DPC
Democratization Policy Council

The EU's Failing Policy Initiative for Bosnia and Herzegovina

A Reform Agenda & Questionnaire Monitoring Report

A DPC Policy Paper

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EXECUTIVE SUMMARY

In late 2014, the European Union adopted as its new strategy for Bosnia and Herzegovina a policy initiative jointly developed and promoted by Germany and the United Kingdom. The initiative focused on structural socio-economic reforms that were to be rewarded with advances in BiH's EU integration process – a response to violent social protests against unaccountable politics in February 2014 that highlighted popular dissatisfaction in BiH with the EU's policy failure over the previous decade.

The new EU BiH initiative did yield some initial successes in 2015 and 2016. BiH authorities agreed a 'Reform Agenda 2015-18' with the EU and International Financial Institutions (IFIs), a broad blueprint for socio-economic reform that, if fully implemented, could have broken the country's patronage system. Some initial implementation of the Reform Agenda and the formal fulfillment of some additional EU conditions prompted the EU's General Affairs Council in September 2016 to grant the final reward in EU integration envisioned in the initiative – a referral of BiH's membership application to the European Commission for its Opinion on granting candidate status. In December 2016 the Commission took the next step and handed over its Questionnaire to BiH. More significantly, the International Monetary Fund (IMF) signed a loan arrangement with BiH in September 2016 designed to support the Reform Agenda, based on exceptionally strict financial conditionality and prompting the governments in BiH to concede on some previously unimaginable reforms.

However, these successes were short-lived, limited and superficial. From early 2017, it became evident that the initiative would be a failure when it formally concludes at the end of 2018. Throughout 2017, implementation on all fronts came to an almost complete standstill, although EU representatives and other international officials continue to pretend the initiative is still alive. Extensive interviews with key officials make it clear that the performance of the EU itself led to this unfortunate failure:

1. In the face of resistance from political elites defending their entrenched patronage interests, the EU did *not* stick to strict conditionality, but resorted to old habits of lowering the bar and negotiating with BiH officials and political leaders behind closed doors, in effect colluding with the opponents of reform and making a mockery of the EU integration process.
2. From 2016 onwards, the relationship between the EU and the IFIs faltered as they began to diverge in their approaches to strict conditionality. In 2017, EU institutions began to undermine the IFIs' push for economic reform, and by the end of the year EU representatives successfully pressured the IMF to give up its policy of strict financial conditionality.
3. Strengthening the rule of law was vital for any initiative aimed at promoting a market economy free of political interference. Yet the EU aimed exceptionally low on rule of law reforms under the Reform Agenda, creating a weak foundation for systemic reform. At the same time, EU representatives pushed for the non-transparent parliamentary adoption of key Agenda measures, lending tacit support to the gross violation of parliamentary rules of procedure by the ruling coalitions, further undermining of the rule of law.

While a combination of factors has contributed to this failure, the underlying cause is the EU's failure to embed the mostly *technical* initiative in a comprehensive and genuinely *political* strategy.

As an epilogue to the failure of this initiative, the EU is now faced with a political challenge related to constitutional reform for which it is ill-prepared: amending the BiH Election Law following the Constitutional Court ruling in the Ljubić case. At the same time, the Croatian government's explicit support of the ethno-nationalistic agenda of the HDZ BiH poses a serious threat to EU unity in its approach to BiH, particularly related to constitutional reform. The EU – so eager to avoid any discussion of constitutional reform – has now found itself painted into a corner.

Against this background, there is a high likelihood that following the October 2018 general elections the EU will be forced to face the country's biggest constitutional crisis since the end of the war and the failure of its BiH initiative.

Recommendations for a Genuine Policy Strategy

Rather than seeking to frame the Agenda as a success, the EU must accept the failure of its current BiH policy initiative and prepare a genuinely strategic approach. The EU, specifically the most committed, pro-enlargement member states, in cooperation with EU institutions involved in enlargement, and supported by non-EU states committed to BiH including the US, Canada, Norway, and Japan, must do the following:

1. *Attainment of candidate status*

- The European Commission in its Opinion should *not* give a recommendation to grant candidate status to BiH, but propose to make it conditional on the implementation of a selection of outstanding Reform Agenda measures crucial to put an end to the country's patronage system.
- A series of additional requirements should aim to reverse certain democratic reform rollbacks from the last decade, as well as implement pending measures from the Structured Dialogue on Justice.

2. *Opening of accession negotiations*

- Opening accession negotiations should be made conditional on the implementation of further important measures left over from the Reform Agenda.
- A number of measures aimed at improving the functionality of governance institutions, to be identified based on BiH's answers to the Questionnaire, plus further unimplemented measures from the Structured Dialogue should be added.

3. *"Accession Plus"*

- Begin working on a concept for a future political process for constitutional reform, an "Accession plus" process that clearly links progress in EU accession to meaningful progress in constitutional reform, by adding a Chapter 35 on Constitutional Reform to the future EU Accession Negotiation framework for BiH.

This concept should aim at the EU setting a number of principles for constitutional reform that guarantee the accountability and functionality of state institutions, provide a meaningful constitutional framework for democracy, the rule of law and a functioning market economy;

EU institutions and leading member states must already now begin engage as follows:

- Start to strategically communicate the rationale and principles of the future EU constitutional reform policy to the BiH citizens and political elites alike.
- Openly confront and limit Croatia's attempts to sabotage future constitutional reform in BiH which is based on an ideological/ethnonationalist perception of BiH politics and society.

Between now and opening of accession negotiations

Between now and the granting of an accession negotiation date for BiH, the EU must:

- Re-engage with the IFIs, in particular with the IMF, to return to a policy of tough financial conditionality tied to the most important elements in the Reform Agenda.
- Make BiH citizens its prime allies for reforms related to EU integration by developing a policy of strategic communication towards BiH citizens in which the EU is seen as the partner of citizens, not just officials.
- Maintain the international community's executive Dayton instruments, in particular EUFOR Althea's UNSC Chapter 7 mandate, as a safety net, confidence-building measure and deterrence to actors who think they would benefit from instability.

- Select an independent, senior political figure as the next EU Special Representative to BiH.
- End the Structured Dialogue on Judicial Reform and develop a new approach to judicial reform.
- Seriously engage in solving the looming constitutional crisis related to the BiH Election Law and the Ljubić case. Exert strong political pressure on BiH political parties, in particular the HDZ BiH, aimed at pushing through an election law amendment that includes a one-time regulation of the election of the House of Peoples of FBIH delegates – to be succeeded by a broader reform of the electoral systems within the framework of a future wider constitutional reform.

I. Introduction

In November 2014, Germany and the United Kingdom (U.K.) initiated a new EU policy initiative for Bosnia and Herzegovina (BiH) aimed at unblocking the country's long-stalled EU integration and reform process. The initiative was also a reaction to violent social unrest that broke out in large parts of the country in February 2014. The new approach shifted the policy focus to structural socio-economic reform, under the so-called Reform Agenda 2015-18, and held out progress towards EU membership as an incentive for BiH to both implement the reform program and meet other EU conditions. This would be further supported by the application of strict financial conditionality in collaboration with International Financial Institutions (IFIs).

In March 2017, the Democratization Policy Council (DPC), in cooperation with the Heinrich Böll Foundation in BiH, produced a policy paper: "Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative."[1] The report's findings confirmed that the new EU initiative had led to a certain, though still limited, reform momentum not seen in over a decade. BiH authorities, in cooperation with the EU and the IFIs, in July 2015 agreed the Reform Agenda – a broad-based program for structural socio-economic reform that, if consistently implemented, had the potential to put an end to the country's patronage system – and started implementation.

During the late spring and summer of 2016, BiH managed to agree steps to meet the EU's additional conditions. The conditions included the publication of the results of the highly disputed 2013 census; adaptation of the Interim Trade Agreement of the country's Stabilization and Association Agreement (SAA) to the EU entry of neighboring Croatia; and agreement on a so-called Coordination Mechanism for BiH to speak with one voice in its relationship with the EU. For its compliance with the EU initiative's conditions, BiH was rewarded with the foreseen three steps in the EU integration process: entry into force of the SAA; allowing delivery of BiH's EU membership application; and, in September 2016, a referral to the European Commission by the EU's General Affairs Council (GAC) of the country's application, in preparation of the Commission's official opinion – all required for BiH to attain candidate status. In December 2016, the Commission handed over its so-called Questionnaire to the BiH authorities. BiH authorities' answers to the more than three thousand questions forms the basis for the Commission's future Opinion. Furthermore, in September 2016, the International Monetary Fund (IMF) had approved a new credit arrangement, entitled the Extended Facility Fund (EFF). This budget support loan was designed to support structural economic reform, based on a policy of extraordinarily strict conditionality. Together with the approval, the first credit tranche was paid out.[2]

However, despite these positive signs, DPC's 2017 policy paper also highlighted substantial shortcomings that casted doubt on whether the EU initiative could attain its goals. Up until March 2017, only in one of the seven areas covered by the Reform Agenda (modernization of the labor market), had there been core measures implemented. Specifically, this was the adoption of new entity labor legislation. Despite the praise these adopted laws drew from the EU and the IFIs, they still fell far short of their declared aims. At this point in time all other areas of structural reforms were still at an early, preparatory stage. Since 2015,

[1] http://www.democratizationpolicy.org/pdf/DPC_EU_BiH_Initiative_Monitoring_Report.pdf.
[2] Ibid.

numerous delays in the implementation of reform measures had occurred. This was primarily the result of disputes among the ruling political elites, in particular on the State and Federation levels. This exposed a political culture of defensive tactics by those with entrenched interests potentially endangered by the foreseen structural reforms. With the Reform Agenda due to end in December 2018, and as 2018 is an election year, a very limited time slot remained to implement the multiple structural reforms. This made it impossible for many of them to be completed within the timeframe, even under "best case" conditions presupposing genuine political will.

The EU's "other conditions," as laid out in the 2017 DPC paper, also suffered several delays, and "breakthroughs" were mostly made possible by the EU falling back into its old habit of retreating from conditionality in the face of resistance[3]: EU institutions lowered conditionality, ignored self-set deadlines, and in some cases dropped conditionality entirely. Even when conditions *were* fulfilled, it was mainly due to the EU's lack of attention to the *substance* of the "solutions" agreed among BiH political leaders. This therefore turned conditionality into a mere box-ticking exercise, raising doubts whether these solutions would ever function in practice.

Any progress in implementing the Reform Agenda was mostly achieved thanks to the IMF's strict financial conditionality. However, when it came to the EU's additional conditions, it was only the resistance from more pro-active EU member states (Germany and the U.K.) that prevented EU institutions from lowering conditionality standards even further.

On that basis, in the spring of 2017 it appeared highly questionable that the EU would be able to press BiH political elites to lead the Union's Bosnia initiative towards a successful ending. First and foremost, "success" would require fully implementing the Reform Agenda, as well as BiH authorities' successful preparation of the answers to the "Questionnaire," and based on the operational tools provided by the new coordination mechanism, in a reasonable period of time. At the same time, due to the GAC's decision of September 2016, the EU remained without any strategy that would condition advancement in Reform Agenda implementatin against progress in BiH's EU integration process.

The past year (April 2017-18) shows that these grim forecasts were in fact too optimistic. A pre-election atmosphere already developed at the beginning of 2017, nearly two years ahead of the 2018 general elections, undermining the work of the various governments even more than in previous years. As a result, the Reform Agenda implementation seems to have almost come to a complete halt, stuck by the continuous failure of ruling elites to pass a law on excise tax – which was only finally adopted at the very end of 2017. In parallel, payment of the second tranche of the IMF credit, originally foreseen for the end of 2016, remained blocked for over a whole year, only to be released at the beginning of 2018. Moreover, the authorities were not able to complete the answers to the Questionnaire by May 2017, the indicative date originally set by the European Commission, following shifting announced timelines. It took until the end of February 2018 for the completion and handover to happen. In light of such developments over the last 12 months, it would have been reasonable to adjust the EU initiative's grim prospects for success back

[3] As highlighted by DPC in various publications over the last decade, for example: Bassuener/Weber, *House of Cards: the EU's "reinforced presence" in Bosnia and Herzegovina*, DPC Policy Paper, Sarajevo-Berlin, May 2013, pp.8-12; available at: http://www.democratizationpolicy.org/pdf/may.pdf.

in spring 2017 to reflect the subsequent sharp slowdown in implementation of reform measure. Instead, there neither has been nor is there any talk among EU officials about the failure of the Union's current Bosnia initiative, let alone any planning on a new policy approach to the country.[4]

In the absence of such serious strategic planning, this report begins to fill that gap, through diagnosis and prescription. It assesses the EU initiative's prospects for success/failure by its official ending in December 2018, as well as the country's prospects for further progress in EU integration. Both assessments are based on a comprehensive analysis of the main developments in BiH since the beginning of 2017. Section One evaluates the progress made (or not) in implementing the Reform Agenda, measured against the Agenda's action plans. Section Two assesses the BiH authorities' preparations of answers to the EC Questionnaire as well as the role the coordination mechanism played in that process. Section Three investigates the causes of the failure of the EU's initiative. The final section lays out recommendations for a more consistent and strategic future EU policy towards BiH.

This paper is based on the study of public and non-public documents, as well as field research and a large number of interviews conducted through 2017 to 2018 in BiH, Berlin and Brussels.

II. Status of the Implementation of the Reform Agenda

In June 2015, the EU and the IFIs agreed with the State and entity executives on a broad economic reform agenda specifically designed for BiH. The "Reform Agenda for Bosnia and Herzegovina 2015-2018" set out the "main plans for socio-economic and related reforms at all levels of government during the remainder of their democratic mandates," i.e. until the 2018 general elections. It defined "a broad set of medium-term priorities" that were to be "distilled into specific measures and undertakings" implemented throughout 2015-16. Thereafter these priorities would be further refined, subsequently resulting in "specific measures that will bring the Agenda into the medium term."[5] The Reform Agenda, aimed at creating a stable macroeconomic environment and boosting economic growth, focuses on seven areas:

[4] The European Commission's 2018 country report and communication on enlargement policy note that reform implementation in 2017 was limited to only "a few reforms and the notable adoption of the excise legislation," but interpret this as a "delay in the delivery on a number of reforms," respectively as "a slowdown of the reform process." *Bosnia and Herzegovina 2018 Report*, *2018 Communication on EU Enlargement Policy*, European Commission, both published April 17, 2018, available at: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-bosnia-and-herzegovina-report.pdf; https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417_strategy_paper_en.pdf.

[5] Reform Agenda for Bosnia and Herzegovina 2015-2018. Working Translation, pp.1-2; available at: http://europa.ba/wp-content/uploads/2015/09/Reform-Agenda-BiH.pdf.

