

Implementation = Expanded Capacity = Better Public Service



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Implementation = Expanded Capacity = Better Public Service

BiH farmers began a sit-in in front of the Joint Institutions Building in Sarajevo at the end of June, and launched demonstrations at border crossings around the country. The farmers are angry because the BiH authorities have not produced a coordinated agricultural policy that will give the BiH agricultural sector the technical and financial support that farmers in the rest of Europe enjoy.

The farm demonstrations point up the direct connection between implementing reforms in order to expand institutional capacity – and, by doing so, providing better public services.

The farmers want a BiH Ministry of Agriculture (something the European Commission also recommends). Even before this ministry is established, there are practical steps that the authorities can take (and quickly) in order to improve the marketing potential of BiH agro-producers. The law establishing the BiH Phytosanitary Agency was passed around two years ago, but the Agency is not expected to have operating premises until the end of this summer. When the Phytosanitary Agency becomes fully operational, joining the State Veterinary Agency which after interminable delays is at last functioning, BiH farmers will have access to a modern certification regime that allows food products from this country to compete effectively with imported products.

Implementing reforms expands the capacity of the authorities to offer better public services. This applies across the board.

When the Competition Law is enacted, the Competition Council can start effectively to prohibit activities that are anticompetitive. When the Consumer Protection Law is enacted, the BiH Consumer Protection Ombudsman can start acting as a powerful advocate for product safety. When the Law establishing a Market Surveillance Agency is implemented, the Agency can start to ensure that, for example, toddlers in this country are not playing with toys that have been made with toxic chemicals. When the Director of the BiH Standardization Agency has been appointed, the Agency will be better able to help BiH companies implement European product safety and quality standards. When the BiH Statistics Agency has adequate capacity, it can begin to deliver the sort of credible and up-to-date statistics that attract investment and help create jobs.

This is by no means a comprehensive list. Much of this quarter's Newsletter is about monitoring implementation of reforms that have in many cases taken years to get onto the statute books.

The clear message is this: getting laws onto the statute books does nothing for this country or its people.

Laws have to be implemented.

How can we tell when implementation is satisfactory?

Easy – that has happened when citizens have begun to enjoy the benefits.

Ambassador Lawrence Butler
Principal Deputy High Representative





MACROECONOMIC REVIEW

This article in the previous quarter's newsletter highlighted the fact that before any of the provisions laid out in the 31 chapters of the *Acquis Communautaire* can be considered as having been met, substantial headway must be made in their implementation.

The need to implement the *Acquis* measures is practical as well as political. Many of the institutions that must be set up as part of the implementation process will increase the efficiency of a given sector or sectors of the economy and improve the service levels within these sectors.

Good examples of this are the public utilities and financial services sectors. The existence of an effective regulator in these sectors is the most important pre-requisite for maintaining performance, especially in terms of attracting investment and improving efficiency. In BiH, much of the recently enacted legislation provides for the setting up of regulatory bodies. Clearly, the object of establishing these bodies is not simply to comply with the *Acquis*, but because there are substantial economic benefits *per se*.

Most European countries have undergone major reorganisation of their public utility sectors in the last fifteen years or so. These reorganisations took place amid (still) continuing concerns about the need to balance the requirements and interests of commercial and private consumers and investors. Ever since it became possible to separate (technologically and commercially) the infrastructure from the provision of services, regulation has been crucial in the smooth operation of the utilities sector. Although each sub-segment of this sector has its own regulatory needs, it has become clear that sectors that have relatively low barriers to entry, a higher rate of technological progress and higher growth in demand require different sorts of regulators from those which have none of these characteristics, e.g. the mobile phone and water sectors.

The regulators play a finely balanced role in as much as they must regulate prices and access to infrastructure as well as promote competition. In BiH, the regulator with the longest pedigree is the Communications Regulatory Agency (CRA) - in charge of regulating all means of communication, including telecoms. Further regulatory agencies are planned especially for the energy and railway sectors. However, for the economy to feel the benefits of reform in any of these sectors the regulatory function needs to be effective. For the regulators to be effective, the laws underpinning their mandate and role must be consistent. Similarly, the regulatory framework and the decision making process within it must be free from sudden changes, while the agencies themselves must be sufficiently well equipped to deal with given tasks. No effective regulation can take place if regulatory decisions can be reversed by decree or if rules are ill defined or ill publicised, or are changed frequently. Unfortunately, BiH has a history of such practices the privatisation of state-owned enterprises offering prime examples.

