays due to disagreements between Bosniaks and Croats. Though the FBH plan met with less criticism, this was not due to a perception of any less threat of corruption. Indeed, the international community considered corruption a primary challenge to development in both entities, as evidenced by an autumn scandal involving the misappropriation of \$22m in reconstruction funds in the FBH, allegedly diverted to wartime organizations.<sup>81</sup>

On 23 November snap elections went forward in RS as the latest development in its ongoing power struggle. Elections narrowly rewarded the position of the parties backing Plavsic and opposed to the SDS. Plavsic's tough stance against corruption struck a cord with the impoverished population, which remained largely shut out from reconstruction efforts.<sup>82</sup>

Meeting in December, the international community showed its resolve when the PIC decided to expand the powers of the OHR. The new authority, subsequently referred to as the Bonn Powers, gave the OHR sweeping new powers to impose legislation and dismiss local officials. The economic consequences of this change were immediately on display when High Representative Westendorp used the powers to impose a design on the currency, thereby removing the last obstacle to introducing a statewide tender. By placing significant executive authority in external hands, the PIC fundamentally altered the BiH institutional structure, and implemented scholars have argued improves the functioning of consociational structures.<sup>83</sup>

For the first time, 1997 budgets were denominated in the new statewide currency, the Konvertible Mark (KM). Though the KM was legal tender, continued disputes on the currency design meant it had yet to begin actual circulation. Continued use of the FRY Dinar

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<sup>81</sup> *ibid.*, 15.

<sup>82</sup> EIU (January 1998), 9.

<sup>83</sup> Roeder and Rothschild (2005), 9.

in RS proved problematic, bringing a spike in inflation, as compared to the increasing monetary stability in BiH (owing to the relative stability of the Croatian Kuna and the BiH Dinar being pegged to the DM). The London Club of commercial creditors, meanwhile, agreed to write down the country's debt by 85.8%, to \$394m.<sup>84</sup>

## 1998

On 17 January, almost two months after the election, President Plavsic finally formed a new RS government. Milorad Dodik, the leader of the Independent Social Democrats (SNSD), became PM. With the SNSD controlling just two of the eighty-three seats, Dodik was an unlikely choice, yet as a moderate, his premiership met international relief.<sup>85</sup> Belgrade silenced SDS protests when it welcomed Dodik's appointment, and Western powers saw an opportunity to enhance the economic recovery of the RS with the extremist's stranglehold on politics broken.<sup>86</sup> The new government quickly demonstrated its strategy of focusing on economic progress, securing greater international assistance for implementing reforms. Dodik's government repealed the previous privatization law, which had met such strong criticism from Western governments, and passed legislation invalidating illegal privatizations. The RS began drafting a replacement law, this time in consultation with international experts.<sup>87</sup> The EIU noted the extent to which the new government was politically accountable to deliver results. "The popularity of the ruling coalition is largely based on the hope of economic improvements from a government which is seen as more competent and less corrupt, and better able to gain international aid...This is why it is so important to Mr. Dodik that he is able to provide evidence of economic improvement; if he

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<sup>84</sup> EIU (January 1998), 15.

<sup>85</sup> Michael Kelly, "A chance to change history; An example of what can happen when good people do the right things," *The Washington Post*, 21 January 1998, A21.

<sup>86</sup> EIU (January 1998), 12.

<sup>87</sup> EIU (May 1998), 20-22.

fails, he would be vulnerable to the claims of the SDS that he is selling out Serb interests for nothing.”<sup>88</sup> With an increase in accountability, reform in RS finally began.

Privatization also made progress in FBH, with the passage of laws both for the sale of banks, and the valuation of enterprises and banks. The latter had been delayed by Croat concerns that transferring the debts of state industries to the FBH Finance Ministry would place a disproportionate burden on Croat taxpayers, who remained the wealthiest group in BiH.<sup>89</sup> Concerns about ‘secret’ privatization deals, conducted outside the purview of the state, remained pronounced in the FBH, particularly in the Croat regions.<sup>90</sup> Meanwhile, growing tensions in the HDZ led to a split within the party between hardliners and moderates, leading the Croat member of the BiH Presidency, Kresimir Zubak, to leave the party and form a new party of Croat moderates, the New Croatian Initiative (NHI).

Also in the spring, the IMF approved its first credit to BiH in the form of an \$81m stand-by credit. In contrast to previous credits which had political strings attached, the new deal for the first time made use of explicit economic conditionality. The move reflected the growing emphasis of the IFIs to begin moving beyond the reconstruction phase of development, toward a wider program of economic reforms necessary to promote the conditions for sustainable growth. Nevertheless, meeting at the fourth annual donors conference in May, international donors agreed to extend the reconstruction period, originally scheduled to end in 1999, by one extra year.

In April, the devaluation of the FRY Dinar as well as building inflationary pressures led the RS to announce that the DM would replace the FRY Dinar until the KM began circulation, which the Central Bank formally launched in July. Pegged to the DM at parity, the KM offered reliable macroeconomic stability to Bosniak regions which quickly adopted it. The Croatian Kuna and FRY Dinar, however, continued to circulate in Croat and Serb

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<sup>88</sup> *ibid.*, 13.

<sup>89</sup> EIU (January 1998), 16.

<sup>90</sup> *ibid.*, 16. EIU (May 1998), 22.

areas. Also over the summer, the Dodik government passed a new bank and enterprise privatization law, which met with greater approval from the IFIs than the previous law. This instance is an important demonstration of early attempts to increase the quality of policy in RS.

In September, the second set of general elections produced encouraging results, with the three nationalist parties seeing a decrease in their vote share. While the SDA, HDZ, and SDS continued to capture the largest share of votes, each won few seats at both levels of government. The SDA lost its majority in the FBH. The HDZ, still enjoying the most discipline amongst its Croat constituents, faced greater competition. The SDS continued its slide in RS politics, showing general satisfaction with Dodik in his first year. In general, the elections showed an increase in party plurality, with moderates making inroads. In an upset demonstrative of the continued importance of ethnic politics, however, Biljana Plavsic lost the RS Presidency to an ultra-nationalist of the Serbian Radical Party of the RS (SRS RS), a group even further right than the SDS.

