

**BOSNIA AND HERZEGOVINA**  
**Stabilisation and Association Report**  
**2003**

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## 1. EXECUTIVE SUMMARY

Irrespective of any ambition to accede to the European Union, Bosnia and Herzegovina (BiH) needs to become a self-sustaining state. Without self-sustainability BiH can neither meet the basic needs of its citizens in terms of security, institutionalised freedom and economic well-being, nor can it integrate into European structures. Self-sustainability is therefore a pre-condition for BiH's advance from dealing with the aftermath of war (reconstruction and peace implementation) to a **transition agenda** in which, like its central and eastern European neighbours, it can concentrate on the reform and technical adjustments necessary for integration into the EU. The past year has seen important advances, but self-sustainability is not yet guaranteed. The recently inaugurated governments with their four-year mandates will be decisive in deciding whether this can be achieved within a reasonable time-frame.

General elections in October 2002 confirmed that BiH, whatever its **political and institutional challenges**, adheres to basic democratic principles. The landmark decision on the implementation of the 2000 BiH Constitutional Court decision on "constituent peoples" has altered the dynamics of national politics and advanced integration. Other achievements such as progressive dismantling of parallel structures within the Federation of Bosnia and Herzegovina (FBiH), deployment of the State Border Service (SBS) at all border crossing points and successful military reductions indicate progress on a wide front. Nevertheless, evidence of real "reform ownership" and of a sustainable domestic political dynamic remains limited: pressure from the High Representative and the international community remained vital for many of the reforms which were initiated. An example of the failure to move from the post-war to a transition agenda is the continued impunity of indicted war criminals such as Radovan Karadzic in Republika Srpska (RS). The fight against corruption and organised crime needs to be strengthened. Failure to address these issues is incompatible with integration into EU structures.

In terms of the **economic** situation, long-term sustainability is still far from guaranteed. After high rates in the second half of the 1990s fuelled by reconstruction aid, growth is slowing down. Estimated GDP is still below half its pre-war level (which BiH is expected to reach only in 2010 or later), even though the presence of the informal economy may distort this figure. The economic and social costs of poor internal harmonisation and co-ordination hamper the efficiency of the State and eliminate the benefits of decentralisation. Public spending remains excessively high, while on its balance of payments BiH continues to run a deficit both in the trade and current accounts. However, over 2002 BiH maintained macro-economic stability, low inflation and continued its efforts towards lower fiscal deficits. Foreign direct investment (FDI) improved in 2002, but BiH still needs to do more to attract foreign investors. There is little evidence that BiH has addressed its chronic dependence on assistance - although this issue will present itself with increasing urgency as international aid declines.

Progress within the **Stabilisation and Association process** (SAP) has been noted. The Road Map was "substantially completed" by September 2002. Of course, the Road Map was never a recipe for perfect government or immediate EU accession, but it was an indication of some pressing issues and a measurement of political will to address them. Regrettably, its substantial completion took too long and its full implementation requires continued attention. The next SAP stage will be a Feasibility

Report which will assess whether BiH is ready to open negotiations on a Stabilisation and Association Agreement (SAA). If it is to catch up with its neighbours, some of whom may have entered the transition phase, BiH must accelerate reform, including those mentioned in the last SAp report, and develop truly self-sustaining structures.

## 2.POLITICAL SITUATION

### 2.1 Democracy and rule of law

*BiH's core challenge - that of building a self-sustaining state able to integrate into EU structures - remains. BiH has taken a number of important steps towards sustainability: it has implemented the 2000 decision of the Constitutional Court on constituent peoples, held successful elections and instituted new governments with four-year terms of office. It has begun to reform the institutional framework of the rule of law and has worked constructively to ensure a stable regional environment. These advances mean that BiH has moved away from the chronic instability of the early post-1995 period.*

*Achievements over the past year reflect action by previous governments at State and Entity levels - and substantial input by the international community. If BiH is to take a qualitative step and move decisively from stabilisation to a full transition agenda, the current four-year legislative period will be decisive. Governments recently elected (and dominated by nominally nationalist parties) have declared their willingness to take forward reform. The seriousness of this intent and their willingness to assume full responsibility for painful reform in the name of a wider good will decide BiH's medium- to long-term prospects.*

#### 2.1.1. Assessment of democratic institutions and attitudes to the state

**Constitution:** Since the 2002 SAp Report BiH has been characterised by some constitutional dynamism. In March 2002 the major political parties, under the guidance of the High Representative, reached agreement on implementing the BiH Constitutional Court's summer 2000 decisions on "constituent peoples". Entity parliaments subsequently adopted the agreement (although the High Representative had to impose elements in both Entities) and amended Entity constitutions now incorporate the agreement. A Task Force, established to ensure implementation of the constitutional amendments, adopted an action plan foreseeing full implementation by early 2003. By requiring representation of each constituent people in each Entity government, administration and judiciary, the constitutional amendments have advanced national integration and considerably affected the dynamic of local and national politics. BiH has thus made important progress in meeting the first recommendation of the 2002 Report.

Following the October 2002 general election the High Representative made further amendments to the F BiH constitution, paving the way for the establishment of Entity and cantonal governments in line with the earlier constitutional amendments. (The corresponding law in RS had already been adopted). The amended law on F BiH government provides for a total of 16 ministers (8 Bosniacs, 5 Croats, and 3 Serbs). The RS Government will also consist of 16 ministries (8 Serbs, 5 Bosniacs, and 3 Croats). The position of Deputy Minister was abolished in the Entities.

**Presidency:** During 2002 the tripartite BiH Presidency, based on the Alliance for Change, generally functioned well. However, disagreement on the financing of a BiH lawsuit against Serbia and Montenegro in the International Court of Justice blocked the adoption of the 2002 State budget for months. This regrettable blockage held up Road Map implementation and did nothing to promote a positive image of BiH. Following general elections in October, SDS, SDA and HDZ took the three BiH Presidency seats. A new BiH Presidency, under initial Serb chairmanship, was

inaugurated on 28 October. In a worrying development (and contrary to a Road Map requirement), the new presidency indicated a wish to reintroduce a system of separate (and presumably ethnically based) secretariats. Following international expressions of concern the idea was dropped.

**Parliament:** The performance of State and Entity parliaments has continued to improve. The BiH House of Representatives and House of Peoples enacted outstanding EU Road Map legislation and a number of other important laws. Despite improved technical expertise, the two Houses sometimes again adopted diverging legislative texts, leading to delays and postponement. Also, voting still often reflects ethnicity, leading, on occasions, to the blockage of vital laws (such as those on civil aviation and public broadcasting). Among the notable events of 2002 was a brief walk-out by Serb delegates to the BiH House of Representatives during the inaugural session in December in protest against the imposition of a Law on the Council of Ministers.

BiH's constitutional set-up means that Entity parliaments have vital legislative roles. In general, they have functioned efficiently, only occasionally adopting legislation at variance with that passed at State level. Obviously, Entity parliaments were affected by the 2002 constitutional changes: the number of delegates to the FBiH House of Representatives was reduced to 98, while the FBiH House of Peoples will have 58 delegates (17 Bosniacs, Serbs, and Croats and seven Others). In the RS National Assembly, a new Council of Peoples was established, composed of eight members from each constituent people and four Others. However, given low minority representation in each Entity, it has been difficult to identify Serb members for the FBiH House of Peoples and Croats for the RS Council of Peoples. While the reforms favour reintegration and encourage inter-ethnic co-operation, they will also complicate systems of government.

**General elections** dominated politics in 2002. On 5 October 2002 voters went to the polls (for the sixth time since 1995) to elect for a four-year term not only the State presidency, but also the BiH House of Representatives, the FBiH House of Representatives, the RS National Assembly, the RS presidency and vice-presidency, the ten Federation Cantonal Assemblies and the municipal council of Zepce. For the first time, the elections were organised (but not fully funded) by BiH itself. They were efficiently conducted (the new BiH Election Commission functioned well) and were virtually free of violence. Notable and commendable were diminished nationalist overtones and a diverse and balanced media coverage. In this, too, a 2002 SAp report recommendation was fulfilled.

57 political parties, nine coalitions and three independent candidates registered for the elections, thus giving voters a real choice. On the negative side, voter turnout was low (54%); young people in particular failed to vote. The elections saw a comeback by nationalist parties. HDZ, SDA and SDS again became the leading parties representing their respective ethnic groups. SDA gained the largest number of seats in the BiH and FBiH Houses of Representatives, while the SDS remained the largest party in the RS National Assembly and took the RS Presidency. HDZ became the largest Bosnian Croat party in both the BiH and FBiH Houses of Representatives. These parties took the positions of Speakers in the State and Entity parliaments. In contrast, the "Alliance for Change", formerly in power in FBiH and at State-level, collapsed. SDP, the leading party in the former Alliance, lost more than half its votes compared with the 2000 elections. Coalition-building proved difficult; new State and Entity governments were formed only in January and February 2003.

**Executive:** The BiH Council of Ministers, based on the Alliance for Change, generally functioned well. As a result, substantial reform measures were unblocked and progress made on some key political and economic issues (admittedly, sometimes under pressure from the international community). Thus, the State executive in co-operation with Entity governments agreed and presented to the Peace Implementation Council (PIC) "Agendas" with reform targets in the fields of economy, rule of law, education and defence. Particularly in the period between substantial completion of the Road Map and an EU Feasibility Report on opening SAA negotiations, it is important that BiH use these Agendas as a compass for reform and effect their implementation.

In December 2002 a reform of the BiH Council of Ministers was imposed by the High Representative on the basis of broad agreement negotiated between the parties. The new law stipulates a non-rotating Chairman for the full four-year mandate of the BiH Parliamentary Assembly. The Council of Ministers was also expanded to a total of eight ministers, with only one Deputy for each ministry. Further, the decision-making process was simplified with a reduction in the number of issues on which consensus is required. The reform should also give the Council a professional and adequately staffed secretariat. Following a recommendation the European Commission, a new Directorate for European Integration under the authority of the Chair of the Council was created. (The previous, under-resourced Ministry for European Integration had struggled to make its voice heard among competing ministries and to co-ordinate interests across State and Entities.) The aim of the reform is to increase effectiveness and policy consistency and to upgrade the authority of the European integration agenda. In February 2003 the reform was complemented by the adoption in national procedure of a BiH Law on Ministries outlining their respective competences.

