

VJEKOSLAV DOMLJAN, SSTS

NECESSITY OF BIH'S J- TURN

- FROM DEFECTIVE TO EFFECTIVE
POLICIES IN REDUCING INACTIVITY
AND UNEMPLOYMENT

LSEE

Belgrade, May 11, 2012

OVERVIEW

2

Introduction

I. Effects of Defective Development Policies

II. Mass Inactivity and Unemployment

III. From Defective to Effective Policies – Key
Ingredients of Effective Policy

INTRODUCTION

3

- BiH suffers from
 - ▣ inactivity
 - ▣ unemployment
 - ▣ underemployment.
- Aim of the presentation is to show
 - ▣ why BiH policymakers should be concerned about inactivity and unemployment
 - ▣ what useful policies could guide them in the future policy
 - ▣ how suffering of those in the labour market or around could be lessened.

INTRODUCTION

4

Low income countries

- resource based
- low technological content
- low wages

B-
H

High income countries

- knowledge based
- high technological content
- high wages

INTRODUCTION

5

- BiH is currently caught in a middle-income trap, preventing it to compete
 - ▣ with low-wage countries in products with low technological content and
 - ▣ with high-wage countries with knowledge-intensive services.

INTRODUCTION

6

- BiH is obliged to
 - ▣ improve productivity to become competitive
 - ▣ generate jobs to decrease unemployment and inactivity
- Government institutions (employment bureaus and educational institutions) should develop policies to address the problem of skills mismatch

INTRODUCTION

7

- growth rates $< 7\%$ should be considered as unsuccessful
- bearing in mind
 - ▣ global economic crisis and
 - ▣ huge public and foreign trade deficits
(forcing BiH to turn to IMF for stand-by arrangement)
- ...it is a great challenge for policymakers.

I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

8

- Given the economic problems BiH is facing, its growth rates over the first decade of 2000s are disappointing
- Rates were not higher due to supply-side failures
- BiH economy suffers from
 - ▣ **static inefficiency** (poor allocation of existing resources, especially labour and land) and
 - ▣ **dynamic inefficiency** (low accumulation of capital of all kinds, primarily “hard” and “soft” infrastructure)

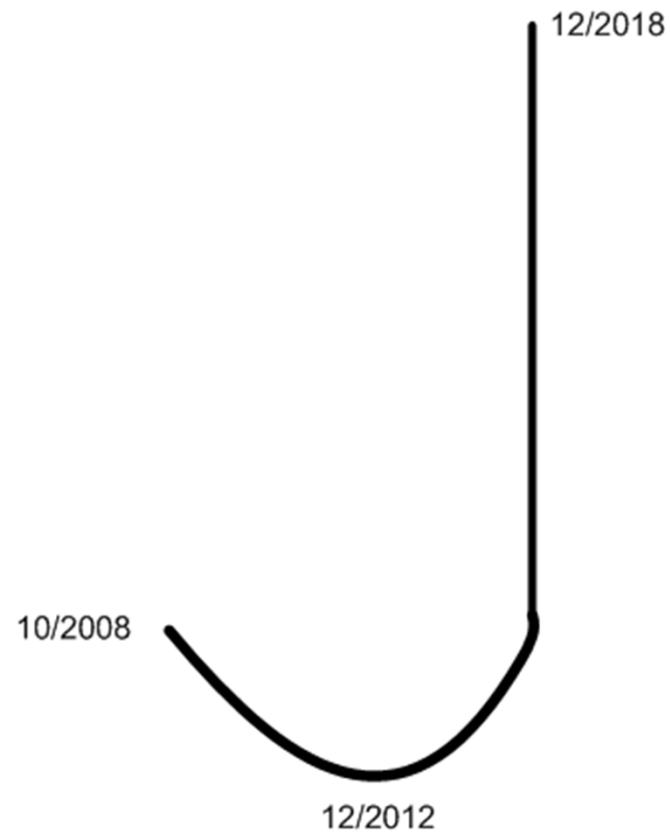
I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

9

- The recipe for disaster (forcing BiH to turn to IMF in 2009), was a combination of
 - ▣ paper **privatization** (the transfer of society's capital to ethnocartels for false money, vouchers)
 - ▣ too much external **liberalization**, and
 - ▣ huge tax wedge for funding **bureaucracy**

