STRUCTURAL CONSTRAINTS AND CHOICE IN MONETARY POLICY REGIME DESIGN:
BOSNIA AND KOSOVO IN COMPARATIVE PERSPECTIVE

A Master's Thesis

by

EMINA ABUANNAB

Department of
Political Science and Public Administration
İhsan Doğramacı Bilkent University
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EMINA ABUANNAB

STRUCTURE AND CHOICE IN
MONETARY POLICY:
LESSONS FROM BOSNIA AND HERZEGOVINA

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to Abdulah, Emina, Mustafa and Nuvejra

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ANKARA

August 2019

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Political Science and Public Administration.

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Assist. Prof. Dr. H. Tolga Bölükbaşı

Supervisor

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Political Science and Public Administration.

……………………………………………..

Assoc. Prof. Dr. Can Umut Çiner

Examining Committee Member

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Political Science and Public Administration.

……………………………………………..

Assist. Prof. Dr. Onur İşçi

Examining Committee Member

Approval of the Graduate School of Economics and Social Sciences

……………………………………………..

Prof. Dr. Halime Demirkan

Director

# ABSTRACT

STRUCTURAL CONSTRAINTS AND CHOICE
IN MONETARY POLICY REGIME DESIGN:
BOSNIA AND KOSOVO IN COMPARATIVE PERSPECTIVE

Abuannab, Emina

M.A., Department of Political Science

Supervisor: Assist. Prof. Dr. H. Tolga Bölükbaşı

August 2019

This thesis analyses Bosnia and Herzegovina and Kosovo in a comparative perspective using the classic method of Most Similar Systems Design by assessing the extent and nature of change in the two states' monetary policy regime. It illustrates how different states that were once part of the same state structure opted for independent monetary policy as opposed to prior foreign-led or unofficial structures in different ways. It answers the question of how much change happened between these two periods ($t_1$ and $t_2$) and what was the nature of the change observed. Relying on the similarities between the two states, monetary policy regime change is analysed over two periods using the policy structure approach. I evaluate the empirical validity of several structural constraint and choice factors against the two cases. I argue that, when structural constraints were more at play in period $t_1$, less change occurred in $t_2$. If and when the states were under different conditions, change was more likely. I conclude by presenting the findings on the effect of structural constraints and choice variables on the decision to change (or not to change) monetary policy regime.

Keywords: Bosnia, Kosovo, Monetary Policy Regime, Most Similar Systems Design (MSSD), Policy Structure

# ÖZET

PARA POLİTİKASI REJİMİ TASARIMINDA YAPISAL KISITLAR
VE SEÇİMLER:
BOSNA VE KOSOVA'YA KARŞILAŞTIRMALI BAKIŞ

Abuannab, Emina

Yüksek Lisans, Siyaset Bilimi Programı

Tez Danışmanı: Dr. Öğr. Üyesi H. Tolga Bölükbaşı

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Bu tez, Bosna-Hersek ve Kosova para politikalarındaki değişimin doğasını ve kapsamını, klasik En Benzer Sistemler Tasarımı metodunu kullanarak karşılaştırmalı bir bakış açısıyla analiz etmektedir.Tez, bir zamanlar aynı devlet yapısında yer alan yeni iki devletin, daha önceki geçici yönetim ve gayri resmi kurumların yönetimindeki para politikalarının yerine, devam eden süreçte nasıl farklı bağımsız para politikaları uygulamaya başladıklarını göstermektedir. Bu tez, bu iki dönemde değişikliğinin boyutlarını ve doğasını araştırmaktadır. Para politikasındaki değişimler iki devlet arasındaki benzerliklere dayanarak, ve "politika yapısı yaklaşımı"nı kullanarak, iki dönemde analiz edilmiştir. Ayrıca, birkaç yapısal ve seçim faktörü de bu iki vakada test edilmiştir. İki devletin, yapısal kısıtlamaların daha güçlü olduklarında, değişim göstermemektedir. Farklı koşullarda devletlerin değişikliğe meyilli olduğu ortaya çıkıyor. Son olarak, bulgular yapısal politika ve seçim değişkenlerinin para politikasını değiştirme (ve ya değiştirmeme) kararı üzerindeki etkisi, yansıra çalışmanın diğer çıkarımlarını ortaya koymaktadır.

Anahtar kelimeler: Bosna-Hersek, Kosova,En Benzer Sistem Tasarımı, Para Politikası Rejimi, Politika Yapısı

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# POLITICAL ECONOMY OF MONETARY POLICY REGIME CHOICES

## 1.1. Introduction

"But what money will they use?" is generally not the first thing that comes to one's mind when a country declares independence. Bosnia and Kosovo's declarations of independence from Yugoslavia were followed with a complicated international arms conflict that not only shook the whole region, but also effectively altered the way international actors deal with crises. The armed conflicts took place in Bosnia and Herzegovina (Hereinafter BiH; Bosnia) from 1992 to 1995, and in 1998-1999 in Kosovo. These unfortunate circumstances further drove the focal point away from monetary policy structures. However, new states define their place in the world through monetary policy regime choices. Political economic history tells us, monetary policy regime choice is, in fact, one of the most important decisions newly found states face. Both in Bosnia and Kosovo, central banks were the very first institutions formed immediately after the events — the Dayton Agreement in Bosnia and the promulgation of UN Resolution 1244 in Kosovo – that marked the end of war. Analysing a state's initial approach to monetary policy has much wider implications than monetary policy itself, particularly in small, open economies such as Bosnia and Kosovo that quick fix of rapid integration into the world economy.

This thesis explores the extent and nature of change in Bosnia and Kosovo's monetary policy regimes in the pivotal moment of passing on to independent monetary policymaking marked by the formation of central banking authorities of the two states, namely the Central Bank of Bosnia and Herzegovina (hereinafter the CBBH) and the Central Bank of the Republic of Kosovo (hereinafter the CBRK).

Bosnia and Herzegovina declared independence from the Socialist Federative Republic of Yugoslavia in 1992. Almost immediately after, a three-year-long conflict started. The ramifications of the conflict left the state's infrastructure in shambles and its population internally and externally displaced. In 1995, an agreement was reached between representatives of all parties involved in the conflict in Dayton, Ohio, under the supervision of various international actors. The agreement was named The General Framework Agreement for Peace in Bosnia and Herzegovina (Appendix C). Strikingly, the formation of the CBBH under a specific currency board arrangement took centerstage in the Framework Agreement. The Agreement also provided for an independent currency — the Bosnian convertible mark, hereinafter KM — pegged at par with the Deutschmark (hereinafter the DM). When all of this was happening, there was already a central banking institution present in Bosnia, named the People's Bank of Bosnia and Herzegovina (NBBH). Moreover, the NBBH had been unofficially implementing a monetary policy very similar CBBH. Everything went according to the plan as laid out in the Agreement and eventually the NBBH was liquidated. With its liquidation emerged the CBBH in 1997, and the Bank begun implementing independent monetary policy as the sole central banking authority in Bosnia. As the Agreement also called for, the Bank was operating under a currency board arrangement.

In Kosovo, a destructive war destroyed the already shaky state institutions due to decades of peaceful resistance. This resistance was in the form of a nation-wide civil servants' boycott of the central Yugoslav administration. In 1999, after a three-month-long bombing of Serbia by the NATO, the UN promulgated Resolution 1244 that proclaimed Kosovo a UN mandate under the United Nations Interim Administration Mission in Kosovo (UNMIK). The UNMIK's activities were organised under four pillars. One of these pillars was in charge of economic reconstruction. It was under this pillar that the Banking and Payments Authority of Kosovo was formed. In 2008, Kosovo declared *de jure* independence from Serbia. With this declaration emerged the Central Bank of the Republic of Kosovo. This was when the UNMIK transferred all civil administration to local officials. These developments marked the beginning of the period of independent policymaking in Kosovo.

The question of monetary policy regime choice in the EU candidate states has been largely explored in a richly-diverse set of literatures on comparative politics, international political economy and comparative public policy. While these bodies of literature produced much valuable research on the larger candidates states, there is limited research focusing on Bosnia and Herzegovina and Kosovo, with even less focus on the two states in a comparative perspective.

Most studies concerned with Bosnia and Herzegovina in the wider framework of policy change are conducted with a focus on the EU integration process and issues with contested statehood and limited state capacity (Börzel, 2009; Börzel, 2011; Bieber, 2010; Dimitrova & Steunenberg, 2016; Fagan & Dimitrova, 2019; Gilbert & Mujanovic, 2015). Other studies focus on issues of conditionality and compliance in the relationship between EU and Bosnia (Demekas, Horvath, Ribakova and Wu, 2007; Gromes, 2009; Noutcheva, 2012; Noutcheva, 2009; Renner & Trauner, 2009; Vachudova, 2009). These studies mostly isolate endogenous and exogenous factors that act as policy restraints in Bosnia's EU integration journey, defining Bosnia as the "laggard" state of the Western Balkans, unwilling or unable to implement a sound policy that complies with EU accession chapters; unwilling due to either policymakers' never-ending chase for ethnic or personal interests or the "Gordion's knot" that is the constitutional reform in Bosnia (Chandler, 2013; Crisis Group Report, 2012, p.1; Zahar, 2008).

Another group of studies focuses largely on policy implementation and policy change in the light of peace-building and culture (Belloni, 2001; Elgström & Smith, 2006; Kappler and Richmond, 2011; Redekop, 2019; Vesnic-Alujevic, 2012). With reference to monetary policy, studies largely still consider policymaking in reference to post-conflict institution building (Blejer & Skreb, 2012; Chossudovsky, 1996; Fry, Julius, Mahadeva, Roger & Sterne, 2000; Pugh, 2002; Silajdzic, 2005; Starr, 2004). Other studies explore Bosnia's currency board arrangement with reference to domestic actors' role in day-to-day business of the CBBH, particularly banks, almost always in the context of either ethnic divides inside the country or economic reconstruction (Gedeon & Djonlagic, 2009; Mirascic, 2011; Kahmi & Dehejia, 2006; Tzifakis & Tsardandis, 2006).

A very similar pattern is observed in the case of Kosovo. Although less in volume due to Kosovo's complicated position in the international arena, studies that analyze policy change mostly do so in the wider framework of EU integration, low-income states or in the light of tensions between Kosovo and Serbia (Economides & Ker-Lindsay, 2015; Fagan, 2011; Joireman, 2016; Korovilas, 2002; Obradovic-Wochnik, 2012; Pula, 2014; Papadimitrou, Petrov & Greiçevci, 2007; Sen and Kirkpatrick, 2011). Most recurring themes are Kosovo's recognition issues as well as questions of internal ethnic divides standing in the way of successful policymaking. The literature focusing on monetary policy in Kosovo is scarce. Policy change is generally assessed in terms of policy change in post-conflict countries (Barisitz, 2007; Korovilas, 2002; Svetchine, 2005; Starr, 2004; Tansey, 2007). Studies in public policy that include both Bosnia and Kosovo generally focus on issues of contested state capacity, central bank independence, EU accession, international peace-building efforts and democratization (Beiber, 2004; Dursun-Ozkanca, 2012; Marko, 2008; Manning, 2004; Stojarova, 2012; Van Willigen, 2013; Wilde, 2000; Szekely & Horvath, 2014).

An overview of these bodies of literature on these two countries reveals that there are three approaches to analysing monetary policy regime change in Bosnia and Kosovo. The first approach focuses on phenomena that determined the states' current positions, such as historical experiences of war and its effect on institutional and economic structure. This approach, which I will coin as structural, showcases research that highlights all these structural factors. A second approach underplays the impact of these structures on states and, instead, focuses on the key choices made by domestic policymakers. This approach, which I will coin as choice, also couches studies on the eventual effects public opinion had in shaping policy in these countries. A final and a third approach largely relies on abstract concepts like "historical ethnic divides" or "protection of vital national interests" to explain all changes in policy-making.

The objective of this thesis is to identify any similarities or differences in Bosnia and Kosovo's experiences with monetary policy in terms of policy change driven by structural and/or change variables. I hope the implications of this thesis go beyond a contribution to the body of knowledge in monetary policy analysis due to Bosnia and Kosovo's peculiar past experiences and institutional setups. This thesis emphasises the centrality of structural and choice factors on monetary policy regimes choices in small, open economies. Secondly, by emphasising monetary policy choices by key policymakers in both states, this thesis will identify the outcomes of two diverse pathways to peace-building through monetary policy strategies. Thirdly, the thesis helps explore a set of conditions under which policymakers operate in areas of limited statehood. Under some of these conditions, it shows how, even with limited state capacity, policymakers have managed to make room for manoeuvring at critical junctures. It illustrates how different states that were once part of an identical state structure started implementing independent monetary policy as opposed to prior foreign-led structures in very different ways. Therefore, this thesis aims at answering the question of how much change happened in the monetary policy regime in Bosnia and Kosovo between periods of informal or externally led policymaking and independent policymaking, and under what conditions did policy change — or lack thereof — emerged?

## 1.2. Background information on the SFRY

In order to fully understand the variables and cases at hand, it is important to present the two states' roles in Socialist Federative Republic of Yugoslavia. For the sake of clarity and length, this section focuses on economic crises that emerged in the decade preceding the disintegration of Yugoslavia in the early 1990s. After a short introduction on Yugoslavia in general, the crisis period in 1980s is outlined. Next, Yugoslavia's monetary policy is briefly explained to help better understand the starting point of Bosnia and Kosovo once they started making policy decisions as independent states.

The Socialist Federative Republic of Yugoslavia (SFRY) was formed in 1946 following the abolition of the Kingdom of Yugoslavia (1929-1945). The six constituents forming the SFRY were Socialist Republic (SR) Bosnia and Herzegovina, SR Croatia, SR Macedonia, SR Montenegro, SR Serbia and SR Slovenia. There were also to

Socialist Autonomous Provinces, SAP Kosovo and SAP Vojvodina, which after 1974 were *de facto* equal to the SRs (Huntington, 1996).

### 1.2.1. Economy in SFRY: Crisis, Reforms, Legacy

Yugoslavia's model of socialism was based mainly on worker's self-management, decentralisation, social ownership and a growing reliance on the market (Uvalic, 1992). Considering these factors, many considered Yugoslavia an outlier to other centralised economies. On the other hand, Yugoslavia had many features peculiar to highly-centralized states: commitment to non-private property, planning and egalitarianism (Uvalic, 1992).

For decades following the formation of the Socialist Federative Republic of Yugoslavia, it was considered a prominent socialist federative state, with relatively good economic performance compared to Western European states and way ahead of other socialist economies (Sapir, 1980). However, following president Tito's death in 1980, a slow but gradual economic decline took place. Many see this crisis as the beginning of the end of Yugoslavia, quoting economic inequalities stemming from Tito's asymmetric federalism present in Yugoslavia, alongside the incapability of institutions to deal with Yugoslavia's foreseeable bankruptcy (Petak, 2003; Borak 2000). Unemployment, as well as general economic development as measured by per capita domestic product at purchasing power parity showed large asymmetries among member states (Borak, 2000). For example, the unemployment in the Socialist Republic (SR) of Slovenia in 1985 was 3,5%, while it was 38,4% in Kosovo. Slovenia was comparable to New Zaeland in terms of growth, while Kosovo was closest to Pakistan (Borak, 2000).

A number of economic misbalances were further catalysed by the second OPEC oil shock, including high external debt due to overvaluation of currency and current account deficits. In order to address these, many policy reforms took place, including a flexible exchange rate policy (Frenkel and Taylor, 1993). Although helpful from the side of external debt, the domestic situation further deteriorated over time. In 1980, inflation rates were marked at around 40%. In 1985, it reached 80%. Two years later it rose to 200%, urging a wage freeze by the government and yet another set of reforms, this time supported by a stand-by agreement with the IMF and cooperation with foreign investors (Frenkel and Taylor, 1993).

At the end of 1989, Yugoslavia introduced a stabilisation plan which included a step to freeze wages by replacing the Yugoslav dinar with a new currency pegged to the DM. Following the peg, inflation dropped to a single digit in less than a year. However, social turmoil had already started, and it's impossible to know whether this heterodox model of dealing with inflation would remain. What did remain, however, is an inflation trauma ingrained into institutions, ideas and memory of policy-makers in all the states that emerged from the conflict.

### 1.2.2. The Conflict and Disintegration of Yugoslavia

Yugoslavia disintegrated in the period between 1990 and 1995, and everything was swept away. Conflicts erupted between the Yugoslav federal army (JNA) and Slovenia and Croatia after their consecutive declarations of independence. The conflict spilled over to Bosnia in 1992. Severe fighting took place until 1995 when Croatian forces took control over all of Croatia's territory and Bosnian forces regained control over a substantial part of Bosnian territory. The Dayton Peace Agreement was signed in Dayton, Ohio by all three parties and marked the end of war in Bosnia. Socialist Republics of Serbia and Montenegro alongside autonomous regions of Kosovo and Vojvodina (both part of Serbia at the time) continued to operate under the name of SFRY until the war in Kosovo started in 1998. The conflict lasted a bit over a year until 1999, and Kosovo gained *de facto* independence and was put under a special UN mandate called the UN Interim Administration Mission in Kosovo (UNMIK). In 2003, Serbia and Montenegro decided to use their historical names, and Yugoslavia was no more. In 2006, Montenegro declared independence from Serbia following an independence referendum.

