

**GOVERNANCE AND DEMOCRACY  
IN BOSNIA AND HERZEGOVINA**

**POST-INDUSTRIAL SOCIETY AND  
THE AUTHORITARIAN TEMPTATION**

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## *Preface*

In the summer of 2002, the United Kingdom's Department for International Development (DFID) approached the European Stability Initiative to conduct a Governance Assessment of Bosnia and Herzegovina. The Governance Assessment was designed to study the evolution of government in Bosnia, and to "assess more fully the constraints on positive decision-making" across all levels of government in Bosnia. Its goal was to promote an open debate within Bosnian society on what constitutes good governance, in order to build up democratic pressures in favour of change.

During the second half of 2002, using a team of Bosnian researchers, ESI carried out investigations across Bosnia and Herzegovina on the social and economic challenges facing the country, and how Bosnian governments are responding to them. The empirical research was concluded in October 2003, and the conclusions presented to a range of different audiences during 2003 and the first half of 2004, in Bosnia and Herzegovina and outside.

This paper now presents this analytical work to a wider audience. Additional background material on the governance assessment is also available on the ESI website ([www.esiweb.org](http://www.esiweb.org)). The views expressed in this report are those of ESI, and do not express the opinion of either DFID or the government of the United Kingdom.

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## I. INTRODUCTION

Bosnia and Herzegovina is going through a period of profound social and economic dislocation. The industrial society built up over decades of socialist development has collapsed, without leading to the development of a new economy driven by private-sector growth. The effects of this collapse on Bosnian society are severe, with alarmingly low levels of employment, worsening poverty rates and widespread economic insecurity. The economic crisis also sharply curtails the ability of government in Bosnia to provide basic services, from road maintenance to social benefits, and threatens the financial sustainability of the state itself.

In the aftermath of war, the Bosnian policy agenda was focused on peace-implementation tasks: security, demobilisation, reconstruction and return. Nine years on, economic and social problems have re-emerged as the main preoccupation of Bosnian citizens.<sup>1</sup> They have also become the primary concern of international organisations active in Bosnia.<sup>2</sup> This Governance Assessment therefore focuses on how government in Bosnia is responding to this new set of challenges.

Observers of government in Bosnia typically begin with the question of *structure*: whether or not the constitutional design that emerged out of the different compromises that ended the war is conducive to effective governance.<sup>3</sup> The research for this project, however, produced two important findings which challenge this conventional approach. First, there are clear continuities between problems of governance found in the former socialist Yugoslavia and those in Bosnia and Herzegovina today. Second, problems of governance in Bosnia are remarkably consistent across different regions and layers of government, despite wide variations in constitutional architecture. If similar dynamics can be seen in the multi-tiered Federation, in unitary Republika Srpska and even in the District of Brcko, which operates under international control, it suggests we need to look beyond the formal structures to patterns of behaviour which run deeper than the shortcomings of the constitutional settlement.

The report begins by looking at the problem of legacies and policies, and by introducing the key concepts of the passive state and the authoritarian temptation. Chapter III analyses features of Bosnia and Herzegovina's development path that set it apart from other transition countries and that *explain* the depth of the problems governments face and the passivity of large parts of society and the elites in

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<sup>1</sup> A World Bank study in December 2002 concluded: "Unemployment and poverty are perceived as the most important problems of the post-war period": "Bosnia and Herzegovina - Local Level Institutions and Social Capital Study", June 2002, p. 11. In a poll in February 2002, 60% of respondents rated employment as one of the two most important issues determining their vote, far ahead of corruption in government, emigration of youth and adequacy of public services. By contrast, only 13 percent of voters rated 'national interests' in their top two concerns: NDI, "A survey of voter attitudes in BiH: summary report", 28 February 2002. In a survey in March 2002, fewer than 25% of Bosnian citizens believed their government was going 'in the right direction': SEEDS & IDEA, "SEE Public Agenda Survey January-February 2002", 14 March 2002.

<sup>2</sup> High Representative Ashdown told the BiH parliament in December 2002: "Nothing, I repeat nothing, worries me more than this country's economy."

<sup>3</sup> There were three main steps: the Washington Agreement 1994, creating a Federation of cantons; the Dayton Agreement 1995, which turned this Federation and Republika Srpska into two units of a federal state; and the Brcko Arbitration in 2000, which added a "District" as discrete unit.

confronting these. Chapter IV looks at what the crisis of “industrial society” means in different parts of the country and for different social groups, including public servants. Chapter V investigates the public sector’s response through a number of case studies of the policy process in action, in the agricultural, forestry and spatial planning areas.<sup>4</sup>

## II. The Bosnian Governance Dilemma

### A. *The cult of the expert and the passive state*

This Governance Assessment has identified some very serious shortcomings in the present system of governance in Bosnia and Herzegovina. A number of key *governance capabilities* – attributes recognised internationally as constituting basic building blocks of an effective, democratic system of government – are clearly absent from Bosnia today.

- Many important social groups, particularly the poor and the rural population, have limited opportunities to influence the formulation of public policy and government practice.
- Public policy in key development areas (industrial, rural or social policy) fail to facilitate private-sector investment and to promote the growth needed to reduce poverty.
- The pattern of public expenditures is not pro-poor; on the contrary, it is notably regressive in favour of the more privileged social groups and areas with large concentrations of civil servants.
- The objective of equitable and universal provision of effective basic services appears ever more remote.<sup>5</sup>

In the absence of these key capabilities, governments in Bosnia are manifestly failing to mount an effective response to the social and economic crisis which is presently unfolding. It is this lack of capacity which now poses the principal threat to the Bosnian state-building project.

The key features of Bosnian governance, and the policy outcomes they have generated in the post-war period, have deep roots in the socialist past. They have proved remarkably resilient, surviving radical changes to the legal system and to the formal structures of government.

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<sup>4</sup> During the research for this project, ESI undertook a series of additional case studies in areas ranging from industrial policy to education and social policy. Some of the background material is available on our website: [www.esiweb.org](http://www.esiweb.org).

<sup>5</sup> DFID has proposed a set of seven “key governance capabilities”. In addition to the four mentioned above, they include ensuring “personal safety and security with access to justice for all”, “accountable national security arrangements” and “honest and accountable government that can combat corruption”: David Beetham, Sarah Bracking & Stuart Weir, “Governance Assessment Framework”, prepared for DFID, August 2000.

In fact, a succession of failed, top-down reform initiatives is part of the legacy of the former Yugoslavia. The last decade of the former Yugoslavia was marked by endless, sterile reform debates. As the economic historian Harold Lydall noted in 1989:

“Almost all reputable intellectuals are deeply disillusioned with the present system... They keep emphasizing the need for freer market relations, truer self-management, more democracy within the existing system, and more responsible behaviour by political leaders. But these are all officially approved ideas and, no matter how often they are repeated, their restatement has no significant effect as long as the core of the system remains intact.”<sup>6</sup>

There were two core elements to the system: the institution of self-management and social ownership in the economic sphere; and the lack of genuine democratic accountability in the political sphere. The system of corporate governance in the socially owned economy functioned without real owners, and the system of political governance operated without direct accountability of the government to the governed. The constant process of amending and elaborating the Yugoslav constitution and legal system could never make up for the lack of these two essential *disciplining mechanisms* in business and politics: the prospect of bankruptcy for failing enterprises and the prospect of electoral defeat for the architects of public policy. These problems condemned the Yugoslav economy to stagnation and decline, which accelerated dramatically once the external prop of massive foreign borrowing was removed after 1979.

The political system of the former Yugoslavia also proved to be extremely poor at reconciling the clashes between different interest groups which are an inevitable feature of any society. Without a genuinely open and participatory process for determining the public interest, the system could not generate policy outcomes which were recognised as legitimate. In the end, this produced a fatal policy paralysis – both an inability to take difficult decisions in the face of scarce resources, and an inability to accomplish reform in the face of bureaucratic and public resistance.

The socialist public administration was a “rule making elite”, relying on legislation which did not reflect real compromises among those it affected, and which as a result proved very difficult to implement whenever it clashed with real interests. Political rhetoric was shaped by the cult of the “expert” (*strucnjak*) – the technician who was thought to be best placed to determine the public interest. Political reality was characterised by the *passivity* of public institutions: reform debates replaced the daily work of building reform coalitions and generating popular support for the transformations which were needed.

Bosnia today has two very important advantages over the pre-war period: its neighbours, Croatia and Serbia-Montenegro, are no longer willing or in a position to question the country’s continued existence; and the vast security establishment, which once responded aggressively to any threat to its privileges, has been largely dismantled through the successful, post-war demilitarisation process. The risk of slipping back into open conflict is therefore greatly reduced.

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<sup>6</sup> Harold Lydall, *Yugoslavia in Crisis* (Clarendon Press, 1989), p. 7.

Otherwise, however, post-war Bosnia and Herzegovina faces very similar challenges, and similar dangers to those its elites failed to overcome in its first tragic chapter of democratic self-governance. The heavy dependence on a constant flow of external capital – be it the large credits of the 1970s or the reconstruction programme of the post-Dayton era – remains, as do the dangers of economic collapse and social implosion.

In the economic sphere, the most basic solution to the problems of socialist self-management lies in finding *owners* for productive assets, who have a direct, personal interest in ensuring that the value of their investment is maintained and enhanced. Though the institutional forms required to achieve this are often complex, the principle of *interests* as the basis for better *corporate* governance is clear. There is a clear parallel to this in the political sphere: here citizens – through interest groups or political parties – must likewise assert themselves if they want to see government act on their behalf. Attempts to find shortcuts and alternatives to working with interest groups as the basis of good governance – whether self-management socialism or the developmental authoritarianism of Kallay and Tito – have failed. However, decades of technocratic development imposed on a passive population in the name of “progress” have left a powerful legacy, seen above all in a pervasive distrust of democracy itself.

#### *B. The demand and supply of information*

One of the most important discoveries of this governance assessment was the striking absence of reliable information on matters of public policy in almost every policy sphere. Government in Bosnia operates without a solid base of information on what is happening in society.

The democratic process depends upon information. Policy makers need information about society in order to make effective policy choices. At the same time, citizens need information about the workings of government, in order to hold it to account for its actions. At the most basic level, without information on population levels and demographic trends, government cannot plan the delivery of social services. As James Scott has written:

“If we imagine a state that has no reliable means of enumerating and locating its population, gauging its wealth, and mapping its land, resources and settlements, we are imagining a state whose interventions in that society are necessarily crude.”<sup>7</sup>

A detailed age and gender breakdown of population forecasts is needed if local authorities are to plan their public services efficiently. School enrolment rates have implications for staffing levels in schools and for school buildings, and a detailed occupational breakdown of workforce forecasts is needed if establishments of further education are to develop appropriate training programmes. A detailed breakdown of industrial output is required if authorities are to undertake effective industrial policies.

One of the most striking problems in Bosnia is the absence of a census. A census was deferred in the post-war period due to the high level of internal displacement and the

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<sup>7</sup> James Scott, *Seeing Like a State* (Yale University Press, 1998), p. 77.

on-going process of return. However, with property repossession now complete, Bosnian governments urgently need an accurate picture of the post-war population. However, there seems little interest in pursuing the matter. The lack of demographic data feeds into a lack of reliable information at all levels of government. Public institutions are operating in an information vacuum, cut off from the social groups they are supposed to serve. As a result, many of their policy choices are strikingly unreal. This also makes it difficult for citizens to judge the performance of government by tracking the impact of social services, or comparing the performance of different public institutions. As the former director of the World Bank Operation Evaluation Unit noted:

“social learning cannot take place without institutions that can channel public protest into responsive shifts of public policies. That channelling is done through the *generation, dissemination and interpretation of information* that promotes public understanding of policies and programs... Public protest and participation transform the energy of disappointment into reform, when evaluation lends a helping hand.”<sup>8</sup>

The shortage of information in Bosnia is not primarily a problem of *supply*, however. The results of investigations, fact-finding missions or institutional audits undertaken by foreign or local consultants in the post-war period add up to a substantial body of knowledge. The problem is in the way this information is used within the policy process – in the *demand* for information. Across the different areas we have examined, there is a remarkable absence of goal-oriented approaches to solving real-world problems. This is a reflection of a profoundly distorted political process, which generates little demand for tangible social and economic policy outcomes. In contemporary Bosnia and Herzegovina, reform debates tend to be so superficial that policy makers have little need for reliable information.

A critical part of the daily task of all public institutions in a democracy is the gathering of the information they need for their operations. Only where government interacts on a daily basis with different social groups, and interest groups press information on the government as part of advancing their interests, will the business of government naturally generate information. The shortage of information in Bosnia is above all a sign of the passivity of government and the weakness of interest-group politics.

### C. *Overcoming the self-management legacy*

The Yugoslav system of government distributed important public functions across a wide range of autonomous (“self-managing”) institutions. It also blurred the lines of division between the public and private spheres, often mixing production, regulation and policy setting within the same institutional setting.

The costs of this arrangement were readily apparent. Autonomous institutions developed interests of their own which often diverged from the public interest. In the public sphere as much as in the private economy, they tended to run down the value of their assets over time. Self-management weakened the capacity of government to

<sup>8</sup> Robert Picciotto in Rodwin & Schon (eds), *Rethinking the Development Experience: Essays Provoked by the Work of Albert O. Hirschman* (Brookings, 1994), p. 219.

control the use of public resources and to ensure they were used to further public policy. The role of the state was limited to mediation, with much of the policy or strategic policy-making capacity located outside the administration.

This legacy survives in Bosnia in numerous hybrid, semi-public institutions and agencies, from the bodies managing the country's forests, the faculties of its universities, the chambers that legally represent its businesses to the public body which in Sarajevo canton is responsible for managing market stalls. What these bodies have in common is the right to use public resources in a non-market setting without much corresponding control on behalf of those who provide these resources.

Overcoming the self-management legacy means subjecting these institutions to clear lines of authority back to an elected government, and ensuring that they are permanently accountable for their use of public resources. It also means drawing clear lines between the public and private spheres, and ensuring that commercial functions are separated from government and subject to the discipline of the market.

It is not enough, therefore, to tighten *legal* controls over public institutions. Controlling the tremendous waste of public resources which characterises government in Bosnia requires a much more dynamic relationship between elected governments and all public institutions. Without active supervision and control by elected representatives and politicians, *any* bureaucracy will tend towards passivity, content to pursue its own institutional interests in the form of comfortable salaries and little confrontation.

Robert Dahl once noted that the essence of modern democracy is the intense process of interest group bargaining within the political process:

“few Americans who look upon our political process attentively can fail, at times, to feel deep frustration and angry resentment with a system that on the surface has so little order and so much chaos. For it is a markedly decentralized system. Decisions are made by endless bargaining; perhaps in no other national political system in the world is bargaining so basic a component of the political process... [Yet] with all its defects, it does nonetheless provide a high probability that *any active and legitimate group will make itself heard effectively at some stage in the process of decision making.* This is no mean thing in a political system.”<sup>9</sup>

In Bosnia, the development of interest-group politics has been slow and uneven. The most active and influential interest groups in Bosnia today – the public administration, industrial workers, veterans – were also the most important under the old political system, and their impact on the policy process remains highly visible. There is, however, still little sign of active political participation from new groups such as small-business proprietors, or traditionally marginal groups such as private farmers, or from other combinations of taxpayers or consumers of public services. The passivity of public institutions can only be overcome through public pressure generated by such groups on the political process.

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<sup>9</sup> Quoted in Daniel Bell, *The Coming of Post-Industrial Society: A Venture in Social Forecasting* (Harper, 1973), p. 308.

An important constraint on the development of Bosnian democracy is therefore the extremely low level of regard of politicians and the political process itself. Few figures are held in lower esteem in Bosnia than the politician, who is widely seen as a self-serving figure with little interest in the problems of ordinary people. When citizens expect little from the political process, they make little effort to form into interest groups and place demands on politicians. This creates a self-reinforcing dynamic of low expectations and low performance. This pattern is also reinforced by the suspicion of politicians in general which guides many of the reform initiatives promoted by the international mission in Bosnia. Implicit in many international programmes is a desire to de-politicise the work of public institutions in Bosnia: politics itself is in danger of becoming a dirty word in the present reform discourse.

There are good reasons why certain public institutions in democratic systems may be separated from the immediate influence of the government of the day, whether for the purpose of creating institutional checks and balances or in order to enhance stability and predictability in certain policy areas. However, these are exceptions to a more fundamental principle. In the vast majority of policy areas, the democratic system depends upon elected representatives to ensure that the behaviour of public administration serves the public interest.

### **III. LEGACIES OF AUTHORITARIAN DEVELOPMENT**

The Bosnian war was such a traumatic and disruptive event that it is easy to suppose that Bosnian history began in December 1995 with the signing of the Peace Agreement. The horrors of the war and the difficulties of the post-war period were so intense that it is tempting to regard the pre-war period as a golden age. But both ignoring the recent past and glorifying it are obstacles to understanding the challenges that Bosnian society, and Bosnia's elected leaders in particular, face today.