In October the Paris Club of sovereign creditors wrote off two-thirds of BiH's Yugoslav era debt. Overall in 1998, the RS made progress in meeting its revenue targets by reducing tax evasion on customs revenues, which continued to be the most important source of revenue. FBH, meanwhile, made less progress on this front, largely because Bosniaks and Croats continued to stall on dismantling wartime administrative structures, the ensuing bureaucratic confusion of which aided corruption and tax evasion.<sup>91</sup> Defense and social transfers continued to account for the bulk of spending,<sup>92</sup> marking the presence of a key intervening variable predicted by the ethnicity and growth literature.

Further evidence of this trend came when the OHR criticized the FBH for overvaluing privatization vouchers for veterans by KM2.7b, which it asserted was a vote buying scheme

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<sup>91</sup> EIU (October 1998), 18-19.

<sup>92</sup> EIU (May 1998), 17.

by the SDA and HDZ.<sup>93</sup> The result was a delay in the target start date for FBH privatization. In a sign of Croatia's continued sponsorship of Croats in Bosnia, the FBH signed two economic deals with Croatia. While economically sound, the agreements met with ambivalence from Bosniaks, who worried about Croatia's financing of Bosnian Croats with \$75-100m in funding per year. The RS, meanwhile, again spiraled into a constitutional crisis as the hardline president refused to nominate a government headed by Dodik, despite such a coalition having sufficient support to pass in the National Assembly. In the absence of a new government, Dodik's previous government continued on in caretaker capacity.

At the end of 1998, wages in FBH continued to exceed those of the RS, with the year's averages in each entity coming to KM329 and KM120, respectively. The gap was narrowing, however, as a result of the increase in RS economic activity that came with an influx of reconstruction funds.<sup>94</sup>

### **1999**

On 3 March, the customs law passed in 1998 entered into effect, thereby harmonizing customs duties between the two entities. A row between RS and FRY over trade that had begun the previous April, meanwhile, continued, increasing pressure for RS to continue the drawn out process of switching fully to the KM.<sup>95</sup> Shortly thereafter, the OHR removed the RS president for obstructing the formation of a government.

In late March, the NATO bombing campaign against FRY in response to the Kosovo war sparked an economic collapse there. The effects were felt throughout BiH, but particularly in RS, where a sharp drop in customs and increase of expenditures on refugees

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<sup>93</sup> EIU (October 1998), 20-21.

<sup>94</sup> EIU (April 1999), 20.

<sup>95</sup> *ibid.*, 17-18.

put the budget under severe strain. Usage of the KM spiked in RS to 50% of all transactions as the FRY Dinar collapsed.<sup>96</sup>

Distribution of FBH privatization vouchers for apartments and enterprises began in May. Strategic enterprises and banks were not included in this process. In June, a PIC meeting issued conclusions condemning an increase in corruption in BiH, widely interpreted to be directed at the SDA.<sup>97</sup> The RS also made progress on privatization with a pilot scheme in July, during which nine small enterprises were sold at open auctions.

Corruption gained further attention in August when a *New York Times* article alleged the loss of almost \$1b in donor funds during the reconstruction. The article detailed scandals involving each ethnic group, though underscoring the June report, the FBH seemed to be the most egregious violator. The report laid blame primarily on the “nationalist leaders who keep Bosnia rigidly partitioned,” citing the UN representative to BiH saying “the war is still being fought bureaucratically through obfuscation, delay and avoidance by a group of leaders who do not want to lose power.”<sup>98</sup> Assessing the storm around the scandal, the EIU wrote:

**One of the main reasons why, three-and-a-half years after the end of the war, BiH is still far from being a viable economy...is that the process of peacebuilding has relied on consensus between the main nationally based political parties. Their agenda of creating ethnically homogeneous enclaves, in which they would have unchallenged authority, has remained unaltered...Progress in bringing BiH closer to a normal society, in which institutions function and democratic norms are respected, threatens their current power structures...The internationally sponsored reconstruction program...has created a situation in which they have benefited from international assistance while simultaneously carrying out their own political agendas.**<sup>99</sup>

Donor agencies and local politicians strongly denied the article’s claims.

With several FBH parliamentary sessions ending without Bosniak and Croat deputies being able to even agree on an agenda, legislation intended to unify the groups’ pension systems and employment bureaus stalled, a serious setback for restructuring. Meanwhile, the

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<sup>96</sup> *ibid.*, 20.

<sup>97</sup> PIC Steering Board, “Steering Board Deeply Concerned About Lack of Progress,” (Brussels) 18 June 1999. <[http://www.ohr.int/pic/default.asp?content\\_id=6796](http://www.ohr.int/pic/default.asp?content_id=6796)>

<sup>98</sup> Chris Hedges, “Leaders in Bosnia are said to steal up to \$1 billion,” *The New York Times*, 17 August 1999 A1.

<sup>99</sup> EIU (October 1999), 8.



failure of two large FBH banks underscored the urgent need for bank privatization in order to unfreeze the country's financial system, but with internal disagreement stalling both entities, the issue remained frozen. These crises resulted in several key realignments at the end of 1999. The RS finally and unambiguously banned the use of the FRY Dinar, and transactions in KM rose to 95%, finally marking the effective alignment of RS monetary policy with the Central Bank.<sup>100</sup> In FBH, USAID – the external director of the privatization program – suspended its assistance over continued obstruction. Finally, the death of Croatian President Franjo Tudjman in mid-December preceded the January 2000 elections in Croatia, in which the HDZ suffered a stunning defeat. The new government said it would stem its financial support for Bosnian Croats, marking the most decisive shift in the position of an external lobby actor over this survey's period.

