



European Bank
for Reconstruction and Development

Bosnia and Herzegovina country diagnostic:

Private investment challenges
and opportunities
2022



Country diagnostics are a European Bank for Reconstruction and Development (EBRD) tool for identifying the main obstacles to entrepreneurship and private-sector development in the economies where it operates. They also help to shape the Bank's priorities and project selection in formulating new country strategies. Each diagnostic informs the EBRD's policy engagement with the authorities in that country.

Each diagnostic assesses national progress and challenges in developing a sustainable market economy. Private-sector development and entrepreneurship are at the heart of the Bank's mandate, but in all of the Bank's investee economies, the private sector faces a range of problems and obstacles. The country diagnostic highlights the key challenges facing private companies and shows where each economy stands relative to its peers on the Bank's six transition qualities – competitive, well governed, green, inclusive, resilient and integrated – highlighting the main deficiencies and gaps in each.

The diagnostics draw on a range of methodologies and best practices for assessing how big certain obstacles are. Extensive use is made of the Bank's in-house expertise and surveys, such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as other cross-country surveys and reports from institutions such as the World Bank, the World Economic Forum and the Organisation for Economic Co-operation and Development (OECD). For some larger countries, the diagnostics also draw on specially commissioned studies of selected issues that are critical to private-sector development.

The EBRD's Country Economics, Strategy and Policy (CESP) team lead the diagnostics, drawing substantially on the expertise of sectoral, governance and political experts in the Policy Strategy and Delivery (PSD) Department and consulting widely with experts across the Bank in preparing the final product. The diagnostics are shared with the EBRD Board during the country strategy process and published during the public consultation period.

The views expressed in the diagnostic papers are those of the authors only and not of the EBRD or its shareholders.

For more information, go to <https://www.ebrd.com/publications/country-diagnostics>.

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Contents

Executive summary	5
1. Political economy.....	7
2. Economic background and outlook.....	8
3. Key challenges in the economy	10
3.1. Improving governance and the business environment.....	10
3.2. Increasing private-sector competitiveness	16
3.3. Building back better – greening the energy sector and strengthening inclusion	20
References.....	25
Annex 1: Qualities of a sustainable market economy	30
Competitive	31
Well governed.....	33
Green.....	35
Inclusive	37
Resilient	39
Integrated	42

Executive summary

Bosnia and Herzegovina is a small Western Balkans economy of 3.3 million people. Due to a complex constitutional set-up stemming from its post-conflict reconstruction, the country is institutionally and economically fragmented, without a common economic space. Such a system makes decision-making slow and suboptimal and frequently delays or halts necessary structural reforms.

The key challenges to private-sector development are weak public governance, which makes the business environment rather difficult, and the low competitiveness of the private sector. To boost economic growth and make it more sustainable, the country also needs to reduce its reliance on highly polluting coal and increase the use of its untapped human capital resources, as there are large cohorts of inactive women and unemployed youth in the labour market.

Based on this diagnostic paper, the economy could grow at a faster and more sustainable pace if the authorities were willing and able to conduct the necessary structural reforms, including:

1. **Enhancing the business environment for the private sector by aligning business laws and regulations between the national entities (the Federation of Bosnia and Herzegovina and the Republika Srpska), strengthening their implementation and fighting corruption.** Legal and administrative complexity creates significant obstacles for businesses in the country. Strengthening the rule of law (also by implementing existing legislation consistently), while at the same time aligning laws and regulations with those in the European Union (EU), could facilitate the EU accession process.
 - Example of a potential action: Review the current legal and administrative frameworks of each entity (in a selected number of areas) that affect the business environment, such as starting a business, and undertake the necessary reforms to streamline the process and establish identical rules across the two entities.
2. **Improving the governance of state-owned enterprises (SOEs) by establishing clear ownership policy.** Bosnia and Herzegovina still has a large SOE sector, which performs poorly compared with SOE sectors in central, eastern, southern and south-eastern Europe (CESEE) and local private-sector companies. The establishment of clear ownership rationale, key performance indicators and an effective governance system would support the overall improvement of SOEs and potentially facilitate the privatisation of some of these enterprises. This would help to create a level playing field between SOEs and the private sector.
 - Example of a potential action: Adopt a state ownership policy in each entity that is in line with international best practice, along with time-bound action plans to implement the policies, including privatisation decisions.
3. **Building on the existing strengths of firms producing more complex products and further integrating them into global value chains.** Bosnia and Herzegovina is more economically complex than expected for its income level, but is less integrated into global value chains than firms elsewhere in the EU. Further integration would create more opportunities for firms to grow and diversify into products of even greater complexity.
 - Example of a potential action: Review the extent to which firms could diversify and better integrate into global value chains and introduce appropriate policy support measures to facilitate this process.
4. **Raising digital awareness and develop skills in the information technology (IT) sector.** While the use of online sales platforms by small and medium-sized enterprises (SMEs) is slightly more advanced than that of SMEs in the EU, Bosnian SMEs rarely consider adopting more advanced IT technologies, such as cloud computing, big data or an enterprise resource system. A lack of awareness and inadequate IT skills are considered the main obstacles to greater digitalisation.
 - Example of a potential action: Undertake a digital awareness campaign and strengthen the educational system for IT skills development.
5. **Reducing dependence on highly polluting coal-fired generation while ensuring a “just transition” for those that would be affected by the closure of coal mines and thermal power plants (TPPs).** The energy sector is the most important sector for the greening of the economy. Currently, a significant share of electricity is generated from coal (lignite). Replacing coal with renewables and closing down coal mines and TPPs is essential in order to green the economy, but could create short-term challenges for local employment and growth.

- Example of a potential action: Develop a “just transition” strategy for the closure of coal mines and TPPs and adopt a more market-based support scheme for the further development of the private renewable energy sector.
6. **Ensuring that vocational education and training provision and educational policy in general are aligned with the needs of the private sector.** Skills mismatches are a prominent feature of the labour market in Bosnia and Herzegovina. Dual education programmes and the involvement of employers in identifying the skills needed, the standard definitions of occupations and skills development would greatly improve the responsiveness of the formal and informal education systems to the needs of the labour market.
- Example of potential action: Establish sector skills platforms or councils for key strategic sectors and promote further the concept of dual learning across administrative units.

This diagnostic document consists of the following sections: (1) political economy; (2) economic background and outlook; (3) key challenges in the economy; and (Annex 1) qualities of a sustainable market economy.

1. Political economy

Bosnia and Herzegovina is a republic created from the former Yugoslavia, which got its current shape from the Dayton Peace Accords that ended the devastating war of 1992-95. The country's challenges stem to a great extent from the legacy of this war and the Dayton agreement. The latter paved the way for peace and stability in Bosnia and Herzegovina and has supported it ever since. At the same time, it created a uniquely complex institutional structure, which has led to fragmented policymaking. The country comprises two entities – the Federation of Bosnia and Herzegovina and the Republika Srpska, whose governments have more powers than the central government – and three “constituent peoples”. At the central level, the decision-making process is based on a daunting system of checks and balances, which were designed to protect the interests of the “constituent peoples”, but which often encourage their representatives in the central state bodies to demonstrate their commitment to their respective ethnic communities rather than to the state. This is further complicated by the fact that ethnic-based political parties continue to dominate the political scene.

The complicated system of governance hampers the efficient functioning of the state, even though some businesses have adapted over time to circumvent the barriers. The country's constitutional set-up means that many of the weaknesses common to other Western Balkans countries – such as the capacity of the public administration, excessive politicisation (in Bosnia and Herzegovina's case, also the “ethnification”) of the civil service, weak judiciary, corruption and red tape – have been multiplied in Bosnia and Herzegovina.

Without a comprehensive reform of the system of governance, meaningful progress towards a more efficient and democratic state may be difficult. Several unsuccessful attempts have been made over the years to reach an agreement on constitutional reform. Local ethnic leaders fundamentally disagree on the optimal internal organisation of the country and, consequently, on the deeper reforms required to overcome some of the country's dysfunctions.

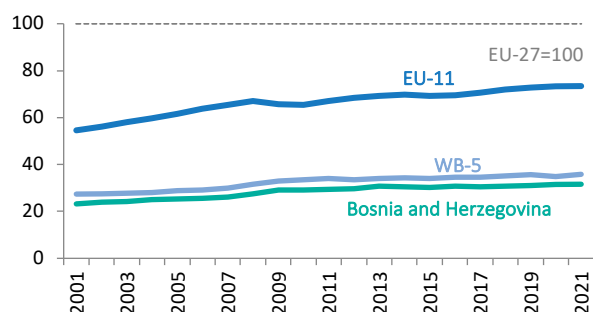
However, not all obstacles can be blamed on Dayton. Nothing in the Dayton Accords prevents privatisation, for example, which has stalled in some parts of Bosnia and Herzegovina for many years. Unlike in some other countries of in south-eastern Europe, where the process of privatisation has advanced over the years of transition, in Bosnia and Herzegovina, and particularly in the Federation of Bosnia and Herzegovina, the main economic power and main economic assets are still in the hands of the state. More precisely, they are in the hands of the leaderships of its ethnic political parties. The practice of distributing managerial positions in key public companies between the political parties is to a great extent a legacy of the former Yugoslavia, but it is aggravated in Bosnia and Herzegovina by the application of an “ethnic key”. The system of trading seats on the boards of key state-owned companies between political parties on winning elections is one of the cornerstones of the current inefficient system of governance.

Bosnia and Herzegovina has significant natural resources by regional standards. It also has a favourable position at the crossroads of some regional infrastructural corridors. Its participation in regional cooperation and integration processes makes it part of the wider Western Balkans market, which is more attractive to foreign investors than the region's individual small economies. Accelerating the privatisation of selected assets in key sectors and reforming the SOEs could be an efficient way of unlocking Bosnia and Herzegovina's economic potential and giving a boost to the economy, which has been dragged down by poorly governed public companies. Privatisation could also become a catalyst for other important reforms.

2. Economic background and outlook

Figure 1: Living standards lag those in the EU

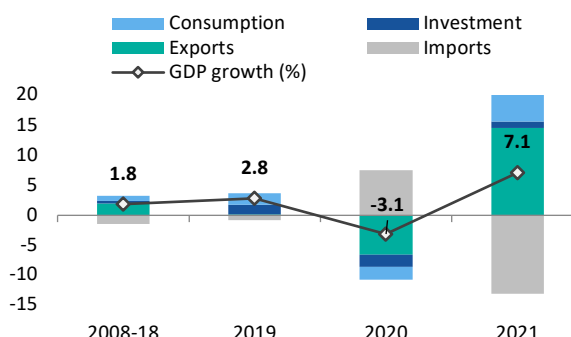
GDP per capita, US\$ purchasing power parity (PPP)



Source: IMF (2022), authors' calculations

Figure 2: GDP has been driven by the external sector

Contribution to GDP growth (pp), 2008-18, simple average



Source: Eurostat

The small, open economy of Bosnia and Herzegovina is slowly catching up with EU income levels. Like other Western Balkans countries, Bosnia and Herzegovina belongs to a group of upper-middle-income economies.¹ Prior to the Covid-19 pandemic-induced contraction of 2020 and the subsequent rebound in 2021, real gross domestic product (GDP) had grown by around 2 per cent annually in 2010-19, which is less than one would expect from a country at a similar level of development. Its GDP per capita catch-up was somewhat faster thanks to negative demographic trends, as many people emigrated in search of better economic opportunities. As of 2021, Bosnian GDP per capita was around the Western Balkans-5 average, but only one-third of that of the EU-28 and 45 per cent of that of the new EU member states (the EU-11).²

The service sector accounts for most of Bosnia's GDP. Services' share of GDP creation amounted to more than 60 per cent in 2021, while these sectors provided jobs for 57 per cent of the employed.³ Within services, those related to tourism (trade, transport, food and accommodation) added most value (one-fifth of GDP). Industry is prominent, contributing some 20 per cent of GDP, of which 14 per cent relates to manufacturing. Industry is the second-largest employer in the country, accounting for one-third of employment. Agriculture remains important, with the primary sector contributing around 6 per cent of GDP and providing jobs for 9 per cent of official employees⁴ (the agricultural sector is characterised by a large number of informal employees and this figure is probably conservative). However, farms are mostly small in size,⁵ family owned and characterised by low productivity.⁶ The sector is also subject to limited cooperation between policymakers, scientific institutions, advisors and producers.⁷ Overall, the economy is a net food importer.

Thanks to its industrial heritage, the country has a relatively strong manufacturing base. The most important branches of manufacturing are the production of food, base metals and metal products, and wood and furniture, which together account for half of total manufacturing value added.⁸ Exports of goods account for around 31 per cent of GDP (2017-20 average), which is a somewhat below Serbian levels. However, these exports mostly consist of raw materials and low-value-added products (metals, metal products, wood, furniture, clothes and footwear). Most Bosnian exports go to the EU (73 per cent in 2019), followed by Central European Free Trade Agreement (CEFTA) countries (17 per cent).⁹

Tourism is one of the fastest-growing sectors, with still a lot room for improvement. Prior to the pandemic, exports of services accounted for 11 per cent of GDP in 2017-19.¹⁰ Among services, those related to

¹ See World Bank (n.d.a).

² See IMF (2022).

³ See Agency for Statistics of Bosnia and Herzegovina (2022a; 2022b).

⁴ The agricultural sector is characterised by a large number of informal employees and this figure is probably larger in reality.

⁵ The average utilised agricultural area is smaller than 3 ha, according to the Ministry of Foreign Trade and Economic Relations (2018).

⁶ At an average yield for cereals of 4.3 tonnes per hectare of land in 2015-17, land productivity in Bosnia and Herzegovina was similar to the regional average, but significantly below that in the EU-28 (5.4 tonnes per hectare). Source: FAO (2019).

⁷ See European Commission (2014).

⁸ See Agency for Statistics of Bosnia and Herzegovina (2021a).

⁹ See Agency for Statistics of Bosnia and Herzegovina (2020).

¹⁰ Exports of services declined to 6.4 per cent of GDP in 2020 on the back of pandemic-related restrictions.

tourism dominated; travel and transport services accounted for around 70 per cent of total services exports.¹¹ Its rich history and beautiful natural landscapes are attracting more and more tourists. Between 2010 and 2019, the country recorded a 3.3-fold increase in foreign tourist arrivals,¹² with travel and tourism adding (directly and indirectly) 10 per cent to GDP in 2018.¹³ Following a severe contraction in 2020 due to the Covid-19 pandemic, the tourism sector did significantly better in 2021. However, the number of overnight stays remained significantly below 2019 levels. There is a lot of room for improvement, as indicated by the country's standing in the Travel & Tourism Competitiveness Index.¹⁴ Ranking 105th out of 140 countries in 2019, Bosnia and Herzegovina was also the least competitive economy in the region in terms of travel and tourism.¹⁵ It was judged to have a poorer business environment (ranking 134th) and a weaker overall infrastructure system (97th) for the development of the travel and tourism sector than the other Western Balkans economies.

