

Reconstruction and Developments in the Banking Sector of Bosnia and Herzegovina

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Abstract: Bosnia and Herzegovina (BIH) is a young republic in the South Eastern Europe, which become independent from Yugoslavia in 1992. The independency was a tough process and the economy of BIH seriously damaged in the civil war period during 1992-1995. But BIH Economy has been reconstructed and improved by taking important steps after the war. BIH Banking sector has also been developed significantly and restructured during the last decade. This paper examines both the current situation of the banking system of the Bosnia and Herzegovina and the developments in the sector after 1995. Main economic indicators for BIH in last decade reveal a strong post-war recovery. The developing banking system in BIH laid the base for tremendous change and improvement compared to other sectors. By promoting the institutional development of the bank regulatory authorities in both entities over the past few years most inefficient and problematic banks closed and helped to change, respectively. Entering of strong foreign banks in the country leads to the result of enhancing of the level of confidence through a sharp increase in citizens deposits as well as a total deposits increasing can be concluded. In last 12 years banking sector of BIH significantly improved. For example total deposits in commercial banks of BIH increased by 769 %, total loans given by the commercial banks increased by 497 %, and total assets of the commercial banks increased by 530 % from 1997 to 2008.

Keywords: Banking Sector, Bosnia and Herzegovina, Foreign Direct Investment.

Introduction

After the iron curtain collapsed many centrally planned economies, divided in those south East European (SEE¹) and Central Eastern Europe (CEE) replaced the previous social system of centrally planned economy to a non-socialist society with a liberalized economy. These low-income countries use economic liberalization as their main engine of growth. Among transition economies SEE are relatively less developed and structurally lagging behind the CEE. The region of the aforementioned region experienced a different way of reconstruction and development path. Bosnia and Herzegovina lagged behind the relatively developed republics of former Yugoslavia like Croatia, Slovenia, and Serbia. In this paper we give an overview about the banking sector of Bosnia and Herzegovina (BIH) analyzing in particular the developments from 2000 to 2008.

1. Economic Overview

1.1. From Yugoslavia to Modern Bosnia and Herzegovina: Historical Background

For centuries powers have collided in this region. With the dissolution of the communist regime in the late 1980s national feelings comes up especially in Serbia. Attempts to save the Yugoslav Federation were made, but as opinions diverge widely about a common future among the national leaders in the new countries Macedonia, Bosnia and Herzegovina, Croatia, Serbia and Slovenia entailed to the collapse of the former Yugoslav Federation. Consequently the new established states disintegrated it from the centrifugal. While Croatia and Slovenia was declaring independence in 1991, paramilitary origins from Serbia occupied several

¹ According to EBRD Office for South East Europe, SEE is as defined Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR of Macedonia, Moldova, Romania, Serbia, Montenegro and Kosovo. (EBRD, 2009).

Bosnia and Herzegovina towns killing civil Bosniaks¹ and Croats. Thousands of people died in this clash of ethnic groups, as well a lot of the population seeks for refugees. As a consequence Bosnia and Herzegovina was faced with serious humanitarian and social problems. The conflict lasted 1992-1995 until the Dayton Peace Agreement² was signed in Paris in December 1995 between the counterparts (Malcolm, 2002). For mobilizing international support for the Agreement a Peace Implementation Conference was held in London on December 8-9, 1995 which resulted in the foundation of the Peace Implementation Council (PIC). The PIC comprises 55 countries and agencies that assist the peace process in diverse ways (PIC, 2006) So the regional political situation were 'sealed' and post-war endeavors began to overcome the existing problems in the financial and economic structure, legislation and administration as well. The prime point in the Dayton Agreement is that a multiethnic society has to be lived in a divided country with two entities but jointly guided by a central government.

With a rotating and collective three-member presidency Bosnia and Herzegovina (BIH) is being ruled. The state of BIH is the central authority. Although recognized as a parliamentary democracy it is governed by the international community under tutorship of the Office of High Representative for BIH, which was established as a condition of the Dayton Agreement. The High Representative (OHR) is charged with observing the implementation of the Dayton agreement and coordination of the activities of international organization and intervenes in situations of unwillingness of the main parties to cooperate (e.g. the new flag design) or to take economic reform seriously. (OHR, 2009) With one confederation, two entities, ten cantons in the Federation, five administrative areas in the Serb Republic, a special Brcko district, plus municipalities and local government unit presents a very complex political system in the world which conceals meaningful barriers and bureaucratic hurdles that will need to overcome to succeed (Petricevic and Danis, 2007: 424). Under the supervision of the United Nations both entities and the district handles on the defined conditions of the Dayton peace Agreement separately whereas in fiscal issues, these entities are autonomous. That means '*the duplication of many domestic policy functions and weakens incentives for cooperation*' (Cuc, 2005) which suggests the conclusion that inter-ethnic trust will be undermined so that it makes difficult to agree on the decisions needed to take the country forward (OHR, 2008). All of the countries had, plain-spoken, consummately differences in starting positions at the beginning of the transnational process of the former Yugoslav countries. In 1990, BIH has also started a wide-reaching process of reconstruction and development of its political, economic, social and legal systems as an independent (apart from extensive international aid) country and capable of sustainable development beginning with economic liberalization and implementation of market-oriented reforms for pursuing long-term growth. (Petricevic and Danis, 2007: 418) The integration to the world economy took place under extremely complicating circumstances for Bosnia and Herzegovina (BIH). First of all it had been thinking about economic restructuring and renovation.

