The Politics of Privatization in Post-Dayton Bosnia

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Introduction

In the early 1990s, Sarajevo’s Holiday Inn became a well-known symbol of the tragic and bloody ethnic conflict that tore Bosnia-Herzegovina apart. As the hangout of choice of the international press corps covering the war, the unlovely yellow hotel became something of an icon, its battered façade appearing with regularity on television screens around the world. Throughout the siege, the fact that the hotel – considered by some to be among the world’s ugliest buildings – remained standing amid the surrounding destruction was for many observers one of the most poignant of the war’s many ironies.

In the wake of the Dayton Peace Accords, which brought the Bosnian conflict to a halt in late 1995, Sarajevo’s Holiday Inn again became a symbol of Bosnia’s unhappy fate. As a result of a shady privatization deal which transferred majority control of the state-owned hotel into the hands of a local businessman for a fraction of its value, the Holiday Inn came to symbolize the new Bosnia, where corruption is rampant, and where well-connected insiders of the ‘right’ ethnicity can gain control of key state-owned assets for a song while the vast majority of the population remains destitute.

More broadly, the Holiday Inn deal – which was ultimately annulled only after an outcry by international officials and a lengthy investigation by the local financial police – is symptomatic of Bosnia’s troubled transition process. Like the sale of the hotel, Bosnia’s economic transition to date has been heavily tainted by ethnic politics and corruption, has exposed rifts not only between the goals of the international community and local political actors but also among international agencies, and has ultimately produced little in the way of concrete benefits for ordinary Bosnians.

As both a post-conflict and a post-socialist state, Bosnia is in many ways a sui generis case of post-socialist transition. While Bosnia shares many of the challenges faced by other post-socialist states, such as consolidating democracy, competing in an increasingly open and liberalized global economy, and reining in kleptocratic elites, Bosnia must also contend with a war-shattered economic infrastructure and a severely divided population. In addition to making the transition from socialism to capitalism, therefore, Bosnia also faces the challenge of making the transition from war to peace and from contested to consolidated statehood. As such, the economic reform process is inevitably intertwined with the country’s unresolved ethnic conflict, which has largely monopolized the
energies of Bosnia’s own political elites and of the international agencies struggling not only to keep Bosnia together but also to transform it into a modern market democracy.

Within this context, this paper will examine the privatization process as it has unfolded in post-Dayton Bosnia. As a key element of the standard transition package implemented – with decidedly mixed results – in other Eastern European contexts throughout the 1990s, privatization has everywhere been designed as a mechanism for freeing the productive assets of a transition society from the ‘dead hand’ of socialism. Privatization advocates have consistently argued that privatization is necessary both to de-politicize economic life and to provide the basis for economic recovery and growth. The central argument of this paper, however, is that in the case of post-Dayton Bosnia, the privatization process has thus far failed on both counts. What international advisors originally envisaged as an apolitical, rapid and orderly transfer of assets from public to private hands has become a corrupt, ethnicized, and protracted struggle for power, which has done little to stimulate economic growth or promote inter-ethnic reconciliation. These results are even more lamentable since they could have been mitigated, if not entirely avoided, had Bosnia’s privatization process been tailored more carefully to the country’s unique circumstances.

The Post-Dayton Context

As far as starting points for economic transitions go, it is difficult to imagine a more difficult position than the one in which Bosnia found itself in late 1995. The country’s social and political infrastructure had been shattered by nearly four years of bitter ethnic conflict, while the majority of its industrial infrastructure was destroyed and much of the remainder plundered. At the same time, Bosnia’s human resource base was scattered and in disarray, with one Bosnian in two – more than two million people – displaced either within the country or abroad as a result of the war.

Compounding this situation was the fact that the peace deal itself was less a permanent settlement than an uneasy ceasefire. The deal crafted at Dayton left in place the same political forces responsible for Bosnia’s descent into war, and represented a tenuous compromise between partition and unity, and between recognizing the rights of refugees and displaced persons to return home and acknowledging the legitimacy of ethnically-pure territories. Because the Dayton agreement failed to resolve the core issues around which the war was fought, each side in the Bosnian conflict “is still fighting the war for statehood; only their means of securing territory and national survival have changed” (Woodward, 1997: 29).

Worse, the nationalist political parties have financed this ongoing competition – and their own efforts to retain power – by consolidating their grip on economic power within areas they control and resorting to widespread corruption. Peter Singer has recently suggested that ‘the criminalization of the Bosnian body politic’ now represents the single greatest threat to the
implementation of the Dayton agreement, concluding that “instead of the expected shift from ethnic nationalism and war to political pluralism and economic liberalism, there is only a tightening vise of corruption and cronyism” (2000: 31).

