THE CREDIT RATING EVALUATION AND ITS CONSEQUENCES (CASE OF BOSNIA AND HERZEGOVINA)

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Abstract
The credit rating level is indicator which is created for financial investors (creditors, stockholders etc.) to be used for risk dispersion and investments profitability evaluation in certain countries and enterprises. It is so important for transitional countries whose economic development significantly depends of FDI entrance and creditworthiness on international financial market.
Bosnia and Herzegovina has experienced the credit rating decreasing on two occasions during the 2011. The subject of this paper is the consideration about sovereign credit rating on the example of Bosnia and Herzegovina through the next items: the nature and content of credit rating, methodology of credit rating evaluation, the importance of certain credit rating determinants, credibility of agencies for credit rating evaluation and possibilities for credit rating increment.
Key words: *credit rating, agencies for credit rating evaluation, determinants and methodology of credit rating evaluation, Bosnia and Herzegovina.*

JEL Classification: F 34; G 18; G 28;
Review
Received: Mart 12, 2012 / Accepted: June 28, 2012

1. Credit rating and agencies for its evaluation

Sovereign credit rating represents opinion about the overall business environment (security, political and economic risks...) and especially about credit-worthiness of certain country. On the other words, it is the evaluation of the investing risks in certain country and its indebtedness possibilities on international financial market. It presents very important information that is used by institutional investors looking to invest abroad, creditors in determining credit conditions (interest rates), in evaluation of future revenues repayments, in financial portfolios determining (i.e. investments in shares of stocks, bonds, promissory notes and other securities). The data for credit rating evaluation is collected from different official sources (such as agencies for statistics, central bank reports, different public reports of government departments and economic chambers etc.), but also from unofficial sources (economic institutes, opinions of some business partners, important politicians and famous economists...).[1]

Credit rating agencies are institutions for credit rating evaluation, which they do by using much different qualitative and quantitative information for a certain state or company. There are

[1] In the case of Bosnia and Herzegovina, two agencies (Standard & Poor's and Moody's Investors Service) go to B&H at least once a year to talk and collect data from B&H state and entity officials, representatives of institutions, representatives of international community, businesspersons and academics with the goal to get a comprehensive view about the actual situation of the country. www.cbbih.ba

the „big three“ credit ratings agencies, two American and one British: Standard & Poor's, Moody's and Fitch, which operate worldwide. Sovereign credit ratings of the states in the world are determined by these credit rating agencies.

But, it is necessary to emphasize few important weaknesses of these agencies.

The credit rating agencies have to fulfil the conditions of confidence, independence, objectivity and transparency. But, these agencies are private and profitable institutions and that's why it is reasonable to predict that they could be affected by different interest groups (certain government, big firms, banks etc.). The credit rating evaluation is directly connected with the interest rate level. But, the same interest groups (states or firms) who pay credit rating agencies also issue the bonds and that’s why they are interested for the lower interest rates which are determined by credit rating evaluation. On the other side, the credit rating evaluation made by a credit rating agencies is a „public good“, because it is used not only by the government or firms who have ordered and paid redemption fee for credit rating evaluation, but also by all other investors (firms, individuals, governments ...) who want real and honest credit rating evaluation. If it is unreal it could bring huge loss for certain countries. As the credit rating services are paid by only one side, it is obvious that there are potential conflicts of interests.

2. Sovereign credit rating of the EMU members and USA

At the recent time, i.e. especially since the credit rating decrement for many countries in the world at the beginning of 2012, the credit rating agencies had been recognized as the important actuators of global financial crisis, especially within the EMU. Standard & Poor’s decreased the credit rating of France, Italy, Spain, Cyprus, Portugal, Austria, Slovakia, Slovenia and Malta at the January 13th 2012. This has caused many negative consequences for these countries. The stock exchanges have reacted so negative even earlier, at the end of 2011, when the Standard & Poor’s has announced the possibility of credit rating decrement for many countries within the EMU. Also, the investors have become incredulous toward EMU market, because the credit rating decrement means the interest rates increment on credits and lower credit-worthiness on international market for many EMU countries.

