



Josef Pöschl

Bosnia and Herzegovina: Is the worst still to come?

Bosnia and Herzegovina (BiH) is not what one would call a stronghold of optimism, particularly not in these days and certainly not among those responsible for the funding of public sector activities. Last December, the finance minister of the Federation of Bosnia and Herzegovina (FBiH), Vjekoslav Bevenda, uttered concerns that the economic crisis might reach its peak only in 2010. In January 2010, Dragan Vrankic, the central government's finance minister, said the crisis had reached BiH with a delay, and the same could hold true for recovery. Revenues from tax collection, customs and social security contributions have shrunk; arrears are on the rise. This gave a bad fit with past boom years' high increases in public sector wages and social benefits for war veterans, and they had to be revised at least partially in the context of a stand-by agreement with the IMF. In the first half of 2009, the discrepancy between revenues and law-based expenditure obligations brought the FBiH fiscal system close to collapse. For BiH, the agreement with the IMF and the need to comply with it had a crucial stabilizing impact. Continued investment into infrastructure is very much needed, so the IMF, and should not be subject to cuts. At the same time, BiH has to fight the fiscal deficit. Recovery alone will not do the job; there is need for public sector reform in the context of a new, more suitable constitution. The economy suffers from a disproportionate public sector and above-average public sector wages. The government (using the plural would in fact be more appropriate in the case of BiH) still controls an important segment of the corporate sector with a large burden of unsettled liabilities. This is certainly not a guarantee for good management. To give an example, Energopetrol makes losses from operating a countrywide network of petrol filling stations.

From a macroeconomic point of view, the government and the public utilities sector are a kind of 'fixed-income block', and its high share in GDP reduces the impact of the crisis on GDP development. By Central East and Southeast European standards, a GDP decline of about 3% in 2009 is quite modest. The counterpart to the fixed-income block is relatively small. It is located within the private sector and consists especially of producers of tradable goods and services who are as much impacted by the international crisis as in comparable countries.

Voices from the private sector are, again, quite pessimistic, in spite of some encouraging examples of success even under current conditions. The metal industry is upset as the parliament has paved the way for government subsidies last year, but money has never started flowing, and employees fear additional layoffs. At an Economic and Social Council meeting at the end of January 2010, a representative of an FBiH employer association warned that in the near future a number of companies may have to lay off part of their work force or shut down completely. More loans are turning bad and have become a source of concern for micro credit organizations in particular. The

board of the FBiH Banking Agency has adopted interim measures for loan rescheduling. A bank is free to agree on the rescheduling of a natural or legal person's loan excluding current account overdrafts, as long as that person is not in default for over three months. Managers of non-financial companies are disappointed by worsened borrowing conditions and banks' reluctance to finance exports, whereas banks complain about lack of clients with good quality projects, which prevents them from using their full lending potential. They defend high commercial lending rates (in the range of 8-10%) with complaints about expensive foreign capital. Real estate prices fell significantly in 2009 and may fall again in 2010. The volume of transactions is low.

BiH is running a large trade deficit with its partner countries in the framework of the Central European Free Trade Agreement (CEFTA), and discomfort with all kinds of trade liberalization (CEFTA, SAA/IA, WTO) is widespread. This is particularly true for farmers, as the BiH government cannot afford supporting them as much as is the case, e.g., in Croatia or the EU.

Most of the external assessments of the country's economy are also rather pessimistic. BiH holds rank 109 in the World Economic Forum's Global Competitiveness Report 2009-2010 and rank 87 in a World Bank study focused on trade logistics. In mid-January, Valentin Inzko, High Representative (formally at least, still) and EU Special Representative, characterized the economy as being in a sad state. According to him, the loss of 70,000 jobs after October 2008 was not exclusively attributable to the international crisis; BiH has missed opportunities of adopting investment-friendly legislation and has not reformed the banking supervision in a way that would facilitate SME credit access. The latest EU progress report encourages a speeding-up of accession efforts after many months of very slow progress. In December 2009, Standard & Poor upgraded the economy's credit rating (to B+ for long-term and B with stable outlook for short-term credits), whereas in January 2010 Moody's decided to keep its rating constant (B2 with stable outlook).

