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1 General review

1.1 Major agricultural market developments in 2005

The food sector in Bosnia & Herzegovina comprises two distinct sectors: the processing sector is populated by firms with entrepreneurial spirit that have access to credit, whereas much agricultural production comes from farms that are small and backward in production terms. The common characteristic of both segments is that they operate under unorganised, uncertain market conditions and suffer in comparison with foreign competition.

In 2005, both GDP and GVA continued the growth seen over the four previous years, but current production remains below capacity and is insufficient to meet the population's needs. 2005), saw the introduction of five new regulations affecting the food sector, of which the two most important are the introduction of a value added tax (VAT) and for protection of market competition.

The country is currently experiencing the first impacts of the 17% VAT on food prices and the consequences for agricultural producers are yet to be seen. Agricultural producers and their representative institutions are among the most severe critics of the VAT rate.

Adoption of the Law on Competition and establishment of the Competitiveness Council is another relevant event for the economy of Bosnia and Herzegovina in general, and particularly for the market of agricultural and food commodities. Among other issues, this Law regulates behaviour and relations between economic agents and forbids actions that endanger healthy market competition.

Another important event was the establishment of the Agency for Food Safety which took place in April, 2005. This institution will be under direct competence of the Bosnia and Herzegovina Ministry of Agriculture and Rural Development.

1.2 Agricultural and rural policy developments

In 2005, as in previous years, no significant funds were allocated to supporting agriculture and developing the agricultural sector. Out of a total budget in the two entities that amounted to 1,001 million EURO, only 25.7 millions (2.6%) were allocated for the development of agriculture. It should be mentioned that Republika Srpska allocated much more (3.5% of total budget, 16.9 millions EURO) than Federation of Bosnia and Herzegovina (1.7% or 8.8 millions EURO). The major part of funds 16.8 million EURO (65%) was allocated to market price support measures. Rural development policy remains of marginal interest in Bosnia and Herzegovina, where the department dealing with rural development problems was only established in 2005. The situation in Republika Srpska differs to a certain extent, as 1.9 millions EURO was allocated for rural development in 2005.

Current negotiations about constitutional changes in Bosnia and Herzegovina indicate the establishment of a common Ministry of Agriculture at the state level in the near future. A common state institution would treat the complex problems of the agricultural sector in a uniform manner thus putting all agricultural producers in Bosnia and Herzegovina on an equal footing.

Rural development and related policy in Bosnia and Herzegovina should still be considered in relation with post-war situation. This means that activities should still be oriented on removing remaining mine-fields from agricultural land surfaces in order to enlarge natural production capacities and on offering support to refugees and displaced population to return to rural areas.

Strong rural communities are essential for future political and economic stability of Bosnia and Herzegovina. They will not emerge without well worked out, planned and organized activities that would result in balanced support for both farm and non-farm income generation and full access to high quality health and education. Rural development programmes are needed to initiate wide actions to achieve sustainable rural development, with particular attention to increase non-farm rural employment. By reducing reliance on farm income, increased access to non-farm employment would also allow an increase in the sale or lease of rural land and so facilitate an increase in farm size.

Rural development strategy begin with the preparation of canton and municipality- level rural development plans that reflect the needs and aspirations of local people and the nature of the local resource base. Local government, non-governmental organisations (NGO's) and donors intend to use these plans as the basis for designing job and business training programmes and to establish micro-credit lines suited to small enterprise development. Besides, at the end of 2004 and the beginning of 2005, several regional strategies for economic development have been produced within the framework of the EU CARD Programme. These strategic documents encompassed problems of rural regions with the proposal of the whole range of activities and project proposals that are waiting for potential domestic or international financiers.

Currently mid-term strategy of agriculture development of Federation of Bosnia and Herzegovina is being worked out and it is expected to be finished by the middle of 2006. This document encompassed to a great extent rural development issues in the entity in which agriculture takes important place. According to this document, development of agriculture in rural areas must not bee treated separately but within the frame of integrated approach to rural development.

1.3 Issues related to the enlargement

The intention of Bosnia and Herzegovina is to become, as soon as possible, part of the European Union. Therefore, economic reforms, struggle for competitiveness and market principles are aims and dominant determinations of future agricultural production of Bosnia and Herzegovina. Entire fulfilment of these tasks can be achieved only gradually, but as fast as possible, which means in accordance with internal adjustments and transformations.

