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MASTER'S THESIS

INDUSTRIAL POLICY IN BOSNIA AND HERZEGOVINA

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INTRODUCTION

Economic development of Bosnia and Herzegovina (hereinafter: BiH) has been staggering for the past 20 years and somehow it seems as nothing can push the country out of the quick sand it has been in. Gross Domestic Product (hereinafter: GDP) is falling, unemployment rising and political instability heating up. The aim of the thesis is to analyze the development of Bosnia and Herzegovina and analyze, as well as evaluate existing development and industrial policies in the context of the observed socio-economic characteristics of BiH, with the final purpose of preparing suggestions for more suitable policies or industrial policy framework that would better promote the development of the country in the future. The idea is to present the major problems BiH has been and still is facing and evaluate how the problems are being dealt with.

The goal of the thesis is to reach a conclusion on what is being done inadequately in Bosnia and Herzegovina for years now and to give suggestions to correct it. The conclusion reached is that BiH has not had a successful industrial policy implemented in the past and that current situation is not as promising as suggested by international organizations. The purpose of the thesis, in essence, is to evaluate the situation in BiH, and give a conclusion on what went wrong, when and why. First step in finding a cure, is determining a cause. The purpose of the thesis is to find a cause of staggering growth and why there were no industrial policies successfully implemented in BiH in order to find a cure and implement policies which would lead to a boost of economy of BiH.

The following research questions will be answered:

RQ1: What does the development economics say about industrial policy and how does the economic theory define the need for an industrial policy?

First research question explains the need and importance of industrial policies, as the central topic of the thesis. Approaches to industrial policies by several authors are given to present a more clear picture on what industrial policies are and why they matter. In addition to the general need for industrial policies, an answer is given to the significance of industrial policies for developing countries, to which Bosnia and Herzegovina belongs to.

RQ2: What are the characteristics of the economic development in BiH until today?

Second research question focuses on BiH and its socio-economic development from period of Socialist Federative Republic of Yugoslavia (hereinafter: SFRY) until today. Due to significance of the Republic of Bosnia and Herzegovina for today's situation in BiH, the analysis went as far as to SFRY period. An overview of development was given, ending with a SWOT analysis of the current economic situation in BiH.

RQ3: What are the characteristics of the industrial and development policies in BiH?

Third research question focuses on industrial policy in BiH and analyzes the existence and success of industrial policies in the past and now. A potential explanation of inadequacy of past industrial policies is given, along with an analysis of current set of industrial policies: Reform Agenda. Whether reform agenda is good for BiH or not is answered. Proposals for the future structural reforms and implementation of industrial policies are given.

Desk research is used as the main methodological tool in the thesis due to the nature of the topic of the thesis. In the theoretical part existing literature is described, analyzed and summarized. The second part (RQ2-4) will be based on a combination of literature review and study of data (secondary, statistical sources). Data analysis encompasses: collecting, analyzing, integrating and presenting data in the most suitable way for this thesis and finally describing the data and relevance for the conclusions drawn. Limitations faced in preparation of the thesis were lack of relevant and reliable data on BiH, especially during the war and in the post-war years. Local sources are scattered and often unreliable and have to be triple checked while global sources are limited due to size of the economy.

The structure of the thesis is presented in the following couple of sentences. Firstly, a theoretical concept of industrial policy is introduced along with different approaches to the industrial policy. Given that focus of the paper is BiH, a developing country, a differentiation in significance of industrial policies between developed and developing countries is made. Continuing, a socio-economic development of BiH is presented to give readers insight into the economy. Country overview, along with a political insight and economic development is presented. Due to relevance for current situation, an overview of BiH from membership in SFRY until today is given. In terms of economic development, a macroeconomic environment, labor market and business climate are analyzed. The chapter on socio-economic development of BiH is ended with a SWOT matrix of the current economic situation in BiH. The third chapter analyses the industrial policy in BiH. In order to properly assess industrial policy, chapter starts with an overview of main development goals, followed by an analysis of industrial policy in the past and now. Analysis of industrial policy now is correlated to the Reform Agenda for BiH 2015-2018 and six areas of reform the Agenda covers. The thesis is ended with proposals for the future.

The main contribution of the thesis is in depth analysis of development of BiH, in scope of industrial policies and government action. An overview of development from membership in SFRY until today was given, with a thorough SWOT analysis of the economy. Main problems and suggestions for the future were given, which could help in future politicizing and policy making.

1 INDUSTRIAL POLICY IN THEORY

In order to assess industrial policy in BiH, a theoretical concept of industrial policy needs to be presented. For the purpose of the thesis, a general definition of industrial policy is given with explanation of importance of industrial policy. In next section, several different approaches to industrial policy are given. The theoretical part is concluded with chapter on importance of industrial policy for developing countries. Given there are significant differences between developed and developing countries, especially in terms of industrial policies, this chapter was added to narrow the concept to BiH.

1.1 What is an industrial policy?

In the words of Stiglitz and Greenwald (2014) whatever the state does is some kind of industrial policy, be it just liberalization or privatization. Industrial policy is a wide concept encompassing all actions government takes; there is no one or two policy tools that can be attributed to it. It can extend from general measures across different spheres to narrower sector specific measures (Bole, Prašnikar, Gazibarić, Hrastel, & Korelc, 2014). Since market themselves do not result in Pareto efficient outcomes and create a number of pervasive market failures, governments are constantly attempting to correct these failures by implementing various industrial policies. So, an industrial policy could be defined as a policy that helps overcome or diminish the market failures. Another potential definition is, a government attempt at shaping structural change in a way government deems suitable. So, intentionally or not, all governments are engaged in industrial policies. The only difference lies in awareness. Governments either consciously introduce industrial policies or unconsciously, but either way industrial policies are inevitable. Usually industrial policies are comprehended as growth promoting, but should be seen as any policy redirecting economy's sectoral allocation.

Debate should not be whether countries need to introduce the industrial policies, but in which way. The key is framing the question the right way. Forming successful industrial policies requires deep thinking and understanding of surroundings, as well as the goal that implementation of particular industrial policy is aimed at achieving. There is no "one size fits all" with industrial policies. What worked for one economy is not a success recipe for another, despite potential similarities of either economies or policies. For those opposing industrial policies, argument of those in favor is that the question is not framed the right way. The danger of industrial policies, besides shaping them wrong, is rent seeking and misuse, especially in less stable economies such as BiH. But, this is an aspect of a political economy and should be addressed in such way. Hence, special attention to capabilities and governance of public sector, those who carry out the process of designing and implementation of industrial policies, should be given.

To sum up, the center of industrial policy thinking needs to be the direction in which the economy should move, given current state of institutions and development, as well as historical background. Focus on thinking in terms of long-term growth and progress, rather than short term (Stiglitz & Greenwald, 2014).

1.2 Different approaches to industrial policy

Spector, Chapsal and Eymard (2009, in Bole et al., 2014) claim that the concept of industrial policy means different things to different people. This paragraph provides an overview of alternative views on industrial policies, by Stiglitz and Greenwald (2014), Spector et al. (2009) and Aghion, Boulanger and Cohen (2011, in Bole et al., 2014).

Stiglitz and Greenwald (2014, in Bole et al., 2014) explain the necessity of industrial policies by inefficiency of the markets. Capital market on its own is incapable, and if capable, not efficient, in distributing resources toward sectors which exhibit potential and growth-enhancement capacities. The role of the government is to overcome this discrepancy. Spector et al. (in Bole et al., 2014) oppose the view, claiming competition and rivalry among firms are far more efficient than state intervention. The fallacy of government intervention is susceptibility to misuse and rent seeking. Aghion et al. (in Bole et al., 2014) is an intermediate of the two opinions. A combination of the two approaches should be made, in a way they complement each other, to achieve the end result. Bole et al. (2014) present a matrix differing between these three approaches. A summary is presented in the Table 1.

Table 1. A matrix of alternative approaches to industrial policy

Aspects	Stiglitz and Greenwald (2014)	Spector et al. (2009)	Aghion et al. (2011)
MOTIVATION for the industrial policy	markets are inefficient, especially financial markets	there are no market failures, all markets clear	climate change is a market failure
	financial crises develop endogenously	crisis are exogenous	China is an example of industrial policy implementation
DRIVER of economic growth	learning is result of R&D, highly localized and easier among large firms	there are no significant learning spillovers	endogenous growth in competitive economy can be attributed to spillovers of R&D
THE ROLE of competition in building knowledge	knowledge is not generated by markets	competition policy is the best industrial policy	competition is important, but not crucial and government actions could help
A NEED for industrial policy	to create a learning society	no need, it produces national champions	supportive role
MEASURES and CHARACTERISTICS of industrial policy	broadband measures	horizontal measures	Basic directions

Source: V. Bole et al., *Industrial policy in theory and EU practice*, 2014, p. 15

As far as measures are concerned, Stiglitz and Greenwald (2014, in Bole et al., 2014) propose “low” exchange rates, selection of a winner which promotes learning in the society and spillovers, stimulation of trade and everything else that enhances knowledge creation and learning in the society.

Spector et al. (in Bole et al., 2014) point to the importance of competition policy, and using competition policy as an alternative to industrial policy in resolving many problems raised by Stiglitz and Greenwald, for example. Aghion et al. (in Bole et al., 2014) again combine the two approaches with a proposal of industrial policy complementary to competition policy and sectoral policies.

1.3 Role of industrial policy in developing countries

For the theoretical introduction of the concept of industrial policy to be completely applicable to BiH, a role of industrial policy in developing countries is presented. Developed and developing countries differ significantly, on a number of parameters, signaling industrial policies need to differ and different approach needs to be taken.

Industrial policies bear special importance for developing countries. Stiglitz and Greenwald (2014) differentiate between developed and developing countries in terms of gap in knowledge, not only in resources. Hence, in order for developing countries to close this gap faster, they need to strive for knowledge enhancement and creation of a learning society. This is where industrial policies step in.

A gap in time also needs to be taken into consideration when comparing industrial policies. What worked one hundred years ago on developing countries may not, and most likely will not work on developing countries today. No country is the same and “one size fits all” motto cannot be applied when it comes to industrial policies and their implementation. Early industrializers, which are today’s developed countries, had a certain path of progress and implementation of industrial policies, which were relatively similar then, but are not even similar to today’s developing countries. World has become much more dynamic and widespread than before and no common recipe can be found. An example of an ill constructed “one size fits all” industrial policy is Washington consensus, which was pushed to developing countries without considering effects on learning and knowledge. The difference between developed and developing countries can be clearly noticed in labor supply. While developed countries strive for saving labor, developing are abundant in labor. Hence, implementation of policies or borrowing industrial policies from developed countries, can be detrimental for developing countries since unemployment is a problem and with such reproduced labor-saving policies, problem can become even worse. Not only labor approach differs, but also prices of factors of production, meaning same approach cannot be even considered, let alone applied.

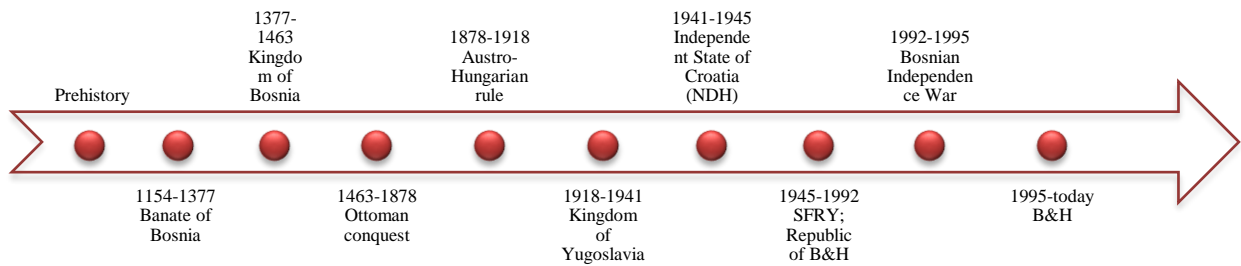
To sum up, the goal of developing countries is to implement industrial policies which promote learning and create a learning society in order to close the knowledge gap to developed countries faster. On the other hand, goals of industrial policies implemented in developed countries are to save labor and other expensive factors of production, as well as to promote innovation and lead new technological processes. Direction of industrial policies which developed and developing countries should undertake differs strikingly (Stiglitz & Greenwald, 2014).

2 SOCIO-ECONOMIC DEVELOPMENT OF BOSNIA AND HERZEGOVINA

2.1 Country overview and brief history

BiH is located on the Balkan Peninsula, in Southeastern Europe. Country covers 51.209 km², out of which 51.197 km² is land and only 12.2 km² is coast/sea (Directorate for European Integration, 2017). According to Agency for Statistics of BiH (2017) estimated population of BiH on 30.06.2015. was circa 3.5 million people. Country follows Currency Board Arrangement, which pegs BAM to EURO, in ratio €1.00 to BAM 1.95583. As far as administrative organization is concerned, BiH has two entities, which are further subdivided into cantons and municipalities, and one district, which is also subdivided into municipalities. Official system of government is democracy. According to World Economic Forum (hereinafter: WEF) Global Competitiveness Report 2016-2017 BiH ranks 107th out of 138 countries with GCI Global Competitiveness Index (hereinafter: GCI) score of 3.8 out of 7. GDP of BiH in current US\$ is \$ 16.191.716.214,68 and GDP per capita also in current US\$ is \$ 4.249,33, based on World Bank data (2017). BiH has a rich history and the country was populated from early periods of Neolithic age. Figure 1 presents the timeline of BiH from prehistorical period until today. The country was populated in early Neolithic age and was raided by various people at the time. First mention of the country is in work of Byzantine Emperor Constantine “De Administrando Imperio” in the mid-10th century, as horion Bosona. Kingdom of Bosnia grew out of Banate of Bosnia, and gained independence in 1377 with Tvrtko I Kotromanić as king. Kingdom of Bosnia ceased to exist with conquest by Ottoman Empire. However, Bosnia still maintained its identity with name of the country, culture and territorial integrity. After Ottoman Empire, Austro-Hungarian Empire occupied territory of BiH, but this occupation did not last too long. After World War I BiH joined the South Slav Kingdom of Serbs, Croats and Slovenes, which was soon renamed Kingdom of Yugoslavia. During World War II Bosnia was part of Independent State of Croatia. After World War II, Socialist Federative Republic of Yugoslavia was created and Republic of BiH became 1 of the 6 constituent republics. Republic of BiH remained part of SFRY until 1992, when independence was declared and the war started. In 1995 BiH gained independence with Dayton Accords and still follows organization declared by the Peace Accords in 1995.

Figure 1. Timeline of history of Bosnia and Herzegovina

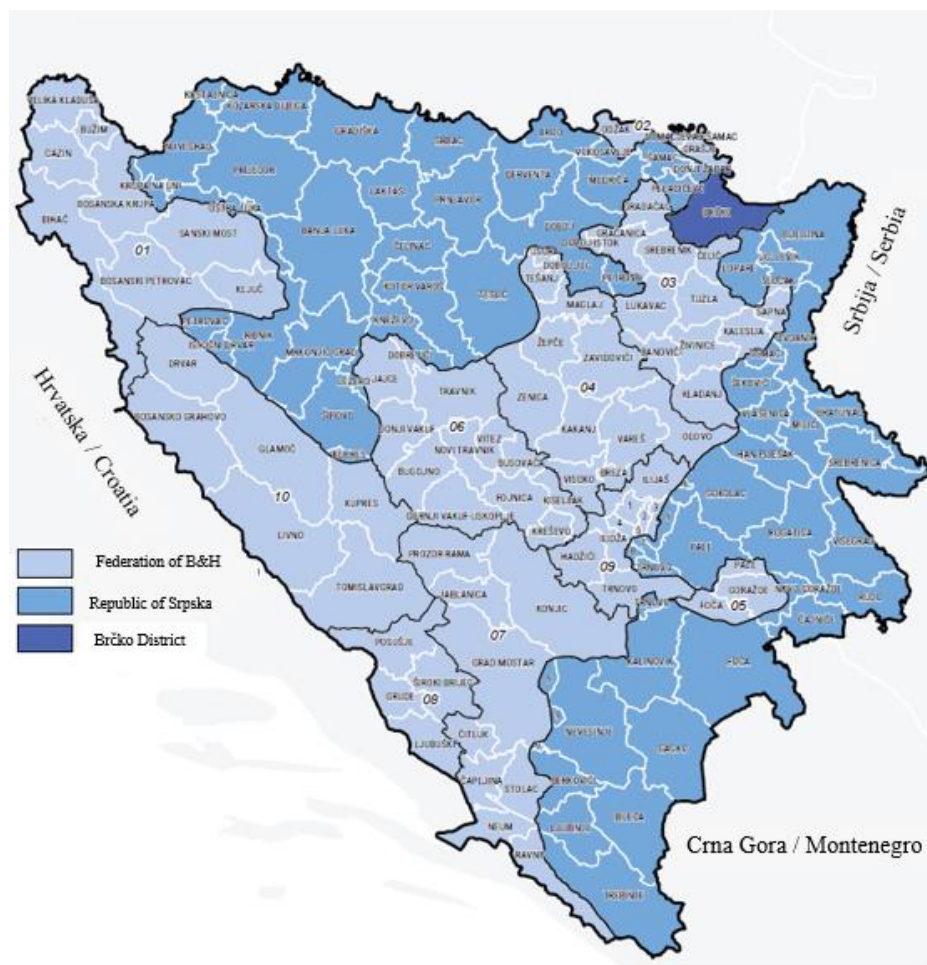


Source: Visit my country website: *Bosnia and Herzegovina*, Istorija Bosne i Hercegovine (n.d.)

2.2. Political organization of Bosnia and Herzegovina today

Bosnian independence referendum was held on 29th of February and 01st of March 1992. 99.44% of voting body, 64.31% of population voted for sovereign BiH which allowed for international recognition of BiH as independent country (“Referendum o nezavisnosti,” n.d.).

