

Key Reforms in Final Quarter



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Key Reforms in Final Quarter

The Macroeconomic survey in this quarter's Newsletter notes a phenomenon that has been experienced by all the transition countries – successful reforms generate economic restructuring that necessitates more reforms. In other words, the more reforms you adopt the more you need to adopt. The same article notes that in mid-transition, perceptions of “happiness” among citizens tend to dip. BiH is at that dipping point, which means that at a time when the reform agenda seems dauntingly long the enthusiasm of the general public for more reforms is far from robust.

How do we address this?

By acknowledging that public skepticism is entirely understandable. Incompetence and corruption in the field of economic management have delayed the implementation of some key reforms in BiH and thus delayed the benefits that these reforms can bring – so the public has been left with much pain but little gain.

The answer to this is not to slow down, but to speed up the implementation of reforms so that we can get through the agenda and so that citizens, more and more, have something to show for their effort and their forbearance.

Three key reform initiatives will take centre stage in the final quarter of 2005:

- A BiH Salary Law, requiring government salaries to be kept in line with resources, will be presented to parliament, and should come into force in 2006. This is a difficult but necessary step towards giving BiH a government structure that is efficient and affordable.
- New legislation on obligation relations, aimed at modernizing the BiH business environment and encouraging investment and job creation, will go into parliamentary procedure. It has taken years to prepare this legislation but it can be enacted in a fraction of that time. It will replace the existing obsolete laws and furnish BiH with commercial regulations that meet European Union standards.
- The RS authorities will take prescribed steps to address the wholesale fraud, theft and incompetence uncovered by the Supreme Auditor at Elektroprivreda RS and Srpske Sume. Corporate misconduct is not, needless to say, limited to these two firms. The auditors have systematically exposed management shortcomings at public companies around the country, highlighting the urgent need for the authorities to apply corporate governance legislation enacted in the course of 2004. The RS Government has been put on notice that it will be held to account if it fails to take necessary steps. Responsible officials at all other levels of government should take note.

Public enthusiasm for reform has dipped – all the more reason for politicians to pull out the stops and start delivering the benefits of reform to citizens.

Ambassador Lawrence Butler
Principal Deputy High Representative





MACROECONOMIC REVIEW

The EU's decision to launch the process that will eventually lead to the accession of Croatia and Turkey, places Bosnia and Herzegovina's relative position in a harsh light. BiH has a very long way to go. However, the eleventh-hour agreement on police reform has opened the way for a quantum leap in the right direction. BiH had risked missing the accession train completely. This has not happened. The way is now clear for the launch of Stabilisation and Association talks perhaps by as early as December 2005.

It is now crucial that the authorities address the issue of reform fatigue. This means cracking a basic conundrum – EU membership is still distant, yet the reforms required to secure membership appear to involve immediate hardship; benefits deferred often seem like benefits denied.

On the one hand, the need to highlight the parlous state of the BiH economy is clear. Politicians and citizens must understand that the status quo is unsustainable, the old system is unsalvageable and the only realistic economic future for BiH is based on thorough – sometimes painful – transition.

But at the same time, it is imperative that reforms start to deliver benefits, even modest benefits, in the near term. It is morally unacceptable and politically irresponsible simply to promise hard-pressed citizens that things will get better four or five years down the line.

The task of painting a realistic picture of the economy – identifying problems that need to be addressed urgently and identifying at the same time areas where there have been real improvements – is made almost impossible by the inadequacy of the statistics-gathering system.

Where figures are available they are seriously distorted as a result of a fitful and far from completed privatisation process. Many state conglomerates that appeared under the pre-war

system to be operating at a profit, were in fact over-staffed and underproductive. Those that haven't been closed down are still overstaffed and underproductive, but where they once showed bogus earnings, they now contribute to bogus employment figures, as workers who are still on the books but haven't actually worked for years are still listed as members of the workforce. These companies show radically reduced output figures, adding to the economic doom and gloom scenario. This is compounded by a tendency among many companies to conceal earnings in order to minimise tax liabilities.

