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## **BOSNIA AND HERZEGOVINA'S FOREIGN TRADE: SOURCE OR BARRIER FOR ECONOMIC DEVELOPMENT**

Review

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### ***Abstract***

*Bosnia and Herzegovina (B&H) is a small and open country in which foreign trade plays an important role. Unfortunately, the country has a continuous foreign trade deficit. As is well known, export growth, as an autonomous component of aggregate demand, has a multiplicative effect on the growth of national income, but in open economies the effects of foreign trade on income depend also on marginal propensity to import. Export to foreign markets for many domestic companies is difficult due to their low competitiveness and many non-tariff barriers. The main characteristic of B&H foreign trade, as well as a continuous deficit, is having the European Union (EU) as the dominant trading partner. What can be done to improve the country's position in international trade? The countries in the region have expressed their aspiration to join the EU by CEFTA and Stabilization and Association Agreement (SAA). Integration is intertwined with trade-relations. So, how Adopted SAA that entered into force on February 1, will affect our foreign trade balance? Will it stabilize our economy and be a development basis, or will it put B&H exporters in even harder position? Progressive liberalization may have unintended consequences. Analysis of B&H foreign trade in the light of the EU association process, indicators of production and geographical structure and suggested answers on mentioned questions are given below.*

***Keywords: foreign trade, deficit, Bosnia and Herzegovina***

## 1. INTRODUCTION

Why do some countries enjoy a high standard of material living, while others do not? Why do some countries achieve high growth rates, while other countries have much slower growth, or even stagnate? One of the main macroeconomic goals of each country along with stable prices, high rate of employment and a stable foreign trade balance, is to achieve as high as possible economic growth and development. All these goals are linked.

Bosnia and Herzegovina is a transitional country, burdened by many problems of post-war economic reconstruction. It is a small and open country in which foreign trade plays an important role. It has a lot of potential (especially in agriculture, forestry, and tourism) but it also has many barriers to development of a balanced internal market, which became too big for weak B&H economy to deal with and to achieve a better position in the international market. B&H has expressed a desire to join the EU by the CEFTA and Stabilization and Association Agreement (SAA). Integration with the larger market is intertwined with trade-relations. The focus of this paper is B&H foreign trade characteristics, expected agreement effects on the B&H economy, expected impacts on foreign trade balance and on opportunities to grow and develop.

In this paper the applied policy of B&H foreign trade, the reasons why B&H has a foreign trade deficit, the most important trade partners, the structure of trade, and the advantages and disadvantages brought by liberalization and agreements with the EU are examined. The weaknesses and potentials of the B&H economy are highlighted.

The literature relevant to foreign trade and its link to growth and development in general is reviewed. Then the general situation in B&H and its impact on the country's position in international trade is described. The SAA, as a main economic and political Agreement that has a great influence on B&H foreign trade policy and its position in the international market, is summarized. Finally, conclusions and recommendations for policy makers are presented. Understanding the interaction of numerous obstacles and which of them have a direct impact on foreign trade, growth and development is important for policy makers and for prioritizing reforms.

## 2. LITERATURE REVIEW

Considering for how long the influence of foreign trade on economic development and general well-being has been known, foreign trade has long been a subject of special interest for overall economic policy and economic science in general. The observed motives, incentives and benefits of foreign trade have resulted in many different theories and doctrines about it, from the mercantilist protectionist doctrine, through classicist to neo-liberalist and globalist. There are numerous discussions in the literature based on the link between growth, trade and openness.

A positive correlation between them is advanced in the work of Adam Smith (1776). According to Smith, opening up free trade does not result in only a one-time productivity growth (for example in a period of trade liberalization), but it leads to a permanent increase in productivity. Since then numerous theories have supported his conclusions. Their common characteristic remains the attempt to prove the positive correlation between the openness of the economy and long-term rapid growth, and the superiority of a liberalized economy compared to a protectionist economy, through the channels of more efficient allocation of resources, faster productivity growth, and, particularly important in recent years, faster and easier transfer of knowledge (Lovrinčević, 1999). The fundamental issue of economic development is related to the attitude of the country towards international trade. The country should resist the temptation to produce all it needs. Openness to trade and FDI ('FDI' – Foreign Direct Investment) will help in ensuring the rapid movement of countries forward to the best world practices in different sectors (Samuelson, Nordhaus, 2010, p.532).

