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## **The Effects of the European Union Enlargement on Foreign Trade of Bosnia and Herzegovina**

### **Ефекти проширења Европске уније на спољну трговину Босне и Херцеговине**

#### **Summary**

*In times of globalization, there is a worldwide trend of creating various regional economic integrations which aim to benefit for their members. Almost all of the countries belong to or aspire to belong to a group. One of them is Bosnia and Herzegovina. As a member of CEFTA since 2006, Bosnia and Herzegovina has built its foreign trade position together with other members, with which it has had exceptionally immense level of cooperation. Bosnia and Herzegovina is committed to joining the European Union, but the accession process is facing a lot of difficulties and going slowly, so that the time of receiving full membership is completely uncertain.*

*Croatian withdrawal from the zone of free trade for the sake of joining the European Union has had inevitably serious consequences for the rest of the countries, reflected in decreasing the volume of mutual trade, stricter standards for export and differences in tariff and non-tariff barriers relative to those that existed during the membership in the same integration. At the same time, there is a change for the new member of the European Union, which improves its trade relations with for-*

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sign countries and confirms some theoretical standpoints on the effects of regional integration. Although mostly positive, these effects are not equally distributed to all members of the European Union.

The aim of this study is to investigate the effects of the European Union enlargement on the foreign trade positions of new member states, as well as the countries which are in the accession process and have a significant exchange with the European Union. Through the analysis of indicators of the member countries, a possible direction of foreign trade development of Bosnia and Herzegovina on its path towards full membership in the European Union is presented.

**Keywords:** Bosnia and Herzegovina, the European Union, enlargement policy, foreign trade, economic growth

## Резиме

У вријеме глобализације, у цијелом свијету долази до стварања различитих регионалних економских интеграција, чији је циљ остваривање користи за своје чланице. Гођово све земље припадају или теже да припадају некој интеграцији. Једна од њих је и Босна и Херцеговина. Као чланица СЕФТА-е од 2006. године, Босна и Херцеговина је традила своју самољнољрљовинску ѓозицију заједно са друђим чланицама, на које је дила (и остала) изузетно уђуђена. Босна и Херцеговина је одредилеђена за улазак у Евројску унију, али ѓроцес ѓриклучења иде уз досђа тељскођа и сђоро, теако да је вријеме стицања ѓунољравнољ чланства ѓотђуно неизвјесно.

Истђуђањем Хрватљске из зоне слободне трљовине зарад уласка у Евројску унију, неиздјежно настђају оздљбне ѓосљедице ѓо ѓреостђале земље, које се одледају у ѓаду обима међусодне размјене, остђриђим стђандардима за извоз и разликама у царинским и нецаринским баријерама у односу на оне које су ѓостђојале за вријеме чланства у истђој интеграцији. Истђовремено долази и до ѓромјена ѓо нову чланицу Евројске уније, која ѓодољшава односе размјене са иностранством и ѓодврђује нека теорјјска стђановиђђа о ефектђима регионалних интеграција. Иако улавном ѓозиђивни, ови ефектђи нису једнако расђоређени на све чланице Евројске уније.

Циљ овољ рада је испђиђивање ефектђа ѓроширења Евројске уније на самољнољрљовинску ѓозицију нових чланица, као и земаља које су у ѓостђуку ѓридруживања, а имају велику размјену са Униђом. Кроз анализу ѓоказатеља земаља чланица ѓрезентђује се ѓравац мођуђељ развоја самољне трљовине Босне и Херцеговине на ѓуђу ка ѓунољравном чланству у Евројској унији.

**Кључне ријечи:** Босна и Херцеговина, Евројска унија, ѓолиђика ѓроширења, самољна трљовина, ѓрљвредни расђ.

## **1. Regional economic integrations and their effects**

Regional integrations are characteristic of modern international economic relations, and accession to the European Union, as an integration of a high level, one of the priorities of the Western Balkan countries. In addition to primary benefits arising from the various forms of regional integration relating to strengthening the ties between member countries, an increase in the volume of trade and a favorable foreign trade position, there are other motives for their development. These benefits primarily refer to the removal of tariff and non-tariff barriers, reduction or elimination of other trade restrictions, monetary cooperation, free movement of people and capital, joint research, etc. (Popović, 2016).

Regional integrations can be divided in several ways. Balassa (1961) indicates that the initial stage of regional economic integration includes: free trade area, customs union, common market, economic union and full (total) economic integration. This basic division has changed over the years and expanded with changes in global trends. Nowadays, regional integration can be considered as a form of association: regional autarky, free trade area, customs union, common market, economic union, monetary union, fiscal union and political union (Crowley, 2002).

Although any form of regional integration implies transfer of a part of the member states autonomy, or at least a change in the policy towards other countries, the highest form of integration is economic and political unions. They constitute central political and democratic institutions that govern the community and solve transnational issues, and in which the sovereignty of member states is marginalized (for example the influence of individual states in the US) (Popović, 2016).

The main effect of the regional trade liberalization is a reallocation of resources (Kovačević, 2000). It is quite clear that it is in the interest of the member countries to achieve as many benefits as possible from accessing the same, but they should ultimately be reflected in the improvement of the overall economic environment. In this sense, it is about dynamic effects of regional integration and their long-term benefits for the member states: scale economy, greater and faster technological change, expansion of productive techniques in the framework of the common market and the progress of the national economy as a whole. In addition to dynamic, there are static effects of regional integration. They are reflected in the so-called trade creation and trade diversion.

