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Current Economic Situation in Bosnia and Herzegovina

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Abstract

This article provides an overview of the current economic situation in Bosnia and Herzegovina. Beginning in the second half of 2008, macroeconomic conditions in B&H began precipitating a decline in economic activity. While the global financial crisis was among the factors contributing to this decline, it was far from the only factor. Problematic macroeconomic conditions were also a result of B&H's own structural and political problems, caused largely by the shortcomings of a political entity comprising two autonomous entities. Due to such problems, the governments of B&H turned to the International Monetary Fund for assistance. This article analyzes the effects of the first two "stand by" arrangements made between the IMF and B&H and discusses implications for further, ongoing stand by arrangements made between the IMF and B&H. This paper also examines the lack of unified economic space between The Federation of Bosnia and Herzegovina and The Republic of Srpska, which has resulted not only in ineffective monetary policy but also in different fiscal and taxation systems between the two entities. While various existing analyses claim that B&H has little hope of resolving its economic woes due to its current political and economic structure, this article offers solutions and measures that, if successfully implemented, would lead to more efficient recovery and self-sustainable economic growth.

Introduction

While there are many countries in Southeastern Europe with economic and historical backgrounds similar to that of Bosnia and Herzegovina (B&H), the complexity of the economic and political structures integral to a nation created by the joining of two autonomous entities contributes to many unique economic conditions within B&H. While most of the Balkan nations are now experiencing the negative effects of the current global recession, B&H has long suffered internal economic struggles due to its own unique political and economic structural limitations. These unique political limitations date back to the establishment of the “awkward” Constitutional and Dayton Peace agreement, which established two entities: The Federation of Bosnia and Herzegovina and the Republic of Srpska. To make the political limitations of B&H even more complex, the larger of the two entities, the Federation of Bosnia and Herzegovina, is comprised of ten cantons, each with its own government and constitution. This political and legal framework has caused the existence of overlapping competences, which negatively affects each sector, mainly the economy. It is due to this political establishment and the fact that in the past two decades, Bosnia and Herzegovina has endured severe economic instability while undergoing economic transition from a closed-command economy to an open-market economy, that structural economic limitations have imposed great barriers for B&H at this time. One of those structural economic barriers is a high rate of structural unemployment, meaning that a high unemployment rate is caused by structural difficulties that have caused an underdeveloped economic system. To help alleviate this instability, B&H solicited financial and consultatory support from the International Monetary Fund (IMF). This article will provide specific data that will aid in explaining the current economic environment in B&H and will outline future economic prospects for Bosnia and Herzegovina.

Macroeconomic Parameters and Accumulation of Problems for B&H

Despite the leadership and guidance of the International Monetary Fund and the World Bank, the transition for Bosnia and Herzegovina from a closed-command economy to an open-market economy has been neither smooth nor painless. The process, in fact, continues to define the present economic situation in Bosnia and Herzegovina. While most of the physical infrastructures of the country were destroyed during the wars that resulted in the independence of B&H (1992-1995), the country somehow gathered its physical and financial resources and made an attempt to recover. However, due to the establishment of a rather clunky constitution and a central government with highly limited power, issues of practical governance began to arise shortly after B&H was established. The constitution of Bosnia and Herzegovina recognizes that the nation comprises two autonomous entities: (1) The Federation of Bosnia and Herzegovina (FB&H) and (2) The Republic of Srpska (RS), with a third region, the Brčko District, being ruled by local governance (though under the sovereignty of Bosnia and Herzegovina). Both entities have their own constitutions and, as it has been already stated, the larger of the two entities, the Federation of Bosnia and Herzegovina, is made up of 10 *cantons*, each of which has its own government and constitution. As a result, there is no singularly efficient way to stimulate the economy of the nation of B&H. As such, even before the current recession struck, B&H had pronounced structural problems, which, combined with the slow pace of structural reform, made economic recovery from cyclical (or short term) issues in B&H significantly challenging. Recovery

from cyclical economic trouble is difficult due to problems related to B&H's decentralized system of decision-making as well as the lack of a unified economic policy and unified market.