Yugoslavia's monetary policy and its general understanding of economic setup cannot be explained as either highly centralised or market-oriented — it is best explained as starting on the highly centralised, state-led part of the spectrum in the early years after WWII, progressing toward a market economy in the late 1980s prior to dissolution through a set of top-down reforms introduced consistently in increments of one year, five years, and one ten-year plan. The Yugoslav banking system was also reorganised many times as a part of these reforms. Post-war years were marked as a mono-bank system, but was eventually developed into a two-tier system of commercial banks alongside national banking networks. However, commercial banks in Yugoslavia did not quite function as those in its Western-European counterparts.

In order to understand financial instruments that Bosnia and Kosovo inherited from Yugoslavia, the Yugoslavia's Social Accounting Office (SDK) carries a vital role (Coats, 2007). The SDK, better known as the payment bureau, was part of Yugoslavia's financial network headed by the Main Office of the Republic. It was both a payment mechanism and a tax collector, ensuring the state financial system is cashless and controlled. All public and private cash transfers were made through the payment bureaus. Both in Yugoslavia, as well as in Bosnia and Kosovo following its disintegration, the SDK payment bureaus had a monopoly over non-cash payments. Although commercial banks were carrying transferable deposits, all money orders went through the SDK which evidenced and maintained accounting records for banks (Coats, 2007). Thus, the banks were effectively further widening the SDK's role from a payment system to a sort of financial police — an instrument of control set by the government directed at all sorts of economic activity, providing knowledge of how much money is circulated at any point by whom, and what for (Interview 5). The SDK had an extensive branch network that continued to operate well after the independence of Yugoslavia's consecutive states. The willingness to replace these bureaus will show itself to be one of the most daunting tasks in monetary policy of Kosovo and Bosnia post-independence.

The previous section has briefly presented Yugoslavia's economic crisis and disintegration. The purpose of this section is to showcase the institutional and financial challenges that Bosnia and Kosovo faced in the early days of their independence based on Yugoslavia’s legacy. The following section will explain in detail the methodology and research design used in this thesis.

## 1.3. Research Design and Research Methods

This section discusses briefly the methods and research design used in this thesis as well as selection criteria for case studies. Proper research strategy is the most important means to design a sound study. A research strategy is a general plan of how the research question posed by the author is answered, guided by the research question and objectives (Thornhill, Saunders and Lewis, 2009). Research strategy’s "broad method of reasoning" (Trochim, 2006; p.1) can be inductive (action research, ethnography and archival research), deductive (experiments, surveys) or mixed (case studies, ground theory). A research strategy is then supported and implemented with the help of proper method.

Research methods are broadly divided into qualitative and quantitative methods. Qualitative and quantitative research methods stem from the naturalistic and positivistic philosophies, respectively (Newman & Ridenour, 1998). The debate between qualitative and quantitative researchers is rooted in their assumptions on the nature and reality, our ability to measure it using "objective" or "subjective" methods. Quantitative research is broadly defined as research that explains reality in numerical data using mathematical methods such as statistics (Creswell, 1994). Qualitative research is multi-faceted and challenging to define. However, it is most often defined as any research that does *not* use mathematical or other means of quantification to produce findings (Strauss & Corbin, 1998). However, qualitative research as opposed to quantitative research should not be seen as a dichotomy, but rather as an "interactive continuum" that exists in common reality (Newman & Rindour, 1998; p. 1).

Most studies dealing with monetary policy regime choices use quantitative methods (Devereux & Lane, 2006; Gali & Monacelli, 2005; Kim & Nelson, 1999; Owyang & Ramey, 2004). However, this thesis uses a qualitative method of research to conduct an in-depth analysis of structural and choice factors and circumstances that determined monetary policy regime choices in Bosnia and Herzegovina and Kosovo, including policy trends and smaller macroeconomic determinants considering the structural approach, and credibility, confidence and government and public preferences in the choice approach.

One of the reasons why a qualitative research method was more appropriate for this particular thesis is that the information needed to answer these questions are not available to the general public. A small number of policymakers and observant NGOs such as those given a monitoring role by international organisations have the bulk of knowledge on this topic. Therefore, using a large-n analysis would not offer plausible findings. This thesis uses elite interviews with key informants in both states to test the main arguments (Ball, 1994). Additionally, other necessary data was collected from other primary sources as well as literature. This type of analysis which involves a small-n analysis and many variables is called the comparative method (Ljiphart, 1971).

The comparative method is generally divided into two types: most different systems design (hereinafter MDSD) and most similar systems design (MSSD). These two types of comparisons are based on the works of John Stuart Mill's method of difference and method of agreements (Mill, 1872). The most different systems design is based on Mill's method of agreement. This method argues that, if two cases are indistinguishable except for one instance, then that one instance is the cause, or an integral part of the cause of the occurrence at hand (Mills, Durepos and Wiebe, 2009). The most similar systems design, on the other hand, assumes objects of research as similar as possible, with as many equal variables except for one whose effects are observed (Anckar, 2008).

This research is based on MSSD. This choice relies on a formulation of MSSD and MDSD by Anckar (2009) which categorises research into MSSD or MDSD depending on the level of analysis, deduction or induction or variance of the dependent variable. Bosnia and Herzegovina and Kosovo, the cases analysed in this thesis, are very similar in a number of control variables (historical legacy, geographic and demographic characteristics, policy leaning processes and similar) and different in regard with one dependent variable — their monetary policy regime designs. A possible drawback to this method is that asserting similarities and differences is very subjective and may translate different from researcher to researcher (Verba, 1967). This is why it is crucial to carefully select cases based on sound criteria.

### 1.3.1. Case Selection Criteria

Choosing criteria for case selection is oftentimes a daunting task because the analysis usually goes beyond the case itself: it is going to represent a population of cases outside of its research scope (Seawright & Gerring, 2008). One of the most common criteria used in comparative research is that of state size. However, all ex-Yugoslav states are relatively small in population, area and GDP. Therefore, these criteria were not fit for this thesis. The criteria for case selection in this thesis was the following: 1) the state had to be one of the ex-Yugoslav sates, 2) it should not be a member state of the European Union, 3) there had to be multiple policymaking actors (for examplei local and international) and 4) the states had to have a peculiar monetary policy regime appropriate to explore through either MSSD or MDSD.

The first criteria was set because a gap in literature was observed when it comes to ex-Yugoslav states. There are many studies that deal with monetary policy regimes in Central and Eastern European states, but a very few that analyse any of the ex-Yugoslav states: Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Serbia or Slovenia.

The second criteria eliminated Croatia and Slovenia from the lot as they accessed the EU in 2013 and 2004 respectively. Their monetary policy regime choices could therefore be explored using the same sets of arguments as in the cases of many other CEECs due to similar outcomes.

The rationale behind the third criteria is that international presence and influence in key moments of state-building played a very important role in all subsequent processes. This factor is only present in ex-Yugoslav states and is very rarely observed as influential in other CEECs because it implies a conflict in the near past and conflict-resolution processes led by international organisations. This criteria, therefore, eliminated Serbia and Montenegro (one state at the time of independence and creation of their monetary policy regimes) and Macedonia as there was no administrative international presence on the ground strong enough to affect monetary policy decisions.

Fourthly and finally, monetary policy regimes in Serbia, Montenegro and Macedonia were not deemed appropriate for analysis using neither MSSD nor MDSD. After the disintegration of Yugoslavia, Serbia and Montenegro continued to operate as Yugoslavia. Hence, there were not particular changes in the institutional setup of said states to be observed. After 2003, Montenegro declared independence from Serbia in a peaceful manner. They opted for direct euroisation in 2002. No significant international presence was recorded mostly due to the peaceful breakup.[1]

This thesis relies on a number of similarities between Bosnia and Herzegovina and Kosovo, such as history, statehood, demographics, geographical proximity and regional circumstances as well as on the outcome of having adopted a different monetary policy regime in the years post independence.

Bosnia and Herzegovina declared its independence from Yugoslavia in 1992. However, due to the three-year Bosnian war that followed the independence, the state was only able to stabilise in 1995 after the Dayton Peace Agreement was signed. The agreement stipulated the governmental structure of Bosnia and Herzegovina alongside its constitution. It was in the Dayton peace agreement's Article VII that the central bank of Bosnia and Herzegovina (CBBH) was first mentioned as an independent institution, and the monetary policy regime in Bosnia was first defined as a currency board mechanism.

On the other hand, Kosovo, operating as a UN mandate under the UN Interim Administration in Kosovo (UNMIK) adopted the euro in 2002. The UNMIK had total

[1] Note that this thesis disregards the presence of foreign troops and focuses on international organisations carrying out administrative roles only.

authority over the territory of Kosovo, alongside all legislative, executive and administrative  judiciary powers. An institution called Central Banking Authority of Kosovo was formed by UNMIK and later renamed as the Central Bank of Kosovo after independence.

Although Kosovo formally declared independence from Serbia in 2008, 15 years after Bosnia, the two states are deemed as most appropriate for analysis through MSSD due to their common history, geographical and demographical similarities. Some of these similarities include, but are not limited to ethnic dynamics, war-ridden recent past, historically similar monetary/exchange dynamics and the fact that the international community, including the EU, World bank, the IMF and the UN played an important role in their processes of state-building and asserting statehood in the respective states.

In this thesis, Bosnia is compared against Kosovo, and Kosovo is compared against Bosnia in addressing both first-order and second-order questions. The reason for choosing this type of comparison is that the two cases are exceptional — there is no other measurement rod against which they could be compared that would provide sound explanations to the questions posed. This thesis therefore seeks variation across cases, and then uses that variation for the explanatory part of the thesis. Variation of policy change across the two states is determined by using the policy structure approach, which is elaborated in Chapter 2 (under section 2.2). The policy structure approach will be used to operationalise change in policy across states for $t_0$ and $t_1$, where $t_0$ represents the period from the declaration of independence until the formation of an independent monetary policy, and $t_1$ is the period of practicing independent monetary policy. Variables that affected monetary policy regime choices are operationalised through an extensive review of literature in comparative public policy, international political economy and international comparative politics. Both cases are tested against these variables and their effectiveness is deemed as effective or not effective. Finally, implications of the results of comparison are offered in the last chapter.  The limitations of the approach presented in this thesis is that it is not fit to make generalisations about a lot of other states due to the characteristics of $t_0$ and $t_1$.

However, with small adjustments in the periods considered, I hope that this thesis provides space for further research on the influence of different factors on the policy processes of newfound states.

### 1.3.2. Data Sources

This thesis is based on three main primary data resources. The first set of primary data comes from official reports and other strategy documents and statements by the Bosnian and Kosovar governments, their central banks, the World Bank, the IMF and the EU. The second set of primary documents includes data from newspaper databases and archives such as LexisNexis and Factiva as well as empirical material presented in journal articles, books and report papers written by scholars for international or private organisations such as banks and policy advisory companies. The third set of primary data comes from interviews with key senior informants , which were conducted in 2018 and 2019 in both states.

Primary literature helped set the tone and identify the main points of the research. Key issues and recurring themes were identified by exploring archive material from national and international sources. The policymaking process was identified and relevant variables were isolated. Other sources helped put all this data in perspective. The interviews helped immensely in unpacking the motivations, attitudes, and ultimately the choices of policymakers in designing their monetary policy strategies.

Since interviews were so instrumental in unpacking the monetary policy regime choices, I elaborate on the method as well as the data I obtained in more detail below. In doing so, I rely on Bleich and Pekkannen’s "Interview Methods Appendix" to address some of the key methodological issues concerning date obtained by interviews and explain how they stand in this thesis (Bleich and Pekkanen, 2013: 95 to 105).

Bleich and Pekkanen (2013) recommend that researchers present several key methodological choices in an appendix: sample frame, response rate and type, additional and "snowball" interviews, saturation, format and length, recording method, response rate and consistency of reported opinions or quotations and confidence levels and compensation of strategies. Although Bleich and Pekkannen recommend this approach to ensure transparency in studies with a much larger n analysis, it is nonetheless a sound strategy to ensure that all concerns have been covered prior to presenting the data.

The interviewees include three senior representatives in Central Banks, one NGO representative that deals with monitoring economic development of the states in question, and two senior bureaucrats that were directly involved in the process of policy implementation part of the policy process in Bosnia and Kosovo (Appendix A). One of the interviews was conducted through email due to unforeseen circumstances. All the rest were conducted in person and recorded via a voice recording device. The interviews conducted in English (1,2,4) were later transcribed using a specialised transcription software. The interviews conducted in Bosnian (3,5,6) were transcribed manually. A follow-up interview via telephone was conducted with interviewees 2 and 3 to ensure clarity. The author reached out to 15 institutions and persons, and got a response from 12. Three of the interviewees felt like they would not be able to give a good interview on the topic at hand, and three others could not find time in their agenda for scheduling a face-to-face interview as they were not comfortable conducting the interviews over telephone of in a virtual environment. The author had to go through special governmental protocols to obtain interviews 3 and 4. Interview 4 and 6 were based on the traditional "snowball" method. Due to the small n of interviews, I cannot deem whether I have reached a saturation point.

The interviews were conducted using a very similar set of interview guidelines with minor changes to account for state differences (Appendix B). However, since the interviews were conducted in two different states, the answers are not consistent across countries. Surprisingly, the interviews reveal a high level of consistency in answers across institutions in the same country. The interviews took between forty minutes and one hour. The first two interviews were conducted in the early phases of the research process as the interviews demanded international travel between three countries. The author made sure that the interviews covered all possible themes that occurred in the literature up to that point. In the final stage of research, it was noted that each interview covered each of the variables explored in this thesis.

## 1.4. Organisation of the Thesis

This thesis is organised as follows. The introductory framing chapter also presents an overview of key elements of the research design, background information as well as research methods. This chapter shows that the thesis relies on a comparative research design that relies on the classic method of Most Similar Systems Design when comparing the cases of Bosnia and Kosovo in terms of continuity and change as well as the conditions under which change emerges in monetary policy structures. The chapter also provides an overview of the data sources used in the thesis and the method of data reporting.(Chapter 1). The second chapter (Chapter 2) is consisted of a review of several bodies of literature shedding light on analysing public policies and monetary policy regime choices. This chapter presents a review of how different bodies of literature conceptualise and operationalise policy change through the policy structure approach for exploring continuity and change in monetary policy regime choices in Bosnia and Kosovo. This chapter presents key variables that the literature emphasises that influence monetary policy decisions in emerging, small, open economies in general. It also focuses on Central and Eastern European countries, including Bosnia and Kosovo, and discusses how different studies explain monetary policy regime changes or their lack thereof. Chapters 3 and 4 present the case studies of monetary policy regime decisions in Bosnia and Kosovo. These chapters show in rich empirical detail of policy change as conceptualised and operationalised in Chapter 2 (Section 2.1). They also specify the conditions under which monetary policy regime choices have been made in these two states. These choices have been conceptualised and operationalised through the framework developed in Chapter 2 (Section 2.1). Finally, Chapter 5 offers a summary of the comparative findings of this thesis and provides a brief evaluation of further implications as described under the objectives of the thesis.

# CHAPTER II
# MEASURING POLICY CHANGE AND EXPLAINING MONETARY POLICY REGIME DESIGN: THE STATE-OF-THE-ART ON ANALYZING POLICY CHANGE

## 2.1 Introduction

This section aims to present the state-of-the-art on monetary policy regime choice. The state-of-the-art rests on richly-diverse bodies of literature on international political economy, comparative political economy, and comparative public policy. This chapter is divided into two parts. The first part will present insights from the comparative public policy literature which features the policy structure approach. The second part will present the state-of-the-art on the factors that affect policymakers' monetary policy regime choices. This part is further divided into two: the first subsection will explore structural factors at play, while the second will focus on choice factors. The conclusion will present those variables deemed appropriate for this thesis and the logic behind this choice.

## 2.2. The State-of-the-Art on Analyzing Policy Change:

### Insights from Comparative Public Policy

This thesis will try to explain the change in monetary policy regimes in Bosnia and Herzegovina and Kosovo through factors that had driven the change by looking at the extent of policy change. In order to asses the extent of policy change, Peter Hall's theory of social learning and changes in policymaking presents an analysis of policy changes from the perspective of social learning. It disaggregates the policymaking process into three subtypes based on the particular variables involved: policy goals, policy instruments or techniques and policy settings. The first order change encompasses changes that occur "in the light of experience and new knowledge" (Hall, 1993; p. 278). These changes in policy are carried out regularly and bear little to no implications to the overall policy goals and instruments. The second order change, in which particular policy instruments are altered based on previous practices, is more extensive compared to first order change but yet again has little to no toll on the overall policy goals. The third order change — the paradigm change — portrays a situation in which the policy setting changes, the instruments change, and a general "hierarchy of policy goals shifts" (Hall, 1993; p. 279).

