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**SMALL AND MEDIUM ENTREPRISE
SECTOR DEVELOPMENT IN BOSNIA-
HERZEGOVINA**

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1. Importance of SMEs Sector

As soon as economy has for a goal the satisfaction of people's needs on the highest possible level (maximization of consumption) in a frame of the available possibilities (resources and technologies), it is clear that the best way to express the importance of complexed, and an economic subject, which SMEs are, is through their contribution to achieve that goal. Since this scope is extremely GDP as a merely used indicator is not appropriate enough, the importance of SMEs should be viewed also from the point of its contribution to achieve others, non GDP derived goals, as the employment growth, the economic stabilization and the export growth.

Regard to all these aspects e.g. indicators of their measuring, the SMEs until the 1980s were considered as marginal, and inferior compared to the large companies. But during the crisis and recession in the 1970s and the 1980s, when the large companies have started to base their efficacy, SMEs proved to be more flexible and also efficient, and became the subject of public interest and theoretical economic analysis. Thanks to the results shown and proved since then, the SMEs today are no more considered as inheritance of pre-capitalism development stage, but as an important sector of economic activity which in certain cases plays the forcing role in regional economic growth (just to mention the Italian example of Emilia Romagna region).

In addition to these quantitative, impersonal indicators of the importance of the SMEs, should be also be mentioned.

Establishing and managing a small firm offers to its owner and manager the possibility to make his/her dreams to become a reality. Entrepreneurship, in that case, as the way of living, we can consider as artistic, and it is obvious that it means more than working just in order to survive.

The existence of SMEs and their specific features offers an advantageous working environment not only for their owners and managers but also for all employees. Smaller and simpler work units, provide more (human)-friendly work conditions to the workers; the sense of belonging to the firm, more direct and clear involving and contributing to the firm's final result, which often does not occur in large, impersonal companies. It is particularly evident during the first stages of firm's life cycle.

Because of their size and vulnerability to the market changes, SMEs are forced to steady innovating. It is clear that due to limited financial sources, the SMEs are not able to invest in large, basically scientific research projects, as are large companies, but that is why they are a source of continuous final improvements of products and processes. Innovating for them means surviving on the market.

The importance of SMEs is also great if we take into account regional development. SMEs often embody the continuity of traditional artisan production, typical for some territorial areas, and closely tied to the family relation. On that way the growth of the SMEs involved in such production means growth and industrial development of the area without breaking the connections with the local environment and close adaption to the existing social and environmental local context.

What are those particular characteristics of SMEs in comparison with the large companies. Logically both, as the advantages and the disadvantages are the consequences of the size as "diferentia specifica". The first advantage is about their flexibility, both in the sense of organizational and managerial structure, which is thanks to its simplicity obviously more flexible; and production where the higher flexibility is the result of the lack of large scale production. The smaller firms are more responsive to the changes on the side of demand, and to the technology changes. Their possibility of a quick response, and shift to the new products and technologies is greater.

The small-scale production gives SMEs the opportunity to specialize in the satisfaction of particular customers needs, and preferences towards products and services, in which large firms are not interested. That is why small firms often compete on smaller market segments offering a so-called niche products. It is case with both

consumer, specialize their operation if they do not have access to other SMEs that in turn have concentrated their activities in a complementary specialization. It's in this sense that the local level should be dedicated to encouraging the development of the resources (in terms of financing, technology, human resources needed to enable them to become competitive players). Providing these resources allows the firms to remain small because they may rely on "externalities", and helps to promote increased specialization of both firms and surrounding institutions.

However, it is necessary to develop the complementarities among the firms and to sustain a process of relative specialization of the SMEs. This is a bottom-up approach, because it is necessary to identify a group of firms (either by sectorial or technological affinities) and to establish a reciprocal trust to allow the individual firms to feel themselves a part of a common body.

The reorganization of a structural funds demonstrates that the success of such initiatives depends of the direct knowledge of the local context and the capacity to intervene to create a progressive coalitions in specific territorial and technological frameworks. This means creating local networks of productive firms, service companies, local authorities, and universities. In many cases, the establishment of one or more service centers with the role of meeting the converging interests and creating the basis for cooperation and social trust has realized this type of intervention. One of the fundamental functions of the national level of policy making is to stimulate this local networking by favoring the specialization of these networks while encouraging the national networking of the local networks.

Careful attention must be dedicated to the creation of human resources within the local and the national innovation system. This means not only creating the training centers and the universities, but above all it means the creating of projects at the national level which combine universities, research institutions, and local service centers. Crucial to the success of this policy approach is the ability to create new firms and, on the other hand, to promote the relationships between the firms and the educational and research system which encourages the multiplicity of actors present in the production system

All the member countries, and the EC Commission, support start-ups of the new firms. Most financial incentives have been established during the 1980s, but in most cases, these direct financial support schemes have been integrated and in several cases substituted by their own businesses. The EC Reports on State aids the industrial sectors showed clearly that there is a trend from financial support to service supply, from central government to local authorities (EC, 1990).

Regional governments try to create a favorable local environment for industrial development through direct involvement of all the local public and private actors for the definition of common development programs. These programs have to be supported by the integrated use of complementary policy instruments offered by regional, national, and Community authorities to promote industrial development and innovation, such as training programs, export consortia, service centers, common research and application technology projects.

Local partnership is the key issue for the structural funds reform. This principle is crucial because it outlines that the development of the less-favored areas results from a variety of complementary projects, activated by different levels of public authorities, with the direct involvement of private sector, entrepreneurial associations, local organizations that shape the local community as an environment. This approach assumes that the basic externality for the development of the local forces is provided by the local community, with its history, traditions and collective norms. These elements can establish the collective trust that it is necessary for the growth of the economy.

Looking at the elements incorporated in the-Treaty-of Maastricht, and analyzing the programs launched by the Commission, it is evident that the European Community considers industrial innovation as a dynamics to be a result of collective, systemic and cumulative effort.

Obviously, SMEs in formerly separate countries have grown in diverse circumstances. The European firms work in a well-established institutional contexts, which are framed by the national institution of education, training, research and the diffusion of technical progress. Thus, the capabilities of the firms are strongly affected by the local externalities and by the national context.

The policy approach proclaimed by the Commission is therefore based on the convergence of national systems of the innovation-educational system, research networks, training support, technical and market information assistance - and on the support from the national and the local authorities for networking potentially innovative firms, both on the local and transitional levels, which could then become the drivers of endogenous growth.

Therefore, the new European approach to the industrial policy is not devoted to the supporting individual firms but rather to the identifying methods of public interventions which creates productive relations on the local level. Attention is now focused on the variety of relations which frame a system of firms and local institutions within which interventions can be aimed to the encouraging cooperation and of giving a direction to the process of reciprocal specialization of those involved in production.

Various levels of policy makers are involved. The most macro level is that of the trade area, and this is the level at which the policy regarding the creation of the Single Market takes place. However, it must also provide the guidelines for the economic activity within its borders. This includes antitrust regulation and a general pro-competition stance. Standards for the quality and for the consumer protection must be determined at this level.

A special issue in a context of regulated opening is product standardization. This is clearly top-down process, but in order for this to work, there must be an analogues process from the bottom-up that indicates the existing technological level of the firms and designs an acceptable plan to achieve the new standards. Clear rules governing the economic behavior and the access to functioning institutions ensures that firms in dominant position may not abuse their power in the economic arena. This provides the needed stability to allow the SMEs to operate.

Technical standards do not mean mass production of low-quality goods. Products must be made corresponding to given technical standards to ensure their marketability within trade area and to prevent each SMEs from having to start from scratch to try to determine what will work and what will not. This - is not small saving in terms of costs.

Standards are also imposed upon manufacturers to safeguard consumers. On one hand, this may be seen as a burden (more costly materials, special testing, etc.), but it is linked to a certification process that allows the producers to ask higher prices for their certified goods.

More specifically, the regional trade agreement must also establish the guidelines for the sub-contractual relationships. These regulative measures help setting the parameters within which the SMEs may become more specialized and may engage in varied forms of cooperation with the knowledge that other firms and institutions are also subjected to the trade region's rules.

Open markets create new opportunities for the firms if they are able to adjust to draw advantage out of them. Small firms may be able to adjust to the new market demands more quickly than the large firms can, and the small firms may be more appealing to the prospective foreign partners in terms of joint ventures and even direct investments. Policy should be aimed to help the SMEs catch-up in terms of technology, human resources and processes of internationalization.

Policy dedicating to create a favorable conditions for SMEs to participate actively in an open market must be put in place by the various national governments. Also on the national level there must be policies that encourage SMEs to become more specialized. But this brings us to the local/regional level in which the SMEs will not

3. Bosnia and Herzegovina - General Overview

3. 1. Geographic determinants of the economic environment and country's natural resources

Bosnia and Herzegovina is a small country, located in the central part of the Balkan peninsula, covering an area of 51,129 sq. km. In the West and North sides it borders with Croatia (931 km), in East and South sides with the Federal Republic of Yugoslavia (606 km).

BiH territory is endowed with considerable reserves of natural resources, which have been the basis for the industrial development of the country. Most important energetic sources are the coal reserves (3.9 billion tons), of which 63 percent is constituted of lignite, and 37 percent of brown coal, Bauxite reserves stand on about 86 million tons, lead and zinc on about 60 million tons. Non-metal raw material deposits like rock salt are numerous. There are also significant deposits of barite, asbestos, china clay, gypsum and building material (decorative stone, limestone, dolomite, clay and gravel-sand). Iron reserves amount to 718 million tons.

2.7 million hectares or 53 percent of the total land area is classified as forest land. High forest represent the greatest value. On 1.3 million hectares timber mass structure is unfavorable, with deciduous trees more spread than conifers, it results in a shortage of timber mass for both woodworking and pulp industries.

The hydro-power-potential is significant, with about 9000 km of water courses, including the border rivers Sava and Drina. There are also a number of lakes and reservoirs for power station and industrial plants, like Modrac near Tuzia. The hydra-power potential, particularly of some rivers as Drina, is far from having been fully utilized, both in terms of energy and irrigation purposes.

3. 2. Population

BiH has a relatively small human resources basis. The 1991 census accounted 4,354,491 inhabitants (70 percent more than in 1948), living in 1,208 households, with an average of 3.6 persons each. Population density was 85 persons per sq. km. with significant deviations: from 6 inhabitants per sq. km in the less inhabited regions, up to 435 in the Tuzla area. The mortality rate has decreased from 14.5 per thousand in 1953, to 6.6 per thousand in 1988. Infant mortality rate has decreased even more from 143/1,000 inhabitants in 1953, to 18/1,000 in 1981. Illiteracy rate, in the same period decreased significantly, by 1991 it was 14 percent of the total population, compared with 48 percent rate in 1948.

In 1991, the share of active population (in age from 18 to 65) was 38 percent. The composition of the population has drastically changed after the 2nd World War: from 1948 to 1991, the share of population living in urban areas increased from 12.43 percent to 36.2. In 1991, the most populated towns were: Sarajevo (527,049 inhabitants), Banja Luka (195,692 inhabitants), Tuzla (131,168), Zenica (145,517), Mostar (126,628), Doboj (102,549) and Bihac (70,732).

Because of the war, there is not precise data on the present-day population. The lack of official estimates on the population is due to the absence of an unified institute able to obtain data for the entire territory of BiH.

Current estimations were done on the basis of data from the statistical institute of the Federation of BiH and from that of the Republika Srpska: the total population of both entities would be 4.18 million, including more than 1.2 million refugees. Estimated residents amount to 3.2 million, 78 percent living into the Federation, and 22 percent into the Republika Srpska.

The war has taken a heavily toll on population. About 250,000 persons had been killed, more than 200,000 injured and 13,000 permanently disabled. The World Health Organization (WHO) estimates that about a third of the population suffers from post-trauma stress disorders.

War-related population movements, which were intensive and took various forms, are now a great obstacle for the achieving of a figure, at least approximate, on the volume and the structure of the population. Besides, 1.2

million refugees are living abroad and more than half a million people have been displaced within the territory of Bosnia and Herzegovina. Another large number of inhabitants had to move within the same city: this phenomenon is characteristic in the regions of heavy war casualties, first of all the capital Sarajevo, where entire suburbs had been displaced into safer areas of the city or where minimal living conditions simply existed.