A currency-board arrangement (CBA), in place since 1997, has helped macroeconomic and financial stability. Monetary policy in Bosnia and Herzegovina is conducted through the CBA. The Bosnian currency, the convertible mark (BAM), was first pegged to the Deutsche Mark (at a rate of 1:1), replaced by the euro in 1999 (at 1.95583 BAM per €1). According to the IMF, the CBA “has provided a credible anchor for the stability of the financial system and the overall economy”.¹⁶ Prior to the pandemic, supported by prudent fiscal policy, it helped to maintain low inflation, which averaged 0.7 per cent over 2010-19. In line with global trends, inflation pressures increased in 2021 on the back of elevated energy and food prices.

In the decade prior to the Covid-19 pandemic, growth was driven by domestic demand. In 2010-19, consumption and investment contributed similarly to GDP growth (2.0 and 1.8 percentage points, respectively). Net exports had only a marginal positive effect on growth (0.3 percentage points), as the positive contribution of exports of goods and services (2.1 percentage points) was largely offset by import growth.

The previously moderate growth rate gave way to a pandemic-induced contraction of 3.1 per cent in 2020. Before the outbreak of Covid-19, economic growth had already been decelerating. With the pandemic, it turned negative on the back of falling exports, consumption and investment. The tourism sector was severely affected; foreign tourist arrivals decreased by 84 per cent in 2020. At the same time, trade, transport and accommodation and food services recorded a combined decline of 15 per cent. The crisis also hit the manufacturing sector, whose output fell 4.4 per cent, with certain manufacturing industries decreasing their output significantly. Remittances from the country's large diaspora also shrank by 15 per cent, negatively affecting consumption.

Economic activity recovered strongly in 2021, but the outlook for 2022 is increasingly uncertain. The economy grew 7.1 per cent in 2021, largely driven by very strong external demand and recovering domestic consumption. The country's export basket expanded by more than 40 per cent in real terms during the year on the back of high demand from EU countries, Bosnia and Herzegovina's traditional export destination. Household consumption grew 6 per cent in real terms, driven by pent-up post-Covid spending and supported by a recovery in remittances. Investment growth was mildly positive due to the large contraction in 2021, but has not yet returned to pre-pandemic levels. GDP growth is expected to moderate towards the long-term growth rate in 2022 due to the strong recovery that has taken place and the more volatile macroeconomic environment. The economic impact of the war on Ukraine is expected to be reflected in a further rise in prices (annual inflation reached 13.2 in April 2022), which will erode disposable income, a slowdown in eurozone export markets and general uncertainty. The strong impetus of export growth in the first few months of 2022 should partly offset the anticipated slowdown, however.

Public debt remains moderate despite the increase. In response to the Covid-19 crisis, the entity governments adopted measures to mitigate the economic consequences of the pandemic. The government agreed on new loan arrangements with international institutions and significantly increased borrowing in the domestic financial market to finance the increased spending. The former include the IMF (€333 million under the Rapid Finance Instrument) and its Special Drawing Rights (SDR) allocation, as well as the European Commission (€250 million under its macro-financial assistance initiative). Public debt was estimated at 36.5 per cent of GDP as of end 2021, up around 3 per cent from end 2019.¹⁷ However, as large contingent liabilities are not captured in the headline figures, the true public debt ratio is likely to be higher.

¹¹ Travel services accounted for around 50 per cent of total services exports, while transport services accounted for another 20 per cent.

¹² See Agency for Statistics of Bosnia and Herzegovina (2021a).

¹³ See World Bank (n.d.b).

¹⁴ See WEF (2019a).

¹⁵ Please note that Kosovo was not included in the report.

¹⁶ See IMF (2021).

¹⁷ See IMF (2022).

Key challenges in the economy

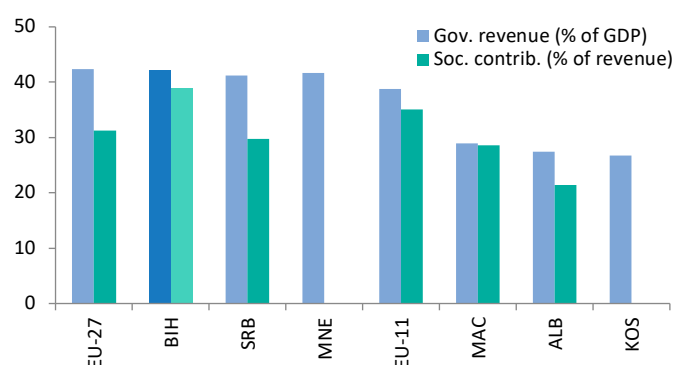
2.1. Improving governance and the business environment

Bosnia and Herzegovina potentially has the world's most complicated government structure ... The signing of the Dayton Accords in 1995 ended the war, but also created a new administrative reality. The country's constitutional and institutional set-up is complex, making governance very difficult. Moreover, forming a government, as a first step in decision-making, can take a long time, as shown by the 2018 general election. Indeed, the Federation of Bosnia and Herzegovina still lacks an entity government due to disagreements over the election law between the main Bosniak and Croat parties.

... resulting in a large public sector, burdened with numerous issues ... The public sector in Bosnia and Herzegovina employed over 200,000 people at end 2021,¹⁸ which is a quarter of total paid employment.¹⁹ The public administration is not only large, but also complex, often with overlapping competences, duplication of functions and unclear responsibilities across various levels of government. Insufficient professionalisation, limited implementation capacity and political interference are additional issues. Reforming the civil service is also important from the perspective of the EU approximation process. In its latest report, the European Commission noted that the country was at an early stage of public administration reform and that it needed to ensure "a professional and depoliticised civil service and a coordinated countrywide approach to policy-making."²⁰ What's more, SOEs provide work for a significant number of people, so the public sector accounts for up to half of all employment in the country.²¹ Working in the public sector is perceived as safer than in the private one, and wages are sometimes higher, distorting the labour market. The public sector is also burdened with substantial payment arrears which are weighing on private-sector suppliers, but potentially also negatively affecting other public services, due to unpaid contributions to health and pension funds.²²

Figure 3. Government revenues and social contributions

Percentage of GDP, 2017-19 simple average



Source: IMF WEO April 2022 and WB WDI

... which is expensive to maintain, increasing the tax burden on businesses. At 42 per cent of GDP in 2016-21, Bosnia and Herzegovina's general government expenditure was among the highest in the Western Balkans (the other five countries averaged 33 per cent of GDP).²³ At the same time, at 42 per cent of GDP for the same period, the country had the highest government revenues in the region, some 3 percentage points higher than the EU-11 average.²⁴ When asked to pinpoint the biggest obstacles they were facing, 18 per cent of firms in Bosnia and Herzegovina said tax rates, only slightly behind the No.1 obstacle, political instability (chosen by 21 per cent of firms).²⁵ The tax wedge is higher in Bosnia and Herzegovina than in most regional peers.²⁶ Labour taxes are particularly problematic, with high social-

¹⁸ The sum of the number of employees in three sectors: public administration and defence; compulsory social security; and education and human health and social work activities. See Agency for Statistics of Bosnia and Herzegovina (2022c).

¹⁹ Persons in paid employment are all those who have signed a work contract with an employer for a fixed or unspecified period, irrespective of type of ownership and of whether they work full or part time. Information from the Labour Force Survey points to a higher number of total employed people of 1.15 million in 2021.

²⁰ See European Commission (2021).

²¹ See Cegar and Parodi (2019).

²² See European Commission (2020b).

²³ See IMF (2022).

²⁴ Ibid.

²⁵ See World Bank Group (2020).

²⁶ See IMF (2021).

security contributions. Indeed, social contributions accounted for almost 40 per cent of government revenues in 2017-19, significantly above the regional or EU-11 average.²⁷ Consequently, entrepreneurship is discouraged, employment has been reduced and the informal economy has been stimulated, all of which are probably weighing on economic growth.

Satisfaction with public services and transport infrastructure is low. People in Bosnia and Herzegovina seem to be among the most regionally dissatisfied with the quality of public services (police, government, health, etc.) and transport infrastructure.²⁸ An IMF study showed that, in 2015, Bosnia and Herzegovina had one of the largest motorway and railway density gaps, as well as one of the largest air transport gaps, in the region.²⁹ The relatively low quality of transport infrastructure was also confirmed by the World Economic Forum, according to which the country ranked 108th out of 141 countries in 2019.³⁰ In line with that, in 2021, nearly 60 per cent of respondents considered travelling by road in Bosnia and Herzegovina unsafe, the highest percentage in the region.³¹ The country seems to lack resources to maintain the existing road network.³² As in the whole country, the institutional structure in the transport sector is very complex and fragmented. It is split between the Republika Srpska and the Federation of Bosnia and Herzegovina entities and the self-governing Brcko District,³³ making coordination and decision-making more difficult. The system is further hampered by being overstaffed by non-technical employees (for more information, see the section on the state footprint on page 14.

Governance indicators lag the rest of the region, amid a negative perception of the business environment. The country lags other Western Balkans countries on all six governance indicators compiled by the World Bank,³⁴ but mostly on government effectiveness, political stability and regulatory quality. Out of these three indicators, two are most relevant to private-sector development: government effectiveness and regulatory quality.³⁵ In all three of the poorly performing areas, there has been limited improvement over the past decade, with some deterioration more recently. According to the European Commission, countrywide strategies and measures to support business development (such as the adoption of policies on SMEs, the use of e-signatures and a reduction in para-fiscal charges) are long overdue due to the over-politicisation of the business environment and related socioeconomic reforms.³⁶ Moreover, the lack of improvement in the rule of law and the functioning of countrywide supervisory and regulatory institutions is stifling the country's business environment.³⁷ Consequently, Bosnian companies have a significantly more negative view of the business environment and the support provided to them than their peers in the Western Balkans region and the EU. One in two Bosnian SMEs has a negative view of the country's general business environment, compared with one in four in the Western Balkans more broadly and one in five in the EU-27.³⁸ The same holds for the perception of the legal and administrative environment and the quality of support services provided to businesses in this regard.

The complex legal and regulatory environment prompts informal practices and creates more room for corruption. Bosnian companies complain most about tax rates, corruption and competition from the informal sector.³⁹ Almost four in 10 firms cite tax rates and three in 10 cite corruption and competition from the informal sector as major obstacles to doing business. Compared with the Western Balkans-5, tax rates and corruption seem to be more of an issue in Bosnia and Herzegovina, while the opposite holds for competition from the informal sector. In addition, the areas where Bosnian businesses face significantly more challenges than their regional counterparts are tax administration and business licensing and permits.

The perception of corruption is very high ... Some recent surveys show that three quarters of respondents in Bosnia and Herzegovina believe businesses and the private sector are affected by corruption, while 80 per cent of them link public administration and corruption, the highest shares in the region.⁴⁰ According to

²⁷ According to [World Bank World Development Indicators](#). Data for Kosovo and Montenegro were not available.

²⁸ See RCC (2021).

²⁹ See Atoyan et al. (2018).

³⁰ See WEF (2019b).

³¹ See RCC (2021).

³² See Mladenovic and Queiroz (2020).

³³ For more detail, see, for example, Mladenovic and Queiroz (2020) and World Bank (2016).

³⁴ See [World Bank World Governance Indicators](#).

³⁵ Government effectiveness reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Regulatory quality reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private-sector development.

³⁶ See European Commission (2020a).

³⁷ See European Commission (2021).

³⁸ See European Commission (2020c).

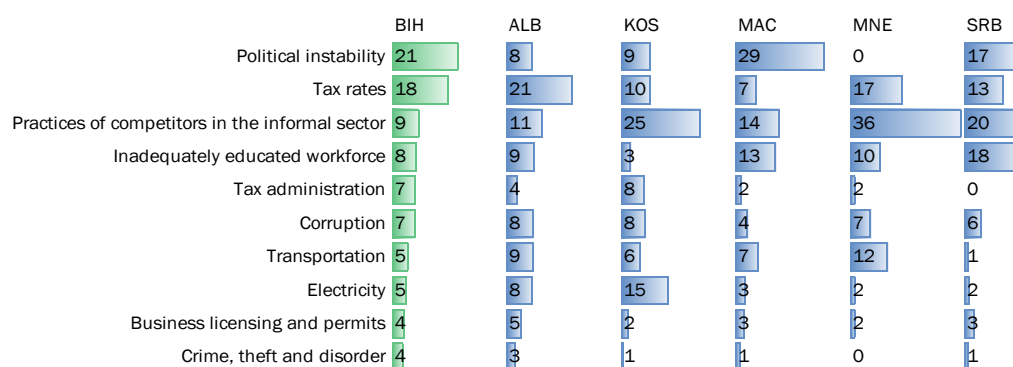
³⁹ See BEEPS VI, World Bank Group (2020).

⁴⁰ See RCC (2021).

Transparency International, Bosnia and Herzegovina ranked 110th out of 180 countries in the world in 2021 on corruption perception.⁴¹ This was 7 points below the score achieved in 2012, suggesting little to no improvement in the fight against corruption. According to the European Commission,⁴² corruption remains widespread and is a serious concern, with all levels of government showing signs of political capture, directly affecting the daily lives of citizens. This has contributed to the erosion of trust; a large majority of the general population has a very low level of trust in the country's public institutions and does not believe them to be independent of political influence.^{43, 44}

Figure 4. Top 10 major constraints on doing business

Per cent of firms identifying it as such



Source: BEEPS VI⁴⁵

... potentially also deterring companies from participating in public procurement. This might also be the reason why four out of ten companies decided not to take part in a public tender or a public procurement procedure in the previous three years, even though they could have offered the goods or services solicited. Again, this was among the highest shares in the Western Balkans.⁴⁶

The informal economy is estimated at (a rather stable) 30 per cent of GDP and employment.⁴⁷ Initially stimulated by the increased economic uncertainty after the collapse of the socialist system and war, informality nowadays seems to be driven not only by the need for additional income, but also by the wish to avoid institutional rigidities (such as contracts prescribing an eight-hour working day), high taxes and burdensome administrative procedures. By applying certain informal practices (such as evading taxes and paying employees under the counter), new companies find it easier to survive and gain some competitive advantage over older and more established ones. While on average three out of 10 firms in Bosnia and Herzegovina perceive the practices of competitors in the informal sector to be a major constraint on doing business,⁴⁸ informality is much more present among medium-sized and small firms than among larger companies. Low public trust in institutions and the high perception of corruption make it more difficult to tackle the issue.

The country's high degree of decentralisation is echoed in different business regulations and implementation procedures for different entities, making the business environment unfriendly and uncertain. For example, the procedure for starting a business is regulated by a national framework law (Framework Law on the Registration of Business Entities in Bosnia and Herzegovina), plus three additional laws for each entity and the district of Brcko.⁴⁹ Similarly, both entities have their own company laws regulating the establishment, operation and termination of businesses.⁵⁰ The Foreign Investment Promotion Agency of Bosnia and Herzegovina, meanwhile, stipulates six steps for starting a company in Republika Srpska and seven steps in the Federation of Bosnia and Herzegovina, with significant cost differences between the entities (see Figure 5). The implementation of procedures also differs. In Republika Srpska, a company can be registered and obtain licences and permits in any of the 11 branches

⁴¹ See Transparency International (2021).

⁴² See European Commission (2020a).