To build institutions, one must always begin with what is there – with structures, traditions, skills and expectations inherited from the past. To promote development, one must start from where people live, where factories have been built and what skills and expectations different groups have acquired. For this one must study *the past in the present*: the enduring legacy of assets, liabilities, norms and expectations built up over many decades.

The path of Bosnia's industrialisation is particularly important. It reveals a long tradition of authoritarian development and provides a backdrop to the ongoing collapse of most of the industrial base and the persistence of large areas of rural underdevelopment. These conditions define the problems which Bosnia's politicians must struggle to overcome, while at the same time sharply constraining the resources available to them to do so.

Over the past 120 years, the development and industrialisation of Bosnia has been imposed from above. This tradition began under the Austro-Hungarian administration before the First World War, continued under the Yugoslav monarchy in the inter-war period and reached its height under the communist regime from 1945 to 1990. It leaves a society, and in particular a political elite, strongly inclined to look to outsiders for solutions to their problems.

A. *Kallay and the agrarian question*

Making their case for the occupation of Bosnia and Herzegovina to the Congress of Berlin in 1878, the imperial authorities of Austria-Hungary argued that the chief causes of instability in the remote province were social and economic. Referring to the unresolved “agrarian question” – a system of land tenure which kept the overwhelmingly rural population trapped in underdevelopment – Foreign Ministry Andrassy announced: “Only a strong and impartial government can solve it.”<sup>10</sup> The Austrians argued that imperial rule would be a blessing to Bosnia, delivering stability by improving the lives of the common people. They pledged “first to raise the living standard of Bosnia-Herzegovina; then to concentrate on education; and finally to turn to political self-government”.<sup>11</sup>

The Austrian administration initiated the first investments in road and rail infrastructure. It granted concessions in forestry and mining, built up the old Turkish saltworks in Tuzla, and funded its own costs by establishing government monopolies over salt and tobacco. While in the Ottoman period the highest social prestige had been enjoyed by Muslim landowners, in the Austrian period their place was taken by public officials, most of whom were foreigners. The rapid growth of the bureaucracy led to the development of a small service sector in Sarajevo.<sup>12</sup>

However, during the Austrian period there was little sign of a domestic entrepreneurial class emerging. The longest-serving governor, Bernhard von Kallay, offered generous subsidies and guaranteed purchase agreements to foreigners willing to invest in Bosnia. Private businesses were almost exclusively foreign, operating with close links to the government. None of the main industrial plants were established with loans from banks located in the province itself.<sup>13</sup> Foreign investment of this kind did little to stimulate development in Bosnia. Committed to ensuring the survival of new industries, the government ended up heavily subsidising and ultimately owning and managing many of the enterprises. When criticised for playing the role of industrial entrepreneur, Kallay responded:

“I would be very happy if the initiative would come from other sources. But because, with very few praiseworthy exceptions, up to now no industrial power came forward in either Austria or Hungary to establish industries in Bosnia-Herzegovina, nothing could be done, but allow the government to take the initiative and to create jobs for numerous people, to advance the domestic consumption of such products which cannot find an export market.”<sup>14</sup>

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<sup>10</sup> Tomasevich, *Peasants, Politics and Economic Change in Yugoslavia* (Stanford Univ. Press, 1955), p. 107.

<sup>11</sup> Peter Sugar, *The Industrialisation of Bosnia-Herzegovina 1878 – 1918* (Seattle, 1963), p. 56.

<sup>12</sup> As the British Consul noted at the time: “Even formerly there were almost too many merchants and shopkeepers for the trade of the place, and now the number is out of all proportion to the wants of the inhabitants”: *ibid.*, p. 46.

<sup>13</sup> The first local savings bank was located in the city of Brcko, famous for exporting dried plums: *ibid.*, p. 92. The first manufacturing company established by Bosnian entrepreneurs was a small textile factory with a dozen workers in 1884.

<sup>14</sup> *Ibid.*, p. 58.

Although the industrial labour force grew to around 65,000 by 1912, life changed very little for most of the population. According to one historian, development under the Austrians

“left the over-populated countryside to its own devices. A network of military garrisons, gendarmeries and bureaucracy was superimposed on an initial network of factories and railways. The local population derived little benefit from such development policies... At best, they picked up unskilled jobs in the factories, casual jobs in connection with the construction and maintenance of the railways, or minor posts in the administration.”<sup>15</sup>

When the Austrians withdrew in 1918, “Yugoslavia inherited some good roads, a railway network, a few fully equipped and operating industrial plants, and several empty factory buildings.”<sup>16</sup>

Crucially, despite the concentration of legislative and executive power in the hands of the governor, the Austrian administration made no attempt to tackle the “agrarian question”, and the problems of rural overpopulation and poverty became worse than ever.<sup>17</sup> The majority of people were bonded tenant farmers (*kmets*), paying heavy taxes to support a narrow administrative and clerical elite. An average Herzegovinian *kmet* in the late 19<sup>th</sup> century paid more than 44 percent of his income in taxes and dues to the government and the landowner, which stifled innovation and investment. As Peter Sugar noted, the result was that “most peasants were not very ambitious and devoted more energy to devising means of fighting the landowners, crop evaluators and tax collectors than to raising production.”<sup>18</sup>

The situation changed little in the inter-war period, when Bosnia became an economic backwater within the new Kingdom of Yugoslavia. During the brief period of Yugoslav parliamentary democracy, “constitutional and ethnic politics absorbed so much energy and begat such ill-will that insufficient time and vigour were available for pressing social and economic problems.”<sup>19</sup> The fragile parliamentary process collapsed with the onset of the Great Depression. Capitalising on widespread public disgust with parliamentary paralysis and governmental instability, a royal dictatorship launched itself with a display of enthusiasm and administrative reforms, suggesting for a while that a benevolent autocracy might make progress where parliamentary democracy had failed. However, it quickly exhausted its energy in the face of escalating social and economic problems. On the eve of World War II three quarters of Bosnia’s population still depended on subsistence agriculture. Bosnian society remained trapped in underdevelopment.

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<sup>15</sup> Z. Zeman, *Pursued By a Bear: The Making of Eastern Europe* (London, 1989), p. 44.

<sup>16</sup> Peter Sugar, *op. cit.*, p. 67.

<sup>17</sup> The Bosnian population grew rapidly from 1.158 million people in 1879 to 1.898 million people in 1910: Z. A. B. Zeman, *op. cit.*, p. 43.

<sup>18</sup> Peter Sugar, *op. cit.*, p. 11.

<sup>19</sup> Joseph Rothschild, *East Central Europe between the Two World Wars* (Univ. of Washington, 1974), p. 236.

## B. *Fortress Bosnia*

The central promise of Yugoslav communism was the mass transformation of peasants into industrial workers, under the guiding hand of the communist party. As Tito's leading ideologue, Eduard Kardelj, saw it, "the peasant question is not to be resolved primarily in agriculture but in industrialisation of the country, with the transfer of a large part of the labor force from the village into industrial production and other economic activities."<sup>20</sup> Fifty years of Yugoslav socialism can be assessed through the successes and failures of this project.

In its first phase, however, socialist development in Bosnia was driven by a quite different logic. Following Yugoslavia's expulsion from Cominform in 1948 and the sharp rise in tensions with the Soviet Bloc, Bosnia became central to Tito's self-defence strategy. Fearing simultaneous attack from the north (Hungary) and east (Bulgaria), and drawing on the experience of Partisan successes in World War Two, Tito turned the remote central Bosnian region, with its rugged mountains, heavily wooded areas and natural caves, into Yugoslavia's fortress and the centre of its military industries.<sup>21</sup> Defence-related investment on a grand scale was made possible because the split with the Soviet Union brought massive financial assistance from the United States. By 1962, aid from the US had reached US\$2.3 billion,<sup>22</sup> by some estimates adding as much as 2 percent to average annual GDP growth.<sup>23</sup>

Before this period, the forbidding geography of Bosnia's remote central region had been a barrier to development. The population had gravitated towards the more accessible north of the country, particularly the fertile agricultural plain of the Posavina.<sup>24</sup> By the 1950s, however, this logic was reversed as the Yugoslav regime poured enormous resources into defence-related projects across the mountainous centre, building the impressive network of roads, bridges and tunnels which still form the core of Bosnia's transport infrastructure.<sup>25</sup> Formidable engineering works were undertaken across the republic: underground hangars and airstrips in Bihac and Blagaj, underground arms factories near Gorazde and Konjic (the latter, Igman, has five galleries enclosing 20,000 m<sup>2</sup>), and underground command and control centres.

During this period, military industries became the driving force behind industrialisation: Bratstvo in Novi Travnik (howitzers, multiple rocket launchers), Slobodan Princip Seljo/Vitezit in Vitez (explosives), Soko in Mostar (jet aircraft), Famos in Sarajevo (engines for tanks and armoured personnel carriers), Slavko Rodic in Bugojno (fuses for mines and grenades), Pobjeda in Gorazde (detonators), Cajevac

<sup>20</sup> Quoted in Susan Woodward, *Socialist Unemployment: The Political Economy of Yugoslavia 1945-1990*, p. 67.

<sup>21</sup> S/1994/674/Add.2 (Vol. I) - 28 December 1994, *Final report of the United Nations Commission of Experts established pursuant to Security Council Resolution 780 (1992), Annex III: "The military structure, strategy and tactics of the warring factions"*.

<sup>22</sup> See Susan Woodward, *op. cit.*, p. 192; Lampe, J., *Yugoslavia as History: Twice There was a Country* (2<sup>nd</sup> ed., Cambridge UP, 2000).

<sup>23</sup> Lampe, *op. cit.*, p. 275.

<sup>24</sup> Between 1878 and 1910, the population in the northern administrative districts of Banja Luka and Donja Tuzla increased from 458,000 (39% of the total population) to 829,000 (43%). The least densely populated areas were Central Bosnia and Herzegovina: see Sugar, *op. cit.*, p. 5.

<sup>25</sup> The share of national income spent on defence reached 16.7% by 1950: Lampe, *op. cit.*, 253.

in Banja Luka (radar and electronics) and many others.<sup>26</sup> Energoinvest produced mortar barrels and guns in Tuzla, using steel founded in Zenica and cast in Jelsingrad near Banja Luka.<sup>27</sup> The largest of these companies were later amalgamated to create the vast UNIS (United Armaments Industries Sarajevo) complex, which eventually incorporated 60 separate plants across the former Yugoslavia and built Sarajevo's landmark twin tower blocks. As well as supplying the Yugoslav army, the defence industry exported extensively to "non-aligned" and other developing countries, including Iraq, Saudi Arabia, Libya, Kuwait, Burma and Algeria, earning around US\$20 billion in hard currency during the 1980s. On the eve of Yugoslavia's collapse, 55 percent of this industry, one of the largest in Europe, was located in Bosnia and Herzegovina.<sup>28</sup> One USAID report states that Bosnian military contractors fulfilled state orders of over US\$700 million in the year before the war.<sup>29</sup>

To meet the needs of this production, more than 100,000 skilled workers were relocated to Bosnia from other republics in the 1950s. The rise of new military enterprises required building new urban centres. The founding of the modern town of Vitez in Central Bosnia, for example, coincided with the building of the Slobodan Princip-Seljo explosives factory in 1950. The factory and the town were planned together from Belgrade, and the construction work was undertaken by a military-controlled company from Travnik. New apartment blocks were built to accommodate the large number of soldiers and technicians settled in the area, many from Serbia and Slovenia. Similar stories can be told for Novi Travnik, Bugojno and other towns across Bosnia.

However, the extent of military-related investment in the 1950s and 60s proved to be a mixed blessing. Because of the volume of investment, Bosnia was long treated in official policy as a "developed republic" and denied the civilian investments channelled into Serbia, Macedonia and Montenegro, even though it remained objectively one of the poorest parts of Yugoslavia. Bosnia's development fell further behind the other republics. In 1953, it had a *per capita* income of 74 percent of the Yugoslav average; by 1971, this had fallen to 53 percent.<sup>30</sup> By 1971, only 1 percent of the population had completed university training and 36 percent had less than three years of primary education.<sup>31</sup>

One of the most important social trends during these decades was the rise of the peasant worker (*seljacki industrijski radnik*), who continued living in the rural areas while travelling often long distances to jobs in the factories.<sup>32</sup> Many agricultural

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<sup>26</sup> Most of these companies also diversified into civilian production. Famos, for example, produced engines for Mercedes, while the output of UNIS ranged from consumer electronics to bicycles and motor vehicle components. The civilian production line was organisationally distinct, but in most cases was unable to survive the collapse of military production.

<sup>27</sup> Milan Vego, "The Muslim Defence Industry in Bosnia and Herzegovina", *Jane's Intelligence Review*, Vol 6-5 (1994), p. 213.

<sup>28</sup> Milan Vego, "The army of Bosnia and Herzegovina", *Jane's Intelligence Review*, Vol. 5-2 (1993), p. 63.

<sup>29</sup> USAID, "Sector Survey: Metalworking", May 1998, p. 87.

<sup>30</sup> Sabrina Ramet, *Nationalism and Federalism in Yugoslavia 1962-1991* (2<sup>nd</sup> ed., Bloomington 1992), p. 143-144.

<sup>31</sup> *Ibid.*

<sup>32</sup> Cvetko Kostic, *Seljacki Industrijski Radnici* (Belgrade, 1955). While the urban population grew relatively slowly, from 14% in 1948 to 28% in 1971, the number of people employed in

households supplemented inadequate subsistence agriculture with a modest wage income, taking advantage of the social services (pensions and health care) which came with jobs in the socially owned economy.<sup>33</sup> A study of Bosnia's industrial flagship, the Zenica steel plant, in the 1950s showed that rural workers faced a daily commute of up to 8 hours from their villages.<sup>34</sup> Internal migrants formed the bulk of the labour force in the textile, wood and construction industries across Yugoslavia, and 60 percent of the miners in Serbia and Bosnia.<sup>35</sup>

Of the military-industrial base which once formed the backbone of the Bosnian economy, little now survives. In 1992, the JNA transported as much military industrial plant as possible back to Serbia. The armaments factories were fought over and divided among the warring parties, and much of the skilled labour force left the country. Moreover, the old integrated system of production collapsed with the break-up of Yugoslavia. Through conscious policy, military industries had been developed around a network of mutual dependence<sup>36</sup> between Bosnia and Serbia. It was said that, in order to produce a single bullet, it was necessary to cross the river Drina three times, rendering isolated plants of little value in the post-war climate. The collapse of military industry was a shock to the Bosnian economy at least as severe as the closure of the Welsh coal mines or the decline of traditional industries in Southern Belgium, Northern England or the new German *Länder*. Yet it has received surprisingly little attention from either Bosnian or international policy makers.

### C. *The golden age of Bosnian socialism*

The industrialisation of Bosnia reached its high point during the 1970s. Massive investment in industry finally brought about dramatic changes in Bosnian society. Standards of living rose, surpassing those of other socialist countries at the time, creating an increasingly educated and urbanised population. For most Bosnians, these were years of achievement – an industrial golden age culminating symbolically in the Sarajevo Winter Olympics of 1984, and the reference point against which most Bosnians measure their current lives. As the World Bank noted, “this standard conserved itself as a notion of the last ‘normal’ period in the economic history of the nation; the current living standards still fall short of this benchmark.”<sup>37</sup>

Industrial development in the 1970s saw the rise of new social groups. There was a massive increase in wage employment across the country. Women entered the work force in ever larger numbers, particularly in the textile sector.

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agriculture fell sharply, from 77% of the population in 1948 to 40% in 1971: Sabrina Ramet, *op. cit.*, p. 138.

<sup>33</sup> Until 1965, health insurance and pensions were unavailable to those without jobs in the socially owned sector.

<sup>34</sup> See Michael Palairat, “The mismanagement of the Yugoslav rural economy, 1945 – 1990” (unpublished), pp. 18-19.

<sup>35</sup> Susan Woodward, *op. cit.*, p. 192.

<sup>36</sup> Known as ZINVOJ - *Zajednica industrije naoruzanja i vojne opreme Jugoslavije* (Union of Yugoslav Armament and Military Equipment Industries).

<sup>37</sup> “Preliminary Findings from the LSMS”, BiH authorities in cooperation with the World Bank, August 2002, p. 5.

The 1970s also saw the rise to prominence of a new group of educated, white-collar employees. Until 1945, Bosnia had no institutions of higher education.<sup>38</sup> The first non-theological faculties began to appear in Sarajevo after the Second World War, and in the 1970s new universities were established in Banja Luka, Tuzla and Mostar, often with a strong focus on technical subjects such as engineering and metallurgy. By the late 1980s, 14 percent of the Bosnian workforce had a university qualification.

