

European Stability Initiative

Turning point

The Brussels PIC Declaration and a state-building agenda for Bosnia and Herzegovina

7 June 2000

At its meeting in Brussels on 23-4 May 2000, the Peace Implementation Council (PIC) produced a programme for the next phase of the Bosnian peace mission, which marks a dramatic shift in international priorities. The international community has now pledged to concentrate its resources on building the core structures required for Bosnia to function as an integral and independent state. The PIC Declaration contains a remarkably specific programme for building effective institutions at state level and creating a single Bosnian economic space. It calls for:

- state institutions to have their own independent funding;
- donor assistance to be channelled to BiH through state institutions;
- a professional state civil service to be urgently established;
- the Office of the High Representative (OHR) to rapidly develop state-level regulatory bodies in telecommunications, energy, transport and media;
- all international policies to support the creation of a single economic space;
- direct international involvement in the restructuring and privatisation of strategic industries.

State-building and economic reform are intimately connected. Only functioning joint institutions will overcome the deep problems in Bosnia's divided economy. At the same time, economic reform can become the main engine for the progressive development of a viable state of Bosnia and Herzegovina.¹

The Brussels PIC Declaration is shorter and more concrete than its predecessors. It indicates the priority areas in which the OHR is to mobilise international influence to create Bosnian institutions capable of taking responsibility for the new state. It thus establishes clear benchmarks to measure the performance of both Bosnian and international institutions in the coming two years.

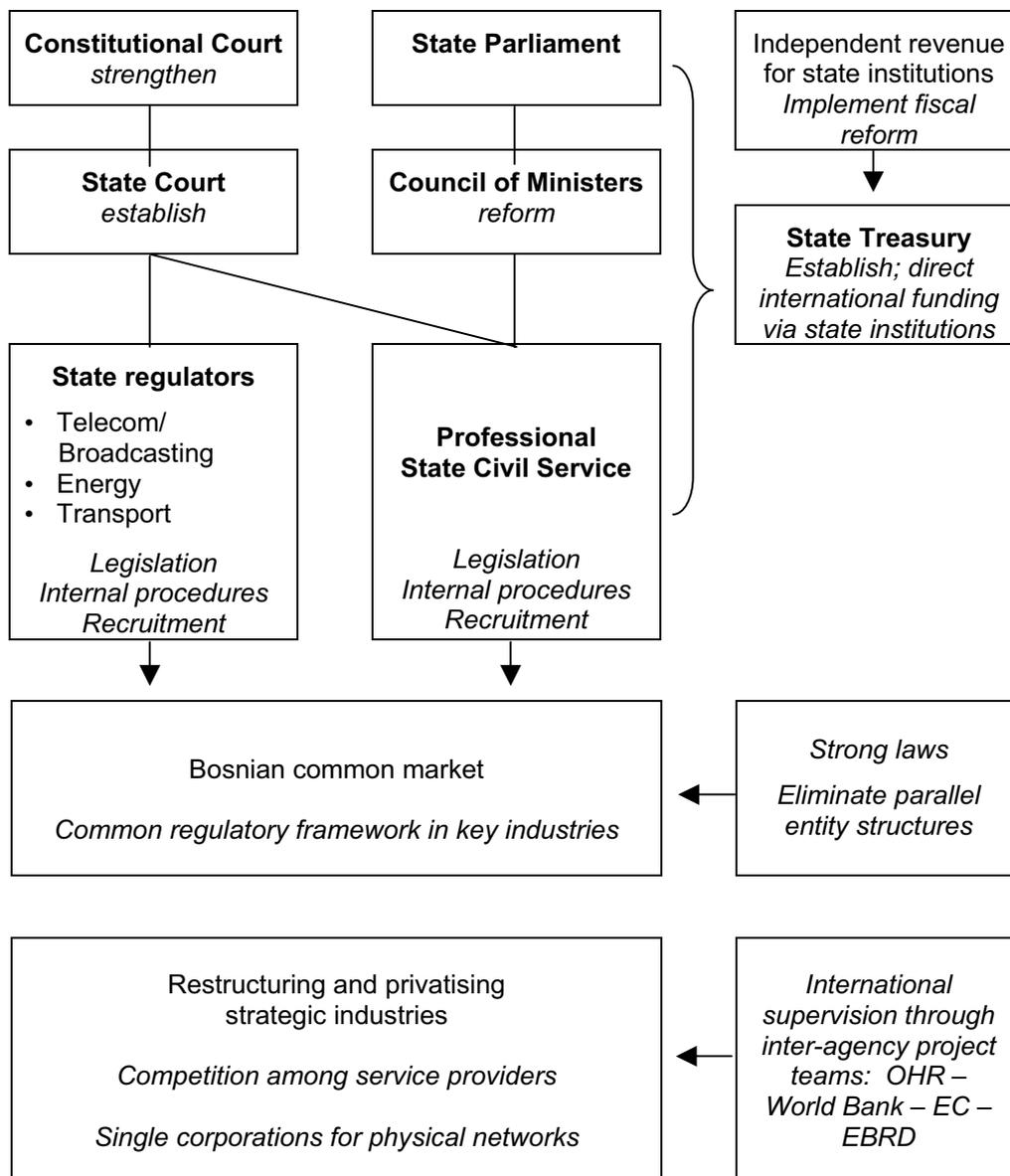
By narrowing its focus, the PIC reflects the growing concern that international resources will not be available at their current levels for much longer. Attention must now be focused on the structural issues which are key to Bosnia's survival.

