

Newsletter

Economic Reform and
Reconstruction
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NEW PRAGMATISM PRODUCING IMPROVEMENTS IN BIH BUSINESS ENVIRONMENT

During the last quarter there has been significant progress in improving the BiH business environment.

On 30 September, the Council of Ministers adopted the draft Law on the Indirect Taxation System, which has now been submitted to the BiH parliament. This law will give BiH the kind of modern fiscal system which is indispensable for sustained economic development. This legislation when it is enacted will represent a strategic breakthrough in the country's economic rehabilitation.

On 12 September the Coordination Board for Economic Development and European Integration, which brings together the State and Entity economic ministries, heard presentations from experts from Hungary and Serbia & Montenegro on the successful strategies applied in their countries to overcome structural obstacles to privatisation. Until now, privatisation has produced only modest results in BiH – giving the entire process a bad name, it has come to be associated with political corruption and financial sleight of hand -- and has failed to unleash the kind of investment flows the country desperately needs. At its 12 September session the Coordination Board agreed to establish a Working Group which will bring together experts from the Entity privatisation agencies and the relevant ministries to propose practical solutions to the legal and administrative obstacles that have bedevilled privatisation until now. The Working Group will make its first report by the end of the year..

On 29 September in Sarajevo Federation Prime Minister Ahmet Hadzipasic and Federation Finance Minister Dragan Vrankic unveiled the Special Auditor's reports into BH Telecom and HPT Mostar. Two days later, in Banja Luka, RS Prime Minister Dragan Mikerevic unveiled the Special Auditor's report into Telekom Srpske. The findings of these audits were consistent with those already undertaken at the Elektroprivredas, the Vodoprivredas, and the employment bureaux. They reveal the persistence of an outdated mindset, a culture of privilege and party affiliation (abandoned in the rest of Central Europe) where tenders are conducted in a way that favours insiders instead of customers, where senior managers operate without adequate controls, where bookkeeping is opaque and administration is bloated and inefficient.

So the Prime Ministers have committed themselves to enacting, by the end of this year, corporate governance legislation that will strengthen institutional safeguards and close loopholes in which managerial fraud currently thrives. The legislation will establish a detailed code of ethics for all public-company employees, from the chairman down, and will require the setting up of internal controls and strict approval processes for procurement, distribution of profits and adherence to business plans. Companies will be obliged to compile financial statements to international bookkeeping standards -- which means every last KM must be accounted for. The new rules will also make it clear that board members must *understand* their legal obligations. When they are held accountable they cannot plead ignorance. And if they break the rules they will be liable to a fine, or imprisonment in serious cases.

I believe we may be witnessing the beginning of a change in the mindset of serious politicians that is essential for real reform. The authorities are beginning to display the kind of pragmatism and focus that can get basic building blocks of a positive business environment in place. If this is sustained it will open the way for investors and entrepreneurs to transform the BiH economic landscape and deliver real benefits to citizens, in terms of employment and services.

Ambassador Donald S. Hays
Principal Deputy High Representative

TAX POLICY

BiH Council of Ministers Adopts Draft Law on the Indirect Taxation System of Bosnia and Herzegovina

Meeting on 30 September 2003, the BiH Council of Ministers unanimously adopted the draft Law on the Indirect Taxation System of Bosnia and Herzegovina (draft Law). A detailed account of the provisions of this draft Law was set out in the previous Newsletter.

The Council of Ministers also called for the draft law to be adopted by the BiH House of Representatives and House of Peoples under an urgent procedure so that the process of merging the Customs Administrations, setting up the Indirect Tax Policy Governing Board and introducing Value Added Tax (VAT) can get underway.

It should be noted that the Council of Ministers made only one change to the draft Law presented to it by the High Representative. This change concerned the location of one of the regional centres of the Indirect Tax Administration (ITA). The draft presented to the Council of Ministers had stipulated that the four regional ITA Administration Centres would be located in Banja Luka, Sarajevo, Mostar and Brcko. The Council of Ministers determined that Tuzla rather than Brcko should be the location of one of these four regional centres. From a practical and tax policy point of view, this change has no impact.

It is vital that the draft Law in its current format is not distorted in the course of Parliamentary procedure. The continued vocal support of the International Community – through financial organizations, donors and embassies – will help ensure that this reform takes place.

TRANSPORT

Rail Transport

An important Railway Roundtable was held in Sarajevo on 2 September 2003. The object was to discuss the state of the rail sector and the drafting of a law for the railways of Bosnia and Herzegovina. The

Roundtable provided an open forum for discussion and support for the process of drafting the new law. The result of the meeting was the establishment of a Working Group and a commitment to have a draft completed by December with another roundtable to follow, which will include international experts.

The RS and Federation governments have been discussing shifting the transport of oil imports from road to rail, although no decision has been taken yet. Before the war, most petrol products were transported by rail; however due to the damage sustained by the rail network, this is now done by truck. With the rehabilitation of the rail network, it is important that transport of oil products and all heavy materials now be transferred back to the railways. Among other things, this will make it possible to reduce rail subsidies.

All of the factors, including such things as reducing congestion on the roads, competition in the distribution of oil, pricing, service, quality control, safety and environmental impacts and -- most important -- government budgets indicate a strong case for supporting the transport of oil and other products by rail. More than a year ago, Croatia decided to move oil transport onto the railways, and this was implemented without any adverse effect.

Road Transport

The BiH Council of Ministers coordination team in charge of supervising construction of the Corridor Vc motorway is negotiating with Bosmal and with the Croatian Government. It is expected that the group of experts under the Ministry of Communications and Transport will propose that the BiH CoM issue a tender for a comprehensive feasibility study.

