

# Policy Analysis

*New Capitalist system of Bosnia and Herzegovina:  
Reform Agenda and Social Cohesion Model as its  
Instruments*

Prof. dr. Adisa Omerbegović-Arapović

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Kontakt: [info@vpi.ba](mailto:info@vpi.ba) [www.vpi.ba](http://www.vpi.ba)

Uz podršku:



# ***New Capitalist system of Bosnia and Herzegovina: Reform Agenda and Social Cohesion Model as its Instruments***

## ***Summary***

After twenty five years of transition Bosnia and Herzegovina has failed to establish a coherent and recognizable model of capitalism. The political economy of the country is based on the combination of opposing elements of capitalist and socialist economic models. The underlying value choices are not based on the grounds of social consensus, thus resulting in the growing economic and social deviations, which are threatening the survival of existing social, economic and political order. The last answer by the political actors to these disturbances has been the *Reform Agenda*, serving as the package of reforms predominantly the social and economic ones. However, the Reform Agenda does not contribute enough in order to push the society towards the new value choices which are necessary to establish: a more just society, economic development and a control over capitalism. On the other hand, the *Social Cohesion Model* presents the unused instruments of the redistribution of income and fiscal democratization. By comparing the key elements of the Reform Agenda and Social Cohesion Model, this study provides alternative choices, which ultimately lead towards a different and a potentially more just social outcome, which is in the interest of the citizens and the *raison d'Etat*.

## ***Introduction***

Two and a half decades after Bosnia and Herzegovina (B&H) informally adopted a free market mechanism as an instrument for the allocation of resources, the government is faced with the implementation of the Reform Agenda<sup>1</sup>. This package of reforms which includes economic, social, judiciary and governance reforms was proclaimed a priority for the national economy in order to reform it out of the crisis in which the nation has been stuck for a significant period of time. The domestic economy is characterized by the low level of investment, poor public finances<sup>2</sup>, unstable pension fund ineffective system of social protection, education system which is not complimentary with the labor market, high unemployment rate, low rate of the working population, ineffective fiscal system, inefficient public services, high level of corruption, cumbersome, expensive and ineffective public administration, and political clientelism. Even though, the reforms are undoubtedly welcomed from the perspective of social and economic justification, this study analyzes the potential outreach of the Reform Agenda in the context of changes in the choice of values that will determine the future of capitalism in B&H, as well as the future path of BH economic development.

1 'Reform Agenda for Bosnia and Herzegovina 2015-2018' was the result of this attention of foreign actors and is a push towards BH political actors in direction of action in the area of socio – economic policies that would work towards betterment of economic and social performance of BH economic system. 'Reform Agenda for B&H 2015-2018' says that it is 'closely aligned with the aims of the EU's new approach to economic governance in the Western Balkans and is in conformity to Economic Reform Programme as a fundamental element to encourage comprehensive structural reforms to maintain macroeconomic stability and to boost growth and competitiveness.' (Reform Agenda, 2015:1) The Reform Agenda for Bosnia and Herzegovina 2015-2018' (in this text 'Reform Agenda') aims to foster sustainable, effective and steady economic growth and creation of a more just social environment. The Reform Agenda represents a crucial instrument for BH economic-social development and it creates conditions for stepping-up European integrations process of B&H. The Reform Agenda is closely aligned with the aims of the EU's new approach to economic governance in the Western Balkans and its priorities were previously discussed with International Institutions – Delegation of the European Union, World Bank, International Monetary Fund and other international organizations and institutions who cooperated in the agenda designing process. The Reform Agenda has a comprehensive focus on the following areas: Public Finance, Taxation and Fiscal Sustainability, the Business Climate and Competitiveness, the Labor Market, Social Welfare and Pension Reform, Rule of Law and Good Governance, Public Administration Reform.

2 Entity and Cantos Budget Deficits are feature which is not going away for some time.

**The free market is just a mechanism which is used in combination with other underlying values resulting in a specific economic model.** In this manner the factors such as the ownership over resources, equality vs. equity, "big" vs. "small" state, measures of fiscal democracy (on whom does the tax burden fall), the system of governance etc. specify the model of capitalism (e.g. Social Capitalism Model, Anglo-Saxon Model, Asian Model, Market Socialism, European Model<sup>3</sup>) or a combination of a variety of models, which by the way, is the fundamental characteristic of the BH Economic Model.

Since the adoption of free market mechanism, B&H has not been able to establish effective control mechanism over capitalism even though the country has been trying to build institutions and policies with a mandate to regulate the markets, protect the legality and competitiveness. The market regulators have been established, however, their roles are not proactive, which has resulted in unsuccessful free market adoption. Some of the evident consequences have been insufficient economic development, large inequalities, low quality of public services, large grey economy, etc. which has given enough room to the critics of BH economic model to proclaim it the "Neoliberal Capitalism"<sup>4</sup>, which is characterized by deregulation.