⁴³ See RCC (2021).

⁴⁴ See European Commission (2021).

⁴⁵ See EBRD, World Bank and EIB (2018).

⁴⁶ See RCC (2021).

⁴⁷ See Pasovic and Efendic (2018).

⁴⁸ See World Bank Group (2020).

⁴⁹ The Law on Registration of Business Entities in the Federation of Bosnia and Herzegovina; Law on Registration of Business Entities in the Republika Srpska; and Law on Registration of Business Entities in Brcko District.

⁵⁰ For more detail see, for example, the [Foreign Investment Promotion Agency of Bosnia and Herzegovina](#).

of the Agency for Intermediary, IT and Financial Services (APIF), while in the Federation of Bosnia and Herzegovina, there is no similar one-stop contact point.⁵¹

Figure 5. Steps in and costs of establishing a company in Bosnia and Herzegovina

	Federation of Bosnia and Herzegovina (generally applied)	Republika Srpska	Canton of Sarajevo
<i>Step 1</i>	Establishment contract (by notary)	Verification of the founding act by a notary	Stipulate a founding act and have it notarised (1-5 days)
<i>Step 2</i>	Payment of initial capital	Payment of initial capital	Obtain a statement from a commercial bank that the full amount of the capital has been paid in; pay the registration fee to the budget account of the cantonal court (1 day)
<i>Step 3</i>	Registration at the competent court (municipality/district commercial court) (5 days)	Registration request submit at the Agency for Intermediary, IT and Financial Services (APIF) (3 days)	Obtain a statement from the tax authorities that the founders have no tax debts (1 day)
<i>Step 4</i>	Making a company stamp	Making a company stamp	Registration with municipal courts (10 days)
<i>Step 5</i>	Opening a bank account at a commercial bank	Opening a bank account at a commercial bank	Buy a company stamp (1 day)
<i>Step 6</i>	Registration of the company and staff with the Tax Administration	Registration of staff with the Tax Administration	Obtain a certificate of business premises (10 days)
<i>Step 7</i>	Statement of the company founder about fulfilment of all requirements for starting activity (submit to the competent inspection department)		Apply for company tax identification number and register main activities (5 days)
<i>Step 8</i>			Open a company account with commercial bank (1 day)
<i>Step 9</i>			VAT registration (30 days)
<i>Step 10</i>			Notify the commencement of business activities to the Cantonal Inspection Authority (1 day)
<i>Step 11</i>			Acquire a fiscal device from one of the certified distributors and register the device with the Tax Administration (18 days on average)
<i>Step 12</i>			Enrol the employees in a health insurance with the Health Insurance Institute and in the pension insurance scheme (1 day)
<i>Step 13</i>			Adopt and publish a rule book on matters of salary, work organisation, discipline and other employee regulations (1 day)
<i>Cost</i>	Approximately BAM 2.500	Approximately BAM 350	Approximately BAM 1,350

⁵¹ See World Bank Group (2019).

Source: Foreign Investment Promotion Agency of Bosnia and Herzegovina and the World Bank

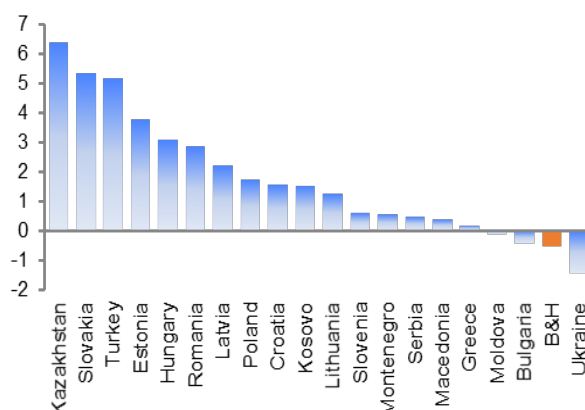
The complex governance structure not only constrains local businesses, but also deters foreign firms from entering the market. Bosnia and Herzegovina has a strong industrial heritage, relatively low labour costs and significant untapped human potential.⁵² Still, the complicated political and institutional structure discourages foreign investors who find it complicated to navigate the country's complex setting.⁵³ In addition, necessary structural reforms advance very slowly. Consequently, foreign direct investment (FDI) is low, ranging, on average, from 2 to 3 per cent of GDP annually,⁵⁴ while the stock of FDI is one of the lowest in the region. Furthermore, as of end 2020, 45 per cent of FDI had gone into just three service sectors (financial services, telecommunications and trade).⁵⁵

- *The state footprint is large, with weakly governed SOEs*

State-owned enterprises (SOEs) continue to play a critical role in the economy. The privatisation process in Bosnia and Herzegovina has not been completed and there has been limited progress on restructuring the country's SOEs. Consequently, the SOE sector in Bosnia and Herzegovina is larger than in most other countries in the CESEE region. At around 100 per cent of GDP in 2016, the stock of SOE assets in Bosnia and Herzegovina was the highest among the CESEE countries.⁵⁶ SOEs also provide work for a significant number of people, while at the same time remaining largely unreformed and inefficient. The latest available data suggest that there were 80,000 people working in the SOE sector in 2017 (11 per cent of total employment).⁵⁷ Despite their lower productivity, average wages at SOEs were 40 per cent higher than in the private sector. In 2019, in the two entities of Bosnia and Herzegovina, there were 315 and 235 SOEs, respectively.⁵⁸ However, neither entity has a consolidated list of SOEs at all levels of government, as only centrally owned SOEs appear on the lists produced by the Federation of Bosnia and Herzegovina and Republika Srpska. SOEs are owned by an entity, canton or municipality and operate in all sectors of the economy. The majority are small and medium-sized municipal utilities, while the most revenue and employment are generated by SOEs owned by the Republika Srpska or the Federation of Bosnia and Herzegovina. The largest of the latter operate in the electricity generation sector (in both entities), mining (coal mines in the Federation of Bosnia and Herzegovina), manufacturing (weapons factories), agriculture (the Republika Srpska forest company), and transportation (road and highway companies and railways).

Figure 6. Return on assets of non-financial SOEs

Per cent, 2014-16



Source: Borkovic and Tabak (2020)

SOEs in Bosnia and Herzegovina perform poorly, make losses and have a high level of indebtedness.⁵⁹ In 2014-16, Bosnian SOEs recorded one of the lowest returns on assets in central and south-eastern Europe (–0.5 per cent).⁶⁰ They also seem to perform weakly compared with the rest of the national economy. In 2017, returns on assets and equity and the liquidity ratios of SOEs were substantially lower than the same

⁵² The unemployment rate has decreased since 2015, but remains high, at 17 per cent in 2021, especially for youth (38 per cent).

⁵³ See World Bank Group (2019).

⁵⁴ In net terms.

⁵⁵ Central Bank of Bosnia and Herzegovina [statistics](#).

⁵⁶ See Richmond et al. (2019).

⁵⁷ See Cegar and Parodi (2019).

⁵⁸ Ibid.

⁵⁹ Ibid.

⁶⁰ See Borkovic and Tabak (2020).

indicators for the private sector.⁶¹ In fact, in 2017, almost half of all SOEs were illiquid, requiring budgetary support, while 14 of the 20 largest SOEs faced high or very high financial risk. At the same time, 12 per cent of SOEs were technically insolvent, with negative equity. Unconsolidated SOE debt accounted for around 26 per cent of GDP at end 2017. This figure also included tax and social security contributions arrears of around 4 per cent of GDP, mostly held by the railway and mining companies.

SOEs in the transport sector (roads, railways and airports) are not only numerous, but also poorly managed and often inefficient. In Bosnia and Herzegovina, there are four public road companies. In the Federation of Bosnia and Herzegovina, the Public Company (PC) Motorways of the Federation of Bosnia and Herzegovina is in charge of motorways and high-speed roads, while the PC Roads of the Federation of Bosnia and Herzegovina is in charge of main roads. Regional roads are managed by cantonal road directorates and local roads are managed by municipalities and cities. In the Republika Srpska, the road companies are PC Republika Srpska Motorways (for motorways) and PC Republika Srpska Roads (for main and regional roads). The various municipalities of Republika Srpska manage local roads and streets. In 2017, SOEs in the transportation sector (mainly highway and railway companies) held about half of total SOE debt.⁶² According to a recent EBRD-commissioned study,⁶³ road companies in Bosnia and Herzegovina are overstaffed, with the number of technical staff low compared with non-technical staff, and in need of significant improvement in corporate governance. One of the study's recommendations was to introduce key performance indicators that could be monitored, so that SOE staff could be held accountable to elected officials and the public. Other recommendations include, for example, the enhanced use of public-private partnerships and performance-based contracts in the road sector, to engage the private sector more. Railway companies in the entities are considered highly risky financially.⁶⁴ The Republika Srpska railway company is undergoing operational and financial restructuring with World Bank support, and the equivalent Federation of Bosnia and Herzegovina company may need a similar arrangement to reduce financial risk for the Federation.⁶⁵

The exercise of the state's ownership function is not subject to detailed rules, and the objectives of state ownership are not clear. There is no government policy (such as a state-ownership policy) or law in either the Federation of Bosnia and Herzegovina or the Republika Srpska to define the overall objectives of state ownership, or the manner in which it is implemented (such as the establishment of key performance indicators and the monitoring of their performance). The state ownership function is organised differently in the two entities. While in the Federation of Bosnia and Herzegovina, ownership is decentralised and led by line ministries, in Republika Srpska, the state-owned Investment and Development Bank of Republika Srpska (IRBRS) performs to a certain extent (through its funds) the role of a centralised ownership entity. However, this seems to be limited to SOEs that are listed. Even in those cases, the IRBRS acts through authorised representatives at the general shareholders' meeting of SOEs, who are ultimately appointed by the Republika Srpska government. Very little information is available on how the ownership function is exercised in practice in both entities.

Initial steps to improve the oversight of SOEs were taken in 2021. Both entities are working on establishing and operationalising units within their prime ministers' offices to improve entity-level SOE oversight and management.

All SOEs are required to establish a supervisory board, with a mandatory two-tier system⁶⁶ ... There does not seem to be a well-regulated process for identifying suitable candidates for board membership and neither SOEs nor the authorities seem to rely on nomination policies or pools of board-ready candidates to ensure the most appropriate board composition. There does not seem to be a requirement for independent board members and competency requirements are not comprehensively defined.

... but the responsibilities of the supervisory board do not seem to be in line with best practices. Some of the key functions (such as approving business plans and budgets, setting and monitoring performance objectives and overseeing risks) are absent from their responsibilities. Similarly, boards' responsibilities do not seem to include the oversight of environment, social and governance (ESG) and climate-related risks and opportunities. Boards are not required to establish subcommittees to assist them in specific matters. The law in both entities requires the establishment of audit committees in SOEs, however, this committee is appointed by the general shareholders' meeting, which is not in line with best practice. The composition of the committee is largely unregulated and usually does not include supervisory board members, which

⁶¹ See Cegar and Parodi (2019).

⁶² Ibid.

⁶³ See Mladenovic and Queiroz (2020).

⁶⁴ See European Commission (2020a) and Cegar and Parodi (2019).

⁶⁵ See Cegar and Parodi (2019).

⁶⁶ Consisting of a single board of directors.

effectively prevents it from being a board committee and severely reduces its role in the board's decision making.

Internal control frameworks seem to demonstrate some serious weaknesses. SOEs are required to have internal audit units, however the head of this audit can be appointed by the supreme audit institution rather than the SOE's audit committee. Moreover, the head of the internal audit function is a (non-voting) member of the audit committee, which presents a conflict of interest and is not in line with good practice. SOEs are required to undergo external audits of their financial statements and are subject to state-level audits. SOE employees are obliged to adopt codes of ethics.

The non-financial disclosures of SOEs could be improved. Only a minority of companies analysed by the EBRD disclosed their articles of association, the minutes of the general shareholders' meeting, supervisory board members' qualifications, and board and audit committee activities on their websites or in their annual reports.

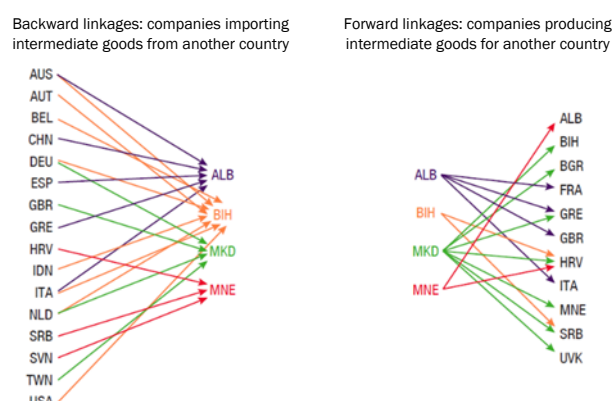
2.2. Increasing private-sector competitiveness

SMEs in Bosnia and Herzegovina are major contributors to the economy. In 2020, there were 74,570 enterprises and **entrepreneurs** in total in the country.⁶⁷ SMEs, or companies employing up to 250 people, accounted for 99.6 per cent of all enterprises, with the vast majority being small firms, employing fewer than 50 people (97.9 per cent of the total). At the same time, SMEs provided 70 per cent of employment and created 66 per cent of value added.

Although they could be exporting more, Bosnian SMEs seem to be comparatively strong exporters ... According to some analyses, Bosnia and Herzegovina is more economically complex than expected for its income level.⁶⁸ In 2020, it ranked as the fourth most complex country (out of 127 countries) in the Economic Complexity Index.⁶⁹ The largest contribution to export growth over 2013-19 came from moderate- and high-complexity products and services, such as travel and tourism and electrical machinery and equipment products. The latter, as well as industrial machinery, are viewed as sectors with high potential for the diversification of production, which could support economic growth. Goods exports emerged as a significant growth driver in 2021, recording annual growth of 35 per cent, though anecdotally this appears to be a consequence of existing companies expanding production rather than a sign of diversification.

... among which there are also several "hidden champions". Hidden champions are highly successful SMEs that are global or regional leaders in their respective niches, but are usually unknown to the wider public due to their business-to-business (B2B) nature (hence "hidden"). Research from 2018-19 discovered six hidden champions in Bosnia and Herzegovina, mostly in the manufacturing and information and communications technology (ICT) sectors.⁷⁰ They ranged from coffee roasters and producers of retro-style electric bicycles to software producers. With 1.6 hidden champions per 1 million of population, the country ranked seventh out of the 22 (mostly CESEE) countries studied. Nevertheless, these companies are relatively small compared with the overall business community in Bosnia and Herzegovina.

Figure 7. Global value-chain connectivity in the Western Balkans



Source: Ilahi et. al. (2019).

⁶⁷ Excluding agriculture. See Agency for Statistics of Bosnia and Herzegovina (2021c).

⁶⁸ See Harvard Growth Lab (n.d.).

⁶⁹ See OEC (n.d.).

⁷⁰ See IEDC-Bled School of Management and CEEMAN (2019).

