

**"ECONOMIC CHALLENGES FOR BOSNIA AND HERZEGOVINA ON
THE ROAD TO MEMBERSHIP IN THE EUROPEAN UNION"**

**Program of Support to Research in the Field of Public Policies:
On the Subject of Macroeconomic Aspects of Accession of BiH to the EU**

Research conducted by: MSc Econ. Natasa Zrilic,

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"Sooner or later the whole of Europe will have to unite and all the main branches of the European family will one day become partners. We must reach the highest possible level of integration of Europe, without destroying its individual characteristics and traditions of its many ancient peoples"

Winston Churchill, Zurich, 1943

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INTRODUCTION

Accession to the European Union (EU) is a strategic goal of Bosnia and Herzegovina (BiH), and a general interest of all its citizens. The process of accession to the Union represents not only a strategic goal but also a series of necessary economic, political and social reforms that need to be implemented in the process of integration. BiH is looking at a long process of adjustment of its institutions, laws and legal regulations, policy measures and instruments, and even of customs and habits of the population.

The experience of transition countries, new EU members, shows that the EU membership touches directly or indirectly almost every sphere of social life. That experience shows that the process of approximation and adjustment, besides obvious advantages and financial support, has also its difficult moments, i.e. huge political, economic and social problems. These problems need to be overcome if the country is to become a serious and successful candidate for membership.

The purpose of conducted research is to assist in finding solutions to some of the issues arising from the process of accession of Bosnia and Herzegovina to European economic integrations. The research consists of two working parts that include important macroeconomic aspects of the process of accession of Bosnia and Herzegovina to the European Union.

The first part of the research represents an overview of current macroeconomic parameters in BiH, and an estimate of trends of these parameters over the coming medium-term period (2005.-2010.). It also discusses the measures of macroeconomic stabilization and

development priorities in Bosnia and Herzegovina (in its entities, the Federation of BiH and the Republic of Srpska). It presents the situation in overviews of the most important sectors in BiH (agriculture, industry and energy), as well as the short-term development tendencies of these branches. The accent is also placed on trade policy and regional economic development in Bosnia and Herzegovina, because of their importance for the Stabilization and Association Agreement BiH and EU.

The second working part of the research discusses the requirements for EU membership, i.e. it clarifies the first forthcoming contractual relation between the EU and BiH, the Stabilization and Association Agreement; subsequent BiH application for full EU membership; opening of negotiations on membership with the EU; and position of BiH as a candidate for full membership in the European Union. It shows the importance of appropriate definition of the future strategy of relations between BiH and European Union, as well as the importance of consensus in BiH in further implementation of reforms and accession, paying special attention at economic issues in the society, i.e. the necessity to strengthen the proper economy of BiH. The research touches also on importance of vertical and horizontal distribution of power in BiH in the affairs of European integration and in the process of meeting the economic requirements of *acquis*.

Conclusions and some recommendations resulting from this research are given in the end to propose the directions and ways for Bosnia and Herzegovina to achieve general long-term benefits of the membership in the European Union. In Appendices A, B and C to the research, the author presents some additional considerations of the above mentioned themes, trying to introduce broader knowledge about these themes to the readers. We sincerely hope that some of our considerations given in this work will contribute to better understanding of European integration processes and future role of BiH there in.

2. OVERVIEW OF MACROECONOMIC PARAMETERS IN BOSNIA AND HERZEGOVINA ON THE ROAD TO ADJUSTMENT TO THE EUROPEAN UNION

2.1. Overview of Transition in Bosnia and Herzegovina at the End of 2005

Openness to the world market, as well as inclusion in the processes of globalization and regionalization, is an assumption of stable economic growth and development of every country, even as small as Bosnia and Herzegovina. This means that small countries must have a vision of their own development i.e. they must know what role and place they can have in the globalization processes. Involvement in the global processes is now unfolding through regional integrations where small countries are joining the integrations they naturally gravitate towards. Therefore, the European Union is naturally imposed as a way into the global international economic flows for Bosnia and Herzegovina. This is also the case with other countries of the Western Balkans.

Bosnia and Herzegovina has always been a part of European political, cultural and economic space. It is still not a member of the European Union, but aspirations are present as to it happening in the near future. Economic advantages of the membership are seen in decrease of investment risk for foreign investors, improved access to single market upon conclusion of a free trade agreement with the EU, and easier penetration to other world markets.

On the other hand, there are certain political and economic advantages also for the present EU members that arise from the accession of new members such as Bosnia and Herzegovina. The most important political advantages are certainly the growth of safety and stability in Europe,

and further strengthening of its role. Economic benefits for the EU are seen in enlarged single market, growth of direct foreign investment flows to new markets and economic reconstruction arising from enlargement.

The territory of Bosnia and Herzegovina occupies only 4.1 percent of the EU territory, and the population of BiH comprises only somewhat less than 1 percent of the EU population. Gross domestic product (GDP) of BiH amounts to mere 0.14 percent of the European, and GDP per capita of BiH amounts only to 6.04 percent of that of the EU¹. Table 2.1. gives some comparative indicators for Bosnia and Herzegovina and European Union.

Table 2.1. Some Comparative Data for BiH and EU

	Area (000 km²)	Population in Million	GDP (in Billion USD)	GDP per Capita (in 000 USD)
Bosnia and Herzegovina	51.209	3.8	11.342	1.263
EU-15	1249.0	378.0	7894.5	20.9
BiH/EU (%)	4.1	1	0.14	6.04

Source: BiH Bureaus of Statistics, 2003; EUROSTAT, 2003.

The country of Bosnia and Herzegovina consists of two entities (the Federation of BiH – FBiH and the Republic of Srpska – RS) and joint institutions of power. It is a relatively small economy in the region, with about 4 million inhabitants. According to estimates, it account for 12 percent of the Western Balkans GDP and 17 percent of the population (2002 data). With GDP per capita of about 1.400 euro in 2002, it is one of the least developed economies. In 2003, the GDP still amounted to 60 percent of its pre-war level.

The structure of 2002 GDP included agriculture with 12 percent, industry with 21 percent, services with 62 percent, and civil engineering with 5 percent. There are differences in GDP

¹ European Commission Directorate-General for Economic and Financial Affairs, European Economy, Occasional Papers, N5 (2004) *The Western Balkan in Transition*, p. 35 (online) available at: http://europa.eu.int/comm/economy_finance/publications/occasional_papers/occasionalpapers5_en.htm

structure between the entities of BiH, although the general trends are similar. So, the primary sector (agriculture, fishery and forestry) is still an important sector in the RS (20 percent of GDP), while in the Federation of BiH it has fallen down to less than 10 percent of GDP. Secondary sector (industry and mining) has maintained the level of $\frac{1}{4}$ of entity GDP in the FBiH. Disindustrialization was more notable in the RS. Here, industry covers only about 16 percent of GDP, out of which sector of electricity production account for one third of industry value added. In the services sector, although financial and business services showed constant growth, government services still account for a great part of general services, especially in the FBiH. This also reflects the more complex administrative structure and higher wages in public administration in the FBiH than in the RS.

BiH is a very open economy, with goods and services export-import ratio of 85 percent of 2002 GDP. However, this result is a consequence of imports being larger than exports. EU is BiH's main trading partner and according to estimates it accounts for 40 percent of BiH foreign trade.

The process of integration of Bosnia and Herzegovina in the European Union overlaps with the process of transition and has value added because it is currently encouraging continued implementation of economic reforms. The main goal of the started transition is democratization and development of the market economy of the Western European type. The transition package that is being implemented in BiH is based on the rules of the Washington consensus² and its use in BiH has started in 1996, after the termination of four-year warring period (1992-1995). The institutions that lead the transition are: International Monetary Fund

² More details on Washington consensus in the book by Pitic, G. (1999) *Eurotransition*, Bureau of Statistics, Belgrade, p. 20-30

(IMF), World Bank³, USAID and EU. Due to support from these institutions and other donors, the tasks on structural reforms were continued, all the way until today.

Namely, after the war, at a conference held in London in December 1995, the European Union and the World Bank estimated the needs of BiH at the amount of 5.1 billion US\$ (that was 9.7 billion KM at the time) for the first five years of post-war reconstruction, and invited other bilateral and multilateral donors to get involved in this reconstruction with them. In order to implement the Rehabilitation and Reconstruction Priority Program, five donors' conferences were organized in the past period, with the greatest participation of the World Bank, European Union, USA, and Japan.

Table 2.2. shows the European Union contribution to BiH as a whole (in KM) during the period 1996-2000, pledged at five previous conferences, and additional out-of-conference pledges⁴.

**Table 2.2. Contribution of the European Union to Rehabilitation of BiH in Period 1996-2000
(in million KM)**

Donors Conferences	(I) 1995	(II) 1996	(III) 1997	(IV) 1998	(V) 1999	Additional	Total
EC Pledge to BiH	141.7589	422.0737	516.0234	562.9392	432.6432	42.3136	2117.752
Other Donors to BiH	770.6973	1597.2113	1532.156	1572.7408	1248.80209	904.0614	7625.669
Total Pledges to BiH	912.4562	2019.2850	2048.1794	2135.6800	1681.44529	946.375	9743.421

Source: RS Government, Ministry of Economic Relations and Coordination, Reconstruction and Development Priority Projects, September 2000

This pledged support from the EU and other donors during this period was mainly intended for the reconstruction of public infrastructure, return of refugees and displaced persons to their homes, peace implementation and establishment of functioning institutions. Not all the

³ More details on the International Monetary Fund and the World Bank in the book by Dr Acin D. (2003.) *International Economic Relations*, Pigmalion, Novi Sad, p. 136-189

⁴ More details on rehabilitation and reconstruction in BiH in my previous research: *Rehabilitation and Reconstruction of BiH (Republic of Srpska)*, May 2001

funds pledged by the donors' community for the rehabilitation of BiH have been fully implemented. There are several reasons for all the non-implementation of the funds on both sides, but one thing that is certain is that the role of the EU and other donors in post-war reconstruction of BiH cannot be disregarded.

During the period 2000-2005, external assistance was gradually decreasing because donors were confronted with the requests from other countries and their funds were exposed to pressure. According to the donors, the aims of reconstruction and rehabilitation were partially achieved, and funds needed to be directed towards technical assistance as support to economic transformation. However, regardless of the decrease in international assistance, the country is still not self-sustainable.

When considering BiH economic growth indicators, the first thing that should be kept in mind is that the statistical data on these indicators are still not reliable, i.e. the application of the same methodologies on data collection and processing in both BiH entities was started only recently. That was enabled by the entry into force of the new Law on Statistics of 2003, which triggered higher quality of processing and analysis of data obtained from the statistical institutions of BiH entities, led by the BiH Statistics Agency.

In short, Bosnia and Herzegovina had been successful in postwar period in the achievement of macroeconomic stability due to implementation of a huge number of reforms. The inflation was lowered, the fiscal accounts were improved, the confidence in national currency was established, the burden of external debt was decreased and external reserves grew. Strict compliance with the currency board arrangement introduced in 1997 helped slowdown the retail prices inflation to one-digit levels and below one percent during the period 2002-2004.

The great external account deficit still represents a key macroeconomic challenge. Even though from 2002 the exports have been growing faster than the total goods imports in euros, they still represent only 10 percent of GDP. The structure of goods imports, which comprise about one third of GDP, is lately shifting towards the goods not used for reconstruction, and primarily towards consumer goods and oil derivatives. Domestic demand is supported by significant growth of household credits, as well as by constant high levels of remittances from workers abroad and private transfers. So, the current account deficit had grown fast to 22 percent of GDP in 2002, but tightening of fiscal policies and banks supervision caused it to drop to about 17 percent of GDP in 2003 and 2004. As a response to continued macroeconomic stability, the interest of foreign investors for investment in BiH also grew. Net inflows of foreign investment showed constructive growth from 2002, reaching the level of 5 percent of GDP in 2004. Between 1995 and 2004, GDP real growth rate increased almost four times, while exports grew ten times, and retail price inflation was stabilized at levels similar to those in industrial countries. Lately, the growth rates in entities are coming closer, which signalizes improvement in integration of local economy.

The prevailing opinion is that the BIH progress has been most impressive in the fields of financial sector, trade policy and public finances. The reforms in the financial sector were focused on the abolition of Payment Bureaus and establishment of modern payment system, liberation of the country from ownership of banking sector and successful entry of foreign investors in this sector, consolidation of banking sector with low fiscal costs, and establishment and gradual strengthening of regulatory framework for business. The reforms of trade policies were very high-profile, with adoption of the most liberal trade regime in the sub-region and negotiations on bilateral trade agreements in Southeastern Europe in line with the Stability Pact principles. Significant progress has been made in taxation policy and

administration, including rates harmonization throughout the country, and improvements in collection and application of regulations.

Table 2.3. shows key economic indicators during the period 1998 – 2004⁵.

Table 2.3. Key Economic Indicators in BiH 1998-2004

	1999	2000	2001	2002	2003	2004
Annual Percentage of Change						
GDP Real Growth Rate	9.6	5.5	4.3	5.3	4.0	5.7
Industrial Production Index	11.9	9.3	-2.0	11.5	3.0	12.4
Retail Prices Inflation (CPI)	2.8	5.0	3.2	0.3	0.6	0.4
Gross Salaries (as GDP %, unless stated otherwise)	11.4	12.9	6.8	6.9	8.2	2.8
Gross Investment	21.0	20.6	18.8	20.4	19.9	20.3
National Savings	12.8	8.1	2.2	-1.3	2.2	3.0
Consolidated Government Revenue	59.9	55.4	53.8	49.7	49.6	48.9
Consolidated Government Expenditure	67.7	64.5	58.8	53.4	51.0	50.0
Out of which Capital Expenditure	17.5	14.9	14.7	9.3	8.1	6.4
Balance (upon Maturity, Including Grants)	-7.8	-9.0	-4.9	-3.7	-1.3	-1.1
Goods and Services Exports (in million US\$)		1285	1309	1354	1808	2231
Goods and Services Imports (in million US\$)		2749	2961	3418	4025	4716
Current Account Balance	-9.3	-12.5	-16.6	-21.7	-17.7	-17.3
Total External Debt'	65.5	41.6	39.8	37.7	33.3	31.1
External Debt Servicing (in % of Goods and Services Exports)	10.1	7.5	6.1	9.2	8.2	6.5
Gross Reserves in Foreign Currencies (in months of import)	1.9	2.1	5.1	4.5	5.3	6.1

Source: Authorities, IMF, The Fourth Audit of Stand-By Arrangement, February 2004; Staff Report on Article IV, January 2004, the World Bank staff estimates

Note '': includes the resulting amount of the London Club equivalent to about 280 million US\$

2.2. Macroeconomic Trends in BiH 2005 – 2010

In further implementation of priority economic reforms aimed at bringing Bosnia and Herzegovina closer to the European Union, the country should abide by ten golden rules of the Management Development Institute, in order to keep its economy competitive These are:

- Create a stable and predictable economic environment;
- Create flexible and resilient economic structure;

⁵ World Bank, Poverty Reduction and Economic Management Unit for the Region of Europe and Central Asia, Bosnia and Herzegovina, Country Economic Memorandum, (May 2005) *Report no. 29500-BA*. p. 8 (online) available at: <http://worldbank.ba>

- Invest in traditional and technological infrastructure;
- Promote private savings and domestic investment;
- Develop aggressiveness at foreign markets (via exports), as well as attractiveness of the country for direct investment;
- Focus on quality, promptness and transparency in public administration;
- Maintain optimum ratios between the wage levels, productivity and taxes;
- Preserve the social structure by removing wage disparity and strengthening the middle class;
- Invest heavily in education, especially at the secondary level, and in the long-term training and knowledge improvement of the labor;
- Balance the economies of vicinity and globality to ensure durable wealth creation, while preserving the value systems that citizens desire.⁶

Namely, there is still much work to be done in Bosnia and Herzegovina in the coming medium-term period, in order for the country to reach a sustainable level of economic development and move its macroeconomic indicators closer to the developed western economies. These facts indicate the importance of turning to production, importance of industrial policy, incentive to productiveness development, and competitiveness on the road to convergence towards the EU. These very elements are seriously missing in the Washington Consensus, which represents a package of illusionist expectations regarding the recovery of BiH. BiH can hardly be integrated into the EU without further growth of production and employment.