The newly educated elite filled the growing number of managerial and technical jobs in the enterprise sector and the public administration.<sup>39</sup> The rise of self-management and social planning in the 1970s – a system of government where resource allocation decisions were taken not by central planners, as in other socialist systems, but through an intricate system of negotiations and voluntary agreements among countless autonomous actors – magnified the number and importance of these white-collar positions. According to one economic historian,

“Social planning absorbs a great deal of valuable time, especially the time of management, which might otherwise be used in improving efficiency. The main beneficiaries have probably been economists, lawyers and bureaucrats, who have obtained large numbers of well-paid jobs from the system.”<sup>40</sup>

Although they were periodically condemned by official ideologists as “unproductive”, it was these groups, rather than blue collar workers or peasants, who were the real power base of the Communist Party.<sup>41</sup>

During the 1970s, Bosnia acquired 322,000 new jobs – a 59 percent increase – at a rate of nearly 3,000 jobs a month for a decade. This was accompanied by rapid urbanisation. The economic geography of the republic changed substantially. The Tuzla basin doubled its employment between 1970 and 1990.<sup>42</sup> Peripheral areas such as Herzegovina acquired for the first time a network of enterprises. In all, more jobs were created in the 1970s and 80s than over the previous century.

As in earlier periods, however, the resources to fund this rapid development came largely from outside the republic. Between 1965 and 1988, Bosnia received around US\$3 billion in investments from the Yugoslav Fund for Underdeveloped Republics.<sup>43</sup> This in turn was dependent on generous credits from the World Bank and international commercial lenders. In the first half of the 1970s, a massive 32 percent of annual investments in fixed and working capital in socialist Yugoslavia came from foreign sources.

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<sup>38</sup> The Higher Islamic Sharia Law School opened in Sarajevo in 1937. Teachers had the same status as professors in the Kingdom of Yugoslavia.

<sup>39</sup> In Germany in the 1920s, this new administrative and technical class was called the “new middle class”. C. Wright Mills uses the idea in his 1951 book *White Collar: The American Middle Classes* (Mills, 1951).

<sup>40</sup> Harold Lydall, *op. cit.*, p. 17.

<sup>41</sup> As Susan Woodward put it: “the most vexing employment problem in the 1980s was not with industrial workers but with civil servants, white collar administrators and staff, and the social services – in the language of Yugoslav socialist ideology, ‘unproductive’ people on ‘guaranteed salaries’ from budgetary employment”: *op. cit.*, p. 30.

<sup>42</sup> On the territory of what is today Tuzla Canton, the number of employed increased from 55,913 in 1970 to 109,386 in 1990: Tuzlansko-Podrinjskog Kantona, “Strategija Obnove i Razvoja”, p. 25.

<sup>43</sup> Ramet, *op. cit.*, 51.

**Table 1: Employment growth in Bosnia, 1948-1990<sup>44</sup>**

	1948	1952	1971	1981	1990
Total population	2,564,000	2,791,000	3,761,000	4,136,000	4,516,000
Working age population	1,381,996	1,598,000	2,222,000	2,696,000	3,037,000
<b>Total employment</b>	<b>210,063</b>	<b>352,370</b>	<b>546,337</b>	<b>868,451</b>	<b>1,054,295</b>
Employment in the socially owned sector	-	264,900	538,046	854,557	1,026,254
<b>Official unemployment</b>	-	<b>4,272</b>	<b>32,549</b>	<b>142,912</b>	<b>283,478</b>

With the second oil crisis of 1979, the golden age came to an abrupt end as commercial credit from international banks dried up. However, employment growth continued by official *diktat*, with socially owned factories instructed to increase their workforce year on year without regard to their financial performance. In this way, Bosnia acquired another 150,000 jobs in the socially owned sector. Despite the systematic over-manning, unemployment rose steadily, while productivity and wages fell. Yugoslavia found itself in a spiralling debt crisis, forced to postpone repayments of principal. Real social product fell by 6 percent from 1979 to 1985, in a process of decline which accelerated towards the end of the decade. Writing on the eve of war, the economic historian Harold Lydall commented:

“The decline in the standard of living has been so great that it is difficult to think of any other country that would not have responded with major political changes, or even revolution.”<sup>45</sup>

By the late 1980s, it was clear even to official observers that Yugoslavia’s industrial structures had been built on the flimsiest of foundations. Much of the foreign capital raised in the 1970s had been squandered, with vast sums poured into large-scale projects that proved to be either technically or economically inefficient.<sup>46</sup> In 1987, Yugoslav prime minister Branko Mikulic (a Croat from Bugojno) informed the federal parliament that “more than half of the foreign debt was invested in projects which turned out to be mistaken, or was used for consumption.”<sup>47</sup>

This short-lived golden age left Bosnia with a mixed heritage. Although employment creation had been the primary rationale for the investment boom, employment in Bosnia always remained low. Even at its peak in 1990, only 35 percent of the Bosnian working-age population was employed, compared to an EU average of 64 percent.<sup>48</sup> An important part of the working-age population also left to seek work “temporarily” in foreign countries, particularly from Herzegovina. Furthermore, the system of compulsory employment creation in socially owned enterprises created high rates of underemployment and paid positions which were highly artificial. This was

<sup>44</sup> Sources: *Materijalni i društveni razvoj SR Bosne i Hercegovine 1947-1972; Statistički godišnjak 1991*, pp. 447-467. Note that the estimated population in 1990 here exceeds the 1991 census figure.

<sup>45</sup> Harold Lydall, *op. cit.*, 1989, p. 9.

<sup>46</sup> Harold Lydall, *Yugoslav Socialism: Theory and Practice* (Clarendon, 1984), p. 53.

<sup>47</sup> *Ibid.*

<sup>48</sup> By contrast, the lowest employment rate in the European Union today can be found in parts of southern Italy, Spain and Greece: Campania (40.7%), Puhlia (44.3%) or Andalucia (49.9%).

part of a wider problem of Yugoslav industrialisation. In 1981, *socialist* Yugoslavia had the highest unemployment figures in all of Europe.<sup>49</sup> As the president of the League of Communists of Yugoslavia, Stipe Suvar, stated in 1988: “If an efficiency-oriented reform were put into place, two to two and a half million workers would be thrown out of work.”<sup>50</sup>

In the last few years of Yugoslav socialism, the entire economic system was in deep crisis, threatening to undermine the social advances of the previous decades. The resulting mismatch between the expectations of a society which aspired to European standards of living and the harsh economic realities created an environment which was dangerously conducive to conflict.

#### IV. THE CRISIS OF INDUSTRIAL SOCIETY

##### A. *The limits of reconstruction*

In addition to its horrendous human cost, the Bosnian war of 1992 to 1995 was an economic catastrophe on a vast scale. According to World Bank estimates, nearly one half of the capital stock was lost during the war. More than 412,000 units of housing were damaged or destroyed (one third of the total housing stock).<sup>51</sup> More than a million people left the country. War brought industrial production in Bosnia almost to a standstill. The cumulative effects of mass displacement of workforces, isolation from markets and materials, disputes over control of industrial property and the destruction or theft of plant and equipment left Bosnian industry in 1996 operating at as little as 10 percent of its pre-war capacity.<sup>52</sup>

Many people, both Bosnian policy makers and their international advisers, argued that, once the physical effects of the war were overcome, the Bosnian economy could pick up where it left off and make a quick transition to market conditions. The expectation was that, within a few years, Bosnians would recover at least their pre-war living standards. As late as 2002, the World Bank wrote:

“Bosnia and Herzegovina... had a relatively diversified economy, a well developed industrial base, ranking among the leaders of the region, and a highly educated labour force. Unlike other centrally planned economies, its economy was relatively open and was market oriented. All these factors augured well for the country’s relatively smooth and successful transition to a market economy... However, war interrupted this process.”<sup>53</sup>

This interpretation, which was widely shared by members of the post-war Bosnian political and economic elite, overlooked the extent of the problems on the supply side of the Bosnian economy – the legacies of outdated technology, excess capacity, over-sized workforces and enterprise debt whose origins stretch well back before the war.

<sup>49</sup> Susan Woodward, *op. cit.*, p. 191.

<sup>50</sup> *Ibid.*, p. 192.

<sup>51</sup> World Bank, “Bosnia and Herzegovina – Post-Conflict Reconstruction (Country Case Study)”, May 2000.

<sup>52</sup> World Bank, “Bosnia and Herzegovina: 1996-1998 Lessons and Accomplishments (PEIR)”, May 1999, p. 13.

<sup>53</sup> World Bank, “From Aid Dependency to Fiscal Self-Reliance: A Public Expenditure and Institutional Review”, October 2002, p. 9.

It also explains why international financial organisations consistently overestimated the potential for recovery of the Bosnian economy.

In its first post-war review of public spending published in 1997, the World Bank set out its hope that by 2000 the country's output would be back at 70 percent of the 1990 level, and public spending would be close to the regional average of 40 percent of GDP. This proved unattainable. In fact, even the worst case scenario outlined by the World Bank was too optimistic (see table 1). By 2000, growth had slowed sharply before Bosnia had recovered half of its pre-war output, and public spending remained at 66 percent of GDP.<sup>54</sup>

**Table 2: Over-optimistic growth projections, 1998-2003<sup>55</sup>**

	1998	1999	2000	2001	2002	2003
<b>Projected GDP growth (%)</b>						
Best case – 1997	27	20	12	10	8	5
Worst case – 1997	15	10	8	6	6	5
Projected – 1999 <sup>56</sup>	18	15	15	14	10	5
Projected – 2001 <sup>57</sup>	18	8	14	14	10	5
<b>Actual GDP growth (%)<sup>58</sup></b>	<b>15.6</b>	<b>9.6</b>	<b>5.4</b>	<b>4.5</b>	<b>3.8</b>	<b>3.3</b>

Four years after the end of the war, the levelling out of GDP growth was not the only sign that the post-war recovery was running into difficulty. Sector studies showed that Bosnian industries were accumulating losses at an alarming rate. A USAID *Economic Update* from February 2000 concluded that “growth was negative or flat in many sectors where the Federation ought to enjoy a comparative advantage,”<sup>59</sup> and that employment growth in the Federation had largely come to a halt.<sup>60</sup> In Republika Srpska, industrial production was collapsing from an already low level.<sup>61</sup> Enterprise indebtedness was becoming a serious problem. The USAID report estimated that, in the Federation, for every 100 KM of wages paid to (private and public) employees, there were 30 KM of losses.<sup>62</sup> In Republika Srpska, losses per employee (KM 3,500) were double the average annual net wage.

Thus, Bosnian companies were sinking ever deeper into debt just as they were to enter the privatisation process. Not surprisingly, there were few serious investors willing to

<sup>54</sup> IMF, “Staff Report”, July 2003, p. 25.

<sup>55</sup> World Bank, “Public Expenditure Review”, Vol. II, November 1997.

<sup>56</sup> World Bank, “Lesson and Accomplishments”, 1999, p. 47.

<sup>57</sup> World Bank, “Bosnia and Herzegovina: Enterprise and Bank Privatisation Adjustment Credit”, June 1999.

<sup>58</sup> IMF, “Staff Report”, July 2003,

<sup>59</sup> USAID, “Economic Update”, 25 February 2000, p. 4.

<sup>60</sup> USAID, “Between December 1998 and December 1999, registered employment increased by only 3,057”: *ibid.*

<sup>61</sup> USAID: “in the fourth quarter of 1999 was 8 percent lower than the level observed in the same period of 1998”: *ibid.*

<sup>62</sup> *Ibid.*, p. 11.

take on responsibility for loss-making, indebted and increasingly illiquid enterprises.<sup>63</sup> The privatisation process turned into a costly charade. Most companies were sold through a complex voucher system, designed to compensate Bosnian citizens for the pre-war and war-time debts owed them by the state. In reality, however, granting citizens the right to acquire shares in companies which in many cases had negative asset value was a purely notional compensation. No effort was made to restructure companies in advance of sale, and no system of privatisation through liquidation was established. Voucher privatisation attracted neither new managers nor new capital to change the trajectory of the companies.

**Table 3: Where public expenditure increased, 1998-2002 (million KM)<sup>64</sup>**

	1998	2002	Change 1998-2002	% Change
State	138	495	+ 357	+ 258%
Federation	682	1,040	+ 358	+ 52%
Cantons & municipalities	1,106	1,082	- 24	- 8%
FBiH off-budget funds	879	1,359	+ 480	+ 54%
Republika Srpska	357	879	+ 522	+ 146%
RS municipalities	42	69	+ 27	+ 64%
RS off-budget funds	261	499	+ 238	+ 91%
Brcko District	0	150	+ 150	-
<b>Total</b>	<b>3,465</b>	<b>5,573</b>	<b>2,108</b>	<b>+ 60 %</b>

Systematic overestimates of the country's economic potential and the impact of outside assistance also had dire consequences for the making of fiscal policy. Despite the severity of the economic conditions, all levels of government in Bosnia except cantons and municipalities in the Federation increased their budgets steadily. The international community, led by OHR, contributed to the problem through institution-building strategies which attracted qualified staff into key institutions by offering unsustainable salaries. The year 2000 marked the intensification of international efforts to build up the institutional capacity of the central government. The State Border Service was established, initially with foreign funding, but by 2002 it was the second largest budget entity in the central government at KM 52 million. Several other independent agencies were created with salaries above the usual administrative scales. An OHR decision in 2000 more than doubled the salaries of judges across the country. There was a sharp rise in public expenditures in the District of Brcko, which soon had by far the highest levels of public salaries in the whole country. Each of these initiatives were seen as a key state-building objective, and pushed by international organisations. Collectively, they added considerably to the cost of government and reinforced the problem of public-sector wage inflation.

The result is that today government in Bosnia and Herzegovina imposes a heavy burden on an impoverished society with an extremely weak economy. In 2002,

<sup>63</sup> This situation led to very different projections. As USAID noted: "The World Bank sees another three years of double-digit GDP growth for BiH. By contrast, analysis carried out at the Private Sector Development Task Force resulted in a much gloomier picture."

<sup>64</sup> 2002 figures from IMF, "Staff Report", July 2003, p. 29-30. The table excludes transfers by the entities to the state budget. The state budget includes debt servicing.

Bosnia and Herzegovina had domestic revenues of KM 5.6 billion, equivalent to 52 percent of its total estimated GDP (KM 10.8 billion).<sup>65</sup> This made Bosnia “one of the highest-taxed economies in Central and Eastern Europe.”<sup>66</sup> Bosnian governments and public funds then spent KM 6.1 billion, equivalent to almost 56 percent of GDP.<sup>67</sup> This compares to a regional average of public spending of around 40 percent of GDP.<sup>68</sup>

However, although Bosnia’s public expenditure is very high relative to national income, it is low in absolute terms. The Bosnian public sector spends €846 per resident annually, compared to €4,299 in Slovenia.<sup>69</sup> Total public spending across all levels of government in Bosnia amounts to less than a third of the annual budget of the city of Vienna.<sup>70</sup> Furthermore, a large share of this total is spent on current expenditure – that is, sustaining the public institutions and administrators themselves – rather than on government programmes or investments in Bosnia’s future development.

As compared to the compressed living standards in the rest of society, Bosnian public servants in general live well. The prize public servant positions – at state level, in independent agencies, the Federation administration, Mostar City and the Brcko District – offer among the best salaries in the country. In both Republika Srpska and the District of Brcko, public administration jobs on average constitute the most highly paid sector of the economy (see table 4). Across the board, salaries in the administration far exceed average salaries, by 35 percent in the Federation, 57 percent in Republika Srpska and 67 percent in Brcko District.

Brcko, which is under direct international supervision, has the most expensive public administration in the country. According to the 2002 budget, the mayor’s salary in Brcko stood at KM 3,910, a department head or police chief received KM 3,450, and an ordinary policeman or secretary received KM 828. The gap between those on and off the budget was likewise highest in Brcko. Outside the administration, salaries in forestry, agriculture, trade or hospitality were all below KM 300 (even though a basic food basket for a family of four cost KM 408 in July 2002<sup>71</sup>). This suggests that the higher salaries in Brcko were not related to any high level of productivity in the local economy.

Salary pressures are strong across all levels of governments. Government employees have a clear sense of entitlement, stemming from their education levels and their pre-war standard of living. However, only certain levels of government have found the means to fund higher salaries. Outside these privileged institutions benefiting from close international attention, there are layers of government whose bargaining position

<sup>65</sup> The numbers are based on estimates of the IMF: “Staff Report”, July 2003, p. 27.

<sup>66</sup> PEIR, p. i.

<sup>67</sup> The difference between revenues and expenditures is made up largely by international credits: IMF, “Staff Report”, July 2003, p. 27. See also Jean-Luc Bernasconi, World Bank, “Overview of public spending composition in BiH: Proceedings of the Public Expenditure Conference”, 4-5 March 2003: [www.worldbank.ba](http://www.worldbank.ba).

