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# **Bosnia and Herzegovina**

## **2005 Progress Report**

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## A. INTRODUCTION

### 1. Preface

The European Council in Feira in June 2000 confirmed that

*“its objective remains the fullest possible integration of the countries of the Western Balkans region into the political and economic mainstream of Europe through the Stabilisation and Association process, political dialogue, liberalisation of trade and cooperation in Justice and Home Affairs. All the countries concerned are potential candidates for EU membership”.*

In view of the EU-Western Balkan Thessaloniki Summit in June 2003, the General Affairs and External Relations Council adopted “The Thessaloniki agenda for the Western Balkans: moving towards European integration”<sup>1</sup>. The Thessaloniki agenda strengthened the Stabilisation and Association process by introducing new instruments to support the countries’ reform and European integration efforts, including European Partnerships. This agenda was endorsed by the European Council and by the countries of the Western Balkans in June 2003.

In June 2005, the European Council reiterated that:

*“... each country’s progress towards European integration, taking account of the evolution of the acquis, depends on its efforts to comply with the Copenhagen criteria and the conditionality of the Stabilisation and Association process. Moreover, in this process, regional cooperation and good neighbourly relations will remain essential elements of EU policy.”*

The structure of the report is largely the same as that used in previous years and assesses the implementation of the Stabilisation and Association process. The report:

- describes the relations between Bosnia and Herzegovina and the Union;
- analyses the political situation in Bosnia and Herzegovina in terms of democracy, the rule of law, respect for human rights and the protection of minorities;
- assesses the economic situation in Bosnia and Herzegovina in terms of economic developments and progress towards economic stability and competitiveness;
- reviews Bosnia and Herzegovina’s capacity to implement European standards, that is, to gradually make legislation in key policy areas more compatible with European legislation and standards;
- examines the extent to which Bosnia and Herzegovina has addressed the European Partnership priorities.

This report takes into consideration progress since the 2004 report. It covers the period from March 2004 to 30 September 2005. It looks at whether planned reforms referred to in the 2004 annual report have been carried out and examines new initiatives, as well as assessing the overall level of implementation.

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<sup>1</sup> Conclusions of the General Affairs and External Relations Council, 16 June 2003.

Progress has been measured on the basis of decisions *actually* taken, legislation *actually* adopted and the degree of implementation. As a rule, legislation or measures which are in various stages of either preparation or Parliamentary approval have not been taken into account. This approach ensures equal treatment for all countries and permits an objective assessment of each country in terms of their concrete progress implementing the Stabilisation and Association process.

The report draws on numerous sources of information. Bosnia and Herzegovina has been invited to provide information on progress made since the publication of the last report. Council deliberations and European Parliament reports and resolutions have been taken into account in drafting the report.<sup>2</sup> The Commission has also drawn on assessments made by various international organisations, in particular the contributions of the Council of Europe, the OSCE, the international financial institutions, and non-governmental organisations.

## **2. Relations between the EU and Bosnia and Herzegovina**

### *Recent developments in bilateral relations*

Bosnia and Herzegovina is participating in the Stabilisation and Association Process (SAP). Currently, there is no contractual framework between the EU and Bosnia and Herzegovina. Political and technical dialogue has been taking place through the **Consultative Task Force (CTF)**, which meets regularly several times a year. Formal contractual relations should be established through the conclusion of a **Stabilisation and Association Agreement (SAA)**.

A Feasibility Study on Bosnia and Herzegovina's readiness for negotiating and implementing an SAA was adopted by the Commission in November 2003. To monitor progress on the Feasibility Study's priorities, six Consultative Task Force (CTF) meetings have been held. Bosnia and Herzegovina has made significant progress in addressing these priorities.

As a result of the Thessaloniki Agenda, the first political dialogue meeting at ministerial level between the EU and Bosnia and Herzegovina was held in September 2004 (in troika format). A second ministerial meeting took place in September 2005 alongside the annual UN General Assembly meeting.

EU-Bosnia and Herzegovina inter-parliamentary meetings, attended by delegations from the Bosnia and Herzegovina Parliamentary Assembly and the European Parliament, took place in November 2004 and May 2005. Although no formal relations exist with the European Economic and Social Committee, an introductory visit establishing contacts with civil society bodies took place in March 2005.

Bosnia and Herzegovina has been an increasing focus of EU political interest, especially in relation to CFSP and ESDP measures. In June 2004, the Council adopted a Joint Action on an EU military operation in the country (EUFOR/Althea). This decision led to the deployment of troops by the end of 2004. Also in June 2004, the European Council adopted a Comprehensive Policy with regard to Bosnia and Herzegovina as one of the European Security Strategy's initial implementation priorities. The mandate of the EU Special

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<sup>2</sup> For the European Parliament the rapporteur during the reporting period was Mrs. Doris Pack, MEP.

Representative (EUSR) to the country, whose role is to “offer the EU’s advice and facilitation in the political process and to promote overall political coordination”, has been extended until the end of February 2006. There are ongoing discussions within EU bodies for a new police mission which should replace the current one (EUPM) as from 1 January 2006. The EU Monitoring Mission continued to operate on the basis of its Joint Action. Its current mandate expires at the end of 2005.

The first **European Partnership** for Bosnia and Herzegovina was adopted by the Council in June 2004 (*see part C – European Partnership: Overall Assessment*). Its short-term priorities coincide to a large extent with those identified in the 2003 Feasibility Study. In May 2005, Bosnia and Herzegovina adopted an action plan addressing the European Partnership priorities. Although the formal adoption of this action plan was delayed, notably by the opposition of Republika Srpska, Bosnia and Herzegovina has been able to make considerable progress in addressing many of the partnership’s short-term priorities.

Bosnia and Herzegovina’s main **trading** partner is the EU. In 2004, exports to the EU increased by 12% compared to 2003, accounting for 72% of BiH’s total exports. Imports from the EU increased by 9% in 2004 compared to 2003, amounting to 67%.

Main exports to the EU were manufactured goods, raw materials, agricultural products and transport equipment. Main imports from the EU were machinery and transport equipment, agricultural products and chemicals. Some trade disputes between the EU and Bosnia and Herzegovina have taken place in the reporting period. Conditions for imports into Bosnia and Herzegovina of beer and liquid detergents originating in the EU raised some concerns in 2004 due to non-compliance with WTO practices and EU standards. In the context of its WTO accession process, Bosnia and Herzegovina did not adequately verify the compatibility of its offer for liberalisation of trade in services with the Community *acquis* and obligations deriving from the future SAA. It is important that Bosnia and Herzegovina improves coordination and cooperation with the Commission in all WTO-related matters.

Bosnia and Herzegovina has benefited since 2000 from **Autonomous Trade Measures** (ATMs). These measures allow almost all imports originating in Bosnia and Herzegovina to enter the EU without quantitative restrictions and exempt from customs duties. The only exceptions are some beef and fish products, sugar and wine, to which tariff quotas apply. The ATMs have helped improve Bosnia and Herzegovina’s export performance, although a considerable trade deficit with the EU persists (EUR 1.65 billion in 2004). Bosnia and Herzegovina has been unable to take full advantage of the ATMs due, among other things, to its lack of technical certification standards and difficulties to guarantee the authenticity of its certificates of origin. Further reform and industrial restructuring are necessary, in order for the country to take full advantage of the ATMs.

#### *Community assistance*

Since the end of the war in 1995, **Community assistance** to Bosnia and Herzegovina has totalled more than EUR 2 billion. The PHARE, OBNOVA and CARDS programmes provided about EUR 1.15 billion to Bosnia and Herzegovina during the 1995-2004 period, of which EUR 72million in 2004.

Since 2001, the main source of EU assistance for Bosnia and Herzegovina has been the CARDS programme. The support provided through CARDS in 2005 concentrates mainly on the European Partnership priorities, which address the country’s political and economic

situation, as well as the requirements it must meet to be able to implement the future SAA. Total CARDS assistance to Bosnia and Herzegovina in 2005 amounts to EUR 49.4 million. The four main areas supported are:

*Democratic Stabilisation* (EUR 3.1 million) - to help the Bosnia and Herzegovina authorities meet their responsibilities regarding the return and re-integration of refugees and internally displaced persons and to ensure that citizens have access to professional and impartial media which, among other things, help increase mutual understanding among the country's constituent peoples. This includes proper regulation of broadcasting and telecommunications.

*Good Governance and Institution Building, including Administrative Capacity and Justice and Home Affairs* (EUR 31.3 million) – (1) to reform Bosnia and Herzegovina's judicial system by strengthening its effectiveness and impartiality, bringing the legal framework for fighting organised crime and terrorism into line with EU standards, and enabling the judicial system to use modern investigative techniques; (2) to reform the police forces, enhancing their capacity to enforce the rule of law and guarantee security and stability; (3) to develop and implement integrated border management to facilitate the legal movement of people and goods across the borders and to ensure border control; (4) to strengthen the State's capacity to formulate and implement an asylum and migration policy consistent with EU and international standards; (5) to achieve sustainable, effective and transparent public administration; (6) to further support customs and taxation policies and administration so as to maximise revenue and minimise the impact of organised crime and corruption in these fields.

*Economic and Social Development, including the Environment* (EUR 14.5 million) - to improve investment climate and develop a fully functional internal market in Bosnia and Herzegovina, to promote trade by implementing an effective trade policy, to help Bosnia and Herzegovina maximise IFI's assistance for developing its infrastructure, to strengthen State-level capacity for environmental protection and to help the country reform its vocational education and training systems, as well as its higher education (the Commission has so far supported 66 co-operation projects with universities in the EU in the context of the CARDS-financed "Tempus" programme).

*Community Programmes* (EUR 0.5 million) - to help Bosnia and Herzegovina start participating in Community programmes. A Framework Agreement on Bosnia and Herzegovina's participation in Community Programmes has been ratified. Bosnia and Herzegovina's financial contribution (its 'entrance fee'), to cover the cost of its participation in the programmes, may be partly paid from the CARDS budget.

Bosnia and Herzegovina also benefits from the **regional CARDS** programme, which in 2005 has an overall budget of EUR 40.4 million to support measures of common interest to the Western Balkans region, such as infrastructure development, institution building and cross-border cooperation.

CARDS financial support in Bosnia and Herzegovina is implemented by the European Commission Delegation in Sarajevo. Implementation rates are satisfactory, reaching 93% in terms of commitments and 84% in terms of disbursement for the period 2001-04.

In addition to CARDS assistance, Community funds amounting to approximately EUR 28.8 million were provided in 2005 to support the EU Police Mission (EUPM), the Office of the High Representative (OHR) and the EU Special Representative (EUR 20 million, 8.5 million and 0.27 million respectively). Bosnia and Herzegovina has remained a focus country for the

European Initiative for Democracy and Human Rights and benefits from the LIFE environmental programme and the 6th Framework Programme for Research and Development. Support for de-mining has continued under the Anti-Land Mines Action Programme.

Bosnia and Herzegovina has also benefited from **EU macro-financial assistance** (EUR 60 million, composed of an EUR 20 million loan and an EUR 40 million grant). This assistance was disbursed in three instalments. The first two were paid in 2003 and 2004. In July 2005, following fulfilment of the related conditions, the third and final instalment of EUR 15 million was paid.

The Directorate for European Integration of Bosnia and Herzegovina (DEI) has the overall coordinating role for Community assistance. With the help of CARDS, the DEI's Aid Coordination Division has improved its capacity and is now able to act as a real National Aid Coordinator. Senior Programming Officers (SPOs) have been appointed for most Ministries and other institutions. SPOs are responsible for the development of project proposals within their respective institutions, steering the programming process internally and coordinating with other relevant external bodies. For the first time, Bosnia and Herzegovina is taking a leading role in programming and the DEI and the SPOs have prepared project proposals for 2006. This is an important step towards the possible future decentralisation of Community assistance. Civil society organisations have regularly been consulted on the priorities and detailed scope of Community assistance during this process, through the Bosnia and Herzegovina NGO Forum.

### *Twinning*

One of the main challenges facing Bosnia and Herzegovina is the need to strengthen its administrative and judicial capacity. The Thessaloniki European Council decided to extend the “**twinning**” mechanism, used with success during the recent enlargement, to the Western Balkans. Twinning makes the public sector expertise of existing EU Member States available to the partner country through the long-term secondment of civil servants and accompanying short-term expert missions and training. The objective is to enhance the partner country's public administration in order to ensure proper implementation and enforcement of legislation. The Western Balkans can also draw on Member States' expertise through the so-called “twinning light”, a mechanism which is used to support projects of a more limited scope.

Under the CARDS programme, two twinning projects have already been finalised (Ministry of Security, State Border Service) and one project (Communications Regulatory Agency) is ongoing.

Nine "twinning light" projects have also been initiated to assist several Ministries, Directorate and Agencies in areas such as internal organization and overall improvement of administrative capacity, preparation for the participation in Community Programmes and progressive alignment to European standards.

## **B. IMPLEMENTATION OF THE STABILISATION AND ASSOCIATION PROCESS**

### **1. Political situation**

The conditions of the Stabilisation and Association process were set out in the conclusions of the General Affairs Council in April 1997. To become EU members, the countries need to satisfy the criteria established in the Copenhagen European Council conclusions of June 1993. The Copenhagen political criteria stipulate that countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.”

Issues to be assessed include democratic principles, human rights and the rule of law, respect for and protection of minorities, and regional cooperation. In addition, specific issues of relevance to individual countries are examined, including respect for international obligations such as peace agreements and cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY).

In November 2003, the Commission presented a **Feasibility Report** assessing the suitability of opening Stabilisation and Association Agreement (SAA) negotiations with Bosnia and Herzegovina. It concluded that the pre-conditions were not yet fully met, listing sixteen priorities to be addressed before negotiations could be opened. The report also concluded that the Commission would propose a recommendation for a Council decision to open negotiations as soon as it ascertained that significant progress had been made in meeting the priorities identified in the report.

The **2004 Stabilisation and Association Process (SAP) Report**, issued some months later, concluded that Bosnia and Herzegovina’s progress had been moderate on the priorities identified by the 2003 Feasibility Study relating to the political situation. It underlined that further, sustained efforts were needed to consolidate the emerging reform dynamic observed in the country and ensure that the achievements made in State-building were not reversed. Regarding cooperation with the ICTY, the report considered that Bosnia and Herzegovina had only made limited progress.

As regards **democracy and the rule of law**, the 2004 report welcomed the progress achieved by Bosnia and Herzegovina in developing its judicial system, notably through the preparations for establishing the High Judicial and Prosecutorial Council (HJPC) and the establishment of the Bosnia and Herzegovina State Court and Prosecutor’s Office. It also welcomed Bosnia and Herzegovina’s progress in fulfilling a number of its Council of Europe post-accession commitments. In the area of public administration, the report noted Bosnia and Herzegovina’s commitment to developing a comprehensive, country-wide public administration reform (PAR) strategy and the establishment of a Functional Review Steering Committee to guide the systemic and functional reviews which would feed into the PAR strategy. Nonetheless, the report also outlined a number of weaknesses and stressed, in particular, the need to improve the overall functioning of democratic institutions, strengthen the new State-level ministries and agencies and ensure proper coordination between the State, the Entities and the Brcko District.

On **human rights and protection of minorities**, the report welcomed the success registered in the areas of refugee return, restitution/repossession of property and the transfer of human



rights institutions from international to Bosnia and Herzegovina's responsibility. However, it also underlined the need for the country to further improve its human rights record.

As far as **regional issues** were concerned, the report welcomed Bosnia and Herzegovina's active participation in regional initiatives. In terms of bilateral relations with regional neighbours, it noted increased and generally constructive cooperation with Croatia and Serbia and Montenegro.

The section below provides an assessment of political developments in Bosnia and Herzegovina since the 2004 report, including the overall functioning of the country's executive and judicial system, the rule of law, respect for human rights, protection of minorities and regional issues. Such developments are closely linked to Bosnia and Herzegovina's ability to implement the reforms and reach the standards that are required to make further progress in the Stabilisation and Association process and towards the EU.

### **1.1 Democracy and the rule of law**

Following the declaration of independence in April 1992, Bosnia and Herzegovina was plunged into a three-year long civil war. This led to major displacements of population and to extensive physical and economic destruction. On 21 November 1995, in Dayton (USA), a peace agreement put an end to the war. The Dayton Peace Agreement retained Bosnia and Herzegovina's international boundaries and created two Entities within the Bosnia and Herzegovina State: the Bosniak/Croat Federation of Bosnia and Herzegovina (the Federation of Bosnia and Herzegovina) and the Bosnian Serb-led Republika Srpska (the Republika Srpska). In accordance with the agreement, an UN-mandated High Representative was established to support peace implementation. Currently, the High Representative also acts as EU Special Representative.

The Dayton Peace Agreement (DPA) grants the High Representative and the international community a significant role in the overall administration of the country and provides the Bosnia and Herzegovina constitutional framework. The *Constitution of Bosnia and Herzegovina* is an annex to the DPA. It specifies that Bosnia and Herzegovina is a democratic State operating under the rule of law with free and democratic elections and provides for a highly decentralised State. This high degree of decentralisation led to the establishment of a large number of governments and related administrations. The Constitution also provides for a sophisticated system of checks and balances to guarantee the rights of Bosnia and Herzegovina's "constituent peoples", i.e. Bosniaks, Croats and Serbs. State and Entity constitutions establish blocking mechanisms protecting the "vital interests" of these constituent peoples.

While the DPA has had the invaluable merit to stop the war and to bring peace and stability to Bosnia and Herzegovina, the adequacy of the Dayton constitutional system to the present circumstances is frequently questioned both within and outside the country. It is widely considered that the structures deriving from the DPA are too complex and fiscally unsustainable. It is also considered that the role and powers granted to the international community need to be progressively phased out as the country achieves normalisation.

From a European integration perspective it is difficult to argue that the present constitutional order is optimal. The current set up does not support swift decision-making and hampers reform implementation. This undermines Bosnia and Herzegovina's

possibilities to make rapid progress in its way towards the EU. Despite considerable achievements towards the strengthening of State institutions, major reforms continue to be delayed by divergences within State institutions and between the central State and the Entities. Attempts to create new State structures or to transfer competences to the State level are often perceived as undermining the Entities and their sustainability. This mistrust towards any transfer of competences from Entities or cantons to the central authorities is a major obstacle to any serious move towards a comprehensive and sustainable reform of the institutions and the constitutional order.

Municipal *elections* were held in October 2004. These were the first elections entirely financed and organised by the Bosnia and Herzegovina authorities, and were generally considered to have been held in accordance with international standards. In April 2005 the High Representative issued a decision withdrawing the international members from the country's Election Commission. This development marked another important step in the transfer of ownership to the country authorities. Nonetheless, the problems identified in the 2003 Feasibility Study in relation to the election of the Bosnia and Herzegovina Presidency members and the delegates to the House of Peoples have not yet been addressed. According to the Council of Europe's Venice Commission, the elections to both the Presidency and the House of Peoples are incompatible with Article 14 of the European Convention on Human Rights.

Staff shortages at the Audit Department of the Electoral Commission hamper implementation of the Law on Political Party Financing. While the State-level Law on Conflict of Interests has been successfully implemented, Entity legislation makes provision for different enforcement bodies which may jeopardise uniform handling of conflict of interest cases throughout the country.

The next Parliamentary and Presidential elections are expected to take place in October 2006.

Bosnia and Herzegovina has a directly elected tripartite *Presidency*, which rotates on an eight-month basis. The presidency is responsible, *inter alia*, for conducting foreign policy, proposing annual budgets and representing Bosnia and Herzegovina in international organisations. Presidencies also exist in the Entities.

Several past Presidency members have been obliged to leave office because of activities considered incompatible with the Dayton agreement, and relations within the Presidency have sometimes been strained over divergent views on Bosnia and Herzegovina's constitutional order and future. In March 2005, the High Representative removed a member of the Presidency following corruption charges against him. These developments have adversely affected the functioning and public perceptions of the institution.

### *Parliament*

Bosnia and Herzegovina has a bicameral State-level parliament, as well as parliaments at the Entity, Brcko District and cantonal levels.

The Bosnia and Herzegovina Parliamentary Assembly has in general been favourable to European integration, and most legislation related to the 2003 Feasibility Study has been adopted in an expeditious manner. Both parliamentary Houses (the House of Representatives and the House of Peoples) have adopted resolutions giving full support to

European integration and urging the authorities to speed up the integration process. This has not prevented political parties and delegates from occasionally delaying the adoption of specific laws necessary for the country's progress in the Stabilisation and Association Process.

The State Parliament has become more efficient in preparing legislation, and the technical committees in both Houses have grown in importance. However, although the situation has improved in the last year, the Bosnia and Herzegovina Parliamentary Assembly continues to be hampered by a lack of technical resources and qualified personnel. A number of deficiencies identified in the Feasibility Study still persist. The Parliament continues to meet infrequently, holding regular sessions approximately twice a month only. The pace and quality of legislative output continues to be strongly affected by slow input from the Council of Ministers and by the lack of an adequately qualified and organised parliamentary administration. The pace of the legislature is also affected by often cumbersome parliamentary procedures. This leads to the occasional abuse of emergency ordinances and to the adoption of legislation through accelerated procedures, which limits the Parliament's participation in the legislative process. External oversight of the Parliamentary Assembly by civil society remains limited.

Although the political parties all support European integration and structural reform in general, they are not always ready to make the necessary concessions to achieve real progress. Members of the State Parliament often continue to vote along ethnic lines or owe their first allegiance to the relevant Entity. This difficulty is compounded by the continued existence of sometimes competing centres of legislative authority at Entity and cantonal levels. There is a clear need to ensure better and institutionalised co-ordination of legislative programmes between all levels of authority.

### *Government*

There have been a number of political deadlocks in the State-level Council of Ministers and the Republika Srpska Government which have adversely affected the normal work of the executives. Following the tabled resignations of two Serb Ministers from the Council of Ministers at the end of 2004, the work of the State-level government was blocked for almost two months. Further problems occurred when a Minister resigned following corruption charges and an open conflict erupted between the Chairman of the Council of Ministers and the Minister of Foreign Affairs. Moreover, in December 2004, as a result of non-cooperation with the ICTY, the High Representative/EU Special Representative and the United States announced a series of sanctions aimed mainly at Republika Srpska. In the wake of these measures and as a sign of protest, the Republika Srpska Prime Minister resigned, and with him the entire government. In February 2005, a new government was formed. The government of the Federation of Bosnia and Herzegovina has remained largely stable, even though two Ministers were replaced in September 2005.

