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# **Rural and agricultural policy in Bosnia and Herzegovina and the EU CAP: development in line with moving targets**

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**Abstract:** Bosnia and Herzegovina (B&H) is a potential candidate country for European Union (EU) accession, however, the situation is dynamic and tasks are complicated. EU Common Agricultural Policy (CAP) has been reformed by the permanent process and further reforms are planned for the period 2014-2020. B&H has to define its priorities and to develop the unique strategy for their own rural territories and agricultural sector; and at the same time to take into account the potential future framework of CAP. Therefore the problematic challenge is to set a consistent policy developed according to strategic needs of Bosnia and Herzegovina and at the same time to proceed with the EU accession process taking into account potential implications of policy reforms. The purpose of this paper is to analyse development of agricultural and rural policy in B&H within the context of CAP after 2013, to draw up financial implications of potential accession of B&H into the EU in terms of rural and agricultural support and to analyse potential integration and competitiveness of agricultural sector in EU common market. Results allow concluding that B&H strategy in the context of evolving CAP and EU enlargement is pragmatic; however, there could be unexpected effects from harmonizing direct support measures in entities. B&H shows a relatively low competitiveness of the agro-food sector comparing to the EU15 while the situation is positive comparing economic indicators with EU12.

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**Keywords:** agricultural policy, rural development, EU budget, comparative analysis, enlargement, Bosnia and Herzegovina

Bosnia and Herzegovina is potential candidate country with the prospects of joining the European Union when the established conditions will be met. Currently B&H is on path of gradual alignment with the *acquis communautaire* including harmonization of agricultural support and implementation of rural development measures (Erjavec et al., 2010), however, as mentioned by European Commission (EC, 2011a), adoption of EU requirements in the area of agriculture and rural development has remained at an early stage. Furthermore, the situation with the EU Common Agricultural Policy is dynamic, and tasks are complicated.

CAP has been reformed by the permanent process and next reform is set up in Regulations proposals for planning period 2014-2020 with respect to new challenges for agricultural sector. Policy measures will be re-considered and the funding and distribution of the budget between countries as well (EC, 2011b, 2011c). Anyway, the future framework of CAP will remain having strong influence on competition conditions within the EU common economic space. Bosnia and Herzegovina has to develop its own unique strategy for development of its rural territories and agricultural sector. Therefore the problematic challenge is to set a consistent policy developed according to strategic needs of B&H and at the same time to proceed with the EU accession process taking into account potential implications of CAP reforms.

The process of integration of new-comers into the EU common market since last enlargements in 2004 and 2007 have stressed an interdependence of economic and political issues as the concept of Old Member States (OMS) and New Member States (NMS) is still outstanding (Bandovića et al., 2010). OMS here are considered as EU15<sup>1</sup>, and NMS - as EU12<sup>2</sup> countries. The primarily considered positive economic effect from free trade with agro-food products left the other possible effects generated by CAP not sufficiently assessed. The key issue for accession is the competitiveness of the agriculture and related economic sectors which has been mostly forgotten in the debates on the accession impacts and necessary policy reforms. Up to accession attention should be given to get economics as competitive as possible, and gradual EU-like policy programming and implementation in B&H could assist for that for successful integration. Therefore an increase of agricultural competitiveness should be the first priority of the policy. And CAP with substantial financial means could help with this in pre-accession and accession process and also later, could be a target for B&H and should not be underestimated.

The paper is structured as follows. The methodology of the research is presented. The characteristics of Bosnia and Herzegovina rural and agricultural

<sup>1</sup> Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, United Kingdom.

<sup>2</sup> Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia.

policy and the EU CAP after 2013 proposals in terms of objectives, measures and level of funding are given. The calculation of potential EU funding for B&H 1st and 2nd Pillar envelopes in case of B&H accession into the EU in 2020 is drawn up. The results of comparative analysis regarding potential of integration of B&H into common EU market of agricultural and food products in comparison with EU15 and EU12 countries and agro-policies serving for that are given. Finally, conclusions regarding agricultural policy in B&H in light of competitiveness, potential accession and CAP reforms are derived.