Figure 2. Administrative map of Bosnia and Herzegovina from 1995 until today



Source: Agency for statistics of BiH, *Thematic bulletin 03: Demography 2015, 2016*. p.3

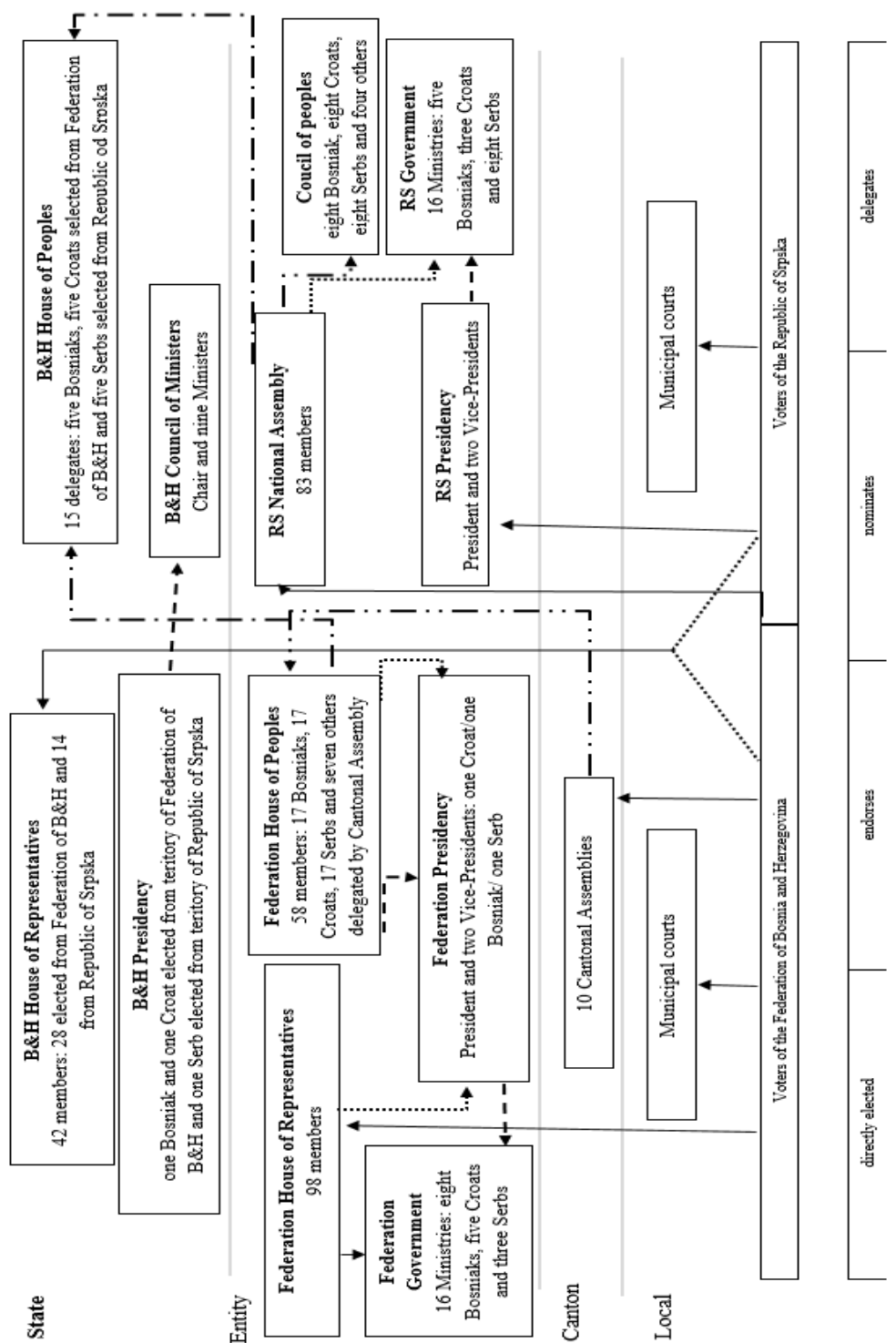
This led to a war in BiH, which lasted for four years and was ended in 1995 by Dayton Accords. Dayton brought Constitution of BiH that is still in force and regulates, among other things, the administrative division of BiH and political system in the country. Figure 2 presents the administrative organization of BiH. The country is divided in two entities and one district: Federation of Bosnia and Herzegovina (hereinafter: FBiH), Republic of Srpska and District of Brčko. Federation is further divided into 10 cantons, which are subdivided into 79 municipalities. Republic of Srpska is divided into 62 municipalities. The district of Brčko is a separate administrative unit under sovereignty of Institutions of BiH.

BiH has multiple levels of rule: state, entity, canton and municipal level. State level encompasses foreign affairs, defense, border control, elections, foreign trade, fiscal and monetary policy and similar. Entities have very high level of autonomy: they have a president, parliament, government and judicial system. They have jurisdiction over civil administration, health care, education, police, regional planning and others. Cantons have cantonal government and although they are subject to Federal laws they have high levels of autonomy: their own Assembly and government. Their jurisdiction encompasses: health care, education, culture and sport, internal affairs and civil administration. Municipalities also have their own government and service. In the words of Borger (2015): “Its name (Dayton, Ohio, USA) has come to encapsulate Bosnia’s purgatory: life in absence of war, but never quite at peace. And a long way from happiness or normality.” Significant changes in the Constitution have not been made since 1995. Politicians are satisfied with the current state, since it allows them to do as they please. Borger (2015) described the system as “cash cow for politicians”. The tripartite political system in Bosnia and Herzegovina is unique in its complexity. The three presidency members are from the three constituent nations - one Bosniak, one Serb and one Croat with chairmanship rotating every eight months. If you declare yourself in any other way than the three mentioned above, there is no place in political world for you in Bosnia and Herzegovina (Borger, 2015). World known case, Sejdić and Finci v. Bosnia and Herzegovina addressed this issue. Representatives of Romani people, Sejdić Dervo, and Jewish nation, Jakob Finci, sued Bosnia and Herzegovina. The Constitution of Bosnia and Herzegovina from 1995 disables them to be elected in the Presidency of BiH and House of Peoples of BiH due to their nationality. The discrimination was acknowledged, but justified by the circumstances in BiH at the time when the Constitution was brought, leaving things unchanged.

Nardelli, Džidić & Jukić (2014) relate the current setting to the Dayton Peace Accords: “Bosnia is home to what is most probably the world’s most complicated system of government. Any understanding of this rather unique constitutional and institutional set up needs to begin with the Dayton Peace Accords.”

A hierarchical representation and division of BiH according to levels of government mentioned above is presented in Figure 3.

Figure 3. Legislative and executive bodies of Bosnia and Herzegovina



Source: The Portland Trust, *Economics in Peacemaking: Lessons from BiH*, 2009, p. 26

Institutional framework in Bosnia and Herzegovina created complex decision making on multiple levels and duplication if not triplication of public services. For example, Federation of BiH has 11 ministries of health. The costs associated with the maintenance of these 11 ministries are too high and result in expensive, yet inefficient service in health care department. Another extreme example are separate train companies: one in Federation of Bosnia and Herzegovina and one in Republic of Srpska. The end result of existence of the two separate entities is the change of locomotives when train enters the territory of the opposite entity. Not only it increases costs, but also inconvenience for both workers and passengers and makes railway extremely unpopular despite connectivity and potential of faster movement of people and goods than roads (World Bank Group, 2015).

2.3 Economic development of Bosnia and Herzegovina

Usually when economic situation and welfare is mentioned, GDP is the first thing that comes to our mind. However, sometimes if not most of the time, GDP is a poor measure of welfare of an economy and can present misleading conclusions. As Stiglitz (2016) pointed on example of USA, despite the fact GDP has been increasing every year, the situation is worse for most Americans. Real wages 60 years ago were higher than real wages today. Taking previously mentioned in account, additional measures, besides GDP, are used to describe the situation in Bosnia and Herzegovina. Only GDP and purely economic indicators will not present the situation properly. The following section is divided into BiH within SFRY, transition in BiH, development of BiH until today and concluded by a SWOT matrix of economic situation in Bosnia and Herzegovina today.

2.3.1 Bosnia and Herzegovina within Socialist Federal Republic of Yugoslavia

From 1945 until 1992 Republic of BiH was part of the SFRY, along with Croatia, Macedonia, Montenegro, Serbia and Slovenia. SFRY included six socialist republics. Capital city of the Republic was Belgrade and common currency was Yugoslav dinar. Official system of government was federal one-party socialist republic. Madison Project Database (2017) recorded GDP of SFRY in current US\$ and GDP per capita in current US\$ in amounts of \$ 16.191.716.214,68 and \$ 4.249,33 respectively. SFRY followed the so-called centrally planned economic system. Governments implementing this economic system believe that effective and efficient allocation of resources cannot be attained through free market economy and that only through central plan all citizens can enjoy equal economic prosperity. For all federal units in SFRY government decided **what** will be produced, **how much** of particular good/services will be produced **and at what price** will it be sold/bought.

For Bosnia and Herzegovina, the focus was on heavy industry and energy production, due to natural resources present.

Significant industries at the time in Bosnia and Herzegovina were: mining, metal-processing, black metallurgy, steel and aluminum production, textile, wood, chemical, food processing, drugs, weapons and military industry. A number of natural localities in Bosnia and Herzegovina has pushed the overall country industry towards development of industries related to extraction of ores: salt locality (Tuzla), iron locality (Vareš), bauxite locality (Jajce, Čitluk), brown coal locality (Banovići) etc.

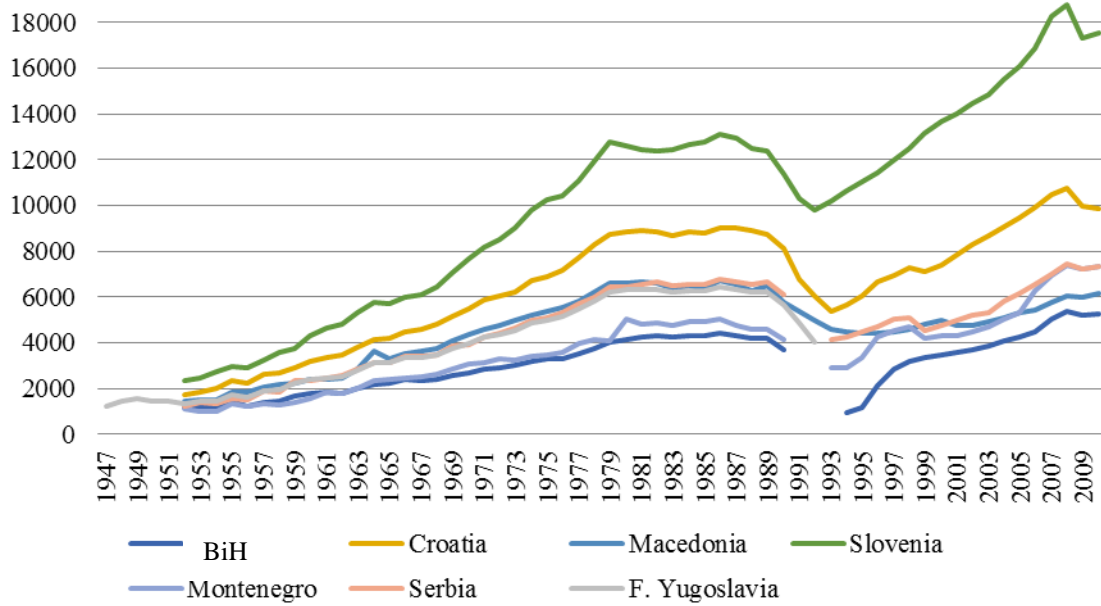
Prior to the 1990s Bosnia and Herzegovina had around one thousand companies which employed around half a million people. Out of those one thousand companies, 12 were great conglomerates which carried the industrial production and employed 44% of workforce. 99% of exports of Republic of BiH was attributed to these 12 companies (Tulić, 2013). Previously mentioned top 12 industrial giants in BiH at the time were: Agrokomerc (food processing industry), Soko (military industry), Unis (group of leading companies¹), Energopetrol (oil company), Zora (candy and chocolate production), Koksara Lukavac (electricity production), Slavko Rodić (part of military complex of SFRY), Famos (engine factory Sarajevo, partnered with Mercedes-Benz), Pretis (ammunition production), Tas (car factory Sarajevo), Hidrogradnja (construction company) and Union Invest (construction company) (Murić, 2014). Most of the big companies and large number of smaller ones from the period of Yugoslavia have been unsuccessfully privatized after the war and, even if they exist today, are in huge debts and problems. In short, they are merely shadows of giants they once were.

Despite these big conglomerates and companies, according to the Madison Project Database (2017), Bosnia and Herzegovina was among the least developed in terms of GDP per capita (in constant 2010US\$) in Yugoslavia. Figure 4 shows GDP per capita in Republic of Bosnia and Herzegovina and rest of the countries in SFRY, as well as SFRY in total. Levels of GDP per capita of Bosnia and Herzegovina are below the total SFRY level along with Montenegro. Serbia and Macedonia are around the overall SFRY level and Croatia and Slovenia are way above the GDP per capita of SFRY as a whole.

The most developed/richest economies in SFRY were Slovenia and Croatia, followed by Serbia and Macedonia. Bosnia and Herzegovina and Montenegro exhibited the lowest GDP per capita levels among the six, making them the least developed in the group.

¹ UNIS presented group of companies acting in various industries: car manufacturing and motor vehicle parts production, metal processing industry, chemical industry, machines and tools manufacturing, telecommunications, electronics, hotel business and catering, tourism, rent-a-car etc

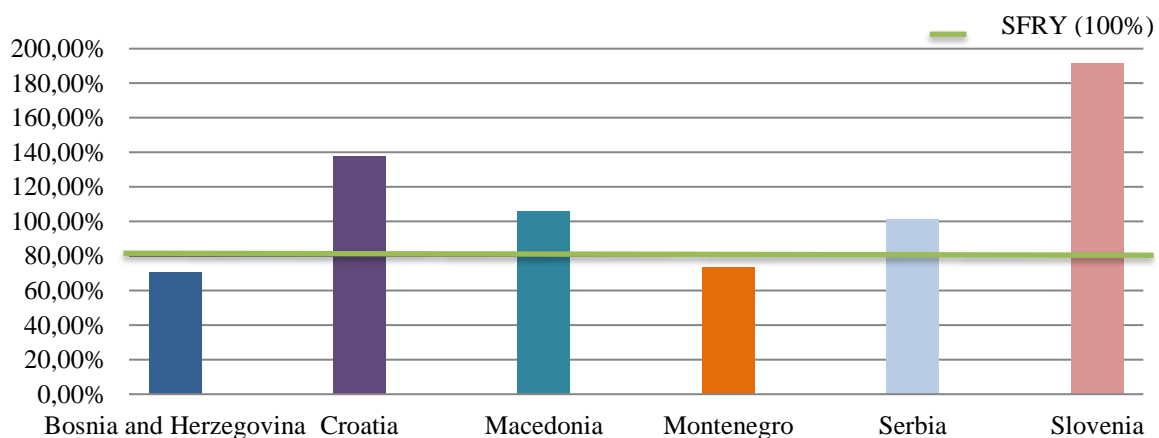
Figure 4. GDP per capita of SFRY (1990 Int. GK\$) from 1947 until 2010



Source: Data on GDP of SFRY and individual countries collected from the Madison Project Database, 2017

To further evaluate the level of a country within the SFRY a new variable: $GDP_{pc\ x/SFRY}$, x being the abbreviation for country in question, was created. The variable presents the average of GDP per capita (1990 Int. GK\$) of particular country over GDP per capita (1990 Int. GK\$) of SFRY. The results are presented in Figure 5. What can be noticed is that $GDP_{pcSLO/SFRY}$ is two times GDP_{pc} of overall Yugoslavia, whereas $GDP_{pcBiH/SFRY}$ and $GDP_{pcMNE/SFRY}$ are around 0.7 times of Yugoslavia. This confirms the previous conclusion that BiH and Montenegro were among the least developed, in terms of GDP, in SFRY.

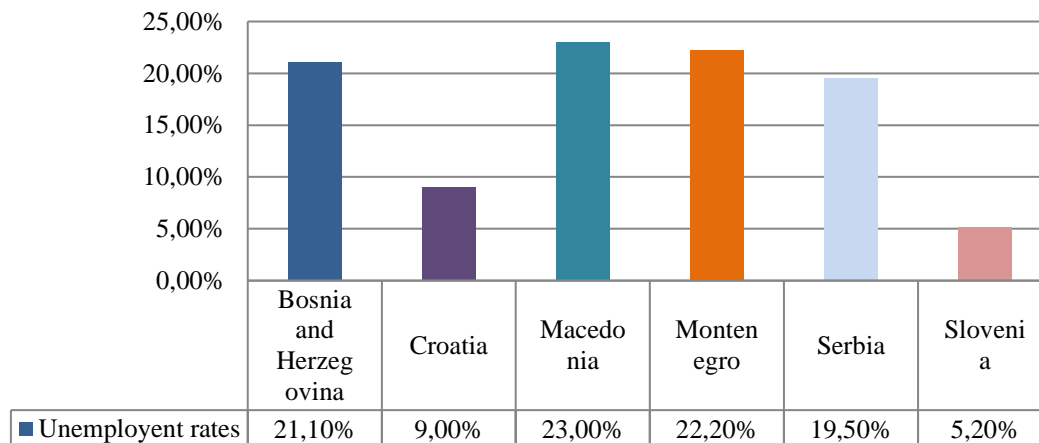
Figure 5. Average value of GDP pc over GDP pc of SFRY in total from 1947 until 1992



Source: Data on GDP of SFRY collected from the Madison Project Database, 2017

In Yugoslavia, according to Štiblar (2013), unemployment was quite an issue. Only Croatia and Slovenia had unemployment rates below 10%, whereas the rest of the administrative units had unemployment rates around 20%. Unemployment rates are presented in Figure 6.

Figure 6. Unemployment rates in socialist republics in SFRY from 1989 until 1990



Source: Data on unemployment rates in ex-Yugoslav countries collected from F. Štiblar, *Economic Growth and Development in Post Yugoslav Countries*, 2013, p.3

To sum up, BiH was among the least developed countries in SFRY according to both GDP and unemployment. However, since economic system was based on central planning where the government also dictated prices between Republics, the question whether they were realistic and did the government, intentionally or not, manipulate the growth and development in the republics could be posed.

2.3.2 Transition in Bosnia and Herzegovina

After Bosnian independence referendum (1992), civil war broke out in BiH and lasted until Dayton Accords were signed in 1995. Most of the data from 1992-1995 is unavailable, but the effects of war can be presented by comparing situation in 1990s and 1995. Domestic authors, Efendić & Hadžiahmetović (2015) summarize the consequences of war: “At the signing of the Dayton Peace Agreement in 1995, compared to 1991 BiH had around 23 percent fewer people, industrial production dropped more than 90 percent, and the unemployment rate was also around 90 percent. Estimated GDP per capita fell from \$1,900 in 1991 to around \$500 in 1995. The total war damage in terms of the replacement costs of productive capacities was estimated in the range of \$15–20 billion, while the overall damage from the war was estimated to be in the range \$50–70 billion (World Bank 1996, 1997). Such an economic collapse in Europe was without precedent since the end of the Second World War.” According to Štiblar (2013) the GDP of Bosnia and Herzegovina decreased to a 15% of pre-war level.