Even in normal conditions, a statistical appraisal of so intensive changes is difficult. In war time and with the actual division of the country it could not be expected at all. In fact all the forms of the communication virtually does not exist, even between two suburbs of the same town (in Mostar, for example), not to mention the inter-entity communication, therefore the statistical figures presented here, not only those concerning population, but statistics in general, should be considered mere estimations, without any possibility to find out how precise or rough they may be.

With the cessation of the hostilities the losses of population have not stopped. The presence of landmines and unexploded devices in many of the front-line areas are the most dangerous factors for personal security, but landmine contamination is also an issue for all aspects of the reconstruction, resettlement and community development. Although the information is extremely limited, rough estimation of the number of landmines in BiH ranges from 1.5 to 4 million. More than 15,000 minefields have been already identified, but many of the existing minefields maps and records are unreliable, while the mine fields have not always been mapped. The clearing of all mines will take years, probably decades, and will be very costly. Despite the efforts done until today, many mines remain and a major clearance effort is undoubtedly required to reduce the risks for communities and make it possible the reconstruction implementation and the resettlement projects.

All the sectors of the economy have suffered for the great loss of human resources resulting from emigration, military mobilization and war casualties, Unfortunately the largest share of the burden bear the youth. In the existing circumstances, it is hard to expect that the causes of the continuing deterioration of the human potential are going to be removed fast. A recent demographically study forecasts a period of 15-20 years as necessary to reach the pre-war population level in Bosnia and Herzegovina.

3.3. Political Framework

The basis of the new BiH State is the Peace Accord stipulated in Dayton (Ohio, USA) in November, 1995, which provided for the cessation of military activities. The Peace Agreement, formally signed in Paris, in December 1995, affirms the existence of BiH as a unique State (with one seat at the UN and in other international organizations), within the borders it had as a federal unit of the former Yugoslavia: the same borders that had been already internationally recognized after the declaration of independence in April 1992.

The central part of the Peace Agreement is the new Constitution, which regulates the internal division of the country into two Entities: the Federation of BiH and the Republika Srpska, according to the ethnic division resulting after the four years of war. The Federation of Bosnia and Herzegovina gathers the Bosniac-majority area and the Croat-majority area, that include 51 percent of the entire territory. The Republika Srpska is formed by the Serb-majority area and includes 49 percent of the territory. However, the decision on the appartenance of the city of Brcko has not been made yet: currently this area is under the protection of the International Police Task Forces and it is administered by a representative of the International Community.

The results of the local elections, held in September 1997, have significantly deviated from this "51%-49%" principle, but the real establishment of the new administrative bodies and the work of the local administrative units are being implemented very slowly, because it is very difficult to overcome the division of the territory and the power at the ethnic level.

State Institutions

The Constitution provides the division of the Power into three branches: executive, legislative, and judiciary. At the State level, the main institutions are: the Presidency of BiH, the Council of Ministers, the Parliamentary assembly, the constitutional court and the sole central Bank as national monetary authority.

On territorial basis institutional competencies are break down on three levels: federal level, entity level, and local level. The central government has the authority on policies of foreign affairs, foreign trade, customs, monetary stability, international financial obligations, immigration policy, refugee and asylum, international and inter-entity law enforcement, international and inter-entity communications and transport and on the airtraffic control.

The Federation and the Republika Srpska have competence on defense policy, internal affairs (police) justice, tax and customs administration and on the policies of agriculture, industry, commerce, energy, transport and communications, education, health and social services. The Entities also have authority over refugees and displaced persons and over the reconstruction process. Any governmental function nor expressly assigned by the Constitution to the State institutions is under the authority of the Entities.

Cantons and the municipalities are responsible for public service provisions on health, education and for some social expenditure.

Finances

The State institutions do not have own revenues, but they are financed by the contributions of the Entities: two-thirds from the Federation, and one-third from the R.S. Each year on the proposal of the Presidency, the Parliamentary Assembly must adopt a budget covering the expenditures required to run the State institutions. If the budget is not approved in due time, the budget of the previous year acts as a provisional basis.

The Central Bank

The Constitution calls for establishing of a sole Central Bank issuing a new currency that will be the legal tender on the whole territory of BiH. It should bring to end the existing situation where on 50,000 sq. km of territory four currencies are circulating: the Bosnian Dinar, the Croatian Kuna, the Yu-Dinar, and the Deutsche Mark. The new Bosnian currency, called "Konvertibilna Marka" (KM) is pegged to the Deutsche Mark (DM) at 1:1 rate and the peg is guaranteed, i.e. the Central Bank holds 100% of had currencies reserves backing its own liabilities. The currency board arrangement makes impossible the use of a monetary policy to stimulate economic growth and stability. This "independency" of the Stfite monetary authority is further emphasized by the fact that in the first six years of operating the Governor of the BiH's Central Bank must not be a citizen of BiH, neither a citizen of any neighboring country, but he is appointed by the IMF. In less than one year (common Central Bank has been established in August 1997) the Governor has been already changed.

3.4. Economy

3.4.1. Pre-war review

Before the war, the main determinants of the BiH economy were the endowments of the natural resources, the mixed socialistic-marketing system based on self-management and with a relative freedom of enterprises, the federal economic policy and the position of the country within the Yugoslav system. The structure of the so called Gross Social Product (a macroeconomic indicator widely used in the Yugoslav social accounting, which differed from the GDP since it did not included some services), shows the prevalence of industry. The large conglomerate producing textiles, tools, automobiles, industrial equipment, lumber, processed food, beverages, chemicals, and building equipment contributed for almost half of BiH GSP (8.3 billion USD in 1990). The construction sector contributed for about 7 percent of GSP. Agriculture had a minor role: less than 10 percent of GSP. Agricultural development was constrained by the limited extension of cultivable land (1,589 million hectares), the unfavorable climate and the economic policy, which neglected it. According to the international standards, BiH was on the verge of the critical subsistence level. Agricultural production covered only 50 percent of the national needs and about 25 percent of the commercial consumption (Economic Map of Bosnia and Herzegovina, Chamber of Economy of BiH, Sarajevo, June 1996).

The services sector was relatively underdeveloped, like in other socialist countries. Although its contribution to GDP and employment has slightly increased in the late 1980s, thanks to the growth of trade and tourism, the sectoral total turnover was still very low if compared to the available capacities and the potential of the development.

The BiH economy was highly dependent on the Yugoslav system, with considerable importance of inter-republic trade. In 1986, the total value of the goods purchased by Bosnia-Herzegovina from the rest of Yugoslavia was four times the total value of BiH imports and 38,6% of the final consumption consisted of goods originating from the other republics. These connections were particularly important in the energetic and military sectors, as well as in agriculture. Thanks to natural endowments, BiH was net exporter of electric power, but a large part of the investments in this sector came from the other republics.

For strategic reasons, the Yugoslav military sector was concentrated in BiH. By 1991 military production sited in BiH accounted for about 60 percent of the Yugoslav defense plants total output. This was the segment of the industry where the degree of the inter-regional integration within Yugoslavia was the greatest.

In 1990, BiH export outside the former Yugoslavia amounted to 2.05 billion USD, equivalent to 14,4% of the total Yugoslavian exports. It gave to BiH nearly 200 million USD of trade surplus.

BiH foreign trade by commodity^a, 1990 (million USD)

	Exports fob	Imports fob
Food and live animals	25.5	102.6
Beverages and tobacco	16.6	22.4
Other raw materials	369.2	125.5
Fuels and lubricants	29.2	596.1
Vegetable oil	0.0	5.7
Chemicals	193.4	181.0
Manufactures ^b	638.5	271.3
Machinery and transport equipment	427.8	433.9
Manufactures (miscellaneous)	356.2	24.1
Others	0.1	4.2
Total	2,056.1	1,866.9

^aGoods classified by ITC definition; ^bOf which clothing and footwear are the most important subcategories
Source: Statisticki Godisnjak Jugoslavije (quoted from EIU country Profile 1996-9, London 1997)

3. 4. 2. War consequences on the economy

The war has brought BiH economy almost to a standstill. In 1995, the Bosnian per capita income had fallen to 500 USD, barely a quarter of the 1990 level. In 1994, exports were less than 200 million USD and imports to approximately 700 millions USD.

The war has destroyed much of the physical infrastructure of the country and disrupted the economic systems that were in place. A large percentage of the population has become partly dependent on humanitarian food aid and there have been extensive damage to water supply, power generation, roads and telecommunication facilities. Estimates on actual conditions in some economic activities follow.

Industry: before the war, BiH had approximately 1,000 industrial and mining enterprises employing around 450,000 people. Since then, 45 percent of all industrial plants have been destroyed and even more have been looted. The oil refineries have been even more devastated: only one of four remains.

Power supply: the electric generation capacity has fallen to approximately 20 percent of the pre-war level and coal production to less than 10 percent. Natural gas has assumed major importance for the city of Sarajevo. In 1994, gas consumption constituted 70 percent of all energy consumption.

Telecommunications: the damage to the existing system is estimated in 500 million USD and completion rates for daytime international calls have fallen to 1-2 percent. By 1995, there were only about 260,000 telephone connections and 400 international lines in operation, before the war they were 375,000 and 4,000 respectively.

Housing: sixty-three percent of the housing stock has sustained the same damage, and eighteen percent of the units have been destroyed. In addition, one-third of the health care facilities and half of the school buildings have been heavily damaged.

The three and a half year war, apart of enormous number of victims and destruction, resulted also in a division of the country in three parts - ethnic regions of Bosnia, which fared differently during the war, and had diverse economic systems, as well. The area, during the war, controlled by the Bosnian government suffered the most important devastation: industrial production fell to 5 percent of the pre-war level.

The Croat majority areas preserved most of its economy by maintaining close links with the neighboring Croatia. In this area the infrastructure is largely undamaged and the industrial production has decreased by 15 percent only.

In the Serb majority areas, the economic activity has declined severely the economic embargo imposed by the for the international community and for the damages the basic infrastructures.

Major economic indicators before Dayton agreements

	1991	1994	1995
GDP (million USD)	8,670	1,538	2,105
Real GDP growth (%)		-	33
Income per capita (USD)	1,979	357	501
Unemployment rate (agriculture excluded)			
The Federation of BiH	27	-	53
The Republika Srpska	27	-	53
Average wages (DM)			
Federation	666	-	94
Republika Srpska	666	-	51
CPI, % of change end of the year			
Federation	114	-	-12
Republika Srpska	114	-	133
Trade balance (% of GDP)			
Exports	24	9	15
Imports	-19	-48	-63
Balance (foreign trade deficit)		-8	-9
Foreign debt (USD m)	1,057	3,245	3,518
Debt service ratio (%)		196	135

Source: *Bosnia and Herzegovina; From recovery to sustainable growth*, World Bank study Washington, D. C. May, 1997

3. 4. 3 Reconstruction program

Activities on preparation for economic recovery and reconstruction program started in late 1995, under the umbrella of IMF and World Bank.

The program should be implemented within a pattern of extremely complex circumstances, given not only by the intensity of destruction and war damages, but also by many other factors like the unprecedented political framework, the transition to the market economy, the legacy of the former system, the lack of the resources, etc. So the reconstruction task is extremely complicated and requires huge investment, skills, time and political will. The first goal of the reconstruction program is the recovery of the basic infrastructures to create the necessary conditions to restart the industrial production and generate employment, as well as to support the establishment of the basic institutions responsible for transition to the market economy.

The International Community has pledged 5.1 billion USD over a four-year period for the priority reconstruction. The schemes below show the dynamics of the investments and their territorial and sectoral distribution.

Year	amount of investment (billion USD)
1996	1.03
1997	1.60
1998	1.40
1999	1.09

total investment into the Federation of BiH	USD 3.7 bn
total investment into the Republica Srpska	USD 1.4 bn

Sectorial distribution of the total investments (million USD):

	million USD	% distribution
1. Water supply	380	7.5%
2. Electric power rehabilitation	893	17.5%
3. Transportation	698	13.7%
4. Telecommunication	567	11.1%
5. Agriculture	330	6.5%
6. Industry	400	7.9%
7. Education	275	5.4%
8. Health care	540	10.6%
9. Housing	600	11.8%
10. Demining	200	3.9%
11. Support for governmental institutions	30	0.6%
12. Social funds	80	1.6%
13. Demobilization	100	2.0%
Total	5,093	100.0%

In order to provide the financial resources, some donors' conferences have been organised with the participation of the international organisations, foreign governments and NGOs. The World Bank and the European Commission are in charge for the organisation, coordination, implementation and supervising of the conferences. They closely cooperate (not always successfully) with other donors involved in various ways in the reconstruction and with representatives of the Bosnian government at all levels.

