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Bosnia and Herzegovina: transfers and loans bolster economic advancement

Bosnia and Herzegovina (BiH) continues to import much and export little. In 2004, exports made up less than one third of imports: EUR 1.7 billion as against EUR 5.4 billion. Admittedly, throughout 2003 exports grew at a much faster rate than imports: 29% as against 8%; however, in absolute terms the increase in both was almost identical. The reliability of these figures is limited: they differ considerably from the trade figures published by the main trading partners; the monitoring of cross-border transport is still incomplete; and improper invoicing is probably widespread. Possibly, the trade deficit is smaller than suggested by the balance of payments figures.

According to the balance of payments for 2004, several factors contributed to covering the trade deficit of EUR 3.7 billion and increasing the country's currency reserves by EUR 0.3 billion. Trade in services recorded a surplus, with exports close to EUR 0.7 billion and imports close to EUR 0.4 billion. The balance of incomes recorded a surplus of roughly the same magnitude, whereas net current transfers were more substantial: EUR 1.5 billion. Capital transfers amounted to EUR 0.4 billion and foreign direct investment accounted for another EUR 0.4 billion, while other investment, mainly in the form of new loans, amounted to EUR 0.6 billion with errors and omissions of over EUR 0.4 billion. Should these balance of payments figures correspond (roughly) to reality, the reason for imports consistently outstripping exports by a factor of three lies in the massive inflow of transfers and new loans. Such inflows are likely to become scarcer during the next few years, so it is highly important to establish an appropriate infrastructure for more production of domestic value-added.

BiH was a net exporter in three commodity groups. Whereas trade in wood and wood products registered a large surplus in 2004, it shrank appreciably over the period January-May 2005 compared to the same period in the previous year. BiH is also a net exporter of arms and ammunition: thanks to a surge in exports expansion, the surplus took on substantial proportions in the period January-May 2005. In that same period the third surplus was registered in respect of miscellaneous products; however, this commodity group only accounts for an insignificant share in overall trade. Several commodity groups notorious for their deficits experienced major slumps: not surprisingly, the groups in question were fuels, textiles and apparel. In the case of two other commodity groups, animals and animal products and transport equipment, the reasons for the higher trade deficits are less obvious. Deficits in respect of vegetable products and prepared foodstuffs, chemical products as well as machinery and mechanical appliances were significantly reduced.

In countries with a weak industrial structure, low wages tend to boost the international competitiveness of those producing tradables and attract newcomers. As mentioned in the *wiiw* report of March 2005¹, gross monthly wages in BiH are as high as those in Slovakia; hence, far in excess of wages in Bulgaria and Romania. This has since become an issue in BiH. Central bank spokesmen are now insistent that the fixed peg, 1,965 BAM per euro, is not under threat, pointing out that the central bank has accumulated a large stock of currency reserves. Under the circumstances this standpoint seems quite justified, despite the tendency of the present peg regime to keep the number of internationally competitive BiH companies at a low level. Aluminium and steel manufacture might prove the exception.

BiH will continue to enjoy macroeconomic stability in terms of prices and the exchange rate. The GDP will continue to grow by around 5% annually; in 2006 it might even touch 6%, should Mital Steel expand steel production in Zenica to the level projected and thus stimulate business activities over a broader range. In any event, the situation on the labour market is unlikely to change substantially in the short and medium term; this means that official labour will remain scarce and unofficial labour plentiful. It thus remains an open question to which degree, at a figure of 40%, the level of unemployment is over- or underestimated.

The pace of institutional changes is slow. If changes are to materialize at all, massive pressure from international bodies and foreign powers is still required. In the meantime, however, the authorities have postponed until 1 January 2006 the new value-added tax scheme that was to be introduced across the country. A draft for a new income tax scheme has also been tabled. This is of fundamental importance to the Federation of BiH. Hitherto, each canton has had its own tax regime; however, it may take years for the reform to come through.

The government of Republika Srpska vetoed a policy reform which would have deprived the interior ministry of its power, despite the EU having made the initiation of talks on a Stabilization and Association Agreement (SAA) contingent upon that particular reform being introduced. For the time being Bosnia and Herzegovina thus remains in legal limbo with the European Union. As for the countries in the West Balkans in general, the EU has entered into a debate on drawing up regulations pertaining to an Instrument for Pre-Accession Assistance. The draft lists BiH as a potential candidate country. Up until the time when BiH gains candidate status, the proposal does not envisage increasing the volume of assistance that the country currently receives under the umbrella of the CARDS programme. It is not clear when a SAA will be signed; however, it is patently obvious that the shift from SAA to candidate status will take a number of years.²

¹ *wiiw Research Reports*, No 314, March 2005, p. 89.