In our view, pure pessimism is not justified. If we take industrial output data on the years 2009 and 2008, in a number of industries the December-on-December results are much better than the results of full-year comparisons. This is the case, for example, for textiles and clothing, where the full-year change was -3% whereas the December-on-December change was +24.7%. Wood and wood products, again a rather important BiH industry, also recorded a switch from negative to positive (-16% vs. +5.6%) as well as leather and leather products (-1.8% vs. 14.3%). In the case of transport equipment, the switch was from +2.9% to +33.4%. In recent years, this has been a small but dynamic sector. A switch from massive decline (full-year change) to small decline in the December/December ratio occurred in machinery as well as electrical and optical equipment. The output decline in basic metals and metal products, a key industry, was worse December-over-December (-25%) than in a whole-year comparison (-17.2%). However, Aluminij Mostar, one of the big players in this branch, now plans to return to higher capacity utilization in response to improved world market prices. The decline in the output of non-metallic mineral products, too, was larger in December than in the full year, pointing to decreased construction activities. These figures were not subject to any adjustment, which makes their interpretation more difficult. In a few months' time, the degree of recovery of at least some of the industries will become clearer.

The small overall decline in industrial production, -3.3% (2009 over 2008), follows mainly from the increase in the output of coke and refined petroleum products (+498.6% sic!) in the context of the relaunch of production of the Bosanski Brod refinery in December 2008. The December-on-December increase was merely 9.6%. The company envisages a modernization and expansion of its production.

The GDP development during the next few months and years will of course be massively influenced by international business climate developments. Should the latter be favourable, any export expansion will be easier; citizens working abroad will earn more money and send more remittances, and more foreign capital will be inclined to enter the country. We count with a return of export expansion, which will increase over time. It is quite feasible that BiH will manage to become a WTO member in 2010, finally. A new WTO-conforming institutional framework together with institutional reforms associated with the SAA-related Interim Agreement with the EU could boost exports. However, imports will start growing again as well. A return to current account deficits as large as they were in the past is unlikely. Import development will have to be better adjusted to export growth.

Gross fixed capital formation will depend on projects the public sector will perform in cooperation with the EU and IFIs, as well as on the private sector's investment decisions. The former are on track, whereas the latter will not gain momentum rapidly: capacity utilization is low; the stock of accumulated profits is low; and borrowing will remain more costly than it was in the past.

Private consumption will remain stagnant because of unemployment, which will remain high for quite some time, and wage growth, which will be slower than in the past. All this adds up to an only modest export-led resumption of GDP growth up until 2012. If so, one of the most severe problems of the BiH economy, and society, will continue to persist: less than one third of the population is economically active in the sense of having or seeking a job. Less than one quarter of the population has at least what is regarded as employment in terms of the labour force survey; and less than 20% are officially registered as employed. These dejecting circumstances have contributed to a political climate in which the majority of voters tend to opt for the status quo as a risk-minimizing strategy.