Box 1: Initial Reform Agenda Areas

- labor market;
- business climate and competitiveness;
- public finance, taxation and fiscal sustainability;
- state-owned enterprises (SOEs);
- social welfare, pension and health care reform;
- public administration reform;
- rule of law.

This section analyzes reform measures implemented in the seven areas in the period since September 2016, when the EU General Affairs Council made the decision to task the Commission with an "Opinion" on BiH's membership application. In addition, it will analyze the measures that remain to be implemented by the end of 2018. Based on this analysis, the paper will then assess the potential for the various and significant structural reforms to be realized within the allocated timeframe of the agenda.

In fall 2016, the GAC decided to grant BiH its final reward foreseen within the's EU BiH initiative, for, among other developments, the "meaningful progress" made in implementing the Reform Agenda. However, this was already based on major concessions. As an EU member state official, involved in the decision-making process described:

"The report of the Commission on which was decided that BiH had made meaningful progress… was more akin to a Swiss cheese than solid analysis of the actual situation at that moment in time. I never read a document with so many adjectives to illustrate that policies were not yet implemented, still in planning phase, or under consideration etc. as in this report."[6]

Implementation of the Reform Agenda had been slow even before September 2016. However, in the time since the GAC decision, implementation of the many measures, then still classed as unimplemented in the Council of Ministers of BiH's and the entity governments' Reform Agenda actions plans, ground almost completely to a halt. This was symbolized most vividly in the repeated failure to adopt the excise tax law, for which failed negotiations persisted for over a year (see subsection 3. below). Conflicts within the ruling coalitions at State and Federation level escalated further, at times nearing complete collapse, and substantially impeding the legislative work of both. Simultaneously, the Republika Srpska (RS) government pointed fingers to Sarajevo, insisting the entity government was the only one fulfilling its obligations. Banja Luka itself was also stalling reform implementation and distracted from its inaction by highlighting political conflicts in other parts of the country.

Consequently, it was only in March 2017 that the fourth joint Council of Ministers of BiH-entity

[6] Interview with EU member state official, 2017.

governments' quarterly progress report on implementation of the Reform Agenda was published (with the third report published in September 2016). It remained the only report published in 2017, due to the lack of substantial progress that year that might have justified the publication of subsequent reports.[7]

After seeing the already limited reform momentum gradually collapse after the EU's September 2016 decision, the U.K. and Germany concluded in November of that year that the Reform Agenda's implementation was not proceeding effectively. They agreed that the EU approach should be strategically amended to tighten the Agenda, specifically refocusing on just four-to-five of the most important reform issues that would secure at least a partial implementation of the Agenda. The idea of the amended approach was to address the limited time period remaining before the end of 2018 (when the Agenda should officially come to a conclusion), and also take into account that 2018 would be an election year that left limited maneuvering space for implementing reforms. That proposal, however, met strong resistance from the EU Delegation to Bosnia and Herzegovina. The conflict resulted in a compromise agreement to "focus" on 13 reform measures, some of which were not even part of the original Reform Agenda, but played important roles in the relationship between the EU and BiH during that time. Those 13 items included, *inter alia*:

- adoption of amendments to an excise tax law package, reform of state-owned enterprises (SOEs), adoption of two key FBiH tax laws, reform of the Federation pension system, adoption of a public administration reform strategy (all part of the Reform Agenda), reform of the High Judicial and Prosecutorial Council (HJPC) internal rules (all: Reform Agenda measures);
- adoption of a new HJPC law (foreseen for years within the framework of the EU's Structured Dialogue on Justice),
- adoption of several BiH sectoral strategies (on transport, energy, rural development) important for access of BiH to EU pre-accession funds (not being part of the Reform Agenda).[8]

This agreed "focus" on only 13 of the remaining dozens of reform measures foreseen in the action plans was never communicated to BiH authorities, let alone made public. It equaled a tacit recognition of failure, i.e. the recognition that full implementation of the Reform Agenda until the end of 2018 was by far out of reach. At the same time, EU institutions' resistance to focus on a limited number of measures, selected according to their relevance regarding structural reforms, clearly mirrored the European Commission's previously demonstrated reluctance to enforce strict conditionality. Asked about the criteria for the selection of these 13 measures, a Commission official described them as "measures already in parliamentary procedure and low hanging fruit."[9]

The following sub-sections review the initial 7 main focus areas in the Reform Agenda to assess what was, and was not, achieved, including prospects for full implementation by the end of 2018.

[7] *Četvrti Konsolidovani Izvještaj o Napretku Provođenja Akcionog Plana za Realizaciju Reformske Agende Bosne i Herzegovina, Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti*, Sarajevo/ Banja Luka, March 14, 2017.
[8] Interviews with EU member states officials, Sarajevo 2017.
[9] Interview with EC official, 2017.

II.1. Labor market

Until September 2016, labor market reforms – in the form of new entity labor laws, which were already adopted in 2015 - were the *only* Agenda area in which major systemic measures had been implemented and enforced. As the previous DPC monitoring report scrutinized, the new laws formally met the proclaimed target of introducing better employment flexibility. However, their provisions were a mix of a reduction in employment rights in certain areas and an improvement in others. Perhaps even more significantly, the laws failed to address all the other rationales for their enactment.

Rather than enhance progress, the governments' performance in pushing through the new legislation substantially damaged the social dialogue between employers, employees and the government. Further, it weakened the (already compromised) trade unions' power, which was subsequently undermined further by additional actions on the part of both entities' governments from the beginning of 2017. Trade union associations in both entities managed to strike collective branch agreements but only in a part of the branches where they had previously existed. In the RS, workers have remained without a general collective agreement as the entity's employers' association seized the opportunity to avoid an agreement offered by the new Labor Law.[10]

In the Federation of BiH, employers' and trade union associations signed a general collective agreement in February 2016. This followed a delay of over two years caused by the entity government ignoring requests from both associations to extend the agreement's applicability to *all* employees in the Federation. As a result, at the beginning of March 2018 the employers' association decided to pull out of the agreed general collective agreement. Extending the applicability would have, among other issues, regulated the minimum wage in the entity – as requested by trade unions and employers' associations alike.

The structural problems associated with non-implementation of workers' rights by employers in the private sector has remained untouched, due largely to the broad and pronounced weakness of the rule of law.[11] At the same time, the issue of over-privileged employee positions in the public sector (public administration and state-owned enterprises), which is the result of political employment by the ruling parties and one of the main features of the country's patronage system, has also remained unchanged. While some measures to prevent a further rise of the public wage bill were implemented in 2017,[12] the failure of progress in public administration reform (discussed below) means that no serious steps have

[10] One of the key features of the new entity labor laws forced the trade unions to negotiate new general and new branch collective agreements with employers' associations. In case when they two sides could not agree, trade unions were left without collective agreements. The new laws thus shifted the power balance substantially towards the side of the employers' associations.

[11] Letter by the president of the Economic-Social Council of the Federation of BiH Edhem Biber, dated August 25, 2017; "Savez samostalnih sindikata: Nećemo dozvoliti ukidanje Općeg kolektivnog ugovora," Klix.ba, March 1, 2018, available at: https://www.klix.ba/vijesti/bih/savez-samostalnih-sindikata-necemo-dozvoliti-ukidanje-opceg-kolektivnog-ugovora/180228152.

[12] *Zakona o izmjenama Zakona o plaćama i naknadama u organima vlasti FBiH*, January 2017; *Kolektivni ugovor o izmjenama i dopunama Kolektivnog ugovora za službenike organa uprave i sudske vlasti u FBiH*, November 2016.

been taken to lower the comparatively high salaries and allowances in the public sector, and thus create a more equitable balance between earnings in the public and private sector.

In the Federation of BiH, in early 2017, a deeply problematic draft amendment to the Labor Law was entered into parliament and adopted by both houses, despite resistance from employers and trade unions. The amendment only stalled because it was adopted in two slightly different versions. Both texts differ in their wording only, but not in substance, as both versions constitute a clear reform rollback.[13] The proposal prescribed that the government set the minimum wage, replacing the current procedure of agreement between employers' association and trade unions through the so-called - Economic-Social Council.

Alarmingly, the proposed law effectively promoted the use of the grey economy (illegal employment), as it would reduce fines on employers who hire illegally. More significantly, a provision originally proposed by the government, which would have extended the Federation Labor Inspection Service's authority (currently limited to entity institutions and Federation-owned public enterprises) to the 10 cantons of the Federation, was removed during parliamentary procedure at the insistence of the Croatian Democratic Union (HDZ BiH). As employers' and trade union association representatives explained to the author, this proposal serves the interests of the HDZ-controlled cantons in Western Herzegovina. Specifically, it benefitted the municipality of Međugorje, a place of annual pilgrimage for millions of Catholic worshippers from around the world. Restaurants, hotels and private accommodations traditionally evade legal obligations to register most of their guests and employees, and thus form a key element in the HDZ's patronage system.[14]

Entity governments insist that employment rates have risen and unemployment rates have declined since the implementation of the Reform Agenda began, as a direct result of measures undertaken.[15] However, as labor market experts explain, the statistics are, at least partially, misleading. In terms of increased employee numbers in BiH, there are marked differences between the data on the number of employees provided by the tax agencies and those provided by the employment agencies. This of course raises doubts on the reliability of the statistics. That being said, there may still have been a positive effect, not in terms of the creation of new jobs, but rather that the measures undertaken resulted in previously unregistered employees acquiring official employment status.[16]

[13] *Nacrt Zakona o Izmjenama I Dopunama Zakona o Radu FBiH*, December 2016; *Prijedlog Zakona o Izmjenama I Dopunama Zakona o Radu FBiH*, February 2017; *Izjašnienie vlade Federacije Bosne I Hercegovine o amandmanima na Prirjedlog zakona o izmienama i dopunama Zakona o radu koje ie podnijela Skupšitina Zapadno-hercegovačkog kantona*, March 13, 2017.
[14] Interviews with FBiH employers and trade union association representatives, Sarajevo 2017.
[15] *Četvrti Konsolidovani Izvještaj o Napretku Provođenja Akcionog Plana za Realizaciju Reformske Agende Bosne i Herzegovina*, p.11: „Fadil Novalić i zaposleni u FBiH," *Istinomjer.ba*, October 26, 2017, availabe at: http://istinomjer.ba/fadil-novalic-zaposleni-u-fbih/.
[16] Interviews with labor market experts, BiH 2017.

Conversely, statistics indicating lower numbers of unemployed people is in fact the result of the intensified labor migration not reflected in the data. This primarily reflects BiH citizens who can temporarily migrate to EU countries thanks to their possession of Croatian (EU) passports.[17]

Reform Agenda implementation – main developments	
Progress in liberalization of labor market neutralized by weakness of rule of law	
Privileged position of public sector employees/labor market distortion remains untouched	
Trade unions, social dialogue weakened	
Strengthening of FBiH labor inspection service prevented; in RS not even targeted	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

II.2. Business climate and competitiveness

Improving the business climate and instilling a culture of competitiveness remains crucial to creating an effective market economic framework in Bosnia and Herzegovina. This aim is something that has long been promoted by the International Financial Institutions (IFIs) in BiH. The Reform Agenda has focused on addressing the main structural constraints in this area:

- the complexity and inconsistency of regulatory frameworks and tax system;
- high administrative barriers for businesses;
- hidden state subsidies and other forms of public assistance.

Until September 2016, a number of measures to improve the regulatory framework and ease the conditions for registering and running businesses in the country had been either planned or implemented.[18] Since then, implementation of the Agenda has slowed substantially.

For the first time in post-war BiH, authorities in the country's two entities (with support from USAID) managed to compile a registry of the huge number of para-fiscal fees[19] existing at all levels of governance. According to the business community, the registry was a relative success, recording approximately 85 percent of existing fees. Yet since 2017, entity governments failed to implement the next step of the process – adoption of legislation that would fix the number of para-fiscal fees and prevent authorities

[17] Ibid.
[18] *Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative*, pp.20-22.
[19] A *para-fiscal fee* is a tax on a specific product or service by which a government raises money for a specific purpose. The money raised is usually paid to a body other than the national tax authority, i.e. in the case of BiH directly to entity, cantonal or municipal governments.

from introducing new or additional fees in the future. At the same time, governments on various levels have adopted a large number of decrees, introducing additional para-fiscal fees.[20]

In the Federation, the adoption of two core laws were delayed indefinitely: the Law on Contributions and the Personal Income Tax law. Originally foreseen in the Agenda Action Plan to be adopted in March 2016, they were only introduced into FBiH Parliament in February 2017. To date they still remain blocked as part of the permanent crisis between the ruling coalition partners. The laws aim to reduce the financial burden on employers. Non-adoption of the laws, within the context of other related reform measures, currently produces the opposite effect, resulting in higher financial burden for private sector companies.[21]

From 2017, implementation of other key measures aimed at improving the regulatory framework in BiH, in particular in the Federation, remained largely blocked. Draft laws proposed by the Federation government, such as the Law on Games of Chance, the Law on Forests , and the Law on Tourism, which caused the long-term coalition crisis in 2016, are still stuck in parliament to date. This was mainly due to the fact that they threatened the entrenched patronage interests of the Croatian Democratic Union of Bosnia and Herzegovina (HDZ BiH).

Furthermore, a planned new law on bankruptcy, aimed at improving bankruptcy procedures in the Federation, has been passed. Paradoxically, a new law on concessions proposed by the Federation government was successfully passed but has been heavily criticized by business representatives for its bad quality.[22] While the Federation Commission on Concessions has only approved a very low number of concessions in recent years, the state-level commission has not approved any concessions whatsoever in the last 12 years. The fact that the mandate of most of its members formally expired a decade ago only served to aggravate the situation further. The state-level commission is not targeted in the Reform Agenda at all. At the same time, the Federation government's efforts to simplify business registration procedures - by introducing the so-called 'one-stop-shops' (that already exist in the RS) - have yet to yield any results. The measure, originally planned for introduction in October 2016, (then postponed to mid-2017), remains unimplemented.[23]

Strengthening regulation and surveillance of the banking sector and protecting it from political interference has been another core part of the Reform Agenda, with the International Monetary Fund (IMF) taking a lead role. In 2016, following the collapse of two domestic banks in the RS, the IMF managed to force the entity government to liquidate the two banks and accept stress tests for additional domestic banks. Furthermore, the RS government relented under pressure and withdrew its representatives from the decision-making process in the entity development bank on credits to private companies. During the end of 2016 and beginning of 2017, new banking laws and banking surveillance agency laws were adopted in both entities. However, since that time, both governments have failed to prepare new laws on the

[20] *Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti*, March 2017; interview with FBiH employers' association representative.
[21] Ibid.
[22] Interview with FBiH employers' association representative.
[23] Ibid.; https://www.klix.ba/vijesti/bih/komisija-za-koncesije-bih-postoji-vec-12-godina-a-nije-izdala-nijednu-saglasnost/170329018; http://www.nezavisne.com/novosti/bih/Mandat-im-istekao-2009-a-primaju-po-3500-KM/436915.

entity development banks. Both banks remain under heavy influence of the ruling political elites. Equally, the appointment process for new members to the RS banking surveillance agency board indicates continued political interference in the agency's work.[24] Most importantly, since 2017 there have been no measures taken to strengthen the rule of law in BiH's economy, in which enforcement of contracts remains almost impossible without access to (political) corruption.