Bosnian companies seem to be part of global value chains to a limited degree. The EU is the key destination for Bosnian goods exports, with almost three-quarters of exports going to the bloc, followed by neighbouring CEFTA countries (17 per cent of exports in 2021,⁷¹ of which Serbia and Montenegro are its main trading partners). However, only one per cent of SMEs report being part of a global value chain, compared with seven per cent in the EU-27.⁷² Global value-chain participation by Bosnia and Herzegovina has focused on clothing, footwear, machinery and the automotive sector. Like other Western Balkans countries, participating firms in Bosnia and Herzegovina seem to have diverse and developed backward linkages with EU and Organisation for Economic Co-operation and Development countries (OECD), but not so much with local suppliers, and with limited forward linkages. The latter indicates that these firms mostly assemble final products. As global value-chain participation is also in low-value-added segments, this might signal the need to deepen it and expand into other skills-intensive sectors, such as processed agriculture and ICT.⁷³

If implemented as initially planned, the EU carbon border-adjustment mechanism could significantly affect the export competitiveness of Bosnian companies.⁷⁴ According to preliminary estimates,⁷⁵ Bosnia and Herzegovina could potentially be the most affected country given the size of its exports to the EU in affected industries and their associated carbon intensity, followed by other economies neighbouring the EU, such as North Macedonia, Ukraine and Serbia. With significant greenfield FDI inflows into carbon-border tax-affected sectors, the tax could also discourage foreign investment in these sectors in Bosnia and Herzegovina.

The productivity of SMEs in the country is low ... Average SME productivity in Bosnia and Herzegovina, measured as value added per employee, amounted to €13,950 in 2016, less than a third of the EU average (€42,700).⁷⁶

... which may be linked to the unproductive use of resources due to institutional weakness and corruption, but also the fact that only a few Bosnian SMEs see innovation as a driver of growth. Just four per cent of SMEs say they plan to grow as a result of introducing some kind of innovation.⁷⁷ As the main obstacles to innovation, they cite a lack of financial resources (28 per cent of companies), the legal and administrative environment (18 per cent) and the difficulty of predicting a market response (12 per cent). These shares are lower than in the EU, but this may simply reflect an overall lower awareness of the need to innovate rather than to objectively lower obstacles.

The environment for credit provision is generally favourable, which is also reflected in access to finance being a less important obstacle.⁷⁸ Access to finance seem to be less difficult for Bosnian companies, with only one in 10 firms selecting it as a major obstacle to doing business (as opposed to two in 10 in the Western Balkans-5).⁷⁹ Most Bosnian companies (over 70 per cent) rely on internal sources of financing,⁸⁰ and those choosing external sources prefer bank loans. Somewhat surprisingly, at 58.5 per cent of GDP in 2020, credit to the private sector is above the Western Balkans-5 average of 50.4 per cent.⁸¹ However, there appear to be large gaps in the areas of factoring, the venture capital ecosystem and financial literacy.⁸² Also, government financial support schemes for SMEs are limited and specific to the different entities, with little standardisation. Both the Federation of Bosnia and Herzegovina and the Republika Srpska have credit guarantee schemes in place, but only limited take-up is reported.

When looking at firms' ambitions and strategies to grow, Bosnian SMEs stand out as being far less specific about their growth strategy than firms in the EU or more developed non-EU countries.⁸³ Similarly to other Western Balkans countries, only very few SMEs in Bosnia and Herzegovina have a growth strategy in place (14 per cent compared with 34 per cent in the EU-27). And, while between one-third and two-thirds of their peers in other countries can pinpoint expected sources of growth (such as digitalisation,

⁷¹ See Agency for Statistics of Bosnia and Herzegovina (2022d).

⁷² See European Commission (2020c) and ECB (2021).

⁷³ For more detail, see, for example, World Bank Group (2017; 2019) and Ilahi et al. (2019).

⁷⁴ In July 2021, the EU set out plans to replace carbon subsidies in selected industries with a carbon border-adjustment mechanism as part of the European Green Deal. The mechanism, effective from 2026, would charge additional levies on imports of goods which would have faced extra carbon charges if they were produced in the EU. This would cover mainly aluminium, cement, electricity, fertilisers, iron and steel. The levy aims to establish level playing field among EU producers and exporters to the EU and avoid export of pollution to more lenient jurisdictions.

⁷⁵ See Langella et al. (2021).

⁷⁶ See European Commission (2019).

⁷⁷ See European Commission (2020c).

⁷⁸ As reported in the BEEPS VI. See World Bank Group (2020).

⁷⁹ See World Bank Group (2020).

⁸⁰ See World Bank Group (2018).

⁸¹ See [World Bank World Development Indicators](#).

⁸² See OECD et al. (2019).

⁸³ See European Commission (2020c).

innovation, entrance to new markets), Bosnian SMEs indicate that they are eager to grow, but are unable to identify key sources of growth.

The Covid-19 pandemic impacted businesses. An assessment from June 2020 indicated that the crisis caused significant cash-flow challenges for micro-, small and medium-sized enterprises (MSMEs) and put 245,000 workers at risk of losing their jobs.⁸⁴ The most impacted sectors included trade, transport, agriculture, accommodation and food services, as well as several largely export-oriented manufacturing sub-sectors (apparel, rubber and plastic, wood and wood products, minerals and food). A survey conducted in autumn 2020 showed that Bosnian SMEs suffered, in particular, from payment delays and regulatory obstacles.⁸⁵ The biggest obstacles to doing business were payment delays (43 per cent), followed by the regulatory or administrative burden (38 per cent) and access to finance (18 per cent).

Entity authorities responded to the crisis by providing support for healthcare, workers and businesses. Support measures included six-month bank-loan repayment moratoria, compensation/solidarity funds to help firms by subsidising social-security contributions and providing minimum wages to workers in affected sectors, and the establishment of guarantee funds, among other things.⁸⁶

Going forward, greater public support could also help a greener and more inclusive recovery and encourage digitalisation. Only a few SMEs consider ESG-related actions to be part of their operations. The share of SMEs reporting that they implement recycling, resource-efficiency measures, sustainable product development, workforce diversity measures, etc., is a fraction of that among their EU peers. While it is not fully clear why many SMEs refrain from such actions, a lack of financial resources and know-how seems to play an important role – and this is where public policy can help address key issues.⁸⁷ SMEs could also benefit from more support when it comes to the adoption of more advanced digital technologies to ensure their performance does not further lag that of peers.

- *Bosnian SMEs' readiness for digitalisation*

The IT sector is emerging as an important part of the Bosnian economy to encourage digitalisation. In 2021, the ICT sector created 5.5 per cent of all value added in the country. Within the sector, the sub-sector of computer programming, consultancy and related activities has been flourishing in recent years. The number of firms and entrepreneurs in the sub-sector more than doubled in just two years, amounting to 1,410 as of end 2020 compared with 605 active firms in 2018.⁸⁸ Furthermore, employment in the IT sector more than tripled between 2012 and 2019 (to more than 6,250 people), growing 10 times faster than in the rest of the economy.⁸⁹ IT employees also have significantly higher salaries. At end 2021, the average net salary in the ICT sector of around €770 was almost 70 per cent higher than the net average salary of the country, while the average salary for the fastest-growing subsector of computer programming, consultancy and related activity, recorded an average wage of around €1,010, nearly double the national average salary. Furthermore, ICT exports almost doubled between 2014 and 2019, reaching close to €370 million (9 per cent of total services exports).

Despite online sales playing a slightly more important role for SMEs in Bosnia and Herzegovina than for SMEs in the EU ... An online presence is becoming more and more important worldwide, even for the smallest of businesses. In Bosnia and Herzegovina, nearly two-thirds of SMEs had a website in 2021.⁹⁰ This was somewhat below the figures of the EU-27, Serbia and Montenegro, but in terms of online sales, Bosnian SMEs compare well with the EU average. In 2021, 20 per cent of Bosnian SMEs had e-commerce sales⁹¹ of at least 1 per cent of turnover (compared with 19 per cent of SMEs in the EU).⁹² Larger Bosnian companies⁹³, however, lagged their European counterparts in this regard (27 per cent versus 39 per cent in 2020, respectively). In 2020, e-commerce marketplaces turned out to be more popular sales channels for Bosnian companies than their own websites or apps, also more popular than in the EU.

... Bosnian SMEs employ relatively fewer ICT specialists ... In Bosnia and Herzegovina, 13 per cent of SMEs employed ICT specialists in 2020 compared with 17 per cent in Serbia and 18 per cent in the EU-27.⁹⁴ The

⁸⁴ See ILO (2021).

⁸⁵ See European Commission (2020c).

⁸⁶ For a more detailed overview of measures, see, for example, ILO (2021).

⁸⁷ See European Commission (2020c).

⁸⁸ See Agency for Statistics of Bosnia and Herzegovina (2018a; 2021d).

⁸⁹ See Ekonomski institut Sarajevo (2020).

⁹⁰ EUROSTAT online data code isoc_ciweb.

⁹¹ E-commerce refers to the trading of goods or services over computer networks, such as the internet. Enterprises that receive e-commerce orders may be divided into those making e-sales via a website or apps (web sales) and those making e-sales via electronic data interchange (EDI).

⁹² EUROSTAT online data code: isoc_ec_eseln2.

⁹³ Those with 250 employees or more.

⁹⁴ EUROSTAT online data code isoc_ske_itspen2.

percentage is naturally higher for large enterprises (73 per cent in Bosnia and Herzegovina). SMEs, on the other hand, which reported a hard time filling their ICT-related vacancies, with nearly three-quarters of SMEs that recruited or tried to recruit ICT specialists saying they experienced difficulties finding an adequate candidate.⁹⁵ Potentially related to the lack of skilled staff, Bosnian SMEs also provide less training to existing staff on ICT matters (15 per cent compared with 20 per cent in the EU-27 in 2021).⁹⁶

... and their focus is on more basic digital technologies. More than 60 per cent of SMEs in Bosnia and Herzegovina intend to adopt or have adopted basic digital technologies (email and website), but are not considering more advanced technologies, such as cloud computing, big data, etc.⁹⁷ At the same time, 26 per cent of Bosnian businesses recognise the need to introduce more advanced digital technologies (compared with 42 per cent in the EU).⁹⁸

Slow progress in using some of the more advanced digital services suggests a risk that Bosnian SMEs might be left behind in terms of digitalisation. For example, the use of cloud computing services is alarmingly low among Bosnian SMEs; only 9 per cent of SMEs used these services in 2021, compared with 29 per cent in Serbia, 14 per cent in North Macedonia (in 2020) and 41 per cent in the EU-27.⁹⁹ Such services can be useful, particularly to smaller businesses, which may not have the scale for an investment in their own capacity to be worthwhile. In addition, while the rate of adoption between 2018 and 2021 was positive in Serbia and the EU, it stagnated in Bosnia and Herzegovina. Similarly, only 5 per cent of Bosnian firms analyse big data internally (compared with 13 per cent of EU firms).¹⁰⁰

SMEs cite a lack of skills, financial resources and ICT infrastructure as the top three obstacles to greater digitalisation ... Only 4 per cent of Bosnian SMEs have a strategy or action plan to digitalise, which is more than in rest of the Western Balkans region (0-1 per cent), but significantly less than in the EU-27 (21 per cent).¹⁰¹ In this context, Bosnian SMEs cite a lack of skills (15 per cent of SMEs), a lack of financial resources (14 per cent) and a lack of ICT infrastructure (10 per cent) as key obstacles. However, these obstacles appear to be less severe than in the EU and are comparable to other countries in the region – apart from Kosovo, where businesses face significantly higher barriers.

... but it seems many SMEs often lack proper understanding of what it means to “go digital”. Anecdotal evidence suggests that many non-IT companies think “going digital” is about having have a company website, or are concerned that digitalisation will lead to layoffs in future, so are resistant to considering further digitalisation. Also, firms often lag on the adoption of an enterprise resource planning (ERP) system, as they do not clearly perceive the benefits of such an investment. On the flip side, there is a cost, both in terms of money and time, to introducing such a system and making it work.

Thus, local IT companies providing customised products to local businesses significantly lag those offering outsourcing services to firms abroad. IT firms in Bosnia and Herzegovina can be divided into two groups: (1) those offering programming services (that is, outsourcing) to foreign companies and (2) those providing local solutions. The latter have not seen much growth, as domestic demand remains subdued. The former, in contrast, with their focus on exporting services abroad, have experienced rapid growth in recent years and now clearly dominate the sector. They also offer much more favourable salaries than the latter. This also explains why the highly skilled are more willing to engage in export activity than with local companies.

Mismatches between supply and demand and skills are the biggest factors limiting faster growth of the local IT sector. A lack of skilled IT developers is a global phenomenon, but it seems to be even more pronounced in Bosnia and Herzegovina. Demand for IT experts significantly exceeds supply, leaving 42 per cent of related vacancies unfilled.¹⁰² According to a study by Strik Consulting,¹⁰³ the current institutions that are educating personnel for the IT sector in Sarajevo Canton, by their structure, their current enrolment quotas, their educational curriculums, profiles of teaching staff, capacity and the fact that there is no specialised IT educational institution, are a highly limiting factor in the further development of the IT sector. Some suggested actions include: revising enrolment policies and adjusting them to the needs of the software industry; improving IT education at primary schools; establishing vocational IT schools; introducing distance learning in the tertiary IT educational sector; and strengthening IT programmes for

⁹⁵ EUROSTAT online data code ISOC_SKE_ITRCRN2.

⁹⁶ EUROSTAT online data code isoc_ske_ittn2.

⁹⁷ See European Commission (2020c).

⁹⁸ Ibid.

⁹⁹ EUROSTAT online data code isoc_cicce_use.

¹⁰⁰ EUROSTAT online data code ISOC_EB_BD.

¹⁰¹ See European Commission (2020c).

¹⁰² See Ekonomski institut Sarajevo (2020).

¹⁰³ See Strik Consulting (2017).

retraining and additional training. Also, there is a view that the IT sector should be declared a strategic industry for the development of the economy in Bosnia and Herzegovina and granted certain tax incentives.¹⁰⁴

IT firms and the whole business community would also benefit from more government engagement, including the adoption of a broadband strategy and the introduction of e-government services and e-signature. While the country has a 4G network, a broadband strategy is still lacking. The digitalisation of government services has been on agenda for a while, but it is progressing very slowly. A law on electronic signature is awaiting full implementation, despite the fact that it was adopted back in 2006. E-signature needs to be harmonised countrywide, which requires coordination, cooperation and data exchange between the different administrations.¹⁰⁵ The availability of some government e-services, such as the provision of personal documents (birth certificates, citizenship papers, etc.), permits and some other document online, is perceived as the worst of all the Western Balkans countries.¹⁰⁶ Stepping up digitalisation would also reduce the opportunity for a grey economy.

2.3. Building back better – greening the energy sector and strengthening inclusion

- *The energy sector*

The energy sector is the most important sector for the greening of the economy of Bosnia and Herzegovina. It accounted for 84.2 per cent of the country's production-based greenhouse gas (GHG) emissions in 2018,¹⁰⁷ largely due to the use of coal for electricity generation. In 2020, Bosnia and Herzegovina emitted 22.4 million tonnes of CO₂.¹⁰⁸ In per capita terms in 2020, it was the highest emitter in the Western Balkans region, at 6.8 tonnes. The second-highest emitter in the region was Serbia (at 6.6 tonnes), followed by Kosovo (at 5 tonnes).¹⁰⁹

The country's energy sector is heavily dependent on coal. Around 65 per cent of electricity in Bosnia and Herzegovina was generated from coal (lignite) as of 2020.¹¹⁰ The country's thermal power generation capacity is entirely lignite-fired, comprising four state-owned plants built between 1966 and 1985 and one private plant (Stanari), which came online in 2016, making it the youngest lignite plant in the Western Balkans.

