

ECONOMIC DEVELOPMENT AND SOCIAL PROTECTION

While donor activities in Bosnia and Herzegovina (BiH) in the area of economic development are varied, the underlying goals of the donor community can roughly be grouped into two interlinked categories: 1) laying the foundations for sustainable economic development and growth by assisting BiH's transition to a fully-functioning market system; and 2) reducing poverty and economic exclusion. As with most donor interventions in BiH, the overarching aim is to assist the country as it moves closer to EU standards and principles, and eventual EU accession.

The first section of this chapter provides an assessment of BiH's macroeconomic challenges and donors' efforts to improve the policy framework. Achieving a stable macroeconomic environment is an essential condition for sustained economic growth, employment generation, and poverty reduction. The second section discusses donor activities in the area of supporting the Small and Medium-sized Enterprises (SME) sub-sector, a key driver of the above-mentioned priorities. International agencies aid this sub-sector both directly, by increasing businesses' competitiveness, and indirectly, by assisting the development of an enabling business environment. The third section focuses on donors' direct capital support to actors in the financial sector. The special attention to this area underscores its key importance to the achievement of a properly functioning and vibrant market system. The final section discusses donor activity in the area of social protection systems, given their link to the overall economy and crucial role in preventing poverty and social exclusion. The chapter's conclusion summarizes the areas in which international agencies are active, and the extent to which donor support has contributed to progress in this sector. Finally, it discusses which areas should be given highest donor priority going forward.

The three areas of economic development addressed in this chapter and the country's social protection systems are interrelated. Appropriate macroeconomic policies and the foundation they create are required for the achievement of sustainable economic development. This resulting stability can have a direct, significant impact on the overall business climate, and sets the stage for expansion of the SME sub-sector, a proven driver of new employment. Furthermore, a stable, trusted, and efficient Financial sub-sector represents one of the pillars of a functional market economy. Finally, properly operating social protection systems and a healthy economy mutually reinforce one another, and at the same time are capable of identifying those who are vulnerable to poverty and social exclusion and provide them with the necessary assistance.⁴³

A healthy market economy relies on a properly functioning social protection system in different ways. First, unemployment insurance assists workers with frictional unemployment, a necessary condition in any market economy as supply reacts to ever-changing market demands. Second, proper social protection helps to create a more dynamic investment environment, as individuals are more willing to make riskier investments, secure in the knowledge that, for example, a future pension creates a floor below which they will not fall in case these investments are lost.

Focus on Poverty Reduction and Employment

This chapter focuses on the economic dimensions of poverty. Although improving economic "functionings" does not ensure poverty alleviation, as many *functionings* cannot be immediately purchased in a market (e.g. transportation if there are no roads, or literacy), it is the fundamental *functional deficiency* associated with poverty. Furthermore, given that (1) unemployment is the key manifestation of *functional deficiencies* in the economic sphere, and (2) there is a well-documented correlation between unemployment and poverty, this perspective is also useful for the purpose of guiding and focusing policy prescriptions.¹

There are many dimensions of poverty in BiH. While in general, BiH citizens enjoy the same legal rights as other advanced societies around the globe, the reality is that the former experience *capability deficiencies* that represent impoverishment by negatively impacting their ability to choose how to live their lives. For example, almost one third (29%) of the BiH labour force is not *capable* of living a financially secure life because people cannot find gainful employment. The causes of this *capability deficiency* are *functional*,² such as lack of access to post-secondary education. The most recent labour force survey shows that the unemployment rate for citizens who had not finished post-secondary education is 31%; for those who had completed post-secondary education, it is 11%.³ There is also a gender dimension to these deficiencies: the unemployment rate for women who have finished secondary schooling but not post-secondary education, is nine percentage points higher than their male counterparts (37.4% and 28.2% respectively).⁴

¹ Amartya Sen, *Development as Freedom* (New York: Alfred A. Knoff, 1999).

² Ibid.

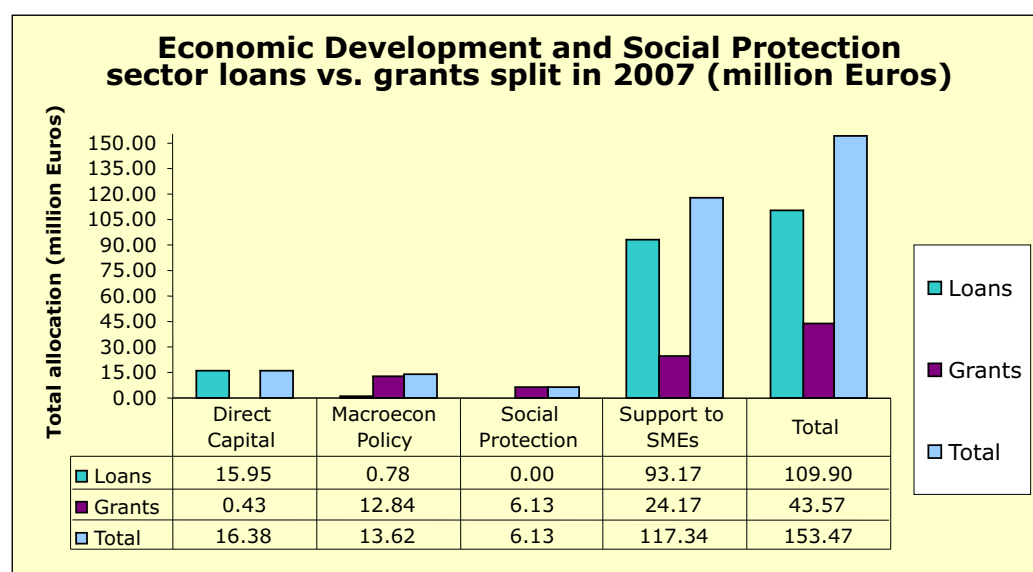
³ Labour Force Survey 2007, BiH Statistics, FBiH Institute for Statistics, RS Institute of Statistics, with support from UNDP, DFID, and the World Bank.

⁴ Ibid.

⁴³ This especially impacts the elderly, the young, individuals with disabilities, and other populations with only limited ability to participate in economic activity, for example, due to a lack of access to paid employment.

At the state level in BiH there are three key institutions dealing with economic development and social protection: the BiH Ministry of Finance and Treasury (MoFT), the Directorate for Economic Planning (DEP), and the BiH Ministry of Foreign Trade and Economic Relations (MoFTER). In addition to coordinating the Entities' activities, MoFTER is tasked with a wide range of economic development responsibilities, which include drafting foreign trade policy, preparing macroeconomic strategic documents, cultivating the business environment and entrepreneurship, fostering competition, encouraging tourism, and developing a single economic space.

At the entity level, economic development responsibilities in the Republika Srpska (RS) are split between the Ministry of Trade and Tourism and the Ministry of Economy, Energy and Development. In the Federation of BiH (FBiH) these responsibilities are divided between the Ministry of Trade, Ministry of Tourism and Environment, Ministry of Development, and Entrepreneurship and Ministry of Energy, Mines and Industry.



In 2007, donor agencies allocated a total of € 153.47 million to the Economic Development and Social Protection sector. Of this amount, € 43.57 million was in the form of grants and € 109.9 million in the form of loans. The greatest share of funding (€ 117 million) was allocated to the Support to SMEs and Improvement of the Business Climate sub-sector. The lending agencies are the EIB, EBRD, Spain/AECID and the World Bank.

Macroeconomic Policy Support

Sector definition	<p>Based on DAC definitions, the Macroeconomic Policy Support sub-sector comprises the following efforts:</p> <ul style="list-style-type: none"> • Activities aimed to support macroeconomic, fiscal and monetary policy and planning, as well as economic and social analysis and forecasting; • Formulation of trade policy and regulations; • Industrial policy and administrative management; • Un-earmarked contributions to the government budget; support for the implementation of macroeconomic reforms; and general programme assistance also fall within this category. <p>DAC codes: 15110, 15120, 331, 32110.</p>
DCF donors	Austria/ADA, France, Germany/GTZ, Italy/IC, Norway, Spain/AECID, Sweden/SIDA, USA/USAID, the EC, UNICEF, and the World Bank.
Key government partners	The Directorate for Economic Planning (DEP), the BiH Ministry of Finance and Treasury (MoFT), the BiH Ministry of Foreign Trade and Economic Relations (MoFTER), the FBiH Ministry of Trade, the FBiH Ministry of Development and Entrepreneurship, the FBiH Ministry of Labour and Welfare, the RS Ministry of Trade and Tourism, and the RS Ministry of Economy, Energy, and Development.
Other key international organizations (IOs)	The Office of the High Representative (OHR).
Total donor allocation to the sector in 2007	€ 13.6 million.
Sector strategies	There is no statewide sector strategy. The MTDS (which is now expired) is used for guidance. New state-level development strategies are being produced.
Donor coordination	There are no formal coordination mechanisms. No regular donor meetings take place.