In practice, it means that the goal can be achieved by the means of: a) quick creation of favourable macro-environmental conditions and offering development support within domestic economic ambient; b) negotiations with WTO, realistic assessment and accepting rules and responsibilities with regard to external surrounding; c) further strengthening regional economic integrations with South-East European Countries (JIE and/or CEFTA); d) social transformations and economic adjustments aimed to join EU.

To achieve the final goal, join EU, Bosnia and Herzegovina will face lots of tasks. First of all, it has to organize itself in a better way and to strengthen economy through current bilateral, agreement-based relations with countries from Balkan as well as with countries from wider surrounding with which Bosnia and Herzegovina, as the matter of fact, does not have good development experience. Besides, more respectable position in actual Western Balkan or CEFTA integrations that are just being advocated should be looked and fought for. The speed of joining EU is the issue of crucial importance for Bosnia and Herzegovina. The path to achieve this goal understands following: to find out by the means of policy solution for functional organization of the state, and as far as economy is concerned, it mainly includes issues related to preparing agriculture to sustainable life in this community. The essence of these issues is in changes that have to take place in the countries of Central and Eastern Europe in order to make them prepared to bring their future under the common European roof.

In fact, it is all about following criteria and standards that economies of all approaching countries have to meet: to establish market economy that can be integrated in European economy; to prepare economic subjects for competitive fight with imported commodities and to adjust to set of laws, regulations and procedures known as acquis communitarie. As far as agriculture is concerned, all requirements merge into one: to build only the sector that will be competitive on demanding international food market.

Bosnia and Herzegovina can reach EU only by supporting only commercial agricultural production that is focusing agricultural policy to those production units that can, with their size and production, contribute to commercial character of agricultural production and to reduction of trade deficit that the sector has been recording during the whole post-war period.

Market orientation will be achievable only if economic competitiveness of the sector is brought up to higher level, which can be achieved by: activating available resources on chosen number of chosen production directions; introduction of new technologies for chosen productions and accepting marketing as the concept of business behaviour.

These principles give support to the strategy approach that advocates modern production technologies and catching up with the efficiency of market competitors. They are further supported by the means of marketing and lead to such production structure that would build up future on foreign markets on the quality and maintain certainty in domestic demand.

It is hard to say what is the structure that would stand future internal EU (in which BH will be the member state) competition the best. Nevertheless, it is already know, on the basis of the experiences of the new member states that are much more powerful than Bosnia and Herzegovina, that the way to big and competitive cattle raising farms for structurally backward regions is much longer and more difficult than, for example for modern and highly profitable fruit-growing or truck-farming, or for organic production with already existing European market.

Previous statement is largely denied by current production sector structure in which plant production dominates with 60%, which is the fact that makes space for Bosnia and Herzegovina for adjustment to demand even on domestic, not to mention foreign market.

Structural changes will follow this direction, but only in these products with chances to become favourite brand on both domestic and foreign food marketplace.

2 Assessment and outlook: market integration in the cereal sector

2.1 Introduction

Due to relatively modest ploughed field surfaces and dominant hilly-mountainous areas in which both actual and potential yields are limited by unfavourable agro-climate factors, Bosnia and Herzegovina can not be considered as cereals producing region which particularly applies for its bigger entity, Federation of Bosnia and Herzegovina. In 2005, in 552,000 ha of total sown ploughed field surfaces, the share of cereals was 58%, respectively 321,000 ha. The leading crops in the structure of land surfaces sown with cereals are maize (kernel) with 195,600 ha (61%) and wheat with 81,400 ha (25%), while barley, rye, oats and triticale, sown on remaining 44,000 ha are of less importance. Average yields per hectare of all cereal crops are still far behind those achieved in EU countries. The main reasons for this, beside already mentioned limited agro-climate conditions, are unfavourable farm' structure, small and split farm land, insufficient use of certified seed and very low level of applied agro-technical measures, first of all use of artificial fertilizers and herbicides. Thus, the yields of cereal crops gained in 2005 are customary for Bosnia and Herzegovina: wheat 3.1 t/ha, barley 2.6 t/ha, oats 2.3 t/ha. Average maize yield (kernel) in 2004 was 5.1 t/ha. Such modest average yields made following total achieved production: wheat 249,000 tons, barley 53,400 tons and oats 41,800. Total maize production in 2004 was 990,000 tons.