Reform Agenda implementation – main developments	
Reform of entity development banks (new laws) not implemented	
Reform of banking surveillance agencies thwarted by political appointment of board members	
Laws to limit para-fiscal fees not passed	
Adoption of FBiH Law on Contributions and on Personal Income Tax remain stuck in parliament	
Restructuring of troubling domestic banks in RS uncertain	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

II.3. Public finance - fiscal sustainability

Failure to establish control over public spending and taxation, and thus ensure fiscal sustainability, has been one of the main threats to socio-economic stability in BiH. This has been evidenced most notably since the international community transferred full political responsibility for economic, social and fiscal policy to domestic elites in 2005-2006. Full "ownership" led to an explosion in public sector employment and social transfer payments that are not needs-based – two core pillars of the country's patronage system. Consequently, public spending and indebtedness rose drastically.

Fiscal consolidation efforts undertaken since 2015 in the framework of the Reform Agenda, have yielded several positive, but still limited, results. GDP rose by 3.1 percent in 2015, 3.2 percent in 2016, and by 2.7 percent in 2017. Furthermore, public finances partially stabilized, government spending in percentage of GDP dropped slightly in 2016-17, BiH's external debt fell in 2015, rose in 2016 and is estimated to have fallen to 61.1 percent in 2017 (the lowest level since 2013).[25] This is, in part, the result of certain public spending restraints and a rise in revenues, in particular in the Federation of BiH. The primary reason, however, is the marked improvement of the output of BiH's economy, including a rise in exports, as well

[24] Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti, March 2017; "Političke igre i talovi kao okovi oko vrata Razvojne banke FBiH: Nema uprave, nema ni kredita," Klix.ba, Mrach 6, 2018, available at: https://www.klix.ba/vijesti/bih/politicke-igre-i-talovi-kao-okovi-oko-vrata-razvojne-banke-fbih-nema-uprave-nema-ni-kredita/180212092; "Stranački kandidati u Upravnom odboru Agencije za bankarstvo," Capital.ba, February 12, 2018, available at: http://www.capital.ba/stranacki-kandidati-u-upravnom-odboru-agencije-za-bankarstvo/; interview with IFIs official, 2018.
[25] Figures according to the IMF.

as a favorable international economic environment. As businesspeople in both entities stress, growth in economic output is the result of their activities, despite, not because of the governments' economic policy.[26]

Budgets in both the RS and the Federation were adopted on time in 2016 and 2017. However, in the Federation the parliament adopted the 2018 budget slightly late, in January 2018. In 2015, executives on State and entity levels implemented a public wage bill freeze as well as an indefinite hold on hiring, though they have since tried to add new public administration jobs in the form of fixed-term employment and consultancies. Since 2017, state, entity, and cantonal governments have resisted the World Bank's effort to compile public employment registries – a task prescribed in the Reform Agenda. Since the World Bank was prevented from completing the registries, governments did not have to adopt plans on reduction of public sector employment, let alone implement them. Adoption of such plans has been rescheduled to December 2018 – which is when the Reform Agenda will officially end.[27]

In addition, intended legislative measures for entity governments to exert control over public spending of lower level governments have met political resistance. This included the prevention of an expansion of the treasury system in the Federation to the budget management systems in cantons, which would have enabled the entity government to exert control over excessive public spending by the cantons. Implementation was foreseen for March 2017, and has now been moved to March 2019, after the Reform Agenda has ended.[28]

Public spending restraints in 2016 and 2017, in both entities, have been realized at the expense of a massive suppression of economically meaningful public investments, precisely the opposite of what had been advocated for by the IFIs. Furthermore, the RS government continued its policy of blocking the rise of the BiH state-level budget, proposed in order to finance necessary investments. This follows the RS's long-standing policy of weakening the state, a policy that has kept the state budget at the level of 2012. In 2017, RS government representatives used their veto power in the BiH Fiscal Council to reject a proposal for a modest budget rise of 20 Million KM (roughly 10m Euros). Items covered in the proposal were: the rise of salaries of officials in state-level police agencies (based on a decision adopted by the BiH Parliament); additional funds for the Central Election Commission of BiH (related to the October 2018 general elections); and the purchase of two helicopters for the Armed Forces of BiH. In addition to these items, the RS government has blocked important investments for a period of years, for example investment in the BiH border police and improving border crossings infrastructure. The lack of such investments has directly damaged the country's economy and security.

The two entity governments, in their 2018 budgets, have estimated a rise in overall budget spending by three to five percent. This increase could mark a worrying departure from the previous years' policy of

[26] Interviews with representatives from the BiH business community and with IFIs representatives, BiH 2017.
[27] *Staff Report for the 2017 Article IV Consultation, first review under the Extended Facility Fund*, IMF Country Report No. 18/39, January 29, 2018, available at: http://www.imf.org/en/Publications/CR/Issues/2018/02/13/Bosnia-and-Herzegovina-2017-Article-IV-Consultation-First-Review-Under-the-Extended-45624; interviews with BiH financial experts and IFIs representatives, Sarajevo 2017.
[28] IMF Country Report No. 18/39.

spending constraints, particularly in in the RS where the projected rise of expenditures is not matched by an equivalent increase in revenues. At the same time, the RS government has announced an additional three percent rise in pensions in the entity for the 2018 election year, yet it remains unclear how it will finance the difference.[29]

In 2017 the two entities remained without the second tranche of the IMF's September 2016 credit arrangement (75m Euro), originally foreseen for the end of 2016. This appeared to have little impact for the Federation, which could be due to the marked rise in revenues. However, it did cause an issue for the RS. The smaller BiH entity still managed to avoid a budgetary crisis due to two instances of external help. In August 2017, the Russian government settled an old debt to BiH and paid 125m U.S. Dollars, which was divided up by the entities according to the established formula (1:2 RS:FBiH). In October the same year, the RS government arranged a commercial loan from the Commercial Bank of Belgrade under favorable interest rate conditions. This agreement followed a meeting between the presidents of the RS and Serbia, Milorad Dodik and Aleksandar Vučić.[30]

The rise in revenue collection in the Federation of BiH – an 8.15 percent increase in 2017 compared to the previous year – was the result of the work by the new, acting director of the tax authorities, Safet Isović. In recent years he has managed to improve the surveillance activities of his office in spite of the substantial underfunding of the office and continued political resistance from the ruling coalition. Resistance came from the Federation of the BiH government via a series of measures to prevent Isović freezing the bank accounts of major public enterprises and institutions (which owe substantial debts) in order to force them to fulfil their financial obligations, thus protecting the largest public debtors from sanctions. In February 2018, a coalition crisis broke out over the alleged attempt of the HDZ BiH government members, headed by the finance minister, Jelka Miličević, to prevent the selection of Isović as the new permanent director. A permanent coalition crisis could only be prevented by effectively suspending the selection process.[31]

In August 2017, the ruling coalition in the RS forced the Republic's Auditor, Duško Šnjegota, and his deputy to resign. It was alleged this was because his office, in an audit report on the government's budget implementation, had revealed that the RS government was manipulating budgetary statistics in order to fake fiscal stability.[32]

[29] Interviews with BiH finance experts, BiH, 2017.
[30] Interview with BiH finance experts; "Komercijalna banka Beograd dala kredit Vladi RS od 25,6 mil EUR," *E-kapija*, October 4, 2017, available at: https://www.ekapija.com/news/1897668/komercijalna-banka-beograd-dala-kredit-vladi-republike-srpske-od-256-mil-eur.
[31] „Porezni dugovi se gomilaju radi socijalnog mira," Business Magazine, Sarajevo October 9, 2017; "U januaru 2018. godine naplaćeno ukupno 384.715.473 KM javnih prihoda," February 8, 2018, available at: http://www.pufbih.ba/v1/novosti/1103/u-januaru-2018-godine-naplaeno-ukupno-384715473-km-javnih-prihoda; "Vlada FBiH: Upitna podrška Šerifu Isoviću?," Oslobođenje, February 8, 2018, available at: https://www.oslobodjenje.ba/vijesti/bih/vlada-fbih-upitna-podrska-serifu-isovicu; Interviews with FBiH business representatives, 2017.
[32] Izvještaj o provedenoj finansijskoj reviziji Konsolidovanog godišnjeg finansijskog izvještaja za korisnike budžeta Republike Srpske za period 01.01-31.12.2016. god., Glavna služba za reviziju javnog sektora RS-a, Banja Luka July 20, 2017, available at: http://www.gsr-rs.org/static/uploads/report_attachments/2017/08/18/RI028-17_Lat.pdf;

Excise tax – the Reform Agenda's Sejdić-Finci

In 2017, the adoption of a law on excise tax was the one Reform Agenda issue upon which all EU and IMF energy and focus was concentrated on. During this time, progress on almost all other Reform Agenda measures was stalled. Raising the state-level excise tax on fuel by 0.15 KM (7.5 Euro Cents), in order to finance the construction of highways, was a key measure included in the Reform Agenda Action Plan for state-level authorities from 2015 onwards. This was originally supported by all ruling parties in the BiH Council of Ministers (CoM BiH) and in both entities. It aimed at boosting economic growth and employment in a way that meant BiH could avoid having to take further loans that would increase the country's debt.[33]

As with the implementation of most agenda measures, adoption of the excise tax rise, originally foreseen for December 2015, was delayed. When it was finally placed on the agenda in late 2016, it was drawn into internal coalition disputes and was subsequently blocked during the time that the political parties shifted into election campaign mode as 2016 drew to a close. Following almost half a dozen failed implementation attempts the excise tax law was finally adopted by the BiH Parliament in December 2017.

Disagreements between the ruling (and opposition) parties on the State and entity levels over the excise tax law amendment had grown into an all-out blockade of the Reform Agenda. For parliamentary parties it became a means to settle scores and to hide their genuine reform resistance behind one single reform measure. Consequently, the importance of this reform measure was grossly exaggerated. For the EU, the approach became to "get-it-passed-whatever-the-substance." This very much mirrored the role implementation of the so-called Sejdić-Finci ruling assumed as a condition in the EU's failed 2007-14 policy approach to BiH.[34] Raising excise tax on fuel, which would lead to an increase in fuel prices by 7.5 Euro cents per liter (in a country with an average monthly net salary of 420 Euro in 2016[35]) was a politically sensitive issue. It was to turn into an explosive political issue during the time of the subsequent election campaign – a campaign that started exceptionally early, at the beginning of 2017, almost two years ahead of election day.

The first parliamentary showdown over the amendment occurred in March-April 2017, when the law failed by a narrow vote. This was attributed to the MPs from the Serb coalition partner in the Council of Ministers, and three MPs from the Bosniak Party of Democratic Action (SDA), voting with their opposition colleagues against the law. The Alliance for Change (the parties participating in the CoM but acting as the opposition in the RS) resisted the measure they had previously supported because they wanted to prevent the government coalition in the RS from access to additional funds that might be used for purposes other

"Glavni revizor RS Duško Šnjegota podnio ostavku," Radio Slobodna Evropa, August 31, 2017, available at: https://www.slobodnaevropa.org/a/28707251.html.

[33] *Akcijioni plana za provedbu Reformske agende Vijeća Ministara Bosne i Hercegovine*, October 2015; interviews with EU and IFIs officials, Sarajevo 2016.

[34] On the role, implementation of the Sejdić-Finci ruling by the European Court of Human Rights (ECHR) as a condition for EU integration played in the EU's 2007-14 policy towards BiH, see: Bassuener/Weber, *House of Cards: the EU's "reinforced presence" in Bosnia and Herzegovina*, DPC Policy Paper, Sarajevo-Berlin, May 2013, pp.7-8; available at: http://www.democratizationpolicy.org/pdf/may.pdf

[35] IMF data.

than the financing of highway construction. They suspected that the RS would use the additional funds to benefit their campaign in the 2018 elections.

The three SDA MP dissidents, led by Senad Šepić, who had previously failed in the competition for party president, capitalized on the standoff to settle scores with their party leadership. The outcome of the dispute saw the dissidents leave the SDA and go on to form their own party. Both groups of MPs joined the opposition who contended the additional revenues from the excise tax on fuel would go to the country's Single Account for indirect taxes. From there it would be divided among the entities and was then free to be used in a non-transparent manner, specifically, for measures that would likely deviate from the original purpose of the tax. At the time, the argument was dismissed by the SDA and the SDA-Chairman of the Council of Ministers of BiH, Denis Zvizdić.[36]

For the European Commission, passage of the excise tax became ever more important due to its link with the upcoming Western Balkan summit at Trieste in July 2017. The signing of an agreement by the Western Balkan Six (WB6) on the formation of a Transport Community, with project funding worth 500 Million Euro (which included highway projects in BiH) was scheduled for Trieste. Adoption of the excise tax law was made a condition for BiH in order to profit from the project funding. Correspondingly, the IMF had turned the excise tax into a key, *de facto* condition for the payment of the second tranche, under the 2016 credit arrangement with BiH.[37]

Within this context, between March-April of 2017, EU member state diplomats and representatives of the EU Delegation to BiH met with every MP in the BiH Parliament. The EU officials engaged in a type of "arm-twisting" mission, insisting "this is for the EU perspective, this is good for BiH."[38] Furthermore, they defended their own actions, asserting that they had remained within the limits of "strict respect for the principle of political ownership" (sic!).[39] High-level EU Delegation officials even undermined the implementation of another crucial reform measure, hoping to avoid additional political complications that could prevent a majority vote for the excise tax law (see subsection on State-owned enterprises). They also pressured IFI representatives to support the dropping of the excise tax condition for BiH's signing of the Transport Community Treaty, a position advocated for by Chairman of the Council of Ministers, Zvizdić, and supported by the EU Delegation This endeavor ultimately failed amidst resistance from member states like Germany, from the DG NEAR, and the EC Enlargement Commissioner, Johannes Hahn, in Brussels.[40]

During fall 2017, following BiH's late signing of the Transport Community Treaty, new and increased pressure on the Council of Ministers and parliament was building to finally have the excise tax law passed. Commissioner Hahn, in two subsequent letters to Zvizdić, set a deadline, initially for September, but then extended to October after the September deadline failed. This new impetus also was to no avail. The

