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Newsletter

Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)

Sarajevo, December, 1998, Vol. 1, Issue 10

Economic Task Force Secretariat

**OHR in co-operation with IMG International Management
Group**

Economic Indicators BiH

Federation of BiH (Federation)

Annualized growth rates* (excl. net wage)	July-98	Aug-98	Sep-98	Oct-98
Average net wage (KM)	329	335	339	n/a
Retail price growth	3.3%	3.7%	2.4%	1.9%
Cost-of-living growth	2.9%	3.1%	2.7%	2.3%
Real wage growth	19.6	20.8%	21.9%	n/a
Industrial Production growth	40.5%	32.6%	29.7%	22.9%

(Source: Federation Statistical Institute & OHR Estimates)

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

Republika Srpska (RS)

Annualized growth rates (excl. net wage)	Mar-98	Apr-98	May-98	June-98
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Average net wage (kM)	147	129	123	128
Retail price growth	12.2%	28.6%	30.4%	35.0%
Cost-of-living growth	14.4%	37.2%	36.7%	36.6%
Real wage growth	150.6%	118.1%	94.1%	106.2%
Industrial Production growth	34.0%	25.5%	29.7%	31.8%

(Source: RS Statistical Institute & OHR Estimates)

Officially-reported economic performance in the Federation continues to be positive. Price inflation fell further in October. Industrial production growth is still above 20% but is clearly declining. Extraordinary growth due to war recovery seems to be slowing down and emphasizes that the time will come in the near future when rapid growth due to war recovery and donor aid inflows will end. Third-quarter statistics for the RS have not yet been released but will be included in the next Newsletter.

Economic Policy and Reform

Privatization Monitoring Commissioners

An independent Commission has been established to monitor compliance of the privatization process with the GFAP and the Framework Law on Privatization of Enterprises and Banks. The Commission is also tasked with providing expert advice on privatization-related matters to the High Representative.

The OHR has appointed three highly-qualified and experienced individuals to serve as Commissioners. Mr. Sweder van Wijnbergen, currently Secretary General of the Dutch Ministry of Economic Affairs, will serve as Chairman. Other Commissioners are Mr. Jaan Manitski, first Foreign Minister of the Republic of Estonia and afterwards Chairman of the Estonian Privatization Agency, and Mr. Daniel Weinstein, a retired U.S. judge.

The Commission's first meeting will take place in January

1999. The Commissioners will be assisted by a permanent secretariat composed of three experts and an assistant. During its first meeting, the Commission will probably address the issue of mixed companies (capital shared between public owners and private investors).

Soldiers Claims in the Privatization Process

On November 19, the deadline expired for a decision on the ratio between claims from soldiers of the Armija of BiH and soldiers of the HVO with respect to their participation in the privatization process in the Federation. The same day High Representative Carlos Westendorp received a letter from HDZ President Ante Jelavic stating that he accepted a ratio of 28 percent for the Croat HVO to 72 percent for the BiH Army. On November 19, the High Representative also received a letter from SDA President Alija Izetbegovic stating that his position was a ratio of 20 percent to 80 percent respectively.

In view of the urgency to begin the privatization process in the Federation and the failure of political leaders to reach a decision, the High Representative arbitrated by setting the ratio between the two Federation Army components at 24 to 76 percent. The High Representative also requested that the authorities charged with implementing the decision act quickly so that claim books could be allocated to beneficiaries as soon as possible.

RS 'Devaluation' of the Yugoslav Dinar: A Step in the Right Direction

On November 9, the RS Government decided to use the street rate of 1 DM to 7.5 YuD (Yugoslav dinar) instead of the official rate of 6 YuD per 1 DM set by Belgrade for payment of taxes within the RS. This decision was taken unilaterally by the RS. The Central Bank of BiH (CBBH) was not involved in making this decision and could not be, given that the CBBH is responsible only for the KM-DM exchange rate and that both the YuD and DM are foreign currencies in BiH. The RS Government's decision was an unusual move given that it is not the monetary

authority over the YuD. The RS stated that its decision was intended to boost tax revenues.

