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Limited Sovereignty and Soft Borders in Southeastern Europe and the Former Soviet States: The Challenges and Political Consequences of Future Changes in Legal Status

Session II:

Limited Sovereignty and Economic Security: Survival in Southeastern Europe

On March 1, 2007, the Harriman Institute/East Central European Center convened the second session in its special seminar series on “Limited Sovereignty and Soft Borders in Southeastern Europe and the Former Soviet States: The Challenges and Political Consequences of Future Changes in Legal Status,” with Professor Michael Pugh of the University of Bradford as the main presenter. Dr. Pugh’s paper was entitled “Limited Sovereignty and Economic Security: Survival in Southeastern Europe.” The discussant for the session was Jacques Paul Klein, former Under-Secretary General of the United Nations, and former head of the U.N. Mission in Bosnia-Herzegovina.

Dr. Pugh began his presentation by examining the factors limiting economic development in Bosnia and Herzegovina (BiH) due to the consequences of sovereignty in the country being shared between the international community, the Bosnian central government, and the entity

governments. Pugh argued that the consequences of shared sovereignty are exacerbated in BiH by the significant spatial divergences in economic activity and growth rates across the country, particularly in the labor market. Often overlooked by the international community, the issues of widespread unemployment and dim prospects for job growth constrain economic welfare and challenge most individual’s mere survival in this environment. The presence of these overwhelming obstacles begs the question “How do people manage to cope?” According to Pugh, the survival economy that has evolved in Bosnia is both “a negotiation with, and resistance to, economic policies introduced from the outside.”

Pugh introduced the challenges to economic security in BiH with an overview of recent strands of political discourse on sovereignty. Citing the work of David Chandler and Stephen Krasner, Pugh identified a shift in our conceptual understanding of the meaning and obligations of

sovereignty in the 1990s—away from an emphasis on granting sovereign states the right to protection from outside intervention in their internal affairs, to emphasizing a more limited degree of sovereignty which creates an obligation on the part of the international community to protect victims in a conflict. In this framework, the primary responsibility of a sovereign state is to defend its own people, and in cases where it cannot (or will not), the international community can justifiably elect to intervene. This rationale then also gets transferred to other forms of the international community's relations with a state: for example, if outside actors are willing to provide economic aid to a particular state, they then feel entitled to a say in how the funding is applied. The result is shared sovereignty, created by this interplay of internal and external actors. As Pugh notes, this mechanism has been one of the primary engines of statecraft in Bosnia and Herzegovina, with domestic forces often suppressed and subordinated to the policies of the Office of the High Representative (OHR).

Pugh, however, believes that in the cases where international actors have intervened in the Balkans, sovereignty has not been shared in the economic sphere. Rather, the Dayton and Rambouillet agreements reflect particular notions of a liberal market economy inculcated within the constitutional arrangements of both BiH and Kosovo. Key to the establishment of free market conditions in the former command economies of Southeastern Europe have been the international financial institutions (IFIs) which have been instrumental in designing economic policies in the region. Stimulating economic growth has been largely dependent on dismantling the socialist state systems and creating an environment amenable to the free market, through IFI-sponsored policies such as balancing budgets, creating new tax systems, shoring up the currency, and providing greater macroeconomic stability. The BiH economy, to a great extent, has been externally constructed and aligned with the interests of the European Union. In spite of these IFI-designed efforts, however, economic growth has been widely elusive.

As Pugh observes, the cracks in the foundation of the BiH economy were visible early

in its development. The double-digit growth BiH experienced immediately following the conflict was fueled in large part by international organizations active in the area, and GDP transfers attributable to the international presence still play a significant role in the economy, accounting for nearly 9 percent of GDP and amounting to roughly three times the amount of foreign aid BiH receives. The injection of new money into BiH's war-torn society had positive effects, but stagnation and decelerating growth set in quickly as production slowed and unemployment mounted. The economic situation in BiH has worsened in recent years to a point where the majority of people surveyed in opinion polls express a belief that the economy will only continue to deteriorate, and Pugh cited a recent study which revealed that over 70% of adults aged 18-35 would leave BiH if they had the means, a measure used by the UNDP as an early warning sign of crisis.

In his explanation of the challenges facing the BiH economy, Pugh pointed to longstanding territorial divergences in southeastern Europe as a fundamental determinant. Several key areas of industrial production, including Zenica and Tuzla, were hit particularly hard by the war. Other cantons that inherited a weak infrastructure as a legacy of the dissolution of Yugoslavia declined even further throughout the conflict, and, according to Pugh, were transformed into internal borderlands. Slightly beyond the control of the central government, several of these regions have exhibited a modicum of growth closely associated with their ability to take advantage of their position as arbitrageurs. Outlying regions have fared considerably worse than urban centers such as Sarajevo and Banja Luka, which continue to attract the international resources that support job growth. BiH also continues to rely heavily on remittances from abroad, which are exceptionally critical to supporting depressed areas.

