

**PROPERTY RIGHTS, CORRUPTION, ENFORCEMENT OF CONTRACT AND
ECONOMIC DEVELOPMENT IN BOSNIA AND HERZEGOVINA**

By

Nadza Kazic

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

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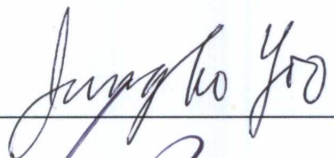
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Committee in charge:

Professor Yoo, Jungho, Supervisor



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ABSTRACT

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By

Nadza Kazic

The pillars of economic development, here seen in securing property rights, enforcement of contract and fighting corruption, are not given proper attention in Bosnia and Herzegovina. These pillars are necessary and must be secured in order to allow firms to exist and to operate in the market. The research hypothesis is that a coordinated set of policies that encompasses property rights and enforcement of contract reforms, with the adequate fight against corruption, may serve to put Bosnia and Herzegovina on a solid and successful course of long term economic development. I approached this problem by looking into the existing legal and institutional system in regard to property rights, enforcement of contract and corruption. Moreover, I used the example of Botswana, to support the hypothesis. The results have shown that some fundamental laws have yet to be adopted and there is a lack of political will in tackling these issues.

Dedicated to my family

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Chapter 1 - Introduction

The 1992-1995 war damaged the economy of Bosnia and Herzegovina severely. The damage to the economy from the war was immense in regard of the economic and production potential. In addition, the affects of war were felt in the technology in production area, which added 10 years to the already existing lag of 20 years behind the developed world.

More than 15 years have passed since the war ended, and Bosnia and Herzegovina is still struggling to get the economy on the right track. It faces many problems today. Some of them are corruption, unfavorable business environment, lack of an economic development strategy and high unemployment rate. It is already lagging behind the development of region in many aspects and it must begin to develop as soon as possible to avoid completely falling behind.

Attempts were made to restructure and reconstruct the economy of the country. Among others, the government has tried to support SME through various channels. Unfortunately, the efforts did not lead to the strengthening of the private sector and thus economic development of the country.

The government of the Federation of Bosnia and Herzegovina, one of the two entities in the country, has in the previous years seen the need for industrial revitalization and has therefore proposed the document “Project proposal of development of industrial policies in Federation of BiH”. It was adopted by the House of Representatives of Federation of Bosnia and Herzegovina in 2010. The project proposal defines in which direction the industry in Federation of BiH will develop in the next ten years. In addition, Development Strategy of Bosnia and Herzegovina for the period 2008-2013 was created, but it has not yet been adopted

at the state level and the level of the entity of Republic of Srpska. 2009-2011 SME Development Strategy in Bosnia and Herzegovina was created with the objective to create better work conditions for the SMEs. As short term priorities, coherent legal and institutional framework for SMEs and adoption of the SME Strategy were listed.

All these government strategies and incentives might help the economic development in the short run, but it is debatable whether they will be successful in the long run. To achieve economic development in the long run, the government should focus on establishing a proper foundation. The foundation, seen in functioning institutions, can determine the economic development of a country and can account for the difference between poor and rich countries. Furthermore, it will provide security of property rights, contract enforcement, stimulate entrepreneurship, and among others, suppress corruption, thus creating a fruitful environment which will allow firms and industries to prosper on their own. This same foundation has not been properly set in Bosnia and Herzegovina.

The importance of institutions is emphasized in the Index of Economic Freedom, where they are considered to be one of the 12 pillars of competitiveness. One of the most important issues covered within the institutions pillar is the issue of property rights. It evaluates to what extent the private property rights are protected by laws as well as the degree to which its government enforces those laws.¹ In the 2011 Index of Economic Freedom, Bosnia and Herzegovina ranked 129th out of 142 countries, indicating that the property rights are weakly protected. Certain progress has been made in terms of time it takes to register property, shortening it from 84 to 33 days, but that is far from securing property rights.

¹ The Heritage Foundation and the Wall Street Journal: 2011 Index of Economic Freedom, <http://www.heritage.org/Index/> (Accessed October 1, 2011).

Weakly protected property rights are interlinked with corruption and enforcement of contracts. Bosnia and Herzegovina is one of the most corrupt countries in Europe. It ranked 91 out of 178 countries analyzed in the Transparency International's Corruption Perception Index 2011.² Corruption is present in everyday life and leads to inadequate functioning of political and economic institutions. In addition, the number of procedures for enforcing contracts is 37 in Bosnia and Herzegovina, 20 being the least number of procedures a country has. The duration of disputes lasts astonishing 595 days.

In the World Bank's "Doing Business Report 2012", Bosnia and Herzegovina was ranked at 125th position for ease of doing business.³ When comparing the data from the region, only Kosovo was ranked worse. FYR Macedonia is leading in the region when it comes to starting a business, with only 3 days necessary to start a business in Skopje, whereas in Sarajevo, Bosnia and Herzegovina, it takes 40 days to start a business. This can and does affect the economic development of the country as well as the region.

The countries with secured property rights, contract enforcement, and less complicated bureaucracy will have more new businesses emerging, and thus will develop faster. Moreover, if a country in the region has a more favorable environment for starting a business, and is among others successful in fighting corruption, entrepreneurs from other countries might consider opening their businesses and contribute to the development of that particular country.

All this affects the business environment in Bosnia and Herzegovina, and thus economic development. Many people refrain from starting a business in Bosnia and Herzegovina due to

² Transparency International, <http://www.transparency.org/> (Accessed April 20, 2012).

³ The World Bank :Doing Business 2012, <http://www.doingbusiness.org/~media/FDPKM/Doing%20Business/Documents/Annual-Reports/English/DB12-FullReport.pdf> (Accessed April 15, 2012).

the unstable business environment. If property rights are not secured, if one cannot enjoy the fruits from his labor, then there is no incentive to go into business. Property rights must be secured in order for firms to operate in the market. Moreover, if it is difficult to enforce a contract, if the process takes too much time, it will as well negatively affect their decision to start a business.

The incentives the government provides for firms and industries will not generate long term economic development of Bosnia and Herzegovina. Without the proper foundation which would allow for firms to grow and be profitable on their own, long term development will not be possible. Without proper foundation, seen in secure property rights, contract enforcement and suppressed corruption, Bosnia and Herzegovina will not develop in the long run. My research hypothesis is that a coordinated set of policies that encompasses property rights and enforcement of contract reforms, with the adequate fight against corruption, may serve to put Bosnia and Herzegovina on a solid and successful course of long term economic development.

To investigate this hypothesis, I will look into existing legal and institutional system in regard to property rights, enforcement of contract and corruption and analyze whether they are hindering the economic development of Bosnia and Herzegovina. Furthermore, I will look into existing SME strategies, development strategies and projects regarding industrial policies to analyze what was recognized by the government as the impediment to the development of Bosnia and Herzegovina, and whether they have proposed a solution to the problem.

In support of my hypothesis, I will use the example of Botswana, which serves as a successful example of how a proper foundation established affects the economic development of a country. Botswana is one of the most developed countries in the Sub-Saharan Africa, and this

is due to the fact that companies and individuals do not need to fear of property appropriation and do not need to offer bribe in order to help their own business.

Chapter 2 - Literature review

Previous research acknowledges that the role of institutions is vital for economic development. Functioning institutions, among others, need to provide security of property rights, contract enforcement, stimulate entrepreneurship, and suppress corruption. The quality of institutions can determine the economic development of a country and can account for the difference between poor and rich countries.

The development of Bosnia and Herzegovina has stagnated and is in fact lagging behind the region. It is precisely these property rights, corruption and contract enforcement which are important for the development of the country. The hypothesis of my paper is that a coordinated set of policies that encompasses property rights and enforcement of contract reforms, with the adequate fight against corruption, may serve to put Bosnia and Herzegovina on a solid and successful course of long term economic development.

The first segment of the literature review will concern the issue of property rights and allocation of resources. The second segment of the literature review covers the issue of the importance of institutions on the economic development, more specifically, the importance of property rights, corruption and enforcement of contract. This literature review attempts to demonstrate and support my hypothesis.

2.1 Property rights and allocation of resources

Many economists have recognized the importance of property rights. Adam Smith (1776) wrote in *Wealth of Nations*: “Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contract is not supported by law...”⁴. He emphasized the importance of law for the economic development and prosperity of a country and why it is necessary to secure the property rights and enforce contracts for better business operations.

In *Road to Serfdom*, Friedrich A. Hayek wrote: “What our generation has forgotten is that the system of private property is the most important guarantee of freedom, not only for those who own property, but scarcely less for those who do not”.⁵ He explained that individuals can only decide what to do on their own when the control of the means of production is divided among people who act independently. When the economic power is centralized, in hands of the state, individuals would not be able to act independently. He further explained that in a country where there is enforcement of the Rule of Law, i.e. a state of order in which events conform to the law, individuals can follow their personal goals, without fearing the government will intervene.

When addressing the problem of externalities, the economist Ronald Coase claimed that when transaction costs are equal to zero and when property rights are properly defined, it will have no affect on the allocation of resources. It would only affect the distribution of income and

⁴ Smith, Adam, *Glasgow Edition of the Works and Correspondence Vol. 2a „An Inquiry Into the Nature and Causes of the Wealth of Nations“*, Vol. 1 (1776); edition used: *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Vol. I ed. R. H. Campbell and A. S. Skinner, vol. II of the *Glasgow Edition of the Works and Correspondence of Adam Smith* (Indianapolis: Liberty Fund, 1981).

⁵ Hayek, Friedrich A., *The Road to Serfdom* (Chicago: University of Chicago Press, 1944), pp. 103–4.

wealth between the involved parties. In this case, involved parties can reach an agreement on their own, without the involvement of a legal system, and both parties could gain from it.

In reality, the transaction costs are never equal to zero. Coase explained: “In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. **These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost**”.⁶

Since the transaction costs are not equal to zero, the importance of institutions and legal systems rise to the surface.

“... Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about...In these conditions the initial delimitation of legal rights does have an effect on the efficiency with which the economic system operates. One arrangement of rights may bring about a greater value of production than any other. **But unless this is the arrangement of rights established by the legal system, the costs of reaching the same result by altering and combining rights through the market may be so great that this optimal arrangement of rights, and the greater value of production which it would bring, may never be achieved**“.⁷

⁶ Coase, Ronald H, „The Problem of Social Cost.” *Journal of Law and Economics* 3 (1960).

⁷ Ibid.

In the case when transaction costs are positive, the affected parties would turn to the legal system for solving the issue, since the outcome depends of the allocation of rights. The main problem concerning resources, when it comes to Coase, is that they are not owned by someone. Moreover, disputes over the use of resources could be resolved if the resources were given as private property.

The importance of property rights and allocation of resources was also identified by Besley and Ghatak (2009) as well as Libecap (1989). Besley and Ghatak questioned what determines property rights and the mechanisms through which property rights affect economic activity. In their paper, they claimed that where the property rights are not secured, there will be an inefficient allocation of resources.⁸ Moreover, Besley and Ghatak explained that property rights are not exogenously given, as it is believed by mainstream economists, thus, they evolve over time. Property rights are driven by economic and political forces and these forces must be taken into account to ensure that property rights are well-defined and enforced.⁹

Libecap also claimed that property rights matter and affect the economy. He stated that property rights affect economic behavior through incentives.¹⁰ Moreover, they can shape the economic behavior by assigning ownership to resources.¹¹ Property rights can have public goods aspect if such reduced transaction costs and thus encourage investment.

⁸ Besley, Timothy J. and Ghatak, Maitreesh, Property Rights and Economic Development (March 2009). CEPR Discussion Paper No. DP7243.

