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Newsletter

Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)

Sarajevo, April 1998, Vol. 1, Issue 2

**Economic Task Force Secretariat
OHR in co-operation with IMG International Management Group**

Economic Indicators BiH (*)

** This month all data refer to the Federation, next month we will cover both RS and Federation.*

	Dec-97	Jan-98	Feb-98	Last 12 months
Average net wage (DM)	308	300	N/A	22.6%
Retail price growth	0.1%	0.5%	0.7%	9.5%
Cost-of-living growth	0.9%	0.8%	1.2%	8.4%
Real wage growth	6.7%	-3.4%	N/A	14.3%
Industrial Production growth	9.5%	-19.7%	11.2%	24.6%
Real effective exchange rate				-7.2%

(Source: Federation Statistical Institute & OHR Estimates)

Although nominal wages are low, there has been strong real wage growth over the past year. Recovery in the official level of industrial production continues into early 1998. There has been appreciation of the real exchange rate in 1997, by roughly 7% (calculated using data for major trade partners of the Federation, excluding Slovenia and Croatia).

Foreign Investment

Number of foreign companies investing:

Company:	one owner	shareholding
1996	297	297
1997	272	304

Declared investments (in DM):

<i>One owner company</i>	in kinds & rights	in cash
1996	1,525,218	1,091,980
1997	1,297,358	411,000
<i>Shareholding company</i>		
1996	7,879,472	2,132,588
1997	18,500,536	3,521,790

Note: Most of Foreign Investments in Canton 10, Canton 8 and in part of Canton 7, are not included in the above figures.

(Source: Ministry of Foreign Trade and Economic Relations)

Economic Policy and Reform

1998 Budgets near Completion

In the Republika Srpska (RS), the 1998 budget (DM 468 million) was adopted by the National Assembly on 14 March 1998. The draft budget (DM 917 million) of the Federation of BiH (Federation) was adopted by the House of Peoples and will now be discussed by the House of Representatives. The State budget (DM 183 million) for 1998 has been approved by the Council of Ministers and forwarded to the Presidency. According to the Constitution, it is now up to the Presidency to forward it to the Parliamentary Assembly for discussion and adoption.

The three budgets are presented as an insert to this issue together with budgets for 1997. All three budgets have significantly increased. For both the RS and the Federation, substantial increases in tax revenues and external financing are expected. State budgetary expenditures are expected to rise by more than 70%. In 1997, however, Entities provided very few resources for the State budget, and the international community had to finance the gap.

The budgets presented here do not give a completely accurate picture of the fiscal position of BiH. First, there is probably substantial amount of off-budgetary expenditure. Second, the RS government has not gained full control over the disposition of its customs revenues. Third, the accounts of publicly-owned enterprises are not incorporated into these budgets. Finally, differences in the fiscal-federal structures of the Federation and the RS complicate comparison of their budgets. Many revenues and expenditures in the Federation go through the budgets of cantonal authorities, a level of government that is not existent in the RS.

Table 1.	Budget of the Federation of BiH (millions KM/DM)		Table 2.	Budget of the Republika Srpska (millions KM/DM)	
	1997	1998		1997	1998
Revenues	610	822		209-259 /3	365
Customs and Excise Taxes	565	766	Customs and other import taxes	63-73	92

			Other sales and excise taxes	100	158
			Income taxes	28-68	87
Non tax revenue	45	56	Other tax and non tax revenue	18	28
Expenditures	641	917		209 /3	468
Wages	70	88	Wages	25 *	107
Materials and services	19	33	Materials and services	31	38
Military	245 /1	343 /1	Military	73 *	86
Reconstruction	18	30	Reconstruction	9	14
Transfers to invalids	176	257	Transfers to invalids	15	51
			Social Fund	6	15
Transfers to State budget	30	95	Transfers to State budget	0	60
Other	74	71	Other	50	61
Financing	31	95		0 or -50	103
Domestic		15 /2	Domestic	0 or -50	0
External grants and concessional loans	31	80	External grants and concessional loans	0	103
Source: Federation Ministry of Finance and draft 1998 budget			Source: Republika Srpska Ministry of Finance and 1998 budget.		

