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**BOSNIA AND HERZEGOVINA**

**Stabilisation and Association Report 2004**

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# **BOSNIA AND HERZEGOVINA**

## **Stabilisation and Association Report 2004**

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## **PREFACE**

On 18 November 2003 the European Commission published a Feasibility Study which reviewed Bosnia and Herzegovina's (BiH) readiness to open negotiations on a Stabilisation and Association Agreement (SAA) with the European Union (EU). The Study concluded that in the light of reform up to October / November 2003, the Commission hoped that it would be in a position to recommend to the Council the opening of SAA negotiations in 2004. However, such a recommendation would be conditional on BiH making significant progress in addressing the 16 reform areas identified in the Study.

In reaching this conclusion, the Feasibility Study provided an analysis of BiH's current situation. It thus covered much of the ground normally reviewed by the annual report on the Stabilisation and Association Process (SAP). This Report does not repeat that analysis, but instead focuses on initial progress on the 16 priority reform areas since November 2003.

The Feasibility Study also pointed out that BiH is engaged in a number of other reforms which are important for the stabilisation of peace under the Dayton – Paris Peace Accords. Since some of these lie outside the scope of a future SAA, they were not addressed in the Feasibility Study. Nevertheless, they have a bearing on BiH's ability to function as a modern democratic state and thus as a potential candidate for EU membership. A secondary aim of this report is to look briefly at these areas, particularly those mentioned as "Priorities needing Attention in the next 12 Months" in the 2003 SAP Report, and to provide a brief analysis of progress over the past year.

The Thessaloniki Agenda for the Western Balkans identified ways of intensifying the SAP, including the drawing-up of European Partnerships. The Commission now submits to the Council for approval the first European Partnership with BiH, inspired by the Accession Partnerships for the candidate countries. The European Partnership identifies short- and medium-term priorities for action to support efforts to move closer to the European Union. These priorities provide an objective basis on which to measure progress. The Feasibility Study identified 16 priority reform areas to be addressed over the course of 2004. These 16 priority reform areas constitute the most important short-term priorities of the 2004 Partnership. The medium-term priorities build on the 16 short-term priorities. Whilst these reform areas represent the most urgent reform targets for 2004, future partnerships will review priorities in the light of progress made and the evolution of the situation.

## 1. EXECUTIVE SUMMARY

The 16 priority reforms identified in the Feasibility Study relate to BiH's current political situation, to its economic perspectives and to its progress in meeting the technical requirements of the SAP.

On those of the 16 points relating to the **political situation**, progress has been moderate. Government at State level remains under-developed, while tensions between State and Entities still affect government business and reform. Public administration reform has just begun. On respecting human rights provisions and the conditionality associated with the International Criminal Tribunal on former Yugoslavia (ICTY), limited progress has been recorded since end 2003. The Feasibility Study suggested that "a new [reform] dynamic may be emerging within the BiH body politic". Further sustained reform efforts are needed to make this a reality and to ensure that progress made in state-building is not reversed.

The Feasibility Study further pointed out that "economic growth coupled with the reduction of wasteful expenditure would provide the resources for the institutional reform BiH needs". BiH faces major **economic challenges**. As international assistance declines, private investment must be the motor for growth. However, government needs to do its part by establishing a framework favouring investment and enterprise and by effective management of the funds at its disposal. For this reason, the Feasibility Study highlighted the adoption and implementation of a State-level budget law, the recording of all income accruing to public authorities and the implementation of the statistics law as measures which could be achieved in 2004. On budgetary issues some progress has been made, but reliable statistics, the basis of all effective policy-making, remain worryingly elusive. The short-term steps highlighted in the Feasibility Study must be complemented by further decisive structural reform if BiH is to avoid further economic distress.

In terms of meeting the **technical SAP requirements**, the judgement of the Feasibility Study remains valid: "... a pattern of intermittent progress, interspersed with areas where crucial reform has not been completed, or in some cases even begun". Thus, recent successes in areas such as Council of Ministers' approval of an Action Plan for Feasibility Study issues, first BiH convictions for human trafficking and initial steps in setting up the Indirect Tax Authority are diminished by failures in other areas. No point relevant to this section has yet been fully completed. Moreover, it remains a concern that in too many areas where progress has been achieved, that progress has come only thanks to international pressure.

For its part, the EU will deploy all means at its disposal to support BiH reform, ranging from technical and financial support to meet acquis standards, guidance from the EU Special Representative and actions under the European Security and Defence Policy (ESDP) to ensure a stable environment in which reform can proceed. As soon as it ascertains that significant progress has been made in meeting the 16 requirements established in the Feasibility Study, the European Commission will decide on a **recommendation for a Council decision to open SAA negotiations**. Conversely, if progress is insufficient, the Commission will not be in a position to recommend proceeding with such negotiations. Only BiH can ensure success. By successfully addressing the 16 priority points during 2004, BiH would reinforce a dynamic in part established by the Feasibility Study and would create the confidence both at home and abroad that it can address an ever wider and more demanding reform agenda.

