

# Economic Cooperation in Balkans: The Case of Bosnia and Herzegovina

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**Abstract :** This article analyzes economy and investment opportunities in Bosnia and Herzegovina (FBiH) in between 1995 and 2009. FBiH and Turkey have an established cultural, social and diplomatic relations. Historical common bonds are regional realities but economic cooperation is a contemporary necessity to strengthen these bonds. It is questioned if economic cooperation is supporting common bonds in terms of investments and trade. FBiH is currently in the less developed countries list of the World Bank with a high rate of unemployment. Such status is mostly inheritance of socialist - communist past. But such status is also creating a lot of investment and trade opportunities for many countries. Within this context, Turkey should produce a strategy associated with Balkan economies in her trade and development. Currently, neither direct Turkish investments nor economy-politic strategies are sufficient to bestow Turkey a key role in the Balkans.

**Keywords :** Balkan Business; Trade; Investment, Balkan Strategies

## Introduction

Bosnia and Herzegovina Federation (FBiH) with its approx. 52 thousand square kilometers and 4.2 million populations lays in the heart of the South Eastern Europe. It is surrounded by Croatia from the Southwest and South, Serbia from the East and Montenegro from the Southeast. Landform is prevailed with hills and mountains, and forests cover almost 50% of it. It has mediterranean, continental and moderate types of climate.

Amid all potentials, the biggest obstacle in FBiH's economic development is its multiethnic governing system and territorial division. Following table shows selected economic indicators.

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP per cap (Euro)	1,660	1,786	1,958	2,214	2,388	2,561	2,873	3,254	3,648
GDP growth (%)	5.5	4.5	5.5	3.0	6.3	3.9	6.7	6.8	7.1
Industrial production growth (%)	8.8	12.2	9.2	4.8	9.0	10.0	11.0	10.0	9.2
Average net wages (Euro)	190	209	228	247	258	275	300	322	385
Annual inflation (%)	4.8	3.1	0.4	0.6	0.4	3.7	6.1	1.5	6.5
Annual unemployment rate (%)	39.7	40.3	40.9	42.0	43.2	43.0	31.0	29.0	23.4
Trade balance (billion Euro)	-3.00	-3.31	-3.52	-3.67	-3.68	-4.01	-3.41	-4.14	-4.89
Total FDI (mill Euro)	159	133	282	338	567	478	564	1,628	701

Figure 1 : Selected Economic Indicators of Bosnia and Herzegovina [CB of BiH]

GDP throughout period from 2000 to 2008, with average growth rate of 5.5% is actually not enough for a country like BiH. Average growth rate of industrial production, on the other hand, has been more than 9%. In 2008 the oil refinery in Derventa of Republika Srpska has started its production what effected rapid increase of industrial production growth rate by more than 50% in comparison to 2007. The highest growth rate in industry is seen in production of energy, durable – consumer goods and capital products.

As is seen in the figure, FBiH has low inflation rate mostly due to fixed exchange rate of KM to Euro. 1 EUR=1.95 KM is the fixed exchange rate. Stable currency rate of KM to Euro has resulted in stable inflation rate even in the period of increased oil prices in the world market.

Although labor force is well educated and rated, unemployment is still number one problem of economy. One fourth of the labor force is unemployed. This is leading to the black market of labor force. In the region, FBiH has one of the cheapest rates of labor.

#### **Economic Developments**

During the last 15 years, a total investment in FBiH has been €5.3 billion. Total Foreign Direct Investment (FDI) reached to €1,628 billion in 2007. We see a sharp decrease in 2008 mainly because of the world economic crises. Foreign investors did not show much interest for FBiH because of the lack of information on investment opportunities in various sectors. Political instability is certainly another important contributing factor not to develop an image of favorable nation for investments. State division and its complex political structure are hindering economic developments as well as diplomatic relations.

