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1 Introduction and background

1.1 An outline of rural credit facilities

Over the last few decades Bosnia and Herzegovina has passed through several different periods in terms of overall economic and political circumstances. These periods could be roughly defined as follows: the pre-war socialist period with a centrally planned economy (prior to 1990), the war period with no economic activity but outstanding damages to the whole economy and institutional infrastructure (1992-1996), the post-war period (1996 – 2004) characterized by reconstruction and the availability of soft loans and grants from donors, and the period since 2004, when the country's status in the World Bank changed from that of a post-conflict to a transition country. Issues related to rural credit facilities changed over the time and were reflection of general political and economic situation.

In the former Yugoslavia there was a special fund, called the Fund for Development of Under-developed Republics. Being relatively less developed, Bosnia and Herzegovina was a beneficiary of this fund. From these funds, Bosnia and Herzegovina created its own fund for the development of undeveloped municipalities. These funds were allocated either on favourable credit terms or on a grant basis. As undeveloped municipalities were mainly rural ones, they could apply for and get these funds to finance investments in rural areas. This practice was interrupted in the late 1980s, with the dissolution of the former Yugoslavia.

During the war Bosnia and Herzegovina suffered and experienced enormous damage to its economy and infra-structure. According to World Bank estimates, agricultural production was reduced to one third of the pre-war production level; systems for food processing, distribution and trade infra-structure, the stock of agricultural machinery (where losses are estimated at 80%), livestock assets, irrigation systems, barns, warehouses and other farm facilities – all were almost completely destroyed or significantly damaged. In such a situation, the first priority was to reconstruct the basic conditions for the survival of the rural population rather than to develop rural regions as such. Thus, the years immediately after the war were characterized by many programmes and projects being implemented in rural areas with social, rather than commercial and developmental, characteristics. Bosnia and Herzegovina was, at that time, completely dependant on international funds while domestic banks were in the process of privatization and had no funds available for rural credits. During this period the main financial sources were the World Bank, the EU, IFAD, FAO, USAID, GTZ, SIDA, and many other governmental and non-governmental organizations.

One of the most important projects implemented during that time (1996-1998) was the Emergent Farm Reconstruction Project. The total Project budget was 42.4 mill USD, of which the EU Commission grant was 6.9 million USD, IFAD's soft loan 7.3 million USD and the World Bank's soft loan 20 million USD. The main components of the Project were reconstruction of agricultural machinery (32.3 million USD) and of livestock fund (14.4 million USD). The main beneficiaries were farmers from the regions where more than 50% of the agricultural facilities had been destroyed, those who used to have livestock and machinery before the war, or those who were refugees or displaced persons. Credits were given to the farmers under the following conditions: for machinery – 10 years repayment period, 2 years grace period, and 2% interest rate; and for livestock - 5 years repayment period and 2%

interest rate. In the post-war period similar projects with a humanitarian character were implemented across Bosnia and Herzegovina.

Nowadays, Bosnia and Herzegovina still does not have a clear selective development strategy for rural areas, neither has it a selective credit policy that would follow such strategy. This means that the rural population, enterprises and entrepreneurs face credit conditions and credit lines no different to any other business or person in the country. The lack of favourable credit lines that are tailored to the specific characteristics and needs of agriculture is among the most often mentioned obstacles to the development of the sector. Bearing in mind that agriculture is the main income source of the rural population in Bosnia and Herzegovina, agricultural credits are crucial for rural financing. Although establishment of a specialist agro-bank has been advocated by experts for years it has not been established yet.

Still, it cannot be said that there has been no improvement in the sector. Most commercial banks in Bosnia and Herzegovina have gradually developed special credit lines for agricultural producers and/or small and medium enterprises. The Government of the Federation of Bosnia and Herzegovina have founded the Federal Investment Bank that offers special a credit line tailored to agricultural production and this is available through the network of commercial banks. Furthermore, a certain number of micro-finance institutions have been established with different credit lines intended for different population groups or individuals. However, saving-credit associations that could be important facilitators of rural financing still do not have a legal framework for establishment, as the law on these institutions hasn't been adopted yet in either of two entities of Bosnia and Herzegovina.