Clearly, the reform of public utilities in BiH will not produce concrete benefits if the regulatory function is prone to systemic problems that sometimes appear to be endemic in other parts of the public administration.

Among the concrete economic benefits of effective regulation are lower prices, greater competition and better services. Effective regulation lowers the barriers to market entry and ensures that networks are used on a non-discriminatory basis. This, in turn, encourages investment, thus creating jobs and improving services. In BiH, the telecoms sector has progressed furthest down this route.

In the financial services sector, the regulatory function is even more important. The recent relative success of the banking sector in BiH clearly needs to be underpinned by an effective regulator. In fact, some of the most notable banking scandals of the recent past might have been avoided had there been effective regulation in this sector. Currently, the two Entity laws and the Entity regulatory agencies are supposed to



cope with a rapidly expanding sector that has already outgrown Entity boundaries.

While the need for coherent banking regulation in BiH is clear, the need for effective regulation in other financial sectors, notably insurance, is even greater. Indeed, the insurance sector has become the proverbial black sheep of the BiH financial services industry. Low disclosure requirements and minimal oversight have led to a fragmentation of the sector, which lacks enough depth to cope with regular policy-holders' claims and as such is in no condition to act as an engine of growth in ancillary industries.

Better regulation in both the banking and insurance sectors would reduce the latent inefficiencies in BiH's fragmented financial services market. A tendency towards atomisation has already reduced the depth and liquidity of these markets, which, in turn has pushed up the cost of capital, with consequent negative effects on investment, business start-ups and job creation.

One answer to this problem might be the establishment of a single regulator for all financial services. This concept, first launched in the UK in 1997, has gained ground rapidly in many European countries. Thus, for example, Slovakia has had a single regulator for financial services since 2002. The idea underlying financial regulation is to prevent collapses of financial institutions, or at least limit the extent of damage that any such event might cause. At the same time, regulators are there to prevent customers from malpractice and fraud.

The idea behind the concept of a single regulator is that a single regulator would be more effective than two or three regulators dealing with different financial service providers, for example banks and insurance companies. In addition, smaller economies with less developed financial services industries have found this to be more efficient. In BiH the issue is also related to promoting the Single Economic Space.

Clearly, then, the case for effective and independent regulators in the financial services

and public utilities sectors is strong. From the economic standpoint such institutions would promote competition and maintain a level playing field for all participants, while protecting consumers from being exploited by powerful service providers. In BiH, where political influence in the economy is still substantial, the need for regulation of newly privatized and/or unbundled industries is high. Similarly, by virtue of constituting a major part of the *Acquis*-related reforms, the regulation of different sectors in BiH represents the implementation of pre-conditions for this country's accession to the EU and, crucially, its ability to compete within the common market when it gains EU membership.



REGIONAL DEVELOPMENT

Northwest

Since the Economic Development Strategies were created and publicly presented in November 2004, several donors have expressed interest in economic development activities in Northwest BiH.

During the first half of 2005, the Northwest Regional Development Agency hosted delegations from the Czech Republic as well as Danish Government programming missions. In June, the Danish delegation paid its third visit to the Northwest region to finalize its development aid programme (LEDIB: Local Economic Development in the Balkans – BiH and Serbia). The programme is to be implemented over the next three years providing assistance worth € 10 million to the Northwest region. Programme components will cover the business environment, a corporate social responsibility facility, credit facilities, business development services, and research and monitoring, while proposed sectors for intervention include food-processing and agriculture, the construction sector, wood-processing, information and communication technologies.



The EC Delegation received a total of 103 applications from all five economic regions for SME and tourism projects, following publication of an EU RED call for proposals in February 2005. Currently, four projects financed through this fund are being implemented in the Northwest region. It is expected that the Delegation will launch another call by the end of this year.

The SUTRA II (Sustainable Transfer of Return-related Authorities) project, implemented in 12 municipalities (seven of them located in the Northwest region) by UNDP, represents a transition from an internationally monitored reconstruction-oriented planning process to a local development-oriented planning process. It involves the reconstruction of 40 returnees' houses, reconstruction of technical infrastructure, sustainable return and local capacity building. Under the project, the Northwest Regional Development Agency is coordinating the work of commercial and NGO representatives on local action groups.

The OSCE Regional Center in Banja Luka, in cooperation with the Northwest Regional Development Agency organized a conference on youth entrepreneurship and employment on 16 Jun 2005. The conference was organized with a view to generating ideas for involving young people in local economic development and creating possibilities for youth employment and the development of entrepreneurship.