The question that many countries are facing, and to which there is no universally accepted answer in economic science, is whether a country has GDP growth thanks to the increase in exports (ELG, "export led growth"), or growth in exports is a consequence of economic growth (GDE, 'growth driven exports')? The answer to this question is determined by the specifics of individual economies. There is no common formula for understanding economic growth, but a lot is known about it in general. Determinants of growth are: institutions (e.g. quality of educational and government institutions, effectiveness and responsiveness of government), wealth of natural resources, productivity, technological advancement, openness (share in international trade), geographical location and FDI. There is clearly a positive correlation between investments and growth. It is also known that countries achieving economic growth have a large component of foreign trade in their GDP. An empirical study in Croatia for 2000-2011 rejected an ELG hypothesis, and accepted a GDE hypothesis for the Croatian economy (Ratkovski, Bičanić, 2013). It was concluded that export growth in Croatia is derived from indigenous economic conditions, primarily GDP growth. This may mean that conventional measures encouraging exports may not result in its growth. Ratkovski believes that policy makers should therefore strive to improve the economic conditions for businesses in Croatia with regard to their business abroad. In other words, for the Croatian producers primary target is Croatian market, and obstacles at home market cause negative trends in foreign trade too. Bičanić builds on Ratkovski's conclusions. A growth diagnosis carried out in Croatia in 2011 defined low mobility as a main growth obstacle. Openness is one of the mobility dimensions. It is the most important growth factor and the main growth obstacle that has a much wider meaning than export, import and foreign trade by themselves (Ratkovski, Bičanić, 2013).

Feder (1983) analyzed the sources of growth in the period 1964–1973 for a group of semi- industrialized less-developed countries. His conclusion is that growth can be generated not only by increases in the aggregate levels of labor and capital, but also by the reallocation of existing resources from the less efficient non-export sector to the higher productivity export sector (Feder, pp. 59-73).

Many empirical studies have interpreted results in regressions of output variables on export variables as providing support for an export promotion development strategy. Such an interpretation is questionable since these regressions provide no means of determining the direction of causality. Woo and Marshall did causality tests between exports and growth for 37 developing countries. The results cast considerable doubt on the validity of the export promotion hypothesis (Woo, Marshall, 1985).

Gjokaj points out the link between trade, integrations and development. In a country's relations, the development of trade is one of the most important characteristic and component of a modern economic system. As a driver of development, trade is today a new starting point for the integration of the development of economic, political, cultural and social relations, general social stability and modern EU processes. (Gjokaj, 2011, pp 65-78).

By CEFTA 2006 creation and SAA implementation, B&H has been exposed to foreign trade liberalization and adaptation of the national economy, which should bring higher B&H international competitiveness before its full entrance into EU membership. The measurement of the share of intra-industry trade in foreign trade as a whole, as well as in individual economic branches, could be a very significant indicator of the competitiveness and B&H economic development in the context of macroeconomic policy as a whole (Marić, 2011).

In his paper, Marić tested the hypothesis that the turnover of goods increment and foreign trade deficit decrement should be positively correlated with the intra-industry trade increment. The economic hypothesis, which has been confirmed by many studies and empirical data in the past, that countries that have longer common borders and have reduced barriers on foreign trade (customs duty and quotas) will have a higher level of intra-industry trade among themselves, is not confirmed by the example of B&H foreign trade. Although B&H mainly has had an increasing trend of foreign trade amount and high openness of the economy, the majority of B&H foreign trade is inter-industry trade. This is a consequence of B&H's significantly lower competitiveness level than all of its foreign partners.

### **3. METHODOLOGY AND DATA**

Qualitative analysis is based on published scientific and professional papers dealing with the issue. Secondary data sources used in qualitative analysis are the Agency for Statistics of Bosnia and Herzegovina and the B&H Ministry of Foreign Trade and Economic Relations. Based on the collected data, descriptive methods, analysis of import and export data by tariff number, and comparative analysis are used.

In addition to the absolute values of imports and exports, surpluses and deficits, in the foreign trade analysis simple indicators are used: foreign trade coefficient (openness indicator), the export-import ratio (the rate of import coverage by export). Calculations are explained in the paper.

The paper is exploratory, as it aims to provide familiarity with a certain problem and make it more accessible and known, and also it provides a basis for future empirical research.

#### **4. BOSNIA AND HERZEGOVINA - FOREIGN TRADE ANALYSIS**

No matter how materially rich some countries are, there is no country that is economically independent, i.e. able to produce everything its population needs, without foreign trade, especially nowadays when needs are more dynamic and product cycle is getting shorter and shorter. For strong economies, foreign trade and foreign markets represent resources, as well as target markets for their goods and services. For smaller countries, foreign trade represents a way of market expansion as well as the ability to satisfy population needs better and possibility to get new technologies and equipment which will stimulate their growth. Foreign trade necessity is shown through openness which implicates foreign trade rate in the country's overall GDP. In general, small countries like Bosnia and Herzegovina, are more open than big ones.

Why is it important to analyze foreign trade continuously?

Analysis of foreign trade is important:

- For companies involved in foreign trade or those that are planning to be involved, so that they fully understand what is required to be successful.
- For foreign trade policy creators to set the best climate for success.
- For foreign companies that are considering investments in a certain country, to enable the best policies to encourage such investment.
- For university professors, students, journalists, politicians and the wide public in order for them to fully understand their country's situation.

For example, companies involved or planning to be involved in foreign trade should know product structure for imports as well in exports, i.e. which products are mostly present, in what quantity, what prices, and what are the future expectations for these variables etc. Foreign trade policy creators make decisions to improve country status based on foreign trade analysis (for example, they increase or decrease customs, quotas, or completely abolish them, stimulate exporters, make administration procedures easier or harder to deal with etc.)