## 2. POLITICAL SITUATION

### 2.1. Points covered in the Feasibility Study

*“More effective governance – Implement the Law on the Council of Ministers and the Law on Ministries. Convene meetings of the Council of Ministers and of Parliament with sufficient regularity to tackle government business expeditiously. Ensure that new State ministries and institutions created by the 2002 Law on the Council of Ministers become properly operational. Implement fully the 2003 – 2004 “Action Plan for Priority Reforms” and establish for 2004 (and following years) a consolidated State-level government work plan matching policy priorities with budgetary resources.”*

Consolidation of the **new State-level ministries and agencies** proceeds slowly. Ministry rulebooks have been adopted but recruitment has been limited, concentrating at senior civil servant level. A Secretary-General has been appointed to the Council of Ministers, but little other progress has been made on making other government services operational. Budgetary constraints for 2004 will negatively effect recruitment and thus operational capacity. All new ministries and agencies have problems identifying **suitable premises**. Nevertheless, some new ministries have been active in drafting legislation – with international input. Cross-ministerial coordination meetings have been initiated, but coordination between the State, Entities and the Brcko District remains weak. There is no evidence yet that the **output of government and parliament** has improved significantly. Delays by the Council of Ministers in addressing and forwarding to parliament legislation on a number of core laws appear symptomatic of under-developed management capacity and diverging political agendas within government.

Continuing BiH determination to realise the national **Action Plan for Implementing Priority Reforms**<sup>1</sup> is welcome. In practice, progress is moderate, not least because a number of the reforms have been only partly implemented. Further, partly as a result of disagreement between State and Entity governments on how to finance new State institutions, the 2004 State budget has not yet been adopted. Late adoption has retarded reform and delayed the adoption of a consolidated government work plan for 2004.

*More effective public administration – Make further effort towards creating an effective public administration, including developing a comprehensive and cost-estimated Action Plan for public administration reform with a clear distribution of competences (for example in the areas of police and health). Fund and co-operate with the Civil Service Agencies at State and Entity levels.*

At the March 2003 meeting of the Peace Implementation Council, BiH undertook to develop a comprehensive, country-wide **public administration reform** (PAR) strategy by autumn 2004. In this context a National Co-ordinator, an Inter-Governmental Task Force (IGTF) and number of working groups meeting in regular session have been formed. In November 2003 the three prime ministers signed a Memorandum of Understanding (MoU) with the European Commission setting up a Functional Review Steering Committee to guide the systemic and functional reviews which will feed into the PAR Action Plan for autumn 2004. Meeting PAR reform targets will certainly throw up difficult questions about the organisation of the public service throughout BiH. To achieve effective administrative reform, effective BiH leadership and clear strategic guidance are required.

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<sup>1</sup> This government Action Plan was adopted in August 2003. It is not identical with the subsequent January 2004 Action Plan designed to address the issues and reform priorities identified in the Feasibility Study.

The **Civil Service Agencies** (CSA) of both BiH and Republika Srpska (RS) have been operational since February 2003 and October 2002 respectively. The leadership of the agency in the Federation of Bosnia and Herzegovina (FBiH) was appointed only in March 2004 after months of disagreement between the governing parties. The agency itself is not yet functional. Politically motivated civil service appointments still occur at all levels.

*“Effective judiciary – Adopt legislation establishing a single High Judicial and Prosecutorial Council for BiH with the aim of consolidating appointment authority over the Entity judiciaries and strengthening the independence of the judiciary throughout BiH. Provide appropriate staff and funding for the State Court.”*

A law foreseeing a single **High Judicial and Prosecutorial Council** (HJPC) at State level has been drafted. The Entities have approved the transfer of authority to the State, but in the case of RS with significant reservations and a delay of over six months. Since the mandate of the existing three Councils expires in spring 2004, the adoption of relevant legislation is urgent. Moreover, it is essential that adequate funding is foreseen in the 2004 and subsequent State budgets to support the Council.

The **reselection of judges and prosecutors** has continued with the aim of completing the process by end March 2004. Over half the process has been completed. A shortage of qualified personnel remains a constraint.

The **BiH State Court** and the **Prosecutor’s Office** are now operational in suitable premises, although they remain dependent on international funding and staff.

*“Effective human rights provisions – Adopt and bring into force outstanding legislation supporting refugee returns. In particular, introduce, adopt and implement legislation on the BiH Refugee Return Fund. Complete the transfer of the human rights bodies to BiH control. Ensure that unresolved cases of the Human Rights Chamber are dealt with and that the Chamber’s responsibilities are transferred to the Constitutional Court. Provide adequate funding for the Court. Assume full national responsibility for the State Ombudsman and make progress on the merger of the State and Entity Ombudsmen.”*

Early 2004 reports criticised BiH’s human rights record (and in some cases that of the international community) for inadequacies on minority (including Roma) rights, gender equality, access to social services, workers’ and detainees’ rights, unwarranted electronic surveillance, people trafficking, etc. However, successes have also been registered. In January 2004 BiH formally assumed responsibility for refugee returns. Returns continue, albeit at a lower rate, while property law implementation nears completion in all but a few municipalities. Significantly, RS implementation rates have caught up with those in FBiH. In November 2003 amendments to the Law on Refugees and Displaced persons entered into force and a **BiH Return Fund** was established, although the latter, without a director or funds, has not yet begun to operate. As required by the law, a new Commission for Refugees and Displaced Persons and four new regional centres (replacing Entity agencies) have been established. The regional centres are not yet operational. Moreover, the Entities and Brcko District have not yet harmonised their legislation on that of the State.

