

# **Economic Newsletter, Vol. 4, Issue 3, October 2001**

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## **1. Privatization - New headway**

In both Entities the privatisation program is now progressing at an accelerated pace. The first encouraging results obtained in the group of strategic enterprises are a sign that the restructuring of the country's economy and its transition to a free market is on its way.

### **RS Repulika Srpska**

In the previous edition of the Newsletter, it was mentioned that the 55% sale of capital in large-scale enterprises through vouchers had been achieved. The actual distribution of shares to the new shareholders (citizens or Privatization Investment Funds – PIFs) required considerable time due to the complexity of the operation and can now be considered as completed. Most of the new General Assemblies have convened and the sale of the remaining part of the State capital in every company is ongoing. The new shareholders have until the end of October to file complaints if they are not satisfied with the allocation of shares.

For the strategic companies, the situation has evolved significantly during the last three months. The Alumina plant **Birac** in Zvornik has been sold to the Lithuanian investment bank Ukio that acquired 64% of the company for 10 million KM associated with a long-term investment plan. In the case of **Banja Luka Brewery**, the best offer was received from the large international group Interbrew and the contract is now under final negotiation. The paper company **Celex** in Banja Luka was successfully tendered and the final sales contract with a Slovakian investor is expected to be signed before the end of November 2001.

At the insistence of OHR, donor organisations involved in the privatisation process and potential investors, the RS government has passed a new decree modifying the majority rules for major decisions to be accepted by General Assemblies and Management Boards a simple majority is now acceptable rather than 75% as was the case previously.

This is certainly a positive move that will reassure foreign and local strategic investors.

### **Federation of BiH**

The second round of Public Offering of Shares (POS) for certificate holders planned by Privatisation Agencies for large-scale enterprises is about to begin. According to the revised system, the process will be shorter than before and the first phase completed before the end of the year.

Regarding strategic enterprises, two recent successes may be noted: the sale of 42% of the Joint Venture between

**Unis** and Volkswagen (state share) to the Slovenian company Prevent for 2 million KM plus 18 million KM additional investments; and, the acquisition of 51% (35million KM) in **Fabrika Cementa** in Lukavac by the company Allas from Austria. In spite of the prevailing economic situation, these two investments by international groups are encouraging signs of interest for the business potential of the country.

Direct negotiations between the Cantonal Privatisation Agency and potential buyers of the large printing house **Oko** in Sarajevo concluded in mid-October and Dnevni Avaz was awarded the bid. The possibility of an appeal against this decision is not excluded, considering the dominant position of Oko in the local printing market and the keen interest of Oslobođenje also to acquire this company.

The sale of **Fabrika Duhana** in Sarajevo through tender is temporarily halted due to alleged irregularities in its past management. A clarification of the ownership structure of the company is also necessary before the privatisation process can be resumed.

The WB has recently signed a long term credit agreement of 11 million KM with the FBiH Government (9M with the RS) to fund its privatization support activities to approximately 28 strategic enterprises in the Federation (18 in the RS). The WB advisors are expected to start their activity at the beginning of 2002.

## **2. Agriculture: Forestry in the Federation**

The forest in Bosnia and Herzegovina covers about 2,7 million hectares covering more than 50 % of the total land area. The forestry sector in both Entities could be a major source of income for Bosnia and Herzegovina but it currently faces significant problems such as illegal logging, lack of a forest management plan, huge overhead costs, no financial transparency and no clear institutional structure.

To improve the situation, OHR is assisting the Federation Ministry of Agriculture, Forestry and Water (MoAFW) to enact a new Forestry Law. OHR, together with the international community (in this case mainly the European Commission and the World Bank) seek to achieve the following goals:

1. sustainability
2. transparency
3. strict separation of administrative / authority functions from commercial functions
4. free access for private business
5. strong inspection activities to protect the environment

These should be achieved by a new administrative organization that will implement the forest management plan.

To accomplish this in a cost efficient manner, independent cantonal profit centers will be established to gain a clear picture of the financial status of each profit center, e.g., cutting, transport, reforestation, and road maintenance.

This reform process is designed to reduce the current heavy administration – almost 30 different forest administrations (Sumes) often act without co-ordination. Additionally, out-sourcing for activities such as cutting and reforestation should be introduced, which should be tendered to private companies or privatised “state forest enterprises”. As a result, the whole system will be more transparent, with increased revenues and reduced expenses. A portion of the financial surplus will be used in the forestry fund to assist with crisis management and the remainder will be shared between the Cantonal and Federation governments. The end result will be a sustainable forest sector that will protect the environment, render business activities more transparent and efficient, and also be more competitive on the world market.