¹ ESI background paper, *Taking on the Commanding Heights – integration of network industries as a tool of peacebuilding*, 3 May 2000; Knaus, Bennett & Cox, *Bosnia needs a Robert Schuman*, Wall Street Journal Europe, 9 May 2000.

As always, the challenge is implementation. To accomplish the institution-building goals set out by the PIC, there must be significant changes to the way the international community organises its efforts. Resources – particularly human resources – must be matched to objectives. The PIC agenda requires the development of effective interagency co-operation in highly technical areas, in such a way as to advance an overall political vision. OHR has to provide the political leadership, while the international financial institutions and their consultants offer the technical expertise. The international financial institutions need to be reassured that OHR has the capacity and willingness to focus on overcoming the political obstacles that implementing this agenda will inevitably raise.

This Report examines the main elements of the state-building agenda set out by the PIC. It also raises some practical issues to be addressed immediately.

Key institutions and PIC agenda



1. Institutionalising the state

“The Council supports **the High Representative’s efforts** to ensure that State institutions are empowered, efficient and adequately financed through dedicated revenue sources. State institutions need their own **independent funding**. The Council requests **the donor community** to funnel its assistance to BiH directly through State institutions. The Presidency and the Parliamentary Assembly must re-establish the Council of Ministers and assure adequate funding for State-level ministries.

Substantial progress on the establishment of a professional civil service is urgently needed.”²

Until now, state institutions have functioned as theatres of nationalist politics, with the entities and parallel power structures conspiring to keep the state weak and under-developed. The common institutions have been kept hostage to short-term political disputes, and have been unable to establish their own institutional identity. Effective state-building requires that the state institutions become a centre of power in their own right, counterbalancing the dispersed federal structure created in Dayton. Only a functional state can enter European institutions.

The first step identified by the PIC for developing an institutional identity for the state is to create a permanent, independent and professional civil service, outside of the ‘nomenklatura’ patronage networks of the political parties.³ OHR is involved in the preparation of a state civil-service law, which will address matters such as professional qualifications and standards. Independent public service boards to supervise hiring, dismissals and promotions will help to protect the civil service from improper political influence. Any new institution established from now on, including new ministries at the state level, should be staffed according to the same principles.

By institutionalising personnel matters, the state civil service can become a meritocracy where careers are made through service to an institution, rather than loyalty to a political party. A conscious effort should be made to attract younger professional staff. Secure and well-paid jobs in functioning institutions may even entice educated Bosnian citizens to return from abroad. In time, a professional civil service will itself become a key constituency for promoting the development of the state.

A second element required for the development of a state civil service is independent revenue. For the time being, the state has almost no revenue-raising powers,⁴ and is dependent on irregular transfers from the entities. Fiscal relations are the essence of any federal structure, dictating power relationships more effectively than constitutional provisions. The PIC Declaration invites the international community to begin serious work on identifying independent revenue sources for the state – such as a share of customs and excise revenues, or the much-discussed option of a Value Added Tax. The International Monetary Fund and the World Bank insist that any tax

² Brussels PIC Declaration, 23 / 24 May 2000.

