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Review

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THE IMPACT OF WARS ON THE ECONOMY OF THE EUROPEAN UNION AND BOSNIA AND HERZEGOVINA

Summary: *Current local and regional wars—such as the conflict between Russia and Ukraine, as well as wars in the Middle East—are causing noticeable changes in the global economy, regardless of their geographic distance. The aim of this research is to demonstrate that although these wars occur far from Bosnia and Herzegovina and the European Union, they exert a dominant influence on financial flows, global supply chains, and established trade routes for goods and services. Given the current state of global markets, the hypothesis is that external factors may now affect the functioning of the economy and trade networks in the EU and BiH more than ever before. Countries possessing energy resources, wheat, or other key production inputs exert dominant influence—regardless of their geographic location—and changes in their domestic markets can have global repercussions. The events unfolding today are driving up inflation, triggering population migrations, and prompting searches for alternative sources of energy and raw materials, often under significantly costlier and more complex transportation conditions. This paper employs secondary analysis as its research method.*

Key words: economy, current wars, inflation, taxes, wages, energy sources, raw materials, global market

JEL classification: *E00, O3, O32, O2, O23*

INTRODUCTION

This paper, using a secondary research method, examines how war—whether of a local or regional nature—can exert a broad and dominant influence on changes in the functioning of economic systems and supply chains at the global level. The aim of the study is to demonstrate that although military actions may be geographically distant from Bosnia and Herzegovina—and the Middle East far from the European Union—these wars nevertheless have a dominant impact on financial flows, global trade chains, and established channels for the exchange of goods and services.

This paper will also illustrate how current wars have influenced inflation in Bosnia and Herzegovina, wage increases aimed at offsetting inflationary costs, and their effects on consumer spending. Additionally, the study will show how the wage growth observed in Bosnia and Herzegovina over the past few years has affected household expenditure differently, and how inflation has curtailed consumption. The hypothesis proposed in this work will be tested and either confirmed or rejected: namely, that external factors influence the functioning of the economy and the operation of supply chains in the EU and Bosnia and Herzegovina now more than ever.

Furthermore, the paper will demonstrate the dominant influence of countries that possess energy sources, raw materials, food, and other production inputs—regardless of their geographical location—on the global economy.

1. THE IMPACT OF LOCAL CONFLICTS ON GLOBAL TRADE CHAINS

Some authors, based on consumer price indices from various countries, have confirmed that in fact the Russia–Ukraine war deepened inflation on a global scale, and that the inflation rate differed only in proportion to each country's trade volume with the warring nations (Maurya and Bansal and Kumar 2023, 1837). Naturally, the greater the trade volume, the higher the inflation rate.

This information merely corroborated various views and findings previously associated with this subject. Europe's—and the world's—dependence on countries that possess energy resources or other essential commodities—such as wheat, corn, minerals, metals, and other inputs long active in trade exchanges—is unmistakable. From a political standpoint, one cannot ignore the strength of the Russian economy and the Western economies' dependence on it.

Global supply chains have developed under the umbrella of globalization, bringing both significant advantages and drawbacks. The focus of international trade has cantered on financial barriers and cooperation, irrespective of national borders.

Some authors (Broner and Ventura 2016, 1499) analyzed globalization and financial flows, noting that many countries have removed restrictions on foreign financial transactions, addressed issues related to international trade receivables, and experienced effects from financial globalization.

In their analysis, they stated that the effects of globalization depend on the extent of a country's integration into the globalization process—in other words, they depend on that country's level of development, productivity, savings, and institutional frameworks.

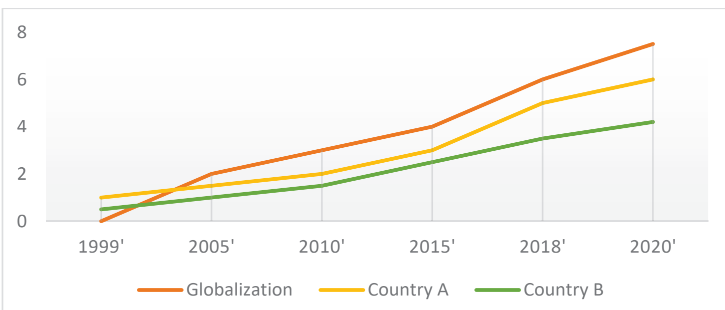


Figure 1. Development of Globalization (author)

The globalization development graph shows the trajectory of globalization (orange line) from 1999 to 2020, when globalization peaked under normal economic conditions. As early as 2020, disruptions in trade chains began due to the impact of the coronavirus, which led to widespread lockdowns, barriers, quarantines, and border closures. This virus caused the greatest disturbance to the functioning of supply chains up until that point.

