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Newsletter

Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)

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

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1. Economic Indicators

Bosnia and Herzegovina (BiH)

	May-00	Jun-00	Jul-00
Unemployment (persons)	418.692	421.611	
Net wage (KM)		355	

Federation of BiH

	May-00	Jun-00	Jul-00
Unemployment (persons)	264.665	264.585	
Employment (persons)	412.708	412.726	
Unemployment ratio (1)	42,4%	42.3%	
Net wage (KM)	406	408	
Retail price growth	0.3%	0.1%	0.6%
- annual growth (2)	-0.6%	0.6%	2.2%
Industrial prod growth	4.7%	0.2%	-9.3%
- annual growth (2)	14.2%	12.2%	1.4%

Sales to RS (KM million)	11.2	8.3	10.4
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Republika Srpska (RS)

	May-00	Jun-00	Jul-00
Unemployment (persons)	154.027	157.026	154.027
Employment (persons)		228.834	
Unemployment ratio (1)		40%	
Net wage (KM)	272	259	285
Retail price growth	0.6%	1%	1.1%
- annual growth (2)	13.2%	11%	10%
Industrial prod growth	-19.4%	-1%	6.2%
- annual growth (2)	20.8%	24.2%	9.5%
Sales to FBiH (KM million)	3.1	3.7	2.7

Sources: BiH Agency of Statistics, Federation Statistical Institute, RS Statistical Institute. Growth figures are over one month, unless indicated otherwise. Inflation in KM prices.

(1) Number of unemployed over employed plus unemployed, excludes waiting list (52.059 persons in June 2000) and gray economy;

(2) Annual figure, month this year over month previous year;

(3) Number of unemployed over employed plus unemployed;

(4) Figures for BiH represent aggregate values from RS and Federation data submissions.

2. Progress in the Policy Reform Dialogue on Labor Issues in BiH

Discussions between the authorities of both Entities and a joint World Bank/OHR/ILO team have taken place to finalize an agreement on three key laws (2 in the RS and 1 in the Federation). This dialogue has been concluded, and the three draft laws were submitted to the respective Governments, for onward transmittal to Parliament. It has been envisaged that these laws would be enacted in autumn, thereby fulfilling some of the critical pre-Board actions necessary for approval of the proposed World Bank Social Sector Adjustment Credit. A brief outline of the key components of these laws is detailed below, together with a short overview of the intended effects and their contributions towards achieving a market based economy within BiH. Progress is well advanced in creating a similar labor law framework in Brcko District. Throughout this exercise, a guiding theme has been the need to harmonize the laws in both Entities and the District to ensure a uniform labor market framework throughout BiH.

Federation: Law on Job Placement

This new law is designed to establish a legal framework for the Federation Employment Service, an Entity-wide job placement service creating the opportunity for private employment services and establishing a more viable and financially sustainable unemployment benefit insurance system. While the exact benefit structure has yet to be finally approved by the Government, the draft submitted reduces the duration of benefits to a maximum of six months (from 24 months), with a maximum replacement rate (benefit formula) of 45% of the average monthly wage. Further attempts to improve the financial viability of the system include an elimination of the obligatory cross fund transfers (pension and health insurance contributions) from the Employment Fund (generated by a 3% tax on payrolls).

RS: Law on Working Relations

This new law is the equivalent of the recently amended Federation Labor Law and is similar in composition and legal requirements. This law is a modern labor law that is ILO compliant and appropriate for a market economy, providing the necessary balance of safeguards for employees and employers. Key provisions such as minimum

compensation payments based upon length of service are exactly the same as that provided in the Federation Labor Law. This new law also eliminates the waiting list system in the RS, with compensation for those currently on the waiting list no higher than the levels provided under the amended Federation Labor Law. In addition, it establishes an appeals mechanism for those who believe their rights under existing labor law in the RS have been violated, with a prescribed system of compensation. The exact number of employees currently on the waiting list in the RS is not precisely known by the authorities, however the estimates range from 20,000 to 30,000. All liabilities for severance of those on the waiting list is a firm-level obligation.