**The upcoming socio-economic reforms to which the attention is brought today due to the frightening prospects of BH economics and social disequilibrium, even though necessary, are dangerous if we fail to establish a coherent value system corresponding to the concrete chosen model of capitalism.** Therefore, it is necessary to analyze the Reform Agenda in the context of its long term contributions to the development of BH society and the expected results in the context of social outcomes. The political culture in B&H is not at a stage to generate clear ideological values which could breathe alternative economic paradigms. In the light of the aforementioned, this study compares the Reform Agenda and the Social Cohesion Model<sup>5</sup>, as potential instruments for profiling BH Model of Capitalism.

## **Background of BH Political Economy**

Bosnia and Herzegovina which was struck by the war two decades ago today uses free market mechanisms in order to organize its economic activity. The necessary institutions and public systems needed for the functioning of free markets has been developing slowly, leaving the markets 'free' in the wrong sense i.e. the markets became unregulated. This practice has not resulted in the provision of freedom to a single market player, which is the crux of the definition of free markets. The systems of public healthcare, social protection, employment and pension were inherited from the command economic system of ex-Yugoslavia, the so-called "Socialist Self Governance" which was financed by putting the tax burden mainly on the labor and the customer. The revenues from the labor taxes in ex-Yugoslavia were allocated to the healthcare, culture, education, capital investments into infrastructure, social protection and pension system. This was understandable for ex-Yugoslavian regime as there was practically no phenomena of unemployment, and no taxes on capital existed as capital was social capital. No taxes on property existed as property (apartments, land etc.) was obtained through state planning. If we exclude the revenues from indirect taxation, BH tax system is for the most part based on the tax system inherited from ex-Yugoslavia which was adjusted to the circumstances of that economic system.

The economic system had depended on funds coming in from outside and ex-Yugoslavia was highly indebted prior to its fall out. Hyper-inflation was a disease which appeared due to money creation being exercised continuously and it was eroding living standard in relation to Western Europe, which was already lower. The System based on collective motivations has hampered the spirit of entrepreneurship,

3 See Gregory and Stuart (2004) for detailed description of these models.

4 See Social Cohesion at the Center: A New Initiative for Stability and Prosperity of the Western Balkans, June 2015 available through the Web.: <http://library.fes.de/pdf-files/id-moe/11385.pdf> i [http://www.fes-europe.eu/index.php?option=com\\_content&view=article&id=539%3Aa-new-initiative-for-stability-and-prosperity-in-the-western-balkans&catid=39%3Averans-taltungsrueckblick&Itemid=69&lang=de](http://www.fes-europe.eu/index.php?option=com_content&view=article&id=539%3Aa-new-initiative-for-stability-and-prosperity-in-the-western-balkans&catid=39%3Averans-taltungsrueckblick&Itemid=69&lang=de)

5 New Initiative for Stability and Prosperity of the Western Balkans' which was an outcome of policy development exercise in 2014 towards positive political and economic situation in the Western Balkans which is underlined by socio-democratic values ((afterwards 'Social Cohesion model') and called for the establishment of 'a new social and economic model and the replacement of the current neo-liberal model' that provides fiscal and tax justice, democratization through the introduction of wealth registry.

which is felt even today and dramatically determines cultural obstacles to free market economy, and acts as an obstacle to the establishment of the system of individual motivations.

The period of war in B&H in economic sense meant destruction of infrastructure and negative supply shock, i.e. the ability of the economy to produce goods and services. The base in the context of education and needed technology for economic development has been destroyed, hence the postwar B&H had a lower GDP for almost 20 years than the prewar B&H, leading to a much lower standard of living. The end of war opened up the border of B&H not only for commerce and people but also for new liberal economic paradigms. The postwar economic system was transformed and adopted free market mechanisms for allocation of resources, however, this has produced poor results when assessed by a number of criteria.

Because of the permanent political problems and dis-functions of the state coordination mechanisms this post war period failed to generate a strategic economic plan. The painful period of transition from previous system of mixed economy to free market economy has started. This was period of *rent seeking*<sup>6</sup> economics and quick gains by particular groups. In the absence of quick reforms and building of institutions which are necessary to support the 'free market' system—primarily effective regulators—the markets have been 'free' in the wrong sense. They were not free for every player and individual economic agent from the power of strong players—but free from effective regulation, so that a few could have manipulated the system for their own selfish interest and against the interest of consumers or broader social interest. This practice has been characterized by the critics as the "Neoliberal Economic Model," which is a questionable claim.

The transition has created winners that have been paying very low taxes on capital and profits, big players that have reaped huge profits and could live with high costs of economic activity. They have operated through the system while avoiding paying taxes as transition was also period of lack of rule of law, political influence and omnipresent corruption at every step which could have affected functioning of the judiciary, thus encouraging clan capitalism<sup>7</sup>. With the adoption of VAT in 2006 the Public Sector multiplied in size and spending, while profits and capital remained taxed only marginally or not at all. Nowadays, many bring attention to the tax system and see it as the biggest obstacle for the Labor Market – the high tax burden on labor is seen as an obstacle to job creation i.e. economic activity, and as an instrument that promotes grey economy (Compact for Growth, 2014).

