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Bosnia and Herzegovina: economic performance better than its reputation

It is a broadly shared guess that the economy of Bosnia and Herzegovina (BiH) is growing continuously by slightly over 5% per year. The statistical office calculates nominal GDP values by aggregating the gross domestic products of the two entities Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS). The contributions of the individual industries to GDP are the basis of these calculations; estimates of demand-related categories such as private consumption and investment and also estimates based on income categories are lacking. A calculation of the GDP deflator is also lacking, thus an official real GDP growth rate does not exist either. New efforts to change this situation are under way, also aimed at improving the preconditions for future cooperation with the EU and gradual integration. Already in the past several years, the EU has funded projects designed to improve national accounting and statistics. Forthcoming new projects are of a larger scale. The problem is that the key to success will consist in achievements in terms of harmonization of methodologies of the two entities. Nobody will be able to push this through easily. The best strategy would be to equip a state-level institution – or a consortium of such institutions – with sufficient capacity and authority to produce official and reliable state-level figures. Such an institution, however, would only be able to raise confidence in its data if it combines methodological strength with visible independence from political influences.

Within an important segment of the corporate sector, enterprises enjoy a protected position on the domestic market whereas foreign markets play hardly any role. Electricity production and distribution as well as telecommunications are prominent examples. Compared to EU countries these sectors have a higher share in the GDP and enjoy more political influence. Their managements live in symbiosis with the political sphere. This remains the case also in Republika Srpska, where the government sold the telecommunications company to its Serbian equivalent. In another type of companies managers are interested in unrestricted access to foreign input markets and at the same time also in borderless access to sales markets. Yet this type of internationally competitive enterprises is underdeveloped in BiH; their influence on politics is limited. Regarding tradables, BiH is weak in producing, but strong in importing. In the past several years, export revenues covered merely about one third of import expenditures; more recently, the ratio has started moving closer to 50%. This means that an important gradual improvement is going on. The metal sector plays a positive role in this context – Aluminium Mostar and Mittal Steel in Zenica play a key role, with many small and medium-sized companies expanding as well. Some of them are producing inputs for EU-based car makers. This type of activity could face hard times in the future, as tough international competition is likely to challenge the traditional centres of European car industry. As a rule, the metal industry has

not yet reached pre-war production volumes. The production of tradables remains limited mainly to semi-finished goods. This is also visible in wood processing, which is another traditional stronghold of BiH manufacturing. Particularly weak is the food industry: BiH imports most of the food that people consume. Other countries' (including the EU) subsidizing practices are one of the reasons, whereas exports suffer from the fact that the government has never developed supportive institutional settings.

Wages in BiH are higher than elsewhere in the Balkans, disregarding Croatia. The same is true for average household incomes. True, remittances from family members working outside the country contribute to this fact. However, also the citizens of neighbouring countries enjoy such support. Much of the money transfers enters the country through unofficial channels, so that the balance of payments registers large amounts of money under the errors and omissions section. A recent IMF study has articulated doubts about the accuracy of the central bank's balance of payments figures. Better monitoring practices would probably produce evidence that imbalances are less dramatic than present figures are suggesting.

Likewise, improved monitoring practices on the labour market would produce evidence that BiH is not such an extreme outlier as currently published figures would indicate. A recent labour force survey concluded that in April 2006 the rate of unemployment was 31% instead of around 45% as registration-based figures suggest. The latter figure seems to reflect an exaggerated number of unemployed persons as well as an underestimation of the number of employed persons. Even the result of the labour force survey has raised doubts; in fact, the rate of unemployment could be significantly below 30%. In any case, the number of persons with a regular job is low relative to the number of citizens. Consequently, the population faces serious social security problems, and official labour is burdened with high contributions to the social security system.

When on 1 January 2006 the government introduced a uniform value-added tax rate of 17%, the poorer segment of the population faced a substantial decline in real incomes. Previously, for most of their consumption the rate of indirect taxation had been significantly below 17% if not even zero. The price index performed a one-off jump and then stabilized at the new higher level. In the absence of hikes in energy prices, it might even have fallen in the course of the year 2006. The rate of inflation for 2006 was 7.1%. In real terms, the official economy's wages hardly exceeded the level of 2005. In 2007, inflation will again be moderate whereas wages will start growing again. The public sector profited from the new tax system in terms of higher revenues, whereas ruling politicians lost in terms of popularity. The elections of October 2006 changed the political landscape. Milorad Dodik (from the Independent Social Democrats Party) now holds an absolute majority in the parliament of Republika Srpska and an unchallenged position as RS prime minister. In

addition, his party-fellow Nikola Spiric has become prime minister on the state level, or, as this position is called officially, chairperson of the Council of Ministers.

