

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

Newsletter

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

Sarajevo, March, 1999, Vol. 2, Issue 2

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

#### **Economic Indicators BiH**

##### **Federation of BiH (Federation)**

<b>Annualized growth rates* (excl. net wage)</b>	<b>Nov-98</b>	<b>Dec-98</b>	<b>Jan-99</b>	<b>Feb-99</b>
<b>Average net wage (kM)</b>	354	356.6	-	-
<b>Retail price growth</b>	1.40%	1.80%	1.70%	-
<b>Cost-of-living growth</b>	2.30%	2.30%	2.10%	-
<b>Real wage growth</b>	23.90%	15.90%	-	-
<b>Industrial Production growth</b>	20.90%	15.40%	17.20%	-

(Source: Federation Statistical Institute)

\* Growth of indicator from month in 1997 to month in 1998.

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

<b>Annualized growth rates (excl. net wage)</b>	<b>Nov-98</b>	<b>Dec-98</b>	<b>Jan-99</b>	<b>Feb-99</b>
<b>Average net wage (kM)</b>	207	236	-	-
<b>Retail price growth</b>	70.80%	78.10%	24.30%	6.60%
<b>Cost-of-living growth</b>	75.60%	84.90%	25.40%	6.80%
<b>Real wage growth</b>	-9.10%	5.10%	-	-
<b>Industrial Production growth</b>	13.20%	15.50%	-	-

(Source: RS Statistical Institute)

## **Economic Policy and Reform**

### **Reform of the Payment Bureaus**

The Payment Bureaus (PBs) are a major obstacle in the transformation of BiH to a modern market economy. An International Advisory Group (IAG), comprised of representatives from USAID, the IMF, the World Bank, US Treasury, CAFAO, the EU and OHR, was established to assist and advise authorities in both Entities on the dismantlement and elimination of the PBs and to provide technical assistance to the institutions that will take over the functions currently performed by the PBs. The IAG is served by a full-time secretariat. On February 19 and 22,

the IAG discussed a “blueprint” for PB reform with Prime Minister Dodik of the RS and PM Bicačević of the Federation.

The Payment Bureaus (*ZPP* and *ZAP* in the Federation, and *SPP* in the RS) are an inheritance of the Social Bookkeeping Service (SDK) of the former Yugoslavia. As the SDK was designed as a control mechanism to support a centrally planned social economic system, the PBs had and still have monopoly control over all domestic payments. Every night firms must deposit their cash with the PBs. The PBs also provide other functions—treasury, tax collection, statistics, accounting, etc. The monopoly of the PBs, together with their non-transparency and high transaction fees, cause high risk for private enterprises and prevent the development of a strong commercial banking sector. The associated costs for the BiH economy are huge.

Drawing on earlier studies by IMF and the World Bank, USAID developed a strategic plan to eliminate the PBs from the economy. The process will be orderly and all functions currently performed by the PBs will be transferred to other government institutions or the private sector. The first steps will be to complete a functional analysis (IAG has engaged the authorities to ensure that legislation and other conditions are in place) and to establish corporate government over PB management. The PBs will be fully liquidated by December 2000. *More information: USAID (206-691) or Thijs van Rens, (OHR).*

### The BiH Statistics Agency

After its opening in November 1998, the BiH Statistics Agency (BiHAS) started to be operational. Through a close co-ordination with the Federation and RS statistics institutes the BiHAS has finalised the draft of the first joint bulletin containing data aggregate covering the whole country.

The BiHAS in consultation with the International Community also produced the list of surveys to be carried out: family budget, labour force, and census were defined as top priorities. As planned in early February 1999, the Swiss/EFTA and Swedish delegations visited BiH to make the final assessment in order to proceed with the implementation of the first phase of the overall statistics project. The information technology development and the English training are due to begin soon.

Through co-ordinated efforts of the donor community, considerable attention was put on rehabilitation activities for the BiHAS. The Italian Government rehabilitation projects should focus on providing a definitive location for the BiHAS in the Marijin Dvor building. Additionally, the rehabilitation of the RS statistics institute in Banja Luka is also under consideration. The ongoing co-operation between the East and West statistics offices in Mostar, accentuates the need to reunify the office in a single one.