Statistical data published by statistical agencies and institutes, custom services, central banks, and foreign trade chambers are extremely important. Bosnia and Herzegovina has a foreign trade balance deficit, the bigger share of which is a deficit of trade in goods, amounting to 6,723 billion BAM in 2016. An imbalance may be periodical, cyclic and structural. B&H's balance of payment is characterized by structural imbalance in total, as well as in foreign trade. Perhaps a better description would be "fundamental imbalance" (Stojanov, 2000,

p.39) that can be corrected only by changing the currency rate, but in B&H we have a currency board. This imbalance is caused by the country's market opening up too rapidly after total destruction by the war of 1992-95 and the fact that the country is on a much lower level of technological development comparing with its main foreign partners.

Bosnia and Herzegovina is a small and open-trading country. In a perfect competitive market it is impossible for it to affect global trade movements. The size comparison with the GDPs (2015, USD rounded) of some other countries shows a stark difference: B&H 16,191 billion, Switzerland 670,789 billion, USA 18,036,648 billion, EU 16,311,897 billion, Croatia 48,732 billion (Word Bank, 2017). The only possible solution is more effective adjustment.

The openness to trade of a country firstly depends on its foreign trade policy (i.e. how liberal or protective), then on the level of productivity and technological development, then on the production structure and production diversity, tradition etc. The most important foreign trade partner for B&H is the EU, of which it is an associate member and potential candidate for membership. EU is the largest market participating in global GDP with a share of 20%. The EU has had a major role in creating the global market system, due to GDP value (14 billion EUR) and internal market openness with 2,415 billion EUR export value and 2,188 billion EUR import value. Activities of the EU helped in creation of the World Trade Organization (WTO). Trade openness has brought and continues to bring many advantages to the EU, considering that more than 30 million jobs in the Union depend on foreign trade.

Table 1

Trade openness (foreign trade coefficient) of Bosnia and Herzegovina in the period 2010-2015

Year	Import (in thousand BAM)	Export (in thousand BAM)	GDP (in million BAM)	Openness
2010	13.616,20	7.095,50	25.346	82%
2011	15.525,43	8.222,11	26.210	90%
2012	15.253,04	7.858,34	26.193	88%
2013	15.170,17	8.380,50	26.743	88%
2014	16.199,28	8.681,74	27.304	91%
2015	15.851.692	8.987.194	28.522	87%

*Source: Agency for Statistics of Bosnia and Herzegovina, author's calculations*

Openness is measured by the contribution of foreign trade to overall GDP and it shows how much a country depends on its trading partners. Openness (foreign trade coefficient) of B&H in the period 2010-2015 is shown in Table 1.

Foreign trade coefficient ( $I_o$ ) indicates foreign trade share in a country's total GDP in one period. It is calculated as the ratio of the sum of exports (E) and imports (M) to GDP:

$$I_o = \frac{E+M}{GDP} \quad (1)$$

High openness and uncompetitive trade result in a high foreign trade deficit. Foreign trade volume does not necessarily indicate a good openness rate. Many industrial sectors may be exposed to foreign competition and it does not reflect on import growth. Those sectors may keep their market share and prevent imports by being highly competitive and by keeping prices low enough. The importance of exports for a country's growth and development is measured through increase in employment, growth in international reserves and national competitiveness, getting new knowledge and technologies, and sustainable growth and development. Export minimizes addiction of local firms to local markets and implies risk dispersion. Barriers for B&H export growth are: grained production, insufficient production capacities, lack of clear national export strategy, difficult access to global capital, problems connected with transfer of new technologies and knowledge etc. Competitiveness is *conditio sine qua non* in international trade and it determines a country's success and position in foreign trade.

According to economic theory, liberalization and freeing up of a country's foreign trade result in a higher standard of living for its participants, but under the premise of an equal development level. By involving themselves into free trade, countries accomplish benefits, but also they are more exposed to disorder in global trade (external shock). WTO is the leader of trade liberalization and a promoter of free multilateral trade. That is why most countries are members. It is a risky to stay outside, both in economic and in the political terms. The WTO has 164 members, and B&H has had the status of an observer since 1999.

Table 2  
Bosnia and Herzegovina foreign trade in goods indicators 2007-2016

Year	Export (in thousand BAM)	export index t/ (t-1)	Import (in thousand BAM)	import index t/ (t-1)	Volume (in thousand BAM)	Index	Balance(in thousand BAM)	index	Export/ import ratio (%)
2007	5.936,58	/	13.898,24	/	19.834,83	/	-7.961,66	/	42,71
2008	6.711,69	113	16.292,52	117,2	23.004,21	115,7	-9.580,83	120	41,19
2009	5.531,20	82,4	12.355,18	75,8	17.886,38	77,7	-6.823,98	71,2	44,77
2010	7.095,50	128	13.616,20	110,2	20.711,71	115,8	-6.520,70	95,5	52,11
2011	8.222,11	115,9	15.525,43	114	23.747,54	114,6	-7.303,32	112	52,96
2012	7.858,34	95,6	15.253,04	98	23.111,38	97,3	-7.394,70	101	51,52
2013	8.380,50	106,6	15.170,17	99	23.550	101,8	-6.789,68	91,8	55,24
2014	8.681,74	103,6	16.199,28	106,8	24.881,02	105,6	-7.517,54	110,7	53,59
2015	8.987,31	103,5	15.851,86	97,8	24.839,18	99,8	-6.864,55	91,3	56,70
2016	9.416,62	104,8	16.139,33	101,8	25.555,94	102,8	-6.722,71	97,9	58,35
Average	7.682,16		15.030,13		22.712,29		-7.347,97		

