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Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)

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1. High Representative Imposes Package of Laws to Boost Economic Reform in BiH

On November 12 and December 20, the High Representative imposed a wide-ranging package of laws and amendments designed to ensure Bosnia and Herzegovina maintains the momentum of economic reform that are so vital to all citizens' future

well-being and security.

The standstill in government activities following the elec-tions in Bosnia and Herzegovina and the urgency of economic reform persuaded the High Representative to take decisive ac-tion and impose these laws and amendments. A consistent legal framework based on market economy criteria and Euro-pean practise will send a positive signal to foreign and domes-tic investors and business persons.

The laws and amendments meet long-established deadlines and accession criteria for the country's eventual integration into European structures. They also meet the demands of the inter-national financial institutions working in Bosnia and Herze-govina and will ensure continued access to international fund-ing. Reflecting this progress, the IMF approved the next tranche of the Stand By Credit on December 22.

Dismantling of the Payment Bureaus:
The Peace Implementation Council (PIC) called for the elimination of the payment bureaus at its Madrid meeting in 1998 and repeated this call when it met in Brussels in May 2000. The payment bureaus made financial transac-tions in BiH cumbersome and operated in a non-transparent manner, deterring potential investors. Their abolishment is also one of the requirements of the "EU Road Map", the ful-filment of which is the condition for a feasibility study with regard to a Stabilisation and Association Agreement between Bosnia and Herzegovina and the EU. Lastly, the payment bu-reausą elimination is one of the measures Bosnia and Herzego-vina must take to qualify for membership in the Council of Europe.

As part of this dismantling process, the International Ad-visory Group for Payment Bureaus and Payment System Transformation, which is chaired by the United States Agency for International Development (USAID) and also comprises the US Treasury, the World Bank, the International Monetary Fund (IMF), the EU, the Customs and Fiscal Assistance Of-fice

(CAFAO) and the Office of the High Representative, has been working closely with the BiH authorities. However, some legislation necessary for a smooth transition within the appropriate legal framework and the establishment of an operational banking sector was still outstanding. At the request of the International Advisory Group, the High Representative imposed the laws and amendments which were missing:

The RS Law on Payment Transac-tions will regulate rights and responsibilities of all participants in the payment system.
*The RS Law on the Internal Payments Sys-tem*will regulate in-ternal operations within the payment system and define impor-tant governance and management issues.

*The RS Law on Financial Opera-tions*establishes a clear legal foundation for payment operations by businesses in RS.

Amendments to three Federation Privatization Laws (first, to the Law on Claims in the Privatization Process that are based on the dif-ference between pension amounts received and pension amounts to be received by beneficiaries of the rights stemming from the Pension and Disability Plan, second, the Law on Recording and Settlement of Citizensą Claims in the Privati-zation Process and third, the Law on Privatization of Enter-prises) will transfer payment bureausą responsibilities in the area of privatization to the Federation Privatization Agency.

*Amendments to the Federation Law on Wage Tax*will give the Tax Administration greater powers to enforce tax collection and strengthen budgets in cantons and municipalities.

Amendments to the Federation Law on Con-tributions will boost the powers of the Tax Administration to collect contributions for social security funds and improve the financial health of the social safety net.

These Laws and Amendments complete the legal frame-work of the payment bureausą transformation. The new pay-ments system, via commercial banks, began operations on 5th January 2001. It is essential that all organisations and busi-nesses open a bank account to enable them to carry out pay-ments from this date. They are now responsible for paying taxes themselves and pro-actively. The tax administrations will control and enforce the collection of taxes.

Customs

Amendments to the BiH Law on Customs Policy will update customs regulations to be consistent with current EU customs policies and procedures and thereby facilitate trade between Bosnia and Herzegovina and the EU. They will also enable refugees to return to BiH without having to pay customs duties on their personal belongings, or having to show at the border detailed lists of these belongings previously approved by BiH Consulates. This should support returns to Bosnia and Herzegovina, an OHR priority. In addition, the Amendments will close a series of duty free shops at border crossing points to crack down on smuggling and improve the collection of revenues. The continued reform of the customs system was also a requirement of the PIC Brussels Declaration of May of last year. The IMF, the World Bank and CAFAO had encouraged the BiH authorities to adopt these amendments for over a year, but they were shuffled between the Council of Ministers and the BiH Parliament without resulting in their adoption. Fi-nally, these international organizations asked the High Repre-sentative to impose the Amendments.