Beginning in the third and fourth quarters of 2008, the macroeconomic conditions of B&H began precipitating negative economic trends and contributed to a general decline in economic activity. As a direct result of this economic slowing, the unemployment rate rose, which in turn lowered the growth of the GDP. These combined problems manifested themselves in an unequal distribution of income among the citizens of B&H, which led to numerous strikes and demonstrations that at times seemed likely to turn into social unrest. This was the backdrop against which the global financial crisis hit Bosnia and Herzegovina. For the past five years, the model for the economic growth and recovery of B&H has been based on an attempt to „catch up“ with the rest of the Southeastern European region and other member nations of the European Union. This model for the economic growth and recovery of Bosnia & Herzegovina has required a high degree of liberalization in both external and internal economic relations. Toward this end, trade was liberalized after the signing of the CEFTA agreement in 2006 and the Stabilization and Association Agreement (SAA) with the EU in 2008. Unfortunately, however, any economic growth resulting from the liberalization of trade was based on the significant expansion of B&H government's lines of credit because, at that time, it was primarily credit that supported domestic consumption. This reliance on credit triggered a very high national deficit, somewhere between 12% and 15% of the GDP. Because of this, external financing became the focus of macroeconomic stability, meaning that the stability of an entire economic system relied on the external credit, which only increased government's total debt.

The following table will offer different macroeconomic parameters including nominal and real GDP, unemployment rate, and inflation rate based on the Consumer Price Index. This table provides exact data that will aid in a better understanding of the extent of the poor economic conditions in Bosnia and Herzegovina from 2005 to 2010.

Main macroeconomic parameters (International Monetary Fund, April 2010):

B&H	2005	2006	2007	2008	2009	2010
Nominal GDP (in billions KM)	16.928	19.121	21.647	24.552	26,541	TBD
Real growth rate (%)	3.9	6.2	6.8	5.5	-3.0	TBD
Unemployment rate (% of total labor force)		31.10	29.00	23.40	24.10	27.20 (42.60)
Inflation, CPI	3.6	6.1	1.5	7.4	2.0	TBD

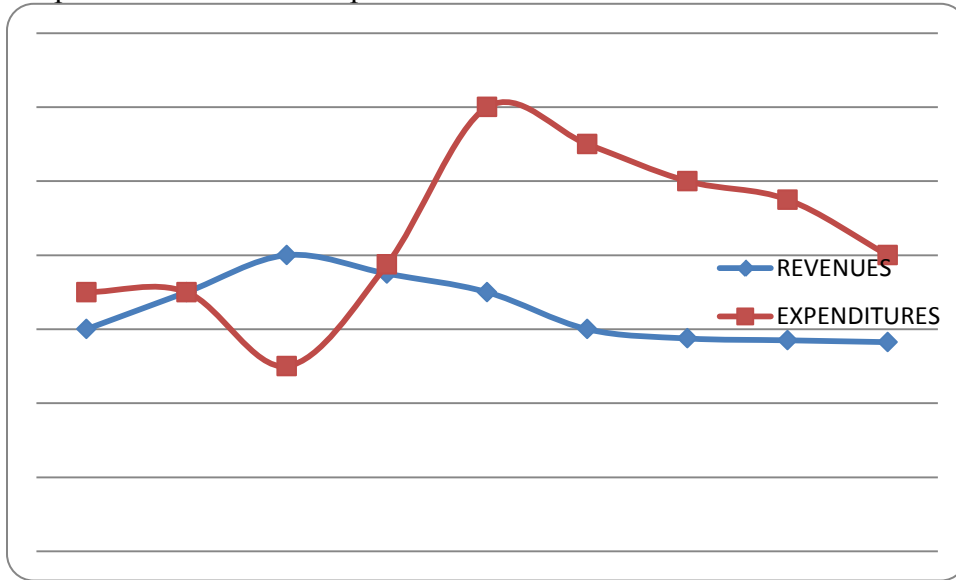
The main macroeconomic indicators in 2009 and some for first two quarters of 2010 are as follows: in 2009, GDP fell by 2.9%, industrial production by 3.3%, exports of goods and services by 17.6%, and imports of goods and services by 24.2%. Simultaneously, the country's current deficit improved from -13.3% of the GDP in 2008 to -6.6% in 2009. The budget deficit reached 5.3% of the GDP in 2009. Foreign direct investments decreased by 50% from their 2008 levels. Since the war in Bosnia and Herzegovina (1992-1995), the fiscal sector has been permanently out of the desired stabilizing flows. Public spending has increased annually (since 1995) due both to the complex structure of the government of B&H and the lack of a unified economic policy or clear development plan. As a result, public budgets were unsustainable even before the recession began. The current global economic crisis caused an already high unemployment rate in B&H to rise further. Indeed, the current imbalance in the labor market