The voucher privatization<sup>8</sup> has been largely characterized as a successful experiment with unsuccessful outcomes, as it was accompanied by shameful devaluation of vouchers on the streets so that few with cash could have bought many times bigger worth of coupons on the streets from people who had no choice but to sell them to survive. This kind of privatization led towards the enrichment of the few and ownership of companies which had insufficient working capital or economic justification. This was also the seed of social problems which came with the privatized and under capitalized companies where employees were not receiving their salaries or employee benefits<sup>9</sup>. The society has never cleaned itself from this occupation of capital. The revision of privatization and origins of wealth are topics that come up before elections, quickly to be forgotten later on. This is one of the problems which this society has turned its eyes from, whether it be consciously or unconsciously? This issue is not only characteristic to our society, and one of the solutions can be found through tax system. **As Piketty (2014, 524) points out choice of fiscal system has a chance to cure the unfairness of ill begotten means as tax on wealth would be faster than all courts to systematically correct for previous injustices of capital accumulation. This is the reason why society needs to turn special attention to fiscal system and fiscal policies.**

Liberalization of BH economy in terms of free flow of capital, goods and services have led to the development and liberalization of the financial sector, which has propelled the growth in consumption and credit. In macroeconomic sense this means that we are living two decades of trade deficit which was financed by capital flowing into the country, which has been unsustainable from the beginning. In

6 Rent-seeking is an attempt to obtain economic rent (i.e., the portion of income paid to a factor of production in excess of that which is needed to keep it employed in its current use) by manipulating the social or political environment in which economic activities occur, rather than by creating new wealth. Daurerstadt M. and Schildberg A. (2006)

7 For some work on clan capitalism in the world see Kosals T. (2007), Essays on Clan Capitalism in Russia, *Acta Oeconomica*, Vol. 57 (1), pp. 67-85

8 For detailed description of various models of privatization see Torok L. (2013), The Comparative Analysis of European Privatization Models, Global Virtual Conference, April 8-12, 2013.

9 Health coverage was tied to employment status meaning that when an individual is employed but not receiving their salary or health coverage benefits they are left virtually without healthcare insurance.

other words B&H has been granted to spend more than it produces for a long period of time. Today we have a shift away from such practices and for the first time we are faced with austerity. This is one of the political reasons why the reforms are needed. Large public sector and credit expansion have enabled expansion in GDP for a long period of time – or growth of economic activity, despite the fact that the underlying structural weaknesses of the economic system have remained. The question is whether this growth has been accompanied or has resulted in the desired level of development?! . The BH society has progressed in quite haphazard fashion while due to previously stated flaws in functioning of the rule of law, regulation of the markets, and lack of coordinated strategy the growth has resulted in growing social differences, oversized public sector in relation to real economy, consumer society which is disproportional compared to productive side of the economic activity and archaic and inefficient education, health, transport and social protection systems. These chronic flaws cannot be compatible elements with the free market mechanism.

Lastly, but not the least important, is the lack of understanding in BH society that a free market mechanism is just a mechanism and that different value systems and value choices still remain available to B&H. Unfortunately, the political culture in B&H is not at a stage to generate clear ideological values which should have generated alternative economic paradigms. Therefore, it can be said that we did not choose whether we are going to live in the system of social capitalism, neoliberal capitalism or some other system of values that are going to follow a certain free market mechanism. Through the silent consent of the political elites and citizens, B&H was unprepared to accept free market capitalism leaving the country stuck with all of the negative elements of the process of transition.

**Finally, it was not the maturity of BH political actors that rose the question of economic reforms but social injustices and disequilibrium that threaten to explode into social unrest and political upheaval, and a threat of destabilization of the economic system that have now brought the attention of foreign actors towards the reform processes. The crisis of public finances, which has been going on for five years and is resulting in further needs for the IMF, World Bank and EU financial support, are therefore the key motivation for political actors to turn to reform processes as defined in the Reform Agenda.** Perhaps it is the right time for BH public to understand that the primary choice in the democratic political processes is towards the underlying values of an economic model. In this context it is the right time to evaluate how the Reform Agenda fits into this process of building a sustainable economic model which will not be challenged by the rising inequality, as its rise threatens the democracy itself. As Bertrand Russell has pointed out that 'plutocracies and their hereditary elites had failed to stem the rise of fascism', the local political elites will most likely fail to prevent the phenomena that will crumble BH democracy if the inequalities of the BH society are not taken seriously.

BH economic system in today's context resolutely requires democratization. Political democracies that do not democratize their economic systems are inherently unstable. This economic democratization once upon a time required taxing of the inherited assets in order to achieve economic democratization in Europe. In this context the current momentum in B&H stresses the importance on the tax policy, because it is going to be of a key importance to direct the society towards economic democratization.

