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Bosnia and Herzegovina 2006 Progress Report

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COMMISSION STAFF WORKING DOCUMENT

Bosnia and Herzegovina 2006 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 Balkans region.

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

- briefly describes the 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 gradually approximate its legislation and policies with those of the "*acquis*", in line with a Stabilisation and Association Agreement and the European Partnership priorities.

The period covered by this report is 1 October 2005 to 30 September 2006. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are under preparation or await 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 sources include contributions from the government of Bosnia and Herzegovina, the Member States, European Parliament reports¹ and information from various international and non-governmental organisations.

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

1.2. Relations between the EU and Bosnia and Herzegovina

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

The **Stabilisation and Association Agreement** (SAA) negotiations were officially opened in November 2005. Negotiations have progressed well from a technical point of view and a substantial part of the text of the future SAA has been agreed. However, the conclusion of the

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

² Enlargement Strategy and Main Challenges 2006 – 2007.

negotiations is dependent on Bosnia and Herzegovina's progress in implementing key reforms. In the meantime, Bosnia and Herzegovina continues to benefit from autonomous trade measures granted by the EU.

The Reform Process Monitoring (RPM) – a successor to the former Consultative Task Force – is currently the main instrument for political and technical dialogue between the EU and Bosnia and Herzegovina. Six RPM meetings have been held since the start of the SAA negotiations with the aim of monitoring and encouraging reform.

The EU continues to deploy considerable resources in Bosnia and Herzegovina within the framework of the Common Foreign and Security Policy (CFSP) and the European Security and Defence Policy (ESDP). A new EU Special Representative (EUSR), who also continues to be the High Representative, was appointed in January 2006. The EUSR's mandate has been strengthened through the revision of the relevant Joint Action in July 2006. Additional staff and resources have been assigned to his office. The EUFOR/Althea mission continues to be present in Bosnia and Herzegovina with some 6,000 troops. The mandate of the EU Police Mission (EUPM) was extended for two years from the beginning of 2006. The streamlined mission is now focused on the fight against organised crime and is advising on police reform. The mandate of the EU Monitoring Mission (EUMM) has been extended until the end of 2006. The EU has expressed its intention to reinforce its engagement in Bosnia and Herzegovina after the expected closure of the Office of the High Representative (OHR) on 30 June 2007.

The revised European Partnership for Bosnia and Herzegovina was adopted in January 2006. Bosnia and Herzegovina then adopted an action plan to address the European Partnership priorities in March 2006.

In July 2006, the Commission submitted to the Council draft negotiating directives for the negotiation of agreements on visa facilitation and readmission with Bosnia and Herzegovina.

The EC pre-accession **financial assistance** allocated to Bosnia and Herzegovina amounts to € 51 million in 2006. Bosnia and Herzegovina also participates in a number of other EU programmes.

In addition to pre-accession assistance, Community funds amounting to approximately € 24.1 million were provided in 2006 to support the offices of the EU Police Mission, the High Representative, the EU Special Representative and the EU Monitoring Mission.

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, and good neighbourly relations, and the 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 is an annex to the Dayton/Paris Peace Agreement (DPA). Although the DPA put an end to the war and brought peace and stability to Bosnia and Herzegovina, the adequacy of the Dayton constitutional system to the present circumstances is widely questioned. The structures deriving from the DPA are complex and fiscally unsustainable. The current setup does not allow swift decision-making and hinders reform implementation. This undermines Bosnia and Herzegovina's capacity to make rapid progress towards the EU.

Efforts to gradually reform the constitutional framework have so far failed. The Parliament of Bosnia and Herzegovina rejected a reform package agreed by political party leaders in April 2006. The package included among other things enhanced State-level competencies, improved and simplified decision-making procedures and representation of minorities in the State Parliament. Bosnia and Herzegovina thus missed the opportunity to take a first and important step towards a more democratic and efficient state.

The evolution of the Bosnia and Herzegovina Constitution is necessary. Efforts need to be stepped up to create functional and affordable state structures which fully respect human rights and support the process of European integration. This constitutional reform cannot be imposed. It should be decided by consensus amongst the population of Bosnia and Herzegovina.

Parliament

Bosnia and Herzegovina has a bicameral State-level parliament, as well as parliaments at the level of the Entities, Brcko District and cantons. Bosnia and Herzegovina's various parliaments have in total over 760 members. Bosnia and Herzegovina's Parliamentary Assembly has generally remained favourable to European integration. It has increased its capacity to prepare legislation and the work of its technical committees has improved. The use of emergency ordinances and the adoption of legislation through accelerated procedures have been reduced.

Nonetheless, political parties and delegates have continued to delay and block the adoption of specific laws necessary for progress in the Stabilisation and Association Process. Members of the Parliament frequently continue to vote along ethnic lines. The State Parliament was negatively affected by the Serb representatives' decision to boycott its sessions in May 2006. This boycott, which lasted one month, was a protest against delays in establishing a "Truth Commission on the sufferings of Serbs, Croats, Bosniaks, Jews and Others" in Sarajevo during the war. Parliamentarians also remain highly influenced by pressure groups pursuing their individual interests. The rejection in September of the long-awaited Law on Pharmaceutical products and medical devices is one example.

The Parliamentary Assembly has met more regularly, but the pace and quality of legislative output remains affected by slow input from the Council of Ministers. The Assembly is still hampered by insufficient technical resources, a unqualified parliamentary administration and cumbersome parliamentary procedures. Its European Integration Committee has remained largely inactive. There is a lack of relationship between the executive and the legislative organs. Cooperation with the Council of Ministers remains inadequate, and there is no coordination of legislative agendas between the State parliament and those of the Entities. External oversight of the Parliamentary Assembly by civil society is still limited.

Presidential and parliamentary **elections** (at State, Entity, cantonal, and Brcko District level) took place on 1 October 2006. Forty-eight political parties, eight coalitions and twelve independent candidates participated in the elections, a reduction in comparison with those held in 2002. These were the first elections since the Dayton/Paris Agreement to be fully administered by the authorities of Bosnia and Herzegovina. Preliminary conclusions of the OSCE Office for Democratic Institutions and Human Rights (ODIHR) indicated that the elections represented a step forward in consolidating democracy and rule of law, and were conducted generally in line with international standards. However, failure to amend the Constitution made it impossible for the elections to comply fully with the requirements of the European Convention for Human Rights (ECHR). Moreover, the pre-election period had an adverse effect on overall reform implementation, including on key issues such as police restructuring and the constitutional reform. Inflammatory rhetoric on identity and ethnicity-related issues impacted in particular on legislative reforms requiring transfer of competencies from Entities to the State.

Government

The Presidency of Bosnia and Herzegovina continues to rotate on an eight-monthly basis, and its mandate includes a role in foreign policy, proposing annual budgets and representing Bosnia and Herzegovina in international organisations. The Presidency has met relatively regularly, and taken key decisions such as advancing defence reform. The Presidency has also played a constructive role in the constitutional reform debate. However, Presidency members mostly show their first allegiance to their Entity and their constituent people. This hinders the work of the Presidency secretariat and its functions are often performed by Presidency cabinets. Major divergences between Presidency members include Bosnia and Herzegovina's lawsuit against Serbia and Montenegro at the International Court of Justice. The Venice Commission has indicated that the election of Bosnia and Herzegovina's tripartite Presidency does not comply with the European Convention for Human Rights (ECHR).

Presidencies also exist in the Entities, with the Federation's President being elected indirectly, and the President of the Republika Srpska being directly elected.

Within the State Government, some consolidation has taken place. The Economic Policy and Planning Unit - which has become the Directorate for Economic Planning - was formally established by a law adopted in September 2006. This body has continued to function well and has ensured the monitoring of the Medium-Term Development Strategy updated in March 2006.

The Directorate for European Integration (DEI) has played an important role within the Council of Ministers and has further promoted the European integration objective. It has maintained its efforts towards improving co-ordination with, and the involvement of, State and Entity ministries through regular meetings with the EU Integration Coordinators of these ministries. The DEI has developed an Action Plan to address the European Partnership priorities and a Strategy for European Integration, which have been adopted by the Council of Ministers. It has also remained Bosnia and Herzegovina's focal point for assistance programming.

Dependence on the international community in terms of legislative drafting is declining.

However, the Council of Ministers continued to experience internal tensions and deadlocks, which have slowed progress. In terms of personnel, no major changes have occurred.

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 Parliamentary Assembly failed in September 2006 to agree on the creation of two new Ministries within the Council of Ministers.

The General Secretariat is operational, but shortages in staff remain, as well as an overly politicised environment. The Legislative Office is functioning but a lack of staff prevents it from reviewing all the required legislation. The implementation of the State Government Strengthening Plan (SGSP), designed to reinforce the capacities of the State Government, has made no real progress. Legislation to clarify the use of real estate by the State institutions has been prepared, but remains controversial and has not yet found a proponent.

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 met very infrequently and does not have an institutional role. More institutionalised cooperation and increased political will from all stakeholders is needed.

A new Government in Republika Srpska (RS) was appointed in February 2006, following a motion of no confidence stemming from difficulties in adopting the 2006 budget. A considerable amount of legislation has been passed by the new executive in recent months, mainly related to organised crime, privatisation and public administration. Nonetheless, a number of actions undertaken by this Government have been controversial. There are doubts whether it followed the appropriate civil service procedures for the removal of a considerable number of high officials from the administration. The appointment of prosecutors to the new RS Special Prosecutor's Office contradicted the powers conferred to the High Judicial and Prosecutorial Council (HJPC) and required remedial action. Furthermore, the executive's positions on key issues such as police reform, the redistribution of taxes collected by the Indirect Taxation Agency (ITA) and inflammatory comments about a possible referendum for self-determination in Republika Srpska have raised concern.

The work of the Federation Government has also occasionally been obstructed by internal political issues. In January 2006, work was held up by internal disputes about ministerial appointments.

The international community remains deeply involved in Bosnia and Herzegovina on the basis of the Dayton mandate. The High Representative (HR) continues to play a significant role. In addition to his Dayton-mandated responsibilities, he has the authority to impose legally binding decisions through the so-called Bonn powers. The number of binding decisions adopted was substantially lower in 2006 (46 decisions by the end of September compared with 91 decisions in 2005). No major reform required for European integration has been imposed by the HR.

The HR also acts as the EU Special Representative (EUSR). The mandate of EUSR is to "offer the EU's advice and facilitation in the political process and to promote overall political coordination in Bosnia and Herzegovina". This mandate was strengthened in February and July 2006 and has been extended until February 2007. The EUSR has a small number of designated EUSR staff who continue to be embedded into the Office of the High Representative (OHR).

The Peace Implementation Council (PIC) agreed in June 2006 that OHR will begin preparations to close on 30 June 2007. The PIC steering board agreed to review in early 2007 the OHR closure, taking into account the overall situation in Bosnia and Herzegovina and the region. The Commission supports the closure of the OHR, provided that the necessary conditions are met.

OHR's departure will lead to a reinforced EU engagement in Bosnia and Herzegovina, including a strengthened mandate for the EUSR. In June and October 2006, the High Representative for the Common Foreign and Security Policy/Secretary General of the Council Javier Solana and Enlargement Commissioner Olli Rehn submitted joint reports to the Council on the future role and organisation of the EU in Bosnia and Herzegovina.

The phasing out of the OHR should imply increased ownership for the authorities of Bosnia and Herzegovina and the end of the Bonn Powers.

The EUFOR/Althea mission continues to operate throughout Bosnia and Herzegovina with approximately 6,000 staff. The mandate of the EUPM was extended in December 2005 by two additional years. EUPM now has a strengthened mandate focusing on the fight against organised crime and police restructuring. The OSCE mission continues to be present in Bosnia and Herzegovina with some tasks deriving from the Dayton/Paris Peace Agreement.

Public administration

Bosnia and Herzegovina has made some progress in this area. The National Strategy for the Reform of the Public Administration was finally adopted. The adoption of this strategy partly addressed a key priority of the European Partnership (EP). Support staff for the Public Administration Reform Coordination Office (PARCO) has also been appointed.

The Bosnia and Herzegovina Civil Service Agency has been more effective in recruiting staff for the various administrations. It processed 53 vacancy publications, hiring a total of 259 civil servants between October 2005 and September 2006.

After considerable delays and extensive lobbying by the international community, the new Ombudsman Law was adopted in March 2006. It foresees the merging of the Entity Ombudsmen Institutions with the State Ombudsman in line with international conventions. The actual merger is expected to take place as of January 2007.

Coordination between the State and Entity level Civil Service Agencies has improved. It needs now to be further formalised.

However, further efforts are indispensable. Bosnia and Herzegovina needs to accelerate reforms in this area in order to build a transparent, efficient and independent public administration, able to respond better to the needs of its citizens and the requirements of EU integration.

Bosnia and Herzegovina remains affected by cumbersome administrative structures. Human and budgetary resources allocated to the Public Administration Reform Coordination Office (PARCO) are still insufficient. The reforms recommended by the sectoral functional reviews have not yet been carried out. The recently adopted National Strategy for the Public Administration Reform needs to be properly implemented to fully address the relevant EP key priority. A major issue in the European integration and public administration reform process is to develop central policy-making and coordination capacities to ensure coherence and

consistency among various policies, as well as informed decision-making. This will require new organisational arrangements, procedures, staffing and development.

While some steps have been taken, the consolidation of the State level ministries and institutions has been proceeding slowly. Further action is necessary to meet the EP key requirement of ensuring that all State-level ministries and institutions are adequately financed, operational and properly equipped, namely in terms of premises and staff. Harmonisation of the three Civil Service Laws – amongst other things to allow for transfer of civil servants between government levels – is also necessary.

Limited budgetary resources and premises continue to delay recruitment of the necessary personnel. Bosnia and Herzegovina is still far from recruiting the large number of civil servants provided for in the State-building plans. Recruited staff are often not always of an appropriate standard. Attracting young and well-qualified staff and adequately skilled senior managers remains a challenge.

Work towards a professional and apolitical civil service with recruitment and promotion based on experience and merit has been limited. Insufficient safeguards against political interference in public administration continue to exist regarding senior management positions - where ethnic identity and party membership play a significant role.

Individual institutional budgets do not allocate funds to training on a regular basis. The Bosnia and Herzegovina Civil Service Agency has an annual training budget of approximately € 40,000. Coordination and cooperation between central personnel units at State and Entity levels take place, but mainly through foreign assistance programmes. The Council of Ministers adopted a training programme on European Integration in May 2005. However, large-scale implementation of this programme has not been carried out due to lack of funds.

