BOSNIA AND HERZEGOVINA AS A SMALL, OPEN TRANSITION-ECONOMY IN THE MIDST OF GLOBALIZATION ON THE CROSSROAD

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Abstract

The globalization process at work in the world economy, and its “functional” intercontinental integration, makes the firm (transnational corporation) the most decisive factor in the world economy. This paper considers whether for a small transition-economy speedy globalization may be more harmful than beneficial. The case in point is the economy of Bosnia and Herzegovina.

INTRODUCTION

Within the context of changes which today increasingly reflect world interdependence, especially economic interdependence, the aim of this paper is to establish the causality and interdependence between economic development strategies and the position of small open medium and less developed economies regardless of whether the focus of concern is the » inward oriented development process» or «outward oriented development strategy.

Our basic thesis is that the small open economy, which is also a debtor country as it is f Bosnia and Herzegovina, cannot be completely independent in selecting strategy of economic growth.

Functional integration of the world economy has been taking place more and more intensively since seventies. “Transnationalization” of the world economy has been making independent national economic strategies less efficient. Functional integration demands a world economic policy and world government. It demands also a high level of integration and coordination of national economic policies which, thus, cease to be: a) exclusively national, and b) become increasingly interdependent.

The development of an integrated world economy makes questionable: a) strategies of economic growth and theories relating to comparative advantages; b) the adequacy and applicability of theories of economic policy, that is, the adequacy of contemporary economic thought and theory; e) the adequacy and aims of theories of international trade, and the theory of foreign trade impulse.

Transition countries since 1990's have been facing two international phenomenon to tackle with: globalization of the world economy and transition process to be delivered efficiently within that same globalization process. We pose the following question: is it possible for small open less developed transition economy to fight those phenomena, and preserve own national economic and social interests? The case of B&H transition, and lessons (not) learned so far might be instructive for further deliberation on that subject matter.
BASIC PROPOSITIONS OF THE PAPER ON GLOBALIZATION AND ECONOMIC THEORY

THOUGHTS ON GLOBALIZATION

The world economy is at a crossroads. Indeed it has already taken giant steps into the third technological revolution. International economic relations have become almost completely globalized turning the world economy into a "great village". In this "great world village" we no longer witness competition between two ideological systems or blocks. Comparative economic systems are unlikely in the future to be part of the university syllabus. In transition they will be replaced by the study of comparative economic policies - but only in transition on the threshold of the formation of three economic blocks: the USA - Canadian – Latin American block; the European block; the Japanese - Southeast Asian block. This will not mean the disappearance of competition on the world market, indeed it may become fiercer, but it will be the competition of economic blocks within an expressive imperfect market.

A transnational world economy will sooner or later bring about complete globalization when the need for comparative economic policies will disappear and the need arise for a single economic policy. The world market for labor, goods, capital and know-how is already today so fully integrated that it challenges the validity of many theories. It is becoming increasingly clear that F. Graham was right when as long ago as 1948 he said: "The pre-eminent, the fatal defect of the classical theory lies in the failure of its authors to recognize the crucial importance, or for the most part even the existence, of commodities produced in common either in each of two international trading countries or in some two or more of many such trading countries... It is impossible to exaggerate the significance of the common commodity..."1

In support of this we may quote Adam Smith who in his Wealth of Nations wrote: "A merchant, it has been said very properly, is not necessarily the citizen of any country. It is in great measure indifferent to him in what places he carries on his trade; and a very trifling disgust will make him move his capital, and together with it the industry which it supports, from one country to another"2.

According to Kindelberger, Violet Barbour strengthened Adam Smith's

3. Ibid.
position by asserting: "The international capitalist from his latest to his earliest appearance has generally been, where business was concerned, a Man without a Country and the seventeenth century Amsterdammer though by no means a man without a city, was strikingly uninhibited by abstract considerations of patriotism or by theories of economic nationalism."^3

If Kindelberger is right, and we believe he is, that under conditions of “transnationalization” or ” transglobalization” of economic life the transnational firms refuse to submit to the typically second-best (and frequently non-economic) policies of the countries in which they are located, then economic theories be they: Keynesian or Monetarist, Post-Keynesian or the School of Supply Side economics are no longer valid. Theories of economic policy are nationally colored and have national aims. They favor strategies of economic growth and development predominantly in the national interest thus coming into conflict today with the internationalization of capital which works according to different criteria.