Prior to Hall's theory, categorisations of policy change were mostly depicted through learning from past experiences, decisions made by policy experts as opposed to politicians as well as autonomy of state from the society when making these decisions (Hall, 1993). These explanations of social change are inadequate for this particular thesis due to Bosnia and Kosovo's peculiar position at the time of policy making: the policy change explored in this thesis came about hand in hand with a total regime change in which all known paradigms were contested and eventually changed in all segments of the state. Policy learning as a base for policy change makes sense in countries with long policy traditions and cultures.  In newly formed states, particularly those that emerged after the disintegration of a larger union, past experiences are unreliable and inapplicable to present because they reflect a skewed picture of possible outcomes based on the culture and tradition of their previous entity.

However, Peter Hall's theory, although an invaluable instrument in understanding policy change, is not a good fit considering the cases at hand. While perfectly applicable to constantly stable entities, due to the peculiar post-war context of Bosnia and Kosovo, policy-making as such was not done in the traditional way that can easily be defined through large categories such as goals, instruments and paradigms. Change was happening behind close doors, oftentimes informally or under close supervision or directive of international influences. A need to consider this type of change in larger detailed was observed. Therefore, in this paper, policy change is conceptualised by using a specific analytic tool — the policy structure approach (Graziano, 2012).

This approach aims to asses the extent of a policy change by assessing the nature and extent of policy change through examining four key dimensions of policy change over time: objectives, principles, procedures, and instruments (Graziano, 2012). By examining the change in each of these dimension between $t_0$ and $t_1$, the policy structure approach unpacks the extent of change that took place by using a simple hypothesis: the more policy dimensions changed, the more change was present at $t_1$. The ways of assessing change under the policy structure approach is as follows: if there is no *de facto* or *de jure* change in a dimension, it is defined as no change/continuity. If there is little change observed, it is defined as an adjustment. If there is a considerable level of change, it is named as substantive change (Graziano, 2008; p. 588).

Policy change was similarly operationalised on the case Europeanization of policy-making in Turkey in Bolukbasi, Ertugral and Özçürümez in 2018, as well as in Bolukbasi and Ertugral in 2013. This thesis will assess policy change using categorisations from the aforementioned studies. Graziano's categorisation of policy change is as follows: "policy continuity" occurs when none or one policy dimensions change, "policy adjustment" happened where two or thee policy dimensions changed, and "policy transformation" occurs where all policy dimensions change. This thesis will therefore explore monetary policy regime change in Bosnia and Herzegovina and Kosovo between periods $t_0$ and $t_1$, where $t_0$ is the period from declarations of independence of BiH and Kosovo until the formation of independent central banks, and $t_1$ is the period of independent policymaking marked by the creation of an independent central bank in both states, the Central Bank of Bosnia and Herzegovina and the Central Bank of the Republic of Kosovo. Afterwards, an examination of most influential factors in policy-making extracted from the literature is assessed in order to define why certain policy choices were made.

## 2.3 The State of the Art on Monetary Policy Regime Choices: Insights from International and Comparative Political Economy

This part reviews the comparative and international political economy literatures on key issues concerned with monetary regime choices. This part focuses on monetary regime choices worldwide but largely focuses on CEECs for two reasons. Firstly, a wider frame was necessary as the literature on BH and Kosovo on their own is very limited. Secondly, most CEECs made their monetary regime choices in the same timeframe and were faced with similar challenges as Bosnia and Herzegovina (hereinafter BH) and Kosovo. Consequently, expanding the focus to consider countries that have transitioned from socialism to capitalism in the European context was appropriate due to the characteristic set of challenges faced peculiar to these states.

The literature on monetary policy in transitioning states has been largely divided into two approaches. The first approach argues that policy choices are generally made due to choice factors such as policy learning mechanisms, EU accession procedures, policy-makers preferences and public opinion. The other approach looks away from choices and preferences and explains policy choices in structural determinants such as institutional setups, credibility and confidence concerns, macroeconomic characteristics, domestic economic indicators and level of autonomy of said states. Overall, structural factors are seen as equally important as choice factors in shaping exchange rate regime choices in transition economies and all seem to bear the same weight in decision-making. In this thesis, I will adjudicate between these two sets of claims in order to asses the nature of policy change that occurred in Bosnia and Herzegovina and Kosovo in the period marked as $t_1$.

### 2.3.1. Structural Constraints on Monetary Policy Regime Choices

This section reviews the literature on the effect of structural constraints on monetary policy regime choices in CEECs. These constraints include exogenous influences, state-specific institutional setups, credibility and confidence concerns, macroeconomic characteristics and domestic macroeconomic indicators.

In the international political economy literature, timing was generally considered a circumstance, not a cause or a determining factor in decision-making. 1970s and 1990s were marked by a global trend towards a greater exchange rate flexibility (Bleaney, Tian and Yin, 2015). After 1990, however, we observe a turn towards pegs again, particularly in CEECs. Firstly, the period after 1990 was a turbulent one for CEECs and analogously countries in Western Balkans. Political and economic transitions took place, and new states were left face to face with a steep learning curve of monetary policy making.

Arguably, due to the post-communist context, CEECs were "taught" policymaking by the EU, Western countries and various international organisations (Dandashly, 2008; Johnson, 2006). Ideas, beliefs, know-how and institutional patterns were also adopted from one state to another resulting in "trends" in monetary policy regimes — primarily, the formation of independent central banks and protecting price stability (McNamara, 2002; Johnson, 2006). This trend has continued all the way until Eastern Enlargement and, in some cases, up to this day. Even those states among CEECs that had a floating currency in this period — such as Poland, Czechia, Slovakia and Hungary - used a more flexible intermediate form of exchange rate regimes (Josifidis, Allegret and Beker-Pucar, 2009). The fact that many states in the region decided to go down the same path is obviously not the only factor that pushed policymakers in the direction of a fixed exchange rate. Most CEECs made conscious policy decisions that would help them in their accession journeys, contingent on different sets of criteria. However, it was the EU, various member states and their central banks as well as international organisations such as the IMF and World Banks that set the tone right and gave CEECs this idea in the first place (Johnson, 2002, 2003, 2006).

State autonomy is an important concept to consider regarding CEECs and, analogously, BH and Kosovo. All these — alongside all other ex Yugoslav states — faced the challenge of building a state from the ashes of USSR and SFRY. All these newfound states would not only have autonomous borders, but would function in a completely different way than any of their previous regimes. The issue of asserting autonomy and sovereignty was a priority. Credibility, or the lack thereof, seems to be an important factor that shapes domestic policy choices according to some (Özkan & Sutherland, 1995), while others refute this claim stating that credibility cannot be imported (Nuti 2005; Winkler, Mazzaferro, Nerlich and Thimman, 2002). It was observed that transitioning countries lacking credibility have often used an exchange rate anchor as a "policy crutch (Levy-Yeyati et al, 2010).

On the other hand, monetary policy regime choices seem to be connected to the level of economic size, development and independence (Dyson, 2002). A research tested the monetary independence hypothesis on CEECs in 2006 and among other findings, found that countries with more flexible exchange rate regimes showed a higher level of independence (Cuaresma & Wójcik, 2006). A study focusing partly on CEECs found that countries most likely to use anchor currencies are small, have a history of high inflation, and is, in many ways, close to a large and monetarily stable country. (Alesina & Barro, 2002) Analogously, some authors have suggested that financially less developed countries are more likely to adopt a hard peg (Lin & Ye, 2011).

Many theories have been proposed to explain exchange rate regime choices in states. Up to today, two main theories are used to analyse these phenomena — the optimum currency area theory and the currency crisis theory.

One of the seminal works of exchange rate regime choices produced by Mundell in 1961 focuses on optimum currency areas and explores the role of a number of structural factors that affect regime choices, such as factor mobility, economic size and openness, trade and later on, capital mobility (Mundell, 1961). The evidence provided strongly implies that regime choices are made largely depending on possible sources internal of shocks (Barrell and Dury, 2002). Others have offered different explanations such as amount and projections of sustainability of monetary reserves, credibility and logistical costs of adopting and leaving a certain regime. (Ozkan & Sutherland, 1995) Hake, Lopez-Vincente and Molina (2014) found a common pattern of macroeconomic stability expressed by inflation volatility and banks' funding in foreign currency being a strong "driver" of monetary policy in CEECs, Western

Balkans and Latin America (Hake et al, 2004). Some early works have suggested that states chose regimes based on speculative attack anticipation. (Obstfeld, 1994; Grauwe & Grimaldi, 2002)

Some other studies focused on different macroeconomic indicators to explain regime choices in CEECs. For example, capital flows control could aid a healthier transition to an OCA (Beaumont et al, 2000). Finally, more recent works test OCA theory on CEECs and finds that inflation rates and macroeconomic stability strongly influence regime choices (von Hagen & Zhou, 2002).

However, none of these factors — except for inflation rates and sustainability of monetary reserves — can be applied to BiH and Kosovo due to the peculiar circumstances these states were in when they made their monetary policy choices. A set of past experiences may only influence monetary policy regime choices when there is a state tradition in that direction (Dyson, 2010). BiH and Kosovo were never autonomous states before they faced such challenges.

On the other hand, currency crisis literature largely defines regime choices — more specifically, the choice to move from a fixed to a floating currency — as brought exogenously (Flood and Marion, 1999). Similarly, some combined OCA and currency crisis literature and found that inflation, output growth and openness can be used to best explain exchange rate regime choices (Masson & Ruge-Murcia, 2005; Ghosh, Gulde, Ostry and Wolf, 2002). Some have asserted that exchange rates regimes are chosen considering the impact of nominal exchange rate regimes on exchange rate volatility. (Hossain, 2010; Ghosh et al, 2002) Some evidence suggested that smaller states are more likely to adopt fixed exchange-rate regimes due to a simple domestic cost-benefit analysis: smaller states have lower GDPs and, should it come to that, transitioning from a fixed exchange-rate regime into a monetary union would not be a particularly difficult or controversial move (Johnson, 2008). Again, the inflation factor would possibly play a role in BH and Kosovo's choices due to Yugoslavia's "inflation trauma" (Jovic, 2001), and geographical size would definitely be a factor, but other economic indicators mentioned above are much less likely to have affected any of these choices due to limited past experiences and little chance of foreseeing developments due to unstable regional circumstances.

To sum up, there are several structural factors that may affect monetary policy choices in developing states. Policy learning mechanisms defined as policy trends are one of them. Credibility, the level of autonomy, size, level of openness and degree of trade with partners were proved to shift policymakers' decisions towards harder pegs in 1990s and early 2000s in CEECs. Other factors such as state-specific macroeconomic characteristics were also evidenced as influential in shaping policymakers ideas. Therefore, it is highly possible that this was the case in BiH and Kosovo as both states are in 1) considerable geographical proximity to CEECs, 2) share a similar history in terms of nation state systems and 3) shared a common goal of eventually joining the EU and were thus expected to address equal accession conditions.

#### 2.3.2. Choice-Theoretic Variables in Explaining Monetary Policy Regime Choices

This section will review the literature on variables that drive monetary policy regime choices. These variables include the prospect of EU accession, choice of trade partners, identity politics, cost-benefit analysis of logistical costs of one regime vis-a-vis another, inflation levels and output growth. There is a general understanding in literature that adopting any currency is tightly related to gaining a sense of national identity in new states (Marcussen, Risse, Engelmann-Martin, Knopf and Roscher, 1999). Central bank independence is one of the main ways in which CEECs sought legitimacy and asserted sovereignty yet reenforced their higher identity as European (Johnson, 2008; Quaglia, 2005; McNamara, 2002; Grabel, 2000). The prospect of joining the EU is considered one of the main incentives for picking direct Euroisation over any other regime. (Backe & Wojcik, 2019)

In the early 2000s, the introduction of some form of fixed exchange rate through a currency board system was largely proposed as an ideal solution for emerging CEECs that would help fast-track their financial integration into the EU system. (Gulde, Kahkonen and Keller, 2000) Some argued that permanently joining the EMU and thereby committing to a fixed exchange rate can provide a great credibility gain that would outweigh losses from giving up independent monetary policy. (Ravenna, 2005) CEECs, many authors concurred, were quick in macroeconomic stabilisation and their monetary regime choices were found to be largely influenced by the prospect of EU entry. (Markiewicz, 2006) Others argued states may be inclined to pick harder pegs or heavily managed exchange rate prior to EU accession in order to decrease the Balassa-Samuelson effect and prevent high inflation rates that would obstruct satisfying the Maastricht criteria. (Natalucci & Ravenna, 2002) Some have even proposed adjustments or total waiver of the Maastricht criteria considering Balassa-Samuelson effect and the cost of defence from speculative attacks in the years prior to accession (Buiter & Grafe, 2002; Szapary, 2000).

Moreover, globalisation, understood as world market integration, has greatly influenced the literature on regime choices in emerging and transitioning countries (Shambaugh, 2004). Research in the early 2000s suggested that a successful transition from socialism to capitalism includes many factors such as a new network of partners and contractual relationships, both domestic and abroad, that would firmly integrate the said country into the fabric of the free floating team (Roland, 2002). It was also suggested that smaller states facing a globalised market, particularly those that emerged from previous bigger unions, confront cultural constraints in choosing regimes. Their choices, rather than reflecting the newly acquired independences and size, more often reflect their past (Anckar, 2007). Research has also provided evidence that implies external competitiveness to be one of deciding factors in regime choices (Klyuev, 2002). Bordo and Flandreau (2001) have found that, although a floating exchange rate may be the best choice for developed, financially stabile countries, emerging countries may be better off with other options due to limited international financial integration. Higher-than-ever international capital mobility urged emerging states to consider a regime that would help keep exchange costs lower in light of increased international trade. In 2001, the overwhelming advice to states facing such challenges was to pick a regime that would make trade with partners or neighbours cheapest and keep a close eye on the way their currency interacts with the region's dominant currency (Bordo and Flandreu, 2001).

Some studies argued that macroeconomic indicators were not sufficient to fully explain monetary regime choices in CEECs. (Dandashly &Verdun, 2016) In these studies, the bulk of decision-making when it came to transitioning to euro lies on governments themselves, more specifically, government preferences and policies, the level of autonomy of central banks and state-specific institutional setups (Dandashly & Verdun, 2016). These factors are only partially applicable to cases at hand. Government preferences are most likely to play a role, but the influence of institutional setups and central bank independence in decision-making in Bosnia and Herzegovina and Kosovo as defined in this thesis could be more limited than its Central and Eastern European counterparts. The monetary policy regime choice was made in a period of limited statehood and unstable institutional setups in Bosnia and Kosovo. However, institutions set in place by previous interim and unofficial decision-making bodies will be taken into consideration in this thesis.

In conclusion, there is a plethora of choice factors that were claimed to affect monetary policy choices in developing European countries. Primarily, prospects of EU accession seem to be key in forming monetary policy for transitioning European states. Secondly, trade with neighbours and other states carries the implications of need for a cost-benefit analysis in the light of logistical costs of both transitioning to another system as well as exchange costs in the case of trade between states with different currencies. Thirdly, government preferences, state-specific institutional setups and central bank independence are outlined by some to be significant in shaping monetary policy. The approach that emphasises structure which sets forth factors that are more circumstantial and straightforward. On the other hand, the approach emphasising choice offers the answer in the policymakers themselves, or in many smaller determinants that work together or alongside structural factors to shape ideas for a possible exchange rate policy mechanism.

## 2.4 Summary: From Measuring Monetary Policy Regime Change to Explaining Policymakers' Choices

The previous section presented in detail prior research concerning the factors that influence policy choices in developing states with an accent on CEECs. However, not all of the factors extracted from the literature are applicable to the two cases on hand. This section will shortly present which of the factors were left out of the thesis and the reasoning behind this decision.

In the structural approach, policy learning mechanisms, international trends, outside influences, state autonomy, economic size and openness and plenty of small, macroeconomic indicators were studied. The macroeconomic indicators at hand are, in order of appearance: factor and capital mobility, sources of internal shocks, sustainability of monetary reserves, speculative attack anticipation, capital flows control, inflation rates, output growth and exchange rate volatility. In order to determine any of these factors, there needs to be a particular timeframe of at least a few quarters in which movement of any of there variables can be estimated. Due to the limited framework of this thesis (post-Central Bank formation in two states), most of these factors are not observable due to their nonexistence. For example, Bosnia had virtually no trade of its own prior to formation of the Central Bank of Bosnia and Herzegovina and analogously the creation of its monetary regime. The logical reason behind not including this particular set of variables into the study is that, since they were virtually non-existent, they couldn't have had any effect on monetary policy regime choices. The exception to this is inflation and trade defined as the prospect of trade with neighbours and partners. Inflation will not be included in the study based on its numerical rates, but rather as a concept of "high inflation trauma" which Bosnia and Kosovo may have inherited from the previous regime.

In the approach emphasising choice, most variables are applicable and will be explored in this thesis. These include EU accession aspirations, globalisation as determined by trade integration, national identity politics, internal and external credibility and monetary confidence, state-specific institutional setup and government preferences. The only variable that will not be included is independence of central banks. Again, as the thesis is concentrated to the moment of formation of and independent central bank and first official monetary policy, and there was no prior official central bank, this variable is inapplicable. However, the thesis will refer to important instances where the institutions that served unofficially as central banks made decisions that possibly affected monetary policy regime choice from the point of view of previous institutional setups.