The credit rating decrement for some EMU countries that have been experienced the high foreign indebtedness increment and bad economic and political situation at few recent years was expectable and reasonable (for example, Greece, Italy, Portugal, Spain, Slovenia ...), but for some countries (for example France and Austria) are not. The European Financial Stability Facility (EFSF) is a special purpose vehicle financed by members of the EMU, so its credit rating depends of EMU country members which guarantee for it. After the credit rating decrement of many EMU countries (France and eight other EMU members) on13 January 2012, Standard & Poor’s consequently lowered the credit rating of the European Financial Stability Facility to AA+ from AAA on16 January 2012. This credit rating downgrading will cause negative consequences for the EFSF because its work is based on borrowing from abroad on the international market and guarantees given by the EMU countries. The goal of EFSF is the financial stability in EU by providing financial assistance to EMU country members in debt crisis. First of all, it concerns on PIIGS countries.

After the credit rating of many EMU countries was downgraded at the end of 2011, the independence and the objectivity of credit rating agencies has become questionable (all “big three” are without EMU). In the sense of solving this problem, the *Roland Berger Strategy Consultants*[2] initiates the project for establishing the new European Rating Agency. This new agency will be organized as a private non-profit foundation. In that way, it will strengthen the credibility of the new European credit rating agency and diversify the investor base, thereby further reducing potential conflicts of interest. Currently, the Roland Berger Strategy Consultants is in talks with the key European financial institutions (numerous financial institutions from the EU and Switzerland)

[2] Roland Berger Strategy Consultants, founded in 1967, is one of the world's leading strategy consultancies.

with a view to securing seed capital totalling EUR 300 million for a European Rating Agency to be established in 2012.[3] This new institution will be placed as a counterweight toward the “big three” profit credit rating agencies.

Also in the USA, the credibility of the “big three” credit rating agencies has become questionable. It was earlier than in Europe, i.e. in 2007 when the Standard & Poor's gave the highest credit rating level (AAA) for the Lehman Brother's bank just before its bankruptcy.[4] Even, the criterions for credit rating evaluation were reducing, because there where high market competitions among credit rating agencies and their profits were huge. Namely, the banks have paid the credit rating agencies and these agencies gave them the highest credit rating evaluation as well as to their bonds because of the goal to achieve profit. It was also in the case of sovereign credit rating evaluation. For example, the Standard & Poor's reduced the USA credit rating from the highest level AAA to AA+ for the first time in the history at the summer of 2011, because of high budget deficit and public debt increment. On the other side, China has never had the credit rating of the highest safety and reliability (triple A) despite the fact of China's rapid economic growth and its unquestionable more and more economic power in the world.

The requirements for more effective control under the work of credit rating agencies have become stronger after these credit rating evaluations.

3. The credit rating of Bosnia and Herzegovina and its consequences

B&H has been using the credit rating evaluation services from Standard & Poor's and Moody's Investors Service.[5] These two agencies have very similar credit rating scale. The Standard & Poor's rating system is as follows, from excellent to poor: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC, C, D. Credit rating lower than a BBB- rating is considered as speculative (junk). The Moody's rating system is similar, from excellent to poor, as it follows: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca, C.[6]

The current B&H sovereign credit rating is evaluated on very low level by both agencies (Standard & Poor's and Moody's). It is very close to the group C which includes countries which are in bankruptcy and where nobody of investors wants to invest (Greece is currently the only European country within the group C). According to the current credit rating, Bosnia and Herzegovina is classified in a group with Cambodia, Ghana and Honduras, while all of the neighbour countries are ranked on significantly higher level.

Table 1: Comparative review of rating grades

Moody's Investors Service	*Standard & Poor's*	*Brief description of rating category*
Investment grade		
Aaa	AAA	Highest quality credit rating, minimum degree of risk
Aa1 Aa2 Aa3	AA+ AA AA-	High quality credit rating, very low credit risk
A1 A2 A3	A+ A A-	Upper-medium credit rating, low credit risk

[3] http://www.rolandberger.us/news/2012-01-23-european_rating_agency_project.html

[4] Lehman Brothers Holdings Inc. declared bankruptcy September 15, 2008. It was the largest bankruptcy in U.S. history with $613 billion dollars of debt. http://www.sourcewatch.org/index.php?title=Lehman_Brothers

[5] Bosnia and Herzegovina hired Moody's Investors Service in 2003 and Standard & Poor's in 2008.