may in fact have been caused by the most severe consequences of the global crisis in B&H: the creation of both structural and cyclical *unemployment*. The characteristics of structural (long-term) unemployment and cyclical (short-term) unemployment imply a substantial cost to the unemployed individuals themselves as well as a significant loss of potential output to the country on the macroeconomic level. An imbalance in the labor market often naturally arises from changes within the business cycle and can be temporary (cyclical) in nature, correcting itself within a relatively short span of time. However, during the current extended period of global economic crisis, what might have been cyclical unemployment in B&H has become persistent or long term, thus causing the even more deeply embedded—or structural—unemployment; in other words, the drastic increase in the number of unemployed persons and decrease of available job openings as a result of the current global economic crisis has had the effect of rendering cyclical unemployment virtually permanent.

Problematically, in turn, periods of sustained high unemployment such as this one can have the effect of further increasing the rate of unemployment below which inflation begins to accelerate, a phenomenon known as *hysteresis*. As such, if the demand for labor does not increase, there is little hope that unemployment in B&H will return even to the rates at which it stalled after the time of the country's creation in 1995. Instead, unemployment will likely remain at its current recession levels. High rates of ongoing unemployment, in turn, place pressure on the country's budget, which cause further conflict due to a highly uneven distribution of income. Economic inequality between employed and unemployed persons (and even among employed persons) is further deepening and undermining social cohesion in B&H. Higher inequality results in higher crime rates, a higher degree of corruption, higher macroeconomic instability, and even lower life expectancy. This is why sustainable growth during a recession is a highly complex problem.

Indeed, the structural problems such as ongoing unemployment have plagued B&H throughout the entirety of its post-war history. The results of those structural problems can be seen through a consistently high unemployment rate. These structural problems have made labor markets inflexible, all of which resulted in very low GDP growth. The cyclical problems started with the fund transfer increase in 2006, when certain legislation was adopted without having the financial means to back it up. A couple of laws in regards to the benefits of war veteran population were adopted and the same have placed extra burden on already stretched budgets. Social transfers amounted to anywhere between 60-65% of the entire budget. Of course, these problems continued with the effects of the global recession in 2008. Starting with 2007, budget expenditures started exceeding budget revenues, and that is shown on Graph 1, where this is expressed as a percentage of total budget regarding the social sector

Graph 1: Revenues and Expenditures from 2004-2011



Sources of the Budget Imbalance

Recession often leads to deficit due to the fact that along with the decline of economic activity, tax revenues, employment, and income also decline. However, the current budget problems in B&H cannot be exclusively traced to the global recession. Bosnia and Herzegovina has structural problems all its own (many of which can be traced back to the time of the Dayton Peace Agreement, which ended Bosnia's war and facilitated the creation of Bosnia and Herzegovina). In short, the budget problems in B&H have not been caused only by the current recession; to claim that B&H's budget troubles can be blamed primarily (or entirely) on the current global economic crisis is an oversimplification. Not only does this explanation not provide a complete illustration of the crisis' effects on B&H, but this explanation also overlooks factors internal to B&H that must be acknowledged and addressed in order for the country to thrive both economically and politically once the global economic crisis passes.

The budget crisis in B&H must be understood as a function of B&H's own poorly considered fiscal choices and its unique political landscape. First, B&H set the stage for budgetary crisis when it opted to finance imports externally, which ultimately increased the country's debt. This choice was significant because now that credit is less available (as a result of the slow down in world financial markets), B&H finds itself with no way to finance the import of goods. At the same time, B&H's own exporting has slowed, which has had the effect of further decreasing national revenues. On the political level, B&H is also responsible for the budgetary crisis inasmuch as the country has virtually accepted the position in which it finds itself, which is to say, the country has not fought tooth and nail to see its way out of crisis. Instead, it has relied on the relative budgetary stability achieved with the aid of the IMF (and its stand by arrangement); this arrangement has served to lull politicians and citizens into believing that all is well, a perception which will likely continue until the next elections, when the negative effects of quasi-macroeconomic stability will be more acutely felt and, perhaps, reflected again in a further increased rate of unemployment. Certainly, the effects of a global recession are, without question, damaging, but the economic crisis in Bosnia and Herzegovina is not entirely imported, nor does current unemployment in B&H reflect typical, cyclical unemployment rates compatible

with typical ebbs and flows of economic strength. The problems in B&H are both structural and political.

