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## **Global Economic Crisis, Political Uncertainties and Possibilities for Reforms in Bosnia and Herzegovina**

### **1. Introduction**

It is a well-known fact that the basic cause of the latest global economic crisis is a huge disproportion between the amount of money in circulation and real values. Some estimates have shown that the all forms of monetary values amount to ca 4-5 times more than the existing real values at the global level!

The “balloon” first burst in the US real-estate market, but then it spread to all the world countries, with a smaller or greater intensity. The crisis spread from financial markets to the real economy sector, seriously hitting manufacturers of oil, cars, and all the others to a smaller or greater extent.

In the second half of 2009 global economy started to stabilize, mainly owing to better financial conditions due to significant interventions by some developed countries’ governments. Still, it is expected that the recovery process at the global level will be fairly slow, and that the leading world economies could experience the sustainable growth of activities as late as in the second half of 2010.

Depending on the incentive measures by individual countries’ governments, the speed of moving away from recession will vary. For instance, the US Federal Reserve System has maintained its reference interest rate in the 0% to 0.25% range since December 2008, which significantly supported the functioning of financial market and stimulated economy. European Central Bank and Bank of England did something similar. Governments of Germany and France were also efficient and fast to stimulate consumption and thus created faster recovery.

Effect of the global economic crisis on Bosnia and Herzegovina became evident late in 2008. In this period, most basic economic indicators – particularly industrial manufacturing, exports, imports, employment, investment and consumption - started to deteriorate significantly. The crisis due to external factors effect is still present, and its gravity is best illustrated by the fact that 70,000 B-H citizens lost their jobs in 2009 only! In that year, exports fell by 21% and imports by 26% compared to the previous year, 2008.

Demand for loans by citizens decreased significantly; banks thus have big surpluses of resources allocated for these purposes which they cannot find market for. FDI has been halved, and they are an indispensable condition for starting a new investment cycle and solving the unemployment problem. Central Bank of Bosnia and Herzegovina decreased foreign currency reserves from BAM 6.9 billion in October 2008 to BAM 5.8 billion in July 2009. In such a situation, a stand-by arrangement was signed with the International Monetary Fund for the amount of EUR1.2 billion, on very unfavourable terms with respect to obligations taken.

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Actually, it requires painful cuts in state administration and revision of relief to specific population categories. Since it is believed that about 30% population is below the international poverty standards level even without these cuts, these measures will clearly lead to social revolt and political problems.

However, I believe that economic crisis in Bosnia and Herzegovina is not due only to the global economic crisis, and that our internal political problems have had a more significant impact on it.

These problems were created by issuing the Constitution of Bosnia and Herzegovina in Dayton in 1995. The agreement reached in Dayton was a political compromise that stopped the war but, by artificially dividing the state into two entities with a high level of autonomy, extremely lowered the possibilities for its overall economic development.

The present political conditions are such that, at the level of state Parliament and House of Peoples as the supreme legislative authority, it is possible to block any reasonable economic decision and development of a unified strategy for a way out of economic crisis. At the level of Parliament, these can be blocked by given coalitions of political parties, and in the House of Peoples, by any of the constituent nations in Bosnia and Herzegovina. There are numerous examples that clearly show the kinds of damage caused by the Dayton Constitution in the unchanged form, but I will discuss only one which, I believe, caused the greatest damage, difficult to quantify accurately.

It is the border between two entities named Republika Srpska and Federation of Bosnia and Herzegovina. This line, drawn by a political compromise, destroyed the economic consistency of previous regions.

## **2. Economic Consequences of Political Division of Regions of Former Yugoslavia and Bosnia and Herzegovina**

It is clear that the essential goal of all regional integrations, such EU, NAFTA and others, is association of geography and economy. Market expansion in terms of geography results in a number of advantages.

Mutual dependence of smaller regions that enter broader integrations increases, leading to additional economic effects. In these smaller regions, trends toward autarchy decrease.

The aim of the paper is to use the example of disintegration of former Yugoslavia and possibility for economic re-integration of its parts in order to confirm the hypothesis of the advantages of market expansion, accompanied with the increase in mutual dependence and decrease in the smaller regions' autarchy.