1. The budgeted figure for 1998 is only slightly larger than the estimated wage bill for the new, professional army of the Federation and does not take into account dedicated external assistance for the "Train and Equip" program.
2. Privatization revenues.
3. Revenue estimates for 1997 are considered highly incomplete. The lower figures correspond with information reported to the new government, and corresponds mainly to revenues received on taxes levied in Yugoslav dinars. Taxes levied in foreign exchange have much lower

amounts than could be expected. The higher revenue estimates serve as a base for assessing likely developments in 1998, with revenue administration better under control. The expenditure figures marked with an asterisk (*) are considered those most likely to be understated.

Table 3.	Bosnia and Herzegovina - State budget (in millions of KM/DM)		
	1997 Budget	1997 Estimate	1998 Budget
Expenditures	136	110	183
Administrative	40	35	57
Debt service	96	75	126
Revenues	136	50	173
Fees	20	20	20
Transfers from Entities	116	30	153
External financing	0	60	10

Initial Agreement on IMF Credit to BiH

Bosnian authorities have reached understanding with the IMF on a program that could be supported by an IMF stand-by arrangement. The financing available under the program would be \$82 million. The agreement was possible after the last obstacle, the approval of liquidation of the National Bank, was removed.

The Letter of Intent for the proposed stand-by arrangement will now be reviewed by IMF management. If approved, the letter can be signed by local authorities, after which the IMF executive board will make a final decision in May.

The program will cover a range of macroeconomic and structural policy commitments, involving both the common BiH institutions and those of the two Entities, in order to achieve the framework for sustained economic growth in BiH.

In addition, the signing of the Letter of Intent could open the possibility for an agreement regarding two World Bank projects: the Public Finance Structural Reform Project, and the Enterprise Privatization and Bank Restructuring Project. If an agreement is reached, these projects will provide both technical assistance and initially over DM 200 million of budgetary support from the World Bank to the Entities.

Difficulties in Implementation of Customs Tariffs

Last month's newsletter announced the implementation of the Customs Tariff Law as of 13 March. Initially, neither the RS nor the Federation implemented the Law. Both Entities have now instructed their respective customs administrations to start applying the new tariffs.

However, previously established import duties and preferential trade agreements are still in place. The special duties as well as the preferential agreements must be abolished since they are in violation of the unified customs policy for BiH.

Progress in Privatization

The RS is ready for a newly designed privatization program after nullifying previous legislation. The High Representative considered that the privatization process, initiated by the former government, is unconstitutional. The new program is currently being developed with help from several international organizations.

A State Law on Privatization has also been drafted. The law is sent to the Council of Ministers, but so far it has failed to discuss the law. The purpose of the law is to create a secure legal environment for the privatization process to be carried out by the Entities.

Restored Trade Flows expected soon

The OHR recently took the initiative to establish a working group in order to remove existing obstacles to trade between the Entities. Existing trade barriers conflict with the principle of free movement of persons, goods and services throughout the whole of BiH, as stipulated in the Constitution.

The working group is chaired by the OHR and consists of representatives from the RS and the Federation, supported by international experts.

The first step is for the Entities to recognize each other in their respective trade legislation. The Entities need to accept the fact that BiH is one economic space and have to act accordingly. Following this recognition, the parties can start to work on harmonization of taxes, which will benefit both parties since it will decrease tax evasion.

US Support to the RS Budget

In addition to the budgetary support for the RS government that was announced last month, the United States have decided to provide an additional amount of \$5.0 million (DM 9.3), which totals more than DM 27 million of direct support from the donor community. The funds from the US will be implemented by the OHR within the next few days.