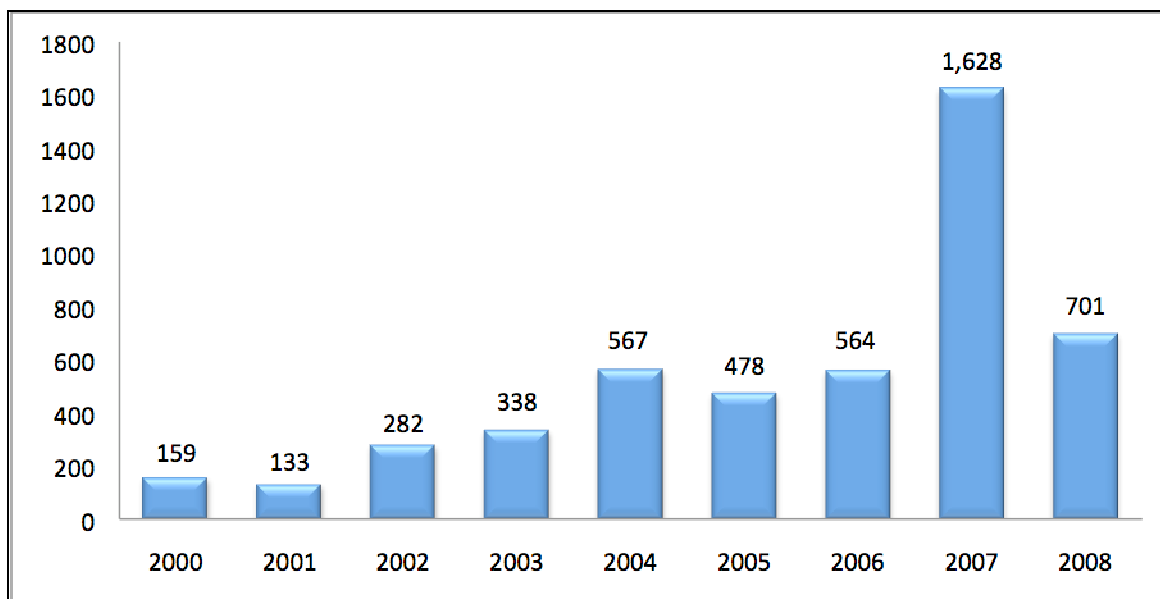


Figure 2: FDI in FBiH

Amid all, FDI has concentrated in manufacturing, banking and telecommunication. The percentage share can be seen on the Figure 3 below.

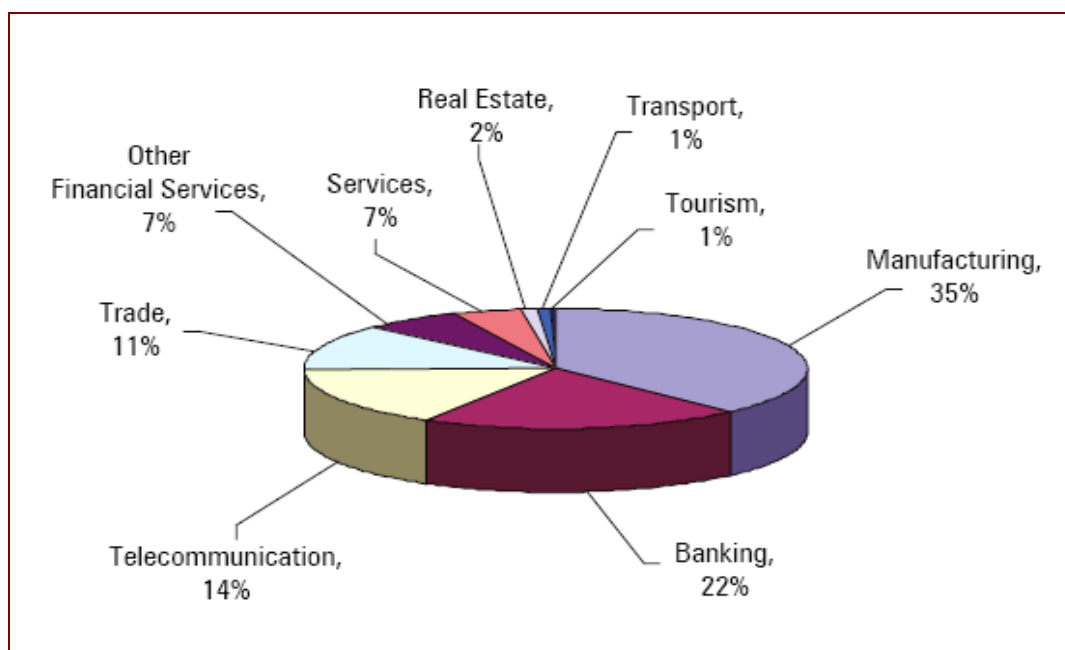


Figure 3: FDI in FBiH by Sectors [FIPA, 2009]

