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## **COMPETITIVENESS OF BIH IN THE CONTEXT OF EUROPEAN AND GLOBAL INTEGRATIONS**

### **Abstract**

*In today's open and integrated world economy, the problem of competitiveness without doubt has a central place. It has shown that ever more intense competition in the conditions of all present globalisation is threatening to the survival, equally, as of companies that are not able to transform, be inovative, productive and responsive to pressures from the environment, and as well whole national economies and communities. Bosnia and Herzegovina get a chance to improve national competitiveness through Stablisation and Association Agreement, ie. through the proces of accession to the European family. Reforms that are necessary to happen are a good path to correct principles of global competitivnes and to create preconditions for economic sustainablity, development and growth. However the role of the state, at the time of growing economic and political power of transnational mega-corporations, the devious development of technology, knowledge economy, despite numerous oppositions, is very important to balance development and to reduce negative consequences for unprepared and underdeveloped economies and national economies, which is also economy of BiH.*

**Key words:** *competitiveness, Stabilisation and Accession Agreement, EU integrations, BIH, reforms, global competitivness index, foreign investments.*

**JEL:** O52

## 1. COMPETITIVENESS IN THE FOCUS OF ECONOMIC THOUGHTS

Competitiveness has a central place in economic thoughts both in developed countries and developing countries. According to OECD definition<sup>1</sup> competitiveness is ability of the country to produce goods and services under free and fair market conditions and that pass the test of international market along with maintaining and increasing real income of the population.

Traditionally, international competitiveness of countries is explained by international exchange theories that come from Adam Smith. But today's global economy is too complicated to be explained by this traditional theories. Result of this is classic „The Competitive Advantage of Nations“ of Harvard professor Micheal Porter where he suggested a new theory of competitiveness according to which national prosperity is not inherited but created by strategic choices. While in the past development of a country was based on comparative advantages like cheap work force and natural resources, today advantage factorial conditions based on knowledge and development infrastructure, high technology and inovations are deemed to be basis for economic development. Today it is not important which products you produce, but how you produce them. Thus the competitiveness of the products in international context is the best reflected in the foreign exchange trade of one country. The EU is the one of the most competitive communities and leading trade force of the World. But it is important to address that total exchange of its countries refers to intra-community exchange (Kandžija, Makrosustav EU, p.84) ie. exchange between its members.

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<sup>1</sup>OECD was founded on the founs of OEEC that operated from 1948 to 1960 in order to administratively organize American aid to the European economy after WWII (Masshall's plan). Today, the main task of the organisation is economic expertize and favoring economic coperation between developed countries, but OECD mandate covers al economic, social and ecological problems, and especially: encouragement of sustainable development and employment, increase of living standard, keeping financial stability, support to economic development of other countries, contribution to the growth of the world trade. The European Commission also participates in various working programs, schemes etc. (Kandžija V. Cvečić I: Ekonomika i politika Europske unije, 2011)

Competitiveness is a multidimensional phenomenon – necessarily present at the level of company, sector and nation as a whole. Some economists see national competitiveness through the prism of macroeconomics and its variables. But, what is in that case for example with Japan, Italy, South Korea that had rapid growth of living standard despite of tax deficit, Germany and Switzerland despite of appreciation of the currency, Italy and Korea despite of high interest rates. Others see competitiveness of the country in cheap and numerous labour force. But Switzerland and Sweden have prospered on high salaries even in the case of lack of labour force. Thirds connect competitiveness with abundant national natural resources. And again contradiction of Germany, Japan, Italy, South Korea, all countries with limited natural resources.

When defining competitiveness at the macrolevel, or at the level of countries, it often starts with research that sublimates current theoretical knowledge about competitiveness, and that generally did not change significantly till today. Trabold (1995) analyzes four significant aspects of competitiveness deepening knowledge of the aforementioned, but also of other authors:

- possibility of selling on the global market (export),
- possibility of attraction of investments (location),
- possibility of economy adjustment, and
- possibility of creation and increase of disposable income.

Three derived indicators of competitiveness, according to this definition, at the national level are directly measurable (growth of GDP, export movement and FDI inflow). The ability of economy to adjust that can be seen in the speed of economy's reaction to changing market conditions and notice of new possibilities and opportunities is not possible to cover with one macroeconomic indicator. In the analysis this variable is sometimes seen in data on development of the research and development sector. Globalization issue is always necessarily linked to competitiveness, or according to economists globalization issue lies on the fact that companies have to learn to enter the foreign markets and to increase their global competitiveness.

Observing competitiveness from the marketing point of view, and according to opinion of one of the leading marketing authorities Kotler, all companies before their going out to the market shall focus on some basic questions as: what market position we will try to achieve first in our own country, then on the continent and in the world? Who will be our competition and what are their strategies and means? Where we will produce and generate our product? What strategic alliance we will build with other companies? Kotler says that mini global scene of the own market where the global companies already are and compete with their own products to the domestic companies is some kind of preparation and check if domestic companies can come in 'fight' with big, global 'players'.

Anto Domazet says that essence determination of global economy is based on its qualitative features, such as the focus on world needs, creation of world key segments of the market, focus on common features of demand, demand, preferences and patterns of consumers' consumption, development of global marketing mix, investment or partnership at the global basis as the way of entering the global market etc. (Domazet, A. 2001, p.91). Therefore a smaller company can be global provided that its business activity is based on strategy that respects qualitative basics of global industry.

When speaking about competitiveness of the one whole economy, it can be expressed through its ability to achieve productivity, or national income that enables welfare to their citizens and increase of their share in the global market of goods, services and capital. Likewise, competitiveness of the national economy will for sure be greater if national economy solves disadvantages of own positions in the global market by attracting investments and investors in the country, who will then participate in the competitiveness of national economy.

In the global economy competitiveness of countries refers to their ability to be competitive basis of business companies, domestic and foreign ones.