### ***Economic Model of B&H: The choice?***

Political economy deals with the public choice and institutions that bring us closer to an "ideal society". Public debate is necessary in this process. No society in the world, has the luxury to run the experiments to see the potential outcomes of different economic models and systems, as controlled experiments are not possible in the field of economics and politics. However, we should not neglect the historical experience of the last two decades which serves as the principal source of knowledge of the effects that past choices or the lack of them have had on the present state of the BH economic system. The economists must be methodologically pragmatic, as political and economic changes are intertwined and must be studied together. Keeping this in mind we can tackle the question of the economic development of the postwar B&H. **The new economic policies are needed in order to correct the bad outcomes of BH economics from the recent past. An ideological profilation of political parties, as agents of social representation, is required in order to articulate different economic value systems through the political processes.** With the main goal to serve as a catalyst of political processes in B&H in mentioned direction, this paper is going to present some of the values that the political parties in the developed

liberal democracies uphold in their ideologies, in accordance with the standard political-economic specter<sup>10</sup>.

The transition towards a functioning free market economy is in B&H associated with the implementation of the so called 'neo-liberal capitalism' in socialist inheritance setting, which was also termed as mixed system (Gregory and Stuart, 2004:392). 'Free markets' have benefited those well connected to obtain rent profits and corrupt practices were not sanctioned by the inefficient or politically controlled judiciary. Therefore, resulting in portraying 'capitalism' as a scapegoat, without understanding that it was the incoherent economic system and dysfunctional political system which produced the current outcomes. **Drawing attention away and populist blaming of the market capitalism as an abstract enemy is just an excuse of the elites for the two decade long failure and an attempt to make a permanent alibi instead of bearing the responsibility for the political, criminal, moral and historical outcomes.**

The domestic 'failure of transition' happens at a time when capitalisms in developed liberal world is facing serious crises on its own due to rising inequality, high unemployment of certain segments of society, and unfair system of state protection of capital after the financial and economic crisis of 2007/2008. In words of Piketty (2014:570): '...institutions in which democracies and capitalism are embodied need to be reinvented again and again' in order to cure for these failures. B&H has to find its own way to tailor capitalism in order to ease the accumulated injustices of transition. **The challenges of capitalism that become problematic during the period of transition towards functioning capitalism are additionally complicated as they can be interpreted as arguments for the need of a dramatic change of course. However, the failures of transition towards functioning market capitalism must not be used as a justification to go back to state intervention and social state what we knew of in the ex-Yugoslavia i.e. the destruction of the newly formed spirit of liberalism.** Finding a way to democratically control the capital does not mean leaving the processes of free allocation of resources thought a market mechanism. The value choices which are going to be presented in the paper are going to define the future of the economic system in B&H and its overall benefit for the society which stem from the free market mechanism.

The choice of the economic model has to be put in the perspective of the overall goal of the economic activity which is the development of the society by improvement in the living standard. 'Output (GDP) is of course a function of many underlying factors...privatization is the first step in transition, but restructuring is essential and is a major indicator of systemic change..' (Gregory and Stuart, 2004:394). As explained earlier, the privatization was a seed of problems which are still felt in BH economic system, while the restructuring was either slow or non-existent. The restructuring of the public sector is a revived topic in the Reform Agenda. Trade is also an important link in the transition process because it can lead to economic growth which may ultimately improve social outcomes, which means that free trade is fundamentally important. However, in order for the openness of B&H economy to contribute to improvement of living standard, both the nature of economic growth and the forces that contribute to this growth have to be sustainable in the long term. (Gregory and Stuart, 2004). In this sense B&H is lacking the direction and strategy how to achieve these developmental goals.

Nevertheless, few underlying choices are crucial whatever development strategy we choose to pursue. Ideally, the present Reform Agenda should be examined against how it contributes to the long-term developmental goal of BH society and the social outcomes that it subscribes to. The Reform Agenda should be compared with the Social Cohesion Model because it is the social cohesion which is the missing component in the last 20 years of economic transition. Nevertheless, a theoretical model of social cohesion for example, has one interpretation and meaning in the context of Germany or France and an entirely different meaning in the context of B&H, a country plagued with grey economy, deficient in the rule of law, and weak representation of social interests.

10 For insight into ideological-economic doctrine of political parties in B&H see Omerbegovic Arapovic A. and Arapovic A. (2013), *Ekonomaska doktrina parlamentarnih političkih stranaka u Bosni i Hercegovini kao determinanta evropskih integracija, Sui Generis*, Broj 1. pp 75-91.

The following chapters are going to present alternative value choices which can be complimentary with the free market mechanism without compromising the assumption that the BH economy allocates resources freely through the market mechanism, and upholds the principles of competition on which the EU economies are based on.

