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Bosnia and Herzegovina in value-added tax fever

By 1 January 2006 the new value-added-tax system came in operation. Apart from those on capital markets, it taxes all transactions with one single rate of 17%. The latter fact triggered fierce discussions already prior to its implementation, and they continued afterwards, when people saw themselves confronted with increased prices for food, housing and public utilities. The consumers' perception differs considerably from that of statistical offices who maintain that all in all the VAT-induced rise of the price index, being the net outcome of increases and reductions, is moderate. Towards the end of the year, the forthcoming change of the tax system also gave reason to enhance business activities such as domestic trade and imports.

In 2005, most probably the real GDP grew somewhat faster than in previous years. However, a safe confirmation of this observation may never be possible. Bosnia and Herzegovina (BiH) is still living without fully developed national accounting. The relatively large statistical offices from the two entities (Federation of BiH and Republika Srpska) derive their GDP estimates from supply-side figures, whereas the poorly staffed office for the country as a whole confines itself to aggregating the entities' figures. No double- or triple check (from the expenditure and income side) is being done so far. As a result, even the estimates of official sources diverge by a wide range: for example, for 2004 the BiH Statistical Office records a nominal GDP growth of 9.2%, which implies very high real growth given that according to indicators available inflation was very low. According to estimates of the Central Bank, which closely cooperates with the IMF, real GDP growth was about 6% in 2004. In both cases the estimates exclude the informal sector. Identifying incapability of statistical offices as the culprit for the persistent lack of national accounting would be too simplistic. This phenomenon is only one example for the continuous lack of coordination and cooperation in public administration, or, in other words, feeble public governance.

Although accurate aggregate GDP data are lacking, there is no doubt that during the last few years real sector activities kept expanding significantly. The set of latest available data suggests that this trend has not experienced interruption and will remain valid also in the nearer future. Industrial output growth, albeit still from a weak base, is robust. The main engine of this is a limited number of successful larger companies, most of them foreign-owned, whereas the performance of many others has remained poor. From a demand side point of view, real growth of wages and a slight increase in employment are supporting the growth of private consumption. Estimates for the growth of gross fixed investment are not available, but it should be substantial, a conclusion which is supported by the expansion of construction activities and by machinery and mechanical appliances being the largest

component of imports. Of course, the big unknown is changes in inventories, which have the potential of impacting GDP growth significantly. The public sector figures are signaling priority given to fiscal discipline rather than to growth acceleration. Exports of goods, with base metals and articles thereof as their largest component, still cover only about one third of import expenditures, but the former are now growing much more than the latter. The expansion of the trade deficit would have come to a standstill, had there not been a strong increase in the bill for imported fuels. The balance of services is positive and has climbed to over 5% of GDP, and a strong inflow of remittances continues to be the main responsible for keeping the current account deficit much below the trade deficit (below 25% of GDP compared to over 50%).

The country's corporate sector has never fully recovered from the setback it suffered more than a decade ago and remains unable to employ a satisfactory number of citizens in an efficient way. About 630,000 persons are registered as employed, whereas a not much lower figure, over 520,000, is registered as unemployed. Even more disturbing is the fact that during the last years registered employment more or less stagnated, whereas the number of persons registered as unemployed is on the rise over time. Large parts of the corporate sector need an overhaul, which in the short term however usually increases unemployment. This will further go on in a situation which is tense and politically delicate already. There is the argument that these registration figures do not tell you the truth. On the one hand, some of those registered as employed actually do not work, whereas many others are registered as unemployed, but are active in the informal sector. Labour force surveys came to the result that the rate of unemployment in recent years may have been below 20%. Even with this being the case, the situation would not be comfortable. The business sector is split between those who do fully meet their obligations towards tax authorities and social security institutions and those who do not at all or do it only partially. This situation also creates a sharp contrast between those who enjoy the privilege of being protected by social security institutions and those who do not. Aggregate income is on the rise, but not many citizens see themselves profiting from this development.

