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Bosnia and Herzegovina: solid economic growth and political unease – par for the course

Economic activities continue to expand in Bosnia and Herzegovina (BiH). Expansion is most evident in certain manufacturing sectors, construction, trade and other services. The country has benefited from the high demand on international markets for metallurgical products. This has had an impact on exports which are growing rapidly, even when compared to imports. Nonetheless, the gap in the trade balance, EUR 3.4 billion (2006), is inordinate for a country with a GDP of EUR 9.2 billion. On the other hand, the gap has lessened compared to previous years: a clear sign of improvement. Whereas in the period 2002-2003 exports covered only one quarter of imports, by 2006 the ratio stood at EUR 2.7 to 6.1 billion or 44%. In that year exports increased by 29%, although not all of that was real growth. Following the introduction of the VAT on 1 January 2006, a higher proportion of trade flows came into play in statistics. The figures for the period January-May 2007 point to a boom in machinery imports, as a result of which imports have expanded faster than exports (31% versus 20%, year-on-year).

As for the high trade deficits, some well-known as well as some less well-known sources have been contributory factors. Remittances from abroad are a comparatively well known source, but only in so far as they enter the country through official channels. Unregistered revenue from tourists (and quasi-tourists) plays a significant role. The same holds true for household and company borrowings (registered and unregistered) from abroad. The inflow of foreign direct investments has been modest; it is currently declining rather than rising.

FDI has never been a really strong factor in BiH. Despite this, in certain segments of the corporate sector foreign-owned enterprises play a major or even dominant role; this is particularly the case in commercial banking. Some foreign investors were fortunate enough to have paid only a modest entrance fee; hence, they do not rank high in FDI statistics. Were the number of foreign investors to be far greater, primarily in manufacturing, the country's export performance would be stronger, as the experience of many other countries has shown. Foreign investors still face manifold stumbling blocks – a host of different government bodies at different levels are intent upon justifying their existence and are eager to conserve a plethora of regulations to support them in their aspirations. Investors from neighbouring countries (Austria, Croatia and Slovenia) find their way around more easily, as is confirmed by the data. For those investors who have sussed out the rules of the game, BiH offers good business opportunities. Of course, even those investors suffer from the country being split into two economic spaces: a problem that has never been overcome. If a company is active in both parts of the country, it faces double the trouble on account of income tax issues, divergent rules and administrative constraints.

In both economic and other terms, BiH is a highly decentralized country. Its citizens are busy expanding their economic activities; this is plain to see in both the main cities (Sarajevo, Banja Luka, Mostar and Tuzla) and rural areas. New businesses and production plants are cropping up everywhere. Only the territories close to the eastern and south-eastern border are poor and still lag behind. The rural population falls into two categories: those who are participating in their country's new prosperity and the many who have not yet managed to do so. The latter group either lives off remittances from abroad – as distinct from social security payments – or eke out a living through subsistence farming. Possibly close to half of the population are smallholders working tiny plots of land. It is thus puzzling to see that the country is a large net importer of processed and unprocessed agricultural products: exports of agricultural produce and products amounted to EUR 55 million over the period January-May 2007 compared to imports over the same period amounting to EUR 432 million. A large proportion of the population suffer from some kind of social exclusion; for example, they have little chance of being offered a job or their access to public utilities is limited. Most people no longer live where they lived before the war; they are the victims most severely hit by social exclusion. BiH citizens are sometimes criticized for their lack of mobility – the exception being that many people are bent on finding a livelihood outside the country. However, even moving from one canton to another can cause a lot of problems; for example, it impinges on claims under the social security system. In fact, matters get much worse if an individual decides to move from one entity to the other. These factors contribute to unemployment. Information on the extent of unemployment is slowly improving. Undoubtedly, registration figures fail to provide a complete picture. LFS figures from April 2006 indicate an unemployment rate of some 30%. Some experts are convinced that even this figure is exaggerated. Of course, a high proportion of unregistered labour means that only a small proportion of the people are paying into the social security scheme. 533,000 persons were registered as unemployed in April 2007: some 17,000 more than the previous year.

In 2006, BiH households saw consumer prices leap by 7.2%: a side-effect of introducing VAT. Given that an index for the country as a whole is being worked on, the price index for each of the two entities (Federation of BiH and Republika Srpska) shows a one-off leap that started a few months prior to VAT being introduced only to end soon thereafter. Both before and after that leap, no inflationary pressure was to be discerned; hence, we can expect low inflation for 2007. ITA (the countrywide Indirect Tax Authority) revenues expanded comfortably. The poorer segments of society had to sacrifice a large share of their incomes to pay for increased prices of food, accommodation and public utilities.

The introduction of VAT hit the poorer segment of the population hard, while richer households may well have increased their rate of consumption. The marked increase in bank loans to households would seem to point in that direction. Nevertheless, it is unlikely that household consumption was the major engine of GDP growth in 2006. Investment – in

construction and new machinery – should have contributed to growth; exports undoubtedly did. The BiH Office of Statistics is currently working on a pioneer project directed towards the calculation of GDP expenditure categories. The Office will publish its findings later this year; the figures will relate to 2005 and 2006. This marks a first step towards charting hitherto unknown territory. Other uncharted areas remain: for example, the lack of reliable population figures. In that respect, one will have to wait until the first post-war census in 2011, to which support is being lent by EUROSTAT.