Trade creation happens when producers in one member country realise that they can import and export more to other member countries as a result of tariff elimination, because, in line with the general market principles, it makes goods more competitive (when Great Britain entered the European Economic Community - EEC it increased trade volume with existing EEC members). On the other

hand, trade diversion can be viewed from two aspects, depending on whether member countries adopt a single customs policy at the level of the Union or retain individual conditions for the third countries. In the first case there would be a diversion of imports from the most efficient country to the one with the most favorable trading conditions (after entering the EEC Great Britain began implementation of a single customs policy, which decreased exchange between Great Britain and New Zealand, the country with which it previously had a free trade agreement - Commonwealth Free Trade). In another case, trade diversion would relate to the routing of exports to a non-member state with the most favorable terms of trade (e.g. Russian exports to CEFTA countries would be directed to the country with the lowest tariffs).

Trade creation and trade diversion effects represent static benefits or losses from economic integration, depending on whether there are greater benefits from trade creation or losses from trade diversion.

The importance of regional economic integrations is not only reflected in the changes in the foreign trade position and economic growth of the member countries, but also in many other aspects of human life. These communities of states and nations often adopt common principles and values. A good example of this could be the European Union, the most complex integration of the modern era, with its motto *In Varietate Concordia* (United in Diversity).

## **2. Establishment, development and enlargement policy of the European Union**

Plan of Robert Schuman, the French Minister of Foreign Affairs, is considered to be the beginning of European unification. In order to control the production and distribution of coal and steel in France and Germany, and to disable redirection of production for the war needs, as well as to control the economic recovery in Germany, the two countries signed an agreement in Paris in 1951, with the participation of Italy and the Benelux countries. This contract established the European Coal and Steel Community, the first of the three communities that created today's European Union. The European Economic Community - EEC and the European Atomic Energy Community - Euratom were established in Rome in 1957. These three organizations joined into the European Communities - EC under the Brussels agreement (1965) – an organisation with common institutions which developed and functioned under this name until the Maastricht Treaty in 1992. That was when the agreement on the creation of the European Union was achieved.

The development of the European Union went through two parallel and related processes. The European Union was in its development transformed from a

free trade zone, across a single market and a monetary union, to a form of incomplete fiscal and political union. In addition to the transformation from lower to higher forms of regional integration, there has been the process of including new members, commonly called the European Union enlargement process. Of the initial six member states with approximately 200 million people, the European Union now has 28 member countries with around 507 million inhabitants with solid purchasing power.

Member states vary considerably in size and the level of economic development. From Germany, with over 80 million inhabitants (about 16% of the total population of the Union) to Luxembourg, Malta and Cyprus, which together make up less than 0.5 percent. Also, there is asymmetry in the economic development of member states, from tiny Luxembourg with GDP per capita of almost 65,000 euros and large Germany with 29,000 euros to Bulgaria which has GDP per capita less than 10,000 euros. These large differences among member states point out their different positions in the decision-making process, but also the diversity of the consequences that these decisions can have on different countries. It is easy to assume that, in such circumstances, the decisions taken by the authorities of the Union may cause asymmetric shocks, especially during a recession. While one country can benefit from certain decisions, others may face even greater difficulties.

The European Union enlargement policy has also evolved over time, from the basic conditions in the process of accession of new member states to complete conditionality (Špirić, 2010).

**Table 1.**  
*Chronology of the European Union enlargement*

Enlargement	Year	New member countries
I	1973	Great Britain, Denmark and Ireland
II	1981	Greece
III	1986	Spain and Portugal
IV	1995	Sweden, Finland and Austria
V	2004	Poland, Hungary, Czech Republic, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Malta and Cyprus
V+	2007	Romania and Bulgaria
VI	2013	Croatia

The enlargement policy has always consisted of three components: economic, legal and political. Economic component implies that a country that wants to join the EU must have a market economy developed to the extent that it can be competitive in the single European market. Legal component implies that a country accepts standards that are applied in the Union and must be ready to adapt its leg-

islation to these standards. The political component can be defined as the ability of institutions to ensure democracy and the rule of law, as well as the acceptance of political objectives of the Union.

These components were the basis for defining the membership criteria adopted in Copenhagen in 1993, namely:

- Political: the ability of institutions to ensure democracy, the rule of law, respect of human rights of minorities and the acceptance of Union's political objectives;
- Economic: existence of a functioning market economy and the ability of market participants to cope with competitive pressures within the Union;
- Legal: adoption of the *acquis communautaire*.<sup>3</sup>

Regardless of the initial general principles and later clearly stated criteria, both before and after the Copenhagen summit, each circle of enlargement was carried out in given, specific circumstances and relationships, political climate and economic situation. Each circle carried its peculiarities depending on the country-applicant and the general geopolitical situation.

The first rounds of enlargement included countries that were already relatively economically stable, democratic, developed and significantly adapted to EU legislation (with the exception of the Mediterranean countries: Greece, Spain and Portugal). Later rounds of enlargement established a complete conditionality policy, which today includes specific requirements for each potential candidate country.

Union's policy, manifested through policies of its most powerful members, determined the pace and direction of enlargement. This policy, which was much more than the Copenhagen political criteria, paved the expanding decisions, sometimes without considering the set of previously established conditions and criteria, or at least applying them selectively.