The consolidation of the State-level ministries and agencies has continued to proceed slowly. Although the State-level ministries have become operational and the other bodies provided for in the Law on the Council of Ministers have been established, the appointment of personnel has been slow, and many of these institutions are not yet fully staffed. The lack of staff clearly affects Bosnia and Herzegovina's legislative and policy development capacity, as well as its capacity to implement reform. Within the State government, the record of advancing legislation through parliamentary procedure to

adoption continues to be limited. This sometimes reflects a lack of political will and diverging national interests, but also results from structural weaknesses such as underdeveloped legislative drafting abilities and inefficient support structures. In terms of legislative drafting, dependence on the international community is still strong, although clearly declining.

The Council of Ministers adopted a State Government Strengthening Plan (SGSP) designed to reinforce the capacities of the State government. The SGSP aims to improve central government effectiveness by establishing: (i) a Commission for Property Management; (ii) an Implementation Plan for the Civil Service Agency and (iii) a Commission on Public Assets. The timelines established in the SGSP have largely been missed and Republika Srpska in particular has been unwilling to participate in the Commission on Public Assets, claiming it to be unconstitutional.

To address the problem of fragmented policymaking, the Council of Ministers, in cooperation with the Entity governments, produced the Medium-Term Development Strategy. The objective was to elaborate a strategy for medium-term economic development, to be implemented from 2004 to 2007. Based on the final draft of the document, the Council of Ministers and the Entity Governments approved an Action Plan for the implementation of the most urgent reforms. As a result, the Economic Policy Planning Unit (EPPU) was established under the authority of the Chairman of the Council of Ministers. The EPPU is designed principally to coordinate socio-economic research related to European integration and to coordinate the implementation of Bosnia and Herzegovina's Medium-Term Development Strategy.

The Legislation Office, responsible for ensuring internal legal harmonisation, has been established, and its director has been appointed. The General Secretariat is now operational, and a permanent General Secretary has been nominated. However, it still lacks the staff to carry out all its tasks under the Law on the Council of Ministers and suffers from an overly politicised environment. In Bosnia and Herzegovina, many functions normally associated with general government departments are carried out by the Prime Minister's and other Ministers' private offices (cabinets).

The Directorate for European Integration (DEI) has continued to play an important role within the Bosnia and Herzegovina Council of Ministers and to promote European integration in general. The DEI, which is under the direct responsibility of the Chairman of the Council of Ministers, has improved co-ordination with, and the involvement of, State and Entity ministries through regular meetings with the EU Integration Coordinators of these ministries.

The DEI has developed an Action Plan to address the European Partnership priorities. The document was approved in May 2005 after serious delays due, in particular, to Republika Srpska's disagreements. The DEI has played a key role in promoting the debate on European integration, and has held regular seminars and meetings with the public. It has also developed a Communication Strategy with the aim of stimulating Bosnia and Herzegovina public support for the European integration process.

The overall staffing situation of the DEI has improved, although some key functions, such as the Head of the Aid-Coordination Department, have not yet been filled. The DEI's aid-coordination capabilities have increased and DEI has been able to play a more prominent role in assistance programming. Senior Programming Officers from State

ministries and key institutions have been nominated to take part in the programming exercise. There has also been progress in developing the DEI's legal harmonisation department. Nonetheless, despite real progress in all the DEI's departments, sustained efforts and training are necessary to further develop its capacity.

### *International community*

On the basis of the Dayton mandate, the international community continues to be deeply involved in Bosnia and Herzegovina. The High Representative continues to play an important role. In addition to his Dayton-mandated responsibilities, the High Representative has the authority to impose legally binding decisions through the so-called Bonn powers. This has, in practice, been used in three ways: (i) to enact legislation, (ii) to remove officials from office and (iii) to impose other binding decisions. The number of decisions adopted by the High Representative is down in 2005 (52 by the end of September) compared with 2004, when there were 158 (including the dismissal of 59 officials in June 2004 for non-cooperation with the ICTY). There has been a gradual shift towards decisions which merely follow up policies already agreed in advance. The High Representative has begun to lift some of his earlier sanctions, e.g. the ban on political involvement imposed on a number of individuals. Nevertheless, in March 2005 the High Representative removed a Bosnia and Herzegovina Presidency member following corruption charges against him and his refusal to step down voluntarily. The High Representative has also needed to appoint the Director of the State Investigation and Protection Agency (SIPA) and the Director of the State Border Agency (SBS). In both cases, the intervention of the High Representative was the result of the Council of Ministers' inability to agree on candidates for these key posts.

The use of the Bonn powers continue to play a role in achieving reform. Nonetheless, the Bosnia and Herzegovina authorities have to a certain extent taken ownership of the reform process and, in the reporting period, the High Representative has not imposed laws or decisions directly related to the Feasibility Study priorities.

The current High Representative also acts as EU Special Representative. The mandate of the EU Special Representative (EUSR) is to "offer the EU's advice and facilitation in the political process and to promote overall political coordination in Bosnia and Herzegovina". This mandate has been extended until February 2006. The EUSR holds monthly coordination meetings and has a small number of designated EUSR staff who continues to be fully integrated into the Office of the High Representative (OHR).

In December 2004, the EUFOR/Althea military mission took over from the NATO-led SFOR mission. At the same time, NATO's continued long-term commitment to Bosnia and Herzegovina was marked by the opening of new NATO Headquarters in Sarajevo. EUFOR continues to operate with a force of roughly the same size (around 7,000 troops), the same task force structure and under the same basic mandate as did SFOR. It has the main peace-stabilisation role and monitors the implementation of the military aspects of the Dayton Agreement. It successfully undertook its first major operation, inspecting military facilities throughout the country, in December 2004. An aspect in which it differs from SFOR is that it has an explicit mandate to provide support in the fight against organized crime, the aim being to strengthen security and help Bosnia and Herzegovina increase its self-governing and self-policing capacity.

### *Public administration*

Bosnia and Herzegovina has slowly begun to address the related findings of the Feasibility Study, which identified public administration reform as a major challenge. A Coordination Office for the Public Administration Reform (PAR) was established in October 2004 under the authority of the Chairman of the Council of Ministers. The PAR Coordinator has played a role in promoting the public administration reform agenda, but has been hampered by the lack of sufficient budget resources, adequate premises and the necessary support staff. As a result, preparations for a comprehensive, country-wide public administration reform strategy, which was scheduled to be approved in the autumn 2004, were seriously delayed. The Action Plan for the reform of Bosnia and Herzegovina's public administration has not yet been adopted.

Despite some improvements, efficiency of Bosnia and Herzegovina's public administration needs to increase. In an attempt to address this issue, reviews of seven public administration sectors have been carried out (police, justice sector, education, health, agriculture, environment and refugee return). In addition, a system review of the entire public administration was published in March 2005, examining horizontal aspects such as human resources, public finance, legislative drafting, administrative procedures, information technology and institutional communication. The reviews resulted in detailed recommendations to the authorities on how to improve Bosnia and Herzegovina's public administration and make it more cost effective and efficient. Implementation of these recommendations has so far been limited. Entity governments, in particular Republika Srpska's, have occasionally been hostile to rationalising the public administration, as this would entail a transfer of competence from the Entity to the State level.

Work towards a professional, non-political civil service with recruitment and promotion based on experience and merit has made progress as regards lower-level civil servants. However, at present, there are still insufficient safeguards against political interference in public administration when it comes to senior management positions, where ethnic identity and party membership continue to play a significant role.

Regarding remuneration, the Council of Ministers has decided to amend the Bosnia and Herzegovina Constitution by deleting a paragraph specifying that "compensation for persons holding office in the country's institutions may not be diminished during the officeholder's tenure". This decision, which was adopted at Parliamentary level in September 2005, was taken following the International Monetary Fund's advice that the State level salaries should be reduced by 10%.

Civil service legislation exists at State and Entity level, as do Civil Services Agencies in charge of law implementation. The Civil Service Agencies (CSA) of both Bosnia and Herzegovina and Republika Srpska (RS) have been operational since 2003. The Federation agency became fully operational in October 2004. The Bosnia and Herzegovina Civil Service Agency has thus far been unable to recruit the large number of civil servants provided for in the State-building plans. This is due in part to cumbersome and time-consuming procedures, but also to poor prioritisation by the recipient institutions. From the beginning of 2004 until mid-May 2005, the Civil Service Agency had processed only 69 vacancy publications, hiring a total of 284 civil servants. In an attempt to address this inefficiency and to speed up the hiring of civil servants, the Civil Service Law has been amended. In addition, practical problems related to the lack of adequate premises remain a barrier to the proper operation of the State Ministries and

other State-level institutions. Despite the awareness of the authorities and the initial measures taken by them, this problem has not yet been completely resolved.

The accountability of public officials has improved and codes of conduct exist at State and Entity levels. Separate laws on free access to information are in force at the various levels of government. These laws also deal with access to government-held information. Information is accessible to the citizens following a written request but the public tends not to exercise this right.

Bosnia and Herzegovina has a number of administrative control procedures, namely the Ombudsmen's institutions, the State Audit Office and the Civil Service Complaints Board. The Law on Bosnia and Herzegovina's State Ombudsman was amended in December 2003, and as of January 2004 the Institution was effectively transferred from international to Bosnia and Herzegovina responsibility. Three national Ombudsmen (one from each constituent people) were subsequently appointed. A new Law, which foresees the merging of the Entity Ombudsmen Institutions with the State Ombudsman, has been drafted. This law is in line with international conventions but it has not yet been adopted due to political and institutional lobbying and the Republika Srpska's opposition. In the meantime, the Republika Srpska National Assembly passed amendments to its own Ombudsman law and introduced two deputies to the current Ombudsman (one of each of the other constituent peoples). In the Federation there have been no recent changes. Most of the complaints received by the Ombudsmen over the reporting period concern access to justice and social rights. Cases regarding restitution of property, which in the past constituted their main workload, are now less numerous.

A State Audit office conducts annual audits of all the State institutions. This office has reported major deficiencies and financial irregularities in many institutions, including the Bosnia and Herzegovina Presidency. Adequate follow up to these reports needs to be ensured. A Civil Service Complaints Board operates as a second-instance body for resolving appeals against decisions rendered by the Bosnia and Herzegovina institutions pertaining to the status of civil servants. The Board also acts as the second-instance body in disciplinary procedures conducted against civil servants and supervises the decisions rendered by the institutions related to the labour law status of civil servants. However, the second-instance appeal bodies for administrative procedures are not clearly identifiable. Given that the country has four laws on administrative procedure - for the State, the two Entities and Brcko District respectively -, it is not always an easy matter to determine which one is applicable and with which second-instance body an appeal should, where applicable, be lodged.

In May 2005 the Council of Ministers adopted a training programme on European integration. The programme includes general and specialised training packages for civil servants, but implementation has not yet begun. The need for education on European integration issues has been recognised as a priority in training programmes organised by bilateral donors and the EU.

The issue of local self-governance is a responsibility of the Entities. Given the very complex set-up of the Federation of Bosnia and Herzegovina and the significant powers devolved to the cantons, the reform of local self-government remains a hostage to conflicting approaches. In March 2005, a new Federation draft Law on the Principles of Local Self-Government began its journey through the Federation's Parliament but has not yet been adopted. According to the Council of Europe, the draft law falls short of the

standards of the Charter of Local Self-Government on a number of critical points, including the definition of local self-government. In Republika Srpska, the new Law on Local Self-Government has entered in force, but implementation is at an early stage.

Following the entry into force of the new status of Mostar in March 2004, the city is building up a single administration. There has been some progress in unifying the city administration, but it has been slowed down by limited co-operation between the local political forces.

### *Police and defence reform*

After many difficulties and delays, positive developments were eventually registered in the area of police reform. On 5 October 2005, the Republika Srpska National Assembly supported a proposal for a political agreement on police reform. This proposal was in line with the principles outlined by the European Commission for this matter, e.g. i) all legislative and budgetary competences vested at State level; ii) no political interference with operational policing; iii) functional police areas determined by technical policing criteria. This "Agreement on the Restructuring of Police Structures" was also endorsed by the Parliament of the Federation of Bosnia and Herzegovina and the State Parliament. It is now essential that this political agreement be timely and properly implemented, in particular through the establishment of the Directorate for the Implementation of Police Restructuring by December 2005 and the preparation and adoption of an action plan for the reform implementation within the timelines set by the agreement.

Progress in the area of defence reform has been considerable, despite some sporadic resistance among sectors of the armed forces. The prospect of Bosnia and Herzegovina joining NATO's Partnership for Peace (PfP) has proved a stimulus to progress. Entity and State parliaments have approved the Defence Reform package which includes full State-level competence for defence, a single defence budget, the elimination of the Entity Ministries of Defence, the abolition of general conscription, as well as a restructured and smaller reserve force.

Bosnia and Herzegovina has reached the benchmarks endorsed by the North Atlantic Council as criteria for credible candidacy for Partnership for Peace (PfP) and recent progress on the defence reform should help the country to achieve its PfP objective. However, the lack of full co-operation with the ICTY, in particular the failure to arrest the indicted war criminals Mladic and Karadzic, continues to be an obstacle to Bosnia and Herzegovina's eventual entry into PfP.

### *Judicial system*

The *structure* of the judicial system in Bosnia and Herzegovina reflects the internal structure of the country, and courts exist at State and Entity level and also within the Entities. There are 192 courts in Bosnia and Herzegovina. Judges number 1,018 (25.4 per 100,000 inhabitants) and prosecutors 271 (7 per 100,000 inhabitants). The courts at State level include members who are not nationals of Bosnia and Herzegovina: three members at the Constitutional Court and twelve members at the State Court. The foreign judges of the State Constitutional Court are appointed by the President of the European Court of Human Rights, while those at the State Court (and the prosecutors at the State Prosecutor's Office) are appointed by the High Representative. A re-selection process for



all judges and prosecutors was completed in 2004. This resulted in the removal of approximately 20% of the judges and prosecutors. A parallel court-restructuring system reduced the number of judicial positions and courts. As regards prosecutors, the number remained around the same, due to the increased responsibilities of prosecutors under reformed criminal procedure codes.

The *independence* of the judiciary is entrenched in law and is generally respected in practice. The Bosnia and Herzegovina judicial system has undergone a number of structural changes. The High Judicial and Prosecutorial Council (HJPC) came into being as a Bosnia and Herzegovina institution in June 2004. The HJPC has broad powers in relation to the judiciary, at all levels of government, including the *appointment and disciplining* of judges and prosecutors. The relevant law sets out strict eligibility criteria for appointment to the bench, including a detailed application process, detailed disclosure of personal interests, interviews, investigations, etc. Initial problems related to the funding of the HJPC and the State-level courts have been solved, and the Council of Ministers has decided on the status and salary levels of the HJPC staff. The HJPC consists of a total of fifteen members: eleven judges or prosecutors from the Entities (selected by judges and prosecutors from different categories), two attorneys (one selected by the Bar Chamber of each Entity), and two other members (selected one by the State Parliament of Bosnia and Herzegovina and one by the Council of Ministers).

Judges and prosecutors are paid relatively high *salaries*, both when compared to salaries in Bosnia and Herzegovina generally and also when compared to their peers in other countries in the region. Nonetheless, a decision freezing judicial salaries was imposed by the High Representative in December 2004 and a comprehensive review of the system of judicial remuneration is currently underway.

There are two judicial *training* centres, one in each Entity. While the State and Brcko judiciaries have no formal training centre, they generally participate in training programmes and activities organised by the Entities. Training on a wide range of substantive and procedural topics is particularly important given the large volume of legislative changes over recent years, including fundamental changes to the Bosnia and Herzegovina legal system. Training courses on judicial *ethics* and topics such as initial training for newly appointed judges exist and are continually developed in conjunction with relevant national and international stakeholders. Knowledge of EU law is still limited, partly because much of it has not yet been incorporated into national law. Training courses and other awareness-raising exercises in this field are ongoing. Regarding human rights, a wide range of human rights instruments have been incorporated into national law, most notably the European Convention on Human Rights (ECHR). Efforts need to continue in order to ensure proper implementation of human rights provisions and to achieve full compatibility of criminal legislation with the ECHR. Care should be taken to further develop the legal framework for witness protection, in such a way as to ensure that the safety of vulnerable witnesses is appropriately balanced with the accused right of defence.

The *budgetary* process for the judiciary is fragmented across a range of budgetary authorities. This leads to considerable disparities in the funding of the judiciary and in the quality of courts which, in turn, give rise to serious concerns about the equality of citizens before the law. The general level of *infrastructure and equipment* varies widely, although the material situation of the judiciary must be seen in the context of the overall

difficult economic situation of all institutional sectors.

There continues to be a significant *backlog* of cases before the courts, particularly in the field of civil and administrative law. This needs to be addressed. It is necessary to ensure that recent legislative changes to streamlining civil procedures and other efforts lead to concrete results in this area.

### *Anti-corruption policy*

Surveys and assessments conducted by both national and international organisations confirm that corruption remains a serious and widespread problem in Bosnia and Herzegovina. Corruption affects almost all aspects and levels of society.

On the ratification of international conventions in the anti-corruption field, Bosnia and Herzegovina has ratified the UN Convention against Trans-national Crime, the Council of Europe Criminal Law Convention on Corruption and the Council of Europe Civil Law Convention against Corruption. The UN Convention on Fighting Corruption (Mérida Convention) was signed in September 2005. Bosnia and Herzegovina has not yet signed the Additional Protocol to the Criminal Law Convention on Corruption, and it is not yet a party to the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

The State-level Criminal Code includes chapters dealing with corruption, sanctions against corruption and measures to promote official accountability. The same issues are also covered by the relevant Entity legislation, but there is a need to harmonise the relevant criminal codes. Anti-corruption efforts have been reinforced by the adoption of a Law on Conflict of Interests and the adoption of a National Anti-Corruption Strategy under Bosnia and Herzegovina's Mid-Term Development Strategy. However, this document does not yet contain an Action Plan with detailed measures and timelines, and has so far had very little impact. Laws on public procurement and new legislation on the Indirect Taxation System have been adopted, but implementation is still at an early phase and the impact of this legislation in reducing corruption remains to be seen.

The Ministry of Security and the State Investigation and Protection Agency (SIPA) coordinate anti-corruption efforts at State level. A special Department for Organised Crime and Corruption, including international prosecutors, has been established within the Prosecutor's Office of Bosnia and Herzegovina. The courts have begun to prosecute cases of alleged corruption by both private citizens and politicians (including a former member of the State Presidency). Nonetheless, while the judicial system has the capacity to prosecute corruption, the number of successful prosecutions remains low, and mainly based in the activity of international prosecutors. With the establishment of the State Court and the State Prosecutor's Office, the primary responsibility for investigating, prosecuting and trying most of the major cases of organised crime and corruption is progressively being transferred from international to national bodies.

Bosnia and Herzegovina is a member of the Council of Europe Group of States against Corruption (GRECO). The GRECO's first evaluation round report was adopted in 2003 and recommended, among other things, the establishment of a body responsible for the enhancement of country-wide anti-corruption activities, the harmonisation to the largest possible extent of criminal and criminal procedures codes within the country, and to develop adequate public procurement rules at State and Entity-level. The second

evaluation round report, which will provide detailed comments on the implementation of the first report's recommendations, is expected to be produced at the end 2005. Bosnia and Herzegovina is also involved in the Stability Pact's Anti-corruption Initiative (SPAI). In this respect, the SPAI Regional Secretariat was opened in Bosnia and Herzegovina in March 2004.

## **1.2 Human rights and the protection of minorities**

### *Observance of international human rights law*

There has been progress on the human rights front. As regards the transfer of the human rights bodies established by the Dayton Peace Agreement from international to Bosnia and Herzegovina's control, the Bosnia and Herzegovina and Entity Prime Ministers signed in June 2004 an agreement to transfer the competences of the Commission for Real Property Claims (CRPC) to the State government. Subsequently, the CRPC database was transferred to State authority and is now functioning. The Presidency of Bosnia and Herzegovina appointed the members of the new Commission in November 2004. The Commission is now operational.

As the successor of the Human Rights Chamber, the Human Rights Commission was established in the Bosnia and Herzegovina Constitutional Court in early 2004. The Commission has substantially reduced the backlog of human rights cases. Its mandate has been extended until the end of 2005.

Bosnia and Herzegovina has ratified a number of international conventions on human rights, including the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR). Bosnia and Herzegovina has also ratified all major UN Human Rights Conventions, in some cases as a successor to the Socialist Federal Republic of Yugoslavia. Bosnia and Herzegovina's record in reporting to the international monitoring bodies has improved, but needs to improve further.

Bosnia and Herzegovina legislation provides for the protection of all the human rights and freedoms identified in the European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols. According to the Bosnia and Herzegovina Constitution, these rights apply directly and have priority over all other legislation.

The first judge from Bosnia and Herzegovina at the European Court of Human Rights has been elected. In 2004 the European Court of Human Rights issued no judgments on Bosnia and Herzegovina. However, at the end of 2004 a number of applications were lodged (205) and a number of applications allocated to a deciding body (137).

Bosnia and Herzegovina has not yet examined the compatibility of national legislation and practice with that of the European Convention on Human Rights (ECHR) and, although representation is ensured through the Office of the Attorney of Bosnia and Herzegovina, a Government Agent before the European Court for Human Rights remains to be appointed.

In relation to personal data protection, the status of protection of personal data in Bosnia and Herzegovina remains unsatisfactory. The new Law on Protection of Personal Data, providing for the establishment of the Data Protection Agency, has not yet been adopted.

### *Civil and political rights*

The Constitution of Bosnia and Herzegovina and the Constitution of the Federation of Bosnia and Herzegovina do not allow the *death penalty*. However, Article 11 of the Republika Srpska Constitution still allows the death penalty for capital crimes. This is not compatible with EU standards.

State and Entity Constitutions prohibit *torture and ill-treatment* and Bosnia and Herzegovina has ratified the European Convention for the Protection of Human Rights and its relevant protocols. Occasional physical mistreatment of prisoners has been reported, but investigations of police misconduct and police accountability have improved. Professional Standards Units have been established as internal affairs investigative units in each of the Entity Ministries of Interior and Brcko District. The presence of these units has led to the proper processing of complaints for police misconduct and to disciplinary decisions in accordance with standard procedures.