<sup>68</sup> World Bank, PEIR, p. 17.

<sup>69</sup> Slovenian consolidated public spending was €8,500 million for a population of 1.9 million. Slovenia’s GDP was € 22.9 billion.

<sup>70</sup> The budget of the City of Vienna in 2001 was €9.95 billion: [www.wien.gov.at/finanzen](http://www.wien.gov.at/finanzen).

<sup>71</sup> Brcko District Statistical Office, “Statisticki podaci”, No. 4, September 2002, pp. 7-8.

is low, and who find themselves starved of funds. The Federation cantons have faced declining revenues, in large part because decisions on their tax rates have been taken at Federation level.

**Table 4: The privileges of administration - Republika Srpska and Brcko District**

Sector	Republika Srpska, 2001 <sup>72</sup>	Brcko District, 2002 <sup>73</sup>
	<i>Average salary = 100</i>	
Public administration	157.0	167.0
Financial sector	153.8	103.4
Energy and water	138.2	110.6
Transport and communications	128.1	68.5
Health	123.5	145.3
<b>Average salary</b>	<b>100.0</b>	<b>100.0</b>
Agriculture	83.5	33.6
Construction	70.2	42.0
Industry	67.9	43.0
Average salary in KM	<b>KM 309<sup>74</sup></b>	<b>KM 669</b>

In addition, regional variations are significant and widening. The most prosperous parts of post-war Bosnia are the administrative centres, which host both international and domestic public institutions. The regional economic “success stories” are those with a bureaucratic growth pole: Sarajevo, Mostar and Banja Luka. The concentration of public servants leads to higher rates of domestic consumption, stimulating the private sector by attracting traders, retail services and, increasingly, financial institutions. This in turn leads to higher indirect tax revenues that can be used to fund public-sector wage increases. This arrangement works well for the administrative centres but it is highly disadvantageous for other parts of the country, squeezing service delivery in most other municipalities and Federation cantons.

**Table 5: Wages increase in the Federation, 1999 to 2002<sup>75</sup>**

Canton	Average net Monthly wage		Increase
	1999	2002	
Una-Sana	406	470	+ 64 KM
Tuzla	361	443	+ 82 KM
Zenica-Doboj	332	391	+ 59 KM
Central Bosnia	326	396	+ 70 KM
Herzegovina-Neretva	418	544	+ 126 KM
Sarajevo	482	620	+ 138 KM

<sup>72</sup> World Bank, “Labor Market in Postwar Bosnia and Herzegovina”, 2002, p. 94.

<sup>73</sup> Brcko District Statistical Office, *op. cit.*, p. 6.

<sup>74</sup> Source World Bank, “Labor Market Study”, 2002, p. 9.

<sup>75</sup> Sources: for 1999 – USAID, “BiH Economic Update”, 25 February 2000, p.41; for 2002 – Federal Employment Office, “Statisticki pregled”, June 2003: [www.fzs.ba/podaci](http://www.fzs.ba/podaci).

The imbalance between salaries in the public sector and in the rest of the economy poses serious challenges. The growing financial crisis means there is little scope to continue with a mode of institution-building, where independence and inter-ethnic co-operation are ‘purchased’ with abnormally high salaries paid by Bosnian taxpayers. The inequity is likely to become an increasingly serious political issue, forcing Bosnian governments to take on what is perhaps the most important of Bosnia’s interest groups – the administration itself. At the same time, an open-ended process of cuts in salaries and staff numbers would complicate administrative reforms and make it more difficult to create a motivate and proactive administration.<sup>76</sup>

The fundamental problem of Bosnian public finances is the disappointing post-war economic recovery. Nine years after the end of the war, the former mainstays of Bosnian industry have not recovered. Very little secondary wood processing still takes place in Bosnia, and the timber industry is reduced to the export of logs. Agro-processing is severely limited by overcapacity in old facilities such as dairies, and by a shortage of domestic agricultural produce. The chemical industry has largely collapsed. Textiles and leatherworking, sectors developed in the 1970s to boost employment in rural areas and among women, have been rendered largely uncompetitive by Bosnia’s high wage costs. Metalworking, previously centred on military production, is in a deep crisis. The big names of Bosnia’s industrial history – Energoinvest, Unis, Sipad, Bratstvo – are little more than hollow shells, whose decline has continued throughout the privatisation process.

The international reconstruction programme did not “kick-start” the Bosnian economy, as its authors had hoped.<sup>77</sup> High growth rates reported in the period from 1996 to 1999, averaging 40 percent of GDP annually, proved to be shallow. These numbers were registering the direct effects of international spending, and were driven in part by the rapid increase in *public* sector salaries, all against the disastrously low post-war GDP. This form of economic growth generated little new employment outside the public sector. It was the equivalent of a temporary oil boom, driving up imports and prices without changing the structure or competitiveness of the economy.

#### *B. Reconstruction and public assets*

Post-war reconstruction aid to Bosnia did not change the basic dynamics of decapitalisation and depreciation of public assets, including infrastructure. This is clear from looking at the condition of public utilities like railways, water or district heating, all of which have benefited from large injections of international funds in recent years.

In 1990, the Bosnian railway transported 26 million tons of freight and 13 million passengers. A decade later, following a heavy international capital injection, it moved

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<sup>76</sup> As Christopher Pollitt and Geert Bouckaert argue, while there is no contradiction in principle between spending cutbacks and productivity increases, “continued, repeated downsizings destroy any basis for confidence and commitment... They also destroy institutional memory, reduce the chances of survival for any ‘public service ethic’ and lead to a hollowed out and ultimately less competent form of government”: *Public Management Reform – A Comparative Analysis* (Oxford University Press, 1999), p. 163.

<sup>77</sup> Conclusions of the Peace Implementation Conference Held at Lancaster House, London, 8-9 December 1995, par. 3.

only 4.8 million tons of goods and 1.3 million passengers. The collapse of domestic output had left Bosnia with little need for freight services. With demand so low, the railways do not generate enough revenue to cover routine maintenance.<sup>78</sup> As a result, the two entity railway companies generated combined losses of over €29 million.

In Sarajevo, the cantonal water company has been a major recipient of international reconstruction aid since the war. In 2001, it managed to cover its operating costs of KM 41 million only with the help of a KM 8 million subsidy from the cantonal budget. However, according to its own accounts, it failed to cover its annual depreciation costs of KM 25 million, and is therefore dis-investing at an alarming rate. This problem is common across the water sector, and most other utilities. A 1999 USAID report examined the financial condition of ten water utility companies and concluded: “by almost any measure, almost all the *vodovods* are in extremely poor condition.”<sup>79</sup> The 2002 annual report of the Zenica water company described the problem bluntly:

“Depreciation ought to be a genuine cost item, covering the replacement of fixed capital and facilitating a self-sustaining system. However, due to the low percentage of collections and the resulting impossibility of offsetting the replacement of fixed capital by depreciation, the company is consuming its own substance.”<sup>80</sup>

There are various reasons why the utility sector continues to de-capitalise, despite the extent of international assistance. One is the low capacity of many Bosnian households to pay for utilities, and the genuine reluctance of municipal companies to discontinue services to displaced persons and social cases. The gap in collections often becomes an implicit social transfer. Since municipal or cantonal institutions have little cash to support poor households, utility companies end up consuming their own capital in order to provide subsidies in kind.

A second problem relates to external conditions. Certain infrastructure networks were built to support the needs of companies or industries which no longer operate, and are poorly suited to a post-industrial community. The excess capacity translates into higher maintenance costs, which often cannot be extracted from consumers. Again, the implicit survival strategy of utility companies is to transform fixed capital into working capital by neglecting maintenance and re-investment.

A third reason is institutional weakness in the utility companies themselves. There has been extensive legal reform of their corporate governance. However, despite new laws, utilities continue to operate as they did in the pre-war period. The introduction of modern accounting standards that take into account items such as depreciation is recent, and companies often lack the expertise to operate them. As the World Bank noted after international accounting standards had been introduced into the law: “it is

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<sup>78</sup> While passenger kilometers in 2001 stood at 4% of the pre-war total and goods transported at 18.5%, total employment in the two railway companies (6,585) was 28% of the pre-war total (23,856). World Bank, “BiH Railways Company Profile and current situation”, October 1998 and “Preliminary analysis of the railways of BiH”, September 2002.

<sup>79</sup> USAID, “Plan for Institutional Strengthening of Ten Selected Pilot Vodovods”, 1999, p. 30.

<sup>80</sup> JP Vodovo i Kanalizacija in Zenica (2002), p. 5.

clear that few accountants understand (or are capable of applying) the entities' accounting and auditing standards in the preparation of financial statements."<sup>81</sup>

Supervision of public utility companies by the appropriate government (the "owner") is done through "governing boards" (*upravni odbori*), which are responsible for approving annual reports and important financial and operational decisions. Being on a board is a lucrative post by the standards of Bosnia – often well above KM 500 for one monthly meeting. Board members tend to have little interest in controlling wage inflation – a problem which is particularly acute in the large post and telecommunications and electricity utilities. Most importantly, they fail to represent the interest of the "owner" of the company – being society at large – in preserving the value of the company over time and ensuring its long-term viability. Relatively high wages in utilities suggest that funds which should go into maintenance are going into remuneration.

With these problems unresolved, international reconstruction provided Bosnia's utilities with a capital injection that enabled them to continue on for a few more years. What it has not been able to do has been to remove the causes of this overall dynamic of de-capitalisation and decline.

### *C The social consequences of deindustrialisation*

In the West since the 1970s, sociologists have described the emergence of "post-industrial society." They refer to the decline in industrial employment caused by rapid advances in technology, accompanied by the emergence of a sophisticated service sector in which knowledge and information are at a premium. In advanced economies, de-industrialisation is associated with rapid development, when the growth in the service sector absorbs workers displaced from manufacturing as a result of rising productivity. In Belgium or the United Kingdom, the proportion of civilian employment in industry declined by 45 percent between 1955 and 1998.<sup>82</sup>

Even in advanced economies, de-industrialisation can lead to serious regional problems, as in the case of the United Kingdom in the last two decades:

"some 2 million manufacturing jobs were shed between 1981 and 1997 (one third of the nation's factory employment base), while the service sector added 4 million new jobs (a growth rate of 30 per cent). Yet the process of labour market conversion from manufacturing to services has been highly geographically uneven. Manufacturing decline (or 'de-industrialisation') has primarily disadvantaged the manufacturing heartlands of the North and West, while service sector growth has disproportionately benefited the South and East."<sup>83</sup>

In those Central and East European countries which are candidates to join the European Union, employment in industry has also fallen between 25 and 50 percent

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<sup>81</sup> World Bank, "Bosnia and Herzegovina: Draft Country Financial Accountability Assessment", p. 21.

<sup>82</sup> Theodore Kariotis, "The economy: growth without equity" in Couloumbis, Bellou & Kariotis, *Greece in the Twentieth Century* (Taylor & Francis, 2003), p. 243.

<sup>83</sup> Jamie Peck and Adam Tickell in Johnston, Matthews & Gardner (eds), *The Changing Geography of the United Kingdom* (Routledge, 1999), p. 152.

between 1989 and 1997.<sup>84</sup> As the European Union found when preparing for future regional development strategies, old industrial centres and peripheral regions are the areas hardest hit by the economic transition. Industrial centres are severely affected by privatisation, enterprise closures, high rates of unemployment and the difficulty of re-integrating workers with low or outdated skills into the new labour market. Rural areas are marked by underdeveloped infrastructure, low educational levels and a partial return to subsistence agriculture.<sup>85</sup> However, in recent years, Central European countries have shown signs of *re-industrialisation*, and are catching up in the productivity of manufacturing.<sup>86</sup>

In Bosnia and Herzegovina, the collapse of industrial employment takes place against a very different background. First, even before the war there was a very low activity rate (*i.e.*, the percentage of the working age population that is actually working). Second, the social system of socialist Yugoslavia had always been markedly inegalitarian: for decades, there had been a *de facto* redistribution of resources from poorer, rural areas to wealthier, urban areas. Under today's crisis conditions, the poorest receive almost no support. Third, underdevelopment always had a strong regional dimension in pre-war Yugoslavia. The problem of regional imbalance is exacerbated in post-Dayton Bosnia by a highly inequitable system of fiscal federalism. In the UK, there are *positive* transfers into regions with structural problems (through investment programmes by the UK government and the European Union, and through unemployment and social benefits). In Bosnia today, the transfers of funds between regions is regressive, with the distribution of indirect taxes strongly favouring administrative centres where consumption is relatively high.

In the former Yugoslavia, despite endemically low employment rates, there was no real attempt to provide for the social needs of the unemployed, particularly in the rural areas. The authorities tended to deliberately under-report the problem; Susan Woodward notes that: "nowhere was there an attempt to identify the actual labor supply."<sup>87</sup> This reflect an official indifference towards the unemployed:

"No charity, sympathy, or welfare for the unemployed was appropriate, for it would only reduce the resources going to real accumulation and give monies to people who were not contributing to real output. Moreover, as Tito put it in his attack on the system of guaranteed provisions in January 1949, 'budgets create dependence'."<sup>88</sup>

In Bosnia today, the social groups with the least access to employment are women (who have among the lowest employment rates in all of Europe, comparable to Kosovo and Turkey) and the young. Labour market policies, in so far as they exist, target those who already have jobs – hence the continuous rise in wages since 1996, despite high unemployment. A highly static labour market, in which workers change jobs only slightly more frequently than in the socialist period, favours the older, educated and male population.<sup>89</sup> It is, to quote the World Bank, a labour market that

<sup>84</sup> European Commission, "Second Report on Economic and Social Cohesion", 2001, p. 22.

<sup>85</sup> *Ibid.*, p. 23. For the latter, the Commission predicts that "structural reforms in agriculture are likely to lead to large-scale job losses in future years."

<sup>86</sup> Peter Havlik, "WIIW Research Reports", No. 297, July 2003.

<sup>87</sup> *Ibid.*, p. 196-8.

<sup>88</sup> Woodward, *op. cit.*, p. 177.

<sup>89</sup> World Bank, "Labor Market Study", p. xii.

“militates against young workers, labor market reentrants (who are often women) and the unemployed.”<sup>90</sup> The gap between male and female participation in the labor force “is easily the highest in the region.”<sup>91</sup>

**Table 6: Comparative labour force participation rates**<sup>92</sup>

	<b>Labour force participation rate (%)</b>
Greece (1998)	61.8
Portugal (1998)	70.1
Spain (1998)	63.3
Italy (1998)	58.8
BiH (1990)	37.5
BiH (2002)	< 30.0

The share of people younger than 35 in the workforce has decreased strongly in comparison to the pre-war period. In 2000, the employment share of the 25 to 43 age group was 23 percent, compared to 37 percent in 1990, while the share of those with more than 20 years of work history increased by 10 percent.<sup>93</sup>

“In sum, new formal employment has brought little fresh blood – the postwar formal sector workforce largely consists of the same pool of workers, who are becoming gradually older and who exit the workforce at pensionable age.”<sup>94</sup>

This is precisely the opposite of structural change in the post-industrial West: few new jobs are created, few unproductive jobs are brought to an end, and there is little shift of employment from less productive to more productive sectors. The losers are those who were never part of a worker’s collective, those who were excluded during the war for ethnic reasons, and those who have never had a chance to enter the labour market.

Those hardest hit by social and economic change – the very poor – receive very little support from the state. Outsiders are often surprised by the lack of demand for social welfare reform in post-war Bosnia:

“Despite significant distortions in the social safety net (social welfare and child protection expenditures in BH are the lowest in South East Europe, while veterans benefit expenditures at 3.5 – 4 percent of GDP are extremely high by any country’s standards) and long standing discussion dating back to 1999 (involving both potential winners and losers in the reform process) on what needs to be done to restructure the system, beneficiaries of reform and the public at large are still reluctant to press for changes.”<sup>95</sup>

<sup>90</sup> *Ibid.*, p. ix.

<sup>91</sup> *Ibid.*, p. xii.

<sup>92</sup> For all EU country rates, see: Bank of Greece, *Greece’s Economic Performance and Prospects*, p. 476. Rate of employment is the number of officially employed in the public and private sector as percentage of the working age population. Bosnia 1990: *Statisticki Godisnjak Jugoslavije 1990*.

<sup>93</sup> *Ibid.*, p. x.

<sup>94</sup> *Ibid.*

<sup>95</sup> World Bank, “CAS Progress Report”, p. 11.

In fact, this too is in large part a reflection of expectations inherited from the socialist period, in addition to the objective financial constraints.