The first donors' conference was organized in December 1995: 1.4 billion USD were pledged for the reconstruction activities in the first year of programm implementation. In April 1996, the second conference followed providing finance for the programm continuation during that year.

Program implementation has shown positive results: in 1996, GDP grew at 50 percent rate, although from a very low levels. The industrial production has also grown significantly, but it was still far from its pre-war level. The employment and the level of average wages increased and the population became less dependent on the humanitarian aid and started to return to a normal life. However, despite the initial positive results, obstacles and difficulties to the programm implementation are still numerous.

The division of the country on ethnic basis and the reluctance to cooperation among the different parts are the greatest obstacles, as the slow progress in the civil aspects of the Dayton Peace Agreement is demonstrating.

The resistance to the establishment of common State institutions make impossible the refugees return and there is a lack of an institutional framework regulating the economy and all the other aspects of the community life. Uncooperative behaviors are characteristic of the three national parties which share the power in Bosnia and Herzegovina. Therefore, the International Community has put in place new measures aimed to force the local powers to coordinate themselves in the reconstruction effort.

The financial aid has become conditional, being guaranteed only to those who show will and results in the Peace Accords implementation and not solely at the State level, but also at the level of municipality authorities. In addition, the Conference on Peace Accords Implementation, held in Bonn in December 1997, has given larger authority to the International Community's High Representative (actually Carlos Westendorp has replaced Carl Bildt), who is responsible to coordinate and supervise the implementation of the civil aspects of Peace Accords. For example, after months of long fruitless discussions in the Presidency, in the Council of the Ministers and in the Parliamentary Assembly about the design of the new national flag, he decided by himself the final solution.

Changes in the political leadership of the Republika Srpska represent another positive result determined by the conditional policy of financial support distribution. During the first year of reconstruction this Entity received less than 5 percent of the total international aid because of the scarce collaboration of the political leaders, the protection given to the war criminals, the obstacles posed to refugees return and the lack of implementation to the projects that needed inter-Entity cooperation.

With the settlement of President Biljana Plavsic and the new local authorities, after the elections of November 1997, who seem to be less radical, but more pragmatic and cooperative than their predecessors, changes in the political situation of the Republika Srpska have been significant, but not sufficiently stepped forward. However, the World Bank have planned to invest about 70 million USD exclusively in the Republika Srpska, along with other projects including both the Entities that are already under implementation.

Unfortunately the lack of cooperation is not exclusive of the RS government, also the other Federation partners show this attitude. It is visible in the slow building of Federal Institutions and in the deficiency of political and legal conditions to support reconstruction, economy and civil life recovery. These obstacles have already produced negative results in 1997, with slower reconstruction activities and GDP growth, and represent a serious danger for the peace process and the future life in Bosnia and Herzegovina.

Update on the Reconstruction Program Implementation

While the delay in holding the 3rd donors' conference made less intense the reconstruction effort, the activity continued during 1997 on the projects previously agreed. According to the World Bank, in February 1998, halfway of the four-years reconstruction program, twenty projects were under implementation for a total cost

of 1.46 billion USD. For these projects the WB has committed about 435 million USD of concessionary funds from the International Development Association (IDA).

The direct involvement of the WB in a wide range of sectors has significantly attracted cofinancing from other donors. At the end of February 1998, the number of contracts underway with the WB financing and funds in trust had grown to 2,553, corresponding to the sum of 350 million USD.

Bank funding represents, in average, one third of the total cost of the projects supported by the WB, which uses its own funds as "seeded capital" ensuring a broad geographic scope and development impact, thanks to the close partnership with other multilateral and bilateral donors.

Of the total of 20 projects currently under implementation, eleven are joint projects for both the Entities. They include education, central heating, mines clearance, demobilization, public works, local initiatives, primary health-care, emergency gas recovery and emergency industrial recovery. In addition, following the new course of the Republika Srpska leadership authorities, swift economic recovery has been promised and the level of reconstruction investments are sharply increasing.

The projects implementation is under responsibility of State and Entity governments, which have established Project Implementation Units (PIUs), for that purpose. In January 1998, using the sale World Bank's funds, contracts valued at 201.3 million USD were completed (fully implemented). An additional 37.6 million USD of contracts had been assigned and are currently under implementation.

Together with a total of 35.7 million USD of the contracts being procured, other 274.6 million USD, or the 82 percent of the total approved World Bank funding for the reconstruction (excluding budget support) has been let for bidding to date. All the projects enjoy a large financial support by other donors, some of which entrust their funds to the World Bank for administration. Including such funds, the value of contracts completed or assigned under the World Bank management up to date is USD 348.9 million.

The implementation summary and the approved projects currently under implementation are presented in the following tables:

Implementation Summary (January 31, 1998)

Contracts	Total costs (million USD)	WB own funds (million USD)	other WB- managed funds (million USD)	Total WB- managed funds (million USD)	WB- managed funds on total costs (%)
Completed	463.6	201.3	97.3	298.6	64.4%
Contract signed	140	37.6	12.7	50.3	35.9%
Being procured	137	35.7	26.7	62.4	45.5%
To be procured	313	61	40.2	101.2	32.3%
Financing gaps	286.4	0	0	0	0.0%
Budget support	119	99	20	119	100.0%
Total	1,459	434.6	196.9	631.5	43.3%

Approved Projects in Implementation

Project Name	total costs (million USD)	WB own funds (million USD)	other WB- managed funds (million USD)	total WB- managed funds (million USD)	WB-manage- funds on tota costs (%)
Emergency Recovery	160	45	64,6	109.6	68.5%
Farm Reconstruction	50.4	20	8.2	28.2	56.0%
Water, Sanitation, Solid Waste	74.5	20	5.2	25.2	33.8%
Transport Reconstruction	163	35	3.5	38.5	23.6%
War Victims Rehabilitation	30	10	3.2	13.2	44.0%
Education Reconstruction*	32.8	10	0.7	10,7	32.6%
District Heating Reconstruction*	44.5	20	0.3	20.3	45.6%
ElectricPower	196.4	35.6	10.1	45.7	23.3%
Landmine Clearence*	67	7.5	5.8	13.3	19.9%
Housing Reconstruction	60.4	15	13.8	28.8	47.7%
Demobilization/Reintegration*	20	7.5	1.4	8.9	44.5%
Public Works and Employment*	45	10	12.7	22.7	50.4%
Local Initiatives*	18	7	9.5	16.5	91.7%
Essential Hospital Services*	33.5	15	5.2	20.2	60.3%
Emergency Industrial Restart*	50	10	14.5	24.5	49.0%
Second Transport Reconstruction*	184	39	10.9	49.9	27.1%
Second Education Reconstruction*	11	11	0	11	100.0%
Reconstruction Assistance Project	65	17	7.3	24.3	37.4%
Emergency Gas Reconstruction*	43.5	10	0	10	23.0%
Transition Assistance Credit	110	90	20	110	100.0%
Total	1,459	434.6	196.9	631.5	43.3%

*joint Federation and Republika Srpska projects

Source: *The World Bank, Bosnia and Herzegovina Priority Reconstruction Projects - Update, February 1998.*

3. 4. 4. Current macroeconomic situation

Despite some improvement in the living conditions of the population and in the economic and the social situation, the reconstruction task ahead is still enormous. About 90 percent of the damaged housing stock remains unrepaired, at least 360,000 people in the country are displaced and without a proper accommodation. More than 50 percent of the population is still dependent on humanitarian aid because of the unemployment and low salaries. The resumption of roads and railways has been partial and uneven. As mentioned above, the obstacles to economic recovery are not only related to the wartime destruction and the lack of finance, but are also of a political kind. This explains why, for example, the railway traffic has been resumed only partially and with huge delay, although the system was technically ready to operate.

The third International Donors' Conference, in late July, raised 1.2 billion USD - some 200 million below the target - in grants, aid and soft loans for the continuation of the 1997 reconstruction program. Some 1,06 billion USD of the total pledged is for the reconstruction projects, while the remaining 140 million is earmarked for the peace implementation activities. During the conference, to point out the political obstacles that delayed this event, it was emphasized again that only those who comply with the provisions of the Dayton peace agreement

will be given access to the funds. The warning was particularly addressed to representatives from the Republika Srpska, who were told that the 30 percent of the total amount initially earmarked for their Entity would be forthcoming only on those conditions.

The donors conference had been postponed for the slow progress in the agreeing on a program of economic legislation intended to establish the structures necessary for the functioning of the State. When the conference was finally convened in July 1997, one of the most important requirements, the agreement on a common currency, was still unfulfilled because of the arguments on the design of the coins and banknotes. However, a major progress has been made in setting up the common Central Bank, thanks to the USA assistance that has provided the necessary equipment. At the end of October 1997, the IMF appointed Peter Nicholl from New Zealand as a new Central Bank governor, replacing Serge Robert from France.

An important step to establish the State institutions has been the adaption of the 1997 budgets for BiH and for the two entities. In July 1997 the first allocation from the state budget was made by the BiH Presidency that disbursed funds to finance the BiH Institutions, the Commission for the Human Rights, the Commission for the Property and Legal Requirements and the Commission for the Mine-Clearing Operations.

Public sectors expenditures and revenues were balanced on all levels - State, Federation and the RS, thanks to the external financing (40% of all state public expenditures in 1996 was financed by international donors). The Dayton accord envisages the reorganization of the fiscal system both in the two entities and on the level of the central government. The central government is dependent on the entities and the international community for its revenue. The 1997 state budget was adapted by middle June 1997, and it amounted in DEM 136 million (USD 76 million). The two entities providing DEM 25 million (two thirds the federation, and one third the RS) from customs and other duties, while the rest came from the IMF, the World Bank, and other donors. The largest part of the budget, some DEM 97 million, went towards servicing foreign debt, while DEM 31.5 million have been used for financing BiH's common institution.

As expected, in 1997, the delay in the release of fresh funds due to the postponement of the donors conference resulted in a slowdown in growth after the 50 percent GDP increase recorded in 1996. Domestic demand for industrial products, mainly building materials and machinery, contracted when the implementation of on-going project slowed down and start-ups of the new projects were limited. In the Federation, the fluctuations in industrial activity, that took place in the first half of 1997, continued during the whole year: the industrial output contracted by 10.6% in July and rose up by 10.1% in August 1997. Industrial output in January-August 1997 was up 38% year-on-year. According to the Federation Statistics Bureau, the sharp decline in the industrial output in July was mainly caused by the fall in the production of electric power (electric power generation is the most important industrial sector in both Entities, in 1996 it accounted for 33.6% and 35.9 of the total industrial output of the Federation and the Republika Srpska respectively).

In August 1997, the industrial output reached only 15% of the level of August 1991, indicating the extent of the depression caused by the war. The pace of economic revival that might be expected in a post-war economy is still lagging, because the reconstruction depends on a large extent of the political conditions attached to foreign aid and donors finance remains the main source of economic activity in the country.

According to official statistics, the rate of inflation in the Federation was fairly stable in the second and third quarters of 1997, around 12-14% year on year. The increase in the prices of food and services were reported as the main causes. The slowdown in demand, due to lower levels of economic activity, has been reflected in slower growth of industrial prices. The Federation Institute of Statistics claims that its data covers the whole territory of the Federation, but this should be treated with some skepticism, especially in the areas under Croat control, where the Kuna still circulates.

After a moderate increase in the second quarter of 1997, the levels wages in the Federation have stagnated. A monthly increase of 2.2% was recorded in May 1997 in the Eederation, bringing the net average mouthly wage to 260 DM; the figure for August was roughly at the same level. However, this figure does not include the wages of the workers employed by international organizations, which are much higher than those paid by local employers. The non-production sectors wages grew stronger than those of the other sectors. In the Federation, the wage differential between the areas under the Bosniac control and those under the Croat control remains substantial. In the Republika Srpska the wages are much lower, with an average monthly level of 84 DM in June 1997: in this month the year-on-year increase was 52%.

The labor market remains depressed. Following a slight decline in the total number of employed in March and April 1997, the official data has shown a small increase in the Fedoration between May and August of the same year.

A majority of the new jobs was created in the housing, public utilities, catering and forestry sectors.

The unemployment rate remains still more than 50% for the whole country: it is estimated at 48% in the Federation and 68% in the Republika Srpska. The stagnation in the employment figures suggests that the current reconstruction-led growth is doing little to bring about a sustainable, long-term economic recovery. The persistence of so high levels of imemployment is one of the basic problems from the economic and political points of view, as it represents a great obstacle to the success of the whole peace process, the reconstruction and the stabilization of the country. The industrial sector contributed to most of the pre-war employment and its very slow revovery is the major reason for the lack of jobs at the present-day.

