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MASTER'S THESIS

**THE IMPORTANCE OF INSTITUTIONAL AND LEGAL FRAMEWORK
FOR PRIVATIZATION: THE CASE OF THE FEDERATION OF BOSNIA
AND HERZEGOVINA**

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INTRODUCTION

In the early nineteen-nineties, countries of the Eastern, Central and South-Eastern Europe were facing a significant challenge of implementing a comprehensive transformation of the existing economic and social order and introducing market economy and democracy. There was a strong consensus about the need to abolish the practice of government-set prices and to liberalise the market, and about the relevance of privatization of state-owned companies. Without a doubt, the main change in the countries in transition, including Bosnia and Herzegovina (hereinafter: B&H), pertains to the issue of proprietary relations. The concept of any form of a social self-management model, where property belongs to everybody and nobody, was completely outdated and obsolete. For these reasons, the process of the overall social and economic changes, i.e. the process of transition, had no alternative. In its essence, this process represented a strong political and economic movement for fundamental changes in all spheres of social and economic life (Brada, 1996).

Process of privatization is actually a current problem that has been present in the European countries undergoing the process of transition already for two decades and it represents a form of ownership restructuring (Estrin, 1997). Transition economy is a term denoting the so called transition countries which transit from a command economy to a market economy, i.e. from socialism to capitalism (Estrin, Hanousek, Kocenda, & Svejnar, 2009). Privatization can be defined as the sale of property, whereby it is transferred from the government or public sector to the private sector. In other words, privatization is a process of sale of social, i.e. state capital in state companies, public companies and other legal entities in line with the requirements defined by the law (Megginson & Netter, 2001). Accordingly, privatization is an integral part of the economic transition which implies the process of transformation of a centrally planned economy into a market economy that is currently in progress in all post-socialist countries (Estrin, 2007). The main objective of privatization is to increase efficiency of companies through better business motivation and reduced costs, financial recapitalization, better working discipline, better organisation, new investments, etc. The process of privatizations also results in a better financial position of the state in several ways: income from privatization, subventions to state and social companies and increased tax revenues due to increased economic activity (Estrin, 2007).

The process of transfer of ownership from the public to the private sector represents a process of economic and political transition of a society. Private ownership, as a predominant ownership system in a market economy, implies market efficiency and competitiveness of companies and their participation in the global market of labour, goods, services and finances, as well as the investments, employment, increased income and profitability, in addition to the increased economic growth and development of the state (Estrin, 2007). Privatization in B&H is a comprehensive process creating a wide range of opportunities for domestic and foreign citizens and legal entities to participate in purchase of state capital, including companies, banks and real estate with the existing tenancy rights. "Strategic companies" selected to be sold through public

calls for bids offer numerous possibilities for privatization in whole B&H (Domazet, Čaušević, Mahmutovic, Dedić, & Gotovuša, 2008).

The mode of privatization is determined depending on the economic and quantitative objectives to be achieved. In addition, it also depends on companies offered for privatization and interest among potential buyers, specificities of the sector in which the company, subject to privatization, operates (Domazet et al., 2008). Experience of the transition countries, particularly in the field of privatization, indicates that revolutionary changes in the political system do not automatically result in efficient ownership systems. While economic-political measures, such as liberalisation and macroeconomic stabilisation, yielded first results rather quickly, transformation of the ownership system proved to be far more difficult than anticipated and it did not always generate expected economic results (Shah, Rashid, Ulla, & Ahmed, 2009). In the course of transition, different results in the field of restructuring and modernisation of the sector of companies made it clear that the selection of privatization strategy and applied methods is of utmost importance in creation of market structures (Bennett, Estrin, & Urga, 2007). However, what is it that determines the concept of privatization strategy and why is it that a certain method is selected? By using the theory of institutional changes, it can be demonstrated that privatization strategies do not necessarily have to be in line with the economic calculations for efficiency, but that the selection of a certain privatization strategy shows characteristics of path dependency. This means that certain structures and institutions of the old system can codetermine further course of privatization and result in suboptimal solutions (Bennett, Estrin, & Urga, 2007). Such knowledge and experience of successful transition economies can provide valuable assistance when developing the concept of future privatization.

A number of studies postulate that the success of privatization reform indeed requires the existence of well-developed legal and regulatory framework and institutional governance that regulate economic transactions and minimize transaction costs of sales and market operations (Estrin et al., 2009; Zinnes, Eilat, & Sachs, 2001; Eagle & Christensen, 1994). Eagle and Christensen (1994) emphasize the need to reform the inherited governmental administrative structures and processes from the past communist regime and establish institutional and regulatory setting necessary to effectively implement privatization policies. The institutional factors include, among others, the rule of law and the definition and protection of private property rights, company and bankruptcy laws, legal efficiency and contract enforcement, quality of government, the effectiveness of the judicial system, and political risks such as the risk of expropriation, the risk of contract repudiation, and the extent of corruption (Smaoui & Boubakri, 2004). Brown, Earle and Telegdy (2006) suggested that privatization in transition economies succeeds in that it substantially improves productivity only if the proper institutional setting is in place. Similarly, the results of Smaoui and Boubakri (2004) study confirm that for privatization to succeed, the existence of efficient and well functioning governance institutions is fundamental. Further, Banerjee and Munger (2004) show that legal institutions emerge as a significant determinant of privatization. In the same manner, Bartolotti, Fantini and Siniscalco

(2001) looked at the impact of political, economic and institutional factors on the privatization process. The empirical analysis shows that different legal frameworks are associated with radically different patterns of investor protection and corporate governance around the world.

There are three empirical studies which explore the relationship between institutional environment and the privatization in Bosnia and Herzegovina. More specifically, Bayliss (2005) conducted a study exploring the relationship between different privatization methods and policy outcomes in medium-sized industrial enterprises in Serbia and Bosnia and Herzegovina. One of the aims was to consider the effects of the policy environment on privatization. A survey was carried out on fairly small sample of 40 privatized enterprises (19 in Bosnia Herzegovina and 21 in Serbia). Overall, the findings indicate that privatization has so far brought little improvement in the financial performance of enterprises in Bosnia Herzegovina, and suggest that privatization can be difficult to achieve in a post-war context due to low incomes, weak institutional and political systems and, hence, little investor interest. Finally, Domazet et al. (2008) analyzed the causes of low investor interest in the privatization process in the Federation of Bosnia and Herzegovina. They used qualitative analysis in the form of interviews with persons who are closely associated with the privatization process in the Federation to identify the strengths and weaknesses of privatization process in Federation. The researchers also conducted a detailed analysis of the existing privatization laws. In this study, they reached out to the conclusion that privatization in the Federation did not have the desired effects. One of the key findings of this study is that investors, in particular good-quality, strategic investors, show such a poor interest due to two basic groups of reasons. The first group of reasons includes regulatory and privatization policies environment, which prevent certain groups of investors to participate in privatization. The second group includes non-adequate companies listed for privatization and unsuitable privatization methods, where the focus is given to unattractive, struggling companies which should be declared bankrupt rather than being privatized. The number of available attractive companies for privatization has been reduced and even when such privatization procedures are launched, they usually become suspended without appropriate arguments. Essentially, the authors of this study point out that one of the main reasons for this to happen was the inefficient legal framework and the low capacity of the agencies to carry out the privatization process. Furthermore, Transparency International B&H published the analysis of privatization process in B&H, in June 2009. Transparency International B&H assessment of privatization process in B&H indicated that privatization failed to fulfil the expectations due to the following: stalling in the very process of privatization, lack of transparent and clear rules and criteria, particularly with regard to the privatization of so called companies of strategic relevance, unequal treatment of potential investors which led to significant decline of market capital, both in the Federation of B&H and Serb Republic, failure to comply with the principles of corporate management, which consequently resulted in the lack of available information regarding the owner's rights and liabilities/responsibilities, lack of the rule of law, conflicts of interest of public officials involved in the privatization process.

In recent years, B&H has expedited the process of privatization of companies of strategic relevance with the objective to increase the economic growth and volume of foreign investments. Nevertheless, a certain number of strategic companies, including large companies in the sector of telecommunications, agriculture, utility services, etc. has not been privatized yet and this represents an opportunity for potential foreign and local investors. The year 2008 was followed by a rapid decline of privatization process in Federation of B&H, which was caused by different factors: global crisis, worsening of economic and financial situation and market position of non-privatized companies. This was, naturally, accompanied by poor privatization menu, lack of interest of foreign investors, and the Government of Federation of B&H's delays in making decisions on the manner and method of privatization.

The privatization of public enterprises, economic sectors, or entire economies raises strategic, legal, institutional, and economic issues and challenges. Given the importance of privatization for the economy, and given that only barely half of the foreseen 1999 capital in Federation of B&H has been privatised we deem that this topic must by no means be neglected, notwithstanding the current privatization standstill in Federation of B&H, and B&H too. This master thesis will approach on privatization process, with an emphasis on the legal, institutional and policy dimensions of the process. We will take a critical look at the goals and achievements of the privatization process in the Federation, and point out the strengths and weaknesses of the institutional and legal framework associated with the privatization process.

Notwithstanding the importance of the earlier studies, we have limited understanding of specific features related to the existing institutional and regulatory environment in the Federation of Bosnia and Herzegovina that inhibit the successful implementation of privatization process. The impact of legal and regulatory framework on privatization process in the Federation of Bosnia and Herzegovina has not been sufficiently investigated. This thesis attempts to fill in this gap in the existing literature. Given the complexities associated with the political and administrative structures of the privatization process in Bosnia and Herzegovina, in this thesis we focused on Federation of Bosnia and Herzegovina, and its privatization laws and institutions.

General assessment of the privatization process in BH, so far, shows that privatization has not met expectations. Most of the problems have been associated with weak institutional capacity and inadequate regulatory framework (Domazet et al., 2008). The overall objective of this thesis is to look more closely at the sources of and the causes of unsatisfactory performance of the privatization process in Federation of Bosnia and Herzegovina that are related to the institutional and regulatory arrangements.

The principal objectives of this master's thesis are as follows:

- To present a comprehensive analysis of the concept, scope and the character of the privatization process and its origins in the Federation of Bosnia and Herzegovina;

- To explain and critically examine the legal and institutional framework for privatization in the Federation of B&H and in selected European countries from a comparative perspective;
- To identify and analyse specific institutional and legal issues which arise during the implementation of privatization policy, programs and transactions;
- To analyse institutional capacity of privatization related institutions in the Federation of Bosnia and Herzegovina to undertake successful privatization;
- To draw policy conclusions related to institutional and regulatory arrangements virtues/shortcoming and propose specific policy recommendations for those individuals and organisations participating in the privatization process in Federation of B&H.

In this thesis we will use the literature review method in order to critically examine the existing theories about privatization, and postulate the theoretical framework for privatization relevant to the specific and distinctive context of transition economies. The same method will be used in an attempt to analyse previous research on privatization in transition economies that is more empirical in focus. Next, we will survey the literature and gather relevant data and information related to the privatization process in Federation of B&H.

Further the qualitative analysis will be conducted to assess the institutional capabilities and their relevance for privatization process in Federation of B&H. For this purpose we will use data and information gathered through semi-structured interviews conducted with persons who work in the Privatization Agencies and management of the companies that went through privatization. An attempt will be made to deepen our understanding with respect to institutional capacity to undertake privatization, as well as specific problems and issues associated with the privatization process, in particular factors which inhibit effective implementation of the process and overall implications on the results of the privatization. Based on these we will draw important implications for policy.

1 TRANSITION ECONOMIES WITH SPECIAL REFERENCE TO B&H: THE CONTEXT OF INVESTIGATION

Transition is usually defined as a change from a less efficient and instable system into a more efficient one, through the change of the “manner of allocation and distribution of resources”. Overall, transition is an extensively used term linked with numerous different fields and processes in modern society and economy. Transition as a macro-social change, together with globalisation and liberalisation, is a universal feature of modern society. In a political sense, transition of former socialist countries represents a transformation of an autocratic and totalitarian society into a democratic one. In terms of the economy, transition represents a

transformation of the overall economy from the concept of state ownership and planned economy to the concept of market economy based on private ownership (Goodhue, Rausser, & Simon, 1999). Transition economies undergo economic liberalization, where market forces set prices rather than a central planning organization. Trade barriers are removed, there is a push to privatize state-owned businesses and resources, and a financial sector is created to facilitate macroeconomic stabilization and the movement of private capital (Brada, 1996). Furthermore, transition of a macroeconomic environment primarily refers to monetary, fiscal, customs, banking and foreign trade policies. In addition, the process of transition implies an all-inclusive institutional transformation. Successful transition requires a new proprietary, formal, institutional and regulatory structure (Estrin et al., 2009). In addition to this, transition is supposed to also transform business philosophy of companies in order to embrace the ideas of modern management, marketing, development of modern organisational and technological structures, which represents a starting point for the transition on a general level, and not only on a micro level. Growth of the economic efficiency and profitability is possible only in those companies which have adopted the modern management functions (Goodhue, Rausser, & Simon, 1999).

At the turn of the decade from the 1980s to 1990s, a new term “transition countries” emerged. The term “transition countries” was specifically used to denote different categories of countries, primarily the former communist countries of the Central and Eastern Europe and former Soviet Union (Meyer, 2002). However, transition does not only occur in former socialist countries. It is also present in the countries of South Europe and South America and other parts of the world. Meyer (2002) points out that besides the international factors, transition in the former socialist countries was influenced by many other factors, such as economic, cultural and political ones. Transition as a gradual process includes transformation of the economic, political, legal, social and cultural structure of a society. Transition integrates each individual society into a global world, offering it a perspective to become a post-industrial society and to advance into the post-modern era.

The early 1990s were characterised by large political and economic reforms in Central and Eastern Europe. As the process of the overall transformation of a social system, all its subsystems and structures advanced (politics, law, social culture, etc.), reforms in these countries were met with enthusiasm, support and advice from developed countries with market economy. This also meant a fast and complete transformation from a centrally planned to market economy (Meyer, 2002). As pointed out by Estrin (2007) the beginning of the 1990s, all European transition countries went through a deep transitional crisis. This crisis was manifested as a drastic decrease of gross domestic product, consumption, employment, productivity and standard of living in general. In some countries, the crisis also included a severe growth of prices and living costs, i.e. high inflation rates.

Different initial circumstances, choice of strategy and stabilisation in management of the transition programme, political and social consensus, environment and other issues determined the path and influenced results of transition processes in individual countries. Those countries

that in the course of earlier reform preparations were better prepared for transition got closer to achieving pre-transitional levels for some economic indicators, such as Gross domestic product (hereinafter: GDP), inflation rate, unemployment rate, etc. (Nellis, 1999). Although some transition countries had certain common features inherited from the socialist system when they embarked on their journey towards democracy and market economy, we can not simply refer to them as being identical. In early transition process, there were some differences in socialist systems in the Eastern, Central and South-Eastern Europe. The reason for this was that the countries like Hungary, Yugoslavia and later Poland, started the reforms earlier, thus shifting away from classical socialist system, unlike the countries such as Soviet Union, Bulgaria and Czechoslovakia which retained the classical system until the mid-eighties of the 20th century (centralization versus decentralization) (Cvjetičanin, 2013). In addition to some common features, conditioned by the system and the differences in implementation of socialist system, individual countries in Eastern, Central and South-Eastern Europe considerably differ also in terms of their respective cultural and historical characteristics shown in early transition process. In addition, to their respective differences in historical experiences with market-economy, the baseline position of a certain country is conditioned by the level of industrialisation and proximity of Western industrial countries (Nellis, 1999). This position, depending on the path traversed towards the reforms, sets the direction of privatization, and thus may have an impact on the outcomes of the process.

Whereas in the first transition stage (1990-1994) all transition countries were equally affected by the negative developments such as recession, unemployment growth, spiking inflation rates, the second stage, starting in 1995, saw more stabilisation and divergence (Nellis, 1999). In this stage, the efficiency of economies was influenced to the varying extents, due to different transition concepts and, in particular, selected approaches in privatization. While Hungary and Estonia were relatively successful in implementing privatization through sale, the voucher privatization in Czechoslovakia, on the other hand, failed to produce expected results. According to Nellis (1999) although the transformation of ownership went relatively smoothly in Czechoslovakia, aided by the distributed free vouchers, it did not adequately influence the restructuring or the inflow of the capital. The forms of “insider”-privatization, which was implemented, for instance, in Russia, proved to be insufficiently successful much like the privatizations implemented largely via management or worker-buyout in some successor countries of the former Yugoslavia.

Other examples of path-dependant privatization process can be found in the successor countries of the former Yugoslavia. These countries are struggling with the serious problems to adapt their economies to European Union (hereinafter: EU) internal market and to increase their competitiveness. The causes for this situation we may find in dissolution of the state and war conflicts. However, the primary cause is a rather slow transformation of socially owned companies in all successor countries of former Yugoslavia which, with the exception of Slovenia, resulted in a rather inefficient ownership structures (Domazet et al., 2008).

European Bank for Reconstruction and Development (hereinafter: EBRD) developed a set of indicators to measure the progress in transition process. Common transition indicators include: Large-scale (mass) privatization; Small-scale privatization; Governance and enterprise restructuring; Price liberalization; Trade and foreign exchange system; Competition policy; Banking reform and interest rate liberalization; Securities markets and non-bank financial institutions; Infrastructure reform.

In its Transition Report, EBRD made a first step in reforming transition indicators to expand the coverage of sectors and emphasise the quality of market institutions. In addition, to present a large number of new sector-level indicators, both in corporate and energy sector, the alternative set of indicators had to be introduced in financial sector. Report was developed based on the old and new indicators. The best results, according to overall and traditional indicators are noticeable in Central Europe, Baltic States, followed by Turkey, whereas the poorest results are exhibited by Central Asia. Even the EU member states need to implement significant reforms in some areas, in particular in the area of sustainable development, energy sector, transport, and in some areas of financial sector. Recent empirical experiences show that economic transition processes in all Eastern European, Central European and South European former socialist countries vary in terms of dynamics, pace and results.

Table 1. European Bank for Reconstruction and Development Transition progress indicators by country

		2006	2007	2008	2009	2010	2011	2012
BOSNIA AND HERZEGOVINA	Large scale privatization	2,7	3,0	3,0	3,0	3,0	3,0	3,0
	Small scale privatization	3,0	3,0	3,0	3,0	3,0	3,0	3,0
	Governance and enterprise restructuring	2,0	2,0	2,0	2,0	2,0	2,0	2,0
	Price liberalization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Trade & Forex system	3,7	3,7	4,0	4,0	4,0	4,0	4,0
	Competition Policy	1,7	2,0	2,0	2,0	2,3	2,3	2,3
CROATIA	Large scale privatization	3,3	3,3	3,3	3,3	3,3	3,3	3,3
	Small scale privatization	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Governance and enterprise restructuring	3,0	3,0	3,0	3,0	3,0	3,3	3,3
	Price liberalization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Trade & Forex system	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Competition Policy	2,3	2,7	2,7	3,0	3,0	3,0	3,0

table continues

continued

		2006	2007	2008	2009	2010	2011	2012
FYR MACEDONIA	Large scale privatization	3,3	3,3	3,3	3,3	3,3	3,3	3,3
	Small scale privatization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Governance and enterprise restructuring	2,7	2,7	2,7	2,7	2,7	2,7	2,7
	Price liberalization	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Trade & Forex system	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Competition Policy	2,0	2,3	2,3	2,3	2,3	2,7	2,7
MONTENEGRO	Large scale privatization	3,3	3,3	3,3	3,0	3,3	3,3	3,3
	Small scale privatization	3,7	3,7	3,7	3,7	3,7	3,7	3,7
	Governance and enterprise restructuring	2,0	2,0	2,0	2,0	2,0	2,3	2,3
	Price liberalization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Trade & Forex system	3,7	4,0	4,0	4,0	4,0	4,0	4,3
	Competition Policy	1,0	1,7	1,7	2,0	2,0	2,0	2,0
SERBIA	Large scale privatization	2,7	2,7	2,7	2,7	2,7	2,7	2,7
	Small scale privatization	3,7	3,7	3,7	3,7	3,7	3,7	3,7
	Governance and enterprise restructuring	2,3	2,3	2,3	2,3	2,3	2,3	2,3
	Price liberalization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Trade & Forex system	3,3	3,3	3,7	4,0	4,0	4,0	4,0
	Competition Policy	1,7	2,0	2,0	2,0	2,3	2,3	2,3
SLOVENIA	Large scale privatization	3,0	3,0	3,0	3,0	3,0	3,0	3,0
	Small scale privatization	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Governance and enterprise restructuring	3,0	3,0	3,0	3,0	3,0	3,0	3,0
	Price liberalization	4,0	4,0	4,0	4,0	4,0	4,0	4,0
	Trade & Forex system	4,3	4,3	4,3	4,3	4,3	4,3	4,3
	Competition Policy	2,7	2,7	2,7	2,7	3,0	3,0	2,7

Source: *European Bank for Reconstruction and Development, Transition report (Stuck in Transition), 2013, p. 49.*

The EBRD assesses progress in transition through a set of transition indicators. The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigid centrally planned economy and 4+ represents the standards of an industrialized market economy. Assessments are made in six areas. Bosnia and Herzegovina progresses slowly in implementation of reforms, especially in the last couple of years when it is hard to achieve any tangible reform results. EBRD country-level transition indicators show that B&H scored nearly maximum points (4) in price liberalization, trade and foreign exchange system, reflecting the

widely liberalised and open economy. The country has achieved fairly good result (3) in small and large-scale privatization. The poorest performance was observed in governance and enterprise restructuring (2-), as well as in competition policy (2+), two areas which are traditionally challenging for the implementation of reforms. The good results in these areas are usually associated with the countries in well advanced stages of transition. At the level of sectors, the partial progress was observed in the last three years. The most noticeable was the launching of the implementation of the first PPP in transport sector in 2012, which includes construction and maintenance of motorway Dobož-Vukosavlje, the part of trans-national Corridor Vc. If this project proves to be successful, it may be an important signal for other countries in the region. Reforms in other sectors continue to be incomplete for some time. Privatization has stagnated, whereas the private sector development is threatened by poor business environment.

Bosnia and Herzegovina endorsed and has been implementing the principles of multiparty democracy, pluralism, and market – based economy. In parallel, the functioning of the state and its democratically elected institutions has been affected by the specificities of its constitutional make-up. 1995 Dayton Agreement has created an extremely complex institutional structure and fragmented decision-making mechanism. As a result, many weaknesses, which are common for other Western Balkan countries, were multiplied in B&H, which makes doing business in this country extremely demanding. Without a comprehensive constitutional reform, it will be difficult to achieve further progress towards the more efficient state, implementation of reforms and EU approximation (Domazet et al., 2008). In the last five years, global crisis has affected the economy of Bosnia and Herzegovina, though the domestic factors have significantly contributed to the weakening of country's economy. Poor domestic demand, unfavourable external environment and political stalemate continue to prevent country's recovery. The high and ever increasing unemployment rate, which currently stands at nearly 30%, also suppresses consumption. Simultaneously, the lower growth in Eurozone has a negative impact on export activities of Bosnia and Herzegovina and capital inflow (Transparency International B&H, 2009). Inflation rate remains low because it reflects suppressed domestic demand.

Bosnia and Herzegovina has considerable economic potentials in many sectors; however, the complex political environment and lack of willingness to implement profound structural reforms have delayed successful use of these potentials. Due to this, country's transition progress has stagnated for years. B&H is lagging behind other SEE countries, according to majority of reform and business environment indicators. The country has a comprehensive privatization programme, but only a small number of major companies are listed for privatization.

Similarly to other countries in the region, the path of B&H towards sustainable growth and development requires much better focus on improving the business environment to develop private sector, strengthen the inter-entity ties and relations with neighbouring countries and better exploit the natural resources of the country. Transparency International B&H (2009) states that unfavourable external and internal circumstances will, most probably, have restrictive effect

on the growth of B&H in the next two years. Certain growth is expected in the mid-term period, provided that global and regional circumstances are improved. However, the economy continues to be challenged in many areas, not only because the region is in difficult situation, but also because internal complexity of political structure of the country and poor investment climate constitute major obstacles for investments. There is also a risk of weakening of fiscal position if the authorities, especially in the Federation, fail to fulfil obligations assumed in line with International Monetary Fund (hereinafter: IMF) fiscal consolidation programme, as a result of strong pressure exerted by different interest groups. Any deviation from the programme may jeopardize further investments by European Union and World Bank.

Overall, the slow transition progress and slow privatization dynamics has characterised the B&H economy transition path (EBRD, 2011). Hence, in sections to follow, apart from elaborating the theoretical framework of investigation, we look more closely at the privatization issues in B&H with an aim to improve our understanding as to why this process has not delivered the expected outcomes. We pay attention to selected approaches to privatization, and analyse the legal and institutional framework for privatization in this country.

2 TRANSITION AND PRIVATIZATION OF THE STATE CAPITAL: THEORETICAL PREMISES AND EMPIRICAL EVIDENCE

2.1 Privatization of the state capital: a brief historical background

In its widest sense, privatization is a transfer of resources from one title holder to other title holders, including the transfer of management, where they are expected to efficiently utilise these resources (Estrin, 2007). In order to be able to entirely understand the definition of privatization, it is necessary to distinguish different types of ownership and their characteristics. According to Hamm, Stuckler and King (2010) there are different types of ownership, but the most significant differentiation of ownership relevant for privatization pertains to public and private ownership. The main characteristic of the public property relates to social production and direct fulfilment of societal needs. The objective of the production itself, in its wider sense, is to satisfy the needs of the members of a community, such that needs are known in advance and influenced by a number of factors (including political, moral, religious), while the diversity of these needs remains limited (Estrin, 2007). Hence, public ownership is associated with collective responsibility and complex decision making process. In the context of private ownership, the objective of the production is somewhat different, in that it, principally reflects on an ambition to make and maximise profit through the production in the market. Mutual relations between individuals are established through the market, which provides a possibility of choice for final consumers and ensures competition to all producers. All participants in the market are exposed to the competition, which is in turn assumed to foster greater efficiency of market transactions.

Which form of ownership is more efficient – private or state ownership? This issue was a matter of dispute for almost one century. History has proven that the private ownership is the only healthy foundation for economic life (Estrin et al., 2009). Experience with state ownership was unfavourable. Performance of state companies usually was below expectations to the detriment of state budget and consumers. Being poorly managed and led by political objectives, having redundant workforce, inadequate organisation and obsolete technology, not being competitive, depending on state aid and offering unrealistic prices, these companies are a clear proof of inferiority of the state ownership and unfeasibility of the idea of a developed state (Estrin et al., 2009).

Along these views, and in a broader historical perspective, the dominance of private ownership is considered a characteristic of the modern market economy. Historically speaking, dominance and emergence of privatization is linked to the return of the “*laissez faire, laisser passer*” economy, which represents an idea of economic freedom wherein the economy should be left free from state interventions, along the theoretical premise that markets are efficient and as such underpin efficient allocation of resources (Megginson & Netter, 2001). In modern economic history, the first privatization processes were conducted in the United Kingdom (1953), the then Western Germany (1959), Norway (1961) and Canada (1970). The first privatization programmes were initiated in Chile (1973), UK (1981), Japan (1985), France (1986) and in 1987 in the USA, Canada, Italy, Portugal and transition countries and countries under socialist rule (Brainerd, 2002). Megginson and Netter (2001) state that privatization, as a form of a structural policy is correlated to the beginning of the rule of Margaret Thatcher’s government in the UK. This was an attempt to minimise the increasing influence of the state on economy and its direct participation in economic activities. The prevailing opinion was that the strong influence of the state hinders private initiative and disrupts functioning of the capitalist society. Although she served as Prime Minister, Margaret Thatcher, known as Iron Lady, advocated privatization to reduce the state share in the capital of the country. After her initiative, a wave of privatization spread to Germany, Italy and France, rapidly becoming a world trend. It can be said that Margaret Thatcher managed through her work to promote privatization, which at the time was no an easy thing to do.