The EU Public Procurement Project has organized two presentations related to the new Public Procurement Law for representatives of the business sector and the local authorities. However, full implementation of this Law is dependent on the establishment of the Public Procurement Agency and the Public Procurement Review Body, which has been delayed by the Council Of Ministers for months now.

Northeast

The absence of a systematic economic approach, and the inadequate involvement of the authorities has had a negative impact on

promising sectors of the northeast region and has hampered the development of existing potential.

A lack of vigour and accountability has been especially evident in the field of privatization and the restructuring of state-owned companies. Huge corporate liabilities have deterred potential investors. Furthermore, the authorities are still reluctant to launch bankruptcy proceedings through which companies could be restructured and viable parts turned around.

The mining and energy sectors – key sectors in the Northeast economy – have witnessed improvements in production. Annual coal production has increased, which has led to a corresponding increase in deliveries to thermal power plants. The Tuzla power plant has expressed its intention to increase production capacity either by upgrading the existing generator block or by building a new one, whichever proves to be more cost-efficient. BiH in general has huge power production potential. However, obstacles to revitalization and to the improvements needed to ensure that supply matches growing demand have precluded systematic planning. Problems include accumulated debts in the mining industry and the non-existence of a real government strategy in the energy and mining sector.

On 20 June 2005, Banovici Coal Mine officially became a member of EUROCOAL, the EU Mining Association. Membership will give Banovici Mine access to the latest mining innovation technology).

Forestry represents one of BiH's most important – certainly its most ubiquitous – natural resources. The wood industry in the Northeast region is focused predominantly on the first stages of processing (i.e. semi-products). Value is added after the products are exported to other markets. Illegal logging and illegal wood processing are major problems in this sector. Two things are necessary: to reorganize forestry management and to implement thoroughly the corporate governance reforms that have been enacted, so that companies in the forestry sector



start to perform more efficiently, transparently and productively.

Some positive results have been accomplished in the agriculture sector. Overall production has significantly increased over the last two years.

Production at the Swedish Bos Agro Food Refrigeration Facility in Srebrenica is to be expanded from 500 to 1000 tons. Bos Agro Food is 100percent export oriented and its focus is mainly on raspberries. Investment worth 600,000 KM for the expansion of the company's production capacity underlines the commercial potential for food production, not just in the Srebrenica area but in the Northeast region as a whole.

The presence of LWF and USAID LAMP, and the results of their efforts to foster agricultural start-ups, has been significant. However, the absence of a coordinated BiH agricultural policy is preventing the full exploitation of this sector's huge potential.

Improved quality control systems for imported and domestic products and the introduction of EU certification would significantly improve the competitiveness of BiH agricultural products.

Southeast

In May the FBiH and HNC Privatization Agencies announced the sale of state shares in two companies from the Herzegovina region.

- After a failed attempt to privatize the Mostar Tobacco Factory through an international tender in 2001, the FBiH Government decided to sell 67 percent of the state's share in the company through direct negotiations with a buyer. The value of the state capital is estimated at KM 17.6 million. The company currently has 149 employees and operates at just 20 percent of capacity.
- Approximately KM 10 million (representing 67 percent) worth of the state capital in MI "SOKO" Equipment Production Company is to be privatized

through a tender published by the HNC Privatization Agency. The company has 65 employees and produces equipment for distribution centres, warehouses, petrol stations, and specialist shops as well as furniture for schools and kindergartens and metal furniture for offices.

The Elmaco and Dalekovod firms from Mostar organized a symposium on "Wind Power - Power of the Future" on 4 June. The symposium gathered foreign and domestic experts, representatives of power-supply companies, faculties of engineering and representatives of cantonal and state ministries with the aim of presenting the results of studies carried out till now on the use of wind power for the production of electric energy. A set of recommendations, among them a call for the adoption of legislation that would regulate this branch of activity and an expression of support for the establishment of a technology park in Mostar, were adopted as the main conclusions of the meeting. The first concrete results of a long-term study carried out by Dzemal Bijedic University in cooperation with a group of Austrian companies were announced. The study recommends that the first two (of more than 30) wind-power farms, should be installed in the area of Podvezje by the end of this year. The whole project is worth € 60 million and its implementation should make possible the supply of 39,000 households with electric energy. The implementation of similar projects by Elektroprivreda HZHB with the support of the Spanish Government, which has donated equipment for carrying out necessary studies, is expected.