The speed of a country's entering the Union measured by the length of the period from submission of the application to a full membership is very different. Great Britain fulfilled formally and essentially all the conditions for admission; however, it still had to submit the request twice - in 1961 and 1967. This country became a member 12 years after the first application. The primary reason for that was the determined opposition of French President De Gaulle. In addition to the possible grounds of competitive and economic nature, the main motive for De Gaulle's opposition was the standpoint that the entry of Great Britain into the EU would strengthen the influence of the United States on the further develop-

<sup>3</sup> Since the problem of insufficient administrative capacity in the process of accession of new members occurred in a large number of candidate countries, in 1995 at the meeting of the European Council in Madrid another criterion was established - administrative. Administrative criterion is the ability to create an efficient system of public administration in order to ensure the quality of the process of adopting and implementing the *acquis communautaire*.

ment of the community. Time has shown that De Gaulle's assumption was correct. Today the European Union, at its own peril, carries out economic sanctions against the Russian Federation, while Great Britain makes history as the first and the only country to voluntarily leave the Union. A referendum held in June 2016 revealed a deep division within one of the most powerful countries of the Union and showed that despite all the efforts some countries make to gain membership, there are those which do not find retaining the same a priority.

Negotiations between the Union and some other countries lasted even longer. Turkey formally began accession process in 1987, received the status of the candidate in 1999, and started negotiations in 2005, alongside Croatia. Croatia became a member in 2013 and Turkey has not, even after 30 years. The German Democratic Republic, a country which had about 17 million people before unification with the Federal Republic of Germany, entered the European Union through the unification of Germany. No negotiations on eligibility and conditions took place.

Enlargement of the European Union is mainly realized through joined entering of smaller or larger groups of countries. Only in two exceptions, a single country was admitted. These were Greece in 1981 and Croatia in 2013. Indeed, the German Democratic Republic was separately incorporated into the European Union through the unification with the Federal Republic of Germany, although this enlargement of the Union - and it is enlargement beyond doubt - is rarely or never mentioned in discussions on the topic of EU enlargement.

What is essential for the analysis of the effects of enlargement on foreign trade of the old and new members, as well as foreign trade of non-members, is the collective or individual accession of new countries. What is the difference between joining the group of countries and individual entering? Precisely the fact that there are various positive and adverse effects of trade creation and trade diversion and various dynamic effects on new members, or countries that are not included in the Union but were important trade partners of the new member states before their accession to the Union.

All countries that joined the Union within a group were strongly connected to other members of the group, especially regarding economy and foreign trade. We could see that during the third enlargement when Spain and Portugal entered the EU. A similar situation happened with the fourth extension when Sweden, Finland and Austria joined the European Union, countries that already had strong foreign trade ties with the EU. Many new member countries were connected through the European Free Trade Association - EFTA (whose members were some of the first and third extension countries before joining the EU: the United Kingdom, Denmark, Portugal, and fourth extension countries: Sweden and Austria). Furthermore, the fifth major expansion countries: Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Bulgaria and Romania were members of

free trade zone CEFTA before integration. Strong foreign trade connections also existed between the Baltic countries: Estonia, Lithuania and Latvia.

Foreign trade of countries that entered the European Union within groups had a high level of geographic concentration before accession. The largest part of foreign trade was related to trade with countries within the group and/or the European Union. Foreign trade with the rest of the world was in many new EU member countries relatively small, and the effects of trade creation due to the entry into the Union greatly exceeded the negative effects of trade diversion.

### **3. The effects of EU enlargement on foreign trade of new members**

Many analyses indicate that foreign trade has a positive impact on economic growth (Nikolić, 2005). This is especially emphasized when arguing about the impact of export on production growth and national income (Krajišnik, Tomaš, 2014). Export causes an increase in production greater than the invested abroad, which is determined by the foreign trade multiplier (Machlup, 1950).

The main reason why a country has potential gains from trade is that trade increases the choice of the economy, which means that it is always possible to allocate income to realize all gains from trade (Samuelson, 1962). Foreign trade is a potential source of profit if the gains from trade outweigh the losses, regardless of the possible impact on the redistribution of income. A better way to assess the overall gains from trade is to ask a different question: Could those who realize gains from trade compensate losses to those who suffer, and still be in a better position? If so, then it is a potential source of trade gains for all (Krugman, 2008). Another question that arises after a positive answer to the above is: Are they willing to do so?

External trade is paramount for the European Union and its members. The European Union is the largest trading force in the world (Vukmirica, Špirić, 2005). All countries that joined the European Union had a positive effect on foreign trade, although these effects had different intensity in different countries. Moreover, the distribution of the overall effects on the foreign trade between old and new member countries, as well as between large and developed and small and less developed countries was different.

The benefits of joining the European Union on foreign trade of new members are reflected in the increase in foreign trade, especially export growth, which first resulted in a reduction of the current account deficit and then the realization of surplus.