In the former Yugoslavia, the primary social welfare strategy was employment creation. Social transfers played a minor role in the system, and were not by and large directed towards relieving poverty. One regressive form of social transfer occurred in housing. Socially owned apartments, which were allocated by employers to their workers, were largely the preserve of officials, managers and technicians. Only 23 percent of socially owned apartments were occupied by manual workers. Thus, social housing was used for those with higher qualifications and greater social influence, while the poorer classes built their own houses or lived as sub-tenants or with extended family. Vukotic-Cotic wrote in 1988:

“Social transfers are oriented toward the urban population, and the more one moves from urban to rural areas the less important they become... The distribution of social transfers among social groups is more unequal than the distribution of original revenue.”<sup>96</sup>

This tendency to tolerate high levels of inequality still exists in many policy areas. As the World Bank noted in relation to higher education: “Access to academic secondary schools and subsequently to tertiary education is much too limited and unequal.”<sup>97</sup> In both tertiary education and health care, public funding tends increasingly to be supplemented by informal contributions from consumers, creating a partially privatised system which favours those able to pay for services.

It is striking how little public debate on these issues goes on within Bosnia. It appears that those social groups who received little from the state in the pre-war period continue to have the same low expectations. Until they coalesce as an interest group, able to assert their rights through the political party system, or unless political parties begin to see in them a possible constituency by specifically addressing their needs, they are likely to continue to be marginalised.

In the absence of a functioning social safety net, poverty is becoming a widespread phenomenon. According to the Living Standards Measurement Survey, 15.6 percent of people in the Federation and 24.8 percent in Republika Srpska are living below the general poverty line (KM 1,843 per person).<sup>98</sup> An additional 1.1 million people are living precariously just above this line. As the World Bank notes, poverty “risks affecting even a typical household.” Less than a quarter of the estimated 190,000 people most in need (those with mental and physical disabilities, elderly without family care) receive any assistance.<sup>99</sup> According to a detailed study of social welfare in the municipalities of Zenica and Gornji Vakuf in the Federation and Banja Luka

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<sup>96</sup> Quoted in John Allcock, *Explaining Yugoslavia* (Hurst, 2000), p. 195.

<sup>97</sup> World Bank, PEIR, p. 88.

<sup>98</sup> This line was adopted as part of the preparation of a Poverty Reduction Strategy Paper. It covers the costs of meeting basic nutritional requirements and essential non-food items such as housing and heating.

<sup>99</sup> UNDP, “Bosnia and Herzegovina: Human Development Report 2002”, 2002, p. 54.

and Trebinje in Republika Srpska, of a combined population of 425,740, only 1,700 people receive any cash support.<sup>100</sup>

The vast majority of transfers to households are benefits for war invalids and families of fallen soldiers. Veterans benefits must be understood against the background of the rapid and strikingly successful demobilisation of three large armies after Dayton. However, veterans and their families are not a vulnerable social category – according to the available data, their level of welfare is somewhat above the average<sup>101</sup> – and their benefits are not means-tested. However, as a well-organised and highly vocal interest group across the country, the veterans have resisted all attempts to reduce their benefits.

Finally, it is a remarkable feature of Bosnian society that the areas hardest hit by the consequences of economic decline are also those that have the fewest resources to confront them. Both in Republika Srpska and in the Federation, Centres for Social Work are largely financed from municipal budgets. The benefits they are able to offer therefore depend upon the financial situation of each individual municipality. In Republika Srpska, the variation in spending levels *per capita* between the lowest and highest spending municipalities is 1:10, although for those who do receive benefits, the monthly payment is the same across the entity (KM 40). In both entities, there are laws setting out clearly who is entitled to social welfare, but the percentage of those who actually receive a benefit varies with local conditions. Not only does this produce highly inequitable outcomes; it also means that the limited staff resources of the Centres for Social Work are consumed by assessments which may bring no benefit to the citizen.

#### *D. Post-industrial Republika Srpska*

It is common to hear both Bosnian and foreign commentators attribute problems of governance in Bosnia to the complex constitutional system, with its decentralisation and institutional duplication. The case of Republika Srpska provides a useful counter-balance to this idea. As a unitary entity, Republika Srpska is not burdened with a complex constitutional structure. Social and economic policy rests in the hands of a single administration in Banja Luka. Yet the government of Republika Srpska seems largely paralysed in the face of the economic and social problems engulfing the entity.

In Republika Srpska, the trajectory of de-industrialisation has been much steeper than in the Federation. Republika Srpska was denied the cash injection of international reconstruction aid for the first years after Dayton. In 1999, when the aid began to flow, it managed a slight recovery, before slipping back into recession.<sup>102</sup> Some companies managed to re-start production, but few succeeded in bringing their product to market. Industrial output was achieved through the accumulation of debts, mainly in the form of unpaid taxes, contributions and utility bills, all of which end up on the public budget, and through wage arrears. Companies accumulated 2 KM in

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<sup>100</sup> DFID, “Reforming the Systems and Structures of Central and Local Social Policy Regimes in Bosnia Herzegovina, Programme Memorandum”, November 2000.

<sup>101</sup> PRSP team, “Poverty profile in Bosnia and Herzegovina”, p. 8.

<sup>102</sup> IMF, “Staff Report”, August 2002, p. 5.

debts for every KM they paid out in salaries. Industrial output fell by 14 percent from 2000 to 2001,<sup>103</sup> as companies became too illiquid to sustain production.

Not surprisingly, privatisation in these conditions has proved next to impossible. There were 66 large companies in Republika Srpska which entered the privatisation process with more than 400 workers. In the first three years, not more than five managed to attract a serious buyer, whether domestic or international, who was willing to pay cash for the company and invest further funds in production.<sup>104</sup>

As a result, Republika Srpska has disastrously low employment figures. In 2002, 232,700 people were registered as employed.<sup>105</sup> More than half of these work for the government or in public companies. There are only 48,800 jobs left in the former socially owned sector, even though the liquidation of defunct companies is yet to begin. The new private sector is small in scale, dominated by traders and retail services. With no more than 60,000 registered employees, its capacity to absorb redundant industrial workers is minimal.<sup>106</sup>

Compared to 232,700 in official employment, Republika Srpska's social burden is large and growing. There are 217,600 pensioners,<sup>107</sup> 84,000 families on child welfare benefits and 92,700 war invalids and families of fallen soldiers.<sup>108</sup> There are also 100,530 registered "social cases"<sup>109</sup> and 143,800 officially unemployed,<sup>110</sup> although only a handful of these receive regular benefits. The massive imbalance in these figures makes it clear why Republika Srpska is struggling to provide social benefits.

**Table 7: Employed, unemployed and pensioners in Republika Srpska, 2002<sup>111</sup>**

	Number	As % of total employed
<b>Employed</b>	<b>232,722</b>	<b>100.00</b>
State	126,178	54.22
Private sector	59,744	25.67
Mixed ownership, co-operatives	46,800	20.11
<b>Seeking work</b>	<b>143,832</b>	<b>61.81</b>
<b>Pensioners<sup>112</sup></b>	<b>181,708</b>	<b>78.08</b>

<sup>103</sup> *Ibid.*

<sup>104</sup> A government document explains the problem as follows: "Enterprises manage their affairs burdened with high debts, technically and functionally obsolete equipment and workers insufficiently trained for the market economy": Ostoja Kremenovic, Djuradj Banjac, Borislav Obradovic (eds), *Privatization in RS: Book of Regulations*, Banja Luka: Official Gazette of RS, 2000, p. 5.

<sup>105</sup> Sources: RS Institute of Statistics, "Monthly Statistical Review", No. 2002/2 (April-June); World Bank, PEIR and Labor Market Study; PRSP, "Annex III: Social Sector"; UNDP, "Human Development Report 2002".

<sup>106</sup> RS Institute of Statistics, "Monthly Statistical Review", No. 2002/2 (April-June), p. 46.

<sup>107</sup> Including both old-age and disability pensioners: *ibid.*, p. 34.

<sup>108</sup> PRSP Team, "Draft Development Strategy – PRSP", Annex III, Social Sector, December 2002, p. 30.

<sup>109</sup> World Bank, PEIR, p. 81. This includes 100,531 cases registered with the municipal Centres for Social Work and 84,000 beneficiaries of child welfare payments.

<sup>110</sup> RS Institute of Statistics, "Monthly Statistical Review", No. 2002/2 (April-June), p. 33.

<sup>111</sup> *Ibid.*, p. 45.

Beneath these bleak outlines, however, it is remarkable difficult to find any hard information about how people live in Republika Srpska. In this post-industrial society, citizens have become isolated from the state. Forced to pursue survival strategies outside the formal economy, from subsistence agriculture to black-market trade, they do not contribute to public revenues and receive little in the way of public services. They have become, quite literally, invisible to the state.

The most dramatic sign of this is the uncertainty over Republika Srpska's population. The official figure is 1.47 million. However, one Bosnian demographer has convincingly challenged this, estimating the real number to be as low as 1.06 million.<sup>113</sup> There can be no clearer evidence of low governance capacity in Republika Srpska than the fact that the entity cannot ascertain its own population within a margin of 40 percent. With such uncertainty, all other socio-economic data, from unemployment rates to poverty estimates, are almost worthless. For example, it is commonly said that *per capita* income in Republika Srpska is significantly lower than in the Federation. However, as table 9 shows, depending on the population figures used, citizens in Republika Srpska could be anything from 30 percent poorer to 9 percent wealthier than in the Federation.<sup>114</sup>

**Table 8: *Per capita* GDP in 2001 under different population estimates**

	<b>Population estimate</b>	<b>GDP (mil. KM)</b>	<b>GDP per cap. (mil. KM)</b>
<b>Federation</b>			
Central Bank figures <sup>115</sup>	2,822,862	7,224	2,559
Statistics Institute figures <sup>116</sup>	2,318,972	7,224	3,115
<b>Republika Srpska</b>			
Statistics Institute figures	1,449,477	2,978	2,055
Unofficial estimate	1,066,324	2,978	2,793
<b>Bosnia and Herzegovina</b>			
High case	4,272,339	10,202	2,388
Low case	3,385,296	10,202	3,013

One attempt to fill the gaps in the official data was the Living Standards Measurement Survey (LSMS), which surveyed 2,395 households across 11 municipalities in Republika Srpska in 2001. In this relatively small sample, 36 percent of all employment was in the "grey economy".<sup>117</sup> This has led some observers to conclude that unemployment across the country is far less severe than the official statistics

<sup>112</sup> If one adds disability to old-age pensioners, the total number of recipients of pensions rises to 217,000.

<sup>113</sup> See UNDP, "Human Development Report 2002", Annex 2, quoting studies carried out by Ilijas Bosnjovic.

<sup>114</sup> The international community in Bosnia has resisted the idea of holding a census in BiH, for fear that it would be seen as marking the end of the refugee return movement and somehow legitimise remaining ethnic divisions.

<sup>115</sup> Central Bank of Bosnia-Herzegovina, "Bulletin 4", January-December 2002, p. 45.

<sup>116</sup> Federal Statistical Agency: [www.fzs.ba](http://www.fzs.ba)

<sup>117</sup> World Bank, Labor Market Study, p. xi.

indicate. However, most of the “grey economy” is simply the survival strategies of those who have been forced out of regular employment. It includes some unregistered employment in private business (without social contributions or health insurance) and informal trading activities. The largest part of the “grey economy” (47 percent), according to LSMS data, is subsistence agriculture. What appears to be happening is that many of the families who first moved from agriculture into industrial employment in the 1960s and 70s are now forced to return to the villages and lifestyles they abandoned a generation ago. For many people, the preferred option is to emigrate or, in the case of the displaced, never to return.

## V. POST-WAR POLICY MAKING

The past two chapters have concentrated on the social and economic context of governance in Bosnia – what we call the crisis of industrial society – and the objective constraints it creates for the operations of government and the delivery of public services. In this chapter, we offer concrete case studies of how public institutions reacted to this crisis in a number of specific policy areas in recent years. The focus remains on the relationship between governance and development

Each of these case studies is presented in the form of a narrative in order to show the relationships among different actors – public administrations (ministries, municipalities); independent agencies (privatisation agency, forest agency); public enterprises (both industrial companies and utilities); and the private sector – and how the interaction between them affects governance outcomes.

### A. *Agriculture – politics without interests*

During the communist period, agricultural policy was centred exclusively on the socialised sector: on the 397 co-operatives and agro-combines which held 10 percent of the agricultural land and by 1989 employed 21,370 people.<sup>118</sup> In the post-war period, however, these big socialised systems – Hepok (Mostar), Agrokomerc (Velika Kladusa); Agrokrajina (Banja Luka); Semberija (Bijeljina); PTK (Tuzla) – had largely collapsed. This left behind a rural economy of smallholders, which the state had traditionally ignored. In the post-war period, there has been little sign of any shift in government policy to reflect this new reality.

#### 1. *The absent “farmer”*

On the eve of the war, the private agricultural sector consisted of family farms with inadequate plots of land and levels of productivity that were not much beyond subsistence level. While industry grew tenfold between 1955 and 1989, agriculture merely doubled its production.<sup>119</sup>

Socialisation of agriculture succeeded only to a very limited degree in Bosnia. A forced collectivisation drive after the Second World War proved a costly failure and was abandoned in 1953 after causing mass food shortages. Once participation in the co-operatives was made voluntary, they shrank rapidly from a height of 17 percent of

<sup>118</sup> Statistical Yearbook 1991, p. 519.

<sup>119</sup> Vlado Smoljan, *Poglavlja iz Ekonomske historije Hercegovine IV*, Mostar 1999, p. 166.

all agricultural land to only 4 percent. However, the maximum size of private landholdings was limited to 10 hectares for high-grade land.<sup>120</sup> Inheritance laws encouraged further fragmentation, so that the number of private plots in Bosnia increased from 412,000 in 1949 to 497,000 in 1969. As a result, the typical family plot in Bosnia is between two and five hectares, spread across 6 or 7 separate parcels of land. The small scale of agricultural production in Bosnia presents a major structural problem as peasants have little chance of generating enough cash income to invest in increased productivity.

In the 1960s, the socialisation of agriculture was pursued through the creation of agro-industrial combines (*poljoprivredni kombinati*) – large, vertically integrated systems for the cultivation, processing and marketing of agricultural produce. By 1990, these agro-combines accounted for 6 percent of the land. Even though 90 percent of the agricultural land remained in private hands, all official policy initiatives – from programmes for the mechanisation of agriculture to the introduction of new farming techniques – were oriented towards the combines. There were many veterinarians in pre-war Bosnia, but they rarely ventured out into the world of private agriculture, where most households had only one or two head of cattle. Agricultural experts who would graduate from the agricultural faculty of Sarajevo university went on to work for co-operatives, SOEs or the administration.

The private sector was left to languish in low-productivity, largely subsistence conditions. *Per capita* investment in infrastructure in rural areas, particularly the highlands, was up to 70 percent below the Yugoslav average. Poor transport made it difficult for rural farmers to bring their produce to market. Even before the war, the economic motive to pursue agriculture was so low that 22 percent of the agricultural land was simply abandoned.

Socialist authorities viewed the *seljaci* (peasants) as backward and ideologically suspect, prone to religious and national sentiment. They were long excluded from social benefits such as pensions and health insurance, unless they took jobs in the social sector. Peasants and rural areas in general were also poorly represented in the political structures. The solution to the problem of rural development implicit in official ideology was the disappearance of the peasant class altogether, through the creation of industrial jobs and mass urbanisation.

As a result of these policies, there were no private agricultural entrepreneurs (“farmers”) producing for markets on a commercial basis. What emerged was a mutual dependence of blue-collar industrial work and subsistence agriculture. The land provided security against job loss and low-cost living, and was therefore rarely sold. The greater part of the farm work was done by the very young, the old and women, while the men commuted to a factory job.<sup>121</sup>

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<sup>120</sup> Higher limits applied for low-grade land.

<sup>121</sup> As Michael Palairret noted: “The strongest analogy of the position of the peasant-worker family was with the rural cottage industry worker of an earlier period, who combined the two insufficiencies yielded by the land and by industrial labour to achieve a sufficiency in subsistence goods and cash income” in “The mismanagement of the Yugoslav rural economy 1945-1990”, unpublished manuscript, p. 14.

This is the historical background to the poor conditions which now prevail in rural Bosnia. With the closure of factories, many families in rural areas have lost their wage income. They are at risk of falling back once again on subsistence agriculture, supplemented by irregular cash earned in the so-called “grey economy”.

## 2. *The state of post-war agriculture*

In 1998/9, an effort was co-ordinated by the UN’s Food and Agricultural Organisation (FAO) to develop the outline of a strategy for agricultural development. It was felt that the time had come to move beyond reconstruction towards sustainable development. Working groups were established, and the strategy was published in 1999. Its objective was “to find ways to overcome structural problems in the agricultural and rural sectors.” The FAO report expressed concern about the state of the agricultural sector in 1999:

“Only the areas planted to fodder and industrial crops continue to increase, while the area in vegetable production is relatively stable and the area of maize and wheat has declined since 1996/97. *This halt in the recovery process is of considerable concern.*”<sup>122</sup>

It noted that after extensive destruction during the war, the total area harvested in the Federation reached approximately 55-65 percent of its pre-war levels, but then began to decline again after 1999. Dependence on imported food was increasing.