Pugh (2002) claims that per capita GDP decreased to about 20% of its prewar level. Regardless if 15% or 20% is taken as reference point, the level to which BiH declined is astonishing. Despite the fact that GDP started growing rapidly afterwards, especially in 1996, in 2001 economic base was estimated to be only at 50% of pre-war level (Wiese, 2010). According to research by Pugh (2002) this was far less than International Monetary Fund (hereinafter: IMF) projected. The transition reforms, and transition in general, that were implemented in BiH were much slower and less efficient than international institutions predicted. The idea was to establish a market economy, which would along with the democratic setting very soon reach and surpass the pre-war level. However, this equation: *“Democratization + Market Economy = Peace”* did not match Bosnian reality (Tomaš, 2013). In order to establish a market economy, several areas had to be addressed. In order for a market economy to function properly, a stable, enabling business environment has to be created which would support existing and attract new entrepreneurs. A stable business environment should simplify investment and doing business in the country.

Characteristic for BiH was large amount of social property, which was contrary to the concept chosen and had to be dealt with. The process of privatization represents one of the most significant transitional changes. New foundations of the market economy are created through private ownership, increasing productivity of the companies acting in the market. Privatization and spirit of private ownership require liberalization of markets and opening economy up to the rest of the world. This should also be supported by a stable financial sector which should be expanded and further developed. All previously mentioned things are interrelated and complement each other. Unfortunately, processes were either incompletely implemented or poorly conducted (Tomaš, 2013). Dayton Accords were inappropriate as tool in economic sphere, they served as political tool in prevention of further bloodshed, but in economic sphere they were completely inadequate. Majority of companies in BiH were social, communal ownership², economic life was highly politicized, which contradicted the idea of market economy. One of the four bullet points above is privatization of state capital, as one of the key concepts in moving BiH closer to being a market economy. The model of privatization which was chosen in BiH i.e. voucher schemes and transferring ownership to workers via these vouchers was inappropriate. The model was subject to corruption and led to war profiteers and criminals obtaining shares in large companies, which were then pieced and sold for equipment and construction sites. Instead of rising once great companies from the ashes, they ran them further into ground (Pugh, 2002). According to Tulić (2013) more than 90% of companies were not successfully privatized.

² Merriam Webster Dictionary, 2017 defines communal ownership as the ownership of land or other property by a community so that each member has a right to use the property or a portion of it, Oxford Dictionaries, 2017 define social ownership as a form of collective ownership in which the control and organization of an industry, company are shared, especially by its workers or by the community at large,

Instead of everyone being better off after the privatization, majority ended up being worse off. The blame is to be found in both people who managed the process of privatization and those who took the companies over. The explanation can be found in corruption in general and corruption in privatization process. Instead of expanding and building the companies, new “managers” looked for their own benefits and self-interest.

The core of the inefficiency and discouragement of the transition process is the fact that Dayton Peace Accords ended the war, but did not bring the peace. Neither of the two sides was fully satisfied with the outcome and the result was a dysfunctional, decentralized state. Tomaš (2013) identifies two forms of moral hazard in BiH: the important role of international community in the transition process and independence of public administration spending in BiH with the economic conditions in the country. Most of the reforms were pushed forward by these international institutions; there is almost no authentic reform initiated and implemented by local authorities. Majority reforms were and are still being brought in exchange for financial aid or membership in international organizations (EU, NATO, CEFTA and similar). The existing local institutions were inapt to successfully carry the transition process out. Country such as Bosnia and Herzegovina and in a political turmoil, in which it is, since 1990s, required much stronger institutions.

As Tomaš (2013) sums it up: “However, inefficient privatization, poorly managed system of foreign investments, undefined economic system, inadequate foreign-trade policy and lack of vision of development led to the collapse of entire areas of production. Spontaneous structural adjustments proved to be the most expensive form of adaptation, accompanied by serious consequences in social and political spheres.” Bosnia and Herzegovina has decreased to a 15-20% of pre-war level in 1995; in 2001 it has reached 50% of pre-war level and GDP in 2011 amounted to 80% of the GDP in 1990s. Basically, in 2013 Bosnia and Herzegovina has not yet reached the pre-war level (Tomaš, 2013). Majority of transition countries reach and surpass the pre-transition GDP level in the first five years of transition. In the case of BiH in eight years after end of the war, the country has not managed to catch up with Republic of Bosnia and Herzegovina. The first set of post-war, transitional reforms has been brought and with weaker success than expected, having BiH lagging behind its old self and its neighboring countries. As Tomaš (2013) put it, Bosnia and Herzegovina and its citizens have been experiencing various types of crisis for years. People have grown so used to it, that we accept the “crisis mode” as the normal one. Hard life, low standard of living, political and other instability, poor infrastructure, inefficient state apparatus, inefficient administration, low standard of public services, breach of rights, corruption, failure of the system over and over have become part of everyday life.

The question could be posed if Bosnia and Herzegovina has finished with its transition process or should it have finished given results of the transition process?

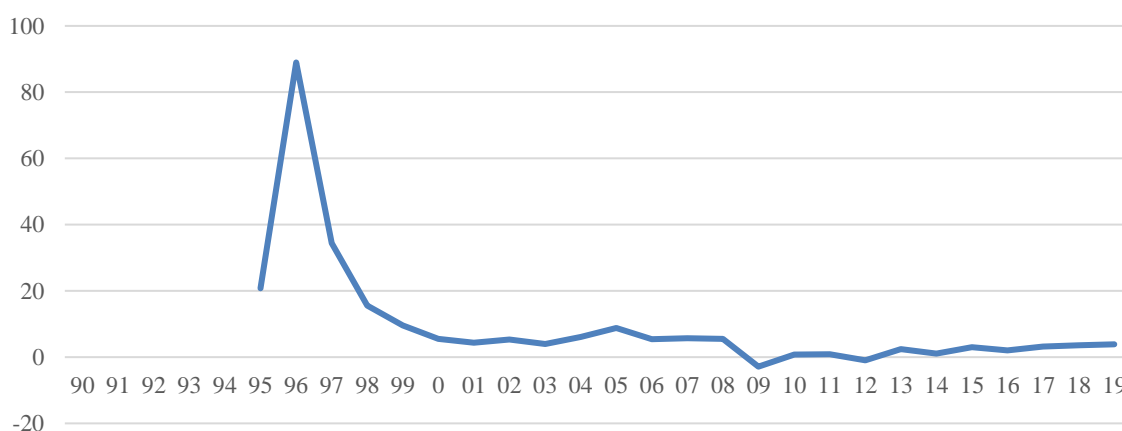
2.3.3 Development of Bosnia and Herzegovina until today

To present the development of BiH until today, several subchapters have been created. The analysis is started with macroeconomic environment and main determinants including GDP, inflation, stability of the currency and the arrangement introduced removing option to manage monetary policy, imports and exports, investments in the country and from the country, as well as review of public debt. The analysis continues with presentation of labor market in Bosnia and Herzegovina. People are the heart and soul of a country and they are the ones leading country either forward or backward. The impact of war, both short-term and long-term, is first presented, followed by consequences on human capital. The gap between labor supply and labor demand as the most prominent issue in labor market is also addressed. Unemployment, especially youth unemployment is mentioned and presented in numbers, which are concerning. This paragraph ends with education and mishaps in this area. The chapter is concluded by analysis of business environment in BiH. Competitiveness of the country is analyzed, followed by presentation of data on corruption by Transparency International and concluded by Doing business parameters for Bosnia and Herzegovina on starting a business, getting various permits and enforcing contracts.

2.3.3.1 GDP and other macroeconomic characteristics

As previously mentioned, in 2013 BiH has not yet reached a pre-war level in terms of GDP per capita. In words of many authors, the situation was and still is “dire”. In the years after war GDP started growing vigorously, especially in 1996, reaching a growth rate of almost 90%. However, BiH had only reached a 50% of prewar level in 2001. The growth rates of GDP declined after 1996, stabilizing to around 5% in the following years and to around 3-4 % in last decade or so (Wiese, 2010). The growth rates are presented in Figure 7 along with growth rates projections for 2017-2019.

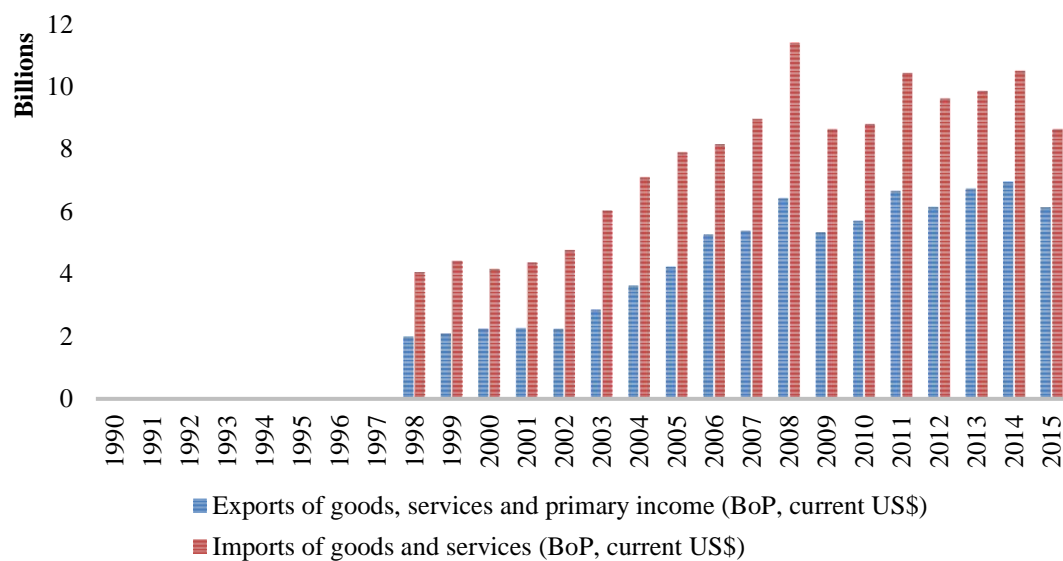
Figure 7. GDP growth rates of Bosnia and Herzegovina from 1990 until 2019



Source: Data on GDP growth rates of BiH collected from World Bank (2017); IMF (2017); Directorate for Economic Planning of BiH (2017)

What can be noticed is that growth rates in 1996. were around 90%, which is not unusual for post war countries. The growth rates stabilized, falling to around 5% prior the global financial crisis in 2008. BiH as a small economy is highly susceptible to global changes and trends, both positive and negative. According to the World Bank (2017) the recorded GDP growth rate in 2015 was around 3% and around 2% in 2016. Figure 7. also presents the average of projections of real growth rates for 2017-2019. The average was taken from three sources: World Bank (2017), IMF (2017) and Directorate for Economic Planning of Bosnia and Herzegovina (2017). The differences among the three sources are negligible and may have arisen due to a stricter approach or a looser approach. It is expected that real GDP growth rates will grow at a rate 3-4% annually. Relatively low growth rates of GDP can also be linked to large imports. Figure 8 presents the size of imports and exports in Bosnia and Herzegovina from 1990 to 2016. For years now, BiH has been importing more than exporting. Not only placement on foreign markets is low, the coverage of domestic market is extremely poor. Instead of pushing domestic production primarily on domestic market and “blocking” foreign products, protecting domestic actors in the market, more and more is imported.

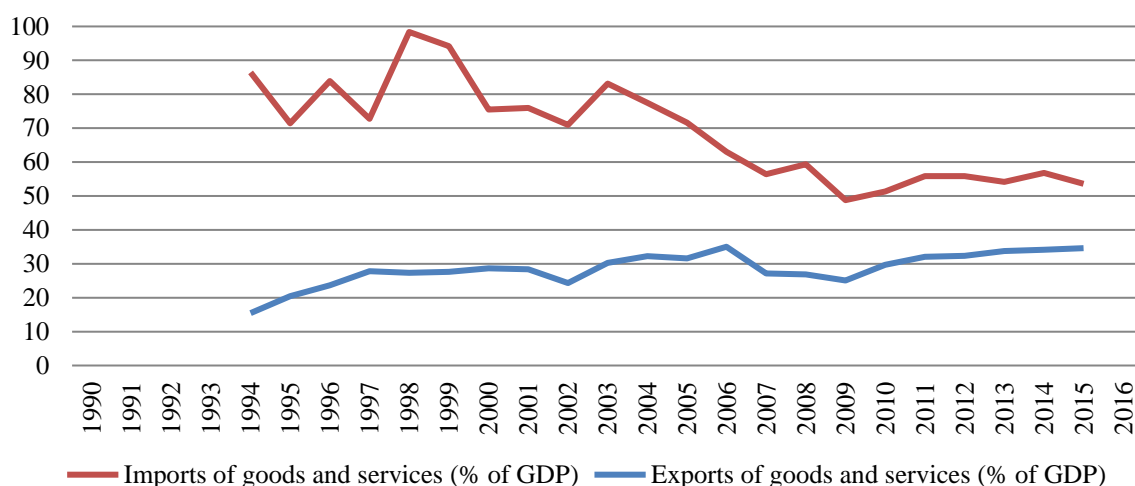
Figure 8. Imports and exports of goods and services of BiH from 1990 until 2016



Source: Data on exports and imports of BiH collected from World Bank database, 2017

Figure 9 presents imports and exports as percentage of GDP. Additional graph is provided to point to the relevance of the size of imports and exports, not only in absolute terms as in Figure 8., but also in relative, in terms of GDP, in Figure 9.

Figure 9. Imports and exports of BiH (as % of GDP) from 1990 until 2016

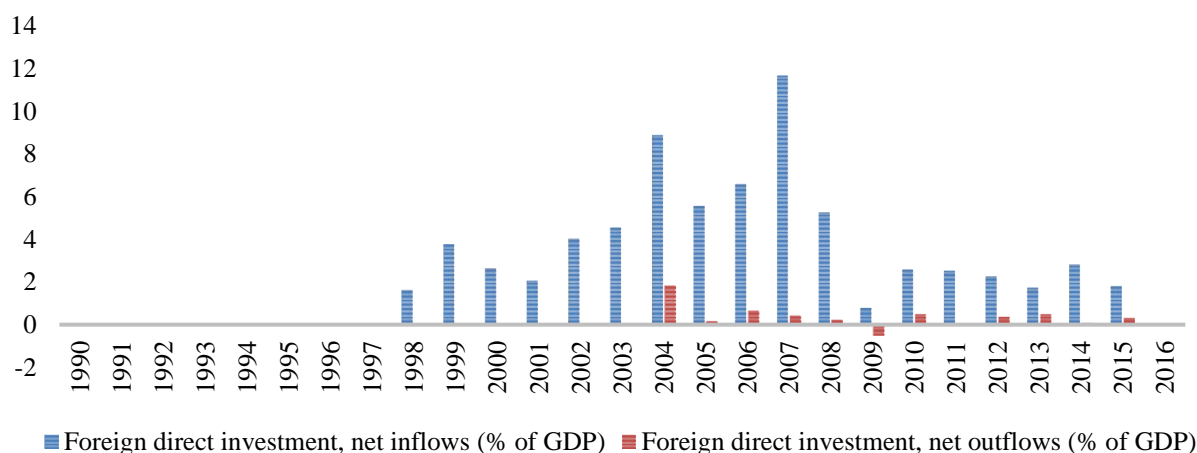


Source: Data on exports and imports of BiH collected from World Bank database, 2017

The recorded rate of imports as % of GDP in 1994 was around 86%, while in the same period recorded rates of exports as % of GDP were around 15%. The difference is huge, but not unnatural for a war recovering country. However, in 2005 imports were at level of around 70% and exports around 30%. Despite doubling of exports, imports still remained quite high. Last recorded data is for 2015, with imports amounting to around 50% of GDP. Even more concerning fact is that exports (as % of GDP) are increasing at almost insignificant pace. In 20 years or so the exports have barely doubled, and remain at level of around 30% of GDP. Currency Board Arrangement, provides BiH with a relatively stable currency and also protects from currency risk. Importers and exporters do not have to manage exchange rate risks which are brought on by appreciation/depreciation or revaluation/devaluation. For circumstances in Bosnia and Herzegovina, linking BAM to EURO seems to be working. Low inflation and currency stability is what I would point out as the advantages of this arrangement.

Despite relatively stable macroeconomic environment, and the fact investors are protected from currency risk, FDI levels have been moderate to low in the past 20-30 years. Figure 10 shows entire FDI inflow/outflow from 1990 to 2016. FDI flows are recorded from 2008 onwards. What can be noticed is that net outflow of FDI is in general negligible and that it is showing downward trend. Bosnia and Herzegovina has no FDI attraction strategy and it is visible from amount of FDI inflow and outflow. A peak of FDI inflow was in 2007 when it amounted to a little bit over 11% of GDP. Since then FDI has had a decreasing trend and in 2015 recorded FDI inflow level was little below 2% of GDP as recorded by World Bank (2017). The situation with FDI outflow is even worse, the peak was in 2004 with 1.8% of GDP. In 2015 recorded FDI outflow was below 0.5% of GDP. Presumption is FDI outflow recorded in 2004 and today are either real estate in neighboring countries or financial instruments purchased as method of saving.

Figure 10. FDI inflow and outflow of BiH from 1990 until 2016



Source: Data on FDI flows in BiH collected from World Bank database, 2017

Public spending in BiH is problematic and inefficient. According to IMF (2015) public spending on wages and consumption of goods and services accounts for circa 55% of current expenses in Bosnia and Herzegovina. World Bank Group (2015) confirms percentage of around 50% of GDP on public sector expenses. The average expense on these items by Western Balkans countries is 38%.

Despite higher expenditures than some western countries, BiH does not have public services that match these high expenditures. BiH ranks second in the region, in terms of size of public sector, following Croatia. The state apparatus is significantly bigger than of more advanced emerging European countries. Compared to Macedonia and Albania which in 2013 spent an average of 5% on wages in public sector, BiH in the same year spend around 12%. Social assistance spending is lower in BiH than among its peers; but within the social assistance sphere there are significant differences. In some aspects such as health care or non-contributory social assistance BiH stands out, whereas in some such as education, pensions and labor market is at the margin or even below the regional average (IMF, 2015). The composition of BiH's public expenditures is unique in its inefficiency, with extremely high expenditures on wages and consumption, leaving very little for other components.

Regardless of high public expenditures, debt levels of BiH are still bearable and are increasing at a moderate pace. Table 2 presents the percentage of public debt to GDP for ex-Yugoslav countries, along with their rankings given this criterion. According to WEF Global Competitiveness Report 2016-2017 public debt in 2015 in BiH was 45.5% of GDP, which compared to countries in surrounding, is not as severe. BiH, along with Macedonia has the best ranking i.e. is in the lower group of countries concerning indebtedness. Serbia has a public debt level of 77.40% of GDP, ranking it 111th out of 138 countries. Croatia is ranked even higher, 118th out of 138 countries, with debt level of 87.70% of GDP.