BiH's complex system of government has thus seen significant reform. Implementation should lead to more effective government, but opportunities for obfuscation and blockage remain. As before, extreme decentralisation can make sensible harmonisation and internal co-ordination difficult, with obvious effects on executive efficiency. Any further reform should strive to reduce the complexities of government.

**Local authorities:** Following the October elections, the High Representative imposed amendments to the FBiH constitution with the aim of reducing the number of administrative layers at cantonal level. The "Special Regime" cantons with their systems of parallel government were abolished, the number of ministries in cantonal governments was reduced and the functions of cantonal Presidents (governors) and cantonal Deputy Minister posts were also abolished.

**Armed Forces:** The armed forces in BiH have been substantially downsized. If in 1995 430,000 men were under arms, by 2002 the figure had been reduced to 22,000 in both Entities. FBiH armed forces have been reduced to 13,200 (after a payment of up to €5,000 to each dismissed soldier), while the RS Armed Forces foresee reductions to 6,600 in 2003 (with €4,000 severance pay). Despite these cuts there remain serious doubts about the operational capability of what remains. Some 80% of Entity defence budgets are reportedly allocated to salary costs. The Entities are effectively disarming through the decay of their respective hardware.

Over the year, defence structures in BiH have been gradually reformed. At State level the Standing Committee on Military Matters (SCMM) has been reviewed and strengthened. At the January 2003 Peace Implementation Council (PIC) meeting,

BiH representatives, in a paper on "Defence Policy in BiH: Mission and Pledges", committed BiH to implementing defence reforms that would facilitate BiH's further integration into the European family of nations. In particular, there was agreement to strengthen State-level institutions exercising civilian command and control, to provide comprehensive and transparent parliamentary oversight of State-level defence institutions and to develop professional and affordable forces capable of defending BiH sovereignty and territorial integrity. Finally, the Armed Forces in BiH would be restructured to enable them to participate in NATO's Partnership for Peace, to integrate into Euro-Atlantic structures and to engage in peace-support operations throughout the world. These commitments now need to be implemented.

Scandals affected Entity armed forces during the reporting period. The RS air force was grounded and its Commander suspended in May, due to alleged intelligence activities directed against SFOR. In October, the RS Army was found to be in breach of the Dayton Agreement by possessing too many attack helicopters. In May, SFOR detected more than 9,000 grenades and three tons of gunpowder in secret warehouses in east Mostar. Senior officials from the FBiH Army were sentenced after illegal arms trade with Kosovo. Perhaps more seriously, an RS-based aviation company, "Orao", was found to have exported military equipment and technical assistance indirectly to Iraq in contravention of a UN arms embargo. Resignations and dismissals ensued, but the international community insisted on full investigation. The case, at first denied by RS, underscored the pressing need for stronger state-level structures, as it revealed a lack of democratic control over the military industrial complex. It underlined that the BiH state, which is responsible for carrying out BiH's obligations to the UN Security Council, had no control over export policy (since export permits were issued by Entities). Subsequently, responsibility for the approval of arms exports was reattributed to the State Ministry for Foreign Trade and Economic Relations. It is essential that this responsibility is met properly.

**International Presence:** The role of the international Community remains vital to the reform process. In May 2002 Lord Ashdown took over as a "double-hatted" High Representative and EU Special Representative (thus emphasising BiH's "European vocation"). The new High Representative prioritised justice, rule of law and economic reform and stressed the need for a properly functioning State administration. Following the October 2002 elections, the High Representative identified six "tests of seriousness" for the BiH government, including the introduction of VAT and further reform of the customs services. Despite continuing calls for BiH to assume ownership of reform, the new High Representative has continued active use of his "Bonn powers". Nevertheless, recognising that full implementation of Dayton should lead to BiH assumption of responsibility and thus to a diminution of the still intrusive role of the international community, OHR has developed a Mission Implementation Plan highlighting steps over the next years to "transition points" at which authority should be transferred to BiH.

In January 2003 a three-year **EU Police Mission** (EUPM), led by an EU Police Head of Mission and reporting through the EU Special Representative / High Representative to the Council, took over from the UN International Police Task Force (IPTF). EUPM is the first civilian crisis management operation under the European Security and Defence Policy (ESDP). The mission is made up of seconded police staff from 33 countries, with most officers coming from EU Member States. Running costs are funded from the Community budget through a contract between the Commission and the Police Head of Mission, while salaries are covered by sending

countries. EUPM complements other EU programmes in BiH, working in synergy with CARDS support for reform of the administration of justice and police. EUPM officers are co-located with local authorities on State, Entity and cantonal levels covering criminal police, public order and security, criminal justice, internal affairs, police administration, the State Border Service and the State Information and Protection Agency (SIPA). EUPM has no executive powers: it "monitors, mentors and inspects" police work, rather than assuming active police duties. This should underline BiH's increasing responsibility and a corresponding declining international role.

As BiH's security situation has stabilised (and new global challenges have emerged) SFOR has downsized to around 12,900 troops. The EU's December 2002 European Council conclusion to the effect that it is willing to lead a military operation in BiH following SFOR is a further indication of a long-term EU commitment. "Streamlining" has continued throughout the international presence in BiH. On completion of its mandate, the UN mission to BiH closed, while OSCE, UNHCR and others have rationalised and downsized their field presence.

### *2.1.2. Assessment of judicial system, law enforcement and respect for rule of law*

In an attempt to break into the vicious circle of problems besetting BiH, the international community has emphasised the establishment of rule of law as a prerequisite for progress (cf. the 2002 SAP Report. Also, the High Representative: "First justice, then jobs through reform").

**Judicial system:** The last SAP Report highlighted a judicial system in need of systemic change. In February 2002, the Peace Implementation Council (PIC) adopted a new, re-invigorated judicial reform strategy for BiH. Key elements of the strategy are re-selection of judges and prosecutors, a re-structuring / reduction of courts and prosecutors' offices and the establishment of centres for judicial and prosecutorial training. The reform, modelled on successful Brcko District reforms, is implemented under new High Judicial and Prosecutorial Councils at State and Entity levels. This strategy, a departure from the previous peer-review system, is now well underway and completion is envisaged by end 2003. With the "Jobs and Justice" programme, presented to meetings of the Peace Implementation Council (PIC) Steering Board in 2002, BiH governments committed themselves to this reform agenda. Nevertheless, RS deputies in the State parliament twice blocked attempts to pass the Criminal and Criminal Procedure Codes in urgent procedure. The codes were finally imposed by the High Representative in January 2003.

The mandate for Constitutional Court judges expired in May. New judges (three international and six national) were elected, but in September the High Representative cancelled the appointment of two RS judges since appointment procedures had not been followed. Despite Road Map recommendations, the Court is still confronted with limited financial means and personnel resources. In November 2001 the High Representative imposed the Law on State Court, and in May 2002 the first judges to the court's Appellate Division were appointed. The State Court, with three judicial divisions (Criminal, Administrative and Appellate) and covering issues of State-level competence, began work in January 2003. This was a significant milestone in securing the rule of law in BiH. The possibility of establishing an International Humanitarian Law division within the State Court to deal with lower level war crimes is under discussion.

**Police:** Many of the obstacles to effective policing in BiH identified in the last report persist. Although BiH may, by some estimates, be "over-policed" in terms of both its population and reported crime, the effectiveness of its policing is hampered inter alia by inadequate resources, poor equipment and training, low levels of pay (giving incentives for corruption), the lack of a central police information system and unreliable statistical data. Minority recruitment has improved, but remains low. IPTF provisionally decertified 472 serving police officers, but local authorities did work with IPTF to establish Police Commissioners in every police administration (cf. the 2002 Report recommendation.) A particular challenge is the improvement of inter-Entity, inter-service and inter-agency co-operation. There must be political commitment to the financial sustainability of police forces. From 1 January 2003 EUPM has worked to enhance further professionalism and to support a move towards European and international standards. BiH's aspiration to integrate with the EU implies that it will show strong commitment to EUPM objectives.

The **State Information and Protection Agency (SIPA)**, dealing primarily with the protection of embassies, institutions and senior officials was established in October 2002. The agency also gathers information on crime at state-level jurisdiction (terrorism, international crime, trade and manufacture of drugs, crimes punishable under international humanitarian law, etc.). The High Representative appointed SIPA Directors in October. Finally, the Bosniac and Bosnian Croat intelligence services were merged into a FBiH Intelligence Security Service.

**Respect for rule of law:** The 2002 report highlighted the pernicious effect of the inter-weaving of business, administrative and political interests in BiH. Unfortunately, evidence persists to the effect that corruption remains deeply rooted in public and business life. To address some elements of **corruption** in the BiH political space, the High Representative tightened provisions on immunity granted to public officials and limited the number of public office-holders who can invoke immunity from prosecution. Immunity is retained for parliamentarians to allow them to act and speak independently when performing their duties, but immunity was suspended for public office-holders committing acts outside their official duties. Also, in October a law on conflict of interest, policed by the BiH Election Commission, came into force. Under the law any public official may be fined, removed or referred to criminal prosecution who acts to further personal financial interests rather than the public good.

The last year was also marked by financial scandals which went to the heart of government in both Entities. In June the FBiH Finance Minister was removed from office after a Financial Police report indicated that a company had avoided an estimated €2.5 million in customs duties on imports and had been allowed to claim back a customs deposit of around €850,000. Subsequently, the Director of the FBiH customs administration resigned. In another case, a prominent meat factory was alleged to have benefited from illegal exemptions on customs duties (with an estimated loss to the FBiH exchequer of more than €6 million). A report by the Customs and Fiscal Assistance Office to BiH (CAFAO) on criminal activities in the RS customs revealed a network involved in multi-million euro fraud and irregularities. In these and other cases the BiH Courts have so far failed to produce any significant verdicts.

