

INTERNATIONAL MONETARY FUND



Staff Country Reports

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BOSNIA AND HERZEGOVINA

Selected Issues

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Approved by the European Department

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I. BOSNIA AND HERZEGOVINA: CATCHING UP OR FALLING BEHIND OTHER TRANSITION ECONOMIES?¹

Core Questions and Findings

- **How does Bosnia and Herzegovina's (BiH) level of national income compare with other economies at a similar stage of development?** BiH enjoys a reasonably high level of national income. GDP per capita (adjusted for cross-country differences in purchasing power) is broadly similar to that of its immediate neighbors. And once remittance inflows are included, Bosnia and Herzegovina appears to have a level of per capita income well above the average for the Balkan region. Moreover, after an allowance is made for Bosnia and Herzegovina's relatively late start to transition and the detrimental effects of the 1992-95 war, its income level appears to be in line with that of other transition economies at a similar phase of development.
- **How does BiH's growth dynamics compare?** Using conventional convergence analysis, Bosnia and Herzegovina's rate of economic growth appears to fall short of that achieved by other countries at a similar phase of development, although data uncertainties cloud the analysis.
- **What are the implications of the growth gap for the future?** BiH risks falling behind, rather than catching-up with, other transition economies—and the rest of Europe—in terms of its economic development. This could delay the process of convergence to and integration with the European Union, including its ambitions to eventually adopt the euro.
- **How to boost the growth prospects?** Accelerated structural reforms and macroeconomic stability remain key to achieving higher and sustained growth rates. Enterprise restructuring and privatization, alongside improving the business environment and reducing labor taxes, are critical to unlocking the potential for increased private investment and job growth. And meaningful structural fiscal reforms are needed to maintain BiH's hard won macroeconomic stability—an important prerequisite to achieving high and sustained growth rates.

¹ Prepared by Graham Slack and Irena Jankulov.

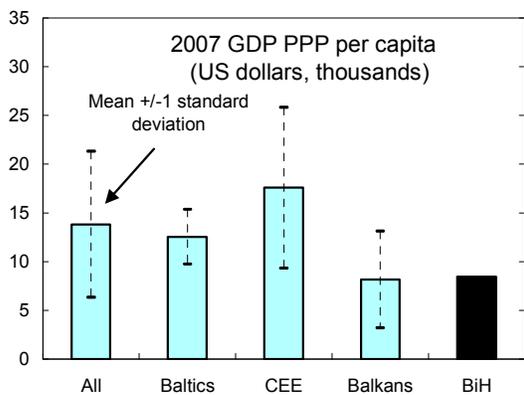
A. Introduction

1. **Bosnia and Herzegovina (BiH) has come a long way since it embarked upon transition in 1995.** It has maintained respectable annual GDP growth rates of 5-6 percent since 2004, and experienced rapid export growth and strong inflows of foreign investment, underpinned by the currency board and significant donor assistance. Considering that this economic record has been achieved in the context of a difficult post-war setting, it appears all the more impressive.

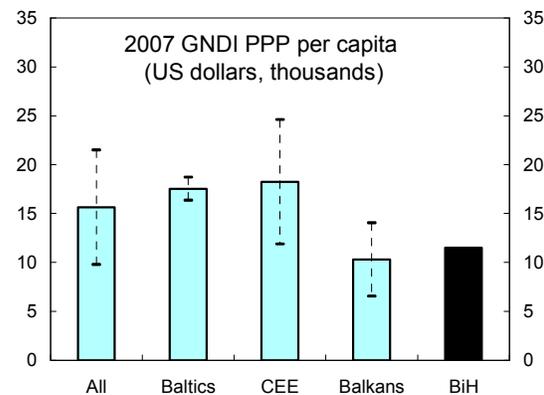
2. **When examining an economy's performance it is useful to draw comparisons with other similar economies.** This is especially so for a European emerging economy such as BiH that is aiming to catch-up, or converge, with its peers and is aspiring to join the EU and to adopt the Euro. With this in mind, this paper explores BiH's economic record in a cross-country setting and asks whether the country is on or off the convergence path followed by other emerging European economies at a similar phase of transition.