Law on Employment and the Rights of the Unemployed

This law is similar to the Job Placement Law in the Federation, insofar as the law establishes an Entity-wide employment, job placement service and a revised unemployment benefit system. The maximum duration of unemployment benefits has been reduced to twelve months (from 30 months), but with a more graduated range, starting at two months dependent upon the length of service and the payment of the necessary unemployment insurance contributions. While the maximum duration is higher than that envisaged in the Federation (which has not yet been approved by the Federation Government) the effective average period will be quite similar. The maximum replacement rate has been set at 40%.

Overall effects

Passage of these laws will provide a labor regulatory framework that will be well understood by foreign investors, as well as providing a more flexible regime for all employers. These laws are similar to what would be found in Europe or other OECD countries and support the economic imperative of accelerating the pace of job creation in BiH.

3. The High Representative Annuls RS Restitution Laws

Following discussions with senior officials of the RS Government, officials within the BiH diplomatic community, international organizations present in BiH, and the leaders of the religious communities of BiH, the High Representative on August 30 annulled the RS Law on Return of Confiscated Property and Compensation. At the same time, the RS Law on Return of Seized Real Property and the RS Law on the Return of Seized Land were also annulled. The RS Restitution programme was considered to be unfeasible, ill-conceived, an impediment to economic reform, and of no benefit to persons whose property has been nationalized.

Under the annulled laws, the RS assumed financial responsibility for compensating claimants whose property could not be returned. The RS has no estimate of how much compensation it may have been obliged to pay.

Furthermore, to carry out the restitution programme the RS Government would have to set up new administrative bodies. It was considered that neither these new administrative bodies nor the courts would have the funds and personnel to properly carry out their duties in an efficient and timely manner. Also, experience has shown that similar administrative bodies in BiH frequently issue decisions based on the claimant's ethnicity, but not on the relevant facts of the claim itself. The High Representative is not convinced that the RS has taken sufficient action to ensure that these administrative bodies will function in a non-discriminatory manner.

4. Amendments to the Law on Funds, Management Companies and Investment Funds

The High Representative issued a decision amending the Federation Law on Funds, Management Companies and Investment Funds. Paragraph 3 of Article 134, which had limited the period in which Private Investment Funds (PIFs) could subscribe to shares to three months, has now been deleted.

Citizens of Bosnia and Herzegovina are able to subscribe to shares either by direct subscriptions to companies or through PIFs. PIFs are an essential part of the (voucher) privatisation process and will manage shareholders' investments on their behalf, saving both administrative expenses and using the PIF management's expertise.

Some private Investments Funds began collecting subscriptions from BiH Citizens in May 2000 under the assumption that a list of companies and equities to be offered under the Public Offering of Shares would soon be published. This list would show citizens the investment opportunities open to the Private Investment Funds. Unfortunately, the Federal Privatisation Agency postponed the announced publication.

The International Advisory Group on Privatisation has informed the High Representative that without being aware of their investment opportunities, citizens would not know how their investments would be deployed by the PIFs' fund managers, and thus be unlikely to subscribe to the PIFs. This meant that PIFs could not capitalise the legally required minimum value of two hundred million KM (face value of vouchers) within the three-month subscription period.

The High Representative, by removing the three-month limit for the subscription collection from the Law on Funds, Management Companies and Investment Funds, has ensured that PIFs will have more opportunity to collect the minimum subscription required. The FBiH Securities Commission is now authorised to issue regulations that govern the deadlines for subscription to PIFs.

Recent results indicate that two PIFs have now reached the minimum capital requirements.

5. BiH Law on Statistics awaits parliamentary procedure

In order to further enhance the development of the BiH statistical activity, emphasis has been put on providing an appropriate legal framework.

The BiH Statistical Agency under the guidance of EUROSTAT and in close cooperation with the entities' statistical institutes and the International Community, recently finalized a draft Law on Statistics. The draft received support from the BiH Ministry for Civil Affairs and Communications and is in the final review stage before undergoing parliamentary action.