Ploughed field surfaces sown by cereals in Bosnia and Herzegovina tend to decrease. Thus, total surfaces sown with cereals in 2005 decreased by 12% compared with 2000, by 22% for wheat, by 6% for maize, by 10% for barley and by 25% for oats. Such a trend is the reflection of, first of all, the lack of quality state agricultural policy measures and the lack of the state interest for this production.

Significantly higher needs for cereals than the domestic production cause Bosnia and Herzegovina to import substantial quantities. The total value of cereals' imports in 2005 was 88,891,000 EURO which was 9% of the total import of the agricultural food commodities. The main exporter of cereals to Bosnia and Herzegovina is Hungary (40%). Serbia and Montenegro takes the second place (39%) as the result of Free trade agreement between Bosnia and Herzegovina and Serbia and Montenegro. Total cereals import of Bosnia and Herzegovina records permanent increasing trend, thus in total trade balance cereals' import increased from 52,687,000 EURO in 2000 increased by almost 70% in 2005. The leading imported crop is wheat. As Bosnia and Herzegovina's estimated total annual requirement for wheat is 600,000 tonnes, insufficient domestic production is supplemented by substantial imports which vary, depending on the year, from 350,000 to 500,000 tonnes. Besides, such a big imported quantity is partly result of the fact that significant quantities of domestic production (on the average 1/3) are used on-farm. Export of cereals is very modest and in 2005 it amounted to 486,000 EURO. In the future Bosnia and Herzegovina is likely to continue to import cereals, as even in the actual draft of the medium-term strategy (Federation of Bosnia and Herzegovina) of agricultural development up to 2010, no significant incentive measures are mentioned that could stimulate this production and make Bosnia and Herzegovina less dependant on cereals' import.

2.2 Infrastructure (storage capacity and transportation)

Before the war (1992-1995) there were 18 large-scale state flours and feed mills in Bosnia and Herzegovina, that were equally disposed throughout the whole territory of the country, relatively well modern equipped and with total installed capacities for storage and processing of 455,000 tonnes of wheat. Actual number of these mills is 14. The total number of the mills increased due to 64 newly constructed and founded small private mills, so there are altogether 78 mills in Bosnia and Herzegovina. Total installed capacities are estimated on 650,000 tonnes of wheat annually. Most of the mills in Bosnia and Herzegovina are intended for flour and cattle feed, and only 20 of them are only for animal feed production.

Cereals' storage capacities in Bosnia and Herzegovina are based on existing mills. Capacities are very different and vary from several thousands tonnes to 65,000 tonnes, which is capacity of wheat silo KLAS in Sarajevo. Information obtained from Grain Association of Federation Bosnia and Herzegovina say that the quality of storage facilities and their technical and technological characteristics vary a lot. Formerly state owned mills have satisfactory storage conditions unlike majority of small private mills that are built up on the basis of old fashioned technical-technological equipment.

However, both entities lack regulations on minimum technical, technological and sanitary standards that every single mill, bakery or pastry factory has to meet, regardless the ownership or capacity. There is no permanent market, financial and sanitary control of the raw materials and commodities, nor any standardised recording of all business activities in accordance with bookkeeping regulations. A significant black market exists in grain and flour.

Under these circumstances, the profits that can be made from milling and baking are such that the number of mills and bakeries (especially small ones) could continue to increase.

The transport of cereals, like the most other products in Bosnia and Herzegovina is mostly oriented to road traffic. The powerful road lobby that has existed in Bosnia and Herzegovina since the war end resulted in weak and slow reconstruction of the railway infrastructure. Therefore, trucks, whose number is increasing year by year, are main transport means for cereal transport. This, of course, causes increased transport costs and consequently increases of mill, bakery, pasta and confectionery prices. According to estimations made by Grain Association of Federation of Bosnia and Herzegovina, transport costs amounts to 21-40 EURO per ton of transported grain. Considering the trend of constant increase of oil price on world market, further increases of both transport costs and final cereal' products prices are expected. Besides, reconstruction of railway traffic infrastructure in Bosnia and Herzegovina is still political issue, and there are no indications of significant improvement regarding it.