The “exit strategies” of the three Dayton-mandated **human rights institutions** are currently being implemented, effectively putting human rights protection under BiH control. The transfer of **Commission for Real Property Claims** (CRPC) assets and responsibilities to BiH has been delayed due to FBiH opposition. The mandate of the **Human Rights Chamber** expired in December 2003; its case backlog was transferred in January 2004 to a temporary Human Rights Commission within the **BiH Constitutional Court**. The latter, reinforced by a funding increase to cover its increased workload, has started dealing with new cases. The

mandate of the International Ombudsman expired in December 2003; the **national BiH Ombudsman** office now comprises three national members. There is Entity opposition to merging existing Ombudsman institutions into a single BiH body.

*Comply with existing conditionality and international obligations – Fully co-operate with ICTY, particularly on the part of RS, notably in bringing indicted war criminals to justice before the international tribunal ... Complete outstanding Road Map steps. Comply with the Dayton-Paris Peace Accords. Take steps to implement BiH's Council of Europe post-accession criteria, especially in areas of democracy and human rights."*

Co-operation with the **International Criminal Tribunal on former Yugoslavia** (ICTY) remains inadequate. RS personnel have taken part in recent actions with the international Stabilisation Force (SFOR), but their participation was no more than nominal. Thus, while local law enforcement capacity may have improved, it is not yet clear that such operations can or would be organised, realised or followed up without international involvement. In December 2003, a commission, initially delayed by RS reticence but now with RS, international and victims' family participation, was established to investigate the Srebrenica events of July 1995. The commission has met regularly, but has been accused of political bias in its working methods and findings.

Preparations continue with BiH support for the specialised **War Crimes Chamber** within the State Court. A Joint Executive Board for the War Crimes Chamber was established with the involvement of the BiH ministries of Justice, Security, Treasury, and Foreign Affairs. A first meeting took place in December 2003. BiH will in future need to assume increased political, administrative and financial responsibility for the Chamber. Its establishment also implies the need for BiH investigative capacity in this sector.

In early 2004, a number of **Road Map** steps still require action: implementation of public service broadcasting reform, improved State and RS implementation of the decisions of the human rights institutions (including better reporting to international human rights bodies) and further steps towards a single market in BiH (cf. section 4.1).

In the context of its post-accession criteria for the **Council of Europe**, BiH continues to make progress. However, the process of amending the BiH Election Law and addressing the constituent identity of each people has not yet begun.

## **2.2. Other Priorities Areas identified in the 2003 SAP Report**

Since the 2003 Report, four reform commissions staffed by BiH nationals and chaired by a representative of the international community have been operative. These developed reform proposals on indirect taxation (cf. section 4.1), **defence, the intelligence services** and the **Mostar City administration**.

The work of the **Defence Reform Commission** responded, at least in part, to the failings evidenced by the **Orao scandal**. Investigations lent weight to arguments in favour of military reform and the strengthening of the State's ability to control military import and export licences. The Defence Commission, established in May 2003, proposed a legislative package, adopted by parliament in December 2003, defining State-level defence structures, a BiH Ministry of Defence, State-level command and control, parliamentary oversight and a significant reduction in armed force numbers. There have been delays in implementing the law. The creation of coherent BiH military structures will contribute to generally improving internal security and provide a favourable environment for SFOR troop reductions. Remaining security concerns may nonetheless require an international security presence. An **EU follow-on mission to SFOR** would thus provide important support to the SAP integration process.

Progress was slower in the case of two other reform initiatives. In the intelligence sector a commission produced proposals for a single State-level **intelligence agency**. Owing to political disagreement, the Council of Ministers did not consider the law. The High Representative thus took a decision requiring the Council to forward the draft to parliament. Here, the law was adopted in March 2004, but in versions requiring harmonisation. In the case of reform of the **Mostar city administration** divided ethnic and party interests meant that no final agreement on a new city statute was reached. Regrettably, imposition again proved the only way to overcome divided and apparently irreconcilable ethnic and party interests.

The 2003 Report further identified a need to co-operate fully with the **EU Police Mission** (EUPM). EUPM relations with local police are good; local forces accept EUPM mentoring and the BiH Police Steering Board has functioned successfully. A further requirement related to the need to ensure respect for the **freedom and security of journalists**. Although abuses occur (e.g. alleged FBiH intelligence service “bugging” of journalists), infringements seem more incidental than systemic. On the other hand, BiH journalists have been criticised for inadequate objectivity and for ignoring decisions of the BiH Press Council.

BiH continues to promote **regional co-operation**. Its active chairmanship of the South East Europe Co-operation Process (SEECF), with a focus on justice and rule of law, deserves particular mention. Continued participation in Stability Pact initiatives is welcome. (Cf. Strategy Paper, section 4.5 Regional Initiatives.) In terms of bilateral relations with states of the region, the Serbian and Montenegrin president’s November 2003 public apology to BiH citizens for wrongs committed during the 1992–1995 war was welcome and was followed by agreements on scientific and technical co-operation and border-crossing facilitation. A December 2003 meeting with Croatia brought agreements on improved bilateral co-operation, but no agreement on Ploce. With both Croatia and Serbia Montenegro visa requirements were eliminated from January 2004. On the negative side, there is a danger that bilateral relations with both countries could suffer from BiH’s current failure to implement free trade commitments (cf. section 4.1).