### **3. Banking Sector: Continuing Progress**

Progress in the bank consolidation process is continuing, with identification underway of State-owned banks in both Entities that will either attract investors (foreign and/or domestic) or enter into liquidation by year-end. Two more banks in the Federation, the Turkish Ziraat Bank and Micro-Enterprise Development Bank, have qualified for membership in the deposit insurance scheme, bringing the total to six in the Federation. A working group is nearing completion of a draft text to merge the Entities’ deposit insurance agencies into one body at the State level, with the expectation of submitting draft legislation by mid-November. With regard to the banking regulatory agencies, Central Bank Governor, Peter Nicholl, has convened a working group composed of senior government representatives from both Entities to discuss transferring those agencies’ responsibilities to a unified organization under the umbrella of the Central Bank. Both merger efforts are aimed at achieving greater efficiencies, harmonization of regulatory activities, and lower cost operations, which will also enhance the business environment in a single economic space.

### **4. Taxation - Harmonizing and Stabilizing the Revenue Flows**

#### **Budget**

Both the State and the Entity governments have addressed the possibility of re-balancing their budgets for 2001 with the IMF mission. Although overall discussions are still ongoing, there was agreement that the Republika Sprska should retain its current 2001 budget – no re-balancing is needed. A rescheduling of an international credit repayment has made it possible for the RS to transfer an additional 3 million KM to the State administrative budget. The Federation Government will supplement this with an additional 6 million KM transfer to the State. Additional revenues are, however, still needed to cover the suggested expenditures of the State.

The IMF also discussed the 2002 budgets with the State and the Entities. The State Minister of Treasury, Dr. Ante Domazet, has announced that he is planning structural changes to decrease the dependency of the State on Entities’ transfers. State level taxes, e.g., the Tax on Movable Property or a portion of the dividends of the Central Bank are being considered as potential additional revenue sources for the State.

The Budget was also discussed extensively at the Consultative Partnership Forum. Treasury Minister Domazet pointed out that the original Budget had not been planned realistically and that expenditures had already exceeded forecast levels for the year. The Council of Ministers’ (CoM) efforts to reduce expenditure have been insufficient, and all agreed that strict financial discipline must be applied at every level. In the discussion of the

succession funds Dr. Domazet stated that these would not be used for administrative purposes, but to fulfill obligations. These funds will not be available until the Agreement has been ratified by Parliaments of all of the successor states, not likely to occur until the end of the year. Neither the Entities or the State have so far produced a draft budget for 2002.

### **Customs**

A proposal to improve the collection of customs duties by introducing a Single account for the Customs revenue was presented to the PIC Steering Board Political Directors on 30 October 2001. The problems – undervaluation of dutiable goods, competition between entity customs authorities for revenue, inconsistent compliance with the Customs Policy Law of BiH – are generally acknowledged. One long-term proposal to solve the problems in customs administration involved creating a unified customs administration at the State level. Short of full integration, a step in the right direction could be the creation of a single account.

### **Tax policy and tax administration**

The Brcko District authorities have advised that the new Income Tax Law for both natural and legal persons will be submitted to the Brcko Parliament. This law has been drafted in close cooperation with the Entities and the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ).

## **5. The Stability Pact: an Important Role for BiH**

On 25 and 26 October, the Stability Pact held its Regional Conference in Bucharest under the co-chairmanship of the European Commission and the World Bank. This was the second major meeting of the Pact since its inception, and an important moment for regional cooperation in South Eastern Europe. Bosnia Herzegovina was represented by a substantial delegation at this Conference. It was able to demonstrate active participation in the Pact and also highlight that BiH is an important country included in the European Union Stabilisation and Association process (SAP), for which the now well-known “EU Road Map” is but one stage. BiH co-chaired Working Table II on infrastructure investment.

Foreign donors plan to pledge about \$2.2 billion towards rebuilding the Balkans, but will warn countries of the need to wean themselves from handouts and to attract major investment. Delegates are being reminded that recovery from a decade of war, and the goal of European Union membership, depend on governments improving cooperation, enacting reforms to lure foreign capital and cracking down on corruption and organized crime.

The Pact’s fanfare launch, attended by 40 world leaders, has accompanied its more modest successes in channeling aid money to infrastructure projects and the promotion of economic reform. The Bucharest conference, held under its auspices, aims to shift the focus toward longer-term aims, notably an increase in private capital flows to the region from the \$4.5 billion last year. Donor support is vital but can only do so much, especially given the bureaucratic obstacles to getting projects off the ground. One of the biggest problems is the high degree of expectations of immediate results; to deliver meaningful infrastructure projects takes much longer.

Financing will be announced for 27 infrastructure projects to improve transport links and deepen economic integration among the nations of south-eastern Europe in a new support package for the Balkans, targeted on transport, energy and environment projects, with the latter focused on water and waste management. The Yugoslav federation will obtain nearly Euros 400M; Croatia and Bosnia-Herzegovina can expect about Euros 300M each, while Albania is expected to secure about Euros 250M.

## **6. Transportation: A Busy Period**

### **Air Transport**

The BiH Government and the European Union signed an agreement to provide the necessary funds to bolster Bosnia's Civil Aviation Department under the ICAO sponsored OPAS (Operational Assistance) program.

The European Commission approved 1.37 million Euro (2.68 million KM) for the reconstruction of Mostar Airport. The funds will be used for a new control tower at the airport, as well as other accompanying equipment.

The Council of Ministers generally accepted the text of a platform for the conduct of negotiations to conclude an agreement with Croatia for the provision of air navigation services within a part of the air space of BiH.