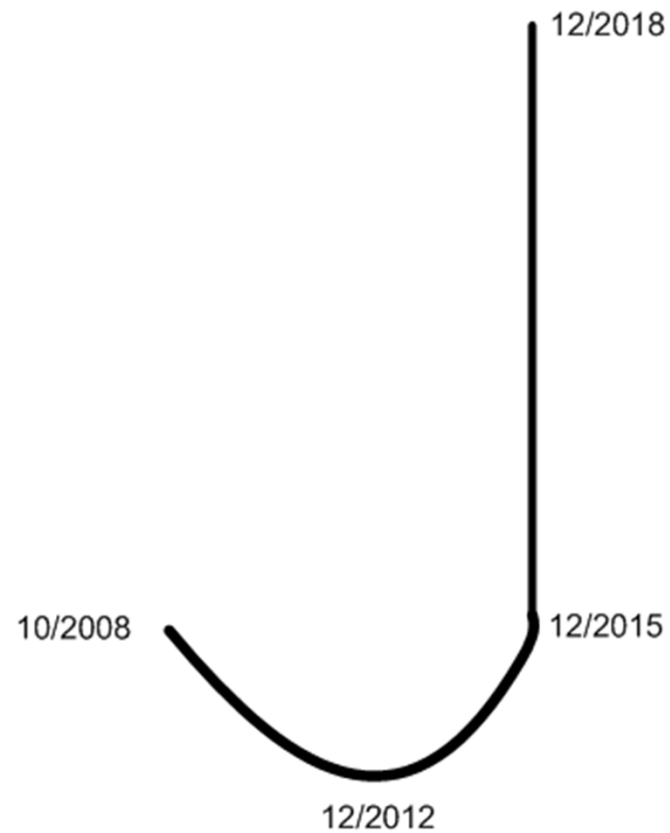
I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

10



I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

11



I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

12

- BiH is among the least competitive European and Central Asian economies
- Even the worse, its competitiveness has been strongly decreasing since 2008
- to increase its competitiveness, the BiH economy should be transformed into the knowledge based one

I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

13

Global Innovation Index (INSEAD)		Knowledge economy index (World Bank)		International innovation index (BCG)	
Country	rank	Country	rank	Country	rank
Macedonia	67	Macedonia	57	Albania	67
Armenia	69	Georgia	68	Azerbaijan	68
Georgia	73	Turkey	69	Armenia	75
BiH	76	BiH	70	Macedonia	76
Albania	80	Armenia	71	Georgia	77
Kazakhstan	84	Kazakhstan	73	Kyrgyz Republic	81
Kyrgyz Republic	84	Azerbaijan	79	Moldova	83
Azerbaijan	88	Albania	82	Tajikistan	93

I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

14

- The BiH export base is
 - ▣ very narrow, rooted in low skills and raw materials (timber, alumina, aluminium etc.) with knowledge-intensive manufacturing or services contribution to total exports with less than 1 %
 - ▣ only gradually shifting its sectoral structure towards services – transport and tourism
 - ▣ to be extended towards knowledge-based services (air transport, banking, insurance, legal services etc.)

I. EFFECTS OF DEFECTIVE DEVELOPMENT POLICIES

15

- Reaching Bulgaria and Greece (the least competitive EU member country)
 - ▣ asks for the jump of about 30 places at the WEF's ranking list and
 - ...8-10 years of proper economic policies
- BiH is the last Balkan country, the second only to Ukraine within Europe by the easiness of doing business (Doing Business 2012)

II. MASS INACTIVITY AND UNEMPLOYMENT

16

- According to the BiH population surveys, unemployment is listed as the main problem, followed by corruption

