

USAID/Bosnia and Herzegovina

Annual Report

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Bosnia and Herzegovina

Performance:

Background: Bosnia and Herzegovina (BiH) has come a long way in the nine years since the end of the war. The economy has recovered substantially. Gross Domestic Product (GDP) growth is projected to be 5% in 2004, up from an estimated 2.7% GDP growth rate in 2003. More than one million refugees have returned to their pre-war homes. The banking sector has flourished, with numerous foreign banks entering the market, increasing the availability of credit. Bosnians have administered two free and fair elections.

These achievements were made possible by the Dayton Peace Accords, which stopped the war and provided a political structure for normalization. Nevertheless, as the country strives toward European integration it is becoming increasingly obvious that more effective and efficient government in Bosnia will be necessary. Too many layers of government--especially in the Federation, which is further divided into 10 cantons--have created poor definitions of responsibility and insufficient financing. Some improvements in the governance structure have been made. The Federation Constitution was amended prior to the municipal elections in October 2004 to enable the direct election of mayors. They previously were appointed by municipal councils, and reflected narrow party concerns rather than the public interest.

On the economic front, while the country has achieved a remarkable degree of fiscal stability, the current account deficit (imports are three times exports) indicates that BiH has not yet managed to become competitive on the world market. BiH's economy has too few formal participants. Pension and social welfare cost contributions are too high for employees and have led to the growth of the informal or grey economy, which may account for as much as three fourths of the employment of young people. The dearth of foreign investment in BiH is also a significant factor in its slow development. BiH represents a small market with little spending power and offers relatively little incentive for companies to locate factories in the country. In addition to its market size, the weak rule of law represents a major constraint. A lack of infrastructure is another factor that impedes investment. BiH currently has no navigable rivers and has only 15 km of four-lane highway in the entire country. And while the country does have a port, its legal status remains unclear. BiH's main assets are its natural resources including hydro-electric power, which has the potential to make BiH the only exporter of electricity in the region.

Bosnia and Herzegovina's growth as a state is further stymied by a lack of consensus on a shared vision. The Serb entity is fiercely protective of its separate status and resists attempts to consolidate governance at the State level, although progress has been made in establishing a state-level Ministry of Defense, intelligence service, indirect tax administration and value added tax. Hard-line nationalist parties are still in power and often lack the political will to effect change, while opposition parties, especially in the Federation, remain for the most part weak and unfocused. BiH still functions in part as an international protectorate with the Office of the High Representative (OHR) acting as the ultimate governing authority. While OHR has certainly driven the reform process, the continuing international presence has also stifled political maturation by allowing politicians to avoid responsibility for taking tough decisions. This lack of ownership has led as well to delay in thorough implementation of reforms.

Millennium Challenge Account criteria rank BiH's performance high in the areas of health and education, and substantially below average in terms of ruling justly, starting a business and regulatory quality. These rankings mirror USAID's current strategy.

U.S. Interests and Goals: Bosnia has achieved much in the nine years since the Dayton Agreement, but still remains a fragile state. U.S. interest in BiH remains the conversion of this multi-ethnic country from a source of regional instability to a peaceful, viable state on the road to European integration along with its

neighbors. The economy continues in transition to a market economy and is heavily dependent on foreign aid. U.S. interest is to help Bosnia strengthen its institutions, reduce its dependence on foreign assistance, and complete the transition to a modern European economy tied to Euro-Atlantic institutions which contribute to regional stability. The goals of facilitating the transition to a market economy and developing a modern democratic state are reflected in USAID's two principal strategic objectives (SOs). The economic restructuring SO concentrates on reforming policy; strengthening financial systems to enhance SME access to credit; and improving the capability of SMEs to operate and compete in a global economy. USAID's SO for democratic reform focuses on: increasing citizen participation; strengthening the legal system; and developing a more responsible, transparent, and accountable government. Through a third cross-cutting SO, USAID is assisting in anti-trafficking efforts and helping BiH stay, at a minimum, a Tier Two country.