Overall in 1999, previous trends largely continued. RS suffered higher inflation due to continued use of the FRY Dinar.<sup>101</sup> The RS also ran a higher fiscal deficit, which represented 3.5% of GDP, as compared to a deficit of just 1.3% in FBH though much of this difference resulted from the war in FRY.<sup>102</sup> International donors continued to make up for the shortfall, while the public sector grew to represent two-thirds of GDP.

## 2000

By April the FBH had made initial progress in privatization, with the sale of seventy of its 300 small enterprises complete. At the same time, however, FBH tender privatizations met with criticism from the OHR, who ultimately fired the Federation Privatization Agency head. Whereas the voucher scheme aimed to dispense with state assets quickly, tender privatization was instead oriented toward restructuring strategic enterprises, such as power companies and telecoms. Preparations for banking privatization neared completion in RS, the

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<sup>100</sup> EIU (January 2000), 20-21.

<sup>101</sup> World Bank, (2000) 3.

<sup>102</sup> World Bank, (2000) 2.

need for which was underscored by prohibitively high annual short-term loan rates between 9 and 40.3%.<sup>103</sup>

FBH reform snagged when ethnic divisions led to a second failure to pass pension reform. By summer, the WB had grown impatient with what it considered to be one of the biggest obstacles to private firm growth, and established a new commission tasked specifically to help the entities reform labor laws, and ideally harmonize them in the process. The PIC also adopted a new strategy at its May meeting in Brussels. Economic reform constituted one of three pillars of the strategy, which was further divided between three priorities: state regulation of telecommunications, energy, transport, and media; the creation of a single economic space in BiH; and restructuring public firms. Along these lines, the Council's conclusions declared that aid was no longer to flow through the entities, but should now be channeled through the state Treasury.<sup>104</sup> The moves reflected the international community's determination to begin moving elements of the post-communist transition forward. In November, USAID reengaged in FBH privatization, and the OHR imposed pension reforms on both entities to break the deadlock in FBH and fix an RS law deemed inadequate by the WB.

In the run-up to the fall elections, EIU noted that "Mr. Dodik's government has not only failed to launch a decisive fight against crime and corruption...but has itself earned the reputation of being corrupt."<sup>105</sup> The new President of Serbia, Vojislav Kostunica, signaled his preference for the SDS.<sup>106</sup> In FBH, the HDZ formally split from its Croatian counterpart. All three developments would prove critical in the elections, with the latter two again revealing the importance of Serbia and Croatia on intra-BiH politics.

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<sup>103</sup> EIU (May 2000), 19.

<sup>104</sup> PIC, "Declaration of the Peace Implementation Council," (Brussels: 2000).

<sup>105</sup> EIU (August 2000), 13.

<sup>106</sup> EIU (November 2000), 21.

The international community also changed tack on elections, convinced that moderates could only perform well under new electoral rules. Using its discretion to impose election law, the OSCE implemented new electoral rules one month prior to the November elections, hoping to draw on key integrationist insights to help moderates. The new rules introduced open party lists and multi-member constituencies (MMC) for both entity and state parliaments, as well as the AV for the RS Presidency.<sup>107</sup> The AV was already used for parliaments.

The elections resulted in generally even splits between nationalist and non-nationalist parties in entity and state parliaments. The SDS, however, regained a stronger position in RS, though it fell short of an outright majority.<sup>108</sup> Consequently, the new rules did not go nearly as far as the OSCE had hoped in promoting centripetal politics. Instead, results indicate that the OSCE's blatant attempt at electoral engineering backfired. Imposed so shortly before the elections, and with the international community's objectives well known, nationalist parties exploited what they framed as an intentional bias against them.<sup>109</sup> Furthermore, while attempting to harness integrationist insights, the implementation of multi-member constituencies in conjunction with the AV made a fatal mistake. As Reilly argues, the AV is only effective at accomplishing centripetal aims under conditions of single-member constituencies. Combined with MMC, the AV leads to overwhelmingly majoritarian outcomes and makes it possible for a strong party to capture every seat.<sup>110</sup>

The close of 2000 also marked the end of the reconstruction. At the time, RS was in a noticeably worse position. Per capita GDP was just 75% of the national average. While

<sup>107</sup> Roberto Belloni, *State Building and International Intervention in Bosnia*, (New York: Routledge, 2007), 80.

<sup>108</sup> The OHR banned the Serbian Radical Party of RS (SRS RS) from taking part in the 2000 elections, and it is speculated that most of the party's supporters switched to the SDS. The SDS received 1% more votes and gained one additional seat in 2000 compared to the combined SRS RS and SDS 1998 vote.

<sup>109</sup> Belloni (2007), 80, 84.

<sup>110</sup> Instead, the proper mechanism for preferential voting in a MMC is the single transferable vote. Reilly (2001) 151, 153. For a general overview of the flaws of electoral engineering in the 2000 elections, see Belloni (2007), 80-87.

unemployment figures were comparable between the entities,<sup>111</sup> the distributional effects of this divergence were notable. While 27% of citizens lived below the national poverty line, in RS the figure was almost double.<sup>112</sup> The average net wage in FBH was KM426, compared to KM299 in RS.<sup>113</sup> These figures did, however, represent a narrowing in the wage gap. It is important to note, however, that these indicators of development mask significant difference within FBH. Croat cantons of the former Herzog-Bosnia remained the wealthiest, and significantly integrated with Croatia. At the end of this period, however, Croatia's shift signaled a key disengagement from FBH politics.

The WB attributed the difference between RS and FHB primarily to the later start of donor assistance in RS.<sup>114</sup> It also, however, judged FBH to surpass RS on privatization work.<sup>115</sup> RS lagged in other pillars of post-communist reform as well, most notably macroeconomic stability, which had been a result of the delayed switch from the FRY Dinar. This, in turn, indicates another key trend over this period, which is RS's reliance on FRY, which readily intervened on its behalf. As EIU aptly notes, "Post-war reconstruction in the RS began seriously only in 1998, following the inauguration of a more moderate government."<sup>116</sup> Thus, its lag in restructuring was overwhelmingly a result of the first two years of this period.