# CHAPTER III

# MONETARY POLICY REGIME CHANGE AND POLITICS OF CHOICE IN BOSNIA AND HERZEGOVINA

This chapter presents an in-depth case study of monetary policy regime change and politics of choice in Bosnia and Herzegovina. In order to fully understand the variables behind monetary policy regime choices, I present Bosnia's position in Socialist Federative Republic of Yugoslavia. For the sake of clarity and length, this section focuses on economic crises that emerged in the decade preceding the disintegration of Yugoslavia in the early 1990s. After a short introduction on Yugoslavia in general, the crisis period in 1980s is outlined. Next, Yugoslavia's monetary policy is briefly explained to help better understand the starting point of Bosnia and Kosovo once they started making policy decisions as independent states. Then, Bosnia and Kosovo's cases are analysed in the theoretical framework outlined in Chapter 3.

The study analyses cases by firstly dividing them in three time periods: $t_{-1}$, $t_0$ and $t_1$. $T_{-1}$ represents the states prior to independence when they were still a part of Yugoslavia. The aim of this period is to introduce institutions and instruments that were present in further periods. This period will not be included in the analysis of policy change using the policy structure approach. $T_0$ represents the states in the period between independence and formation of an independent, official monetary policy. Period $t_1$ represents the period between $t_0$ and the present, the period in which the two states implemented their own independent monetary policy. The cases of Bosnia and Kosovo are explored in this thesis by 1) determining the extent of change that occurred in monetary policy in the period between $t_0$ and $t_1$, 2) assessing the nature of that change and 3) identifying differences in variables that helped shape policy in both cases.

This section will present Bosnia's role in Socialist Federative Republic of Yugoslavia, the period outlined in section 4.0 as $t_{-1}$. Bosnia and Herzegovina was one of the six autonomous republics that constituted Socialist Federative Republic of Yugoslavia. Statistically speaking, considering above-mentioned asymmetries among socialist republics, the SR of Bosnia was somewhere in the middle-to-bottom half of the scale as measured by unemployment, ranking consistently halfway between the best-ranking Slovenia and bottom-ranking Kosovo (Statistical Yearbook of Yugoslavia, various years). Bosnia was the centre of metal industry in Yugoslavia. With many natural resources including iron ore, brown coal, bauxite, zinc and aluminium, Bosnia's contribution to Yugoslavia's economy was mostly reliant on energy, metallurgy and industry of minerals (Muhamedagic & Oruc, 2009). Despite the fact that Sarajevo, the capital of Bosnia, was the third best city to live in based on life quality, in Yugoslavia according to GDP index in 1984, mining and metallurgy proved itself as not very sustainable in the post-war period due to infrastructure losses.

Following Croatia and Slovenia, Bosnia and Herzegovina declared independence from the SFRY in March 1992. Although the United Nations and most member states quickly recognised Bosnia as an independent state, the Yugoslav National Army and other militias present on ground launched a war against the newfound state. As a result of the conflict, approximately 250.000 died and and about 3 million of the total 4.4 million were displaced. This war marked Bosnia's early statehood and all state-building efforts ere made in very difficult conflict situations.

### 3.1. Bosnia following Independence: $t_0$

This section will briefly explain series of political economic events in Bosnia and Herzegovina in the period between its declaration of independence in 1992 until the

Central Bank of Bosnia and Herzegovina was formed in 1997 focusing on monetary policy making processes. This section is organised in three parts. First, the unofficial monetary policy of Bosnia prior to formation of CBBH in 1997 is explained. Secondly, instruments used in this period are explored, as they turned out to be extremely important in future policymaking processes. Thirdly, the Dayton Agreement and its implications to Bosnia's monetary policy making is briefly explained.

In 1992, a new government was appointed in Bosnia immediately after the war had started. In the next three years, the government was dismissed and new governments were set in place four times due to political conflicts as well as unfortunate deaths of its members. Therefore, the policy-making processes were ambiguous and mostly unknown to the general public.

The monetary situation in BiH during the war years was complex and riddled with political issues. The NBBH was formed in 1992 with a strong cooperation of the Ministry of Finance and the Government of BiH. However, after attempts at free circulation in 1994, the decision was made to transfer to a currency board-type of management. The members of the government at the time, led by Haris Silajdzic as prime minister and Neven Tomic as finance minister alongside local experts, quoted inflation trauma and close prospects of peace as main reasons for this decision (Interview 3).

In 1992, alongside independence efforts, a National Bank of Bosnia and Herzegovina was formed (hereinafter NBBH). This period was "exceptionally hard and challenging", "characterised by insecurity, limited resources and an overwhelming sense of struggle" (Interviews 3 and 4). In 1992, the NBBH introduced the Bosnian dinar (BHD), a new currency that would replace the Yugoslav dinar.

Some challenges the NBBH faced are manifested through the institution's efforts to properly operationalise the Bosnian dinar. The designs were made in Sarajevo in 1992 and faxed to Slovenia for printing. However, Sarajevo fell under siege that would continue for almost four years. The printed money could, therefore, not be delivered to the main office of the NBBH and was instead shipped to one of its branches in the smaller city of Zenica. The currency was introduced at 350 BHD to 1 DM. However, it could not be circulated over the full territory of BiH due to safety and transportation issues over besieged and occupied territories. As a solution, the NBBH produced coupons and Yugoslav dinars with special stamps that would serve on these problematic territories (Sudetic, 1992). Eventually, inflation skyrocketed yet again mainly due to black market exchange rates (Shanker, 1992).

In 1994, when the official inflation rate of the BHD reached 322% in the Federation and 297 million percent in Republika Srpska (which used a currency pegged to the Serbian dinar), the NBBH launched a reform to address this issue. A new BHD was printed in Zenica and measures were adopted to control its value. Eventually, these measures started resembling a currency-board like arrangement (interviews 3 and 4), and the exchange rate was contained at 100:1DM by 1995.

Despite the government's efforts to operationalise and install confidence into the dinar, on the small territory of BiH, four currencies were in circulation. Primarily, the DM and the Bosnia Dinar were used, alongside the USD and the Swiss Franc. In the Croat-majority region, the Croatian kuna was used. The Serbian dinar was circulating on the territory of Republika Srpska. "You could use any money you had on you at the moment when buying bread from a supermarket… It was incredibly chaotic but eventually it all worked somehow", a senior bureaucrat that worked for the Treasury at the time says (Interview 6).

The structure of the payment bureaus was divided into three: the Bosnian majority formed an institution called the Payment Transactions Bureau (ZPP), the Croatian minority called its equivalent ZAP, and the Serbian minority called it the Central Payment Bureau (SPP). These three institutions — the ZPP, ZAP and SPP - functioned in the exact same way, the only difference being the ethnic divide of its users and their respective currencies of choice: the ZPP made official transactions using the Bosnian dinar, the ZAP used Croat kuna, and the SPP used the Serbian dinar. All three, however, accepted the German mark. Through this system, the NBBH became an unofficial central banking authority, which issued its own currency under the currency board arrangement (Interviews 3, 4, 5).

Considering the money-police role of the payment bureaus that was unacceptable in a small open liberal economy that Bosnia was earning to be, the faith of the institution had become a burning question immediately post-Dayton (The Economist Intelligence Unit, 1999). Lack of infrastructure and a regime change on the state-level were main limiting factors in implementing sound policy at this time. The first post-war elections were made in 1996 in BiH. In 1998, despite the formation of the CBBH, the SDK was still more vital to financial functioning of the state due to the lack of another instrument that would ensure regular, registered money transfer.

### 3.2. Formation of the CBBH - $t_1$

In 1995, the leading parties of BiH, Serbia and Croatia came together in the city of Dayton, Ohio, in order to draft a peace treaty that would put an end to the three-year-long conflict and agree upon BiH as a sovereign state. Political divisions in BiH were agreed upon, as well as the structure of the government. The constitution of BiH makes up Annex 4 of the agreement (Appendix B). The state was structured as a federal state with two entities — the Federation of Bosnia and Herzegovina and Republika Srpska — with a central government and a common central bank and constitutional court.

On 20th June 1997, the CBBH was formed through a provision in Article VII of the agreement as the "sole authority of issuing currency and for monetary policy throughout Bosnia and Herzegovina" (OSCE papers Dayton Agreement, 1995). The CBBH's objectives and responsibilities were not set forth in detail in the Agreement. However, it was determined that the CBBH would not be able to extend credit during its first mandate of 6 years, and that the first Governor will not be a native. Eventually, Peter Nicholl, a prominent New Zealand economist, was appointed as governor. He performed the role until 2004.

After Peter Nicholl assumed the role of governor, everything about monetary policy structures turned out to be a rather big controversy among government officials apart from the idea of currency board arrangement. The currency's name and designs were disputed for many months between the three ethnic groups, the branches of the CBBH and its role was a hot topic as it represented yet another point of asserting one's ethnic difference over the others. However, all these issues were solved with timely interventions of the IMF officials, the Governor and the OHR by imposing a currency design (Westendorp, 1998; Currency Design and Basic Markings Decision, Official Gazette 22/11).

Finally, the faith of the payment bureaus was under question. There was a serious need for interregional settlements due to high expenses of trading with foreign currencies that all countries in the region would accept. The payment bureaus and the way they operated after the formation of the CBBH is discussed in more detail in the following sections. However, it is important to state that commercial banks were allowed into the market for the first time ever in the traditional role, independent of the SDK. Thus, the old way of doing things was brought to an end in 2001, and a new instrument called the Real Tıme Gross Settlement System (RTGS) was introduced by the CBBH with the help from the IMF, the World Bank, the US Treasury, the USAID and other international actors. This system enabled transfer of  funds from one bank to another — or, in this case from banks to the payment bureau — in real time on a gross basis.

Structurally, the formation of the CBBH was a giant leap ahead in institutionalising the newfound-state's monetary policy, but there were many challenges ahead. Primarily, the issue of leftover institutions and traditions had to be addressed. The structure of the CBBH was stipulated in the Dayton Agreement and constitutionally protected as an idea from the IMF Executive Directors on behalf of G7 (US, Germany, Japan, France, UK and Canada). There were a few solutions on the table, the first of which was installing a hard peg with any stable currency.

This system was already in place to an extent and was favourable from the point of view that it demanded no central bank that would issue its own currency or follow up with its quantities. However, an IMF expert at the time narrates that there were a few concerns about this system (Coats,2007). Primarily, the drafters of the solution did not believe that Bosnia had enough infrastructure to make the changeover. Later, the seignorage from issuing money would go to the Bundesbank instead of the native Central bank. Finally, they were worried that using the DM as a currency would not have enough subjective impact on the system in the sense that it would not represent a clean slate and support nation-building the way that a national currency might (Coats, 2007).

A strict currency board arrangement offered solutions for these concerns. However, there were still many logistical shortcomings to the plan: the banking sector was in shambles, there was no knowledge of quantity of money circulating in Bosnia in the first place apart from foreign investor grants, and it was under question whether the economy would come alive in the next few years at all (Yee, 1999). Eventually, the benefits outweighed the costs. The fact that the BHD was already in circulation, that it had a fixed exchange rate to the DM and was fully convertible, and that the culture of the currency board was well understood among the state's officials and people played in favour of a currency board (Interview 3). Finally, currency board demands less infrastructure than a completely independent central bank (Interviews 3 and 4).

### 3.3. Measuring Monetary Policy Regime Change through Policy Structure Approach

The following section will evaluate policy change in the periods between $t_0$ and $t_1$ based on the policy structure approach. The four key dimensions of policy as defined by the policy structure approach — principles, objectives, procedures and instruments — will be presented in a chronological order referring to $t_0$ and $t_1$. The observations will be presented in the summary following these sections.

### 3.3.1. Principles

In the period $t_0$ (1992 up to 1998), the principles of the NBBH can be characterised as a struggle for independence but unwillingness to change its *modus operandi,* which was, in the case of Bosnia, the mindset of a centralised government that fully dictates monetary policy through the central bank without much transparency. In 1992, the NBBH was formed in a peculiar environment of conflict and with no infrastructure. A senior representative in the CBBH speaks of this period:

> "These were very hard times characterised by difficulties that this type of environment brings, namely hyperinflation and instability. The NBBH was determined to make a thorough reform that would address these issues for good as much as the circumstances allow so… which would lead to economic stability and assert Bosnia's position on the map." (Interview 4)

Soon after, a lot of the circumstances had changed — the Dayton Agreement set up an environment of peace with intermittent smaller-scale attacks. First democratic elections were made in 1996. The CBBH was formed ($t_1$) and was functioning almost seamlessly after the initial cultural shock that lasted a few months (Coats, 2007). The CBBH was a clean-slate, a foolproof institution that provided more stability than it demanded, leaving the struggle for stability from $t_0$ a distant memory (Coats, 1999).

At this point, the CBBH takes great pride in the fact that the institution almost singlehandedly provided more than 20 years of stability without any major oscillations. Principles turned from unity and keeping a state together under any price to inclusivity and sound policy. As opposed to ambiguity and lack of accountability in $t_0$, period $t_1$ is characterised with transparency, sound policy and healthy auditing mechanisms (Interview 3). The principles of stability and "foreseeing issues before they even come up" (Interview 3 and 4) *de jure* only partially changed, but *de facto* everything was new.

3.3.2. Objectives

In the period $t_0$, the objectives of the NBBH as well as the government in general could be characterised as "keeping the head above water". Independence and autonomy alongside unity inside the state borders among all its citizens, regardless of ethnicity, were the main objectives of the wartime government. The idea was reflected in monetary policy. The Bosnian dinar, although mostly used by the Bosniak majority, was imagined as a monetary unit for all (Interviews 3 and 4). Keeping it alive and circulating, as well as preserving the payment bureaus under any cost was reflective of the government stance on governance in general. It was not until 1998, the starting point of $t_1$, that this way of thinking shifted.

In $t_1$, due to ceasefire and later on, signing of the Dayton Agreement, stability was no longer a goal, but rather the status quo. Full convertibility and free cash influx from abroad were quoted as main goals of the CBBH (Interview 4; CBBH 2019). Once the NBBH was liquidated and the payment bureaus were reformed, a period of stability commenced. At this point, monetary policy makers were building more than just an exchange rate mechanism, they were setting an example of how a state institution should and could function in BiH.

Further goals to reach and sustain were much more detailed, such as issues of inflation and price stability (easily reachable by maintaining currency board rules in place), promotion of the state as to attract FDI, as well as good cooperation with banks and providing confidence were seen as more important. This is arguably the biggest change in objectives, as commercial banks were not allowed in Bosnia at $t_0$. Old goals were old, new goals were modern and resembled more to those of a regular open-market economy. "Consistency alongside right timing of monetary activities are extremely important for our financial system" said the first native governor of the Central Bank, Kemal Kozaric.

Currently, high levels of stability due to very low levels of inflation and strict following of currency board rules have shifted the thinking from monetary policy regimes to structural reforms and economic efficiency. The current governor, Senad Softic, stated in a meeting of Governors of Central Banks for Western Balkans in 2018: "Bosnia should focus on structural reforms and efficiency in economy in order to become competitive and resistant to exogenous shocks". However, there is no change in the official policy. Arguably, the ideas about policy objectives have changed but actions and policies have not.

3.3.3. Procedures

Due to the state of war, procedures inside the NBBH are ambiguous and unknown to the general public. Bosnia was a state with no laws or constitution of its own. Officials speak of it reluctantly and government papers and inaccessible or non-existent, depends on who you ask. However, what is known is that executive and procedural decisions were in many cases made single-handedly without previous consultations due to difficulties in communication. The Presidency of BiH was authorised with executive *and* legislative powers (Parliamentary Assembly BiH, 2010). The NBBH printed currency, made plenty of wartime loans to the government and tried to follow up with required reserve after 1994. This implies that the procedures were very hierarchical and exclusive. However, in $t_1$, we observe substantial change in these points.

The first couple of years of the CBBH were defining for the future of the institution. The main goals and objectives of the CBBH were stipulated in the Dayton Agreement in 1995, but de facto procedures were set up during this "trial period" of the CBBH that lasted roughly from 1997 to 1999 (Interview 4). Late liquidation of NBBH due to resistance was a big issue, in the words of the first governor Peter Nicholl, as it led to constant bickering among government officials inside the CBBH that caused further instability and distrust towards the Convertible Mark (Nicholl, 2018). Eventually, certain procedures related to currency design and decision-making processes were imposed by the OHR.

Once the teething problems were over, the system seemed to work seamlessly. Ways of appointment were updated to follow up with the state's regime change. An elected parliament appointed the CBBH board members. As with everything else, changes made to the Central Bank Law and its procedures were followed by political tensions and power struggles between Bosnia's three ethnic groups. However, it was the small details that were subject to discussion — the main principles of business were not under question anymore.

The first Governor of the CBBH, Peter Nicholl, put an end to the endless bickering by singlehandedly deciding which concerns raised by different groups were justified and which were not, oftentimes triggering reactions from the general public.[2] His decisions were approved by the OHR. Thus, the procedures of the CBBH took its main form that is preserved until today with minor changes.

More recently, the CBBH developed a new set of procedures that are updated frequently. Internal procedures are primarily focused around maintaining a sound mechanism of internal revisions and healthy audit processes (CBBH - 20 years of stability report, 2017). Each organisational unit has its own set of procedures aimed at identification, assessment and risk control. "We try to foresee eventual issues before they come up. In order to do this our procedures are crucial." states the current governor of the CBBH, Sead Softic, stated in an interview from 2017.