### **Rail Transport**

Prospects for rail traffic are enhanced with the opening of the railway Corridor Vc between Budapest, Hungary through BiH to the port of Ploce. This will be made possible with the opening of the Samac bridge at the BiH-Croatia border in December. The necessary operating agreements are being put into place to provide for the establishment of the railway traffic between BiH, Hungary and Croatia.

The draft RS Railway Law was presented in the RS National Assembly on October 2, 2001. The RS Railways were established in 1992 but until now followed legislation from the former SFRY, which is not based on a market system. This Law provides for uniform conditions on construction, maintenance, and supervision of railway transport (RS only); obtaining membership in international organizations; issuing licenses to operators for goods and passenger transport; conditions for use of railway infrastructure with no discrimination (as stipulated by EU Directives); and other details related to rail transport.

The RS Railways (ZRS) and the Krajina Construction Company signed an agreement on construction of a new railway station in Banja Luka. The project, worth 2.1 million KM, is financed by the RS Government, the city of Banja Luka and ZRS.

### **Road Transport**

The BiH Federation Minister of Transport and Communications and representatives of selected contractors have signed an agreement for the completion of construction on the Zenica-Sarajevo roadway, i.e., the section Podlugovi-Josanica. The total value of the works on the section, which is 11.5 kilometres in length, amounts to 58.7 million KM.

The World Bank's recent appraisal mission visited BiH

and approved a USD \$30 million loan under its Road Management and Safety Project for rehabilitation and safety of the road network in BiH. Conditions for the approval of this project are dependent on a State law on roads, which would determine the policy development and main principles of ranking in the BiH road network, as well as defining the jurisdiction of Entity regulations in this field. The loan is also conditional on institution-building in the form of strengthened road administrations and the BiH Road Infrastructure Corporation (BRIC) as well as enhancing expenditure efficiencies and the development of a road safety strategy.

### **Water Transport**

Meetings have taken place between BiH, Croatia and the FRY to develop a Stability Pact proposal for opening navigation on the Sava River. Prior to the war the Sava River was an important waterway for the region which, by

flowing into the Danube, also provided an important connection to Central Europe. Traffic now is virtually non-existent since the river needs to be dredged in parts, and the port infrastructure rehabilitated. Also, as the Sava is an international river, a navigation protocol must be negotiated between the riparian states.

## **7. Telecommunications Sector: Getting Back on Track**

Following consultations with parties over the summer, the Communications Regulatory Agency (CRA) submitted a final draft Action Plan, concerning the next steps of policy implementation, to the Council of Ministers for discussion. The Action plan identifies several key actions to improve the opportunities of the existing operators as well as to facilitate new investment. Among the actions mentioned are issues such as the issuance of new licences for the incumbent operators, adoption of rules on interconnection and pricing and the definition of universal service obligation.

The Communications Law has still not been adopted by the Council of Ministers. It was agreed that an amended draft would be presented to the Council of Ministers to refresh the discussions.

The process regarding the third GSM tender was finally cancelled after two bidders out of five expressed their intention not to participate further. Since that time the CRA and the Council of Ministers have been in consultation about the next steps to take in the mobile market.

## **8. BiH Economic Data January-September 2001**

**Source: FBiH and RS Statistical Offices**

<b>Indicator</b>	<b>Federation of BiH</b>	<b>Republika Srpska</b>	<b>BiH (OHR estimate)</b>
GDP nominal 2000 GDP nominal 1999 Nominal increase 1999-2000 Real increase 1999-2000 (minus inflation)	6,698 billion KM 6,141 billion KM + 9,0% +7,8%	2,463 billion KM 2,180 billion KM + 13,0% -0,6%	9,161 billion KM 8,321 billion KM +10,0% +5,5%
Index of Industrial Production 09/01(FBiH) 07/01 (RS) compared to 2000 average 09/01 (FBiH) 07/01 (RS) compared to 09/00 (FBiH) 07/00 (RS)	+10,4% +14,3%	-13,1% -10,1%	+3% +6,1%
Retail Price Index 09/01(07/01 RS) compared to 2000 average 01-09/01 compared to 01-09/00 (07 RS)	+1,7% + 2,3%	+5,9% +8,9%	N/A N/A
Average Net Salary 07/01 07/01compared to 2000 average	439 KM +6,5%	303 KM +10,4%	390 KM +7,2%

Number of Employed 05/01 Number of Registered Unemployed 05/01	406,783 persons 263,228 persons	227,740 persons 154,236 persons	634,523 417,464
Number of pensioners in 05/01 Average pension in 05/01	280,533 persons 170 KM	179,073 persons 105 KM	459,606 145 KM
Imports 01-09/01 (FbiH 01-08/01) Exports 01-09/01 (FbiH 01-08/01) Trade deficit – January to August/September 2001 Import/Export coverage	3,201 billion KM 1,169 billion KM 2,032 billion KM 36,5%	1,228 billion KM 0,451 billion KM 0,777 billion KM 36,7%	4,429 billion KM 1,620 billion KM 2,809 billion KM 36,6%

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