At the same time, the agreement reached at Dayton also failed to provide the new Bosnian state with the tools necessary to effectively consolidate its statehood. Bosnia’s Dayton constitution created a weak central government, responsible for little more than foreign and inter-entity relations, while most real power was vested in Bosnia’s two entities: a fractious Muslim-Croat Federation and the Serb-dominated Republika Srpska (RS). Tellingly, responsibility for defence in post-Dayton Bosnia lies not with the state, but with the entities, while state institutions are almost entirely dependent on financial transfers from the entities. And since the Muslim-Croat federation remains more fiction than reality, Bosnia has yet to fully move beyond the situation of three hostile, self-governing ethnic enclaves that prevailed at the end of the war.

Complicating matters further within the post-Dayton context has been the ambiguous role of the international community. Originally, the international community was envisioned as simply the overseer of the peace agreement, with the local parties doing the bulk of the implementation work. However, as it became clear that the local parties – and in particular the leaderships of Bosnia’s Serb and Croat communities – were less than completely committed to the full implementation of Dayton, an exasperated international community has taken an increasingly active role. The gradual accretion of international power in Bosnia – largely in the hands of the international High Representative – has led to what one commentator has called a ‘dysfunctional protectorate’, in which the Office of the High Representative (OHR) has significant powers to impose legislation and remove obstructive officials, but lacks real power to enforce Dayton’s key provisions (Lyon, 2000: 110). Political power in Bosnia today therefore rests uneasily between the international community and Bosnia’s own democratically elected governments.

Technocrats and Nationalists

Since the start of the Dayton process, economic recovery and transformation have been recognized as crucial to the success of the Dayton project and to the survival of the Bosnian state. In Bosnia’s post-conflict environment, therefore, the initial international reconstruction package of some $5.1 billion (US) was seen as an essential ingredient of the peace process. If Bosnia could be made economically viable, so the argument went, the country’s fragile peace could become self-sustaining, and if Bosnians of all ethnicities began to see concrete benefits from citizenship in the Bosnian state, in the form of jobs or other economic opportunities, then the centrifugal forces pulling the country apart could be contained.

At the same time, economic recovery has been touted as a potentially sustainable path to renewed multiculturalism in Bosnia. Charles Boyd, for
instance, suggests that even if forced re-integration of ethnic communities may ultimately prove to be self-defeating, “as economic opportunity invites interaction, these same people will gradually become confident that they can live again in a mixed society” (1998: 53).

While the initial international strategy for Bosnia’s economic rehabilitation envisaged the orderly and staged progression from humanitarian relief to reconstruction to economic reform, from the outset the privatization process marched to a different beat. On the one hand, Bosnia’s privatization programme was developed under the guidance of the US Agency for International Development (USAID), and was therefore largely separate from the economic reform process overseen by the OHR. On the other hand, the privatization process, which was put together beginning in 1997, seemed to operate on a different timeline from other elements of the reform process, as USAID officials originally envisaged a transparent and rapid privatization process that was to be largely completed within a two-year period.

In retrospect, this ambitious schedule appears oddly naive given the well-known difficulties of privatization elsewhere in Eastern Europe. Almost without exception, privatization in post-socialist states has been far more complex and problematic than originally conceived. Privatization programmes have been plagued by substantial delays and by serious corruption, and even in cases where state-owned enterprises have been successfully transferred into private hands, the newly privatized companies did not prove to be the engines of economic growth that reformers hoped they would be. In institutionally-weak transition economies in particular,

most high-quality assets have ended up in the hands of the resourceful, agile and well connected few who for a variety of reasons have tended not to embark on the thorough restructuring that might have justified their acquisition of the assets. In an institutional vacuum privatization can and has led to stagnation and decapitalization rather than to better financial results and increased efficiency (Nellis, 1999: ix).

Given these challenges, the last several years have seen somewhat of a reassessment of the mainstream approach to privatization. The first element of this reassessment is an abandonment of speed as a fundamental priority. As John Nellis has suggested, particularly in weaker transition states (among which Bosnia must surely be counted) there is a strong case to be made for “a necessarily slower and less dramatic form of case-by-case or tender privatization, aimed at creating, from the bottom up, the climate in which monied, core, competent investors can and will take over the presently stagnant and decapitalized firms” (1999: 27). Similarly, others have suggested that more important than speed is the establishment of an appropriate competitive environment and the institutionalization of mechanisms to ensure effective corporate governance of assets, whether privatized or unprivatized (Kolodko, 2000: 115). Implicit in these conclusions is the notion that the disappointing results of privatization can be at least partly explained by the failure of reformers to fully appreciate the importance of solid institutional foundations to the
privatization process, and by their over-confidence in the ability of markets to spontaneously and benignly organize themselves. In other words, in the absence of an appropriate institutional framework – including those institutions underpinning the rule of law, functioning and well-regulated capital markets, an efficient tax-collection regime, and an effective banking system – privatization was bound to have unpredictable and often perverse consequences. Significantly, however, the original privatization timeline in Bosnia implied that privatization was to be a done deal before the broader economic reform and institution-building process was even fully underway.