## **Reform and Stagnation: 2001 – 2006**

### ***2001***

The new RS government, formed in January, represented a coalition including both the SDS and the moderate Party for Democratic Progress (PDP), thus ending the three year

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<sup>111</sup> World Bank, (2000), 4.

<sup>112</sup> *ibid*, 4.

<sup>113</sup> EIU, (May 2001), 25.

<sup>114</sup> World Bank, (2000), 3.

<sup>115</sup> *ibid*, 11-12.

<sup>116</sup> EIU, (May 2000), 22.

Dodik government. While the SDS was part of the coalition, however, international pressure kept it out of formal government, though it received many posts in industry as compensation.<sup>117</sup> In a sign of the renewed prominence of the SDS, relations were patched with FRY, marked by the signing of a new agreement on special relations between the two in March. During its comeback, the SDS had emphasized economic factors, and highlighted Dodik's failure to meet his pledge of stamping out corruption. After much wrangling, ten moderate parties dubbed the Alliance for Change formed a state government in February, followed shortly thereafter with a government in the FBH. This represented the end of ten years of rule by nationalists in the entity. The Alliance, which enjoyed a clearer majority at the state level, focused its inaugural address on economic issues.

The HDZ, which had a greater chance of maintaining power in FBH, reacted angrily. Tension escalated in April, with violence breaking out in Mostar following an international raid on a bank suspected of backing the HNS. The violence represented the culmination of what the EIU judged to be "an attempt by HDZ BiH radicals to hold on to the powers, privileges and funds secured during the 1992-95 war and its aftermath."<sup>118</sup> Zagreb, meanwhile, clearly indicated it did not support the HNS, and revoked the 1998 agreement on special relations with the FBH.

On the economic front, the FBH finally managed to disband the socialist-era payment bureau monopoly on internal payments, transferring transactions to commercial banks. This reform had been underway since 1998, but repeated disagreement by nationalist parties, which used the bureau as a source of cash, had delayed the transfer.<sup>119</sup> Rounds of voucher privatization ended in both entities in March.<sup>120</sup> The release of final entity budget figures for 2000 showed the beginnings of a gradual reversal in the relative quality of each entities'

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<sup>117</sup> EIU, (February 2001), 18-19.

<sup>118</sup> EIU (May 2001), 16.

<sup>119</sup> EIU, (February 2001), 22.

<sup>120</sup> EIU, (May 2001), 21-22.

fiscal policy. For the first time, RS ran a smaller deficit than the FBH. While this represented a modest fall in the RS deficit owing to strong revenue growth, the FBH deficit doubled over the same period.<sup>121</sup> While the FBH deficit remained lower as a proportion of GDP, this did reflect a noticeable shift. A prime cause of the FBH budget woes was the cantons.<sup>122</sup> The FBH was further plagued by high defense and transfers to war veterans, its largest two expenditures; the latter category included separate systems for Bosniaks and Croats.

At the same time, however, an audit of RS spending revealed several gross violations under the previous Dodik government, resulting in criminal charges being brought. The RS also continued to run higher arrears. Another report revealed that a partial privatization of Aluminij Mostar in 1997 was illegal, significantly undervaluing the firms assets and conducted without approval by FBH. The sale benefited a Croat company, and had consolidated HDZ control of the smelter. An EU inspection found the RS to have a lower tax base for a range of goods, which resulted in 1,500 FBH firms registering in RS.<sup>123</sup>

On 23 August the state finally passed a permanent election law largely followed the 2000 provisional OSCE rules, though it did remove the AV for the RS presidency. Consequently the electoral rules, which many criticized for reinforcing ethnic divisions, became permanent. Meanwhile, the HDZ boycott of government gradually lost steam over the course of the year. At the year's end, the HDZ ended its boycott of FBH institutions.

At the same time, difficulties in the RS increased, as the SDS blocked important reforms, which in turn resulted in a halt to non-budgetary international assistance, a factor that led RS output growth to slow. Developments in the FRY also affected RS adversely. Budgetary pressures did motivate an acceleration of privatization in RS.<sup>124</sup> In a positive

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<sup>121</sup> *ibid.*, 20-21.

<sup>122</sup> EIU, (August 2001), 21.

<sup>123</sup> EIU, (November 2001), 22.

<sup>124</sup> EIU, (February 2002), 16-17.

development, inflation in RS finally began converging with FBH, dropping from 14.6% in January to a tolerable 2.2% in December. The drop indicated a delayed end to the instability caused by the FRY Dinar's use.<sup>125</sup>

## 2002

In March, the leading political parties agreed on a package of constitutional reforms meant to comply with a 2000 ruling by the Constitutional Court, which had found that all three ethnic groups enjoyed equal constitutional standing throughout the entire state. The agreement, which had been forged without the support of the three nationalist parties, prescribed the following changes: the establishment of an upper house in the RS; agreement that PMs, presidents, and their respective deputies were not to be of the same ethnicity; the curtailment of veto rights by each group; and the establishment of a special council to rule on the legality of these vetoes. While guaranteeing Bosniaks and Croats a greater role in RS governance, therefore, the reforms simultaneously sought to remove some of the deadlock accruing from the vetoes over the previous six years. This change constitutes the third notable revision to the BiH institutional structure.

In early 2002, FBH completed the privatization of its banking sector. The benefits had already begun emerging in 2001, when the sector posted its first net profits since 1997. Process was slower in RS, where only four of eleven banks privatizations were complete. With enterprise privatization concluding in both entities, the last major challenge would be selling strategic companies, where vested political interests were most involved.<sup>126</sup>

In other policy developments, the launch of the Euro went smoothly, and replaced the DM as the currency underpinning the KM. The switch revealed the degree to which the population remained suspicious of banks when savers rushed to exchange large reserves of

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<sup>125</sup> *ibid.*, 25.