Nowadays, the process of privatization is most frequently initiated by a difficult economic situation characterised by high state indebtedness. Unfortunately, in the course of the development of society and economy, privatization has not always been successful and frequently has side effects manifested as the growth of unemployment, loss of national property, with inconclusive evidence relating to whether privatization has served the purpose of leading to higher economic efficiency. Some of the characteristics of privatization that are important to mention and related to negative externalities have been discussed by Brainerd (2002). For instance, he, critically assesses the arguments supporting the views that privatization is a way to improve the state and municipal budgets. According to him, that would then mean that the privatized facility can be sold for the price exceeding the market price, while in reality the opposite happens. It often

happens that smaller financial burdens are changed for larger long-term financial burdens. He further warns, that privatization may lead to undesired social developments in that it may weaken the position of employees – private owner has the possibility to cut jobs and discontinue sale, fire employees, reduce wages and social benefits; as well as in that it weakens the regulatory position of the state. Taking this into account, one should point out that privatization is usually accompanied by downsizing the workforce, and reducing the social programmes and rights. Further, economic goals of privatization are likely to be inferior to the political ones, and the characteristic of decisions on most viable acquisitions is susceptible to corruption (Brainerd, 2002).

This explains why, the term privatization is often referred to in a negative context. Even though there is a general trend of privatization, it is accompanied by fear of this process. Analyses of experiences in the implementation of this process indicate that there are the same expectations and fears in the process of privatization (Schmidt, 1998). The most often encountered fears are: fear of losing national property, fear of sale of national property, privatization opening the room for interference of foreign partners in domestic economy and politics, fear of privatization increasing prices and transforming state monopoly into private monopoly, fear of privatization jeopardising long-term investments, fear of government losing control over crucial industry and not being able to run a firm protection policy, fear of inability to privatize companies generating losses (although, this has recently become a possibility), etc. (Lieberman, Ewing, Mejsirik, Mukherjee, & Fidler, 1996). It is very much because of this fear of privatization, i.e. as a mechanism for defence from fear of privatization, that different terms are used in different countries to denote privatization. For example, the term “prioritisation” is used in Australia, “national capitalism” in Chile, “economic democratisation” in Costa Rica and Jamaica, “partners in development” in Egypt, “transformation” in Thailand, “denationalisation” in the UK and Portugal, etc.

Considering the former socialist economies, Hungary was the first country to initiate the process of privatization and finalise the phase of the so call epochal or semi-privatization, which essentially meant the strengthening of the private sector. This process began in 1990 with the adoption of the new law on enterprises, which introduced a complete freedom for private initiative and establishment of private companies in all forms. The entire process of privatization was managed by the Agency for State Property and revenue from privatization was intended for payment of debts (Lieberman et al., 1996). Czechoslovakia adopted a concept of economic reform, and privatization concept as its integral part, in 1989 and 1990, which included: reprivatization (restoring of nationalised property to its owners), “small privatization” (sale through public auctions of small firms in the sector of services), “large privatization” (large state owned companies made projects for their own restructuring which were submitted to the competent ministry for verification). Poland regulated the process of privatization with the Law on State Companies from 1989 and Law on Privatization from 1990 (Lieberman et al., 1996). Privatization in Poland was characterised by a promise of fast privatization, which was far from

the real pace of the process of privatization (Lieberman et al., 1996). Russia adopted the Law on Privatization of State and Municipal Companies, which stipulated the obligation of adoption of an annual privatization programme. In accordance with the Law, companies are grouped on the basis of the potential for their privatization: facilities for which privatization is mandatory, facilities intended for privatization which do not fall in the group of the companies for mandatory privatization, state and municipal companies with different difficulties in terms of their privatization (Brainerd, 2002). These are only a few examples of the solutions applied in socialist countries during the process of privatization. It is important to emphasise that there are numerous solutions and methods that were used in the course of privatization, as we discuss in great detail in sections to follow.

All in all, privatization process can be launched due to various goals, which may vary, depending on whether the privatization is to be implemented in the market economies or in the transition countries. Privatization which is implemented in the market economies aims to increase efficiency, ensure redistribution of GDP and alleviate pressure on the budget, whereas the one implemented in transition countries should in addition ensure achievement of political goals in terms of initiating the process of democratisation of the society and providing opportunities to exercise political and personal freedoms. Though they may be numerous political goals, the common in transition economy context include development of private property being a foundation of liberal and democratic order, strengthening the middle-class population, depolitisation of economy and society etc. (Estrin et al., 2009). The privatization in transition countries should also lead to creation of market economy and private entrepreneurship, and result in increased economic efficiency and budget revenues (in order to mitigate negative impacts of necessary radical reforms which ought to be conducted in many areas of transition economies) (Estrin et al., 2009). Generally speaking, specific goals of privatization in transition economies may include: creation of new jobs, economic growth, regular payment of retirement benefits, implementation of social programmes, improved living standard, stimulation of local development, financing of economic development and environmental programmes, denationalisation and many other (Guislain, 1997). In sections to follow, we consider in depth the main theoretical proposition related to the privatization, its benefits and expected outcomes as well as privatization models and main issues.

2.2 Why do countries privatize?

In terms of the reasons for privatization, there are two main points of view. The first one emphasises the general reason for privatization which is applicable to any model of economy and which refers to increasing the economic efficiency via increased corporate level efficiency. This main argument is based on the two key findings (Estrin, 2007, p. 3):

- The sole objective function of a private company is to maximise a certain business result, while the objective function of public companies, in addition to maximising business and

production results, is also to maximise consumer surplus and gain, as well as to pursue certain state objectives and interests.

- Private property facilitates free entry into the market and entrepreneurial initiative, thus having an effect on the improvement of the competitive structure of the market.

The second point of view gives specific reasons for privatization applicable to transition economies departing from the economic system which is regulated and structured by the state. The transition from a centrally planned to a market economy is a very complex process and can be observed from different aspects. The changes occur in the structure of the economy, in political arrangements, social values, population mind-set etc. The unprecedented challenge of building a market economy in post-communist countries demanded innovative approaches and fresh ideas, particularly to accelerate institutional reforms and increase social acceptance of market principles. Privatization has been a particularly important phenomenon in the transition process of European economies. In these economies, privatization constitutes an integral part of the economic transition. The basic and most important economic goal of privatization in transition economies has been to create efficient economy based on domination of private ownership, rather than to have one which rests on inefficient social and state property concept (Estrin, 2007). The multi-decade experience of socialist economies indicated that the economy, which is dependant on social and state property and their unhealthy incentives, can only end up in inevitable stagnation or crisis, with rather bleak prospects of achieving economic progress. Therefore, reformers in the transition economies placed a large emphasis on privatization.

From the perspective of large state capital, as has been the case of former socialist economies, privatization of state property has been associated with many advantages. Some of these include the following (Hamm, Stuckler, & King, 2010; Estrin et al., 2009):

- Benefit for corporations-the new private owners have a strong incentive to turn failing public enterprises into successful businesses and privatization also gives new businesses access to investment capital that government cannot provide;
- Increased competitiveness-often privatization of state owned monopolies occurs alongside deregulation. This can be the greatest spur to improvements in efficiency;
- Decreased burden on the state due to spill over-governments are motivated by political pressures rather than sound economic and business sense. For example a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state owned enterprises often employ too many workers increasing inefficiency;
- Increased efficiency- the main argument for privatization is that private companies have a profit incentive to cut costs and be more efficient;

- Innovation encouraging environment-private firms operate in a free market with increasing competition, therefore, private firms invest more in research and development;
- Reduced political influence - a government thinks only in terms of next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because;
- Smaller public sector- selling state owned assets to the private sector raised significant sums for many governments. There are many industries which perform an important public service, e.g. health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry, and with smaller public sector the government can focus more on these non profit public services and offer better services.

Overall, as postulated by Hamm, Stuckler and King (2010) privatization of state and social property represents the main precondition for new investments, restructuring of the economy and financial market, creation of an efficient economic environment, that would overall lead to more dynamic European and world integration processes of these economies. They note that privatization of state and social capital implies the establishment of new standards and introduction of European standards in the course of the development of market institutions and efficient corporate governance. This system of ownership implies greater market efficiency through fostering competitiveness and companies' participation in the global market structures leading to an overall improvement of macroeconomic and microeconomic parameters of the state, i.e. its faster development and growth. The basic idea is that private owners and the managers whom they appoint will bring in improved performance and raise the chances of the company to survive in competitive race, by introducing new technologies and products, new sources of financing, better organisation, and, in general, better management of the company. As pointed out by Estrin (2007) the fundamental objective of privatization in transition economies has been to enhance company performance. Transforming state owned assets into private hands can improve corporate efficiency, and, particularly with the privatization of infrastructure, the benefits can spill over to the rest of the economy. Therefore an important initial motive for privatization was to focus attention to profits as the sole objective for the enterprise sector. The economic problems of the socialist system were largely associated with the state ownership and planning. As a result, firms did not attempt to maximize profits, and productive efficiency was a low priority. Instead, weak monitoring of managers by the state as owner and the absence of external constraints gave management almost total discretion to follow their own objectives – rent absorption, asset stripping, employment, social targets. Since managers did not have to bear the consequences for their own actions, mistakes were condoned and losses were subsidized (Estrin, 2007).

Furthermore, according to Estrin (2007) privatization could improve financial situation in the state and lead to substantial public savings allowing for more productive and efficient public

investments in the course of transition. He points that privatization in essence initiates finding of the existing unused resources in the form of private savings or alternatively foreign investments; and renders support to stronger financial discipline while departing from the state ownership and dispersing the ownership rights and responsibilities. More specifically, by selling the state and social capital, the state can obtain considerable amount of funds which it may use either to finance general beneficial activities or to service its debts. Financial position of the state is influenced by two things: abolishment of subsidies which the state, prior to privatization, used to provide for socially owned and state-owned enterprises, and increased tax revenues which result from intensified and more efficient production. Moreover, the privatization is expected to induce better business environment and allow for private sector growth. Privatization is often associated with abandoning the practice of injecting incentives into continuously favoured state and socially owned companies at the expense of private sector, which for the latter represents a huge impediment and prevents its further development (Estrin et al., 2009). The state used to bail out loss-making and inefficient state and socially owned companies, by continuously providing all sorts of subsidies (loans and foreign currencies below the market price, preferential treatment in import, renunciatory, tax benefits etc.), meaning that modest resources were redirected from more productive to less productive and non-productive companies.

In the light of the foregoing discussion, the expectations from the future owners in a transition economy context include:

- new investments,
- new equipment and technology,
- modern management models,
- new forms of organisation,
- new markets,
- production growth,
- increase in overall living standard.

While, expectations from the state as an authentic protector of the wider social interest include policies to enhance, Increased efficiency of privatized companies; Production growth; Employment growth; Export growth; Increase in overall living standard (Estrin et al., 2009). In addition to above goals, there are so called secondary privatization goals, such as: Ensuring budget revenues; Assistance to local communities; Addressing the issues of restitution.

2.3 How to implement privatization: privatization methods and their relevance

Generally, speaking we can categorise privatization methods in accordance with the substantiated models of privatization in the literature. For instance in studies by Boycko, Shleifer and Vishny (1995) and Bennett, Estrin and Urga (2007) there are principally for privatization model indicated, and these include :

- internal privatization,
- external privatization,
- distribution of shares to all citizens, and
- privatization by establishing the holding companies.

Although the majority of literature states only above four basic privatization models, the privatization process itself can be implemented via many models. However, it is important to note that each company is an entity for itself and that plethora of various privatization methods are being used in practice.

2.3.1 Internal privatization

Internal privatization includes sale (at very low prices) or free cession of stocks i.e. shares to employees of the company or to those who used to be company's employees (retirees). The sale of stocks is conducted at certain discount or via allocation of shares, which is determined based on the seniority, salary level etc. (Gouret, 2007). The free allocation of stocks is often combined with stock sale. Also, there is a concept of the "second round" in privatization, which, in internal privatization, means that the shares are sold to the highest bidders, provided that they are the employees of a given company. Also the shares may be sold at lower rates, because the buying power of employees or majority of them is insufficient (Estrin, 2007). In addition, the low price of shares provokes curiosity and makes the employees more interested for the privatization. Internal privatization also includes the ESOP model (employee stock ownership plan). Pursuant to this model, the employees set up the fund which receives the loans from the banks up to the amount equalling the value of the company. Employees repay the loan, and obtain the stocks depending on the share of the loan they had paid off. Once the loan is entirely repaid, the employees acquire a full ownership over their shares. Depending on the adopted and previously agreed rules, there are two options: 1) employee can sell its shares to any buyer and 2) the shares continue to be a part of company portfolio until the employee retires.

Advantages of internal privatization:

- It is easily and quickly implementable;
- It is, politically speaking, popular amongst the employees of successful companies, because

- they have an opportunity to purchase high market value stocks at lower prices;
- It represents a spontaneous process, because the privatization reflects the will of employees, and occurs without the influence of the state.

Disadvantages of internal privatization are as follows:

- It leaves room for a possible manipulation of employees by directors and individuals in control of the company;
- It leaves room for a possible deliberate creation of company's loss, thus decreasing its value and, implicitly, the value that is to be paid in privatization (due to this, the state privatization agencies were established in many countries);
- Using this model implies that employees in successful companies enjoy privileges compared to their counterparts in companies that are not successful and the public servants;
- Very low budget revenues.

2.3.2 External privatization

According to Gouret (2007) external privatization includes public auction of shares, open for all citizens, both the locals and the foreigners. The shares are sold to the highest bidders. External privatization has mechanisms for implementation of privatization which ensure protection of small investors and reduce the concentration of ownership. If foreign investors show increased interest, due to favourable prices, and if there is a political reason to determine the percentage of shares which can be sold to foreign nationals, there is a possibility to organise several auctions, in compliance with the set out rules. The funds obtained through external privatization belong to the state.

Advantages of external privatization are as follows:

- It ensures high budget revenues;
- It ensures optimal allocation of shares, which is performed pursuant to economic principles, i.e. the shares are obtained by those who are willing to pay the most for it;
- When foreign investors are involved, this privatization model ensures foreign currency revenue for the state and, as a rule, more efficient business operations and more contemporary management in the companies.

Disadvantages of external privatization are as follows:

- Problems in setting the price of shares, which occur due to the non-existent capital market in transition countries;

- When it comes to foreign investors, there is a risk that a huge percent of shares might be unjustifiably sold to the foreigners, which could result in the state losing control over its property;
- Lack of relevant institutions and information on sales of shares at real price.

2.3.3 Distribution (allocation) of shares to all citizens

Distribution (allocation) of shares to all citizens is performed through sales of the shares of a given company at very low prices or via cession of shares for the benefit of all citizens above 18 years of age (criteria for allocation of shares may vary) (Bennett, Estrin, & Urga, 2007).

After having obtained the shares, each citizen may sell and purchase the shares at the established securities market. This leads to creating a certain concentration of stocks.

Advantages of distribution (allocation) of shares to all citizens:

- Simplicity;
- Equality – all citizens are equally represented when it comes to the country's property;
- Dissolving the closed circles in companies and certain areas;
- Stimulation of capital market activities – certain number of citizens demonstrates the need to sell their shares.

Disadvantages of distribution (allocation) of shares to all citizens:

- Lack of budget revenues;
- High dispersion of ownership prevents a dominant legal owner i.t. titular of property to be established, which is necessary if a company is to be successful in doing business;
- Practical method of implementation of this model cannot ensure complete fairness in distribution, due to different values of the individual companies in which the citizens have shares. Also, neither are the contributions of individual citizens in creating the state property the same – they also vary from citizen to citizen.

2.3.4 Privatization by establishing the holding companies

Privatization by establishing the holding companies rests on the idea that the holding companies are privatized and not the state-owned. The shares of holding companies are sold (or ceded without a fee or compensation) to all citizens. It is also possible to cede the shares to foreign nationals. The buyer purchases the shares of a holding company which controls the majority of shares in some other companies. In this way, the holding companies actually constitute the mediators between the share-holders and the company. It is expected that the holding company

will ensure efficient business operations and implementation of modern management in the given company (Estrin, 2007). In fact, the holding company performs financial operations of interest for the companies they control, but they also, to a significant extent, participate in management and control of all the processes in these companies. Rather than launching the individual privatizations, the state establishes several holding companies which will manage dozens of individual companies, aiming to maximise the profit. In the course of time, the concept of holding has been modified. Instead of being state-owned, the holding companies should be privatised. The buyer would purchase the shares in one of the holdings. Thus, the one would control the company in holding's system. In this way, privatization is performed indirectly.

Advantages of privatization via the holding companies:

- Possibility to establish holding companies in a short period of time, thus enabling the establishment of capital market;
- Seasoned local and foreign experts can be appointed to central positions in the hierarchy of holding companies

Disadvantages of privatization via the holding companies:

- Insufficient influence of individuals on business operations of the company;
- Poor interest of citizens to purchase holding shares due to insufficient economic and financial literacy;
- Privatization process is time-consuming.

Based on above privatization process models we may reach conclusion that the owners of privatized companies may vary:

- employees of the company (inside owners),
- local or foreign individual persons (outside owners),
- institutional investors such as banks, financial institutions, holdings, retirement funds etc.

The EBRD summarized the primary and secondary privatization models that were used in different transition countries. The most often used primary model for privatization was the distribution of shares method, and the most frequently used secondary model was external method.

Table 2. EBRD classification of privatization models by countries

	Primary	Secondary
Albania	Internal	Distribution of shares
Azerbaijan	Distribution of shares	External
Belarus	Internal	Distribution of shares
FYR Macedonia	Internal	External
Bosnia and Herzegovina	Distribution of shares	External
Bulgaria	External	Distribution of shares
Montenegro	Distribution of shares	External
The Czech Republic	Distribution of shares	External
Estonia	External	Distribution of shares
Georgia	Distribution of shares	External
Croatia	Internal	Distribution of shares
Armenia	Distribution of shares	Internal
Kazakhstan	External	Distribution of shares
Kyrgyzstan	Distribution of shares	Internal
Latvia	External	Distribution of shares
Lithuania	Distribution of shares	External
Hungary	External	Internal
Moldova	Distribution of shares	External
Poland	External	Internal
Romania	Internal	External
Russia	Distribution of shares	External
Slovakia	External	Distribution of shares
Slovenia	Internal	Distribution of shares
Serbia	Distribution of shares	External
Tajikistan	External	Distribution of shares

Source: *European Bank for Reconstruction and Development, Transition report (Crisis and Transition)*, 2011, p. 87.

2.4 Previous research on privatization and its effects in transition countries

This part will focus more on the former studies and researches conducted on privatization, with special reference to privatization in transition countries, theoretical premises and the expected outcomes elaborated earlier. One of the main issues many authors were interested in is about the link between methods of privatization and growth of a country. For example, Bennett, Estrin and Urga (2007) examined how different methods of privatization might have affected growth in transition economies. Using several econometric specifications, including fixed effects and GMM, they estimated a cross-country panel growth model for 1990–2003. The findings indicate that only voucher privatization has been significantly associated with faster growth. Moreover, neither private sector development *per se* nor capital market development exercised a significant

influence. In another study, Bennet, Estrin and Maw (2005) tried to investigate why countries in many cases chose mass privatization as the primary method of privatization. Their study shows that the political imperative to eliminate the widespread ownership of firms by the state in the early phase of the transition process was not necessarily attained at the cost of the government's revenue objectives. The aim of rapidly reducing state ownership through mass privatization may have been rational in an economic as well as a political sense. Gouret on the other hand clarifies what dominant methods of privatization contributed to the macroeconomic gains from privatization during the transition. He discovered that economic performance gains come only from the use of gradual sales as a primary method of privatization (Gouret, 2007).

Another big group of studies was focused on relations between effects of privatization and ownership structure in transition countries. For instance, Estrin et al. (2009) and "Shock therapy" approach refers to sudden and radical changes that occur when a country is in transition from a central-planned to a market economy. Shock therapy reforms include price liberalization, massive privatization of state-owned enterprises and trade liberalization. The most important policy implication of their survey is that privatization per se does not guarantee improved performance, at least not in the short run. Type of private ownership, corporate governance, access to know-how and markets, and the legal and institutional system matter for restructuring and performance. Foreign ownership tends to have a positive effect on performance. Estrin et al. (2009) made an extensive study about effects of privatization and ownership. They distinguished separately the impact of privatization on efficiency, profitability, revenues, and other indicators and distinguished between studies on the basis of their econometric methodology in order to focus attention on more credible results. The study was undertaken in order to summarize what had been learned so far and what new conclusion can be derived. They discovered that the effect of privatization is mostly positive in Central Europe, but quantitatively smaller than that to foreign owners and greater in the later than earlier transition period. In the Commonwealth of Independent States, privatization to foreign owners yields a positive or insignificant effect while privatization to domestic owners generates a negative or insignificant effect. Crivelli (2012) focused on financial aspect of privatization. In his study he uses a panel of 20 transition countries over 19 years to address a central question of fact: Did privatization help to promote local governments' fiscal discipline? His study was about links between privatization and the fiscal decentralization reforms. The main findings of the study showed that privatization alone will not significantly contribute to establishment of fiscal discipline to local governments. However, privatization and subnational fiscal autonomy along with reforms to the banking system – restraining access to soft financing – may prove effective at improving fiscal balances among local governments.

Overall, the empirical literature examining the benefits and outcomes of the privatization process in transition economies reveals mixed results and inconclusive evidence. It definitely points to privatization being a very complex and socially sensitive transition process characterised by many different and important features some of which we discuss below.

2.5 Privatization problems and issues

Notwithstanding the earlier elaborated main theoretical propositions relating to the benefits and expected outcomes of privatization, the literature on privatization entails cautiousness associated with many factors that influence the privatization process and its outcomes, which largely explain the inconclusive evidence resulting from the empirical investigation on privatization. For instance, according to Estrin et al. (2009, pp. 10-12) in order for the privatization process to succeed, several important preconditions have to be fulfilled:

- Selection of appropriate methods and efficient organisation of activities pertaining to the implementation of privatization;
- Stable macroeconomic environment;
- Adequate economic policy;
- Transparent system and stable system of regulations and measures setting the rules of the game in economics.

Privatization is not a simple series of transactions, but a continuous and long-term process which depends on a number of factors. Privatization of individual companies can be made more predictable and less vulnerable to corruption if the country, in addition to generally good and transparent government structure and track record of previous successes, has in place detailed elaborated and clear privatization policy and strategy which, without a shadow of a doubt, establish the fundamental rules in a transparent manner (Transparency International B&H, 2009). The policy should determine the general position of the government with regard to privatization, the purpose and objectives to be achieved, as well as the methods preferred. This should include the clearly set criteria on what companies are to be privatized and when. Privatization policy should, also, determine institutional aspects (whether the responsibility should be entrusted to a separate, central privatization agency or divided between different technical ministries) and protective control and supervision measures (internal and external audit, parliamentary supervision, etc.). Privatization has to be flexible with a possibility of change of privatization plans, considering that the market conditions change rapidly and thereby prescribed principles, measures and manners of privatization cease to be a viable option for the implementation of the process itself (Estrin et al., 2009).

Furthermore, the vulnerability of privatization to corruption and other forms of malfeasance is, to a large extent, determined by the chosen method and modalities of privatization, general political and administrative environment in the country, nature and quality of its basic economic structure (whether the country has a competition-based economy or not; is the economy controlled and regulated by the state, or even „trapped“ by oligarchic elements), quality of the laws and institutions, regulations and regulatory framework which pertains to privatization programme

and its control, and, most importantly, by the level of transparency of privatization rules and of all the steps in privatization process (Transparency International B&H, 2009). We have to bear in mind that there is a clear and direct correlation between traditional policy of free access to information and freedom from corruption in all countries, as has been indicated, year to year, by the Transparency International's Corruption Perceptions Index (hereinafter: CPI), which ranks the countries around the world in terms of the degree of perceived corruption.

The quality of privatization process and its vulnerability to corruption are also largely determined by the degree of development of an efficient parliamentary control, financial market institutions, and the judiciary. In the countries where these institutions are in their early stages of development we may identify a particularly vulnerable risk points, in addition to the common corruption entry or risk points. These risk points, on one hand, include shortcomings in the functioning of financial market institutions such as stock exchanges and banks which possess international experience and connections and, on the other hand, absence of efficient control institutions such as external and internal audit institutions or functional parliamentary supervision. In this context, what may be of value is a central, independent anti-corruption agency, respected and supported by the Parliament and executive power, able to investigate and process the cases of corruption among highly positioned politicians and corrupted entrepreneurs who maintain close high-level political ties, and ensure that they will be held accountable for their deeds (Transparency International B&H, 2009).

Possible problems in privatization process were globally identified, mainly by the role of International financial institutions. Impetus for rapid privatization process and „successes“, has yielded to more systematic, more comprehensive and detailed preparations and procedures for implementation, which were based on efficient and transparent privatization policies, laws and institutions (Estrin et al., 2009). These global experiences provide valuable information and, at present, influence similar processes in many countries and institutions. In order to ensure coordination of the process of privatization, a state needs to establish an institutional system and bodies (ministries, agencies, etc.). They are supposed to take responsibility in the course of implementation of privatization. At the same time, it is necessary to adopt adequate regulations which will enable efficient transformation of state companies. In view of the highlighted importance of institutional and regulatory arrangement for privatization, and the purpose of this thesis, in sections to follow we investigate the importance of, the nature and the character of institutional reform in the privatization context, while referring to previous literature on the matter.

3 THEORETICAL FRAMEWORK OF INVESTIGATION

Process of privatization requires many changes in the existing institutional and regulatory system of a country. Instrument of new institutional economics, which can be classified as continuation

of neoclassical economic theory and which was elaborated in the works of Douglass North – enables us to skip the boundaries of individual research areas and examine economic processes while respecting institutional structures, with the objective to explain the emergence, change and work of institutions. Research subjects include ownership rights, laws and markets and the economic analysis takes into account their costs and efficiency. A starting point is the assumption that social processes are determined by institutional relations, their right to act and structure of their initiatives. If privatization, as a change of the ownership system, is understood to be a part of the institutional change, then the complex procedures of redefining ownership rights and possession rights can be examined using the theory of institutional changes.

North (1991) defines institutions as ‘humanly devised constraints that structure interactions’. Accordingly, institutions are rules of society which reduce complexity and insecurity in everyday events and which determine the conditions of exchange. The institutional framework is therefore very important for efficiency of the economy and of a society (North, 1991). Unlike institutions, North perceives organisations as entities which were made to maximise usefulness of individual members. They include unions, political groups and public bodies. Institutions are not permanent and they change over time. According to North, the institutional change is a continuous process which begins by a mutual interaction between institutions and organisations, which is of key importance for understanding the historical change. Institutions exist, not only as formal rules – as constitutions, laws and rights of possession, but also as informal restraints – such as sanctions, customs, traditions and codes of conduct (North, 1991). While formal institutions can change in a rather short period of time, informal ones, such as conventions and traditions, change at a slower rate and have tendency not to change (North, 1991).