The external sector

Before the war BiH half of a merchandise trade surplus, with the exports amounting to some 15% of GDP. However, wartime disruption of economic activity halted virtually all export activity until 1994. The start of the reconstruction program has brought about a rapid increase in trade in 1996, albeit from a very low base. Imports, particularly of consumer goods and fuels, increased several times to an estimated USD 1,9 billion, including imports needed as a part of the international aid program. It is estimated that consumer goods constitute more than a half of the total imports, as to slow revival in the economic activity keeps imports of raw materials and intermediates down.

The pick-up in exports was very modest, estimated at around some USD 336 million in 1996, as a domestic production capacity remained limited and the firms faced the problem of finding the markets for their goods. In contrast with the imports, the composition of the exports is largely concentrated in raw materials and intermediates. Wood and semi-finished wood products are the most important export commodity, since this sector has been spared much of the devastation suffered by the rest of the industry.

A significant percentage of both imports and exports across the "soft borders" with Croatia and Serbia is not recorded in the official statistics, so the available data is only of the limited use. Most of the recorded trade is with Croatia, Serbia, and Slovenia, traditionally important markets for BiH, followed by Italy, Germany, and Austria. In the short term, as the economy experiences the initial phase of recovery from near total collapse, rising imports and a wide trade deficit are inevitable, as the exports will take longer time to recover. The revival of BiH's export potential is contingent on many factors, while the import needs will remain significant in the medium term, this is likely to put a constant strain on the balance of the payments. A proper assessment of the scale of the external imbalance and its policy implications will be possible only when foreign assistance through the reconstruction program winds down.

The trade deficit, which reached an estimated nearly 509% of GDP in 1996, is being financed by foreign aid as well as by remittances from abroad. The current-account deficit increased from an estimated 20% of GDP in 1994-95 to 26% (excluding official transfers) in 1996, mostly as a result of the widening the trade deficit and the

accumulation of arrears on external interest obligations. With the trade deficit likely to remain wide for the time-being, and with the service sector unlikely to provide a significant source of income in the near future, BiH will rely on remittances from émigrès to redress the external balance and prevent the current-account deficit from opening up too much.

Capital flows and foreign debt

BiH inherited a substantial external debt from former Yugoslavia, which has been virtually unserviced since the independence. In 1996 the outstanding external debt, including arrears, was estimated at 115% of GDP. The largest part of the total debt, some USD 1.1 billion was to the London Club of commercial creditors. Owing to the indulgence of the international community, outstanding arrears to both the World Bank and the IMF were cleared in 1995 and 1996, which paved the way for a normalization in relations with the external creditors. Negotiations with the London Club in July 1997 ended in the reduction of the total debt and rescheduling on favorable terms of the USD 404 million debt for which BiH has assumed responsibility. A similar agreement is expected with respect to debts owed to the Paris Club of official creditors. This will provide for cash-flow relief as well as debt relief, so that the creditworthiness of BiH may be restored and the inflow of foreign capital encouraged. This is important, since the financing needs of the country will remain significant in the medium terms.

Net inflow on a cash basis primarily due to receipts from transfers and services increased in the second half of 1996, and continued to do so during 1997, resulting in an increase in the gross official reserves. BiH's total foreign reserves were estimated to provide 3.2 months of imports cover in 1996.

The BiH dinar was linked to the D-mark at rate of BiHD100:DM1, and the new currency, convertible mark at a rate of KM 1:DM 1. As for the foreign exchange policy, exporters are required to repatriate foreign exchange earnings from exports within 60 days. In addition a portion of export earnings - 15% in the federation, and 20% in the RS - must be surrendered in exchange for domestic currency. In the federation, the surrender requirement extends to importers, who are required to make 10% of total sales in BiH dinars.

Financial services

In line with the Dayton agreement, a single central bank for the whole BiH has been established, and a Frenchman Serge Robert was appointed to be its governor in September 1996, and later replaced by Peter Nichol from New Zealand.

The commercial banking sector in BiH as for September 1997 consisted of 57 banks, 46 of which in the federation and 11 in the RS. Privately owned banks accounted for 60% of the total number, while in the remaining 40% of banks the state is the majority shareholder. Most of the private banks emerged during the war and its aftermath, either through ownership transformations or as new start-ups.

The bulk of the banking sector is insolvent and burdened by non-performing assets, estimated at 90% of total capital. This is particularly the case with the larger banks, mainly the successors of the pre-war banks which engaged in poor lending practices to state-owned enterprises. Typically, these were banks dealing with international creditors, the financing of large-scale projects and whole-sale trade. They are mostly concentrated in Sarajevo, and few in other industrial centers of the country. In contrast, the private banks tend to have healthy balance sheets but they are typically small, with short experience, and cater for regional markets, their capital, in the federation, amounted to DM 225 million -- 35.7 1% of the total at the end of June 1997.

On the whole, the banking sector is not strong enough to support the investment activity on a larger scale. Most banks engage in short-term trade-related activities. The banking system faces a complex process of restructuring and privatization, which the experience of other transition economies suggests will be very difficult, if it is to assume an appropriate role in the kind of market economy BiH is trying to build. This process is critically hindered by the uncertainties surrounding the outcome of the peace process. The EBRD has made a first step towards starting the process by designating two banks in the federation and one in the RS in which it will participate with equity capital.

3. 4. 5. Economic Policy

Given the continues effective three-way division of BiH, the management of the economy remains fragmented. The fragmentation is reflected in the fact that four currencies circulate in the BiH. Although the agreement in principle of the establishment of a single currency, the convertible mark has been reached under a heavy international pressure, its introduction has been delayed.

The effects of the war in the three areas of BiH were diverse, so they also have to coped with them in different ways.

The economy in the Bosniac-controlled areas has suffered greatest by the war, but its authorities exercised the greatest degree of independence in economic policy. After the introduction of the new BiH dinar in 1994, fixed to the DM at the rate of 1:100, they pursued prudent macroeconomical policies, stabilizing the currency and bringing the inflation under control. The economy in the Croat- controlled areas has to a very considerable extent been integrated with that of Croatia. Price stability was achieved following the implementation of Croatia's stabilization program at the end of 1993.

Similarly, the RS benefited when Yugoslavia initiated its stabilization program in 1994, although it returned to higher inflation when Serbia imposed an economic embargo on the RS later that year in an effort to persuade the RS's leadership into a more compromising approach to the settlement for BiH.

Following the establishment of the Federation, efforts has begun to synchronize and integrate the economic system of the two federation partners, focusing initially on the establishing of a unified payments system and trade. Progress has been slow. Macroeconomic stability has however been maintained, mostly because of the strict fiscal and monetary policy based on the principles of the currency board.

With the end of the war the emphasize switched to the reconstruction, following the enormous wartime destruction, in this effort. BiH has depended on the assistance from the international community, which on the first donor's conference has pledged USD 5,1 billion for a three-four-year period to meet critical needs. especially in rebuilding infrastructure and housing. the restoration of basic health and education services, care of the most vulnerable sections of the population. institution building, and for kickstart production.

An important element in the reconstruction effort in BiH is its contribution to the overall consolidation of peace and reintegration of the country. For this reason there has been considerable emphasis on rebuilding the infrastructure, with its integrative character. In addition, it is hoped that economic revival and the restoration of normal economic life will provide a greater incentive for normalization at the political level. For this purpose, the promotion of employment, as a means of giving the population a stake in the country's future, is of particular interest.

In 1997 the international community's emphasis switched to creating the conditions for sustained recovery beyond the immediate post-war reconstruction. To this end, so called, Quick Start Package was formulated, which adoption by the BiH Assembly in June 1997, following intense international pressure. marked a milestone in creating a country-wide macroeconomics policy framework. The package includes a set of basic laws on the

creation of a central bank on foreign debt foreign trade, customs tariffs and customs policy and budget, covering the whole country. The implementation of the package will take time and various transitional agreements, including the common convertible mark, have been formulated. The maintenance of macroeconomic stability remains a high priority. To this end, the new currency is to be based upon a currency board and the financing of fiscal expenditure through domestic banks has been ruled out.

While promoting the post-war reconstruction, the IMF and the World Bank have recognized that this will not be sufficient to provide for a long-term, sustainable economic recovery. BiH must also undertake all the reforms necessary for a transition to a market economy; structural employment, or underemployment, was a problem before the war, and the mere reconstruction of prewar industries would not provide a solution to the country's long-term economic difficulties. Most enterprises in both entities remain state-owned and the privatization is high on the governments agendas. Managing the reconstruction effort remains the key task for the present, but the BiH authorities have also embraced the need for far-reaching structural reform, as impressed upon by the international community.

Privatization plans have proceeded in both the Federation and the Republika Srpska was the first to frame a privatization law. Under the legislation adopted in 1996, 38 percent of the State enterprises shares are supposed to be distributed to citizens who register to participate; 44 percent should be kept by State privatization funds to be distributed for the benefit of social groups such as war veterans, pensioners and large families; the remainder should be sold for cash. The International Community, including the World Bank, has been very critical of that plan, saying that it lacks of transparency and is opened to manipulation from enterprise directors and politically connected investors. Despite the Western appeals to cancel the plan, the Republika Srpska authorities have declared their intention to go ahead with the sale of over 200 State firms.

The Federation adopted a privatization law in October 1997. It was drawn up in consultation with western experts and a plan was agreed with international approval. It initially calls for the privatization of small enterprises. The law envisages voucher privatization: vouchers will be people with claims and loss of property related to the war. The law also allows for auctions and public tenders, foreign and domestic investors will be treated equally.

Legislative framework

Dayton agreement created a basis for existence of parallel legislation regulating business activities. The first on the State level, which regulates monetary policy foreign trade and tariffs, foreign debt, and budget, and legislation at the entities level which regulates all other aspects of economic activity. Additionally, the division of the country in three parts has created the situation in which exists practically three different legislations. Although with the establishing of the Federation this should have been reduced to two, what presumed a unique legislative framework on the whole federation the implementation of Washin on the accords has been very slow and in practice there still exist different rules in cantons with Croat or Muslim majority. Legislation in the Republika Srpska is completely autonomous of the others in the federation, and is more similar to the one existing in the Federal Republic of Yugoslavia.

The "Quick Start Package" adoption in June 1997 is the first step in creating an unique country wide framework for macroeconomic policy. Its implementation will required numerous transitional laws on the State level, as well as changings in the legislations on the entities level. This process will take time, but both governments are performing very dense activity in this field and it is expected that after the elections in 1998 the new legislation approval in both entities will accelerate. At the moment the basic laws regulating business activities are very similar to those existing in former Yugoslavia adopted during the Mr. Markovic's government. In the Federation all the legislation adopted during the war by the Assembly of the Republic of BiH has to be changed and approved by the Federal Parliament. Until now new Law on Enterprises has been adopted and other basic laws

(as those on tax legislation, civil code, banking sector on payments regulation, are in discussion before the Federal Parliament's commissions). The stabilization of the business regulation is the part of overall political and macroeconomic stabilization, and at the moment it is hard to give any serious analysis given all the uncertainty and the fluidity existing in the country

SMEs Sector Supporting Policies

Although the climate of consensus that SMEs sector is going to be basis for future BiH economic development is widespread it is hard to speak about concrete step done in order to facilitate its growth. Before the war, this sector both private and state-owned has been neglected, and its contribution to GDP and total employment has been minor. However, the reform of 1988 has brought radical changes, and the number of firms and the importance of this sector has grown. During the war this process has been interrupted, as overall economic activities, although not completely stopped what proves new privately owned enterprises born during the war time, largely engaged in retail trade.

The industrial policy favoring the SMEs sector still does not exist, as it is hard to expect it before overall stabilization of the country. The significant effort has been done by the international community (through various programs sponsored by the World Bank, EBRD, USAID and other donors) offering basically credit lines, and technical assistance programs to the privately owned small and medium firms. The purpose of this programs is to help growing private sector of the economy, and is also motivated by its greater flexibility and possibility to create employment and economic revival in a relatively short time and without large investments which is not the case of the large state-owned enterprises which have dominated in the structure of BiH economy before the war.

