

Zlatko Bosnić

## Bosnia and Herzegovina's economic boom

The economy is booming in Bosnia and Herzegovina (BiH): most visibly in the construction sector – public and private, urban and rural, official and grey. In the manufacturing sector, a trend towards specialization in metallurgy is to be discerned, with a ripple effect on mining and quarrying. The generation of electricity continues to contribute significantly to the GDP; the transport sector is also growing. Trade has become a very important and rapidly expanding contributor to the GDP; its share in total GDP is scarcely less than that of manufacturing. This is a trait common to less developed countries. It is also accompanied by a pronounced and ever deeper divide between the recently emerging small class of 'new rich' and the broad masses of 'new poor'.

Trade as a key sector in tandem with weak manufacturing corresponds to the image of a society that imports much and exports little. In 2005 imports of goods amounted to EUR 6 billion; exports to EUR 2 billion. The country can afford this skewed life-style given the massive support, mainly on a private basis, that it enjoys from abroad. The transfers recorded in the balance of payment statistics cover but a fraction of the total inflow. Most people prefer to use informal and invariably less costly conduits to transfer funds. Many of the incoming remittances feed into imports; insofar as this is the case, they have no impact at all on the GDP. They do, however, push household expenditures up to a level equal or higher than the GDP as a whole. It is unclear whether this is actually the case as really reliable GDP estimates are not available. National accounts are still not fully developed; official GDP estimates could well be 'under-estimates'. For its part, however, BiH no longer creates the impression of being a country with a GDP per capita as low as some EUR 2000<sup>1</sup>. From a political viewpoint, there may be little incentive to refrain from citing underestimates; low GDP figures may well prolong the grace period that international financial institutions grant when it comes to servicing foreign debt. If indeed they do underestimate ongoing economic activities, low GDP figures might prove costly in another way. Drawing a picture of the economy gloomier than reality might discourage investment, domestic and foreign.

As figures for the first quarter of 2006 confirm, foreign direct investment shows a shrinking tendency. Companies already in situ tend to reinvest part of their profits; newcomers, however, are rare. For many reasons, BiH is not very competitive as a location for greenfield investment. At the same time, scope for acquiring existing plants is limited, as privatization has almost come to a standstill. Privatizing companies capable of attracting

---

<sup>1</sup> That figure is derived from calculations based on exchange rates, whereas calculations using the wiiv purchasing power estimates would yield a figure of some EUR 4600: albeit still on the low side.

foreign capital has met with little enthusiasm. Prominent examples are telecom companies and electricity suppliers. In both cases, the industry is split into three along ethnic lines.

At the beginning of 2006, BiH introduced value-added tax (VAT); it comprised a flat rate of 17% on all items. From a technical point of view, it proved a success; initial data point to a substantial increase in the revenue accruing to the Indirect Tax Authority. The reform may have reinforced taxpayer discipline; ultimately, however, it may also imply higher taxation on sales. In the final months of 2005, households and enterprises alike went on a shopping spree purchasing imported goods, whereafter imports in the first months of 2006 were unusually low. Exports did not display any such disruption. All these developments are very much in line with those in other countries in the region, such as Croatia, Macedonia or Serbia and Montenegro.

From a political point of view, introducing VAT has increased the likelihood of the parties in power losing votes in the elections scheduled for 1 October 2006. The previous indirect tax regime levied different tax rates on different products. For example, basic food or medicines were not taxed at all. Not surprisingly, the new rate (17%) has brought about a major increase in consumer prices. It had already become visible in the last quarter of 2005 only to gain additional momentum when the world market prices for mineral oil took off. Compared to mid-2005, the consumer price index in February 2006 (or, more precisely, the cost of living index as its substitute) rose by about 10%. From that month onwards, the index began to drop slightly. It would thus appear that the inflationary impact of introducing VAT has come to an end. Even if these slight month-on-month declines continue, the index throughout 2006 will still be much above the values for corresponding months in 2005. As a result, for 2006 as a whole an inflation rate of less than 5% is unlikely. Should public utilities go up in price as rumoured or oil prices continue to surge, the rate of inflation could easily rise to 7% or 8%. The poorer segment of the population has experienced a decline in real income; the government's attempts to offset this at various levels of government have not been firm enough to allay fears and resentment.

In economic terms, we can expect 'more of the same' for the future. Official GDP growth is likely to remain strong; in terms of growth, exports will continue to outstrip imports with the trade deficit possibly stabilizing at around EUR 4 billion: the figure for 2005. The IMF will provide for the development of the public sector's budget, so that larger deficits are unlikely to occur. The handling of internal public debt or, more exactly, of claims that generate debt will remain a major topic of concern. The EU will continue its efforts to support the country's gradual integration into European structures and further the adoption of the *acquis*. Whether a major change takes place on the political stage or not, reforms will continue to encounter all kinds of obstacles. In other words, the difficult political situation will continue to have an adverse impact on economic developments.