1.2 Major credit and rural policy developments in 2005

Agriculture, ever since the end of the war, has always been mentioned as one of the most important and strategic economic activities for Bosnia and Herzegovina, both by state officials and by local and international experts. According to the Dayton Agreement, and the Constitution of Bosnia and Herzegovina that was derived from it, there was no Ministry of Agriculture at state level. Therefore, different agricultural policies have been applied in the Republika Srpska and in the Federation of Bosnia and Herzegovina, which has been the reason for the different economic positions of farmers across the state as a whole. Experts from both entities have frequently emphasized the need for the establishment of a common Ministry at state level, but this idea has never been realized as there is no political will for it. Awareness of the need for a common state Ministry of Agriculture was raised further following the publication of the "Functional review of the agricultural sector in Bosnia and Herzegovina" (2004) financed by EU. One of the key recommendations of this study is that a "common ministry of agriculture and rural development is the main condition for any further important progress towards EU integration and for the development of rural regions in Bosnia and Herzegovina". As the result of this raised awareness, a political consensus on a common ministry has been achieved during the last round of negotiations between the political parties and this issue is expected to come before Parliament in near future.

During last few years, improvements have been made in the sense that agriculture got concrete, financial support, and not only verbal support, in relation to the issue of agricultural credits. Thus, in the Republika Srpska, from January to November 2005, 1.4 million EURO (12.2% of total amount paid for incentive measures) were allocated for reimbursement of the interest paid on agricultural credits. Ministry of Agriculture of the Federation of BH allocated a significantly lower amount, 75,000 EURO (only 1% of the total budget) for agricultural support. But, as the Federation BH has another level of governance, cantons, this kind of

support was financed by each cantonal Ministry of Agriculture according to the available funds and according to the significance of agriculture for the canton concerned.¹

In both the entities of Bosnia and Herzegovina, in 2005, special departments for rural development were established within the Ministries of Agriculture. But modest human resources in these departments, as well as the budgets allocated to them, unfortunately suggest that these departments will probably not play an important role in rural development related issues in the near future.

Currently, designing the mid-term strategy for agricultural sector development is taking place. The draft has already been written and will soon be distributed to all key stakeholders. This draft includes a certain number of recommended measures that could contribute to 'rural finance' issues. According to the draft strategy, the adoption of a law related to the establishment of saving-credit associations is predicted by the end of 2006. Rural finance in Bosnia and Herzegovina has already suffered because of the lack of such a law. Thus, an on-going project, financed by IFAD, "Livestock and rural finance development", failed to place 3.5 million USD intended for rural finance through SCA as there was no legal framework for these institutions, and consequently the rural areas of Bosnia and Herzegovina lost valuable funds due to the lack of an appropriate legal framework.

