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Newsletter

Economic Reform and Reconstruction in Bosnia and Herzegovina (BiH)

Sarajevo, September 1998, Vol. 1, Issue 7

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)	Apr-98	May-98	June-98	July-98
Average net wage (km)	324	318	319	n/a
Retail price growth	7.7%	5.6%	4.3%	3.3%
Cost-of-living growth	8.5%	6.1%	3.7%	2.9%
Real wage growth	15.7%	14.9%	19.2%	n/a
Industrial Production growth	26.5%	35.8%	23.7%	40.5%

(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)

Price inflation fell even further in the Federation in July. Growth in the real wage and industrial production remain strong.

In the RS, price and cost-of-living inflation accelerated dramatically in April and by mid-year was running at over 30% on an annualized basis. This can be explained by the fact that there was a large devaluation in the official Yugoslav Dinar-DM exchange rate in April. Real wage growth has declined since its peak in March, but the level of real wages in 1998 still dramatically exceeds its 1997 level. Industrial production growth also remained strong through June.

(More information on this subject can be obtained by: the OHR Economic Department, Mr. B. Roberts, Tel: 447275 or at the IMG Economic Section, Mr. P. Hulshoff, Tel: 666273)

Economic Policy and Reform

Establishment of the BiH Agency for Statistics The Council of Ministers of BiH has established the BiH Agency for Statistics (BHAS), a State-level agency responsible for producing national statistics on economic and social indicators.

The BHAS will be responsible for producing and publishing aggregate statistics for BiH based on data submitted by Entity statistical institutes. The BHAS will also represent BiH on statistical matters in international organizations, serve as a contact point for the donor community, and foster cooperation between the Entity statistical institutes.

The BHAS is responsible solely to the Council of Ministers and will be managed by a three-member Management Board representing the three constituent peoples of BiH. The Management Board of the BHAS has already been selected by the Council of Ministers. As an interim measure, until 1 September 1999, an international coordinator, from the European Commission, has been appointed. The coordinator will assist the Management Board and act as an arbitrator when required.

Establishment of the BHAS will result in the release of considerable financial assistance up to approximately KM 10 million from the European Union, Italy, Switzerland, and Sweden for BiH statistical institutes.

Central Bank is Net Seller of KM There is good news to report on the introduction of the new currency in BiH, the KM. When the Central Bank of BiH (CBBH) was established in August 1997, it took over foreign reserves of DM from the NBBH (the former Central Bank). By end-June 1998, immediately prior to the introduction of the KM, these reserves had fallen by 50 million DM, reflecting the fact that the CBBH was a net buyer of Bosnian Dinars in that period.

From end-June to early September 1998, the CBBH was a net seller of KM, and its foreign exchange reserves rose by 60 million DM. The level of net sales hovered at low levels in the summer but were accelerating in early September. This is a very encouraging development in the introduction of the new currency.

The levels of net sales have been highest in Sarajevo. The CBBH has also been a net seller of KM in Banja Luka, albeit at a lower level. It has been a net buyer of KM in Mostar, reflecting the fact that the greatest difficulties in achieving acceptance of the KM have been in the Croat areas of the Federation.

Privatization in the Federation : Military Pay Claims Have Been Inflated Unpaid soldier claims are one of the three categories of citizen claims in the privatization process (the

others being general claims and frozen foreign exchange accounts). An issue has recently arisen from the fact that Federation authorities wish to over-allocate soldiers claims. This over-allocation of unpaid salaries for soldiers results from (1) compensation exceeding the actual value of unpaid salaries, and (2) vouchers allocated to persons who have never been soldiers.

The Bosnian Army has issued pay books to their unpaid soldiers but apparently also to ineligible persons. The total value of the Bosniac soldier claims is KM 5.4 billion. Despite the fact that their soldiers (less than 30,000 in total) have already been paid, the Croat HVO claims, on behalf of some 230,000 individuals, amount to an additional KM 3.4 billion. Instead of the current KM 8.7 billion estimate, a more realistic valuation of total Federation soldiers' claims would be between KM 4 and 5 billion.

If implemented, this politically-motivated overestimation would make soldiers the main beneficiary group in privatization. Pending a political solution between Bosniac and Croat members of the Government, the mailing of vouchers to privatization participants will likely be delayed. This in turn would unnecessarily delay the starting date of the privatization process. Another consequence would be the devaluation of other claims (incl. those of genuinely entitled soldiers), with a resulting negative impact on refugee return.

The OHR desires that a political solution be achieved without its involvement. However, if on the political level a solution is not found by the end of September, OHR might request the Government, in order not to delay privatization further, to exclude this claim category until the issue is resolved.

Federation External Debt Law Passed On September 3, the Federation House of Peoples approved the Federation External Debt Law, which will be officially gazetted later this month. Passage of this key law is an important step in building confidence among foreign creditors to extend loans to BiH. The law ensures that the Federation's share of repaying debts

incurred by the State of BiH to foreign creditors is an unconditional liability and will be satisfied from general Federation budgetary revenues.