Donor Relations: Overall development assistance to Bosnia Herzegovina amounts to approximately \$300 million each year. The World Bank and European Union (EU) are the two largest donor institutions in BiH, with the U.S. being the largest bi-lateral donor. Other significant contributors include the German, Swedish, Dutch and Japanese governments, as well as the European Bank for Reconstruction and Development (EBRD). USAID works closely with the German, Swedish, and Dutch governments who support minority returns through housing reconstruction in areas where USAID funds infrastructure. USAID has worked closely with the World Bank in the water sector, and the EU has played a major role in reforming water laws and policies on the entity level. USAID also has close collaboration with other major donors in the power sector. Partners in this sector include the World Bank, Spanish, Italians, Norwegians, Japanese, Canadians, and EBRD. On the economic front, USAID works closely with the European Commission, the World Bank, German KfW and GTZ, JICA, and EBRD in carrying out its activities. Rule of Law activities are coordinated closely with the Office of the High Representative (OHR). USAID is working with the Swedish International Cooperation Agency (SIDA), with both donors providing equal funding for the \$20 million Governance Accountability Project, which will improve customer service and management profiles in 40 municipalities throughout the country.

Challenges: BiH faces two principal challenges in moving towards a modern European state. The governance legacy of the Dayton Peace Accords is problematic. BiH has a weak overall national authority coupled with too many layers of government, and poorly defined responsibilities resulting in ineffective costly service provision. BiH's governance problems are reflected in the low comparative ranking of all indicators for assessing Democratic Reform used by the Europe and Eurasia Bureau for Monitoring Country Progress: rule of law, political processes, civil society, media, and corruption.

The second challenge is to facilitate the transition of its economy to a more modern market oriented one, capable of competing effectively in the global trade. While the BiH economy has progressed and will register a 5% growth rate this year, it still remains very uncompetitive. The public sector GDP is large and privatization has moved slowly. Though the growth rate is improving, the GDP is still only about 50% of the level it was prior to the war. Investors are troubled by the poor investment climate encumbered by excessive taxation and regulations. Foreign domestic investment is one of the lowest levels in the Balkans. Exports trail imports by a factor of three to one, putting a great deal of pressure on the current account of the balance of payments. The gap is made up by foreign aid, remittances from abroad and expenditures of foreigners working in BiH.

Key Achievements:

1. Private Sector Economic Growth: Economic reform assistance in FY 2004 focused on small and medium-sized enterprise development, streamlining and rationalizing direct taxation, and transparent and efficient government budget formulation, banking improvement and supervision, and accounting reform.

USAID programs in FY 2004 helped expand SMEs' access to finance by providing direct technical assistance for completing loan applications and training bank and micro lending officers to do risk analyses in the agricultural, wood, and tourism sectors. Through this effort 27 companies received loans valued at approximately \$3.8 million during the past year. Under an investment guaranty program with three commercial banks USAID provides a 50% guaranty for loans offered to agribusiness, tourism, and

wood processing. An additional \$10.7 million in loans have been made since the inception of the program in FY 2003. USAID assistance has helped modernize the BiH's tax administration by training staff, streamlining processes, and introducing a wireless communication system and a tax payer single identification number. Tax collection increased for the Federation entity by 6%, the Republika Srpska entity by 10% and the state Government by 10%. USAID's programs assisted in the establishment of a national Bankers Association of 22 banks; it is lobbying Government to create a single registry of accounts and to strengthen deposit insurance agencies. USAID also helped develop a state level law for using movable property as collateral; this will ensure a more predictable environment for lending to SMEs by the commercial banking system. USAID's assistance in passing a new state-level framework for the Accounting and Auditing Law has brought the BiH into alignment with modern European practice and has helped in the progress toward creating a single economic space for the country. USAID's work to restructure and reform the electricity sector resulted in legislation to create a single State Transmission Company and Independent Systems Operator at the state level. It also led to the establishment of new energy regulatory bodies. The activities are geared towards helping BiH realize its potential to be the only exporter of electricity in the region.

2. Democratic Development: In FY 2004, BiH, with assistance from USAID, continued to make progress in its democratization efforts. One particularly noteworthy achievement was amending the Federation Constitution to allow for the direct election of mayors in the Federation in time for the October elections. These changes came about due to USAID's support for local advocacy efforts in collaboration with the Embassy political office. Previously, mayors were elected by municipal councils, often leading to narrow party interests being placed above the public interest. In preparation for these municipal elections, USAID assistance programs also focused on reforming political parties and training in how to run issues-based campaigns. USAID programs explained the appropriate role of a modern, democratic opposition, and provided techniques and methodologies for promoting issue-based politics through local party structures.

In FY 2004, USAID opened 14 local government "one-stop shops", which serve as the first point of contact between local governments and their citizens. USAID now supports a total of 25 one-stop shops throughout BiH, which have reduced waiting times for local government services by 70%. USAID's local government reform initiatives have helped improve citizen perception of this level of government. For example, the percent of citizens reporting confidence in municipal government institutions went from 47.3% in 2003 to 55.8% in 2004.

