

# COMBATTING CORRUPTION IN BOSNIA AND HERZEGOVINA

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## HEARING BEFORE THE COMMISSION ON SECURITY AND COOPERATION IN EUROPE ONE HUNDRED FOURTEENTH CONGRESS SECOND SESSION

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# COMBATING CORRUPTION IN BOSNIA AND HERZEGOVINA

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## COMBATting CORRUPTION IN BOSNIA AND HERZEGOVINA

May 25, 2016

COMMISSION ON SECURITY AND COOPERATION IN EUROPE  
WASHINGTON, DC

The hearing was held at 2 p.m. in Senate Room 212-10, Capitol Visitor Center, Washington, DC, Hon. Roger F. Wicker, Co-Chairman, Commission on Security and Cooperation in Europe, presiding.

*Commissioners present:* Hon. Roger F. Wicker, Co-Chairman, Commission on Security and Cooperation in Europe; Hon. Christopher H. Smith, Chairman, Commission on Security and Cooperation in Europe; Hon. Jeanne Shaheen, Commissioner, Commission on Security and Cooperation in Europe; and Hon. Robert Aderholt, Commissioner, Commission on Security and Cooperation in Europe.

*Member present:* Hon. Scott Perry, Representative from the State of Pennsylvania.

*Witnesses present:* Amb. Jonathan M. Moore, Head of the OSCE Mission to Bosnia and Herzegovina; Thomas O. Melia, Assistant Administrator, Bureau for Europe and Eurasia, USAID; Srdjan Blagovcanin, Chairman of the Board of Directors of Transparency International, Bosnia and Herzegovina; and Dr. Valery Perry, Sarajevo-based Independent Researcher and Consultant and Senior Associate at the Democratization Policy Council.

### HON. ROGER F. WICKER, CO-CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Mr. WICKER. Welcome. Welcome all. I am United States Senator Roger Wicker, and I'm happy to convene this hearing on the fight against corruption in Bosnia and Herzegovina.

Chairman Smith and I have visited Sarajevo together in the past, and I appreciate his continued leadership toward ensuring a stable and prosperous country.

The United States, as we all know, cares deeply about the sovereignty, stability, recovery, and future prosperity of Bosnia and Herzegovina. Since my first visit in 1995, the country has made tremendous progress. However, more needs to be done by the international community and Bosnian leaders to sustain these advancements.

Here in Congress, my fellow commissioners, Senator Jeanne Shaheen and I were among those working to nurture private-sector entrepreneurship in Bosnia and Herzegovina. Last July, we participated in a presidential delegation to commemorate Srebrenica's

20th anniversary. We heard from Bosnians eager to create and grow their own businesses. On the 20th anniversary of the Dayton Accords in November of last year, we introduced the Bosnia and Herzegovina-American Enterprise Fund Act to grow small- to medium-sized businesses throughout the country.

Unfortunately, corruption in Bosnia and Herzegovina is widespread. Recent news reports have highlighted scandals involving senior politicians and concerns that financial assistance to communities that experienced flooding in 2014 may have been misused. In its Corruption Perceptions Index, Transparency International ranked Bosnia behind all other countries in the region except Kosovo and Albania.

Demonstrative steps need to be taken by all levels of government to improve transparency and the rule of law. Left unchecked, corruption will hinder Bosnia and Herzegovina's integration into Europe and NATO. Twenty years after Dayton, there is no excuse for corruption and the risk it brings to prosperity for future generations.

I have raised these concerns with officials at the State Department. I encourage the administration to continue to support prosecutors and judges who focus on high-profile corruption and economic crime cases. The United States Government should also continue its support for investigative journalism and nongovernmental organizations advocating reform.

We cannot gloss over the country's deficiencies. Transparency and the rule of law are critical pillars to the future prosperity of Bosnia and Herzegovina. The people of Bosnia have already suffered through so much.

I want to thank our government and the NGO witnesses for joining us this afternoon. The Helsinki Commission looks forward to your insights and counsel on the steps required to enhance transparency and the rule of law in Bosnia and Herzegovina.

Now, when other members arrive, perhaps they will have statements also, but we'll get right to witnesses.

Our first witness today is Ambassador Jonathan Moore, head of the OSCE Mission to Bosnia and Herzegovina. The ambassador is well-known to the Helsinki Commission, with previous postings not only in Sarajevo but also in Belgrade, Minsk and Vilnius. Ambassador Moore also served as a congressional fellow in the Office of the Speaker of the House, as a national security fellow at Stanford University's Hoover Institution, and as a deputy chief of mission at the U.S. embassy in Namibia. So welcome to Ambassador Moore.

Our second witness is the Honorable Thomas Melia, assistant administrator at USAID for Europe and Eurasia. Mr. Melia is also well-known to the Helsinki Commission for his time with the National Democratic Institute, Freedom House, and as deputy assistant secretary in the State Department's Bureau for Democracy, Human Rights, and Labor. Earlier in his career, Assistant Administrator Melia worked on the staff of the late Senator Daniel Patrick Moynihan. Given his extensive career focus on human rights and democratic development, we look forward to his insights regarding the issue of the day.

Next, Mr. Srdjan Blagovcanin, our third witness, is chairman of the board of the Bosnia Chapter of Transparency International.

Transparency International has done much to expose corruption and to counter corrupt practices in Bosnia and Herzegovina, throughout Europe, and around the world. Mr. Blagovcanin has more than a decade of experience as a promoter of good governance and anti-corruption reforms, and of rule-of-law initiatives. I want to thank you for traveling to Washington to participate in this hearing.

And finally, Dr. Valery Perry, an independent researcher and consultant who has worked for various organizations, including the United Nations Office on Drugs and Crime, the U.N. Development Programme, the OSCE, and NATO in Bosnia and Herzegovina. Dr. Perry is currently studying ways to counter violent extremism in Southeast Europe and Turkey. The Commission looks forward to Dr. Perry's recommendations on ways to promote the rule of law and promote transparency in Southeast Europe.

So, we will get started with our witnesses right away, and we will begin with a statement by Ambassador Moore.

**AMB. JONATHAN M. MOORE, HEAD OF THE OSCE MISSION TO BOSNIA AND HERZEGOVINA**

Amb. MOORE. Mr. Chairman, good afternoon, and thank you very much for this opportunity and for the attention that you and all the members of the Helsinki Commission give to Bosnia and Herzegovina. You know very well that everything in the Balkans is political, and that all politics is local. In that spirit, the OSCE team throughout Bosnia and Herzegovina is engaged across the country with partners at all levels of society to help foster stability, build respect for human rights, and put its citizens on the path to prosperity.

Let me give you some quick and concrete examples. Education was one of the many victims of the war. Communities and ethnic groups were divided, and so were their schools. OSCE in Bosnia and Herzegovina has engaged at all levels to support quality education and bring schools and students together.

Simply lecturing politicians and parents is not effective. As you know from your constituents, they have a right to be heard. We have found places where schools can be combined, meaning that children learn with each other and from each other, instead of being separated. And instead of trying to impose our will, we have negotiated successfully with those same parents, as well as with politicians and religious leaders, to tear down barriers. Zepce, a mixed community in central Bosnia, is a shining example of this.

Our OSCE mission is very active in the sector of rule of law. We are one of many partners fighting trafficking in persons. We have an extensive team monitoring war crimes cases, where more than 20 years after the war justice has not been done. In this, the mothers of Srebrenica are some of our most enthusiastic and effective allies.

Our network of local partners is also essential for combating violent extremism. Terrorist attacks in Bosnia and Herzegovina, much more than elsewhere, fundamentally threaten the country's stability. The 19 Coalitions Against Hate that the OSCE Mission in Bosnia and Herzegovina support have already proven their value in calling for tolerance and community values instead of division

and revenge. Thanks to the Coalition Against Hate in Zvornik, as well as to the mayor and Islamic community among others, the community there found positive common ground after the terrorist attack which occurred there in April of last year.

Our skills and achievements in those areas, and our large field network of 10 offices around the country, give us a clear view of corruption, the main topic of today's hearing. We are engaged with our domestic and international partners, including Transparency International, to bring public and media attention to the problem, to support reform efforts, and help lessen the burden of corruption on the people of Bosnia and Herzegovina.

It is clear that simply having laws and institutions is not enough. Laws must be implemented and obeyed, and prosecutors and judges must do their jobs. Furthermore, old patterns of political patronage must stop. A lack of transparency in hiring employees in public institutions, concealing budgets, and even enrolling university students on political grounds blocks opportunities for the country's talented young people and also obstructs, as we've seen, foreign investment.

We have geared up our rule-of-law team at the OSCE Mission to Bosnia and Herzegovina to monitor corruption cases, where there have been far too few convictions. And we strongly support the cause of greater transparency. The public has a right to know who is working in public enterprises and for how much. Both with regard to prosecution and transparency, Sarajevo Canton is a particular leader.

In conclusion, thank you again for this special opportunity. A personal note: We have seen each other on Capitol Hill, Vilnius and Minsk, Medjugorje and Dubrovnik, Belgrade and Tirana, Sarajevo and Srebrenica. Please visit us again so I can show you what OSCE in Bosnia and Herzegovina is doing, and introduce you to the people whose success is our goal. I very much look forward to your questions, Mr. Chairman, and to the views of my fellow panelists. Thank you.

Mr. WICKER. Well, thank you very much. And it has been a pleasure to be with you, Ambassador Moore, and to speak to individuals in these various locales one-on-one. There's nothing like a personal visit, and I certainly think when Senator Shaheen gets here she might mention what an honor it was to join with Secretary Albright and President Clinton and Congressman King in being part of the official delegation to the 20th anniversary of the Srebrenica massacre. And I believe we made a real contribution in a bipartisan and bicameral way in that regard. So thank you for mentioning that, and whenever I get a chance I do encourage my colleagues, to the extent that we can take care of business at home and for our constituents, that we do look to our role internationally.

And we'll move to Mr. Melia and take your statement, sir. Thank you for being here.

**THOMAS O. MELIA, ASSISTANT ADMINISTRATOR, BUREAU FOR EUROPE AND EURASIA, USAID**

Mr. MELIA. Thank you, Senator Wicker, for the opportunity to testify today on corruption in Bosnia and Herzegovina and the re-

gion, and on the efforts of the U.S. Agency for International Development to address this challenge.

As Secretary of State Kerry said in his remarks at the recent Global Summit on Corruption in London, “criminal activity literally is a destroyer of nation-states.” Furthermore, corruption is a significant obstacle to national social, economic and political development—the focus of my agency.

Corruption leads to a weakening of democratic institutions, economic decay by discouraging investment, increased inequality, and it deprives states of the resources they need to advance their own development. In the wider European region, states weakened by corruption are also more susceptible to malign pressure and manipulation from Putin’s Russia, as any semblance of a rules-based order often seems to take a backseat to power, influence and greed.

Finally, endemic corruption threatens states by depriving them of the most important resource of any democratic government: the trust and confidence of its citizens. Where public trust is absent, there can be little expectation of cooperation by citizens with government to build resilient democracies, let alone to do what is needed to counter emerging threats like violent extremism.

For these reasons, the Obama Administration sees addressing the problem of corruption—and the need for open, effective representative governance—as a significant U.S. national security priority. Understanding that, we in the U.S. Agency for International Development work with governments, civil society, independent media, political actors and citizens to build the capacity to limit the likelihood of corruption, and to uncover, investigate and punish corruption when it occurs.

It is a sad fact that corruption is a major problem throughout the Balkan region, and Bosnia is no exception. As you pointed out in your opening statement, Senator, Bosnia has a very low score on the Transparency International Perceptions of Corruption Index. More troubling, perhaps, is that according to this index, Bosnia is actually losing ground in its fight against corruption, its score having fallen by four points in the last three years. This is consistent with findings from Freedom House’s *Nations in Transit* data series on anti-corruption measures in Bosnia, and on democratic reforms more broadly, which show that the modest gains that were made in all measures peaked around 2006, with stagnation or backsliding in the years since.

All of this indicates that corruption in Bosnia and Herzegovina is bad, even by Balkan standards, and possibly getting worse. When one takes into account Bosnia’s multiple levels of government and the fact that by some estimates the public sector makes up 50 percent of Bosnia’s GDP, the depth of the problem and its impact on citizens’ lives becomes all the more clear. Therefore, growing the size and strength of the private sector in Bosnia is of critical importance, both for the prospect of economic development and as a concrete means to limit the impact of corruption by limiting the opportunities of public officials to engage in rent-seeking behavior.

USAID does this in several ways. For example, we have a new Development Credit Authority agreement in place with three commercial banks, valued at \$30 million, as well as three older agree-

ments valued at \$46 million. To date, these loans have enabled the banks to disburse loans to more than 120 private firms, supporting close to 2,800 private-sector jobs and generating over 500 new jobs in the private sector.

USAID is considering new opportunities, as well. This week, a team of economic experts from USAID is in Bosnia assessing what other options may be available to support the country's economic growth and prosperity. This is in part in response to the proposal that you and other members of this Commission have made in sponsoring legislation to authorize an enterprise fund for Bosnia. Our team in Bosnia this week is looking at whether this would be the right approach, in tandem with looking at some of the other mechanisms that we have in place or might be able to put in place.

We are also working to make public finance more transparent and accountable, reducing opportunities for irregularities and corruption. We have projects that are working to expand electronic services for payment of direct taxes and in the procurement process in Bosnia so that there are more opportunities for competition and for small businesses to participate in government contracts, but also there's more transparency, which reduces the possibilities for corrupt rent-seeking.

Corruption also occurs when local producers skirt regulatory standards—think of watered-down milk and other diluted products—to keep costs down. And especially when it comes to medicines and things like that, it puts consumers at real risk.

We have a USAID project being implemented by Cardno Emerging Markets that helps to mitigate corruption by supporting agricultural producers to adopt stringent EU regulatory import standards. This program facilitated EU approval for a number of dairies to export milk to the EU, contributing to the economic growth.

On the demand side of the equation, we support watchdog NGOs and investigative journalism, including Transparency International, but also including a network of independent journalists whose reports connect the dots as part of professional investigative journalism, and these civil society and journalist stakeholders have brought to light a number of corrupt officials and their corrupt dealings. This advocacy is critical, since three-quarters of Bosnia's annual \$1.7 billion worth of procurements is done non-competitively, and hundreds of these procurements are awarded to companies owned or co-owned by elected officials.

We're also working to support the institution of a new special anti-corruption unit in the Bosnia and Herzegovina federal prosecutor's office, mandated by a 2014 anti-corruption law.

Organized crime often depends on the inability of law enforcement to track illicit activity across borders. So that's why the journalists and the NGOs who can cross borders and report widely on their findings play an important role in advancing the exposure and control of corruption.

In conclusion, though the threats posed by corruption in Bosnia to its economy, its public service, and to the state itself are great, we in USAID are working with our partners to limit opportunities for corruption, uncover them when they occur, and see that they are investigated and punished. We're doing this together with our European partners, who in some cases enlarge our AID programs

with donations from other governments' donor agencies. We're also working closely with other U.S. Government agencies, such as the Department of Justice, which provides expert advice and assistance to investigators, prosecutors and judges.

This effort will require significant political will from Bosnia's leaders, NGOs and citizens. Progress will not be easy, and constraints related to the structure of the constitutional system in Bosnia may limit the possibilities for dramatic or early progress. Nevertheless, we will remain engaged.

Thank you for the opportunity to testify, and I look forward to your questions.

Mr. WICKER. Thank you very much, Mr. Melia.

Mr. Blagovcanin.

**SRDJAN BLAGOVCANIN, CHAIRMAN OF THE BOARD OF DIRECTORS OF TRANSPARENCY INTERNATIONAL, BOSNIA AND HERZEGOVINA**

Mr. BLAGOVCANIN. Thank you very much, Senator Wicker and Chairman Smith. Thank you very much for this opportunity for me to speak on what I consider a very important topic.

There are a lot of arguments to rightfully claim that corruption is the biggest problem today in Bosnia and Herzegovina. Direct damage to the country reaches hundreds of millions of dollars disappearing from the budget due to corruption. Indirect damage, due to a lack of investment caused by corruption, is difficult even to estimate.

The crux of the problem is political corruption, which involves the highest political and public officeholders. Twenty years after the war, Bosnia and Herzegovina remains a country completely captured by corruption, where it is virtually impossible to get any public service without having to resort to corruption.

Most relevant studies clearly indicate that in recent years Bosnia and Herzegovina has not seen any progress in strengthening the rule of law and the fight against corruption. Corrupt political leaders hold sway over key institutions in the country. This allows them to use all economic resources of the country in their own private interests.

Political control over the judiciary and law enforcement agency allows corrupt leaders to be protected from prosecution. There are almost no cases of political corruption that result in judgments of conviction. Political corruption is ignored by public prosecutors because of political influence.

The crux of the corruption problems lies in how political parties are organized. Devoid of basic internal democracy, they operate in a mafia-like manner. Their basic principle of operation is based on the distribution of the spoils. Their booty are budgetary funds, public companies, and public institutions.

Political elites use clientelistic appointments as the main method of exercising control over institutions. In this way, political leaders create clientelistic networks, which they use to run the country. The real and almost unlimited power lies in the hands of a few ethno-political leaders.

The political leaders are therefore not interested in reforms and European integration. They have learned their lessons from Cro-

atia and Romania, two countries that had to tackle political corruption and prosecute their political leaders as part of their process of joining the EU. Therefore, the interest of political elites in the country is solely and exclusively to maintain the status quo. Any progress in the reform implementation directly affects and limits their power, and exposes them to criminal prosecution. Therefore, their strategy is to rhetorically accept reforms, while in practice they only feign reforms.

Pervasive corruption affects human rights and freedoms. Cases of repression against the media and civil society remain widespread. Corruption within institutions prevents citizens from accessing justice. A backlog of over 2 million cases, in a country of 3.5 million people, means that the judicial system is completely blocked. Adjudication of disputes takes years to complete.

The consequences of corruption are felt by citizens on a daily basis. Corruption exposes them to additional costs to pay for health, education and administrative services. Also, corruption undermines economic development of the country, trapping the majority of its people in poverty and depriving them of employment opportunities. The way the market is organized has a pernicious effect on the private sector. Privileged access to public tenders and privatization processes is reserved for cronies.

Therefore, I want to reiterate what I said at the beginning: corruption is the biggest problem in Bosnia and Herzegovina today. Without progress in fighting corruption, it is not possible to make progress in the implementation of any other reform.

How to make a breakthrough? As Fukuyama rightly pointed out, all reforms are inherently political. Therefore, it is about generating political will for reforms and not only strengthening capacity of the institutions. Leveraging and articulating the public's deep mistrust in the government through citizens' active involvement in decisionmaking should be prioritized in order to avoid another wave of destructive protests like those of 2014.

Past experience shows that simply calling on leaders to undertake reforms and to take responsibility is not sufficient. Generating a genuine and articulated internal demand for reforms is key to achieving sustainable progress. Thus, I believe that reforming the way political parties operate and introducing internal party democracy would create conditions for dismantling the clienteleistic networks run by political leaders.

Another important aspect of the reform concerns the strengthening and reforming of the judiciary. The judiciary must finally assume responsibility for prosecuting corruption. For this to happen, it is imperative to ensure that it is independent in its work and free from any political interference.

In any case, Bosnia and Herzegovina still needs strong international support in undertaking reforms to strengthen the rule of law and fight against corruption. This also requires that the current EU reform agenda be expanded to include a detailed and specific plan for combating corruption and strengthening the rule of law.

Thank you very much again for the opportunity to serve as a witness at this hearing today. And in addition to my written statement that I submit, I would like to ask you to include in the record

a paper that I recently authored for Johns Hopkins University. I believe it's highly relevant for the discussion today.

Mr. WICKER. Without objection, it will be admitted into the record at this point.

Mr. BLAGOVCANIN. Thank you very much, Senator Wicker.

Mr. WICKER. Well, thank you, sir. And that was about as breathtakingly downcast a report as I've heard about a country in a long time, but helpful nonetheless.

Dr. Perry.

**DR. VALERY PERRY, SARAJEVO-BASED INDEPENDENT RESEARCHER AND CONSULTANT, SENIOR ASSOCIATE AT THE DEMOCRATIZATION POLICY COUNCIL**

Dr. PERRY. Thank you. And I'd like to thank everyone for organizing this hearing today to put this very important issue back on the agenda.

We've heard a number of vivid descriptions about the situation of corruption in Bosnia and Herzegovina today. And it's clear that the politics of corruption makes meritocracy impossible, weakening institutions and promoting brain drain of the best and brightest of the country. The politics of corruption also results in a system in which floods can devastate one-third of a country and no leaders or officials are held responsible or are held accountable for their failure to prevent, protect, prepare, or respond to such a disaster.

The politics of corruption weaken the notion of civil society, shared purpose and joint vision, instead strengthening informal practices, patronage networks and exclusionary practices that are particularly damaging to a country only one generation removed from the most violent conflict since World War II. No political system anywhere is immune from corruption. Systems, structures and incentives either encourage or impede corruption. Societies ideally organize themselves in a way that minimizes corruption and maximizes the public good. This can be hit or miss anywhere and no design is ever perfect.

However, Bosnia's political economy was shaped by the war and by the Dayton Peace Agreement that ended it in 1995. Dayton was, and remains, a made-in-America product. For this reason, it's important that we're having this discussion. The problem of corruption in Bosnia is not a technical problem. It's a political problem. In the absence of fixing the core political problems that both prevent accountability and allow impunity, all of the projects, capacity building, technical support and money in the world will not overcome the fundamental inherent weaknesses and democratic contradictions at the core of Bosnia's unaccountable political system.

In fact, after two decades and literally thousands of well-intended projects, it's time to consider not only the diminishing returns of such approaches, but the broader negative impact of such efforts actually maintaining the illusion that a system that has failed for 20 years can in fact somehow be made to work. Continuing to prop up a system proven to be ineffective is akin to hoping that updating the software on your 15-year-old computer will help its performance. At some point you need to recognize that the problem isn't the software but the hardware, and that no patches or workaround will improve its performance.

So what should be done? I'll focus on three specific recommendations today. First, a package of legislative reforms aimed at reducing the possibilities for official corruption, abuse of office and collusion should be developed and supported. This would include laws related to conflict of interest, political party financing, and freedom of information, among others. And Transparency International has written on this in the past as well. Laws, by-laws and statutes regulating public enterprises also need to be urgently overhauled in line with available guidelines and international good practice. Many existing USAID and other U.S.-funded programs—ranging from support for investigative journalism to critical justice sector reform—can be better coordinated and recalibrated to support this effort.

It's important to recognize that there will be political and, in turn, institutional resistance to such reform, and every effort will be made to evade proper implementation. We've seen this happen for years. However, there would be overwhelming public support among the citizens. Further, such an initiative would be very much in line with the European Union's own reform agenda, and in fact the notion that the country's business environment can be improved without improving this environment of corruption reflects a fundamental misunderstanding of the political economy in Bosnia today.