While considerable work lies ahead of the BiHAS, the professional and continued co-operation among the various actors involved may pave the way for a successful final result.

### **Additional Import Duties replace illegal customs practices**

On 18 February 1999, the Council of Ministers of BiH adopted a decision on a list of commodities to which additional import duties will be applied. These import duties, levied on top of the customs tariffs, replace the so called ‘prelevmans’. The prelevmans were levied by legislation of the Entities and therefore contradictory to the Constitution of BiH which grants the responsibility for customs policy to state level institutions.

This has been a difficult issue where both entities were not able to reach a common position for over six months. The main contentious point was to arrive at acceptable levels of additional duties so that the domestic industry in both Entities could be protected. A breakthrough was reached at a meeting chaired by the Deputy High Representative Didier Fassin on 27 January 1999, with Minister Kurtović (Foreign Trades and Economic Relations) and the Ministers of Trade from both entities.

The decision on additional import duties clears the way for proceeding negotiations on harmonising sales and excise taxation (see elsewhere in this newsletter). Once this is agreed, the different excise rates on imported goods, which are in fact a hidden form of customs, will be abandoned. The last step to full implementation of the Law on Customs Policy of BiH is the abolishment of the preferential treatment of goods coming from Croatia to the Croat parts of the Federation, and goods coming from the Federal Republic of Yugoslavia to the RS. These imports are currently charged only 1% administrative costs instead of the full customs rates, despite repeated requests from the OHR. *For more information contact Thijs van Rens – OHR, or Jasna Hajder OHR Banja Luka (058 – 217*

## Harmonisation of Indirect Tax rates between Entities

On 11 August 1998, the Ministers of Finance and Trade of the Republika Srpska and the Federation of BiH, signed an agreement to remove obstacles for trade of goods and services between the two Entities. The main points of the "August agreement" were to amend the Entity legislation to recognise trade between the Entities and to bring this legislation in line with EU standards, to repeal illegal tax and customs practices and replace them by additional import duties on the state level, to establish co-operation between the Entity's fiscal administrations, and to harmonise sales and excise taxation.

In the field of indirect taxation, the point of collection and the base price for the sales tax has been brought in line. A working group was charged with drafting a proposal for harmonised excise and sales tax rates. The main bottlenecks were the list of excisable goods, and the difference in excise rates between domestically produced and imported goods. Lowering excises on imported goods would imply a revenue loss. Therefore the working group experienced severe delay, awaiting agreement on additional import duties (see above in this newsletter). These additional duties are meant to replace the different excise rates for imported goods.

Since the additional imported duties were adopted by the Council of Ministers, the working group has started meeting again. A common list of excisables has been composed, and substantial progress has been made in harmonising excise rates in the most difficult areas (cigarettes, petrols and alcohol). *More information: Jean Tesche US Treasury (tel 201810), Thijs van Rens (OHR).*

## Update on Customs Fraud Cases

Various Customs fraud cases in BiH currently under investigation and monitored by OHR and CAFAO all involve remarkably similar facts. Although customs policy is made at the BiH State level, administration is conducted by customs administrations at the entity level. Customs policy directs that customs duties are paid to the entity in which the goods are delivered. Smugglers have seized on the lack of co-ordination between the entities and the poor administrative procedures of the Federation. The typical custom fraud case involves trucks transporting high tariff goods through a Federation border crossing point. At the border, the driver and transit agent declare the goods are destined for the Republic of Srpska. Rather than delivering the goods to the Republic of Srpska, the goods are delivered to the black market. This denies the Federation both the tariff and sales tax from these goods.

In 1998, CAFAO completed the instillation of a computer database for the Federation Customs Administration. In addition, OHR and CAFAO created liaison teams between the entities to share necessary customs information. Within a few months, data was analysed and the Customs Administration was able to identify widespread customs fraud.

