







# Weekly Briefing

**Bosnia-Herzegovina Economy briefing:  
Reform Agenda- economic success and political failure**  
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## **Reform Agenda- economic success and political failure**

### **The Reform Agenda**

After 6-year long stagnation period, in summer 2015 BIH COM (Council of Ministers) launched program of economic reforms termed Reform Agenda 2015-2018, a comprehensive reform package initiated by the European Union to prevent “Greek scenario for BIH”. The Agenda was designed as an economic plan which would act simultaneously on three levels of government and encompass a broad range of measures, including fighting corruption and patronage, improving the conditions for market economy and curbing gray economy, wage and pension adjustments, decreasing the size of public sector, enhancing rule of law, regulating tax system, etc.

Central government announced that the Agenda has been successful, around 60% of the measures have been carried out or are in the process of implementation. However, the critics are generally not very convinced in the success that Agenda proponents advertised throughout the last three years. A simple reason can be found in over-extensive set of measures envisaged by the Agenda, from welfare, tax, judiciary to administration reform, giving thus a leeway to substitute qualitative progress in one particular sector with quantitative mishmash of halfway and half-hearted reforms in virtually all areas.

According to Center of Civic Initiatives (CCI), NGO that in annually published “State of Nation” report tracks the success of the Agenda, a lack of clear, quantifiable goals and measurable results are “purposefully ingrained into Agenda” to blur responsibility for reform implementation. On the other hand, foreign analysts forewarned that the Agenda is failing to tackle two main issues which the “EU Initiative for BIH”, a German-based set of reform proposals from 2014 to reboot Bosnian economy. They are political patronage and corruption in public sector and poor record in advancing towards sustainable market economy are almost intact. In early 2018, German DPC Center published report “Failing

Initiative for BiH” claiming that political parties, especially HDZ BiH, virtually blocked the administration reform by obstructing the work of Federal Parliament. According to their analysis, it was easy job to do, given the fact that reform required constitutional amendments, for which HDZ political machine in Federal Parliament could easily yield opposition of one-third of MPs. Serb parties, anti-centralist and clientelist establishment just jumped on the wagon. External political pressure and inter-party consensus on reforms was not in place, leaving the main task to technocrats in federal government not versed in political negotiations. As a result, the main reforms were stalled for two years (2015-16) after which 2017 parliamentary crisis (FBH) diminished hopes for the groundwork reforms and only “cosmetic changes” have been prioritized.

### **Impact on Bosnian economy**

Bosnia and Herzegovina has been one of Europe’s worst performing economies after the 2009 recession period. In 2010-13 period, economic growth stagnated within 0.5-0.8 %, public debt swelled at 45% of GDP, direct FDI decreased from 5.4% in 2008 to 1.4% in 2010. Moreover, unemployment surpassed 30% in some areas, 18% of people lived below poverty line. At the same time 13% of GDP was spent to maintain administration, making Bosnia and Herzegovina a country with the most expensive administration in Europe.

In order to meet requirements from its main international creditors (IMF, the WB), the EU envisaged Reform Agenda carried out by central, entity/district and cantonal levels of government and included three action plans covering fiscal, administration& welfare and business reforms. The first stage, in the late 2015 and throughout 2016, set out the “test” measures including the tax adjustments, increase of extra duty levies (tobacco, alcohol, petrol) and tax collection enforcement, the cuts (employment freeze, layoffs, benefit cuts) in public sector, structural reforms in the labor law and enhancing business environment. The second, ongoing stage of the Agenda involved strengthening of the initial measures and more comprehensive consolidation of fiscal system,

public administration reform and strict public employment policies. It has also probed the idea to increase the current VAT rate from 17% to 20-23%. Moreover, it also included reorganization of welfare redistribution, restructuring of state-owned enterprises, reforms in health sector, pensions and wage adjustments, enhancing rule of law and tackling wide-spread corruption by giving more power to courts and POs.

Out of 172 measures, the federal government adopted around 120, 34 measures are currently carried out and the rest are not yet considered for implementation. Similar success rate has ROS, with 62 implemented out of 78 measures according to the action plan. From 2015 until 2018, GDP registered stable growth (within 2.5-3.2%), private sector slightly grew and pulled the exports to increase by 17% in 2017. Public debt decreased, accounting for 36% of GDP by 2017. The federal government reversed continuously expanding trend of unemployment which in 2017 stood at 20%. ROS, on the other hand, has recorded slow trend of decreasing unemployment rate, but Vienna Institute for Economic Studies predicted stable falling unemployment rate for the whole country, falling under 20% by this year.