The rate of inflation for the year 2004 is likely to slightly surpass 2.5% which is a unusually high rate compared to past years. In the first nine months of 2005, the year-on-year rate of inflation averaged 2.3%, and in the last quarter it was probably higher. The increase is attributable mainly to increases in regulated prices for a few goods and services. Even under the currency board regime the central bank is not completely left without monetary policy instruments, as we could see in 2005. A strong credit expansion by commercial banks prompted a reaction by the central bank; it lowered its remuneration rate from 2% to 1% and increased the mandatory deposit rate from 10% to 15%. Most of the lending goes to the household sector. Lending rates are, although being slowly declining, still as high as 8.3% for long-term loans. Aggregate deposits (6.5 billion Bosnian convertible mark, BAM) were not much below the volume of loans (BAM 7 billion) at the end of September 2005.

Starting operation of the new tax system at the beginning of an election year was a heroic act indeed. It was a big step towards a better integrated country. The outcome in political terms is not yet predictable. No matter who will win the next elections, much will have to be done to build up structures as required for EU accession. BiH has joined the club of high-growth countries, but to join the European Union also, it will have to put immense effort into improving public governance.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 ¹⁾ | 2006 | 2007 |
|---|--------|---------|---------|---------|---------|---------|-----------------------|----------|-------|
| | | | | | | | | forecast | |
| Population, th pers., mid-year | 3725 | 3781 | 3798 | 3828 | 3832 | 3842 | 3845 | . | . |
| Gross domestic product, BAM mn, nom. | 8990.0 | 10050.0 | 10960.0 | 11651.1 | 12303.0 | 13439.8 | 14690 | 15880 | 17000 |
| annual change in % (real) | 10.0 | 5.5 | 4.5 | 5.5 | 3.0 | 6.0 | 6.5 | 6 | 6 |
| GDP/capita (EUR at exchange rate) | 1234 | 1359 | 1475 | 1556 | 1642 | 1789 | 1950 | . | . |
| GDP including NOE, BAM mn, nom. ²⁾ | 12802 | 14160 | 15410 | 16170 | 16954 | 17980 | 19650 | . | . |
| GDP/capita, incl. NOE (EUR at PPP - wiiw) | 4620 | 4880 | 5150 | 5350 | 5500 | 5770 | 6140 | . | . |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) ³⁾ | 8.0 | 7.9 | 4.9 | 5.7 | 5.1 | 12.1 | 11.0 | 10 | 10 |
| Net agricultural production, total | | | | | | | | | |
| annual change in % (real) | 4.1 | -23.5 | 11.3 | 1.2 | -7.3 | 7.1 | . | . | . |
| Reg employees total, th pers., end of period | 630.9 | 640.6 | 625.6 | 637.7 | 634.0 | 626.4 | 626 | . | . |
| annual change in % | -3.1 | 1.5 | -2.3 | 1.9 | -0.6 | -1.2 | -0.1 | . | . |
| Reg. unemployed, th pers., end of period | 409.3 | 421.2 | 422.2 | 441.9 | 459.6 | 491.3 | 523 | . | . |
| Reg. unemployment rate in %, end of period | 39.3 | 39.7 | 40.3 | 40.9 | 42.0 | 43.9 | 46 | 46 | 46 |