Overview

The achievement of macroeconomic stability in BiH, due to prudent fiscal⁴⁴ and monetary policies, has been a positive development in the country's recent economic history. Thanks largely to the second year of revenue gains from the Value Added Tax (VAT), the government achieved a balanced budget in 2007 and although the inflationary trend at the end of 2007 is somewhat troubling, low inflation has been the norm under the currency board arrangement.⁴⁵ However, although macroeconomic stability is a *sine qua non* condition for sustained economic development, it does not constitute the final aim of any set of economic policies. Indeed, in BiH, many major issues need to be addressed in the interest of guaranteeing economic progress and creating a solid institutional economic structure that will enable BiH to achieve its human development goals.

Real Gross Domestic Product (GDP) growth has been fairly stable, averaging approximately 6% per year since 2000.⁴⁶ While this is in line with policy projections, it is below potential and not sufficient to achieve significant decreases in overall unemployment. One of the contributing factors to this somewhat disappointing level of economic activity is BiH's low productivity level.⁴⁷ The country's high unemployment rate, most recently measured to be 29%,⁴⁸ is perhaps the most visible and most important issue that macroeconomic policy reform must address. While this figure is an improvement on a year-over-year basis (compared to 31.1% in 2006),⁴⁹ the rate remains stubbornly high, and this slow progress is not sufficient to achieve a significant reduction in the incidence of poverty throughout the country.

Poverty metrics in BiH range from 14% to 24%.⁵⁰ Furthermore, youth unemployment in BiH is approximately double the overall rate, a disconcerting fact both in terms of the present and the

⁴⁴ It should be pointed out that the efficacy of government spending is well below potential due to the burdensome and inefficient public administration system.

⁴⁵ In the fourth quarter of 2007, inflation, driven by rising global food and energy prices, reached 4% year-over-year, making the annual figure of 1.5% somewhat misleading. In 2006, prices rose by 7% due to the introduction of the VAT and increases in certain regulated prices, but these were seen as one-time effects. Indeed, during the first three quarters of 2007, price stability returned as expected. This jump in the fourth quarter of 2007 is of concern as the increase is being driven by factors beyond the control of the domestic government, and may not be temporary.

⁴⁶ BiH Central Bank.

⁴⁷ World Bank Country Partnership Strategy for BiH 2008–2011 (The World Bank, 2007), 90. It should be noted though, that labour productivity improved by 4% in 2006 according to the European Commission, *Bosnia and Herzegovina Progress Report 2007* (The EC, 2007).

⁴⁸ *Labour Force Survey (LFS)*, 2007 (using ILO methodology).

⁴⁹ LFS, 2006.

⁵⁰ UNDP Human Poverty Index, 2004: 14%; World Bank Living Standards Measurement Survey, 2004: 18% (with a further 30% at risk of poverty in case of an income shock); UNDP National Human Development Report, 2007, Laeken Indicator: 24%.

anticipated future social and economic repercussions. While substantial informal economic activity and remittances from abroad help to improve the financial situation of many citizens, in order to significantly reduce unemployment, and thus poverty, the achievement of inclusive economic growth is of paramount importance.

The issues listed above represent the major macroeconomic challenges BiH is facing. One of the underlying issues affecting economic development progress is insufficient coordination and cooperation among governments on economic policy. Moreover, the lack of a state-level economic strategy also hinders progress towards the creation of a single economic space. This is coupled with the dearth of quality data, as well as the lack of government capacity for analyzing statistics and using them to inform policy. As a result, policy formulation and reform are not yet sufficiently evidence-based.

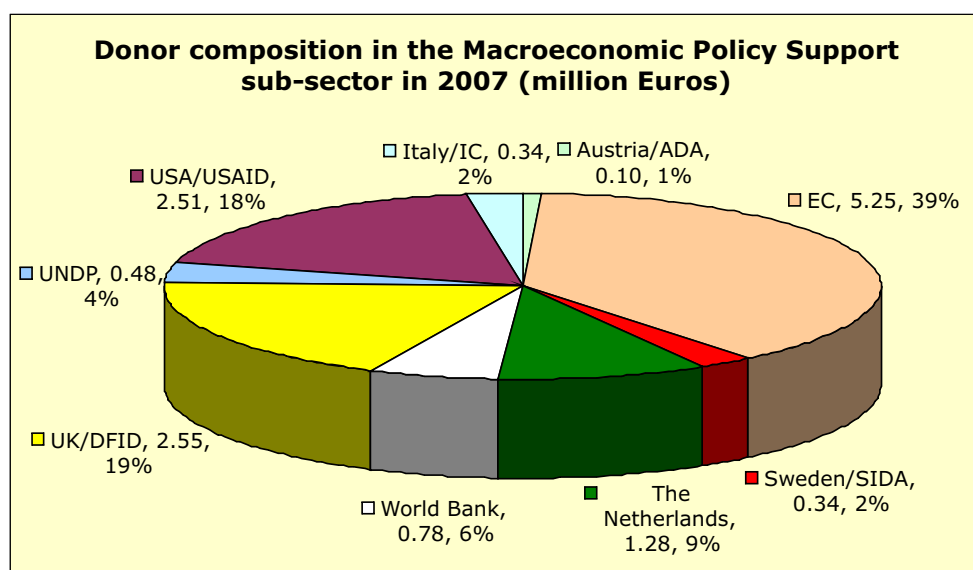
However, it should be pointed out that domestic ownership of the economic policy agenda has increased markedly, suggesting that if agreement on policy reform is achieved, progress is much more likely to be sustained.

Other factors that are associated with particular macroeconomic issues are also important. Burdensome direct taxation policies hinder entrepreneurship growth, and consequently employment. Inefficient and non-transparent government expenditure practices are a source of waste. Certain labour policies encourage informal activity, such as those that make it difficult for employers to fire employees who are not performing well, and those that restrict labour mobility, thus disadvantaging both workers and employers. Given the currency board arrangement, BiH does not have sovereignty over its monetary policy, but this mechanism has thus far been successful in achieving price stability. BiH does not have a domestic bond market and has significant liabilities regarding foreign currency assets frozen during the war, as well as war reparations claims.⁵¹

While the activities undertaken by donors in the area of Macroeconomic Policy Support vary significantly, international agencies have generally approached these issues by focusing on analysis, advice, advocacy, the provision of technical assistance, and capacity building.

Donor activities in 2007

The donors in the Macroeconomic Policy Support sub-sector include Austria/ADA, Italy/IC, the Netherlands, Sweden/SIDA, UK/DFID, USA/USAID, the EC, UNDP, and the World Bank. Together they contributed € 13.6 million, of which € 0.78 million in loans and € 12.84 million in grants. With the overall goals of achieving inclusive economic growth, reducing unemployment, and decreasing poverty, donors have focused on several key areas. These include: creating strategies; contributing data and analysis; improving the legislative framework, especially with regard to tax and labour policy reform; developing the monetary system by assisting with the creation of a domestic bond market; and supporting the EU accession agenda.



⁵¹ Moody's Investors Service, Analysis: Bosnia and Herzegovina, April, 2006.

In 2007, **UK/DFID** continued to work towards the achievement of inclusive growth in BiH, specifically focusing on growth that creates jobs and achieves human development progress. This focus is both consistent with BiH priorities and the development assistance agenda of the new UK government. To this and other ends, UK/DFID has been supporting the BiH Government in articulating the country's new development strategies both in terms of technical assistance and capacity building.

Also in 2007, **UK/DFID, the Netherlands, and Sweden/SIDA** each committed € 5 million over three years to the Enterprise Sector Recovery Fund (ESRF). The use of the Technical Assistance Fund, jointly financed by UK/DFID, the Netherlands and Sweden/SIDA, will be managed by a locally recruited Secretariat, directed by the BiH Government Steering Board. The Fund aims to support the implementation of the economic recovery section of the MTDS. Governments will offer policy guidance and the prioritization of reforms put forward to the ESRF for funding.