Using the official rate of 6 YuD per DM to calculate sales taxes on imported goods when they were being paid for at the parallel rate of roughly 7.5 YuD per DM was causing the RS to forego tax revenues. Another (unstated) reason is that the RS does not benefit from “seigniorage” revenue on the YuD: when FRY prints new YuD and spends them through their state budget, this causes inflation and devaluation which negatively affects both the FRY and the RS, but the RS does not benefit from the original printing and spending of the new currency.

On November 12, FRY announced a cessation of all electronic payments operations with the RS. This seriously disrupted trade between the two regions, because only a portion of such trade can be financed with cash. drop-off in the level of trade necessarily lowers RS tax revenues due to a drop in customs, sales and excise taxes on imported goods.

On December 1, the RS National Assembly discussed the “devaluation” and its consequences. Intense pressure was put on the Government to retract its decision, which the Government agreed to do during the session. The OHR fully supported the decision of the RS Government and regrets that it will be withdrawn. There are no sound economic prospects for an RS based on the YuD.

This incident heightens the urgency for the RS to strengthen use of the KM. The devaluation incident has further undermined confidence in the YuD. Because the YuD will continue to weaken given economic policies in the FRY, the RS will almost certainly have to confront these issues again in the future. The OHR will closely monitor progress in having all tax and utility bills paid in KM. The RS should also be encouraged to redirect its trade to partners other than FRY, and the international community should carefully explore all other measures that could strengthen the use of the KM in the RS.

How Does BiH Compare to Other Transition Economies?

The Wall Street Journal Europe's Central European Economic Review has published a comparison of 27 transition economies in central Europe and the former Soviet Union. Twelve experts from investment banks and consulting firms gave the countries scores from 1 (worst) to 10 (best) on the following criteria: economic strength; balance of payments; business ethics; integration into world economy; liquidity/ease of buying stocks; rule of law; price stability; productivity; currency stability/investment climate; and political stability. These individual scores were averaged into an overall score, and the countries were ranked from 1 to 27.

Country	Overall Score	Rank	Country	Overall Score	Rank	Country	Overall Score	Rank
Hungary	8.3	1	Slovakia	5.8	10	Uzbekistan	3.4	19
Slovenia	8.3		Moldova	5.1	11	Ukraine	3.4	
Poland	8.1	3	Kazakistan	5.1		Yugoslavia	3.4	
Czech Republic	7.6	4	Romania	4.7	13	Turkmenistan	3.3	22
Estonia	7.5	5	Kyrgyzstan	4.7		Russia	3.3	
Latvia	7.0	6	Macedonia	4.5	15	BiH	3.2	24
Lithuania	6.8	7	Georgia	4.5		Albania	3.2	
Croatia	6.4	8	Azerbaijan	4.4	17	Belarus	2.8	26
Bulgaria	5.9	9	Armenia	4.2	18	Tajikistan	2.3	27

It is interesting to note that BiH scored below 5 in all individual categories except price stability, and that it was ranked next-to-last on rule of law, third from the bottom on political stability, and last on liquidity/ease of buying stocks.

These rankings reflect the perceptions of well-informed analysts working for firms particularly active in investing in transition economies. The table shows that BiH is perceived to rank among the most unstable and badly-managed countries of the transition world. This helps to explain why BiH has received almost no foreign investment to date.

Progress In Implementing State Budget; Audit Planned

Despite numerous problems, significant progress was achieved in implementing the 1998 State budget. Transfers from the Entities are now secured (the current delay is only one month), although the lack of inflow of own-source revenues continued. The Ministry of Civil Affairs and Communications (MCAC) has distributed funds to beneficiaries on time (except for the Ministry of Foreign Affairs where payments were delayed because of political difficulties with employment policies).