**3**.3.4 Instruments

In the period $t_0$, the NBBH was not officially recognised as a central monetary authority of BiH on all of its territory. Therefore, any monetary policy structure was partially implemented in a fragment of the state territory. However, there were quite a few instruments present. This period can be divided into two separate timelines: the first is the period from 1992 until 1994 before *de facto* currency board rules were adopted by NBBH, and the second period is 1994 to 1997 where NBBH acted as a loose currency board until it was liquidated.

The period between 1992 and 1994 was quite dynamic in terms of monetary policy instruments. Apart from logistical difficulties outlined above stemming from

[2] In one instance, an article in The Guardian compared the internationally appointed Office of the High Representative's way of governing Bosnia to a "feudal fiefdom", much to the OHR's dismay.

wartime environment, decisions on business were made on a whim in order to secure the mere existence of NBBH and the BHD as an independent currency. Not unexpectedly, inflation rates skyrocketed almost instantly after the BHD was sent into circulation. It was impossible to learn how much money was in circulation due to lack of transparency of the payment bureaus and territorial disunity (Coats, 2007).

However, in 1994, "a prospect of stability and the end of war drama was in sight, so the NBBH started its efforts to stabilise the BHD" (Interview 4). These efforts resulted in adopting a series of anti-inflationary measures, denomination, and change in emission policy. The final result largely resembled a currency board arrangement. Although NBBH was not officially ordinating under a currency board, *de facto* it was not any different from it (Interviews 3, 4, 5).

The one important instrument that operated seamlessly both throughout $t_{-1}$ and $t_0$ is the payment bureau. All payment operations were carried out through highly obscure and ambiguous payment bureaus, or later on their successor institutions, the ZPP, ZAP and SPP. Therefore, how much NBBH could operate and follow through with its goals is not clear. A reform including officially recognising BiH's central banking institution as well as solving payment bureaus was highly needed.

One of the main requirements of the CBBH was to ensure a safe, stable and transparent money transfer between commercial banks. There was a dire need for the old payment bureaus to step away and for the CBBH to completely overtake all money transfers in the system, which further required installing a series of other financial instruments (Interview 6).

This proved itself a daunting task. The NBBH operated through the payment bureaus and was supposed to step down and be liquidated simultaneously with the foundation of the CBBH. This did not happen (Interview 6). There was hesitation from both sides. Finally, the liquidation of NBBH and partial dissemination of the payment bureaus required coordinated two-year-long efforts by local government, the IMF, the World Bank, the USAID, the US Treasury and other donors and experts and was realised in 2001.

A few instruments were introduced at this point to take over part of the payment bureaus role. The Real Time Gross Settlement System (RTGS), netting mechanisms such as giro clearing multiple times a day, a credit registry was formed, Society for Worldwide Interbank Financial Telecommunication (SWIFT) was introduced, and the Euro Medium Term Note flexible debt instrument was set up. Many other smaller-scale systems were introduced that enabled the CBBH to comply with international standards and keep transparency in place (CBBH 20 Years of Stability Report, 2017).

However, the required reserve ratio remains the only monetary policy instrument available to the CBBH. The CBBH officials have numerously stated that there is no prospect of changing the currency board arrangement in the near future (Interviews 3 and 4; klix.ba, 2014; FENA, 2019). "We closely follow potential effects of world's biggest economies and asses risks related to foreign currency leaving the territory. Bosnia will continue using this system in all its segments whenever deemed necessary" stated the Governor of the CBBH in an interview in 2018.

Nevertheless, there are some important circumstantial factors which greatly affect the way in which exchange reserves are controlled. For example, a senior official in the CBBH states that although *de jure* the CBBH is only allowed to use required reserves, *de facto* there is another type of instrument present:

> "Although required reserve is essentially a credit expansion control instrument, it's also in a way a reserve of liquidity for crisis situations. As the CBBH is not a lender of last resort for commercial banks, this represents a breach of required reserve control. Therefore, the CBBH relies on this instrument, namely bank liquidity regulation. This was demonstrated quite clearly during the 2008 crisis" (Interview 4).

Recently, Governor Softic has underlined that the CBBH is dedicated to innovation and that it endorsed a new monetary policy instrument — communication policies, underlining that the CBBH is not just a "big exchange office", but an institution dedicated to promoting stability in the whole country with or without traditional monetary policy instruments (Softic, 2018).

## 3.4. Explaining Monetary Policy Regime Choice

The first part of this section will explore the effect of structural constraint variables to policymaking in Bosnia and Herzegovina in the period $t_1$. The second part will explore choice variables in the same framework. The summary section will outline those that were deemed effective.

### 3.4.1. Structural Constraints

This section will discuss variables outlined in section 3.4 in relation to the case of Bosnia as well as in relation to one another, more specifically factors that affect regime choices in terms of policy trends among similar groups of states based on historical junctions, size and level of openness.

The currency board area originated in the UK in the early 1800s as an extreme form of pegged currency rates. Exchange rate management and money supply powers are taken away from the central bank under currency board — the central bank is usually there to apply and overlook if the currency board rules are properly implemented and to direct its limited instruments as seen appropriate. The main feature of currency boards is its rule-based nature: sustainability requires a high level of discipline in fiscal policy and rigorous banking supervision (Lane, 2002). However, there are many differences between currency boards as imagined in 1800s and those present after 1990. Primarily, the latter is free of government intervention, and is generally understood as functioning with a combination of provisions and choice (Nenovsky et al, 2002). Overall, currency board arrangements provide a high level of stability, and in satisfying circumstances, low inflation and acceptable interest rates.

Currency-board arrangements are seen as appropriate for small but very open economies that can benefit from low logistical costs of trade with partners, and whose size directs its inability to affect world prices in goods and asset markets.

Estonia (in 1992) was the only other small, open economy in the wider region that went through similar transitions with BiH with satisfactory results by installing a currency board arrangement (Ialnazov and Nenovsky, 2001). Estonia was, however, never quoted as a relevant factor in Bosnia's regime choice. A senior bureaucrat that was employed in the Treasury of BiH in 1997 explains: "I do not know if we were even aware of what's happening in Estonia at the time. I wasn't. We were in a state of war and decisions were made based on the expertise of our officials" (Interview 4).

Considering Bosnia and the way worldwide trends may have affected its choice, these factors have to be taken into consideration. "Bosnia was a new country and needed a clean slate in 1994, there had to be something new", a top-tier bureaucrat in the CBBH that was directly involved in shaping Bosnia's first monetary policy under currency board says of this point in time.

Dragan Kovacevic, a senior officer in the CBBH from its most early years explains in a paper written for the Bank of International Settlements that the process was affected by three transitions that occurred in Bosnia at the time: "transition from war to peace, from a socialist-command economy to a market-oriented economy and from being part of a federation to being an independent state" (Kovacevic, 2003; p. 59). Analogously, Bosnia's structure as a small, open economy with a complex institutional setup affected the choice to formalise the CBA in Bosnia (Kovacevic, 2003). Other sources also imply that Bosnia's structure as a small, open economy played a big role in policy-maker's decision to set up a CBA:

> In 1995 and 1996, in cooperation with an expert team from the IMF, the macroeconomic model of BH was defined as a small open economy as a central bank that functions like a currency board with a pegged anchor currency. … This model functioned successfully back then and still functions, and is, I

> believe, necessary considering the complexity of BiH's institutional setup and the general political situation. As a small, open economy BH is dependent on foreign capital input, and is in dire need of macroeconomic stability in order to ensure it. This model has done the job of ensuring and sustaining macro-economic stability perfectly. (Interview 4)

Some other important determinants in monetary regime choices are structural macroeconomic components such as cost-benefit analysis of logistical costs and inflation rates. As explained in Chapter 1 and 2, (Sections 1.3.1 and 2.3.1), Bosnia and Herzegovina carried a large burden of inflation trauma from Yugoslavia. This trauma turned out to be justified in the years following BiH's declaration of independence as Bosnian dinar's inflation skyrocketed. Bosnia's peak inflation was 322% in June 1992, causing prices to double every two weeks (Hanke and Kraus, 2012). After inflation showed no signs of reaching regular levels, the provisional war government of BiH decided to make a thorough reform as soon as the end of war was in sight in 1994 (Interview 3; Pugh, 2002). This was done by denominating the old Bosnian Dinar and replacing it with the New Bosnian Dinar which had 100% coverage in DM and was pegged to DM in a ratio of 100:1 (Interview 3). In 1997, BiH joined the IMF and attended the first meeting of the Board of Governors in Hong Kong (New York Times Byline, 1995). It was underlined that the foundation of the CBBH as a currency board primarily aims to prevent inflationary monetary expansion (Coric, 1997).

Capital flows, particularly in the form of trade and personal remittances are oftentimes quoted as decisive in the direction of hard pegs. Literature implies that policymakers make this decision based on the assumption of eventual largest trade partners as to minimise exchange expenses resulting from trade. All participants in interviews that were conducted for this thesis quoted better regional trade integration as the key to economic development for all countries of Western Balkans (Interviews 1, 2, 3, 4, 5, 6). However, no Western Balkan state trades most with another Balkan state, but they all trade most with the EU. It seems that a hard peg to the euro was the right choice for Bosnia - despite having a huge trade deficit over the years, currently marking at -16,8% of GDP - its biggest trade partners have consistently over the past few decades been, in order of amount of trade, Germany, Croatia, Italy, Serbia (and Montenegro until 2003) and Slovenia, out of which only is not in the eurozone (World Bank Group Data).

Asked about the effect of remittances of Bosnia's extensive diaspora on the decision to introduce a hard peg to a major European currency, policy-makers and key informants are dismissive (Interviews 3, 4, 6). However, data implies that Bosnia does not receive little remittances, it just does not receive a lot either. Remittances amounted to a staggering 48% of GDP in 1998, implying that this influx of foreign currency could hardly be overlooked by teams of international and local experts that were involved in Bosnia's monetary policy choices. As Bosnia's GDP grew, the percentage dwindled, but a look at aggregate numbers shows the numbers heavily concentrated between 10-11% in the past 15 years. Bosnia ranks 30th worldwide by remittances' percentage in GDP (World Bank Group Data, 2019).

### 3.4.2. Choice Variables

Building credibility and installing confidence into both population as well as foreign investors was one of the most important factors considered when choosing Bosnia's monetary policy regime (Interviews 3 and 4). As a small open economy, Bosnia was largely dependent on FDI and constant influx of new capital. In the first meeting of the IMF and WB only months after foundation of the CBBH in 1997, the IMF governor for BiH Manojlo Coric underlined the importance of inflation, currency-board's rule-based nature as well as its promotion of confidence and credibility among foreign investors as three key features that demonstrate the importance of credibility to assure stability, discussed in more detail in sections 3.3.1 and 3.3.2.

A representative of the CB of Bosnia, Dragan Kovacevic, explained this choice in a report prepared for the Bank of International Settlements in the following words: "We believed it was very important that the citizens of BiH (and potential foreign investors) continue to have complete confidence that the exchange rate will remain fixed against our anchor currency" (Kovacevic, 2003, 59). Confidence and trust in the stability of the Deutsch mark was, in his view, the biggest reason why the currency board decided to link newly-designed KM to DM.

The argument of confidence was once again invoked by the first Governor of the the CBBH Peter Nicholl in 1999 when the KM's peg  had to be transferred from the DM to EURO. Nicholl explained that, due to the general public having complete trust in the anchor currency (DM), by tying the KM to DM, some of that confidence transferred onto the CBBH, allowing it to get credibility despite having no track record (Nicholl, 1999, 2).

In a matter of about a year, Governor Nicholl expressed satisfaction with the level of confidence of the population into the domestic currency. "Bosnia could have chosen to adopt the DM… But instead they picked to have a domestic currency tied 1:1 to the DM. The main reason was that the new county needed symbols of its existence and unity. Having its own currency is one such symbol." (Nicholl, 1999 ). A senior representative of the CBBH makes a similar claim: "The emission of our own currency is without a doubt an expression of sovereignty, statehood, legal continuity and identity of Bosnia and Herzegovina" (Interview 3).

On the other hand, a certain level of path-dependency is observed in Bosnia's choices at this point. Prior to the formal introduction of CBA in Bosnia, in 1994, faced with exorbitant inflation rates, the war government in BiH introduced currency board rules to Bosnia's system and pegged the Bosnian dinar to the DM. In a way, the formal introduction of the CBA in 1997 continued what was *de facto* in effect already. A senior representative in the CBBH stated in an interview with the author:

> "Considering that the NBBH was already managing Bosnia's monetary policy under currency board rules prior to formal foundation of the CBBH in 1997, there is no doubt that (NBBH) affected greatly the formation of the CBBH under these terms, regardless to the fact that these two institutions do not have any tangent points." (Interview 4)

The first governor of the CBBH also outlined similar reasons in favour of currency board: "due to many financial traumas from the past, Bosnia values a stable currency and the idea of currency board therefore has a high level of political and public support within BiH" (Nicholl, 1999; p. 2).

There is no data on public support to currency board specifically, but the fact that even before the formal introduction of the peg, the DM was most commonly used currency on the territory of BiH reflects the public confidence into the DM. A few months after the introduction of KM, Governor Nicholl explains how he realised that confidence in KM was installed: he'd go to a shop around the corner, and if the cashiers were mixing KM and DM, it meant that they really believed that 1KM was indeed worth 1DM. Gradually, the DM disappeared and the KM became only currency in circulation (Nicholl, 2018).

Another factor related to government preferences in the prospect of EU accession. Primarily, abolishing currency board to switch to a floating currency is logistically very hard and expensive. However, making the switch from currency board with a peg to an anchor currency is very easy. Many have quoted this particular point as a catalyser of Bosnia's policy choices (Kamhi and Dehejia, 2006). Entering the eurozone is a credible exit strategy from the CBA for BiH, as shown by experiences of Estonia, Lithuania and Bulgaria. There is virtually no other option for BiH at this point (Interview 5).

When asked about the effect of EU accession procedures to Bosnia's regime, a senior representative of the CBBH states: "The process of accession of BiH to EU is still in early phases… the CBBH has developed a strategic plan that will facilitate the CBBH's eventual integration into the EMU and ensure a painless transfer to the euro" (Interview 4). Answering another question, the same representative states: "obviously, this plan aimed at taking Bosnia a step further toward EU integration process. There is no doubt that the CBA will be invaluable once the time comes for Bosnia to become integrated into EU's monetary system". Another interview also reveals that the idea of EU accession was present in the minds of policy-makers in

Bosnia as far back as 1997, albeit as a far-fetched plan. "Of course Europe was our plan from day one, even before the CBBH was formed, as a distant idea but still important to us. And it is without a doubt that the CBA will facilitate Bosnia's integration into the EU" (Interview 5).

### 3.5. Summary and Conclusions

This section will briefly summarise the findings of previous sections — specifically the extent of change observed in Bosnia through the policy structure approach and the operational variables behind this choice.

Table 1: Policy Structure Approach: Bosnia

| Policy Structure Approach - Dimensions | Principles | Objectives | Procedures | Instruments |
|---|---|---|---|---|
| **Bosnia** | Adjustment changes | Adjustment changes | Substantial change | Substantial change |

Four policy dimensions were analysed for change against Bosnia's monetary policy. The findings are as shown in table 1. There is a considerable shift in three policy policy dimensions: principles, procedures and instruments. The analysis of the objectives dimension demonstrates partial change that is not formally introduced, albeit evident. Considering 's categorization of policy change presented in Chapter 2 (Section 2.2), based on policy dimensions, the extent of change in Bosnia lays between policy transformation and policy adjustment, where policy transformation involves change in all four dimensions and policy adjustments change in two or three. As change in the objectives dimension is not formally introduced, Bosnia seems to lean towards the "policy adjustment" category of change.

In terms of variables that affected this change, the findings are as displayed in Table 2:

| Table 2: Structural variables' impact on policy change in Bosnia and Herzegovina | |
|---|---|
| **Structural constraint variables** | **Operational** |
| **Structural trends** | No |
| **Exogenous policy learning mechanisms** | No |
| **Size and openness** | Yes |
| **Cost-benefit analysis** | No |
| **Inflation trauma** | Yes |
| **Trade** | No |

According to the analysis presented in section 4.5.1, structural constraint variables were not considerably operational in Bosnia in $t_1$. All variables except for size and openness as well as inflation trauma are seen as passive and they had minimal to no effect on the monetary policy regime choice in Bosnia and Herzegovina. On the other hand, a glance at choice variables draws a different picture, as displayed in Table 3 — all referential variables were operational in $t_1$ in Bosnia and Herzegovina:

| Table 3 Choice variables' impact on policy change in Bosnia and Herzegovina | |
|---|---|
| **Choice variables** | **Operational** |
| **Credibility and confidence** | Yes |
| **Path dependency** | Yes |
| **EU accession aspirations** | Yes |
| **Government preferences** | Yes |
| **Previous institutional setups** | Yes |

In summary, Bosnia registered a high extent of change in policy between $t_0$ and $t_1$. At $t_1$ , structural constraint factors were mostly not operational — Only the variables concerning size and openness and inflation trauma in the states were effective. By contrast, among choice variables, all were operational in $t_1$. Therefore, an observation can be made that change in Bosnia was driven by the choice variables.