Furthermore, when considering institutional changes, it can be concluded that historical and other conditions affect current decisions and accordingly determine direction of future development. Mutual interdependence of certain institutions, influence of old institutions on new ones and rigid informal institutions lead to such a development of events which depends on historical path and which is characterised by elements of the past. Such dependence on a historical path narrows down the number of potential alternatives and thus determines the future path. Once the developmental path takes some direction, it becomes amplified by externalities of surrounding network and mutual interaction of institutions and organisations (North, 1991). Therefore, dependency on the historical path is a self-reinforcing process. By using the theory of institutional change, it is possible to notice that the choice of the privatization strategy in the process of transition is not only the result of economic calculations, but it demonstrates the signs of dependency on the historical path. Accordingly, decisions to be made today or tomorrow are determined by the past, i.e. certain structures and institutions of the old system can codetermine the further course of privatization.

Many transition countries experienced that privatization could not be carried out under the existing governmental administrative structures or processes. More specifically, the process of privatization has often required specific institutions in place, as well as competences, skills and

experiences that cannot be usually found in public sector of transition economies. The skills and experience needed - as well as the decision-making process and accountability requirements - demanded a unique approach. Because of that, many transition countries established special institutional bodies in order to conduct the privatization process in an easier and more successful manner. In order for these institutions to be functional, it was first necessary to adopt adequate laws. The law on privatization determines entities which are responsible for privatization with the objective of its efficiency, transparency and lawfulness. The privatization law only defines their role in the privatization process, while their status, rights, duties and other issues relevant for their work are regulated by separate regulations. Specific institutional and legal changes that were introduced will be further elaborated in the text below. In this part of the thesis, we will present the models of privatization institutions used in transition countries, research work on this topic and conclusions reached.

3.1 Legal and institutional framework for privatization

There are numerous studies that investigate the importance of institutions that is institutional and legal framework in the privatization process. Naguib (2009) investigates in his paper the difference between the Egyptian and Argentinean approach to privatization and foreign direct investment (hereinafter: FDI) and how their different policies, institutions and regulations affected the progress of their respective privatization programmes and FDI participation. The analysis indicates that, in Egypt, the legal framework of privatization did not explicitly incorporate FDI participation. FDI regulations were developed separately from privatization regulations. As a result, a foreign investor in Egypt is faced with multiple laws and multiple regulating agencies for FDI. Unlike in Argentina, the legal framework of privatization explicitly incorporated the participation of FDI, and FDI regulations were totally liberalised. This explains why FDI participation in Argentine privatization during 1989 – 2000 accounted for 63% of privatization proceeds, while, in Egypt, FDI participation accounted for only 24% of privatization proceeds during 1993 – 2000. Furthermore, what helped the Argentine government to apply a speedy privatization was the existence of strong and unanimous political and public support to privatization. In Egypt, on the other hand, there has been constantly a division among the government officials regarding which SOEs to be privatised and by what method, and that was partly influenced by personal objectives and a desire to keep office. In other words, the privatization programme in Egypt progressed without any regulatory agencies in place. And by the time it reached to a halt in 2005, the government was just starting to create regulatory bodies. In summary, Naguib's study shows that the basic difference between the Argentine and Egyptian experiences with privatization and FDI is that while in Argentina full liberalisation of FDI regulations was coordinated with the application of speedy privatization programme, backed up with strong political and public commitment, in Egypt, FDI liberalisation developed gradually and separately from the application of a relatively cautious and conservative privatization programme that lacked unanimous commitment from the various parties involved.

Analysing the Russian privatization experience, Black, Kraakman and Tarassova (2000) identify three factors that may explain the failure of the reform in this country:

- Mass privatization of state-owned enterprises generated a large number of expropriation activities by new managers.
- The incentives towards profit put in place before the restructuring of privatized firms were diluted in a hostile environment characterized by a constraining fiscal system, high government corruption, a heavy bureaucracy and a high organized crime rate.
- The failed privatization of the bigger firms jeopardized any future reform and failed to convey credibility. Failed transactions enhanced opportunities for corruption and for expropriation of the firms' resources by new owners, without any legal consequences.

The authors conclude that decision makers should pay a particular attention to build the adequate institutional infrastructure in order to avoid any incentives for expropriation or corruption, and to further enhance market economy. Without such infrastructure, mass privatization of large firms will fail to boost economic growth.

Hanousek and Filer (2002) discussed the example of the Czech Republic that privatized through vouchers before putting in place private or public regulatory bodies, ultimately resulting in multiple opportunities of expropriation by managers and majority shareholders of newly privatized firms. On the other hand, those countries that have put in place privatization that favour ownership concentration have obtained better results. Hanousek and Filer (2002) explained this by the fact that economies in transition have been functioning with lagged legal systems based on the Soviet law, which includes no laws to govern the corporate world. Pistor et al. (2000) however argue that it is not so much the lack of laws but rather the lack of enforcement of existing laws that contributed to the failure of privatization in transition economies.

In his study of the privatization reform in Africa, Nellis (2005) argues that "Privatization outcomes are heavily affected by the institutional setting in which divestiture takes place". Nellis (2005, p. 11) sustains that the appropriate institutional infrastructure that guide market operations should consist of " The definition and protection of property rights, contract enforcement and commercial dispute settlement through lawful, peaceful means, or, more broadly, court decisions that are timely and based on the law, not payments; a degree of regulatory capacity; functioning bankruptcy/insolvency regimes; and a public administration that meets modicum standards of predictability, competence and probity and thus lowers transactions costs". He concludes that if these institutions of legal governance are not working properly, privatization will likely lead to suboptimal or even negative results.

Zinnes et al. (2001) use a panel data set from twenty-five transition countries over a period 1990-1998 to find that privatization does not by itself increase GDP growth. They use indicators

representing the components of the depth of privatization and privatization progress in their analysis and suggests that a positive effect of privatization on economic growth is present when privatization is accompanied by in-depth institutional reforms including the rule-of-law, hard budget constraints, and investor protection. Hence, the results of their study suggest that if these institutions are not developed privatization actually exhibits adverse impact on economic performance. Further, Brown et al. (2006) suggests that privatization in transition economies succeeds in that it substantially improves productivity only if the proper institutional setting is in place including: private property rights protection, rule-of-law, hard budget constraints, competition and regulation. Similarly, the results of Smaoui and Boubakri (2004) study confirm that for privatization to succeed, the existence of efficient and well functioning governance institutions is fundamental. They use a sample of 56 developing and developed countries over the period 1986-2004, and a GMM technique to estimate the impact of the quality of governance institutions on the success of the privatization reform, while controlling for macroeconomic and political factors. They measure the quality of the country's institutions with an equally weighted index of the following governance indicators: corruption, law and order, bureaucratic quality, government stability. Further, using a sample of 35 developing countries between 1982 and 1999, Banerjee and Munger (2004) investigated the macroeconomic, political and institutional determinants of privatization. To measure the governance or institutional quality they have used institutional variables created by aggregating the rule of law, bureaucratic quality, corruption, risk of expropriation, and repudiation of property. Their results show that legal institutions emerge as a significant determinant of privatization. In the same manner, Adams and Mengistu (2008) examined the determinants of privatization for a sample of 22 Sub-Saharan African countries over the 1991-2002 period, showing that the institutional infrastructure is a major determinant of privatization in Sub-Saharan African countries. Bartolotti et al. (2001) looked at the impact of political, economic and institutional factors on the privatization process. The regressions run a sample of 34 countries over the 1977-1999 period. The empirical analysis shows that different legal frameworks are associated with radically different patterns of investor protection and corporate governance around the world. They conclude that investor protection is an important determinant of privatization. Specifically, the market value of a company and consequently its privatization proceeds will be lower where legal protection is poor since there will be a lower demand for privatized equity by minority shareholders.

3.2 Institutional framework for privatization: an overview

Although there is no such thing as a unique or ideal institutional structure ensuring the effective implementation of a privatization program, Guislain (1997) argues that it is of utmost importance to clearly define the respective roles and powers of the major authorities involved in the privatization process e.g. parliament, relevant ministries, privatization agency(ies), public holding companies, privatization funds, securities exchanges, SOE management and board of directors. Different transition countries have adopted different institutional arrangements for mass privatization ranging from the formation of a privatization institution as an independent

state agency subject to political control only at top, or simply by delegating privatization policy and implementation issues to a relevant ministry. Most institutional frameworks for privatization comprise three different levels of decision making:

- Cabinet/Prime Minister or President level – few decisions are taken at this level and they are usually of an overall policy nature that formulate approaches on labour issues, liabilities to banks and financial institutions, environmental liabilities and other recurring issues, as well as decisions on which enterprises to include in the programme at any given time.
- A Cabinet Sub-Committee or Privatization Board. This is normally comprised of key ministers supplemented, in the case of a privatization board, by experienced private sector/civil society figures. This is the body that takes the key decisions in the course of a transaction, such as approval of choice of privatization method and of preferred bidder.
- The executive/implementation level, which comprises a dedicated Privatization Unit of professionals headed by a senior figure who leads the privatization programme.

International experience demonstrates that an effective institutional structure for privatization will have the following key characteristics:

- an effective institutional setting,
- legal authority,
- strong executive body,
- an effective head of the executive body,
- a close relationship between the executive body and the political decision-makers,
- appropriate delegation of decision -making,
- a strong communications capability.

Guislain (1997) argues that developing an adequate legal framework governing privatization process is essential. Specifically, he points that enacting privatization law offers several advantages: it represents an immediate and concrete statement of explicit political support for and commitment to the privatization process, increases the accountability of the executing agency, makes it more difficult to undo the reforms being implemented, and provides an opportunity to change (and improve) the existing business environment to facilitate privatization. The development of specific legal instruments that indicate who is empowered to initiate a privatization transaction; request the initiation of a transaction; prepare the transaction; organize the buyer selection process; negotiate the deal; authorize the conclusion of the operation; sign the pertinent agreements; ratify these agreements where appropriate; implement the privatization agreements; and ensure their correct execution by all the parties, is considered essential in

ensuring transparency, accountability and the success of the privatization process in general (Guislain, 1997; Guriev & Megginson, 2006).

3.3 Legal framework for privatization: an overview

Privatization laws provide authority to government agencies and clarify the rights of investors, both domestic and foreign, to participate. These laws are supported by elements of the wider legal framework such as corporations and capital markets laws. Laws regarding privatization provide the authority and procedural requirements for ensuring that transfers occur in an open and responsible manner (Mullan & Ceddia, 2003). Institutions are shaped by the law and institutions that serve public purposes are based upon public law. The quality of a system of public law relates to clarity, enforceability, and commitment. To be effective, laws must be accepted as legitimate by those to whom they apply (Hamm, Stuckler, & King, 2010).

The choice of whether or not to enact a privatization law depends upon the constitutional and legal circumstances of the country concerned (Guislain, 1997). Guislain (1997) and Guriev and Megginson (2006) state even if a separate privatization law is not mandatory, such a law can serve a variety of purposes, such as to:

- Define the government's objectives and establish commitment to the privatization process;
- Make amendments to existing laws which otherwise would be an obstacle to privatization;
- Create institutions with the authority to implement privatization;
- Avoid the "vacuum of authority" which can lead to spontaneous or unauthorized privatization;
- Allow for the financial restructuring of enterprises prior to sale;
- Define the methods of privatization and any limitations on potential bidders; and
- Provide for the allocation of sale proceeds.

The legal framework of the country should support privatization in two respects (Guislain, 1997):

- Laws may be required to govern the process of preparing enterprises for privatization and undertaking the transactions; and
- The overall legal environment must be one in which the newly-privatized businesses can obtain access to land and credit, enter into enforceable contracts for their inputs and outputs, and compete on a basis of equality with one another and with the residual state sector.

The success of privatization reform requires the existence of well-developed legal framework of governance that regulate sales and market operations. International best practice and experience

illustrates that the privatization process, programme and institutional framework should be underpinned by primary legislation (Estrin et al., 2009; Zinnes et al., 2001; Eagle and Christensen, 1994). The adoption of privatization legislation gives political legitimacy to privatization and gives legal authority to act to a specialised unit (Estrin et al., 2009). Despite their importance in shaping the privatization process, the legal impact on privatization has been rarely investigated. According to Guislain (1997), the legal environment ensures that the contracts are enforced, conflicts are resolved, minority shareholders' rights are respected and bankruptcy and transactions between economic agents are well regulated. Securing property rights thus relies on the way existing laws are enforced. This implies contract law enforcement as well as law existence on the books. Guislain (1997) argues that during the preparation of the privatization process, it is important to specifically address the following issues: how the laws on property rights are defined and enforced, what kind of constraints there are on the transfer of property rights, whether there are any restrictions on foreign ownership, how efficient the judicial system is, how individual rights are protected, etc. When the legal system is not well defined and property rights are not well protected, a new legislation must be put in place at the time of privatization in order to eliminate any obstacles to the effective transfer of ownership to maximize the chances of success of the reform. In a nutshell, implementing privatization definitely requires a reform of the legal system.

4 THE TRANSITION PROCESS IN B&H

4.1 Historical background in brief: The war and the demise of Yugoslav Federation

In the period between the World War II and 1991, when it was one of the six republics of the former Yugoslavia, Bosnia and Herzegovina has achieved a significant economic transformation. Economic growth averaged 5% a year (Statistical yearbook, 2006, p.23). In 1991, income per capita amounted to \$ 2.400,00, excluding the service sector, which was a common practice in the former socialist economies. Twelve large companies accounted for 35% of the gross domestic product and four of them generated more than 40% of total exports. Companies were organized as self-managed companies of associated labour, compliant with the principle of a self-managed market economy, which was a halfway between a centrally planned and a modern market economy. In 1990-1991, Bosnia and Herzegovina's main foreign trade partners were the former Union of Soviet Socialist Republics (hereinafter: USSR), Germany and Italy. The trade with European Economic Community (hereinafter: EEC) countries generated a surplus in 1991. Major export sectors were chemicals, ferrous metallurgy, metal processing, leather shoes, electrical appliances, finished wood, timber and panels, and finished textile products (Domazet et al., 2008).

The war in Bosnia and Herzegovina started in April 1992, following the dissolution of Yugoslavia, adding to the political and security destabilisation. Elections in B&H 1991 resulted in a deep schism between the three major political parties in the Parliament, particularly with regard to the independence issue. The referendum on independence, which was held on March 1, 1992, was boycotted by Bosnian Serbs. The referendum produced a nearly two-third voter turnout of whom 99 percent supported B&H's independence, which was declared immediately. Following this, B&H was admitted as a Member of the United Nations and received international recognition by European Union and United States. Bosnian Serbs refused to accept it (Bayliss, 2005). In April 1992, the local Serbian militia, with the backing of the elements of the Yugoslav military, started the war which quickly infected all three ethnic groups (Transparency International B&H, 2009). The ensuing war lasted for 3.5 years, until the late 1995. Although it is impossible to obtain the exact data on human and material losses suffered in the war, there is a general consensus that human suffering and losses were unparalleled in the history of Europe after the World War II. The devastating impact of war on the health was reflected in mortality rate of the infants in B&H, which grew from 7.4 in 1991 to 14.0 deaths per 1000 liveborn babies in 1995 (Statistical yearbook, 2006, p.25). The war inflicted huge material damage. According to Transparency International B&H, over the two thirds of residential homes and apartments were damaged, and one fifth was completely destroyed. It is estimated that nearly 30-40% of hospitals were destroyed and 30% of health workers lost either to death or emigration. In late 1995, up to 70 percent of school facilities were destroyed, damaged or used for another purposes, and many teachers' lives were lost as well. Until the end of war, industrial production saw a huge decline. It is estimated that its volume was only 5 percent of the 1990 level. 45% of industrial plants and facilities were destroyed while electricity and coal production amounted to 10 percent of the pre-war output; livestock number declined to 30 percent of the pre-war number. Until 1994, gross domestic product and GDP per capita dropped to a less than 20% of the pre-war level, which was considerably lower when compared to the 1989 – 1990 period and when compared to any other country in the Eastern Europe and former Soviet Union (Statistical yearbook, 2006, p.23). The unemployment and poverty were widely spread at the end of the war. Peace was achieved in the late 1995 owing to determined efforts of the United States and European Union.

The war ended by the Dayton Agreement signed in Paris on 14th December 1995. Along the lines of the peace negotiation process peace was agreed on November 25th, and the Dayton Agreement has established the constitution of the B&H as an independent state. The resulting state constituency of B&H is extremely complex including two Entities many levels of government, and principally reflecting the aspirations of the three major ethnic groups to retain as much as possible control over their affairs. More specifically, the state of B&H is characterised by a unique political structure, within which the country is comprised of two entities, Serb Republic accounting for 49 % of the territory and Federation of Bosnia and Herzegovina covering 51 %. Federation is comprised of ten cantons.

Overall B&H has 13 governments (ten cantons, two entities and one state government of Bosnia and Herzegovina), and very limited powers reflecting minimum competences over economic policy issues (e.g. monetary policy, international trade and debt, indirect taxation). The Government of the state of B&H was vested with minimal powers, its role being limited to bear minimum powers necessary so as to be perceived as a single sovereign country. The majority of powers and competencies were allocated to the two entities. The entities retained the competencies regarding the separate military and police forces, as well as the competencies over nearly all economic policies including fiscal revenues, supervision of banks and provision of social services. The State depends on the entities in servicing its external debt – for financing diplomatic missions and covering administrative costs. The government of Srb is centralised, to a large extent, whereas the Federation of B&H is divided into 10 cantons which are basically organised along the ethnic lines. Each canton has its Prime Minister and the government. They have retained control over the majority of the revenues relating to direct taxation generated on their respective territories and, in addition to other functions, have competence over the education and health services, including the higher education. The further division, in addition to the entity and cantonal level, includes municipalities and cities. In addition to two entities, in 2000, under the ruling of a special international Arbitral Tribunal the Brčko District B&H was established. Brčko District, under its Statute, is a single administrative unit of local self-government existing under the sovereignty of Bosnia and Herzegovina. It has its own multi-ethnic administration, police and judiciary. The District is demilitarized and it ensures all necessary freedoms for its citizens.

In addition to the state apparatus, B&H saw establishment of the Office of the High Representative (hereinafter: OHR), vested with extraordinary powers. The institution of the High Representative was created in the Dayton Peace Agreement to oversee implementation of the civilian aspects of the Agreement. In practice, the OHR has considerable powers and may impose the legislation and remove public officials from positions. Therefore, the international community has been extensively involved in the management of the country (Transparency International B&H, 2009).

To summarise, the political stage of B&H is characterised by several levels of government, huge number of parties and frequent reluctance or refusal of political leaders to achieve mutual cooperation regarding the issues which should be of a common interest. These factors have affected economic and social progress of B&H throughout the entire post-conflict period, as we discuss in more detail in sections to follow.

4.2 The evolution and the character of the transition reforms in the post-war period in B&H-an overview

Bosnia and Herzegovina's economy, much like the economy of other former socialist countries, has been undergoing the process of transformation from non-market, former self-managed economy to a modern market economy. The transition package which is being implemented is

based on the “rules of the game“ established under the Washington Consensus Domazet et al., (2008). This consensus comprises transition policies recommended by the World Bank and IMF. These policies are targeted at vital areas of economies of the former socialist countries which include Bosnia and Herzegovina as well. Accordingly B&H implemented policies of macroeconomic stability principally relying on independent Central Bank authority functioning under the Currency Board arrangement, pursued rapid and ‘passive’ trade liberalisation immediately in the aftermath of Dayton Peace accord, and aimed at rather quick privatization of the state capital, without proper consideration of institutional reforms necessary to pursue market liberalisation and privatization policies effectively (Silajdzic, 2012; Domazet et al., 2008). Furthermore, in the early years of post-war reconstruction and transition B&H opted for mass privatization including rapid privatization and liberalisation of the financial sector of the economy, given the scarce financial capacity of the public sector. Furthermore, eroded institutional infrastructure pertaining to limited knowledge and human resource capabilities in a more general context resulted in the transition reforms being principally led by the International Financial Institutions i.e. the International Monetary Fund, and the World Bank. This is, to some extent, the result of war, and different political options that appeared after the war. Conflicting interests of the entities, against the interest of the entire Bosnia and Herzegovina, challenge the integral structure of the state and all of its state functions. For this very reason transition policy was mostly implemented on the basis on the entity laws, which resulted in non-efficiency of transition process (particularly in stimulating the foreign investments).

At the very beginning of transition, the "blossoming" was both promised and indeed expected. However, although the transition reforms have been ongoing for over 20 years, they have not yielded the expected outcomes. For instance, Domazet et al. (2008) conclude that the process of economic development has hardly even started, and that the economy is far from being on the path of successful transformation. They conclude that it is becoming increasingly evident that the country needs an alternative solution for its economic development. Bosnia and Herzegovina falls under the category of less advanced transition countries.

Prior to the war, the population of Bosnia and Herzegovina was 4.4 million. The preliminary results of 2013 Census show that B&H has population of 3.791.622. In 1998, 61% of the population lived in poverty, per definition of necessary income which enabled a 4-member to buy less than 2/3 of defined basket of goods to fulfil their basic needs (Statistical yearbook, 2006, p.24). In Federation of B&H, nearly one quarter of population living under the line of poverty (Transparency International B&H, 2009). The average daily income of indigent person is so low that these persons literally survive from the financial aid received from their relatives in the country and relatives and friends living in abroad, international humanitarian aid and occasional work in grey economy (Transparency International B&H, 2009).

The official statistics recorded an impressive growth of gross domestic product in the first years after the war: 21% in 1995, 69% in 1996, 30% in 1997, and 18% in 1998 (Statistical yearbook, 2006, p.25), albeit from the low base. During the war, the GDP plummeted to such a low level

that the recorded growth in the nineties is proportionally high only as a very low-base percentage. The table 3 indicates the evolution of GDP and GDP per capita for B&H in the period 2008-2012. The growth of 5.59% recorded in 2008 was the last relatively high growth rate recorded. In forthcoming years B&H saw the rapid GDP decline and even the negative real GDP growth rates in 2009 and 2012.

Table 3. The gross domestic product of Bosnia and Herzegovina, the first results, July 2013

Year	Nominal GDP (in millions of KM)	Nominal GDP (in millions of USD)	GDP per capita in B&H (in KM)	GDP per capita in B&H (in USD)	Real GDP (in %)	Population (in thousands)	The average annual rate KM/USD
2008	24898	18626	6480	4848	5,59	3842	13367
2009	24202	17204	6928	4477	-2,83	3843	14068
2010	24773	16774	6446	4365	0,72	3843	14769
2011	25680	18263	6688	4756	1,02	3840	14061
2012	25654	16848	6688	4392	-1,1	3836	15227

Source: *Federalni zavod za statistiku [Institute for Statistics of the Federation of B&H], Statistical Yearbook 2013, (n.d.), p. 28.*

In the next table (table 4) we may see the changes in the GDP per entities in B&H, in Bosnia and Herzegovina, Serbia, Croatia and 27 EU member states. Although significant oscillations in the real GDP growth in % in B&H have not been observed, when compared to the other countries, it is evident that its amount per capita is substantially lower against if compared to other countries in the region. The GDP per capita in EU averages at about KM 50.000,00, in Croatia at about KM 20.000,00, while in Serbia the living standard is approximated at about KM 8.000,00, whereas in B&H it averages about KM 6.400,00 (in Serb Republic the average GDP is KM 5.900,00, in Federation of B&H KM 6.900,00).

Table 4. The changes in the GDP per entities in B&H, in Bosnia and Herzegovina, Serbia, Croatia and 27 EU member states

	2009.					
	RS	FB&H	BH	Serbia	Croatia	EU 27
Nominal GDP (in million BAM)	8.236,30	15.428,80	24.202,00	56.491,00	89.863,00	23.044.725,60
GDP, nominal growth rate in %, (y/y)	-3,0	-2,5	-2,8	2,2	-2,8	-5,7
GDP, real growth rate in %, (y/y)	-3,0	-2,6	-2,8	-3,5	-6,0	-4,2
Population (estimation, thousands)	1.435,20	2.327,30	3.842,60	7.320,80	4.429,10	499.723,50

table continues

continued

	2009.					
	RS	FB&H	BH	Serbia	Croatia	EU 27
GDP per capita (in BAM)	5.739,00	6.629,40	6.298,00	7.715,70	20.289,30	46.115,00
	2010.					
	RS	FB&H	BH	Serbia	Croatia	EU 27
Nominal GDP (in million BAM)	8.318,20	15.901,20	24.772,80	54.775,20	88.743,80	23.944.114,40
GDP, nominal growth rate in %, (y/y)	1,0	3,1	2,4	5,9	-0,2	3,9
GDP, real growth rate in %, (y/y)	0,8	0,8	0,7	1,0	-1,2	1,8
Population (estimation, thousands)	1.433,00	2.337,70	3.843,10	7.306,70	4.417,80	501.103,40
GDP per capita (in BAM)	5.805,00	6.802,20	6.446,00	7.512,30	20.087,90	47.782,80
	2011.					
	RS	FB&H	BH	Serbia	Croatia	EU 27
Nominal GDP (in million BAM)	8.682,40	16.401,80	25.680,10	61.550,60	89.791,10	24.701.073,40
GDP, nominal growth rate in %, (y/y)	4,4	3,1	3,7	11,3	2,0	3,2
GDP, real growth rate in %, (y/y)	0,8	1,0	1,0	1,6	0,2	1,5
Population (estimation, thousands)	1.429,70	2.338,30	3.840,00	7.276,20	4.284,90	502.477,0
GDP per capita (in BAM)	6.073,00	6.931,70	6.684,00	8.459,20	20.955,30	49.158,60
	2012.					
	RS	FB&H	BH	Serbia	Croatia	EU 27
Nominal GDP (in million BAM)	8.585,00	16.469,10	25.654,30	58.542,50	85.552,30	25.228.543,60
GDP, nominal growth rate in %, (y/y)	-1,1	0,4	-0,1	-4,9	0,0	2,0
GDP, real growth rate in %, (y/y)	-1,1	-1,1	-1,1	-1,7	-2,6	1,6
Population (estimation, thousands)	1.429,30	2.338,30	3.836,00	7.241,30	4.284,90	502.422,60
GDP per capita (in BAM)	6.006,00	7.043,00	6.688,00	8.084,00	19.966,10	50.090,10

Source: *Investiciono-razvojna banka Republike Srpske [The Republic of Srpska Investment-Development Bank]. Economic Monitor 2013, n.d., p. 89.*

Bosnia and Herzegovina has considerable economic potentials in many sectors; however, the complex political environment and lack of willingness to implement profound structural reforms have delayed successful use of these potentials. Due to this, country's transition progress has stagnated for years. As pointed out by Transparency International B&H (2009) transition reforms not only saw very little progress especially in the last 8 years, but may be considered a failure considering the pattern of economic and industrial restructuring, especially in the last decade. It coincides with the time when the foreign experts, in addition to the local experts, became increasingly engaged B&H is lagging behind other South East Europe countries, according to majority of reform and business environment indicators. The country has a comprehensive privatization programme, but only a small number of major companies are listed for privatization.