It is necessary to continue the market transformation of BiH economy while preserving the macroeconomic stability. The result of that policy would be accelerated economic growth

⁶ Dr Kovacevic, M. (2002) *International Trade*, Faculty of Economics, Belgrade, p. 260-261

with prices stability and sustainable position of the balance on current account. Another result would also be dropping of the unemployment rate. These activities will be encouraged by the BiH membership in the World Trade Organization, and further establishment of contractual relations with the European Union. The privatization process should be accelerated in order to improve the efficiency of economy, and the accent should be placed on development of small- and medium-sized enterprises that represent an important pillar of the future development of BiH. This means that BiH must develop its economics of production (supply) based on development of a large number of new enterprises that represent a pillar of its future development. Without that, BiH will be in position neither to comply with the second Copenhagen criterion about the establishment of strong, efficient market economy, nor to ensure its position within the EU single market.

The scenario for further implementation of reforms in both BiH entities with the support from international community in coming period (2006-2010) implies and is conditional upon the following presumptions:

- Continued compliance with the Currency Board arrangement;
- Continued efforts on consolidation of public expenditures;
- More rigorous credit policy that would result in lower current account deficit;
- Faster structural reforms, especially in relation to business environment, privatization and labor market, which would gradually bring about the growth of domestic savings;
- Absence of external shocks.

Table 2.4. shows the needs for external financing by international community, that would follow future progress in implementation of reforms in BiH⁷:

⁷ World Bank, Poverty Reduction and Economic Management Unit for the Region of Europe and Central Asia, Bosnia and Herzegovina, Country Economic Memorandum, (May 2005) *Report no. 29500-BA*. p. 27 (online) available at: <http://worldbank.ba>

Table 2.4. BiH Needs for External Financing

	Annual Average for Each Period (in Million US\$)	
	2005-2009	2010-2014
Financing Needs	1,625	1,107
Current Account Deficit (Including Official Transfers)	1,445	885
Depreciations (Total)	110	139
Change in Net External Assets (Including Net IMF credits + increase)	70	83
Financing Sources	1,625	1,107
Official Capital Grants	180	100
Payments (Total)	130	161
Other (Net LT and ST Inflows) ¹	600	153
Private Investments	780	693

Source: World Bank staff estimate

Note: ¹ Including short-term capital gains and capital not included elsewhere

The projection of trends of key macroeconomic parameters in accordance with these presumptions is given in the following table 2.5.⁸

Table 2.5. 2.7. Reforms Scenario 2005-2009

	2005	2006	2007	2008	2009
(Percentage of Change in Relation to Previous Years)					
GDP Real Growth Rate	5.4	5.0	5.0	5.0	5.0
Real GDP per Capita	4.9	4.5	4.7	4.7	4.7
Retail Price Inflation	1.0	2.0	2.0	2.0	2.0
Goods and Services Exports	14.3	15.5	13.8	12.5	11.0
Goods and Services Imports	6.8	6.5	5.8	5.3	5.0
Out of which Not Reconstruction-Related	9.3	8.0	7.0	6.5	5.7
(Percentage of GDP)					
Gross Investment	20.8	20.5	20.5	20.8	21.0
National Savings	4.1	6.2	8.4	10.6	13.0
Out of which National Savings	1.9	2.9	3.8	4.7	5.5
Out of which Private Savings	2.2	3.3	4.7	6.0	7.4
Consolidated Government Revenue	48.9	47.1	45.8	44.7	43.8
Consolidated Government Expenditure	50.0	47.3	45.5	44.2	43.2
Out of which Capital Expenditure	6.4	5.5	4.9	4.8	5.0
Fiscal Balance	-1.1	-0.2	0.3	0.5	0.6
Current Account Balance	-16.8	-15.2	-13.4	-11.6	-9.8
External Debt	52.7	49.4	46.2	42.9	39.7
Out of which Public External Debt	30.0	28.2	26.2	24.2	22.1
External Debt Servicing (in % of Goods and Services Exports)	6.4	6.9	5.8	5.0	5.2
Gross Official Reserves (in months of Goods and Services Imports)	5.4	5.2	5.0	4.8	4.6

⁸ World Bank, Poverty Reduction and Economic Management Unit for the Region of Europe and Central Asia, Bosnia and Herzegovina, Country Economic Memorandum, (May 2005) *Report no. 29500-BA*, p. 25 and 26, (online) available at: <http://worldbank.ba>.

Since the decreasing trend of international assistance in BiH is continuing, the most urgent macroeconomic challenge in the coming period is to increase domestic public and private investment, while initiating a higher domestic savings rate as well as a greater volume of foreign direct investment. The investments would enable job creation and dropping of unemployment rate, which is currently among the highest in the region. Complying with further macroeconomic stabilization, foreign investments might grow and be maintained at the rate of 6 percent of GDP, which is an average amount that can be seen with successful economies in the region. Labor market reforms and corporate sector restructuring remain the most important transition priorities for the coming medium-term period. Deeply rooted weaknesses in the corporate sector, which are reflected in losses and over-indebtedness, should be dealt with urgently in order to strengthen external competitiveness, economic growth and employment growth, and to support the adjustment of external current account deficit. Implementation of bankruptcy proceedings, removal of administrative barriers to businesses and additional strengthening of single economic space within BiH, all represent preconditions for efficient revival of companies. The priority is to improve and develop the corporate sector, which will be a strong pillar of economic activities in the coming period. Proposed policies would bring about continued maintenance of the annual growth rate of 5 percent over the coming medium-term period, which would reflect the growth of production level. These policies should at the same time be combined with the reduction of external current account deficit, i.e. with strengthening of domestic production, supply and exports, as well as with better business results of local companies. This requires also further improvement of the finance sector in BiH, which would enable investment of better and more adequate funds in the country for encouragement of economic activities.

Concerning fiscal reforms, the authorities should certainly focus on continuation of value added tax introduction, which represents a key reform for creation of better economic ambiance for business. Greater financial discipline upon introduction of VAT in the country will open the issue of efficient coordination of revenue distribution between the entities and the state of BiH. On the other hand, the budgets will have to take into account the revenue risk arising from the introduction of VAT. The final aim of this entire approach is to allow orderly distribution of revenue to final beneficiaries. The revenue to be collected at the single account of the Indirect Taxation Administration will primarily finance the following items of expenditures: country's obligations related to external debt servicing, administrative costs of common bodies of BiH, budget of the Indirect Taxation Administration. The remainder of revenue will be distributed between the entities and Brcko District, most probably in accordance with a criterion set in advance, such as location of final sales in case of the VAT on revenue from sales during the first year, i.e. to municipalities – the final beneficiaries. Therefore, the framework for fiscal policy coordination between the state and the entities needs additional strengthening in order to address the present and the future fiscal challenges. This implies that it is necessary to ensure the responsibility for revenue spending at all levels in BiH, in order to limit the spending. All BiH institutions should equally share the fate of the budget filling in BiH and entities, which unfortunately has not been the case so far. This would enable continued maintenance of macroeconomic stability in BiH, by all BiH institutions.

The key to achieving macroeconomic sustainability is further decrease of the share of public expenditure in GDP. This means decrease of expenditures on wages in public administration at all levels in BiH, which should make up for the increase of expenditures on capital investment. It is necessary to provide better vertical coordination between the entity and the

common institutions in BiH, in order to avoid the duplication of functions and inadequate number and structure of staff in certain positions. Exaggerated adoption of new institutions and EU rules may more harm than support macroeconomic stability and budgets in the coming phases of transition.

The solutions for EU adjustments within the entities and BiH should be sought within the existing entity and common institutions, whose capacities would be built-on and fully used, since that is much simpler and more economical to implement at this moment. The principle of decentralization should be complied with at all levels in BiH, all the way down to the individual citizen. For each following extension of institutions in BiH, the financial issues should be discussed, i.e. the price of new reforms, and whether the required need can be solved within one of the present institutions. It would not be good to find ourselves in a situation of having a great number of new EU institutions and no funds for their capacities filling, thus having the institutions that do not function in practice. This also implies the balancing of average wages within all institutions in BiH, since it was noted that some newly established institutions and agencies at BiH level as well as at that of the entities, have developed their own wage structures without reference to present wage rates in general administration.

The Currency Board arrangement is probably still the best short-term and medium-term policy for maintenance of further stability of local currency and limited inflation growth. However, since BiH is a country committed to the EU accession, an optimum solution for long-term monetary policy of this country should be sought in the Euro system. Commitment to the EU in itself imposes *euroisation* upon entry into the EU and meeting of convergence criteria of Maastricht related to the adoption of euro. At present, BiH does not comply with

two out of four convergence criteria of Maastricht (interest rate and budget deficit). Until achievement of the goal of entry into the euro system, it is necessary to maintain the present system with gradual modifications. The transition to Euro would improve legal and economic ambiance in BiH. This would trigger investors' greater trust in investments in this area. Bulgaria is in a similar position, having also a currency board and aspiring to the EU membership⁹.

Solving the issue of huge internal debt will also represent one of the greatest medium-term challenges for successful functioning of the state and entities in general, and for avoiding of state functioning paralysis due to charges brought against it before international and local courts. The greatest share of these claims relates to frozen foreign exchange savings, material and nonmaterial war damages, inherited outstanding obligations in pensions and war wages, as well as social allowances to soldiers. For the time being, there is a consensus among governments about the impossibility to settle these debts at nominal rate, and preparations of strategy and legal framework are ongoing along with the plans to solve this issue. An agreement has been reached with the representatives of international community to limit this internal debt to 10 percent of GDP, but such a solution to the debts issue extends the time limit for debts payment, which has a negative impact on support and confidence of the public in relation to their rights. Any other solution would require either tax increase or further drastic decrease of public expenditure, which is also not acceptable for the authorities. There are efforts to find the solution in earmarking and investment of government bonds, which would replace a part of debts, but the modalities of the emission of and trade in these bonds are still not known. The drafting of the Framework State Law on Internal Debt is also ongoing and it should be adopted very soon and give further guidelines for payment of all domestic

⁹ More on the subject of *euroisation* in the book by Mr Vilendrecic, S. (2005) *Abandoning the System of Currency Board in Transition Economies*, Textbooks and Teaching Aids Institute, I. Sarajevo

claims. After that, by the end of 2007, it is expected that the verification process of all claims will be completed and that the payment schedule will be made in accordance with fiscal sustainability. By that time, some minor cash payments would probably be made, in accordance with the abovementioned limitations of 10 percent of GDP. The authorities should start solving this complex problem through practically feasible solutions of entry into a new area, relatively unknown in BiH, of bonds trade. In general, local authorities must show more creativity in imposing and implementing their proper development priorities for which support should be sought from the international community, with mutual consensus of different parties.

Cautious external borrowing will still be the way towards creditworthiness. BiH is currently in the group of moderately credit-indebted countries with medium-level income, and in comparison to some other countries the external debt is not high. Repayments of the first post-war IDA arrangements and Stand By have begun and for the time being these payments are unfolding in an undisturbed manner. The authorities should consider more carefully further possibilities for the country to establish creditworthiness, which would create a possibility for the adequate level of credit-indebtedness directed towards higher road of growth and development, projected on proper needs (e.g. credits for road infrastructure, entrepreneurial infrastructure, investment in information technologies).

2.3. Most Important Sectoral Policies in BiH

❖ Agriculture

Agriculture is one of the key activities in the structure of social production in BiH. Bosnia and Herzegovina has about 2,600,000 ha of agricultural land, out of which 1,608,000 ha or 63

percent is cultivable, and pastures constitute the remaining 37 percent. Out of the total of cultivable land, arable land and gardens constitute 1,070,000 ha or 68 percent, orchards 96,000 ha or 3.8 percent, vineyards 5,300 ha or 0.2 percent and meadows 432,000 ha or 28 percent. Intensive agricultural production requires about 25 percent of the total agricultural land. In BiH there is 0.41 ha of cultivable land per capita or 0.73 ha of agricultural land per capita.

The issues of development of agriculture in BiH are defined at the level of its entities (Republic of Srpska and Federation of BiH), while at the same time coordination of development policies, cooperation with international partners, and relation with external markets are at the level of common institutions, primarily with the Sector for Agriculture and Rural Development of the Ministry of Foreign Trade and Economic Relations, and a number of agencies that deal with quality improvement of BiH agricultural products in order to place them at export markets.

The request for establishment of Ministry of Agriculture at BiH level, which would be connected with the Ministries of Agriculture of both entities, will soon be resolved in dialogue of all political authorities in BiH, although it may happen that this issue encounters opposition from the BiH Fiscal Council, because they would have to earmark the budget funds for administration.

However, the authorities of both entities expressed readiness to start building-on the capacities of present institutions at all levels, which would then be in position to start seriously developing the agriculture of BiH and gradually adjust it to the EU policy. In the Republic of Srpska, the BiH entity which favors agriculture more, the adoption has already

taken place of the Medium-Term Agriculture Development Strategy, which takes into account the specifics of the EU CAP and gives proposals for future development of this important sector. The Strategy Action Plan has also been made and it follows the investments in agriculture, harmonized with the RS budget. In the coming period it will be necessary to prepare a great number of programs and policies for agricultural development of entire BiH.

The primary task in BiH is to strengthening the new institutional capacities for successful management of negotiations with the EU on conclusion of the Stabilization and Association Agreement. The greatest portion of this Agreement relates to the issues of agriculture and trade policy and it will be necessary to establish and appoint human and material capacities for negotiations with the EU. The issue of negotiations aimed at conclusion of the SAA refers to further liberalization in markets between the EU and BiH for circulation of certain groups of products, primarily agricultural products. Adequate implementation of financial support of the EU via programs for agriculture adjustment such as Special Accession Program for Agriculture and Rural Development (SAPARD) will require administrative framework and human resources in this sector. So, like in other sectors, it will be necessary to train the capacities for planning and efficient usage of EU assistance funds to candidate countries, to start harmonizing local legislation in the field of agriculture with that of the EU, and to establish a quality control system for all priority products. The process of approximation of local production protection to the protection of products in the EU has already begun in BiH, as well as the modernization of land reform with strengthening and building on the capacities in this sector at all levels (faculties, institutes, cooperatives, expert services). The priority is further stimulation of farmers who produce healthy food, with preservation of pure natural environment, and support to farmers in less developed regions. BiH is on a good track concerning development of this sector, but it is necessary to provide better coordination and

information flow within the work of all institutions that deal with these issues, as well as greater information exchange with the institutions of the EU.

The extension of common agricultural policy on BiH will have a significant effect on farmers and consumers. The farmers will benefit from the measures of common agricultural policy that involve import restrictions to third countries, export benefits, structural funds, price support, and direct payment of earnings.

Current trade ratio in agriculture and food between Bosnia and Herzegovina and EU is negative. It is very hard to anticipate how this ratio will move with the common agricultural policy. Namely, it is not easy to estimate which groups of agricultural products will be winners or losers because of the common agricultural policy. It seems that small landowners will lose under the growing pressure of competition, while big landowners might win. According to some estimates, the producers of milk and meat will also be winners. The suppliers of agricultural equipment will benefit.

Some economic groups will experience mixed effects. Food producers use products imported from third countries and mostly lose from greater measures of common agricultural policy, which results in price growth. They will profit from the growing quality of agricultural raw materials purchased within the EU. Agricultural exporters will mainly profit from export benefits.