Employment

The Federation Law on Job Placement and Social Security of the Unemployed is part of a package aimed at bringing BiH labor legislation in line with European market economies. It will put the Federation Employment Bureau on a proper legal footing and do away with inefficiency and non-transparency in the

unemployment benefit system. The Law is the last piece of a series of requirements in the field of labor and social legislation, which BiH needed to meet in order to qualify for the World Bank Social Sector Adjustment Credit of 20 million USD. As in the case of the other laws and amendments, the PIC had urged for a broad-based reform of the labor legislation in Bosnia and Herzegovina. The need for the Federation Law on Job Placement had been discussed with the Federation Labour Ministry for two years, but the proposal was withdrawn from the agenda of the Federation House of Representatives in mid-October following heated debate, and not re-submitted due to the election void.

The BiH Law on Assets of the Employment Bureau of Bosnia and Herzegovina enables the transfer of assets from the former Socialist Republic of BiH Employment Bureau to the Federation Employment Bureau and the Cantonal Employ-ment Services for the proper exercise of their competence and the preservation of an Employment Bureau at the State-level. This package brings economic reform in Bosnia and Her-zegovina yet another step forward. The so-called "soft big bang" strategy developed by OHR in order to create a busi-ness-friendly environment is now completed. The OHR and its international community partners will continue to push for economic reform as Bosnia and Herzegovina must urgently become economically self-sustaining. An attractive business climate with an appropriate legal framework is now either in place or in sight. BiH can now be considered as a place worth considering for investors. The High Representative also issued a Decision extending by three months the validity of his 27 April 2000 Decision that banned the re-allocation of socially owned real property, in particular socially owned land. The 27 April 2000 Decision would have expired on 31 December and will now remain in force until 30 March 2001.

2. New Standardization, Metrology and

Accreditation System in BiH

On November 12, 2000, the High Representative issued six Decisions on the establishment of a four-pillar system of accreditation, standardization, me-trology, and certification/testing for BiH industrial products. This system is a precondition for the normal functioning of industry and trade, and especially for the export of BiH prod-ucts. Although the European Union liberalized imports from Bosnia and Herzegovina, FYROM (Macedonia), Albania and Croatia, exporters in these countries must still pass the con-formity assessment procedure to prove their products comply with existing EU product legislation and standards.

The set of six laws (on accreditation, standardization, metrology, measur-ing units, the establishment of the Institute for Accreditation and the Institute for Standards, Metrology and Intellectual Property Protection) will create a quality system in BiH which is in line with European Union regulations. These state level institutes will provide service to all com-panies in BiH. Companies will be provided with all necessary information on product regulations in the European Union and the Accreditation Institute will certify their products in the fu-ture. Only with this certification will the European Union and the world markets be open to BiH products. The existing En-titiesą institutes for standardization, metrology and patents will become part of the new system, and financing will be provided by the state budget and by revenues generated by the Institutes. Currently the export levels of BiH products are a mere fraction of the pre-war level and cover only 25 to 30% of im-ports, according to official statistics. The recent decisions will remove the technical obstacles for BiH exports. Export promo-tion is urgently needed in BiH, and it is up to BiH companies to use their creativity and flexibility to open the gate to Euro-pean Union markets.

3. Public Utilities and Implementation of Annex 9 High Level Coordination Continues

The five-member BiH Commission on Public Corporations (CPC) meets regularly every 2-3 months, last meeting on October 12. The two Entity Prime Ministers and the Federation Deputy Prime Minister represent the Entity governments, while Principal Deputy High Representative Ambassador Ralph Johnson (Chairman), and Joseph Ingram, Resident Representative of the World Bank in BiH, represent the IC. International members are appointed by the President of the EBRD. While the Commissionąs main function is to implement Dayton Annex IX (i.e., to help reunite the countryąs utilities and infrastructure), it has increasingly recognized that creating joint utility enterprises must fit in with or – even better – support market sector reform and contribute to creating the BiH common economic space. Annex IX public corporations can play a role by taking on responsibility for natural monopoly components of network infrastructure sectors such as the gas and power transmission trunk lines traversing BiH.

4. Railway Sector Trying to Regain Market Share

A recent review of the railway sector in BiH carried out on behalf of the CPC concluded that despite the fact that much reconstruction of the network has been completed, railways in BiH have not been able to recover their transport market share or improve their financial performance. Prime Ministers intend to request their respective Entity railways to develop plans to significantly improve marketing and financial performance, including rationalization measures such as sale of assets no longer needed. The ongoing Swedish SIDA-sponsored railway management development program can assist BiH railways improve their economic performance.