Bosnia and Herzegovina, like its neighbors, has undergone a long and painful economic and political transition process. Although the transition was aided and guided by the IMF and the World Bank (institutions that mainly use a neo-liberal approach), the country's economic system itself has kept some of its socialist characteristics. (When we say this, we do not consider the political regime, but we are specifically considering the old economic system.) For example, the way pension and retirement funds and health plans are set up strongly resembles the old system of solidarity: B&H's expenditure on the social welfare of its citizens amounts to anywhere from 60-65% of the entire budget. After this, there are essentially no funds left for the investment in infrastructure or the economy in general. There is no production of new value, and the economy continues to slow down, which further increases the rate of unemployment. This way of allocating budgetary funds has led to a liquidity problem. This means that public spending has had to be the primary engine of growth, which worked fairly well until 2007-2008. During those two years, though the main macroeconomic parameters were solid (GDP growth rates were 6.2 and 5.5%), fiscal limitations were more acutely felt than they had been prior to that time.

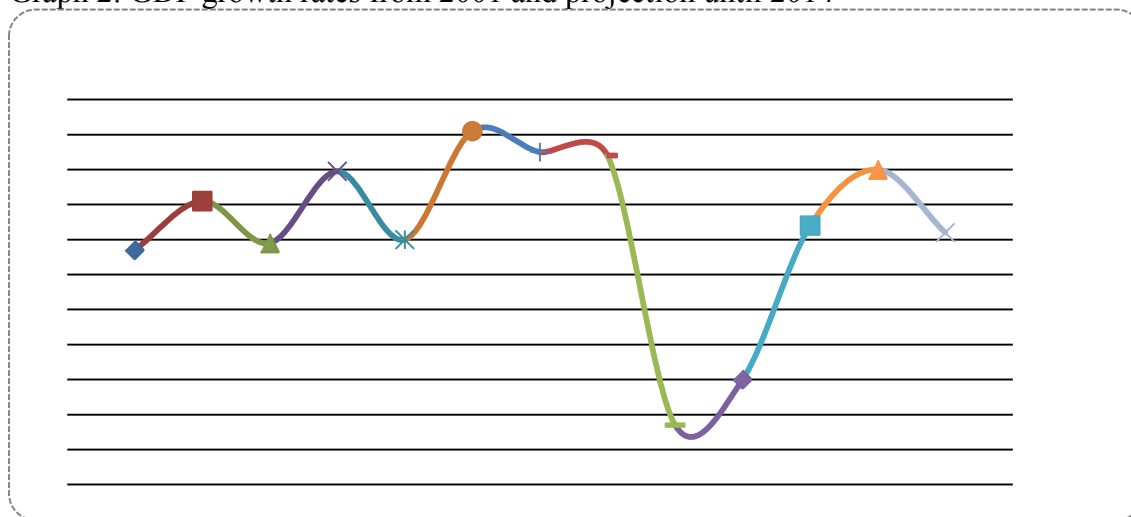
It was for this reason that B&H saw no alternative but to approach the IMF and WB for assistance in these matters. Under pressure from the IMF and the WB, the elimination of political sources of imbalance had to be the first approach within the solution order. Political sources of imbalance referred to the legislation adopted in 2006 that placed extra burden on already stretched budgets. In its structural package the IMF explicitly stated that the country, specifically both entities, the Federation of Bosnia and Herzegovina and the Republic of Srpska, had to cut down on social expenditures by a certain percentage spelled out in the Letter of Intent. In the case of B&H, the public expenditures category had to be decreased by 10% across the board. In reality, we are talking about austerity measures on all levels.

Long-term Problems: Economic Growth and Competitiveness

The main issue for B&H is the (un)sustainability of economic growth and the absence of real and structural convergence. Since B&H has failed to narrow the gap of income per capita relative to the EU, the challenges of real convergence will remain relevant in the medium and long term. Bosnia and Herzegovina's structural establishment, according to the EU standards, is still in line with the neo-liberal approach of an open-market economy. Inefficient structural convergence has caused an even higher unemployment rate and mismatch between labor demand and supply. Since 2001, B&H has had a stable and dynamic path of economic growth, but considering its low starting point and questionable sustainability of economic growth, such growth was insufficient for the EU members. This was mainly due to the fact that this type of dynamic economic growth was a result of foreign donations and aid-driven economy, not a result of successful implementation of structural, institutional, and economic reforms. Revenues from the privatization, international of economic aid, and remittances from abroad played a great role in relatively high "dynamic" pre-recession growth. For example, privatization revenues for the Federation of Bosnia and Herzegovina in the period 1999-2009 amounted to 9 billion BAM (local currency), and for the Republic of Srpska, revenue privatization amounted to 1.7 billion BAM (see www.vladars.net, www.fbihvlada.gov.ba). Bosnia and Herzegovina has received anywhere from 10 to 12 billion US dollars in international financial assistance intended to aid in the country's economic reconstruction, but the whereabouts of most of that aid are still subject of