Economic theory and practice are focused on the individual nation and the international economy is focused on the individual firm.

As a result, existing international trade theories are no longer completely but only to a limited extent valid. According to B. Ohlin the basic goal in international trade “is to provide instruments and knowledge that can make it easier to construct economic and social policies - internal and external - that will bring a nation or a group of nations closer to accepted goals.”^4

Accordingly, if it is firms and not nations that are the basis of the contemporary international economy, then focus of Theory of comparative advantage must shift from the national to the functional. Firms, that is, multinational companies, have their offer curve and their curve of comparative advantage. The standard theoretical model of international trade 2 x 2 x 2 is increasingly irrelevant for contemporary economics and for the international competitiveness of individual nations. The offer curve of an individual firm may not always coincide with the offer curve of a national economy.

**THOUGHTS ON THE RELEVANCE OF ECONOMIC POLICIES**

In the development of economic thought to date, there has been a fascinating interdependence between economic events, economic ideas and economic policies. One of the most obvious examples of the interaction since the

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4.Ohlin,B.( 1979),Some Insufficiencies in the Theories of International Economic Relations, IFS .Princeton UN .pp A
Second World War is the change of focus from unemployment, a Keynesian idea and economic policy, to inflation, that is, Monetarism, as an idea and policy. An analogous change occurred in the acceptance of Philip's curve and Okun's law from the Second World War until 1970’s, and their replacement by the vertical Phelps's curve together with the notion of rational expectations.

With the formation of the IMF and GATT, as institutions concerned with international finance and trade based on principles of free trade and comparative advantages, the stage was set for the greatest prosperity that the world economy has ever experienced to date.

In the years immediately after 1945 the supply curve of national economies showed a positive Keynesian slope. During the fifties and sixties "it came to be accepted wisdom that businessmen were always in a position to set prices at a margin over costs that would provide them with a rate of return at which they would be happy to invest more. The OEEC in a 1961 report stated: The share of labor, apart from cyclical shift, remained remarkably constant in almost all countries around 1950. With high employment, business has been able to maintain a profit margin". 5

During the fifties it became generally accepted that the Philip's curve, that is a Keynesian type of economic policy was completely compatible for national economies in their attempts to control deflation and also inflation.

It is certainly true that in comparison with XIX century economic liberalism internal economic equilibrium came to have priority over equilibrium of the balance of payments. Foreign trade and currency measures were targeted to achieve affirmative and useful effects from the foreign trade multiplier and accelerator in the interests of economic growth of the national economy. Keynesian economy policy at home was supplemented by choice of a growth strategy based on the theory of the comparative advantages of the 2x 2 x 2 model.

At the beginning, while the argument for protecting new industries was valid, a policy of import-substitution was the dominant strategy for the economic growth of small open economies as also for large countries. In time the small open economy, which had become a price taker, became more and more geared to an export growth strategy, and had become not only the price taker but also the rule taker. Concentration on the production of an increasing number of "tradables" ever increasingly made the small and medium countries dependent countries. Unless, of course, the countries concerned had opted for the Prebish or Myrdal models of isolation from the world economy with all the negative consequences of such a decision for growth (as was the case of Latin America). In spite of this, the production of firms of the small open economy more or less

completely became part of the offer curve of national economies. The process of “transnationalization“- globalization of the world economy had begun.

In 1958 the currencies of the EEC countries became convertible with the result that their markets and their economic policies became interdependent. Europe now very quickly became competitor of the USA. From 1960-1965 wages in Europe and Japan, the main US competitors, rose from between 2-6 per cent annually, white wages in the US fell during the same period 0.7 per cent. The new wage relationships caused a balance of payments surplus in America which reached 6.6 billion dollars in 1964.6

However, acceptance of the concept of full employment based on the slogan “We're all Keynesians today” required in the USA, and not only there, an expansive monetary policy. In the meantime the expenses of financing the Vietnam War increased, with the result that inflation soon became enemy number one for the American economy. In 1971, for the first time since 1888, America had a balance of trade deficit of 2 billion dollars.