Since 1994, Austrian companies are leading in FDIs. Serbia and Croatia have also been on top of the list. Historical and political bonds of these three countries make them invest in FBiH. Austria is also giving free education for the citizens of FBiH. This will result in political implications in the mid-future. On the other hand, Turkey as foreign investor is in the 10<sup>th</sup> place on the list with €113 million. Besides common history, culture, tradition and religion, Turkish investors have not shown considerable interest to invest in FBiH.

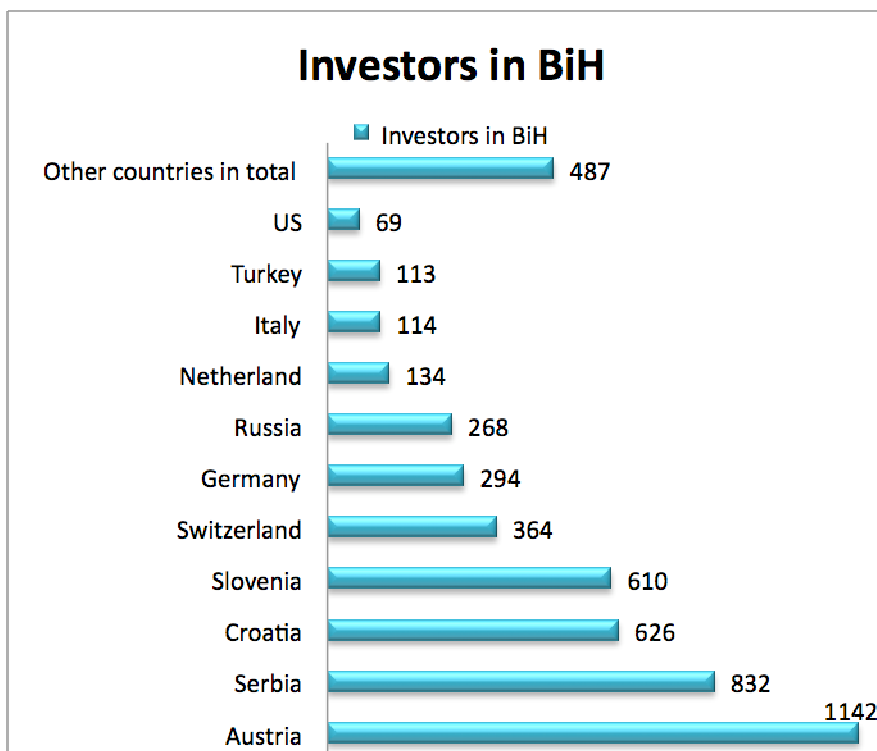


Figure 4: Foreign Investors in FBiH

In order to increase trade, FBiH has adopted significant unilateral reforms since the end of the war 1995. It has the lowest tariff rates on agricultural products in Southern and Eastern Europe countries. It has signed a free trade agreement with Central Europe (CEFTA) which turned to be disadvantageous for FBiH economy. However, according to World Trade Indicators of 2008, FBiH trade regime is considered quite successful in comparison with many similar countries. As is seen in figure 5, FBiH economy is consistently giving trade deficit. This deficit is covered by foreign aids and debts. If it goes on the same manner, FBiH would end up to be a heavily debted country of Balkans.