Such programs are:

- BRFF - Bosnian Reconstruction Finance Facility and Economic Stabilization
- EBRD's Project for Equity Investment in Private Banks.
- EBRD's Bosnia-Herzegovina Reconstruction Equity Fund
- SOROS BAP - Business Assistance Program

BRFF — Bosnian Reconstruction Finance Facility and Economic Stabilization

The Bosnian Reconstruction Finance Facility (BRFF) serves two important purposes: (1) to provide immediate balance of payments assistance to Bosnia and Herzegovina, and (2) to provide quick-disbursing financial support to Bosnian enterprises. Financial support helps Bosnian businesses to repair plants and equipment, to obtain spare parts, to get production started and reinvigorate the commerce.

The emphasis of the BRFF is on quick impact. Grant funds are deposited into a separate dollar accounts of the Bosnian government as a multi-donor effort to meet the country's reserve and monetary requirements. More importantly the first loans were made available to commercially-viable Bosnian enterprises by the summer of 1996.

The first phase of the project uses Bosnian commercial banks as agents rather than financial intermediaries. Credit decisions are based on the commercial criteria and made by an autonomous on-lending management unit (OMU), staffed by experienced U.S. bankers. Bosnian commercial banks bring loan applications of their client enterprises for review. In return, they receive an origination fee for any successful loan application. Loans can be used to finance the working capital fixed asset, project finance and related import requirements of local businesses.

The BRFF is market-driven. Few preconditions are established for the participation other than commercial viability of the specific borrower and the loan request. Loans are made on non-concessional terms - successful applicants will be those who can generate the cash flow to repay the loan. At least 87.3% of the funds are for the projects in the U.S. IFOR sector and Sarajevo.

Enterprise borrowing eligibility criteria give preference to:

- private sector or privatizing firms which offer high employment generation potential:- projects which with minimal capital, help reactivate existing local productive capacity; - firms which will utilize domestic inputs and have export potential: and
- proposals which directly support the renovation of homes and/or business.

The program tend to target enterprises employing 10-500 employees; the maximum loan size is 1 million Deutsche Marks (DM).

Broader Program Impact: - jump start economic activity, get people back to work; leave behind a sound, market-oriented banking sector which can finance the private sector, Bosnian bank staffers will gain from working with the OMU's American technical staff, USAID finances also additional training and technical assistance for commercial bankers and bank regulatory authorities.

EBRD's Project for Equity Investment in Private Banks.

The banking sector composed of old state-owned banks and young private banks has been very much affected by the war. The capital of the state-owned banks has been wiped out and the majority of the qualified staff has either left the country, moved to new banks or was killed. The new private banks are very small and unable to absorb and to process large amounts of money.

However, the situation in the financial sector is likely to evolve very dramatically as the reconstruction effort will bring enormous growth for business and there will be large amounts of money flowing into the country over a short period of time. The financial sector could potentially benefit from a sharp increase in money transfer, new investments and trade financing.

The objective of this project is to strengthen the private banking sector in order to enable these banks to provide more effective financial intermediation and answer the financing needs of the productive sector. These banks will be the conduit for the substantial amounts of money which will be flowing into the country as a result of the reconstruction program.

Based on preliminary discussions with local financial institutions the EBRD proposed to take equity participations in a selection of private banks. These investments would need to be complemented by donors funds in the form of a capital grant. In addition to the equity participations, additional funds will be sought for the substantial and longer term technical assistance program for these banks. The World Bank will assist the government in the restructuring of the state banks.

The proposed approach by the EBRD would be to select two to three banks in Sarajevo (covering the territory controlled by the Bosnian government), then at a later stage one bank in Mostar (covering the Bosnian Croatian region and eventually one bank in Banja Luka (covering the Serbian territory) for an equity participation.

At this stage the total amount to be invested by the EBRD is estimated to be DEM 5 million for all the five banks of which approximately DEM 2 million for the Sarajevo region, DEM 2 million for the Herzegovina region and DEM 1 million for the bank from the Republica Srpska. In addition to our own funds, DEM 5 million is expected to be contributed from donors in the form of a capital grant.

Grant money would also be required for the preparatory work and for the substantial and longer term technical assistance program for these banks. Long term (project implementation) technical assistance would be preferably in the form of a twinning arrangement with a foreign bank. Each Bosnian bank will have a separate arrangement with a foreign bank which will "adopt" the Bosnian bank and work with it over the first two years. If this is not achievable then technical assistance funds will be used to recruit, as regular staff in each of the banks competent and experienced foreign bankers who could train local staff. Since the banks are fairly small and although living conditions are not easy, the cost of implementation should not exceed DEM 1.5 million per bank.

The twinning arrangements will cover a period of two years for each bank. At a later stage, the EBRD will select the best performing banks and consider participating in further capital increases. Credit lines to these banks will also be considered if more favorable funding is not available.

Although the proposed project is based on a selection of five banks, it is proposed to proceed with investment as soon as funding has been identified for at least one bank.

EBRD's Bosnia-Herzegovina Reconstruction Equity Fund

The EBRD made an initial visit to Bosnia-Herzegovina in 1995 to determine the scope for an equity fund modelled on the early stage equity funds already established in other parts of Central and Eastern Europe and the former Soviet Union. Meetings with various ministries confirmed that the Government is committed to privatization and that although important aspects of the privatization program remain to be finalized, elements necessary for successful transition to a mature market economy are already in the process of being established. The priority is for new capital for reconstruction and development of the enterprises. The governments have already undertaken significant amount of preparatory work. For example the Ministry of Energy and Industry of the Federation of Bosnia and Herzegovina has prepared a list of 700 investment projects.

Based on these initial observations and subject to further enterprise screening, the EBRD considers that it is both desirable and feasible to establish an early stage equity fund as soon as possible. The structure of the fund would need to be adapted to reflect the particular circumstances of Bosnia-Herzegovina. The objective of such a fund would be to revive the industry sector by providing much needed equity capital to the potentially viable local companies with a view to allow an effective resumption of their operations.

The concept of the project is to establish a ECU 45 million Bosnia-Herzegovina Reconstruction Equity Fund (BREF) to provide new equity capital to medium sized privatized and other private business in Bosnia-Herzegovina to assist the process of post war reconstruction, The BREF would be managed by a private fund management company selected by competitive tender. The fund manager would be requested to co-invest at least ECU 1.5 million and would be responsible for all aspects of the investment process including providing essential on the ground support to the investing companies. The fund would be daumbed in size with a further injection of private and EBRD equity as soon as it had established a successful track record and invested a substantial portion of the initial capital. Ultimately, the EBRD donors and private investors would have provided one third (excluding the fund manager's coinvestment and initial enterprise screening costs) of total financing of ECU 90 million.

Assuming that appropriate financing has been mobilized, the BREF will be in a position to start the operations in 1996 with the first disbursement following as soon as possible thereafter. Disbursements are expected to take place over a period of 5 years. Meanwhile, the EBRD will review progress with the investments by the BREF and determine the feasibility and timing of increasing the size of the Fund.

SOROS BAP - Business Assistance Program

Credit lines for the small privately owned enterprises with 4-6 workers involved in production or retail. The credit amount is DEM 5.000-25.000 for an enterprise, within one year, interest rate 11 per cent monthly. Interests are to be paid each three months. Distribution of the credit through the commercial banks. All the enterprises have to present detailed business plan and statement about past activities including revenues and expenditures flow on monthly bases, Fund is projected on \$ 1.5 million; with help of George Soros Foundation -- \$ 5 million. Bosnian government -- \$ 3 million, and other donors -- \$ 7 million,

The International Labor Organization (ILO), also plans to spend \$ 30.7 million on a program geared towards employment promotion and small enterprise development.

Given the short period of the program implementation, and the lack of official statistics it is difficult at the moment to give analysis of how successful these program are. As minimal illustration we can use the results published by the Chamber of Economy, about the number and the ownership structure of the enterprises engaged in economic activities on the territory of the federation in 1996 and 1997.

Table 8.
REGISTERED ENTERPRISES

Ownership	ECONOMY					
	January- June 1996		January-December 1996		January-June 1997	
	1	2	3	4	5	6
TOTAL	6,700	100,00	9,519	100,00	10.750	100,00
State owned enterprises	831	12,4%	812	8,5%	882	8,2%
Privately owned	5.447	81,3%	8.124	85,3%	9.305	86,6%
Cooperative ownership	84	1,3%	100	1,1%	97	0,9%
Mixed ownership	338	5,0%	483	5,1%	466	4,3%

Note: Data is related only to the Bosniac-controlled part of the Federation BiH

Source: BiH Chamber of Economy, September 1997

As we can see from the table, the number of privately owned enterprises has dramatically increased respect the pre-war level, reaching 86,6 percent of all registered enterprises. In 1990 the private sector's share in total employment was only 2,65 percent. Unfortunately there is no equivalent data for the current years, and the figures presented in the table could lead to a wrong conclusion, given that large part of the registered enterprises are one-man companies, engaged basically in retail trade and services, employing often only one person. Additionally there are also numerous enterprises registered by the Court, but performing no economic activity.

Table 9.
Financial results of the economy by ownership structure

Current prices: million BiH dinars

	1996					1997				
	total	ownership				total	ownership			
		state	private	coop.	mixed		state	private	coop.	mixed
Reven.	20.808	7.993	11.044	67	10757	42.079	3.576	9.062	23	29.436
%	100.00	38.15	53.08	0.33	8.44	100.00	8.05	21.5	0.1	69.9
Expend	65.150	54.284	3.939	166	6.760	39.449	11.478	3.532	113	2.326
%	100.00	83.32	6.05	0.25	10.38	100.00	84.9	9.0	0.3	5.8
Profit	12.306	3.195	8.018	43	1.050	39.688	2.868	8.188	23	28.609
%	100.00	25.96	65.16	0.35	8.53	100.00	7.2	20.6	0.1	72.1
loss	74.128	64.220	3.746	95	6.066	32.482	27.099	3.225	80	2.078
%	100.00	86.36	5.05	0.14	8.18	100.00	83.4	9.9	0.2	6.5

Note: Data are related only to the Bosniac-controlled part of the Federation BiH

Source: BiH Chamber of Economy, September 1997

Table 10.*Financial results of the economy by sectors*

current prices: million BiH dinars

	Sector of economy											
	total	indust.	agric.	forestry	water	constr.	transp.	trade	touris.	handic	comm.	financ.
1996												
regist. enter.	9.519	1.317	200	45	8	872	575	4.834	286	363	93	926
Share	100.00	13.8	2.1	0,5	0,1	9.2	6.0	50.8	3.0	3.8	1.0	9.7
reven.	20.808	5.121	202	260	45	1.851	2.460	7.013	1.208	354	654	1.548
Share	100.00	24.6	0.9	1.2	0.4	8.9	11.8	34.1	5.8	1.7	3.1	7.4
expen.	65.150	44.835	356	645	44	520	7.490	4.229	358	272	5.659	743
Share	100.00	68.8	0.5	1.0	0.2	0.8	11.5	6.5	0.5	0.4	8.7	1.1
Profit	12.306											
Share	100.00											
Loss	74.128	55.493	137	541	50	410	6.722	3.477	285	295	6.276	443
Share	100,00	74.9	0.2	0.7	0.3	0.6	9.1	4.7	0.4	0.4	8.5	0.6
I-VI'97												
reg. enterp.	10.750	1.506	230	62	9	1.019	681	5.345	315	422	106	1.055
Share	100.00	14.0	2.1	0.6	0.1	9.5	62	49.7	2.9	3.9	1.0	9.9
Reven.	42.097	2.834	87	135	12	1.344	576	5.928	29.226	242	372	1.314
Share	100.00	6.7	0.2	0.3	0.0	3.2	11.4	14.1	69.4	0.6	0.9	3.2
Expen.	39.499	23.023	345	669	33	908	6.326	2.983	247	244	3.971	700
Share	100.00	58.4	0.9	1.7	0.1	2.3	16.0	7.6	0.6	0.6	10.0	1.8
Profit	39.688	2.468	82	120	5	970	694	4.871	28.907	201	156	1,214
Share	100.00	6.2	0.2	0.3	0.0	2.4	1.7	12.3	72.8	0.5	0.4	3.2
Loss	32.482	19.445	295	667	31	699	4.635	2.800	193	228	2.795	680
Share	100.00	59.9	0.9	2.1	0.7	2.2	14.3	8.6	0.6	0.7	8.6	2.0

As we can see from these data, the relative importance of the sectors has radically changed respect the situation before the war. Share of industry and mining has decreased from 50% to less than 15%, reason for such a change is in the fact that these enterprises has suffered greatest direct war damages and has lost their markets. The most important sector has become the trade sector (50.8% of the total revenues in 1996) where exists the greatest number of private enterprises. Other important sectors are construction and financial services, once again sectors related to the reconstruction activities, where exist huge number of new start-ups, what proofs what we has already mention about the economic growth of BiH in the post-war period. The recovery of the industrial sector is hard to expect before the conclusion of the privatization process, and overall stabilization of political conditions. It is expected that the authorities with help from the international community are going to solve the problem of the large state enterprises which previously have been the basis of the economic growth, contributin to GDP and employment. Slowness of their recovery is the main reason of the still extremely high unemployment and the low level of GDP.

