

Bosnia and Herzegovina's Economic Prospects and Historical Background*

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The essay discusses the socio-political challenges for the economy of Bosnia and Herzegovina and its foreign trade in goods and services, including the Hungarian relation. The study uses descriptive tools and secondary data. Wedged in between Croatia and Serbia, Bosnia and Herzegovina's economy is inextricably linked to the dramatic events of the past and the still unresolved social and political conflicts. Within Yugoslavia, Bosnia and Herzegovina was a member state with significant export potential, but the war and ethnicisation have devastated the economy. The state administration of the Dayton system is expensive, and the foundations for capital flows, privatisation and European convergence are developing slowly. Capital flows, the Instrument for Pre-accession Assistance (IPA) and international aid play an important role in balancing the foreign exchange balance. A significant item reducing the negative current account balance is the amount of remittances, which is six times higher than FDI. Remittances have become the largest source of external financing, increasing dependency and exacerbating the vulnerability of the economy.

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1. Introduction

With a developing market of nearly 18 million people, the outlook for the six Western Balkan countries (Serbia, Bosnia and Herzegovina, Montenegro, Kosovo, North Macedonia, Albania) is positive. At 2.7 per cent, 2017 GDP growth was slightly lower than the rate of 2.9 per cent from 2016, but in 2018 the expansion amounted to 4 per cent, while it was 3.3 per cent in 2019 (*WBG 2019*). Prior to the outbreak of Covid-19, most Western Balkan countries made progress, as poverty declined and household incomes increased. The pandemic, however, pushed the Western

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Balkan countries into a deep recession, and the global outlook remains uncertain. The European Union's economy contracted by 8.4 per cent in 2020, with economic activity in the Western Balkan region falling by 4.8 per cent. For the EU-27, real GDP growth is forecast to be 4.5 per cent in 2021 and 3.5 per cent in the Western Balkans (*WBG 2020a*). According to the European Commission's Winter 2021 Economic Forecast¹, the EU-27 economy will grow by 3.9 per cent in 2022, while the Western Balkan economy will expand at a rate of 3.7 per cent.

In 2019, the EU-27 remained the Western Balkans' main partner for both exports (68 per cent) and imports (61 per cent), with manufactured goods accounting for 81 per cent of EU imports from the Western Balkans (*Eurostat 2020*). In its National Export Strategy for 2019–2030², Hungary treats the Western Balkan market as a priority area, in addition to its strong opening to the East and South and its cooperation with the Visegrád and Carpathian Basin countries. It supports the promotion of SMEs' market activity, the stimulation of Hungarian capital exports, participation in privatisation, and, with the means at its disposal, helps to accelerate EU accession.

The foreign economic relations system of the former Yugoslav successor state, Bosnia and Herzegovina (BiH), with a population of 3.3 million, can be described along four strategic axes. Bosnia and Herzegovina's most important foreign trade partner is the European Union, with around 72.3 per cent of exports. The main partner countries are Austria, Germany, the Netherlands and Italy, but Switzerland is also one of the Western European countries contributing to stabilisation. The share of the other Yugoslav successor states (especially Serbia, Slovenia and Croatia) in foreign trade also remained significant, at around 1/3. Bosnia and Herzegovina's cooperation with the Islamic world — Turkey, the United Arab Emirates, Saudi Arabia and Kuwait — is a distinct foreign economic phenomenon in the region.

This essay is a descriptive research based on secondary data, examining the economic situation and prospects of Bosnia and Herzegovina for the period 2000–2020, seeking an answer to the question of whether it is able to finance its balance of payments and imports of goods and services. In order to understand the country's economic situation, it is necessary to briefly review the Yugoslav era, independence and the post-war conditions, including the still unsettled relationships between the Serbian and Croatian territories and the coexisting religions and ethnicities. Ethnicisation and clientelism are recurring concepts in the *second section* and in the essay. In Bosnia and Herzegovina, the elites organised on an ethnic basis seek to control the privatisation process and expropriate development subsidies for

¹ https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/winter-2021-economic-forecast-challenging-winter-light-end-tunnel_en

² <https://2015-2019.kormany.hu/download/e/ca/91000/Nemzeti%20Export%20Strat%C3%A9gia%202019-2030.pdf#!DocumentBrowse>

foreign working capital investments. The clientistic networks and ethnicisation of politics hamper economic growth.³

The *third section* reviews the progress of Bosnia and Herzegovina's integration into the European Union. The *fourth section* briefly presents the introduction of the new national currency, the convertible mark and the currency board. The *fifth part* analyses the foreign trade in goods and services between Hungary and Bosnia and Herzegovina and discusses the opportunities for Hungarian exporters and importers. The *sixth section* highlights that the most serious economic problem is the international balance of payments position. The trade balance is passive, and imports cannot be reduced either for production or for consumption: therefore, expanding exports is a fundamental necessity. Capital imports must be increased, as the two sources of financing – aid and remittances from people working abroad – cannot be relied on in the long term. Aid is a political decision, and remittances are gradually declining for generational reasons. Accession to the European Union is an important consideration in the general interest of both the Union and Bosnia and Herzegovina.

2. Independence and post-Dayton Bosnia and Herzegovina: the lost decade

After some 600 years, Bosnia and Herzegovina regained its independence with the February 1992 referendum. On 6 April 1992, after the European Economic Community formally recognised the country's independence from the Federal Republic of Yugoslavia, the first diplomatic contact at ambassadorial level was established with Hungary. Following the breakup of Yugoslavia, the Dayton Peace Agreement of 21 November 1995 — formally signed in Paris on 14 December — ended the three-and-a-half-year war in Bosnia. The peace agreement ensured a post-conflict political settlement, a new constitutional status, regional stabilisation and the start of economic reconstruction.