The **EC** has a very wide variety of activities in this sub-sector. For example, it is involved in assisting the development of employment and trade policies, and promoting the labour market and export of goods. Accordingly, the EC provides capacity building to the Central Bank, the State Agency for Labour and Employment of BiH, DEP, and MoFT in the implementation of the Decentralization System in BiH.

In 2007, **UNDP** continued to provide policy makers with independent advice based on sound socio-economic analysis. In a country with a weak statistical system and strategic planning framework, reports focusing on social inclusion, pension reform, and social protection systems were developed through participatory processes, and the production of a Labour Force Survey was again supported. *The Early Warning System* data and reports, the *National Human Development Report*, as well as the priorities, perspectives and concerns of the citizenry in the *Oxford Research International Survey 2007* were important contributions.

USA/USAID is engaged in the analysis of the regulatory environment in both the FBiH and the RS, and seeks to identify redundancies in the legal framework and present options for streamlining. The introduction of the VAT represented a major step in indirect taxation reform, and USAID subsequently shifted its focus to supporting the reform of direct taxation (personal and corporate income taxes, and real estate tax). USA/USAID offered technical assistance to the FBiH and BiH Governments to progress with tax reform legislation. To further reform in the Labour Sector, USA/USAID completed an analysis of legislative changes necessary to avoid duplication. This donor also provided assistance for the formulation of new occupational health and safety legislation in both Entities, and helped with the development of a new labour inspection policy in the RS.

The US Treasury programme focuses largely on the areas of fiscal and monetary reform. Specifically, activities associated with fiscal reform aim to improve the taxation framework. To this end, an advisor from the US Treasury has worked with domestic stakeholders towards tax policy changes in both Entities. Another Treasury advisor has provided technical assistance and capacity building at the state level to help the BiH Government create a domestic bond market in anticipation of the forthcoming bond issuance to cover wartime obligations.

Italy/IC is also widely involved in supporting this sub-sector, partially through job creation initiatives as well as through efforts to improve the skills of stakeholders in the field of planning, valorization, and territorial resources, in order to attract investments from abroad.

Enterprise Sector Recovery Fund

The ESRF's objective is to finance technical assistance to support the achievement of medium-term development strategies in the following areas:

- Transparency and control of public expenditure;
- Improvements to the business environment;
- Increased flexibility and mobility of labour;
- Strengthening of the health care financing system;
- Enhancement of the pension system;
- Acceleration of privatization;
- Resolution of the outstanding debts of the real sector.

The ESRF has two governance structures: (1) A structure to set funding priorities, which is led by a Steering Board composed of assistant ministers from the entities and the Council of Ministers (CoM), and chaired by the Director of DEP; and (2) An administrative control structure whereby a Secretariat (financed by the ESRF) is responsible for project implementation, with the Donor Council playing the same role as the World Bank for a technical assistance credit.

The **World Bank** aids the alleviation of poverty through financial assistance (grants and development loans) to the BiH Government. The World Bank focuses on strategic development projects. Additionally, it conducts analytical work and dispenses expert advice, aimed to inform policy and reform processes. In 2007, the World Bank Board approved its new Country Partnership Strategy (CPS), developed together with the BiH authorities, which lays out the strategy for the World Bank's operations in BiH during the next four-year period. The new CPS defined two pillars, which this donor finds to be of critical importance for BiH's continued economic growth and social inclusion: first, improving the environment for private sector-led growth and convergence to Europe; and second, enhancing the quality of public spending and the delivery of public services to the vulnerable. In 2007 the World Bank had 16 active projects in its portfolio. It also completed a *Public Expenditures and Institutional Review*, which was a comprehensive and in-depth analysis of the efficacy and efficiency of public spending and institutional arrangements.

Until the end of 2007, **Austria/ADA** also provided assistance to the Governing Board of the Indirect Taxation Authority (ITA) for the introduction of the VAT in BiH. Through this project the Macroeconomic Unit of ITA was staffed and the secretariat of the Governing Board (National Fiscal Council) established.

Sector strategies

As noted above, there is no state-level economic strategy in place although the revised Medium-Term Development Strategy 2004-2007 (MTDS) was the primary strategy document covering this area. It was broken down by sector and issue. While there were action plans contained therein, there were no budgets associated with them; and thus many were not completed. As such, the MTDS was less a comprehensive economic development strategy with operable actions, pledged funding, and clearly defined priorities, than a collection of desirable outcomes. Admittedly, there was some benefit to having such a broad strategy in terms of aligning donor priorities with national priorities. However, a more favourable option would be a strategy that focuses attention on the highest priority areas based on a carefully considered vision that is in line with EU accession priorities, and thus optimizes the use of scarce resources.

Furthermore, the MTDS technically expired as of January 1, 2008, and the replacement strategies are still in the development stage. However, it is noteworthy that government decisions are no longer driven by donors, which is a major shift and another indication of the positive movement towards substantially increased domestic ownership.

Positive developments and challenges in the sector in 2007

The signing of the Platform for Action, which was an Office of the High Representative (OHR) initiative, was one of the few bright spots in the Macroeconomic Policy sub-sector during 2007. This agreement between the authorities of the FBiH, the RS, the Brčko District and other stakeholders represents a commitment from government and civil society actors to work on priority macroeconomic reforms. This can be seen in particular regarding the establishment of a Fiscal Council and an Economic and Social Council, which will help to coordinate policies at the state level.

Among the challenges to achieving macroeconomic policy reform, donors note the lack of understanding of the importance of evidence-based policy making that uses quality, current data. Several international agencies are therefore trying to address this issue through linking statistics-focused projects to strategic planning and policy development.

Coordination and ownership

Given the significant macroeconomic issues facing BiH, macroeconomic policy support is an extremely important area of focus for international agencies. The donor map of this field consists of a relatively small number of actors. With the emergence of the EC as the primary source of donor funding, BiH's EU accession agenda, and hints of donor fatigue, the number of international agencies engaged in this area is not expected to increase. Thus, formal donor coordination has not been organized. International agencies generally work well together and

communication lines are considered open and well used. However, some members of the BiH donor community have not yet fulfilled their Paris Declaration obligations. Although the country's difficult political and development environment and the donors' different organizational structures can make it quite challenging, donors must make a greater effort to achieve compliance.

Government ownership at the entity level is considered to be quite strong, which suggests that future reforms will have a healthy chance at being sustained. While support to improving state-level ownership would be useful, on the whole, the bigger issue, and current challenge, is increasing cooperation and coordination across Entities' governments.

Future activities

According to donors, advocating for improved state-level macroeconomic coordination must continue to be a high priority area. Capacity building and technical assistance will remain key modalities of supporting ministries and DEP. Human resources departments must be strengthened in order to make recruiting more transparent and to give government institutions more flexibility with hiring practices. At the state level, DEP has a key role in three areas: providing economic forecasting and planning; monitoring the implementation of the MTDS; and coordinating activities. Further support and capacity building would be useful to enable DEP to fulfill these roles. In general, the EU accession agenda must be supported, thus both donor and domestic activities to this end will continue to be important.

Support to SMEs and Improvement of the Business Climate

Sector definition	<p>Based on DAC definitions, the Support to SMEs and Improvement of the Business Climate sub-sector comprises the following elements:</p> <ul style="list-style-type: none"> • Direct donor support to the development of small and medium-sized enterprises in the industrial sector, including accounting, auditing, and advisory services. • Tourism policy and administrative management <p>DAC codes: 250, 32110, 32130, 332.</p>
Key DCF donors	Austria/ADA, Germany/GTZ/KfW, Italy/IC, Japan/JICA, the Netherlands, Norway, Spain/AECID, Sweden/SIDA, Switzerland/SDC/SECO, USA/USAID, UK/DFID, EBRD, the EC, EIB, UNDP, and the World Bank.
Key government partners	The BiH Ministry of Finance and Treasury (MoFT), the BiH Ministry of Foreign Trade and Economic Relations (MoFTER), the FBiH Ministry of Trade, the FBiH Ministry of Development and Entrepreneurship, the RS Ministry of Trade and Tourism, and the RS Ministry of Economy, Energy, and Development.
Total amount of donor allocations to the sector in 2007	€ 117 million
Sector strategies	There is no state-level strategy. The Entities are moving towards the same objectives.
Donor coordination	No regular donor coordination meetings; ad hoc coordination only, often organized bilaterally.