Second, the lessons of unsuccessful past privatizations in Bosnia must be studied, learned and applied by domestic and international interlocutors alike to understand both their role in further strengthening an oligarchical class of political and party leaders, and to understand why part of the country that has privatized nearly all of its public assets, the Republika Srpska, has in fact failed to enjoy any broad and durable economic or social benefits after such privatization. Future privatization should be put on hold until such time as there are reforms to the broader ecosystem to ensure fairness and transparency. Otherwise, the country risks seeing a further enriched and emboldened political elite, accompanied by questionable foreign investment in enterprises which is often more about real estate and asset stripping than about building a robust economy for the people of Bosnia.

Third, it's critical to understand how the election system in Bosnia contributes to the lack of accountability and makes it not only possible, but natural, for politicians to be elected and reelected without delivering anything to their voters other than limited and targeted patronage. Much has been written about this issue. Current election law reforms being discussed will in fact make it harder for new or small parties or independents to participate in the political system. This will further entrench the dominant political elite and party machines that have held control for a generation, further eroding the checks and balances needed to fight corruption.

Substantial election reform is needed so that citizens actually know who really represents them at every level of governance and can vote them in and out of office; so that they have constituent services offices in their community that they can address with their interests and concerns, and, most importantly, to ensure that people in Bosnia and Herzegovina have the chance to be represented on the basis of being a citizen, not on the basis of being a Bosniak,

Croat a Serb, or the always marginalized others. These reforms could effect substantial change, and in fact do not require a Dayton II. In fact, any elite-driven, foreign-sponsored effort to try to engineer such reforms would very likely create a system even worse than the one we see today. Instead, reforms need to be citizen-focused, combining coordinated top-down support and bottom-up grassroots activity to create momentum among all political players and squeeze the elites to listen to their constituents.

Bosnia and Herzegovina is a small country of less than 4 million people. And it's fair to ask why the U.S. should continue to spend time on it, considering the many other foreign policy priorities and humanitarian crises facing the world today. The answer is simple: If the U.S. and its partners cannot support the development of a functional and accountable system in Bosnia, how can it possibly hope to support positive and peaceful political outcomes in other parts of the world? If the U.S. and its partners do not learn the lessons of failed postwar power sharing in Bosnia, there is the potential that similar foundational weaknesses will be introduced into other areas in crisis around the world, creating an illusion of peace and stability while corruption and spoilers flourish, social discontent is manipulated and society becomes entrenched in a state of frozen conflict.

Finally, the same systemic failures and factors that allow corruption and unaccountable governance to thrive in these frozen conflicts actually foster the civic marginalization, social alienation, and in the worst cases enable the rise of extremist groups and radicalized individuals seeking extra-institutional remedies to political and social maladies.

In closing, corrupt politics and the pain of an economic transition which has delivered very little benefit to the majority of people have not only reinforced public frustration with the post-war situation, but has revealed increasing dissatisfaction among people with the very ideas of democracy and capitalism, promotion of which have been some of the core U.S. foreign policy goals for more than two decades.

It's not too late to reverse these recent negative trends, though the clock is ticking as social divisions have reified and hardened in the divide and rule politics of the past generation. More ethnic politics and virtual partition will not help. Laws, strategies and initiatives that seek to hardwire accountability into the system, backed up by meaningful conditionality and enforcement mechanisms, can. I'm hopeful that this hearing will put this discussion back into the spotlight, and generate momentum for the change that's so desperately needed if the promise of Dayton Bosnia is to be fulfilled. Thank you.

Mr. WICKER. Well, thank you very much, Dr. Perry. And I do think everyone in the room can agree that the statements made have been vivid today. And obviously we have a lot of room for work.

It's my pleasure now to recognize Chairman Chris Smith for whatever opening statement he might have.

**HON. CHRISTOPHER H. SMITH, CHAIRMAN, COMMISSION ON  
SECURITY AND COOPERATION IN EUROPE**

Mr. SMITH. Thank you very much, Mr. Chairman.

In lieu of the opening statement, I would ask consent that it be part of the record since we're well into the hearing.

Mr. WICKER. Without objection.

Mr. SMITH. And I thank you, because this hearing was your idea. I thank you for chairing it and for bringing us all together. This is extremely important and very, very timely.

Just a couple of questions. And I'm sorry I missed some of the testimonies. We had votes on the House floor—Mr. Perry as well—so that's why we are late.

Mr. Melia, in reading your testimony you've made some excellent points about the importance of journalists. As we all know, in Azerbaijan, a Radio Free Europe stringer, or reporter, Khadija Ismayilova, was released. She had a seven-year prison sentence. We actually had a hearing of the Commission on her and the concerns that an American—you know, a woman writing for Radio Free Europe was arrested because she exposed just that, corruption, everything we're talking about today. We're awaiting more details about what has happened, but you talked about your journalist initiative and how important that is. And I'm wondering how unfettered those journalists really are. Are they able to report robustly, go anywhere, report any time without fear of retribution, physical or criminal liabilities?

Secondly, let me ask a question about the about the noncompetitive contracts you talked about, which obviously are a grave invitation for fraud of the highest order. All of you might want to speak to this—in our efforts to promote reform are we pushing low-bid and, even more importantly, best value? We've found in our procurement here in the United States that it's not always necessarily the lowest bid, but best value where objective criteria used by the procurers to ensure they're getting the best deal from competent vendors? And it seems to me, since so many of these contracts are noncompetitive, we've learned so many lessons in America about sole-source procurement. Sometimes it works. Sometimes it absolutely does not. And many times, particularly at the state and local level where there's even less transparency in the United States, a lot of people make a lot of money illicitly using noncompetitive sole-source contracting.

Thirdly, several weeks ago I met with Ms. Munira Subasic from the Association of Mothers Action of the Srebrenica and Zepa Enclaves. She herself lost her husband, son and 20 others at Srebrenica in July of 1995. Her frustration today regards the seeming impunity of hundreds of people, an estimated 850, implicated in the violation of international humanitarian law during the war who had their cases transferred from the international tribunal to the Bosnian courts. To this day these cases have not been processed, not one of them, which is outrageous on the face of it. And my question would be the extent to which corruption in law enforcement may be playing a role in that prosecutorial discretion where they do nothing.

On trafficking, a similar issue. The numbers have gone down in terms of prosecutions and convictions. We're awaiting the most re-

cent TIP report. It will come out shortly. We'll get a better feel for where Bosnia is. But it was tier two last year. And the prosecution side of the report points out in 2014 one prosecution, no convictions in 2014. That's not a good record. And we know in the United States, every country, the commodification of women, the selling of women is increasing, not decreasing. We just had a major briefing of that last week from some of the NGOs that are involved, including ECPAT, which is the End Child Pornography and Trafficking organization. So I ask you what role corruption might play in that.

And finally, Mr. Chairman, when we were at one of our OSCE Parliamentary Assembly meetings—I believe it was 2000, in Bucharest—it was all about corruption. As you pointed out, Secretary Kerry's statement about how it ruins democracies. And that's exactly what that entire conference was about, how it hijacks democracies and is the equivalent of the worst of the worst of human rights abuses.

Mr. Melia, if you would start.

Mr. MELIA. I can take a crack at a couple of those. I think Ambassador Moore and the others may be better suited to respond to your latter couple of questions.

Let me say on journalism, you asked if the investigative journalists are unfettered and able to do their work. They are to a large extent, although a lot of their work doesn't get reported in the mainstream media. There's a fair amount of sensationalist faux-investigative journalism where scandals of one politician leaking information about his or her rival pops up in the newspapers or on television—that kind of clouds the discourse. The work that we support through the RIJN, which is the Regional Investigative Journalism Network, which is connected to the larger worldwide Organized Crime and Corruption Reporting Project, which got so much attention with the Panama Papers release in recent weeks, is dedicated to professional, fact-based, triple-checking-your-sources kind of journalism.

It's led by an American reporter from the AP named Drew Sullivan, who has trained a generation of journalists across the wider region, including Khadija Ismayilova, who you referred to. It was great news today that she was released on the eve of her 40th birthday. I don't know if that was coincidence or not. But I think the worldwide campaign against her unjust imprisonment had a lot to do with it as well. So she's a part of this network. It was founded in Sarajevo 20-some years ago, and grew region-wide from this very place. And so their work may not always be on the headline evening news in Bosnia, but it does get out and is around and is a constant fact-based source and a key reference point. So it does have an impact, even if it's not always on the evening news.

On procurement, which as I think we've all said in different ways and, as you know, is where political corruption interfaces with economic perversion of the marketplace. In Bosnia, as in a number of other countries from Ukraine throughout the region, where we have willing partners in legislatures and in ministries we do have a number of programs—and this is true in Bosnia—where we are helping to build out systems for increasingly transparent electronic procurement so that it's out there what's being sought by a government agency. On the one hand, it enables additional bidders to get

involved, so small businesses who may be located in small towns or remote from the capital get a chance to get in the marketplace. This contributes to lowering prices in some cases. But it is also clearer what the government is buying, and for how much.

This is a work in progress. These systems get designed, get legislated, get put out there in regulation. I would say in all these countries, including in Bosnia, we're in midstream in trying to help build them out and get people trained to use them, and then increasingly put more and more stuff online into these systems. So I think the electronic age has many ups and downs in our lives, but I think in this one regard e-procurement is an important step for combatting corruption.

Mr. SMITH. Yes, Ambassador Moore.

Amb. MOORE. Chairman Smith, thank you very much for the opportunity. We look forward to seeing you back in Bosnia again. Enjoyed our trip together to Medjugorje.

Let me just make some quick responses. First of all, when it comes, of course, to media freedom OSCE works very closely with a citizen of Bosnia and Herzegovina, Dunja Mijatovic, who is in an additional year as OSCE's representative for freedom of the media. Our mission and our media team work very actively directly with journalists, of course, and editorial offices and all around the country to support them.

There have been some very concerning cases of raids of editorial offices, including by police armed with weapons, the seizure of computers, as well as individual assaults against journalists, most recently in the town of Visegrad, when journalists trying to report on a rally of the so-called Chetnik Movement were assaulted. These cases need to be investigated and prosecuted. The authorities responsible for rule of law as well as the police need to keep in mind what the rights and freedoms of journalists are. We use our voice—hopefully—eloquently, but we have certainly not solved the problem. It is a big part of what we try to do when it comes to media freedom issues.

On transparency, we had the chance slightly earlier to talk about absolutely the need for transparency so that people know what is being spent in the name of the citizens, how many of their taxes are going to whom, what the salaries are, who gets what jobs. I pointed to Sarajevo Canton as a particular good example of this. Working with the media, they released salary information, the names of key employees in all kinds of public institutions. And although people know that corruption is everywhere, it was extremely interesting for the public to actually have the facts to see how outlandish and excessive a number the salaries were. We very much encourage that. And that example in Sarajevo Canton needs to be repeated throughout the country.

And thank you also, of course, for mentioning Munira Subasic and other Mothers of Srebrenica. We spend a tremendous amount of time with them. Munira has asked for the support of the OSCE mission. And just a couple of weeks ago we co-sponsored a conference where we also brought in Serge Brammertz, the chief prosecutor of the court in The Hague, to talk about exactly this sort of issue. There are too many unresolved cases. The war ended more than 20 years ago and Munira and the other mothers, the other

survivors, and in the name of the people—victims of genocide and war crimes, they need to be—that needs to be respected.

Criminals need to be brought to justice. The OSCE mission supports this process; we're working with judges and prosecutors at different levels, we've engaged a very comprehensive expert-level analysis to make sure that the courts and the prosecutors, especially at the state level, are doing their job. We hope to have the results of that in the near future. It is unacceptable to all of the victims and to us that more persons have not been brought to justice there.

Mr. SMITH. Did anybody want to touch on trafficking and the decrease in prosecutions and convictions?

Amb. MOORE. With regard to trafficking in persons, yes, you're exactly right. Of course, you know very well that the report will be coming out soon. I don't know what the content of that report will be, since I am coming from OSCE structures. But on all levels, we want to see more prosecutions brought about. Sarajevo Canton is a good example of this because young people and women who have been victims have not felt comfortable coming forth with testimony and speaking directly to prosecutors.

With our assistance, the prosecutor in Sarajevo Canton has specifically made space and reached out to victims, so that they feel more comfortable coming into the office and telling their stories. They're concerned that there might be retribution against them. And the prosecutor there, Dalida Burzic, has done an excellent job of creating a welcoming atmosphere so that victims of trafficking can also feel that their rights are upheld.

Mr. SMITH. Thank you, sir.

Mr. WICKER. We are joined by Representative Scott Perry of Pennsylvania, Representative Robert Aderholt of Alabama, and my colleague Senator Jeanne Shaheen of New Hampshire.

Representative Perry, do you have questions for the panel?

**HON. SCOTT PERRY, REPRESENTATIVE FROM THE STATE OF PENNSYLVANIA**

Mr. PERRY. I do, sir. Is now the time?

Mr. WICKER. Now is the time.

Mr. PERRY. Excellent. Well, I apologize also for being late and missing your testimony—Dobar dan!

I know the discussion is generally about corruption, but I do have something I think potentially relates to at least some types of corruption, if not the corruption of society in Bosnia, and particularly with their security situation, in particular the security risks that relate to the infusion of Saudi financing for things such as the King Fahd Mosque, which was associated with the teaching—I guess at least the teaching—and some of the rhetoric for the attacks in Paris and, of course, some of the ammunition and the weapons came directly through Bosnia. And I'd like to hear some comments on that as well.

And, Dr. Perry, I'm sorry I missed your presentation. We just went over trafficking, but I'm interesting in your solution set for governance. When I was there, I was with the Stabilization Force. And I know it was stabilized. Nobody saw that as long lasting or efficient in any way. And quite honestly, I'm amazed that it's lasted

as long as it has. But I'd like to know your perceptions—as shortly as you can, or as briefly as you can—about what America's involvement in that regard should be. With those two questions.

Mr. WICKER. OK. Shall we start, then, with that question and then we'll go to the issue of the influence of foreign money? Dr. Perry.

Dr. PERRY. Thank you for getting right to the core of the crisis of political accountability in Bosnia. Over the last 20 years there have been a number of different efforts to try to re-engineer the structure and the politics and the constitution of Bosnia. And none of them have succeeded for a variety of different reasons. Now there are a lot of different actors who feel that the main way to move the country forward is by EU accession. And everybody does agree that EU membership would be good for the country. It's just not going to happen anytime soon. It took 12 years for Croatia to finish its accession process. And Croatia agrees that it's a country. And that's something that's still lacking in many ways in Bosnia and Herzegovina.

However, it doesn't mean that it's impossible to try to look for some fundamental changes in the system in Bosnia. For example, there's a number of structural reforms that could make a big difference and also demonstrate to citizens, to civil society, to regular people that change is possible. For example, there is no ministry of agriculture of Bosnia and Herzegovina, no state-level ministry of agriculture, which has led to numerous roadblocks in terms of people being able to export their goods. While there has been a lot of technical support to try to help dairy farmers and others to be able to meet the criteria at various levels to export their goods, in a market of 3.5 million people, the notion that there's no concerted statewide agricultural development strategy is, quite frankly, a bit ludicrous.

And what's even most frustrating is that there is quite broad public support for this. A majority of Serb citizens in the Republika Srpska surveyed recently, but also going back to 2013, support this because they recognize that they're losing from this current system. Developing a set of reforms to the constitution to allow for a ministry of agriculture would demonstrate that this is possible and that the sky does not fall, that people are no more or less a Bosniak or a Serb or a Croat than they were before. And it would also show civic groups, NGOs, that change is possible and that they can drive it. And so I would want to support that. There's other low-hanging fruit related to health care reform, which would enjoy very broad support, and a campaign on trying to ensure and promote health care mobility around the country, which doesn't exist, would be another fundamental structural change that would be possible.

These structural changes would also, in the longer term, be complemented with some fundamental changes to the way that people elect their representation. If you ask the average Bosnian citizen who represents them in the state or entity or cantonal parliaments, they can't give you a name. Sometimes they'll say, well, this party does, but they can't tell you somebody who they can hold accountable. And this is a reflection of the system, the election law, and the constitution, which the parties, quite frankly, like because this

way it's harder to be voted out for failing to deliver for your constituents.

The one layer of government that does function the best is the level of the municipality. And I don't think it's any surprise that mayors are directly elected. The problem is that if you keep the system in place right now, the mayors hit a ceiling. There's only so much they can do because almost all of the money is controlled by the ethno-dominated cantonal and entity budgets. And it's always manipulated.

We saw some very interesting examples of some very good mayors who responded appropriately in the 2014 floods. And those who sought to try to work across party or ethnic lines were often punished in the media and by a number of other politicians who want to keep these issues alive. So again, I would argue for an effort to look at some structural reforms in the short term, to create some new state-level competencies supported by citizens, but then also try to find a way to make sure people know who represents them and that there's actual responsibility and accountability in that relationship.

Mr. WICKER. Before we get to part two, Dr. Perry, Mr. Blagovcanin suggests that laws need to be amended with regard to the political parties. Apparently you agree with that. If both of you could comment on what specifically is wrong with the laws governing how the parties operate, and how does that contribute to corruption?

Dr. PERRY. Sure. One law is the law on political party financing, which creates an awful lot of ambiguity about money coming in from public enterprises and other sources, and then funding not the public good and not politicians, but funding party machines in a very cronyistic manner. And so this could very easily be amended. When you look at a number of other pieces of legislation, there's no requirement for transparency. So again, as was noted earlier, it's very difficult for people to find out what's going on and to really be able to hold people to account in that way.

I would also now note that when we're looking at some of these issues of political party democracy inside the parties, because of the way that electoral units have been gerrymandered following the war, creating generally ethnically clean election districts, this means that there's never ever any reason to be moderate or to put your hand across to the other side. In fact, it behooves you to be extreme and to keep ethnic fear and tensions alive. And until that changes, we're not really going to see anything positive happening. And we've had a couple interesting examples where a political party will lose a substantial number of municipalities in local elections and there will still be no change in leadership in that party. This is not normal politics. Usually when a party substantially loses there is change in the leadership at the top. But that does not exist because it's still a very clientelistic system. And I'm sure Srdjan would be able to provide some more light on that.

Mr. WICKER. Mr. Blagovcanin, is it public money or is it donor money, as Dr. Perry put her finger on the problem?

Mr. BLAGOVCANIN. I would say it's public money, but in addition to that—

Mr. WICKER. It's taxpayer money?

Mr. BLAGOVCANIN. Exactly. But in addition to that, I would like to add to what I mentioned in my statement, that I believe that the key problem when it comes to political corruption is how political parties are organized. Without internal democracy, political parties are functioning like mafia structures. Their only goal is to secure spoil. And spoil is public finances, public institutions, public companies. So I believe that introducing legislation which will provide for internal democracy inside the parties would be extremely important to democratizing the country as whole.

Mr. WICKER. Now, before we move to Senator Shaheen, Ambassador Moore, can you help Representative Perry and the panel out on the issue of the influence of foreign money coming in?

Amb. MOORE. Absolutely. Mr. Perry, thank you very much for your question on the issue of radicalization. Terrorist attacks in Bosnia and Herzegovina, much more than in many other countries, fundamentally threaten the country's stability. We have recent numbers which are probably low estimates that there are 130 citizens of Bosnia and Herzegovina in Iraq or elsewhere in that region, part of Daesh or other forces. About 43 of them have been killed in that fighting. About 50 have returned. And they're being tracked very carefully, although I have to say that sort of work is not the kind of work that OSCE directly engages in.

Radicalization is a huge problem. There are certain questions, obviously, about how some of the funding gets to Bosnia and Herzegovina. There have been huge—theoretically humanitarian—donations to fund the building or rebuilding of religious institutions, houses of worship, in different parts of the country. The issue of fundamentalism and increasing radicalization, especially through social media, the Internet, in some cases people who've returned from Syria who are trying to recruit people to go to Syria, is a very comprehensive problem.

At the same time, I would say it's slightly outside the scope of the OSCE mission, which doesn't cross lines into intelligence work. Our focus is on working more directly with the public. And we've had a lot of success with local communities where mayors and neighbors and the Islamic community, Catholic and Orthodox communities, are very aware of what's going on in those communities. They come together to talk about community values. That's something actually the OSCE mission in Bosnia and Herzegovina supports—19 coalitions like that around the country. After some concrete terrorist attacks like the one in Zvornik in April last year, the community came together again. Instead of calling for revenge, Orthodox and Islamic leaders sat down together and said: This is not what our community is about. We have to investigate this. We have to move forward. We have to come together. So it is a comprehensive issue.

In terms of exact sources of funding, some of them are private, some of them come through, of course, states. You mentioned the interest of some countries in the Middle East in Bosnia and Herzegovina. There are, of course, individuals—that seems to be the bigger problem—who were radicalized, who came—in fact, I'm sure you're very familiar from your military service with those who came to Bosnia to help fight on that side—and some of them have stayed. Not enough of them have left. But the level of

radicalization in society is a huge problem. And again, while any terrorist attack has terrible consequences for the victims, in Bosnia and Herzegovina it could really tear the country apart. So we pay very close attention to this and, speaking on behalf of the OSCE mission, particularly at the local level, as well as with the Ministry of Security.

Mr. WICKER. Before I recognize Senator Shaheen, Dr. Perry, have you observed, as have I, that mayors trained in New Hampshire are really better mayors in Bosnia and Herzegovina?

Dr. PERRY. Perhaps we should start sending more politicians to train. No, it is interesting, though, that for the past two decades, there have been a lot of different capacity development efforts to try to build a new cadre of political leaders. But there's very little that we can see that has actually transferred into the day-to-day business of politics. It's very difficult to make that leap. Either people go to New Hampshire, fall in love with it, and decide to never leave and never go back to Bosnia. Or, sometimes if they go back to Bosnia, they seek to try to change things from within, but they get so frustrated because they're not actually able to operationalize the new things they learn, that they either give up or try to go and get a job at an embassy or the OSCE or someplace else that's a little bit better than the private sector.

And so it's very difficult to try to find examples of individuals who have been able to make it past this ceiling to try to really change the level of discourse in politics. And this is after 20 years and probably thousands of people trained by either American or other funds.

Mr. WICKER. Senator Shaheen.

**HON. JEANNE SHAHEEN, COMMISSIONER, COMMISSION ON SECURITY AND COOPERATION IN EUROPE**

Mrs. SHAHEEN. Well, for those of you who don't know, Senator Wicker was referring to the mayor of Srebrenica, whose family fled to New Hampshire after the massacre and who went back and became mayor. So we're very proud of him.

I want to follow up on that line of questioning because I think you mentioned, Dr. Perry, that there are enclaves of the different ethnic groups and that sort of has gotten baked into the way government works in the country. How much of that is the result of the Dayton Accords and how much of it can actually be changed at this point?