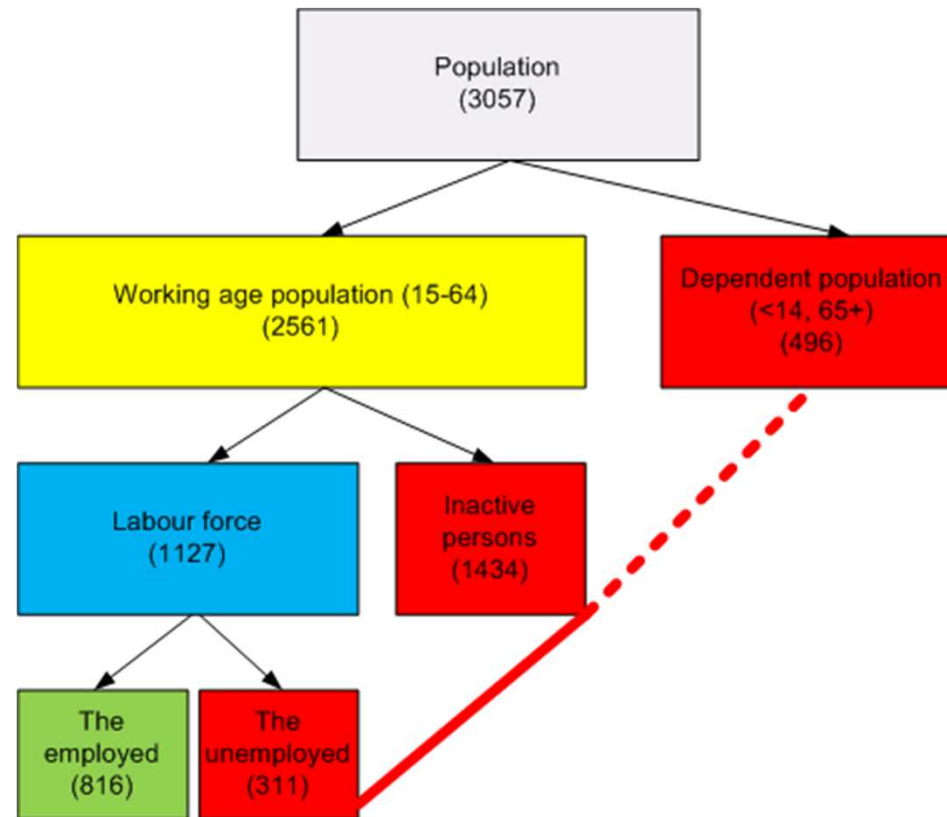
II. MASS INACTIVITY AND UNEMPLOYMENT

17

- Working-age population:
 - 1/3 employed
 - 1/3 unemployed
 - 1/3 inactive

II. MASS INACTIVITY AND UNEMPLOYMENT

18



II. MASS INACTIVITY AND UNEMPLOYMENT

19

- The BiH's inactivity rate of 56.0 %
 - ▣ 1.43 million persons out of a total working-age population of 2.56 million do not participate in the labour market and are inactive
- Out of the unemployed,
 - ▣ 80.7 % unemployed >1 year
 - ▣ even 42.1 % of the unemployed are looking for a job > 5 years
- the unemployed person waits for a job for 4.5 years.