The government succeeded to increase coverage of imports by export by 5% within the last two years, which was done by more coordinated export strategies towards regional and non-European markets. Foreign Trade ministry attached more importance to export of agricultural products which registered significant increase in the both entities. Foreign investments occurred in energy and retail sector. In 2017, Bosnia and Herzegovina ranked 3rd in the world in terms of the number of new jobs created by foreign investment, relative to the number of inhabitants.

Overall, given the continuation of current trends in employment, exports and foreign direct investment for the first half of 2018, Bosnia and Herzegovina is on track to register another successful business year. This “fresh breeze” of progress in regard to business climate was the one of main reasons why current COM Chairman Zvizdic has highest approval rate among Bosnian politicians.

Nevertheless, current public opinion is divided between optimistic predictions that see the wind of stable growth coming and critical accounts ascribing the main driving force to external factors. Similar discussions were held prior the recession in 2009, only this time critics are more presumptuous in demanding parallel steps in resolving permanent political crisis and optimists are more careful in belief that Bosnia and Herzegovina is able to carry out economic reforms without foreign guidance and oversight.

### **Main criticisms**

Not counting the failure to carry out parallel administrative reforms, the success of Reform Agenda as the process of the implementation of economic policies has met its first criticisms in general socio-economic terms. Government spending cuts and pro-business policies haven't done a lot to increase the standard of living. Number of people living below poverty line remained unchanged, while income inequality has increased. Additionally, these series of reforms instead of unifying pro-reform minders furtherly exacerbated political crisis and ethnic differences.

The public debt hike was stopped by decreasing expenditures in administration and putting more control over budget rebalancing. According to the Agenda, rebalancing of cantonal budgets required more scrutiny and involved more coordinated planning. However, critics of “cosmetic changes” claim that the government only decreased the rate of foreign borrowing, as it was required by IMF; while debt to commercial banks in loans and bonds continued to expand. Instead of relying on financial help from abroad, federal, republic and cantonal governments resorted to unregulated domestic borrowing. Some sources claim that recalculated public debt jumped to 40% and requires cap sealing before it backlashes on current public spending cuts.

In terms of overall success in liberalizing the market and upgrading business environment, Bosnia and Herzegovina made some progress, but in relative terms. According to World Economic Forum ranking from 2017 –

usually quoted in critical reports – Bosnia and Herzegovina made no move and is still one of the least attractive European countries for doing business. Poor record in fighting against corruption, weak and dependent judiciary and political patronage are continuing to be main obstacles for foreign companies.

Fighting tax evasion and ubiquitous gray market continues to pose significant challenge to reformers. Different sources put a share of gray economy as high as 22-25% of GDP, highest among the countries in the region and causing a loss of 1-2 billion EUR through tax evasion. Law enforcing mechanisms aside, uncoordinated and conflicting bureaucracy aggravates the picture.

Tax policy adjustments are more frequently result of political bargaining rather than fiscal planning. Despite declarative commitments in the Agenda, the government expectedly tried to avoid or delay tax reform by introducing first “para-fiscal” levies on luxurious goods with suspicious paths of redistribution. Tax reliefs and benefits to small entrepreneurs intended to curb grey economy, according to figures, proved insufficient as there was no significant decline in scope of unregulated economic activities. Ultimately, when tax rate adjustment came on the agenda, the government faced figures that signaled relative fall of average income per capita and delayed the implementation.

Above mentioned figures relate to a long-term living wage deficit that Bosnia and Herzegovina shares with regional countries. Despite relatively stable inflation rate, Bosnia and Herzegovina has expanding gap between the wage adjustment rate and living wage threshold. According to some estimates, average wage only covers about 50%-70% of living costs. On top of that, expensive public sector made average wage and pensions unsustainably higher than in the rest of the countries in the region. As a result, average wage increase of 4% in the last four years was swallowed by expanding rate of inflation and forced government to retreat from plans to freeze wages in public sector.

This brings a ball back to the main problem-generating issue and the reason for starting the Reform Agenda, i.e. public sector cuts and reversing the trend of

overemployment in administration. In the last three years administration shrank only by 3% and the percentage of the employed in public sector is still very high (23-24%). It is easy to detect that more radical austerity measures should be enforced to decrease the size of public sector, but this is where political problem just begin.