Local self-government reform, in line with the European Charter for Local Self-Government, is underway. Both Entities have adopted laws on local self governance which are, in principle, aligned with the Charter. However, in a significant number of areas, additional provisions are required to ensure full implementation of the rights arising from the Charter. The legislation foresees a greater role of the municipalities, including through the allocation of revenues. Nevertheless, the allocation of the appropriate financial means is still not ensured and the distribution of the newly introduced value added tax is, as yet, not fully regulated. Overall implementation of this reform remains at an early stage.

The establishment of a single administration in Mostar continues to be undermined by poor cooperation between the local political forces. The harmonisation of the statutes of the various institutions, the unification of public utility companies and the completion of procedures for the recruitment of civil servants is particularly urgent. In September 2006, the High Representative appointed a Special Envoy to Mostar to find solutions to these issues.

Little progress has been made as regards **police reform**. The requirements set out in the Agreement on Police Restructuring of October 2005 have not yet been fulfilled. While the Police Restructuring Directorate has been established, the work of this Directorate has been undermined by the obstructive attitude of Republika Srpska representatives. This has led to delays in the implementation of the Agreement, which is a key priority of the European Partnership (*see also section 4.3.4 on Police*).

Civil Military Relations

Progress in the area of defence reform has continued. The Bosnia and Herzegovina Defence Law was adopted in December 2005. Both Entity Ministries of Defence ceased to exist on 31 December 2005 and all defence related tasks and personnel were transferred to the State Ministry of Defence as of January 2006. The definitive size, structure and stationing of the Armed Forces was decided by the Bosnia and Herzegovina Presidency in July 2006. A Parliamentary oversight Committee has also been established at the State-level. A Defence Reform Co-ordination Group has been established to supervise and monitor reform activities. Successful (re)appointment of management positions at the State Intelligence Agency (OSA) has been undertaken and a permanent location for the Agency has been found.

Bosnia and Herzegovina has met the benchmarks endorsed by the North Atlantic Council as criteria for credible candidacy for Partnership for Peace (PfP). However, the failure to locate and contribute to the arrest of the indicted war criminals still at large has continued to be an obstacle to Bosnia and Herzegovina's eventual entry into PfP.

Judicial system

The structure of the judicial system in Bosnia and Herzegovina reflects the internal structure of the country. Courts exist at State and Entity levels and also within the Entities. The number of Courts and Prosecution offices has been increased to 208, with 1,281 judges and prosecutors in office. Overall, the judiciary continues to be independent. The High Judicial and Prosecutorial Council (HJPC), which appoints judges and prosecutors, has performed well. In November 2005 a Code of Ethics was adopted. It contains guidance to judges and prosecutors for exercising their authority in a fair, transparent and independent manner. The reform of the minor offence courts is progressively advancing: the legislation was passed in April 2006 and in September the restructuring was completed in Republika Srpska. A Strategy against juvenile delinquency has also been adopted and a detention centre for young people in conflict with the law has been established. As regards human resources, the salaries of judges and prosecutors, which had seen uncontrolled growth in recent years, were harmonised, slightly reduced and frozen by a decision of the High Representative in December 2005. The recruitment of judicial associates at the courts of first instance in both Entities as well as at higher courts (District and Supreme Court) has also started.

The Courts at State level continue to employ non-BiH citizens, with the Constitutional Court employing three international judges and the BiH State Court and BiH Prosecutor's offices employing 16 and 6 international staff respectively.

However, further efforts are necessary to improve the functioning of the judicial system. The full responsibility of Bosnia and Herzegovina in terms of finance, administration and proper functioning of the judicial system remains to be accomplished. Obstacles to the efficient operation of the judiciary persist, such as four parallel and separate jurisdictions at State, Republika Srpska, Federation of Bosnia and Herzegovina and Brcko levels; incoherent systems of laws; directives coming from fourteen Ministers of Justice; and four different bar exams for lawyers. There has been a high rate of reversal of judgements in major criminal cases at the Court of Bosnia and Herzegovina.

The judicial system is not completely free from political interference. The Government of Republika Srpska attempted to appoint the Special Prosecutor for the Entity in May 2006, which is a prerogative of the HJPC. The executive branch also provided evidence of interference in the judicial system, particularly through the questionable use of pardons. There is a persistent lack of well-trained judges, prosecutors and support staff, especially at the

lower levels of the judiciary.

Progress in ensuring Bosnia and Herzegovina's full responsibility for the budget of the judicial system is slow. The financial resources allocated to the judiciary are largely consumed by salaries, leaving limited funds for operational expenses. The judiciary continues to be financed from fourteen different budgets at various levels, i.e. from the State, from both Entities, from the ten cantons and from the Brcko district. A conference to evaluate achievements and future financial needs of the BiH State Court was organised in Brussels in March 2006. The conference managed to initially raise € 7.7 million for the Court.

Little progress has been made with the backlog of cases before the courts, which remains a critical issue. There was over 1.3 million unresolved cases registered as of 31 December 2005. Most of the pending cases concern the enforcement of utility bills. Progress has also been limited regarding judicial co-operation in civil and criminal matters with other countries.

Anti-corruption policy

Bosnia and Herzegovina is a member of the Council of Europe Group of States against Corruption (GRECO), and it is involved in the Stability Pact's Anti-corruption Initiative (SPAI).

A positive development was the adoption in June 2006 of the 2006-2009 Strategy for the Fight against Organised Crime and Corruption. This strategy now needs to be properly implemented. During implementation, Bosnia and Herzegovina needs to pay particular attention to developing the necessary structures and increasing enforcement capacity.

The fight against corruption has also been reinforced through the Law on Conflict of Interests and the laws on public procurement and VAT. Sustained efforts are needed to ensure the correct implementation of this legislation.

The courts have begun to prosecute cases of alleged corruption by both private citizens and politicians. Nonetheless, the number of successful prosecutions remains low and there is clear scope for improvement.

Bosnia and Herzegovina has not ratified the UN Convention on Fighting Corruption (Mérida Convention) and has not signed the Additional Protocol to the Criminal Law Convention on Corruption. It is not yet a party to the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

There is no clear legal definition of the term "corruption" in Bosnia and Herzegovina's criminal legislation. Anti-corruption legislation is not fully harmonised across the country. The State-level Criminal Code includes chapters dealing with corruption, sanctions against corruption and measures to promote official accountability. The same issues are also covered by the relevant Entity legislation, but there is a need to harmonise the various criminal codes. The rapid development of an appropriate legal framework remains central. GRECO recommendations need to be fully taken into account together with the other relevant global conventions originating in the Council of Europe, OECD and UN.

Overall, Bosnia and Herzegovina has made limited progress in dealing with corruption, which remains a serious issue.

2.2. Human rights and the protection of minorities

Observance of international human rights law

Bosnia and Herzegovina has made good progress in addressing the judicial backlog at the Human Rights Commission of the Constitutional Court. Since January 2004, this institution has been the judicial body responsible for reviewing pending cases on human rights violations. In the period January 2005-June 2006 it tackled almost 3,900 cases. The Human Rights Commission is working steadily on finishing the pending cases, but the Court continues to receive a considerable number of new applications. The relevant authorities need to make sure that decisions taken by the Human Rights Commission and the former Human Rights Chamber are adhered to - such as in the "Palic case", the missing persons in Eastern Sarajevo and the case related to the citizens and residents of Bosnia and Herzegovina currently detained in Guantánamo Bay.

Bosnia and Herzegovina has ratified all major UN and international Human Rights conventions, as well as the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR). Actual implementation of these instruments needs to improve. Current legislation enshrines most of the principles included in the European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols (ECHR). The Constitution of Bosnia and Herzegovina guarantees that international conventions supersede any other legislation and are directly applicable.

A working group was set up in January 2006 to examine the compatibility of national legislation and practice with that of the ECHR. The process of drafting the compatibility report has been re-launched. A Government Agent to the European Court of Human Rights has been appointed. In 2005, 212 applications originating from BiH were registered at the European Court of Human Rights. Only one has been declared admissible and, so far, no judgements have been issued.

Civil and political rights

Ethnic issues are still very present in the country as a whole and are often misused by political parties. Widespread ethnic discrimination remains. This affects key aspects of the citizen's life such as employment, education, housing, health and social care, pension benefits and access to local services. It also has a negative impact on the integration of returnees to their pre-war homes. Follow-up of investigations of ethnic-related cases does not always reach the required standards.

The Constitution of Bosnia and Herzegovina and the Constitution of the Federation of Bosnia and Herzegovina do not allow the death penalty. Article 11 of the Republika Srpska Constitution however still allows the death penalty for capital crimes. This is not compatible with ECHR Protocol No. 6 concerning the abolition of the death penalty.

Torture and ill-treatment are prohibited by State and Entity Constitutions. Investigations into police misconduct and standards of accountability have continued to improve, but there is room for further improvement. Follow-up of earlier cases is unsatisfactory.

As far as **access to justice** is concerned, trials in Bosnia and Herzegovina are public and the defendant has the right to counsel at public expense if the defendant is charged with a crime punishable by long-term imprisonment. The law provides that defendants also have the right of appeal, the right to confront and question witnesses as well as to present witnesses and

evidence on their behalf. However, there is still no coherent nationwide scheme of publicly funded legal aid in civil cases due to limited financial resources. Legal aid in civil cases is primarily provided on an ad hoc basis by privately funded NGOs. Concerns therefore exist as to the guarantee of equality before the law.

As regards **arbitrary arrest**, legislation guarantees the principle of presumption of innocence. This principle is generally applied and pre-trial detainees are held separately from convicted criminals. The Government has permitted visits by independent human rights observers and international community representatives and has given widespread and unhindered access to detention facilities and prisoners.

Regarding the **prison system**, some efforts have been made to address the issue of juvenile delinquency and to separate adult from juvenile inmates. Continued action to reform this system remains necessary however, notably in order to improve facilities, address the problem of overcrowding and introduce alternatives to prison sentences. There have been protests over poor living conditions, inadequate medical treatment, extortion through bribes and physical abuse by prison guards. Some incidents of ethnically-motivated violence among inmates have been reported. Entity legislation on prisons still needs to be adjusted to take into account the amendments introduced by the Criminal Procedure Code and the State Law on the Execution of Criminal Sentences.

The **freedom of religion** is enshrined in Bosnia and Herzegovina's Constitutions. A State Law on Freedom of Confession and Legal Status of Churches and Religious Communities gives comprehensive rights to churches and religious communities and gives them the legal status they had not previously enjoyed. Nonetheless, clear instructions for the implementation of this law have not yet been issued. Religious intolerance is still present. The misuse of religious symbols and buildings for political purposes has had a negative impact on inter-religious dialogue and interethnic relations.

The country's Constitutions provide for **freedom of expression, including the media**. Freedom of the press has been considerably enhanced and freedom of expression has generally been respected by all authorities. Libel and insult provisions have been removed from the penal code and defamation and libel cases are addressed exclusively under the civil code. Mass media and especially newspapers largely remain ethnically divided and influenced by political parties. The self-regulation instruments set out in the Press Code do not operate efficiently. In practice, media professionals sometimes disregard the press code of conduct and show a lack of sensitivity towards, for example, gender, ethnicity and issues relating to vulnerable minorities.

Regarding public broadcasting, the necessary State-level legislation has been adopted. Republika Srpska has also passed the relevant law. However, the Federation of Bosnia and Herzegovina has been unable to complete the legislative process due to a decision of the Federation's Constitutional Court. Lack of a complete legal framework and the establishment of the necessary institutions are delaying proper implementation of the public broadcasting restructuring. Adopting all necessary legislation at State and Entity level and ensuring its implementation is a key priority of the European Partnership.

Bosnia and Herzegovina's constitutional framework provides for **freedom of assembly and association**, and these rights are usually respected. A wide range of social, cultural, and political organisations operate without governmental interference.

As regards **civil society organisations**, few NGOs have a country-wide field of action, even though the Law on Associations and Foundations allows NGOs to register freely at the State Ministry of Civil Affairs and Communications and to be active anywhere in the country. Many organisations prefer to register at Entity level as a result of the cumbersome procedures necessary to obtain a State-wide registration. NGO financing remains an issue. Current legislation does not give sufficient incentives to the business sector or private donors to provide support. Partly as a consequence of the war, many NGOs were created and developed in donor-driven mode, with very weak links to real societal demands.

Civil society development in Bosnia and Herzegovina is adversely influenced by the complex administrative organisation of the country as well as by political misuse of ethnic and religious diversity. Religious communities have displayed an increasing interest in public affairs. Their influence is extending to areas reserved to public authorities, such as the education sector.

Economic and social rights

Bosnia and Herzegovina's legislation incorporates some of the international instruments pertaining to **women's rights**, such as the Convention on the Elimination of All Forms of Discrimination against Women. The principle of equal pay for work of equal value is explicitly introduced in the Gender Equality Act of 2003, which also defines and prohibits both direct and indirect discrimination, as well as harassment and sexual harassment. Lack of measures to enforce the adopted provisions however creates a great rift between the *de facto* and *de jure* situation. The Central Agency for Gender Equality is responsible for the implementation of the Law on Gender Equality and related activities. There are Gender Centers operating at State and at the Entity-level. The Agency has developed the Gender Action Plan for Bosnia and Herzegovina in cooperation with the Entity Gender Centres.

Nonetheless, access of women to employment remains difficult. Women's participation to the labour market is low compared to men and is limited to certain typical occupations. Many women are not covered by health insurance. Women continue to be under-represented in politics and in executive authorities. Trafficking in women for purposes of sexual exploitation remains a problem. The law prohibits sexual harassment, but prosecution of cases is rare. Five "Safe Houses" have been established by NGOs to give shelter to women suffering from domestic violence, which remains an underreported issue.

Discrimination is also present in terms of sexual orientation. Although equal treatment is guaranteed by the Constitutions and existing Criminal Codes do not penalise sexual orientations, the concrete implementation of these principles is not ensured and homosexuals are often discriminated against.

As regards **children's rights**, the Convention on the Rights of the Child is incorporated into the legal system of Bosnia and Herzegovina. Governments of both Entities remain generally committed to rights and welfare of children. The Ministry of Human Rights and Refugees has drafted an Action Plan for Children for the period 2002 – 2010 under the auspices of UNICEF. Nonetheless, problems remain regarding health and social protection and many children are not covered by health insurance. Disabled children lack sufficient medical care and educational opportunities. Moreover, domestic violence against children remains an issue.

Bosnia and Herzegovina's institutional set up in the field of **education** is particularly complex. Improvements regarding the legal framework have been slow, with key legislation

regarding pre-school, vocational training and higher education still pending. As a result, Bosnia and Herzegovina is not fulfilling the requirements set out in the Bologna Process. Implementation of the existing legislation is weak. Little progress has been made in preventing the separation of children in schools along ethnic lines. This is a serious issue that needs to be addressed. Ethnically neutral education has not been achieved and pupils and students in a minority position frequently face a hostile environment.