Notes: t - current year, t-1- previous year

Source: Agency for Statistics of Bosnia and Herzegovina, author's calculations

It is clear, from tables 1 and 2, the highest foreign trade deficit was in 2008, in amount higher than 9.5 billion BAM, i.e. over 150% of export value. The global economic crisis also hit B&H foreign trade. Last year the deficit was 6.72 billion BAM, 141.84 million less than for 2015, i.e. 2.07% less. Export/import ratio in 2016 was 58.35%, the highest ratio over the ten year period 2007-2016. This indicator is important because it shows how much a country is able to maintain balance in foreign trade. Exports were 4.78% higher in 2016 than in 2015, and the average annual value of exports over the last 10 years (2007 to 2016) was 7.68 billion BAM. Imports were 1.81% higher in 2016 than in 2015, and the average annual value of imports over the last 10 years was 15.03 billion BAM.

Table 3

The real GDP growth and foreign trade growth rates, 2010-2015

Year	Real GDP growth rate (%)	Foreign trade growth rate (%)
2010	3,03	15,8
2011	1,05	16,6
2012	2,48	-2,7
2013	-1,1	1,8
2014	1,3	5,6
2015	0,7	-0,2

Source: Agency of statistics of Bosnia and Herzegovina and author's calculations

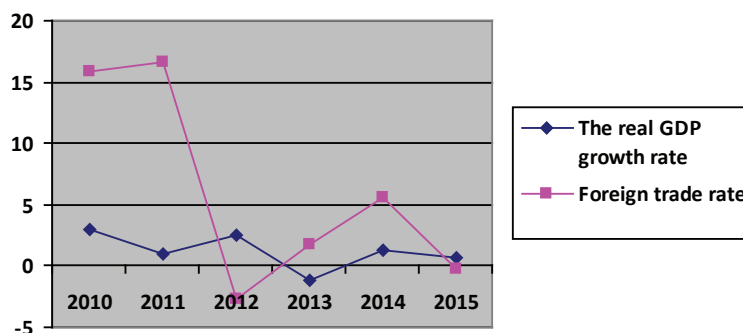


Figure 1 The real GDP growth and foreign trade growth rates, 2010-2015

Source: Agency of statistics of Bosnia and Herzegovina and author's calculations

Looking at figure 1, we can see that in 2010, 2011. and in 2014. real GDP growth and foreign trade growth had positive correlation. In rest of the observed period correlation was negative. It stays to see what will happen after coming into force Adopted SAA. Conclusion is that foreign trade is not source of economy growth in B&H. It is inevitable to work on productivity growth and production growth, competitiveness, policy stabilization and foreign trade policy, as an *engine of development*, after that foreign trade can be growth accelerator.



In 2016 the largest export categories were: seats (TN 9401) 6.97% of total exports; treated wood (TN 4407) 3.63%; electrical energy (TN 2716) 3.42%; shoes with rubber sole (TN 6403) 3.34%; other furniture and its parts (TN 9403) 3.16%. As we can see, export structure of B&H is highly unfavorable. Products with lower stage of treatment and large numbers of items are dominating exports. That implies a low coefficient of export concentration. B&H does not have strategically important products and it is on a low specialization level. As an autonomous component of national income, exports should have a significant influence on it to change positively. Changes in public consumption, autonomous personal consumption, autonomous investments and exports result in multiple changes of income in the same direction. However, in open trade we must consider the role of imports. It indicates that the effect of foreign trade depends on marginal propensity to import, and then, with a domino effect, that influence is reflected on the other macroeconomic variables (employment, production level, price stability...). As evident in the tables, B&H has had a foreign trade deficit for many years. It is a country unique in the world due to its policy and administrative structure, demography structure, and many other things, including a currency board. That means it is crucial to achieve growth in production and export, in order to maintain macroeconomic stability and macroeconomic policy based on actions of the currency board, because changes cannot be made by national currency devaluation.