I was struck—and I'm sure everybody on the panel has been to the country—but I was struck when I was there that much of the challenge around getting people to work together seemed to be based on the fact that when the peace was set up after the war, the country was so divided by ethnic groups that it was very hard to think about how to get people to work across those ethnic lines for the benefit of the whole country.

So I wonder if you could speak to that and to the extent that that's baked in, and is there a way to fix it. You talked about some reforms, which I think make a lot of sense, but it sounds like those are sort of tinkering around the edges.

Dr. PERRY. Sure.

At the 20-year anniversary of Dayton event in Dayton this past November, it was interesting to see that pretty much everyone who was there noted that when they were working on the Dayton Agreement and the Dayton constitution, that they never thought that the structure would remain in place 20 years later. There was always an assumption that the issue would be readdressed and overhauled at some point because they recognized the inherent contradictions within the draft even as they were doing it.

But that fundamental reform hasn't happened, and you're right that we've ended up seeing instead municipalities, cantons, entities and then the state level, and even the lower levels have really been dominated by various ethno-national issues, meaning that there is no sense of political ideology in the country in terms of left-right. It's just, you know, they are crooks, but they are our crooks and people feel a need to try to protect that in that way.

What's frustrating is that many people look at the war in Bosnia and say it wasn't an ethnic conflict; it was a conflict about power and influence in which ethno-national issues and religion were manipulated by the leaders fighting it. But now, 20 years later we've seen that a number of these identity issues have begun to harden in a way that will not be fruitful for the long-term future of the country. There is no incentive for cross-group coordination. While there's nothing technically preventing a number of municipalities in Herzegovina from working together to develop a business enterprise zone, the political parties don't want to see it because they want to maintain the control that they have within the current environment.

And what's most troubling to me is that when I see people who are my age, different people who are parents, et cetera, they remember what joint life was like. They remember what it was like to fall in love with someone from the other side and to go to concerts and to travel. Their children don't have that. There have been a number of different efforts, mostly with foreign funding, including the OSCE, to try to bring kids together on different study trips, et cetera. But these are never, ever done by the local officials, and they're never done with any real effort to try to change the education system.

And I think this is one of the big risks. The problem in the education system is not about school buildings. It's about what children are learning. Right now we have a system where there is essentially a Catholic curriculum, an Orthodox curriculum and a Muslim curriculum, and about 40 percent of this content is different among the three. So children are growing up and coming of age and never being able to see that they're citizens of the same society. And until we tackle what children are learning, the future looks grim.

And I would also just point out that this is very much related to radicalization, because the lack of having any critical thinking, media literacy and analytical thought mainstreamed into the primary and secondary school systems means that a lot of people, especially in poorer rural areas, don't have the skills to try to counter effective grooming by radicals.

And so, unfortunately, educational reform is necessary in a substantial way, and the politicians and political parties will resist it

because the best way to maintain control is by making sure that citizens can't question the system, and don't know how to change a system in which they're not being served.

Mr. WICKER. Representative Robert Aderholt is chairman of a subcommittee on the Appropriations Committee in the House and is vice president of the OSCE Parliamentary Assembly.

Robert, we're glad to have you join us.

**HON. ROBERT B. ADERHOLT, COMMISSIONER, COMMISSION  
ON SECURITY AND COOPERATION IN EUROPE**

Mr. ADERHOLT. Thank you, Senator. It's good to be here. Thanks for everybody being out for this hearing.

Dr. Perry, you mentioned something I want to just follow up on. A little earlier you talked about the way that districts are drawn and you said they're drawn in such a way where there is no encouragement to reach over to the others. Expand on that a little bit and talk about how these districts are drawn and if there is any way that you see that this could be changed for the future.

Dr. PERRY. Unfortunately they largely reflect the ethnic cleansing that happened during the war and then the legitimization of all of these various units of administration after the Dayton Agreement.

The sad fact is a lot of municipalities and regions that were once quite mixed are now more or less homogenous. And that's been maintained, and would take some time for that to reverse. Return has not been complete because of the many political impediments over the past 20 years as parties have sought to maintain homogenous districts. I wouldn't seek to start trying to change lots of lines of municipalities, et cetera, but there are different ways that you can change the vertical integration among the various levels of government to try to have more political responsiveness in terms of the election systems.

Right now nobody needs to campaign on issues saying, you know what, I cleaned up the community park, I put lights in and I've gotten a new highway paved. They basically campaign on issues of us-versus-them ideology and then also on patronage, basically promising that they'll continue to pay privileged pensions to veterans of their group, that they will continue to pay various different payments and subsidies to their people, as opposed to an actual issue-based campaign.

And unfortunately, I'm pessimistic that this can change because over 20 years a lot of very smart people, from the National Democratic Institute, from a number of different USAID agencies and European agencies, have sought to try to change this to create an environment where issues are front and center. And after 20 years it really hasn't changed, and the elections we saw over the past couple cycles were more of the same. And in fact, the election results in 2014 took us back to the same parties that started the war in 1991 and 1992. So I think there's a need to sort of try to fundamentally look at where are these points that are keeping this ethnic system in place?

Mr. ADERHOLT. So where we would see this is like, for example, in Republika Sprska. When the parliament meets in Banja Luka—I think it's Banja Luka where the Republika Srpska Assembly

meets—they would have the districts drawn within the Republika Srpska are very ethnically—

Dr. PERRY. More or less. I mean, one very interesting thing right now is that while a census—the first postwar census was conducted in 2013—the results have not been released because the various political parties can't agree on how the data should be counted or analyzed. And this is because they really don't care about some of the basic census issues we would think of: how many people live in a family, what their roof construction is made out of and whether they get their water from a well or from a sewer system, a public system. All they want to do is try to consolidate and formalize the ethnic redistribution that has happened over the past number of years.

In Republika Srpska you do have some areas where return has been moderately successful. However, it's still much more of a majority-minority relationship as opposed to any sort of joint ideologically driven, issue-driven coalitions at any level of government. And unfortunately, as time has passed and as return slowed down, and in a number of cases has even reversed, it's getting harder and harder for people who are either a minority or who choose not define, to try to find any political home and influence the system, which is creating a cycle where dominant ethnic politics is getting even stronger instead of weaker.

Mr. WICKER. Mr. Melia, you mentioned that you are—I guess USAID is looking at S.2307, the Bosnia and Herzegovina-American Enterprise Fund Act, authored by Senator Wicker and Senator Shaheen, and that you're not quite sold on it yet. As you know, this bill would authorize an enterprise fund modeled after the support for Eastern Europe Democracy Act of 1989. It would fund small- and medium-sized enterprises. It would be directed by a board of six American investors. USAID would be involved. It doesn't score, I assume, the appropriation bill funding it would score but it is presently scored as having no cost.

What needs to be done, in the opinion of any of you that are familiar with this act, to make it work? And is it an opportunity for us to put some conditions there that the enterprise fund would kick in if progress or steps were made in the direction of a more pluralistic approach to government and concrete steps to avoid corruption?

Mr. MELIA. Two kinds of thoughts in reaction to the proposal come to mind. One is that, to the extent that a new enterprise fund might make sense—and it might—I would ask the question about whether it should only apply to Bosnia and Herzegovina. As we look around the region, we've had these enterprise funds in Albania, in Bulgaria and Romania, and then further to the north in Hungary, Slovakia, Poland and the Baltics. So one question would be: Why only Bosnia and Herzegovina? There are other countries in the neighborhood that might be in the same situation. So that's one question.

The second question or second set of issues is really about what the need for it is in Bosnia and/or in other countries. That's why we have a team on the ground now of finance experts who are doing dozens of interviews with people in the business world, in the banking sector to explore the credit marketplace there. In part, this

is driven by the bill. We wanted to get a fact-based assessment in order to inform our reply to it or our suggestions on how it might be refined.

Mr. WICKER. And we appreciate that.

Mr. MELIA. So that assessment is underway now. We have a team out there that will be back in the next week or two and we'll be putting together a report that we'll share hopefully before the legislative process advances much further.

We have in place five finance mechanisms in Bosnia and Herzegovina. They're called Development Credit Authority guarantees, which essentially provide kind of backstop loan guarantees for banks to invest more readily in small and medium enterprises and in privatized businesses. They have not been fully subscribed. That is, there's money on the table that could be lent out to businesses that has not been borrowed.

Part of the assessment is looking at why that is, why there's money available to be invested in businesses and the businesses aren't asking for it. It may be administrative or other hurdles. It may be a lack of awareness of how credit works. Obviously the lending authority is different than an equity investment that was the hallmark of the earlier enterprise funds.

They actually bought stakes in companies and, through that ownership share, would provide technical assistance on corporate governance and business development and all that. So it was more than just a loan from a bank. It was a loan with—or it was an investment with—benefits, and it came from the know-how of the people involved in the enterprise funds.

So that's the difference. If there's this alternative model, which is the enterprise fund as opposed to the credit authority, that would make a difference in way that makes sense in Bosnia, then we'd be—

Mr. WICKER. Have they worked anywhere?

Mr. MELIA. Yes, they've worked in several places. If you look at the—

Mr. WICKER. But where could you point us?

Mr. MELIA. Well, nearby in Albania.

Mr. WICKER. Albania has been a success, on balance?

Mr. MELIA. There's been a number of businesses that were jumpstarted and rebooted and succeeded. And the fund then sold off its shares and cashed out at a certain point and the businesses went on their way.

Mr. WICKER. Was it 30 million [dollars]?

Mr. MELIA. Albania, I don't recall offhand. It may have been 30 million [dollars] was put in there originally.

Mr. WICKER. OK, well, let us know on the record other success areas.

You know, why Bosnia and Herzegovina? Senator Shaheen, I think it's for the same reason we're having this hearing, for the same reason that we have a capacity crowd in here, it's that the very power and influence of the largest superpower in the history of the world was brought to bear to end a conflagration and to see if we can make pluralism work in the area that gave rise to the term "balkanization."

Ambassador Moore, do you have any thoughts to add? I'm sure you don't, but—[laughter]—let me pull them out of you.

Amb. MOORE. Mr. Chairman, I'm a diplomat; I always have thoughts. Thank you for the opportunity.

Mr. WICKER. And on the one hand—[laughter].

Amb. MOORE. I only have one hand.

Mr. WICKER. OK.

Amb. MOORE. I swore the oath to the Constitution of the United States with it.

To be clear, there are some success stories. And we've found it very successful to focus on them. Senator Shaheen made reference to the mayor of Srebrenica. The mayors in towns like Zepca and Zvornik and Bijeljina, they are multiethnic communities. They don't have the balance they had. Valery is exactly right to point out that there hasn't been enough return, but you have Serb majors trying to talk about the rights of their Bosniak fellow citizens. Again, I quoted the former speaker: All politics is local. Absolutely. All the more so in the Balkans.

A way to focus and highlight and perhaps fund—whether it's brick-and-mortar projects or it's to support entrepreneurship in those communities where mayors have reached out to all of their fellow citizens to try and make a difference, to try and counteract all of the tensions and the divisions that were, it's true, enshrined in the Dayton Agreement—there are some positive examples that we can build on. When those opportunities are shown in a certain set of communities, they can be seen elsewhere.

Reference was made earlier to the fact that before the war everybody lived together. Well, yes, they did but they still went to war. Just having them live next to each other isn't enough. This is why our focus, of course—following the guidance from the Helsinki Commission and looking at human rights—it's not just, yes, I have a neighbor who is one of "those" but their kids go together to the same schools, they work in the same enterprises, they respect each other's right and freedoms, they celebrate each other's holidays together. That's a very comprehensive project.

And Valery is right in that framework too. Political parties are very reluctant and generally unwilling to do that. It's the sort of thing that the international community can encourage. OSCE is trying to do that on the ground there. Your visits and your attention help to foster that as well. There are so many people telling good stories and doing good things. Unfortunately, they may be the exception rather than the rule, but we need to support them.

Mr. WICKER. Mr. Blagovcanin.

Mr. BLAGOVCANIN. I just need to add one thing. Sometimes, or even maybe oftentimes, a religious community or communities in Bosnia and Herzegovina are playing a role which is not quite positive. Sometimes the orientation is towards homogenization of the ethnic groups in Bosnia and Herzegovina, and sometimes they are inspiring interethnic problems in terms of hatred and similar things. So that's just in addition to positive examples. Since I'm not a diplomat, I'm always trying to find the negative. [Laughter]

Mr. WICKER. Senator Shaheen.

Mrs. SHAHEEN. Well, thank you.

I would add to why is this room full and why does this hearing matter the fact that what happens in Europe matters to us, that the trans-Atlantic partnership is critical to our security and that, as we've seen, one of the places that is still not whole, free and at peace in Europe is the Balkans.

And so it is not in our interest, just as I think it's not in Europe's interest, not in Bosnia and Herzegovina's interest, to have continued ethnic strife, to have continued recruitment of foreign fighters, to have continued concerns about impediments to the country becoming a functioning democracy. So that gives opportunity for all of its citizens. So I would say there is a lot at stake here and it's important for us in the United States to pay attention.

Ambassador Moore, I would like to go back to the earlier reference to the Mothers of Srebrenica because they have also been in our office. And as you know, the mandate of the International Tribunal on War Crimes in the former Yugoslavia is to expire next year. Can you talk about whether you think that it should be renewed, what the chances of that are, and what the prospect of continuing to go forward with the prosecutions are? You mentioned it a little bit.

Can I then also ask you or others on the panel to talk about what's being done to counter violent extremism, the efforts to recruit foreign fighters that are going on in the country?

Amb. MOORE. Senator Shaheen, thank you very much for that.

Yes, certainly in regards to all the members of the Commission from the Mothers of Srebrenica, I was so pleased that Munira and other mothers we were able to cosponsor this event just a couple of weeks ago. They were very keen to see justice done, and we want to see justice done as well.

There is a huge backlog of cases. These crimes occurred more than 20 years ago, and yet in so many instances, the vast majority, nobody has been brought to justice. The prosecutors and judges need to do their job. They need to do a better job. And we are trying to help them do that by monitoring the process of conducting these trials. We are supporting the mothers and other institutions in trying to get as much attention to these issues as possible.

You mentioned ICTY, the International Criminal Tribunal for the former Yugoslavia. It is wrapping up by the end of next year. I think that's a good, illustrative example. Everyone reacted in various ways to the conviction of Karadzic, the acquittal of Seselj. In both cases the chief prosecutor, Serge Brammertz, with whom we work very closely, is appealing those judgments, seeking a longer sentence in the Karadzic case and of course seeking a conviction in the Seselj case. No one was universally satisfied by those verdicts. "It wasn't enough or it was too much," et cetera.

The same problem does exist in Bosnia and Herzegovina. I think it's unfair to have some people on the local level there look at everything through a political compass. It's not true that each conviction and each acquittal has political overtones or antecedents, but each and every case is seen in that political context. We want to make sure that it's a question of seeing justice and not politics. We want to make sure that the prosecutors present strong cases against all of the potential defendants with all of the evidence that's before them.

In terms of the major cases that ICTY is dealing with, they have those two appeals to deal with. They also have the Mladic case. It's been their intention and they've taken these steps to forward other cases involving war crimes and genocide in Bosnia and Herzegovina to the courts in Bosnia. That process is still underway. Again, the work needs to be improved, and we're trying to help that done in the name of all of the victims and in the name of bringing justice.

Mr. WICKER. Let me ask you this: Do you think there is, among a majority of leaders in the rank-and-file Bosnians, a desire to end the corruption and to devise a better, more inclusive, pluralistic government without all of these hyphens, and yet they just can't seem to bring themselves to a place where this gets critical mass?

What I'm asking is if there is something to be said for inviting all the parties back to Dayton, or to a Dayton or to a Geneva or someplace and see if everyone could agree to hold hands and have a do-over and get this right this time? We know that 20 years ago we never dreamed that the structure we imposed would still be there in 2016. So would anyone like to—Dr. Perry, you're about to jump at that. Yes. [Laughter.]

Dr. PERRY. Yes. No, I think that while fundamental constitutional reform and structural reform is needed, a Dayton II would be the wrong way to do it because the leading political parties don't have a vision and don't have a desire for a joint life in which you've got civic parties in a pluralistic community. And there's really no interest in pressing forward with these reforms. There's a lot of—

Mr. WICKER. Among the public?

Dr. PERRY. I'm saying among the political parties.

Mr. WICKER. No, but what about among the public?

Dr. PERRY. I think there's more of a sense that this is unsustainable among the public, but the people really just don't know what to do. We saw in 2013 and then 2014 a number of civic protests that started to come out, very often related to issues related to corruption and ineffective governance, but they fizzled out for a number of reasons that have been analyzed and studied. Really, there was no political option to which they could hitch their wagon, so to speak.

And so dealing with the political elites on any of these unresolved issues at a Dayton II would, in my view, be almost worse than what we've got now because it would probably end up creating a complete partition by creating a Croat entity, a Serb entity, and a Muslim or Bosniak entity, because that's the writing we see on the wall today. And we're seeing a lot of steps happening under the guise of federalism to create more ethno-territorial borders within the country so everyone has their own fiefdom, and this is completely—

Mr. WICKER. And actually they've got quite a bit of company around in Europe, don't they?

Dr. PERRY. They do, and this is what's quite troubling again. There are many very functional federal states, but they're looking for ethnic federalism where you're only representing the people who are from your ethnic/religious group and no one else. And this will do nothing to make a cleaner, more effective, more accountable democracy.

And I was glad you used the word “pluralism” earlier because, unfortunately, we’re seeing less and less pluralism as things move forward because there’s almost an end-run end game now as political parties and politicians and some of the elites who have gained a lot of money and influence over the past two decades are seeking to consolidate everything they can before the party ends.

Mr. WICKER. But, gentlemen, we’re taking steps backwards. Everyone agrees. Is there any big idea to break the logjam in this little country and make it work? [Pause.] Thank you. [Laughter.]

Amb. MOORE. No. Again, all politics is local. There are local successes. If we can bring more attention to them, maybe we can inspire, maybe we can in some cases shame people to act differently, but there is no single fix.

And Dayton II—I have to agree, Dayton II is not an option. The circumstances that forced an end to the war after three-and-a-half years of terrible crimes are just not there, not in the region and not elsewhere in the world. The mechanisms exist. If they choose to agree, they choose to amend their constitution, they have the ability to do that. The international community doesn’t.

Mr. WICKER. So there’s not a desire to move to something different—

Amb. MOORE. No.

Mr. WICKER. —just the inability to get there.

Folks, thank you very much. Does anyone else have anything to add for the good of the order? Final comments, Mr. Melia.

Mr. MELIA. One last comment to take this back to where we started about corruption. I think in various ways everybody has said that it is this overlarge, interlocking governmental structure that has the public sector at every level so overlarge. That is a driver of corruption. There’s just too much, too many public officials handling the people’s money.

Mr. WICKER. And I think Freedom House recognized that in a recent report.

Mr. MELIA. So this is a driver of corruption and I think we need to understand that this constitutional structure is one of the contributors to this problem, among other problems.

Mr. WICKER. Final comment, Dr. Perry.

Dr. PERRY. Sure.

Again, I think that we really need to try to speak directly to the 99 percent of citizens in the country rather than only going through the filter of the political parties and trying to reach out to do some of these things. When you talk to people, when you talk to teachers and farmers and small business people, and young people who simply want to get on with it, they’re not talking about the same issues that we hear the political parties talking about.

They’re not concerned about which census forms to count or not count so you can have more or less Muslims or Catholics in a given piece of territory. They want something normal. It’s just that there are no tools right now to try to easily vote people out of office or in office, or to try to get prosecutors to start cases to prosecute and hopefully incarcerate people.

Mr. WICKER. Term limits maybe.

Dr. PERRY. Some people would like that, I bet, in many countries, I suspect. And I think that we need to work with the public in this

way to create more of a grassroots sense of reform and possibility supported by a top-down set of conditionality and pressure related to the EU and other drivers to try to squeeze the middle that has simply been completely unresponsive to the needs and desires of the vast majority of citizens.

Mr. WICKER. Final comments from Ambassador Moore and Mr. Blagovcanin. Ambassador Moore.

Amb. MOORE. Well, we're there, of course, to make sure that, like other participating states in OSCE, Bosnia and Herzegovina fulfills its OSCE commitments. And one of the ways they can do that and fight this effort against corruption is by pursuing the path to integration. They have declared their interest in joining NATO. They're on the path towards the EU.

It's a long and slow path, but they need to make some very specific reforms on that path. That should help in some areas, but there are still concrete things that we can do, especially by shining a light on the positive examples that do exist there. And when you come there again and you see that, I hope you will agree.

Mr. WICKER. Surely the EU is not going to admit a government that's structured like it is.

Amb. MOORE. I am unaware of any pre-decision by the EU in terms of exactly what the structure should be. There's a long list of requirements that they need to fill, the thousands of pages of the *acquis communautaire*, the different chapters that have to be reviewed. They will need to implement all kinds of laws, not just introduce those laws, when it comes to public financing, when it comes to political parties and their activities, when it comes to how the judiciary works. It's not a perfect fix, but there's work that they'll have to do.

Mr. WICKER. But as you say, they also have to decide they actually are, in fact, a country.

Amb. MOORE. The sense of nationhood in Bosnia and Herzegovina we haven't touched on, but of course it's a very—

Mr. WICKER. We touched on it briefly.

Amb. MOORE. Yes.

Mr. WICKER. And, Mr. Blagovcanin, you have the last word of this hearing.

Mr. BLAGOVCANIN. Very briefly, starting point for consideration of all future reforms should be that political elites in a country do not have any interest to reform anything. That's the best system in the world for them. They are accountable to no one. They control everything. They control public finance, public companies, lives of the people. So it's about articulating the people's deep mistrust in the system, how to ensure that citizens can influence what's going on in the country. Thank you very much.

Mr. WICKER. Thank you very much.

Let me speak on behalf of the entire panel here. We are absolutely thrilled at the turnout today, the interest expressed by the attendance of rank-and-file individuals from whatever organizations or backgrounds. And we are grateful to the panel for their expertise and testimony. Thank you all. And this hearing is closed.

[Whereupon, at 3:28 p.m., the hearing was adjourned.]

# APPENDICES

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PREPARED STATEMENTS

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PREPARED STATEMENT OF HON. ROGER F. WICKER, CO-CHAIRMAN, COMMISSION ON  
SECURITY AND COOPERATION IN EUROPE

The United States, as you all know, cares deeply about the sovereignty, stability, recovery, and future prosperity of Bosnia and Herzegovina. Since my first visit to Bosnia and Herzegovina in 1995, the country has made tremendous progress. However, more needs to be done by the international community and Bosnian leaders to sustain this progress.

Here in Congress, my colleague Senator Jeanne Shaheen and I are among those working to nurture private sector entrepreneurship in Bosnia and Herzegovina. On the 20th anniversary of the Dayton Accords, we introduced the “Bosnia and Herzegovina-American Enterprise Fund Act” to grow small- to medium-size businesses throughout the country.