<sup>126</sup> EIU April 2002, 22-23.

cash held in DM. The trend was particularly pronounced in RS, where banks only held KM107m in deposits before the switch, as compared to KM1.34b in FBH, where a Deposit Insurance Agency guaranteed holdings; no such institution existed in RS. In August, the introduction of a state-level agency alleviated this issue and helped unify the financial sector.<sup>127</sup>

The same month, the IMF approved its third stand-by arrangement with BiH. Core priorities included clearing the public debt (totaling 150% of GDP) and imposing greater fiscal discipline. In meeting IMF conditions to sign the agreement, entities first agreed to reform and harmonize consumption taxation. Starting in July, the tax would be standard across the state, a key step as the IMF sought to move toward a unified value-added tax (VAT). Another priority, decreasing tax evasion, continued to proceed, particularly in RS, where a centralized structure aided oversight.<sup>128</sup> The FBH demobilized 10,000 soldiers, a move that promised greater fiscal sustainability in the future.

Over the summer, another round of corruption scandals rocked the country. In June, an investigation revealed that misdeeds in FBH resulted in a single company evading KM5m in customs. Though the finance minister denied wrongdoing, the OHR stepped in to remove him when he refused to step down. The scandal provoked a split in the Alliance for Change, with the moderate Croat party of the former minister deciding it would not stand with the coalition in the upcoming elections. The move dealt a serious blow to the Alliance, which had already been criticized for a lagging economic program. In a parallel development, another investigation revealed rife corruption in the RS customs administration, which enjoyed close ties to the SDS. A separate investigation resulted in charges against Dodik.

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<sup>127</sup> EIU October 2002, 21.

<sup>128</sup> *ibid.*, 19-21.



In the context of continued corruption, opinion polls showed economic issues to be the most important issue to voters.<sup>129</sup> October election results confirmed that voters' expectations had not been met, bringing to an end the Alliance for Change and returning the nationalists to power at all levels of government. While the three nationalist parties did not gain sufficient support to lead governments alone, low thresholds and a high degree of fragmentation made it difficult for the moderates to form coalitions.<sup>130</sup>

### **2003**

The state was the first to form a government, bringing the three main nationalist parties together in a coalition. The new CoM emphasized speeding up economic reforms at its inauguration. The RS formed a governing coalition similar to its previous arrangement, with the SNSD in opposition. Within days of the new government taking power, however, a scandal involving a bank sale for €1 forced the finance minister to resign. The FBH was again last to come to form a government, with the HDZ and SDA ultimately agreeing to share power.

At the start of 2003, the RS Bankruptcy and Liquidation Law entered effect, a key step in improving the business environment. Both entities made progress in fiscal consolidation by reducing expenditures, though FBH missed revenue targets by 13.6%. Figures from 2002 revealed both entities improving revenue collection as a result of reducing tax evasion.

Over the course of 2003, it became clear that banking privatization and reform was paying dividends when new figures revealed a strong expansion in bank liquidity and private lending. In response, new regulations increased the Central Bank's levers over monetary policy. The Bank acted quickly by tightening policy and demonstrating the important

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<sup>129</sup> EIU (April 2002), 18.

<sup>130</sup> EIU (January 2003), 16.

centralizing effect of the reform. An initiative of fifty regulatory reforms pushed by the OHR and nicknamed the “Bulldozer Project” eased regulatory burdens in both entities. In July, customs reform further harmonized duties between the entities, while the creation of a central Indirect Tax Authority (ITA) paved the way for centralizing revenue collection.

In contrast to this raft of reforms, privatization stalled following its completion for most banks and small/large non-strategic enterprises. The remaining companies were primarily the strategic enterprises, exactly those privatizations which promised to be the most contentious. Nevertheless, the picture that begins emerging in 2003 is one of an increased pace of reform, combined with the locus of economic policy beginning to shift to the state. As RS finally began pulling even with FBH in completed reforms, the pace of convergence between the entities accelerated.

## **2004**

Early in the year, RS succeeded in passing laws reforming internal debt, comprised of private domestic claims against the government. Many of the claims were a result of the war, and settlement of the arrears was a key EU condition. Meanwhile, a comparable law in the FBH foundered, remaining stalled until November.<sup>131</sup> Over the summer, the ITA assumed responsibility for customs collection, though confusion around this period led to a temporary decrease in revenues.

Throughout 2004, consumer credit growth showed signs of slowing, in an indication that the Central Bank’s increased authorities were proving effective. As the Federation law on bankruptcy came into effect, unemployment increased as many private firms began long-delayed restructuring. Economic trends from the previous year continued, with harmonization spurring further convergence between the entities.

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<sup>131</sup> EIU (October 2004), 21.

The municipal elections in October confirmed the central position of the nationalist parties, albeit largely as a result of the highest post-war apathy yet – turnout was just 46.8%.<sup>132</sup> In a slight reversal from the 2002 elections, moderates made gains. Leading the opposition appeared to benefit the SNSD, which saw its popularity surge. The elections failed to bring fresh impetus to the RS, however, and by the year's end, the government had lost its majority in the National Assembly.

## 2005

In January, revisions to the Central Bank law entered into effect, bringing bank supervision and licensing under its direct authority. Previously, the Central Bank had merely coordinated the two entity banking agencies, meaning the reform moved another important economic policy to the state, a trend compounded when new rules on the ITA came into effect. Under the rules, the ITA distributed funds to the state directly, and to the entities secondly, thereby ending the procedure whereby the state relied on transfers from the entities.<sup>133</sup>

In February, the RS resolved its governing crisis when the SDS formed a new government in the National Assembly. The move marked the first time the SDS exercised overt control over the parliament since its ouster in the 1997 snap elections. The SNSD protested the formation, and with its continued popularity, the balance of power for the SDS remained tenuous. With the SNSD continuing to emphasize economic issues, pressure began to build for a resumption of the privatization process.

