

# **OHR: Economic Newsletter, Vol. 3, No. 5, June 2000**

Newsletter

## **Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)**

Sarajevo, June, Vol. 3, Issue 5

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

### **Economic Indicators**

#### **Bosnia and Herzegovina (BiH)**

	<b>Dec-98</b>	<b>Jan-99</b>	<b>Feb-99</b>	<b>Mar-99</b>
Unemployment (persons)	398639	401775	404940	407859
Net wage (KM)	330	335	337	329

#### **Federation of BiH**

	<b>Dec-99</b>	<b>Jan-00</b>	<b>Feb-00</b>	<b>Mar-00</b>
Unemployment (persons)	261 793	263 082	264 602	NA
Employment (persons)	410 104	411 020	411 199	NA
Unemployment ratio (1)	42.4%	42.5%	42.5%	NA
Net wage (KM)	386	381	398	NA
Retail price growth	0.5%	0.4%	0.8%	-0.3%
- annual growth (2)	-1.0%	-1.1%	-0.3%	-0.8%
Industrial prod growth	0.3%	-8.2%	-0.6%	6.8%
- annual growth (2)	9.1%	21.9%	19.9%	14.6%
Sales to RS (KM million)	9.4	3.3	6.8	8.5

#### **Republika Srpska (RS)**

	<b>Jan-00</b>	<b>Feb-00</b>	<b>Mar-00</b>	<b>Apr-00</b>
Unemployment (persons)	To be revised			
Employment (persons)	To be revised			
Unemployment ratio (1)	To be revised			
Net wage (KM)	222	237	291	272
Retail price growth	1.0%	2.6%	0.1%	0.6%
- annual growth (2)	10.8%	14.1%	13.5%	13.2%
Industrial prod growth	-30.8%	23.3%	24.5%	NA
- annual growth (2)	-1.6%	7.4%	11.1%	NA

Sales to FBiH (KM million)	3.2	2.0	3.3	NA
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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 (53 912 persons in December '99) and gray economy;

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

## Economic Policy and Reform

**PIC Approves the High Representative's Strategy** The members of the Peace Implementation Council (Council) and the leaders of Bosnia and Herzegovina, met in Brussels on 23-24 May 2000, to review progress in BiH and to set priorities for a new accelerated phase of peace implementation. The Council confirmed the High Representative's plan to expedite economic reform, accelerate refugee return and strengthen the Common Institutions of Bosnia and Herzegovina.

The Council underscored that the security situation has stabilized, major reconstruction is completed, the return of refugees and displaced persons is accelerating, the Brcko District is established and political pluralism is gaining strength. Each of these accomplishments largely reflects the result of intensive international efforts.

The Council recognized the High Representative's role in coordinating the international donor community's efforts and supported the use of his mandate including removal of obstacles that prevent economic reform and, in turn, choke economic growth. The Council expressed its dissatisfaction with the slow pace of domestic peace implementation since its Madrid meeting in December 1998.

The Council confirmed that deepening economic reform and creating the conditions for self-sustaining market-driven economic growth to avoid an economic crisis, as BiH makes the transition from a donor dependent economy, should be the central priority. The Council urged donors to continue to condition their assistance upon the implementation of concrete and specific reforms. The critical elements of economic reforms are:

- **Creating a single economic space:** To increase efficiency and economies of scale, there should be a harmonized, country-wide approach in a number of areas, including: taxes, competition, public procurement, financial services, standards and regulations, banking, public utilities, electric power, telecommunications and transport/railways. These steps are preconditions for BiH's integration into Europe and form the building blocks for a single economic space.

The Council called on the High Representative to ensure rapid development of State-level regulatory mechanisms for telecommunications, energy, transport, and media. The Council also called on the State authorities, in consultation with the High Representative, to identify and establish adequate domestic funding sources for the State budget.

- **Enabling private sector growth:** To succeed economically and attract private capital to sustain growth, BiH needs an attractive business environment. The Council urged BiH authorities to remove promptly the barriers obstructing the development of the private sector and to establish simplified procedures for foreign and domestic investors. The Council urged the authorities to proceed with broad-based reform of the taxation and customs systems, labor legislation, the social security system, the banking system, the unaffordable military structures and the unsustainable governmental bureaucracy at all levels. The Council called for adherence to the current timetable to dismantle the payment bureaus by December 2000.
- **Privatization:** The Council encouraged greater emphasis on tender privatization that would encourage the injection of new management and capital. The Council welcomed the involvement of international experts to ensure that the privatization process moves forward quickly and in the interest of the people of BiH. The OHR, via the Economic Task Force, will

ensure co-ordination and monitoring of the privatization process, in particular, through the International Advisory Group on Privatization, and report to the Steering Board of the Council.