Table 4  
Goods with highest share in B&H export according Tariff number

ORDINAL NUMBER	TARIFF NUMBER	DESCRIPTION	VALUE OF EXPORT (MILION BAM)					PERCENTAGE 2016	INDEX
			2012.	2013.	2014.	2015.	2016.		
1.	9401	Seats;	521,16	577,09	613,58	616,70	656,58	6,97	106,47
2.	4407	Treated wood;	242,04	252,51	291,52	321,32	341,77	3,63	106,36
3.	2716	Electrical energy;	150,17	471,91	308,67	284,43	322,46	3,42	113,37
4.	6403	Shoes with rubber sole;	253,98	301,88	337,54	307,75	314,14	3,34	102,08
5.	9403	Furniture and its parts;	197,07	219,08	223,43	254,60	297,96	3,16	117,03
6.	8708	Parts and supplies for motor vehicles with tariff numbers 8701 until 8705;	158,88	212,59	245,64	250,91	250,97	2,67	100,02
7.	7601	Aluminum in row shapes;	457,19	397,07	367,78	344,30	247,75	2,63	71,96
8.	8544	Insulated wire and other insulated electrical conductors;	101,75	98,53	139,10	189,46	198,76	2,11	104,91
9.	2836	Carbonates; Peroxide carbonates	123,27	123,70	151,80	170,87	198,16	2,10	115,97
10.	6406	Footwear parts	102,03	112,78	146,87	162,81	193,58	2,06	118,90
Total (1-10)			2.307,55	2.767,14	2.825,94	2.903,14	3.022,13	32,09	104,10
Other			5.550,79	5.613,35	5.855,81	6.084,17	6.394,4	67,91	105,10
Total			7.858,34	8.380,50	8.681,74	8.681,74	8.987,31	100,00	104,78

Source: Analysis of foreign trade exchange of Bosnia and Herzegovina 2016, MINISTRY OF FOREIGN TRADE AND ECONOMIC RELATIONS

Table 5

Overview of products with the highest deficit share according to Tariff Number

Ordinal Number	Tariff Number	Description	Deficit value (mil. KM)					Share 2016 (%)	Index
			2012.	2013.	2014.	2015.	2016.		
1.	2710	Petroleum oil, except raw;	-745,10	-773,74	-752,79	-726,00	-708,35	10,54	97,57
2.	8703	Personal vehicles;	-492,96	-488,80	-520,40	-542,48	-597,42	8,89	110,13
3.	2709	Petroleum oil- raw;	-1.196,31	-1.199,71	-1.034,42	-633,87	-515,63	7,67	81,35
4.	3004	Medicines;	-324,36	-316,11	-371,55	-330,20	-333,33	4,96	100,95
5.	2701	Stone coal, briquettes ;	-363,06	-308,82	-317,24	-303,59	-250,98	3,73	82,67
6.	4107	Beef letter further treated ;	-104,07	-136,79	-177,29	-187,06	-199,19	2,96	106,49
7.	8517	Telephone	-149,73	-168,21	-172,31	-186,45	-198,26	2,95	106,33
8.	2711	Petroleum gases;	-307,11	-232,49	-218,78	-207,52	-153,71	2,29	74,07
9.	4011	New outside Pneumatic tires;	-99,30	-99,59	-108,69	-116,43	-132,65	1,97	113,93
10.	2203	Beer and malt products	-134,35	-138,23	-142,90	-144,13	-127,39	1,89	88,39
Total (1-10)			-3.916,35	-3.862,48	-3.816,36	-3.377,73	-3.216,91	47,85	95,24
Other			-3.478,35	-2.927,19	-3.701,18	-3.486,82	-3.505,80	52,15	100,54
Total			-7.394,70	-6.789,68	-7.517,54	-6.864,55	-6.722,71	100,00	97,93

Source: Analysis of foreign trade exchange of Bosnia and Herzegovina 2016, MINISTRY OF FOREIGN TRADE AND ECONOMIC RELATIONS

Table 5 shows goods with the highest contribution to the trade deficit. In table 6, it is evident that in 2016 deficit declined compared with 2015, both in industrial products trade (1.75 % less) and in foreign trade in agricultural products (2.79% less). It is necessary to emphasize that the openness of a country to trade has to be in accord with its level of development. Excessive and premature opening and liberalization may have fatal consequences for a young, undeveloped economy like that of B&H, mostly because of ineffective producers without a chance to compete in the market with highly competitive firms from more developed countries. The result is that B&H imports goods that may be produced by her own economy, for which there are resources and which do not require sophisticated technology. The most obvious example is in the agricultural sector. Despite good climate, and available land and water supplies, that sector has the highest share in the foreign trade deficit: more than two billion BAM (table 6). The fact that the overall foreign trade deficit in 2016 was 7 billion BAM and that 30% of the overall deficit was made up of trade in agricultural products, means that something has to be done in this sector which has so much potential. In particular, this sector is the largest employer of people in B&H; these people have a proud history and experience in farming and, with more attention to training and improvements in methods of farm management and technology, great gains could be made in its contribution to reducing the trade deficit, both by replacing imports and increasing exports. Many improvements in the management of small farms are possible and these would allow farmers to remain on their land and have a good income, while greatly assisting the country's economy. From the tables above we can see that export and import structure did not change a lot during past few years.