4. Some Consideration on Possibilities for SMEs Sector Development Bosnia and Herzegovina

As it is well known from the reality in the high developed market economies an active entrepreneurial, and new firms sector is important, and maybe a necessary factor to create economic growth and development. In the case of Bosnia and Herzegovina as an post-war, post-communist economy, the growth of the entrepreneurial activities is even more important. Growing the new firms sector is associated with new jobs creation, innovation, and also with the economic change. In case of BiH it includes the change of industrial

structure, as well as the ownership structure of the economy. Here we will give an introductory overview of the situation concerning entrepreneurship in Bosnia and Herzegovina at the present time.

The entrepreneurship in Bosnia and Herzegovina as it is the case of the all socialist, central planned economies, has nor long neither strong tradition. The basic form of the enterprises ownership was so called "social ownership", and almost the whole GDP had been realized in the social owned firms. Entrepreneurship, private property and self-employment have had only marginal role in the economic life. The conditions for doing business - social, political, legal, cultural and, economic environment were unfavorable for individual entrepreneurs. That is why the main motives for entering this sector of economic activities were often not economic ones (making profit), then psychological, or family reasons. Privately owned enterprises existed in a few sectors - as handicraft (shoemakers or hairdressers); free professions (lawyers, for example); tourism and services (cafes and restaurants); and so called home works. Some estimations says that on this way has been employed less then 4% of work force, what shows the law importance of entrepreneurial sector.

The first remarkable steps on promoting the entrepreneurship and small business have been done at the beginning of 1980s, with the promotion of so called "Economic Stabilization Program". The aim of measures, the Program included, were change of industrial structure, promoting employment, mobilization of private capital for economic growth, and attract the so called Gastarbeiters to return and invest in the country. Although this program was supported with numerous resolutions it failed in the realization of its goals, because of the lack of the concrete actions in economic policy domain. Because of that, situation on entrepreneurship had not been changed in remarkable size.

At the end of the 1980s, the Prime Minister's Mr. Markovic government started with the radical reform of economic system in former Yugoslavia. The most important feature was the liberalization of economic life. The Law on Enterprises from 1989, for the first time after the Second World War, has proclaimed the full equality of all ownership forms and provided the more favorable institutional framework for the entrepreneurship. The new legal regulation had simplified the procedure required to establish and register a new firm, gave the full freedom in choosing the scope of activities, and revoked the limits existing before for the private enterprises, as limited numbers of employees. It also promoted profit as the basic motive for doing business, instead of former socialistic, not always economic values. The economic policy was also characterized with import liberalization, stabile exchange rate, decreasing inflation rate, and promoting all the forms of economic activities. As the result of such a policy, the new firms birth rate increased rapidly as well as overall interest in entrepreneurship.

According to the Law on Enterprises it was possible to establish different forms of an enterprise in private, social, state or co-operative ownership - corporation, limited company, partnership or so called "one man company". The choice of the form was free, and the capital requested for the establishing a firm was low. All the new firms were able to register very broad scope of activities, only few field was limited for state enterprises, communications, for example. The major part of the new firms operated in retail, foreign trade, handicraft in services and small scale manufacturing, and other services. Some of the reasons for such sectorial structure, and lack of new entrants in industrial sector, were the struggle of new entrepreneurs to avoid risks, expectation for fast and high returns on the invested capital, low sources of available capital, the lack of entrepreneurial tradition, the lack of managerial knowledge and institutional support for small business promotion and development. To enter the business and to manage operation of a small retail shop was quite simple - no large investment was needed, no special equipment or managerial or professional skills. Demand for imported goods was high and increasing due to liberal import policy, lower prices, higher quality and stabile exchange rate. A lot of new established firms were just re-registered former handicraftshops. Large number of these new firms faced troubles and fast bankruptcy what is a normal result of the lack of experience and knowledge.

The situation in Bosnian economy after 1992 has been radically changed. There is a sentence saying that in the war and in love nothing is forbidden. In the light of this sentence there is no sense to implement any rational role, or economic law in order to explain the situation in Bosnian economy during the war time. That is why I am going to mention only one thing - in spite of impossible and incredible circumstances numerous already existing enterprises continued to operate, and even new ones were established in last four years.

The present situation in Bosnia and Herzegovina is characterized with a lot of open issues in the political and economic field, but the entrepreneurial/new firm sector is growing, and it is expected to grow even faster in the future time. The reasons for this growth are quite different if we compare them with the reasons existing in other, especially high developed countries. Even the same grounds have different influence regards to the specific environment which exist in Bosnia and Herzegovina today. With the next I will try to explain main reasons for growing interest in small business in Bosnia today.

Growing demand. It is obvious that the presence of demand for goods or services offers is the basic condition for the establishing of a new business. The growing demand in Bosnia and Herzegovina, as a post-war economy, today is obvious in almost all sectors, although it is difficult to give any estimation about the total demand (because of the decrease in population, purchasing power and economic activities). The sector where the growing demand is maybe the highest is construction. The need for material and services is very high due to the destruction during the war time. The financial sources for constructing are mainly the credit lines and donations for reconstruction, while the citizens and enterprises do not have available resources for individual reconstruction. The opportunities for getting credit and making business in this sector are although quite high and it is normally to expect a lot of new firms in these sector.

Growing Population. Growing population, especially in the age of 25-50, is the next reason for growing entrepreneurship in normal (developed, west) economies. In our case we can hardly speak about increase in population. The number of war victims, refugees, and people which were forced to leave their homes is high, and the facts show a decrease in the population. In the same time the structure of the population is very different in sense of age, education, sex, ethnicity etc., what creates a lot of opportunities for new businesses establishing. The number of foreigners who for different reasons visit or stay in Bosnia and Herzegovina -- as UN or IFOR soldiers, journalists, diplomats and tourists is also very large. Because of their high purchasing power and different consumption habits the opportunities for a lot of businesses (especially in the services sector) are open.

Increase in income and ownership. Generally speaking, an average income and ownership of the Bosnian citizens has strongly decreased, and it is normal to expect the negative influence of this factor on the new firm establishment. However, one of the consequences of the war time is a strong decomposition in the society in sense of the property. In last few years it has been established one part of society, so called "war profiteer's". Their property is now much larger, and they are the core of new entrepreneurial class. Those people are expected to remain active in the business life, especially due to the weaknesses in legal regulations of the economic activities, and all the chaos which now exists in the political and the economical macroenvironment.

Employment. The level of capacity use in Bosnia and Herzegovina economy during the war time was less than 10 per cent, there are more than 500.000 unemployed workers, reconstruction and revival of the production in most of the pre-war existing enterprises needs a lot of time and financial resources. Because all of that most of the people are looking for their chances in the small business - as entrepreneurs or as employees. One of the reasons for that are also the higher wages in the private enterprises, and unclear property rights in former social owned enterprises. The process of privatization has been neglected during the war, and with the realization of privatization programs which are in place in both entities it is expected that more favorable framework for new start-ups, and existing small business will be created.

Governmental Policy. Almost all the laws which regulate the establishment of new firms and economic activities in general are quite the same as in the former Yugoslavia. There are still a lot of non-solved issues, for example the problem with the fiscal policy extremely unfavorable for the small businesses, but with time there are expected improvements in this field, too.

At the end I will add some specific factors which are important for the growing of entrepreneurship in Bosnia today. First is the policy of the donors organizations and agencies -- International Monetary Fund, World Bank, European Union, European Bank for Reconstruction and Development, United States Agency for International Development, and others, which relate their financial support to particular governmental policy, amongst other privatization of assets, liberalization, and economic stabilization. All of the donors insist on

using financial help, and credit lines for investments in the privately owned small and medium sized enterprises. Most of them also have established different kind of projects in order to help privately owned enterprises, to promote entrepreneurship, as technical assistance programs, training programs, equity financing program, etc., as we could see from the overview of multilateral and bilateral reconstruction programs.

Univercityies and other institutions in Bosnia and Herzegovina are also aware that managerial skills and knowledge that represent a very important condition for SMEs development. During the last period of time they offered a lot of courses and training programs aiming to help the new entrepreneurs to manage their business in a better and more efficient way.

It is necessary to add a factor which also has a great influence on the growing entrepreneurship - the psychological attitudes of the entrepreneurs, and mentality of the Bosnian people. Again it is necessary to mention the war, which served as a more then a shock-therapy to all the people, and helped in breaking all the illusions and prejudices about entrepreneurship which existed in past, socialist time. During last four years the people in BiH had to cope with incredible troubles, and everyone who survived is ready to cope with hard competition on the market place, to take its destiny (in fact just economic one) in its own hand nevertheless, how risky it could be. Knowing that facts and optimism and virtuosity of the Bosnian people I am quite sure in better living in this area in very close future.

5. Experiences of SMEs Development in Other Transition Economies

5.1. Change of Industrial Structure

The growth of the private sector, and in particular of SMEs in Central and Eastern Europe and in the former Soviet Union has been phenomenal. According to London-based journal "The Economist", by the end of 1994, 65% of GDP in Czech Republic, 60% in Poland and Hungary, and 50% in Russian federation and 50 to 55% in the Baltic countries were the contributions of private sector business activities.

Small business entrepreneurs have tended to flourish in all the Eastern and Central European Countries, as well as in the NIS. The number of privately owned enterprises had grown drastically after 1989, for example, in Russia there are more then two million private enterprises compared with only 40,000 just few years ago, in Poland the number of privately owned enterprises reached also 2 million of which more then 92 percent employed less then five workers.

A large number of those enterprises are obviously newly start-ups, operating merely in retail trade, services, handicraft, and rarely in small-scale manufacturing. The new entrepreneurs are usually involved in self-employment, operating in the so called "gray" or informal economy. They do so after facing situation in the market economy that cannot offer them suitable formal employment.

The emergency of vicious criminal elements, whose activities are not always clearly differentiated from legitimate business in the eyes of many in the large population, has hardly helped to raise the status of private business, which is due to the years of state, centralized planning prevailing negative. In order to support successful and prospering private business in this region it was needed to separate and protect it from entanglements with organized criminal groups on one side, as well as to support and develop entrepreneurs friendly social, cultural, legal and regulatory environment, on the other.

5. 2. Business Environment; Change of the Economic System

The basic characteristic of the transition process is the change of the economic system, which means the shift from centrally planned, state controlled to free market economy. That is a systematic reform change of the fundamental rules of the game, of the institutions that shape behavior and guide organization. For transition to succeed it must restructure the institutional basis of the social system, which involves change of business legislation, change of property structure, and reshaping the social services and the social safety net.

Freeing prices, trade, and entry to the markets from state controls while stabilizing the economy is the first task of the transition policy in order to build a thriving market economy capable of delivering long-term growth in living standards.

The importance of the new businesses that emerge in response to the lifting of restrictions during transition process is great. New entrants means change of industrial structure, change of the property structure of economy, and means more competitive markets. That's why the new entrants, especially privately owned SMEs are an inevitable part of the liberalization process.

To be widespread and effective, the entry must be cheap and administratively easy. And to operate efficiently new firms must have a wide access to the markets for their products and inputs. The second condition is about the efficacy of the trade and price liberalization, and of course the stabilization of macroeconomics environment.

Most governments in the region have approved the programs and the legislation aimed to stimulate the SME's development. In Russia there was approved a federal law providing support for SMEs, in Poland in Spring 1995 the Polish government has approved a wide-range policy program for the SMEs sector, in Belarus in 1992 the government approved a state program of support for developing entrepreneurship, in Slovakia the goverment has declared in various resolutions its support for SMEs development and recognized the need for the government to create the necessary environment for entrepreneurial development; in Romania privatization laws have provided the framework for government support for private SMEs.