Improvements must continue in 1999, and the financial practices of the Common Institutions must move closer to normal standards. Further steps include helping BiH set up a Treasury to consolidate all financial functions of the Common Institutions.

An audit will be carried out by a multi-expert team in January 1999, in order to support the establishment of a Treasury and Supreme Audit Institution, and to implement the 1999 budget in a more fiscally sound manner. The audit team will be chaired by a member of the Council of Ministers and will include representatives from MCAC and the international community. (See chart on 1998 State Budget Implementation in insert.)

Bosnia & Herzegovina Statistics Agency Opens; Donors Pledge Assistance

In November, the Bosnia & Herzegovina Agency for Statistics (BHAS) opened its offices in the UNIS Building in Sarajevo. BHAS is responsible for aggregating statistical data on a national level from data compiled by the Federation and the RS statistics agencies. By year's end, BHAS plans to report aggregated/ national data on employment/unemployment, education, health, agriculture, forestry, construction and traffic. Aggregated data will not be available, however, for prices and industrial production.

To assist all three agencies at the State and Entity levels in

meeting European and international reporting standards, donors, led by the European Commission (EC), have pledged approximately DM 10 million over the next three years. At a recent donors meeting, the three statistics agencies agreed to provide by January 1 1999, a list of their priority needs to the EC's International Coordinator who will work with donors to ensure proper phased delivery of assistance. At the meeting, it was also agreed that the Swedish Mission should begin delivery of its aid package immediately, the first phase of which will focus on information technology development and English training.

BHAS's opening and the pledge of donor assistance are important steps in improving the availability of decision-making information at the Entity and State government levels and in providing national-level data for international and domestic users.

Organization of Public Services

EIB Signs Agreement

The European Investment Bank (EIB) and the BiH Ministry of Foreign Trade and Economic Relations signed an agreement to settle a pre-war credit extended to the former Elektroprivreda, a state company. Unlike the Paris Club of Creditors, which is composed of sovereign creditors, the EIB as the Bank of the European Union is not allowed to reschedule debts or write off unpaid interests. The BiH State is now guarantor of the debt. The Agreement does not specify who is actually going to pay and this has to be worked out by the BiH State. For example, the debt could either be shared between the Entities according to the law on external debt or divided between the three Elektroprivreda's.

The first part of the credit will probably be used in the infrastructure sector for roads and railways. An EIB assessment team is expected in country in mid-December to talk with ministries at the State and Entity levels and to visit

Sarajevo, Banja Luka and Mostar.

Border Rail Issues

A proposed agreement between the Republic of Croatia and BiH on Regulation of Border Railway Traffic is under consideration. Expert groups from Croatia and BiH have met and agreed on all but one of the 24 articles in the proposed agreement.

Much of the impasse is related to differing views on ownership and control of the station and areas near Martin Brod. Croatia and BiH have proposed differing crossing stations for the operation of the Una rail line, the rail line between Bihac in BiH and Knin in Croatia. Croatia has proposed border crossing stations at Martin Brod (for Croatia) and Kulen Vakuf (for BiH). BiH has proposed border crossing stations at Martin Brod (for BiH) and Licka Kaldrma (for Croatia).

Because of the impasse at the Expert Group level, it appears a political resolution is needed. On November 13, the High Representative informed President Tudjman that, until the Border Commission decides otherwise, he considers Martin Brod to be part of BiH. The recently-adopted Croatia/Federation Agreement on Special Relations may have a positive bearing on this matter. The proposed agreement has foreseen annexes that could address this and other border issues. An Inter-State Council for Cooperation has also been formed and, at their initial meeting, underlined the importance of resolving border-related issues, including those related to the border railway traffic agreement and road transportation.

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[Summary Report:](#) Donor Aid to BiH as per 1 December 1998

[Summary Overview](#) on Credit Lines

[State budget](#) update October 98

Office of the High Representative