## Culture of Meritocracy versus Political Clientelism<sup>11</sup>

History of economic development is also a matter of political and cultural development and each country must find its own distinctive path and cope with its own internal divisions. The post war B&H has too many internal divisions that obstruct its development and it has yet to learn to cope with its political challenges that hamper economic performance and exacerbates problems of transition from mixed economy (self-governed, centrally planned economy) into liberalized economy of free flow of capital, goods and services, and a free market a mechanism. The institutions which regulate markets have been set in order to ensure principle of competitiveness. However, the market outcomes are associated with the presence of corruption, grey economy, and monopolistic and oligopolistic influences. At the same time internal political divisions have been serving to further deepen system of political clientelism at the expense of promoting meritocracy and equality of all individuals in front of the law. This has resulted in a climate not conducive to foreign investment based on productivity and competitive economic gains but has invited rent seeking for politically motivated investments which on many occasions has not resulted in positive economic results for the country. This is potentially reason why authors of Social Cohesion model name this period 'FDI promotion model'. However, on the macroeconomics level, the FDI promotion has however never materialized on a large scale<sup>12</sup> in the context of competitive economic gains, and even if it did, this would not have been a disadvantage *per se*. Likewise, on the microeconomic level, this meant that it was not an average economic player (or investor) that could succeed in the system based on merit and without political connections and who had protection of rule of law on his side<sup>13</sup>, without having political connections or using corrupt actions. This could be the reason that FDI became associated with bad investments and poor outcomes.

In order to correct this structural obstacle of economic development, BH society has to develop a tradition of hard work and meritocracy which has been lost due to the destruction of a value system over the past two decades. Therefore, the economic transformation will have to start with the discussion on values and cultural transformation. In this regard, the Social Cohesion Model, voices for "fight for meritocracy and against political patronage through strengthening of mechanisms of democratic control." The Reform Agenda helps towards this cultural transformation through its reform of the Rule of Law and Good Governance measures which are to provide for corruption free society and efficient judiciary. The reform of Public Administration is undertaken towards fiscal sustainability and quality of public service, but again upholding the rule of law and not rule of people. The clearest statement the Reform Agenda gives towards this objective of change of culture is "to promote hiring public servants being assessed on the basis of pre-established eligibility criteria... to ensure the recruitment of those ranked highest". (Reform Agenda, 2015:7).

Both of the discussed documents have a clear orientation towards meritocracy as a value which the BH society and its economic system have to be based on. However, the concept of meritocracy cannot be far reaching without inaugurating the principal of equal opportunities. The Labor Market reform is important in this context as it lays the ground for more or less meritocratic BH. The Labor market reform works towards more efficient and liberal market. The Labor Law has been overprotective far too long of few groups which are precluding employment of new workers and creating huge disparities in the rights of workers in public vs. private sector. The new legislation is desirable from the perspective of reform of the labor market rigidities, but also to uphold the worker's rights by using the auditing and judiciary instruments. In the process of the reform of the labor market, the lack of organized labor

11 Political clientelism is defined as giving political goods in return for electoral support. See Stokes S.C. (2009), Political Clientelism, The Oxford Handbook on Comparative Politics.

12 When we look at FDI flows into B&H they are mainly related to financial sector alike in the region of Western Balkans and negatively related to GDP for the region. For further study on regional FDI flows see International Monetary Fund (2015) publication Western Balkan: 15 Years of Economic Transition

13 See World Justice Report, 2014.



unions in combination with the presence of political clientelism, risks labor reforms which could result in the labor reform detrimental to the workers, and in the long run detrimental to the society. The Social Cohesion Model calls for the strengthening of labor unions. Nevertheless, the strengthening of labor unions does not have to happen exclusively through the instruments of collective agreements which can overrule the law, and which protect particular interests harming the interest of society as a whole in order to promote the interests of a segment of the electorate employed or protected by the political parties within the public sector. The public policies must ensure the mechanisms of decreasing the power of the state and political parties compared to other sectors, thus the strengthening of labor unions should be used to protect the interest of the entire labor force and not the particular interests or to maintain the unfair *status quo*.

The reform of Public Administration presents the most obvious choice in public policy towards meritocracy and away from political influence over the resource allocation and public services. This issue is not directly mentioned in the Social Cohesion model but it is indirectly treated through its choice of strengthening citizen participation and equity as a means of acquiring rights in the economic system. **However, equal rights or equal opportunities do not necessarily mean equality; hence we must not become trapped into the economic redistribution with a socialist theme. Artificial equality discourages effort, hard work, innovation, excellence, and achievements. Promotion of officials in the public sector (also as a general principle) based on results and merit is of a crucial importance in this public debate.** This argument which is common for both documents is in the interest of BH society regardless of other value choices.