# CHAPTER IV

# MONETARY POLICY REGIME CHANGE AND POLITICS OF CHOICE IN KOSOVO

This chapter is structured in the same way as the preceding Chapter IV. Primarily, some basic background information on Kosovo is provided for the period $t_{-1}$. Secondly, chapter provides an analysis of change in policy dimensions based on the policy structure approach. Thirdly, structural and choice variables are tested on the case of Kosovo. Finally, a summary is provided after each section that outlines conclusions of both analyses.

## 4.1. Kosovo following Independence: $t_0$

UNMIK was formed by UN Resolution 1244 in June 1999 (Appendix D). It aimed for an "immediate and verifiable end of violence and repression in Kosovo" (UN Resolution 1244, NATO Press release no.M-NAC-1(99)51, 1999). Among other goals, there was deployment of an effective civil administration to Kosovo, establishment of an interim administration and total withdrawal of all military and civil local staff from the government apart from religious objects, key border crossings, minefields and those employed in international organisations. Apart from UNMIK, the International Security Force (KFOR) was also operating in Kosovo. KFOR's role was similar to that observed in East Timor and was closely tied to ensuring security. However, UNMIK was an unprecedented body, not so much by its nature, but rather by its extent: Cambodia and Bosnia all had operating governments and UN bodies were supervisory with the right to veto. The total displacement of local government is peculiar to Kosovo and was not observed before.

UNMIK's main objectives were based on four pillars, each corresponding to a different task area. The first pillar, humanitarian assistance, was led by Office of the

High Commissioner for Refugees and UNHCR. The second pillar, civil administration, was managed by the UN. The Organisation for Security and Co-operation in Europe (OSCE) was responsible for democratisation and peace-building. Under pillar IV, reconstructing the economy and infrastructure was managed by the EU. (Von Carlowitz, 2004; Resolution 1244; 1999). Generally speaking, UNMIK took over all branches of the government, as well as the "authority to administer the judiciary" (UNMIK Regulation 1999/1, July 1999).

Monetary policy was a burning questions due to the disastrous shape of the Yugoslav dinar, which was still legal tender in Kosovo. A set of actions was fast-tracked to implementation under the 4th pillar of UNMIK - the reconstruction of economy and infrastructure. Primarily, privatisation of the finance sector was one of the first objectives of the UNMIK. A proper banking sector was established. With the dinar losing its value in mind-boggling speed, the population had turned to DM in the 90s almost absolutely for saving and money transfer purposes. Quickly after its establishment in 1999, UNMIK made the DM legal and its use got facilitated. However, money supply of DM was a burning issue. The SDKK had to be dismantled and quickly all over Yugoslavia. In 1999, the Banking and Payments Authority of Kosovo (BPAK) was formed and set in place of the SDKK's payment bureaus.

4.2. Formation of the the CBRK: $t_1$

In August 2006, the Banking and Payment authority of Kosovo was transformed to the Central Banking Authority of Kosovo, which represents an intermediate form between the UN-led BPAK and the independent CBRK. This institution was then once more transformed into the Central Bank of the Republic of Kosovo in 2008. The institution as such was completely set up at this point down to the smallest procedure through regulations of the UNMIK. Ever since, the CBRK functioned under strict rules of a dollarised economy. Its main goals are outlined as following: "1) to foster soundness, solvency and efficient functioning of the stable market-based financial system, 2) encouraging the market emergence of safe financial instruments and 3) supporting the general economic policies in Kosovo … in accordance with the principles of an open economy" (CBRK, Law on the Central bank of Republic of Kosovo 03/L209, 2010).

## 4.3. Measuring Monetary Policy Regime Change Through Policy Structure Approach

The following section will evaluate policy change in Kosovo in the periods between $t_0$ and $t_1$ based on the policy structure approach. The four key dimensions of policy as defined by the policy structure approach — principles, objectives, procedures and instruments — will be presented in a chronological order referring to $t_0$ and $t_1$. The observations will be presented in the summary following these sections.

### 4.3.1. Principles

Resolution 1244 Annex 1 (Appendix D) defines the general main principles of the UNMIK as "comprehensive approach to the economic development and stabilisation of the crisis region"(Resolution 1244, 1999; Appendix D). Due to total overturn of staff in all institutions in Kosovo, principles of monetary policy were followed more or less seamlessly as regulated by Resolution 1244 (1999). However, for a short while in 1999, there were parallel structures made up of governments led by local politicians, namely Hashim Thaçi  and Ibrahim Rugova. UNMIK has struggled particularly with those unwilling to cooperate or resisting changes imposed by the UNMIK, particularly in the field of payment operations (Coats, 2007). The IMF experts outlined that these were deliberate efforts by some local managers to perpetuate chaos as a "smoke screen for illegal activities" (Coats, 2007).

Once the Banking and Payments Authority of Kosovo (BPAK) was founded, its most basic principle was simply autonomy (Regulation No 2001/2, 2001) which could be interpreted as autonomy from both the old regimes, other state institutions as well as the UNMIK. The second present theme in papers on UNMIK and other reports is "efficiency and safety", implying that in the circumstances of shaky institutions and shaky politics, the only way to stay afloat is to keep swimming and not stop (Resolution 1244; IMF Staff Visit Report, 2003). "Right after the war, we needed to ensure breathing space as well as space to properly cooperate with other emerging institutions. We did not aim for much more than that — it was impossible. Stability was the initial idea and it continues to be so" (Interview 3).

As observed in the case of Bosnia, stability in this context implies safety under all costs. However, "safe" policies are those inherited from the old regimes as shown on Yugoslavia's policies in 1980s and 1990s. The initial monetary policy in Kosovo as led by the BPAK was that of little risk, maximum gains for as long as possible. From this point of view Kosovo, much like Bosnia, seemed to be caught in a limbo, stuck between the muscle memory of old policies and the prospect of great success under new ways. However, some change was observed after the CBBK was formed in 2008. The idea of autonomy of the CBRK from exogenous effects is now understood as *sine qua non a*nd is off the table. However, the issue of "stability under any cost" remains. Setting aside applaudable efforts of the CBRK to sustain healthy policy and transparency, the ongoing circumstances of the country due to political tensions as well as a low, albeit growing level of regional integration keep an air of instability and threat active, perpetuating the notion of stability and little risk. A senior representative in the CBRK explained this in practical examples: "We invest in very liquid, very safe A-rated institutions in the EU. We work hard… We pick small but positive return rates or no at all, unlike some other Central Banks in the region" (Interview 2).

### 4.3.2. Objectives

Objectives of the BPAK and later on the CBRK are the most consistent dimension of Kosovo's monetary policy. In a press release, the UNMIK outlined the objectives of the EU-led Pillar IV as "…to form the basis of a competitive, efficient market economy" (UNMIK/PR/1638, 2007). The wording is invaluable: competitiveness implies total reform of the previous centralised, socialist system towards a profit-oriented open market economy. Efficiency, as one of the main principles of neoliberalism, further asserts this claim.

However, a focus on the details that follow tells a different story: the BPAK adopted a "risk-based" supervisory approach where most supervisory resources are allocated to the riskiest areas, namely individual banks (BPAK Annual Report, 2002). The main objective of the BPAK was therefore to avoid risk at any cost, further elaborating the stability/safety vs. liberty conundrum.

The Central Bank of Kosovo defines its objectives in a similar manner after 2008. Specifically soundness, solvency and efficient functioning of the market, as well as safe financial instruments and efficient allocation of resources are principal objectives of the CBRK (CBRK Functions and Responsibilities, 2008). Efficiency, but safety are still the main themes in objectives of this institution, effectively leaving no room for further advancing of the status quo in terms of monetary policy regime.

4.3.3. Procedures

UNMIK regulations offer a legal framework for the operation of the BPAK in line with EU and international standards, relying on the fact that it was drafted by international policymakers from the WB, IMF, USAID, US Treasury and the EU. However, due to circumstances and low predictability, these regulations were subject to many changes. With each new institution built in Kosovo, a certain provision was amended. Thus, the initial regulations were very wide and driven by general ideas. In 2002, there were many sets of regulations, directives and advisory materials that clearly outlined procedures for each and every sphere of monetary policy particularly, as well as administrative economic conduct in general. (BPAK Annual Report, 2002).

With the formation of Kosovo's own institutions, there was a dire need of these detailed procedures as to train the local staff for the eventual changeover from UNMIK to local government. Clear instructions and supervision were given to the "new" management and staff by UNMIK, but the existing procedures were used wherever applicable and adjusted as needed. These adjustments were reflected in a number of regulations that were adopted with the aim of licensing and overseeing financial institutions. The use of currency was specified by a stream of Administrative Directions that first specified that any currency could be used in Kosovo as long as all parties agree upon it (UNMIK Regulation No 1999/4, 1999). A few months later, the

DM was made legal through Administrative Direction 1999/2. Two years later, due to the changeover of DM to EURO, the UNMIK called upon its capability under 1999/4 and switched the DM with EURO. These procedures can be characterised as hierarchical and exclusive due to its roots in the former regime, yet flexible as they were subject to changes as seen appropriate.

There turned out to be many difficulties with this approach. The local staff seemed not to grasp the new system and was reluctant to adjust to the new systems developed by the UNMIK. As a result, the BPAK did not deliver records on money transfers for the whole first year of operating, urging the IMF to re-think this hard-edge reform path and switch the thinking in a way that focuses on minimal changes with maximum training. (Coats, 2007).

Much like the provisions provided by UNMIK to regulate the BPAK, the Law of the CBRK is consistently changing to address the changes in institution-building that goes on to this day in Kosovo. The procedures drafted with considerable assistance from the IMF set forth independent central banking as the focal point of conduct. The CBRK led Kosovo's membership to the IMF and was applauded for "strengthening the sustainability of their policy framework" (IMF Press Release, 2009). There was a considerable shift from hierarchical, exclusive regulations to a modern, flexible, inclusive ones in the period after 2008. Lately, policymakers in Kosovo are focused on adjusting the Law on the Central Bank to better fit EU requirements, as shown in the latest changes to the Law of the CBRK specify procedures related to external auditing (CBRK Law No. 05/L –150).

#### 4.3.4. Instruments

After the formation of the BPAK, policy instruments and the proper applications thereof remained a major concern. The currency regime that was adopted unanimously with great fervour gave very little policy instrument choice, limited to fiscal policy and money supply management through fixed-deposit instruments. Both of these turned out to be problematic in the early days of Kosovo under UNMIK due to either ambiguous directives and incompetent training of the local staff or general lack of understanding of the relationship between policy goals and available instruments. Issues with payment transactions were addressed quite promptly: the Yugoslav SDK was replaced with the BPAK immediately post war, without the "adjustment period" that caused many issues in Bosnia.

As the CBRK was formed, new concerns emerged involving instruments of the euroised economy. The lack of traditional monetary instruments puts more weight on financial policy instruments such as fixed deposit, market risk analysis, wage flexibility and bank balances (Tyrbedari, 2006). Low-risk instruments were promoted as soon as they were available in Kosovo a few years post-war and continue to be used regularly and exclusively. When asked about the lender of last resort function, representative from the CBRK answer carefully: "The CBRK is not a lender of last resort and we never applied this policy " (Interview 2). Upon further inquiry whether it would be applied in times of a deeper crisis, the answer is still clear: CBRK knows that it is an option de facto, but strongly hopes that they would never have to apply it.

## 4.4. Explaining Monetary Policy Regime Choice

In this section, I will analyse variables specified in Chapter 2 (Section 2.3) in relation to the case at hand. Dollarisation (hereinafter referred to euroisation when in the context of Kosovo) is a second form of hard currency peg. Under euroisation, the currency rate is fixed to another currency (in the case of Kosovo, the euro), and the anchor currency is at the same time legal tender in the subject state. Euroisation, thus, presents a choice made when policy-makers want to protect their currency from instability led by any endogenous or exogenous shocks (Berg and Borensztein, 2000; Quispe-Agnoli, 2002

As outlined in section 3.1, Kosovo’s first experiences with hard pegs was in 1990s while it was still a part of Yugoslavia. The New Serbian Dinar was pegged to the DM. In this period, Kosovars started using the DM informally in daily lives, while state institutions such as the SDKK ordinated with the Dinar. UNMIK established the DM as legal tender in 1999, and then amended it to euro under Administrative

Direction 1999/2 and 1999/4. When the Central Bank of the Republic of Kosovo was formed in 2008, it was envisioned as a continuation of the BPAK and therefore it continued operating on the same legal foundation as the BPAK. All previous administrative directives and laws regarding the BPAK, including those that set up DM and euro as legal tenders, were transferred to the CBRK. Therefore, in order to change its monetary policy regime, Kosovo had to re-consider a set of structural constraint and choice factors.

This section outlines these determinants in the case of Kosovo in two groups based on findings. Primarily, structural constraint factors that include international trends, past experiences, inflation trauma, logistical costs and size and development are considered. Secondly, a group of choice determinants as operationalised based on literature review on the relevant topics.

#### 4.4.1. Structural Constraints

Following the CBA trend of 1990s, there was a worldwide shift from CBAs and anchor currencies towards official dollarisation or euroisation, in the case of Kosovo and Montenegro, the two economies leading this trend (Ponsot, 2014). This trend is generally seen as stemming from the need for asserting credibility to facilitate cross-border capital movement as prescribed in the Washington Consensus (Ponsot, 2014).

However, Kosovo and Montenegro seem to be lonely in the euroisation movement due to their common past experiences and are significantly different than other cases of dollarisation that occurred around similar times, particularly Ecuador and El Salvador. (Winkler et al, 2004). Rather than looking at euroisation in the case of Kosovo as a separate trend in monetary policy regime choices, it should be seen as a continuation of the CBA trend from the 1990s that includes most of its rules and discipline, without the domestic currency.

Another factor mentioned in literature that can be observed as loosely tied to "trends" is the effect of globalisation on small open economies such as Kosovo and Bosnia. Higher capital mobility under a smaller cost was definitely a factor in Kosovo’s decision to adopt euro (Interviews 1 and 2). Although Kosovo and Bosnia are states with least trade with the EU in the Western Balkans, Kosovo officials seem to be optimistic about the future of this point quoting cheaper trade costs between neighbouring states once political obstacles are left behind (Interviews 1, 2). However, this factor is less likely to have affected monetary policy regime choices in 1999, and almost certainly not in 2008.

In both points $t_0$ and $t_1$, Kosovo had virtually no trade with its neighbours except for Albania which is not in the eurozone. The situation has slightly changed post 2008 when Kosovo started trading more with Macedonia. However, due to strong political reasons, Kosovo’s government imposed a 100% tax on goods imported from Serbia and Bosnia in 2019, quoting the incapability of Serbian and Bosnia authorities to recognise Kosovo as an independent state. This further dwelled rather shaky trade relations. In summary, if international trade was in minds of policy-makers when they opted for direct euroisation, it was not due to a prospect of trade relations with neighbours, but rather with the EU.

Kosovo carried a high inflation trauma following decades of episodes of hyperinflation starting in 1980s throughout 1990s. Inflation trauma is often outlined as one of the main reasons behind the urgent decision to use a hard peg in the newly formed state. "A serious inflation trauma is embedded into the minds of the Kosovar people, maybe even more so than other former Republics" (Interview 2). The reason why this policy-maker would separate Kosovo from other SRs is because Kosovo did not leave Yugoslavia before the worst was over in terms of hyperinflation. Kosovo faced one of the world’s worst hyperinflation under Yugoslavia in the period between 1993 and 1995. In January 1994, estimates suggest that price increase reached 5 quadrillion percent. Only higher levels of inflation were registered in Zimbabwe in 2008 and Hungary in 1946. At the time when Kosovo opted for euroisation, annual inflation stood at over 40% due to a set of measures taken by the government, including 18 devaluations where a total of 22 zeros being cut off (Windiscbauer, 2016). The dinar was therefore completely discredited and its use was limited to Serbian population in the north of the state.

Relevant literature and past experiences show that hard pegs are highly effective in containing inflation. However, there was still the question of costs of euroisation that demanded a detailed cost-benefit analysis by the UNMIK. The biggest costs related to these types of changeovers are the logistical costs of changeover to another currency and losses of cash from "seigniorage" due to the inability of the Central Bank to print money. However, policy-makers at the time believed that these costs would outweigh the benefits brought by the introduction of euro. Euro was not only a currency, it was the base of a prospective sound monetary foundation of the state on which all further economy was to be built (Svetchine, 2005).

Very similarly with Bosnia, as a small, open economy, Kosovo had to count on FDI as a catalyser of its economic growth. The IMF experts seem to be unanimous on the topic of credibility in the CBRK: the euro has installed credibility that helped Kosovo grow in the past 20 years, both under the UNMIK as well as an independent state (Fetini et al., 2005).

On the other hand, there was another large source of foreign currency to Kosovo - remittances. World Bank data shows a steady influx of aggregate personal remittances consistently amounting to over 14% of GDP after 2008, and reaching up to 20% between 2004 and 2009 (World Bank Country Data). Thus, Kosovo lies on average a well 5% above Bosnia in terms of the percentage of remittances in GDP. All these cash inflows were — and still largely are — made in cash through informal channels (Havoli, 2009).