II. MASS INACTIVITY AND UNEMPLOYMENT

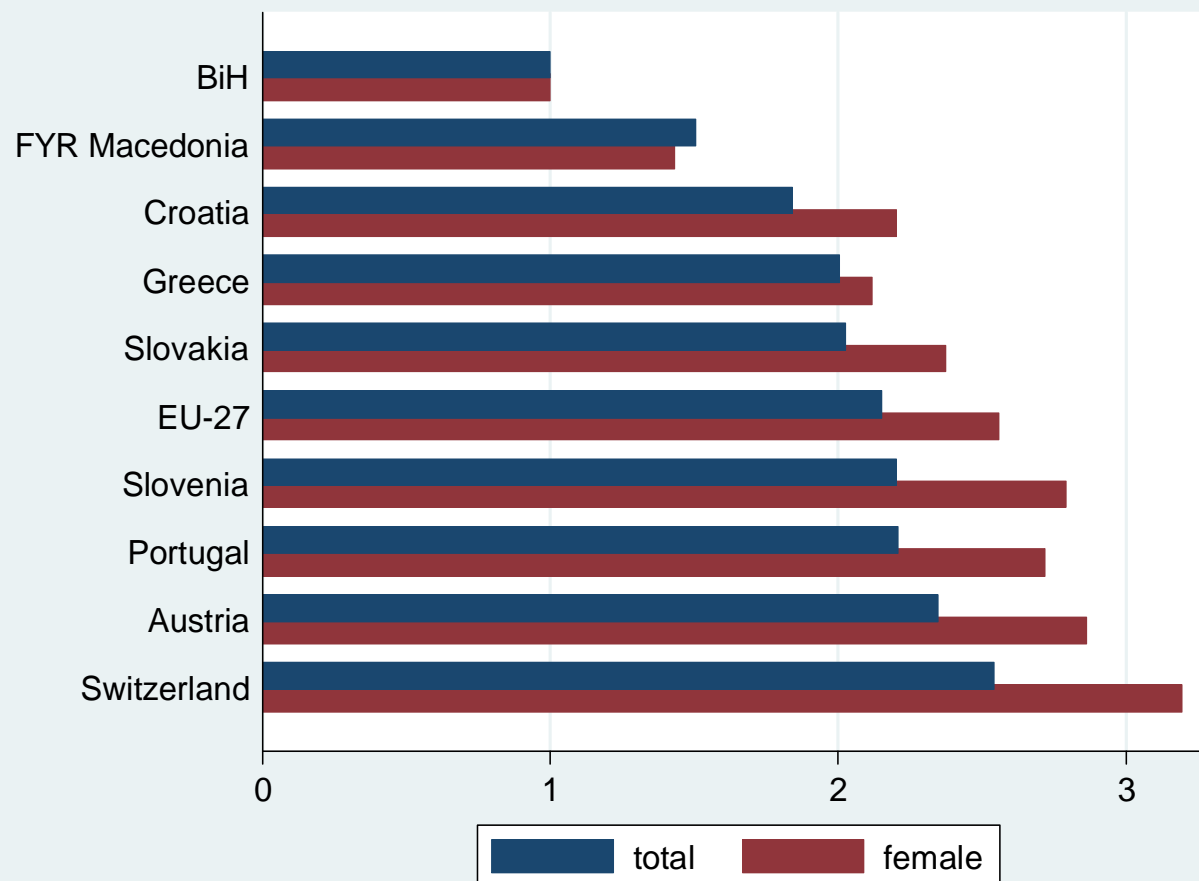
20

- BiH would have **to double** its employment rate to catch up with EU member states with the *lowest* employment rates

II. MASS INACTIVITY AND UNEMPLOYMENT

21

**Total and Female
Employment
Rates, BiH and
Comparators,
2010 (total) and
2008 (female)
(BiH=1)**



II. MASS INACTIVITY AND UNEMPLOYMENT

22

- It is not feasible even theoretically
 - ▣ since BiH does not have as many unemployed persons as needed to fulfil that
- Reaching that would ask for a mass transfer from the inactive to the unemployed, which is not feasibly practically
- the inactive population consist of unemployables
 - ▣ $\frac{2}{3}$ of them has completed only primary schooling or less,
 - ▣ $\frac{1}{3}$ of them has secondary education and
 - ▣ 3% has university education

II. MASS INACTIVITY AND UNEMPLOYMENT

23

- The inactive population consists of
 - ▣ 47 % of inactive males who consider themselves 'retired'
 - ▣ a good portion of the 46 % of inactive females who consider themselves 'housewives'
 - ▣ **21 % of inactive males and females who consider themselves 'unable to work'**

II. MASS INACTIVITY AND UNEMPLOYMENT (in 000)

24

needed for doubling the employment rate	where to look for them		
	currently the unemployed:	to be sought for among the inactive	
816	311	505	
		students	105
		the discouraged inactive	68
		the 'missing' (to be sought among the retired, disabled, and housewives)	332

II. MASS INACTIVITY AND UNEMPLOYMENT

25

- There are obviously too many barriers to doubling the employment rate, eg. lack of capital
 - ▣ in reality there are no monetary helicopters
 - ▣ necessary to invest in job creation on average 15,000 EUR
- 40-60 % of investments in the pre-crisis period financed by 'exported savings'
- high investment rates in the pre-crisis period (24-28 % of GDP) were financed by inflows of FDI, workers' remittances and primarily by mothers' banks loans extended to their daughters' banks

II. MASS INACTIVITY AND UNEMPLOYMENT

26

- Even when growth rates were 5-6 % as in the pre-crisis period, BiH faced jobless growth.
- When growth oscillating between -2.9 % (2009) and 0 % (2012),
 - ▣ the number of jobs available in the private sector is declining
 - ▣ while in the public sector it is increasing, making inactivity and unemployment more severe.

III. From Defective to Effective Policies – Key Ingredients of Effective

27

- Before BiH lay big, urgent, medium-term economic tasks such as
 - building up an attractive business & investment environment
 - building up clusters and international value chains
 - job creation
 - export increase
 - local savings mobilisation
 - building up businesses
 - public deficits decrease, and
 - pouring public investments into scientific and physical infrastructure etc.