**Table 2.**  
*Export of goods and services (% GDP)*

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cyprus	58.17	57.40	56.19	53.99	53.82	50.18	47.34	47.71	49.54	49.73	50.83	55.43
Czech Republic	47.06	57.43	62.31	65.29	66.55	63.36	58.81	66.18	71.62	76.53	77.25	83.62
Estonia	57.46	61.53	65.92	63.51	63.22	66.82	60.84	75.12	87.93	88.39	86.09	84.73
Hungary	56.60	60.02	63.15	74.63	78.61	79.96	75.06	82.62	87.53	87.42	88.76	89.25
Latvia	36.13	38.87	43.15	40.03	38.55	39.46	42.45	52.98	57.83	60.87	59.40	58.02
Lithuania		47.40	53.92	55.69	50.42	57.14	51.94	65.40	75.06	81.71	84.07	81.76
Malta	78.83	78.41	76.81	86.49	89.22	87.78	78.78	88.18	93.61	93.63	93.51	93.70
Poland	33.39	34.64	34.92	38.20	38.82	38.32	37.58	40.47	43.14	45.05	46.09	47.45
Slovenia	50.90	54.97	59.58	64.70	67.60	66.11	57.24	64.32	70.42	73.25	74.69	76.80
Slovakia	62.09	68.61	72.07	81.19	83.54	80.44	67.64	76.49	85.32	91.80	92.95	91.93
Romania				32.28	29.30	30.43	30.60	35.42	40.03	40.00	41.98	41.13
Bulgaria				48.00	53.31	53.62	43.79	55.14	63.64	64.60	68.39	67.90

Source: Author's analysis based on the data from: <http://databank.worldbank.org/>

The results of the analysis show that in the period prior to observed countries' entering the EU, i.e. in the period from 2000 to 2003, there was a slight decline in exports in most countries, except Poland, Slovenia and Slovakia. Also, immediately after joining the EU, most countries have increased exports, except Malta, whose exports in 2005 decreased by 2% compared to 2003, and Cyprus, whose exports in 2003 amounted to 58.1% and in 2005, they amounted to 56.2% of GDP. It is evident that not all countries were equally ready to enter the European single market and competition on it.

In the period from 2003 to 2005, the largest increase in the share of exports in GDP had the Czech Republic (32%). The smallest growth was recorded in Poland (4%). A significant decline in exports happened to all member countries in the period from 2008 to 2010, and it was caused by the global economic crisis. During this period, the largest decline occurred in Slovakia where the share of exports in GDP in 2009 dropped by 15% compared to 2008. After 2010 there was a growth in the share of exports in GDP in all countries.

Looking back at 2014, or 10 years after integration into the EU, it is evident that all countries recorded significant growth in the share of exports in GDP, except Cyprus, where the share in 2014 decreased by 3.4% compared to 2004. All other countries had an increase, from the minimum of 19.3% in Malta, to the highest 72.5% in Lithuania. Significant growth was also reported in Hungary in the amount of 48.78% and France in the amount of 45.60%. We can see that the share of exports in GDP in Romania since joining the EU has been constantly growing. It amounted to 29.3% in 2007 and to 41.13% in 2014. Unlike Romania,

which has had a steady increase in the share of exports in GDP, Bulgaria has recorded more modest growth, together with a decline in times of economic crisis.

An increase in exports, which among other things happened due to the effects of trade creation and dynamic effects of integration of these countries into the European Union, had a positive effect on the trade balance among the new member states, which transited from the zone of the larger or smaller foreign trade deficit to countries with surplus.

**Table 3.**

*Foreign trade balance (%GDP)*

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cyprus	1.53	-0.12	-0.54	-2.96	-4.81	-10.78	-4.50	-5.57	-3.42	-1.93	2.48	2.76
Czech Republic	-1.2	0.81	2.35	2.74	2.45	2.17	3.88	3.10	3.95	4.95	5.81	6.85
Estonia	-8.50	-7.88	-5.10	-10.15	-8.88	-3.93	4.96	6.36	5.82	1.00	1.44	2.62
Hungary	-3.97	-3.96	-2.29	-1.11	0.70	0.35	4.06	5.36	6.16	6.86	7.59	7.27
Latvia	-12.55	-15.47	-14.47	-20.70	-19.07	-12.89	-1.61	-1.46	-4.98	-4.41	-2.92	-2.86
Lithuania	-7.08	-7.02	-7.18	-10.20	-13.08	-11.57	-1.68	-1.88	-2.55	0.86	1.25	0.12
Malta	0.30	-2.19	-3.09	-4.53	-2.36	-1.50	-0.23	3.42	4.71	3.41	3.41	3.42
Poland	-2.65	-2.54	-0.94	-1.90	-3.30	-4.87	-0.75	-1.81	-1.76	-0.21	1.89	1.28
Slovenia	-0.32	-1.44	-0.64	-0.05	-1.30	-1.93	1.87	1.55	1.10	4.39	6.01	8.14
Slovakia	-1.89	-2.73	-4.59	-3.99	-1.12	-2.84	-1.41	-1.42	-0.89	3.70	4.54	4.18
Romania				-12.01	-13.89	-13.04	-6.04	-5.73	-5.33	-5.16	-0.56	0.09
Bulgaria				-17.46	-19.16	-20.16	-8.56	-2.79	0.98	-2.84	-0.58	-0.71