During the first two decades of the Yugoslav era, BiH was one of the poorest constituent republics. Its agriculture, characterised by small and private enterprises, was unable to meet domestic demand, and food was mostly imported. A major transformation took place in the 1950s, when the Yugoslav federal government opted for the strategic development of heavy metal and military industry in Bosnia and Herzegovina, located in the heart of the republic. Power plants, steelworks, metal-working plants were built, and the electro-energetics sector was established. Its geostrategic position helped it to become a centre for the development of the Yugoslav military industry. During the same period, agriculture, forestry and livestock farming also boomed, and BiH became a net exporter of food, especially

³ Papić, Z.: *Ethicka privatizacija: neograničene mogućnosti prevare* [Ethnic Privatization: unlimited possibilities for cheating]. Dani, Sarajevo, 6 August 1999.

meat, dairy products, fruit and vegetables (*Bakota 2019; Čaušević 2013*). Exports are currently at 30 per cent of GDP, one of the lowest in Europe, but if it were able to export as much as it did in Yugoslav times, its exports would triple (*Goldstein et al. 2019*). Yugoslavia, including Bosnia and Herzegovina, experienced its golden age between 1952 and 1965. At 4.46 per cent, GDP growth in Yugoslavia between 1950 and 1985 was so high that it was exceeded only by Taiwan (6.64 per cent), Japan (6.26 per cent) and China (5.10 per cent) (*Kovač 1995:282*). *Peštek et al. (2021)* point out that in the years immediately preceding the war, Bosnia and Herzegovina produced more high-value-added products than the Yugoslav average, and its trade balance showed a surplus. In the second half of the 1980s, however, signs of internal structural crisis emerged in Yugoslavia. Economic decentralisation progressed slowly, and access to foreign markets was limited. The lack of horizontal diversification in industry weakened the potential for economic development. Socialist self-management disintegrated with the rise of national and economic ethnocentrism and then disappeared with the outbreak of the war.

After the war, the economy of Bosnia and Herzegovina was in ruins. GDP fell by 80 per cent from 1991 to 1992 and by two thirds from 1991 to 1995. By 1995, the population of 4.3 million shrank by 1 million as a result of atrocities and the exodus of refugees. An estimated 100,000 people died in the Bosnian war, 80 per cent of whom are Muslim Bosniaks. Atrocities against civilians in Bosnia were the worst politically motivated violence in Europe since the Holocaust (*Karamehic-Muratović — Kromják 2021:1*). The massacre of more than 8,000 Bosnian Muslim men and boys in Srebrenica, eastern Bosnia, was declared a war crime by the International Criminal Tribunal for the former Yugoslavia (ICTY) in 2001. With the monitoring of potential genocide crimes, several nations are on genocide watch (*Karamehic-Muratović — Kromják 2021*).

The 1990s was a lost decade for both the Yugoslav region and Bosnia and Herzegovina. The disintegration of the Federal Republic of Yugoslavia, the loss of markets, the disruption of decades-old production chains, armed conflicts, international isolation, sanctions, poor economic governance and corruption contributed to a drastic, 50 per cent drop in GDP. According to a UN survey, in 1999, two-thirds of the Yugoslav population lived in poverty, i.e. had a monthly income of less than USD 60. The war destroyed both the economy and the infrastructure: 'Because of the war, 40 per cent of the bridges and 35 per cent of the roads became unusable. The airport of Sarajevo was destroyed. The damage to the country's 1,000-kilometre rail network is estimated to have reached USD 1 billion' (*HCCI 2020:18*). Four-fifths of the power generation equipment fleet was lost. In order to recover, the country needed substantial international economic, reconstruction and humanitarian aid (including a USD 20 billion credit line from the EBRD).

The Dayton Peace Agreement is an 'effort' to make the heart of the Balkans a 'unified' country. In 1995, the current divided, federal state structure was

created. Currently, the Republic of Bosnia and Herzegovina consists of two entities, or second-level government bodies: the Federation of Bosnia and Herzegovina (*Federacija Bosne i Hercegovine*), which comprises 51 per cent of the country — and is divided into 8 Bosnian- and Croat-majority cantons and the capital Sarajevo — and the Bosnian Serb Republic (*Republika Srpska, RS*) with Banja Luka as its centre, comprising 63 local governments. The city of Brčko and its surrounding areas, which are divided between the two entities, form an autonomous administrative region of the Brčko District, with a special status, whose governance is directly exercised by the state of Bosnia and Herzegovina, in cooperation with the European Union, in addition to local authorities. The official languages of all three administrative entities are Bosnian, Serbian and Croatian. Of the 3.3 million population, 50.7 per cent are Muslim Bosniaks, 30.8 per cent are Orthodox Serbs and 15 per cent are Roman Catholic Croats. *Estrin — Uvalic (2014)* showed a relationship between the lower volume of direct capital investment and the negative perception of the Balkans, which can be traced back to potential investors' perceptions of the region.

The 1995 Dayton Peace Agreement established the foundations for a democratically organised state, but it did not end ethnic conflicts. Territorial entities redrew the map of Bosnia and Herzegovina and were configured according to the constituent peoples (Muslim Bosniaks, Orthodox Bosnian Serbs, Catholic Bosnian Croats). The formation of a unified economic region and public sphere within the state is paralysed by ethnicisation, clientelism and a governance structure organised along ethnic lines, the maintenance of which requires nearly half of the country's GDP. With corporate management linked to political elites, enterprises earmarked for privatisation can fall into the hands of the 'ethnic oligarchies' concerned (*Vučetić 2002*). Bosnia and Herzegovina resists modernisation, insisting on ethnic identities, political clientelism and forms of economy that are at odds with globalisation and structural transformation (*Pugh 2005*). Earlier, *Sells (1996:124)* pointed out the Balkanism of the advanced Western national economies, which approaches the people of Bosnia and Herzegovina as 'tribal haters outside the realm of reason and civilisation'.

The international community, urging economic reconstruction and peaceful consolidation, focuses its attention on economic corruption that threatens direct social well-being, and sets aside clientelism and the black economy that ensures economic 'survival'. The development financing of donor countries has been realised with the participation of war entrepreneurs and local brokers, through the coincidence of common interests (*Pugh 2002; 2005*).

The sustainability of the Dayton system is made uncertain by autonomy claims. In 2015, the Bosnian Serb Republic, 83 per cent of which is inhabited by Orthodox Bosnian Serbs, launched a referendum initiative on secession. In the Federation of Bosnia and Herzegovina, where 70.4 per cent of the population is Bosnian, the Catholic Bosnian Croats, representing 23 per cent, are seeking to form their own entity.