## 2. COMPETITIVENESS OF BIH IN THE CONTEXT OF EUROPEAN INTEGRATION

The constant economic and social crisis in Bosnia and Herzegovina indicates that it is very important to ensure support to comprehensive measures to strengthen competitiveness and growth at local, regional and national level in order to create possibility for economic recovery. Support to economic and social development is one of the main goals of the European integration process. The Council of Ministers of the European Union has set political and economic conditions for development of bilateral relations back in 1997, so it provides the possibility to Bosnia and Herzegovina to use autonomous trade preferences. In May 1999 Stabilisation and Association Process began. It offers clear possibility of interaction for Bosnia and Herzegovina, as well as for five other countries of the Western Balkan region to the EU, and progressive partnership where EU offers to each country mix of trade concessions, economic and social support and contractual relations. Stabilisation and Association Agreement<sup>2</sup> signed by the Community and its members with Bosnia and Herzegovina should give a 'break' to integration process through its basic elements that is based on the four freedoms<sup>3</sup> and measures for application and implementation of standards and normatives of the EU in all areas:

- promotion of integration of BiH in the community of democratic countries;
- respect for international law principles and rule of law;
- respect for democratic principles, human rights and media freedom;
- development of market economy;

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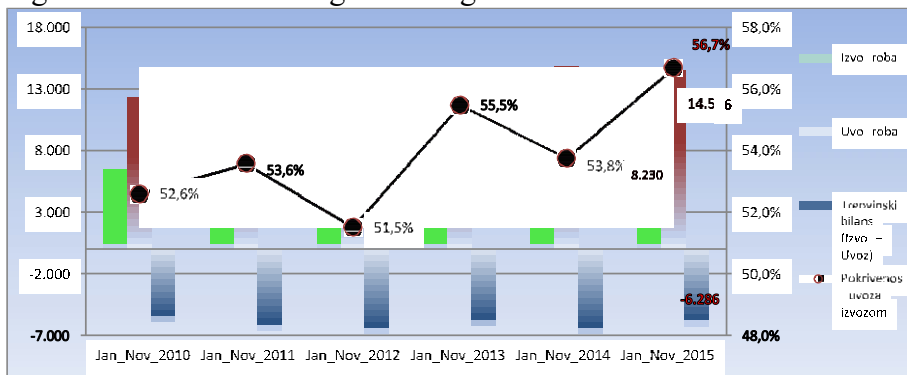
<sup>2</sup>After Bosnia and Herzegovina has support the Written statement in accordance with the conclusions of the Council from 15 December 2014, necessary conditions for SAA entry not force at 1 June 2015 are achieved. The SAA has replaced temporary agreement on trade and trade issues from 1 July 2008. source:www.europa.ba

<sup>3</sup>Internal market include are without internal borders where the movement of goods, people, services and capital is free and ensured in accordance with provisions of Agreement of EU functioning. Internal market (28 countries and more than one billion of citizens) is one of the key sources of common policies and law regulations and key achievements of legal and economic integration in Europe, as a whole, according to data of International Monetary Fund, and currently it is the biggest economy in the world. Source: Europska unija, skupina autora, Mate Zagre, 2010.

- creating regional cooperation;
- promotion of free flow of goods;
- improvement of economic growth and competitiveness;
- establishment of effective institutions;
- reduction of crime and corruption;
- improvement of citizens' quality of life;
- promotion of better education and creation of new jobs;
- improvement of regional energetic and transport infrastructure.

In order to facilitate integration path of Bosnia and Herzegovina into European flows and to make Bosnia and Herzegovina more competitive, free access of products from BiH to the internal market of the EU was introduced (Antobonus Trade Measure – ATM). Fifteen years after European Union is the most important foreign trade partner to Bosnia and Herzegovina.

Figure 1. Review of foreign exchange in 2015



Source: Direction for european planning

From the standpoint of main trade partners in the mentioned period it can be seen that export has increased to Germany 6,8%, Slovenia 6,3% and Italy 0,8%, while from the other hand it can be seen that BiH's export has reduced to Croatia 3,2%, Serbia 2,4% and Austria 0,7%. Overall it can be seen that Bosnia and Herzegovina has realized total export of goods in the amount over 8,2 billion BAM for the period January-November 2015, what represents increase of 3,5% in comparison to the same period of the previous year. Observed by

specific products it can be seen that the highest rate of growth and therefore the most important contribution to the export growth can be noticed at export of meat and meat products – more than 60%, weapons and ammunition 43%, basic chemical products 14,4%, sawn timber 10,5% and aluminium 8,7%. If BH export is observed by geographical structure it can be seen increase of export in the EU countries by 2,6%, while export in the CEFTA countries is reduced for 0,5%. Foreign trade deficit is reduced for 6,1% in comparison to the previous year but that did not improve imbalance in the import export coverage, ie. foreign trade deficit that was 56,7% for months before.

Foreign trade imbalance is a clear indicator that Bosnia and Herzegovina has extremely low level of economic competitiveness in comparison to EU member countries, but also in comparison to the most enlargement countries. Unemployment is high, especially among young populations, and lack of work force with appropriate qualifications is also evident since educational institutions do not satisfy labour market needs. In the medium and small entrepreneurship sector it is still limited access to „green“ products, innovative technology, business support services and sources of financing for local entrepreneurship, access to the broadband internet and digital skills, especially for production and export oriented small and medium companies.

In order to prepare and bring closer BH political, legal and economic reality to the ruling one at unique area of EU and to the Copenhagen criteria for growth, competitiveness and employment, the European Commission has established instrument of pre-accession assistance IPA I in 2007, and in 2014 BiH has established IPA II with the EC for the period 2014-2020.

In order to reduce disadvantages of IPA I Bosnia and Herzegovina has made indicative strategic document in cooperation with the European Commission that is to establish priorities for financial assistance of the EC to Bosnia and Herzegovina at its path towards EU. This document analyzes impacts of political stalemate on the path towards the EU as well as unfinished agreement on comprehensive coordination

mechanism for planning and implementation of pre-accession assistance (IPA II).