## 2.2. Human rights and the protection of minorities

*Since the 2002 SAP Report, improvements in human rights have been slow, but progress was made on the institutional framework. For example, constitutional changes were effected in the Entities and State-level government showed a new willingness to provide some, but not yet full funding for the human rights institutions. Institutional arrangements for the future of the BiH Human Rights Chamber remain to be secured. Further improvements in minority refugee returns and property law implementation continue to reverse "ethnic cleansing". RS still lags behind in the observance and implementation of human and minority rights. In many places limited social and economic opportunities for returnees are a major disincentive - and could lead to returnees abandoning their repossessed properties. Indeed, for all Bosnians economic hardship counters the effect of institutionally protected rights.*

*As the international community draws down its effort in support of refugee return, national authorities need to increase their administrative and financial input.*

### 2.2.1. Civil, political, economic, social and cultural rights

Constitutional changes as a result of the 2000 Constitutional Court decision on "constituent peoples" represented an important advance in formally securing citizens' **civil and political rights** throughout BiH. Mechanisms protecting the "vital national interests" of each constituent people were established. In July 2002 BiH ratified the European Convention on Human Rights, thus enabling BiH citizens to turn to the European Court after having exhausted domestic remedies. The work of the Dayton-mandated human rights bodies, Ombudsman and Human Rights Chamber, has continued, facilitated in part by a new willingness of State government to contribute to but not yet fully cover their running costs (and thus, in part, meet a 2002 Report recommendation). Plans to merge the Human Rights Chamber with the Constitutional Court (with completion originally foreseen before end 2003) have moved slowly. The mandate of the Commission for Real Property Claims (CRPC) expires at the end of 2003; the take-over of its responsibilities by national authorities will be facilitated if the Commission manages to deal with its outstanding caseload by that date.

Despite some institutional progress, barriers to the exercise of human rights and abuses still occur. Seven years after the war, thousands of human rights abuses (including disappearances) remain to be fully investigated, punished or redressed. Today, State and Entity Ombudsmen report that the most frequent violations of human rights relate to equality before the law, property rights and right to work. Compliance with decisions of the human rights institutions remains mixed: F BiH has the best record, while State and RS authorities still do not execute decisions satisfactorily. Some disappointment has been expressed about the record of former Alliance for Change governments in addressing human rights issues. The international community too has been criticised; for example, SFOR was criticised for holding a suspect thought to have links with terrorist networks.

The **economic and social rights** of BiH citizens remain necessarily limited by continuing economic debility. Officially, around 40% of the population is unemployed and around 20% live below the poverty threshold. As living standards have declined, BiH has seen strikes and some social unrest. This reflects the conspicuous failure of the rudimentary social security systems to address the needs of the economically most deprived. Ironically, BiH has one of the most generous systems of veteran entitlements in Europe. Transfers to (and tax breaks for) the politically influential and mobilised veterans constitute the single biggest Entity social

transfer - and have put severe strains on Entity budgets. The **health** sector in both Entities remains weak with inadequate funding. Parallel health systems persist within FBiH, and the 1998 FBiH Law on Health remains largely unimplemented. In RS the sector does not suffer from the same excessive decentralisation, but is plagued by financial crisis. **Education** has recently been a focus. A series of Education Targets was presented to PIC Political Directors in November 2002 by the BiH authorities.

The independence of the **media** and freedom of expression are largely respected, but independent journalists face similar levels of threat and abuse as in previous years. Following criticism, the FBiH government withdrew a draft Law on Protection from Defamation from parliament in summer 2002. In November the High Representative imposed an amended version of the Law on Protection against Defamation, designed to protect individuals from false accusation. During the reporting period, the Law on Public Broadcasting Service (PBS) was enacted (a Road Map requirement), although the High Representative initially had to impose it. The first state-wide TV news under the PBS started in May. The collection of TV licence fees has improved, but remains very low in RS.

**NGO** development remains slow. Improved inter-NGO co-operation was evidenced by participation in consultations for the Poverty Reduction Strategy Paper.

### ***2.2.2. Minority rights and refugees***

In June 2002 the two houses of the BiH parliament adopted a Law on the Protection of Rights of National Minorities - but in incompatible versions. The law is thus not yet in force. The law establishes the rights and obligations of national minorities in BiH and the obligations of BiH authorities in respect of them.<sup>1</sup> Despite the law, discrimination against Roma reportedly persists.

The **return of refugees and displaced persons** continued during the past year and reached encouraging levels. By the end of 2002 almost one million refugees and displaced persons, among them around 390,000 minority returnees, had been able to return home.<sup>2</sup> Estimates put the number of remaining displaced persons registered in BiH at around 367,000. Difficulties persist: minority returnees still face some local difficulties and harassment. The murder of three Bosnian Croat returnees in Konjic in December 2002 was the gravest single return-related crime since the war. During 2002 violence reportedly rose in the major target areas for minority returns. Also, the sustainability of many returns is in question. Some minority returnees reportedly wish to leave because of socio-economic difficulties and harassment encountered. In January 2003 BiH presented to the PIC an "Annex VII (GFAP) Strategy" detailing a transfer of responsibilities for refugee returns to domestic institutions. The realisation of the strategy and the sustainability of the return process will in part depend on domestic political will and the availability of funding.

There is a strong **regional dynamic** in the BiH returns process. There are some 125,000 BiH refugees in neighbouring Serbia and Montenegro and in Croatia, although it is unlikely that all of them wish to return. BiH is still host to some 22,000 refugees from Croatia and 6,000 from Serbia and Montenegro (including Kosovo). In 2002 some 33,000 also returned to BiH from further abroad. Returns across the

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<sup>1</sup> According to the law a national minority is a group not belonging to any of the three constituent peoples and made up of those with same or similar ethnic origins, traditions, customs, religion, language, culture, etc.

<sup>2</sup> Figures from UNHCR (BiH).

region would be facilitated by a greater compatibility of laws, rights and obligations across BiH, Croatia and Serbia and Montenegro.

**Property law implementation** within BiH improved by over 20 percentage points during the year. At the end of 2002, the overall implementation rate in BiH had reached around 70%, but around 80,000 unresolved claims remain. Since minimum requirements had been met, the EU Road Map steps relating to property law implementation and refugee returns were deemed to have been met in May 2002.

### 2.3. Regional Co-operation

*The July 2002 summit of BiH, Croatian and then FRY heads of state was symptomatic of improving bilateral relations and regional co-operation. BiH also made progress in integrating into regional and global organisations (as urged in the 2002 Report); accession to the Council of Europe was a notable success. Gradually a network of bi- and multi-lateral ties are consolidating BiH's position within a more stable regional environment. Where the regional order has been questioned, and thus stability put in question, this emanated not from BiH but from neighbouring states.*

*Unfortunately, BiH's good record on regional stabilisation has not been matched by full compliance with all other aspects of the Dayton agreement. Chiefly, because of RS obstruction and inaction, there has been inadequate progress on Article IX of the General Framework Agreement on Peace (GFAP), namely support to the prosecution of war crimes. No progress has been made on the arrest of Karadzic - and the relevant 2002 Report recommendation remains unfulfilled. Inadequate effort in this respect is incompatible with EU integration.*

#### 2.3.1. Multilateral relations

The General Framework Agreement on Peace (**GFAP - Dayton Agreement**) remains the basis of BiH's constitutional identity (annex 4) and its regional position. Civilian aspects of the Agreement remain to be fully implemented, but the last year has seen progress on human rights (annex 6), refugee returns (annex 7) and police reform (annex 11). Calls to "re-open Dayton" have been further resisted.

BiH co-operation with the **International Criminal Tribunal for the former Yugoslavia (ICTY)** remains mixed. In April 2002 the RS-set deadline for indictees to surrender expired without a single war-crimes suspect contacting the RS government; ICTY defendants from RS thus forfeit potential government legal assistance. In some regions, notably in RS, a veritable "hagiography of war crimes" has developed, and in parts of the RS army, police and some political circles opposition to the arrest of ICTY-indictees persists. Symptomatically, just before general elections the RS Bureau for Relations with ICTY presented a widely condemned report on the Srebrenica massacre, playing down the number of victims. In October, former RS President Plavsic pleaded guilty to crimes against humanity. Karadzic remains at large thanks in part to a network of financial support, although RS authorities claim to be unaware of his whereabouts. More positively, ICTY access to archives and witnesses in RS has improved somewhat. ICTY is more satisfied with the level of FBiH co-operation.

On 11 April BiH signed the Rome Statute of the **International Criminal Court (ICC)** in New York. The BiH authorities resisted a US proposal on a bilateral agreement based on the US Service Members Protection Act. US demands for ICC immunity for its forces led to a dispute with allies and an initial failure to renew the

mandate of the UN Mission in BiH. The dispute resulted in a compromise and the extension of the UN mandate in BiH until 31 December 2002.

In April 2002 BiH joined the **Council of Europe** (CoE). This was an important recognition of progress since the war. On accession, BiH undertook to meet over 90 post-accession commitments with deadlines for completion between six months and three years; these are subject to detailed monitoring. BiH also aspires to join NATO's **Partnership for Peace** (PfP) programme. However, NATO has identified as essential a single chain of command, parliamentary oversight of defence and full membership of the Council of Ministers for the Secretary General of the Standing Committee on Military Matters.

BiH has also continued to work within the **Stability Pact for South Eastern Europe**. In late 2002 this led to an agreement on the Sava Initiative to redevelop the Sava river basin and to a Memorandum of Understanding on regional electricity markets. Within the Pact work also continues on refugee returns and regional free trade. In August 2002 the BiH parliament adopted an amendment to the Law on Customs Tariffs and started the **World Trade Organisation** (WTO) accession process. BiH aspires to WTO membership in 2004. Co-operation with other regional initiatives - **the South East Europe Co-operation Process, the Central-European Initiative, the Adriatic-Ionian Initiative and others** - continues.

### *2.3.2. Bilateral relations*

BiH's interest in **regional stability** has meant continued concentration on the development of bilateral relations within the region. A high-point was the summit of the Heads of State of BiH, Croatia and Serbia and Montenegro which took place in July 2002 in Sarajevo. This marked an important step towards regional accommodation. It concluded with a joint declaration agreeing to implement the Dayton agreement, maintain the inalterability of the borders, promote refugee returns and co-operate on European integration. Subsequent statements by Serbian representatives, e.g. questioning BiH territorial integrity, have been at variance with this statement.

**Bilateral economic relations** continued to improve in 2002. The end-2002 deadline for implementation of the June 2001 Memorandum of Understanding (MoU) on Trade Liberalisation and Facilitation in the framework of the Stability Pact played a major role. In line with the MoU and the recommendations of the 2002 SAp Report, Bosnia and Herzegovina has almost finalised almost all the necessary bilateral negotiations, although difficulties connected with implementation have been reported (cf. section 4.2.1).

Relations with **Albania** present no particular problems. A free trade agreement awaits ratification. BiH requested asymmetric treatment.