Even leaving aside the question of the desirability of rapid privatization, those assuming that Bosnian privatization could be carried out quickly and efficiently clearly underestimated the complexity of the country’s political situation. This reality meant, for example, that rather than creating a single state-wide privatization agency as elsewhere, Bosnian privatization was to be carried out at the entity level. Complicating matters further was that fact that the country’s Muslim-Croat Federation was itself divided into ten cantons, with both Muslim and Croat nationalist parties demanding control over the privatization process in cantons they controlled. At the end of the day, therefore, Bosnia was saddled with an immense and cumbersome privatization infrastructure of 10 cantonal and two entity privatization agencies.

Not only has this arrangement precluded speed and efficiency, it has also raised immediate concerns about the ethnicization of the process. Haris Silajdžić, for example, a relatively moderate member of Bosnia’s Council of Ministers, refused to approve framework privatization legislation in the absence of an international monitoring body responsible for ensuring fairness for all ethnic groups (PMC, 2000: 5). And while a Privatization Monitoring Commission was ultimately established, it proved unable to effectively prevent privatization from becoming another battlefield in Bosnia’s ongoing ethnic conflict.

For its part, USAID’s own perspective on Bosnia’s privatization programme was based on the belief that economic recovery could only be generated through the rapid transfer of state-owned enterprises into private hands, regardless of whether or not the institutional underpinnings to support both the process and its aftermath were in place. To be fair, such an approach in the Bosnian context was not entirely unreasonable, given that most state-owned companies were stagnant and increasingly under ruling party control, yet it ignored the inherent dangers of privatizing in an institutional vacuum. It is also clear that USAID has viewed privatization as a technical rather than a political exercise, and has been more concerned with the fact of privatization than with the identity of the new owners. The agency has appeared largely untroubled by the fact that international investors would not rush to invest in a rickety post-conflict state such as Bosnia, nor by the fact that in post-Dayton Bosnia, virtually the only locals with resources to buy state-owned enterprises were members of a rather unholy alliance among the ruling parties, the increasingly powerful mafia, and elements of the old socialist-era nomenklatura. Nor has there been much concern
that the voucher component of Bosnia’s privatization programme (discussed below) would tend to reinforce ethnic divisions and provide opportunities for the wealthy, the corrupt, and the politically-connected to consolidate their power. As elsewhere in Eastern Europe, there was – and remains – a general consensus among international actors in Bosnia that even if state-owned enterprises end up in the hands of crooked ethnic nationalists in the first instance, over time the market will ensure that the new owners will either become, or will cede ownership to, ‘good’ capitalists.4

For their part, Bosnia’s ruling nationalists have had no illusions about an orderly, apolitical and technocratic privatization process, and few reservations about manipulating the process for their own political ends. In general, the experience of privatization in Bosnia over the past several years reveals a two-pronged strategy by ruling parties on all three sides of Bosnia’s ethnic divide: first, delay the process as much as possible, since within the tripartite Bosnian partocracy a state-owned enterprise is as good as a party-owned enterprise; and second, ensure that whatever privatization does take place leaves former state enterprises in the hands of either (in descending order of preference) the ruling parties themselves, their friends and allies, or their ethnic compatriots.

One key difference between Bosnia’s privatization process and those of other Eastern European states is the absence, in the Bosnian case, of a local political constituency committed to the process. Consequently, the primary driving force behind privatization in Bosnia has been the international community, while Bosnia’s own political elites have been far more preoccupied with the continuing national question and the maintenance of their own political power than with genuine and transparent economic transformation, which is often perceived – quite rightly – as a threat to their political interests. This reality is complicated by Bosnia’s awkward division of power, which leaves the actual implementation of the privatization process in the hands of local governments while the international community plays a largely advisory role.

In such circumstances, it is unsurprising that the ruling parties have largely failed to conscientiously embrace the cause of privatization. As the International Crisis Group reported in 1999, “the ruling political parties deliberately and consistently find bureaucratic reasons for delaying the start of privatization, so as to retain their hold over the economy and policy, as well as to profit from the financial gain accruing from state-owned assets” (1999: 12). Consequently, as of early 2001 fewer than 10 percent of large-scale enterprises within the Muslim-Croat Federation had been privatized, while in Republika Srpska the figure was less than five per cent. In exasperation with the lack of progress, in May 2000 the High Representative sacked the politically-appointed head of the Federation Privatization Agency’s management board, a decision which followed closely on the heels of USAID’s temporary suspension of its support for the Federation privatization process.

From the perspective of Bosnia’s peace process, until very recently the outcomes of cases in which privatization has gone ahead have been at least as troubling as the persistent pattern of delay and obstruction. Given that one of the
core goals of international efforts in Bosnia is to undermine the strength of the hard-line nationalist parties on all sides, there has been surprisingly little concern over the fact that in the majority of cases, the ruling parties essentially sold public enterprises to themselves or to their allies through shady and non-transparent privatization deals. A May 2000 report on Bosnian corruption by the US General Accounting Office raised a red flag over the issue of ethnicized corruption within the privatization process, noting that the majority of already privatized companies belong to the nationalist parties (2000: 31). Similarly, in 1999 the head of Bosnia’s non-nationalist Social Democratic Party charged that the privatization process was a ‘robbery in progress’, in which the ruling nationalists were selling the state’s wealth to themselves ‘for petty cash’ (Dnevni Avaz, 1999).