The Business Service Centre Mostar (BSC) has registered a new investor, ZINKTECHNIK, from Sweden, which will invest approx € 1million in a metal processing company. The building is currently being renovated to receive machinery in the autumn of 2005. Initially, the company will create 15 new jobs. This will rise to a total of 25 positions in the course of the next year if the investment begins to show a profit. The BSC has also established contacts with Bari and the Puglia region in Italy, and has in this way



launched projects in tourism, agricultural education and quarrying. Mostar has been invited by these two regions to make a presentation at the Fiera de Levante, the biggest Fair in the South of Italy, in the autumn of this year.

In June, Roing, a private company from Ljubuski, whose main activities are production, processing and packing food additives, spices, and medical and aromatic plants, opened a modern dehydration facility with a capacity of 500 to 1000 kg/h, in Hotanj, Capljina Municipality. The project has been implemented in cooperation with a Dutch company, Dika/Hak & Partners, under the Dutch Programme for Cooperation in Central and Eastern Europe. The project has helped Roing to develop its business and marketing plans and establish an integrated chain that will take eco-medical herbs and vegetables all the way from the field to the market. The company has 50 subcontractors at present and produces 60 tons of products. The total investment made in the company thus far amounts to € 850,000.00. The Dutch partner identified the issue of land use as one of the main difficulties faced during the implementation of the project. The company now has around 70 ha of land at its disposal but would like to cultivate much more.

Owing to its climate and geographical position, the Herzegovina region has always been recognized as being suited to the development of extensive agricultural production, which can create new jobs with relatively small investments. Many international organizations have assisted in the development of this sector. Hence, for the last five years the Norwegian Government has supported the agricultural cooperative, Dubrave, from Prenj in Stolac Municipality, in exporting potatoes to the Norwegian market. Quantities contracted for this year amount to 420 tons. Another agriculture project has been supported in Citluk. The Norwegian foundation, Jaren Produktutvikling, donated KM 472,000 to the agriculture cooperative, Agroplod, to put in operation a grape juice production facility, while another KM 30,000 was donated as financial back-up to Agroplod's working assets.

Two concession agreements, one for a bauxite mine and another for the exploitation of drinking water, were signed in June in the Eastern RS by the RS Ministry of Economy, Energy and Development. Starsped d.o.o. Company from Gacko plans to invest KM 400,000 for the exploitation of a bauxite mine in the municipalities of Berkovici, Ljubinje, Nevesinje and Trebinje and process 60,000 tons of bauxite per year, which will be further used for the needs of the aluminum plant, Birac, in Zvornik. The agreement was signed for a period of 25 years and is expected to result in the creation of 69 jobs. A 30-year concession agreement for the exploitation of drinking water from the Bregava River source has been signed with the company Bakus d.o.o, from Berkovici. The project investment is worth KM 6.25 million and will create 25 new jobs.

In April this year Mostar hosted its International Trade Fair in the Free Trade Zone for the eighth time. This year, the partner country was the Republic of China, which was represented by more than 40 companies. Apart from the general Trade Fair, there were also two specialized sections - the Wine Fair, featuring wine-growing equipment, which was organized for the third year in a row, and the Book Fair organized for the first time this year. Around 550 companies from 29 countries, representing various sectors of industry (wood, chemicals, metal, tourism, cosmetics, food, telecommunications, information technology, civil engineering, graphics, automobiles) participated in the Fair. Presentations, roundtables and seminars were organized during this event. One of these highlighted the production and economic possibilities of the Herzegovina-Neretva Canton organized for companies and representatives of the Emilia Romagna region in Italy.

Mostar also hosted another Fair, which has started to acquire the characteristics of an international event. The third fair of economy, agriculture, food and tourism, called the Days of Cherries 2005, was organized with the support of the FBiH and HNC Governments and the City of Mostar. This year, the Fair was held under the motto "agro tourism in the eco village". Among



participants there were around 80 exhibitors of organic food, fruit & vegetables, and wooden furniture. Tourism offers and products of Croatia, Italy and Hungary were also presented. A number of agriculture, tourism and economic development themes were discussed at a roundtable prepared by the Sarajevo Agriculture Institute and the Mostar Faculty for Agro-Mediterranean Studies.

Central

Projects being undertaken under the auspices of REZ include an initiative to promote self-employment in agriculture through technical assistance and market networking. Focused within Central Bosnia and Herzegovina Region, this project is being implemented in the municipalities of Zepce, Zavidovici, Maglaj and Doboju Jug.

The objectives of the 15-month project are to support conditions for sustainable economic growth, promote self-employment, and strengthen and build the capacity of partner agriculture associations.

