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Bosnia and Herzegovina: at long last an EU associate

The GDP in Bosnia and Herzegovina (BiH) grew quite significantly again in 2007: by 6%. Assuming that the overall picture drawn from the data is correct, this is somewhat less than in 2006 (6.7%), the best year to date in the current decade. We have to reckon with still less, yet robust growth in 2008. In terms of growth rates, advantage vis-à-vis the EU remains. The economy continues to catch up, albeit from a rather modest starting point.

Prospects of slower private consumption growth and an increase in volume of imports

Data for the first quarter of 2008 are not yet available; however, we can safely assume that the leap in the consumer price index in 2007 will slow down private consumption growth in 2008. There is no indication, however, that investment growth will suffer to a similar extent. The construction sector is highly active throughout the country – albeit less so in the south-east region, the poorest area of the country. Export growth is also likely to remain strong, mainly on account of the country's specialization in metals: a sector enjoying favourable market conditions. It seems that the rise in world market prices has had a significant negative impact on demand for food and energy. Nevertheless, the country now has to settle much higher bills for its food and energy imports.

After the hike, price levels are stable again

In recent years, BiH has experienced long periods of either no inflation or even light deflation, interrupted by rather abrupt leaps and bounds in the price index. In 2006, the leap was due to higher taxation following the introduction of VAT. The more recent kick, even though it occurred already back in October and November 2007, was attributable to the increase in world market prices for energy and cereals. In the meantime, however, the price index has stopped moving. Even if the index remains stable for the rest of the year, annual average inflation in 2008 will be close to 6%. In BiH, increases in world market prices for energy and food tend to have a strong inflationary impact. In the basket of consumer goods basket, energy and food are 'heavyweights'. Only a minor share of the population, somewhat less than 20%, earns income from employment (compared to close to 50% in Slovenia). This calculation is based on LFS methodology; it thus includes persons working only a few hours per week, for instance, in unregistered jobs. About half a million people or 13% of total population draw pensions, the average monthly amount being very low (about EUR 130). Remittances from relatives working abroad constitute another major source of income. In recent years, they have invariably amounted to approximately EUR 1 billion per annum. That figure refers solely to remittances through official channels. Overall, domestic and foreign-based earners of

income support a large number of BiH citizens who do not earn incomes of their own. Under these circumstances, the rise in prices for housing, heating and food mean a serious reduction of income for a large proportion of the population. A recently published survey revealed that a large segment of society is living in straitened circumstances. For example, 93% of young married couples do not have homes of their own and more than 80% of the young people (in the age group 16-30) live with their parents. This is hardly likely to change very soon. At the same time, real estate prices are booming in the context of increasing income disparity; they are said to have doubled in 2007 (up to about EUR 2500 per square metre for new housing in central Sarajevo). Not surprisingly, public discontent has been aired over a number of price increases.

Contrary to the other types of income mentioned above, regular wages increased significantly in the first few months of 2008. In the first quarter of 2008, gross nominal wages averaged EUR 570 – up by 13% over the same period of the previous year. For the most part, this is attributable to an increase in public sector wages.

Strengthening cooperation with the outside world

Negotiations on the country's membership in the World Trade Organization (WTO) could still yield a positive outcome in 2008. Some of the necessary institutional arrangements (for example in the field of food safety) are already in place; however, changes have yet to be introduced in the field of commercial law.

The fact that a social insurance agreement with Slovenia entered into force on 1 July 2008 is indicative of some progress in terms of regional integration. BiH has signed similar agreements with Croatia and Macedonia. Another lesser example is the South Adriatic Eurodistrict: a cooperation platform encompassing Bosnia, Croatia, Montenegro, Albania and Italy. It includes Dubrovnik (Croatia), Scutari (Albania), Tivat, Budva, Herceg Novi, Kotor, Ulcinj (Montenegro) and a number of Italian towns. The aim is to foster joint of infrastructure development projects.

In the current year, by far the most important achievement has been the signing of the Stabilization and Association Agreement (SAA) between BiH and the EU on 16 June 2008. The interim agreement between Bosnia and the European Union entered into effect on 1 July. Starting from 1 August, it foresees a reduction in tariffs on primary and processed materials as well as equipment and machinery coming from EU countries. In the initial stage, BiH will halve the tariffs on a number of industrial products (plaster, gas, paints, cellulose, wood, agricultural machinery, tools, etc.). For oil, rubber and leather products, paper, clothes, footwear, cement, brick, telephones and the like, BiH import tariffs will initially be cut back to 75%. Lower prices for imported materials and technical equipment is good news for BiH manufacturers, although it also means that many of them will have to face stiffer competition on account of less protection. Under the agreement products categorized as sensitive (e.g. milk and meat) will remain protected up to the very moment of EU accession. One of the greatest barriers to improving the competitiveness of the food processing sector is the lack of laboratories entitled to ensure conformity with international standards.