Overview

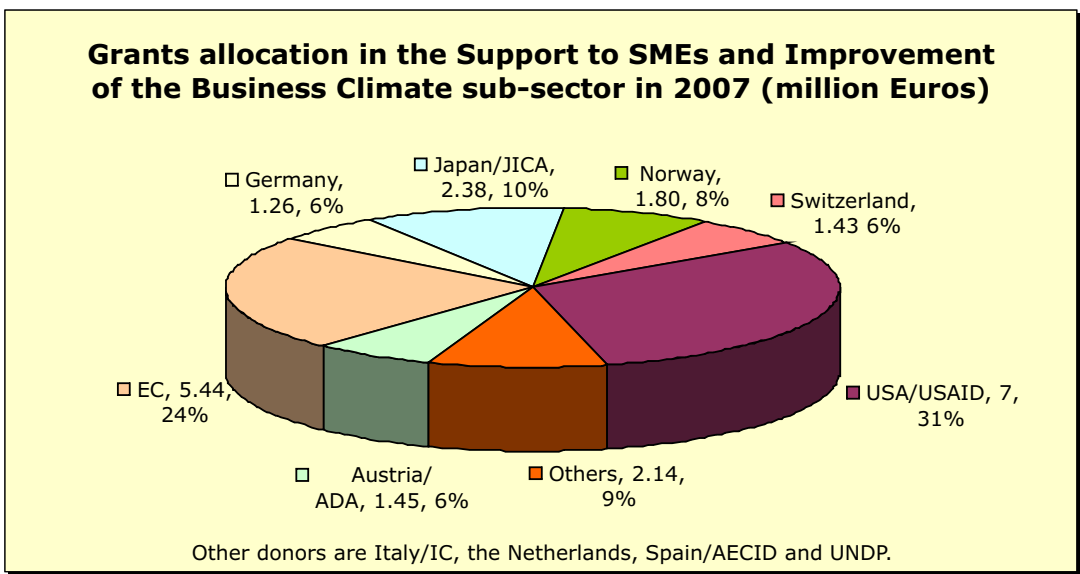
The private sector in general, and the Small and Medium-sized Enterprise (SME) sub-sector in particular, represents an area of significant potential for economic growth, job creation, and poverty reduction. However, much of this promise remains untapped for various reasons. There is no single economic space in the country, business creation and operation are hindered by burdensome administration and red tape, and statewide strategies for SMEs and Tourism do not exist. Moreover, transportation infrastructure is inadequate, there is a low level of business acumen among the citizenry, there is not enough institutionalized support to offset this factor, and there is a lack of understanding of the importance of private sector development and especially SMEs among the civil service.

Progress has been made to address some of the key challenges and donors have provided financial and advisory support for this. The legal framework has been made more consistent and certain barriers hindering and retarding the start-up and operation of businesses have been removed. Businesses are enjoying better support thanks to improved organizational structure, and at least ten donors are engaged in active initiatives aimed at improving the business climate and supporting SMEs. Until recently, sector strategies had not been in place to guide donors, but they are now either complete or are in progress.

Future initiatives should focus on continuing to untangle the web of laws and regulations BiH businesses deal with, progressing further towards the creation of a single economic space, supporting the development and implementation of SME strategies, and improving links between educators and the labour market. While there is significant domestic ownership of activities in this area, the BiH Government is not engaged in donor coordination. It would be beneficial to all involved if the government would take a stake in this important function.

Donor activities in 2007

The donors to this sub-sector in 2007 were Austria/ADA, Germany/GTZ/KfW, Italy/IC, Japan/JICA, the Netherlands, Norway, Spain/AECID, Sweden/SIDA, Switzerland/SDC/SECO, USA/USAID, UK/DFID, EBRD, the EC, EIB, UNDP and the World Bank. Together, they contributed a total of € 117 million, of which € 93.17 million were loans and € 24.17 million were grants.



As articulated in the BiH Ministry of Foreign Trade and Economic Relations' *Paper for Public Discussion* (Draft) regarding an SME Development Strategy in BiH,⁵² the major issues that need to be resolved for the enhancement of conditions for SME development in BiH include: 1) the creation of a consistent legal framework and the removal of barriers hindering and retarding the start-up and operation of businesses; and 2) the development of an institutional framework to provide business support. Donor activities in this sub-sector generally fall into one of these two categories, or are defined as interventions specifically targeting the development of business activity in a specific economic sector. In addition, donors have also been engaged in activities supporting the competitiveness of businesses, increasing their ability to generate income, and promoting tourism.

The creation of a consistent legal framework and the removal of barriers hindering and retarding the start-up and operation of businesses - The key donors to this area are the Netherlands, Sweden/SIDA, Switzerland/SDC/SECO, UK/DFID and USA/USAID. **The Netherlands, Sweden/SIDA and UK/DFID**⁵³ support the Enterprise Sector Recovery Fund (ESRF), which provides aid to the transformation of the BiH economy through technical assistance in order to restructure both individual enterprises as well as institutions which bear on enterprise behaviour. **USA/USAID** focuses on the business regulatory environment and advocates for legislative reform. In particular, USA/USAID is working to streamline the construction permit process. **Switzerland/SDC/SECO** finances FIAS/ International Finance Corporation's (IFC) Subnational Competitiveness Project that facilitates process of the revision and harmonization of regulations and administrative procedures at different levels in order to increase competitiveness of the selected locations and reduce the compliance costs of business.

Norway is undertaking an assessment of the business climate as a follow-up to the OHR's "Bulldozer" process and USA/USAID's "Guillotine" process in the RS, which both put emphasis on reducing business regulations. In the interest of minimizing obstacles to registering new businesses, the **World Bank** aided the implementation of the Business Registration System, which installed 16 registration courts throughout the country. UK/DFID is engaged in activities that promote a single economic market.

EBRD has been supporting regulation of the micro-credit sector, and assisted with the Microcredit Associations Law that was recently passed, under which micro-credit firms will now be subject to oversight by the banking sub-sector.

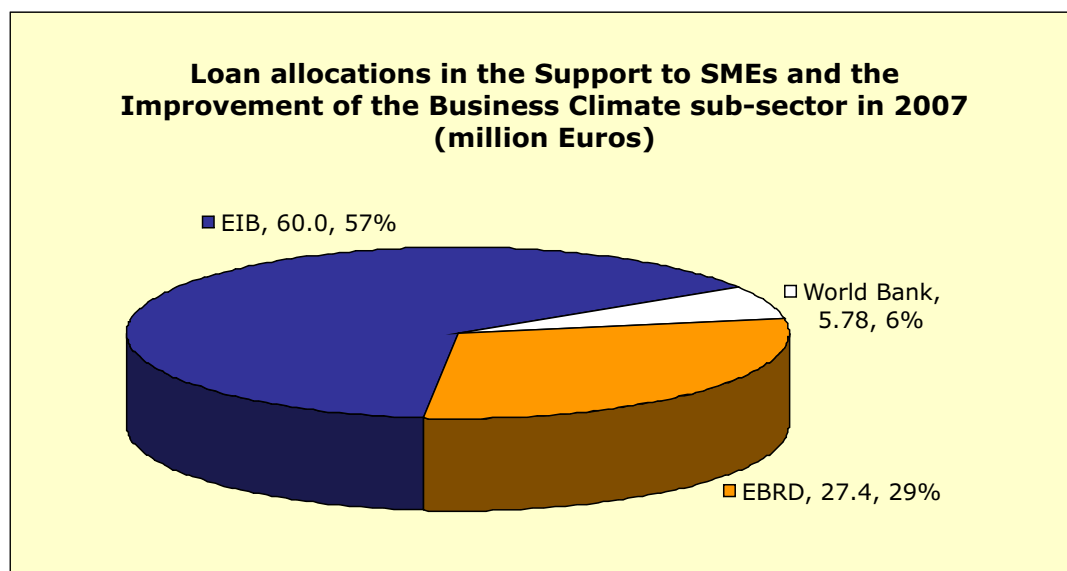
The development of an organizational structure or institutional framework to provide better business support - There are several donor initiatives ongoing in this field. **The Netherlands'** support of the IFC's regional PEPSE initiative, which works on alternative dispute resolution techniques, is a case in point. The goal is to establish an Association for Mediation, which would give businesses a quicker and thus cheaper way of dealing with their grievances as an alternative to the slow and inefficient court system.