## **Objectives, methodology and background**

The purpose of this paper is to analyse development of agricultural and rural policy in B&H within the context of CAP after 2013, to draw up financial implications of potential accession of B&H into the EU in terms of rural and agricultural support and to analyse potential integration and competitiveness of agricultural sector in EU common market.

The method of the research is comparative analysis. In order to reach the objectives defined for this paper the methodology which includes the following steps has been applied:

- qualitative analysis of legal documents related to rural and agricultural policy with respect of policy objectives, instruments and measures;
- qualitative and quantitative analysis of support level and criteria for its distribution;
- application of socio-economic and policy indicators for quantification of objective criteria in order to establish the ceilings for policy support in B&H under 2nd Pillar budget after accession. Calculation of potential allocation of 1st Pillar direct support budget.
- quantitative analysis of economic situation in agriculture and rural areas in B&H, EU15 and EU12 in terms of gross value added (GVA), productivity in agriculture, trade with food products and agricultural and rural support;
- comparative analysis of competitiveness and potential integration based on productivity and trade indicators for B&H, EU15 and EU12;
- evaluation of consistency and sustainability of agricultural and rural policy of a country in the context of evolving CAP and EU enlargement paying attention to economic integration conditions from the point of competitiveness.

According to Balassa (1961) the economic integration can take five forms that represent increasing degrees of integration: a free-trade area, a customs union, a common market, an economic union, and a complete economic integration. The EU has been selected as the only example of economic integration having gone through the various stages up to an economic union. The research on the common market, transition issues, the Economic and Monetary Union and EU enlargement are illustrative that the integration goes in line with the political developments, and is very much a response to the signals emitted by the political centres and actors. According to that an important issues are the degree of

structural asymmetries between the members of an integration arrangement; and impact of the agreement on economic development. In several research, the integration processes built on asymmetric groups where a leading country/countries perceives enough benefits to justify the provision of the collective good (the integration agreement) has been expected to be the more dynamic and effective ones. In other research it has been assumed that the basic precondition to start a stronger regional integration process is a stronger domestic development experienced by each country in the region combined with the political and social willingness of the majority of the members to build the trade block. And there should not be large margin of difference in the domestic development (political, social, economic and technological) among its members (Estrada, 2009).

The role of agriculture and CAP has often been misunderstood or underestimated in the European integration processes and the decision-making system. This is also due to the complexity of CAP and strong ideological connotation of these issues. The experience of integration processes in other countries shows that agriculture is one of the most demanding sectors and certainly a sector with the most extensive obligations during the accession process (Vassiliou, 2007).

## **Development of rural and agricultural policy in Bosnia and Herzegovina and the EU CAP**

Strategies, programs and legal acts for implementation of rural and agricultural policy in case of Bosnia and Herzegovina are developed at two main levels:

- B&H state level - Law on agriculture, food and rural development; Strategic plan of harmonization of agriculture, food and rural development of B&H for 2008-2011; Operational program of harmonization of agriculture, food and rural development of B&H for 2008-2011; programming of financial assistance under the Instrument for Pre-Accession Assistance (IPA);
- Entities level of Federation of Bosnia and Herzegovina (FB&H) and Republic of Srpska (RS) and Brčko District (BD) – Mid-term strategy for development of agricultural sector in FB&H for 2006-2010 (the extension for two more years has been approved); Strategic plan for development of agriculture in RS up to 2015; Strategic plan for rural development of RS in period of 2009–2015.

To proceed successfully with adoption of EU rules and obtaining the EU pre-accession funding B&H has to develop programs and legal acts at the state level. For that both entities have to deliver their own strategic plans which often become an impede factor for further progress. Agriculture plays more important role in economy of RS than in Federation of B&H, FB&H has not prepared yet its entity's level strategy for rural development, and due to that the country-wide rural development strategy cannot be developed as well.

The amended Law on financial support to agriculture and rural development of the Federation defines the types of incentives between Cantons and the Federation. However, due to the absence of a rural development strategy, product subsidies feature much more prominently in the financial support structure than rural development measures. Country-wide Law on wine which is in the spotlight of EU regulation remain to be adopted as well.

