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BOSNIA AND HERZEGOVINA 2007 PROGRESS REPORT

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TO THE EUROPEAN PARLIAMENT AND THE COUNCIL**

Enlargement Strategy and Main Challenges 2007-2008

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COMMISSION STAFF WORKING DOCUMENT

Bosnia and Herzegovina 2007 Progress Report

1. INTRODUCTION

1.1. Preface

Since March 2002, the Commission has reported regularly to the Council and the Parliament on progress made by the countries of the Western Balkan region.

This progress report largely follows the same structure as in previous years. The report:

- briefly describes relations between Bosnia and Herzegovina and the Union;
- analyses the situation in Bosnia and Herzegovina in terms of the political criteria for membership;
- analyses the situation in Bosnia and Herzegovina on the basis of the economic criteria for membership;
- reviews Bosnia and Herzegovina's capacity to implement European standards, that is, to gradually approximate its legislation and policies with the *acquis*, in line with a Stabilisation and Association Agreement and the European Partnership priorities.

The period covered by this report is from 1 October 2006 to early October 2007. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are being prepared or awaiting parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on many sources. As usual, these include contributions from the government of Bosnia and Herzegovina and from the Member States, European Parliament reports¹ and information from various international and non-governmental organisations.

The Commission draws detailed conclusions regarding Bosnia and Herzegovina in its separate communication on enlargement², based on the technical analysis contained in this report.

1.2. Context

Bosnia and Herzegovina is a potential candidate for EU membership. Negotiations on a Stabilisation and Association Agreement (SAA) between Bosnia and Herzegovina and the EU were officially opened in November 2005. They have not been formally concluded due to Bosnia and Herzegovina's lack of progress in implementing the necessary reforms. Bosnia

¹ The rapporteur for Bosnia and Herzegovina is Ms Doris Pack.

² Enlargement Strategy and Main Challenges 2007-2008.

and Herzegovina's complex institutional arrangements, frequent attacks to the Dayton/Paris peace agreement and nationalistic rhetoric have undermined the country's reform agenda.

In the meantime, Bosnia and Herzegovina continues to benefit from autonomous trade measures granted by the EU.

An international presence under UN auspices has been in place in Bosnia and Herzegovina since 1995. It will be terminated once the Office of the High Representative (OHR) is phased out. However, the closure of the OHR depends on the developments in Bosnia and Herzegovina and in the region. The EU has continued to deploy considerable resources in Bosnia and Herzegovina in the framework of the Common Foreign and Security Policy (CFSP) and the European Security and Defence Policy (ESDP). It has expressed its intention to reinforce its engagement in Bosnia and Herzegovina upon the closure of the OHR.

1.3. Relations between the EU and Bosnia and Herzegovina

Bosnia and Herzegovina is participating in the **Stabilisation and Association Process (SAP)**.

Negotiations on a **Stabilisation and Association Agreement (SAA)**, which is a central element of the SAP, were officially opened in November 2005. Technical negotiations were finalised in December 2006. In May 2007, the Member States endorsed the outcome of the negotiations, but reiterated that, to conclude the SAA, Bosnia and Herzegovina will need to meet the conditions set out by the EU prior to the opening of negotiations. The SAA will be **initialled** as soon as Bosnia and Herzegovina has made sufficient progress in addressing these requirements, notably police reform. The **signature** of the SAA will require evidence that the police reform is irreversibly on track, as well as full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). Progress in the areas of public broadcasting and public administration reform will also be required before the SAA is signed. Failure of Bosnia and Herzegovina's political leaders to achieve the necessary reforms and to conclude the SAA would seriously undermine Bosnia and Herzegovina's prospects of European integration.

The EU provides guidance to the authorities of Bosnia and Herzegovina on reform priorities through the **European Partnership**. Progress on these reform priorities is encouraged and monitored through Reform Process Monitoring (RPM) meetings, which remain a central channel for political, economic and technical dialogue between the EU and Bosnia and Herzegovina. Eight RPM meetings have been held since the publication of the last progress report, including Economic Dialogue meetings, which was held in May and October 2007.

The regular meeting between members of the European Parliament and parliamentarians of Bosnia and Herzegovina took place in June 2007. In September 2007, an EU/Bosnia and Herzegovina Ministerial Troika was organised to discuss key political issues.

The EU has continued to deploy considerable resources in Bosnia and Herzegovina in the framework of the Common Foreign and Security Policy and the European Security and Defence Policy. A new EU Special Representative (EUSR), who is also the High Representative, took office in July 2007. The mandate of the EUSR is to offer the EU's advice and facilitation in the political process and to promote overall political coordination in Bosnia and Herzegovina. The EUSR mandate was strengthened in March and July 2007 and has been extended until February 2008. The EUFOR/Althea mission has downsized its troops to 2,500 while ensuring the capacity to contribute to the maintenance of a safe and secure

environment. Extension of the mandate of the EU Police Mission for two more years from the beginning of 2008 is being discussed. The EU Monitoring Mission, with its headquarters in Bosnia and Herzegovina, will close by the end of 2007. The EU has expressed its intention to reinforce its engagement in Bosnia and Herzegovina upon the closure of the Office of the High Representative (OHR), which is envisaged for June 2008. However, the closure of the OHR will be subject to developments in Bosnia and Herzegovina and in the region.

In September 2007, the EU and Bosnia and Herzegovina signed agreements on visa facilitation and readmission. The new arrangements on visa facilitation are important to facilitate people-to-people contacts. They will simplify procedures for issuing visas for certain categories of citizens of Bosnia and Herzegovina, including students, scholars, businesspeople, journalists, and tourists. They will also keep the cost of visas at its current level and, in some cases, lead to visas free of charge. This will allow more interaction between citizens of the EU Member States and the citizens of Bosnia and Herzegovina.

As regards pre-accession **financial assistance**, the 2007-2009 Multi-Annual Indicative Planning Document (MIPD) for Bosnia and Herzegovina was adopted in June 2007. Assistance for the country under the 2007 IPA (Instrument for pre-accession assistance) programme totals € 62.1 million. The areas of main focus are strengthening rule of law and public administration structures, economic and social development and democratic stabilisation, including support to civil society. In addition, € 6.4 million has been provided from Community funds to support the budget of the Office of the High Representative until June 2008.

Remaining CARDS as well as IPA assistance is implemented by the EC Delegation in Sarajevo. The management of aid on a decentralised basis is a medium term objective for Bosnia and Herzegovina. Preparations to implement the decentralised implementation system have been slow during the reporting period. The complex institutional and political environment in the country has adversely affected a number of projects and implementation rates have recently declined somewhat, although they remain high.

Regarding financial assistance to **civil society**, the 2007 IPA programme will provide € 3 million for projects which will focus on strengthening local democracy and increasing the capacity of civil society to take part in political dialogue. In January 2007, the Framework Agreement for Bosnia and Herzegovina's participation in **Community Programmes** entered into force. No Memorandum of Understanding for participation in specific community programmes has been established so far.

2. POLITICAL CRITERIA

This section examines progress made by Bosnia and Herzegovina towards meeting the Copenhagen political criteria, which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors regional cooperation, good neighbourly relations with enlargement countries and Member States, and respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia (ICTY).

2.1. Democracy and the rule of law

Constitution

Bosnia and Herzegovina's constitution, which is contained in Annex IV to the Dayton/Paris Peace Agreement (DPA), establishes a complex institutional architecture. The DPA put an end to the war and brought peace and stability to Bosnia and Herzegovina. Progress has been made under the current constitutional structure, but it prevents swift decision-making and therefore hinders reform and the capacity to make progress towards the EU.

Since the Bosnia and Herzegovina Parliamentary Assembly rejected a package of proposed constitutional amendments in April 2006, no further attempts have been made to amend the constitution. Wide disagreement between the political parties on the scope of the future constitutional reform continues.

Nationalist rhetoric from political leaders from all the constituent peoples, challenging the Dayton/Paris Peace Agreement and therefore the constitutional order, has been common. This negative rhetoric has hindered reform in a number of fields. Following the verdict of the International Court of Justice, a number of Bosniak politicians called for unilateral constitutional changes especially in relation to the status of Srebrenica. The political leadership in Republika Srpska has continued to make statements about the possibility of a referendum on self-determination and withdrawing competences from the State level.

On the basis of the Dayton/Paris Agreement, the international community continues to maintain a significant presence in Bosnia and Herzegovina. The Office of the High Representative and the EU Special Representative have been working closely with the European Commission on issues related to European integration. However, the authorities of Bosnia and Herzegovina have not demonstrated the capacity to take further political ownership and responsibility over reform. Due to the tense political situation and the lack of reform, the High Representative has continued to play an important role in facilitating reform and governance issues. Between 1 January and 30 September 2007, the High Representative used his executive powers on 31 occasions, which included the imposition of legislation and the removal of officials.

Taking into account the situation in Bosnia and Herzegovina and in the region, in February 2007 the Peace Implementation Council (PIC) Steering Board agreed to postpone the closure of the Office of the High Representative until 30 June 2008. The PIC Steering Board agreed to review the situation in February 2008.

As a result of the failure to reform the constitution, the 2006 general elections were conducted under provisions that are in violation of the European Convention on Human Rights (ECHR). The election of Bosnia and Herzegovina's tripartite Presidency and the delegates to the Bosnia and Herzegovina House of Peoples continue to be in contravention of Protocol 12 of the ECHR. As a consequence, three cases have been brought before the European Court of Human Rights by members of the Jewish and Roma communities and by a Bosniak resident in Republika Srpska respectively.

The Entities have failed to bring their constitutions into line with the March 2006 decision of the Constitutional Court of Bosnia and Herzegovina ruling that the Entity coat of arms, flag and anthem were not in line with the State-level constitution of Bosnia and Herzegovina. Republika Srpska has agreed on new symbols, but these have been challenged in the

Republika Srpska Constitutional Court. The Federation of Bosnia and Herzegovina (Federation) has formed a commission to propose new Entity symbols.

Overall, Bosnia and Herzegovina's political leaders have given limited attention to the necessary reforms and nationalist rhetoric has prevailed. Bosnia and Herzegovina has made no progress towards creating more functional and affordable State structures which support the process of European integration, e.g. through constitutional reform.

Parliament

Presidential and parliamentary elections (at State, Entity, Canton and Brčko District level) were held in October 2006. These were the first elections since the Dayton/Paris Agreement to be fully administered by the authorities of Bosnia and Herzegovina. The elections were generally run in accordance with the international standards for democratic elections.

Bosnia and Herzegovina has a bicameral State-level parliament, along with parliaments at the level of the Entities (the Federation of Bosnia and Herzegovina and Republika Srpska), Brčko District and Cantons. Following the general elections in October 2006, the new Bosnia and Herzegovina House of Representatives was inaugurated in November 2006, but the House of Peoples was not constituted until mid-March 2007. Likewise, full constitution of the Federation Parliamentary Assembly was seriously delayed by divergences between political parties and the late formation of the cantonal governments.

Bosnia and Herzegovina's Parliamentary Assembly's legislative work has been hampered by the intransigent and ethnically oriented position of the country's political leaders. The House of Representatives and the House of Peoples have met infrequently and parliamentary activities have proceeded slowly. Committee work has also been affected by inter-ethnic divergences. A Committee for European Integration was reconstituted after the 2006 elections. Despite increased resources, the committee has remained largely inactive and has minimal influence in the parliament in addressing issues relating to European integration.

The pace and quality of legislative output remained affected by slow input from the Council of Ministers, resulting in adoption of only a limited number of laws. The chairmanship of the Parliamentary Assembly continues to rotate on an eight-month basis, which hinders efficiency. Members of Parliament generally continue to vote along ethnic lines and remain highly influenced by pressure groups pursuing individual interests. This tendency has increased over the past year due to the deterioration of the political environment.

The Parliamentary Assembly is still hampered by inadequate technical and human resources and cumbersome parliamentary procedures. Cooperation with the Council of Ministers remains inadequate, and there is no coordination of legislative agendas between the State and Entity parliaments.

Overall, there has been limited progress in improving the efficiency of the Parliamentary Assembly of Bosnia and Herzegovina. Its work has been adversely affected by the tense political climate, systematic voting along ethnic lines and insufficient administrative resources.

Government

As a result of the rejection of the constitutional amendments in April 2006, the Presidency of Bosnia and Herzegovina continues to rotate on an eight-monthly basis. Its mandate includes a

role in foreign policy, proposing annual budgets and representing Bosnia and Herzegovina in international organisations. The election of Bosnia and Herzegovina's tripartite Presidency continues to be in contravention of Protocol 12 of the ECHR as it does not allow citizens not belonging to the three constituent peoples to stand as candidates and determines the ethnicity of each candidate elected from the Entities.

The Presidency resulting from the October 2006 elections was inaugurated in November 2006. The Presidency has met regularly. However, its members mostly continued to show first allegiance to their Entity and their constituents, and little capacity to find common positions. They remained divided on key issues such as the verdict of the International Court of Justice in the genocide case *Bosnia and Herzegovina v. Serbia* and developments regarding Srebrenica. The Presidency members also repeatedly failed to present a joint stance in representing Bosnia and Herzegovina abroad.

Republika Srpska was able to form its government shortly after the elections, but considerable delays were encountered at State level and the Federation. The Bosnia and Herzegovina Council of Ministers was established in mid-February 2007. It has experienced internal tensions and deadlocks. Complicated decision-making procedures, capacity problems, lack of political will and diverging national interests in government and parliament continue to delay the adoption of legislation. The work of the Council of Ministers is also suffering from the limited powers granted to the Chairman (Prime Minister).

The Directorate for European Integration (DEI) is directly attached to the Council of Ministers. It has continued to play an important role as Bosnia and Herzegovina's focal point for EU assistance programming. It has further promoted the objective of European integration by continuing its efforts to improve coordination of State and Entity ministries. However, the DEI's work has been hampered by the politicised climate, and the Council of Ministers has not used the DEI's capacities to the full extent. DEI's human resources also need to be strengthened.

The Directorate for Economic Planning is responsible for monitoring the Medium-Term Development Strategy and is preparing to coordinate the production of a new National Development Strategy and the ensuing National Development Plan. The General Secretariat is only partly operational and is only slowly taking on a greater coordinating role. In order to strengthen the capacity of the General Secretariat in April 2007 the Council of Ministers approved a new rulebook considerably increasing its staff. The Legislative Office is functioning but a lack of professional staff, premises and office equipment prevents it from properly reviewing all the required legislation. Both in the Legislative Office and in the wider administration, there is still a substantial lack of knowledge of EU law, European integration processes and foreign languages. Awareness of the need further to develop and modernise the legislative basis and legal drafting traditions of the country is also lacking.

Final responsibility for the difficulties in government work lies with the leadership of the political parties. On a number of occasions, the Council of Ministers has been left out of negotiations on reform issues for which the government would normally be responsible. Similarly fragmented policy-making between the State and the Entities is still an issue. The Coordination Board for Economic Development and European Integration, which is designed to harmonise State and Entity agendas has only met infrequently since the new governments were formed. Coordination between the authorities is therefore minimal and depends largely on personal and party interests. Another serious handicap for policy planning in Bosnia and

Herzegovina as a whole is the lack of proper statistics, including an up-to-date population census.

In the Entities, the Republika Srpska government was established in November 2006, whereas the Federation government was not formed until the end of March 2007. The Republika Srpska government has been efficient in adopting legislation, especially in the economic field, and has made progress with attracting foreign investment. It has continued its policy of strengthening its own legal framework, often without coordination with the other governments in Bosnia and Herzegovina. It remains generally opposed to the transfer of powers to State level, for example on police and economic matters, and has threatened to reverse previous transfers of powers. The Republika Srpska executive has continued with its sometimes harsh rhetoric, although its position on the situation in Srebrenica has been constructive. The Federation government has been less efficient in legislating, and its work has been affected by the difficult political climate and diverging party interests in the governing coalition. In two Cantons, governments were not formed until ten months after the elections, and then only after the High Representative had cut the financing of the four main political parties as a result of the delays.

Overall, Bosnia and Herzegovina's State-level government structures have been unable to overcome internal conflicts – often based on ethnic or Entity allegiance – and to avoid deadlocks. As a result, there have been serious delays in reform implementation.

Public administration

Some limited progress has been made in the area of public administration reform. Bosnia and Herzegovina's administration participated in the technical part of the negotiations for a Stabilisation and Association Agreement in a professional manner. In April 2007, a new Public Administration Reform Coordinator was appointed with a four-year mandate. The Public Administration Reform Coordination Office has been allocated the budgetary resources necessary to complete its staffing, although recruitment for most of its positions is still ongoing. All the governments have adopted a joint platform for implementation of the Public Administration Reform (PAR) Strategy, which defines responsibilities at political, coordination and implementation levels. In July 2007, a Memorandum of Understanding on establishment of a Public Administration Reform Fund, financially supported by the EU, was signed. The fund, which will manage an initial allocation of € 4.5 million, is not yet operational.

Recruitment by the State Civil Service Agency has improved, although it is still far from optimal. Coordination between the State- and Entity-level Civil Service Agencies has improved, with joint involvement in several large-scale training schemes. An initiative to establish a joint Institute of Public Administration, which has received initial approval from all three Civil Service Agencies, would be a first step towards closer cooperation. Harmonisation of the three Civil Service Laws, among other things to allow transfers of civil servants between government levels, is pending.

Bosnia and Herzegovina remains affected by cumbersome administrative structures. The National Strategy for the Public Administration Reform has yet to be properly implemented. There has not yet been any systematic and coherent action driven by local ownership. The PAR Coordinator's Office continues to be dependent on foreign assistance. The Coordination board for the PAR has not yet taken up its role as a political steering force. The reforms recommended by the sectoral, functional and horizontal system reviews have not been carried

out. Genuine support for the process from the various government structures is necessary for effective implementation.