In general, economies in the Balkan region are ordinary classified as late starters. That is why their performance is described as not very stable when compared to those of Central European countries. During the communist period, through decades, enterprises and industrial plants were largely focused toward the satisfaction of wants of the ex-Yugoslavia market. Heavy industry was mainly centered in BIH. As the least developed country in the region there were efforts in BIH in the early 1990s to minimize the affect of heavy industry on the economy and develop therefore light industries such as for example consumer goods, finance, electronics. Devastations of the existing infrastructure decreases GDP per capita during the war period. With the adopting and implementation of the Mid-term Development Strategy (PRSP) BIH was being encouraged to preserve macroeconomic stability with significant growth rates boot in GDP and industrial production.

Because of destroying all economic capacity³ during the ethnical conflict period, BIH was forced to follow another development path. In contrast to other transition economies where institutional transition has progressed further, a highly vexing regulatory environment in BIH has occurred inconvenient situations for investors and further success of the transition process. (Petricevic and Danis, 2007: 425-426) As a result complex and difficult structures which are often changing brings out that BIH has the following serious deficiencies: inefficient public sector, obstacles for business⁴, high current account deficit⁵, and complex government, fragmented policymaking inadequate coordination between the state and entities, democracy, widespread corruption and a fractured labor market which are in need of improvement. Red tape occurs with respect to independent administrative areas which are Federation of Bosnia and Herzegovina, Republika Srpska and Brcko⁶. Different rules within the country exists (Klamert, 2008: 4-7). In spite of this claims, "...*Bosnia*

¹ Bosniak refers to Muslims live in Bosnia and Herzegovina.

² The Dayton Peace Agreement in 1995 sets the bases for the establishing of modern Bosnia and Herzegovina and its economic recovery.

³ The post-war role of manufacturing and industry in GDP fell by virtually 90% of lost output, declining of Gross Domestic Product, workforce lost their jobs.

⁴ E.g. no central tax administration exists

⁵ Which will in turn lead to a further increase in the current-account deficit

⁶ The entities are to a large extent independent as for legislation and there is no real deferral legal system.

and Herzegovina are moving ahead with the implementation of their respective Interim Agreements and have made progress in important reform areas.” (Europa Press Releases 2009)

1.2. Economic Development in Bosnia and Herzegovina during the Last Decade

Selected economic indicators for BIH between 2000 and 2008 presented in Table 1 reveals a strong post-war recovery. Continued growth in industrial production over the past years can be seen. Inflation rate stabilized at EU levels. Economic growth in BIH has been impressive with GDP. The economy should remain strong in 2008 as a result of domestic demand with consumption and investment substantially supported by foreign aid flows. Nominal GDP in 2008 was about 12 billion Euros. In 2008, average real GDP growth rate was around 7.0%. GDP per capita reached EUR 3,648 in 2008. International trade has been a major source of economic growth. Unemployment is soaring with approximately 25%. Large and widening current account deficits are not surprising for transition economies. One of the key imbalances in the economy of BIH is its high trade deficit which is ultimately leading to a significant current account deficit in the balance of payments. The trade deficit rise remarkable for countries like BIH given that they are being swift integrated with the economies of the European Union. Encourages foreign investment have been remained. The significant increase in foreign direct investments (FDI) could be the most important instrument in financing of the overall balance of payments. Efforts to attract foreign investment lead to the development of the State Foreign Investment Policy and the successful reform of the banking system as well as the customs reform.

Table 1. General Economic Indicators of Bosnia and Herzegovina

Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008
Nominal GDP (billion EUR)	5.5	5.9	6.6	7.4	8.1	8.7	9.8	11.1	12.5*
GDP per capita (EUR)	1,660	1,786	1,958	2,214	2,388	2,561	2,873	3,254	3,648*
Real GDP growth rate (%)	5.5	4.5	5.5	3.0	6.3	3.9	6.7	6.8	7.1*
Industrial production growth rate (%)	8.8	12.2	9.2	4.8	9.0	10.0	11.0	10.0	9.2*
Average net wages (EUR)	190	209	228	247	258	275	300	322	385
Annual inflation rate (%)	4.8	3.1	0.4	0.6	0.4	3.7	6.1	1.5	6.5*
Annual unemployment rate (%)	39.7	40.3	40.9	42.0	43.2	43.0	31.0	29.0	23.4
Currency reserves (million EUR)	522	1,379	1,270	1,428	1,779	2,160	2,787	3,425	3,219
Trade balance (billion EUR)	- 3.00	- 3.31	- 3.52	- 3.67	- 3.68	- 4.01	- 3.41	- 4.14	- 4.89
Deposits of households in Commercial Banks, mill EUR	267	740	829	985	1,273	1,629	2,097	2,641	2,662
Total FDI (mill EUR)	159	133	282	338	567	478	564	1,628	701*
FDI contribution to GDP (%)	2.9	2.2	4.3	4.6	7.0	5.5	5.8	14.7	5.6*
Population (in million)	3.30	3.32	3.35	3.35	3.38	3.38	3.40	3.40	3.44

Source: FIPA – Foreign Investment Promotion Agency of Bosnia and Herzegovina (2009), Investment Opportunities in Bosnia and Herzegovina, Sixth Edition, February 2009, Sarajevo, p.10