[6] Source: Moody's Investors Service, Standard & Poor's

Baa1 Baa2 Baa3	BBB+ BBB BBB-	Medium credit rating, moderate credit risk
Non-investment (speculative) grade		
Ba1 Ba2 Ba3	BB+ BB BB-	Credit rating with speculative characteristics, substantial credit risk
B1 *B2* B3	B+ *B* B-	Credit rating speculative, high credit risk
Caa1 Caa2 Caa3	CCC+ CCC CCC-	Poor credit rating, very high credit risk
Ca C	CC C SD D	Highly speculative credit rating, likelihood of obligations default, selective default, default

Source: Bloomberg, Moody's Investors Service, Standard & Poor's (www.cbbih.ba)

Table 2: B&H sovereign credit rating history

a) Moody's Investors Service

Rating	*Date*	*Status*
B3 / on review for downgrade	April 3, 2012	Rating downgraded
B2 / negative outlook	May 16, 2011	Outlook revised
B2 / stable outlook	May 17, 2006	Rating upgraded
B3 / positive outlook	March 29, 2004	Rating assigned

Source: Moody's Investors Service

b) Standard & Poor's

Rating	*Date*	*Status*
B / stable outlook	March 28, 2012	Rating affirmed / Outlook revised
B / On Watch Negative	November 30, 2011	Rating lowered
B+ / negative outlook	July 28, 2011	Outlook revised
B+ / stable outlook	December 8, 2009	Rating affirmed
B+ / stable outlook	December 22, 2008	Rating assigned

Source: Standard & Poor's

Also, Bosnia and Herzegovina has the lowest credit rating in the region excluding the Greece that is one step under the B&H.

The lower credit rating on B&H consequently will cause the higher interest rates on credits to the state (i.e. interest rate on treasury bonds) domestic firms and inhabitants, because the capital which B&H banks take from abroad, i.e. on international financial market becomes more expansive. So, the investors will have to pay higher insurance premium for their investments because of credit rating downgrading and that's why the level of FDI entrance in Bosnia and Herzegovina will be lower. As a final result, all these will cause the investment entrance decrement, unemployment increment and lower life standard of B&H inhabitants.

Table 3: Review of long-term sovereign credit rating for countries in the region

Country	*Moody's Investors Service*	*Standard & Poor's*
	Long-term / Outlook	Long-term / Outlook
Albania	B1 / stable	B+ / stable
Bosnia and Herzegovina	*B3 / on review for downgrade*	*B / stable*
Bulgaria	Baa2 / stable	BBB / stable
Montenegro	Ba3 / stable	BB / negative
Greece	C	SD
Croatia	Baa3 / stable	BBB- / negative
Hungary	Ba1 / negative	BB+ / negative
Macedonia	-	BB / stable
Romania	Baa3 / stable	BB+ / stable
Slovenia	A2 / negative	A+ / negative
Serbia	-	BB / stable

Source: Bloomberg, data updated on April 04, 2012

4. Determinants of B&H credit rating evaluation and the measures for its upgrading

There is no unique mathematical formula for credit rating calculating. Credit rating agencies evaluate the credit ratings for the states using different concrete economic and non-economic criterions. It is complex process which is based on collecting and analysis of different public and non-public or private information. So, the credit rating evaluation for particular state is also subjective, based on experience and subjective judgment of credit rating agencies on what information are the most relevant for credit rating evaluation of certain country. This is obvious on the example of Bosnia and Herzegovina, because the last credit rating evaluations from these two agencies were different.[7] However, credit rating for particular state is mostly based on the agency's analysis of their credit history and analysis of their economic trends in the past as well as on the forecasting of their long term economic trends in the future.