BULLDOZER COMMITTEE



Bulldozer Phase II, launched on 4 June 2003, is well underway. A total of 50 reform recommendations were approved during three Plenary Sessions held in Sarajevo on 29 July, 11 September and the 29 September. These proposals will be scrutinised and fine-tuned by legal and management experts before the end of October. The aim is to have all 50 reforms enacted by the end of the year - matching the success achieved by Bulldozer Phase I.

The 50 proposals were discussed and approved by members of the six Regional Bulldozer Committees and the National Committee on Agriculture. Their collective goal was to recommend practical ways of eliminating pointless bureaucracy or inefficient regulations that make it hard to run companies in BiH and create jobs.

Examples of these bureaucratic and procedural obstacles to investment include the requirement that small businesses must have their invoices certified at a relevant tax office before they can invoice their customers. This wastes entrepreneurs' time and affects companies' cash flow because they cannot invoice customers promptly. This can threaten the ability of small-scale enterprises to conduct normal business.

Another example involves the amount that RS authorities charge for issuing a permit (in addition to the usual incorporation fee) to trading companies that wish to do business internationally. Whereas in the Federation, this additional sum is KM 64, the same fee amounts to KM 1,000 in the RS. There appears to be no justification for charges of such magnitude in the RS. This practice discourages business and investment and undermines the Single Economic Space.

An Emergency Reform Unit (ERU) has been established by the Federation. The RS is in the process of establishing its ERU. However, the BiH Council of Ministers has not yet set up an ERU. All three governments have committed to establishing ERUs.

The ERUs are made up of seconded civil servants who will be responsible for getting the Bulldozer proposals through government and parliamentary procedure and supervising their speedy implementation. They will provide a direct link between the business community and the very heart of the governments of BiH. Ideally, the ERUs will make the governments more aware of and responsive to the taxpayers' needs.

In August, the Bulldozer Committee published 200,000 copies of a concise guide to privatisation. This guide explains the benefits which transparent and effective privatisation processes can bring to the people of BiH. In addition, the guide contains a number of case studies which feature privatised local companies as examples of what a successful privatisation process can achieve. The brochure reached almost every household in the country through distribution as a newspaper supplement.

Articles about the Bulldozer effort are accessible through the OHR website on <http://www.ohr.int/ohr-dept/econ/bulldozer-initiative/index.asp>

ENERGY SECTOR

On 17 September a donors' meeting was held at the European Commission in Brussels to review the status and direction of BiH electric power reform and its linkage with the Southeast Europe regional electricity market, and also developments more generally in the sector.

The donors reiterated that implementing the Power III project and restoring the BiH electric power infrastructure are critical elements in completing the regional energy market.

The Commission emphasised the importance of Bosnia and Herzegovina's capacity both to take ownership of vital reforms such as the restructuring of its electric power sector, and to play an active and responsible role in regional co-operation such as the development of a functioning regional electricity market. This is seen as a key indicator of the country's progress in the Stabilisation and Association Process.

Till now, there have been several key successes in the reform process of the BiH electricity sector:

- Adoption of State and harmonised Entity Electricity Laws (in 2002).
- Regulators:
 - The three Commissioners of the State Electricity Regulatory Commission have been appointed.
 - FBiH Regulator: Commissioners nominated by the Federation Government; to be appointed by the Parliament.
 - RS Regulator: Commissioners nominated by the RS Government; to be appointed by the RSNA.
- Adoption of harmonised RS and FBiH Restructuring Action Plans
- Transmission Company and Independent System Operator: draft laws submitted to the CoM.

However, the Brussels meeting noted that much remains to be done, and welcomed OHR's continued monitoring of the implementation of the reform process.

BUDGETS

On 22 September the BiH Council of Ministers adopted the draft 2003 budget rebalance. The draft rebalance amounts to 211,939,624 KM. The increase from the original 2003 budget adopted was caused mainly by the surplus achieved in 2002, and as the result of an increase in government revenue.

The budget is reform-oriented, and priorities connected to current reforms (the court system, SIPA, SCMM etc.) are adequately reflected in the draft rebalance.

This draft will now be presented to the Presidency, and then to Parliament.

Internal debt

Reacting to the IMF's presentation of the internal debt situation, the BiH Council of Ministers established a Working Group on Internal Debt. The Working Group held its first meeting on 5 August 2003. It is supported by the International Community, which has offered technical assistance.

The Working Group met throughout August and September, and has produced three drafts of laws which will temporarily suspend payment upon court decisions on individual cases related to **internal** debt (frozen foreign currency deposits, war claims (material and non material) and government arrears until end 2002).

These laws would give Governments time to develop a strategy for resolving the issue of internal debt, and enacting the necessary legislation. The tentative deadline for is 1 March 2004.

PRIVATIZATION

The 15th session of the Coordination Board for Economic Development and EU Integration (Coordinating Board) held on 12 September in Sarajevo was dedicated to privatization. The meeting noted that relaunching the privatisation process is a stated near-term priority of the BiH governments. Representatives of privatisation agencies and relevant ministries from Hungary and Serbia & Montenegro also attended the

meeting, and presented experiences and lessons learned from privatization processes in their countries.

The Entity governments have identified a variety of legal, administrative, and institutional hindrances to a successful and transparent privatization process. Significant work on identifying these obstacles has already been done, and operational documents have been prepared by both Entities. The Action Plan agreed at Mrakovica in June and adopted by the BiH Council of Ministers and Entity governments in July commits the Entity governments to tender at least five strategic companies each by the end of 2003 and remove a range of impediments to successful privatization.