BIH is still an importing country. Main trading partner for BIH is the EU with a participation of approximately 50% beside Croatia, Turkey, Serbia and the USA. BIH holds a Free Trade Agreement with Central European Countries (CEFTA). But so far, BIH also has free trade agreements with Turkey, as well as preferential export regimes with e.g. the European Union, USA, Japan, Norway, New Zealand, and Russia. In 2007 trade amounted totally 10,141,783 (in thousand Euro) and in 2008; 11,758,560 (in thousand Euro). Consumer borrowing and growth in real wages boosts private consumption in 2007. The “golden age” of BIH was achieved during the 1970-1980 period, which culminated in the Sarajevo Winter Olympic Games in 1984 (Petricevic and Danis, 2007: 425). As a middle-income country BIH reach 67% of GDP in the service sector, 22

% in industry, and 10 % in agriculture (World Bank, 2009). In 2008 BIH reached GDP per capita: amounted by 3,648 Euro. First steps regarding privatization were undertaken under the leadership of the U.S. Agency for International Development in 1997 while the Framework Law for Privatization of Companies and Banks was enacted in 1998. As in most fields the Federation and the Serb Republic have here also their own privatization laws, which complicate the ongoing process of development. (Petricevic and Danis, 2007: 428) In spite of encountering obstacles, both post-communist and postwar periods, BIH has rendered an enormous development in post-conflict reconstruction transform its economic structure, It has the willingness to be more integrated in the international environment.

1.3. Efforts to Integrate with the European Union

Developments in terms of international integration depend largely by their achievement of EU integration. Forcing reforms in the judicial system is one of the primary preconditions for further support by the EU. The Stabilization and Association Progress (SAP) is the EU's framework for the Western Balkan countries regarding pre-accession issues. It achieves a secure and fast transition to a liberalized economy, approach to a eventual EU accession as well as stress of regional cooperation. The first step towards to assist them in adopting and implementing of EU standards a membership with the EU for BIH represents the Stabilization and Association Agreement (SAA), initialed in the end of 2007, after approving by the Council of the European Union and signed in 2008. Moreover, the EU assists the country under the 2007 IPA (instrument for pre-accession assistance). The first step in the EU integration process has been started with establishing the Consultative Task Force in 1998 which was redefined in 2006 to "Reform Process Monitoring". (Weyerstrass, 2008: 395) In fulfilling economic criteria for being a Membership of European Union BIH is virtually capable to do it (Efendic and Medjedovic, 2006).

1.4. Foreign Direct Investment (FDI) in Bosnia and Herzegovina

The last year evidence is given for significant effort to open its economy to foreign investments. For foreign investors relevant laws in BIH are the Law on the Policy for Foreign Direct Investments and the Guidelines on the Registration of FDI. Commensurate with the economic theory foreign investors want to take advantage of yielding a higher return who is taking a risk abroad in a capital-scarce country. However, doing business in BIH is burdensome for out coming investors with respect to nontransparent business regulations, obstacles in administrative procedures as well as weak judicial structures (Petricevic and Danis 2007: 430-431). In BIH and in the other SEE countries at all, the total amount of FDI inflows is relatively quite low and volatile and is not prevalent affected by traditional factors of FDI attraction¹. It depends to a large extent on (completing) the privatization process. (Škuflić and Botrić 2006: 73) Greatest (historical) interest gains CEE countries from its immediate neighbors. Regarding the data it is apparently that the service sector in BIH absorbs more FDI than the manufacturing sector. With the increasing inflow of foreign capital into the banking sector, quality of services provided increase, overall sector's efficiency continue to increase. (Babić-Hodović and Burić, 2005: 1429) Reforming the business environment in BIH is also high on the Worlds Bank's agenda. The IMF also pursues assistance for BIH.

Leading multinational corporations, among others Coca-Cola, IBM, Microsoft, Procter & Gamble can be quoted, seeks investments opportunities in BIH in the last years. With the actively operation in BIH of international companies domestic companies could benefit on this way from knowledge spillovers especially in management as well as profits from technology transfers. On the other side there may be a more tightly integration of local firms in the world market. So the role of FDI in this context is straightforward. The more increase investment activities in BIH from abroad is available the more positively contribution to the growth rate of the economy is possible according to the theory.

When the foreign direct investment in BIH divided by sectors between May 1994 and December 2008, the largest FDI flow was in manufacturing with the 35% of the total FDI inflows. Banking follows it by 22%, and then telecommunication comes with 14%, and trade with 11% (FIPA, 2009: 16)

The cumulative volume of FDI attracted to BIH had experienced a considerable amount, extensively in the banking sector after 1995. Though they have been active in promoting FDI they haven't been as successful as countries like Croatia, Romania and Bulgaria which were the main attractors of FDI in the last years in this region. Since May 1994 to December 2008, the most investment was made by companies from Austria 27.1 %, Serbia 15.6%, Croatia 11.7%, Slovenia 11.4%, Switzerland 6.8%, Germany 5.5%, Russia 5%, The Netherlands

¹ The efficiency of institutions is one of the essentially factor (Bénassy-Quéré et al. 2005). This comprises of tax systems, the ease of starting up a company, lack of corruption, law of contract, transparency, safeguarding of property rights and efficiency of justice (Škuflić and Botrić 2006: 82-83).

2.5%, Italy 2.1%, USA 1.9%, Turkey 1.3%, and other countries 9.1%. Investments in telecommunication, transportation, tourism, and services record constant growth. In the manufacturing sector the participation is 35% in total investment (FIPA, 2009: 15-16).