For 2005, both the FBH and RS adopted smaller entity budgets. While the FBH continued to run a deficit, the RS made a significant by assembling a balanced budget. In April, RS revealed a three year KM634m public investment program. It also adopted a law

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<sup>132</sup> EIU (January 2005), 17.

<sup>133</sup> EIU (April 2005), 19.

on business registration, bringing the RS in line with a state law from the previous year. The FBH had passed a similar law one month earlier. After much wrangling, 2005 ended with the state parliament passing legislation clearing the way for the implementation of the VAT at the start of 2006.

## 2006

The introduction of VAT was another significant centralization. The new system was remarkably simpler, and yielded a large one-off increase in budget revenues. VAT would later be shown to have produced a one-off spike in inflation as well, but the spike proved short-lived. RS efforts from 2005 to revitalize its privatization agenda produced a stunning turn around in 2006. The entity gained particular attention for its sale of Republika Srpska Telekom to the Telekom Srbija, the Serbian telecommunications firm. At €646m, the privatization was the single largest in BiH to date, with Telekom Srbija beating out Telekom Austria's next best bid of €467m. While filling RS coffers, however, the price led many to allege an overvaluation indicative of external sponsorship. The WB had estimated the sale to generate just €250m, and even the optimistic RS estimate had only hoped for €500m.<sup>134</sup> Noting that Telekom Srbija remained in the Serbian state's possession, some also questioned whether the deal could truly be considered privatization; many speculated that it was an attempt to buy the loyalty of RS.<sup>135</sup> While FBH pushed for a joint privatization of all three telecoms simultaneously, claiming this would result in a better deal for each firm, RS had ignored the request.<sup>136</sup>

FBH, on the other hand, experienced a marked decline in its relative fiscal position. In a last minute reform during the run-up to the fall elections, parliament hurried through a new law on veteran payments, drastically increasing both eligibility (quadrupling those

<sup>134</sup> EIU (October 2006), 21.

<sup>135</sup> Author interviews, Sarajevo (2009).

<sup>136</sup> EIU (January 2007), 20-21.

receiving beneficiaries from twenty to eighty thousand) as well as the amount paid to veterans. The move was widely interpreted as an attempt to buy support for the ruling nationalist coalition. The elections resulted in a strong win for the SzBiH and SNSD, with the parties replacing the SDA and SDS as the new main Bosniak and Serb parties. In a curious development, however, both parties – formerly considered moderate – engineered their win by adopting extreme rhetoric, outflanking the former nationalist parties.

### **Recent Trends: 2007 – present**

In 2007, the IMF noted that “Progress in macro-critical reforms – corporate restructuring, private sector development, improving the business climate, labor market liberalization...has been made in the RS but very little in the Federation.”<sup>137</sup> In an addendum to the report, it was even more blunt, writing that RS is “now reforming faster and has fostered competitive advantages over the Federation that herald the prospect of it pulling ahead of the Federation in the coming years.”<sup>138</sup>

The situation continued into 2008, with the Fund again observing that “Policies are diverging between the entities, with RS making steady progress on reforms and FBH finding it difficult to mobilize action on needed reforms.”<sup>139</sup> The WB has been more subtle in lauding distinctions between the entities, but has similarly noted the superior reform agenda of RS.<sup>140</sup> Since passing the 2006 law on veteran payments, FBH has been in a near constant state of budgetary crisis. Despite strong pressure to reform the law,<sup>141</sup> compromise between groups has proven impossible, as any revision is likely to bring more benefits for Bosniaks

<sup>137</sup> IMF, “Bosnia and Herzegovina: Staff Report on the 2007 Article IV Consultation and Statement by the Executive Director for Bosnia and Herzegovina,” Country Report 07/268, (June 2007), 13.

<sup>138</sup> *ibid.*, 57.

<sup>139</sup> IMF, “Bosnia and Herzegovina: Staff Report on the 2008 Article IV Consultation and Statement by the Executive Director for Bosnia and Herzegovina,” Country Report 08/327, (Aug. 2008), 4.

<sup>140</sup> See World Bank, “Country Partnership Strategy for Bosnia and Herzegovina for the Period FY08-FY11,” (November 2007) 7, 48, 53. The International Crisis Group has also noted this divergence, writing that “RS has pulled well ahead of the Federation in economic reform.” “Ensuring Bosnia’s Future: a New International Engagement Strategy,” International Crisis Group, Europe Report No. 180 (15 February 2007) 24.

<sup>141</sup> World Bank, (November 2007), 53.

than Croats, leading Croats to employ their veto.<sup>142</sup> RS, meanwhile, has continued to boast a surplus.<sup>143</sup> Privatization receipts have greatly eased constraints on the RS budget, providing a cushion to run surpluses while maintaining heavy infrastructural investment.

RS has also proven more able to reform in other key areas, particularly regulation and taxation. RS was first to pass corporate and income tax reform, both simplifying the code and lowering the rate of taxation. It also eased the legislative burden on business, modifying 6% of its total business regulations, and eliminating entirely an additional 32%.<sup>144</sup> As a result, it now takes just twenty-three days to register a business in RS, compared to forty in FBH.<sup>145</sup> While reforms continue in RS, however, the same parties frequently block reforms in the state parliament.

In May 2008, the results of these trends became evident, when the net wages in RS surpassed those in FBH for the first time in the post-war period. Most recently, all levels of government have had to reign in expenditures in response to the financial crisis. While RS has proven more or less to do so, but FBH has neared bankruptcy and is in emergency negotiations with the IMF. At the time of writing, repeated attempts to reign in veterans' benefits in the FBH had met only with failure, and privatization remained stuck.

