

BUDGETARY SUPPORT TO AGRICULTURE IN BOSNIA AND HERZEGOVINA, AND EURO - AND WTO INTEGRATION PROCESSES

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Abstract

Bosnia and Herzegovina (BiH) and its agriculture are facing big challenges - from gradual approximation to full adoption of the EU Common Agricultural Policy (CAP), and full membership in the World Trade Organization (WTO). The budgetary support to agriculture in BiH is still far from the above integration processes both in qualitative (types of measures, criteria for support, ways of implementation) and in quantitative terms (budgetary transfer amounts both in total and per unit). Although these integration processes are a strategic determination for BiH, they can also contribute to the continuation of numerous negative trends in a larger number of agricultural subsectors in BiH. In order to avoid possible negative consequences and in order for BiH to best prepare for needed integrations, it is necessary to initiate certain reforms of budgetary support to agriculture in BiH. The comparative analysis of agricultural policy of BiH and EU CAP indicate a still large gap between them and a significant difference both in the range and structure of measures. In both BiH entities, direct payments based on output make a larger part of direct support to producers; whereas, they almost do not exist in the EU countries. Regarding the WTO integration, the support policy in BiH is mostly based on the measures that are subject to limits in WTO (Amber Box measures) and as well that several key agricultural products considerably exceed the *de minimis* threshold of 5%. This can be a big problem, particularly from the angle of continuation of implementing some agricultural support measures after the BiH membership in WTO.

Key words: *agricultural policy, Bosnia and Herzegovina, budgetary support, CAP, EU, WTO*

Introduction

Agricultural policy in BiH is carried out at several distinct levels because of the political system complexity. Without a single national ministry that would cover the field of agriculture, agricultural policy management is partly handled by the Division for Agriculture, Food and Rural Development within the Ministry of Foreign Trade and Economic Affairs. The entity level of creating and implementing agricultural policies is composed of separate ministries of agriculture, water management and forestry in Federation of BiH (FBiH) and the Republika Srpska (RS) and they, along with the Division for Agriculture within the Government of District Brcko (DB), are the most important institutions competent for agricultural policy in BiH. In addition to the entity level, FBiH has also the cantonal level (10 cantonal ministries) where the management of agricultural policy considerably determines the overall position of agricultural producers and the sector as a whole. The budgetary transfer amounts, agricultural policy measures, rural development policy and criteria to support producers are only part of the policy that is under the exclusive competency of the entity/cantonal ministries of agriculture, i.e., the Division for Agriculture within the Government of DB. In fact, agricultural policy in BiH does not exist; it is rather an aggregation of policies by entities and cantons without much coordination among them. Such

policy is unstable, very often depends on political orientation and more determined to serve to a "higher interest" than strategic goals. Incomparability of the policy is not a problem for itself but a fact that testifies about the populism and lack of strategy and vision in the politics (Bajramović et al., 2010a).

Based on previous experiences of EU integrations some conclusions useful for BiH can be made. There a lot of critics on CAP (Atkin, 1993, Ritson and Harvey, 1997, Tracy, 1997, Sapir et al., 2003) in the literature, but BiH, if wants EU membership, should incorporate itself into CAP mechanism (Erjavec, 2004, Harrop, 2000). The countries with clear aspirations toward the EU integration have to take over the concepts, mechanisms and implementation systems of CAP at the very beginning. (Erjavec et al., 2010, Bajramovic et al., 2010b). CAP is a complex system of legal regulations, budgetary support and public regulatory interventions that considerably affect the situation in agriculture and rural areas in the EU. Gradual adaptation to CAP measures and instruments in the pre-accession period aims to prepare the country for effective integration into a complex institutional and legislative EU CAP system. An additional value of this process derives from the fact that this is the way for agricultural producers in a (potential) candidate country for the EU membership to prepare timely for a significantly different approach such as the CAP planning and implementing. Significant differences in the range and way of implementing agricultural policy measures make the EU accession a challenge for every candidate country, particularly for less-developed countries such as BiH. Because of continuous changes, it is often said that CAP is a "moving target" for all EU candidate countries (Erjavec et al., 2010, Salputra and Erjavec, 2012).