The Rule of Law and Good Governance of the Reform Agenda are complementary in attempting to cure corruption, concentration of power in the hands of the few, strengthening the role of institutions, and to establish a meritocratic model of governance. The challenge will be to identify which policies promote the independent functioning of institutions and are a move away from direct political entanglement (e.g. Civil Service Law). Additionally, the Social Cohesion Model identifies the financing of political parties and open governance approach as crucial in enabling citizen participation into decision making. Pragmatically speaking more transparency in decision making process provides more rule of law, meritocracy, efficiency of the public sector, less elitism, and strengthens the institutions which should cumulatively lead to economic development and more efficient role of the market mechanisms in the economic development.

### ***Redistribution: Equality or Equity?***

Bosnia and Herzegovina, like many transition systems, is in fact mixed system where much of the old socialist regime legislation, arrangements and policies coexist along mechanism of allocation of resources through free markets and free movements of capital, goods and services. Market mechanisms were introduced to handle resource allocation, while the economic and social policies did not follow up to accommodate this change fast enough and were not reexamined in the light of their appropriateness for free market economy. It is important to examine the long run importance of the issue of equity, given the higher expectations of society in this area stemming from the socialist inheritance. A correct interpretation of the ideals of equity can determine the success or failure of the transition of BH economy. The economic policy and the policy of redistribution of incomes will significantly affect the success of the BH transition towards a social capitalism model or any other model of capitalism to which the country subscribes to.

It is not difficult to portray the picture of (in)equality in B&H, as beside statistics we are continually faced with realities of failures of BH privatizations, low living standard of pensioners, disparities between salaries in real sector and public sector, outrageously high unemployment rates among youth and women<sup>14</sup>, etc.. On the other hand, the society expected a different outcome – more equality, even at the expense of equity, as the redistribution of incomes is emphasized more than equity in socialism, whereas capitalism prefers the opposite ideal.

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14 See Report on Progress of B&H (2014), European Commission.

Contrary to its social inheritance and expectation, during the transition BH system of social protection was not directed towards those in need<sup>15</sup>. This is an area with fertile grounds for corrupt and politicized decision which was used for 'buying' votes from those who became the clients of governments, regimes and political parties this way. This was done through the social protection system which is based on entitlements and not connected to wealth status which generates inefficient outcome, deepens inequality and increases budget deficit. The Reform Agenda rightfully works towards better targeting of social protection and a reduction of inequalities<sup>16</sup>. There are very pragmatic financial reasons for the reform of social protection and pension system because they contribute to the long term macroeconomic sustainability. This choice is desirable regardless of the creation of the new BH model of capitalism because it contributes towards more equality of the most vulnerable categories of society.

The Social Cohesion on top of social protection insists on minimum wages, minimum income schemes and youth guarantees. In prospective future the BH economic model has to evaluate how much good or harm minimum wage brings. The new BH economic model has to set the level of minimum wage ensuring that it does not work against unemployed persons<sup>17</sup>, as a high minimum wage could eliminate new jobs and it does not curb unemployment<sup>18</sup>.

The Reform Agenda rightfully works towards better targeting of social protection based on the real needs and the wealth status of an individual in order to curb inequality which is in line with the Social Cohesion model of better social safety nets. **Social safety nets are precondition to deep structural reforms, which have to happen hand in hand with the fine tuning of the labor market. The corruption and political clientelism in the past played a big role in determining social transfers. The Reform Agenda skips an important task - of the revision of the users of social benefits, as illegitimately acquired entitlements are the main obstacle for equality.**

## ***Ownership of Resources***

The problem of inequality is exacerbated by the huge public sector which does not leave any room to cure the problem with more public spending. New efficient public sector is needed in order to leave space for better public goods and services. Developed market economies with a socialist heritage are finding themselves in similar situations and the solution can be made out of new organizational forms of ownership (Piketty, 2014, 483)<sup>19</sup>. Natural resource funds that are filled by income from concessions and sales could offer dividends to all citizens, or fund better public goods and services, while preserving market mechanisms in managing these resources efficiently need to be evaluated as an option for BH economic model. Neither the Reform Agenda, nor the Social Cohesion model poise the important question of the ownership of natural resources, which will to the large extent determine our ability to tackle inequality and will influence our economic and human development to large extent.

The faulty privatization of the society's resources in the past, especially with the privatization of big companies, has significantly diminished the capacities to generate economic activity. Now, the analogous process could take or is taking place through privatization of natural resources and public companies that are still in the state ownership, under the pretext of years-long inefficient management. The direct benefits of these resources should be felt by many generations of BH citizens, and the correct delimitation between the ownership and the management of these resources can be crucially positive in context of the sustainability of the new BH economic system. While the arguments of lack of efficiency in management of these resources and lack of competitiveness of the state companies are used as arguments for privatization and even though the politically motivated management of these

15 Compact for Growth, 2014

16 Ibid.

17 'A reckless wager: A global movement towards much higher minimum wages is dangerous, Economist, July 25, 2015. stresses that the minimum wages are much less effective than tax credit in helping those on lower end of the social ladder and can be harmful if set too high.