1.3 Access to rural credit – uptake and issues

Rural areas in Bosnia and Herzegovina were always to a certain extent neglected as there was no strategy or policy that would be sensitive and recognize special limits and needs of rural areas. Even before the war, when a fund for the development of under-developed regions existed, agricultural producers, the poor rural population and private entrepreneurs and enterprises were not able to benefit from it, as it was intended only or mainly for state-owned business. During the war, rural regions suffered at least as much damage as urban ones, but reconstruction of these regions was significantly slower, and, although these regions have so far been within the focus of the large national and international funds, the average living standards and the social and economic infrastructure is still poor; and the implemented projects appear to have had a social and humanitarian focus rather than a developmental impact. According to the World Bank's estimates, 55% of the total B&H population live in rural areas. Due to enormous war damage on economic infra-structure, the high unemployment rate and the poor educational structure the rural population is now even more reliant on agriculture than it was before the war. On the other hand, it is clear that the perceived high risk factors related to agriculture prevented lenders from providing the needed finance and credits for this critical sector at the beginning of the post-war period. The lack of credit lines tailor-made for agriculture and other rural businesses is probably the most often mentioned obstacle and missing link in the development of agriculture, and has been identified as a crucial issue by both national and international experts and specialists. To improve this situation, in 2002 the EC initiated a rural credit line with a grant estimated at up to 5 million EURO, to establish rural finance in BH through a project called "Seed Capital and Credit Facilities" aimed at various beneficiaries such as refugees, internally displaced persons, farmers associations and cooperatives. This, and many other valuable projects, gradually improved the situation and provided remarkable help for the rural population, but they remain as the only successful projects while a permanent, systematic, legally framed rural finance policy, supported with sound policy measures, is still missing. By the time a

¹ For example, Ministry of Agriculture in Tuzla Canton allocated 400,000 EURO for this purpose in 2005, which resulted with placement of 4 million EURO of agricultural and food processing credits.

sound rural finance policy is introduced the rural population, agricultural businesses, other rural businesses and entrepreneurs will have credit sources and terms which are identical to those available to their urban counterparts.

At the moment, one comforting fact is that the whole of Bosnia and Herzegovina is well covered with banking institutions and micro – finance institutions and their branch offices, so at least rural areas have physical access to existing credit lines, and can be properly informed about them. According to a recent investigation of the World Bank Group (in 2005) into the ease of doing business, 155 countries were analysed and ranked in 10 indicators of which the indicator ‘getting credit’ – was one. Bosnia and Herzegovina’s overall ranking was 87, and in the ‘getting credit’ indicator its rank was 9! The basis for evaluation were indicators such as legal rights for borrowers and lenders, and factors such as the scope, access and quality of credit information through public registries and private bureaus. This means that legislation in the banking sector in Bosnia and Herzegovina is appropriate and the banking sector can serve as a solid basis for possible future measures related to rural finance policy.

2. Availability and performance of rural credit facilities

2.1 Assessment of short-term credit sources

Bearing in mind that there are no agricultural or rural credit institutions that deal exclusively with agriculture and other rural businesses in Bosnia and Herzegovina, there are two sources from which rural individuals, collectives and enterprises can get short-term credits under the same conditions as any other applicant. One of these sources is the commercial banking sector, and the other is the micro-finance institutions.

The banking sector in Bosnia and Herzegovina has been successfully privatised, according to World Bank Country Brief (2006). Currently, there are 10 banks in the Republika Srpska² and 24 banks in the Federation of Bosnia and Herzegovina³. Most of the banks are private or dominantly private-owned (75% in FBH and 100% in RS). In 2005 banks in RS placed 744 million EURO in credits, out of which 25.5% were short-term loans. About 75% of this amount was placed in the private business sector. Banks in the Federation of Bosnia and Herzegovina in the first nine months of 2005 (status 30.9.2005) placed a total amount of 2.5 billion EURO, out of which 21% were in short-term credits. The share of the private business sector of the total placed credit was 43.9%, but there are no available data on credits for agriculture or other rural economic activities on entity or state level.

Most commercial banks in Bosnia and Herzegovina offer short-term credits aimed at the financing of working capital, but only one of them has a special short-term credit line for agricultural producers (ProCredit Bank). This bank operates across the whole territory of Bosnia and Herzegovina, so potentially all citizens have access to it. Credits of up to 10,000 EURO are given for working capital over an 18-24 month period, the monthly interest rate is 0.9%, with one co-signer (up to 2,500 EURO another agricultural producer can be co-signer). The application procedure is simple and very quick. In most of the commercial banks in the whole of Bosnia and Herzegovina there are short term credits intended for the financing of working capital for small and medium enterprises and micro-businesses. These credits amount to up to 50,000 EURO, the repayment period is up to 2 years, in most of the cases there is no grace period (except in the Federal investment bank) and the interest rate varies

² Banking Agency of the Republika Srpska, report, (status 20.01.2006),

³ Banking Agency of Federation of Bosnia and Herzegovina.

from EURIBOR + 3% up to 13%. Only two banks in RS that have tailored special credit lines for SMEs do not require collateral for these credits.

