

USAID/Bosnia and Herzegovina

Annual Report

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Bosnia and Herzegovina

Performance:

Country Setting: Bosnia Herzegovina is currently in the midst of transitioning from international community oversight to increasing reliance on its own domestic institutions. As members of the international community (including SFOR) more seriously consider their exit plans, they are also increasingly concentrating on developing local capacities to take over in their absence. Much work remains to be done. Currently, the three hard-line ethnic parties are all back in power and citizen disillusionment with government is pronounced. Nevertheless, progress has been made in uniting the country under the umbrella of state-level institutions. A BiH State Court and Prosecutor's Office have been created, while a unified military command and single national intelligence agency are within reach. In addition, legislation for a cross-entity tax authority has been drafted and a system allowing entities to compare taxpayer information has been put into place.

Currently, the UNDP ranks BiH as the second poorest country in Europe, after Albania. In its January 2003 survey, 47.9% of households were below the poverty line, defined as the ability to purchase a basic basket of goods. Economic growth is projected to be 3.3% of GDP in 2003, down from 3.8% in 2002. The IMF estimates that inflation will remain low (around 1%), thanks to Bosnia and Herzegovina's currency board arrangement, which ties the konvertible mark (KM) to the Euro at a rate of approximately 2:1. Bosnia's domestic debt is estimated to be as high as KM 8.4 billion, or 74% of its projected 2003 GDP.

Although unemployment is reported at 40%, an active grey economy, coupled with macroeconomic stability, weakens the impact of that statistic. Nevertheless, the benefits of operating businesses outside the law continue to outweigh the benefits of becoming legitimate. OHR's "Bulldozer Committee", a group composed of BiH businesspersons and members of international financial institutions, has attempted to address impediments to business with a series of reforms that have helped make the country more hospitable to local and foreign investors. The committee continues to work on additional reforms to improve the business climate.

Another area of great progress lies in the banking sector. USAID's recently finished Business Development Program devoted significant resources to training banks in competitive yet prudent credit practices while other activities concentrated on the establishment of competent bank supervision agencies and the establishment of a deposit insurance fund. Results of these efforts are reflected in that total deposits in the banking system grew to \$3 billion in FY 2003 from \$2.5 billion in FY 2002 while outstanding loans grew to \$2.4 billion in FY 2003 from \$1.9 billion in FY 2002. Lending has grown more slowly than deposits, however, due to the risky nature of pricing or enforcing loans in BiH.

Expanding access to credit for low-income returnees has become an area of focus for USAID as numbers of minority returnees decline. Minority returns in BiH peaked in 2003 but are decreasing mainly because employment opportunities and infrastructure for returnees are still lacking. USAID, along with other members of the international community, has ceased almost all funding for infrastructure repair projects. Instead, the agency is supporting minorities with small income generation grants and loans to individuals, community groups and businesses, provision of legal aid services, and facilitation of linkages between producer communities and internal and external markets. This assistance is being directed at low-income returnees whose incomes and resources are often below the threshold level to qualify them for bank loans or even micro-credits.

One of the most unusual and far-reaching contributions USAID is making in BiH involves the installation of automated budgeting systems in Treasury Departments throughout the country. The new financial

information management system (FIMS) promotes increased transparency of government financial transactions. Previously, each Ministry (at both the entity and canton levels) was accustomed to having its own bank account and approving its own purchases without regard for budgets that had been approved. The result was rampant overspending and a lack of transparency. FIMS' internal controls ensure that obligations against the budget are recorded immediately when incurred, and unauthorized payment requests are rejected. This minimizes growth of unfunded liabilities and payment arrears; improves reporting for budget expenditures; permits better evaluation and analysis of budget and spending proposals; and permits closing of spending entities unauthorized bank accounts. The controls and spending restrictions imposed by the system earned the State of BiH a surplus of 6 million KM (approximately \$3 million) in FY 2002 alone. In FY 2003, USAID followed on its successful implementation of automated accounting and budget execution systems for the State, Federation and Republika Srpska (RS) Treasury Departments by expanding the system to the cantons. It is expected that the cantons will benefit equally as the system greatly helps in fighting corruption because it makes it easier to assign responsibility and hold officials accountable. The permanent record of each financial transaction will facilitate audits and empower the Supreme Audit Institutions (SAI) to do their job. Implementation of the FIMS satisfies IMF conditionality at the State, entity and cantonal levels. It also supports ongoing World Bank internal control initiatives.