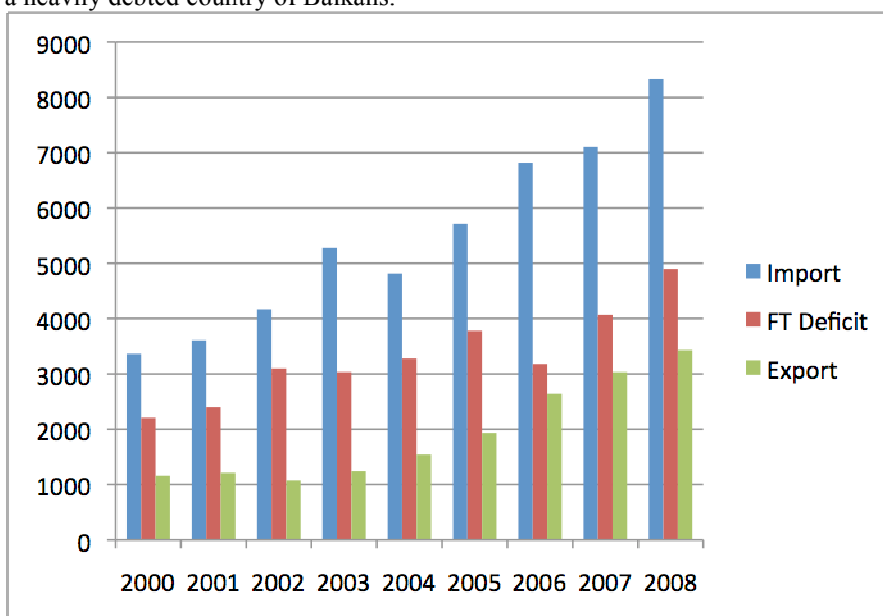


Figure 5: Foreign Trade Balance in FBiH (x million)

#### Turkey - FBiH Economical Cooperation

Turkish – FBiH political relationship is nowadays quite good. But this goodness is not backed by economical cooperation, therefore would not last long. A very sophisticated strategy should be followed. Turkey

should produce a master economic development plan encompassing the Balkans as well as the Caucasians and the Middle-east.

Post war economic cooperation with FBiH has not been progressed well. For example, the agreement on avoiding double taxation has been endorsed with Iran in 1996, but not endorsed until 2005 with Turkey. In the mean time, nearly four thousand Turkish companies which were engaged in different activities, from construction to trade, had to abandon their operations except just sixty-five of them stayed. In other words, in the late nineties and early 2000's FBiH has not offered considerable incentives to investors. Trade exchange between FBiH and Turkey in 2008 became 136 million [ASR, 2009] which made her to be the ninth trade partner of FBiH.

On the other hand, Serbian media reported on how presidents of Serbia Boris Tadić and of Turkey Abdullah Gül agreed to boost bilateral relations in political and economic cooperation. Additionally, the two discussed possible political and cultural cooperation. President Tadić has proposed the construction of an Islamic cultural and educational center near Belgrade. Both invited Turkish businessmen to invest in Serbia. Tadić asked also Turkish businessmen to invest in the construction of the highway from Belgrade to the Montenegrin coast, which will be passed through the Sandzak – the part inhabited by Muslims. About a dozen Turkish businessmen visited the capital Novi Pazar in Sandzak, and with representatives of local authorities to discuss the possibilities of economic cooperation and investment.

Amid all historical enmity between Turkey and Serbia, it seems that Serbia provides more incentives to Turkish investors, and the state is more willing to be partner of Turkey. But the Serbs in FBiH strongly oppose the Turkish presence in these areas. Serbs with the support of Croats by all possible means hinder any cooperation between Turkey and FBiH.

FBiH with its changed course of politics in recent years toward foreign investors offer various solid areas for investments. Investment opportunities in such sectors as wood processing, mining, metallurgy, energy, infrastructure and food industry are highly considerable

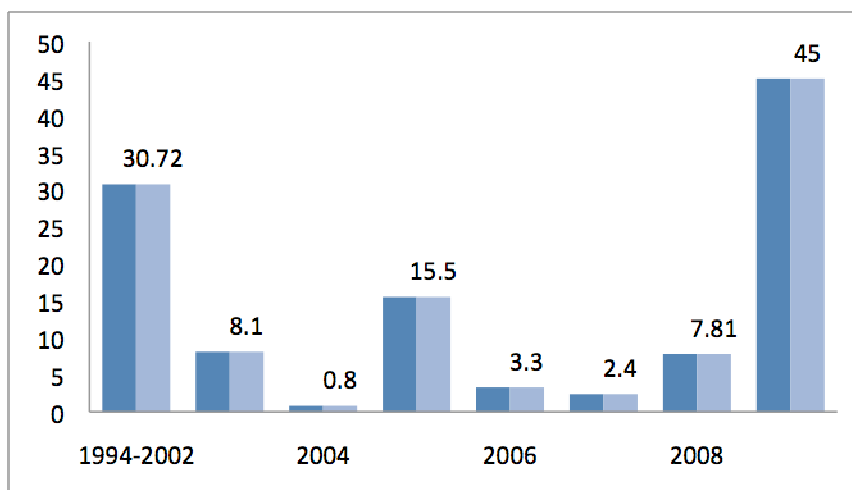


Figure 6: Turkish direct investments in FBiH in period May 1994 to November 2009 [FDIA, 2009] (millions of Euro)