The active RS reform agenda has won plaudits from the international community, with the IMF recently devoting an entire chapter to the convergence in income levels between the two entities, showing 'strong evidence' that RS has been converging to Federation levels in recent years.<sup>146</sup> Importantly, this accelerated level of growth still leaves RS at a lower GDP. Nevertheless, as the IMF notes, if the trend remains strong into the future, there is a possibility of RS surpassing FBH. The IMF concluded that this trend is attributable to the

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<sup>142</sup> EIU (May 2008), 12.

<sup>143</sup> EIU (March 2009), 5.

<sup>144</sup> IMF (June 2007), 50.

<sup>145</sup> World Bank, (November 2007), 63.

<sup>146</sup> See Graham Slack with Irena Jankulov, "An Assessment of Economic Cohesion," in *Bosnia and Herzegovina: Selected Issues*, IMF Country Report No. 07/269, (June 2007), 49-57.

implementation of delayed reforms.<sup>147</sup> Taking into account the delayed start of the reconstruction in RS, as well as recent harmonization, therefore, it is necessary to emphasize that comparison of recent growth trends largely reflect *convergence* between the entities. Consequently, this does not imply that RS is surpassing FBH, nor does it necessarily indicate that RS has consolidated a lead over FBH in market consolidation.

On the latter point regarding post-communist reform, while it is true that RS has surpassed FBH on certain key reforms, it remains to move beyond a state of partial reform and consolidate a position as a full market economy. This assessment was confirmed in every expert interview conducted, at times in very strong terms. Two recent independent studies support this conclusion. The first shows that while perceptions of corruption are mildly more positive in RS, perceptions of ease of doing business are similarly pessimistic across both entities.<sup>148</sup> In a sub-national regional survey, Banja Luka (in RS) ranked above Sarajevo and Mostar (in FBH) on three measures of regulatory quality, but only by one position. The same study concluded that contract enforcement is worse in Banja Luka than the other two cities.<sup>149</sup> Finally, at the time of writing, a developing scandal has pitted Dodik at the center of a corruption investigation, suggesting that the SNSD continues to benefit from insider advantages and rent-seeking. Another recent report on a key strategic privatization in RS offers further support, and casts doubt on the largely completed privatizations of strategic enterprises.<sup>150</sup> These conclusions are not intended to negate recent reforms in RS, which has certainly fostered some competitive advantages. But it does underscore the extent to which these are relative advantages, and marginal in the overall perspective.

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<sup>147</sup> *ibid.*, 57.

<sup>148</sup> “Gallup Balkan Monitor,” *European Fund for the Balkans*, (2008) <<http://www.balkan-monitor.eu/index.php>>

<sup>149</sup> World Bank, “Doing Business in South East Europe,” (2008).

<sup>150</sup> Transparency International “Government donated the RS Oil Industry incurring additional damages of half a billion KM,” (7 April 2009).

## V. SUMMARY OF TRENDS AND ANALYSIS

### Summary of Trends

A brief summary of the past fourteen years will assist in pinpointing the dominate trends before moving to analysis. For FBH, this process is relatively straightforward. In general, the entity has exhibited a consistent pace of reform. A slight acceleration of reforms may be noted in the early years of the present decade. Following 2002, and becoming more pronounced after 2004, this trend has dropped off, and in recent years has slowed to a point nearing stasis. Nevertheless, continued progress, while minimal, may still be observed in the largest remaining task, strategic enterprise privatization. This progress, however, is diminished by the recent deterioration of fiscal performance. While this overall pace has not been rapid by any stretch, it has also not shown wide variation over time.

RS, on the other hand, has vacillated much more. In 1996-97, reform made zero progress. From 1998-2000, the start of reforms broke this trend. By 2002-2003, progress had led the reform agenda in RS to largely catch up, as exhibited by RS's completion of enterprise and bank privatization within a matter of months after FBH. In 2005, renewed focus led to the preparation of further reforms, which in the period since 2006 has led RS to overtake FBH in terms of ultimate progress along the reform trajectory. As discussed above, however, this active legislative agenda has not produced an unambiguous position as more advanced in the market-building process.<sup>151</sup> Overall, BiH's position along the course of reform is still best classified as partial, a categorization that applies to the entities as well.<sup>152</sup> Finishing the reform agenda is not a foregone conclusion in either entity.

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<sup>151</sup> A majority of interview subjects pointed to the importance of distinguishing between legislation and implementation, with RS frequently failing in the latter (though not necessarily more so than FBH).

<sup>152</sup> This inference is drawn from assessing the variance in EBRD indicators. EBRD, "Transition Indicators by Country," (2009) <<http://www.ebrd.com/country/sector/econo/stats/tic.xls>>



## Analysis

The case studies above show many signatures of the intervening variables hypothesized by the ethnicities and growth literature. It is clear that both exhibit poor economic policy. Furthermore, under a clear situation of ethnic voting, corruption is rife. Disagreement between ethnic groups has been revealed to repeatedly delay reforms. Perhaps most readily observable is the clear impact on fiscal policy. Similar to the trends observed in U.S. municipalities, entity budgets have been wracked by chronic spending problems. In both cases this involves high levels of social transfers and defense spending (the latter corresponding to police spending in U.S. cities). Chronic deficits and high debt per capita are also observed frequently. Both trends have been particularly pronounced in FBH. While the ethnicities and growth literature thus provides a good framework, however, given the relative stability of entities' ethnic composition, it is less able to explain variation of these trends over time and space.<sup>153</sup>

In FBH, one of the few shifts noted involves an acceleration of reform after 2000. This change corresponds to a key shift in the sponsorship of Croatia, an external lobby actor. Following this shift, the HDZ attempted to apply a tactic it had used frequently in previous years to satisfy its demands by walking out of government. With Croatia refusing to intervene under its recently inaugurated moderate leadership, however, the HDZ tactic proved ineffective, and it eventually ended its boycott, effectively returning with its credibility in tatters. A period of slight reform acceleration followed.