⁹ Ibid.

¹⁰ Libecap, Gary D., "Property rights in economic history: Implications for research," Explorations in Economic History, Elsevier, vol. 23(3), pages 227-252, July 1986.

¹¹ Libecap, Gary D. Contracting for Property Rights, New York: Cambridge University Press (1989).

Savoia et al. (2004) have done empirical studies on the effect democracy and inequality (of land and income) have on quality of institutions. They concluded that property rights and economic institutions are affected by income inequality and democracy. Moreover, democracy was positively correlated to property rights and economic institutions.¹²

2.2 Property rights, corruption, enforcement of contract and economic development

Many studies were conducted to support the premise that sound institutions cause higher economic growth. Glorious Revolution which occurred in the 17th century in England is recognized as a revolution which redistributed political power. Redistributed political power was hence followed by institutional changes, which led to strengthening of property rights, thus leading to economic growth.¹³

Property rights enforcement is widely recognized as one of the main characteristics of sound institutions. Acemoglu stated that secure property rights provide encouragement for companies and individuals to take risks and invest.¹⁴ A study conducted by Knack and Keefer has as well shown that property rights have an impact on investment and growth.¹⁵

In his book “Institutions, Institutional Change and Economic Performance“, Douglass North asserted the importance of institutions for the long-term economic development of a country. He stated that the quality of institutions directly affects the economic performance of a country and whether the economy will be successful or will fail. North further emphasized the importance of contract enforcement: “the inability of societies to develop effective, low-cost

¹² Savoia, A., J. Easaw, and A. McKay “The Relationship between Inequality and Institutions: An Empirical Analysis,” Department of Economics and International Development Working Paper, University of Bath (2004).

¹³ North, Douglass C. and Barry Weingast (1989) “Constitution and Commitment: The Evolution of Institutional Governing Public Choice in Seventeenth-Century England”, *The Journal of Economic History*, 49/4: 803-832.

¹⁴ Acemoglu, Daron: “Root Causes: A historical approach to assessing the role of institutions in economic development.” In *Finance and Development (F&D)*, June 2003, Volume 40, Number 2.

¹⁵ Knack, Steven and Philip Keefer. “Institutions and Economic Performance: Cross-Country Tests Using Alternative Measures,” *Economics and Politics*, 7, 207-227 (1995).

enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World”.¹⁶ He stated that the lack of secure property rights and contract enforcement will deter investments in the country, hence leading to weak growth rates and inefficient economy. North also explained that in order to assure contract compliance, a third-party is necessary to enforce it and by “third-party enforcement”, he means “the development of the state as a coercive force able to monitor property rights and enforce contracts effectively”.¹⁷

Questions have arisen in which way corruption can affect the economic development of a country. Aidt (2009) analyzed whether corruption “sands“ or “greases“ the wheels of development. Using the example of de Soto’s experiment¹⁸ – examining the length it takes to obtain permits legally to start a small tailoring business to show why the economic activity was forming in the informal sector -- and Uganda’s example of the low amount of public funds which reached the intended destination, he clearly showed that the corruption affects economic development negatively.¹⁹ He emphasized that while corruption can in some occasions “grease” the economy – by helping companies in certain situations, in most instances it is an impediment to development and can lead to misallocation of resources.

An informal sector is created when among others, property rights are weak.²⁰ Individuals choose to work in the informal sector because the weak institutions cannot provide them with a sound environment for their economic activities. Barro (2000) went further and explained

¹⁶ North, Douglass C., *Institutions, Institutional Change and Economic Performance* (New York, NY: Cambridge University Press, 1990).

¹⁷ Ibid.

¹⁸ De Soto, H., „*The Other Path: The Invisible Revolution in the Third World*“, New York, Harper (1990).

¹⁹ Aidt, Toke S, Corruption, institutions, and economic development, *Oxford Review of Economic Policy*, Volume 25, Number 2 (2009) pp.271–291.

²⁰ Barro, Robert J. “Rule of Law”, Democracy, and Economic Performance, in Gerald P. O’Driscoll, Jr., Kim R. Holmes, and Melanie Kirkpatrick, [2000 Index of Economic Freedom](#) (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2000), p. 36.

that corruption is not always unacceptable, since it may lead to positive economic activities which could have been suppressed under certain regulations. Still, many economists agree that corruption hinders the economic development of a country. Where there are weak institutions and corruption, the number of economic activities which could be accomplished legally is reduced, and eventually it will affect the economy.

Analyzing the causes behind wealth disparity between nations, Roll and Talbott (2001) discovered that wealth disparity was mostly caused by factors governments could actually change. Those factors were, among others, property rights, regulation, political rights, black market activities and government expenditures. Entrepreneurs cannot change these determinants by themselves and thus, effective government is necessary in their provision and enforcement. Their empirical studies have shown that there is strong correlation between per capita income, and property rights, black market activity and regulation, showing the highest level of significance.²¹ In order to develop faster, countries must enforce strong property rights, and tackle issues such as corruption and overwhelming regulation.

Robert Hall and Charles Jones conducted empirical studies testing why productivity varied across nations. They have come to a conclusion that the variations in productivity can be explained by the differences in institutions and government policies, i.e. social infrastructure.²² A favorable social infrastructure enables firms and individuals to acquire skills, make investments and produce goods and services. To explain the difference in the development levels between countries, Acemoglu and Robinson also pointed out to the

²¹ Roll, Richard and Talbott, John. "Why Many Developing Countries Just Aren't". The Anderson School at UCLA, Finance Working Paper No. 19-01. (2001).

²² Hall, Robert, and Charles Jones. 1999. "Why Do Some Countries Produce So Much More Output per Worker Than Others?" *Quarterly Journal of Economics* 114, no. 1: 83–116.

quality of institutions - to be more specific, to the evolution of property rights.²³ To support this statement, they used the example of the Democratic People's Republic of Korea and the Republic of Korea. While private property was neglected in the centrally planned economy of The Democratic People's Republic of Korea, it was protected under the capitalist Republic of Korea. In addition to the secure property rights, investments were encouraged, thus supporting the economic development and leading to rapid growth. Today, the Republic of Korea is one of 20 largest economies in the world, whereas the Democratic People's Republic of Korea is still struggling with economic growth.

Dani Rodrik explained that poor countries lack among others an outline of property rights system, rule of law and functioning government. The lack of the same is what separates the developed from poor countries.²⁴ Rodrik also pointed out what characteristics sound institutions should poses: "Desirable institutions provide security of property rights, enforce contracts, stimulate entrepreneurship, foster integration in the world economy, maintain macroeconomic stability, manage risk-taking by financial intermediaries, supply social insurance and safety nets, and enhance voice and accountability."²⁵ He further explained that sound institutions are necessary for the market to function and that even minor institutional reforms could have an impact on the economic growth.

Chafuen and Guzmán (2000) analyzed how corruption affects property rights. They claimed that corruption makes property rights insecure and thus affects economic development.

²³ Acemoglu, Daron and Robinson, James. "The Role of Institutions in Growth and Development," (2010) in Leadership and Growth, ed David Brady and Michael Spence 135-64, Washington, DC: The World Bank on behalf of the Commission on Growth and Development.

²⁴ Dani Rodrik, 2000. "Institutions for High-Quality Growth: What They are and How to Acquire Them," NBER Working Papers 7540, National Bureau of Economic Research, Inc.

²⁵ Dani Rodrik, 2008. "Second-Best Institutions," American Economic Review, American Economic Association, vol. 98(2), pages 100-104, May.

Furthermore, they have conducted empirical studies that have shown that there is negative correlation between economic freedom and corruption.²⁶

Adam Smith (1776) said that trade, and hence an economy, cannot grow when contracts are not supported by the law and enforcement of contracts is not effective.²⁷ The enforcement of property rights and thus, enforcement of contracts, can be affected by a corrupt bureaucracy.²⁸

Acemoglu and Verdier (1996) stated: "For the state to have a role in enforcing property rights, some contractual problems must exist between private parties.... production requires two agents, and one of the entrepreneurs needs to undertake an investment, but the returns accrue to the other one...The effort of the first agent has to be rewarded, and this necessitates a contractual arrangement."²⁹ The government is required to enforce contracts, because without the support of the government, the entrepreneur cannot rely on the other entrepreneur's word regarding executing his obligations. If the bureaucrats in charge of enforcing the contract are corrupt, the bureaucrat will be more likely to make an unprincipled decision. In such an environment, the entrepreneur is less likely to do business.

To conclude this literature review, it can be assumed that property rights, corruption and contract enforcement play an important role in the economic development of a country. Many researchers have conducted empirical analysis and proven that they affect the economic

²⁶ Chafuen, Alejandro and Eugenio Guzman. 2000. "Economic Freedom and Corruption," In 2000 Index of economic Freedom, edited by Gerald O'Driscoll Jr., Kim Holmes, and Melanie Kirkpatrick. Washington, D.C.: Heritage Foundation.

²⁷ Smith, Adam, Glasgow Edition of the Works and Correspondence Vol. 2a „An Inquiry Into the Nature and Causes of the Wealth of Nations“, Vol. 1 (1776); edition used: An Inquiry Into the Nature and Causes of the Wealth of Nations, Vol. I ed. R. H. Campbell and A. S. Skinner, vol. II of the Glasgow Edition of the Works and Correspondence of Adam Smith (Indianapolis: Liberty Fund, 1981).

²⁸ Acemoglu, D. & Verdier, T., "Property Rights, Corruption and the Allocation of Talent: A General Equilibrium Approach," Working papers 96-5 (1996), Massachusetts Institute of Technology (MIT), Department of Economics.

²⁹ Ibid.

development. The lack of the same represents an impediment to the economic development of a country and therefore is necessary for the country to make progress, develop and grow.

Chapter 3 - The Complex Structure of Bosnia and Herzegovina

Bosnia and Herzegovina is administratively divided into two autonomous entities: the Federation of Bosnia and Herzegovina (51%) and the Republic of Srpska (49%). Additionally, the area around the town of Brčko has received the status of District. The Constitution of Bosnia and Herzegovina is an integral part of the General Framework Peace Agreement for Bosnia and Herzegovina (Annex 4), better known as the "Dayton Agreement", which was initialed on November 22, 1995 in Dayton, Ohio and signed on December 14, 1995 in Paris. With this Agreement, Bosnia and Herzegovina was transformed in to a complex and decentralized government structure consisting of two entities - the Federation of Bosnia and Herzegovina and the Republic of Srpska.

Bosnia and Herzegovina shares a common central government, but legislative and executive power is exercised at the entity levels.³⁰ The legal system is also non-transparent and uncoordinated. Corruption is present in every segment. Furthermore, by creating the two entities within one country, two separate economic spaces have been created. Attempts to make progress towards creating the single economic space have been limited.

This all affects the decision of entrepreneurs when considering starting a business in Bosnia and Herzegovina. For the development of the country, it is necessary to create a single

³⁰ German Development Cooperation with Bosnia and Herzegovina, Federal Ministry of Economic Cooperation and Development, http://www.bmz.de/en/what_we_do/countries_regions/europa_udssr/bosnien_herzegowina/index.html (Accessed, November 14, 2011).

economic space in Bosnia and Herzegovina, which will support free movement of goods, capital and services.