Turkish direct investments in FBiH show discontinuity. There is no tendency of increase or decrease. Immediate after the war, Turkish companies wanted to invest on the area, but they met different obstacles in political and economical means. Firstly, there were not regulations or law protecting foreign investments. Secondly, big companies couldn't operate in full potential because of the lack of interim goods and services in the market. Furthermore, small companies and investors had high rate of risks.

Few large Turkish companies operate today in FBiH. As we can see from the graphs above the highest investments from Türkiye in FBiH were in 2005, and 2009. The first large Turkish Company which started to operate in FBiH was T.C. Ziraat Bankası in 1997, more than half of overall investments in period of May 1994 to 2002 were directed from T.C. Ziraat Bankası [TZB-B, 2010]. In 2005 Kastamonu Entegre, or "Natron-Hayat" d.o.o. Maglaj invested 14 million Euro, and total Turkish investment in 2005 were 15.5 million Euros. Another big investor is Turkish Airlines (THY) which has bought BH Airlines from the privatization. THY possesses 49% of the company capital [BHA, 2010].

Investment potential of FBiH, is still rich, especially in energy, construction and agricultural sectors. There must be incentives and sophisticated strategies by the Turkish Government to stimulate companies to invest more in the region. The sectors which are the most invested by Turkish companies are: production, banking, transportation and trade distribution [FDIA, 2009].

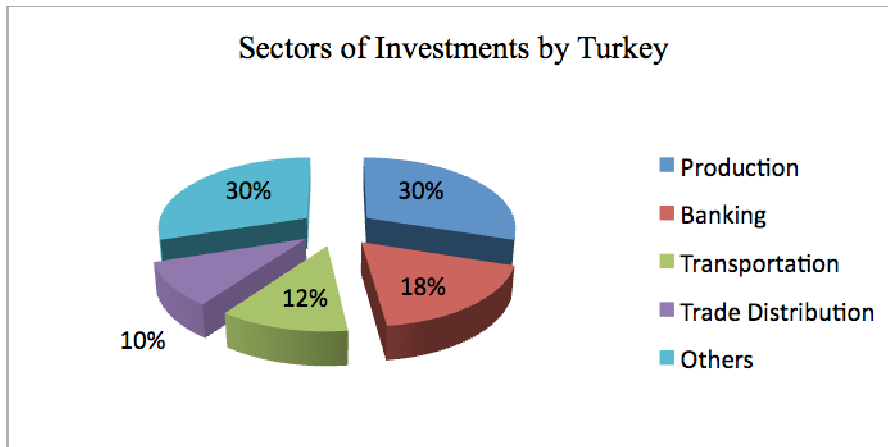


Figure 7: Sectors invested by Turkish companies

Unlike direct investments, there is higher interest of Turkish companies and businessmen to export to FBiH. The trade is at the moment in a better improvement.

Free Trade Agreement between Turkey and FBiH has fully entered into force on 1<sup>st</sup> of January, 2006. The basic objectives of this Agreement are promotion of the expansion of mutual trade, the harmonious development of economic relations and to ensure financial stability for companies of other party which operates in the state. In addition both states have to provide fair conditions of competition for trade. Agreement on Avoiding Double taxation between Turkey and FBiH on income and property tax has entered into force in July 2008. Any income or property earned in one country by assets whose owner is a resident of the other is taxed only once, at the rate of whichever country owner chooses.