Political competition theory offers helpful insights in understanding RS. Initially, there was virtually no competition in RS politics, and by implication, politicians had little accountability to voters. A constitutional crisis in 1997, however, provided a minimal level of competition through increased party plurality, allowing voters a choice to emphasize

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<sup>153</sup> While there has been some shift due to minority returns, ethnic distribution in BiH is far from the pre-war levels. Donais (2005), 128-141.

economic change. Very quickly, this made clear that politicians who showed zero progress on economic revival would not remain in office. Once this consensus emerged regarding initial reform, RS's centralized structure meant it was free of some of the impediments that frequently caused delay in FBH. Every expert interviewed conceded that the institutional structure of FBH was a key factor debilitating policy. In particular, RS enjoys more restrictions on the use the ethnic veto, and lacks the cantons level, two of the structures that have been the most frequent causes of problems in FBH.

After ten years of reform, however, both entities remain only partially reformed. This contradicts the predictions of neo-liberal market reformers, who expect the process of privatization to create a class of market agents who will push for further reforms in order to protect their new holdings. Instead, the corruption that has been rife in both entities has created a class of agents beholden to political power in order to generate lucrative rents. In a context where political structures work to reinforce ethnic cleavages, the salience of other potential cross cutting cleavages, such as class, is diminished. In BiH, the electoral structure provides an incentive toward centrifugal politics, as was aptly displayed by the 2006 electoral strategy of both SzBiH and SNSD, which ran from the center to the right in an effort to win votes.

It is hardly surprising that consociational structures diminish political competition in BiH. After all, Lijphart himself refers to consociationalism as government by an elite cartel. Indeed, it is this very mechanism – the reduction of risk by the limitation of uncertainty – by which consociational structures are theorized to mitigate polarization. Robust accountability, however, requires more than just the semblance of a democratic process, it requires uncertain outcomes. This is the lynchpin that has kept post-communist elites honest, and it is also the one feature which it is difficult for consociational democracy to provide. In post-war Bosnia

and Herzegovina, consociationalism has made reform difficult to achieve in FBH, and difficult to achieve well in RS.

## VI. CONCLUSION

This paper approaches development in post-war BiH from a sub-national perspective. In so doing, it fills a lingering gap in surveys of the BiH political economy, generating a more thorough overview of each entity over the past fourteen years. In applying political competition theory in conjunction with a political economy framework of ethnicity, this study finds that many BiH idiosyncrasies can be understood by the role political institutions play in exacerbating ethnic cleavages. Together, these dynamics have acted to the detriment of economic policy. As predicted by integrationist scholarship, instead of minimizing polarization, consociational arrangements have led to centrifugal politics. It should be noted, however, that this work considers this trend only in the field of economic policy; it is a possibility that consociational democracy is an economic ill necessary to avoid violence.

Nevertheless, this finding does have implications for the future development of BiH. In noting the recent reforms made by RS, many analyses have called upon FBH to match its counterpart's progress. Given the institutional structure pinpointed by this work as a cause of delay, however, such advice seems simplistically naïve. Worrisome for both entities is the prospect that without revisiting the consociational arrangements, it may prove difficult to break out of the partial reform realm and into the fullness of open market democracy. At present, it is unclear whether EU conditionality is sufficient to provide the necessary catalyst.

More generally, this work generates some interesting hypotheses by synthesizing formerly distinct literatures. It expands on Collier's work by allowing that it might not be democracy alone that helps countries avoid the economic curse of ethnic diversity, but perhaps the specific *form* of democracy as well. In BiH, consociational democracy has worked to exacerbate ethnic tension. Further work is needed to determine if this is a general trend, as well as what forms of democracy might alleviate this pattern. Most originally, this work shows that in the context of post-communist transition, consociational democracy might

not provide the full political accountability necessary to ensure that reforms are not captured by insiders. Luckily, BiH does not yet appear to be entirely entrenched in a state of partial reform equilibrium. Finalizing the transition to full market democracy may face serious challenges, but neither is failure a foregone conclusion.

## APPENDIX: DATA AND SOURCES

Empirical data is assembled from a wide variety of sources, and includes quantitative, qualitative, and interview materials. Quantitative data is not entirely reliable for the post-war period, and figures generated by the entities are not strictly comparable. Economic data is collected from entity, national, and international agencies, and provides a quantitative indication of the effects of differing reconstruction and reform experiences. Thus, while illuminative, it is more evident of general trends.

Much of the observed difference between the cases lies in policy processes, the analysis of which demands qualitative assessment. The data regarding this policy and economic environment comes from a wide variety of news, academic, and non-governmental sources, including an assessments of policy processes. Analyses from the Economist Intelligence Unit are available quarterly across the entire period of the study, and thus provide a uniquely consistent manner of qualitative evaluation, by which to triangulate sources.

Two competing studies regarding market perceptions at the sub-national level were made available at the end of 2008. The studies use different methodologies, and thus provide an excellent triangulated manner of assessing overall progress toward a full market economy in each entity at the end of the survey period. The first, the World Bank's "Doing Business in South East Europe 2008" employs roughly 200 experts in a broad based technical evaluation of the legal framework. The survey includes three cities from BiH, one from each of the main ethnic centers. The second source, the Gallup's "Balkan Monitor" complements technical expertise with a large-n survey of the local population. Over 2008, Gallup surveyed 1,000 citizens of BiH in the local language, and provides data disaggregated at the entity level.

Finally, nine semi-structured<sup>154</sup> expert interviews were conducted by the author in April, 2009, spanning both entities, and all three ethnic groups as well as international observers. Interviewees represent a cross-section of experts, including policy-makers, politicians, international agencies, and policy analysts. To avoid biasing answers, interviews were open-ended. A standard set of questions, including questions corresponding to competing theoretical explanations, was covered in each interview. Interviews facilitated research, and provide a plausibility check of the theoretical interpretation. Interview material complements qualitative and quantitative data, with no one form being sufficient (see List of Interviewees).

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<sup>154</sup> Matthew Miles and Michael Huberman, *Qualitative Data Analysis: an Expanded Sourcebook* (London: Sage, 1994).

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