⁵² Prepared by WOTRS with technical assistance from the International Finance Corporation. Note that a state-level SME strategy has been postponed due to entity-level concerns regarding giving up jurisdiction over the SME sector to the State.
⁵³ UK/DFID does not feature in the graph, as this donor did not report any allocations to this sub-sector for 2007. Nevertheless, UK/DFID continues to actively support SME growth and the improvement of the business climate.

Norway is also very much involved in aiding the institutional support framework. To this end, Norway launched the *E-BIZ Centre* project to create a standardized Information Technology support system for the Wood, Agriculture, Tourism, and Iron and Dye sectors, in the interest of modernizing these traditional fields. Furthermore, Norway set up an organized system for empowering Information Technology firms in the form of a business incubator. **Spain/AECID** is also involved in strengthening institutional capabilities, in the interest of achieving proper operation of the market system, and thus a better allocation of resources. The **World Bank** helped to improve the efficiency of the inspection systems in both Entities.

The development of business activity - The **EC** provides grant aid to SMEs for the purpose of business development and job growth. This includes support of Regional Development Agencies (RDAs), which help businesses boost competitiveness and facilitate regional development. EC grants are also available for improving business infrastructure, enhancing market information flow, and developing the Tourism sector. All EC grant funds for enabling the business environment pass through non-profit organizations.

EIB supports SMEs through indirect financing provided to local partner banks that on-lend funds to SMEs and municipalities. These activities represent a key sector for EIB operations in the region, with positive results in terms of job creation and economic benefits.



The Netherlands has significant involvement in the Srebrenica Region, supporting various tourism and sustainable economic development initiatives. The Netherlands has developed a close cooperation with the RDA in central BiH. It provides assistance to its network of business consultants in the region, through which this RDA can actively work on capacity building for SMEs in the region. Furthermore, the Netherlands has set up export-training programmes with all RDAs, to enhance SMEs' abilities to tap into export markets. The Netherlands is also supporting SMEs in the Agriculture sector in northwestern BiH.

Sweden/SIDA approved the *Northeast Regional Development Association - Competitive Regional Economic Development (NERDA CREDO)* project. The CREDO project's overall objective is to create and sustain jobs, reduce poverty, and improve the economic status of northeastern BiH. CREDO's direct purpose is to foster economic development through support to SMEs in the selected industrial sectors as well as to coach and prepare a local training provider to supervise and carry out a management training programme, called *Improve Your Business*, to SMEs. Also, CREDO builds the capacities of NERDA and local governments, and develops the local market for consulting services.

Spain/AECID is involved in promoting the development of SMEs through the introduction and development of the Voucher System, which provides educational support and other consultancy services. Spain/AECID also continues to aid regional economic development initiatives, like the Sarajevo Economic Region Development Agency (SERDA) and the Regional Development Agency for Herzegovina (REDAH).

UNDP has recently adopted a Private Sector Development Strategy at the corporate level, which identifies its core mandate in five priority areas as follows: establishing policy and institutional framework; facilitating pro-poor value chain integration; enabling investments in pro-poor goods and services; fostering inclusive entrepreneurship; and promoting corporate social responsibility in support of the MDGs and inclusive markets. UNDP has been implementing private sector activities and specific projects in BiH since 2004. Area-based development programmes, in particular the *Srebrenica Regional Recovery Programme* and, more recently, the *Upper Drina Regional Development Programme*, have been active in facilitating inclusive entrepreneurship, identifying cluster opportunities, and providing micro-financial incentives. Similarly, the Growing Sustainable Business project has been designed to support pro-poor investments and value-added chains, while the Corporate Social Responsibility project has mobilized 24 local and international companies and investors to provide best practices and to raise awareness.

EBRD has financed six of BiH's leading microfinance institutions to date: EKI, € 6 million and Mikrofin, € 8 million in 2006; Sunrise, € 4 million, Partner, € 8 million, Prizma, € 2 million, and MI BOSPO, € 3 million in 2007. EBRD will also provide technical assistance to help them in their commercialization and future transformation to deposit-taking institutions. These institutions have an average sub-loan size of less than € 2,000 and are often active in rural areas where there are no banks.

The **World Bank's** new Country Partnership Strategy highlights the expansion of business activity and increase of economic opportunities, the improvement of key infrastructure, the strengthening of regional cooperation to manage public goods, and the invigoration of privatization and corporate restructuring as priorities issues.

Activities supporting the competitiveness of businesses and increasing their ability to generate income The main donors in this field are **UK/DFID, Germany/GTZ,⁵⁴ Switzerland/SDC/SECO** and **USA/USAID**. Germany/GTZ assists businesses of all sizes. Current efforts are directed towards indirect SME support within the framework of local and regional economic development aiding local SME/LED agencies in the preparation and implementation of priority economic projects from municipal development strategies, including improvements to the investment climate.

Switzerland/SDC/SECO, in cooperation with Germany/GTZ, also helped to cultivate business development services in northern BiH through the assistance of a local demand-driven SME consulting market, the introduction of special methodology for start-up and entrepreneurship training, capacity building for local supporting institutions, and direct aid towards the establishment of several business associations in different sectors. Switzerland/SDC/SECO also assists companies in increasing their effectiveness and improving their access to finance by introducing good corporate governance practices and strengthening capital markets as well as educational institutions within IFC's Corporate Governance Program. Finally, Switzerland/SDC/SECO supports the sustainable SME structure in Banja Luka and Tuzla region in the following sectors: Wood Products, Furniture, Metalworking, Light industry, and Start up.

USA/USAID is creating an online database to help eliminate unnecessary steps in the building inspection process. USA/USAID is also attempting to stimulate growth and employment in the Tourism, Craft, Trade, and Agriculture sectors, as well as supporting value-added chain development in the interest of increasing the profitability of exports.

Tourism - Austria/ADA was active in the development of the Tourism sector in BiH in 2007 through an educational grant that supported tourism policy and management training. **France** offered wide-ranging aid in the form of technical assistance and Official Development Assistance in cooperation with the **EBRD**. Activities included training, analytical inputs, an ecotourism project, a partnership arrangement between the Central Bosnia Canton and the Auvergne region, and the secondment of an expert to MoFTER. **Italy/IC** was also involved in aiding ecotourism, using a regional modality including valley regions in BiH, Kosovo, and Macedonia. **Japan/JICA** contributed to the development of ecotourism by focusing on skill and capacity development in the private and public sectors. In the second half of 2007, **Spain/AECID** supported ecotourism in the municipality of Šabići, Trnovo Town Hall and Sarajevo Canton by facilitating the reconstruction of traditional mountain houses and the economic development of Mostar through the improvement of the tourism sector.

⁵⁴ Germany/GTZ has identified specific economic sectors for support: textiles, garments, shoes, leather, wood products and furniture, metalwork, and tourism.

Sector strategies

Currently, the only sector strategies are the RS SME Strategy 2006-2010 (which focuses on the privatization process) and the Regional Development Association strategies. The FBiH strategy is under development and is expected to be completed in 2008. Until it is finalized, some donors are using the Government Plan of Operations for guidance. A state-level strategy is expected at some point in the future. Other guidance has come from the MTDS (although the focus is more on social issues), the European Integration Strategy of Bosnia and Herzegovina, and strategy documents from the DEI.

Positive developments and challenges in the sector in 2007

A very important development was the establishment of a state-level working group for the purpose of drafting an SME strategy, a pre-requisite for acquiring IPA funds when BiH achieves EU accession candidate status. The creation of an SME strategy by the RS Ministry of Economy was also a positive development, and the FBiH made progress towards the completion of a similar strategy. Important business registration reform laws were passed, the process of business registration in the RS has been greatly shortened, and tax rates were improved.

Furthermore, there is a general consensus that the issue of enhancing the business climate and especially recognizing the importance of and supporting the SME sub-sector has risen as a priority issue. This is due in part to a better understanding of the SME sub-sector's latent potential for economic growth and employment generation, and its importance to BiH's EU accession goals. This being said, a common refrain among donors when surveyed about the pace of progress during 2007 was that it was a disappointing year, due mostly to the political stagnation that occurred as a result of the delays in forming the FBiH and BiH Governments in the early part of the year, and the political crisis towards the end of the year.