Currently, it is difficult to adopt a law on the census to be performed in 2011. There is a split regarding whether the questionnaire should address ethnic and religious affiliation. In the absence of consensus results, it will be hardly possible to integrate BiH into the EU. Per capita measures are of key importance in a number of aspects. In October 2010, BiH will vote for new members of the parliaments and of the BiH presidency. Thereafter, serious work on a new constitution may start. Here again, there is a sharp divide in BiH. The current reality is de facto federalism in a way that bears adverse consequences for the country's economic performance. In Banja Luka, the leadership of Republika Srpska seems determined to expand federalism to a degree close to independence, whereas in the FBiH the majority of political leaders tend to strictly reject the concept of BiH federalism. There may evolve something like Serbia and Montenegro's drifting apart scenario, but hardly with the same outcome. Or, things may develop in quite another direction: thanks to the recent adoption of the Lisbon Treaty it has become feasible that in the next few months or years Serbia will enter the fast track towards EU integration. In this case, Banja Luka's focus may turn towards BiH's EU integration, so that the elaboration of joint solutions can start.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 ¹⁾	2010	2011	2012
	Forecast								
Population, th pers., average	3842	3843	3843	3843	3842	3843	3843	3843	3843
Gross domestic product, BAM mn, nom. ²⁾	15786.0	16927.9	19121.1	21758.8	24716.6	23900	23700	24200	25200
annual change in % (real) ²⁾	6.3	3.9	6.9	6.0	5.4	-3	-1	1	3
GDP/capita (EUR at exchange rate)	2100	2300	2500	2900	3300	3200	3100	3200	3300
GDP/capita (EUR at PPP - wiiw)	4800	5100	5700	6300	7000	6900	.	.	.
GDP by expend. approach, BAM mn, nom. ²⁾	16680.2	18177.6	21366.1	24708.6	27933.7	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	15017.5	16513.9	18064.3	19930.8	22369.7	21370	.	.	.
annual change in % (real) ²⁾	.	6.2	4.5	6.0	5.5	-4	-1	0	1
Gross fixed capital form., BAM mn, nom. ²⁾	4044.4	4889.5	4756.8	6446.4	7429.7	5910	.	.	.
annual change in % (real)	.	18.5	-9.4	28.8	9.6	-20	0	5	8
Gross industrial production ³⁾									
annual change in % (real)	12.1	10.8	11.5	6.4	11.0	-6	0	3	7
Gross agricultural production, total									
annual change in % (real)	27.7	-0.5	2.3	.	.	.	.	.	.
Employed persons - LFS, th, April	.	.	811.0	849.6	890.2	859.2	820	820	820
annual change in %	.	.	.	4.8	4.8	-3.5	-5	0	0
Employees total - reg., th, average	637.2	642.8	653.3	686.1	705.6	650	650	650	650
annual change in %	0.3	0.9	1.6	5.0	2.9	-8	0	0	0
Unemployed persons - LFS, th, April	.	.	366.8	346.7	272.0	272.3	.	.	.
Unemployment rate - LFS, in %, April	.	.	31.1	29.0	23.4	24	27	27	27
Reg. unemployment rate, in %, end of period	43.2	44.1	44.1	42.5	40.6	43	44	44	44
Average gross monthly wages, BAM ⁴⁾	748	796	869	954	1112	1200	.	.	.
annual change in % (real, net) ⁴⁾	3.5	3.4	2.3	8.4	8.4	5.6	.	.	.
Consumer prices, % p.a. ⁵⁾	0.8	3.0	6.2	1.5	7.5	-0.4	0	1	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	40.4	42.1	44.9	45.2	44.1	42	42	43	43
Expenditures	38.8	39.6	42.0	43.9	46.1	45	46	45	45
Deficit (-) / surplus (+)	1.6	2.4	2.9	1.3	-2.0	-3	-4	-2	-2
Public debt, nat. def., in % of GDP ⁶⁾	25.5	25.6	22.0	29.6	27.6	30	30	30	30
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn ⁷⁾	-1318.7	-1499.7	-769.6	-1151.5	-1879.1	-950	-1000	-1000	-1000
Current account in % of GDP	-16.3	-17.3	-7.9	-10.4	-14.9	-7.8	-8	-8	-8
Exports of goods, BOP, EUR mn ⁷⁾	1677.0	2059.7	2687.3	3091.5	3522.0	2900	3000	3200	3500
annual growth rate in %	28.7	22.8	30.5	15.0	13.9	-18	3	7	9
Imports of goods, BOP, EUR mn ⁷⁾	5354.5	6021.5	6093.0	7233.6	8341.3	6200	6400	6700	7100
annual growth rate in %	7.6	12.5	1.2	18.7	15.3	-26	3	5	6
Exports of services, BOP, EUR mn ⁷⁾	696.1	798.6	903.8	1062.1	1125.9	1000	1030	1080	1150
annual growth rate in %	9.4	14.7	13.2	17.5	6.0	-11	3	5	6
Imports of services, BOP, EUR mn ⁷⁾	349.3	352.4	375.0	442.4	438.7	400	400	410	420
annual growth rate in %	3.0	0.9	6.4	18.0	-0.8	-9	0	2	2
FDI inflow, EUR mn ⁷⁾	566.9	493.1	572.4	1546.2	726.0	250	300	400	700
FDI outflow, EUR mn ⁷⁾	1.2	0.4	3.2	17.2	9.2	3	5	5	5
Gross reserves of NB excl. gold, EUR mn ⁸⁾	1778.8	2160.0	2787.4	3424.9	3218.9	3080	3050	3050	4000
Gross external debt, EUR mn ⁹⁾	2061.4	2217.9	2081.5	2025.4	2168.0	2500	2700	2700	2500
Gross external debt in % of GDP	25.5	25.6	21.3	18.2	17.2	20	.	.	.
Average exchange rate BAM/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/EUR ¹⁰⁾	0.850	0.857	0.875	0.898	0.923	0.907	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2000 according to ESA95 (including shadow economy, real growth rates based on previous year prices). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) From 2005 District Brcko included. - 5) Until 2005 costs of living, from 2006 harmonized CPI. - 6) Based on IMF data. - 7) Converted from national currency with the average exchange rate. - 8) From 2006 including investment in foreign securities.- 9) Gross external public debt. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics and IMF. Forecasts by wiiw.