18 Ibid.

19 Perhaps along the lines of Nordic model of state ownership of natural resources. State intervention was seen as necessary due to the lack of private capital and in order to secure national control of *natural resources*. Furthermore, there was a clear ideological rationale for state *ownership*, as in the *Nordic welfare model* the state was (and still is) an important player. Fellman (2008)

companies and the corrupt activities are destroying the value of these companies on a daily basis, a partial privatization of these resources can be conducted by merging public ownership with efficient management.

The current inefficiency which is a result of political meddling in the management of public resources can't be taken as an argument to make a decision of ownership of these resources in one direction only-towards their outright privatization<sup>20</sup>. Leases and intergenerational funds can be employed and public private partnership can become solution to efficiently run public resources. Nothing in the Reform Agenda or in the Social Cohesion Model precludes us from inventing domestic and authentic ways of combining the principles of markets with the public ownership, especially in the energy sector. It is in the national interest to fight for new ways which protect the long-term interest of the BH society.

## **Who Pays the Taxes?**

What form taxes take is the crux of political debate in any society. Tax is also a way of defining norms in the ideological sense by imposing a legal framework on economic activity and therefore it sends an important signal when capital is left free from the tax burden. Before in history tax on capital was more suspect than labor income, which is in contrast to today (Piketty, 2014). B&H has inherited the tax system of high burden on labor income and imposed low taxes on corporate income. **In the context of B&H where the privatization has been marred with undervaluation of coupons, the mechanism through which broader society was robbed of value through morally wrong if not corrupt privatizations, the courts and regulators have been ineffective to prevent a few from reaping profits, operating in grey economy and not contributing to society in terms of taxes; the tax policy has to become the main subject of political disputes. The tax on capital (wealth) would be much faster and systematic than all courts in clearing this injustice. BH society will have to find its way in reinventing itself beyond the framework established in the Reform Agenda. Even a wealth tax with very low rates can be a source of knowledge and a force for democratic transparency. Tax on capital is also a middle path and a way to correct for the decades long mistakes, as it does not de-motivate capital accumulation but it serves to prevent spreading of inequality inherent in the present system.**

The question of redistribution is not mentioned in the Reform Agenda, whereas the Social Cohesion handles the redistribution issue directly by treating the issue of the introduction of progressive taxation and wealth tax. Mere progressive tax on income from labor would not be a significant change from the present value choices as the brunt is laid on ordinary citizens through taxation of labor income already. **The biggest difference between these two documents is in Tax on Wealth and democratization of economics, where the Social Cohesion model is very clear in this aspect as it calls for identification of citizen's wealth which is a key condition for fair taxation. In the post privatization B&H the measure of tax on wealth would indeed be faster than all courts in curing injustices of ill begotten capital and grey economy profits that did not contribute towards the society.** The tax on capital/wealth might be one of the most important redistribution questions on which BH society should decide as this will be one of the defining points of our economic model and which form the capitalism is going to take. Therefore, while the Reform Agenda goes in desired direction of curing the ills of big state, the society in terms of fiscal policy has to go beyond the Reform Agenda when it comes to the issue of fiscal policy, since the Reform Agenda does not problematize above mentioned value propositions in the context of deciding on the type of fiscal system.

In simple terms those who have acquired wealth through privatization do not live from salaries and work. In fact the fiscal reform is limited to a reduction of taxes on labor and the broadening of the tax base. If this fails to bring the desired outcomes, the Reform Agenda suggest an increase of VAT as the next choice. **Furthermore, the progressive taxes on income puts more burden on those who earn more, which can be viewed as more just. However, such system would not be in favor of the workers and those who live from work, while it would work in favor of the owners of capital who**

<sup>20</sup> Successful management of public resources by politically independent management in China serves as a proof that management can be separated from ownership successfully. For example State Owned Enterprises in China are sometimes hard to differentiate from private owned companies. See article How Red is Your Capitalism: Telling a state-controlled from a private firm can be tricky, *Economist*, September 12, 2015.

**reap profits that are burdened with low taxes, and this is the crux of the injustice and inequality of the current fiscal policy.**

The potential increase of VAT would negatively affect those with lower income as VAT is known as regressive tax i.e those with lower income pay proportionally higher taxes relative to their income, hence nothing would be changed in the context of the value system which determines the current BH economic model. It is also very unlikely that Reform Agenda will propagate for the higher tax on capital, tax on wealth or tax on profits as these are claimed to destimulate influx of foreign capital or investment promotion objective. However, these interests have to be placed behind much more fundamental value choice that the BH society has to incorporate into its economic model if the benefits of such choice are incomparably higher.

B&H currently has one of the lowest corporate income tax rates in Europe<sup>21</sup>, but it has a weak performance in attracting foreign direct investment which speaks of the importance of other more important factors that will determine level of investments. The question of fairness of tax system and big state which is built mainly on tax on labor, VAT and various charges is to be debated in BH society in the context of fiscal fairness and democratic control on capitalism.