Despite the steps taken over the reporting period, efforts are still needed to meet the European Partnership's key requirement that all State-level ministries and institutions be adequately financed, operational and properly equipped, particularly in terms of premises and staff. Consolidation of the State-level ministries and institutions has continued, but slowly. Limited budgetary resources and premises continue to delay recruitment of the necessary staff. The planned move to a new government building in late 2007 is expected to help alleviate the office space problem.

No progress has been made on regulating ownership rights to State property. As a result, the High Representative has extended the temporary prohibition of disposal of State property until 31 December 2007.

Sustained action is necessary to establish a professional civil service with recruitment and promotion based on experience and merit. There are still insufficient safeguards against political interference in public administration, where ethnic identity and party membership play a significant role. Apart from the lack of personnel, structures within the ministries need substantial improvement in terms of delegation, distribution and exercise of powers, cooperation mechanisms and strategic planning capacity. Further efforts are necessary to modernise the human resources management system comprehensively.

The Ombudsman Law, which was adopted in March 2006, provides for merging the Entity Ombudsmen Institutions with the State Ombudsman in line with international conventions. The merger was expected to occur in January 2007, but it has not yet taken place. The State Ombudsmen have not been appointed.

Local self-government reform, in line with the European Charter for Local Self-Government, is still underway. Both Entities have adopted laws on local self-governance. In November 2006, the Council of Europe's Congress of Local and Regional Authorities noted that the legislation on local self-government in Republika Srpska and the Federation is on the whole compatible with the principles of the Charter, but that the local governments have no clear constitutional guarantees, that municipalities are strongly dependent on financial transfers from higher level authorities and that corresponding local revenue bases are extremely low. Changes to the Republika Srpska budget system law and the Federation revenue collection law adopted in 2006 assign specific percentages of the single account revenue to Entity, Cantonal and municipal governments.

The complex administrative structures in Bosnia and Herzegovina and, in particular, in the Federation remain an obstacle to efficient local self-government. Bosnia and Herzegovina also needs to harmonise its local self-governance legislation throughout the country.

Lack of cooperation between local political leaders has prevented the establishment of a single administration in Mostar. In September 2006, the High Representative decided to appoint a Special Envoy for Mostar to address the outstanding problems. Subsequently, the issues of Herzegovina Radio-Television, parallelism in the urban planning sector, divided cultural institutions and ongoing delays in reforms of the Mostar administration were resolved completely or partly through the intervention of the Office of the High Representative.

The situation in the Srebrenica region remains a particular problem. Following the verdict of the International Court of Justice in Bosnia and Herzegovina's genocide case against Serbia, Bosniak politicians proposed a Special Status for Srebrenica, under direct State powers and outside Republika Srpska. This demand led to increased political tension in Srebrenica and throughout the country. As a result, the Republika Srpska government has given Srebrenica the status of a special socio-economic zone, and it has adopted an economic and social development plan for the region. In May 2007, the High Representative appointed an International Special Envoy for the Srebrenica region.

As regards the restructuring of the police, the police restructuring directorate (PRD) submitted its report to the Council of Ministers in December 2006. The PRD's report has been taken as the basis for further discussion on the police reform. However, due to the lack of political will and diverging views over the powers and administrative borders of the police, no agreement has been reached. As a result, the country's police remain fragmented (*See also section 4.3.4 on police*).

Overall, there has been some progress in the area of public administration. However, Bosnia and Herzegovina is still in an early phase of the public administration reform implementation, which needs to be accelerated. The country's complex and cumbersome structure continue to undermine efficiency. Significant further efforts towards an efficient, professional, stable, accountable and transparent civil service at all level of government are necessary.

Civilian oversight of the security forces

The Joint Parliamentary Committees for Defence and Security and the Intelligence and Security Committee have continued to perform their duties properly. In terms of defence reform, the transfer of EUFOR's residual Dayton tasks and functions to the Bosnia and Herzegovina authorities is in progress. Action has been taken as regards the disposal of the Armed Forces' surplus weapons and military equipment, but progress is slow. The transfer of defence property from the Entities to the State has not been completed and is being hampered, in particular, by Republika Srpska. In terms of intelligence reform, there has been progress on issues such as counter-terrorism, organised crime and war crimes. The Bosnia and Herzegovina Intelligence and Security Agency has provided timely intelligence on individuals on the "Srebrenica list".

As a consequence of progress in the defence reform, including the establishment of democratic control of the armed forces, NATO invited Bosnia and Herzegovina to join the Partnership for Peace and the Euro-Atlantic Partnership Council in November 2006. The Partnership for Peace Agreement was concluded in December 2006.

Judicial system

Consolidation of the judicial system continued to progress, but in a difficult environment.

The structure of the judicial system in Bosnia and Herzegovina reflects the internal structure of the country. Courts exist at State and Entity levels and also within the Entities. At State level, the system consists of a Ministry of Justice with limited powers and staff, the State Court with an international registry, and the High Judicial and Prosecutorial Council (HJPC) which substantially guides the justice reform but has only limited resources. The HJPC, as an independent and autonomous body, continues to play an important role in improving the situation of the judiciary. It has contributed to increase professionalism, resources and

efficiency. Nevertheless, the HJPC position is not sufficiently secure within the constitutional framework and its role is frequently challenged.

The HJPC sharply reduced its international staff and increased its national staffing in line with its strategy of transferring power to national hands. The international members have gradually been shifting from being actively involved in daily operations to mentoring and monitoring at strategic level. Nonetheless, as the funds provided from the national budget to the HJPC and courts and prosecutor's offices have not increased, they remain dependent on international funding.

The status of the Judicial and Prosecutorial Training Centres in the Entities as the recognised key institutions for the professional education of current and future members of the judiciary was consolidated. A medium-term training strategy has been developed. However, the lack of staff in the Training Centres continues to hinder effective training.

Within the Entities, the minor offence reform was successfully completed, with the minor offence courts being merged with regular courts and with the appointment of additional judges. A new enforcement system for collection of fines was developed. Newly appointed judges and related staff were trained in implementing the new Entity Laws on Minor Offences and in using the new Registry of Fines. Further staffing was completed at Entity level with the appointment of judicial associates for first instance courts by the HJPC.

Despite the generally positive developments mentioned above, serious obstacles to the efficient operation of the judiciary persist. These include: four parallel and separate jurisdictions at State, Republika Srpska, Federation and Brčko District levels; incoherent systems of laws; directives issued by fourteen Ministers of Justice; four different bar examinations for lawyers; and a high rate of reversal of judgements in major criminal cases at the Court of Bosnia and Herzegovina. The judicial system is not exempted from political interference. In the parliamentary and executive branches of the governments, there are attempts to reverse reforms already implemented to allow greater political influence in the work of prosecutors and judges. A comprehensive justice sector development strategy is urgent.

The slow processing of cases due to backlog, poor management skills and the scarcity of modern equipment and premises creates obstacles to establishing an effective judiciary. The deployment of computer applications to improve case management was completed in six courts. However, there is not yet a systematic action plan to reduce the growing backlog of pending cases at courts. At the end of 2006 there were almost two million pending cases (although half of these concerned utility issues). Further efforts are needed to introduce alternative out-of-court resolution measures such as mediation and arbitration. The backlog of cases in the Constitutional Court also remains high (over 3,000 cases at the end of 2006). Due to the lack of a Supreme Court in Bosnia and Herzegovina, the Constitutional Court is increasingly acting as an appellate court.

Progress in the area of cooperation between police and prosecutors was limited. Harmonised rules for cooperation between police and prosecutors have not yet been established. The majority of prosecutors and police officers still have difficulties in understanding and applying the four Criminal Code Procedures which are in force. This continues to be a concern.

Further efforts are needed to harmonise the criminal law system. Bosnia and Herzegovina still lacks a single Criminal Code and Criminal Procedure Code, resulting in highly diverse case law. As a result, the same crime continued to be met with different punishments across the country. Insufficient quality of defence in criminal cases, lack of understanding of new criminal legislation and insufficient education of judges, prosecutors and law enforcement officials remain core problems in implementing judicial reform.

Little progress was made in the area of juvenile justice. Implementation of the strategy and action plan against juvenile offences adopted in July 2006 has not started. A coordination body was set up at State level to monitor its implementation. However, the lack of appropriate and well-regulated juvenile correctional facilities and alternative measures for juvenile offenders continued to seriously hinder the establishment of an efficient system to address juvenile delinquency.

Regarding the local prosecution of war crimes, the State Investigation and Protection Agency (SIPA) is investigating some 500 cases dealing with war crimes. At State level, trials are generally held within a reasonable time and in compliance with internationally recognised fair trial standards. In July 2007, investigations were opened on 93 individuals who were believed to be involved in networks supporting indicted war criminals and who were on the so-called Srebrenica List. At the same time, the Republika Srpska police suspended 35 serving policemen who were on the Srebrenica List. However, war criminals need to be prosecuted more vigorously, in particular at Entity level. Impunity continues for many perpetrators of crimes during the war. A country-wide strategy for dealing with war crimes cases is required.

Overall, preparations by Bosnia and Herzegovina to develop an effective and efficient judicial system are advancing. However, it has continued to face fragmentation and disparities across the judicial frameworks. Sustained efforts are necessary to improve efficiency and to ensure the independence of the judicial system.

Anti-corruption policy

During the reporting period, Bosnia and Herzegovina ratified the UN Convention on Fighting Corruption (Mérida Convention), although ratification of the Additional Protocol to the Criminal Law Convention is still pending. There was some progress on enforcing the law on conflict of interest, with the Central Election Commission sanctioning a number of elected officials and preventing them from running for office. A National Anti-Corruption Strategy and action plan was adopted in 2006, but the implementation has not been satisfactory, due in part to a lack of resources.

The second evaluation report adopted by the Council of Europe Group of States against Corruption (GRECO) in December 2006 underlined the need to enforce the legal framework and to improve coordination and training of the agencies involved in fighting corruption and seizure of the instruments and proceeds of crime. Limited action has been taken in this regard. No action has been taken to improve anti-corruption legislation. The Criminal Codes of the State, Entities and Brčko District establish a general obligation to report suspicions of criminal offences - including corruption - but no legal measures are in place to ensure confidentiality and to protect civil servants reporting such cases. Amending the laws on elections and on the financing of political parties is necessary to prevent corrupt practices, and the law on conflict of interest needs to be further clarified. Prevention and enforcement need to be strengthened. No independent anti-corruption agency has been established. Convictions for corruption remain limited.

Overall, Bosnia and Herzegovina has made limited progress in dealing with corruption. Corruption is widespread and remains a serious problem. Strategies and action plans are in place, but they are not properly implemented. More vigorous investigation and prosecution is necessary.

2.2. Human rights and the protection of minorities

Observance of international human rights law

As regards **ratification of human rights instruments**, Bosnia and Herzegovina has ratified all the major UN and international human rights conventions, including the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR). Substantial delays in fulfilling the reporting obligations have continued. The Constitution includes most of the principles of these human rights conventions and guarantees that they supersede national legislation. Although the conventions are directly applicable, implementation needs to improve.

In a number of cases the decisions of the Human Rights Commission of the Bosnia and Herzegovina Constitutional Court were not properly implemented. This had led to a number of cases being lodged before the European Court of Human Rights. In January 2007 the European Court of Human Rights issued its first judgement against Bosnia and Herzegovina. At the end of 2006, a total of 286 applications from Bosnia and Herzegovina were registered at the Court.

With regard to **promotion and enforcement of human rights**, progress has been made in addressing the judicial backlog of cases at the Human Rights Commission of the Bosnia and Herzegovina Constitutional Court. Since January 2004, the Commission has been responsible for reviewing cases of human rights violations. In December 2006, amendments to the General Framework Agreement for Peace in Bosnia and Herzegovina were made allowing pending cases to be transferred directly to the Constitutional Court. Despite this progress, a significant number of cases still remain to be tackled. Implementation of the decisions of the Human Rights Commission remains insufficient due, in particular, to the reluctance of the Entity governments to compensate victims. There has been no progress in addressing the question of the citizens and residents of Bosnia and Herzegovina currently held in Guantánamo Bay. This case has now been referred to the European Court of Human Rights.

Overall, Bosnia and Herzegovina has made limited progress in improving the observance of international human rights law. It has achieved results in addressing the backlog of human rights-related cases, but there is room for improvement as regards the implementation of rulings. Implementation of international human rights conventions also needs to improve.

Civil and political rights

As regards **prevention of torture and ill-treatment and the fight against impunity**, State and Entity Constitutions prohibit torture and ill-treatment. Bosnia and Herzegovina is party to the Convention for the Prevention of Torture. However, it has failed to appoint members to the relevant committee. Recent assessments of the situation in prisons and in police detention have shown that more needs to be done. Cases of abuse of prisoners and detainees by the police or prison guards have occurred. There remains a need to improve the investigation of cases of alleged misconduct.

The death penalty is prohibited by the Constitution of Bosnia and Herzegovina and by the Constitution of the Federation of Bosnia and Herzegovina. Article 11 of the Republika Srpska Constitution still allows the death penalty for capital crimes, which is incompatible with ECHR Protocol 6. However, Republika Srpska does not apply the death penalty in practice.

Access to justice in civil and criminal trials remains a matter of concern and equality before the law is not always guaranteed. In criminal trials, judges often do not fully inform defendants of their right to counsel at public expense. As a result, defendants do not request legal aid. Legal aid in civil cases is primarily provided on an *ad hoc* basis by privately funded NGOs. Further efforts are needed to increase the budget of the defence counsel and to establish a nationwide legal aid scheme for criminal and civil trials.

The right to a fair trial is formally incorporated into the four criminal procedure codes of Bosnia and Herzegovina. However, in lower level courts judges have tended to neglect the presumption of innocence.

The **prison system** remains divided and management of penitentiary institutions is split between the State and the Entities. There is no unified practice of criminal sanctions. This division needs to be addressed in order to create a coherent prison system which ensures that human rights standards are applied in the same way throughout the country. At State level, there is no prison facility, but only limited detention capacity annexed to the State Court for custody purposes. There are plans to construct a high-security prison facility. No specific detention facilities exist for female inmates.

Prison facilities and supervision need to improve to address the problems of overcrowding, poor living conditions, inadequate medical treatment and physical abuse by prison guards. The criminal legislation provides the possibility of alternative penalties in the form of community work. This alternative was officially introduced in 2003, but a lack of acceptance has prevented its use. The Entity legislation on prisons has not been adjusted to the amendments of the Criminal Procedure Code and the State Law on the Execution of Criminal Sentences.

All the constitutions provide for **freedom of expression**. This has generally been respected by the authorities. The media remain ethnically divided. The effectiveness of the self-regulation instruments set out in the Press Code is limited. The Republika Srpska authorities refused to cooperate with the State-wide broadcaster for a period.

The Communications Regulatory Agency monitors audiovisual media, including how they deal with ethnicity, gender and minority issues. The public broadcasting law in the Federation has not been formally adopted. The adoption of this legislation is necessary to complete the legal framework for public broadcasting reform, which is a key priority of the European Partnership and one of the conditions for the signature of the Stabilisation and Association Agreement.

The constitutional framework of Bosnia and Herzegovina includes the right to **freedom of assembly and association**, which is respected by the authorities.

Some progress has been made as regards **civil society organisations**. The Council of Ministers signed an agreement on cooperation with the non-government sector and appointed a senior programming officer. Civil society organisations continue to register mainly at Entity level, because the registration process at State level is perceived as more bureaucratic. Few

NGOs are therefore active country-wide. The Ministry of Justice is increasingly addressing this issue and providing more information on how NGOs can register at State level. The 2007 Republika Srpska Law on Income Tax exempts social assistance and humanitarian aid from taxation.

The Bosnia and Herzegovina Constitution provides for **freedom of religion**, and a State Law on Freedom of Confession and Legal Status of Churches and Religious Communities is in place. However, religious intolerance is still present in the country. Leaders of the religious communities have continued to intervene in political issues.

Overall, Bosnia and Herzegovina has made little additional progress as regards civil and political rights. Some steps have been taken to support civil society development, but the sector remains weak overall. There is room for improvement as regards the prevention of ill-treatment and the fight against impunity, as well as access to justice and equality before the law. The poor functioning of the prison system has led to a number of escapes from prison, including of war criminals. The long-awaited Federation legislation on public broadcasting is still pending.

Economic and social rights

Provisions on gender equality and **women's rights** are included in the law. However, the situation of women in Bosnia and Herzegovina has not improved. Trafficking in women and domestic violence remain issues of concern. Access to employment remains difficult and women's participation in the labour market continues to be low compared with men. Many women are not covered by health insurance. Provisions to guarantee women equal pay are in place but they are not applied. There have been no specific measures to address this situation and to facilitate women's employment. Women continue to be under-represented in politics and official authorities. There are no female ministers in the State government and out of the 57 parliamentarians in the Bosnia and Herzegovina Parliamentary Assembly only seven are women.

Although the legal framework is in place, **children's rights** are not fully secured. Problems remain in the field of health, social protection, education and domestic violence against children. Children's attendance of early childhood education programmes is low. Children with disabilities and Roma children continue to lack sufficient medical care and adequate educational opportunities.

With regard to **socially vulnerable and/or persons with disabilities**, discrimination against people with disabilities is prohibited by the legislation of both Entities. However, the fragmented legal and financial framework does not provide for the same social protection for all citizens throughout the country. Numerous groups of the population are excluded from social protection and assistance benefits. The privileged treatment of war veterans continued to have negative effects on other socially vulnerable people and people with disabilities. Socially vulnerable people and people with disabilities often lack access to health protection and the labour market, as a general framework for equal treatment in employment and occupation has not been established. Accessibility legislation is not being implemented and effective policies need to be put in place. The inadequacies in the social welfare systems adversely affect conditions of the handicapped, including the mentally ill. The latter remain particularly vulnerable to social exclusion. Adjusted budgetary allocations and the establishment of a Council for Disabled Persons are necessary in order to improve the situation of disabled and socially vulnerable persons.

