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BOSNIA

Crime and Corruption Threaten Successful Implementation of the Dayton Peace Agreement

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our recent report, completed at your request, on the impact of crime and corruption on the implementation of the Dayton Peace Agreement, which was signed in December 1995 by regional, Bosnian, and international community representatives.[1] The agreement was designed to help Bosnia achieve a self-sustaining peace, under the direction of an internationally appointed High Representative and a NATO-led military force. With the signing of the agreement, the Bosnian national government was created, and the two entities created during the war (the Federation and Republika Srpska) were recognized.

During 1996-99, the United States and the international community committed more than $4 billion to finance civil aspects of the agreement; as of March 2000, U.S. military costs to support the agreement totaled about $10 billion. The United States, NATO, and the Peace Implementation Council have developed a transition strategy, or conditions often called benchmarks, under which the military force could be withdrawn from Bosnia. Several of these conditions directly relate to reducing corruption.

I will summarize our July 7 report's three main points: (1) how organized crime and public sector corruption have affected implementation of the Dayton Peace Agreement in Bosnia, (2) what the international community has done to improve Bosnia's law enforcement and judicial system and reduce corruption, and (3) how international assistance resources are being safeguarded and whether such assistance is being used by Bosnia in place of domestic revenues lost due to crime and corruption.

I should note at the outset that in doing our review, we did not conduct independent investigations of specific corruption-related cases. Instead, we examined studies, reports, and other documents published by NATO, the Department of State, the U.S. Agency for International Development, the United Nations, and many other international organizations. The evidence and conclusions presented in these documents are based on

[1] *Bosnia Peace Operation: Crime and Corruption Threaten Successful Implementation of the Dayton Peace Agreement* (GAO/NSIAD-00-156, July 7, 2000).

analyses and investigations of corruption in Bosnia. We also interviewed an extensive list of top-level officials, both governmental and non-governmental, responsible for or knowledgeable about programs and activities in Bosnia. We based our conclusions and recommendation on this extensive documentation coupled with the first-hand experience and judgments of high-level international officials in Bosnia.

RESULTS IN BRIEF

We found a near consensus opinion among officials we interviewed that endemic crime and corruption in Bosnia is threatening the successful implementation of the Dayton Peace Agreement and that until the situation is satisfactorily addressed the conditions for the complete withdrawal of the NATO-led force will not be met. Although some of the U.S. and NATO conditions have been met, none of the progress in implementing the agreement is yet self-sustaining according to the High Representative and others. Bosnian leaders from all three ethnic groups have not made a concerted effort to curb corruption and have often acted to obstruct the reform process in general. Bosnia's law enforcement and judicial systems are inadequate and institutionally incapable of prosecuting cases of corruption or administering justice. Bosnian, international, and U.S. efforts to correct weaknesses in these systems have achieved only limited success and have not measurably reduced political influence over the judiciary or the economy.

We found that international assistance, including U.S. assistance, is generally not being lost to fraud and corruption in Bosnia and that such assistance has been protected by a number of internal controls. However, we did find incidents of corruption in the international assistance effort. Further, the assistance provided could supplant the hundreds of millions of dollars the Bosnian governments lose each year to customs fraud and tax evasion. Moreover, the Bosnians spend a large percentage of their revenues maintaining three competing militaries that are primarily designed to fight each other. According to the High Representative, the size and structure of these forces are incompatible with the defense needs of Bosnia and are financially unsustainable. The international community has provided about $407 million in budget support to cover Bosnia's budget deficits, and most of this support is not controlled or audited.

Consequently, the international community cannot be sure how the money it has provided is spent.

CRIME AND CORRUPTION THREATEN THE DAYTON AGREEMENT

Pervasive illegal activity is negatively affecting progress in reforming Bosnia's legal, judicial, and economic systems; achieving U.S. policy objectives in Bosnia; and attaining the Dayton Peace Agreement's ultimate goal of a self-sustaining peace. Unless Bosnian officials make concerted efforts to address this problem, the benchmarks for the complete withdrawal of NATO-led forces will not be met. According to U.S. and international organization officials, to date, Bosnian leaders have not demonstrated sufficient political will to reform. Bosnia's nationalistic political parties continue to control all aspects of the government, the judiciary, and the economy. Thus, they maintain the personal and financial power of their members and authoritarian control over the country. Bosnian leaders from all ethnic groups may have little incentive to combat corruption, since curbing corruption may reduce their ability to maintain their control.

Wartime underground networks have turned into political criminal networks involved in massive smuggling, tax evasion, and trafficking in women and stolen cars. Investigations have shown that certain smuggling operations could have been successful only with the participation of customs officials. In addition, according to the Department of State, criminal elements involved in narcotics trafficking have been credibly linked to public officials. The proceeds from the narcotics trade are widely believed to support illegal institutions maintained by ethnic extremists.

