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Center for Civil Military Relations, Naval Postgraduate School, Monterey, California

Economic Aspects of Security and Peace in Bosnia: Challenges and Opportunities

Richard Temsch

Peace is a prerequisite for sustainable economic development and prosperity, but a functioning economy with low unemployment and a reasonable standard of living are also requirements for durable peace. The Bosnian economy has been going through a twofold transition: from the Yugoslav Communist system to a Capitalist market economy and from a war to a peace economy. While ex-Yugoslavia did not have a strict command economy, compared to the rest of Communist Eastern Europe, the Bosnian war has damaged or destroyed virtually every factory in the country and indeed most commercial and residential structures. A few hundred thousand people were killed during the war, many others left Bosnia, and another large portion of the population has been displaced within the country by ethnic cleansing. The breakup of Yugoslavia has disrupted the trade connections with the most important suppliers and customers outside of Bosnia. Ethnic cleansing has cut off links within the country. The Dayton Peace Accord defined the country as two administratively (and ethnically) separate entities: Republika Srpska and the Federation of Bosnia and Herzegovina. The Federation itself has ten cantons with their own administrations. The central government is weak and has not many competencies.

Most industrial enterprises that survived the war are to be privatized or have been privatized already. This is difficult because of the resulting job cuts and the already high unemployment. The SME sector faces tremendous financial problems. Business loans for start-up companies are very difficult to get, because loan applicants lack sufficient collateral. This impedes long-term investment by Bosnian entrepreneurs. Foreign direct investment is hampered by red tape and extortion. There is no legal certainty and commercial law can rarely be enforced in court.

The sluggish economy in most donor countries, along with persistent problems in Bosnia, such as corruption, graft, continual ethnic hostility and resistance to change from large parts of the political establishment, has led to frustration among donors. Besides, the focus of donor attention has shifted to other regions, first to Afghanistan, now to Iraq, countries that are far more populous than Bosnia. This has left Bosnia with less donor money and other assistance and may lead to a further reduced SFOR contingent in the near future.

On the other hand, compared to five years ago, the Bosnian population seems to be slowly doing better. Not everybody, for sure – the disparity is growing. However, the streets are full with cars, many of which are new, and the shopping malls are packed with local patrons during the weekends. Despite the high unemployment rate, many Bosnians have two or three jobs. The black economy, in particular black labor, contributes significantly to the GDP. The flipside is tax evasion.

Trade has developed rather well in recent years. Short-term loans, as needed for buying merchandise, are available at high interest rates. The currency is freely convertible with the Euro at the fixed exchange rate of KM 1 = 0.51 EUR. Till the end of 2001 the German Mark was legal tender, along with the Bosnian Convertible Mark. Foreign banks have entered the scene, but their main earnings are transaction fees rather than return on investments.

Supermarkets, shopping malls and boutiques are well stocked and the prices compare to those in the European Union. Restaurants are still somewhat cheaper, but hotels are even more expensive than in the EU. Many retailers accept credit cards, and over the last three years banks have installed ATMs, which are connected to the international networks. The presence of a large international community enhances this development. Expatriates spend over $30 million per month in Sarajevo alone.

December 2002 figures from the Office for Statistics show that industrial production has recently increased significantly in both entities of BiH. It grew by 20.1% in November in the Federation BiH, which brings the annual average up to 18%. In Republika Srpska, for the first time after the war, industrial production grew by 5% in the third quarter of 2002. This may indicate that the production crisis has bottomed out.

Foreign direct investment is vital for privatizing the large state-owned enterprises and boosting industrial production in order to reduce the large trade deficit. The new High Representative has nominated a “bulldozer committee”, which aims to push through about 50 items of legal and tax reform to create better investment conditions.

Some improvements are already under way. The currency board has been extended. It has been successful to eliminate the exchange rate risk, lower inflation and raise investor confidence. With the aid of the Stability Pact, free trade agreements have been signed with most countries in the region. Recognizing the danger for South-East Europe to fall behind in the development of the information society, the Stability Pact also formulated the eSEE Initiative on January 24, 2001. Its objectives are to help SEE seize the opportunities of the new technologies, promote full participation across SEE and prevent further divide, facilitate cooperation between international, bilateral and private donors, ease the cooperation between the public and private sector and society, and encourage cooperation across SEE for economic and democratic stability

A value added tax on the state level of about 15% is planned to replace the entity sales taxes by January 2005, and the corrupt entity customs authorities will be replaced by a customs authority on the state level.

While all these efforts and some recent positive economic figures should inspire cautious optimism, many Bosnian and foreign analysts agree that without the presence of international armed forces, the UN and the High Representative, the situation could still destabilize and ethnic hostilities might reemerge. Moreover, Bosnia could become a hub for drug and human trafficking, even a breeding ground for terrorism. Therefore, the country may have to remain under international supervision for some more years, until the political problems have been sorted out between the three ethnicities. Under such control and with the various support programs in place, there is a real chance for sustainable recovery and successful integration into the new Europe.

In 2002 the economy grew by 4.5%, which is twice of what was expected, and is projected to grow further by 5% in 2003 and beyond. The fiscal deficit is at 4% by 1.5% lower than projected. Inflation is very low at 0.25%, the foreign debt has been stabilized at $2.7 billion and foreign direct investment has grown to $300 million in 2002.