Coordination and ownership

While there is an adequate amount of donor coordination during the project formulation stage (in the interest of avoiding overlaps), during implementation, coordination is generally *ad hoc* and is organized bilaterally rather than on a broad scale. The BiH Government does not take an active role in coordination, although this would benefit all involved. This change could be facilitated by capacity building initiatives to, for example, the Foreign Investment Promotion Agency (FIPA) to better understand the needs of donors. The move of the Aid Coordination Unit from MoFTER to MoFT, and the significant expansion and strengthening of this department should have a positive effect in this regard.

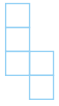
Donors noted that domestic actors have indeed taken significant ownership of activities in the sub-sector. The line ministries were highlighted as being particularly engaged, although it is easier to achieve buy-in at the higher levels of government than among the average civil servants.

Future activities

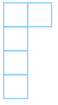
Donors call for continued focus on business regulatory and administration reform in the FBiH, so that the FBiH can catch up to the RS in this respect. They noted that there is a need for overall simplification and harmonization of business laws and regulations throughout the country. Further progress towards the achievement of a single economic space is required to reduce redundancy and remove artificial constraints to business development.

In order to address human capital deficiencies, the education system should pay more attention to the needs of the labour market and international standards in the interest of supporting foreign investments. Moreover, donors suggested that the problems with the pension system and social security that hinder mobility of labour should be tackled.

International agencies also recommended addressing the problems with the VAT system that are restricting exporters. Technical assistance should be provided to the RS SME Agency for institutional capacity building, and to the FBiH SME Agency, when one is created (the EC plans



to do so). Donors noted that FIPA requires support to enable it to perform ground-level analysis in order to better facilitate foreign investment. There is additionally a need to create incentives for budding entrepreneurs. Finally, EU accession requirements must be understood and prioritized.



In terms of gaps, it would appear that aside from USAID's creation of an online database to increase the efficiency of the building inspection process, not enough focus has been placed on improving the statistical system.



Direct Capital Support - Financial Sector

Sector definition	<p>Based on DAC definitions, the Direct Capital Support Financial Sector comprises the following elements:</p> <ul style="list-style-type: none"> • Financial sector policy, planning and programmes; • Institution capacity building and advice, financial markets and systems; • All formal sector financial intermediaries; credit lines; insurance, leasing, venture capital, etc. • Micro credit, savings and credit cooperatives. <p>DAC code: 240.</p>
Key DCF donors⁵⁵	Germany/KFW, Spain/AECID, USA/USAID, EBRD, the EC, and EIB
Key government partners	BiH Ministry of Finance and Treasury.
Total amount of funds to the sector	€ 16.4 million.
Sector strategies	There is no state-level strategy. The Entities are moving towards the same objectives.
Donor coordination group	Donor activities are coordinated through bilateral meetings only. The sub-sector is characterized by close coordination.

Overview

Direct capital support to the Financial sector has been a donor support success story. Banks are no longer donor dependent, and assistance to micro-finance institutions is being scaled back to 50%, with the private sector covering the rest. Thus, in this area, the market mechanism is poised to take over from donor support. The Financial sector will not represent an obstacle to EU accession as all reform processes are on track; only minor adjustments may be required. The remarkable performance in the Financial sector is reflective of the relatively solid institutional set up and the transfer of knowledge and capital by strong European banks that have entered the market. Among the pillars of the Financial sector are a strong Central Bank that ensures a stable (pegged) currency with relative price stability,⁵⁶ and a positively developing Deposit Insurance Agency that strengthens public confidence in the financial system. Major remaining steps ahead are the unification of the two banking agencies and the further formalization of the microfinance sector.

Donor activities in 2007

The donors in the Direct Capital Support Financial sector are Germany/KFW, USA/USAID, EBRD, the EC and EIB. Of these donors, EBRD, the EC, EIB, Spain/AECID and USA/USAID contributed € 16.4 million in 2007, of which € 15.96 million was in the form of loans and € 0.43 million in the form of grants. The other donor agencies continued their involvement in the sector, but did not make additional allocations during 2007.

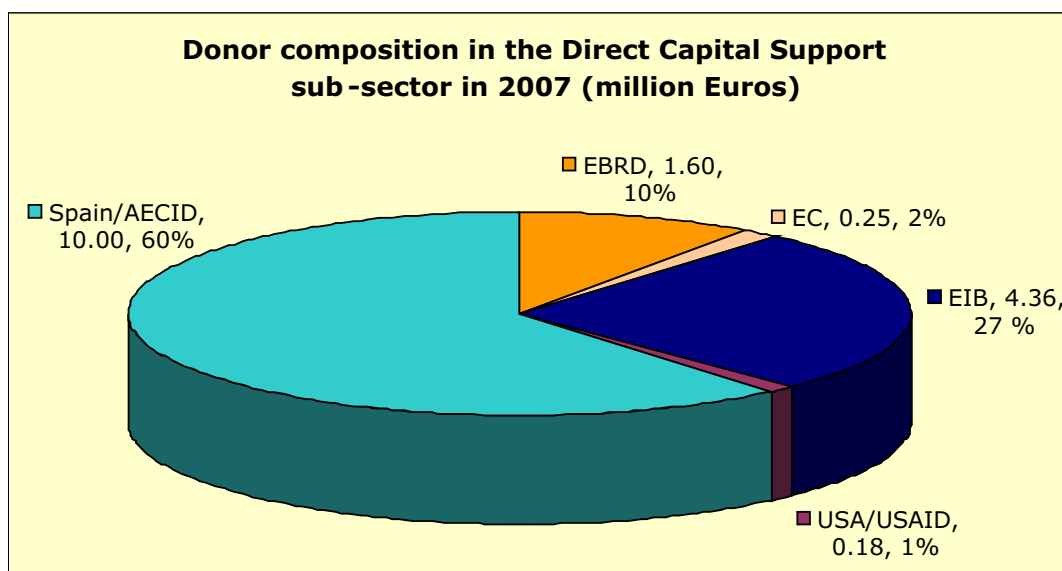
The **EBRD** provides credit lines to local banks and gives technical assistance. EBRD also offers loans for business purposes through micro-credit organizations, banks, and other non-bank financial firms. For example, EBRD provided € 10 million to Raiffeisen Bank and € 5 million to Raiffeisen Leasing Sarajevo that will be made available to entrepreneurs, giving them the opportunity to expand their business, like by leasing production equipment. In the micro and small business finance field, EBRD has financed, to date, six of BiH's leading microfinance institutions. These institutions have an average sub-loan size of less than € 2,000 and are often active in rural areas where there are no banks. In 2007, EBRD signed the first two projects under the Local Enterprise Facility totaling € 5.3 million.

Germany/KFW continues its activities to provide sustainable refinancing options for the BiH Financial sector on the basis of private investors. The main vehicle is the European Fund for South East Europe (EFSE) as a joint donor approach of various countries, development banks and the EU. Several development banks and private investors have offered significant funds to refinance loans for SMEs that are provided by MCOs and banks.

⁵⁵Additional information received from Sweden/SIDA indicates that this donor also supports the microfinance sector; however no data to this effect has been entered into the database. Sweden/SIDA reports that disbursements in grant capital to two microcredit organizations (LIDER and EKI) in BiH are approximately €4.5 million.

⁵⁶However, as noted above, the jump in prices in the fourth quarter of 2007 was somewhat disconcerting.

The EFSE is still supplemented by Germany/KfW with a Credit Guarantee Facility (CGF), and by **Sweden/SIDA**, BiH Swiss Social Fund, the Netherlands Development Finance Association, Council of Europe Bank, and the German Federal Ministry of the Interior with funds in the European Fund for Bosnia and Herzegovina (EFBH). Both CGF and EFBH are managed by KfW. The CGF strengthens ties between the Micro Finance Sector and the local banks, and facilitates local banks' access to the refinancing options of International Banks. EFBH has a specific Refinancing Line that will support financing options for SMEs and housing. Due to the revolving character of those funds no new allocations have been necessary. Due to the success in the Financial sector over the past years, there is a good chance that there is no necessity for additional extension of those vehicles. EBRD, **EIB** and Germany/KfW have provided substantial loans for the EFSE.