investigation. In 2009, foreign remittances to Bosnia and Herzegovina totaled 2.1 billion US dollars and represented 12.7% of GDP for that year (The World Bank, 2011). In summary, pre-recession growth of the GDP for the period of 2001-2007 was 6% annually and was supported by very strong growth of domestic expenditures and investments that were financed by the powerful increase of credit lines, diaspora remittances, and high metal prices. Regardless of these “dynamics,” however, GDP growth rate during the pre-recession period was insufficient for B&H to catch up to the economies of EU member nations. Even at the highest growth rate of 6.2%, (during a period of 2.6% growth rate of EU at that time), B&H needed 32 years to close the gap of the 75% average GDP of EU. Because of this, one of the suggestions stressed the importance of imperative growth rate of 10%.

Graph 2: GDP growth rates from 2001 and projection until 2014



Along with the recession, the effects of which were first felt at the end of 2007, an immediate fall of exports (in 2009-21,4%) and foreign remittances (9%) was experienced [when?]. This was followed by the increase of bank interest rates and the decrease of investments. From the European perspective, B&H is characterized by the absence of real and structural convergence, especially when considering the existence of the market, the functioning of the economy, and its competitive ability. As the market transformation for B&H is reduced to macroeconomic stability, the country only enjoys stability of so-called nominal economic indicators (stability and convertibility of local currency, fixed exchange rate and low inflation rate). However, this stability is handicapped by the entity establishment of the country that undermines macroeconomic stability and does not correspond with the real economic progress. Each of two entities has its own economic policy and a different direct taxation system, which additionally undermines the possibility of the existence of a unified economic policy on the state level. On the contrary, real economic indicators reflect the economy falling behind in terms of constant high unemployment rate, high current account and payments deficit, maintenance of high levels of external debt via international transfers and credits, and insufficient growth rate to close the gap between the EU and B&H.

Considering other components, (employment, external trade, etc.), real convergence of B&H is even more endangered. On the one hand, the country has a very low starting GDP and GDP per capita (in 2009 GDP per capita amounted only to about 31% of the average from E-27),

and on the other hand there are very serious structural problems that the country faces. Some of them include:

Dominant formation of the GDP is accompanied by the sectors with very low new value, whereas sectors that characterize GDP growth (manufacturing and construction) have very low growth rates (manufacturing and construction sectors have been most severely struck by the global financial crisis and are very slow to recover).

Registered unemployment rate in the beginning of 2010 was 42.6% including “gray economy“ (roughly 40 % of employed persons are employed in some form of government sector and as such are not producing new value).

Highly unfavorable correlation between current account balance and GDP.
Consistently high unemployment rate, which forms a very powerful informal sector of the economy and which absorbs a significant number of employees.

Employers have tendency not to report all of their employees because of the excessive budget contributions for each employee; all of this only adds to the unemployment rate, but the inspections are not doing enough to cut down informal sector of the economy.
Systematically supported belief that the small salary burden will increase employment at the expense of the retirement tax, which will endanger the well-being of retired people (even the smallest salary cut will decrease spending and slow down the business cycle, and since the pension/retirement fund reforms has not been implemented yet, any salary burden at the expense of the retirement tax will place severe tensions on the existing “generation solidarity“ pension system).

Even though, in recent times, trade has significantly improved its penetration on the EU market, it did not significantly improve economic growth due to unfavorable trade balance. The permanent structural crisis has made the domestic business sector the least organized and the least competitive in the region of SEE. In comparison to the region, B&H is behind when considering the size of structural indicators: business start-ups, registration, and contract enforcement. Also, the Central Eastern Free Trade Agreement (CEFTA) plays an important role in the B&H export-import sector. Within CEFTA, we have witnessed that B&H is exposed to competition of the imported agricultural products whose countries of origin are supplying subsidies to them. Recent devaluation of currencies in some countries of the region impose a danger of reducing the relative competitiveness of domestic companies, but this effect could be mitigated by reducing relatively high contribution rates that would have an impact on the competitiveness of the labor force. Also, the possibility that a low level of national savings that could be used to finance investments is endangered by pro-cyclical and expansionary fiscal policy on the one hand and on the other hand by a de-stimulative business atmosphere and high interest rates, which are de-stimulative to small and medium enterprises (SMEs) and investors.