[36] Interview with BiH Parliament MP, Sarajevo October 2017.
[37] Interview with EU and IFIs officials, Sarajevo October 2017; https://ec.europa.eu/transport/themes/international/news/2017-07-12-western-balkans-summit-2017-delivering-region_en.
[38] Interview with BiH Parliament MP, Sarajevo October 2017.
[39] Interview with EU member state diplomat, Sarajevo October 2017.
[40] Interview with EU member state diplomats, Sarajevo October 2017.

ruling coalition of the CoM was even further away from securing a majority in the parliament, as the coalition partner - the Party for a Better Future (SBB), the SDA's main Bosniak political rival - acted as a kind of opposition within the government, joining the Alliance for Change in its rejection of the excise tax law.[41] Caught between the need to garner support from a parliamentary opposition which demanded a law based on transparent spending of the expected additional revenues, and the insistence of the ruling party in the RS (the Alliance of Independent Social Democrats, SNSD, and its leader Milorad Dodik) to stick to the previous non-transparent version, Zvizdić agreed with Banja Luka on a revised version of the excise tax law. The revised version suggested a compromise of the competing interests: instead of a rise in excise tax on fuel by 0.15 KM, the road toll fees on fuel would be raised by 0.15 KM, while excise tax of 0.15 KM would only be raised on bio-fuel and bio-liquid. This way, the opposition's demand would be met, as road toll fees are attributed to a separate bank account at the Central Bank of BiH and can't be reassigned into the general budget, while the excise tax on bio-fuel and bio-liquid would still bring in several dozen million KM additional revenues per year that could be redirected for discretionary use.[42]

However, despite the internal compromise and renewed arm-twisting of EU officials towards MPs, which resulted in the SBB shifting towards support of the revision, opponents of the law still retained a majority in the House of Representatives' finance committee, and thus a veto power that could prevent passage of the law. Consequently, on December 8, 2017 the coalition majority reverted to a dirty trick in the Parliament's second chamber, the House of Peoples. The law proposal was adopted by shortened procedure in the first and second, i.e. final reading. They then forwarded it to the first chamber, the House of Representatives, thereby changing the priority from shortened to urgent procedure. This represented a gross violation of parliamentary procedures. In a dramatic marathon session, the majority in the House of Representatives (at 04:50am on December 15) adopted the excise tax law amendment package in urgent procedure. This was the only process that enabled them to bypass the finance committee and get the law pushed through.[43] EU officials in Sarajevo and Brussels praised the decision, completely ignoring the gross violation of the law that had enabled this "great breakthrough." More alarmingly, on February 15, 2018 the Constitutional Court of BiH rejected a request, filed by 19 MPs, to annul the excise tax law based on the obvious violation of the law. This decision highlighted a worrying trend in the politicization of the Court judges' ruling in politically sensitive cases.[44] Publicly, EU officials ignored the ruling's troubling background, only admitting in private that they were fully aware the adoption of the excise tax law was

[41] Interview with BiH Parliament MP, Sarajevo October 2017.
[42] Interview with tax expert, Sarajevo December 2017; inofficial BiH Indirect Tax Authority data.
[43] "Delegati očekuju usvajanje seta zakona o akcizama i u PD," Vjesti.ba, December 7, 2017, available at: https://vijesti.ba/clanak/385159/delegati-ocekuju-usvajanje-seta-zakona-o-akcizama-i-u-pd; "Na maratonskoj sjednici državni parlamentarci noćas usvojili Zakon o akcizama," Klix.ba, December 15, 2017, available at: https://www.klix.ba/vijesti/bih/na-maratonskoj-sjednici-drzavni-parlamentarci-nocas-usvojili-zakon-o-akcizama/171214126.
[44] http://www.ustavnisud.ba/dokumenti/_bs/U-5-18-1117606.pdf; on the worrying trend of politically influenced decisions by the Constitutional Court of BiH, see: Bodo Weber, "Bosnian Croat leadership on course to throw Bosnia and Herzegovina into electoral chaos," https://ba.boell.org/de/2017/12/21/bosnian-croat-leadership-course-throw-bosnia-and-herzegovina-electoral-chaos.

only enabled by "a gross violation of the law."[45]

Finally, despite all the efforts made, there is a high likelihood that the revenues from the raised road toll fees won't even be made available for spending on transport infrastructure. Due to the hasty compilation of the excise tax law package, Council of Ministers officials made an obvious technical mistake that annulled the Indirect Tax Authority's (ITA) coefficient (in force since 2009), which concerned the distribution of revenues from the road toll fees among the entities (and Brčko District). Agreement between the entities on a new coefficient is therefore needed, yet over the last ten years, agreement between the entity governments on the distribution of revenues from any indirect taxes has proven to be almost impossible. If such a scenario occurred, it would mean that the revenues from road toll fees from the new excise tax law (that form the basis of Bosnia-Herzegovina's membership in the Transport Community, and the signing of multimillion credit contracts with the EBRD) will be stuck within an account of the Central Bank of BiH. In fact, one could argue that this concern has already been realized– at a meeting of the ITA Board on March 22, 2018, representatives of the two entities failed to agree on a coefficient.[46]

Reform Agenda implementation – main developments	
Consolidation of budget at expense of low investment; at same time road toll fee revenues remain blocked	
Economically meaningful investments at State level blocked by RS resistance against even modest rise in state budget	
Compilation of public employment registries & employment reduction plans blocked	
Introduction of control measures for FBiH over cantonal spending blocked	
Work of FBiH tax authority, RS auditor seriously hampered by entity governments	
Risk of rise in budget expenditure in 2018 election year for campaign purposes	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

[45] Interview with EU official, Sarajevo, February 2018.
[46] Zakon o uplatama na jedinstveni račun raspodijeli prihoda, January 2018, available at: http://sllist.ba/glasnik/2017/broj91/broj091.pdf; "Nema saglasnosti u Upravnom odboru UIO za raspodjelu sredstava od cestarina," *Klix.ba*, March 22, 2018, available at: https://www.klix.ba/vijesti/bih/nema-saglasnosti-u-upravnom-odboru-uio-za-raspodjelu-sredstava-od-cestarina/180322117.

II.4. State-owned enterprises

State-owned enterprises (SOEs) have been correctly identified in the Reform Agenda as the second key element in BiH's inflated public sector (next to public sector/civil service employment), as well as a key political tool of the existing patronage system. SOEs, particularly the larger, more profitable ones, serve as cash cows for the ruling political elites. Non-transparent and badly managed, they suffer from politically-motivated overemployment and privileged wages and rights. At the same time, there exists a substantial number of *de facto* bankrupt companies, that entity governments have avoided liquidating over many years due to high financial obligation-debts, for example towards (former) employees many of whom cannot retire with a pension due to unpaid social contributions.

To address this issue, the Agenda foresaw the restructuring of SOEs by way of privatization, restructuring, or liquidation. In 2016, the Federation government agreed to let World Bank consultants screen all state-owned enterprises. The intention was to prepare for the subsequent restructuring of telecom companies, mines and the entity's railroad company. The RS government rejected a similar complete screening, and only agreed to cooperate with the World Bank on its railroad company. Towards the end of 2016, both entity governments adopted restructuring plans for their railroad companies, developed in cooperation with the World Bank, in line with Reform Agenda Action Plans deadlines.[47]

There was some progress in the area of State-owned enterprises in 2017, though these were typically limited and of a politically non-sensitive nature. The Federation government sold its minority shares in a number of companies, though only in a fraction of the companies foreseen in the Reform Agenda. Moreover, some of the sales proceeded in a nontransparent manner, with the involvement of offshore companies.[48] A crucial reform measure drafted in 2016, foreseen in the Agenda, passage of a Law on Linking Missing Years of Service, was given up entirely by the FBiH government in 2017. The law would have enabled the retirement of employees from non-viable SOEs by way of the government paying missing social contributions related to the years of 1992-2014, and would have subsequently allowed the companies to be liquidated. The government was, unsurprisingly, unable to secure the hundreds of millions of Euros necessary to implement the law. Instead, it shifted to regulating missing contribution payments on a rolling basis, only for employees that reached retirement age. This approach merely solves the problem for a few dozen employees per year, and falls far short of finding a solution for the tens of thousands of employees affected.[49]

In terms of the restructuring of the entity railway companies, in 2017 the FBiH government changed its plan and did not enter into an arrangement with the World Bank. Instead it started its own restructuring activities, leaving the process without external oversight. In the RS, implementation of the restructuring of the heavily indebted railway company did not start in 2017. It was only in December 2017, that the government signed a loan agreement of 51.3 Million Euro with the World Bank for restructuring the

[47] Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative. p.22.
[48] "Prodaja FDS-a poziv za investitore ili za istražne organe," N1, September 16, 2016, available at: http://ba.n1info.com/a113183/Vijesti/Vijesti/Prodaja-FDS-a-poziv-za-investitore-ili-za-istrazne-organe.html.
[49] Interview with BiH journalists.

company. Under the arrangement, the company's huge debt to the RS government was to be turned into equity. Simultaneously, the company was obliged to use part of the loan to finally pay its debts related to employees (unpaid allowances, social contributions et al.), totaling 42m EUR. Finally, by 2021, the company was required to reduce its current workforce of 3,100 employees by half, to be consistent with the World Bank's assessment of the size of overstaffing, and related record low work productivity. Most of the reduction, up to 1,000 staff members, is scheduled to take place in 2018. However, it remains to be seen whether the RS government is serious in undertaking such a decisive rationalization step, especially during an election year.[50]

The real political battle in 2017 was over the larger, more profitable public companies, specifically, the restructuring of the two telecom companies in the Federation, *BH Telekom* and *HT Mostar*. It was a battle in which the political resistance of the ruling elites prevailed – thanks to the support by the EU Delegation in Sarajevo. Under BiH's 2016 credit arrangement with the IMF, until October 2016 the Federation government was obliged to complete financial and operational due diligence for both companies, in cooperation with the IFIs.

However, it was not until spring 2017 that the IFIs reached a major breakthrough in negotiations with the FBiH government. The government agreed not only on due diligence for both companies, but even on the restructuring and privatization of the BH Telecom. All IFIs (World Bank, IMF, EBRD) were supportive of this move. BH Telecom is controlled by the SDA, and according to IFI's assessments - three times overstaffed. Nevertheless, Prime Minister Fadil Novalić, whose party, SDA, traditionally controls BH Telekom, was prepared to put his political career at risk for pushing through this major step of reform. Yet strong political resistance came from the leadership of the HDZ BiH, which controls HT Mostar. The leadership feared that the SDA Prime Minister's concession on BH Telekom would force the HDZ to give in on a real restructuring, and ultimately the (potential) privatization of HT Mostar. Consequently, the HDZ insisted that only the originally planned due diligence of both companies was to be undertaken. In the end, and much to the disdain of the IFIs, it was the intervention of the EU Delegation (EUD) to BiH, which sided with the HDZ BiH. This undermined and ultimately killed the privatization plan. As a result, not even due diligence was conducted in 2017.

Regarding the concrete issue of privatization, the EUD's intervention can be assessed differently. Restructuring of SOEs in the Western Balkans has always been controversial. The IFIs' regular insistence on privatization has often clashed with ruling elites' conduct of privatizing politically sensitive companies in a corrupt manner. Yet, it is the EUD's political motives and the results of its intervention that are crucial. It was the EUD's focus on getting the excise tax passed in March-April 2017 that led them to intervene. They feared that Novalić's efforts to move forward the telecoms issue could lead to the Prime Minister's fall and complicate the efforts made on the excise tax law front. Ironically, in April 2017, the EUD ended up empty-handed on both ends: it failed to get the excise tax adopted in the BiH Parliament and, at the same time, it had prevented a major reform that would have cut into the elites' patronage system, in a

[50] IMF Country Report No. 18/39; *Project appraisal document on a proposed loan in the amount of EUR 51.3 Million to BiH for a Republika Srpska railways restructuring project*, World Bank, November 14, 2017, available at: http://www.worldbank.org/projects/P161122?lang=en.

way the excise tax item never could.[51]

Reform Agenda implementation – main developments	
RS Railway company restructuring delayed, restructuring of other SOEs never accepted by entity government	
Sale of FBiH minority shares partly non-transparent	
Agreed privatization of BH Telecom stopped, conduct of due diligence blocked	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

II.5. Pension & Health Care System Reform

In both entities, the pension and health care systems are financially unsustainable due to the unfavorable ratio of contributors to beneficiaries. Furthermore, both systems, alongside social transfer payments to privileged groups like war veterans (especially in the Federation), have been turned into foundational elements of the existing patronage system. The Reform Agenda targeted only some of those elements, and the existing measures have either not yet been implemented, or they have been operationalized in in a manner that makes it questionable whether they will have any structural impact.

In terms of the reform of the health care system, the RS government promised to streamline its network of health care institutions, and thus substantially lower costs, by May 2016. However, the reform was not implemented in 2016 and has not been implemented since. Another measure expected to bring soaring costs under control was the introduction of the health care funds into the Federation treasury system in the health sector, but again this was never implemented despite the initial December 2015 deadline. At the same time, the issue of politically motivated over-employment in non-medical staff was entirely omitted from the Reform Agenda in the RS from the outset. In the Federation, the Agenda foresaw the streamlining of both the network of health care institutions and the ratio between medical and non-medical staff. This was to be completed in 2016 – neither measure has been implemented to date.[52]

In order to target non-needs-based social transfer payments to politically-favored social groups in the Federation, the Reform Agenda proposed the establishment of a centralized database system which would have the capacity to record all beneficiaries by November 2016. Despite the March 2017 Reform

[51] Information based on several interviews with IFIs and EU member states officials, 2017.
[52] Akcioni planovi za provedbu Reformske agende za sve nivoe vlasti, 2015; Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti, March 2017; IMF Country Report No. 18/39.

Agenda implementation report listing the measure as "completed" it has not been implemented, but was dropped entirely with a budget cap introduced instead.[53]

Regarding the reform of non-sustainable pension systems in BiH, the RS government completed the introduction of a voluntary pension fund towards the end of 2017, a year later than originally planned. The government introduced the public pension fund into the entity's treasury system, a measure that stabilized payment of pensions, but put an additional fiscal burden on the entity budget. With a ratio of 1.1 contributor to 1 beneficiary in 2016, the fund's expenditure remains far greater than its revenues, and the average pension rate remains at a level that is consistent with old age poverty. Nevertheless, in 2016 the RS government concluded that further reforms of the pension system were not necessary.[54]

In the Federation, pension system reforms were either blocked or distorted by the entrenched patronage interests of the ruling parties, most notably those of the HDZ BiH. The planned completion of the so-called 'third phase' of the audit of privileged veteran pensions presented yet another stumbling block. This was a measure that had been long resisted by the HDZ even before the introduction of the Reform Agenda, particularly in Western Herzegovina – a stronghold region of the party. The reform was ultimately dropped in 2017 due to the ruling party's resistance, indeed there were even political demands at the time by the HDZ BiH for an ethnic division of the Federation Veterans' Ministry.