Membership in the WTO, as second targeted integration for BiH requires different, but no less reforms that are primarily related to the mechanisms and types of supports to agriculture and rural development. Actually this is a limitation of the total budgetary support (base AMS – Aggregate Measurement of Support) and the limitations related to certain measures that can be used in support. One of the important obligation that BiH will have after joining this organization (has not been in focus until recently) is the harmonization and coordination of agricultural policies at all levels of government. This includes the same criteria for creating, implementation and control of agricultural policies.

The aim of this paper is to determine the current budgetary support to the agricultural sector in BiH and the achieved level of the EU CAP convergence. Furthermore, the paper will present structure of the support according to the WTO classification of measures aiming to find out to what extent the domestic budgetary support complies with the provisions of the Agreement on Agriculture (AoA) of WTO agreement. Based on the results obtained recommendations are offered on how to improve the integration processes.

Material and methods

For the analysis and the comparison of agricultural policy of Bosnia and Herzegovina as country preparing for the EU accession with the CAP it was used a methodological tool called the APM (Agri-Policy Measures), developed by Rednak and Volk (2010). A uniform classification of agricultural budgetary support was created using the current EU concept based on the policy pillars as a basic starting point, combined with the OECD PSE classification. The EU program aspect (pillars, axes) has been applied at higher levels of aggregation, whilst setting forth the OECD PSE criteria for the formation of groups or subgroups under individual pillars and particularly for defining the lowest level of classification (basic headings). Thus, the APM allows for a rough analysis of budgetary transfers to agriculture also according to the OECD PSE classification and *vice-versa* (Volk et al., 2012). For determination of achieved WTO integration processes we used WTO AMS methodology¹ that categorizes incentive measures into three groups, i.e. in three boxes:

¹ Source: Ministarstvo vanjske trgovine i ekonomskih odnosa (2002)

Amber Box, Blue Box and finally the Green Box. According to this classification, measures which are classified in the Amber Box are directly related to production of, either individual products or all agricultural products in general and as such they have the greatest impact on trade. The amount of these measures is determined by appropriate AMS methodology into single AMS indicator. AMS calculated from the base period is the subject of observed decrease in percentage and time interval. Blue Box measures are measures within the framework of the so-called limiting production program, while Green Box measures may not have or may have only a minimal distortion effect on the trade (Gorter and Ingo, 2002). Source of data for all figures regarding agricultural policy in the paper was own calculations based on available public data and internal documents of entity's (DB) ministries of agriculture and cantonal ministries (departments) of agriculture of FBiH compiled in APM database created through the FAO-SWG project (2014).

Results and discussion

Budgetary support to agricultural sector of BiH

The total agricultural budget in BiH in the observed period 2002–2012 continuously increased, with some minor fluctuations in the years of the global economic crisis and its consequences on BiH.