One of the problems faced and complained by the SMEs in all the countries is the high taxation, and administrative procedures. Serious efforts have been made to reduce the regulation toward a simplification of administrative and taxation procedure, as well as the introduction of tax concessions for SMIEs entrepreneurs. For example in Russia SMEs working in the priority sectors are exempt from income tax for the first years of business activity. There are also exemption from property tax, as well as tax on profit in all the countries. This is a stimulating, but not sufficient measure in order to support SMEs development, if other conditions are not favorable for the entrepreneurs.

The simplification of administrative procedures has been applied in all the countries, shortening considerably the registration period for new SMEs, making it much easier to license a new enterprise compared to a few years ago. Demands for statistical reports have been reduced lightening administrative burden on the entrepreneurs.

But despite the enactment of a range of laws and the promulgation of decrees which give support to the creation and development of SMEs, a proper legal system able to defend the private property and enterprises and to enforce the contracts is still lacking in most of the countries. More needs to be done in this sense quickly, to ensure the strengthening and the continuity of theSMEs.

As everywhere, finance has emerged as a most pressing problem for the new and expanding SMEs in the transition economies. The banking system left behind the state-controlled economy is not appropriate to meet the financing needs of growing private sector, and especially of SMEs.

During the years 1990-95 the banking system has been changed in all the transition economies. There are now thousands of private commercial banks operating throughout the Russian Federation, as well as in all the Central and Eastern European Countries. This is occurred both as result of privatization of the existing banks and also through the growth of the new private ones. The main problem at the time is the fact that many of these banks are heavily undercapitalized, and managed in a bureaucratic fashion. That makes them less responsive to the financial needs of the SMEs. Despite certain positive experiences, like the Russian Small Business Fund, and other credit schemes in Poland and Hungary, in all the countries still exists a heavy need of training and advice how to deal with SMEs borrowers, and of financial support to the banking sector as well.

There have been also developed some innovative financial support projects, like Ostrava Regional Fund in the Czech Republic, which was created as a venture capital company, or several equity financing organizations, called Small Enterprise Assistance Fund, which operate with USAID, or EBRD funds through Poland, Bulgaria, and Russia. The size of investments by the SEAF, for example are from \$25.000 to \$300.000 in the enterprises with 15 to 150 employees and assets up to \$250.000. This organization provide both equity and loans, but avoid to invest in the completely new start-ups, providing support to the already existing prospective enterprises.

There are a lot of programs providing credit lines for SMEs sector through all these countries, with support from different international donors. Some of these programs are PHARE (EU) programs in Slavakia and Poland, which offers grants of up to 25 percent of the costs of a new investment, mainly in fixed assets, provided a minimum part of a project cost is contributed by the entrepreneur (15 percent if the project is above \$250.000). The justification for providing grants rather than credits is that through providing grants it is easier for entrepreneurs to obtain the rest of the capital needed, apart from their own contribution, in the form of loans from the banks. Having received the grant, the entrepreneur is able to comply with collateral requirements, and with a reduced debt burden, the risk of lending by bank is lower.

Another multilateral program which gives credit support schemes is also EU established TACIS program, which operates through the NIS.

Despite the fact that due to the lack of information on the loan repayment levels of the various financial assistance programs in transition economies, what could be partially explained with the fact that many of these lending projects are relatively recent, exist a general opinion that all these schemes approved less effective than it was expected. As the example can serve the experience with credit, project for SME in Kyrgyzstan, developed by Kreditanstalt fur Wiederbau of Germany. There were received about 200 applications for a total credit of DM 140 million, but only seven of the loan requests (or DM 7 million) were approved. The lack of marketing, financial and general marketing knowledge approved to be major obstacle for more efficient loans programs. Most of the applicants needed technical assistance to assess the market potential and to prepare realistic business plans, which are the basic condition in credit improvements.

5. 3. Institutional Support Framework

In 1990, there was virtually no institutional nor governmental support for the SMEs. It is remarkable how, five years later, there was such a large proliferation of business advisory center, foundations for assistance and promoting the SMEs, local and regional enterprises agencies and support institutions of different kinds. Associations of small business entrepreneurs, chambers of commerce, economic societies and other private sector membership organizations have also sprung up, both to lobby the government for a better policy and legal framework for the SMEs, and to help the entrepreneurs to promote and to market their products. In several of the CEECs have been established national and regional development agencies with funding from the central government.

Support institutions and training courses have been set up in all the countries. All of these centers offer a wide range of advisory services and training courses to the entrepreneurs. Most of them have been set with the financial and technical assistance of different donors, as Integrated Advisory Service in Romania, set up with help from GTZ, Germany; another example is a net of Small Business Development Centers established in Romania and Russia through help from Washington State University financed by USAID.

Many of the centers and institutions are struggling to find appropriate qualified and experienced staff as well as the funding to increase their operations. The up to day experiences on these centers activities show more a picture of ambitious plans rather than concrete results and achievements. Some of the centers reflected healthy local and grass-roots initiatives but were started sometimes without adequate information about the problems to be dealt with and the needs of potential clients, and with insufficient resources to accomplish the role they had allotted themselves.

The institutional support framework needs to be assessed to ensure that local and regional support institutions are to be encouraged where there is sufficient demand for the services. Care could be taken that limited financial and staff resources are not overstretched and are used effectively.

5. 4. Donor Approaches

Donor agencies have been very active in setting up centers and SME support institutions. EU's PHARE program has helped to set up agencies and centers in Slovakia, UNIDO has been involved in Romania, EU through TACIS have helped in Belarus, several different bilateral donors have helped the Foundation for Enterprise Development in Hungary, and the British Council and UK Know-How Fund have provided the assistance in setting up the support centers in Poland.

Poland has sought to coordinate the various centers and agencies (32 Business and Information Centers helped by PHARE program) through the Poland Foundation for the Promotion and Development of SME which has been set up.

The support centers and agencies set up with donor help often approach of the advisors sent by the aid agency and sometimes the experience of the donor home country. This is not to say that these efforts are inappropriate on all occasions, so long as the local agencies and groups are given a suitable opportunity to decide on the applicability of the approach in their own situation. But it is obvious that foreign assistance is more successful if it is really based on the needs of the local entrepreneurs, and if it is based on a real partnership concept. Local partner should be a real partner in defining the needs and ways of meeting them, not just the recipient of ready recipes. Local partners know the history, the culture and the social background of the country, and without their full involvement is impossible to create an effective support program. The high level of technical and educational level of the local staff have made them quick learners, and capable to be equal partners to the West donors.

In order to assure future sustainability, after the donor funding has eventually been phased out, donors have generally encouraged the local support institutions to charge for the services they offer. This is generally a positive trend, but could also lead that same centers to spread out their activities, and range of services more over their staff's capability, or the main purpose of their existence (missions). But knowing the conditions in which these institutions are operating, first of all being power of their customers, and irregularity of demand for services they offer, there is needed more patience and longer time perspective in order to make them sustainable.

Also, given the limited resources, both staff and financial in all the transition economies it is necessary to limit overabundance of the proliferation and decentralization of the local support institutions, although some decentralization is desirable and certainly more effective in reaching out to the SMEs. In order to balance the efficacy of operation these institutions in using resources, it is necessary to do an assessment of the potential demand.

The high technical level of the entrepreneurs, who justifiable aspire to set up SMEs using modern technologies, to compete on the world market, which is remarkable in all the transition economies, justifies the trend towards "innovation centers", For example, 37 percent of employees of SMEs in the Russian Federation, including the entrepreneurs are university graduates (a World Bank study of SMEs in St Petersburg found 60 percent of SME owners were graduates).

5. 5. Training

Training is usually one of the first forms of assistance provided by the donors. Most training activities are combined with consultancy and direct advice to the enterprises. Different institutions offer a wide range of training programs in different fields of activities, from courses "how to start a business", to more specific courses on the development of business plans, business legislation, tax regulations and procedures, accounting. The experience show that there is a need to focus more training on marketing, and financial

management, and to develop more training material and courses directly related to the situation prevailing in these countries. In order to meet these needs it is necessary to prepare the training programs at least with the cooperation of the local trainers staff (university staff, administrative officers, business consultants) who know the peculiar characteristics and needs of the entrepreneurs in their countries. It is also needed to organize first a training program for "trainers", who, as we've mentioned earlier, are quick learners, and who are able to adapt the donor's program to be delivered in local language, and to selected target groups.

PART II- Proposal for A Small Business Support Center

The actual concept of the economic development, economic and industrial policy of Bosnia and Herzegovina give significant importance to entrepreneurial activities as important generator of reconstruction and further development. In order to activate this important part of the economic system it is necessary to create the basic conditions favorable to motivate private initiative and entrepreneurship. In this sense the state has important role, but it is also necessary to use all other forms of rational organization of entrepreneurs. One of these forms is establishing of a Small Business Support Center.

The basic goal of this paper should be to give a conceptual proposal for a center, (using the experiences of similar institutions in developed countries and knowing and respecting peculiarities -- needs and possibilities in Bosnia and Herzegovina today), which conform the conditions of flexibility and rationality. The optimum solution is hard to achieve, but in the given circumstances, when exists great need for institutions of such kind, every attempt in that direction is useful.

The proposed concept does not present a final, organizational and formal solution for the Center, but gives only the main framework of its basic mission and goals, as well as the activities how to achieve it.

Why to establish such a center?

Today, after the four years of war, Bosnia and Herzegovina is a poor developed and devastated country regard to all objective economic criteria. There is no sense to give any comment about the political conditions for its revival, and to predict its future in political terms, which is more than unpredictable. But despite all, we can assume that the economic prosperity of the country, and of all its entities and other parts, is an ultimate goal.

At circumstances when it is necessary to invest large funds in reconstruction and modernization of the infrastructure (in transport, communication, construction etc.) the support to SMEs sector presents the fastest and easiest way for directing the private capital to manufacturing and services providing activities.

We've already mentioned earlier the main advantages and disadvantages of the small enterprises, so now we will mention again only the disadvantages: an entrepreneur's isolation, scarce financial funds, the lack of different kinds of information (about customers, competitors, technologies, products, standards, etc.), the lack of quality managerial knowledge and skills. In Bosnia and Herzegovina today it is even symptomatic how, despite the significant efforts done by government and foreign donor's in order to promote and support the private initiative, results are more than scarce. It is obvious that the achieving of better results takes time, but some pitfalls are notable also now, and a coordinate action could give synergetic effects.

Most, if not all, programs based on credit lines for small enterprises show worse results than expected. The biggest, on the first glance visible problems are: the low level of applicants response, the bad quality of received applications, and then the lack of meeting requested conditions, and finally, although there are not enough information about it, the low level of credit repay rates.

In order to find out why is it so we can ask next questions:

- How many potential applicants have even heard about the programs?
- How many of those who have heard about it, had understood it well?
- How many of them gave up to apply just after first hearing about?
- How many of them gave up during the procedure to apply?

The possible reasons that answers on all the questions mentioned above were "few", could be next:

The way of announcement all support measures, as offered credit line, for example, is usually not appropriate to reach targeting audience.

The announcements are usually full of the short-words that mean nothing in any language, especially not in language which is used to be spoken in Bosnia (OMU; BRFF; EBRD; BAP, to mention only some of them), what makes them hardly understandable to the potential entrepreneurs.

All the programs are aimed to the private or privatized enterprises, immediately able to start operating, in circumstances when before the war there virtually was no private enterprises, and when the privatization process haven't started. The applicants are also requested to present business report from previous years of operating, when it is well known that in period 1992-1996 Bosnia and Herzegovina was a battlefield?!

Unfortunately, very few potential applicants know what is a business plan, or a feasibility study, not to mention if they are able to make it?!

The small part of those who in attend to perform its business idea in an acceptable business plan had looked for an expert's help (thorough scarce and inadequate ex-system's institutions) gave up hearing about the price and the time needed to design it. It is not far of the truth that making a business plan costs more then wanted credit, but anyway, some thousands DM spent for a few papers, for an aspirant entrepreneur seems quite a lot of money.

The efforts done in order to overwhelm these and similar obstacles are unfortunately just isiland solutions, and have not shown significant results.

Different training courses are just a firsts step and scarce support to entrepreneurs, and they meet only a small part of potential entrepreneurs, for exaniple, Small Business Management Course, organized in Sarajevo in 1995 received more then 300 applications, and it was possible to approve only 30 students).

Management and Entrepreneurial Center in Zenica blamed about low response among the entrepreneurs, saying this: "We offer some hundreds of investment programs, but nobody comes to ask about.". This approach does not deserve any comment.

Those who are able to produce an acceptable feasibility study, or business plan, are few, and because of that can not meet the existing needs, and they are in the position to ask high price for their services.