The most important economic indicators that determine the low level of the sovereign credit rating in Bosnia and Herzegovina are:

Low GDP per capita. If the income per capita is higher, the taxable capacity of the state is also higher. In that case, the state will have higher creditworthiness in the sense of its credit repayment abilities because of its higher tax revenues. So, the countries with the highest GDP per capita (for example United States, Switzerland, Luxembourg ...) have also the highest credit rating level.

Low GDP per capita in B&H is a consequence of very high and rising registered unemployment rate which is probably the highest in the Europe (40.3% in 2008, 41.5% in 2009, 42.9% in 2010, 43.3% in 2011, 44.5%[f] in 2012)[8] with very negative economic, social and political consequences.

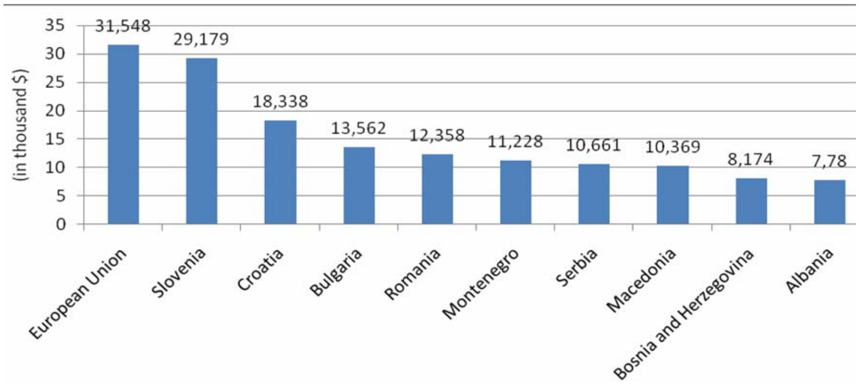
Slow economic growth (real GDP growth). The successful foreign debt repayment can be realized in a long term only if the GDP growth rate is higher than the interest rate. So, if that difference is higher the foreign debt repayment will be easier in the future. Unfortunately, Bosnia and Herzegovina has experienced very low GDP growth or even negative growth in the recent years: 0.5[f] (2012), 1.8[e] (2011), 0.7 (2010), -3.2 (2009)... On the other side, the average interest rate of

[7] On March 28, 2012, the Rating agency Standard & Poor's confirmed sovereign credit rating on Bosnia and Herzegovina at „B" and changed the rating from „negative outlook“ on „stable outlook“. But, on April 3, 2012, the Rating agency Moody's Investors Service downgraded sovereign credit rating on Bosnia and Herzegovina at „B3" on review for further downgrade.www.cbbih.ba

[8] B&H Agency for Statistics. http://www.bhas.ba/

external debt is 1.45% and 2-3% on internal debt.[9] If this trend of low economic growth is going to continue it will bring problems in foreign debt repayment and reduce the current credit rating.

Table 4: List of countries by GDP per capita (2011)



Source: World Economic Outlook Database-September 2011, International Monetary Fund.

Low international competitiveness level. It creates very high and continuous deficits on current account balance which indicate the problems that are related with foreign debt repayment and collecting of new financial means. The current account deficit (as % of GDP) was as follows: -7.9% (2011), -5.6% (2010), -6.8% (2009), -15.1% (2008)... [10]

The real exchange rate. B&H has been applying the currency board system since its establishment. It is fair to suppose that the nominal exchange rate of domestic currency (BAM) in terms of reserve currency (EUR) is significantly appreciated because of the main B&H macroeconomic indicators and trends (high and continuous foreign trade deficits, growing external debt, FDI decrement, low GNI per capita, very high and growing unemployment ...). This appreciated exchange rate policy has very negative consequences such as: encouraging of imports and discouraging of exports, the exchange rate reserves decrement and consequently the decrement of economic growth and possibility of external debt repayment. The foreign debt repayments and foreign trade deficits at following years will make high pressure on the devaluation of domestic currency. The B&H economy is not in the position to repay its foreign debt abilities and deficits by export and the real possibilities of additional privatization are very limited. It will decrease the life standard of domestic inhabitants and additionally imperil the sovereign credit rating.