### **2.1. The diversity of theoretical approaches to regionalization**

The theoretical basis I will use as a support for the confirmation of my hypothesis includes different concepts of regionalization and their effect on economic development. There are three groups of concepts recognizable in this respect: non-geographic, geographic, and economic-geographic.

The non-geographic concepts of regionalization focus on administrative, historical, technical and other similar criteria of regional area organization.

The geographic concepts of regionalization focus on geographic criteria, which are very diverse and consistently elaborated in theory.

The economic-geographic concept of regionalization implies a significantly more complex approach in the selection of a greater number of diverse criteria, both economic and geographic ones.

The complexity, pronounced dynamics and conditions of contemporary social and economic development processes cannot even objectively articulate one-sided, simplified and non-integral concepts of regional development. It is for this reason that the concept of nodal and functional regionalization, as the most complex and most unified one, is most frequently studied, modeled and applied in practice.

Compared to others, this concept of regionalization is the most realistic in reflecting all the complexity of the modern world development, primarily characterized by high conditionality and mutual dependence regardless of state borders. At present, it appears an almost irreplaceable model in structuring an area on regional bases.

It is the concept of nodal-functional regionalization that has been considerably disrupted in the case of disintegration of former Yugoslavia and an artificial political division within the present state of Bosnia and Herzegovina. Before its disintegration, Yugoslavia was a region where geography and economy were in harmony, and where mutual dependence between smaller regions was extremely high. The degree of mutual dependence between regions within Yugoslavia can best be seen on the example of Bosnia and Herzegovina as one of its smaller regions (republics).

GDP exchange between Bosnia and Herzegovina and its surrounding in 1990 (the last normal pre-war year in terms of business) is shown in the following table:

	US\$ bil.	%	Total exchange
GDP	10.33	100.00	%
“Exports” to other ex-Yugoslav republics		57.00	80.00
Exports beyond ex-Yugoslavia		23.00	

In 1990, trade surplus in the exchange with foreign countries, beyond ex-Yugoslavia was achieved amounting to US\$ 0.5 billion, or 4.8% of GDP.

The exchange of 80% GDP with the entire surrounding, and 57% GDP with ex-Yugoslav republics lead to conclusion that B-H is highly dependent on exports, and that these are extremely high percentages that are unattainable in the conditions of disintegration.

## 2.2. The economic consequences of disintegration of the former Yugoslav region

Until 1990, former Yugoslavia as a whole had numerous economic advantages compared to all the other countries of the communist political system. Actual consequences of these advantages included far better economic performances of former Yugoslavia compared to all the other communist countries, and a higher level of its population's standard of living.

However, this was due not only to the advantages of economic system, but also to the market size and complementary character of its smaller regions, i.e. former republics.

A well-known Croatian economist, Branko Horvat, who is one of the first advocates of East European economic integrations, also convincingly proved all the advantages of former Yugoslavia system and market in his papers. For these reasons, I believe that it is realistic to forecast that this region will continue to be a market with very intense economic relations in the future as well, due to tradition, language and cultural similarities and complementary resources. Naturally, it will not be an obstacle for broader integrations. On the contrary, economic dependence processes will thus strengthen, and trends toward autarchy will decrease, due to greater opportunities in a broader market.

Before the disintegration of Yugoslavia, Bosnia and Herzegovina was a whole the parts of which were complementary in terms of economy. Geography and economy were in harmony in this region.

Respecting primarily ethnic and military-political criteria, the Dayton Accord divided Bosnia and Herzegovina into two parts, tearing thus the long established hierarchical, functional, economy-infrastructure and all the other links between big urban centers, lower-ranking centers and their hinterland, starting from resource potentials, manufacturing and other contents. The areas were divided in such a way that some parts of one Entity spread over the most dynamic core of a macro-region in the other, while the other Entity remained with the parts of the region with the most unfavourable spatial, structural, and infrastructural structures. Direct results of this fragmentation include the loss of space-interaction potential, urban contents, disruption of urban fittings. In 1991, the sum of the potential of interactive conjunctions in the B-H city system amounted to  $282,597 \times 10^4$  of interaction impulses. Torn conjunctions between towns had negative consequences.

The analysis of urban system functioning in twelve towns in B-H and taking into account six towns in each of the two Entities respectively (FB-H – Sarajevo, Zenica, Tuzla, Mostar, Bihac, Bugojno; RS – Banja Luka, Brcko, Bijeljina, Prijedor, Doboje, Trebinje), show that total losses would amount to  $114,884 \times 10^4$  interaction impulses which, compared to the B-H interaction potential of  $282,597 \times 10^4$ , amounts to 40.56%.