The offer curve of the American economy had become a vertical. The world was at that point looking for a new economic policy. When the curve had become a vertical Keynesianism became counterproductive. Nevertheless, economists went on trying to cure stagflation by counterproductive Keynesian methods supported by a policy of fluctuating currency rates of exchange. By passing to fluctuating exchange rates in an attempt to save Keynesianism, the effect of the Phillip's curve deepened stagflation the world over. This showed that although the world might have become interdependent, isolationism was still very much alive. In other words priority was still given to the national interests. The supranational concepts, due to the process of transnationalization of the world economy, were to gain impetus as soon as the time was ripe. The prosperity of the world economy was certain at some point or another to come to an end.

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According to C. Dumas "the long expansion of the 1950s and the 1960s consisted to a considerable degree of more of the same... This relates directly to the inadequacy of present capacity, not only in the implied need to invest in new industries' and write down the capacity in shrinking traditional industries but also in the need to transform by new investments the productive processes of industries with still salable products but outmoded method... Both the incentive to
apply advanced labor-saving technology, and the actual development of such techniques have to be linked to the large increase in wage cost over the past thirty years”.

The world economy had to enter a phase of structural transformation. This was well presented by Schuker in his «American Reparations to Germany» in which he gave a reminder that the world economy had for 300 and more years experienced what he called- long waves. Long waves went together with the process of the concentration and centralization of capital, that, is with the growth of firms and their efficaciousness.

The natural result of this was that after 1980 Keynes was replaced by Monetarism. Monetarism had a slogan: "Governments do not solve the problem they are the problem". The Welfare State had played out its role of guardian of economic progress and prosperity. The new economic policy operated under the slogan: "The best industrial strategy is: tough penalties for business failure, high rewards for success and low interest rates without inflation".

Monetarism brought bankruptcy to many firms in all the countries that resorted to it. Since then on Monetarism has become «main stream» economic policy. Even so, Monetarism is still a national economic policy, it still has a national identity. Operating within national economic development goals, Monetarism achieved structural transformation of the economy in all countries where it took hold, and in the process led to the centralization of capital and the creation of gigantic companies. In the world economy it created conditions for intercontinental economic integration of companies. According to Denis Lumb competition in traded goods rose significantly, since such goods are exposed to global competition. «Between 1979-1989 in America 1.4 million jobs were lost in industry, yet industrial production increased by about 30 per cent. Integration between the transnational corporations of the USA and Europe attained 200 billion dollars annually. In 1989 alone in Europe the business of European transnational companies was integrated by more than 50 billion dollars. Between 1984-1988 direct European and Japanese investment in the USA increased by 108 billion dollars and 37 billion dollars respectively».9

Graham's contention concerning the production of «goods in common» is today vindicated. Seems that the production of «goods in common» demands the

9.Lumb,D.(1990),What Does it Mean to Join the World Economy, OECD
formation of a world economic policy and world government by replacing national economic policies by a world economic policy.

Any theory of international trade formed according to the principles of the theory of comparative advantages $2 \times 2 \times 2$, regardless of whether the production curve is the result of differences in technology (Ricardo) or in proportional availability of factors of production (Heckscher-Ohlin), it will with increasing difficulty explain the Leontiev paradox. In an imperfect market Vernon's theory of foreign trade impulse is a far better explanation of the true role of firms on the market and in the international division of labor. Even though Vernon's theory of foreign trade impulse still places the firm and its products in the aggregate offer curve of a national economy. Multinational companies are concerned only by where to locate their production. Decisions concerned with financial sources are of secondary character, since the international financial markets are largely integrated and show a tendency towards complete integration. In this context recent work of: Krugman, Lancaster, Porter and others in their research to evolve an adequate theory of foreign trade stress characteristics not of countries but of products or industries. The comparative advantage characteristics that underlie trade patterns are viewed as dynamic and often endogenous rather than static and exogenous. As a result, the welfare implications of trade considered in this framework, and that of intra-industry trade in particular, are fraught with ambiguity and fragility unknown to the classical and neoclassical paradigms.

BOSNIA AND HERZEGOVINA TRANSITION: LESSONS (NOT) LEARNED

**Factors Shaping B&H Economic Recovery**

When considering both: the strategy for economic development of B&H since 1995, and the effects of the strategy achieved so far, one has to take into consideration relevant external and internal factors of both: economic and political nature.

Two external factors have had decisive influence on B&H economy.

The first factor is the process of globalization of the world economy, and the “Washington consensus” providing the basis for treating transition countries and transforming it into “small open economies.”