Numerous reports show, and international organization officials confirm, that Bosnian law enforcement officers' allegiance is often to ethnic political parties rather than to the public. For example, police in some areas work for local party officials and protect the business interests of the officials, intimidate citizens, and prevent the return of refugees. Similarly, political officials are involved at many stages of the judicial process. The

selection of judges in Bosnia is the product of political patronage, and judges' salaries are controlled by political party structures. We were told that there are good and honest individuals throughout Bosnia's judicial system. However, criminal leaders, many of whom are closely linked to ruling political parties, are ready to threaten judges, prosecutors, police officers, lawyers, or witnesses with violence, even death, to act in a particular way. Such influence over the courts often prevents cases involving organized crime and corruption from being heard.

ANTICORRUPTION EFFORTS HAVE ACHIEVED LIMITED SUCCESS

Bosnian, international, and U.S. anticorruption and judicial reform efforts have been initiated over the past 4 years, but they have achieved only limited success in reducing crime, corruption, and political influence. While international efforts could correct weaknesses in Bosnia's legal and judicial systems and provide needed supporting structures for the rule of law, the Bosnian government's efforts have primarily been to create committees and commissions that have failed to become operational or measurably reduce crime and corruption.

The Office of the High Representative has developed a strategy for coordinating international anticorruption efforts. However, the strategy is essentially a recitation of existing international efforts, and although the work of the international community is collegial, it is not truly coordinated. Despite the lack of a truly coordinated effort, international organizations, including the European Commission, NATO, and the United Nations, have implemented a number of anticorruption and judicial reform efforts. For example:

- The European Commission's Customs Assistance Office has established an anticorruption program that is considered the most successful effort. The Office has assisted in establishing needed customs legislation and customs services at the entity level. Investigations conducted and systems put in place by the Office have identified incidents of corruption and illegal activities that have resulted in the loss of millions

of dollars in customs duties and tax revenues. In addition, customs officials perpetrating illegal activity have been exposed.

- The NATO-led Stabilization Force (SFOR) helped the entity armed forces establish an office of the inspector general to help eliminate fraud and corruption in the entities' armed forces. The office's investigations have led to the removal, reassignment, or suspension of noncompliant personnel.
- The U.N. International Police Task Force has focused on restructuring, retraining, and democratizing the local police. The task force has established a certification process through which each police officer is evaluated against specific criteria, including involvement in human rights abuses during the war. In addition, the task force has created specialized units to train Bosnian police in public security issues such as organized crime, drug-related activities, corruption, and terrorism. Some progress is being made, but the linkage between the police and the political parties still has not been broken.
- The international community has implemented a number of efforts to make Bosnia's weak and politically influenced judiciary more independent and professional. The Office of the High Representative for example, has imposed laws to expand the jurisdiction of the Federation Supreme Court, strengthen the Federation prosecutor's office, and provide special witness identity protection. In addition, the United Nations established the Judicial Assessment Program in 1998 to monitor and assess the judicial system in Bosnia.

Despite the need for these and other efforts, they have had limited impact, partly because high-level Bosnian officials have not shown a sufficient commitment to fighting crime and corruption.

U.S. anticorruption efforts, led by the U.S. Agency for International Development (USAID), seek to curtail corruption through the elimination of communist-era financial control structures and the privatization of state-owned enterprises. Experience in Central and Eastern Europe has shown that the best, and possibly the only, way to accelerate the establishment of a sound, competitive commercial banking system is to

attract the business of reputable foreign banks. Although efforts to establish a private banking system in Bosnia are progressing, the U.S. government and international community have had little success in attracting a prime-rated international bank to come to Bosnia.

Privatization efforts have encountered problems, and corruption may undermine the process. According to the United Nations and other experts, the privatization process is another opportunity for government and party officials to profit through corrupt activities. For example, officials may solicit bribes from those interested in obtaining certain assets or sell the assets to themselves at prices below their value. Further, privatization could legitimize political factions' ownership of companies if those factions have the resources to purchase the better companies through private investment funds or other means. The documentation required to privatize Bosnian companies, including opening balance sheets and privatization plans, is being provided by enterprise managers who are not precluded from bidding on the companies, which is clearly a conflict of interest. Several officials told the U.S. Agency for International Development that they were depressing the value of their firms so they could purchase them for less than their true value. The head of the Office of the High Representative's Economic Department publicly stated in April 2000 that a majority of already privatized companies belong to the nationalist political parties. In May 2000, the High Representative removed the president of the management board of the Federation Privatization Agency from his post due to persistent and serious obstruction of the privatization process in the Federation.