A State-level external debt law was passed in 1997. To complete the legal framework for repayment of external debt obligations of BiH, it is now necessary for the RS to pass a law that incorporates the same positive features of the Federation external debt law.

Capital Market and Commercial Banking Laws Enacted On 26 June and 3 September, the RS National Assembly and Federation House of Peoples respectively approved a series of laws on capital markets, including laws on securities, registry of securities, and establishment and management of investment funds. These laws are crucial for establishing a properly-functioning post-privatization capital market and represent an important step forward in the economic reform program for BiH.

The RS and Federation have also both established Banking Agencies to supervise commercial banking in the two Entities. After almost two years of consideration by the Government, a Federation commercial banking law was passed by the House of Peoples on 3 September. The adoption of this law strengthens the powers of the Federal Banking Agency and is a significant step forward in creating a modern banking system in BiH. The RS Government has yet to propose a commercial banking law to its National Assembly.

State Customs Policy Law Adopted At its sessions of 1 and 2 September, the BiH Parliamentary Assembly adopted the Law on Customs Policy of BiH. The Law will come into force only on 1 January 1999 so as to provide time to prepare for the implementation of the Law.

The Law on Customs Policy will introduce modern customs procedures in BiH that are based on the existing European Customs Code.

With the adoption of this Law and the Customs Tariff Law that has been in force since March of this year, the new customs legal regime for BiH is finalized. Full implementation of both

Laws is a prerequisite for a unified BiH customs territory.

RS and Federation Agreement on Tax and Trade Issues On 11 August, the Ministers of Trade and Finance of the RS and the Federation signed an agreement in which they committed themselves to removing obstacles to trade within BiH. This is another step forward in attaining freedom of movement of persons, goods, services, and capital in BiH.

The agreement focuses on: compatibility of sales and excise tax legislation, harmonization of sales and excise tax goods and rates, repeal of illegal entity taxes, the introduction of temporary additional customs duties at the state level, and cooperation between the Entities on tax collection and the fight against tax evasion.

Even though much remains to be done to achieve full implementation of the agreement, the Ministries of both Entities have recognized that from a legal point of view they cannot ignore the presence of the other Entity and that they will both benefit economically from mutual cooperation.

Organization of Public Services

Improvement on Transport Cooperation with Croatia Three texts regulating transport between Croatia and BiH have been adopted by the Council of Ministers were adopted in August and early September: the Border crossing agreement for rail traffic, Regulations for navigation on the Sava River, and an annex to the existing Memorandum of Understanding on reconstruction of Bridges.

All three texts must now be considered by the Croatian Government and, if agreement is reached, signed by both parties. Since drafts have already been exchanged, signing can reasonably be expected within two weeks.

The first agreement on Railways will make it possible for commercial traffic to resume between the two countries. Despite technical, political and legal difficulties, local and international railroad traffic is increasing steadily. Re-

organization of railroad companies and establishment of the Joint Entity Railway Corporation are on track.

The agreement on navigation on the Sava river will allow experts from both sides to carry out technical work required before river traffic can resume. This work includes de-mining, cleaning, and marking of the river. Navigation on the Sava is of high importance for some cities along the river, including Brod and Brcko. It is also vital for the Croatian town of Sisak, whose port has been out of operation since the beginning of the war.

Finally, the agreement on the reconstruction of Bridges will secure cooperation of both states with the donors (the EU and the USA). As a consequence, it is realistic to expect that the reconstruction program will adhere to the original schedule. Bridges in Brcko, Brod, Samac, Gradiska, Dubica, Kostajnica, Jasenovac, and Novi Grad will soon be reconstructed. Additionally, the reconstruction of the bridge in Orasje, financed by the World Bank, should be completed within two months, and the reconstruction of Karuse bridge (in Doboj close to the IEBL) should start within two weeks. A timetable for these projects will be included in the next issue of the Newsletter.

*(More information on this subject can be obtained from:
the OHR Economics Department, Mr. L. Pearson, Tel:447275)*

Reconstruction Update

The chart on the next page shows that the funds flowing into the RS drastically increased since 1997. The RS share in the projects that were completed in 1998 and are ongoing, is about 20%. Additionally, the RS also benefits from the many "inter-entity projects" that are not taken into account in this percentage. The reconstruction of high voltage electrical transmission lines is a typical example.

In absolute numbers, the amount spent in the RS evolved from about KM 113 million during 1996 and 1997 to nearly KM 400

million in the first 8 months of this year (projects completed and ongoing in 1998). The increase in the amount of aid towards the RS is related to the changes in the Government at the beginning of the year. However, many projects recently finished were usually already planned or prepared in 1997 and part of the ongoing projects were also started before 1998.

The amounts spent in the Federation evolved from KM 1.2 billion (1996-1997) to about KM 1.5 billion.(1998 completed and ongoing) At the state and inter-entity level there was a net decrease of about KM 22 million to KM 203 million.

For further information concerning this publication please contact:

Paul Hulshoff, IMG – tel.: 666273 / 666020

Clement van de Coevering, OHR – tel.: 447275

[Donor aid as per 1 September 1998](#) (130kB) | [Regional Breakdown Graph](#) (10kB)

Office of the High Representative