In Bosnia and Herzegovina, however, corruption is a widespread occurrence. News reports have highlighted scandals involving senior politicians. There has been concern about where outside assistance to communities who experienced flooding in 2014 really went. Transparency International has ranked Bosnia behind all other countries in the region except Kosovo and Albania in its corruption perceptions index.

Demonstrative steps need to be taken by the state-level, entity-level and local governments to improve transparency and the rule of law. Left unchecked, corruption will hinder Bosnia and Herzegovina’s integration into Europe and NATO. Twenty years after Dayton, the conflict is no longer an excuse for corruption amongst the bureaucrats and politicians who are stifling the prosperity of future generations. With youth unemployment at 60%, young people leave the country if they get a chance. Bosnia and Herzegovina is losing its future.

I have raised my concerns with State Department and believe these concerns are shared. The United States should continue to support prosecutors and judges who focus on high-profile corruption and economic crime cases. The United States should also continue its support for investigative journalism and non-governmental organizations advocating reform.

If we support Bosnia and Herzegovina, we cannot gloss over the country’s deficiencies. The people of Bosnia have already suffered through so much. We need to support them and their aspirations for themselves and their children. We need to insist that their political leaders are responsive to the needs of the people they represent and accountable for their own actions. With this, opportunity and progress will follow.

## PREPARED STATEMENT OF HON. CHRISTOPHER H. SMITH, CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Today's hearing focuses on a country of traditional concern to the Helsinki Commission—Bosnia and Herzegovina—but also on a concern that pervades the Western Balkans and many other states of the OSCE—corruption.

Twenty years ago, Bosnia was in the first and most difficult phases of its recovery and reconciliation following the brutal conflict that began in 1992 and ended in 1995 with outside intervention under U.S. leadership culminating in the Dayton Peace Accords. The country was devastated, and its people traumatized by conflict marked by the ethnic cleansing of villages, the shelling of cities and numerous other crimes, including the genocide at Srebrenica.

Today, many of the physical scars of that period are gone, but the country still struggles under a complicated political framework reflecting the war-ending compromises adopted at Dayton. Beyond the well-known ethnic divisions, Bosnia's progress in the past decade has been stymied by official corruption to the detriment of its citizens' quality of life and the prospects for the country's integration into Europe. While corruption is, indeed, not unique to Bosnia, perhaps it is worse there than elsewhere in part because of the lack of post-Dayton reforms. Rather than fix what's wrong with the country, which could threaten those currently holding political power, officials at all levels simply focus on helping themselves to the privileges and opportunities that come with that power.

People who have been through so much already deserve something better than this.

This hearing will examine the current situation regarding corruption and its causes in Bosnia and Herzegovina, and look at efforts by the United States and the international community, along with civil society, to combat it.

As they proceed, I hope our distinguished and expert witnesses could address two issues that may be related to corruption and are of particular concern to me.

First, several weeks ago I met with Munira Subasic from the Association of "Mothers' Action of the Srebrenica and Zepa Enclaves." Munira had herself lost over 20 members of her family at Srebrenica in July 1995. Her frustration today regards the seeming impunity of hundreds of people—an estimated 850—implicated in violations of international humanitarian law during the war, who had their cases transferred from the international tribunal to the Bosnian courts. To this day, these cases have not been processed, which is an outrage.

I would like to know to what extent corruption in law enforcement and the judicial system protects possible war criminals from facing justice. I also would like to hear whether these same people implicated in horrible crimes during the war might today be part of the corruption problem. I assume that someone willing to engage in ethnic cleansing would not hesitate from also taking a bribe, or committing fraud.

Second, trafficking in persons remains an ongoing problem across the globe, including the Balkans and Bosnia and Herzegovina. In the immediate post-war period, the heavy international presence in Bosnia generated a tremendous, unforgivable but, unfortunately, largely unpunished demand for trafficked women as part of the sex trade, and the suppliers were as blatant as they were aggressive in their criminal enterprise. Measures were eventually taken in response, and Bosnia's record improved markedly until recent years when the trend has been generally downward.

Trafficking is a crime that takes organization, but it can be most successful in countries vulnerable to corruption. I would therefore like to know the extent to which our witnesses feel Bosnia's record in regard to trafficking in persons is linked to its record in regard to corruption.

With this introductory comments and concerns, I would now like to turn to the Commission's Co-Chairman, Senator Roger Wicker of Mississippi, who has been vocal in regard to the need for Bosnia to address corruption issues and will chair the remainder of this hearing.

## PREPARED STATEMENT OF BENJAMIN L. CARDIN, RANKING MEMBER, COMMISSION ON SECURITY AND COOPERATION IN EUROPE

The Helsinki Commission, which celebrates its 40th anniversary next week, has a long history of support for Bosnia and Herzegovina—before, during and after the 1992–1995 conflict there—which continues to this day.

Much of my contribution to this effort has focused on the need to provide justice for war crimes, crimes against humanity and genocide. In that regard, the sentencing earlier this year of Radovan Karadzic by the International Criminal Tribunal brought particular satisfaction to those of us who pressed for years to have him apprehended and transferred to The Hague.

Unfortunately for far too many people in Bosnia and Herzegovina, any satisfaction they may feel is overshadowed by frustration over the situation in their country today, and the struggle simply to make ends meet. The collective privileges of the major ethnic groups take priority over the individual human rights of those belonging to those groups, let alone those who do not.

Inside what Freedom House has called these “ethnic fiefdoms,” we see patronage and corruption that benefits and protects the political elite. We do not see transparency. We do not see accountability. As a result, we do not see much progress in Bosnia today. We have tried repeatedly—during hearings, or during congressional visits to Sarajevo like the one I led in 2009—to encourage reform. It is frustrating to see how little has been accomplished given what we know is the country’s potential.

We rightly criticize Bosnia’s political leadership for this situation. However, the international community—mostly the European Union but also the United States—has a large role to play in Bosnia and, as a result, some responsibility for encouraging their behavior. In particular, there has been an emphasis in our policies and assistance on maintaining existing stability at the expense of promoting positive change. Intransigence is accommodated, while conditions—such as resolving the Sejdic-Finci ruling to give Roma, Jews and others equal access to public office—are cast to the side. We helped create government institutions but negotiate with party bosses and often ignore civil society initiatives. We have encouraged constitutional and other types of reform but have focused too much on getting quick, incremental results when the people deserve something more.

While corruption is a profound problem throughout the Western Balkans, this situation exacerbates it, and I hope this hearing and other efforts will encourage the international community to take a tougher line in combatting corruption.

Within the OSCE, I have been active over the years in encouraging multilateral efforts to combat corruption, such as removing immunity from corrupt parliamentarians. I also welcomed the adoption in 2012 of the Dublin Declaration on Strengthening Good Governance, giving renewed emphasis to work in this area. One recent suggestion made in the spirit of this Declaration has been to follow the Financial Action Task Force recommendations for reviewing the financial activities of “politically exposed persons.” Public figures never like to have their financial activities scrutinized, but the public interest in thwarting abuses such as money laundering, bribery and fraud is clear. It will build trust within Bosnia and between Bosnia and its trading partners.

Finally I want to also mention that much of my current work regarding the OSCE has been focused on countering various forms of intolerance in our societies. We know that, throughout Europe, enforced segregation of communities, discrimination based on creed or color and a more general denial of opportunities for advancement, puts democracy at risk, and provides fertile ground for violent extremism, including that which can lead to terrorism. Some of these conditions exist to varying degrees in Bosnia and Herzegovina, a country made more vulnerable by its sense of victimization in the 1990s. The corruption that exists could encourage their development and make it more difficult to thwart terrorist or other violent threats. I hope our witnesses can address this issue in their remarks.

PREPARED STATEMENT OF AMBASSADOR JONATHAN M. MOORE, HEAD OF THE OSCE  
MISSION TO BOSNIA AND HERZEGOVINA

I am deeply grateful to Helsinki Commission Co-Chairs Smith and Wicker and Commission members and staff for the opportunity to address key topics of relevance to Bosnia and Herzegovina and the wider community of OSCE participating States. I would like to especially thank the Commission's Policy Advisor Bob Hand, who stands as a shining example of expertise and commitment due to his abiding interest and decades of engagement in the Balkans. On behalf of my distinguished team, I would like to express our appreciation for your attention and support.

Bosnia and Herzegovina faces many challenges. The OSCE Mission to Bosnia and Herzegovina, with an extensive network of 10 offices throughout the country and 320 dedicated professional staff, works every day with people in local communities as well as the most senior political leaders—and everywhere in between—to help keep the peace, protect fundamental rights, ensure the rule of law, and build prosperity.

The framework for OSCE activities is grounded in the Dayton Peace Accords, negotiated at Wright-Patterson Air Force Base in November 1995 and signed in Paris, France one month later. "Dayton" is far from perfect, but it succeeded where other efforts failed. The peace accords and the constitution enshrined in them—which can only be changed through democratic means—continue to serve as a key foundation for Bosnia and Herzegovina and its citizens. Dayton brought OSCE to Bosnia and Herzegovina, giving us a special role in conducting and observing the elections. The role of the OSCE Mission has evolved: the Central Election Commission took on the responsibility of running elections in 2002. While taking on other tasks with the goal of helping the country achieve its OSCE commitments and integration aspirations, our Mission has maintained an diverse and active field presence and is engaged in a variety of fields, seeking and keeping very close ties with institutions, organizations, and individuals at all levels of society.

The Mission's work encompasses OSCE's three dimensions—politico-military, economic and environmental, and the human dimension—with the assistance and guidance of the Chairman-in-Office, the Secretariat, and other institutions, including the Parliamentary Assembly and this Commission. Our international partners include the Office of the High Representative, the United Nations, the European Union, the International Criminal Tribunal for the Former Yugoslavia, the Council of Europe, and bilateral embassies. The Mission's role in Bosnia and Herzegovina is expertly facilitated by strong media and policy planning teams, who advance and promote our extensive programmatic work in the areas of education, human rights, security cooperation, democratic governance, and the rule of law.

Given the special opportunity to address to Commission today, while I will speak with particular focus on the main topic of corruption, I would also like to raise education, where our Mission has the lead role for the international community; the rule of law, where we have a comprehensive role in monitoring the work of the courts and prosecutors; and combating violent extremism, where the Mission has achieved some concrete successes, particularly at the local level.

#### *Education*

Education has been identified by many as one of the country's highest priorities. The children of Bosnia and Herzegovina will only prosper if they have quality education: they need the skills, knowledge, and judgment to succeed in a modern and increasingly diverse world. Quality education requires well-trained teachers, professional administrators, effective curricula, up-to-date materials, safe conditions, and an inclusive environment. The protection of various distinctions, including languages of instruction, is an accepted international principle, one sought by most parents in Bosnia and Herzegovina.

At the same time, segregated education is an obstacle that must be removed. In many schools, children of different ethnicities have no opportunities to interact with each other. That interaction is a vital element of the learning process. In the aftermath of the war, it is a reality that for many people in Bosnia and Herzegovina their identities are defined by their language and religion: denying that fact is not a path to a solution, and those rights must be respected. Administrative unification of schools—such as in Zepce, a community where we have very close cooperation—has been proven to be a positive step. By bringing children together, they gain insight into how to be better citizens of BiH and the world. In addition, by saving money wasted on duplicative staff and programs, more resources are available to repair school buildings and purchase the equipment and technology needed to provide quality education.

The OSCE Mission to BiH works with schools, parents, teachers, administrators, and political leaders to advance these goals. The fact that numerous jurisdictions have distinct and separate responsibilities for education makes work in this sector difficult; there is no single authority. It must also be said that in some communities the problems seem all but impossible to solve. Nevertheless, there are others where we have found and encouraged examples of success; where diversity, tolerance, respect, and vision have led to improved social and educational conditions. Religious communities have also played a very positive part in these efforts.

We are proud to have engaged the most senior political leaders in joint events and statements to define the importance of the issue: at the same time, the best proof of success is seen in visits to those schools—even in the smallest communities—where children are getting the instruction their parents want, and where unnecessary and artificial barriers between ethnic and religious groups are fading away.

#### *Rule of Law*

Victims and witnesses are critically important for the successful processing of war crimes. The OSCE Mission to BiH is playing an established role in this field, with a team of legal experts that focus on the processing of war crimes cases. In that work, we have the full support of the country's High Judicial and Prosecutorial Council, close collaboration with ICTY, and comprehensive relations with judges and prosecutors at all levels. This effort, supplemented by important funding from the European Union, helps bring war criminals to justice so many years after the end of the war.

While our international partners are essential, it is a source of pride for the Mission to have the endorsement of victims' families for what we are doing in this area. Just a few days ago, our Mission supported an international conference hosted by the Mothers of the Srebrenica and Zepa Enclaves and the Association of Victims and Witnesses of Genocide.

Our relationships with judges and prosecutors and our proven professional capacities equip us for engagement in other areas as well. We are the only international actor assisting judges and prosecutors in processing hate crimes. Separately, we are a partner in efforts to combat trafficking in persons, and are preparing a rule book for the processing of trafficking cases.

#### *Combating Violent Extremism*

The problem of Foreign Terrorist Fighters (FTF) attracts much of the international community's attention. Reliable estimates of the numbers of FTF in Syria and Iraq vary: Minister of Security Mektic has stated that there are approximately 130 citizens of Bosnia and Herzegovina currently in Syria and Iraq, while 43 citizens have been killed in the conflict and around 50 have returned. However, far higher numbers have travelled from other OSCE participating States, and the impact of violent extremism within Bosnia and Herzegovina is a deeper concern.

At home, Bosnia and Herzegovina has seen four terrorist attacks over the past six years, resulting in the deaths of two soldiers, two policemen, and the wounding of a third policeman in the October 2011 attack on the U.S. Embassy. The country's authorities are working to do what they can, but Bosnia and Herzegovina is vulnerable. Given the deep scars left by the war, terrorist attacks could greatly damage the stability of the country if they lead to acts of revenge and a growing cycle of conflict.

Combating violent extremism requires extensive coordination as well as the collecting of key data. The OSCE Mission to Bosnia and Herzegovina, given its mandate and capacities, is not in a position to gather or analyze sensitive information. However, we are taking advantage of our grass roots-level involvement throughout the country to make a difference: as in other areas, we see clear evidence of the essential role played by local communities. Having helped establish a series of 19 Coalitions against Hate across Bosnia and Herzegovina, we found in them natural allies to build tolerance and combat violent extremism. These are locally-constituted groups of individuals and NGOs dedicated to working with each other as neighbors to emphasize positive and common rights and build broader respect and understanding throughout their communities. After the April 2015 terrorist attack in Zvornik, the local coalition there played a central role together with the mayor and the Islamic community in calling for calm and tolerance and opposing acts of revenge.

Building on a project funded by the U.S. Government, we have now integrated the fight against violent extremism as a permanent element of our security cooperation effort, one joined by colleagues from all policy and programmatic areas.

### *Corruption*

As the Helsinki Commission has noted, corruption presents a comprehensive challenge to Bosnia and Herzegovina, where it can be found in numerous forms and at different levels. It threatens the functionality of public and private-sector institutions, wastes public resources, deters foreign investment, and damages citizens' trust in government and the political system. Despite Bosnia and Herzegovina's political figures and agencies increasingly voicing their concerns over the perennial dangers presented by corruption, there has been limited activity or political will to combat the issue directly. There are some innovative and important efforts underway to prosecute cases of corruption and to provide greater transparency, and we are using our voice and our resources to support them. In Sarajevo Canton, the government has set a high standard by revealing the salaries of many public officials, and the cantonal prosecutor is making headway on a comprehensive case of corruption where the management of a public enterprise blocked foreign investment. However, there are not enough examples of that, and clearly existing laws and institutions are not enough: more work must be done.

The OSCE Mission to BiH has considerable potential added value for work in this sector, including: our expertise in rule of law and judicial affairs, as noted above; our heightened visibility and political leverage; our close support for governments at multiple levels; our regular engagement with various public sector institutions; our expertise with gender issues; and our extensive field office network and consequent local knowledge and working relationships. As in other areas, this last point is particularly relevant to our strengths in complementing the work done by others in the international community.

Our Mission has met with numerous stakeholders, all of which responded positively to the prospect of greater Mission involvement in anti-corruption work, especially at the local level and in the area of trial monitoring. We have heard from various partners and potential donors that significant extra-budgetary funding might be available for anti-corruption projects initiated or run by the Mission. In addition to emphasizing the need for anti-corruption work with our existing partners such as educators, the media, local and higher-level representative bodies, and security institutions, there are two particular areas where we are well placed to do more:

1) Corruption case monitoring: Despite the high number of allegations and investigations concerning corruption in BiH, there are relatively few indictments and still fewer convictions. A low prosecution rate in suspected corruption cases undermines public faith in state agencies, as officials widely believed to be guilty of corrupt practices are seen to act with impunity. We are prepared to use our existing expertise and practices in trial monitoring to develop a framework for expanding and more comprehensively following and scrutinizing the prosecutorial processes and capacities of BiH authorities. A potential U.S. Government-funded project (\$500,000) includes a needs assessment for capacity-building activities based on trial monitoring findings which will be a crucial first step.

2) Good economic governance and transparency/anti-corruption "Beacon Scheme": As noted above, most international partners are focusing anti-corruption activities at the entity and state levels, but the Mission has a unique capacity for more localized engagement. The Beacon Scheme in Bosnia and Herzegovina was launched in August 2005 by the OSCE and the Council of Europe as a means to identify, recognize, and promote innovation and excellence at the municipal level of government. Based on the UK Beacon Scheme, each year a number of themes are selected, and municipalities are invited to provide evidence of how they have achieved excellence in these areas. Successful municipalities receive a small grant to enable them to share their best practices with other municipalities, thereby improving the overall standard of local governance in Bosnia and Herzegovina. It is a proven methodology that encourages best practices and positive re-enforcement between municipalities. Existing templates and established practices mean that the Scheme could be rapidly implemented. Moreover, it demonstrates positive action to the public at the local level, where citizens most frequently interact with state authorities. Municipal and city authorities could be encouraged to innovate and adopt new practices for improving (financial) transparency and/or tackling corruption at the local level and promoting a positive business environment. Taking advantage of our field office network, the Mission could also utilize our Governance and Press and Public Information teams to further replicate and publicize best practices countrywide. These activities could go hand in hand with other possible initiatives in the area of good governance, e.g. reducing barriers to local economic development, increasing accountability mechanisms and promoting concepts and standards of good governance at the local level.

*Conclusion*

Thank you again for the important opportunity to discuss these issues. I can tell you that from my many contacts with the people of Bosnia and Herzegovina that they want better lives for themselves and their children. They are tired of rhetoric and platitudes: they want results. Your attention and support will help us to continue to achieve positive results. Please take the opportunity to visit us so we can show you what we are doing and introduce you to the people whose success is our goal. I look forward to your questions, and to hearing the views of my fellow panelists.

PREPARED STATEMENT OF THOMAS O. MELIA, ASSISTANT ADMINISTRATOR, BUREAU FOR EUROPE AND EURASIA, UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

Thank you, Mr. Chairman, Mr. Co-Chairman, and members of the Commission, for the opportunity to testify today on corruption in Bosnia and Herzegovina (BiH), and on the efforts of the United States Agency for International Development (USAID) to address this challenge. I would like to begin by describing the consequences of corruption, and then placing corruption in Bosnia in a broader regional context. Finally I will describe how USAID is working to help BiH, its citizens, government and NGOs, to fight corruption and to mitigate its harmful impact on society.

It is fitting that the Commission for Security and Cooperation in Europe is addressing this topic, because corruption is an issue of national and regional security. As Secretary of State Kerry said in his remarks at the recent global summit on corruption in London, “criminal activity literally is a destroyer of nation states.” Corruption poses a direct security threat to states by enabling the smuggling of arms, persons, and drugs.

Furthermore, corruption is a significant obstacle to development, the focus of my Agency. USAID’s mission is to partner to end extreme poverty and promote resilient, democratic societies while advancing our prosperity and security. But corruption leads to a weakening of democratic institutions, economic decay by discouraging investment, increased inequality, and deprives states of the resources they need to advance their own development.

In the Europe and Eurasia region, states weakened by corruption are more susceptible to malign pressure and manipulation from the Russian Federation and other countries, as any semblance of a rules-based order often seems to take a back seat to power, influence, and greed including oligarchs, whose geopolitical goals do not respect international commitments to transparency, rule of law, and fair play. Finally, endemic corruption threatens states by depriving them of the most important resource of any democratic government—the trust and confidence of its citizens. Where public trust is absent, there can be little expectation of the cooperation of citizens with government to build resilient democracies, let alone do what is needed to counter emerging threats like violent extremism.

For these reasons the Administration sees addressing the problem of corruption, and the need for open, effective, representative governance as a significant priority. U.S. foreign assistance plays an important role in formulating country-specific anti-corruption strategies, and USAID democracy, rule of law, and governance programming is in the forefront in many of these efforts. In the transitioning countries of Europe and Eurasia, USAID cannot succeed in our mission as an agency if corruption is permitted to go unchecked and unpunished. Understanding that, the Agency works with governments, civil society, independent media, political actors, and citizens to build the capacity to limit the likelihood of corruption, and to uncover, investigate and punish corruption when it occurs.

To understand the problem of corruption in BiH, it must be seen in its regional context. It is a sad fact that corruption is a major problem throughout the Balkan region, and BiH is no exception. According to the most recent Transparency International Perceptions of Corruption Index (2015), BiH had a score of 38 (on a 100 point scale, with lower scores indicating higher perception of corruption), placing it 76th out of 168 countries surveyed, behind all of its Balkan neighbors except Albania (88th) and Kosovo (103rd). More troubling, perhaps, is that according to this index BiH is losing ground in its fight against corruption, with its score falling one point in the past year, and four points from 2012. According to the World Bank’s World Governance Indicators (2015), control of corruption in BiH has changed little, if at all, from its worst days immediately after the conclusion of the war. This is consistent with findings from Freedom House’s “Nations in Transit” data on anti-corruption measures for BiH, and on democratic reforms more broadly, which show that modest gains that were made in all measures peaked around 2006 with stagnation or backsliding in the years that have followed.

Finally, USAID’s National Survey of Citizens’ Perceptions 2015 reports that over one in five persons surveyed reported paying a bribe to a public official, most often to doctors, nurses and police officers. Sixty-three per cent of citizens nationwide believe that the judiciary is not effective in combating corruption, and 62 per cent believe that public officials who violate the law are neither identified nor punished.

All of this indicates that corruption in BiH is bad by Balkan standards, and possibly getting worse. When one takes into account BiH’s multiple levels of government, and the fact that, by some estimates, the public sector makes up fifty per cent

of BiH's GDP, the depth of the problem and its impact on citizens' lives becomes all the more clear.