Anti-cyclical Policy

Basically, we are considering a complementary strategy of the implementation of anti-cyclical policy along with short- and medium-term policies of business environment improvement, the long-term strategy of opening a new approach to wholeness, and the concept of integration of economic and social development in the medium and long-term periods. In reality, anti-cyclical policy is reduced to (1) a reduction of public spending, and (2) the increase of public revenues, which is made possible through monetary and fiscal policy measures.

The main problem of B&H is a very low level of belief in the institutions of the system, along with a fairly unstable political, social, and economic environment, all of which is due to rather insufficient state structure. Everyone remains dedicated to creating an atmosphere that is going to attract FDIs, but due to the above, actually doing so remains a problem.

Even though B&H has had and still has its problems from within, the most severe global economic crisis since the Great Depression has left B&H with very negative effects on the entire economy, like almost every other country in the region. B&H has been severely struck by the global financial and economic crisis, which has only deepened the country's own negative macroeconomic conditions. The crisis has made current imbalances within the economy even worse, which in effect made macroeconomic stabilization and economic prosperity next to unattainable. Because of the negative effects of the economic crisis, as well its own economic turbulence and problems from within (deficits and in-liquidity), B&H had no choice but to turn to the IMF for assistance. Even though the IMF is guided by the Washington and Post-Washington Consensus and its credit loans are based on the "Conditionality principle" and structural reform package, B&H had no choice but to negotiate "stand by" arrangement. The current "stand by" arrangement with the IMF was signed in 2009. The Letter of Intent created by the B&H government outlines the entire structural adjustment package and includes all the reforms that need to be undertaken in order to receive different tranches of credit funds. The IMF has approved an arrangement allowing B&H to pull 1.014.600.000 SDR (or 1.200.000.000 Euros) over a period of three years (shared in the following ratios: FB&H 2/3 and RS 1/3 of funds). The "stand by" arrangement is worth 600% of B&H quota within the IMF amounting to 169.100.000 SDR. It has been approved under the following conditions: five years repayment period, three years grace period included into repayment period starting from each tranche allocation, each tranche is being repaid in eight equal quarterly payments upon expiration of the grace period, and the interest rate is changeable, determined by IMF's SDR, currently at 1.45% annually.

As far as "stand by" arrangements with the IMF are concerned, B&H has had two of those in the past, in the period from 1998-2004. Through those, it has pulled 162 million in special drawing rights (SDRs); 1 SDR = 1.183 Euros. The effects of those arrangements can be seen through macroeconomic parameters. For example, the nominal GDP (in millions KM) in the year 2000, was 10,054; in 2001-10,959; in 2002 -11,267; in 2003 -12,173; and in 2004 it was 12,911. Real GDP (in percentage) was, in 2000-5.5%; in 2001-4.4%; in 2002-5.5%; in 2003 3.5%; and in 2004 -5.1% (see www.imf.org).

When analyzing this data, it can be said that the nominal GDP rose progressively every year during the "stand by" arrangement, and the real GDP has risen every year except in 2001 and 2003. Although this cannot be fully credited to the effects of the arrangement with the IMF, to some degree the structural programs outlined in the Letter of Intent and the IMF conditionality contributed to this effect.

When looking at the nominal and real GDP, it needs to be pointed out that the inflation rate is not being taken into account because of the existence of a Currency Board within the Central Bank of B&H. The Currency Board has pegged the convertible mark (KM-BAM) to the Euro, which helps contain the inflation rate. Basically, the Euro is being used as an anchor. By definition, the inflation rate of a country using a currency (in this case Euro) as an anchor should never exceed the inflation rate of the country from which an anchor currency rate comes. This system enables B&H to have stable monetary policy (without autonomy of monetary policy), but it also prevents the Central Bank from employing active monetary policy measures intended to

stimulate the economy, which constrained B&H further during the recession. As such, the Central Bank is not in a position to undertake monetary operations such as expansionary monetary policy, which would stimulate the business cycle and economic growth. When B&H opted for this type of monetary policy, with the Euro as an anchor, it had to give up its monetary policy independence, which at that time seemed the right thing to do because the local currency (KM-BAM) had to be kept stable, at least for the time being.

