

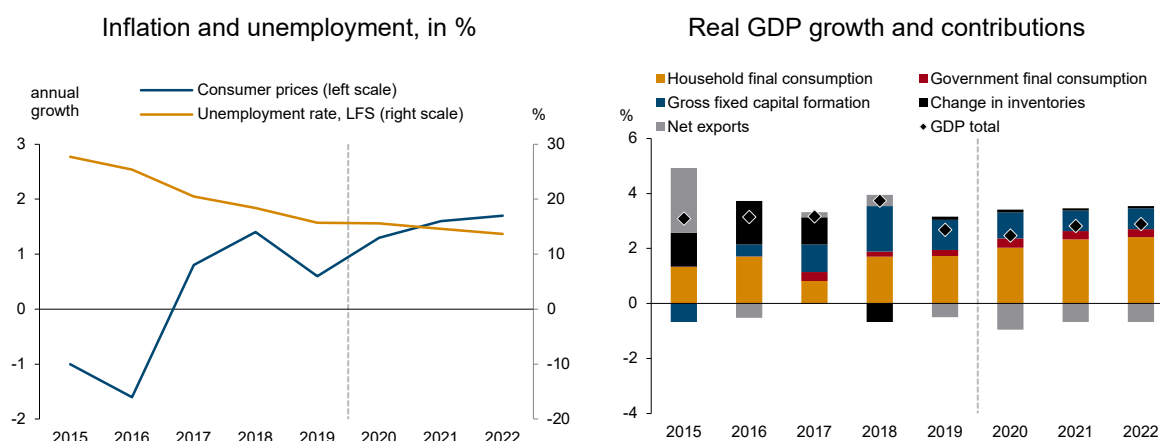


## BOSNIA AND HERZEGOVINA: Fiscal consolidation amidst a potential migration crisis

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After previous setbacks following the global financial crisis, the Bosnian economy is expanding steadily, with an expected growth rate of around 2.7% in 2020 and 3% p.a. in the period 2021-2022. The official unemployment rate is expected to decline further, from 30% in 2020 to around 28.5% in 2022; however, this will partly be a result of the great 'brain drain' and the withdrawal of workers from the labour market. Even though growth continues to be stable, the newly formed central government may yet be challenged by the emergence of a potential migration crisis in spring/summer 2020.

**Figure 6.3 / Bosnia and Herzegovina: Main macroeconomic indicators**



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**Despite political uncertainties in 2019, economic growth remains stable.** Bosnia and Herzegovina's economy is expanding steadily, with an expected growth rate of around 2.7% in 2020 and 3% p.a. in the period 2021-2022. The economy is being driven by investments in the energy sector, construction and manufacturing. Especially remittances from abroad and tourism, combined with higher wages, will boost private consumption to an average of 3% p.a. in the period 2020-2022, which will further contribute to BiH's growth. The country's exports of goods and services will not exceed 4.5% p.a. in the period 2020-2022, due to only moderate sales of intermediate products, especially from its aluminium industry.

**The main objective of Bosnia and Herzegovina's fiscal policy in the period 2020-2022 is to strengthen fiscal stability and sustainability through a reduction in tax debt and increased taxpayer discipline, as well as through the creation of a more favourable business environment.** The adoption by the Council of Ministers of a state budget for 2020 will facilitate the arrangement with the IMF dating from 2016, and will enable the unfreezing of a EUR 553.3 million loan to support economic reforms. The IMF wants BiH to reorient its fiscal policy, by reducing current spending in order

to create room for much-needed investment in infrastructure. The funds provided by the IMF lending programme will have a positive effect on the budget, which is why the deficit will narrow to an average of 0.4% of GDP in the period 2020-2022. A decline in global oil prices and higher prices for aluminium (BiH's main export good) will mean that the country's current account deficit decreases to 3.5% p.a. in 2020-2021, before rising again to 3.7% p.a. in the period 2022-2024. With high emigration and a large diaspora, remittances will remain strong and will continue to finance parts of the country's trade deficit.

**Projects to expand Bosnia and Herzegovina's transport and energy infrastructure provide incentives for foreign investments beyond 2020.** With the formation of a new government, it is now expected that government expenditure will increase by around 1.6% p.a. in 2020 and 2021. This increase in public spending will likely focus on the energy and security sectors (the National Border Police has repeatedly urged the government to invest in national security, due to the increased influx of refugees and migrants into BiH). Projects to expand the transport and energy infrastructure are attractive, thanks to funding from the European Union. The government aims at increasing the share of renewable energy. Those policies offer incentives to invest in the energy sector beyond 2020, especially to China and Russia. In 2019, Bosnia and Herzegovina started to work on an integrated National Energy and Climate Plan for the period 2021-2030, in order to align itself with EU energy and climate policies. This long-term energy strategy further facilitates major investments from the European Union and elsewhere.