To combat corruption and limit its impacts on the state and society, the United States is supporting both democratic, inclusive governance (including by strengthening the justice sectors and civil society) and economic growth (including through private sector development, fiscal reforms, and reform of the energy sector).

Growing the size and strength of the private sector in BiH is of critical importance both for the prospect of economic development and as a concrete means to limit the impact of corruption by limiting the influence of public officials in rent-seeking behavior. USAID is working to do this in several ways. For example, USAID has new Development Credit Authority agreements in place with three commercial banks valued at \$30 million dollars, as well as three older agreements valued at \$46 million dollars. To date, loans have been disbursed to 120 private firms, supporting close to 2,800 private sector jobs and generating over 500 new jobs in the private sector.

In addition, recognizing that governance and economic development at the local level are crucial to success, USAID is implementing Business Friendly Certification (BFC). By reforming municipalities and increasing transparency, BFC will improve the business enabling environment, ultimately contributing to additional private sector growth.

USAID is always considering new opportunities as well. This month, a team of economic growth experts from USAID is in Bosnia assessing what other options may be available to engage to support the country's economic growth and prosperity. Several members of this Commission have sponsored legislation authorizing an enterprise fund for Bosnia, and this team is looking at whether or not this would be the right approach to grow the private sector.

The Agency is also working to make public finance more transparent and accountable. With a local partner, Finit Consulting, USAID works to eliminate non-transparent nuisance taxes for businesses, reducing opportunities for irregularities and corruption. The project will also improve transparency in government finance through the provision of IT solutions for budget management and the Treasury by introducing and expanding e-services for payment of direct taxes. This support will also be used to help entity tax administrations to conduct risk-based audits.

Due to the risk posed by large transactions, the energy sector is an area of specific concern in the fight against corruption. Through an activity implemented by Advanced Engineering Associates International, USAID is working to transpose EU Energy Directive requirements into local legislation to govern the operation of the energy sector in BiH. Transparency in areas including the permitting of energy infrastructure projects will help to limit opportunities for corruption in this sector.

Corruption also occurs when local producers skirt regulatory standards (say, with watered-down milk) to keep costs down, putting consumers at risk. A USAID project, implemented by Cardno Emerging Markets, helps mitigate corruption by supporting agricultural exporters to adopt stringent EU regulatory import standards, particularly food safety and veterinary and phytosanitary procedures. Recently, this program facilitated EU approval for eight dairies to export milk to the EU. As more producers meet EU standards there will be less room for corrupt practitioners to compete.

While our economic growth efforts look to limit opportunities for corruption, other efforts are building the capacity to help citizens and civil society to uncover corruption when it occurs, and helping state bodies effectively investigate and punish culprits.

For example, partnering with a local Bosnian organization, the Center for Media Development and Analysis, USAID is helping to build a coalition of 60 local NGOs to advocate for implementation of anti-corruption reforms necessary for EU integration. USAID supported civil society and legislative stakeholders as they initiated adoption of whistleblowers' protections in 2013. Last year, with our assistance, a group of local NGOs started an advocacy campaign to increase transparency, competitiveness and accountability within the public procurement system and align it better with EU standards. This advocacy is critical since three quarters of BiH's annual \$1.7 billion dollars-worth of procurements is done non-competitively and hundreds of these procurements are awarded to companies owned or co-owned by elected officials. A few weeks ago Transparency International, also supported by USAID, presented legislative proposals to clarify and de-politicize the issue of conflict of interest in BiH. Similar actions are planned in the areas of public employment, health and education, which have proven to be sectors highly susceptible to corruption. The program also promotes civic monitoring, supports the production of independent, investigative video documentaries to expose corrupt individuals and provide evidence for prosecutions. Finally, as part of this project's efforts to raise awareness and un-

derstanding of corruption affecting citizens, USAID, together with our NGO partners, staged a traveling exhibit on the lack of procurement transparency in BiH's public sector, featuring a dozen items procured by entity governments at grossly inflated prices. The exhibit opened in Sarajevo, and was staged in ten major cities. A Facebook post on the exhibit generated more "likes" than any post in the page's history, and was viewed by over 170,000 people.

The justice sector is another critical front in the fight against corruption. Partnering with Millennium DPI Partners, USAID helps prosecutors, judges, other justice sector officials and institutions be more responsive and accountable in the administration of justice, to better serve the needs of citizens. This effort, along with other U.S. government efforts including that of the Department of Justice, counters corruption by encouraging more efficient prosecution of cases of corruption and organized crime, and by strengthening justice sector institutions' ability to uphold public integrity and mechanisms of self-accountability. Through this project, USAID has partnered with all 19 prosecutor's offices to help them to prosecute cases of corruption and organized crime more effectively and efficiently by improving the performance and authority of prosecutors, recognized as the weakest link among officials. USAID is also working with the Department of Justice's Office of Overseas Prosecutorial Development, Assistance and Training (OPDAT) on advising anti-corruption prosecutors, improving police-prosecutor cooperation, and providing case-based mentoring to Bosnian counterparts in anti-corruption cases. We are also working, through mentoring, training and technical assistance to BiH's High Judicial and Prosecutorial Council (HJPC), to institute new management systems for appointment of new judges and prosecutors—the most common "entry point" for politics into the work of the justice sector—and to conduct performance appraisals, give merit-based promotions and to provide incentives and rewards for the successful prosecution of cases.

Regional collaboration is also key to fighting corruption. USAID is working with other countries in the region to ensure that regional best practices are shared with Bosnian counterparts. We will also support the institution of a new special anti-corruption unit in the BiH Federal Prosecutor's Office, mandated by a 2014 anti-corruption law. USAID is also helping to increase cooperation and coordination among hundreds of state, entity, and cantonal law enforcement and justice sector institutions to prevent leaks of sensitive information that undermine the investigation and successful prosecution of corrupt cases. To strengthen disciplinary procedures for judges and prosecutors, USAID helps the state-level Office of the Disciplinary Counsel to better manage complaint procedures and autonomously review the conduct of judges and prosecutors and to recommend appropriate sanctions for unethical conduct and corruption of judicial officials.

Finally, since "justice delayed is justice denied," this project initiated improvements in the efficiency of enforcement of judicial decisions through a data-driven process that has led to recommendations, including a Judicial Effectiveness Index to identify bottlenecks and inefficiencies, which were embraced by the HJPC.

While corruption and organized crime often depend on the inability of law enforcement actors to track illicit activity across borders, journalists are not bound by such limitations. Sunshine, as they say, is the best disinfectant. The first step in countering corruption is to expose it. Through the Regional Investigative Journalism Network (RIJN), journalists receive more intensive training and practical experience in producing documented, high-quality investigative journalism based on best international standards and practices. The program is designed to link these journalists across borders, improve their investigative skills through on-the-job training, and use innovative digital technologies to collaboratively produce cross-border investigative reports. It also works to build citizen demand to reduce corruption, fraud, and other criminal activities through increased exposure to professionally produced investigative journalism. RIJN has proven its ability to serve as a platform for getting results in exposing corruption, from its revelation that a prime minister in Bosnia and Herzegovina received a free apartment, leading to his indictment and eventual resignation, to its current reporting on regional corrupt leaders' links to offshore accounts in the Panama Papers. RIJN has carefully tracked the impressive dividends from its reporting across the region: the recovery of at least \$600 million in hidden assets by tax authorities; the closure of more than 1,300 companies; investigations, indictments, and arrests by law of 80 people—including an ex-president; and the resignation or sacking of ten government officials.

In conclusion, though the threats posed by corruption in BiH—to its economy, its public services and to the state itself—are great, USAID is working with our partners to limit opportunities for corruption, uncover them when they occur, and see that they are investigated and punished. We are doing this together with our European partners, in some cases leveraging U.S. Government funds with donations

from allies. USAID is also doing this with other U.S. Government agencies, such as the Department of Justice, which is providing expert advice and assistance to investigators, prosecutors, and judges in BiH. The existence in BiH of the EU reform agenda, the broader EU Association process, and initiatives such as the Open Government Partnership offer BiH and its partners an opportunity to intensify efforts to fight corruption.

This needs to be an ambitious, substantive, and multifaceted agenda for changes in law and in practice—changes that will impact the daily lives of Bosnia's citizens. This effort will require significant political will from BiH's leaders, NGOs and citizens. Progress will not be easy, and constraints related to the structure of the constitutional system in Bosnia may limit possibilities for dramatic progress. But despite these challenges, our decades-long commitment to peace in BiH demands our best effort.

Thank you for the opportunity to testify. I look forward to your questions.

PREPARED STATEMENT OF SRDJAN BLAGOVCANIN, CHAIRMAN OF THE BOARD OF  
DIRECTORS OF TRANSPARENCY INTERNATIONAL, BOSNIA AND HERZEGOVINA

Thank you very much, Mr. Chairman, Thank you very much for this opportunity for me to speak on what I consider a very important topic.

There are a lot arguments to rightfully claim that corruption is the biggest problem today in Bosnia and Herzegovina.

Direct damage to the country reaches hundreds of millions of dollars disappearing from the budget due to corruption in public procurement and privatization. Indirect damage, due to a lack of investment caused by corruption, is difficult even to estimate.

The crux of the problem is political corruption, which involves the highest political and public officeholders. There are numerous well-documented corruption cases involving political leaders and top party officials.

Twenty years after the war Bosnia and Herzegovina remains a country completely captured by corruption, where it is virtually impossible to get any public service without having to resort to corruption. Most relevant studies clearly indicate that in recent years Bosnia and Herzegovina has not seen any progress in strengthening the rule of law and the fight against corruption and, as such, is among the worst-ranking countries in the region.

Corrupt political leaders hold sway over key institutions in the country. This allows them to use all the economic resources of the country in their own private interest.

How pervasive corruption actually is can be seen on an everyday basis. Due to corruption in public procurement, taxpayers' money—that is the money of the citizens of BiH—is used to procure goods, services and public works at prices that are severalfold greater than their actual cost.

The example of the two recently collapsed banks also reveals the ruthless extents of corruption, with total damage exceeding half a billion dollars. The two cases involve the highest public officeholders, and the indictments against them have not been brought yet.

Political control over the judiciary and law enforcement agencies allows corrupt leaders to be protected from prosecution. There are almost no cases of corruption that result in judgments of conviction. Political corruption is ignored by public prosecutors because of political influence.

The crux of the corruption problem lies in how political parties are organised. Devoid of basic intra-party democracy, they operate in a mafia-like manner. Their basic principle of operation is based on the distribution of the spoils. Their booty are budgetary funds, public companies and institutions. Political elites use clientelistic appointments as the main method of exercising control over institutions. In this way, political leaders create neopatrimonial-clientelistic networks which they use to run the country.

The real and almost unlimited power lies in the hands of a few ethno-political leaders, while institutions remain devoid of any content and are mere shells without any power.

The political leaders and the ruling political parties are therefore not interested in reform and European integration. They have learned their lesson from Croatia and Romania, two countries that had to tackle political corruption and prosecute their political leaders as part of their process of joining the EU. Therefore, the interest of political elites in the country is solely and exclusively to maintain the status quo. Any progress in reform implementation directly affects and limits their unbridled power and exposes them to criminal prosecution. Therefore, their strategy is to rhetorically accept reforms and advocate for the country's progress towards the EU, while in practice they only feign reform.

Pervasive corruption affects human rights and freedoms. Corrupt politicians turn a blind eye and a deaf ear to the criticism coming from civil society organizations and the media. Hence, cases of repression against the media and civil society remain widespread.

Corruption within institutions prevents citizens from accessing justice. A backlog of over 2 million cases, in a country of 3.5 million people, means that the judicial system is completely blocked in practice. Adjudication of disputes takes years to complete. Court rulings, even those made by the Constitutional Court, are not complied with unless they are in the interest of the privileged few.

The consequences of corruption are felt by citizens on a daily basis. Corruption exposes them to additional costs to pay for health, education and administrative services. Administrative corruption is part of everyday life for citizens.

Another consequence of corruption is the growing inequality, where the privileged few have access to all public resources, while the vast majority of citizens are deprived of access to public services.

Also, corruption undermines economic development of the country, trapping the majority of its people in poverty and depriving them of employment opportunities. For years Bosnia and Herzegovina has been among the worst-faring countries in Southeast Europe when it comes to attracting foreign investment.

The way the market is organized has a pernicious effect on the private sector. Privileged access to public tenders and privatization processes is reserved for cronies, operating on the principle that losses are “socialized” while profits are privatized.

Therefore, I want to reiterate what I said at the beginning of my talk. Corruption is the biggest problem in Bosnia and Herzegovina today. Without progress in fighting corruption it is not possible to make progress in the implementation of any other reform. It is impossible to reform the judiciary if it is corrupted. It is impossible to reform education if it is corrupted. Or public administration, or any other field for that matter.

How to make a breakthrough?

As Fukuyama rightly pointed out, all reforms are inherently political;<sup>1</sup> therefore it is about generating political will for reforms and not only strengthening capacities of the institutions. Leveraging and articulating the public’s deep mistrust in the government through citizens’ active involvement in decision making should be prioritized in order to avoid another wave of destructive protests like those of 2014. Past experience shows that simply calling on leaders to undertake reforms and to take responsibility is insufficient. Generating a genuine and articulated “internal demand” for reforms is key to achieving sustainable progress toward integrating the country into the EU.

A viable solution to the problem of political corruption must be found at the level of the political system. Which in this case means the democratization of the political system and, above all, the key actors of the political system, namely political parties. Reforming the way political parties operate and introducing intra-party democracy would create conditions for dismantling the clientelistic networks run by political leaders that have captured the country’s institutions.

Furthermore, it would allow a wider range of people to influence the political processes and this would, in turn, lead to better articulation of the demand for change and reforms.

Another important aspect of the reform concerns the strengthening and reforming of the judiciary. The judiciary must finally assume responsibility for prosecuting corruption. For this to happen, it is imperative to ensure that it is independent in its work and free from any political interference. To counter political interference, it is crucial to ensure transparency in the appointment of judges and prosecutors.

The judiciary has to gain public trust. This implies that the work of the judiciary is based on the principles of transparency and accountability.

In any case, Bosnia and Herzegovina still needs strong international support in undertaking reform to strengthen the rule of law and fight against corruption. This also requires that the current EU reform agenda be expanded to include a detailed and specific plan for combating corruption and strengthening the rule of law.

Thank you very much again for the opportunity to serve as a witness at this hearing today.

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<sup>1</sup> Fukuyama (2014).

PREPARED STATEMENT OF DR. VALERY PERRY, SARAJEVO-BASED INDEPENDENT RESEARCHER AND CONSULTANT AND SENIOR ASSOCIATE AT THE DEMOCRATIZATION POLICY COUNCIL

### *Introduction*

I would like to thank Representative Smith, Senator Wicker, and the Helsinki Commission for organizing this hearing.

We've heard a number of vivid descriptions of the problem of corruption—and the politics of corruption—in Bosnia and Herzegovina today.

The politics of corruption makes meritocracy impossible, weakening institutions and promoting brain drain of the country's best and brightest.

The politics of corruption results in a system in which floods can devastate one third of the country and no leaders or officials are held accountable for their failure to prevent, prepare, or respond to such a disaster.

The politics of corruption weaken the notion of civil society, shared purpose and joint vision, instead strengthening informal practices, patronage networks and exclusionary practices that are particularly damaging to a society barely a generation removed from the most violent conflict in Europe since World War II.

No political system anywhere is immune from corruption. Systems, structures and incentives either encourage or impede corruption. Societies ideally organize themselves in a way that minimizes potential for corruption and maximizes the public good. This can be hit or miss; no governmental design is ever perfect.

Bosnia's political economy was shaped by the war and the Dayton Peace Agreement that ended it in 1995. Dayton was, and remains, a "Made in America" product. For this reason it is important that we are having this discussion today.

### *What Should Be Done*

The problem of corruption in Bosnia is not a technical problem; it is a political problem. In the absence of fixing the core political problems that both prevent accountability and allow impunity, all of the projects, capacity building, technical support and money in the world will not overcome the fundamental weaknesses and democratic contradictions at the core of Bosnia's unaccountable political system.

In fact, after two decades and literally thousands of well-intended projects, it is time to consider not only the diminishing returns of such approaches, but the broader negative impact of such efforts actually maintaining the illusion that a system that has failed for 20 years can in fact somehow be made to work. Continuing to prop up a system proven to be ineffective is akin to hoping that updating the software on your 15-year old computer will help its performance. At some point you have to recognize that the problem isn't the software, but the hardware, and that no patches or workaround will improve its performance.

So what should be done? I will focus on three specific recommendations today.

First, a package of legislative reforms aimed at reducing the possibilities for official corruption, abuse of office and collusion should be developed and supported. This would include laws related to conflict of interest, political party financing, and freedom of information, among others. Laws, by-laws and statutes regulating public enterprises also need to be urgently overhauled in line with available guidelines and good practice. Many existing USAID and other U.S.-funded programs—ranging from support for investigative journalism to critical justice sector reform—could be better coordinated and recalibrated to support a holistic approach.

There will be political and in turn institutional resistance to such reform, and every effort will be made to evade proper implementation; we have seen this happen for years. However, there would be overwhelming public support. Further, such an initiative would be very much in line with the European Union's own Reform Agenda, and in fact, the notion that the country's business environment could be improved without these reforms reflects a fundamental misunderstanding of the political economy in post-Dayton Bosnia.

Second, the lessons of unsuccessful past privatizations in BiH must be studied, learned and applied by domestic and international actors alike, to understand both their role in further strengthening an oligarchical class of political and party leaders, and to understand why part of the country that has privatized most of its public assets (the Republika Srpska) has failed to enjoy any broad and durable economic or social benefits from these transactions.

Future privatization should be put on hold until reforms to the broader ecosystem have been implemented; otherwise the country risks seeing a further enriched and emboldened political elite, accompanied by questionable foreign investment in enterprises which is often more about real estate and asset stripping than about building a robust economy for Bosnia and its people.

Third, it is critical to understand how the election system in Bosnia contributes to the lack of accountability and makes it not only possible but natural for politicians to be elected and re-elected without delivering anything to their voters other than limited and targeted patronage. Much has been written on this topic. Current election law reforms under consideration will in fact make it harder for new or small parties or independent candidates to participate in and influence political life. This will further entrench the dominant party machines that have held control for a generation, further eroding the checks and balances needed to resist and deter corrupt practices.

Substantial election reform is needed so citizens know who really represents them at every level of governance and can vote them in and out of office; so constituent service offices operate in communities and serve as a link between representatives and the citizens they represent; and to ensure that citizens have the chance to be represented in government at every level. Representation should not be based on ethno-national affiliation—whether a voter is a Bosniak, Croat or Serb, or the consistently marginalized “Others”—but simply whether a voter is a citizen.

These reforms could effect substantial change, and do not require a “Dayton 2.” In fact any elite-driven, foreign-sponsored effort to engineer reforms would very likely create a system even worse than the one we see today. Instead, reforms need to be citizen-focused, combining coordinated top-down support and bottom-up pressure to create momentum among a population that is ready for such change, but uncertain how to disempower the system that has so effectively captured the country for so long.

#### *Why Does BiH Matter?*

Bosnia and Herzegovina is a small country of less than 4 million people. It is fair to ask why the U.S. should continue to spend time on it, considering the many other foreign policy priorities and humanitarian crises facing the world today.

The answer is simple: if the U.S. and its partners cannot support the development of a functional and accountable system in Bosnia, how can it hope to support positive and peaceful political outcomes in other parts of the world?

If the U.S. and its partners do not learn the lessons of failed post-war power-sharing arrangements in Bosnia, there is the potential that similar foundational weaknesses will be introduced into other peace deals, creating an illusion of peace and stability while corruption and spoilers flourish, social discontent is manipulated and society becomes entrenched in a state of frozen conflict.

Finally, the same systemic failures and factors that allow corruption and unaccountable governance to thrive in frozen conflicts foster civic marginalization, alienation, and in the worst cases enable the rise of extremist groups and radicalized individuals seeking extra-institutional remedies to political and social maladies.

In closing, corrupt politics and the pain of an economic transition which has delivered little benefit to the majority of the population in Bosnia have not only reinforced public frustration with the post-war situation, but has revealed increasing dissatisfaction with the very idea of democracy and competitive markets—promotion of which have been core U.S. foreign policy goals for more than two decades.

It is not too late to reverse recent negative trends, though the clock is ticking as social divisions have reified and hardened in the “divide and rule” politics of the past generation. More ethnic politics and virtual partition will not help. Laws, strategies and initiatives that seek to hardwire accountability into the system, backed up by meaningful conditionality and enforcement mechanisms, can.

I’m hopeful that this hearing will put this discussion back into the spotlight, and generate momentum for the change that is so desperately needed if the promise of Dayton Bosnia is to be fulfilled.

Thank you.

**MATERIAL FOR  
THE RECORD**

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## How Bosnia's Political Economy Holds It Back And What to Do About It

*Srdjan Blagovcanin and Boris Divjak<sup>1</sup>*

### Executive Summary

Twenty years after the Dayton agreements ended its devastating war, Bosnia and Herzegovina is mired in a corrupt political economy that feeds its political party bosses and their loyalists while leaving the country's economy in ruins, its governing institutions all but bankrupt and its citizenry in dire need. The first post-war decade (1996-2006) saw a spurt of assistance-driven economic growth and international intervention to create governing institutions, but little reform has been accomplished since. Stalled on the path to European Union membership, Bosnia and Herzegovina needs to find ways to limit the predation of its politicians, unburden its entrepreneurs, and prosper its people.

The required stimulus can no longer come from international intervention of the sort practiced in the first post-war decade by the High Representative. The European Union expects Bosnia and Herzegovina to meet its entry requirements by exercise of its own sovereignty and will rather than by imposition. The will does not exist today, because many of those in power expect to lose benefits and even fear going to prison if an independent judiciary, free media, energetic civil society and truly democratic processes were to hold corrupt parties accountable for exploiting the public trust for private gain.

As things stand now, the political economy in Bosnia and Herzegovina is unfavorable to reform. Its:

- political leadership and parties serve narrow interests,
- stalled economy is overburdened with public debt,
- complex business environment hampers recovery and growth,
- informal networks foster patronage, privilege and cronyism,
- state-owned enterprises generate mainly economic losses and political party revenue,
- judiciary is gradually moving under political party control,
- media and civil society are unfree and living in fear,

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- unemployment and poverty are on the rise, and
- captive state is unable to implement even reforms that are approved in legislation.

In order for Bosnia and Herzegovina to clear a way forward, the existing political economy has to change. This will require a multi-faceted effort, mainly implemented by Bosnians but supported by the European Union. Privatization, commercial law reform, internal democratization of political parties, a more independent judiciary, a vigorous civil society, an end to media subsidies from the government are all necessary, but none will suffice on its own.