USA/USAID entered into four DCA agreements with three BiH commercial banks (Unicredit, Volksbank, and UPI Bank) where USAID guarantees up to 50% of loans that these three banks make to BiH SMEs in wood processing, agro-business and tourism (maximum value of a portfolio is \$ 47 million). **Spain/AECID's** strategic objective in microfinance in BiH is to combat poverty through facilitating the access of micro entrepreneurs residing in the country to the formal financial systems through the Microcredit Fund for Basic Social Development Projects Abroad. In BiH the Fund has several partner financial institutions: Sunrise, Partner, Mikrofin, EKI, Prizma, MI-BOSPO and LOK Mikro.

Sector strategies

Both the FBiH and the RS have their own set of banks. While they are largely moving in parallel towards a market-based approach, there is room for strengthening the state-level coordination mechanism.

Positive developments and challenges in the sector in 2007

Ironically, the most positive development in 2007 was what did not occur. The international financial crisis did not spillover into BiH, thanks to the previous exit of the state banks and the completion of the privatization process, and support from stable, foreign parent banks. Challenges included political disruptions and economic activity that lags behind the progress achieved in the Financial sector.

Coordination and ownership

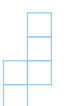
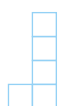
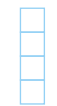
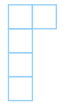
Coordination across relevant donors has been very good in this area. There are no formal coordination mechanisms, as there are relatively few donors, and bilateral meetings have

sufficed. Steering groups include all major donors, and information sharing has been of high quality, thus the streamlining of activities has been generally successful.

Given the strength of the Financial sector and general agreement regarding appropriate underlying structures and proper market functioning, there is little need for government involvement.

Future activities

One area that requires attention is the development of unified banking strategies and oversight. Overall though, the Financial sector is in good shape, and is well positioned to accommodate more rapid levels of economic growth in the general economy.



Sector Social Protection

Sector definition	<p>Based on DAC definitions, the Social Protection sub-sector comprises the following elements:</p> <ul style="list-style-type: none"> ▪ Social legislation and administration; ▪ Institution capacity building and advice; ▪ Social security and other social schemes; ▪ Special programmes for the elderly, orphans, the disabled, street children; ▪ Social dimensions of structural adjustment; ▪ Unspecified social infrastructure and services, including consumer protection. <p>DAC codes: 16010, 16030, 16050.</p>
Key DCF donors	Austria/ADA, Italy/IC, Norway, Spain/AECID, Switzerland/SDC/SECO, USA/USAID, the EC, UNICEF, UNDP, and the World Bank.
Key government partners	The BiH Ministry of Civil Affairs (MoCA), the FBiH Ministry of Labour and Welfare, the RS Ministry of Labour and Veterans' Affairs, and the RS Minister of Health and Welfare.
Total amount of funds to the sector	€ 6.13 million.
Sector strategies	There is no state-level strategy. The Entities have their own systems. There are Pension Reform Commissions in both Entities to present recommendations for legislative changes in the near future. The social protection and inclusion systems for children are currently being strengthened.
Donor coordination	There are no formal coordination mechanisms.

Overview

Pension and social protection systems play an important role in preventing poverty and social exclusion among the elderly, the young, individuals with disabilities, and other population groups with limited ability to participate in economic activity, for example, through a lack of access to paid employment. Rising inequality, economic insecurity, and social exclusion undermine social cohesion and economic growth, leading to increasingly fragile societies and often contributing to social disintegration and in some cases conflict. Unemployment, poverty, and discrimination are all important factors in social exclusion and must be addressed comprehensively if social stability and increasing levels of social and economic welfare are to be achieved and sustained for all members of society. These complex and inter-related issues have serious implications for the sustainable reduction of poverty and the achievement of the Millennium Development Goals, in particular MDG 1.⁵⁷

The paragraph above explains the importance of social protection and social inclusion as two aspects of increasing equality, safety and social cohesion. The social protection and inclusion agenda can be combined to imply the development and application of a broader set of social policies that will ensure access to social, economic, cultural, political and civil rights, and development of the social and economic potentials of each individual.

A properly functioning social protection system must provide adequate benefits that are allocated on an equitable basis. Moreover, it must achieve substantially complete coverage, without discrimination. It should also be financially sustainable and transparent.

Unfortunately, the social protection system in BiH falls short in all of these areas. The distribution of benefits is neither equitable, being based on status rather than need, nor sufficient. While poor households rely on pensions for 90% of income, women's benefits fall below the poverty line, and men's benefits are barely above it. Coverage is incomplete, as only two-thirds of workers have jobs with social protection benefits and only 54% of the elderly receive a pension. It is also discriminatory, since 78% of men receive a pension but only 41% of women do, and over 90% of public sector workers have jobs with social protection benefits, compared to less than 10% of farmers. The ratio of contributors to pensioners is falling, and projected pension expenditures are rising unsustainably. Citizens do not have easy access to their social

⁵⁷ Social Protection Systems and Pension Reform in Bosnia and Herzegovina (UNDP, 2007).

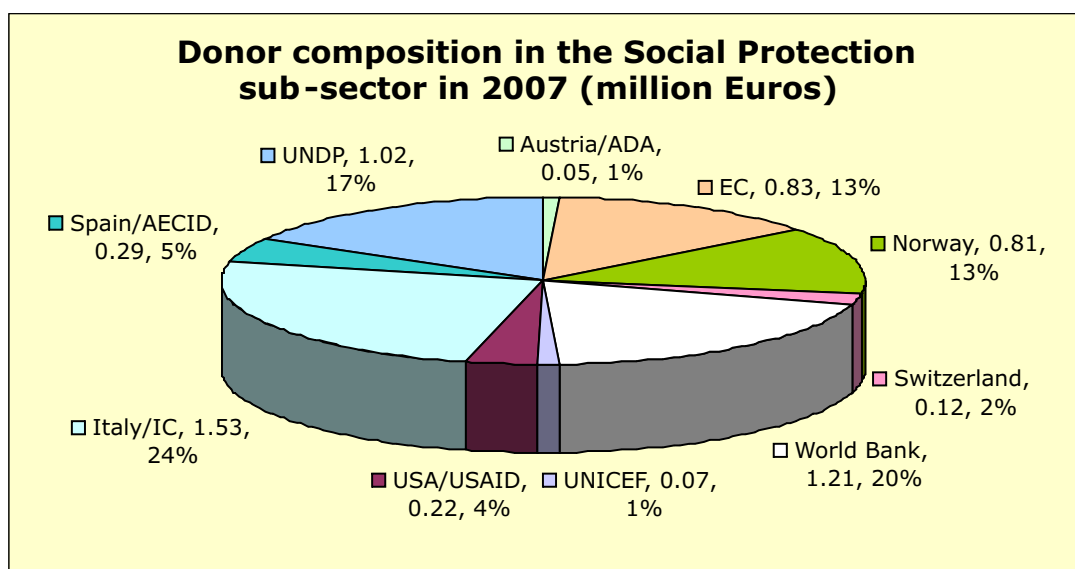
protection and pension account information, and thus do not understand the ramifications of underpayment of contributions.

The social protection system in BiH has an insurance-based component (healthcare and pensions) and a component funded from the state budget (social assistance). There are two social protection systems in BiH, one in each Entity, with further fragmentation within each system (e.g. pension funds are managed as separate programmes). While policy is set at the entity level, certain financing responsibilities are delegated to the cantonal and municipal levels.

Donors have generally approached these issues with a combination of analytical research, advocacy, and direct support to reform processes. In the future, international agencies should continue to aid reform that is necessary to address the key shortcomings of the current system, such as the inadequacy and inequity of coverage and benefits, financial sustainability, and transparency.

Donor activities in 2007

The key DCF donors to this sub-sector are Austria/ADA, Italy/IC, Norway, Spain/AECID, Switzerland/SDC/SECO, USA/USAID, the EC, UNICEF, UNDP, and the World Bank. Together they contributed € 6.13 million in the form of grants during 2007.



The **World Bank** has contributed research in order to assist the BiH Government to better allocate funds. Furthermore, the World Bank has offered significant support to the pension reform process through the *Social Insurance Technical Assistance Project* (SITAP). The World Bank was also involved in advocating for greater health insurance coverage of the population, and to this end, endeavored to reduce the number of citizens working in the grey economy, who either do not receive health insurance coverage, or are illegally registered as unemployed at the employment bureau in order to receive coverage. Furthermore, this donor has been promoting reforms to increase the portability of the health insurance within the country.

