



Weekly Briefing

**Bosnia-Herzegovina economy briefing:
BIH- FDI and the contribution to BIH economy
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BIH- FDI and the contribution to BIH economy

According to the last available data (August 2018) published by the Central Bank of Bosnia and Herzegovina (CBBIH), on December 31 2017, the total amount of foreign direct investment in BIH was BAM 13,449 billion (EUR 6.9 billion). This is total registered investment stock which places BIH, according to the UNCTAD Annual Report on Global Foreign Investments, on the second position among the countries of South-Eastern Europe.

Direct foreign investments in 2017 amounted to KM 777.7 million (EUR 397.6 million), where the data indicate an increase in foreign investments by 37.9% compared to the amount in 2016, or by 28.8% compared to the five-year average (2012-2016 period).

The official data for FDI in 2018 are expected to be published by the CBBIH at the end of August 2019, but BIH Agency for Foreign Investment Promotion holds that based on the first preliminary data for the period January - December 2018, a positive growth trend can be expected in terms of total direct foreign investments. According to the balance of payments (with estimated retained earnings), direct foreign investments for 2018 amounted to KM 800 million (EUR 409 million).

Foreign direct investment in Bosnia and Herzegovina – a short historical overview

In 2007, Bosnia and Herzegovina had the largest registered inflow of foreign direct investments of KM 2.6 billion, mainly thanks to the privatization of large state-owned companies. In 2008, the inflow of foreign investments to BIH in total amount of KM 1.3 billion was still confirming positive trend, especially since it was realized without significant privatization transactions and with a fair share of investment in the manufacturing sector and realization of greenfield investment.

The global economic crisis has affected BIH in more or less the same level as other regional dependent market economies with significant decline in investments in 2009 and positive trend of foreign direct investment in 2010 and 2011. However, despite promising estimates, investment flows in 2012 and 2013 did not maintain a positive trend.

The amount of foreign direct investment peaked in 2014 when a total of KM 811 million was registered, an increase of 99.2% compared to the previous year. According to CBBIH data, in 2015 inward FDI decreased for 21.5% to KM 637 million and negative trend continued in 2016 (KM 564 million registered or -11.5%).

In 2017 inward FDI again increased by 37.9% stopping a negative trend from the post-

recession period and there are general expectations that the growth of FDI and investment rate in general will continue in 2018 (pending the publication of official data) as well as in the current year. From an incomplete data (excluding the amount of retained earnings) for the first three quarters of 2018, in January-September 2018 period, the amount of direct foreign investments was at the level of the same period of the previous year (2017). Although it is still early to confirm a stable trend on FDI growth, projections remain generally optimistic for the previous and the current year. Explanations for positive trend are different. While the most opinions hold that FDI growth reflects positive trends in the region, some also argue in favor of reform agenda carried out in the last four years that decreased red tape and enhanced coordination of BIH institutions.

Regarding the total foreign investment stock from 1994 to December 2017, the biggest investor (country) was Austria (KM 2.6 billion or 1.3 billion euros) followed by Croatia, Serbia and Slovenia, while other significant investor-countries include: Switzerland, Austria, Turkey and the United Kingdom.

The data from BIH Agency for Foreign Investment Promotion shows the most significant amount of foreign direct investment was registered in the manufacturing sector (32%) and the banking sector (26%). A share of the total inflow of the former is untypically lower than in the manufacture due to flawed privatizations of BIH banks and also, as argued, strong industrial tradition of BIH.

Structure of foreign direct investment (at the end of December 2017)

The total foreign direct investment in BIH (KM 13,449 million) is divided into equity holdings and retained earnings in the amount of KM 9,993 million (EUR 5,109 million) and other equities KM 3,456 million (EUR 1,767 million).

According to the CBBIH official data, direct foreign investments in 2017 amounted to KM 777.7 million or EUR 397.6 million in 2017. In the structure of foreign direct investment in 2017, the shareholdings amounted to KM 362.1 million (or EUR 185.1 million), the retained earnings amounted to KM 420.8 million (EUR 215.2 million), while the remaining capital was negative and amounted to KM -5.3 million (EUR -2.7 million). Foreign direct investment in 2017 was 37.9% higher than in 2016. Registered shareholdings were higher in relation to the previous year (KM 290.8 million in 2016), retained earnings also increased significantly (KM 163.3 million in 2016), while other capital recorded a decrease compared to 2016 (KM 110.0 million in 2016). In 2017, ownership shares accounted for 47% of total foreign direct investment in BIH.