Organization of Public Services

BiH Public Corporations

The framework for an optimal organization of public utilities in BiH is laid out in Annex 9 of the General Framework Agreement for Peace in BiH (GFAP). A Commission on Public Corporations has been established by both Entities, and is chaired by Mr. Monnory, Director for BiH of the European Bank for Reconstruction and Development (EBRD). The task of the Commission is to examine the establishment of BiH Public Corporations to operate joint public facilities, such as transport, energy, postal and communication facilities. In particular, the Commission will look into the internal structure of such Corporations, as well as the necessary conditions for ensuring their successful, permanent operation and the best means of procuring long-term investment capital.

Following encouraging results on the railways, the High Representative wishes to see the major sectors reorganized before the end of 1998; electricity, telecommunications, post and (other) transportation. Preliminary meetings have started in electricity and telecommunications.

Railway Corporation Established

The Bosnia and Herzegovina Railway Public Corporation was established on Monday 6 April by the Prime Ministers of both Entities. This is a major step in the re-organization of the railway sector.

The Corporation will carry out three types of tasks: the organization of traffic in the country (allocation of train paths), the harmonization and construction of infrastructures and equipment and the representation of railways for international matters. Donors are encouraged to contact the Corporation to prepare and implement their railway projects. The Board of Directors of the Corporation elected its chair on 6 April; the Chairman is Pavo Boban, the Vice-Chairman is Marinko Bilijanovic, the Secretary is Narcis Dzumhur.

Four tasks remain before completion of the reorganization of railways in BiH:

- to pass a railway law in the Federation and establish the Federation railway company,
- to amend the RS law on railways,
- to agree on the share of the debt and rolling stock,
- to liquidate ZTP Sarajevo company, the previous BiH railway company.

Mail Delivery between Entities will resume

On 6 February, the first post-war delivery of mail from Sarajevo to Banja Luka took place. Further negotiations have led to an agreed text for a Memorandum of Understanding (MoU), to be signed on 23 April by representatives of the State and the two Entities.

According to the MoU, the parties will initially establish three mail transports per week between Sarajevo and Banja Luka, on a reciprocity basis.

Furthermore the parties recognized the need to examine urgently the options for restructuring the post sector in accordance with Annex 9 of the GFAP.

Telephone Links in BiH Re-established

Recently, a total of 90 telephone lines between the two Entities became operational. There are three links of 30 lines each: Sarajevo-Bijelina, Tuzla-Bijelina, and Trebinje-Mostar. Negotiations led by the OHR will result in an additional -temporary- 30 lines between Banja Luka and Sarajevo.

The resumption of telephone operations was possible after the completion of a DM 9 million EC Phare project to reconstruct the backbone of the RS telecommunications infrastructure.

Status of Reconstruction

Coming Donor Conference should increase Help to the RS

The fourth donor conference for BiH will be held in Brussels on 7 May 1998. The purpose of the conference, hosted by the World Bank and the European Commission (EC), will be to confirm the 1998 tranche of the \$5.1 billion target set after the signature of Dayton agreement for four years (1996 to 1999 inclusive). The three previous conferences (1995, 1996 and 1997) resulted in donors pledging close to \$3.4 billion.

The conference will have a special focus on the reconstruction needs for return of Refugees and Displaced Persons. The High Representative will also strongly recommend to the donor community to increase their effort in the RS, including the eastern part. As a result of the former political situation in RS, only a small fraction (estimated at 5 to

10%) of the total aid was directed towards the RS. It is the opinion of the High Representative that the standard share of 2/3 for the Federation of BiH and 1/3 for the RS should apply in the long term. This would require an immediate share of 50% in the RS for 1998, to make up for the past.