**We recommend that:**

1. The High Representative continue to fade into the background, unless peace and security are threatened, and that the European Union requirements drive the reform effort.
2. The Bosnian authorities make a concerted effort to simplify their governing structures in accordance with the principle of subsidiarity.
3. The parliament require internal democracy in all political parties and end political appointment of executives in state-owned enterprises, which should conduct procurement and privatization as well as receive loans and subsidies only in accordance with European Union rules.
4. The parliament cut red tape and administrative costs, freeze government hiring and require that elected officials declare their assets and state-owned enterprises publish budgets and financial reports.
5. The European Union revive the dormant structured dialogue on justice, insist as a condition for assistance on implementation of its recommendations and verify that judges are appointed solely on the basis of professional qualifications.
6. The judiciary eliminate backlogs and focus its efforts on large-scale corruption cases, with assistance from the European Union. Travel bans and freezing of assets abroad is an instrument the EU and foreign governments should consider to aid the process.
7. The entity and state parliaments end media subsidies, require open competition for government advertising and any civil society funding, and strengthen the role of ombudspeople, auditors and regulatory agencies.

None of these reforms will be easy, because they will impinge on vested interests and deeply ingrained practices. But piecemeal reforms will not succeed without this kind of broader effort to change the political economy.

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### Introduction – BiH the transition laggard and a post-conflict reconstruction disappointment

After two decades of an intense and robust state-building, Bosnia and Herzegovina (BiH) still exhibits characteristics of a failed state. The EU integration process is completely blocked. The country has not yet requested candidacy. It is last in the line among the Western Balkan countries for accession to the EU, with the exception of Kosovo.

The starting situation of the state-building process was complex. The Dayton peace accords (DPA) that ended the conflict in 1995 provided for a highly decentralized structure without some basic state functions at the central government level. The country was placed under international civilian and military supervision. Given the institutional discontinuity with the pre-war situation, absence of rule of law, and immense wartime violations of human rights, the establishment and building of institutions was fraught with great challenges. The state-building process was essential for BiH in the post-war period.

Starting in 1997, the international community, personified in the Office of the High Representative (OHR), intervened directly in running the country with the help of other international or *ad hoc* institutions. During this top-down, internationally driven state-building phase, the OHR was mainly oriented towards stabilizing the country through eliminating obstructions to the implementation of the DPA and establishment of basic government functions. During that period the “Bonn” powers<sup>2 3</sup> were used widely to dismiss elected and appointed officials the OHR believed were obstructing implementation of the DPA. Imposition of legislation in that period helped establish basic prerogatives of the state, such as the state symbols and a single currency, and secured freedom of movement throughout the country by removing internal checkpoints and imposing common license plates.

By 2000, with the EU gaining more influence over reforms in BiH, the country entered a mixed phase of both interventionist and membership-driven state-building. This is when the European Union (EU) introduced the first set of conditions and the mandate of the OHR was modified to include also the functions of the EU Special Representative (EUSR).<sup>4</sup> From 2002 until 2011 the

High Representative and the EUSR was the same person. In this phase key institutions at state level were established (state-level judiciary and law enforcement agencies) and the responsibilities and composition of the Council of Ministers were expanded, alongside independent agencies responsible for the conduct of elections, supervision and regulation of electronic broadcasting, etc. All these reforms were implemented primarily as a result of the imposition by the OHR.

International management of the state-building process created dependence of domestic political actors on the international community. They avoided painful reform measures that could cost them support

<sup>2</sup> Format of the international presence in BiH after the war was determined by the DPA, through establishment of the OHR as the “final authority in theatre to interpret the agreement” Security Council Resolution 1031 of 15 December 1995 confirmed the position and authority of the OHR, provided for in the DPA. The Peace Implementation Council (PIC), a group of 55 countries and international organizations that sponsor and lead the peace implementation process, later on elaborated this mandate further adding further powers to the High Representative’s (HR) mandate. The aim of the London Peace Implementation Conference, held on 8 and 9 December 1995, was to mobilize international support for the implementation of the Agreement. The conference established the Steering Board of the PIC to work as the executive arm of the PIC.

<sup>3</sup> As originally conceived, the main function of the OHR had been to supervise and co-ordinate the implementation of DPA. The role of the OHR was significantly augmented at a meeting of the PIC in Bonn in December 1997. The “Bonn powers”, agreed by the governments – members of the PIC, frustrated by the obstructionism of the Bosnian parties still in power, allowed the OHR to issue laws by decree and to remove officials and elected politicians from their jobs. No judicial institutions in Bosnia, not even the Constitutional Court, have the jurisdiction even to review the actions of the OHR.

<sup>4</sup> The idea behind establishing of the European Union Special Representative (EUSR) presence in 2002 was “complementing the role of the HR with the tasks of the EUSR, thereby maximizing synergies. In other words, the ‘hard power’ of the Bonn powers was complemented by the ‘soft power’ of the EUSR, charged with accompanying the country towards the negotiations of the Stabilisation and Association Agreement (SAA) with the EU and to pursue the European destination of BiH [...], proclaimed by the European Council of Thessalonica in June 2003.” The EUSR has been in a personal union with the HR for more than 9 years.

at the polls. Irresponsible local political elites got used to waiting for the international community to take the necessary reform measures. Blame for the necessary pain involved would be apportioned to the international community, while credit for the few successfully implemented reforms would be claimed by the local political elites.

The role of the OHR has gradually declined, in parallel with the emergence of increasing opposition to intervention among key PIC member states regarding his purpose, in spite of the fact that the formal powers remained unchanged. Ever more extensive criticism of the OHR started also to come from international organizations. Thus, the Parliamentary Assembly of the Council of Europe expressed the following view: "... the Assembly considers it irreconcilable with democratic principles that the High Representative should be able to take enforceable decisions without being accountable for them or obliged to justify their validity and without there being a legal recourse".<sup>5</sup> The Venice commission also concluded in its opinion from 2005 that it is "certainly not a normal situation that an unelected foreigner exercises such powers in a Council of Europe member state and the justification for these powers for the future merits not only political but also legal consideration [...] such an arrangement is fundamentally incompatible with the democratic character of the state and the sovereignty of BiH."<sup>6</sup> It was in 2005 that the PIC first expressed its commitment to completely replace the OHR, with its wide Bonn powers, with the EUSR, who would have an exclusively European agenda based on voluntary acceptance of conditions.

Harsh criticism of the OHR's actions, the inability of the key PIC member countries to achieve agreement on its actions, as well as the inevitability of the OHR's closure ultimately led to a decision setting out the objectives and conditions to be met prior to the official termination of the High Representative's mandate (so called '5+2 Agenda').<sup>7</sup>

While the use of interventionist state-building instruments helped establish key institutions needed for elementary functioning of the state, after the abandonment of such a model in practice, reforms came to a halt, jeopardizing everything that had been achieved in the state-building process. Following the abandonment of the use of the so-called Bonn powers, progress in meeting the EU requirements has been almost non-existent.

#### **The country's executive serves its own narrow interests**

Bosnia's institutional framework today is not viable. Following the reduction of the OHR's interventions, the institutions have become prey for political parties, which have used political appointments and

<sup>5</sup> Parliamentary Assembly of the Council of Europe (2004).

<sup>6</sup> European Commission for Democracy Through Law (2005).

<sup>7</sup> Political Directors of the Peace Implementation Council Steering Board (PIC SB) at their meeting in Brussels on 26 and 27 February 2008 set out the requirements that need to be met by the BiH authorities prior to the closure of the OHR. These requirements are well established, approved by the PIC SB and have all been previously recognized by authorities in Bosnia and Herzegovina. The objectives that need to be delivered by the BiH authorities prior to OHR closure are:

- Acceptable and Sustainable Resolution of the Issue of Apportionment of Property between State and other levels of government;
  - Acceptable and Sustainable Resolution of Defence Property;
  - Completion of the Brčko Final Award;
  - Fiscal Sustainability (promoted through an Agreement on a Permanent ITA Co-efficient methodology and establishment of a National Fiscal Council); and
  - Entrenchment of the Rule of Law (demonstrated through Adoption of National War Crimes Strategy, passage of Law on Aliens and Asylum, and adoption of National Justice Sector Reform Strategy).
- In addition to these objectives, the PIC SB agreed that two conditions need to be fulfilled prior to OHR closure:
- signing of the SAA; and
  - a positive assessment of the situation in BiH by the PIC SB based on full compliance with the Dayton Peace Agreement

fiscal blackmail to create a partitocracy. Institutions subordinated to political parties have been unable to significantly improve the quality of government, rule of law, and protection of fundamental human rights and freedoms. Effective governance is prevented by ethnic veto mechanism built into the legislative system, while abuse of constitutional mechanisms designed to ensure fair ethnic representation within state institutions has led to ethnically motivated behavior by elected officials. Furthermore, poor institutional capacities and inadequate coordination among numerous levels of government and between the institutions of individual governments leads to a lack of policy coherence. An indicator of efficiency of the Council of Ministers is that in the past eight years not once has the state budget been adopted by the annual legal deadline – 15 October.<sup>8</sup>

As a result, BiH has an oversized, ethnically divided and inept state apparatus which consumes around 50% of GDP<sup>9</sup> and is burdened with administrative shortcomings and complex decision making processes, complicating the government's policymaking, public finance and human resource management.

The failure of the so-called 2006 April Package of Constitutional Reforms<sup>10</sup>, as noted by many analysts and commentators, was the milestone that marked the beginning of a permanent political crisis threatening to overturn the results achieved earlier in the state- and institution-building process. The Nations in Transit study shows that from that time the country has made no progress in the fundamental areas that are prerequisites for a functioning democracy: the rule of law and protection of human rights. National democratic governance has even deteriorated since. The overall democracy score has slightly worsened compared to 2005.

<sup>8</sup> Centre for Civic Initiatives (2015).

<sup>9</sup> World Bank (2014).

<sup>10</sup> The first comprehensive initiative to amend the Constitution of BiH came in 2005. The initiative was launched by the former Deputy High Representative Donald Hays (USA). The initiative was supported by the Department of State and the US Embassy organized direct negotiations between political leaders. After negotiations behind closed doors, the political leaders came up with an agreed proposal for constitutional changes in March 2006. The proposals envisaged the strengthening of the state-level government, with the formation of two new ministries (Agriculture and Technology), as well as strengthening of the state-level parliament along with increasing the number of MPs. Following the fine-tuning and approval by political leaders, the initiative was submitted to the parliament in April 2006, whereupon it came to be referred to as the April Package of Constitutional Reforms. The strongest opponent of the initiative was Haris Silajdžić's "Party for BiH" (SBiH), considering the envisaged reform insufficient and merely cosmetic, and leading to a definitive division of the country. The constitutional amendments failed to receive the necessary parliamentary majority because of the opposition coming from SBiH. The cables released by WikiLeaks later revealed that SBiH allegedly resorted to bribery and subterfuge to get the MPs to vote against the amendments.

Nations in Transit Ratings and Averaged Scores

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Electoral Process	3.25	3.00	3.00	3.00	3.00	3.25	3.25	3.25	3.25	3.25
Civil Society	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Independent Media	4.00	4.00	4.00	4.25	4.50	4.50	4.75	4.75	4.75	4.75
National Democratic Governance	4.75	4.75	4.75	5.00	5.00	5.25	5.25	5.50	5.50	5.75
Local Democratic Governance	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Judicial Framework and Independence	4.25	4.00	4.00	4.00	4.00	4.00	4.25	4.25	4.25	4.25
Corruption	4.50	4.25	4.25	4.25	4.50	4.50	4.50	4.50	4.75	4.75
<b>Democracy Score</b>	<b>4.18</b>	<b>4.07</b>	<b>4.04</b>	<b>4.11</b>	<b>4.18</b>	<b>4.25</b>	<b>4.32</b>	<b>4.36</b>	<b>4.39</b>	<b>4.43</b>

Table 1: Nations in Transit 2014, Freedom House (2014)<sup>11</sup>

Another key characteristic of BiH is a large gap between the laws and practice, or lack of consistent implementation of the laws.<sup>12</sup> Thus, according to the Global Integrity Report 2011, BiH ranks among the countries with the lowest level of actual implementation of legislation.<sup>13</sup>

Arbitrary and inconsistent implementation of the law by the state administration is a result of insufficient institutional capacities and their subordination to political parties. Judicial institutions, suffering from unclear division of responsibilities, huge backlogs of cases and subordination to political power centers, fail to provide citizens with access to justice within a reasonable period, while acting protectively towards public officials by ignoring cases of high-profile political corruption, elaborated below.

The independence of the executive is weakened by the autocratic way in which political parties operate, with no internal party democracy and concentration of real power in the hands of their leaders. Thus, all important executive and legislative decisions (such as reform of the constitutional system and harmonization with the European Convention on Human Rights, issues

related to state property, the census, and the distribution of managerial positions in state institutions) are made in the informal meetings between the political party leaders. These decisions are subsequently sent to parliaments for adoption merely to meet the form.<sup>14</sup> An example of the aforementioned practice was the process of negotiations on constitutional reforms following the European

<sup>11</sup> The ratings reflect the consensus of Freedom House, its academic advisers, and the author(s) of this report. The opinions expressed in this report are those of the author(s). The ratings are based on a scale of 1 to 7, with 1 representing the highest level of democratic progress and 7 the lowest. The Democracy Score is an average of ratings for the categories tracked in a given year.

<sup>12</sup> Transparency International BiH (2014b).

<sup>13</sup> Global Integrity (2012). The survey ranks countries on a 0-100 scale, where 100 is the maximum score, measuring the quality of the legal framework and the level of its actual implementation. BiH's legal framework received a score of 92, and for the level of its actual implementation 35.

<sup>14</sup> Al Jazeera Balkans (2012).

Court for Human Rights' ruling in the so-called Sejdić-Finci case.<sup>15</sup> After almost five years of informal negotiations the leaders failed to reach an agreement to reform the Constitution and the Election Law in line with the European Court's ruling.

The bargaining process behind formation of the executive is best illustrated by the formation of the BiH Council of Ministers and the FBiH Government following the 2010 general elections. In violation of the FBiH constitutional provisions and without a majority in the House of Peoples, the FBiH Government was elected in 2010 only to be dismissed in a no-confidence vote two years later. However, the Government continued to operate in a caretaker capacity because political leaders were unable to agree on the formation of a new government. The Council of Ministers was not formed until almost two years after the 2010 election. Even then, its composition (i.e. members of the coalition) changed twice in a very short period of time, and it remained effectively blocked for a largest part of its mandate.

Executive authorities often abuse the authority of the legislative branch. A 2014 example concerns the decision of the FBiH Government to transfer funds from the special-purpose disaster account to current budget spending, just days before the floods struck the country with devastating consequences. No one has ever been called to account for unauthorized spending of funds earmarked for flood protection and defense.

When it comes to the fight against corruption, a general conclusion stemming from the EU Progress Reports as well as reports of non-governmental organizations is that the government in BiH has so far failed to adequately come to grips with corruption. This is evidenced by the fact that only 10% of the legal and institutional measures envisaged under the 2009–2014 Anti-Corruption Strategy and Action Plan have been implemented in full.<sup>16</sup> In recent years the executive has initiated changes to dilute important anticorruption laws, most notably the Conflict of Interest Law. Although the Law on the Agency for the Prevention of Corruption and Coordination of the Fight against Corruption was adopted in December 2009, it took Council of Ministers almost three years to adopt the Rules on the Agency's internal organization, thus delaying the start of the Agency's operations.

It therefore appears the BiH politicians are only pro-European at surface, while unprepared to subject themselves to the Brussels checks and balances and the various institutional and otherwise reviews. The picture portrayed is that of a dissonance between how the people feel (most surveys show 4/5 to 3/4 in support of EU integrations; source Nezavisne Novine (2015)) and the political behavior. Nominally, the EU integration is the declared political vision and therefore the acqui and the conditionalities this roadmap brings along is what can strengthen democracy and citizen participation. In the short run addressing directly the major changes in running the executive or legislative is highly unlikely, therefore the recommendations of this paper focus dominantly on the 'in-between' public institutions, political party reforms, NGO sector, media etc., all of which can benefit from the accession process. Ultimately, once a greater independence of the justice sector is displayed, the political landscape will start changing much more rapidly.

<sup>15</sup> In December 2009 the European Court of Human Rights issued a decision ruling on the applications lodged by two prominent citizens of Bosnia and Herzegovina (Sejdić – Finci), complaining that the Constitution of BiH and the electoral law deny passive suffrage to the group of so-called "others", i.e. those who do not belong to the three constituent ethnic groups eligible to stand for election to the Presidency of BiH and House of Peoples of BiH. The Court's decision ordered that changes should be made to the relevant provisions of the Constitution and the laws that discriminate against "others" thus making them eligible to stand for election.

<sup>16</sup> Transparency International BiH (2013).

**Textbox 1: Abuse of public office: Our way or the highway**

There are numerous examples of appointments to highest executive offices of persons who were convicted of or are under investigation for corruption.<sup>17</sup> Also, several ministers and other executive officeholders had been involved in the disruption of public peace and order, in physical confrontations in public places or drunk driving. Nepotism and clientelism is widespread, as demonstrated by the two Entity Prime Ministers who employed their closest relatives in public enterprises. Despite the fact that all the above cases were widely reported in the media, no one has ever been called to account.

Following elections in 2010 and establishment of the Government of FBiH, a total of 939 decisions regulating different personnel/staff positions, removals of management in public companies and institutions and subsequent new appointments were recorded. Prime Minister of FBiH Nermin Nikšić appointed his brother Mirsad Nikšić as the Executive Director for Maintenance in the public company FBiH Roads and Highways. Also, Ivan Šakota, son-in-law of Jerko Lijanović, Deputy Prime Minister and Minister of Agriculture of FBiH, was appointed the Executive Director for economic and financial matters in the same company.

**Political parties – the corruption generator**

Following the war, during the period of interventionist state-building, virtually all social and state institutions in the country underwent seemingly ambitious reform processes, with the exception of political parties. There is still no comprehensive law on organizing or funding political parties at the state level, so they are all established and registered separately in each Entity, according to the relevant Entity's law, which limits their activity to that Entity.<sup>17</sup>

Meanwhile, mafia-like political parties have seized substantial control over social, public and economic resources in the country. The vast majority of party bosses have held the leader's position for more than 15 years. Over that time, their wealth skyrocketed. Some estimates from news media<sup>18</sup> say that the most powerful political leaders secretly accumulated wealth worth hundreds of millions.

The current political elites in the country emerged in the early 1990s, with the introduction of the multiparty system in BiH, consolidating power during the war and the post-war ethnic frictions. The internal party election process is fraudulent. Senior party leaders appoint their loyal supporters as delegates to the election conventions or assemblies. These in turn vote for the leaders who appointed them, helping them get re-elected. Lists of candidates for the general elections are drawn up in a similar manner. Loyal party supporters get appointed into managerial positions in public enterprises or political offices in local governments. Once appointed to these positions by the party leaders they are expected to provide party funding. The appointments within a party are never merit or competence based, but rather contingent on loyalty to the party leadership.<sup>19</sup>

<sup>17</sup> The Entities' Laws on Political Organizations provide for different founding thresholds: in FBiH, the 1991 Law on Political Organizations (Official Gazette of the Socialist Republic of Bosnia and Herzegovina 27/91) provides that a political party may be founded by at least 50 citizens (Article 11, FBiH LPO), in RS, Article 11 of the RS LPO (Official Gazette of Republika Srpska 15/96 and 17/02) request at least 500 citizens for the establishment of a party, while in Brčko 300 citizens are necessary (BD LPO, Official Gazette of the Brčko District 12/02 and 19/07).

<sup>18</sup> A leading source is [imovnapolitikara.cin.ba](http://imovnapolitikara.cin.ba) - investigative journalist portal on wealth of politicians, Center for Investigative Journalism.

<sup>19</sup> Bertelsmann Stiftung (2014).

**Textbox 2: Political party *modus operandi***

It is common practice for political parties to receive donations from companies doing business with the executive authorities. This is in clear violation of the Law on Financing of Political Parties. The Center for Investigative Reporting in Sarajevo (CIN) has found that six leading political parties took nearly 210,000

KM between 2006 and the end of 2010 from 70 private businesses that had contracts with the government. The ruling political parties also received donations from 39 companies that held contracts with government-controlled public companies. While the law prohibits accepting donations from companies that have done business with government, the same does not apply to doing business with public companies.

When it comes to direct transfers from the budget, in 2012, out of 21 million KM in agricultural subsidies that the FBiH Ministry of Agriculture provided, at least 2.7 million KM went to firms that applied with non-existent businesses or were owned by party colleagues and the minister's family, according to the same report.

CIN also reported that at least 20 firms owned by officeholders or candidates running for the upcoming elections have concluded at least 166 contracts with public companies and agencies worth at least 13.7 million KM between 2007 and August 2010. The amounts on some of the contracts were impossible to determine as the contracts available to the public are insufficiently specific.

Many political parties have gone so far as to include the name of their party leader in their official name.<sup>20</sup> 77% of the population perceives political parties to be the country's most corrupt institution.<sup>21</sup>

**Textbox 3: Embedded networks – example of Milorad Dodik**

When Milorad Dodik, the leader of Independent Social Democrats (SNSD), a party that also carries his name as a suffix, was on trial for misuse of public funds in 2005, the chair of judge panel was Milorad Novković, and the prosecutors Milan Tegeltija and Zoran Lipovac. The court acquitted Dodik of the criminal charges and ever since the careers of the prosecutors and chief judge progressed considerably. Milorad Novković was appointed President of the High Judicial and Prosecutorial Council (HJPC) of BiH, Milan Tegeltija has been appointed the President of Banja Luka Court. After Novaković's mandate expired, he was appointed the President of the HJPC, while Zoran Lipovac held a ministerial position, after which he was appointed a Constitutional Court judge.

A similar case was appointment of the BiH Ombudsman, who is legally expected to be independent and non-partisan. Ljubomir Sandić, one of the SNSD leaders, was appointed Ombudsman. Another instance was the Supreme Audit Institution (SAI) RS. Duško Šnjegota, previously Deputy Finance Minister and a close affiliate of SNSD, was appointed the Head of SAI RS. Džerard Selman, who had been a member of the Steering committee of SNSD, was appointed Chief Justice of the Constitutional Court of the RS, even though the related law explicitly requires that person not to have any political affiliation.