Also, it is necessary to analyse the historical data, because the country which has had the problems related with its foreign debt repayment has significantly higher risk and lower credit rating than it is a case with the countries which haven't had such problems. On January 2012, Bosnia and Herzegovina was disabled to serve its foreign debt in amount of 14.5 million BAM because the state budget for 2012 hasn't been adopted. The consequences of this are default of interest, restrictions on new loans and credit rating decrement. During the period 2002-2008, the B&H public foreign debt was maintaining approximately on the same level about 4 billion BAM. After that, the public foreign debt has been significantly increasing and in the middle of 2012 it reached 7.5 billion BAM.[11] The characteristics of B&H foreign debt are fast increment and inadequate use. If this trend continues, the B&H will become highly indebted country very soon.

[9] Ibid

[10] There is a prediction for the period 2012-2014 that current account deficit will increase on -9.6% GDP (2012) and -10% GDP (2013-2014). Source: Directorate for Economic Planning, The Economic and Fiscal Program for Bosnia and Herzegovina 2012-2014, Sarajevo, 2012, p. 13

[11] The B&H foreign debt (in million BAM) was as follows: 4.290 (2002), 4.014 (2003), 4.032 (2004), 4.338 (2005), 4.071 (2006), 3.961,3 (2007), 4.240,3 (2008), 5.234,1 (2009), 6.288,8 (2010), 6.660,2 (2011). Source: Ministry of Finance and Treasury; http://www.mft.gov.ba

Besides quantitative indicators, the credit rating evaluation includes many non-economic indicators such as: the country reputation in the world (goodwill), political (un)stability, public sector efficiency, demographic factors (population growth rate, population age structures ...), the education system efficiency, the health system efficiency etc, that couldn't be expressed by quantitative indicators. So, the main reason of B&H credit rating decrement during 2011 was the general political instability, i.e. the fact that the Council of Ministers of Bosnia and Herzegovina wasn't being established for almost fifteen months and consequently the state budget didn't exist (there was the decision for temporary financing). Also, the Moody's Investors Service downgraded sovereign credit rating on Bosnia and Herzegovina from B2 on B3 / on review for downgrade because of political instability.

The very important reason for the low level of B&H credit rating is public sector ineffectiveness. Bosnia and Herzegovina has had the very high level of public expenditure[12] because of complex state structure (5 levels of state government) and accordingly massive public administration.[13] According to the data for 2011, the expenditure share for wages in the public sector was the relatively highest in Bosnia and Herzegovina and it was 12.8% of GDP. Two neighbour countries, Croatia and Serbia had the expenditure share for wages in the public sector about 10% of its GDP and Germany as the most competitive economy in Europe had the expenditure share for wages in the public sector only 7.4% of its GDP.[14] Besides this, serious problem for Bosnia and Herzegovina is in the fact that the average wage level in public sector is significantly higher than the average wage level for the economy as a whole. At the end of 2011, the average wage of all employees in the state was 416 EUR and the average wage in public sector was 583 EUR. So, the difference was 40%. Such difference between average wage in public sector and average wage of all economy is the highest in the region.[15] Bosnia and Herzegovina has to realize the public sector restructuring that concerns the reducing of employees number and wage level in public sector, saving and higher efficiency. It will enable additional money for production investments (traffic structure building, energy sector, agricultural sector, new technologies ...) or for subvention in certain areas where Bosnia and Herzegovina has had the highest foreign trade deficits. It will contribute to the easer foreign debt servicing and higher credit rating level.

However, the most important way of sovereign credit rating improving in Bosnia and Herzegovina is adequate macroeconomic program implementation which will enable the higher production, unemployment decrement and improvement of all another factors which determine the sovereign credit rating level. Bosnia and Herzegovina is trapped by implementation of inappropriate neoliberal economic concept of economic development (so called "Washington Consensus"[16]) where the privatization of the state-owned enterprises, free market competition and FDI entrance are considered as the main actuators of economic development. The consequences of this inadequate program are high unemployment without economic growth, high foreign trade deficits, etc. Bosnia and Herzegovina has to create its own macroeconomic development program based on structural reforms which require serious changes and saving within the economic system and

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[12] Expenditure of General Government (as a percentage of GDP) was: 41.6% (2006), 43.8% (2007), 46.2% (2008), 47.5% (2009), 46.7% (2010). Source: B&H Central Bank.