In relation to **socially vulnerable or people with disabilities**, legislation in both Entities prohibits discrimination against people with disabilities. Nonetheless, war veterans are granted privileged treatment - one third of the total budget is allocated to them. This has an adverse impact on other categories of socially vulnerable and disabled persons, given the limited resources available. Around 50% of disabled persons do not have health protection and the vast majority are unemployed. The accessibility legislation is not being implemented. Effective policies to support socially vulnerable people remain to be developed.

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

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

In relation to **social dialogue**, the main problem in Bosnia and Herzegovina is the complex form of government and the fragmentation of legislation. Social dialogue is decentralised to the Entity level, and the Entities of Bosnia and Herzegovina each have their own legislation and their bodies for social dialogue. The State-level Ministry of Civil Affairs has taken some initiatives in this respect and has requested assistance from the Community and ILO in establishing a country-wide Economic and Social Council. However, the Council of Ministers has so far been unable to push this initiative forward and the Council has not yet been established.

The two main Entity unions have formed a Confederation (KSBiH), with the Presidency alternating between them. As a result the Confederation has been awarded observer status by the European Trade Union Confederation (ETUC). The Ministry of Justice is however continuing to block the registration of the KSBiH, since the Federation union (maintaining the title of the pre-war Bosnian union federation) also requests registration at State level. This is hindering social dialogue, which is requested by both employers and employees. A State-level employers' association also exists, encompassing the associations at the Entity level. In general, the high level of informal economy is a problem for the organisation and development of both workers' and employers' associations. The lack of balance between

bipartite and tripartite social dialogue and between industry and sectoral negotiations constitutes an additional issue.

Regarding **property rights**, the property repossession process in Bosnia and Herzegovina is practically completed and only some residual cases remain to be addressed by the Commission for Property Claims of Displaced Persons and Refugees. The Commission's mandate has been extended until the end of 2006 to address these cases appropriately.

Minority rights, cultural rights and the protection of minorities

As regards **minority and cultural rights**, Bosnia and Herzegovina is party to the Council of Europe Framework Convention for National Minorities. Bosnia and Herzegovina has signed the European Charter for Regional or Minority Languages. Ratification is pending.

The convention for national minorities has not yet been adequately implemented. The provisions of the European Charter on teaching minority languages, on media broadcasting for national minorities and on proportional representation in public authorities and in the civil service have not led to substantial changes in practice. Members of minorities rarely participate in the parliaments and municipal assemblies. There are only two associations of national minorities: one association in Republika Srpska, and the Bosnia and Herzegovina Council of Roma. The Council of National Minorities was established in March 2006 to promote the role of minorities in public life, but it is not yet operational.

The 2003 Law on the Protection of National Minorities, and the amendments introduced in 2005, have not been fully applied.

Failure to adopt reforms to the constitution has perpetuated the exclusion of the national minorities from institutions such as the House of Peoples and the tripartite Presidency. Excessive emphasis placed by Bosnia and Herzegovina's legal framework on the status of Bosnia and Herzegovina "constituent peoples" (i.e. Bosniaks, Croats and Serbs) has an adverse effect on the protection of minorities that do not belong to these "constituent peoples". It also hampers Bosnia and Herzegovina's evolution towards a State based on citizenship rather than on ethnic representation.

The **Roma** population is estimated between 40,000 to 80,000 people and remains the most vulnerable of the 17 national minorities recognised by the State on the basis of the 1991 census. Full and effective equality has not been secured for the Roma, who continue to be particularly exposed to discrimination and face difficulties in housing, health care, employment and education. Their illiteracy rate is very high. The 2005 National Strategy for the Roma has not been properly implemented. Concrete improvements for the Roma community have been scarce.

Over one million **refugees and displaced persons (DPs)** have reposessed their pre-war homes in Bosnia and Herzegovina. The figure for real occupation, in particular regarding the so-called "minority return", is substantially less.

The Return Fund established by the State Law on Refugees became operational in 2005 and has contributed to the reconstruction of residential units in 30 municipalities. Bosnia and Herzegovina needs to ensure the sustainability of this instrument. The State Commission for Refugees and DPs is also operational and, as set out in the relevant legislation, NGOs are participating as observers.

The de-mining process continues in Bosnia and Herzegovina. It is a key factor in refugee return. It is estimated that there are still 67,000 mines and about 650,000 unexploded destructive devices affecting 10,000 localities. A new Mine Action Plan to 2009 has been adopted. Implementation will require continued involvement of the international community.

Regional cooperation on refugees has continued, notably in the framework of the 2005 Sarajevo Declaration (*see also item 2.3 on Regional issues and international obligations*).

The number of returnees is decreasing significantly, but the process of return has not yet been completed. Bosnia and Herzegovina's representatives estimate that approximately half a million people are considering returning, and there are still a considerable number of registered refugees and DPs within Bosnia and Herzegovina. Limited progress has been made in improving the conditions required to make return sustainable, including access to reconstruction assistance, employment, health care, pensions, utilities and an unbiased education system.

The Law on Amendments to the **Citizenship** Law was adopted in December 2005. The Law foresees the establishment of a Commission for the Review of Citizenships granted during and in the aftermath of the 1993-1995 war. An earlier commission had existed in the Ministry of Civil Affairs, but proved ineffective. A more robust Commission was established in January 2006, with input from the Ministry of Security and Ministry of Civil Affairs, and three International Members. Thus far the Commission has revoked approximately 100 citizenships on the grounds of false personal information. Bosnia and Herzegovina has also announced plans to deport some of these naturalised citizens. About 200 additional cases are under investigation.

2.3. Regional issues and international obligations

Overall, compliance with the **Dayton/Paris Peace Agreement** has been ensured. Nonetheless, the pre-election period was marked by frequent allusions by Republika Srpska political leaders to the organisation of a referendum on self-determination in this Entity. The EU and the international community have made clear that such a referendum would be contrary to the Dayton Agreement and to the constitution of Bosnia and Herzegovina, and that it would not be tolerated.

Bosnia and Herzegovina has honored most of its **Council of Europe post-accession commitments**. However, little progress has been made regarding outstanding commitments in the areas of elections and education. Implementation of adopted legislation remains weak.

Bosnia and Herzegovina's cooperation with **the International Criminal Tribunal for the former Yugoslavia (ICTY)** has continued, but it remains to be deepened. Full cooperation with the Tribunal is a key priority of the European Partnership. One additional indicted war criminal was transferred to The Hague in June 2006.

The co-operation of the Federation of Bosnia and Herzegovina with the ICTY has remained satisfactory, while the cooperation of the Republika Srpska is not yet fully sufficient. Some positive steps have been taken as regards the local prosecution of indicted war criminals and the documentation required by the ICTY. Some parts of Republika Srpska's wartime archives have been handed over to the Tribunal. There has been no additional arrests of indicted war criminals by the Republika Srpska police. However, Republika Srpska has made some efforts against the networks supporting ICTY indictees and in tracing some of the fugitives. There is no credible information available about the present location of Karadzic.

Bosnia and Herzegovina has taken legislative steps to implement the 2004 EC Regulation on the assets freeze of ICTY fugitives. Proper implementation needs to be ensured.

In relation to domestic **war crimes trials**, some progress has been achieved. At Entity level, this progress has been limited. There are twenty-six ongoing cases in the Federation, nine in Republika Srpska and one in Brcko District. Local courts in both entities are poorly equipped and witness protection is not fully ensured. This has an adverse effect on proceedings. At the State level, progress has been more evident following the establishment of the War Crimes Chamber at the State Court. From October 2005 to September 2006, 173 new case files have been opened in the Section I War Crimes. Four verdicts have been handed down.

The sharing of evidence between the ICTY and the War Crimes Chamber at the State Court has proved crucial for the effectiveness of these institutions. The transfer of information and evidence to facilitate prosecution in Bosnia and Herzegovina is advancing progressively. Since September 2005, the State Court has received five criminal proceedings under *Rule 11 bis* from ICTY. There are plans to transfer additional cases from the ICTY to Bosnia and Herzegovina shortly. However, local handling of war crimes requires further resources. The appointment of national judges at the State Court should be completed without further delay. Appropriate prison facilities for sentenced war criminals are also necessary.

In 2003 Bosnia and Herzegovina ratified a bilateral immunity agreement with the United States which runs contrary to the “EU guiding principles concerning arrangements between a State party to the Rome Statute of the **International Criminal Court** and the United States regarding the conditions of surrender of persons to the court”, adopted by the Council of the EU in September 2002. No new developments have taken place in this respect.

There has been continued progress in the implementation of the Sarajevo Declaration between Croatia, Serbia, Montenegro and Bosnia and Herzegovina on the return of **refugees**. However, the process has been slowed down by the lack of political consensus on two remaining open issues: 1) a fair settlement mechanism in Croatia for lost Occupancy Tenancy Rights (OTR) and 2) the recognition of pension and other rights for working years spent in Serb controlled areas of Croatia during the war. There have been several Task Force meetings, but it has not been possible to make progress on these matters. A ministerial meeting has been planned to find a way forward. The concerned governments need to make further efforts to rapidly resolve the outstanding issues, and to fulfil the plans to present a comprehensive Road Map for each country and to agree on a Joint Implementation Matrix.

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

Bosnia and Herzegovina continues to be an active participant in regional cooperation initiatives, such as the Stability Pact for South East Europe, the South-East European Cooperation Process, the Central European Initiative, the Adriatic-Ionian Initiative and the Danube Cooperation Process. Bosnia and Herzegovina is committed to the establishment of the Regional Cooperation Council. It is currently chairing the Adriatic-Ionian Initiative.

In April 2006 Bosnia and Herzegovina signed a joint declaration for the establishment of a regional free trade agreement within the framework of an enlarged and amended CEFTA in Bucharest. It has participated in the negotiations that started in June 2006. Bosnia and Herzegovina has concluded bilateral free trade agreements (FTAs) with all countries in South-East Europe. Bosnia and Herzegovina has also signed a free trade agreement with Kosovo in

October 2006. However, it has continued to face difficulties in implementing these agreements with neighbouring countries. Bosnia and Herzegovina needs to make further efforts to ensure the correct implementation of the FTAs.

Bosnia and Herzegovina is party to the Energy Community Treaty which came into force in July 2006. In June 2006, it signed the agreement on the European Common Aviation Area.

Bilateral relations with other Western Balkan countries have continued to be generally satisfactory, although little progress has been made on outstanding issues.

Overall, relations with *Serbia* remain good. However, Bosnia and Herzegovina's suit against Serbia and Montenegro at the International Court of Justice (ICJ) for alleged state sponsored genocide has occasionally inflamed political discourse and relations both between Bosnia and Herzegovina and Serbia, and also within Bosnia and Herzegovina. The case is under court procedure. Hearings were concluded in May 2006 and a final outcome is expected shortly. The State Border Treaty with Serbia has not yet been signed. Republika Srpska has intensified contacts and cooperation with Serbia and a new Agreement on Special Parallel Relations was signed in September 2006. Some trade issues between Bosnia and Herzegovina and Serbia remain unresolved.

With regard to *Kosovo* issue, the official stance of Bosnia and Herzegovina stresses the importance of a negotiated settlement. However, Republika Srpska has been supporting the Serbian position, and political leaders have occasionally drawn parallels between the Kosovo status issue and Republika Srpska's right to self-determination.

Bosnia and Herzegovina recognised the independence of *Montenegro* in June 2006.

While relations with *Croatia* remain relatively stable and bilateral contacts have been increasing, there has been little progress on resolving issues such as the agreement on the Port of Ploce and the agreement on Settling Property Issues. Trade issues between Bosnia and Herzegovina and Croatia remain open. Ratification of the 2005 Agreement on Demarcation of the Land and River Borders is on hold. The publication of a Croatian plan to construct a bridge on the Peljesac area has also been an issue between both countries as this bridge would apparently limit ships' access to Neum port.

Good relations with *the former Yugoslav Republic of Macedonia* were confirmed during the visit of its Minister of Foreign Affairs to Bosnia and Herzegovina in April 2006. A number of bilateral agreements have been signed, including on mutual legal assistance, property rights issues, extradition and mutual execution of court rulings in criminal matters.

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

3. ECONOMIC CRITERIA

3.1. Introduction

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.

3.2. Assessment in terms of the Copenhagen criteria

3.2.1. The existence of a functioning market economy

Economic policy essentials

Efforts were made to improve coordination of economic and fiscal policies. The National Fiscal Council (NFC) started its work in 2005, with the aim of coordinating and setting targets for fiscal policy. However, since its establishment, the NFC has operated without a clearly defined legislative basis and lacks mechanisms to enforce and break deadlocks. As a result, it has encountered frequent stalemates and its decisions have not been considered binding. Disagreements have been frequent on how to allocate indirect tax revenues between different levels of government. Progress on finding a legal solution to strengthen fiscal coordination has been slow and no concrete results have so far been achieved. The need for improved coordination has increased with the introduction of the single account as this receives the revenues from indirect taxes. Overall, coordination of and agreement on economic and fiscal policies between different levels of government have remained problematic.

The analytical capacity to support coordinated economic and fiscal policy making has improved, but from a low base. The authorities have taken over the task of compiling fiscal data from the IMF. They have also taken greater responsibility for the budget process, where the IMF and the OHR had previously played an active role. A law was adopted which creates an institutional basis for economic policy analysis at the state level. Analytical capacity at state level has also strengthened. The track record in keeping agreed policy promises has been mixed and backtracking has occurred in several cases. Bosnia-Herzegovina did not fully comply with World Bank agreements, particularly regarding the Federation. To summarize, analytical capacity improved but remained rather weak and policy coherence was often lacking.

Macroeconomic stability

The economy grew by an estimated 5.5% in 2005, down from 6% in 2004³. The economy has continued to be based strongly on raw materials and related manufacturing. Rising raw material prices as well as volume increases have played an important role in supporting growth. Privatisations, mainly in the RS, have also triggered some production increases in other sectors. In the RS total industrial production rose by nearly 20% in 2005 and had increased to 25% in August 2006 year-on-year. The Federation experienced a more moderate growth rate in industrial production of 5% in 2005 and of 5.5% in August 2006 compared to a year earlier. However, detailed analysis of economic developments is impeded by poor availability of statistics. To conclude, economic growth remained relatively strong but the growth base was narrow.

Export growth was supported by improved reporting as well as stronger performance in some sectors. Still, the merchandise trade deficit was 53.3% of GDP⁴ in 2005. The current account deficit expanded from 20.8% of GDP in 2004 to 22.5% in 2005. However, a large part of the widening was driven by increased imports in the fourth quarter of 2005 in the run-up to VAT introduction. It was matched by a sizeable reduction of the current account deficit in the first

³ Estimates for growth in BiH vary between different sources. Estimates for 2005 mostly range between 5% and 6% of GDP.