A large number of cantons in the Federation have not paid social contributions to their employees for a period of several years. Included in this number are the cantons in Western Herzegovina. In 2017 the Western Herzegovina Canton resumed payment of social contributions into pension and health care funds after five years of non-payment – not as a result of the Reform Agenda, but because their citizens revolted.

In January 2018, after a one-year struggle, the Federation parliament finally adopted a new Law on Pension and Disability Insurance, aimed at making the pension system more transparent and financially sustainable. The reformed insurance was to be subsequently introduced into the treasury system. While the new law represents a certain improvement in terms of transparency and the discouragement of early retirement, the core aim of financial sustainability was missed due to entrenched political interests. In its original law draft, sent to parliament in February 2017, the government amended pensions to a new points system with a basic coefficient set to 1.36 points. However, had the law been adopted straightaway and the pension system brought under the treasury system from the beginning of 2017, this coefficient would have led to an unsustainable fiscal rise in pension costs. In actuality, the law was blocked in parliament by the HDZ, who demanded a much higher coefficient of 1.44. This demand was supported by the third coalition partner - the SBB. In the end, a "compromise" solution was found between the SDA, HDZ and SBB, which raised the coefficient to 1.4, and in addition introduced one-time pension rises of 5 to 10 percent for certain categories of pensioners, to be paid with the new system entering into force in

[53] Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti, March 2017; IMF Country Report No. 18/39.

[54] Interview with BH financial expert, Sarajevo, 2017, Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlasti, March 2017; "Evropski dobrovoljni penzijski fond počeo sa radom u Srpskoj," *Blic*, November 30, 2017, available at: https://www.blic.rs/vesti/republika-srpska/evropski-dobrovoljni-penzijski-fond-poceo-sa-radom-u-srpskoj/sv7hr7c.

April 2018. The government gave conflicting indications of the fiscal effect of the new pension law and at the same time postponed the introduction of the pension system into the treasury for two years, i.e. April 2020.[55]

Reform Agenda implementation – main developments	
Real impact of FBiH pension system reform remains unclear	
RS government decided no further reform of pension system needed	
Rationalization of entity health systems staff structure & network of health care institutions not implemented	
Completion of audit of veteran pensions politically blocked, and ultimately dropped	
FBiH database on social transfer payments not established, and ultimately dropped	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

II.6. Public Administration Reform

The oversized and costly public administration, staffed based on party affiliation rather than competence, has long formed one of the core features of BiH's patronage system and of the dysfunctional and fragmented institutional system. Public Administration Reform (PAR) - elusive for years - was therefore made one of the areas targeted by the Reform Agenda.

Structural reforms, however, have not occurred and there seems little chance of their achievement in the near future. In 2016 the World Bank was tasked with drafting a screening report on reform efforts undertaken in the post-war period. While the World Bank's findings and recommendations have not been made public, they have had no obvious impact so far. EU and IFI representatives agree that nothing has been achieved in terms of PAR within the Reform Agenda framework.[56]

It was an obligation for BiH authorities to draft and approve a new public administration reform strategy by the end of 2016, which would cover the period 2017-20. A working group was formed in 2016, but at the time of writing (spring 2018) there is still no strategy compiled. In the absence of a new strategy, authorities agreed in 2015 to continue implementing the previous strategy (2006-14) that had expired in

[55] Interviews with financial experts and journalists, Sarajevo 2017; *Prijedlog Zakona o penzijskom I invalidskom osiguranju*, February 2017, available at: http://www.parlamentfbih.gov.ba/dom_naroda/v2/userfiles/file/Materijali u proceduri_2017/Prijedlog Zakona o penzijskom i invalidskom osiguranju-BOSANSKI JEZIK.pdf; *Zakon o penzijskom I invalidskom osiguranju*, available at: http://www.parlamentfbih.gov.ba/dom_naroda/v2/userfiles/file/Materijali u proceduri_2017/Prijedlog zakona PIO_261017_bos.pdf.

[56] Interviews with IFI and EU officials, Sarajevo-Brussels 2017.

2014 but had only been partly implemented by then. Analysis shows that implementation of the previous strategy avoided tackling the structural problems.[57] Unsurprisingly, by the end of 2017, of the 16 Million EUR provided by international donors for implementing the previous strategy, contracts for projects in total valuing only half of the funds had been signed. Moreover, only one out of 29 projects was completed by then. In 2017, implementation of the remaining 'old strategy' measures was close to zero.[58]

Authorities in BiH, on all levels of governance, continued trying to circumvent the moratorium on new employment in the public sector (introduced in 2015 as one of the Agenda measures) through contract-for-service employment. While the public wage bill freeze (also introduced in 2015) continued to be respected, political resistance towards the development of public employment registries, with which the World Bank had been tasked, killed any plans for substantial reduction in employment in public administrations within the Reform Agenda timeframe.[59]

In the post-war era, human resource management remained the area of PAR where there has been least effect since the beginning of the reforms. In 2017 the Federation government cooperated with civil society organizations to prepare legislation for a more transparent hiring system. However, as the legislation was included as part of the Labor Law amendments, which entered into the entity parliament in February 2017, the legislation got stuck due to inner-coalition conflict over another measure included in the amendment, targeting illegal employment (see sub-section on labor market above).[60]

Reform Agenda implementation – main developments	
2017-20 Public administration reform strategy still not drafted & approved by April 2018	
No measures to end political employment in public administration adopted	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for a (social) market economy fulfilled	No

[57] *The Principles of Public Administration: Bosnia and Herzegovina*, SIGMA, November 2017, available at: http://www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf.
[58] Ured za reviziju institucija BiH, *Efikasnost pripreme projekata reforme javne uprave u BiH*, Sarajevo, December 2017, available at: http://www.revizija.gov.ba/revizioni_izvjestaji/revizija_ucinka/Izvjastaji2017/?id=5741; PARCO BiH, *Polugodišnji izvještaj o napretku, januar-juni 2017*, July 2017, available at: http://parco.gov.ba/wp-content/uploads/2017/10/Polugodi%C5%A1nji-izvje%C5%A1taj-o-napretku-2017.-1.pdf.
[59] *Appointment and Recruitment in the Public Sector in Bosnia and Herzegovina. Monitoring Report 3*, Centri Civilnih Inicijativa BiH, December 2017, available at: http://www.sposobnimanepodobnim.ba/file/download/274/390; interview with IFIs official, Sarajevo 2017.
[60] *Appointment and Recruitment in the Public Sector in Bosnia and Herzegovina. Monitoring Report 3*; for more details on the Labor Law amendment, see sub-section on labor market.

II.7. Rule of law - Including the Fight Against Corruption

The structural socio-economic reforms covered by the Reform Agenda could never be successfully implemented without functioning rule of law in BiH. Prioritizing the strengthening of the rule of law as a key part of the Agenda was thus imperative. The need became all the more significant as, over the last decade, political elites have systematically dismantled the international community's achievements in strengthening the independence of the judiciary and democratic policing. This has routinely been facilitated by the EU's willingness to compromise on the elites' attacks on the constitutional order and the rule of law institutions. Nevertheless, rule of law was the area in which the Agenda, along with its accompanying actions plans, aimed the lowest. Subsequently, planned measures have been entirely ineffective in strengthening the rule of law, and some of the planned measures have not been implemented at all and in some cases abandoned completely.

Adoption of a new country-wide Justice Sector Reform Strategy for 2014-18 occurred only in September 2015. This was only after the EU pressed the other stakeholders involved in the drafting process to give in to a RS government demand (its approval was conditional on acceptance of a specific wording into the strategy).[61] Adoption of the strategy's action plan didn't occur until March 2017, much later than the timeframe planned to cover the strategy. As the most important measure, the Reform Agenda planned the introduction of commercial courts in the Federation. Commercial courts currently existed only in the RS, however against the backdrop of a heavily politicized judiciary, the courts do not function well. A World Bank feasibility study, published in December 2016, subsequently recommended that commercial courts should not be established in the FBiH, and to instead strengthen the existing commercial departments of regular courts. No such measures have been undertaken since, and the poor functioning of the commercial courts in the RS has remained outside the remit of the Agenda.

Meanwhile, the RS government has decided to establish two more commercial courts in the entity, a decision made without any coordination with the High Judicial and Prosecutorial Council of BiH (HJPC). This is considered an illegal attack on the HJPC's authority over the management of the judicial system of the country, consistent with the RS regime's decade-old undermining of state-level judicial institutions.[62]

On a different issue, transformation of the appellate chamber of the Court of BiH into a separate court through the adoption of a Law on Courts of BiH, too, the RS government in 2017 continued its long-term attempt to undermine the state-level judiciary, and supported by the HDZ BiH (who heads the BiH Ministry of Justice). The RS government's attempt to use the debate on court transformation to diminish the jurisdiction of the Court of BiH has been a constant cause of friction with the European Commission and between BiH authorities from 2013 onwards. This debate has taken place within the framework of the EU's ill-designed Structured Dialogue on Justice, established in 2011 to appease the RS leader Milorad

[61] On the details, see: *Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative*, p. 27.
[62] *Akcioni planovi za provedbu Reformske agende za sve nivoe vlasti*, 2015*; Improving Commercial Case Management in the Federation of Bosnia and Herzegovina. Feasibility Study*, World Bank December 2016; interviews with BiH judiciary officials, Sarajevo, 2017.

Dodik, who threatened with secession of the entity from BiH.[63] The RS-HDZ BiH attempt to use the Appellate Court issue to advance their own interests continued in 2017, and ultimately led to the escalation of a conflict with the European Commission. A justice ministers meeting took place on July 20th 2017 in the framework of the Structured Dialogue on Justice in Banja Luka. The EC delegation, headed by DG NEAR Western Balkans director Genoveva Ruiz Calavera, agreed with the ministers that BiH authorities would produce a draft Law on Courts of BiH that was to be based on the 2016 recommendations by EU legal experts. However, in a follow-up letter to Calavera, BiH Justice Minister Josip Grubeša attached a draft law that mirrored the RS-HDZ intentions, inconsistent with what had been agreed at the July meeting. In a letter to Grubeša dated August 4, 2018, Calavera, in an uncharacteristically blunt statement, noted that the agreed task i.e. to transpose the core principles of the EU acquis into a draft law text, "encounters difficulties which are of political rather than legal nature. Hence political responsibility has to be assumed by those not working constructively towards a satisfactory solution."

In response, Calavera announced:

> "In the absence of necessary political determination by the sides, the European Commission does not see it appropriate at this stage to continue the facilitation of the discussions on the criminal jurisdiction of the BiH Court which has entailed to date substantial use of EU tax payers' money for the development of expertise."[64]

EC withdrawal from work on the Law on Court of BiH, arguably *the* core measure discussed within the Structured Dialogue on Justice, was the Commission's first consequential step within this context, signaling an implicit recognition of the failure of the Structured Dialogue. Nevertheless, to date the EC has refrained from commenting on the impact of this decision on the future of the Structured Dialogue.[65] There has been no public discourse on this development by the EC and it was not mentioned in the Commission's 2018 Bosnia and Herzegovina report.[66]

Throughout 2017 a number of measures aimed at fighting corruption were introduced, however, they proved to have zero impact. This has much to do with the fact that the BiH's judiciary and police continue to have a record of no sustained convictions in cases of high-level corruption. Implementation of a FBiH Law on Suppression of Corruption and Organized Crime, adopted by the previous ruling coalition in the Federation in 2014, continues to be delayed. Finally, at the beginning of 2017, Prime Minister Novalić announced the establishment of a special department for the fight against high-level organized crime and corruption cases at the entity's Supreme Court and Federal Prosecutor's office. Alongside this announcement, the government provided 5 Million KM for capital investment, yet planning for the necessary office space only started in December 2017. Due to the non-implementation of the law, the FBiH judiciary has, since 2014, essentially suspended its work on high-level cases of corruption and

[63] *Substantial Change on the Horizon?*, p.27.
[64] Letter by DG NEAR Western Balkans Director, Genoveva Ruiz Calavera, to Minister of Justice of BiH, Josip Grubeša, Brussels, August 4, 2017.
[65] Interview with EU member state official, November 2017.
[66] European Commission, *Bosnia and Herzegovina 2018 Report*.

organized crimes.[67] In the RS, the heavily politicized judiciary has remained unchanged. Within the Reform Agenda, no measures had been foreseen to tackle the structural problems of the entity judiciary.

Reform Agenda implementation – main developments	
Introduction of commercial courts in FBiH dropped; proposed alternative measures to strengthen *existing* courts have not been implemented	
Measures targeted at the dysfunctional commercial courts in the RS never included in the RA	
Establishment of special court/prosecution departments on organized crime & corruption in FBiH has not happened since 2015	
RS government continues to undermine State level judiciary	
Prospects for success/failure of the Reform Agenda by December 2018	
Full implementation of Reform Agenda measures	No
Foundations of the patronage system destroyed	No
Conditions for (social) market economy fulfilled	No

II.8. The IMF Credit Arrangement

As the previous DPC monitoring report concluded,[68] the International Financial Institutions' (IFIs) core role in drafting and implementing the Reform Agenda was crucial for pushing the BiH authorities to move on reforms. It was this success that decisively contributed to the 2016 breakthrough, which enabled the EU to approve BiH's next step in integration. This happened in parallel to the International Monetary Fund's conclusion of a three-year loan, the Extended Facility Fund (EFF) with BiH authorities, and the payment of the first credit tranche in September 2016. The EU agreed to move handling of most areas of the Reform Agenda over to the IFIs. First, because it included many items on which the IFIs had been engaged in BiH for many years, and second, because the IFIs had tools at their disposal that the EU did not (i.e. the Agenda encompassed many issues that the EU would normally deal with within the accession negotiations framework). This included clear benchmarks for a conditionality-based policy on structural socio-economic reform.

