

# **OHR: Economic Newsletter, Vol. 2, No. 6, July 1999**

Newsletter

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

Sarajevo, July 1999, Vol. 2, Issue 6

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

#### **Economic Indicators BiH**

##### **Bosnia and Herzegovina**

	Sep-98	Oct-98	Nov-98	Dec-98
Unemployment (persons)	389254	391243	394496	398639
Net wage (KM)	303	316	319	330

##### **Federation of BiH**

	Feb-99	Mar-99	Apr-99	May-99
Unemployment (pers)	261019	262609	262273	
Employment (pers)	407057	407064	407179	
Unemployment ratio (1)	39%	39%	39%	
Net wage (KM)	371.9	365.1	375.5	
Retail price growth	0.2%	-0.1%	-0.2%	0.0%
- annual growth (2)	1.2%	0.5%	-0.2%	-0.9%
Industrial prod growth	-1.6%	11.9%	1.5%	-3.5%
- annual growth (3)	3.6%	14.4%	11.7%	1.7%
Sales to RS (KM mln)			3.40	7.07

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

	Feb-99	Mar-99	Apr-99	May-99
Unemployment (pers)	142152 (Dec 98)			
Employment (pers)	250000 (estimate 1998)			
Unemployment ratio (1)	36% (Dec 98)			
Net wage (KM)	195	198	200	201
Retail price growth	0.0%	2.5%	2.6%	1.3%
- annual growth (2)	8.3%	16.1%	12.7%	16.7%
Industrial prod growth	23.5%	14.6%	-25.4%	-3.9%

- annual growth (3)	6.3%	15.9%	-12.6%	4.2%
Sales to Fed. (mill. KM)			2.45	2.36

Sources: BH 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, ex-cludes waiting list and gray economy.

(2) Annual figure, last 3 months over 3 months last year.

(3) Annual figure, month this year over month last year.

## Economic Policy and Reform

### Konvertible Marka in Croatia and Hungary

On 28 June 1999, Peter Nicholl, the Governor of the Central Bank of Bosnia and Herzegovina signed a contract with the Splitska Banka on purchase and sale of KM in Croatia.

The Chief Executive Officer of Splitska Bank stated that this decision would improve business along the Adriatic coast where tourism has been severely damaged recently and most tourists visiting Croatia are citizens of BiH.

Initially, the KM will be exchanged in 75 branch offices of the Splitska Banka, from Dubrovnik to Zagreb with a commission not exceeding the charge for other foreign currencies. The exchange rate for DEM will apply to all KM transactions.

As of 15 July 1999, selected branches of the Budapest Bank and the entire network of Raiffeisen Bank will commence the sale and purchase of the KM. Depositors of KM in BiH will be able to withdraw Forint in Hungary and vice-versa. This is expected to promote trading activities.

### Anniversary of the Konvertible Marka

On 21 June 1999, the Central Bank of Bosnia and Herzegovina celebrated the anniversary of the KM. Despite popular misgivings towards the currency, the bank note has increasingly gained confidence. The CBBH balance sheet has grown to KM 340 million in May 1999 from KM 150 million, a year ago – an increase of 127 percent. The CBBH accounts received a sound score by a reputable accounting firm.

As the currency gains acceptance in Bosnia and Herzegovina, its use is also increasing, notably in the Republika Srpska where payments by the Government as well as collection of public revenues are hovering at 70 percent. The KM is the dominant means of payment in BiH. This has propelled trade between the Entities and increased economic activity. Pegged to the Deutsche Mark, the KM has a fixed exchange rate with the Euro. The goals for the year ahead include the introduction of the KM 1 and 2 coins, and eventual disappearance of the DM, Kuna and Dinar from the payment system.

### Tax Harmonization

On 8 June 1999, the Ministers of Finance and Trade signed a memorandum to harmonize excise taxes in both Entities. With the sales tax rate already being similar, this agreement will make the indirect tax regime about the same in both Entities. Distortions in internal trade and possibilities for tax evasion have thus been reduced.

What may be even more important, is that with the same agreement, differences in excises for imported and domestically produced goods have been removed. Different taxes on import are a form of customs policy, and should be regulated at the State level. Therefore, the previous excise tax systems were not in accordance with the Constitution of BiH. Amendments to the excise tax laws in both Entities will be submitted to parliament by 15 July 1999.

### Credits and Grants

The Directors of the World Bank and the International Monetary Fund recently approved several credit programs and the Stand-By Arrangement for BiH.

The World Bank will provide \$122 million, comprising of credit for public finance adjustment (\$72 million) and privatization (\$50 million), of which 70 percent and 30 percent will be allocated to the Federation and the RS respectively. In addition, \$12 million will be available for export credits.