Table 6

Structure of foreign trade in goods (by the sort of products, in million BAM)

	SORT OF PRODUCT	2012.	2013.	2014.	2015.	2016.	Share (%)	Index
EXPORT	Industrial	7.220,35	7.706,71	8.032,41	8.169,68	8.482,21	90,08	103,83
	Agricultural	637,99	673,78	649,34	817,63	934,41	9,92	114,28
	<b>TOTAL</b>	<b>7.858,34</b>	<b>8.380,50</b>	<b>8.681,74</b>	<b>8.987,31</b>	<b>9.416,62</b>	<b>100,00</b>	<b>104,78</b>
IMPORT	Industrial	12.436,50	12.418,79	13.447,46	12.960,89	13.189,36	81,72	101,76
	Agricultural	2.816,54	2.751,38	2.751,81	2.890,97	2.949,96	18,28	102,04
	<b>TOTAL</b>	<b>15.253,04</b>	<b>15.170,17</b>	<b>16.199,28</b>	<b>15.851,86</b>	<b>16.139,33</b>	<b>100,00</b>	<b>101,81</b>
DEFICIT/ SUFICIT	Industrial	-5.216,15	-4.712,08	-5.415,06	-4.791,21	-4.707,16	70,02	98,25
	Agricultural	-2.178,55	-2.077,60	-2.102,48	-2.073,34	-2.015,55	29,98	97,21
	<b>TOTAL</b>	<b>-7.394,70</b>	<b>-6.789,68</b>	<b>-7.517,54</b>	<b>-6.864,55</b>	<b>-6.722,71</b>	<b>100,0</b>	<b>97,93</b>

*Source: Analysis of foreign trade exchange of Bosnia and Herzegovina 2016, MINISTRY OF FOREIGN TRADE AND ECONOMIC RELATIONS*

The role of companies from B&H in the foreign market is not improving because of their low competitiveness, but also because of non-custom barriers used by highly developed countries. Despite the GATT limiting traditional foreign trade barriers by making custom rates lower, which since then have been minimized by WTO, there are new, sophisticated instruments of protection that developed countries use. That includes different standards, technical regulations, certificates, confirmations etc., which producers from undeveloped states cannot satisfy or require. All those sophisticated measures imply many non-custom barriers, i.e. measures of indirect protection, and make foreign trade even harder for those companies from undeveloped countries like B&H. This results in less foreign trade in quantity of goods than it would be possible without those barriers. Also in trade with EU, there are many standards that are hard to reach for B&H exporters.

If you look at the payment balance of any country, you would see that the highest value item of current account is import and/or export. That is the reason why all countries are focusing on export growth, which is conducted by different instruments, and is mostly described under the concept of export stimulation or export subsidies. The goal is to increase competitiveness of exporters and to improve their position in global trade. It is achieved by many tools: export credits, direct export subvention, help from the state through giving various confirmations and certificates for required standards and through providing information about foreign partners, return of toll and customs, currency devaluation, promotion of export etc.

B&H may export only a few products, mainly raw materials and semi-manufactured products, due to not satisfying international laws and standards applying to foreign trade. On the another hand, without an adequate within-country system of regulation and safety and quality checks for imported products, almost everything can be imported into the country. This is not only bad for the trade deficit but it allows the import of inadequate and potentially harmful products.

Table 7

## Deficit / Surplus by regions

Region	Value (Million BAM)					Share (%)	Index
	2012.	2013.	2014.	2015.	2016.		
EU	-3.643,12	-2.937,82	-3.277,38	-3.192,21	-3.188,65	47,43	99,89
CEFTA	-320,87	-343,52	-504,84	-622,83	-663,71	9,87	106,56
EFTA	9,48	58,61	78,07	53,30	73,94	-1,10	138,71
FTA*	-266,63	-318,60	-347,81	-290,07	-285,90	4,25	98,56
REST OF THE WORLD	-3.173,55	-3.248,36	-3.465,57	-2.812,80	-2.658,38	39,54	94,51
TOTAL	-7.394,70	-6.789,69	-7.517,53	-6.864,60	-6.722,71	100,00	97,93

Notes: \* Free Trade Agreements Countries (Turkey)

*Source: Analysis of foreign trade exchange of Bosnia and Herzegovina 2016, MINISTRY OF FOREIGN TRADE AND ECONOMIC RELATIONS*

Knowing geographical import-export concentrations is very important, because the activities in foreign trade partner countries affect B&H. Table 7 shows foreign trade balance by regions. Comparing to 2015, in 2016 trade in goods deficit with EU (0.11 %) and Turkey (1.44 %) declined. In the period 2012-2016, the deficit in trade with the EU declined, which is a good trend that encourages the EU association process. In the same period, the trade deficit in goods with CEFTA countries increased. Only with EFTA was there a foreign trade surplus. In 2016 compared to 2015, there is export growth (14.5 %) and import growth (2.31%), as well as surplus growth (38.71%). Trade in goods with the “rest of the world” is characterized with export growth (by 2.72 %), import decline (by 3.88%), as well as deficit decline (by 5.49%).

B&H has the highest deficit in trade with: China, Serbia, Italy, Croatia, Russia, Germany, Poland, Turkey, USA and Brazil. The highest B&H export share goes to (up to 74.32 %): Germany, Italy, Croatia, Serbia, Slovenia, Austria, Turkey, Montenegro, Netherland and Hungary (B&H Agency for statistics).

Croatia left CEFTA, and joined the EU in 2013, what affected B&H and Croatia foreign trade balance because of custom reintroduction on imported products from Croatia to B&H. The value of import from Croatia fell from 2.2 billion BAM in 2012 to 1.6 billion in 2016.