The second factor is the Dayton Peace Accord signed in 1995. Signed on December 14, 1995 in Paris, the Accord ended military hostilities on the territory of Bosnia and Herzegovina and fixed its external borders. NATO forces were to implement the Peace Agreement for a limited period, followed by the international bodies (OSCE, OHR and UN). The Accord outlines the constitution of the state, which provides for full freedom of movement of persons, goods, services and capital.
Two internal entities were established -- the Federation of B&H with 51 per cent and Republic Srpska (RS) with 49 per cent of the territory. The Federation has 10 cantons.

While the Accord placed banking and custom regulation at the central state level, fiscal policy was transferred to the entities and cantons and no instruments were provided for shaping country-wide macro-economic policy. This ties the hands of the central state concerning the formulation of unique strategy for economic development, including industrial policy.

In practice, Bosnia and Herzegovina lacks the power to formulate and conduct: monetary policy, fiscal policy, foreign exchange rate policy, and policies regarding privatization, incomes, and social welfare. Moreover, industrial policy-making is, in effect, impossible under the rules of the game of "Washington consensus" imposed on the country by the World Bank and IMF.

The policy package coming from and implemented by the IMF and the World Bank has been seen, and still is, as the only way of achieving macroeconomic stabilization, quick privatization, and efficient inclusion of B&H into world economy increasing her competitiveness.

Yet the evidence seems to the contrary. The “Frankenstein” economy a (nick name for B&H) simply does not perform as has been expected, and globalization seems to have contributed more to the social misery than to socio-economic progress of B&H.

High unemployment rate (45%) in the mid of 2005 speaks enough, despite all of the efforts undertaken by international community in supporting B&H economic growth and development.

The Neoclassical concept for development of the economy of B&H eliminated: the state intervention in the economy, the infant industry argument, foreign trade policy. In the same time, convertibility of currency and liberal foreign trade sector with average tariff rate of barely 6% (with deconstructed domestic production) provokes a rational entrepreneur to import products from third countries, thus increasing balance of payments deficit of B&H and its entities respectively.

The question is: for how long it can be tolerated without financial support of the international community and remittances sent by huge B&H Diaspora?

Answer to that question lead us to the following proposition: B&H needs to have its economic borders and its own economic policy, in order to create necessary preconditions for both:

1. Dynamic economic development that could help the country to catch up with “real economic convergence “with developed countries of the EU and,

2. For increase of her competitiveness as a precondition for successful integration into globalized world economy.
Dynamic economic development can hardly be achieved by the current development concept, entailing full openness and liberalization of B&H economy and having in mind real capacities of B&H economic subjects.

“WASHINGTON CONSENSUS “ IN B&H ECONOMY

In the chapter “Towards Establishing a Market Economy” in the document “B&H Towards Economic Recovery” prepared by the World Bank, European Commission and EBRD, a basic strategy for economic recovery and the role of government was set forth.

The package contains all the elements of the theory and the practice adopted in the East European countries. The exception to this, a very important one which was unnecessary in other East European countries concerns the physical reconstruction of B&H. Issue of physical reconstruction of B&H relates to the filed of infrastructure, and do not have anything in common with industrial restructuring. Industry should be started from the remnants and based on new industrial facilities and industrial type of organization.

The World Bank document states:

a) “The basic strategy for economic recovery should rest upon the private sector as a main starting device of the growth of economy and employment. Besides, the majority of medium-term economy growth will have to come from the extension (the development) of the service sector and the development of light industry on the basis of private enterprises. The property now held by the state firms which do not operate can be used by private sector. What is needed here is to identify the useful parts of the state firms and to sell them through simple and quick mechanism of privatization” 10) Therefore, a quick privatization, the dismantling of state firms, the development of small and medium size enterprises along with light industries and the service sector should have been levers for the growth of the B&H economy in the coming period. The World Bank continues:

b) “The role of the state in the economic and development strategy, which is governed by the private sector, is not unimportant, but it is of shifted focus. It should concentrate on the maintenance of healthy macro-economic conditions, on the establishment of a relevant legal and institutional framework, which stimulates uninterrupted functioning of a free market and providing basic public goods and social services, such as defense, public order, education, health service.” 11) The reform of banks and firms is a major project which must be implemented in B&H. Sizeable inherited bad credits, as well as old foreign currency accounts must be excluded from the balance sheets of banks. At the same time, large and inefficient state firms must be closed or restructured. 12)
A special problem has been created by an issues of numerous claims on the Government, including the claims of individuals, unpaid wages and pensions, restitution for post-war nationalization, claims pertaining to frozen foreign exchange deposits.) “A great many individual claims could be dealt with by exchanging them for privatization certificates (vouchers) which, together with cash, could be used for transactions during the privatization process.” 13) Regarding the institutional structure of the state of B&H, the World Bank has argued that the most appropriate approach may be a flexible process for the restructuring and privatizing of firms and banks on a regional basis. In line with this approach, the privatization programs should have been applied regionally (i.e. on the level of the Republica Srpska and on the level of a cantonal group, an individual canton or on local levels, within the Federation) 14)