It was first and foremost the IMF, with its 550 Million Euro credit to BiH, that could be convinced to adopt a policy of strict financial conditionality, coupled with clear public (and non-public) messaging by its representatives, aimed at supporting the Reform Agenda and in close cooperation with the EU and the other IFIs – a real exception considering the standard operating mode of the IMF. This happened only as a result of heavy advocacy by EU member states leading on the EU BiH initiative. It was the IMF's leverage of financial conditionality that led to the first results in 2016 and saw the ruling elites yield on certain

[67] *Akcioni Plan za Realizaciju Reformske Agende Bosne i Herzegovina za Sve Nivoe Vlast*i, March 2017, interviews with BiH judiciary officials, Sarajevo, 2017.
[68] *Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative*, pp.31-33.

structural reform demands. An illustrative example was the RS regime's surrender on steps toward reforming part of the entity's banking system, which (potentially) entailed the removal of the regime's financial tools which it used to exert substantial control over the private economic sector – an unprecedented change when one considers the last decade.

However, in parallel with the breakdown of the implementation of the broader Reform Agenda (following the EU's September 2016 concessions to BiH), the implementation of the EFF conditions also broke down. This change of dynamics culminated in the IMF compromising on reforms in BiH, and ultimately in surrendering on its policy of tough financial conditionality, under pressure from EU institutions.

Following the conclusion of the EFF and payment of the first credit tranche of 75 Million Euro in September 2016, the first review of the EFF was scheduled for December of the same year. This was to be followed by the payment of the second tranche of, again, 75m Euro. However, while some of the benchmarks were more-or-less met on time - such as the adoption of entity and state-level budgets for 2017 and new entity laws on banks and on banking surveillance agencies - key conditions – such as the adoption of a state-level law on excise tax and regulations on deposit insurances in banks, plus the conduct of due diligence for the two Federation telecoms companies – remained unimplemented.

The EFF arrangement had defined 24 benchmarks, only six of which were to be implemented in 2017 (two by March and four by June 2017). Of the remaining 18 benchmarks, four were to be implemented continuously, while the remaining 14 had a deadline set as the end of 2016. Predictably, only a small number of these 18 benchmarks had been met by the end of 2016. As most benchmarks related to state-level and Federation measures, they were blocked due to intra-coalition conflict and political resistance, and the RS government was able to claim it had fulfilled its obligations. While it is true that the RS-side had met a larger proportion of their benchmarks, the RS government was capitalizing on the political disputes of the other entity to avoid progressing in politically harmful reforms. With no real progress in sight, during summer of 2017 the IFI officials admitted that the EFF was effectively defunct and that it was only because of a formal technicality that it could not be terminated. The Fund would continue to run until 2019 without any further credit payments being made.[69]

Contrary to these predictions, however, developments took a different course. In the fall of 2017, as noted above a new international push for the adoption of the excise tax law package was launched. EU institution representatives started to exert massive pressure on the IMF to abandon its tough conditionality policy, and ultimately managed to get the IMF headquarters on their side. IMF officials subsequently announced a set of conditions necessary to fulfill in order to conclude the first review and pay out of the second credit tranche, which meant a substantial lowering of conditionality: the "new" conditions simply included adoption of the excise tax law and of a law on deposits, and the signing of a contract with an international consultant for due diligence of the FBIH telecoms (that is only the preparation of the conduct of due diligence, not its conduct as such).[70]

[69] IMF Country Report No. 16/291, September 2016; interviews with IFIs and EU member states officials, 2017; "Parodi: Bez povećanja akciza nema tranše od 155 miliona maraka," *Capital.ba*, December 9, 2016, available at: http://www.capital.ba/parodi-bez-povecanja-akciza-nema-transe-od-155-miliona-maraka/.
[70] Interviews with IFIs and EU member states officials, 2017.

Following the adoption of the excise tax law package in mid-December 2017, IMF officials from Washington immediately visited BiH to prepare the first review. As part of the retreat from stringent conditionality, the previous key condition on adoption of the deposit law was abandoned. Instead adoption of 2018 budgets were reintroduced. In February 2018 the first review was concluded and payment of the second credit tranche, 6 months ahead of general elections in BiH, was approved. The IMF agreed on the BiH authorities' terms of renegotiating the EFF. The IMF staff report on initial progress[71] mentions that the "first review of EEF has been delayed by a year," citing non-passage of the excise tax law package as an important reason. The report insists economic performance indicators for BiH were solid and since September 2016 there had been progress on the structural benchmarks, "though several are delayed because of technical or capacity reasons."

Further into the report, however, the authors recognize that out of the 24 benchmarks, only 10(!) had been met by February 2018. The adapted EFF arrangement reveals the extent of the compromise made on the previous policy of tough conditionality aimed at structural reform measures. Implementation of those reform measures would have profoundly undermined the foundations of the political elites' patronage system. The IMF agreed to extend the EFF by a full year, thus basically substituting the year that had been lost 2017 in implementing the loan-related reform measures, and due to political elites' continuous blockage of this reforms. Deadlines for all unmet benchmarks were extended, some beyond the timeframe of the Reform Agenda's 2018 remit. The report cites mostly "technical" reasons for the non-implementation of core measures instead of the real, political reasons for reform blockage. Finally, the IMF agreed to drop some of the highly-sensitive benchmarks. They added seven important new structural benchmarks aimed at guaranteeing future fiscal stability. However, when asked about prospects for the implementation of reforms in 2018, EU member states and IFIs officials admit that they expect no progress to be made during the election campaign year – "everything will be stalled, just like during 2017."[72]

III. The Questionnaire and the Coordination Mechanism

In Sarajevo, on December 9, 2016, Enlargement Commissioner Johannes Hahn handed over the so-called "Questionnaire" to the Chair of the BiH Council of Ministers, Denis Zvizdić. The BiH authorities were expected to provide answers to more than 3000 questions, which would elucidate the current state of the political system, state institutions and the economy in BiH. After provision of the initial answers, a follow-up of several hundred more questions would be submitted to authorities. The complete set of answers serves as the main basis for the Commission to prepare an "Opinion" upon whether BiH has the necessary capacities to meet the Copenhagen criteria for EU membership. A positive "Opinion" is the basis for granting candidate status, which would then be followed by the next step of opening accession negotiations.

As examined in this paper, as well as the previous DPC monitoring report, the decision to deliver the

[71] IMF Country Report No. 18/39, January 29, 2018.
[72] IMF Country Report No. 18/39, interviews with EU member states and IFIs officials, March 2018.

Questionnaire was preceded by major EU concessions to BiH. This included the communication by high-level EU officials to political leaders in BiH in early 2016 that they could submit BH's membership application. Similarly, the September 2016 GAC-decision to forward the application to the Commission in order to have them prepare an Opinion – a submission that was based more on hope for the BiH authorities' future implementation of the Reform Agenda than on the measures realized by that time.

The answers given by the BiH authorities' to the large number of questions was to be the test run for the new internal "coordination mechanism," which after much delay, was agreed among governments on State and entity levels in August 2016. The mechanism aimed to get BiH to "speak with one voice" in its communication with the EU, establishing a hierarchy of several coordinating bodies. This included thematic working groups at the lowest level and the Collegium for European Integration at the top; all bodies consist of representatives of executives from all governance levels – state, entities, cantons and the Brčko District. Decisions were to be taken by consensus. A system of consensus represented a major breakthrough for the RS Dodik regime and Croat ethnic ruling party in terms of their long-term objectives to change the nature of the BiH state, and essentially undermine the constitutional order. They aim at moving towards a system of increased ethno-territorialization that puts entities and cantons on a par with the State. The move was supported by the EU, which was eager to get *any* deal agreed on the coordination mechanism, irrespective of its efficacy.[73]

Alongside the Questionnaire, Commission officials provided basic methodological instructions to BiH authorities. Questionnaire answers should be merely descriptive and avoid judgements or opinions. Conversely, BiH authorities at the various different levels of governance were expected to submit collectively agreed answers. In cases of political disagreement, rather than providing separate answers from different levels of governance, the Commission expected them merely to note "we don't agree on an answer."[74]

In its Questionnaire the Commission set the end of May 2017, a date six months ahead, as an "indicative date" to receive BiH's replies. This timeframe revealed the Commission's limited trust in the BiH authorities' capacity to process the set of questions within a reasonable period. This timeframe was twice as long as that given to the last recipient of a Questionnaire, Serbia, and longer than it had taken any previous country to provide its answers (four months). From the outset, the resulting process proved even more inefficient than anticipated. At the December 2016 delivery of the Questionnaire in Sarajevo, the Council of Ministers' Chair, Zvizdić, requested to Commissioner Hahn that the Commission send its experts to sit in on all coordination mechanism bodies to coordinate the work of BiH authorities on the answers. The move demonstrated Zvizdić's low expectations and threatened to make a mockery of the whole process. The request was promptly rejected by the Hahn. The process of setting up the coordination mechanisms and starting work on the answers had already outlasted the EC's original deadline. The working groups were finally established in March 2017. The Directorate for European Integration of BiH (DEI BiH) was appointed the lead institution, charged with coordinating the process of compiling and

[73] *Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative*, pp.31-33; see also introduction to section I on Reform Agenda of this paper.
[74] Interviews with EC and CoM of BiH officials, Sarajevo and Brussels, 2017-18.

agreeing on the answers. The Directorate set up a software system that provided a platform for institutions at all governance levels to add their contributions and to have full access to all other stakeholders' answers. However, work on agreeing joint answers did not start until the summer 2017 when the RS government ended its refusal to enter its contributions into the database, citing alleged fears that "Sarajevo" would edit or change its answers.[75]

Unlike what the Commission's had originally envisioned, procedures evolved and became distorted as time passed. The Council of Ministers rejected to adopt the "we don't have a joint answer"-approach, instead encouraging joint answers on as many questions as possible. As a CoM official contended, adopting the approach suggested by the Commission from the outset would have resulted in half of the questions being submitted without joint answers. Unlike the EC guidelines, once answers were posted on the software platform, all of the executives started to comment on the contribution of the others. The EU Delegation to BiH was the main contact point for technical assistance on the Questionnaire for BiH authorities. Its involvement further complicated the process. For example, there was a rotation in the position of the presidents of the working groups, introduced after a proposal made by EU Head of Delegation, Lars Gunnar Wigemark. This had the unintended result of causing poor continuity in the work of the groups. In addition, the EUD further muddied the waters by pressing for the inclusion of RS government officials in BiH meetings with EU officials, despite the DEI BiH being the country's single point of contact for communication with the EU.[76]

The ruling BiH political parties' political clashes over the last decade on the constitutional and political system of BiH was echoed in their ability to agree on joint answers in the Questionnaire. This has informed the endeavor more than the positive fact that in the end, and after a historically long process, they managed to reach agreement on all answers. The RS government adopted its traditional usurpatory approach to the State. Their officials entered meetings with non-negotiable RS government conclusions that they insisted had to be the "starting point of coordination." The RS government also demanded to provide its own answers, not only to questions related to the RS, but on all questions related to state-level institutions and competences. Further, the RS allowed no comments from other BiH authorities on its own contributions.

According to CoM officials, there were some answers submitted by the RS relating to the state-level that were of better quality than the ones provided by State institutions, which resulted in the RS's submissions being accepted as BiH's official answers. Other answers were in clear violation of the BiH Constitution. Unlike the RS, the HDZ BiH did not insist in giving separate answers to State-level or Federation-related questions. Instead the HDZ BiH concentrated their energies on putting cantons on par with the Federation (and the State). The party's representatives within the coordination mechanism focused their political attentions almost exclusively on the Federation Ministry of Education and Science. Since 2010, when the FBiH Constitutional Court ruled that the ministry's competences were not in line with the entity

[75] This was despite the fact that Serbs headed 11 out of the overall 16 working groups, partly as representatives of the RS government, partly as representatives of the CoM of BiH. Interview with CoM official, 2017; interviews with EC and CoM of BiH officials, Sarajevo and Brussels, 2017-18.
[76] Interviews with EC and CoM of BiH officials, Sarajevo and Brussels, 2017-18.

constitution, the HDZ has insisted on the abolishment of the ministry. Yet to date, the Ministry has neither been abolished nor the Court's ruling implemented. In the negotiations over the related chapters of the Questionnaire, HDZ officials insisted that not only should the answers provided by the Ministry not be accepted, but the Ministry's existence should be omitted from the answers entirely. This measure was in direct conflict to the EC principles, as the answers were to describe the current status of state institutions, which also included the existing Federation government ministries. Bosniak party representatives, on the other side, occasionally used the coordination mechanism procedures to fight the existence of the RS. This led to a situation where, for example, Bosniak representatives insisted the RS be excluded from the answer to a question on child protection, even though the institution of an ombudsmen for child protection in BiH currently exists only in the RS.[77]

As the more technical elements of the process of compiling the Questionnaire answers neared its end in late fall 2017, the real political disputes came to the forefront. In November 2017 95 percent of the answers had been completed. Of the remaining 165 questions, some 80 were of a technical nature. The political dispute was focused around approximately 60 of the outstanding questions. The majority covered areas such as the fight against terrorism, finance, economic statistics and the management of EU funds. The disputes tended to be initiated by the RS government's position. Surprisingly, the entity government, by and large, did not dispute the factual existence of State-level institutions, which it had for years opposed. There were notable disputes between the RS government and Serb representatives in the Council of Ministers of BiH. Another major disagreement involved the HDZ's attack on the FBiH Education Ministry. Further, the three members of the State Presidency of BiH, remained in a stalemate for months on whether the Presidency represented the "head of state."

In December 2017 the coordination mechanism's highest-level body, the Collegium for European Integration, met for the first time to find a solution on the remaining 60 questions. The most contentious struggle during the meeting involved the FBiH Education Ministry. In the end, a compromise was reached which served the interests of the HDZ BiH most greatly: The party leadership conceded on listing the Ministry among the entity government's institutions, and in return all of the Education Ministry's contributions to the Questionnaire answers were omitted.

During the meeting the disagreement over the results of the 2013 census – a source of significant conflict - was resolved between the state-level and the RS government. Back in 2016 the conflict between the CoM and the RS government over the census results, i.e. over the number of BH citizens residing in the RS, concluded with the BiH Statistics Agency publishing its census results, which were later accepted by the EU. The RS rejected the official BiH census data and has used its own data in entity statistics. Due to the associated difficulties of the RS government and the State using different data sets, the decision was made to include both statistics in the responses to five questions that related to population numbers – as they referred to economic statistics officially in use in the RS, and thus based on the RS government's number of citizens in the entity. Finally, the BiH Presidency members agreed on their institution representing the head of state.[78]

[77] Interviews with CoM of BiH officials, Sarajevo, 2017-18.
[78] Interviews with CoM of BiH officials, Sarajevo, 2017-18.