Through USAID's Democracy Network, more than 150 NGOs improved their capacities. The project helped mobilize 35,000 citizens in 47 different advocacy campaigns. USAID also supported training programs for NGOs on fundraising techniques and public relations strategies. Several client organizations instituted their first fundraising campaigns and raised funds. Due to USAID's comprehensive civil society support, the NGO sector continues to develop and demonstrate its vitality. Overall, the NGO Sustainability Index revealed a slight improvement from last year with a score of 3.9 (on a scale of 1 to 7 with 1 being the best).

USAID's media efforts significantly increased the quantity and quality of locally-produced programs and investigative print stories and led to an increased use of media research in decision-making processes. Finally, USAID's rule of law activities trained approximately 1,000 judges and lawyers on new Civil Procedure Code provisions. USAID also trained lawyers on alternative dispute resolution to help them use a recently adopted Mediation Law. Increased use of mediation as an alternative to litigation will help alleviate the tremendous case backlog within BiH courts.

3. Minority Returns USAID's program to support minority returns assisted in the relocation of approximately one million of the two million persons who were displaced. The assistance centered on the provision of services and economic assistance to communities and individual returnees. USAID funded a small grants program for projects promoting local democracy and refugee return opportunities and provided income-generation grants and loans promoting economic self-sufficiency in areas of refugee returns. More than 2,000 grants and loans were provided to 32 communities in support of their efforts to aid returnees. USAID programs completed 13 power projects, two water projects, and eight kilometers of

feeder roads benefiting more than 2,000 families.

4. Gender: In September 2004, USAID completed its three-year Bosnia-Herzegovina Women's Economic Network Project (BHWEN). The project provided technical and financial support to local initiatives aimed at promoting women's economic and political leadership in BiH. BHWEN has become a viable network that serves as a focal point for women entrepreneurs in the dissemination of information on financial services and products, opportunities for start ups, and employment. Through this project, women have obtained credit, started businesses, and linked up with other women to exchange experiences. They have been able to form cooperative business ties and advocate for changes in the business environment. In preparation for the development of its Country Strategic Plan beginning in FY 2006, USAID/BiH will conduct a gender assessment in January 2005. It will identify key gender issues and constraints that need to be addressed in the new strategic plan and make recommendations on how USAID/BiH can achieve greater gender integration in its programs.

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 Accelerated Development of the Private Sector

1.3.1 Regulations and Policies Foster Private Sector Development

1.3.1.1 Improved Management of Government Expenditures through a Rational Treasury Function

1.3.1.2 Accountable, Transparent and Modern Tax Administration Regime that Simplifies Compliance

1.3.1.3 Independent Electric Power Regulatory Body Effectively Administers Regulatory Functions

1.3.2 A Market-Driven and Properly Regulated Financial Services Sector

1.3.2.1 Independent and Self-Supporting Government Agencies Regulate the Financial Sector

1.3.2.2 Financial Intermediaries and Markets Operate According to International Standards

1.3.3 SMEs Effectively Compete in a Market Economy

1.3.3.1 Private Businesses have Access to Formal Financing

1.3.3.2 SME Community with Advocacy Capability and Access to Business Support Services

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 A More Participatory, Inclusive Democratic Society

2.1.1 Increased Citizen Participation in Political and Social Decision Making

2.1.1.1 NGOs Effectively Represent Citizens and Influence Decision Making

2.1.1.2 Citizens Better Exercise their Civic Rights and Responsibilities

2.1.1.3 Viable Private Sector Broadcast and Print Media Provide Broad Range of Objective

Programming

2.1.2 Strengthened Legal Systems Promote Increased Access to Justice

2.1.2.1 Judicial and Legal Institutions Strengthened

2.1.2.2 Increased Demand for and Access to Justice

2.1.2.3 Selected Legal and Administrative Reform in Support of Democratic Governance and a Market

Economy

2.1.3 More Responsive, Transparent and Accountable Governance

2.1.3.1 More Competitive Inclusive Political Process

2.1.3.2 More Effective, Representative Legislatures

2.1.3.3 More Responsive, Transparent and Accountable Local Government

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 Sustainable Minority Returns

3.1.1 Access to Basic Services in Target Communities Re-Established

3.1.1.1 Rehabilitated Facilities Servicing Returnees

3.1.1.2 Communities Maintaining Service Facilities

3.1.2 Improved Economic Self-Sufficiency in Target Communities

3.1.2.1 Private Micro-Businesses Expand

3.1.2.2 Agricultural Property Returned to Rightful Owner

3.1.2.3 Agricultural Land De-Mined

168-0420 Cross-Cutting Programs