In the field of **labour rights and trade unions**, no changes occurred over the reporting period. Ratification of the Revised European Social Charter is still pending. There has been no progress on the State-level registration of the trade union Confederation (KSBiH). Ethnic discrimination in employment is widespread.

The complex system of government and the fragmentation of legislation further hamper social dialogue. No steps have been taken to harmonise the legislative frameworks. Despite some initiatives by the Ministry of Civil Affairs, a country-wide Economic and Social Council has not been established. The lack of clarity regarding trade-unions recognition has blocked further progress in establishing collective bargaining and moving towards voluntary collective bargaining. The size of the informal economy, the complex form of government and fragmented legislation continue to hinder the development of workers' and employers' associations.

In the area of **anti-discrimination policies**, the State and Entity Constitutions guarantee equal treatment of all people. Bosnia and Herzegovina has not adopted a comprehensive anti-discrimination law, even though anti-discrimination legislation exists in several areas. Implementation is however deficient. Discrimination on the basis of sexual orientation is common.

Progress has continued on securing **property rights**. The mandate of the Commission for Property Claims of Displaced Persons and Refugees has been extended until the end of 2007 to address residual property repossession cases. Land administration reform continued, leading to improved legal security of land property rights and a stronger real estate market. A Land Administration Coordination and Advisory Board has been created in the Ministry of Justice at State level. This body is made up of representatives from the Entity Geodetic Administrations, the Entity Ministries of Justice and international donors.

Overall, very limited progress has been made as regards economic and social rights. Legal provisions to prevent discrimination and to protect the rights of women, children and socially vulnerable people do exist, but implementation is overall poor. No developments have taken place regarding labour rights and trade unions. A country-wide economic and social council has not been established. A positive note is that the process of repossession of property by displaced persons has been successfully completed.

Minority rights, cultural rights and protection of minorities

As regards **minority and cultural rights** and the **protection of minorities**, there are 17 officially recognised minorities in Bosnia and Herzegovina. The three constituent peoples – Bosniaks, Croats and Serbs – do not constitute minorities. Bosnia and Herzegovina is party to the Council of Europe Framework Convention for National Minorities, but ratification of the European Charter for Regional or Minority Languages is still pending. The second report on the Framework Convention was due in 2006 but has not yet been submitted. Many of the provisions of the Law on National Minorities have not been applied. Similarly, amendments to the Election Law aimed at improving the political representation of minorities have not been implemented. Amendments need to be made before May 2008 in order to allow national minorities to run for the 2008 local elections. No progress has been made in reforming the Bosnia and Herzegovina Constitution, and minorities therefore continue to be excluded from the House of Peoples and the tripartite Presidency. This problem was also underlined by the March 2007 concluding observations of the UN Committee on the Elimination of Racial Discrimination.

Bosnia and Herzegovina's legislation provides free broadcasting time for minorities, but limited capacity prevents them from making full use of the time provided. Greater emphasis on capacity-building is necessary in order to allow minorities to exercise their rights to media representation. The Council of National Minorities, which will perform an advisory function to the Parliamentary Assembly, is not yet operational. The National Minority Council has been established in the Republika Srpska, but not yet in the Federation.

Many **refugees and internally displaced persons** (IDPs) do still not benefit from basic pension and health provisions. The security situation for returnees has generally improved, although isolated incidents of violence have occurred.

From January to December 2006 around 5,600 returns were registered in Bosnia and Herzegovina, of which 4,600 were minority returns. The number of returnees continues to decline, but the process of return has not yet been completed. Around 120,000 people are officially registered as refugees and displaced persons wishing to return. The Return Fund is financing the reconstruction of housing in 30 municipalities and is supporting a project aiming to close collective centres for refugees and displaced persons. Further measures are needed to improve conditions for sustainable returns, in particular regarding access to employment, health care, pensions and education. Regular and up-to-date information on the numbers and flows of refugees, IDPs and returnees is central to addressing the issue appropriately.

The process of de-mining in Bosnia and Herzegovina, important to facilitate the return process, is continuing. The De-mining Plan for 2007 has been adopted and is being implemented by the De-mining Commission in Bosnia and Herzegovina.

As regards missing persons, approximately 13,000 people who went missing during the war have not been found or identified. In 2006, new mass graves were discovered and about 2,500 human remains were exhumed. In June 2007, the Council of Ministers appointed the Steering Board of the Institute for Missing Persons. This should allow the Institute to become operational.

The review of citizenship granted during and after the war was in progress over the reporting period. The State Commission for the Review of Decisions on Naturalisation of Foreign Nationals in Bosnia and Herzegovina has proposed to revoke the citizenship of over 600 persons. The State Commission is continuing its work.

The Law on the Protection of Ethnic Minorities continues to be poorly applied, in particular as regards the **Roma** population. Roma continue to be the most vulnerable minority. Discrimination against this community persists, with problems in access to housing, social services (health), education and employment. Some action has nonetheless been taken regarding the implementation of the 2005 "Strategy for Addressing Roma Problems". Some efforts have been made to improve the education of Roma in schools and universities. In some municipalities, Roma children have been given school material, textbooks and financial assistance for hot meals and school transport. The implementation of the action plan on educational needs of Roma and other minorities led to an increase in the so far very low enrolment rate at all educational levels. However, only around 30 % of the Roma children complete primary education. Greater efforts are needed to fully implement the Roma Strategy and the necessary action plans. Bosnia and Herzegovina has not yet subscribed to the Decade of Roma Inclusion 2005-2015.

Overall, Bosnia and Herzegovina's progress in the area of minority rights, cultural rights and protection of minorities has been limited. Education has seen some progress through the adoption of legislation, but the enforcement of provisions regarding minorities is weak. Minorities remain excluded from access to certain political posts. Concrete action is necessary to improve the socio-economic integration of returnees and to support the Roma population which continues to face very difficult living conditions and discrimination. Efforts to address the issue of missing persons need to increase.

2.3. Regional issues and international obligations

Implementation of the **Dayton/Paris Peace Agreement** has continued, but nationalist rhetoric by political leaders from all constituent peoples challenging the agreement and the constitutional order has been frequent. For further details see section 2.1 Constitution above.

Bosnia and Herzegovina has honoured most of its **Council of Europe (CoE)** post-accession commitments. However, only limited progress has been registered in the outstanding commitments that Bosnia and Herzegovina undertook on joining the CoE. Bosnia and Herzegovina remains under CoE monitoring.

Bosnia and Herzegovina's cooperation with the **International Criminal Tribunal for the former Yugoslavia (ICTY)** has progressed and is now at a generally satisfactory level. The signature of the Stabilisation and Association Agreement (SAA) will require full cooperation with ICTY.

Cooperation by the State and the Federation with ICTY has remained good, while cooperation by Republika Srpska has improved. In line with its action plan, Republika Srpska intensified its efforts to arrest indicted war criminals. In May 2007, the Republika Srpska police facilitated the arrest of one war criminal indicted by ICTY. Coordination between the State and Entity levels in targeting the fugitives' support network is improving. Transfers of information and evidence to facilitate prosecution in Bosnia and Herzegovina continued. As regards the freezing of assets of ICTY fugitives, legislation is in place. Some preliminary steps were taken in relation to one indicted war criminal, even though the process is still at the very beginning.

The State Court of Bosnia and Herzegovina has performed well as regards the indictees transferred from the ICTY to be judged locally. It has received a total of six cases under rule 11 bis³ of the ICTY Rules of Procedure and Evidence involving ten indictees. The State Court has completed the trials in two of these cases. The workload of the State Court has increased from 170 active cases in October 2006 to 205 active cases in May 2007. The escape of a sentenced war criminal was a negative development. It highlighted deficiencies in the legislation and the lack of a State-level high-security prison. Witness protection in sensitive war crimes cases remains a problem.

As regards the **International Criminal Court (ICC)**, Bosnia and Herzegovina still maintains a bilateral immunity agreement with the United States of June 2003 granting exemptions from ICC jurisdiction which does not comply with the EU Common Positions on the integrity of the Rome Statute as well as related EU guiding principles on bilateral immunity agreements. It needs to align with the EU position.

³ ICTY Rule 11 bis establishes the procedure for the referral of a case by the ICTY to a national court once an indictment has been confirmed by the ICTY.

No decisive progress has been achieved on implementing the Sarajevo Declaration, which aimed at finalising the **refugee** return process by the end of 2006. The process remains blocked by the lack of political consensus between the signatories. Further efforts are urgently needed, particularly from Croatia, to resolve the outstanding issues, namely how to deal with compensation claims from those who lost occupancy and tenancy rights (OTRs) in Croatia and recognition of pensions and other rights for years spent working in Serb-controlled areas of Croatia during the war.

Overall, Bosnia and Herzegovina has continued to implement the Dayton/Paris peace agreement, although the agreement has frequently been challenged by key political leaders. Progress in cooperating with ICTY has been made, and full cooperation now needs to be achieved. Regarding the implementation of the Council of Europe post-accession requirements, progress has been more limited.

Regional cooperation and good neighbourly relations form an essential part of the process of Bosnia and Herzegovina moving towards the European Union.

Bosnia and Herzegovina continues to be an active participant in regional cooperation initiatives such as the South-East European Cooperation Process (SEECP), the Central European Initiative, the Adriatic-Ionian Initiative and the Danube Cooperation Process. In its capacity as the presidency-in-office of the Adriatic-Ionian Initiative, Bosnia and Herzegovina hosted meetings of the High Officials Committee and regional events on economy and tourism, protection of cultural heritage, environment and cooperation in fight against organised crime. Bosnia and Herzegovina held also the presidency of the Migration, Asylum and Refugees Regional Initiative (MARRI). The Stability Pact is in the process of transition to a more regionally owned cooperation framework and Bosnia and Herzegovina hosts the Secretariat of the new Regional Cooperation Council.

Following a difficult internal debate, in September 2007 Bosnia and Herzegovina ratified the enlarged and amended Central European Free Trade Agreement (CEFTA). Bosnia and Herzegovina is party to the Energy Community Treaty, which came into force in July 2006. Bosnia and Herzegovina is lagging behind with meeting its obligations under the Treaty, especially in relation to gas sector. This is mainly due to the positions taken by Republika Srpska.

After considerable delays Bosnia and Herzegovina ratified the European Common Aviation Area (ECAA) in September 2007.

On the whole, **bilateral relations with other enlargement countries** have continued to be good, although little progress has been made on outstanding issues.

Relations with *Serbia* were affected by the judgement on Bosnia and Herzegovina's lawsuit against Serbia and Montenegro for genocide. In February 2007, the International Court of Justice (ICJ) found that acts of genocide had been committed in Srebrenica. The ICJ judges concluded that "*Serbia has not committed genocide through its organs or persons whose acts engage its responsibility under customary international law, in violation of its obligations under the Convention on the Prevention and Punishment of the Crime of Genocide.*" They also found that "*Serbia has not conspired to commit genocide, nor incited the commission of genocide*" and acquitted Serbia on charges that it was "*complicit in genocide.*" However, the Court ruled that Serbia did not use its influence to prevent the genocide of Bosnian Muslims in Srebrenica in July 1995. It also found that its leaders failed to comply with international

obligations to punish those who carried out that massacre. The verdict was followed by an exchange of diplomatic notes between the two countries.

There were few other developments affecting bilateral relations between Bosnia and Herzegovina and Serbia. Serbia opened a Consulate in Banja Luka in May 2007. Issues relating to the State border, property relations and trade remain unresolved. The Inter-State Council between Bosnia and Herzegovina and Serbia did not meet in 2007.

Republika Srpska has continued to intensify contacts and cooperation with Serbia on the basis of the Special Parallel Relations Agreement signed in September 2006.

With regard to *Kosovo* (under UNSCR 1244), the official stance of Bosnia and Herzegovina underlines the importance of a negotiated settlement.

Relations with *Croatia* remained stable and bilateral contacts have been increasing. Agreements on dual citizenship and on joint supervision of the State border have been signed. However, other border and trade-related issues have not been settled. There has been no concrete progress in addressing the agreement on the port of Ploče, transit through Neum and the agreement on settling property issues. Ratification of the 2005 Agreement on Demarcation of the Land and River Borders is on hold, and the border dispute involving two islands – Veliki Skoj and Mali Skoj – remains unsolved, as does the issue of the Una river border. Croatia's plan to build a bridge through the Peljesac peninsula has not been endorsed by the Bosnia and Herzegovina authorities.

Relations with *Montenegro* have intensified. Montenegro has opened an embassy in Sarajevo. Bosnia and Herzegovina has opened an embassy in Podgorica.

Good relations were maintained with the *former Yugoslav Republic of Macedonia*, with reciprocal high level visits.

Diplomatic contacts with *Albania* have been limited but relations remain good.

Bosnia and Herzegovina has concluded a Free Trade Agreement with *Turkey*.

Bilateral relations with EU Member States remain good. The EU is Bosnia and Herzegovina's main trading partner. Trade takes place in particular with Austria, Germany, Slovenia and Italy.

Overall, Bosnia and Herzegovina has continued to participate actively in regional cooperation. It must ensure the proper implementation of signed agreements, including CEFTA. While good neighbourly relations have prevailed, there has been little progress in addressing the outstanding issues, notably as regards trade and border-related issues.

3. ECONOMIC CRITERIA

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 and the capacity to cope with competitive pressure and market forces within the Union.

3.1. The existence of a functioning market economy

Economic policy essentials

The government submitted its first Economic and Fiscal Programme for 2006-2008 in December 2006, providing a basis for analysing prospective developments in economic and structural reform over the programme period. The programme noted the shortcomings stemming from the fact that the developments in 2006, along with the lines of policy of the incoming governments after the October 2006 elections, had not been fully captured.

Consensus has not yet been reached on the fundamentals of economic policies, reflecting the diverging views between the State level and the entities on the essentials of economic reform and coordination. The lack of consensus on implementation of reforms was manifest, in particular, in the Federation of Bosnia and Herzegovina, where the privatisation and restructuring of publicly owned enterprises has slowed down, partly as a result of the protracted process of government formation after the 2006 elections. In general, necessary reforms in areas such as labour markets, fiscal sustainability and restructuring or financial supervision have not been carried out, either at Entity or at State level. In addition, there is limited consensus on the degree of any transfer of competences to State institutions and, where it has occurred, it has often been accompanied by an increase in spending. In the area of fiscal coordination, negotiations about formalising and improving the activity of the National Fiscal Council continued, but with no tangible results. In general, a lack of coherence and consensus on economic policies prevented the acceleration of reforms at State, Entity and other government levels.

Macroeconomic stability

In 2006, real GDP growth was 6.2%, up from 4.3% in 2005, driven by domestic demand and a notable rise in net exports. Economic activity grew strongly in sectors such as wholesale and retail trade, real estate, construction, financial intermediation and manufacturing, reflecting a favourable external environment and more accurate reporting of real export values after the introduction of value-added tax (VAT). In 2006, industrial output expanded by 7.5% in the Federation and by 19.1% in the Republika Srpska, led by above-average increases in production of chemicals, metals, furniture and machinery and equipment in the former and of rubber and plastic products, metals and wood and furniture products in the latter. In the first eight months of 2007, the year-on-year increase in the volume of industrial production was 11.9% in the Federation, exceeding the modest 0.4% growth in the RS. Overall, economic growth accelerated in 2006 on the back of a more dynamic catching-up process in the RS and has remained strong in 2007, this time driven by the Federation. The shift towards higher value-added activities has been sluggish in both entities. The quality of statistical information remains rather weak.

The current account deficit almost halved to around 11% of GDP from 2005 to 2006, primarily due to a reduction of the trade deficit by around 11 percentage points of GDP. The introduction of VAT in January 2006 led to more accurate reporting of export values and a frontloading of imports in the second half of 2005. As a result, in 2006 imports were almost flat in nominal terms, while exports grew by around 29%, also helped by favourable export price developments. The favourable trend did not continue into 2007, when imports rose by about 24% year on year in the first six months, widening the trade deficit by 29%.

In 2006, the substantial trade deficit of around 35% of GDP was financed to a large extent by worker remittances in the forms of private current transfers and employee incomes which totalled around 18% of GDP on a net basis. Net FDI inflows covered only about one third of the current account deficit. In the first half of 2007, the privatisation of Telekom Srpske and a pick-up in greenfield investments boosted net FDI inflows to above 8% of the projected GDP. Due to strong capital inflows, the official foreign exchange reserves had increased by 25%, year on year, at the end of August 2007. External public debt further declined to around 21% of GDP at the end of 2006, while total external debt is estimated at around 51% of GDP. In conclusion, despite a temporary improvement in 2006, external imbalances widened again in 2007, but with increased coverage by net FDI inflows.

Employment in the formal sector increased by 1.7% year on year in June 2007. The officially registered unemployment rate increased slightly to 44.2% over the same period. The labour force survey showed a marginal increase in the employment rate to 31.2% in April 2007 from 29.7% a year earlier. While the employment rate increased to around 35% in the Republika Srpska, it remained almost flat in the Federation at about 29%. At the same time, the unemployment rate declined modestly to 29% from 31.1% over the same period and stood at around 25% in the Republika Srpska and 31% in the Federation. The still very high unemployment rate and the sizeable differences between the levels and dynamics of registered and survey-based labour data point to the existence of a fairly large and growing informal labour market and of serious structural rigidities. The reform of personal income taxation in the Republika Srpska helped to reduce the fairly high labour tax wedge. The Federation government took steps to replicate the reform and harmonise direct taxation in the two entities.

Overall, unemployment is very high and job creation is hampered by significant structural rigidities, in particular high taxation of labour, distorted wage-setting mechanisms and low labour mobility. Relatively high and poorly targeted social transfers reduce the incentive actively to seek a job.