Switzerland/SDC/SECO's important contribution to the sub-sector is the support they provide DEP in the preparation of the Country Development Strategy and Social Inclusion Strategy 2008-2013. The overall goal of BiH's involvement is to define in a participative and transparent manner the long-term goals and priorities of the socio-economic development framework.

UNICEF is working to support the transformation of the social protection and inclusion system for children in BiH. In partnership with the **Norwegian** government, **UK/DFID** and the **EC**, UNICEF began a project in 2007 that will address the functional gaps within the legislative, financial, monitoring and evaluation systems in the country as they relate to children and their families. These efforts include: ensuring their coverage by the social protection system, and promoting social inclusion and more equitable access to social and economic rights. This will be done through cross-cutting cooperation established between the sectors of Health, Education,

Social Welfare and Justice. Results will inform the modeling of strengthened referral mechanisms for children at the community level and will ensure improved tracking, needs-based targeting, and social and educational inclusion of children found particularly vulnerable due to their ethnic, economic, or social status within communities, or physical disability. The final desired outcome of the process would be a fiscally sustainable and country-specific national strategy for the social protection and inclusion of children. Sectoral work in education, early childhood development, HIV-prevention and mine risk education all form parts of UNICEF's work to promote the social inclusion of children in BiH.

In 2007, UNICEF also continued its work on the establishment of a 'human rights-based approach to child social protection' model in cooperation with the Entity Ministries of Social Welfare and national NGOs. The model focuses on the establishment of inter-disciplinary and community-based approaches to social protection and inclusion of children.

The **EC** has several activities in this sub-sector. For example, the EC works on the economic and social reintegration of landmine survivors in BiH, and the socio-economic empowerment of particularly vulnerable groups such as female war victims and mine victims, under direct and active participation of local partner organizations dealing with marginalized populations. The EC has a significant focus on child protection, particularly for disadvantaged children. At a system level, the EC plans to conduct a Social Sector Review in 2008, as well as to work towards enhancing the social protection and inclusion system for children in BiH.

UNDP's major contribution to this area in 2007 was the publication of the *Social Protection Systems and Pension Reform* study, which was developed through a participatory process that included a wide spectrum of relevant political and practitioner stakeholders. This report was a follow-up to UNDP's *National Human Development Report* of 2007, which focused on the topic of social inclusion in BiH, highlighting some of the major issues. UNDP is also implementing several projects focused on the protection of vulnerable groups, particularly in connection with HIV/AIDS prevention and treatment.

Austria/ADA's focus in this sub-sector is on the integration of handicapped adults through work therapy. For one of their projects, two groups of six people will be employed on a half-day basis and through this they will become more integrated into the community. Another project, *Integration of Disabled People into Communities of BiH*, was initiated to provide assistance to people with disabilities, so that they can, by fulfilling their needs, show that they are equal to other citizens in the community. **Italy/IC** works on similar initiatives, providing support for the disabled, but with a special concentration on children and youth. In 2007, **Spain/AECID** worked to increase social and economic capacities, and particularly in the areas of production and labour, focusing on vulnerable communities.

Recognizing that a family environment provides the best opportunities for a child's full emotional, physical, and intellectual development, **USA/USAID** strives to move children from institutions to foster families. Their programme continues to develop the fostering model in Tuzla Canton, strengthening the professional services related to social and child protection, raising public awareness, and providing support for establishing a Fostering Framework for BiH. The programme focuses on strengthening the Centres for Social Work to provide family-based services for children who are at particular risk of separation from their families, due to disability, conflict with the law, the consequences of violence, or some other reason.

Sector strategies

There is no overall strategy for social protection in BiH. The Entities have separate systems, and while there are no expectations of unification, stakeholders across the board agree that greater coordination and information sharing would benefit all involved. Pension Reform Commissions are operating in both Entities and new legislation is expected to be discussed in the first half of 2008.

Positive developments and challenges in the sector in 2007

Significant agreement was achieved between the FBiH and the RS, enabling people greater access to those health facilities that are closest to them. The hospital network was rationalized, and a single, common package of treatment for the whole country was agreed upon. In the RS, the public-private-partnership model was further developed.

Progress towards pension reform included extensive training for government officials, such as computer training to perform proxy means testing. This has improved officials' ability to project likely outcomes from different policy initiatives, and thus has improved the policy development process. Some movement towards the introduction of a voluntary third pillar was made, particularly in the RS. The World Bank has been supporting these initiatives.

The single biggest challenge to reform in 2007 was the lack of political will. In cases where political support was evident, change was achieved. Without this political backing, no progress can be attained. To a large extent, at the practitioner and administrative levels across regions, there is broad agreement regarding challenges associated with the system and what steps should be taken to address them.

Coordination and ownership

There are no formal coordination mechanisms in the Social Protection sub-sector. Dialogue is generally considered to be positive; parties are informed of each other's activities and are invited to participate where appropriate. However, given the growing number of donors in this field, especially in light of the new Social Inclusion Strategy, regular means of coordination are recommended.

Future activities

The shift from a status-based to a needs-based system is of paramount importance. A minimum benefit "floor" has to be implemented to protect BiH's most vulnerable citizens, and the system must achieve financial sustainability. Additionally, the issue of transferability of pension benefits across Entities needs to be addressed.

Conclusion

Overall, progress in economic development is continuing at a pace that is in line with policy projections. There have been small improvements in key areas such as unemployment, but these remain below potential. The country's ability to reform its social protection systems, making them more effective, equitable, and sustainable, relies to a large extent on the strength of the economy underpinning them and the political will to implement reforms called for by BiH practitioners working within the social protection system network.

In 2007, there were some positive developments, such as the signing of the Platform for Action, the establishment of the state-level working group tasked with articulating an SME strategy, the achievement of greater cross-entity cooperation in the Health sector, and progress towards pension reform. Unfortunately, these successes were overshadowed by delays in the political realm.

National strategies that donors can use for guidance in this field are either not yet in place, or are generally fragmented in terms of not covering the whole country or not supporting an entire domain (e.g. pension reform is proceeding largely on its own, rather than as part of an overall reform process of the entire social protection system). A need for support in this area remains.

Nevertheless, almost all donor activities in the four areas discussed in this chapter are well aligned to the major issues associated with them. This is a testament to the relevance of the activities that donors have chosen to undertake.

1. **Macroeconomic Policy:** The donor focus on inclusive growth addresses the two key, related macroeconomic issues of unemployment and poverty. Data and analytical contributions fill in research and information gaps in the interest of supporting evidence-based policy making. Investigations into the legal framework and advocacy activities for change are aimed at reducing institutional complexity. The provision of expert technical assistance is helping the BiH Government with fiscal and monetary reform.
2. **SMEs and Improving the Business Climate:** Donors focusing on the elimination of inconsistencies in the legal framework are helping with the development of a single economic space. Streamlining administrative requirements for businesses reduces burdensome red tape. Institutionalized business support centres act as offsets to the general lack of business acumen. Numerous and varied direct interventions such as giving grants for business infrastructure development, promoting the Tourism Sector, and bolstering value-added chains support business growth and business creation.
3. **Direct Capital Support Financial sector:** Capital aid to specifically selected micro-finance organizations promote rural development and SMEs.
4. **Social Protection:** Supporting the pension reform process addresses the lack of sustainability, the inequity, and inadequacy of the current systems. Efforts to facilitate access to health insurance coverage across Entities improve citizens' rights and help to create a single economic space. Analytical research contributions support the overall reform process across the entire social protection system. Assistance provided to the BiH Government with strategy development processes enhances the capacities of domestic officials and provides guidance in defining social policy priorities.

Priority areas going forward in the area of macroeconomic policy include advocacy for better state-level macroeconomic coordination, and capacity building and technical assistance in support of ministries and DEP. In the interest of assisting the development of SMEs and improving the business climate, efforts must continue to focus on artificial constraints hindering business development and deficiencies in human capital caused by an education system that does not act in concert with the labour market. Strategies in the banking sector must be unified. While there are many areas that could be improved in the social protection system in BiH, in general, movement from a status-based to a needs-based system, the institution of a minimum benefit "floor" to protect the most vulnerable citizens, such as children, and the achievement of financial sustainability will remain top priorities.

Donor coordination in areas where there are relatively few players (Macroeconomic Policy, Direct Capital Support Financial sector) has been generally good, albeit ad hoc and informal. However, in the area of SMEs and Improving the Business Climate and Social Protection, where there are many donors, coordination needs to be strengthened.