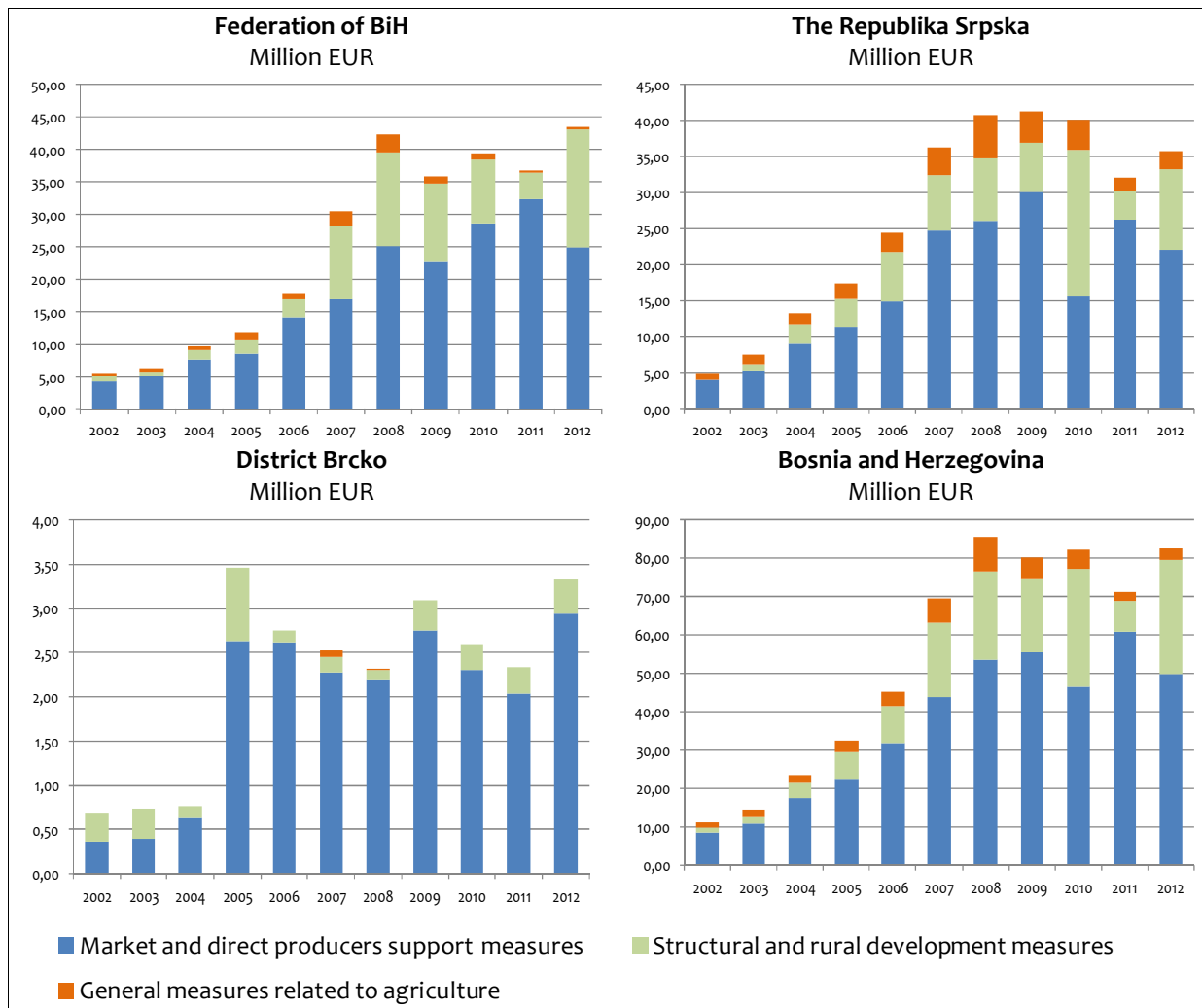


Figure 1: Budgetary support to agriculture according to group of measures in BiH (total and per entities and District Brcko) for period 2002-2012

In 2002, the total budgetary transfers to agri-food sector at the country level amounted to EUR 11.12 mil., and increased almost eight times in 2012, reaching EUR 82.73 mil. The main characteristic of the observed period is the fact that support funds for agricultural sector

have been considerably increasing since 2007 as a result of increased budgetary revenues and introduced value added tax.

Agricultural policy of BiH and its entities (including the district) is composed of three pillars, i.e., groups of measures, as follows: Pillar I – Market and direct producer support measures, Pillar II – Structural and rural development measures and Pillar III – General measures related to agriculture. In FBiH Pillar I policy measures (market and direct producer support measures) dominate in the structure of budgetary transfers and account for average 70% of the total agri-food budget in the observed 11-year period, making up even nine-tenth of the entire support in some years, as was the case in 2011. The second group of measures by importance are structural and rural development measures, while Pillar III and its general measures related to agriculture form the smallest part of the total sector support, and that is one of the reasons for the farmers' poor knowledge of science, a low level of sector promotion and marketing, and generally insufficient institutional capacity building in the sector (Bajramović et al., 2014). Similar positive tendencies of increase in agricultural budget were also present in RS. Except in 2010, the sector support mainly covered Pillar I market and direct producer support measures, the share of which was 62%–82%. Structural and rural development measures came second in the total agricultural policy in this BiH entity, and unlike FBiH, RS paid much more attention to Pillar III policy and general sector support, which had regularly accounted for more than 10% of the total budgetary support until 2011. This is probably one of the reasons why this BiH entity has better institutional capacities in this sector, including a very important field of knowledge transfer and the role of agricultural advising in it.