The lack of progress in coordination between the State and Entities in alignment with the *acquis* in agriculture and rural development has a negative impact on trade with agricultural products. Development of a functioning system to implement the food safety *acquis* remains a priority to increase trade in agricultural products. Implementation of Operational program is still needed for preparations for the Instrument for Pre-Accession Assistance for Rural Development (IPARD) (EC, 2011a). If country prepares to function in a common market under the CAP, understanding, programming and implementing agricultural policy is of crucial importance. Setting up an efficient support structure for monitoring agriculture and agricultural policy is a part of the accession process which is often underestimated by government structures; its absence could jeopardize the meeting of political goals of accession process.

The CAP frame already relevant for the B&H is composed of pre-accession support for rural development measures. The main accession tasks which can be done also in pre-accession process are (Erjavec, 2008):

- Legal harmonisation of four main CAP legal systems (direct aids, market interventions, rural development, financial rules);
- Policy reforms and economic adjustments. The agro-food chain and rural economies have to be modernised and prepared for a „soft landing” into CAP framework after accession. The main objectives have to be to increase competitiveness and provide income alternatives for rural inhabitants.

The CAP is in a constant reform process and therefore is a moving target. In future EU agricultural sector must respond to the new challenges of climate change, environmental degradation, pressing concerns in relation to food security, territorial balance and the pursuit of sustainable growth. Faced with these challenges, the forthcoming CAP reform is targeted to result in a greener policy unlocking economic potential in rural areas, accompanying the restructuring of agriculture and supporting farmers’ income to maintain a sustainable agriculture sector throughout Europe. The reformed CAP will promote resource efficiency in order to maintain the production base for food, feed and renewable energy across the whole EU and supporting diversification of economic activity in rural areas so as to promote balanced territorial development throughout Europe. 1st Pillar will continue to provide direct support to farmers and to support market measures. Direct support and market measures are funded entirely by the EU budget, so as to ensure the application of a common policy throughout the single market. 2nd Pillar of the CAP will continue to deliver specific environmental public goods, improve the competitiveness of the agriculture and forestry sectors and promote the diversifica-

tion of economic activity and quality of life in rural areas. Rural development policy retains the long-term strategic objectives in line with the Europe 2020 strategy. Member States have flexibility in the design of the measures, based on specific national and regional needs but reflecting EU priorities. Measures in 2nd Pillar are co-financed by Member States, which helps to ensure that the underlying objectives are accomplished and reinforces the leverage effect of rural development policy. With most measures potentially serving more than one objective or priority, current axis system will be abolished as the programming on the basis of priorities should ensure balanced programmes. The current cooperation measure is extended to support a wide range of types of cooperation (economic, environmental and social).

The main priorities of agricultural and rural policy included in Operational Program of Bosnia and Herzegovina (2008) are:

- 1st Priority Area: Establish the required institutional capacity, coordination and implementation mechanisms, at all levels;
- 2nd Priority Area: Enhance the quality and safety of domestic products with a competitive advantage in production, processing and trade;
- 3rd Priority Area: Support primary production with direct farm support measures to gradually align between entities and with EU measures;
- 4th Priority Area: Increase competitiveness of the agro-food sector of B&H through indirect support measures for production, processing and trade
- 5th Priority Area: Protect the rural environment of B&H through support for agro-environmental programmes;
- 6th Priority Area: Diversify rural activities and improve the quality of life in rural areas.

However, these priority areas are only the plan and just have started to be implemented. There is no unified policy even between entities for providing subsidies which mostly are product-based and not aligned with the EU agricultural policy type of measures. The lack of an efficient administration and effective rural credit schemes impedes the competitiveness of farmers and the agro-processing industry throughout the country.

Budgetary support for agricultural producers is the only form of possible policy mechanisms which is fully functional in B&H. Ministry of Foreign Trade and Economic Relations of Bosnia and Herzegovina (*MVTEO BiH*, 2011) has reported that in 2010 it accounted 84.7 million EUR reaching again the level of 2008 which due to B&H budgetary crises has been reduced in 2009. According to OECD classification for market support measures has been spent 6% of total budgetary support, 37% - for rural development support, the major part or 49% - for direct producers' support, and the rest or 8% - for general and other support. In recent years, direct producer support has been the main element of agricultural budgetary transfers, however there can be observed diverse inner structure of support in B&H. In 2010 in RS rural development support was higher the level of direct support while in FB&H and BD direct support remained dominant. In B&H there are four types of direct support:

i) payments based on output; ii) payments based on area or animals; iii) payments to reduce input costs; iv) other compensatory payments. Direct payments based on output have been dominating in RS followed by input subsidies while in FB&H output and area/animals based payments was of the same amount, but having almost no input subsidies. BD has only area/animals based direct payments. Major part of output based payments is paid for milk production. Input subsidies are paid to reduce input costs for diesel and fertilizers used in crop production. Other compensatory payments are mostly related to crops and animals diseases. Payments based on output, area and/or per head payments and input subsidies are in forms of support that are not in agreement with the reformed Common Agricultural Policy.

Rural development funds mainly have been intended for restructuring of agriculture through investment support increasing competitiveness (64% of total rural development funding) and have been gaining importance as preparations for the approaching accession continue. In 2010 significantly increased payments devoted to improvement of rural infrastructure and also for diversification of economic activities in countryside (32% of rural development funding). In such a way country has been preparing to implement rural development policy according to EU measures. However, only a small proportion of funds are related to environment measures. General awareness of the environment, less favoured areas and animal welfare issues is relatively low. This policy is not a priority, which is in a way understandable, as it is difficult to find interest and rationale for such measures in the areas facing rural poverty and subsistence farming.

The EU enlargement especially in 2004 and 2007, when the poorer countries of Central and Eastern Europe joined the EU, has increased both economic and political diversity between members, and the issue of economic convergence became of increased importance. Unfortunately current policy does not serve the base for equal competition (Salputra, 2011). Unequal support level for producers in the EU Member States is one of the reasons which determine unequal competition conditions on the market. Higher support for product allows putting this product on the market with lower price compared to other producers and gives competitive advantage for certain countries. Those issues could explain the slow progress of integration within the EU common market where observed policy asymmetries would lead to economic development asymmetries.

### **Potential financial implications of accession of B&H into the EU on agro-rural support**

The Multi-year Financial Framework (MFF) proposal for 2014-2020 provides that significant part of the EU budget should continue to be dedicated to agriculture, which is a common policy of strategic importance. The framework set out in the MFF foresees that the CAP should maintain its two-pillar structure with the budget for each pillar maintained in nominal terms at its 2013 level

and with a clear focus on delivering results on the key EU priorities. Thus, in current prices, the CAP should focus on its core activities with EUR 317.2 billion allocated to 1st Pillar and EUR 101.2 billion to 2nd Pillar over the 2014-2020 periods. The distribution of rural development support should be based on objective criteria linked to the policy objectives taking into account the current distribution. That is complemented by additional EUR 17.1 billion consisting of funding for research and innovation, food safety, food support for the most deprived persons and new reserve for crises in the agricultural sector and participating in European Globalization Adjustment Fund, thus bringing the total budget to EUR 435.6 billion over the 2014-2020 period (EC, 2011b). Assuming potential accession of Bosnia and Herzegovina into the EU in 2020, the MFF and Regulations proposals can be used for preliminary calculation of EU funding potentially available for direct payments and rural development in B&H. According to EC (2011c) direct area payments in EU27 countries in 2020 still could vary from 141 EUR/ha up to 420 EUR/ha. The average rate for EU12 is proposed at the level of 218 EUR/ha. National ceiling for direct payments in B&H in this study will be quantified based on assumptions of B&H accession into the EU in 2020 and funding for direct payments negotiated not lower than minimal rate and not higher than average EU12 rate. The funding for 1st Pillar dedicated to B&H can be estimated for utilized agricultural area 1.7 million ha. In case that gradual phasing-in of EU direct payments will be applied for B&H, in 1st year of accession they would be reduced to 25% of the full envelope and reach 35–55 EUR/ha. Based on these assumptions we can estimate that in temperate scenario potential inflow from direct subsidies in 2020 could be around EUR 58 million (see Table 1). So, in case of accession the financial implications of policy comparing to current direct support level in B&H could be an increase by more than one third.