Table 2.6.¹⁰ Losers and Winners: Common Agricultural Policy

Measure	Interest Groups									
	Farmers		Producers Exporters		Producers Importers		Suppliers of Agricultural Equipment		Consumers	
	K	D	K	D	K	D	K	D	K	D
1. Import Duties from Third Countries	+	+	-	-	-	-	+	+	-	-
2. Export Benefits	+	+	+	+	-	-	+	+	-	-
3. Structural Funds	+	+	+	+	+	+	+	+	?	?
4. Support to Prices	+	+	+	+	-	-	+	+	-	-
5. Direct Payment of Earnings	+	+	+	+	-	-	+	+	-	-

Item 3 depends on location of consumers. Those working in aided areas buy the products from supported companies. The other population loses since their tax money is spent on support to certain regions.

Evaluation: "+" - positive, "-" - negative, "0" - neutral, "?" - uncertain;
K – short-term period (1 to 5 years), D – long-term period

❖ Industrial Policy

Like in agriculture, the issues of industrial development in BiH are defined at the level of its entities (Republic of Srpska and Federation of BiH), while at the same time coordination of development policies, cooperation with international partners, and relation with external export markets are at the level of common institutions, primarily with the Sector for Small and Medium-Sized Enterprises of the Ministry of Foreign Trade and Economic Relations, Foreign Investment Promotion Agency, Competitiveness Council and some other bodies. There are also a number of agencies, centers, chambers of commerce and finance organizations for support to entrepreneurship development at all levels. The Declaration on BiH Industrial Policy Strategy, the RS Industrial Policy Strategy and the Industrial Policy Development Strategy of the Federation of BiH represent a basis for improvement of competitive capacities of BiH economy. In the coming period it will be necessary to build on these documents along the lines of positive experiences of this sector in the EU and measures for its adjustment in the future EU member states.

¹⁰ Tang, H. (2000) *Winners and Losers of EU Integration Policy Issues for Central and Eastern Europe*. Washington, D.C.: The World Bank, Bertelsmann Stiftung, p. 76

Currently, the competent BiH authorities, together with the abovementioned institutions, are implementing a number of different programs aimed at: acceleration of privatization process and corporate restructuring, strengthening of export possibilities of companies, support to development of new small- and medium-sized enterprises, creation of framework for business improvement in BiH, and support to a number of strategic industry branches. A part of the funds from the budget, although a significantly small one, is allocated also to scientific and research programs, aimed at improvement of business and development of companies. These mentioned measures are aimed at insignificant growth of industrial production in BiH. In the coming period, in order to improve the competitive position of BiH and its prospects for inclusion into the EU market, it will be necessary that all participants in this sector in BiH make much more efforts. The existing institutions must be strengthened and developed in order to respond adequately to the challenge of development and improvement of entrepreneurial sector in BiH.

There are several reasons for stronger and more efficient intervention by all the actors in this sector, which would enable development and improvement of BiH economy:

▪ **In BiH Economy There is a Number of New Companies That Need Assistance in Development:**

This argument for support is found in the economies of scale and it is one of the oldest and most popular arguments of state intervention policy. It is considered that developing industry is functioning below optimum size and that it could never reach the low costs that can be reached by firms that have been operating longer and that can achieve the economies of scale. Therefore these firms need start-up subsidies. It takes a lot of skill to choose the right firms that will later grow into competitors. This is a difficult task for BiH authorities, which have

limited funds at their disposal, and they will have to provide a more organized approach to support to small- and medium-sized enterprises in BiH.

▪ **In BiH There is a Need for Incentive Policy in Certain Strategic Industry Branches:**

The new theory of trade and strategic industrial policy, unlike the neoclassical theory, finds that certain industries and services are relatively more important for the economy than others. These are the industries that can provide the economies of scale, wide relations, and effect on the rest of the economy. In that case industrial policy should be selective, which means that it should be based on the choice of winners/losers. This is always difficult and requires quite a quantity of information. Smaller countries such as BiH can here rely on selective policy that might be more risky. BiH must ensure the best possible usage of limited proper sources via specialization in sectors in which there are potential advantages, such as some light industries, wood industry, and tourism.

▪ **In BiH There is a Need for Establishment of Industrial Agglomerates:**

Newly established developing small firms in BiH can be united in industrial agglomerates that should in the future grow to the size of multinational companies. In doing so, also the costs of their operation would be reduced.

▪ **In BiH There is Accentuated Need for Bigger Funds Allocation to Support Research and Development:**

Although technological progress is a basis for economic growth, a firm will invest in research and development only if it can keep the results. Since once scientific discovery is discovered it is freely available for everyone's use, a small number of firms has incentive to invest more in this field. The solution to this market drawback is twofold: on one hand, there is patents

system that gives the investors a temporary and exclusive right to use new knowledge they have created, and on the other there is public financing of basic researches at universities and in technical laboratories. In this first case, the question is whether the firms need more than patents system as incentive to create new findings. Sometimes developed countries finance one part of research in private firms. Therefore, the support from BiH authorities to every form of research and development might be of use, especially to various already high-profile companies in BiH.

Other arguments for stronger support of BiH authorities to investment, such as social arguments reflected in regional development and protection of natural power, are rather strong needs in BiH. The companies must be encouraged to introduce ecological components in production. All must know that a well-educated management and a well-trained labor are the most valuable asset that can solve all the problems. Therefore an urgent development of human resources in BiH will be required. It will also be necessary to establish Competitiveness Councils with governments, entrusted with the task to propose measures and policies for improvement of competitiveness. Anyway, the decisive importance will lie with the future support from the EU to this complex task, based on greater access to the EU funds.

❖ **Energy**

Together with seven countries of the region, Bosnia and Herzegovina is a party to the Athens Process related to regional cooperation in the field of energy. Thereby it undertook to create a Regional Energy Market in Southeastern Europe and integrate it into the internal energy market of the Community. For the purpose of this creation of an energy community in Southeastern Europe at the end of last 2005. year, BiH undertakes to take part in the

establishment of a common electricity and natural gas market with the countries of the region, which would operate in accordance with standards of the EU energy market into which it should integrate. That can be achieved by gradual takeover of portions of the *acquis* that relate to energy, environmental protection and competition. These obligations constitute an integral part of priorities of the European Partnership for BiH, which arise from the conclusions of the European Council made at the gathering in Thessalonica, and priorities of the Feasibility Study. It should be noted that the contract establishing the energy community has been prepared on the model of the Treaty establishing the European Community. It is anticipated that the energy community enjoys a legal person status, which allows to the countries of the region direct integration into the energy market of the EU, regardless of the status of the country in the process of approximation to the EU membership. Along with that, the establishment of energy community institutions is also anticipated (Council of Ministers, Standing Working Group for Coordination of Activities, Regulatory Board, Regulatory Forum and Regulatory Secretariat). Thereby the countries of the region undertake to eliminate customs duties and other restrictions to exports and imports of networked energy, including the application of indirect taxation and other measures with similar effect.¹¹

❖ **Regional Economic Development**

BiH has set a strategic goal of becoming an EU member before 2015. It will now take much more than hitherto to get acquainted with the EU policies aimed at support to development and strengthening of proper economy. One of them is the regional policy. Authorities together must establish the priorities for regional development within BiH and assistance pertaining thereto. Although regionalization has had a negative context until recently, the representatives

¹¹ Dr Hadziahmetovic, A. (2005) *Economy of Europe*, Faculty of Economics, Sarajevo, p. 238

of the international community are lately persistently insisting on the establishment of economic regions, conceived in the way to link the parts of both entities (EURED project). For that very reason, such a concept is obviously facing opposition in the Republic of Srpska, since the concept of regional organization has not yet been adopted, unlike in the Federation of BiH, where Cantons represent regions.

Within BiH it is necessary to develop infrastructure, which would enable absorption of means and investments from the EU funds. Elaborated cooperation will speed up the implementation of development priorities, strengthening of proper economy and the very entry into the EU.

The area of single market of the countries of the Western Balkans should also be regarded in the context of regional development policy. There is accentuated need for improvement and strengthening of trade and economic position at the markets of the countries within that area. The future Stabilization and Association Agreement between Bosnia and Herzegovina and European Union highlights the same elements by means of provisions on regional cooperation, aimed at development of economy of the region. Therefore there should be discussions about regional infrastructure projects, which would accelerate revival and revitalization of economy in the region of the Western Balkans and enable its faster entry into the EU. Countries of the region should candidate these projects (e.g. projects that reflect the needs for cooperation in the areas of Dubrovnik-Trebinje, Plitvice-Bihac, Macva-Semberija) for EU funds jointly. This would improve the negotiating positions of the countries of the region for entry into the EU, and contribute to greater stabilization of circumstances for development in the region.

❖ Trade

With the exception of trade in sensitive products, free trade is the main principle and aim of economic relations between the EU and future candidate countries. Free trade concludes numerous measures for common trade, such as elimination of quantitative and qualitative import and export restrictions and application of the same regimes to domestic products as to import goods from other free trade areas. The elimination of trade barriers lowers the level of domestic production protection and intensifies the competition. The main losers are domestic producers, who are losing in competition with import goods, currently protected by non-customs-related barriers. The main winners are consumers, exporters, producers who use imported goods as raw materials in their production processes and take part in inter-industrial trade with the EU.

Trade liberalization has so far been the most progressing area of integration between Bosnia and Herzegovina and EU. Trade trends between Bosnia and Herzegovina and European Union are liberalized to a great extent. The only limitation is the EU protectionist regime for agricultural products and trade in certain services. On the other hand, the goods produced by BiH are relatively competitive (or not competitive at all), do not meet the high EU standards and therefore have a weak access to this market. Also, the protectionist regime protects the interests of EU producers and limits the exports from Bosnia and Herzegovina to the European Union. That will be in the way to forthcoming preparations for accession to the EU. It would be good for Bosnia and Herzegovina to prepare, together with the other countries of the region, an analysis of losses caused by the protectionist trade regime during the previous decade. It should be offered to the EU with a proposal for joint negotiations on problem solution. There is no simple solution to this problem. Export potential in Bosnia and

Herzegovina is rather low and it will remain limited in the future due to low competitiveness. At the same time, imports will continue to grow. This will cause trade deficit to grow over the medium- and long-term period. A lot will depend also on BiH potential to develop its own economics of supply, i.e. to develop production capacities whose range of goods can compete with European markets. For how long can economy sustain trade deficit? Obviously, not for so long.

The current total foreign trade of BiH by sector for periods 01-11-2004 and 01-11-2005 is given in Table 2.7.¹²

**Table 2.7. Total BiH Foreign Trade by Sector
For Periods 01-11-2004 and 01-11-2005**

					in KM	
	Imports	Exports	Imports	Exports	Increase in %	
	2004		2005		Imports	Exports
Agro-industrial sector	1.752.343.970	155.324.209	1.755.207.759	209.177.946	0,16	34,67
Mineral fuels (oil, coke, gas, petrol) and electricity	961.892.558	238.951.894	1.293.906.961	295.163.000	34,52	23,53
Chem. pharm. production, fertilizers, plastics, caoutchouc and rubber	1.201.067.969	219.975.342	1.362.285.848	326.444.808	13,42	48,40
Stone, lime, cement, concrete, ceramics and products	377.406.090	47.370.617	379.847.890	66.091.289	0,65	39,52
Leather, fur, textile and products	685.463.202	310.622.984	774.717.771	314.356.245	13,02	1,2
Wood, paper and furniture	502.214.764	597.826.569	533.020.818	609.145.511	6,13	1,89
Ores, metals and products	772.563.734	661.176.866	1.019.840.852	980.631.348	32,01	48,32
Machines, devices, mech. devices, kettles, vehicles and weapons	2.132.107.523	441.632.362	2.468.961.921	640.828.173	15,80	45,01
Other various products	85.423.004	16.535.645	82.380.889	14.122.838	-3,56	-14,59
TOTAL	8.470.482.812	2.689.416.489	9.670.170.709	3.455.961.156	14,16	28,50

From this Table it is obvious that during the first eleven months of 2005, in comparison with the first eleven months of the previous year 2004, there was a growth in total BiH foreign trade in all sector branches, but with a greater percentage of growth of exports than imports. That shows a positive growth of industrial production in BiH during the past period, which is still insufficient to deserve significant praises.

¹² BiH Foreign Trade Chamber (August 2005) *Overview of Achieved Foreign Trade in BiH for Year 2004 and Period January – November 2005*

The effect of integration on domestic producers varies significantly, depending on their production. Those exporting to the EU mainly use free circulation of goods, especially after the EU phase of antidumping and other protectionist measures under which BiH products were treated. Free circulation of goods is one aspect of single market. The second is common foreign tariff already applied unofficially and constituting a part of the EU foreign trade policy. In most cases the common foreign tariff will be adopted upon formal accession of BiH to the EU.

The relation between winners and losers in this case depends on whether BiH will apply a more or less liberal trade regime before accession to the EU. Under the one currently in application in Bosnia and Herzegovina, customs rate for import products is mostly fiscal in nature, rather than protectionist. These policies are of benefit to certain domestic producers, but also unfavorable for consumers. In the coming period, some changes will occur in customs tariffs. If BiH would adopt zero customs regime for import products, on entry into the EU it would have to increase this rate and that way protect its domestic producers.

Adoption of measures that are part of the EU foreign trade policy (including import customs and commercial protectionist instruments, such as antidumping liabilities) will mostly have different effects on buyers and producers in BiH. Domestic producers in BiH may benefit from basic protectionist measures applied at the EU level, which harm the buyers.

On the other hand, more complicated introduction of protection at the EU level, as well as controls of state allowances and other forms of assistance to local producers from the European Commission, may decrease future power of our domestic producers. This is currently not a priority, since BiH does not have incentives or subsidies from the state budget

for its export products. They must be developed through economics of supply. EU membership introduces major changes in the balance of powers of national lobbies, strengthens the forces of groups such as consumers and exporters whose interests are often disregarded in political decisions on trade policy. The following Table 2.8. shows the classification of majority winners and losers in chosen areas. Estimated effects are based on the EU principles and norms that BiH must adopt in order to be admitted to the EU.

Table 2.8.¹³ Losers and Winners: Free Circulation of Goods

Measure	Interest Groups							
	Importers		Producers_EX		Producers_IM		Consumers	
	K	D	K	D	K	D	K	D
1. Elimination of Import Taxes and Quotas	+	+	-	-	+	+	+	+
2. Elimination of Export Taxes and Quotas	0	0	+	+	+	+	0	0
3. Harmonization of Standards and Rules	-	+	-	+	-	+	?	?
4. Common Recognition of Standards and Rules	+	+	-	+	+	+	+	+
5. Non-Discriminatory Regime	+	+	-	-	+	+	+	+
6. Elimination of Customs Duties within the Single Market	+	+	-	-	+	+	+	+
7. Common Foreign Tariff	?	?	?	?	?	?	?	?
Item 3: positive: possible security growth, negative: present products that will not meet higher standards disappear from the market, so the consumers with lower demand and lower income will be in a less favorable position. Item 7 depends on the current customs level.								

Evaluation: "+" - positive, "-" - negative, "0" - neutral, "?" - uncertain;
 K – short-term period (1 to 5 years), D – long-term period;
 Producers_EX: producers not jeopardized by changes in import regimes;
 Producers_IM: producers importing capital and raw materials needed for production.

2.4. Special BiH Macroeconomic Development Policies on the Road to the EU

The process of approximation of Bosnia and Herzegovina to the European Union will be followed by a series of problems that are not highlighted in political structures or in economic field, starting from that that the entry into the EU implies not only economic benefits but also costs. This has been reflected in experiences of other countries of Central and Eastern Europe during the last decade. In BiH there is still no careful analysis of costs attached to becoming

¹³ Tang, H. (2000) *Winners and Losers of EU Integration Policy Issues for Central and Eastern Europe*. Washington, D.C.: The World Bank, Bertelsmann Stiftung, p. 74

an EU member or losses from acceptance of integration rules that are not optimum for the level of development of BiH. The application of these standards requires financing that would burden even the less developed EU members. So, the costs of the EU accession start to emerge before the effects.