Net foreign direct investment inflows recorded in the balance of payments during last 13 years for selected SEE and CEE Countries are given in Table 2. As the government is committed to meet the EU set of criteria strengthen the business environment for foreign investors in Table 2 it is shown evolving of FDI inflows. While several neighboring countries are making substantial progress towards a functioning market economy compared to the most developed Eastern European countries BIH is lagging behind in the context of attracting foreign investors. However, in terms of volume the inflow of foreign investments has been considerably increased in BIH during the past years. Additional boost to FDI inflows comes from EU candidature. With this assertiveness Bulgaria and Romania and some other Central and South Eastern Countries commended a phase of significant privatization in the last few years.

Table 2. Foreign direct investment (net inflows recorded in the balance of payments) -in USD million

Selected SEE and CEE Countries	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 (Est.)
Albania	97	42	45	51	143	207	135	178	344	283	325	651	880
Bosnia and Herzegovina	0	0	100	90	146	119	266	382	708	579	710	2.023	1.200
Bulgaria	138	507	537	802	998	803	876	2.070	2.879	4.005	7.583	11.433	8.472
Croatia	466	348	842	1.392	1.105	1.398	552	1.927	732	1.551	3.212	4.644	4.098
Czech Republic	1.280	1.259	3.575	6.220	4.942	5.474	8.282	1.814	3.941	11.630	4.598	7.930	5.500
FYR Macedonia	11	30	128	32	175	441	105	117	322	94	424	700	612
Hungary	3.335	3.715	3.070	3.060	2.151	3.573	2.722	479	3.405	5.586	3.640	2.197	4.763
Moldova	23	78	75	38	127	102	132	71	146	199	223	481	679
Montenegro	na	na	na	na	na	10	84	44	63	482	585	717	783
Poland	4.445	4.863	6.049	7.239	9.327	5.804	3.901	4.284	11.761	6.951	10.727	17.976	12.951
Romania	415	1.267	2.079	1.025	1.051	1.154	1.080	2.156	6.368	6.587	10.957	9.818	11.000
Russia	1656	1.681	1.492	1.102	-463	216	-72	-1.769	1.662	119	10.753	6.800	20.000
Serbia	0	740	113	112	50	165	475	1.365	966	1.550	4.264	2.195	2.487
Slovak Republic	199	84	374	701	1.897	1.520	4.130	1.913	3.052	2.279	4.178	2.881	3.156
Slovenia	167	303	221	59	71	226	1.508	-174	281	-67	-215	-353	280
Turkey	612	554	573	138	112	2.854	957	1.252	2.005	8.967	19.065	19.940	15.400

Source: EBRD (2006) Transition report 2006: Finance in transition, <http://www.ebrd.com/pubs/econo/6813.htm>, accessed 15.04.2009.

2. Banking System in Bosnia and Herzegovina

The developing banking system in BIH laid the base for tremendous change and improvement compared to other sectors. By promoting the institutional development of the bank regulatory authorities in both entities over the past few years most inefficient and problematic banks closed and helped to change, respectively. After privatization process of state owned banks entering of strong foreign banks in the country leads to the result of enhancing of the level of confidence through a sharp increase in citizens deposits as well as a total deposits increasing can be concluded. Deposit growth raised significantly during the currency conversion to the Euro in late 2001. The banking system in Bosnia-Herzegovina will continue to evolve and consolidate.

2.1. Central Bank of Bosnia and Herzegovina

The Central Bank of BIH was founded under the Dayton Peace Agreement and started its work as a federal-level institution on August 11, 1997. It is headed by the Governing Council of the Central Bank acting, by law, as an independent central financial institution. Article 7 of the BIH Constitution (Annex 4 of the Dayton Peace Accords) arranged the structure of the central bank. the "Law on the Central Bank" was adopted in June 1997. (Tesche, 2000: 319) The Central Bank of BIH is the only monetary authority in the country. Formulating, adopting as well as controlling the monetary policy of BIH are the main objectives of the CB and operates some kind of a Currency Board Arrangement as designated in the CB law and in the Dayton Peace Agreement. Both "fixed exchange rate" and "rule-based approach to monetary policy" (CEFBIH, 2004; Kovačević, 2003: 59-60)

Thus the Central Bank cannot use monetary policy to lean against rising demand¹. It has few monetary policy tools at its disposal.

The new country-wide currency Convertible Mark (Konvertibilna Marka, KM) was introduced in June 1998 and replaces the three different currencies in use in the different parts of BIH. It was formerly pegged to the German Mark. In 2001 the peg was changed to the Euro at a rate of 1 KM = € 0.51129. Inflation has been relatively low in the federation after the introduction of the KM, as would be expected in a currency board system: *“There is no other type of monetary policy, other than the adoption of the DEM as the currency of BIH, that could have given a country like BIH a stable and trusted currency and low inflation this quickly.”* (Kovačević, 2003: 60). An institution, the Fiscal Council, has been established is responsible for coordination of fiscal policy.