Similarly to other countries in the region, the path of B&H towards sustainable growth and development requires much better focus on improving the business environment to develop private sector, strengthen the inter-entity ties and relations with neighbouring countries and better exploit the natural resources of the country. Transparency International B&H (2009) states that unfavourable external and internal circumstances will, most probably, have restrictive effect on the growth of B&H in the next two years. Certain growth is expected in the mid-term period, provided that global and regional circumstances are improved. However, the economy continues to be challenged in many areas, not only because the region is in difficult situation, but also because internal complexity of political structure of the country and poor investment climate constitute major obstacles for investments. There is also a risk of weakening of fiscal position if the authorities, especially in the Federation, fail to fulfil obligations assumed in line with IMF fiscal consolidation programme, as a result of strong pressure exerted by different interest groups. Any deviation from the programme may jeopardize further investments by European Union and World Bank.

5. THE PRIVATIZATION PROCESS IN B&H

5.1 The privatization in Bosnia and Herzegovina: the evolution and the character of the early transition privatization reforms

As discussed earlier in the thesis, privatization in transition countries rests on neoclassical hypothesis that private ownership brings greater efficiency in using resources and larger gains at macro-economic level, i.e. it enhances faster economic growth (Estrin et al., 2009). Therefore, the programme of economic privatization has been considered as one of the most important programmes which pertain to economic development and transition process in this country. Overall, the implementation of this programme is aimed at better using of all national potentials and individual capacities for the purpose of development of the country (Nellis, 1999).

Privatization process in B&H began already in 1990, at the time when B&H was still within the then Socialist Federal Republic of Yugoslavia (hereinafter: SFRY). The entire Yugoslavia was at the time involved in economic reforms including the transformation of ownership (Domazet et al., 2008). The year 1990 was a year of profound changes around the world. Majority of the countries of the Warsaw Pact initiated drastic transformation of their political and simultaneously, economic system. In an attempt to ensure that Yugoslavia followed the current trends in Europe, the Government of Yugoslavia adopted a programme of comprehensive reforms which were designed to gradually structurally transform the Yugoslavian economy into a free-market economy, attempting to build and enhance competitiveness of its industries within European and global perspective (Bayliss, 2005).

As it was the case with the rest of Yugoslavia, the companies in B&H were social property instead of being state-owned. In Yugoslavia, the so called social ownership represented a special form of collective ownership. The social ownership i.e. “company ownership” delegated to the workers, differed from the private and state ownership in terms of not having a clearly defined legal owner i.e. titular (Constitution of the Socialist Federal Republic of Yugoslavia, Official Gazette of Socialist Federal Republic of Yugoslavia, no. 9/74). Because of the negative definition of this form of ownership it was difficult to derive positive economic rights. This was particularly the case since the late eighties of the 20th century and beginning of the privatization process, first in the former Yugoslavia, and later in its successor countries. In addition to social ownership, the worker self-management, in particular– as a striking characteristic of Yugoslavian economic system – was a model which gave workers control over production means thus enabling them to participate in production process of the company (Bayliss, 2005). Therefore, it is no surprise that already in 1988 responsible stakeholders, via constitutional reform, pushed through the far-reaching reforms towards market economy. Since then it was possible to establish private companies without any conditions and 1989 Law on Privatization enable, amongst other, to transform the existing socially owned companies into private (Official gazette of Socialist Federal Republic of Yugoslavia, no. 84/1989). Competence over the launching and implementation of privatization was given to the companies i.e. workers’ councils. Since, under the Law, the income generated from privatization had to be distributed to each Republic where the company was headquartered, and management of socially owned companies had to make decisions to abolish their own rights, it was easy to understand why they were reluctant to do so or why they attempted the “block” the privatization of “their” companies. Individual privatizations begun to be launched only after the amendments to the 1990 Law on Privatization, under the term of Ante Marković as Prime Minister of Yugoslavia.

Privatization in line with the so called “Markovic’s model” was based on the method of internal buyout of shares (MEBO privatization model). This privatization method, at the very beginning of transition, seemed to be the best solution, as it considerably reduced fear of privatization and unfairness (Transparency International B&H, 2009). The sale to ‘Insiders’ was favoured because under the new law it was foreseen to issue “internal shares” at considerably discounted prices to

managers and workers, thus making it difficult to sell the companies' shares to foreign investors (Domazet et al., 2008). This model was widely socially accepted because workers were assumed to have built the companies' assets and created the long term perspectives of a companies' value added generation. Thus, by being involved in the work of the company and co-owners at the same time, whereby employees were co-responsible for business decisions, was assumed an additional motivation for employees in performing their tasks successfully (Domazet et al., 2008). These changes in Yugoslavia were also supported by the IMF and international community and were characterised as the most courageous and comprehensive reforms ever undertaken by a social country. Result of this process was privatization of capital in the amount of KM 1.4 billion or 8% of the total capital in B&H (Agencija za Privatizaciju u Federaciji BiH, 2014). Transparency International B&H concludes that thanks to the funds obtained through this privatization process, the Government managed to cut the external debt of the then SFRY in half in the period of only 18 months, which is considered to be the biggest success of this privatization process. Implementation of this model of privatization ended with the beginning of the war.

After dissolution of SFRY, responsibility for privatization was transferred to individual successor countries. However, the structures, set out within SFRY, such as social ownership linked with workers' management, notwithstanding solid baseline conditions such as e.g. extensive decentralisation and early entry into the reform processes, hindered efficient and quick transformation of ownership structures, significantly impacting the choice of privatization methods in successor countries. Overall, considering the context of fragile political framework, the privatization in former Yugoslav Republics was focused more on social and political acceptability than on economic efficiency (Bayliss, 2005). Hence, the early privatization process in B&H was implemented in such way in Bosnia that it resulted in only a small number of companies' shares being transferred to employees, while the slow pace and the dynamics of the early privatization process was accompanied by the difficulties of rising political conflicts and ethnic tensions within the country. The early privatization process was disrupted by the 1992-1995 war that severely impacted the potentials for successful transition reforms including privatization.

5.2 The privatization process in post-war transition period in Bosnia and Herzegovina

In the aftermath of Dayton Peace Accord, specifically since 1997, privatization has been the major policy in the entire country. With the end of the war, basic legal requirements were fulfilled for the beginning of the privatization process while reflecting on privatization approaches and the models used at the time in the countries in transition. In the aftermath of the war, specifically as of January 1st 1996, the state assumed ownership over the socially owned companies, and adopted a law whereby all social property was transformed into state property. Although analysts have different opinions concerning this law, the main argument for its

adoption was a need to ensure that a 'property' has a title holder, i.e. owner. By that law, which governed the transformation of social property, the state became the owner of:

- Natural assets and resources in general use;
- Social capital as presented in the balance sheet of legal entities as of 31 December 1991;
- Resources for which the right of use and management was held by local communities, social organisations, associations of citizens and political organisations, provided these resources were obtained from the budget;
- Real-estate built or otherwise acquired with budgetary resources or other resources of budgetary nature.

Notwithstanding the legal prerequisite on privatization, the economic setting within which the privatization was to be implemented had changed dramatically compared to the economic conditions of early transition reforms i.e. prior to the war. Bosnian economy suffered greatly in 1991 – 1995 war. The incomes and revenues suffered drastic decline, production capacities were mostly entirely physically devastated or suffered significant losses and large number of population left the country. Before the war, industrial sector of Bosnia and Herzegovina was dominated by 12 large companies, including Energoinvest, Unis, Šipad, Famos, Rudi Čajavec, Soda, Agrokomerc, and UPI. Beside these industrial titans, there were many privately owned small and medium sized enterprises. When the war ended, the companies had to struggle with devastating war damage and loss of markets. Even before the war, technology in these companies was obsolete and, on the top of it, the huge portion of that equipment was destroyed in war. The post-war politics focused on privatization, which implied conflicting interest and very little support was to be given to the state-owned companies. Domazet et al. (2008) notes that international «experts» imposed a concept under which our companies needed to be urgently sold, at any price, within a one year (quick privatization), with no need for previous restructuring or revitalisation of the companies. According to the dominant view on privatization imposed by the IFIs, it has been argued that restructuring and revitalisation would be performed by the new owners – private entrepreneurs, because the state either did not know how to do it or did not want to do it. According to Transparency International B&H in practice, this concept proved to be a strategic nonsense. Until today, the privatization failed to considerably stimulate production and programmed restructuring of the companies, modernise production facilities and induce employment (Bayliss, 2005, p. 84). Domazet et al. (2008) emphasize that in general, business environment was not favourable for investments due to bleak competitiveness prospects of privatising companies, weak market institutions, lack of transparency, poor and inefficient judiciary, and above all complex legal and regulatory environment underpinning the privatization process. In addition, the country was plagued by omnipresent corruption with cronyism and nepotism dominating the business environment.

Overall, the implementation of privatization programme in B&H differs from the way this programme was implemented in other post-communist countries mainly due to the economic damages caused by the 4-year war and the inefficient governance structures. Privatization in B&H has been difficult to achieve given the post-war context of the country characterized by low incomes, weak institutional and political systems and, hence, low investor interest (Bayliss, 2005). Considering that the country is comprised of the entities – Federation of B&H, Serb Republic and Brčko District B&H, which have different privatization programmes, the privatization in Bosnia and Herzegovina has been inevitably challenged by additional problems associated with complex administrative structures of the economy and challenges of post-war economic reconstruction and political reconciliation. Specifically, the legal and the institutional framework for privatization in B&H was created in accordance with the Constitutional premises of B&H as a state, hence by establishing Agency for Privatization of the Federation of B&H along 10 cantonal privatization agencies in Federation of B&H, Directorate for Privatization of Serb Republic and Office for Privatization of the Brcko District. Since 1997, the responsibility for privatization has been transferred to entities, and it has been implemented at the entity levels, with further fragmentation of the policy implementation at the cantonal levels in Federation of B&H. The basic law at the level of B&H is the Framework Law on Privatization of Companies and Banks in Bosnia and Herzegovina. This law recognises the right of the entities to privatize the companies and banks at their territories, which are not privately owned (Domazet et al., 2008). The law is aimed to facilitate the privatization process and to make it more transparent for the benefit of the citizens. Both entities have their respective agencies for privatization, distinct privatization laws and goals they want to achieve within the privatization process.

Overall, post-war privatization in B&H was implemented in several ways that is relying on different methods of privatization. However, mass privatization via voucher privatization through public offerings was principally endorsed under the entity privatization laws and used until 1999. This model primarily enabled the purchase of property, shares or total state capital in the enterprises, by using the certificates as means of payment. The citizens received certificates and, thus, were given the starting positions to open the private ownership share in generated social property. By opting for mass (large-scale) privatization, as a model used to change the existing structure of ownership over the state-owned property, the opportunity was given to all citizens of legal age to assume, through various claims, the ownership over the part of the capital which used to be socially owned. Majority of the state capital was privatized via this very model. By using this privatization model, the country created the pre-requisites to service its internal debt to its citizens. The biggest advantage of this model is reflected in relatively quick and transparent method of transformation of the capital from the state to private property, which is exactly what is needed in the transition economy. Analysts agree that the biggest disadvantage of this model is that it led to pure transformation of the ownership of the capital; however, it failed to launch new investments necessary for successful business operations in a market economy, it resulted in rather dispersed ownership structures leading to poor governing capacities of new privately

owned companies, as well as poor internal knowledge capacities and know-how necessary for successful corporate restructuring and revitalisation of production activities.

The voucher system, which was implemented in B&H, is considered particularly unsuccessful because it failed to provide fresh capital, new technologies and new managerial know-how. Bayliss (2005) concluded that the privatization in B&H did not serve to encourage economic development and strengthen competitiveness of B&H economy. Such a result was to be expected, if we take into account the fact that our transition process was solely focused on transformation of ownership. On the other hand, it ignored other, very important transition components (financial, organisational, managerial, market and programmed restructuring) which would increase efficiency and competitiveness of the companies at local and international market (Domazet et al., 2008). Many factors have affected the course of privatization process to date in B&H. Transparency International B&H (2009) emphasised the most important factors:

- Very poor management and preparation of companies for privatization. As noted earlier, as of January 1st 1996, the state assumed ownership over the socially owned companies. These companies have been poorly managed by the relevant ministries and no responsibility or accountability was determined for the state of these companies. Poor management of state companies is reflected in the situation in the companies such as Agrokomerc – Velika Kladuša, Krivaja - Zavidovići, and many others. Preparedness of the companies for the privatization was in particular affected by ownership disputes (Aluminij Mostar, Sarajevo Tobacco Factory – FDS, etc.), unknown and possible hidden liabilities of the companies, overpriced bookkeeping value of the companies, etc.
- Unfavourable environment for investments and starting up the business. Potential investors have assessed that their investments in B&H are threatened by the risk and uncertainty, due to the following: legal uncertainty (complex and non-harmonised legal framework, non compliance of domestic legislation with EU requirements, non-synchronised regulations which govern the same matter differently, inconsistency in enforcement of the laws, failure to implement bankruptcy proceedings), inefficiency of judicial bodies and land register authorities, absence of active social policy for workers who are laid off in privatization process (social uncertainty), poor business environment, fragmented economic space, poor image of the country, political instability of the country and the region, open and indirect political interference and obstructions of privatization process.
- What is offered is not competitive. Domestic companies were devastated in the war, completely paralysed, the production ties were severed, while the technology has become obsolete, and the markets were lost due to disappearance of a single Yugoslavian economic space. All these weaknesses were magnified by the poor management in the period of transition of the companies into state ownership. Instead of «goodwill», we introduced «badwill» into our privatization process.

- Highly decentralised and inadequately coordinated process of privatization is one of the key factors of failure. Privatization is implemented at the level of entities, pursuant to the entity legislation. In addition to entity institutions (Federal Agency for Privatization in the Federation of B&H and Directorate for Privatization in the Serb Republic), there are ten cantonal agencies for privatization. Their activities were inadequately coordinated and consequently they acted differently in the privatization process.
- Inconsistency in drafting the privatization legislation is yet another factor which contributed to the inefficiency of privatization process, and it resulted from the endorsement of the recommendations of the so called international privatization experts.

All in all, International Financial Institutions have been heavily criticised with respect to privatization policy recommendations and priorities in Bosnia and Herzegovina, and especially with respect to policy measures in the early years of transformation including proposed privatization methods (e.g. voucher privatization), and the suggested dynamics of implementation of privatization programmes which was not consistent with the pace and character of institutional reforms in the economy. One of the important arguments stated that the recommendations for quick privatization imply strong institutional capacity to manage the process effectively; that they depend on the initial socio-economic conditions and requirements for each country and that privatization, in particular, should not be plagued by certain prejudices (Transparency International B&H, 2009). The difficulties experienced in Bosnia Herzegovina, have to do with limited investor interest due in large part to the fragile and fragmented political and economic structure, the context which is far beyond the scope and the relevance of the privatization policy *per se* Bayliss (2005).

6 PRIVATIZATION PROCESS IN THE FEDERATION OF B&H: AN EMPIRICAL INVESTIGATION AND CRITICAL ANALYSIS OF LEGAL AND INSTITUTIONAL FRAMEWORK FOR PRIVATIZATION

6.1 Methodology

Earlier in the thesis we used the literature review method in order to critically examine the existing theories about privatization, and postulate the theoretical framework for privatization relevant to the specific and distinctive context of transition economies. The same method was used to analyse previous research on privatization in transition economies that is more empirical in focus. The special emphasis was on studies related to the assessment and the relevance of the institutional and regulatory framework for privatization in selected transition economies.

Next, and in this section of the thesis, we surveyed the literature and gathered relevant data and information related to the privatization process in Federation of B&H. Specifically, we reviewed

the evolution of legal and institutional framework for privatization in the post-war transition period principally by analyzing relevant laws and legal provision. An attempt was made to critically examine the existing laws and procedures related to the privatization process, so as to deepen our understanding of the legal extensiveness and efficiency, as well as on the effectiveness of privatization policy, methods and procedures in place.

Further, for the purposes of this analysis, and with an ambition to look more closely at the sources of and the causes of unsatisfactory performance of the privatization process in Federation of Bosnia and Herzegovina that are related to the institutional and regulatory arrangements, the qualitative analysis was conducted. For this purpose we analyzed data and information gathered through semi-structured interviews conducted with persons who work in the Federal Privatization Agency and two cantonal agencies for privatization. Also, eleven companies were interviewed for the purpose of this research. An attempt was made to deepen our understanding with respect to the legal framework and institutional capacity to undertake privatization, as well as specific problems and issues associated with the privatization process. In particular we focus on factors which inhibit effective implementation of the process and look at overall implications on the results of the privatization. Based on these we draw important implications for policy.

6.2 The privatization process in Federation of B&H: an overview

6.2.1 Privatization goals

As indicated earlier, the privatization process in B&H including the Federation entity presented a major structural policy reform in the post-war transition period, and its implementation started in already in 1997 in the early years of post-war reconstruction and fragile political structures. We begin the analysis by elaborating and briefly commenting on the goals of privatization in the Federation of B&H. It is essential to define privatization goals because in doing so, we determine the central, focal point of the process and the underlined priorities assumed to be achieved along this process. These goals can either complement or contradict each other. The Agency for Privatization of the Federation of B&H defined the following privatization goals:

- Contribution to a development of economic reforms and transfer to institutions and mechanism of market economy;
- Recovery of lost markets and entry into international market of capital and goods;
- Introduction of new technologies and contemporary forms of capital management;
- Introduction of Western standards and principles into business operations;
- Inflow of foreign capital required to revitalize the economy;
- Ensuring the revenues for the state and alleviation of pressure on the state budget;

- Development of competition, and removal of monopoly over the goods and services market.

In the light of the envisaged privatization goals, it could be postulated that privatization process holds a major importance in that it influences development prospects of B&H economy and the dynamics of its integration into the European economic structures. For these reasons, privatization process is a rather delicate topic which should be approached with great caution. In view of these goals, it is not surprising that the effects of privatization are considered of utmost importance by wider society. Hence, the failures of the privatization process are perceived as major political drawback, with far-reaching implications for economic restructuring perspectives, and consequences felt throughout the country. The effects of failed and poor privatization of companies in Federation of B&H continue to be felt among population and throughout the country.

6.2.2 Legal setting for privatization

Privatization in the Federation of B&H is implemented pursuant to the Law on privatization of companies in Federation of B&H. Draft law was prepared as early as August 1996, and the Federation of B&H Parliament adopted it in 1997. Since that time the Law was changed eleven times, last time in 2009 (the changes to the Law on privatization of companies in Federation of B&H will be discussed in greater detail in section 6.3 of this thesis). This Law sets out general rules for the privatization process in Federation of B&H. The Law envisaged the establishment of privatization agencies as independent institutions in charge of approving and implementing the privatization process in Federation of B&H. Importantly, the Law stipulates that any domestic or foreign natural or legal persons can buy enterprises or their property in the privatization process. Subjects in privatization process are both the company being privatized and the buyer.

Under this Law, the competence for implementation of privatization is principally vested in cantons i.e. ten cantonal agencies for privatization. Privatization of companies was conducted through the sale of shares and property under the competences of eleven distinct agencies for privatization. Specifically, the bodies authorised to sell state capital in Federation of B&H are the ten Cantonal Agencies for Privatization of the Federation of B&H. This has led to highly fragmented and decentralised governance structures of the privatization process where each agency separately implements privatization of the state capital at the territory of one canton. The Law on privatization of companies stipulates that each company that was privatized had to prepare a privatization programme and opening balance sheet for privatization that were submitted to a competent privatization agency (cantonal).

Privatization methods included the public sale (auction), public call for bids and alternatively, direct sale, while means of payment in the privatization process include: certificates for claims of private persons against the Federation, certificates for claims of legal entities against the Federation for compensation for the property subject to restitution, securities, cash and assets as

stated in military records and certificates in foreign currency of members of the armed forces in B&H (Agencija za Privatizaciju u Federaciji BiH, 2014). The Law on Privatization also regulates the so called small privatization which refers to the obligation of privatization of those companies that have the capital of up to KM 500.000,00 and up to 50 employees, as well as of those companies whose main business activities are trade, hospitality activities, services and passenger traffic.

Other laws relevant for privatization process in Federation of B&H include:

- Law on payment instruments in privatization process;
- Law on privatization investment funds;
- Law on securities;
- Law on securities registry;
- Law on Securities Commission.

Law on payment instruments in privatization process sets forth what are the allowed methods of payment; in Federation of B&H these include securities and money. As a payment instrument in the privatization process, it is also possible to use certificates issued based on citizens' claims. Namely, all persons with citizenship of the former Socialist Republic of Bosnia and Herzegovina and permanent residence status in the territory of Federation of B&H on 31 March 1991, who were ages 18 and above on the day when this Law came into effect, have a right to a general claim, i.e. a certificate in the amount of 100 points, based on participation in creating and managing public-owned property. The number of points assigned per each certificate based on a general claim is increased by 10 per each full year of insurance service (Law on privatization of enterprises, Official Gazette of Federation of B&H, no. 27/97). The Federation of B&H also adopted the Law on Establishing and Processing Citizens' Claims in the Process of Privatization. Such claims include claims on the basis of pre-war foreign currency savings, compensation for denationalised property that cannot be returned to initial owners, unpaid salaries of the members of the Army of the Republic of Bosnia and Herzegovina, Croatian Defence Council and Police and general claims by citizens, as established by the Law on Privatization of Companies.

The legal provisions on privatization in Federation of B&H allowed for the establishment of Investment Funds (hereinafter: PIF) with the objective of collection of certificates issued to citizens in the Federation of B&H, allowing for supposedly more efficient allocation of certificates pertaining to PIF strategic investments decisions in companies i.e. exchange of certificates for shares in the companies that were being privatised. Law on privatization investment funds prescribes conditions for establishment and functioning of the investment funds and the funds management companies, issuance and sale of stakes and shares, as well as buy-out of stakes, promotion of funds, duties performed for the funds by third persons, and oversight

carried out over the funds operation, funds management companies, depositary banks and banks used by individuals who engage in sale of stakes and shares. PIF were established as joint stock companies. Citizens would entrust their certificates to the PIF management companies and these companies used certificates solely in order to establish PIFs, whereby citizens became share holders in the PIFs. PIFs used certificates to participate in the process of privatization of companies, but one PIF could invest at most 10% of collected certificates for purchasing of shares in one company (dispersion of risk). For the purpose of this Law, the investment funds are financial institutions in charge of issuing securities to collect capital and invest it in other companies (Law on privatization investment funds, Official Gazette of Federation, of B&H no. 39/98).

Furthermore, Federation of B&H adopted the Law on Securities and established Securities Commission, as a central regulatory body, Registry of Securities and Sarajevo Stock Exchange, also enabling and regulating transparent public offerings of state capital/shares. Law on securities regulates the securities in the territory of Federation of B&H, activities and bodies of an organization in charge of operations of the registry of securities in Federation of B&H. Securities are identified as documents or electronic records containing the rights which can be neither exercised nor transferred independently, i.e. (Agency for Privatization of the Federation of B&H): Shares; Bonds; Certificates (issued for a period of over one year); Other long term securities; Investment contract, which can be used to get funds from third parties; Another transferable document on investment. The registry conducts activities of registration, safekeeping and maintaining information on securities, as well as activities of securities transfer, in accordance with the law regulating the issuance and trading of securities (Law on securities registry, Official Gazette of Federation of B&H, no. 39/98, 36/99 & 33/04). Law on Securities Commission has established the Commission, which is to ensure the application of the law and oversee its implementation along with other regulations that are related to the securities issuance and trade (Law on Securities Commission, Official Gazette of Federation, of B&H no. 39/98, 36/99 & 33/04)

The privatization of banks was carried out pursuant to the special law and under the competence of the entity ministries of finance. More specifically, banks in the Federation of B&H were privatised pursuant to the Law on Privatization of State Capital in Banks. For this purpose, a special tasks force for privatization of banks was established. Its activities ended in November 2002 (Domazet et al., 2008). Accordingly, all banks that in their capital structure had over 50% of state capital were included in the process of privatization. The process of privatization of banks was run by the Ministry of Finance. In the same manner as other companies, banks were obligated to prepare an opening balance sheet, however bank shares in the process of privatization could only be paid with cash, provided that the loans for purchase of shares did not come from the capital of the bank that is a subject to privatization. The funds acquired through the sale of existing shares were allocated to the budget of the Federation of B&H, while the funds for purchase of newly issued shares belonged to the bank (Agencija za Privatizaciju u

Federaciji BiH, 2014). Contracts on sale of bank shares were approved by the Federation of B&H Government, while the contract itself, which had to be in a written form, was signed by the Ministry of Finance who managed and supervised the process.

6.2.3 Institutional setting for privatization

Federal Agency for Privatization aims to act as advisor to cantonal agencies, to coordinate their work and to arbitrate eventual disputes between the cantonal agencies and other privatization stakeholders (Agencija za Privatizaciju u Federaciji BiH, 2014). The privatization Law did not attribute executive role to the Federal Agency for privatization i.e. it cannot command cantonal agencies what to do or not to do.

As mentioned earlier, in the Federation of B&H, the process of privatization is highly decentralised encompassing Federal and the ten cantonal agencies for privatization. Decentralisation effectively means that each canton, pursuant to its own regulations, established an agency for privatization which is tasked to implement privatization of state capital at the level of a canton, with limited powers vested with the Federal agency. It is more of a consultative body with clearly constrained supervisory roles. The Agency for Privatization is a legal entity which is responsible for the implementation of the privatization process in the Federation of B&H. In the context of Federation of B&H, cantonal privatization agencies are legal entities authorised to sell capital, i.e. the state property, promote, initiate conduct and control the process of privatization (Agencija za Privatizaciju u Federaciji BiH, 2014). Eventually, the competence over the implementation of the privatization process belongs to the cantonal privatization agency. More specifically, cantonal agencies for privatization have clearly defined responsibilities and specific tasks. Some of these tasks include:

- Organisation and facilitation of privatization of companies at the territory of their respective cantons;
- Approval of opening balance sheet of companies in accordance with the methodology for preparation of companies for privatization;
- Management, implementation, organisation and monitoring of privatization of companies at the territory of their competence;
- Signing of contracts on privatization of companies through sale, leasing, etc;
- Organisation and facilitation of education and professional development in the field of privatization;
- Providing advisory assistance to the companies undergoing privatization at the territory of their competence.

The Agency for Privatization of the Federation of B&H was established in 1996. The Agency is a specialised organisation conducting specialist, advisory, promotional and other tasks pertaining to privatization (Agencija za Privatizaciju u Federaciji BiH, 2014). Tasks of the Agency of Privatization also include the approval of opening balance sheet and privatization programme. Also, it should conduct privatization of those companies that have property at the territory of several cantons, companies with utility infrastructure of relevance for the Federation of B&H, military industry companies, companies which in their balance statements show partially or entirely rights and liabilities and the same capital, companies for which the competence was, by special agreements, transferred from the cantonal level.

Essentially, the Federation of B&H Privatization Agency does not have the authority over cantonal agencies and it is not a hierarchically superior body to them, but it can provide advice, monitor and supervise implementation of laws and other regulations in the area of privatization, coordinate work of cantonal agencies, arbitrate in disputes between cantonal agencies and parties in the privatization process at their request.

A secondary role of the Agency is to organise and stimulate education and professional development in the field of privatization. What is important to emphasise is that the Agency has a possibility to provide advice to cantonal agencies and to control and monitor implementation of laws and regulations during the privatization process. One of the Agency's tasks is to perform coordination among cantonal agencies. Should the need arise the Agency will participate in organisation and coordination of awareness raising and promotional activities. In accordance with regulations on general administrative procedures, the Agency for Privatization of the Federation of B&H is authorised to issue and adopt individual administrative enactments.