Important Challenges: One of the biggest challenges faced by USAID in BiH concerns the role of the international community, specifically the Office of the High Representative (OHR). On the one hand, the OHR can be immensely helpful by imposing change in cases where needed reforms are not being implemented or legislation has stalled. On the other hand, BiH politicians have come to rely on the OHR as a way of avoiding responsibility for making tough decisions themselves and weathering the political fallout. Another big challenge is the unwieldy bureaucratic structure of government. The entity system put in place by the Dayton Peace Accords allows for two sets of laws throughout the country that are often not compatible. This often has the effect of restricting activities to one or the other entity, thus undermining efforts to consolidate the three ethnicities into one cohesive country. Finally, in the Federation the system of 10 cantons adds another layer of bureaucracy to an already overloaded government and saps resources by duplicating the structures of the entity government. Overall in 2003, it is projected that government spending will consume almost 59% of total GDP.

USAID has addressed the problems of unwieldy, unresponsive government with programs that are developing local capacity, especially at the municipal level. Efforts include activities that help municipalities to become more efficient, transparent, and responsive to citizens needs, as well as programs that are teaching citizens how to take the lead in resolving community problems. USAID is also encouraging the creation of state-level institutions whenever possible, and working on harmonizing legislation in cases where state-level mechanisms do not exist.

Key Achievements: USAID made substantial progress in a number of areas in 2003. Significant gains were made in policies pertaining to energy sector restructuring, tax administration and local governance. The challenge in the coming years will be to build on these gains as well as achieve a more streamlined bureaucratic structure to allow for a more efficient, responsive government.

1. **A More Participatory, Inclusive Democratic Society:** In BiH the three main nationalist political parties are all back in power and voter apathy is pervasive throughout the country. USAID's Parliamentary Internship Program is helping to mold a new generation of political participants who view their role as one of service rather than entitlement. More effective, responsive local governments are also helping restore citizens' faith in democracy. USAID's direct city management advice to select local governments is helping make dramatic improvements in internal efficiency, customer service profiles, financial management and economic development strategies. Municipalities are also becoming more efficient and transparent with One-Stop-Shop service centers for citizens and businesses. These centers greatly reduce the confusion and burden involved in dealing with local governments. USAID activities to enhance civic participation in social and political processes resulted in the adoption by three municipalities of the survey method for enhancing civic participation in the creation of municipal budgets. Overall, some 75 community problems involving approximately 37,000 people were resolved as a result of USAID support. In the area of civil society, USAID's support for NGOs resulted in the formation of four issue-based

coalitions advocating for children at risk, the prevention of alcohol and drug addiction, environmental protection and the rights of the disabled. Ten new "Infodoms" opened throughout the country. (Infodoms are internet centers designed to help small towns and villages initiate civic and business activities.) In the media sector, USAID's ongoing support for the successful (and now profitable) Mreza Plus network is reflected in the fact that the number of people watching independent broadcast media is now twice what it was two years ago (11% versus 5%).

The belief of citizens in the possibility of justice is a necessary condition for economic development, peace, and democracy. Through training and technical assistance to judges and bar associations, work in improving the curricula on law schools, assistance in drafting the necessary legislation in BiH, and through public education projects and increasing the demand for justice, USAID is creating the necessary preconditions for a transparent rule of law society in BiH. In FY 2003, as a result of training activities under the Rule of Law program, 600 judges and 500 lawyers were introduced to the provisions of the new Civil Procedural Law and the new Law on Enforcement of Judicial Decisions. The USAID-supported Public Advocacy Center (PAC) assisted 118 individuals with freedom of information (FOI) requests while 270 public officials were trained on FOI at seven training sessions conducted throughout the country. USAID's Administrative Law and Procedural Systems (ALPS) Reform Project works to improve access to justice by increasing the responsiveness and effectiveness of the administrative justice system in the Federation of BiH. Activities, such as the adoption of "notice and comment" provisions are providing citizens with greater opportunities to comment on government actions in municipalities throughout the entity. The establishment of an Administrative Law Clinic at the University of Sarajevo Law Faculty is training students through mock courts as well as internships on the intricacies of new administrative laws.