Despite the participants' success in agreeing on most open questions, the December 2017 meeting still left seven questions unresolved. One of those questions related to the management of IPA (the Instrument for Pre-accession Assistance) funds, a long-time conflicting issue originating from the RS's usurpatory view on the state. Other issues were related to missing persons and of the fight against terrorism. In both cases, the dispute revolved around the competences of state-level and entity-level institutions as well as the competing, ideologized judgements of the different parties. It took two rounds of meetings between political leaders in January and February 2018 to reach compromises for these last disputed items. On February 28, 2018, during the visit of Commission President Jean-Claude Juncker, Enlargement Commissioner Hahn and the EU's High Commissioner for Foreign and Security Policy, Frederica Mogherini, CoM Chair Denis Zvizdić and the President of the Presidency of BiH, Dragan Čović, officially submitted the answers to the EU – a full 14 months after receiving the Questionnaire.[79]

While the ruling parties' representatives' political infights within the coordination mechanism framework took place behind closed doors, their leaders were engaged in an intensive public spin about a potential date for BiH submitting its Questionnaire answers and, more significantly, for receiving candidate status. HDZ BiH leader and BiH Presidency member Dragan Čović stood out in this public relations farce. In its internal EU integration masterplan of end of 2016, the Presidency planned to submit the first and second round of the answers to the EC for March and May 2017 respectively. Ambitiously, the Presidency aimed at a deadline of December 2017 to obtain not only the Commission Opinion, but candidate status as well.

As the internal BiH process was further complicated, Čović moved the candidate status date in his announcements. In November 2017 he insisted that it would be granted by April 2018. When announcing the handover of the answers in December, he later insisted that BiH would receive candidate status by the end of 2018. It was clear by December that BiH authorities would not complete the answers by the end of 2017. At this point, Čović, who held the rotating office of President of the BiH Presidency until end of February 2018, resorted to desperate measures. On December 4, 2017 at a closed meeting between the BiH Presidency and the EC Enlargement Commissioner in Sarajevo, Čović told Hahn that he knew BiH authorities had not "done their homework," but begged him to persuade the EC to nevertheless grant BiH candidate status – prior to March 2018, and thus within his mandate as President of the Presidency. At the end of his one-day visit, Hahn gave a press conference. Though visibly annoyed, he did not reveal the details of his Presidency meeting. Instead he stated that, in relation to the country's EU integration process, "there is no such thing as a free lunch." Despite the open rejection Čović's desperate appeal, two days later on December 6, Josip Brkić (Čović's highest ranking Croat in the Ministry of foreign affairs of BiH) visited Brussels. At as closed meeting with EU member states' representatives, he told the present European diplomats not to dare send a second round of questions – a completely unrealistic demand, but fully in line with Čović' frantic actions. At the turn of the year, Čović finally admitted publicly that candidate status was out of reach for 2018.[80]

[79] Interviews with CoM of BiH officials, Sarajevo, 2017-18; "Zvizdić i Čović predali Upitnik Junckeru," *N1*, February 28, 2018, available at: http://ba.n1info.com/a246050/Vijesti/Vijesti/Zvizdic-i-Covic-predali-Upitnik-Junckeru.html.
[80] *Master Plan procesa integriranja Bosne in Hercegovine u Europsku Uniju*, BH Presidency, September 2016; interviews with EU officials and member states diplomats, Sarajevo and Brussels, 2017; recording of the Hahn December 4, 2017 press statement, provided by the EUD to BiH.

Despite the questionnaire drama that paralleled the 2017 Reform Agenda implementation blockage, EC officials insist that the process was a positive and progressive endeavor. Officials stressed that because authorities eventually managed to compile the answers and have tens of thousands of pages translated into English, the Commission will now have the current state of BiH comprehensively documented,[81] and can utilize this to work on BiH's further EU integration process. However, this assumption has several flaws. First, if the purpose of the Questionnaire was around BiH authorities demonstrating their capacity to achieve the Copenhagen criteria in the future, then the fact that there was a 14-month, long-delayed process of compiling the answers is as important as the content of the answers themselves. Second, the credibility of the answers, in terms of providing a comprehensive picture of BiH state and economy, is questionable. The DEI of BiH has no capacities to verify whether the data provided by the various levels of governance to the answers is correct. The EC intends to double-check and triangulate data with other sources available to the Commission, but it is unlikely this will be a sufficient basis to vet all of the information. Finally, many of the answers do not reflect the current circumstances of state institutions, politics and economy, but are instead the product of situational compromises between the multitude of actors involved in the obligatory consent-based decision-making process involved in answering the questions. As a CoM official noted, "there is a lot of childishness in the answers, which is the result of political compromise."[82]

Next Steps, Constitutional Reform

In the absence of answers to the Questionnaire, there was no basis for the European Commission to make any practical measures of planning, let alone to take decisions on the next steps in BiH's EU integration process – on the content of the EC's Opinion, its recommendations regarding granting of candidate status, and the subsequent opening of accession negotiations.

One official explained that there are basically two options for the Commission regarding the Opinion: The first, known as 'the Montenegro scenario' entails the EC giving a positive Opinion and recommending the granting of candidate status. This step would most likely be followed by setting conditions for the subsequent phase, i.e. the opening of accession negotiations. The second would involve the EC providing no recommendation, but setting a number of benchmarks and conditions to be implemented before the EU decides on the candidate status. This has only once applied before, in the case of Albania. Most EU officials interviewed consider the Albania scenario the most likely. Both scenarios would demand the EC to strategically envisage a set of conditions for granting the next step(s) in EU integration. The fundamental issues that came up in discussions with the author were the outstanding, non-implemented parts of the Reform Agenda on the one side, and institutional-constitutional reform issues on the other.[83]

While there is some initial thinking taking place within the EU regarding a strategic approach to BiH that

[81] The English version of BiH's answers to the EC Questionnaire is available at: http://dei.gov.ba/dei/direkcija/sektor_strategija/Upitnik/odgovoriupitnik/Archive.aspx?pageIndex=1&langTag=en-US.
[82] Interviews with European Commission and CoM of BiH officials, Brussels-Sarajevo 2017-18.
[83] Interviews with EC and member states officials, 2017.

incorporates the remaining steps in EU integration, no serious work on policy strategy is currently underway. Contrary to a lackadaisical approach, this should be regarded as an urgent venture, not least because internal EU conflicts over BiH's constitutional matters have already emerged in 2017. As Bosnia and Herzegovina's EU integration process entered a new stage with the EU 2016 decision, which asked the EC to start working on an Opinion, the Commission has started to consider BiH more meaningfully in matters related to the EU's acquis, including constitutional matters. This resulted in a serious conflict between Croatia, acting as a *de facto* uncritical supporter of the leading Bosnian Croat party, HDZ BiH, and the rest of the EU. The Commission had insisted that BiH's constitutional system does not guarantee one of the core principles enshrined in the acquis – the equality of citizens. In July 2017, at a COREPER meeting in Brussels ahead of the Second Stabilization and Association (SAA) Council meeting between BiH and the EU, Croatia forcefully resisted mentioning "equality of citizens" in the joint EU SAA meeting position of the Commission and the member states. Instead, Zagreb insisted on inserting the term "equality of constituent peoples." This position, consistent with certain Croatian ethnonationalistic views on BiH, meant a *de facto* rejection of the acquis. It placed Zagreb against the rest of the member states, including many not normally proactive on the Western Balkans. The Croatian government ultimately backed down, but only after the lack of member states' consent had threatened the holding of the meeting with BiH – which would have been a first in the EU's enlargement policy history. The conflict has since continued.[84]

IV. Causes of the Failure of the EU BiH Initiative, and the Attitudes Towards It

When the German and U.K. foreign offices put together their German-British Bosnia initiative (which was later adopted by the EU as its new BiH initiative) starting at the end of 2014, they insisted that their proposed policy deviated substantially from the EU's previous, failed policy, in place since 2007, towards the Western Balkan state. The authors of the initiative maintained that the new approach would focus on structural socio-economic issues, leaving aside politically sensitive issues. This would, first and foremost, avoid constitutional reform, a measure that had allegedly proven to be "intractable" for a number of years. This approach was intended to unblock the reform deadlock and help the European integration processes progress.

The motivation for this new approach contained a rationalization aimed at disguising the EU's role in turning politically sensitive issues into intractable ones. Nevertheless, if followed through vigorously, the new initiative, particularly the Reform Agenda, could potentially have dismantled the country's patronage system, and thus created important preconditions for tackling constitutional reform issues. However, as the analysis presented in this paper has demonstrated, the new approach did not work – despite EU officials' repeated claims of success. In fact, the current performance of EU officials and institutions towards and within BiH resembles that of the period before 2014, when the failure of the previous EU policy was initially recognized. It seems clear that most of the energy of EU officials is currently focused on maintaining a semblance of process and progress, while in private many EU and member states officials recognize that the initiative has in fact failed.

[84] Interviews with EC and member states officials, 2017.

It is thus worth to analyze the five main causes of failure, including some explanations provided by the EU and other international officials involved in the initiative.

1. Too Broad an Agenda

Certain EU and member state officials argued that the Reform Agenda was, from the start, too broad. They claimed that this made it difficult for the EU and lead member states to operationalize the initiative and keep focused.[85] There is certainly some truth to this argument. Having a reform agenda with dozens of measures certainly made it easier for EU institutions to evade a policy of tough conditionality, as the EU Delegation's strong opposition towards the German-British push for focus on a small number of reform issues at the end of 2016 suggested. However, this alone is not a sufficient explanation. Even the broad Agenda, with its large number of reform measures, had clear benchmarks and deadlines that provided an adequate structure for a policy of tough conditionality.

Such a conditionality-based approach would, however, have required the EU to use the incentives of BiH's EU integration as a means to incentivize domestic actors to implement those precisely defined reform measures and deadlines when the Reform Agenda was adopted in July 2015. Instead, in 2014 the EU in advance softened its proposed conditionality when it accepted the German-British initiative. It lowered the conditions for granting the ultimate reward in EU integration - the forwarding of BiH's membership application to the Commission for preparation of an Opinion -from full implementation of the Reform Agenda to "meaningful progress" – a synonym for soft conditionality in EU terminology. Additionally, the breadth of the Agenda cannot be a justification for most stakeholders to turn a blind eye, throughout 2017, on the almost complete blockage of reforms, visible to everyone in BiH, nor did it prevent the EU from reacting forcefully instead of further softening its conditionality.

2. No EU Policy Concept for Post-September 2016

DPC's first monitoring report argued that due to the EU's decision in 2014 to give up on the condition of full implementation of the Reform Agenda for reaching the last step in progress on EU integration foreseen in the BiH initiative, the EU remained without a policy concept as well as a conditionality for pushing through the continuation of reforms after September 2016.[86] This was even more disastrous as the real substantial parts of the structural economic reforms (the parts most painful from the perspective of the political elites in BiH) were yet to be implemented. Indeed, with the GAC's September 2016 decision the reform process and the already limited momentum of 2016 broke down almost entirely. Still, nothing prevented the EU from engaging with this challenge from fall 2016 and developing a new policy approach aimed at full implementation of the Reform Agenda. This approach would have to rely even more strongly on the IFIs' conditionality, as the EU had given away the rest of its leverage in September that year.

3. "Financial conditionality doesn't work in BiH" – EU vs. IFIs Approach to Conditionality

In 2014 structural economic reforms became one of the top priorities of the EU's enlargement policy for the whole of the Western Balkans. This was an expansion of the EU's internal 'European Semester' to the

[85] Interview with EU member states diplomats, EU official, 2016-18.
[86] *Substantial Change on the Horizon? A Monitoring Report on the EU's New Bosnia and Herzegovina Initiative.*

(potential) candidate countries.[87] The extent of the changes the Reform Agenda encompassed though, was unique for the pre-accession stage of EU integration, and required close cooperation with the IFIs. Even more significantly, the Reform Agenda targeted the patronage system used by BiH elites as their socio-economic basis. Specifically, it demanded leverage that the EU, for many years, had refrained from resorting to – financial conditionality. When the German-British initiative was presented in 2014, political leaders in BiH doubted that the EU would be willing to apply strict conditionality. "The EU will never cut off funds, because they fear social unrest," one of the leaders noted.[88] Nevertheless, the member states leading the EU BiH initiative in 2015-16 succeeded in getting the IMF on board for a policy of strict financial conditionality.

One year later, in the context of the breakdown of the reform dynamics in 2017, IFI representatives concluded that "financial conditionality obviously doesn't work in BiH."[89] This, however, represented more an expression of resignation, a rationalization of a failed endeavor in which the IFIs had invested more than any other international actor, than a correct diagnosis. In fact, financial conditionality *did* work in BiH, as demonstrated by the IMF's success in taking a stricter line. For example, in the summer of 2016, the IMF induced the RS regime to screen the part of their domestic banking system that plays a crucial role in the regime's patronage system. Moreover, they had the government agree to remove its representatives from decision-making on credits at the entity development bank.

It was in fact the EU institutions' weak approach to conditionality that, from the outset, contradicted the IFIs' tough approach. The EU soft approach undermined the IFIs' tough stance, and led to a paradoxical scenario in which the EU managed to persuade the IMF to give up on its strict conditionality. *This was the ultimate defeat of the EU BiH initiative.* As this paper and the previous monitoring report's findings have shown, early in the process the EU fell back on its old habits of lowering conditionality in the face of elite resistance to reforms. While EU officials continued to preach the dogma of "ownership," behind closed doors, they practiced arm-twisting towards BiH policy-makers, directed to force the adoption of reform legislation– a move which simultaneously aimed, almost exclusively, at keeping *any* reform process alive, regardless of its substance or integrity. This performance again demonstrated that the concept of ownership for the EU in BiH does not serve to encourage domestic BiH actors to take political responsibility, but instead has served for many years as a cover for lack of political will.

That EU institutions had again organized the implementation of the EU initiative as a closed shop operation between EU officials and political leaders in BiH, an approach which had already failed in 2014, served the purpose of its soft approach on conditionality. The failure here is that EU officials avoided pursuing an effective policy of strategic communication, which would have seen them take the opinions of BiH citizens seriously and involved them as EU partners in reform. Therefore, by choosing not to adopt

[87] Matteo Bonomi, *Economic governance in the Balkans: Towards a more sustainable path of economic development*?, *European Policy Center*, Policy Brief, November 10, 2016, available at: http://www.epc.eu/documents/uploads/pub_7130_ecogovernanceinbalkans.pdf.
[88] Bassuener/Perry/Vogel/Weber, *Retreat for Progress in BiH? – The German-British Initiative*, DPC policy paper, November 2014, p.7; available at: http://www.democratizationpolicy.org/pdf/DPC Policy Paper - Retreat for Progress in BiH.pdf.
[89] Interviews with IFIs representatives, 2017.

a strategy in which they named and shamed the key political figures who blocked reforms, the EU colluded with reform resistance and cut off any potential pressure that could have emerged from within the country itself.