The search for the root causes of economic hardship in BiH, however, leads to the broader structural problems faced by the economies of the former Yugoslavia. One of the principal explanations for uneven economic transition in the region frames the issue as a clash between an externally introduced version of liberal modernity and a primitive, corrupt elite resisting these outside

influences. Pugh, however, sees linkages between external policies and the domestic elite that tend to be overlooked. Although all parties have engaged in finger-pointing, Pugh argued that there has been a coincidence of interests between outsiders and “war entrepreneurs” – those who emerged from the conflict with accumulated capital. Thus, the war entrepreneurs quickly realized that they could benefit more by working within the new system and shaping its evolution. Various interests have competed in promoting their respective sectors, often to the detriment of other areas of the economy. In implementing an externally designed model for economic transition, however, BiH has been forced to accept an idealized version of development which ignores inconsistencies and local peculiarities. For instance, as Pugh observes, there has been a strong effort to remove protections for agriculture, even though such safeguards are widely employed in advanced economies. A lack of investment and increased foreign competition has exposed these contradictions to the displeasure of many in BiH’s shrinking agricultural sector.

Labor market problems in BiH remain one of the primary obstacles to economic growth, according to Pugh. While official statistics tend to vary based on the metric employed, the unemployment rate based on job registration reached a staggering 45% in 2006. As Pugh argued, large sections of the population do not officially participate in the labor force, while those who have a steady job have often been the beneficiaries of a labor market in which age begets privilege. In this environment, the majority of wages are in arrears and labor rights are often largely ignored. Paradoxically, as Pugh notes, international aid funding to support job growth has often been targeted at the most egregious violators of the international labor conventions which BiH has signed.

The truth about the labor market in BiH is that it remains heavily biased toward unregulated employment in informal sectors. According to Pugh, the true figure for overall unemployment, factoring in individuals employed in the grey economy, hovers slightly above 20%. The vast numbers of individuals informally employed do not pay any income tax and exist beyond the reach of the state in terms of the protection of their labor

rights. Pugh believes that BiH’s economic strategy – making the country’s economic environment conducive to foreign enterprises that will ultimately employ people locally – has been a failure. The “Jobs and Justice” program, as Pugh notes, had very little to say about creating new jobs, but focused instead on apprehending war criminals and improving the business climate. While the majority of new job growth in the past decade has been in the small- and medium-business sectors, these areas of the economy have shed more jobs than they have created, thus increasing overall unemployment. As a result, instead of stimulating economic growth and increasing employment, economic policies developed by outside actors have driven an increasing number of individuals into the informal sector in order to survive economically.

Pugh points to several mechanisms which he calls “tricks of life” that have allowed individuals to make ends meet in BiH’s stagnant economic environment. First, legacy entitlement payments, particularly to veterans and war widows, remain disproportionately high. These disbursements, which do not disappear once obtained, have enabled many people to cope. Second, the non-observable economies of corruption and fraud have actually been an enormous boon to the economic welfare of many in BiH and beyond, particularly in Montenegro, where an estimated 50% of GDP stems from trade in illegal cigarettes. Third, and perhaps most significant of all, remittances and transfers from abroad play an active role in supporting BiH’s population. According to Pugh, this phenomenon is only partially observable, as only 50% of the transfers are processed through banks. Although central bank estimates fall in the 11-13% of GDP range, accounting for sums processed through couriers raises this figure to a staggering level – roughly 34% of total GDP. This figure amounts to more than the total aid provided by the IFIs, USAID, and other governments bilaterally. For Pugh, these “traditional quests for sufficiency and subsistence” represent a kind of low-level resistance to the internationally administered economic policies, and contribute to a broader sense of cohesion in a society fragmented by growing wealth disparities under a regime of shared sovereignty. In this manner, locals in BiH

can point to the imbalances supported by the system of shared sovereignty as an externally introduced social ill.

The influence of the international community is also felt in BiH's political economy, particularly when looking at the immunity enjoyed by external actors. Pugh sees the mechanisms for ensuring the accountability of internationals as flimsy, creating a double standard of behavior that serves as a disincentive to support external policies. Locals possess no rights of appeal against acts of wrongdoing committed by the international community. Pugh highlights the case of the international Director of the Indirect Tax Authority in BiH, who took actions that disadvantaged the *Republika Srpska* (RS) in terms of collecting revenues, and later claimed immunity when the RS Prime Minister filed suit. As the International Court of Justice continues to struggle with issues surrounding the immunity of actors in BiH and beyond, the international's lack of accountability severely hinders greater cooperation between outsiders and locals on political and economic matters.

Pugh's analysis of the state of BiH's economy is not a forecast of gloom and doom, as he provides several practical solutions for addressing the consequences of shared sovereignty. In Pugh's estimation, these include: the recognition of greater regional autonomy; the promotion of cross-border economic activity (such as farming cooperatives); supporting production and infrastructure development for industry and agriculture in adopting an import substitution model; greater FDI regulation to provide for more transparent privatizations; a simplification of the VAT tax regime; broader programs for encouraging job growth and reducing the impact of shadow economies; and a loosening of regulations in the moribund labor market. In sum, Pugh believes that creative approaches beyond the traditional neoliberal model must be considered in order to stimulate growth in BiH. Furthermore, the evolution of the BiH economy will have significant implications for the policies adopted in Kosovo, where the economic situation shares many parallels with the early stages of transition in BiH.

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