Bosniaks emphasise the transformation of Bosnia and Herzegovina into a civil state. In Bosnia and Herzegovina, economic reconstruction is part of a broader peace-building process, with an integrated strategy at its core, that takes into account long-term social and political factors (*Tzifakis — Tsardanidis 2006*). The Dayton reorganisation was adapted to the requirements and perspective of EU membership. The stability of Bosnia and Herzegovina is an important security interest of the EU-27, and therefore it supports its Euro-Atlantic integration into the NATO, the WTO and the European Union. Wedged in between Croatia and Serbia, Bosnia and Herzegovina cannot be treated as a separate region. 'The three countries function, figuratively speaking, as communicating vessels; the movements and events in Zagreb and Belgrade are manifested and reflected in Bosnia in the same way, and vice versa: any turbulence within Bosnia and Herzegovina has an impact on Croatian and Serbian domestic politics' (*Varga 2009:220*). BiH is within a 100 km radius of Hungary; Hungary, too, supports the acceleration of the European integration process as a remedy for internal ethnic divisions and structural problems (*Huszka 2015:117*).

3. Perspectives: positive and negative signs

Following the 1992–1995 war, the country embarked on a path to the EU, thanks to effective cooperation with The Hague. In 1997, it was able to enter into a trade partnership with the EU, and in 1998, a joint work group was set up to facilitate the technical assistance of the EU. In 1999, the European Commission established foreign policy, strategic, economic and legal cooperation with the country. On 24 April 2002, it became a member of the Council of Europe and then, together with other countries of the Western Balkans, was nominated as a potential candidate at the European Council summit in Thessaloniki in June 2003. As a sign of the EU integration process, negotiations with companies from EU member states on the trade part of the Stabilisation and Association Agreement (SAA Interim) that regulates conditions for the exchange of goods, started in 2005, which finally took effect on 1 July 2008. From 1 May 2007 onwards, the presence of CEFTA countries in the market of BiH also increased. As a result of the visa liberalisation process launched in 2008, the EU visa-free regime for citizens of Bosnia and Herzegovina entered into force on 15 December 2010.

As the EU made further steps towards EU integration conditional on the amendment of the constitution⁴ (*ECHR 2009*), after seven years, the ratification process of the Stabilisation and Association Agreement (SAA)⁵ between Brussels and Sarajevo was completed on 1 June 2015. After the SAA came into force, tariffs, quotas and duties were gradually reduced to a minimum. The SAA is a milestone in the country's economic integration with the European Union. On 9 September 2016, the

⁴ With regard to ending discrimination against minorities.

⁵ Stabilisation and Association Agreement.

government of Bosnia and Herzegovina adopted the Protocol on the Adaptation of the SAA (Adaptation Protocol — AP), which entered into force on 1 February 2017. In the short term, the SAA AP has caused a loss of customs revenue (the maximum loss of customs revenue for agricultural and food imports is estimated to be in the range of EUR 26–35 million per year) and may put further pressure on some sectors. However, the SAA AP affects only 8 per cent of Bosnia and Herzegovina's agricultural and food imports from the EU, as most agricultural and food imports have already been liberalised. The new AP provides the country's agricultural and food products with preferential access to the EU market by increasing quotas on EU exports of wine, sugar and fish. Access to the Bosnian market for EU farmers and food producers has been facilitated by the reduction of tariff-rate quotas (TRQs) for a number of products (*WBG 2017*). Duty-free treatment for industrial products and additional provisions for agricultural products help liberalise trade in goods between the European Union and Bosnia and Herzegovina.

Since 2010, BiH has been seeking to take further steps towards the EU. In addition to making intellectual property rights EU-compatible, it has also carried out the harmonisation of the less transparent public procurement system of 2004, due to the developments provided by EU tendering opportunities. Finally, it was the last of the countries of the former Yugoslavia (with the exception of Kosovo) to formally apply for EU membership on 15 February 2016.

In May 2019, the European Commission, in the Opinion (Avis) on the country's application for EU membership, identified 14 key priorities for the country to meet as conditions for starting EU accession negotiations, which were endorsed by the Council of the EU as a comprehensive roadmap in December 2019. After a five-year stalemate, in Sarajevo, in July 2020, parliamentary representatives agreed on the rules of procedure for the EU — Bosnia Stabilisation and Association Parliamentary Committee, with which Bosnia fulfilled one of the priorities of the European Commission.

4. In Bosnia and Herzegovina, the national currency is the convertible mark

Bosnia and Herzegovina's central bank (CBBH⁶) was established at the end of 1997. In 1998, a new national currency, the convertible mark (CM), was issued, which unified the financial spheres of the three entities. The German mark was accepted by all parties,⁷ so the exchange rate of the convertible mark was pegged to the German currency. After the German mark was replaced by the euro in 2002, the convertible mark was exchanged for the new EU currency at the same fixed exchange rate as the German mark (1 CM = 0.511292 EUR). This meant that CBBH did not pursue a sovereign monetary policy, but maintains a currency board

⁶ Central Bank of Bosnia and Herzegovina.

⁷ Due to the devaluation of national currencies, it was de facto used even before.

arrangement. Due to the currency board, inflation was reduced and kept low, and public confidence in the national currency was restored, as indicated by the growing share of deposits in convertible mark.⁸ Pegging the convertible mark to the euro boosted foreign investor confidence and improved the country's macroeconomic prospects (*Ilgün and Coskun 2009*). On 1 June 2012, a new series of 10, 20, 50 and 100 CM banknotes was issued, and these, according to a report by the CBBH (2017), contain security features of European standard.

5. Foreign trade in goods and services between Hungary and Bosnia and Herzegovina

Bosnia and Herzegovina's ratio of exports to GDP was 15 per cent in 1994, and the rate has risen to 40 per cent twenty-five years later. Growth rates are largely dependent on the share of its main trading partners – Germany (13 per cent), Italy (11.3 per cent), Croatia (10.8 per cent) and Serbia (10.6 per cent) – and the global economic activity. According to the Agency for Statistics of Bosnia and Herzegovina (July 2020), in 2018, the country's exports of goods in global trade turnover increased by 12.1 per cent to EUR 9.8 billion, while total imports amounted to EUR 6.084 billion (+10.7 per cent). In trade services, exports amounted to EUR 1.7 billion compared to imports of EUR 523 million. In 2019, exports were EUR 5.875 billion (3.4 per cent lower than in 2018), while imports were EUR 9.9 billion (1.2 per cent higher). Exports of trade services increased to EUR 1.9 billion, and imports of such to EUR 633 million. The trade balance of Bosnia and Herzegovina is structurally deficient. According to an analysis by *Lloyds Bank (2019)* based on data from the Foreign Investment Promotion Agency (*FIPA (2020)*), the trade deficit increased by 17 per cent on an annual basis in 2019. The development of foreign trade continues to be hampered by low productivity levels, limited access to financing and administrative barriers. Tariffs are relatively low for most products, but there are various non-tariff barriers. Anti-dumping and countervailing duties are sometimes imposed to protect local industry when the price of a commodity is well below the domestic market price or when it is subsidised by the state (*Lloyds Bank 2019*).