When controlling legality of the entire privatization process, the Federal Agency checks the following:

- determined value of the capital or property of the subject of privatization,
- compliance of the privatization programme and restructuring programme with regulations,
- whether the funds paid based on conducted sale are compliant with the sales contract and implementation of the sales contract the Agency is a party to.

Observing the competences of the Federation of B&H Agency and considering its decentralisation, it can be concluded that it is prevented to successfully manage the process of privatization in its entirety. All of this resulted in the inefficiency and improvisation in preparation and management of this process, as we discuss in great detail in sections to follow.

6.3 Implementing privatization process in Federation of B&H

To prepare for the privatization process, enterprises are expected to draft privatization programmes and initial balance sheet for privatization, all of this which is submitted for approval

to the competent privatization agency (Law on privatization of enterprises, Official Gazette of Federation of B&H, no. 27/97).

The privatization programme must include:

- basic information about the enterprise,
- methodology, i.e. combination of the privatization methodologies,
- envisaged method of sale and method of payment,
- employment scope and structure in post privatization period, and
- initial value of the enterprise.

Amendments to the legislation (the Law on Privatization of Companies and the Law on Opening Balance Sheet of Companies and Banks) envisaged and adopted in the second half of 2006, created an possibility to dynamise privatization process through organisational restructuring of the companies and capital sale via stock exchange. Effectively the new legal provisions allowed for Privatization of parts of companies, established following the division of companies in several parts as independent technical and economic units. The purpose was to create more favourable conditions in companies subject to privatization. Further, the new amendments to the Law on Privatization gave the Federation of B&H Government certain authorisations so that it can decide that certain companies can be privatized in accordance with special regulations or that a part of or the entire state capital can be exempted from the privatization process. The decision on exemption of the state capital from the process of privatization of up to 30% of state capital is made by the Federation of B&H Government. When it comes to the exemption from privatization of state capital exceeding 30%, such decision is made by the Federation of B&H Parliament at the proposal of the Federation of B&H Government (Bayliss, 2005).

The Law provides for privatization of enterprises to be carried out by sale of capital or property, as well as enterprise shares and stakes to another legal person. Government in charge of the state capital management in an enterprise decides on the method, i.e. methodology of privatization; while the privatization procedure is carried out – as per this Law and a decision of the competent government - by respective privatization agency at the level of a canton or Federation of B&H, depending on which government holds management rights in an enterprise (Law on privatization of enterprises, Official Gazette of Federation of B&H, no. 27/97).

The competent privatization agency carries out the sale of an enterprise through (Agencija za Privatizaciju u Federaciji BiH, 2014):

- public call for bids (tender),
- direct negotiations,

- stock market,
- open bidding, and
- public offering of shares.

Legal basis for sale of state-owned capital and privatization methods is given in Article 11, of the Law on privatization of enterprises in Federation of B&H, which reads: “Government in charge of management of the state capital in an enterprise will decide on the method, i.e. methodology, of privatization; in line with this Law and decisions of the competent government, the privatization procedure will be carried out by the competent privatization agency at the level of canton or Federation of B&H, depending on which government holds the management rights in the given enterprise. The sale of enterprise will be carried out by the competent agency through: public call for bids (tender); direct negotiations; stock market; open competition, or public offering of shares.“

However, it is important to note the Rulebook on procedure of sale of property and shares or stakes of enterprises, adopted in 1999 has changed 19 times in the period up to 2003. For the purpose of the Rules, the sale of shares also includes the sale of stakes in an enterprise (Rulebook on procedure of sale of property and shares or stakes of enterprises, Official Gazette of Federation of B&H, no. 28/05, 53/07 & 76/09). These rules establish the system for sale of enterprises, i.e. property and shares of an enterprise through public auction, public call for bids, public offering of shares and direct negotiations. Effectively, it was not prior to 2003 that privatization preceded following these other methods.

Specifically, in 2000, Rulebook on privatization through tendering was adopted. Provisions of this rulebook specify sale through public call for bids (tender). Tender is a method of sale involving public call for bids from prospective buyers, which includes a set of pre-determined criteria based on which the received bids will be evaluated and the initial price quote. Prior to the Rulebook on privatization through tendering and Rules on procedure of sale of property and shares or stakes of enterprises in Federation of B&H, certificates-based or mass privatization was the only method of privatization. Thus, majority of enterprises in Federation of B&H were privatised in this way.

Tender (bid invitation) as the method of privatization of the state capital represents collection of bids in line with previously published requirements (Bennett, Estrin, & Urga, 2007). In Federation of B&H, Tender method is intended to be used only in extraordinary cases, when strategic partners express interest in the companies which are being sold. Tenders for sale of shares or stakes in a company are facilitated by competent privatization agencies, which publicise a public call for bids in print media and at the Federal Agency for Privatization web site. As set out in the Law on privatization of enterprises, any local or foreign natural or legal person is eligible to participate in the tender procedure. This provision was aimed at attracting strategic investors, who would in addition to obligations set out in the privatization contract also

have intrinsic motives to undertake some of the vital restructuring and investments in the enterprises they buy (Agencija za Privatizaciju u Federaciji BiH, 2014).

Criteria for evaluation of offers include:

- price,
- investment commitment,
- employment scheme,
- business plan, and
- overall quality of the bidder.

Sale through direct negotiations is regulated in the Rulebook on a sale procedure through a method of direct negotiations (Official Gazette of Federation of B&H, no. 28/05). The method of direct sale is used when it is impossible to implement privatization by employing one of the above methods. This is an option that can be pursued following one unsuccessful tender or auction procedure. In this case, the relevant agency for privatization enters into direct negotiations with the bidders who expressed interest to buy state capital (Agencija za Privatizaciju u Federaciji BiH, 2014). The privatization commission can open direct negotiations with bidders whose offers were formally accurate. During the negotiations, all bidders may through direct competition with each other improve elements of their offers. Upon closing the negotiations, the privatization commission carries out the final evaluations and based on the approval of the director of the competent agency for privatization it takes a decision to announce the winner or the fact that direct negotiations have failed (Agencija za Privatizaciju u Federaciji BiH, 2014). The procedure, conditions and method of sale of the state-owned capital in the form of shares at the stock market is regulated by the Rulebook on procedure of sale of the state-owned capital at the stock market (Official Gazette of Federation of B&H, no. 34/08).

Small privatization via public sale (auction) as privatization method in Federation of B&H is used predominantly in privatization of smaller companies, parts of the companies or equipment (Domazet et al., 2008).

6.4 Main characteristics and outcomes of the privatization process in Federation of B&H

B&H entities initiated privatization in 1998 and 1999. Initial value of the capital offered for privatization in RS amounted to KM 8.28 billion in about 1,100 companies and 13.52 billion in the Federation of B&H in approximately 1,450 companies (Domazet et al., 2008). The plan was to privatise this property partially through securities issued to citizens on the basis of the pre-war

foreign currency savings, unpaid wartime salaries, etc. and partially for cash, through tenders, calls for bids and direct sale procedures (Bayliss, 2005).

As indicated earlier, although the privatization law envisages different methods of privatization by further amendments to the law adopted in more mature phase of the transition process, the early privatization process was characterised by mass privatization. Voucher privatization through public offerings was principally endorsed and favoured policy option in both entities including Federation. The method of public offering of shares (hereinafter: POS method) was principally endorsed with an attempt to rapidly and quickly transform the ownership structures within the economy. The state capital of the companies was offered to the citizens, in exchange for citizens' claims (certificates) or the cash money. Implementation of POS method in Federation of B&H started in 2001, and was completed in November 2002. In 2-year period, a total of 3 cycles of public share offerings were implemented. In this way, 752 companies were privatized, to the value of KM 7.8 billion (Agencija za Privatizaciju u Federaciji BiH, 2014).

According to Transparency International B&H (2009) the process of privatization of state capital in the Federation of B&H proceeded at a rather slow rate and even so called "mass (large-scale) privatization" was inadequately managed. Thus, in the period from 1999 to 2003, a total of three cycles of public share offerings were implemented, each with different requirements. Table 5 provides details on the number of firms and the amount of offered capital that was privatized with this method. Accordingly, the total bookkeeping value of the privatized state capital in the Federation at the end of 2007 was estimated to be KM 3.6 billion, while the total value of the capital paid in certificates was estimated to be KM 7.83 billion. A total of 765 companies were privatised through such initial public offerings, which resulted in over 55,000 new shareholders in these companies.

Table 5. Public Offering of Shares in Federation of B&H

	Number of firms	Offered capital	Registered claims	Number of shareholders
First POS	537	2.445.731.994,71	4.965.032.958,71	30.417
Second POS	157	483.179.605,09	1.002.130.900,04	6.127
Third POS	71	703.964.062,38	1.870.086.284,25	18.699
Total	765	3.632.875.662,76	7.837.250.143,00	55.243

Source: Agencija za Privatizaciju u Federaciji BiH [Federal Agency for privatization], 2014.

The privatization through use of certificates entails a large number of natural persons in possession of certificates. Privatization is a process expected to resolve some of the crucial problems an enterprise might be facing. Giving priority to public offering of shares has lead to

across the board privatization of enterprises and resulted in frontal (unselective) implementation of the privatization process. After a total of three public calls for subscription of shares, mass privatization in Federation of B&H ended in November 2002. There were 765 enterprises privatised (partially or in full) by using this model, thus crating conditions for establishment of new ownership structure in these enterprises (Agencija za Privatizaciju u Federaciji BiH, 2014).

In addition to certificates, in the period 1999-2006, around 600 companies were privatized through tender procedures. The total number of companies privatised through tenders in the Federation of B&H in the period 1999-2006 was 600, with the total nominal value in the amount of KM 1.53 billion, while their established price was KM 782 million. In privatization of these companies, additional investments in the amount of KM 1.24 billion were agreed (Domazet et al., 2008). Finally, Agency for Privatization of the Federation of B&H at the moment of their privatization, these 600 companies had a workforce of 41,958 employees and in addition to this number, additional 13,487 persons were employed.

Total results of the privatization in the period from 1999 to 2011 (up until privatization came to a stop) are the following (Domazet et al., 2008):

- State capital in the amount of KM 5.65 billion was sold. Accordingly, over 41.85% of state capital nominated for sale was privatised through all forms of sale, including the so called small privatization.
- The price achieved for this capital was KM 9.027 billion. Out of that amount, KM 8.485 billion was paid in certificates and the amount paid “in cash” was KM 0.542 billion.
- A total of 1079 companies were privatized entirely and 94 companies were partially privatized. Out of that number, 274 companies were privatized in the small privatization.
- Therefore, 74.4% of the companies foreseen for sale, in accordance with the register from 1999, were entirely privatized. A total percentage of the companies that were either entirely or partially privatized is approximately 80.82%.

In 2011, the total bookkeeping value of the sold capital and assets, achieved in the sale of one (1) company and 10 (ten) pieces of property in different companies was KM 2.359.189,11, while the achieved selling price was KM 2.174.879,00. The financial resources acquired through the sale of property belong to the companies. In 2011, the Federation of B&H Privatization Agency conducted a sale of 6 (six) pieces of company property (income belongs to companies) (Agencija za Privatizaciju u Federaciji BiH, 2014).

In the last several years, privatization has entirely stopped in both entities. In RS, after the privatization of the telecommunications company *Telekom*, there is no more attractive property and following the amendments to the Law on Privatization, the remaining property will be privatized solely for money and mainly through stock exchange (Transparency International B&H, 2009). In the meantime, laws in both entities have been amended several times and there

were several failed attempts of privatization or attempts to privatize companies that did not have defined ownership structure, which made potential buyers withdraw, as this sent a message of an insecure market (Domazet et al., 2008).

The 2014 privatization plan is mainly determined by the remaining companies that can be offered for privatization, i.e. companies which fall under the competence of the Federation of B&H Privatization Agency, and their privatization status and condition in terms of economic and financial resources, human resources and other aspects. It is planned in 2014 to privatize the following companies: Remontni zavod d.d. Travnik, Hidrogradnja d.d. Sarajevo, Šipad export-import d.d. Sarajevo, Fabrika duhana Mostar d.d. Mostar, Energopetrol d.d. Sarajevo, Unis - udružena metalna industrija d.d. Sarajevo, KTK d.d. Visoko, Željezara Zenica d.o.o. Zenica, Agrokomerc d.d. Velika Kladuša, Konfekcija Borac d.d. Travnik and Unis Pretis d.o.o. Vogošća.

6.5 Reasons for poor privatization outcomes: critical assessment with special reference to legal and institutional infrastructure

Domazet et al. (2008) analyzed the causes of low investor interest in the privatization process in the Federation of Bosnia and Herzegovina. In this study, they reached out to the conclusion that privatization in the Federation did not have the desired effects. Domazet et al. (2008) identifies the following characteristics of the privatization process so far:

- entity level privatization (Federation of B&H, Serb Republic and Brcko District),
- decentralised system of implementation in the Federation of B&H reduced methods of sale,
- imprompt changes of privatization objectives,
- situation in companies (limited productive potentials),
- inadequate preparedness of companies for privatization,
- legal insecurity,
- social tensions,
- inadequate legal solutions and applicable regulations,
- inadequate customs and fiscal policy, and
- informal economy and corruption.

The authors posit that these characteristics may be well associated with failed privatization outcomes and poor performance of privatised companies in general. In paragraphs to follow we examine in depth the reasons for poor privatization outcomes, along the lines of those proposed by Domazet et al. (2008), related past empirical literature and following interviews with

respectable local academic scholars and experts in the field. For the purpose of better understanding the reasons behind failed privatization, including legal and institutional impediments to privatization, the interviews were conducted with Professor Fikret Čaušević and employees of the Federal Agency for Privatization (Appendix A & Appendix C). Mr Fikret Čaušević, PhD is currently affiliated with the School of Economics and Business, University of Sarajevo as a Professor of Economics and International Finance and the author of many books and articles in the field of international finance, financial markets and institutions, foreign trade and national competitiveness analysis. Professor Čaušević is extensively involved in the privatization process through research and critical assessment in the course of privatization.

Overall, the characteristics of the institutional and legal setting prevalent in Federation of B&H supports the view, that political interest prevailed over economic and wider social interests of the privatization process. For illustrative purpose was extract from the Transparency International B&H (2009) study the emphasised the problem of political resistance to the process itself with explicit promotion of narrow local and political interests. With regard to this issue, prof. Fikret Čaušević (Appendix C) pointed that, in fact, the most serious omission in the privatization is related to the fragmented institutional and legal setting in Federation of B&H, pertaining to 'ethnic' based privatization (privatization along the ethnic lines). Namely, the privatization laws grouped the enterprises territorially along the entity boundaries, meaning that the enterprises or parts of enterprises belonged to the entity in whose territory they were located. Furthermore, the enterprises in Federation of B&H were further divided between cantons and fell under the responsibility of competent cantonal privatization agencies. Considering that entities and cantons are mostly ethnically "clean" this opened door to ethnic privatization which created unhealthy climate of competition among the entities.

The subsequent decentralised institutional setting was, no doubt, led by political goals and has openly undermined economic efficiency principles and objectives of the privatization process, leading to fragmentation of companies along cantonal competence lines. In particular, the principal of territorial division stands at odds with basic economic rationales associated with productive potentials of enterprises. Moreover, the highlighted impromptu changes of privatization objectives, generally reveals the problem of privatization process being over-politicised, including consequent fragmentation and inconsistency in governing the privatization process effectively. In terms of the former assertion i.e. 'over-politicised', previous studies point in particular that the early privatization i.e. mass privatization was to serve short-sited government-political interests per se at the expense of wider societal ends. This includes paying debts to citizens, fast privatization of all commercial companies in a short period of two to three years without consideration of privatization outcomes, employment issues, ineffective use of income from sales, low efforts in finding strategic partners.

The decentralised system for implementation of the privatization process in Federation of B&H present an important reasons underpinning slow privatization implementation, poor outcomes and limited investors' interest. As concluded by Transparency International B&H (2009) study,

with such defined competences and decentralisation, the Agency for Privatization of the Federation of B&H is prevented to successfully manage the process of privatization in its entirety, which results in inefficiency, improvisation in preparation and implementation of the process due to limited knowledge and competencies that rest within these institutions, In addition, one of the problems addressed by the experts/professionals from the Federal Agency for Privatization, rests within bad coordination and subordination between the Federal and cantonal privatization agencies. 'Most of the competencies fall under the cantonal level, while the Federal agency has only advisory role. Due to complexity of the privatization process, according to employees of the Federal Agency for Privatization: '...the Federal Agency should be given greater competencies.' Similarly, Transparency International B&H (2009) study concluded that it is necessary to amend the Law on Agency for Privatization of the Federation of B&H in order to strengthen its position in terms of authority over cantonal agencies.

Furthermore, the legal provisions on privatization, though providing a solid framework to govern privatization, have been considered inappropriate to manage the process effectively. For instance, as pointed by Čaušević (Appendix C) laws were not harmonised with certain sectors, i.e. were not specified in line with the needs of different sectors of industry and economy, in view of the fact that there are great differences between for example textile and metal sector, with different production processes, enterprise structure, respective markets, and different productive potentials that the legal, institutional and policy setting should have taken into account.

Notwithstanding this, the initial legal setting envisaging reduced sale methods and mass voucher privatization present one of the key factors influencing poor privatization outcomes, as argued at length by the previous studies (Domazet et al., 2008; Transparency International B&H, 2009) and found as major reason behind privatization failures in the course of this research. The prevalence of the public offering of shares method (POS) in exchange for certificates undermined the potentials for effective revitalisation of core business activities following privatization and increased competitiveness. This economic process includes enterprise restructuring, embracing new technologies and establishing market linkages, and in particular relations with foreign markets. Instead, citizens traded their certificates for shares and stakes in enterprises, but they had no obligation and in most cases they did not know how to introduce the essential reforms in these enterprises, let alone limited access to capital and poor initial conditions of the enterprises. Domazet (2008) states that the privatization by POS method failed to enable inflow of fresh capital required to discharge the liabilities plaguing the majority of the companies and improve their financial standing, and neither it launched restructuring of the companies which is an essential pre-requisite for their survival at the market. Similarly, as pointed by prof. Čaušević: 'Great damage was also inflicted at the very beginning of the privatization process, whereby a large number of enterprises were privatised through mass privatization. This created great dispersion of ownership in the enterprises supposedly ineffective form of governance, the new owners were not obliged to restructure enterprises or invest into

them, which is a necessary pre-condition if the privatization process is to be successful ' (Appendix C). Principally, for that reason early mass privatization did not yield the expected results and it repeated the same mistakes made in Poland and the Czech Republic. Essentially, it was only the ownership structure that changed in these enterprises, with the transfer of public property to possession of 'other-than state' legal entities, which was not followed by any of the other vital changes and necessary capital investments. However, as observed in this research, there were some exceptions to this general trend. The enterprises which were bought by their own workers and management and had successful cooperation with foreign companies and investors from the period before the war, or have managed to enter into formal collaboration with foreign enterprises (i.e. mainly through vertical integration) after the war, had the advantage of the so-called knowledge capital. The experiences and knowledge of workers and management acquired in the period before war, as well as foreign collaboration in the aftermath of war (Silajdzic, 2012) enabled these enterprises to continue doing business successfully.

All in all, the slow process of upgrading and amending the legal framework on privatization in Federation of B&H has diverted potential investors interest and failed to allow for setting of the proper economic incentives. First, although - the laws which allowed for other privatization methods to be used, such as: tenders, direct negotiations and stock market sale, were introduced, their implementation required the adoption of the earlier mentioned Rulebooks. Prior to their introduction that is before 2003, other privatization methods were in principal, not used as means of privatization. This has significantly postponed the endorsement of other supposedly more appropriate privatization methods. Second, although the initial legal provisions inhibited government competences to restructure state companies, were modified as discussed in section (6.3), the amendments embody formal i.e. legal division of economic or technical units subject to privatization. The changes did not reflect on the privatization policy option allowing state intervention in the effective restructuring and revitalisation of the companies by the means of investments, state aid or any other policy measure. In view of this, though these legal changes provided some potential to attract strategic investors they effectively did result in the desired increased competitive potential of the state enterprises, and the situation in companies i.e. the initial conditions in state enterprises did not change much as a result. The situation in companies reveals the limited productive potentials of companies listed for sale including bad market position, large debts, obsolete technology, redundant workforce – which all affect the sale in “as is” condition. In addition, inadequate preparedness of companies for privatization especially related to poor knowledge and insufficient skills for managing companies within the free-market (Domazet et al., 2008), as well as lack of expertise involvement in the process, and the poor knowledge capabilities of the privatization (cantonal) agencies for privatization, as noted by the Federal Agency for privatization, further undermined the potential for proper setting of the 'offer' along the privatization of the companies.

Last but not least, the unpreparedness of general public for privatization, legal insecurity, social tensions, further undermined the process. For instance, lack of public trust in justification,

transparency and lawfulness of the privatization process Transparency International B&H (2009) study recognised as one of the reasons for poor privatization results, which was also aggravated by the negative attitude of the general public and failure to provide continuous education about the process of privatization (particularly in the post-privatization period).

In the light of the foregoing discussion, Transparency International B&H (2009) posit that relevance of privatization imposes the need to assess the results achieved so far and the conditions under which this process has been implemented, i.e. to assess the measures that should be taken in order to improve the environment for investments and privatization.

There are other numerous and multifaceted reasons to pursuing more effective privatization process in recent period including the effects of the global crisis, deterioration of economic and financial situation, further deteriorating market position of non-privatized companies and continuing poor offer in privatization explaining the lack of interest among foreign investors. For instance, the complex governing structures and decentralised system prevalent in Federation of B&H prevents the establishment of a unique economic space even on the Federation territory further pertaining to low investors interest due to diseconomies of scale, fragmented regulatory framework resulting in high operational and transaction costs of doing business in the Federation of B&H. No doubt, this inefficient regulatory framework and poor quality of institutions further undermined the effective implementation and led to poor strategic investors' interest, and outcomes of the privatization process. Domazet et al. (2008) has found that legal inefficiency, in particular- deficient cadastral documentation-, inadequate customs, fiscal policy and working regulations along side with poor/non-existent industrial policy, informal economy and corruption were considered important barriers to effective implementation of the process. These particular drawbacks are far beyond the scope of privatization policy per se.

Privatization offers many opportunities for countries in transition, such as Bosnia and Herzegovina. From the aforementioned studies, it is evident that inadequate institutional and regulatory framework was one of the reasons that privatization results in the Federation of B&H are unsatisfying. Therefore, in this thesis we further evaluated the institutions and laws that are associated with the privatization process in the Federation of Bosnia and Herzegovina.

6.6 The legal and institutional framework for privatization: the results from qualitative analysis

As noted earlier, for the purpose of this investigation, we conducted qualitative analysis based on semi-structured interviews with relevant government representatives from privatization agencies, as the key stakeholders in the process (the questionnaire used in the interviews is available in the Appendix). We have talked with representatives of the Federal Privatization Agency, and two cantonal agencies, for the purpose of better understanding of legal and institutional framework of privatization process in Federation of B&H (Appendix A). Also, eleven companies were interviewed for the purpose of this research (Appendix B). The aim of this part of the survey was

to get a better picture of the privatization process carried out in individual firms. In sections to follow we critically assess the legal setting and institutional capabilities and their relevance for privatization process in Federation of B&H, based on the results of the survey.

Generally, we were interested first in obtaining the government representatives and companies management' general assessment of the privatization process in Federation of B&H. Second, we asked a set of questions relating to legal provision and its effectiveness. The literature highlights the importance to clearly define the respective roles and powers of the major authorities involved in the privatization process (Guislain, 1997). For that reason, we asked whether the agencies have a significant role in implementation of privatization and achieving the economic objectives of privatization, and what are the key responsibilities of the agencies in the process of privatization. The development of specific legal instruments that indicate who is empowered to initiate a privatization transaction; request the initiation of a transaction; prepare the transaction; organize the buyer selection process; negotiate the deal; authorize the conclusion of the operation; sign the pertinent agreements; ratify these agreements where appropriate; implement the privatization agreements; and ensure their correct execution by all the parties, is considered essential in ensuring transparency, accountability and the success of the privatization process in general (Guislain, 1997; Guriev and Megginson, 2006).

Third, we also asked a set of questions relating to the institutional capabilities including the deficiencies in the organizational structure of the agencies, and whether there is an overlap in responsibilities with other agencies or institutions. Specifically, we were interested in an assessment of institutional capacity related to the lack knowledge, expertise, human and financial resources. The results of Domazet et al. (2008) analysis point out that the low capacity of the agencies to carry out the privatization process in Federation of B&H, was one of the important reasons for an unsuccessful privatization process in the Federation.

6.6.1 Critical review of the legal framework for privatization process in Federation of B&H: Main findings

When asked what are the main obstacles in the existing regulations and laws and other obstacles in practice, which hinder the privatization process or render this process impossible, concerning the privatization objectives, the majority of respondents stated that legal framework is good, however, too general i.e. partly insufficient and inconsistent with other important legal provisions. They also emphasized the slow development of the proper legal setting as important impediment to privatization success. Further amending of the law came much after the launching and initiation of the mass privatization in 2001.

The problems principally arise because other relevant laws were not harmonized with the Law on Privatization. The both cantons stated that problems plaguing the companies' property (assets) are unresolved legal and proprietary issues. The Law on Privatization has not been harmonized

with the Law on Land Register. The property (assets) of many companies was recorded and kept as state property, notwithstanding the inaccuracies in land registers and the known fact that some assets were mortgaged and encumbered. In addition, the process of ownership verification was circumvented to speed up the privatization. This has resulted in cases where a company was privatized, whereas the portion of its property (assets) was not owned by the state, i.e. the company being privatized. For example, in the case of "Fabrika duhana" Mostar (Mostar Tobacco Factory), the party entered into an agreement with a Bulgarian company, however, it turned out that the Tax Authority had encumbered the entire property of "Fabrika duhana" with the mortgage. The pre-requisite set by investor was that no mortgage was acceptable if the company was to be purchased. Under the law, the Tax Authority was not allowed to remove the mortgage from the property of "Fabrika duhana", which resulted in cancellation of the contract.

In addition, the privatization of companies was considerably hindered due to the previous war, obsolete or destroyed technological capacities, surplus of workforce, and capital encumbered with losses and debts. The Federal Agency representatives stated that the unfavorable situation regarding the companies prior to their privatization could be addressed by implementing the Law on Companies and the Law on Bankruptcy. As a result, these companies would have been more attractive to investors. One of the problems are the lengthy procedures which hinder and slow down the process, where many decisions have to be forwarded to supervisory boards or presented before the relevant authorities, which is rather time consuming. The law failed to define the status of the company, in the case when procedure to break the sales contract was launched. In this scenario, at least the property (assets) i.e. the capital of the company should have been protected. The companies were, to a large extent, essentially destroyed, because after the break of contract they did not operate. Another problem was development of initial privatization programme. There was an obvious lack of privatization experts at the time in B&H – very few people were educated to deal with the privatization issues. In the other hand, it was required to implement fast privatization, therefore the privatization programs and initial balances were of the poor quality.