The monetary policy of the Central Bank of Bosnia and Herzegovina (CBBH) is conducted under a currency board arrangement with the euro as the anchor currency. The CBBH kept reserve requirements unchanged in 2006 and the first half of 2007. Annual credit growth slowed from 27.3% in 2005 to 23.4% in 2006. It bounced back to around 28.6% at the end of August 2007. The annual growth of broad money accelerated from 18.2% at the end of 2005 to 24.6% at the end of August 2007. Nonetheless, its coverage by foreign exchange reserves was ample at around 87.5% at the end of August 2007. A higher rate of inflation was recorded in 2006 on the back of the introduction of VAT and changes in administered prices. This receded significantly in 2007. The 2006 end-year consumer price index inflation stood at 6.1%. It declined to 0.9% by the end of August 2007. In conclusion, the currency board arrangement continues to underpin macroeconomic stability, despite the relatively rapid growth of domestic credit.

The replacement of sales tax by VAT in 2006 contributed to increasing consolidated government revenue to around 45% of GDP in 2006, greatly influencing the fiscal stance in 2006 and 2007. The increase in revenue by close to 4% of GDP from 2005 to 2006 resulted in increased spending at all levels of government, totalling more than 3% of GDP, and a rise in the budget surplus to 2.9% of GDP. The budget of State institutions increased by about 1.4% of GDP, due to transfers of powers from the Entities, of which 1.2% of GDP was spent on a higher wage bill. The transfer of functions to State level was not accompanied by an equivalent reduction in spending by the Entities, which also increased their expenditure as a

share of GDP. Public spending increased by around 1.6% of the Entity's GDP in the Federation and by 2.9% in the Republika Srpska.

The 2007 budget execution at different levels of government shows continuing increases in public-sector wages, social transfers and welfare spending. In particular, the Law on demobilised soldiers adopted in the Federation added to aggregate social spending. Despite good revenue collection in the first half of 2007, the temporary nature of some of the high VAT revenue recorded in 2006 raises concerns that the large spending commitments in 2007 could result in a deterioration of the fiscal position. Overall, the relative consolidation of public finances in 2006 was accompanied by a slippage of expenditure which weakened the quality of the fiscal adjustment and added to the fiscal risks.

The external public debt of Bosnia and Herzegovina is on a downward trend, from around 26% of GDP at the end of 2005 to 21% at the end of 2006. However, domestic public debt is expected to raise the fiscal burden significantly in the years ahead, due to a large stock of unsettled domestic claims. The two entities further implemented the Law on the settlement of liabilities from frozen foreign currency deposits, which is expected to increase the domestic public debt significantly, in particular in the Federation. Other domestic liabilities relate to the claims for war damages. Finally, the bill on restitution, which has been sent to parliament but not yet adopted, could undermine fiscal sustainability if it fails to align financial compensation with the budget's long-term ability to pay. The Republika Srpska adopted a Debt Law which limits government borrowing by introducing sub-ceilings on the level of debt service relative to current revenue from the preceding year. A similar law is awaiting adoption in the Federation. In conclusion, both entities have made some progress on settling domestic claims, but the final outcome still represents a significant fiscal risk.

The improved macroeconomic policy mix from 2006, reflected in a higher surplus of the public-sector savings/investment balance and a substantial reduction of the current account deficit, was based on one-off factors that would not be repeated in 2007. The most important one was the introduction of VAT which, despite its overall positive impact, also allowed a weakening of the quality of fiscal adjustment by creating room for a large increase in public current spending. At the same time, the reform of direct taxation in the RS as of January 2007 simplified the tax system and reduced the fiscal burden, which could alleviate the distortions of the labour market in particular. In general, one-off factors helped to improve the macroeconomic policy mix in 2006, but the quality of public spending deteriorated.

Interplay of market forces

In 2006 and 2007, the Republika Srpska made further progress on privatisation and, after the sale of Telekom Srpske, around 63% of the initial stock of State-owned capital for privatisation has been sold. In addition, privatisation of the Republika Srpska oil businesses – Oil Refinery Brod, Oil Refinery Modrica and Petrol a.d. Banjaluka – is almost complete. The setting-up of the Investment-Development Bank of Republika Srpska for the purpose of managing the remaining State ownership, completing privatisation and investing privatisation proceeds via various funds, is intended to improve allocation of public resources, but at the same time threatens to crowd out private-sector activities, in particular in the banking sector. Similarly, adoption of the development programme of Republika Srpska – which plans to invest a large share of the funds in industrial activities, corporate restructuring and housing construction – could run counter to the initial objective of divesting State ownership.

In 2006 the private sector's country-wide share in GDP remained around the 55% level recorded in 2005. The main reason for this was the slowdown of the privatisation process, which affected the Federation most. In 2006, the various privatisation agencies in the Federation (Entity and cantonal) sold stakes in 14 companies, with the total capital privatised worth € 86 million and investment commitments of around € 87 million. This equals only about 2% of the total State-owned capital slated for privatisation in 1999, bringing the cumulative percentage of capital privatised so far in the Federation to around 41%, of which only about one quarter was privatised by direct tendering. Cash proceeds from these privatisations in 2006 totalled some € 12 million. In 2007, the Federation Privatisation Agency plans to privatise another 3% of the initial stock of State-owned capital, either by direct tendering or by stock-exchange sales, and to restructure a further 3% of that stock prior to privatisation. However, the process came to a standstill, as tenders for some strategic companies (e.g. Energoinvest and Hidrogradnja) were cancelled and privatisation of Aluminij d.d. Mostar was delayed, diminishing the prospects for faster privatisation in 2007. What is more, the situation in late August was that the privatisation process, except for the ongoing sales, had been put on hold by the Federation cabinet until a general privatisation policy is formulated.

Free market entry and exit

Implementation of a single business registration system started in a limited number of courts in June 2007. It should shorten the procedure for court registration to five days and reduce the number of documents required. Survey data suggest that up to June 2007 no particular progress was made on the procedures for starting a business, obtaining licences or closing a business. However, some progress was made on reducing the number of inspections faced by companies in both the Federation and the Republika Srpska. Furthermore, the RS authorities are close to completing a regulatory impact analysis aimed at reducing red tape, known as the "guillotine process". Bankruptcy procedures have been improved and the number of cases initiated and closed by the courts has gradually increased. Less progress has been achieved on applying bankruptcy procedures to the high number of insolvent publicly owned companies, as suggested by the large and increasing amount of state aid and public-sector subsidies. Major obstacles to business entry persist in areas such as obtaining licences, registering property, enforcing contracts and paying taxes. Overall, company registration and licensing procedures have improved marginally, but significant administrative inefficiencies are continuing to hamper market entry and exit and making it difficult to do business.

The legal system

The judicial system continues to suffer from slow court proceedings, poor case management and a large and growing backlog of unresolved cases. Political interference in the system has occasionally occurred. Overall, these circumstances impair the business environment by undermining effective enforcement of creditor and property rights.

Development of the financial sector

Banks hold a dominant position in the financial sector and their assets grew to around 82% of GDP in 2006, up from 76% in 2005. There were 32 banks operating at the end of 2006 (compared with 55 in 2000), with foreign capital controlling about 83% of the total bank capital. Privatisation of banks was completed in 2006 in the Republika Srpska. In the Federation three banks remain in public hands, all under provisional administration. The five largest banks held around 59% of the total assets of the banking system at the end of 2006,

similar to 2005. This, along with the narrowing of interest spreads, shows that bank consolidation is not hindering market competition.

Non-bank financial sectors recorded sustained growth in 2006. The leasing market grew by around 30% to 2.4% of GDP at the end of the year. The insurance sector is fragmented and obstacles remain for the operation of insurance companies of one Entity in the other one. The sector's assets are estimated at about 3.2% of GDP. Loans in the micro-credit sector totalled 2.5% of GDP. New harmonised Entity-level laws were adopted on micro-credit institutions along with amendments to the laws on banking supervision agencies in order to bring the micro-credit sector under the scope of banking supervision agencies. In 2006, the market capitalisation of the Sarajevo Stock Exchange increased by 76% and ended on almost 95% of GDP in the Federation, while the Banja Luka Stock Exchange increased its capitalisation by 175% to more than 121% of GDP in the Republika Srpska. Overall, at the end of 2006 stock market capitalisation of both exchanges in Bosnia and Herzegovina stood at 108% of the country's total GDP. In conclusion, the financial sector is developing rapidly.

Financial stability indicators point to a strengthening of the banking system in 2006. The ratio of non-performing loans to total loans decreased to 4% at the end of the year. Although marginally lower than a year earlier, the capital adequacy ratio was relatively high on 17.7% at the end of 2006. Over the same period, average return on equity increased by 2.3 percentage points to 8.5%, suggesting improving profitability. A single credit registry was established for legal entities in 2006 and extended to physical entities in early 2007. However, banking supervision is conducted by two separate Entity agencies under the weak coordination of the CBBH and thus remains fragmented. The rapidly growing leasing operations have not yet been included in any supervision framework, although in the Republika Srpska newly adopted legislation brought leasing operations within the scope of banking supervision. Overall, supervision of the financial sector has not been adequately strengthened.

3.2. The capacity to cope with competitive pressure and market forces within the Union

Existence of a functioning market economy

Macroeconomic stability has improved. Economic operators are able to take decisions in a climate of relative stability and predictability, despite risks related to a deterioration of fiscal and external balances. The slowdown of structural reforms, in particular in the Federation, together with the lack of consensus on economic policies and the continuing strong influence of the public sector in the economy, still hinder efficient allocation of resources by market mechanisms.

Human and physical capital

The Higher Education Law has been adopted. A package of other education laws, including one on vocational training, is still awaiting adoption. Efforts have been made to improve the quality of vocational training and to establish a closer link with the needs of the labour market. Despite some improvement, enrolment rates for secondary and higher education and graduation rates remain relatively low. According to the labour force survey, participation in the labour market is still very poor, as indicated by an activity rate of around 44% and an unemployment rate which declined marginally to 29% in April 2007. The authorities are taking a number of active labour market measures to alleviate the current situation, but

without much success. Improved performance on the labour market depends heavily on reducing labour market rigidities and increasing labour mobility. Overall, the reform of the education system has been progressing only slowly and the low education outcomes do not justify the relatively large number of initiatives and public spending in this area. The weak performance of the labour market requires strong structural adjustments.

In 2006, as in the previous year, FDI went predominantly to the financial sector, but the manufacturing sector also attracted about a quarter of the inflows. Investment totalled around 21% of GDP in 2005. FDI inflows into Bosnia and Herzegovina increased moderately, from 5.5% of GDP in 2005 to 5.8% in 2006, bringing the total stock of FDI per capita to a relatively low € 780. However, so far in 2007 FDI inflows have risen sharply, taking the FDI stock per capita to over€1,000 euros. Upgrading of the telecommunications and transport infrastructure has continued, particularly of local road construction. Development of the R&D sector is hindered by obsolete research infrastructure, weak performance of higher education and a massive brain drain of scientists. To conclude, the upgrading of physical capital is progressing, but in a low gear.

Sector and enterprise structure

Legal frameworks that would allow financial restructuring and debt write-offs for State-owned enterprises were put in place in both entities in 2006. In addition, the privatisation legislation was amended in the Federation to allow, *inter alia*, the splitting-up of State-owned enterprises into viable components that would be subsequently sold, although so far it has had no tangible impact on the volume of privatisation. The new legislation on financial restructuring in the Republika Srpska has produced some positive results, facilitating the sale of the oil-refining companies.

In the Federation, the rescheduling and writing-off of state-owned companies' accumulated budget arrears allowed outside the restructuring/privatisation process can have damaging effects on corporate governance in the long run. In addition, the plans to restructure the energy sector by including profitable and non-profitable units in joint entities diminish the long-term viability of the sector. Overall, the restructuring of state-owned enterprises is progressing fairly slowly and is hindered by the vested interests of enterprise managers, trade unions and decision-makers.

The liberalisation of network industries has continued, with mixed results. Some progress has been made with the preparations for opening up the electricity market, but less in the gas sector. Unbundling of distribution and generation in the energy sector is proceeding slowly. Some progress has been made with liberalisation of the telecommunications sector, in particular in the form of privatisation of Telecom Srpske. Structural separation of the railway companies has yet to be completed in the two entities and these companies are still loss-making. To conclude, only limited progress has been achieved on liberalisation of the network industries.

The gradual shift in the sectoral structure of the economy towards services – retail and wholesale trade, financial intermediation and real estate – is continuing. At the same time, the structure of exports and industrial production reveals a shift towards higher value-added goods. This trend is more marked in the Federation and, overall, is proceeding at a slow pace.

The small and medium-sized enterprises (SME) sector is growing, but has to cope with a difficult business environment. Access to longer-term financing and the lack of collateral

remain problematic. Progress has been achieved at Entity level, but there is no consensus on establishing a support framework for SMEs at State level, which would help the country to comply with the European Charter for Small and Medium-Sized Enterprises. The Federation adopted a law to promote the development of SMEs. The Republika Srpska National Assembly approved a strategy for the development of SMEs for 2006-2010. To sum up, some progress has been made at Entity level on setting up structures to support SMEs, although uncoordinated in terms of a country-wide strategy.

State influence on competitiveness

Some progress has been made on enhancing transparency on State aid by compiling a preliminary state aid inventory for 2004-2006. The majority of Bosnia and Herzegovina's support programmes would not qualify as state aid schemes, given that they usually last less than a year or are even adopted on an *ad hoc* basis. The amounts granted are large and increasing and varied, on average, from 1.7% to 4.5% of GDP over the period, depending on the estimation method. A large proportion of the support goes to sectors such as public transport and utilities, agriculture and mining. State intervention in the productive sector remains significant. The Competition Council increased its activity on carrying out investigations and issuing decisions. Sustained efforts are now necessary to achieve more effective anti-trust control.

Economic integration with the EU

Bosnia and Herzegovina is an open economy with total trade equivalent to around 103% of GDP in 2006. This share went down slightly from about 108% of GDP in 2005, mainly due to the frontloading of imports prior to the introduction of VAT. In 2006, the EU continued to be the most important trading partner with shares of around 69.4% of Bosnia and Herzegovina's total exports and of 60.2% of its total imports. FDI inflows from the EU declined temporarily in the first half of 2007, following the large sale of Telecom Srpske to a non-EU company. Overall, integration of trade and investment with the EU remains strong.

The consumer price indexed-based real effective exchange rate calculated in relation to 20 trading partners appreciated by around 4.2%, year on year, by the end of June 2007. In the first six months of 2007 it appreciated moderately (by around 2.1%) compared with the 2003 level. In 2006, the unit labour cost-based real exchange rate against the euro appreciated by around 2%, despite an increase in labour productivity of about 4%. Consequently, price competitiveness was largely preserved.

The per capita income of Bosnia and Herzegovina, measured in purchasing power standards (PPS), was around 29% of the EU-27 average in 2006, slightly up on 2005.

4. EUROPEAN STANDARDS

This section examines Bosnia and Herzegovina's capacity gradually to approximate its legislation and policies to the *acquis* related to the internal market, sectoral policies and justice, freedom and security, in line with a Stabilisation and Association Agreement and the European Partnership priorities. It also analyses Bosnia and Herzegovina's administrative capacity

4.1. Internal market

4.1.1. Free movement of goods

As regards horizontal measures, progress has been made on dismantling Bosnia and Herzegovina's Institute for Standards, Metrology and Intellectual Property and establishing three separate Institutes – one for Standardisation, one for Metrology and one for Intellectual Property – from the beginning of 2007.

Some progress has been made as regards **standardisation**. The Institute for Standardisation has been established and the director has been appointed. The Institute is carrying out standardisation activities based on the principle of voluntary standardisation and is adopting as national standards the standards of the European standardisation organisations CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standardisation) and ETSI (European Telecommunications Standards Institute). So far 7641 European standards (ENs) have been adopted as Bosnia and Herzegovina's standards, a large majority of them by the declaration method. The Institute is an associate member of CENELEC and a partner standardisation body of the CEN. Lack of human resources is undermining the capacity of the Institute for Standardisation to perform its tasks effectively.

As regards **accreditation**, the Institute for Accreditation is working in accordance with the requirements of the EN 45000 and ISO/IEC 17000 series of standards and with the recommendations and guidelines issued by European cooperation for Accreditation, the International Accreditation Forum and International Laboratory Accreditation Cooperation. The Institute has so far accredited 30 conformity assessment bodies. It has 11 permanently employed specialists and around 40 outside experts (assessors and technical experts). Bosnia and Herzegovina needs to establish the conditions for future international recognition of its test and calibration results and certificates. It also needs to prepare the Institute for Accreditation to sign the multilateral agreement with European cooperation for Accreditation.

Little progress has been made as regards **metrology**. The legislation on metrology is not harmonised with the EU requirements, which call for separation between legal, scientific and industrial metrology and harmonisation of the State-level and Entity-level legislation. Bosnia and Herzegovina needs to develop a metrology system in line with the EU Member States' best practices and to develop metrology services of internationally recognised quality within the framework of national metrology infrastructure. In addition, it needs to start to prepare the Bosnia and Herzegovina Institute for Metrology for future full membership of EUROMET (European Collaboration in Measurement Standards), EURACHEM (European Federation of National Associations for Analytical Chemistry), WELMEC (European Cooperation in Legal Metrology), OIML (International Organisation of Legal Metrology) and the Meter Convention.

No significant progress has been made on **conformity assessment** activities. Conformity assessment is not performed on locally manufactured or imported products before they are released onto the market.

Little progress has been made with **market surveillance**. Bosnia and Herzegovina has established the Agency for Market Surveillance which, along with the inspectorates of the Entities and the customs offices, will form the market surveillance system. The Agency is not yet fully operational. The market surveillance system is still largely based on mandatory

standards and pre-market control, which involves certification of products before they are put on the market. Further development of a market surveillance system based on appropriate new and old approach product legislation is needed. The country needs to develop the capacity of its market surveillance system in order to guarantee the safety and compliance of technical products in accordance with EU market surveillance good practice.