⁴ Grey economy not included.

half of 2006, as exports grew by 30% and imports weakened by 1.5% compared to the same period the previous year. After adjusting for the effects of VAT introduction on imports, the current account deficit seems to remain fairly stable at around 20%. In summary, despite some temporary improvements, underlying external imbalances continued to be large.

FDI Inflows were strongly related to the privatisation process. Other types of investment inflows grew significantly in 2005, to 13% of GDP, and financed over half of the current account deficit. These inflows were partly a result of transfers from foreign parent companies to their banks to finance increased lending and higher capital requirements. Such mainly banking-related investment inflows decreased somewhat in 2006, but their role in financing the current account deficit remained strong. Inflows of foreign direct investment (FDI) fell from 7% of GDP in 2004 to around 5.2% in 2005 and decreased further to 3.9% of GDP in June (year-on-year). Errors and omissions in the balance of payments statistics remained large at around 20% of the current account deficit. Overall, the current account deficit was mainly financed by FDI inflows and inflows via the private sector.

External public debt continued to decrease and reached 27.2% of GDP at end of 2005. Most loans are on concessional terms and the debt service was therefore only 4.1% of the value of exports in 2005. However, the private sector's external indebtedness increased. Total external debt was estimated to be close to 60%. To summarise, total external debt grew as a result of increased private sector borrowing.

Progress has been made in setting out new conditions of repayment for different types of claims on the government related to the war and pre-war period. For frozen foreign currency deposits, a state level framework law was adopted which outline conditions for debt restructuring. Legal frameworks concerning the restructuring of war damage claims have been adopted at entity- level. However, amendments to the law, aiming to shorten the repayment time drastically from 13 to 5 years, was put forward but not yet voted upon. An agreement to restructure the debt to the net present value of 10% of GDP was previously struck down by the courts and future arrangements will be more costly. Restitution claims are estimated to be large and the terms of restructuring therefore fiscally important, however, no solutions have yet been agreed or adopted. Overall, some progress has been made in addressing the issue of domestic debt claims, but uncertainty remains about the final fiscal impact.

Official data show that unemployment rose from 43% in 2004 to 44.6% in 2005. Using ILO definitions, unemployment was estimated at 31% in April 2006. Taking informal jobs into account, unemployment is estimated to be closer to around 20% of the working-age population, although no recent official estimate is available. Unemployment remained largely of a structural nature. It also varied considerably with educational levels and was high among the young. Employment creation in the formal sector has stagnated. The informal sector has absorbed some of the new entrants and laid-off workers, increasing informal employment. In conclusion, job creation remained slow and unemployment very high.

Inflation reached 7.6% in January 2006, compared with only 0.4% a year earlier. The main ⁵ underlying factor was price increases related to VAT introduction, but higher energy prices and increases in regulated prices also played a role and influenced price increases in other sectors. Inflation slowed down in the first months of 2006 and reached 6.8% year-on-year in March but then picked up again. In August 2006, inflation reached 7.1% in the Federation and

⁵ Measured by Retail Price Index.

9.8% in the RS year-on-year. Overall, inflation rose substantially from low levels, mainly driven by supply side factors.

Bosnia and Herzegovina continued to operate a currency-board arrangement. The Convertible Mark (KM) remained pegged to the euro. The main policy tool has been the rate of reserve requirements for commercial banks, which was further increased to 15% of liabilities at the end of 2005. The upward trend in foreign exchange reserves has continued. Net foreign reserves increased by 20% in euro terms during 2005 and covered 4.2 months of imports. Reserves rose another 17% in the first 7 months of 2006. In summary, the currency board remained the anchor for monetary policy and reserves continued to increase.

Fiscal policy was tightened in 2005, but public spending is high and increasing. The consolidated budget balance switched from a deficit of 0.6% of GDP in 2004 to a surplus of 0.9% in 2005⁶. This change stemmed from stronger sales and excise tax revenues and a reduction in expenditures. However, the state and entity budgets for 2006 were expansionary and reflected the pre-election climate. The increases were mostly of a permanent nature. In addition, a War-Veterans Law adopted in the Federation will significantly raise expenditures. Despite some rebalancing of budgets in mid 2006, government expenditure is therefore set to increase from an already high level of around 50% of GDP⁷ and the fiscal position is likely to worsen. Government expenditures remained inefficient and the large resources spent generated weak outcomes. Overall, public expenditures increased from a high level while efficiency in spending stayed low.

A single VAT rate was successfully introduced across the country in January 2006. This was an important reform supporting the creation of a single economic space and the reduction of the grey economy. Total indirect taxes increased by 30% in the first seven months of 2006 compared to the previous year, but the increase was partly due to temporary factors. The size of the permanent revenue increase is therefore still uncertain but is not likely to fully cover the increases in expenditures. In summary, the introduction of VAT has been a success and has resulted in increased revenues.

Exports have been increasing, but are composed of a small and mostly raw-material based range of products. This makes revenues sensitive to commodity prices and the growth base narrow. The persistence of a large current account deficit reflected high private consumption and an insufficiently dynamic and partly loss-making corporate sector. The large imbalances represent a particular challenge in the context of the currency board and require prudent fiscal policies. Looming fiscal pressures, from for example the unsettled domestic debt and costs for institution building, therefore pose a particularly significant risk. The willingness and ability have been limited in tackling the underlying structural problems and viewing fiscal policies in the long term. To conclude, despite relatively high growth and low inflation, there are threats to macroeconomic stability.

Free interplay of market forces

Private sector activity reached 55% of GDP in 2005, up from around 50% in 2004. In the RS, the privatisation process proceeded and 38 companies were sold. Almost all of these were larger enterprises. A detailed plan on the privatisation of Telekom Srpske was adopted in June 2006 and the tender procedures were launched in September. Amendments to the Federation's

⁶ Includes all levels of government, off-budget funds and foreign-financed projects.

⁷ Grey economy not included.

Law on Privatisation, supporting some improvements to the process, were enacted in mid 2006. From the initial nominal capital intended for privatisation in the RS, 40%⁸ remains to be privatised mostly in the utilities and infrastructure sectors. The privatisation process slowed down further in the Federation and 13 companies were sold. This mainly reflected a lack of political will, a complex institutional decision-making structure and an inadequate legal framework. 60% of the initial capital nominated for privatisation in the Federation remains to be privatised. Overall, progress in privatisation has been uneven and the size of the public sector is still large.

Coordinated efforts to improve the business climate were weak. At the State level, the Association of Employers was responsible for identifying problems and barriers but had little influence over policies. The RS started its own initiative to identify administrative barriers and initiate changes, but the process was still at an initial stage and had not yet influenced the operational climate for companies. In summary, no significant improvements of the business environment were observed.

Free market entry and exit

In 2005, starting a company involved 12 steps and took on average 54 days, which was 5 days more than in 2004. The cost for business registration has remained high, although it has varied across the country. Acquiring all the relevant licences and permits to start operations took on average 467 days and was particularly costly ((25 times GDP per capita). Registering property took on average almost a year and involved 7 different steps. The laws adopted in 2004 and 2005 allowing for the creation of a single business registration system have not been fully implemented, due mainly to a lack of technical capacity. These were aimed at reducing registration times and costs. Overall, starting a business has remained time-consuming and costly.

Since the adoption of new bankruptcy legislation in 2003, some gradual improvements have occurred. The average time to process a procedure has been reduced from 3 to 2 years and over 400 cases have been initiated in the courts. However, thousands of companies are still facing insolvency and have not yet been put into bankruptcy procedure. To conclude, some improvements have been achieved concerning bankruptcy procedures.

Adequate legal system

The country has a relatively high number of courts, but there is still a large backlog of unresolved cases. Political interference in the system has occurred. Overall, the legal system still hampers the business environment.

Sufficiently developed financial sector

Banking operations have continued to grow strongly and total assets have increased from 68.6% to 80% of GDP. This growth was supported by a continued expansion of lending to the private sector from 38% to 46% of GDP. The number of banks increased from 33 to 34. Foreign banks dominate the sector and their ownership increased further to 73% of total capital. Privatisation of banks has been completed in the RS, but in the Federation six banks have remained in public hands. They accounted for 13% of total banking sector capital. In

⁸ According to law, 15% of privatised capital needs to be given to state controlled pension and restitution funds. If the numbers are adjusted for this, around 50% of initial capital remains in state hands.

2005, the banking sector represented around 80% of total financial sector assets. Overall, the banking sector has continued to expand rapidly and is dominated by foreign banks.

Interest rate spreads between loans and deposits narrowed from 6.6% in 2004 to 5.4% in 2005 amid increasing competition. Return on equity rose from 5.8% to 6.4%. The lending expansion was partly financed by the foreign parent companies. This resulted in an increase in long-term foreign liabilities of the sector by 34% in 2005. Increased lending also resulted in a fall of the capital adequacy ratio from 18.7% to 17.7%. The share of non-performing loans for the sector as a whole has continued to decrease. To summarise, competition in the banking sector has increased.

The two stock exchanges both increased their market capitalisation by around 70% in 2005. The number of traded securities more than doubled and total capitalisation increased to around 60% of GDP at the end of 2005. However, most of the shares traded were in investment funds. The RS adopted a Securities Market Law supporting better operation of markets and tougher disclosure principles. To conclude, stock market capitalisation has grown rapidly and some improvements in the regulatory framework have occurred.

Banking supervision was conducted by two separate entity banking agencies, and was coordinated by the Central Bank. The approach shows clear limitations in the increasingly integrated banking sector, but no agreement could be reached on how to merge supervision. Laws to strengthen the regulatory framework for micro finance institutions have been adopted in both entities. Supervision for other parts of the financial system, such as insurance, is fragmented and still developing. Leasing operations have remained outside the scope of supervision. Overall, supervision of the financial sector has remained fragmented and is underdeveloped in certain areas.

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

Existence of a functioning market economy

The functioning of market forces is hampered by the strong influence of the public sector in the economy and the weak business environment and legal climate. Despite some improvements, markets are also sometimes fragmented between the entities. Overall, the macroeconomic setting provided a fairly stable environment for market actors, but the institutional and legal framework was often not supportive of private sector development.

Sufficient human and physical capital

Several laws to support reforms in the educational sector have been prepared, such as state-levels laws on Higher Education and on an Education Agency, but have not yet been adopted. The sector is being managed by a total of 23 organisations at different levels of government. The resources spent are comparatively large but outcomes are weak. Enrolment rates are relatively low for secondary and higher education. There are substantial mismatches between the labour market and the knowledge provided by education, particularly for vocational training. There are also large regional disparities in student performance. This is a reflection of limited harmonisation and coordination across the country and differences in funding. To conclude, in the educational sector structures have remained inefficient and outcomes weak.

Laws at entity-levels aimed at simplifying the complex direct income taxation systems have been prepared. In the RS a new legal framework has been adopted, while in the Federation proposed legislation has been rejected by the parliament. The institutional structure has

remained complex. There are 12 separate organisations responsible for employment service operations and another 13 for labour market policies. Labour market legislation was fairly harmonised across the country, but there were still large differences in some areas, concerning unemployment benefits, for example. In addition the legal framework is rigid and non-wage labour costs high. The laws prepared in the two entities differed and taxation rules continue to be different between the entities. Overall, limited progress was achieved in improving the functioning of labour markets.

Active labour market programmes existed at both state and entity levels. The scale of policies have remained modest and focussed on subsidising employment rather than enhancing skills. However, the large number of institutions involved in active labour market policies complicated the systematic development of policies. Mobility of workers has remained low and labour markets continued to be fragmented. To conclude, coordination of labour market policies was weak and the labour market remained fragmented.

The FDI stock per capita reached € 495. Around 58% of total FDI went to the industry and 16% were directed to the banking sector. Yearly FDI inflows decreased from over 7% of GDP in 2005 to around 4% of GDP in mid 2006, mainly as a result of lower privatisation-related inflows. The institutional framework and capacity to deal with R&D issues have remained weak and fragmented. Overall, FDI inflows remained strongly linked to the privatisation process and the R&D framework remained weak.

Adequate sectoral and enterprise structure

The share of employment in manufacturing decreased during 2005 by around 1%, to 22% in the Federation and 23.5% in the RS. The share of formal employment in agriculture remained low, at around 2.5% in the Federation and 3.5% in the RS⁹. However, official statistics do not include a large part of the working population. Overall, the share of different sectors in total employment seemed to remain fairly stable.

Both entities have separately performed some SME related activities, but with a lack of coordination of policies. A comprehensive draft SME strategy was blocked due to opposition to the proposed creation of state-level structures. Business-government dialogues and training to support entrepreneurship have been weak. To conclude, responsibilities for SME policies continued to be fragmented.

The RS adopted a law allowing enterprises to be privatised to reschedule their debt. This was to assist their restructuring and sale. In the Federation however, legal changes implied that debt can be rescheduled without any real restructuring of the company taking place. Corporate governance practices generally remained deficient. Large parts of the corporate sector, both privately and publicly owned, need restructuring. The lack of incentives for managers and owners to embark on restructuring remained a major obstacle to change. Some legal changes have been adopted in the RS concerning the Privatisation Investment Funds, to improve ownership structures and incentives to restructure mainly in the voucher-privatised companies. Overall, progress in enterprise restructuring continued to be slow although some improvements were made to the regulatory framework.

⁹ Labour force survey data however showed that real employment in the agricultural sector was around 20% and employment in industry 30% in April 2006, with no comparative older data available.

Utilities and infrastructure facilities stayed publicly-owned. Generally the regulatory frameworks have improved, but remained weak with fragmented responsibilities. In the energy sector, reforms concerning unbundling of transmission have proceeded. Progress towards liberalisation and increased competition has been slow. To conclude, utilities and infrastructure remained publicly-owned and despite some improvements in regulatory structures the frameworks remained weak.

State influence on competitiveness

The Competition Council, created in 2004, started to play a concrete role in the market. It was given more power, improved its alignment with the *acquis* and expanded its regional coverage. Public procurement procedures improved and progress was made in establishing the full institutional framework foreseen in the law. However, no improvements have been made in the area of state aid and there has been no monitoring or comprehensive information on the scope of state aid. The state level has no competence in this field and state aid is mainly provided by several lower levels of government with little transparency. An Intellectual Property Institute has been established but is not yet fully operational. In summary, some progress has been achieved in improving the competitiveness climate.

Trade integration with the EU

Trade in goods and services as a share of GDP amounted to 122% in March 2006 year-on-year, compared to 117% in 2004. Imports constituted 83% of GDP. The EU has remained the most important trading partner. In 2005, trade with the EU increased and its share of total trade decreased and reached 53% of exports and 50% of imports. In the first quarter of 2006, exports to the EU increased considerably to 59% of total exports. Exports to neighbouring countries with Free Trade Agreements in place increased from 39% to 42% of total exports in 2005. 70% of trade has been achieved with five countries, three of which are in the EU. This points to a dependency on developments in a few markets. The composition of exports has continued to be narrow. Minerals, metals and related products accounted for 40% and chemicals and wood products accounted for another 20% of total exports. To summarise, trade openness continued to increase but with a continued dependency on a few markets and products.