Moreover, all agencies agreed that expectations set before the new owners were unrealistic, especially as they were demanded to keep the existing work force, although it was a surplus of workforce, from their point of view. According to their view, the price set for a certain enterprise is determined by the market, and it is realistic and acceptable for the investors who are interested in buying it, but the conditions set by the government towards the prospective buyers influence value proposition of the investment. In most privatization contracts the investors were required to keep all the employees of the enterprise, and even hire new ones. For the investors this is a cost and redundant work force, because due to technological advances in the production process the number of the necessary workers has reduced. The law should have provided for the option that investors are not required to keep the workforce; the state should have addressed the social issues of workers, instead of requiring the investors to keep them. Since the investors were conditioned by certain contractual obligations, they failed to meet the deadlines for fulfilment of the

obligations, or they, in general, failed to meet the obligations. The situation in the state and companies should have been taken into account when privatization process was launched, and essentially as argued redundant workforce should have been taken care through state social programmes (Appendix A).

Good example of social programme for employees in the privatization process is the programme adopted in Republic Serbia (Government decision setting the redundancy programme in the process of streamlining, restructuring and preparation for privatization, Official Gazette of Republic Serbia, no. 64/05). The programme pertained to the following:

- Transfer to other jobs - ensures that an employee remains employed in the same company, but performs other types of jobs. These jobs must correspond to his/her qualifications, and may be performed both at the existing or some other location.
- Work for another employment - ensures that employee continues his/her employment in another environment. Depending on the specific situation, an employee may be sent to another employer, on temporary or permanent basis.
- Re-training and additional training – training of an employee to perform other jobs, usually jobs in high demand, which facilitates employment. The re-training itself includes training and acquiring skills to perform another job. On the other hand, additional training includes training to perform more complex jobs within the same profession. After having acquired additional training, employee is assigned to other jobs in the same company, or transferred to another company.
- Part-time work – a person remains an employee, and his/her work time may not be shorter than the half of the full work time.
- Other measures include: achieving higher education level/ academic achievements, temporary employment or work which is not performed in the employer's premises, occasional contingent work, work under the temporary service contract, additional work, support to self-employment etc.

In addition to legislative discrepancies, there were certain problems in cooperation between public bodies (Tax Administration, Employment Bureau, Pension Fund, Agency, courts). For example, courts were not prepared for dealing with cases pertaining to privatization and very often it happened that there were multiple judgments in the same case. Accordingly, there were cases when an investor made investments in a company and the Agency was ordered to return that company to state ownership. However, the largest problem is the lack of cooperation with other agencies, like, for example inspection controls. When the Agency establishes that the terms of the agreement are not respected, e.g. that employees are not paid their salaries, the Agency only notifies competent inspection controls about the situation whereby its responsibility ends. Only afterwards, the rulebook was amended giving the Agency wider powers. Now, if the terms of the agreement are not fulfilled, the Agency also notifies the Cadaster and the company is

forbidden to manage its assets and activities, which forces a new owner to fulfil the obligations under the contract.

Cantonal privatization agencies provided us with the results of privatization activities in their cantons and the Federation of B&H. Privatization activities in the Cantons, which means also in the Federation of B&H, are in stagnation. The results show that the interest in privatization is considerably reduced.

From its establishment to 31 December 2007, the Privatization Agency of Zenica-Doboj Canton concluded 380 sale contracts. Out of that number, 67 contracts refer to large privatization and 313 to small privatization, with the following structure:

Table 6. Privatization activities in Zenica-Doboj Canton

Method	Number of contracts
Large scale privatization	67
Small scale privatization (total)	313
Small enterprises	25
<u>assets:</u>	<u>288</u>
tender	119
direct agreement	53
auction	116

Source: *Agencija za Privatizaciju u Federaciji BiH [Federal Agency for privatization]*, 2014.

The total value of the offered state capital in all three public offerings in Zenica-Doboj Canton was KM 352.904.935,43 for 112 companies, i.e. state owned capital in these companies.

A total of 70 privatization contracts were signed in Central Bosnia Canton by the end of 2013:

Tabel 7. Privatization activities in Central Bosnia Canton

Method	Number of contracts
Large scale privatization	19
Small scale privatization	24
Direct agreement	6
Auction	1

Source: *Agencija za Privatizaciju u Federaciji BiH [Federal Agency for privatization]*, 2014.

91 companies were privatized through the public offering of shares on the basis of three public offerings in Central Bosnia Canton in the amount of KM 396.976.524,28.

6.6.2 Critical review of institutional framework and competencies of the agencies in privatization process in Federation of B&H: Main findings

When asked about the key responsibilities of the agencies in the process of privatization, they said that an agency organizes and facilitates privatization of companies, initiates and participates in preparation and adoption of regulations and other documents in the field of privatization, approves, implements and monitors privatization at the territory of a canton/the Federation, signs contracts on privatization of companies and monitors and controls implementation of laws and other regulations in the field of privatization (Appendix A).

For that reason, we asked whether the agencies have a significant role in implementation of privatization and achieving the economic objectives of privatization. The agencies agreed that they cannot achieve the objectives of privatization on their own. They implement and monitor the privatization process. Attracting foreign investors and creating attractive environment for investment is very difficult and does not fall under the competences of the agencies. The state is trying to motivate foreign investors and gives them many legal subvention.

The fact that the agencies were not given space to amend the initial privatization programme shows that the agencies essentially play the role of a mediator in the process of privatization. The privatization programme reflects the initial situation in a company. Content of the programme is defined by the law. The privatization programme, proposed by a company, presents the situation in a company: balance sheet, registered activities, structure of employees by age and education, market position, market environment. On that basis, the Agency either confirms a privatization method proposed by the company or suggests another method it finds to be more suitable for that company. In addition, the form of payment is also defined by the law. At the beginning, the only means of payment were certificates. In a later stage, the requirement was that the minimum 30% of the value was paid in cash and the rest in certificates. Nowadays, cash is the only means of payment and the Agency cannot have any influence on that. Agencies never modified the proposed privatization programme in a part related to the structure and number of employees after privatization. The buyer, in accordance with the law, has the obligation to keep all employees who are employed in the company at the moment of signing of the contract for a certain period of time and the Agency has no right to change anything. When it comes to small privatization, companies propose a number of employees through their managing boards and competent agencies accept their proposal, because the Agency would go beyond its competences should it try to change such decision, which is also defined by the Law on Privatization. In addition, the initial value is determined on the basis of the balance sheet (“active”, “passive”, “neutral” sub-balance). When a company is sold for the first time, paid value cannot be lower than the initial value. However, if it is sold for the second time or through direct sale agreement, a company can be sold for a lower price than the initial value. It can also happen that the capital

is sold for a lower price, provided the investor is obligated to make additional investment, keep the current employees and employ new employees.

When preparing a contract for privatization, agencies follow the content of the public tender. The contract is based on the tender. The investor attaches to the contract its business plan and plan of investments in the company. The contract stipulates the amount of investments, deadlines for investments, activities and employees. The agreement has to be formulated as clearly as possible, in order to avoid any later disputes. The buyer is obligated to report to the Agency on its business performance every six months. It rarely happened that privatization negotiations were not finalized, because the tender always contains precise specifications. Surely, there were cases that potential buyers had certain requirements, e.g. to layoff redundant workforce, but the Agency did not take such requests under consideration nor was it in a position to do so.

There is a general agreement that there are no deficiencies in organizational structure of the Agency. During the period of intensive privatization, all agencies used to hire external auditors. This indicates inadequate professional structure, characterized by redundancy of certain professions and lack of others. When it comes to financial resources, the situation is currently very unfavorable in all cantonal agencies which finance themselves through privatization (a part of privatization revenues is used to finance the respective cantonal agency). All agencies agree that there is no overlapping of competences with other privatization agencies.

Both cantonal agencies assessed the privatization process in their respective cantons as partially successful, while the Federation Agency assessed that the privatization was not successful. The Federation of B&H Agency thinks that, from the very beginning, the selected model of privatization was not adequate, because the aim was to achieve mass and fast privatization, which was directed by the international community. All agencies agree that the process of privatization in majority of cases did not contribute to achieving the objectives of privatization, in the sense of revitalization of industry/companies, growth of productivity and technological capacities and competitiveness of industry/companies.

6.6.3 Review and challenges of the law on revision of privatization: main findings

The pressure to have a more lawful and transparent privatization process resulted in enacting the Law on Revision of Privatization of State Capital in Enterprises and Banks of Serb Republic in 2006, whereas the respective law for the Federation of B&H was enacted in 2014. This Law sets forth the subject, procedure, institutions and resources required to implement revision of privatization of the state-owned capital in enterprises and banks of Federation of B&H, in an attempt to protect the rights of citizens as established in the Federation of B&H Constitution, state-owned property in the privatization process in Federation of B&H and the public interest. For the purpose of this Law, the revision is identified as the process of examining and evaluating the accuracy of privatization process carried out in the Federation of B&H enterprises and banks, which more specifically includes: procedures and written communication of the competent

institutions in charge of privatization, procedures related to preparation and implementation of the privatization of enterprises and banks, documents (business records and account books), financial records and accounting statements/financial reports, financial and accounting transactions pertaining to privatization of enterprises and banks, manner in which the money from sale of enterprises and banks was disposed of, signed contracts on privatization and credible documentation on execution of contractual obligations, as well as any changes with regards to name of the enterprise or termination of its operation, which was not in line with the privatization contract. The revision was to be conducted for the purpose of establishing whether the process of privatization of state-owned capital was done in line with the law. It was also review the contracts signed as part of the privatization process and look into whether commitments undertaken by the contracting sides were being respected. In addition, the revision was to protect the public interest in the process of privatization of state-owned capital and property and rights, together with the connected capital of the enterprises, and to prevent illegal disposing of the money acquired required through sale of enterprises and banks.

Currently, all agencies have the objective to finalize privatization, annul the existing contracts and initiate necessary procedures if the terms of the contract are not fulfilled, as well as to initiate adoption of amendments to the regulations in relation to the privatization model.

When it comes to the recently adopted Law on Revision of Privatization and newly established Agency for Revision, all privatization agencies agreed to provide all information they possess to the new agency for revision. Moreover, they are of the opinion that it will not be easy to implement this law and that the same problems will be encountered as with the Law on Privatization (Appendix A).

Looking at the issued certificates of fulfillment of contractual obligations, in majority of cases, the agencies issued certificates, whereby the privatization is considered to be successful. However, if we take into account wider issues than the contract itself, it is obvious that some companies are no longer successful and that some of them even went bankrupt. Nevertheless, after fulfillment of the contract, Agency has no further competences. Some of the companies that were privatized and that are still successful are Metalno d.d. Zenica, Agrokop Visoko, Pobjeda Tešanj, Natron Maglaj.

Notwithstanding this, it is worth mentioning that there are a number of risks involved in this process. First, it may result in seizure of property which has already been sold and this may send a negative message to other potential investors – message which reads that their private ownership rights are neither guaranteed nor protected. At the end of the day, it may have a very negative impact on the image of B&H in the world, as noted by Transparency International B&H (2009). As a consequence this may further deteriorate foreign direct investments Bosnia and Herzegovina, which already has the lowest percentage of foreign direct investments, compared to other transition countries. Last but not least, judging by Transparency International's opinion, the public is mostly concerned that revision processes will turn into political showdowns between

the present and former parties in power, instead of being an objective and thorough monitoring of malfeasance in privatization.

6.6.4 Critical review of the privatization process: responses from selected privatized firms' management

Eleven companies were interviewed for the purpose of this research (Appendix B). The companies vary in size, business activities, and methods of privatization. We inquired about the method of privatization, duration of privatization process, any hindrances that may have occurred in the privatization process, as well as any problems companies may be facing in their operation, and especially in problems of conducting business activities related to privatization - any privatization-related shortcomings.

Table 8. Results of interviews conducted in eleven firms

Name of company	Established	Year of privatization	Number of employees	Method of privatization	Duration of privatization	The current state of the companies	Problems during privatization
"ALBA" Zenica	1990	1999	150	Joint venture	Less than a year	Satisfying	No problems
"Cementara" Kakanj	1978	2000	400	Tender	Less than a year	Satisfying	No problems
"Ekor-Komerc" Zenica	1985	2002	70	Marković 51% POS 49%	Less than a year	Satisfying	No problems
"IGM" Visoko	1987	2001	60	Marković 56%, Auction 22%, Compensation with State 4% POS 18%	Less than a year	Satisfying	Complicated process, but without problems
"MannHummel" Visoko	1974	2003	500	Marković 51% Direct negotiation 49%	Less than a year	Satisfying	Problems with bureaucracy, long lasting procedures

table continues

continued

Name of company	Established	Year of privatization	Number of employees	Method of privatization	Duration of privatization	The current state of the companies	Problems during privatization
"Metalno" Zenica	1947	2004	300	JUD 49 % Tender 51%	Less than a year	Satisfying, except outdated workforce	No problems
"NatronHaya t" Maglaj		2005	840	Joint venture	3-4 years	Satisfying	Yes, there were problems
"Pobjeda" Tešanj	1955	2007	250	Marković 23% POS 49% Tender 51%	Less than a year	Satisfying	Lengthy procedures
"ServisTrans" Donji Vakuf		2005	40	Marković 49% JUD 51%	Less than a year	Satisfying	No problems
"ŽGP" Zenica	1947	2006	34	1. Tender (contract was canceled) 2. Increase in share capital	Less than a year	Unsatisfying	Yes, the first privatization contract is terminated
"ZIM" Zenica	1959	2001	91	Tender	Less than a year	Problems can not be linked to privatization	No problems

The table shows that the privatization process in all companies lasted less than a year, not including the wide gap which followed Marković -era privatization, mainly due to the war which ensued. All companies fulfilled the obligations arising from the privatization contracts, and the relevant privatization agency certified that the privatization was completed successfully. All companies except for one have stated that their operation continues to be satisfactory. The companies we interviewed do face problems that may be expected in the current economic and market climate, and are not related to the privatization as such. The privatization process was assessed as satisfactory in most companies, while only three companies stated that the process as such was implemented without any problems whilst being rather lengthy and complex. Out of the eleven companies, two companies were privatised by tender sale, two by joint venture, while six companies were different privatization methods were combined (Marković-era privatization, public offering of shares, tender procedure). In case of one company, ŽGP Zenica, sale by tender

was attempted, however, the contract was cancelled in 2001, and the capital was returned to the state. At the time, the state owned approximately 67%, while approximately 30% of the company was in the ownership of a private investor. Shareholders Assembly adopted proposal to increase equity, and as a result private investor (JATA Group) gained 67% of shares, thereby increasing the company value by 1.6 million BAM, whilst the Government of Zenica-Doboj Canton now owned 30% of the ZGP's shares.

The two companies created through the joint venture, ALBA and Natronhayat, operate very successfully. In case of NatronHayat, the investor invested 90 million Euro in the new enterprise, five times the contracted amount; however, this enabled NatronHayat to become producer with references required at foreign markets. The competent authorities have not fulfilled any contractual obligations, while the foreign partner has fulfilled all the obligations, even exceeding the scope of contractual obligations.

Cement Factory Kakanj serves as yet another positive example. German company Heidelberg Cement bought major share in the Cement factory Kakanj by participating in international tender, the pilot project of large privatization in the Federation of Bosnia and Herzegovina. The success of privatization in this particular case may be attributed to extensive lobbying with international investors on account of the company. It should be noted that Heidelberg Company, the current owner of the Cement Factory Kakanj, paid 15% higher price as compared to the book value of the cement factory Kakanj and the ask price in the privatization process. This is the result of lobbying on account of the cement factory, hence the most serious investors ended up competing between themselves during the negotiation phase.

The research leads to the conclusion that even if the privatization does not enjoy positive image in the Federation of B&H, there are numerous examples of privatized companies which operate successfully; moreover, it is unlikely that these companies would continue to operate or retain the jobs they provide had they not been privatised. Obviously, some companies faced difficulties due to failure of the competent authorities to fulfil obligations arising from privatization contracts or the lack of commitment of the authorities to addressing specific issues facing the companies. In addition, a the three-year period after a company is privatized during which agencies and authorities monitor the operation, development and employment in the privatized companies is too short to assess the success of privatization. The period should be extended, as from the economic perspective once a company is established the intention is for the company to operate indefinitely, therefore the three years in the lifetime of a company are not long enough in order to gain insight into the actual state of the company. Any company is a dynamic entity, both in the temporal and spatial terms, a company undergoes great changes in the period following privatization, therefore the three year period is not sufficient to ascertain whether the privatization ensures long-term stability of the company.

CONCLUSION

Privatization primarily means transferring ownership and control of government or state assets, firms and operations to private investors (Shirley & Walsh, 2001). Process of privatization is actually a current problem that has been present in the European countries undergoing the process of transition already for two decades and it represents a form of ownership restructuring (Estrin, 1997). Transition economy is a term denoting the so called transition countries which transit from a command economy to a market economy, i.e. from socialism to capitalism (Estrin et al., 2009). Privatization is considered to be an essential part in the process of creating capitalism out of communism (Estrin, 2007).

One of the main arguments for the privatization of publicly owned operations is the estimated increases in efficiency that can result from private ownership. Megginson and Netter (2001) indicate that privatization could be expected to improve enterprise's efficiency and profitability. The real challenge of privatization is not just to sell an enterprise or shares. Much more, it is to seize the opportunity to refocus the role of government and public administration, increase economic efficiency, and adapt an enterprise, a sector, or the economy as a whole to the fast-changing requirements of the international economy.

However, many transition countries experienced that privatization could not be carried out under the existing governmental administrative structures or processes. More specifically, the process of privatization has often required specific institutions in place, as well as competences, skills and experiences that cannot be usually found in public sector of transition economies.

A number of studies postulate that the success of privatization reform indeed requires the existence of well-developed legal and regulatory framework and institutional governance (Estrin et al., 2009; Zinnes et al., 2001; Eagle and Christensen, 1994). Further, Brown et al. (2006) suggests that privatization in transition economies succeeds in that is substantially improves productivity only if the proper institutional setting is in place. Similarly, the results of Smaoui and Boubakri (2004) study confirm that for privatization to succeed, the existence of efficient and well functioning governance institutions is fundamental. Also, Bartolotti et al. (2001) looked at the impact of political, economic and institutional factors on the privatization process. Specifically, the market value of a company and consequently its privatization proceeds will be lower where legal protection is poor since there will be a lower demand for privatized equity by minority shareholders. Guislain (1997) and Guriev and Megginson (2006) have emphasised that adoption of the law on privatization sets foundations to establish institutions which have competencies to implement privatization.

There are two empirical studies which explore the relationship between institutional environment and the privatization in Bosnia and Herzegovina. More specifically, Bayliss (2004) conducted a study exploring the relationship between different privatization methods and policy outcomes in medium-sized industrial enterprises in Serbia and Bosnia Herzegovina. Overall, the findings indicate that privatization has so far brought little improvement in the financial performance of enterprises in Bosnia Herzegovina, and suggest that privatization can be difficult to achieve in a post-war context due to low incomes, weak institutional and political systems and, hence, little

investor interest. Finally, Domazet et al. (2008) analyzed the causes of low investor interest in the privatization process in the Federation of Bosnia and Herzegovina. The authors of this study point out that one of the main reasons for the poor outcomes of privatization, was the inefficient legal framework and the low capacity of the agencies to carry out the privatization process.

The overall objective of this thesis was to look more closely at the sources of and the causes of unsatisfactory performance of the privatization process in Federation of Bosnia and Herzegovina that are related to the institutional and regulatory arrangements. This thesis does not attempt to address the whole range of issues and concerns of privatization. Instead, the less ambitious objective of this thesis was to analyze what were the accomplishments of privatization process so far and what have been the reasons for the unsatisfactory performance, particularly those related to the privatization institutions and privatization laws in the Federation of Bosnia and Herzegovina. Specifically we critically examined the existing legal framework for privatization, institutional capacity and governance structures responsible for the implementation of the privatization process in the Federation of Bosnia and Herzegovina.

The process of ownership transformation in Bosnia and Herzegovina started in 1990 and was performed through a model of management and employees buy-out ("Marković's privatization") (Agencija za Privatizaciju u Federaciji BiH, 2014). This process was interrupted by the war which started in 1992 and ended by the Dayton Peace Accord signed in December 1995. The privatization process in B&H has been relunched in 1998, and implemented largely relying on a voucher privatization method in this post-war transition period. The privatization process is still in progress. In Bosnia and Herzegovina, there are three separate privatization systems which belong to existing three administrative units: Federation of Bosnia and Herzegovina, Republic of Srpska and the District of Brčko (at the state level, unless the imposed law, there is no legislation concerning privatization). In Federation there are, besides the Federal Agency for Privatization of Bosnia and Herzegovina, ten additional cantonal privatization agencies. The issue arises whether the Law on Privatization of Companies in Federation of B&H, which is the foundation of all other laws related to privatization, and Law on Privatization Agency, have actually established an institution which has competencies and expertise to implement privatization in this entity effectively.

In addition, the Law on Privatization of Companies in Federation of B&H clearly shows that the main role in privatization process in this entity is attributed to the Government of the Federation of B&H and ten cantonal governments. Although the Article 2 of the Law hereof reads: "*Agency for Privatization of the Federation of B&H (hereinafter: the Federation Agency) and cantonal privatization agencies (hereinafter: cantonal agency), established under the separate law, shall approve and implement the privatization process*", the Article 11 reads "*The mode, i.e. method of privatization is to be decided by the authorities which hold competencies to manage state capital in the particular company, whereas the privatization process, under this Law and decision of the relevant government, is to be implemented by the Agency for privatization of the Federation of Bosnia and Herzegovina, depending on which government exercises the right to managing the given company*" (Law on privatization of enterprises, Official Gazette of Federation of B&H, no. 27/97).

We may observe that all agencies mostly exercise advisory and monitoring functions in privatization process in Federation of Bosnia and Herzegovina, i.e. they primarily act as a mediator in the entire process. The cantonal agencies are vested with more competencies, because in Federation of Bosnia and Herzegovina, privatization has been transferred from entity to cantonal level. Although it was established, the Federal Privatization Agency does not act as the major body in privatization process which would bring together and coordinate the activities of cantonal agencies at the level of the Federation. The Federal Agency has no authority over ten cantonal agencies, save its advisory role.

In our research we asked the privatization agencies to evaluate the existing legal and institutional framework in the Federation of Bosnia and Herzegovina and identify the main obstacles in the existing regulations and laws and other obstacles in practice, which hinder the privatization process or render this process impossible.

The results of this research indicate that the advisory and mediatory role is rather evident for all privatization agencies, which was confirmed by all agencies involved in the survey. Agencies may give their professional opinion and suggest solution for specific companies to their relevant authorities and governments, but at the end of the day, the governments make decisions, and the agencies implement them. The agencies agreed that they cannot achieve the objectives of privatization on their own. They implement and monitor the privatization process. Attracting foreign investors and creating attractive environment for investment is very difficult and does not fall under the competences of the agencies. There is a general agreement that there are no deficiencies in organizational structure of the Agency. During the period of intensive privatization, all agencies used to hire external auditors. This indicates inadequate professional structure, characterized by redundancy of certain professions and lack of others. When it comes to financial resources, the situation is currently very unfavorable in all cantonal agencies which finance themselves through privatization. All agencies agree that there is no overlapping of competences with other privatization agencies.

While interviewing the representatives of the Federal privatization agency, we learned their opinion that entire privatization process should have been implemented at the state level. The error was made at the very beginning, by allowing the entity-level privatization which, as professor Čaušević pointed out, resulted in entity privatization becoming the ethnic privatization. The situation in the Federation was additionally complicated by fragmenting the privatization at ten cantonal levels.

In the light of the foregoing discussion, Guislain (1997) and Guriev and Megginson (2006) stressed the importance of amendments to the existing laws related to privatization process, i.e. to amend the existing laws to avoid the situation where the existing legal framework might prevent successful implementation of privatization. According to the experts, this is exactly the problem which occurred in the Federation. According to the deputy director of Zenica-Doboj cantonal agency, the biggest challenges has been a lack of harmonisation of Law on Land Registers with the Law on Privatization of Companies. The assets and property in many companies was kept as state property, although it was known that land registers comprised inaccuracies, and that some assets were under the mortgage and encumbered. The process of

verification (vetting) of companies was circumvented to speed up the privatization. This resulted in situations where privatization occurred, notwithstanding the fact that the portion of the assets was never owned by the state, i.e. privatised company in the first place. Furthermore, there were cases of conflicting inter-institutional situations which slowed down and hindered the work of privatization agencies, due to the laws not having been harmonised and amended.

Also, for the purpose of this research, eleven companies were interviewed. The results show that the privatization process in all companies lasted less than a year. All companies fulfilled the obligations arising from the privatization contracts, and the relevant privatization agency certified that the privatization was completed successfully. The privatization process was assessed as satisfactory in most companies, while only three companies stated that the process as such was implemented without any problems whilst being rather lengthy and complex.

Given the complexity of the structure of the Federation of B&H, we deem that the Federal Agency should have been given more encompassing competencies to manage the overall privatization process in Federation of B&H. In this way, this complex and demanding process would have been brought together at the entity level. We should take into account the complexity of privatization process and a relatively small economy of B&H.

According to what we were told in the Federal Privatization Agency, the stipulation of the Law on Privatization of Companies, which requires retention of all existing workforce and company activities, poses a huge challenge. The mandatory retention of existing company activities should be avoided, because, in many cases, this very activity or activities is/are exactly the reason why the company which is offered for sale is not considered attractive. Instead, the option should be provided for the buyer to suggest the optimal use of resources which one is to inherit. Feasibility study for privatization of a specific company should provide forecast regarding the price of the job to be retained or created. Investor should be allowed to opt between the possibility to actually ensure jobs and compensate the opportunity costs of jobs for the jobs one cannot ensure, after having ensured the minimum number of jobs. In addition, the investors who are not able to ensure the jobs under the contract, should be given the opportunity to buy-off the jobs per increased price, instead of cancelling the contract.

The employers are obliged to establish the number of required employees and total surplus of the workforce, as a basis to establish the new organization and systematization of jobs. The surplus of the workforce (redundant employees) may occur due to various changes in a specific company, such as technological, economic and organizational changes within the company. The obligation of an employer is to address the labor and employment status of redundant employees. The law should have stipulated that investor is not to inherit the redundant employees; instead, redundant workforce should have been taken care of through state social programmes.

Overall, it may be concluded that it is the lack of investor interest that is the main obstacle to privatization in Bosnia Herzegovina, but this is not necessarily the legacy from conflict, but may possibly have to do with the fact that the companies have limited competitive potentials in the wake of increased global competitiveness and increasingly complex sourcing of competitive gains by companies. The findings from this survey are that the privatization programme in

Bosnia Herzegovina faces particular difficulties. Privatization in Bosnia Herzegovina has been a slow and tortuous process. The shortcomings of the earlier approach have now become clear but, despite immense difficulties in attracting investors into a process which has itself contributed to the decline in the sale ability of state enterprises, donors are attaching growing priority to the achievement of privatization. Policy-makers need to be realistic about prospects for foreign direct investment and that low investor interest pertains to bleak productive potentials of the state-owned manufacturing enterprises. Although, major improvements could be made with respect to enhancing institutional capability and promoting more efficient governing structures with respect to privatization in Federation of B&H as argued at length in this thesis, the results from this survey are not sufficiently vigorous to support an argument for an alternative privatization policy as a solution.