The biggest problem with Bosnian coal plants is the emission of sulphur dioxide (SO₂). The lignite used in the plants has a high sulphur content, making these plants the second-biggest contributor to SO₂ emissions in absolute terms in the whole Western Balkans region after Serbian thermal power plants. Bosnia and Herzegovina alone emits more than twice the cumulative amount of SO₂ allowed four Western Balkans countries under the National Emissions Reduction Plan (NERP).¹¹¹

The country keeps exceeding agreed emission limits ... As a signatory of the Energy Community Treaty, Bosnia and Herzegovina became subject to the Large Combustion Plant Directive (LCPD) in 2018. The Directive sets emission limits for SO₂, nitrogen oxides (NO_x) and dust (particulate matter) for plants with a rated thermal input equal to or above 50 MW. Under the Directive, the country signed up to the NERP, but continues to far exceed agreed emissions limits. In 2020, Bosnia and Herzegovina failed to meet the ceilings for all three pollutants and, in March 2021, the Energy Community Secretariat launched an infringement case against it.¹¹²

... due to delays in installing emissions abatement technology (flue gas desulphurisation). An important recent development was an investment in desulphurisation equipment at the Ugljevik power plant.¹¹³ Although the loan by Japan International Cooperation Agency (JICA) was signed in 2009, works only started in 2017 and were completed in October 2020 (rather than by the end of 2019). The new flue gas desulphurisation unit should extend the lifespan of the power plant to 2035, helping the country meet EU environmental requirements.

¹⁰⁴ For more detail, see Ekonomski institut Sarajevo (2020).

¹⁰⁵ For more detail, see for example, European Commission (2020b).

¹⁰⁶ See RCC (2021).

¹⁰⁷ See Climate Watch (n.d.).

¹⁰⁸ See the IEA [data browser](#).

¹⁰⁹ <https://ourworldindata.org/co2/country/bosnia-and-herzegovina> Ibid.

¹¹⁰ Ibid.

¹¹¹ The National Emissions Reduction Plan (NERP) is an implementation mechanism that allows plants to be gradually brought into compliance as a group, with the better-performing plants balancing out the poorer-performing ones. In the Western Balkans, this mechanism is being used by Bosnia and Herzegovina, Kosovo, North Macedonia and Serbia. See CEE Bankwatch Network (2021).

¹¹² See Energy Community Secretariat (2021b).

¹¹³ See CEE Bankwatch Network (2021).

Only very few of Bosnia and Herzegovina's thermal power plants (TPPS) are set to comply with the LCPD by 2023 ... The three oldest units (Tuzla 3, Tuzla 4 and Kakanj 5) "opted out" of the LCPD, meaning that they are allowed to operate for a total of 20,000 hours between 2018 and 2023, after which they either need to close or comply with the emissions limit values for new plants under the Industrial Emissions Directive. Based on their current load factors, these units are expected to run out of operating hours by mid-2023 at the latest.¹¹⁴ Amid a global energy price increase, in March 2022, the parliament of the Federation of Bosnia and Herzegovina approved the cancellation of the application of the opt-out regime for two TPPs, Tuzla 4 and Kakanj 5, deciding to extend their operation to 2028. The Energy Community Secretariat has said that this is "a clear breach of the obligations of Bosnia and Herzegovina under the Energy Community Treaty".¹¹⁵ The organisation had already opened a case against Bosnia and Herzegovina in February for failing to meet the ceilings for air pollutants set in its NERP.¹¹⁶

... a number of new lignite-fired power plants have been proposed recently ...¹¹⁷ The most advanced of these is Tuzla 7, for which a financing deal was signed between the Bosnian power utility Elektroprivreda Bosnia and Herzegovina (EPBiH) and the China ExIm Bank in November 2017. This financing benefits from a state guarantee, which the Energy Community Secretariat has denounced as illegal state aid. A dispute settlement procedure is ongoing and the Secretariat has threatened sanctions over the project. This guarantee alone more than doubled Bosnia and Herzegovina's public debt exposure to support measures for coal-based electricity production to 6 per cent of GDP, by far the highest percentage in the Western Balkans. Construction was supposedly ready to begin in early 2021, but it remains highly unclear whether the plant will be commissioned at all.

... and coal subsidies exceed incentives paid to renewable energy producers. The sector is also heavily subsidised, putting stress on the public budget. For example, in 2017, the government provided €45.8 million in direct subsidies for electricity production from coal, compared with €25.0 million of paid incentives for production from renewables.¹¹⁸ Also, at around €2/MWh in 2019, coal subsidies in Bosnia and Herzegovina were higher than the incentives paid to renewable energy producers.¹¹⁹ In November 2020, the country signed the Sofia Declaration on the Green Agenda for the Western Balkans, pledging to work towards a carbon-neutral economy by 2050. Under the declaration, the country committed to gradually phasing out coal subsidies.

Currently, there are three operational wind plants in the country and no utility-scale solar photovoltaic (PV) plants. The wind plants (51MW at Mesihovina, 36MW at Jelovača and 48MW at Podveležje) came online in 2018, 2019 and 2021, respectively. They are located in the Federation of Bosnia and Herzegovina entity and operated by state-owned EPBiH. A privately-owned wind plant (66MW Grebak) is reportedly being constructed in the Republika Srpska and a number of other projects are at various stages of development across the country. According to some estimates, the country's cost-competitive solar PV and wind potential by 2030 (up to 2,955 MW and up to 12,810 MW, respectively) is significantly higher than existing capacity.¹²⁰

The grid allows for much more renewable capacity. In 2020, the State Electricity Regulatory Commission (SERC) almost doubled the national limit for grid-connected wind plants (to 840MW) and solar PV (to 825MW), creating space on the grid for significantly more renewable capacity.¹²¹

¹¹⁴ According to the Energy Community Secretariat (2021a), the TPP Kakanj 5 will reach the end of the opt-out timeframe already over the course of 2021.

¹¹⁵ See Energy Community Secretariat (2022a).

¹¹⁶ See Energy Community Secretariat (2022b).

¹¹⁷ See CEE Bankwatch Network (n.d.).

¹¹⁸ See Energy Community Secretariat (2019).

¹¹⁹ See Energy Community Secretariat (2021a).

¹²⁰ See IRENA, Joanneum Research and University of Ljubljana (2017).

¹²¹ See Energy Community Secretariat (2020).

Just Transition

Mining has a long tradition in Bosnia and Herzegovina. Currently, the country has around 14 relatively important active mines,¹²² producing mainly brown coal and lignite, most of which are used in local TPPs. The majority of mines are located in the Federation of Bosnia and Herzegovina. As of end 2021, mining and quarrying employed 16,468 people in the country¹²³ (around three-quarters of which worked in the Federation entity).¹²⁴

Diversification away from coal poses socioeconomic risks for the workers and, potentially, the communities involved. Experience shows that people whose livelihoods depend on carbon-intensive assets, especially in so-called “mono-towns”,¹²⁵ can suffer strong socioeconomic effects from the transition to a greener economy. The effects include rising unemployment rates, economic stagnation, a decrease in public revenues and mental health issues.¹²⁶ The imminent closure of the three TPPs following the opt-out from the LCPD poses a risk not just to the jobs at the power plants, but also to jobs in coal mining, due to the reduced demand for coal. The workforce of EPBiH, one of three state-owned power utilities in the country, has already decreased (from 10,500 in 2009 to 7,200 in 2020), mostly due to the company’s economic challenges. The company now plans to restructure its seven indebted coal mines and further cut the number of employees over the next three years to 5,200. Also, the competitiveness of the remaining coal-fired plants is expected to decrease markedly with the introduction of CO₂ emission prices under the EU Emissions Trading System (ETS).¹²⁷

Saving jobs by opening new coal-fired TPPs would also come at a high price, however, including for nearby countries. Some of the jobs might be saved if the announced new TPP projects materialise, but these would come at the risk of locking in carbon-intensive energy production. In addition, an analysis shows that two proposed coal power plant projects (Tuzla 7 and Banovići) would have a substantial negative impact on air quality and public health, not just in Bosnia and Herzegovina, but also over an area extending several hundred kilometres from the power plants.¹²⁸ Over the next 30 years, the two plants could cause as much as 960 premature deaths, the majority of which would affect neighbouring and nearby countries (Croatia, Serbia, Montenegro, Albania, Slovenia and Italy).

A just transition means the benefits of a green economy transition are shared, while vulnerable regions and people are protected from falling behind. Early planning and appropriate short- and long-term measures are essential to support affected workers and to address major social and economic changes in times of transition from coal. Workers could be supported in different ways, from early retirement, compensation schemes, upskilling, reskilling and job relocation services to mental health support and access to financial resources.¹²⁹ In Bosnia and Herzegovina, discussions on a just transition roadmap have just started at state level and in the Federation of Bosnia and Herzegovina entity, and will need to become more concrete in terms of possible measures and efforts to manage this transition. Active labour-market policies will be needed to assist affected workers with reskilling, upskilling and finding new quality jobs, not only through internal redeployments but also through external transfers in the regional labour market. Early planning and developing a national reskilling strategy could help to ensure a smoother, just transition of the country’s coal regions to a low-carbon economy.

¹²² See United Kingdom and Bosnia and Herzegovina (2017).

¹²³ See Agency for Statistics of Bosnia and Herzegovina (2022c).

¹²⁴ See Agency for Statistics of Bosnia and Herzegovina (2021c).

¹²⁵ Towns that depend on one large enterprise.

¹²⁶ For more detail, see, for example, EBRD (2020).

¹²⁷ See Energy Community (2019).

¹²⁸ See Myllyvirta (2019).

¹²⁹ For more detail, see, for example, EBRD (2020).

Bosnia and Herzegovina does not have an adequate, market-based support scheme for new renewable energy projects. A feed-in-tariff (FiT) has remained in place for small-scale solar PV, although this was scheduled to expire in 2021. Renewable producers under the FiT scheme have guaranteed offtake and are not subject to balancing responsibilities, against state aid guidelines. Although a proposal for a market-based support mechanism was submitted to the Energy Community Secretariat for review in 2020, no new scheme has yet been adopted by the government, creating significant uncertainty for potential investors.

Full implementation of the Third Energy Package at state level is a crucial outstanding step to developing a competitive and integrated energy market that is capable of supporting the country's decarbonisation efforts. The Bosnia and Herzegovina electricity sector is fragmented and very complex in terms of administrative, legislative and regulatory structure. For example, the country has three incumbent electricity generating companies, operating along ethnic lines,¹³⁰ and three electricity market regulators. Unbundling in the electricity sector is at a very early stage. The legal unbundling of the distribution system operators in Republika Srpska was completed, but not in the Federation of Bosnia and Herzegovina. The country is even further behind on gas market reforms and has yet to transpose the requirements of the Third Energy Package, which could support the phasing out of its reliance on coal. The two entities operate distinct gas markets and are subject to a number of Energy Community infringement cases.¹³¹

- *Economic inclusion*

Bosnia and Herzegovina has one of the most challenging labour-market situations in the region, with very low employment and activity rates ... Despite some increase over the past decade (2011-21), labour-force participation in Bosnia and Herzegovina remains the lowest in the Western Balkans. At 59 per cent in 2021,¹³² it was around 5 percentage points below the Western Balkans average.¹³³ Similarly, the employment rate has been on the rise, but at 49 per cent in 2021,¹³⁴ remained well below the regional average.¹³⁵ Both activity and employment rates are significantly lower in the Federation of Bosnia and Herzegovina than in the Republika Srpska (by around 10 percentage points as of 2019).¹³⁶

... especially for women, whose participation in the labour market is significantly lower than expected for countries at a similar level of development to Bosnia and Herzegovina. Although employment and activity rates rose somewhat over the decade from 2011 to 2021, women's position in the labour market did not improve. The gender gap in labour-force participation and employment rates has remained stagnant and large, with women's activity and employment rates around 25 percentage points lower than those for men.¹³⁷ Hence, the country has one of the lowest female employment rates in the Western Balkans, with around one in three women in employment. A number of factors might be contributing to this situation, including family responsibilities and a lack of affordable (or any) childcare provision (especially in rural areas), but also cultural and religious norms, which dictate that household tasks are a woman's responsibility and take priority over paid employment.¹³⁸ Due to their low level of education, limited job opportunities and traditional patriarchal values, Roma women are by far the most disadvantaged group, with 80 per cent of them jobless, nine per cent informally employed, seven per cent engaged in begging and just 2-4 per cent employed in the public sector.¹³⁹

The informal economy is pervasive, with one in three people informally employed. Informal employment as a share of total employment is relatively high (at 30.5 per cent as of 2019).¹⁴⁰ More than 90 per cent of these people work in the informal sector (mostly as independent workers) and around nine per cent in the formal sector (where salary is at least partially undeclared). Informal employment is significantly more widespread in rural areas and it is more common among less educated and older individuals. Agriculture accounts for more than half of all informally employed people in the country; almost nine out of ten people working in agriculture work informally.

Despite a downward trend in recent years, the unemployment rate remains high ... In 2021, the unemployment rate stood at 17.4 per cent, down almost 11 percentage points from 10 years prior. The Covid-19-induced crisis resulted in a slight rise in unemployment from 2019 to 2021, the first rise in five

¹³⁰ JP Elektroprivreda BiH (Bosniak part of the Federation of Bosnia and Herzegovina entity), JP Elektroprivreda HZHB (Croat part of the Federation entity) and MP Elektroprivreda RS (Republika Srpska). See CMS (n.d.).

¹³¹ See Energy Community Secretariat (2020).

¹³² See Agency for Statistics of Bosnia and Herzegovina (2022b).

¹³³ According to national Labour Force Survey estimates. Data for Kosovo were unavailable.

¹³⁴ See Agency for Statistics of Bosnia and Herzegovina (2022b).

¹³⁵ According to national Labour Force Survey estimates. Data for Kosovo were unavailable.

¹³⁶ See Agency for Statistics of Bosnia and Herzegovina (2021b).

¹³⁷ See Agency for Statistics of Bosnia and Herzegovina (2014; 2022a).

¹³⁸ See, for example, World Bank (2015) and Somun-Krupalija (2011).

¹³⁹ See World Bank (2015).