2.2. Supervision Agencies

From the end 1990s on new modern banking laws were issued. Within an institutional-based guidance of the banking sector, the regulation and supervising is distinguished from the systematic as in the European countries, in which, in BIH, the monitoring and observing authority is assigned to the Banking Agency of the Federation of BIH (FBA BIH), the Banking Agency of the Republic Srpska (BARS) and partly, the Deposit Insurance Agency of BIH (DIA). The Federation Banking Agency started functioning in 1997. The Federation Banking Agency is responsible for bank licensing and supervision. The National Bank of Republic Srpska has been converted to the Banking Agency of the RS in mid-1998 after enabling legislation was passed in March 1998 (Teseche, 2000: 319-321). In 1998 two laws were passed to set up bank privatization: the “Law on the Privatization of Banks” and the “Law on Opening Balance Sheets for Enterprises and Banks”. Supervisory agencies both in the FBA BIH and the BARS conducting banking supervision in Bosnia and Herzegovina, which are each governed by individual entity-level legislation. Both are authorized to grant and revoke licenses and measures banks. The CBBH coordinates the activities of the two entity agencies. Basically the FBA BIH and the BARS, among both, and also between these and the DIA exists a cooperate agreement. To effectively implement the Basel principles the banking supervision agencies got a great deal of technical assistance (IMF, 2006: 28).

Deposit Insurance Agency of Bosnia and Herzegovina (DIA) is established by the “Law on Deposit Insurance in Banks of Bosnia and Herzegovina” in 2002. DIA is an independent, non-profit, legal entity with full authority under the Law of the State. Head Office of the DIA is located in Banja Luka, and there is one Branch Office in Sarajevo and Banja Luka. Agency has its own regulations *“and is also characterized by established policies and procedures of deposit insurance, the amount of indirect deposit and the existence of ex ante financing; disbursement of insured deposits is financed mainly by the deposit insurance institution)...”* *“A bank can join the deposit insurance system, i.e. become a member of this program, if it meets the preconditions prescribed by the Law on Banks, holds a license from one of the entity-level banking agencies and is at least 90 per cent privately owned.”* (Željko, 2008: 34)² In 2009 there are 25 banks which are signed the Contract on Deposit Insurance (DIA, 2009)

2.3. Commercial Banks

According to the Law on Banks the commercial banks in BIH are enabled for banking activities and operations. Overall, the main share of assets in BIH is today privately owned. Foreign-owned banks have been the main drivers of credit growth. The list of the commercial banks operating in the Bosnia and Herzegovina in 2009 is given in Table 3. Center offices of the 19 banks in the list are in Federation of Bosnia and Herzegovina, while center offices of the 10 of them are in RS.

¹ Instead BH must use fiscal and income policies.

² For a more detailed insight, see Murph 2006

Table 3. Commercial Banks in Bosnia and Herzegovina in 2009

	Name of the BANK	Center Office	Official Website
1	ABS banka d.d. Sarajevo	Sarajevo	http://www.absbanka.ba
2	BOR banka Sarajevo	Sarajevo	http://www.borbanka.ba
3	Bosna bank international d.d. Sarajevo	Sarajevo	http://www.bbi.ba
4	FIMA banka dd Sarajevo	Sarajevo	http://www.fimabanka.ba
5	Hypo Hypo Alpe-Adria-Bank d.d. Mostar	Mostar	http://www.hypo-alpe-adria.ba
6	Intesa Sanpaolo Banka d.d. Bosna i Hercegovina	Sarajevo	http://www.intesasnpaolobanka.ba
7	Investiciono-komercijalna banka dd Zenica	Zenica	http://www.ikbze.com.ba
8	Komercijalno-investiciona banka dd V.Kladuša	Velika Kladuša	http://www.kib-banka.com.ba
9	NLB Tuzlanska banka dd, Tuzla	Tuzla	http://www.nlbtuzlanskabanka.ba
10	Postbank BH d.d. Sarajevo	Sarajevo	http://www.postbankbh.ba
11	Privredna banka Sarajevo d.d. Sarajevo	Sarajevo	http://www.pbs.ba
12	ProCredit Bank Sarajevo	Sarajevo	http://www.procreditbank.ba
13	Raiffeisen Bank dd BiH	Sarajevo	http://www.raiffeisenbank.ba
14	Razvojna banka Federacije BiH	Sarajevo	http://www.ibf-bih.ba
15	Turkish Ziraat Bank Bosnia dd Sarajevo	Sarajevo	http://www.ziraatbosnia.com
16	UniCredit Bank d.d.	Mostar	http://www.unicreditbank.ba
17	Union banka d.d. Sarajevo	Sarajevo	http://www.unionbank.ba
18	Vakufska banka d.d. Sarajevo	Sarajevo	http://www.vakuba.ba
19	Volksbank BH dd	Sarajevo	http://www.volksbank.ba
20	Balkan Investment Bank AD Banja Luka	Banja Luka	http://www.bib.ba
21	Bobar banka ad Bijeljina	Bijeljina	http://www.bobarbanka.com
22	EEFC Bank, a.d. Banja Luka	Banja Luka	http://www.iefkbanka.com
23	Hypo Alpe-Adria-Bank a.d. Banja Luka	Banja Luka	http://www.hypo-alpe-adria.ba
24	Komercijalna banka AD Banja Luka	Banja Luka	http://www.kombank-bl.com
25	NLB Razvojna banka	Banja Luka	http://www.nlbrazvojnabanka.com
26	Nova banka ad Banja Luka	Banja Luka	http://www.novabanka.com
27	Pavlović International Bank a.d.	Slobomir Bijeljina	http://www.pavlovic-banka.com
28	Unicredit Bank a.d. Banja Luka	Banja Luka	http://www.novablbanka.com
29	Volksbank a.d. Banja Luka	Banja Luka	http://www.volksbank-bl.ba

Commercial banks in Bosnia and Herzegovina provide more than 10.000 jobs for residents of BiH. Number of employees of the BiH banks is increasing nearly 10 percent each year. Number of Employees of the Banks in Bosnia and Herzegovina both in Federation of Bosnia and Herzegovina and RS are given in Table 4.