Limited progress has been made with technical regulations transposing the **old and new approach directives** into national legislation. The Council of Ministers adopted a Decision on an Action Plan for Implementation of the Programme on the Transposition of Technical Regulations that defines the division of powers between the institutions responsible for transposition and implementation of technical regulations. No technical regulations transposing the Community *acquis* have yet been adopted and no internal consultation and notification mechanisms have been established.

The country lacks many important line ministries at State level and specific areas of technical regulations must be formally assigned to the existing State Ministries in accordance with their general areas of competence. Consequently, the majority of technical regulations are not covered by any government body. The new approach directives covered by the Ministry of Foreign Trade and Economic Relations are an exception. Partly due to the aforementioned deficiencies of the institutional framework, there is no systematic knowledge of specific regulations in force. Most areas of the harmonised EU *acquis* are hardly regulated or have not been implemented at all or else they are regulated at Entity level, often based on diverging provisions, thus creating obstacles to operation of the internal market even within the country. In addition, there is neither an enquiry point with a reliable database on the product legislation in force (mainly laws inherited from the former Yugoslavia) nor applicable conformity assessment systems and infrastructure needed by local manufacturers and potential exporters to Bosnia and Herzegovina.

The Law on Pharmaceuticals and Medical Devices has not yet been adopted. Consequently, no national agency for medicinal products has been established. This continues to undermine the establishment of a real internal market within Bosnia and Herzegovina in this sector.

Some progress has been made in the area of **consumer protection**. The Office of the Ombudsman for Consumer Protection provided for by the Consumer Protection Law has been established. The Section for Consumer Protection, Market Surveillance and Competition at the Ministry of Foreign Trade and Economic Relations has also been set up. Nonetheless, the rights that the legislation confers on consumers are not sufficiently protected in practice. The activities of the State-wide Consumers' Association have remained limited due to lack of resources.

Overall, Bosnia and Herzegovina's preparations in the fields of standardisation, accreditation, conformity assessment, metrology, market surveillance and consumer protection remain at an early stage.

4.1.2. Movement of persons, services and right of establishment

No progress has been made regarding **movement of persons**. The labour legislation remains fragmented and labour mobility limited. There is no uniform social security system and social benefits differ between Entities and even between cantons. This situation undermines the prospects for a coordinated social security mechanism with the EU. Ensuring the portability of pension and health benefits between individual social security systems would facilitate

mobility within the country. No steps have been taken towards granting social security benefits for resident family members of foreign nationals working in Bosnia and Herzegovina. Bosnia and Herzegovina is lagging behind with preparations in the field of movement of persons.

No new developments have been reported in relation to the **right of establishment** for companies. EU companies can establish their operations in Bosnia and Herzegovina with the same rights and obligations as local firms. Nevertheless, local and foreign businesses and self-employed individuals continue to be burdened with excessive administrative procedures for licensing and business permits. A new business registration system, introducing a uniform, simplified and significantly shorter procedure for registering new business has been developed, but is not yet fully operational. Bosnia and Herzegovina is one of the most difficult and costly places for businesses in the region.

Concerning **freedom to provide services**, no progress has been made on drawing a clear distinction between the obligations of foreign operators who provide cross-border services on a temporary basis and of those service providers who are permanently established.

The rapid consolidation of the banking sector has continued. Foreign banks dominate the sector. No progress has been made on establishment of a single State-level supervisory agency for banking. Separate Entity banking legislation still prevails, and banks continue to be licensed and supervised by two separate Entity agencies. The lack of uniform State-level legislation and of a single regulator makes supervision in line with international best practices extremely difficult. The capacity of banking regulators and supervisors needs to be reinforced. As regards international cooperation, a Memorandum of Understanding has been signed with the Montenegro banking supervisor.

Both Entity banking agency laws have been amended to include supervision over micro-credit organisations (MCOs) and savings and loan institutions, the latter for Republika Srpska only. Many MCOs operate across Entity borderlines and are affected by the same split regarding licensing and supervision as banks.

The amendment to the Republika Srpska Banking Agency Law introduced immunity from legal prosecution for the Head and Deputy Head of the Republika Srpska Banking Agency. However, in order to comply with the Basel principles, immunity from prosecution also needs to be extended to the staff. In the Federation, the amendments to the Banking Supervision Agency Law adopted in October 2006 extended immunity to all staff of the Federation Banking Agency.

The Central Bank expanded the Central Registry of Corporate Loans to include consumer loans with effect from January 2007.

As regards insurance, the State Agency's role has remained limited. It includes harmonisation of Entity legislation, international reporting and coordination and arbitration between the Entity supervisory agencies. Licensing and supervision remain under the authority of the Entity agencies. Supervisory enforcement capacity in the insurance sector needs to be upgraded. Secondary legislation necessary to implement the Insurance Acts, including by-laws on the format of insurance companies' financial reports and solvency rates, was adopted in the Federation with the aim of complying with the *acquis*. Republika Srpska has made some progress in adopting secondary legislation, but important by-laws that would enable companies established in the Federation to operate in the Republika Srpska are still missing.

No progress has been made with the adoption of the State-level legislation on leasing and obligations. The Federation approved the transfer of powers over obligations and leasing to the State level, but Republika Srpska continues to be opposed. Republika Srpska has adopted its own leasing law. The Federation has also started preparations in this direction. This undermines the prospect of a real internal market in this field.

The Republika Srpska adopted a new Security Markets Law in 2006, while the Federation failed to follow suit. In general, the Entity securities markets are lacking a coherent legislative and regulatory framework since the Entities' Securities Market Laws are not harmonised. The oversight remains fragmented between the two Entity-level Securities Commissions; in fact, no effort has been made to establish a single securities regulatory body. The institutional setting for coordination of capital markets policies and regulation between the two Entities is not in place.

In the area of **company law**, as regards accounting and auditing, the National Strategy and Action Plan on Accounting and Auditing were adopted in March 2007.

Bosnia and Herzegovina's preparations in the area of services, establishment and company law remain at an early stage.

4.1.3. Free movement of capital

There have been few new developments as regards the **free movement of capital**.

Bosnia and Herzegovina has continued to apply relatively liberal rules on inward capital flows. Certain restrictions remain on outward transfers by individuals and non-residents as well as on the holding of foreign accounts by resident entities. Restrictions on foreign direct investment apply only to the armament and media sectors, where the foreign capital stake is limited to 49%. Transfers and repatriation of profits and remittances plus foreign currency transfers by domestic and foreign companies are liberalised. The State-level Law on Foreign Direct Investment and the Entity-level implementing legislation establish transfer and repatriation rights.

The Federation adopted an amendment to the decision on the general conditions under which resident entities are allowed to hold foreign exchange in bank accounts abroad. This adjusted the provision that permits resident legal entities to open and manage a bank account abroad, if holding a foreign (non-resident) bank account is a precondition for approval of loans. This change will liberalise international financial flows and provide easier access to credit abroad for resident legal entities.

Republika Srpska adopted amendments to the 2003 Law on Foreign Exchange Operations granting all residents the right to hold foreign exchange accounts in foreign banks, provided these are used for ongoing transactions and capital transfers. It also deleted the provision empowering the Republika Srpska government to lay down the conditions under which the foreign exchange market operates. No progress has been made towards adopting a State Framework Law on foreign currency operations.

Bosnia and Herzegovina has a modern **payment system structure**. The Real Time Gross Settlement and Gyro clearing systems comply with the Core Principles for Systemically Important Payment Systems issued by the Bank for International Settlements. The payment system comes under the supervision of the Central Bank. Memoranda of Understanding have

been signed with Montenegro and Serbia to further facilitate international transactions with these countries.

Overall, Bosnia and Herzegovina's preparations in this area are on track.

4.1.4. *Customs and taxation*

Limited progress has been made in the area of customs and taxation.

As far as **customs rules** are concerned, the customs legislation reflects the *acquis* as it stood in September 2003. It needs to be adjusted to subsequent changes. There is room for improvement in implementation of the existing legislation, amongst other things because operational instructions have not yet been adopted on a number of customs procedures. The customs tariff of Bosnia and Herzegovina needs to be aligned with the most recent version of the EU Combined Nomenclature, notably with a view to implementation of the future Stabilisation and Association Agreement (SAA).

Supervision of the five operational free zones in Bosnia and Herzegovina has not improved. There has been no adequate and consistent control on goods entering or leaving the free zones. Imports of equipment for production activities are still exempted from customs duties. This provision is not in line with the *acquis* and needs to be adjusted.

In some cases, Bosnia and Herzegovina has continued to use price lists instead of the transaction value to determine the customs value of imported goods. This method is contrary to the *acquis*, the SAA and the country's own customs legislation. In addition, the customs valuation rules have not been consistently applied throughout the country. New comprehensive, GATT-compliant instructions on valuation addressing this issue were adopted in September 2007.

Bosnia and Herzegovina has not dismantled its customs fees for the processing of customs declarations.

In the area of origin, the Indirect Taxation Authority (ITA) will become, upon the entry into force of CEFTA, the only authority in Bosnia and Herzegovina empowered to request and carry out verification of EUR 1 movement certificates for trade with the EU and CEFTA countries. Centralisation of verification of preferential origin certificates within a single body is necessary for proper implementation of diagonal cumulation in the context of CEFTA and the future SAA.

As regards **administrative and operational capacity**, ITA has made progress in combating fraud and corruption by increasing the level of risk analysis and intelligence work. This has led to some results in terms of detection of smuggled and counterfeit goods. Some 90% of the staff of the law enforcement sector within ITA have received training on anti-smuggling, intelligence and investigation operations. A free line to which citizens can report their complaints has been opened. ITA has taken steps towards the systematisation of its internal organisation. Further efforts to strengthen ITA's administrative capacity are nonetheless necessary, in particular as regards internal audit, risk analysis and intelligence/investigation. Stronger action needs to be taken in the fight against corruption. Communication between the different sectors and field units within ITA needs to be further improved. So far, little exchange of information or feedback to ITA headquarters exists. In addition, working conditions at some of the border crossing points hamper efficient and effective work.

As regards computerisation, Bosnia and Herzegovina has not yet decided which customs declaration processing system it will use in future (Asycuda, currently in use, or Alice).

Regarding **taxation**, progress has been made on VAT collection. Bosnia and Herzegovina's VAT legislation is largely in line with the VAT Directive. Legislative proposals were prepared to introduce a zero rate for certain categories of products. Such rates, if introduced, would not be in line with the Community *acquis*.

The Law on Excises has been implemented. Further amendments are needed to align the legislation with European standards. Bosnia and Herzegovina needs to refrain from introducing excise legislation that would discriminate against imports. This would be contrary to the *acquis*, as well as WTO and CEFTA rules.

Some progress has been made on harmonisation of direct taxation. Republika Srpska and the Brčko District now have similar rates of corporate and personal income tax. The Federation has taken steps towards harmonising direct taxation with Republika Srpska and Brčko. The new legislation in the Federation is expected to enter into force in January 2008.

In the field of business taxation, a gap analysis is being carried out to identify existing measures which could be contrary to the Code of Conduct on business taxation.

As regards administrative capacity, the VAT collection units have been staffed, procedures have been set up, and training has been provided. However, additional training is needed to further enhance tax collection, including training on risk analysis techniques.

The authorities have made no progress on selecting an indirect tax revenue allocation model and disputes over the methods for revenue distribution have continued. The High Representative imposed a decision setting the share of revenue to be distributed to Brčko District. However, this is only an interim solution until an agreement is reached.

Bosnia and Herzegovina's preparations in the fields of customs and taxation are moderately advanced, but only limited progress was made over the reporting period towards addressing the issues identified in last year's report.

4.1.5. *Competition*

Further progress has been made in the area of **anti-trust** control. However, the 2005 Competition Law still requires further alignment with the *acquis*, in particular to ensure that services are covered by the legislation.

The Competition Council adopted two implementing acts – the regulation on the method of notification and criteria for assessing concentration of undertakings as well as the Rulebook for maintaining the Registry of records for concentrations. The competition authorities carried out 62 investigations during the reporting period and issued 48 final decisions, including in the fields of banking mergers and telecom acquisition. The number of decisions taken has significantly increased over the past year. Amendments to the rulebook of the Competition authority increasing the number of employees have been adopted. Sustained efforts are now necessary to ensure that recruitment procedures are successfully completed.

Bosnia and Herzegovina's preparations in the area of anti-trust are moderately advanced.

Initial progress has been made on **state aid**. Data for a preliminary state aid inventory have been collected, although a more comprehensive exercise will be necessary to meet the requirements of the Stabilisation and Association Agreement. The necessary legislation and the establishment of an operationally independent state aid monitoring authority remains outstanding.

Preparations in the field of State aid need to be accelerated.

4.1.6. Public procurement

Some progress has been made in the field of public procurement. Implementation of the existing legislation and development of implementing legislation have continued.

With regard to the institutional set-up, staffing levels in the Public Procurement Agency and in the Procurement Review Body (PRB) have remained unchanged and need to be increased. Newly received complaints are being resolved at a satisfactory pace, in line with the PRB's rules of procedure, but there is still a backlog of cases from 2006, when the PRB lacked a quorum to take decisions.

Standard tender documentation was adopted in May 2007 and has become binding as of July 2007. Further attention to and investment in electronic publication of procurement notices and development of e-procurement is needed.

Obligatory preferential domestic treatment remains in force and is being phased out at a rate of 5% every two years until 2011, when it is due to be abolished. The electricity sector is entirely excluded from this preferential domestic treatment by a decision of the Council of Ministers in November 2006.

There have been attempts to challenge the current legislative framework for public procurement. The calling into question of the State's powers in this area is a bad signal in terms of the commitment to a single public procurement system.

As regards enforcement of the public procurement legislation, there is a strong need to improve the capacity of contracting entities to manage procurement procedures efficiently and to strengthen administrative capacity at all levels of procurement.

Bosnia and Herzegovina's preparations in the field of public procurement are moderately advanced.

4.1.7. Intellectual property law

Little progress has been made with regard to intellectual property rights.

The Institute for Intellectual Property took up its responsibilities on 1 January 2007. The head office of the Institute is located in Mostar, while branch offices have been established in Sarajevo and Banja Luka. The Institute is not fully operational. Lack of resources and serious understaffing undermine the Institute's capacity to perform its tasks effectively and to carry out its whole mandate, for example in relation to copyright and to the auditing of collective management societies.

No progress has taken place concerning industrial property rights. The non-harmonised legal framework and division of powers within the country remain a problem. The lack of a

centralised database makes it impossible to perform a search to avoid conflicts between new signs or commercial names and those already registered.

Enforcement remains weak. Bosnia and Herzegovina is not yet able to implement and enforce its national legislation or international obligations in this field. The authorities have taken some action and achieved some results, but high levels of counterfeiting and piracy nevertheless persist and the country remains a distribution point of such goods to the rest of Europe.

Significant efforts are needed to make the Institute for Intellectual Property fully operational. Similarly, much work needs to be completed, implemented and enforced to bring the national and international legal framework up to European standards.

Bosnia and Herzegovina's preparations in the field of intellectual property law remain at an early stage.

4.1.8. Employment and social policies

Little progress has been made regarding **employment** policies. No State-level Action Plan for Employment has been established.

The labour market situation in Bosnia and Herzegovina remains worrying in the whole country. There is no job creation to absorb the growing labour force. Informality remains high. The employment rate remains at very low levels (29.7%, Labour Force Survey – LFS – 2006). Unemployment already at extremely high level continued to increase. The unemployment rate stood at 31% (LFS based) in 2006. Youth unemployment is over 60% (LFS 2006) and the bulk of unemployed are very long-term unemployed (only 13.4% of unemployed have been unemployed for less than 12 months; half of the unemployed have been unemployed for over 2 years and a fifth for over 5 years).

Bosnia and Herzegovina's labour market is characterised, amongst other, by significant structural rigidities in terms of wage setting mechanisms and high taxation of labour. The complex institutional and administrative structure and the extreme fragmentation of the labour market are also major obstacles for improving its functioning. Substantial and persisting deficiencies in the employment administration, regulative framework and labour market institutions do not allow for a significant and effective development of employment policies. Rationalising and improving capacity of ministries and administration in the field of employment and social affairs need to be addressed as part of the Public Administration Reform.

Active labour market programmes are being implemented, some of which focus on training and improving the skills of job-seekers, but resources are lacking to develop the latter on a wide scale. The development and implementation of these programmes are however fragmentary. Better coordination is necessary to ensure effectiveness and efficient allocation of the programmes' design in a context of scarce resources. No particular action has been taken, for example, to favour employment of women, people with disabilities and minorities. The lack of accurate data and information system is also a major obstacle for further progressing in developing effective approaches towards the unemployed. Reforming unemployment registration is an urgent task in order to streamline support to those in need.

As regards **social policies**, social statistics and analyses that can serve as a sound basis for fostering the development of social inclusion strategies and the evaluation of programmes are scarce and need to be improved. The different social security systems adversely affect workers and citizens in general. Rights to health insurance and other *social protection*, including unemployment benefits, continue to depend on which Entity and to some extent in which canton they live in. However, there is no political consensus on establishing a State-level social policy, with Entities and cantons maintaining their constitutional rights to establish policy and deliver services. The recommendations of the Functional Review on the Refugee Return sector concerning the transformation of the Ministry of Human Rights and Refugees into a ministry with a mandate for social protection have not been implemented.

There is no progress regarding the development of a legal framework for *health and safety at work* or towards a general *anti-discrimination* law. Ethnic discrimination in employment remains an issue.

The *public health* system in Bosnia and Herzegovina consists of 18 public health institutes at Entity, cantonal and regional level. The capacity of these institutes varies but the system falls short to guarantee appropriate health care to citizens - even if it consumes a very significant part of the country's budget. There is a clear need to improve coordination and governance in the sector as a key element in improving equity and equal access to health care services. Collection of statistics and reporting of health-related data to international organisations needs also to improve. Initial steps to address these issues have been taken by the State-level Ministry of Civil Affairs through the establishment of a new Department of Health.