In light of this, the Coordination Board agreed to form a privatization Working Group with the task of developing and proposing solutions for identified obstacles to privatization.

The Working Group held its first meeting on 12 September. It consists of representatives of the FBiH and the RS privatization agencies (Zlatan Dedic of the Federation Privatization Agency and Zoran Dosen of the RS Directorate for Privatization), and representatives of the Federation Ministry of Energy, Mining and Industry, the RS Ministry of Economy, Energy and Development, the Federation Ministry of Finance, the RS Ministry of Finance, the BiH Council of Ministers, and the Foreign Investment Promotion Agency. This concentration of experts from the relevant ministries will give the Working Group the technical and political capability necessary to address fundamental difficulties with the BiH privatisation process to date and propose practical, coordinated solutions which can be applied in the near term.

SOCIAL SECTOR

BiH Employment Bureau Systems

About a year ago the World Bank initiated a project to audit and review the work of all BiH Employment Institutes. The project was endorsed by the relevant BiH government institutions. The World Bank engaged PriceWaterhouseCoopers (PWC) to undertake a "Special Review of the BiH Employment Institutes."

The PWC audit team encountered numerous obstacles in its work. These obstacles were posed by the management of the BiH Employment Bureau and the

Federation Employment Bureau management, both of which refused to grant the auditors access to certain crucial information regarding their operations. For instance, both the BiH Employment Bureau and the Federation Employment Bureau conducted loan programs to companies aimed at generating employment. In 2002, the Federation Employment Bureau disbursed around 30 million KM through these loan programs. The auditors, however, were refused access to information on these loans.

Furthermore, the auditors found that the scope of activities of the BiH Employment Bureau was completely unclear, and that it had undertaken certain tasks that were clearly a competence of the Federation Employment Bureau. According to the auditors, the BiH Bureau continued to perform activities such as arranging employment of BiH citizens abroad and protecting their rights, monitoring the implementation of international conventions and agreements, providing help in choosing professions, managing projects and financing programs for pre-qualification of unemployed individuals, and managing the social security funds of BiH citizens employed abroad (primarily in Germany). "As a result, there developed a parallelism of activities performed by the BiH Bureau and those performed by the Federation Employment Bureau," the auditors concluded. Moreover, the financial management and accounting practices of both the Federation and BiH Employment Bureaux failed to meet modern requirements for transparency, accountability, and efficiency.

What is extremely worrisome now is that the BiH Employment Bureau has continued to operate despite the fact that it was legally abolished under the new BiH Law on Ministries and Other Administrative Bodies and the European Directorate of March 2003. The activities of the Bureau were to be taken over by the new BiH Labor and Employment Agency.¹ The World Bank and the OHR have repeatedly urged the BiH Council of Ministers to take appropriate steps to close the Bureau, undertake an investigation into possible corruption and launch the new BiH Labor and Employment Agency. The reluctance of the CoM to address this issue is a matter of serious concern.

Likewise, both the World Bank and the OHR have addressed the Federation Government advising them to adopt the audit report and follow the auditors' recommendations to improve the alarming situation in the Federation Employment Bureau. The Federation Government has merely concluded that the audit report

is incomplete and it cannot be adopted in its present form (the only reason it is incomplete is because of the failure of the Bureau to provide relevant information to the auditors).

It is perplexing that neither the BiH Council of Ministers nor the FBiH Government recognize the urgency of this matter. Unemployment levels remain extremely high while the employment bureaux continue to operate inefficiently, burdened with a lack of transparency, unsound policies, and poor management.

CIVIL AVIATION

Director General for Civil Aviation

In June the BiH Council of Ministers approved the restructuring of the Directorate of Civil Aviation in BiH. However, the CoM failed to appoint a Director General until October.

On 8 July 2003, the CoM Personnel Commission released the names of candidates for the position of Director General and two Deputies. In June, a Commission composed of five aviation experts (including two international experts) of the Civil Service Agency, selected the nominees. Then, the CoM failed to discuss the appointments, despite repeated requests by the International Community to do so. As a result, the European Commission suspended the EC/ICAO Institution Building Project. On 2 October, the CoM appointed Đorđe Ratkovića as Director General of the Directorate for Civil Aviation of Bosnia and Herzegovina; Đelal Hasečić was appointed Deputy Director General and Head of the Regulatory Division, and Marinko Šimunović was appointed Deputy Director General and Head of the Air Navigation Division.

BiH now has in place the necessary and properly organized administrative machinery to supervise its airspace and to plan to expand domestic management of its upper airspace.

BiH to get a new Law on Civil Aviation

The new draft Law for Civil Aviation in Bosnia Herzegovina was approved by the CoM on 29 July 2003. The law was adopted on first reading by the House of Representatives on 24 September and by the House of the Peoples on 30 September. Six amendments have been proposed.

¹ The Law on the BiH Labor and Employment Agency was adopted in July this year. However, the launch of the Agency cannot begin until the BiH Employment Bureau is closed, its assets transferred to the Agency, and until the Council of Ministers appoints the management for the Agency.

The new law brings BiH into complete compliance with International Civil Aviation Organisation regulations and practices and European recommendations, and will facilitate the establishment of a single Civil Aviation Authority. This will effect a clear separation between the regulatory functions at State level [Directorate of Civil Aviation in BiH (BiH DCA)] and operational functions at Entity level [Fed CAD (Federation Civil Aviation Directorate), RS CAD (RS Civil Aviation Directorate) and, if necessary, external bodies]. Adoption and full implementation of this law is also a requirement for BiH's membership of the Joint Aviation Authority.