There was no shortage of structural problems. The only *industrial* crop left was tobacco, where subsidies were given largely for social reasons. Yields for potatoes were “very low by western European standards.”<sup>123</sup>

As a result of the war, “vines were left untended and died, and most of the irrigation systems were destroyed. Most of the nurseries and rootstocks were also destroyed.” FAO estimated the cost of replacing and upgrading vineyards at US\$ 100 million and added that “substantial donor and government support for this investment is unlikely, given the limited public resources available and the relatively small contribution that the sector makes to production, employment and exports.”<sup>124</sup> Most of the vineyards of BiH are in the Mostar region on an area of 5000 ha beside the Neretva river. The pre-war industry was controlled by HEPOK, an agrokombinat which owned 40 percent of the vineyards, produced about 96 percent of commercial wine and was the sole marketing agent for domestically produced wine. Around 80 percent was sold on the domestic market and the balance was exported to Croatia. The remaining 3,000 ha consisted of small private sector vineyards which produced wine for their own consumption. War damage halved the area under production; trellis systems were damaged, vines were left untended and died, and most of the irrigation systems were destroyed.

The FAO study saw a potential for vegetable production (which requires little working capital) and berry fruit industry, which has a high demand for seasonal labor.

<sup>122</sup> UN FAO, “A Medium Term Agriculture Sector Strategy for the Federation of Bosnia and Herzegovina”, August 1999, p. 10.

<sup>123</sup> *Ibid.*, p. 11.

<sup>124</sup> *Ibid.*, p. 12.

The pre-war production was dominated by plumbs (accounting for two thirds of all fruit trees), but yields then were low and production costs high.<sup>125</sup> There had been a profitable berry fruit industry before the war. However, some 60 percent of the pre-war area of 700 ha was damaged during the war. Berry fruit production has a high return, high demand for seasonal labour, creating rural employment. But “significant associated investment is needed in processing facilities and cool-stores and a considerable effort is required to develop exports.”<sup>126</sup>

It had also proved impossible to restore pre-war herds of cattle, sheep and pigs. The number of sheep in the Federation decreased from 650,000 in 1990 to 236,000 in 1996. Low-input small scale farms dominated life-stock production before the war, with very low per animal performance largely due to poor animal nutrition.<sup>127</sup> Sheep production has long been falling in BiH. Total sheep numbers fell as the marginal hill and mountain areas that are the traditional domain of sheep production were steadily abandoned. War accelerated this decline. FAO predicted that as profitability is low, sheep production was unlikely to recover to pre-war levels.

Pre-war farm equipment included some 60,000 tractors, 80 percent coming from Belgrade. More than 60 percent of all tractors and equipment were lost during the war. The emergency reconstruction program had replaced around one percent of tractors, or 669, by 1999.<sup>128</sup>

The FAO report concluded a series of seminars with the entity ministries of agriculture recognising that the *technical* solutions to many of Bosnia’s agricultural problems were “well known to national experts”. However, strategy formulation and consistent implementation over a long period of time was impossible within the current institutional structures.

“Technical progress will be minimal unless it is preceded by fundamental changes to the pre-war approach to agriculture policy and to the institutional base for extension, research and plant and animal improvement and selection.”<sup>129</sup>

Such changes never took place. Although this remains the most extensive study available on agriculture, the FAO report was never formally adopted by the Federation government. It was set aside after the 2000 elections. Despite considerable rhetoric to the contrary, post-war agricultural policy was erratic and largely ineffective, irrespective of the party or coalition in power.

### 3. *Elusive subsidies*

Before the war, there had never been an agricultural policy for the private sector; and there had never been the expectation of one by the vast majority of agricultural households. There were few interactions between authorities and agricultural producers, and few incentives to provide targeted support services. This is an enduring legacy: ministries have yet to learn to become responsive to the rural

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<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*, p. 13.

<sup>128</sup> *Ibid.*, pp. 4 & 13.

<sup>129</sup> *Ibid.*, p. 16.

population; and the existing private agricultural producers have yet to become an effective lobby, defining and then defending their interests.

If we analyse policies pursued in the post-war period we find three main elements: institution building, tariffs and subsidies. On the institutional side, all of the public bodies had first to be established, in particular the entity and cantonal ministries of agriculture. In the first three post-war years, institution building followed the needs of the reconstruction process. Inside the Federation Ministry, the most important section was the Project Implementation Unit (PIU), created to administer international projects.

In 1999 the FAO strategy recommended further and urgent institution building in the public sector in order to better support new agro-processing companies, small and large-scale *commercial* farmers and rural development and the creation of non-agricultural rural employment. This required strengthening policy analysis capacity of the entity ministries and inspired a major institution building project financed by the European Commission between 2001 and 2002.

However, international consultants found a series of systemic problems. The ministry had no practice of consulting with affected interest groups, or with evaluating the impact of its existing programmes. The main function of the Federation Ministry for Agriculture, Water Resources and Forestry was seen to be the preparation of legislation, usually drafted without consultation, even with the cantons. As permitted by the Federation constitution, many cantons adopted their own agricultural legislation to fill the legal vacuum in the post-war period. Clashes with later Federation laws caused extensive confusion in the field and required time-consuming harmonisation exercises. Some of the Federation laws, such as the Law on Agricultural Land and the Law on Co-operatives, are clearly applied little in the field.

A system of protective tariffs on imports (*prelevmani*) was introduced in 1997 on 270 food products. Nominally an attempt to protect domestic producers, the system was not based on any analysis of market trends and, because of structural weaknesses on the supply side, had no effect on increasing domestic production. The FAO study noted that tariffs even applied to imported cows, inhibiting the replenishment of domestic herds. They raised costs for the domestic agro-processing industry, which cannot secure enough domestic produce to sustain production and therefore depends upon imports.

However, the system of tariffs raised KM 100 million for the Federation budget. When the tariffs were first introduced, the government proposed to make these funds available to the agricultural sector in the form of credits through the Federation Investment Bank.<sup>130</sup> This scheme operated for a while, but was apparently abandoned after 2000. Since then, no more than ten percent of these revenues have been returned to the agricultural sector, and the system of tariffs has simply become another form of indirect tax to support the Federation budget. With no impact on agricultural production, its only impact has been to increase the cost of living of those it was designed to help.

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<sup>130</sup> “Odluka o programu koristenja sredstava za unapredjivanja poljoprivredne proizvodnje i prehrambene industrije u 1998. godini”, Official Gazette FBiH 10/98, 8 January 1998.

The most visible public policy supporting agriculture in the Federation, however, was to have been a sharp increase in agricultural subsidies. The main economic and social policy platform of the Alliance government was a document entitled “Macroeconomic Vision for the Development of the Federation.”<sup>131</sup> Launched in July 2001, it contained the Alliance government’s pledge “to attack the present economic situation, which is catastrophic.” A key avenue of attack was seen to lie in the agricultural sector. Stimulation of agricultural production would soak up labour made redundant through the collapse of industry, while helping to overcome Bosnia’s disastrous trade deficit.

Promoting the strategy in Bihac in 2001, former Finance Minister Grabovac declared:

“The Federation government gives priority to the development of agriculture, because this sector, with the least investment, offers the most rapid results in the form of new employment and import substitution. The basic goals of the Macroeconomic Vision are raising living standards, stability and economic prosperity, and the task of agriculture is the increase of exports and lowering of the trade deficit.”

The document contained a series of measures to stimulate agricultural production. It continued the policy of special tariffs (*prelevmani*) on imports to protect domestic production. It proposed to increase the availability of affordable credits for farmers through a KM 150 million fund, offered at interest rates of 5 to 6 percent. It also announced a dramatic increase in agricultural subsidies, to be administered at Federation level, totalling “at least KM 50 million”. After veterans’ benefits, the subsidy scheme was the most expensive initiative envisaged in the 2002 Federation budget, representing the Alliance government’s flagship programme for economic revival and employment creation.

The process by which the Federation government determined the scale of the subsidy programme was arbitrary, even capricious. Early in 2001, each of the Federation ministries was invited to submit proposals for inclusion in the Macroeconomic Vision. An official within the Ministry for Agriculture, Water Management and Forestry came up with a list of measures covering agriculture, water projects, forestry and veterinary services, totalling KM 30 million. The proposal was based on consultations with various state-run research bodies and on comparisons with similar programmes in Republika Srpska and Croatia, but did not include consultation with either the cantonal ministries of agriculture or any interest groups representing farmers.

In mid-2001, the Federation finance minister, Mr. Grabovac, asked the ministry to revise the agricultural subsidy programme upwards to a total of KM 64 million. The agriculture minister, Behija Hadzihajdarevic, protested that there was not enough agricultural production in the entire Federation to absorb subsidies on such a scale.<sup>132</sup> After a process of negotiation between the two ministers, a figure of KM 54.9 million

<sup>131</sup> Federation BiH, “Makroekonomska vizija razvoja F BiH Protiv postojeće ekonomske situacije”, [www.komorabih.com/servisi/glasnik/61naslov15.html](http://www.komorabih.com/servisi/glasnik/61naslov15.html).

<sup>132</sup> ESI interview with the Federation Minister of Agriculture Hadzihajdarevic, November 2002.

was eventually written into the 2002 Federation budget, including KM 46 million in subsidies and a number of other agricultural projects.

The 2002 Federation budget anticipated an increase in revenues of KM 390 million, or 33 percent, over the previous year. It was from these additional funds that the Federation expected to fund its agricultural subsidies, together with other spending initiatives such as industrial subsidies, refugee return programmes and a reduction in arrears in pensions and war invalids' benefits. However, the revenue estimates were highly inflated. Early in 2002, the IMF asked the Federation government to defer certain expenditure programmes, to see whether the additional revenues would in fact eventuate. In September 2002, the budget was revised downwards by around KM 170 million, and in the end the revenue increases never eventuated. On 30 June 2002, the Federation government decided to reduce its subsidy programme to KM 10.1 million. In the end, only KM 6 million in agricultural subsidies were disbursed for the year.

The subsidy scheme (and, by extension, the Macroeconomic Vision itself) had no impact at all on agricultural production. According to Minister Hadzihajdarevic, the ministry never expected to receive the funds and, even with the programme reduced by 90 percent, was still able to pay all the subsidies requested of it.<sup>133</sup> The government conveniently blamed the IMF for blocking its flagship economic policy, even though the funds had never existed in the first place. The main casualty was the credibility of the policy process itself.

The subsidy story reveals more than just poor budgetary management on the part of the Federation government. The initiative (like other, smaller programmes in earlier years) was not based on any analysis of the real needs of the agricultural sector, and it was never clear what the government hoped to achieve by it. According to the UN Food and Agricultural Organization (FAO), the case for agricultural subsidies in Bosnia is relatively weak, and would only apply where, based on a detailed comparison of domestic and international prices, it is determined that they could help boost domestic production to a level which would allow it to compete successfully with imports. In any other conditions, subsidies would simply lead to misallocation of resources.

However, the Federation offered subsidies for crops such as wheat, corn and soya bean, where its own analysis showed that Bosnian farmers would never be competitive. It acknowledged explicitly that its subsidies for tobacco production amounted to a social programme, designed to help the large number of rural households dependent on small-scale tobacco production. In milk production, the subsidies available to a typical small dairy producer were too small to help them increase production, providing only a minor supplement to household income.<sup>134</sup> Overall, there was no justification for the Federation government's claim that its subsidy scheme provided a means of boosting either production or employment in the rural areas.<sup>135</sup>

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<sup>133</sup> *Ibid.*

<sup>134</sup> Farmers producing a minimum of 300 litres of milk per month would qualify for a subsidy of KM 0.15 per litre, giving around KM 550 per year for a household farm. As a new cow costs at least KM 2,000, such a small subsidy could not help them to increase production.

<sup>135</sup> In its 1999 agricultural strategy document, the UN FAO recommended phasing out all subsidies except for modest encouragement to farmers to retain young milk cows.

#### 4. *The invisible countryside*

The FAO paper had strongly emphasised the need of public support to “extension services” to private farmers, to promote and support the adoption of new agricultural techniques which would boost productivity, increase the marketable surplus and set in motion a process of structural change in the sector. These would include services such as livestock identification to facilitate breeding, control of seed varieties and education and advice services to improve farming techniques. Developing extension services – and interacting directly with a dispersed agricultural population – was seen as the key institution-building challenge in the agricultural field.

In stressing the importance of improving the links between government and agricultural producers, the FAO report underlined that these functions would be most effectively performed by regional government close to the producers – at cantonal level in the Federation and by sub-entity regional structures in Republika Srpska.

In the Federation, progress has been hampered by the lack of clarity on the roles of the Federal and cantonal ministries of agriculture. There is no agreement on the division of responsibilities, no common policy framework and no joint operations. In the absence of any regular contacts between them, the two levels of government operate in parallel, each ignoring the efforts of the other.<sup>136</sup>

In fact, the Federation ministry tried on occasions to build up its own system of direct contacts with farmers, bypassing the cantonal level altogether. For example, it developed its own subsidies for milk production, instructing dairies to report on the delivery of milk by individual farmers, and then paying the subsidy via bank transfer to a special account established by the farmer. This was an extremely resource-intensive system, requiring the ministry to maintain a registry of around 10,000 private farmers and administer a large number of small payments. It also did not generate any meaningful contact with the farmers. The Federation had no reliable means of checking whether they were in fact producing the volume of milk claimed, nor of determining whether its subsidies were having any effect on levels of production, nor of providing extension services to complement the subsidies.

Certain cantons have made more progress in developing extension services. Tuzla Canton appears to be the most advanced, carrying out a variety of initiatives designed to increase the capacity of the private sector to absorb different forms of financial assistance, from domestic and international sources. It has detailed knowledge of the commercial farmers on its territory, and implements more modern and imaginative intervention strategies. The cantonal ministry has regular and friendly contacts with the Republika Srpska ministry of agriculture, and has travelled to Serbia and Switzerland to help build up business connections.

It is also at the cantonal level that one finds information on producers today, an obvious prerequisite for any credible policy. In Tuzla, a study found that of 67,492 households (roughly half the cantonal population) who own a plot of agricultural land, there were only 232 commercial farmers with more than five livestock actively

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<sup>136</sup> Interviews with the ministries of agriculture at Federation level and in Tuzla, Central Bosnia and Una Sana cantons.

participating in a market economy. Outside of this tiny commercial farming sector, the rest of private agriculture was made up of subsistence farmers, working small plots of land with barely any mechanisation. With very low productivity they produce for occasional sales in local green markets.<sup>137</sup>

**Table 9: Agricultural producers - Tuzla Canton 2000-2001**

	Number
Population	490,000
Agricultural households	67,500
Commercial farmers	227
Poultry	85
Dairy cattle	85
Beef cattle	35
Pigs	20

There are only 87 commercial dairy farmers with a total of 486 cows. There are, however 56,363 cows in more than 67,000 individual *agricultural households*. All of these structural problems impact on the domestic food processing industry, which remains dependent on imports. Collection costs for domestically produced milk run to 6.5 pfennigs per litre, as compared to only 1 pfennig a litre in Western Europe due to the more efficient structure of production. Milk can be imported from Slovakia at a cost of 1 pfennig per litre, making domestic production uncompetitive. The whole agro-processing sector in Tuzla canton employs 2,106 people.

**Table 10: Agroprocessing companies – Tuzla Canton 2000-2001**

Sector	No. of companies	No. of workers
Mills	10	163
Bakeries	90	579
Beverages	24	288
Dairies	7	137
Fruit processing	7	288
Slaughterhouses	9	102
Cattle fodder	4	20
Savoury snacks	5	193
<b>Total</b>	<b>156</b>	<b>1,777</b>

FAO noted that agriculture alone cannot provide a solution to Bosnia's rural underdevelopment, without other methods of employment creation in rural areas. Contrary to the notion in the Macroeconomic Vision that agriculture has the potential to soak up redundant industrial labour, the reality is that modernisation of the agricultural sector would reduce the number of families living off the land, who

<sup>137</sup> ESI found the same situation in Central Bosnia Canton, where the canton had commissioned a strategy on agriculture and agroprocessing: "Strategija razvoja poljoprivrede srednjobosanskog kantona 2001–2010", April 2001.

would then need to find new livelihoods. This however would require a genuine policy reform that has so far not taken place.