The countries-investors with the biggest share in outward FDI in 2017 were Austria (KM

187 million), Croatia (KM 102.0 million) and Slovenia (KM 101.7 million). The following countries registered significant increases in FDI capital (over KM 20 million): Switzerland (KM 59 million), Serbia (KM 53.9 million), Germany (KM 53.5 million), Italy (KM 45 million), Luxembourg (KM 41 million), Saudi Arabia (KM 39 million), United Arab Emirates (KM 27 million) and Kuwait (KM 24 million).

In 2017, the activities with the highest number of foreign investments registered (over KM 20 million) are: Financial service activities other than insurance and pension funds (KM 261.2 million), Retail trade (not incl motor vehicles and motorcycles) with KM 110.2 million, Manufacture electricity, gas, steam and air conditioning supply with KM 64.2 million, Manufacture of basic metals with KM 50.7 million, Manufacture of motor vehicles, trailers and semi-trailers with KM 46.5 million, Manufacture of tobacco products with KM 45.4 million, Real estate business with KM 40.6 million, Wholesale trade, except motor vehicles and motorcycles BAM 38.1 million, Leather and related products BAM 25.0 million and Construction of construction buildings with BAM 20.8 million.

Major issues and challenges for sustainable FDI growth

- Rule of law issues. The fact that the authorities at all (central, entity, cantonal) levels in BiH ignore or reject binding court decisions, including the decisions of the Court of BiH and the Constitutional Court of BiH, as well as the decisions of the European Court of Human Rights has been recently criticized by HR Valentin Inzko particularly because it is “not a good message for potential investors.”
- Expensive, complicated and inefficient administration procedures delaying small and middle sized FDI. Here, the biggest issue is obtaining registration, building permits as well as work permits for temporary stay for foreign workers. This is especially pronounced in small-to-middle size investment and is the main obstacle that hampers horizontal FDI from neighboring countries and BiH diaspora.
- Complaints on “unadjusted” or “non-business-friendly” labor legislation. A large number of small, medium companies are complaining that a burden of employment incentives and policies falls on them, despite their overall contribution to FDI. Only large foreign funded companies are beneficiaries of special provisions and exemptions regarding labor legislation.
- Uneven distribution of FDI. As highly decentralized country, BiH has very uneven distribution of FDI on central and federal level. In RS, greater agglomeration of Banja Luka (Prijedor, Banja Luka, Gradiska) receive the most of inward FDI. In FBiH,

Sarajevo, West Herzegovina and Tuzla Canton are attracting far more FDI compared to other cantons and municipalities.

- Unfavorable investment image. Just like the rest of the Western Balkans region, BIH has a serious problem with a weak investment image in the world, mainly due to economic and political instability. While there are regional and domestic initiatives aiming to boost the investment image, there is a concern that BIH is also falling behind the region in implementing necessary policies and regulations. General perception is that Serbia and Montenegro have done more to attract foreign investors and thus increase employment and economic stability.
- Moving away from a low value-added FDI to technology-driven FDI. BIH economy relies on export of natural resources (energy, wood, metals) and had inward FDI patterns that were particularly linked to the exploitation of natural resources. Some regional (cantonal) governments made a set of policies to encourage value-added investments that come in with 'technological package'. However, while some areas do attract value-added and technology-driven FDI, BIH in general picture is still considered to be in transition from a South (FDI destination) country and lacking investment in technologies and services generating higher return for local economy.
- Dissipating labor force. Most of inward FDI in BIH was driven by cheaper labor costs. With advancing problem of labor migration and population loss BIH in the long-term might lose this advantage, or even eventually see jobs generated by European companies moving to more accessible and stable labor markets of neighboring Serbia, Bulgaria, Albania.
- Infrastructure building delays. The WB region is slowly building its road and railway network to sustain and support larger inflow of FDI. BIH is not exception to this, but its overall network of roads and railways accessible for modern transportation of goods and services is still lagging behind the rest of the region. This may pose long-term opportunity costs for BIH in attracting FDI that is oriented to easy-to-access destination countries.