As regards health protection, limited progress has been made as regards establishing the legal framework and administrative capacity that is in line with EU policy. A regular conference of health ministers of Bosnia and Herzegovina, which will act as a permanent advisory and coordinating body in the country, has been established. Further progress is necessary in the implementation of international commitments in health, in particular the WHO Framework Convention on Tobacco Control (FCTC) and the International Health Regulations (IHR).

Overall preparations regarding social policies are lagging behind whilst Bosnia and Herzegovina's preparations as regards employment policies remain at a very early stage and are undermined by extreme fragmentation.

4.1.9. *Education and research*

Some progress has been made in the field of **education**. The framework law on higher education was adopted in July 2007. This law is particularly important in order for Bosnia and Herzegovina to meet the requirements of the Bologna Process and the Lisbon Convention. In the context of European programmes, experts from each university have been nominated for the promotion of the Bologna process and other higher education reforms. The laws on the education agency and on pre-education have also seen considerable progress towards adoption. The law on vocational education remains pending.

However, beyond the legislative level, progress has been limited. The 2003 framework law on primary and secondary education, which mandated the introduction of nine-year primary education in schools, is not yet fully implemented. Proper coordination between the 14 ministries of education is not ensured. Some progress has been made in eliminating divisive and discriminatory symbolism from schools through the implementation of the criteria on school names and symbols, but continued efforts are necessary. Steps have been taken to

provide students with common textbooks in the areas of history and geography. However, the practice of "two schools under one roof" - which separates pupils in schools along ethnic lines - has continued in some areas of the country. This remains a serious concern.

Improving the efficiency of public spending in education is a pressing matter. Education outcomes are low whilst public spending on education is considerable.

Preparations in the area of education have seen some progress, notably through the adoption of the higher education law. Considerable efforts need now to be devoted to adopt the outstanding legislation and to ensure proper law implementation, thus making progress towards implementing the EU's life-long learning objectives. In the field of culture, Bosnia and Herzegovina has not adhered to the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions.

As regards **research**, Bosnia and Herzegovina's science and research potential is in a critical condition. The training of a new generation of researchers is not being undertaken, most of the research infrastructure is obsolete or in the need of repair. Bosnia and Herzegovina has not developed a countrywide research policy framework. Research policy remains designed and implemented at Entity level. Links with industry and universities need to be enhanced. Considerable efforts are needed if the country is to take full advantage of its envisaged participation in the EU 7th Framework Programme for Research and Technological Development.

In the area of research, preparations are at an early stage

4.1.10. WTO issues

Some progress has been made in the negotiations on WTO accession. Internal preparations to become a WTO member are advancing, albeit slowly.

4.2. Sectoral Policies

4.2.1. Industry and SMEs

Limited progress has been made in the area of industry and SMEs.

As regards industry, no countrywide industrial policy strategy has been established. While the privatisation process has accelerated in Republika Srpska, limited progress has been made in the Federation.

Republika Srpska adopted its Securities Law in 2006 and is implementing it. The Federation has not yet adopted the equivalent law. The corporate governance environment remains inconsistent and there has been no progress towards harmonising the Entity regulations. No corporate governance code applicable in the whole country has been developed.

The establishment of the Export Promotion Agency within the Foreign Trade Chamber was formalised by a decision of the Council of Ministers. The Export Promotion Council has also been set up, and has identified policy priorities that need to be tackled. A business plan has been adopted for the Foreign Investment Promotion Agency, along with a strategy to promote foreign direct investment and an operational plan for a new Foreign Investors Support Fund. Nonetheless, the business environment continues to be insufficiently supportive to business and trade development.

Regarding SMEs, the SME Development Agency in Republika Srpska has adopted an SME Strategy for the period 2006-2010. The Federation has adopted a law to promote SMEs, but implementation remains at an early stage. In the municipalities, efforts have been made to respond to the needs of the business communities by establishing business zones, business incubators and business support services. Some positive steps can be observed at regional level where the Regional Development Agencies, Business Support Centres and the Euro-Info Corresponding Centre are functioning successfully. However, the fragmented and non-harmonised legal and institutional framework for SMEs, combined with the lack of a State-level strategy, continue to undermine development of the sector and to hamper Bosnia and Herzegovina's capacity to meet the requirements of the Charter for Small Enterprises.

Preparations in the area of industry and SMEs remain at an early stage.

4.2.2. *Agriculture and fisheries*

In the field of **agriculture and rural development**, some developments have taken place. The Agriculture, Food, Forestry and Rural Development Sector in the Ministry of Foreign Trade and Economic Relations has become operational. The Council of Ministers has adopted a decision related to the creation of a unified administrative farm and clients' register, which will facilitate the application of support programmes in a harmonised way across the country. The State-level law on Agriculture, Food and Rural Development and the State-level law on Wine have been passed by the Council of Ministers. The adoption of these laws would be a major step forward.

Still, no countrywide agricultural strategy has been developed, and the State-level Ministry for Agriculture, Food and Rural Development has not been established either. Entity legal frameworks for agriculture remain not harmonised.

Collection and processing of agricultural data remains weak. The method applied and the accuracy of the data are not in line with EU standards. The level of cooperation between the statistical and agricultural administrations at Entity level remains inadequate. Overall, the lack of reliable and comprehensive statistics is hampering the development of agricultural policy.

The support for agriculture and rural development has increased significantly, in particular in Republika Srpska. Access to credits, advisory services and training for farmers has improved. However, weaknesses remain regarding land ownership, land use, market access and market restructuring. This hampers the productivity and economic potential of the sector.

Little progress has been made on **food safety**. The Food Safety Agency of Bosnia and Herzegovina is in operation, but its human resources remain weak and further staff are needed. Implementation of the 2005 State-level Food Safety Law has not started due to the absence of implementing legislation. The responsibilities within the food safety control chain at Entity and State level need to be clarified in order to ensure proper implementation of the law and to create conditions for the transposition and implementation of the EU rules on food hygiene and official control, including "Hazard Analysis and Critical Control Points" rules. The capacity of the laboratories remains limited.

In the area of **veterinary and phyto-sanitary policies**, the lack of amendments to the State-level Veterinary Law has delayed harmonisation of the veterinary legislation and implementation at Entity level. Coordination between the State Veterinary Office and the Entities' administrations has improved. Common decisions have been taken along with *ad-hoc*

activities on combating outbreaks of animal diseases. However, the State Veterinary Office has not coordinated the Bosnia and Herzegovina veterinary services in a way which ensures adequate control of public health and animal welfare. No mechanism has been established to facilitate cooperation between the different State-level institutions involved in this sector.

Development of an identification and registration system for bovine animals has continued, but there are still major shortcomings in the system. Identification of sheep, goats and pigs is at an early phase. Weaknesses remain as regards enforcement of legislation, laboratory diagnostic capacity, data collection, animal movement system and, in general, the absence of a national infectious disease strategy. A "Residue Monitoring Plan" concerning aquaculture has been approved.

The State Plant Health Administration is not operational. The rulebook on internal organisation was only adopted in September 2007 and the necessary additional staff has not yet been recruited. Implementing legislation in the field of plant health, seeds, seedlings and plant health protection products has not yet been adopted. The deadlock in establishing the State Plant Health Administration has negative implications on facilitation of trade and improved competitiveness for Bosnia and Herzegovina's agricultural products.

Competences between the various administrations involved in implementing veterinary and phyto-sanitary policies are not sufficiently clear and the necessary coordination is not ensured. This impedes the proper functioning of the Border Inspection Posts.

As regards exports of **fishery** products to the EU, Bosnia and Herzegovina is not yet in the list of authorised third countries. Bosnia and Herzegovina's request is under evaluation.

Overall, Bosnia and Herzegovina has made little progress in the area of agriculture and fisheries. Preparations are advancing, but slowly.

4.2.3. *Environment*

Bosnia and Herzegovina has made limited progress in the environment sector. Environmental issues are dealt with primarily at Entity level. At State level, the Ministry of Foreign Trade and Economic Relations (MoFTER) has the authority to deal with some issues concerning natural resources, including environmental protection. The implementation of the environmental legislation by the Entities remains an issue. Communication channels between administrative levels and relevant authorities with regard to the enforcement of legislation are weak.

Some progress has been made as regards **horizontal legislation**. In April 2007 Bosnia and Herzegovina ratified the Kyoto Protocol. In May the Council of Ministers adopted the decision on implementation of the Montreal Protocol regulating issuance of licences, quotas and permits for export and import of substances depleting the ozone layer. Implementation of the existing environmental impact assessment legislation requires further improvement, and shortcomings need to be dealt with. The State needs to be involved in projects of national interest and projects with possible trans-boundary effects. Further efforts are needed towards ratification and implementation of the relevant international conventions, including the Espoo Convention on Environmental Impact Assessment in a Trans-boundary Context.

No developments can be reported with regard to **air quality**.

Regarding **waste management**, there has been limited progress on implementation of the legislation. No progress has been made on legislative support for recycling and recovery of priority waste products which can no longer be disposed of at landfills. However, some positive developments have taken place, for example as regards the recovery and recycling of specific materials such as vehicle accumulators.

Little progress can be reported in relation to **water quality**. Water Information System is under development, with the required software and hardware purchased and with the staff trained. The System needs to be further developed, and data collection and processing improved. Implementation of the Water Laws in the Entities has been delayed until the implementing legislation is in place. Establishment of Water Agencies is a priority in order for management, at river basin level, to take effect. Insufficient waste water treatment remains a key environmental challenge. Bosnia and Herzegovina has not yet ratified the amendments to the Barcelona Convention and its Protocols.

Limited progress has been made in the field of **nature protection** as regards implementation of the Ramsar Convention on Wetlands. The relevant implementing legislation is still missing. No progress has been reported as regards the transposition of certain aspects of the Birds Directive, as required by the Energy Community Treaty.

In the field of **industrial pollution and risk management**, little progress can be reported. Further efforts are required, especially on issuing, monitoring and implementing integrated environmental permits. Channels of communication between competent authorities in this field require urgent improvement.

Little progress has been made regarding **chemicals**. In March 2007, Bosnia and Herzegovina acceded to the Rotterdam Convention on the prior informed consent procedures for certain hazardous chemicals and pesticides in international trade.

No progress can be reported on **genetically modified organisms (GMOs), noise and forestry**.

Bosnia and Herzegovina suffers from limited **administrative capacity** and has scarce financial resources for the necessary environmental investments. The administrative capacity of the Ministry of Foreign Trade and Economic Relations to act as the national authority in this field is undermined by the lack of a legal or institutional framework. Entity Environment Inspectorates are now operational. However, they have limited capacity to effectively control environmental compliance. Implementation of the environmental legislation by the Entities remains a concern. Communication and coordination between administrative bodies with regard to enforcement of the legislation are weak.

No State-level Environment Agency has been established. The State-level legislation on the environment has not been adopted, although it is required in order to create a framework for harmonised nationwide environmental protection and in order to clarify the powers of the administrative levels. With regard to integration of environmental issues into other policies, no developments can be reported.

While there have been improvements in monitoring and collecting raw environmental data, further efforts are required to improve quality of processed data. An environmental monitoring system needs to be implemented. Reporting to the European Environment Agency needs further improvement as it is not yet systematic.

Investment programmes for environmental infrastructure need to be prepared. Some progress has been made with the establishment of the Entity-level environment funds; however, further efforts are required to make them operational.

Overall, Bosnia and Herzegovina's preparations in the field of environment remain at an early stage. Bosnia and Herzegovina needs to substantially enhance the administrative capacity and strengthen the environmental protection institutions, in particular at State level. The establishment of an operational State Environmental Agency, a harmonised legal framework for environmental protection, and a functioning environmental monitoring system would constitute significant steps forward. The number of professional environmental specialists remains low. The country suffers from limited absorption capacity and has very limited financial resources for the necessary environmental investments. Bosnia and Herzegovina also needs to enhance its efforts with regards to obligations under international conventions.

4.2.4. *Transport policy*

Bosnia and Herzegovina has made some progress in the transport sector.

Good progress has been made in the development of the **trans-European network of transports**. Bosnia and Herzegovina has continued to participate in the development of the Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO) and has approved the Second Rolling Five Year Multi-Annual Plan 2007-2011 (MAP). The implementation of the priority projects, the coordination of investments and the annual revisions of the MAP require continued cooperation in the framework of SEETO.

Some progress can be recorded in the **road sector**. Legislation on traffic regulation and licensing of vehicles and drivers is covered by the Law on Road Traffic Safety, which is considered to be compliant with the corresponding *acquis*. Progress has been made on road maintenance, resulting in some degree of improvement in capacity and safety. In the framework of the Stabilisation and Association Agreement (SAA), Bosnia and Herzegovina has undertaken to ensure unrestricted Community transit traffic through its territory as of the entering into force of the Interim Agreement. However, limited additional progress can be reported in the process of approximation of legislation. Preparations in this sector need to be accelerated.

In the **railway sector**, some progress has been made with the implementation of the State-level Law on Railways. The Railway Regulatory Body, which also acts as the National Safety Authority, has come into operation and staff selection is ongoing. Separation of the railway undertaking and infrastructure management functions has progressed, but remains to be completed. The Federation has agreed to the establishment of a single infrastructure manager, while the Republika Srpska government still insists on having a separate infrastructure manager. The Entity Railway Laws are not in line with the *acquis*. Efforts to improve the quality of the railway service have continued with the purchase of new equipment. The key remaining issues for implementation of the Railway Law are the appointment of the infrastructure manager and implementation of the EU safety directives. Preparations in this sector are advancing at a slow pace.

As regards **air transport**, some progress has been made. In September 2007, Bosnia and Herzegovina ratified the European Common Aviation Area (ECAA) Agreement. It now needs to apply it, including market access rules. Some progress can also be reported as regards the implementation of the first transitional phase aviation *acquis* under the ECAA. However,

significant parts remain to be implemented notably in the fields of aviation safety, security and air traffic management. EUFOR has transferred responsibility for air traffic control in the lower airspace to the civil aviation authorities. The European Bank for Reconstruction and Development (EBRD) has approved a loan to Bosnia and Herzegovina for implementation of the air traffic management strategy adopted by the State, which will enable the country to take over full responsibility for air traffic control in the middle and upper airspace as well. However major steps are still required. Changes to the civil aviation administration and completion of separation of the regulatory and operational functions in accordance with the *acquis* are pending. The country has yet to establish its civil aviation authority and air navigation services provider. Preparations in this field have started.

Some progress has been made as regards **inland waterways** and **maritime transport**. The Federation of Bosnia and Herzegovina has adopted a Law on Water Transport, covering both means of transport. Preparations for the rehabilitation and development of the Sava River waterway are on-going and the pre-feasibility study was completed in May 2007. The Sava Commission Experts Group is carrying out activities in regard to harmonisation of rules and regulation for navigation and transport/traffic safety and marking the navigation route on the Sava River. However, Bosnia and Herzegovina is not a party to the SOLAS Convention (International Convention for the Safety of Life at Sea) or to the ISPS Code (International Ship and Port Facility Security Code). Preparations in these fields remain limited.

Overall, Bosnia and Herzegovina has made some progress in the field of transport. Sustained efforts remain necessary, particularly as regards legislative alignment and the development of the administrative capacity to ensure proper implementation.

4.2.5. *Energy*

Limited progress has been made in the field of energy. The Energy Department in the Ministry of Foreign Trade and Economic Relations is operational and a Head of Department has been appointed. Staffing is to be completed and overall capacity remains low.

There have been no developments as regards **oil stocks and security of supply**. In February 2007 Republika Srpska privatised its main oil refinery. The sale should bring significant benefits to Bosnia and Herzegovina, and specifically to the Republika Srpska economy, and will reduce import dependence. The Russian buyer will be allowed to produce fuel of a quality below EU standards and to distribute it throughout the country for a transition period of forty-two months. In the meantime, the facilities will have to be modernised to produce fuels of the required quality.

Bosnia and Herzegovina is a full member of the Energy Community Treaty. As of 1 July 2007, the country is bound to apply the relevant energy *acquis*, except for the provisions on market opening to which a specific timetable applies. This deadline has not been met. While there has been good progress on the roadmap for electricity, particularly in technical rules and monitoring of supply, no progress can be reported on the roadmap for the gas sector. A country-wide legal framework for the gas sector is not yet in place. The system operator and regulator have not been established. Preparations in this area are lagging behind.

Regarding the **internal energy market**, the independent system operator (ISO) and the transmission company (Transco) for the electricity sector have been established. Transco has completed formation and can now operate in full compliance with the legal framework. However, cooperation between Transco and ISO remains insufficient, and the transfer of

liabilities remains to be completed. ISO issued a first indicative generation plan for 2007-2016. This plan is being updated for the period 2008-2017. However, there is no coordination between the Entities as regards investment planning. The limited quality of the data and insufficient information from the relevant Entity ministries have undermined the preparation of a definitive generation plan. Transco's investment planning for development of the transmission network depends on this definitive plan.

Some progress has been made as regards the opening of the electricity market, which started at the beginning of 2007 for major industrial consumers. Further opening is expected in 2008.

Regarding regulation of the electricity market, the State Electricity Regulatory Commission and the two Entity regulators are operational. They have adopted new sets of tariffs for the current year, as well as key rulebooks on market opening and connection to the grid. However, no progress has been made towards establishing a single regulatory system. Furthermore, there have been some attempts by the authorities to influence the regulators, notably in relation to tariff-setting.

Limited progress has been made on implementing the Entities' Action Plans for restructuring the power sector. One immediate priority is to speed up the unbundling of electricity generation and distribution in both Entities. Adoption of the Distribution Grid Codes is under way although the distribution system operators have not yet been established. Privatisation is not being considered by these plans

Bosnia and Herzegovina has not developed a comprehensive energy strategy yet. Little progress has been achieved in other energy sectors (coal, oil, biofuels, district heating and **renewable energy**) or on **energy efficiency** and sustainability measures.