Table 4. Number of Employees of the Banks in Bosnia and Herzegovina

BANKS	2006	2007	2008
1 ABS Banka dd Sarajevo	297	326	367
2 BOR Banka dd Sarajevo	40	42	46
3 Bosna Bank International dd Sarajevo	104	145	173
4 FIMA Banka dd Sarajevo	58	101	148
5 Hercegovacka Banka dd Mostar	98	93	89
6 HVB Central Profit Banka dd Sarajevo	476	465	
7 Hypo Alpe Adria Bank dd Mostar	492	550	620
8 Intesa Sanpaolo Banka dd bih	233	479	509
9 Investicijska Banka fbih Sarajevo	84	104	
10 Investiciono Komercijalna Banka dd Zenica	163	154	177
11 Komercijalno Investiciona Banka dd Velika Kladuša	66	65	67
12 LT Gospodarska Banka Banka dd Sarajevo	196		
13 NLB Tuzlanska Banka dd Tuzla	479	472	493
14 Poštanska Banka dd Sarajevo	63	97	118
15 Privredna Banka dd Sarajevo	170	163	166
16 Procredit Bank dd Sarajevo	595	831	884
17 Raiffeisen Bank BH dd Sarajevo	1.348	1.543	1.721
18 Turkish Ziraat Bank dd Sarajevo	108	129	150
19 Una Banka dd Bihac	61	59	59

20 Uni Credit Banka BH dd Mostar	840	840	1.406
21 Union Banka dd Sarajevo	175	179	176
22 Vakufska Banka dd Sarajevo	175	184	197
23 Volksbank BH dd Sarajevo	285	340	358
24. Nova Banjalucka banka a.d. B. Luka	Na	521	523
25. Hypo Alpe Adria Bank a.d. B. Luka	Na	510	528
26. Bobar banka a.d. Bijeljina	Na	149	152
27. NLB Razvojna banka a.d. B. Luka	Na	497	506
28. Volksbank a.d. Banja Luka	Na	234	237
29. Balkan Investment Bank a.d. B.Luka	Na	159	162
30. Pavlović International Bank a. Slobomir	Na	205	208
31. Nova banka a.d. Banja Luka	Na	462	481
32. Komercijalna banka a.d. Banja Luka	Na	99	106
33. IEFK banka a.d. Banja Luka	Na	13	22
TOTAL	Na	10.210	10.849

Source: Banking Agency of the Federation of Bosnia and Herzegovina (2008) and Banking Agency of the Republica Sirpska (2008)

3. Developments in the Banking Sector

The reform program about banking system was also of increasingly interest in the former Social Federal Republic of Yugoslavia which aimed implementing of necessities for development. But with the beginning of the ethnical conflict in former Yugoslavia many reforms couldn't never implemented. In the former Yugoslavia the banking system was pretty centralized. Additionally it was dominated by a number of socially-state-owned banks apart from small private banks. (Tesche, 2000)

After war damage and highly influences through policies set forth by international (financial) organizations, (e.g. IMF, EBRD, The World Bank, EU, etc.) the banking sector in BIH gains the opportunity to restructure themselves in order to render regular banking services in accordance with free market conditions since 1997 with the building up the Central Bank in BIH. In compliance with the institutional framework it is aimed to reach a long-term political, security and economic stability. Decisions were made to a bank-based financial system, which underlines the predominance of banks in financial intermediation. (Sevic, 2000a, Sevic, 2000b). Reforms in the banking sector have so far produced best results. It has realized a sizable progress due to accelerated privatization and liberalization of the banking sector among all the sectors in BIH, with significant confidence in banks, improvements in terms of extending credits to businesses and households and presented one of the fundamentals of economic development of the country (PRSP, 2004: 92-93). Besides, it is wide-range accepted that state ownership is in comparison to private ownership less efficient and foreign-originated banks are most efficient of all (Bonin et.al, 2008; Fries and Taci, 2005; Weill, 2003). Investments from quality banks especially from Austria, Italy, Turkey, Germany and Slovenia BIH have one of the most advanced financial sectors in the region. In the framework of the institutions-building process and the restructuring of the State Banks, foreign investors allowed entering the banking sector by buying important shares in the state-owned banks when these were "ready" for privatization and often not meeting the minimum requirements of financial soundness (Babić-Hodović and Tesche, 2006). Main foreign investors in the banking sector of BIH are shown in Table 5.