### **2.3. General Evaluation**

For 2004 the Feasibility Study set a **substantial reform agenda**. The seemingly heavy reform programme appears less demanding when it is remembered that few of the reforms identified are new. It is welcome that the Council of Ministers, with DEI support, has adopted a structured and methodical approach to reform. In late December 2003 an action plan for addressing the Feasibility Study priorities was adopted and in January 2004 presented to parliament. The document outlines deadlines and responsibilities among the BiH institutions. Its existence is testimony to both organisational will and structured thinking. The aim is to address most of the issues before the end of the summer 2004 – a realistic but certainly ambitious schedule. A February 2004 multi-party declaration in favour of European integration is also welcome – but must be followed by action.

The first ten months of 2003 saw welcome reform. Advances came inter alia in establishing a new Council of Ministers, initiating public administration reform, introducing a new Criminal Code and Criminal Procedure Code, starting the functioning of the State Court, providing important input to the Feasibility Study, continuing refugee returns and further improving property legislation, etc. At the end of the year, the passage of laws on indirect taxation and on defence – after international prompting - was also welcome, marking advances towards a self-sustaining BiH state. However, on the negative side, late 2003 and early 2004 saw opposition to intelligence reform, to a new Mostar statute and other unwelcome steps (see section 4 below). The concern is thus twofold. First, hope for a new and clear reform dynamic has not been clearly confirmed, indeed political obstruction of reform is still frequent. Secondly, BiH “ownership” of reform remains limited; in most advances, international

initiative, input and pressure was key. Inadequate domestic political will and capacity inevitably have an adverse impact on the implementation of adopted reforms. This would not be an adequate basis on which to build a SAA.

### 3. ECONOMIC SITUATION

#### 3.1. Points covered in the Feasibility Study

*Reliable statistics – Implement the Law on Statistics, aiming at the creation of a functioning system of statistics with clear lines of responsibility and co-ordination mechanisms.*

Despite a November 2003 agreement between the three statistics agencies to move to a **single BiH statistics system**, there has been very little progress. The (imposed) Law on Statistics has not yet been adopted in national parliamentary procedure and the planned Statistics Council not yet established. The Entities have persistently objected to a stronger role for the State-level institution. Director and Deputy Director posts have been advertised at the State agency, but political disagreements have prevented appointment. In January 2004 the agency did, however, initiate a household consumer survey leading eventually to a BiH consumer price index.

From January 2004 the BiH Central Bank began releasing new monthly BiH **foreign trade commodity data** at BiH level. This is a welcome development made possible by the processing of data provided by the ASYCUDA system in the customs administrations (although it is, arguably, a task which the Statistics Agency should fulfil).

*Budget legislation – Adopt and start to implement a budget law covering multi-annual budget planning and forecasting and start to elaborate a consolidated government account.*

BiH currently has no State-level **budget law regulating budget preparation and financial management** and no consolidated government account. A first draft finance law (which benefited from comments by the international financial institutions) has been established. The new finance legislation would provide a legal framework for multi-annual budget planning, execution and control. Future budgets would be based on a medium-term (three-year) financial plan, with fiscal responsibilities clearly separated and provisions for both sound execution and control. At Entity level, existing budget laws need to be revised (e.g. by incorporating multi-annual planning), but so far no action has been taken in this respect.

Up to now the Central Bank has ensured the compilation of general government data. Although this task should normally be that of the (State) Ministry of Finance, the authorities have pointed out that this can only be done when a full Treasury system is implemented at all sub-Entity levels (cantons and municipalities). On a more institutional level, the International Monetary Fund (IMF) has pointed out that BiH lacks an institution to establish an annual consolidated fiscal balance and to apportion targets to the State and Entities, thus ensuring the realisation of a consolidated balance target throughout the year. The Fund further pointed out that the Governing Board of the Indirect Tax Authority (ITA) could be developed into a **Fiscal Council** able to assume this role. It appears that within the ITA Governing Board a consensus has emerged on this suggestion.

*Budget practice – Take steps to record all income accruing to public authorities at different levels of government, including grants and other forms of international assistance.*

The integration of extra- and off-budget resources into the budget is essential for the appropriate preparation and control of BiH budgets. Currently, many revenues and resources linked to grants and foreign donations are not included in the budget (only budgetary support is). Tentative estimates suggest that around 40% of Entity and sub-Entity resources remained

unaccounted for. Recently, however, some progress has been recorded. A system of registering donations has reportedly been established at State level and in the Entities, closely linked to the treasury system. The system should be introduced in FBiH cantons by April 2004, while in RS a similar pilot project is underway in five municipalities.

### **3.2. Other Priorities Areas identified in the 2003 SAP Report**

To facilitate economic reform, the IMF and the European Commission (cf. also section 5) provide budget support to the BiH State and Entities. In 2003, under the IMF Stand-by Arrangement (SBA - adopted in 2002 and worth around €100 million), BiH continued **macro-economic stabilisation** and achieved significant fiscal consolidation while maintaining price stability through adherence to the Currency Board. Latest data point to a consolidated budget deficit of 3.4% of GDP (with a slight surplus after grants) and a country-wide inflation rate of around zero.