Relations with **Croatia** have developed slowly but positively. Zagreb has continued to work with its BiH counterpart to reinforce BiH State institutions and discourage Bosnian Croat separatism. For example, when some one hundred Croats from Drvar moved to Croatia following their (legal) eviction from occupied housing early in 2002, the Croatian government co-ordinated its position carefully with its BiH opposite number. In summer 2002 an agreement on investment incentives and protection was signed, as was an accord on joint border crossings, thus enabling the opening of the disputed Kostajnica border point in August. Also, an agreement on co-operation in fighting corruption, smuggling, drug abuse and organised crime was

signed resulting in improved co-operation. Not all concerns have been resolved: the issue of the port of Ploce remains contentious - unfortunately, Croatia has refused to ratify the agreement signed in 1998. Finally, Croatia's lack of regionally compatible property legislation has hindered regional returns and put a brake on property law implementation within BiH.

Relations with **Serbia and Montenegro** have also improved despite a continuing case for alleged genocide at the International Court of Justice. Although border demarcation has not been finally resolved, a draft border treaty exists. Political dialogue between Serbia and Montenegro on the one hand and BiH on the other continues both in the Inter-State Co-operation Council and in the framework of the South East European Co-operation Process. Six bilateral agreements regulating practical issues have been signed, with a large number of others still awaiting signature. In June an agreement on free trade began to be implemented, consolidating Serbia and Montenegro's position as a leading trading partner (particularly with RS). In October the countries signed an agreement on dual citizenship giving the citizens of each country equal rights irrespective of domicile. Air traffic connections have recommenced.

In general, Serbia and Montenegro's special parallel relationship with RS has not disrupted bilateral relations. The former has reportedly stopped financial transfers to the RS army, although pension payments apparently persist. Remaining close ties between the RS and Serbian militaries and military industrial complexes are evidenced by the "Orao affair". On a state level, bilateral relations suffered when President Kostunica stated that RS is a "member of the all-Serb family only temporarily separated from its motherland, Serbia" - a statement with the potential seriously to undermine BiH national and regional stability. Also, the Serbian Prime Minister connected the GFAP, in particular the position of RS, with Kosovo's final status. Both statements drew criticisms from BiH politicians and the international community and pointed to unresolved tensions.

A Free Trade Agreement with the former Yugoslav Republic of Macedonia was signed in April 2002. It provisionally entered into force in July 2002.

Relations with **Slovenia** have remained sub-optimal due to problems related to old foreign currency savings belonging to BiH citizens in Slovenia's Ljubljanska Banka. Some BiH politicians and NGOs urged a boycott of Slovenian products because of unpaid Bosnian foreign currency savings. Only in July 2002 did the BiH Parliament ratify a free-trade agreement with Slovenia. Nevertheless, Slovenia remains a major investor in BiH.

Free trade agreements have been signed with **Turkey** and **Moldova**. Negotiations with **Rumania** were completed in December 2002, while negotiations with Bulgaria are nearing completion.

Over the past year BiH's relations with the **PIC Steering Board** have been further consolidated. The fact that the BiH authorities have presented agreed reform targets at meetings of the Steering Board may be indicative of a relationship characterised by greater partnership. Implementation of the targets would of course be firm evidence of growing partnership.

#### **2.4. Priority areas needing attention in the next 12 months**

- Ensure effective government within the restructured BiH Council of Ministers and the operability of the new ministries of Communications and Transport, Justice

and Security. Implement fully the reorganisation foreseen under the BiH Law on Ministries.

- Ensure rigorous follow-up to the "Orao affair" and other cases of significant malfeasance.
- Implement the Defence Targets presented to the January 2002 meeting of the PIC. In particular, ensure civilian command and control over the Armed Forces.
- Ensure full co-operation with EUPM.
- Ensure adequate resources for the Constitutional Court. Complete reform of the judicial system\*\* and in particular ensure the full operability of the BiH State Court and Prosecutor's Office.
- Ensure that the freedom and security of journalists is respected.
- Assume full operational and financial responsibility for the human rights bodies and further improve compliance with human rights decisions and property law implementation, particularly in RS.\*\*
- Implement the transfer of responsibility in the returns sector to local authorities and ensure implementation of the Annex VII (GFAP) Strategy.
- Implement rule-of-law measures outlined in the Jobs and Justice agenda, particularly those reforms identified as essential in year one.
- RS to ensure full co-operation with ICTY, including support for the arrest of Karadzic.\*
- Ensure the conclusion and implementation of regional free trade agreements.

### 3. ECONOMIC SITUATION

#### 3.1 Current Economic Situation

*Over the past year BiH has maintained macro-economic stability, low inflation, and continued its efforts to improve fiscal performance. Nevertheless, given rising external debt servicing requirements, weak private investment, a very high current account deficit and declining international assistance, BiH needs further vigorous reform. The IMF Stand-By Arrangement approved in August 2002 will provide a framework for economic growth through continued commitment to the currency board arrangement, further fiscal consolidation and structural reform. BiH's aim must be to turn a currently aid-dependent economy into one driven by SME development, FDI and exports.*

It remains difficult to analyse BiH's economic situation due to a continuing **lack of reliable statistical data**. However, there is now an agreement between BiH statistical institutes to harmonise methodologies and establish an internationally recognised system of national accounts and foreign trade statistics at State level. A BiH Law on Statistics, imposed by the High Representative in October 2002, requires co-operation between Entity institutes and reinforces State authority in compiling statistical data. This should make it possible to begin a more complete macro-economic assessment by the end of 2003.

\*\* Recommendation included in the 2002 SAP Report and only partially implemented.

\* Recommendation included in the 2002 SAP Report and basically not implemented.

Currently available indicators suggest a steady fall in annual **GDP growth**. After high aid-driven growth rates in the first half of the 1990s, growth declined from 5.6% in 2000, to 4.5% in 2001 and is estimated at 4% for 2002. Estimated GDP in 2002 amounted to about €5.7 billion - still less than half the pre-war level. GDP per capita, measured on the basis of purchasing power parity, remains among the lowest in the region at around €1,900 in 2001. However, if other informal sources of income are taken into account (e.g. non-registered transfers by BiH citizens abroad, employee income in unrecorded micro-firms, undeclared company revenue, etc.), the level of GDP could rise by 20%. According to official data, between January and September 2002 **industrial output** in the FBiH rose by 7.5% compared to the same period in 2001. In RS, after a fall of nearly 18% in 2001, industrial production continued to fall in 2002, although at a slower rate, with first three quarters' data showing a decline of 7%. As regards the structure of GDP, 2001 figures (the most recent available) show that agriculture accounts for 13% of GDP, industry and utilities for 23%, services for nearly 58% and construction 6%.

As recommended in the 2002 report, BiH maintained macro-economic stability. Continued adherence to the **currency board** arrangement kept **inflation** subdued - in the first nine months of 2002 roughly zero in FBiH and 2% in RS. Nevertheless, the index of total living costs in 2002 rose by 2.2% in FBiH and 3.5% in the RS compared with the 2001 average. With the Convertible Mark (KM) pegged to the Euro at 1.95583, the **exchange rate** remains stable. The net international reserves of the Central Bank amounted to €54 million at the end of 2002, an increase of 40% over the end of 2001, reflecting the conversion into KM of previously unrecorded DM savings following the introduction of Euro notes and coins in 12 EU countries. According to the GFAP, the mandate of the Central Bank governor expires in mid-2003 at which point a Bosnian is expected to hold the position.

**The average net monthly salary** in BiH in August 2002 was €215, higher in FBiH (€251) than in the RS (€188). The **official unemployment rate** in June 2002 was around 41% in FBiH and 40% in the RS. The recent demobilisation of 10,000 soldiers from the FBiH army drove up unemployment in that Entity. The streamlining of public administrations under Civil Service reform may bring further lay-offs. Nevertheless, official unemployment statistics remain misleading given the large but undisclosed number of workers in the grey economy. Unofficial World Bank estimates suggest that the actual unemployment rate may be half the official figure.

Although unemployment is an important determinant of **poverty**, the recently completed Living Standards Measurement Survey indicates that 60% of the poor live in families where someone is employed. It also points out that a third of the poor are below the age of 18, and that there is a strong link between low education levels and poverty. While the survey underlines that 20% of the BiH population lives in poverty (in RS 25% and in FBiH 16%), there is also a suggestion that a further 30% live close to the poverty line. This means that BiH society would be very vulnerable in the event of any further economic decline or external shock.

**Fiscal performance** has improved, although the size of the government sector remains large, with public spending at around 56% of GDP. Efforts to reduce the high general government deficit (14.5% of GDP before grants) were continued in 2002. The authorities aimed for a consolidated budget deficit of 11.5% (5.5% after grants); driven by the expenditure side of the budget, they cut pensions and investment spending. However, given the better revenue performance recorded for

the first nine months of 2002, the estimated consolidated budget deficit has been revised downwards at 9.4% of GDP (4% after grants).

In RS, thanks to implementation of the Law on Tax Administration passed in October 2001, improved **tax collection** meant increased revenues of €17.6 million in the first six months of 2002. Also, customs and excise duty collection increased by 41% (admittedly, from a low base). Meanwhile in FBiH, customs and excise duty revenue increased by 3% over the same period of 2002 and there was a 16% increase in the tax collection in the first eight months of 2002 compared with the same period in 2001. Better tax inspector oversight contributed to the increase in revenue.

On the external side, the **balance of payments** still shows deficits, both on the current account and trade account. The current account deficit for the first three quarters of 2002 was €1.507 billion, a 31% increase over the same period in 2001, largely due to increased imports of goods and services in 2002. The current account deficit remains very high and (excluding official transfers) will amount to 21% of GDP in 2002, a slight fall from the recorded 23% of 2001.

As advocated in the 2002 Report, efforts to reduce barriers to FDI initiated in 2001 continued in 2002. In 2002 net **FDI** is expected to reach €260 million, compared with €145 million in 2001. Efforts to improve the investment climate remain vital given the need to finance the high current account deficit and to attract higher levels of private capital in the context of declining aid flows.

**Foreign debt** is estimated at 52% of GDP in 2002. Its structure by lender shows that 50% is owed to the World Bank, 19% to the Paris Club, 5% to the London Club and 4% to the IMF. Debt service as a percentage of exports of goods and non-factor services is relatively low (8% in 2002), reflecting the concessional nature of much of the debt and favourable debt rescheduling agreements. However, total external debt service will increase in the medium term, from US\$ 81 million in 2001 to US\$ 200 million by 2004 (a debt service ratio of broadly 9%) as payments to international financial institutions increase.