- **Fight against corruption:** The Council expressed deep concern over ingrained corruption in BiH which undermines democratic governance, wastes public resources and hinders the development of the market economy. The Council urged measures for improved transparency in public budgets and institutional capacity-building to end the systemic nature of corruption.

During this crucial period of economic reform, the Council urged the BiH authorities to closely collaborate with the international community and encouraged the International Financial Institutions to unequivocally apply conditionality.

## World Bank Announces Strategy for BiH

The World Bank announced a new Country Assistance Strategy (CAS) for Bosnia and Herzegovina that will, over the next two to three years, support the authorities as they continue to build and strengthen the institutions and policies of good governance at the State, Entity, and local levels, including planning for fiscal adjustment. The CAS would support up to US\$300 million in IDA resources over the period, provided the key reform measures outlined are taken.

The Bank's objective in its partnership with Bosnia and Herzegovina is to increase economic opportunity and improve the quality of life for all Bosnians. In light of the country's development priorities, the strategic objectives of the CAS for fiscal year 2000-2002 will be:

- to help *strengthen weak and fragmented governance arrangements* to build a solid foundation for broad-based self-sustaining growth and democratic participation;
- to help *foster sustainable and inclusive private sector-led growth and employment* as the most important means of improving economic opportunity for all Bosnians; and
- to help *build social sustainability by establishing affordable and equitable social services* for all Bosnians, including a social safety net for the most vulnerable.

Bosnia and Herzegovina faces two specific challenges in the period ahead. First, it must begin to take ownership of its economic future by assuming increased responsibility for economic policies and outcomes. This will mean strengthening governance at all levels and reducing dependence on the international community. Second, it must promote sustainable growth and employment in an inclusive way that provides increasing incomes and opportunities for all Bosnians. Reforms aimed at increasing private sector activity, and, in parallel, measures to ensure that growth is inclusive and that safety nets are in place for those who cannot feel its full benefits are needed.

The fiscal year 2000-2002 CAS is formed on the basis of consultations with stakeholders in Bosnia and Herzegovina, including the government and a broad range of representatives and groups from within civil society. The CAS is also based on close consultations with other partners in the international community. It is consistent with, and builds on, the major thrusts of the Bank's previous CAS and the lessons of implementation.

Finally, the CAS also fits within the broader framework of the Regional Strategy Paper for Southeast Europe, developed by the Bank and the European Union in the context of the Stability Pact. The reform agenda set out in this CAS is one to which all partners in Bosnia and Herzegovina's development effort will contribute in one way or another. The World Bank Group's support will continue to be selective. The Bank Group has been asked by the authorities and by other key partners, to continue the policy reform, and the supportive role it played during the last CAS, which few other donors are able to assume. In tandem, the Bank intends to disengage from reconstruction related activities over this CAS period.

## The High Representative Removes Obstacles to Private Sector Development

Last month, the High Representative took two measures to advance economic reform. He removed the President of the Management Board of the Federation Privatization Agency and he issued Decisions amending the banking laws in each of the Entities.

As the High Representative has pointed out, a successful privatization process is key to private sector development in BiH. Economic reform is one of the central strategic priorities of the High Representative for the coming period.

The President of the Management Board had persistently and seriously obstructed the privatization process in the Federation. In particular, he delayed the adoption of tender regulations of the proper international standards, which led to unsatisfactory tender results and obvious lack of transparency. He insisted contrary to all advice, on an unnecessarily early deadline of 29 February 2000, for the publication of tenders which led to enterprises being tendered without necessary preparation. He also prevented the implementation of the Federation Government's agreements with the International Community. As a result of these actions, the Federation Government was compelled to suspend the all-important tender process.

The High Representative therefore had no choice but to remove the President of the Management Board from office.

The High Representative's Decision to simultaneously amend the banking laws in both Entities created one of the conditions for sound banking supervision, essential for the establishment of a reliable and efficient banking system.

The Entity laws did not provide protection for bank supervisors, examiners and officials of the banking agencies from personal liability arising from the normal performance of their duties. As a result, they were anxious and hesitant to carry out their duties as required. Protection of this type of officials is both customary and necessary for strong and independent bank supervision. Most Western countries have such protection. The Basle Committee states that this is one of the pre-conditions to develop effective bank supervision.

The international community had proposed amendments to the Entity Banking Laws in the past, but despite repeated promises by government officials, no action had been taken. The High Representative was therefore forced to step in.