Compared to two mentioned neighboring countries BiH, with debt level below 50% of GDP, is still holding relatively well.

Table 2. Public debt as % of GDP and ranking in ex-Yugoslav countries

BiH	Croatia	Macedonia	Montenegro	Serbia	Slovenia
45.50%	87.70%	38.60%	66.40%	77.40%	83.30%
64th/138	118 th /138	48 th /138	97 th /138	111 th /138	114 th /138

Source: Data on public debt in ex-Yugoslav countries collected from WEF Global Competitiveness Report 2016-2017

The ratio of government debt to GDP of BiH does not exceed the reference point of European Union (hereinafter: EU) Convergence criteria of 60% (European Central Bank, 2017). Basically, according to this criterion Bosnia and Herzegovina could become member state of the European Union. Government budget deficit, recorded by WEF Global Competitiveness Report 2016-2017 was 1.4% in 2015, which is below the Maastricht criteria of 3% of GDP. Macroeconomic environment in Bosnia and Herzegovina is relatively stable, given other circumstances. As far as access to financing is concerned, access to loans and money was limited when needed the most. BiH does not have a developed capital market in terms of access to financing. The central role in terms of financing and access to financing is attributed to banks. Capital market is underdeveloped and extremely small in scope and number of financial instruments.

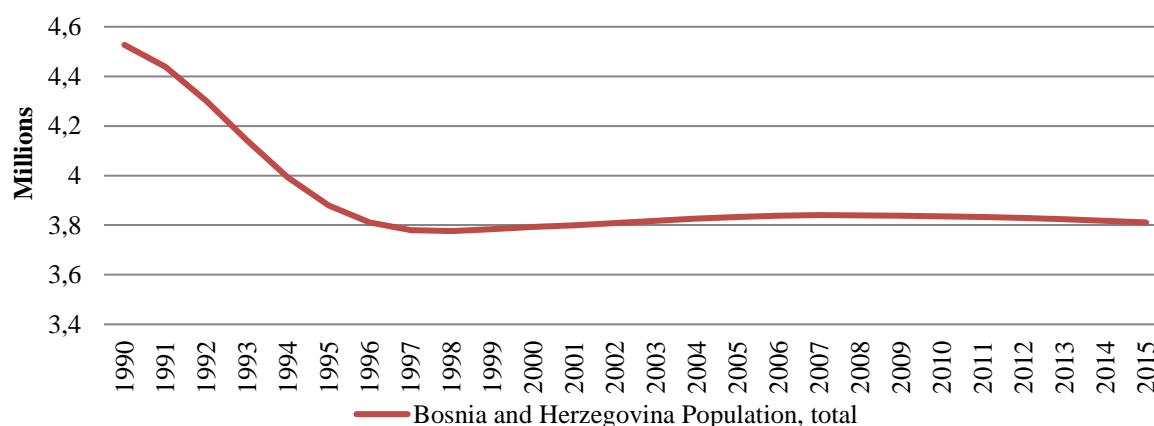
The data from WEF Global Competitiveness Report 2016-2017 report a level of financing through local equity market at 2.7 out of 7 with a decreasing trend. Along with this, regulation of securities exchanges is evaluated at 3.2 out of 7 with a decreasing trend, confirming the leading role of banks in entire Bosnia and Herzegovina. Not surprisingly, capital market organization is multi-layered with stock markets in Sarajevo and Banja Luka. Capital market is badly coordinated and non-functional. In 2012, according to World Bank (2017) only 743 companies in entire Bosnia and Herzegovina were listed at the stock markets. According to the official data from Sarajevo stock exchange and Banja Luka stock exchange turnovers in 2016 were around BAM 755 million and around BAM 625 million, respectively.

According to World Bank (2017) interest rates on loans in 2002 were almost 10% and less than 4% on deposits. In order for economy to recover and factories and industry to be built and rebuilt, enormous amount of money is needed. Due to high risk of potential loaners, many had to give up or look for different ways. The loan rates in couple of past years have been stabilizing and have fallen to under 5%. These high interest rates and limited access to money could also explain the underdevelopment of local economy.

2.3.3.2 Labor market

Again, GDP is not the only measure that should be considered when presenting development of a certain country, especially BiH. Besides fall in GDP and evident loss to economy of BiH, immense damage to land and cities has been made. The extent of damage to material resources of BiH was beyond first recognized in the post-war period. The data on minefields in 2017, Research by Mine Action Centre (2017) of BiH, suggests that safety of around 15% of population, circa 545 thousand, is still endangered by explosive devices. But damage to material resources can be disregarded to extent of the permanent impact to human capital. Stiglitz and Greenwald (2014) emphasize the importance of human capital in creation of learning economy and dynamic learning society. Most of the people in BiH went through a certain trauma in the war period: either they were injured themselves, lost someone close or lost their homes. Capabilities of the people who suffered four years in war cannot be compared to capabilities of those same people in the prewar period. Capabilities of generations brought up in the war cannot be compared to a normal upbringing child's capabilities. Large number of people decided to flee and to stay in various developed countries and to build their lives there instead to return (Tomaš, 2013). According to Federal Ministry of Displaced Persons and Refugees (2011) more than 2.2 million people have been misplaced out of BiH. Figure 11 presents the population movements from 1990 onwards. Based on the data of 1991 Census Republic of BiH had around 4.3-4.5 million of people. First and last census since has been undertaken in 2013. According to state Agency for Statistics (2013) BiH had 3.5 million of inhabitants in 2013. In 20 years or so population decreased for approximately one million people. The number of people lost in war and displaced has yet not been exactly determined; but the presumption is that around one hundred thousand people were killed and around two million have been displaced. Population of BiH is among the fastest shrinking and ageing populations in the world (World Bank Group, 2015).

Figure 11. Population of Bosnia and Herzegovina from 1990 until 2015



Source: Data on population of BiH collected from World Bank database, 2017

According to Balkan Insight (2010) research conducted in 2009, over 1.75 million citizens of BiH may suffer from symptoms of Posttraumatic stress disorder, which influences their everyday life and lives of their children. Research was conducted only in Sarajevo, and out of 1.000 people surveyed, 909 lived under the siege. World Bank (2017) on net migration are recorded only for years 1992, 1997 and 2002 with net emigrations of approximately 750 thousand, 160 thousand and 35 thousand people. We should keep in mind these are net migrations, number of people also returned after end of the war. The data on emigration of tertiary educated inhabitants are recorded only for years 1990 and 2000. 23% out of all tertiary educated people emigrated in 1990 and 20% in 2000. BiH has been losing its human capital constantly even 20 years after end of the war. Birth rates have fallen significantly, while death rates have increased. Presumption is that young people are reluctant to start their families due to uncertainty and fear for their future and the future of their children.

According to the last estimate, unemployment in BiH was almost 43%. World Bank (2017) recorded that 90% of unemployment is long-term unemployment. World Bank Group (2015) evaluated that only 1 in 3 working age adults has a job, only 1 in 4 has a formal job and out of these formal jobs around one half is in the public sector. Around 35% of public expenditures in 2014 were reserved for payrolls of employees in public sector, whose number in 2011 amounted to 135 thousand in BiH. The most desirable employer in BiH is the state, since it provides long-term employment (extremely well protected employees) and higher payrolls. Contrary to most countries in Europe where state is the “least desirable employer”, since less risk equals lower payroll than in private sector, in BiH it is the opposite. According to recorded data by Ekonomski Institut Sarajevo (2015), BiH is second, immediately after Palestinian areas, in regards to inactivity of population. Two thirds of working age population in BiH is inactive, meaning not employed or not looking for a job at all. Hence, labor mobilization is quite an issue in Bosnia and Herzegovina.

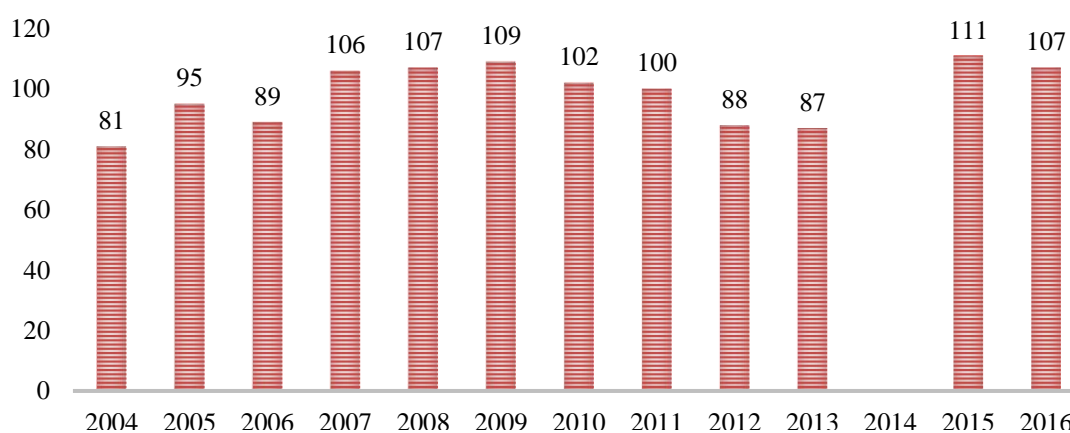
Special attention should be given to youth unemployment, which is among the main causes of extreme brain drain. According to the Union for Sustainable Return and Integration in BiH data (2016) around 80 thousand people have emigrated BiH since 2013. Not only individuals are emigrating, but entire families move to different countries. Situation in BiH is a vicious circle in which one thing affects several others, enabling individual aspects to prosper. Youth unemployment is an issue, which is further deepened by discrepancy between labor market and education. According to IMF (2015), only 5% of GDP is spent on education in BiH. The amount itself is not much lower than that of BiH’s peers; however, the fragmentation and 14 ministries of education make it much less efficient than among the neighboring countries. There are duplications of provisions and the amount of 5% is spread out on too many sides, leaving none attended. The structure of education spending explains inefficiency. More than 80% is spend on wages, leaving less than 20% on system development and needed resources.

Some countries focus on vocational training, overcoming the gap between labor market demand and education supply. Unfortunately, practical experience has been declining in trend in BiH. Education sector in the country does not supply the skills and competencies needed in the labor market, both domestic and international. This persistent problem is not solved by vocational trainings and practical experience, making it a rooted problem.

2.3.3.3 Business environment

WEF Global Competitiveness Report 2016-2017 defines competitiveness as the set of institutions, policies, and factors that determine the level of productivity of an economy, which in turn sets the level of prosperity that the country can achieve. In order to assess a country's competitiveness and business environment, a so called Global Competitiveness Index³ was created. According to WEF Global Competitiveness Report 2016–2017, BiH is ranked 107th out of 138 countries in the sample, with GCI of 3.8 out of 7. International Institute for Management Development (2017) does not have data for BiH recorded and BiH is not among the sample countries in their competitiveness rankings, so WEF reports will be used. The changes in WEF rank from 2004-2016 can be reviewed in Figure 12. What can be noticed is the worsening situation of BiH: in 2012 rank was 88 out of 144 countries and today Bosnia and Herzegovina has fallen almost 20 places behind. Essentially, BiH was ranked higher in 2004 than it is today. Overall index is comprised of 12 different indices (pillars), which are based on 114 indicators. In order to understand the score of 3.8 out of 7 in 2016 for BiH, individual indices by pillars are presented in Figure 13.

Figure 12. GCI rankings of Bosnia and Herzegovina from 2004 until 2016

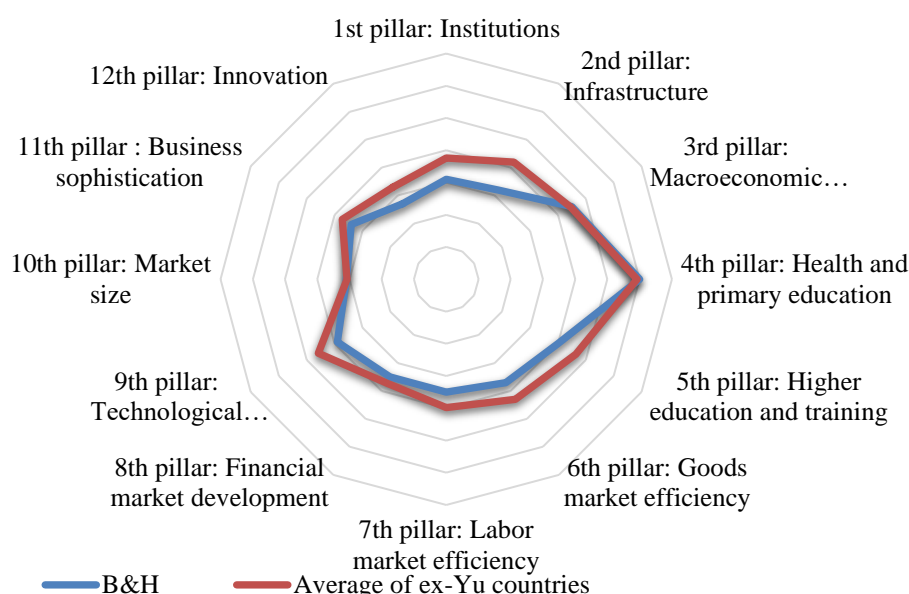


Source: Data on GCI rankings of BiH collected from Federal Institute for Development Programming (2016), Competitiveness Bosnia and Herzegovina 2016-2017, p. 17

³ Global Competitiveness Index covers 12 pillars and 114 indicators that capture concepts that matter for productivity and long-term prosperity. GCI scores from 0 to 7, 0 being the lowest and 7 being the highest value.

Figure 13 also presents the average value⁴ of all 12 pillars for ex-Yu countries. Values of pillar indices are: Institutions (3.1/7), Infrastructure (3.2/7), Macroeconomic environment (4.5/7), Health and primary education (6/7), Higher education and training (4.0/7), Goods market efficiency (3.7/7), Labor market efficiency (3.5/7), Financial market development (3.5/7), Technological readiness (3.9/7), Market size (3.1/7) and Innovation (2.7/7).

Figure 13. GCI individual pillar values 2016-2017 for BiH and ex-Yu countries



Source: Data on GCI pillar values on BiH and ex-Yugoslav countries collected from WEF Global Competitiveness Report 2016-2017

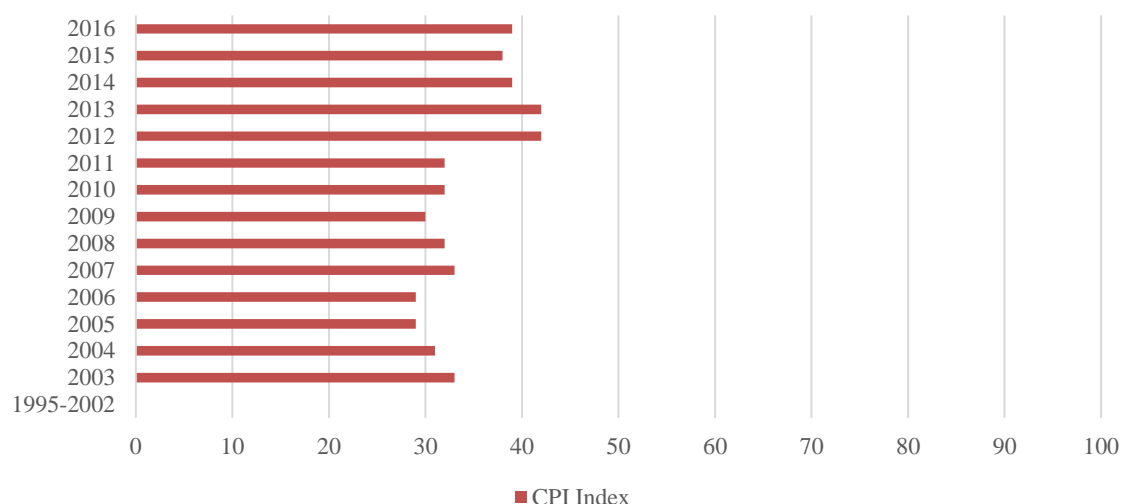
Institutions pillar is ranked 126th out of 138, with value of 3.1 out of 7. The institutions are on far lower level than is expected and justified by war that happened over 20 years ago. What can be noticed is that average of ex-Yu countries is not much higher on this account, signaling institutions were inherited from the “old” system. Reminiscence of socialist institutions seems to persist with large inefficient bureaucracy on top. According to number of authors, bad institutions seem to persist and represent a rooted problem.

World Bank Country Policy and Institutional Assessment Indices (2017) indicate that little has changed throughout years; average score of indices is around 3.6 out of 6. The most problematic factors for doing business according to WEF Survey (2017) are: inefficient bureaucracy, corruption and government instability which is in accordance with previous.

⁴ Individual pillar values were added up and then merely divided by five (number of countries) to get the average score of ex-Yu countries, BiH excluded. The average value was taken due to simplicity in comparison and due to high number of indices to be compared.

Figure 14 presents the Corruption Perception Index by Transparency International (2017) for BiH since 1995 until 2016. The index ranges between 0 and 100, 0 being highly corrupt and 100 being very clean⁵.

Figure 14. CPI Index of BiH from 1995 until 2016 by Transparency International



Source: Data on CPI index values on BiH collected from Transparency International CPI Reports 1995-2016

What can be noticed is that very little has changed/improved in BiH regarding corruption in the past 15 years. Data prior to 2003 are unavailable. The score in 2003 was 33⁶, whereas in 2016 the score value is 39. In 2003 BiH ranked 70th-76th from 133 countries and in 2016, 83rd out of 176 countries.

Comparison of Bosnia and Herzegovina to neighboring countries is presented in Table 3.

Table 3. CPI Index 2016 of ex-Yugoslav countries

BiH	Croatia	Macedonia	Montenegro	Serbia	Slovenia
39/100	49/100	37/100	45/100	42/100	61/100
83rd/176	55 th /176	90 th /176	65 th /176	72 nd /176	31 st /176

Source: Data on CPI index values in 2016 for BiH and other ex-Yugoslav countries collected from Transparency International CPI Report 2016

⁵ For years from 1995 until 2011 index ranged between 0 and 10, with 0 being highly corrupt and 10 being extremely clean; for purpose of comparison these values have been pondered (merely multiplied with 10) to range from 0 to 100 and be comparable with 2012 onward values

⁶ Original CPI value was 3.3 (range 0-10)

BiH and Macedonia are the most corrupt among the six, with close values of 39 and 37 respectively. They are followed by Serbia with score of 42 and good 10 places ahead. Difference can be noticed in Slovenia, which was under strong influence of Western countries and more developed than the rest and hence good 10-12 point above best of the rest and 20 places or so ahead. Scores on corruption in most ex-Yugoslav countries are generally high and are among the top problems for doing business listed in WEF Executive Opinion Survey 2016 in WEF Global Competitiveness Report 2016-2017, even for Slovenia.