The target group of participants includes at least 100 local/returnee families chosen from existing agricultural producer associations.

All the beneficiaries have successfully undergone agro and business training.

The 50 most successful beneficiaries have received a greenhouse with a water supply system, and seedlings.

There are 24 women beneficiaries (48 percent), and 17 workers (34 percent): below the age of 35.

The greenhouses were delivered and set up in March and April.

The first production cycle (producing tomato and pepper) is now ongoing.

REZ is also promoting the introduction of IT to public administration, including municipal registry

offices, through a project that will provide municipal departments with modern IT equipment, adequate software and network connections. The project envisages establishing a One-Stop-Shop that will take citizens through the municipal organization and handle collection and issuing of all official requests/decisions in one place. In addition to improving direct services to municipal residents this is likely to have a positive impact on the municipal business environment.

Another project involves establishing a Local Economic Development Team that will focus on developing SME and local agricultural potential. These teams, established within municipal administrations, will have five members - municipal officials and representatives of business, farming and youth groups. Consulting services will be provided and support given in registering new companies. The teams will organise training sessions, joint participation at fairs, and cooperation at the regional and State level, and promote the work of local companies as well as marketing the community itself as an attractive place for investment.

REZ is also engaged in establishing a database on agricultural resources, which will make available an inventory of local resources, in particular of land.



FISCAL SECTOR

BiH Works to Put It's Fiscal House in Order

On 14 May the Prime Ministers and Finance Ministers established the BiH Fiscal Council. The Fiscal Council has a countrywide mandate to prepare revenue projections, define the consolidated public budget expenditure target, decide on how budget funds will be distributed among the State, Entities and District, and determine overall expenditure limits for each. This is another major step for BiH towards becoming a normal state that coordinates its fiscal policy and ensures that it is on a sound economic base.



The budget targets for 2006 and projections for 2007 and 2008 should be agreed before the summer recess. The budget parameters will form the envelope within which cabinets prepare detailed budget proposals for parliamentary consideration later this year.

A mission from the International Monetary Fund will assist the Fiscal Council with their task during July. The IMF mission and the BiH authorities will also resume negotiations for a Stand-By Arrangement and discuss ways of strengthening the legal basis of the Fiscal Council and integrate it into the larger budget legislative framework.

A key challenge for the Fiscal Council is to make room in the consolidated budget for the cost of those state-level institutions needed to guarantee the security of BiH and facilitate integration in the European Union. To help meet that challenge, the Fiscal Council restructured and renewed the mandate of the Fiscal Sustainability Working Group, a panel of BiH public finance experts appointed by the Finance Ministers and drawn from the civil service and academia. The FSWG experts, led by assistant ministers of finance and working in partnership with the OHR, resumed its formal meetings on 14 June.

The FSWG is nearing completion of a draft State Law on Salaries that will unify the compensation schemes for all employees of state-level institutions in a single system, while paving the way for more comprehensive public administration reform in the future. The new legislation will provide a mechanism for bringing state salaries into line with compensation prevailing in the Entities and the private sector. That will open room in the state budget to complete the staffing of existing institutions.

The next phase of the FSWG's work is to free resources for further state-building by examining ways of reducing the costs and increasing the efficiency of the canton and municipal levels of government. The FSWG is considering whether municipal reforms such as implementation of the treasury account system and achieving appropriate staffing levels should serve as conditions for increased guaranteed financing for

municipalities from the Single Treasury Account funded by the customs revenue and the new VAT. FSWG experts will work with specialists from the International Community as this effort proceeds.

All recommendations from the FSWG are for the consideration of the Fiscal Council, the body now responsible for ensuring that BiH taxpayers receive the public services they pay for and can pay for the public services they receive.



AGRICULTURE

In the last quarter there has been no progress towards establishing a coherent agricultural policy and restructuring the agriculture sector in accordance with the recommendations in the EU's functional review. Farmers and those in the agro-business sector have consistently urged the authorities to take concrete steps and reform the administration of agriculture in BiH. Unfortunately, the authorities have failed to do this.

Reorganising the administration of agriculture is an issue on which farmers in both Entities have the same position. The foreign trade deficit is enormous with regard to food products, while almost two thirds of citizens live on the countryside and directly or indirectly depend on agriculture for their livelihood. It is clear that farmers and processing companies are experiencing common problems partly because the current organisation of the administration of agriculture does not reflect farmers' needs or the needs of the BiH economy as a whole.