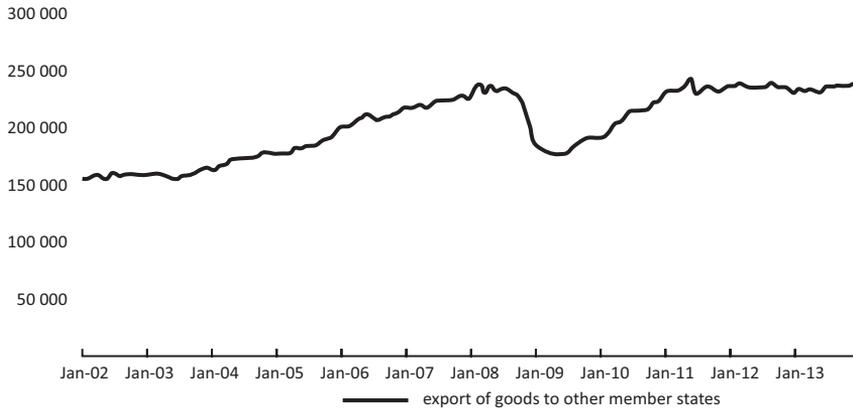
Source: Author's analysis based on the data from: <http://databank.worldbank.org>

In the year before entering the EU, all countries of the fifth enlargement had a foreign trade deficit, except Malta and Cyprus. The largest deficit was recorded in Bulgaria and Latvia, -17.46% and -12.55%, respectively, and the smallest in Slovenia and the Czech Republic, -0.32% and -1.2%, respectively. Countries with a low deficit in foreign trade, such as Slovenia, the Czech Republic, Slovakia and Hungary were the most prepared for the membership. In just a few years, they became relatively fast countries with a surplus, e.g. the Czech Republic from the very first year of its membership. In countries with a high deficit, balancing the foreign trade was a slow process, but it still happened.

Ten years after joining the EU, all countries recorded a foreign trade balance improvement. All countries had foreign trade surplus in 2014, with the exception of Latvia, which had a deficit of -2.86% of GDP. It should be noted that Latvia had a deficit of -15.47% of GDP in 2004, so it also made a significant improvement in the trade deficit during the ten years of its membership in the EU. In the year of joining the EU, Romania and Bulgaria had a foreign trade deficit in the amount of -13.9% and -19.1% of GDP. In 2014, Romania achieved a surplus of 0.09% of

GDP, while Bulgaria had a foreign trade deficit of -0.7%, which represents a significant decrease compared to 2007.

This positive change was certainly due to the effect of trade creation and increase of intra-regional trade among member countries of the Union. This is particularly evident in the movement of exports to other EU member states.



**Graph 1.** Movement of intra-regional exports in the EU from 2002 to 2013

Source: <http://ec.europa.eu/eurostat/>

The analysis clearly shows that, unlike the previous period, export to other member countries had steady upward trend since 2004 - the year of EU enlargement. This trend of increasing export lasted from 2008 to 2009 when there was a decrease due to the economic crisis. After that, there was an increase in export between countries within the Union, but also some stagnation in the recent years.

**Table 4.**

*Export of goods to other member countries in the period 2003 - 2013 (bill. EUR)*

	Austria	Belgium	Bulgaria	Denmark	Estonia	Finland	France
2003.	63.3	172.6	3.8	42.5	3.0	29.2	228.8
2013.	92.0	247.6	13.4	52.6	8.7	31.0	258.8
	Greece	Netherlands	Croatia	Ireland	Italy	Cyprus	Latvia
2003.	6.7	207.8	3.4	61.6	166.0	0.3	1.9
2013.	12.8	328.8	5.3	48.9	209.3	0.9	7.2
	Lithuania	Luxembourg	Malta	Hungary	Germany	Poland	Portugal
2003.	3.8	9.5	1.0	31.2	414.5	35.4	22.3
2013.	14.1	11.2	1.1	63.4	623.4	113.8	33.3
	Romania	Slovakia	Slovenia	Sweden	Spain	Czech Rep.	United Kingdom
2003.	10.9	13.7	8.5	50.5	99.5	35.1	182.1
2013.	34.5	53.7	19.2	72.9	150.0	98.6	178.0

Source: <http://ec.europa.eu/eurostat/>

Effects of the integration process on intra-regional export were significantly different in different countries. All member countries except the United Kingdom and Ireland had an increase in intra-regional export. It can be seen that some countries “seized” significantly larger portion of that increase. Germany and the Netherlands with about 330 billion euros increase in intra-regional exports had a greater increase than the twelve countries of the fifth major expansion. If we exclude two largest countries, Poland and Spain, from the twelve countries of a big expansion, we can see that Germany’s increase in intra-regional exports of 208.9 billion euros was higher than other ten (small) countries of the fifth enlargement. Although the focus of this paper is not a deeper analysis of the effects of various policies that member states implement, it is interesting to compare the intra-regional increase in exports of similar size countries with different monetary policy. Thus, the Czech Republic, which remains outside the euro zone had an increase of 64.5 billion euros, while Greece, whose currency is the euro, had a ten times smaller growth of only 6.1 billion euros.

The reasons for major differences can be found in different economic structures and levels of development, in size of the countries, as well as in differences in the competitiveness of individual economies. Similarly, the policies implemented at the level of the Union had a different impact on different countries. For example, the weakening of the euro against other currencies was in favor of German strong export sector, but not in favor of Greece which had massive debts.

The global economic crisis caused considerable asymmetric shocks within the Union and in the recovery period gave a contribution to these differences. “When the currency of a country with a deficit exchanges at a fixed rate for the currency of its partners with a surplus, its international value remains fixed. That sounds great if you live in such country and possess a lot of its money. But it is a terrible thing for the vast majority of its people who have little money. Once a series of successive bankruptcy starts, revenues are doomed to decline while private and public debts to foreign banks remain the same. The price paid for fixed exchange rates is a deadly embrace of the country which has experienced a bankruptcy, poor citizens and insolvent private sector. A vicious circle, heinous vortex, leads the majority of citizens to indebtedness, the country to stagnation, and the entire nation to shame.” (Varoufakis, 2016).