3.1 Economy of Bosnia and Herzegovina

Bosnia and Herzegovina was one of the poorest republics in the former Yugoslavia. Its GDP was 70% smaller than the GDP of Slovenia, which was the most developed republic. The economy was centrally planned. It focused on large public enterprises whereas private enterprises were not recognized during the socialist period. Industrial production was concentrated in 12 large companies, focusing on mechanical, metal and chemical industries among others.³¹

The 1992-1995 war damaged the economy of Bosnia and Herzegovina severely, with total losses estimated at over \$110 billion. The damages were the greatest in regard to production potential, destruction of economic potential and infrastructure (road and rail networks, telecommunications, etc). War had an impact on the economy not only in terms of destroyed infrastructure, but also in terms of loss of markets -domestic and foreign. During the time it was a part of Yugoslavia, Bosnia and Herzegovina exported over 50% of its production to other Yugoslav republics.³²

In 1991, the technology in the production area in Bosnia and Herzegovina showed a lag of 20 years behind the developed world, while the additional technological lag caused by the war in

³¹ Faculty of Mechanical Engineering, University of Sarajevo; Faculty of Mechanical Engineering and Computer Science, University of Mostar. Development of Industrial Policies in the Federation of BiH. 2009.

³² European Environment Agency :Country profile (Bosnia and Herzegovina), http://www.eea.europa.eu/soer/countries/ba/soertopic_view?topic=country%20introduction, accessed October 1, 2011.

the period 1992-1995 was estimated at 10 years.³³ Additional problem the country was faced with during the war as well as today is brain drain. Almost 60% of scientists with a technical education have left the country.³⁴

The transition process from a centrally planned economy to a market economy had already been started in the late 1980s and 1990s in Eastern Europe, but the war in Bosnia and Herzegovina halted the transition process until the war ended in 1996. After the war, Bosnia and Herzegovina started with restructuring and reconstructing the economy. One of the main issues was prioritizing small and medium enterprises over the large public enterprises which were common in the socialist era.³⁵ The government has tried to support SME through various channels, but the results were unsatisfactory. All the efforts did not lead to the strengthening of the private sector and thus economic development of the country.

Today, Bosnia and Herzegovina is considered an open economy. The GDP per capita (based on PPP) in the year 2010 was \$7,816 slightly increasing from \$7,659 in 2009. The Report of Country Partnership Strategy for Bosnia and Herzegovina specified the shares of value added: “Some 65 percent of value added is created in service sectors (retail trade, public administration and financial services, etc.) while the remaining 35 percent is split between manufacturing, 25 percent (industry, construction and energy production); and agriculture 10 percent”.³⁶

³³ Ibid.

³⁴ Stojanov, Dragoljub., Supply-side industrial strategy : the case of Bosnia and Herzegovina, *Cooperation South*, (2, 2000) : 64-84.

³⁵ Ministry of Foreign Trade and International relations of Bosnia and Herzegovina. Small and Medium-Sized Enterprise Development Strategy in Bosnia and Herzegovina 2009 – 2011.

³⁶ The World Bank – Bosnia and Herzegovina Partnership, Country Program Snapshot, April 2011.

Regarding trade, it is mostly conducted with EU member countries and countries from South East Europe. The main export products are: base metals, products of mineral origin, machinery, mechanical and electrical equipment, wood products, products of chemical industry, food products and transport equipment, while the main import products are products of mineral origin, machinery, mechanical and electrical equipment, base metals, products of chemical industry, food products, transport equipment, wood and wood products.

Analysis of exports and imports in accordance to their economic purpose shows that in most cases Bosnia and Herzegovina exports and imports intermediate products, with the share being 41.7% and 29.5% respectively. Furthermore, mostly imported are non-durable consumer goods 26.2% and capital goods 16.4%.

In the period 2000-2008, Bosnia and Herzegovina was running trade deficit. According to the data of the Central Bank of Bosnia and Herzegovina, during the same period the total amount of exports grew from 2.05 billion KM to 6.88 billion KM. In addition, total amount of imports grew from 7.64 billion to 16.32 billion KM, increasing the trade deficit from 5.58 billion KM to 9.42 billion KM. Only in 2008, the trade deficit had increased for 1.32 billion KM.³⁷

The economy of Bosnia and Herzegovina went through a recession in 2009, following the global financial crisis of 2008. The economic growth dropped by 9 % in 2009, from 5.7% to -3.1% in 2009. Job creation was halted and the unemployment rate stayed at a very high level, around 40%. Furthermore, it slowed down the poverty reduction in the country. In 2009, the trade deficit declined by 29.4%. The decline was a result of decrease of domestic imports and not as a result of improved position of Bosnian products in the foreign markets.³⁸

³⁷ The Central Bank of Bosnia and Herzegovina, <http://www.cbbh.ba/>, (Accessed February 10, 2012).

³⁸ Ibid.

The economy showed slight improvement in 2010, recovering to 0.8% and is expected to reach 2.2% in 2011. The improvements were mostly a consequence of increased foreign demand, thus increasing exports to these foreign markets. Exports amounted to 7.03 billion KM in 2010, increasing by 28.7 % compared to previous year. Imports increased by 10.2%, amounting to 13.61 billion KM, leading to a decrease in trade deficit by 4.5 % to 6.51 billion KM. Overall, the recovery from recession was slow, with an increase in unemployment, making cuts in public-sector wages and social welfare benefits to restrain the budget deficit.³⁹

Chapter 4 - Efforts of the government to improve the economic development of Bosnia and Herzegovina

Government of Bosnia and Herzegovina is attempting to improve the economic development of the country by creating various strategies, such as the Development Strategy of Bosnia and Herzegovina, SME Development Strategy, projects regarding industrial policies, etc.

Development Strategy of Bosnia and Herzegovina was created by the Directorate for Economic Planning of Bosnia and Herzegovina for the period 2008 – 2013. The Development Strategy is based on creating a competitive economy aimed at increasing employment, following the principles of sustainable development and macroeconomic stability with greater social justice. Nevertheless, it should be noted that this Development Strategy has not yet been adopted at the state level and the level of Republic of Srpska, only at the level of the Federation of Bosnia and Herzegovina and the District of Brcko. Sense of future adoption at the state level is questionable since it is already 2012.

³⁹ The World Bank – Bosnia and Herzegovina Partnership, Country Program Snapshot, April 2011.

In the Development Strategy, the importance of strengthening productivity and competition of domestic economy is emphasized through:

- Completion of privatization by the end of 2013;
- Restructuring of state-owned enterprises and privatized firms;
- Reducing the tax and non-tax burden on the economy, especially regarding contributions;
- Increasing the mobility of the labor market;
- Reducing the informal economy as well as other forms of unfair competition;
- Improving the business climate, particularly in the area of greater investment protection (acceleration of the process of contract enforcement and increase the efficiency of the courts).⁴⁰

One of the biggest challenges of Bosnia's economy is its competitiveness. It is one of the least competitive countries in Europe. The Development Strategy refers to the “Doing Business” indicator, where they draw the conclusion that enforcement of contract, property registration, starting a business and getting a credit are among the main reasons for the weak competitiveness of the Bosnian economy. In the Strategy, they go further on explaining that the legal framework for conducting economic activities is not developed and briefly mention that investment and trade will be jeopardized, unless the property rights and enforcement of contract were secure. Although they recognized these barriers, they do not go into details proposing specific measures how to improve these impediments to the competitiveness of the economy.

⁴⁰ Bosnia and Herzegovina Directorate for Economic Planning, “Development Strategy of Bosnia and Herzegovina”.

One of the priorities for improvement of macroeconomic stability is the improvement of foreign trade. According to the Strategy, measures to be taken for the realization of the priority are:

- Encouragement of restructuring, modernization and standardization of operations and product development in accordance to the requirements of the key foreign markets;
- Policy development of strategic products;
- Strengthen the support for exporters.

The last two measures require state interference in terms of favoring one product over another, as well as giving financial incentives to exporters. Regarding the strategic product, they state that it is necessary to stimulate the production of goods and services which are not made (or not made sufficiently enough) in Bosnia and Herzegovina, and are therefore imported. Furthermore, the production surpluses would be placed on international markets. As for the exporters' support, the Strategy emphasizes the necessity to financially support current and potential exporters, whether it is by tax incentives, guarantees, insurance, financial schemes, etc.

To support these measures and the export promotion policies, the example of Korea was used and how the import substitution policy in the 1950s only led to 2-3% growth, whereas export promotion in the 1960s led to over 7% of economic growth. Unfortunately, the economic growth of Korea was not government-led as it is widely believed.⁴¹

⁴¹ Yoo Jungho, "Myths about Korea's Rapid Economic Growth", KDI School of Public Policy and Management (2009).

The export expansion in Korea happened much before the government decided to pursue export promotion policies. In fact, it happened after the Korean Won devalued three times at the beginning of the 1960s. That resulted in an expansion of manufactures exports, thus leading to a change in policies – export promotion replaced import substitution. The switch to export promotion was not something that the government planned, but it was rather a decision they made seeing the result of already increased exports.

2009-2011 SME Development Strategy in Bosnia and Herzegovina was created with the objective to create better work conditions for the SMEs. As short term priorities, coherent legal and institutional framework for SMEs and adoption of the SME Strategy as well as establishment of SME Agency were listed. Most countries in Western Balkans except Bosnia and Herzegovina already have an SME Agency.

The objectives mentioned in the SME Development Strategy are very broad and general, such as: “Stimulate growth through targeted support to high-growth, innovative and export-oriented SMEs“; “Improve the business support environment (legal and financial environment, institutional business support infrastructure)“; “Provide incentives to new businesses across all sectors of the economy“; “Improve competitiveness of SMEs on domestic and foreign markets“, etc.⁴² No one can certainly deny the importance of these general objectives. The problem is that they do not provide specific objectives or measures on how to reach these goals.

The SME Strategy also lists the laws and regulations which should be adopted in order to support to SMEs. Laws such as the Law on Registration, the Law on Accounting and

⁴² Ministry of Foreign Trade and International relations of Bosnia and Herzegovina. Small and Medium-Sized Enterprise Development Strategy in Bosnia and Herzegovina 2009 – 2011.

Auditing (both only needed to be reviewed and modified), the Law on SME Promotion and Entrepreneurship, the Law on Statistics and the Law on Companies of entities and Brcko District are seen as a necessity for the development of SMEs and the normal conduct of business.

The Law on Property Rights, which at the time of creating the Strategy was not yet adopted in the Republic of Srpska, and is still not adopted in the Federation of Bosnia and Herzegovina, cannot be found on the list. Moreover, throughout the whole Strategy, the issue of corruption and enforcement of contract and the impact it has on entrepreneurship is not mentioned. It can be concluded that the government considers property rights as given, and moreover does not consider weak property rights, enforcement of contract and corruption to be an obstacle for SME development.

Another attempt of the government to boost the development of the country are projects concerning industrial policies. In 2010, the House of Representatives of Federation of Bosnia and Herzegovina adopted the document “Project proposal of development of industrial policies in Federation of Bosnia and Herzegovina” highlighting the need for industrial revitalization in the entity. The project proposal defines in which direction the industry in Federation of Bosnia and Herzegovina will develop in the following ten years. Among others, it elaborates how the Federation of Bosnia and Herzegovina will be positioned in the market and how it will find the funds for future funding of industrial projects.

The Republic of Srpska developed the project “Strategy of Industrial Policies of Republic of Srpska” already in the year 2000. The project was initiated on the basis of the Declaration of the Peace Implementation Council conclusions (Madrid Declaration) and the Program of the

Ministry of Industry and Technology of the Government of the Republic of Srpska. The role that exports have in the economic growth of a country is undeniable. The problem arises when one is using export promotion and other industrial policies to reach that goal. Whether they are using subsidies, import tariff exemptions, tax breaks, or cheap credit to promote certain industries, it has been difficult to prove the significance of these measures.⁴³ No matter how many successful cases of industrial policies exist, there are as many failures – and they are not gladly discussed.