Official statistics gathering is thoroughly incapable of reflecting the various shades of grey in the economy. The reality is that, earnings, on aggregate and individual levels, are probably higher than reported, as are consumption patterns.

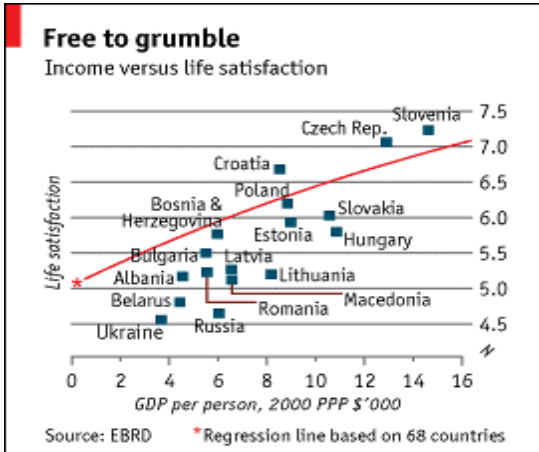
The upshot is that the urgency of corporate restructuring is underappreciated, as are modest but real improvements in living standards.

The process of social polarisation witnessed in other transition economies has been made more extreme in BiH as a result of the war and its attendant chaos. A new and prosperous business class has been, in terms of popular perception, compromised by the presence in it of black marketeers and other criminals, while the gap between sharp suits driving Mercedes and the majority of citizens has grown so wide that the majority can rightly ask who exactly is transition supposed to benefit.

A recently published EBRD paper investigates the link between economic transition and happiness¹. It finds that, overall, people in the transition countries feel dissatisfied with the reform process even after more than a decade of transition. However, it also shows that those countries that have made the greatest progress in transition have the "happiest" citizens.

¹ Sanfey, P. & Teksoz, U. "Does transition make you happy?", *EBRD Working Paper No. 91*, April 2005





So, citizens do recognise the benefits of reform when those benefits become real.

BiH stands in the middle of the transition-happiness spectrum. Reforms undertaken successfully to date (for example, currency board arrangements and privatisation of banks) have produced a recognisable increase in “happiness”.

Which is good news.

More challenging are the findings of another EBRD paper², in which the authors, noting the “strong, positive link between the advance of transition in one year and growth in subsequent years,” conclude that higher growth requires further reforms.

“Reform” is here to stay.

There is no question of using reform fatigue as an excuse to put on the breaks.

So reform fatigue has to be tackled by constantly linking the effort to a tangible dividend. You have to be able to show people that things are – even if only incrementally – actually getting better.

And you have to do this against a backdrop of economic upheavals caused by the re-allocation

² Falcetti, E.; Lysenko, T. & Sanfey, P. “Reforms and growth in transition: re-examining the evidence”, *EBRD Working Paper No. 90*, March 2005

of assets within and between economic sectors that is part of the transition process.

In practical terms this means, in the case of BiH, that workers must, for example, recognise that the current economy will produce more part time and less ‘durable’ jobs than before.

Citizens – and their political leaders – must also recognise that half hearted reforms are likely to do more harm than good.

The EBRD notes in its paper on reforms and growth that the harder steps come in the middle stages of the reform process (when also, incidentally, the happiness levels were seen to drop), and BiH is roughly at this stage now. It is therefore of crucial importance for BiH’s future that the current reform fatigue does not develop into a longer term malaise that could threaten the progress made thus far. As one recent article in *The Economist* concludes: “...given the correlation between happiness and small business, cutting the bureaucracy, taxes and corruption that stifle them makes sense. Luckily, that is what almost every post-communist country is trying to do. Sadly, the places that need it the most do it slowest.”³



REGIONAL DEVELOPMENT

Northwest

In August, ARDA NW presented, in cooperation with the London School of Economics, the North West Economic Region Business Environment Survey. The goal of the survey was to identify key sectors in this region that can be further developed and create new jobs, with donors’ support.