The Holiday Inn sale is a typical case in point of this trend. In the immediate aftermath of the sale, one Sarajevo newsmagazine published details of the cozy business relationship between the buyer – a prominent Sarajevo business figure named Nedim Čaušević – and the state-owned telecommunications monopoly, adding that the director of the Federation Privatization Agency was a former senior telecom official with close connections with Čaušević. Not incidentally, the FPA director at the time was also a close relative of former Federation Prime Minister Edhem Bičakčić, a senior figure from the Muslim-nationalist Party of Democratic Action (SDA) and widely considered to be among Bosnia’s most corrupt politicians. The strong scent of corruption and cronyism that permeated the Holiday Inn sale from the very beginning – and the fact that the Čaušević-led group paid about 5 million DM in cash for an asset valued at 48 million DM – led to its annulment in February 2001, even though many in the international community continue to insist that the sale was ‘technically’ legal. Yet as Ermin Čengić, a journalist with the Sarajevo weekly newsmagazine Dani, has suggested, “you can only guess, but the fact that the hotel was sold for 10 times less than its real value suggests that opportunities were created for the buyer by politicians.”

While similar stories abound in both the Federation and in Republika Srpska, a somewhat different process has unfolded in the Croat-majority areas of Herzegovina. During the war and its immediate aftermath, the ruling Croatian-nationalist HDZ party encouraged what has become known as ‘co-capitalization’, in which companies from neighbouring Croatia invested heavily in Croat-controlled areas of Bosnia. The result was to transfer majority ownership – in a legally dubious fashion – from the Bosnian state to Croatian companies. In the case of Aluminij Mostar – Bosnia’s most profitable firm and “one of the financial mainstays of the HDZ parastate in Herzegovina” – majority ownership was divided between its Croat employees and Croatia’s TLM Šibenik following the wartime ethnic cleansing of the company (ICG, 2001: 25). Similarly, in a number of municipalities currently under Croat control but which were overwhelmingly Serb-majority before the war, virtually every enterprise is now controlled by a Croatian company (Buff, 2000: 7). And since such companies are unlikely to re-employ returning refugees or displaced persons from minority
communities – the director of Aluminij Mostar has gone on record declaring that the company was Croat and would remain so – this situation is likely to act as a powerful deterrent to sustainable minority return, a key pillar of the peace agreement (ICG, 2001: 25). An international audit commissioned by OHR to look into the privatization of Aluminij Mostar recently came under fire for suggesting that the arrangement be allowed to stand, underlining the fact that for the most part these ‘spontaneous’ privatizations have been accepted as a fait accompli by the international community (Kebo, 2001).

Overall, the way the privatization process has unfolded over the past several years indicates that the process has done more to date to entrench the economic positions of Bosnia’s nationalists and reduce the prospects of ethnic reintegration than to establish the foundations for sustained economic growth and recovery. Daniel Besson, the head of OHR’s Economics Department, argues that the Bosnian variation on crony privatization is a case of the cure being worse than the ailment: “I would say that what we are creating with this type of privatization is worse than what existed before.”

Voucher Games

One of the key dilemmas of privatization in post-socialist states has surrounded the question of finding competent, responsible owners for newly-privatized enterprises. Transition states almost by definition lack a dynamic capitalist class ready to step into the breach left by the withdrawal of the state from economic life. As Peter Gowan has suggested, in most cases “those in the target state with the cash to buy a steel mill would be very few in number and without question former or current crooks at the head of Mafia pyramids” (1995: 15). And while inflows of foreign direct investment were initially expected to compensate for the lack of local capital, for the most part privatization has not triggered the massive inflows of foreign investment that reformers anticipated.

In response to the difficulty of finding deep-pocketed buyers for ailing state-owned enterprises, many Eastern European states turned to voucher privatization. This strategy, adopted most comprehensively in Russia and the Czech Republic, involved the free distribution of vouchers to the general population, which individuals could then convert into shares of privatized enterprises, either directly or through managed investment funds. While offering a relatively quick fix to the problem of transferring state assets into private hands, as well as helping to secure public support for privatization, this solution meant abandoning any hope of generating badly-needed revenues for the state through the sale of public enterprises.

More significantly, perhaps, voucher privatization by itself had no answer to the problem of generating capital for enterprise restructuring and modernization. A key assumption with cash sales is that the buyer has enough resources not only to make the purchase but also to reinvest and restructure in order to ensure profitability. Voucher sales, on the other hand, have often been little more than transfers of paper, with the new owners being just as likely to
engage in asset-stripping as to make long-term investments in the future health and viability of the firm. At the same time, this method of privatization has contributed to the consolidation of economic power in the hands of the few by enabling those with means, connections and resources to engage in active secondary trading of vouchers. Vouchers are initially bought from impoverished citizens for a small fraction of their face value and then used to buy up state-owned property and assets for next to nothing.