2. Accelerated Development of the Private Sector: USAID's economic reform programs in the immediate post-war period focused on SME financing and direct firm-level assistance, and those efforts were successful. As a result, USAID strategically refocused its efforts on strengthening the competitiveness of SMEs in three key sectors: agribusiness, wood processing and tourism. As part of the refocus, USAID ended its flagship Business Development Program (BDP). During its seven years of existence, the BDP made nearly 600 loans worth \$162 million to Bosnian enterprises. The vast majority of these firms were privately owned. One of the greatest accomplishments of the BDP was the creation of 15,000 jobs and preservation of another 30,000. In 2003, several locally based banks purchased the BDP loan portfolios for a competitive price, demonstrating the immense progress the banking sector has made since the end of the war. USAID support for SMEs continued with a project to create competitive SME clusters in the wood and tourism sectors through vertical integration throughout the industries. In the wood sector, USAID assistance resulted in sawmills and furniture manufacturers coming together to develop a plan for turning their wood waste product into energy. Support for SME development was also provided through the BH Women's Economic Network, which used training to promote financial literacy among rural women interested in starting up businesses of their own. In addition, USAID accounting and auditing activities converted over 300 private sector companies to International Accounting Standards (IAS). USAID took a step towards improving SME access to credit with the design of a database for a modern computerized public registry system that will provide information regarding existing claims on movable property, thus assisting lenders to perfect and exercise collateral.

USAID continued its efforts to reduce the cost of government in 2003 by expanding to the cantons its successful implementation of automated accounting and budget execution systems for the State, Federation and Republika Srpska (RS) Treasury Departments. USAID, supported by an advisor from the U.S. Treasury Department, also developed requirements and created a systems design for a streamlined and modern tax administration in Bosnia and Herzegovina known as TAMP. The new system encompasses all individual and legal status taxpayers in the country and is designed to accurately identify taxpayers and ensure their compliance with tax laws. TAMP's establishment of a central database of taxpayer registration information within each of the three tax administrations, including implementation of a single taxpayer ID number, has improved significantly the accuracy of collection efforts. Modernization of the system resulted in an increase in tax revenues in both entities of 8%, while the number of registered taxpayers increased by 12% in just one year.

3. Sustainable Minority Returns in Support of the Creation of a Multi-ethnic Society: When returnees go

to the ballot box, they can help to moderate the nationalistic political local governments voted in by majority residents and force governments to act responsibly by responding to the needs of citizens regardless of their ethnicity. However, the return of minority refugees and displaced persons to their homes of origin is predicated on more than just adequate housing. USAID facilitated the return of ethnic minorities to their pre-war communities through repair/rehabilitation of water, electricity, schools, and transportation services. In 2003, more than 50 projects started in 2002 were completed, which restored electricity to 1,800 families; provided potable water to 350 families; reconstructed schools serving 650 students; and improved transportation conditions for over 200 families. Another factor that greatly influences the ability of minorities to return to their pre-war homes is the ability to earn a living and support their families. Many have pre-war experience in agriculture, but their incomes and resources are often below the threshold level to qualify them for bank loans or even micro-credits. USAID is assisting these low-income returnees with small income generation grants and loans to individuals, community groups and businesses, provision of legal aid services, and facilitation of linkages between producer communities and internal and external markets. Numerous cooperatives have been formed and repayment rates are close to 100 percent. The activity has also given borrowers a credit record, increasing their possibilities to obtain traditional bank loans.

In the areas of institutional strengthening, restructuring and reform of the electricity power sector is critical for several reasons. The sector has the potential to be one of the largest export earners and employment providers for the country, it is also a requirement for joining the European Union. The task is made most difficult, however, by the unwillingness of hardcore, nationalist parties that have been siphoning off money from their respective electricity companies for years. USAID helped to put an end to the corruption by sponsoring audits that revealed massive corruption in the sector and led to the removal of key officials from public positions. Following that, USAID efforts achieved significant progress in this area in FY 2003 with the passage of a State Electricity Law, as well as approval in both entities of action plans for critical restructuring of that sector.

4. Cross Cutting Initiatives: USAID's participant training program sends mid- and senior-level officials, business leaders and citizen activists to the U.S. and, in some cases, to Central and Eastern Europe for intensive short-term training. In FY 2003, 1,657 persons received training under the program. The results of the training are concrete and manifold. For example, Brcko District has become the first regional government to introduce a budget process based on treasury operations, as a result of U.S.-based training for Brcko Government officials.