To overwhelm these obstacles takes time and a broader change, but same steps could be done immediately. Establishing a Center for Entrepreneurship Support is such a step. Establishing it in short period of time, organizing and equipping it adequately, with funds and skilled stuff, a large number of today existing problems could be rationally rminimized, and in time, we believe, with the stabilization of other circumstances, also solved.

1.The Objectives of the Center

The rmajor objective of the Center is providing expert support to all small enterprises. As small enterprises we refer to all the individuals and groups which are or intend to get involved in doing business with their own capital.

The basic principles of operating this Center should be:

- direct aegis of the state; it means that the founder should be a state institution -- Chamber of commerce, for example; the aim of this principle is to obtain direct relationship between the economic policy and the system with the center's activities, as well as to protect the center of commercialization;
- compulsory membership of all small enterprises; provide to all entrepreneurs the availability of centers services, and for center means having accurate and broad information about the needs, and current situation in entrepreneurship; the membership should be a simple procedure for all the registered enterprises;
- fast obtained self financing; this principle is positive, but not necessary, when the availability of skilled staff is very scarce, and need for the services, due to unawareness of customers limited on few products, there is no fear of monopolizing; and as experience from some other countries shows, insisting on this principle could lead to the irrational using of available resources and unsatisfied demand.
- using services of external specialized institutions and experts; this principle is necessary, because the Center could not be equipped with the experts of all kind. In situation, as it is now, when the availability of experts is very limited, it is necessary, for the Center to train its own staff;
- continuous work on creating favorable climate for entrepreneurship, and protecting the interest of its members. This principle could be obtained thanks to direct relationship the Center would establish with the policy makers, and with the entrepreneurs.

2. Services the Center should offer

The main services The Center should offer to its members are:

- consulting activities in different fields of management
- information collecting and disseminating
- research activities
- training and education activities.

2. 1. Consulting activities

Small enterprises, according to the definition, have a need for various kinds of expert help in all fields of doing business. In our conditions, there is no institutional network which provide the consulting services, and a necessary and the only rational solution is to organize, with the state support, on one place the offering of such services for a broad public of entrepreneurs.

The main fields of consulting the Center should offer are the following:

- consultation in legal aspects of doing business
- consultation in financial management
- consultation in accounting

and industrial market. This kind of specialization is the basic source of competitive advantage for the SMEs, together with their "youth" which means that they are operating on young, fast growing markets.

It is through that small is nice, but it also could be a disadvantage if it is about a firm. The lack of the large-scale production, means often but not necessarily always, a higher production costs. Withstand competition which offer the same products on lower prices in this case is difficult.

Small firms have scarce financial resources, often related with family savings, which are not sufficient for providing the growing expansion. The availability to reach external financial sources is also low for the SMEs, particularly in the countries with under-developed banking system.

The scope of human resources availability in the SMEs is also small. Small firms are not able to attract high quality students, to invest in the developing expert knowledge of its staff, as large firms are.

Managerial knowledge and skills are also often low in SMEs especially if they are closely related to the family. These, and other here not mentioned disadvantages, could be, and often are, obstacles for the growth and the competitiveness of the SMEs.

2. SMEs Development Support Policies - EU Experiences

Knowing the importance of SMEs sector to the economic growth and development, the advantages and the disadvantages of small firms, governments, and other institutions supporting the economic development, are creating policies and instruments in order to help this sector of the economy. The policy's regards the SMEs growth goal is to overwhelm the obstacles mentioned above, and to promote the characteristics which are advantageous, as well as to help the SMEs to place themselves in the frame of broader processes, as are trends of economic integration, globalization, transition.

The policy approach to the SMEs growth and competitiveness is changed, both because of changing the view on their competitiveness (the SMEs are no longer considered to be marginal, less effective, and unable to compete on broader market), as well as because of changing the global framework in which the policies are to be implemented -- creating a Single market and the European Union, for example.

Here we are going to give a short overview of a range of policy intervention used in the EU to support—SMEs competitiveness and growth, including the promotion of technological innovations, financial incentives for SMEs, human resources development, improving access to information and markets, entrepreneurship promotion initiatives.

The approach to policy regards the SMEs in the countries of the European Union has been evolved in parallel with the changes in the view on the SMEs' role in economy, and the evolution of the integration process – the European Union creation.

The traditional approach to the SMEs support, typical for the closed, national economic policy, was aimed to create national champions through various protection measures. This approach considered the SMEs as not efficient, marginal, and enable to sustain competitive pressing of the open market. The policy intervention merely involved government protection and subsidies to small firms.

The new approach to the industrial policy is based on the idea that the SMEs can be competitive in international markets if they have certain characteristics. The goal of the policy is no longer the protection, but rather the provision of financing, information, services, training, etc. that help small firms to gain and sustain the competitive position.

The difference between these two types of policies approaches is important. The protectionism form of policy could be defined as "the state instead of the market", but the new approach embodies the state's commitments to the creating as many truly competitive firms as possible.

It is interesting the discussion of industrial policy within a regional trade agreement. The fact that such an agreement does not affect the member countries to the same extent or in the same ways, implicates the question if all the countries could implement the same policy approach. The unilateral opening of a small, previously closed economy presents several particular problems. In fact, small economy that has been closed to international competition for a longer period, is usually characterized by firms that are highly despecialized because they have operated in a restricted market. Rapid unilateral opening exposes the local firms to international competition with the firms of larger dimensions and increased specialization. Therefore, the rapid

opening of the economy could destroy the national producers and create a sudden industrial crisis, or at least, a strong resistance by the potential losers, and conflict with those subjects which could receive advantages from opening the economy.

Having in mind the problem mentioned above of opening the market to the international competition, it is imposed a doubt which policy approach should be implemented in an economy like the Bosnian one is today? The challenge is whether to implement old protectionism approach in order to help the new companies getting born, and then gradually open the market and let them face the international competition, or - starting process of establishment of the new enterprises in an open environment, and on that way, forcing the new, young firms to cope with international competition from the very beginning of their existence. Both approaches offer some benefits and pitfalls. It is quite clear that the second approach, if successful, - is a better one, but what are the chances for it to be successful, and what kind of crisis (a half of active population is jobless, and the infrastructure is almost completely destroyed) should we expect, if this policy would not be successful?

That discussion is quite useless now -- the choice has already been done. Bosnia should develop the SME's sector of its economy in the general frame of so called small, open economy. There is no sense to discuss how free/or forced that choice has been, the challenge is to create a sound and stable institutional frame in order to help the new created enterprises to be capable withstanding a strong competition. It is going to be very difficult, but anyway the experience from EU countries could be useful, not in order of simply copying it, but to create as good policy as it is possible. Anyway, it is also necessary to provide direct international support to the policy makers, as well as to the entrepreneurs, in forms of technical assistance, training programs, financial aids, involvement in the international programs aimed to SMEs development support, etc.

The following is an overview of European Union's policy approach regards to the SMEs growth and competitiveness.

During its creation, the EU's industrial policy consisted of two main stages. The first regarded the development of the Single market itself. This meant a wider market for all the firms, thereby lowering the costs of entering what once was the foreign market, and that meant an advantage for the small firms, since they had not been able to finance such an expansion.

The process of liberalizing the market requires the reorganization of the firm's capacities to a wider perspective. It is necessary to manage the process of opening the market in order to create the conditions for the reorganization of the firms related to enlarged markets. This not only involves the progressive elimination of the tariff barriers, but also implies the identification and reduction of non-tariff barriers, which results from the differences in the institutional frameworks. For this reason, when the process of the European integration was revived after a long period of decline, it was necessary to sustain the opening process with a clear industrial strategy to favor market dynamics and industrial reorganization. The term "industrial policy" was erased, but a variety of structural intervention were promoted to stimulate the market forces, end especially the SMEs- through promoting the conditions for effective competitiveness of the entire economy. The step toward an open market was therefore accelerated.

Using its own databases and equipped with experts in marketing Center should provide the small firms the needed help when they have to make decisions about:

- Marketing strategy -- market segmentation, product differentiation, positioning...
- Products or services characteristics,
- Pricing,
- Distribution -- select the distribution channels, information regards the physical distribution,
- Promotion.

Consultations on technology

The Center should provide to its members the general consultations about technologies, serving as a nucleus for the future innovation center. The field of consultations provided should be:

- Consultations on choosing appropriate technologies for production, or doing services
- Consultation about product features.
- Consultations about using new advantages technologies, etc.

Human resources management

The Center should provide consultations in the field of:

- Consultation on the personal recruiting, and laying off
- How to select the best candidates
- How to motivate, and pay personal
- How to organize the jobs
- How to train the personal, etc.

Consultation on computerization and information technologies

In addition to providing a mediator role for the engagement of specialized institutions, the entrepreneurs are needed to be informed also about the possibilities and the benefits of using a computer in doing business.

2. 2. Information collecting and disseminating

The Center should necessarily create a general database and a specialized type about SMEs in its field of activities. All the members of the Center should use the information collected on this way.

The necessary information the Center should collect is about:

- demand, customers,
- supply-competitors,
- products-services,
- suppliers-purchasing,
- technology trends-innovation,
- promotion, available media, etc.
- channel of distribution
- logistics
- potential business partners
- investment fluids, etc.

The Center should have on line connection to most important international databases and networks of similar institutions, providing this way the information for its members. The Center should also offer help to its members in using all the benefits Internet offers, as well as other forms of information support.

- consultation in marketing management
- consultation in human resources management
- consultation in technology
- consultation in information technologies

Legal consulting

Although all the countries try to simplify the legal procedure for doing business, still its correct understanding, and optimal decision making requires expert knowledge. The simplest procedure of getting a license for doing business, which in fact presumes having made a decision about the legal form/status of enterprise, requires knowledge and skill, usually using a lawyer, or other expert. Engagement of an expert saves time, nerves, and money.

Offering legal consultation in the Center is a rational solution, as far as it means fast solving of routine orders, typical for all the enterprises, registration at the court, for example. Such service could be offered on a mass basis, but also specific, more sophisticated services, which need a special knowledge, should be offered by the Center. In last case, the Center should play the role of a mediator for providing a specialized expert for its clients. Anyway, as a point of meeting demand and supply of legal expert knowledge the Center will approved its existing.

Consultation in financial management

Financial management is in all the enterprises one of the most important fields of management. Making optimal decisions in this field requires expert knowledge and skill, due to the importance and the risk it involves. That's why it is normally to expect a high demand for the consultation of this kind.

The entrepreneurs would ask an expert help when they are in the situation to make a decision regard to:

- choose the optimal structure of financial sources, both internal and external;
- get information about available external financing, and to choose optimal solution,
- choose optimal solution of assurance assets,
- make or buy decisions -- regard to equipment purchase, product's parts, material, etc.

Consultation in accounting

Accounting evidence is a legal duty for all enterprises, and also necessary informational support for decision making. Due to the changes in economic system and going towards the market economy the accounting system in Bosnia and Herzegovina has also been changed. The aim of consultation services provided in this field is to provide the entrepreneurs:

- Information and consultation about compulsory reports, accounting standards, and laws;
- Information about available specialized institutions and experts for accounting services, assistance for providing their services,
- Consultations about available computer supporting accounting systems,
- Information about the accounting software packages available on the markets...

Marketing consultations

The first condition for a successful business activity is to provide a market for its products or services. That means knowing the needs of the customers, their preferences regards the product, knowing its competitors,

and on the basis of that knowledge choosing the marketing strategy. Providing all the necessary information is not an easy task, it requires time, money and knowledge, which a small enterprise can hardly provide. Because of that collecting market information, and doing marketing research is rational to organize in one place -- in the frame of the Center's activities.

2. 3. Training and education

The Center should offer on continuous basis training for the entrepreneurs. These activities should have a form of various training courses in all interesting fields of management a small business. The Center would for this purposes engage external experts knowing the needs and the interests of the entrepreneurs and knowing the possibilities of the teachers.

2. 4. Organization of the Center

The Center should be a non-profit institution, operating with the financial support of the state. It would be managed by the Boards of directors, representing the government, financial institution, entrepreneurs, and scholars. The manager of the center should be a high qualified person, with education in business management, and appropriate experience in managing an institution of similar kind. The staff should be chosen respecting high professional criteria, with knowledge of the foreign languages, computer using, and ability for research and consulting work. All the staff should be, if possible, trained through international training programs, what would assure its high quality and ability for coordination and interaction with foreign donors, and international institutions of interest.

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