In addition to asymmetric shocks from the time of recession, the period of prosperity has led to a reduction of differences in the development of new and old member states. It seems that the process of convergence is also present at the global level, in which developing countries are trying to catch up with developed countries, despite the differences between the rich and the poor that remain large. Moreover, there is no evidence that the process of catching up happens primarily due to investments of the first in the others; on the contrary (previous

experience shows that investments of the others in their own country seem more certain) (Piketty, 2015).

In order to overcome asymmetric shocks caused by the crisis within the European Union, it would be necessary to develop a different, active role of the state. The state must keep an eye on proper incentives (Stiglitz, 2013). However, the European Union is not a state and does not have a unified fiscal policy that would allow income distribution from countries with prosperity to countries in crisis. Europe is not completely united. It is a collection of states that have their own budgets (because there is very little fiscal integration) and their own labor markets (because labor mobility is small) - but do not have their own currencies. And that creates a crisis (Krugman, 2012).

In addition to asymmetric shocks, the crisis affected the position of some countries in the Union, but also the EU enlargement policy. EU enlargement in 2004 was called the “big bang”, because it was the largest accession to the Union. Truthfully, those were different times. The world was facing economic expansion: economic growth, foreign direct investment grew year in year out, the political climate in the world was good. At the EU summit in Thessaloniki in 2003, the door was open to enlargement to the countries of the Western Balkans. The economic crisis of 2008 has changed everything. The crisis in the eurozone, debt crisis, particularly in the south of the EU or its less developed area, high unemployment, the problem of getting out of the vicious circle – all led to questions of further development of the EU. Nevertheless, Croatia was admitted as the 28th member of the Union in 2013 (Vukmirica, Špirić, 2014). This latest enlargement of the European Union had a significant impact on foreign trade of Bosnia and Herzegovina which was one of Croatia’s most important foreign trade partners.

#### **4. Effects of the last EU enlargement on foreign trade of Bosnia and Herzegovina**

The historical and cultural connection between Bosnia and Herzegovina and Croatia makes economic interdependence of these countries almost naturally given. Their geographical location necessitates connectivity of infrastructure systems and allows frequent exchanges of various types of goods and services.

Croatian foreign trade position before and after joining the European Union had similar characteristics to the positions of countries examined in Section 3 of this paper. After the acquisition of EU membership, Croatian exports increased by about 20% compared to the value before the membership. There was also an increase in import, but to a lesser extent, so the export-import coverage ratio tends to increase.

**Table 5.**  
*Croatian export and import in the period 2011-2015*

\*000 EUR

Year	Export (X)	% of change in export	Import (M)	% of change in import	Export-import coverage ratio (X/M)
2011	9.582.161		16.281.147		58.85%
2012	9.628.468	0.48%	16.215.896	-0.40%	59.38%
2013	9.589.448	-0.41%	16.527.900	1.92%	58.02%
2014	10.368.782	8.13%	17.129.405	3.64%	60.53%
2015	11.527.852	11.18%	18.482.861	7.90%	62.37%

Source: Author's analysis based on data from document "Republic of Croatia Statistical Yearbook 2016" Croatian Bureau of Statistics

In addition to the total volume of exchange, it is interesting to observe trading with the European Union, with an aim to determine the existence of the trade creation effect.

**Table 6.**  
*Croatian trade with the European Union in the period 2011-2015*

\*000 EUR

Year	Export in EU	% of change in export	Import from EU	% of change in import
2011	5.735.364		10.065.202	
2012	5.601.436	-2.34%	10.133.930	0.68%
2013	5.926.536	5.80%	12.220.028	20.59%
2014	6.622.207	11.74%	13.082.393	7.06%
2015	7.683.383	16.02%	14.420.099	10.23%

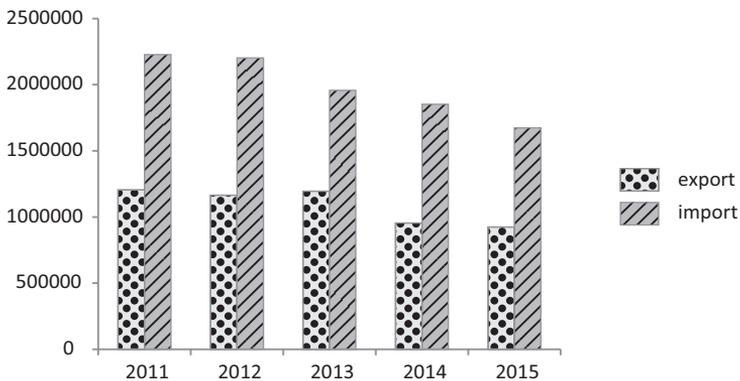
Source: Author's analysis based on the Croatian Bureau of Statistics data basis from, <http://www.dzs.hr/>

After the Croatian accession to the European Union, the effect of trade creation appeared, which is evident from the increase in Croatian export by 37% and import by 42% from 2012 (the year before entry) to 2015.