B. A Reasonable Level of National Income

3. **BiH appears to enjoy a reasonable level of per capita income.** Despite its late start to transition and the devastating effects of the 1992-1995 war, GDP per capita in BiH is broadly similar to that in neighboring Balkan countries. Moreover, this is only a partial measure of BiH's income as it excludes the sizeable remittances inflows to the country. Once such inflows are included in the measure, BiH's Gross National Income (GNI) per capita appears to be well above the Balkan average (US\$11,500 versus US\$10,300). Nevertheless, (BiH) continues to lag well behind the rest of emerging Europe.



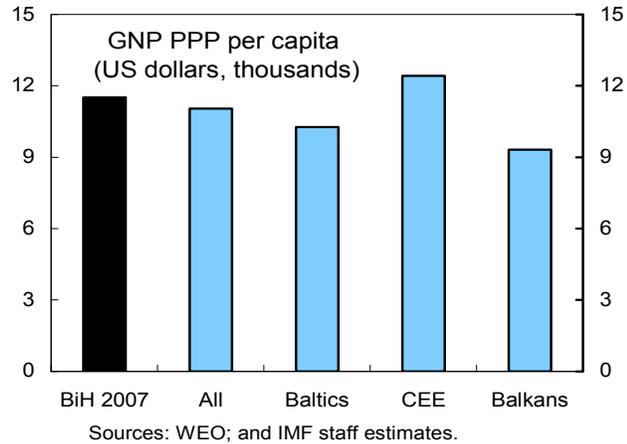
Sources: WEO; and IMF staff estimates.



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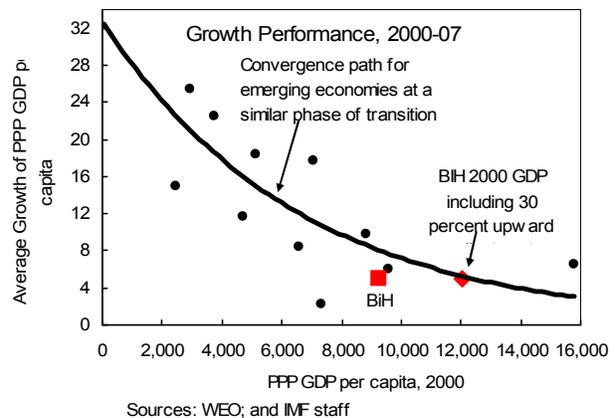
C. Late Comer and the War Effect

4. **Such a contemporaneous comparison of income levels across countries is perhaps unfair to BiH.** This is for two reasons: (i) no allowance is made for BiH’s relatively late start to transition—most European emerging economies began their transition during 1990–92, whereas BiH did not start its transition to a market-based economy until 1995; and (ii) no allowance is made for the detrimental effect on BiH’s transition path of the 1992–1995 war—something that other emerging countries did not experience. One way to control for both this “latecomer” and “war effect” is to compare BiH’s 2007 income level with the one of other transition economies in 1999. Using a lag of eight years recognizes that BiH embarked upon its transition path five years later than most other emerging economies,² and allows an additional three years to compensate for the fact that BiH experienced a war just before the start of its transition. Under this approach, GNI per capita in BiH appears to be broadly in line with that of other transition economies at a similar phase of transition.



D. Catching-up or Falling Behind?

5. **Despite maintaining a reasonably good level of per capita income, BiH’s growth dynamics appear to be somewhat less impressive.** Controlling for differences in the level of income across countries, BiH’s rate of growth appears to fall short of that achieved by other countries at a similar phase of transition.³ The implications are stark: despite its relatively high level of income, BiH risks falling behind, rather than catching-up with, other transition



² The lag is proportionately shorter for those economies that embarked upon transition after 1990.

³ The same approach as described earlier was used to control for Bosnia and Herzegovina’s latecomer status and the war effect. Specifically, BiH’s economic performance between 2000–07 is compared with other countries’ economic performance eight years earlier (depending on when they embarked upon transition).