| Average gross monthly wages, BAM | 503 | 541 | 652 | 661 | 716 | 747 | 790 | . | . |
| annual change in % (real, net) ⁴⁾ | 9.7 | 4.0 | 14.8 | -0.6 | 7.3 | 3.4 | 3.2 ^{I-VIII} | . | . |
| Consumer prices, % p.a. ⁵⁾ | 5.6 | 4.9 | 3.2 | 1.3 | 1.1 | 0.7 | 2.9 | 2 | 1 |
| General government budget, in % of GDP | | | | | | | | | |
| Revenues | 57.7 | 53.8 | 49.7 | 44.0 | 43.2 | 41.5 | . | . | . |
| Expenditures | 65.5 | 60.7 | 53.1 | 44.2 | 42.4 | 39.7 | . | . | . |
| Deficit (-) / surplus (+), % GDP | -7.8 | -7.0 | -3.3 | -0.2 | 0.8 | 1.8 | . | . | . |
| Public debt in % of GDP | . | 58.8 | 48.2 | 42.2 | 34.0 | . | . | . | . |
| Current account, EUR mn ⁶⁾ | -470.6 | -446.3 | -841.6 | -1263.8 | -1539.5 | -1544.2 | -1650 | -1620 | -1600 |
| Current account in % of GDP | -10.2 | -8.7 | -15.0 | -21.2 | -24.5 | -22.5 | -22.0 | -20.0 | -18.4 |
| Gross reserves of CB excl. gold, EUR mn | 442.6 | 522.2 | 1378.7 | 1260.0 | 1421.7 | 1767.8 | 2015.7 ^{IX} | . | . |
| Gross external debt, EUR mn ⁷⁾ | 1914.7 | 2073.6 | 2260.6 | 2193.8 | 2054.2 | 2036.4 | 2185.1 ^{IX} | . | . |
| FDI inflow, EUR mn | 165.9 | 158.6 | 132.8 | 281.8 | 337.6 | 400.4 | 240 | . | . |
| Exports of goods, BOP, EUR mn ⁶⁾ | 780.7 | 1226.3 | 1268.1 | 1168.5 | 1303.0 | 1677.0 | 2100 | 2600 | 3200 |
| annual growth rate in % | 31.8 | 57.1 | 3.4 | -7.9 | 11.5 | 28.7 | 25 | 24 | 23 |
| Imports of goods, BOP, EUR mn ⁶⁾ | 3875.3 | 4226.7 | 4576.4 | 4692.2 | 4974.1 | 5354.4 | 6100 | 6600 | 7100 |
| annual growth rate in % | 14.9 | 9.1 | 8.3 | 2.5 | 6.0 | 7.6 | 14 | 8 | 8 |
| Exports of services, BOP, EUR mn ⁶⁾ | 435.3 | 488.4 | 555.9 | 552.0 | 601.4 | 666.5 | 780 | 900 | 1050 |
| annual growth rate in % | 6.0 | 12.2 | 13.8 | -0.7 | 8.9 | 10.8 | 17 | 15 | 17 |
| Imports of services, BOP, EUR mn ⁶⁾ | 267.2 | 302.0 | 311.6 | 332.3 | 366.5 | 367.7 | 370 | 380 | 400 |
| annual growth rate in % | 10.9 | 13.0 | 3.2 | 6.6 | 10.3 | 0.3 | 1 | 3 | 5 |
| Average exchange rate BAM/USD | 1.834 | 2.119 | 2.186 | 2.077 | 1.734 | 1.576 | 1.556 ^{I-X} | . | . |
| Average exchange rate BAM/EUR (ECU) | 1.956 | 1.956 | 1.956 | 1.956 | 1.956 | 1.956 | 1.956 | 1.96 | 1.96 |
| Purchasing power parity BAM/USD, wiiw ⁸⁾ | 0.651 | 0.675 | 0.688 | 0.682 | 0.686 | 0.693 | 0.692 | . | . |
| Purchasing power parity BAM/EUR, wiiw ⁸⁾ | 0.745 | 0.767 | 0.788 | 0.789 | 0.804 | 0.810 | 0.832 | . | . |

Note: BAM: ISO-Code for the Bosnian convertible mark.

1) Preliminary. - 2) GDP figures including the Non-Observed Economy (NOE) are based on IMF estimates. - 3) wiiw estimates based on weighted averages for the two entities (Federation BiH and Republika Srpska). - 4) wiiw calculation. - 5) Costs of living. - 6) Converted from the national currency. - 7) General government foreign debt. - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

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