However, there is no question about the entire process causing long-term positive results. In light of globalization and integration processes, the space for progress and prosperity of BiH outside European Union is rather limited. The process of integration will require significant efforts of BiH citizens, particularly of economy, public administration and unions, in order to implement necessary adjustments. The most of these adjustments would be unavoidable anyway, in the context of transition to market economy. Secondly, it is necessary to highlight that further integration with the Union is a necessary but not sufficient condition for achievement of progress and economic stability. BiH must manage its economic policy in the way supportive to basic economic reforms, tending towards macroeconomic stability and allowing emergence of entrepreneurship.

European Union has offered the Stabilization and Association Agreements to the countries of the Western Balkans in order to bring them closer to the membership. These Agreements impose the need for stronger regional cooperation and initiation of common projects aimed at economic modernization of the region and its greater stability and safety. The countries of the region have the opportunity to build a small Europe again, before they are ready for the big one. So, it would be reasonable to also consider as soon as possible the potential to establish a customs union of Balkans countries, and there are several facts in favor of this. Today almost all of Europe is interconnected by a series of economic agreements that comprise a dense network of free trade, trade preferences and customs unions. The way to the customs union is

facilitated by the fact that harmonization of regulations, especially of customs rates with the EU and the WTO, will harmonize the regulations in individual countries of the region. Further regional integration and subsequent integration with the European Union is the only way to improve the environment in which BiH companies are operating. In doing that, the most important economic effects of regional integrations, on which the very European Union grew, should also be kept in mind.

Entry into the EU implies strengthening of the main pillars for the EU accession process. The first pillar is modern and efficient institutions. Improved implementation of regulations will be necessary, as well as faster establishment of new institutions and improved functioning of the existing. Therefore, it will be necessary to make decisive moves on public administration reform faster, since the entire procedure of negotiations with the EU depends on the quality of public administration. The second pillar is developed private sector. The third pillar is powerful financial system with sound banking and developed financial markets. The fourth pillar is new investments and modern technologies as a condition for growth of our productivity and competitiveness. The main pillars of new investments should be local private sector and foreign direct investment.

The estimate of positive and negative effects of integration on certain sectors of economy is a very complex job that requires making of an intersectoral model of economy with several simulations of models (e.g. under the circumstances of elimination of import customs duties, under the circumstances of associated membership and under the conditions of full membership in the EU). On the other hand, experiences and estimates made in other countries cannot be used sufficiently well for the anticipation of effects, due to differences in the structure of economy, level of development and other specifics linked to individual economy.

Certain rules can be initiated so that the sectors that have already been export-oriented and exposed to competition game do not experience great difficulties, since they have proven it is easier for them to adjust. On the other hand, the sectors that used to enjoy wide protection must put great efforts in adjustment and becoming efficient and competitive. A relatively easier adjustment can be expected also with the complementary sectors (financial services, tourism, and energy).

Concerning the social dimension of EU integration, we estimate that the integration will be of most benefit to the following classes: youth, highly-educated, speakers of foreign languages, part of public administration dealing with the EU issues, people with entrepreneurial spirit, capable, flexible and dynamic regions. Losers in the EU process may be recognized in the following social groups: unskilled and immobile population, regions incapable to absorb high amounts of EU funds, the old, those without additional financial income, public administration not involved in the EU matters. Given this, the authorities must use various measures and policies to help the new social structure which is being formed and which will be of key importance for new relations. What BiH can do in the coming period is: adopt many system laws, and implement measures and policies that will allow employment of population and growth of the living standard in this area. The membership in the European Union on its own is anyway not a factor of success of an economy.

The governments must conduct active development policy, policy of investment and job creation, pricing policy and revenue distribution harmonization policy, as well as active fiscal and monetary policies. In doing so, it is necessary to work on the achievement of basic development goals of the country which are seen in: growth of consumption and income per

capita, poverty reduction, wider access to health services, growth of education level of population, establishment of clean environment.

Investment in education and future experts, and good policy of self-employment, which would create the conditions for them to start families, is a key to prevention of further youth drain from the territory of the Western Balkans region. Strategy of education, development founded on the concept of economics of supply and creation of proper development capacities would give to the entire region, not only to Bosnia and Herzegovina, a new dimension of prosperous area, an area which is worth remaining in, and in which there are potentials for better living conditions. Any other approach, hesitation in implementation of economic reforms and relying upon international assistance without proper development vision will distance us from development and lead to new instabilities.

3. KEY RELATIONS FOR BIH AND EU

3.1. Strategy of Future Relations between Bosnia and Herzegovina and European Union

The relation between European Union and Bosnia and Herzegovina so far has been short but intensive. Association with the European Union has no alternative. That must be a long-term goal of the BiH state. The most important policies and instruments that Bosnia and Herzegovina should apply during the transition period are more or less clear. Pre-accession economic policy must gradually converge towards the economic policy of the EU member states. The most difficult for BiH is yet to come. How should we prepare to have most gains from accession and to decrease the costs?

The accession process of the Western Balkans countries is essentially based on the model of previous enlargements and is not created in the way to help the transition economies. The authors of the Union program consider that accession and transition require the same policies. The applicants are forced to implement the policies of the European Union that were developed earlier for progressive, industrialized economies, and not for transition economies, and that is why often, in many parts of Southeastern Europe, it is not possible to find developed forms of complex institutional structure for implementation of EU policy. Moreover, the corresponding EU policies are additionally inadequate for the economies of the Western Balkans countries, as well as for the countries of Central and Eastern Europe; for example, expensive parts of ecological and social policies. This is not surprising, because EU is not a development agency, but rather a club with members of choice.

Further down the road towards EU, BiH will still face a whole range of steps in line with requirements of stabilization and accession process and criteria for membership that need to be undertaken in order to become an EU member. The forthcoming "**Road Map for the EU Membership**" includes the following key steps:

- Strengthening the establishment of negotiating teams with the EU comprising the most competent local experts aware of EU policies. The EU negotiating team is a small executive team expected to coordinate the process of preparations of the countries for membership. That team must have strong political support, so that it can cope with the priorities of other ministries, and it should also be very competent for legal harmonization. The judiciary should be competent to implement the laws inspired by the EU law or, if it is not, it will favor the culture of non-acceptance of laws;
- Negotiations on Stabilization and Association Agreement;

- Initialing and signing of Stabilization and Association Agreement (estimate: end of 2006, under the best scenario);
- Entry into force of Interim Agreement (provisions of SAA covering trade and trade-related matters, in force before the ratification);
- Ratification of the Agreement at the European Parliament, the Parliamentary Assembly of BiH and Parliaments of the member states;
- Entry into force of the Agreement, fulfillment of obligations arising from that Agreement;
- Submitting of request for full membership (estimate: end of 2008, under the best scenario);
- European Commission prepares the opinion on candidacy based on the answers to questions given in the Questionnaire addressed to BiH authorities;
- EU Council of Ministers adopts the opinion and makes the decision on beginning of negotiations with the candidate;
- Negotiations on 31 areas of *acquis communautaire* and preparation of Accession Agreement;
- Signing of Accession Agreement (estimate: 2011-2012, under the best scenario);
- Ratification of the Agreement at the European Parliament, the Parliamentary Assembly of BiH and Parliaments of the member states;
- Application of transitional provisions;
- Membership in the EU, which triggers the international responsibility of BiH (estimate: 2015, under the best scenario);

So, the integration into the European Union represents basic long-term foreign policy strategy of Bosnia and Herzegovina that has no alternative. At first sight, year 2015 seems so distant. But deadlines for entry are extremely short and demanding. Our aim is to meet as many

criteria of Copenhagen and Maastricht as possible, regardless of being a member or not of the EU or of some new creation that will exist at that time.

In doing so, it should be highlighted that social consensus is becoming a decisive factor of survival, development, and adaptation of Bosnia and Herzegovina to the European Union. The social consensus means an agreement between the key actors – holders of political and economic power, political parties, unions, social movements, non-governmental organizations, media, and citizens – on basic principles of state and economic reforms that are a condition for BiH development and its association with the EU. The importance of consensus is reflected in specific, historical position of our country. It is a country i.e. a society with high conflict potential, with massive social impoverishment of citizens who are living under the heavy burden of economic problems. To lay stable foundations for a new country, increase capacity for peaceful conflict resolution, or provide higher standard of living is therefore not possible without a wide social consensus.

The condition for reforms is social consensus, with the presumption that everyone will renounce their maximalist interest and adopt the **win-win logics (no one loses, everyone wins)**. That would also contribute to greater mobilization of entire social energy for changes and discontinuation of further perilous divisions. The EU would perceive such behavior as positive. The reforms that are being initiated are aimed at transforming BiH into a stable society with incontestable presumptions for development, i.e. with marked road of development into a normal European society.

Numerous limitations by the EU mainly prolong the negotiations process and distance our economy from faster access to big EU funds. Secondly, long lists of limitations that many

members must give up on during the process of negotiations on accession may increase the anti-position on the EU, while national political groups may use such a step to promote the ideas on sales of the country to foreign interests (primarily to the EU). Thirdly, many limitations may expand passive behavior of vulnerable population. Fourthly, limitations may be counterproductive and a lot will depend on "negotiations package" during the last phase of the pre-accession period. At that point, there will be no time for certain companies/sectors to prepare to face the competition. Therefore, some sectors or companies that might become winners will become losers in reality, as a result of consequential adjustment supported by government policy.

Moreover, the progress of negotiations with the EU in further but important detail marks future costs of adjustment. As candidate country is progressing towards membership, the awareness is rising among its population that everyone personally might be put in danger. However, the public majority of these groups will not become opportunists; they will rather join the group of indecisive, hesitating citizens. That is why the media and organizations that form, educate and direct public opinion in BiH will play an important role. Open communication policy is necessary in order to start the discussion on real and potential costs and benefits. Primarily, a realistic presentation of real benefits from integration, those already materialized and yet to be materialized, is necessary. Secondly, open discussions on real and potential costs should be complemented by ways and means to avoid and alleviate the costs.

Finally, the time of accession defines the distribution of winners and losers. Currently, BiH must adjust to the EU rules that are a necessary condition for membership. We all know that prompt membership offers more benefits than costs. Firstly, any postponement may lead to

renouncing gains in growth, investment, structural changes and integrations into the international production and network of services. Secondly, the efforts to join the EU fast may remain unrewarded and cause the growth of disappointment in business circles and society as a whole, which may lead to local economic and political problems. Thirdly, slow growth, low level of investment and decline of attractiveness in international business community may slowly increase potential migrations.

A precondition for integration is successful transition process, i.e. implementation of market reforms in economy and introduction of the rule of law. Therefore, transition and integration into the EU processes are linked and interrelated. The reforms and EU integration share a goal: modernization of economy and country in order to create higher and better living standard for citizens.

Implementation of Stabilization and Association Agreement may help us in restructuring process, fulfillment of conditions for full membership, modernization of infrastructure, use of finances for regional projects, and legal harmonization. BiH's own capacity to make legal, economic and political adjustments and its readiness to contribute to regional cooperation and stability in Southeastern Europe will serve as basis for transition from the status of potential candidate to the status of full candidate for EU membership, and for further negotiations on full membership.

Simply put, over a medium-term period we must provide awareness that total economic development of the country and region in general depends equally on correct understanding of economic reforms and correct social program that must be a part of general policy. By the end of 2015, we should tend towards becoming a full EU member in the second round of

accession. Efficient, fast and complete implementation of the Stabilization and Association Agreement will be of particular importance for credibility of the country and it will provide efficient implementation of the second phase preceding the final EU membership.

The BiH Strategy for Integration into the EU is finalized. This strategy will define goals, measures and responsible institutions, as well as integration schedule. The costs-benefits analysis should be made as a separate document of quantitative nature that would show the macroeconomic and microeconomic (sectoral) effects of integration. These two documents are bases for long-term negotiating positions of the country. Numerous analyses of specific integration issues are necessary as well as consensus in the society on their best solutions. These are access to single market, common agricultural policy, structural and regional policies, appropriate financing, associated preparation costs, development of various components of infrastructure, consumer protection, development of human capital, preparations for challenges of computerized society, complete trade liberalization, circulation of capital and labor, consequences of brain drain. This is built through BiH Strategy for Integration into the EU.

The strategy of future relations with the EU tackles also correct analysis of impact of the integration on entire BiH society and its transition. In brief, long-term benefits of EU membership are reflected in: improved competitiveness of proper economy, enlarged internal market, knowledge and technology transfers, growth of investment. In the short run, the integration will bring about: acceleration of final phases of transition, mutual lowering of the present levels of customs tariffs, increased competition, harmonized costs of business. For our producers, further integration into the EU market means growth of competition, lower prices, enlarged internal market, growth of investments; and for buyers – growth of supply and lower

prices. In the final phases of transition, the impacts of integrations are seen in faster remaining privatizations, liberalization of financial services and increase of assistance to budget, while the EU accession itself has direct influence on harmonization of agricultural policy with the common EU agricultural policy, adoption of high EU standards in the area of ecology and adoption of necessary changes to regional development policy.

The Strategy of BiH Integration into the EU deals with the influence of integrations on certain sectors of economy. Development is mostly unfavorable for most pre-war heavy industries in BiH (metal, military, machines, etc.) and semi-production of primary products. Agricultural production, which is not protected by the present Free Trade Agreements, represents a separate problem. Lack of investments and entrepreneurial activities is a reason of slow modernization of this sector. At this point, the agricultural sector in BiH cannot confront the competition from the EU. Without political support (better access to credits, clear legal regulation of proprietary rights over agricultural land and other), the problem of losers in agricultural sector will aggravate during the preparatory period for accession.

Labor migration from BiH is another problem. Due to economic and social crises during the transition period, and huge differences in incomes, the labor from this area is interested in going to the EU countries and elsewhere. The migration policy must be balanced, taking into account that the migrations have both positive and negative effects. That is why the attention should be paid at those who can contribute to national development now as well as in the future. These are young talents and well-trained experts of any age. They should be assisted in finding jobs and providing accommodations, which would influence their staying here.

The differences in GDP per capita between EU countries have been evident during the last decade. The gap between certain EU regions is growing. This may happen also in BiH, due to the flows of direct foreign investments that will go to the regions with more attractive conditions for economic activities. The capacity of BiH institutions to prevent growing regional differences is limited. A regional strategy should be developed by 2010 with appropriate policy for its implementation that would imply identification of regions that need more assistance and introduction of economic initiatives for their greater attractiveness in the eyes of foreign investors.

A ten-year investment strategy should also be developed. The strategy should define appropriate investments, sources of financing (domestic savings, foreign investment, EU funds, etc.), role of public and private sectors, and big projects. During the pre-accession period BiH needs big investments according to the EU standards. These funds will mainly be provided from domestic savings and external sources. That will burden the budget by means of public investments in infrastructure.

Health and pensions reform will have similar consequences, especially under the conditions of high unemployment, low incomes and growing youth emigration. Trade liberalization and accession to customs union will reduce budgetary revenues from import duties. Adjustment of domestic tax system to EU standards may lower some taxes. On the other hand, the financing of preparations for association may speed up the pressure for higher taxes. A harmonized budget is necessary and desirable for economy, but it comes with a price. If the price of harmonized budget is high, which is expected to be the case during the pre-accession period, flexibility should be exercised to achieve the main economic, social and other aims. Under such conditions, closer cooperation is necessary between monetary and fiscal policies.