It is also questionable whether the government would be competent enough to successfully target the “winning” industries. They could also be keen in favoring industries due to certain special interest they have.⁴⁴ It could all lead to failed industries and thus, wasted resources. Moreover, inefficient government intervention can also lead to government failure. Nevertheless, it should be noted that this cannot be a permanent solution for the long-term development of the country.

Chapter 5 - Property rights, corruption and enforcement of contract in Bosnia and Herzegovina

In this part of the paper I will analyze how property rights, corruption and enforcement of contract affect the business environment in Bosnia and Herzegovina, and thus affect the economic development of the country. The factor of property rights has been chosen as an indicator of business environment, since the securing of property rights is of great importance for the sustainability of the economic development. Corruption and enforcement of contract is interlinked with property rights and must be taken into account when analyzing the business

⁴³ Commission on Growth and Development. The Growth Report: Strategies for Sustained Growth and Inclusive Development”, Washington D.C.,2008.

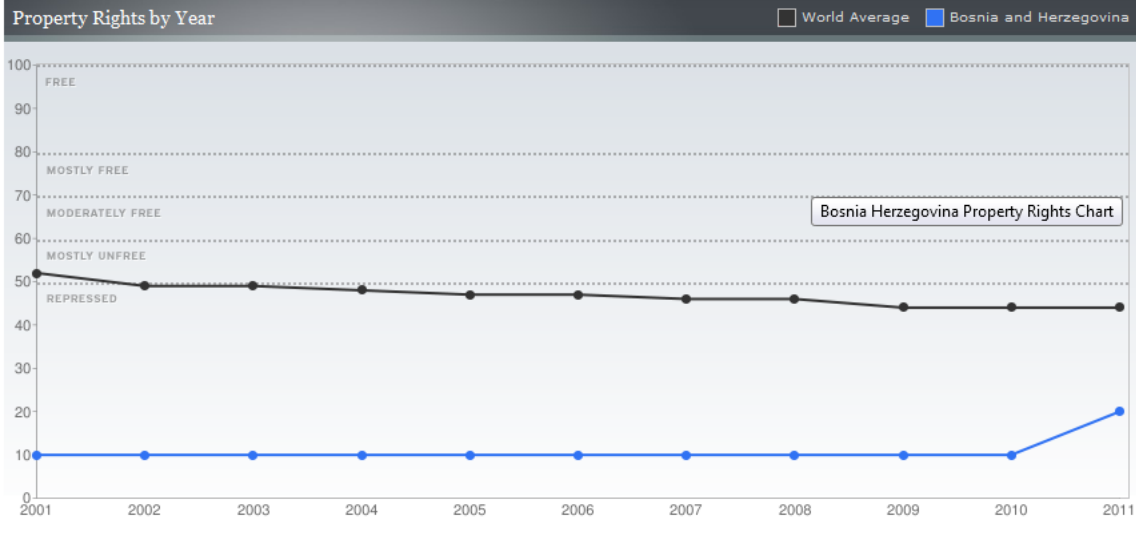
⁴⁴ Ibid.

environment. Enforcement of contracts is considered a necessity in guaranteeing integrity in the market. Furthermore, countries with good contract enforcement produce and export more products than countries with poor contract enforcement.⁴⁵

5.1 Property rights

The Heritage Foundation’s Index of Economic Freedom has among others the indicator for property rights. In the Index of Economic Freedom, they emphasize the importance of property rights stating: “Secure property rights give citizens the confidence to undertake entrepreneurial activity, save their income, and make long-term plans because they know that their income, savings, and property (both real and intellectual) are safe from unfair expropriation or theft“. ⁴⁶ In the Index of Economic Freedom 2011, property rights freedom in Bosnia and Herzegovina was ranked 146 out of 183 countries. This low ranking means that property rights are unreliable.

Figure 1: 2011 Index of Economic Freedom - Property Rights Chart: Bosnia and Herzegovina and World Average



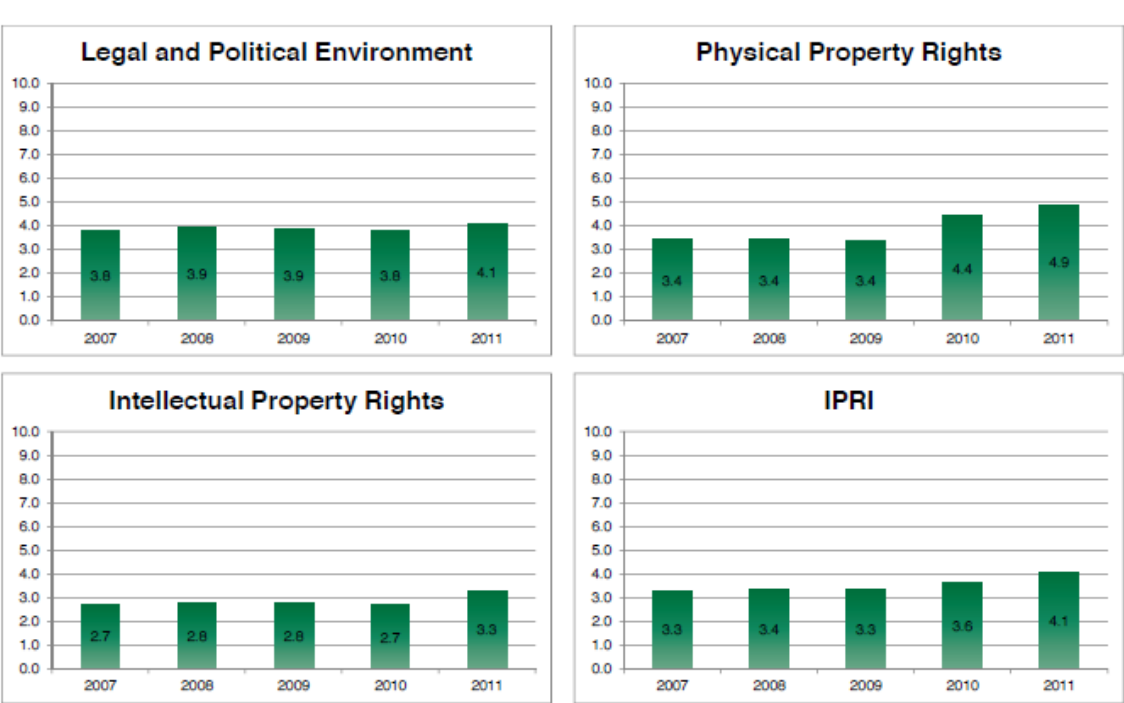
Source: Heritage Foundation (2011)

⁴⁵ Nathan Nunn, 2007. "Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade," The Quarterly Journal of Economics, MIT Press, vol. 122(2), pages 569-600, 05.

⁴⁶ The Heritage Foundation and the Wall Street Journal: 2011 Index of Economic Freedom, <http://www.heritage.org/Index/> (Accessed October 1, 2011).

The International Property Rights Index (hereinafter: IPRI), in-depth international measurement of property rights, consists of three components: Legal and Political Environment, Physical Property Rights and Intellectual Property Rights. It placed Bosnia and Herzegovina in 113th place of 129 countries. Moreover, Bosnia and Herzegovina was placed in the bottom 10 in the Physical Property Rights component together with countries such as Chad, Ukraine and Bangladesh.

Figure 2: 2011 International Property Rights Index for Bosnia and Herzegovina



Source: IPRI

Bosnia and Herzegovina showed certain improvements in *Judicial Independence*, *Registering Property* and *Access to Loans* subcomponents, which raised the Legal and Political Environment and Physical Property Rights component and thus raising the IPRI of the country. The result is nevertheless worrying and should raise concerns.

The Law on Property Rights in Bosnia and Herzegovina, which is supposed to be harmonized at the state level, has been adopted only in the Republic of Srpska in November 2008 and is applied since January 2010. This law marks the biggest reform in the area of property and legal matters.⁴⁷ It extensively regulates the issue of property rights. It is stated that this law: “re-establishes the principle "superficies solo cedit" i.e., the unity of the property, unimodality of property rights, introduces new property rights, land debt and rights to construction, exerts the conversion of rights arising as a result of socialization (the right to use, disposal and management) to the right of ownership and revokes an enormous number of valid regulations”.⁴⁸

The Law on Property Rights Relations has existed in the Federation of Bosnia and Herzegovina, the larger of Bosnia and Herzegovina’s two entities, since 1998. There has been substantial change in this field since 1998, and the purpose of the Law on Property Rights, which is already adopted in the Republic of Srpska, is to fully and in one place regulate the right of ownership right as the fundamental property right. The adoption of the Law on Property Rights is slow, where only the draft of this law has been adopted by the House of the People of the Federation of Bosnia and Herzegovina in September 2011. The stalling of adoption of such laws causes damage to the business environment. Additionally, inequality between the entities regarding the adopted laws, creates a favorable environment in one part of the country, and thus, could cause businessmen to consider starting a business in the entity which has a better environment for them.

⁴⁷ Analysis of reflection of the draft of the Law on Property Rights FBiH on Local Self governance and accompanying laws, Governance Accountability Project, http://www.bihgap.ba/dokument_new/policy%20publikacije/Analiza%20%20Stvarno-pravna%20reforma%20FBiH%20LOCAL.pdf (Last Accessed November 5, 2011).

⁴⁸ Ibid.

Certain progress has been made in the land registry administration. The reform in this area has led to the reduction of numbers of procedures necessary for registration of real estate. Furthermore, old land registries and cadastral records have been digitalized, resulting in decreasing the time it takes to register property from 331 days in 2008 to 33 days in 2011 in the city of Sarajevo, and from 145 days in 2008 to 117 days in 2011 in Mostar.⁴⁹ The reform of property registration since then has been lagging.

5.2 Corruption

Corruption is considered to be one of the impediments to development in Bosnia and Herzegovina. Bosnia and Herzegovina ranked 91 out of 183 countries in the Corruption Perception Index 2011 of Transparency International. Moreover, in the Transparency International's 2010 Global Corruption Barometer, 59% of interviewees believed that the corruption has increased in the past three years in Bosnia and Herzegovina.⁵⁰ Additionally, they believed that the anti-corruption actions of the government were ineffective.

Corruption is related to the distortion of the business environment. The business/private sector received a rating of 3.6 (1 meaning not corrupt at all and 5 extremely corrupt) in the 2010 Global Corruption Barometer. It shows that the corruption is perceived as relatively high in institutions dealing with business matters.

In the year 2000, the World Bank did extensive research on corruption. Their report "Bosnia and Herzegovina Diagnostic Surveys of Corruption", covered three surveys where 700 public

⁴⁹ The World Bank: 2011 Doing Business Sub –South East Europe, <http://www.doingbusiness.org/reports/subnational-reports/south-east-europe> (Accessed November 6, 2011).

⁵⁰ Transparency International, Global Corruption Barometer 2010.

officials, 350 enterprise managers, and 1,200 individuals were interviewed.⁵¹ The report has shown that corruption imposes a financial burden for firms and loss of time when dealing with bureaucracy issues.

Table 1: Bribe reported by entrepreneurs in Bosnia and Herzegovina

Type of service	Mean amount of bribe (in KM, 1 KM = 0,51129 EUR) as reported by entrepreneurs
To get connected to and maintain public services (electricity, telephone)	288
To get licenses and permits	463
To deal with taxes and tax collection	609
To gain government contracts	504
To deal with customs/imports	601
To deal with courts	216
To deal with health/sanitation/fire inspectors	120

Source: World Bank, Bosnia and Herzegovina Diagnostic Surveys of Corruption

The average amount of bribe entrepreneurs had to give in 2000 was between 120 KM and 609 KM. In addition to the financial aspect of corruption, entrepreneurs had to spend a certain amount of time dealing with the bureaucracy. Corruption is also seen as an obstacle for acquiring licenses, permits and certificates which are necessary for firms.⁵²

Corruption in the legal and regulatory process, unpredictability of legal and policy environments and changes in government economic policies were all seen as impediments to development of the business environment and increase business risk. Private firms were more vulnerable to unpredictability and changes than public firms since public firms are better connected and better informed. This makes public firms more prone to influencing policies.⁵³

⁵¹ The World Bank: Bosnia and Herzegovina Diagnostic Surveys of Corruption, 2001.