The first successful attempt at prosecuting individuals involved in customs fraud involved a group of seven drivers. These seven drivers were responsible for making numerous deliveries of high tariff goods to the black market. The Federation Customs Administration, with the help of CAFAO, developed a list of trucks and drivers who had multiple "open" border crossing declarations. An exercise was developed to stop drivers with open border notifications. In a single day at the Orasje border crossing point, seven drivers were stopped and detained. Investigation revealed the drivers had driven their goods to the Arizona Market. No duties were ever paid. OHR and CAFAO were directly involved in the investigations and prosecutions. OHR provided expert advice and facilitated the transfer of evidence between the entities. The drivers were successfully prosecuted and received sentences ranging from seven months to two years and seven months.

In a case related to the 7 drivers case, a middle man facilitated the delivery of black market goods to the Arizona Market. Each of the drivers testified that he unloaded the shipments at the Arizona Market and paid the drivers. The man was convicted of smuggling activities and received a nine month sentence.

A similar prosecution was initiated in Mostar. Instead of going after drivers however, the transit agent and importer were put under investigation. As a result, officials from a Mostar company were charged and the case referred to an investigative judge. During the investigation, a high level customs official testified falsely in an attempt to aid the smugglers. As a result, charges were filed against the Customs Official who was based in Sarajevo. The investigative judge still has the case and we are awaiting a decision.

The BAZ Continental case in Mostar is awaiting trial. In this case, paperwork was submitted to the Federation Customs Administration by officials of BAZ Continental. This paperwork falsely claimed that certain high tariff goods had cleared customs in the Republic of Srpska and that duties were paid. Investigation revealed the stamps used on the paperwork were false. OHR and CAFAO provided paperwork to the investigative judge in the Federation from the Republic of Srpska which showed the goods were never delivered. The drivers involved in this case were released after 90 days pre-trial detention and are awaiting trial.

A similar smuggling scheme was conducted in Livno. There was unmistakable evidence that goods were not delivered to the Republic of Srpska clearing house declared on the border crossing notification documents. Unfortunately, the Municipal Prosecutor handling the case dismissed it without presenting all necessary evidence. Questions of a cover-up remain. After reviewing the case, the Federation Prosecutor indicated he would consider filing charges against the Livno prosecutor for failing to perform his duties. The Federation Prosecutor however, decided against such action. There is a civil case involving the owners of the trucking company who transported the goods in which they filed suit against the Federation for return of their import tariff guarantee. Citing the dismissal of the criminal case, the Livno judge ordered the Federation to return the guarantee. The case is pending appeal in the Cantonal Court in Livno.

Finally, a dozen trucks were seized in Bihac. These trucks were identified as having been involved in previous smuggling activities. It is interesting to note that although no criminal prosecutions are pending against any of the owners or drivers of those vehicles, the owners have walked away from the trucks and have made no attempt to claim them.

### Council of Ministers pass by-law on Customs Policy Implementation Commission

In its session on 25 February 1999 the Council of Ministers adopted the "decision on the regulation of the composition, operation and authority of the BiH Customs Policy Implementation Commission (CPIC)". Six other by-laws to the Customs Policy Law had already been adopted on 21 January 1999. The most important parts of the legislative framework for customs is now in place. The CPIC will prepare drafts for the remaining implementation laws, which are of a technical nature and non-controversial.

Unlike what its name might suggest, the CPIC is not meant to monitor the implementation of the customs policy. Its main tasks are to draft regulations and advise the Minister of Foreign Trade and Economic Relations. To supervise implementation the Council of Ministers will, in co-operation with the EU Customs and Fiscal Assistance Office (CAFAO), establish a working group as described in article 2, item 4, of the Law on Customs Policy.

### Trade agreement between BiH and Croatia

Preliminary work has started to open negotiations between Bosnia and Herzegovina and Croatia concerning a trade agreement. Croatia has expressed its wish to see economic relations with BiH normalised through such an agreement and has forwarded a first draft to BiH.

On the BiH side, the Presidency has appointed a three member delegation to negotiate the agreement with Croatia. The three members are Vice Chair Neven Tomic, Minister Kurtovic and Minister Loncar. A first meeting with Croatia is planned for beginning of March. In the meantime, internal BiH discussions have started with the participation of both entities to prepare the BiH position.

It is in the interest of BiH to normalise its economic relations with neighbouring countries for the benefit of its economy and for a full respect of the GFAP.