In order to facilitate a solution to this problem OHR has recommended that a State-level working group responsible for implementation of the EU recommendations be established. To date, these recommendations have not been the subject of serious consideration by the authorities. The BiH Ministry of Foreign Trade and Economic Relations has called on the Entities to appoint representatives to the working group, but the RS Government has until now declined to do so.

If BiH does not reform its agriculture sector before it starts negotiations on a Stabilisation and Association Agreement with the EU there is a real danger that it will not be able to meet the accession requirements. The current organisation of the agriculture sector is also likely to be an obstacle to BiH's capacity to absorb and utilize EU pre-accession funds.

Therefore it is necessary to start restructuring this sector now. The experience of the new accession countries shows that they have benefited from EU membership particularly in regard to their agriculture sectors. The reason for this is that the new member states implemented EU recommendations ahead of membership.

Reform of the agriculture sector would help BiH to start benefiting from the Free Trade Agreements and to strengthen its trade relations with partner countries.

Veterinary

In cooperation with the BiH Ministry of Foreign Trade and Economic Relations and the BiH Directorate for EU Integration, the BiH State Veterinary Office (SVO) has submitted a progress report to the EU Food and Veterinary Office (FVO) in Brussels, providing an overview of the work of the SVO in the period from 2003 to 2005. The report includes information on implementation of the EU recommendations from the Feasibility Study (establishment of a coherent trade policy) as well as an invitation to the EU FVO Veterinary Inspection department to carry out an inspection visit in BiH.

According to preliminary information the report has been well received and the FVO has decided to send an inspection team, whose task will be to evaluate the performance of the SVO and inspect several aquaculture companies with a view to allowing fish exports to the EU. The inspection visit will take place in August 2005 and it will be the first opportunity to secure an expert evaluation of the implementation of EU requirements in the veterinary sector. During the inspection visit the SVO will assess the practical implementation of primary and secondary

legislation and the reliability of the BiH veterinary system. This inspection visit will be the first since 2000 and will also offer an opportunity to identify strategic weaknesses in the BiH veterinary system.

Phytosanitary and Food Safety Agencies

November 2005 will mark exactly one year since the BiH Council of Ministers received a list of candidates for managerial positions in the BiH Phytosanitary Agency. Due to a clear lack of political leadership and determination, no candidates have been appointed. Businesses and citizens are paying the price for this inefficiency on the part of the BiH authorities. As a result of the apparent political gridlock, it is difficult to find qualified candidates to apply for these top jobs.

The situation in the case of Food Safety Agency is similar. In this case the job announcement has not been yet published. The Council of Ministries had sought to appoint an acting director and establish operational bodies as stipulated by the framework Law on Food Safety, but this initiative has been withdrawn from the CoM agenda for unknown reasons.

STATISTICS

Modern BH Statistics Gathering

The adoption of a BiH Action Plan to implement priority statistical activities in 2005 is an important step towards establishing a reliable and coordinated system for producing countrywide BiH statistics. Up to now, all of the planned priority statistical activities in 2005 have been accomplished in line with the Action Plan. In the past, because of a lack of cooperation or because of the non-use of accepted international methodologies, the system for producing statistics did not work.

Recent developments have actively helped to create a situation whereby the BH statistical system has started to provide both domestic and

international users with quality statistical products.

Activities related to the Household Budget Survey have been successfully completed. It is worth mentioning, that for the first time Bosnia and Herzegovina will have reliable data on incomes and expenditure of BH households. A public presentation of this project is scheduled for 14 July.

At the same time, preparatory activities for the Labour Force Survey have begun. An international coordinator for this project has been selected, while activities related to the preparation of survey methodologies, questionnaires, and a sample calculation are ongoing. The pilot project, with envisaged pilot survey results, is to be completed in the course of October, and the major survey is to be organized in April 2006. As a result, the statistical system of Bosnia and Herzegovina will be for the first time in a position to provide reliable data on the BiH labour force.

There are two ongoing joint activities with the OECD and Eurostat. The first project is related to the creation of a system to assess BiH's Purchasing Power Parity (PPP), measuring how much the KM can buy in terms of an accepted international benchmark currency (usually US dollars). PPP exchange rates are used in international comparisons of standards of living. There is also a joint project with OECD and Eurostat aimed at addressing the issue of producing statistics that cover non observed activities, which, in the case of BiH's economy, account for 30 percent or more of the official GDP figure, an extremely high ratio.¹

Some major statistical legislation is to be adopted in the near future (the Law on BiH Classification of Economic Activities – fully in compliance with NACE (Classification of Economic Activities in the European Community) rev1.1. BiH Classification of Types of Constructions – fully in

compliance with CC (Classification of Types of Constructions in the European Community), BiH Methodology of Foreign Trade Statistics, and BiH Methodology of Statistics on Investments).