The micro-credit sector in Bosnia and Herzegovina had a significant role during the post-war period in poverty reduction and support to the small and medium entrepreneurial developments among the socially endangered population that has no possibility of obtaining financial resources from the traditional banks. Since 1996, Bosnia and Herzegovina facilitated the development of this financial sector through the Local Initiatives Project (LIP) supported by the World Bank and through the support of the international non-governmental organizations. The main role of micro-financing institutions lies in the fact that they serve the clients who do not have collateral and have low income or no income whatsoever. In the period from 1996 until today 14 micro-financing organizations have been established. According to data of AMFI (Association of Micro-finance Institutions in Bosnia and Herzegovina) micro-credit organizations are currently serving app 130,000 of active clients and are managing credit potential in the amount of 150 million EURO.

MFI in Bosnia and Herzegovina relies mainly on funds from different international and local governmental and non-governmental organizations and institutions (WB, EU, USAID, GTZ, Federal investment Bank and so on). The network of MFI covers the whole territory of Bosnia and Herzegovina and they offer credits that amount 250 – 15,000 EURO for agricultural producers and cooperatives, rural groups and individuals and entrepreneurs under following conditions: repayment period from 12 to 36 months, grace period from 6 – 9 months, with interest that varies from 0.7% up to 3% on monthly basis. No business plan is needed in most of the cases, and when such a document is needed employees of MFI are available to help. No collateral is requested, only co-signers. Application and evaluation procedures are very quick so the money can be at applicant's disposal within few days.

2.2. Assessment of medium-term and long-term credit sources

There are no available official data at state level about the total amount of medium-term and long - term credits placed in agriculture or other rural activities and business. The total amount of long-term credits placed in 2005 in RS was 559 million EURO, while in the Federation of Bosnia and Herzegovina the equivalent amount was 3,874 million EURO (respectively 6.9 times higher than in RS) for just the first three quarters of 2005. The share of private business subjects within the total credit beneficiaries was 42.5% in RS and 43.9% in FBH, while the majority of long-term credit funds were allocated for credit finance for citizens rather than for investment.

Practically the only source of medium and long-term credits for rural activities are those in commercial banks intended for agricultural investment finance and for small and medium enterprises. Almost all banks have such long-term investment loans, and all funds from international donors and creditors go through the commercial banks as well.

The only credit line that is explicitly aimed at rural finance is the KfW fund credit line, called 'Credit for financing in rural areas' placed through Raifeissen Bank d.d. Sarajevo. The target group for this credit line is small and medium enterprises with less than 50 employees involved in one or more of the following economic activities: food-processing, food and agricultural transport, the distribution and marketing of agricultural commodities, dealers of agricultural and food processing inputs from rural regions and any other economic activity in rural regions. Credit is given under the following conditions: the credit amount is between 2,200 – 46,000 EURO, the payment period is two years with a 9 months grace period for

agriculture and 6 months for other activities for working capital, and 5 years with 9 months of grace period for agriculture and 6 months for other activities for investments. Interest rate is EURIBOR + 6%. Sound business plans and collateral is requested.

Conditions for long-term credits in commercial banks for agriculture are: amount from 10,000 to 250,000 EURO, a repayment period of up to 8 years, a grace period of up to 2 years, an interest rate of between 6% and 11.5%. All commercial banks require a business plan and collateral for long-term credits.

Long-term credits for SMEs are given under following terms: a credit amount of between 5,000 EURO and 380,000 EURO, a repayment period of between 3 and 10 years with a 6 – 12 months grace period, and interest rates varying between EURIBOR + 4% up to 8%. Business plans and collateral are requested.