Between 2007 and 2013 Bosnia and Herzegovina get over 615 million euros from (IPA I) and second phase IPA II is in the process since 2014 to 2020 of which 165 million euros is intended for:

- support for political reforms, preparation for EU membership and related institution and capacity building,
- support for economic, social and territorial development,
- strengthening the capability of beneficiary countries listed in Annex I to fulfill obligations arising from EU membership through support to full adjustment with acquis and its implementation and adoption,
- strengthening regional integration and territorial cooperation,
- support for employment, education, promotion of work equality and human resources development.

Because of lack of comprehensive EU coordination mechanism, assistance to BiH will be directed only to sectors with agreed strategies and sufficient coordination within the sector. However, EU assistance is just one way to achieve necessary improvement. BiH needs assistance also from other donors and international financial institutions to ensure long-term growth and development and to become more competitive in the European and global frameworks. Preparations for EU integration are for sure one good step towards creation of pre-conditions for national competitiveness and creation of more favourable political, economic, legal and especially administrative environment. In 2016 BiH submitted formal „application for EU membership“ in accordance with article 49 of the Treaty on European Union within the Netherlands' chairmanship at the EU Council<sup>4</sup>.

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<sup>4</sup>After BiH submits credible application for EU membership, the European Commission sends to BiH detailed Questionnaire, evaluates answers that BiH submits and gives recommendation to the Council of the European Union (28 members) whether BiH should get candidate status, and also it can determine date for opening negotiations for accession. After finishing negotiations Agreement on accession is signed that has to be ratified by member countries, and European Parliament gives it agreement. On certain date country access to the EU. Source: [www.dei.gov.ba](http://www.dei.gov.ba)



### 3. MEASURING GLOBAL COMPETITIVENESS

Progress issues in today's world can be placed in totally different context than twenty years ago. Economy and market relations become almost completely open, and that means also that they are hardly predictable. Custom policy is even less important and beside that all market, cultural, technological and other barriers are ruined. World economy for years has been in the phase of deep structural at the intersecion between currently dominant mass production and new production model based on scientific technological, information-communication activities, infrastructure and services. When it comes to mass production, the return of globalisation gives competitive advantage to countries with cheap production factors (especially labour) and from that comes growth of countries like China and India at global economic scene. China has 533 million of city population that is equal to the total population of USA, Japan, France and Great Britain together. By 2030 that number should increase for more 341 million that represents numerical equivalent to the whole Western Europe by the number of migrations form rural areas to cities over 20 years.

Europe is in the process of change and seeking for new economic advantages based on seeking for new role of welfare state and afirmation rule of science, technology, information-communication infrastructure and services. The goals of this change are given in Lisbon Strategy, especially in the part that determines funds for research and development at 3% of GDP. This allocation for research and development in North Europe and Great Britain have been so far more successful than in other European countries.

Position of some countries according to certain aspects of competitiveness are subject of analysis of different international institutions. Some of these researches clearly use term competitiveness in its name, eg. WEF (World Economic Forum), GCI (Global Competitvness Index)<sup>5</sup>, and other metodologies are using terms like

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<sup>5</sup> World Economic Forum measures movements of competitiveness for more than three decades. Since its establishment in 1979 profesor Klaus Schwab developes constatly competitiveness index to understand changes of country's needs as well as

economic freedom, improvement in transition or business conditions. Generally different researches of international institutions on level of competitiveness may be divided into two groups according to the approach used. The first group includes researches of WEF and IMD (International Institute for Management Development). In their analysis level of competitiveness of certain country is ranked according to the economic system (social and international relations), the state role and the institutional framework. Other group of research (Worldbank and Heritage) is focused on significant determinant of development – regulations related to business activities. For group of transition countries EBRD's Transition Progress Index is also available. What is common to all mentioned researches is that in determining position of certain country, except „hard“ statistical data they use especially designed surveys. The aim of this surveys is to measure those factors of competitiveness that are not available from standard data, first of all it is about efficiency and independence of judiciary, inclination to innovations, quality of business management, corruption and state impact on business in certain country. It is obvious that this indicators, in the part related to survey researches, result of the perception of respondents on the state in the economy. Using research of Lovrinović, Mikulić and Rajh where they analyzed different methodologies and indicators of national competitiveness and taking into account their conclusion that they have determined with great reliability and using two different analysis techniques that methodology of WEF that publishes Global Competitiveness Index, the best in a large group of analyzed transition countries describes improvement by certain areas and correlates with achieved level of economic development and in this work we used exactly WEF results (2015-2016) to describe condition of global competitiveness of Bosnia and Herzegovina.

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evolution of competitiveness nature. Since 2005 the main tool for competitiveness evaluation is Global Competitiveness Index (GCI) made in cooperation with profesor Xavier-Sala-i-Martin from Columbia University. Source: The Global Competitiveness Report 2015-2016

## **4. COMPONENTS OF BH COMPETITIVENESS THROUGH 12 PILLARS OF COMPETITIVENESS**

Economicists usually describe competitiveness as set of institutions, policies and factors affecting productivity level of certain country. Productivity level, from the other side, represents level of progress some economy can reach. Productivity level also determines some return on investment rates that are basic drivers of economic development. Some economists include factors like macroeconomic stability, corruption, security, education, labour force health,, financial development regulation, effective use of talents, incentives for companies to invest in R&D, size of the market, participation of women in labor force. World Economic Forum, constantly developing impact of different factors on competitiveness of country, has established that factors should not be observed individually given the complexity of economic development process. Thus GCI (Global Competitiveness Index) covers wide range of determinants of country productivity including micro and macro level, dividing them into twelve pillars of competitiveness: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and vocational training, product market efficiency, financial market development, technological readiness, market size, business sophistication and innovation. Just through the pillars of competitiveness of the World Economic Forum we observed and compared competitiveness of Bosnia and Herzegovina with countries in its environment, of which just one country has full membership in the EU.