3.2. Vertical and Horizontal Distribution of Competencies in Bosnia and Herzegovina for European Integration Matters

One of the conditions for EU membership, set at the Summit in Copenhagen (1993), is full adjustment of internal legal system of candidate country to the legal system of EU, i.e. using EU vocabulary – the entire *acquis communautaire* must be adopted and applied. The task of estimation of legal harmony and analysis of necessary changes must be carried out primarily by public administration.

Keeping in mind that EU legislation encroaches on all areas of the rule of law, and that Bosnia and Herzegovina is a country with complex constitutional structure that requires (in line with constitutional competencies) active contribution from the entities, this project needs to include almost all departments at the BiH Council of Ministers level and entities level, in order to establish as good coordination as possible.

Although it is indisputable that BiH Council of Ministers led by the BiH negotiating team and Directorate for European Integration will negotiate about the accession of Bosnia and Herzegovina to the European Union, both entities must take active part in building of policy, strategy and tactics of negotiations in the field of economic relations, and in particular of relations with the EU.

Distribution of tasks and responsibilities is relatively clear: the negotiations that the international community is intending to have only with Bosnia and Herzegovina as internationally recognized entity, fall within the competence of BiH, with obligation of BiH to build common policy, strategy and tactics for negotiations together with the representatives of

competent ministries at the level of BiH Council of Ministers and entity authorities, those of the Republic of Srpska and the Federation of BiH. However, the application of these political agreements, especially of those that bring new, harmonized legislation or adjustment of the present, including also the preparation for acceptance of international conventions, should be within the competence of entity authorities, with the exception of very few incontestable competences of BiH.

On the way to the entry into the European Union there are several levels of negotiations with the EU, but the most important and the hardest are the negotiations in internal, domestic field. Therefore it is important to provide support from the media for all activities being implemented.

The building of a new legal order in Bosnia and Herzegovina should not start from “ground zero”, as it is often done. It is necessary to provide coordination of activities, not only of state bodies and agencies but also of scientific institutions and experts, in adjustment of legal order of Bosnia and Herzegovina to European law. One of the most important activities should be a critical analysis of present draft laws, model laws formulated by the experts, and valid joint laws. Some countries emerged from the former SFRY that are now serious new members of the European Union (Slovenia for example) took over the federal Yugoslav legislation and persistently adjusted it to European integrations. A list of laws that need to be reformulated should be made, while others should be changed by means of amendments.

The following steps in the reform of economic and social sphere are anticipated for EU accession: economic stabilization, economic transition and adoption of EU rules and regulations. Economic stabilization has so far been implemented with success and there is no

reason to believe that it will not continue on the same course. Economic transition essentially represents a shift of economic and financial sectors to operation under market principles. It will be necessary to complete the process of proprietary transformation, perform banks rehabilitation, close or integrate losing companies, move the social function from companies to the state, encourage entry into the production of new, profitable, local and foreign production units.

Adoption of EU rules and regulations represents the third key step in preparation for EU accession. This step is important since it supports the previous two. It is executed in several stages. High priority is given to regulations related to the areas in which EU norms can give incentive to or facilitate the processes of stabilization or transition (the laws related to investing, takeover of companies, privatization, etc.), while lower priority level is given to regulations that are, although important in themselves, not in direct short-term relation with the main elements of reform.

The shift to full market economy while implementing the transition will bring about serious changes in the field of labor and labor market. Structural modernization of our economy will cause additional discharge of labor. Withdrawal of people from active labor will undoubtedly be manifested in rise of social costs and number of the unemployed. The unemployment rate would be lesser only if, simultaneously with this, there would be accelerated processes of employment in services sector and self-employment. This possibility is real because experiences of other transition countries show that, with decrease in number of the employed in industry, there was job creation in the sector of small- and medium-sized enterprises and in the sector of public and private services.

It is necessary to redirect the employment policy and make it an active employment policy. According to the EU standards, active policy measures concern also the persons experiencing difficulties in finding jobs. This primarily affects youth, workers with lower qualifications, and middle-aged people whose qualifications no longer meet the new requirements of production, i.e. services of new type, sort and quality. Similarly, there is forthcoming activation of employment program in less developed regions. Active re-training and upgrading programs should be directed towards increase of labor mobility, overcoming of obsolete knowledge and skills and especially creation of opportunities for employment of specific social and qualification groups.

CONCLUSIONS AND RECOMMENDATIONS

The purpose of this research is to assist in understanding of EU requirements and situation in Bosnia and Herzegovina and to propose concrete conclusions and recommendations of necessary measures. Since this is a long-term project, in the coming period it is necessary to renew the knowledge on certain fields, i.e. to introduce new themes. In doing so, the EU is not regarded as given fact, but as an ever-changing construction, and we are thinking about adjustment to the future, enlarged, not the present Union. That is why it is necessary to track constantly the development of conditions in member states and candidate countries that remain after the first subsequent enlargement of EU.

First, before presenting recommendations for future research, it is important to give answers to some questions related to this research:

- **What are the Obligations of the Union Member States?**

European Union is a result of the process of cooperation and integration started in 1951 between six countries (Belgium, France, Germany, Italy, Luxembourg, Holland). After more than fifty years and five rounds of enlargement, the European Union today has twenty-five members. Concerning the level and way of cooperation between the member states, and mechanisms and levels of decision-making in the Union, European Union is the only true regional integration of all.

The duty of each country is to apply legal regulations of the EU, known as the legal patrimony of the Community (French *acquis communautaire*), and to contribute actively to

the achievement of EU goals through activities at the levels of member states and entire EU. Another duty of each EU member state is to pay to the EU budget a part of its revenue from value added tax in force in that country (the share is calculated by a special formula) and direct member states' contributions defined in relation to the size of its gross domestic product.

▪ **What are the Reasons for Bosnia and Herzegovina's Membership in the European Union?**

Already in 1998, Bosnia and Herzegovina has set a strategic goal of EU membership by means of the Declaration on the Future in the EU. Participation in integration process in the European continent is a political goal that represents the efforts of BiH to respond to the challenges of globalization. The practical reasons for membership are seen in that one day the BiH citizens would not be wasting their time at border crossings, and that the access of our market to the European would create the most favorable presumptions for faster economic growth. The accession to the European integrations is a process unfolding simultaneously with the implementation of economic reforms, and encouraging the process of economic rehabilitation.

Pending entry into the EU, BiH should complete the transition processes, including establishment of efficient market economy, create the conditions for market liberalization by the European Union, and allow strengthening of local companies in order to enable them to compete at the European market. EU membership will favor the development of those sectors or companies that will be competitive enough at the European market, and contribute to better linking of our business sector with the European.

That is why entry into the European Union would allow to Bosnia and Herzegovina the following:

- Inclusion into a stable political and economic environment, which would favor its social and economic development;
- Representation of BiH interests during decision-making in the EU that influences foreign and internal policies;
- Growth of reputation of Bosnia and Herzegovina;
- Access to internal market of the EU that presently has 450 million inhabitants;
- Providing of stable business environment and offering of new development possibilities within the economic and monetary union;
- Expansion of possibilities for growth of exports;
- Incentive to competitiveness of local companies, which will trigger modernization of operation, usage of new technologies and growth of productivity of these companies;
- Better access to capital, equipment, knowledge and technologies in the Union, which will influence the growth and development of our society as a whole;
- Opening of education possibilities for BiH citizens, and employment opportunities in EU member states;
- Access to the EU funds intended for environmental protection, investment in transport networks, incentives to agriculture, and general decrease of gap between regions and member states of the EU.

The negative aspect of entry into the EU comprises short-term high expenses that those BiH face. Since the transition process in most countries, as well as in BiH, overlaps with the process of integration into the EU, it is hard to assign the costs to only one or another. Another negative aspect is that these short-term costs are borne by certain social groups –

companies that are not competitive in newly created circumstances and that will have to invest in modernization of production and operation in line with the EU standards, and state and entity institutions that will have to make significant efforts to strengthen the institutions and enable them to implement EU regulations.

- **What is Necessary for Bosnia and Herzegovina to Become a Member of the European Union?**

First, it must negotiate with the Union as soon as possible and conclude the Stabilization and Association Agreement. The Agreement defines general principles, political dialogue, regional cooperation, free circulation of goods, labor migration, establishment of legal entities, providing of services and capital, harmonization and implementation of laws, market competition regulations, judiciary and internal relations, cooperation policy and financial cooperation. The Stabilization and Association Agreement will give the status of associated member to the signatory, Bosnia and Herzegovina, and of potential candidate for EU membership, once it enters into force. Agreement represents the beginning of institutional relations between the EU and BiH, which would lay the foundations for full membership. The implementation of this Agreement, i.e. of the Interim Agreement that precedes it as a transitional phase, would result in market liberalization by the European Union, which would eliminate customs duties and other restrictions to imports of most products from BiH to the EU market, under the condition that they meet the standards.

It should be highlighted that there are transitional periods for so-called sensitive products during which measures will be undertaken to strengthen local entrepreneurs for participation in the internal market of the EU. More precisely, already at the beginning of future

implementation of the Interim Agreement between BiH and EU, customs duties will be eliminated on a great number of products, while for sensitive industrial products and agricultural products some transitional periods will be agreed during which these duties will be gradually reduced and/or eliminated.

After all this, for BiH to really become a full EU member, it must first submit a request for EU membership to the EU Council, accompanied by the request for estimation of compliance in relation to the criteria of Copenhagen. In this phase, before opening of negotiations between the EU and a candidate country such as BiH, there is screening, i.e. the procedure to identify the fields of legislation of a candidate country that need to be adjusted to the legislation of the Union, and extent to which these adjustments are necessary. The Council makes the decisions on beginning of negotiations. The decision on beginning of negotiations is linked with the conclusions of inter-governmental conference of the governments of EU member states, held each four years (the last was held in 2004), during which the most important strategic issues in the Union are considered, including its enlargement. When the Conference concludes that certain country is ready to be recognized as a candidate for membership, that is to open the negotiations on accession with it, the negotiations are initiated within 6 months following the end of intergovernmental conference. After the conclusion of negotiations, the draft Accession Agreement is made between the EU and the candidate country, which must be approved by the European Parliament and the Council of European Union. After that, the Agreement is signed. In order for it to enter into force, it must be ratified by the EU member states and the candidate country. Depending on the legal structure of the candidate country, a referendum may be conducted as one of the instruments of ratification in that country. Upon completion of ratification of the Accession Agreement, the candidate country becomes an EU member state.

And finally, an issue of special interest to all peoples in BiH at this moment:

- **Could Entry into the EU Cause Losing of a Part of the National Identity?**

The experiences of present EU member states indicate that with entry into the EU no part of the national identity is lost. Respect of national identities is guaranteed by the Treaty on European Union, whose Article 6 stipulates that "*The Union shall respect the national identities of its member states*". Portugal and Ireland for example have still kept the characteristics of their national identity, such as language and culture.

With the accession into the European Union, Bosnia and Herzegovina and its entities (Federation of BiH and Republic of Srpska) will transfer a part of their sovereignty to the level of common decision-making in the Union. This relates to the areas the decisions on which are made at the Union level, i.e. the areas such as internal market, customs union, transport, economic and monetary union, common agricultural policy, environmental protection etc. That does not mean that BiH and its entities will renounce that part of sovereignty, but just that they will apply it in a different way, harmonizing their activities and decisions at all levels of competence with other member states and building the administrative structure in BiH that can respond to the challenges of EU, aimed at more efficient decision-making and regulation of the areas in which it is considered that common decisions and activities can achieve more than any one member on its own.

Our Recommendations for Continuation of Transition of BiH Economy to Market Economy and Acceleration of the Process of Integration into the European Union:

- We have perceived that Bosnia and Herzegovina has numerous advantages: favorable perspectives of long-term growth and efficiency of investment, low inflation rate, harmonized interest rates, stable exchange rate, favorable structure of banking system, rich agricultural land and even good starting points for development of civil society; but it also has disadvantages: low share of private sector in social product, high internal debt, underdeveloped securities market, high allocations for social policy and social care, non-critical proliferation of regulations, and often fails the exams of building of civil society and protection of the rights of individuals. Our aim must be the recognition and improvement of advantages, and recognition and removal of disadvantages, and we must know how to use wisely the positive results, advancements and progresses. Although it seems that political and legal conditions are crucial, economic issues will surely arise over a long term.

- Therefore, our recommendations primarily relate to improvement of economic situation, i.e. to maintenance of fast and stable growth, low inflation, external stability, decrease of deficit, decrease of debt, growth of domestic savings, reform of labor market, public administration reform, decrease of tax burden. Economic policy oriented towards investment, future liberalization, modernization of privatization process and more intensive cooperation with direct foreign investments, belongs to this set of policy instruments at which BiH must pay attention. Instead of passive reception policy, BiH must develop an offensive, active approach that speeds up and to a certain extent favors the adjustment to the EU criteria.

- The reforms should be implemented before they start being imposed from outside. Although adjustments in most areas need to be implemented as soon as possible, being careful is essential because there are areas for which it would pay off to wait for the accession. In all areas concrete implementation plans should be made with deadlines and clear distribution of responsibilities, authorities and obligations. Most steps need to be undertaken as soon as possible, without waiting for BiH to become an EU member. The decision on adjustment will not be easy, because there are great needs for budget allocations.

- In public administration there are discussions about institutional changes that may not be implemented overnight and that cannot wait, because the entire accession process will primarily depend on the quality of public administration. BiH should devote special attention to strengthening of public administration, in order to ensure that the line ministries implement properly the numerous legal reforms we have already committed to. In doing so, special importance will lie with coordination, human resources teaming, motivation, responsibility, and internal and external control in all segments of public administration.

- For changes in judiciary it will not be sufficient to change the laws, but it will be required to make deeper changes in human resources and social circumstances, even the change in the structure of judges, lawyers and other staff. Better coordination and monitoring of social policy programs requires, for instance, better statistics and further research of social programs. The reforms must be comprehensive, and it is necessary to define aims, strategies, schedules, deadlines, and responsibilities in all areas.

- In order to reduce lagging behind in relation to EU education average, it is necessary to upgrade the quality of education at all levels. In high education, for instance, it is necessary to solve the problems of validation of diplomas and cooperation with foreign countries, to introduce programs in English and new interdisciplinary programs, and to establish doctoral studies.

- There are no analyses giving overview of concrete financial indicators of the benefits of the accession to the European Union. Namely, in order to obtain concrete financial and other indicators of influence of the BiH legal system adjustment to EU regulations, an analysis must be made of the impact of introduction of EU regulations on each individual field such as agriculture, industry, energy and environmental protection. Such an analysis would be a preparatory phase for making of costs-benefits analysis, a roof document that would give an overview of financial and other indicators of advantages and disadvantages of BiH integration into the EU.

- The greatest portion of costs of the EU accession process will be borne by the state and entity budgets, i.e. by the taxpayers from BiH. A part of costs for the EU is covered by the Union itself via programs of technical and financial assistance such as PHARE, CARDS and SAPARD programs. In many areas, such as consumer protection, environmental protection or education, there are international programs that BiH as a country or its individual entities, regions, cities, institutions, companies or nongovernmental organizations, can already engage in and that should be taken advantage of. The pre-accession funds can be of great assistance in infrastructure improvement in the region. Bosnia and Herzegovina will have to fulfill several conditions in order to obtain the maximum amount of the EU pre-accession funds:

prepare good projects, find enough money in local budget for co-financing of projects, control strictly the distribution of European and its own money, and create strong regions with local consensus. The main expected problem is finding sufficient local funds for co-financing of projects.

- The abovementioned issues of adjustment to the EU are already priorities of the development of the complex community of BiH. It is certain that the authorities in BiH should start considering them carefully and precisely on a daily basis, within the bodies in charge of the most important decision-making in the country such as: Coordination Board for Economic Development and European Integration and Fiscal Council of BiH. The Parliamentary Assembly of BiH together with the entity Parliaments could also provide significant input in accelerated implementation of priority activities on the way to the EU. However, the key task for the implementation of development priorities is still at the common and entity institutions that can mark the road of BiH to European society in the best and fastest way.