In light of the highly diversified development potential of this region companies from the following six sectors were considered: Wood Processing, Tourism, Textiles, Information

³ “Change and decay”, *The Economist*, 25th August 2005



Communication Technologies (ICT), Agriculture and Food Processing, and Construction.

Of the businesses asked, 24 percent said that political and macro-economic instability is their main concern. Around 17 percent of companies noted that a lack of access to capital, lack of proper infrastructure and lack of innovation are the main obstacles to growth. A further 16 percent of interviewed companies believe that corruption is the main problem, while the same percentage said competition was their main concern. Only 12 percent of interviewees see red tape as the principal obstacle to their business success. For 10 percent, taxes present a major problem, while the remaining interviewees (5 percent) ranked other problems as major obstacles to doing business.

Interestingly, more than half of the companies surveyed anticipate at least moderate business growth, 19 percent think that their business will remain stable, and 17 percent expect to experience huge problems in the next five years. The survey reveals the level of cooperation among companies within their respective sectors. A total of 28 percent of companies believe that there is a certain amount of competition in their sector, while for 27 percent of companies there is a balance between competition and cooperation. For 3 percent of companies cooperation within the sector is very good, while 15 percent acknowledge only a modest amount of cooperation among companies.

Following completion of data collection and analysis, sectors recommended for further support are, first, the agri-business and, second, the construction sector. The textile sector is a third possible candidate for support in NW BiH, but should be further assessed in light of the potential risks involved.

Northeast

The last quarter has been characterized by some notable cases of business expansion in the SME sector:

Regarding privatization 67 percent of state owned assets of the Tesla Car Battery Factory in Brčko have been privatized. The buyer made a commitment to invest 7.3 million KM over the next three years, and to hire 152 employees. The new owner has indicated that the latest technology production equipment will be installed in the factory. Previous tender proposals failed due to inadequate environmental protection plans, especially concerning the lead smelting facility at Tesla's premises. The new owner has given assurances that there is now no reason for community concern.

The Vegafruit food processing company signed a contract with Podravka - one of the leading food companies in the region. The contract, estimated to be worth 300,000 Euros, covers licensed production of Podravka's products by Vegafruit Mala Brijesnica. This contract is not limited to licensed production; Podravka is also committed to distributing Vegafruit's products. According to Podravka's BiH Director, the two companies are already negotiating details regarding the introduction of an organic food production programme. The value of this programme would also be in the range of 300,000 Euros. The arrangement with Podravka will not affect production of Vegafruit's own products.

In August 2005, Vegafruit introduced a new production line increasing the company's production capacities by an additional 20 percent. This has enabled Vegafruit to process entire daily shipments of fruit and vegetables during the harvest season(s), from all 7,000 contracted/cooperating farmers. Vegafruit's annual production plan is 30,000 tons of products, with a total market value of 50 million Euros.

With the arrival of a new majority owner, Dita Detergent Company has begun implementing a new business strategy. Dita's goal is to regain a leading position in the domestic market as a detergent supplier. Dita's products are widely available in the Czech Republic, Albania, Slovenia, Croatia, and Kosovo. The company's new strategy envisages the introduction of Dita's products in Serbia and Montenegro, Austria and



Russia. With this in mind, the new management has decided to invest 1.7 million KM in modernization of the production process. In the past, Dita's business results and product quality have been below expectation. However, following the introduction of new management, focus is now being placed on procuring the best ingredients, modernizing laboratory facilities, and introducing new packing designs, among other things. The object is to restore the quality of and the public's confidence in Dita's 140 different product lines.

Plamingo d.d. a company from Gracanica which specializes in the production and galvanization of plumbing fittings, has nearly completed work on a water purification facility in Vojvodina (Serbia and Montenegro). The entire engineering design of the facility was created and implemented by Plamingo. The total value of the contract is 500,000 Euros. The Plamingo Company began with the export of plumbing fittings and galvanized elements but then expanded into the transfer of engineering solutions. Last year, Plamingo registered foreign currency sales of 1.5 million Euros, and this figure is projected to rise to 2 million Euros this year. Plamingo has also started to export products to France; and it is engaged in supplying "Hella" car parts.