The IMF will provide \$24 million to the Federation and \$12 million to the RS for balance of payments support. In addition, \$23 million, in equal shares to the Federation and the RS, for "Kosovo augmentation" would be available for budgetary support. The IMF Board of Directors commended the local authorities for progress in macro-economic performance and maintaining prudent fiscal policies. They stressed the need to refrain from new expenditure commitments and noted that political difficulties continue to hinder policy implementation.

The Council of the European Union has decided to provide to BiH a macro-financial assistance package to support institutional and policy reforms aimed at establishing a market economy. The policy conditions of these funds are consistent with those outlined in the IMF Arrangement. The assistance will comprise of a loan of EURO 20 million and a grant of EURO 40 million, but only after the outstanding obligations to the European Investment Bank (Euro 7.6 million) are fully met.

The government of the United States will provide \$17 million to the Republika Srpska and \$5 million to the Federation for budgetary support.

The government of Denmark will provide nearly KM 260,000 to the Republika Srpska for supporting budgetary expenditures.

### Special Relations Agreement: Federation-Croatia

Since the framework agreement on Special Parallel Relations (SPR) between the Federation of BiH and the Republic of Croatia was adopted by the House of Representatives on 13 April 1999, several annexes to this agreement have been signed by the parties. On 23 June 1999, the annexes on science, technology and education, and tourist co-operation were officially signed. On 2 July 1999, the delegations of Federation and Croatian governments agreed upon another six annexes (reciprocal payment of pensions, co-operation in the field of culture, protection from natural disasters, economic co-operation, energy and social protection).

The annex on economic co-operation does not regulate foreign trade relations, as this is a State matter. Trade and customs matters between Croatia and BiH will be regulated in a State level trade agreement, negotiations on which are in progress. Annexes to the Special Relations agreement that were not yet adopted include environmental protection, traffic, veterinary, and plant protection.

### Payment Bureau Reform Update

On 1 July 1999, the House of Representatives expeditiously passed the amendments to the Law on Internal Payment System in the Federation. The next step is the approval by the House of Peoples. Of the four members of the governing board, one has been appointed.

The International Advisory Group (IAG) met with the Minister of Finance and representatives of the Development Bank of the Republika Srpska and the consulting firm of Deloitte and Touche on the plan for separating the Razvojna Banka (Development Bank) from SPP, the RS payment bureau. Representatives of the IAG were concerned that the new Razvojna Banka would take over majority of the assets of the SPP and the bank would have a large competitive advantage, bordering a monopoly position, in the financial sector of the RS. A new version of the separation plan will consider these concerns.

In each of the three payment bureaus in BiH, a financial verification will start this month. An internationally reputed auditing firm will determine the real value of the assets and liabilities of the ZPP, ZAP and SPP. This information is necessary for the transfer of these assets to the institutions, which will take over the functions currently performed by the payment bureaus.

### Rural Development Planning seminar

The cost of large rural exodus to cities, in the long-term, is more expensive than development of the rural areas, and employment generation programs. On 15 June 1999, a seminar started, where 17 local experts of three ethnic groups worked non-stop for 2 1/2 weeks to develop the concept of Rural Development Planning, initiated by the

OHR. The purpose of this seminar was twofold: to provide training in Rural Development Planning using a participatory approach, and to prepare an actual Rural Development Plan for the municipality of Vitez.

The OHR would like to emphasize the necessity of sound Rural Development Plans for some 50 percent of the population living in rural areas. International Community assistance is required to initiate the process and its implementation. (*More information: Herman Assen or Jerome Bossuet, OHR*)

## Organization of Public Services

### Reform of the Water Sector

Significant changes in the Federation water regime, spear-headed by OHR, is moving ahead with the full support of the Federation government. The Federation law, policy and management are inadequate in protecting the quality of water from widespread pollution and preventing water shortages.

One of the main targets in the short term, is the creation of a Federation Ministry of Natural Resources, which will combine components of environmental protection, water resources, and forestry that are currently divided between two ministries. The availability of natural resources, and their impact on social and economic development, makes reform in this area an urgent necessity. Federation environmental legislation should be brought in line with the principles of international law and EU standards. The OHR continues to look for support of the International Community to strengthen reforms in this area.

### Electricity Sector

The BiH Elektroprivreda (EP) successfully brought the Kakanj Thermal Power Plant Unit 7 back on line, with an installed capacity of 230 MW. With this unit operating, EP-BiH will have much greater capacity to perform planned maintenance work on other units of the Federation electrical grid. Potential for exports of power has also improved.

The Norwegian government has agreed to provide KM 250, 000 grant to prepare electricity laws at both the State and Entity level. Nevertheless, it is likely that the Madrid deadline for implementing the State Law on Electricity (30 June 1999) will not be met.

The US Trade and Development Agency signed agreements on two grants to the Federation Ministry of Energy, Mining and Industry, to finance a feasibility study for the Konjic Power Plant and a restructuring study for the Mid-Bosnia and Tuzla Coal Mines. Teshmont Consultants Inc. started a feasibility study to determine the optimal configuration of a BiH transmission grid. The outcome of this study will be the identification of the remaining reconstruction needs of the transmission system. The study will establish a basis for development and implementation of the SCADA system and an integrated communication system.