The new law lays out the new BH DCA organization to be implemented by the Director of the BiH DCA.

Future of Mostar and Sarajevo Airports

Hand-over of Mostar Airport Services, run by SFOR, to the civil authorities will take place when ICAO Standards (mainly fire fighting capabilities) have been met. This hand-over must be completed by the end of 2003, when the French DETAIR will withdraw.

A Thales radar is being installed at Sarajevo International Airport and should be operational by the end of October, when the French military radar will be withdrawn. Local controllers are now undergoing intensive training with a view to acquiring Approach Control (radar and procedures) licenses. Controllers are also undergoing Approach Director/Supervisor training. They will take over from French controllers and begin providing air traffic services in full compliance with ICAO Standards. Later they will complete Instructor training.

AGRICULTURE

Agriculture/Phytosanitary sector

The BiH Council of Ministers has yet to establish a State-level Administration for phytosanitary issues. The main task of the Phytosanitary Agency is to deal with the protection of plant health, to collect and disseminate information, to regulate public services in the domain of plant protection, to maintain inter-Entity coordination, to prepare legislation and policy on plant health, to coordinate activities aimed at preventing the introduction and spread of harmful organisms, to report to international organisations on plant health, to prepare and implement treaties, conventions and

bilateral agreements, and to operate under the central authority of the BiH government (an EU requirement). Along with the State Veterinary Office, the Phytosanitary Agency is the crucial agency responsible for ensuring that the agricultural sector receives all the administrative, regulatory and political assistance it requires in order to increase production, income, exports and jobs. Failure to establish this agency has dealt a significant blow to BiH agriculture.

Establishment of the Phytosanitary Agency will bring BiH one step closer to WTO and EU accession. When the Administration is established its officials must begin dealing with accumulated problems related to agriculture development and harmonization of the BiH system with international requirements.

The BiH Law on Health Protection of Plants, which will establish the Phytosanitary Agency, was adopted on 18 August 2003. The law clearly places phytosanitary jurisdiction at the State level, in accordance with international practice. The Entities, however, will have to implement corresponding Entity legislation, harmonised, with the State legislative framework. The Ministry of Foreign Trade and Economic Relations is responsible for setting up the Phytosanitary Agency. In parallel with MOFTER, the Phytosanitary Commission (a State-level body in charge of phytosanitary issues during the transition period before the establishment of the Phytosanitary Agency) in cooperation with the BiH Civil Service Agency will define the Terms of Reference for the appointment of the first three Administration officials (Director, Deputy Director and Secretary).

The Phytosanitary Commission was established in April 2003. The Commission consists of representatives from MOFTER, the FBiH and RS Agriculture ministries and a representative from Brcko District. Representatives of the European Commission, the German Agency for Technical Cooperation and the OHR are also members of the Commission. The purpose of the Phytosanitary Commission is to supervise the phytosanitary sector until the establishment of the Phytosanitary Agency.

Immediately after the Commission was established, the BiH Law on Phyto Pharmaceutical Resources, the BiH Law on Seed and Seedlings, and the BiH Law on Mineral Fertilizer were drafted. The BiH Law on Plant Variety Rights is still in procedure. These laws will enforce basic requirements for BiH to participate in international agricultural trade.

The Commission has also moved forward with initiatives related to BiH accession to the relevant international and regional conventions. It has prepared basic legislation/laws/rulebooks that will be implemented by the Phytosanitary Agency.

Perspectives

With increased inter-Entity cooperation and appropriate financial resources the phytosanitary sector can make significantly faster progress. A modest level of investment – from international agencies, BiH government agencies or private investors – can generate a very substantial dividend, as the possibilities for near-term production increases are high, and this would have an immediate impact on the balance of trade.

TELECOMMUNICATIONS

The provision of good telecom services at reasonable rates is one of the key elements for the attractiveness of the market place. After the establishment of a legal framework in BiH and the regulators efforts to introduce tariff regulation as well as an interconnection of telecom services critical elements to create a competitive environment in BiH the focus has shifted towards improving good corporate governance in public companies. The Independent Special Auditor has investigated the three telecom operators in BiH over the last several months and concluded that over 90 million KM could be added to the bottom line of their revenues if only basic issues such as intransparent tendering practices, excessive donations, inappropriate control practices, etc., were addressed. All companies are marred by extremely poor corporate governance and an high level of management failures.

As a consequence both Entity Prime Ministers committed themselves to prepare and adopt a good corporate governance package before the end of this year. This package consists of a series of laws on business legislation, procurement, auditing and accounting and obligations. The objective of these reforms is not only simply to respond to the findings but to inaugurate a comprehensive root-and-branch reform of the public sector.

Furthermore, PM Hadzipasic and PM Mikerevic declared that they would hold responsible all those individuals that are responsible for the failures. They also reconfirmed privatization of the telecom companies. This privatization process has progressed satisfactorily only in the Republika Srpske so far, where the appointment of privatization advisors is expected to happen in the next quarter.

During the last quarter the focus will continue to be on improving good corporate governance of the telecom companies and the regulator's efforts to start tariff regulation.

BANKING

BiH Central Bank Developments – A Retrospective

As the banking reforms enacted over the past year have begun to take root and the beginnings of a more unified banking system are emerging – evidenced particularly by the merger of the two Entity deposit insurance agencies – the statutory review of the Central Bank's (CBBH) role offers a timely opportunity to assess the progress of this critical sector in the economic reform process. A recent address by Central Bank Governor Peter Nicholl provided a summary of the evolution of the CBBH and its future prospects. The following information is extracted from Gov. Nicholl's presentation.