Hungary's bilateral economic relations with Bosnia and Herzegovina are dominated by trade in goods. According to the Statistical Office, in 2019, BiH was Hungary's 40th trading partner, accounting for 0.2 per cent of total Hungarian foreign trade. Hungary is the ninth most important trading partner in the total foreign trade of Bosnia, with a share of 2.58 per cent. Over the past twenty years, Hungary's bilateral foreign trade relations have been developing (*HCSO 2020*). From 2001 to the end of

⁸ In addition to the convertible mark, the kuna, the euro and — in the territory of the Bosnian Serb Republic — the Serbian dinar are also present in payment practices in tourist cities; see: Milekic, Sven: *Welcome to Mostar, a Town of Many Currencies*. *BalkanInsights*, 16 June 2017. <https://balkaninsight.com/2017/06/16/welcome-to-mostar-a-town-of-many-currencies-06-15-2017/>. Downloaded: 7 November 2020.

2019, the foreign trade value of Hungary's imports at current price increased from EUR 5.96 million to EUR 142 million, while Hungarian exports rose from EUR 230 million to EUR 317 million; the latter shows a change of 164.3 per cent.

The foreign trade value of services doubled from 2008 to the end of 2019. In 2008, Bosnia and Herzegovina accounted for 3.4 per cent of total Western Balkan services exports, and 6.4 per cent in 2017. Despite the slowdown in 2018 and 2019, the doubling between 2008 and 2017 shows dynamic progress, similar to the candidate countries Albania and North Macedonia.

According to the exporter database of the Hungarian Chamber of Commerce and Industry, Hungary's most important export services to Bosnia and Herzegovina are: alternative and renewable energy (wastewater and waste treatment technologies), water management (chlorinators, chlorine dioxide dosing systems), agricultural and food-processing technology (grain storage and silo systems), ICT (IP-based complex telecommunication network solutions, client call systems), R&D knowledge-intensive services and technology transfer (liquid chromatography), engineering services and exhibition management, and medical technology (resting and stress ECG systems). Based on the data from the Foreign Trade Chamber of Bosnia and Herzegovina, the largest share in the direction of Hungary is represented by international transport.

According to the data from the HCSO (Hungarian Central Statistical Office) and the Agency for Statistics of Bosnia and Herzegovina, Hungary's economic relations grew until 2018, when the change became more and more negative. Hungary's surplus is significant. Compared to the previous two years, Hungarian exports increased by 21.6 per cent and imports by 54.1 per cent. In 2019, Hungarian exports slowed by 12 per cent and Bosnian exports by 15 per cent, while in 2020, the pandemic caused a drop of more than 80 per cent on both sides until the third quarter (*AS of BiH 2021*).

Prior to the devastating war in the 1990s, when the country was a constituent republic of Yugoslavia, priority was given to heavy and military industry, which accounted for 51 per cent of GDP. By contrast, in 1999, the weight of industry and mining was only 23 per cent (*Pap 2004:52–53*). Heavy industrial rust belts were created, and the emphasis was on private agriculture. However, the small size of estates was an obstacle to achieving significant agricultural production. Small farms ensured survival and self-sufficiency; their production contributed little to the market. Thus, in the early 2000s, Bosnia and Herzegovina's food imports were 16 times higher than the value of its food exports (*Tzifakis — Tsardanidis 2006*).

In 2017, industrial production grew at a rate of 5 per cent, with its main sectors being steel production, coal mining, iron industry, automotive industry, textile industry, tobacco production, manufacture of furniture and petroleum refining.

The country's economy was heavily dependent on non-ferrous metal exports, with a large share of investments affecting production sectors (34 per cent) and the banking sector (22 per cent) (*HCCI 2020*). According to the data from Trading Economics, the most important export products of Bosnia and Herzegovina, and also the most significant Hungarian imports, are: iron, stainless steel, wood, charcoal products, furniture, lighting signs, prefabricated buildings, machinery, boilers, electronic and mechanical equipment and footwear products. The country's primary import products, which are also the most significant Hungarian exports, are: food (grain, animal fats, cooking oil), electrical machinery, passenger cars and other motor vehicles, mineral fuels, chemicals, plastic derivatives, and cosmetic and pharmaceutical products.

The volume of Hungarian imports in 2013 reflects the economic situation of Bosnia and Herzegovina. According to HCSO data, 90 per cent of the total imports of EUR 96.7 million is made up of manufactured goods worth almost EUR 84 million. In the case of Bosnia and Herzegovina, food, beverages and tobacco account for 22 per cent of imports of EUR 308.7 million and manufactured goods for 42 per cent. Of Hungary's imports of EUR 156 million in 2017, EUR 137 million is the value of manufactured industrial goods (chemical products, inorganic chemical products, metal products, non-metallic mineral products, footwear, cork and wood products), so the ratio remained essentially unchanged. Bosnia and Herzegovina's economy is founded on extractive and manufacturing industry based on natural resources. The main areas of Hungarian imports continue to be: minerals, non-ferrous metals, corundum, iron, aluminium and steel, metal-bearing ores and scrap metal, machinery and components (e.g. car components), wood and wood products (e.g. charcoal, furniture, paper). In the 2020s, the most important product groups of Bosnia and Herzegovina's imports will be machinery and technologies for the renewal and development of infrastructure networks (roads, tunnels, bridges, heating plants, sewers and water mains), and in terms of food supply, agricultural products, small agricultural machinery and chemicals.