The Inmer Dairy has introduced a new line of Tetrapak milk packaging. The capacity of the new packaging line is 6,000 litres of milk per hour, and the total amount invested in this capacity expansion is 1.2 million KM. Inmer has expanded continuously for a number of years and today cooperates with 1,600 dairy farmers; some of these farmers individually produce up to 600 liters of milk daily.

Vocni rasadnik d.d. Fruit Trees Nursery from Srebrenik has been awarded the ISO 9001/2000 Standard Certificate for production of continental fruit seedlings. This opens access to markets of neighboring and EU countries. The nursery currently produces 450,000 seedlings annually, which makes it the largest BiH seedling producer, and the third largest on the territory of Ex-Yugoslavia. Access to new markets, especially

the West European market, will almost certainly result in Vocni Rasadnik hiring more employees. The Bimal Brcko Cooking Oil Factory has complained that its production capacity now exceeds the supply provided by domestic oleiferous farmers. Total arable land suitable for oleiferous plants is not being fully utilized. Just 10,000 acres out of 30,000 available acres are currently used. At this point, local farmers grow 20,000 tons of oleiferous vegetables for the factory, while remaining 80,000 tons of oleiferous plants for processing are being imported! Bimal exports 60 percent of its products, and the company's annual export turnover is 40 million KM. So far, 25 million KM have been invested in this factory since privatization, and a further 5 million KM will be invested this year in reconstruction of the cooking oil reservoir, which, once restored, will allow a threefold increase in production.

Southeast

This summer, the City of Mostar hosted the 10th Assembly of European Regions' Summer Annual Conference "Crossing the Bridge – Welcome to Europe". More than 150 representatives of 30 countries from 250 regions and 12 interregional organizations discussed a regional approach to building a self-sustainable economy and joint efforts in preserving cultural diversity in Europe.

In cooperation with the EURED project, Regional Economic Development Awareness Conferences were held in all five economic regions throughout BiH. REDAH's conference, on 19 September in Mostar, offered an opportunity to discuss the implementation of the Herzegovina economic development strategy and to review the results of already completed, currently implemented and potential future projects.

So far, EURED has invested around 450,000 € in the Herzegovina region, financing various projects aimed mainly at developing the SME sector, agriculture and tourism. Future REDAH activities will be oriented towards establishing a number of regional centres, including an information centre, a tourism development centre (in cooperation with USAID), an agriculture



development centre (in cooperation with the Spanish Embassy in BiH) and a regional centre for the development of small and medium size enterprises (in cooperation with the City of Mostar and the FBiH Ministry of Economy, Development and Craft).

Positive business news:

A three-year contract on producing rolls for the car industry, worth 15 million €, has been signed between Valjcići company from Konjic and Schaeffler Group and Fag company from Germany. This contract continues the successful cooperation among these companies that has already lasted for several years. The contract will add 30 new jobs to the 80 existing employment positions at Valjcići. The company exports all its products. Overall, this contract represents a step forward for the metal industry of Konjic Municipality.

Aluminij, from Mostar, and FEAL, from Siroki Brijeg laid the foundation stone for a new joint factory for aluminium processing in Mostar on 26 July. The new factory (90 percent owned by Feal d.o.o. Siroki Brijeg and 10 percent by Aluminij d.o.o.), will produce high quality pressed profiles and elements in accordance with the latest technologies. Construction work should be completed by mid-2006. It is expected that the new factory, whose value is estimated at 32 million KM, will employ around 100 employees.

On 21 July the HNC Privatization Agency signed a contract on the sale of 67 percent of the state capital in MI SOKO Equipment Production Company from Mostar. The Slovenian investor agreed to pay 292,000 KM for the offered state shares in the company and to invest an additional 2.8 million KM in modernizing the company's facilities and settling specific obligations. Apart from keeping 65 currently employed workers, the buyer has undertaken to employ an additional 25 people over the next three years.