> "Instability and costs of conversion to a shaky local currency could have scared investors away. When the CBRK was formed in 2008, there was a major crisis underway in the eurozone. These fears combined with the logistical costs of the changeover to a domestic currency would virtually remove the option of a domestic currency from the table — had it ever been there" (Interview 1).

Considering cost-benefit analysis, an IMF paper on Kosovo from 2004 also underlines the costliness of the whole process of changeover to the DM and the euro.

However, the benefits of having a stabilised economy and facilitated trade with the EU will outweigh this cost, granted further investment in labour and goods market flexibility (Moalla-Fetini, Hatanpää & Hussein, 2004).

4.4.2. Choice Variables

As discussed in Chapter 2 (Sections 2.3.1 and 2.3.2), fixed exchange rates are considered as instruments of "importing" the credibility of anchor currency's home country. In Kosovo, one of the biggest factors of this choice was the fact that the general population had the stable confidence in DM prior to the war: very few, if any, used the Yugoslav Dinar due to its instability and exorbitant inflation rates. Confidence in foreign currencies already existed for decades, particularly the DM and eventually euro, as far back as late 1980s during Yugoslavia's hyperinflation episodes.

> "We rely greatly on remittances as a state. Our people were used to keeping DM, pounds and USD under the mattress for decades as a safety net shall there be another hyperinflation. Making DM and euro official helped them take the money out from under the mattress and transfer some of that confidence into our institutions. Restoring of rebuilding the use of a former currency was not even an option" (Interview 1).

Analyzing government preferences in the case of Kosovo is quite different than Bosnia because there was *de iure* and *de facto* no local government when official euroisation took place. UNMIK was officially responsible for all administration on the territory and euroisation was their unilateral decision. The question, therefore, is not why the Kosovo government decided to adopt the euro, but why it did not decide to switch over to some other currency post-independence.

Considering local government's choice to continue using euro in 2008, issues of path dependency, logistical costs, stability and risk assessment arise. By the time Kosovo declared independence and its Central Bank was formed in 2008, euro was already set up as the formal currency by the UNMIK. In this section, exceptionally from the rest of the chapter, I will refer to UNMIK preferences in $t_0$ when considering "government" because the aim of the section is not to characterise the nature of the local vs. international administration, but rather to assess their views on euroisation as a policy and how these particular views affected the policy-making process.

There are conflicting claims concerning this issue between the IMF officials that worked on the ground in Kosovo in 1999 and current high-ranking local officials. The former claim that there was a strong political desire among the Albanian majority to set up a currency of their own which had to be turned down by the UNMIK due to Kosovo's status as a province of Serbia (Coats, 2007). On the other hand, when inquired about a possible local currency or adoption of the Albanian *lek,* all interviews conducted in Kosovo stated that option was never on the table (Interviews 1, 2). Almost a decade after 1999, in an IMF paper, an official claimed that the procedure of adopting DM was introduced with less than minimal level of local consultation with local officials, and that the lek was indeed mentioned multiple times by locals (Coats, 2007).

As the EU was in charge of Pillar IV of reconstruction in Kosovo related to economic reconstruction, it is very curious to explore the stance of EU experts on direct euroisation in the light of comments made by EU officials that this type of unilateral euroisation is incompatible with EU law from 2007 made after Montenegro similarly declared euro as legal tender (Barber, 2007). Considering the general negative stance of international actors involved to direct dollarisation largely due to its high level of irreversibility, the decision to choose such a regime for Kosovo in 1999 must have been out-weighted by other factors. Due to its special status under UNMIK, Kosovo was unable to fully participate in the EU Stabilisation and Association Process. This yielded some fairly creative solutions, such as the Stabilisation and Association Tracking mechanisms, an instrumental body made of officials from the European Commission, UNMIK and Kosovo Provisional Institutions (Friedrich, 2005). This way, strategies were developed that would set Kosovo's pace under the SAP without being fully immersed as other former SRs were.

When asked whether the prospect of EU accession played a role in Kosovo's direct euroisation process, a senior official in the CBRK says defensively:

> "We understand as institutions that we will have to go through EU accession chapters just as everyone else. It is true that we will not have the issue of changeover to euro but we have been working on preparing ourselves for EU accession in other spheres… we believe that there will be a way for Kosovo to find a solution to this unique issue. Montenegro will most possibly go through this procedure before us and will set a precedent for us. We will most likely follow their path" (Interview 2).

However, it is notable that he avoids answering the question posed and instead defends the choice of unilateral euroisation, probably due to the inexplicable dilemma of EU leading Kosovo's euroisation on one side, and EU officials making jabs at Kosovo and Montenegro due to unilateral euroisation on the other.

## 4.5. Summary and Conclusions

This section will briefly summarise the findings of previous sections — specifically the extent of change observed in Kosovo through the policy structure approach and the operational variables behind this choice.

Table 4 Policy structure approach: Kosovo

| **PSA-Dimensions change** | **Principles** | **Objectives** | **Procedures** | **Instruments** |
|---|---|---|---|---|
| **Kosovo** | No change | No change | Adjustment change | No change |

As shown in Table 4, the analysis of policy dimensions against the monetary policy regime in Kosovo presented in section 4.3 shows considerably less change than in Bosnia. All dimensions except for procedures remain unchanged after period $t_1$. The extent of change in procedures, although formally high, is hard to frame due to the fact that the change in procedures was triggered by the gradual overturn of administration from UNMIK to local officials in every institution in Kosovo. Taking this into consideration, Kosovo's monetary policy change can be characterised as policy continuity in terms of Graziano's classification which one or no policy dimensions register change (2012).

In terms of variables that affected policy change, as presented in Table 5, structural constraint variables were strongly operational. All variables apart from trends in monetary policy were deemed effective.

Table 5 Structural variables' effect on policy change in Kosovo

| Structural constraints | Operational |
|---|---|
| **Structural trends** | Yes |
| **Exogenous policy learning mechanisms** | Yes |
| **Size and openness** | Yes |
| **Cost-benefit analysis** | Yes |
| **Inflation** | Yes |
| **Trade** | Yes |

In terms of choice variables, as displayed in Table 6 below, choice variables were much less effective than structural variables. All choice variables apart from credibility and confidence are found ineffective in $t_1$ in Kosovo.

| Table 6 Preferential variables' effect on policy change in Kosovo | |
|---|---|
| **Choice variables** | **Operational** |
| **Credibility and confidence** | Yes |
| **Path dependency** | No |
| **EU accession aspirations** | No |
| **Government preferences** | No |
| **Previous institutional setups** | Yes |

In summary, Kosovo displays a much lower level of change between $t_0$ and $t_1$. Unlike Bosnia, there is no policy adjustment or policy change recorded. Structural variables were found much more effective in $t_1$. Choice variables present little effect, wherein even those deemed effective were limited. Therefore, the conclusion is made that policy continuity in Kosovo was supported by structural factors.

# CHAPTER V

# COMPARATIVE CONCLUSIONS

## 5.1. Introduction

This thesis aims to examine the relationship between structure and choice in monetary policy regime choices and continuity and change in monetary policy structures in Bosnia and Kosovo. I argue that the extent of change in monetary policy in Bosnia and Herzegovina and Kosovo can be explained by two different sets of conditions in the two states that policymakers find themselves in. I show how two sets of variables — structural constraints and choice-related — explain these policy choices by tracing how these variables influence key decisions by policymakers at critical junctures.

In this thesis, I show that it was much less "historical ethnic divides" or ethno-nationalism reflected in a never-ending pursuit of "vital national interests" driving policy change. After all, these two factors are too abstract, which make them nearly impossible to measure. These are also contingent on subjectivities from both the researcher and the subject of research. This thesis will address the gap in literature of monetary policy regime choices in Bosnia and Kosovo in comparative perspective. It does so by focusing on the insights the first two conventional approaches provide on monetary policy regime choices: approaches emphasising structural constraints and others emphasising policymakers' choices. In light of these bodies of literature, this thesis will seek to answer the following questions: How much change happened in the monetary policy regime in Bosnia and Kosovo between periods of informal/externally lead policymaking and independent policymaking? Under what conditions did policy change — or lack thereof — emerged?

The empirical data I present in the thesis has a twofold structure. First, I show direction and magnitude of continuity and change in the monetary policy regime through the help of the policy structure approach in the cases of Bosnia and Kosovo. The thesis presents empirical data on four key dimensions that make up the monetary policy regime: principles, objectives, procedures and instruments. Change in each was assessed for periods of $t_0$ and t1, where $t_0$ stands for the period between the declarations of independence of case states and the forming of the state's central bank/the formation of an independent monetary policy, and $t_1$ stands for the period between the formation of the state's central bank until today. Change is defined as policy continuity where only one dimension recorded change, policy adjustment where two or three dimensions recorded change, and policy change where all four dimensions changed. In Bosnia and Herzegovina, $t_0$ represents the period between 1992 and 1997, and $t_1$ represents the period between 1997 and the present. In Kosovo, $t_0$ represents the period between 1992 and 2007, and $t_1$ represents the period between 1997 and the present.

Second, the thesis presents empirical data on variables I identified through a detailed review of several bodies of literature on monetary policy regime choices and the variables that structure them. It is with the help of these variables I operationalised and assessed decisions by policymakers at the critical juncture of $t_1$. The following section will provide a brief overview of the empirical findings presented in this thesis.

## 5.2. Political Economy of Monetary Policy Regime Choice in Bosnia

In Chapter 3, I examined four key dimensions of the policy structure of the monetary policy regime as specified in Chapter 2 (Section 2.3) on the case of Bosnia and Herzegovina. With this template, I assessed the magnitude and direction of policy change in Bosnia's and Kosovo's monetary policies in the periods between $t_0$ and $t_1$. My findings show that, in terms of principles, there emerged a clear shift in the way of how key policymakers were between $t_0$ and $t_1$. The period $t_0$ was characterised with ambiguity and wartime circumstances until 1995, and power struggles after 1995. After the creation of the Central Bank in 1997, and further on total liquidation of the NBBH, macroeconomic stability (with its ramifications for fiscal as well as monetary discipline) and stability in the standard operating procedures (manifested in regularity) in the overall design and implementation of monetary policy became the main leading principles guiding the monetary policy regime under the CBBH.

Regarding objectives, there was also a discernible shift, albeit to a lesser extent. More specifically, reducing inflation and ensuring a sustained inflow of foreign capital remained the most significant objectives of policymakers from 1994 to present. What changed in the transition from $t_0$ to $t_1$ was the cost that policymakers were willing to pay in order to reach these objectives. At $t_0$, the NBBH was one of the political issues that all the key actors parties involved struggled with. Strikingly, however, once we were at $t_1$, it became almost unimaginable for the CBBH to not be anything but independent from the ebbs and flows of day-to-day politics. At a glance, the policy objectives characterising these two different periods show a high level of resemblance. Yet, upon further inspection, there is a significant shift between the ways in which reducing inflation and sustaining capital inflows as the main objective of the CBBH was achieved and where it stands in the past two decades.

In terms of the procedures, there emerged a paradigm shift stemming from the rewriting of all state laws from scratch in the course of drafting the Dayton Agreement. The clean slate brought about novelties that were largely alien to the day-to-day running of this political economy. In the transition, transparent and inclusive procedures that are thought to conventionally fit for a small, open, liberal economy effectively replaced the largely hierarchical and ambiguous procedures as we moved away from $t_0$.

The policy instruments dimension had a much larger scope with a multi-layered nature. Again, it looked as if, *prima facie*, monetary policy instruments showed little change between the NBBH's monetary policies and those under the CBBH. However, the NBBH was not an official currency board. This meant that the required reserve ratio instrument was formally introduced in $t_1$ with the emergence of the CBBH. One of the biggest official changes in instruments was the transfer from the outdated payment bureau system to more modern RTGS and SWIFT systems. However, the payment bureaus (ZPP) were not abolished to this day, although their roles have changed in significant ways. Most strikingly, these institutions are definitely no longer the "money-police" institutions they were before in the previous period. Finally, bank liquidity regulation is another instrument that is not officially available to the CBBH under the CBA, yet was used in the past during periods of serious economic crises. All of these changes show that there was significant change in the policy structure of the monetary policy regime under the CBBH. When seen from the lens of the comparative public policy literature, however, these changes do not amount to what the literature calls a ‘paradigm change’.

In the following section, the direction, the nature and the extent of the effect the variables selected through a review of literature (Chapter 2, Section 2.3) will be briefly outlined. Under the approaches that emphasise structure, I tested whether international monetary regime trends, cost-benefit analysis and the effect of inflation on policy-makers’ decisions would make any impact on monetary policy regime choices of policymakers. First, my findings I’ve presented in Chapter 3 (Section 3.5) shows that international trends of CBA played a minimal role on their own, but an important role combined with Bosnia’s structure as a small, open economy. Second, in line with the literature, my findings also show that policymakers made a cost-benefit analysis, and based on their revealed choices (which are corroborated by my interview data) that they decided that the possible benefits of CBA outweighed the costs. Third, my findings also shows that inflation was by far the most important factor considered when Bosnia’s decision to set up the CBBH as a currency board was made.

In the variables under choice, my data shows that domestic and international confidence and credibility played a large role in policymakers’ monetary policy regime choice. Path dependency, explained as the tendency of policymakers to not take new risks, but rather resort to previously made decisions, stand out as an operational pattern. The variable of the prospect for EU accession was very significant in driving monetary policy regime choices as my interviews demonstrated. Strikingly, however, and despite scholarly expectations otherwise, EU accession did not massively appear in official papers. The fact that my interviewees shared their strong commitment to

EU accession which did not travel into the official documents suggest a lower-than-expected degree of influence in the hearts and minds of policymakers.

## 5.3. Political Economy of Monetary Policy Regime Choice in Kosovo

Analysing Kosovo in terms of the extent to which the policy structure in the monetary policy regime changed, I observe a clear much lower degree of change compared to those changes in Bosnia. In terms of principles, my data shows that there was a small adjustment in the guiding principles of monetary policy under the UNMIK – put in effect under the BPAK and the CBRK . While the BPAK's principles were "autonomy and reconstruction", the CBRK was focused on soundness and efficiency of the market with an overwhelming presence of the principle of macroeconomic stability at any cost, implying a tendency towards perpetuating the relatively stabile, but ineffective status quo. Although the principles nominally changed in the books, the policy of little risk and maximum gains has been a constant between $t_0$ and $t_1$ in Kosovo.

With regard to the policy objectives, again little to no shift was observed. Safety and stability above all, with little if any risk are the capital characteristics of both the BPAK and the CBRK's policies. With little risk on one side and efficiency on the other, a certain policy paralysis is observed where safety and stability inhibit possible efficiency.

In the period $t_0$, a new set of detailed procedures were put into effect under the UNMIK. These procedures remained subject to change as deemed necessary in the 7-year period until the CBRK was formed. Thus, a very stable ground was laid out by the UNMIK for domestic policymakers to take over. This slow, but reassuring tempo of constant changes in procedures continued after $t_1$. Ostensibly, there is a small albeit steady trend of change in the procedures that characterise the new monetary policy regime. However, these changes in no way represent a deviation from the groundwork set by the BPAK.

Analysing instruments, less change is observed and the ones that did happen were on the level of adjustment opposed to total shift. Many changes were made during $t_0$, particularly in terms of payment systems. As a result, the CBRK had a clean slate to work on. Due to issues in training and adaptation, the BPAK had a long *de facto* "adjustment period". However, by $t_1$, it seemed that everything was working out smoothly. The CBRK still has a strong policy of using safe instruments introduced by the UNMIK and is determined to continue this trend.

In the following sections, the nature of variables identified in Chapter 2 (Section 2.3) will be briefly outlined as applied to the case of Kosovo. Based on the approach that emphasises structure, my findings suggest that, first, variables related to international trends are largely ineffective in influencing policymakers to change policy due to the fact that Kosovo was one of the leaders of the trends. Kosovo was more likely to influence other states to go down the same path than to be influenced. Second, my findings also show that capital flows, defined as international trade with neighbours, plays a partially effective role in influencing policymakers towards change due to small volume of trade with neighbours. Third, inflation trauma emerges as a highly significant variable that helps us explain the monetary policy regime choices in Kosovo. After all, this came up in interviews with key policymakers time and again and it was often quoted as the main reason that the policy of "stability and low-risk" was chosen in the first place. Fourth, cost-benefit analysis was deemed ineffective in driving monetary policy regime choices. Although the cost of euroisation was much higher than other alternatives on the table, it was still put in effect due to the belief that eventually, stability and other advantages it offered would level out the high costs.

Finally, Kosovo's political economic structure as a small, open economy exposed to external constraints, my data suggests, played a big role due to its dependency on FDI for economic growth.

From the approach that emphasises choice, credibility is found to be highly effective due to the aforementioned dependency on FDI inflows. Government preferences, especially my interview data shows, were ineffective because there was virtually no effective domestic government in times when the ground was laid for a new regime for Kosovo — policy decisions were strong-handedly taken by international actors at the time. The EU accession aspirations variable is officially denied by state representatives and reports, yet affirmed in interviews.