Despite these drawbacks, voucher privatization was adopted in Bosnia primarily because of its appeal as a means of facilitating a quick and efficient transfer of state assets into private hands and as a mechanism for liquidating citizen claims against the state. These claims – in the form of frozen foreign currency accounts, unpaid wages for soldiers, and general claims of citizens who had contributed to the pre-war economic development of Bosnia – were to be converted into vouchers that could be used to purchase socially-owned flats (within the Federation) or shares in privatized enterprises.

Unsurprisingly, whatever the intentions of international advisors, the initial distribution of vouchers to citizens was not immune to the machinations of Bosnia’s nationalist elites. In both entities, the ruling parties in control of the process generously interpreted their obligations to certain categories of claimants from their own ‘side’ of the conflict – including unpaid soldiers, war veterans and war widows – with these categories receiving nearly half of the total vouchers distributed (Buff, 2000: 2). The result was a disproportionate distribution of vouchers to ethnic majorities in both entities.

The voucher distribution process in Republika Srpska, which – unlike in the Federation – required citizens to register in order to receive vouchers, exacerbated this implicit discrimination against minorities, refugees and displaced persons. The registration requirement has been widely acknowledged as an attempt to deter minorities, notably displaced Muslims and Croats now living elsewhere in Bosnia or as refugees abroad, from participating in privatization. And while the RS government eventually responded to international pressure on this issue by opening several registration offices on the territory of the Federation and extending registration deadlines, the registration requirement undoubtedly limited the numbers of participating refugees and internally displaced persons.

There have also been reports of RS authorities permitting Serb refugees from Croatia to register for privatization, even though as non-citizens such refugees are ineligible to participate (Buff, 2000: 4). These trends point to a clear ethnic bias in the registration process in order to inflate the number of Serbs while deflating the number of non-Serbs participating in the process. This conclusion becomes even more significant given the method used for valuing vouchers in the RS. While in the Federation vouchers have a face value, in the RS the value of a voucher depends on the number of investors interested in a given company. The greater the number of investors, the lower the value of each voucher invested. There is therefore good reason to suspect that inflating the number of Serbs participating in the process is aimed at least in part at reducing
the value of vouchers held by non-Serbs, thereby reducing the chances that minority returnees will gain majority control of key enterprises.

Within the Muslim-Croat Federation, on the other hand, the fact that vouchers have a vastly overinflated face value in relation to their market value has produced, as in other transition states adopting voucher privatization, an active secondary market for vouchers. While many citizens have used their vouchers to purchase socially-owned flats, in the desperately poor conditions of post-war Bosnia many others have chosen to sell their vouchers for whatever the market will bear. For those with money – notably members of the nationalist-mafia-nomenklatura networks – the desperation of ordinary citizens has been a golden opportunity, as they have been able to buy up certificates for as little as three per cent of their face value and turn around and invest these certificates in privatized enterprises at their full face value. In the case of the Holiday Inn, for example, the tender offer of five million DM in cash was supplemented by an additional 10 million DM worth of vouchers collected for next to nothing from individual Bosnian citizens.

Even leaving aside the ethnic and political machinations surrounding voucher privatization, there has also been considerable criticism of the process in strictly economic terms. The Privatization Monitoring Commission, for example, noted that while vouchers can be successful in privatizing non-productive assets such as apartments, in no case have they been used successfully to revitalize the productive assets of a transition economy. In both Russia and the Czech Republic, the use of vouchers as a method of privatization failed to bring in essential products, markets, management, know-how, and cash, and was doomed to failure in the absence of appropriate institutional underpinnings. As the Commission noted in its final report, “a familiarity with other countries’ experience of voucher privatization should have, even in the particular political context of BiH, warned people off this method of privatization” (2000: 33). Similarly, David Ellerman has recently suggested that “if the wave of voucher privatization in the early 1990s is now seen as tragedy, then the current efforts of diehard voucheristas to install voucher programs in war-torn Bosnia should be seen as farce – if it were not for the adverse consequences for the citizens” (2001: 36).

Despite all this, voucher privatization has moved forward at an accelerated pace throughout 2001, with shares in some 850 enterprises in the RS and over 1,000 in the Federation being made available to either individual voucher holders or to privatization investment funds (or PIFs, which are managed pools of privatization vouchers). On the one hand these public offerings of shares represent a major step forward on the privatization front, since they have been relatively open and transparent, and are transferring a significant portion of enterprise capital from state into private hands. On the other hand, the results of the voucher privatization process will inevitably have implications for ethnic reintegration, particularly given the discrimination against ethnic minorities in the voucher distribution process. This discrimination has been particularly evident in the RS, and it is therefore unlikely that non-Serbs will emerge from the
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voucher privatization process in that entity with much to show for it. The situation is somewhat more complex in the Federation, since even though PIFs have tended to be organized along ethnic lines, nothing prevents ‘Croat’ PIFs from investing in Muslim-majority areas, and vice versa. At the same time, the RS government has effectively gutted its voucher privatization program by issuing an order stating that even though an investment fund can acquire as much as 55 per cent ownership in a privatized company, it can only name two members to the company’s governing board (typically made up of eight to ten members). As the International Crisis Group noted in a recent report, by preventing majority owners from exercising effective control over a company, “this latest ruling might as well have been crafted with the express purpose of sabotaging the privatization of state-owned enterprises in the RS, and leaving them as playthings of the regime” (2001: 23).