Even though this system still seems to be very efficient, problems start in time of crisis. Of course, the reason for concern is the incapability of the Central Bank to implement active monetary policy measures such as a discount rate, open-market operations, and lending operations. The Central Bank of B&H, because of the Currency Board, does not have those operations at its disposal. Basically, there are only two instruments of monetary policy that B&H's Central Bank can undertake, and those are prescribed levels of reserves for commercial banks (lowered from 18% to 14%) and very low degrees of open-market operations.

Current IMF Assistance

Due to lack of these monetary instruments for the stimulation of the economy, Bosnia and Herzegovina was forced to turn to the IMF for the third time in its short history. We will briefly specify the latest “stand-by” arrangement with the International Monetary Fund. Due to the absence of an adequate monetary policy intended to stimulate the economic activity and without sufficient financial investments, the effects of the recession could only have been mitigated through rigid austerity and fiscal policy measures. Austerity measures have only slowed down the already slow business cycle. Basically, during times of recession, countries are supposed to increase spending in order to stimulate the economy. Some fiscal policy measures were undertaken, but those did not result in the intended or desired outcome. Instead, therefore, the government opted for various credit lines. It is important to state that B&H has very limited economic space in the implementation of anti-cyclical policies, and considering the existence of the Currency Board, fiscal policy has become the most powerful instrument that the country has at its disposal to influence business activities and public budgets in the recession times. Basically, the Central Bank only prescribes the minimum level of the commercial bank's reserves and coordinates the work of entity banking agencies.

Along with measures already undertaken (minimum level of reserves that the CB prescribes, “stand by” arrangements with the IMF, austerity measures, etc.), the following measures have been proposed:

- 1) Fast fiscal policy adjustment in times of recession (direct taxation and Value Added Tax—taking into consideration EU directives of low rate $\geq 5\%$, a high rate $\leq 22\%$); (Bosnia and Herzegovina operates on single VAT rate of 17% across the board. There are suggestions to implement differentiated VAT policy where the basic foodstuffs, therapeutic products, and certain drugs would have lower VAT rate, for example of 5%, and other luxury goods would have increase VAT rate of up to 22%. but the majority of decision makers believe that a VAT rate of 17% will do the job as long as sufficient and effective social assistance programs get implemented).
- 2) Emission of the public debt with the objective to implement measures of financing capital expenditures (domestic and credit loans keep increasing public debt but more efficient measures of financing capital expenditures must be implemented; up to this point, credit loans are only “putting the budget fires out”).

- 3) Implementation of the progressive taxation system so that redistribution of wealth can be implemented more equally (Federation of Bosnia and Herzegovina has implemented a unified income tax of 10% and the Republic of Srpska has implemented unified income tax of 8%; the tax base is everything above 300 BAM per month. However, the existence of a non-unified income tax rate for two entities is not the only problem. Bosnia and Herzegovina is in desperate need of a progressive taxation system because the existing system mainly aids those that are wealthy and does not protect those in need).
- 4) Possibility of taxing policy and the direction of elimination of the non-taxing portion of the income. (All employees that receive their income from the budget, at any level of the government, have non-taxing portion of the income. This portion consists of expenditures for meals and transportation to work. This problem does not exist in other entity of Bosnia and Herzegovina - the Republic of Srpska. The Federation of Bosnia and Herzegovina is currently working on a policy proposal to eliminate this non-taxing portion of income in such manner as to increase the taxation base and directly increase budget contributions.)

Suggestions for the “Brighter” Future

In order to eliminate pre-recession generators of the economic downturns, improve the sustainability of financial stability, and achieve long-term economic growth, two things need to be secured upon the completion of the IMF's current "stand by" arrangement: political stability and a functional and unified market, which will require structural reforms and measures for improving competitiveness, such as the following:

Increase in the liquidity of the business sector through bank guarantees; The sector of commercial banking must take more proactive role in order to increase the liquidity of the business sector and to stimulate the business cycle.

Credit loans from the Investment Bank (export-oriented companies, SME, farmers). Investment banks of FB&H and RS have so far been operating like commercial banks where all credit loans were approved by Credit Boards that did not take into consideration specificities of the development of small and medium enterprises, export-oriented companies, and the agricultural sector. It is imperative for both entity governments to rethink and revise the role of these banks in order to stimulate economic growth in the sectors mentioned above.