As required by the SBA, the **Currency Board** continues to operate, since August 2003 with a new Governing Board. Also, in the context of the IMF programme, banking supervision was strengthened by enforcing current prudential regulations; new capital requirements apply since January 2003 and have been met by all banks. Moreover, regulations on banks' foreign currency exposure were amended to include assets and liabilities indexed to foreign currencies. In June 2003 both the second and third tranches of the SBA were disbursed, totalling around €33 million. As a result of delays in preparing a comprehensive plan on domestic debt and a proposed RS wage increase, the programme had to be extended to February 2004, when the fourth and final tranche was successfully disbursed.

Economic reform was also supported through a second package of **Community macro-financial assistance** (€60 million, including €20 million loan and €40 million grant). As for the first package, implementation is linked to progress in economic and structural reforms. The first grant tranche of €15 million was disbursed in February 2003. Over the year BiH made slow but continuous progress on conditionality for the second tranche. This eventually led to the payment of a €10 million grant in December and a €10 million loan in January 2004.

The 2003 report also highlighted the need to make progress in **implementing 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**. While commendable progress has been made with Bulldozer Initiative (cf. section 4.2), other aspects of improving the economy and the business environment have had more mixed results: a single business registration system has yet to be established and the privatisation of large strategic companies has stalled. (At end 2003 only 18 out of 56 strategic companies had been sold in FBiH and 4 out of 80 in RS). Apparent lack of political will, problems of corporate governance and corruption continue to discourage investors.

**Adequate transfers** were made from Entities to the State during 2003.

### **3.3. General Evaluation**

In the context of improving macro-economic management, the Feasibility Study identified the short-term need to implement reform of the statistics sector, to revise budget legislation and improve budget practice. Concrete progress in these areas **still needs to materialise**. The recommendations of the 2003 SAP Report in the economic area have, however, been broadly satisfied.

Despite some success in macro-economic stabilisation, BiH is **not yet firmly on the path of self-sustaining growth**. As pointed out in the Feasibility Study, productive capacity and thus

exports remain weak; FDI, though improving, is insufficient to compensate for large current account imbalances. Private sector development needs to be encouraged through an improved business environment, better corporate governance, reduced labour rigidities, revived privatisation and the creation of an environment which facilitates market exit and entry. Even if / when BiH addresses the limited short-term priorities identified in the Feasibility Study, it will still have a challenging medium-term agenda to address. This underlines the need for coherent, but urgent action.

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

##### 4.1. Points covered in the Feasibility Study

*European integration – Ensure the proper and full functioning of the Directorate for European Integration, including its aid co-ordination capacities.*

The **Directorate for European Integration** (DEI) has developed an important role within the BiH Council of Ministers and has emphasised to State and Entity bodies the importance of meeting the 16 Feasibility Study reform areas on time. In December 2003, on a DEI proposal, the Council of Ministers agreed mechanisms to improve co-ordination on European integration issues at State-level and between State and Entity bodies. BiH has also begun work on a European integration strategy (which will presumably reflect BiH's unilaterally declared aim of preparedness for EU accession by 2009).

The CSA conducted a review of **DEI staff**, and recruitment at lower levels has progressed. However, the three DEI departmental heads are not yet in place. As a result DEI's aid co-ordination and legal co-ordination capacity remain below par.

*Develop the BiH single economic space - Establish the Competition Council. Introduce provisions on the mutual recognition of products in the legal order of BiH and implement a consistent and effective public procurement regime throughout the country. Remove all duplicate licences, permits and similar authorisation requirements to allow service providers (including financial institutions) to operate throughout BiH without having to fulfil unnecessary administrative requirements. Create a single business registration system that is recognised throughout BiH.*

Although the BiH **Competition Law** was adopted in October 2001, this was followed by years of inactivity. Today the law remains unimplemented and Entity offices for competition and consumer protection remain to be established. However, State, RS, and FBiH authorities have now committed themselves to nominate members to the Competition Council and to fill these positions by April 2004. A single, acquis-compatible **public procurement law** was drafted in late 2003. The draft law has uniform rules, but leaves responsibility for procurement with the contracting authorities. The single draft law has the advantage of being compatible with EU and WTO requirements; it would reduce operating costs, eliminate anti-competitive practice and promote the single market. Although rapid and full adoption of the law is essential if BiH is to manage public resources more effectively, the RS authorities, in a worrying development, withdrew their initial support for the law. Laws establishing separate institutes for **standards**, for **metrology** and for **intellectual property** have been adopted by the Council of Ministers, but not yet by parliament. The appointment of the Director of the BiH Institute for Standards has been outstanding for years, but the Director and Deputy Director for the Accreditation Institute have been appointed and in December 2003 assumed their duties.

Over the reporting period, no progress on removing duplicate licences, permits and other authorisation requirements has been made. Problems with the recognition of administrative

documents by various jurisdictions still create barriers for businesses wishing to operate throughout the country. A draft law creating a **single business register**, a long-standing commitment, is under consideration, but so far no action has been taken. That the BiH single market remains incomplete was demonstrated in early 2004 by the reported experience of a consumer product company investing in BiH which, allegedly because of “legal obstacles” could distribute its product only in FBiH.