### 5.4. Comparative Conclusions on the Political Economy of Bosnia and Kosovo: The Centrality of State Structure

Considering the findings of the policy structure approach in Bosnia and Kosovo in comparative perspective, there are a few critical junctures that come to surface. First and foremost, again in comparative cross-national terms, a higher level of change in monetary policy regime choices is observed in Bosnia in $t_1$ when compared to those in Kosovo. The principles and procedures dimensions of the monetary policy structure display a total shift whilst objectives and instruments show partial adjustment-type changes over time. In Kosovo, all but procedures show less to no change. Procedures showcase very little change directed at adjusting the existing procedures.

In terms of the explanatory power of the two competing approaches to explaining monetary policy regime choices, structural constraints were much less operational in Bosnia than in Kosovo. While only a select set of variables emphasised in structuralist accounts (i.e. inflation trauma and size and openness) were more effective in bringing about policy reversals in Bosnia, all variables couched in structural constraint approaches have explanatory power in Kosovo. By contrast, from approach that emphasises choice, no variables were effective in Kosovo apart from credibility and confidence, while they were all operational in Bosnia. Therefore, based on my data I conclude that while structural constraint factors played a much greater role in Kosovo's decision not to change its monetary policy regime, choice variables were more influential in Bosnia's decision to change certain aspects of its monetary policy in $t_1$.

Based on this conclusion, the next analytical question emerges: what are the conditions under which change emerged (or did not emerge). To paraphrase for the two cases under study, under what conditions present in Kosovo but absent in Bosnia do we observe structural constraint factors acting as a policy constraint and imply lower levels of change in monetary policy choices? What conditions were present in Kosovo that rendered it a case providing evidence for accounts emphasising structure as opposed to those in Bosnia? What constrained Kosovo from making different choices? In order to answer these questions, I summarise my data I presented in Chapters 3 and 4 (Sections 3.2 and 4.2) and emphasise the setup of the states in times of exception leading up to $t_1$.

In $t_0$, Bosnia and Herzegovina was a unitary state, independent and autonomous albeit under a lot of pressure during the war. In 1995, the Dayton Agreement specified some aspects of statehood such as a very brief constitution, the structure of main state institutions and similar (Appendix 3). However, the implementation of the agreement was left over to mostly local politicians. The Office of the High Representative (OHR), an international monitoring body, was formed as to oversee the domestic (civilian) implementation of the Agreement.

The OHR was equipped with quite extensive policy implementation powers. Their powers ranged from legislative powers with no opportunity for appeal by local officials to the power to remove from office public officials that violate the Dayton Agreement. However, the historical record shows that the OHR had remained a largely advisory body in Bosnia, using its powers only in the very early years of Bosnia's statehood when parties in the legislative were unwilling or unable to reach an agreement in due time on key issues such as citizenship or design of bank notes. Although oftentimes subject to criticism due to the extent of powers vested in the OHR, the fact the OHR invoked their powers so very little implies a high level of autonomy of local policymakers.

The Agreement also stipulated that the first governor of the CBBH was to be a foreigner. Peter Nicholl served the role for six years. However, he did not singlehandedly create Bosnia's monetary policy; he was there to ensure a sound transfer to CBA and put in circulation the local currency. Bosnia's monetary policy was already drafted in the Dayton Agreement, that was again authored by many international as well as domestic parties, one of which are members of Bosnia's first government. The Dayton Agreement was therefore a guideline with a hard framework, but a lot of room for manoeuvre given to local officials.

In the case of Kosovo during the new period, a much different picture emerges. After Kosovo was declared a mandate under the UN and the UNMIK took over the total administration of Kosovo, there was a total displacement of local staff from all administration with the exceptions of border police, religious bodies, minefields and those already employed in international organisations. The UNMIK's leading bodies such as the IMF have made a pledge of consulting local experts, but have later on admitted that there was little to no local expertise involved in the making of some of its biggest decisions, as mentioned in Chapter 4 (Section 4.5).

By contrast, the Dayton Agreement was a "deal" with no space for maneuvering outside its broad framework. Amending and changing the Agreement is such a tedious task that had been discussed in state institutions for decades, but never implemented. All the details that regard the rest of the administration were promulgated through the Parliament with the exception of OHR's above-mentioned involvement.

On the other hand, the UNMIK amended, changed and revised Resolution 1244 many times. The Resolution gave much more extensive powers to the interim administration compared to those conferred upon the OHR. Laws covering most, if not all aspects of civilian government were drafted under the UNMIK, from the Law of Assembly to directives on the registration of private vehicles. The transfer to self-government was executed incrementally and slowly through the Provisional Institutions for Self-Government (PISG). The opposite is observed in Bosnia where, the moment the ink dried on signatures concluding the Dayton Agreement, the local government was left to swim on their own with a lifeboat in the form of OHR that seemed to prefer to observe whatever happens from afar than to get involved.

Comparing the two key documents that defined Bosnia and Kosovo in crucial moments of state-building, the Dayton Agreement (Appendix C) and Resolution 1244

(Appendix D), they seem to provide the same extent of directives. However, in contrast to the UN Resolution 1244, the Dayton Agreement defined all aspects of domestic political and economic administration, institutional structure and ways of appointment of public officials down to ethnical quotas in ministries. However, the laws and procedures were left over to the first Bosnian government to decide upon. The only direct involvement the international community had *de facto* was their tight overview of the election process in 1996. After that, it was all up to Bosnia itself. Therefore, structural factors, including but not limited to those outlined in the case analysis, acted as a policy constraint in Kosovo and perpetuated the status quo and limited change in policy compared to Bosnia.

In the light of these pieces of data, the reasons why Kosovo "chose not to choose" and complied with previous structures becomes clearer. The whole state structure was already set up by the UNMIK, everyday business was largely up and running almost seamlessly, and there was very little space left for maneuvering that wouldn't cause a stir and be considered highly controversial by locals and foreign officials alike, it was the more stable way. In Bosnia, this was simply not the case.

The implications of this thesis can therefore be widely summarised as following: primarily, structure mostly acted as a policy restrain in Kosovo after independence in 2008, and the lack of such structure in Bosnia was a driver of policy change in the same period.

### 5.5. Some Thoughts for Future Studies

This outcome is quite puzzling, particularly considering the contrasting current political outcomes in Bosnia and Kosovo. At a glance, Kosovo currently seems much more independent and autonomous in terms of government structure, without the restrictions of the Dayton Agreement as seen in Bosnia. A panacea to the conflict in 1995, the Dayton Agreement had been the driving force behind policy change in Bosnia due to its flexibility based on clearly defined yet broad provisions and the room for manoeuvring it left to local officials. Nevertheless, with hindsight, we witness the Agreement's contradictions and shortcomings.

For the past 15 years, since the first constitutional reform talks took place in Bosnia, the intricacy of making any changes to any part of the Agreement resulted in perilous paralysis of the political system. Any change to the Agreement would cause grievances to some party in Bosnia. The current form of the constitution, as shown in Annex IV of the Agreement (Appendix C) demands two key state institutions, namely the tripartite presidency and the parliamentary House of Peoples to be equally divided between Bosnia's three main ethnic groups - Serbs, Croats and Bosniaks, regardless of the state demographics. The main issue with the Dayton Agreement's ethnic quotas is not the disproportionality of representatives, but that it effectively alienates and restricts all other ethnicities from entering the government, including Bosnia's Roma and Jewish populations, alongside any others that don't identify with the three groups. Following a human rights lawsuit in the ECHR (Sejdic and Finci v. Bosnia and Herzegovina, 2009), where members of Bosnia's minorities complained about the discriminatory provisions, UK and German foreign ministers sent an open letter to Bosnia's citizens and government, pledging to catalyse Bosnia's EU membership aspirations if a plausible reform package was delivered by Bosnia's politicians. Bosnia's politicians responded with radio silence.

Currently, although still binding, the Resolution 1244 is highly irrelevant in Kosovo's day-to-day politics, while the Dayton Agreement is more often than not seen as an inhibitor to Bosnia's progress. The tables have turned in favour of Kosovo since $t_1$. This thesis aimed at showing the effect of structural constraints and policymakers' choices on designing monetary policy regimes in Bosnia and Kosovo, but its implications go further. This thesis brings to surface a phenomenon where structural factors that acted as a policy constraint in one period turned into policy catalysts in another as seen in Kosovo, and what was once a push factor in Bosnia to implement independent policy is now a policy constraint. This pendulum may as well be characterised as yet another case of the Balkan exceptionalism.

The interaction of structural and choice variables in the relatively short period of the recent two decades seems to be a result of two different approaches to statehood defined by two different ideas of peacemaking and rebuilding of state structure. Minimum involvement of foreign actors over a long period of time without an exit route in Bosnia compared to Kosovo yielded good initial results from the perspective of independent policymaking. Maximum involvement for the first few years with a clearly drafted exit route in the case of Kosovo raised many eyebrows but turned out to be a good solution in the long run. On the other hand, the state structure as defined by the Dayton Agreement rendered Bosnia more resilient to outside pressures in policymaking. Considering its current position, Kosovo also marks many hardships, particularly external issues of recognition alongside domestic issues of ethnic conflicts overspilling into politics. However, if this same study was to be replicated and include a more recent time frame, I firmly believe that the results would be much different from presented here. This may imply space for further research.

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# APPENDICES

## Appendix A

## LIST OF INTERVIEWEES

1) Senior representative in the Governor's Office in the Central Bank of the Republic of Kosovo
2) A key informant in a non-governmental monitoring organisation in Kosovo
3) Senior representative in the Governor's office in the Central Bank of Bosnia and Herzegovina
4) Senior representative at the Director's office in the Tax Administration of Bosnia and Hezegovina
5) Senior bureaucrat in the Tax Administration of Bosnia and Herzegovina
6) Senior bureaucrat in the Payment Bureau of Bosnia and Herzegovina, former employee of the BiH Treasury

Appendix B

INTERVIEW QUESTIONS

1. General framing question: How was the decision to install a currency board in Bosnia/to opt for full euroisation in Kosovo made? What/who you think affected this decision most?

2. In your opinion, what factors were at play when policy makers decided to change Bosnia's/Kosovo's formal currency?

(a) Do you see any dominant policy strategy

à Why not earlier?

à What is the source of this timing?

à asserting sovereignity? hyperinflation trauma?

à europeanization?

(b) Were there any pressures stemming from international actors to KM (convertible mark)?

3. Counterfactual: Had there been no international presence, would currency board still take place? Why KM pegged to DM and not something else?

4. Counterfactual: Without Dayton/Resolution 1244, OHR and IMF guidelines, how would the central bank manage policy in theory?

5. Opinion: how did the CBBH/CBRK deal with 2009 eurozone crisis?

6. How did the currency changeover in 1998/2002 come about?

7. Back in the early 2000, how did you work with the EU? What were your points of agreement/disagreement?

8. How are your relations with the rest of the state bureaucracy?

9. Do you recall any times there was a clash between you and government institutions in regard with monetary policy decisions?

10. How do you explain BH's/Kosovo's current monetary and fiscal policy strategy?

Appendix C

DAYTON AGREEMENT - RELEVANT EXCERPTS

The Republic of Bosnia and Herzegovina, the Republic of Croatia and the Federal Republic of Yugoslavia (the "Parties"),

Recognizing the need for a comprehensive settlement to bring an end to the tragic conflict in the region,

Desiring to contribute toward that end and to promote an enduring peace and stability,

Affirming their commitment to the Agreed Basic Principles issued on September 8, 1995, the Further Agreed Basic Principles issued on September 26, 1995, and the cease-fire agreements of September 14 and October 5, 1995,

Noting the agreement of August 29, 1995, which authorized the delegation of the Federal Republic of Yugoslavia to sign, on behalf of the Republika Srpska, the parts of the peace plan concerning it, with the obligation to implement the agreement that is reached strictly and consequently,

Have agreed as follows:

…

Article II

The Parties welcome and endorse the arrangements that have been made concerning the military aspects of the peace settlement and aspects of regional stabilization, as set forth in the Agreements at Annex 1-A and Annex 1-B. The Parties shall fully respect and promote fulfillment of the commitments made in Annex 1-A, and shall comply fully with their commitments as set forth in Annex 1-B.

Article III

The Parties welcome and endorse the arrangements that have been made concerning the boundary demarcation between the two Entities, the Federation of Bosnia and Herzegovina and Republika Srpska, as set forth in the Agreement at Annex 2. The Parties shall fully respect and promote fulfillment of the commitments made therein.

Article IV

The Parties welcome and endorse the elections program for Bosnia and Herzegovina as set forth in Annex 3. The Parties shall fully respect and promote fulfillment of that program.

Article V

The Parties welcome and endorse the arrangements that have been made concerning the Constitution of Bosnia and Herzegovina, as set forth in Annex 4. The Parties shall fully respect and promote fulfillment of the commitments made therein.

Article VIII

The Parties welcome and endorse the arrangements that have been made concerning the implementation of this peace settlement, including in particular those pertaining to the civilian (non-military) implementation, as set forth in the Agreement at Annex 10, and the international police task force, as set forth in the Agreement at Annex 11. The Parties shall fully respect and promote fulfillment of the commitments made therein.

Article XI

This Agreement shall enter into force upon signature.

DONE at Paris, this [21st] day of [November] , 1995, in the Bosnian, Croatian, English and Serbian languages, each text being equally authentic.

For the Republic of Bosnia and Herzegovina

For the Republic of Croatia

For the Federal Republic of Yugoslavia

Witnessed by:

European Union Special Negotiator

For the French Republic

For the Federal Republic of Germany

For the Russian Federation

For the United Kingdom of Great Britain and Northern Ireland

For the United States of America

Annex 4 - Constitution of the Republic of Bosnia and Herzegovina, Article VII: Central Bank

Article VII: Central Bank

There shall be a Central Bank of Bosnia and Herzegovina, which shall be the sole authority for issuing currency and for monetary policy throughout Bosnia and Herzegovina.

1. The Central Bank's responsibilities will be determined by the Parliamentary Assembly. For the first six years after the entry into force of this Constitution, however,

it may not extend credit by creating money, operating in this respect as a currency board; thereafter, the Parliamentary Assembly may give it that authority.

2. The first Governing Board of the Central Bank shall consist of a Governor appointed by the International Monetary Fund, after consultation with the Presidency, and three members appointed by the Presidency, two from the Federation (one Bosniac, one Croat, who shall share one vote) and one from the Republika Srpska, all of whom shall serve a six-year term. The Governor, who shall not be a citizen of Bosnia and Herzegovina or any neighboring state, may cast tie-breaking votes on the Governing Board.

3. Thereafter, the Governing Board of the Central Bank of Bosnia and Herzegovina shall consist of five persons appointed by the Presidency for a term of six years. The Board shall appoint, from among its members, a Governor for a term of six years.

Appendix D
RESOLUTION 1244 - RELEVANT EXCERPTS

Adopted by the Security Council at its 4011th meeting, on 10 June 1999

…
Determined to resolve the grave humanitarian situation in Kosovo, Federal Republic of Yugoslavia, and to provide for the safe and free return of all refugees and displaced persons to their homes,
…
Reaffirming the call in previous resolutions for substantial autonomy and meaningful self-administration for Kosovo,
…
Decides on the deployment in Kosovo, under United Nations auspices, of international civil and security presences, with appropriate equipment and personnel as required, and welcomes the agreement of the Federal Republic of Yugoslavia to such presences;
…
Requests the Secretary-General to appoint, in consultation with the Security Council, a Special Representative to control the implementation of the international civil presence, and further requests the Secretary-General to instruct his Special Representative to coordinate closely with the international security presence to ensure that both presences operate towards the same goals and in a mutually supportive manner;
…
Affirms the need for the rapid early deployment of effective international civil and security presences to Kosovo, and demands that the parties cooperate fully in their deployment;
…
Annex 1: Statement by the Chairman on the conclusion of the meeting of the G-8 Foreign Ministers held at the Petersberg Centre on 6 May 1999
…
Deployment in Kosovo of effective international civil and security presences, endorsed and adopted by the United Nations,
…
Establishment of an interim administration for Kosovo to be decided by the Security Council of the United Nations to ensure conditions for a peaceful and normal life for all inhabitants in Kosovo;
…
Comprehensive approach to the economic development and stabilization of the crisis region.

Appendix E: Resolution 1244

REGULATION NO. 2001/24: AMENDING UNMIK REGULATION NO. 1999/20 ON THE BANKING AND PAYMENTS AUTHORITY OF KOSOVO

The Special Representative of the Secretary-General, Pursuant to the authority given to him under United Nations Security Council resolution 1244 (1999) of 10 June 1999,

Taking into account United Nations Interim Administration Mission in Kosovo (UNMIK) Regulation No. 1999/1 of 25 July 1999, as amended, on the Authority of the Interim Administration in Kosovo

…

For the purpose of enhancing the authority of the Banking and Payments Authority of Kosovo with respect to the licensing, supervision and regulation of financial institutions in Kosovo,

…

Section 1

Status of the Banking and Payments Authority of Kosovo

The Banking and Payments Authority of Kosovo (hereinafter “the BPAK”) is a distinct public legal entity.