Sector Status Summary Report on Reconstruction in BiH (as per April 1998)*1

Sector Type	
Agriculture	100,619,310
Education	86,426,286
Energy	288,628,282
External Debt Service	44,595,306
Finance & Trade	30,077,213
Government Institution Building	68,569,995
Health	145,929,288
Housing	292,606,519
Industry & Industrial Finance	302,133,168
Landmine Clearing	37,197,155
Multi-Sector	8,318,343
Other	4,018,082
Peace Implementation Activities	101,433,377
Social Support	134,394,201
Telecommunications & Communications	19,871,624
Transport	227,078,047
Water & Waste Water Management	101,861,053
Grand Total	1,993,757,251

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Donor Status Summary Report (as per April 1998)*1

Figures in DM

Country	Completed	In Imple- mentation	Not Specified	Total Contracts
(NOT SPECIFIED)	12,620,781	0	771,000	13,391,781
Australia	75,000		0	75,000
Austria	31,968,222	22,244,323	2,113,223	56,325,768
Belgium	407,508	4,366,162	0	4,773,671
Bosnia and Herzegovina		11,210,500	2,289,000	13,499,500

Canada	117,000		0	117,000
Council of Europe Social Development Fund		66,460	0	66,460
Czech Republic	1,148,871		1,374,000	2,522,871
Denmark	314,364		314,364	628,727
Dutch Trust Fund	50,188,204	12,448,395	48,710	62,685,309
EBRD			18,409,709	18,409,709
European Commission	118,343,223	77,867,961	43,360,346	239,571,529
Finland	1,476,926	4,241,779	220,912	5,939,617
France			3,842,223	3,842,223
Germany	11,262,908	8,523,000	23,483,350	43,269,258
Greece		3,492,930	8,732,325	12,225,255
Iceland	0	1,222,525	0	1,222,525
IFAD	9,553,789		0	9,553,789
IFC	0	8,800,000	0	8,800,000
International NGO	340,000		0	340,000
Islamic Development Bank (IDB)	4,133,848	13,686,772	0	17,820,620
Italy	20,380,225	10,215,768	5,073,604	35,669,598
Japan	5,944,574	37,387,723	660,631	43,992,927
Jordan		202,912	0	202,912
Malaysia	292,642	17,288,463	11,726,096	29,307,201
Muli Country Trust Fund	68,630,267	38,784,779	2,071,089	109,486,135
NATO	25,697,430		10,585,522	36,282,952
Netherlands	6,561,846	11,922,722	5,613,488	24,098,055
Norway	25,585,585	3,672,888	873,232	30,131,706
Qatar	3,040,762		0	3,040,762
Saudi-Arabia	30,740,773	20,519,669	5,063,557	56,323,999
Slovenia	3,103,332		0	3,103,332
Soros Foundation	804,537		1,435,516	2,240,053
Sweden	9,261,726	150,000	1,309,849	10,721,575
Switzerland	1,861,240	516,746	1,441,555	3,819,541
Taiwan	142,000	0	0	142,000
Tunis	384,222	0	0	384,222

Turkey		3,169,359	0	3,169,359
UN Trust Fund	50,000		0	50,000
UNDP	657,899	4,289,768	1,520,734	6,468,401
UNHCR	25,211,588	16,183,037	102,194,399	143,589,025
UNICEF	2,387,660		0	2,387,660
United Kingdom	32,459,545	1,635,263	42,631,109	76,725,917
United States	119,903,816	117,362,612	137,135,006	374,401,434
World Bank	211,916,455	262,426,701	8,289,716	482,632,872
World Vision International	305,000		0	305,000
Grand Total	837,273,768	713,899,218	442,584,265	1,993,757,251

Source of information: RCM Database

*1: Figures include all contracts since June 1996.

*2: Figures include all contracts both completed and in implementation.

In the RCM Database, "Contract" is defined as a signed agreement between the Donor or intermediate Agency and the final executor of the works.

Column "Completed" specifies funds for works completed **only**.

Column "In Implementation" specifies funds for works underway **only**.

Column "Not Specified" specifies funds for which no milestones have been provided, therefore the status could not be determined.

Note: This report is based on information provided by Implementing Agencies and other participants willing to contribute to the RCM Database. Therefore, the ETF Secretariat nor the RCM Database can take any responsibility for incorrect or incomplete information potentially contained within this report. Original values are converted to DM based on average exchange rates for 1997.

Office of the High Representative