⁵² OECD and EBRD, Enterprise Policy Performance Assessment: Bosnia and Herzegovina, Enterprise Policy Performance Assessments, OECD, Paris. 2005.

⁵³ The World Bank: Bosnia and Herzegovina Diagnostic Surveys of Corruption, 2001.

The survey which was conducted among entrepreneurs for the research paper, “Enterprise Policy Performance Assessment: Bosnia and Herzegovina”, showed that 70% of entrepreneurs were not aware of government programs aimed at tackling the issue of corruption. This suggests that a problem of poor implementation of these programs exists. Moreover, it shows that these programs had little or no impact in fighting corruption.

In 2009, the National Anti-Corruption Strategy 2009-2014 and accompanying Action Plan were adopted. The Strategy defines the overall objectives of the fight against corruption and the required resources and methods of implementation, while the Action Plan identifies measures that are needed to be implemented, along with naming responsible institutions and deadlines for implementation. Furthermore, the Law on the Agency for Corruption Prevention and Co-ordination of the Fight against Corruption was adopted by the Parliamentary Assembly of Bosnia and Herzegovina in late 2009. This law establishes the Agency whose objective is preventing the impact of corruption on development of democracy and respect for fundamental human rights and freedoms. Additionally, the objective of the Agency is to prevent the undermining of economic development in Bosnia and Herzegovina, and to coordinate the fight against of corruption. The Agency should be independent and self-governed, and should act on behalf of or with consent of the court.

At first glance, it seemed Bosnia and Herzegovina was finally ready to address the issue of corruption more thoroughly and take necessary steps in fighting it. The 2011 Progress Report of the European Commission has shown otherwise. The Progress Report indicates that all the findings are repeated each year, and thus are ignored by the authorities in Bosnia and Herzegovina. Other problems are that the laws aimed at fighting corruption are not harmonized at different government levels; delay in implementation of the Strategy exists as

well as unfamiliarity of institutions with the Strategy.⁵⁴ What causes all these problems is the lack of political will in combating the issue of corruption.

There have been many problems with establishing the Agency for Corruption Prevention and the Co-ordination of the Fight against Corruption. Within the first year of establishment, the Agency had done nothing concrete – it had no executive power, employees, and among others, did not adopt rules of procedures. The finally elected administration of the Agency was appointed by political lines.⁵⁵ This could jeopardize the future work of the Agency which can fall under the control and influence of parties.

5.3 Enforcement of Contract

The enforcement of contract indicator in the Doing Business Report of the World Bank measures the number of procedures which are necessary to enforce contracts through courts, as well as the time and cost of completing the procedures.⁵⁶ In the 2012 Doing Business Report, Bosnia and Herzegovina was ranked 125 out of 183 in ease of enforcing contracts. It is next to countries such as Kenya, Jamaica and Côte d'Ivoire. In a commercial dispute, 37 procedures are required to enforce contracts through courts, 595 days to complete the procedures and it would cost an astonishing 40% of the claim, with 20,7% being the EU average. What is worrying is that no reform has been done in this field for the past 4 years which would make enforcement of contracts easier.

⁵⁴ Bosnia and Herzegovina 2011 Progress Report, Commission Staff Working Paper SEC1206 final, European Commission, 2011 http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/ba_rapport_2011_en.pdf (Accessed November 11, 2011).

⁵⁵ The administration Agency for the Prevention of Corruption, appointed by political lines, Transparency International Bosnia and Herzegovina, July 15, 2011, <http://ti-bih.org/en/4279/the-administration-agency-for-the-prevention-of-corruption-appointed-by-political-lines/> (Accessed November 12, 2011).

⁵⁶ The World Bank: 2011 Doing Business Sub –South East Europe, <http://www.doingbusiness.org/reports/subnational-reports/south-east-europe> (Accessed November 6, 2011).

The property rights freedom of the Index of Economic Freedom also includes contract enforcement. The 2011 Report stated that the judicial system in Bosnia and Herzegovina does not cover commercial activities adequately, contracts are unenforceable and court decisions are difficult to enforce.⁵⁷

Commercial courts, which could speed the process of contract enforcement, exist only in Republic of Srpska, one of two entities in Bosnia and Herzegovina. The District Commercial Courts were established by the Law on Changes of the Law on Courts and started with work in May 2010. By establishing these commercial courts, it allowed for commercial courts to take over jurisdiction from the Basic Court, and thus making progress in enforcement of contracts. The positive changes of these commercial courts can be seen in the shortening of the filing period for commercial claims from 6 months to a month and a half, and reducing the enforcement period to less than 400 days.⁵⁸

In the Federation of Bosnia and Herzegovina, commercial disputes are handled in municipal courts which have set up special commercial departments. But these commercial departments lack in court staff and a problem of backlog of unresolved cases exists. These are just some issues which entrepreneurs face in this entity.

⁵⁷ The Heritage Foundation and the Wall Street Journal: 2011 Index of Economic Freedom, <http://www.heritage.org/Index/> (Accessed October 1, 2011).

⁵⁸ The World Bank: 2011 Doing Business Sub –South East Europe, <http://www.doingbusiness.org/reports/subnational-reports/south-east-europe> (Accessed November 6, 2011).

Table 2 below shows the flow of commercial cases in the municipal and basic courts in 2009:

Table 2: Case flow of commercial cases in the municipal and basic courts in 2009

Commercial cases	No. of unresolved cases as of 1.Jan.2009 I	No. of cases received in 2009 II	Total no. of cases processed in 2009 III = I + II	No. of cases resolved in 2009. IV	No. of unresolved cases as of 31.Dec.2009 V = III - IV
Commercial cases	13812	9275	23087	9514	13573
Small value commercial disputes	8398	7620	16018	4950	11068
Liquidation cases	1457	1431	2888	1384	1504
Ex officio liquidation procedures	0	73	73	71	2
Bankruptcy procedures	565	359	924	337	587
Other	8	0	8	4	4
Total	24240	18758	42998	16260	26738

Source: The 2009 Annual Report of the High Judicial and Prosecutorial Council of Bosnia and Herzegovina

The tables show an overwhelming number of unresolved cases. In most cases, the number of unresolved cases at the beginning and end of the year is almost the same, which suggests that the court is inefficient in handling all the cases and is lacking in number of court personnel which could help reduce the number of case backlogs.

In order to improve court administration and strengthen enforcement procedures through mediation, technical assistance was provided by the World Bank, SEED and USAID. Furthermore, the Law on Mediation was enacted in 2004 in Bosnia and Herzegovina. It defines the process of mediation, the principles and the role of mediator in the process, and deadlines, if the judicial proceedings are in progress.

Mediation was introduced as an alternative to solve business disputes - as an alternative to the expensive and inefficient court procedures, but this out-of-court settlement method has not been used often. Such methods of dispute settlement could shorten the time of procedure and save money for both parties which are important and valuable for business performance. Furthermore, it could decrease the number of cases which end in discontinuation of business relationships.

While mediation can be successful in easing the burden of the courts, it should not completely substitute for the judicial system. The government should not rely only on alternative dispute settlement procedures, but should rather still work on making the judicial system more efficient.

Chapter 6 - Significant empirical studies demonstrating the importance of property rights, contract enforcement and corruption in economic development

Due to the nature of the subject of the paper, it was difficult to test the hypothesis by conducting empirical research on the case of economic development in Bosnia and Herzegovina. Therefore, in order to support my hypothesis, I relied on previous empirical studies on the significance of institutions and on the successful example of Botswana's economic development.

Many empirical studies were conducted proving the importance of institutions for the economic development of a country. Institutions play a vital role in providing a favorable environment for stimulating entrepreneurship by securing property rights and among others, enforcing contracts.

A study conducted by Knack and Keefer (1995) showed that secured property rights and contract enforcement have an effect on investment, thus affecting the economic growth of a country. To research this matter, they used variables from International Country Risk Guide (ICRG) and Business Environmental Risk Intelligence (BERI). ICRG variables referred to: "Corruption in Government," "Rule of Law," "Expropriation Risk," "Repudiation of Contracts by Government," and "Quality of the Bureaucracy".⁵⁹ Low scores on Rule of Law and Expropriation Risk indicate reduction in investments due to the investor's fear of possible loss of investments. Scoring low in Corruption in Government and Quality of the Bureaucracy indicates lack of competence and misallocation of public goods. Moreover, it increases the likelihood of property appropriation. The last variable, Repudiation of Contracts by Government, represents as well a constraint to economic activities. The BERI index consisted of "Contract Enforceability," "Nationalization Risk," "Infrastructure Quality" and "Bureaucratic Delays".⁶⁰

Prior to their research, most research focused on the Gastil measures of political freedom and measures used by Barro (1991), mainly being measures of political instability. Knack and Keefer believed these indexes were not good representatives of measures of institutions used to explain economic performance and that it was better to use more specific indicators of property rights and contract enforcement.⁶¹

Empirical analysis showed that institutions that protect property rights were correlated with economic growth. When investments were controlled for, institutions still had a significant effect on growth, emphasizing the effect property rights had on allocation of inputs. Moreover,

⁵⁹ Knack, Steven and Philip Keefer. "Institutions and Economic Performance: Cross-Country Tests Using Alternative Measures," *Economics and Politics*, 7, 207-227 (1995).

⁶⁰ Ibid.

⁶¹ Knack, Steven and Philip Keefer. "Institutions and Economic Performance: Cross-Country Tests Using Alternative Measures," *Economics and Politics*, 7, 207-227 (1995).

Knack and Keefer explained that discouraged investments are a result of violated property rights, which ultimately obstructs economic growth.

One of the most important empirical studies which was influenced by Knack and Keefer's findings was conducted by Robert Hall and Charles Jones. Using the example of United States and Niger in the year 1988, they pointed out that the output per worker in the United States was 35 times higher than output per worker in Niger. Hall and Jones questioned why output per worker varied enormously between countries. They claimed in their paper that "differences in capital accumulation, productivity, and therefore output per worker are fundamentally related to differences in *social infrastructure* across countries", defining social infrastructure as "the institutions and government policies that determine the economic environment within which individuals accumulate skills, and firms accumulate capital and produce output".⁶² Moreover, a favorable social infrastructure enables firms and individuals to acquire skills, make investments and produce goods and services.