### **4.1. Competitiveness of BH economy**

Domestic, national competitiveness, and most economic authorities will agree, is the answer of question what exactly determines production efficiency and its growth? What is the most efficient way to connect own labour and capital? How to equip company to be competitive in sophisticated industrial segments to produce efficiently quality product? It shall be addressed that there are international competitors, in industry and industrial segments, with genuine competitive advantages in just few countries. The competitiveness of

BH economy, Hadžović, M. (2010) links with macroeconomic indicators claiming that one of the most important factors of inadequate and unfavorable penetration on the world market is precisely consequence of bad macroeconomic environment that in principle offers very small or no incentives to raise first of all productivity of manufacturing, business environment that mostly has branch character and company influence as third factor that should translate in practice positive competitive advantages. If judging by basic economic indicator of GDP or its movements in the last ten years, Bosnia and Herzegovina clearly stagnated in the last years and maintained poor macroeconomic indicators.

The economic, social and cultural situation of underdeveloped countries is a global problem. Low level of income (low-income equilibrium) as main characteristics of poor countries, may be only interrupted, in the opinion of many economists, by concentrated and sufficiently strong development effort. In order for the growth boost to get full swing (Mesarić M.) it is necessary firstly to build material infrastructure (transport and energetic system, telecommunications etc) and social and institutional infrastructure (education, banking system, efficient state administration, legal system etc). The role of state should be very important, most economists agree with this, especially in transition countries. Economists like Galbraith J.K, Myrdal G. strongly argue thesis that national coordination and direction of economic processes are necessary in the conditions of modern „corporate“ capitalism.

Underdeveloped countries, according to Mesarić M. (2001) beside reduced economic power, still have sufficient opportunities to affect socio-economic development flows, thanks to their powers in areas of legislation, monetary and fiscal policy, and especially thanks to significant role in reallocation of national income through national budget, that is 40% and up to 60% (Sweden) of national income in the European countries. However, role of the state is extremely difficult if public spending is not in proportion to public interests, such as the situation in Bosnia and Herzegovina where public spending mostly refers to salary payments in public sector and not injection in business sector or other public interests for national sustainability, growth and development. That certainly does not promise projection of GDP movements in the next period.

Table 1. GDP movements projections for the period 2016-2016

Indicator	Projections			
	2015	2016	2017	2018
Nominal GDP in billion BAM	29.054	30.316	31.887	33.738
<b>Nominal growth in %</b>	<b>3,0</b>	<b>4,3</b>	<b>5,2</b>	<b>5,8</b>
GDP deflator (previous year)	100,5	101,3	101,9	101,7
Real GDP in billion BAM (previous year)	28.901	29.936	31.281	33.177
<b>Real growth in %</b>	<b>2,5</b>	<b>3,0</b>	<b>3,2</b>	<b>4,0</b>

Source: DEP, Economic Reforms Program 2016-2018

It is significant that, for the first time in 2005, when Bosnia and Herzegovina was included in WEF (World Economic Forum) criteria for assessing of global competitiveness, observed among 104 countries, was ranked 98th. Ten years after Bosnia and Herzegovina is ranked 111th observed among 140 countries. Competitiveness of Bosnia and Herzegovina is mostly based on cheap labour force, natural resources (water, ore, forests...) that have low level of processing that are used rentlessly and without any plan.

In this moment it seems that growth of national competitiveness of Bosnia and Herzegovina so far has been vicious circle of unsuccessful government's economic, institutional and infrastructure measures and inefficient business strategies. Unfavorable socio-economic and especially political position of Bosnia and Herzegovina in the European and global frameworks is mostly caused by entity division that led to numerous paralelisms as well as to division of interests of entity governments, and thus division of markets and market institutions as evidenced by the still unarticolated and uncoordinated cordination mechanism that can jeopardize for sure status of Bosnia and Herzegovina in the European family.

Table 2. Identified 'entity' key obstacles for growth and competitiveness in Bosnia and Herzegovina

Federation of BiH	Main obstacles for growth
Unsustainable condition in public finances	High public spending with high budgetary deficit, high tax burden, high debts for unpaid contributions, grey economy, high public debt, inefficient and too large public administration, jeopardized long-term sustainability of health sector, inefficient work of public sector and control bodies.
Unfavourable business climate and competitiveness for investment	Hidden entitlements to big companies, unclear bankruptcy procedures, large number of para-fiscal charges, complicated procedures for companies registration and other deadlines for obtaining building permits and energy connections, lack of restructuring program of public companies.
High unemployment	Especially youth unemployment (60%), high rate of grey economy, incompatibility of educational system with labour market.
Unsustainable condition in public finances	Poor targeting of social benefits, high level of unpaid obligations to funds
Grey economy	Corruption

Republic of Srpska	Main obstacles for growth
Budgetary deficit and increase of public deficit	Necessary implementation of fiscal consolidation that gradually will lead to decrease of budgetary deficit and mid-term to decrease of public debt level.
Labour market	Non-flexible labour market and labour legislation, significant level of grey economy in almost all fields
Too large public administration	Necessary reform of public administration and reform of public companies first of all Željeznice Republike Srpske (Railway of Republic of Srpska) to establish sustainable and profitable companies
Unfavourable business climate and competitiveness for investment	Law are too complicated, large costs, investment risks, corruption
Unsustainable social care system	Firstly health sector

Source: DEP, CBBIH, ISD – made by author

The Reform Agenda for Bosnia and Herzegovina for the period 2015-2018 has obliged Bosnia and Herzegovina to connect with objectives of new approach to the EU, economic governance at the Western

Balkan through improvements in six areas from one side, and from another side to maintain macroeconomic stability of the country in accordance with the economic reform program and to enhance growth and competitiveness.

The Reform Agenda that is to be implemented in Bosnia and Herzegovina refers to six key areas:

1. Public finance, taxation and fiscal sustainability
2. Business climate and competitiveness
3. Labour market
4. Social care and pension system reform
5. Rule of law and good governance
6. Public administration reform

- Public finance, taxation and fiscal sustainability

New fiscal framework should on the one hand set the level of public debt on the downward path, while creating 'room' for increase of public investments with decreasing public sector involvement in economy in the same time. Fiscal consolidation should be implemented by reducing public spending and increasing public revenues. Increase of public revenues should be done by increasing tax revenues, widening tax base, reducing grey economy, reducing tax exemptions and improving tax administrations activities.