### Post

The Postal Banking workshop held on 14 June 1999, was successful. The World Bank representative promised to take a positive view of any subsequent requests for further support e.g., possibility of providing financial services through the network of the post offices. The idea of twinning with a foreign partner received an enthusiastic response.

The second meeting to discuss the Post Law for Bosnia and Herzegovina will be held in early August.

### State Border Service

The establishment of a capable multi-ethnic State Border Service, has been a priority since the Bonn Peace Implementation Council in December 1997. The Luxembourg Conference held a year ago emphasized again the need for such border protection. In December 1998, the Madrid PIC posed a specific deadline to deploy an initial contingent on the State Border Service by October 1999.

On 24 June 1999, the High Representative and the Special Representative of the Secretary-General of the United Nations met with the BiH Presidency to discuss the State Border Service initiative. The meeting progressed positively and the High Representative secured a signed joint statement confirming the Presidency's political commitment to implement the Border Service as a State-level institution.

The Presidency also agreed to establish a joint working group, chaired by the OHR, to finalize the draft Law on State Border Service. The OHR developed the initial draft in co-operation with the SFOR, the UN, and the Customs and Fiscal Assistance Office (CAFAO) of the EU. The draft was reviewed by experts of the German Ministry of Interior. The compact framework law establishes the Border Service, assigns its duties and powers, and provides for a transitional solution until the Border Service is operational. The specifics will be dealt with through sub-legal regulations.

## Reconstruction Update

### Railway Sector

With over 1000 km of railway track, a volume of 13 million passengers and 30 million tons of goods per year, the BiH railways used to be one of the most important means of transportation in the country. During the war, direct and indirect damage resulted in a total collapse of the railway traffic. Fourteen bridges, 190 km of overhead contact line, signaling and telecommunication devices, centers for traffic remote control, and electric facilities along the network were severely damaged or destroyed. Lack of maintenance amplified these effects resulting in heavy deterioration of the system.

So far, the International Community under the Reconstruction Program has committed US\$49 million for the railway sector. As a result of the implementation of the Emergency Transport Reconstruction Program (ETRP), the entire main railway network has become operational at reduced speed and with minimum safety standards (see attached map). A recent achievement is the temporary start on 1 July 1999 of the passenger train link between Sarajevo and Ploce, after a seven-year break.

Some inter-Entity rail traffic exists, but current demand is low. It is expected that passenger traffic will start shortly between Doboj and Maglaj, as well as between Doboj and Tuzla. Train links currently in function/operable are: Doboj-Zenica-Sarajevo-Ploce (Croatia) which is part of the pan-European corridor V; Croatia-Brcko-Tuzla-Doboj-Novi Grad-Croatia; Zivinice/Tuzla-Zvornik-FRY; and Novi Grad-Bihac-Knin (Croatia). The Doboj-Samac-Croatia line is operational but not in function pending reconstruction of the Samac bridge.

Some US\$69 million are still required for the completion of the network rehabilitation (telecommunication links, electrification, signal safety devices, traffic remote control) in order to ensure that BiH railway functions with minimum safety standards and at pre-war speed. The rehabilitation of two segments of the electrified lines (Sarajevo-Visoko and Zavi-dovici-Doboj) would allow the start of an electric train service between Sarajevo and Banja-Luka.

In addition, budgetary and technical support to the Joint Railway Public Corporation is needed for the continuation of its activities. So far, the Corporation has been instrumental in the identification of funding gaps and prioritizing projects, in establishing comprehensive timetables for the entire railway network, and in solving matters of common interest to the Entities (See also vol.1, [issue 2](#))

Credits, Grants and Budgetary Support For Bosnia and Herzegovina			
Agency & Country	Federation	RS	Estimated Disbursements
<b>World Bank credits</b>			
Privatization	\$30 mln	\$20 mln	July & December 1999
Public finance	\$42 mln	\$30 mln	August & December 1999, 2000
<b>IMF credits</b>			
Balance of Payments	\$24 mln	\$12 mln	July 1999
Balance of Payments (Kosovo augmentation)	\$11.5 mln	\$11.5 mln	July 1999

<b>European Union</b>			
(Total assistance of EURO 60 million will consist of EURO 40 million in grants and EURO 20 million in credits.)	EURO 30 mln	EURO 30 mln	September 1999, 2000
<b>USAID</b>			
Budgetary Support	\$5 mln	\$17 mln	July 1999
<b>Denmark</b>			
Budgetary Support	–	KM 260,000 (approx.)	July 1999

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

- Current Status of BH Railways Network
- Donor Aid to BiH as per 1 July 1999

Office of the High Representative