The Trebinje Centre for Herzegovina Development, the Municipal Agency for Development of SMEs, and the NGO, the

League for Protection of Private Property and Human Rights, are in the process of establishing a business incubator for young/future entrepreneurs in the Eastern RS as part of USAID's and SIDA's Government Accountability Programme (GAP). The project, worth 37,500 USD will provide training for 20 participants on how to use modern technologies and know-how in running their future businesses and will offer advice and encouragement to young people to start their own businesses. Space for the incubator will be allocated and refurbished by Trebinje Municipality.

Herzeg Med, a limited liability company from Trebinje, which processes, packs, markets and sells honey under the Herzeg Med brand name, has successfully completed negotiations with Gettco International Corporation from Qatar for the export of the first five tons of its regular honey production to the Near East market. The value of this first consignment will be around 30,000 USD. Exported products are packed in the form of a hand-made gift package containing a wide range of the company's honey goods. Negotiations with another potential partner from Qatar are underway. Apart from increasing export of its products, the company's future plans include (if it can secure financial backing) the construction of a modern processing/packing plant and warehouse in accordance with ISO and HACCAP standards, a significant increase in the number of subcontractors (it is estimated that there are over 1,000 individual beekeepers in Eastern Herzegovina) and an initiative for production of glass containers and cardboard boxes (in cooperation with other nascent entrepreneurs).

Although the exact number of tourists who visited the Herzegovina region this summer is not known – because of the inadequate statistics-gathering system currently in operation in BiH – the tourist season appears to have been very successful. The most visited destinations this summer were Mostar, Medjugorje, Blagaj and Neum. According to some estimates around 50 buses entered Herzegovina daily at peak season, most visiting Mostar, which, following the reconstruction of the Old Bridge and its nomination to UNESCO's World Heritage list, has definitively resumed its



status as one of Europe's most attractive tourist destinations. It is estimated that more than 500,000 tourists have visited Mostar in the last eight months. However, the majority of these visits were organized as day-trips. Even though this brings significant income, it is clear that the potential for tourism development is still very much underexploited. Efforts must be made to increase the number of visitors, prolong their stay in the region and extend the tourist season throughout the whole year.



FISCAL SECTOR

Fiscal sustainability – Law on Salaries

Good progress has been made in drafting the State salary law. This will require government salaries to be kept in line with resources. This law will meet the demands of the Parliament as well as the IMF. While the Parliament had already urged the Council of Ministers to prepare such a law last year the IMF made a 10 percent reduction of the wage bill a precondition for the next IMF Stand-by arrangement.

The BiH Parliament again called on the Council of Ministers to present the Law on Wages when it adopted the first amendment to the BiH Constitution, on 30 August in the House of Representatives. This first constitutional amendment was necessary in order to enable the alignment of wages of existing State civil servants and employees. The House of Peoples has still to adopt this constitutional amendment in its second reading.

The draft proposes the abolition of certain allowances (such as hot meal and holiday allowances), introduces a fund for cash premiums for outstanding results, and limits overall funds for bonuses (police, defence, intelligence, etc.) while leaving discretion to managers to allocate bonuses to individual positions.

After responses and comments from stakeholders have been collected, the final draft

will be presented to the Council of Ministers in the next few weeks. It is envisaged that the law will enter into force in 2006.

Value Added Tax (VAT)

It cannot have escaped the attention of many people that the introduction of VAT is now less than three months away. The final stages of preparation are underway for the launch on 1 January 2006.

By the end of September:

- Around 16,000 companies had applied to the Indirect Tax Authority (ITA) for VAT registration. Around 20,000 companies are expected to register in total although the final figure may turn out to be a little higher than initially expected
- The ITA and other bodies (such as public accountant Revicon) are running numerous seminars for business and companies across the country
- The overall ITA reform process has so far resulted in an increase of public revenue collection into the single account, and witnessed the merger of three customs administrations into one and the transfer of staff from the Entity Tax Administrations into the ITA for VAT introduction and operation



AGRICULTURE

The RS Government has rejected an EUT recommendation on establishing a BIH framework institution in the agriculture sector (BiH Ministry for Agriculture and Rural Development).