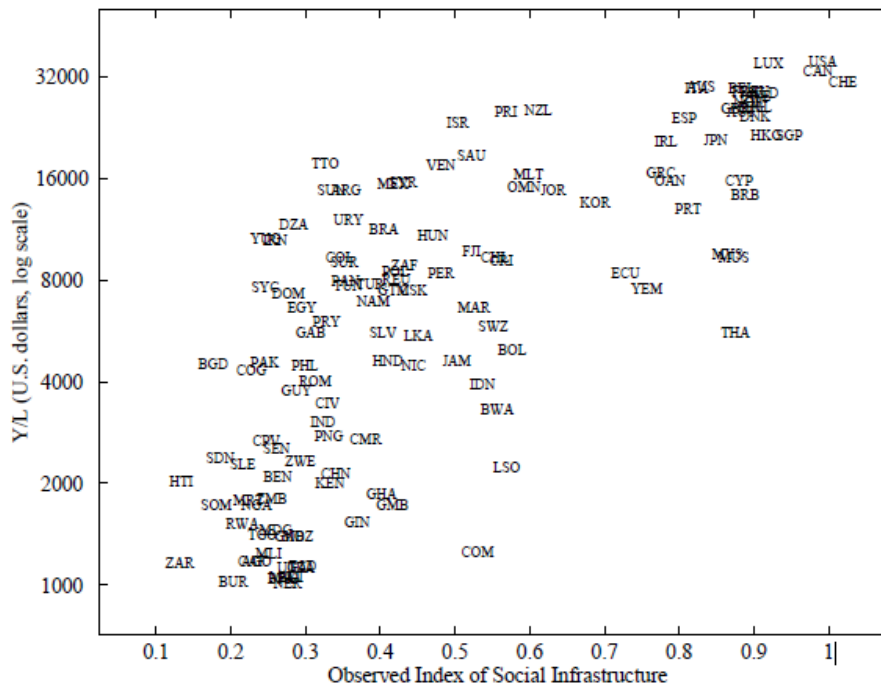
The extensive research of Hall and Jones included 127 countries with data for the year 1988. The data consisted of data on output, labor input, average educational attainment, and physical capital.⁶³ In addition, they have created an index of social infrastructure, consisting of an index of government anti-diversion policies and an index of openness to international trade. The government anti-diversion policies index incorporated following measures: law and order, bureaucratic quality, corruption, risk of expropriation, and government repudiation of contracts.⁶⁴

⁶² Hall, Robert, and Charles Jones. 1999. "Why Do Some Countries Produce So Much More Output per Worker Than Others?" *Quarterly Journal of Economics* 114, no. 1: 83–116.

⁶³ Hall, Robert, and Charles Jones. 1999. "Why Do Some Countries Produce So Much More Output per Worker Than Others?" *Quarterly Journal of Economics* 114, no. 1: 83–116.

⁶⁴ *Ibid.*

Figure 3: Social Infrastructure and Output per Worker



Source: Hall, Robert, and Charles Jones. Why Do Some Countries Produce So Much More Output per Worker Than Others?"

The empirical analysis Hall and Jones have conducted has shown that output per worker was positively correlated with social infrastructure. Furthermore, their empirical analysis has shown that while the level of education and differences in physical capital explain only to a certain degree the variation in output per worker across countries, the variations can be better explained by the social infrastructure.

While the government can successfully provide a social infrastructure and encourage product activities, it can also have a negative impact and hinder country's development. Through predation in the form of corruption, property expropriation and confiscatory taxation, the government can negatively interfere in the business environment. Where the social infrastructure is weak, individuals will be reluctant to start a business and it will affect their

incentive to invest. Overall, a country with better social infrastructure will develop faster in the long run and thus have a higher GDP.

Roll and Talbott (2001) questioned what causes wealth disparity between nations. Their research included data for the period 1995- 1999 from sources such as The Index of Economic Freedom, Freedom House, World Bank and CIA Factbook. Variables which were included in the study were property rights, black market activities, political rights, regulation, civil liberties, trade barriers, inflation, government expenditures and freedom of the press. Additionally, they used GNI per capita as a measure of economic well-being, stating that it is more reliable than using growth.

Table 3 Cross-Country multiple regressions of GNI per capita on fourteen determinants

	b		c		b		c		b		c		b		c	
	1999		1998		1997		1996		1995							
Trade Barriers	<u>-1235</u> <i>-6.26</i>	<u>-857</u> <i>-2.61</i>	<u>-155</u> <i>-6.46</i>	<u>-570</u> <i>-1.73</i>	<u>-1632</u> <i>-8.73</i>	<u>-665</u> <i>-1.93</i>	<u>-1234</u> <i>-4.79</i>	<u>-337</u> <i>-0.88</i>	<u>-1757</u> <i>-7.24</i>	<u>-629</u> <i>-2.15</i>						
Taxes	<u>420</u> <i>0.74</i>	<u>375</u> <i>0.50</i>	<u>-383</u> <i>-0.74</i>	<u>1004</u> <i>2.77</i>	<u>292</u> <i>0.43</i>	<u>437</u> <i>0.59</i>	<u>319</u> <i>0.68</i>	<u>1074</u> <i>1.81</i>	<u>86</u> <i>0.19</i>	<u>817</u> <i>1.49</i>						
Government Expenditures	<u>2476</u> <i>5.49</i>	<u>-394</u> <i>-1.01</i>	<u>2111</u> <i>5.32</i>	<u>468</u> <i>0.73</i>	<u>1888</u> <i>5.36</i>	<u>-932</u> <i>-2.48</i>	<u>1102</u> <i>2.98</i>	<u>-659</u> <i>-1.54</i>	<u>980</u> <i>1.13</i>	<u>-1111</u> <i>-1.92</i>						
Government Intervention	<u>478.5</u> <i>1.17</i>	<u>-235</u> <i>-0.41</i>	<u>574</u> <i>1.32</i>	<u>-130.4</u> <i>-0.26</i>	<u>155</u> <i>0.34</i>	<u>-550</u> <i>-1.16</i>	<u>149</u> <i>0.51</i>	<u>-524</u> <i>-0.93</i>	<u>728</u> <i>1.63</i>	<u>-219</u> <i>-0.48</i>						
Monetary Policy	<u>-1497</u> <i>-7.89</i>	<u>1423</u> <i>4.37</i>	<u>-1530</u> <i>-8.00</i>	<u>1217</u> <i>3.30</i>	<u>-1535</u> <i>-7.84</i>	<u>545</u> <i>1.58</i>	<u>-1490</u> <i>-8.49</i>	<u>600</u> <i>1.86</i>	<u>-1273</u> <i>-7.04</i>	<u>101</u> <i>0.30</i>						
Foreign Inv. Barriers	<u>-145</u> <i>-0.48</i>	<u>-164</u> <i>-0.23</i>	<u>-168</u> <i>-0.49</i>	<u>135</u> <i>0.17</i>	<u>-463</u> <i>-1.29</i>	<u>1152</u> <i>1.31</i>	<u>-476</u> <i>-1.29</i>	<u>1103</u> <i>1.54</i>	<u>-711</u> <i>-1.80</i>	<u>209</u> <i>0.39</i>						
Banking Restrictions	<u>-437</u> <i>-1.66</i>	<u>-1120</u> <i>-1.92</i>	<u>-361</u> <i>-1.10</i>	<u>-397</u> <i>-0.70</i>	<u>-293</u> <i>-1.02</i>	<u>-1095</u> <i>-1.79</i>	<u>-282</u> <i>-1.07</i>	<u>34</u> <i>0.05</i>	<u>-660</u> <i>-2.77</i>	<u>-345</u> <i>-0.62</i>						
Wages and Prices	<u>-294</u> <i>-1.04</i>	<u>-716</u> <i>-1.33</i>	<u>-222</u> <i>-0.66</i>	<u>-948</u> <i>-1.58</i>	<u>210</u> <i>0.63</i>	<u>-1208</u> <i>-1.61</i>	<u>449</u> <i>1.06</i>	<u>-1282</u> <i>-2.28</i>	<u>-344</u> <i>-0.86</i>	<u>-131</u> <i>-0.17</i>						
Property Rights	<u>1778</u> <i>12.61</i>	<u>2205</u> <i>8.92</i>	<u>1849</u> <i>12.34</i>	<u>1940</u> <i>7.31</i>	<u>1958</u> <i>9.75</i>	<u>2536</u> <i>9.80</i>	<u>2102</u> <i>10.00</i>	<u>2211</u> <i>10.10</i>	<u>1665</u> <i>9.46</i>	<u>1720</u> <i>6.86</i>						
Regulation	<u>-1495</u> <i>-5.08</i>	<u>783</u> <i>1.59</i>	<u>-1982</u> <i>-6.77</i>	<u>-97</u> <i>-0.19</i>	<u>-1507</u> <i>-3.77</i>	<u>904</u> <i>2.18</i>	<u>-2093</u> <i>-6.03</i>	<u>-204</u> <i>-0.37</i>	<u>-1905</u> <i>-4.89</i>	<u>581</u> <i>1.85</i>						
Black Market Activity	<u>-1607</u> <i>-11.08</i>	<u>1981</u> <i>5.99</i>	<u>-1465</u> <i>-7.34</i>	<u>1802</u> <i>5.74</i>	<u>-1667</u> <i>-7.90</i>	<u>1611</u> <i>5.12</i>	<u>-1511</u> <i>-9.42</i>	<u>1572</u> <i>3.85</i>	<u>-1264</u> <i>-9.51</i>	<u>2052</u> <i>5.21</i>						
Political Rights	<u>533</u> <i>3.84</i>	<u>427</u> <i>1.99</i>	<u>506</u> <i>2.05</i>	<u>487</u> <i>1.78</i>	<u>629</u> <i>2.69</i>	<u>490</u> <i>1.67</i>	<u>792</u> <i>3.47</i>	<u>431</u> <i>1.26</i>	<u>877</u> <i>3.99</i>	<u>775</u> <i>2.80</i>						
Civil Liberties	<u>863</u> <i>5.28</i>	<u>1343</u> <i>6.66</i>	<u>909</u> <i>2.96</i>	<u>836</u> <i>2.48</i>	<u>1063</u> <i>3.77</i>	<u>809</u> <i>2.72</i>	<u>1160</u> <i>4.65</i>	<u>778</u> <i>3.14</i>	<u>1240</u> <i>5.29</i>	<u>857</u> <i>4.08</i>						
Freedom of the Press	<u>1074</u> <i>7.16</i>	<u>1696</u> <i>6.22</i>	<u>1125</u> <i>4.69</i>	<u>1710</u> <i>3.42</i>	<u>992</u> <i>4.47</i>	<u>1581</u> <i>3.74</i>	<u>1212</u> <i>5.94</i>	<u>1719</u> <i>4.36</i>	<u>1178</u> <i>5.84</i>	<u>1514</u> <i>3.67</i>						
Intercept	<u>7878</u> <i>16.50</i>		<u>7916</u> <i>23.77</i>		<u>8378</u> <i>22.29</i>		<u>8105</u> <i>21.64</i>		<u>9220</u> <i>11.33</i>							
Adjusted R-square	.846		.819		.818		.829		.819							
N	157		156		148		142		134							

Source: Roll, Richard and Talbott, John. "Why Many Developing Countries Just Aren't"

Table 3 shows Cross-country multiple regressions of GNI per capita on fourteen determinants with the bordered entries denoting a significance level of at least 95%. Furthermore, the empirical analysis has shown that over 80 percent of GNI per capita variations between nations can be explained by variables they have used. There is strong correlation between per capita income, and property rights, black market activity and regulation, showing the highest level of significance.⁶⁵ They further go on explaining that with secure property rights, favorable environment would be created for entrepreneurs. Moreover, with secure property rights, economies of developing countries could develop on their own, without much external help. Entrepreneurs also tend to be cautious when considering investing in states where property rights are not protected due to likelihood of property expropriation. Black market activities are one of the consequences of weak property rights. Roll and Talbott's research has also shown that GNI per capita was negatively correlated to excessive regulation, affecting the decision of entrepreneurs whether to go into business or not.

Factors which caused the wealth disparity among nations is something which governments can actually change. Roll and Talbott emphasized in the paper: "Once a developing country government establishes the rules to a fair game and ensures their enforcement, it would be well advised to stand back and enjoy the self-generating growth".⁶⁶ Government is a key player in providing and enforcing these rules, which among others include strong property rights, tackling issues such as overwhelming regulation, black market activities and corruption, thus enabling entrepreneurs to conduct their businesses properly.