It is shameful that the bluntest public messaging on conditionality in 2016-17 came from the representative of the IMF (by design, the least political of all international players in BiH), echoed by a smattering of EU member states' ambassadors (Germany, U.K., Netherlands). In addition, the fact that German and U.K. officials only managed to partly prevent EU institutions from lowering conditionality confirms that the German-U.K. initiative was being hampered from the start. The fact that the initiative did not originate from, and ultimately was not driven by the top leadership of their respective governments, limited the leverage of German and British officials to fight back against the EU institutions' traditional practice.

4. The Rule of Law Underplayed

A functioning rule of law is key for a working market economy. Throughout the implementation of the Reform Agenda, business representatives in BiH stressed that a functioning rule of law is far more important than any of the other measures foreseen within the Agenda that aimed to improve the business environment.[90] It is no coincidence that the Agenda did not aim very high in the area of rule of law. On the one hand, the EU could not entirely exclude the rule of law from the Agenda. On the other, it could not approach it forcefully, as this was a policy area in which the EU had for a decade failed to muster the political will to fight back against reform rollback by political elites – as demonstrated by the failure of the EU's ill-designed Structured Dialogue on Justice.

5. Intractable Issues Becoming Distracting Issues

The EU BiH initiative's approach – to set aside "intractable" issues related to BiH's dysfunctional constitutional-institutional system, i.e., constitutional reform – worked only in one aspect, while it completely failed in another. This partial realization of the approach represents another cause of the failure of the initiative. Even though the EU had since 2014 completely put aside constitutional matters, these "intractable" matters kept rearing their heads, leading to almost permanent political conflicts between the ruling political parties at State and entity level. Those conflicts consumed a large chunk of the executives' and legislatures' attention, undermining the work on reforms.

For example, during the second half of 2016, the conflict over the RS government's unconstitutional referendum on the RS day consumed political attention in BiH. This was promptly followed by a failed attempt by Bosniak State presidency member, Bakir Izetbegović, to revive BiH's genocide lawsuit against Serbia at the International Court of Justice (ICJ)[91]. This led to a month-long political crisis, during which the Serb parties in the Council of Ministers of BiH *de facto* suspended their membership. For the past several months, the political conflict over the implementation of a controversial decision by the

[90] Interviews with representatives from BiH business, Sarajevo-Banja Luka 2016-17.
[91] "Bosnia to Revive Genocide Lawsuit against Serbia: Izetbegovic," *BIRN*, February 17, 2017, available at: http://www.balkaninsight.com/en/article/bosnia-serbia-icj-genocide-appeal-02-17-2017.

Constitutional Court of BiH on the country's election law in the Ljubić case[92] has been threatening the stability of ruling coalitions and parliamentary majorities, with effects for the necessary reforms.

EU officials have reacted to these continuous crises by labeling them as "distracting" issues, demanding that political leaders and elites focus on the core socio-economic reforms. In essence, such reactions can be interpreted as symbolic of the EU's helplessness and willful ignorance. The EU's labelling of the crises as "distractions" meant they were not addressed in its policy approach, and this approach has neither resolved the issues nor did it make them disappear from the everyday political agenda in BiH. For BiH political elites, the constant political conflicts over the dysfunctional and contradictory constitutional order ultimately serve as political means to block democratic and market economic reforms while pursuing their own narrow agendas. In the light of the EU's approach to ''distracting'' issues, it has a certain logic on its side that, when the Union formally ends its current policy initiative to BiH at end of 2018, with the termination of the Reform Agenda, it might be faced with a constitutional matter – the election law issue — for which it is ill-prepared, as it has no policy nor any red lines on constitutional changes. After the October elections, the EU might have to face the deepest constitutional crisis in BiH since the end of the war.

[92] On the details of the ruling and the political conflict over its implementation, see: Bodo Weber, "Bosnian Croat leadership on course to throw Bosnia and Herzegovina into electoral chaos," *Heinrich Böll Foundation* Sarajevo, December 22, 2017, available at: https://ba.boell.org/de/2017/12/21/bosnian-croat-leadership-course-throw-bosnia-and-herzegovina-electoral-chaos.

V. Conclusions and Recommendations

In late 2014, Germany and the U.K. presented the rationale and main elements of their joint political initiative for Bosnia and Herzegovina that was soon to be adopted by the EU as its new BiH initiative. This set politically sensitive issues such as constitutional reform aside and instead focused on seemingly less sensitive issues of structural socio-economic reform. This process started with a concession (allowing BiH's SAA agreement to enter into force in return for a written, non-binding commitment to reform by the political leaders) to unblock the country's stalled EU integration process. Understandably, this raised serious concerns among political observers about the meaningfulness of the initiative and thus its prospects for success.[93]

The initiative yielded some positive results – the ruling political elites managed to agree on a broad, comprehensive agenda for structural socio-economic reform. If thoroughly implemented, the Reform Agenda had the potential to begin to break the country's patronage system. Even more surprising, throughout 2016, leading EU member states succeeded in getting the IFIs on board for an unusually strict policy of financial conditionality. However, from the very start, and in the face of continuous failure by BiH's political leadership failures to support the letter and spirit of the Agenda, implementation of the new EU BiH initiative turned into a confrontation between dedicated member states including Germany and the U.K. and EU, as the EU institutions responded to reform resistance by falling back into old habits. These included reluctance to set clear benchmarks and strict deadlines, and the subsequent lowering of conditionality; a closed shop-approach focused entirely on BiH domestic political elites, instead of integrating BiH citizens as natural partners and allies; and finally, treating the EU BiH initiative more as a technocratic process than as a political endeavor. In addition, it proved impossible to set aside the core causes of BiH's dysfunctional state, politics and economy – a constitutional order and incentive structure that trades genuine accountability for institutionalized, patronage-based ethnocratic rule.

What links these immediate causes of the failure of the EU BiH initiative is the fact that the initiative from the outset lacked a strategy grounded in an understanding of the real impediments to genuine reform in the country over the past decade. The joint initiative was supposed to bridge the pre-2014 German-British divide over the EU's policy towards BiH, but instead ended up being driven not by the highest levels of government but by mid-level officials in the German and UK foreign offices[94] – which was exactly where the failure of previous policy approaches had been located. Devising a strategic policy would have required the top leaders of these governments to be vested in the initiative, which always required political – not just simply technical – engagement.

[93] See, for example, DPC's critical analysis of the German-British initiative: Bassuener/Perry/Vogel/Weber, "Retreat for Progress in BiH? – The German-British Initiative," *DPC Policy Paper*, November 2014, available at: http://www.democratizationpolicy.org/pdf/DPC Policy Pape - Retreat for Progress in BiH.pdf.

[94] In the aftermath of the violent social unrest in BiH in February 2014, the country initially caught the attention of then German foreign minister, Frank-Walter Steinmeier. But with the outbreak of the Crimea crisis in April that year, negotiations with the FCO within the German Foreign Ministry were handed down within the hierarchy. At the FCO, there had been a particular focus on BiH since William Hague had become foreign secretary in 2009. But negotiations with Berlin were soon handed over to Hague's successor, Philip Hammond, who was much less vested in the Western Balkans. Interviews with German and British ministry officials, 2014-15.

It could be argued that part of the reason why the EU BiH initiative failed was that, in a certain respect, it aimed higher than any previous policy initiative since the EU took over Western leadership of Western Balkans policy in 2005. But it also failed more profoundly than any previous policy initiative. It demonstrated what is possible for the EU in BiH when tough conditionality, including financial conditionality, is applied – but only if this policy of conditionality is applied as part of a clear political strategy.

Recommendations for a Genuine EU BiH Policy Strategy

A genuine reform breakthrough is highly unlikely in the election year of 2018, and further delays are inevitable post-election as the parties will scramble and fight to form governments at various levels. It is therefore high time for the EU to accept the failure of its current BiH initiative and prepare a new strategic approach and policy framework. This strategy needs to have the support of the leadership of key EU member states – notably Germany, the U.K., and France. The future strategy should build on the groundwork of, and the lessons to be learned from, the failed EU BiH initiative; specifically, the set of socio-economic reforms on which work has begun. Another building block are the replies by BiH authorities to the Questionnaire as well as the work which will be undertaken by the European Commission in the coming months on an Opinion on BiH's membership application. However, given the fact that BiH's application for membership remains non-credible, and that the country with its current institutional framework cannot become a member of the EU, a much deeper, and longer-term approach is required.

Such an approach should consist of an integrated concept for the next steps in BH's EU integration – candidate status, opening of accession negotiations – as well as start work on a concept for the country's future accession process already now. Such a concept must be tailored to the challenges of BiH's constitutional and political system and drivers of reform resistance. The approach needs to be understood by the EU as genuinely political, rather than technocratic, and implemented, and communicated, accordingly. In order to set such a strategic policy framework, the EU, specifically the most committed, pro-enlargement member states, in cooperation with EU institutions involved in enlargement, and supported by non-EU states committed to BH (the US, Canada, Norway, Japan), must do the following:

1. *Attainment of candidate status*

- The European Commission should refrain from giving a recommendation on granting candidate status in its upcoming Opinion on BiH's membership application. Instead,
- it should propose to make candidate status conditional on the implementation of a selection of outstanding Reform Agenda measures crucial to put an end to the country's patronage system.
- A series of additional requirements should aim to reverse certain democratic reform rollbacks from the last decade, for example the current BiH Conflict of interest law or the RS Law on Courts.
- A final condition for granting candidate status to BiH should be the adoption of a pending measure from the Structured Dialogue on Justice – adoption of a BiH Law on Courts, based on EU experts' previous recommendations.

2. *Opening of accession negotiations*

- Opening accession negotiations should be made conditional on the implementation of additional important measures left over from the Reform Agenda.
  Some measures of structural socio-economic reform from the agenda as well as the IMF credit arrangement that cannot be implemented in a meaningful way without constitutional reform of BiH's governance system, such as workforce reduction in public administration, should be moved to BiH's future accession negotiation process.
- A number of measures aimed at improving the functionality of governance institutions should be added to the socio-economic conditions for granting opening of accession negotiations. These conditions should focus on the reform of state-level regulatory bodies (such as, for example the BiH Competition Council) that are dysfunctional due to decision-making procedures grounded solely in ethnic power-sharing.
- Further unimplemented measures from the Structured Dialogue, including a new Law on the High Judicial and Prosecutorial Council, should be added to the conditions.

3. *"Accession Plus"*

- Start working on a concept for a future political process for constitutional reform, an "Accession Plus" process that clearly links progress in EU accession to meaningful progress in constitutional reform. That is, to add a Chapter 35 on Constitutional Reform to the future EU Accession Negotiation framework for BiH. This would include opening, closing and interim benchmarks for chapter 35, as well as adopting a mechanism for the EU to be able to freeze accession negotiations if there was to be insufficient progress on constitutional reform.

This concept should not aim at telling Bosnians and Herzegovinians *how* to reform their current, dysfunctional constitutional system; rather the EU should set a number of principles for constitutional reform that guarantee the accountability and functionality of state institutions and provide a meaningful constitutional framework for democracy, the rule of law and a functioning market economy. Such principles should take into account, among others, previous Venice Commission opinions as well as various unimplemented rulings by the European Court of Human Rights (ECHR). With this approach the EU would ensure that BiH has the capacity to meet the Copenhagen criteria for membership.

Such principles of constitutional reform should include:

  - A clear division of competences, and according revenues, among the various layers of governance.
  - The strengthening of the oversight functions of the State.
  - An approach that shifts the burden of proof that certain state functions can be better managed by the entities and cantons (or: municipalities), based on close cooperation of and coordination among them, to those sub-state levels. Failure to prove their capability automatically leads to such governance functions moving to either the State and/or municipal level, the latter being based on the principle of subsidiarity.
  - Strong local self-governance as defined by the Council of Europe's Charter on Local Self-

governance.

- Limitation of the decision-making processes based on ethnic consent of the representatives of the three constituent peoples to a precise, narrowly defined list of "vital national interests". The competences of the second chambers of parliaments at State and entity level should be reformed accordingly.
- A balance between collective and individual rights in a way that ensures the unhindered exercise of collective as well as individual rights without any form of discrimination of citizens that belong or don't belong to the three constituent peoples.
- To end the fragmentation and politicization of the judiciary as well as of the security agencies.

EU institutions and leading member states should develop this 'Accession Plus' policy concept during the window of time it has before deciding on BiH's opening date for accession negotiations. However, even before that, they must engage with the following:

- Start to strategically communicate the rationale and principles of the future EU constitutional reform policy to BiH citizens, and political elites alike.
- Openly confront EU member state Croatia in its attempts to sabotage future constitutional reform in BiH by basing it on the political elites' ideologized perception of BiH politics and society, and its over-identification with the policy of the HDZ BiH. The EU should confront the issue by developing an effective communication strategy with the Croatian public. Such a communication strategy should aim to deconstruct the conventional, collectivist ethno-nationalist perceptions of BiH and instead promote views that help differentiate between Bosnian Croats as such and the policy of the dominant Bosnian Croat party.

Between now and opening of accession negotiations

Between now and the granting of an accession negotiation date for BiH, the EU must do the following:

- Re-engage with the IFIs, in particular, with the IMF, and encourage them to return to a policy of tough financial conditionality which would be tied to the most important elements in the Reform Agenda. The principal focus needs to be to tackle the country's deeply rooted patronage system.
- Make BiH citizens their prime and direct allies for reforms related to EU integration. To ensure this the EU must develop a policy of strategic communication towards BiH citizens through the use of traditional and social media, as well as messages at town-hall meetings aimed at citizens based on their location and their social interest groups (economic sectors, etc.);
- Maintain the international community's executive Dayton instruments, in particular EUFOR Althea's UNSC Chapter 7 mandate, as a safety net and deterrence against any attempts by the political elites to employ the escalation of inter-ethnic tensions in order to avoid structural economic and political reform. This will be crucial to back the employment of strict financial conditionality;
- Select an independent, senior *political* figure as the next EU Special Representative to BiH.
- Officially end the Structured Dialogue on Judicial Reform. Develop a new approach to judicial reform within the current framework of the SAA and the upcoming steps in EU integration, until the opening

of accession negotiations. Such an approach should aim at reversing the reform rollback of the current decade and the strengthening of judicial officials ready to defend, fight for the independence of the judiciary. Finally move towards a policy of naming and shaming political actors who are responsible for reform resistance, to become part of a political communication strategy in BiH.

- During the coming weeks, seriously engage in solving the looming constitutional crisis related to the BiH Election Law and the Ljubić case. This can be achieved by exerting strong political pressure on BiH political parties, in particular the HDZ BiH, aimed at pushing through an election law amendment that includes a one-time regulation of the election of the House of Peoples of FBIH delegates. This could then be succeeded by a broader reform of the electoral systems within the framework of a future wider constitutional reform.