In general, the financial system in BIH is dominated by the banking sector while the nonbank financial sector is not so much developed. Rapidly increasing of internet banking in developed countries has not the same insight in BIH due to various factors. Progress in e-banking needs to be done in this country. (Basheska-Gjorgjeska et.al, 2006) The consolidation process of the banking sector came mainly on the back of foreign direct investments through the acquisition of private - or already privatized - banks. Privatization of the banking sector is almost completed. 90% is private capital, of which 77% is foreign private capital, while 13% is local private capital. There are 29 commercial banks operating in BIH in 2009. A strong concentration of capital among several large banks is noticeable so a few banks holds a large amount of the total capital. Out of the total number of commercial banks, 25 are included in the state deposit insurance scheme. Investment in banking sector in period 1994-2008 amounts 1.2 billion Euros and represents 22% of total investment in BIH. BIH has been given "B2" credit rating with the stable outlook by Moody's Agency (May 17, 2006) Standard & Poor's Rating Services assigned 'B+' credit rating with stable outlook to Bosnia and Herzegovina. (December 22, 2008) (FIPA 2009: 22)

Table 5. Main Foreign Investors in the Banking Sector *

BH Bank	Country	Investor		Amount (thousand KM)
"Hypo Alpe-Adria-Bank" d.d. Mostar	Austria	Hypo Alpe-Adria-Bank AG		183.000
Raiffeisen BANK d.d. Bosna i Hercegovina	Austria	Raiffeisen International Bank Hold., AG	163.854	168.922
	Austria	Millenia Beteiligungsverwaltungs GmbH	5.068	
"Hypo Alpe-Adria-Bank" AD Banja Luka	Austria	Hypo Alpe-Adria-Bank AG		120.837
"UniCredit Bank" d.d. Mostar	Croatia	Zagrebačka Banka d.d.	78.228	118.174
	Austria	Bank Austria Cred.	29.079	
	USA	Internat. Fin.Corp.	6.831	
	Italy	Unicredito It. S.p.a.	3.900	
	Spain	Transmadrid	136	
"Bosna Bank International" d.d. Sarajevo	UAE	Dubai Islamic Bank	25.920	47.520
	Saudi Arabia	Islamic Development Bank	21.600	
"Volksbank BH" d.d. Sarajevo	Austria	Ostereichische Volksbank.		47.000
AD "Volksbank" Banja Luka	Austria	Volksbank Int. AG		42.471
"BBI Leasing Real Estate" d.o.o. Sarajevo	Saudi Arabia	Islamic Development Bank	21.531	39.905
	UAE	Abu Dhabi Islamic Bank.	18.374	
"NLB Razvojna banka" a.d. Banja Luka	Slovenia	Nova Ljubljanska Banka	21.245	36.028
	Germany	LHB Inter. H. Bank	12.171	
	Serbia	Vojvodanska banka	2.611	
"CBS Bank" d.d. Sarajevo	Germany	LHB Inter. Hand. AG Frankfurt	11.789	26.993
	Slovenia	Banka Domžale	15.114	
"Turkish Ziraat Bank Bosnia" d.d. Sarajevo	Turkey	T.C. Ziraat Bankasi		25.000
"IEFK Banka" A.D. Banja Luka	Russia	Istočno Evropska Fin. Korporacija i drugi		20.000

* The banks which also invested in BIH can be quoted as:

- Komercijalna Banka a.d. Beograd, Serbia;
- Poteza Adriatic BV Amsterdam, The Netherland;
- Ukio Bank Invest Grupe, Litvania;
- Istočno Evropska Finansijska Korporacija, Russia;
- Steiermarkische Bank und Sparkasse AG Graz, Austria.

Structural changes in the banking system, adoption of modern principles of evolving the banking industry leads to a bank-based financial system in BIH (Željko, 2008: 28). The banking system is dominated by large foreign banks, which have been the main source of credit growth in BIH, and has improved the soundness of the financial system. As a consequence these altered the nature of risks of financial stability. This means that no longer a traditional risk in banking slovenly crisis is assumed but rather the risk to the sustainability of foreign exchange reserves increasing from the potential for capital flow volatility. (IMF, 2006: 11-12, 28) The following list¹ is taken from the Ministry of Foreign Trade and Economic Relation BIH, for the period May 1994- December 2008. It shows the foreign Investors in the Banking sector which registered investment in amounts higher than 20 million KM.

In last 12 years there is a significant increase in both deposits and loans of the commercial banks in BIH. Total deposits in Commercial banks' accounts was only 1.382,4 million KM in 1997, while it is 12.013,2 million KM which is 769 % more than the amount in 1997. This shows the increasing confidence in the BIH financial sector. Total loans given by the commercial banks was only 2.439,6 million KM in 1997, while it is 14.561,1 million KM which is 497 % more than the amount in 1997. This shows the financial support of the financial sector to the development of the BIH economy and households (Table 6).

The balance sheet volume of the commercial banks in BIH is also has been continually increased during last 12 years. Analytical Accounts of Commercial Banks in Bosnia and Herzegovina are given in Table 7. Total assets of the commercial banks was only 3.336,9 million KM in 1997, while it is 21.040,9 million KM which is 530 % more than the amount in 1997.