When we talk about direct producer support measures (figure 2), the structure of share differs, depending on the entity. So, in FBiH direct support to producers mostly pertained to direct payments and was the most popular support measure. Unlike FBiH, support to variable inputs in RS has a significant share in direct support to producers, in addition to direct payments. This was particularly evident during 2009–2012 with the exception of 2010, when the share was one-third (2009) to one-half (2011) of the total funds allocated for Pillar I policy in this BiH entity. Figure 2 evidently shows that direct payments based on output dominate over the payments based on current area/animal in the structure of direct payments to producers at the BiH level over the entire observed period. In this, there is a clearly different entity approach to this group of policy measures. Direct payments based on output in RS had been the only direct payment to producers until 2005, when the payments based on current area/animal were introduced. The latter payments had a considerable share in this group of policy measures including the year 2008, but during 2009–2012 direct payments based on output became topical again, accounting for average 85% of all direct payments. Bulk of these payments were intended for milk producers who were mostly paid on the basis of produced amounts or amounts bought from them, and among other production types, support to the producers of arable crops, fruit and vegetables should be mentioned. Although payments based on output still have a large share in FBiH, it is encouraging that the payments based on current area/animal increase its share because it is a measure toward the harmonization with EU CAP and WTO integration processes. The support based on current area/animal is practically the first step in the transition of support policy toward EU CAP arrangements.