Real effective exchange rate (REER) of the KM depreciated slightly in January to October, but then regained its value and was close to its level a year before at the end of 2005. In the first half of 2006, the REER remained fairly stable. The main influences of the REER are fluctuations in the exchange rate with some of the neighbouring countries. These are the main trading partners outside the Euro area. Overall, price competitiveness has remained broadly stable.

4. EUROPEAN STANDARDS

This section examines Bosnia and Herzegovina's capacity to gradually approximate its legislation and policies with those of 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

Little progress has been made as regards **standardisation and certification**. Bosnia and Herzegovina has not yet begun implementing 2004 legislation on the establishment of three independent Institutes for Standards, Metrology and Intellectual Property. Consequently, issues related to standards (as well as to metrology) are still addressed by a common structure, the Bosnia and Herzegovina Institute for Standards, Metrology and Patents (BASMP). BASMP is a Partner Standardization Body in the European Committee for standardization (CEN) and an affiliate member of the European Committee for Electro-technical Standardization (CENELEC). BASMP is also a full member of the European Telecommunications Standards Institute (ETSI).

By the end of 2005, 6028 European Standards (EN) had been adopted as Bosnia and Herzegovina standards (BAS), a great majority of them by the declaration method. Out of the total number of adopted ENs, 1120 are those which confer presumption of conformity to essential requirements of technical regulations.

The Institute for Standardisation established 40 technical committees as well as 64 working groups with 724 hired experts to prepare BAS standards. The Director of the Institute for Standardisation remains to be appointed.

Few developments have taken place in the field of **metrology**. The management positions (director and deputy director) of the Institute of metrology have been filled. The Institute is an associate member of the Organisation for Legal Metrology (OIML) and, since January 2006, has been an associate member of EUROMET (European Collaboration in Measurement Standards). In May 2006 the Rulebook on the Internal Organisation of the Institute for Metrology was adopted. The Commission for takeover and distribution of tasks, equipment, archives and pecuniary assets as well as civil servants and employees has begun its work. The legislation on metrology is not harmonised with EU standards which require a separation between legal, scientific and industrial metrology. Moreover, the existing Entity Laws on metrology are not fully harmonised with the state level legislation. A study providing a basis for the preparation of a strategy for the development of metrology in Bosnia and Herzegovina has been completed.

The Institute for Accreditation has so far granted 26 accreditations, 11 to test laboratories, 4 to calibration laboratories, 2 to product certification bodies and 9 to inspection bodies. In 2005, 6 new employees were recruited, bringing the total number of staff to 10 and adequate offices and equipment have been made available for its operations.

Limited steps have been taken as regards **market surveillance**. The management posts at the Market Surveillance Agency have been filled and a decision regarding the location of the Agency has been taken. Nonetheless, the Agency is not yet operational. The market surveillance system remains largely based on mandatory standards and pre-market control. Further development of a market surveillance system based on appropriate product legislation is needed.

The 2004 Law on Technical Requirements for Products and Conformity Assessment is in force, but its relevance is limited since no technical regulations transposing the *acquis* in the field of conformity assessment have been adopted and there is lack of a proper conformity assessment infrastructure. An Instruction on the Method of Developing and Procedure of

Adoption of Technical Regulations was adopted in May 2006, but internal consultation and notification mechanisms have not been formally established.

Currently there is no conformity assessment system in place. As a temporary measure, the Ministry for Foreign Trade and Economic Relations has been mandated to give authorisations to individual bodies that are performing activities similar to conformity assessment as regards specific products. Conformity assessment is not performed on locally manufactured and imported products before they are released on the market. A Programme of Transposition of Technical Regulations was adopted in May 2006.

Some progress has been achieved in the area of **consumer and health protection**. The Consumer Protection Law of 2003 has been replaced by a new act that introduces the institution of the consumer protection ombudsman and gives increased rights to consumers in Bosnia and Herzegovina. The relevant Ombudsman institution has not yet been established. Bosnia and Herzegovina also has a state-wide Consumers' Association, which aims to promote the Laws on Competition and Consumer Protection. The activities of the association are still limited, as it has no sources of funding apart from a symbolic membership fee.

A Law on Medical Products and Medical Devices has been drafted and submitted to the Ministry of Civil Affairs, but was rejected by Parliament. As a result, a domestic monopoly production is maintained. The establishment of a National Agency for Medical Products and Medical Devices that should have been regulated by this law is therefore still pending.

Institutional and legislative developments provide a basis upon which Bosnia and Herzegovina needs to build to establish a strong system of consumer and health protection throughout the country.

Bosnia and Herzegovina's preparations in the fields of standardisation, certification, metrology, market surveillance and consumer and health protection remain at an early stage.

4.1.2. Movement of persons, services and right of establishment

There are no particular developments to report with regard to the **movement of persons**. There has been no progress in relation to the movement of workers. The labour legislation and the policy framework remain fragmented and labour mobility continues to be limited. Foreign nationals, including EU citizens, with legal residence in either Entity have legal access to employment. They need to obtain a work permit. These working permits are valid for one year and may be extended. They are issued only if no unemployed, qualified citizen of Bosnia and Herzegovina is available to fill a particular vacancy. Informal administrative procedures for foreigners (e.g. educational qualifications requirements/verification) are often cumbersome and represent a deterrent to mobility. As for social security rights, the social security system of Bosnia and Herzegovina remains fragmented and technically inadequate to provide for a coordinated social security mechanism with the EU. Moreover, the system does not provide entitlements to social security benefits for dependent, resident family members of foreign nationals working in Bosnia and Herzegovina.

Bosnia and Herzegovina's efforts in the area of movement of persons need to be stepped up.

Limited progress has been made in the area of **services**. Banks in Bosnia and Herzegovina are still subject to separate Entity legislation and are supervised by two different Entity-level Banking Supervisory Agencies. The lack of a single State-level legislation and of a single banking regulator undermines the implementation of supervisory practices in line with

international best practices. The Central Registry of Corporate Loans in Bosnia and Herzegovina, established within the Central Bank, started operating in April 2006.

The members of the Administrative Board of the State Level Insurance Supervisory Agency and the Agency's Director were appointed in December 2005. However, staff recruitment started only recently and the Agency is not yet fully operational. Furthermore, State-level legislation did not transfer supervisory competencies to the State-level Agency and therefore supervision continues to remain at Entity level.

No progress can be reported with regard to obligatory relationships and leasing legislation. As the Law on Obligations, which affects various aspects of commercial activity, such as real estate markets, mortgage lending and leasing, is yet to be adopted at State level, obligatory relationships are regulated by the non-harmonised Entity-level legislation, based on an outdated Law on Obligations from 1978.

Republika Srpska adopted in August 2006 a new Securities Market Law, which aims at aligning Bosnia and Herzegovina's legislation to the *acquis*.

Some progress can be reported in bringing the accountancy and audit fields into line with international standards. According to the State- and the Entity-level Accounting and Auditing Laws, as of January 2006, International Financial Reporting Standards (IFRS), and International Standards of Auditing (ISA) are applicable in Bosnia and Herzegovina. However, thresholds for application of IFRS are very low, raising questions about both the proportionality of this requirement and the capacity of the authorities and of the domestic accounting and auditing professions to apply them in practice. These laws define also the uniform requirements for professional certification and licensing as well as for the professional development of accountants and auditors, in line with the International Federation of Accountants (IFAC) criteria.

No additional development has taken place in relation to the **right of establishment**. Bosnia and Herzegovina continues to exercise a flexible regime on business establishment. All EU companies may freely establish their operations in Bosnia and Herzegovina, subject to national treatment (with the same rights and obligations as Bosnia and Herzegovina nationals). All enterprises operating in Bosnia and Herzegovina are also allowed to acquire land and property. The current legislation forbids nationalisation, expropriation, and requisition of those properties (except in instances of national interest, with payment of appropriate compensation). No cases of expropriated property have been reported so far.

Notwithstanding the liberal establishment regime, various informal factors continue to represent obstacles to establishment. These include cumbersome administrative procedures, corruption and poor enforcement of laws, mainly in respect of contracts and property rights.

No significant changes have occurred in relation to **company law**. The framework legislation on Single Business Registration in Bosnia and Herzegovina, adopted in 2004, and the Entity-level legislation, adopted in 2005, which aim to partially reduce the registration times and costs, are still not properly enforced.

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

4.1.3. *Free movement of capital*

No particular new developments have been observed in the area of **free movement of capital**.

With regard to **capital movements**, Bosnia and Herzegovina continues to exercise a liberal regime of inward capital flows, but imposes certain restrictions on outward transfers by individuals and non-residents. With regard to foreign direct investment inflows, restrictions only apply to the armament and media sectors where the foreign capital stake is limited to 49 percent. Transfers and repatriation of profits and remittances as well as foreign currency transfers by domestic and foreign companies are fully allowed. The State-level Law on Foreign Direct Investments and the implementing Entity-level legislation ensure transfer and repatriation rights.

Domestic and foreign companies may hold multiple bank accounts to make or receive payments in foreign currency. There are no exchange restrictions or controls on local currency and the effective currency board arrangement with a fixed peg provides for full convertibility of the Convertible Mark (KM) into the Euro. However, all foreign exchange operations, including transfers of foreign exchange, are regulated by non-harmonised Entity-level legislation which is not fully aligned with European standards.

Bosnia and Herzegovina has a modern **payment system** structure. The reform of the payment system has been particularly successful. The Real Time Gross Settlements (RTGS) and Gyro Clearing systems are almost entirely compliant with the Core Principles for Systematically Important Payment Systems issued by the Bank for International Settlements (BIS). The Central Bank holds the payment systems under its jurisdiction. Commercial banks carry domestic payment transactions, with the Central Bank serving as a settlement agent.

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

4.1.4. *Customs and taxation*

Limited additional progress has been achieved in relation to **customs rules**. Customs legislation is in place and is largely aligned to the *acquis*. Its full implementation needs to be ensured, especially in areas such as origin, valuation and simplified procedures.

Bosnia and Herzegovina has five operational free zones. Requests for new free zones have been submitted. There has been no consistent control on goods entering or leaving the free zones. The Law on Free Zones and the Law on Amendments to the Law on Customs Policy, adopted in June 2006, exempt from customs duties equipment imports for production activities in free trade zones. This is not in line with the *acquis*, which establishes that free zones are part of the customs territory and that such equipment can normally not be exempted from duties.

As for customs valuation of imported goods, during part of the reporting period Bosnia and Herzegovina continued to use price lists instead of the transaction value for determining the customs value basis for certain types of goods, a method which is contrary to the WTO rules, to the standstill clause of the EU's Autonomous Trade Measures, to the future SAA and to Bosnia and Herzegovina's own customs law (in particular Article 26 Customs Policy Law). In April 2006 a letter was sent by the Indirect Taxation Agency (ITA) to all regional centres to rectify the situation, but consistent implementation throughout the country remains to be confirmed.

Bosnia and Herzegovina needs to dismantle customs fees for processing customs declarations as these are contrary to the *acquis*.

With regard to the **administrative and operational capacity**, the Indirect Taxation Authority (ITA) has made further progress in the area of customs. After the successful merger of the three customs administrations into the ITA, a single account was established. ITA is pursuing its efforts in combating fraud and corruption, and training for its entire staff on a Code of Conduct in line with EU standards is ongoing. There are currently 2164 staff (including the VAT section) working in ITA. Nonetheless, sustained efforts remain necessary. The capacity of the ITA internal audit, investigation and intelligence unit needs to be further improved, and risk analysis needs to be further developed.

Since January 2006 ITA has been the only competent authority for issuing and requesting verification of EUR 1 movement certificates for trade with the EU. The Ministry for Foreign Trade and Economic Relations (MoFTER) is responsible for the verification of EUR 1 movement certificates for Free Trade Agreements concluded with other countries. The distribution of competences between ITA and MoFTER concerning origin issues, however, is not clear. This is causing problems of management on origin issues which may increase when diagonal cumulation involving the EC and other Stabilisation and Association Process countries is introduced. Amendments to the Law on Customs Policy are necessary, as at present there is no legal basis for the provisions on origin regulating the application of the ATMs.

In June 2006 an agreement on cooperation and mutual assistance between the Indirect Taxation Authority of Bosnia and Herzegovina and the Ministries of Finance of the Republic of Bulgaria, the former Yugoslav Republic of Macedonia, the Republic of Montenegro and the Republic of Serbia was signed in Skopje.

As regards computerisation, the Bosnia and Herzegovina authorities confirmed in June 2006 that they want to continue working with the ASYCUDA computerised customs declaration and processing system rather than opting for Alice Customs, an alternative customs declaration processing system developed with EU assistance.

Overall, in the field of customs, Bosnia and Herzegovina has only partially met its targets.

As for **taxation**, there has been progress in the area of indirect taxation with regard to the implementation of value added tax (VAT). A single-rate VAT (of 17%), with exports zero rated, was introduced on 1 January 2006. The VAT legislation is based on the EU 6th Directive on VAT. The VAT threshold is 50,000 KM (about € 25,000) and companies can opt to register even if below the threshold, which is in line with the *acquis*. The implementation is well underway and the increase in revenues has so far exceeded expectations. Further efforts will be needed to enhance tax collection. This should include issues such as use of risk analysis techniques.

While the introduction of VAT has been successful, there has been little progress on the selection of a long-term Indirect Tax revenue reallocation model. Disputes over methods of revenue distribution have resulted in frequent delays. Equally concerning are attempts by Bosnia and Herzegovina's authorities to move the VAT legislation away from European standards by extending the zero-rate tax and introducing exceptions for certain categories of supplies. Implementation of social programmes aimed at mitigating possible negative effects of the VAT introduction is delayed.

The implementation of excise law is progressing and ITA tax stamps for excise products are in place. Indirect tax legislation will however need to be further aligned with the *acquis*.

There has been some limited progress with regard to direct taxation. Bosnia and Herzegovina has a very complex system, as responsibilities are dispersed amongst Entities and municipalities. All Entities have their own profit/corporate tax, personal income tax and property tax. The District of Brčko has a very favourable system, with a single flat rate of 10% for corporate and income tax. A similar regime has been introduced in Republika Srpska where the National Assembly adopted the Personal Income Tax Law in August 2006 (10% flat rate corporate tax and income tax with progressive rates and a number of exceptions and reductions). The Federation has so far failed to adopt a new income tax law.