The impact of the new arrangement with the EU will be lower prices because of lower prices for imports and more competition; inflation in the second half of 2008 should thus be low.

SAA – the beginning, not the end

Proceeding from the signature of the SAA to actual EU accession will call for an enormous effort, especially in the case of BiH. Preparations to date have been wanting in many respects. In a recent seminar, experts stressed that BiH currently uses less than 20% of the pre-accession funds provided by the EU, even though still more funds could be made available subsequent to further negotiations with the EU. Some EUR 440 million have already been allocated for the period 2007-2011 under the heading of Pre-Accession Assistance (IPA).

The government will have to initiate many steps, if it is to ensure that the country benefits from the SAA. For example, the BiH Parliament will have to adopt a law on establishing a national fiscal council: a European Partnership requirement. By so doing, BiH would provide for fiscal coordination between the state and the two entities (Federation and Republika Srpska). Another important task, which has been in the offing for years, will be the conclusion of an agreement on the allocation of indirect tax revenues. In 2006, BiH introduced VAT without solving the allocation issue.

For large segments of the population, the most attractive ripple-effect of the SAA is that it will pave the way to visa-free travel to EU-countries. Formal talks on that issue started in May. A positive conclusion will depend on the country fulfilling specific criteria and meeting conditions laid down in the road map for BiH.

According to reports in the media, the general public's hopes for improvement are mainly focused on something happening independently of what the people do of their own accord. These new-found hopes derive from such events as the discovery of oil in the north of the country, reports of businessmen from Hungary and Qatar interested in investing heavily in BiH winter tourism, Saudi Arabian interests in investing in the country's food sector or General Electric's expression of interest in investing in power generation. At the same time, however, the willingness to push reforms through is lacking. For example, a recently published study concluded that BiH could export much more electricity, were it to adopt such measures as consolidating the national power grid, harmonizing laws at both the domestic and EU levels, and meeting its international commitments in a responsible fashion. According to the OSCE Mission in BiH, higher education is yet another field where reforms have been insufficient. Although the universities claim emphatically that they have implemented the Bologna Process, in practice little has changed and adequate institutions are lacking. Only if assertive and tangible reforms are introduced, will EU integration progress smoothly.

Looming fiscal stress and strain

In recent years, the public sector has managed to maintain a more or less balanced budget. This is likely to remain so in the future, irrespective of the trade regime designed by the SAA reducing import-related government revenues that in previous years totalled some EUR 200 million (or 1.9% of the GDP in 2007).

The government's foreign debt is moderate (EUR 2 billion or 19% of GDP at the end of 2007); its servicing absorbs about 2% of the annual GDP. The major problem is internal debt, the size of which will depend on decisions relating to: (i) compensation of different types of claims, such as restitution of real estate; and (ii) compensation for bank accounts frozen during the war. Depending on the decisions ultimately taken on these issues, the government will have to set aside large appropriations in future budgets in order to service internal debt; fewer funds will thus be available for other purposes.