³ The ‘nomenklatura’ system is described in *Bosnian Power Structures*, ESI report, October 1999

⁴ A law imposed by the High Representative in 1999 allows the state to charge fees for certain administrative services, such as issuing passports.

reform should be revenue neutral, given the already high burden on Bosnian tax payers. This suggests an urgent need for an overall review of the tax system, tying together institution-building requirements and macro-economic imperatives.

The PIC has also taken the dramatic step of calling on all international donors to channel their financial assistance via state institutions. Until now, almost all reconstruction funds have been spent at local level, while direct budgetary support has gone mainly to the Entities. This pattern of assistance has helped the separate ethnic structures to maintain their autonomy and undermine state-building efforts.⁵

If international funds are channelled instead through a State Treasury, it will make it impractical for any party to refuse to participate in the work of the state. Of course, funds given for purposes within the exclusive competence of the Entities will be spent by the Entities. However, if the funds pass first through state institutions, they can begin to supervise how those funds are spent, for example by ensuring that the Entities act consistently with Bosnia's single market and respect Bosnia's international obligations. It will also make it untenable for the entities or different nationalist parties to allow key institutions such as the Council of Ministers to lapse into disuse, as has happened in recent months. Incentives, not outside diplomatic pressure, need to drive institutional development.

2 Regulatory structures and the single economic space

"We call on the BiH authorities to enforce the constitutional provisions for an internal market... There should be a harmonised, country-wide approach in a number of areas, including: taxes, competition, public procurement, financial services, standards and regulations, banking, public utilities, electric power, telecommunications and transport/railways... **All international community policies** should support these reforms.

The Council accordingly **calls on the High Representative** to ensure rapid development of State-level regulatory mechanisms for telecommunications, energy, transport, and media and to ensure that there are no duplicative or conflicting regulatory competencies at any level of government."⁶

The Constitution of Bosnia and Herzegovina guarantees the 'four freedoms' essential to the creation of a single economic space: freedom of movement of persons, goods, services and capital. Taken from European Union law, this has been the legal basis for creating a genuine common market in Europe. A common market requires strong laws (either centralised or harmonised), and regulatory bodies capable of enforcing them. Promoting the legal and institutional foundations of a single economic space should be the main concern and focus of the European Commission through its Consultative Task Force (CTF).

The legacy of the communist economic system and war-time ethnic divisions has been a proliferation of economic regulatory jurisdictions. They exist at entity, cantonal or even municipal level, and within illegal parallel structures, while some

⁵ ESI Paper 'International power in Bosnia', 30 March 2000, chapter II.D.

⁶ Brussels PIC Declaration, 23 / 24 May 2000.

large enterprises have remained self-regulating. These mechanisms have been totally ineffective at controlling the divided public-sector monopolies, or at introducing market competition. They have not been insulated from political party control, and have acted to preserve the division of Bosnia into three economic spaces. Their unpredictable and intrusive methods of operating have been thoroughly unattractive to both international and domestic investors.

The economic advantages of replacing them with a single state jurisdiction are obvious. Only a common regulatory structure will create a single Bosnia-wide market in any given industry, allowing firms in each entity to compete with each other and earn revenue across the entire territory of Bosnia.

The PIC calls for the High Representative to take the leading role in the creation of State-level regulators in four strategic industries – telecommunications, media, energy and transport. It makes it clear for the first time that these "PIC industries" are areas where the state should exercise its authority *to the exclusion of the Entities*. Parallel entity structures must not be allowed to duplicate the authority of the state. This requires a clear state law, a single state regulatory agency and a state court.

It is not sufficient to establish short-term co-operative arrangements between the Entity Prime Ministers, which have been accepted by the international community in the past. Weak inter-entity institutions with uncertain budgets and unclear jurisdiction, such as the Road and Railway Corporations, have left the entities with a de facto power of veto and have inevitably become dysfunctional.

Preparations are already underway to restructure the existing Independent Media Commission and Telecommunications Regulatory Agency into a single state-level structure, which will regulate the interrelated areas of telecommunications and broadcasting. In an landmark legal opinion issued in 1999, OHR found that the state had constitutional authority to pass laws and establish institutions in this area, by virtue of its responsibility for foreign affairs, foreign trade and other essential state interests.⁷ Negotiations have also begun to establish a state electricity regulator.