The yellow line represents Country A, a developed, economically stable nation that fully engages in and follows the process of globalization—including the exchange of goods and services, financial flows, trade, labor mobility, and all other aspects encompassed by globalization.

Country B (green line) exemplifies a nation of average development and moderate participation in globalization. It does not have fully stable institutions or a highly developed economy but leverages globalization's advantages and strives to actively participate in global processes.
The example of the coronavirus pandemic shows that any country facing a major crisis—such as the virus—naturally turns inward first, solving its own problems and seeking alternative sources for food, medicines, medical supplies, and other essentials from domestic supply chains or local sources. Imports faced difficulties since borders were closed and movements were tightly controlled.
A second, more localized yet highly impactful disruption was the Russia–Ukraine war. Russia is a leading global exporter of energy resources and industrial metals. Alongside Ukraine, Russia is also a major exporter of wheat—they together account for roughly 25% of the global wheat market. Armed conflict always leads to diversions in distribution, import, and export chains. When a significant energy exporter is involved, global supply chains for oil, electricity, petroleum products, and food are affected, ultimately resulting in inflation and prolonged price increases.
Economic relations in any society manifest as intertwined interests. The European Union, on one hand, imposed sanctions on Russia; while on the other hand, EU economies were significantly dependent on Russian energy and Ukrainian wheat. During wartime conditions, the EU and neighboring countries were forced to find alternative—and often more expensive—substitutes. China, as a long-standing partner of Russia, secured access to Russian energy and helped cushion Russia from economic losses.

2. ENERGY MARKETS UNDER THE INFLUENCE OF VARIOUS SITUATIONAL FACTORS

Energy sources hold a crucial place in any economy—unconditionally—because a country's strength is reflected in its economic development and its political-diplomatic ability to secure energy at the lowest possible prices.
Energy resources drive economies and production, whether they involve oil, petroleum products, electricity, water, metals, or minerals—each is an indispensable factor in the production chain. If one factor is missing, production cannot be completed.
Significant technological advancements have enabled the development of renewable energy sources such as solar power systems. These technologies attract considerable global attention because electricity production remains expensive in many countries, and electricity is a vital component of production processes. However, the deployment of solar energy technology faces technical, economic, and institutional barriers. At the same time, some authors note that the cost of solar energy is significantly lower than traditional commercial sources, and that production technologies have advanced considerably, resulting in more affordable prices (Govinda and Kurdgelashvili and Narbel 2012, 460).
Moreover, increased electricity production through combined methods—such as hydroelectric, wind, solar, and traditional thermal power plants (and even mining)—could partially relieve pressure on oil prices. For this reason, many automobile manufacturers in recent years have been racing to take the lead in electric vehicle production.

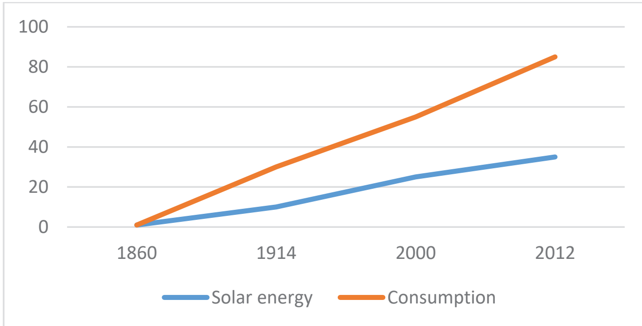


Figure 2. Electricity Consumption and the Technological Development of Solar Energy Production (author)

The graph shows the increase in electricity consumption (orange curve) and the development of technology for solar energy production (blue curve).

3. IMPACT OF LOCAL AND REGIONAL WARS ON THE EU ECONOMY

The past five years have been marked by significant economic shifts, transitioning from deflation and stagflation to the current inflationary pressures. The surge in energy prices, particularly electricity, gas, and oil, has been a major contributor to this inflation. Europe has been notably affected, especially due to its substantial reliance on Russian and Ukrainian resources, including energy supplies, wheat, and other critical commodities.