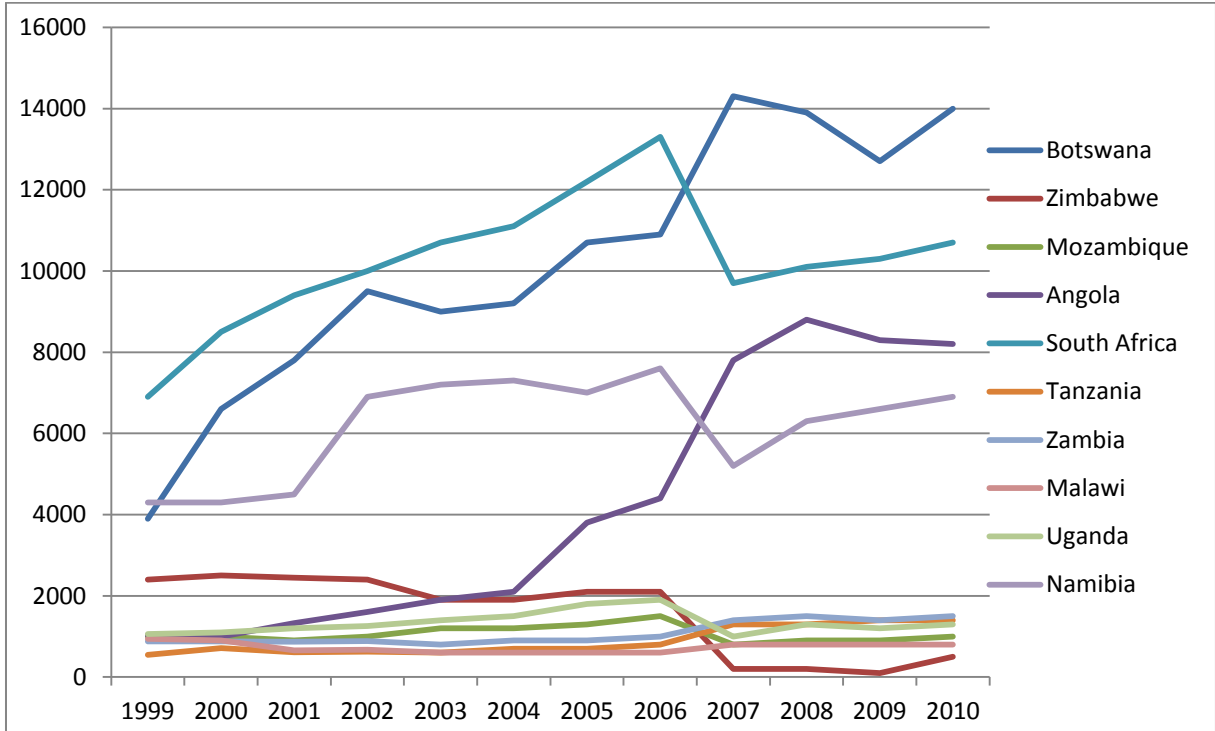
⁶⁵ Roll, Richard and Talbott, John. "Why Many Developing Countries Just Aren't". The Anderson School at UCLA, Finance Working Paper No. 19-01. (2001).

⁶⁶ Roll, Richard and Talbott, John. "Why Many Developing Countries Just Aren't". The Anderson School at UCLA, Finance Working Paper No. 19-01. (2001).

6.1 Supporting evidence: Successful case of Botswana’s economic development

Botswana serves as a perfect example of how a proper foundation established affects the economic development of a country. With \$14,000 GDP per capita (PPP) (2010 est.)⁶⁷, it is one of the most developed countries in Sub-Saharan Africa.

Figure 4: GDP per capita (PPP) for 10 countries in Sub-Saharan Africa (in US dollars)



Source: Central Intelligence Agency, The World Factbook

In 2010, the GDP per capita (PPP) for Sub-Saharan Africa was only \$ 2,258.02. Figure above shows the GDP per capita for 10 Sub-Saharan African countries. As seen, Botswana’s economic performance outranks the performance of most Sub-Saharan African countries. How did Botswana become one of the most developed countries in that region? Unlike many of their neighboring countries, Botswana chose to follow the ideas of market economy and

⁶⁷ Central Intelligence Agency. The World Factbook: Botswana. <https://www.cia.gov/library/publications/the-world-factbook/geos/bc.html> (Accessed January 5, 2012).

securing property rights for the people. By doing that Botswana has had impressive economic growth rates for many years (est. 8.6% in 2010).⁶⁸

The success of Botswana is a result of long-term effort of the government to secure property rights and strengthen the institutions. The political elite of Botswana includes among others cattle owners and tribal actors, and they have certainly contributed to adoption of policies and laws in favor of securing land rights.

The legal framework covering land issues consists of formal and customary laws, ie laws which are based on traditions and customs. It is dedicated to ensuring property rights. Since there are 38 tribes in Botswana it was very important that “The Tribal Land Act“ and “The Tribal Grazing Lands Policy“ were included within the legal framework. With “The Tribal Land Act”, authority was transferred from chiefs to land boards and thus enabled citizens to be able to lease the tribal land for commercial purposes. “The Tribal Grazing Lands Policy“ concerns the privatization of grazing land and is very important since it enables citizens to lease parts of formerly unfenced, communal land.⁶⁹

In the 2012 Doing Business Report, Botswana was ranked 54, with the Sub-Saharan Africa average being 137. Most of the Sub-Saharan African countries performed poorly and can be found at the very bottom of the Doing Business Report. Majority of those African countries are characterized by weak legal institutions as well as expensive and less efficient regulatory processes, thus affecting the property rights protection.

⁶⁸ Central Intelligence Agency. The World Factbook: Botswana. <https://www.cia.gov/library/publications/the-world-factbook/geos/bc.html> (Accessed January 5, 2012).

⁶⁹ USAID Land Tenure and Property Rights Portal. Country Profile: Botswana, <http://usaidlandtenure.net/usaidltpproducts/country-profiles/botswana> (Accessed January 7, 2012)

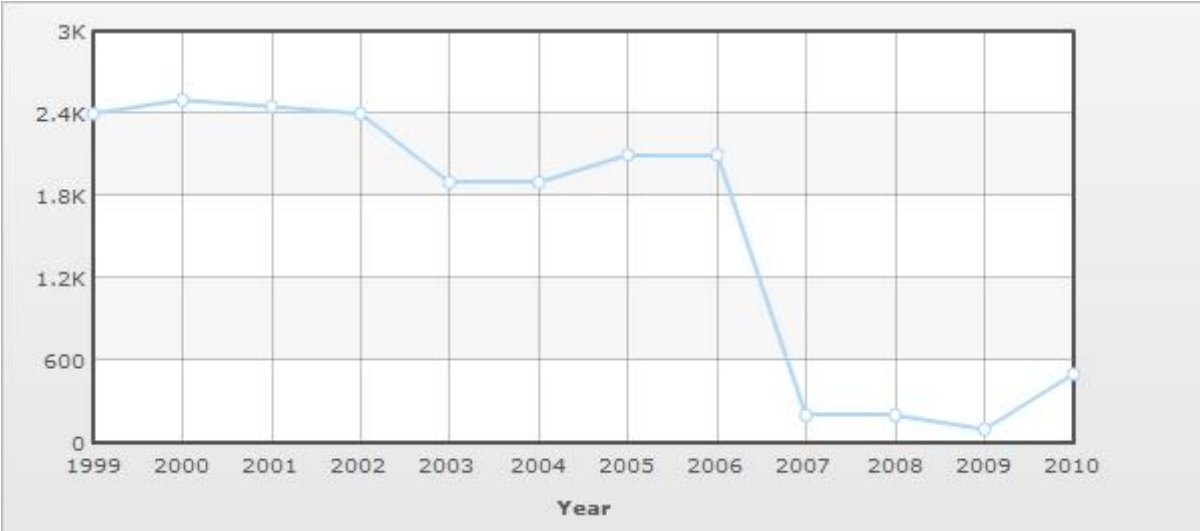
In the component of ease of registering property in the 2012 Doing Business Report, Botswana was ranked 50, with only Ghana and Sudan ranking better from all Sub-Saharan African countries. The cost of transferring property in Botswana is expensive, consisting of 5% of the value of purchase price. Lowering these costs in the future will contribute to creating a favorable business environment, and thus improving their ranking in the Doing Business Report.

Botswana was also ranked 38 in the 2011 International Property Rights Index, placing it right next to countries such as South Korea and Israel. Within the Sub-Saharan region, it was outranked only by Mauritius. The Physical Property Rights component of the IPRI which includes Protection of Physical Property Rights, Registering Property and Access to Loans, received 7.2 out of 10 points, making improvements since 2010. All other Sub-Saharan African countries, except South Africa, are ranked behind Botswana, with Zimbabwe being the worst, ranking at 128th place.

Land reform in 2000 in Zimbabwe, Botswana's neighboring country, has led to seizure of property rights. It caused foreign direct investment to drop immensely and many companies to close their business.⁷⁰

⁷⁰ Halder, Pragna. "What Causes Prosperity?" Association of Private Enterprise Education Essay Contest (2005) <http://www.apee.org/pdf/essay/halderessay2006.pdf> (Accessed January 7, 2012)

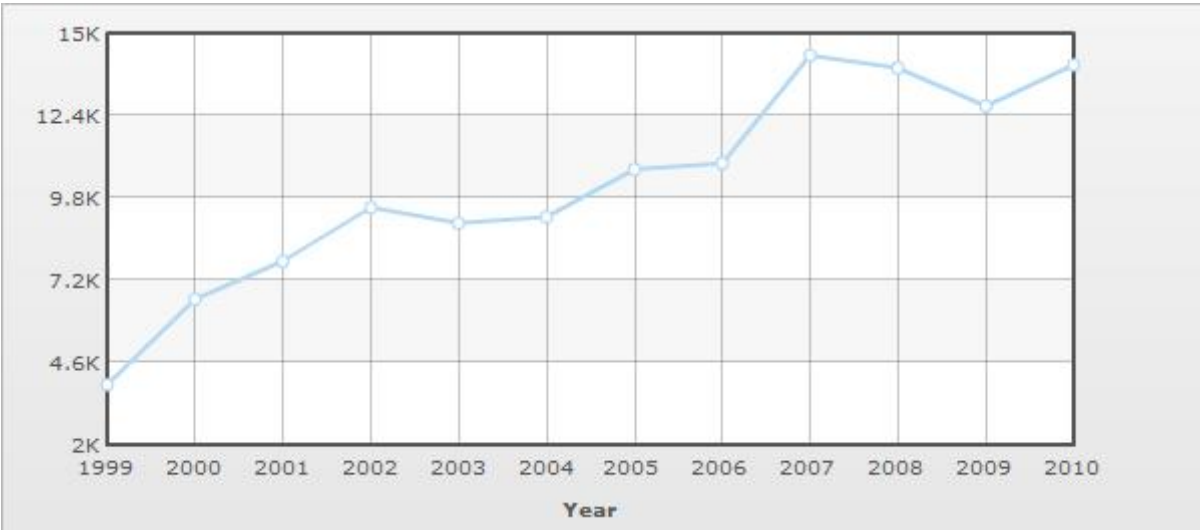
Figure 5: GDP per capita in Zimbabwe for the period 1999 – 2010 (in US dollars)



Source: Central Intelligence Agency, The World Factbook

Since the land reform has been implemented in 2000, the GDP per capita of Zimbabwe has dropped from \$2,500 to \$500 in 2010. During the same period, the GDP per capita of Botswana has increased from \$6,600 in 2000 to \$14,000 in 2010.