Within this context, some of the incentives and advantages for foreign investments provided by FBiH are:

- Exemption from the payment of customs duties and customs fee for investment
- Right to open accounts in any commercial bank in domestic or any freely convertible currency on the territory of FBiH
- Protection against nationalization expropriation, requisition or measures having similar effects, such measures may take place only in the public interest in accordance with the applicable laws and regulations against the payment of an appropriate compensation, in instance compensation that is adequate, effective and prompt,
- Right to freely employ foreign nationals, subject to the labor and immigration law in Bosnia and Herzegovina

Moreover, the rights and benefits which are already granted and obligations imposed by the Law on the Policy of Foreign Investment cannot be terminated or overruled by later passed laws and regulations. It means that investor is responsible to laws and regulations which he has obliged in time of his starting job. In addition, if investors realize that recently passed law or regulation is more favorable for its investments, he/she has right to choose under which regime the respective foreign investments to be governed. Finally, there is no restriction on repatriation of profits. Foreign investors have right to transfer abroad, freely and without delay, in convertible currency, proceeds resulting from their investments in FBiH, including incomes from investments in form of profit, dividends, interests, and any other form.

There is only one restriction on foreign direct investments in FBiH according to the law, foreign equity ownership of an enterprise engaged in the production and sale of arms, ammunition, explosives for military use, military equipment and public information must not exceed 49% of the equity of the enterprise. In case of investments in mentioned sector, foreign investor must receive prior approval from the competent body of the respective entity. The restriction applicable to domestic investment on account of public policy, public health and protection of the environment are equally applied to foreign investment.

### Free Trade Zones

The free zones are part of the customs territory of FBiH managed by the founder of the free zone [OG, 2002]. Users of the free zones are not obligated to pay VAT (value added tax, in FBiH 17% of good's/service's value) and import charges. In addition to these, investments, transfer of profit and transfer of investments are free of charge.

Potential of free zones is huge but not exploited by Turkish investors yet. FBiH has free trade agreements with Central Europe, Albania, Serbia, Moldova, Montenegro, Macedonia, and Kosovo. Moreover FBiH has preferential export regimes with all EU countries, Norway and Switzerland. According to agreement

all goods of FBiH origin that fulfill EU technical – technological standards and conditions, can be exported to all EU countries, without paying customs and other similar duties [OJEU, 2008].

### **Investment Opportunities**

According to Agency for Foreign Investment Promotion, the top seven investment sectors of FBiH are: Tourism, Agricultural and Food Processing Industry, Energy, Wood, Transport, Mining and Metal Processing, Automotive.

Energy sector is one of the most powerful in FBiH, with long tradition and huge potentials and opportunities for further development and investment. It encompasses such main subsectors as Coal, Electric power, Oil & Natural gas.

FBiH is richly endowed with natural recourses and conditions which create superb environment for agricultural production, including availability of labor, land, and other natural resources, as well as suitable climate. The enormous agricultural potentials are only partly realized, in spite of huge human and natural recourses.

FBiH agricultural sector could be great opportunity for potential investors from Turkey which could activate and benefit these huge frozen potentials, with reasonable investments. Around 50 % of FBiH's agricultural land has not been cultivated and very suitable for organic production. Land, as well as water and other natural resources are unpolluted and free from chemical fertilization and the routine use of pesticides [FMPVS, 2010].

According to the World Tourism Organization there is a big potential in FBiH tourism markets. It is increasing with a rate of 10.5%. There are huge potential for development due to breath – taking natural beauties, and everlasting historical and cultural heritage. Turkish citizens are very interested in cultural tourism packages. Beside the cultural opportunities, FBiH is known by its wild nature especially for those who like sport activities, and clean environment.

Transport sector in Bosnia and Herzegovina became one of the most active and vibrant sectors within FBiH economy, due to the ambitious physical and institutional development programs - covering roads, railways, aviation, inland waterways and urban transport - adopted by FBiH governments, and supported by various international, predominantly financial institutions (World Bank, EBRD, etc.)

### **Privatization Opportunities for Turkish Investors**

Privatization will take place in the field of electric-power, trade and communications (except road transport), waters, an exploitation of mines and woods, a public information, a lottery, arms industry, a military equipment, veterinary and communal activities [OG, 2008]. Some of the largest state owned enterprises will be on the market in 2010 such as electric-power, communication, production and public information. The investments in arm industry, and military equipment would be from vital interest for FBiH Muslims and Turkish government in straightening its position on Balkan. Some of the companies which will be privatized in 2010 are from vital importance for Turkish investors, such as Alminij Mostar, Fabrika Duhana Mostar, Hidrogradnja, Energoinvest Sarajevo, Bosnalijek Sarajevo [PA, 2009]. Those companies have low rate of risk due to their high demand, and monopoly position which they keep in domestic market.