*Consistent trade policy – Establish a coherent and comprehensive trade policy and revise existing legislation to ensure a consistent policy on free zones. Establish at State-level certification and other procedures for the export of animal products and a phytosanitary office that are EC-compatible, with a view to promoting exports, but also enhancing standards and the single economic space.*

BiH has a persistent merchandise trade deficit (in 2002 estimated at over 35% of annual GDP). Responding to this concern, the Poverty Reduction Strategy Paper (PRSP) exercise produced a study entitled “**Strategic Trends in the Development of Foreign Trade and Encouraging Exports**” and submitted it to the Council of Ministers for adoption in late 2003. The document is welcome but unfortunately does not address weaknesses such as BiH’s limited impact assessment and negotiating capacities.

BiH continues to pursue **World Trade Organisation (WTO)** membership. However, in the context of **regional trade**, 2004 saw unwelcome developments. Despite commitments under existing free trade agreements (FTAs), but in response to domestic lobbying, BiH unilaterally postponed for three months tariff reductions on agricultural goods from Croatia and Serbia and Montenegro. This development, though purportedly temporary, is worrying: it demonstrates less than full compliance with international commitments and thus raises questions about BiH’s will to respect future SAA and WTO commitments. It further indicates poor FTA preparation and limited ex ante evaluation capacity.

Since November 2003 there has been no further progress in addressing the problems associated with BiH’s **free zones**: legal inconsistencies remain, activities which are incompatible with EU standards (e.g. customs clearance of goods not physically present on BiH territory) persist, and inadequate monitoring of activity within / around free zones continues. Despite these problems, new free trade zones have been created. The authenticity of BiH **certificates of origin** still causes concern. Under the present set-up, abuse is possible, even likely, since the procedure is relatively new and there is no tradition of checking traders’ accounts.

On **product certification**, partial progress can be reported. The **State Veterinary Office** is operational, but the Entities have failed to align their legislation with the State Veterinary Law and co-operation mechanisms remain embryonic. FBiH inability to provide funds for the veterinary sector, and in particular for an animal identification scheme, is a constraint. Further progress is required if BiH is to comply with EU Food and Veterinary Office recommendations. A **BiH Phytosanitary Agency**, replacing the current system of divided Entity jurisdiction, remains to be established. Initial steps have been taken in drafting framework laws on technical requirements and conformity assessment, market surveillance and general product and food safety.

*Customs and taxation reform – Proceed with implementation of the recommendations of the Indirect Tax Policy Commission. Ensure parliamentary adoption of the Law on the Indirect Tax Authority, including the adoption of the related enabling legislation. Ensure implementation, including the appointment of a Director for the Indirect Tax Authority and the functioning of the new customs authority. Demonstrate progress in preparing the introduction of VAT with a view to beginning on schedule.*

After initial progress, work on establishing the BiH **Indirect Tax Authority** (ITA) slowed down in late 2003 and 2004. Full parliamentary adoption of the ITA law and the appointment of an ITA Director were achieved in December 2003. The ITA Governing Board has been established and is operational, although three experts remain to be appointed. A customs merger team has been nominated. An operational budget has been agreed by State and Entities and this should allow the recruitment of senior staff. On the other hand, the creation of an IT strategy remains outstanding. No adequate headquarters building has yet been identified in RS. The ITA did not meet its original deadline for beginning work (January 2004). Operations now seem more likely to begin in summer 2004.

Delays have also affected the introduction of **VAT**; early 2006 is now the probable starting date. A VAT development team has been appointed, but is still not operational and thus no VAT implementation plan has been drawn up. No VAT registration threshold has been established. Delay means postponing the benefits and savings associated with reform and could endanger public finances (as other receipts from customs duties decline with the progressive introduction of free trade regimes).

*Integrated energy market – Implement Entity Action Plans for the restructuring of the electricity market.*

Initially, in 2003, there was Entity agreement on action plans to restructure the **electricity sector**. The BiH Council of Ministers adopted legislation establishing an Independent Systems Operator and a Transmission Company; this legislation is, however, still in parliamentary procedure and subject to protracted debate and attempts from several parties to dilute the substance of the law. In addition, the FBiH action plan was successfully challenged in the Entity Constitutional Court. Reform has thus come to a halt. This is a serious setback. In a further unwelcome early 2004 development, the High Representative felt compelled to intervene in FBiH because of the breakdown of negotiations between Aluminij Mostar and its electricity provider. The absence of a framework for resolving this situation threatened to undermine the electricity grid and could have led to the closure of BiH's largest exporter. Major donors are now reconsidering their support to the sector.

As part of its commitment to **regional co-operation**, in December 2003 BiH signed a MoU setting out rules and objectives for a regional energy market in south east Europe. (Cf. Strategy Paper, section 4.4 Co-operation in other sectors.) BiH committed itself to bring its laws, regulations and administrative practice into line with the MoU no later than July 2005.