Another problem present in all aspects of life in BiH is bribery. According to World Bank (2017), reported bribery incidence in terms of % of firms facing at least one bribe payment request in 2013 was 10%; namely 1 in 10 firms (according to the official data) faced at least one bribe request. What about unreported requests and paid bribes? Bribery is not only present in business world, but in education and schooling, health institutions and government offices as well. Such high level of reported and most likely even higher level of unreported bribery can be explained by administrative inefficiency and sluggishness of officials.

Infrastructure index is raised by quality of electricity supply and fixed telephone lines otherwise it probably would have been lower. The value is again below the score of ex-Yugoslav countries. There are no large investments in infrastructure in Bosnia and Herzegovina, roads are being fixed and not rebuilt, which can be noticed in transport of goods and people.

Macroeconomic environment pillar has value of 4.5 out of 7 and BiH is ranked 76th out of 138 countries. Despite relatively stable macroeconomic situation, there is a possibility index is overvalued since some sectors perform extremely well – creating a false image, whereas others are on the verge of failing. The index value is slightly above the average of ex-Yu countries. Individual characteristics of macroeconomic environment were explained previously.

Health and primary education GCI is 6.0 out of 7, but enrollment rates in primary education are 97.5% making the index much higher and above the average of ex-Yu countries. The explanation is mandatory primary education is in Bosnia and Herzegovina, hence such high rates. Health provision is provided, since BiH has remnant of Yugoslavian social state, but the quality of health care is questionable at times due to previously explained complexity and duplication.

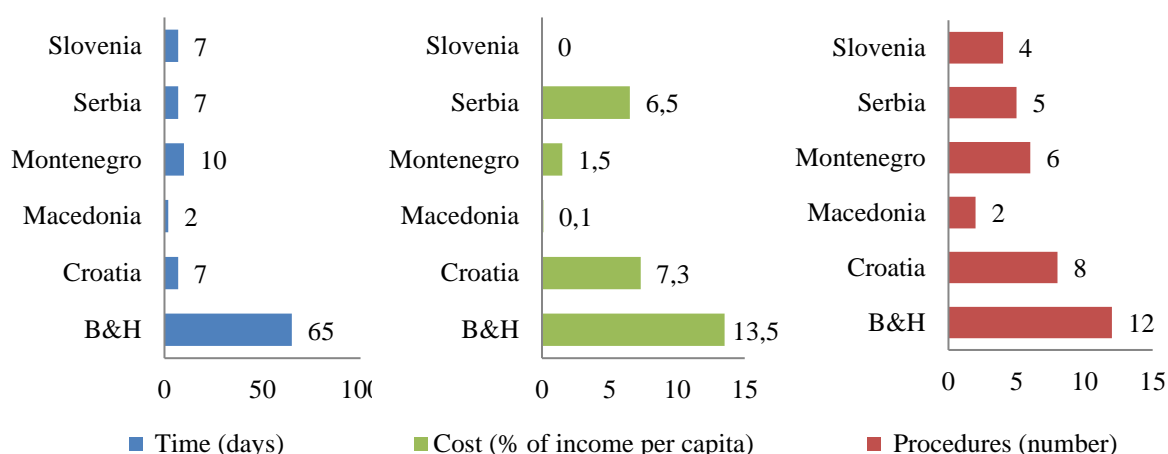
Despite the score of 4.0 out of 7 on Higher education and training, detailed analysis of the index, shows that quality of education scores 2.5 out of 7 which is extremely low and that enrollment rates in tertiary education are below 50%. Educated people are not specialized for industry needs, creating an issue of structural unemployment.

Labor market is not efficient, WEF Global Competitiveness Report 2016-2017 assigns score of 3.5 out of 7 to GCI index for labor market and there are extreme limitations for employers seeking employees and consequences for firing people, which makes most employers hesitant to hiring. Labor market is inflexible and restrictive. Individual characteristics of education and labor market environment were explained previously.

Goods market efficiency pillar ranks BiH 129th among the sampled countries. Bosnia and Herzegovina is a small market and according to GCI, domestic market size index is 2.8 out of 7 compared to 3.9 out of 7 foreign market size index. Imports are higher than exports, signaling we are importing values and tastes as well, rather than exporting. Business Sophistication Index is 3.4 out of 7, with local supplier's quantity and quality at values of 4.0 out of 7. These values are moderate, however size of import of BiH is much higher than size of export which signals that suppliers are mostly internally oriented and despite higher than average quality and quantity, they do not provide the necessary push to the industry to move globally. As far as competition is concerned, intensity is 4.5 out of 7 according to GCI. Despite the fact that suppliers and firms are not internationally and globally strong, the within country competition is quite strong. As far as home demand conditions are concerned, the average net monthly payroll in Bosnia and Herzegovina, according to the last published data, is circa € 436 (BAM 853,00). Average pension paid out in February 2017 is circa € 190 (BAM 373,64). Given these are average, not lowest payrolls/pensions, we can with certainty conclude that buyers in BiH are not sophisticated, nor demanding. Even better said, majority of them is not since they cannot afford to be. For most buyers, price is the determining factor, since their living standard does not allow for more than that. Buyer sophistication, according to GCI is 2.1 out of 7 with downward trend, confirming what was mentioned previously.

Based on the data from Doing Business (2017) profile on Bosnia and Herzegovina it takes around two months and 12 procedures, along with approximately cost of 13% of income per capita in Bosnia and Herzegovina to start a business in the said country. Compared to previous, it takes eight days, five procedures and approximately cost of 3% of income per capita in OECD high income countries. Not only it's more demanding and takes longer, starting a business is more expensive in Bosnia and Herzegovina than in OECD countries. But given level of development of BiH compared to OECD high income countries, results are not surprising. More appropriate comparison is to the ex-Yugoslav countries, given shared history. Figure 15 presents an overview of ex-Yugoslav countries in terms of starting a business in 2017. Macedonia requires two days, two procedures and cost of 0.1 % of income per capita. Bosnia and Herzegovina is by far the worst regarding number of procedures, time needed to start a business and cost, even compared to the neighboring countries i.e. ex-Yugoslav countries.

Figure 15. Doing business 2017 overview for ex-Yugoslav countries



Source: Data on doing business parameters on BiH and other ex-Yugoslav countries collected from individual country profiles on Doing business website, 2017

This might explain high presence of shadow economy in BiH. Presumptions are that it was over 30% but that it is decreasing with years. Legal right index score is 7 out of 12 (World Bank, 2017) and the time required to enforce a contract is around 600 days according to Doing Business (2017), with cost amounting to circa 36% of the claim making it infeasible to pursue this road. WEF Global Competitiveness Report 2016-2017 score on efficiency of legal framework in settling disputes is 2.7 out of 7, confirming low efficiency.

As most of the Europe, BiH has a bank based system and financial market is not as developed as overseas in the States. The index of financial market development is very close to the ex-Yu average. Banks are abundant in capital and are offering loans and competing among each other, lowering interest rates in BiH and making capital affordable to more people. In 2015, Ease of access to loans indicator was 2.0 out of 7 compared to 4.0 out of 7 in 2016 signaling positive changes have occurred in this area.

According to WEF Global Competitiveness Report 2016-2017 BiH scores 3.9 out of 7 on technological readiness, making it 76th country in the sample of 138 countries. Technological readiness is defined as adoption of technologies by individuals and businesses. There has been an increase in Firm level technology absorption and Internet users as % of population. BiH has progressed circa 30 places, in first, despite a small increase in index value (0.1). Most likely firms in BiH are becoming more advanced and improving learning capabilities. IT sector has become quite developed and a lot of foreign firms outsource in BiH. The number of Internet users as % of population has been increasing, especially in 2016, but this could also be attributed to the structure of the population and job requirements. However, in terms of FDI and technology transfer, BiH has been losing its place. Presumably due to political instability and perception of unsafety.

As far as Innovation is concerned, again we come across the legislative issues and the stability in country. Potential for innovation and innovations themselves are present, but what lacks is (government) support. The costs of innovations and applications for patents are too high and even when they have potential, it is often not recognized. Or, it is recognized by foreign investors – leading again to brain drain and pushing BiH back in the vicious circle.

Besides purely economic factors and indicators, Ranking of Happiness has been taken into consideration. According to the World Happiness Report (2017), BiH ranks 90th out of 155 countries and we were happier in 2014-2016 than in 2005-2007. Index encompasses GDP per capita, social support, healthy life expectancy, freedom to make life choices, generosity, perceptions of corruption and Dystopia. Bosnia and Herzegovina scores 5.182 out of maximum 10, only slightly above Macedonia and most important component of happiness in Bosnia and Herzegovina is social support. A complete comparison with ex-Yu countries is represented in Table 4.

Table 4. Summary of world happiness report rankings for ex-Yu countries

BiH	Croatia	Macedonia	Montenegro	Serbia	Slovenia
5.182/10	5.293/10	5.175/10	5.237/10	5.395/10	5.758/10
90th/155	77 th /155	92 nd /155	83 rd /155	73 rd /155	62 nd /155

Source: Data on happiness index of BiH and other ex-Yugoslav countries collected from the World Happiness Report 2017, Figure 2.2. Ranking of Happiness 2014-2016

WEF Global Competitiveness Report 2016-2017 provides classification of countries in terms of stages of development. There are five stages identified: stage one where factor-driven economies are placed, next stage is identified as transition from stage one to stage two, stage two where efficiency-driven economies can be found, followed by a transitional stage to the final stage of innovation-driven economies. Summary is given below:

1. factor-driven economies (35 economies),
2. transitional stage to efficiency-driven economies (17 economies),
3. efficiency-driven economies (30 economies),
4. transitional stage to innovation-driven economies (19 economies),
5. innovation-driven economies (37 economies).

Out of 138 countries, 35 are classified as factor-driven economies. Transitional phase to efficiency-driven economies numbers 17 countries, whereas 30 countries are placed in the actual stage of efficiency-driven economies. Majority of countries in sample, 37, is in final stage, innovation-driven economies, whereas 19 are in process of transition to the final stage.


BiH is in the 3rd stage, along with Serbia, Macedonia and Montenegro. Croatia is in transitional stage to innovation-driven economy, whereas Slovenia is already there. Characteristic of an efficiency driven economy is improvement of production and production processes, along with higher product quality. Competitiveness of an economy is driven by 5th, 6th, 7th, 8th and 10th pillar⁷. For an economy to move to an efficiency-driven economy, 11th and 12th⁸ pillar have to be highly developed to be able to sustain the standard of living imposed by high wages. Production processes are at the highest level in this stage of development (WEF Global Competitiveness Report 2016-2017).

The data on BiH is limited, especially for first post-war decade. Global sources do not provide data on education expenditures, undernourished population, employment in different industries etc. Local data sources are, to say the least, limited and have to be thoroughly checked for accuracy and reliability.

2.4 SWOT analysis of economic situation in BiH today

2.4.1 Strengths

Table 5. Strengths of Bosnia and Herzegovina

SWOT matrix	Summary of main strengths
<p style="text-align: center;">Strengths</p> 	geographical position: in the hearth of Europe
	proximity and acquaintance with SEE markets
	access to sea: Neum and proximity to port Ploče
	natural resources (water, wood, minerals, soils etc.)
	relatively stable macroeconomic environment
	soundness of banks 4 out of 7
	stable currency (Currency Board Arrangement); €1 = BAM 1.95583
	S&P: B/stable outlook; September 9, 2016
	Moody's: B3/stable outlook; February 26, 2016
	industrial tradition
	not too high/moderate public debt level (45.5% of GDP)

Source: SWOT matrix on BiH created using data from WEF Global Competitiveness Report 2016–2017, Doing Business country profile (2017) and Agency for Statistics BiH Thematic bulletin 03 (2017)

⁷ 5th pillar: higher education and training, 6th pillar: efficient goods markets, 7th pillar: well-functioning labor markets, 8th pillar: developed financial markets, 9th pillar: the ability to harness the benefits of existing technologies and 10th pillar: large domestic or foreign market.

⁸ 11th pillar: business sophistication, 12th pillar: innovation

Strengths are summarized in Table 5. The geographical position of BiH continues to be the strength from mediaeval times until today. The country is located on the Balkan Peninsula, in the hearth of Europe with access to sea and neighboring Serbia, Croatia and Montenegro. Country has a history of trade with neighboring countries and similarities in both languages and tradition. It is abundant in natural resources, especially water and land/forests. Its soil is favorable for agriculture and it's more than abundant in pastures and grasslands. Current trend in the world is "return to the nature", which makes BiH, also very interesting for nature tourism. Macroeconomic environment is relatively stable; country is subject to strong external shocks such as 2008 crisis but will not give up due to any shock. Explanation of stability of macroeconomic environment was given in the previous paragraph with moderate inflation, acceptable public debt and normalizing interest rates. According to WEF Global Competitiveness Report 2016-2017 banks are stable and sound; they score 4 out of 7. The interest rates have stabilized and access to financing is much more affordable and easier to get than in previous years.


Currency Board Arrangement fixes BAM to Euro and since all BAM have to be covered with equivalent amount of Euro in Central Bank of BiH currency is relatively stable and country is no subject to currency depreciation/appreciation or devaluation/revaluation. Public debt level, mentioned previously, is still not worrisome, it is below 50% of GDP meaning we are still not "in over our heads".

Previously mentioned signalizes that BiH is relatively stable and that, despite what may seem, is suitable for investment and industry. Standard & Poor's (S&P) and Moody's evaluated credit rating of B and B3 respectively, with stable outlook (Central Bank of BiH, 2017). BiH has an industrial tradition. In the previous paragraph some of the Bosnian giants were mentioned, which were present and known in the entire world. People who worked and managed those companies were Bosnians, so tradition and potential is there.

2.4.2 Weaknesses

Weaknesses should be carefully addressed to avoid becoming a permanent vulnerability. Summary of weaknesses of BiH is presented in Table 6. The state apparatus in Bosnia and Herzegovina is among the least efficient in the world and probably among the most expensive ones. The numbers and amount of money required to sustain administrative organization of BiH is astonishing. Most of the budget money, gathered from taxes and levies is spent on sustaining this apparatus. Previous paragraph on doing business in Bosnia and Herzegovina, explains the inefficiency of existing bureaucracy and consequences it has on FDI inflow and investment in general. First three bullet points in the weaknesses part of SWOT matrix are interrelated and correlated. Political and administrative organization on several levels requires enormous state apparatus, which is inefficient due its size and disorganization.

Table 6. Weaknesses of Bosnia and Herzegovina

SWOT matrix	Summary of main weaknesses
<p>Weaknesses</p> 	inefficient government bureaucracy
	expensive and inefficient state apparatus
	political and administrative organization (3-4 levels of government)
	high unemployment level (around 0.5 million people)
	high skilled workforce unemployment level (around 35% of registered unemployment)
	high youth unemployment
	discrepancy between labor market demand and supply of work force
	weak access to financing for new companies/startups
	unfavorable business climate
	weak national competitiveness
	obsolete infrastructure, remains from SFRY
	poor privatization & poor investment in Research & Development

Source: SWOT matrix on BiH created using data from WEF Global Competitiveness Report 2016–2017, Doing Business country profile (2017) and Agency for Statistics BiH Thematic bulletin 03 (2017)

Unemployment, especially youth unemployment, which is an issue hardly addressed in BiH. A couple of years ago this was a problem, today it is a pressing matter due to percentage of young people leaving and growth in numbers with each year. Brain drain is a sore spot for BiH, mainly attributed to high youth unemployment and lack of perspective and support for young people. According to WEF Global Competitiveness Report 2016-2017 scores on capacity to retain and attract talent are below 2 out of 7. Registered unemployment is around half a million people, as reported by Agency for Statistics of BiH (2017), out of which around 35% are highly skilled people. The worst fact regarding the gap between supply and demand of labor is that it is hardly recognized and no solution is being sought for. Number of students is decreasing and many young people are turning to various information technologies academies instead of faculties, due to simpler admissions and ability to obtain degrees faster. This allows them to access the labor market sooner.


Despite the fact access to financing has been improved and interest rates have decreased, access to financing for startups still remains an issue. Banks are their only option, due to underdevelopment of financial markets in this sense. Unfortunately, banks recognize most of startups as too high risk. Even if loans are approved, they are too expensive and not suitable for startups. The problem at hand is non-existence of meeting point of investors and inventors, a place where people who need money and have money can meet. Lately, several organizations have been created to supports startups and help them find financing and overcome the first obstacles they encounter. One of the most famous is Networks doo Sarajevo, which organizes various events supporting young companies.

Unfavorable business climate was explained in previous paragraph into great detail. According to Doing business (2017) starting a business requires 12 procedures and 65 days. In addition to this, infrastructure is obsolete and investment in e.g. highway is taking too long and is tied up too much procedural activities.

2.4.3 Opportunities

There are many potential opportunities Bosnia and Herzegovina can capitalize both locally and globally, given its strengths. Opportunities are summarized in Table 7.

Table 7. Opportunities of Bosnia and Herzegovina

SWOT matrix	Summary of main opportunities
<p>Opportunities</p> 	favorable investment opportunities → new industries (innovation in BiH, but not in the EU/world)
	infrastructure from SFRY
	low taxes (10% income and personal income tax)
	low taxes and contributions on wages
	low inflation levels (around 1% annual change)
	BiH diaspora/emigrants (transfers 10-11% of GDP back to BiH; (Systematic Country Diagnosis, World Bank Group, 2015)
	Muslim population and landscape attractive to Arabic and Muslim world
	nature tourism (mountains, hills, sea, waterfalls, hiking and cycling trails)
	city and village tourism (historical heritage; indigenous way of living)
	human capital; creative, adaptable and language proficient work force
	access to European funds
	FDI: strategies to attract FDI
	Reform Agenda 2015-2018

Source: SWOT matrix on BiH created using data from WEF Global Competitiveness Report 2016–2017, Doing Business country profile (2017) and Agency for Statistics BiH Thematic bulletin 03 (2017)

BiH has been lagging in European and world trends. American eBay, now multinational, was founded in 1995 and has been growing ever since. BiH Pik.ba, a platform similar to eBay, but on local language and for local market(s) was founded in 2009 and was a huge success. The platform was success due to its inventiveness and novelty. In reality, it was merely a novelty in Bosnia and Herzegovina, known to the world decade and a half prior to that. There are number of such opportunities that could be started in Bosnia and Herzegovina and have been started in the last several years. IT sector in BiH has been booming because BiH companies managed to capitalize on trend of outsourcing with quality services and low(er) costs.