Amendments to the *pre-trial detention* chapter of the Criminal Procedure Code guaranteeing the principle of presumption of innocence and a new State Law on the Execution of Criminal Sentences have been adopted. These should now be followed by amendments to the Entity legislations on prisons. Pre-trial detainees are held separately from convicted criminals. As concerns detention facilities, the process of *prison* reform is on-going. Efforts need to continue in a coherent and coordinated manner. Prison standards remain in general poor, and overcrowded facilities are still a problem. There are no separate prisons for female or juvenile inmates. Particularly worrying is the lack of means to tackle the issue of juvenile delinquents. Ethnically motivated incidents have been reported. The provisional 21-bed pre-trial high security detention facility for Bosnia and Herzegovina has become operational, covering the needs of the War Crimes Chamber. In future, it will also be used for people held in connection with cases of alleged organised crime.

As regards *access to justice*, Bosnia and Herzegovina's legal framework provides for the right to legal representation and legal aid. In criminal cases, legal assistance is mandatory. Legal aid is also provided if a defendant is judged by the court to be unable to conduct his own defense. However, the implementation of this right is not secured to all individuals on a transparent and consistent basis throughout the country. The availability and quality of legal aid varies greatly depending on where the defendant is facing trial. Therefore, serious concerns exist as to the guarantee of equality before the law. Limited financial means lie at the root of the problem. Legal aid in civil cases is primarily provided on an ad hoc basis by privately funded NGOs. There is no coherent nationwide scheme of publicly funded legal aid in civil cases.

The Bosnia and Herzegovina Constitutions provide for *freedom of religion*. A State-level Law on Religious Freedom provides comprehensive rights to religious communities and grants them a new legal status. Despite the constitutional and legal provisions protecting religious freedom, religious intolerance is still present in the country. Ethnic symbols, clerics and religious buildings have been targets of ethnically motivated violence. Local police has not always conducted serious investigations into incidents of this nature.

The country's Constitutions provide for *freedom of expression* and *freedom of the press*, although laws safeguarding freedom of the press were delegated to the cantons in the Federation of Bosnia and Herzegovina, and to the central authorities in Republika Srpska.

Freedom of expression has generally been respected by all authorities although verbal attacks on the mass media from politicians and public officials have occurred. Occasional physical attacks and sporadic attempts by political forces to exert pressure have also been reported. Mass media and especially newspapers largely continue to be ethnically divided and influenced by political parties. A Bosnia and Herzegovina Press Council exists, but has no means to enforce a code of ethics on the printed media. A positive development was the December 2004 merger of three journalists' associations from Sarajevo, Mostar and Banja Luka.

In terms of broadcasting, the State-wide channel BHTV1 started broadcasting in August 2004 covering almost the entire Bosnia and Herzegovina territory. In addition, two Entity public channels continue to exist (FTV and RTRS) as well as a number of private and local channels. The State law on the public broadcasting system was eventually adopted in October 2005. Considerable progress has also been made towards the adoption of the State law on the public broadcasting service. Once all State level legislation will be formally adopted, Bosnia and Herzegovina will need to pass the relevant legislation at Entity level. The main objective of all this legislation is to bring together the three present public broadcasters (the two Entity broadcasters and the nation-wide one) into a single legal entity managed through a single steering board, to prevent mono-lingual channels. This should contribute to reducing ethnic divisions and to preventing the undue political use of public TV services.

The Communications Regulatory Agency (CRA) has continued to function effectively. The presence of the CRA and the effectiveness of its complaints procedure and enforcement provisions considerably reduced the level of inflammatory language in the electronic media, and the environment for electronic media is now more transparent and better regulated. Both the staff and resources situation of the CRA have substantially improved. The CRA has issued long-term broadcast licenses to all private radio and TV stations in Bosnia and Herzegovina, which now have licenses to operate for a period of approximately 10 years, while public stations received licenses for two years. Bosnia and Herzegovina has also ratified the European Convention on Trans-frontier Television.

The country's Constitutions provide for *freedom of assembly* and *association*, and the authorities generally respect this right. The Law on Associations and Foundations of Bosnia and Herzegovina is in compliance with the European Convention on Human Rights and Freedoms and it guarantees the exercise of the right to association. However, in practical terms NGOs continue to encounter numerous obstacles when trying to register under the provisions of the Law.

Ethnic issues remain important in the country and ethnic identity continues to be used by political parties. While ethnically related incidents have overall decreased, follow-up investigations in a number of cases have been problematic. There is also harassment and *discrimination* against minorities, most notably the Roma population. Discrimination in employment and education remained a key obstacle to the sustainable return of refugees and displaced persons.

Bosnia and Herzegovina's Constitutions prohibit discrimination on the basis of sexual orientation, and existing Criminal Codes do not penalize sexual minorities or restrict their rights. However, this is not enforced in practice and homosexuals are frequently discriminated against. There are reports that people belonging to sexual minorities have been dismissed from their jobs and mistreated in schools and elsewhere. The media and

society in general are also hostile to sexual minorities. In 2004, Bosnia and Herzegovina's first organization for affirmation and protection of human rights of sexual minorities was established. In general terms, it appears that efforts are still necessary in order for Bosnia and Herzegovina to meet EU standards in terms of protection against discrimination. These standards require the implementation of the principle of equal treatment between persons irrespective of racial or ethnic origin and the establishment of a general framework for equal treatment in employment and occupation, irrespective of religion or belief, disability, age or sexual orientation.

The Bosnia and Herzegovina Law on Associations and Foundations provides *Non-Governmental Organizations* (NGOs) with the possibility to register in the whole territory of Bosnia and Herzegovina. Whilst there is a legal basis at State level for NGOs to operate "State-wide", few NGOs have a country-wide field of action. By-laws for the establishment and operation of NGOs are complicated and do not help the rapid development of local organizations. NGOs also have serious difficulty in raising the necessary funds. Civil society development is slowed by the complex set-up of the country. Partly as a consequence of the war, many NGOs were created and developed in donor-driven mode, with very weak links to real societal demands. The nationalist agendas of many political parties have also atomized civil society and provoked many NGOs to act on an ethnic basis.

### *Economic and social rights*

The current socio-economic situation in Bosnia and Herzegovina has an adverse effect on the protection of economic and social rights. Officially, up to 40% of the population is unemployed. Around 20% live below the poverty line, with a further 30% close to it. This reflects in part a failure of social security systems to address the needs of the most economically deprived.

In the area of *gender equality*, Bosnia and Herzegovina applies the Convention on the Elimination of All Forms of Discrimination against Women, and has also accepted the Beijing Declaration and Action Platform. A Law on Gender Equality was adopted in 2003, and was the first legislation in Bosnia and Herzegovina to regulate this issue. An Agency for Gender Equality has been established and is now operational. In addition, two Entity Gender Centers exist. In November 2004, the Bosnia and Herzegovina Ministry of Human Rights and Refugees submitted a report on actions taken concerning the application of the Convention on the Elimination of All Forms of Discrimination against Women, pointing to the progress achieved in terms of legislation and overall implementation capacity. Despite some developments, there continues to be a considerable difference between legislation and practice. The participation of women in politics and public life continues to be limited. Domestic violence, which is seldom reported to the authorities, remains a problem.

In the field of *children's rights*, the Convention on the Rights of the Child is part of the Bosnia and Herzegovina Constitution. The Council of Ministers adopted an Action Plan for Children for the period 2002 – 2010. This Action Plan is based on the conclusions of the World Summit for Children. A Council for Children has been established as an advisory body to the Council of Ministers. This Council has been recently reinforced and now has 15 members, most of whom are civil society representatives. Social services for children remain limited. Education is free and compulsory, until the age of 15. Children

up to 15 years of age are entitled to free medical care under the law, but in practice, medical care for children is not ensured unless they are covered by medical insurance paid for by their parents. Children with special needs lack sufficient medical care and educational opportunities. There is generally no discrimination between boys and girls in terms of education and access to medical care. However, separation of children in schools along ethnic lines is a growing problem due to the lack of implementation of legislation on primary and secondary education. The use of two systems in primary education and three national education programmes is obstructing vertical and horizontal mobility of students.

In relation to the *socially vulnerable*, legislation in both Entities prohibits discrimination against the disabled. Nonetheless, people with disabilities resulting from the war are granted privileged treatment. Legislation regarding access facilitation for disabled people is not being implemented. The unemployment rate among the persons with disabilities is very high.

As far as *labour rights* are concerned, in May 2004 Bosnia and Herzegovina signed the revised European Social Charter, but ratification is still pending. Access to social protection continues to be a major concern. The practical organization of the social security system often deviates from enacted legislation. Differences between social security rights enjoyed by Bosnia and Herzegovina citizens persist, not only across the two Entities but also across the cantons in the Federation of Bosnia and Herzegovina. This situation leads to serious practical problems which adversely affect Bosnia and Herzegovina's workers and citizens in general.

The Entity Constitutions and labour laws allow workers (except members of the military) to form and join *trade unions* of their choice without previous authorization. Legislation in both Entities prohibits discrimination by employers against union members and organizers, in accordance with ILO standards. Collective bargaining is provided for but, in both Entities, it does not take the form of voluntary direct negotiation between a union and individual employers. Collective bargaining agreements instead largely apply as work agreements between the Government and workers in the public sector. The law provides for the right to strike and workers exercise this right in practice.

In relation with *social dialogue*, the main problem in Bosnia and Herzegovina is the very complex form of government and the fragmentation of legislation. Social dialogue is decentralized to the Entity level, and the Entities of Bosnia Herzegovina have each their own legislation and their bodies of social dialogue. The State-level Ministry of Civil Affairs has recently taken some initiatives in this respect and has requested assistance from the Community and the International Labour Organization (ILO) in establishing a Bosnia-wide Economic and Social Committee. The two main Trade Unions active at the Entity-level started merging in June 2005 for the purposes of participating in the State Economic and Social Council, and created an umbrella organisation at the State-level. A State-level employer association, encompassing the associations at the Entity level, also exists. In general, the high level of informal economy is a problem for the organisation and development of both workers and employers' associations.

In order to tackle the problem of fragmented legislation, the representative employers in both Entities have been associated with the "Bulldozer Initiative" to clear a path through the fragments of legislation which would allow businesses to develop. Efforts in this area need to continue. The lack of balance between tripartite and bipartite social dialogue, and

between cross-industry and sectoral negotiations, constitutes an additional issue.

*Minority rights, cultural rights and the protection of minorities*

Bosnia and Herzegovina is party to the Council of Europe Framework Convention for National Minorities, but has not signed the European Charter for Regional or Minority Languages.

Bosnia and Herzegovina authorities have started to pay attention to national minorities, as demonstrated by the adoption of the Law on the Protection of Rights of Persons Belonging to National Minorities and the amendments to the Election Law. Furthermore, the Entities have harmonized their relevant legislation, allowing for further development of minority language education. Nonetheless, implementation remains insufficient. The provisions on teaching minority languages, on media broadcasting for national minorities and on proportional representation in public authorities and in the civil service have not prompted substantial changes in practice. New consultation structures for national minorities, such as the proposed Council of National Minorities and corresponding bodies at Entity level, have not been set up, despite legal obligations. As regards access of minorities to political posts, rigid rules are still in force at State level, but some progress has recently been made at Entity level in terms of widening access to minority representatives. Further efforts are necessary to address the exclusion of persons belonging to national minorities from access to certain posts at State and Entity levels.

As indicated by the report of the European Commission against Racism and Intolerance (ECRI), the excessive emphasis put by Bosnia and Herzegovina's legal framework on the status of Bosnia and Herzegovina "constituent peoples" (i.e. Bosniaks, Croats and Serbs) has an adverse effect on the protection of Bosnia and Herzegovina's minorities that do not belong to these "constituent peoples". It is also considered to be an obstacle to the enjoyment of individual human rights by all citizens of Bosnia and Herzegovina, and to Bosnia and Herzegovina's evolution towards a State based on citizenship rather than on ethnic representation.

Serious problems remain in the application of the Framework Convention for National Minorities with regard to the Roma population (estimated at 40,000 to 80,000 people). Full and effective equality has not been secured for Roma, who continue to be exposed to discrimination and face particular difficulties in fields such as housing, health care, employment and education. The Bosnia and Herzegovina authorities established a Council of Roma in 2002 consisting of representatives of 22 Roma organizations. This Council continues to have a very limited role. In 2005, the Council of Ministers established a Roma Board as a part of the Ministry for Human Rights and Refugees. The Board consists of 18 members and is under the responsibility of the Council of Ministers. The adoption of the National Strategy for Roma in July 2005 has been a positive development. It needs now to be properly implemented.

Other minorities in Bosnia and Herzegovina such as Jews and Ukrainians have fewer problems in comparison with those of the Roma, but the poor implementation of minority-related legislation also affects them. Minority languages are not in use in the administration, judiciary and education. Minority groups do not have their own printed media. Procedural problems mean members of minorities rarely participate in the parliaments and municipal assemblies. An association of national minorities has been



established in Republika Srpska. No similar organization exists in the Federation or at State level, apart from the Bosnia and Herzegovina Council of Roma.

### **1.3 Regional issues and international obligations**

Bosnia and Herzegovina has continued to promote *regional cooperation*. It successfully chaired the South East Europe Co-operation Process from April 2003 to April 2004 and has also participated actively in other regional initiatives such as the Central European Initiative, the Adriatic-Ionic Initiative, the Southeast Europe Cooperation Initiative, and the Danube Cooperation Process.

Bosnia and Herzegovina has met its Stability Pact commitments and ratified Free Trade Agreements (FTAs) with Albania, Bulgaria, Croatia, the former Yugoslav Republic of Macedonia, Moldova, Romania, and Serbia and Montenegro. However, Bosnia and Herzegovina has encountered difficulties in implementing these FTAs. It needs to make further efforts to ensure their proper implementation.

In terms of bilateral relations with other Western Balkan countries, Bosnia and Herzegovina and Serbia and Montenegro have continued to meet regularly in the framework of the Inter-State Co-operation Council. A number of bilateral agreements, including on defense cooperation, determination of border crossings and facilitation of flow of persons and goods have been signed. In December 2004, the Serbian President offered an apology to Bosnia and Herzegovina for the war crimes committed in Bosnia and Herzegovina, and in July 2005 the Serbian President and other officials from Serbia and Montenegro attended the commemoration of the 10<sup>th</sup> anniversary of the Srebrenica genocide. The close relationship between Republika Srpska and Serbia continues, but does not hinder normal inter-State relations. Nevertheless, some issues between the two countries persist. Bosnia and Herzegovina's court case against Serbia and Montenegro to the International Court of Justice (ICJ) for alleged genocide is still pending and has occasionally inflamed the political discourse. The State Border Treaty has not yet been signed. In February 2005, Bosnia and Herzegovina adopted a temporary decision on introducing 30% duties on exports of flour and beer from Serbia and Montenegro. Since then the divergences have partly been resolved and both Serbia and Montenegro and Bosnia and Herzegovina have withdrawn their protective measures.

Relations with Croatia have also developed and the countries have met at the Inter-State Council. Bilateral agreements on avoiding double taxation and implementing verdicts in criminal proceedings have been signed. A document entitled "Guidelines for Improvement of Relations between Bosnia and Herzegovina and Croatia" has been agreed. The bilateral Inter-State Border Commission has agreed on the demarcation of the border, although this agreement has not yet been ratified. A co-operation agreement on border police has been negotiated. The Agreement on Dual Citizenship has been signed. Notwithstanding these positive developments, there has been little progress on resolving issues such as the agreement on the Port of Ploce and the agreement on Settling Property Issues. In March 2005 Bosnia and Herzegovina suspended part of the FTA with Croatia. Political contacts at the highest level have been limited during the reporting period and, for several months, bilateral diplomatic communication was lowered to the level of Chargé d'Affaires.

Relations with the former Yugoslav Republic of Macedonia are good and have been

developing at political level. Bilateral agreements have been signed, for example on regular air traffic and social insurance. Discussions on agreements on extradition and mutual execution of court rulings in criminal matters have been finalised and an agreement on mutual legal assistance is under consideration.

Relations with Albania have continued to be good and both countries have agreed to enhance co-operation notably in the area of justice and home affairs.

Regarding *refugees and displaced persons (DPs)*, by the end of 2004 over one million refugees and displaced Persons had returned to their pre-war homes and municipalities in Bosnia and Herzegovina. This is considered by both domestic politicians and the international community as constituting real and tangible progress. Nonetheless, the process of return has not yet been completed. Bosnia and Herzegovina's representatives estimate that approximately half a million people still wish to return. In addition to the wide range of conditions required to make return sustainable, including access to reconstruction assistance, employment, health care, pensions, utilities and an unbiased education system, continuing concerns for the safety of individual returnees remain. The Bosnia and Herzegovina Ministry for Human Rights and Refugees, with the support of UNHCR, has carried out a new registration exercise for refugees and DPs. The results show that there are still over 180,000 registered refugees and DPs within Bosnia and Herzegovina.

The Law on Amendments to the Law on Refugees and DPs in Bosnia and Herzegovina, which foresees the establishment of the Return Fund and the State Commission for Refugees and DPs, entered into force in November 2003. After serious delays, the Entities adopted harmonized legislation in early 2005. The adoption of the State Law on Refugees and DPs made the establishment of the Return Fund possible, and the Fund has slowly become operational. Efforts should now continue to ensure the financial sustainability of the Fund. The State Commission for Refugees and DPs is also operational and, as foreseen by relevant legislation, NGOs are participating as observers. The four regional offices of the Ministry of Human Rights and Refugees have been established and have become fully operational.

The de-mining process in Bosnia and Herzegovina, an important factor in refugee return, continues. A Mine Action Plan for 2005 has been adopted. The plan was prepared on the basis of the revised "De-mining Strategy 2005-2008 for Bosnia and Herzegovina" and envisages that areas suspected of containing landmines in Bosnia and Herzegovina will be reduced by 181 km<sup>2</sup> in 2005.

The implementation rate of the property repossession process in Bosnia and Herzegovina is considered as a major achievement. According to the authorities of Bosnia and Herzegovina, 99.5% of the cases have already been resolved. Outstanding cases will be addressed by the Commission for Property Claims of Displaced Persons and Refugees, appointed by the Bosnia and Herzegovina Presidency. The Commission's mandate expires at the end of 2005, but could be extended if necessary.

The Parliament of the Federation of Bosnia and Herzegovina has adopted the Law on Return, Allocation and Sale of Apartments. The law foresees the return of apartments for which repossession claims have not been submitted by owners from 1991. Some 6,000 apartments are covered by this law, of which 3,000 are in the Sarajevo area. Unclaimed apartments have mostly been used as alternative accommodation for refugees and

displaced persons.

Regional co-operation on refugees has also increased, notably through the commitment by Bosnia and Herzegovina, Croatia and Serbia and Montenegro to join forces in order to resolve the issue of refugees before the end of 2006. It is important that the compromises included in the “Sarajevo Declaration” of January 2005 be rapidly implemented.

Bosnia and Herzegovina’s co-operation with the *International Criminal Tribunal for former Yugoslavia (ICTY)* has improved, as a result however of increased pressure by the international community. Republika Srpska has been showing a more co-operative attitude and has developed a policy encouraging voluntary surrenders. Since December 2004, fifteen indictees for Bosnia and Herzegovina-related war crimes have been transferred to The Hague. The international community has recognized the progress made. Nonetheless, efforts need to increase further so as to ensure that all indicted war criminals still at large are rapidly apprehended and brought to justice.

Efforts have been made to comprehensively catalogue all persons implicated in the Srebrenica genocide. The Commission investigating the Srebrenica events produced a report which has also been endorsed by the Republika Srpska government. The continued co-operation of Republika Srpska is necessary to uncover the whole truth and to punish those who committed criminal acts. Other significant steps have been the establishment of an ICTY Monitoring Group involving Bosnia and Herzegovina authorities and representatives of the international community, and the organization of information campaigns to raise awareness among Republika Srpska’s citizens of the political and economic damaged that indictees at large represent for the Entity and the country as a whole.

Regarding the freezing of ICTY fugitive assets, Bosnia and Herzegovina has taken legislative steps to implement the 2004 EC Regulation on the assets freeze. The Ministry of Interior of Republika Srpska has reported that the relevant legislation is being implemented and that assets belonging to ICTY indictees have been frozen. The Bosnia and Herzegovina Central Bank has also confirmed that indictees’ bank accounts have been blocked.

In relation to *domestic war crimes trials*, the establishment of the War Crimes Chamber within the State Court in early 2005 aims at ensuring the effective and independent prosecution of individuals accused of war crimes. The Office of the Registrar – the Registry for War Crimes and Organised Crime within the State Court, which provides support to the Special Departments for War Crimes and Organised Crime, became operational in January 2005. The registry is responsible for management and administration of the War Crimes Project (including the administration of the registry, the Special Chamber, and the Special Department). Maximum-security prison facilities for pre-trial and post-conviction detention have also been established. Following ICTY’s decision, a number of war crimes cases have been transferred from The Hague. The transfer of the first indictee to be tried in Bosnia and Herzegovina took place in September 2005.

As regards the *International Criminal Court (ICC)*, Bosnia and Herzegovina ratified in 2003 a bilateral immunity agreement with the United States which runs contrary to the “EU guiding principles concerning arrangements between a State party to the Rome Statute of the ICC and the United States regarding the conditions of surrender of persons

to the court” adopted by the Council of the EU in September 2002. No developments have taken place in this respect.

In its post-accession monitoring report in April 2005, the *Council of Europe* concluded that Bosnia and Herzegovina, after three years of membership, has honoured most of its post-accession commitments. It noted that “in addition to the notable progress with respect to co-operation with the ICTY, there also have been positive developments in the fields of human rights and the rule of law”. Nonetheless, it also stressed that implementation of adopted legislation remains weak. It is now urgent that Bosnia and Herzegovina fulfils its outstanding commitments, notably in the areas of elections and education, and that it makes determined efforts to ensure proper implementation.

#### 1.4 General evaluation

As regards the **political situation**, Bosnia and Herzegovina has made progress in further consolidating the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. Most of the Council of Europe post-accession commitments have been fulfilled. Nonetheless, continued efforts remain necessary in order to ensure a non-reversible, self-sustaining state able to assume full responsibility for government.