In relation to Bosnia and Herzegovina's adherence to the principles of the Code of Conduct on business taxation, a gap analysis aimed at identifying the existing measures which could contradict those principles is necessary. Some tax schemes which require attention from this point of view have already been identified (e.g. 5 years' direct tax advantages in free zones, reduction of 20 % in the Federation for foreign companies) but a thorough assessment has not yet been carried out.

Tax reforms in the field of direct taxation should begin, particularly taking into account the company tax directives. A Treaty Network based on the latest OECD model should be completed.

Overall, Bosnia and Herzegovina's preparations in the area of indirect taxation are advancing. The tax administration needs to further improve computerisation and pursue its anti-corruption policies. Preparations regarding direct taxation remain at an early stage.

4.1.5. Competition

Bosnia and Herzegovina is progressing steadily in the area of **anti-trust** control. The Competition Act adopted in July 2005 was a positive step. Further amendments (e.g. geographical market definition) remain necessary for alignment to the *acquis*.

As of January 2006, the Entity offices for Competition of Banja Luka and Mostar, which were organisationally part of the Entity Ministries of Trade, became part of the Competition Council.

In the period between August 2005 and March 2006 the Competition Council developed a dozen implementing legal acts aimed at aligning the legislation with the *acquis*. The Council's staff currently numbers 19, 7 of which were recruited in the reporting period. The competition authorities have carried out a number of investigations and have issued several opinions, including in the field of public transport, TV advertising and banking mergers. Of 25 filed cases, 18 have so far been resolved by binding decisions, of which 5 in the reporting period. In 2006 one *ex-officio* case was also initiated.

The Council has established contacts with relevant authorities in the region - a Memorandum of Cooperation and Understanding with the Agency for Market Competition of the Republic of Croatia was signed in March 2006 - and with EU countries, as well as multilateral cooperation with the appropriate international bodies, organisations and institutions in the competition domain. Negotiations on a Memorandum of Co-operation and Understanding with the former Yugoslav Republic of Macedonia are currently underway.

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

There is still no significant development with regard to **state aid**. Relevant legislation has not yet been developed and there is no State-level body responsible for the monitoring of aid given from the public budget. As a result, a comprehensive inventory of state aid schemes has yet to be established. The lack of control is exacerbated by the fact that the granting of state aid remains the responsibility of Entities, Cantons and Municipalities.

Preparations in the field of state aid remain at an early stage.

4.1.6. Public procurement

Some progress has been made in the field of **public procurement**. The implementation of existing legislation has continued.

Institutionally, the progress is notable but needs to be sustained. The State-level Public Procurement Agency started operation in December 2005. It now has adequate budget and equipment to fulfil its mandate. As of June 2006, 12 staff members, including the Director and 2 members per branch office in Banja Luka and Mostar, have started work. This is about half the staffing level planned by 2007. The Public Procurement Agency Board was established at the end of 2005.

Standard tender documentation and electronic publication of notices is becoming the standard in procurement performed by public bodies. Officials who deal with procurement procedures in these bodies, judges and a number of operators from the private sector have undergone training on specific aspects of public procurement law and regulations.

The current provisions on the obligatory application of preferential domestic treatment give a price preference of up to 15% to domestic bidders. This preference is decreasing by 5% every two years and at this pace will be completely abolished by 2011.

The Procurement Review Body, which rules on complaints and reports to Parliament, was established after a long delay and has experienced some problems. In December 2005 five of its six members were appointed but three resigned, including the chairman. The Review Body thus lacked the quorum necessary to make decisions on tender appeals. The result was a rising number of appeals and many suspended public contract procedures. The authorities addressed this problem in August 2006 through the appointment of a fourth member. The Procurement Review Body has now resumed its work.

Overall, Bosnia and Herzegovina's preparations in the field of public procurement have been initiated.

4.1.7. Intellectual property law

Limited progress has been made with regard to **intellectual property rights**. The Book of Rules for the internal organisation of the Intellectual Property Institute was approved by the Council of Ministers in May 2006 and five units were established. The Institute currently has 13 employees. The 2006 budget provides for the recruitment of 34 additional staff, with the aim of reaching a total of 64 members.

The Institute does not yet carry out all its mandated functions (i.e. in relation to copyright, it does not audit Collective Management Societies) and is currently significantly under-

resourced, undermining its capacity to perform its tasks effectively. The Institute, which is also competent for patents, has received three applications since the beginning of 2006.

Due to the lack of a centralised database it is not possible to perform a search to avoid conflicting designs and trademarks. This results in a high level of legal uncertainty.

As for **enforcement**, Bosnia and Herzegovina does not adequately enforce intellectual property rights (IPR). High levels of counterfeiting and piracy exist in Bosnia and Herzegovina, which continues to be a distribution point for counterfeit and pirated goods to the rest of Europe.

Bosnia and Herzegovina is not yet able to implement and enforce key international agreements on IPR to which it is a party. It is a member of the World Organization for Intellectual Property (WIPO) and party to a number of important IPR conventions such as the Paris Convention for the Protection of Industrial Property, the Madrid Agreement Concerning the International Registration of Marks, and the Bern Convention for the Protection of Literary and Art Works.

4.1.8. Social policies

Few developments have been registered in relation to **employment policies**. Many political, social, and administrative issues need to be tackled to properly address this matter. Amongst other things, it is necessary to further promote active labour measures to improve the skills of job-seekers (adequate training, opportunity for first professional experience, etc.).

While "State Reports on Employment Policies in Bosnia and Herzegovina for 2004 and 2005" were jointly prepared by the main competent institutions at State- and Entity-level, Bosnia and Herzegovina does not yet have a National Action Plan for Employment.

An obstacle to the good functioning of the Bosnia and Herzegovina labour market is its large degree of fragmentation and its complex administrative structure. The policy responsibilities for the labour market are divided between the State Agency for Labour and Employment and many other organisations at Entity and Cantonal level. Under these circumstances, policy making is particularly cumbersome and the Agency has only a limited influence on it. Moreover there is no single labour market legislation, unemployment benefits vary within the country and the mobility and flexibility in the labour market is low, as is the level of job creation.

The complex form of government and the fragmentation of legislation have not favoured the development of an adequate system of collective bargaining. This, together with high labour taxes, contributes to the inflexibility of the labour market.

The creation of an up-to-date legal framework for occupational safety and health and its implementation and enforcement remain important issues for social progress.

In the field of **education**, little progress has been made. The country's institutional setup remains complex, with fourteen Ministers responsible for education (one at State level, one per Entity, one for the Brčko District and one for each of the ten Cantons).

Some developments have been registered as regards the implementation of the 2003 Framework Law on Primary and Secondary Education, which mandated the introduction of nine-year primary education in schools. This nine-year cycle will be introduced in all but one

canton as of the next school year. There has also been some limited progress in eliminating divisive and discriminatory symbolism from schools through the implementation of the Criteria on School Names and Symbols adopted in April 2004. However, no significant steps have been taken to prevent the separation of pupils in schools along ethnic lines, which remains a serious issue.

Little progress has been made in adopting education-related legislation which has been under preparation for years. The Higher Education Law has not yet been adopted. The Law on the Education Agency, the Framework Law on Vocational Education and Training and the Framework Law on Pre-school Education are also pending. The adoption of the Higher Education Law and Law on Education Agency is of particular importance for Bosnia and Herzegovina to meet the requirements of the Bologna Process and the Lisbon Convention. In the area of education, Bosnia and Herzegovina is lagging behind its targets.

4.2. Sectoral policies

4.2.1. Industry and SME

No significant developments can be reported in the area of Industry and SME. The industrial strategy has not been adopted. The industrial sector in Bosnia and Herzegovina remains characterised by low productivity and poor competitiveness. The authorities of Bosnia and Herzegovina have not yet developed a sound and comprehensive industrial policy and no steps have been taken towards the establishment of an integrated research policy.

Some progress can be reported in the area of privatisation and restructuring of companies, with a relative acceleration of the privatisation process in Republika Srpska. However, Bosnia and Herzegovina still retains a large portfolio of wholly state-owned firms, and privatisation of strategic firms has continued to be slow. Reopening of past privatisation can easily damage investors' confidence and should be avoided. Action remains outstanding on the work and the streamlining of the procedures of the country's existing privatisation agencies, in particular in the Federation. A Securities Law and an Investment Funds Law were adopted in Republika Srpska. Regarding corporate governance, implementation of legislation remains problematic and awareness is limited. There is no corporate governance code and there are significant differences between corporate governance regimes in the Entities.

Limited progress has been registered in this area through the adoption of the State Law on Registration of Legal Entities, which aims to streamline and harmonise the Entity laws on company registration. Entity and Brčko District laws have been aligned to mirror the State Law. The registration process remains however different in modalities and costs between Entities and Brčko District and a fully harmonised system has therefore not yet been achieved. Full implementation of this legislation is now required. An Export Promotion Agency has been established within the Foreign Trade Chamber. An Export Promotion Council has also been established. A new Director of the Foreign Investment Promotion Agency was appointed in December 2005 and the staffing level has increased from 8 to 15 members. Overall, the business environment remains insufficiently supportive to business and trade development.

As regards SME policy, Bosnia and Herzegovina has not yet adopted the draft SME Development Strategy, which proposes the establishment of a central SME policy capacity, including the setting up of a State-level SME Agency, a State-level SME advocacy system and other policy instruments. Consequently, no progress has been made in implementing the

priority actions identified by this draft strategy. The adoption of a sound SME strategy remains crucial to providing the country with a comprehensive policy framework for SMEs.

Beyond the SME strategy, little tangible action has been taken to support SME development. Despite the adoption of legislation in the Federation aimed at providing incentives to SMEs, concrete progress is needed towards developing suitable financial instruments favourable to businesses, establishing a tax policy able to further support business start-ups, and restructuring the current system of Chambers of Commerce. The use of research and innovation policy as a means to support economic reform and capacity-building remains low.

Whilst Bosnia and Herzegovina remains committed to the European Charter for Small Enterprises, the absence of a policy and implementation capacity at State-level implies that it can not reap any real benefit.

Bosnia and Herzegovina's preparations in the area of industry and SMEs remain at an early stage.

4.2.2. Agriculture and fisheries

Overall, limited progress has been made in the field of **agriculture**. The section for Agriculture, Food, Forestry and Rural Development within the Ministry of Foreign Trade and Economic Relations increased its staffing and took more ownership of its activities. The development of a comprehensive agricultural strategy is delayed, partly due to the lack of a State-level legal framework and of a State Ministry of Agriculture, Food and Rural Development. Policy making remains at Entity level and no coordination mechanisms are in place to ensure its harmonisation. In the absence of constitutional changes, the creation of the State-level Ministry of Agriculture, Food and Rural Development depends on the Entities' political will.

Harmonised collection of statistical data and international reporting on plant and animal production remain weak. The establishment of reliable and comparable agricultural statistics is hampered by the absence of framework State-level legislation.

The agricultural sector needs to address a number of weaknesses, such as uncertainties regarding land ownership, modernisation of the production and processing industry, low productivity, low land use and access to market. Insufficient financial resources for agriculture and rural development – approximately 4% of the total budget allocated – and the absence of consistent policy are preventing the sector's development.

Food safety responsibility is shared between the State level and the Entity level authorities, including approvals prior to import, food certificates and food laws and regulations. The 2005 State Food Safety Law set up a system for transposition of Old Approach directives which apply to food products. It also determined the tasks of the recently established Food Safety Agency of Bosnia and Herzegovina (FSA), which is the designated competent institution for food legislation. The Agency needs to be better equipped in human resources to perform its tasks more efficiently. Co-operation and co-ordination between the State and the Entities needs to be improved further to ensure proper implementation of legislation.

Bosnia and Herzegovina's preparations in relation to agriculture are still at an early stage.

Limited progress has been achieved in relation to **veterinary and phytosanitary policies**. The State Veterinary Office has increasingly taken the role of the competent authority in the

veterinary sector. It has initiated the implementation of the Veterinary Law by preparing the necessary implementing legislation. Efforts remain necessary to ensure that the Phytosanitary Agency has the sufficient resources to implement its tasks.

A first "Residue Monitoring Plan" has been prepared. The "National system for control and reporting of infectious diseases" has been established. The "Decision on the conditions to be fulfilled by the facilities for slaughtering animals, treatment, processing and storing of products of animal origin" was adopted. An "Operators' Manual" for border veterinary inspection has been developed. Appropriate measures were taken as a response to an outbreak of avian influenza and other contagious diseases in the region. A decision on establishment of official and reference laboratories was adopted in order to comply with EU standards.

However, there is a serious shortfall in the actual implementation of the above mentioned legislation, due to a lack of human and financial resources and weak coordination between State and Entity veterinary services. Limited progress has been made as regards border veterinary inspection posts. The decision on the conditions of the facilities for slaughtering animals aims to address the lack of a Hazard Analysis Critical Control Point in Bosnia and Herzegovina, but implementation has been imperfect.

In order to export to the EU market, Bosnia and Herzegovina needs proper laboratories and certification bodies. Actual establishment of the reference laboratories is ongoing. Only one food and feed testing laboratory is accredited by the Bosnian Accreditation Body (BATA) according to internationally recognised accreditation standards. Reference laboratories were established for animal health monitoring and residue monitoring and control in line with EU standards.

The implementation of the Animal Identification and Movement Control Scheme has been jeopardised by the unregulated supply of ear marks for cattle. Preparations for the identification and registration of sheep and goats have not started.

In the phytosanitary sector very limited progress has been achieved, only a regulation on wood packaging material has been adopted. The law on plant health is not yet fully implemented.

Preparations in the veterinary and phytosanitary area have been launched, but need to be accelerated.

As far as **fisheries** is concerned, the coastline of Bosnia and Herzegovina measures about 21 km and the country has no sea fishing fleet. Fish production consists mainly of trout and carp. Bosnia and Herzegovina has made progress in meeting conditions for exporting fishery products to the EU. It is expected that such exports will become possible once a number of outstanding EU requirements related in particular to legislation, laboratories, competent authorities, farms and safety controls have been met. Following the European Commission Food and Veterinary Office mission, Bosnia and Herzegovina's authorities have submitted the required documents which will form the basis for a possible revision of the export status.

4.2.3. Environment

Bosnia and Herzegovina's preparations in the field of the environment remain at an early stage. Environmental issues are primarily dealt with at Entity level. The Ministry of Foreign Trade and Economic Relations has the authority to deal with issues of natural resources,

including environmental protection, at State level. As regards the integration of environmental issues into other policies, no particular developments can be reported.