**Table 1. Criteria for allocation of rural development support and potential level of EU funding in Bosnia and Herzegovina in 2020 comparing to EU15 and EU12**

Indicators	Bosnia and Herzegovina	EU15	EU12
Utilized agricultural area (UAA) eligible for direct payments, thsd. Ha	1 656	117 612	43 455
Agricultural labour, thsd.	166	4 420	4 941
GDP in pps per capita, index EU27=100%	30%	110%	61%
Direct support in 2010, thsd.EUR	41 113	35 924 122	5 641 493
Rural development support in 2010, thsd.EUR	31 533	16 873 708*	6 926 097*
Potential funding for 1st Pillar in 2020, thsd.EUR	58 000**	33 316 078	9 464 201
Potential funding for 2nd Pillar in 2020, thsd.EUR	130 000**	16 873 708	6 926 097

\*- including EAFRD and national funding, average per year of 2007-2013; \*\*- authors' estimations.

Source: Agency for Statistics of B&H; Eurostat; MVTEO BiH; IACS statistics of EU Member States; Proposal for Regulations (EC, 2011c; 2011d).

For allocation of aid for rural development in the EU three criteria mentioned in current regulations are used – agricultural area, labour in agriculture and GDP in purchasing power standard per capita. In 2010 agriculture employed 166 thousands of economically active people or 19.7% of total employment in B&H, and that is also reflected by GDP. As in the current case, less developed regions should continue to benefit from higher co-financing rates. Calculation for B&H based on application of economic indicators on current 2nd Pillar budget for EU12 has been done by the following equation:

$$2Pillar_{B\&H} = \frac{UAA_{B\&H} * GDPpps_{B\&H}}{UAA_{EU12} * GDPpps_{EU12}} * 2Pillar_{EU12},$$

Funding for rural development comparing to current level in B&H could increase significantly - more than four times.

## Results from comparative analysis

Comparative analysis of B&H and the EU will allow answering on two questions. The first one is – do the situation with agricultural productivity, trade and support is sufficiently similar to ensure integration of B&H into common EU space, meaning, would it be competitive within it? The first answer will help to answer also the second question – how to proceed in the best way in pre-accession and accession process in order to obtain the high as possible level of competitiveness until entering the EU, that means, should B&H switch directly to EU policy or taking into account its economic and budgetary situation would have „an excuse” for not applying policy in the EU way already now, but to switch somehow gradually? Comparison of support for agriculture and rural development available being within EU with that one available now should allow to plan the future situation and to prepare B&H for that, however, uncertainty factors should be taken into account because direct support for farmers can be adjusted in short terms while rural development policy is more considered as long term policy.

The indicators are defined for measurement of integration progress related to policy and economic dimensions. CAP as being common should be similar at least in objectives for all countries of the EU. The policy indicators show the level of support. The economic indicators are related to productivity and trade balance issues. The last ones make strong further consequences for countries position in the EU common market. The productivity levels reflect how countries would capture the possible fluctuations in product and factor prices; trade balance for food, drinks and tobacco reflecting the dominance and its tendencies of country groups in extra and intra EU market. The main indicators will be comparatively analysed at the level of B&H, EU15, and EU12. Member states are split into old and new member states in order to follow how different groups can compete within the common market.

Compared to the EU, support level for agriculture and rural development in B&H is relatively low. However, a low level of budgetary support is not unu-

sual for the countries at such a level of economic development and is comparable with levels in the new Member States prior to accession.

**Table 2. Comparative analysis of economic and policy indicators in Bosnia and Herzegovina, EU15 and EU12 in 2010**

Indicators	Bosnia and Herzegovina	EU15	EU12
Gross value added in actual prices in agriculture, mio EUR	782.4	123,123.7	20,685.9
Share of agriculture in GDP	7.6%	1.2%	2.5%
Labour productivity in agriculture as GVA per employed, EUR/person	4 712	27 856	4 187
Land productivity in agriculture as GVA per area, EUR/ha	472	1047	476
Direct support, EUR/ha	25	305	130
Rural development support, EUR/ha	19	143	159
Net trade of food, drinks, tobacco with EU27, mio EUR	-284	5833	-2633
Net trade of food, drinks, tobacco with other countries than EU27, mio EUR	-642	-7341	2976