The Central Bank is a relatively young organization, having begun operations in 1997 as a State-level institution serving as the only monetary authority in BiH. Monetary policy is the Bank's most important function, which it operates through a strict currency board arrangement under law. The basis for the choice of the currency board mechanism was threefold: it provided a firm, fixed exchange rate anchor in an economically unstable environment; it removed discretion where institutions and decisions were agreed only with great difficulty; and, currency boards had previously demonstrated considerable success in a number of transition countries. The BiH currency board is characterized by 1) a fixed exchange rate, legally specified; 2) full foreign exchange backing for all CBBH KM liabilities; and 3) full convertibility of KM liabilities into the anchor currency (previously the Deutsche Mark, now the Euro). The success in maintaining full exchange backing is evidenced by the reserves of some KM 144 million at the end of August 2003, a steady growth from KM 29.4 million in December 1998. It is interesting to note that the level of foreign reserves has fallen somewhat from their peak in 2001, mainly due to the fact that commercial banks have expanded their domestic credit and as a result, have reduced the level of their deposits being held at the CBBH. Currently, the CBBH's net foreign reserves represent over three months of import coverage, generally considered to be a comfortable level.

As the statutorily-mandated review of the CBBH's monetary role is now under consideration, a key element in these deliberations is whether the currency board arrangement has been successful. By any objective standard, the verdict must be a positive one. The KM has enjoyed remarkable stability against the Deutsche Mark and the Euro since it was introduced, it has remained fully convertible since its introduction, and the inflation rate in BiH is low and stable, hovering in the 0.7 to 0.9 percent range since 2001. Moreover, the KM is the dominant transactions currency in the country and the proportion of bank deposits denominated in KM is growing, although more than 50 percent are still denominated in foreign currency. This positive performance has been an important factor in attracting foreign direct investment.

In recognition of the stabilizing role of the currency board arrangement, the BiH Presidency have announced that this function will continue as one of the principal features of macro-economic policy in BiH, a position shared by both the State and Entity governments. The most important reason for this is that the policy has produced major economic and social benefits, and has been particularly important in conveying a sense of stability in the postwar reconstruction environment. Finally, the longer-term goal of BiH's accession to the EU will be facilitated by the existing linkage between the KM and the Euro.

OHR MOSTAR

Investment saved at the last moment

The summer months in Mostar were marked by political disagreements and difficult negotiations over the fulfillment of conditions for the World Bank's offer to finance a Solid Waste and Management Project. Waste disposal has been a long-term problem for Mostar and has been a cause of disputes among leading parties and city officials. Hours before the World Bank's deadline (after which it had threatened to withdraw its offer of funding) Mostar City Council met the Bank's conditions and established a single municipal Public Utility Company.

Before the war Mostar had one Public Utility Company with two sub-structures: Parkovi, responsible for infrastructure and public parks, and Komos, responsible for collection and disposal of waste. However, as a consequence of the war, these two companies split. Parkovi has operated in the Croat-majority

municipalities, while Komos has operated in the Bosniak-majority municipalities.

During the period of EU Administration, more than 4,5 million DM was invested in establishing a modern waste-disposal site, located in Uborak on the east bank of the Neretva, within the boundary of Mostar North Municipality. In the absence of political will among Croat parties to make joint use of this site, it has been administered solely by Komos.

However, with the failure to build a planned Croat facility, Croat parties began lobbying for access to the Uborak site. Negotiations resulted in the October 2002 agreement according to which Croat-majority municipalities could use the dump, paying 60 KM per ton of waste.

In the meantime, in June 2002 the World Bank approved the Project for Solid Waste and Management in Bosnia and Herzegovina, worth \$18 million, which includes interest-free credit, a 35-year repayment period and a 10-year grace period. Mostar became a potential candidate for participation in this scheme, with the possibility of receiving a \$2million soft loan. Moreover, if this project were successfully implemented the World Bank would be ready to provide an additional \$5-million grant from the Global Environment Fund for cleaning the Neretva River.

The World Bank set the following conditions: the City should establish one city waste-disposal company whose Director would be empowered to sign a subsidiary credit agreement with the Bank. This company must manage waste disposal; prices of solid-waste disposal must be consistent with European standards and equal for all clients; and the company should not have more than 25 employees. The deadline, which had been extended five times, was set for 30 September 2003. If the conditions had not been met, the World Bank would have considered reallocating the funds to other regions.

Following several attempts by the Mostar City Council to pass a Decision on the formation of a single Solid Waste Utility Company "Uborak," agreement was reached at a final extraordinary session held on 30 September 2003. During this session, a Decision on the formation of City Waste Dump UBORAK was adopted, and a provisional director and provisional executive director of the company were appointed.

The resolution of this issue, after years of disagreement, is likely to send a positive signal to potential investors in the City of Mostar.

Hnc government faces difficult financial challenges

Lack of revenue in the Herzegovina-Neretva Canton Budget has once again caused turbulence between the HNC Government and the trade-unions, this time resulting in strikes in the education sector at the beginning of this school year. This has, no doubt, put the Government in a very difficult situation, given the fact that it is constantly struggling to distribute salaries to its budget beneficiaries regularly and is, moreover, faced with huge debts from previous years, amounting to 43,5 million KM (as of December 31, 2002).

While the strike at elementary schools teaching under the Bosniak curriculum lasted one week, the strike at elementary and high schools teaching under the Croat curriculum lasted five weeks. Bosniak high schools, on the other hand, have not suffered any disruption this school year.