*Public broadcasting – adopt legislation in line with European standards and the Dayton – Paris Peace Accords and take steps to ensure the long-term viability of a financially and editorially independent single State-wide public broadcasting system for Bosnia and Herzegovina, whose constituent broadcasters share a common infrastructure.”*

Reform of the **public broadcasting system** (PBS) remains tortuous and slow. In early November 2003, the three Prime Ministers agreed reform: the establishment of three legally separate and complementary broadcasters, one providing State-wide services and the others serving their Entities, each with its own responsibility for determining content. A single, uniform and mandatory subscription system was foreseen. The RS government agreed and implemented relatively quickly a system of subscription collection, but in FBiH proper subscription fee collection has been slow to start. Despite existing model legislation, no State-level law has yet been approved by parliament.

*Tackling crime, especially organised crime – Build up a State-level law enforcement capacity by allocating the necessary resources and facilities to ensure the full functioning of the State*

*Information and Protection Agency and the BiH Ministry of Security. Proceed with structural police reform with a view to rationalising police services.*

Under EUPM guidance, policing continues to improve, but **structural reform of BiH's multiple police forces** has barely begun. Enthusiasm for police reform is limited, particularly in RS.

In early 2004 the Council of Ministers approved and passed to parliament for consideration laws setting up the **State Information and Protection Agency (SIPA)**. An executive SIPA, when established, would contribute to a coherent rule of law system which includes the State Court and State Prosecutors. Disagreements over the location of SIPA's headquarters (reflecting other political battles) delayed progress, but in December 2003 the Council of Ministers identified new temporary accommodation and committed itself to finding permanent premises. The operational capacity of the new BiH **Ministry of Security** continues to grow slowly.

Over the reporting period, BiH has recorded some success in fighting organised crime. The special chamber within the BiH State Court covering **organised crime and corruption** has brought trafficking cases to successful prosecution. Although trafficking continues, this indicates that there has been improvement in co-operation between the BiH public prosecutor, police and the State Border Service. At Entity level, first prosecutions for money laundering have been brought and some senior politicians have been prosecuted for corruption and business crime.

In the framework of the EU-Western Balkans Forum a first meeting of justice and home affairs (JHA) ministers took place in late November 2003 as a follow-up to the November 2002 London conference on organised crime. At the meeting BiH presented eight practical measures designed to support the fight against crime. These range from the establishment of new, specialised agencies to the exchange of information. Among the measures presented to the conference was an **Action Plan against Organised Crime** containing benchmarks, deadlines and resource requirements. An action plan against money laundering was included.

*Managing asylum and migration - Ensure the establishment and operation of proper structures dealing with asylum and migration*

A BiH Law on the Movement and Stay of Aliens and Asylum entered into force in October 2003. Related by-laws are currently in preparation. Responsibility for **(im)migration** and the personnel in this sector has been transferred to the Ministry of Security, but practical progress has been slow. Staffing remains a problem and there is little progress in transferring the Inspectors for Foreigners to Ministry of Security jurisdiction.

On **asylum** the Ministry of Security is now formally responsible for processing asylum requests (but there remains a worrying division of competence between the Ministry of Security and the Ministry of Human Rights and Refugees). In practice UNHCR still implements asylum policy. The Ministry of Security is due to take over responsibility for refugee status determination from UNHCR in July 2004, but so far little real capability is present.

#### **4.2. Other Priorities Areas identified in the 2003 SAP Report**

Since its launch in November 2002, the **Bulldozer Initiative** has sought to remove administrative and bureaucratic obstacles to business and investment. Success in the first phase, with 50 reforms adopted by government in May 2003, encouraged the establishment of a **Bulldozer Phase II**, launched in June 2003. A further 50 reform recommendations were submitted to government in November 2003. Partly as a result of this initiative, investment

levels in BiH have continued to rise; FDI is expected to be confirmed at around €280 million (nearly 5% of GDP) in 2003.

The **State Border Service (SBS)** is now fully staffed and its deployment complete (although operational capacities remain constrained by financial and technical weaknesses). SBS, with EUPM support, co-operates with police services, customs authorities and the prosecution services. The introduction of intelligence- and investigation-led policing (focussing on traffickers rather than trafficking victims) has produced improved results in addressing human trafficking and other cross-border crimes. Implementation of the **national anti-trafficking plan** and the **protection of trafficking victims** have advanced. As a follow-up to the May 2003 Ohrid conference, BiH presented five measures designed to enhance border security and management at the November 2003 EU – Western Balkans ministerial Forum on JHA.

#### 4.3. General evaluation

In this as, in other areas, BiH's record of **progress is mixed**. On those of the 16 points relevant to compliance with SAP technical standards some advances have been made. Thus, for example, full parliamentary adoption of the ITA law containing provisions for four regional offices is welcome. Also, as regards the recommendations of the 2003 Report, there have been advances with the Bulldozer Initiative and consolidation of the SBS. However, progress on the recommendations of the Feasibility Study has been incremental; none of the Feasibility Study recommendations has yet been fully completed. For BiH the technical reforms associated with the SAP are essential to conclude and implement a SAA.

Finally, to make definitive progress, reform needs to be both implemented by all relevant actors and consistently pursued over time. For example, RS refusal to support EU-compatible public procurement legislation is worrying; it may indicate a lack of commitment to reform. In addition, the effect of political agreement among prime ministers on PBS reform could be undermined by the unwillingness of FBiH public bodies to implement a subscription fee collection system for radio and television. Similarly, BiH has a good record on regional co-operation and is improving its relations with its neighbours. However, the unilateral, temporary postponement of FTA commitments vis-à-vis Croatia and Serbia and Montenegro gives cause for concern. Progress is welcome, but satisfactorily addressing the 16 priority areas identified in the Feasibility Study will require unity of political will and further determined effort.