As a result, regulatory reform is at a different stage of development in each of the target industries referred to by the PIC. Ideally, state regulatory structures should be established according to a common design, rather than reinvented as the product of separate negotiations. In the past, the authorities have always insisted on reducing regulation to the lowest common denominator. The international community should now turn this argument on its head: reform of each industry should follow a common path, using models based upon international best practice and modified for the unique political environment of Bosnia.

A number of features of existing state institutions, such as the Central Bank and the Independent Media Commission, may be drawn on. Close international involvement in the institution during its development phase may be appropriate, including international personnel in management positions. Decision-making processes must be designed to allow the institution to enter highly contested fields without becoming

⁷ OHR Legal Opinion 1999/3, "On the competence of Bosnia and Herzegovina to regulate the use of the electromagnetic spectrum for telecommunication and broadcasting". For a discussion, see Annex to ESI paper, 'Taking on the commanding heights – integration of network industries as a tool of peace-building', 3 May 2000.

deadlocked. The 3 + 1 formula used in the governing board of the Central Bank (three Bosnian representatives under a foreign chair, who has the casting vote in case of a tie) is one possible model to follow. The institutions need the autonomy and financial resources to attract employees or hire consultants with the appropriate technical skills. They must be given strong investigative and enforcement powers. They must be established so that they can become financially independent, by charging license fees on the enterprises which are the end users of the network systems. They should be priority beneficiaries of international technical assistance.

3. Judicial review at state level

“The Council considers the strengthening of the Constitutional Court and the establishment of a State court to be major priorities.”⁸

The state cannot develop economic regulatory structures, or even ordinary administrative procedures, without its own system of courts. According to the European Convention on Human Rights and accepted constitutional principle, decisions such as the granting or withholding of commercial licenses must be subject to judicial review. A state court, dealing with all matters of state competence from immigration appeals to inter-Entity crimes to competition law, is necessary to make state involvement in these areas legitimate.

International agencies working in the judicial reform area have already identified the main criteria for a strong and independent judiciary. Two areas of particular concern are personnel matters (clear professional and personal qualifications for office; independent selection boards; codified professional standards; judicial training institutes) and budgetary questions (guaranteed funding from the state budget; financial autonomy from the ministries of justice).

The Constitutional Court of Bosnia and Herzegovina also has a vital role in the scheme. As well as offering a last instance appeal, the Constitutional Court has the potential to advance the state-building process by ensuring that State and Entity laws comply with the European Convention on Human Rights, and that Entity laws do not conflict with the four freedoms. The Constitutional Court will also be called upon to arbitrate on the distribution of powers and functions within the federal structure. For the time being, many decisions of a constitutional nature are being taken by the High Representative. To allow the High Representative eventually to withdraw from that role, the Constitutional Court must be developed into a much stronger institution.

4. International involvement in restructuring strategic industries

“The Council encourages greater emphasis be placed on tender privatisation that encourages the injection of new management and capital. **Direct intervention by the High Representative may be necessary** in strategic industries and in cases where the privatisation process is suspect. The Council welcomes the involvement of international experts.”⁹

⁸ Brussels PIC Declaration, 23 / 24 May 2000.

⁹ Brussels PIC Declaration 23 / 24 May 2000.

In order for state-level bodies to be effective in the regulation of strategic industries such as telecommunications and energy, the current ethnically-segregated public sector monopolies must be broken up and new competitive structures created. This process must be supported by a method of privatisation which brings in new management and capital. Because this restructuring process strikes at the heart of the nationalist regimes and their war economies, it will meet with considerable resistance, and can only be accomplished through decisive use of international power.

Large enterprises such as the three PTTs (which provide telecommunications and postal services) and the electricity companies (which control generation, transmission and consumer sales) must be restructured before they can be privatised. This process is furthest advanced in the broadcasting area, as a result of an OHR-led campaign which began in 1997.

The international agencies will need to establish structures to gather as much information as possible about the current state of the different sectors, to support the restructuring process. In each industry, there are certain common steps that need to be taken:

- engage consultant auditors and financial and management experts to develop restructuring plans;
- develop state legislation, and repeal or amend conflicting entity laws;
- re-charter the existing enterprises and establish opening balances, resolving disputes over the ownership of assets;
- implement the restructuring, under close international supervision;
- privatise publicly owned enterprises and assets in such a way as to attract foreign capital and new management expertise, based on advice from international transaction advisers (investment bankers).