Besides these credit lines, it is important to mention the Federal Investment Bank (FIB) and its credit lines as being the most important source of credit finance for the agricultural sector. The FIB was founded by the Government of the Federation of Bosnia and Herzegovina. The FIB has a special credit line financed from financial means collected from levies, aimed at providing long-term investment credits for agriculture. The beneficiaries are farmers, cooperatives and agricultural enterprises from the Federation of Bosnia and Herzegovina. The credit amount depends on the purpose of the loan, and the interest rate is between 8% and 10%. The repayment period is from 18 months to 7 years. What makes this credit line unique is its sensitivity to the biological characteristics of agricultural production, particularly plant production. This is reflected through a grace period that no other bank in Bosnia and Herzegovina offers. The grace period in the FIB credit line is from 6 months up to 36 months (for fruit and wine growing). Apart from agricultural investment credits, the FIB also has investment credits for SMEs under following terms: amount up to 1 million EURO, payment period up to 84 months, grace period up to 9 months and interest rate equivalent to EURIBOR + 5%. All credits from the FIB credit lines are distributed through 18 commercial banks in the Federation of Bosnia and Herzegovina.

As already mentioned, the long term IFAD Project “Livestock and rural finance development” is currently being implemented in Bosnia and Herzegovina (2002-2008). The total Project budget amounts to 25.5 million USD (9 million USD for RS and 16.5 million USD for FBH) and its main components are: the development of livestock production and entrepreneurship, the reconstruction of rural infrastructure and rural microfinance development. The third component has not been implemented due to the lack of an appropriate legal framework. Within the component reconstruction of rural infrastructure 51 micro-projects were implemented in FBH (total amount 3.46 million EURO) and 26 micro-projects were implemented in RS (total amount 1.21 million EURO). Project Coordination Units from both entities estimate the number of this component’s beneficiaries at 95,000 rural inhabitants. Furthermore, in this project there is a credit line for livestock and agricultural machinery acquisition and small and medium enterprises development. Funds are placed with clients through chosen commercial banks under the following conditions: a repayment period of four years for livestock, 3-5 years for machinery and up to 7 years for SME, grace period 6 months for livestock and up to 18 months for SMEs, and an interest rate of 6-7%. Own participation to the level of 10-15% of the total credit is required for machinery and SMEs.

2.3. Assessment of the adequacy of credit sources

In evaluating the available credit sources, the ease of obtaining credit and the adequacy of the credit terms need to be analysed separately. For short – term credits, agricultural producers are very satisfied with the procedure for getting credits from micro-finance institutions, it is simple and very quick, and for most of the poor rural inhabitants this is the only credit they have access to. Business plans are required only for larger amounts of credit, and in most cases there is no need for collateral. Personnel from MFI are willing to help with a business plan and in most cases are familiar with agriculture and other rural businesses. They also inform the rural population about existing credit possibilities, even in direct contacts they themselves initiate. However, the interest rate for this type of credit is typically far too high for agriculture, and the cost of access to borrowed capital is much higher in MFI than in commercial banks. Furthermore, instalments are repaid monthly regardless of seasonal factors, so the only advantage of MFI for small rural businesses is the easy and quick procedure for obtaining short- term loans. These comments apply equally to short – term credits for entrepreneurs as well.

When it comes to medium and long – term credit, the situation is even worse. The only permanent source of this form of credit is the commercial banks the application procedure is more complicated, a lot of administrative work has to be done, a detailed business plan has to be submitted, and adequate collateral is needed (at least in most cases, see section 2:1) all of which tend to make investment credit lines inaccessible for most of the poor clients in rural areas. Being registered as business entities, entrepreneurs and small and medium enterprises are in a somewhat better situation. Even so, interest rates for long – term credits are too high for both agricultural producers and other rural businesses. The efforts of the government in Bosnia and Herzegovina to subsidize interest for agricultural credits is welcome, but is far from being enough to meet the needs of the sector. As funds are not enough for all credit applicants in the sector there is an opportunity for corruption, and many farmers claim that they all do not have the same chance to be subsidized.