The new Rule Book on Internal Organization of the BiH Agency for Statistics has been adopted by the CoM. Out of 45 staff proposed, the BHAS is planning within this year to have hired 25 employees (compared to more than a hundred at each of the Entity Institutes).

With the statistical legislation adopted, the setting up of new organizational structures and the allocation of premises (the BiH Institute will share its offices with the Federal Institute for Statistics as of July), and with the Agreement on improvement of the work of a single professional statistical structure in Bosnia and Herzegovina (to be signed in the next few weeks) it should be much easier for the BHAS to lead and coordinate the statistical system of Bosnia and Herzegovina successfully, producing internationally comparable and reliable BiH statistics.



UTILITIES SECTOR

Transport

The BiH Law on Railways, which took two years to draft and steer through parliamentary procedure, was finally enacted on 30 June 2005. The Law on Railways is part of a larger process of transforming the railway sector and opening it up to foreign and domestic investment. The economy can only grow so far with the railway system in its present state of disrepair. Companies might produce more widgets, but they can't get their widgets to market unless there is rolling stock available to transport the widgets. So, this is not just about railways but about the whole economy.

Passage of the law opens the way for the EBRD to disburse around € 150 million worth of funds for new railway projects.

¹ IMF Country Report No. 05/198, Bosnia and Herzegovina Selected Economic Issues, pg. 50, June 2005



Energy

Electricity Sector Reform

The two main issues at the moment are completion of the institutional framework by establishing the Transmission Company and the Independent System Operator, and introducing a regulatory regime. This will contribute to the establishment of a rationalized power system based on sound regulation.

Establishment of the Transmission Company (Transco) and Independent System Operator (ISO).

Laws on the establishment of ISO and Transco were adopted in July 2004. Since then, however, implementation has proceeded slowly. In recent months, significant progress has been made, with the appointment of both Management Boards. The ISO General Manager was appointed on 22 June. With earlier Board approval of the Statute and the development of other documents necessary for registration, legal registration of the ISO was expected to take place by the end of July.

The appointment of the General Director of Transco was also expected by the end of July. The focus of the formation of Transco is now on the assets allocation issue, the division of assets between distribution and transmission and generation and transmission.

Regulatory Framework

State and Entity electricity regulators, which have been established and fully staffed as of the Summer of 2004, have been going through intensive training in order to start fulfilling their role. Efforts have been invested in the development of several important documents, which have been adopted or were to have been adopted by the end of July 2005:

- Rules of Practice and Procedure
- Rules on Hearings
- Licensing Rules
- Rules on Tariff Methodology

Also, the state electricity regulator (SERC) adopted its Decision on the Method of Determination of Interim Tariffs for Electricity Transmission and the ISO.

Importantly all of these rules have been prepared and adopted through a transparent process, whereby they were initially made available for public comment. General public hearings were held and also each commission held several technical hearings, where experts were able to provide their opinion.



ECONOMIC TRANSITION

Privatization

A success story in the RS: on 1 June the Jelsingrad company (a foundry located in Banja Luka) was privatized. The RS Government sold 65 percent of the state capital for 100,000 KM plus the commitment of another 10.3 million KM in investment over the next three years and a commitment to employ more than 350 people in the first year.

Furthermore, the RS Directorate recently closed the public tender for privatization of Banja Luka Brewery, with two bidders. After previous failures, there are positive signs that privatization will be completed this time round. Taking into account lower than average beer consumption in BiH, there is a good market opportunity for this brewery to increase its market share by utilizing fresh capital to upgrade its operations. Interestingly, one of the two bidders is Sarajevo Brewery. The other bidder is a UK capital venture company.

With regard to the political aspects of privatization, the need for consolidation of privatization agencies in the Federation becomes obvious. Many of the cantonal agencies are facing financial problems. The activities of Cantonal Privatization Agencies in the Federation are funded from the proceeds of sales of state-owned enterprises. Since they have already privatized many of the larger enterprises under



their jurisdiction, they are currently struggling financially.

Even more importantly, there is a question over whether cantonal agencies can fulfill a key aspect of their mandate -- to monitor and to audit the execution of privatization contracts and sale agreements. These agreements are typically made with the time horizon of three years upon closure of transaction, and many agencies currently lack sufficient resources or sufficiently trained staff to accomplish this task. The alternative may be to consolidate some of the activities of several cantonal agencies, in order to create a pool of resources. Additional training may also be required for legal staff from cantonal agencies and from relevant ministries, in order to improve their understanding of applicable laws, and ultimately to reduce the number of legal disputes coming before the courts.