- Business climate and competitiveness

Prosperity and growth should be based on attracting investment. It can be seen from indicators in this work that for attracting investors it is necessary to reform business environment. According to the Reform Agenda it should include: implementation of new laws on custom policy that should reduce administrative requests and ease trade, adjustment of laws from financial sector to directives from the EU, implementation of new laws and practice for investors protection, new laws on companies and direct foreign investments and simplification and automation of business entities registration. Also, this reform should strengthen national quality control and adjust it with EU requests. Reform should encourage public-private partnership or feasibility of implementation of fiscally sustainable public-private partnerships and achievement of greater involvement of private sector in infrastructure development.

- Labour market

First of all it is necessary to reform education system in order to connect it better with labour market. Reform should include support for the first job seekers, with active discouragement of activities in grey economy, and significant reduction of social care contributions. The reform means that rights of workers are protected in accordance with standards of International Labour Organisation and EU labour directives.

- Social care and pension system reform

Social care systems should be reformed in consultation with the World Bank and IMF and it should mean protection and increase of social support for those who need it.

- Rule of law and good governance

There is no fight against organized criminal, terrorism and corruption without encouragement of rule of law in Bosnia and Herzegovina. Reform of judicial system refers to adoption of strategy to combat corruption and conflict of interest in judiciary, strengthen disciplinary responsibility of the holders of judicial functions, make decisions within reasonable period of time. Reform implies also identification of measures that should additionally improve integrity of police agencies at all levels, and continue cooperation with international police forces and Europol.

- Public administration reform

It should try by this reform to achieve more modern, competent, transparent, efficient, cost effective and responsible public administration that should improve provision of public services and achieve savings. Plans should include basic, systematically important reforms for public finance management reforms.

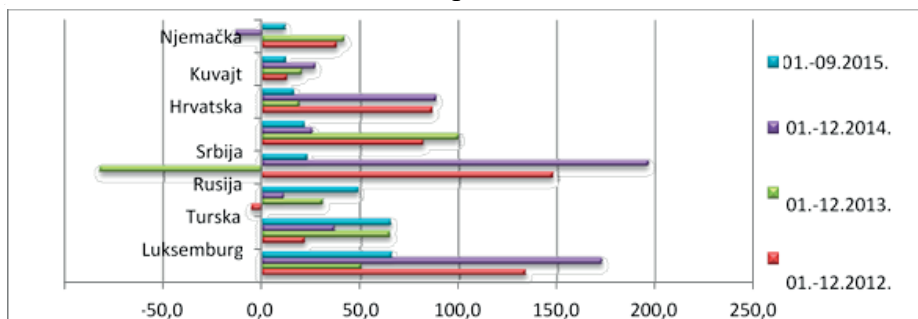
## **4.2. Foreign investments in order to strengthen export competitiveness**

The efficiency, amount and structure of investments in BiH would be, without doubt, a good presumption for successful restructuring and strengthening of global, export-oriented competitiveness and



achievement of high sustainable growth rates in longer period of time. According to data of Central Bank of Bosnia and Herzegovina for the three quarters in 2015 direct foreign investment is down by 33,8% in comparison for the first three quarters in 2014. BiH is aware that it is responsible by itself for creation of more attractive environment for foreign investors like healthy and competitive domestic sector , legal and institutional frameworks that encourage investment without discrimination, liberal foreign exchange system, flexible labour market, quality publi sector regulation. It is invested the most in processing industry 28 million BAM, telecommunication 66,2 million BAM, financial activities and insurance 28,6 million BAM. The rating agency Standard&Poor's has confirmed sovereign credit rating B with stable outlook (on 11 September 2015) to Bosnia and Herzegovina. According to the latest published revised data of the CBBiH, in the first three quarters the most of foreign direct investments came from Austria 65,8 million, Luxembourg 65,3 million and Turkey 48,5 million. The largest withdrawl of capital was in France 40,6 million BAM and Slovakia 17,4 million BAM.

Table 2. Investments in BiH in the period 2012-2015



Source: CBBiH

In order to start thinking on attraction of foreign investments it is necessary to have political stability, or lon-gterm oriented capital. Investment that can impact positively on development of the host country never comes into the unstable and politicaly turbulent areas. Just political instability attract the most speculative, 'dirty' capital that expects high earnings in short term due to all possibilities before any corruptive actions.

Direct foreign investments are not just international transfer of financial capital but they can include transfer of modern technology and other intangible assets, Bilas V., Franc S. (2006). On this way companies can change strategically and significantly impact on productivity growth and long-term economic growth in beneficiary countries, and contribute on this way to the national competitiveness. Therefore, direct foreign investments are deemed to be one of the basic channels through which developing countries get access to the most modern technologies whose diffusion has an important role in defining economic growth. Positive effects of direct foreign investments in the host countries are (Bilas, Franc, 2006):

- increase of employment
- conserving jobs in joint ventures with domestic companies
- modernization of production equipment and transfer of new technologies and knowledge
- strengthening competition
- increase in export
- positive contribution to the GDP and trade balance
- increase of spending in local economy
- contribution to regional restructuring
- filling the state budget through profit tax, income tax and payments of employees contributions
- improvement of corporate culture
- more efficient integration of beneficiary country of foreign capital in international economy

Table 3. Strengthening of market efficiency

Strengthening efficiency	BiH/140 countries	Croatia/140 countries	Serbia/140 countries	Montenegro/140 countries	Macedonia/ 140 countries
Efficiency of product market	129	105	127	70	33
Efficiency of labour market	131	105	118	74	84
Financial market development	113	88	120	44	52
Technological capacity	79	43	51	55	63
Size of market	97	79	75	131	108

Source: The Global Competitiveness Report 2015-2016, made by authors

Just through mentioned effects strengthening of national competitiveness can be seen as well as through WEF pillars of competitiveness or global competitiveness index for 2015.

Bad efficiency indicators or poor ranking of Bosnia and Herzegovina according to aforementioned factors speaks for the fact that economic condition in the country still does not show satisfying growth of national income per capita, insufficient market potential, slow growth of economic activities what causes again large number of unemployed and poverty in general.