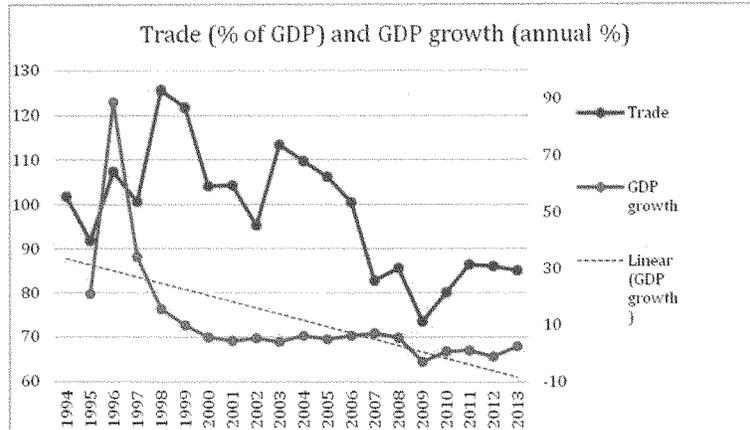
**Following a short post-conflict surge the economy quickly went flat**

BiH has progressed only slowly on the economic recovery and reform path. Much of the immediate post-war assistance of donor funds resulted in restart of some manufacturing capacities and the service industry, but that quickly subsided, as the national authorities attempted to take over the reform agenda. Growing disengagement of the international community and strengthening of the national grip over the economy led in fact to a reversal of many reforms and prolonged suffering of the

<sup>20</sup> Official name of the Alliance of Independent Social Democrats include the name of party leader Milorad Dodik, also the name of Democratic front include the name of party leader Željko Komšić.

<sup>21</sup> Transparency International (2013).

economy and the real sector. This is best illustrated by the GDP growth as well as the trade data.



The GDP growth rate dropped significantly following the immediate aftermath of the conflict, with a negative trend overall. By 2000 this had stabilized just below 6% until 2009, which is when GDP reached a negative or a barely positive balance. This is mirrored in the trade figures, which have recorded mostly a downward trend since the late 90s. As the economy went through a surge in the late 90s, the trade volume followed suit. The relatively stable mid-2000s saw another expansion in trade, chiefly also because the internal market began to prosper while the GDP growth stabilized. However the downward trend began again before the global economic crisis and the BiH economy has not recovered since.

Instead, the economy is dependent on external borrowing and remittances coming from the large and expanding migration, which no longer consists of genuine asylum seekers but rather is economic in nature.<sup>22</sup>

<sup>22</sup> Source (chart data): World Bank (2015).

Foreign debt rose steadily since the early 2000s and more recently exceeded 60% of GNI, becoming a key source of revenues for the budget. Looking at the expenditure side, it is mostly invested in unproductive items. Over 60% of the RS and FBiH entity budgets finance public sector salaries and the social safety network, on top of which there is a significant portion for foreign debt servicing in each entity budget or another 30% on average.<sup>23</sup> That percentage relative to the entire budget, but also the absolute payments for salaries and social benefits have been steadily rising from one year to another, which led to further foreign and domestic borrowing as well as tax increases (VAT, income, corporate etc.). The budget deficit still stands at -3.6% of the GDP.<sup>24</sup> This imbalance in turn led to social instability, unrest and riots in early 2014.

Political instability as the biggest obstacle to the national economy was reported by 25.1 per cent of BiH firms in 2009, which rose to a staggering 31.4 by 2013. By comparison, that same year only 10.8 per cent of firms globally reported political instability as an issue (13.5 in the Central and Eastern Europe region according to World Bank Enterprise Surveys data).

Because of large migration outflows during the war period in 1990s, BiH is the sixth leading country in terms of receiving remittances as a percentage of GDP (ranging between 13 and 23 per cent during 2006-2010). Annual inflows of international remittances, through the banking system only, are estimated at US\$ 2.228 billion by the World Bank<sup>25</sup> in 2010, which represents a staggering **45.5 percent** of the US\$ 4.9 billion worth of total exports of goods and services of the country in that same year (in current prices).<sup>26</sup> But the World Network of Bosnian Diaspora estimates the remittance inflows to be almost double, as the majority of remittances are sent as cash transfers through informal channels<sup>27</sup> and support household consumption, thus keeping the system from collapsing altogether.

#### **Complex business environment hampers recovery and growth**

Meanwhile, the un-restructured, fragile economy continues to underperform: in the composition of GDP by end use, exports of goods and services account for 29%, while imports come to -52.4%.<sup>28</sup> Thus exports are disappointingly low, while imports remain high, causing the lasting negative net trade balance and outflow of capital. The real sector is overburdened with taxes that are being pumped into the unproductive public sector.

<sup>23</sup> Budgets: Republika Srpska (2015) and Federation BiH (2015).

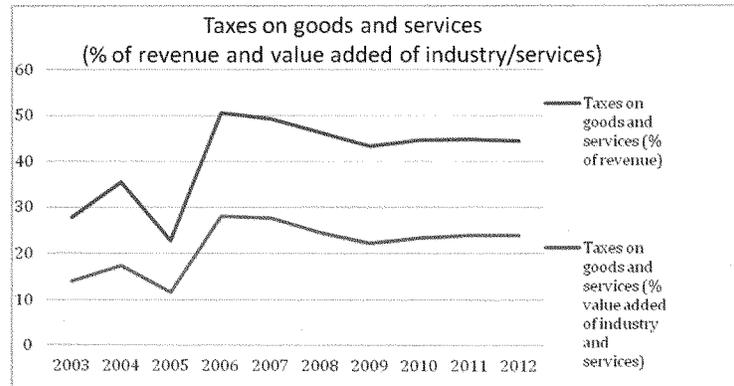
<sup>24</sup> 2014 est., CIA (2015).

<sup>25</sup> World Bank (2011).

<sup>26</sup> Source: World Bank (2015).

<sup>27</sup> Oruc (2011).

<sup>28</sup> CIA (2015).



This key source of government income recorded a significant rise in mid-2000s and remains more than 50% higher than in the post-war years. The World Bank's Enterprise survey<sup>29</sup> also reflects this movement: in 2005 companies did not consider taxes too large a problem, but by 2009 it was. It remains one of the key problems the private sector identifies, though rising concern about instability has reduced its relative saliency.

Percentage of firms identifying tax rates as a major constraint (through WB Enterprise Survey (2013))<sup>30</sup>:

Year	Percentage
2005	15.7
2009	37.8
2013	20.3

Enterprise ownership and legal incorporation structure in the non-agricultural, formal private economy reveals another worrying trend:

Economy	Year	Proportion of private domestic ownership in firm (%)	Proportion of private domestic ownership in firm (%)	Proportion of foreign firm owner(s) (%)	Percent of largest status publicly listed company	Percent of firms with legal status privately held	Percent of firms with legal status of legal Proprietors hip	Percent of firms with legal status of Sole Proprietors hip
All Countries		87.7	9.2	83.1	3.1	39.1	40.0	
Eastern Europe & Central Asia		93.7	4.9	85.1	1.7	85.2	9.8	

<sup>29</sup> World Bank (2013).

<sup>30</sup> This should also be observed in relative terms: as the aforementioned fear of political instability rises, the other issues in relation drop, given the response criteria in the survey.

Bosnia and Herzegovina	2002	42.8	10.2	66.2	17.6	16.0	0.0
Bosnia and Herzegovina	2005	79.7	13.0	78.9	7.5	16.4	0.0
Bosnia and Herzegovina	2009	89.4	5.2	92.0	13.8	56.7	26.5
Bosnia and Herzegovina	2013	93.4	5.4	88.1	3.3	96.7	0.0

There has been a steady change of ownership structure, with foreign capital fleeing the country. While BiH took pride in the early 2000s in having a greater presence of foreign capital than the average CEE country, this figure now reaches only about 1/3 of the peak foreign investment. From a high of \$2.1 billion in 2007, foreign direct investment (FDI) totaled \$392 million in 2012.<sup>31</sup> Meanwhile, capital was changing hands and concentrating in the hands of a few (88-92% of firm capital held by the largest owners). The same goes for legal incorporation: while public listing was popular in 2000s, it drops four-fold by 2013 and switches largely to the much less transparent and very concentrated limited liability company. At that same time, sole entrepreneurship and small crafts are being butchered by bureaucracy and the resulting management costs, so they diminished to the point of disappearance from the economic landscape of the country. Capital is being concentrated among a few powerful people, while well-intended business-oriented individuals are leaving the private sector.

#### **Informal networks: story of patronage, privilege and cronyism**

The country is confronted with systemic and rampant corruption – a problem that is not only an obstacle to the implementation of reforms, but also poses a serious threat to everything that has been achieved so far in terms of state- and institution-building. TI BiH analyses indicate widespread political corruption in the country as well as “state capture,” which denotes a situation in which the regulatory framework is tailored to suit the interests of particular economic agents.

Nationalist elites that have gradually tightened “state capture,” prioritizing their own over the public interest (see textbox 4). “While most types of corruption are directed toward changing how existing laws, rules, or regulations are implemented with respect to the bribe payer, state capture refers to corrupt efforts to influence how those laws, rules, and regulations are formed.”<sup>32</sup>

Another aspect of patronage, privilege and cronyism concerns the management of public enterprises, which have been overtly integrated into political parties as their informal subdivisions. Their principal reporting line is towards the political parties, whose prominent cadres are the formal management. A vital aspect of corruption is public procurement, where many forms of embezzlement are tolerated – from addition of innumerable annexes altering the contract value after the signing, to failing to deliver on the prepaid contract etc. For the system to function with impunity, political parties exert control of law enforcement agencies and the judiciary in order to avoid prosecution. This is often managed under the umbrella of ethnic divisions in law enforcement and judiciary that enables their

<sup>31</sup> US State Department (2014).

<sup>32</sup> Hellman, Kaufmann (2001).

effective party control. Media are extensively used to back such operations.<sup>33</sup>

**Textbox 4: Blurred line between state budget and private pockets**

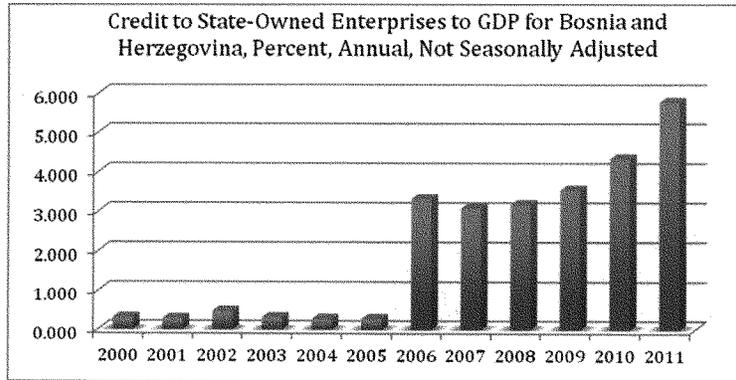
Evidence exists of executive officeholders using direct budget transfers as subsidy payments to their own private firms or firms owned by their closest relatives. During Minister Vahid Hećo's term of office (2006-2010) as the Ministry of Energy of FBiH, he distributed nearly KM 15 million worth of subsidies to private businesses in FBiH and Brčko District. Journalists of the Centre for Investigative Journalism (CIN) found that at least KM 4 million of that amounts had been allocated to companies whose owners or directors were members of or donors to the ruling parties in FBiH. Similarly, the RS Investment and Development Bank (IDB), which is run by the Government of RS, provided capital injections or gave soft loans to companies owned by high-ranking officials and their relatives. "Fruit Eco" is a private company for production and distribution of fruit and vegetables from Gradiska in which Igor Dodik, son of RS Prime Minister/President Milorad Dodik, owns 50% of the shares. The firm was established in 2007, by Igor Dodik and Mirko Dobric, another Dodik close relative, with the minimum founding capital of 2,000 KM (1,000 Euros) - 1,000 KM from each. In July 2008, the Credit Committee of the RS IDB, which was then presided over by Prime Minister Milorad Dodik, decided to award a 3,000,000 KM loan with mostly concessionary terms to "Fruit Eco" company, with a repayment period of 15 years and a grace period of 3 years.

**State-owned enterprises as a key generator of economic losses and party revenue**

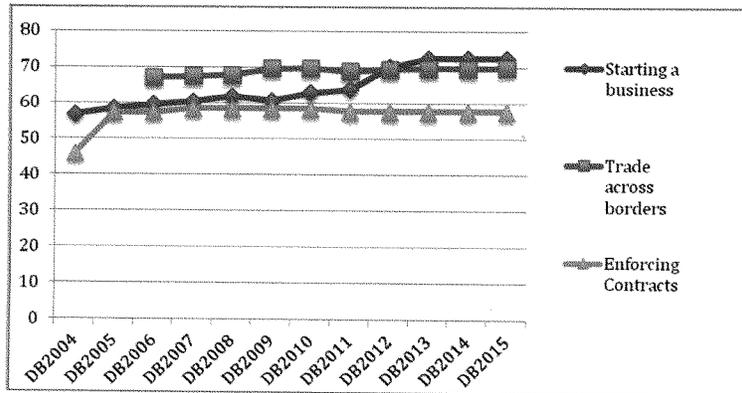
The concentration of capital is fueled through direct fiscal transfers to state-owned companies (SOEs), run by the political cronies of the parties in power.

Some of these formerly successful SOEs have accrued significant debts from unpaid health and pension contributions. Potential investors are required to assume these debts and maintain the existing workforce by the inflexible privatization agreements offered to them. This, too, contributed to the significant shrinking of foreign investment in the last several years. Artificially employed labor remains a budgetary liability and further subsidies are being poured into these SOEs in order to maintain social stability and preserve peace, at the expense of the shrinking real sector and expanded borrowing, both domestic and foreign.

<sup>33</sup> Over the last 15 years, TI BiH, Center for Investigative journalism and other organizations and media have exposed numerous corruption

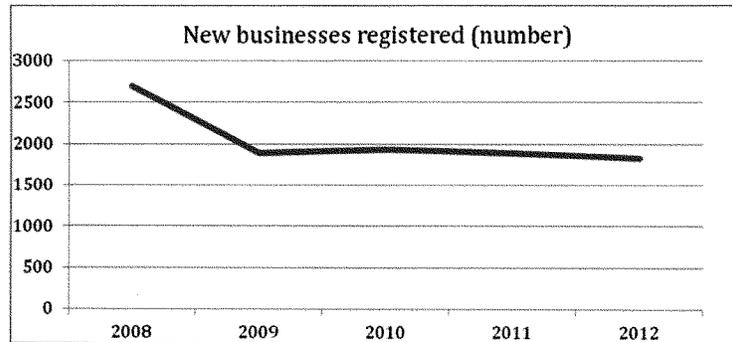


Meanwhile, the governments at all levels did very little or nothing to improve the business environment and remove the mounting non-tariff barriers as the distance to frontier for the selected key investment climate indicators in the Doing Business demonstrates for BiH over years.



There has been almost no progress reforming the business environment in over a decade, as bureaucracy does little to let go of the status quo and its privileges in the form of official fees and sometimes related informal payments associated with issuance of licenses, permits (especially in the construction sector). This leaves the BiH economy with a hugely oversized state-owned sector that keeps accumulating arrears and debts. The environment for the real sector is anything but a level playing field. High barriers to entry, concentration of power, lack of access to capital for unconnected entrepreneurs, and difficult conditions for managing a business mean few businesses dare to enter the market. The number of start-

ups annually has fallen by about 1,000 to 1,828<sup>34</sup> and showed no sign of post-global crisis recovery.



For those that continue to operate in the market, the sources of funding have become scarcer. The economy in the immediate post-war period saw fast growth financed mostly through sales. In more recent years firms increasingly borrow to keep the workforce employed and thus preserve social stability. Some of that funding comes from the banks that are state-owned or are subject to party interests, which enables unsound borrowing. Around two-thirds of BiH firms now borrow capital from banks or other financial intermediaries, which is higher than the global or CEE average, which is just above 1/3 of all businesses.<sup>35</sup> Many of these loans are channeled through the highly political entity-level development banks. Subsidies to the SOEs and politically connected private sector have thus surged to the dramatic new highs. The entity budgets for 2015 envisage the following: the RS budget foresees KM 99,844,500 for subsidies (27,320,000 to SOEs and 60,000,000 to private enterprises and agriculture); while the FBiH subsidies total KM 130,097,311: 57,933,599 to SOEs (2014 ended with subsidies to SOEs of: 112,373,908) and 72,163,712 to private enterprises and agriculture. Together that represents almost KM 230 million, which is approximately one-third of FBiH total borrowing or 1/2 of RS borrowing in foreign and domestic markets.

The mere existence of 13 different privatization laws for 13 different constituencies (10 cantonal, FBiH, RS and Brcko) has led to several different models of privatization implemented by 13 agencies. To date the results of the process have been impossible to measure and the ownership structure of the privatized entities remains unclear.

The costs of such a poor management of the public sector and particularly the SOEs are borne entirely by the real sector and the citizens: through borrowing, now and in the future. Taxes are being diverted to subsidies that cover negative enterprise balances. These taxes are collected from the few that produce new value to fund those that produce nothing or even negative value. Additionally, SOEs and the public sector engage in non-transparent and often corrupt public procurement practices, which is another expense picked up by the citizens, who have no access to the proceeds that could have been raised through sale of state property. This represents an additional opportunity cost resulting in lack of fresh capital, new technologies and new employment. As the private sector shrinks and foreign investment leaves,

<sup>34</sup> 2012 figures, World Bank (2015).

<sup>35</sup> WB Enterprise Surveys (2009) and (2013).

entrepreneurship is on the verge of collapse.

The only ones to profit from the perseverance of the large state-owned sector and particularly the large infrastructure and utility monopolies are the political cronies who launder public money through their accounts and syphon them into the private or party coffers (through illicit procurement, ghost workers in pay-lists, fictitious expenditures, etc). This has provided the incentive to renationalize some of the already privatized companies. The RS Government approved debt-equity swaps (increasing the share owned by the state sector) from 2013 by means of a law (Law on Special Tax Debt settlements<sup>36</sup>), Art.5 of which states that “accrued tax arrears can also be serviced by means of [...] (b) conversion of tax debt into ownership (equity) in the society”. The entity governments and particularly RS has since rapidly been increasing the share of SOE employees in the economy, preserving for the time being social peace and indebting public finances even further (due to growing subsidies). At the same time, renationalization helps the internal party cadre policies by creating employment opportunities for loyal cronies.

The politicians continue to appoint leaderships of SOEs that in turn engage in reducing the equity of the enterprises and increasing liabilities, through debt creation. Any change in government, particularly in FBiH, leads to a large scale replacement of SOE management from new party ranks. These individuals have their hefty salaries secured through the entity and cantonal budgets irrespective of their performance. Political appointees are also pushed into the boards of directors or supervisory boards, which enjoy large honoraria for their political rubber stamping of management decisions.

Procurement of goods and services also occurs in the same political circles that appointed the management, benefiting only selected firms and individuals. As such procurement is subsidized through the budget, there is no reason to rationalize or select the lowest bidder, but typically an expensive politically appropriate one. This is a racket the SOE managers use to pay back those who hired them and who politically and financially continue to sponsor their work. Some of the private sector also participates in such rackets, but in the form of paid ads in the political party bulletins and controlled media, as several NGOs have been reporting.<sup>37</sup> SOEs’ debts are often written off and again transferred to the real sector through external borrowing. These are examples of the ‘embedded networks’ that saw their predecessors in similar forms during the Alberto Fujimori regime in Peru or that of Slobodan Milosevic in Serbia during the 1990s.<sup>38</sup>

Reports of the public sector supreme audit institutions (SAIs) have consistently identified systemic problems in relation to how budgets are spent, but the executive has not demonstrated genuine willingness to act on the audit report recommendations. SAIs of both FBiH and RS have attested to large-scale mismanagement in performance audits of the utility companies, such as electricity and railroads. Supreme auditors used to be extremely critical in the 2000s, which led to a ‘hostile takeover’ of those institutions in the current decade, largely ensuring political compliance and far more positive reporting. Even so, all of the above continues to be highlighted in the SAIs’ reports.<sup>39</sup>

The structural damage is perhaps even more far-reaching than the immediate damage. The playing

<sup>36</sup> Zakon o posebnim načinima izmirenja poreskog duga (2013)

<sup>37</sup> According to a 2011 survey 81% of BiH private business owners believe that the political interference in the operations of business sector is very strong, and 61.1% of them report to have met with political demands in their work (Transparency International BiH (2014b)).

<sup>38</sup> ‘Embedded networks,’ term used by Transparency International to illustrate groups connected through governing structures that operate on the grounds of conflict of interest and favoritism to benefit the group or their parts, and by fostering individual interest, they act against the public ones of the citizens.

<sup>39</sup> Examples from the Audit Reports of the Telekom a.d. Banja Luka (2005) and of Elektroprivreda BiH d.d. Sarajevo (2005) both public enterprises.

field is not level and there are permanent attempts to hamper the unconnected private sector in efforts to compete with the SOEs and crony businesses. The image of BiH abroad is disastrous, which keeps any fresh FDI at a safe distance, targeting successful transition economies and reformers. Political and economic power concentrates with the selected few and corruption levels increase. Social protection trickles down in order to avoid civil unrest. Foreign borrowing is the key means to maintain the minimum required, but it simply reprograms the current financial crisis to tomorrow at a premium price. There have been no serious attempts to address the budget deficit through reductions in expenditure on salaries in the public sector, as these are steadily growing each year. So the problem is left to the coming generations who get born with an unsustainable debt. In parallel, the remnants of the authentic private sector are maneuvering their way out of tax compliance in order to stay in business and maintain minimum employment.

The direct and indirect damage from the 'embedded networks' running the economy are manifold. The example of the Brod oil refinery illustrates all too well what proportions this can take.

#### **Textbox 5 – Brod Oil Refinery**

Transparency International BiH in 2009 published an extensive report on privatization in BiH which included a detailed analysis of the Agreement on privatization of the oil industry of Republika Srpska (NIRS). Not only did the report show that financially there are no positive effects of that transfer, but in fact losses and liabilities were calculated for the public finances for a long period to come. Using a conservative approach when analyzing the agreement, initially concealed by the authorities, approximately a billion KM (half a billion euros) in the first years of operations were transferred to the RS public debt when the refinery was awarded to an unknown, Russian entity with secretive management structure – Nyeftegazinkor. Examples of the direct costs are the non-concessional loans provided by the Russian firm to the Oil Refinery in Brod, i.e. to itself as a new owner. The value estimate of the industry following the sale was so low that it immediately caused the stock price of the business to slump at the Banja Luka Stock Exchange to a fraction of the pre-sale level (a drop of over 90%). The price agreed was never paid in full and only about half was paid into the RS Budget.

Meanwhile the losses continue to accumulate beyond TI BiH's conservative prediction. In 2010 alone the Oil Refinery added KM 372 in losses and failed to pay KM 133 million in tax arrears. In 2011 the RS Government extended the grace period for collection of the arrears to 2019. However the losses continued in hundreds of millions per annum, chiefly borrowing from the mother company at very uncompetitive terms. Production was halted several times.<sup>40</sup>

The citizens of BiH were meanwhile subjected to a higher than market price for fuel that came via the refinery as a means of domestic industry protection, through high levies on the imported oil derivatives. Today the refinery owes scores of monthly salaries to its labor, resells oil derivatives of dubious quality at a premium price to the end users, and continues to accumulate debt that has long surpassed any market value of the industry. It now would cost far more to shut down than to continue production.<sup>41</sup>

#### **Judiciary gradually moving under party control**

The judicial reform that has been implemented over the last ten years with major support from international institutions failed to ensure an efficient and independent judiciary able to tackle the challenge of corruption. The EU 2014 Progress Report as well as Transparency International B&H reports note that BiH is still far from effective prosecution of corruption. Only very few low-ranking

<sup>40</sup> (Vaskovic blogspot: <http://slobodanvaskovic.blogspot.com/2014/12/rafinerija-brod-prestala-s-proizvodnjom.html>).