The trade-unions in general presented a number of demands to the Government, notably regarding the signing of a collective agreement, payment of contributions and overdue salaries, 20 percent of salaries for September 2002, compensation for homeroom teachers, and speeding up the payment process for regular salaries. Although the Government, following a number of discussions, met their main demands, the trade-unions insisted on fulfillment of all their demands.

As time passed, the gap between the two sides was widening. While the Government was trying in all possible ways to end the strike, the trade-unions were becoming even more intransigent, encouraged by the Decision of the Cantonal Court, which confirmed the legality of their strike.

The Government called upon teachers, parents and pupils to start classes immediately, arguing that they cannot realistically meet the trade-unions' demands due to insufficient revenue collection. However, the unions were calling on the same parties to support their stand and continue with the strike.

At last, unions completely ended the strike on October 2, 2003. While the Croat High School Trade Union signed the agreement with the Government, Croat Elementary Trade Union ended the strike without reaching an agreement. They both will start the legal procedure against the Government at the court, in order to fulfill all their demands.

This strike should serve as a clear warning to the HNC Government that it needs to seriously address its ineffective budget planning and spending practices. It

needs to cut and prioritize expenditures, streamline its administration, introduce better financial control and transparency of spending and work with the Cantonal Tax Administration on better collection of revenues. Moreover, it needs to develop a financial adjustment plan for current government debts and, above all, introduce development components to the budget, which practically do not exist at present. Unless the Government activates itself concerning this question, it will constantly face crises such as the one that just ended in the education sector.

Hnc institute for public health

Although the FBiH Law on Health Care (1998) stipulates the formation of cantonal institutes for public health within six months of its adoption, Herzegovina-Neretva Canton still has two Institutes for Public Health (IPH). One of these operates in the Bosniak-majority municipalities and was established in 1995. The other, a branch of the FBiH Institute that took over employees of the former Croat Inter-Cantonal Institute when that body was abolished, covers Croat-majority municipalities in the HNC.

Following the unification of the HNC Health Insurance Fund (HNC HIF), on the initiative of the HNC Minister for Health, Labour and Social Welfare, the issue of the formation of the HNC Institute for Public Health was finally raised. To this end, a meeting on establishing the HNC IPH was held in September this year, where all relevant parties from the Canton, including the FBiH Minister of Health and Director of the FBiH IPH, were present.

In the outcome of that meeting, a Working Group was formed to prepare a document assessing the current situation and proposing modalities for future organization and establishment of Cantonal IPH. As this task was completed at the end of September 2003, the HNC Minister of Health will now have to present it to the HNC Government.

Prior to this initiative of the HNC Minister of Health, the Management Board of HNC HIF had already discussed current and future financing of the IPH. In fact, they took a decision to stop fully financing IPH operations in the Bosniak-majority areas, which was a policy carried over from the previous system, and only partially finance them until the end of 2003. Furthermore, it was determined that all future payments to the IHP will be regulated on the basis of the contract for provided services, as regulated by the FBiH Law on Health Care (1998).

This initiative represents an additional step towards abolishing long-standing parallel institutions in this Canton.

OHR BANJA LUKA

Recovery of Industrial Production in the Republika Srpska Continues

While severe drought destroyed almost one third of RS primary agriculture sector output during 2003, the sharp 10-percent decline in RS industrial production in 2001 and 2002 has been reversed this year. Industrial production between January and August, compared to the same period in 2002, increased by 5.5 percent². A 14-percent increase in energy production in this period was the main contributor to the overall sector growth, bearing in mind that energy generates 34.2 percent of total RS industrial output.

Positive trends have been reported in the following sectors as well:

- Food processing grew by 8.7 percent³
- Mining (coal and lignite) grew by 16.2 percent
- Textiles grew by 22.3 percent
- Pulp and paper production was three times higher during the reporting period, compared to the same period last year⁴

The Birac alumina (aluminum oxide) factory in Zvornik began production recently after two years of preparation. This is likely to have a positive impact on industrial production figures in the near-term, and on BiH's trade figures, since Birac's production is export oriented⁵.

OHR TUZLA

Ze-Do Canton Business Service Center Opens

At its inauguration on 30 December 2002, the Zenica Dobojski (Ze-DO) Canton Government made pledges to initiate a series of activities that would help make Ze-Do Canton more business-friendly.

One of the three important projects the ZDK Government was working on is the Business Service Center (BSC). During the past 4 to 5 months, the Ze-Do

² The RS Institute of Statistics, Banja Luka: Industry Statistics

³ Food processing generates 13.1 percent of the total industrial output

⁴ State-owned company CELEX Banja Luka was bought by foreign partner from Slovakia (ECOINVEST, Ruzomberok) in 2001. It invested 17.5 Million KM in restarting production from 2001 to mid-2003 and now the paper-processing industry has almost fully recovered.

⁵ Birac was one of the biggest exporting companies in former Yugoslavia

Government made an enormous effort to establish a modern center that will meet the requirements of the businesspeople, and on Wednesday, September 24, 2003, the BSC was officially opened.



Remarks by Deputy HR and Head of OHR Economics Department, Patrice Dreiski at the opening of the Zenica Business Service Centre

The Business Service Center is a One Stop Shop, providing administrative support to businesses, as well as access to a database containing information on available financing, information on real estate/facilities, foreign and domestic markets, and information on laws, and governmental or NGO subsidies applicable in Ze-Do Canton. This means that entrepreneurs can avail themselves of a service that will, on their behalf, deal with all the bureaucratic procedures that have to be dealt with in order to do business in the canton.