Given the combination of the inherent problems with voucher privatization and Bosnia’s especially acute institutional vacuum, it is perhaps unsurprising that its experience with voucher privatization has produced, after more than four years of effort, rather disappointing results in terms of economic revitalization. The prospects for the future are little better. In the aftermath of the initial public offering of shares in the Federation, for example, the issue of inherited debt became a source of tension between the government and those PIFs that had just become owners of formerly state-owned enterprises. Because of a glaring absence of fresh capital for investment and the re-commencement of production, let alone for clearing the backlog of inherited debt, many of the hundreds of newly privatized enterprises immediately faced the possibility of imminent bankruptcy (Simić, 2001). This problem has been exacerbated by the fact that the most viable of Bosnia’s state-owned enterprises have been set aside as ‘strategic enterprises,’ leaving only more marginal companies up for grabs through voucher privatization.

The Foreign Investment Puzzle

In 2000, in the wake of the suspect Holiday Inn sale and USAID’s suspension of privatization funding, the international community in Bosnia began to shift its approach to privatization, and in particular to the question of attracting foreign capital. The initial response was the establishment of an international advisory group on privatization, which brought together most of the large international agencies, including USAID, the EU, OHR, the World Bank and IMF, and the European Bank for Reconstruction and Development. In recognition of Bosnia’s troubled privatization process to that point, the group recommended setting aside some 140 ‘strategic’ enterprises – 86 within the Federation and 52 within the RS – for which international investors would be sought. In order to ensure transparency, international consultants were to be assigned to each file.

This revised approach reflects the general consensus that the long-term hopes for economic recovery in Bosnia rest on the country’s ability to attract
foreign investment. There is little concrete evidence, however, that this new approach will be any more effective in attracting major foreign investors to Bosnia. While there have been some exceptions – at the time of writing there have been four enterprises within the Federation privatized through this route – there are good reasons why foreign investors will remain wary of Bosnia. More than six years after Dayton, Bosnia remains an unstable, corrupt place with a small, divided market, few functioning institutions and a decidedly unfriendly business environment. The investment climate has scarcely improved over the past several years, as the networks of party power – supported by complex and extensive systems of illegal financing – have deep and extensive roots that are only gradually being exposed. As Kristina Hemon of the International Crisis Group suggests, “There’s an entire world that needs to be uncovered and dismantled for the economic system and the rule of law to function here. This is a tremendous task, and a dangerous one.”

In light of these considerations, OHR’s Economics Department has also taken a much more active role in the privatization process, particularly in the effort to create a more favourable institutional environment for privatization. This follows the May 2000 meeting of the international Peace Implementation Council in Brussels, which called for a dramatic acceleration of the economic reform process (2000). In the aftermath of the PIC meeting, OHR has pushed through a series of measures designed to further the reform process, including reform of the labour and pension laws, banking sector reforms, greater harmonization of the entities’ tax regimes, and new rules to ensure the transparency of the privatization process.

The other positive development with respect to the future of Bosnia’s privatization process was the establishment in February 2001 of Bosnia’s first non-nationalist governments since the break-up of Yugoslavia. New governments at both the state and Federation level are the result of delicate coalition-building among Bosnia’s non-nationalist opposition parties in the aftermath of the November 2000 national elections. Within the Federation at least, the installation of a non-nationalist government has helped to accelerate privatization, while the removal of nationalist hardliners from the governing boards of major unprivatized enterprises has denied the former ruling nationalists of a major pillar of their power. In Republika Srpska, however, the situation is much less hopeful, as the continued dominance of the hard-line SDS party has effectively blocked most economic reform efforts. All of the new non-nationalist governments, ultimately, remain fragile, and recent attempts by the nationalist Croat HDZ to form a third, Croat-majority, entity within Bosnia are a reminder that the country’s future remains far from secure.

Conclusion

More than six years after the signing of the Dayton Peace Accords, Bosnia’s economic situation – and the situation of most individual Bosnians – remains wretched. Bosnia’s GDP is still at less than half its pre-war level, while
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in the absence of continued international aid the country’s economic growth rates would probably be in negative figures. Estimates of unemployment range from 40-50 percent, while pension payments are chronically in arrears and social unrest is increasingly visible (Lyon, 2000: 111). Fully 62 percent of young Bosnians say they want to emigrate and start a new life somewhere else (UNDP, 2000: 35). Most troubling of all, Bosnia faces the prospect of an even deeper economic crisis as international aid flows begin to decline.