BiH has successfully negotiated a new 15-month **IMF Stand-By Arrangement** (SBA) worth about €100 million) which was approved by the IMF Board in August 2002 and which was one of the priorities identified in last year's report. The first tranche of around €29 million was disbursed soon after approval. The programme focuses on policies to achieve post-reconstruction growth through a continued commitment to the Currency Board and further fiscal consolidation. In addition, the programme foresees structural reforms in tax policy, privatisation, trade policy and improvements in the business environment. Following an IMF staff mission and the adoption by caretaker governments of the 2003 budgets both at State and Entity level, in December 2002 the IMF Board approved the First Review of the SBA and disbursed the second tranche (€18 million). The EC, too, will support reform through macro-financial assistance (see Section 5 below).

### **3.2 Existence of Free Market Economy and Structural Reforms**

*Although it has initiated some structural reform, BiH still faces a heavy reform agenda. The continuing fragmentation of the national market means wide-ranging losses and inefficiencies. Slow progress on strategic privatisation means that BiH did not meet the recommendation of last year's Report and has not been able to realise fully its economic potential.*

*BiH has recognised these issues and in a Reform Agenda adopted in July 2002 pledged to address them. BiH must now live up to the commitments made in that document and substantially accelerate the momentum of reform.*

In July 2002 Entity and State governments agreed with the PIC a **Reform Agenda for the Economy** (“Jobs and Justice”). The reforms are designed to support the development of a competitive market economy and to facilitate private investment. The ambitious target is to create 60,000 new jobs in the private sector by end 2004. Governments vowed to expedite the privatisation of strategic companies, to establish a sound business environment and reinforce bankruptcy procedures, to eliminate market entry barriers and thus to attract foreign capital and know-how.

The establishment of the Reform Agenda is welcome; its actual implementation will be a litmus test of political commitment. Some actions have been undertaken to improve the business environment: the Foreign Investment Promotion Agency was established as an independent professional body, while Entities harmonised their foreign investment laws. In September a new bankruptcy law was passed in RS, while it is still a draft in FBiH. However, weaknesses in the judicial system may hamper implementation. The authorities also sought to improve the business environment by facilitating both enterprise entry and exit and by lowering administrative costs.

**Strategic privatisation** figures high in the Agenda. In FBiH, the privatisation of large-scale companies with a total book value of over €8.8 billion is being carried out mostly through public share offers (36% of the companies) and tenders (41.2%). Success rates vary. Most companies offered for public shares were successfully sold, but tender privatisation was less successful. In FBiH, of the 56 “strategic companies” prepared for privatisation with international help, five were privatised in 2002 (compared with six in 2001). Tenders have been launched for another 28. In RS, from a list of 80 companies, only one was sold in 2002 (three in 2001), with tenders launched for another 23. Strategic privatisation in the RS was seriously hindered by amendments to the RS Privatisation Law requiring the prior approval of the RS National Assembly in the case of strategic, state-owned enterprise. Persistent problems with corporate governance and restructuring remain a disincentive to investment in both Entities.

### 3.3 Management of Public Finances

*BiH public finances remain a concern. Despite the earlier introduction of auditing at State and Entity levels of government, resources continue to be wasted through fraud and mismanagement. Furthermore, the State's ability to function remains constrained by inadequate and unreliable funding. To address some of the major weaknesses in public finance, the international community has promoted the introduction of VAT at State-level and the unification of the currently Entity-based customs services with a view to supporting efficiency and moving BiH closer to a generally accepted EU model.*

The size of the government in BiH remains a concern. The effect of high levels of public spending is often negated by corruption and the poor quality of the public services. However, significant steps towards fiscal consolidation have recently been achieved. In 2002 BiH **public finances** improved at Entity level through better enforcement of revenue collection and the implementation of newly established Treasury systems. Moreover, as suggested in last year's report, Entities have taken

some steps to downsize the public sector, notably by reducing the number of military personnel (although this was associated with inevitable initial increases in expenditure due to severance pay). There is, however, little evidence of rationalisation of the wasteful duplication of administrative effort associated with FBiH's multiple cantonal structures. Also, in the limited cases where powers have been transferred from Entity to State, administrations remain over-staffed.

From the revenue side, current estimates of RS revenue losses in 2001 due to unpaid taxes were around €256 million, more than a half of the RS annual budget. Sales tax is widely avoided and fraud in both Entities is reported at around €255 million. Meanwhile customs revenue is declining due to a growing number of free trade agreements and to fraud and evasion. Estimates of losses due to customs fraud and mismanagement range from €150 to over €300 million per annum - almost equivalent to the State budget. Furthermore, despite the recommendations of last year's SAP Report, the BiH State remains without a reliable source of own income and thus dependent on annually negotiated transfers from the Entities.

To address these weaknesses, attention has focused on the introduction of **state-level VAT** and customs reform, both of which were identified as priority areas in the 2001 SAP Report. Their introduction would support public finances, better fund State institutions and would promote a sustainable fiscal stance. In addition to favouring the BiH single market, State-level VAT seems likely to result in efficiency gains and the reduction of fraud, corruption and evasion. In February 2003 the High Representative issued a Decision establishing a seven-member Indirect Tax Policy Commission. The Commission is charged with drafting legislation establishing a single State-wide VAT, merging separate customs administrations and establishing a State-level Indirect Tax Administration. The Commission should complete its work by end July 2003. In some quarters, particularly in RS, there has been resistance to reform and the work of the Commission as reform would entail rationalisation and allegedly increase the role of the State.

In 2003 the **budget of the BiH institutions** will face severe constraints. Despite increased State-level powers and the creation of new institutions, the 2003 draft State budget reflects "no policy change" and is set within 98% of the 2002 budgeted figures. Under the constraints of the IMF Stand-By Arrangement, 2003 budget planning anticipates revenue reductions relative to 2002. (Some reductions reflect non-recurring 2002 Succession Funds and declining donor support.) However, increases are foreseen for some 2003 budget lines such as the Communications Regulatory Agency, the Civil Service Agency, the BiH State Court, and for institutions to be established in 2003 (the Prosecutors' Office, a Veterinary Agency and the Competition Council). Since some State institutions will assume new responsibilities in specific areas (e.g. the State Information and Protection Agency), the State Treasury has requested Entity transfers to finance these institutions. Overall, Entity transfers to the BiH budget would increase by 12% over the 2002 budget.

### **3.4 Priority areas needing Attention in the Next 12 Months**

- Implement fully the BiH Law on Statistics and ensure an internationally recognised system of national accounts and foreign trade statistics at State-level.
- Respect the conditions for the delivery of the IMF Stand-By Arrangement and EU macro-financial assistance.

- Implement reforms scheduled for year one outlined in the Reform Agenda for the economy, notably in the area of improving the business environment, attracting foreign investors and product certification.
- With the aim of further fiscal consolidation and development of the BiH single market, move from sales tax to the introduction of VAT at State-level by January 2005.\*\*
- To allow it to meet its institutional, legal and policy commitments, the State must have adequate resources and the Entities must continue to make timely and adequate transfers to the State.\*\*

#### 4. IMPLEMENTATION OF THE STABILISATION AND ASSOCIATION PROCESS

##### 4.1. General evaluation

*Since the 2002 SAP Report, BiH prioritised the Road Map, achieving substantial completion in September 2002. Regrettably, completion was occasionally held up by political battles. Sometimes, legislative progress was made at the Council of Ministers, but delayed in parliament. Sometimes, other issues took precedence: for reasons unrelated to the Road Map the 2002 State budget was adopted only at end May, thus negatively affecting payments to State institutions. The record on implementation of Road Map legislation remains moderate. There is little proof that BiH has used the Road Map and "EU requirements" to dynamise reform.*

*Following completion of the Road Map and pending the outcome of a Feasibility Report on opening SAA negotiations, BiH reform efforts should be guided by the reform agendas (such as "Jobs and Justice ") negotiated with the international community in the PIC. In developing these agendas care must be taken to ensure that they are compatible with SAP requirements, the *acquis communautaire* and BiH's long-term aim of EU integration.*

*BiH's administrative capacity remains under-developed and faces structural impediments such as differing legal bases. Capacity-building thus needs to be complemented by rationalisation. A step in this direction was taken with the reform of the Council of Ministers. This reform now requires domestic ratification and sustained implementation effort. In the context of OHR's Mission Implementation Plan, BiH must prepare to accept ever greater political and administrative responsibility.*

*The creation of the Directorate for European Integration is welcome. Its authority and capacities need to be quickly established in practice.*

##### 4.1.1 Current position

The 2002 report stressed that BiH needed to complete the Road Map - and here progress was made. In autumn 2002 there was agreement that the Road Map had been substantially **completed**. This assessment reflected the fact that BiH had, for Road Map purposes, completed around 15 of the 18 steps and made some progress on the outstanding three points. In an October 2002 letter to the new BiH presidency the Commission underlined the need to continue work on outstanding points and to implement adopted legislation. In due course, a Feasibility Report on opening SAA negotiations would begin. Until such a report is completed, the letter argued, BiH should orient its reform efforts on the Reform Agendas concluded with the

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\*\* Recommendation included in the 2002 SAP Report and only partially implemented.

international community in the meetings of the PIC Steering Board. Progress on these agendas will affect the outcome of the Feasibility Report.

#### *4.1.2. General assessment of administrative capacity*

The BiH **administration** remains fragmented, poorly equipped, the personnel lack professional qualifications and are still often politically nominated. There are administrative overlaps and co-ordination between the different levels of administration is still lacking. The respective legal frameworks remain incompatible across the different levels. At State level, the administration remains small and under-resourced. In contrast, at Entity level and below, resources are often wasted through functional duplication. Administrative incoherence was reflected in the "Orao affair": it was RS that independently oversaw illegal exports, but the BiH state which bore responsibility for infringements of the weapons embargo before the UN.

First steps towards addressing inefficiencies have been taken by State and Entities. The BiH Economic Development Strategy, agreed in 2001, provides a framework and priorities guiding public administration reform. The aim was to restructure at Entity level and to develop a professional administration through simplification, training, computerisation, etc. On the basis of these policy objectives, RS has driven forward reform, but in FBiH progress has been slower. At State level, a Law on the Civil Service was first imposed in May 2002. A **Law on Civil Service** in the Institutions of BiH was adopted in national procedure in June 2002. The law reorganises government structures, stipulates a new professional status for employees and establishes the Civil Service Agency. Similar, compatible laws are required in the Entities. Reform of public administration is thus at different stages throughout BiH.