In 2003, USAID contributed to a nationwide network of safe houses for victims of trafficking. The project benefited trafficked girls and women stranded in BiH who required shelter and support. With the departure of the International Police Task Force (IPTF), however, raids on houses of prostitution decreased markedly and USAID could no longer justify the expense of maintaining the safe houses, which often hosted only one or no women at all. USAID is currently considering the utilization of FY03 carry over to fund a project to combat trafficking in humans by using a human rights framework through effective participation of citizens and civil society in the decision-making process.

In September 2003, USAID completed funding of the Counseling and Referral Service project in collaboration with the International Organization for Migration. Over 8,000 former soldiers requested assistance from this project. All attended civic education seminars that focused on the importance of democracy, human rights, and civil society. A considerable number of ex-soldiers received support for vocational training and education. Small business start-up opportunities for the former soldiers were assessed and offered by project business consultants and agricultural experts.

Gender: Women entrepreneurs receive targeted support from USAID's BH Women's Economic Network, which uses training to promote financial literacy among rural women interested in starting up businesses of their own. In the participant training program, USAID strives to include as many female participants as possible in in-country, third-country, and U.S.-based training programs. The importance of including female participants is explained to the counterpart organizations, contractors and grantees proposing participants. It is also a weighted factor in choosing final candidates from among the proposed participants.

Trade Capacity Building: Through the Global Trade and Technology Network (GTN), USAID is facilitating mutually beneficial trade relationships between Bosnian companies and firms throughout the region and in the U.S. GTN BiH is a program designed to assist BiH businesses to build partnerships with firms in the U.S. and South-East Europe (SEE). GTN provides free services to BiH businesses. The assistance helps them increase trade, implement joint ventures, and enter into licensing and franchise agreements. GTN facilitates linkages between Bosnian firms and firms in Croatia, Albania, Romania, Hungary, Bulgaria, Macedonia, Montenegro, and the U.S. through qualified trade leads. To date, some 150 BiH businesses have registered with the GTN database. Over the last year GTN has facilitated numerous transactions worth over \$1.5 million; approx. 60 percent were regional deals within SEE and the remaining 40 percent were with U.S. companies.

USAID's Cluster Competitiveness Initiative promotes increased trade in the wood processing industry by providing technical assistance to private companies. Companies are chosen based on their potential for generating employment, exports, and investment. To date, over 30 private companies in the value-added wood sector have received technical assistance in areas of developing better business practices and strategic marketing plans.

USAID recently launched a new program called Linking Agricultural Markets and Producers and Processors (LAMP) that focuses on strengthening producers, processors and wholesale and retail enterprises in the agriculture sector and their market linkages. The program includes assistance in marketing Bosnian products in-country and abroad, as well as training in food safety and quality standards that will make products more attractive to foreign clients.

USAID is also assisting BiH in its WTO accession process.

Country Close and Graduation:

Results Framework

168-0130 Accelerated Development of the Private Sector

SO Level Indicator(s):

Private sector businesses registered
Private Sector Share of GDP

- 1.3.1** Regulations and Policies Foster Private Sector Development
- 1.3.2** A Market-Driven and Properly Regulated Financial Services Sector
- 1.3.3** SMEs Effectively Compete in a Market Economy

168-0210 A More Participatory, Inclusive Democratic Society

SO Level Indicator(s):

Freedom House Democracy ranking for Political Rights and Civil Liberties
Increase in the number of citizens who say that their civic participation has increased.

- 2.1.1.** Increased Citizen Participation in Political and Social Decision Making
- 2.1.2.** Strengthened Legal Systems Promote Increased Access to Justice
- 2.1.3.** More Responsive, Transparent and Accountable Governance

168-0310 Reduced Human Suffering and Crises Impact -- Democratic Reform

168-0311 Sustainable Minority Returns in Support of Creation of a Multi-ethnic Society

SO Level Indicator(s):

Change in number of internally displaced persons and refugees returning to their homes

- 3.1.1** Access to Basic Services in Target Communities Re-established
 - 3.1.1.2** Communities Maintaining Service Facilities
- 3.1.2** Improved Economic Self-Sufficiency in Target Communities

168-0420 Cross-Cutting Programs