As regards **nuclear safety and radiation protection**, a State-level framework law has been prepared and is in the final phase for adoption. The law provides for the establishment of a state regulatory agency for nuclear safety and radiation protection, which should facilitate the accession of Bosnia and Herzegovina to several international conventions dealing with nuclear safety and radioactive waste management. At present the situation in the field of nuclear safety and radiation protection requires significant improvement in terms of coordination and organisation of the activities at the level of Bosnia and Herzegovina, equipment, modernisation of facilities, technical capacity and human resources. The storage facility for sealed radioactive sources is not licensed according to international standards and practices. Particular attention needs to be paid to the monitoring of areas contaminated with depleted uranium.

Overall, Bosnia and Herzegovina has started preparations in the field of energy. They need to be accelerated, in particular to meet the requirements of the Energy Community Treaty.

4.2.6. Information society and media

Bosnia and Herzegovina has made some progress in this area.

As regards **electronic communications and information technologies**, a majority share in the Republika Srpska telecoms provider was sold to Telecom Srbija at the end of 2006. The telecommunications sector policy was updated in November 2006 until the end of 2007. The liberalisation process has continued, albeit slowly. Competition remains in its very early stages and not all competitive safeguards have been introduced. Since the beginning of 2006

twelve licences have been issued to new providers of fixed public telephony services but only a few of the newly licensed operators have so far completed the administrative and technical procedures. Carrier selection has been introduced, although it is only available from two providers. Carrier pre-selection was introduced in July 2007, but the implementation specifics still need to be agreed. Number portability and local loop unbundling (LLU), important also for the roll out of ADSL by alternative operators, have not yet been introduced. Tariffs are far from rebalanced - with the last step of the first phase of rebalancing being introduced on 1 January 2008. Alternative operators have reported issues of price squeeze which need to be addressed.

Market liberalisation and the introduction of competition represent new challenges for the Communications Regulatory Authority (RAK), especially taking into account the specificity of Bosnia and Herzegovina's market, with three incumbent operators. The RAK needs to be better equipped in terms of human resources to be able to promote competition in the market, in particular by improving the market conditions for alternative operators and by ensuring the introduction and implementation of the necessary competitive safeguards. The capacity of the relevant sections in the Ministry of Transport and Communications also need to be strengthened.

The independent status of the RAK is well established, in particular the legal arrangements regarding their financial independence and the appointment of its Director General. The possible adoption of the draft Law on Wages and Allowances, which would bring the RAK within the civil service, could hinder RAK's independence. Ensuring the independence of the Agency (including maintaining their financial independence and the respect of the procedures in the appointment of the Director General) is of crucial importance to the development of the broadcasting and (tele)communications market.

No progress has been made to transform the Citizens Identity Protection System Directorate into a State-level Agency for Information Society in charge of implementing the Strategy for Information Society and its Action Plan, as well as of coordinating related activities throughout the country.

Progress has been made regarding **information society services**. Bosnia and Herzegovina has ratified the Council of Europe Convention on Cybercrime. Legislation on electronic commerce has also been passed. The e-signature law was adopted in November 2006 but the implementing by-laws still need to be adopted. Legislation for conditional access services has not yet been adopted.

Some progress has been made as regards **audiovisual policy and media**, in particular in approximating Bosnia and Herzegovina's legislation to the European Convention on Trans-frontier Television. The Advertising and Sponsorship Code has been revised in accordance with the Convention. The RAK has also started the revision of the Broadcasting Code of Practice. However, the Federation of Bosnia and Herzegovina has been unable to adopt the necessary public broadcasting legislation and the implementation public broadcasting reform continues to be delayed.

Bosnia and Herzegovina is not a party to the UNESCO Convention on Cultural Diversity. Ratifying this Convention is necessary for Bosnia and Herzegovina's participation in media-related Community Programmes.

Bosnia and Herzegovina's preparations in the field of information society and media are advancing, but particular efforts are necessary to tackle the outstanding issues of the adoption of a complete legal framework in the area of public broadcasting and the establishment of a State-level agency for Information Society. Real competition in the telecommunications sector needs to be achieved. The independence of the RAK needs to be preserved.

4.2.7. Financial control

Some initial steps have taken place in Bosnia and Herzegovina in the area of public internal financial control (PIFC). In November 2006, a working group at State and Entity level prepared Internal Audit Laws for all government levels, but the adoption of all the relevant laws has not yet been completed. In August, another working group was established to develop an overall comprehensive PIFC policy guaranteeing a balanced development of internal control and internal audit systems. So far, no Central Harmonisation Units has been established.

Limited progress can be reported regarding external audit. After new external audit legislation was adopted in 2006, the supreme audit institutions (SAIs) of Republika Srpska and of the Federation of Bosnia and Herzegovina have appointed new managements. At State level, appointment of the Auditor-General and Deputy Auditor-Generals has been due for over a year.

The SAIs report to the relevant parliaments. While the reports of the SAIs are widely available, there has been insufficient follow-up to the reports and to the SAIs' recommendations. No progress has been made to formalise coordination between the SAIs by establishing a permanent secretariat. In addition to the three existing SAIs, Brčko District has established its own SAI based on its own Audit Law, which is further fragmenting the system.

Overall, Bosnia and Herzegovina's progress in the area of financial control has been limited and preparations remain at an early stage.

4.2.8. Statistics

Cooperation between the Bosnia and Herzegovina Agency for Statistics (BHAS) and the two Entity statistical institutes has not improved. The 2005 Agreement, designed to strengthen the coordinating role of BHAS in harmonising methodologies and disseminating State-level data, has not been fully implemented. A Memorandum of Understanding has been signed between the Central Bank of Bosnia and Herzegovina and BHAS. A similar agreement is being prepared with the Indirect Taxation Authority in charge of collecting external trade data from the customs authorities.

Concerning classifications, legal acts have been adopted for the CPA (Classification of Products by Activity). Preparations are being made for the introduction of COICOP (Classification of Industrial Consumption by Purpose). The next steps will be to transpose the State laws into Entity laws and to implement the classifications as prescribed by the State-level agency in the various areas of statistics.

In the area of demographic and social statistics, initial steps have been taken to prepare a population census. Preparation for a population census in 2011 needs to continue as the lack of data is a serious handicap for policy design and implementation in the country. Regarding labour statistics, a second Labour Force Survey was organised.

Some progress has been achieved on compiling macro-economic statistics. The 2006 Consumer Price Index has been published. However, there is still no calculation of GDP at constant prices and preliminary estimates for the non-observed economy have been introduced in the national accounts. The plan for development of the national accounts in Bosnia and Herzegovina has been implemented as far as the reporting period is concerned. Quarterly accounts do not yet exist.

Structural Business Statistics are still not based on business registers. Almost no information is available at State level on transport and tourism. The same applies to energy statistics. The accuracy of external trade statistics is not sufficient even though some improvements such as the introduction of import and export price indices are being made.

There has been limited progress on agriculture statistics. Most data concerning agriculture are collected using non-harmonised methods, in particular for animal and meat production. There is no recent information on the structure of the agriculture sector. Work has started on the collection of agro-monetary statistics.

The number of staff of the BHAS has been increased. Additional financial and human resources have also been allocated to the Entity institutes. Better human resource management, including improved training, is nevertheless required.

The statistical system in Bosnia and Herzegovina remains weak and does not fully meet national and international requirements. Problems with production of statistics are amplified by the complicated institutional set-up and poor cooperation between Entity and State-level institutions. Priority has to be given to statistics on external trade, national accounts and business. Greater efforts have to be made on dissemination of statistics. Better and institutionalised coordination is required between the three statistics institutes, combined with better cooperation with other producers of statistics.

Bosnia and Herzegovina's preparations in the field of statistics remain at the initial stage.

4.3. Justice, freedom and security

4.3.1. Visa, border, control, asylum and migration

Progress in the area of **visa** management has continued. Bosnia and Herzegovina has been preparing for the entry into force of an EU-level visa facilitation agreement which was signed in September. Bosnia and Herzegovina has lifted its visa requirements for Bulgaria and Romania. All EU citizens can now enter the country without visas. The number of visas issued at the border has been reduced further (927 in 2006 against 2,049 in 2005). Efforts have been made to prepare for the transition to the four categories of visa used by the EU in the Schengen context.

Further steps have been taken towards introduction of biometric passports, which is due in 2008. In July 2007, the High Representative imposed changes to the Law on travel documents of Bosnia and Herzegovina and the Law on identity cards of citizens of Bosnia and Herzegovina, which made it possible to seize travel documents.

All data entered into local systems in diplomatic missions and consular offices are now transferred electronically to the central administration in Bosnia and Herzegovina. The migration information system came into operation in September 2007. Its visa module is

working and the diplomatic missions abroad are connected. Nonetheless, there is still room for improvement of management of visas.

The country's preparations in the field of visas are on track, even though no action has been taken on harmonisation of Bosnia and Herzegovina's visa lists with the EU list.

Bosnia and Herzegovina has made some progress on **border management**. Efforts to reinforce the border police of Bosnia and Herzegovina have continued. The internal structures of the border police have been further developed, which has improved the operational capacity for surveillance and control of the State borders. Inter-agency coordination and exchanges of information have been enhanced. Closer cooperation between the border police and the Indirect Taxation Authority has led to an increase in detection of smuggled and forged goods.

Still, there is a lack of mature coordination structures and limited administrative capacity. There has been limited progress on implementation of the integrated border management (IBM) strategy. A revised strategy - fully complying with EU guidelines - and the corresponding action plan have not yet been adopted. The Ministry of Security does not yet play a central role as overall coordinator for IBM issues. Cooperation with neighbouring countries is taking place, but not yet in any sustained and structured way. Unresolved border demarcation issues are adversely affecting control of the green border. Several international and regional obligations in the field of border management have not yet been met. Budgetary resources for implementation of the IBM strategy/action plan have not yet been fully secured.

In 2007, Bosnia and Herzegovina concluded an international border cooperation agreement with Croatia. However, implementation is lagging behind due to limited capacity.

Further improvements have been made to border crossing points, but many still remain poorly equipped. Limited political attention and incomplete land expropriation remain obstacles to sustained progress in this area.

Overall, Bosnia and Herzegovina has partially met some of its objectives in relation to border management, but many more measures need to be taken in the short and medium term.

Asylum procedures in Bosnia and Herzegovina are generally in line with international standards. The number of asylum applications remains low and has even dropped substantially compared with 2005. The asylum sector is taking timely decisions, and the State court is working efficiently as the appeal body. The average time for a final decision is four months.

The administrative capacity of the asylum sector has improved. Nearly two thirds of the 24 posts provided for in the Ministry of Security's rules of procedure have been filled. The country of origin information system is in place, which makes it possible to determine eligibility and status. The sector has moved to new premises, helping to improve the conditions for proper registration and eligibility assessment.

Responsibilities for asylum-seekers and refugees are divided between the Ministry of Security and the Ministry for Human Rights and Refugees (MHRR). Action has been taken to clarify their roles and responsibilities. However, the MHRR has not yet improved its capacity or developed an information system for managing evidence on people with recognised refugee status or other forms of international protection.

Bosnia and Herzegovina lacks an appropriate asylum reception centre. It has not yet assumed full control of the existing ones, which are still funded by the UNHCR. These centres lack the capacity and standards required to serve as long-term official asylum centres.

Bosnia and Herzegovina's efforts in the field of asylum are largely on track.

Some progress has been made as regards **migration**, but further efforts are needed. The secure reception centre set up for irregular migrants is a positive step. Construction of a temporary centre is in its final phase. The preliminary project for a permanent centre has been finalised. Staff for the temporary centre have been recruited and trained.

As far as readmission is concerned, Bosnia and Herzegovina signed an EU-level readmission agreement in September 2007, which should enter into force at the beginning of 2008. It has continued its efforts to establish readmission agreements with non-EU countries. No particular problems have been identified with implementation of the existing readmission agreements, but particular attention should be paid to the treatment given to non-EU nationals. Bosnia and Herzegovina has been willing to readmit its own nationals, even when no readmission agreement is in force.

There has been a notable increase in interceptions during attempts to cross the border irregularly. In 2006, a total of 1,289 persons were intercepted when trying to enter or leave the territory of Bosnia and Herzegovina (in 2005, 655). In 2006, foreign nationals were relocated from Bosnia and Herzegovina, mostly from the former Yugoslavia and Albania. At the same time, 1,350 citizens were readmitted from abroad. However, there is still considerable room for improvement in the area of border control in order to fight illegal migration.

Since 1999, Bosnia and Herzegovina has been granting temporary admission status to persons from Serbia and Montenegro, whose last place of residence was Kosovo. This status was withdrawn at the end of September 2007 when around 3,000 refugees originating from Kosovo lost their right to temporary refuge. A number of them have been granted refugee status or have submitted asylum applications in the meantime.

New structures have been introduced to handle migration issues. These include a Service for Foreigners' Affairs, which was established in October 2006 as a specialised body under the State-level Ministry of Security. This service has 16 field offices dealing with in-country asylum applications and immigration matters. However, operation of the service is undermined by the failure fully to meet its staffing requirements and its insufficient legal basis and powers.

No State-level migration strategy has been adopted so far. Staffing of the migration sector of the Ministry of Security remains low, with around 50% of the planned staff. A new Law on movement and stay of aliens and asylum-seekers has been prepared, but has not yet been adopted.

Overall, preparations in the area of migration have been launched, but the pace needs to be accelerated.

4.3.2. *Money laundering*

Some further progress has been made with implementation of anti-money laundering measures. The Financial Intelligence Unit (FIU) in the State Investigation and Protection Agency (SIPA) has continued to increase its staff and has increased its capacity. In addition, a

training strategy has been developed and a memorandum of understanding has been signed with Spain. The number of transactions reported by banks and other institutions in accordance with the FIU reporting requirements increased in 2006 compared with 2005. During 2006, the FIU reported to the Prosecutor's Office of Bosnia and Herzegovina 23 money laundering cases involving approximately € 26 million and 40 persons. The FIU froze 23 transactions adding up to some € 1.2 million.

Efforts need to continue. Since money-laundering is regulated by the Entities' criminal codes, criminal sanctions for money laundering are not applied in the same way throughout Bosnia and Herzegovina. The Law on the confiscation of illegally acquired property has not been adopted. This is hampering enforcement of anti-money laundering measures. As regards preventive measures, supervision of non-banking financial institutions and intermediaries remains limited. Information-sharing and inter-institutional cooperation between the FIU and other law enforcement agencies, including the criminal investigation department of SIPA, need to be improved.

Bosnia and Herzegovina is advancing in the fight against money laundering. Sustained efforts remain necessary, however.

4.3.3. *Drugs*

Bosnia and Herzegovina remains primarily a transit country for drug trafficking, with increasing local consumption.

Some progress has been made in this area. The gradual recruitment of staff for the department for the suppression of the abuse of narcotic drugs in the Ministry of Security is a positive development. Law enforcement has improved. Seizures and dismantling of clandestine chemical laboratories have increased, but remain low in absolute terms. International cooperation has also increased and a number of operations have been successfully concluded. A central database of cases of illegal use of drugs and precursors has been established in the Ministry of Security.

Nonetheless, further action remains necessary. The commission on narcotic drugs provided for in the Law on the prevention of narcotics and precursor abuse has not yet been established. There is no national focal point for the European information network on drugs and drug addiction run by the European Monitoring Centre for Drugs and Drug Addiction. No State-level drugs policy in line with EU standards has been developed.

As regards enforcement, results against drug trafficking are not yet sufficiently convincing. Bosnia and Herzegovina's law enforcement bodies are not adequately equipped to fight trafficking in drugs and inter-agency and international cooperation needs to be enhanced. In this context, continued reinforcement of the State Investigation and Protection Agency, the border police, the customs administration and the Ministry of Security is crucial.

No significant steps have been taken to raise public awareness of the dangers of drugs.

Bosnia and Herzegovina has initiated preparations in the field of drugs, but drug trafficking remains a serious concern. Sustained efforts are required.

4.3.4. *Police*

Some progress has been made with regard to the operations of the police. However, no progress has been made regarding the overall police restructuring, aiming at unifying the police forces under a single State police structure. As a result, the country's police remains fragmented.

The Police Restructuring Directorate, which came into operation in January 2006, completed its report on the police reform in December 2006. The relevant authorities and the political parties have failed to reach agreement on the Police Restructuring Directorate's approach and further efforts by the international community to facilitate an agreement on the police reform have equally been blocked. Lack of progress in this area is seriously undermining Bosnia and Herzegovina's progress towards the EU.

Implementation of many operational tools has continued (including the telecommunications system, databases, computer-based investigation, criminal analysis systems and forensics). The tools are actively used countrywide. Nonetheless, the way they operate is not optimal in the current organisational set-up. Sustainability will be guaranteed only if the overall police reform is accepted and progressively implemented.

The question of decertified police officers was resolved in April 2007. The UN Security Council allows decertified police officers to re-apply for jobs with the police forces, provided they meet certain conditions, including specific recruitment requirements and procedures set out in the Law on police officials of Bosnia and Herzegovina.

The Ministry of Security has concluded a strategic agreement with Europol to improve and strengthen the means to fight organised crime and terrorism. International agreements on police cooperation have been concluded with several countries, along with an agreement between the Indirect Taxation Agency and Interpol. The country also ratified the Police Convention for South-East Europe in April 2007. However, the liaison office required by the agreement with Europol has not yet been established.

The State Investigation and Protection Agency (SIPA) has made further progress. It has become increasingly involved in sensitive investigations, including coordinating cantonal and Entity police services in this area. However, further efforts are necessary to make this agency fully operational, including allocation of adequate premises, appointment of its director – the post has been vacant since January 2007 – and completion of recruitment of SIPA's staff.