While it has become a reflex on the part of the international community in Bosnia to blame the lack of progress towards economic recovery on the intransigence of local authorities, it is difficult to escape the conclusion that the international community itself must bear some of the responsibility for Bosnia’s current economic morass, and in particular for the failings of the country’s privatization process.

First, the initial emphasis on early and rapid privatization appears in retrospect to have been clearly misguided, as it ignored the political complexities of post-Dayton Bosnia, the recent history of privatization in other transition countries, and the risks of undertaking privatization in an institutional vacuum. In this sense, the persistent obstruction by the ruling nationalist parties could almost be considered a stroke of good fortune, as this has allowed at least the beginnings of an institutional infrastructure to be put into place prior to the privatization of the largest state-owned firms. Had Bosnia’s nationalist elites enthusiastically embraced privatization from the outset, it is likely that the country’s ethnically-compartmentalized economy would now be completely in the hands of three mutually-hostile nationalist-mafia cabals, with profound implications not only for economic recovery but the future of Bosnia as a multiethnic state.

Secondly, as in other transition states there was an overemphasis on the fact of privatization and an underemphasis on outcomes. This has led to relative indifference on the part of the international community to both abuses of the voucher privatization process and to the fact that the nationalist parties and their allies were, at least in the early stages of the process, gaining control of virtually everything that was privatized. As noted above, this approach was based on the premise that even the most distasteful private owners were preferable to continued state ownership, and the expectation that the market would ultimately ensure economic rationality once ownership was in private hands. While the evidence of this trend from other transition contexts is far from convincing, in the case of Bosnia the immediate impact of ethnic and party privatization – to the extent that it has taken place – has hardly been consistent with the broader goals of the Dayton Peace Accords.

Third, expectations regarding foreign investment in Bosnia were – and to a great extent remain – overly optimistic. To the extent that the international advisors recognized the dangers of ethnic privatization, they anticipated that such problems would ultimately be resolved by the involvement of foreign investors in the process, either in the initial round of privatization or in the subsequent buying and selling of enterprises. There were similar expectations with regard to the
injections of capital required to revitalize key enterprises in the post-privatization period; given Bosnia’s own capital deficiencies, foreign capital continues to be considered the only hope for a sustainable Bosnian economic recovery. With a few prominent exceptions, however, foreign investors remain wary of Bosnia.

Fourth, from the outset of the Dayton implementation process, the economic and political tracks of the reform agenda in Bosnia have been insufficiently integrated. Even today, international officials and agencies working on economic issues approach Bosnia’s problems more from a technical than a political perspective, while those with specifically political mandates tend to lack a consistent focus on economic issues. The reluctance of the international community to resist the efforts of Bosnia’s nationalists to both channel privatization along strict ethnic lines and to manipulate the process for their own ends is therefore deeply inconsistent with the more interventionist stance taken by the international community in attempting to ensure Dayton’s full implementation. The failure to address or overcome this inconsistency may explain in part the limited success to date of both the economic and political tracks of the post-Dayton process in Bosnia.

More generally, Bosnia’s experience with privatization appears to underline the weaknesses of a one-size-fits-all model of economic transformation, which pays insufficient attention to the peculiarities of local circumstances. This, in turn, lends credence to recent calls for the adoption of a ‘contingency approach’ to economic transformation, which recognizes that there is no single best model of capitalism and that economic reforms should be much more sensitive to local needs and conditions (Likić-Brborić, 1999). If ever there was a case for tailoring an economic reform and recovery strategy to the specific needs of a particular country, then surely Bosnia is it. No other transition state has faced quite the same bundle of challenges – of simultaneously trying to build a functioning state, a viable market economy, and a sustainable peace out of the wreckage of nearly four years of bitter ethnic conflict – that Bosnia has. In this context, much could have been done to improve Bosnia’s privatization process, and to ensure that it contributed to, rather than undermined, broader peacebuilding and state-building efforts.

First, and perhaps most importantly, a revised approach would have started with a recognition that privatization, particularly in the hyper-politicized context of post-Dayton Bosnia, is an inherently political as well as an economic process. Given Bosnia’s recent history and the perpetuation in power of those most responsible for it, it should have been entirely predictable that the country’s ruling parties would manipulate the privatization process for their own political ends. An acknowledgment of this reality, as well as a greater recognition of the need to support the broader goals of promoting ethnic reintegration and marginalizing extreme nationalists, might have produced a different approach to privatization on the part of the international community. This might have included, for example, an insistence on the creation of a single, multiethnic, state-wide privatization agency in place of the dozen party-controlled agencies that emerged, and more rigorous international oversight to prevent abuses within the
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voucher component of the programme. A more politically-attuned approach would have also have meant greater scrutiny of potential buyers to exclude the most offensive elements of Bosnia’s political community from the process (in the same way that these same elements have been excluded from the formal political process). In short, it would have meant abandoning a single-minded commitment to getting public assets into private hands as rapidly as possible in favour of a more nuanced approach that balanced both political and economic considerations.