5. Roadworks: Progress and Detours

All activities envisaged under the World Bankąs Second Emergency Transport Reconstruction Project (SETRP) will be

completed by December 31, 2000. The project has included the rehabilitation of bridges across the Otoka, Ygar and Crna Rijeka rivers and the Sanski Most bridge. At the same time, the SETRP Completion Report states that several sections on the main road network have seriously deteriorated. Damage includes potholes, cracks, deep rutting and increasing surface roughness. Among the main causes are inadequate maintenance, non-respect of axle load limits and a dramatic increase in traffic volumes (2-3 times higher than pre-war levels) near the larger cities, while road capacity has virtually stagnated. Given this background there is a clear need to improve road network maintenance and target physical improvements to improve road traffic safety. The situation in the Federation is particularly critical, requiring that the government urgently allocate at least KM 30 million in 2001 to road maintenance. BRIC, the new Joint Road Infrastructure Public Corporation, is expected to play a crucial role in setting and enforcing common road standards, coordinating road management between Entities and joint planning of network development. The World Bankąs Aide-Memoire for a Possible New Road Project (Transport III) recommends that BRIC focus on improving maintenance and safety on corridor roads of significant economic importance to BiH.

6. Progress in Telecommunications Privatization

A new Telecommunications Policy for BiH that promulgates privatization and staged liberalization of the sector was approved by the BiH Presidency and the Council of Ministers in late November 2000. The implementation plan calls for the immediate liberalization of the market for non-voice, with domestic fixed telephone services two months later. The market for public mobile services will accommodate four operators between now until December 2002, at which time it will be further liberalised. The existing, fully publicly owned GSM operators will be awarded radio licences immediately. International voice telephony is to be liberalized no later

than 2005. The BiH Telecommunications Regulatory Agency (TRA) is expected to take a strong leadership role in enabling the telecom sector reform, and the EBRD is providing technical assistance to TRA in developing the necessary legal and administrative tools. The World Bank intends to assist by providing privatization advisors. Furthermore, the role of the TRA will expand in the near future to include the broadcasting regulatory functions of the Independent Media Commission (IMC).

7. Energy Sector Electricity Law Delay Continues

Energy sector market reform has not yet begun. While the new policy calling for the creation of a separate joint-power-grid transmission company and of an independent energy sector regulator has been approved by the Federation, the RS has not yet acted. The submission of new Electricity Laws to Entity Parliaments is a key condition, both for the successful launch of the reform process in BiH and to obtain approval of the proposed World Bank (IDA) Power III Loan Project worth US $230 million. NORAD of Norway has offered to support the drafting of a first BiH, State-level Electricity Law. Co-financing for Power III is expected to come from EBRD, EIB and bilateral donors such as Germany, France, Netherlands, Greece and Canada. Given the delays already encountered, it appears doubtful that first tenders will be published before May 2001.

8. Tax Reform Underway

An International Advisory Group on Taxation was established in July 2000, comprised of representatives from OHR, IMF, WB, US-Treasury, USAID, GTZ and CAFAO. The IAGTąs goal is to address the deficiencies of the pre-sent tax system, move toward medium term sustainability of the public finances and create an environment conducive to private sector development. One of the most urgent objectives is to eliminate all types of double taxation. Longer term rec-ommendations include broadening the bases of various taxes in order to facilitate reductions of

the very high rates currently in force and move towards a value added tax.

The IMF has recently presented a feasibility study regarding VAT, pointing out that there are three possible levels for implementing the tax. A decision will have to be made to determine on which level the VAT should be implemented, recognizing that intro-duction of a value added tax cannot be implemented before July 2003. The World Bank is evaluating the social contribu-tion system and will make recommendations, while noting that a change in this area will take up to two years. GTZ will be responsible for evaluating and providing recommendations regarding personal income taxes and corporate taxes. In parallel with changes to the legal framework, the US Treasury, CAFAO and GTZ are assisting the two Entities in modernizing their tax administrations. This includes establish-ing a proper tax registration system, computerization, efficient control and enforcement of taxes and an education system both of tax employees and tax payers.