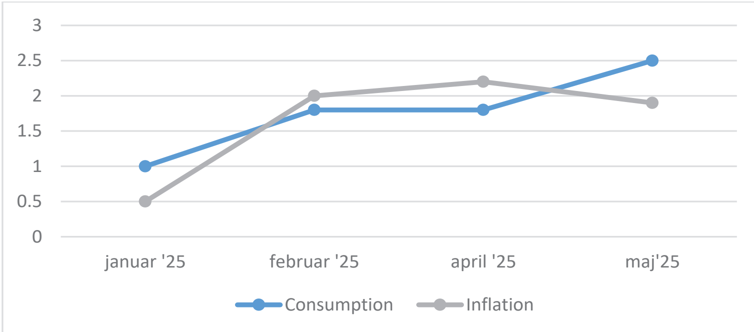
Political changes have also influenced economic dynamics. In response to Western sanctions, Russia has redirected its trade focus towards Asia, particularly China, moving away from European partners. These sanctions aim to exert peaceful pressure; however, in Russia's case, the West attempted to influence Russia to cease its conflict with Ukraine, despite Europe's significant dependence on Russian energy resources.

Consequently, Europe is experiencing rising inflation rates. Historically, Russia and Europe have maintained a long-standing economic partnership, with Russia supplying raw materials and Europe providing financial capital. However, the ongoing conflicts in Ukraine and the Middle East have disrupted the functioning of supply chains for goods and services, financial flows, and trade operations within the European Union.

The increase in the cost of basic necessities, such as bread and meat, is a direct result of the overall price escalation, primarily driven by rising energy costs (electricity, gas, oil) and supply chain disruptions. Notably, European countries import 47% of their gas and 25% of their oil, predominantly from Russia. Alternative solutions are significantly more expensive. Additionally, the rise in labor costs further exacerbates inflationary pressures.

Long-term inflation poses a substantial risk, potentially leading a country into recession. Currently, Russia is most at risk of recession due to its involvement in the war, financing the conflict, and shifting its economic focus towards a war economy, which yields no productive results other than costs and negative economic growth. Typically, a country enters a recession after experiencing two consecutive quarters of negative economic growth.

Russia's negative economic growth is further aggravated by sanctions, reduced exports, and declining investments, presenting significant economic challenges for the country.



Graph 3. Inflation and Consumption (Author)

Graph 3 illustrates the relationship between inflation and consumption. When inflation is very low, it can have a stimulating effect on the economy. However, as inflation rises, it negatively affects consumption. The orange line represents the increase in inflation, while the blue line shows the corresponding decline in consumption. Conversely, when inflation decreases, consumption tends to rise, indicating that a reduction in inflation has a stimulating effect on consumption. It is important to note that a decrease in the inflation rate does not imply its elimination; rather, it signifies a slower rate of increase.

4. IMPACT OF GLOBAL FACTORS ON THE ECONOMY OF BOSNIA AND HERZEGOVINA

For years, the world has been witnessing the creation of a new global order, where economic, rather than national, boundaries are being established. In this system, the world is viewed as a unified entity. However, amidst political and financial uncertainties, shifts are occurring in the global economy. The previous trend of erasing national borders and replacing them with global trade boundaries has entered a new phase of restructuring.

Political and economic relations are interconnected. Political instability leads to economic instability, and vice versa. Political crises and ongoing wars result in significant changes in trade and economic relationships, leaving negative effects, primarily inflation. In the countries of the Western Balkans (WB), including Bosnia and Herzegovina, slower economic growth is anticipated (Krasniqi and Krasniqi 2024, 57). One of the primary reasons for this is significant economic and trade uncertainty. The inflation in Bosnia and Herzegovina is a result of various factors. External factors, such as global energy price increases and disruptions in supply chains due to the wars in Ukraine and the Middle East, are beyond Bosnia and Herzegovina's control. Internal factors that Bosnia and Herzegovina can influence include fiscal and monetary policy reforms. Wage increases also contribute to inflation, and to halt or slow its growth, several mechanisms can be considered. Addressing inflation is a complex and prolonged process. If inflation persists long-term, it leads to a decrease in the currency's value, as significantly more money is needed for the same goods. To slow down or halt inflation, it is essential to reduce consumption (Duca-Radu and Kenny and Reuter 2021). Typically, this is achieved through tax increases.