Croatia has been one of the most important trade partners of Bosnia and Herzegovina for years. Although during 2015 Bosnia and Herzegovina exported to Germany in the value of 1412.9 million BAM (15.7% of total exports), and to Italy in the value of 1214.9 million BAM (13.5% of the total exports), Croatia is its third largest trade partner, and the first from its neighboring countries. The value of exports to Croatia in 2015 was 925.2 million BAM or 10.3% of total exports.

In the context of foreign trade relations of Bosnia and Herzegovina and Croatia, it is interesting to observe the volume of trade of Bosnia and Herzegovina with some regional groups before and after 1 July 2013. For example, the highest export in 2011 was to the EU amounting to 4586.7 million (55.8% of total exports). Export to CEFTA countries in 2006 amounted to 2873.9 million (35% of total exports). The first year after the Croatian accession to the European Union brought a significant change in these relations, and in 2014 Bosnia and Herzegovina had total exports to the EU worth 6,266.6 million EUR (72.2% of total exports), while exports to CEFTA 2006 countries fell to modest 1,358.2 million EUR (15.6% of total exports). The foregoing indicates an increase in the geographical concentration of exports from Bosnia and Herzegovina to the EU, which was even before at a very high level and which carries potential risks of excessive exposure (Krajišnik, 2013). This situation could additionally be changed if Serbia joined the European Union before Bosnia and Herzegovina, which is quite realistic scenario.

Over a few years, the export and import between Bosnia and Herzegovina and Croatia had the following movements:



**Graph 2.** Export from Bosnia and Herzegovina to Croatia and import from Croatia in the period 2011-2015. Source: Author's analysis based on data from the Agency for Statistics of Bosnia and Herzegovina publications "BiH trade with foreign countries" for 2011, 2012, 2013, 2014 and 2015

In the period from 2011 to 2015, there was a bigger decline in imports than exports, which at the time of Croatia's accession to the European Union might not have been expected. On the other hand, the sharpest fall in exports in this period occurred precisely in 2014, the first year after Croatia became a full member of the European Union. The coverage of imports by exports in 2013 was the highest and amounted to 61.06%, which is for Bosnia and Herzegovina an excellent result. In the following year, after the Croatian accession to the EU, this ratio

fell to 51.58%, and with a slight increase in 2015 it remains at approximately the same level.

When it comes to the structure of goods and services that are most traded between the two countries, they can be classified as follows:

**Table 7.**

*Exports of Bosnia and Herzegovina to Croatia and imports of Croatia according to SITC*

*\*000 BAM*

Year	TOTAL	Food and live animals	Beverage and tobacco	Raw materials, inedible, except fuel	Mineral fuels, lubricants and related products	Animal and vegetable oils, fats and waxes	Chemical products	Goods classified by material	Machinery and transport equipment	Various manufactured products
Export										
2011	1.204.440	136.128	28.740	89.169	236.687	34.932	34.093	503.322	39.913	101.454
2012	1.164.998	138.057	27.230	74.444	232.349	47.068	44.417	455.916	37.873	107.643
2013	1.194.637	106.105	27.679	86.423	374.790	36.612	44.531	373.526	36.563	107.825
2014	955.047	64.574	24.867	92.148	201.224	11.492	40.793	346.305	38.280	135.364
2015	925.166	64.537	22.433	99.451	193.789	3.138	47.262	287.912	48.182	158.461
Import										
2011	2.226.508	433.576	176.580	74.050	843.545	15.966	196.453	278.217	117.710	90.410
2012	2.202.563	443.306	181.547	84.352	854.629	19.485	186.186	249.958	99.530	83.570
2013	1.956.381	347.471	154.728	70.419	773.203	8.952	177.712	262.367	82.303	79.227
2014	1.851.693	294.783	134.759	63.533	682.486	11.721	187.434	293.126	97.584	86.265
2015	1.673.068	311.009	131.378	54.888	541.742	6.737	184.661	275.856	87.433	79.364

Source: Author's analysis based on data from the Agency for Statistics of Bosnia and Herzegovina publications "BiH trade with foreign countries" for 2011, 2012, 2013, 2014 and 2015

Traditionally, Bosnia and Herzegovina has the largest export in sectors "Goods classified by material" and "Mineral fuels, lubricants and related products". On the import side, in addition to "Mineral fuels, lubricants and related products", the most important sector is "Food and live animals".

This structure of the goods that are the most frequent subject of exchange indicates that Bosnia and Herzegovina does not use its natural resources in a proper way. If we take into account the fact that just in 2015 Bosnia and Herzegovina imported almost five times more food and animals than it exported, and in the beverage and tobacco sector almost six times, the question is why. Bosnia and Herzegovina is rich in resources such as energy, drinking water, and has favorable natural conditions for production in some branches of agriculture (horticulture, animal husbandry and fishery) and in these segments it could achieve a compara-

tive advantage. However, this is currently not the case. The reasons for the unfavorable relations in trade with Croatia may not be found solely in the benefits that Croatia has as a member of the European Union, since these unfavorable relations in observed sectors existed years before the enlargement of the Union.