- Attraction of FDIs, green field investment and investments in general. The government at all levels must undertake additional measures to create a more attractive environment for different kinds of investments.
- Competitiveness of the export (CEFTA, EU). It is imperative to re-negotiate CEFTA and implement certain protective measures in order to preserve the domestic production.
- Decrease of import of agricultural products. The government must increase the level of subsidies and other means of assistance provided for the agricultural sector in which there is a lot of potential for development.
- Exploit the energy sector. Bosnia and Herzegovina is a resource rich country (hydropower, coal mines, etc.), and it is very attractive for investments in the energy sector, but due to current political and economic instability, investors still tend not to engage in these investments. Governments at all levels are tasked with creating a favorable and attractive environment for the development of this highly profitable sector.

- Partnership between the public and private sector. The progressive privatization was not as successful as expected and this new type of partnership between the public and private sector is expected to provide a higher level of investments as well as productiveness.
- Cooperation between universities and the economy. Higher education institutions must take a more proactive role in strategy formulation and achieve closer cooperation with the decision-makers.

Considering all of this, it can be concluded that the focus for economic policy in the period to come should be on the following:

- Macroeconomic stability, including reduction of public expenditures and of reliance on the IMF, and the stabilization of the financial sector.
- Making the business environment attractive by making procedures easier, reconstructing the Investment banks, taking protective measures, and enacting anti-dumping and compensatory measures.
- Improvements of the position of domestic production and businesses by increasing the liquidity of the business sector; provide favorable credit lines via investment bank to SMEs, farmers, exporters, etc.

In summary, in order for B&H to get closer to the EU, it is necessary to secure a high rate of economic growth, especially because the current high rates that are above the region average did not secure even remote competitiveness of B&H, even among SEE countries. Removal of the existing trade barriers to and stimulation of the economic growth in B&H also represents long-term fulfillment of the preconditions for joining the EU. The possibilities of CEFTA must be explored to a greater extent.

More importantly, economic development and growth based on the concepts of the demand-managed approach and free market must be changed, and the driving force must become a supply-side approach through (a) structural change and increase of the real supply, (b) stimulation of work, savings, and investments, (c) improvement in allocation of resources and efficiency overall, and (d) influencing the progress of technological advances and further education of personnel. There is an interpretation of some economists that controlled inflation up to 20% could increase employment of 10-15%. Of course, these tasks cannot currently be undertaken or even considered because of the Currency Board at the Central Bank. By the definition of an “anchor” currency, (which B&H has in the Euro), the inflation rate in B&H (which in 2009 was 2.5%) can never be permitted to exceed the inflation rate of “anchor’s” native country. Basically, according to the piece of legislation establishing the Currency Board at the Central Bank, Bosnia and Herzegovina has given up the autonomy of its monetary policy. Bosnia and Herzegovina’s current economic growth is based on a neo-liberal pattern of stabilization as the dominant economic objective, in which monetary policy has been tasked with two goals: growth and stability. Supported by other measures, monetary policy has offered decent solutions in the sector of inflation control and elimination of negative recession effects, but the experience reflects failure in other sectors, and that is where the recession is being beaten. Inflation is not being controlled, and when the inflation is being controlled, sufficient growth cannot be secured. This approach has been forced onto B&H and it has produced macroeconomic stability as the transition objective and not only as its first step. Some scholars are constantly criticizing the IMF and WB for implementing measures based on the Washington Consensus, basically designed for powerful countries, but turned out to be unsuccessful for the small developing countries such as B&H. Some would go as far as to say that the Washington

Consensus with its shock therapy and progressive and fast privatization represents an imminent danger to the future of B&H.

To conclude, we cannot blame anyone for the poor economic performance but ourselves. “..... in time of crisis, every country becomes a hostage of its own past” (Mecagny, Atoyan, Hofman, & Tzanninis, 2007). Even though there is a lot political turbulence in this country, these are times when we have to put all of those differences aside, because poverty and recession do not care about our color, ethnic background, gender, or nationality. For such a long time, we have wasted our energy and other resources in attempt to prove which race is better or worse, which gender or nationality is superior. If nothing else, to those that still think that these things really make a difference, the recession has “opened eyes.” Only close cooperation and coordination is going to enable us to beat the recession and prosper.

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