In the broadcasting area, OHR is already in the process of engaging a “transfer agent” and an expert team to implement the High Representative’s Decision of 30 July 1999 on the restructuring of public broadcasting. It is vital that external experts are engaged in such a way that they do not see the entity governments as their clients. Their terms of reference – to create a Bosnia-wide common market and a modern, competitive industry shielded from improper political influence – must be drawn up by the international community. Of course, expertise of this type does not come cheaply, and if the PIC countries are serious in their proposal, they will need to provide the necessary resources.

Once the blueprint has been developed for each of the target industries, OHR will need to lead the way in carrying out the restructuring process in the face of inevitable political resistance from those who benefit from the status quo. Implementation strategy will be critical. The High Representative’s legislative authority will need to be supported by careful use of international financial power. As an immediate first step, the Economic Task Force should carry out a study of which international funding instruments could be used as leverage, including projects to be financed by the European Investment Bank and the European Bank for Reconstruction and Development in the framework of the Stability Pact. The inter-connectivity of these network industries with international networks also offers the potential for leverage.¹⁰

¹⁰ A previous ESI paper, *International power in Bosnia*, describes some of the different forms of international influence which are available.

5. The path ahead

The goals set out by the PIC in its Brussels Declaration form the core of a coherent state-building agenda. Each of the programmes described above are inter-dependent and mutually reinforcing; none can be successfully implemented in isolation. Together, they combine to address three of the most important peace-building goals:

- creating an effective state;
- weakening illegal power structures by reducing the role of political parties in the economy;
- creating the conditions for economic development.

Over the past four years, inflexible divisions of responsibility within the international community have prevented the development of a consistent approach to state building. Each of the programmes outlined in the PIC Declaration will require the full range of international resources, expertise and influence, mobilised under the overall political direction of the High Representative. Developing genuine inter-agency project teams which can make this possible must be the first priority, replacing the loose inter-agency working groups that have mushroomed during the past years.

Improving the focus of international efforts in Bosnia necessarily requires that the international community abandon some of its activities, to free up resources for others. Over the years since the Dayton Agreement, the international mission has acquired more and more programmes and objectives, while refusing to abandon activities which are unproductive or outdated. This problem is particularly acute for OHR, which has come to see itself as a kind of shadow government, responding to every issue in the public arena. The greater the number of issues into which it is drawn, the less intensive its efforts inevitably become. OHR should begin to disengage from the micro-management of short-term political disputes, in order to focus on the goals and strategies which offer the greatest long-term returns. The PIC Steering Board must do the same, shifting its focus from the latest political crisis to implementing sustainable structural reforms.

The state-building project is here sketched only in outline. Careful attention must now be given to filling in the details, where the devil invariably lies. Each of the programmes in the PIC Declaration requires close study and policy development. Methods must be identified of explaining the process to the Bosnian people, and demonstrating the immediate and medium-term advantages to various interest groups in both entities.

The focus on state-building in the Brussels PIC Declaration is a constructive and forward-looking interpretation of the concept of 'ownership'. The international community is beginning to look towards the time when Bosnia can stand up as a sovereign state within Europe. To reach that goal, international power needs to be brought to bear on creating the core institutions which will make that possible.

The European Stability Initiative is a think-tank focusing on South Eastern Europe and registered as a non-profit association in Berlin.

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Since September 1999, ESI has published four major reports and eight background papers. All publications are available on the ESI web-page. Presently ESI employs one person in the Berlin head-office, two analysts for the ESI Bosnia project and two analysts for the ESI Montenegro project.

Despite modest resources, ESI has established itself in less than a year as "a think tank changing international policy on Bosnia" (Financial Times), "one of the most significant think tanks in the region" (OSCE Head of Mission Robert Barry), "the people on the Balkan circuit with the clearest view of what needs to be done" (former Finnish president Martti Ahtisaari). In recent months ESI has been invited to present its ideas to representatives of Steering Board countries, the EU ambassadors in Sarajevo, the World Bank Bosnia team, the EU High Representative for Foreign Policy, EU Commissioners and numerous foreign ministries.

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