As regards democratic principles, Bosnia and Herzegovina assumed full organisational and financial responsibility for the 2004 municipal elections. Further progress has been made in implementing the Law on the Council of Ministers and the Law on Ministries. Efforts need now to continue to increase the effectiveness of the executive and legislative bodies, to ensure that State-level institutions are properly equipped to implement their tasks and to strengthen co-ordination between State and Entities.

Some positive steps have been taken in the field of public administration. A Coordination Office for the Public Administration Reform has been established; the Directorate for European Integration has been reinforced; a review of key public administration sectors has been carried out. Increased efforts are now necessary to create a modern and effective civil service. The comprehensive action plan for public administration reform has not yet been adopted. Lack of the necessary staff and of adequate premises for the various administrations is a recurrent issue. Building up training capacity for civil servants is also crucial.

Progress has been made regarding the judicial system. The legislation establishing a single High Judicial and Prosecutorial Council has been adopted. This legislation has strengthened the independence of the judiciary throughout the country. Bosnia and Herzegovina is progressively taking over responsibility from the international community for the management of its judicial system.

Further efforts are necessary to fight corruption. While prosecution of a number of specific corruption cases has been ensured, many continue to escape justice. Adequate anti-corruption action plans have to be prepared and implemented. The adoption of the law on the conflict of interest has been a positive step. Its consistent implementation needs to be ensured.

Positive developments have taken place regarding the defence reform through the adoption of the legislation necessary for the establishment of a single smaller and professional army, in line with NATO’s Partnership for Peace requirements. Regarding

police reform, the endorsement by the Entity and State Parliaments of an agreement on the restructuring of the police in accordance with EU requirements is welcome. Proper implementation is now required.

The outstanding legislation supporting refugee returns has been adopted and the Refugee Return Fund has been made operational. Significant progress has been achieved regarding the return of refugees and displaced persons to their pre-war areas. The priority should now be to complete the process and to work towards socioeconomic integration of returnees. The transfer of human rights bodies from international to national responsibility has seen considerable developments. However, continued progress is necessary in order to meet international standards in the area of human and minority rights. In this respect, due attention should be paid to avoiding division of schools along ethnic lines. Efforts should also be devoted to improve the integration of the Roma minority.

Co-operation with ICTY has seen improvements. However, further efforts should be made to achieve full co-operation with the Tribunal so that all indictees be brought to justice. Constructive co-operation with neighbouring countries has continued. Nonetheless, proper implementation of the regional Free Trade Agreements should be ensured. Bosnia and Herzegovina should also make efforts to meet the outstanding Council of Europe post-accession requirements, notably regarding elections and education.

## 2. Economic situation

In the 2003 Feasibility Study on Bosnia and Herzegovina's preparedness to negotiate a SAA with the EU, the Commission concluded that:

*"In general, Bosnia and Herzegovina has developed **sound macroeconomic policies** and made some progress with structural reform. Nevertheless, risks to macro-economic stability remain. Against the background of declining foreign assistance, high current account deficits and a persistent lack of self-sustaining domestic growth (hampered by weak corporate governance and labour market rigidities) could endanger currency stability with potential effects on inflation and the sustainability of debt servicing. On the fiscal front, public expenditure still concentrates on current rather than investment spending. Also, external public debt is on a downward trend, but domestic public debt, which includes arrears, war damages and frozen currency deposits, has not yet been fully quantified."*

In the 2004 Report, the Commission stated that:

*"Despite some success in macro-economic stabilisation, Bosnia and Herzegovina 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 Bosnia and Herzegovina 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."*

In examining the economic developments in Bosnia and Herzegovina, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union;

and by the Conclusions of the Council of Ministers of 29-30 April 1997, which stated that contractual relations with the EU require

- macroeconomic institutions and policies necessary to ensure a stable economic environment;
- comprehensive liberalisation of prices, trade and current payments;
- setting up of a transparent and stable legal and regulatory framework
- de-monopolisation and privatisation of state-owned or socially owned enterprises;
- establishment of a competitive and prudently managed banking sector.

In the analysis below, the Commission has followed the methodology applied in previous annual Reports.

## 2.1 Economic developments

### *Macroeconomic developments*

*Economic growth strengthened and inflows of FDI increased but external imbalances remained large.* GDP growth increased during 2004 to around 5%<sup>3</sup>. A rebound in agricultural production as well as increased industrial production in both entities contributed to the higher growth rate. GDP per capita also increased, from EUR 1,642 in 2003 to EUR 1,732 in 2004. External imbalances remained very large but declined slightly during the year, estimates pointing towards a reduction of the current account deficit from 24.5% in 2003 to 23.3% in 2004. The main explanatory factor to the imbalance is the large trade deficit, partly fuelled by growth in banking sector credit to the private sector. FDI inflows increased during the year and reached in total around 7% of GDP. However, inconsistencies and low quality of statistics creates a high degree of uncertainty about the exact economic situation and developments. The currency board, which pegs the Bosnian KM to the Euro, has been successful in keeping monetary stability and inflation was contained around 0.5% in 2004. The government's external public debt situation improved further, partly driven by exchange rate effects, and the external debt declined to 30.7% of GDP at end 2004. However, large unsettled domestic

#### **Bosnia and Herzegovina - Main Economic Trends**

		2000	2001	2002	2003	2004	2005	
Real GDP growth	%	5.6	4.5	5.5	3.5	5.0		
Inflation rate	% (average)	4.8	3.1	0.4	0.6	0.4	2.5	June yoy
Unemployment rate	% of labour force	39.7	40.3	40.9	42.0	47.0		
General government balance <sup>1</sup>	% of GDP	-16.3	-10.4	-8.6	-6.5	-4.8		
General government balance <sup>2</sup>	% of GDP	-7.0	-3.3	-2.2	-1.3	-1.1		
Trade balance	% of GDP	-49.8	-55.1	-55.8	-54.6	-51.1	-9.9	1st qu. <sup>3</sup>
Current account balance	% of GDP	-9.8	-16.0	-22.0	-24.5	-23.3	-3.8	1st qu. <sup>3</sup>
External debt	% of GDP	40.3	40.3	36.8	32.7	30.7	32.8	1st qu. <sup>3</sup>
	Billion €	4055	4421	4291	4018	3983	4257	1st qu.
Debt–export ratio	%	218.5	183.7	171.9	135.8	120.6	90.0	1st qu. yoy
Foreign direct investment	% of GDP	3.2	2.6	4.1	5.4	7.3		
	Million €	161.1	147.6	219.4	337.6	487.7		

<sup>p</sup> Projections (1) before grants (2) after grants (3) GDP for 2004 is used

Sources: National authorities, IMF, EC estimates.

debt claims risks raising the public debt burden substantially in the near future. The process of fiscal consolidation continued, although at a slower pace, with the consolidated government budget balance estimated at –1.1% of GDP in 2004 compared to -1.3% in 2003.

<sup>3</sup> The Central Bank of Bosnia and Herzegovina estimates real growth at 3% in 2003 and 5% in 2004. IMF estimates real GDP growth to have been 4% in 2003 and 6% in 2004 while the WB estimates GDP growth to 6.5% in 2004.

## *Structural reforms*

*Structural reforms have progressed, although in some areas at a slow pace.* Reforms aiming to harmonise conditions between the two entities have continued. Important steps have been the creation of the Indirect Tax Authority (ITA) and the merger of the Entities customs administrations into the ITA as well as the adoption of the legal base for a unified system of indirect taxation. In May 2005 a National Fiscal Council was established which should determine overall fiscal revenue and expenditure targets and strengthen fiscal coordination, although the Council has not yet a formal legal basis. A few large privatisation deals were concluded in 2004 but the overall progress in privatisation was limited. Advances concerning corporate restructuring were slow and loss-making companies constitute a serious inefficient allocation of resources. The financial sector, and in particular the banking sector, have continued to strengthen and the regulatory environment improved.

## **2.2 Progress towards economic stability and competitiveness**

### *Establishment of market principles*

The development of market principles requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

*Coordination of economic policies has improved, but policy making remains strongly influenced by the international community and further coordination improvements are needed.* There is broad political consensus on the currency board, managed by the Central Bank, being the appropriate monetary and economic policy framework. In other areas of economic policy making, the process is complicated by Bosnia and Herzegovina's political and administrative organisation, the need for extensive coordination between different stakeholders and the lack of efficient structures and appropriate capabilities to carry out coordination and policy formulation. However, cooperation has been improving and the views on economic policy have converged to some extent. The Indirect Tax Authority (ITA), which started functioning in 2004, created a new platform for cooperation and the newly established National Fiscal Council, together with for example increased analytical capacity within the ITA, aims at strengthening fiscal coordination and analysis and determining overall fiscal revenue and expenditure targets. However, there is still uncertainty as regards the future operational functioning of the National Fiscal Council, which has not yet any formal legal base.

*GDP growth accelerated in 2004 to around 5%<sup>1</sup>.* A rebound in agricultural production as well as increased industrial production in both entities contributed to the higher growth rate. Growth in industrial production was in particular driven by increased production in the mining and metal industry, processing industry and electricity and water supplies. Bosnia and Herzegovina is a small and relatively open economy, which in combination with large external imbalances increases the vulnerability to adverse external shocks.

*External imbalances remained very large.* The large trade deficit, estimated at 50% of GDP in 2004, reflects the weak export capacity of Bosnia and Herzegovina as well as the



credit expansion over the last years, which have contributed to rising imports. It is also likely to reflect the underestimation of GDP, which recent studies have shown to be severe. Some positive signs as regards the external situation have emerged. Export growth accelerated from 12% in 2003 to around 20% in 2004, while import growth slowed to 7% relative to the previous year, trends which continued in the first half of 2005. Private transfers constitute an important source of financing, covering around 30 % of the trade deficit. However, the current account deficit remained very high and decreased only slightly, from 24.5% to 23.3%. FDI increased by 45% in 2004 compared to 2003 and represents an increasingly important source of financing, covering around 30% of the current account deficit, while official transfers continued to decrease. The financing of over 20% of the current account deficit remains unclear, which highlights the particular weaknesses in the balance-of-payments statistics.

*Unemployment is high and increased during 2004.* According to official statistics the share of unemployed to the total work force increased by 6% and was over 48% at the end of 2004. However, these figures do not capture actual unemployment and official estimates of actual levels point towards real unemployment of 19% in 2003 and 21.4% at the end of 2004. The upward trend in unemployment took place despite the stronger growth during the year. However, total employment increased by 2% indicating a rise in the overall labour force. Unemployment is to a large degree of structural nature, as underlined by an average waiting period for a job of more than three years. It is even longer for the older segment of the work force, which has difficulties entering the labour market. Persons above 54 years old only account for 8% of the total number of employees. Employment in the private sector remains low at 36% of total employment.

*Inflation has been low but is showing signs of an increase.* Inflation, measured by retail price index<sup>4</sup>, averaged 0.4% in 2004 but is according to the Central Bank estimated to have increased during the first half of 2005 to 2.5% year on year. Inflation has historically been higher in the Republika Srpska but the differences have been gradually reduced.

*The currency board has continued to be the anchor for monetary policy.* After initially pegging the Convertible Mark (KM) to the DEM, the KM remains since 2002 fixed to the euro at an unchanged rate. As the framework of the currency board limits the scope for monetary policy, the main policy tool has been the level of reserve requirements for commercial banks. As a response to credit expansion, reserve requirements were increased in 2004 from 5% to 10%. During 2004 the real effective exchange rate of the KM remained fairly stable and depreciated only by two percentage points, the depreciation being a result of a weakening of the KM in relation to the Croatian Kuna.

*Despite continued fiscal consolidation current public expenditure remains comparatively large.* The consolidated government balance improved from -1.3% in 2003 to -1.1% of GDP in 2004<sup>5</sup>. Despite the rapid reduction of the deficit from 2000 onward, total current expenditure as a share of GDP is around 50% of GDP. Social benefits are the largest expenditure item in both entities and constituted 36% of government expenditure (without municipalities), partly a reflection of costly pension and war veteran

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<sup>4</sup> Consumer price index not available

<sup>5</sup> IMF estimates.

compensations. On the revenue side, the collection of customs and excises was less than expected and as a consequence rebalancing of budgets took place in both entities during 2004. The share of the federal state's own expenditure to total expenditure rose slightly in 2004, from 2.9% to 3.5%. Major changes to the fiscal architecture have taken place, as indirect taxation was harmonised and competences in this area transferred from the entities to the newly formed Indirect Taxation Authority (ITA). While the new arrangement better secures the funding of the state level, which previously relied on transfers from the entities, it increases the need for fiscal coordination. External government debt decreased further to 30.7% of GDP. The reduction was due to the weakening of the USD, in which 20% of the debt is nominated, as well as net repayment of loans. However, there are also large outstanding domestic debt claims which remain unsettled. The agreement, previously reached, to restructure the public debt was struck down by the constitutional court and revised terms of settlement are likely to raise the public debt burden substantially.

*Given the currency board arrangement and high external imbalances, an appropriate policy mix requires prudent fiscal policies.* Despite increasing exports, the current account deficit has remained large. Although some attempts to slow down credit growth were done, growth has remained substantial, fuelling imports, and domestic savings remained low. Moreover, substantial losses among companies seem to generate overall negative savings in the corporate sector as well as having negative implications for the overall business climate. In the setting of a currency board this situation puts strong pressure on the fiscal stance. In addition, the domestic debt claims will after a settlement of outstanding claims also likely increase fiscal pressure significantly.

*Progress in price liberalisation has been limited and regulated prices largely prevail for utilities and infrastructure as well as in some other areas.* Price regulations are decided upon separately in the two entities and are also in certain areas handled on municipality and cantonal level. Harmonisation has taken place as regards the methods for deciding on regulated prices and tariff structures are cost-related, but regulated price levels still differ between the entities for some products. Differences also exist as for which products/services price regulations are used in the two entities. In general, prices in the areas of energy, telecommunication, railway transport and local utilities are regulated and the markets dominated by monopoly players. In the Republika Srpska price regulations also exist for other products such as for certain types of bread and wood.

*The size of the private sector has increased slightly over the last years.* Its share in GDP increased from 45% in 2002 to 50% in 2004.

*Privatisation progressed at a rather slow pace, reflecting weak political will and complex structures and regulations.* The poor financial situation of many companies has also been a major deterrent to the process. A few large companies, mainly in the mining and metal industries, were privatised in 2004. Despite these sales, overall progress in privatisation has been limited. In the Federation, 39% of total capital planned to be privatised had been successfully sold at the end of 2004, while 53% had been sold in Republika Srpska. Successful conclusions of privatisation deals were hampered by the fragmented and partly weak institutional framework where privatisation agencies have insufficient power to fully administer and finalise sales. The sale of remaining enterprises is also complicated by large labour forces and contingent liabilities, which make them less

attractive to buyers. In the energy sector and fixed line telecom sector public ownership and monopoly or oligopoly markets prevail.

*The business climate has slightly improved and barriers have been reduced, but enterprises are still hampered by boundaries between the entities, a weak entrepreneurial climate and bureaucratic procedures.* Initiatives to reduce red tape and facilitate the establishment and functioning of private companies, in particular through the so-called “bulldozer” committee, have been ongoing for some time and certain improvements have been achieved. The procedures for establishing a business have been shortened but still involved on average 12 different steps and took, on average, 49 days in 2004<sup>6</sup>. To harmonise and simplify the registration processes across the Entities, a state framework law on business registration was adopted in 2004, which aims at creating a state-wide business register. The fee levels for registration still need to be harmonised and reduced. Establishing a new business remains costly, business registration fees amounting to on average 46% of per capita GDP in 2004. Accessibility to credit for private companies has improved with the expansion of the banking sector, but finding sources of finance remains a serious constraint for many companies. Banks rely heavily on collateral as security. Registering of property took on average 331 days in 2004. Micro-finance institutions therefore play an important role as a source of finance for smaller enterprises. Bankruptcy legislation has recently been improved and harmonised between the entities, bringing the laws up to international standards. However, the efficient implementation of the new law remains uncertain.

*The judicial system remains weak and the business climate is adversely affected by arbitrary and discretionary decisions.* The enforcement of property rights is weak, although the implementation record has improved somewhat concerning pirate copies and other intellectual property rights. A new law with provisions for a separate institute for Intellectual Property was adopted in 2004, but the institute is not yet operational.

*The banking sector is dominated by foreign-owned banks and the sector has continued to expand and deepen.* Bank lending to the private sector (excluding public enterprises) increased from 32% of GDP in 2003 to 40% of GDP in 2004. Credit to households continued to expand strongly and grew by 34% in 2004 and credit to non-financial private enterprises increased by 33%. Lending to publicly owned enterprises decreased as a share of total lending. In June 2005, the year on year growth rate was constant for credit to non-financial private enterprises while it had slowed somewhat, to 29%, for credit to households. Foreign-owned banks dominate the banking sector and accounted for 84% of total banking sector capital in 2004. The sector has also become moderately concentrated with 5 banks holding 62% of total assets. Bank privatisation has been completed in the Republika Srpska where all banks are majority-privately-owned, while in the Federation of Bosnia and Herzegovina a number of banks remain in public ownership. These banks account for 15% of total banking sector capital, a share which increased by 5% in 2004 due to an increase in capital by the Federation’s government in one bank.

*The presence of foreign banks and strengthened regulations and supervision has contributed to raising competition and the quality of operations.* Interest spreads have continued to decrease, being on average 6.6% in 2004, and confidence in the banking

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<sup>6</sup> According to the World Bank survey Doing Business

system has been enhanced by the mandatory deposit insurance scheme which by the end of 2004 covered close to 90% of all deposits. Exchange rate risks in the banking system have been reduced by increased reporting requirements and improved regulations concerning indexation of assets and liabilities in foreign currency.. Regulations concerning maturity structures have also been improved, but as a consequence of long-term loans growing much faster than long-term deposits, miss-matches in maturities have remained a concern for certain banks. The rapid credit expansion has not resulted in a deterioration of the quality of the loan portfolio and the share of non-performing loans to total loans have continued to decrease, from 9% in 2003 to 6.6% in 2004<sup>7</sup>.

*Other parts of the financial sector are less developed.* However, stock markets grew quickly during 2004. Total market capitalisation at Banja Luka Stock Exchange increased by 84%, resulting in capitalisation of 12% of GDP and capitalisation at Sarajevo Stock Exchange also increased. Markets for corporate or government bonds still do not exist.

### *Competitiveness of the economy*

The competitiveness of an economy depends on progress in establishing market principles and achieving a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also depends on the amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the contractual obligations of an SAA and of future membership the higher the degree of economic integration it achieves with the Union before accession. Both the volume and the range of products traded with EU Member States provide evidence of this.

*Although inflation is low and economic growth has expanded, threats to macroeconomic stability are mounting.* These are mainly related to very large external imbalances in the context of a currency board arrangement and linked to the un-restructured corporate sector, which affects both the economic prospects and the business climate negatively. Public expenditure is also high and partly inefficient, and government interference in the economy is substantial. In addition, the domestic debt claims, when settled, risk significantly increasing the fiscal pressures.

*Labour markets are inflexible, in particular for the labour force in the large and publicly owned enterprises, and quality and coordination of education are often inadequate.* Labour market participation is low, with only 43% of the population being employed in the formal economy. The market is fragmented and labour mobility is low and hampered by a lack of coordination between employment agencies across the country. The wage setting system, in particular in the public sector, remains rigid and non-transparent. Funds set aside for stimulating job creation is very limited. The educational system is fragmented and is managed by in total 23 organisations at different levels of government with overlapping functions. There is no coherent legal framework for schooling. Regulations and teaching curriculum are often out of date. In combination with a lack of

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<sup>7</sup> NPL defined by the CBBosnia and Herzegovina as loans in category C-E (where A is top quality and E is the lowest quality)

strategic planning and coordination of education this affects the quality negatively. Educational spending rose from 5.7% of GDP in 2003 to 6% of GDP in 2004. However, 80-90% of educational spending finances staff and limited funds are set aside for capital investments. Primary school enrolment rates are around 95%. The literacy rate for the age group 15-24 is high (over 99%) but it is below 90% for the whole population above 15. Primary education has recently been expanded from 8 to 9 years but the successful implementation of the reform will require additional funds. Vocational training is not prioritised and does not meet the needs of the labour market.

Progress with regard to employment and social policy is part of the work towards European standards. Further efforts to establish economic and social rights as well as to promote employment and encourage social dialogue will contribute to improving governance and economic performance.

*Inflows of foreign direct investment (FDI) have increased.* FDI inflows grew by 45% in 2004 and reached 7.3% of GDP, the rise being supported by accomplished privatisation deals during the year. Out of total foreign investment between 2000 and 2004, 60% were channelled into production, largely through the purchase of privatised assets, while 15% were invested in the banking sector. Although major reconstruction efforts have been made concerning infrastructure, needs in the areas of roads, railways and telecommunication remain substantial.

*Enterprise restructuring has been limited, both for the core industrial base of the pre-war period as well as for public utilities and infrastructure.* The process, in particular for the corporate sector, has been hampered by vested interests, as well as limited capacity and incentives for bankruptcy procedures. It was also complicated by enterprises' large losses and work forces. For privatised companies, ownership is often fragmented and weak. Limited funds have been injected to support restructuring and as a result corporate governance often remains weak. For public utilities and infrastructure, restructuring has not yet started in any more systematic way. Some legal reforms have been achieved concerning the energy sector, creating a base framework for further reforms. Efforts to reform the railway sector are commencing.

*The share of public sector services remains high.* In the Federation of Bosnia and Herzegovina, according to figures for 2003, agriculture accounted for 7.9% of total output, down from 8.4% in 2002. The construction sector has stopped its previous decline and recovered slightly to 4%. Despite a moderate manufacturing sector, the economy continues to be based on publicly provided services (29%, including health and education) and some private-sector services, in particular trade and transport. However, in Republika Srpska, agriculture was considerably higher, at more than 18% in 2004, and public sector contribution to output in 2004 was 24% lower. In both parts of the country, however, the share of public-sector services has fallen rather recently. In terms of employment, in 2004 more than 30% of total employees worked in public administration, including health and education.

*Small and medium-sized enterprises still play a relatively small role.* The SME sector in Bosnia and Herzegovina is small and the share of SMEs per inhabitant is low. The regulatory environment which affects companies in general has slightly improved, but there are no clear specific SME oriented policies. An SME development strategy was developed in 2004 but has so far not been adopted. This strategy is essential for the

development of capabilities necessary to ensure full participation in the European Charter for Small Enterprises as well as possible future participation in Community programmes.