**MACRO-ECONOMY OF THE ECONOMIC RECOVERY OF B&H**

The World Bank was thinking that the stimulus for economic growth will come from the reconstruction process, and not from export, as has been the case in East Europe. The macro-economic policy of the 2-3 year transitional period must be different, therefore, from the standard one. World Bank experts were of the opinion that the main macro-economic challenge of the transitional period (reconstruction period) is management of the great influx of donations and favorable credits, the removal of bottleneck during the reconstruction period, and control of inflationary pressures. Maintaining macro-economic stability, however, is considered a key issue for successful recovery and economic growth.

Under the World Bank and the IMF program, Central Bank of B&H was supposed to have foreign governor for the next 6 years. Monetary policy should have been restrictive and carried out by a currency board regime.

B&H was supposed to be integrated into international markets as a “price taker” with a fixed exchange rate of national currency pegged to the DM. In
practice, it meant that the prices in B&H cannot deviate from German (world) price level. The country is, thereby, losing the potential advantages of the effects of the so-called “Philips curve”. Monetary policy, one between the strongest instruments of macro-economic policy, has virtually being taken away out of hands of the B&H authorities.

THE EFFECTS OF «TRANSITION PRESCRIPTIONS» ON BUSINESS SECTOR OF B&H NINE YEARS LATER

In the project «SURVEY AND ANALYSIS OF THE DEBT STRUCTURE OF A SAMPLE OF BOSNIAN ENTERPRISES» performed in the second half of 2004, by the author of this paper, and on behalf of the World Bank and DFID, we have got the results and picture of B&H business sector in conformity with «the prescriptions». Author of this paper considers that better result could not have been obtained within the «prescribed prescription».

Within the research questionnaires were sent to 377 companies B&H wide. 187 companies have responded to questioners either in direct contact with researchers (assistant to the professor of the Economic faculty Sarajevo and Banja Luka – about 50%), or in written since they have been approached both: by researchers and “Prism research agency”.

The research has paid special attention to the following criteria:

a) Proportion between state and private firms in sample was 30% of state owned firms and 70% private firms,

b) Export revenue / total revenue ratio of the firms is to be over 10%,

c) Debt has been rescheduled during 2002 in about 30% of firms, particularly in Republic Srpska).

d) Due attention was paid to regional distribution of questioned firms. From within Federation of B&H there were questioned 163 firms: 114 private and 59 state owned.

From within Republic Srpska we questioned 214 firms: 155 private and 59 state owned firms.

Since we have got answered questionnaires from 187 firms, or 50%, we consider that the sample in question and quality of responses do satisfy statistical criteria of the project in question.

In the process of analysis of the data gathered by the survey, we have taken an approach of C. Pitelis, (C. Pitelis - On the determinants of the Wealth of Nations and International Convergence: conceptual issues and policies for transition. SEE Journal of Economics and Development, July 2004). In the approach particular weight is given to “visible hand” of companies, and we
would add to that visible hand of the state, and invisible hand, that is of the
market itself.

“Productivity wheels”, according to Pitelis, are composed from:
- Company itself; its structure, organization and performance,
- Technology present in the companies,
- Human capital appointed by visible hand
- Economic of scale and scope.

Companies operate under determined mezzo – environment- given market
structure and social capital. Visible hand of the state is sketched as
macroeconomic management of the given economy. And finally, there is
significant role for the institutional structure of an economy. In the case of B&H
one additional subject has been having decisive impact - the international
community with its influence on both: politics and economics.

VISIBLE HAND (FIRMS): PERFORMANCE AND ORGANIZATION.

Main attribute of firms in B&H is their size. Majority of B&H firms
belong to the groups of small and medium size enterprises. Having from 50 - 100,
and from 100 -500 employees firms operate in their vicinity, and some of them
penetrate market of B&H. They have a few affiliates Bosnia wide.