The BSC staff

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"Panonika" Salt Lake Opens in Tuzla

To many people, Tuzla Mayor Jasmin Imamovic's idea for a saltwater lake in the middle of the city appeared irrational – the reality has turned out to be eminently rational: a self-financing, family-oriented municipal facility.

During its summer peak, the "Panonika" Lake had 3000 to 5000 visitors daily, and earned 10,000 KM or more

daily, even though children under the age of 7 were granted free admission. After the ceremonial opening (18 July 2003) in a period of only 36 days, a total of 100,000 tickets were sold. The projected visitor-number estimate had been just 1500 daily.

An investment of 1.5 million KM was needed for construction of the lake. The salt water used to fill the



The "Panonika" Lake

lake was pumped from a 10 million year-old seabed located under the City of Tuzla. The city has now coined a new tourism slogan – "Enjoy the salt beach of Tuzla".

Factory Forum

On 20 August, Entity Premiers Hadzipasic and Mikerevic joined PDHR Donald Hays in a series of factory visits in Zenica, Tuzla and Bijeljina. This was part of a larger schedule of industrial visits undertaken by the two Premiers and Ambassador Hays during the summer. In Tuzla Mr Hadzipasic, Mr Mikerevic and Ambassador Hays participated in a Factory Forum, a roundtable discussion with BiH workers' representatives, held in a disused factory facility.

The Factory Forum examined the impact of reform efforts on workers, and explored ways in which workers' representatives can be brought into the reform process more productively. Both Premiers emphasised that the governments are well aware of, and sympathetic to, workers' grievances. The reform process has yet to deliver tangible benefits on a broad scale. However, they insisted that only through deeper and faster reform can BiH make the transition to a vibrant market economy that can create quality jobs. Union leaders participating in the Forum stressed that they are not opposed to privatisation but want to make sure that all privatisations are carried out in a transparent manner.

OHR BRCKO

International Optical System Osijek-Sarajevo Installed

In September, installation of the international telecommunication optical transmission system, Osijek-Sarajevo, with a capacity of 2,5 Gbps, was completed. The system was built and is now being operated by Croatian Telecom and BH Telecom. Work on the system began in October 2002. The main challenge was laying the fibre optic connection under the Sava River, between Gunja and Brcko.

Previously, international telecommunication traffic carried by BH Telecom was routed through Croatia and Hungary, via land-radio relays. The new Sarajevo-Osijek system is BH Telecom's first international optical connection.

The new system will begin operating immediately, improving the telephone connection between BiH and Croatia and BiH and other countries, and considerably expanding BiH's transmission capacity.

Contract on Building the Industrial Zone in Brcko District Signed

After more than two years of intensive negotiations between the Brcko District Government and the Industrialist Union from Venice (Italy), a contract on building the industrial zone in the Brcko District was signed on 22 September 2003 in Sarajevo. Small and medium-sized companies from Northeastern Italy have shown an interest in relocating parts of their operations to the District. Initial investments will be mainly in the textile, food, metal-processing and wood-processing sectors. The industrial zone will cover ca.130 hectares of land. This greenfield investment will facilitate overall economic development in the District and expand the existing economic ties between BiH and Italy.

OHR-Brcko hosts the meeting of the Sava River Initiative

Following a joint initiative by the Brcko Supervisor and the BiH Ministry of Transport, the Strategic Group and Group of Experts for Navigation, of the Interim Sava Commission, met on 24 September, at OHR Brcko. The meeting, facilitated and chaired by the South East Cooperative Initiative, assessed the merits and feasibility of a prioritized dredging program, and it

estimated costs and recommended practical steps to help restore navigation on the Sava river. The results:

- A bathymetric survey of the 165 km of the river in Serbia will be done as soon as possible.
- The survey of the upstream part of the river, from rkm 207 to rkm 222, will be augmented, so that it meets standards met in the Supervisor's Quick-Impact funded survey (profiles surveyed at each 50 m of the river) as soon as possible.

The International Trust Fund for De-mining has approx. 400,000 € that could be allocated to this program.

BUSINESS ENVIRONMENT LEGISLATION

Law on Accounting and Auditing

This law will introduce international accounting standards to BiH, an indispensable step forward. Inadequate accounting standards have allowed the development of a business culture in which fraud and corruption are widespread. Because of this, public companies have lost hundreds of millions of KM through mismanagement, and private companies have been unable to reap the benefits of a disciplined accounting culture – where corporate transparency is the rule rather than the exception, and dishonest firms cannot gain underhand advantage by misrepresenting their financial position. The new law will establish mandatory standards, including those relating to professional ethics, for accounting and auditing to be applied throughout BiH.

One of the key goals of this legislation is to foster the development of a competent, credible private-sector accounting and auditing profession, fully empowered to practice countrywide, promoting investment and fostering economic growth in BiH.

The law is expected to be enacted by the BiH Parliament by the end of October 2003.

Law on Notaries

Notaries contribute to legal security by providing reliable documentation of important legal transactions, and they act as a safeguard against undue haste in concluding contracts. The notary function helps reduce the frequency of contentious legal disputes, thus

reducing the caseload of the court system. The notary institution therefore makes a key contribution to consolidating the rule of law in Bosnia and Herzegovina.

When the Law on Notaries is enacted it will be more difficult for tax evaders to hide behind fictitious firms, since such firms cannot be registered with a notary. The revised process of notaries is scheduled to be completed (including the implementation) by mid 2004.