Further reform is clearly needed, not least because current levels of public spending are worryingly high. Strengthening administrative capacity requires further streamlining, the establishment of effective co-ordination units, the development of human resources and the improvement of communications between different administrative levels.

#### *4.1.3. Impact of the prospect of a SAA on reform*

In addition to urging Road Map completion, the 2002 report recommended that "EU requirements" be used as a "catalyst to dynamise reform". Clearly, SAp and the prospect of a SAA remained a top government priority and thus focused attention on BiH's wider "European vocation" and on specific legislation which might otherwise not have been (as speedily) adopted. Meetings of the Consultative Task Force in March and July 2002 (i.e. less frequent than in earlier years) and the related Working Groups again brought together State and Entities to forge agreement. Also, the need to orient on EU practice was a contributory factor in the current push for reform of customs and VAT. However, the 2002 Report recommendation was only partly realised; there is little evidence of a qualitative acceleration of reform. Also, while Road Map points were declared completed, the related legislation frequently remained without practical implementation.

To dynamise reform at least two related requirements stand out. First, there needs to be political will, shared throughout the political and administrative elite. The prospect of EU integration, though appealing, is apparently still insufficient to induce some to give up entrenched positions and privileges in the name of a wider, long-term good. Secondly, BiH must develop integrated governmental and administrative structures that favour reform. The problem may be less one of limited resources than of a

profound lack of co-ordination between the functions of government. In this context, the horizontal and co-ordinating function of the Directorate for European Integration will be crucial.

## 4.2. Internal market and trade

*The most egregious barriers to an internal BiH market have been eliminated. Economic co-operation between the Entities is improving, but inter-Entity capital and labour mobility remains limited; appropriate legislation at State and Entity level is needed to address this problem. Also, a mindset change is required - significantly, the official RS government website makes no apparent reference to the "BiH single market"!*

*The 2002 report urged further customs reform. As work on this sector has progressed, it has become clear that in their current form customs services are characterised by inefficiency and fraud. The inconsistent application of customs policy is a barrier to a single BiH market. Further customs reform, including the introduction of single BiH customs administration, has been identified as a priority.*

*As experience within the EU shows, the elimination of internal barriers to trade requires protracted, continuous effort. BiH must sustain this effort.*

### 4.2.1. Movement of goods

BiH has removed physical barriers to **trade** within its borders; products from one Entity are now more readily available within the other. The removal of barriers has been reflected in a growth in internal trade. In the first six months of 2002, F BiH sold goods worth over €51 million to RS; in the same period it purchased goods from RS worth over €14.3 million. With the removal of physical barriers, BiH has also begun to address more subtle impediments to the common economic space - prompted in part by business people who have urged the harmonisation of legislation and / or the establishment of State-level legislation and institutions. A veterinary law has been adopted, but phyto-sanitary legislation remains outstanding. Laws on consumer protection are now in place. BiH and Entity authorities have committed themselves through the "Reform Agenda on the Economy" to eliminate double taxation. In November 2002 agreement was reached on harmonised taxes on oil products.

Externally, BiH remains open to trade. 35% of its exports go to other western Balkan countries. Croatia remains the main trading partner for F BiH, and Serbia and Montenegro for RS. Worryingly, difficulties in implementing regional free trade agreements have been reported. These agreements specify WTO technical standards, but BiH does not always have the technical and / or institutional ability to meet these at the required State-level. The EU accounts for around 65% of BiH exports (Italy being the most important market) and around 40% of BiH imports. As in the past BiH has been unable to take full advantage of favourable market access conditions under the EU's Autonomous Trade Measures because it still lacks the State-level institutions able to deliver CE markings or certify compliance with EU safety legislation.

### 4.2.2. Movement of persons, services and right of establishment

There have been improvements in **mobility**. Short-term mobility within BiH was facilitated by moves such as the 1998 introduction of standardised licence plates and the Convertible Mark (KM). However, longer term mobility depends on the adequate provision in both Entities of **services** such as job placement, health care and pensions. Following the November 2001 imposition of laws on pension and disability insurance,

in 2002 Bosniac and Croat pension funds in FBiH were merged. Within existing budget constraints, BiH needs to ensure better and standardised delivery of services, enabling its population to take advantage of employment opportunities throughout the country.

Despite the recommendations of last year's report, **business registration** remains complicated and is handled by the Entities on the basis of Entity legislation. Procedures remain excessively bureaucratic and thus discourage investment and legal enterprise. As part of the Jobs and Justice reform agenda, governments have pledged to cut business registration to 15 days by putting in place a single business registry system with corresponding, harmonised enabling legislation. Other steps such as the introduction of harmonised land registry laws would build confidence in ownership and investment.

As before, BiH citizens enjoy visa-free travel throughout former Yugoslavia except Slovenia. They still need visas for EU states.

#### ***4.2.3 Movement of capital***

Traditionally there has been low public trust in the BiH **banking system**. Popular mistrust became clear on introduction of the Euro when BiH citizens exchanged their DM for KM: the amount of DM exchanged for KM was double the amount held in existing bank deposits! The exchange also dramatically increased bank savings and liquidity. Among recent progress has been the August 2002 introduction of a State-level Deposit Insurance Agency, insuring savings up to KM5000 (around €2500). Ten banks have now been accredited, all in FBiH. Other reforms include increased minimum capital requirements, now set at KM15 million (around €7.5 million). This has led to a consolidation of the banking sector. Foreign banks now dominate the market.

Growing popular confidence in banking and rising levels of saving are welcome, but a low level of banking interaction with the productive economy persists. This is due to the incompatibility of short-term savings with the long-term borrowing requirements of industry, to rigid collateral requirements and to the high-risk nature of borrowing in BiH.

Substantial resources (estimated at about €500-700 million annually) are transferred to BiH from Bosnians living abroad. Many such transactions are however, effected in cash and thus avoid registration by the banking system.

#### ***4.2.4 Customs***

The 2002 Report urged further **customs reform**. Reform is ongoing with international assistance, and since 1996 there has been an almost threefold increase in customs revenue collection. Nevertheless, systemic difficulties associated with the existence of three customs services (one for each Entity plus Brcko District) persist. This undermines work to create a single BiH economic space. Weak implementation of existing legislation, poor co-operation between Entity services and competing Entity interests lead to unacceptable levels of: mis-description (deliberately incorrect description of goods for customs tariff classification); under-valuation (a lower and incorrect value of goods declared to avoid full duty payment); diversion to home use (goods declared for transit but then diverted for sale in BiH); smuggling (goods brought in illegally). Revenue loss as a result of customs fraud alone is estimated at over €200 million per year.

Losses of this magnitude are unacceptable, particularly in a straitened BiH. The efficiency of the administration of customs could be improved by the establishment of a single customs administration at State level. Such an administration could minimise the conditions favouring crime, cut administration costs, facilitate trade, favour the BiH single economic space and bring BiH in line with EU practice. In practical terms, legislative changes would be required leading to an administrative merger of the three customs services. Effectiveness would be improved through harmonisation in terms of employment and pay of customs officials. Also, a revenue account and an Entity allocation formula would be necessary. Most parties accepted the case for customs unification, but some in RS indicated opposition. In February 2003 the High Representative issued a decision establishing an Indirect Tax Policy Commission to draft relevant legislation (cf. section 3.3).

During 2002 the EU noted a significant increase in **sugar imports** from the countries of the western Balkans. Imports from BiH were comparatively small, but potentially of concern. To ensure proper application of preferential arrangements for sugar declared as originating in western Balkans countries, the Commission published a notice to importers in June 2002 leading to precautionary measures within the Community (e.g. a deposit system and systematic import testing). This resulted in the discovery of an alleged fraud in August when traces of *cane* sugar were found in consignments declared as originating in Croatia, former FRY and the former Yugoslav Republic of Macedonia. Like its neighbours, BiH must ensure that its customs services can ensure proper application of preferential rules of origin. EU Customs Blueprints are an important reference.

#### **4.2.5. Competition and state aid**

Explicit subsidies are relatively small at around 1.3% of GDP, but show signs of expanding in both Entities. Yet, enterprises can get access to forms of **state aid** through selective application of legislation and the award of contracts on the basis of contacts and influence. In many cases they have been used to postpone company and sectoral rationalisation. Although the new State government established in January 2003 will, according to its Chairman, promote trade liberalisation, further state aid to agriculture is foreseen.

The unofficial "system" of support to particular enterprises will be harder to sustain as the BiH **Competition Law**, adopted in October 2001, is implemented. The 2003 State budget has for the first time earmarked funds (just over €300,000) for the Competition Council. For the law to become operational, the relevant technical infrastructure will need to be reinforced and Council personnel trained. Moreover, hard budget constraints will need to be imposed on all companies and information and market asymmetries will have to be eliminated.

#### **4.2.6 Public procurement**

Despite the recommendation of the 2002 report, BiH still has no State-level legislation on **public procurement**. Both F BiH (in 1998) and RS (in 2001) enacted procurement legislation, although this did not meet EU and WTO standards. Nevertheless, to combat corruption, promote efficiency and complement new State Treasury systems and public audit institutions, State-level public procurement legislation is required. As with competition policy, effective implementation will require an effective technical and methodological framework, adequate skills and capacities among professional staff and increased public awareness of the issues.

#### *4.2.7. Intellectual, industrial and commercial property rights*

The Institute for Standards, Metrology and Intellectual Property of BiH is responsible for the administration of **intellectual property rights** and the protection of inventions, industrial designs, commodity and service marks and geographic designations. Despite the adoption of laws on copyright and intellectual property, the problem of implementation and enforcement persists. Widespread piracy of intellectual property, especially computer programmes and CDs, continues. These issues will need to be addressed quickly, particularly in the context of WTO accession.