*A number of steps have been taken to improve competitiveness in the corporate sector but state involvement remains substantial.* A Competition Council was established, with offices in the Entities. Companies have started, although so far in small scale, to use the Council as a way to complain and get legal opinions on competitions issues. A new country wide public procurement law at state level, harmonising and improving public procurement regulations, was also adopted although the related institutions (one monitoring and policy-making body and one responsible for ruling on complaints) were after significant delays set up only in June 2005 and are not yet operational. Transparency as regards state aid to enterprises is low and public involvement in the economy remains substantial. There is no established authority overseeing state assistance and no comprehensive inventory of state aid schemes.

*Bosnia and Herzegovina's trade openness has slightly increased.* Trade of goods and services as a share of GDP rose in 2004 according to the Central Bank from 115% to 117% of GDP. Although other estimates show a lower overall level of trade to GDP, the trend is similar. The increased trade is partly a result of the entering into force of Free Trade Agreements with neighbouring countries as well of higher prices and larger traded volumes for some export goods. The high share of trade to GDP mainly reflects large imports, which in 2004 were equal to 83% of GDP while exports only equalled 34%. Recent privatisations in the mining and metal industry have resulted in increased production and the share of raw materials and low value-added products in total exports has increased. The value of exports of base metals (and articles thereof) increased by 35%, to 25% of total exports, where 18% of the increase in value was explained by higher prices and the rest by increased volume. The value of exports of mineral products increased by 50% during the year and reached 12% of total exports. Wood and wood products also remained an important export good, representing 15% of total exports. In 2004, exports to the EU increased by 12% compared to 2003, accounting for 72% of BiH's total exports. Imports from the EU increased by 9% in 2004 compared to 2003, amounting to 67%. Neighbouring countries are becoming increasingly important trade partners and Croatia was in 2004 the largest trade partner both in terms of exports and imports.

In order for Bosnia and Herzegovina to accede to the WTO, the necessary reforms need to be pursued to comply with WTO rules and obligations.

*Export price competitiveness is relatively weak.* Wage levels increased substantially between 1997 and 2003 and continued to increase faster than inflation during 2004. However, if the increase in industrial value added is taken into account, external competitiveness in the formal economy improved in 2004, but wage rates relative to value-added are still comparatively high.

### **2.3 General evaluation**

The **economy** of Bosnia and Herzegovina operates only to a limited degree within the framework of functioning market principles. Further vigorous reform efforts are necessary to address the serious shortcomings in competitiveness of the economy.

Economic growth rebounded in 2004 and industrial production picked up. Inflation remained low while inflows of foreign direct investments were significant. Further harmonisation between the Entities took place, in particular in the area of indirect taxation where competencies were transferred from the Entities to the Indirect Taxation Authority. This created a new platform for cooperation and other efforts to increase fiscal and economic policy coordination were also made, for example through the establishment of a National Fiscal Council. Some steps to improve the business climate were taken. Banking intermediation deepened further as the regulatory framework continued to improve.

However, unemployment and external imbalances have remained very large and fiscal challenges have risen. To maintain macroeconomic stability and safeguard the sustainability of the currency board a prudent macroeconomic policy mix will be imperative. In order to strengthen the productive base of the economy, the largely loss-making corporate sector must be urgently and profoundly restructured and privatisation be accelerated. In addition, actions to reduce the overall government interference in the economy and to improve the business climate will be essential. The flexibility of the labour market should be enhanced and the judicial system, in particular the handling of bankruptcies and property rights, be strengthened. To successfully manage the fiscal challenges, coordination and analytical capabilities need to be improved and the size of public expenditures to be reduced in real terms. These demanding tasks will require swift action and firm political commitment and cooperation between different levels of government.

### 3. European standards

This chapter gives an evaluation of the implementation of the Stabilisation and Association Process. Alongside an evaluation of relevant developments in key areas since the 2004 report and the European Partnerships, the section gives an overall assessment of Albania's progress towards approximating European standards, and of what remains to be done.

This section also incorporates an assessment of Bosnia and Herzegovina's administrative capacity in its various aspects. Bosnia and Herzegovina must upgrade its institutions, management capacity and administrative and judicial systems, both at national and at regional level, with a view to making further progress towards meeting European standards. At the general level, this requires a well-functioning and stable public administration built on an efficient and impartial civil service, and an independent and efficient judicial system.

Under the Stabilisation and Association Process (SAP), the main short-term objective for Bosnia Herzegovina is to conclude a Stabilisation and Association Agreement (SAA) with the EU. However, the country will only be able to properly implement an SAA if sufficient progress is made in a number of areas detailed in this section.

The November 2003 Feasibility Report (on Bosnia and Herzegovina's readiness for negotiating and implementing a Stabilisation and Association Agreement with the EU) concluded, in relation to EU standards, that:

*“Although Bosnia and Herzegovina has reiterated its desire to proceed to a SAA and has articulated its belief that it could handle the challenges involved, there can be no doubt that SAA implementation would be a major challenge. This section, dealing with the technical challenges implied by a SAA has indicated a pattern of intermittent progress, interspersed with areas where crucial reform has not been completed, or in some cases even begun. (...) In short, preparation for and implementation of a SAA is a **holistic exercise** involving all elements of the Bosnia and Herzegovina body politic. If Bosnia and Herzegovina brings political determination and marshals its resources effectively, it could address the sectoral challenges of a SAA within a reasonable time frame.”*

In March 2004, the Commission concluded that in the area of European standards,

*“Bosnia and Herzegovina'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. (...) However, progress on the recommendations of the Feasibility Study has been incremental; none of the Feasibility Study recommendations has yet been fully completed. For Bosnia and Herzegovina 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, Republika Srpska's 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 Federation Bosnia and Herzegovina public bodies to implement a subscription fee collection system for radio and television. Similarly, Bosnia and Herzegovina 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.”*

### **3.1 Internal market**

#### **3.1.1. Free movement of goods**

Some progress has been made in this field.

As regards **standardisation** and **metrology**, in July 2004 Bosnia and Herzegovina adopted new legislation for the establishment of three independent Institutes for Standards, Metrology and Intellectual Property. While management posts for these bodies have recently been fulfilled, the independent institutes are not yet properly established. At present, issues related to standards and metrology continue to be addressed by a common structure (BASMP), which lacks the necessary resources. This structure has no kind of membership in the European Committee for Standardization (CEN), but it is an affiliate member of the European Committee for Electro-technical Standardization (CENELEC) and a member of the European Telecommunications Standards Institute of (ETSI). BASMP has made significant progress towards CEN/CENELEC membership, but it is hampered by the lack of CEN affiliate status and the continued existence of mandatory standards and technical regulations from the former Yugoslavia. 4295 European standards (ENs) have been transposed as Bosnia and Herzegovina's standards.

The staffing levels of the Institute for **Accreditation** improved in the reporting period but remain insufficient to cover all economic sectors. The institute has so far granted 21 accreditations concerning 10 testing laboratories, 3 calibration laboratories, 2 certification bodies and 6 inspection bodies. In June 2005, the Institute signed a cooperation agreement with the European Co-operation for Accreditation (EA). This agreement should help accelerate the process of signing multilateral agreements on the recognition of documents issued by the respective accreditation bodies. In December 2004, a Bilateral Cooperation Agreement was signed with the accreditation body of Serbia and Montenegro. Bilateral agreements are under negotiation with the accreditation bodies of Croatia and the former Yugoslav Republic of Macedonia.

In September 2004, the Parliamentary Assembly adopted the framework Laws on technical requirements for products and **conformity assessment**, as well as **market surveillance**. In line with this legislation, a State-level committee for technical regulations has been established with the task of transposing the EU's New Approach Directives. Even though the Law on Technical Requirements for Products and Conformity Assessment is in force, its relevance is limited since no technical regulations transposing the community *acquis* have been adopted on the basis of this law. The law on Market Surveillance provides for the establishment of a Market Surveillance Inspectorate, which has yet to be established.

Currently, conformity assessment is not performed on locally manufactured and imported products before they are released to the market. To export products to a third country, companies must obtain certification abroad to demonstrate compliance with the regulations of the country of destination. The weakest point in this area is the lack of proper conformity assessment infrastructure. As a consequence, Bosnia and Herzegovina has difficulties in concluding agreements on mutual recognition for products included in the Free Trade Agreements it has signed.

Some progress has been made in the area of **consumer protection**. In September 2004, the Parliamentary Assembly adopted a Framework Law on general product safety. On the basis of the 2003 Consumer Protection Law, Offices for consumer protection, which act as investigatory bodies, were established in each Entity in June 2004. Consumer protection Council members were nominated in November 2004. However, the Council has not been made operational pending adoption of the new Consumer Protection Law. This law will enable the establishment of a Consumer Protection Ombudsman and give consumers several new rights and protection regarding the price of goods and services, advertising of goods and services, accurate labelling of products, consumer credit, package travel and timeshare agreements. It will also ensure the removal of unfair terms from consumer contracts. The Consumer Association, including eight consumer associations, was established in December 2004.

In conclusion, further progress in the fields of standardisation, certification, metrology and accreditation has been made. However, this has been slow and the new legislation is not being properly implemented. Human resources and technical capacities remain limited. The lack of conformity assessment bodies and procedures continue to hinder export capacity. As regards consumer protection, a functional consumer protection system, closer to EU requirements, is still to be accomplished. Moreover, ensuring the existence of a real internal market in Bosnia and Herzegovina is paramount.

In order to address the main shortcomings in this area, Bosnia and Herzegovina should ensure the rapid establishment of independent institutes for standardisation, certification and metrology respectively, and equip them to perform their duties properly. The Institute for Accreditation should be provided with sufficient staff to deal with all major economic sectors. It is important to establish an internal consultation and notification mechanism of new technical regulations prior to their adoption on measures having an impact on trade. The establishment of an appropriate market surveillance structure based on adequate product legislation, the establishment of a Market Surveillance Inspectorate, and the phasing out of contradictory pre-market controls are issues requiring urgent action. Continued efforts are necessary in order to further approximate legislation supporting the free movement of goods to the *acquis*, to transpose New and Global and Old Approach directives, and to adopt European Standards, in particular in order to create conditions favourable to trade. The new consumer protection law should also be adopted without delay, and the relevant implementing institutions should be set up.

### ***3.1.2. Movement of persons, services and right of establishment***

While little progress has been made on the movement of persons, more sustained action has been registered as regards services and rights of establishment.

No developments can be reported regarding the **movement of persons** and the recognition of professional qualifications and diplomas over the reporting period. The blockage of the adoption of a State-level law on higher education has continued, and partly as a result of this the country has been unable to implement the main elements of the Bologna process and the Lisbon Recognition Convention, nor introduce the European Credit Transfer system (ECTS).

No new steps have been taken regarding the movement of workers. Under separate laws in each Entity, legally residing foreign nationals have access to employment. However, this is subject to the granting of work permits and, in most cases, preference is given to nationals. Thus, complete non-discrimination for EU workers legally residing in the country is not guaranteed. Social security benefits are not granted to the dependend family members (spouse, children) of foreign workers. Moreover, the application of coordinated rules on social security for EU workers could be problematic, insofar as the social security system remains basic and fragmented.

Formally, there is a liberal regime on the **right of establishment**. EU companies have the right to establish themselves and operate subject to national treatment. They also have the right to acquire land and property on the same basis as nationals. Current legislation forbids expropriation of investments, except in the public interest. In such cases, all procedures are executed in accordance with applicable laws and regulations, without any type of discrimination and with payment of appropriate compensation. Laws in both Entities implement these conditions. Neither Entity has expropriated any foreign investments to date.

However, informal obstacles to establishment continue to exist (for both national and international operators). Concerns over political stability, difficult access to finance, corruption, anti-competitive practices and cumbersome business registration act as deterrents to investment and enterprise. The poor functioning of the legal system in protecting property rights and contracts also places a significant burden on business development. Administrative obstacles such as land titling, access to land, labour regulations, permits and licensing requirements are seen as a persistent challenge to market entry and competitiveness.

The framework Law on Single Business Registration in Bosnia and Herzegovina was adopted in September 2004. Subsequently, the Entities and the Brcko District have adopted corresponding harmonised legislation. The legislation, which is not yet implemented, provides for a shorter business registration process (to be completed within five days) and the reduction of registration costs. It also allows businesses to be registered for the whole of Bosnia and Herzegovina and introduces a single system for recording data on businesses. Adequate implementation of this legislation should help address the problem of non-registered businesses in Bosnia and Herzegovina's informal economy.

As regards **freedom to provide services**, there have been positive developments in the banking and insurance sectors. Bosnia and Herzegovina does not hinder foreign establishment in the banking sector, and its liberal approach to service provision is demonstrated by the extent of foreign banking within the country and the presence of foreign companies in the transport and courier services sector. Although separate banking agencies still exist in each Entity, Bosnia and Herzegovina has taken initial steps to put banking supervision under State control. This process should be pursued in order to bring

banking supervision to the State level. In July 2004 a single registry of bank accounts became operational. The Law on the Insurance Agency was adopted in April 2004, but the State-level Insurance Agency has not yet been established. The Entities have also adopted mostly harmonised legislation, although some important discrepancies remain.

The Law on foreign trade policy guarantees equal treatment for foreign service providers on the national market, although this may be subject to the requirement to establish a legal entity within the country. Established foreign service providers are subject to the same regulation and tax regime as nationals. The only sector where formal constraints on foreign investment in services persist is the media, where foreign ownership is restricted to 49%. Furthermore, a State-level Law on Accounting and Auditing was adopted in June 2004. Besides establishing mandatory accounting and auditing standards and a professional code of ethics for the entire country, the law defines uniform requirements for obtaining professional accountancy and auditing qualifications, as well as for training, testing, certification and licensing.

To summarise, Bosnia and Herzegovina has made little progress regarding movement of workers. Regarding services, the progress in the banking and insurance sectors is welcome, but an obstacle-free and harmonious service market is not yet ensured. The implementation of liberal legislation in the area of establishment is hampered by a number of informal obstacles, which continue to deter investment. The Single Business Registration legislation is not yet being applied.

Given the above, it is important that Bosnia and Herzegovina takes steps to adopt the State-level law on higher education and to ensure non-discriminatory treatment of EU workers legally working in the country. As regards services, banking supervision should be brought to the State level and effective functioning of the supervisory authority should be ensured. The Insurance Agency should be set up and made fully operational as a matter of urgency. Regarding the right of establishment, continued efforts are necessary to prevent *de facto* discrimination and to remove informal obstacles to establishment. The Single Business Registration system should be made operational. It is crucial that the existence of a real internal market is ensured in all areas covered by this section.

### ***3.1.3. Free movement of capital***

No particular developments can be reported in this field.

While inward transfers of capital are fully liberalised, some restrictions remain for outward transfers, in particular as regards operations by individuals and non-residents. The Law on Foreign Direct Investment guarantees the right to transfer and repatriate profits and remittances and permits local and foreign companies to hold accounts in one or more banks authorised to initiate or receive payments in foreign currency. The implementing laws in both Entities include transfer and repatriation rights.

Buying and selling foreign currency is carried out by licensed banks, as well as by domestic persons authorised to conduct foreign exchange transactions, and there is unrestricted convertibility into euro. No specific exchange controls exist for transactions in local currency. Exports and export proceeds are not subject to repatriation requirements but exporters must be authorised to engage in foreign trade and must provide customs with documentation. Proceeds from invisible transactions and current transfers do not have to be repatriated. With regard to real estate acquisition, EU

companies and citizens have the right to acquire land and property on the same basis as Bosnia and Herzegovina nationals.

The **payment system** in Bosnia and Herzegovina is already comparable to that used in modern international banking. Domestic payment transactions within the country are carried out through commercial banks and the Central Bank acts as the settlements agent. The Real Time Gross Settlement system has been introduced and the operational rules for its implementation have been adopted.

The main remaining restrictions in this area relate to outward transfers of capital. In its efforts to approximate its laws with EU legislation in this area, Bosnia and Herzegovina would have to develop a plan for full liberalisation of capital movements in the medium term.

### ***3.1.4. Customs and taxation***

Bosnia and Herzegovina has made progress in the area of **customs** and the authorities have on the whole ensured the timely implementation of the Customs Reform Plan. A new, single customs law, the Customs Policy Law, was adopted in December 2004. This legislation is an important step towards aligning Bosnia and Herzegovina's customs legislation with the *acquis*.

Under the 2003 Law on the Indirect Taxation System, the customs administrations of the Entities and the Brcko district were merged into a single State-level administration - the Bosnia and Herzegovina Indirect Taxation Authority (ITA) - in January 2005. The customs reorganisation process, including the recruitment of new staff, was completed in early 2005. The ITA has now 1 568 employees. New customs offices were established and 27 former offices closed. Since the ITA's establishment, customs revenue has increased. In the period January - June 2005, ITA collected 10% more revenues than planned for that period. In comparison with the first half of 2004, revenue collection increased by 12%.

As part of the Customs and Taxation reform, Bosnia and Herzegovina has established a Single Account and adopted the Law on the Payment to the Single Account and Revenue Distribution. The system started to operate in January 2005. In the first months of operation, collection and distribution of public revenue to the State, the Entities and Brcko district has been carried out on a daily basis. Bosnia and Herzegovina has also adopted the Law on the System of Indirect Taxation, which provides for a unified indirect taxation system. Indirect taxation, as stipulated by this law, encompasses import and export customs duties, excise duties, VAT and all other taxes calculated for goods and services, including sales tax and road tolls. However, the implementation of the Excise and Sales Tax Law has suffered delays as there have been problems with the procurement of the tax stamps that should appear on tobacco and alcohol products.

As regards customs valuation, Bosnia and Herzegovina is not yet systematically using the transaction value as the basis for determining the customs value, and reference prices are applied to determine the customs value of some products. The use of reference prices is regularly contested and is not in line with WTO standards.

Bosnia and Herzegovina continues to operate free zones. Their management, though improving, remains a source of concern. The Law on Free Zones determines the

conditions for the establishment and operation of these zones within Bosnia and Herzegovina's customs territory. However, the compatibility of the legal framework with the *acquis* remains unclear. Despite the closure of several free zones during the reporting period, five are still in operation. Bosnia and Herzegovina has recently authorised the opening of a new free zone and agreed to the expansion of an existing zone.

Bosnia and Herzegovina has made progress on the legislation governing certificates of origin. Origin issues have been clarified through the Customs Policy Law. The ITA is now the only body responsible for issuing EUR.1 certificates, and new implementing provisions entered into force in January 2005. However, concerns persist on Bosnia and Herzegovina's implementation capacity in this field. A commitment from Bosnia and Herzegovina to enhance its administrative capacity in this respect is therefore needed.

In terms of customs cooperation and mutual assistance in customs affairs, Bosnia and Herzegovina concluded a number of bilateral agreements during the reporting period. The agreement on cooperation and mutual assistance with Turkey was ratified in October 2004.

While some improvements have taken place regarding border crossing facilities, more could have been achieved. The Bosnia and Herzegovina authorities have generally been slow to support the implementation of projects in this area.

In the area of **taxation**, the most significant development has been the adoption of the Value Added Tax Law (VAT). This law has been prepared taking into account the *acquis* in this area. It provides for a single rate of 17%. The Law also contains provisions on the VAT threshold, which has been set at EUR 25 000. Preparations aiming at the entry into force of this legislation on 1 January 2006 are well underway and the registration of companies for VAT purposes has been completed. The tax collection and control capacity remains however an area of major concern. A long term strategy to enhance administrative capacity is therefore needed.

To sum up, the establishment of a single administration in Bosnia and Herzegovina responsible for customs and indirect taxation, the reorganisation of the customs administration and the establishment of a single account for the management and re-distribution of the collected revenues have been important achievements. The gradual approximation of Bosnia and Herzegovina's customs legislation towards that of the EU is welcome. The adoption of the VAT Law and preparations for its implementation are also positive developments.

However, sustained efforts are needed to continue approximation of Bosnia and Herzegovina's customs and taxation legislation to the *acquis*, and most importantly, to increase the administrative capacity to implement this legislation, and to fight against corruption, cross-border crime and fiscal evasion. Adequate functioning of ITA has to be ensured so that revenue collection improves further. As regards free zones, it is necessary to clarify the legal framework and to guarantee adequate supervision of these zones. Origin-related legislation should be properly implemented, so as to prevent fraud in this key area for international trade. Customs valuation rules need to be properly implemented, in accordance with international practices. Bosnia and Herzegovina should also take concrete steps to further improve its border-crossing facilities and ensure successful implementation of VAT as from 1 January 2006. It should also commit to the principles of the Code of Conduct on business taxation. As a first step, it should carry out

a gap analysis aimed at identifying the existing measures which could contradict those principles. Improving transparency and exchange of information with the EU in order to facilitate the enforcement of measures preventing the avoidance or evasion of taxes is also important.

### ***3.1.5. Competition***

Bosnia and Herzegovina has made considerable progress with **anti-trust** measures. Under the Bosnia and Herzegovina Competition Law of 2001, a Competition Council was set up in May 2004 as a State-level competition authority. Offices for competition were subsequently established in the Entities as investigative bodies. These bodies are now operational and fully organised to implement competition policy and law in Bosnia and Herzegovina. The Competition Council is staffed by 14 members. In May 2005, it became a member of the International Competition Network and began the process of joining other international bodies dealing with competition issues. It has also established contacts with the relevant authorities in the region.

In 2005, the competition authorities have carried out a number of investigations and delivered four opinions requested by companies. However, no binding decisions have been adopted by the Competition Council so far. In July 2005 an amended Competition Law was adopted. This law aims at strengthening anti-trust control, notably by providing the competition authorities (Competition Council and Entity Offices for Competition) with enhanced investigation and sanctioning powers. However, the new Competition Law needs a thorough assessment by the European Commission, since several amendments have been added during the process of adoption. Furthermore, the application of a system not involving notification might be premature at this stage. In this initial phase, it would be preferable if Bosnia and Herzegovina would apply a notification system, in order to allow the enforcement bodies and the industry to acquire the necessary level of expertise.

As regards **state aid**, little progress can be noted. While the Bosnia and Herzegovina authorities recognise the importance of reform in this area, adequate legislation has not been adopted nor any progress made in compiling a comprehensive inventory of state aid schemes. No authority in Bosnia and Herzegovina is currently responsible for overseeing state aid granted in the country. According to the Bosnia and Herzegovina authorities, no state aid is provided at State-level. However, the Entities continue to provide public assistance, either to companies or sectors.