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APPENDIXES

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Appendix A: Interviews with Privatization agencies

Federal Agency for privatization

The interview was conducted with :Senad Makić, Assistant Director for Legal Affairs,

Federal Agency for privatization

Interview was held: 18.12.2014.

I CRITICAL REVIEW OF LEGISLATIVE FRAMEWORK IN FEDERATION OF B&H GOVERNING PRIVATIZATION PROCESS

GENERAL REVIEW

- 1. Please identify the main obstacles in the existing legislation and other obstacles encountered in practice which slow down/hinder the privatization process, and/or render it inefficient in terms of privatization objectives? PLEASE LIST 4-6 key obstacles!**

We can hardly refer to legal obstacles, because the laws themselves are precise and good. There may be some procedural issues which hinder, i.e. slow down the process, where many decisions have to be made by supervisory boards or authorities, which is time-consuming. Decisions on privatization method used to be made by supervisory boards of the agencies; now these decisions are made by the relevant authorities. What constitutes the obstacle is the fact that we still lack understanding of what is the actual subject of privatization, and that is a capital which is either encumbered or burdened by losses and debts. The real issue is whether we have anything to offer for sale.

- 2. Please list the examples in practice where the problems have occurred due to, or resulted from inadequate or ineffective legislative solutions?**

I disagree that legal solutions are not efficient. The laws are clear and precise. For a while, there were some opinions expressed that contract control was not defined under the law, and should be governed by a separate rulebook. However, I don't think it is required, since the contracts are clearly defined and worded.

- 3. Based on your experience, please list other problems which constitute the key obstacles in efficient implementation of privatization and which, by its nature, are not legislative? PLEASE LIST 3-4 examples!**

It is difficult to claim that is not a legal issue... We have difficult situation where the companies are plagued by debts, and burdened by surplus of workforce and obsolete technology... In the case of privatization, we demand that investor retains the existing workforce, and furthermore, to provide new jobs, to invest in the company.....The public has also been presented with a distorted image of new investors and new owners.

REVIEW OF SPECIFIC COMPETENCIES OF THE AGENCY

- 4. The Law defines but does not stipulate the competencies of the Agency in the privatization process; more detailed definitions of the Agency's competencies are comprised in the**

Rulebook on Privatization and decisions adopted by the Government/Parliament of the Federation of B&H. Based on your experience and practice, please single out/list 4-6 key competencies of the Agency?

Competence is primarily defined under the law, and the statute arises from it. Some key competencies are:

- to follow and monitor implementation of the law and other privatization regulations;
- to initiate and participate in preparations to enact, and amend the law;
- to process and prepare privatization programs and initial company balances for adoption
- to participate in implementing activities of dividing the company into technical and economic units.

5. Do you deem that, given the competencies, Agency has a relevant role in implementing the privatization and achieving the economic objectives of privatization?

- a) YES (The Agency has a significant role in proposing decisions which pertain to privatization, and which are, eventually, adopted by the Government of the Federation of B&H)
- b) NO (The Agency has mediatory and administrative role in the implementation of privatization)

Agency alone can hardly fulfil privatization objectives. The Agency can implement privatization process. However, attracting foreign investors and creating favourable environment for investments is very difficult and does not fall under the competences of the Agency. The State is making efforts to encourage foreign investors and provides them many legal incentives and benefits, which do not apply to local investors willing to privatise a company, which is unfair, since local investor should be treated the same as foreign investor, and a new buyer, be it a local or a foreign one, is to assume the same obligations under the privatization contract.

6. Pursuant to the Law (Article 4), the privatization programme prepares the company which is subject to privatization, including the initial company value, privatization method and the structure of employees following the privatization. Based on your experience and practice, does the Agency have possibilities and capacities to modify the proposed privatization programme, as provided for in the Law?

- a) YES
- b) NO (in practice it only has a mediatory role)

NOTE (if your answer to previous question is NO, please move to question no. 10!)

Privatization programme reflects the initial company balance and it is the actual state of play and cannot be changed. The law defines what the programme has to incorporate and nothing can be changed in this respect. Eventually, decision on the privatization model is made by the relevant

government/authority, and the Agency only has a power to suggest the model it deems to be the best for a specific company.

7. If YES, does it fall under the competencies and practice of the Agency to modify the proposal of privatization programme which pertains to privatization method and payment arrangements?
- a) YES
 - b) NO

When it comes to payment modalities, it is only the money and nothing can be changed about it, nor should it be changed.

8. If it does, what were the criteria or approach in establishing the method/combination of privatization methods with regard to the particular company? What problems were experienced in terms of determining the privatization method and over the course of employing the specific method in privatization process?

We tried to use two models introduced in 2006; the joint venture model and the model of dividing the company into techno-economic units. This refers to two decrees which are governed by the Law on Companies, and the law supersedes the decree or regulation. For instance, in the case of "Krivaja", the privatization process was already launched, but then various problems were encountered. At first, we try with dividing the company into technical and economic units, which would then, separately, enter the privatization process, and we would continue to keep "Krivaja" as some sort of the backbone and foundation. This attempt failed, so we then pursued the joint venture model with strategic partner. However, due to the pressure exerted by the employees (workforce), this contract was cancelled and now the company is going to bankruptcy. The small group of 170 workers managed to divide 1700-strong company. I am not saying these 170 workers did not have their reasons, or fewer rights than other workers, but this has pushed the company to bankruptcy, which could have been prevented.

9. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to the structure and the number of employees after the privatization ?
- a) YES
 - b) NO

The law stipulates that, when performing the large-scale privatization, we have to retain the existing workforce.

10. If they do, has the Agency been involved/negotiated on the number and structure of workforce with the company/Consultant/future owner/Government of the Federation of B&H, in the consultation process?
- a) YES
 - b) NO

In the cases of small-scale privatization, the companies suggest the number of employees through their supervisory boards and we accept it.

11. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to initial company value?

- a) YES
- b) NO

No, initial value is precise and clearly determined, the capital value is known.

12. What competencies of the Agency arise from the legislative solutions, in the process of negotiations and entering into privatization agreements? In particular, what are the competencies of the Agency in drafting the Privatization Agreement, in the stage of developing the Company Privatization Agreement, in particular with regard to specifying and determining the obligations of the future owner, or e.g. resolving the company debt disputes?

The contract arises from public tender, so everything is already defined, the method, the price... With regard to the contract, Investor submits its business plan and investment plan. As I mentioned already, the contract itself is entirely defined through the public tender.

13. Were there, and how many, attempts to privatise a certain economic operator (company), where the parties reached the stage of specific negotiations, but then process never saw its completion? Was this caused by the lack of institutional capacities and/or legal issues, or other unresolved issues during negotiations with the future owner (general assessment, or give an example)? If this was a legal issue, please specify the laws or the article/s of specific law which caused problems?

The regulations (secondary legislation) and the laws should be harmonised and synchronised. The Law on Privatization is good, but sometimes other issues make things difficult.

GENERAL REVIEW OF PRIVATIZATION PROCESS

14. To our knowledge, the Law envisions restructuring of the company into smaller 'techno-economic' units prior to privatization. However, what actually happened in practice was that instead of dividing the companies based on the principles of assurance of economic efficiency, revitalisation and vitality of the company/companies being restructured, the companies were divided based on the ethnic principles?/cantonal competencies! Do you agree with this assessment?

- a) YES (in principles);
- b) Partially (not in its entirety);
- c) NO (Do you have any comments regarding this observation?)

In principle, I disagree, this was not the ethnic division of the companies; the law stipulates that the entities are to privatise the companies on their respective territories. The issue which arises

here is whether it should be better to implement privatization at the state level instead of on entity level.

15. What are your experiences in implementing the privatization in the canton which falls under the competence of your Privatization Agency, and in the Federation of Bosnia and Herzegovina? In other words, do you consider that the privatization process in your canton is: successful, less successful, or a failure? (Do you have any general comment?)

In my opinion, privatization has, essentially, failed. I think we failed to opt for the appropriate privatization model at the very beginning of the process, because we wanted a mass, large-scale, and quick privatization, which was directed by international community.

16. Do you agree with the assessment that privatization process contributed to the privatization objectives, in terms of revitalisation of the industry/companies, productivity growth, and technological capacity and competitiveness of the companies/industry?

- a) YES (I completely agree),
- b) Partially;
- c) NO (I completely disagree)

(Do you have any comments regarding this observation?)

Yes, to some extent.

CURRENT ROLE OF THE AGENCY AND CHALLENGES

17. What are the current objectives of the Agency and challenges with regard to the privatization? What are the lessons learned, if any?

Taking into consideration accumulated positive and negative experience, we should be ready to remove and change all negative aspects, and to keep all the positive things. The current objectives include amendments of some regulations by the Agency, in the forthcoming period, and introduction of new or improvement of the existing privatization models.

II CRITICAL REVIEW OF INSTITUTIONAL FRAMEWORK AND COMPETENCIES OF THE AGENCIES IN PRIVATIZATION PROCESS IN FEDERATION OF B&H

18. Are there institutional issues that constitute an obstacle/barrier for more efficient enforcement of the law throughout the privatization process?

There are no barriers with regard to the implementation of the law. However, as I have already said, the buyers expect the property they purchase not to be encumbered or indebted, but so far the tax authorities have been reluctant to provide their support and forgive the debts.

19. Are there issues, in terms of human resources and finances, which constitute an obstacle/barrier for efficient implementation of privatization? Please, identify the existing operational gap in the Agency, in terms of the lack of human resources, expertise and financial resources?

I don't think there are any.

20. Are there any gaps in the organisational structure of the Agency? Is it a common practice to hire the additional consultants, and if this is the case, please tell us more about this practice?

It all depends on the scope of privatization activities. Before, we used to hire, but not majority of Agencies performs all activities by employing their own human resources.

21. Is there overlapping in competencies with other agencies? If so, is this a horizontal overlapping – with other cantonal agencies, or is it a vertical overlapping – with the Federal Agency for Privatization?

In privatization procedure, there is no subordination, but coordination. Therefore, the Federal Privatisation Agency can only perform coordination in conjunction with cantonal agencies.

III REVIEW AND CHALLENGES OF THE LAW ON REVISION OF PRIVATIZATION

22. The Law on Revision of Privatization has been enacted, so what is a strategic position of the Agency with regard to this Law?

The Revision Agency has been established. Pursuant to the Law, our Agency should be at disposal of the newly established agency.

23. What is your opinion on this Law? Is it going to be easy to implement it, and what obstacles and risks may be expected during its implementation?

I feel reluctant to answer this question. I think the Agency for Privitisation Revision should provide an answer, and not this Agency, for I am sure we would be in collision with them over certain matters.

FINAL QUESTIONS

24. Please, list the companies in your canton which have undergone a successful privatization process and where different privatization methods were employed?

We have had examples of successful privatizations. There were also privatizations which could have been implemented, but were halted. When reflecting about it retrospectively from this temporal distance, I come to realisation that they should have been implemented. The privatization success stories are rarely discussed; you can only hear stories about privatization failures.

What does successful privatization mean, anyway? Does fulfilment of contractual obligations constitute a successful privatization? If we take this point of view, then this Agency has, in majority of cases, issued certificates on fulfilment of the contract, thus the privatization could be deemed successful. However, if we look beyond the contract/s, and take a wider perspective, we may notice that some of the companies are not doing so well anymore, some have even fallen to

bankruptcy. However, following the fulfilment of the contract, the Agency has no other obligations.

25. The Law envisions that the State may retain the share in ownership (in the structure of capital) of . companies to the maximum of 30%. Please, tell us in which cases the State (upon the proposal of the Government, or decision adopted by the Parliament of the Federation) expressed an interest/readiness to retain the share in ownership of a company, if there were such cases? (Please, provide an example)

This is a restriction on the maximum portion which the government can allocate from capital privatization and keep it in the state ownership; in cases where ownership is up to 30%, the decision is made by the Government, whereas in cases of 50%-ownership, decision is made by the FB&H Parliament. Such cases are very few.

Agency for Privatization, Central Bosnia Canton

The interview was conducted with: Hamida Halilović, Officer

Interview was held: 24.11.2014.

I CRITICAL REVIEW OF LEGISLATIVE FRAMEWORK IN FEDERATION OF B&H GOVERNING PRIVATIZATION PROCESS

GENERAL REVIEW

1. Please identify the main obstacles in the existing legislation and other obstacles encountered in practice which slow down/hinder the privatization process, and/or render it inefficient in terms of privatization objectives? PLEASE LIST 4-6 key obstacles!

In our Canton specifically, we had a problem since the Law on Privatisation was not harmonised with the Law on Land Register (cadastre). The property (assets) of many companies was recorded and kept as state property, notwithstanding the inaccuracies in land registers and the known fact that some assets were mortgaged and encumbered. The process of ownership verification was circumvented to speed up the privatization. This has resulted in cases where a company was privatised, whereas the portion of its property (assets) was not owned by the state, i.e. by the company being privatised. Consequentially, we have companies the status of which remains unresolved even today.

2. Please list the examples in practice where the problems have occurred due to, or resulted from inadequate or ineffective legislative solutions?

Save the above problems, we have not encountered any other issues in this Canton.

3. Based on your experience, please list other problems which constitute the key obstacles in efficient implementation of privatization and which, by its nature, are not legislative? PLEASE LIST 3-4 examples!

The problems were observed in the privatization cases where the bid invitation (tender) or direct sale agreement was used, and where the investors were conditioned by certain contractual

obligations, which resulted in failure to meet the deadlines for fulfilment of the obligations or, in general, failure to meet the obligations.

REVIEW OF SPECIFIC COMPETENCIES OF THE AGENCY

4. The Law defines but does not stipulate the competencies of the Agency in the privatization process; more detailed definitions of the Agency's competencies are comprised in the Rulebook on Privatization and decisions adopted by the Government/Parliament of the Federation of B&H. Based on your experience and practice, please single out/list 4-6 key competencies of the Agency?

All cantonal agencies use the same rulebook which is derived from the FB&H Law on Privatization. Some key competencies include:

- organises and encourages privatization of companies in the Canton;
- approves, implements and supervises privatization of companies in the Canton;
- organises and encourages education and professional development in the area of privatization;
- monitors and supervises implementation of the law and other privatization regulations;
- submits quarterly performance reports to the Cantonal Government;
- organises and conducts information campaigns and issues publications on privatization.

5. Do you deem that, given the competencies, Agency has a relevant role in implementing the privatization and achieving the economic objectives of privatization?
- a) YES (The Agency has a significant role in proposing decisions which pertain to privatization, and which are, eventually, adopted by the Government of the Federation of B&H)
 - b) NO (The Agency has mediatory and administrative role in the implementation of privatization)

We may conclude that the Agency plays an important role in the implementation of the privatization.

6. Pursuant to the Law (Article 4), the privatization programme prepares the company which is subject to privatization, including the initial company value, privatization method and the structure of employees following the privatization. Based on your experience and practice, does the Agency have possibilities and capacities to modify the proposed privatization programme, as provided for in the Law?
- a) YES
 - b) NO (in practice it only has a mediatory role)

NOTE (if your answer to previous question is NO, please move to question no. 10!)

No, not many.

7. If YES, does it fall under the competencies and practice of the Agency to modify the proposal of privatization programme which pertains to privatization method and payment arrangements?
- a) YES
 - b) NO

No.

8. If it does, what were the criteria or approach in establishing the method/combination of privatization methods with regard to the particular company? What problems were experienced in terms of determining the privatization method and over the course of employing the specific method in privatization process?

The method of privatization is set in privatization programme. There are cases where the FB&H makes decisions with regard to the method or the percentage of the company to be privatised and this predominantly used to be the case with large public companies. The method itself is easily determined. The capacity and activity of the company are taken into account. These are factors which play the major role in deciding for a particular method.

9. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to the structure and the number of employees after the privatization ?
- a) YES
 - b) NO

The buyer is required, by the Law, to retain all employees who are employed in the company at the moment of signing of the contract for a certain period of time and the Agency has no right to change anything.

10. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to initial company value?
- a) YES
 - b) NO

No, initial balance is the bookkeeping “image” of the company’s situation and Agency is not authorised to change anything.

11. What competencies of the Agency arise from the legislative solutions, in the process of negotiations and entering into privatization agreements? In particular, what are the competencies of the Agency in drafting the Privatization Agreement, in the stage of developing the Company Privatization Agreement, in particular with regard to specifying and determining the obligations of the future owner, or e.g. resolving the company debt disputes?

Agency covered, in the contracts, the retention of existing workforce, new jobs, retention of the existing activities of the companies and injection of the fresh capital into the companies. All

these issues have already been determined under the Law on Privatization. When it comes to the debts of the company to be privatised, such as unpaid salaries, health and pension insurance and other taxes, we deemed it unrealistic to expect the new owner to settle all these debts. These are the company debts, meaning that these outstanding obligations will be settled through the business operations and profit generation.

12. Were there, and how many, attempts to privatise a certain economic operator (company), where the parties reached the stage of specific negotiations, but then process never saw its completion? Was this caused by the lack of institutional capacities and/or legal issues, or other unresolved issues during negotiations with the future owner (general assessment, or give an example)? If this was a legal issue, please specify the laws or the article/s of specific law which caused problems?

Judging by the experience of this Agency, there were no such cases.

GENERAL REVIEW OF PRIVATIZATION PROCESS

13. To our knowledge, the Law envisions restructuring of the company into smaller ‘techno-economic’ units prior to privatization. However, what actually happened in practice was that instead of dividing the companies based on the principles of assurance of economic efficiency, revitalisation and vitality of the company/companies being restructured, the companies were divided based on the ethnic principles?/cantonal competencies! Do you agree with this assessment?

- a) YES (in principles);
- b) Partially (not in its entirety);
- c) NO (Do you have any comments regarding this observation?)

There is very little I can tell about this, because we had not such cases falling under the competencies of this Agency.

14. What are your experiences in implementing the privatization in the canton which falls under the competence of your Privatization Agency, and in the Federation of Bosnia and Herzegovina? In other words, do you consider that the privatization process in your canton is: successful, less successful, or a failure? (Do you have any general comment?)

Taking into account that majority of the contracts were performed and executed, and given the number of privatised companies, I may conclude that privatization was a success. When it comes to the post-privatization period where, objectively speaking, we witness the crisis in the economy and in the individual companies, I may say that privatization was less successful. I think that all envisioned privatization objectives were not achieved.

15. Do you agree with the assessment that privatization process contributed to the privatization objectives, in terms of revitalisation of the industry/companies, productivity growth, and technological capacity and competitiveness of the companies/industry?

- a) YES (I completely agree),

- b) Partially;
- c) NO (I completely disagree)

(Do you have any comments regarding this observation?)

No, I don't think they were achieved.

CURRENT ROLE OF THE AGENCY AND CHALLENGES

16. What are the current objectives of the Agency and challenges with regard to the privatization? What are the lessons learned, if any?

To complete the privatization process in this Canton in the best possible way.

II CRITICAL REVIEW OF INSTITUTIONAL FRAMEWORK AND COMPETENCIES OF THE AGENCIES IN PRIVATIZATION PROCESS IN FEDERATION OF B&H

17. Are there institutional issues that constitute an obstacle/barrier for more efficient enforcement of the law throughout the privatization process?

No.

18. Are there issues, in terms of human resources and finances, which constitute an obstacle/barrier for efficient implementation of privatization? Please, identify the existing operational gap in the Agency, in terms of the lack of human resources, expertise and financial resources?

No.

19. Are there any gaps in the organisational structure of the Agency? Is it a common practice to hire the additional consultants, and if this is the case, please tell us more about this practice?

No.

20. Is there overlapping in competencies with other agencies? If so, is this a horizontal overlapping – with other cantonal agencies, or is it a vertical overlapping – with the Federal Agency for Privatization?

No.

III REVIEW AND CHALLENGES OF THE LAW ON REVISION OF PRIVATIZATION

21. The Law on Revision of Privatization has been enacted, so what is a strategic position of the Agency with regard to this Law?

In this case, Agency will only play a role of institution which will provide all data to the relevant Agency for Revision.

22. What is your opinion on this Law? Is it going to be easy to implement it, and what obstacles and risks may be expected during its implementation?

I doubt it will be easily implemented; they will encounter the same obstacles and risks which were experienced in the privatization itself.

FINAL QUESTIONS

23. Please, list the companies in your canton which have undergone a successful privatization process and where different privatization methods were employed?

In our Canton, examples of successful privatization include the companies which were privatised by public offering of shares and through tender procedure. We may say that in majority of cases, privatization in this Canton was successful.

24. The Law envisions that the State may retain the share in ownership (in the structure of capita) of . companies to the maximum of 30%. Please, tell us in which cases the State (upon the proposal od the Government, or decision adopted by the Parliament of the Federation) expressed ad interest/readiness to retain the share in ownership of a company, if there were such cases? (Please, provide an example)

There were no such cases in Canton.

Privatization Agency, Zenica-Doboj Canton

The interview was conducted with: Ahmet Begagić, Deputy Director

Interview was held: 05.11.2014.

I CRITICAL REVIEW OF LEGISLATIVE FRAMEWORK IN FEDERATION OF B&H GOVERNING PRIVATIZATION PROCESS

GENERAL REVIEW

1. Please identify the main obstacles in the existing legislation and other obstacles encountered in practice which slow down/hinder the privatization process, and/or render it inefficient in terms of privatization objectives? PLEASE LIST 4-6 key obstacles!

The privatization in B&H was, probably, ill-timed. On one hand, the country was war-ridden, with obsolete or destroyed technological capacities, and on the other hand privatization was supposed to be quick. Two methods were used: public offering of shares and tender procedure, and prior to the war the so called “Markovic’s privatization model” was implemented. All companies were revising this ownership transformation and submitting their programmes to the Agency. The companies had a problem since very few people were educated to deal with the privatization issues. The Federal Agency, in cooperation with cantonal agencies and USAID, invested efforts to provide this education, but this was not satisfactory, therefore the privatization programs and initial balances were of poor quality. In addition, another problem which remains

to plague the companies' property (assets) is unresolved legal and proprietary issues. The equipment, fixed and movable assets were not kept in the companies' records in line with certain realistic market values, so there were huge discrepancies. The companies failed to further derecognise (remove a book entry) these losses. The most common problem this Agency was encountering in the very implementation of the law was that investors, who were buying the companies, used to make grand promises. However, the problems occurred when all the promises were to be translated into the contract, and in many cases these contracts were broken (cancelled), because over the course of time, investors would come to realisation that it was impossible to implement many things they incorporated in the contract; there were discrepancies regarding the new markets and new technologies. A major issue when contract is cancelled is that this process is very lengthy and usually takes several years to complete. The companies were, to a large extent, essentially destroyed, because after the cancellation of contract they ceased to operate. In addition, various schemings and machinations by the buyers contributed to destruction of companies.

2. Please list the examples in practice where the problems have occurred due to, or resulted from inadequate or ineffective legislative solutions?

The law failed to define the status of the company, in the case when procedure to break the sales contract was launched. In this scenario, at least the property (assets) i.e. the capital of the company should have been protected. Furthermore, the law allowed for the company to be subjected to privatization, regardless of the unresolved legal and proprietary issues, but the decision to approve the registration of implemented privatization was not to be issued. What was essentially done here? Something was sold to somebody without having issued a decision which enables it to be entered into the court registry. In addition, the issue of public utility/good (bonum commune) remained unresolved, which rendered impossible or hindered privatization of public utility goods. Therefore, the Government of Zenica-Doboj Canton made a decision to halt the privatization of public/common utility goods until solution is provided by legislation.

3. Based on your experience, please list other problems which constitute the key obstacles in efficient implementation of privatization and which, by its nature, are not legislative? PLEASE LIST 3-4 examples!

The environment, the war-ridden country, obsolete markets and technology, the issue of the mentality of employees and new owners. The lack of cooperation was evident between public bodies (Tax Administration, Employment Bureau, Pension Fund, Agency, courts). For instance, the courts were not equipped to deal with privatization cases and very often there were multiple judgements in the same case. Accordingly, there were cases where an investor made investments in a company and the Agency was ordered to return that company to state ownership.

REVIEW OF SPECIFIC COMPETENCIES OF THE AGENCY

4. The Law defines but does not stipulate the competencies of the Agency in the privatization process; more detailed definitions of the Agency's competencies are comprised in the Rulebook on Privatization and decisions adopted by the Government/Parliament of the

Federation of B&H. Based on your experience and practice, please single out/list 4-6 key competencies of the Agency?

They are:

- organises and encourages privatization of companies in the Canton;
- initiates and participates in drafting, enactment and adoption of privatization regulations and other privatization legislation;
- approves, implements and supervises privatization of companies in the Canton;
- enters into company privatization agreements (contracts) at cantonal level, through sale, leasing and other methods;
- organises and encourages education and professional development in the area of privatization;
- monitors and supervises implementation of the law and other privatization regulations.

5. Do you deem that, given the competencies, Agency has a relevant role in implementing the privatization and achieving the economic objectives of privatization?

- a) YES (The Agency has a significant role in proposing decisions which pertain to privatization, and which are, eventually, adopted by the Government of the Federation of B&H)
- b) NO (The Agency has mediatory and administrative role in the implementation of privatization)

Agency has not experienced problems when implementing privatization, tenders, bids ... However, the lack of cooperation with other agencies, like, for example, inspection bodies was the biggest challenge, because when the Agency would establish that the terms of the agreement were not respected, e.g. that employees were not paid their salaries, the Agency would only notify competent inspection controls about the situation whereby its responsibility ended. Only afterwards, the rulebook was amended giving the Agency wider powers in such cases.

6. Pursuant to the Law (Article 4), the privatization programme prepares the company which is subject to privatization, including the initial company value, privatization method and the structure of employees following the privatization. Based on your experience and practice, does the Agency have possibilities and capacities to modify the proposed privatization programme, as provided for in the Law?

- a) YES
- b) NO (in practice it only has a mediatory role)

NOTE (if your answer to previous question is NO, please move to question no. 10!)

There were some situations. The privatization programme and method, including the balance sheet, are produced by the company, and then submitted to the company's supervisory board, which almost always approves it. In some cases, when Agency advises the company that

particular method is not appropriate for that type of company and activity, and if company rejects to approve it, than the Agency will present proposal before its Managing Board and the method of sale will be changed.

7. If YES, does it fall under the competencies and practice of the Agency to modify the proposal of privatization programme which pertains to privatization method and payment arrangements?

- a) YES
- b) NO

We have already provided answers with regard to how the privatization method is changed. When it comes to payment method, it is governed by the law.

8. If it does, what were the criteria or approach in establishing the method/combination of privatization methods with regard to the particular company? What problems were experienced in terms of determining the privatization method and over the course of employing the specific method in privatization process?

A more common problem was that companies mostly preferred public offering of shares because it was an easier way for them, although for specific companies the tender was the best method. If they refused to endorse our advice, we would submit our assessment to the Supervisory Board of the Agency for Privatization and in that case method was always changed. When indentifying the best privatization method, the following is considered: the capacity, profile and activity of the company...

9. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to the structure and the number of employees after the privatization ?

- a) YES
- b) NO

No, the Agency never asked the company to change this, since there were no social programmes for the redundant employees.

10. If the answer is YES, do the competencies and practice of the Agency include modifications of the privatization programme proposal which pertains to initial company value?

- a) YES
- b) NO

It is not, initial the initial value is determined on the basis of the (initial) balance sheet. However, when a company is sold for the first time, paid value cannot be lower than the initial value, but if it is sold for the second time or through direct sale agreement, a company may be sold for a price below the initial value. Therefore, we had cases where we sold some companes for 1 BAM (KM).