Figure 6 GDP per capita in Botswana for the period 1999 – 2010 (in US dollars)



Source: Central Intelligence Agency, The World Factbook

Zimbabwe is not the only country battling property appropriation. The problem of illegal fencing of communal land exists in Namibia. It is conducted by certain Namibian elite for their personal use, and it is affecting communal farmers.⁷¹ Government support in battling this issue is lacking and there have been no prosecutions in the case of illegal fencing.

Many will pinpoint this success of Botswana due to their wealth in natural resources such as diamonds. It is true that they have affected the economic development of Botswana and its expansion, but many other countries in the Sub-Saharan Africa are as well rich in natural resources but are not as developing as fast as Botswana. Others will link the economic development to the institutions which were left behind from the period of British colonization. Most of African countries were as well colonized, which shows that the colonization is not the main reason of economic development of Botswana. The main reason can be seen in property rights and how they are highly regarded in Botswana. This has among others allowed foreign investors to invest safely in the country without fear of property appropriation. Another reason is the attitude towards corruption.

Botswana is the least corrupt country in Africa according to the 2011 Transparency International Corruption Perception Index, ranking it at 32 out of 183 countries.

⁷¹ Odendaal, Willem. Elite land grabbing in Namibian communal areas and its impact on subsistence farmers' livelihoods (2011). In *Policy Brief*: Institute for Poverty, Land and Agrarian Studies: University of Western Cape.

Table 4: 2011 Corruption Perception Index for Sub-Saharan Africa

Country	2011			Country	2011		
	Africa Rank	World Rank	CPI Score		Africa Rank	World Rank	CPI Score
Botswana	1	32	6.1	Sierra Leone	15	134	2.5
Cape Verde	2	41	5.5	Cameroon	15	134	2.5
Mauritius	3	46	5.1	Eritrea	15	134	2.5
Rwanda	4	49	5	Niger	15	134	2.5
Seychelles	5	50	4.8	Togo	16	143	2.4
Namibia	6	57	4.4	Uganda	16	143	2.4
South Africa	7	64	4.1	Comoros	16	143	2.4
Ghana	8	69	3.9	Mauritania	16	143	2.4
Lesotho	9	77	3.5	Nigeria	16	143	2.4
Gambia, The	9	77	3.5	Côte d'Ivoire	17	154	2.2
Zambia	10	91	3.2	Kenya	17	154	2.2
Liberia	10	91	3.2	Zimbabwe	17	154	2.2
Swaziland	11	95	3.1	Guinea-Bissau	17	154	2.2
Tanzania	12	100	3	Congo, Rep.	17	154	2.2
Madagascar	12	100	3	Central African Republic	17	154	2.2
Malawi	12	100	3	Guinea	18	164	2.1
Burkina Faso	12	100	3	Angola	19	168	2
Benin	12	100	3	Congo, Dem. Rep.	19	168	2
Gabon	12	100	3	Chad	19	168	2
São Tomé and Príncipe	12	100	3	Equatorial Guinea	20	172	1.9
Senegal	13	112	2.9	Burundi	20	172	1.9
Mozambique	14	120	2.7	Sudan	21	177	1.6
Ethiopia	14	120	2.7				

Source: Transparency International

The Directorate on Corruption and Economic Crimes (DCEC), Botswana's corruption investigation body, was established in 1994. It focuses on investigating allegations of corruption, preventions of corruption with emphasis on educating the public about corruption.⁷² Since 2000, their frame work was extended to investigating money laundering.

⁷² Directorate on Corruption and Economic Crime (DCEC), Republic of Botswana. Overview of the DCEC, <http://www.gov.bw/en/Ministries--Authorities/Ministries/State-President/Department-of-Corruption-and-Economic-Crime-DCEC/About-the-DCEC1/Overview-of-the-DCEC/> (Accessed January 10, 2012) .

So far DCEC has been very successful, especially in encouraging and engaging citizens in reporting corruption anonymously. The number of reports received in 1994 was 254, increasing every year and reaching 1851 reports received in 2010. A response team was established and case inspections were introduced to deal with the increasing number of reports.⁷³ Cases which were investigated concerned mostly issues such as illegitimate allocation of land, bribe and procurement.⁷⁴ Challenges emerge in the form of slow court, leading to a slowdown in resolving cases. That being said, it still has had a high conviction rate⁷⁵.

There are some areas where the business environment in Botswana could see improvements. Enforcement of contract is one of them. The main problem is seen in the length of a commercial dispute process in Botswana. According to the World Bank's "Doing Business Report", it takes 625 days to resolve a commercial dispute, with 654,80 being the Sub-Saharan Africa average. There have been no reforms for the past two years in that field. Many commercial cases are settled through arbitration and it is expected that the trend will increase. Just as in Federation of Bosnia and Herzegovina, commercial courts do not exist, and their establishment could speed up the process of resolving commercial cases.

Many objections can arise to the proposal of economic development based on secure property rights and enforcement of contract, and which is free of corruption. The basis of all problems is lack of political will, particularly in combating corruption. Political will can be described as: "the demonstrated credible intent of political actors (elected or appointed leaders, civil society

⁷³ Rudolph. L.B. and Moeti-Lysson, J, The Workings and Achievements of the Anti-corruption Departments- Botswana Case Study- Directorate on Corruption and Economic Crime (DCEC), University of Botswana (2011), Presented at the 2011 Ben-Africa Conference, Zanzibar, Tanzania.

⁷⁴ Ibid.

⁷⁵ USAID Center for Democracy and Governance. A Handbook on Fighting Corruption (1999), http://www.usaid.gov/our_work/democracy_and_governance/publications/pdfs/pnace070.pdf (Accessed January 10, 2012) .

watchdogs, stakeholder groups, etc.) to attack perceived causes or effects of corruption at a systemic level“.⁷⁶ In the case of Bosnia and Herzegovina, The Agency for Corruption Prevention and Coordination of the Fight Against Corruption though established, has done nothing significant yet. Additionally, the competence of elected staff comes into question as they could be inclined to make decisions which would be in interest of the political parties which appointed them. The fight against corruption should be aimed at anyone regardless of their status or position and regardless of the extent of the corruption, and to do that, the Agency should not be under the influence of any political party. Therefore, it is necessary to make the work of the Agency transparent and effective as it is in Botswana.

Overall, many countries, even Bosnia and Herzegovina, can learn from Botswana’s experience. By focusing on strengthening institutions and creating efficient regulatory environment, Botswana has made it easier for entrepreneurs to start and grow a business. It has furthermore created an environment where entrepreneurs do not need to fear of property appropriation and do not need to offer bribe in order to help their own business. In a region such as Sub-Saharan Africa where most of the poorest countries in the world originate from, Botswana serves as a success story and it has proven that secure property rights and absence of corruption are important for a development of a country.

Chapter 7 - Conclusion

This paper set to investigate how property rights, corruption and enforcement of contract affect the business environment in Bosnia and Herzegovina, and thus affect the economic development of the country. The economic development is affected and influenced in many ways, but secure property rights allow for entrepreneurs to enjoy the fruits from their labor.

⁷⁶ Sahr J. Kpundeh, ‘Political will in fighting corruption’, in *Corruption and Integrity Improvement Initiatives in Developing Countries* (New York: United Nations Development Programme, 1998), 92.

Corruption and enforcement of contract is interlinked with property rights and for that were taken into account when analyzing the business environment.

After the literature review, the structure of Bosnia and Herzegovina was explained, together with the economy of the country. One of the main impediments of the country's structure to the development is seen in two separate economic spaces, which complicates doing business in Bosnia and Herzegovina. Additionally, Bosnia and Herzegovina is still recovering from the aftermath of the global financial crisis and is battling with high unemployment.

The government has tried to support SME through various channels, among others creating SME Development Strategy. The Law on Property Rights is not among the laws which they considered were necessary for the SMEs, and thus had to be adopted. Throughout the whole Strategy, the issue of corruption and enforcement of contract and the impact it has on business environment is not mentioned. Industrial policies are another attempt of the governments of entities to develop the country, but cannot be considered a long term solution to the economic development. The 2008 - 2013 Development Strategy of Bosnia and Herzegovina, though not yet adopted at the state level and in the Republic of Srpska, proposes some measures which interfere with the ideas of free market. Those would include favoring one product over another, as well as giving financial incentives to exporters. Even though the government has tried to facilitate economic development by creating these strategies, it has not yet been successful for various reasons.

The issues of property rights, corruption and enforcement of contract in Bosnia and Herzegovina were analyzed separately. The property rights in Bosnia and Herzegovina are unreliable and not secure. The Law on Property Rights has only been adopted in the Republic

of Srpska and is still waiting to be enacted in the Federation of Bosnia and Herzegovina. The land registry administration has made progress by digitalizing old land registries and cadastral records. Corruption is seen as one of the biggest factors of impediments to development in Bosnia and Herzegovina. Although the Agency for Corruption Prevention and Co-ordination of the Fight against Corruption was established, it has not begun fully operating. Another problem represents the elected administration appointed by political lines. Contract enforcement procedures are very slow in Bosnia and Herzegovina. Lack of commercial courts in the Federation of Bosnia and Herzegovina and lack of court staff are a major problem, causing accumulation of unresolved cases.

In order to support my hypothesis – a coordinated set of policies that encompasses property rights and enforcement of contract reforms, with the adequate fight against corruption, may serve to put Bosnia and Herzegovina on a solid and successful course of long term economic development, I used the example of Botswana. Botswana lies in one of the least developed areas in the world- Sub-Saharan Africa, and yet has a GDP per capita (PPP) of \$14,000. Moreover, the GDP per capita (PPP) for Sub-Saharan Africa was only \$ 2,258 in 2010. This achievement can be attributed to the functioning institutions in Botswana, which provide a sound environment for doing business. They secure the property rights, which enables companies and individuals to freely conduct business, without the fear of property appropriation. Botswana's neighboring country Zimbabwe, conducted land reforms in 2000, which led seizure of property. Many companies have closed their business since, and the GDP per capita dropped from \$2,500 to \$500 in 2010. In addition to secure property rights, Botswana is the least corrupt country in Africa. The Directorate on Corruption and Economic Crimes in Botswana has been very successful in tackling the issue of corruption, placing great emphasis on educating the public.

While it is true that the natural resources of Botswana have contributed to the economic development of the country, they are not the main reason of Botswana's success. Moreover, many other countries in the Sub-Saharan region are as well rich in natural resources, but have not yet been successful in reaching the level of economic development as Botswana did. The main difference between Botswana and most of the other countries in Sub-Saharan Africa lies in the institutions which provide secure property rights, contract enforcement and fight corruption.

Overall, the main problem in Bosnia and Herzegovina can be seen in the lack of political will in tackling these issues. The administration of the Agency for Corruption Prevention and Coordination of the Fight against Corruption serve as marionettes for their political parties; property rights are taken as given and backlog of immense unresolved cases exist.

Lack of secure property rights is an obstacle to successful entrepreneurship in Bosnia and Herzegovina. Securing property rights is an imperative condition for establishment of a healthy business environment. It encourages domestic and foreign enterprises to engage in entrepreneurship. More businesses would improve employment rate and contribute to economic development of the country. The issue of property rights should be approached simultaneously with problems of corruption and contract enforcement. Weak contract enforcement cost a lot of money the entrepreneurs. All this affects the decision of the entrepreneur whether he will engage in doing business in the first place. For that reason it is necessary to establish a healthy environment in Bosnia and Herzegovina which will secure property rights, enforcement of contract and is dedicated to fighting corruption.

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