## **B. Mismanaging natural resources**

### *1. Developing Bosnia's forests*

One of the primary objectives of early statecraft from the 18th century onwards was to turn nature into natural resources. In this context, the discipline of scientific forestry was developed to ensure careful exploitation of domainal forests and the greatest possible constant volume of wood. Forest roads were built, the underbrush was cleared, and forest science was developed to define how best to use a renewable resource without diminishing its value. Managing and regulating forests became a task for government.

Forestry has always had a particular importance for Bosnia. More than half of Bosnia's territory is covered with forests, which have long been recognised as a vital natural asset. By the beginning of the 20<sup>th</sup> century, there were 20,000 workers employed in 34 forestry and lumber companies. Until the mid-20<sup>th</sup> century, no other industry in Bosnia employed more people than the wood sector. Today, wood is one of Bosnia's primary export articles, and a new private sector has emerged. It is particularly important to the economies of Republika Srpska and to Una Sana Canton, the northwestern corner of the Federation. Public policy towards this national resource affects tens of thousands of households, new private companies and whole regions of the country.

Most Bosnian forests have been state property since the Ottoman days, and most forest companies have been under state control since at least the beginning of the 20<sup>th</sup> century. In 1990, 90 percent of the forests in the country were socially owned, and 95 percent of all wood was harvested by socially owned companies. The governance ideal of Yugoslav socialism was the "withering away of the state." Public functions, including the control over public resources, were transferred to self-management organisations. Thus, central administrative functions were delegated to socially owned enterprises.

In the socialist system, the maintenance of forests, the felling of timber, and the processing and sale of wood products were all undertaken by large, integrated companies who were assigned the forest in a specific territory. Each enterprise contained sawmills and processors, producing everything from industrial wood to heavy furniture. All enterprises in the Una-Sana area were part of one large holding, Sipad, which also contained units responsible for export and sale and research institutes. In each enterprise (RO) there was also as an integral part an OOUR (*Sumsko Privredno Preduzece – SPPs or Sumarije*) responsible for maintaining the forest in the area assigned to the enterprise and cutting the wood in that area in accordance with annual plans. This was the custodian of the public asset, presenting annual plans for cutting wood.

As a result, the timber conglomerates were self-regulating, and investments in maintaining and developing the forests came from their own resources. Forestry policy was therefore made *inside* the socialist enterprise sector. This governance

structure had limitations which were already obvious in the old system. The processing industry demanded constantly more wood, but had little interest investing in the forests in order to allow for more intensive cultivation. As a result, the forestry companies whose task it was to maintain the common asset were running down the infrastructure by harvesting without sufficient attention to the question of sustainable forest economy.

This merging of public and commercial functions had costs which were readily apparent throughout the socialist period. The industry tended to consume too much wood, while making too little investment in the forests themselves in order to allow for more intensive cultivation. In 1974, there were only 6.5 kilometres of access road per 1,000 hectares of forest – a conventional measure of the ‘openness’ of the forests. By 1996, this had grown to only 8.3 kilometres, which compared poorly to Slovenia’s 15 kilometres and was far behind the Western European standard (for example, Austria’s 38 kilometres). As a result, inaccessible areas of the forest became less valuable for exploitation, producing thinner beams useful only for firewood or pulping, and not for higher-value processing. Similarly, reforestation was consistently neglected. In 1972, there were only 1,991 hectares under reforestation. This had risen to 13,813 hectares in 1985, only to fall again to 8,535 hectares in 1990 as the forest companies began to experience increasing financial difficulties.

The result was a vicious cycle, in which falling revenue in the forestry enterprises led to a worsening in forest management practices, resulting in a progressive deterioration in the value of the economic resource. An analysis prepared by the Sarajevo Economic Faculty in 1996 found: “The wood industry of BiH characteristically used a great deal of wood as raw material, achieved low prices in export because its products were of a bad design and quality, causing losses in the wood industry, which reflected in a chain reaction on the forests.” This was a function not just of poor policy choices, but of the structure of governance itself.

## *2. JP Sume Una Sana and the legacy of self-management*

The north-west of the country was traditionally the heartland of the Bosnian forestry industry: an area including Drvar (today in Livno Canton), Western Republika Srpska, parts of Central Bosnia and the Una Sana area. Fourteen percent of Bosnia’s pre-war production was in Una-Sana canton alone. The forests of Una-Sana account for roughly 20 percent of the Bosnian forests. Forestry and wood processing – with over 20 wood processing companies and 7 sawmills in 1990 – have traditionally been at the heart of the local economy.

Two things happened in the post-war period that completely transformed the wood sector in Una-Sana canton. One was the collapse of the former socially owned *processing* companies. The other was the emergence of a new private sector of loggers and of smaller private saw mills. Out of 20 pre-war companies, only 3 are still active, employing 180 people compared to a pre-war total of 6,000 in this area alone. Thus, the de-industrialisation of the sector has been almost complete, reflecting trends across the country. The large wood-processing companies had always been weak at marketing their product, and soon collapsed under the weight of their accumulated debts.

The disintegration of the large Sipad holding and the collapse of the processing companies raised the question of how forests would be managed in a post-privatisation era. In 1994/5, four units in the canton which had been responsible for the forests within the larger socialist enterprises were nationalised. In the legal vacuum of this period, two became limited companies, one became a municipal public company, and the largest, Risovac based in Bihac, remained in legal limbo. In 1999, a new cantonal law merged them and created a new cantonal public company, JP Unsko-Sansko Sume (“U-S Sume”), which was now responsible for management and logging operations in all of the canton’s socially owned forests.

As a public company, U-S Sume was nominally under the control of the cantonal government, exercised through a governing board (*upravni odbor*). However, the statute of the public company provided that 5 of the 9 members of the governing board came from the company itself. In practice, this meant that U-S Sume operated free of effective control from the government. During its first two years of operations, it never submitted any report on its finances or operations. In addition, key personnel in the ministry, including the minister, were former employees of the company, and worked to protect its autonomy.

The public company that emerged was a very different institution than its socialist predecessors, in terms of personnel and activities. Though it was a lot smaller, it had more experts on its payroll than the four predecessors put together. Before the war, of 3,050 full-time and 2,500 seasonal employees, there were only 170 “expert” staff. By 2002, of 568 workers, 240 were technicians and managers, leaving a decidedly top-heavy organisational structure. In addition, the company now has very little equipment as compared to its predecessor. With an average wage of KM 506, the employees are well paid.<sup>138</sup> U-S Sume has turned itself into a white-collar organisation of technicians and engineers, shedding its manual work-force (now joining the “private sector” in the logging business). It also neglected its core responsibility of investing in maintaining the forests. This is a typical example of a technical elite, securing itself control over a public asset and public sector wages.

This necessarily changed the way it worked profoundly. U-S Sume needed to pay other companies to harvest most of the wood. It simply no longer had the manpower or even equipment. As a result, the company now contracted out 90 percent of the work. Since it was always short on cash, it resorted to paying logging companies in wood (*i.e.*, in return for logging, they could keep a part of what they cut), a practice which was clearly forbidden under cantonal law. By the end of 2002, for such services U-S Sume was indebted to private logging companies in an amount of KM 12 million.

The curious status of U-S Sume – controlling a public resource and exercising a public function, yet largely unaccountable to the public – is a reflection of a broader problem in post-socialist Bosnia, where the state is a complex archipelago of autonomous institutions, operating in isolation from each other and with their horizontal and vertical relationships left undefined. The lack of clear lines of

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<sup>138</sup> The average wage in the Una-Sana Canton in 2001 was KM 442.21. In that year, 31,633 persons were employed and 27,291 workers were registered unemployed in the canton. Source: Statisticki Zavod Federacije BiH.

responsibility shields many public institutions from control by elected governments, making it difficult to hold them to account for their use of public resources. Part of the legacy of self-management is that the administration does not see itself as responsible for controlling powerful administrations and agencies.

### *3. The struggle for wood*

There is no shortage of demand for wood from Una-Sana, as the Croatian market, Republika Srpska, Slovenia, Italy and Austria will absorb as much as is produced, as long as the quality is sufficient. The problem is not in market conditions, but in the governance of the forest industry and the way the scarce resource of wood is allocated.

For a private sector to grow in the wood processing field, what is needed is both *predictability* of public policy and basic *fairness* on the part of the administration, to allow healthy competition. U-S Sume is the exclusive provider of the raw material needed by the new private sawmills. As a result, transparency of its policies is crucial to the existing private sector. When it began to fall short on deliveries of wood to private companies despite prior agreements, it pushed these companies towards bankruptcy: the absence of sufficient wood meant they did not reach the utilisation of capacity required to be profitable. Logical alternatives – public auctions or long-term concession agreements – were also not embraced.

In fact, until 2002 the company had not made public a report on its activities in two years. What finally challenged the unaccountable behaviour of the forestry agency, to allow even a debate on its performance, was the emergence of new (private) interests in the shape of the legally registered private sawmills. In fact, in March 2001, the cantonal ministry of enterprises informed the government that a large majority of sawmills in the canton were unregistered. According to the ministry, only 21 of 79 currently operating sawmills had licenses to cut and process wood. An attached list named each sawmill according to the municipality in which it was located.<sup>139</sup> Nine of the legal sawmills were in Bosanska Krupa.

In 2002, faced with the loss of their livelihoods, private forestry companies joined forces to create an effective lobby, putting pressure on the municipal and cantonal assemblies to force U-S Sume to make its practices transparent. Since most of the sawmills under pressure were in the municipality of Bosanska Krupa, the lobbying began there. In a decision of the municipal council of Bosanska Krupa from 27 November 2002, the management of U-S Sume was criticised for the unaccounted disposal of wood reserves taken from the territory of the municipality, thereby endangering a large number of workplaces.<sup>140</sup> This was followed by pressure on the cantonal elected representatives. A public debate ensued.

Under pressure from the parliament, the cantonal government finally amended the statute of the company in summer 2002 and changed the composition of the governing board. This was the first step in a process of making U-S Sume directly accountable

<sup>139</sup> Letter from the cantonal minister of enterprises, 27 March 2001.

<sup>140</sup> Izvod iz zapisnika sa XXVII vanredne sjednice Opcinskog vijeca općine Bosanska Krupa, održane dana 27 November 2002.

to the elected government. It also began to demand reports on the company's activities.

Following an investigation, the cantonal government on 1 November 2002 placed the blame for the crisis in the sector squarely on the shoulders of U-S Sume and its poor commercial and management practices.<sup>141</sup> Instead of providing a level playing field for the development of a competitive industry, its activities had favoured a few large mills. Once the conduct of the company became public, private entrepreneurs compared their knowledge about quotas handed out by the U-S Sume and established that the company had tendered out more mass than it could possibly cut. It was thus forced to reduce delivery to other companies, making it impossible for them to reach a break-even level of production.

None of this information, which now forms the basis for a broader public debate on the future of forest policy and its implementation in the canton, would have come out without the pressure exerted by a new, commercial interest group on elected representatives. Without an interest and the mobilisation of private resources, there would have been no practical means of holding the company to account.

### ***C. Land allocation and planning post-war development***

Effective planning of land use is a key function of any government. Effective spatial planning policies is also crucial to the improvement of the business environment, particularly for small and medium enterprises. In the socialist system, land management, urban planning, infrastructure and housing policy were focused on the needs of the socially owned sector. There were always insufficient provision for private housing and private business development. There was also, as a result, a widespread culture of disregarding planning controls. Planning was a top-down process, where central planners determined the location of apartment blocks and socially owned enterprises. It was not a responsive system to reflect demographic trends and patterns of development in any independent new private sector.

Planning in a democratic and free-market environment, where people make their own choices where to live or found a business, raises unfamiliar challenges for Bosnian post-war institutions, used either to the command and control planning of a socialist industrial economy or to no planning at all. The last major planning exercise in Bosnia and Herzegovina was carried out in the mid-1980s. Since then, there have been radical changes in the economic system, in the industrial base and in the population distribution, and most existing plans are severely out of date.

In the post-war period, the question of planning also became directly linked to one of the largest *social* issues: the problem of finding housing for displaced persons unable or unwilling to return to their pre-war homes. Across the country, the strategy of authorities became one of using what appeared to be a freely available resource – parcels of socially owned land, much of it agricultural land – in order to address this burning social problem. So what was the capacity of Bosnian planners to produce and give effect to policy choices in an area universally judged to be of critical importance?

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<sup>141</sup> Government of Una Sana canton, “Zakljucak”, 1 November 2002.

### 1. *The displaced and post-war politics*

Studies on the post-war social environment all concur that displaced persons constitute the most vulnerable group in Bosnian society. A poverty profile prepared as part of the Poverty Reduction Strategy Paper found that displaced persons are “considerably more susceptible to poverty than the population that was not forced to move.”<sup>142</sup> The Living Standards Measurement Survey found that displaced persons constitute 45 percent of the extremely poor in the Federation, and 21 percent in Republika Srpska.<sup>143</sup> A social capital study commissioned by the World Bank in February 2002 found that displaced persons have an unemployment rate of 37.6 percent, compared to 24.5 percent among permanent residents (including returnees).<sup>144</sup> If they are working, they are twice as likely to be in insecure, informal employment. In most parts of the country, they have no access to social benefits.

In the bleak economic conditions which prevail across much of the country, families with housing of their own can scrape by on irregular income patched together from different sources. Those without permanent accommodation may be unable to pay for housing on the open market, and are at risk of falling below the minimum conditions for survival. For this reason, housing has become a dominant issue in local politics across the country.

From 1997 onwards, municipal governments were elected by communities in which displaced persons with genuine humanitarian needs figured prominently. Many of them were unable or unwilling to return to their pre-war homes. As international support was concentrated on returnees, municipal authorities came under strong pressure to provide for the housing of displaced persons who wished to stay. Whatever their ethnicity or political orientation, authorities across the country considered it legitimate, and indeed imperative, to help displaced persons to resolve their housing problems. However, in most places, the means available to local authorities for conducting a social housing policy were extremely limited. Outside Sarajevo Canton and Herzegovina, where stronger public finances have allowed for a limited programme of publicly funded housing construction, most authorities did not have the resources to build any new housing.

### 2. *Land for free*

The one resource which appeared plentiful at the local level was socially owned land. Authorities across the country therefore resorted to the expedient of allocating building land free of charge to displaced persons, to allow them to construct new houses.

Under modern conditions, resettlement programmes absorb huge public resources. The only authority in post-war Bosnia and Herzegovina with the financial means to attempt to undertake a major resettlement programme for reasons of *ethnic* politics was the Croat para-state of Herzeg-Bosna, using resources provided by the Croatian

<sup>142</sup> PRSP team, “Poverty Profile in Bosnia and Herzegovina” (draft), November 2002.

<sup>143</sup> Authorities of BiH in co-operation with the World Bank, “Bosnia and Herzegovina: Preliminary Findings from the Living Standards Measurement Survey”, August 2002.

<sup>144</sup> World Bank, “Bosnia and Herzegovina: Local Level Institutions and Social Capital Study”, February 2002, p. 21.

government. Money from the Croatian Ministry of Defence financed the creation of new settlements along some strategic transport routes running south of Mostar towards the coast, and around militarily significant assets like the Mostar airport and the Vitez explosives factory. One of the settlements in Capljina municipality, Suskovo Selo, was named by its residents in honour of Gojko Susak, the war-time Croatian Defence Minister and chief architect of the resettlement programme. The building programme was closely co-ordinated by the Croatian Ministry for Reconstruction and Development, which donated large amounts of construction material according to detailed, annual operational plans.<sup>145</sup> The materials were delivered to HVO-controlled depots in Herzegovina. In some places, HVO engineering units undertook excavation work to prepare the sites.

The bulk of the Croat settlements are concentrated in the triangle Mostar South-Stolac-Capljina. It is estimated that around 4,200 plots of land have been allocated across Herzegovina-Neretva canton.<sup>146</sup> Many of the settlers are Croat displaced persons from Central Bosnia and Bosniac-controlled parts of the Neretva valley, with a high concentration of war veterans. However, if the settlement programme was intended to create a string of fortified towns to guard the borders of a Greater Croatia, it has proved a failure. Stolac and Capljina have both seen sizeable return movements, with more than 1,800 Bosniacs and 1,500 Serbs registered as living in the two municipalities.<sup>147</sup> Across Herzegovina, new settlers are living in close proximity to returnees, with little sign of tension. Instead they are suffering from an absence of employment opportunities in their new homes. Some settlements, although created only a few years ago, are already losing population, with people leaving for Croatia.

In Republika Srpska, the financial resources that allowed the resettlement of internally displaced persons were never found. Instead, after the international community forced the adoption of laws on the return of minorities, the government of Milorad Dodik promised that plots of land would be allocated to all Serbs who faced eviction from temporary accommodation and wished to stay in Republika Srpska.<sup>148</sup> He announced in 1999 that “this year there will be a programme of building 10,000 housing units to resolve the housing problem.”<sup>149</sup> The question of how all this new housing construction would be funded, however, was never resolved.