Table BA

## Bosnia and Herzegovina: Selected economic indicators

	2001	2002	2003	2004	2005 <sup>1)</sup>	2005 1st quarter	2006	2006 forecast	2007
Population, th pers., mid-year	3798	3828	3832	3842	3845	.	.	.	.
Gross domestic product, BAM mn, nom.	10960.0	11651.1	12303.0	13497.0	14750.0	.	.	16570	18270
annual change in % (real)	4.5	5.5	3.0	6.0	5.5	.	.	6	6
GDP/capita (EUR at exchange rate)	1475	1556	1642	1796	1961	.	.	.	.
GDP including NOE, BAM mn, nom. <sup>2)</sup>	15410	16170	16954	17980	19320	.	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	5140	5340	5500	5780	5990	.	.	.	.
Gross industrial production									
annual change in % (real) <sup>3)</sup>	4.9	5.7	5.1	12.1	10.5	4.1	9.7	10	10
Net agricultural production, total									
annual change in % (real)	11.3	1.2	-7.3	7.1	.	.	.	.	.
Reg employees total, th pers., end of period	625.6	637.7	634.0	626.4	630.8	630.9	628.0	.	.
annual change in %	-2.3	1.9	-0.6	-1.2	0.7	1.3	-0.5	.	.
Reg. unemployed, th pers., end of period	422.2	441.9	459.6	491.3	524.1	499.9	530.0	.	.
Reg. unemployment rate in %, end of period	40.3	40.9	42.0	43.9	45.4	44.2	45.8	46	46
Average gross monthly wages, BAM	598	660	717	748	793	774.3	840.3	.	.
annual change in % (real, net) <sup>4)</sup>	15.4	-0.6	7.3	3.6	3.0	.	.	.	.
Consumer prices, % p.a. <sup>5)</sup>	3.2	1.3	1.1	0.7	2.9	.	.	6	4
General government budget, in % of GDP									
Revenues	49.7	44.0	43.2	41.3	.	.	.	.	.
Expenditures	53.1	44.2	42.4	39.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.3	-0.2	0.8	1.8	.	.	.	.	.
Public debt in % of GDP	48.2	42.2	34.0	.	.	.	.	.	.
Current account, EUR mn <sup>6)</sup>	-826.2	-1251.7	-1443.7	-1436.6	-1695.5	-216.9	.	-1700	-1700
Current account in % of GDP	-14.7	-21.0	-23.0	-20.9	-22.5	.	.	-20.1	-18.2
Gross reserves of CB excl. gold, EUR mn	1378.7	1260.0	1421.7	1767.8	2145.3	1756.3	2269.3	.	.
Gross external debt, EUR mn <sup>7)</sup>	2260.2	2193.4	2052.3	2061.4	2192.2	.	.	.	.
FDI inflow, EUR mn	132.8	281.8	337.6	489.0	239.7	59.4	.	.	.
Exports of goods, BOP, EUR mn <sup>6)</sup>	1268.1	1168.5	1303.0	1677.0	2079.6	426.7	.	2500	3000
annual growth rate in %	3.4	-7.9	11.5	28.7	24.0	19.5	.	20	20
Imports of goods, BOP, EUR mn <sup>6)</sup>	4576.4	4692.2	4974.1	5354.5	6084.7	1142.6	.	6600	7100
annual growth rate in %	8.3	2.5	6.0	7.6	13.6	8.7	.	8	8
Exports of services, BOP, EUR mn <sup>6)</sup>	555.9	552.0	632.1	721.0	817.3	150.9	.	930	1050
annual growth rate in %	13.8	-0.7	14.5	14.1	13.3	12.6	.	14	13
Imports of services, BOP, EUR mn <sup>6)</sup>	301.4	320.2	339.2	349.3	370.2	56.0	.	380	400
annual growth rate in %	5.5	6.3	5.9	3.0	6.0	-3.3	.	3	5
Average exchange rate BAM/USD	2.186	2.077	1.734	1.576	1.573	1.491	1.628	.	.
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 <sup>8)</sup>	0.689	0.683	0.686	0.692	0.698	.	.	.	.
Purchasing power parity BAM/EUR, wiiw <sup>8)</sup>	0.790	0.791	0.804	0.810	0.839	.	.	.	.

Note: 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) 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.