APPENDIX A – Chapter 2:

2.1. European Economic Integrations – Model of European Union Development

In 1957 the developed Western European countries signed the Treaty of Rome establishing the European Economic Community and declared it open to all European countries. The task of the Community was to create a common market by a set deadline, and by means of gradual harmonization of economic policies to ensure harmonized development of the economies of Community members, constant and even expansion of economy, increased stability, accelerated rising of living standard and closer links between the member states.

By the Treaty of Rome it was agreed to complete the integration process at the customs level within the first 12 years. However, the integration process was unfolding much faster. So the process of establishment of customs union, as a phase of development of the Community, was completed four years earlier than anticipated by the schedule of completion of integration process, in 1968 to be precise. During that period, the European Economic Community had established a combination of a free trade zone and a customs union. The Treaty of Rome provided for the establishment of joint agricultural policy aimed at growth of productivity in agriculture and satisfactory living standard of the employed in this sector. It also provided for the freedom of labor movement, as well as for the employment within the single area. The process of decision-making in European Union is being increasingly transferred to supranational level. Simultaneously, the crucial elements of economic and political sovereignty remain within the authority of national states. The exception is foreign trade policy, which was entirely transferred to the decision-making of European Commission.

The European Economic Community was earlier structured as an independent and sovereign organization of countries that served as a forum for exchange of opinions and decision-making between its members. The Treaty establishing the European Economic Community provided for its agencies that later expanded, so that today the most important supranational bodies of the EU include: Council of Ministers, European Commission, European Parliament and Court of Justice. Inter-governmental bodies are European Council and European Court of Auditors.

By 2004, the European Community (Union) had been enlarged on five occasions by new countries and members. Finally, the fifth enlargement took place in May 2004 and included accession to the Union of: Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, Slovenia, Check Republic, Cyprus and Malta. Economic interest was the main driving motive for all these enlargements, although the background of enlargement was always dominated by political and security motives.

The most important (elementary) development features of individual EU member countries, and thus of the Union itself, are given in the Table 2.8.¹⁴:

¹⁴ Spiric, N. and Vukmirica V. (2005) *Economic and Monetary Integration of Europe*; Banja Luka, Faculty of Economics, p. 102 – 103.

Table 2.8: Statistical Indicators for 25 EU Member States

	State	Area km2	Population (in Thousands)	Ethnic Groups (in %)	Capital and Number of Inhabitants	GDP (in Billion USD)	Income per Capita (in USD)	Export (in Billion USD)	Import (in Billion USD)	Un-employment (%)
1.	Austria	83850	8070 (2002)	German 90%	Vienna 2,1 mil	217 (2001)	26765 (2001)	70 (2001)	74.4 (2001)	3.9 (2002)
2.	Belgium	30500	10264 (2002)	55% Flanders 35% Walloon	Brussels 996000	279 (2001)	27178	171 (2001)	175 (2001)	6.7 (2001)
3.	Czech Republic	78864	10260 (2002)	94% Czech	Prague 1,3 mil	143 (2001)	13990	30 (2001)	39 (2001)	8 (2001)
4.	Denmark	43070	5334 (2002)	Danish	Copenhagen 1,5 mil	147 (2001)	27600 (2001)	43 (2001)	46 (2001)	4.2 (2000)
5.	Estonia	45100	1377 (2002)	61% Estonian 30% Russian	Tallinn 490.000	13.7 (2001)	10060	4.2	6.5	7
6.	Finland	338145	5178	93% Finnish 6% Swedish	Helsinki 520.000	129	24990	42.9	39	9
7.	France	547026	59453	90% French	Paris 9,5 mil	1427	24223	321.3	326.7	9.2
8.	Greece	131944	10623	98% Greek	Athens 3 mil	147	16500	9.1	28.5	10
9.	Ireland	70280	3841	Celtic majority English minority	Dublin 1,2 mil	113	29860	82.5	50.6	4
10.	Cyprus	9521	790	78% Greek 18% Turkish	Nicosia 200.000	15.7	20820	1.4	6.3	2.3
11.	Latvia	64500	2400	52% Latvian 34% Russian	Riga 890.00	16.7	7045	2.4	4.4	7.7
12.	Lithuania	65200	3690	80% Lithuanian 9% Russian	Vilnius 600.000	26	7106	4.3	6.5	7.3
13.	Luxemburg	2.586	442	Celtic-French and German	Luxemburg 100000	22	50061	9.1	12.9	2.5
14.	Hungary	93030	9917	90% Hungarian 10% Rom	Budapest 2,1 mil	124	12416	29.9	33.9	5.8
15.	Germany	357050	82007	92% German 7,7% immigrant	Berlin 3,5 mil	2062	25103	570.2	492.5	8.1
16.	Poland	312677	38577	98% Polish	Warsaw 1,7 mil	349.8	9051	31.7	51.8	19
17.	Portugal	92080	10033	Portuguese	Lisbon 2 mil	173	17290	23.8	37.9	4.2
18.	Slovakia	49014	5400	86% Slovakian 11% Hungarian	Bratislava 500000	60.7	11243	12	14.7	19
19.	Slovenia	20251	1978	91% Slovenian 7% Serbian and Croatian	Ljubljana 450000	34.5	17367	9.2	10.1	12
20.	Sweden	449964	8833	90% Swedish 2% Finnish	Stockholm 1 mil	215	24275	74	69	5
21.	Spain	504782	39921	72% Spanish 16% Catalanian	Madrid 3 mil	768	19472	108.9	142.6	13
22.	G. Britain	244046	59540	English, Scottish, Welsh, Irish	London 7 mil	1404	23509	268.5	322.8	5.1
23.	Malta	316	392	Maltese	La Valetta 34.000	6.7	17270	3.2	4.5	4
24.	Holland	34000	15930	96% Dutch	Amsterdam 1,5 mil	408	25650	228.8	206.9	2.4
25.	Italia	301230	57503	98% Italian	Rome 3mil	1363	23620	240.7	230.7	9

The tables were made according to the "Countries of the World 2003", the new and improved edition of statistical encyclopedia, by Dusan Ostojic, No limit Books, 2003.

By ratification of the Maastricht Treaty the process of implementation of monetary union was formally open. The key role in establishment of monetary union lies with the European Monetary Institute, which comprises the governors of national central banks and a President

appointed by the heads of states and governments. Already in the beginning of 1996 the most important decisions on transition to monetary union were made and it was established whether the majority of member states complied with the requirements for adoption of joint currency and whether the requirements for full monetary union were entirely fulfilled. Finally, in the beginning of 2002, the Euro was introduced as a single currency in 12 EU member countries and became the means of payment for more than 300 million citizens of Europe. The full economic union represents the most important achievement of Western European integration and way to its creation obviously lasted about half a century. Table 2.9. shows the efforts of the countries of EU-15 to fulfill the Maastricht criteria during the preparatory period for introduction of Euro.¹⁵

Table 2.9. Economic Convergence Criteria

EU-15	Inflation (%)		Public Deficit (% GDP)		Public Debt (% GDP)		Long-Term Interest Rates (%)	
	1997	1999	1997	1999	1997	1999	1997	1999
Germany	+1.4	+1.4	2.7	1.2	61.3	61.1	5.6	4.5
Austria	+1.1	+1.7	2.5	2	66.1	64.9	5.6	4.7
Belgium	+1.4	+2.1	2.1	0.9	122.2	114.4	5.7	4.8
Denmark	+1.9	+3.1	-0.7	-3	65.1	52.6	6.2	4.9
Spain	+1.8	+2.8	2.6	1.1	68.8	63.5	6.3	4.7
Finland	+1.3	+2.2	0.9	-2.3	55.8	47.1	5.9	4.7
France	+1.2	+1.4	3	1.8	58	58.6	5.5	4.6
Greece	+5.2	+2.4	4	1.6	108.7	104.4	9.8	6.3
Ireland	+1.2	+3.9	-0.9	-2	66.3	52.4	6.2	4.7
Italy	+1.8	+2.1	2.7	1.9	121.6	114.9	6.7	4.7
Luxemburg	+1.4	+2.3	-1.7	-2.4	6.7	6.2	5.6	4.7
Holland	+1.8	+1.9	1.4	-0.5	72.1	63.8	5.5	4.6
Portugal	+1.8	+1.7	2.5	2	62	56.8	6.2	4.8
Britain	+1.8	+1.2	1.9	-1.2	53.4	46	7	5
Sweden	+1.9	+1.2	0.8	-1.9	76.6	65.5	6.5	5
EU-11	+1.6	-	2.4	-	72.1	-	6.1	-
Reference	+2.7	+2.8	3	3	60	60	7.8	6.9

Source: European Commission, 2000.

The advantage of European Union of its previous fifteen members is not only the economic space that includes, together with the EFTA countries, about 380 million consumers with good solvency, but also the fact that it represents a key factor of tripolarity of world economy (with USA and Japan). The European Union is the biggest trade bloc in the world, a truly open area in which circulation of people, goods, services and money is almost totally free.

¹⁵ Kandzija, V. (2003) *Economic System of European Union*. Rijeka; Faculty of Economics, p. 253

This is a market bigger than the American, and with no barriers between member states it represents an attractive market space for numerous innovations, entrepreneurship and challenges not only for the countries of the Union but also for those outside the Union.

Table 2.10. shows main statistical indicators: European Union, United States of America (USA) and Japan. Given data indicate great importance and position of Europe in the world of today, especially in terms of economic power.¹⁶

Table 2.10. EU Fifteen Countries in the World (2000)

	World	EUR 15	EUR 15/ World (%)	Japan	Japan/ World (%)	USA	USA/ World (%)
Population in Million	6,078	377.5	6.2	126.7	2.08	272.8	4.4
Area in 000 km ²	148,326	3,232.8	2.18	377.7	0.25	9,809.4	7.31
Population Density per km ²	40.9	117.1	-	335.5	-	28.1	-
GDP in Billion USD (Current Prices)	41,016.7	7,894.5	19.25	3,550	8.65	10,082	24.6
GDP/PC PPP in Billion USD (Current Prices)	6,748	20,912	-	28,000	-	36,300	-
Exports in Billion USD	5,017.3	914	18.2	292.1	5.8	1,148	23.5
Imports in Billion USD	4,745.0	872.5	18.4	383.8	8.09	728	15.4
Export/Import Ratio	105.7	104.75	-	76.11	-	157.69	-

Source: Eurostat, 2003; CIA Fact Book, 2003; WTO, 2003.

However, along with advantages, numerous drawbacks of this market have also been seen over the last twenty years. The gravest among them are the following:

- There is cyclical unemployment growth;
- Share of investment is constantly decreasing;
- Compared to the competitiveness of the USA and Japan, EU creates less jobs, its share in exporting markets is dropping, earmarkings for scientific and research work are lesser, and scientific discoveries are more slowly introduced in production and to the market;
- It also lags behind in launching new products, especially in computer sector;

¹⁶ Kandzija, V. (2003) *Economic System of European Union*. Rijeka; Faculty of Economics, p. 17

- A serious danger for European economic basis is lately also seen in quick Chinese advancement in production of automobiles, computers and high-technology products, as well as in its penetration to the European market.

At the same time, after disintegration of the Council for Mutual Economic Assistance (COMECON), some of the countries of Central and Eastern Europe set the strategic goal: entry into the European Union as soon as possible. Establishment of the Central European Free Trade Zone (CEFTA) helped them to strengthen regional cooperation, as well as to improve mutual economic and political cooperation, all of which accelerated the entry into the European Union. A feature shared by all these countries was elevated level of production, modernization of capacities and developed forms of trade with the EU, which regardless of the proven deficit in trade enabled significant level of economic growth, and brought political and economic stability to this region.

Regional cooperation represented a great support to these countries, present EU members, in their process of accession to the EU. To be more precise, these countries proved their willingness to cooperate and to be part of the Union, and with their successful cooperation in all fields of economic, political and legal segment, they showed the readiness and capability to be part of the regulated system of EU. Intense growth of the level of EU foreign direct investment in these countries resulted in a gradual change in form and level of manufacture of products that were gradually placed at the EU market and elsewhere. All of this did not go easily, nor was it simple. With trade liberalization within the member states there were problems with benefits granted to these countries by means of accession treaties, and with protectionism within the EU market because of sensitivity of certain goods and tendency of more developed members to protect their markets. Anyway, admittance to full EU

membership crowned their efforts to establish efficient market economies capable of coping with the pressure of the single EU market.

With the fifth enlargement of the Union, from 15 to 25 member states, the market of the Union extended by additional 73 million inhabitants, so the Union now has 450 million inhabitants. There is a widespread opinion that the last enlargement of the Community with new countries (primarily the countries of Central and Eastern Europe) might bring about serious problems for the Community at its present level of integration.

Considering the positions of economically most developed countries of the EU on the accession of new members, Germany alone would benefit the most from the last enlargement towards the East. However, Germany is not very ready to take part in further financing of the reforms of structural and agricultural policies, which are now necessary due to changed structure of new members. Germany found support to enlargement with neighboring Austria and Scandinavian countries. Denmark is the next biggest opponent to the EU enlargement, since rich farmers in this country are among the biggest beneficiaries of the EU common agricultural policy, and they are not so eager to renounce their EU benefits in favor of eastern neighbors. Great Britain, being a provider of net funds to the EU budget is also a great opponent to reforms of common agricultural and structural policies. French support to enlargement is more an expression of interest for strengthening of German-French relations, which, from the French point of view, stems from the earlier period and certain prejudice. Simply, they are also afraid of competition from the countries with lower income. In France, as well as in Italy, there is also fear that the enlargement would bring about disregard of the Mediterranean area, which these countries are not only interested in, but also linked to. With Holland, there is a traditional lack of interest in the East, while the countries of Benelux fear

that the enlargement would cause them to lose their piece of the "cake" of European money, which is now available to them on the grounds of concentration of European administration.

So far, this has been the most expensive, most complex and biggest project of the EU, which cost the EU budget 40.5 billion euros during the first two years following the accession to the Union (2004-2006).¹⁷ Finally, it is difficult to anticipate how thus enlarged Union will work with its present institutions. It cannot be avoided that the new membership requires changes in hitherto "sluggish" structure of the Union, before Eastern countries start suffering from increased pressure from their own bureaucracy from Brussels. The new Constitution of the European Union must show its greater efficiency. If it does not, and if the principle of decision-making in the Union used so far is maintained, it will slow down the solution of many issues in enlarged community, and expose economy to the pressures of "intricate" administration.

Estimates show that the potential long-term benefits of membership are much greater than the costs, for the Community as a whole, as well as for new members. Among multiple benefits there are: important market growth to about 450 million inhabitants, greater investment safety, creation of about 300,000 jobs, acceleration of growth rate, faster technological growth, greater EU safety, strengthening of peace and safety in Europe, etc. Enlargement brings the possibilities for expansion to new markets and purchase of company resources in the EU, which would further increase the global EU competitiveness, produce comparative advantages, and increase the economies of scale.

¹⁷ Integration Office DFA/DEA (July 2003) *EU Enlargement: frequently asked questions*. p. 2 and 3 (online) available at: http://www.europa.admin.ch/eu/info_mat/dossiers/e/erweiterung_faq.htm

Naturally, the new members get much more, but the volume of their gains will in a long term depend on their capability to improve national institutions and contribute to their growth prosperity. Apart from potential benefits, new members undertake certain obligations that include also financial commitments – costs.

It is estimated that the greatest costs in the countries of Central and Eastern Europe will still be caused by approximation of their present legislation to the EU provisions in the field of labor, agriculture and environmental protection. The new Western European regulations will decrease their present competitiveness to foreign investors and require new budgetary allocations. Harmonization of taxation policy is a sensitive issue within the new EU. Higher tax rates that should be applied in the economies of Central and Eastern Europe in near future, under the influence of western neighbors, are preventing and slowing down economic growth of these economies and they might be transferred to consumers, as well as the costs of common agricultural policy.