6. Economic catching-up and international balance of payments: A deficit in self-financing?

According to the data from World Bank and the CBBH, after the war-related stagnation, GDP grew at a dynamic pace of 5 per cent per year between 2003 and 2008, right up to the global economic crisis of 2008–2009. In the first half of the 2000s, the pace of economic growth stagnated due to declining international donations and humanitarian assistance. According to the UNOCHA database,⁹ while in 2000, USD 17.7 million in humanitarian aid was received — mainly from the

⁹ <https://fts.unocha.org/countries/28/flows/2019>

governments of the United States and Germany, in a multi-sectoral distribution, but with a special focus on the health system reconstruction — in 2002, the aid amounted to only USD 9.5 million, and in 2003, to USD 4.9 million. International donations did not lead to sustainable economic growth. The decline in international assistance resulted in a slowdown in economic growth. Donor countries kept full control of their resources in order to exercise domestic political power (*Tzifakis and Tsardanidis 2006*). In the period 1996–2001, much of the international aid (USD 5 billion) was spent on basic infrastructure development projects. A major direct capital investment (EUR 1.3 billion) was made in 2007 (*Peštek et al. 2021*).

To maintain the stability of the economy, debt repayments were rescheduled after the war. The high external government-debt-to-GDP ratio (35 per cent) was gradually reduced to below 20 per cent by 2007, but with the escalation of the global economic crisis, it climbed back above 30 per cent by 2014. At the same time, the central budget balance was also in deficit, turning into surplus only in 2015, and approaching the promising pre-crisis level for the first time only in 2017. In 2019, compared to 2018, government debt decreased by 1.4 per cent to USD 6.53 billion. Total government debt as a share of GDP is expected to rise to 40.3 per cent in 2020; the World Bank projects an increase in the budget deficit (3.7 per cent) in 2020 (*WBG 2020b*). The economic damage caused by the pandemic is serious; according to the Focus Economics data as of 3 November 2020¹⁰, in 2020, real GDP growth is –5.3 per cent, while for 2021, 3.9 per cent can be projected.

The trade balance deficit may also be a cause for concern: according to CBBH data, the 2018 deficit of BAM 4.9 billion is 25.8 per cent lower than the 2014 value of BAM 6.2 billion. From 2015 onwards, the deficit decreased steadily, but less and less, while in 2019, it increased to BAM 5.2 billion, and has stabilised at that level since then.

Until 2019, the current account balance deficit was high because trade balance deficit could not be offset by the surplus in other items of the balance of payments. In 2019, exports amounted to BAM 14.28 billion, which is barely 0.5 per cent more than in the previous year. The value of imports increased by a further 1.5 per cent to reach BAM 19.4 billion. Foreign trade deficit narrowed in the first two quarters of 2020, as imports declined more than exports due to a significant drop in transport and transportation services. Compared to the base year of 2015, the export price index fell by 2.6 per cent and the import price index by 4.3 per cent in 2016. In 2017, the export price index increased by 2.4 per cent and the import price index by 0.8 per cent, in 2018 by 6.9 per cent and 4.1 per cent, in 2019 by 7 per cent and 4.5 per cent, and in the second quarter of 2020 by 3.8 per cent and

¹⁰ *Bosnia Economic Outlook*. FocusEconomics, 3 November 2020. <https://www.focus-economics.com/countries/bosnia-and-herzegovina>. Downloaded: 2 May 2021.

2.7 per cent, respectively (*AS of BiH 2020*). According to the statement of Vjekoslav Vukovic, Director of the Foreign Trade Chamber of Bosnia and Herzegovina, the 'increase in the trade deficit was mainly caused by the loss of the Kosovo market and the bankruptcy of the aluminium factory in Mostar'.¹¹ The question arises as to how Bosnia and Herzegovina can withstand such a large trade deficit in its current account balance, and whether this can be offset by a combination of capital inflows, the Instrument for Pre-accession Assistance (IPA), international donations and humanitarian aid.

The UNOCHA database shows that during the 2008–2009 global economic crisis, Bosnia and Herzegovina received USD 13 million in aid after years of significantly reduced international donations. The main donor countries continued to be Germany, Austria, Switzerland and the United Arab Emirates. Until 2014, aid to the country was steadily declining again. In 2012, barely USD 2.4 million was registered. In 2014, when floods in South-East Europe caused severe damage and most of northern Bosnia was flooded, a record USD 20 million in aid was received, including USD 3.3 million from the European Commission and USD 2.7 million from the USA. The aid funds were aimed at food security and mine clearance because the floods had changed the location of the minefields left over from the war, posing a serious threat to the local population. Due to the natural disaster, in 2014, the 2.4 per cent real growth, which was promising in 2013, fell to 1.1 per cent. Until 2018, the amount of aid coming into the country decreased drastically. In 2019, a financial contribution of USD 7.8 million appeared in the foreign exchange balance. To address the refugee crisis in the Balkans, the European Commission provided USD 4.3 million in humanitarian aid to the missions of the International Organisation for Migration and the UNHCR in Sarajevo. In the fight against the COVID-19 pandemic, Bosnia and Herzegovina received USD 22 million in aid to strengthen the health sector, mainly from the European Commission (USD 5 million) and the United Arab Emirates (USD 8.6 million).

The EU's pre-accession funds, i.e. the IPA,¹² also plays a key role in maintaining the foreign exchange balance, this peaked at almost EUR 108 million annually in 2011 and 2012, although these were the two years with the largest current account balance deficits: in 2011, nearly 10 per cent and in 2012, nearly 9 per cent relative to GDP. In 2013, Brussels withdrew half of its annual aid of EUR 109 million to Sarajevo because they had failed to agree on the implementation of the constitutional amendment proposed by the European Court of Human Rights in the Sejdić — Finci case¹³. As a result, funding from IPA II for the 2014–2020 EU budget

¹¹ Schroeder, M.: *Instrument for Pre-Accession Assistance (IPA) to Bosnia-Herzegovina*. EU Delegation to Bosnia and Herzegovina, 2013. http://europa.ba/wp-content/uploads/2015/05/delegacija-EU_2013121012030960eng.pdf. Downloaded: 30 October 2020.

¹² Instrument for Pre-Accession Assistance (IPA).