INTERNAL CONTROLS OVER INTERNATIONAL AID APPEAR ADEQUATE, BUT ASSISTANCE SUPPLANTS BOSNIAN FUNDS

The United States and other international donors have established procedures for safeguarding assistance to Bosnia, and we found no evidence that assistance has been lost on a large scale because of fraud or corruption. Most of the $4 billion supported Bosnia's physical reconstruction, which has largely been successfully completed. However, we did find instances of corruption within the international assistance effort. For example:

- The United States has yet to recover about $935,000 in U.S. embassy operating funds and USAID Business Development Program loan payments deposited in a bank that was involved in corrupt activities and is now bankrupt.
- In July of 1998, the Business Development Program's manager, a foreign service national, was terminated for receiving payments for helping a USAID loan applicant.
- About $340,000 in World Bank-provided funds was lost as a result of a procurement scheme perpetrated with fraudulent documents. As of May 2000, no arrests had been made and no funds had been recovered.

Despite the international community's success at controlling the use of its assistance funds, such assistance has supplanted millions of dollars the Bosnian governments lose every year to corrupt activities such as customs fraud and tax evasion. Determining the total amount of revenue lost because of corrupt practices would be difficult, and the international community has not systematically attempted to make such a determination. However, evidence gathered during successful customs investigations and partial analysis by the Office of the High Representative show that the losses total hundreds of millions of dollars annually. For example, the Office of the High Representative concluded that a moderate estimate of revenue lost due to tax evasion in Republika Srpska is $136 million, or 40 percent of Republika Srpska's annual $347 million budget.

Due to shortfalls in revenue--partly because of corrupt practices noted above--the entity governments incur annual budget deficits which are then funded through direct budget support (that is, monies added to general revenues and not earmarked for specific purposes) provided by the international community. Most of the $407 million committed by international donors for general budget support is not controlled or audited. (App. I shows the organizations that provided direct budget support and the amounts provided.)

Meanwhile, the Federation and Republika Srpska budgeted about 41 and 20 percent, respectively, of their average annual, domestically financed revenue on military expenditures from 1997 through 2000 despite the High Representative's opinion that

sustaining three large, separate armies, primarily designed to fight each other, is not financially feasible.

If the Bosnian governments strengthened the rule of law and identified ways to collect some or all of the hundreds of millions of dollars lost annually as a result of widespread tax and customs duty evasion, the international agencies' budget support might not be needed.

Our report recommended that the Secretary of State lead a reassessment of the U.S. strategy for assisting Bosnia in establishing a democratic government and a market economy. We believe such a reassessment is necessary because without it the United States and other donors may continue to fund initiatives that have little hope of resulting in a self-sustaining democratic government and market economy based on the rule of law and thus lead to the complete withdrawal of NATO-led forces. In particular, we believe State should consider whether direct budget support is an appropriate form of assistance in the current environment in Bosnia, and how it can support those political leaders in Bosnia whose goals for addressing the corruption problem are consistent with the goals of the U.S. and the rest of the international community. Our report also suggests that the Congress may wish to require that the State Department certify that the Bosnian governments have taken concrete and measurable steps to implement anticorruption programs and sufficiently improved their ability to control smuggling and tax evasion before providing future assistance.

State disagreed with our recommendation. According to State, by 1998, it had undertaken a broad reassessment of its strategy for Bosnia and it continually reassesses assistance priorities in Bosnia. However, we found no evidence that State's reassessment or its current strategy address the underlying causes of corruption and the lack of reform, namely the continued obstructionist behavior of hard-line nationalist political leaders.

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Mr. Chairman, this concludes our prepared remarks. We will be happy to answer any questions you or other Members of the Committee may have.

CONTACT AND ACKNOWLEDGMENTS

For future questions regarding this testimony, please contact Harold J. Johnson at (202) 512-4128. Individuals making key contributions to this testimony include F. James Shafer, David M. Bruno, Hynek P. Kalkus, and E. Jeanette Espinola.

BUDGET SUPPORT COMMITTED BY THE INTERNATIONAL COMMUNITY FOR THE FEDERATION AND REPUBLIKA SRPSKA

Dollars in millions

Organization	Amount
World Bank[a]	$244.5
International Monetary Fund	70.0
European Union	60.0
United States[b]	27.0
Other	5.9
Total[c]	$407.4

[a] World Bank funding includes trust funds financed by other donors.

[b] Includes $22 million committed to Republika Srpska and $5 million committed to the Federation but not disbursed due to the Federation government's lack of compliance with U.S. conditions placed on the funding. The United States has tried to persuade other donors to place conditions on the budget support they provide.

[c] Total does not include all budget support provided by all international donors because information on all donors is not readily available. Total does not include cash transfers from Serbia or Croatia. Estimates of these transfers total more than $500 million from 1996 through1999.

Source: World Bank, International Monetary Fund, European Union, USAID, Office of the High Representative, and International Management Group.

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