Statement by the Principal Deputy High Representative Larry Butler and IMF Country Manager Graham Slack on Frozen Foreign Currency Settlement BiH

Principal Deputy High Representative, Larry Butler

Good morning, everyone, and thank you very much for coming. I have been joined today by Graham Slack, who is, as you will know, the country representative of the IMF in Bosnia and Herzegovina.

We are speaking to you this morning because we want to clarify the facts surrounding an issue that has a bearing on Bosnia and Herzegovina 's overall economic stability and on the prospects for job creation and sustained growth in the coming years.

The issue is frozen foreign currency deposits.

There has been a lot of media coverage on this issue in the last few days; we would like to take this opportunity to point up some **key facts**.

- There is a debt settlement package in place. It was agreed in 2005 and is the best possible settlement under BiH's current economic circumstances.
- In sharp contrast to this, the amendments which were adopted by the BiH House of Representatives in September would undermine the country's financial stability,

reduce the governments' capacity to deliver basic public services and would NOT result in higher payments to holders of frozen foreign currency accounts – because the governments' ability to honor their financial obligations would be compromised.

- The 2005 settlement is good for the citizens of Bosnia and Herzegovina and good for the holders of frozen foreign currency accounts
- The September amendments are bad for the people of Bosnia and Herzegovina and bad for foreign currency deposit holders.
- Let's look at the numbers.

***Powerpoint presentation*:**

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- The amendments envision the payout period being shortened from 13 years to five years; and
- Increase the accrued interest between 1992 and 2006 from a fixed ½ percent to the original interest rates established by each bank with each saver, which, depending on the type of currency appears to vary between 5 and 13 percent.
- Applying an average interest rate of 5%, this increases interest payments by approximately KM 1.8 billion KM;

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- Slide two shows the difference between a 5-year and a 13-year payout.
- This chart makes it completely clear why a five-year payout is simply not sustainable.
- Look at this chart carefully – the State cannot pay an additional amount of between KM 500 million and 1.2 billion over the next 5 years. (The enormous increase, by the way, is due to the interest rate). The average annual amont would be equal to the entire BiH annual

State budget.

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- Thus raises the total cost of the settlement to approximately 4.2 billion KM.
- This 4.2 billion KM figure represents a 78-percent increase in the amount that BiH would have to pay out.
- This is also almost equal to 26 percent of this year's projected GDP.

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- Compared with neighboring countries, BiH has the shortest payout period and the highest interest rates per annum – and BiH has the lowest capacity to make these payments.

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- Put another way: 1.8 billion KM would pay wages of all teachers and others from the educational sector for almost 3 years in Bosnia and Herzegovina ; or it would cover the pension expenditures for almost a year in Bosnia and Herzegovina .

Foreign frozen currency depositors argue that these funds must still be available somewhere, either in banks or invested in companies.

This is wrong. These funds were used during the war. They no longer exist.

Frankly, the arguments have been clouded by a large dose of selfishness. *Every* citizen paid a price for the war. Holders of foreign frozen currency deposits are being offered an equitable settlement. Many citizens who lost their homes through war damage, for example, have been less fortunate.

The fact that the House of Representatives has adopted amendments to the settlement has already caused negative reactions. In fact, as many of you will know, in October the New York investment bank, Bear Stearns, downgraded Bosnia and Herzegovina's credit rating from "outperform" to " under perform". This was largely due to the possibility that these amendments would be adopted.

But I want to highlight another point. The way this issue is handled will serve as a very clear indication of the caliber and seriousness of BiH lawmakers. The 2005 settlement clears the way for legislators to move forward with initiatives that will further improve the BiH business environment and thus attract more investment and create more jobs. Rejecting the amendments and defending the existing debt settlement will show that legislators are serious – supporting the amendments, on the other hand, will indicate a refusal to operate within realistic constraints.

I believe you have all been supplied with a one-page fact-sheet laying out the main information in the PowerPoint presentation. Now we'll be happy to take your questions.

Mr. Graham Slack, IMF Resident Representative to Bosnia and Herzegovina

The IMF Executive Board concluded the 2006 Article IV consultation with Bosnia and Herzegovina on October 13. The main conclusions have been published (http://www.imf.org/external/np/sec/pn/2006/pn06117.htm). The background papers for the consultation are currently being translated into the local language and will be made available in the coming weeks. These documents provide a comprehensive analysis of the economic situation and prospects of Bosnia and Herzegovina , as well as the challenges that will face the new governments, and will form the basis of the cooperation between Bosnia and Herzegovina and the IMF going forward.

One of the most significant of these challenges is the ongoing uncertainty surrounding the terms for settling Bosnia and Herzegovina ’s internal debts. Until the terms for settling all of these debts are finalized in a financially responsible manner, this issue will continue to hang like Damocles’ sword over the public finances.

The existing law on frozen foreign currency deposits (FFCD) is consistent with the ruling of Bosnia and Herzegovina ’s constitutional court. As such, it represents a fair and balanced compromise between the need to settle this outstanding liability to the owners of these deposits and the imperative of preserving the financial health of Bosnia and Herzegovina . Even with this law, securing sustainability over the long term will still require tight spending discipline for many years.

Against this background, the proposed amendments to the FFCD law present a stark choice for lawmakers. If approved, these amendments will almost double the cost of settling these liabilities. This will benefit FFCD holders but force a painful adjustment on everyone else: if total government spending is kept unchanged, more budget resources devoted to FFCD holders will mean less resources for education, social assistance, pension support, and investment for the future. And if total government spending increases, this will mean more taxes and less economic growth for everyone. These are the uncomfortable realities that lawmakers should keep firmly in mind when considering the proposed amendments to the FFCD law.