² Breaking out of the Balkan Ghetto: Why IPA should be changed, 1 June 2005, http://www.esiweb.org/pdf/esi_document_id_66.pdf.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2000	2001	2002	2003	2004 ¹⁾	2004 1st quarter	2005	2005 forecast	2006
Population, th pers., mid-year	3781	3798	3828	3832	3832	.	.	.	.
Gross domestic product, BAM mn, nom.	10050	10960	11650	12303	12980	.	.	13700	14600
annual change in % (real)	5.5	4.5	5.5	3.0	5.0	.	.	5	6
GDP/capita (EUR at exchange rate)	1359	1475	1556	1642	1732	.	.	.	.
GDP including NOE, BAM mn, nom. ²⁾	14160	15410	16170	16954	17886	.	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	4910	5200	5490	5610	6010	.	.	.	.
Gross industrial production									
annual change in % (real) ³⁾	7.9	4.9	5.7	5.1	12.1	15.7	4.0	7	10
Employees total, th pers., end of period	640.6	625.6	637.7	634.0	635.7 ⁴⁾
annual change in %	1.5	-2.3	1.9	-0.6	0.3 ⁴⁾
Reg. unemployed, th pers., end of period	421.2	422.2	441.9	459.6	476.2 ⁴⁾
Reg. unemployment rate in %, end of period	39.7	40.3	40.9	42.0	42.8 ⁴⁾	.	.	42	42
Average gross monthly wages, BAM	541	652	661	716	747	733	.	.	.
annual change in % (real, net) ⁴⁾	4.0	14.8	-0.6	7.3	.	.	.	.	.
Retail prices, % p.a.	4.8	3.1	0.4	0.6	0.4	0.4	.	0.5	0.5
General governm.budget, nat.def., % GDP									
Revenues	53.8	49.7	44.1	43.2	.	.	.	.	.
Expenditures	60.7	53.1	44.2	42.4	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-7.0	-3.3	-0.2	0.8	.	.	.	.	.
Public debt in % of GDP	58.8	48.2	42.2	34.0	.	.	.	.	.
Current account, EUR mn ⁵⁾	-502.5	-903.0	-1318.8	-1539.5	-1544.8	-228.6	.	-1500	-1400
Current account in % of GDP	-9.8	-16.1	-22.1	-24.5	-23.3	.	.	-21.4	-18.8
Gross reserves of CB excl. gold, EUR mn	522.2	1378.7	1260.0	1421.7	1767.8	1541.8	1756.3	.	.
Gross external debt, EUR mn ⁶⁾	2073.6	2260.6	2193.8	2054.2	2036.4	.	.	.	.
FDI net inflow, EUR mn	158.6	132.8	281.8	337.6	400.4	47.1	.	.	.
Exports of goods, BOP, EUR mn ⁵⁾	1226.3	1268.1	1168.5	1303.0	1676.9	357.3	.	2000	2400
annual growth rate in %	57.1	3.4	-7.9	11.5	28.7	37.3	.	19	20
Imports of goods, BOP, EUR mn ⁵⁾	4226.7	4576.4	4692.2	4974.1	5354.4	1051.0	.	5600	5900
annual growth rate in %	9.1	8.3	2.5	6.0	7.6	0.6	.	5	5
Exports of services, BOP, EUR mn ⁵⁾	472.4	539.4	536.8	601.4	666.5	125.6	.	.	.
annual growth rate in %	11.1	14.2	-0.5	12.0	10.8	12.5	.	.	.
Imports of services, BOP, EUR mn ⁵⁾	307.5	318.5	339.5	366.5	367.7	61.5	.	.	.
annual growth rate in %	12.8	3.6	6.6	7.9	0.3	3.7	.	.	.
Average exchange rate BAM/USD	2.119	2.186	2.077	1.734	1.575	1.565	1.491	.	.
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 ⁷⁾	0.673	0.686	0.681	0.686	0.676	.	.	.	.
Purchasing power parity BAM/EUR, wiiw ⁷⁾	0.762	0.780	0.769	0.788	0.777	.	.	.	.

Notes: BAM: ISO-Code for the convertible mark in Bosnia and Herzegovina.

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) wiiw calculation. - 5) Converted from the national currency to EUR at the official exchange rate. - 6) General government foreign debt. - 7) Rough estimates based on World Bank and wiiw; price level presumably higher.

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