In summary, the establishment of the Bosnia and Herzegovina Competition Council and the adoption of a new Competition Law in July 2005 have been important developments and confirm ongoing anti-trust efforts. However, the capacity of the Competition Council should be enhanced if it is to fully implement its tasks. Efforts aimed at further aligning legislation with the *acquis* need to continue. As regards state aid, Bosnia and Herzegovina should adopt the necessary State-level legislation to ensure the monitoring of state aid throughout the country and the preparation of a comprehensive state aid inventory.

### ***3.1.6. Public procurement***

Progress has been made by Bosnia and Herzegovina in this field. However, proper implementation of public procurement legislation and procedures remains a challenge.

Until the adoption of the new Law on Public Procurement for Bosnia and Herzegovina in September 2004, there were no unified procurement rules at State level and the responsibility for the implementation was dispersed among various bodies. Against this background, the new law has provided for the establishment at State level of two institutions responsible for public procurement, namely the Public Procurement Agency (a monitoring and policy-making body accountable to the Council of Ministers) and a Procurement Review Body (responsible for ruling on complaints). The Law entered into force in November 2004 and the Entities were to abrogate their own legislation. The authorities of Brcko District and the Federation of Bosnia and Herzegovina made the necessary legislative decisions in due course, but Republika Srpska eventually repealed its legislation only in April 2005. This has delayed the actual establishment of these bodies.

The new legislation is based on the relevant public procurement *acquis*. However, compliance with some key requirements has been deliberately delayed, in particular those related to non-discriminatory treatment, publication of procurement notices and the regime applicable to the utilities sector. The most serious divergence from EU standards is the existence of domestic preferences. Implementing legislation on procurement gives domestic bidders offering local products and using local labour a price preference of up to 15% over foreign bidders or companies offering imported goods. This discriminates against foreign bidders (including EU companies). According to the Bosnia and Herzegovina authorities, the existing domestic preferences are to be gradually decreased, and abandoned as of 1 January 2011.

In conclusion, the new Bosnia and Herzegovina legislation on public procurement constitutes a positive step in approximating the Bosnia and Herzegovina public procurement system to the *acquis*. Bosnia and Herzegovina should now ensure the full implementation of this legal framework, paying particular attention to the establishment of the bodies provided for in the public procurement law and to the overall strengthening of administrative capacities. It should also continue to approximate to the *acquis* and to prepare an action plan for the removal of provisions which may discriminate against EU firms participating in Bosnia and Herzegovina's public procurement operations.

### ***3.1.7. Intellectual property law***

Some positive developments have been taken place in the field of intellectual, industrial and commercial property rights (IPR). However, implementation and enforcement needs to be enhanced.

In July 2004, Bosnia and Herzegovina adopted legislation establishing a separate institute for Intellectual Property. However, while a Director has been nominated, the Institute has not yet been set up and the Institute for Standards, Metrology and Intellectual Property is currently still responsible for IPR issues. In December 2004 the Agreement between Bosnia and Herzegovina and the European Patent Organization on Cooperation in the Field of Patents (Cooperation and Extension Agreement) entered into force. During 2005, a number of actions have been taken by the authorities against vendors of pirate CDs and similar goods.

Bosnia and Herzegovina is a member of the World Organization for Intellectual Property (WIPO) and is a party to five international intellectual-property instruments (Paris



Convention for the Protection of Industrial Property, Madrid Agreement Concerning the International Registration of Marks, Nice Agreement on the International Classification of Goods and Services for the Purpose of Registering Marks, Locarno Agreement Establishing an International Classification for Industrial Designs and the Bern Convention for the Protection of Literary and Art Works). However, despite some targeted actions, such as those carried out in 2005 against piracy, overall enforcement of IPR legislation remains weak. Enforcement of IPR at borders continues to be rather limited, making the country a distribution point for pirated goods to the rest of Europe.

Further action is required if the country is to ensure a level of IPR protection comparable with EU standards. Bosnia and Herzegovina needs, in particular, to implement and enforce the current legal framework, namely by ensuring the proper functioning of the Institute for Intellectual Property, educating economic actors and ensuring adequate training for, and cooperation between, law enforcement bodies and the judiciary on IPR-related matters. The creation and support of collecting societies is vital. Bosnia and Herzegovina should also further develop its legal framework, notably to comply with the WTO TRIPS and approximate to the *acquis*.

### **3.1.8. Statistics**

The Bosnia and Herzegovina's Parliamentary Assembly adopted the Statistics Law in April 2004. The Law enabled the Council of Ministers to appoint a director and two deputy directors of the Agency for Statistics of Bosnia and Herzegovina (BHAS) in September 2004. The Council of Ministers also adopted the 2005-2008 Multi-annual Statistical Program in April 2005. This strategic document clearly defines the mission, vision, main tasks and objectives to be met by the official statistics. Currently there are three statistical institutes in Bosnia and Herzegovina, one at State level (BHAS) and two at Entity level. This situation complicates statistical co-operation and requires strong co-ordination and communication.

Concerning classifications, NACE Rev.1.1 and PRODCOM were introduced. Many other European classifications need to be introduced. For demographic and social statistics, preparations for implementing a labour force survey have started and the household budget survey was improved to provide better weights for the consumer price index.

As regards macroeconomic statistics, some basic GDP calculations are prepared in line with the European System of Accounts (ESA 95). A project to include estimates of the non-observed, informal economy into national accounts is under way. A new methodology for the calculation of the Consumer Price Index was applied in 2004 and Bosnia and Herzegovina participates in the European Comparison Programme for providing GDP data in PPPs. Although estimates on GDP via the production method are available, the quality and completeness of these estimates needs to be improved. In addition, many areas of national accounts and their underlying source statistics still need to be developed.

As for business statistics a pilot survey on industrial enterprises was conducted through a joint effort of all statistical institutes in Bosnia and Herzegovina and data on industrial production at State level were published for the first time in 2005. As regards external trade statistics, the BHAS has produced external trade data at State level for the first time

and transmitted them to Eurostat in April 2005. As regards agriculture statistics, no progress can be reported.

The whole statistical system of Bosnia and Herzegovina is still not compliant with European standards. In particular in the areas of national accounts, business statistics, agriculture statistics and social statistics the process of producing comparable and harmonised data at State level has not yet really started and significant efforts are needed to progress in these fields.

## 3.2 Sectoral policies

### 3.2.1. Industry and SMEs

Limited progress has been made by Bosnia and Herzegovina in the area of industrial policy and SMEs.

No developments can be reported as regards **industrial strategy**. The authorities of Bosnia and Herzegovina have not prepared an industrial strategy or policy guidelines in this area. The industrial sector in Bosnia and Herzegovina remains characterized by low productivity and poor competitiveness. Industrial production has yet to recover its pre-war levels, and capacity utilization remains low. The decline in manufacturing has meant a deterioration of quality and production capacity, not only in traditional sectors, such as armaments, steel, and chemicals, but also in clothing, textiles, leather and wood production. As a result, exports have shifted to low value-added raw materials. Overall, the production of tradable goods has been poor and imports have primarily provided for increased domestic consumption.

Regarding the **restructuring and privatisation** process, Bosnia and Herzegovina still retains a large portfolio of wholly state-owned firms. Privatisation has been largely unsuccessful although rapid privatisation of the country's strategic enterprises has been on the government agenda. By the end of 2004, only 22 out of 108 strategic companies had been privatised. Part of the problem is institutional, as procedures are cumbersome and privatization agencies do not have sufficient capacity to fully administer and finalize sales. There are twelve privatisation agencies in Bosnia and Herzegovina (one for each of the two Entities and one for each of the Federation's ten cantons), often with overlapping powers. Firms with operations in more than one canton or firms of strategic significance can fall within the purview of several cantonal agencies and the federal agency. Failure to diversify leaves companies in disarray, as their financial position deteriorates continually and they continue to accumulate arrears.

The **business environment** has seen some progress, although there is still large scope for further improvements. A number of initiatives are under way, in particular the "Bulldozer Initiative", which aims at removing duplicate authorisation requirements and other barriers to business. In late 2004, responsibility for managing this initiative was transferred to the Bosnia and Herzegovina Employers Association, a newly established organisation which is now implementing the fourth phase of the project.

As regards **SME policy**, Bosnia and Herzegovina has signed the European Charter for Small Businesses and has actively participated in the priority-setting exercises. So far, Bosnia and Herzegovina targets for 2005 have been partially met. Both the Bosnia and Herzegovina Law on Business Registration and harmonised Entity laws were adopted in early 2005; however, the SME Development Strategy, which provides for the establishment of a State-level SME Agency, has not yet been adopted. This strategy is crucial for providing the country with a comprehensive policy framework for SMEs development.

Other important issues for developing this sector are (1) Bosnia and Herzegovina's financial sector which, though much improved, needs to become more responsive to business needs and develop suitable financial instruments favourable to businesses, (2) tax policy, which should

further support business start-ups, and (3) the restructuring of the current Chambers of Commerce, in terms both of organisation and the delivery of services; as it stands, the Chambers of Commerce system is complex and fragmented and rarely delivers real added value to its members. The use of research and innovation policy as a means to support economic reform and capacity building is still low.

In summary, Bosnia and Herzegovina has continued its efforts to remove barriers to business. As regards SMEs, Bosnia and Herzegovina has been striving to make further progress in the framework of the European Charter for Small Businesses and has adopted legislation aimed at facilitating the process of business registering. Bosnia and Herzegovina's short term objectives should now be to adopt and implement an adequate SME strategy, ensure that SMEs are effectively supported by both the financial sector and Bosnia and Herzegovina's overall fiscal policy, and make the Chambers of Commerce more efficient.

As regards privatisation, Bosnia and Herzegovina should make further efforts and find solutions to accelerate this long-delayed process. A sound and comprehensive industrial strategy should also be developed without delay.

### ***3.2.2. Agriculture***

Bosnia and Herzegovina has made some progress on agriculture. However, important shortcomings remain.

It is estimated that the agriculture sector accounted for about 11% of GDP in 2004. 4% of the active population is reported to be employed in this sector, mainly on small subsistence farms.

In November 2004, a section for Agriculture, Food, Forestry and Rural Development was established within the Ministry of Foreign Trade and Economic Relations, although it lacks the necessary resources. As part of the ongoing public administration reform, this section is seen as the predecessor of a future State-level Ministry of Agriculture and Rural Development. Bosnia and Herzegovina still lacks a State-wide agricultural policy and strategy.

There has been limited progress in adopting legislation compatible with EU standards in the agriculture sector. Due to the absence of State-level legislation, the Entities are issuing their own agricultural standards, occasionally resulting in incompatible internal standards. Administrative capacity to enforce legislation also remains weak in most areas. The agricultural infrastructure is outdated and insufficiently integrated, and the quality of products remains poor. Firms are struggling to meet sanitary and phytosanitary standards and, consequently, are unable to utilise fully their export potential. In addition, uncertainties regarding land ownership further constrain the development of the agricultural sector.

However, some positive developments have taken place in the veterinary sector over the past two years. A Veterinary Office, which includes the agency for identification animals and registration of their movements, has been established. In June 2004 the Council of Ministers decided to put veterinary border inspection under State-level authority. The State Veterinary Office was made formally responsible for issuing veterinary certificates. The National Veterinary Council was established early 2005. In June 2005, an amended

Decision on the Veterinary Certificate on the Health of Animals and Shipments products of animal origin came into force. This decision has helped remove barriers regarding the certification of products of animal origin. Bosnia and Herzegovina has also developed export certificates, which are generally in line with the acquis. A new food safety law has been adopted that provides for the establishment of a food safety agency. The agency has not been established yet.

Nonetheless, the uniform and harmonized application of veterinary and food safety standards has still not been ensured. A decision on the establishment of a national network of veterinary laboratories was adopted in August 2005. However, the laboratory capacities and structures to support inspections remain uncoordinated and of uneven quality. In the veterinary field, the current decentralised structures hamper the effectiveness. Results of analyses performed in one Entity are not recognised by the authorities in the other Entity. The animal identification agency consists of a main office and nine regional centres. The animal identification and movement control scheme has started in both Entities, although with significant delays. The national residue monitoring plan needs to be brought into line with EU standards and implemented.

In general, the phytosanitary sector suffers from an unclear legal framework and lack of laboratory capacity, although relevant legislation was adopted in September 2004 (laws on mineral fertilizers, plant protection products, seeds and seedlings and protection of plant breeder's rights). The Council of Ministers has also adopted a decision establishing a phytosanitary agency, although this is not yet operational.

At the beginning of 2005, a State Food Safety Law was adopted. This law provides for the establishment of an independent food safety agency. The agency's director has been appointed, but the agency has not yet been established.

In conclusion, Bosnia and Herzegovina has adopted some new laws in the veterinary, phytosanitary and food safety areas and has continued its implementation efforts, notably in the veterinary sector. While these are steps in the right direction, much remains to be done if Bosnia and Herzegovina is to develop a competitive agriculture sector compatible with EU standards. In this respect, an important element is the development of a comprehensive agricultural strategy for the country, which should be a central element in policy-making and overall coordination in the sector.

Strategic planning should be accompanied by more practical developments. The agricultural section of the Ministry of Foreign Trade and Economic Relations should be provided with the necessary human and material resources to perform its tasks adequately, pending the establishment of a State-level Ministry of Agriculture. The phytosanitary agency should be made operational. The food safety agency should also be established and made operational. A programme for upgrading food processing establishments should be prepared. In the veterinary sector, laboratories and inspection capacities should be enhanced; a reference laboratory needs to be established and sampling procedures compliant with EU requirements should be developed. In addition, to the completion of the animal identification and registration of bovines, an equivalent system should be developed including sheep and goats. It is also crucial that efforts are coordinated between State authorities and the Entities, and between the Entities themselves. Agricultural standards need to be compatible throughout Bosnia and Herzegovina. Analysis performed by competent Entity or State bodies should be recognised throughout the entire country.

### **3.2.3 Environment**

Bosnia and Herzegovina has made limited progress in this field.

Environmental issues are primarily dealt with at Entity level through laws, regulations and standards. Nevertheless, the Ministry of Foreign Trade and Economic Relations has received the authority to deal with issues of natural resources, including environmental protection, at State level. The Ministry's administrative capacity needs to be significantly strengthened to ensure it can carry out these tasks.

As regards the integration of environmental issues into other policies, no particular developments can be reported. The Bosnia and Herzegovina authorities are aware of this basic principle but not yet in a position to implement a policy in this respect.

Regarding **horizontal legislation**, Entity legislation provides for Environmental Impact Assessment (EIA) on the basis of the EIA Directive. Both Entities have adopted by-laws on EIA. In the Federation of Bosnia and Herzegovina a regulation on environmental permits for existing facilities was also adopted.

As regards **air quality**, a monitoring system has been established and is now operational, although an overall structure in charge of the National Environmental Monitoring System is still to be established. The Entities have also adopted legislation on air protection and relevant by-laws.

In the field of **waste management**, there have been some improvements on the legislative front. Current legislation is being implemented according to the Waste Management Strategy. In 2005, the Federation of Bosnia and Herzegovina adopted a considerable amount of implementing legislation in this area. A register of polluters is currently being developed. However, the "polluter pays" principle is not yet being applied.

As regards **water quality**, the collection of data on water quality is not yet functioning well and reporting to the European Environment Agency is not systematic. Poor water quality and insufficient waste water treatment remains a key environment challenge. Water quality is in general poor due to the discharge of almost 95% of municipal and industrial waste directly into rivers, the disposal of waste along riverbanks, and run-off from agricultural areas. Sewage connection is around 50% in urban areas but does not reach 10% in rural areas.

In December 2004, Bosnia and Herzegovina signed the Danube Convention on the sustainable use of the Danube river.

Both Entities and the Brcko District have adopted legislation on **nature conservation**. However, relevant implementing legislation is still missing.

Bosnia and Herzegovina's **administrative capacity** in the field of environmental protection continues to be insufficient. The institutional structure in this field is complex and there is a lack of central coordination and implementation even for international agreements. Capacity on the State level is particularly weak. There is a gap between attribution of environmental responsibilities and means to fulfil them. The number of vacant posts is significant and administrative development is limited. This is shown in the low number of professional environmental specialists in the subject fields, and the many officials who are multifunctional in order to cover for the lack of specialists. In

addition, stronger State-level responsibility for environment is not always accepted by the Entities. Bosnia and Herzegovina also suffers from limited absorption capacity and has very limited own financial resources, which has a negative effect on the possibilities to put in place important environmental investments.

Furthermore, there is an absence of environmental policy and strategy. Although the National Environment Action plan exists, there is no capacity amongst the authorities for deciding on priorities, policy or measures to implement it. A recent operational review of the sector recommended strengthening the capacity of the Ministry of Foreign Trade and Economic Relations and establishing a State Environment Agency. So far these recommendations have not been adequately implemented.

To conclude, some legislative steps have been taken by Bosnia and Herzegovina regarding air, water and waste management since the last report. The proper implementation of legislation in these areas should be treated as a matter of priority. It is also important that Bosnia and Herzegovina ensures that environmental impact assessments are carried out in compliance with the law and that a functioning environmental monitoring system is in place. Bosnia and Herzegovina should take steps towards the progressive application of the “polluter pays” principle. Attention should also be paid to identifying financing sources for the investments needed in the fields of water quality and waste management.

A key prerequisite for real progress is to substantially enhance Bosnia and Herzegovina’s administrative capacity and to strengthen the institutions involved in environmental protection, in particular at State level. Establishing a well equipped and operational State Environmental Agency would be a significant step forward in this respect. The establishment of a nationwide and harmonised legal framework for environmental protection is also important.

### ***3.2.4. Transport policy***

Some progress has been made by Bosnia and Herzegovina in this field.

The organisation of the transport sector in Bosnia and Herzegovina is complex and responsibility is divided between the State and the Entities. Much of Bosnia and Herzegovina’s transport infrastructure has been repaired since the war. However, if the country is eventually to reach operating standards comparable to those in the EU and cope with an increasingly competitive environment, further substantial upgrading is required. The road network consists of approximately 22 600 km, of which the majority are in poor condition. Urgent repair is needed for 10% of main roads, and the situation is worse for smaller roads. The construction of motorways has commenced, with an 11-km stretch completed in 2003, part of Corridor Vc. The European Bank for Reconstruction and Development (EBRD) has also signed an agreement with Bosnia and Herzegovina on the building of a bypass around Sarajevo, also part of Corridor Vc, and the construction of a 29-km stretch in northern Bosnia and Herzegovina, which will connect with Corridor X. The last of the Sava River bridges destroyed during the war has been reconstructed (Jasenovac Bridge) and was inaugurated in June 2005.

At regional level and to ensure its proper connection to the **trans-European transport network**, Bosnia and Herzegovina is participating actively, as chair of the Steering Committee, in implementing the June 2004 Memorandum of Understanding on the South

East Europe Core Regional Transport Network including the Transport Observatory (SEETO). Bosnia and Herzegovina also participated in the High Level Group on the extension of the major trans-European transport axes to neighbouring countries and regions, which was established in 2004.

Regarding **road transport**, Bosnia and Herzegovina has ratified agreements on Road Transportation of Persons and Goods with Denmark and Belarus, and signed similar agreements with Finland, Greece, Bulgaria, Russia and Ukraine. Legislation regarding road transport safety is also being upgraded.

As regards **rail transport**, railways operations in Bosnia and Herzegovina are still managed at Entity level. The infrastructure is managed at State level while ownership of the facilities remains with the Entities. The Law on Railways was adopted by the Bosnia and Herzegovina Parliamentary Assembly in June 2005. This law may be considered a first step towards EU standards. It establishes the distinction between railway transport services and railway infrastructure, and includes provisions on regulation, licensing and compliance. It also enables the appointment of infrastructure managers. However, a revised inter-Entity agreement will be required to cover other aspects of managing the railway system. Despite these preliminary steps, restructuring the railway sector remains a major challenge.

In the field of **inland waterways**, the Sava Commission, laid down by an international agreement between Bosnia and Herzegovina, Croatia, Serbia and Montenegro and Slovenia, was established in June 2005 with its headquarters in Zagreb. This body aims to facilitate the early rehabilitation of the Sava as a navigation route.

Regarding **air transport**, Bosnia and Herzegovina became a member of EUROCONTROL in March 2004. In March 2005, Bosnia and Herzegovina initialled a "Horizontal Agreement" with the EU on certain aspects of air services. Bosnia and Herzegovina is pursuing negotiations on a European Common Aviation Area (ECAA) Agreement. Bosnia and Herzegovina should continue to align its aviation legislation with the aviation *acquis* in view of the ECAA. The recommendations of the ECAA Assessment Visit carried out in July 2005 should be implemented. During the reporting period, Bosnia and Herzegovina signed air services agreements with Greece, Hungary, Bulgaria, the former Yugoslav Republic of Macedonia, Egypt, Libya and Tunisia.

With regard to **maritime transport**, although Bosnia and Herzegovina are contracting parties to several Conventions of the International Maritime Organisation (IMO) and has a limited waterfront, it remains to be confirmed whether the most relevant IMO conventions, from the *acquis* point of view, are properly implemented. Bosnia and Herzegovina is not yet a party to the SOLAS Convention (International Convention for the safety of life at sea) and the ISPS Code (International Ship and Port Facility Security Code) which are relevant for maritime security.

In summary, Bosnia and Herzegovina's efforts to improve its transport infrastructure have continued. Some legislative developments have also taken place in the area of land transport (road and railways). As regards air transport, EUROCONTROL membership and preparations for a European Common Aviation Area Agreement are positive developments. Bosnia and Herzegovina now needs to ensure the progressive approximation of its legislation towards EU standards, in particular technical and safety



standards, social standards and market liberalisation. Sustained improvement of transport infrastructure is also vital for the country's development.

### ***3.2.5. Energy***

Bosnia and Herzegovina has made some progress in this field.