With the aim of strengthening the role of the state agency, in line with the Brussels PIC declaration, three articles of particular importance have been introduced in the proposed law:

- Brcko will be a branch statistical office reporting directly to the state agency;
- Sanctions might be considered in the event of non-compliance by the entity's institutes with the reporting mechanism;
- The Management Board will be composed by a director and a deputy, appointed on professional basis, rather than three representatives reflecting the different constituent peoples. The latter has proved to have a negative impact on cost effectiveness and management.

The BiH Agency of Statistics, which is an example of functional state institutions, continues to receive significant and regular support from donor countries and has achieved full international recognition, provides regular state-level publications, has improved cooperation between the Entities' statistical Institutes and acts as full fledged counterpart for the International Community.

Finally, it should be noted that the East and West statistical offices in Mostar are unified and are now operating out of the same premises as a result of a rehabilitation project financed by the Italian Government and implemented by IMG.

6. Amendments to Law on Pension and Disability Insurance indispensable

The reform of the social safety system in BiH is a growing priority, particularly in view of the anticipated reduced flows of IC funds to BiH.

With regard to pensions, both Entity governments – in conjunction with the WB and the OHR – finalized comprehensive amendment policy packages to the existing Law on Pension and Invalid Fund. The approval of those amendments would guarantee timely payments and would avoid further arrears for the pension funds. It would also protect the elderly by guaranteeing a minimum pension. The Government would pursue sound social and fiscal policy without generating illusionary expectations.

The World Bank's proposal is to pay pensions according to the extent of actually collected contribution revenues. It is worth noting that the proposed amendments do not address past liabilities as their approval would not reduce accrued pensioners' claims. In the Federation, those amendments are a necessary step towards implementing the urgently needed merger of Mostar and Sarajevo Pension Funds.

However, the respective Entities' parliamentary bodies failed to approve the proposed amendments.

The consequences could be disastrous for the future of the economy of BiH:

- 24 million dollars from the Public Financial Structural Adjustment credit urgently needed by the Federation budget would not be released by the World Bank;
- 130 million dollars, support from the World Bank over the next three years would be lost;
- IMF would be obliged to suspend its stand-by agreement;
- Tens of millions of dollars of European and bilateral support could be jeopardized;
- A sharp decline in expected private foreign investment may follow.

Recently the Head of the IMF mission in BiH, the World Bank's representative in BiH, and last, but not least the High Representative met with senior Federation officials and emphasized the urgency to adopt the package of amendments to the pension law. Failure to do so would send a negative signal to potential international investors and international donors backing the peace efforts in Bosnia and Herzegovina.

In the medium- and long-term, pension levels rely on the country's economic performance. Only strong economic growth will ensure the increase in revenues needed to raise pensions.

7. Update on the Peace Implementation Council Agenda, Brussels, May 23/24

7.1 Single Economic Space

Significant steps have been completed or are underway to create a single economic space such as:

- A Draft Law on BiH Chamber of Commerce is ready for parliamentary procedure.
- The BiH Statistics Agency under the EUROSTAT guidance and in close cooperation with the IC finalized a draft Law on Statistics, ready for parliamentary procedure.
- Banks from one Entity can open branches in the other without the need to satisfy capital requirements requested from foreign banks.
- Tax harmonization is ongoing and a working group has been established to oversee all tax issues in BiH. The task of this working group is to establish a medium term tax reform agenda and to deal with day to day tax issues.
- The State Treasury Law has been approved and a Treasury is being established. The Supreme Auditors have been appointed.

7.2 Bank Privatization and Reform

The International Advisory Group for Banking Sector Issues formed in November 1999 focuses on a unified approach to bank privatization and reform, effective regulation/supervision, and deposit insurance.

The Federation has amended the Law on Deposit Insurance in April providing for the proper legal framework to set up a system for securing deposits.