**The tourism sector is expected to grow in BiH and to offer further potential in 2021-2022, with Sarajevo becoming increasingly popular with foreign visitors and investors.** It is evident that Sarajevo Canton is economically one of the strongest regions in Bosnia and Herzegovina. In the last five years, the capital has gained in popularity as a European holiday destination – including for the Arab middle class, due to its Muslim population. Tourism has been helped not just by Sarajevo's relatively favourable prices, but also by BiH's liberal visa policy, which means that people from various Arab countries (and from Russia) do not need a visa to enter the country.

**Bosnia and Herzegovina continues to suffer from negative demographic development and an exodus of workers from the country's labour market.** In the last five years, foreign investors have opened several companies in Bosnia and Herzegovina, in particular in Una-Sana Canton. However, they often struggle to find and employ skilled labour. The health sector in general also suffers from a lack of trained medical personnel, due to Bosnia's 'brain drain'. The overall problem with the withdrawal of skilled workers from Bosnia's labour market is visible not only in the shortage of labour, but also in its quality. This negative trend encourages corruption and means a lack of competition for high-end positions, which contributes to the inefficiency of both the private and the public sector. Due to the country's dysfunctional political system, the central government lacks effective policies to properly address BiH's brain drain.

**After more than a year of political deadlock, the appointment of Bosnia and Herzegovina's new government will open the way for progress towards EU candidate status and socioeconomic reforms in 2020.** However, an overblown and inefficient government apparatus means it is unlikely that those reforms will be carried out swiftly in 2020. Bosnia and Herzegovina is a potential candidate country for the EU, and its government will continue to try to fulfil all the requirements for candidate status. Nevertheless, the political disparities within BiH's separate entities – the Republika Srpska and the Federation of Bosnia and Herzegovina – and the country's constitution (which is desperately in need of

reform) make it unlikely that Bosnia and Herzegovina will achieve EU candidate status in the foreseeable future.

**In 2018, the border between BiH and Croatia became one of the last gateways to northern Europe, which is why more than 60,000 migrants and refugees have registered in the country in the past two years.** It is expected that the number of migrants and refugees will increase substantially in 2020, posing a challenge to the newly formed government in the medium term. In particular the failure to form a government throughout 2019 meant that all efforts to coordinate an effective response to the increased influx of migrants and refugees failed. Due to a lack of proper communication between local administrations and central government, local authorities continue to be overwhelmed by refugees. In January 2020, the Border Police still lacked proper funding and equipment to stop migrants from illegally entering the country.

**The government faces a potential migrant crisis in 2020, aggravated by Croatia's closed-border policy.** The situation on the border with Croatia is also creating tension between the inhabitants of Una-Sana Canton (in particular the city of Bihac) and incoming refugees. The authorities are struggling to ensure proper accommodation for refugees. Tensions continue to run high between the BiH authorities and refugees, as was seen in December 2019, when the infamous Vucjak camp near the border with Croatia was closed down and migrants, eager to reach the EU, protested against their resettlement. As of 2020, the situation of refugees has improved marginally, thanks to the construction of the new Usivak camp, near Sarajevo. However, the Border Police maintains that Bosnia and Herzegovina is likely to face another migrant wave in spring. The new government has yet to develop a proper plan on how to deal with any fresh influx of migrants and refugees. A potential migration crisis could further lead to the emergence of a shadow economy: business owners may be tempted to employ refugees who are not legally able to work in BiH, paying them low wages and thereby swamping Bosnia's labour market with cheap labour.