## The High Representative Addresses Promo International

*Strengthening the Financial System to Stimulate Exports and Investments in Bosnia and Herzegovina* was the theme of the 3rd annual conference of Promo International held in late May. The conference aimed to chart an action plan on economic reform to enhance exports and attract foreign investment. The conference attracted business leaders, government officials and members of the international community.

The High Representative addressed the conference and outlined his priorities endorsed by the Peace Implementation Council. He stressed the need to deepen economic reform and create the conditions for self-sustaining market-driven economic growth to avoid an economic crisis as BiH makes the transition from a donor dependent economy.

The High Representative reminded the audience that the basic instruments for a market economy supported by fiscal reform, a modern customs administration, a sound financial market, and a viable banking sector, essential to facilitate the transition to a market economy and to stimulate growth, are in place. It is for BiH to move ahead and secure a self-sustained market economy.

The conference concluded with a broad array of recommendations in the thematic areas: export promotion; foreign direct investment; private sector development; capital market strengthening; and Investment Compact in the region.

## Bank Privatization in the Republika Srpska Advances

The efforts to privatize banks in the Republika Srpska are showing progress. New management boards have been established in each of the government-owned banks. Banks were to submit their privatization programs to the Bank Privatization Unit. Ten out of 11 banks, which are to be privatized in the RS, have done so. Razvojna Banka has not submitted their privatization program as it is not yet separated from the SPP, RS Payment Bureau. It is not in a position to prepare its balance sheet but expects to do so by the end of June.

Following the approval by the Bank Privatization Unit, the privatization plan will be subject to the consent of the RS Government. So far, the RS Government has approved privatization programs for of five banks — Privredna Banka, Srpsko Sarajevo; Privredna Banka, Brcko; Kristal Bank, Banja Luka; Privredna Banka, Gradiska and Privredna Bank,

Doboj.

Publishing of tender for sale of the banks follows the Government's approval. As of May 17, one tender (Privredna Banka, Srpsko Sarajevo) was published. It received 8 tender bids. They will be compiled in 15 days. The tender for Kristal Banka, Banja Luka is expected in June 2000.

### Co-operation in Customs Development

On 26 May, the Federation Customs Administration and Republika Srpska Customs Administration Directors signed an agreement on co-operation between their Customs Administrations. The agreement, as drafted by the Customs and Fiscal Assistance Office (CAFAO) programme to BiH, provides for co-operation in the future development of the two Customs Administrations and mutual assistance to ensure customs legislation is properly implemented and enforced in both Entities.

The signing of the cooperation agreement between the two Customs Administrations represents an important step forward in achieving a uniform approach to customs throughout BiH. The agreement confirms and also formalizes already existing co-operation between the Entities in the various fields of customs, such as legislation, training, computerization and enforcement.

The continued and consistent application of the State of BiH's customs policy, including the application of uniform customs duty rates and customs formalities throughout BiH, depends on cooperation and communication between the Entity Customs Administrations and will, in turn, contribute to the functioning of a single economic space in BiH. At the same time, improved co-operation is also expected to increase confidence in BiH's customs structures and demonstrate to the outside world that BiH is capable of acting as a single country in customs matters. This will be of significant importance in the ongoing process of establishing similar cooperation agreements on customs matters between BiH and trading partner countries.

### Update on Anti-Corruption Activities

As a part of the Anti Fraud Unit's ongoing anti-corruption efforts in implementing the Comprehensive Anti-Corruption Strategy, AFU facilitated the BiH delegation's participation in the Council of Europe's seminar on strengthening of methods and measures regarding investigation, prosecution and sanction of economic crime, held in Bled, Slovenia from May 10-12. The recommendations for BiH, finalized at the seminar, call for urgently needed institutional and legislative changes.

As mentioned, recognizing the grave consequences of corruption, the PIC resolution in Brussels expressed deep concern over ingrained corruption in BiH.

### Organization of Public Services

**Border Crossings over the Sava River** Significant progress was achieved in the second quarter of this year regarding the opening of permanent border crossings and reconstruction of bridges across the Sava River. On April 5, the bridge at Srpski Brod / Bosanski Brod Slavonski Brod, a major point along the 5c corridor was once again open to traffic. Funded by USAID, the reconstructed bridge replaced an interim ferry service, which served this location for nearly five months.