### **4.3 Sectoral Policies**

#### *4.3.1. Industry and SMEs*

The 2002 report underlined the difficulties investors face in BiH. New small enterprises continue to spring up, but much activity is driven underground by burdensome rules and bureaucracy. Estimates put over 40% of BiH economic activity in the "grey" sector. In an attempt to remove some of the bureaucratic obstacles faced by business, the High Representative launched a "**Bulldozer Initiative**" in November 2002. The Bulldozer Committee has collected from concerned business people information on laws and procedures which hinder legitimate business. Of these, the most important will be addressed through the political system with the aim of removing the 50 most burdensome measures within 150 days. The initiative is welcome on several counts: it concentrates on practical concerns and should thus raise less political opposition and it has arguably built civil society by encouraging citizens to lobby in favour of issues which concern them. Active BiH support would be welcome.

In order to improve further the business environment in line with good practice in EU Member States, the adoption and implementation of the principles enshrined in the European Charter for Small Enterprises is recommended.

#### *4.3.2. Agriculture*

In 2002 the **agricultural sector** evolved slowly but positively. A State-level Veterinary Law was adopted, paving the way for a streamlined control structure. The implementation of an animal identification and movement control scheme was initiated. Further improvements relate to the availability of new rural credits; their absence has in the past limited the development of the sector. Also, the certification of organic food is now possible using EC-based certifiers, a development which in this specialised sector may open new markets for BiH agriculture.

Important issues remain to be addressed. Land ownership still needs to be resolved. Neither State nor Entities have an agricultural policy. Legislation on veterinary and plant care still diverges. Reference laboratories have not been nominated and residue testing programmes and contingency plans are missing. Continuing poor management was demonstrated during a summer 2002 outbreak of blue tongue disease. Since standards still fall short of the technical requirements of the EU market, BiH has been largely unable to take advantage of existing EU trade preferences in the agricultural sector.

#### *4.3.3. Environment*

Inter-Entity and Entity-State co-ordination improved over 2002 thanks in part to the adoption of legislation harmonised between the Entities and approximating to EU

standards. A State level environmental framework law is in development, but this needs to be complemented by an effective environmental administration. BiH participated actively in and indeed in 2002 co-chaired the Regional Environmental and Reconstruction Programme. Also, awareness of environmental issues has increased – public attention has focused on a UN Environmental Programme study on depleted uranium and possible links with an increased incidence of infant leukaemia.

Important steps remain to be addressed: increased public access to information, the systematic introduction of Environmental Impact Assessments and the establishment of the “polluter pays” principle.

#### **4.3.4. Infrastructure**

Although BiH's **transport** infrastructure does not yet meet European standards, much has been done to rectify wartime destruction. The North-South railway on Corridor Vc, and its connection with Corridor X, now meets minimum standards. Now, attention is turning to establishing the regulatory framework needed for a competitive transport market. BiH is gradually being integrated into European civil aviation networks. In August 2002 the Civil Aviation Law was amended, facilitating more efficient management within the BiH Department of Civil Aviation. BiH joined the European Civil Aviation Conference and in January 2003 BiH civil aviation authorities assumed control of Sarajevo airport. Nevertheless, the civil aviation administration remains fragmented and this needs to be addressed in 2003.

In October the High Representative imposed the Communications Law ensuring the establishment of a single economic space in the **telecommunications sector** and reinforcing the Communications Regulatory Agency (CRA). The CRA issued licences to all three fixed-line network operators and providers. Issuing countrywide licences supports the development of a single BiH economic space and promotes competition, thus helping to reduce mobile phone costs (which are among the highest in Europe). Greater commitment by government both to the introduction of competition in the sector and to the development of Information Society services is needed if the investment environment is to become attractive to private investors.

The legal framework for the regulation of the **energy** sector has been completed. A State-level Law on Transmission of Electric Power, Regulator and Systems Operator has been adopted, as have electricity laws for both Entities. This was a precondition for implementation of the Power III programme and foreign investment in the sector. So far the laws remain to be implemented. Local opposition to the privatisation of the Elektroprivreda companies persists. This may in part be explained by the results of special audits on the Elektroprivreda which have thrown up some damning results, confirming massive losses resulting from mismanagement, conflicts of interest, theft and neglect.

No reform of the gas sector has yet begun.

#### **4.4 Co-operation in Justice and Home Affairs**

*BiH faces multiple new challenges in policy areas such as immigration, border control and international terrorism. The establishment of new ministries of Justice and Security constitute a significant development of State capabilities. Current international concerns about terrorism and security have meant that these policy areas have had increased attention both nationally and internationally. In many areas BiH has performed well. It has, for example, made determined and largely*

*successful efforts to improve its border controls and has participated willingly in anti-terrorist efforts. Where weaknesses exist - and they undoubtedly do - they reflect confused and inadequate legal and administrative structures and limited resources. Not surprisingly, the criminal fraternity has exploited these weaknesses. Since these weaknesses affect both regional neighbours and global partners, BiH has come under pressure to address them. As a number of international initiatives demonstrate, BiH has not been left alone in this endeavour.*

#### **4.4.1. Visa, Border Control, Asylum and Migration**

BiH has been both a transit country for illegal migration towards western Europe and a destination for victims of trafficking from countries further to the east. SBS data suggests that BiH has successfully limited illegal migration through its territory. BiH is gradually aligning its **visa policy** on the Community visa list (although citizens of Turkey, Serbia and Montenegro, the former Yugoslav Republic of Macedonia, Russia, Kuwait and Qatar may still enter BiH without visas.) Visas are issued by consulates abroad, but it is not clear that pre-clearance measures (e.g. access to a centralised data-base on undesirables) are rigorous and effective. Experts have criticised the facility with which applicants can switch between visa categories, thus leaving the visa regime open to abuse.

**BiH border control** has improved steadily, although weak points remain. In October the **State Border Service (SBS)** assumed control of all BiH border crossings (with the exception of Tuzla airport). SBS reinforced its operational structure by establishing an investigation unit and plans to establish a unified information and radio-communication system. It should reach full operational strength in 2003. Unfortunately, despite Road Map requirements, SBS has experienced funding problems, although it has so far been able to cover its basic operating costs. There are now 58 official border crossing points, but there are also reckoned to be another 350 points at which the border can be legally or illegally crossed. Border control was further facilitated by the introduction in December 2002 of new identity cards meeting international standards as part of the Citizens' Identity Protection System (CIPS) - although the system now needs to be fully implemented. In January 2003 EUPM took over responsibility for monitoring SBS development. Remaining difficulties include: an uncertain financial basis for SBS, limited surveillance abilities at green and blue borders and the lack of a re-admission agreement with Serbia and Montenegro or Slovenia. Eventually, joint border controls with neighbours would be sensible.

**Immigration and asylum** issues are a previously unknown challenge for BiH - and a challenge which has been complicated by a partial delegation of competence to the Entities. Migration is a State competence, but the Ministry of Human Rights and Refugees (MHRR) has not had the resources to meet the tasks conferred on it; some responsibilities have thus been devolved to Entities or cantons. The 1999 law on Immigration and Asylum was widely criticised. A new State law, renamed the Law on the Movement and Stay of Aliens and Asylum, is in preparation. Moreover, the (now imposed) State-level Criminal Code and the establishment of the BiH Court and the BiH Prosecutor's Office should help address the problem of inconsistent interpretation of immigration legislation. More resources, better co-ordination, improved regional co-operation and adequate detention facilities are required.

**Asylum** requests are still limited in number, but BiH legislation accords with international standards. In theory, MHRR is responsible for processing asylum

requests, but in practice UNHCR has been in charge of implementing asylum policy. BiH needs to plan for the eventual reduction of UNHCR capacities.

#### **4.4.2. Money laundering**

Reports suggest that since the last SAP Report existing legislation on **money laundering** was widely flouted. Three banks alone allegedly laundered the equivalent of over €340 million in a six month period. Further, the amount of money laundered through fictitious companies, using compliant bank officers, may amount to around €1.5 billion per year! The ubiquity of this fraud implies that some courts may also have knowingly connived in illicit registrations of ghost companies, a favourite method of concealing or laundering funds. Detection is further rendered difficult by the fact that large transactions are still often carried out in cash.

BiH legislation on money laundering still reveals important lacunae: while laundering is a crime in both RS and Brcko District, it remains only an administrative offence in FBiH. However, the new BiH Criminal Code classifies money laundering as crime. This legislation will require a change in the FBiH code. BiH membership in Council of Europe frameworks has meant State accession to a number of money laundering prevention conventions. Many of the 40 recommendations issued by the Financial Action Task Force against money laundering remain unimplemented, as does OHR's Comprehensive Anti-Corruption Strategy. The establishment of adequate structures within the police, prosecutors and judiciary and the creation of a properly resourced and functioning Financial Intelligence Unit are essential to combat this crime. Bank and court officials need to be trained and a clear regime for the disclosure of suspicious transactions established.

#### **4.4.3. Drugs**

Over the last year **drug supply and consumption** has remained at worrying levels. Some regional observers have noted that it is "becom[e/ing] epidemic", with children having their first contact with drugs at age 11 or 12. Measures to reduce demand are needed and on the enforcement side police need to develop pro-active investigative capacities in areas such as informants, under-cover agents, communication interception, surveillance, etc. BiH-wide legislation on the classification and licensing of narcotics, psychotropic substances and precursors is needed.

#### **4.4.4. Fighting Organised Crime and Terrorism**

During the year investigations into Herzegovacka Banka continued. The organised corruption identified within Herzegovacka Banka may be symptomatic of a wider systemic problem: sophisticated crime networks take full advantage of differing definitions of crime, of fragmented State structures, of multiple jurisdictions and investigative bodies. Clearly, crime fighting capacities do not match the sophistication of the criminal networks they (should) confront. The particularly brutal form of organised crime associated with **trafficking of women and children** for sexual exploitation persists, sometimes with the involvement of those meant to fight it. In RS, FBiH and Brcko trafficking is not even clearly defined as a crime. Although the BiH Council of Ministers adopted an action plan on trafficking, authorities have obviously lacked both political will and effective tools. The implementation of the BiH Criminal Code and the adoption of the Law on Movement and Stay of Aliens and Asylum would help. Very few trafficking cases are successfully prosecuted.

Although the fact that the Alliance for Change government did not confront organised crime effectively may turn out to be one of its biggest failures, some progress was made in conjunction with the international community through the PIC rule of law agenda. Moreover, BiH has received material and technical assistance. A May 2002 assessment mission by EU experts on **justice and home affairs** made a detailed analysis of the difficulties and produced recommendations. Likewise, a November 2002 London Conference on partnership against organised crime in south east Europe resulted in a number of renewed commitments which, if implemented, will make a qualitative difference. BiH is committed to: (i) bring national JHA practice into line with European and international standards, (ii) introduce legislative measures to empower decisive action, (iii) build up State-level crime-fighting capacity, (iv) improve inter-agency co-operation, (v) establish mutual legal assistance with regional partners and the EU and (vi) finalise and implement a national anti-corruption plan.