Large parts of the population are uneasy about the present state of affairs – for a variety of reasons. For some the reasons are poverty and recent losses in real incomes, others complain the persistent political *impasse*. The new BiH Council of Ministers, chaired by Nikola Špirić, is kept busy with internal squabbles; to date, it has produced little of substance. Whereas the EU and their BiH counterparts have managed to conclude the technical sections of the SAA, the political section has become the main hindrance. The EU is eager to see progress, but the whole thing has been spoilt by the dispute that has erupted over police reform: more an issue of wording than actual reform. In political terms, readiness to cooperate in BiH has reached an all-time low by post-war standards: a scary development for most people.

The BiH population will ultimately pay the bill for the lack of progress on reforms and integration. Their hope for a European style of life will materialize later than it would have otherwise. Preparing for accession to the EU calls for a tremendous effort, as well as much careful planning. BiH is far from being up-to-date in terms of adequate institutional structure. Should the EU decide to interpret and apply the rules strictly, it could take ages before BiH is ripe for membership. Were the open issues in the Balkans – especially the problem relating to the status of Kosovo – to be settled, it would certainly be a helpful move even where cooperation within the country and progress are concerned. At the economic level, private initiative is proving effective; the economy is likely to continue growing.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2002	2003	2004	2005	2006 ¹⁾	2006 1st quarter	2007	2007 forecast	2008
Population, th pers., mid-year	3828	3832	3843	3844	3843	.	.	.	.
Gross domestic product, BAM mn, nom.	12829	13443	14678	15791	17950	.	.	19700	21300
annual change in % (real)	5.5	3.0	6.0	5.5	6.2	.	.	6	6
GDP/capita (EUR at exchange rate)	1714	1794	1953	2100	2388	.	.	.	.
GDP including NOE, BAM mn, nom. ²⁾	16170	16954	17980	19320	20900	.	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	5290	5460	6240	6190	6330	.	.	.	.
Gross industrial production									
annual change in % (real) ³⁾	5.7	5.1	12.1	10.8	11.5	9.8	10.7	11	10
Net agricultural production, total									
annual change in % (real)	7.9	-7.5	20.3	-3.1	.	.	.	.	.
LFS - employed persons, th, avg. ⁴⁾	811	.	.	.	.
Reg employees total, th pers., end of period	637.7	634.0	638.4	642.4	652.8	643.1	661.1	.	.
annual change in %	1.9	-0.6	0.7	0.6	1.6	1.9	2.8	.	.
LFS - unemployed, th pers., average ⁴⁾	366.8	.	.	.	.
LFS - unemployment rate in %, average ⁴⁾	31.1	.	.	30	30
Reg. unemployment rate in %, end of period	40.9	42.0	43.2	44.2	44.8	44.5	44.7	.	.
Average gross monthly wages, BAM	660	717	748	798	869	840	.	.	.
annual change in % (real, net) ⁵⁾	-0.6	7.3	3.6	3.5	1.4	1.3	.	.	.
Consumer prices, % p.a. ⁶⁾	1.3	1.1	0.8	3.0	7.2	7.1	.	3.7	2
General governm.budget, nat.def., % GDP									
Revenues	40.0	44.8	43.4	44.1	.	.	.	.	.
Expenditures	40.1	44.0	41.7	41.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-0.1	0.8	1.7	2.6	2	.	.	0	0
Public debt in % of GDP	34.8	30.6	28.1	31.7	.	.	.	.	.
Current account, EUR mn ⁷⁾	-1252.7	-1438.7	-1443.1	-1716.5	-1043.7	-113.5	.	-1100	-1000
Current account in % of GDP	-19.1	-20.9	-19.2	-21.3	-11.4	.	.	-10.9	-9.2
Gross reserves of CB excl. gold, EUR mn	1260.0	1421.7	1767.8	2145.3	2761.2	2269.3	.	.	.
Gross external public debt, EUR mn	2193.4	2052.3	2061.4	2217.9	2074.5	2169.1	.	.	.
Gross external public debt in % of GDP	33.4	29.9	27.5	27.5	22.6	.	.	.	.
FDI inflow, EUR mn	281.8	337.6	534.0	420.6	337.8	86.3	.	.	.
FDI outflow, EUR mn	.	.	1.2	1.0	.	.	.	.	.
Exports of goods, BOP, EUR mn ⁷⁾	1168.6	1303.0	1677.0	2087.3	2687.3	563.3	.	3300	4000
annual growth rate in %	-7.9	11.5	28.7	24.5	28.7	31.5	.	23	21
Imports of goods, BOP, EUR mn ⁷⁾	4692.2	4974.1	5354.5	6092.9	6093.1	1133.7	.	6400	6800
annual growth rate in %	2.5	6.0	7.6	13.8	0.0	-1.0	.	5	6
Exports of services, BOP, EUR mn ⁷⁾	552.0	636.3	696.1	767.2	888.0	159.5	.	1000	1200
annual growth rate in %	-0.7	15.3	9.4	10.2	15.7	16.1	.	13	20
Imports of services, BOP, EUR mn ⁷⁾	320.2	339.2	349.3	371.5	402.3	62.0	.	430	460
annual growth rate in %	6.3	5.9	3.0	6.4	8.3	9.9	.	7	7
Average exchange rate BAM/USD	2.077	1.734	1.576	1.573	1.559	1.628	1.493	.	.
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⁾	0.689	0.686	0.632	0.681	0.708	.	.	.	.
Purchasing power parity BAM/EUR, wiiw ⁸⁾	0.798	0.811	0.750	0.812	0.859	.	.	.	.

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 BH and Republika Srpska). - 4) Data based on the first LFS April 2006. - 5) wiiw calculation. - 6) Costs of living. - 7) Converted from the national currency. - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

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