Minority of firms have undergone restructuring so far. Firms did
restructure to some extent their internal organization, they reduced number of
overstuffed workers, they to some extent introduced new products in production
program.

Majority of both: state owned and private firms still do have over-surplus
of workers employed (state firms more than private), and despite of that they do
not feel their export competitiveness endangered by overstuffed personal. This is
due to the fact that firms either:
   a) do not pay workers regularly,
   b) or they pay very modest salaries to the workers.

In fact, arrears to the workers are great both in state and private
companies. Likewise great arrears are registered to the: suppliers, to public
companies, to the entities (Federation and Republic of Spike,, and to the state .
Firms are indebted each to other.

Bank appear to be one of the supplier of capital to the firms, but not as
mush as could be expected. That is due to high interest rate, lack of collateral,
lack of good project, and availability of alterative sources of capital for firms.
“Other sources”, not properly defined, are providers of a part of the necessary
funds to the firms, (parents, friends, space rental) etc.

Though firms have been improving their technological resources, they are
still lacking appropriate technology to be internationally competitive.
Firms, both state and private, are not ready to provide «secret» data relating to the sources of fund as well as to their indebtedness, particularly towards workers and state.

Firms privatized by voucher are limited to some extent in their liberty to cut work force down by the provision of privatization law, and partly by moral sentiment.

The most serious threat to the promising firms is widespread developed gray economy. Gray economy represents more serious threat for firms than competition both; from abroad and domestic market.

Firms are disappointed with absence of any kind of supportive state intervention, and particularly with glaring lack of export subsidies and export credits.

TECHNOLOGY

In the sample out of 187 firms new technology has been adopted in 43, 3% of companies very unequally distributed both: within ownership type and within entities. State firms introduced new technology in 36, 5% Federation of B&H (F) and 25% of firms (RS). Private firms within (F) were more technology prone (63, 9%) than (RS) private firms 28, 9%-Mixed firms did well: in (F) 53, 8% and in (RS) 19,4% applying new technology.

Certificate of quality for properly doing business is reached by 35, 3% of all firms, in the same time very unequally distributed between entities and type of ownership. The most active in that respect are private and mixed firms in FB&H (47, 2% and 53, 8%) respectively.

Technology is still obsolete and represent an obstacle with respect to of competitiveness of B&H firms in 27, 8% of the firms in the sample.

To be globally more competitive B&H firms must upgrade its technology. They consider that they need up to 2 years to reach international competitiveness (with similar timing between all types of property) in 34,8% cases, and they need from 3-8 years in 33,2% of firms, again similarly distributed between all three parties: state, private and mixed, with state lagging to some extent behind private and mixed firms.

Only 11, 2% of firms need no new investment to be globally competitive. 26, 3% of firms believe that investment in range of 1, 5 million KM would make them competitive - state firms 17,6% (F) and 33% (RS), private firms 22,4% (F) and even 48,6% (RS).
ECONOMICS OF SCALE AND SCOPE

Majority of firms in the sample belong to small and medium size enterprises (SME). Within range between 100-500 employees there are about 37% of state owned companies and 45.8% and 36.8% respectively of private firms in (F) and (RS). There are similar number of mixed ownership firms in both entities.

With 500-1000 employees there are 4, 3% firms. With more than 1000 employees there are 12.8% of firms mostly state owned firms - 47.4% of state companies, and mixed ownership firms – 38.5% in (F) and 13.4% in (RS).

There are 19, 8% of firms employing between 50-100 workers, and 17.6% of firms having employed from 10-50 employees.

With a yearly turnover above KM 50 million there are 10, 2% of companies in the sample.

Majority of companies are organized in small number of organizational units having between 0-2 units, there are 37, 4% of such size firms. 31 firms have between 3-5 units, or 6% of firms, and 25, 7% of firms have more than 6 units out of 187 firms in the sample.

Majority of firms is located in one entities of B&H, having almost none units abroad. 7% of questioned firms have only one unit abroad, and 4.8% have two units abroad.

SME in B&H, due to their size still do not experience great pressure to expand abroad and export. They are relatively taken small in comparison with giant foreign firms, and therefore not able to exploit the effect of economic of scale.