We will best prove the accuracy of these statements if we compare the map of Bosnia and Herzegovina pursuant to Dayton Accord with the past grouping by regions which were characterized by natural and economic harmony.



Exit from Yugoslavia where it was well fitted into a close-knit whole, division into two parts called Entities, as well as the divisions of smaller regions in an unnatural way, resulted in the emergence of autarchic trends at all levels. Bosnia and Herzegovina as a state is trying to substitute for resources it used to receive in Yugoslavia, both Entities want to complete their respective infrastructures and strategic resources, and smaller regions which are divided between the two entities double many capacities.

Some of the basic economic indicators for Bosnia and Herzegovina as a whole, and for its two Entities separately indicate that post-war results are worse than in most transition countries, which have not experienced the artificial political divisions of their regions. The structure of creating the gross domestic product and the rate of its growth are, among other things, determined by the geographic characteristics of the area.

Besides other factors, the artificial division of the state into two Entities has certainly influenced extremely high rates of unemployment. Actually, many people lost their jobs because large pre-war enterprises, which were the drivers of development and employed most workers, have also been artificially divided. It was for this reason that an enterprise management remained in one Entity and its plants in the other.

Besides illustrating the harmfulness of artificial divisions and autarchic trends within regions, all the presented indicators for Bosnia and Herzegovina and its two entities confirm the hypothesis on possible advantages of regional integrations and market expansion.

My personal opinion is that future research will show that multiplied economic damage due to autarchic regional trends across former Yugoslavia, and particularly in Bosnia and Herzegovina, will surpass the damage due to the war!

A typical example of negative economic consequences of the disintegration of smaller B-H regions after Dayton is the newly formed Sarajevo Canton. At present, this Canton does not include the underdeveloped municipality of Pale and some rural parts of other municipalities. These parts, which have been artificially torn apart from its economic whole, urban and developed Sarajevo, have no opportunities for growth. Their mutual dependence with Sarajevo is the price of autarchy unless the present conditions change.

### **3. Opportunities and threats of Bosnia's inclusion in broader regional integrations**

Opportunities for BiH in entering broader regional integrations include the increase in the potential demand, strengthening of competition that leads to reduced prices and increased quality of supply, creating the economy-of-scale effect, better business cooperation between companies, etc.

The reality of exploiting these opportunities in a shorter term is greater in smaller regions, starting from former Yugoslavia, through Southeast Europe regions to the European Union countries. The reason for this is the fact that the difference in the quality of basic economic indicators is increasing by the same order to the detriment of Bosnia and Herzegovina.

The basic threats to BiH entrance into broader regional integrations include its economic development, poor competitive position of its companies and internal disintegration. Threats increase by the region expansion, and the most serious one is a too fast accession to the European Union.

### **4. Conclusions**

- Linking geography and economics through regional integration brings significant benefits of increasing interdependence of smaller regions and reducing their autarchy tendencies.
- Theoretical model of nodal-functional regionalization is significantly disrupted in case of former Yugoslavia disintegration, as part of Southeastern Europe, and especially in Bosnia and Herzegovina as a sub-region.
- Drastic fall of GDP is the best evidence for this conclusion, as this was not only by war caused but also with artificial divisions of former consistent regions.
- Basic economic indicators for Bosnia and Herzegovina, such as GDP per capita, unemployment rate, the structure of the economy, the ratio of import and export and etc., are much worse than within most countries in transition, which is direct consequence of political division of two entities and disintegration of four former macro-regions, despite the significant assistance of International Community.

- The processes of economic integration at the level of Bosnia and Herzegovina, the former Yugoslavia and Southeast Europe region can proceed in parallel, but the advancement from smaller to larger regions is natural cycle.
- At the level of Bosnia and Herzegovina, the biggest obstacle to the harmonization of geography and economics is the existence of two entities with a large autonomy and autarchy tendencies, which leads to weak central institutions and the lack of a single strategy for economic development.
- Faster economic integration of the former Yugoslavia region is in the interest of all the newly created independent countries, because of the complementarities of resources, tradition and no language barriers.