Concluding remarks

For BiH, becoming an EU member has become a realistic option. Tasks associated becoming a member, however, will necessitate a new working style. Gradually, politicians will become aware of that need. They will face a build-up of pressure given the people's desire for visa-free travel to EU countries and their fear of falling back behind other countries in the region (Albania, Montenegro, Serbia), compounded by the demands of entrepreneurs seeking more support in their struggle to achieve international competitiveness.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2004	2005	2006	2007 ¹⁾	2007 1st quarter	2008	2008 2009 2010 Forecast		
Population, th pers., mid-year	3842	3843	3843	3846	.	.	.	.	.
Gross domestic product, BAM mn, nom. ²⁾	15786.0	16927.9	19121.1	20950	.	.	23300	25100	27100
annual change in % (real)	6.3	3.9	6.7	6.0	.	.	4.5	5	6
GDP/capita (EUR at exchange rate)	2101	2252	2544	2785	.	.	.	.	.
GDP by exp. approach, BAM mn, nom.	16680	18178	21151	.	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4820	5130	5590	6080	.	.	.	.	.
Gross industrial production									
annual change in % (real) ³⁾	12.0	11.0	11.7	6.3	10.5	5.3	5.5	7	10
Gross agricultural production, total									
annual change in % (real)	27.7	-0.5	2.3	.	.	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	15017.5	16513.9	18064.3	19400	.	.	.	.	.
annual change in % (real)	.	6.2	4.5	6	.	.	3	5	5
Gross fixed capital form., BAM mn, nom. ²⁾	4044.4	4889.5	4756.8	5000	.	.	.	.	.
annual change in % (real)	.	18.5	-9.4	5	.	.	8	8	10
LFS - employed persons, th, April	.	.	811.0	849.6	.	.	.	.	.
annual change in %	.	.	.	4.8	.	.	.	.	.
Reg employees total, th pers., end of period	639.1	644.0	664.1	687.4	661.1	766.7	.	.	.
annual change in %	0.3	0.8	3.1	3.5	2.8	16.0	.	.	.
LFS - unemployed, th pers., April	.	.	366.8	346.7	.	.	.	.	.
LFS - unemployment rate in %, April	.	.	31.1	29.0	.	.	29	28	27
Reg. unemployment rate in %, end of period	43.2	44.1	44.1	42.9	44.7	39.3	.	.	.
Average gross monthly wages, BAM	748	798	869	939	989	1120	.	.	.
annual change in % (real, net) ⁴⁾	3.6	3.5	1.4	6.4	13.0	5.5	.	.	.
Consumer prices, % p.a. ⁵⁾	0.8	3.0	6.2	1.5	0.8	6.5	6.5	2.5	2
General governm. budget, nat. def., % GDP									
Revenues	40.4	42.1	44.9	44	.	.	45	44	43
Expenditures	38.8	39.6	42.0	42	.	.	43	42	41
Deficit (-) / surplus (+), % GDP	1.6	2.4	2.9	2	.	.	2	2	2
Public debt in % of GDP	27.5	27.5	22.9	20.5	.	.	.	.	.
Current account, EUR mn ⁶⁾	-1318.4	-1555.5	-816.4	-1400.6	-188.0	.	-1600	-1550	-1500
Current account in % of GDP	-16.3	-18.0	-8.4	-13.1	.	.	-13.4	-12.1	-10.8
Gross reserves of CB excl. gold, EUR mn ⁷⁾	1778.8	2160.0	2787.4	3383.6	2825.8	3342.3	.	.	.
Gross external public debt, EUR mn	2061.4	2217.9	2081.5	1996.1	.	.	.	.	.
Gross external public debt in % of GDP	25.5	25.6	21.3	18.6	.	.	.	.	.
FDI inflow, EUR mn	566.9	478.3	564.2	1477.7	118.3	.	600	.	.
FDI outflow, EUR mn	1.3	1.0	1.9	6.8	1.1	.	10	.	.
Exports of goods, BOP, EUR mn ⁶⁾	1676.9	2059.7	2687.3	3091.5	706.1	.	3600	4200	5000
annual growth rate in %	28.7	22.8	30.5	15.0	25.3	.	16	17	19
Imports of goods, BOP, EUR mn ⁶⁾	5354.5	6021.6	6093.0	7233.8	1485.3	.	8700	9600	11500
annual growth rate in %	7.6	12.5	1.2	18.7	31.0	.	20	10	20
Exports of services, BOP, EUR mn ⁶⁾	696.1	772.1	901.4	970.5	182.5	.	1100	1200	1400
annual growth rate in %	9.4	10.9	16.8	7.7	17.2	.	13	9	17
Imports of services, BOP, EUR mn ⁶⁾	349.2	371.0	400.3	422.0	69.0	.	450	480	500
annual growth rate in %	3.0	6.3	7.9	5.4	11.4	.	7	7	4
Average exchange rate BAM/USD	1.576	1.573	1.559	1.430	1.493	1.307	.	.	.
Average exchange rate BAM/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/USD, wiiw ⁸⁾	0.717	0.727	0.748	0.755	.	.	.	.	.
Purchasing power parity BAM/EUR, wiiw ⁸⁾	0.852	0.859	0.890	0.896	.	.	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2004 GDP figures include the Non-Observed Economy (NOE). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) wiiw calculation. - 5) Until 2005 costs of living, from 2006 harmonized CPI. - 6) Converted from the national currency. - 7) From 2006 including investment in foreign securities. - 8) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics, IMF; wiiw forecasts.