In the absence of own potentials BiH has to turn to attraction of foreign investors who have knowledge, technologies and financial funds that could contribute to increase of efficiency of domestic companies in the field of production and governance. Thus, political and economic instability, social unrest, inconsistent monetary and fiscal policy and generally variable and unstable conditions of business definitely are not stimulative environment for foreign investors.

### **4.3. Ability to adjust BH economy to the globally acceptable market conditions**

The ability to adjust can be seen in that how fast economy response to the change of market conditions and notice new possibilities and opportunities that can not be included in one macroeconomic indicator. National economies that are not able to response to global changes attract or more accurately invest all efforts to attract foreign capital or investments and investors already good positioned at the global market.

In traditional industries that dominated in Bosnia and Herzegovina before 90s most of jobs requested from workers to learn how to do routine functions that mostly remain unchanged. Fast changes of science and technology as well as globalization pressures ask for knowledge based contemporary economies. In economy based on knowledge creation and use of knowledge and ideas have a crucial role in making wealth. Key determinant of knowledge based economy

is human capital or more accurately its significant knowledges, expertise and abilities (Bejaković P., 2006). It seems that ability to create, spread and use knowledge and information becomes more important and often it is deemed to be the most important determinants of economic growth and life quality improvement. Most of theorists would agree that information availability or knowledge availability takes over primary role over all other material factors. Creation of value refers to creation of new knowledge and exploitation of its value. Thus in new conditions of development an intellectual property that has no physical feature becomes the most valuable asset that company, economy or national economy can own. It is not odd that higher education and training to obtain intellectual property are among twelve pillars of competitiveness of World Economic Forum.

Thus it is very important to recognize on time that higher education is public benefit for society that generates knowledge, economic growth but also increases flexibility of labour market to all spheres of development of one society. It is not surprise that European Union through strategic objectives (Europe 2020) of smart, sustainable and inclusive growth puts in the center of its activities research, development and education among five main objectives (employment, research and development, climate changes and energy, education and fight against corruption) whose realisation should measure its success in the next period. Smart growth according to Europa 2020 strategy measurements means to have economy of knowledge and innovation, including firstly improvement of education system quality, encouragement of knowledge transfer, intellectual property protection and better use of information-communication technologies. EU is aware that research and innovations are necessary for growth and employment and thus it want to increase investments in research and development at 3% of GDP to stay at the top of global competitiveness and 'jeopardize' economic domination of USA and Japan.

Unfortunately, Bosnia and Herzegovina clearly lag behind its neighbours and especially behind Europe and rest of developed world in factors that directly determine knowledge and research and development. Events in previous two and half decades have stopped

economic development of Bosnia and Herzegovina and that is the worse in great measure they destroyed its for decades developed scientific potential, staff and infrastructure. Today, with significantly weakened economic basis, scientific potential is difficult to renew and standards and role science and scientific-research activity have in Europe, in our environment are hardly accepted and that can be seen in the table below used also by WEF to assess global efficiency.

Table 4. Pillars of competitiveness related to research and development

Strengthening efficiency by GCI index	BIH/140 countries	Croatia/140 countries	Serbia/140 countries	Montenegro/140 countries	Macedonia/140 countries
Higher education and training	97	51	71	54	46
Technology readiness	79	43	51	55	63
Inovations and sophisticated factors by GCI index	BIH/140 countries	Croatia/140 countries	Serbia/140 countries	Montenegro/140 countries	Macedonia/140 countries
Business sophistication	125	84	133	102	72
Innovations	115	92	113	69	58

Source: The Global Competitiveness Report 2015-2016, made by authors

Quality of higher education and training is crucial for economies that want to raise their chain of values above simple production processes and products. In particular, globalization requests from economies to be competitive or to cherish quality and well educated workers who are able to perform complicated tasks and adjust fast to change of increasing needs of production. Just workers like that create innovations and business sophistication that can be competitive to global markets. Bosnia and Herzegovina is by criteria of this pillars at the base of the list.

Scientific research work at universities in Bosnia and Herzegovina should be based on scientific excellence defined by international indicators and stronger integration with educational process at all levels in order to become one of key drivers of economy and sustainable development through creation of new ideas and

technological solutions, critical thinking and creativity and promoting and keeping cultural and history heritage of the social community it originated from at the same time. There is no progress nor better ranking of innovative and other sophisticated factors at the global level without putting science and technology in the first lines in the fight against unfavorable economic position on the competitiveness ladder or without providing support to real sector in order to increase innovative capacities and competitive ability of companies, especially micro, small and medium by ensuring additional financial funds for education and technology development, directing scientific-research and research-development projects for economy needs, strengthening public scientific-research institutes and institutes at universities and their connection with economy, improving scientific-research and technology infrastructure (equipment, devices, laboratories), increasing financial 'start-up' assistance for high-technology companies, controlling quality of imported goods in laboratories at universities and institutes, increasing involvement of expert professional staff in economy with additional financing of their work.

#### **4.4. Legal, political and institutional environment in function of competitiveness of BH economy**

For sustainable economic growth that means also competitiveness of national economy, Hodžić, K. (2009) it is necessary to develop new approach to Bosnia and Herzegovina wholeness for which it is necessary to ensure the following:

- functioning (complete) market that requests strong financial regulation, development of competitiveness of domestic companies and encouragement of technology transfer with transparency of whole transitional process, as well as
- political presumptions that represent big problem for BiH due to unmistakable divergencies of ethno-national political factors (Ideologies and organisations) in the country<sup>6</sup>.

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<sup>6</sup> Execution of power in Bosnia and Herzegovina is based on very decentralized and expensive structure with divided authorities between state level, entities, cantons and municipalities with lack of functional coordination and mechanism and political decision making. Fragmentation of planning and process of budget making, lack of

Gradually views on state-economic development relation are changing. For example, World Bank has given up of support to idea of „minimal government“. It realizes that there is no sustainable development without successful modern state.