¹³ See more e.g.: <https://www.vajma.info/cikk/tukor/5297/Bosznia-a-Sejdic-Finci-ugy-arnyekaban.html>. Downloaded: 28 April 2021.

period was also put at risk. 39 per cent of IPA I contracts had been concluded with entrepreneurs from Bosnia and Herzegovina, and political instability led to the bankruptcy of several agricultural development projects under the Instrument for Pre-accession Assistance for Rural Development (IPARD).¹⁴

In the absence of EU reform expectations, a coordination mechanism, political coherence and social justice, the IMF was also forced to suspend its Stand-By Arrangement in 2014. It was only in May 2016 that a new agreement was reached, according to which the IMF would disburse the EUR 550 million over three years without interest — but with a servicing fee calculated depending on how much of the allocated IMF quota the country draws on — with loan maturity of 13 years, including a grace period of 4.5 years.¹⁵ Instead of EUR 200 million from the IMF, Bosnia and Herzegovina received only EUR 100 million in 2016, while the World Bank support of USD 50 million — which was already calculated in the 2016 budget — slipped into 2017.¹⁶ After more than a year of political deadlock, when Bosnian politicians failed to form a coalition for 14 months following the October 2018 general elections, negotiations with the IMF resumed in December 2019 and the IPA II indicative allocation of EUR 314.9 million in the 2018–2020 period (out of the total funding allocation of EUR 552.1 million granted for the 2014–2020 budget period) also continued to be used. To tackle the COVID-19 pandemic and support economic rehabilitation, the IMF approved an emergency loan of EUR 330 million in April 2020, while the European Commission allocated an additional EUR 250 million for Bosnia and Herzegovina.¹⁷ In its strategy for 2019–2021, the Federation of Bosnia and Herzegovina estimates that debt management will require external funding equal to USD 1.06 billion for the three-year budget period, which it tries to borrow from multilateral financial institutions to provide 62.2 per cent of all necessary funds. The 2019–2021 debt management strategy of the Bosnian Serb Republic sets the focus on issuing longer-term securities. Its strategy is to diversify its sources of financing, instruments and investors, but the share of external financing should decrease in favour of internal funding.¹⁸

The level of direct capital investments is lower than that of net financial remittances. Apart from the damage caused by the war, the main reasons for this are late economic development, stagnating domestic consumption, the overburdened budget, the complexity of the bureaucracy and legal system, party-political conflicts, low wages, high unemployment and slow progress in privatisation. While the privatisation of

¹⁴ See footnote 8.

¹⁵ Latal, S.: *Bosnia Clinches New €550m Deal With IMF*. BalkanInsight, 20 May 2016. <https://balkaninsight.com/2016/05/25/bosnia-to-get-new-550-million-program-from-imf-05-25-2016/>. Downloaded: 11 November 2020.

¹⁶ Ibid.

¹⁷ Dervisbegovic, N.: *Budget Delays Force Bosnia to Postpone Local Elections*. BalkanInsight, 23 May 2020. <https://balkaninsight.com/2020/05/23/budget-delays-force-bosnia-to-postpone-local-elections/>. Downloaded: 11 November 2020.

¹⁸ *Outlook 2020 Bosnia & Herzegovina*. bneiIntellinews.com, 7 January 2020 <https://www.intellinews.com/outlook-2020-bosnia-and-herzegovina-174066/>. Downloaded: 11 November 2020.

major state-owned enterprises in the Bosnian Serb Republic was completed by 2009, in the Federation of Bosnia and Herzegovina, the process in the telecommunications and energy sectors is still ongoing. The Federation can expect larger FDI inflows (*Peštek et al. 2021*). According to the 2020 financial Work Plan of the Federal Privatisation Agency of the Federation of Bosnia and Herzegovina, 43 per cent of the capital has been privatised, the privatisation of 1,088 enterprises has been completed, and a total of 2,604 enterprises have been sold under the conditions of small-scale privatisation.¹⁹ Proximity to EU markets, the skilled labour force and low labour costs have motivated investment (*Peštek et al. 2021*). Privatisation is a key opportunity but also a risk for the three entities in the country. Based on IMF data, *Santrucek* points out²⁰ that the total debt of typically less productive state-owned enterprises is about 26 per cent of GDP, due to structural problems such as clientelism, corruption (non-transparent public procurements) and ethnicisation. According to *Susic et al. (2017)*, the economic development of Bosnia and Herzegovina is not hindered by the inability of the economy to produce, but by the fact that capital falls into the hands of those who do not use it productively.²¹

Foreign direct capital investment has been registered since 2001. The inflow of FDI was significantly reduced by the global economic crisis. The increase in net investment was shown in 2014 (EUR 414.7 million), which is almost double the 2013 figure. In 2015 and 2016, FDI inflows did not show a positive trend. In 2017, the previous declining FDI trend came to a halt, with foreign direct investment amounting to EUR 436.4 million in 2017. In 2018, the FDI increased by 11.5 per cent compared to 2017, with EUR 487 million being the highest annual FDI since 2009. Foreign direct investments in 2019 amounted to EUR 357 million, a decrease of 26.6 per cent. According to the *FIPA (2020)* announcement, lower investment inflows were caused by, among other things, increased dividend payments in the last quarter of 2019 and acquisitions of foreign-owned corporations by local companies.

Due to Bosnia and Herzegovina's industrial tradition, the largest share of FDI was registered in the manufacturing sector (35 per cent) — with a particular focus on the production of coke, refined petroleum and chemical products — and in the banking sector (25 per cent), but the infocommunications sector also stands out with 12 per cent. A small amount of capital investment was allocated to export-oriented

¹⁹ *Federation of Bosnia-Herzegovina Entity privatized 1,088 Enterprises*. Sarajevo Times, 21 February 2020 <https://www.sarajevotimes.com/federation-of-bosnia-herzegovina-entity-privatized-1088-enterprises/>. Downloaded: 30 October 2020

²⁰ *Santrucek, S.: Failed Privatisation is to Blame for Bosnians' Exodus*. BalkanInsight, 16 May 1999. <https://balkaninsight.com/2019/05/16/failed-privatization-is-to-blame-for-bosnians-exodus/>. Downloaded: 11 November 2020.

²¹ *Santrucek* cites the closure of Aluminij Mostar, the largest state-owned company in the Herzegovina-Neretva canton, in July 2020, as an example of the dangers of the privatisation process becoming ethnicised. The privatisation of the once largest aluminium exporting company officially failed in 2010. The members of the previously announced winning consortium, Glencore-Feal and Dalekovod Zagreb, were exclusively Croatian investors connected to the HDZ BiH (Croatian Democratic Union of Bosnia and Herzegovina) party. (See footnote 17 for the source.)

production, despite its importance for increasing the country's competitiveness (Čaušević 2015). In 2020 H1, foreign direct capital investment fell by 46.7 per cent compared to the same period of the previous year. Owing to the COVID-19 pandemic, FDI worldwide is expected to decline by 30 to 40 per cent, putting severe pressure on Bosnia and Herzegovina as well.