The second key achievement was the reopening of the border crossing Stara Gradiska / Bosanska Gradiska Gradiska on 3 May. The European Union, at a cost of approximately Euro 1.3 million, funded the reconstruction of this bridge critical to trade, traffic and commerce between Bosnia and Herzegovina and the Republic of Croatia. Concurrently, the interim military pontoon bridge, which was the result of a highly coordinated effort of civil-military cooperation between the two countries, was closed at this location. Finally, on 15 June, an International Ferry Service will be established between the Special District of Brcko and Gunja for a period of approximately 100 days during the period of bridge reconstruction. The continuity of traffic between the District and the Republic of Croatia was achieved through a cooperative effort between the European Union, which has financed the reconstruction of the bridge, and USAID, which has funded the infrastructure necessary to implement the interim ferry service.

All of these achievements represent the completion of major milestones in the plan for reconstruction of most of the bridges across the Sava River by the end of the year 2000.

Transportation Master Plan Pacific Consultants International of Tokyo, working on the development of BiH's first integrated, multi-modal Transportation Master Plan, have started Phase II of the study which includes extensive traffic survey activity. An interim report is expected in November and a draft final report in January 2001. The draft final report will outline the initial results of feasibility analyses on several major transport investment projects. Railways

The railway system in Bosnia and Herzegovina deteriorated significantly since 1990 due to the war and lack of investment and maintenance. Total estimated war damage to railways is about US\$1 billion. Since 1996, considerable reconstruction including demining has taken place. It is again technically possible to operate trains over most of the 1,031 kilometer network. However, much of the reconstruction has been to minimum standards; trains operate at considerably reduced speed. As a consequence, railways have been unable to recapture passenger and freight traffic.

Currently, BiH has three railway operators: Railways of Bosnia and Herzegovina (ZBH), Railways of Herzeg-Bosnia (ZHB) and Republic of Srpska Railway (ZRS), the first two of which are under the process of a legal merger to form Federation of Bosnia and Herzegovina Railways (ZFBH). In line with recent European practice to separate railway transport business from managing infrastructure, the BiH Railway Public Corporation (RPC) was established in 1998 with a primary mandate for infrastructure.

Before the war, the railway system transported some 13 million passengers, 30 million tons of freight and operated 20 passenger trains and 10-20 freight trains per day. The current level of traffic stands at about 10 percent. Only one daily international long-distance passenger train Sarajevo-Mostar-Ploce has been introduced. Three more international passenger trains were to have been introduced by the end of May 2000 but the railways failed to do so.

All railway border crossings are now open and international railway agreements have been signed with all neighboring countries. A resumption of industrial activity in the region will make freight volumes rise again. Rapid implementation of pledged, but many overdue reconstruction/rehabilitation projects, will greatly help the railways to respond to demand growth. Rehabilitation assistance of trunk line, envisaged by a Euro 50 million loan from the European Bank for Reconstruction and Development/European Investment Bank, should help to increase competitiveness and allow the railways to take on the transport role.

## Telecommunications

On 14 March, the Telecommunications Regulatory Agency (TRA) of Bosnia and Herzegovina adopted the new Telephone Numbering Plan for all of BiH, which was implemented on 4 June. Both the "old" and "new" numbering systems will run in parallel for the next 2 to 3 months. Additionally, the three fixed network operators concluded Interconnect Agreements on 22 May. The international licenses will be issued by the TRA. PTT BiH and Telecom Srpska also agreed to introduce national roaming, beginning 5 June. These steps represent considerable progress in the telecommunications sector for Bosnia and Herzegovina.

The area codes to follow the country code 387 are: Banja Luka - 51; Bijelina - 55; Brcko - 54; Brcko District - 49; Canton 1 - 37; Canton 2 - 31; Canton 3 - 35; Canton 4 - 32; Canton 5 - 38; Canton 6 - 30; Canton 7 - 36; Canton 8 - 39; Canton 9 - 33; Canton 10 - 34; Doboj - 53; Mrkonjic-Grad - 50; Pale - 57 ; Prijedor - 52; Srbinje/Foca - 58; Trebinje - 59; and Zvornik - 56.

## Establishment of Mostar Joint Water Supply Company

After considerable difficulties, the Mostar City Council unanimously adopted the proposal by the members of the Management Board of the future unified Mostar Water Supply Company, and thus met the important precondition for the implementation of the World Bank Water Project which had been under negotiation for 18 months.

Funds (US\$ 12 million) available under an IDA soft loan will be used for urgent repairs on the water and sewage systems and restructuring of the sector. The establishment of the unified water supply company is significant as this is the first joint public utility in the City of Mostar.

# Reconstruction Update

Please see attached table and also refer to the website of the International management Group.

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

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