HUMAN CAPITAL

Personal contacts with managers of firms suggest that human capital represents one of the most serious deficiencies of B&H firms, and particularly in terms of high quality management. Survey does suggest similar conclusion in that respect. Having a glance at the efficiency of managers to manage ‘cash flow’ of firms, one could discover abilities of some companies and managers to manage of cash flow successfully, and the others who have difficult time in performing that function. Both operate under same macro- economic climate. As far as ability to manage new markets and to increase sale activities, we got similar answers. Personal contacts do suggest that state managers are much less able than mangers of private companies, which we consider as normal consequence of two factors at work:

a) deep involvement of political parties in day to day business of state firms, and

http://services.bepress.com/itfa/15th/art37
b) expectations of privatization, deterring managers from serious work in state companies, and in fact supporting “asset striping”. It is not by chance that majority of firms either public or private are indebted to the state/public companies. Majority of managers are not familiar with VAT to be introduced soon, and that is a good point to show quality and knowledge of domestic managers.

The same managers consider lack of skill of the workers employed in their companies as one of serious obstacle on the way of increasing international capacities of firms. In the same time they consider insufficient qualification of the workers as a reason why workers are not employed enough in firms, and why there are surplus of work force in firms. Additionally, managers are not allowed to dismiss workers due privatization laws and due to some moral sentiment.

Taken altogether, work force in B&H companies is young. In fact, private firms have younger employed workers than state firms. Average workers age is situated within range from 30-46 years. There are only 18.7% employed workers older than 46 years. Quality of workers in terms of diplomas and experience is in all firms in B&H.

**MEZZO-LEVEL OF THE PRODUCTIVITY WHEELS-INDUSTRY CONDUCT - STRUCTURE AND REGIONAL-LOCATION MILIEU**

Mezzo –environment part of “productivity wheels” in the B&H environment is composed of a market structure consisting mainly out of SME, and small companies. Big and internationally competitive firms are almost non-exist. Social capital is particularly weak point of the productivity wheels mechanism. Absence of “trust” between different ethnic group, different perspective of the B&H future, and presence of mafia type activities with enormously present corruption, significantly degrades ability of firms to work hard and efficient. “Gray economy” is particularly unwelcome by regular business parties. Even 44.9% of formal firms in the sample see “gray economy” as the most frightening phenomena for theirs existence. Domestic competition comes next in 43.3% of firms, and then comes danger for market share emanating out of the competition of transnational companies and imports of goods.

**MACROECONOMIC ENVIRONMENT-POLICY MIX AND EFFECTIVE DEMAND**

B&H economy has entered transition process under the conditions of Washington consensus. Philosophy of free market, unconstrained import liberalization and inward FDI were expected to be driving forces of domestic
economic growth and prosperity. That is why, firms in the sample complain about lack of any kind of state support, except to some extent in sense of creating so called «market friendly» environment».

Lack of export subsidies and export credits is absolutely evident. Lack of gradual import liberalization contributed to distraction of many firms. Lack of laws and regulations adequate to contain gray economy,, spoils formal economy.

Restrictive macroeconomic policy, based on the rules of the game of currency board,, supports lack of domestic effective demand, and press firms to export as much as they can.

Infant industry argument is totally neglected.

There is complete lack of any kind of industrial policy. Firms are left on theirs own Under such a circumstance we might even congratulate domestic firms and managers that they survive and even manage to work and export at least primary products. Debt forgiveness by the state to the firms has been provided only exceptionally (2, 1%), and forgiveness of “contributions” is registered in 1,1% of cases. State’s subsidies have been provided to firms in 8, 6% cases, and if they were given they were given to state/public companies.

30, 5 % of firms have stated that bank’s credits are very expensive. They admit that lack of collateral is a reason for not applying for bank credits , and only in 5,35 of firms, consider lack of good programs as a cause for not asking banks credits.

Therefore, one must not be taken by surprise than internal indebtedness is unacceptably high. Firms are indebted to each other, to public companies, to suppliers, to the state, to the workers.

**INSTITUTIONAL SETTING-GOVERNANCE MIX**

Institutional context is particularly sensitive aspect of the whole story pertinent for a successful revitalization and restructuring of B&H companies. Apart from absence of the state in supporting, for instance, a timely import liberalization, or infant industry argument, appropriate foreign exchange rate management etc., Bosnian institutional concept is relevant and responsible for unfriendly business climate present in B&H, and even more for different and numerous failure in creating policy solution.