2.3 Quality of cereals

The main cereal crops in Bosnia and Herzegovina are maize and wheat. Barley, oats and rye production is declining, while triticale production for animal feed has increased over last few years. The only wheat produced in Bosnia and Herzegovina is soft wheat (Triticum aestivum), mainly winter wheat and hence durum wheat (Triticum durum) has to be imported. For quality reasons, but for tradition as well, wheat and maize seeds are mainly imported from neighbouring countries, from institute in Zagreb (Bc hybrids) and Osijek (Croatia) and institutes in Novi Sad and Zemun (Serbia and Montenegro). Beside these, in maize production seed produced by Pioneer (USA) are used as well.

Experts in cereal production from Bosnia and Herzegovina claim that the quality of domestic cereals is rather uniform and there are no significant deviations from year to year. They meet quality standards in chemical and physical characteristics. Only in the cases of extremely humid years, or drought years such as 2003, is quality poor or the yield drastically reduced. However, quantities of poor quality cereals due to uncertified seed use can be found from time to time.

Bosnia and Herzegovina is characterized with another kind of problem. That problem is the quality of imported cereals that varies from year to year and from mill to mill. This problem is the consequence of the lack of good legislation in the field of mill-bakery industry. Only in Federation of Bosnia and Herzegovina, Regulations that regulate conditions, technical-technological equipment and personnel needed for firm to operate in milling industry has been adopted. Regulations on minimum technical-technological conditions for construction and reconstruction of bakeries and pasta factories do not exist in any entity in Bosnia and Herzegovina. Small mills and bakeries take advantage of this situation. They buy wheat and process it into flour straightway without prior laboratory analysis or finishing (washing, separation of unneeded matters). Bakery products of suspicious quality offered to consumers in Bosnia and Herzegovina are result of such practice.

2.4 Possible or existing market distortion

There is no strategic orientation of Bosnia and Herzegovina for cereals production. According to actual Medium-term Strategy of agricultural development of Federation of Bosnia and Herzegovina until 2010, it is planned that total land surfaces sown with cereals will increase to 112,000 ha from previous 91,000 ha, in which emphasize is on increased sowing of maize, triticale, popcorn and sweet corn. The wheat area is expected to increase by only 2.7%, while areas of barley, rye and oats remain at the same level. In both entities in Bosnia and Herzegovina minimum purchase prices for each cereal are determined by the entity governments and these prices are paid mainly by the formerly state-owned mills and the cereals purchased are used as state commodity stocks.

Although the level of interventions on the market of agricultural commodities in Bosnia and Herzegovina is very low, there is a need to reform price policy in agriculture. Guaranteed minimal purchase price for wheat, maize and other cereals did not resulted in market surpluses of these commodities; therefore this measure is not needed any more.. Bosnia and Herzegovina does not have a clear strategy regarding cereals stocks and in consequence there are very limited state actions in the cases of cereals market distortions. Before the war, stocks were determined by law, and each of state-owned mills was obliged to have on stock certain quantity which was followed by financial compensation from the state. Commodity stocks were mainly created on the basis of buying up domestic production. Nowadays, due to very limited budgets, there is a problem to finance stocks so most of the mills in Bosnia and Herzegovina do not have them at all.

With insufficient domestic cereal production, particularly wheat, Bosnia and Herzegovina depends on imports of market surplus from neighbouring countries from where the most of the import comes. Any possible distortion of production or markets in Hungary, Serbia and Montenegro and Croatia would have a direct impact on Bosnia and Herzegovina's cereals' market.

2.5 Assessment of the market integration

Very small farm land size, low and irrational level of machinery use, relatively poor farmer education and the lack of state support in input purchase are just some of the factors that raise cereals production costs and keep the level of production prices for most of cereals in Bosnia and Herzegovina high. So, the average production costs in 2004 for main cereal crops were: wheat 140.3 Euro/tonne, maize (kernel) 136.3 Euro/tonne, barley 135.3 Euro/tonne, oats 187.7 Euro/tonne, rye 170.2 Euro/tonne. With such high prices, cereal produced in Bosnia and Herzegovina can not be competitive neither in the region nor on the international market (for example wheat production costs in 2004 was 140.3 Euro/tonne in Bosnia and Herzegovina while in Hungary it was 90-100 Euro/tonne).

As far as trade and price policy are concerned, key priorities for Bosnia and Herzegovina are: increase of domestic production placed on domestic market, establishment of new system of certification and standardization of agricultural products, establishment of quality control system, development of individual markets to increase agricultural export and reduce trade deficit, membership of WTO and establishment of closer relations with EU.