Regarding **horizontal legislation**, some developments have taken place, notably through the adoption of the Law on Inspections by Republika Srpska in January 2006. In the Federation, the Law on Inspections has been adopted, but its constitutionality is under revision and it has therefore not yet been implemented. Nonetheless, these laws limit inspectors' competencies to spatial planning and civil engineering issues and do not properly cover the range of the environmental legislation. Moreover, as in other areas, the lack of uniform implementation of legislation by the Entities remains an issue. The implementation of the existing Environment Impact Assessment legislation needs to be further improved. Some progress has been made towards ratification and implementation of respective international conventions in the field of environment. Further efforts are needed.

Regarding **waste management**, the Entities have adopted implementing legislation in the following areas: waste categorisation, waste management permits, hazardous waste and its transport, trans-boundary movement and disposal of hazardous waste, transfer of responsibility for waste recovery from producer to waste management facility operator, conditioning plans for existing landfills to operate according to sanitary landfill standards, selective collection, packaging and marking of waste, animal waste and other non-hazardous biodegradable waste. Little progress has been achieved in the implementation of this legislation. In addition, no progress has been made to support the recycling and recovery of priority waste products that can no longer be disposed of at landfills.

Some progress can be reported in relation to **water quality**. A Water Law which integrates the principles of the Water Framework Directive was adopted in both the Republika Srpska and in the Federation. Bosnia and Herzegovina has signed the International Convention for the Protection of the Danube River and the implementation is ongoing as foreseen. Collection of data in this area is not yet functioning well and reporting to the European Environment Agency is not systematic. Poor water quality and insufficient waste water treatment remains a key environment challenge.

Some developments have taken place regarding **air quality**, through the adoption by the Entities of implementing legislation on air protection. This legislation concerns monitoring, threshold values of emissions from various air pollutants and phased withdrawal of ozone depleting substances, in line with the Convention on the Protection of the Ozone Layer. The level of alignment of this legislation with the *acquis* remains to be confirmed.

The absence of skilled professionals in the multi-disciplinary field of **integrated pollution prevention and control** hinders Bosnia and Herzegovina's capacity to tackle issues in this area. Both Entities and the Brčko District have adopted legislation on **nature protection**. Relevant implementing legislation is still missing. No progress has been made regarding **chemicals and genetically modified organisms (GMOs)**.

The absence of a State-level environment strategy has resulted in a very modest strengthening of the environment-related **administrative capacity**. The State-level Environmental law necessary to create the framework for nationwide, harmonised environmental protection has not been adopted. Little has been done to reinforce the State-level capacity. A State Environment Agency has not been set up. Progress in strengthening the administrative capacity of the institutions involved in environmental protection and in implementing existing legislation has been limited. The number of professional environmental specialists remains

low, and the vacant posts considerable. Bosnia and Herzegovina also suffers from limited absorption capacity and has very limited financial resources for the necessary environmental investments. A functioning environmental monitoring system is not yet in place.

4.2.4. *Transport policy*

Bosnia and Herzegovina's preparations are fairly advanced in relation to air transport and have started in the areas of trans-European transport networks, road transport, rail transport and inland waterways. Sustained efforts are now necessary. Preparations in the area of maritime transport remain at an early stage.

Sustained progress is being made regarding Bosnia and Herzegovina's involvement in the development of the **transport networks**. Bosnia and Herzegovina is actively participating in the development of the Core Regional Transport Network and the South East Europe Transport Observatory (SEETO), in particular by approving the first Rolling Five Year Multi-Annual Plan 2006-2010 (MAP). Continued cooperation in the framework of SEETO is required in the context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

Progress has been made regarding **road transport**. As far as infrastructure is concerned, the feasibility studies and preliminary designs for the V-c corridor motorway have been adopted. The preparations for construction of a bypass around Sarajevo, also belonging to Corridor V-c, are completed. Construction of the motorway Banja Luka-Gradiska is progressing and the Republika Srpska authorities have launched a tender for the preliminary design of the Banja Luka-Doboj motorway. Funds have been provided for the repair of roads, and the level of maintenance and planning has improved. The reconstruction of the Sarajevo-Tuzla road is also planned. As regards legislation, the State Law on Road Safety is now in force. Implementing legislation at entity and cantonal level is still pending.

Bosnia and Herzegovina has ratified agreements on Road Transportation of Persons and Goods with Finland, Greece, Bulgaria, Russia and Ukraine. Bosnia and Herzegovina has also ratified the Interbus agreement.

As regards **rail transport**, action has focused on the implementation of the Law on Railways and the completion of the legal framework of the railway sector, thereby transforming the Public Railways Corporation (BHPRC) of Bosnia and Herzegovina into a joint and single infrastructure management company. However, limited concrete progress has been made on this issue. A regulatory body has been set up but is still not operational. Some steps have been taken to improve the railway network.

Good progress has been made in relation to **air transport**. Bosnia and Herzegovina became a candidate for membership of the Joint Aviation Authority (JAA) in December 2005. It signed a "Horizontal Agreement" with the EU relating to certain aspects of air services in May 2006 and the European Common Aviation Area Agreement (ECAA) in June. By signing the ECAA, Bosnia and Herzegovina has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market conditions, safety, security, airport policy, environmental and social issues and air traffic control.

With international support, Bosnia and Herzegovina has started implementation of its Air Traffic Management Strategy. The Sarajevo International Airport is considering further

expansion to meet the planned growth of volume of the passenger traffic in the medium term. A considerable number of internal regulations on air traffic management, safety, aerodrome/airport charges, and airport and aircraft security have been prepared.

No developments can be registered with regard to **maritime transport**. Bosnia and Herzegovina is not yet a party to the SOLAS Convention (International Convention for the safety of life at sea) and the ISPS Code (International Ship and Port Facility Security Code) which relate to maritime security.

Some developments have taken place in the field of **inland waterways**. The Sava Commission has been established, its Secretariat appointed, and work towards designs and studies for the re-establishment of the river navigation route have been started. The unanimous support of regional Ministers of Transport (Slovenia, Croatia, Bosnia and Herzegovina and former Serbia and Montenegro) was signalled by the signature of an agreement. Studies have been carried out on inter-modal transport, and on the market and demand for river transport, to serve as a basis for assistance in rehabilitation of Bosnia and Herzegovina's river ports along the Sava River. Croatia's commitment to constructing the Vukovar-Samac channel is particularly important for Bosnia and Herzegovina. This channel would create a shortcut towards the Danube, Central Europe and Western European Atlantic ports.

4.2.5. *Energy*

Further progress has been made in the field of energy.

As regards oil stocks and security of supply, no progress has been registered. Bosnia and Herzegovina does not hold sufficient oil stocks.

Bosnia and Herzegovina ratified the Energy Community Treaty in July 2006, and is preparing a roadmap for the implementation of the Electricity Transition Strategy (ETS). The Energy Department in the Ministry of Foreign Trade and Economic Relations is operational and increasingly active.

In the electricity sector, transmission has been unbundled with the Independent System Operator (ISO) and the Transmission Company (Transco) being legally established. The transfer of assets and liabilities between ISO and Transco remains to be completed for these bodies to become fully operational.

Regarding regulation of the electricity market, the State Electricity Regulatory Commission and the two Entity regulators are operational. No steps have been taken towards the consolidation of the Entity and State-level regulators. During the reporting period, there have been attempts by the authorities of the Federation of Bosnia and Herzegovina to influence the regulator in relation to the establishment of new tariffs. This is contrary to the EU directives, which require regulators to be independent.

Limited further progress has been made on the implementation of the Entities' Action Plans for the restructuring of the energy sector. An immediate priority in this respect is to start the unbundling of electricity generation and distribution in both Entities.

Little progress has been made in the gas sector. The legal framework is not yet in place. The system operator and regulator have not been established.

Bosnia and Herzegovina's energy strategy has not yet been finalised. Overall progress in terms of energy market liberalisation has been limited despite the reforms in the area of electricity transmission. Little progress has been achieved as regards other energy sectors (i.e. coal, oil, district heating, renewable energy) or energy efficiency measures.

Concerning nuclear safety and radiation protection, a Framework Law of 1999 is not applied evenly across the Entities. The administration for radiation protection is understaffed. The management of high activity spent sources from industry or medical applications needs to be improved.

An appropriate regulatory body should be put in place, and the basic legislation should be completed in order to comply with the *acquis*, in particular regarding the environmental monitoring and radiation protection in connection with medical and industrial applications. Bosnia and Herzegovina should accede to the "Convention on Nuclear Safety", as well as to the "Joint Convention on the Safety of Spent Fuel Management and on the Safety of Radioactive Waste Management", to which Euratom has been a contracting party since April 2000 and January 2006, respectively.

Bosnia and Herzegovina's preparations in the field of energy have been initiated and some of the country's targets have been met.

4.2.6. *Information society and media*

In the area of **electronic communications and information technologies**, some progress can be reported. Bosnia and Herzegovina started the full liberalisation of its telecommunications market in January 2006. Licences (including for the provision of international voice services) have been issued for new providers of fixed public telephone services. Carrier pre-selection, carrier selection, local loop unbundling and number portability have not yet been introduced. A first step towards tariff rebalancing has been taken. Competition remains, at this stage, limited.

Bosnia and Herzegovina still needs to adopt legislation in order to transform the Citizens Identity Protection System (CIPS) 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. The establishment of the Agency for Information Society is one of the remaining outstanding Feasibility Study requirements and the only remaining requirement from the 2003 Bosnia and Herzegovina National Action Plan on Organised Crime.

The Communications Regulatory Agency of Bosnia and Herzegovina (CRA) is in charge of the implementation of legislation and monitoring of the market situation in the area of information society, media and audiovisual policy. It has been active in preparing for effective competition to be introduced in the telecommunications market. With more resources, the CRA will be better positioned to play the necessary active role in promoting competition in the sector. Attempts to exert political pressure on this institution have been reported. The possible adoption of the draft Law on Wages and Allowances, which would bring the CRA within the civil service, could hinder the independence of the institution. Ensuring CRA's independence (including financial) is central.

Limited progress has been made regarding **information society services**. Bosnia and Herzegovina has not yet ratified the Council of Europe Convention on Cybercrime. Legislation on electronic commerce and conditional access services still needs to be adopted.

Some, though insufficient, progress can be reported in the area of media and **audiovisual policy**. At the end of 2005, Bosnia and Herzegovina made a positive step towards alignment with the *acquis* in this field by adopting all the necessary State-level public broadcasting legislation. Republika Srpska has also adopted the relevant laws. The Federation of Bosnia and Herzegovina has been unable to complete the legislative process so far.

In July 2006, the Constitutional Court of the Federation of Bosnia and Herzegovina upheld a complaint that the proposed Entity Law adversely affected the vital national interests of the Croat people in the Federation. This judgement appears to conflict with an earlier ruling of the State-level Constitutional Court. Implementation of the adopted legal framework is proceeding slowly. Overall public broadcasting reform is only possible once all State and Entity legislation is in place and all bodies provided for in the legislation are established and operational. Beyond the adoption of the outstanding Federation legislation, the establishment of the Bosnia and Herzegovina RTV Corporation - charged with property management, international representation, marketing etc - is central.

Bosnia and Herzegovina's preparations in the field of information society and media are at an early stage.

4.2.7. *Financial Control*

Limited progress has been made in the area of public internal financial control (PIFC). Internal Audit Coordinators have been appointed at the State and Entity level and a working group has been set up in order to start the coordinated drafting of internal audit laws at all government levels. Nonetheless, these actions are being taken without the necessary framework of a PIFC Policy Paper, which remains to be developed.

The current PIFC setup is inadequate. The Public Administration Reform Strategy for Bosnia and Herzegovina encourages the development of a PIFC system in line with international control, audit standards (i.a. the INTOSAI Guidelines for Internal Control in the public sector) and EU best practice. More specifically, Bosnia and Herzegovina needs to develop and introduce the modern principles of managerial accountability and functionally independent internal audit, with a focus on assessing internal control systems. The financial management and control system needs to be further developed and harmonised.

No action has been taken to establish a central harmonisation body for PIFC. The establishment and functioning of this organisation is essential for the harmonised and co-ordinated development of a commonly-agreed PIFC strategy. The implementation of the PIFC strategy should lead to the adoption of the necessary legislation and to adequate organisational structures for the internal control systems relating to public funds throughout the public sector. This organisation would also be responsible for the co-ordination of the training needs for management, controllers and internal auditors.

No particular developments have taken place regarding external audit. There are three Supreme Audit Institutions (SAIs) in Bosnia and Herzegovina, one at State-level and one per Entity. Brčko District is not covered by any of the SAIs and has outsourced external audit to a private company. The SAIs are independent from other government authorities and report to the Parliament. It is essential that the SAIs continue to adhere to the recommendations of the LIMA declarations of INTOSAI. The three existing SAIs co-operate through a Co-ordination Board. This coordination needs further strengthening through the establishment of a permanent secretariat. The SAIs have continued to carry out their duties and produced reports

and recommendations outlining, among other things, the shortcomings at the various levels of government. The reports of the SAIs are widely available. There is still a lack of responsiveness and follow-up to the SAIs' recommendations.

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

4.2.8. *Statistics*

Some progress has been achieved in the field of statistics. The signature of the "Agreement on the implementation of harmonised methodologies and standards in preparing the statistical data of Bosnia and Herzegovina" between the country's statistics institutions has been a positive step. This Agreement sets out clear guidelines on the roles and responsibilities of the State-level Agency for Statistics of Bosnia and Herzegovina (BHAS) and the Entities' statistics institutions. As a result of this agreement Entity institutions will be obliged to use statistical standards, methodologies, classifications and nomenclatures regulated by the BHAS pursuant to EU and international standards. However, difficulties have been encountered in the implementation of such agreement.

Since January 2006 the Brčko Bureau for Statistics has operated as an integral part of the BHAS. BHAS has adopted a Work Plan and a Priority Action Plan , as well as a Book of Rules on Organisation and Systematisation. In terms of statistical nomenclature, the nomenclature of Industrial Products of Bosnia and Herzegovina, based on the PRODCOM List of 2005, has been released, as well as initial PRODCOM results for 2003 and 2004. BHAS completed the annual industry surveys IND-21-SBS and IND-21 PRODCOM. National Accounts Statistics and the calculation of GDP are prepared in compliance with ESA 95. BHAS has completed a Household Budget Survey (HBS) as well as a pilot Labour Force Survey (LFS) with full-scale LFS underway, while the Consumer Price Index (CPI) project is in its final stage.

In terms of administrative capacity, BHAS has resolved the issue of its premises, while provisions have been made in the 2006 budgets to hire new staff and procure the necessary equipment. Budgetary appropriations now need to be implemented. BHAS has been active in ensuring donor coordination. It has participated in preliminary discussions for a future census exercise.