Despite being obsolete, infrastructure from ex-Yu still exists and can be used, with improvements of course. Railway, for example leads through entire BiH and could be used both for passenger and cargo transport. Not only would it reduce traffic and number of vehicles on roads, it would increase connectivity within the country and decrease number of traffic accidents. For example, Sarajevo has developed tram line throughout almost entire city. Several months ago, a project was presented to switch powering of trams to solar power supply, which would not only power trams but also allow for sale of extra power generated in this way. It still remains to be seen if anything comes out of this idea.

Taxes and contributions are relatively low in BiH. Current profit tax is 10% without additional dividend tax upon payment of the profit to the owners. Overall income tax is 10% regardless of the income height. This signalizes favorable investment opportunities, and with good FDI strategies BiH could become one of the top European investment countries. In addition to this we have a large number of agents abroad. What is meant by agents is the diaspora. More than 2.2 million people have been misplaced in war and a great number of them stayed in countries they emigrated. A lot of these people are successful and willing to invest in BiH, but are either uninformed or afraid of being cheated out of their money. Recently a program Diaspora for Development i.e. D4D has been started to help diaspora invest in BiH, which should prove to be beneficial to the both parties involved.

Tourism is one of industrial branches that was not taken seriously in BiH. We are abundant in mountains, hills, sea, waterfalls, acres and acres of forest. Hiking and cycling are becoming more popular every day; introduction of hiking and cycling trails could do wonders for our country at favorable prices. Same can be applied for skiing and winter sports. Besides abundance in natural resources, a large part of population is Muslim and entire BiH has around 700 hundred mosques (“Broj džamija,” n.d.). This and increased accessibility to the country has been attracting Arabs and inhabitants of other Muslim countries.


Another opportunity is the Reform Agenda 2015-2018, which if properly implemented should overcome the obstacles and create a healthy business environment for both national and international players in the market.

2.4.4 Threats

Threats are summarized in Table 8 and further explained in the paragraph. Too little is being done regarding marketing and perception of BiH in the world. Instead of creating a positive image of the country in the world, by our media and people in general, a worrisome and dire perception is constantly pushed to the world. We should not be surprised people perceive BiH as high-risk area, when media constantly write about political conflicts, turmoil, illegal referendums and division in the country.

There are success stories, young people that should be example to us all but too little is being said about them and their effort is too little appreciated. Number of people is leaving this country, even if they could find jobs.

Table 8. Threats of Bosnia and Herzegovina

SWOT matrix	Summary of main threats
<p>Threats</p> 	perception of country as a „high-risk“ area
	political instability
	brain drain i.e. emigration of young, educated people
	discrepancy between supply and demand of labor
	corruption
	low tax compliance
	weak contract enforcement
	large shadow economy
	inflexible labor market policy
	insufficient perception on preservation of the environment and natural resources
	weak innovation support despite moderate innovation capacity
	Reform Agenda 2015-2018

Source: SWOT matrix on BiH created using data from WEF Global Competitiveness Report 2016–2017, Doing Business country profile (2017) and Agency for Statistics BiH Thematic bulletin 03 (2017)

People are leaving because they feel undepreciated, because they are fed up with political nonsense and strife. I believe the political situation and instability to be the largest of all threats for BiH, due to consequences it has had and will have. People in Bosnia and Herzegovina have a tendency not to appreciate what they have, namely natural resources and breath-taking environment. The amount of garbage in the rivers, lakes and on the mountains, is shameful. The threat is that potential BiH has for nature tourism, will be eradicated due to pollution and litter.

All of the mentioned bullet points are ones endangering business environment in Bosnia and Herzegovina and pushing investors away. Most of these are addressed in Reform Agenda, meaning they have been recognized as a threat and danger, which is the first step. Remains to be seen if the Agenda will be properly implemented and whether these problems will be eradicated. Reform Agenda is also put here as a threat due to its scope and various areas it covers. The threat of the Reform Agenda in this sense is the potential incapability of Bosnia and Herzegovina to bring forth these reforms.


3 INDUSTRIAL POLICY IN BOSNIA AND HERZEGOVINA

Assessment of industrial policy in BiH is introduced by main development goals of BiH. In order to understand industrial policies and to assess if they are beneficial to the economy or not, a direction in which the economy wants to go should be known. Hence, development goals of BiH are first presented, followed by an analysis of policies in the past and now.

3.1 Main development goals

Central goal of BiH is the admission to the EU. Despite divided opinions on the topic, admission to EU would require many things to change in the country in the scope of both politics and economics. Development goals are summarized in Table 9, with problems identified and goal aimed at achieving.

Table 9. Development goals of Bosnia and Herzegovina

Problems	Goal	
low policy making at state level	Harmonization of BiH single economic space, single labor market, single country	 EU ADMISSION
only few state-level institutions		
no coordination (mechanism) between entities		
poor information exchange within country		
no cooperation between entities		
poor economic performance	Economic growth increase in standard of living, reduction of unemployment	
weak industry and production		
high unemployment		
unviable and unproductive public sector		
low exports, high imports		
disabling business environment	Competitive BiH With good business climate more competitive economy regionally and globally, more investment and more industry	
non-competitive economy		
unattractive to investors		
slow and inefficient administration		
corruption and bribery		
weak accountability	Transparency and accountability higher level of confidence in the state, higher participation and interest	
poor monitoring		
weak enforcement		

Source: Table created using UNDP Assessment of development results: Bosnia and Herzegovina (2009); USAID Country Development Cooperation Strategy 2012-2016 (2012); Reform Agenda for Bosnia and Herzegovina for period 2015-2018; personal opinion of author of the thesis

Economic growth, harmonization of BiH, creation of competitive BiH with good business climate and transparency and accountability were identified as four main development goals of BiH. The goals were identified based on the problems recognized in the country. Development goal of harmonization is extremely important since this is identified as a constant impediment to development in number of areas, including economic progress (UNDP, 2009). BiH, as a small economy, can only progress as a united country and can only succeed in European and world market as such. With creation of a single economic space and a common labor market, aim is to increase productivity and production overall. By simplifying doing business and eradicating factors that impede business climate in BiH goal is to increase competitiveness. All four goals are interrelated in a similar way all problems are interrelated and correlated. Without removal of fragmentation and harmonization of Bosnia and Herzegovina, economic progress cannot be attained. Without economic growth and upgrade of production, country cannot become more competitive. In turn, without creation of a more favorable business climate and harmonization, there is no economic growth. A good business climate cannot be attained without transparency and accountability.

Membership in the European Union is identified as a key driving factor, a single central goal to which Bosnia and Herzegovina strives. After identification of main problems and development goals in Bosnia and Herzegovina, an analysis of industrial policy in BiH is presented in the following paragraph.

3.2 Industrial policy in Bosnia and Herzegovina

Explaining industrial policy in BiH is a challenging task. Country so divided and with so many levels of rule and government encompasses wider area of research than a “regular” country. Due to previously mentioned, the focus will be either on a state or entity level. This section is divided into industrial policy in the past, industrial policy now and industrial policy in the future. What is meant by industrial policy in the past is post-war period until few years ago, now is the period from 2015 onwards i.e. the Reform Agenda 2015-2018 and future period is the period after implementation of Reform Agenda 2015-2018. First period in the sense of industrial policy (past) lasted for quite a long period of time. This can be explained by longer than average transition process of Bosnia and Herzegovina, which was less successful than predicted. In 2015, with the idea of Reform Agenda for Bosnia and Herzegovina 2015-2018 a “new” period has started. A number of policies and changes have been prepared and designed, which will be thoroughly presented in the following chapters. The Reform was pushed forward by international community and is envisioned to tackle the major issues in BiH and in researcher’s opinion this is the first real set of industrial policies in Bosnia and Herzegovina. As far as the future period is concerned, namely period after implementation of Reform Agenda, an opinion on success of the Reform Agenda is presented.

3.2.1 Industrial policy in the past

The carrier of an industrial policy in each country is the Government. For a stable and successful industrial policy to be brought government also has to be stable and successful, as well as united. In framework set by Dayton Accords anything but successful and stable government was set, enabling the possibility of successful industrial policy and overall progress. “One of the costs of reaching this peace was creation of fragile state with dysfunctional economy” (Portland Trust, 2009). Ever since Dayton in 1995, international community has been present and involved in BiH. Aim in the post-war period was to ensure smooth transition process and overall progress and prosperity in the country as soon as possible. The World Bank, IMF, EBRD and other international players, along with several locals, decided that BiH needs to shift to system of a market economy. The state is to remain important, but the role of the state needs to change. The state should provide stable and healthy macroeconomic conditions maintain a strong institutional and legal framework and supply basic public goods and social assistance to its citizens. Given majority of capital in Republic of BiH was “socially owned” one of the most important processes in shifting to market economy was privatization - creation of private capital and replacement of state-socially owned with privately-owned capital. Strategy chosen to be pursued to attain economic growth of BiH included besides rapid privatization, also dissolution of socially/state owned companies, reform of the banking sector, development of SMEs, light industries and the service sector (Portland Trust, 2009).

Table 10. Overview of the industrial policy in the past

Industrial policy goal	Brief explanation of actions and achievements	
Privatization	voucher, mass privatization process	privatization quotas were never fulfilled, most privatizations unsuccessful, millions lost and stolen in poor process
Dissolution of state owned companies	transfer to privately owned companies, shift focus to private ownership	unsuccessful, most of the conglomerates were ruined and are still state owned
Currency board arrangement	BAM was firstly pegged to German mark, later pegged to EUR	No monetary policy, stable currency and stable macroeconomic conditions, spillover of shocks from EU
Trade	within country trade was not liberalized until mid-1998, opposed to sort of a free trade arrangement with neighboring Serbia and Croatia	trade developed across borders (Serbia and Croatia) rather than within
Foreign direct investment	structure of the FDI was inadequate, focus on consumption rather than production development	did not boost job creation, nor the industrial capacity of BiH
Development of services sector	developed and still is the dominant sector in the country	moved unnaturally to a service oriented economy, skipping deindustrialization, lacking in industry and production development

Source: Table on industrial policy of BiH in the past created using The Portland Trust, Economics in Peacemaking: Lessons from Bosnia and Herzegovina (2009)

Given the scope of the socially/state owned companies process of privatization is taken as an example of attempt of industrial policy in BiH in the past. Also, privatization has been the core policy throughout BiH since 1997. Although the Privatization Agency Law was adopted in 1996 in Federation of BiH, which predicted creation of cantonal privatization agencies, it was not until mid-1999 that they started operating. The privatization method chosen was voucher, mass privatization process despite shortcomings shown in other transition countries. The process was started with privatization of small and medium enterprises via voucher schemes. The idea was to prepare and continue with privatization of large enterprises via tender process. By May 2003 around 78% of small enterprises in FBiH and around 55% in Republic of Srpska have been privatized. Over one thousand out of one thousand and 850 large enterprises have been privatized in the same way as small and medium i.e. mass privatization. 440 large enterprises have been intended for tender privatization. The idea of tender sale to serious investors entails restructuring of these companies, making everyone better off by expanding production, promoting exports and hiring more people. Until 2003 only 19 enterprises have been privatized in such way (15 in FBiH and 4 in RS). There was resistance to this type of privatization due to concern for employed workers and local communities. In FBiH in period from 1999-2007 only 53.2% of state capital was privatized, out of which only 9% was actually paid for (rest paid by certificates). Out of 746 companies intended for privatization only 335 firms (44.9%) was privatized via public auctions. Only 56 foreign investors were attracted, with around 20% of total FDI registered in FBiH. Employment of only 55,767 workers was secured, which is around 13,9% of all employed people in FBiH, end of 2007, (World Bank OED, 2004; Ekonomski Institut Sarajevo, 2008).

Instead of being guided by economic development and successful transition to market economy, which would enable increase of efficiency and profitability of the company through private ownership, privatization policy in BiH was guided by selfish incentives of individuals to get rich. The measures undertaken by government were inadequate and had poor results overall. In addition to this, investors were discouraged by unstable legislation, unclear ownership rights and huge debts of companies. During the privatization process there was a lot of wandering in proper dealings, which led to number of companies ruined. Also, there was no controlling process, which allowed companies to be sold at lower prices, allowed new owners to resell machines and equipment etc. Most of the privatization quotas were never fulfilled and large number of companies in BiH is still state owned. Bosnia and Herzegovina is among the five lowest performing transition countries (out of 27) in terms of privatization, as well as in governance and restructuring of said companies. Fabrika Duhana Sarajevo, Tobacco Company was only recently privatized and sold to a foreign multinational company, whereas BH Telecom, largest mobile operator in FBiH is still majority owned by the state (World Bank OED, 2004; Ekonomski Institut Sarajevo, 2008).

The choice of Currency Board Arrangement for BiH has so far, shown to be a moderate solution, due to macroeconomic stability. But Bosnia and Herzegovina had to give up monetary policy for this stability, for what there is no saying if it was a good or a bad decision. There was no real injection with FDI; country leaders were too busy arguing to guide it. FDI and all injections and help programs were used to boost consumption, not production. Instead of building capacity of country to produce, to restore infrastructure, the funds were directed elsewhere. Production, manufacturing and real sector is second to consumption and services, which is largely to blame on unsuccessful privatization. Cooperation and labor mobility between entities is limited; instead of promotion of unity constant discord is pushed. All of the potential industrial policy measures and development strategies presented in Table 10 are incomplete and designed by international players, imposed on local authorities and political leaders.

A question is posed where does the relevance of Dayton Peace Accords lie in economic (under)development of Bosnia and Herzegovina and lack of successful industrial policy in the past and now?

A politically instable, fragile state with dysfunctional economy was created with Dayton Accords along with an overcomplicated system with state and government structure that is constant obstacle to growth and progress. Unsuccessful privatization process, destroyed state owned conglomerates, wasted FDI and aid funds, lagging country competitiveness, focus on imports rather than exports are all consequences of unsuitable compromise and choice of recovery strategies by foreigners. Bosnia and Herzegovina seems more like two countries than part of a single country. Dayton Accords remained permanent solution despite its initial purpose. Many fear if one Article changes, all comes tumbling down so it continues to remain in power in the original writing from 1995. With such, politically instable country, where main topic and issue is nationality and friction between two entities and three constituent nations, economic policy and industrial policy keeps getting lost.

3.2.2 Industrial policy now

As explained, the period of now is presumed to have started in 2015 with notion of Reform Agenda in Bosnia and Herzegovina. The overall situation in the country is complex, moreover since the country is lagging behind in all areas and along with that running out of money. “The promise of great economic rewards from joining EU, has given the EU an effective “carrots and sticks” regime through which they can condition aid and enforce reforms.” (Portland Trust, 2009). 2016 and 2017 are characterized by number of new laws on taxes, labor force, contributions, profit and income. Bosnia and Herzegovina is a member state for EU and currently we are in the process of filling the questionnaire, which represents overall insight in political, legal, social, economic and administrative system of the country.

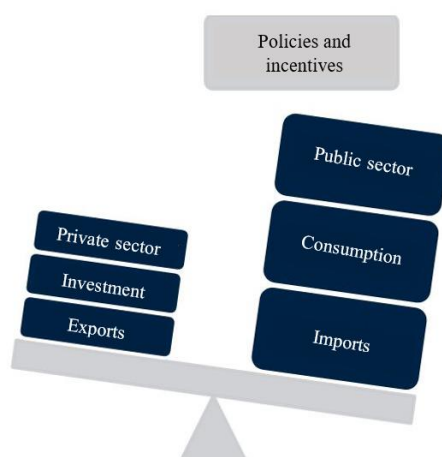
This Questionnaire poses a concern for politicians in both Entities since it reveals number of flaws and necessary corrections in all scopes of the system. Reform Agenda 2015-2018 is one of the initiatives of European Union pushed forward to BiH. The Agenda is directed at all weak points of Bosnia and Herzegovina, but due to bad press and lack of information or the public, the Agenda has a negative connotation. Despite being good for the economy of Bosnia and Herzegovina it is perceived as just another trick by politicians. The full scope of the Agenda is presented in the following paragraph.

Reform Agenda is specific and meaningful for Bosnia and Herzegovina due to several reasons. It encompasses six wide areas of importance, tackling most problems BiH has both internally and globally. Also, this Agenda requires actions on “all levels of government”. “All levels of government” include state, entity and cantonal levels of government, requiring unity. Set of social and economic reforms proposed by the reform is aimed at creating a better fiscal and legal framework for both domestic and foreign investors. There exists an urgent need recognized by all levels of government to rehabilitate the economy of BiH. Obsolescence has become a normality, which cannot remain so and modernization of economy is a must. The aim is to ensure steady and sustainable economic growth, reduce unemployment and increase employment, especially address youth employment, re-organize social assistance making it more appropriate and all in all create an encouraging and supportive environment. Main goals are:

- to strengthen the rule of law,
- to cope with corruption,
- strengthen administrative capabilities,
- to increase efficiency in public institutions.

The Reform Agenda was created in cooperation with international institutions and the EU. The Agenda is related to new approach to economics in the Balkans. Economic reforms as foundations of overall structural reform in order to encourage macroeconomic stability and enhance competitiveness and economic growth. The road of Bosnia and Herzegovina to the European Union depends highly on this reform and its proper implementation. There are also some attempts to amend the Constitution brought by Dayton Peace Accords and to simplify the current organizational structure of the country, but so far unsuccessful (Reform Agenda for BiH 2015-2018). Problem identified in Bosnia and Herzegovina is presented in the Figure 16. A misbalance exists that needs to be rooted out and scale needs to tip over to the other side; private instead of public sector leadership, investment rather than consumption and exports rather than imports. Focus of the entire economy needs to change.

Figure 16. Unbalanced scale of Bosnia and Herzegovina



Source: E. Ferguson, *Growth, jobs and fairness: The Reform Agenda*, 2015.

Given problems identified, the Agenda comprises six wide areas of importance:

- public finance, taxation and fiscal sustainability,
- the business climate and competitiveness,
- the labor market,
- social welfare and pension reform,
- rule of law and good governance,
- public administration reform.

Each of the areas encompasses number of policies and measures to improve the overall area, all in aim to create a supporting business and social environment. An overall restructuring is occurring, with medium and long-term measures and prospects. The Reform is aimed at introduction of enabling role instead of disabling role which the state had until now. Both broadband and horizontal measures are being introduced, in order to create stable and supporting macroeconomic environment. There will be sectoral policies introduced, especially in the labor market. As mentioned previously, the aim is to enhance competitiveness and growth of the entire economy. Further on, reflection on each of the six key sectors will be done.