Mesarić M. gives an important role to the state because of, as he says, negative sideeffects that happen as consequence of contemporary trends and firstly as jeopardizing natural balance, even more polarization between rich and poor individuals, social levels and countries, even more unpredictability, uncertainty and lability of economic processes, even more spread speculative behaviour and business, increase of reckless utilitarianism and unlimited consumerism, even bigger moral, worldview and value dezorientation. Todaro M.P and Smith S.C. think that market system will function good only if there are certain social, institutional and legal preconditions that usually do not exist in developing countries as Bosnia and Herzegovina. Bosnia and Herzegovina is one of transition countries that switch from totalitarian political system to market economy system and multiparty, democratic system that caused many economic and social problems. It was affected by war destruction and is still below pre-war economic activity with large social problems and tensions with quite uncertain prospects for accelerated economic growth.

Reality of Bosnia and Herzegovina is additionally loaded with ethnically complex state that function based on Dayton constitution and still there no sign of national agreement and consensus on constitutional changes. Entity division has brought to numerous parallelisms, division of interests of entity governments and division of market and market institutions that most clear can be seen in the problem of harmonization of coordination mechanism for establishment of stronger relations with the European Union. In such a constellation

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celar responsibility and control mechanisms and lines and division of jurisdictions and responsibilities continue to jeopardize efficiency of public service providing and execution of national powers in a whole.

Fragmentation of judicial system and policy sector worsen fight against comprehensive corruption and organized criminal. Longterm litigations, insufficient implementation mechanism and complex administrative law are the cause of legal insecurity for citizens and companies, and it does not contribute to economic growth nor attraction of foreign investments. Source: CSP, Indikativni strateški dokument za Bosnu i Hercegovinu, 2014-2017

of relations it is difficult to establish favourable conditions necessary for economic development: efficient legal system, corruption suppression, stimulation of fiscal policy and monetary stability. In continuation we have shown the most problematic factors for business in each analyzed countries, Bosnia and Herzegovina, Croatia, Serbia, Montenegro and Macedonia by comparing these four economies from the neighbourhood of Bosnia and Herzegovina.

Table 5. The most problematic factors for business in BiH according to WEF

	BiH	Croatia	Serbia	Montenegro	Macedonia
Access to finance	7,0	10,2	14,8	18,0	18,4
Inefficient government bureaucracy	17,1	16,6	11,9	11,8	9,4
Political instability	10,1	13,9	10,6	3,8	6,8
Corruption	12,0 <sup>7</sup>	5,6	10,0	8,2	7,0
Bad work ethic of labour force	3,8	4,8	6,5	7,8	10,1
Instability of Government/riots	9,1	2,1	6,1	0,3	2,8
Inadequate infrastructure	5,2	2,4	5,8	10,1	6,1
Tax rates	11,2	12,5	5,7	9,5	4,5
Inadequately educated labour force	4,2	5,8	5,3	7,2	10,7
Complexity of tax regulation	7,5	9,3	5,1	5,1	7,7
Criminal and theft	5,1	2,9	4,4	3,7	2,0
Foreign exchange regulations	0,4	1,2	4,2	0,9	0,9
Limited regulations on work	3,0	9,8	3,9	5,1	2,3
Inefficient capacity for inovation	1,6	1,9	2,7	7,0	7,0
Inflation	1,7	0,7	2,5	0,9	2,7
Bad public health	1,0	0,4	0,6	0,6	1,8

<sup>7</sup> In the Report of the European Commission for 2015 it is reported that BiH has achieve certain level of preparedness in the fight against corruption, but legal and institutional frameworks for this fight are still weak and insufficient. National strategy and action plan for fught against corruption are adopted and it remains to be seen what will be its application. In the Federation of BiH in 2014 laws for fight against corruption are adopted but still no institutions are established that should ensure their implementation. Financing of political parties still is not under adeqeuqate control in order to prevent misuse of funds and conflict of interest. Corruption sanctions are insufficient while protection of persons reporting corruption is institutionaly established only at national level but not al lower levels of authorities.



According to this data the biggest interferences for competitiveness are one that cause national or local authorities and not companies by themselves. Business entities also may cause interferences, but state can intervene and remedy it. Factors that affect the most national competitiveness, according to WEF, are: high business costs, high tax burden high public debt, weak total competition that not encourage companies on innovations and competitiveness, unregulated environment protection system and waste management, quality or poor transport infrastructure, difficulties in entities liquidation, non-harmonized legislation, weaknesses in public administration etc.

Activity and role of the state in launching accelerated development and competitiveness can not be limited just on creation of general favourable conditions. Unfortunately, there was no initiative for stimulating and helping entrepreneurial initiatives and projects, encouraging opening new jobs, more efficient inclusion in contemporary technological, informatic revolution and especially attraction of foreign investment, state has to work on improvement of factors that are in causal relation with policy that is again in causal relation with too large state apparatus and large bureaucracy that generates constantly political instability, unstoppable corruption, criminal that leads to instability of the government that usually puts party interest before its national, state interests.<sup>8</sup>

Before everything institutional environment is determined by legal and administrative framework within which individuals, companies and

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<sup>8</sup> Rule of law is still essence of enlargement process. New approach, approved by the Council in December 2011, means that countries should work on issues like legislative reforms and fight against organized criminal and corruption in the early phase of pre-accession negotiations. Bosnia and Herzegovina will have to maintain reform swing by time in key areas of rule of law, especially in the reform of legislative and policy of fight against corruption, independence of key institutions, freedom of expression, policy of fight against discrimination, minority protection and achieve good results in reform implementation, ensuring for reforms to be irreversible and deep-rooted. In that sense, it is important that appropriate strategy and action plans in the area of rule of law and principle rights are implemented fully and on time. Also, it is necessary to strengthen thorough democratic institutions and enable bigger involvement in democratic processes. Further progress in the public administration reform and stronger role of civil society are key in this sense, like mutual platforms for EU integration.

government affect each other to make profit and wealth in economy. Quality of institutions is strongly connected to competitiveness and growth. They affect investment decisions and production organisation and play the main role on the way where societies distribute advantage and bear the costs of development strategies and policies. According to table below it can be seen that Bosnia and Herzegovina is at the base of list of 140 countries observed.