¹⁴⁰ For more detail, see ILO (2020) or Pasovic and Efendic (2018).

years. This decade-long downward trend in the unemployment rate was mainly driven by demographic changes (a shrinking working-age population) and emigration.¹⁴¹ The unemployment rate as of 2019 was higher in the Federation entity than in the Republika Srpska (18.4 per cent versus 11.7 per cent, respectively). In both entities, the unemployment rate for women exceeded that for men by around five percentage points. Although long-term unemployment has declined since 2016, it remained pervasive, at 78 per cent of all unemployed people in 2021, with women slightly more exposed to long-term unemployment than men.¹⁴² People with only primary school education or less saw the highest unemployment rates (24 per cent at end 2021), followed by those with just secondary education (16 per cent), while people with tertiary education seemed to be better off (12 per cent jobless rate).¹⁴³

... particularly for youth ... The position of young people¹⁴⁴ in the labour market has improved significantly over the past decade, but remains challenging. The youth unemployment rate stood at 38.3 per cent in 2021, far lower than the 62 per cent recorded in 2012, but still more than twice as high as the adult rate. At the same time, one in five of the country's youth was not in employment, education or training as of 2020.¹⁴⁵ Skills mismatches, due to the education system not responding adequately to private-sector needs,¹⁴⁶ might be one of the factors hindering youth employment.

... contributing to a brain drain. Poverty, lower-quality and lower-paid jobs,¹⁴⁷ and the low utilisation of human capital (as indicated by low employment and high unemployment rates) have led to high emigration. Furthermore, diaspora networks established abroad, which provide information and resources to newcomers, are facilitating further emigration. While this holds for all countries in the region, emigration seems to be most pronounced in Bosnia and Herzegovina. For example, a recent study found that in 2011-19, the average net migration rate for the population aged 15-39 years was highest in Bosnia and Herzegovina (-12 per cent per 1,000 population) out of all of the Western Balkans countries.¹⁴⁸ Although all age cohorts emigrate, it is more prevalent among the youth. This is mainly down to the high unemployment rate, but also to the pursuit of further education abroad and family reunification.

Consequently, the country is a large recipient of remittances, encouraging low participation in the labour market. Over 2015-20, personal remittances sent to Bosnia and Herzegovina amounted to 11 per cent GDP,¹⁴⁹ the second-highest inflow in the region after Kosovo. Remittances have been on a downward trend, but remained high at around 8 per cent of GDP in 2020 and 2021,¹⁵⁰ possibly due to the lower disposable income of the diaspora as a result of the pandemic-induced crisis. A high reliance on remittances is often viewed as a factor contributing to high "reservation wages"¹⁵¹ and, hence, low labour-market participation rates.

¹⁴¹ See World Bank (2020).

¹⁴² See Agency for Statistics of Bosnia and Herzegovina (2022b).

¹⁴³ See Agency for Statistics of Bosnia and Herzegovina (2022e).

¹⁴⁴ 15-24 years of age.

¹⁴⁵ See World Bank [World Development Indicators](#).

¹⁴⁶ See, for example, ETF (2019) and World Bank (2020).

¹⁴⁷ Wage gaps and changes in them seem to be a key pull factor driving outward mobility from the country (and the whole Western Balkans region). See, for example, Mara and Landesmann (2021).

¹⁴⁸ See Leitner (2021).

¹⁴⁹ See World Bank [World Development Indicators](#).

¹⁵⁰ Authors' calculations based on Central Bank of Bosnia and Herzegovina balance-of-payments data.

¹⁵¹ Reservation wage are the minimum wage a worker requires in order to participate in the labour market.

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Annex 1: Qualities of a sustainable market economy

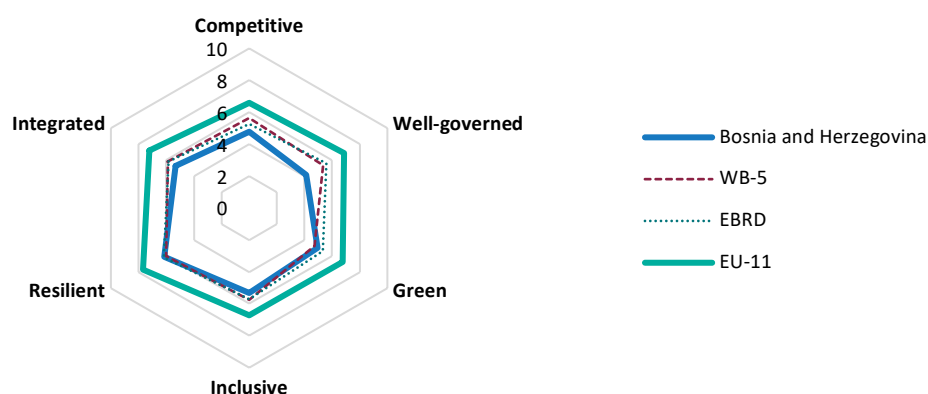
In the EBRD's 2021 Assessment of Transition Qualities (ATQ), Bosnia and Herzegovina ranked 24th out of the 38 economies where the Bank invests.¹⁵² According to the EBRD's methodology for measuring transition, ATQs are composite indices based on six desirable qualities of a sustainable market economy, namely, competitive, well governed, green, inclusive, resilient and integrated. They are obtained by combining information on a large number of indicators and assessments.¹⁵³

According to the ATQs, Bosnia and Herzegovina is the least competitive and worst-governed economy in the Western Balkans and also one of the most poorly governed in the broader EBRD regions. The country performs similarly to the rest of the Western Balkans region on the green and resilient qualities, while the gap is very pronounced for the well-governed (1.2 index points) quality, followed by the competitive and integrated qualities (0.9 and 0.6 index points, respectively). Bosnia and Herzegovina also lags the average of all EBRD regions on all qualities, with the worst showing again being for the well-governed quality (1.5 index points). The economy has a significant room for improvement compared with the new EU member states (EU-11) on all qualities, with a gap ranging from 1.4 index points for inclusivity to 2.7 index points for governance.

The following sections provide brief snapshots of each quality.

Figure 7. ATQs in 2021

(1 – 10 best)



Source: EBRD calculations

¹⁵² The score is calculated as a simple average of scores for the six transition qualities.

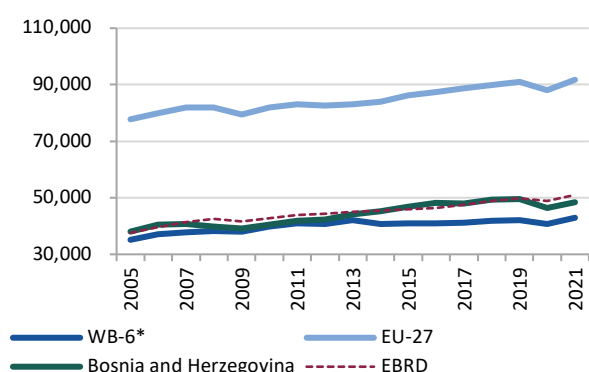
¹⁵³ For more detail, please see EBRD (2021b), pp.125-131.

The economy of Bosnia and Herzegovina is characterised by a fragmented institutional and regulatory framework stemming from a complex political setup, a lack of common economic space, a high tax burden and skills mismatches in the labour market. These challenges weigh on the private sector and lead to persistently widespread informality and high emigration rates. The country fares better than its regional peers when it comes to economic complexity, however.

- 75th out of 131 countries on innovation¹⁵⁴
- 29th on knowledge economy out of 38 EBRD investee economies ¹⁵⁵
- The average net migration rate for the population aged 15-39 years in 2011-19 was -12% per 1,000 population, the highest of the Western Balkans countries¹⁵⁶

Figure 8. Labour productivity

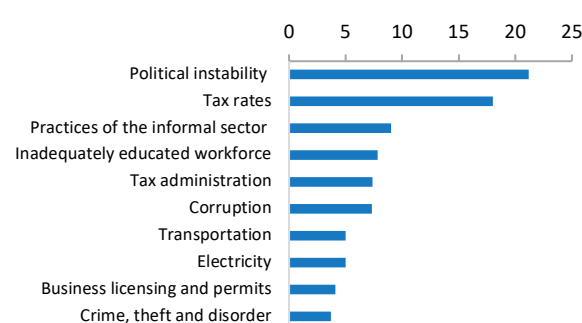
In constant 2017 prices; international US\$, PPP



Source: Ilostat, authors' calculations.

Figure 9. Biggest obstacles to doing business

Percentage of firms



Source: BEEPS VI.

- **Bosnia and Herzegovina is a small, open economy with low goods import duties.** The weighted average of its applied tariff rates amounted to 2.8 per cent in 2018, similar to the regional average and higher than that of the new EU member states (1.7 per cent). The country has free trade agreements with the EU and Turkey and is a member of CEFTA. However, it is not yet a member of the World Trade Organization. Despite low tariffs, other barriers – such as non-tariff barriers, logistical and infrastructural deficiencies, and weak border management – are seen as undermining the country's competitiveness on external markets.¹⁵⁷
- **The quality of the business and regulatory environment in Bosnia and Herzegovina is weak.** The complicated political system translates into a complex institutional and regulatory framework in nearly all areas, which is difficult, timely and costly to navigate and creates significant hurdles for the private sector, undermining entrepreneurship and potentially increasing informality and corruption.
- **Bosnia and Herzegovina lags the Western Balkans-5 average on the EBRD adjusted SME Index (4.2 versus 5.2, respectively).** Its complex business environment and fragmented administrative structure may be placing a burden on firms in the form of excessive regulation, lengthy and complex administrative procedures, taxes and local fees, which ultimately hinder SME development.¹⁵⁸
- **According to estimates from 2019, Bosnia and Herzegovina is more economically complex than the average Western Balkans economy, but significantly less so than the new EU member states.**¹⁵⁹ Bosnian exports mostly consist of raw materials and low-value-added products, with its competitiveness stemming largely from the low prices of inputs, such as labour and energy. Also, the economy seems to be less integrated into global value chains (GVCs) than some of its peers in the

¹⁵⁴ See WIPO (2021).

¹⁵⁵ See EBRD (2019).

¹⁵⁶ See Leitner (2021).

¹⁵⁷ See World Bank (2020a).

¹⁵⁸ See European Commission (2019).

¹⁵⁹ A country's economic complexity captures the diversification of goods exported as well as their degree of complexity. For more detail, see, for example, Atlas of Economic Complexity (n.d.).

region.¹⁶⁰ Bosnia and Herzegovina's GVC participation has focused on clothing, footwear, machinery and the automotive sector, and has been characterised by the final-stage assembly of production, with a few backward linkages to local suppliers. It also remains in the low-value-added segment.

- **Advanced business services (such as financial, insurance services, communications and computer services) made up 32 per cent of all service exports in 2017.** The country's performance in this regard is lower than that of the Western Balkans-5 and EU-11 averages, at 34 per cent and 40 per cent, respectively. In general, the services sector is a major contributor to the country's economy, accounting for some 60 per cent of its GDP in 2021, with less sophisticated services making up the bulk of this.
- **Bosnia and Herzegovina is in the early stages of knowledge economy development.** It ranks second lowest in the region on the EBRD Knowledge Economy Index and 29th overall out of the 38 EBRD investee economies.¹⁶¹ The country seems to score poorest on innovation systems.¹⁶²
- **It also scores below the regional average on skills of the current and future workforce.**¹⁶³ The low quality of education and the skills mismatches in the labour market are seen as key factors behind the low activity rates of the working-age population and the high unemployment rate.
- **Labour productivity is somewhat above the regional average, but significantly lags that of the EU.**¹⁶⁴ In addition to high levels of emigration depleting human capital, this can also be linked to skills mismatches in the labour market, the large share of employment in low-technology industries and low-value-added services, as well as the dominance of micro firms in the enterprise sector.

¹⁶⁰ For example, North Macedonia or Montenegro (data for Kosovo and Serbia were not available). Data are EBRD calculations based on UNCTAD-Eora GVC data.

¹⁶¹ The index has four pillars: institutions, skills, innovation system and ICT Infrastructure. For more detail, see EBRD (2019).

¹⁶² The three dimensions of this pillar are (i) inputs into the innovation system (for example research and development spending), (ii) innovation system outputs (such as patents) and (iii) linkages within the innovation system (such as scientific collaboration, venture capital and value chains)

¹⁶³ Based on data on skills in the in the WEF's *Global Competitiveness Report* (WEF, 2019b).

¹⁶⁴ According to the ILO database. Labour productivity is measured as output (GDP in constant 2017 international dollars, PPP) per worker.

Governance is the area most in need of improvement in Bosnia and Herzegovina. The lack of credible economic vision and decision-making, the prevalence of corruption at all levels of government, the low capacity of the public administration and political interference reflect badly on the business environment. Corporate governance, particularly of SOEs, falls short of guidelines and ranks low in the region.

- 137th out of 141 countries in 2019 on the burden of government regulation¹⁶⁵
- 133rd out of 141 countries on judicial independence¹⁶⁶
- 110th out of 180 countries on corruption perception in 2021¹⁶⁷
- 123rd out of 141 countries on the strength of auditing and accounting standards¹⁶⁸

Figure 10. Public governance

Index; from -2.5 (weak) to 2.5 (strong)

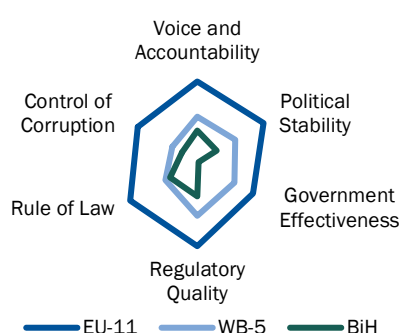
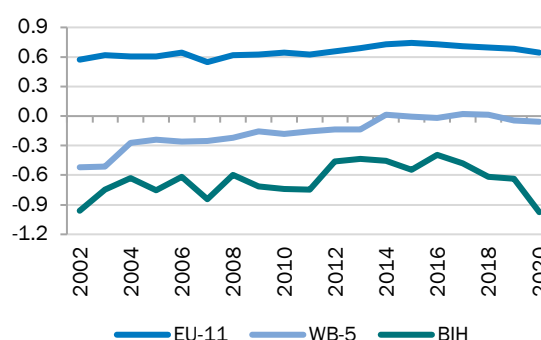


Figure 11. Government effectiveness

Index; from -2.5 (weak) to 2.5 (strong)



Source: World Bank [Worldwide Governance Indicators](#) 2020

Source: World Bank [Worldwide Governance Indicators](#) 2020

- **Bosnia and Herzegovina scores worse than the Western Balkans-5 average on all six World Bank World Governance indicators.**¹⁶⁹ It performs best in the areas of regulatory quality and rule of law, closely followed by voice and accountability (-0.2 in regulatory quality and -0.3 in the other two areas on a scale of -2.5 to 2.5), and by far the worst when it comes to government effectiveness (-1.0 on a scale of -2.5 to 2.5), followed by control of corruption. Compared with the EU-11 and Western Balkans-5, it lags most again (by 1.4 and 0.9 index points, respectively) on government effectiveness (perceptions of the quality of public services, the quality of the civil service and the degree of independence from political pressure, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies). Government effectiveness is constrained by the convoluted institutional setting and further aggravated by low public administration capacity.
- **Weaknesses in the rule of law and the judiciary negatively affect the business environment.** According to the European Commission,¹⁷⁰ the country is in the early stages/has some level of preparation with regard to the judiciary. Integrity issues with regard to judges and prosecutors seem to feature prominently, while rules on their appointment, promotion, conflicts of interest and so on do not sufficiently safeguard their independence. The High Judicial and Prosecutorial Council of Bosnia and Herzegovina has initiated integrity reforms, but these have been met with resistance from within the judiciary, in particular, with regard to the declaration and verification of assets by judges and prosecutors. A recent report¹⁷¹ recognises undue influence on the judiciary and law-making as two factors enabling state capture.¹⁷²

¹⁶⁵ See WEF (2019b).