9. Bank Privatization Moving Forward

Republika Srpska

– After almost three years of intensive work in the area of RS bank privatization, the first concrete results are emerging: The fourth tender published on August 21 for the sale of state shares (65% in total capital) in Agroprom Bank ended successfully as three different bidders bought together 31.61% of the bankąs capital, increasing the percentage of private capital in this bank to 51.23% (in addition to a 15.38 % stake of cooperatives and a further state share of 33.39 %). Negotiations are currently ongoing for the sale of the 90% state stake (in addition to 6% cooperatives and 4% private shares) in Privredna Banka, Doboj, also with international bidders. Furthermore, there are several national and interna-tional bidders for the sale of Kristal Bank which was pub-lished on October 23 and substantive negotiations are expected

soon. On the other side of the ledger, the sale of the state capital in Privredna Banka, Serb Sarajevo, was proclaimed unsuccess-ful due to the inability of interested parties and the Bank Pri-vatization Unit to agree upon the selling price, and the tender for Banjaluka Banka, Banja Luka, did not attract any inter-ested bidders.

Federation

There has been a significant step forward for the Privredna Banks-related group. In late Decem-ber, the BPU Director, SITA Advisor and a strategic interna-tional investor negotiated with the holder of the Czech credi-torąs position on defaulted guaranties (75% of amount). They agreed on a substantially reduced cash payment in lieu of prior agreements. A similar deal will be offered to the other credi-tors. This should clear the way for strategic international inves-tor(s) to take over the Federation Governmentąs interest in the remaining PBS-related banks (Privredna Bank Sarajevo, Central Profit Bank, Una Bank Bihac, Gospardska Mostar and Travnicka Bank Travnik). The investor would then complete the plan for the payment of the defaulted debt, priva-tization plan and restructure the bank(s) determined to be sol-vent. A number of obstacles remain, but these now appear more manageable and this progress is likely to result in all/part of these banks being tendered for privatization in late March or April. Banks or portions not privatized by June 30, 2001 are to go into liquidation in July 2001. This leaves two PBS-debt related banks that self-privatized with obstacles to overcome on their own in order to be viable and competitive. They need outside investors to provide capital for competitive operations. A tender Offer on Union Bank is projected for February. Post Bank has been re-tendered, while Sipad Bank was tendered in November.

10. New Start for Pension Funds in Bosnia and

Herzegovina

Previous articles have described the rationale and urgency for approving the policy amendment package on the Law on Pension and Disability Insurance. Tying current pension payments to available resources was one of the prerequisites to: achieve regular pension payments; avoid the accumulation of further arrears; protect the elderly by guaranteeing a minimum pension; and, ensure the release of outstanding credits of relevant International Financial Institutions (IFIs). Despite extensive meetings involving senior OHR, IMF, WB, Federation and Pensioners Association officials to under-score the urgency of adopting this package of amendments, both the House of Representatives and the House of Peoples failed to do so. In the RS a rather unclear text was adopted which did not reflect the recommendations of the relevant IFIs.

The High Representative was thus compelled to issue a number of Decisions on 12 November 2000, including Amendments to the Federation Pension and Disability Insur-ance Law; Federation Law on Pension and Disability Insur-ance Organization (which provides for the merging of the Sara-jevo and Mostar Pension Fund), and Amendments to the Re-publika Srpska Law on Pension and Disability Insurance. The impact of the implementation of those amendments and Law is yet to be measured as respectively a period of twenty-one days and six months is foreseen to allow the pen-sion structures to make the required necessary administrative changes. Even so, pensioners in both entities are actively op-posing implementation of the provisions.

It is worth noting that protests in the RS began well before the Decisions of the High Representative were issued. While there is no escaping the fact that the condition of the Federation and Republika Srpska pension funds is serious, it is clear that the BiH authorities of both entities are fully re-sponsible for regular and fair payments of pensions – not the International Community. To ensure the economic viability of BiH it is necessary to eliminate the gray economy, black

em-ployment and the exempted social categories such as soldiers and police officers, as well as to enforce strict control mecha-nisms for collecting contributions. It is also imperative for the government to identify alternative revenue sources for the payment of outstanding debts of unpaid pension claims. The Decisions of the High Representative do not address past ar-rears. Only by starting to implement these measures will it be possible to utilize new alternative funds, i.e., privatization cash proceeds and others to be identified.