In July 2004, laws on an Independent System Operator and a Transmission Company were adopted. The Entities have also adopted laws on energy generation and distribution. The Independent System Operator was legally established in July 2005 and the process of establishing the Transmission Company is underway. A State Electricity Regulatory Commission has also been set up, as well as an Energy Department within the Ministry of Trade and Economic Restructuring, which is in charge of energy policy in Bosnia and Herzegovina. However, the Entities have decided to have their own regulators as well. The consolidation of energy regulators is now necessary. Action plans for restructuring the energy sector have finally been agreed by the Entities, most recently by the Federation of Bosnia and Herzegovina in May 2005. These plans set a deadline for restructuring the sector by the end of 2007.

In line with its commitments under the Athens Memoranda, Bosnia and Herzegovina should also reform the gas sector and establish a regulatory body for it. However, little progress has been made so far in this area.

Bosnia and Herzegovina has played an active role in preparing the Community Energy Treaty especially during its chairmanship from January to June 2005. The treaty is aimed at creating a regionally integrated energy market for electricity and natural gas as part of the wider EU market. It was initialled on 13 May 2005 and recently signed.

The resynchronisation of the electricity grid in Bosnia and Herzegovina took place in October 2004. This created the framework for the country's participation in developing a regional electricity market.

Overall, Bosnia and Herzegovina has continued to make progress in the area of energy. The establishment of the Independent System Operator, progress in the establishment of the Transmission Company and a State-level energy regulator, the adoption of the Entity Action Plans for restructuring the sector, the resynchronisation of the electricity grid and the measures taken under the Athens Process are all positive steps.

However, further and continued efforts are needed. It is particularly important to develop and adopt a comprehensive energy strategy, consolidate the state and Entity energy regulators and ensure that the Independent System Operator and the Transmission Company rapidly become fully operational. The implementation of the actions plans for restructuring the energy sector, as well as concrete progress in the gas sector, is equally important. In order to consolidate the steps taken towards Bosnia and Herzegovina's integration into regional energy markets, the requirements resulting from the Energy Community Treaty should be implemented in a timely manner.

### ***3.2.6. Information society and media***

Some progress has been in the area of information society and media.

As regards market liberalisation, no particular development can be reported. The question of breaking up the oligopoly of fixed-line services within the country has not yet been addressed.

As regards the regulatory framework, the Communications Regulatory Agency (CRA) is responsible for regulation in the areas of telecommunication and electronic media, as well as for issuing operating permits to both electronic media and telecommunications operators. The CRA is financially and organisationally distinct from the Ministry of Communications. In November 2004 it took a decision to reduce the prices of voice services for calls between fixed and mobile networks. The decision imposing a price cap for voice telephony services between fixed and mobile networks came into force in January 2005. In March 2005, the Bosnia and Herzegovina Parliament appointed seven members to the CRA Council, which held its first meeting in May 2005. The Council is responsible for determining strategic goals in the sector and monitoring their implementation. It adopts internal CRA rules and acts as the appeal body against decisions by the Agency.

As regards **information society services**, the Council of Ministers adopted the Information Society Development Policy, Strategy, and Action Plan in November 2004. Nonetheless, Bosnia and Herzegovina has not yet adopted the Law on the Information Society Agency. The Law foresees the establishment of the Agency as the main institution for the implementation of the information society development strategy and action plan, as well as for the coordination of related activities in the country. Bosnia and Herzegovina has signed but not ratified the Council of Europe Convention on Cybercrime. It will also need to align its legislation with EU standards on electronic commerce and conditional access services.

Concerning **audiovisual policy**, progress can be reported. The European Convention on Transfrontier Television entered into force on 1 June 2005. In August 2004, BHT Public Television, covering the entire country, started broadcasting. Regarding public broadcasting legislation, the adoption of the Law on the public broadcasting system and the progress made towards the adoption of the law on public broadcasting service have been positive developments. The public broadcasting service law needs now to be urgently adopted. The essential point of the public broadcasting legislation is to bring together the three current public broadcasters (the two Entity broadcasters and the nationwide one) into a single legal entity with a single steering board, with the objective of preventing monolingual channels. This should help reduce ethnic divisions and avert undue political use of public TV services. Bosnia and Herzegovina will also need to ensure the timely adoption of public broadcasting legislation at Entity level and accelerate the structural reform of the public broadcasting sector. Proper implementation of the Council of Europe Convention on Trans-Frontier Television and preparation for progressive alignment with the “Television without Frontiers” Directive are also important issues.

### ***3.2.7. Financial control***

The Supreme Audit Institutions (SAIs) of Bosnia and Herzegovina, at State and Entity level were established by law in 1999. The SAIs are independent from other government authorities, and report to the Parliament. The SAIs are invited to fully adhere to the recommendations of the so called LIMA declarations of INTOSAI. The three SAIs co-

operate in a Co-ordination Board. Their reports are made widely available, however, there is still a lack of responsiveness and follow up to the SAIs' recommendations.

Overall, the current set up for **public internal financial control** (PIFC) is inadequate. Bosnia and Herzegovina should take co-ordinated steps towards developing its Public Internal Financial Control system in line with international control and audit standards<sup>8</sup> and EU best practice. More specifically, Bosnia and Herzegovina should develop and introduce the modern principles of managerial accountability and functionally independent internal audit, with a focus on assessing the internal control systems. The management and control of legality and regularity of financial transactions needs to be further developed and co-ordinated in a harmonised way.

At the Entity level, both the Federation of Bosnia and Herzegovina and the Republika Srpska need to develop decentralised internal audit within a proper public internal control context.

Bosnia and Herzegovina should establish an independent central organisation (preferably in the Ministry of Finance) based on professional standards of transparency and integrity, and which is assured of strong and continuous support from the government. This organisation would be responsible in the long term for the harmonisation and co-ordination of the development and implementation of a commonly agreed PIFC strategy that should lead to comprehensive primary and secondary legislation and to adequate organisational structures for the internal control systems relating to public funds throughout the public sector. This organisation would also be responsible for the co-ordination of the training needs for management, controllers and internal auditors and should receive the human resources and other means needed for its adequate functioning.

### ***3.2.8 Other policies***

Progress with regard to **employment** and **social policy** is part of the work towards European standards. Further efforts to establish economic and social rights as well as to promote employment and encourage social dialogue will contribute to improving governance and economic performance.

## **3.3 Justice, freedom and security**

### ***3.3.1. Visas, border control, asylum and migration***

Bosnia and Herzegovina has made progress in these areas.

As regards the processing of **visas**, as of November 2004, data entered into local systems at Diplomatic Missions and Consular Representation Offices are electronically transferred to the Ministry of Security. This has speeded up the issuing of visas. A Migration Information System, covering all aspects of migration, has also been developed. This system is intended to fully computerise all aspects of visa processing, enabling real-time information exchange between the visa-issuing authority and other designated authorities.

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<sup>8</sup> i.a. the INTOSAI Guidelines for Internal Control in the public sector

The issuing of visas at border crossing points increased in 2004 to around 5 600, compared with 4 300 in 2003. However, due to the application of new instructions limiting the circumstances under which visas may be issued at border crossings, the number of such visas has dropped to around 1 000 during the first six months of 2005.

Bosnia and Herzegovina's visa lists are not aligned with EU lists. Nonetheless, the recent removal of visa requirements for EU citizens has been a positive development.

As regards **border control**, the number of persons denied entry to Bosnia and Herzegovina increased from around 9 400 in 2003 to 10 500 in 2004. In 2004, almost 1 000 persons were apprehended trying to enter Bosnia and Herzegovina illegally, 10% more than in 2003. During the reporting period, Bosnia and Herzegovina adopted a series of laws relevant to border management, namely the Law on Police Officers, the Law on Supervision and Control of Crossing of the State Border, and a new Law on the State Border Service (SBS). The Council of Ministers has adopted new decisions on the internal organisation of the SBS and decided to increase its human resources from 2 000 to 2 500 employees. In July 2005, Bosnia and Herzegovina also adopted the Integrated Border Management Strategy. This provides for enhanced cooperation between the State Border Service, the Indirect Taxation Administration, the phytosanitary and veterinary services and market inspections, on the basis of regional guidelines distributed by the European Commission to all Western Balkan countries in October 2004.

Involvement of the SBS in regional cooperation initiatives has also increased, notably under the South-East European Cooperation Centre, the Democratic Control of Armed Forces Programme, the Ohrid Process and the Stability Pact. Steps have also been taken to enhance cooperation between the SBS and other law enforcement agencies. In June 2005, the Bosnia and Herzegovina State Border Service signed a cooperation agreement with the Border Police of Croatia.

Positive developments have been registered in the area of **asylum**. Since July 2004, the Ministry of Security of Bosnia and Herzegovina has taken over responsibility for refugee status determination from UNHCR, and is assuming responsibility for the management of refugee centres. In June 2004, the Ministry of Security issued a bylaw to the Law on Movement and Stay of Aliens from 2003, prescribing the principles, competent authorities, the requirements and the procedure for acquisition of refugee status and temporary residence on humanitarian grounds. The new legislation broadly meets international standards. In 2005, the Ministry of Security has proposed amendments to the Law on Immigration and Asylum related to the accelerated procedures, detention of aliens, withdrawal/cessation/cancellation of status. The suggested amendments should be made in line with the *acquis* and international standards and by no means delay the implementation of the existing provisions including, particularly, those on asylum and refugees' rights.

The current level of asylum applications in Bosnia and Herzegovina is low (there were only 40 applications for asylum in the second half of 2004); however these may raise in coming years if Bosnia and Herzegovina increasingly becomes a country of destination rather than a transit country. There are still a large number of people enjoying temporary protection (around 3 000 citizens of Albanian origin from Serbia and Montenegro) and finding long-term solutions for them will be a test of Bosnia and Herzegovina's capacity in this field. In this context, the number of staff handling asylum at the Ministry of Security remains low, with only 9 of the proposed 22 staff in place.

There are currently three reception centres in Bosnia and Herzegovina, with a capacity of 815 persons. The authorities of Bosnia and Herzegovina should continue their efforts to assume full responsibility for operating these centres.

In the field of **migration**, Bosnia and Herzegovina is in the process of elaborating a coherent migration policy, covering pre-entry, on-entry and post-entry aspects. The number of illegal immigrants travelling through Bosnia and Herzegovina is being reduced. According to the Ministry of Security, the readmission rate in 2004 was 21 people per month, whereas in 2000 it was still over 1 000 per month. The Bosnia and Herzegovina authorities have taken steps towards establishing a detention centre for irregular migrants. A Law on Services for Aliens, which regulates the Inspectorate for Foreigners, was adopted in July 2005. The adoption of this legislation consolidates at State level the rules on entry, stay and exit for aliens. However, as in the case of asylum, shortages of staff dealing with migration issues remain, notably at the Ministry of Security. A by-law on one-way travel documents of aliens and a by-law on Protection of Victims of Trafficking in Human Beings entered into force in June 2004. The by-law on the establishment of a central database on aliens was adopted in September 2005. The database aims to connect the existing databases at Border Services, Ministry for Foreign Affairs and Ministry of Security into one.

Bosnia and Herzegovina's efforts to regulate readmission have continued. To date Bosnia and Herzegovina has readmission agreements in force with Croatia, Serbia and Montenegro, Sweden, Denmark, Italy and Switzerland, and has signed agreements with Slovenia and Hungary. It has also started negotiations with a number of other countries such as Greece, Spain, Portugal, Germany, Slovakia, Poland, Czech Republic, Bulgaria, Romania, Norway, Albania and the former Yugoslav Republic of Macedonia. Bosnia and Herzegovina has expressed its readiness to conclude a readmission agreement with the European Community.

In 2004, 2 144 Bosnia and Herzegovina nationals were sent back to their country, primarily from Sweden (28%) and Germany (22%). These figures represent a significant decrease from 2003, when 3 387 Bosnia and Herzegovina nationals were repatriated. In 2004, 255 third country nationals were readmitted to the country, considerably less than the 756 in 2003.

In conclusion, there have been positive developments regarding visas, border control asylum and migration. The progressive computerisation of migration-related systems, the adoption of the new State-level law on Services for Aliens and the removal of visa requirements for EU citizens are welcome developments. Efforts have been made to ensure more effective border management in terms of legislation and staff. This appears to be yielding some results. In addition, the implementation of the Integrated Border Management Strategy should help Bosnia and Herzegovina find the right balance between trade facilitation and the fight against illicit trafficking. On asylum, Bosnia and Herzegovina is demonstrating capacity to progressively take over the role played by international organisations. Its attitude towards readmission has continued to be constructive.

Nonetheless, a key pending issue for the immediate future is to ensure that the services dealing with asylum and migration at the Ministry of Security are adequately staffed. This should allow the Ministry to properly develop and implement policy, as well as to perform executive functions without needing to rely excessively on international

organisations. In the area of visas, Bosnia and Herzegovina should progressively align its visa lists with those of the EU and further reduce the number of visas issued at the border. Sustained efforts in the area of border management are equally important, notably by properly implementing the new strategy.

### ***3.3.2. Money laundering***

Bosnia and Herzegovina has made some progress in this area.

A new Law on the Prevention of Money Laundering was adopted in July 2004 and entered into force in December 2004. It represents a further, but still incomplete, step towards alignment with the relevant EU rules, including the Financial Action Task Force standards. For example, although the fight against corruption is high on the political agenda, government transactions have been exempted from the anti-money laundering legislation. Furthermore, sanctions on infringements on the Law on Prevention of Money Laundering need to be dissuasive. It is also noted that anonymous accounts and anonymous pass books seem to be allowed.

The State Investigation and Protection Agency (SIPA) has become the primary agency in Bosnia and Herzegovina responsible for compiling and analysing financial transactions and initiating criminal investigations as appropriate.

A Financial Intelligence Unit (FIU) has been established within SIPA and is now operational. In June 2005, the FIU became a full member of the Egmont Group and has already started receiving reports from the other member countries. In June and July 2005, the Bosnia and Herzegovina FIU signed Memoranda of Understanding with the FIUs of four neighbouring countries - Slovenia, Croatia, Serbia and Montenegro and Albania. Overall, cooperation with the State-level prosecutors competent for these crimes is satisfactory. However, internal cooperation between the FIU and SIPA's Crime Investigation Department needs further improvement.

There has been some concrete action since the new legislation was adopted. The State Prosecutor has frozen EUR 0.75 million in 12 accounts following investigations in cases involving organised crime. However, the enforcement record in terms of convictions, seizures and freezing of assets remains limited at this stage and, as a whole, the enforcement of the anti-money laundering defences is in its initial phase.

In summary, the adoption and entry into force of the new Law on the Prevention of Money Laundering, the designation of the State Investigation and Protection Agency as the central body fighting money laundering in Bosnia and Herzegovina and the creation of the Financial Intelligence Unit are positive developments. Increasing the much needed international cooperation in this area is also a step in the right direction. However, further action is needed, also taking into account that the effectiveness of anti-money laundering defences is adversely affected by corruption organised crime, informal economy and high level of cash transactions. Bosnia and Herzegovina should fully staff the Financial Intelligence Unit and further enhance cooperation between financial intelligence officers and criminal investigators. Efforts to improve money laundering legislation and Bosnia and Herzegovina's enforcement record need to continue.

### **3.3.3. Drugs**

No particular developments can be reported in this field.

Bosnia and Herzegovina is still considered to be primarily a transit country for drug trafficking. A Law on the Prevention of Narcotics and Precursor Abuse has not yet been adopted and the Office for Narcotics has not been established. Bosnia and Herzegovina still lacks a State-level drug policy. According to the 2004 Security Report, issued by the Ministry of Security in 2005, Bosnia and Herzegovina has noted an increase in both trafficking and use of drugs. The report estimates that 80% of the Western European market is supplied with heroin via the Balkan route, which leads also through Bosnia and Herzegovina. There are also indications that Bosnia and Herzegovina is becoming a producer of synthetic drugs. This situation contrasts with the decrease in the number of registered drug-related crimes compared with 2003. The amount of drugs apprehended remains almost negligible for an important transit country in terms of drug trafficking.

Taking into account the above, Bosnia and Herzegovina should significantly enhance its efforts in this particularly sensitive area. It should rapidly develop a State-level drugs policy in line with EU standards, e.g. the EU Drugs Strategy for 2005-2012 and the EU Drugs Action Plan for 2005-2008. The planned Law on the Prevention of Narcotics and Precursor Abuse should be adopted. The establishment of a State-level Office for Narcotics must be considered a priority. Results against drug trafficking will only be achieved if Bosnia and Herzegovina's law enforcement bodies are properly equipped and inter-agency and international cooperation works effectively. In this context, continued reinforcement of the State Investigation and Protection Agency, the State Border Service, the Customs Administration and the Ministry of Security is vital. In the area of drug use, it would be important for Bosnia and Herzegovina to carry out public information campaigns to warn the population, in particular young people, about the risks of drug abuse.

### **3.3.4. Police**

Bosnia and Herzegovina has made progress in this field, although the implementation of the overall police reform is still pending.

At State level, the Law on the State Investigation and Protection Agency (SIPA) was adopted in July 2004. This body has slowly become operational. It now operates in adequate but still temporary premises, and has a sufficient budget to cover its needs. Recruitment has progressed at a slow pace despite the competitive salary offered and a considerable number of posts are still vacant. Nevertheless, most of the departments are now operational, and the Criminal Investigation Department has begun conducting investigations. Some cases are currently being investigated at the request of the Prosecutor, relating to the production and trafficking of drugs, fraudulent documents, human trafficking and the plane crash of the President of the former Yugoslav Republic of Macedonia. There are over 100 war-crimes cases currently under investigation. An Interface Cell for Criminal Intelligence has been formed to channel intelligence input from international stakeholders. In June 2004, an Intelligence Security Agency was established, unifying the two former Entity intelligence services.

Concrete steps have also been taken to increase the performance of State-level operational policing, namely in the fields of forensics, criminal analysis and operation and management of databases and telecommunications. The necessary infrastructure was put in place in June 2005 and is expected to improve the sharing of data and operational capacities. Also in June 2005, fourteen government institutions in Bosnia and Herzegovina signed an agreement on coordinating intelligence, security and police activities in the fight against all forms of serious crime. A coordinating body consisting of competent institutions at State and Entity level held its first session in July 2005.

A Police Restructuring Commission (PRC), set up in July 2004 with a mandate to propose “a single structure of policing for Bosnia and Herzegovina under the overall political oversight of the Council of Ministers”, examined the question of overall police reform. In December 2004, it produced a report including recommendations for the police restructuring implementation. The PRC conclusions have been, for months, the object of debate between the Entities, the State and the international community. Finally, a compromise agreement on the police reform was reached. This agreement has been endorsed by the Entity and State Parliaments.

To sum up, the establishment of the State Investigation and Protection Agency and the reform and centralisation of the intelligence services have been good achievements. Central elements of the police have seen a continued reinforcement over the reporting period. Training has been delivered, investigative techniques improved and infrastructure enhanced. An agreement in line with EU requirements has been reached on the fundamental issue of the overall police restructuring. It is now crucial that this agreement be properly implemented and that a detailed Action Plan for the police reform be adopted in accordance with the agreement’s timeline. Further strengthening of the State Investigation and Protection Agency, notably by completing the recruitment of staff, is also crucial.

### ***3.3.5. Fighting organised crime and terrorism***

Bosnia and Herzegovina has achieved some progress in the **fight against organised crime**.

The legal framework is in place and Bosnia and Herzegovina is a party to the main international conventions in this area. Over the reporting period, there have been some successful prosecutions of persons involved in organised crime, including high-ranking politicians. Bosnia and Herzegovina has made further progress in implementing the Action Plan against Organised Crime presented to EU ministers in November 2003. However, the possibilities of the current legal framework are not always exploited to the full. For example, the possibility of seizing assets following a conviction has not been used so far. It is also to be noted that organised crime remains the single main threat to Bosnia and Herzegovina in terms of security and stability.

Bosnia and Herzegovina remains a country of both origin and transit when it comes to **trafficking in human beings**. Trafficked children, often ethnic Roma, are victims of forced labour. Women most commonly coming from Moldova, Ukraine, Russia, Romania and, increasingly, Serbia and Montenegro, are trafficked through Bosnia and Herzegovina en route to Western Europe. According to the 2005 US “Trafficking in Persons Report”, Bosnia and Herzegovina remains a “tier 2” country (countries where



problems of trafficking subsist despite recognised efforts by the authorities). A National Action Plan for Combating Trafficking in Human Beings was adopted in April 2005 for implementation in the period 2005-2007. It addresses mainly the issues of prevention and protection of victims, as well as the prosecution of crimes based on the State and Entity-level anti-trafficking laws. Since 2003, the Bosnia and Herzegovina Criminal Code defines trafficking of human beings as a major crime. A Law on Witness Protection was adopted in July 2004 and entered into force in December 2004. Nonetheless, some inconsistencies still exist between the different levels of legislation at State and Entity level, which undermine efficient prosecution. The fact that only a small number of trafficking cases have been tried successfully and that sentences are usually light is also a matter of concern. In 2004, police investigated and submitted to prosecutors a total of 47 cases. Of this number, the courts handed down a total of 18 sentences, 12 of which resulted in convictions. The authorities' measures for protecting trafficking victims are still inadequate, even though new rulebooks and by-laws on such protection have been adopted. In 2005, the authorities have provided funding for six NGO-run shelters throughout Bosnia and Herzegovina. The State anti-trafficking coordinator developed and signed memoranda of understanding to unify shelter standards in cooperation with local NGOs, and local police provided security.

Bosnia and Herzegovina has limited possibilities for acting on **terrorism**. The Bosnia and Herzegovina Anti-Terrorism Task Force, established in February 2004 and operating under the Ministry of Security, remains active. During 2004, a total of 83 cases involving international terrorism were processed, a 30% increase from 2003. Bosnia and Herzegovina received 71 requests from Interpol and 12 cases were investigated at the request of domestic institutions. The follow up of these requests led to the investigation of 380 persons for suspicion of involvement in terrorist activities or international terrorist organisations, a 52% increase from 2003. This increased activity is a positive development.

Bosnia and Herzegovina has ratified the European Convention on the Suppression of Terrorism, which entered into force in January 2004. In February 2005, it signed the Additional Protocol to the European Convention on Combating Terrorism.

In conclusion, the fight against organised crime and terrorism remains, despite the progress achieved, a challenge for Bosnia and Herzegovina. Organised crime is considered to be a serious threat for the country's stability, security and socio-economic development. While the steps taken in terms of legislation and structures have to be recognised, Bosnia and Herzegovina should now in particular focus on completing the implementation of its Action Plan against Organised Crime and ensuring the adequate prosecution of criminals. The measures to protect victims of trafficking and for the adequate implementation of the new witness protection legislation should also be enhanced. As regards the fight against terrorism, continued efforts are necessary to increase the capacities of Bosnia and Herzegovina, ensure good coordination between the State Investigation and Protection Agency and the State intelligence service, and reinforce international cooperation.