¹⁶⁶ Ibid.

¹⁶⁷ See Transparency International (2021).

¹⁶⁸ As of 2019. See WEF (2019b).

¹⁶⁹ These are: voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law and control of corruption.

¹⁷⁰ See European Commission (2020a).

¹⁷¹ See Transparency International (2020).

¹⁷² State capture exists when powerful individuals and groups use corruption to shape a nation's policies, laws and economy to benefit their own private interests.

- Bosnia and Herzegovina is still in the early stages/has some level of preparation when it comes to the prevention of and fight against corruption.¹⁷³ According to a European Commission report from end 2021, “corruption indicators have further deteriorated, with all levels of government showing signs of political capture directly affecting the daily life of citizens”. Indeed, the complex constitutional structure multiplies the opportunities for corruption at a subnational and local level.¹⁷⁴ In the 2021 Corruption Perception Index, the country ranked 110th out of 180 countries, scoring 35 points out of 100.
- Public procurement is characterised by very complex procedures that facilitate corruption and give preference to domestic suppliers, which is incompatible with the EU acquis. According to the European Commission,¹⁷⁵ the introduction of a “comprehensive and effective system of electronic public procurement would foster transparency and reduce abuse of public resources”.
- In the EBRD’s assessment,¹⁷⁶ the country’s corporate governance framework is insufficiently strong, with three areas (structure and functioning of the board, internal control and stakeholders and institutions) deemed weak and the other two areas (transparency and disclosure, and rights of shareholders) considered fair and fair to moderately strong, respectively.¹⁷⁷ While the independence of directors and board effectiveness are seen as the weakest sub-areas, financial information disclosure, general shareholders’ meetings and the registration of shareholdings are considered moderately strong.
- The quality of corporate governance of SOEs is weak, the governance framework is complex and fragmented, and there is no clear ownership policy in place. SOEs are often not sufficiently transparent, fiscally sustainable or efficient.¹⁷⁸ According to the IMF, governance framework reforms are necessary to foster transparency and improve accountability.¹⁷⁹

¹⁷³ See European Commission (2021).

¹⁷⁴ For more detail, see, for example, Transparency International (2020).

¹⁷⁵ See European Commission (2021).

¹⁷⁶ For more detail, see Cigna et al. (2017).

¹⁷⁷ The ratings were ordered as follows: very weak, weak, fair, moderately strong and strong to very strong.

¹⁷⁸ See IMF (2021).

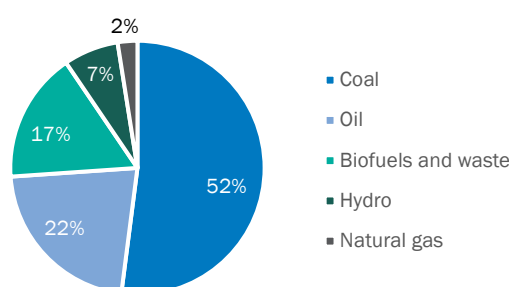
¹⁷⁹ For more detail, see Cegar and Parodi (2019).

Bosnia and Herzegovina's green transition efforts should entail reducing its dependence on coal-powered thermal power plants and scaling up investment in renewables, while ensuring a just transition away from coal. Scaling up energy efficiency measures and, accordingly, the implementation of environmental standards are needed throughout the country's energy sectors.

- Energy intensity (kgoe per €1,000 of GDP) was four times higher than the EU average in 2020¹⁸⁰
- The residential sector accounts for the largest share of final energy consumption (45 per cent in 2020)¹⁸¹

Figure 12. Total primary energy supply by source

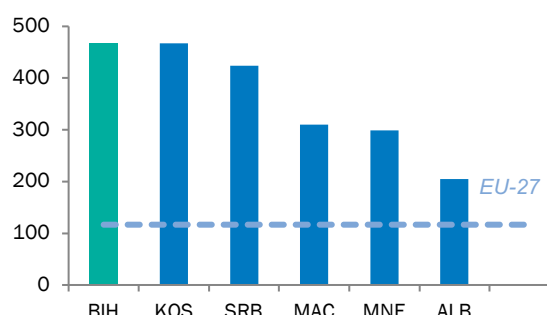
In 2019



Source: IEA

Figure 13. Energy intensity

In 2020



Source: Eurostat

- **Bosnia and Herzegovina's green economy transition needs to focus on investing in sustainable energy and a just and fair transition away from carbon-intensive sectors.** The country's revised Nationally Determined Contribution (NDC)¹⁸² sets an unconditional target for GHG emission reductions of 12.8 per cent compared with 2014 (and a conditional target of 17.5 per cent) by 2030.¹⁸³ The country is party to the Energy Community Treaty and a signatory of the Sofia Declaration.
- **Bosnia and Herzegovina is still in the early stages of harmonising environmental standards under the EU Acquis.**¹⁸⁴ At this stage, the efforts of national institutions are focused on completing the legislation and transposition of EU Directives into national law, strengthening the strategic and institutional framework, and increasing investments in the environmental sector.
- **While having made good progress towards its overall renewable energy target, additional efforts are needed to increase the use of renewables.** In 2019, the country achieved 37.6 per cent¹⁸⁵ renewables in its final gross consumption of energy against a target of 40 per cent by 2020. However, the share of renewables in transport is only 0.4 per cent (compared with its goal of 10 per cent in 2020). Given the country's high reliance on hydropower in the renewables sector, further diversification of renewable sources should be considered, especially given the country's ample wind and solar potential. Transitioning towards a market-based renewables support scheme is one of the requirements under the Energy Community Treaty.
- **At 467 kgoe per €1,000 of GDP in 2020, Bosnia and Herzegovina has the greatest energy intensity of the Western Balkans and four times the energy intensity of the EU average.**¹⁸⁶ There is significant energy savings potential to be had, particularly in the buildings sector. The country is targeting energy saving in buildings as a key step in decreasing final energy consumption, as outlined in the draft National Energy Efficiency Action Plan (NEEAP) 2019–21 and the Fourth Annual Report on the Energy Efficiency Directive for Bosnia and Herzegovina. The largest contribution to its energy saving potential comes from the residential

¹⁸⁰ See [Eurostat database](#).

¹⁸¹ See [Eurostat database](#).

¹⁸² NDCs are a central element of the implementation of the Paris Agreement. They are "national climate plans highlighting climate actions, including climate related targets, policies and measures governments aims to implement in response to climate change and as a contribution to global climate action". See UNFCCC (n.d.).

¹⁸³ According to Bosnia and Herzegovina's first NDC (updated submission), available at <https://unfccc.int/NDCREG>.

¹⁸⁴ See European Commission (2021).

¹⁸⁵ See EUROSTAT, online data code nrg_ind_ren.

¹⁸⁶ Ibid.

sector. The country should prioritise the adoption of the draft NEEAP 2019-21 and the transposition of the Energy Efficiency Directive and the Energy Labelling Regulation. The prevalence of coal remains and will need to be managed to transition to a greener economy. The majority of the country's electricity comes from antiquated coal-fired power plants, some of which are expected to close in the next few years. The country is also planning to build several new coal-fired power-plants that could more than double existing installed capacity. The competitiveness of coal plants in Bosnia and Herzegovina is expected to decrease markedly as the country implements CO₂ emission prices under the EU ETS.

- **Uncontrolled air pollution remains a serious problem.** Sources of pollution range from coal-fired power plants, heating and cooking with solid fuels to industry (such as the production of cement, iron and steel, and chemicals) and ageing vehicles.¹⁸⁷ According to the World Health Organisation,¹⁸⁸ Bosnia and Herzegovina has the world's fourth-highest mortality rate attributable to air pollution. The economic cost of its premature deaths from air pollution was estimated at 21.5 per cent of GDP in 2010.¹⁸⁹ Urgent action is needed to address air quality and is linked to the adoption of the EU Large Combustion Plant Directive and other environmental legislation introduced as part of harmonisation of legislation with the EU.¹⁹⁰ The Energy Community Secretariat opened a case against Bosnia and Herzegovina in February 2022 for failing to meet NERP ceilings for reporting years 2018 and 2019 and thus not achieving a significant reduction in air pollution from thermal power plants.¹⁹¹
- **Bosnia and Herzegovina is not a water-stressed country, but has high water losses due to ageing water infrastructure.** In 2020, 51 per cent of the country's water was lost from the water supply system.¹⁹² The water infrastructure has deteriorated significantly due to insufficient maintenance and the damage caused by the war. In contrast, wastewater treatment has increased significantly, from less than 6 per cent in 2015 to 65 per cent in 2020.¹⁹³ The country is working to develop an Environmental Strategy and Action Plan for 2030 onwards (ESAP 2030+), which will help harmonise legislation with the EU Acquis.¹⁹⁴
- **Bosnia and Herzegovina is vulnerable to a range of physical climate change impacts, especially floods.** The flooding of May 2014, when three months of rain fell in just 3-4 days, was the biggest humanitarian disaster the country had seen since the end of the war.¹⁹⁵ An action plan for flood protection and river management in Bosnia and Herzegovina for 2014-21 is currently being implemented.¹⁹⁶
- **The country lacks an adequate waste management system.** Waste generation needs to be reduced and the reuse and recycling of waste promoted. A consistent countrywide strategy for waste management has yet to be developed.¹⁹⁷

¹⁸⁷ See World Bank (2019a).

¹⁸⁸ See WHO (n.d.).

¹⁸⁹ See WHO Regional Office for Europe and OECD (2015).

¹⁹⁰ See World Bank (2019a).

¹⁹¹ See Energy Community Secretariat (2022b).

¹⁹² See Agency for Statistics of Bosnia and Herzegovina (2021e).

¹⁹³ See Agency for Statistics of Bosnia and Herzegovina (2018; 2021f).

¹⁹⁴ For more detail, see SEI (n.d.).

¹⁹⁵ For more detail, see, for example, OSCE EEF (2015).

¹⁹⁶ See European Commission (2020a).

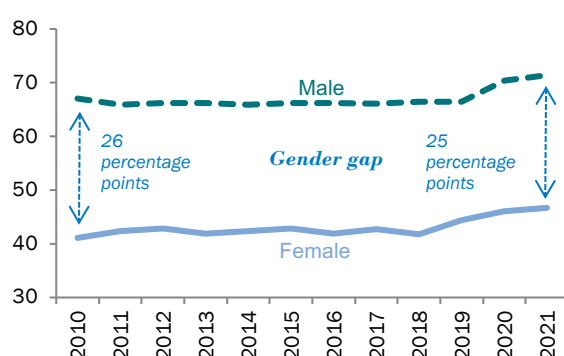
¹⁹⁷ Ibid.

While labour-force participation and employment rates have improved significantly over the past decade, they remain low compared with the rest of the region, with a marked difference in outcomes for men and women. Persistently high youth unemployment rates and skills mismatches point to a difficult transition from education to the labour market, leading to high emigration.

- As of 2021, 47 per cent of women were active in the labour market (compared with 71 per cent of men)¹⁹⁸
- 36 per cent of women were employed (compared with 61 per cent of men)¹⁹⁹
- 38 per cent of young people aged 15 to 24 were unemployed²⁰⁰

Figure 14. Labour-force participation rate by gender

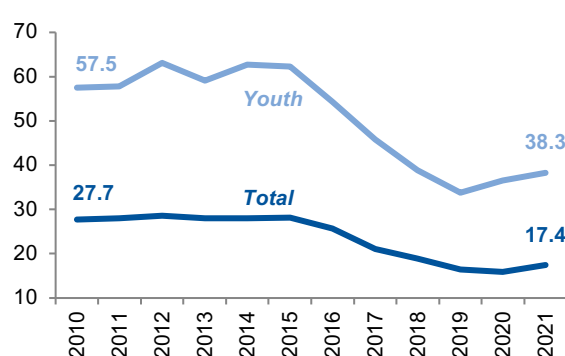
Percentage of total



Source: National labour force survey

Figure 15. Unemployment rate

Percentage of total



Source: National labour force survey

- The quality of employment remains a challenge in Bosnia and Herzegovina. Almost a third of work is undeclared. Informal employment mostly affects people in rural areas and is more common among less educated and older individuals. The sector that sees the most informality is agriculture.
- Labour-force participation among the working-age population (15-64) has increased slightly over the past decade, by around 5 percentage points since 2011. At 59 per cent in 2021,²⁰¹ the labour force participation rate was around 5 percentage points lower than in the rest of the region.²⁰² Also, there is a prominent gap between male and female participation. While seven out of ten men were economically active in 2021, this was true for fewer than 50 per cent of women. In other words, more than half of working-age women do not participate in the labour market.
- The country has one of the lowest female employment rates in the Balkans, with a little over one in three working-age women employed (compared with 61 per cent of men). This is for a number of reasons, such as family responsibilities and a lack of affordable (or any) childcare provision (especially in rural areas), but also cultural and religious norms.
- Alongside North Macedonia and Montenegro, Bosnia and Herzegovina was among the lowest scorers in the Western Balkans region on the Women, Business and the Law 2022 index.²⁰³ While several areas (freedom of movement, laws affecting women's decision to work, constraints related to marriage, constraints on women starting and running a business, and gender differences in property and inheritance) get a perfect score, significant room for improvement exists in the areas of pay and pensions. In other words, the country could consider reforms to improve legal equality for women in these areas.

¹⁹⁸ See Agency for Statistics of Bosnia and Herzegovina (2022b).

¹⁹⁹ Ibid.

²⁰⁰ Ibid.

²⁰¹ See Agency for Statistics of Bosnia and Herzegovina (2022b).

²⁰² National Labour Force Survey data for the Western Balkans-4, as data for Kosovo were unavailable.

²⁰³ See World Bank (2022).

- Despite a decline over the past decade, the unemployment rate remains high, especially for youth. In 2021, 17.5 per cent of the labour force and almost 40 per cent of youth were unemployed. Unemployment is higher in the Federation of Bosnia and Herzegovina than in the Republika Srpska.
- In 2019, 21.2 per cent of young Bosnians were not in employment, education or training, which is somewhat below the regional average (21.9 per cent). Young women are slightly more likely to be inactive than their male counterparts.
- High unemployment rates, skills mismatches and a lack of good job opportunities on the push side, coupled with pull factors such as the nearness of more developed markets with better education and job opportunities, as well as large emigrant communities, contribute to emigration, particularly among young people.
- Fifty-nine per cent of people in Bosnia and Herzegovina had a bank account in 2017, which is 3 percentage points lower than in the rest of the Western Balkans region.²⁰⁴ At the same time, a higher share of men than women had a bank account (63 versus 55 per cent, respectively).
- Around 60 percent of the population of Bosnia and Herzegovina lives in rural areas.²⁰⁵ This population suffers from a “lack of physical infrastructure, culture and social infrastructure as well as employment”, while women face additional barriers in participating in economic activities in rural areas.²⁰⁶ This is aggravated by the typically low educational attainment of women in rural areas and the lack of childcare facilities.²⁰⁷

²⁰⁴ See World Bank [Global Financial Inclusion Database](#).