11. Foreign Trade: Bilateral Free Trade Agreement with Croatia to Boost Trade

The most significant development in BiHąs efforts to develop its foreign trade sector has been the signing of a Free Trade Agreement with Croatia, its dominant trading partner. Originally scheduled for signature at the Zagreb Summit in November, the treaty was stalled by Croatian reservations concerning a proposed new BiH tariff schedule. Following additional negotiations, the BiH Ministry of Foreign Trade and Economic Relations agreed to withdraw this proposal and retain the existing schedule. Both industrial and agricultural products are included in the agreement, slated to enter into effect on January 1, 2001. Bosnian products imported into Croatia will be immediately exempt from duties, while Croatian imports into Bosnia will be reduced by 30 percent in 2001 and be gradually eliminated by 2004. Officials express the hope that this agreement will reverse the decline in commercial exchanges over the past two years. In addition to the bilateral agreement, in November the BiH Council of Ministers adopted the basic BiH negotiating position for its membership application to the World Trade Organization. An observer since 1999, the Government will now assume a more active posture in the application process, although no target date for membership has been announced..

12. Privatization of Enterprises Proceeding Apace

In both Entities, the enterprise privatization process has finally gathered momentum after a long period of uncertainty and delay. Small scale privatizations have progressed with approximately 200 companies sold through auctions, tenders or direct sales in the FBiH and approximately 80 companies sold through auctions and direct sales in the RS. This means that, so far, about two-thirds of the small scale companies have been sold in the FBiH and one-third in the RS. Considering that direct sales are always possible after other methods have failed, it is expected that the privatization of this type of companies would be completed by mid-2001 in both Entities. This also means that among the companies that will not find investors, many will have to be liquidated and their assets sold separately. In the group of large scale enterprises, the pace of privatiza-tion has definitely been slower and only 12 companies have been partly privatized in the RS and 70 in the FBiH to date. This is due to:

a) the complex mix of vouchers (RS), claims (FBiH) and cash to be used for the acquisitions;

b) the diffi-culty of finding key solid investors ready to support the ex-pansion phase of the company after privatization;

c) the uncer-tainty concerning the existing company liabilities and their evolution in time;

d) the virtual absence of local banking in-stitutions ready to provide the necessary credit or capital de-velopment after a takeover. Within the group of large scale enterprises a category of strategic large corporations has been created in order to attract possible foreign investors. They are designated as IAGP (In-ternational Advisory Group on Privatization)

Tender List companies in which international advisors have

been (or will be) actively preparing the prerequisite financial and legal struc-tures for an equitable privatization. There are 52 such corpora-tions in this list in the RS and 86 in the FBiH at the mo-ment. Together, these companies represent approximately two-thirds of the potential country privatization proceeds and there-fore require the greatest attention. The recent introduction of Private Investment Funds (PIF) in both Entities should be a decisive step toward creating a financial liquidity indispensable for the proper functioning of a market economy. The PIFs play a key role by grouping the interests of small voucher- (RS) or claim- FBiH) bearers and enabling them to become shareholders of the newly instituted investment bankers (or rather portfolio managers) at this stage. So far, about 6 PIFs in RS have managed to meet the re-quirements for operating and 9 in FBiH.

13. Economic Data BiH for 3rd Quarter 2000

Source: RS and FbiH Statistical Offices

Indicator	Federation of BiH	Republica Srpska
Index of Industrial Production		
1-9/2000 compared to av.of 1999	+ 5,0 %	+ 4,0 %
1-9/2000 compared to 1-9/1999	+ 10,1 %	+ 7,0 %
Retail Price Index		
1-9/2000 compared to av.of 1999	+ 0,9 %	+ 11,0 %
1-9/2000 compared 1-9/1999	+ 0,6 %	+ 13,0 %

Average Net Salary 9/2000 Average Gross Salary 9/2000	428,42 KM 630,03 KM	289 KM 405 KM
Registered Unemployed Employment	265.954 persons 412.767 persons	154.656 persons (data not available)
No. of pensioners Average pensions	273.728 persons (9/2000) 177,33 KM (9/2000)	169.822 persons (4/2000) 145,06 KM (4/2000)
Imports 1-9/2000 Exports 1-9/2000 Trade deficit 1-9/2000 Import/Export coverage	3,2 billion KM 0,9 billion KM 2,3 billion KM 28 %	1,3 billion KM 0,5 billion KM 0,8 billion KM 38 %

The Agency for statistics of Bosnia Herzegovina released recently the Statistical Bulletin 3/2000, which gives an extensive overview on the Gross domestic product of BiH of 1996 to 1999.

	1996	1997	1998	1999
Gross Domestic Product of BIH, current prices in million KM	4,192	6,367	7,244	8,014
Change in percent to previous year		+ 51,9	+ 13,8	+ 10,6

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