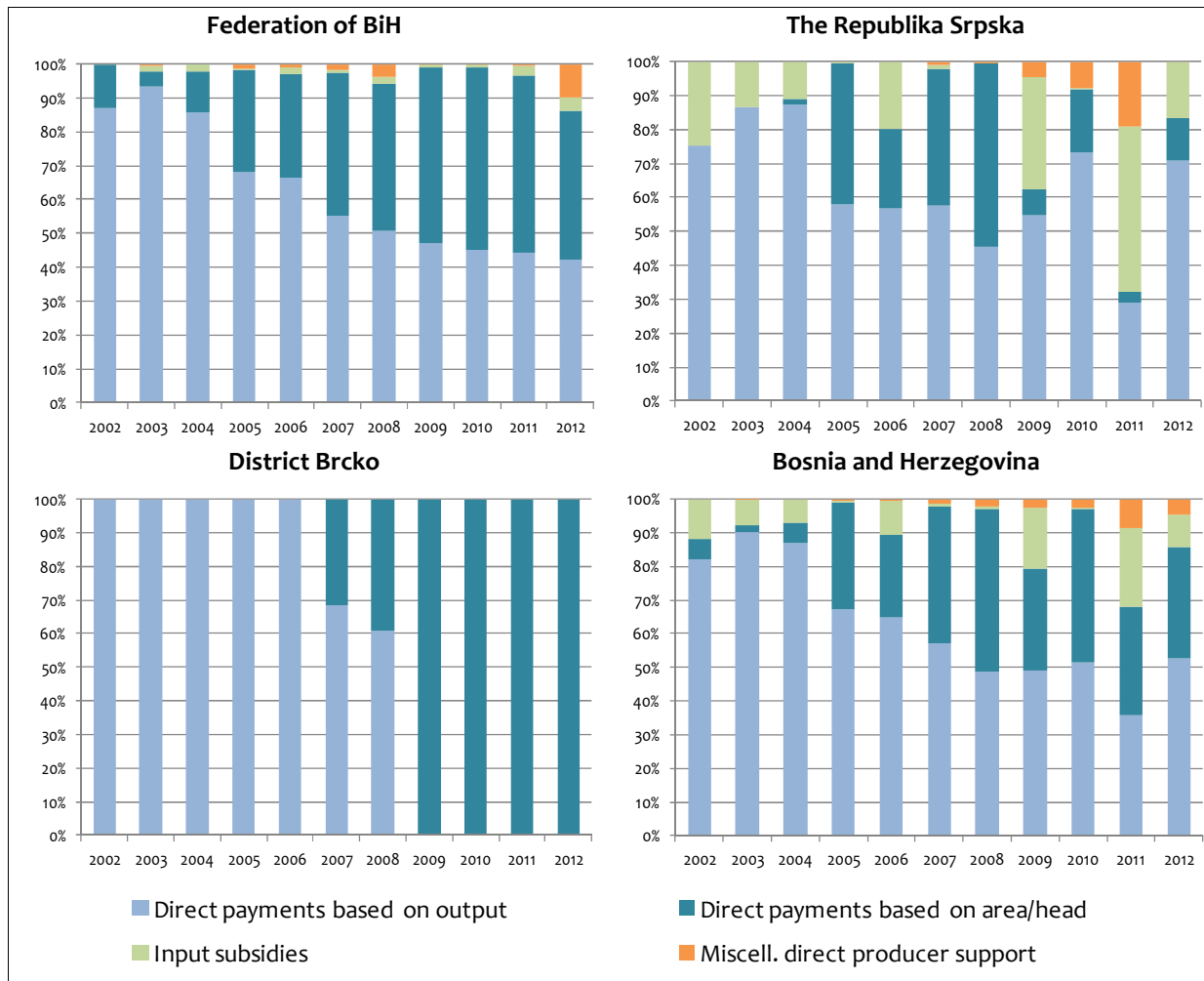


Figure 2: The structure of direct producer support measures in Bosnia and Herzegovina (total and per entities and District Brcko) for period 2002-2012

The comparison of budgetary support to agricultural sector in BiH and EU

Comparison with EU countries and achieved level of CAP convergence is particularly important if we take into account the expressed aspiration of Bosnia and Herzegovina firstly to become the candidate and then a full member of this community. As previously mentioned, the total budgetary allocation for the agricultural sector in Bosnia and Herzegovina, that is to its entities are quite modest. According to FAO SWG project data (2014), in the year of 2012, the total budgetary support to the agricultural sector in BiH per capita is EUR 19, per ha of agricultural land EUR 38 and per employee in agriculture sector EUR 495. This is significantly lower than in the EU-27 countries where in the same year the budget support for the sector per capita was EUR 157, per ha of UAA (utilized *agricultural area*) EUR 450 and per employee in the agricultural sector EUR 7,344. Significant differences are observed too, when the market structure and direct producer support measures structure are compared (Figure 3).

Unlike the EU-27 countries, direct payments based on output are dominant in BiH, especially in the Republika Srpska. When talking about the structure of the first pillar of agricultural policy measures, evident is the significant difference between BiH entities. In the Federation of BiH direct payment share per ha/head are significant, while support in variable inputs is almost symbolic. In the Republika Srpska variable inputs support is an important measure of the first pillar referring to subsidizing fertilizers, fuel and seed material purchase.

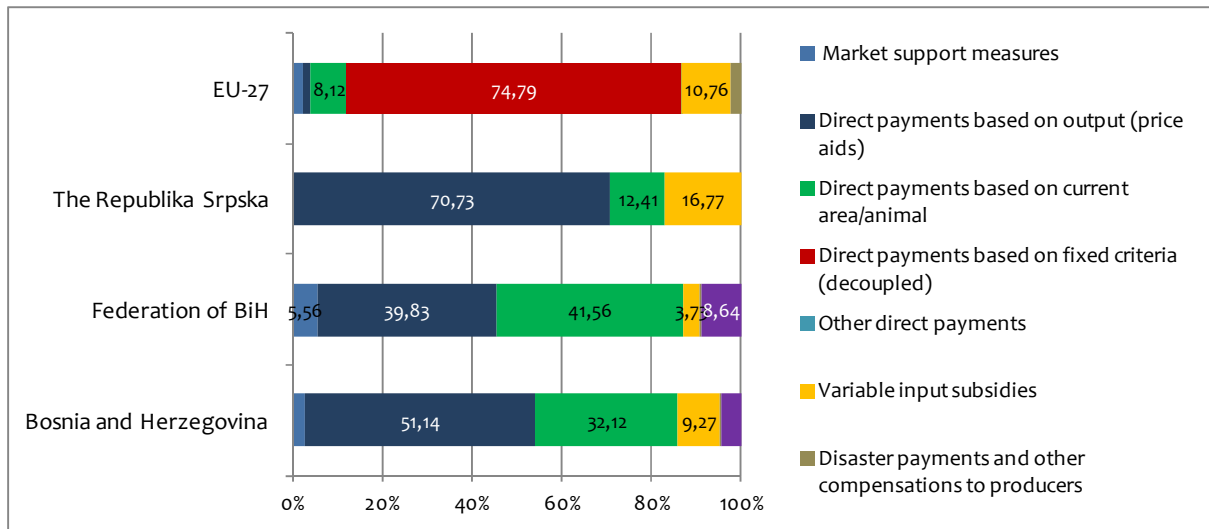


Figure 3: The comparison of the structure of market and direct producer support measures in Bosnia and Herzegovina (state, entity and District Brcko level) with EU-27 in 2012

The previous analysis clearly indicates that BiH will have to increase support to agriculture on its road to EU and adapt its support model to the EU mechanisms. The new model of measures in the EU indicates that BiH and its entities will have to orient toward direct payments based on current area/animal (leave out support per output) in the creation of the future agricultural policy and give more importance to various payments in the rural development policy.