#### 5. EC FINANCIAL ASSISTANCE

Between 2000 and 2003 BiH benefited from around €391 million in EC assistance. Besides CARDS funding, the EC provided balance of payments support in the context of an IMF programme and democratisation funding.

For **CARDS** an EC Country Strategy Paper sets out the main assistance priorities for 2002 - 2006 and a Multi-Annual Indicative Programme defines detailed priorities for 2002-2004. In 2003, €71.9 million was allocated to BiH under CARDS, supporting reforms necessary for a future SAA. The programme focused on **(i) Democratic stabilisation**: Assistance helped BiH, which aims to take full responsibility for refugee returns, through the creation of a transparent system for identifying and financing return needs. The EC also supported legislative, institutional and technical strengthening of public broadcasting. **(ii) Administrative capacity building**: the EC-funded Customs and Fiscal Assistance Office (CAFAO) built capacity in the customs and tax services and highlighted weakness in management procedures. The EC also helped strengthen the Directorate for European Integration and the BiH Department for Civil Aviation. **(iii) Economic and social development**: CARDS support for the privatisation and restructuring of BiH enterprises in

2003 led to substantial investment commitment, job retention and job creation. The EC also helped develop BiH's economy through SME support, micro credit, rural credit, housing and NGO projects. An EC project fund was set up to help bring BiH's regional development framework into line with EU cohesion policy. EC social development targeted vocational education reform and, through the TEMPUS programme, co-operation in higher education.

**(iv) Environment and natural resources:** EC support focused on upgrading the legal framework for environmental policy and on developing rural areas and the agricultural sector.

**(v) In justice and home affairs,** support continued for judicial and prosecutorial reform through the Independent Judicial Commission, the High Judicial and Prosecutorial Councils, and the prosecutors' offices. Training and equipment was delivered to BiH police in co-ordination with EUPM. Technical assistance was provided on immigration and asylum, primarily through the BiH Ministry of Security. BiH continued to benefit from the **CARDS Regional Programme** providing support for integrated border management, democratic stabilisation, environmental development and building state institutions and regional infrastructure.

In 2004 BiH will receive support primarily in the area of administrative capacity building, notably assistance to CAFAO in following up key sector reforms. Public administration reform will be supported. Other areas of concentration will be economic reform and the fight against organised crime. 2004 funding reflects the **additional funds** that were allocated to BiH (€7 million) at the time of the June 2003 Thessaloniki European Council meeting.

In 2003 – 2004 **EC macro-financial assistance** (cf. section 3.2) continued. This assistance, which is conditional on progress in economic and structural reform, involved the disbursement of a first grant tranche of €15 million in February 2003 and a second tranche of €20 million (€10 million grant in December 2003 and €10 million loan in January 2004).

In 2003 the EC provided €12.2 million to support **OHR**, covering more than half its operating budget. €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** and it benefits from the **LIFE** environmental programme and from support through the **NGO, YOUTH** and **horizontal demining** budget lines.

A number of established **aid co-ordination mechanisms** exist. Regular co-ordination meetings are held with EU Member State missions and with other bilateral and multilateral donors to ensure coherent interventions. The national BiH co-ordinator for EC assistance, the Directorate for EU Integration has yet to become operational at national level, but in the closing months of 2003 the conditions for this to begin in 2004 were created.

## 6. PERCEPTIONS OF THE EU

EU issues retain a **high profile in the BiH media**. Frequent and close coverage of a number of EU-related events in 2003 brought home to BiH politicians, and to a lesser extent the BiH public, the potential for BiH integration into EU structures. No relevant opinion polls on EU issues have been conducted so far - the first is expected in spring 2004 – but the public perception of the EU is generally positive.

The **coverage of EU-related issues** in the BiH media is of variable quality. The media are divided between those supporting integration and those which are more sceptical. Some doubt the prospect of membership (although Slovenia's accession should reduce those doubts). The Thessaloniki summit, with its message that the map of Europe would not be complete without the Western Balkans, helped counteract scepticism. Moreover, the results of the Feasibility Study (which on publication dominated the media) showed that the EU does not want to postpone but rather encourage integration.

Media coverage of high-level EU visits and events like the Thessaloniki summit has improved **public understanding** of basic EU-related issues although, in BiH as elsewhere, the public remains most concerned with practical and more immediate issues. The need to obtain a visa for EU visits is the main concern for the general public, in particular among most young people.

**Reforms** have also highlighted the EU role in the public mind. A media campaign in favour of reform by the High Representative / EU Special Representative and others sensitised the BiH public to the need to make progress in a number of key areas. The reform most closely identified with the EU is that of customs and indirect taxation. (Here, the international community learned important lessons: clear messages to the media and to the general public with coordinated media appearances by members of the international community, helped overcome the objections by special interest groups and thus remove political obstacles to progress.)

Undoubtedly, the EU and in particular the SAP is complicated and difficult to communicate effectively to the BiH public. Among BiH institutions, the DEI has led the effort to communicate to the public a rationale for EU integration and the sometimes difficult challenges associated with it.