### 3.4 General evaluation

Since the last report, Bosnia and Herzegovina has made further progress towards meeting **European standards**. Progress has mainly consisted in adoption of new legislation and

the establishment of a number of new institutions. Some efforts regarding the strengthening of administrative capacity have also been registered. It is now necessary to ensure sustained efforts in order to increase its implementation capacity, in particular with a view to a future Stabilisation and Association Agreement.

Regarding *internal market*, Bosnia and Herzegovina has made some progress in the area of *free movement of goods*, in particular through the adoption of new legislation on standards, certification, conformity assessment, general product safety and market surveillance. However, the new legislation is not yet properly implemented. Human and technical resources remain limited and the non-application of conformity assessment on the local production continues to hinder Bosnia and Herzegovina's export capacity. As regards *movement of persons, services and right of establishment*, some additional progress regarding services and establishment has been made, notably through the adoption of legislation in the insurance sector and the establishment of a single registry for companies. No significant developments have taken place in the area of *movement of capital*.

Bosnia and Herzegovina has made progress in the field of *customs and taxation* through the adoption of new customs legislation, the establishment of a single customs administration and the reorganisation of the customs services. A VAT law has been adopted and preparations for its implementation have been made. However, the implementation of this law and the actual collection of VAT are still important challenges. Sustained efforts are required to increase revenue collection, to combat fiscal evasion, corruption and cross-border crime, and to ensure that free zones, customs valuation and origin issues are managed in accordance with EU standards. Specifically on customs valuation, the use of price lists is of great concern. As regards *competition* the establishment of the Competition Council and the adoption of a new competition Law have been positive steps. However, no significant development can be reported in relation to state aids. The *public procurement* system has seen further approximation. Further efforts need now to be made to establish the public procurement agency and the public procurement review body and to make them operational. As regards *intellectual, industrial and commercial property rights (IPR)*, new legislation foresees the establishment of a separate institute for Intellectual Property. Bosnia and Herzegovina has signed a co-operation agreement with the European Patent Organisation and has carried out some actions against piracy. However, implementation and enforcement of IPR legislation remains limited and need to be enhanced.

Regarding *sectoral policies*, Bosnia and Herzegovina has continued its efforts to remove barriers to business and to implement the European Charter for SMEs. However, it has been unable to develop appropriate strategies for the *industry and SMEs* sectors. As regards *agriculture*, some improvements have been made through the adoption of legislation in the veterinary, phytosanitary and food safety areas, but overall strategic planning has been lacking and some of the institutions foreseen by the new legislation have not been established. State-Entity and inter-Entity co-ordination should also be improved. In the area of *environment*, some steps have been taken by Bosnia and Herzegovina in the air, water and waste sectors. Nonetheless, implementation capacity remains limited, due to scarce human and technical resources. In this context the establishment of a well equipped State Environmental Agency should be a priority.

In the area of *transport*, efforts aiming at improving transport infrastructures continue. Legislation on railways has been adopted. Positive developments have also been registered as regards aviation, including in terms of regional co-operation. Nonetheless, sustained efforts are necessary in order to enhance strategic planning, to further improve infrastructure and to ensure the progressive alignment, notably as regards technical and safety standards, social standards and market liberalisation. As regards *energy*, positive developments have taken place in the field of electricity, notably through the establishment of a State-level regulator, and the establishment of an Independent System Operator and a national transmission company. Action plans for the restructuring of the sector have also been adopted by both Entities and co-operation for the establishment of a regional energy market has continued. Bosnia and Herzegovina should now ensure implementation of the various Action Plans, consolidate State and Entity regulatory bodies, accelerate the reform of the gas sector and prepare a comprehensive Energy Policy. Bosnia and Herzegovina has signed the South East Europe Energy Community treaty.

Concerning *information society and media*, some progress has been made. While some steps to strengthen the Regulatory Communications Agency have been taken, the law for the establishment of an Information Society Agency has not been adopted and no progress has been made regarding the liberalisation of the oligopoly fixed-line services. The adoption of the law on the public broadcasting system and the progress made towards the adoption of the State law on public broadcasting service have been positive developments. The corresponding Entity-level legislation should be passed once the public broadcasting service law is formally adopted.

Regarding *justice, freedom and security*, progress has been made in relation to *visa requirements, border control, asylum and migration*. An integrated Border Management Strategy has been adopted and efforts have been made to reduce illegal migration and to increase effectiveness regarding the issuing of visas. Asylum-related responsibilities, performed until now by international bodies, are gradually being taken on by the State authorities. However, staff shortcomings at the Ministry of Security endanger proper implementation of tasks. The number of visas issued at the borders should be further reduced. As regards *money laundering*, the adoption of new legislation and the establishment of the necessary structures have been positive steps. Proper implementation and enforcement of this legislation should now be ensured. Not much has been achieved in the field of fight against *drugs*. Bosnia and Herzegovina should develop a State-level drugs policy, adopt adequate legislation on drugs and precursors and establish a State-level office for narcotics in order to be more effective in the fight against drugs trafficking.

There has been some progress in the area of *police*. In addition to the agreement reached on the overall police reform, State-level bodies have been established and are now operational. Intelligence services have been unified. Training and equipment has been provided. Concerning *the fight against organised crime and terrorism*, a strategy against the trafficking in human beings has been adopted. Further steps have been taken in terms of strategy, legislation and structures, and there has been good co-operation with the international community in the area of counter-terrorism. However, increased efforts are necessary, in particular as organised crime is considered a major threat for Bosnia and Herzegovina's stability and overall socio-economic development. The legislation on data

protection is still pending and should be adopted without further delay. Proper implementation of laws and prosecution of criminals is paramount.

### C. EUROPEAN PARTNERSHIP: OVERALL ASSESSMENT

Bosnia and Herzegovina's progress and overall state of implementation of the Stabilisation and Association process has been examined above. This section assesses briefly the overall extent to which the priorities of the European Partnership, adopted by the Council in June 2004<sup>9</sup>, have been implemented.

The purpose of the European Partnership is to assist the authorities of Bosnia and Herzegovina by identifying short- and medium-term priorities which need to be carried out in order for the country to make further progress towards the EU. The priorities have been selected on the basis that it is realistic to expect that Bosnia and Herzegovina can complete them or take them substantially forward over the next few years.

A distinction is made between short-term priorities, which are expected to be accomplished within one to two years, and medium-term priorities, which are expected to be accomplished within three to four years. The European Partnership forms the basis for programming assistance from EU funds.

Overall, Bosnia and Herzegovina has made good progress in implementing the European Partnership's short-term priorities, and has also started to address some of the medium-term ones. Notable steps have been taken regarding the adoption of the required laws. However, when it comes to implementing of legislation and institution-building, Bosnia and Herzegovina is experiencing greater difficulty. The functioning of the State institutions is not yet adequate, and most institutions are subject to budgetary constraints, leading to a lack of qualified staff, office space and resources in general. As a result, implementation capacity remains underdeveloped in a number of core sectors.

As regards the priorities related to the **political situation**, Bosnia and Herzegovina was able to conduct proper municipal elections in 2004. Cooperation with the ICTY has improved and steps have been taken to support refugee return and the implementation of human and minority rights. Most Council of Europe post-accession commitments have been met. In terms of governance, new State-level Ministries and institutions have been established and, despite some disruptions, the Council of Ministers' functioning has improved overall. As regards public administration, some positive steps have also been taken. The necessary funding has been provided for the Civil Service Agencies at State and Entity levels and inter-agency cooperation has been enhanced. In the field of the judiciary, a single High Judicial and Prosecutorial Council has been established and the overall functioning of the judicial system has improved. Defence and police reform have also seen progress.

To properly address the 2004 political priorities, Bosnia and Herzegovina's efforts should now focus on achieving full cooperation with the ICTY, implementing the outstanding Council of Europe post-accession obligations and establishing a single Ombudsman structure. Further efforts are required to complete the legal and administrative framework for the protection of minorities, and to ensure its implementation. Adequate staffing and suitable premises need to be made available for all State-level ministries and institutions. Bosnia and Herzegovina must develop a comprehensive action plan for public

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<sup>9</sup> Council Decision 2004/515/EC of 14 June 2004 on the principles, priorities and conditions contained in the European Partnership with Bosnia and Herzegovina ( OJ L 221, 22.6.2004, p. 10)

administration reform and ensure its implementation. Further improvement of the coordination between the Entities and the State level is also necessary.

With regard to the priorities relating to the **economic situation**, Bosnia and Herzegovina has maintained a relatively stable macro-economic framework, has continued its efforts to improve the overall business environment and has made some initial progress towards the production of reliable statistics. In the area of budget management, a law covering multi-annual budget planning and forecasting has been adopted and steps have been taken to prepare a consolidated government account. Moreover, progress has been made as regards the establishment of centralised records of all income accruing to public authorities at different levels of government, including grants and other forms of international assistance. A National Fiscal Council has been set up to help enhance fiscal sustainability.

The main remaining challenges are to deal efficiently with the domestic debt and to guarantee the country's financial sustainability, to make further progress in the field of statistics, to further develop capacity for economic planning and budget preparation, to ensure the operation of a consolidated government account, to accelerate structural reform and to further improve the business environment.

As far as the priorities related to **European standards** are concerned, Bosnia and Herzegovina has been able to address a number of them. In the area of the *internal market*, Bosnia and Herzegovina has established a Competition Council and has taken steps towards the mutual recognition of products throughout the country, to remove inter-Entity administrative barriers and to establish a central business registry. Furthermore, it has established the Indirect Tax Authority at State level. As far as *sectoral policies* are concerned, both Bosnia and Herzegovina Entities have now adopted Action Plans for the electricity market and are implementing them. The country has made progress in implementing its commitments under the 2003 Athens Memoranda of Understanding for the establishment of a regional energy market. The adoption of the public broadcasting system law and the progress made towards the adoption of the public broadcasting service law have been positive developments. In the area of *Justice, Security and Freedom*, the State Information and Protection Agency (SIPA) has been made operational and additional resources have been allocated to the Ministry of Security. Bosnia and Herzegovina intelligence services have also been placed at State level, and their capacities have been enhanced. An agreement on the police reform, which takes into account the principles outlined by the European Commission, has been reached.

Nonetheless, the 2004 European Partnership's requirements have only been partially met and sustained efforts remain necessary in order for Bosnia and Herzegovina to move closer to EU standards. In the area of the *internal market*, Bosnia and Herzegovina needs now to ensure that the legislation that it has adopted is properly implemented. Bosnia and Herzegovina should ensure that its trade-related contractual commitments are fulfilled and that the provisions of the free trade agreements it has concluded are respected. Ensuring the adequate supervision and management of free zones in accordance with EU standards is essential. Moreover, the issuing and control of certificates of origin needs to be further enhanced. In relation to Bosnia and Herzegovina's single economic space, it is important to accelerate the removal of duplicate licences, authorisations and similar

barriers within the Bosnia and Herzegovina territory in order to achieve a real internal market. Public procurement legislation should be properly implemented. Continued efforts are necessary to implement the laws on standardisation, metrology and intellectual property, and to ensure the adequate functioning of a single business register.

As regards *sectoral policies*, Bosnia and Herzegovina should ensure that all the necessary public broadcasting legislation, including at Entity level, is eventually adopted and properly implemented, and that the necessary legislation for the establishment of the Information Society Agency is adopted. It should also continue its efforts towards a regional energy market. In the field of environment, Bosnia and Herzegovina should, in particular, strengthen State-level capacity through the establishment of a fully operational State Environment Agency.

In the area of *justice, security and freedom*, the reform of the police should be properly implemented. Sustained efforts are necessary to tackle crime, and in particular organised crime, efficiently. The Ministry of Security should be further reinforced both in terms of staff and funding. The outstanding measures of Bosnia and Herzegovina's Action Plan against Organised Crime should be implemented without delay. The law on the personal data protection should be adopted.

Bosnia and Herzegovina's progress in addressing the issues identified as priorities by the June 2004 European Partnership is discussed in more detail in other parts of this report, notably in Section B.3. On the basis of the findings of this report, the Commission proposed a revised European Partnership for Bosnia and Herzegovina for adoption by the Council. The European Partnership will continue to be a key tool for guiding Bosnia and Herzegovina's efforts to move closer to the EU. It should be given the necessary political attention and should help Bosnia and Herzegovina to set its legislative and institution-building agenda.

## STATISTICAL ANNEX

Statistical data on Bosnia and Herzegovina as of 1 September 2005

<b>Basic data</b>	Scale	Unit	Foot-note	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Population: total	Thousand	Number	1)	:	:	:	:	3.725	3.781	3.798	3.828	3.832	:
Total area of the country	Unit (x1)	km <sup>2</sup>		:	:	51.209	51.209	51.209	51.209	51.209	51.209	51.209	51.209
<b>National accounts</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Gross domestic product	Million	National currency		:	:	:	:	8.604	9.611	10.480	11.651	12.303	13.440
Gross domestic product	Million	EUR		:	:	:	:	4.399	4.914	5.358	5.957	6.291	6.872
Gross domestic product per capita	Unit (x1)	EUR		:	:	:	:	1.181	1.300	1.411	1.556	1.642	1.788
SI: Growth rate of Gross domestic product at constant prices (national currency), relative to the previous year	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
SI: Employment growth (national accounts), relative to the previous year	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Labour productivity growth in GDP (constant prices) per person employed, relative to the previous year	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
SI: Unit labour cost growth (national accounts), relative to the previous year	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
GDP per capita at current prices	Unit (x1)	PPS		:	:	:	:	:	:	:	:	:	:
SI: GDP per capita at current prices, PPS, EU-25=100	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
SI: Labour productivity, PPS (GDP per person employed), EU-25=100	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Agriculture (NACE Sections A+B): share of total gross value added	Unit (x1)	%		:	:	:	:	15,8	13,4	13,0	12,1	10,6	11,5
Industry (excluding construction) (NACE Sections C to E): share of total gross value added	Unit (x1)	%		:	:	:	:	22,7	23,0	22,5	20,9	22,2	22,0
Construction (NACE Section F): share of total gross value added	Unit (x1)	%		:	:	:	:	6,3	5,8	5,1	5,1	4,8	4,6
Services (NACE Sections G to P): share of total gross value added	Unit (x1)	%		:	:	:	:	55,3	57,7	59,4	61,9	62,4	61,9
Final consumption expenditure, as a share of GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Final consumption expenditure: household and NPISH, as a share of GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Final consumption expenditure: General government, as a share of GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
—Gross fixed capital formation, as a share of GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
—Stock variation, as a share of GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Exports of goods and services, relative to GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
Imports of goods and services, relative to GDP	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
<b>Inflation rate</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Consumer price index: total (CPI), growth	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:



relative to the previous year														
<b>Balance of payments</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	
Balance of payments: current account total	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Balance of payments current account: trade balance	Million	EUR	:	:	:	:	:	-1.904	-2.208	-2.193	-2.968	-3.041	:	
Balance of payments current account: exports of goods	Million	EUR	:	:	:	:	:	588	1.158	1.197	1.068	1.200	:	
Balance of payments current account: imports of goods	Million	EUR	:	:	:	:	:	2.491	3.366	3.390	4.037	4.242	:	
Balance of payments current account: net services	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Balance of payments current account: net income	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Balance of payments current account: net current transfers	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Balance of payments current account: net current transfers - of which government transfers	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Direct investment (FDI) in the reporting economy	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
<b>Public finance</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	
General government deficit/surplus, relative to GDP	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
SI: General government debt, relative to GDP	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
<b>Financial indicators</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	
Gross foreign debt of the whole economy, relative to GDP	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
Gross foreign debt of the whole economy, relative to total exports	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
Money supply: M1	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Money supply: M2	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Money supply: M3	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Total credit: credit by monetary financial institutions (MFIs) to total residents (consolidated)	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Interest rates: day-to-day money rate, per annum	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
Lending interest rate (one year), per annum	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
Deposit interest rate (one year), per annum	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:	
EUR exchange rates: average of period - 1 euro = ... national currency	Unit (x1)	Number	:	:	:	1,969	1,956	1,956	1,956	1,956	1,956	1,956	1,956	
EUR exchange rates: end of period - 1 euro = ... national currency	Unit (x1)	Number	:	:	:	1,953	1,956	1,956	1,956	1,956	1,956	1,956	1,956	
Effective exchange rate index (1999=100)	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:	
Value of reserve assets (including gold)	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
Value of reserve assets (excluding gold)	Million	EUR	:	:	:	:	:	:	:	:	:	:	:	
<b>External trade</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	
Trade balance: (all goods, all partners)	Million	EUR	:	:	:	:	:	:	:	:	:	-2.019	:	
Value of exports: (all goods, all partners)	Million	EUR	:	:	:	:	:	:	:	:	:	908	:	
Value of imports : (all goods, all partners)	Million	EUR	:	:	:	:	:	:	:	:	:	2.928	:	
Terms of trade (export price index / import price index), relative to the previous year	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:	

Share of exports to EU-25 countries in value of total exports	Unit (x1)	%	:	:	:	:	:	:	:	:	:	53,1	:
Share of imports from EU-25 countries in value of total imports	Unit (x1)	%	:	:	:	:	:	:	:	:	:	57,6	:

<b>Demography</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Natural growth rate : crude rate of natural increase (births minus deaths)	Unit (x1)	per 1000	:	:	:	:	:	3,7	2,4	1,9	1,4	0,9	:
Net migration rate: number of immigrants minus the number of emigrants	Unit (x1)	per 1000	:	:	:	:	:	:	:	:	:	:	:
Infant mortality rate: number of deaths of children under one year of age relative to 1000 live births	Unit (x1)	Number	:	:	:	:	:	10,1	9,7	7,6	9,4	7,7	:
Life expectancy at birth: male	Unit (x1)	Years	:	:	:	:	:	:	71,3	71,3	71,3	71,3	:
Life expectancy at birth: female	Unit (x1)	Years	:	:	:	:	:	:	76,7	76,7	76,7	76,7	:

<b>Labour market</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Economic activity rate (15 - 64): proportion of the population aged 15-64 that is economically active	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Employment rate (15-64): proportion of the population aged 15-64 that is in employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Employment rate (15-64), male: proportion of the male population aged 15-64 that is in employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Employment rate (15-64), female: proportion of the female population aged 15-64 that is in employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Employment rate of older workers (55-64): proportion of the population aged 55-64 that is in employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
Agriculture, forestry and fishing (NACE Sections A+B) as a share of total employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
Industry (NACE Sections C to E) as a share of total employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
Construction (NACE Sections F) as a share of total employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
Services (NACE Sections G to P) as a share of total employment	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Unemployment rate: proportion of the labour force that is unemployed	Unit (x1)	%	2)	:	:	:	:	39,4	39,7	40,0	41,1	:	:
SI: Unemployment rate, male: proportion of the male labour force that is unemployed	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Unemployment rate, female: proportion of the female labour force that is unemployed	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
Unemployment rate of persons < 25 years: proportion of the labour force aged <25 that is unemployed	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Long-term unemployment rate: proportion of the labour force that is long-term unemployed	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:

<b>Social cohesion</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Inequality of income distribution: ratio of top quintile to lowest quintile	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:

SI: Early school-leavers: proportion of the population aged 18-24 having not completed upper secondary education and who are currently not in any education or training	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Children aged 0-17 living in jobless households: share of children aged 0-17	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Persons aged 18-59 living in jobless households: share of persons aged 18-59	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:

<b>Standard of living</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of passenger cars / population	Unit (x1)	per 1000	:	:	:	:	:	:	:	:	:	:	:
Number of main telephone lines (fixed) / population	Unit (x1)	per 1000	:	:	:	:	:	:	:	223,0	235,8	244,8	:
Number of subscriptions to cellular mobile telephone services / population	Unit (x1)	per 1000	:	:	:	:	:	:	:	117,1	195,6	274,0	:

<b>Infrastructure</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Density of railway network (lines in operation)	Unit (x1)	per 1000 km <sup>2</sup>	:	:	:	:	:	:	:	:	:	:	18,0
Length of motorways	Unit (x1)	km	:	:	:	:	:	:	:	:	:	:	:

<b>Industry and agriculture</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Industrial production volume index (2000=100)	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:
Agricultural production volume indices of goods and services (at producer prices) (previous year = 100)	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:

<b>Innovation and research</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Spending on human resources (public expenditure on education) as a share of GDP	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Gross domestic expenditure on research & development, relative to GDP	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Percentage of households who have Internet access at home. All forms of Internet use are included. The population considered is aged 16 to 74.	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:

<b>Environment</b>	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Total greenhouse gases emissions, CO <sub>2</sub> equivalent (1990=100)	Unit (x1)	Number	:	:	:	:	:	:	:	:	:	:	:
SI: Energy intensity of the economy	Unit (x1)	kg of oil equivalent per EUR 1000 GDP	:	:	:	:	:	:	:	:	:	:	:
SI: Share of renewable energy in electricity consumption	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:
SI: Road freight transport as a share of total inland freight transport (Modal split of freight transport)	Unit (x1)	%	:	:	:	:	:	:	:	:	:	:	:

e estimate  
f forecast  
p provisional

1) As of 30 June.

2) The unemployment rate is not calculated using the ILO methodology. The calculation is:  $\text{unemployment rate} = \frac{\text{number of unemployed people}}{\text{number of unemployed people} + \text{number of employed people}}$ . The number of unemployed people is taken from the Bureau for unemployment (i.e. an administrative register).

Note: The full set of Key indicators is available in [http://europa.eu.int/estatref/info/sdds/en/coop\\_eur/coop\\_eur\\_base.htm](http://europa.eu.int/estatref/info/sdds/en/coop_eur/coop_eur_base.htm). The definitions of the indicators that countries have been requested to follow can be found (in English) in [http://europa.eu.int/estatref/info/sdds/en/coop\\_eur\\_definitions.pdf](http://europa.eu.int/estatref/info/sdds/en/coop_eur_definitions.pdf), which also includes the definitions of the few indicators extracted from Eurostat's database, and from Comext. When countries have indicated divergences from the definitions requested these are indicated in a list of the footnotes.