WTO integration processes

The structure of the support to the agriculture sector according to the WTO classification has been made aiming to find out to which extent BiH budgetary support is consistent with the provisions of the AoA/WTO agreement.

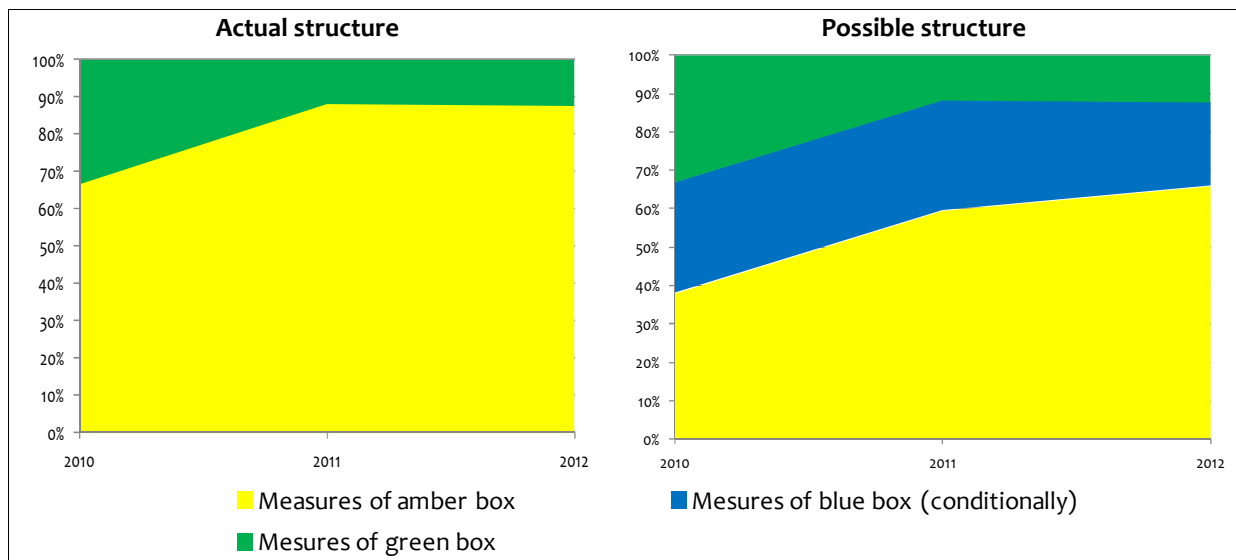


Figure 4: The actual and possible structure of budgetary support to agriculture in Bosnia and Herzegovina according to WTO classification for period 2010-2012

Figure 4 gives an overview of the structure of agricultural support measures according to WTO/AMS classification in a way that left graph provides a structure taking into account the strict adherence to the provisions of the AoA, while the right graph presents data on possible support structure since the direct payments measures per head/hectare could theoretically be

classified as measures of Blue Box. After reviewing the given graphs, it is evident that budgetary support to BiH farmers in general has the characteristics of so-called Amber Box. In the case that a portion of direct support (payments per ha/head) is adjusted to WTO rules, which requires specific, but not too much efforts, budgetary support could play a much smaller part in the Amber Box. Established structure and relationship between "boxes" support the fact that BiH is far from the kind of support system existing in developed countries, that is, agricultural support is still strongly linked to production. By signing the agreements and accession to the WTO such a structure of support can be a big problem because the measures in the Amber Box are included in AMS and are subject to reduction.

As the most developed countries in the world dictate negotiation directions in the WTO and since their support systems are mostly separated from production, it is clear in which direction negotiations are expected to continue under the WTO. In this regard, this paper models BiH budgetary support according to the WTO / AoA criteria.