¹ The lists were kindly provided by Dušanka Brkić (FIPA)

Table 6. Total Deposits and Loans of Commercial banks (of million KM)

DEPOSITS				LOANS			
Year / month	Demand Deposits	Time and saving deposits	Total deposits	Year / month	Short-term loans	Long-term loans	Total loans
1997 / 12	784,1	598,3	1.382,4	1997 / 12	956,7	1.482,9	2.439,6
1998 / 12	983,8	678,7	1.662,5	1998 / 12	1.028,2	1.892,6	2.920,8
1999 / 12	1.107,7	712,1	1.819,9	1999 / 12	852,3	1.928,9	2.781,2
2000 / 12	1.385,8	568,0	1.953,7	2000 / 12	878,3	2.138,6	3.017,0
2001 / 12	2.061,5	1.209,3	3.270,7	2001 / 12	913,3	2.425,7	3.339,0
2002 / 12	2.293,8	1.430,5	3.724,3	2002 / 12	1.097,8	3.183,3	4.281,1
2003 / 12	2.553,8	1.812,3	4.366,0	2003 / 12	1.233,5	3.888,0	5.121,5
2004 / 12	3.121,7	2.456,8	5.578,5	2004 / 12	1.576,2	4.350,9	5.927,1
2005 / 12	3.876,1	3.000,1	6.876,3	2005 / 12	1.837,0	5.707,1	7.544,2
2006 / 12	4.942,2	3.896,7	8.838,9	2006 / 12	2.218,1	7.089,8	9.308,0
2007 / 12	6.025,8	6.112,9	12.138,7	2007 / 12	2.752,2	9.211,4	11.963,6
2008 / 12	5.480,5	6.532,7	12.013,2	2008 / 12	3.714,0	10.847,1	14.561,1

Table 7. Analytical Accounts of Commercial Banks in Bosnia and Herzegovina (in million KM)

ASSETS										
Year	Month	Reserves	Foreign Assets	Claims on General Government	Claims on Non-Financial Enterprises	Claims on Private Sector	Total			
1997	12.	239,5	657,8	133,8	2.171,0	134,8				3.336,9
1998	12.	207,6	604,6	113,0	2.546,8	260,9				3.733,0
1999	12.	274,7	848,4	36,7	2.467,2	277,2				3.904,3
2000	12.	287,4	960,7	33,8	2.584,4	398,7				4.265,0
2001	12.	871,9	1.364,0	32,9	2.601,8	704,3				5.574,9
2002	12.	595,2	1.468,7	60,7	2.714,7	1.505,8				6.345,0
2003	12.	1.004,6	1.561,9	45,6	3.037,6	2.038,3				7.688,0
2004	12.	1.566,6	1.906,1	45,6	3.181,9	2.699,6				9.399,8
2005	12.	2.233,9	2.096,6	50,1	3.955,9	3.538,2				11.874,6
2006	12.	3.061,9	2.328,6	68,4	4.760,0	4.479,5				14.698,5
2007	12.	4.022,3	3.533,9	127,6	5.974,4	5.861,6				19.519,8
2008	12.	3.392,9	3.086,9	264,3	7.440,4	6.856,3				21.040,9

LIABILITIES											
Year	Month	Deposits of Central Government	Other Demand Deposits in Domestic Currency	Other Demand Deposits in Foreign Currency	Time and Saving Deposits in Domestic Currency	Time and Saving Deposits in Foreign Currency	Bonds	Foreign Liabilities	Capital Accounts	Other	Total
1998	12.	222,2	147,5	637,9	8,0	467,0	10,6	1.605,8	1.310,9	-676,8	3.733,0
1999	12.	170,1	584,6	465,5	22,4	577,3	8,7	1.519,3	1.257,0	-700,6	3.904,3
2000	12.	143,2	749,9	554,5	77,9	428,2	4,4	1.577,1	1.096,2	-366,4	4.265,0
2001	12.	277,5	1.016,2	928,5	140,9	907,7	0,1	1.526,5	1.118,8	-341,2	5.574,9
2002	12.	390,3	1.270,3	817,1	272,2	974,4	0,1	1.793,7	1.213,6	-386,6	6.345,0
2003	12.	473,1	1.510,3	818,3	461,9	1.102,5	0,0	2.437,0	1.305,4	-420,4	7.688,0
2004	12.	419,4	1.862,9	988,1	703,4	1.604,6	0,0	2.651,1	1.472,1	-301,8	9.399,8
2005	12.	533,4	2.370,5	1.154,8	818,1	1.999,4	0,0	3.559,3	1.712,5	-273,4	11.874,6
2006	12.	755,1	3.081,9	1.358,8	1.098,8	2.544,4	0,0	4.032,8	2.071,8	-245,1	14.698,5
2007	12.	2.086,5	3.962,3	1.459,3	1.517,4	3.113,2	0,0	5.114,5	2.530,0	-263,4	19.519,8
2008	12.	1.546,7	3.684,9	1.511,6	1.799,5	3.470,6	12,9	6.307,8	3.004,5	-297,5	21.040,9

Source: Central Bank of Bosnia and Herzegovina (2008)

Beside all these developments, an ever increasing number of newly created private banks could be seen over the years. It is a fact, that a lot of foreign investors perceive the Balkan region as a surrounding with high risks for investment. Not only due to fragile political situation, but also from weakened law enforcement agencies. With increasing political stability it can be given good signals to foreign investors. Furthermore the privatization process can be regarded as the main important institutional possible course of action that can happen to the transitional banking sector in BiH to improve the performance within this branch. It is noteworthy that international reserves have been boosted substantially in the banking sector. But overall the banking system in BiH are not internationally competitive: *“Despite constantly increasing participation of foreign banks and other financial institutions in the national banking systems, it is still necessary to persuade foreign investors that the current, constantly improving overall social situation will most likely be sustained in the future, and that they have to opt for long-term operation in the country.”* (Sevic, 2000b: 279) Today the banks are significant players in the Bosnian financial system. Several empirical studies proved the positive relationship between financial sector developments and economic growth (e.g. Alfaro et al., 2003; Babić-Hodović et al., 2008; Babić-Hodović et al., 2009)

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