According to the *CBBH (2020)* data, the main countries of origin, from which some EUR 7.7 billion of foreign capital flowed into the country between 1994 and the end of 2019, are: Austria (EUR 1.4 billion), Croatia (EUR 1.2 billion), Serbia (EUR 1.0 billion) and Slovenia (EUR 554 million). In 2019, remarkable capital investments were also received from the United Kingdom (EUR 43.5 million), Luxembourg (EUR 14.3 million), and Saudi Arabia (EUR 11.2 million). In 2020, most investment came from the EU-27. Among the CEFTA member states, Serbia is the most important economic partner, mainly for the Bosnian Serb Republic. 40 per cent of the country's total foreign direct capital investment in 2018 was directed here (compared to the 13 per cent in 2016). Russian capital continues to play a major role in privatisation within the entity.²² The largest Russian investments are in the capitalisation of oil refineries in Modrica, Bosanski Brod and Banja Luka (Čaušević 2015). The companies are part of the Optima Group majority-owned by NefteGazInkor, a subsidiary of Russia's Zarubezhneft.

While Russian investors play an important role in the Bosnian Serb Republic, the Federation of Bosnia and Herzegovina, populated mainly by Bosniaks, attracts Turkey and the Gulf Arab countries. The 2005 privatisation of the paper and pulp mill (Natron) located in Maglaj is the largest Turkish investment to date. With the support of the SDA (Party of Democratic Action) and its growing presence in the banking sector, Turkey's positions have been consolidated.²³ Investors from Dubai, Qatar, Kuwait and Saudi Arabia are becoming increasingly active in the Federation's real estate market.²⁴ Real estate agencies representing Arab investors also appeared in the relatively predominantly Bosnian region of central-western Herzegovina. A study by *Richet (2019)* points to rising Chinese capital in infrastructure and energy projects. The 300-MW Stanari thermal power plant is financed by the China Development Bank. Increasing Russian, Turkish, Arab and Chinese investment could weaken the presence of the European Union. The increasingly spectacular imprint of the economies of the Islamic world is weakening the perspectives for EU integration, as can be seen in the Turkish example. Strong religious standards run counter to the values of pluralism and

²² Đorđević, N.: *FDI in Bosnia's Republika Srpska is increasing, but there's plenty of room for more*. Emerging Europe, 16 July 2020. <https://emerging-europe.com/news/fdi-in-bosnias-republika-srpska-is-increasing-but-theres-plenty-of-room-for-more/>. Downloaded: 11 November 2020.

²³ Source: Santrucek, see footnote 17.

²⁴ The 'Hotel Bristol', the EUR 50 million 'BBI' shopping centre in Sarajevo, the residential complex 'Poljine Hills' in Ilidža were realised as Arab projects. In Ilidža, a Saudi holding is building Buroj Ozone, the biggest tourism investment of EUR 2 billion in South-East Europe. (Brunwasser, M.: *Bosnia's biggest foreign investment: Bonanza or threat?* BBC News, 22 September 2016) <https://www.bbc.com/news/business-37429682>. Downloaded: 11 November 2020.

tolerance enshrined in Article 2 TEU²⁵. From the perspective of the national integrity of Bosnia and Herzegovina, the Arab Muslim presence creates social, economic and security policy tensions not only for Bosnian Serbs and Bosnian Croats, but also for Bosniaks with a distinct European tradition and a more liberal outlook.

A significant item reducing the negative current account balance is the amount of remittances. According to the *CBBH (2020)* data, in 2019, Bosnia and Herzegovina received USD 2.3 billion in remittances, which is about 11 per cent of its annual GDP. Although this still does not offset the trade deficit, it reduces it. According to the 2019 data from *TheGlobalEconomy.com*²⁶ BiH ranks twentieth in the world in terms of the rate of remittances relative to GDP, and second in Europe after Moldova (16 per cent). The growth rate of its remittances was one of the most dynamic between 2000 and 2008 (payments of USD 2.7 billion were received in 2008), reflecting the remittances of first-generation emigrants. According to the reports from the Ministry of Human Rights and Refugees of Bosnia and Herzegovina, at least 2 million people from Bosnia and Herzegovina are currently living abroad, which is 56 per cent of the country's population. Little analysis is available on the use of remittances, but sporadic evidence suggests that remittances are mainly used for basic consumption and household expenditure, and thus they have a minor impact on investments (*Oruč 2011; Jakobsen — Strabac 2015*). According to the 2007 data and projections from the International Organisation for Migration, in the medium and long term, remittance growth declines as second- and third-generation emigrants reduce or stop sending remittances.

Overall, remittances have become the largest source of external financing, not only for Bosnia and Herzegovina, but also for developing countries in general. In 2018, at the global level, remittances to developing countries (USD 462 billion) were already substantially larger than foreign direct investments (USD 344 billion) (*WBG 2019*). Thus, for peripheral national economies such as Bosnia and Herzegovina — where the dynamism of remittances as a percentage of GDP is 9 per cent higher than that of direct capital investments — remittances have become the largest source of foreign exchange revenue.

The revitalisation of the country that is typically agro-industrial in character is under way, but its overall condition is still difficult to assess because statistical data for the whole state or the entities are influenced by several factors. For one thing, official statistics do not always take into account grey and black economies, which are widespread throughout the country and very rampant at all levels of the society. According to the data from the Agency for Statistics of Bosnia and Herzegovina, although the official unemployment rate was around 40 per cent

²⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN>

²⁶ *Remittances, per cent of GDP in Europe*. The Global Economy, 31 December 2019. https://www.theglobaleconomy.com/rankings/remittances_percent_GDP/Europe/. Downloaded: 2 May 2021.