3.2.2.1 Reform Agenda: public finance, taxation and fiscal sustainability

Problem recognized by international community in this area are essentially too high public expenditures. Despite the fact public debt is still moderate compared to neighboring countries; composition of public spending is problematic, as explained in previous paragraphs. Rising public expenses opposed to too low public revenues can lead to fiscal unsustainability, which is an additional problem this country does not need.

Tax compliance is low since people do not trust the system and are fed up with inefficient administration. According to UNDP (2009) confidence in authorities, at best, has been expressed by two thirds of the respondents, with an overall downward trend to circa 50% of population. Add to that poorly managed and unviable state-owned enterprises, a general dissatisfaction with this area is concerned. Health sector is in constant crisis due to rising costs and inability to cover all levels of government and ministries. Table 11 presents the set of proposed measures and actions in this area of Reform Agenda, as well as effects. In the scope of public finance taxation and fiscal sustainability, several measures in different aspects have been proposed. The essential idea is to decrease costs and increase revenues; to tip the scale over and achieve fiscal sustainability. Budgets have to be “approved” by IMF and in accordance with this agreement placed and maintained on medium-term fiscal foundation. The goal is to decrease the budget deficit, not only momentarily, but permanently. The essence is the placement i.e. to maintain the budget plan and avoid discrepancies at any cost. The reform of public investment in BiH needs to be carried out.

Table 11. Proposed measures of public finance taxation and fiscal sustainability reform

Proposed measure area	Action	Effects
Budget	placed and maintained on medium-term fiscal foundation in agreement with IMF	sustainability of public debt & stability of public finance
	deficit reduction leading to downward trajectory of public debt level	
Investment	more transparent, prioritized planning and execution	increase in scope and quality of public investment
Revenue(s)	reform of taxation system: increase revenues from consumption taxes, expanding the tax base, reducing tax exemptions	increase in public revenues
	additional potential measure: increase VAT rate	
	public administration reform	
	pension and social welfare reform	
	reducing the shadow economy	
	increase cooperation across tax authorities improving tax compliance	
Cost(s)	reduce government sector in economy	decrease in public expenditures
	limit the payroll level in public sector and make it independent of tax revenues	
	strategies to deal with loss making state owned companies	
Revenues and costs	increase in public revenues & decrease in public expenditures	fiscal consolidation
Health care	reform of health sector: new models and sources of funding	reducing health contributions
	increase in excise on tobacco and alcohol	increase of revenue for health insurance funds

Source: Table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

One of the major issues in entire BiH, at all levels of government, is corruption. The investment process needs to be more transparent and should be carried out in accordance with prepared plan. There has to be a prioritization and a medium-term plan for public investment and detailed cost-benefit analysis of each investment. Ideally, this should lead not only to increase in scope, but also in quality of public investment. In an article by Večernji list (2017), Ambassador of Sweden in BiH, Anders Hagelberg, pointed out that according to the last two status reports, public administration could be much more efficient and that corruption is still wide-spread in BiH. He also emphasized the importance of public administration reform for future, as well as integration of BiH in Europe

Revenues need to be increased. Since tax compliance is really low, this issue should be addressed among the first. A cooperation of all levels of government needs to be increased and unity promoted in entire country. Shadow economy is present in BiH at large, so incentives and promotion of legalization should be introduced. By decreasing shadow economy, not only more revenue will be gathered through increased scope of business, but costs of social assistance and unemployment aid will be reduced. The major challenge is to restore the trust of the people in the system. The plan is to expand the tax base and re-evaluate the tax exemptions, removing the unjustified ones. In case of need, VAT rate will be increased, but initial idea is for it to remain at a current level of 17%.

Costs need to be decreased. Entire public sector has to cut costs and lose people. There are too many people, making the system expensive yet inefficient. Economic expert Vjekoslav Domljan, is of opinion that fiscal mess in BiH needs to be resolved, that public expenditures need to be cut by one third at least and strive to decreasing them to a level of one third of GDP, as opposed to one half of GDP currently. He identifies care over politics as a main cause of high public expenditures, social expenditures dominate over economic ones. In his words, first measure should be relieving public sector of 15% of public officers along with a 15% payroll decrease for remaining employees (“Radeći na reformi javne uprave, Vlada FBiH,” (n.d).

Public enterprises are mostly loss-making enterprises; instead of earning money they are running the public budget to the ground. A thorough evaluation of enterprises needs to be done; those that are “dead” need to be liquidated, those for which government has no capacities to upgrade need to be privatized and for those government decides to keep, a reform in management practices is needed. Payrolls in the public sector have to independent of the amount of money at disposal, in the budget. As long as the state is the most desirable employer in terms of money and conditions, nothing has been done. Pension and social welfare programs are inefficient; all recipients of any kind of compensation from the state need to be re-evaluated and number decreased to those in actual need.

A special attention is paid to the bottleneck of the public spending, health care. The existing system is inefficient and unsustainable, so new models and new sources of funding need to be thought of. As added funding to this sector, excise on tobacco and alcoholic beverages will be directly poured into this budget. The goal is to reduce the contributions on health care, without making severe cuts in their budget, all in achieving final goal of sustainable system with high quality of health care. Head of the Justice and Home Affairs and Public Administration Reform Unit in the Delegation of the EU, Chloe Berger, pointed out the importance of this reform for admission of BiH to the EU. European Commission considers this reform 1 of 3 key foundations, along with management of economic affairs and the rule of law (Večernji list, 2017 & Reform Agenda for BiH for period 2015-2018).

The expected results of measures proposed in Table 10 are fiscal sustainability; sustainable level of public debt; efficient tax system, as well as efficient and sustainable health sector.

3.2.2.2 Reform Agenda: the business climate and competitiveness

Business climate in BiH is disabling and unattractive for investors, both domestic and foreign. Contract enforcement is extremely weak, creating unnecessary risk for entrepreneurs, not allowing them to rely on the system to solve any potential problems they encounter. Banks have a central figure in providing funds, and given their risk assessment risk aversion, access to finance for firms, especially startups, is weak. Weak legislative enforcement and high level of corruption and mistrust in system lead to weak national competitiveness. Administration is over-complicated and inefficient pushing people to opt for illegal entrepreneurship explaining strong presence of shadow economy in BiH.

Inefficient and disabling administration is commonly singled out as one of the main issues. Why has FDI fallen with years despite low labor costs and low(er) costs in general? The answer can be found in number of obstacles put in front of investors. In order to make BiH attractive, investors need to know they are playing on a level playing field and that they can turn to government for assistance. First of all, barriers to investment need to be removed and incentives introduced to promote BiH. Hidden subsidies and assistance to large public companies need to be removed. Creation of false national champions has to be stopped, it has proven to be inefficient mainly. Numbers of large companies are only able to survive thanks to subsidies and assistance from the state organs. Not only is this inefficient, it is demotivating for other actors in the market. Procedures for bankruptcy and dissolution of unviable companies have to be accelerated and simplified. The entire process of starting a business, getting various permits (construction permit in particular) needs to be accelerated. The idea of a one-stop shop was launched in 2017 and some municipalities are working towards this idea. This needs to be implemented on a state level. Another great obstacle to investors, especially foreign, is the notion it can take up to several years to close down a business.

Besides improvement in administration, BiH needs to align its customs policy and quality control with EU, to ease access to European markets to domestic companies. In general, more legislation and directives should be aligned with EU practices. Although financial markets exist, they are second to the banking sector. The overall mistrust and instability in the country, make operating in the financial markets insecure and undesirable. In order for this to change, investor protection needs to be enhanced. This would increase possibilities for venture capital and injection needed to startups. There is no meeting place for inventors and investors, leaving number of startups not launched and investors placing money in banks as deposits. This could also be resolved by public-private partnerships, where the state could act as a silent partner and participate in profit. Domestic companies need to be pushed in infrastructure development, to prevent money spilling over abroad. Management practices and complete re-structuring of public enterprises needs to be undertaken.

Table 12. Proposed measures of the business climate and competitiveness reform

Proposed measure area	Action	Effects
Administration	remove barriers to investment	enhance competitiveness and attract investment
	remove hidden subsidies	
	remove assistance to large companies	
	improve bankruptcy procedures	
	speed up resolution process of unviable companies	
	remove administrative barriers	
	simplify business registration	
	improve efficiency of issue of construction permits	
	improve efficiency of issue of electricity connections	
	reform and simplification of customs policy	facilitate trade
	align national quality control with EU regulations	facilitate exports
Investment	improvement in corporate governance	stronger investor protection
	strengthened risk management practices	
	enhance possibilities for venture capital	
	more efficient insolvency frameworks	
Private sector	promote public-private partnerships	increase revenue
	increase participation of private sector in infrastructure development	increase time and reduce costs
Public sector	reclassification of public enterprises: viable and unviable and dissolution of unviable	reduction in costs
	restructuring & privatization of public enterprises	increase in revenues and efficiency
Financial sector	revive banking sector	improvement in lending practices
	align financial sector legislation to EU directives	increased stability in financial sector

Source: table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

The goal of proposed measures in Table 12 is to achieve a favorable business climate in BiH, for both domestic and foreign investors. The state needs to have a supporting role and investors need to feel and to be protected. By making BiH more attractive for investment, a general competitiveness of country will be increased primarily in the European market (Reform Agenda for Bosnia and Herzegovina for 2015-2018).

3.2.2.3 Reform Agenda: the labor market

Labor market in BiH is weak and given planned reforms in public sector, which have to entail reduction in number of people employed, expectations are it will become more critical. So, labor market requires immediate and extreme measures. Concerning fact is not that unemployment exceeds 30%, but that according to the World Bank (2017), 90% of unemployment is long-term unemployment. Besides that, the gap between supply and demand of labor is huge. Schools and faculties are producing excess work forces for over-saturated markets for years now. There is no planning in schooling and medium and long-term analysis of needs of the market. Labor market is inflexible, making employers hesitant to hiring in fear of being cheated by the employees and sued. Legislation is inconclusive and hampers employment on both sides; for employers and employees.

Table 13. Proposed measures of the labor market reform

Proposed measure area	Action	Effects
Costs	decrease of social security contributions	reduction of labor cost
	reduction of labor cost	new investors
		reduction of shadow economy
		reduction of informal employment
	incentives for first time employees	increase of employment
Administration	reform of education system	reduction of gap in the labor market
	medium and long-term schooling planning	
	increase in flexibility in labor market	increase of employment
Legislation	increase inspections	
	increase fines	
	marketing, discouragement of shadow economy and informal employment	
	additional legislation on worker's rights	increase in employment satisfaction
	wage differentiation: skills, qualification, experience and performance based	
	strong discouragement of nepotism and hiring	

Source: Table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

Despite general view that labor in Bosnia and Herzegovina is “cheap”, for domestic companies labor market is not only expensive but also very inflexible. This leads to large number of people working, despite being registered as unemployed. A very popular solution is shadow economy self-employment i.e. majority of carpenters, tailors, bakers and similar work yet are not registered in any way with the government, which treats them as unemployed people. The reform of labor market encompasses reduction in social security contributions in order to reduce labor costs and make employment more attractive. Additional problem is the general mindset. Informal employment needs to be promoted as hazardous for entire country, for all actors in the labor market. According to Federal Employment Service (2017) around 23% of employees in Bosnia and Herzegovina are unregistered. In the words of Mile Ribić, president of the Union of the construction and communal-housing activities of Republic of Srpska, number of unregistered workers is much higher than officially recorded. If entire society judges black market activities, instead of promoting it, with time it will diminish and disappear.

In May 2016, Tax Administration Office of FBiH published a public memo inviting accountants and auditors to report illegal activities and unregistered workers among their clients. In February 2017, they published another memo inviting employers to report their employees, due to “raids” of inspectors, something like a last call (Porezna Uprava FBiH, 2017). Activities have already been started to assist self-employment, subsidies for first time employment and similar. In my opinion, this needs to be lifted to the state level and promote formal employment entirely. Also, barriers to employment and work between entities need to be removed. Discrepancy between legislation in entities and taxes and contributions, makes it almost mission impossible, as stated by Mašić (2013), to hire between entities. What is meant by this is for a company registered in FBiH to hire employees from Republic of Srpska or District of Brčko and vice versa. Inter-entity hiring requires special procedures and a separate payroll and contributions calculation, with certain contributions and taxes remaining in excess (still have to be paid) as overpayment and some have to be paid more due to underpayment. Respecting legislation of one entity very often means breaking the law in the other entities and potential for fine from either of the tax administration officers.

Status of inter-entity employee is a complication for both employee and employer, which explains why it is unpopular and both sides are hesitant to these arrangements (Mašić, 2013). For promotion of country wide employment, this needs to be removed. Instead of promotion of unity and one country, which Bosnia and Herzegovina is, not three separate, a constant strife is created. As long as the labor market is inflexible, informal employment will be present. If a company cannot hire easily seasonal workers and it pays off more to pay a penalty than to deal with administration and complications, problem will persist. Another potential solution to this is to increase number of inspections, increase fines, and perhaps even make them proportional to size of the company.

It is not same for a multimillion corporation to pay a fine of one thousand BAM and for a small, domestic company. Worker's rights need to be protected, but at this point this protection has reached a concerning level. This protection has led to exploitation by the workers. A person on sick leave cannot be fired and there are employees receiving full or almost full payrolls for years without working. On the other hand, courts are so inefficient that the lawsuits against workers in such cases can go on for years. The state refunds only a small portion of the amount paid out (depends on the canton, entity) under condition that sick leave lasts over 42 days and reimbursement is received only for period above 42 days. As stated in the Decision on payroll compensation for temporary inability to work (Canton Sarajevo Health Institute, 2017) the Institute refunds only 80% of the payroll on which taxes and contributions have been paid and cannot exceed 80% of average net payroll in Federation of Bosnia and Herzegovina⁹. Last reported net payroll is BAM 871, equal to circa € 450, meaning a maximum of circa BAM 697 i.e. a little over € 350 is refunded regardless of the payroll amount. In cases when payroll is lower than the average BAM 871, than 80% of that person's net payroll is refunded. Basically, for employers who pay their employees more than the average, they are at an enormous loss when their employees have taken sick leave. Not only they have to employ someone else at their place, they have to pay large sum of money which is not refunded. Given scope of corruption in health care, a large number of sick leaves is unjustified (Reform Agenda for Bosnia and Herzegovina for period 2015-2018).

If measures proposed in Table 13 are implemented properly reduction in shadow economy is expected, which would increase employment and increase state revenues. In addition to that government costs would be reduced due to decrease of social categories receiving social aid. By increasing flexibility in labor market, employment and employer-employee satisfaction would rise, creating a win-win situation in the labor market. This would also push employment of youth to a higher level.

3.2.2.4 Reform Agenda: social welfare and pension reform

It all comes down to costs and sustainability. Existing pension system is unsustainable and paid in contributions cannot cover pensions and other payments required. Number of retired people is growing, along with already high number of military and disability pensions in contrast to stagnating number of employed people and the system cannot sustain itself requiring change to occur before complete collapse.

⁹ Last reported average net payroll in FBiH by Federal Statistics Bureau, 2017

Table 14. Proposed measures of social welfare and pension reform

Proposed measure area	Action	Effects
Administration	reform of social protection financing	reduction in costs and increase in quality (rather than quantity)
	centralized database of all recipients of social aid/protection assistance	
	audits of beneficiaries in order to clear the air out; only those who really need it should remain	reduction in number of people requiring social aid/protection
Legislation	incentives to become active participants in economy	
	resolution of unpaid social contributions	improvement of pension system and sustainability
	reform of privileged pensions	
	reduction of early retirements for high risk occupations	
	introductions of (monetary) sanctions for early retirements	
	introductions of (monetary) bonuses for late retirement	
	development of voluntary pension scheme proposals	

Source: Table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

Social welfare in Bosnia and Herzegovina is reminiscence from Socialist Federative Republic of Yugoslavia, focus was on social aid and everyone being taken care of. Unfortunately, this has largely been misused and led to enormous funds being poured in these aids. Spending on social aid that is not contribution based is close to 4% of GDP and by far the highest in the region (IMF, 2015). A need has arisen to create a centralized database of all recipients of social aid of any kind and to audit these recipients. Only those in actual need should remain among the beneficiaries. This will relieve the social aid program and reduce costs, allowing for quality rather than quantity. For example, reduction of redundant costs could allow for reform of treatment of new mothers in the entire Bosnia and Herzegovina. Currently, new mothers have different treatments in different cantons and entities. For employed mothers who are on maternity leave, the employer is not required to pay anything, by the law. They cannot get fired while on maternity leave, but they do not have to receive any compensation/payroll from the company during the maternity leave. As far as the state assistance is concerned, in Hercegovačko-Neretvanski Canton, for example, a one-time compensation of circa BAM 400,00 is given to new mothers. Imagine a woman receiving a net payroll of one thousand BAM monthly, decreasing to BAM 400,00 monthly in Canton Sarajevo, regardless of size of the previous salary, with additional family member. Or in worse cases, not receiving even those BAM 400,00 in other cantons. Prioritization of social assistances needs to be undertaken. The financing of the pension system has proven unsustainable and new ways need to be found.

The proposed reform of the pension system is to adopt world practices and to introduce a three-pillar system, where:

1. first pillar is mandatory, state owned fund with contributions from gross salary pouring in the fund and financing pensions partly;
2. second pillar is also mandatory, with difference of personal choice of redirecting the funds, in either privately owned or state-owned pension funds;
3. third pillar is a voluntary pillar and represents a private pension fund.

In addition to previous, a calculation of pension funds will be altered and conditions for early retirement, military and disability pensions. Plan is to introduce bonuses for late retirement and penalties for early retirement. The problem in Bosnia and Herzegovina is that there is too much retired people and not enough employed people. Pay as you go system is obsolete and in age-structured country such as BiH cannot sustain itself. Numbers of privileged pensions and conditions to attain privileged pensions are too loose, and need to be a lot stricter. The same goes for early retirement for risky occupations. Instead of offering retirement, a different method can be applied i.e. redistribution of this work force. The aim is to reduce excess costs of pensions and similar payouts and build a system which will not collapse. For current system, a large problem are unpaid social contributions. To move forward, a mess from the past has to be resolved.

A number of unviable companies (mostly socially/state owned), which are in process of bankruptcy for years now, have not been able to deal with the situation of employees. A large number of people is formally employed in these dead companies, with taxes and contributions calculated at the expense of said company, yet not paid due to indebtedness and illiquidity. These companies have been tied up in liquidation and bankruptcy procedures for years, with costs piling up. These employees, to a great extent, have been informally employed, yet are claiming their rights on these taxes and most importantly pension contributions. The complications that have arisen from these situations need to be resolved and stopped, speeding up the procedures or finding a way of stopping claims on pension contributions without actually working and without factories even producing (Reform Agenda for Bosnia and Herzegovina for period 2015-2018).