III. From Defective to Effective Policies – Key Ingredients of Effective

28

- As manoeuvring space on the demand side (based on the rigid currency board regime and an inflexible exchange rate is very limited)
 - ▣ it remains nolens-volens to turn to the supply side i.e. to conducting policies at regional (entity and cantonal) and local (municipal) levels

III. From Defective to Effective Policies – Key Ingredients of Effective

29

	1998 – 2011	2012 – 2018
Policy approach	<ul style="list-style-type: none"> • opinion-based 	<ul style="list-style-type: none"> • evidence-based
Policy type	<ul style="list-style-type: none"> • non-existing hand and non-functioning invisible hand 	<ul style="list-style-type: none"> • mostly invisible and partly invisible hand
Policy aim	<ul style="list-style-type: none"> • none 	<ul style="list-style-type: none"> • full employment
Policy indicators	<ul style="list-style-type: none"> • none 	<ul style="list-style-type: none"> • employment rate
Approach to building up the market economy	<ul style="list-style-type: none"> • non-organic i.e. top-down (privatization) 	<ul style="list-style-type: none"> • organic (clusterpreneurship and entrepreneurship)
Economic sector	<ul style="list-style-type: none"> • intermediation (foreign trade) 	<ul style="list-style-type: none"> • (knowledge) production
Key economic resource and its purpose	<ul style="list-style-type: none"> • (public) physical capital, to be stripped 	<ul style="list-style-type: none"> • knowledge, to be generated
Purpose of the public sector	<ul style="list-style-type: none"> • employing “our men”, rents extracting, decapitalization 	<ul style="list-style-type: none"> • producing public goods
Type of internationalization	<ul style="list-style-type: none"> • import-led 	<ul style="list-style-type: none"> • export-led

III. From Defective to Effective Policies – Key Ingredients of Effective

30

	1998 – 2011	2012 – 2018
Firm type	<ul style="list-style-type: none"> • hyena- and wolf-type 	<ul style="list-style-type: none"> • cow-type
Firms' orientation	<ul style="list-style-type: none"> • profiteering 	<ul style="list-style-type: none"> • innovation
Economic turbulence	<ul style="list-style-type: none"> • privatization • ethnocartels • no bankruptcy ('privatized' state firms serve as a collateral for deliberately not repaying loans) 	<ul style="list-style-type: none"> • mass entrepreneurship • strong clusterpreneurship • fast bankruptcy
Pillars of the economic system	<ul style="list-style-type: none"> • public sector • tycoons (rent-seeking entrepreneurs) • public 'development banks' 	<ul style="list-style-type: none"> • private sector • leader clusterpreneurs • research institutes
Economic drivers	<ul style="list-style-type: none"> • public expenditure • remittances • foreign donations 	<ul style="list-style-type: none"> • private investment • export • foreign direct investment

III. From Defective to Effective Policies – Key Ingredients of Effective

31

	1998 – 2011	2012 – 2018
Legal orientation	<ul style="list-style-type: none">• lawlessness	<ul style="list-style-type: none">• rule of law
Economic drivers	<ul style="list-style-type: none">• public expenditure• remittances• foreign donations	<ul style="list-style-type: none">• private investment• export• foreign direct investment
Legal orientation	<ul style="list-style-type: none">• lawlessness	<ul style="list-style-type: none">• rule of law
Policy appraisal	<ul style="list-style-type: none">• 2 x ‘seven mean years’	<ul style="list-style-type: none">• ‘seven good years’

III. From Defective to Effective Policies – Key Ingredients of Effective

32

- For 2 x ‘seven mean years’, conducted in 1998 – 2011, there are no calculations of economic and social costs of policies
- The costs of inactivity and unemployment are very high in terms of economically vast social distress and severe personal hardship
- „Every puff of Mr. Baldwin's pipe costs us thousands of pounds“ wrote Keynes (1929)

III. From Defective to Effective Policies – Key Ingredients of Effective

33

- deep, mid-term structural reforms should be undertaken aimed at
 - ▣ establishing leader clusters/value chains
 - ▣ supporting gazelles
 - ▣ establishing training centres
 - ▣ supporting R&D activities within clusters
 - ▣ diversifying and better regulated financial systems
 - ▣ activating mega-investment projects
 - ▣ fiscal system overhaul
 - ▣ KM devaluation

III. From Defective to Effective Policies – Key Ingredients of Effective

34

- decreasing inactivity and unemployment should be carrying on as part and parcel of mid-term anti-crisis programme
 - ▣ centred on decreasing all kinds of public spending but on public investments on R&D and physical infrastructure and
 - ▣ restructuring tax revenues (decreasing labour taxation and increasing revenues from property and consumption taxation)