Business Environment

Business Registration

Nine months after adoption of the State Framework Law on Business Registration (29 July 2004), the Entities finally adopted the implementing laws. The FBiH Law on Business Registration was adopted by the FBiH Parliament on 30 March 2005 and published in the "FBiH Official Gazette", No. 27/05 of 4 May 2005, while the RS Law on Business Registration was adopted by the RS National Assembly on 6 April 2005 and published in the RS Official Gazette, No. 42/05 of 26 April 2005. The Business Registration Law of the Brcko District was adopted by the Brcko District Assembly on 8 June 2005 and published in the "Brcko District Official Gazette", No. 15/05 of 16 June 2005.

The new Business Registration Laws provide a legal basis for introducing a new, business-friendlier system of registering a company in Bosnia and Herzegovina, and as such represent a substantial new incentive for business development and job creation.

What will the benefits of the new system be?

First, the business registration procedure, the business registration application forms and the business registration certificates will all be identical throughout the country. Moreover, they will be applicable to all businesses that are to be established in BiH by local or foreign physical and legal persons.

Second, the time needed to register a business will be significantly reduced.

Third, a single business registry/business registration system will be established to keep data on all registered business entities in BiH. The system will be accessible to all registration courts in the country.

Fourth, the new Laws will provide for thorough checks by, and flow of information among various governmental bodies, such as tax and customs authorities, municipalities, statistical institutions, institutions for pension and disability insurance, and the relevant regulatory bodies.

These benefits, however, are fully contingent on the consistent implementation of the Business Registration Laws. Implementation is scheduled to begin within 60 days of the legislation's entry into force and responsibility for this rests firmly with the BiH, Entity and Brcko District authorities. Whether and when will BiH secure a business registration system capable of attracting investment, fostering business and creating jobs depends on them.

Accounting and Auditing

The State Law on Accounting and Auditing was adopted by the BiH Parliamentary Assembly on 29 June 2004 ("BiH Official Gazette", No. 42/04 of 10 September 2004). The FBiH Law on Accounting and Auditing was adopted by the FBiH Parliament on 4 May 2005 ("FBiH Official Gazette", No. 32/05 of 8 June 2005). The RS Law was adopted by the RS National Assembly on 30 June 2005 and is currently in the process of being gazetted.

Following adoption of the new legislation, BiH has taken a major step forward in the reform of



its accounting and auditing sector. The Laws introduce a number of innovations that aim to bring BiH into line with international practice and to contribute to its attempts to align itself with the *acquis communautaire*.

Specifically, the Laws establish mandatory accounting and auditing standards and a professional ethics code for the whole of BiH.

They also define uniform requirements for obtaining qualifications and for the training, testing, certification and licensing of professional accountants and auditors.

Equally important, they provide for the mutual recognition of qualifications, ensure unhindered audits throughout BiH, and establish a State Commission for Accounting and Auditing to monitor the application of accounting and auditing standards in BiH.

These innovations are expected to create a system that ensures the independence, integrity and self-regulation of the accounting and auditing profession, the continuous improvement of standards and a substantial measure of consumer protection. As such, the system will improve BiH's accounting and auditing practices and revitalize the BiH accounting and auditing profession. And that is exactly what is needed.





BIH ECONOMIC UPDATE

BiH Economic Data January – July 2005

Source: CBBH, FBiH and RS Statistical Offices

| Indicator | BiH (CBBH estimate) |
|--|---------------------------------------|
| GDP nominal 2003 (Million KM) GDP nominal 2004 (Million KM) Nominal increase 2003-2004 | 12,170 12,980 + 6.24% |
| Index of Industrial Production 05/04 compared to Ø 2003 05/04 compared to 05/03 | N/A N/A |
| Retail Price Index 05/04 compared to Ø 2003 05/04 compared to 12/03 05/04 compared to 05/03 | 0.5% (year end 2004) |
| Average Net Monthly Salary (in KM) | 515 |
| Number of Registered Unemployed | FBiH 331.639 RS N/A |
| Number of Pensioners Average Pension (in KM) | 474,480 205 |
| Imports 01/05 - 04/05 (Million KM) Exports 01/04 - 08/04 (Million KM) Balance | 3,128,805 1,181,037 (1,947,768) |