In economic terms, Bosnia and Herzegovina has become a 'normal' country, and by Balkan standards the citizens are on average not that poor. Economic activities are expanding continuously, and this is likely to go on further. Also in terms of financial stability the situation is quite satisfactory. Inflation will be low again in 2007; interest rates are high, but declining. The government's budget is more or less balanced, and public debt is low compared to the GDP; this may change, as there are plans to acknowledge different types of claims as payables. The currency is stable thanks to a well-functioning currency board arrangement. The performance could be even better, would the government – or the many governments the country has – be supportive to the corporate sector in general and to the producers of tradables in particular. Then, much more foreign direct investment could flow into the country and would upgrade all kinds of skills and establish new links to the world economy.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007 forecast	2008 forecast
Population, th pers., mid-year	3781	3798	3828	3832	3843	3844	3844	.	.
Gross domestic product, BAM mn, nom.	10908.0	11909.0	12650.0	13324.0	14658.0	15749.0	17800	19600	21100
annual change in % (real)	5.5	4.5	5.5	3.0	6.0	5.5	5.3	5.7	5.5
GDP/capita (EUR at exchange rate)	1475	1603	1690	1778	1950	2095	2368	.	.
GDP including NOE, BAM mn, nom. ²⁾	14160	15410	16170	16954	17980	19320	21800	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	4860	5120	5320	5460	6180	6150	6460	.	.
Gross industrial production									
annual change in % (real) ³⁾	7.9	4.9	5.7	5.1	12.1	10.8	11.5	11	11
Net agricultural production, total									
annual change in % (real)	-21.7	8.2	7.9	-7.5	20.3	-3.1	.	.	.
LFS - employed persons, th, avg. ⁴⁾	813	.	.
Reg employees total, th pers., end of period	640.6	625.6	637.7	634.0	638.4	642.4	651.6 ^x	.	.
annual change in %	1.5	-2.3	1.9	-0.6	0.7	0.6	1.2 ^x	.	.
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	39.7	40.3	40.9	42.0	43.2	44.2	45.6 ^x	.	.
Average gross monthly wages, BAM	539	598	660	717	748	798	874	.	.
annual change in % (real, net) ⁵⁾	3.4	15.4	-0.6	7.3	3.6	3.5	1.8	.	.
Consumer prices, % p.a. ⁶⁾	4.9	3.2	1.3	1.1	0.7	2.9	7.4	4	2
General governm. budget, nat.def., % GDP									
Revenues	49.5	45.7	40.6	45.2	43.5	44.2	.	.	.
Expenditures	55.9	48.9	40.7	44.4	41.8	41.6	.	.	.
Deficit (-) / surplus (+), % GDP	-6.4	-3.2	-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⁾	-429.5	-833.3	-1252.7	-1438.7	-1482.7	-1757.6	-1800	-1750	-1700
Current account in % of GDP	-7.7	-13.7	-19.4	-21.1	-19.8	-21.8	-19.8	-17.5	-15.8
Gross reserves of CB excl. gold, EUR mn	522.2	1378.7	1260.0	1421.7	1767.8	2145.3	2900	.	.
Gross external public debt, EUR mn	2073.6	2260.2	2193.4	2052.3	2061.4	2217.9	2200	.	.
Gross external public debt in % of GDP	37.2	37.1	33.9	30.1	27.5	27.5	24	.	.
FDI inflow, EUR mn	158.6	132.8	281.8	337.6	534.0	420.6	350	.	.
FDI outflow, EUR mn	1.2	1.0	.	.	.
Exports of goods, BOP, EUR mn ⁷⁾	1226.3	1268.1	1168.6	1303.0	1677.0	2087.3	2700	3400	4200
annual growth rate in %	57.1	3.4	-7.9	11.5	28.7	24.5	29	26	24
Imports of goods, BOP, EUR mn ⁷⁾	4226.7	4576.4	4692.2	4974.1	5354.5	6092.9	6700	6800	7000
annual growth rate in %	9.1	8.3	2.5	6.0	7.6	13.8	10	1	3
Exports of services, BOP, EUR mn ⁷⁾	488.4	555.9	552.0	636.3	725.3	817.0	900	1000	1100
annual growth rate in %	12.2	13.8	-0.7	15.3	14.0	12.6	10	11	10
Imports of services, BOP, EUR mn ⁷⁾	285.6	301.4	320.2	339.2	349.3	371.9	400	430	460
annual growth rate in %	6.9	5.5	6.3	5.9	3.0	6.5	8	8	7
Average exchange rate BAM/USD	2.119	2.186	2.077	1.734	1.576	1.573	1.567	.	.
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⁾	0.678	0.692	0.685	0.686	0.638	0.685	0.713	.	.
Purchasing power parity BAM/EUR, wiiw ⁸⁾	0.771	0.793	0.794	0.811	0.757	0.817	0.878	.	.

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.