III. From Defective to Effective Policies – Key Ingredients of Effective

35

- Just as Julian threw *fiscus judaicus* into the fire in 326 AD, since the tax inhibited most dynamic financial and commercial activities in the economy, so should the BiH policy makers eliminate everything preventing entrepreneurship

III. From Defective to Effective Policies – Key Ingredients of Effective

36

- BiH's small size, inadequate infrastructure and lack of competitive production capacities could be overreached through exporting to the South Europe and Mediterranean countries
- Pankaj Ghemawat of IESE Business School argues that two otherwise identical countries will engage in
 - ▣ 42% more trade if they share a common language than if they do not
 - ▣ 47% more if both belong to a trading block
 - ▣ 114% more if they have a common currency and
 - ▣ 188% more if they have a common colonial past.

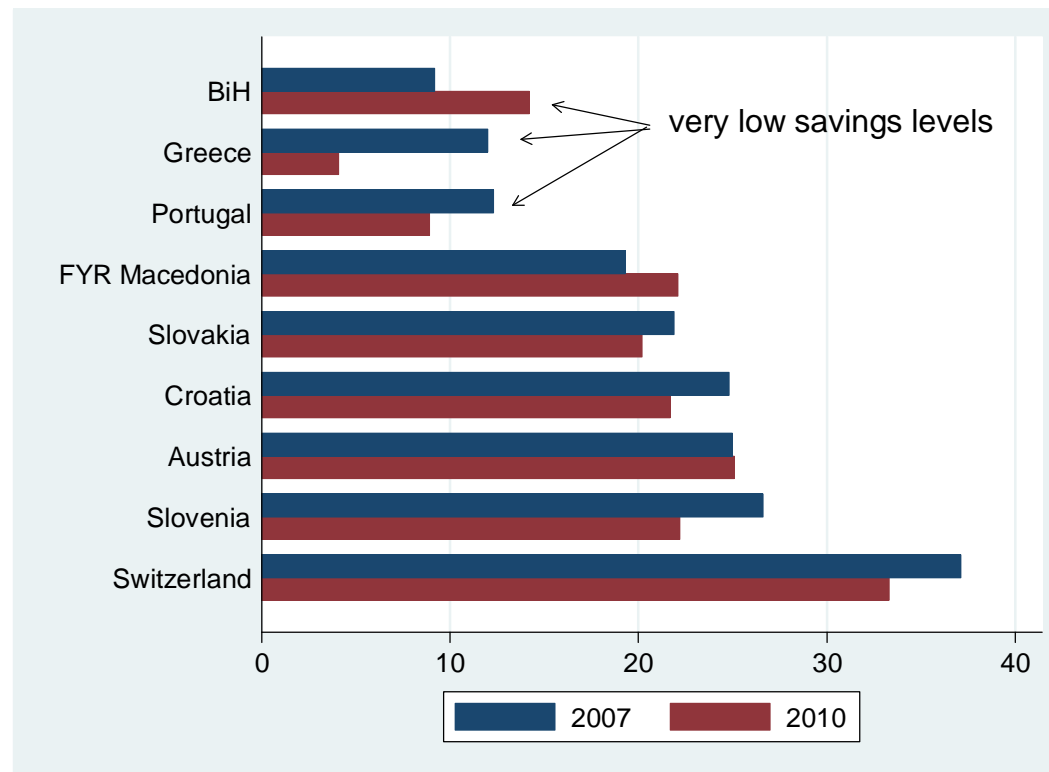
(the Economist, 2011)

III. From Defective to Effective Policies – Key Ingredients of Effective

37

**National
Savings
Rates,
Comparator**

**Countries,
2007 and
2010 (% of
GDP)**



III. From Defective to Effective Policies – Key Ingredients of Effective

38

- Attracting money to the financial system is crucial to ensuring high investment rates
- It is necessary to
 - ▣ establish non-bank deposit-taking institutions,
 - ▣ enable the formation of new types of financial institutions and
 - ▣ introduce new types of financial instruments.
- Foreign banks control 94 % of BiH's banking sector i.e. of the financial sector (as banking sector makes approximately 84 % of the financial system)

III. From Defective to Effective Policies – Key Ingredients of Effective

39

- Taxes and social contributions are currently a major impediment to the rise in employment
- It is necessary to decrease them to enable the entrepreneurial sector to start breathing
- At the same time it could be necessary to increase the general VAT rate and introduce a lower rate for food and drugs to protect vulnerable groups, primarily pensioners