However, after the Croatian accession to the European Union, there was a significant decline in exports from Bosnia and Herzegovina to this country (20.06%), while in the previous year exports grew by 2.54%. There were negative developments within the sectors. Thus, for example, in 2014 exports in the field of animal and vegetable oils, fats and waxes fell as much as 68.61% (in the previous year the decline was 22.21%; negative trend continued in 2015 when the decline of exports amounted to 72.69%), while in the field of mineral fuels, lubricants and related products, which is a powerful trump of Bosnia and Herzegovina, there was a decline of 46.31%. In the previous year, this sector recorded an increase of even 61.30%. Sector analysis indicates the reasons for exchange reduction. These are primarily related to the introduction of customs between Bosnia and Herzegovina and the European Union which did not exist when Croatia was a member of CEFTA. There are also many non-tariff barriers that make it difficult and more expensive to trade between BiH and EU member states, as well as with Croatia (meeting the standards in force in the EU, the administrative procedure, the limits to border crossings etc.).

The aforementioned indicates the significant changes that have occurred as a result of the enlargement of the European Union on the first neighbour of Bosnia and Herzegovina. Given that the Croatian accession to the European Union was separated from the other member countries of CEFTA 2006, the negative effects of this expansion have been even more pronounced.

All analyses clearly indicate that the enlargement of the European Union leads to positive effects on new members manifested in trade creation effect and dynamic effects. Also, it is clear that the enlargement of the European Union affected the change in the foreign trade position of Bosnia and Herzegovina. The change is reflected in the increase of the risk arising from the increase in already high geographical concentration of foreign trade with the European Union. Also, the analysis shows that there have been negative effects of trade diversion in foreign trade between Bosnia and Herzegovina and Croatia. In the period after the Croatian accession to the EU, in both countries there was an increase in total foreign trade, and their mutual exchange has decreased significantly. The negative effects are particularly evident in some export sectors of Bosnia and Herzegovina, so the increase in exports to other countries and the decrease of imports from Croatia have not significantly improved poor trade balance of Bosnia and Herzegovina. The positive effects of the increase of foreign trade with other countries

and increased exports in some other sectors were significantly reduced by smaller trade with Croatia after its entry into the European Union.

The coverage of imports by exports in trade with Croatia after its accession to the EU declined from 61.6% to 51.8%. The situation could further deteriorate in the future. Implementation of the Adapted Stabilization and Association Agreement will further liberalize trade flows. The pressure of foreign competition, which is highly subsidized in the European Union, can be a serious problem for manufacturers in Bosnia and Herzegovina. The analysis of foreign trade relations between Bosnia and Herzegovina and Croatia indicates a greater negative impact of the effects of trade diversion in cases of individual countries joining the EU than in joining a group of interconnected countries. These negative effects are manifested in Bosnia and Herzegovina, i.e. the partner country that remains outside the integration, but also in Croatia as a new EU member state.

Full membership of Bosnia and Herzegovina in the European Union is still far away. The first neighbours, Serbia and Montenegro are ahead of Bosnia and Herzegovina in the negotiation process and they are likely to join the EU before Bosnia and Herzegovina. Such situation would produce a negative impact on foreign trade position of Bosnia and Herzegovina, similar to the one that occurred with the Croatian accession to the European Union.

## **5. Conclusion**

The European Union is regional economic integration of the highest form. It is the strongest trading power in the world. Therefore, changes that are happening within this integration have significant effects, not only on old and new member countries, but also on other countries which are economically connected with it.

The European Union is a very complex organization, because of the large number of member countries that are different from each other in size and economic strength, the way that decisions are made within the Union, but also because of the various interests of individual members.

The European Union, which has 28 member countries, was developed out of free trade zone made for a specific group of products, until it became an economic and monetary union (although not all members of the European Union are part of it, only 19). The Union had 6 member countries at its beginning and also experienced 6 extensions to new members. Both processes - expansion and development - have produced static and dynamic effects of economic integration. These effects, which were clearly seen through the process of trade creation and trade diversion, significantly affected the foreign trade flows, and consequently the overall economic trends of three groups of countries. The first group consisted of the existing members of the Union, the second was made up of new

members that joined the expanding integration, and the third group consists of countries that remained outside the integration, but have strong foreign trade and overall economic relations with member countries.

The economic effects of enlargement of the European Union have been positive for most countries. Many studies were conducted on that subject. However, besides positive effects, there were negative too. Also, the positive effects were not the same for all countries. Significant disparities in the benefits of the creation of free trade zone have appeared between stronger and weaker members, between large and small countries, between countries which entered the Union as a group of mutually connected countries and those which entered individually.

The latest enlargement of the European Union, when Croatia joined, has substantially affected foreign trade status of Bosnia and Herzegovina, since Croatia was one of the most important foreign trade partners of this country.

Union's enlargement to Croatia has led to a significant reduction in foreign trade exchange between Croatia and Bosnia and Herzegovina. The adverse effects of trade diversion have reflected on the foreign trade position of Bosnia and Herzegovina, especially some of its export sectors. The situation in the future can have similar negative consequences if Bosnia and Herzegovina lags behind in the process of joining the European Union in relation to other countries of CEFTA 2006, particularly Serbia, which is its important foreign trade partner. The analysis of foreign trade relations of Bosnia and Herzegovina and Croatia confirmed the thesis about major negative impact of the effects of trade diversion regarding cases of countries that individually joined the EU rather than a group of countries which were mutually connected. These negative effects are manifested both in new member countries and their partners that were left outside integration.

In the accession process Bosnia and Herzegovina must change elements of its foreign trade policy in order to overcome, most importantly, non-tariff barriers that impede its access to the large EU market. This is particularly important when the trade relations between Bosnia and Herzegovina and the EU in terms of customs, as the most important instrument of foreign policy, are almost completely liberalized.

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