²⁰⁵ See UNDP (n.d.).

²⁰⁶ See European Commission (2014).

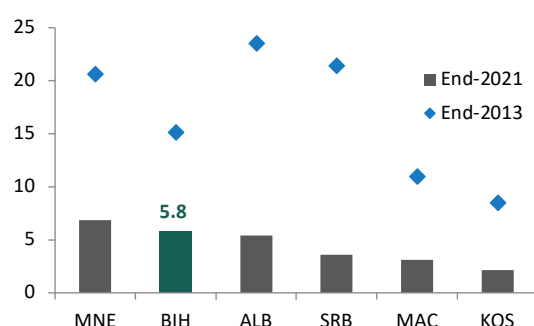
²⁰⁷ See World Bank (2015).

Bosnia and Herzegovina's financial sector is dominated by foreign-owned banks. The sector boasts, stable and profitable indicators, with a relatively high level of credit to the private sector in regional terms. Capital markets are underdeveloped. The country's energy production depends largely on poorly maintained lignite-powered thermal power plants and hydropower, while the two entities' gas markets remain underdeveloped amid limited diversification efforts.

- The banking sector capital adequacy ratio stood at 19.4 per cent in April 2022²⁰⁸
- 5.5 per cent of loans were non-performing in April 2022²⁰⁹

Figure 16. NPLs

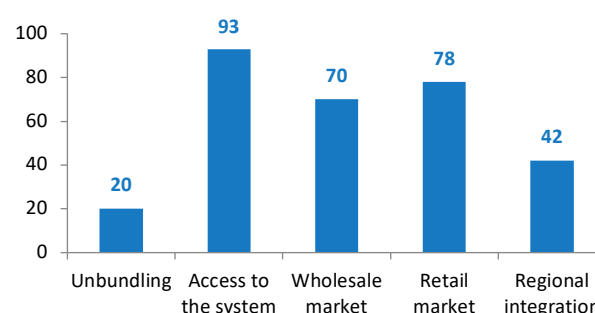
Percentage of total



Source: IMF and national authorities

Figure 17. Electricity-sector reform implementation

Percentage of total, 2021



Source: Energy Community (2021b)

Financial resilience

- Bosnia and Herzegovina's financial system is composed of banks, insurance companies, microcredit financial institutions, investment funds, leasing companies and pension funds. As is common in the economies where the EBRD operates, banks dominate the system, accounting for 88.5 per cent of financial-sector assets as of end 2021.²¹⁰ Most banks are foreign owned.
- As of April 2022, the banking sector comprised 22 commercial banks.²¹¹ Based on the value of the Herfindahl-Hirschman Index (HHI), at end 2020, the Federation of Bosnia and Herzegovina sector was considered "competitive" and the Republika Srpska sector "moderately concentrated".²¹² The sector remains well-capitalised, with a capital adequacy ratio of 19.4 percent in the first quarter of 2022, well above the regulatory minimum of 10 per cent.²¹³ The profitability of banks is satisfactory, with the return on assets (ROA) and return on earnings (ROE) increasing in recent years, to 1.3 per cent and 10.4 per cent, respectively, as of April 2022.²¹⁴
- Over the past decade, deposits in the banking sector have grown at a much faster pace than loans. Since 2016, they have surpassed loans, with the loan-to-deposit ratio falling from 103 per cent at end 2015 to 90 per cent as of end 2019 and further to 76 per cent in February 2022.²¹⁵ This growing reliance on deposit funding has shortened the maturity of banks' liabilities, potentially constraining long-term lending by the sector and making the management of liquidity more challenging.
- Domestic credit to the private sector by banks was 58.5 per cent of GDP in 2020,²¹⁶ the second-highest penetration rate in the region after Montenegro and 4 percentage points above the Western Balkans-5 average.

²⁰⁸ See Central Bank of Bosnia and Herzegovina [statistics portal](#).

²⁰⁹ Ibid.

²¹⁰ See Central Bank of Bosnia and Herzegovina (2022a).

²¹¹ See Central Bank of Bosnia and Herzegovina [statistics portal](#).

²¹² At end 2020, the HHI index was at 1.341 in the Federation of Bosnia and Herzegovina and 1.753 in the Republika Srpska, according to FBA (2021) and BARS (2021).

²¹³ See Central Bank of Bosnia and Herzegovina [statistics portal](#).

²¹⁴ Ibid. Profitability decreased somewhat in 2020, primarily due to the pandemic.

²¹⁵ Ibid.

²¹⁶ See World Bank [World Development Indicators](#).

- The non-performing loan (NPL) ratio has declined significantly, falling from 15 per cent in 2013 to 5.8 per cent as of end 2021. Still, that figure was the second highest in the region and 1.6 percentage points above the Western Balkans-5 average.
- Exposure to the public sector has increased from around zero before the global financial crisis to around 10 per cent in 2018 and has largely remained between 9 and 10 per cent since then. As of February 2022, the banking sector's exposure to the government sector stood at 8.5 per cent of banking-sector assets.²¹⁷
- Bosnia and Herzegovina does not have an effective lender of last resort. The Central Bank of Bosnia and Herzegovina maintains a currency board arrangement with a fixed foreign-exchange rate tied to the euro. This arrangement has served well for more than two decades and is an anchor for macro-financial stability in the country. However, the financial safety net suffers from a lack of a country-wide financial stability funding, which would lead progress on the resolution framework and provide liquidity on an exceptional basis when required, including in case of potential restructuring.²¹⁸
- Capital markets in Bosnia and Herzegovina are relatively small. The country has two stock exchanges – one in Sarajevo (in the Federation of Bosnia and Herzegovina) and one in Banja Luka (in the Republika Srpska), but they are not an important funding source for companies. In 2021, the turnover of shares amounted to around €42 million on the Sarajevo Stock Exchange (SASE) and €50 million on the Banja Luka Stock Exchange (BLSE). As of end 2021, the total market capitalisation of the BLSE stood at €2.1 billion, while the corresponding figure amounted to €2.8 billion for the SASE (compared with €1.9 billion and €2.8 billion at end 2019, respectively).^{219 220}

Energy resilience

- Bosnia and Herzegovina has a relatively small power system, with total installed generation capacity of 4.5GW in 2020. It consisted mostly of large-scale hydro and thermal power generation (2.1GW each). In addition, there are 87MW of utility-scale wind power, 172MW of small hydro power plants and 35MW of small-scale solar photovoltaic (PV) power.²²¹
- Around 60 per cent of generation is from lignite power plants, making the country the second-largest lignite-based power market in the Western Balkans, behind Serbia (about 35TWh) and ahead of Kosovo (about 6TWh).
- Electricity generation fluctuates with hydrological conditions, but is also affected by the age of the thermal power plants, which are very old. For example, hydro electricity generation in 2020 was some 25 per cent lower than in 2019 and overall electricity production was down by 4.3 per cent on 2019.²²² Still, Bosnia and Herzegovina remains capable of meeting domestic demand and is the only net exporter of electricity in the Western Balkans. In 2021, the country exported 8.0TWh of electricity and imported 3.3TWh.²²³ Due to globally increasing energy prices, the value of Bosnian electricity exports grew by nearly 70 per cent year on the year in 2021, with the strong impetus for growth persisting into the first four months of 2022.²²⁴
- The transmission network is interconnected with the bordering systems of Croatia, Serbia and Montenegro.
- Transmission losses are reasonable, at 1.8 per cent, but distribution losses (despite some decrease) remain high (9.1 per cent in 2020, down from 10.3 per cent in 2016).²²⁵
- The two entities operate distinct gas markets and are subject to a number of Energy Community infringement cases. The gas market in the Federation of Bosnia and Herzegovina is fully vertically integrated and effectively closed to competition. The gas market in the Republika Srpska is more open, following the transposition at entity level of the Third Energy Package into primary legislation in 2018. In 2019, around 230 million cubic meters of Russian gas was imported through a single interconnector with Serbia. As of 2021, this gas comes through Bulgaria via the TurkStream pipeline.²²⁶

²¹⁷ See Central Bank of Bosnia and Herzegovina (2022b).

²¹⁸ See IMF (2021).

²¹⁹ See Banja Luka Stock Exchange (2022).

²²⁰ See Sarajevo Stock Exchange (2022).

²²¹ See DERK (2020).

²²² Ibid.

²²³ See Agency for Statistics of Bosnia and Herzegovina [energy statistics](#).

²²⁴ See Agency for Statistics of Bosnia and Herzegovina (2022d; 2022f).

²²⁵ See DERK (2020).

²²⁶ A new 1.2 bcm/year gas pipeline between Serbia and the Republika Srpska is being planned as part of the Balkan Stream project.

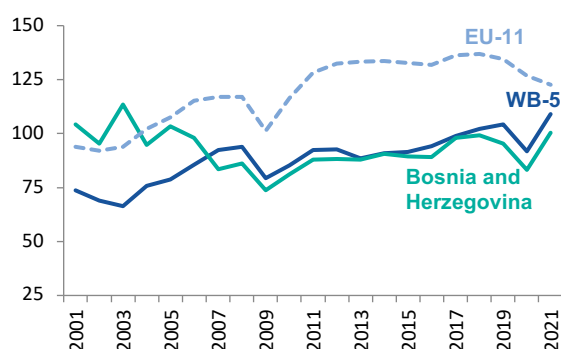
- As Bosnia and Herzegovina's energy sector is managed primarily at entity level, the country has so far been unable to adopt and properly implement the requirements of the Third Energy Package at state level for both gas and electricity. As a signatory of the Energy Community Treaty, Bosnia and Herzegovina is obliged to implement the Energy Community Acquis Communautaire, leading to multiple ongoing infringement cases against the country.

Bosnia and Herzegovina is less integrated than the average Western Balkans economy in terms of trade and investment. Integration into the global value chain is weak compared with the rest of the region and is concentrated in low-value-added sectors. FDI inflows are relatively low compared with the region. There is room for improvement in terms of transport connectivity. Internet use and broadband coverage are at the level of other Western Balkans countries and EU comparators.

- Trade as a share of GDP was at 101 per cent compared with 109 per cent in the Western Balkans-5 and 123 per cent in the EU-11 in 2011²²⁷
- The average annual net FDI inflow was 2.4 per cent of GDP from 2015 to 2020²²⁸
- FDI stock per capita was around half of the Western Balkans-5 average and quarter of the EU-11 average as of 2020²²⁹
- 108th out of 141 countries on the quality of transport infrastructure as of 2019²³⁰
- 72nd out of 160 countries in the logistics performance (international) index as of 2018²³¹

Figure 18. Trade openness

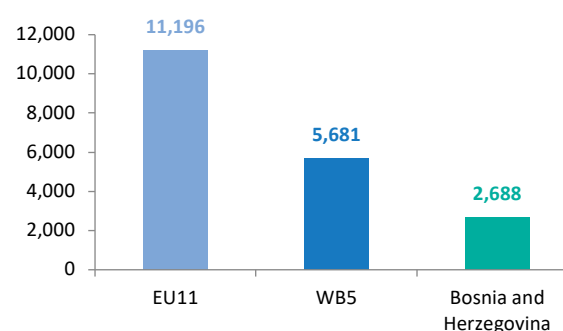
Percentage of GDP



Source: WB WDI (up to 2019) and authors' calculations

Figure 19. FDI stock per capita, 2020

US\$



Source: UNCTAD and authors' calculations

External integration

- Trade openness²³² has increased over the past decade, reaching 101 per cent of GDP in 2021.²³³ This was below both the Western Balkans-5 and the EU-11 average (by around 8 and 20 percentage points, respectively). To date, the country has signed four regional trade agreements – unchanged for the past five years – which is significantly less than the average EBRD or OECD economy (19 and 33, respectively). Bosnian exports largely consist of raw materials and low-value-added products, with a limited level of diversification compared with the EU-11 economies (see the “competitive” quality for more detail).
- At just over 2 per cent of GDP annually,²³⁴ Bosnia and Herzegovina receives significantly less foreign direct investment (FDI) than the average Western Balkans-5 or EBRD investee economy (7 per cent and 5 per cent of GDP, respectively).²³⁵ At €2,688 at end 2020, the stock of FDI per capita was among the lowest in the region.²³⁶ As of 2021, Bosnia and Herzegovina was party to 40 bilateral investment

²²⁷ Authors calculations based on IMF (2022) and national accounts.

²²⁸ Based on ATQ data from the *EBRD Transition Report 2021-22* (EBRD, 2021b).

²²⁹ UNCTAD and authors' calculations.

²³⁰ See WEF (2019b).

²³¹ See World Bank [Logistics Performance Index rankings](#).

²³² Trade openness is measured as the sum of imports and exports of goods and services over GDP.

²³³ Authors' calculations based on IMF (2022) and national accounts.

²³⁴ Five-year average.

²³⁵ Based on ATQ data from the *EBRD Transition Report 2021-22* (EBRD, 2021b).

²³⁶ UNCTAD and authors' calculations.

agreements (compared with a Western Balkans-5 average of 42 and an EBRD EU country average of 102).

- Over the past five years, portfolio inflows have been negative, on average, in Bosnia and Herzegovina, as they have in some other economies in the region and in the majority of EU-11 countries.

Internal integration

- In the area of domestic transport, Bosnia and Herzegovina ranks low on road connectivity and non-road transport infrastructure. The country's logistics competence, the quality of logistics services, and the ability to track and trace consignments are similar to the rest of the Western Balkans, but below the EU-11 average.
- On cross-border integration, Bosnia and Herzegovina performs marginally better than the average Western Balkans-5 country when it comes to the cost of trading across borders,²³⁷ but somewhat worse than the average EU-11 country. According to the World Bank Logistics Performance Index, the country's customs and border efficiency and the ease of arranging international shipments are similar to the Western Balkans-5, but below the EU-11 average.²³⁸
- Electric power transmission and distribution losses in Bosnia and Herzegovina are slightly higher than the EU-11 average, but significantly below the Western Balkans-5 average (by around 50 per cent). The overall quality of electricity supply in the country is slightly below the EU-11 average, but it takes almost half the time to obtain electricity in Bosnia and Herzegovina than in the EU-11.²³⁹
- The country's performance in terms of ICT measures is broadly comparable to the other Western Balkans and the EU-11 countries, with 70 per cent of the population being internet users and 23 per cent having access to broadband. As regards the take-up of 3G technology and its coverage in the country, Bosnia and Herzegovina is also broadly comparable with the Western Balkans-5 and EU-11 based on the latest available data.²⁴⁰

²³⁷ Measured as the time and cost associated with the logistical process of exporting and importing goods. Based on ATQ data from the *EBRD Transition Report 2021-22* (EBRD, 2021b).

²³⁸ See World Bank [Logistics Performance Index rankings](#).

²³⁹ Based on ATQ data from the *EBRD Transition Report 2021-22* (EBRD, 2021b).

²⁴⁰ Ibid.

1502 Bosnia and Herzegovina country diagnostic

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