11. What competencies of the Agency arise from the legislative solutions, in the process of negotiations and entering into privatization agreements? In particular, what are the competencies of the Agency in drafting the Privatization Agreement, in the stage of developing the Company Privatization Agreement, in particular with regard to specifying and determining the obligations of the future owner, or e.g. resolving the company debt disputes?

This mostly related to payment of sales price, investments to the company, introduction of the new technologies, market penetration, retention of the existing activity for the minimum period of three years, retention of existing workforce, creation of new jobs, treating the employees in compliance with the labour laws, a buyer also assumes the obligations for semi-annual performance reporting to the Agency...

12. Were there, and how many, attempts to privatise a certain economic operator (company), where the parties reached the stage of specific negotiations, but then process never saw its completion? Was this caused by the lack of institutional capacities and/or legal issues, or other unresolved issues during negotiations with the future owner (general assessment, or give an example)? If this was a legal issue, please specify the laws or the article/s of specific law which caused problems?

We talked about this before. Privatization is launched, bid invitation is published and then prospective buyers express an interest to purchase the company, however, they set certain conditions, e.g. reduction of the redundant workforce, since for them, objectively, it is a surplus of workforce. However, this is not the practice used by the Agency, so we have not been able to accommodate such requests.

GENERAL REVIEW OF PRIVATIZATION PROCESS

13. To our knowledge, the Law envisions restructuring of the company into smaller ‘techno-economic’ units prior to privatization. However, what actually happened in practice was that instead of dividing the companies based on the principles of assurance of economic efficiency, revitalisation and vitality of the company/companies being restructured, the companies were divided based on the ethnic principles?/cantonal competencies! Do you agree with this assessment?

- a) YES (in principles);
- b) Partially (not in its entirety);
- c) NO (Do you have any comments regarding this observation?)

We have not done this, our colleagues from the Federal Agency would know better.

14. What are your experiences in implementing the privatization in the canton which falls under the competence of your Privatization Agency, and in the Federation of Bosnia and Herzegovina? In other words, do you consider that the privatization process in your canton is: successful, less successful, or a failure? (Do you have any general comment?)

Less successful.

15. Do you agree with the assessment that privatization process contributed to the privatization objectives, in terms of revitalisation of the industry/companies, productivity growth, and technological capacity and competitiveness of the companies/industry?

- a) YES (I completely agree),
- b) Partially;
- c) NO (I completely disagree)

(Do you have any comments regarding this observation?)

Only to some extent.

CURRENT ROLE OF THE AGENCY AND CHALLENGES

16. What are the current objectives of the Agency and challenges with regard to the privatization? What are the lessons learned, if any?

During the period when privatization process was more intensive, the money, i.e. the income generated from this process was allocated to the cantonal budget or the budget of the Federation of B&H, and approximately 5% of this income was used to finance the Cantonal Privatization Agency. We currently have companies which we tried to sell, but failed in doing so, and public utility companies – decision on privatization of these companies has been adopted only recently. We also have companies where the contract we cancelled, but majority of these companies is going to bankruptcy. The objective of the Agency is to complete the privatization process, to perform due diligence of all companies, to analyse the privatization agreements and initiate court procedures in cases of failure to fulfil the contractual obligations.

II CRITICAL REVIEW OF INSTITUTIONAL FRAMEWORK AND COMPETENCIES OF THE AGENCIES IN PRIVATIZATION PROCESS IN FEDERATION OF B&H

17. Are there institutional issues that constitute an obstacle/barrier for more efficient enforcement of the law throughout the privatization process?

Institutional issues include lack of cooperation with other agencies, e.g. inspections authorities, because when the Agency establishes that the terms of the agreement are not respected, e.g. that employees were not paid their salaries, the Agency will only notify the relevant inspection bodies about the situation whereby its responsibility ends. Only afterwards, the rulebook was amended giving the Agency wider powers in such cases.

18. Are there issues, in terms of human resources and finances, which constitute an obstacle/barrier for efficient implementation of privatization? Please, identify the existing operational gap in the Agency, in terms of the lack of human resources, expertise and financial resources?

This Agency never had an auditor (as a staff member). We used to request from the buyer to submit the audit findings, which we then analysed. For a while, we used to outsource external

human resources (auditors), as required, but, I have to emphasise, that the Agency had considerably more funds available at the time. Currently, the Agency is facing the huge challenges regarding the financing of its operations. We witness diminished scope of activities of the Agency, and the surplus of workforce, but still we lack human resources for some specific, specialised jobs. In addition, we may conclude that B&H lacks the system which would enable networking and linking between all the agencies. It turned out that the Federal Agency for Privatization was not what we thought to be – agency to organise the meetings of the representatives of all agencies for consultation etc. For a while, such meetings used to be organised, but not anymore.

19. Are there any gaps in the organisational structure of the Agency? Is it a common practice to hire the additional consultants, and if this is the case, please tell us more about this practice?

I provided an answer to this when responding to the previous question. This used to be the practice during the period when privatization was more intensive, in particular, we used to outsource external auditors since, as I have already mentioned, composition of human resources in the Agency is inadequate.

20. Is there overlapping in competencies with other agencies? If so, is this a horizontal overlapping – with other cantonal agencies, or is it a vertical overlapping – with the Federal Agency for Privatization?

No, there aren't any.

III REVIEW AND CHALLENGES OF THE LAW ON REVISION OF PRIVATIZATION

21. The Law on Revision of Privatization has been enacted, so what is a strategic position of the Agency with regard to this Law?

We will be very responsive to the newly established Agency for Revision of Privatization. We will make available all the documentation and we will be willing to cooperate.

22. What is your opinion on this Law? Is it going to be easy to implement it, and what obstacles and risks may be expected during its implementation?

The Law per se is good. Revision has been done before, and it is nothing new. I doubt this Law will bring any changes. I feel the Law was enacted only to appease the public and, in particular, the employees.

FINAL QUESTIONS

23. Please, list the companies in your canton which have undergone a successful privatization process and where different privatization methods were employed?

Ortačka grupa Metalno d.d. Zenica (Join Venture-Partners Group), Agrokop Visoko, Pobjeda Tešanj...

24. The Law envisions that the State may retain the share in ownership (in the structure of capita) of . companies to the maximum of 30%. Please, tell us in which cases the State (upon the proposal od the Government, or decision adopted by the Parliament of the Federation) expressed ad interest/readiness to retain the share in ownership of a company, if there were such cases? (Please, provide an example)

In our Canton, it never decided to retain the ownership.

Appendix B: Interviews with privatized companies

ALBA d.d. Zenica

Activity: waste collection, transport i management, landscaping, mechanical and manual cleaning and washing of asphalt surfaces, winter maintenance service, collection, transport and separation of recyclable materials.

The interview was conducted with: Miralem Galijašević, Executive Director

The interview was conducted: 22.11.2014.

1. Which privatization method was used to privatize your company?

Preduzeće ALBA d.o.o. Zenica is a joint-venture company established under the Joint Venture Agreement between ALBA Berlin and Zenica Municipality in 1999. 75% of company is owned by ALBA 75%, whereas Zenica Municipality is the owner of 25%. Under the Joint Venture Agreement, ALBA invested working capital and operational resources, while Zenica Municipality invested a “healthy” portion of municipal utility company Komrad and necessary workforce. Establishment of management structures has enabled the start of operations in 1999, and since then the company has had a successful track record. ALBA Zenica currently has 150 employees.

2. How long was the privatization process in your company?

Less then a year.

3. During the implementation of the privatization contract, were there difficulties?

No, there were no difficulties.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

In my opinion, this is a good “privatization” model. The founders had a common interest - ALBA Berlin sought to generate profit through investments, and Zenica Municipality sought the solution to address the problems of utility company which operated with losses.

Cementara Kakanj d.d. (Cement Factory Kakanj)

Activity: production of the wide range of high-quality cements

The interview was conducted with: Hilmo Bjelopoljak, employee since 1977, Company Manager in the period 1991 - 2006 (during the privatization), afterwards the member of Supervisory Board

The interview was conducted: 03.11. 2014.

1. Which privatization method was used to privatize your company?

In 1990, on September 20th, the voting within the company was organised and majority of workers in Cement Factory Kakanj voted for separation of Cement Factory Kakanj from GIK system "Hidrogradnja" Sarajevo. Since 1991, the company has operated as independent joint stock company with majority capital in state ownership. In 2000, 51% of the capital was privatised - German company Heidelberg Cement bought major share in the Cement factory Kakanj by participating in international tender, the pilot project of large-scale privatization in the Federation of Bosnia and Herzegovina. The sales agreement between the Agency for Privatization and HeidelbergCement was entered into on July 21st 2000. Nine global companies participated in the tender, but specific negotiations were entered into with 5 companies.

2. How long was the privatization process in your company?

Duration of privatization process in which HeidelbergCement purchased the cement factory was approximately one year.

3. During the implementation of the privatization contract, were there difficulties?

No. Everything was done in compliance with the law. Heidelber was regularly submitting semi-annual reports to the Agency for Privatization. They have proven their corporate social responsibility, and the liabilities and obligations regarding the employees were fulfilled.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

Cement Factory never recorded any business losses and is one of the most successful companies in the region, with regard to its activities. It should be noted that Heidelberg Company paid 15% higher price as compared to the book value of the cement factory Kakanj (KM 55 million) and the ask price in the privatization process. This is the result of lobbying on account of the cement factory, hence the most serious bidders ended up competing between themselves during the negotiation phase.

Heidelber invested KM 150 million in the cement factory, which was envisioned in the privatization agreement, but 4.5 years earlier than the stipulated deadline.

Ekor Komerc d.d. Zenica

Activity: Non-specialised wholesale trade

The interview was conducted with: Ekrem Oruč, Executive Director

The interview was conducted: 25.11. 2014.

1. Which privatization method was used to privatize your company?

Large-scale privatization 51%, whereas 49% was sold through certificates.

2. How long was the privatization process in your company?

We are one of the few companies which performed entire privatization within the timeframe of 1 year, as defined under the contract.

3. During the implementation of the privatization contract, were there difficulties?

No, there were no difficulties.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

There are small privatization issues, which pertain to the business buildings which were sold within small privatization. This resulted in disputes where the court rulings had to be made on which party offered more, so Agency for Privatization was supposed to pay for some alleged damages suffered by some parties.

”IGM” d.o.o. VISOKO

Activity: construction materials industry

The interview was conducted with: Sulejman Ismić, employee in the legal department

The interview was conducted: 08. 12. 2014.

1. Which privatization method was used to privatize your company?

Privatization was implemented per “Marković model”, through public sale (auction), compensation agreed with the state and public offering of shares.

(approximately 56%, 22%, 4% and 18%).

2. How long was the privatization process in your company?

Privatization process started in 1990 (in line with “Marković model”, Law on Social Capital, dated December 30th 1989). Privatization procedure was completed in 2001, through public offering of remaining shares.

3. During the implementation of the privatization contract, were there difficulties?

No particular difficulties were observed during the implementation of privatization agreement save one thing – the privatization procedure under the Law on Privatization was extremely complicated.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

The company has been operating well, there were no redundant employees, the existing technologies were mostly retained and new technologies adopted. Also, the company is not encumbered or burdened by any liabilities.

Mann Hummel d.d. Tešanj

Activity: development and manufacturing of filters and filtration systems in automotive industry

The interview was conducted with: Mahmut Galijašević, Executive Director

The interview was conducted: 09. 12. 2014.

1. Which privatization method was used to privatize your company?

The company was privatised in line with the rules of direct sale, where 51% of total capital of company UNICO FILTER d.d. Tešanj was offered for sale. In addition to 51%, the employees of UNICO filter, at the time, also sold their shares so that the investor could, eventually, assume 65 percent ownership over the company, which allowed buyer a total control through its Supervisory Board. This was one of the conditions set by the buyer when the company was purchased.

2. How long was the privatization process in your company?

It covered the period from 2004, when the privatization rules were published and submitted to the buyer for the purpose of participation in privatization, until December 22nd 2005, when the parties entered into Agreement on Sale of Shares.

3. During the implementation of the privatization contract, were there difficulties?

The difficulties encountered in privatization include the fact that privatization was very lengthy, which was the result of red-tape and bureaucratic approach of the representative of the owner at the time, and failure of the future owner to understand the complexity of the purchase process.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

Privatization in this case was successful because it has spurred the development and growth of the company, and created new jobs.

METALNO in Zenica

Activity: Company for production, assembly and sale of steel structures and equipment

The interview was conducted with: Radmila Milešić, Corporate Secretary

The interview was conducted: 08. 12. 2014.

1. Which privatization method was used to privatize your company?

In case of Metalno d.o.o., privatization process unfolded in two stages. In the first stage, 49% of the state capital was privatised through public offering of shares. The investors were PIFs (privatization investment funds) and a number of physical entities who were employed in the company.

In 2004, the second stage of privatization saw privatization of the remaining 51% of state capital. International tender (bid invitation) was launched first, but no foreign investors expressed the interest, only the employees of the company who purchased the capital.

2. How long was the privatization process in your company?

The first stage of privatization lasted for nearly 2 months, whereas the second stage lasted 3-4 months. It should be noted that the interval between these two privatization stages was very long.

3. During the implementation of the privatization contract, were there difficulties?

No difficulties.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

No major difficulties were encountered. Currently, there is a problem of aging workforce, but since the younger employees have been recruited, this issue is mitigated.

Natron Hayat Maglaj

Activity: production of various types of paper and paper packaging

The interview was conducted with: Azema Mulasmajić, Executive Director for Legal Issues, HR and Logistic

The interview was conducted: 08. 12. 2014.

1. Which privatization method was used to privatize your company?

This was not the case of privatization pursuant to the Law on Privatization of Companies. In this case, the joint venture company (Limited Liability Company) was established pursuant to the Law on Companies. Natron dd Maglaj, as domestic founder (with 67% of state-owned shares and 33% shares owned by small shareholders) has brought in assets, property, human resources, permits and approvals, whereas foreign partner Kastamonu Entegre, the member of Hayat Holding Group from Turkey, brought in the equity, and assumed obligation to invest in the company. Natron dd Maglaj remains to exist as an independent business entity (non-privatised), which is one of the members/founders of Natron-Hayat doo Maglaj.

2. How long was the privatization process in your company?

The Agency for Privatization made attempts to implement privatization through sale of the state-owned shares, by public bid invitations, tenders and other ways in compliance with the Law. Supported by international advisory institutions, the Agency was lobbying and encouraging the potential buyers of state-owned shares, launching international tenders etc., but the attempts were not successful. All this lasted for approx. 3 -4 years. At the time, Natron operated with very limited capacities, without having launched its main/integrated production and as such, ridden by damages suffered in war, was not able to survive, let alone invest in revitalisation of integrated production of pulp and paper. The company management proposed to the Government (legal owner i.e. titular of state capital) to establish the new company instead of privatising the state capital, aiming to re-launch the production, retain existing employees and establish sales lines, and invest in main production and development packages. The Government and small shareholders supported this suggestion, which resulted in establishment of Natron-Hayat.

3. During the implementation of the privatization contract, were there difficulties?

The problems were encountered during the stage of investments because the foreign partner demanded the highest technological and environmental standards, which considerably exceeded the projected investments under the Agreement on Establishment. Although they were not obliged to invest more than the contracted amount, the foreign partners (owners from Turkey) eventually implemented the entire investment in the period 2006-2008, in the amount EUR 90 million, five times the contracted amount; however, this enabled NatronHayat to become producer with references required at foreign markets. In addition, after having launched the main production, the company was challenged by the problems with supply of main raw material (wood), the majority of which was supposed to be sourced locally, so the wood had to be imported, which costed considerably more due to transportation costs and series of fees and taxes which the neighbouring countries introduced to protect the export of this particular natural resource. At the same time, local companies/forest management companies were exporting the wood, and the government which gave them the rights to do so, did not have strength to stop it. The competent authorities had not fulfilled any contractual obligations, they just paid the lip service (obligations included electricity supply, coal supply, used paper and wood supply, and railway transport). The foreign partner has fulfilled all the obligations, even going beyond the scope of contractual obligations.

4. Does the company currently face problems in business and are there any gaps that can be connected to the completed privatization?

Currently, the performance of the company is very satisfactory, export accounts for more than 90% of total sale, import is minimum, raw materials are sourced locally and available local resources are used to the maximum extent, the status of employees is among the highest in the region with regard to respect of all rights, and exceeds the mandatory minimum, there are no unresolved issues. The standard of employees is improving year in, year out.

Pobjeda d.d. Tešanj

Activity: manufacturing of pumps and filters

The interview was conducted with: Kasim Kontorić, Executive Director of Production

The interview was conducted: 08. 12. 2014.

1. Which privatization method was used to privatize your company?

. Privatized by combined method:

-Marković's model - 23%

-Public offering of shares – up to remaining 49% (i.e. 26%)

-Sale via bid invitation - 51%

2. How long was the privatization process in your company?

Privatization process had started before the war and ended in 2007, when contractual obligations of joint venture (partners) group.

3. During the implementation of the privatization contract, were there difficulties?

No, there were no major difficulties.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

Every company faces challenges in business operations, and our company is no exception, but these problems are not in direct correlation with the privatization.

Servis Trans d.d. Donji Vakuf

Activity: Passenger transportation

The interview was conducted with: Ahmed Žuljko, Director of Internal Control

The interview was conducted: 24. 11. 2014.

1. Which privatization method was used to privatize your company?

Privatization process unfolded in two cycles. In the first cycle, 49% of the state capital was privatised through public offering of shares. The second cycle of the process saw privatization of the remaining 51% of state capital. The employees and the manager purchase the entire company capital and continue to be the only owners.

2. How long was the privatization process in your company?

The duration of second cycle was approx. one year.

3. During the implementation of the privatization contract, were there difficulties?

No.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

No.

ŽGP d.d. Zenica

Activity: civil engineering, building construction and limestone processing

The interview was conducted with: Kasim Alić, Executive Director for Economic and Legal Affairs

The interview was conducted: 08. 12. 2014.

1. Which privatization method was used to privatize your company?

Method used in privatization of ŽGP Zenica was very rare in the Federation of BH. After the cancellation of privatization agreement with Kalen d.o.o., which purchased ŽGP, the capital was returned to the state. At the time, the state owned approximately 67%, while approximately 30% of the company was in the ownership of a private investor. Shareholders Assembly, pursuant to the Law on Companies, adopted proposal to increase equity, through private placement of shares.

2. How long was the privatization process in your company?

Duration of privatization process was approx. one year and no major problems were encountered.

3. During the implementation of the privatization contract, were there difficulties?

In our case, it was not the agreement. As I have already mentioned, privatization was attempted in 2001. Kalen d.o.o purchased the package of shares and entered into privatization agreement. However, the new owner failed to fulfil contractual obligations. It paid the price of shares in certificates. The owner failed to carry out contracted investments, provide bank guarantees, and meet the liabilities towards the employees and suppliers. This resulted in cancellation of the contract. After the court procedure was ended when court ruled that the cancellation of privatization agreement was in compliance with the law, ŽGP was returned to state ownership. At the time, the state owned approximately 67%, while approximately 30% of the company was in the ownership of a JATA Group. Shareholders Assembly was convened to make decision to increase the equity. The minimum required number of capital owners attended the second assembly meeting, (although the Government of Zenica-Doboj Canton was absent), thus the Assembly was able to adopt proposal to increase the equity and as a result private investor (JATA Group) gained 67% of shares, thereby increasing the company value by 1.6 million BAM, whilst the Government of Zenica-Doboj Canton ended up owning 30% of the ŽGP's shares.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

Surely there is. The new owner has its own vision regarding the operations of ŽGP, and is trying to limit the activities of the company to quarry activities and asphalt base, and is reducing the activities in construction sector. The number of employees is being reduced constantly. Since the New Year, the salaries were reduced to the minimum, when the new rulebook on job classification (systematisation) was adopted by the supervisory Board of ŽGP.

ZIM d.d Zenica

Activity: production, processing, and distribution of milk and dairy products

The interview was conducted with: Senaudin Kulačić, Employee in the Legal department

The interview was conducted: 24. 11. 2014.

1. Which privatization method was used to privatize your company?

Public tender in large privatization. 62,43968% of total company capital was offered for sale.

2. How long was the privatization process in your company?

Privatization started in 1999, by determining the initial balance and privatization plan of company ZIM d.d. Zenica. Initial balance and privatization plan were approved on August 28th 2000. Public tender was published in daily paper "Jutarnje novine" on February 12th 2001.

3. During the implementation of the privatization contract, were there difficulties?

On May 11th 2001, Agency for Privatization of Zenica-Doboj Canton (ZDK) selected the group "Dizdarević i ortaci" (Dizdarević and partners) as the most eligible bidder. The second bidder (Forma doo Zenica) lodged a complaint to the Ministry of Agriculture of Zenica –Doboj Canton. On July 26th 2001, the Ministry upheld the complaint, annulled the decision of the Agency and returned the case to the ZDK Agency for Privatization for reconsideration. On October 15th 2001, ZDK Agency for Privatization again selects the group "Dizdarević i ortaci" as the most eligible bidder. The complaint was filed against this decision to ZDK Ministry of Agriculture, which rejected complaint on November 27th 2001. The administrative procedure against this decision was initiated before the Cantonal Court in Zenica which, on September 5th 2002, annulled decision of Agency for Privatization on the selection of the most eligible bidder, and the case was returned to the court of original jurisdiction to reverse the proceedings.

On September 23rd 2003, ZDK Agency for Privatization again decides that "Dizdarević i ortaci" is the most eligible bidder. Forma doo Zenica filed complaint against this decision to the ZDK Ministry of Agriculture, which rejected it on October 23rd 2003. The administrative procedure was initiated against this decision before the Cantonal Court in Zenica which, in the ruling dated October 28th 2005, rejected the complaint as ungrounded. On August 30th 2006, the Supreme Court of the Federation of B&H rejected the Request for Reconsideration of the Court of First Instance's judgement as ungrounded. On February 20th 2009, ZDK Agency for Privatization issued certificate on fulfillment of all contractual obligations.

4. Does the company currently faces problems in business and are there any gaps that can be connected to the completed privatization?

No difficulties were encountered.

Appendix C: Interview with Fikret Čaušević, PhD

The interview was conducted with: Fikret Čaušević, PhD, Professor at the School of Economics in Sarajevo

The interview was conducted: 12. 08. 2014.

1. Please, give us your review of privatization process in the Federation of B&H?

Privatization in B&H, similarly to all countries of former Yugoslavia, began in Marković's era. The capital, which was paid and registered in 1990 in former Yugoslavia per Marković's model, was recognised in 1997. Law on Privatization in FB&H was adopted in 1997. The Law allowed mass privatization (using the certificates as means of payment), i.e. certificated were issued to the citizens who were of legal age on March 31st 1992. Later, in 1998, the Law on Initial Company Balance Sheet was adopted. In addition, laws relevant for privatization include: Law on Means of Payment, Law on Securities, Law on the Register of Securities, Law on the Securities Commission, etc. All these laws are very relevant for privatization process. Rulebook on Purchase of Company Shares is also very important.

The majority of capital was privatised in mass privatization, where certificates were used to purchase the shares in the companies. We should point out the Rulebook on Privatization via Tender Procedure, adopted in 2002, since it allowed for privatization by tender method. The problem with privatization through certificates was that no fresh capital was injected; new owners were not obliged to pursue development of the companies which is, essentially, the purpose of privatization – restructuring, technology development, market development, building the links between the company and the market. Therefore, result of mass privatization through certificates was poor, unlike the privatization through tender (bid invitation) method, which attracted the foreign investors. Natron Hayat is success story about privatization implemented through tender method. There are only few examples of successful privatization via certificates, because this method failed to address the key issues in the companies. Success stories of privatization via certificates include, for example, Metalno Zenica, Pobjeda Tešanj, Enker Tešanj... Why are these companies successful? They are successful because they were privatised by using the so called know-how capital. The employees (workers and management) purchased the companies. They had expertise and knowledge on business activities, operations, market, sector and industry. In addition, these companies used to have presence on foreign markets before the war; therefore, they just continued their organic development. Unfortunately, privatization through certificates, i.e. through private investment funds in majority of cases has failed because the new owners had neither the previous experience in the given sector or business operations, nor the knowledge to develop the business operations in a particular sector etc. Another successful example of company privatised via certificates is Bosnalijek Sarajevo, the company which increased its capital by seven times, and saw 10-fold increase in its export. The mass privatization triggered problems not only in B&H, but Czech Republic, Poland... Another example of successful privatization is TND Comos Gradača, the company which was divided into techno-economic units and then privatised.

Republika Srpska attracted more foreign direct investments then the Federation B&H, but it was unsuccessful, futile foreign capital, meaning what occurred was the money laundry. We can find very few similar examples in the Federation of B&H. Therefore, the foreign capital does not necessarily mean that company value will increase and that privatization will be a success.

When we analyse the privatization successes and failures in the both entities, I have to emphasise that ethnic privatization was indirectly allowed. It was a mistake to allow the entity – based privatization. Furthermore, in the Federation, the cantons were allowed to implement the privatization. Also, large companies were divided into technical and economic units which were further divided between the entities. Many laws, such as the Law on Foreign Direct Investments, were adopted at the state level and implemented at the level of entities. This has resulted in an unhealthy situation where the entities were competing to attract foreign investments.

The privatization story is not to be simplified; it is not “white and black”. In order to obtain the proper analysis of privatization, the series of interviews should be conducted with the management of privatised companies. There are many successful privatization examples. However, there are also many privatization failures, where the court proceedings are underway, or should be initiated. In some cases, the new owners were only interested to gain the land and equipment at favourable price, and to sell it subsequently. Also, it was impossible to successfully

privatise certain companies. These are the companies whose main client was the Yugoslav People's Army (JNA). The companies which were purchased from employees and management, and had no background in pre-war export, most often went to bankruptcy. They had no previous experience with the foreign market; and market in B&H is very small and has no strength to generate adequate demand. On the other hand, successful companies had previous ties with the foreign markets and were established and recognised in the foreign countries, so they just continued to develop after the war.

We should also perceive things in the global context, i.e. movement of capital and credit activities, which were the strongest in the period 2000-2008, until the onset of economic crisis. This was also the period of the most intensive privatization activities.

Another problem in B&H is the Law on Employment, which recognises the laid off employees as employed, which was craftily used by the new owners. We have no data on exact number of unemployed persons in Bosnia and Herzegovina.

2. What are the disadvantages of the existing privatization legal framework in the Federation of B&H?

Law on Privatization failed to take into account specific features of particular industrial sectors. For example, the privatization of a textile company differs from privatization of company in agricultural sector, metal industry, or pharmaceutical sector and vice versa. The differences are huge. The privatization of companies in different sectors varies considerably. Production and manufacturing processes are completely different. Production cycles are different. In some cases duration of production cycle is one day, in other cases several months, in another it takes a year. Also, some sectors are less attractive for investments. The investors were less interested in production sector, where production cycle is longer. The most serious failure was that, under the law, the new owners were not obliged to perform restructuring and investments in the companies.

Great damage was also inflicted at the very beginning of the privatization process, whereby a large number of enterprises were privatised through mass privatization. This created great dispersion of ownership in the enterprises supposedly ineffective form of governance, the new owners were not obliged to restructure enterprises or invest into them, which is a necessary precondition if the privatization process is to be successful.