Summary Comparison: Reform Agenda vs. Social Cohesion Model

Policy/Action	Reform Agenda for BH: 2015-2018	Social Cohesion model for Western Balkan
Social policy	Targeting and efficiency, no equity issue stressed	Targeting, equality, strengthening of social safety net
Labor market	Liberalization, workers' rights	Worker rights, strengthening of the unions
Fiscal policy	Austerity, Lowering tax burden on Labor	Wealth tax, fiscal democracy
Property rights	Faster resolution of disputes, bankruptcy procedure, establishment of commercial courts, public private partnerships	n/a

### ***Economic Development vs. Economic Growth***

Social cohesion model puts forwards a hypothesis that "installed neoliberal economic model has failed to promote economic growth in the Western Balkans" and at the same time proposes that "prosperity depends on the introduction of a new economic model focused on added value economy". To evaluate this hypothesis it is necessary to distinguish economic growth from economic development.

If we were to evaluate the economic changes of the Western Balkans over the last twenty years, even though there has been evident economic growth (GDP grew), it would be debatable whether these economies had a desired level of economic development. Also, the issue of sustainability of achieved growth arises due to large macroeconomic imbalances that have resulted from that growth, due to consumption driven growth. There are also social aspects important for sustainability which deals with how this income growth is distributed.

Economic development implies well-coordinated decisions of the policy makers and society, which aim to promote standards of living and economic health of the community. Economic development can be referred to quantitative and qualitative changes in the economy. This means that it includes a variety of areas such as the development of human capital, infrastructure, regional competitiveness, social inclusion, improvement of healthcare, security, literacy and other goals. Economic development is different from economic growth. While economic development is an endeavor with aims of economic

21 Corporate Income tax: USA (15 - 39%), Germany (16%), United Kingdom (20 - 24%)

and social well-being of people, economic growth is a phenomenon of market productivity and rise in GDP. Consequently, as economist Amartya Sen (1983) points out, “economic growth is one aspect of the process of economic development,” whereas, according to Ranis and Stewart (2001), economic growth and development is a two-way relationship. According to them, the first chain consists of economic growth benefiting human development, since economic growth is likely to lead families and individuals to use their heightened incomes to increase expenditures, which in turn furthers human development. At the same time, with the increased consumption and spending, health, education, and infrastructure systems grow and contribute to economic growth. For sustainable economic growth it is important to inclusively involve all of the able-bodied citizens in economic activity.

The achievement of this inclusive involvement into economic growth in countries that lack efficient rule of law can be very complex. Negative externalities like corruption, prevent inclusive involvement into economic activity and at the same time slow down economic growth; and this phenomenon tends to increase as the economic growth is increasing.

The promotion of FDI should not be characterized as the “neoliberal” model. Additionally, the promotion of investments cannot be considered as a choice of strategy of economic development *per se*. Analogous, to this the approach of promoting value added economy or the promotion of SMEs, which is the suggestion in the Social Cohesion Model, should not be contrasted to the promotion of FDI. On the contrary, these two goals can go hand in hand because they are complimentary.

The public debate of the new comprehensive strategy of economic development of B&H should put social development at the forefront, while the question of distributive justice of economic growth will determine whether it will contribute to the overall social development.

## **Conclusion**

This paper puts perspective on present condition of BH economic model and lack of concerted actions of political agents in bringing true core value propositions that would redefine the BH economic model and place it to the forefront of political processes. The free market mechanism can accompany various choices of core values to result in various models of capitalist liberal democracies depending on distributive justice, fiscal fairness and democracy, meritocracy, and extent of control of the markets to ensure true meaning that writers on free markets initially assumed. At a time of power of particular interests in the markets and politicized decision making, which puts particular interest before social interest and principles, it is of utmost importance to start debate in this society in direction which is almost idealistic—and that is of promotion of greater social good and human development at the forefront of political debate in B&H. Civic society has a large role in contributing towards this process through promotion of greater awareness towards this higher end. Due to this reason this paper is very pragmatic in its methodology and that is separating core value propositions from mechanism of free market, which is not to be blamed for failures of BH economic model at present.

Two analyzed propositions –the Reform Agenda and Social Cohesion model – make quite different propositions in terms of fiscal policy and would result in much different distributive justice and equity. Neither the Reform Agenda nor the Social Cohesion Model present a comprehensive economic model, or economic strategy, or overall set of economic policies hence cannot lead the BH society towards this higher goal --i.e. economic development . Both propositions advocate the promotion of meritocracy and desire similar system of economic incentives. Neither discusses ownership of resources which could be the key determinant of economic development for B&H, its macroeconomic sustainability and the ability to provide better public goods and services. Hopefully, the BH model will evolve once different answers to these questions begin to define political programs of BH political parties and in the end result in new economic strategy as an expression of the new capitalist system of Bosnia and Herzegovina.

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