Table 6. The first four, basic, pillars of competitiveness according to WEF

Principle requests	BiH/140 countries	Croatia/140 countries	Serbia/140 countries	Montenegro/140 countries	Macedonia/140 countries
Institutions	127	89	120	70	52
Infrastructure	103 <sup>9</sup>	46	75	73	78
Macro environment	98	107	125	79	47
Health and primar insurance	48	63	62	33	76

Source: The Global Copetitiveness Report 2015-2016, made by authors

That is why one of the basic tasks of each country is to create a more favourable environment for expression of individual preferencies of citizens and economic entities and their adjustment with colective preferencies. At economic plan that means creation of preconditions for realization of target functions of the company and consumer that

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<sup>9</sup> Harmonization with the EU acquis related to transport sector in Bosnia and Herzegovina should be improved as well as infrastructure related to transport. Bosnia and Herzegovina has to perform obligations accepted in accordance with the Agreement on the Single European Sky and actively participate in the work od SEE-FABA (Approach of functional block of air space for the Southeast Europe) that represents initiative that has an objective to adopt and implement unique air space of the Southeast Europe. Bosnia and Herzegovina shall continue to make efforts in implementation of Memorandum of Understanding on general transport network, Clear progress is achieved in implementation of certain segments of EU directives in the sector of transport. Given that achievement of set objectives requests expensive investments, especially in the domain of transport infrastructure improvement and provision of sufficient capacities, safety and necessary services, BiH needs strong and timely help from the EU in this process to ensure achievement of long-term objectives.

leads to efficiency of business at micro level and also at the level of a whole economy. Thereby creation of necessary market infrastructure or market institutions represents important task of country. By adequate legal regulations state clearly determines frameworks for behaviour of economic entities, stability in interest expression and objectives achievement. By clearly defining behaviour rules and space for economic activity state affects on relation between economic actors and environment in the same time creating conditions for achievement of higher level of social welfare.

Bosnia and Herzegovina has comitted to respect all agreed political and economic criteria by responding on the offer of the EU in the sense of perspective for membership and to help to achieve all this. Conditions known as Copenhagen criteria are harmonized by the Council of the EU in Copenhagen in 1993 and they imply:

- Political criteria: stable instituions guaranteeing democracy, rule of law, human rights and respect/protection of minorities;
- Economic criteria: functional market economy capable to deal with competition and market forces in the EU
- Legal capacities for taking over obligations related to membership in the EU, including aslo respect of objectives of political, economic and monetary union. Adoption of whole legal acquis of the EU (acquis communautaire)
- Administrative harmonization of appropriate administrative structures in order to ensure conditions for gradual and harmounius integration.

## **5. CONCLUSION**

While Bosnia and Herzegovina tries to maintain and increase its macroeconomic stability, growth and competitiveness through the reform of six areas: public finances, taxation and fiscal sustainability, business climate and competitiveness, labour market, reform of social care and pension system, rule of law and good management and public administration reform, global economic reality is formed or better said reformed under even more influence of information technologies in the information society developing as economy off

knowledge. In this kind, prevailing more opened and integrated world economy, problem of competitiveness without doubt has a central place. Namely, it is shown that more intense competition in the terms all present globalization threatens equally to survival of companies that are not able to transform, be innovative, productive and capable to response to pressures from the environment, and also to the whole national economies and communities (EU, USA, Greece, Portugal, Italy, Spain and before that Ireland etc). Lojup A., Peković S. (2013) claim that strategy of USA connected to innovations has the objective to return leadership position of USA in basic researches by investing in human capital, stimulating rapidly growing entrepreneurship and entrepreneurship based on innovations. Knowledge and innovation become permanent preoccupation at national level of developed countries but of countries of lower level of development as well.

The European strategy also sees its priority objective at the global competitiveness path in smart and sustainable growth of Europe that implies development of economy and knowledge society through research activity, education and information technologies, what would imply among other funds for research and development in the amount of 3% of GDP at the level of EU. All that is planned to be achieved through basic initiatives: creation of more favourable business environment to encourage small economy; innovative EU; digital agenda for EU; youth mobility, LLL (life long learning), workers mobility; efficient use of renewable energy resources and creation of EU platform against poverty and exclusion that would be used to improve social inclusion, or to raise at least 20 billion of people from poverty and exclusion. By active monitoring and fulfillment of tasks implying basic European initiatives Europe should have in its strategic plan 75% of employed population by 2020 in the age of 20-64, and just 10% of those who leave educational system early, increase energy efficiency for 20% and for the same amount reduce emission of greenhouse gasses and increase share of renewable energy resources.

In front of Bosnia and Herzegovina is a radical break with history, turning and total devotion to identified and set reforms and strategic programs that will create new business environment that would initiate and popularize knowledge, development of research, developing communities, innovation and technological sophistication and

creativity in the function of creating conditions for economic growth and development. Impossibility to achieve candidate status in the European family and while decade of the lowest position at the ladder of global competitiveness confirms that transition process in BiH still lasts. Bad role of the state is mirrored in macroeconomic disbalance, with especially low GDP, high unemployment, foreign trade deficit, large public spending, inefficient administration, low living standard of its citizens and impossibility to increase productivity and national competitiveness. Before European perspective and making conditions for better position in global frameworks it is necessary to perform Reforms of political and national institutions, institutionally legal reforms, financial market strengthening, establishment of institutionally-legal framework for suppression of corruption and adoption and improvement of relevant anti-corruptive laws, building of physical infrastructure. Just this priorities, that are also conditions of the EU for BiH through fulfillment of principles of Stabilisation and Association Agreement, undoubtedly contribute to creation of political and economical stable state with clear and quality laws and judiciary, or clear and quality economic, legal and administrative framework. Only such state can start to create capital but equally attract foreign investors and achieve basic and necessary conditions for growth and competitiveness at the micro and macro level.

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