<sup>41</sup> (<http://www.nezavisne.com/posao/privreda/Zaduzenost-tri-puta-veca-od-kapitala-302514.html>).

officials are prosecuted.<sup>42</sup> The recent TI BiH report *Monitoring the Prosecution of Corruption in the Courts and Prosecutors' Offices in BiH (2012–2013)*<sup>43</sup> indicates a continued downward trend. The report notes the country's worst performance in prosecuting corruption in the last 5 years, with the number of verdicts and investigations for corruption offences dropping several folds.

In 2013 the Court of BiH delivered only three verdicts for corruption offences, one of which was a guilty verdict. Prosecution of corruption by courts in the Federation of BiH has also seen a decline compared to the previous four years – in 2013 a total of 78 verdicts were delivered for corruption offences, compared to 124 verdicts in 2012 and 113 verdicts in 2011. A decline is also observed in the number of guilty verdicts: only 60 guilty verdicts were delivered in FBiH in 2013, fewer than in the preceding years. Similarly, in RS in 2013 a total of 60 corruption cases were processed, a decrease of almost 50% compared to 2012. The number of guilty verdicts for corruption offences in RS has been in continuing decline during the last five years with just 37 in 2013, a decrease of 40% compared to 2012. Overall, 147 verdicts for corruption offences were issued in 2013 at all levels in BiH, of which 102 were convictions, 36 were acquittals and 9 were verdicts of abandonment.

Numerous scandals and affairs, most of which received wide media exposure, have never seen a proper response by relevant institutions. Judicial reform has brought about few substantial changes in the functioning of the judicial system. One of the biggest problems continuing to limit the judiciary is the excessive backlog of cases and long court proceedings.<sup>44</sup> Citizens and legal entities have to wait a long time for courts to commence a case. The road to justice is time-consuming and expensive. According to World Bank's *Doing Business 2014*, it takes 595 days to resolve litigation in BiH.<sup>45</sup> According to the 2013 High Judicial and Prosecutorial Council (HJPC) Annual Report, as of 1 January 2013 there were 2,112,622 pending cases before the courts in BiH, of which 1,664,328 were the so-called "utility cases" (i.e. cases requiring the payment of the outstanding debts for public utility services).<sup>46</sup> Compared to 2011, the reduction in the backlog was negligible. This means that the backlog problem will, for a long time, continue to be a major impediment to expeditious court proceedings and the right of access to courts and justice within a reasonable period. A common practice is for political officeholders to publicly accuse and place pressure on judges and prosecutors, adding to their reluctance to rule on a case.

The fundamental problem besetting the judiciary still resides in the fact that the country has four nearly autonomous judicial systems – state level of Bosnia and Herzegovina, two entity systems (RS and FBiH), and Brčko District of BiH. These systems are virtually detached from each other in terms of their responsibilities (with some exceptions when cases of war crimes are concerned), as a consequence of the country's constitutional structure. The parliaments continue to pass laws governing the judicial system, despite significant efforts to harmonize specific pieces of legislation in terms of both substance and procedure. This has resulted in uneven judicial practices and unequal treatment of the same or similar factual and legal situations by different courts.

The financing of the courts and prosecutor's offices is even more complicated. The courts and prosecutors' offices are still financed from 14 different budgets, which make the capacities and resources of the courts unstable and unbalanced. It also allows political influence to be exerted on the judiciary through budgeting.

<sup>42</sup> European Commission (2014).

<sup>43</sup> Transparency International BiH (2014a).

<sup>44</sup> Visoki sudski i tužilački savjet Bosne i Hercegovine (2013).

<sup>45</sup> World Bank (2015).

<sup>46</sup> Visoki sudski i tužilački savjet Bosne i Hercegovine (2013).

Since 2006 EU progress reports have continuously warned of the lack of adequate progress in judicial reform.<sup>47</sup> Ever since the initial stages of the international community's engagement in the country, the establishment of an effective and independent judiciary has ranked high on the priority list and has been a condition in all stages of the accession process. Due to the continued lack of progress and the continuing political obstruction, the EU decided to open up a so-called structured dialogue on justice. This is a new tool of the EU, first established in BiH in 2011, aimed at supporting reforms of the justice system. So far, five thematic sessions have been held between representatives of the EU and BiH authorities on reforms that are necessary in the integration process.<sup>48</sup> Except for recommendations, there have been no concrete results of this dialogue as yet. The European Union, its member states and the interested governments may also consider the freeze of assets of politicians under investigation or trial. If found guilty such assets can be repatriated under the provisions of the United Nations Convention Against Corruption (UNCAC) and the bilateral agreements BiH has signed.

**Media and civil society are not free and are operating in fear**

Media freedom and civil society strength appear to have deteriorated further in recent years. The media are divided along ethnic and entity lines, so that they do not cover the entire social and political spectrum, but are oriented towards the particular ethnic segments. As the political centers of power and decision-making are key factors in the financial viability of media outlets, the media often become tools in the hands of the political elites for their mutual confrontations. Advertising, vital to media revenue, has been experiencing a continuing decline over the last five years. The value of this market is now about KM 50 million, which is almost 40% less than in 2009. One of the biggest advertisers is the government, i.e. institutions and enterprises under state control. The RS government over the last five years has also spent more than 10 million on direct subsidies to media close to the government.<sup>49</sup>

**Textbox 6: Media as government PR**

Over the last few years the RS Government has introduced the practice of direct grant assistance to the media. Allocation of direct financial assistance to the media happens without clearly defined criteria and increases in value during election years. This has led to direct assistance allocated either to close contacts of the leaders of the ruling party in RS, or to the media that shortly after receiving support from the Government began to uncritically promote and advocate pro-government views. In 2009 a total of about KM 5 million in grants was awarded to privately-owned pro-government media outlets in RS, in 2010 KM another 5 million, and in 2011 the RS government allocated over KM 3.6 million for direct grant assistance to the media.

A number of media outlets in the country may not be under the direct control of the ruling political structures, but the most powerful and richest outlets find their interest in representing and promoting the views of the government. Media pluralism in BiH has not contributed to the democratization of society, or the media for that matter. Journalists and media outlets who criticize the current leaders (at any level of government) are publically counterattacked and exposed to pressure.<sup>50</sup> In the first six months of 2014, the Helpline for Journalists received 45 reports of direct pressure and threats against journalists.<sup>51</sup> Particularly alarming are the frequent direct attacks on journalists by public authorities, such as a recent police raid in the Klix portal premises. International

<sup>47</sup> Dick (2013).

<sup>48</sup> Delegation of the European Union to Bosnia and Herzegovina (2012).

<sup>49</sup> Friedrich Ebert Stiftung Bosnia and Herzegovina (2014).

<sup>50</sup> Transparency International BiH (2014b).

<sup>51</sup> Friedrich Ebert Stiftung Bosnia and Herzegovina (2014).

institutions have frequently condemned the practice.<sup>52</sup>

Critical and analytical assessment and evaluation of government's performance remains inadequate. Media outlets that are controlled by the government, or depend heavily on government entities for advertising, act largely as spokespersons of the ruling parties rather than objectively reporting on the work of government. There is also a tendency to ignore the most pressing problems in the society, in order to avoid reporting critically on the work of the government.<sup>53</sup>

Civil society in BiH is heterogeneous; it includes various forms of association, ranging from informal communities and volunteers to religious and professional organizations. Some of these organizations are financed from budgets at some level of government (e.g. veterans' associations, trade unions, pensioners' associations) and are more likely to come under the governmental influence. On the other hand, foreign-financed CSOs through democracy promotions programs of EU, USAID and other Western European countries are typically found to be free from undue external interference to a significantly greater extent.<sup>54</sup>

That said, intimidation and violence against activists and civil society organizations continues, mostly involving human rights advocates and activists investigating alleged corruption.<sup>55</sup> There have also been several cases of public pressure on CSOs by actors associated with religious communities<sup>56</sup> and the media in the country. Although the religious communities are supposed to be part of civil society, in BiH they have been repeatedly associated with the ethnic governments, especially in election periods.

Government media lead smear campaigns aimed at tarnishing the image and undermining the integrity of CSOs, promoting arrests of activists, and intimidating them. No authorities strive to protect civil society or human rights activists. What is sadly lacking is an appropriate response by the competent ministries, ombudspersons as well as courts and the police in denouncing threats and attacks. Nothing is done to create an environment in which it would be possible for citizens and their organizations to operate freely. According to official information, none of the above cases has been prosecuted.

#### **Unemployment and poverty are on the rise**

BiH is being driven further into poverty. The 2013 unemployment rate was estimated at 44.5%,<sup>57</sup> though many of these individuals may have been operating in the grey economy.

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<sup>52</sup> OSCE (2014).

<sup>53</sup> Freedom House (2014).

<sup>54</sup> Ibid.

<sup>55</sup> European Commission (2014).

<sup>56</sup> Depo portal (2011).

<sup>57</sup> Labour and Employment Agency of BiH (2014).

	Q4 2009	Q4 2010	Q4 2011	Q4 2012	Q4 2013
BiH	510,580	522,052	536,781	550,574	553,580
FBiH	354,577	351,929	371,090	384,852	386,091
RS	145,396	145,620	153,535	153,458	154,998
Brčko Distr.	10,607	11,503	12,156	12,264	---

Source: Labor and Employment Agency of BiH (2012).

The table above demonstrates an increase in the number of unemployed at all levels in BiH, the total of which rose between 2009- 2013 by 31,414 persons, i.e. by 8.1 per cent.<sup>58</sup>

Unemployment segmented by gender and youth is even more dramatic in FBiH:

	Employment rate (%) in FBiH			Unemployment rate (%) in FBiH		
	2009	2010	2011	2009	2010	2011
Total	30.9	30.4	29.8	44.24	45.09	45.47
Age 15-24	14.6	12.4	12.6	53.9	62.3	59.7
Women	20.7	20.6	20.3	27.9	32.3	32.1

Source: Labor and Employment Agency of FBiH<sup>59</sup>

In order to get a job in the well-paid public administration or government sector, which is a budgetary priority and receives alone close to half of the public finances, it is critical to be networked. Nepotism and cronyism almost entirely dominate the hiring process, as a recent opinion poll demonstrates: 61.6% in 2012, as opposed to 54.3% in 2008, are convinced that connections or bribes buy your way into public sector hiring while about a third agree to some extent (34.0% as opposed to 19.5% in 2008).<sup>60</sup> The trend is downward towards worsening of the public administration, which is ruled by the interests of the few to whom new recruits later remain forever indebted and loyal.

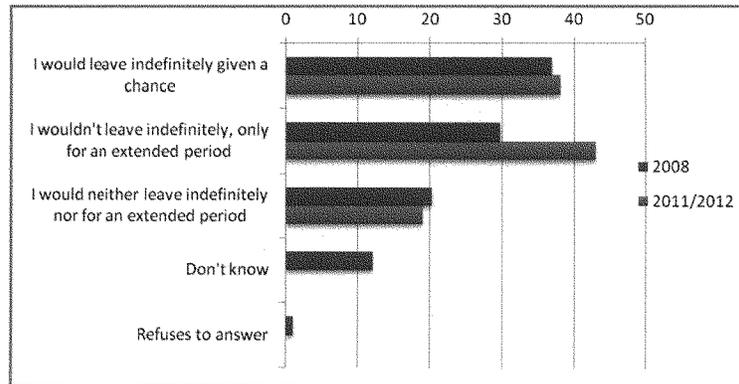
As a result, large parts of the population are considering leaving the country for an extended period of time or permanently. This sentiment also rose between 2008 and 2012.

<sup>58</sup> Centre of Civil Initiatives (2013).

<sup>59</sup> Ibid.

<sup>60</sup> Ibid.

Chart: *Would you leave the country for an extended period of time or indefinitely? (Comparison 2008 and 2011/12)*



Source: *Centre for Civic Initiatives (2013)*.

If the youth possessed the education or skills that are in greater demand abroad, these figures would have likely been even higher.

#### State capture suffocates the future

Complete deletion of boundaries between private and business interests of public officials and the public interest is a feature that characterizes all forms of state capture. In the state capture context, profits only have been privatized, while the losses are "socialized" (i.e., borne by society as a whole). During the period of institutional vacuum, absence of the rule of law and discontinuity of the state, the ethno-national elites were able to achieve full and effective control and influence over all key social institutions, putting up strong resistance to all reform initiatives, most of which came from the international community. It is often assumed that the political will for the EU accession and systemic reforms is there and that the problem lies solely in the lack of capacity.<sup>61</sup>

However developments since the failure of the April package of constitutional reforms in 2006 demonstrate genuine lack of the political will to implement the necessary institutional and economic reforms.

In the vast majority of reform processes, the matrix has largely been the same: after endless discussions and under strong pressure from the international community, even if the consensus on adoption of reform legislation has been reached, the implementation of this legislation is thwarted by failure to secure the necessary funding or by the inability to agree on the appointment of the management. Such was the case with the police reform and the establishment of state police institutions, with the provision of

<sup>61</sup> Pippidi (2011).

funds for the functioning of the state judiciary, establishment of the state-level anti-corruption agency, etc.

As Fukuyama rightly pointed out, all reforms are inherently political;<sup>62</sup> therefore it is about generating political will for reforms and not only strengthening capacities of the institutions. Leveraging and articulating the public's deep mistrust in the government through citizens' active involvement in decision making should be prioritized in order to avoid another wave of destructive protests like those of 2014. Past experience shows that simply calling on leaders to undertake reforms and to take responsibility is insufficient. Generating a genuine and articulated "internal demand" for reforms is key to achieving sustainable progress toward integrating the country into the EU. When it comes to the EU engagement, "until now the EU's transformative power has proved effective in integrating established states; now it is confronted with the challenge of integrating contested states."<sup>63</sup>

### Recommendations – a way forward

Based on the detailed analysis provided above and in order to make case specific and actionable points, this paper makes the following recommendations:

1. **The High Representative**, whose intervention was vital to state-building progress in Bosnia and Herzegovina during the first ten years after Dayton agreements were signed, now has to take a back seat in a reform process driven by European Union requirements but executed by elected Bosnian authorities. The Office of the High Representative should continue to shrink and eventually move to Brussels, conserving the Bonn powers for use only in a situation where peace and security are threatened.
2. **Governance structures** in Bosnia and Herzegovina are over-complicated, duplicative and too distant from the citizens. A decentralized structure consistent with the EU principle of subsidiarity should be the goal, thus reducing bureaucracy and increasing accountability and transparency:
  - a. In cooperation with the EU, an independent commission appointed by the state government should map state, entity, cantonal and municipal institutions and determine at which level functions need to be carried out.
  - b. Following that and under EU expert guidance, the BiH authorities should decide which level most effectively deals with a regulatory issue and annul duplication at other levels. Where feasible and consistent with accountability and transparency, devolution to the municipal level should be a priority.
3. In order for this process to succeed, **the political economy** of Bosnia and Herzegovina has to undergo important changes whose overall effect will be to ensure that the country's executive authorities begin to serve the interests of the citizens who elect them rather than their own.
4. Particularly important will be the following **political party and economic reforms**:
  - a. A new law on political parties should require them to adopt procedures that allow the membership to choose their leaderships in an open and democratic process;
  - b. Political party nomination of SOE managers and staff should be eliminated in favor of a merit-based system;
  - c. Subsidies and loans to SOEs should be limited by direct implementation of the EU State

<sup>62</sup> Fukuyama (2014).

<sup>63</sup> Rupnik (2011).

*Aid acquis.*

- d. Privatization at all levels should be pursued exclusively through internationally supervised processes.
  - e. Procurement by governments and SOEs should likewise be pursued exclusively through processes that meet international standards.
  - f. Red tape and administrative costs need to be cut dramatically. Public service hiring should be frozen to prevent further politicization.
  - g. Governments also need to be more open. Elected officials should be required to make annual statements of their assets; SOE budget and financial statements should be published.
5. The **justice system** needs to become far more independent and professional:
- a. The EU/Bosnia structured dialogue on justice should be revived by making a portion of EU assistance to Bosnia conditional on implementation of its recommendations.
  - b. The High Judicial and Prosecutorial Council (HJPC) should be appointed free of political influence in a process fully open to public participation and CSO scrutiny, monitored and verified by the EUSR.
  - c. The HJPC should rely on international expertise and close collaboration with counterparts from the EU in verifying the qualifications of judges and prosecutors, retiring and replacing those who do not meet the highest ethical and professional standards.
  - d. The judiciary at all levels should adopt work plans that eliminate backlogs and provide for prosecution of corruption, with major cases tried at the state level.
  - e. With EU assistance, key cases of grand corruption involving political leaders should be identified (especially within the areas of public procurement, privatization and major infrastructure) and processed before national judicial institutions as a matter of priority.
6. **Independent Institutions**
- a. Government grants to **media** should be ended and government-sponsored advertising should be placed in accordance with openly competed tenders.
  - b. The government's ombudspeople, regulatory agencies and auditors need strengthening.

Civil society has the same rights to operate in the country, as does in any other EU member state, including to receive funding. State subsidies to NGOs are to be awarded publically, following public calls, transparent award criteria and results published in the press.

**List of Abbreviations**

BiH – Bosnia and Herzegovina  
CEE – Central and Eastern Europe  
CIA – Central Intelligence Agency  
CIN – Centar za istraživačko novinarstvo (Center for Investigative Reporting)  
CSO – Civil Society Organisation  
DPA – Dayton Peace Accord  
EU – European Union  
EUSR – European Union’s Special Representative  
FBiH – Federation of Bosnia and Herzegovina  
FDI – Foreign Direct Investment GDP  
GDP – Gross Domestic Product  
GNI – Gross National Income  
HJPC – High Judicial and Prosecutorial Council  
KM – Konvertibilna marka (convertible mark)  
LPO – Law on Political Organisations  
OHR – Office of the High Representative  
OSCE – Organization for Security and Cooperation in Europe  
PEFA – Public Expenditure and Financial Accountability Assessment  
PIC – Peace Implementation Council  
PIC SB - Peace Implementation Council Steering Board  
RS – Republika Srpska  
SAI – Supreme Audit Institution  
SBiH – Stranka za BiH (Party for BiH)  
SNSD – Stranka Nezavisnih Socijaldemokrata (Party of Independent Social Democrats)  
SOE – State Owned Company  
TI – Transparency International  
UNCAC – United Nations Convention Against Corruption  
USD (US\$) – United States dollar  
VAT – Value Added Tax  
WB – World Bank

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June 17, 2016

The Honorable Roger F. Wicker  
Co-Chairman  
Commission for Security and Cooperation in Europe  
Washington, DC

Dear Co-Chairman Wicker,

At the May 25th Commission for Security and Cooperation in Europe hearing “Combating Corruption in Bosnia and Herzegovina,” you asked that I provide additional details on the successes of the U.S. Enterprise Funds in Europe and Eurasia.

Starting in the early 1990s, following a Congressional mandate, the U.S. Agency for International Development established ten investment funds throughout Central and Eastern Europe and the Former Soviet Union with total authorized funding of nearly \$1.2 billion, collectively known as the Enterprise Funds. These funds were intended to jumpstart capitalism and entrepreneurship, as the funds would provide equity investments in newly privatized companies or start-up businesses. These ownership stakes would enable the fund managers to participate in the governance of the enterprises, which provided opportunities to model best practices in law-abiding corporate governance, consistent with free-market principles. After a period of ten or more years—during which time many of these businesses thrived and generated jobs—the funds would sell off their ownership stake. In many cases, the funds made gains on their investments when they sold these stakes.

Enterprise Funds are an innovative development technique that achieved sustainable economic development impact while catalyzing additional investment resources. They also generated significant income that enabled the U.S. later to endow longer-term Legacy Foundations, which continue to pursue the overarching objective of private sector development, while also returning substantial sums to the U.S. Treasury. The following is a summary of the substantial economic and development impacts provided by funds originally endowed by the U.S. Congress in Europe and Eurasia:

- Over 300,000 jobs were created or sustained through investment and development activities;
- Significant development capital was provided to SMEs and entrepreneurs operating in early-stage transition countries where private investment capital was limited, which helped create an environment where the culture of private enterprise could flourish;
- The Funds and their portfolio companies modeled good corporate governance and ethical business practices demonstrating that it was possible to operate successfully while paying taxes and not paying bribes;
- \$9.8 billion of additional capital was raised from co-investors and the creation of new private sector investment vehicles over the life of the Funds;
- To date, the Funds have returned \$225.5 million to the U.S. Treasury; and
- Remaining proceeds of approximately \$1.2 billion have funded nine long-term philanthropic “legacy” foundations, which continue to promote private sector development, and continue to build goodwill between the US and their host countries after USAID has exited the country.

The Enterprise Funds have demonstrated significant success in achieving their original goal of promoting economic growth and private sector development in the region. These achievements include a wide range of tangible and intangible development accomplishments which are not captured by traditional financial indicators such as profit and return on investment. Still, the Enterprise Funds managed to overcome the challenges of investing in transitioning economies while achieving, collectively, positive overall returns on their investments even though this outcome was not the primary focus of the initial mandate.

As might be expected, the efficacy of individual Enterprise Funds varied by country, based on the economic and political conditions on the ground, as well as the overall investment strategy and specific investment decisions made by each Fund’s Board and management team. The countries in which enterprise funds operated benefited significantly from an economic development perspective. Some of the notable achievements include:

- **The Polish-American Enterprise Fund** established the largest micro-finance institution in Poland, disbursing \$183 million through 69,275 loans;

- **The Romanian-American Enterprise Fund** pioneered investment banking to support privatization of state owned enterprises, including two banks and energy companies, attracting over \$200 million in FDI;
- **The Baltic-American Enterprise Fund** developed the necessary legal structure to support an annual \$100 million consumer mortgage industry and the first mortgage backed securities in Eastern Europe;
- **The Bulgarian-American Enterprise Fund** helped develop the necessary legal structures for mortgage backed securities and real estate investment trusts; and
- **The Albanian-American Enterprise Fund** established a nation-wide bank in Albania, providing Western-style credit cards, ATMs, mortgages, commercial banking services, and \$50 million in syndicated loans for public/private infrastructure projects.

Thank you for your interest in this issue and for the opportunity to testify.

Sincerely,

Thomas O. Melia  
Assistant Administrator  
Bureau for Europe and Eurasia



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