The statistical system of Bosnia and Herzegovina is not compliant with the relevant European standards. Classifications need to be introduced in many areas to establish comparability of statistical information with other European countries. At present, the country produces a very limited amount of economic data, lacking any comprehensive balance of payment statistics and any comprehensive national accounts data. GDP data are only produced on a yearly basis. The collection and processing of agricultural statistics remains deficient. The insufficient quality and availability of economic statistics, in particular concerning fiscal data, national accounts and external balances, is a serious constraint to any economic policy discussion, both within the authorities and with the international community.

Bosnia and Herzegovina's preparations in the field of statistics are in their initial phase. Ensuring completeness of data, especially through the proper co-ordination between all producers of statistics in Bosnia and Herzegovina, upgrading methodology and improving overall quality, remain the key challenges.

4.3. Justice, freedom and security

4.3.1. Visa, border, control, asylum and migration

Steady progress has been made regarding the administration of **visas**. In 2005, 13,589 visas were issued to citizens who required visas to enter Bosnia and Herzegovina. 11,540 were issued by diplomatic and consular offices of Bosnia and Herzegovina, while 2,049 were issued at border crossings. As regards visa processing, all data entered into local systems in diplomatic missions and consular offices are transferred electronically to the Ministry of Security.

In line with the stipulations of the *Law on Movement and Stay of Aliens and Asylum*, visas can only be issued at the border on an exceptional basis and following the recommendation of the Ministry of Foreign Affairs, for a maximum period of 15 days without the possibility of extension. The State Border Service issued 184 visas at the border in the first 3 months of 2006, compared with 352 in the same period in 2005, a reduction of about 48%.

Bosnia and Herzegovina has not harmonised its visas with Schengen requirements and no developments have taken place regarding the harmonisation of Bosnia and Herzegovina's visa lists with that of the EU. Nonetheless, the abolition of visa requirements for all EU citizens has been confirmed, which is a positive development.

Bosnia and Herzegovina's preparations as regards visas are on the right track.

Some progress has been registered as regards **border management**. Steps have been taken to introduce biometrics and security features in passports and chips have been introduced in driving licenses and residence permits. An update of the 2005 National Integrated Border Strategy for Bosnia and Herzegovina and an Integrated Border Management Action Plan are being finalised. However, budgetary means for implementation are lacking. A number of agreements and memoranda of understanding on mutual co-operation between the State Border Service (SBS) and other agencies – mainly the State Investigation and Protection Agency (SIPA) and the Indirect Taxation Authority (ITA) – have been concluded. Clear guidelines for field officers are now necessary so that the agreements are effectively implemented.

Cross-border cooperation with neighbouring countries exists, but mostly on an informal basis. SBS involvement in regional cooperation initiatives has increased, particularly through the Centre for Cooperation in Southeast Europe, the Programme for Democratic Control of Armed Forces, the Ohrid Process and the Stability Pact.

There is room for improvement regarding border control. At present, this mainly consists of basic checks of the validity of driver's license and insurance papers. Equipment to detect falsified documents is not always properly used.

According to data provided by the authorities, in 2005 the number of persons attempting an illegal crossing of the state border, or discovered in the border strip after illegal entry, went down by 25 % compared with the same period of the previous year. The readmission rate has decreased very significantly over recent years. The number of persons sent back to Bosnia and Herzegovina during 2005 was reduced by a further 28 % in relation to 2004.

As far as readmission is concerned, Bosnia and Herzegovina has negotiated agreements on readmission with a number of EU Member States (Austria, Belgium, Denmark, Greece,

Hungary, Italy, Luxembourg, the Netherlands, Slovakia, Slovenia, Spain, Sweden) and other countries (Bulgaria, Croatia, Montenegro, Norway, Romania, Serbia, Switzerland). Negotiations with the former Yugoslav Republic of Macedonia and the Czech Republic are expected in the short term. Bosnia and Herzegovina has presented draft agreements to the Governments of Poland, Turkey, France, Finland, Moldova and Albania. It has also confirmed its readiness to conclude an agreement on readmission at EU-level.

Bosnia and Herzegovina has met some of its objectives in relation to border management, but sustained efforts remain necessary.

Bosnia and Herzegovina has made further progress in establishing a functioning **asylum** system. Individual refugee status determination is conducted by the Asylum Sector of the Ministry of Security.

The asylum procedure is well established. The level of asylum applications is low but it has increased compared to 2004. In 2005, 143 applications for asylum were received by the Ministry of Security. The Ministry decided to grant asylum on 91 cases. The average time for a final decision has been four months.

Nevertheless, some shortcomings still need to be addressed. The Asylum Sector at the Ministry of Security is not yet properly staffed. Premises are small and it is difficult to properly conduct registration or eligibility assessments. The understaffing of the Asylum Sector clearly undermines implementation capacity. For example, no country of origin information system is in place, which makes eligibility and status determination difficult.

Bosnia and Herzegovina also lacks an appropriate asylum reception centre. 142 asylum-seekers are accommodated in the three existing reception centres. These centres were constructed as temporary shelters for large numbers of people following the Kosovo crisis in 1999. They do not have the capacity or required standards to serve as asylum centres. Funding of the centres is dependent on international support.

On the institutional side, further clarification and formalisation of the competences of the Ministry of Security and the Ministry of Human Rights and Refugees are necessary to prevent any confusion and potential inter-institutional conflicts.

Bosnia and Herzegovina's preparations in the field of asylum are on track. Efforts need to continue.

Limited progress has been made in the area of **migration**. The establishment of a migration section within the Ministry of Security was a positive development. However, a National Migration Strategy is lacking. Where elements of strategy and policy exist, they tend to be either in regard to extremely short-term issues – immediate training needs or amendments to a specific piece of legislation – or long-term but loosely defined ones such as compliance with EU standards. There is room for improvement regarding the implementation of the 2003 Law on Movement and Stay of Aliens. The Law itself could also be further improved, but any attempt to amend this legislation needs to take into account EU and international standards in this field.

Staff shortcomings, notably at the Ministry of Security, remain. The staff defined as necessary within the relevant Book of Rules has not yet been recruited, although four additional employees have been hired. Without the necessary human resources the relevant administrations will not function properly.

Bosnia and Herzegovina is committed to establishing a Service for Foreigners as laid down in the July 2005 Law on the Service for Foreigners. The recruitment of the Director of the Service was only completed in September 2006. This lengthy recruitment process has delayed the construction of a reception centre for irregular migrants and the establishment of a common database for aliens between the Ministry of Security, the Ministry of Foreign Affairs and the State Border Service. It has also delayed the full implementation of the Migration Information System, intended to allow full computerisation of visa processing, with real-time information sharing between the body issuing the visa and other appointed bodies.

Bosnia and Herzegovina has taken some steps towards full ownership of the functioning of the reception centres, except for the reception centre for victims of trafficking, where NGOs retain a leading role. Direct assistance for victims of trafficking continues to be managed by NGOs.

Preparations in the area of migration are moderately advanced.

4.3.2. Money laundering

Limited progress has been registered in the area of money laundering. The State Investigation and Protection Agency (SIPA) is the primary agency in Bosnia and Herzegovina responsible for compiling and analysing financial transactions and initiating criminal investigations. The Financial Intelligence Unit (FIU) within SIPA remains inadequately staffed with less than half of the planned positions being filled.

No new legislation against money laundering has been adopted. While current legislation represents a step towards alignment with the relevant EU rules, including the Financial Action Task Force standards, further improvements are necessary. For example, government transactions remain exempted from the anti-money laundering legislation. Sanctions for infringements on the Law on Prevention of Money Laundering are not dissuasive.

Analytical software has been installed to increase the FIU's capacity. The number of operative activities in the fight against money laundering and terrorism financing has increased. Nonetheless, law enforcement remains insufficient. Convictions, seizures and freezing of assets are still limited.

Bosnia and Herzegovina's preparations in the area of money laundering have been initiated but they are still at an early stage of implementation.

4.3.3. Drugs

Some progress has been made in the field of drugs. Bosnia and Herzegovina remains primarily a transit country for drug trafficking, but local production and consumption are increasing. The adoption of the Law on the Prevention of Narcotics and Precursor Abuse constitutes a positive development. However, implementing rules for the Ministries of Security, Civil Affairs and Foreign Trade and Economic Relations need to be adopted. In accordance with the law, a department for narcotics has been set up within the Ministry of Security, but staff recruitment is not complete.

No State-level drug policy in conformity with EU standards has been developed so far. Although the Law provides for a strategy and action plan on narcotic drugs within defined deadlines, work in this area has been delayed by the slow recruitment process for the Ministry of Security's Drugs Department.

According to Bosnia and Herzegovina's data, some progress has been made regarding law enforcement and seizures have increased in relative terms. However, convincing results against drug trafficking will only be achieved if Bosnia and Herzegovina's law enforcement bodies are properly equipped and inter-agency and international cooperation work effectively. In this context, continued reinforcement of the State Investigation and Protection Agency, the State Border Service, the Customs Administration and the Ministry of Security is vital.

Some initiatives have been taken to sensitise the population to the dangers of drugs. These efforts need to be sustained.

Bosnia and Herzegovina's preparations in the field of drugs are at an early stage.

4.3.4. *Police*

Little progress has been made regarding overall police restructuring in Bosnia and Herzegovina. As a result, the country's police remain fragmented and its effectiveness limited.

In October 2005, Bosnia and Herzegovina's political leaders found an agreement on how to bring forward police reform and made a proposal which was in line with the principles outlined by the European Commission: i) all legislative and budgetary competences vested at State level; ii) no political interference with operational policing; iii) functional police areas determined by technical policing criteria. This led to the "Agreement on the Restructuring of Police Structures", which was endorsed by State and Entity Parliaments. This agreement included a number of deadlines: 1) the establishment of the Directorate for the Implementation of Police Restructuring by December 2005, 2) the preparation of an Action Plan for Police Restructuring by September 2006, 3) the Action Plan's formal adoption before the end of 2006 and 4) the endorsement by the Entity and State Parliaments within two months of adoption (i.e. by end of February 2007).

In accordance with this agreement, a decision to establish a Police Restructuring Directorate (PRD) within the Ministry of Security was taken in December 2005. The Directorate, which became operational in January 2006, has been tasked with preparing the Action Plan for Police Restructuring. This Action Plan should include the necessary draft legislation for the police reform, as well as a detailed timeline for the implementation period.

Many delays have occurred in the preparation of the Action Plan, mainly due to the obstructionist attitude of Republika Srpska. The production of the Action Plan has been postponed until the second half of November 2006. Discussions within the PRD on the definition of a police model in line with the three EU principles have been long and controversial. The interference of Republika Srpska's political leaders in the PRD's work has been considerable. Republika Srpska has put in question the legitimacy of the Directorate and criticised its procedures. Since May 2006, the Republika Srpska representative has declined to actively participate in the PRD works and has opted to act just as observer.

Lack of progress on police reform also has other negative consequences. The implementation and full use of operational tools established previously (including databases, computer-based investigation and criminal analysis systems and forensics) is not optimal in the current organisational set-up and will not be sustainable unless the overall reform is accepted and progressively implemented.

Bosnia and Herzegovina's preparations in relation to the overall police restructuring are lagging behind.

Beyond the issue of overall police restructuring, some progress can be registered. The Ministry of Security has taken steps to conclude an agreement with Europol. It is important that this strategic agreement is concluded and that Bosnia and Herzegovina provides its input to the European organised crime threat assessment. The State Investigation and Protection Agency (SIPA) is increasingly active in performing investigations and enforcing legislation. Nonetheless, SIPA is not yet able to take full ownership of some of its responsibilities due to insufficient resources, even though progress has been made in increasing SIPA's staff. Continued efforts are therefore necessary.

4.3.5. *Fighting organised crime and terrorism*

Bosnia and Herzegovina has achieved some progress as regards the fight against organised crime, trafficking in human beings and terrorism.

A national strategy to combat **organised crime** and corruption was adopted by the Council of Ministers in June 2006. This strategy includes a number of benchmarks and envisages the development of action plans by individual law enforcement agencies.

The legal framework to fight organised crime is in place and Bosnia and Herzegovina is a party to the main international conventions in this area. However, the possibilities of the current legal framework are not always exploited to the full. Organised crime remains a threat to Bosnia and Herzegovina in terms of security and stability.

Over the reporting period, SIPA has been increasingly active in conducting investigations and arrests. Organised crime-related activities mainly concern drug trafficking and financial crime. Vehicle theft and subsequent trafficking constitutes a rising problem. National statistical instruments for measuring crime rates however remain elementary and need to be improved.

As regards **trafficking in human beings**, Bosnia and Herzegovina remains a country both of origin and of transit. The 2005-2007 National Action Plan for Combating Trafficking in Human Beings is being implemented. SIPA has a specific department to deal with this issue. Nonetheless, remaining inconsistencies between legislation at State and Entity level undermine effective prosecution. Only a small proportion of the trafficking cases identified have been tried successfully and led to sentences. Sentences remain light. Bosnia and Herzegovina needs to ensure sustained efforts regarding the protection of witnesses and victims of trafficking. Although Bosnia and Herzegovina has the necessary legal infrastructure for this protection, it needs to allocate more financial resources to bring witness protection up to international standards. Approximately sixty persons have benefited from witness protection programmes, of which six were victims of trafficking. Protection for victims of trafficking is maintained only until they have given their evidence in court, putting them at risk thereafter. Bosnia and Herzegovina has signed the Council of Europe Convention on Action against Trafficking in Human Beings. Ratification is still pending.

In July 2006, Bosnia and Herzegovina adopted a Strategy against **terrorism**, but the country's capacity to act against terrorist threats remains limited. The State Investigation and Protection Agency needs to be strengthened to assume its responsibilities fully in this area.

Co-operation with international bodies has continued and a significant number of cases related to international terrorism have been processed. In 2006, a prosecution was initiated at the Court of Bosnia and Herzegovina against five persons suspected of crimes of terrorism.

The investigation of this case had been carried out in cooperation with the police agencies of several EU countries.

Reports by law enforcement bodies on possible terrorist-related activities have increased, notably as a result of anonymous threats to international community representatives and to the local authorities, and of investigation of cases related to the illegal possession/trafficking of weapons and explosives. Checks have been made on a number of aid organisations and civil associations due to suspicion of their involvement in activities linked with terrorism.

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

4.3.6. Protection of personal data

In relation to the right to the protection of personal data, the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data and its Additional protocol regarding supervisory authorities and trans-border data flows entered into force in Bosnia and Herzegovina in July 2006.

Bosnia and Herzegovina adopted in June 2006 a new Law on the Protection of Personal Data. The law foresees the establishment of a Data Protection Agency for Bosnia and Herzegovina. This independent data protection supervisory authority with sufficient powers over the public and private sectors and sufficient means to effectively implement the law is not yet in place.

This situation makes the existence of data protection rules remain purely theoretical, does not ensure their implementation, and is a matter of concern.

STATISTICAL ANNEX