Business Registration

The current business registration system in BiH is expensive, bureaucratic and unduly time-consuming. A BiH Law on Business Registration is now being drafted. This will establish a new system that will stimulate investment and in due course generate more jobs, because it will make it easier to register a new business in this country. The new system will also help develop the Single Economic Space by creating a business registration certificate that is valid throughout BiH and by establishing a countrywide database of registered businesses that provides increased transparency and accountability.

The new system will allow those registering a new business to execute several administrative steps in parallel, rather than consecutively as at present. The system will also be automated, thus reducing possibilities for corruption, and it will be EU-compatible.

MACRO SECTION

Gross Domestic Product has risen consistently since 1997 and official per capita GDP is now estimated at around US\$1,800. However, it is likely that the official data significantly underestimate the real per capita GDP, which according to some estimates may be around US\$2,500, if not higher. At the same time, the data suggest that annual real GDP growth is around 5 percent. Although this rate is far from the heady growth rates recorded in the late 1990s, it is perhaps indicative of the fact that the main post war reconstruction is over and that BiH has reached a more regular and, hopefully, sustainable growth rate similar to those recorded in neighbouring countries and the broader region.

On the monetary side, BiH has been extremely successful. The currency board system that has been operational since 1997 has resulted in a trusted and

stable currency. Thus, the Central Bank of BiH is currently enjoying substantial foreign currency reserves, which rose more than fifteen-fold since 1997 and which could provide about three months of import cover. At the same time, the monetary aggregates show a healthy rise. M0 has risen almost seven times since December 1997, while M2 has risen roughly 5 times in the same period. Notwithstanding, inflation in BiH is negligible – the CPI for 2002 averaged some 0.4 percent for BiH as a whole.

When these two facts are taken in conjunction, however, the results are not as positive as they may appear at first glance. Even though inflation has been nearly eradicated, the fact that the monetary aggregates and the economy as a whole are growing at the same time is an indication that the margin of spare capacity of the BiH economy is still very large and, that, as a result, the growth and performance of the BiH economy is likely well below its potential.

The indices of industrial production for 2002 show that industries in the Federation produced almost 80% more than in 1997, but the figures for the RS are worrying because the same data shows a decline in its industrial production between 1998 and 2002. As a result, RS industries are now producing only 12% more than they did in 1997.

As far as public finances are concerned, a positive trend has been recorded in all three levels of government in BiH. While the State budgets have almost always been balanced, the Entity deficits of the 1990s have been all but eliminated. Thus, in 2002, the public deficit as a percentage of GDP has been 0.8 and 0.2 in the Federation and the RS respectively. However, the various external obligations of BiH amount to some 50 percent of GDP. Due to diligent debt servicing (the level of BiH external indebtedness has been steadily declining since 1998), this is not considered as a major destabilising factor.

More worrying is the growing current-account deficit that BiH has been recording on a consistent basis since the end of the war. This deficit totalled more than US\$2,000 million in 2002 alone – an equivalent of some 40 percent of GDP. The deficit is indicative of the ailing domestic industrial base and its lack of competitiveness both at home and abroad. This predicament is partly a consequence of the regulatory environment and partly a consequence of a complicated tax system. These factors adversely affect the levels of domestic and foreign investment and the efficiency and competitiveness of the BiH economy as a whole. Both the tax system and the current regulatory environment are being overhauled and it is

to be hoped that this will improve the economy's competitiveness.

The overall conclusion is that BiH is not experiencing economic stagnation but despite some very encouraging signs, future growth is dependent on a number of contingencies. These are mostly of a domestic nature and require a considerable change in the domestic regulatory and fiscal spheres. Reforms in these two areas are essential if latent economic potential is to be released and BiH's economy is to improve upon its record to date.

BiH Economic Update

BiH Economic Data January 2001 – March 2003

Source: FBiH and RS Statistical Offices

Indicator	Federation of BiH	Republika Srpska	BiH (OHR estimate)
GDP nominal 2001	7,224 billion KM	2,993 billion KM	9,161 billion KM
GDP nominal 2000	6,698 billion KM	2,734 billion KM	8,321 billion KM
Nominal increase 2000-2001	+ 7.8%	+ 9.5%	+10,0%
Real increase 2000-2001 (minus inflation in RS 6.5%)	+ 6,7%	+ 3%	+5,5%
Index of Industrial Production			
08/03 compared to 2002	+ 14,6%	+ 6%	N/A
08/03 compared to 08/02	+ 8,3%	+ 2,3%	N/A
Retail Price Index			
08/03 compared to 2002	- 0,8%	+ 0,8%	N/A
08/03 compared to 08/02	- 0,2%	+ 1,7%	N/A
Average Net Salary 07/03 (RS 08/03)	530,79 KM	381 KM	480,7 KM*
07/03 compared to 2002 (averages) (RS 08/03)	+ 9,9%	+ 10,1%	+ 10,0%*
Number of Employed 07/03 (RS 6/03)	387.832 persons	249.186 persons	637.017 persons*
Number of Registered Unemployed 07/03 (RS 08/03)	297.477 persons	146.040 persons	443.517 persons*
Number of pensioners in 04/03 (RS 08/03)	286.567 persons	183.640 persons	470.437 persons*
Average pension in 08/03	190 KM	135 KM	168,5 KM
Imports Jan-Jul 03 (RS –Aug)	3.678,9 Million KM	1.388,8 Million KM	5.067,7 Million KM*
Exports Jan-Jul 03 (RS – Aug)	1.177,9 Million KM	328,5 Million KM	1.506,4 Million KM*
Trade deficit Jan-Aug 03	2.501 Million KM	1.060,3 Million KM	3.561,3 Million KM*
Import/Export coverage	32,5%	23,652%	29,7%*

* not completely compatible data (difference in dates)