## 5. THE STABILIZATION AND ASSOCIATION AGREEMENT (SAA)

On June 16, 2008, B&H and the European Communities and their Member States signed the Stabilization and Association Agreement (SAA) and the Interim Agreement on trade and trade-related matters (IA), which entered into force on July 1, 2008. The Stabilization and Association Agreement (SAA) is a new, third generation agreements which the EU offers to Western Balkan countries. The aim is to contribute to economic and political stability of the

Western Balkans. The ultimate goal is a formal integration into the European Union.

The SAA is an agreement of “mixed” character, which means that in areas of cooperation member countries are partly responsible and partly the European Union. Also, before it comes into force, it must be ratified in the parliaments of all Member States and the European Parliament. This means that, except the European Union, the contracting parties are also all member countries, since the SAA covers areas not only within the competence of the EU. It consists of 135 articles and ten chapters: General Principles; Political Dialogue; Regional cooperation; Free movement of goods; Movement of workers, business settlement, provision of services, movement of capital; Harmonization of rights, enforcement of competition law and rules; Justice, Freedom and Security; Politics of cooperation; Financial cooperation; Institutional, general and final provisions.

According to the evolution clause, the SAA confirms the status of a potential candidate for membership in the Union. This is a lot more than other countries have received in their accession treaties. “With the entry into force of the SAA, the EU and B&H relations are moving to a higher level because the obligations arising from political dialogue and regional cooperation (which are not in the Interim Agreement) become part of the contractual relationship” (Directorate for European Integration, 2015). With the entry into force of the SAA, B&H committed itself to concluding regional cooperation agreements with other countries that have signed the SAA within a two years period, with the aim of increasing the volume of cooperation between these countries (Article 15, SAA). One of the main goals, at the same time the backbone of the SAA, is the free trade establishment between Bosnia and Herzegovina and the EU (Article 18, SAA). This implies the gradual establishment of free trade areas for a period of up to 5 years, starting with the entry into force of the IA, in accordance with SAA provisions and the GATT 1994 and WTO provisions. The EU-B&H free trade zone was established in accordance with Article 3 of the IA, on January 1, 2014.

Why is SAA presented in this paper? It is expected that entry the SAA into force will have direct and indirect economic and political benefits, since its activation proves commitment to EU integration and is evidence of gradually fulfillment of membership criteria. The agreement strengthens the position of B&H in the region and the world, gives positive signals to investors and ensures better compliance with the principles of justice, freedom, security, etc. Indirectly, this should lead to an increase in investment, employment and the growth of gross domestic product.

However, damages are also expected from Adapted SAA. Adapted SAA entered into force on February 1, 2017. It defines the import quotas free of custom charge and defines that for all the quantities above them customs will be fully charged. Dairy and meat industries and their processing sectors will be under the biggest challenges due to high competition. B&H producers cannot compete with the low prices of the EU producers stimulated by CAP (Common Agricultural Policy) e.tc. That is only one example. The only way out of this situation for domestic farmers would be to increase export to the Turkish market because

B&H has signed Free Trade Agreements (FTA) with Turkey. But SAA should boost trade between its parties, not to turn it over to another partner. Because of that, it is important to further research possible effects and contradictions of SAA. Fruits and vegetables producers could have gains, as they can export to the EU without customs. Sugar producers also could have gains because they get a 2500-tonne quota and winegrowers because they get a 20,000-hectolitre quota. But the question is how much will be done because our agricultural producers do not meet the safety and quality conditions that the EU is looking for. Also we do not have so many sugar producers and exporters. Germany has pledged to provide technical assistance for the agricultural sector in recovering after the damage that may arise from this agreement.

Announced advantages are many. Freedom of trade in goods which is to be created by the SAA, means that Bosnia and Herzegovina companies have access to an internal EU market with around 500 million consumers, and companies will be able to provide services throughout the EU and compete for public tenders. The SAA also supports the EU and Bosnia and Herzegovina institutional relations established by the “transitional agreement”. The approximation of EU standards for product quality will lead to greater competitiveness and private sector over time, while the gradual introduction of higher consumer protection standards will increase the safety of the citizens. The benefits of SAA are also: greater market competition, which will potentially lead to lower prices and greater choice of goods and services for Bosnia and Herzegovina citizens. The entry into force of the SAA should enable a better business environment due to the gradual approximation of EU laws and standards, which will lead to greater security and confidence for domestic and foreign investors. It should also expect greater efficiency of institutions and more progress on issues of crime rate reduction and corruption, promotion of higher education reform, development of democracy and human rights, and media independence.

The implementation of the SAA implies a new comprehensive reform and full compliance with the Copenhagen Criteria (1993) and the Madrid Criteria (1995), i.e. : the stability of institutions guaranteeing democracy, the rule of law, human rights and the protection of minorities; The existence of a functioning market economy, capable of dealing with competitive pressures and market forces within the Union; The ability to assume membership obligations, including the commitment to the goals of the political, economic and monetary union; Creating conditions for integration by adapting administrative structures. All this requires full engagement of the entire administration, the non-governmental sector and the society in general.