Perfect case in point is partition of country (B&H) into two entities, and entities founded privatization. Divorce between privatization and development has many things to do both: with the partition of country and methods of privatization founded and invented on such a partition.

Lack of unique economic space B&H wide, hand in hand with lack of instruments of economic policy harmonized for B&H as a whole , is story for itself.

http://services.bepress.com/itfa/15th/art37
REMARKS ON PRIVATIZATION AND RESTRUCTURING

Privatization in B&H has been more a failure than a success. Voucher privatization deprived companies from both: fresh capital and new management. What is more confusing then than is that, according to data gathered by filed research, private companies are not as much superior in terms of efficiency and restructuring than state owned companies. They have surplus workers they keep in firms; but they do not complain on wages as a serious determinant of theirs competitiveness. Is that because wages are low, or because workers are not paid?

Private firms do not want to report on indebtedness to different sources. They keep sources of capital and finance as much secret as they can, using often term «other sources» as one of the most serious source for capital and liquidity.

One might conclude that the economy of B&H is still an unsustainable economy. Failed privatization and to some extent misdirected donor assistance could be blamed for such a result, together with domestic political forces. Manufacturing industry contributes to total value added of B&H economy at the end of 2003 by only 12, 97%. Total basic industries (agriculture, hunting, forestry, fishing, electricity, gas and water supply, manufacturing industry) participate in total gross value added by 39, 68%.

Despite all of this, the Survey shows that there are promising firms in B&H economy. They are discovering new markets, they are introducing new technologies, they apply certificates of quality, they try to adjust to the standards of doing business prevailing in the EU.

ECONOMIC DEVELOPMENT OF B&H: UNRESOLVED ISSUES

Accepting aforementioned findings relating to: the state of the quality of the business sector in B&H, presence of gray economy, and unacceptable high unemployment rate, we might to continue to consider the future of B&H, considering some relevant questions, such as:

a) Can B&H have its own efficient strategy of economic development if its central bank functions as currency board?

b) Can B&H, from the point of view of economic growth, apply usefully policy of “hard budget “constraints without adequate level of inflow of fresh capital for investment purpose (let us recall the case of the USA in the 1980’s)

c) How can B&H have a convertible currency having: export/ import ratio of 30% and BOP deficit as high as 40% of GDP,( let us recall the case of British pound in 1947 )

d) Is it possible for B&H, or a small less developed country in general, to be so called “small open economy “, fully liberalizing foreign trade sector, and
having not reached world level of international competitiveness (let us recall the case of Japan or South Korea)

e) What are long run social and economic costs of the policy of a convertible currency declared convertible by decree like, (the case of British pound in 1947) Is it possible and beneficial for a small country to build up and develop its own strategy for economic development under the conditions of the globalized economy. If answer is not, what are the consequences for the country like?

f) Is it possible for a small country to create "offer curve" representing her own comparative (but not competitive) advantage in the world economy dominated by multinational companies?

g) Do we need to consider general restructuring of economic theory and policy, and economic vision of the future world if our aim is a post-communist country restructured and properly integrated into globalized economic system?

h) Or, we are going to face the misery, social unrests and tragedy in post-communist countries. (let us recall the case of Solzhenicin’s book "Russia in Chasm"

We consider that the future of B&H depends to a large extent upon finding the right answers to those questions.

CONCLUSION

B&H as small and less developed country in the process of transition from a socialist self-management economic system into modern market economy is in “aid-driven “stage of pre-development phases.

B&H should be advanced to “factor-driven” stage of development by a deliberate action of economics institution. The country should hardly be left to the forces of free market alone, and she can hardly join globalized world economy not suffering great economic and social losses.

The state, with an active industrial policy, Development funds, Development banks, and active trade policy should direct development and not simply leave it to the rather elementary principles of operation of the open market economy stemming from the work of Ricardo and Heckscer-Ohlin, which ignores an important distinction between dynamic economic approach to development and static characteristics of the Theory.

Transnationalized world economy presumably needs one government. Will it be organized as a sort of “central world government” or as a sort of “Polimorific decentralized world government “(Murakamy 1996) having a world development bank and being based on principle of “Developmentalism” (Murakamy 1996) is a question to be answered by responsible subject of the world economy.
In the meantime, both transition and less developed countries badly need at least some changes of the IMF conditionality in order not to safer as much as they did at least last fifteen years, since the start of transition process. Except in case should “Darwinism” does not sets “rules of the games” in global economy from now on.

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