in 2013–2014, it was 21 per cent in 2017, and the latest 2019 data shows 16 per cent. Within this, however, youth unemployment rate (15–24-year-olds) stands out at 48 per cent. Grey and black economies provide a living for many, and thus the actual unemployment rate could be about 10 percentage points lower. The COVID-19 pandemic could cause increasing redundancies in 2020–2021, mainly in the services sector. The *Eurostat (2019)* data confirm that the social safety-net and self-sufficiency are further threatened by the level of emigration that is exceptionally high in relation to the Western Balkans (–6.4 per cent net migration rate between 2015 and 2020), a low reproduction rate of 1.3 and the accelerating ageing of society (the average age is 43). Compared to the neighbouring Serbia, North Macedonia and Kosovo, depopulation has reached a 20-year high. From 1991 onwards, by 2050, the population could shrink by nearly 29 per cent, and by 2060, the projected average age will be 53 (*UN DESA 2019*). A major challenge for both the productive and the knowledge-based services sectors is that Bosnia and Herzegovina — after Haiti and Venezuela — ranks third among the world’s countries as a loser when it comes to brain drain (*WEF 2018*). Pension funds are not significant, and there is no 3-pillar pension system. The insurance sector also does not play a role in financial intermediation; although the adoption of the Insurance Act is under way, non-life insurance still dominates insurers’ portfolios. On the economic front, the divergent economic visions of the entities and their uneven economic development are also a problem. In addition to the central government, cantonal and local government levels retain powers that make it difficult for the state to guarantee and borrow. Although the non-performing loan ratio has been steadily declining (in 2019, it was below 9 per cent), it is almost three times the pre-crisis level of 3 per cent, which is weighing on lending activity and banking sector profitability.²⁷

7. Summary and conclusions

The essay analyses the foreign economic potential of Bosnia and Herzegovina in the period 2000–2020, including the Hungarian relation. The current EU foreign policy and foreign economic development programmes also include a comprehensive assessment of the relations between the countries applying for EU membership. Currently, the macroeconomic development of the Western Balkans needs to be discussed in the context of the post-2020 cohesion policy and the economic challenges of the COVID-19 pandemic.

The Balkan war, the 1990s, also known as ‘the lost decade’, cannot be ignored. GDP fell by 80 per cent from 1991 to 1992, by two-thirds from 1991 to 1995, and the population of 4.3 million had decreased by 1 million by 1995 as a result of atrocities and the exodus of refugees. The state administration of the Dayton system is very

²⁷ Source: Outlook 2020 Bosnia & Herzegovina, see footnote 15.

expensive, and the foundations of market economy, capital flows, privatisation and European catching-up are only slowly unfolding. Twenty-five years after the end of the war, BiH is struggling with the divergence of political and governmental control. Ethnicisation, clientelism, the black economy, the international community's Balkanism and divergent domestic policy interests in Bosnia and Herzegovina are barriers to sustainable economic development.

Following the international aid of USD 5 billion for economic reconstruction and reconciliation, the economy started to grow. In 1998, a new national currency, the convertible mark, was issued, which unified the financial spheres of the three entities. With the introduction of the convertible mark, the different monetary systems of the three constituent nations were abolished. The exchange rate of the convertible mark was pegged to the German currency. After the German mark was replaced by the euro, the convertible mark was exchanged for the new EU currency at the same exchange rate as the German mark. Due to the currency board, inflation was reduced and kept low, and investor and public confidence in the national currency was restored.

Under the Interim Stabilisation and Association Agreement, which took effect in the mid-2008 and became operational in 2015, the free-trade system contributes to the development of Bosnia and Herzegovina's foreign economic potential. The potentials of this small open economy are enhanced by its proximity to the EU, a well-trained labour force and the export opportunities in the wood-processing, metal-working, automotive, energy, international transport and tourism sectors. Large-scale production also improves the export potential of agriculture. The economic relations between Bosnia and Herzegovina and Hungary are dominated by trade in goods, with 90 per cent of the Hungarian import volume being made up of manufactured goods. The foreign trade value of services doubled from 2008 to the end of 2019. Hungary's economic relations grew until 2018, when the change became more and more negative. Hungary's surplus is significant.

In the post-war decade, import dependence increased, leading to borrowing. Slowing privatisation makes the transition to an export-oriented economy more difficult. The development of privatisation processes and the intensified involvement of the private sector are key points for international competitiveness. Privatisation and FDI inflows took off in different periods in the different entities of the country. Up until 2008, the Federation of Bosnia and Herzegovina recorded higher FDI inflows than the Bosnian Serb Republic, but since 2009, the trend has been reversed. In 2020, most of the investment came from the EU-27. Investments from the neighbouring countries are remarkable, with Croatia being the most important economic partner mainly for the Federation, while Serbia plays the same role for the Bosnian Serb Republic. Russian investment is important in the Bosnian Serb Republic, while the Federation, populated mainly by Bosniaks, attracts Turkey and

the Gulf Arab countries. In Bosnia and Herzegovina, the inflow of Chinese FDI is on the rise; it is reasonable to expect that capital investments polarising the Western Balkan region will have an impact on the political and economic dynamics of the country and the EU. The increase in foreign direct capital investment after 2020 may also be tempered by the global recession caused by the Covid-19 pandemic.

Bosnia and Herzegovina's foreign economic mobility is also weakened by the divergence of the internal economic space and the Serb-Croatian-Bosnian national fault line. Intra-country divergence is reflected in the performance and social welfare of the economy, the growth potential of which is also threatened by mass emigration and the ageing of society. Remittances from economic emigrants are an important source of income for the country's population. Remittances are six times higher than FDI and three times higher than the GDP-based percentage of development assistance. In the short run, remittances have played a useful and indispensable role in complementing institutional social assistance and mitigating the negative impact of low foreign direct investment. The continuous emigration of citizens helps to maintain the current high level of remittances, and thus emigration is not necessarily a negative thing in this respect, but this is true only for the short-term prospects of the country. In the longer term, remittances exacerbate the dependency of Bosnia and Herzegovina, and increase the vulnerability of the economy if the rate of transfers dwindles with generational change. In addition, their inflows may slow down the necessary economic reforms, as they stimulate consumption rather than investment, thus reducing the competitiveness of domestic economy and the activity of labour force as long as they are a substitute for income earned in households through domestic labour. Although remittances balance the foreign exchange balance, the goal can only be for the country to move away from the dependence on international financial contributions towards a balanced trade balance, on the foundation of increased export activity.

It is in the interest of both the Balkans and Europe to achieve and maintain political and economic stability in Bosnia and Herzegovina. Political support and economic assistance from the European Union are essential for this.

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