Republika Srpska was receiving emergency budgetary support from international donors at the time to keep the government afloat. It had no scope within its own budget to invest in building programmes. The only resource which seemed cheap and plentiful was land. Empty construction land on the outskirts of urban areas and farmland abandoned after the collapse of socially owned agricultural combines were at the disposal of municipal authorities.

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<sup>145</sup> See for example, Republic of Croatia Ministry for Development and Reconstruction, “Operative Plan for Implementing the Programme of Donations for the Purposes of Taking Care of Refugee and Exiled Croats from BiH on the territory of HN Canton, Posavina, Central Bosnia and Hercegovina in 1997”, 4 August 1997.

<sup>146</sup> Estimates provided by OHR-RRTF Mostar.

<sup>147</sup> UNHCR, “Recorded minority returns from 01/01/02 to 31/07/02 in Bosnia and Herzegovina” & “Returns summary to Bosnia and Herzegovina from 01/01/96 to 31/07/02”, www.unhcr.ba. This represents approximately 15 percent of the pre-war Serb and Bosniac population.

<sup>148</sup> See for example interview in *Reporter*, 28 February 1999.

<sup>149</sup> *Glas Srpski*, 29 January 1999.

The Dodik government's solution was to authorise municipalities to grant this land free of charge to displaced persons, so they could build houses for themselves. On the surface, this looked like a cost-effective solution to the housing problem. In reality, creating new urban areas generates huge infrastructure costs. In this case these were left to the municipalities or deferred to the future. An Instruction signed by prime minister Dodik on 20 August 1998 elaborated the procedure. The municipalities were responsible for drawing up technical documentation and providing access roads. The usual fees on the allocation of land were waived. It was left to each municipality to decide how much land to allocate to displaced persons, according to its assessment of its own needs.

Based on partial surveys carried out by international agencies and data collected from the municipalities themselves, it appears that just under 20,000 plots of land have been allocated across Republika Srpska between 1999 and 2003. However, beyond distributing land, the Republika Srpska government was able to contribute only modestly to the costs of building houses. It prepared a plan for the distribution of 1,600 packages of bricks, cement and roof tiles valued at KM 8,000, providing around a quarter of the material needed to construct a typical family house. The total cost of the programme came to KM 13 million in materials, plus several million more in transport costs. Only six percent of all those allocated land plots across Republika Srpska received a donation of building materials from the government. The vast majority were forced to rely entirely on their own resources to construct a house. Those who managed to sell a property in one of the Federation urban centres during the post-war real-estate boom may have earned enough to build a house. However, a substantial majority of displaced persons in Republika Srpska are living in dire economic conditions. It is therefore not surprising to find that, based on the limited available data, only a minority of the land plots allocated by municipalities in Republika Srpska are actually under any form of development.

From the perspective of the government of Republika Srpska, the policy of distributing land has had limited success in resolving housing problems. Of the original 415,000 displaced persons in Republika Srpska, only 6,500 families have begun building on a land plot by the end of 2002. At the same time, land allocation has generated large contingent liabilities against municipal budgets, in the form of public demands for infrastructure, which are likely to take many years to clear.

Even Sarajevo Canton, which has more resources at its disposal than governments in other parts of the country, had limited ability to implement a public housing policy through the construction of new housing. Most of its programmes have been directed towards helping war invalids and the families of fallen soldiers. According to the Ministry for Veterans Affairs of Sarajevo Canton,<sup>150</sup> 955 new apartments have been constructed with public funds over the years 1999-2002, including 160 for war invalids and 450 for demobilised soldiers. The Ministry has also donated 749 packages of building material to veterans, valued at around KM 6,000 each. In

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<sup>150</sup> Sarajevo Canton Ministry for Veterans Affairs, "Informacija o stanju u stambenom zbrinjavanju demobilisanih boraca, ratnih vojnih invalida, porodica sehida i poginulih boraca na podruccju Kantona Sarajevo", September 2002.

addition, the Canton Sarajevo Fund for Housing Construction has extended 120 long-term housing credits for building purposes.

In Sarajevo, the political leadership therefore also permitted large-scale housing construction for displaced persons who wished to stay in Sarajevo. In 2002 the Canton was host to around 72,000 displaced persons, making up 18 percent of the post-war population of 400,000,<sup>151</sup> of whom 75 percent originate from Republika Srpska.<sup>152</sup> The population of the Canton had fallen by at least 60,000 since 1991, and there is now more housing space per head than before the war. However, population displacement has led to distribution problems, with post-war family sizes lower and many apartments standing vacant. Housing prices in Sarajevo are high, depending on location. With little commercial housing finance available, buying property is beyond the reach of most people. As a result, the Cantonal Ministry for Housing Affairs estimated that there was an unmet demand for around 20,000 new housing units in Sarajevo in 2002.<sup>153</sup>

In addition to reconstruction the greatest growth in Sarajevo's housing stocks since the war has therefore occurred through the resumption of illegal construction of individual houses. Although there is no official data available, various informed sources estimate that there may be as many as 20,000 housing units constructed illegally across the canton since 1996.<sup>154</sup> The social costs of illegal construction can be vast. New housing is being built on unstable slopes, in water catchment areas and in the protected zone around the Sarajevo airport. There is even reported to be new housing constructed above the main gas pipeline into the city, and in other areas reserved for infrastructure development. As was the case before the war, the authorities were unable or unwilling to enforce planning controls, and there has been no demolition of illegally constructed housing in Sarajevo.

Across the country, the distribution of free building land to displaced persons has not proved to be an effective housing policy. In Republika Srpska, the cost of supplying infrastructure to the new housing areas – including preparing the land plots, access roads, water and sewerage, electricity and telephone connections – was left to the municipalities. However, under the 1998 regulation, the municipalities were required to waive the revenue which would normally be used to fund the development of the land. By waiving this fee,<sup>155</sup> the full cost of infrastructure development had to be

<sup>151</sup> The official population figure published by the Federation Statistics Institute is 400,498. However, the Institute acknowledge that this figures is an estimate, as there is no reliable means of tracking continued urbanisation, the return of displaced persons out of the canton or emigration in the post-war period.

<sup>152</sup> Sarajevo Canton Government, "Plan povratka raseljenih lica i izbjeglica u Kanton Sarajevo, s projekcijom povratka raseljenih lica is Kantona sarajevo u istocni dio Republike Srpske u 2002. godini", February 2002, p. 5.

<sup>153</sup> Interview with Suad Dzindo, Deputy Minister for Housing Affairs, 12 October 2002.

<sup>154</sup> Interviews with Suad Dzindo, Deputy Minister for Housing Affairs, 12 October 2002; Fatima Hadzibegic, Deputy Federation Minister for Urban Planning and the Environment, 14 April 2002; Nazif Babaic, Deputy Mayor of Ilidza, 13 April 2002; Ljubisa Markovic, Mayor of Sarajevo Centar Municipality, 20 November 2002. The Institute for Architecture, Urbanism and Spatial Planning has data on 12,000 new houses, most of which are illegally constructed, but believes the real figure may be much higher.

<sup>155</sup> An exception is Srpsko Sarajevo (principally Pale, Srpsko Novo Sarajevo and Srpska Ilidza), where the beneficiaries were required to pay for the land in instalments over ten years, with a three-year grace period. The City of Srpsko Sarajevo obtained a credit from FRY which enabled

borne by the municipal budget, or charged to the land plot beneficiaries themselves in the form of connection fees. As a result, infrastructure connections are being developed very slowly, as and when the means allow.

Even in Sarajevo, the chaotic form of development of large scale illegal construction places enormous strains on the infrastructure of the city. According to the municipality of Ilidza, “the building of such a large number of illegal objects, which after construction are connected to existing infrastructure, places at risk the functionality of that infrastructure.”<sup>156</sup> This severely compromises the ability of the cantonal authorities to plan for or finance future infrastructure development. Connecting wild settlements after the event is considerably more expensive than planning the infrastructure in advance.

### 3. *The absence of democratic planning*

Spatial or regional planning goes beyond the issue of land use control. One of its purposes is to control patterns of development so as to minimise infrastructure costs, and therefore to maximise the return on public investments. In Bosnia and Herzegovina, the lack of effective systems for planning and financing infrastructure development is bringing existing infrastructure systems to the point of collapse.

The problem of illegal construction is an old one in the former Yugoslavia. Official housing policy centred around the construction of apartments by socially owned enterprises for their employees, and was never sufficient to meet the pressures of rapid urbanisation. The authorities therefore turned a blind eye to the practice of illegal construction. By 1991, the city of Sarajevo was surrounded by a ring of more than 40,000 illegally constructed houses,<sup>157</sup> taking up more than 3,000 hectares of the city’s most valuable construction land.<sup>158</sup> Approximately every decade, the authorities initiated procedures to legalise the new factual situation.

In the post-war period, the system of development planning has decayed even further. Most municipalities do not have the basic information on demographics and housing stocks which would enable them to assess their long-term housing needs. Urban planning systems are not functioning effectively, and the problem of illegal construction is rampant. Many municipalities complain that they do not have the resources to undertake expensive planning exercises. However, without proper planning, they are unable to use their scarce capital budgets effectively.

Developing a functional system of democratic planning in Bosnia, which addresses the need for new housing policies, sustainable infrastructure development and a new system of land tenure, is thus an urgent requirement. The problem is that any real process of reform must involve not just the entities and the state, but also municipalities and Federation cantons, as the levels of government most directly involved in land use and planning matters. At this moment there is no forum for

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it to undertake some of the necessary infrastructure development in advance: information from Srpsko Sarajevo officials.

<sup>156</sup> Ilidza Municipality, *op. cit.*

<sup>157</sup> Information provided by the Sarajevo Cantonal Ministry for Urbanism.

<sup>158</sup> Institut za Arhitektura, Urbanizam i Prostorno Planiranje Sarajevo, “Strateske i programske osnove stanovanja i stambene izgradnje Sarajeva”, June 2002, p. 15.

representatives of the state, cantonal as well as entity ministries of urban planning, representatives of municipal associations from both entities, and experts in the areas of planning, infrastructure, land use and finances. There is nothing similar to the German Spatial Planning Advisory Council (Raumordnungsbeirat), established under the German Spatial Planning Act,<sup>159</sup> a body made up of representatives and experts from municipalities; the spatial planning ministries of the Länder, urban development interests from the private sector and civil society and employers' organisations and trade unions.

Planning and land-use policy affects the economic prosperity of an area, and cannot be viewed as an isolated function of any single public agency; it is inherent in all governmental activities. Planning policy "is the product of a long process of bargaining, negotiation and political compromise that encompasses the views and activities of a wide range of organisations, including central government, local planning authorities, statutory bodies, the market and the public."<sup>160</sup> In Bosnia, however, a strong constituency for planning and land use practices is yet to emerge, despite the obvious benefits it would offer.

## VI. CONCLUSIONS – RESISTING THE AUTHORITARIAN TEMPTATION

At the heart of the Bosnian governance problem – from social policy to natural resource management, from rural development policy to debates over the most appropriate way to spend scarce education resources – lies the lack of engagement by Bosnian citizens and interest groups in the practice of government. Just as a company without the interest of an owner will not use its assets wisely, public institutions which are not subject to constant pressure from citizens exerted through the democratic process will not respond to the needs of the public effectively.

There are many objective reasons for this lack of popular involvement. One is sociological: a society which has suffered so extensively from massive displacement has seen many pre-war social networks disrupted. The other is institutional: not only are most of the Bosnian government institutions a recent creation – every ministry in the country above the level of municipal government is a war-time or post-war creation, but the continuous changes of the institutional landscape and the lack of clarity over responsibilities and division of labour between different levels of government all render attempts by citizens or interest groups to influence the policy process extremely difficult.

However, despite the massive displacement of people and the complete novelty of almost all institutions, the most striking feature of Bosnian governance today is not discontinuity and disruption but continuity: the striking similarities both in policy debates and actual policies implemented between the present and the pre-war socialist past. The most striking continuity concerns the most basic understanding – in the eyes of a significant part of the country's political and intellectual elite – of what good governance actually means. Faced with the enormous problems of today, an important

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<sup>159</sup> See also Rachelle Alterman (ed.), *National-level Planning in Democratic Countries – An International Comparison of City and Regional Policy-Making* (Liverpool UP, 2001), p. 139.

<sup>160</sup> Mark Tewdwr-Jones, *The Planning Polity – Planning, Government and the Policy Process* (London, 2002), p. 8.

part of the Bosnian elite is falling prone to an authoritarian temptation – the belief that policy (mainly understood as legislation) can best be formulated outside the political process, and imposed on society without the participation of stakeholders.

As we have seen, this way of conducting government has deep roots in the former Yugoslav system. It has been reinforced by developments in the post-war period: the overwhelming economic dependency on outside funding, the youth and institutional weakness of public institutions, the preoccupation with interethnic issues (often reduced to the question of where public sector jobs are to be located) and the availability of outsiders prepared to take responsibility for hard political decisions. Many factors combine to feed this authoritarian temptation. There is a long tradition of top-down development, where decisions were taken by outsiders rather than by a domestic entrepreneurial or political class. This leaves an expectation that real development will also have to arrive from outside. There is a lack of tradition of participatory politics in Bosnia. Interest groups have been slow to develop.

Against the background of the general crisis of industrial society, parts of the public administration have been better placed to protect themselves from the compression in living standards which has affected Bosnia over the past twenty years. Both the Yugoslav socialist tradition and, ironically, the international mission in Bosnia extol the role of the expert as a qualified *outsider* whose expertise allows him to identify the public interest without needing to go through the slow and painful process of debate, compromise and constituency-building. This assumes that the public interest *can* be objectively determined, rather than being the outcome of a process of bargaining and balancing among the different interests of many groups. The practical result of this authoritarian temptation is a striking passivity of citizens, interest groups, politicians and – in the final analysis – the public sector as a whole.

Bosnian society faces overwhelming problems associated with structural economic legacies inherited from both the pre-war past and the war itself, which constrain what any government can possibly achieve and deliver. Most citizens see public institutions as self-interested, even parasitic. As we have seen, there is a marked tendency of many public and semi-public institutions to cling to their privileges, allowing public resources to be wasted and public services to decline, while deferring difficult decisions and pushing costs and problems into the future. This, however, is reaching its objective limits. A society which allows its public assets to be run down as soon as they have been reconstructed, which invests little in the education of its future workforce, which spends its resources on (public sector) consumption and which fails to develop policies that might allow the economy to catch up with its regional competitors is not on a sustainable path, however many paper reforms are accomplished.

The looming public finance crisis, if it is to be mastered, will create an even bigger need for a negotiated process of adjustment of the use of scarce public resources. Alternatively, it could reinforce the temptation of those who still benefit under the present system to shield the present, highly inequitable and inefficient distribution of public resources from *political* pressures. Bosnian governments will need to find ways to increase their effectiveness dramatically, without consuming more resources.

The District of Brcko offers a good illustration of the authoritarian temptation at work. For many Bosnians, it represents almost an ideal of a-political government. For many years now, elections have been dispensed with, and all public officials appointed by the international supervisor. Politicians have been reduced to mere administrators; they accept a policy agenda given to them by outsiders, and take no responsibility for governance outcomes. The public sector is able to pay itself exceptionally high salaries by virtue of an external subsidy – in this case, a disproportionately large revenue stream made possible by Brcko’s peculiar constitutional status (*i.e.*, its ability to levy customs and excise on goods transiting Brcko on their way to the entities). The high salaries meet little local opposition, because the funds do not have to be wrested from Brcko’s own taxpayers. This mode of government produces a fine display of multi-ethnic power sharing, and many paper reforms. However, it reproduces the same governance dynamics observed in other parts of the country: the disproportionate size of the public sector; the unsustainable public finances, with the vast majority of revenues used for current expenditure; and a government whose incentives are summed up by the old Bosnian saying – *nemojte talasati* – “don’t make waves”.

To improve the performance of government, the most basic premises of Bosnian politics need to change. There would need to be an open discussion of what is really happening to the Bosnian economy, and a willingness to recognise the structural legacies of the pre-war mode of development. There would need to be a concerted effort to build up concrete information on what is happening in Bosnian society, from the village level to the macro-economy. Citizens would need to demand that their governments respond to their problems and new interest groups would need to begin to believe that it is worth their while to assert their interests through the political system.

Most importantly, Bosnian society – and in particular the Bosnian political and intellectual elites – would need to discard the authoritarian temptation that is such an enduring legacy of the pre-war system. The believe that good governance can be the outcome of a process of *bargaining without stakeholders* and that the *public interest* can be defined by bypassing elected representatives – core values of the technocratic system of self-management socialism – had created a system of governance whose shortcomings were visible well before the outbreak of war. Until those illusions are discarded, the essential problem of the old Yugoslav system of governance would remain untouched, and the potential of Bosnian democracy to deliver good governance outcomes would appear as limited as it is at present.