Bank privatization has begun in the RS with four banks tendered so far (PBS Srpska Sarajevo; Kristal; Banjalucka, Agroprom). The bank privatization is proceeding slowly in the Federation and first tenders are expected this autumn. The solvency question of the PBS group should be solved via a report from an international auditor. A foreign bank opened in Sarajevo in July (Volksbank from Austria) and the Market Banka was bought by the Austrian Raiffeisen Group. The engagement of foreign banks increases competition, speeds up the reform process in the financial sector and, in particular, provides reliable financial sources (for foreign direct investment). The High Representative issued a decision amending the banking law in the RS with regard to providing protection for bank supervisors, examiners and officials of the banking agencies from personal liability arising from the normal performance of their duties. The RS is expected to harmonize its Law on Deposit Insurance in the next months. The IC has indicated its willingness to provide considerable funds and technical assistance for the deposit insurance.

7.3 Business Environment

Several new law initiatives were undertaken to create a more favorable environment for enterprises in BiH (clear ownership titles form the basis for any market economy). A working group on a new Law on Land Registry and Cadaster being attended by both Entities has discussed the draft and is now preparing the necessary by-laws, expected to be completed by the end of the year. Further progress was achieved in preparing a full set of laws in the area of standardization, metrology and intellectual property as statewide recognized standards are a precondition for exporting to world markets. A new Obligation Law project was begun in August and the final draft should be ready by mid 2001.

7.4 Public Utilities and Implementation of Annex 9

Entity governments who created in March the new Annex 9-based joint BiH Road Infrastructure Public Corporation with its seat in Banja Luka have made further progress in mobilizing the new institution. They established the required 12-member Board of Directors, appointed the Management Board and will begin operation this fall. The Commission on Public Corporations has recommended the establishment of three more joint public corporations for natural gas transmission, broadcasting transmission infrastructure, and power transmission. Additional proposals include the post sector, ports, and waterways.

7.5 Energy Sector – Electricity

Creating a viable power sector in BiH will depend on the successful implementation of pro-market reforms including privatization and the establishment of modern regulatory frameworks and institutions. Furthermore, the creation of a common market for electricity in BiH is an important aspect. These requirements became particularly evident during negotiations for the World Bank Power III Project (approximately US \$230m.). OHR has been developing and promoting a package of measures in cooperation with the World Bank and other international players which includes: the creation of an independent regulatory commission for the energy market, an open privatization process which will attract an optimal number of foreign investors, and the establishment of a joint, high-voltage transmission company.

7.6 Telecommunications

The new Telephone Numbering Plan for Bosnia and Herzegovina has been successfully implemented and interconnection agreements were signed. Notably, a new policy for the BiH telecom sector was developed in association with the European Bank for Reconstruction and Development, which will provide guidance for the activities of the Telecommunication Regulatory Authority (TRA). It foresees liberalization of the BiH telecom market (except for international telephone services) to be implemented by December 2000. For the time being, this policy paper has not been endorsed yet by the Council of Ministers. Significant measures to strengthen the role and capability of the TRA have also been undertaken.

7.7 Privatization

The final list of companies/equities which will participate in the Public Offering of Shares will be published in the next few weeks. After the first wave ("Big Bang"), expected in autumn, there will also be a second "wave" of voucher privatization within two years which will include in particular, infrastructure and media companies. Tender regulations that are in conformity with international standards have been approved. Companies of significant importance for the BiH economy have been identified by the privatization agencies and the International

Community which will be tendered with the assistance of the international advisors. The first tender was launched at the end of August.

OHR's role within the privatization process is to provide support for the international partners as well as drawing on its political influence. At the same time, OHR gains from the knowledge and experience of the national and international partners in developing recommendations to the Economic Task Force (ETF) or resolving implementation issues. In this respect OHR drafted the Amendment to the Federation Law on Funds, Management Companies and Investment Funds for example which suspends the deadline for Privatization Investments Funds (PIF's) to collect subscriptions to shares. This decision as other minor action has been coordinated/prepared within the International Advisory Group on Privatization (IAGP) and discussed within the ETF which underlines the strong cooperation within the International Community.

Summary Report Donor Aid to BiH as per October 1, 2000

DONOR AID TO BOSNIA AND HERZEGOVINA

- PROJECTS BY STATUS -

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Information on economic data and trends in BiH are also available on the USAID web site: <http://www.usaid.ba/>

Office of the High Representative