The Entity and cantonal police in particular remain beset with problems. Political interference by Entity and cantonal politicians remains a serious problem, for instance in operational matters and appointments of police officials at managerial level. Petty and serious corruption within the police remains widespread. The fragmentation into many different police administrations has a negative impact on their effectiveness and hinders public confidence in the police. There is considerable room for improvement in investigation of organised crime.

In the area of police, Bosnia and Herzegovina's preparations remain severely undermined by the deadlock in the restructuring process.

4.3.5. *Fighting organised crime and terrorism*

Organised crime remains a cause for serious concern in Bosnia and Herzegovina. Organised crime-related activities still consist mainly of drug trafficking, trafficking in human beings

and financial crime. Vehicle theft and subsequent trafficking is a growing problem. Little progress has been made on improving the national statistical instruments for measuring crime rates, which remain basic.

Out of the action plans provided for by the national strategy to combat organised crime and corruption, only the one on stolen vehicles has been drafted. The criminal procedure based on the accusatorial system shows limitations in a country with different legal traditions. Cooperation between the police and prosecutors is not optimal and this is hampering progress on investigations. The judicial system has not yet adapted to the newly introduced methods of collecting evidence. Inconsistencies between legislation at State and Entity level continue to undermine effective prosecution.

Bosnia and Herzegovina remains a country both of origin and of transit as regards **trafficking in human beings**. Implementation of the 2005-2007 national action plan for combating trafficking in human beings has continued, but no new action plan for the period 2008-2010 has been adopted. Monitoring and reporting on this issue has improved.

According to the data provided by law enforcement agencies and prosecutor's offices for 2006, 34 reports on trafficking in human beings and related crimes were filed against 77 individuals. In two cases a report was filed under Article 250 of the Criminal Code of Bosnia and Herzegovina (organised crime) in connection with trafficking in human beings. The number of investigations increased compared with 2005 and 33 indictments were confirmed by the courts. The courts issued first-instance decisions concerning 30 individuals, 23 of whom were convicted.

As for protection of victims and victim-witnesses of trafficking in human beings, the total number of victims identified, including victims with citizenship of Bosnia and Herzegovina, increased. In 2006, 71 victims were officially identified. Rules have been adopted to protect local victims and victim-witnesses of human trafficking who are citizens of Bosnia and Herzegovina. In April 2007, the Department for Protection of Witnesses in the State Investigation and Protection Agency established cooperation with NGOs managing safe houses, thus allowing more efficient use of resources and available capacity.

Bosnia and Herzegovina has signed the Council of Europe Convention on Action against Trafficking in Human Beings and now needs to ratify it.

Bosnia and Herzegovina has continued to show willingness to address the issue of **terrorism**. International cooperation has continued and a number of cases relating to international terrorism have been processed. There has been some progress on increasing the operational capacity to combat terrorism and financing of terrorism. The State court gave a verdict in its first State-level terrorism trial in May 2007. However, there is still limited coordination between the authorities involved. The mandated law enforcement agency (SIPA) has not been reinforced to tackle terrorism-related issues and most investigations are carried out by the Entity police. Implementation of the 2006 anti-terrorism strategy has been weak. Bosnia and Herzegovina's law enforcement bodies have proposed action plans for implementation of the strategy, but these have not yet been adopted.

Bosnia and Herzegovina has started to fight organised crime, trafficking in human beings and terrorism, but sustained efforts over the long term remain necessary.

4.3.6. *Protection of personal data*

No progress has been made in this area. The independent data protection agency for Bosnia and Herzegovina provided for by the Law on the protection of personal data is not yet in place. This situation means that proper implementation of data protection rules is not ensured. Bosnia and Herzegovina's preparations in the field of data protection are lagging behind.

STATISTICAL ANNEX

STATISTICAL DATA (as of 5 October 2007) Bosnia and Herzegovina

Basic data	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Population (thousand)	1)	3 692	3 696	3 689	3 753	3 790	3 813	3 830	3 837	3 843	3 843
Total area of the country (km ²)		51 209	51 209	51 209	51 209	51 209	51 209	51 209	51 209	51 209	51 209

National accounts	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross domestic product (GDP) (million national currency)	2)	:	:	:	10 713	11 599	12 829	14 505	15 786	16 928	19 106
GDP (million euro)		:	:	:	5 477	5 930	6 559	7 416	8 071	8 655	9 769
GDP (euro per capita)		:	:	:	1 459	1 565	1 720	1 936	2 103	2 249	2 542
GDP (in Purchasing Power Standards (PPS) per capita)		:	:	:	:	:	:	:	:	:	:
SI: GDP (in PPS per capita, EU-25=100)		:	:	:	:	:	:	:	:	:	:
SI: Growth rate of GDP (national currency, at constant prices, % change on previous year)		:	:	:	:	:	:	:	6.3	4.3	6.2
SI: Employment growth (national accounts, % change on previous year)		:	:	:	:	:	:	:	:	:	:
Labour productivity growth: GDP growth per person employed (% change on previous year)		:	:	:	:	:	:	:	:	:	:
SI: Unit labour cost growth (national accounts, % change on previous year)		:	:	:	:	:	:	:	:	:	:
SI: Labour productivity (GDP in PPS per person employed, EU-25=100)		:	:	:	:	:	:	:	:	:	:
Gross value added by main sectors (%)											
Agriculture		:	:	:	11.8	11.5	10.8	9.7	10.5	10.3	10.1
Industry		:	:	:	20.3	20.0	18.7	19.2	19.4	19.3	19.1
Construction		:	:	:	5.2	4.7	4.6	5.2	4.9	5.0	4.8
Services		:	:	:	62.8	63.8	65.9	65.9	65.2	65.4	66.0
Final consumption expenditure, as a share of GDP (%)		:	:	:	:	:	:	:	112.0	111.9	:
Households and NPISH, as a share of GDP (%)		:	:	:	:	:	:	:	90.8e	91.8e	:
General government, as a share of GDP (%)		:	:	:	:	:	:	:	21.2e	20.1e	:
Gross fixed capital formation, as a share of GDP (%)		:	:	:	:	:	:	:	24.3	26.9	:
Changes in inventories, as a share of GDP (%)		:	:	:	:	:	:	:	2.9	0.1	:
Exports of goods and services, relative to GDP (%)		:	:	:	:	:	:	:	27.8e	30.7e	:
Imports of goods and services, relative to GDP (%)		:	:	:	:	:	:	:	66.9e	69.6e	:

Industry	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Industrial production volume index (2000=100)	3)	:	:	:	100.0	105.3e	112.4e	118.0e	132.8e	144.7e	159.3e

Inflation rate	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Consumer price index (CPI), (total, % change on previous year)		:	:	:	4.8	3.1	0.4	0.6	0.4	3.7	7.4

Balance of payments	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance of payments: current account total (million euro)		:	- 311	- 471	- 429	- 834	-1 253	-1 439	-1 443	-1 716	-1 044
Balance of payments current account: trade balance (million euro)		:	-2 803	-3 095	-3 000	-3 308	-3 524	-3 671	-3 678	-4 006	-3 406
Balance of payments current account: exports of goods (million euro)		:	597	781	1 226	1 268	1 169	1 303	1 677	2 087	2 687
Balance of payments current account: imports of goods (million euro)		:	3 400	3 875	4 227	4 577	4 692	4 974	5 355	6 093	6 093
Balance of payments current account: net services (million euro)		:	171	168	203	254	232	297	347	396	485

Balance of payments current account: net income (million euro)		:	728	683	641	595	539	473	389	364	369
Balance of payments current account: net current transfers (million euro)		:	1 594	1 773	1 727	1 626	1 499	1 462	1 499	1 529	1 508
of which government transfers (million euro)		:	393	458	339	450	347	298	261	249	149
Foreign Direct Investment (FDI) in the reporting economy (million euro)		:	60	166	159	133	282	338	534	421	338

Public finance	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General government deficit/surplus, relative to GDP (%)		:	:	:	:	:	:	0.7	1.6	2.4	2.9
SI: General government debt, relative to GDP (%)		:	:	:	37.9	38.1	33.4	27.7	25.5	25.6	21.3

Financial indicators	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross foreign debt of the whole economy, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
Gross foreign debt of the whole economy, relative to total exports (%)		:	:	:	:	:	:	:	:	:	:
Money supply: M1 (banknotes, coins, overnight deposits, million euro)	4)	:	159	562	717	1 377	1 538	1 592	1 808	2 098	2 593
Money supply: M2 (M1 plus deposits with maturity up to two years, million euro)	4)	:	792	1 107	1 262	2 387	2 593	2 810	3 493	4 129	5 150
Money supply: M3 (M2 plus marketable instruments, million euro)		:	:	:	:	:	:	:	:	:	:
Total credit by monetary financial institutions to residents (consolidated) (million euro)	5)	:	1 496	1 422	1 543	1 707	2 189	2 619	3 031	3 857	4 759
Interest rates: day-to-day money rate, per annum (%)		:	:	:	:	:	:	:	:	:	:
Lending interest rate (one year), per annum (%)	6)	:	:	:	:	:	12.6	10.9	10.3	9.6	8.0
Deposit interest rate (one year), per annum (%)	7)	:	:	:	:	:	1.4	1.1	0.9	0.7	0.5
Euro exchange rates: average of period - 1 euro = ... national currency		:	1.969	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Effective exchange rate index (2000=100)		:	:	:	:	:	:	:	:	:	:
Value of reserve assets (including gold) (million euro)	8)	:	145	443	525	1 385	1 270	1 428	1 779	2 160	2 787

External trade	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Trade balance: all goods, all partners (million euro)		:	:	:	:	:	:	-2020u	-2667u	-3 750	:
Value of exports: all goods, all partners (million euro)		:	:	:	:	:	:	908u	1299u	1 920	:
Value of imports: all goods, all partners (million euro)		:	:	:	:	:	:	2928u	3966u	5 670	:
Terms of trade (export price index / import price index, % change on previous year)		:	:	:	:	:	:	:	:	:	:
Share of exports to EU-27 countries in value of total exports (%)		:	:	:	:	:	:	53.4u	54.2u	53.8	:
Share of imports from EU-27 countries in value of total imports (%)		:	:	:	:	:	:	58.5u	53.0u	51.9	:

Demography	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Natural growth rate: natural change (births minus deaths) (per 1000 inhabitants)	1)	5.6	4.4	3.7	2.4	1.9	1.5	1.0	-0.1	0.1	0.4
Net migration rate: immigrants minus emigrants (per 1000 inhabitants)		:	:	:	:	:	:	:	:	:	:
Infant mortality rate: deaths of children under one year of age per 1000 live births	1)	12.4	11.0	10.1	9.7	7.6	9.2	7.4	7.2	6.7	7.5
Life expectancy at birth: male (years)	1)	70.5	70.5	70.5	71.3	71.3	71.3	71.3	71.3	72.1	72.1
Life expectancy at birth: female (years)	1)	75.9	75.9	75.9	76.7	76.7	76.7	76.7	76.7	77.5	77.5

Labour market	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Economic activity rate (15-64): share of population aged 15-64 that is economically active (%)	9)	:	:	:	:	:	:	:	:	:	51.3
SI: Employment rate (15-64): share of population aged 15-64 that is in employment (%)	9)	:	:	:	:	:	:	:	:	:	35.0
Share of male population aged 15-64 that is in employment (%)	9)	:	:	:	:	:	:	:	:	:	46.1
Share of female population aged 15-64 that is in employment (%)	9)	:	:	:	:	:	:	:	:	:	24.0
SI: Employment rate of older workers (55-64): share of population aged 55-64 that is in employment (%)	10)	:	:	:	:	:	:	:	:	:	30.6

Employment by main sectors (%)											
Agriculture	11)	:	:	:	:	:	:	18.1	19.4	3.1	20.5
Industry	12)	:	:	:	:	:	:	24.8	24.2	29.9	30.8
Construction	13)	:	:	:	:	:	:	10.6	10.4	5.6	:
Services	11)	:	:	:	:	:	:	46.5	45.9	61.5	48.7
SI: Unemployment rate: share of labour force that is unemployed (%)	14)	:	:	39.4	39.7	40.0	41.1	41.6	41.8	43.9	31.1
Share of male labour force that is unemployed (%)	9)	:	:	:	:	:	:	:	:	:	28.9
Share of female labour force that is unemployed (%)	9)	:	:	:	:	:	:	:	:	:	34.9
Unemployment rate of persons <25 years: share of labour force aged <25 that is unemployed (%)		:	:	:	:	:	:	:	:	:	:
SI: Long-term unemployment rate: share of labour force that is long-term unemployed (%)	15)	:	:	:	:	:	:	:	:	:	28.4

Social cohesion	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Average nominal monthly wages and salaries (national currency)	16)	:	296.0	343.0	372.0	408.0	446.0	484.0	505.0	538.0	:
Index of real wages and salaries: index of nominal wages and salaries divided by CPI (2000=100)		:	:	:	:	:	:	:	:	:	:
SI: Early school-leavers: share of population aged 18-24 having not completed upper secondary education and not currently in education or training (%)		:	:	:	:	:	:	:	:	:	:

Standard of living	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of passenger cars per 1000 population	17)	:	:	:	:	:	116.4	112.1	116.3	117.0	:
Number of subscriptions to cellular mobile telephone services per 1000 population		2.4	6.8	:	:	117.3	196.4	274.2	:	:	:

Infrastructure	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Density of railway network (lines in operation, per 1000 km ²)		:	:	:	:	:	:	:	20.1	20.1	20.1
Length of motorways (thousand km)		-	-	-	-	-	-	-	-	-	-

Innovation and research	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Spending on human resources (public expenditure on education) relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
SI: Gross domestic expenditure on research & development, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
SI: Percentage of households who have Internet access at home (%)	18)	:	:	:	:	:	:	:	6.6	:	:

Environment	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Total greenhouse gases emissions, CO2 equivalent (tons, 1990=100)		:	:	:	:	:	:	:	:	:	:
SI: Energy intensity of the economy (kg of oil equivalent per 1000 euro GDP)		:	:	:	:	:	:	:	:	:	:
SI: Share of renewable energy in electricity consumption (%)		:	:	:	:	:	:	:	:	:	:
SI: Road freight transport as a share of total inland freight transport (modal split) (%)		:	:	:	:	:	:	:	:	:	:

Energy	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Primary production of all energy products (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Primary production of crude oil (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Primary production of hard coal and lignite (thousand TOE)	19)	:	:	:	:	:	:	214 058	211 325	229 668	:
Primary production of natural gas (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Net imports of all energy products (thousand TOE)	20)	:	:	:	:	:	:	368 673	478 318	627 078	681 392
Gross inland energy consumption (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Electricity generation (thousand GWh)		:	:	:	:	:	:	:	:	:	:

Agriculture	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Agricultural production volume index of goods and services (producer prices, previous year=100)		:	:	:	:	:	:	:	:	:	:
Total utilised agricultural area (thousand hectare)		:	:	:	:	2 126	2 122	2 192	2 196	2 187	2 194
Livestock: cattle (thousand heads, end of period)		:	:	:	:	:	:	:	453	460	515
Livestock: pigs (thousand heads, end of period)		:	:	:	:	:	:	:	596	654	712
Livestock: sheep and goats (thousand heads, end of period)	21)	:	:	:	:	:	:	:	893	903	1 005
Production and utilisation of milk on the farm (total whole milk, thousand tonnes)		:	:	:	:	:	:	:	580	629	662
Crop production: cereals (including rice) (thousand tonnes, harvested production)		1 242	1 184	1 369	930	1 139	1 309	793	1 439	1 350	1 341
Crop production: sugar beet (thousand tonnes, harvested production)		:	:	:	:	:	:	:	:	:	:
Crop production: vegetables (thousand tonnes, harvested production)		261	274	279	176	190	247	204	276	257	297

SI: Structural Indicator

e: estimate

f: forecast

p: provisional

u: uncertain

1. Source: Eurostat.
2. For 2000-2002, the value of non-observed economic activities is not included.
3. For 2001-2006, the rough estimations of industrial production volume index for Bosnia and Herzegovina calculated by Eurostat is checked and slightly corrected by BHAS based on 73 % share of Federation of Bosnia and Herzegovina and 23% share of Republic Srpska.
4. Break in series in 2001.
5. As of 31 December.
6. Short-term lending rates in national currency to private enterprises and cooperatives (weighted average).
7. Demand deposits rates in national currency to households (weighted average).
8. As of 31 December; there is no gold in the reserve assets.
9. For 2006, the source is Labour Force Survey 2006.
10. For 2006, the source is Labour Force Survey 2006; for 2006, population aged between 50 and 64.

11. For 2003-2004, the source is 'Living in BiH' (a panel survey among households); for 2005, yearly average; the number of persons employed in legal entities are collected through regular Monthly survey (RAD-1); for 2006, the source is Labour Force Survey 2006.
12. For 2003-2004, the source is 'Living in BiH'; for 2005, yearly average; the number of persons employed in legal entities are collected through regular Monthly survey (RAD-1); for 2006, the source is Labour Force Survey 2006; for 2006, including section F.
13. For 2003-2004, the source is 'Living in BiH'; for 2005, yearly average; the number of persons employed in legal entities are collected through regular Monthly survey (RAD-1).
14. For 1999-2005, the unemployment rate is not calculated using the ILO methodology. The number of unemployed people is taken from the Bureau for Employment; from 2005 onwards this figure includes data from Brcko District; for 2006, the source is Labour Force Survey 2006.
15. For 2006, the source is Labour Force Survey 2006; data refers to unemployed for 24-59 months.
16. For 1998-2004: net salary; for 2005, including data from Brcko District.
17. Data refers to the Federation of Bosnia and Herzegovina only (official data for the State level are not available).
18. For 2004, source: Household Budget Survey.
19. Estimated value of production obtained using PRODCOM data (volume produced and average unit value).
20. In thousand euro.
21. Excluding goats.