The expected general result from proposed measures is to have a sustainable pension system, which would enable stability and security, without risk of failing. Reform of social system would ensure quality, not quantity. Instead of mass social aid, those who really need it, would be secured and provided for. Basically, effective, efficient and equitable social protection policies would be present.

3.2.2.5 Reform Agenda: rule of law and good governance

The biggest issue with rule of law is the fact citizens do not have trust in the system. Corruption, nepotism and illegal behavior has become so rooted, that most people opt to avoid using the system in problem resolution. Compliance to the legislation is low, which adds to the mistrust in the system and the law. Criminals and politicians openly disobey the law and still manage to avoid fines and stay „protected“ from punishment, which in turn causes overall non-compliance of legislation. The revolt caused by their behavior has caused general non-compliance and non-respect of the law. Given level of presence of corruption in police forces and government inspectors, system in Bosnia and Herzegovina is rotten. It is not without sense that Latin proverb says: *Piscis Primum A Capite Foetet*; fish stinks from the head. Judiciary system is slow and inefficient, leading to enforcement issues and inability to rely on courts and the state to activate your rights. A vicious circle is created, where a strong push is required to break the circle.

Table 15. Proposed measures of the rule of law and good governance reform

Proposed measure area	Action	Effects
Judicial system	reform of judicial system	faster decisions, without loss of quality & decreased costs and increased efficiency
	disciplinary accountability of the members of judiciary	
	increase efficiency of courts	
	unburden courts from utility cases	
	prohibition of conflict of interest	
Legislation and administration	anti-corruption strategy: prevention and monitoring structures	restore security and trust in the system & reduce crime and corruption
	active measures to decrease corruption	
	reform of police sector	
	encouragement of regional and international police cooperation	
	raise investigations on a higher level	
	tightened legislation on confiscation of property	
	tightened legislation on money laundering	
	counter terrorism strategy and action plans	
	alignment of money laundering and financing of terrorism with EU regulations	

Source: Table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

The most urgent matter in this area of reform is the judicial system. Citizens are reluctant to turn to the government, due to sluggishness and inefficiency of the courts.

There are no separate industry courts, making industrial disputes infeasible. If someone owes you a certain amount of money, you would think twice before going to the court. In the end, it is possible that lawyer fees and court taxes are higher than the debt itself and the questionability of collection still remains. Most companies in BiH are limited liability companies, meaning owners are held liable only up to their share in capital¹⁰. The worse that can happen is their companies go bankrupt and their private property remains untouched. Court efficiency needs to be increased by bringing measures that would simplify procedures for straight forward cases. Also, conflicts of interest in courts need to be eradicated by introducing constant checks of the members of judiciary and holding them accountable for their actions.

Results presented in the United Nations Office on Drugs and Crime (2011) place corruption as fourth most important problem in BiH, following unemployment, government underperformance and poverty. According to the WEF Global Competitiveness Report 2016-2017, corruption is still among the top five problems, it is ranked second following inefficient government bureaucracy. Anticorruption policies need to be introduced, but not only policies and strategies, but also strong detection and monitoring system for this to be useful and the proposed measures to have sense. Couple of years ago an anonymous landline and an e-mail address has been created for turning in corrupt professors and faculty's employees. Actions such as this one are a good start, but what lacks is the mechanism to deal with these reported offenses. Police officers are highly corrupt and receive bribes for both small traffic offenses and larger offenses. People have no trust in them, since they are fully aware of their corruptibility. Regional and international police cooperation need to be enhanced. The current solution for criminals, regardless of the type of crime, is to flee to neighboring country. Lack of cooperation within country and beyond allows them to get away from crimes by moving to a neighboring country. Organized crime, according to WEF Global Competitiveness Report 2016-2017 is 3.9 out of 7 and Bosnia and Herzegovina is ranked 112th out of 138 countries. More serious investigations need to be undertaken and legislation on confiscation of private property and consequences of money laundering tightened. Bosnia and Herzegovina should align these practices with the regulations of the EU and attempt at following developed countries in these practices. Along with corruption and money laundering, terrorism and financing of terrorism needs to be addressed. New action plans need to be introduced, especially taking into consideration increased risk all over Europe with recent terrorist attacks (Reform Agenda for Bosnia and Herzegovina for period 2015-2018).

¹⁰ Basic capital required to start a limited liability company is BAM 1.000,00 regardless of number of founders of the company, Doing business (2017)

Expectations of proposed measures and actions in the Table 15 are that Bosnia and Herzegovina will above all have a corruption free environment. It will take a long period of time for corruption to be completely gone, given current scope of presence and length of time corruption has been highly present. It has become, part of common culture and given current state it will take generations to be completely weeded out. A general goal is to restore the trust in the system, so that citizens start believing, relying and finally complying with the legislation and respecting state institutions. Despite moderate levels of crime in the country, it is unsafe and instable, so hopefully with set of measures proposed above a healthy, safe environment will be created.

3.2.2.6 Reform Agenda: public administration reform

The problem with public administration is that there is too much, it is inefficient and extremely costly for BiH. Current model is not working; it is too expensive without any results. Public administration raises public costs significantly and public revenues cannot support these increases. Hence fiscal sustainability of BiH is endangered and presents a pressing matter.

Table 16. Proposed measures of public administration reform

Proposed measure area	Action	Effects
Legislation and administration	reform of public administration management	improve the quality of services provided by public administration sector & reduce costs
	new legislation on public officers and administrators	
	employment based on competence and qualifications	
	limits on hiring in public sector on all levels	
	revision of fund of payroll expenditures	
	greater flexibility in labor arrangements	reduction in corruption and nepotism & reduction of costs
	transparency of public procurement procedures	
	completion of housing and population census	more information and better statistical data

Source: Table on proposed measures for BiH created using data from Reform Agenda for Bosnia and Herzegovina 2015-2018

Administration is made up of people, so in order to change the administration people have to change. Not only people currently employed, but the mindset of all current and future public servants. Management practices need to be reformed and new legislation and rules brought on public officers and administrators. As long as employment is based on nepotism and politics, administration will be a sore spot for BiH. When people start being employed transparently, based on competence and qualifications and start being rewarded and punished based on their success and failures, the administrative system can progress. The pressing matter is to limit hiring in public sector on all levels.

Secondly, legislation needs to be made more flexible so that people can be “easily” hired and fired, relieving them of sense of false security. Current deep-rooted opinion is that a person hired in a public sector is there for life, regardless of efficiency and results presented at work. Once this legislation allows for firing and holding public officers accountable, a selection of current employees needs to be undertaken so that only those competent remain. In general, entire public sector activities need to be made more transparent, public information need to be shared and system held accountable. Public procurement processes are in most cases rigged and a pure example of conflicts of interest. Lack of transparency, corruption and favor based system needs to be removed. Bosnia and Herzegovina needs a more modern, more competent, a cost and time efficient, transparent, effective and accountable public administration. Such administration would be beneficial and enabling for the system and all actors in the market instead of disabling and presenting obstacle, as it is currently (Reform Agenda for Bosnia and Herzegovina for period 2015-2018).

Identified problems, proposed measures and expected results of those measures for all six areas were presented above. Until late 2017, time of this research, number of legislative measures has been brought, namely in the areas of labor market and taxation. More new laws are expected in the coming 2018. Expectations are that there will be a delay with the completion of the reform agenda, but there have been changes and positive signs. With 01.01.2018. new Law on contributions and Law on income tax are expected, which should benefit employees and have neutral effects on employers (in terms of costs). As to public administration and rule of law, significant changes have not been noticed. Despite hints of changes I doubt Reform Agenda is suitable set of industrial policies for current state of Bosnia and Herzegovina. This is explained into more detail in the following paragraph.

4 PROPOSALS FOR THE FUTURE

Previously it was mentioned that Reform Agenda for Bosnia and Herzegovina 2015-2018 does not represent a suitable extensive set of Industrial policies that will support future development despite supporting notion that this is first actual attempt of Bosnia and Herzegovina at industrial policies at which there are positive signs and relative success. Pollin & Baker (2009, p. 16) state that industrial policies need to be designed, targeted and implemented well. Concern regarding industrial policies in BiH is raised especially in the part of implementation. The Reform Agenda is well constructed and, firstly identifies major issues and then proposals on how to tackle these issues. However, implementation is the tricky part in the case of Bosnia and Herzegovina. Given that setting of BiH brought about in 1995 with Dayton Peace Accords still remains unchanged, expectations are not as high as the proposed Reform Agenda suggests. As long as internal friction exists and unity is not promoted both in everyday life, economic life and every other aspect, changes being brought are forced and hence inefficient. As mentioned above, the Reform Agenda was idea of EU and through “monetary blackmail” policies are being brought.

As long as there is no internal initiative for change, as long as entities, districts, cantons and municipalities do not all agree, economic prosperity in its full scope is not possible. What I would identify as major issue is the lack of internal interest to change. Current situation is beneficial to political leaders, because only way for them to remain at power is this sad, dire and poor situation. Until national acknowledgment is made that the only way for Bosnia and Herzegovina to escape this quick sand is to shift from public to private sector, from consumption to investment and from imports to exports, change is not decisive. And again, the only way this could be done properly is for local forces to realize this and push towards change.

Expectations from future, given all mentioned in previous research are that initial administrative organization of Bosnia and Herzegovina from 1995 will be overthrown and a united country will be created. Only then economic reforms can be brought. Countries within a country are not a viable solution, and the sooner this is realized the sooner citizens of BiH will be able to capitalize on potentials of the country. Country has potential to grow, but it is overpowered by political instability and constant struggle within the country. For the prosperity to occur both entities have to work in common interest, rather than in separate interests, disregarding even the notion of the other entity or district. Basically, main concern raised in regards to Reform Agenda 2015-2018 is the size of the bite Bosnia and Herzegovina has been forced to take. A Reform Agenda, as good as it is, may not be the best option for BiH. I am afraid the country will choke on such a big bite and end up being even worse than before. The focus is spread on too many areas at the same time and as the proverb says: “You can't have your cake and eat it (too)”.

Agenda encompasses six wide areas:

- public finance, taxation and fiscal sustainability,
- the business climate and competitiveness,
- the labor market,
- social welfare and pension reform,
- rule of law and good governance,
- public administration reform.

The Agenda revealed all the sore spots and weak areas of BiH, and as such tool is worthy of praise. Where concerns are raised is the timeline of the Agenda. I believe only a small, not enough, part of the Agenda will be implemented and that nothing will change significantly for BiH. Too much, needs to be done in a short period of time. It is impossible to make up for past 20 years for which BiH has been lagging in 3-4 years. It is a process that has to last longer, for it to be done properly. Proposals for the future have been summarized in the Table 17.

Table 17. Summary of proposals for the future Bosnia and Herzegovina

Proposal	Action	Expected effect
Promote unity within country	promote united Bosnia and Herzegovina	more flexibility, more competitive country on a global market, stronger market(s)
	reduce restrictions on labor mobility and doing business across entities	
	create more institutions on a state level	
Domestic inclusion	inclusion of domestic, local individuals and groups in designing, targeting, not only implementing policies and reforms	more suitable and more effective policy suggestions, greater chance of success
	supporting, instead of deciding role of international organizations	
Quality rather than quantity	focus on quality of reform implementation <u>quality rather than quantity</u>	Fewer measures brought, but with higher success rate and better end results
	longer time, but greater scope and success of reforms	
Long-term focus	focus on long-term and reforms/policies from which citizens of BiH, if needed, will reap benefits in 10 years	more successful and more lasting reforms and progress

Source: Summary of proposals on BiH created based on personal opinion of author of the thesis, Catovic

Besides issue of time constraint, Agenda has been forced by the international organizations. There is no internal push towards progress, making this a foreign tool not evaluated by locals. In the previous chapters post-war attempts of international organization in leading BiH through transition process have been explained. As the biggest problem, an unsuitable approach has been identified, which led to BiH lagging behind. It is questionable if BiH ever ended this transition phase or we are still transitioning. It is easy to construct a measure, but hard to construct the measure. I am afraid no one personally involved in this country, cannot propose measures that will lead to progress. Also, one of the biggest deficiencies of the Reform Agenda I would single out not giving importance to unity in BiH. Shifting focus on BiH instead of focus on entities and cantons.

Not recognizing the need to move beyond lower levels of government to the state level and creation of institutions on a state level. Constant obstacle is the strife within country and procedures as if three countries are in question, not one. For the future, I would suggest going step by step and involving locals in creating a reform plan. There are number of scientists and analysts who would be thrilled to be involved, especially among young people. UNDP (2009) identifies demonstrating capacity to lead the reform process as one of the biggest challenges for Bosnia and Herzegovina. A project E4U was initiated by European Union Special Representative in Bosnia and Herzegovina in 2017. The idea of the project is to involve young people in reform process and to enable them to participate with their opinions and attitudes. In words of one of the participants, Ajla Delić, most of young people do not have a real perception on upcoming socio-economic reforms. Hence the project is well thought of, because young people are the ones who need to send the message and raise awareness on this topic and need for reforms and changes.

Another participant, Edin Bečić, points to the issue of youth being uninformed and disinterested, despite the topic being directly related to their future (Dnevni avaz, 2017). Denis Berberović, Teaching Assistant at Faculty of Economics and Business points to the importance of waking up proactiveness in youth, having one group motivating the other one to get involved. Federalna Novinska Agencija, FENA (2017) quoted reporter of European parliament for Bosnia and Herzegovina, Christian Dan Preda, where he stated that only people in BiH know what the solution for BiH is. Politics and politicians should be made aware BiH is not a training ground for achieving personal goals. In my opinion, the process should be led by international organizations, but without their direct involvement in decision making. They should occupy a supporting, rather than deciding role.

In terms of the Agenda what, in my opinion, should have been done differently, is the process. The most pressing matter is above mentioned division of the country and this needs to be worked on firstly. With current state of affairs BiH cannot attain progress in any area, especially economic prosperity and higher living standard. On one occasion, former President of Republic of Croatia, had given his opinion on formation of third (fourth, if Brčko included) entity in BiH. In his view, creation of third entity, is not a solution for Croats in BiH, nor for other constituent nations. BiH should look for solution in united and integral Bosnia and Herzegovina (Bosna, independent portal, 2017). Maybe equally pressing matter is the inefficient and expensive public sector with highly corrupt state officials.

So, as a next step I would suggest creating a detailed plan and timeline how to restore rule of law and good governance, followed by a detailed plan and timeline on reform of public administration. Once these two have been successfully implemented a fourth step would entail dealing with the labor market and the business climate and competitiveness simultaneously. After a solid foundation has been set, reform of public finance and taxation can be introduced to attain fiscal sustainability. This should go hand in hand with reform of social welfare and pension system.

Despite the fact all areas and reforms are correlated and are part of a larger picture, concern is that this cannot be done all at the same time. BiH, currently, has no capacity, not alone, not with assistance of EU and international organizations to carry this Reform out.

CONCLUSION

The thesis was guided by several main research questions and sub-questions presented in the introductory part. The first challenge was to identify what are the theoretical and empirical foundations to industrial policy, primarily what is the role of industrial policy in promoting economic development in development literature. The conclusion reached is that industrial policies are inevitable and only irresponsible governments have the luxury of taking industrial policing lightly.

The main difference between developed and developing countries is the gap in knowledge. In order to close this gap in knowledge faster, developing countries should use industrial policies to promote learning in order to create a learning society.

Presentation of development of BiH is the key chapter in the thesis, since without proper introduction of the reader to the economy itself the analysis of past, current and future industrial policies would not make any sense. With an overview of BiH's historical path the importance of the pre-war period for BiH was explained. The challenge of this part of the thesis was to concisely present situation in BiH to an outsider. Briefly, political situation was presented through an administrative organization of BiH and political system following this administrative organization. Political system was presented since it impedes economic development and pulls the economy backwards constantly. As far as economic development is concerned, an answer on relevance of membership of Bosnia and Herzegovina in SFRY for today's BiH was given. Transition process went slower and weaker in Bosnia and Herzegovina than international organizations expected, due to inadequacy of the policies they envisioned and improper implementation and monitoring. Main focus was placed on development of BiH, where number of factors impacting current and future development was given. GDP is at a relatively low growth rate, with a stable macroeconomic environment. Labor market is inflexible and hampered by inexistence of single labor market, as well as single economic space within the country. Business environment is unsuitable for investment, both local and global and is by far the worst among the countries of ex SFRY. In order to summarize the economic situation in BiH, a SWOT matrix was prepared. As main strengths geographical position, natural resources and potential in nature and stable macroeconomic environment were singled out. As far as weaknesses are concerned, main are complex administrative organization and numerous levels of government, expensive public sector and non-harmonization of BiH in all aspects. Relatively cheap factors of production, nature and proximity to EU are the biggest opportunities BiH can capitalize on. Threats BiH is facing are political instability, brain drain and shadow economy.

After an insight in BiH, the research extended to industrial policies in BiH. In order to evaluate the actions government has been taking in Bosnia and Herzegovina in the past 20 years or so, one has to know where the country was attempting to go. Hence, main development goals for BiH were firstly presented. Main development goals for BiH are harmonization and economic progress, which would pull the country out of the rabbit hole it has fallen in with Dayton Accords in 1995. A first wave of reforms, transitional reforms were inadequate and have not brought much success. The effects and consequences of the second wave i.e. the Agenda 2015-2018, which is in progress, still remain to be seen. Each of the six areas of Reform Agenda was presented with main tools that are being used to resolve problems in these areas. The set of reforms proposed by Agenda may not be the most suitable solution for BiH because it is too much in too short of a period of time and possibility it will backfire exists.

Besides a thorough analysis of BiH, a true contribution of this thesis is the final part, proposals for the future. The challenge for this part was to objectively suggest what and how could be done differently in Bosnia and Herzegovina. Going step by step and thinking more long-term and in a more extended period of time than Agenda 2015-2018 are the main conclusions I would draw from this chapter. The Agenda covers six areas which are all individually challenging, let alone all six at once. I would suggest going one by one, or narrowing reforms down to sectors of areas encompassed by agenda, to ensure better implementation. A general suggestion is to focus on quality rather than quantity of reforms.

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APPENDIX

LIST OF ABBREVIATIONS

- BiH: Bosnia and Herzegovina¹¹
- EU: European Union
- FBiH: Federation of Bosnia and Herzegovina
- GCI: Global Competitiveness Index
- GDP: Gross Domestic Product
- IMF: International Monetary Fund
- SFRY: Socialist Federative Republic of Yugoslavia
- WEF: World Economic Forum

¹¹ According to FIPA, Foreign Investment Promotion Agency of Bosnia and Herzegovina, abbreviation for the country is BiH