Maybe the most important shortcoming of the existing credit facilities is the lack of medium and long – term credit lines that are tailored to the specific economic and biological characteristics of the agricultural sector. For example, except for the Investment Bank of Federation, there is not a single bank that offers a grace period long enough for fruit-growing investments.

As the micro- business sector records expansion and so draws the attention of lending institutions, although there are sufficient credit lines available, again these are typically designed with no sensitivity or understanding of needs of the rural business sector. For loans to farmers, rural entrepreneurs or other rural businesses banks do not yet have an agricultural specialist or a rural business specialist available for clients; instead, they rely on generalists (mainly economists) who do not usually know enough about nature, and the problems, disadvantages, risks and needs of agriculture and related economic activities. In 1998, USAID Business Department, being aware of this problem (since at that time the USAID agricultural credit line was placed through commercial banks) organized training for the banks that deal with agricultural credits in order to educate them and make them familiar with these issues. However, that was a sporadic initiative and banks in Bosnia and Herzegovina have not in practice attempted to train personnel as agricultural or rural credit specialists.

It should be noted that, within the EU PHARE Project implemented in 2000, extension service offices were founded throughout Bosnia and Herzegovina. Among their other tasks and assignments, employees of these offices are in charge of helping farmers with designing business plans and providing other advisory services when applying for credit finance.

To summarize, there are no credit facilities in Bosnia and Herzegovina exclusively designed for providing appropriate credit finance to agricultural and other rural businesses. Typically, the existing credit lines are too expensive and they are inadequate for the current level of development of the agriculture and rural business sectors in Bosnia and Herzegovina.

2.4. Evidence of credit market failure

There is no published evidence of credit market failure in Bosnia and Herzegovina. The reported repayment rate for credit finance placed so far in Bosnia and Herzegovina is reported to be between 95-98%.

2.5. Overview and prospects

In July 2004 the status of Bosnia and Herzegovina under the World Bank's definition officially changed from post-conflict to transition economy. While the country was being treated post-conflict, great deals of funds were allocated, as grants or soft loans, to the reconstruction and development of the whole country including its rural areas. Nowadays, the rural economic sector, and particularly agriculture, has to fight to get access to the appropriate credit finance for recovery and development. There is a common agreement among all national and international experts that the lack of availability of adequate credit funds is among the most serious obstacle for future agricultural development. Currently there is no selective policy where rural areas are concerned, neither is there a selective (specialist) rural credit sector. Credit facilities for rural finance are not adequate, the cost of credit finance is too high and the procedures for obtaining it often complicated. Commercial banks do not have sufficient understanding of the specific needs and problems of agriculture and other rural activities, and government's efforts to alleviate the problem are not sufficient. Foreign governmental and non-governmental sources still play a very important role in the rural credit and micro – credit sector. There is a growing awareness among both experts and authorities that something has to be changed. The draft mid-term strategy for agricultural development has now been finished and it proposes two measures that could have a crucial importance for the rural finance sector. One suggestion being considered is the establishment of an agrarian bank which offers soft loans for agriculture; another is the proposed adoption of a law allowing credit – saving associations. With the establishment of the Department for Rural Development within the Ministry of Agriculture, this has been favourably evaluated by foreign experts. If this draft strategy is adopted and implemented Bosnia and Herzegovina has a chance to create credit lines tailor-made for agriculture, and consequently to create a solid foundation for the establishment of a rural credit sector as the precondition for long lasting and sustainable rural development.

Note: There are no statistics on rural indebtedness available so there is possibility of including a summary of the situation within it this report.

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