The consequences of creation of a single market will not be equal throughout European Union. In certain parts of the Union the employment rate will naturally grow, which will in turn cause the unemployment rate to grow in other parts. It is impossible to exclude the emergence of unemployment in certain sectors and regions. The aim is to achieve as harmonized development as possible of the entire community, and to overcome the gap existing between certain countries and regions in order to decrease the lagging behind of the least developed regions fast.

Keeping in mind the enlargement with the countries whose level of development is way below the least developed countries of the Union of the fifteen, the coming decade in the

Union (2005-2015) will be the decade of adjustment and solution of regional problems within the Union, which will influence further the pace of the Union enlargement with new member states. The pace of adjustment will depend, as so far, on the readiness of both parties to overcome the difficulties.

The strategy of further enlargement of European Union with the countries of Southeastern Europe (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro) relies on fulfillment of conditions arising from the Stabilization and Association Agreement that each of the mentioned countries must conclude with the Union. So, the entry of these countries into the European Union will depend on the pace of full integration of the ten new member states of the European Union from 2004.

Obviously, the way to some sort of the United States of Europe, as European visionaries were imagining them – from Victor Hugo to Winston Churchill or more recent creators such as Robert Schuman, Jean Monnet and Jacques Delors, is long, very difficult and still continuing.

APPENDIX B – Chapter 2

Sectoral Policies in the EU

- **Common Agricultural Policy in the European Union**

Industrial countries tend to use various measures to protect their agriculture and farmers from foreign competition, primarily customs, quantitative regulation of imports, bonuses, compensations, etc. Practically speaking, they use agricultural protectionism abundantly. Agricultural protectionism is particularly conducted by the EU member states through common customs tariff, various levies and import taxes, and a whole range of measures to impact pricing and lowering of costs via various allowances to farmers.

About one half of the EU budget is used for the purposes of common agricultural policy, and agricultural *acquis* accounts for about 40 percent of the total EU legislation. EU norms represent about 1,000 measures targeted at guaranteeing product quality and establishment of work requirements and standards in farms. These processes include growth in the number of cattle, growth in the number of plantations, delivery of products to buyers and other, primarily with farmers in France. About 160 measures represent basic requirements. The application of these measures requires establishment of administrative infrastructure, including veterinary agencies and other institutions, certifications and inspections.

The common agricultural policy of EU is founded in the Treaty of Rome of 1957, in Article 39, which defines **the most important goals in agricultural sector**. These are:

- Increase agricultural productivity by promoting technological progress and by optimum utilization of the factors of production;
- Ensure fair standard of living for farmers by increasing earnings;

- Stabilize the market by bringing supply and demand in balance;
- Ensure variety of food supply to local consumers at reasonable prices.

The main elements of common agricultural policy (CAP) comprise:

- Targeted price – guaranteed minimum price;
- Interventionist price – price at which intervention agencies buy surplus agricultural products;
- Entry price – minimum price at which a product may be imported into the EU;
- Levy – tax paid on the price of import products in order to reach the level of entry price;
- Reimbursement – compensation paid to exporters from the EU in order to overcome the differences between higher EU prices and lower world prices.

The achievement of goals set by the Treaty of Rome is done by four methods¹⁸:

- System of variable levies;
- Deficiency payments;
- System of direct incentives to earnings;
- System of quotas.

System of variable levies applies to products such as wheat, sugar, dairy products, beef and pork, table wine, fish products, fruit, vegetables, eggs and rice. Domestic prices are established independently from world prices, and deviations trigger application of import prices (import levy) or money refund provided through export taxes (export levy). The taxes are variable due to price variations at the world market. **Deficiency payments** represent support per product unit and are based on price guaranteed in advance. These payments cover

¹⁸ Dr Hadziahmetovic, A. (2005) *Economy of Europe*, Faculty of Economics, p. 172

the differences between the market and guaranteed prices. **Direct payments on earnings** allow avoiding impact on earnings above price trends at the market. **System of quotas** allows limitation of supply by means of introduction of limits to production growth. The system of quotas is applied in cases of significant agricultural surpluses at the market whose buying mechanisms require additional costs.

European Agricultural Guidance and Guarantee Fund (EAGGF) was established in 1964 as the key financing instrument for CAP implementation. There is two parts of this Fund:

The Guarantee Section accounts for the greatest part of the Fund (about 95%) and finances interventions at the market, refunds of exports of agricultural products outside EU, assistance in food intended for third countries, and amounts for monetary compensation if needed.

The main purpose of Guarantees Sector is support to prices of the main European agricultural products if necessary, in order to ensure the maintenance of farmers' earnings. This is done through four different mechanisms, depending on product in question. These mechanisms together cover 94 percent of all agricultural products in Europe, and the remaining are left to the functioning of free market.

1. About 70 percent of products (including wheat, barley, rye, corn, rice, sugar, dairy products, beef and mutton) enjoy benefit prices, in forms of constant or conditional guarantees of price and sales. When market prices drop below certain level and other conditions are fulfilled, the intervention bodies buy all products offered to them, store them and finally sell in accordance with Union regulations. The market can also be aided by more flexible funds, such as assistance for storage of pork, subsidies for

destination of table wine, and assistance in buying of the surplus of fruits and products by producing organizations.

2. About 21 percent of products (other cereals, quality wines, certain sorts of fruit and vegetables, pork, eggs and poultry) are protected only to the extent to prevent imports from outside the Union at lower prices.
3. Direct subsidies of one or other type are applied to majority of other products (durum wheat, olive oil, oil plants and tobacco). In case of products mostly imported by the Union, low prices are maintained for consumers while minimum earnings are guaranteed to farmers. In case of oil plants subject to variable import levies, the payments for deficiency products cover the difference between world market prices and prices guaranteed to producer.
4. Depending on the number of hectares under crops or produced quantity, lump assistance includes less than 1 percent of products (cotton, hemp, hops, silkworm, seeds and granulated fodder).

The Guidance Section has much more modest funds intended for financing of structural policies. Unlike with the expenditures for guarantees, within this part the co-financing is anticipated – the EU, as a rule, participates with 25 percent in the costs of structural adjustments of agriculture in certain region, and the rest is financed by the state (modernization, re-qualification, infrastructure) or from another source.

In the system of guaranteed prices, EU ministers of agriculture define the prices each year and they are all under pressure from their agricultural communities to fix them at the highest

possible level. As a result, hyper-production is constantly encouraged, which produces huge accumulation of some products (wine pools), while the costs of storage represent additional burdens to the Fund. The most problematic are farmers producing dairy products, whose costs in 1980 absorbed 43 percent of guarantee fund although the share of dairy products in total agricultural production was less than 20 percent. Wheat (15.8 percent) and sugar (10.2 percent) also absorbed disproportionately big amounts of the Fund. Since then, these products were treated more strictly during the annual price fixing and by 2002 the share of dairy products was reduced to 4.3 percent and of sugar to 3.2 percent.

There are frequent disputes in CAP implementation about the payment of export subsidies (also known as restitutions or so-called refunding), in order to enable European producers to be competitive at world markets. In 1986 the costs of export restitutions amounted to 8,600 million ecus, almost 40 percent of the total costs of guarantee fund, although that amount dropped to less than one fourth by 1994.

Two key phases have marked the development of agriculture – the first until the mid-80s: agricultural productionism, with high allocations for modernization and industrialization of agriculture; and second from the mid-80s until present: post-productivist phase, with integration of agriculture in wider economic, rural, ecological and other frameworks. Very strong lobbying of farmers in certain member states and lack of reforms characterized this area, despite high costs of common agricultural policy for EU consumers, international conflicts with the partners of the World Trade Organization (WTO) and potential budget expenditures for introduction of common agricultural policy to new members.

Mentioned aims, elements and methods of CAP have been in force in the EU, and their reforms have been attempted (Mansholt's plan in the late 60s, Guidelines for European Agriculture in 1981, 1992, reform under pressure from negotiations on trade liberalization within the framework of GATT, the most comprehensive reform of CAP).

During the nineties of the twentieth century, it became clear that the initial model of agricultural policy of the Union used thus far must transform in order to adjust to the situation different from that in 1960, and respond to the challenges of the future. The initial model of EU CAP became unsustainable due to the physical (exaggerated impoverishment of agricultural land and disturbed natural environment) as well as financial parameters (budget of the Union was highly burdened by expenditures for financing of agricultural production and expenditures for financing of excessive reserves of agricultural production).

Reformed strategy of agricultural policy tends to maximize the positive experiences with thirty years long application of the model of common agricultural policy and to minimize, i.e. to remove the drawbacks of this model under the conditions of sufficiency and changed circumstances in agricultural sector in the Union and world economy. This was included in the reform package Agenda 2000, the most radical and most comprehensive reform of CAP in the history of the community, intended for implementation over the period 2000-2006. The reform package was based on the following aims and directions of EU common agricultural policy, which are in force also in its present implementation:

- Ensure necessary number of agricultural population to live in European rural ambiance for a longer term (model of European village), keeping in mind that that is the key factor of natural environment preservation, maintenance of traditional

landscape of European village by means of small and medium agricultural properties (family farms) and protection of natural environment from further destruction. Apart from traditional agricultural production directed towards food production, the reformed strategy encourages the development of production of raw materials of agricultural origin.

- Agricultural producers are expected to achieve two important goals: a) to produce sufficient quantities of food and agricultural products at reasonable prices b) and to manage and preserve natural environment using less intensive agro-technical and agrochemical measures. Development of agriculture with new strategy includes the development not only of primary agricultural sector but also of other forms of economic activities that support the maintenance and preservation of natural environment, and particularly of agricultural land, which is conducive to development of total economy of rural area.

- Prevent further development of agriculture on unbalanced basis, piling up of expensive reserves of agricultural products, and inappropriate expenditures for financing of excessive reserves of agricultural products and especially of food products. It is necessary to exercise greater discipline and control in global planning of the volume of agricultural production (needs balancing), especially of food products up to the level necessary to restore the balance between supply and demand for these products in the countries of the Union. That does not mean that the Union is intending to marginalize its position of the leading importer in the world and of the second biggest exporter of agricultural products in the world. On the contrary!

- In the coming period, encourage the extensive as opposed to intensive method of agricultural production for: a) gradual accumulation of surpluses of agricultural products, especially of wheat, beef, dairy products, wine and tobacco; b) providing of production of high-quality and biologically healthy food, while preserving natural environment; v) discouragement of agricultural producers from usage of agricultural production methods that harm the maintenance and preservation of healthy natural environment.

- Improve the age and social structure of agricultural population in villages. Agricultural sector in the Union is facing a grave problem: these are old households. More than two million farmers are older than 65, and two and a half million are between 55 and 65 years old. A half of these farmers have no heirs in their village. Two out of three farmers are older than 55 and they have small properties – less than 5 hectares.

- Allow retirement, timely retirement that is, of farmers when they reach the age of 55. The surplus of cultivable land that might arise in these cases could be used with certain assistance as conserving reserve for the creation of natural buffer zones or small natural oases, or afforestation, depending on local conditions. The minimum obligation of the owner is to use the land with lesser risk of pollution and destruction of natural environment. By means of these programs, the usage of potential input polluters is significantly diminished (fertilizers, herbicides, pesticides).

- Encourage the change in structure of usage of agricultural land by abandoning cultivation of low-quality land and devoting it to another purpose. Since the Union has huge deficits in wood and wood processing, the issue of afforestation of less fertile

land and land with low crop is one of the priorities in the strategy of agricultural development of the Union. Agricultural producers who experience such decrease in earnings will be compensated according to the model of agricultural policy of the Union.

- Institutional prices and common organization of the market are changed but not abandoned. Abandoned is the model of agricultural policy linking the support to development of agriculture (mechanism of maximum guaranteed quantities) with production values.

Apart from these current directions of common agricultural policy in the EU, there are numerous challenges that the EU will face in 2006. A part of them is linked to enlarged market of ten new EU members, costs of enlargement, internal migrations within the EU, budget planning, crises caused by consumers' strict requirements regarding diseases (mad cow disease, GMO, chicken poisoning). In order to ensure the implementation of common agricultural policy, EU has adopted an additional power to protect the internal market of current members against agricultural products from the countries of Central and Eastern Europe, three years after accession. This power was introduced to guarantee the security of movement of agricultural products within single market, but at the same time represents a limitation for products from Eastern countries.

Promises that the EU will change the quotas and tariffs on agricultural exports from the countries of Central and Eastern Europe have never been concretized. An interesting change will happen in 2006, when the budget of the Union for the seven following years is to be discussed. From that aspect, the countries of Central and Eastern Europe may initiate the

cancellation of common agricultural policy and require its actual reform. The road to equal benefits will be long. Due to slow growth of the main EU economies, the EU budget is not growing much more. The countries of Central and Eastern Europe may initiate future distribution of the funds of common agricultural policy in advance and provide more money for their farmers only if other EU countries spend less.

▪ **Industrial Policy of the European Union**

Competitiveness of a country and its products and services in modern times is not based only on inherited assets. Comparative advantages of a country and market imperfections may be accentuated by means of industrial policy measures. It is a challenge to strike a balance and choose the best features between the approach in which everything is left to the market and approach with too many interventions.

The first attempt to establish EU industrial policy dates back to the 70s. Namely, in 1970 the EU adopted the Memorandum on Industrial Policy (the so-called Cologne Report) aimed at sharpening the EU structural policy, and defined action priorities. Later on, in 1973 the EU adopted also the Memorandum on Technological and Industrial Policies Programs (the so-called Spinelli Report) whose main role was to improve information exchange, coordination of national policies that encourage research and development, common projects of research and development, and elimination of national technical barriers. However, due to the oil crisis in 1973 the countries were somewhat less interested in cooperation. The Program of completion of Internal Market (the so-called Cockfield Report) adopted in 1985 represents a significant step in elimination of non-tariff-related barriers to trade and competition. This Program had an implementation plan for 282 draft laws by 1992 and represents a basis for the

program of 1992. In 1987 the Single European Agreement was also adopted, and it represents a basis for further development of the common EU industrial policy. In 1989, it was followed by the European Companies Statute aimed at elimination of current national tax systems for EU companies. The guiding idea arose from the practice saying that business is simpler if the company operates in a constant legal environment. The Document of Industrial Policy in an Open and Competitive Environment (the so-called Bangemann Communication) is aimed at harmonization of industrial policy with other common policies, and at resolution of difficulties between industries and regions by measures of horizontal policy. The Program of Single Internal Market confirms further EU determination to play an active role in creation of a common industrial policy of the EU member states. And finally, at Lisbon Conference in 2000, the EU set an ambitious goal "to become the most competitive and most dynamic knowledge-based economy in the world, capable to maintain economic growth, increase employment and provide greater level of economic equality". A consequence of this goal is that today the EU industrial policy comprises a range of compulsory measures and regulations. Apart from that, there are other measures such as numerous guidelines, communications, resolutions, working documents, reports and conclusions from working groups, sessions and conferences, and a great number of measures and documents that relate to specific sectors (e.g. industrial cooperation, quality promotion policy, environment and industry, certain industry sectors, sectors of innovation, sector of small- and medium-sized enterprises).

Two main areas in which EU still has an active industrial policy are control of state assistance and support to research and development.

