Analysis of the Republic of Srpska Budget and Economic Policy for 2013

Unfavorable macroeconomic trends over the entire 2012, the uncertainty looming over 2013 and increased allocations for the payment of external debt represent key restraints affecting the amount and structure of the 2013 budget. Still, the budget and Economic policy's measures offer potentially two improvements in the public finance of RS, which include stopping the public sector's growth trend and fixing the structure of public expenditure. Whether these potential improvements will be realized depends on the way of implementation of suggested policies and the possibility of reaching consensus with social partners. However, the quality of the Economic Policy, on mid-term basis, depends on to what extent its implementation will contribute to the economic growth and increase of employment.

Forced budget cuts are unavoidable

A surplus of 100 million BAM is planned in the budget of the Republic of Srpska for 2013. Debt settlement amount is greater than the amount of new debt, thus continuing the consolidation of the budget. However, funds withdrawn in 2009 and 2010 in order to mitigate the consequences of global crisis are now due for repayment in a situation when not only economy is far from nearing growth rates from the period before the crisis, but when even slightest economic growth cannot be expected.

Public sector analysis

In the Economic Monitor No. 7, we wrote: "RS does not have a choice and it will, sooner or later, have to decrease the number of employees in the Government sector. Currently, around 28.5% of employees in RS works in the Government and governmental institutions, which is among the highest percentages in Europe. This information does not include employees in public companies, where the problem of over-employment is also notable. RS holds the record in the size of difference between wages of public and private sectors."

By increasing the amount needed for settling public debt, the trend of decreasing available funds/fiscal space has been continued. Out of total budgetary funds amounting to 1.945 million BAM, debt settlement amount is 463.8 million BAM. Even though total budget has increased by 7% compared to 2012, i.e. for 135 million BAM, the amount of funds available for budget expenditure has decreased by 11 million BAM. Beside the growth of share of allocations for debt settlement from 17.5% in 2012 to more than 23% in 2013, share of total expenditure has decreased by 3% compared to the previous year's budget. Total income has decreased by around 21 million BAM, primarily due to the expected decrease of revenue from issuing natural resources exploitation rights and expected decrease of income tax. The increase of revenues from indirect taxes by 2% is planned, along with the use of 50 million BAM of receipts of nonfinancial assets ("Electrodistribution B&H").

Faced with narrowed fiscal space, the Government of RS proposed justified measures of decreasing wages in public sector. In previous editions of the Economic Monitor we have warned both about wages in public sector from the aspect of comparable position in private sector and about high share of the number of employees in public sector in comparison with the total number of employees (see the Economic Monitor No. 7). The proposed decrease of wages of 10% to 35% and the dissolution of certain agencies should lead to the decrease of allocations for gross wages in an amount higher than 56.5 million BAM, which would lead to the decrease of relative share of allocations for wages in relation to total budgetary funds from 39% to 33%. However, wages decrease should not be viewed as a one-time measure of saving, but as an opportunity to systematically decrease the advantage that a job in public sector has over a comparable job in private sector.

Two occurrences can be especially dangerous while decreasing wages: a kind of "uravnilovka" – linearly decrease of wages according to coefficients, which carries the risk of losing best staff in public sector, and bringing wages back to the previous amount after December 31st, 2013, in case of increased income or pressures by unions. We suggest the Government to revise optimal number of public sector employees and to transparently adapt this number to long term fiscal capacities and needs of the Republic of Srpska. It appears that transparency of this process could be critical for winning public support in a situation of negotiations with social partners.

Economic policy must be directed towards the increase of employment

Economic policy is good to that extent to which it would lead to positive developments at the labor market. Decreasing wages in public sector should be viewed in the context of the biggest problem that the Republic of Srpska has – high unemployment rate, i.e. low employment rate, defined as the ratio of employed persons against labor force. In comparison with the EU and neighboring countries, it is apparent that the rate of labor force employment is very low. Data for 2012 are even worse: employment rate additionally decreased by 0.8% and now it is 35.3%.

Borden on labor

In the "Economic Monitor" No. 6 we wrote: "By increasing income taxes and contributions to the state, negative influence has affected the creation of new jobs, while simultaneously additionally stimulating unreported employment. Therefore, this measure has increased the negative effect of economic crisis on the labor market, which has resulted in the decreased number of employed persons in RS. Speaking in long-term, the fall of employment results in decreased tax basis, which of course leads to lower revenues."

Announcements of improving the business environment are welcome. However, we find that the Government of RS should accept statements by the World Bank on the level of income contribution rates and labor taxation. (see: World Bank – Challenges and Directions for Reform, A Public Expenditure and Institutional review, February 2012). Of course, possible decrease of burdens on labor must be followed by both reforms of non-budgetary funds and by possible increase of revenues from those sources that do not negatively affect trends at the labor market. In this context, we find broader reach led by amendments and additions to the Law on Income Contributions a step in the right direction.

Planned investments insufficient for a greater economic growth?

Planned public investments can be a growth initiator, but can also lead to increased debt. Economic policy for 2013 builds upon the Draft Program of Public Investments for 2013-2015, according to which it is planned to have 742 million BAM for 2013 or more than 8% of GDP, and around 607 million BAM in 2014, respectively. It is stated that sources of funding are to be mostly foreign (81%), mostly credit sources and to a smaller extent grants. Having in mind the expected realistic growth of GDP in 2013 of 0.7%, and 2.5% in 2014, one may ask oneself when can these investments start contributing to economic growth more significantly? Moreover, for 2013 it is planned to decrease unemployment by 0.1% to 25.5%, and to 25.1% in 2014, which clearly suggests that the planned investments will not be able to lead to decreased unemployment even in mid-term period. Regardless of whether being funded from the republic's budget or by state-owned companies, investments must be evaluated on grounds of their contribution to the decrease of unemployment and increase of growth rates. The Government, therefore, must continue to seek policies that will lead to increasing economic growth and decreasing unemployment.

Comparison with the Maastricht criteria can be dangerous

Public debt status should not be compared to the Maastricht criteria, because the amount of public debt below 60% of the gross domestic product does not guaranty safety. Firstly, methodologically, it is wrong to compare countries in transition that have difficult access to the international capital market with developed countries, which have access to capital market or which can get onto debt in their currency. Furthermore, the sustainability of public debt is a function of the realistic growth of gross domestic product and interest rate which can be arranged for the debt. With possible external shocks that could lead to the decrease of GDP and/or higher borrowing price, quick switch is possible from safe zone to zone in which debt settlement becomes difficult. Instead of the Maastricht criteria, for a public debt amounting to 60% of GDP we suggest that the process of advancing towards the EU we identify with the goal of reaching the average employment in the EU of 64.3%.