AMS calculation for BiH was made under the assumption that BiH is developed country with all aspects arising from that status. The reference period is 2010-2012¹; *de minimis* threshold is 5%, while the stipulated AMS reduction degree was 20%. In this case, so-called transitional period for the reduction was six years². AMS for Bosnia and Herzegovina, with reduction in the specified period amounts to EUR 51.7 mil. in 2010, EUR 31.7 mil. in 2011 and EUR 30.9 mil. in 2012, or in average EUR 38.1 mil. Compared to countries in the region, BiH AMS is lower than in Croatia, but higher than in Montenegro and Macedonia. On the base AMS calculated in this way is then applied a reduction of 20% in the next sixth year, so that at the end of the transitional period we get the final amount of the AMS for the country. Thus, Bosnia and Herzegovina would have support averaged about EUR 30.5 mil. at its disposal from measures having the features of Amber Box which is the AMS after reduction. This amount is the upper limit that should not be "broken". To calculate the AMS of EUR 30.5 mil. can be an important limiting factor for the development of agriculture in BiH, considering the need for higher investment in the agricultural sector and increasing its competitiveness.

Despite the relatively low amount of AMS for support, there are two other significant problems. The first one is the unfavourable structure of the AMS, where more than half of the included incentives are for only one product (milk). Another problem is the internal (entity) distribution of AMS reduction. When we talk about subsidies for milk, they participate in AMS with about 60% in average, which is very high. A problem that can occur due to such unfavourable structure of AMS is that any reduction must reflect on the milk producers as the most important agricultural product. This problem may be even greater if provisions of the Doha Proposals come into force. Another problem is the internal distribution of the obligation to reduce the AMS. Farmers in Bosnia and Herzegovina, as already pointed out, are supported from several different levels that have their own models of support and mutually differ not only in the type of measures but in the amounts and criteria for implementation. Given that the rate of reduction of the base AMS implies the whole country, problem will be how to harmonize and distribute obligations for AMS reduction at lower levels of government.

Conclusion

The above analysis of agricultural policy 2002–2012 in BiH and its entities and the comparison with the EU clearly indicates that both formal and essential implementation of accession process and adaptation of agricultural policy to CAP is still at a low and

¹ The reference period is the period of three years which, in principle, a country chooses on its own, but it has to be as close as possible to the current year.

² It should be noted that the obligations regarding domestic incentives for developing countries are somewhat milder (the *de minimis* threshold of 10% reduction of 13%, a transitional period of 10 years)

unsatisfactory level. Agricultural policy in both BiH entities considerably differs from that both in the range and structure of measures, and so the policy implementation is far from the EU model. In both BiH entities, direct payments per output make a larger part of direct support to producers, whereas they almost do not exist in the EU countries.

Accession to the WTO as the second targeted integration for BiH, although less challenging, still carries certain changes that may adversely affect the agricultural sector in BiH. This primarily relates to the support restriction through the Amber box measures, or through measures that are directly related to production. Research results show that from the WTO standpoint, support in BiH is generally restrictive in its nature. An additional concern is very bad AMS structure where milk has a dominant position. This "poor" structure prevents manoeuvring in AMS reduction obligations. The existence of multiple model support within entities is also a problem in terms of fulfilling obligations of AMS reduction - the problem of distribution of obligations within the country.

In order for BiH to face the challenges of the Euro and WTO integrations as easily as possible and have as few negative consequences as possible internal harmonization of agricultural policy is necessary at the entity and DB level including its legislative and institutional aspects. Without this condition it is not possible to make any progress towards adjustment to the obligations that will follow. Reform of support to producers in the context of suspension of certain measures and their replacement with acceptable solutions is also one of the steps that are necessary to do. Reducing the list of supported products and restructuring forms of support (reducing output support in favour of support per ha/head) is something that must be done in the near future. Finally, it is necessary to further strengthen the transparency of expenditures as well as establishment of the missing mechanisms of implementation such as monitoring and evaluation of agricultural policy.

The future EU membership is a basis for political and economic stabilization and development, and as well for necessary modernization of government administration. As for BiH, agri-food sector potentials provide realistic market opportunities that, unfortunately, have not been used for many reasons. This is why BiH needs to engage its intellectual and political capacities, and as well various programs and projects toward the harmonization of value systems, legislation, policies and institutions. We could expect that the current standstill in BiH relating to European integration processes will not mean elimination from the group of ex-Yugoslav republics on the road to EU, which would result in a huge political, economic and social damage.

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