**Table 6.3 / Bosnia and Herzegovina: Selected economic indicators**

	2015	2016	2017	2018	2019 <sup>1)</sup>	2020	2021 Forecast	2022
Population, th pers., average	3,518	3,511	3,504	3,496	3,500	3,490	3,485	3,480
Gross domestic product, BAM mn, nom. <sup>2)</sup>	28,589	29,904	31,376	33,444	34,500	35,800	37,400	39,100
annual change in % (real)	3.1	3.1	3.2	3.7	2.7	2.5	2.8	2.9
GDP/capita (EUR at PPP) <sup>2)</sup>	8,800	9,000	9,200	9,900	10,300	.	.	.
Consumption of households, BAM mn, nom. <sup>2)</sup>	23,095	23,560	24,200	25,144	25,880	.	.	.
annual change in % (real)	1.6	2.1	1.0	2.2	2.3	2.7	3.1	3.2
Gross fixed capital form., BAM mn, nom. <sup>2)</sup>	5,097	5,189	5,653	6,310	6,720	.	.	.
annual change in % (real)	-3.5	2.5	5.8	9.2	5.8	5.0	4.0	4.0
Gross industrial production								
annual change in % (real)	3.1	4.4	3.2	1.6	-5.3	2.3	3.5	4.0
Gross agricultural production <sup>3)</sup>								
annual change in % (real)	12.6	12.0	4.1	2.3	2.0	.	.	.
Construction output total								
annual change in % (real)	1.7	-1.9	-1.1	0.4	-2.1	.	.	.
Employed persons, LFS, th, April	821.5	801.1	815.7	822.4	802.9	810	820	820
annual change in %	1.2	-2.5	1.8	0.8	-2.4	1.0	0.7	0.5
Unemployed persons, LFS, th, April	314.7	272.9	210.7	185.5	149.4	150	140	130
Unemployment rate, LFS, in %, April	27.7	25.4	20.5	18.4	15.7	15.6	14.6	13.7
Reg. unemployment rate, in %, eop	42.9	40.9	38.7	34.7	32.6	.	.	.
Average monthly gross wages, BAM	1,289	1,301	1,321	1,363	1,421	1,470	1,510	1,550
annual change in % (real, gross)	1.0	2.5	0.8	1.7	3.7	2.0	1.3	1.0
Average monthly net wages, BAM	830	838	851	879	921	960	990	1,020
annual change in % (real, net)	1.0	2.6	0.7	1.9	4.2	2.5	1.3	1.1
Consumer prices, % p.a.	-1.0	-1.6	0.8	1.4	0.6	1.3	1.6	1.7
Producer prices in industry, % p.a.	0.6	-2.1	3.0	3.5	0.1	2.0	2.2	2.5
General governm.budget, nat.def., % of GDP								
Revenues	43.0	42.7	43.1	43.1	42.1	42.5	42.6	42.6
Expenditures	42.3	41.5	40.5	40.7	41.1	42.0	42.0	42.0
Deficit (-) / surplus (+)	0.7	1.2	2.6	2.3	1.0	0.5	0.6	0.6
General gov.gross debt, nat.def., % of GDP	41.9	40.4	36.1	34.2	31.7	28.0	27.0	26.0
Stock of loans of non-fin.private sector, % p.a.	2.0	3.5	7.3	5.5	6.6	.	.	.
Non-performing loans (NPL), in %, eop	13.7	11.8	10.0	8.8	7.5	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	.	.	.	.	.	.	.	.
Current account, EUR mn <sup>5)</sup>	-741	-720	-697	-633	-910	-970	-980	-1,030
Current account, % of GDP	-5.1	-4.7	-4.3	-3.7	-5.2	-5.3	-5.1	-5.1
Exports of goods, BOP, EUR mn <sup>5)</sup>	3,679	3,937	4,776	5,327	5,270	5,570	5,870	6,170
annual change in %	5.1	7.0	21.3	11.5	-1.1	5.6	5.4	5.1
Imports of goods, BOP, EUR mn <sup>5)</sup>	7,348	7,561	8,568	9,158	9,340	9,870	10,410	10,960
annual change in %	-2.4	2.9	13.3	6.9	2.0	5.7	5.5	5.3
Exports of services, BOP, EUR mn <sup>5)</sup>	1,515	1,621	1,774	1,876	1,970	2,130	2,300	2,480
annual change in %	20.9	7.0	9.5	5.7	5.0	8.3	8.0	8.0
Imports of services, BOP, EUR mn <sup>5)</sup>	514	530	583	606	637	670	700	730
annual change in %	33.2	3.2	10.0	3.9	5.1	4.8	4.8	4.8
FDI liabilities, EUR mn <sup>5)</sup>	345	284	415	412	450	450	.	.
FDI assets, EUR mn <sup>5)</sup>	85	3	85	-17	40	10	.	.
Gross reserves of NB excl. gold, EUR mn <sup>5)</sup>	4,307	4,768	5,293	5,835	6,311	.	.	.
Gross external debt, EUR mn <sup>6)</sup>	7,937	8,379	8,695	9,251	9,800	10,100	10,400	10,800
Gross external debt, % of GDP <sup>6)</sup>	54.3	54.8	54.2	54.1	55.6	55.2	54.4	54.0
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate from 2017. - 4) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 5) Converted from national currency. - 6) Based on IMF estimates.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.