Second, an initial acknowledgment that the privatization process would inevitably be a complex and lengthy affair might have created space for measures designed to re-start economic activity in the lead-up to privatization. Had a two-year timeline for privatization been both feasible and desirable, then the sequencing of restructuring after privatization might have made sense. Failing this, however, conditioning restructuring on privatization virtually ensured a prolonged unemployment crisis in Bosnia’s post-war period.

University of Sarajevo economist Dragoljub Stojanov has suggested that this is one area where local needs should have taken precedence over the demands of orthodox transition theory. While mainstream transition theorists have long held that the market should ultimately sort out which firms survive and which do not, Stojanov argues that in Bosnia’s case greater emphasis should have been placed on getting the most viable of the country’s public enterprises up and running again prior to privatization. While there are obvious dangers to pouring public money or international aid into party-controlled enterprises, this problem could have been avoided by conditioning funding on the replacement of party-nominated managers by management teams of international and domestic experts, and by insisting on fully transparent financial procedures. While such a solution might not have been ideal in terms of economic efficiency, it would certainly have been preferable to non-productive and highly corrupt status quo that emerged.

At the same time, a more realistic assessment of Bosnia’s attractiveness to foreign investment may have led to a greater emphasis on the re-generation of domestic capital. Stojanov, for one, argues that the rigid macroeconomic stabilization policies currently in place in Bosnia stifle any opportunity for domestic-led recovery, and make economic revitalization unnecessarily dependent on external capital.

Finally, there is also an argument that the international community in Bosnia has invested far too much energy and too many resources into the privatization of large state-owned enterprises and has done far too little to encourage the development of entirely new, or greenfield, economic activities. However, re-configuring Bosnia’s economy to be competitive in today’s global economy (University of Sarajevo Economics Professor Vjekoslav Domljan, for example, imagines turning the country into the Silicon Valley of Southeastern Europe) would require an activist state-led industrial development strategy. Because the international community has not been prepared to support such a strategy – which would necessarily involve worker retraining, entrepreneurship
promotion, and directed investment – it is unlikely that even Bosnia’s incoming moderate governments will be in a position to undertake even a modest role towards this end.

While such thinking challenges many of the core assumptions of the conventional approach to privatization, and to economic transition more generally, it seems not entirely unjustified in light of the unimpressive record of transition in Bosnia to date. Ultimately, it remains to be seen whether the mid-stream adjustments made to Bosnia’s privatization process – which include a greater emphasis on institutional development – will be sufficient to transform the process from a site of ongoing ethnic struggle to an engine of sustainable economic growth. Similarly, it is not yet clear to what extent this change of course represents a shift towards a ‘contingency approach’ to the problems of privatization in Bosnia, or whether it is simply a re-shuffling of orthodox transition strategies. It also remains to be seen whether Bosnia’s new governments can – or will be given the opportunity to – play a more active role in the process of economic restructuring. The final chapter of Bosnia’s privatization story remains to be written, and its outcome may do much to determine whether Bosnia manages to survive and prosper as a multiethnic market democracy.
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Notes

1 The author gratefully acknowledges the financial assistance of the Social Sciences and Humanities Research Council of Canada and the York Centre for International and Security Studies, which has made the research for this paper possible.

2 While Bosnia’s privatization process has included the privatization of socially-owned housing, banks, and enterprises, due to space constraints this paper will focus primarily on enterprise privatization.

3 Author interview with USAID officials, Sarajevo, 16 February 2001.

4 see, for example, Why Will No One Invest in Bosnia and Herzegovina?, ICG Balkans Report No. 64, 21 April 1999, p. 12.

5 “Novi vlasnik Holiday Inna Nedim Čaušević ’93, godine suden zbog ratnog profiterstva!!!”, in Slobodna Bosna, 16 March 2000, pp. 6-7; in February 2001, Bičakčić was sacked by the High Representative from his new position as a director of the state-owned electricity utility amid allegations that he was engaged in massive corruption while Prime Minister; he is now facing criminal charges.

6 Author interview with Ermin Čengić, Sarajevo, 16 February 2001.

7 Annex 7, Article 2 of the Dayton Peace Accords states, in part: “The Parties undertake to create in their territories the political, economic, and social conditions conducive to the voluntary return and harmonious reintegration of refugees and displaced persons, without preference for any particular group.”

8 Author interview with Daniel Besson, Sarajevo, 12 February 2001.

9 Some observers expressed concern early on in the voucher process that the ruling parties would form their own PIFs as a means of retaining control of privatized enterprises. Nationalist party involvement in the PIF process has ultimately not been as significant as feared, even though some PIFs have close party ties, such as the Sarajevo-based Bonus PIF, which has been closely linked to the SDA.

10 Within the Federation, 28 companies were later dropped from the initial list of 86, leaving 58 companies on the list.

11 Author interview with Kristina Hemon and Michael Doyle, Sarajevo, 21 February 2001.

12 Besson interview, op.cit.

13 Author interview with Professor Dragoljub Stojanov, Sarajevo, 23 February 2001.

14 Author interview with Professor Vjekoslav Domljan, Sarajevo, 20 February 2001.

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