Source: Agency for Statistics of B&H; Eurostat; authors' calculations

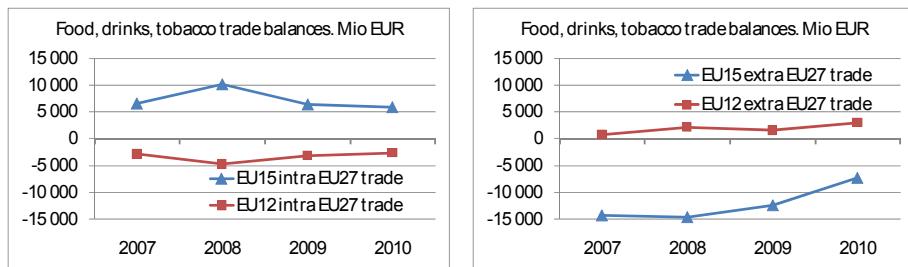
### **B&H, EU15 and EU12: comparing a productivity in agriculture**

Productivity of production factors is very important to succeed in any market. It can be compared between different groups of countries in order to find out is there the case of equal economic development needed as one of preconditions to perform a successful integration. Agricultural land and labour productivity reflected in Table2 show that productivity in terms of gross value added attributed to land is similar in B&H and EU12 while in EU15 it is twice higher. Labour productivity in B&H in 2010 even exceeds EU12, but comparing with EU15 the difference is huge – around six times lower. The troubling issue is that there has not been observed convergence in productivity levels for EU15 and EU12 despite the implemented agricultural and rural policy which should have more enhanced competitiveness of agriculture in EU12.

### **B&H, EU15 and EU12: comparing an extra and intra EU trade**

Bosnia and Herzegovina is net importer of agricultural and food products. The majority of agro-food external trade takes place with the neighbouring countries Croatia and Serbia, at the same time trade integration with the EU remains high as well. The productivity and the competitiveness of the economy are weak. Regarding potential integration into the common EU market there can be taken some learning from EU12 experience. Figure1 show that extra-EU trade balance for food, drinks and tobacco for EU15 has remained negative. At the same time joining to the EU provided a benefits for EU12 growing their exporting capacity outside the EU. The opposite situation can

be observed in terms of intra trade within the EU. EU15 has stable positive balance while EU12 balance in EU common market remains negative.



**Figure 1 EU15 and EU12 trade balances for intra and extra EU27 trade with food, drinks, tobacco**

Source: Eurostat; authors' calculations

The level of competitiveness is different and show more the regionalism process within the EU rather than integration. At some extent it can be explained by unfair competition conditions on EU common market resulting also from CAP – average direct support per ha in EU12 has been more than twice lower than in EU15. Considerable further reform efforts will be needed to be pursued to enable B&H to cope over the long term with competitive pressure and market forces within the EU.

## Concluding remarks

Potential year of B&H accession into EU would be close to the beginning of next planning period and probably to new reforms of EU CAP. Therefore measures of agricultural and rural policy in B&H should be implemented according to the strategic needs for country economic development and using opportunities provided by EU in terms of technical and financial support for development of transparent legislative and institutional systems.

The priorities set in strategic plans for development of agriculture correspond to the EU policy objectives. At the same time agricultural policy in B&H which currently has no real CAP implementation and provides quite low level of support could be successful for increasing of the level of competitiveness of agriculture before accession. A rational and gradual introduction of CAP-like elements taking into account the impact on competitiveness should be continued. At the same time inconsistent between entities direct support policy would be impeding factor for accession process and for successful integration into EU market after that as well.

One of the basic pre-conditions for regional integration – the stronger domestic development of each country in the region, and a small margin of difference among its members for EU15 and EU12 still has not

been fulfilled. Different level of productivity combined with the different CAP conditions hinders the integration process in the EU common market. The empirical assessment of support, productivity and trade variables show the development asymmetries in both – policy and economics trends related to agribusiness and show more the regionalism process within the EU rather than integration. B&H shows a relatively low competitiveness of the agro-food sector comparing to the EU15. At the same time the situation is promising comparing economic indicators with EU12. This could lead to positive effects after opening of the borders after accession, but only in the case that all necessary food safety conditions established by EU rules will be introduced in B&H. Strategic investment in food processing could contribute to efficiency for both agriculture and the overall economy as well.

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