## **6. OBSTACLES, CHALLENGES AND PERSPECTIVES**

Foreign trade system can't be isolated and studied separately from the rest of the economy, because it is necessary to provide a stimulating business environment for domestic companies and for attracting foreign investors. The basic prerequisite for stable and long-term economic growth and development

and for strengthening competitiveness is labor productivity growth. Small countries must have above average efficiency and competitiveness so that they can participate successfully in the international provision of labor (Marić, 2013, pp.12). “The results of the analysis suggest that the Bosnia and Herzegovina economy has a problem of low productivity, namely Bosnia and Herzegovina is at 31% of the EU average “(Federal Institute for Development Programming, Labor productivity in Bosnia and Herzegovina - a condition for strengthening the competitiveness - p.3). In order to increase productivity, it is necessary to increase investment in human capital, technology and the development of company management. The main macroeconomic challenges facing B&H in joining the EU are the high level of public consumption, high budget deficit, high public debt and high foreign trade deficit. The biggest problem is the lack of economic integration in B&H itself. The precondition for achieving all the advantages of accessing the EU market, i.e. for optimal economic development, is both legal and institutional unity in the country, not only by harmonizing the entity’s legal framework and coordination of all levels of government, but through the creation of a comprehensive, unified legal system within the country. How can B&H align its legislation with the EU when it does not have a single legislative framework within the country? Many obstacles and barriers are obvious. For example, in the agriculture sector, which has great potential to develop, having in mind its significant share in the foreign trade deficit, B&H has been able to withdraw substantial funds from EU pre-accession funds and boost the export of agricultural products. Establishment of country level bodies that would manage these funds was necessary, but it was not fulfilled because of the lack of political consensus. Once again, the main barrier, among others, (maybe even the source of all the others) is policy. And without stable policy, there is no economic stability and possibility to grow and develop.

When it comes to food, in EU food safety and consumer protection is the most important. This has led to the adoption of the legal requirements to ensure that the food that is sold in the EU market is safe. EU legislation determines the maximum amount of residues of pesticides and contaminants that can be found on/in food and this must be respected. Because the laboratory capacity in B&H is still not enough to carry out laboratory tests for control of residues in produce in its own market, exporters are forced to perform analyses in neighboring countries. Also, many administrative taxes have to be paid by exporters. Capacities have to be expanded and the country has to lower taxes to encourage exporters and increase their competitiveness.

A big obstacle for investors is the different legislation across the country. If foreign investors hire workers with residences in different entities of B&H, they have to use different payment procedures. No wonder foreign investors avoid B&H. Direct foreign investments were down 40% in 2015 (Foreign Investment Promotion Agency of Bosnia and Herzegovina). In the World Bank 14th annual report, ‘Doing Business 2017 - Equal Opportunities for All’, B&H ranked is 81st in the world for its ease of doing business for foreign investors. It is the lowest ranked country in the region, taking 65 days and 12 procedures to start a business, and 179 days and 15 procedures to obtain



a building permit, which is more than the regional average.

We can't talk about reducing public spending unless a single institutional and legal framework is established. The country must stand behind its exporters, educate them and prepare them for foreign markets, assist them with various incentives and lower taxes, work more on export promotion...but firstly it must make a good climate for producers to grow in their own market. The only thing that is growing is the government spending, and it is not used as a basis to stimulate future growth but to cover current needs.

B&H has potential in agricultural sector (for e.g.in raspberries production B&H is at 11 place in the world- Vodič za izvoz voća povrća u Evropsku Uniju,2016 ), healthy food production, wood industry, tourism, metal industry (reorientation in production from intermediate products to final products). But many challenges also: required reforms in further EU association process, taxes decrement to stimulate producers, more subventions in agriculture, subventions for new jobs, political stability...

## 7. CONCLUSIONS

Bosnia and Herzegovina suffers from chronically large trade deficits, mostly due to rebuilding efforts after the war. In all aspects, the European economy is more competitive than the B&H economy, and many negative effects of liberalization will be shown very quickly, as positive effects are evident only in the long term. But B&H has opted for the European path and has to be ready for the thorns leading up to European stars. As it wants to be part of the EU, B&H has opened its borders to much more competitive EU products. At the same time, authorities must find a way to help domestic producers to increase competitiveness, firstly making a positive business climate for its domestic markets and then by promoting its producers, both in foreign markets and on the domestic market, trying to remind domestic consumers why it is important to buy domestic. This applies in particular to the agricultural sector, wood sector and tourism where B&H has great potential that must be exploited. Even limited analysis of foreign trade and the general state in the B&H economy, as undertaken here, suggests that authorities should be dedicated to solving numerous legal, institutional, political and economic issues in order to achieve the desired rate of economic growth and, in time, economic development and economic convergence with EU countries. At present, foreign trade is based on large imports, and thus cannot be the basis of economic growth and development. In the current economy conditions, growth will certainly not be driven by exports. There is also a need for inevitable painful structural reforms, which should increase the competitiveness of the B&H economy.



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