Turkey would also help to the FBiH government for the privatization. Turkish privatization has proceeded in a slow and incremental manner, evolved after 1984, slowed in the 1990s and boosted in the 2000s. Turkey launched its comprehensive economic liberalization program named as structural adjustment reform in January, 1980. Privatizing of public assets, creating a “flexible” labour market, replacing producer price subsidies in agriculture with direct income transfer program were the main issues of the structural adjustment. [Onis, 1991].

Privatization of State Owned Enterprises emerged as an official state ideology after this liberalization program. The main ideological pillar of the initial attempts were announced as a matter of improving efficiency in production and reducing “excessive” employment and waste in the state enterprise system.

Privatization and competition should be complementary to each other although it may take several years to build up a market-based institutional framework [Sondhof, 1999]. Privatization can and should also occur as a consequence of competition [Liu and Garino, 2001]. In other words, privatization should result in strengthening competition and the competition should encourage privatization. Access to international capital markets has created several global, competitive companies out of hitherto inefficient state monopolies [Matutes, 2000].

Competition and privatization are sometimes uneasy policy bedfellows. Incumbent firms may argue successfully that the purpose of privatization is to strengthen them, through a vastly increased possibility to tap international capital markets, so that they may become global players. But they need to maintain their dominant position at home, by regulatory or other de facto obstacles. This would create added gains for shareholders and thereby contribute to the development of the capital markets but a monopoly would still be the “natural” outcome of the market.

## Conclusions

Good political and diplomatic relations that exist between FBiH and Turkey have not been backed yet by established economic relations. Over the last 15 years, there were various obstacles hindering the progress. But recently, business climate has been changed and Turkish Businessmen together with the government should get their benefit out of it.

BiH with its ethnic structure and religious background could be more than just an economic and political partner. First of all, it could be a very good potential for Turkey to develop or re-gain her traditions of operating in multi ethnic and multi religion markets. She could learn to be a just partner of the market as it used to be throughout the history. This would mean too much for Turkey.

Moreover, Turkey should produce a long term strategic development plan not only for herself but also encompassing the region as well as the Caucasians and the Middle-east. This will help the political and economical stability of the region.

At the moment, there are just seven large Turkish companies which did invest in FBiH in the period of 15 years. The total investments of Turkey amount to 113 million euros, more than half of these funds goes to two companies Turkish Ziraat Bank and Turkish Airlines Companies. The situation in trade is somewhat better. The market of BiH is still looking for goods especially in the sector of agricultural and food industries.

There is a great need for investment in infrastructure, construction of highways and building the first port of FBiH. Big Turkish construction companies would take significant roles in the area with these projects.

Proactive Turkish foreign policy had strong impacts in building closer relations between FBiH and Serbia. Economic investments can further contribute to the development of the peace process in addition to economic prosperity. Economy is very often the initiator of war and peace. With proactive economic policies, concerns of the population about their future existence would be satisfied. Hence, economic policies should be used as confidence building activities in the region.

Turkey through economic investments in FBiH would bring back the trust and hopes to people. In addition to the economic benefits for both countries, the construction of ideological partnership would be much more important for the peace and stability. It would work in both ways as stated by Ibn-I Khaldoun that peace and stability is a prerequisite for economic development [Karatat, 2009].

In the privatization implementations, Turkey would be in great help for the FBiH. It must be evaluated according to political, social and economical structures and conditions of the country.

Privatized enterprises are freed from public sector constraints on investment. They can tap the unlimited supply of the capital markets without any impact on the state budget. Hence, providing better access to finance for enterprises generate higher levels of investment

As we have seen public sector borrowing requirements and public debts were two economic indicators deteriorating the state budget. Privatizing state owned enterprises improves macroeconomic indicators and medium term budgetary revenues. Besides, it is deepening the equity market and the creation of a wide share owning class and is boosting the role of equity markets as a means of channeling savings in the economy.

There seemed no direct relationship with the privatizations endeavors apart from examining the transfer of public undertakings to the private sector to prevent monopolization in the areas the public sector exited. In the same line as privatisation, competition should also be well established to boost the economy as a whole. Turkey can help FBiH to establish a free and sound competitive environment for the market for goods and services. Turkey has passed similar procedures recently and is still building on it.

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