[13] Out of total number of employed in B&H, 10% is employed in public sector, 8.7% in education sector and 6.7% in health sector. Or, to put it differently: out of 1000 inhabitants in B&H, 18 of them are employed in public sector, 15 in education sector and 12 in health sector. Source: B&H Agency for Statistics.

[14] Source: Public Interest Advocacy Centre; http://www.cpi.ba/

[15] In comparison with other countries, the difference between wages in public sector and average wage level in Serbia is 22%, in FYR of Macedonia 20%, in Croatia and Slovenia 16% and in Montenegro 4%. Source: Public Interest Advocacy Centre; http://www.cpi.ba/

[16] Originally, the term «Washington Consensus» refers to 10 recommendations for the countries wishing to reform their economies. The author of the recommendations is the British economist John Williamson (1989). They concern fiscal discipline, modification of public consumption, tax reform, financial liberalisation (interest rate liberalization), introduction of a single foreign exchange rate, trade liberalisation, eliminations of all obstacles to direct foreign investments, privatisation of state-owned companies, deregulation and competitiveness of the market, and inviolability of property rights.

longer period. Short-term and easy solutions are not possible. "*At the present time of the recession, the Keynesian theory of higher government consumption and employment encouragement is applicable and more relevant than ever. The solution lies in strong national investment banks. The capitalism of free market has been confirmed as unstable and unsatisfactory. There is a need for higher economic role of the state, whether in investments or in wealth distribution.*"[17] In that sense, the B&H Government has to encourage the investments in certain economic branches (energy sector,[18] agricultural sector,[19] tourism …) which have significant comparative advantages. For example, the energy sector owns relatively high possibilities for higher production.

There are three firms in majority public ownership which are major producers and distributors of electricity within the B&H power sector. They are the most profitable and the most stable part of B&H economy because the electric power is a good which is practically easy to sell and market demand for her is huge and constantly increases.[20] At the same time, the B&H banking sector has been collecting relatively high amount of saving[21] but there is no effective transmission mechanisms of monetary policy to transmit these saving into productive investments. It is because the banking sector is almost completely in private and foreign ownership.[22] Such banking system is not in the function of economic growth and unemployment decrement but in the function of foreign capital. Banking sector stimulates final consumption satisfied from import (it is obvious from the data mentioned for economic growth, unemployment and current account deficits). So, such banking sector is restrictive for economic development. The bonds issuing from the three public firms within the power sector (with higher interest rate than it is in the banking sector on savings) can be effective transmission mechanisms to transmit the savings from the banking sector into productive, safe and profitable investments in the power sector.

The interest in this mechanism is evident for the bond buyers (investors) because of interest income, electric-power companies and state. The bonds issuing and bonds redemption can be also successful way for pension system reform, that is currently burdening state budget and negatively affects the credit rating. The B&H Government can initiate similar combinations of monetary and fiscal policies in many other areas. For example, about 40% of B&H foreign trade deficit has been realizing in agricultural sector (food and drinks). It is the obvious absurdity because Bosnia and Herzegovina is relatively abundant with agricultural land (around 50% of agriculture land is uncultivated). B&H has to take measures to substitute the imports of agricultural goods with domestic agricultural production.[23] In the long term, all these structural reforms and economic policy measures together (public sector reform, pension system reform, investment

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[17] Citation from the speech of Professor Robert Skidelsky that was held in Zagreb at 11 April, 2012 and organized by Croatian Chamber of Economy. http://www.hrt.hr/index.php?id=48&tx_ttnews%5Btt_news%5D=161032&cHash=d3ac0f07ee

[18] Bosnia and Herzegovina is available with various energy recourses, as follows: the main energy resource is coal (brown coal and lignite), with estimated reserves of 10 x 109 tons; only about 35% of huge hydro potential of over 6000 MW is in use; significant wind energy potential; approximately 1.5 million m3 of forest / wood industry etc.; http://www.fipa.gov.ba/atraktivni_sektori/energetika/

[19] B&H agricultural sector has a great opportunity for potential investors, based on the following main advantages: abundance of agricultural land - around 50 % of agriculture land is uncultivated; favourable climate conditions …; http://www.fipa.gov.ba/atraktivni_sektori/poljoprivreda/

[20] That trend is very intensive after the Fukushima nuclear disaster on 11 March 2011. Few days after this crisis at Fukushima in Japan, Germany shut down seven nuclear reactors and decided to close all its nuclear power plants by 2022. Bosnia and Herzegovina with its energy potential (hydro, thermal …) has a chance for economic development in this area.