The inflation rate could rise further due to crises in international energy markets. A similar situation is expected in the region, as rising energy prices can trigger a chain reaction of increased prices for basic foodstuffs. The European economy has been functioning based on Russian–Ukrainian resources, and due to the war in these countries, disruptions in supply chains have led to increased inflation. Bosnia and Herzegovina's economy is closely tied to European countries, and consequently, price increases have also affected Bosnia and Herzegovina.

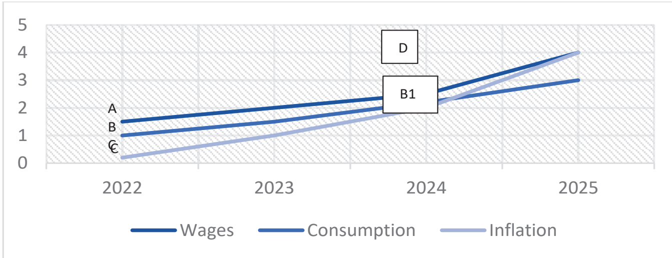


Chart 4. Relationship between Wages, Consumption, and Inflation (Author)

Chart 4 shows the movements of money as disposable income for consumers with fixed incomes in BiH. Line A represents wage increases, while line B represents consumption. From this example, it can be concluded that as disposable income increases, consumption also increases, as both wages and expenses rise. If fixed costs remain the same, the difference in money is spent on new clothing, items, travel, entertainment, etc. When inflation occurs, and its rate rises approximately or equally to the percentage increase in wages, it can be concluded that wage growth has matched the inflation rate, but consumption has decreased proportionally to the inflation rate increase (points D and B1).

CONCLUSION

Several conclusions can be drawn from the above analysis, which at first glance may not seem overly complex. While the war between Ukraine and Russia can be characterized as a local conflict between two countries, economically, this war has global repercussions.
Europe's and the world's dependence on Russian and Ukrainian raw materials confirms that countries possessing energy resources, food, and raw materials can have a dominant influence on other economies, even if they do not share a physical border. Economic interdependence knows no boundaries and can reach various parts of the world. Although trade chains are established over years, emergencies can rapidly alter everything.
The long-standing partnership between the European Union and Russia today largely requires and significantly increases the costs of alternative trade routes, replacing the established ones, from energy, food, and raw materials trade to all other segments. The process of globalization now presents a changed picture of its functioning.
It can be said that today's economy is witnessing a reshuffling of economic systems, a reorganization of global economic and trade flows with significant changes, disruptions, or the creation of a new socio-economic order.
The fact is that the world is grappling with inflation, each region or country in its own way. This phenomenon certainly needs to be kept under control, as it can undermine the financial system or destroy the currency.
Some measures that can influence this include increasing taxes, which reduces consumption, thereby decreasing inflationary pressure as overall consumption declines. Additionally, increasing taxes naturally reduces the budget deficit, thereby decreasing the need for new government debt.
Ultimately, high inflation can undermine confidence in the national currency and the economic system as a whole. This can lead to capital flight, further worsening the economic situation.
Tax increases have a direct impact on reducing inflation through several mechanisms. Firstly, increasing taxes reduces the disposable income of households. This means people have less money to spend, which reduces overall demand in the economy. Reduced demand can help decrease price pressures, thereby slowing inflation.

It is essential to have a clear strategy and apply it effectively. Increasing wages visibly leads to increased consumption, but such circumstances can often lead to inflation. Inflation in Bosnia and Herzegovina is not caused by increases in minimum wages. It is the result of a series of factors, both local policies and global ones.
Bosnia and Herzegovina's economy significantly depends on imports and geopolitical relations with major powers, as well as neighboring countries. Oil is the primary energy source that BiH imports, and it is significant both in production and throughout the supply chain.
If oil and oil derivative prices rise, there is an automatic chain reaction leading to increased prices of basic foodstuffs throughout the supply chain, which further necessitates wage increases to mitigate these price hikes. With the rise in disposable income, in conditions of inflation, you have seen that at one point, inflation exceeds disposable income and leads to reduced consumption.
Local influences such as wars, fires, floods, or other higher powers, regardless of geographic location, can have a very broad and dominant impact on the economy, largely determining the degree of economic cooperation between the affected country and the country undergoing changes.
Managing inflation through taxes and minimum wages is crucial; finding a balance is essential for the optimal functioning of the budget and consumption by the local population.
Based on the data and analyses presented in this paper, the hypothesis can be confirmed that external factors perhaps more than ever influence the functioning of the economy and the course of trade chains in the EU and BiH regions.

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