### Bank Privatisation

The Federation and RS Parliaments passed banking privatisation laws on 26 February and 26 June 1998 respectively. In order to implement the privatisation process, each government established a Bank Privatisation Unit (BPU). The initial step in privatisation is the preparation of Opening Balance Sheets (OBS). Banks whose OBS show a higher value of active assets than liabilities are considered solvent. Solvent banks will prepare privatisation plans, and after approval from the entity government, will enter into the privatisation stage. Payment for bank shares must be in cash. Insolvent banks will be liquidated or merged.

In the Federation, 15 banks were originally candidates for privatisation, but 7 banks notified the BPU that they

were privatised prior to 8 April 1998 when the law went into effect. The Ministry asked the BPU to check these transformations, especially those where state capital has been transformed into private capital. The BPU is now performing these checks. The BPU received opening balance sheets from the remaining 8 banks that are mostly state owned. Three of these have been accepted and forwarded to the Federation Banking Agency for the required solvency test. The remaining 5 balance sheets are under correction.

In the RS, there are 11 State-owned banks. Until OBSs are received, it is difficult to ascertain their status vis-à-vis privatisation.

The deadline for the Federation Government to make decisions on privatisation plan is August 1999; the deadline for the RS government is October 1999.

## **Organization of Public Services**

### **Telecommunications : numbering**

From 26 February – 3 March an ITU expert investigated the technical capabilities of the switching and transmission capacity in Bosnia and Herzegovina in order to determine the possibilities and limitations which the present infrastructure puts on possible numbering schemes. Discussions were held with all the operators, the result of which will be laid down in a detailed report which the expert intends to present before the end of the month. A second mission will be carried out if necessary. The final roundtable to discuss the results of this technical mission and the proposals for a numbering scheme which will be made on the basis of this technical information will be held in Geneva on 15-16 April.

### **Telecommunications Regulatory Agency**

The Council of Ministers at its session of 18 February 1999 appointed the Members of the Telecommunications Regulatory Agency (with the exception of the part-time Croat member). The three full time members are: Emin Skopljak (B), Slobodan Karisik (S) and Jasenko Lasta (C). The part-time members are: Fikret Kasumagic (B) and Mile Bajalica (S).

The CoM instructed the newly appointed members to submit their plans within 3 weeks. To that end there will be a meeting of the TRA on 10 March with the Members of the Agency along with representatives from ITU and OHR.

### **Postal sector**

On 25-26 February, a first preparatory meeting was held in Bern at the headquarters of the Universal Postal Union (UPU) to discuss the draft of the State for Posts. At the meeting representatives were present from UPU and OHR as well as the Netherlands consultant. As a result of that meeting, the text will be amended and submitted to the Bosnian participants in time for the first full meeting which will be held on 29-31 March in Bern.

Following the donation by the Italian Government of six vehicles to the Srpska Post, the mail exchanges between Republika Srpska and the Federation will be carried out by Srpska Post. In principle there is also agreement that the number of mail exchanges should be increased from 3 times a week to once every day. This has not been implemented due to the bad weather conditions over the last month.

The three Ministers responsible for Posts and their respective Directors-General are being invited to the Netherlands for a study visit. The visit is planned to take place from 17-24 March.

*Draft 1999 Budgets: BiH State, Federation and Republika Srpska – see insert*

## **Reconstruction Update**

### **Bridges and Border Crossing points**

The Brod bridge was closed in February and the repair work will last a year and a half. Moreover, the closing of the Gradiska bridge on March 15 is expected to negatively impact traffic and travel times until its reopening in the autumn.

The Joint Border Commission decided during its 24 February session in Zupanja to support the temporary opening of the Novi Bridge, presently restricted to SFOR only, to civilian traffic and trucks. The opening of the Novi Bridge could take place in the next few weeks. Proposals for the use of ferry crossings at Srbac/Davor, Brod (about 25 km east of from Gradiska) and other sites will be considered by the Croatian government and a decision made in two weeks. During the same meeting, the opening of the Trebinje (Ivanica) and Dubrovnik (Brgat) Border Crossing Point was recommended, and the actual opening of the Border to civilian traffic is expected to take place soon.

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Summary Donor Aid

RS Draft Budget – 1999

Draft State Budget

Federation Draft Budget – 1999

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