[21] Total Deposits (In millions of BAM) in Commercial Banks of B&H were: 12,993.0 (2011), 12,530.0 (2010), 12,092.1 (2009), 11,875.1 (2008)…; http://www.cbbh.ba/index.php?id=33&lang=en&sub=mon&table=ukupni_depoziti_i_kreditit_komercijalnih_banka_bih

[22] At the end of 2010, 29 commercial banks in B&H had permission to work. 21 banks were foreign owned, 7 banks were domestic privately-owned and only 1 was majority state-owned. The share of foreign owned banks was 90% of total banking sector assets. Source: Central Bank of Bosnia and Herzegovina Annual Report 2010, p. 80.

[23] For example, Bosnia and Herzegovina is the only country in the region which has never made a decision about minimal percentage of domestic (home-made) goods that the retail trade stores have to have on their shelves.

encouragement, unemployment decrement...) will bring higher sovereign credit rating for Bosnia and Herzegovina.

The credit rating upgrading will function as an accelerator in positive way. It will attract the higher FDI entrance as an additional source of economic growth and reduce the interest rates on international financial market for Bosnia and Herzegovina.[24]

If the negative trends of B&H economy (current account deficits, foreign debt increment, FDI absence, high unemployment without economic growth...) and political instability will continue, Bosnia and Herzegovina will experience the economic collapse similar as it was recently in the case of Greece.

5. Conclusion

The credit rating evaluation is very important because it determines the confidence of investors and interest rate level for certain country. Low credit rating of Bosnia and Herzegovina indicates opinion that Bosnia and Herzegovina has a high risk of defaulting. The sovereign credit rating is the indicator of macroeconomic situation as a whole and it has the role of accelerator. Currently, in the case of very bad economic situation in B&H (fast foreign debt growth, foreign trade deficit, unemployment...) the credit rating downgrading additionally turns down investors from B&H and affects reducing of its creditworthiness on international financial market (i.e. on interest rates increment and smaller possibilities of additional getting into debt).

The structural reforms (public sector reform, pension system reform etc.) and simplifying of doing business process could activate the higher FDI entrance and consequently influence on better credit rating. The political stability is also one of the main preconditions for higher credit rating evaluation. Unfortunately, the B&H political instability has disabled so far the carrying out of structural reforms, decreased the confidence of investors and disabled approach to the higher financial support from abroad.

However, the most important thing for B&H economic development and credit rating upgrading is adequate concept of macroeconomic policy. Bosnia and Herzegovina has to leave the illusions that the switching of state ownership with private ownership (or privatization) and free market competition will bring higher efficiency and economic growth. The neoclassical concept of economic development (so called Washington Consensus) is not appropriate for B&H and it can't get out its economy from the situation of deep recession. Bosnia and Herzegovina has to create its own concept of macroeconomic policy based on Keynesian theory (combination of public investments, moderate inflation that is under control of monetary policy, graduate depreciation of domestic currency and effective customs protection) that is more appropriate in regard to the existing B&H situation (low international competitiveness, high unemployment, unused natural resources ...).

The B&H credit rating upgrading will be also enforced by successful process of approaching to the EU and NATO membership, because it considers stable institutions and higher financial support from the European structural and pre-accession funds.

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[24] The FDI inflow in Bosnia and Herzegovina has had constantly decreasing trend and it was as follows (in millions BAM): 2973 (2007), 1245 (2008), 346 (2009), 94 (2010). Source: Central Bank of Bosnia and Herzegovina, Annual Report 2010, p. 180.

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