- Today, three types of state assistance are considered compatible with the idea of creation of a common market: horizontal assistance at the EU level (e.g. assistance to SMEs, environmental protection, employment and training), regional assistance, and sector assistance. State assistance is gradually dropping in the EU member states (from 3 percent of GDP to 1 percent on average). That is partly a result of the need for the member states to meet the Maastricht criteria for monetary union, and partly of understanding that public management most often does not achieve set goals. The exception is state assistance for regional goals, which grew. The reasons for this can be sought in the regional policy of the EU aimed at promotion of social and economic cohesion within the Union. The programs of support to sectors are also dropping. Although the state assistance is still available to industries with certain problems (the so-called Sunset Industries) it is gradually dropping. Our conclusion is that the state assistance is gradually being put under control although it is hard for the states to renounce that policy instrument. The question is whether that is a result of improvement of economic circumstances, or the state assistance in member states is being replaced with public expenditure at the level of the community.

- When EU spotted that the gap between itself and USA and Japan is widening, concerning scientific and technological discoveries, they started using the instruments of industrial policy in matters concerning research and development, which EU defined through the following measures:

- Incentive to agreements between firms (even the big ones) whose exclusive purpose is development of common research and technological progress, with cooperation staying at pre-competitive basis (i.e. it does not apply to real production) and under the condition that research results be freely available to the members of the consortium, and that they be given to third persons subject to license. Giving to all the firms, small and big, the right to certain

deviation from anti-monopoly rules in the sense to allow long-term agreements on research does not actually mean giving benefits to a certain firm or sector.

- In 1984 EU introduced also subsidies for research and technological progress. EU had realized that it was not necessary to encourage only the sunset industries but also those with increasing perspectives.

- **Energy Policy of the European Union**

The development of energy market, its organization and proprietary relations were not developing in any of the EU countries in line with the previously defined single rules. A greater level of harmonization was achieved only at technical level and in elements that required standardization of equipment production. For all the rest, from economic relations to legislation and proprietary relations, there are specific national solutions, which will continue to exist in the future. Naturally, all the countries of the European Union have undertaken to change the relations in energy sector in line with agreed common standards and rules (Directives of the European Union), but within the framework of possible national solutions.

Reform of Electricity Sector

The sector of electricity has until recently been considered a natural monopoly. The final user had no possibility to choose the supplier, nor individual services. The reform of electricity sector was started in 1997 by entry into force of document entitled EU Directive (EC 96/92) on the Liberalization of the Electricity Market of the EU Member States.

The EU Directive (EC 96/92) sets minimum requirements for opening of electricity market of all the member states of the European Union. Concerning the competition and opening of electricity market, the provisions of the Directive consider the following areas:

- Production of electricity;
- Access to network/system;
- Separation of activities and billing transparency;
- Market opening.

Production: Member states can build new capacities in two ways: upon authorization (approval) and through tendering (competition). The most member states have chosen authorization, which means that the market of electricity production is open to all entities that meet the requirements for obtaining of permit for electric plant construction.

Access to Network/System: In order to allow energy flow through a network from producer to consumer, the network operator is required to allow access to the network in a non-discriminatory manner to all those who meet the technical requirements for access. The rates for access to the network may be regulated or negotiated. The most states have chosen the regulated, which means that the regulator supervises the compliance with rates defined and published earlier.

Separation of Activities and Billing Transparency: In vertically integrated electric companies there is a possibility for network operator to favor its proper electric plants that offer energy to the network, against the interests of other producers. In order to avoid that, the solution is an independent network (system) operator, which simultaneously prevents the flow of confidential information from operator to electric plant.

Market Opening: The threshold for market opening has dropped significantly from the entry into force of the Directive until today. Several countries (Great Britain, Norway, Sweden, Finland) have opened their markets completely.

Reform of Gas Sector in the EU

The reform of European gas sector started by adoption of the EU Directive on Gas Market Liberalization (EC 98/30) for the EU member states: the EU Gas Directive has been in force from 1998. EU member states were obliged to incorporate the provisions of the Directive into their national legislations by 10 August 2000.

The Directive EC 98/30 sets minimum requirements for opening of gas market of all the member states of the European Union. Concerning the competition and opening of gas market, the provisions of the Directive consider the main areas, i.e.:

- Access to transportation system;
- Separation of activities and billing transparency;
- Market opening;
- Storage;
- Regulator.

Access to Transportation System: The Directive gives possibility to member states to choose between the regulated and negotiated access to the network, and it is possible to use combined access. Regulated access means that the countries must calculate and publish the rates for network exploitation and access. In doing so, the role of regulator is to estimate these

rates, publish them and supervise their application. Most countries have chosen regulated approach, while Germany and Austria are using negotiated access to the network. The obligation of regulator in case of negotiated access to the network would be the publication of upper rate limit recommended to the actors in the sector.

Separation of Activities and Billing Transparency: Integrated companies engaged in gas activities should keep separate accounts for transport, distribution and storage of natural gas and, where appropriate, consolidated accounting reports for non-gas-related activities. Special attention will be paid at transparency of costs. So, some of the EU member states have decided to separate the transport from gas supply as a commercial activity within the vertically integrated companies (Austria, Italy, Spain, Holland, Great Britain and Ireland). In the countries that have kept the transport and supply of gas in one company, the task of the regulator is supervision of the behavior of transportation system operator in order to ensure a non-discriminatory access to the network to entities in the sectors that require access to the system/network.

Market Opening: Initially, the threshold for market opening was the consumption of over 25 million m³ per year, and this threshold has dropped with time, so today it amounts to 15 million m³ of gas per year (until 2003). So the markets of Great Britain and Germany are fully open, while Austria, Belgium, Italy, Holland, Spain and Sweden are planning full opening of their markets in the coming few years.

Storage: The access to storage of a third party depends on company.

Regulator: The majority of countries have appointed the regulator to be in charge of electric and gas energy and gas (Belgium, Denmark, Finland, France, Greece, Italy, Spain, and Great Britain). Germany has no gas regulator, but in cases of complaints they rely upon the Market Competition Protection Body.

Current EU initiatives are directed towards providing safety of energy products purchase via promoting international energy trade and investment aimed at strengthening international energy links, enabling internal investment inflow to energy producers, and enabling safe supply with goods and investment, which would be of benefit to the producers as well as to the consumers of energy. Ongoing research program provides for the following:

- Development of environmental protection program;
- Investment in electricity production;
- Investment in oil refining sectors;
- Better transport management;
- More efficient infrastructures;
- Development of program for solar and other forms of energy.

Concerning cooperation with the ten new EU members and future EU members, in the coming period it will be necessary to:

- Implement EU Directives;
- Strengthen the system of transmission operators;
- Provide more efficient coordination system by means of the European Center for Technical Coordination of European Transmission Systems and Cross-Border Electricity Trading;
- Promote transmission system and generate investment by means of stable regulatory environment and tax relief;

- Manage the demand, eliminate price distortion and promote efficiency programs;
- Coordinate standardization and safety of national transmission systems and harmonize technical and administrative rules for interconnectors;
- Revise EU Guidelines for Trans-European Network for better integration of European countries into the European energy market.¹⁹

▪ **Regional Policy of the European Union**

Regional policy is one of the most important EU policies and regional development policy in Europe dates back to the Second World War. Harmonized development of all EU regions is a necessity and a presumption for harmonized development of the entire EU. Every EU member state is solving regional problems, primarily by its own national policy, by means of improvement of its infrastructure with financial support from investors, job creators. European regional policy harmonizes national regional policies in accordance with orientation and certain fixed principles, in order to remove excess assistance between member states. It harmonizes various policies and financing instruments of the EU, giving them a regional dimension and thereby increasing its own influence on regions that need that assistance the most.

The funds for the implementation of regional policy are most often directed to administrative incentives and control of regional development on one hand, and direct investment in production and infrastructure on the other. Individual or combined sources of these funds imply more favorable crediting, tax exemption, incentive to lowering of costs of operation and social security, lowering of costs of energy and public transportation, free locations,

¹⁹ Dr Hadziahmetovic, A. (2005) *Economy of Europe*, Faculty of Economic, Sarajevo, p. 198-199

incentive to labor mobility, participation in investment and similar.²⁰ So, the main aim of the EU regional policy is reduction of present regional disparity and prevention of new regional imbalances via transfer of common potentials of the EU towards regions with economic problems.

Actions of the EU regional policy related to the accession of new members are aimed at reduction of differences between the new members and the EU community average, and lowering of growing internal differences within these future new EU members. The future EU members have aspirations to the EU funds for development of their regions that have great needs for infrastructure development, including environmental protection, productive sector and human resources. Therefore, integral strategies of regional and social development are made, based on which EU funds are later drawn for projects.

The examples of Ireland, Spain, Portugal and Greece show that these countries have developed to a great extent in the late 80s and early 90s after accession to the EU, due to the regional funds directed to infrastructure projects, entrepreneurship development and, especially important, development of human resources. However, at the same time there are concerns about the growth of future regional imbalances among the new enlarged EU of 25 members, where the majority of new countries of Central and Eastern Europe is below the EU average, since regional EU funds are now not sufficient to cover all these regional differences because the growth of EU GDP average does not adequately follow this enlargement.

²⁰ Dr Hadziahmetovic, A. (2005) *Economy of Europe*, Faculty of Economics, Sarajevo, p. 172

APPENDIX C – Chapter 3

▪ Overview of Relations between Bosnia and Herzegovina and EU So Far

Key events in relations between the European Union and Bosnia and Herzegovina so far have been the following²¹:

Table 3.1. Key Relations between Bosnia and Herzegovina and European Union

Year	Relation between EU and BiH
1995, 1996, 1997, 1998 and 1999	Together with the World Bank, European Commission has organized five donors' conferences for rehabilitation of Bosnia and Herzegovina, during which about 9 billion KM of assistance was directed towards BiH. The entire amount of allocated funds has not yet been implemented. Currently, EU assistance to Bosnia and Herzegovina is going through CARDS Program (Community Assistance for Reconstruction, Development and Stabilization), which primarily relates to stabilization, consolidation of democracy, economic reform and regional cooperation.
1997	The Council of Ministers of EU, within its regional approach, sets political and economic requirements for development of bilateral relations with Bosnia and Herzegovina, particularly in the field of trade, financial aid and economic cooperation. BiH is allowed to use autonomous trade preferences.
1998	The Declaration of the European Union shows the future of BiH within the European Union and establishes a framework for closer cooperation. A Consultative Task Force (CTF) EU/BiH is established as a joint body of EU and BiH for consultative assistance in the field of administration, legal framework and policy.
1999	Creation of the process of stabilization and association aimed at stabilization of the countries of the Western Balkans (Bosnia and Herzegovina, Croatia, Serbia and Montenegro, Macedonia, Albania). By this process, European Union undertook to stronger initiatives in the region, but also to higher requirements to these countries in political and economic development and regional cooperation.
2000	Publication of the European Union Road Map for BiH pointing out 16 key steps that BiH should undertake within a short period, before the preparation of the Feasibility Study for opening of negotiations on Stabilization and Association Agreement with the EU. During this year customs-free access to the EU market was expanded for products originally from BiH. The Declaration from the Summit in Zagreb emphasized strengthening of mutual cooperation between EU and five countries of the Western Balkans. These countries undertook to create a free trade zone in the coming ten years, and June of 2001 was set as deadline for BiH to comply with the EU guidelines given in the Road Map.
First Half of 2003	The seminars in Athens and Thessalonica confirmed that BiH and its neighbours are potential candidates for EU accession, while the meeting in Thessalonica elaborated practically the application in the Western Balkans of some of the instruments that have proven efficient in some countries of Central and Eastern Europe.
Second Half of 2003	BiH has prepared answers to 346 questions from the EU that mostly relate to the freedom of circulation of people, goods, services and capital. The questions served as preparation for the visit of EU experts for justice and internal and foreign affairs, who talked with local experts. After that, EU prepared the final opinion on BiH with integral analysis of present situation. European Commission has completed the Feasibility Study on opening of negotiations on Stabilization and Association Agreement. The Study defines the measures BiH must comply with in coming period, so that the Commission would recommend to the Council to start the negotiations on Stabilization and Association Agreement. In economic field, they include customs and tax reforms, budgetary issues, development of single BiH economic space, and trade policy.
First Half of 2005	At the 6 th CTF meeting in May 2005 it was concluded that BiH complied with most of the 18 requirements given in the Feasibility Study, which should allow launching of the negotiations process with the EU on conclusion of Stabilization and Association Agreement. The remaining two issues that require approval of local authorities on the road towards the EU are reform of police forces in BiH and Law on Public Radio and Television Service. The discussions are ongoing within the BiH institutions on the specifics of solutions of these issues. The discussions should allow finding of solutions for these reforms in line with the EU standards, acceptable to BiH, which would allow in case of reaching of agreement the launching of negotiations with the EU on Stabilization and Association Agreement by the end of this year.
Second Half of 2005	EU opened negotiation process with Bosnia and Herzegovina about Stabilization and Association Agreement

²¹ Government of the Republic of Srpska, Ministry of Economic Relations and Coordination (2003) *Information on Relations with the European Union*, p. 2.

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Curriculum Vitae

Natasa Zrilic

Personal Information

Born in 1973 in Zenica, Bosnia and Herzegovina,
Completed primary and secondary education in Banja Luka;

Education

2005 Obtained the title of Master of Science in economics at International postgraduate studies in the field of transition and reconstruction,
1 Master's thesis: Bosnia and Herzegovina and European Economic Integrations

Organized by: University in Banja Luka in cooperation with the London School of Economics, University of Sussex, and University of Bologna (TEMPUS Program);

1997 Obtained the title of graduate in economics at the Faculty of Economics in Banja Luka,
Department: business economy;

1992 Secondary School of Electrical Engineering "Nikola Tesla" in Banja Luka
Department: electronics technician;

Professional Experience

March 2005 – February 2005 Government of the Republic of Srpska
Cabinet of the Prime Minister of the Government of the Republic of Srpska
Advisor for European Integrations and Cooperation with International Organizations

October 2004 – Faculty of Business Engineering and Management, Banja Luka
Assistant for the subject of Global Economy,

April 1998 – March 2005 Government of the Republic of Srpska,
Ministry of Economic Relations and Coordination,
Department of Regional Cooperation and European Integration,

Some Professional Activities so far

January 2005 – ... Member of Coordination Team for monitoring of developments in the field of European integrations in behalf of the institutions of the Republic of Srpska;

July – December 2005 ... Member of the Working Team for making of RS Economic Policy 2006

March 2002 – September 2004 Member of Coordination team in behalf of the Republic of Srpska

for making of Poverty Reduction Strategy in BiH – Development Strategy of BiH;

- June 2002 – July 2004 Quality auditor on IDA project of the World Bank – education;
- January 2000 – January 2002 Member of Steering Committee in behalf of the RS Government on the Gender Equality and Equity Project;
- June 2001 – November 2001 Member of the Working Team of the Ministry on development project of small- and medium-sized enterprises with the Government of Switzerland, SDC;
- April 1998 – April 2002 Government official at the International Aid Coordination and Development Unit – ACDU, supported by the UNDP;

Languages

Serbian (mother tongue), English (very good), Greek (passive),

Professional Papers

- *January 2003: International Economic Relations in Globalization and Influence of Globalization Process on BiH (Republic of Srpska),*
- *October 2002: Privatization in the Republic of Srpska,*
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Trainings

- 07 – 26 June 2004 *Business Development for Women Leaders in Business*
Organization: USA Government, United States Department of State, USA, Washington, Greensboro, Seattle, Kansas City, New Orleans
- 04 – 16 September 2000 *Summer School on Transition in Post-Communist Countries and Europe Integration Processes,*
Organization: University of Bologna, Cervia, Republic of Italy;
- 15 February – 16 March 1999 *Business Management for Bosnia and Herzegovina;*
Organization: Government of Japan, Tokyo, Osaka, Japan;
- 14 February – 06 March 1998 *Projects Implementation and Conflict Management,*
Organization: World Bank and Austrian Center for Peace and Conflict Resolution, Stadtschlaining, Burg, Austria;

Rewards

1988 – "Mitar Trifunovic Uco" diploma;
25 April 1996 – reward for participation in the I Yugoslav competition in management