Since the last SAp Report **terrorist acts** have continued. Internally, they were often directed at returnees. For the international community in BiH a terrorist threat was thought to remain – at different times a number of embassies were closed on the basis of credible threat assessments. BiH's ability to respond to the terrorist threat was hindered by a lack of adequate legislation, but should be improved by the creation of a Ministry of Security bringing together SIPA, SBS, the Interpol office and existing anti-terrorist co-ordination groups. A number of "humanitarian agencies" have been closed and their bank accounts frozen. Although a few mujehaddin groups remain from the war, a greater threat to stability may come from the numerous private security agencies which have sprung up as men have been demobilised from Entity armies.

#### **4.5 Priority Areas needing Attention in the Next 12 Months**

- Ensure full implementation of all Road Map requirements.\*\*
- Ensure the full operability of the new Directorate for European Integration. A clear European integration strategy should be developed.
- Develop an overall BiH public administration reform agenda. Adopt compatible civil service laws in the Entities and complete the review process for civil servants.
- Introduce a modern State law on public procurement\* and implement the law on competition.
- BiH governments to act quickly on the recommendations of the Bulldozer Committee.
- Adopt and start to implement an overall strategy for the unification of Entity and Brcko District customs administration activities. Thence, upgrade customs performance ensuring the ability to handle preferential trade regimes both on the export and import side.
- Implement reforms scheduled for year one outlined in the Reform Agenda for rule of law, notably adoption and implementation of Criminal Codes and Criminal Procedure Codes at State and Entity levels.

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\*\* Recommendation included in the 2002 SAp Report and only partially implemented.

\* Recommendation included in the 2002 SAp Report and basically not implemented.

- To make use of EU trade concessions, comply with EC veterinary and phytosanitary standards and establish appropriate certification procedures.
- Ensure full operability of SBS.\*\*
- Enact and implement the Law on Movement and Stay of Aliens and Asylum. Ensure co-ordination and implementation of visa and migration measures.\*\* BiH should align its visa list with the Community list.\*\*
- Implement the national anti-trafficking plan and ensure protection for trafficking victims including witness protection.
- Ensure implementation of commitments taken at the November 2002 London conference on organised crime.

## 5. EC FINANCIAL ASSISTANCE

Between 1991 and 2002 BiH received approximately €2.4 billion in EC assistance. In addition, EU Member States contributed over €1.2 billion in assistance between 1996 and end of 2001. In 2002, €71.9 million in EC funds was allocated to BiH under CARDS. CARDS offers a long-term assistance approach that addresses in a single programme the needs of the country and reflects both the objectives of the SAP and EC comparative advantages in the field of assistance. It focuses support on reforms and institution-building priorities necessary to implement a future SAA.

CARDS assistance is given on the basis of an EC **Country Strategy Paper** defining the main assistance priorities for 2002-2006 and a **Multi-Annual Indicative Programme** which defines in more detail priorities for 2002-2004. For BiH, priority areas are: democratic stabilisation (refugee return, public broadcasting reform), administrative capacity-building (customs and tax reform, public procurement), economic reform and social development (single economic space, local development, trade liberalisation and promotion of foreign investment, vocational training, university education), environment and natural resources (regulatory framework, environmental monitoring and protection, water and solid waste management), justice and home affairs (administration of justice, judiciary reform, support to Dayton human rights institutions, support to BiH police forces, asylum and migration policy) and integrated border management.

In 2002 the CARDS programme focused on:

**Democratic stabilisation** - Notable results include the return of around 100,000 minority refugees and internally displaced persons, approximately 15% of whom received direct EC assistance. The EC initiated a pilot programme to support the transfer of responsibility for refugee returns to national bodies. It supported economic regeneration measures at local level and the verification and implementation of property rights. In the media sphere, EC assistance helped to secure the adoption of the BiH Law on Public Broadcasting, institutional strengthening of public broadcasting and the provision of essential basic production and transmission equipment. Unbiased BiH-wide news services have now started.

**Administrative capacity building** - the EC-funded Customs and Fiscal Assistance Office (CAFAO) improved competence in the customs services and in revenue collection. In 2002, customs revenue collection rose by 15-20% compared to 2001. CAFAO helped detect customs fraud and highlighted weakness in management procedures together costing the revenue hundreds of millions of Euro annually. It also identified significant sales tax fraud and money laundering. State institutions

were further reinforced through support for the creation of the BiH Civil Service Agency, the BiH Statistical Agency and restructuring of the Department for Civil Aviation.

**Economic and social development** - EC assistance supported five local / regional development agencies. Documented results include the attraction of three foreign investors, the creation of approximately a thousand new jobs through support to 40 SMEs, the privatisation of four strategic enterprises and assistance to restructuring 35 enterprises. Economic infrastructure has been improved through the completion of three bridges on major passenger and freight routes, the redevelopment of main rail links, the reconstruction of Sarajevo and Mostar airports and the supply of medium/low voltage electricity transmission and distribution equipment. Through TEMPUS support has been given to the development of the education system.

**Environment and natural resources** - the EC supported institutional strengthening, particularly focusing on upgrading the legal framework. As a result, a State Veterinary Law was adopted. Additionally, a set of five environmental laws was adopted in RS, while identical laws are in FBiH parliamentary procedure. Further measures focused on rural areas and the agricultural sector. Through rural credit lines, €5 million was distributed to final users.

**Justice and homes affairs** - the EC helped to advance judicial reform by supporting the Independent Judicial Commission and the High Judicial and Prosecutorial Councils. Significant funds were also earmarked to support prosecutorial reform through legal and administrative training and limited equipment for Prosecutors' Offices. As the EU prepared for EUPM, the EC gave technical assistance and to a lesser extent equipment for BiH police forces. Assistance to SBS supported the assumption of control on all BiH's international borders. Co-ordination mechanisms between CARDS assistance and the EUPM, i.e. between the first and second pillar of EU activities, have been established in Brussels and Sarajevo to ensure full coherence of all relevant EU actions.

BiH also benefits from the **CARDS Regional Programme**.

Further, in support of the new IMF programme, the Council of the EU decided in November 2002 to provide further **macro-financial assistance** of up to €60 million to BiH (a €20 million loan and €40 million grant). This is conditional on progress in economic and structural reform. In the light of the positive IMF Review of December 2002, the EC disbursed the first tranche of €15 million grant in February 2003. Under **Council Regulation (EC) No. 1080/2000** OHR received €13.3 million in support, covering more than half its total operating budget. In 2002 €14 million (and in 2003 €20 million) was assigned from the CFSP budget in support of EUPM. BiH is also a "focus country" for the **European Initiative for Democracy and Human Rights**; it was selected for projects relating to ethnic reintegration in north-eastern BiH, enhancement of minority participation in local government, and the development of a counselling centre for women and children - projects together worth €0.98 million. BiH also benefits from the **LIFE** programme targeting environmental management and from support through the **NGO, YOUTH and demining budget lines**. By 30 September 2002 the **European Investment Bank** had signed operations in BiH for a total of €235 million, of which €11 million had already been disbursed. The main areas of activity include road and railways rehabilitation and electricity reconstruction.

The implementation of most project-related EC assistance is “de-concentrated” to the Commission Delegation in Sarajevo. In general, the delivery of assistance has been smooth. It has been quicker where already existing activities have been continued (e.g. refugee return) and more difficult where interventions aim at policy change or where new institutions are created.

A number of established **aid co-ordination mechanisms** exist in BiH in which the Commission Delegation participates. Regular co-ordination meetings are held with EU Member State missions and with other bilateral and multilateral donors in order to ensure coherent interventions. The Commission Delegation emphasised the development of working relations with the national BiH co-ordinator for EC assistance, the now defunct BiH Ministry for European Integration. The new Directorate for EU Integration under the direct authority of the chairman of the Council of Ministers should improve co-ordination at national level.

## 6. PERCEPTIONS OF THE EU

**European integration is a BiH foreign policy priority.** The completion of the EU Road Map and rapid progress in the SAP has repeatedly been declared a top government priority. The outgoing BiH governments pursued the goal of association with the EU. Incoming State and Entity authorities have declared their intention to continue this agenda. For the first time in December 2002, the BiH Presidency with the other regional presidents urged the EU to give “clear perspectives for the SAP countries joining the Union”. Political and administrative elites are increasingly aware of the workload which BiH faces before a SAA or indeed EU membership can become a reality.

No **opinion polls** have been conducted on the level of popular support for European integration or the degree of awareness of EU issues. The details of the EU agenda certainly remain an issue for the elite but have little visible effect on the general public. Moreover, attitudes to the EU differ between town and country, with eastern RS and rural Herzegovina mostly focused inwards on local or regional concerns. Nevertheless, it is widely assumed that association with the EU would bring both personal benefit (e.g. improved travel opportunities) or socio-economic gain (improving business and trade links and regional development). The Euro has been positively received; it can be used in larger towns. It is to be hoped that the imminent accession of Slovenia to the EU will make EU issues and the prospect of EU accession more concrete in the popular mind. Ideally, this would translate into better comprehension of the admittedly difficult reforms associated with EU integration and into more popular pressure in favour of reform.

**EU political leaders** figure prominently in Bosnian public life (along with other international actors). Admittedly, however, the multiplicity of European or EU-related structures (e.g. Commission Delegation, the EU Special Representative simultaneously High Representative, the EU Police Mission, the EU Monitoring Mission and even the Council of Europe) probably lead to confusion in the minds of both general public and the elite.

Coverage of the EU in the media remains generally fair. Interest in EU affairs has increased with the success of the current enlargement process. Over the past year, media correspondents have taken up office in Brussels, with frequent reports on EU matters in TV and other media. Supported by the EC Delegation, the BiH Ministry for European Integration launched an **information campaign on EU integration** and

the SAp, largely directed at the media, civil society and public administration. Also, a "Euro-Info Centre" was established at which (or on whose web site) the public may access specialised information. The EC Delegation has also launched its own web pages as well as a regular publication describing the Delegation's activities and general EU affairs.



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**CROATIA**

**Stabilisation and Association Report 2003**

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