In September 2005, despite warnings from the European Commission and the OHR that a unilateral approach could have negative



consequences, the RS Government adopted the draft RS Law on Agriculture. Earlier in the year the Federation government abandoned an attempt to adopt a similar piece of legislation, accepting the fact that agricultural policy can only succeed if it is formulated and implemented at the State level.

The problem is not the quality of these draft laws but the lack of any cooperation between the State and Entity administrations. Over the last few months there have been several attempts to start implementing recommendations resulting from the EC functional review of the agricultural sector. But these attempts have failed because of an unwillingness to cooperate on the part of the RS. This must have serious consequences for the future EC alignment process as well as for the overall situation in the sector.

The inappropriate legal and regulatory environment will further increase the agricultural trade deficit. . According to official data the highest trade deficit is in the food and beverage manufacturing sector. This may increase in the future unless agricultural sector reform is taking seriously by all players.

Veterinary - Fish exports

In August 2005 the European Union Food and Veterinary Office (FVO) inspected the BiH State Veterinary Agency. This was the FVO's first visit to Bosnia and Herzegovina since 2000. The purpose of the EU inspection visit was to evaluate BiH's veterinary system and to inspect the BiH aquaculture sector in light of prospective exports to the European Union. Preliminary and unofficial results of the EU inspection visit have been positive, and it can be expected that several fish farms will be granted the right to export fresh-water fish to the European Union.

It should be noted that during the EU inspection visit the BiH veterinary authorities acted very professionally.

Critical animal health situation in BiH

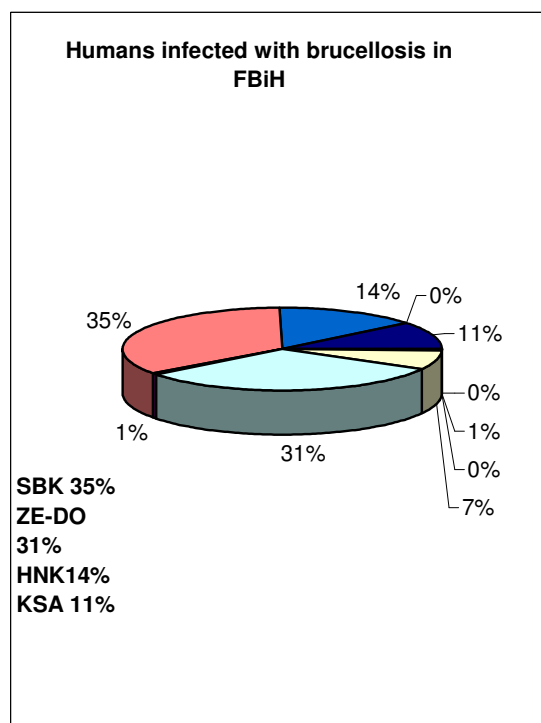
From 2004 until June 2005 several cases of human beings being infected with brucellosis were recorded in the Federation. Cantons with the highest number of infected humans are Central Bosnia, Zenica-Doboj, Herzegovina-Neretva, and Sarajevo.

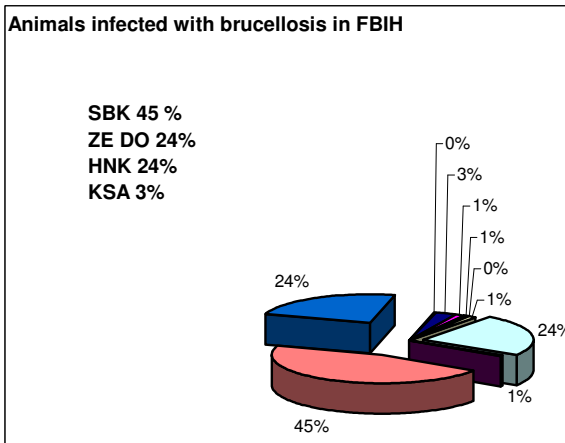
At a meeting with the Cantonal Prime Ministers in September 2005, PDHR Larry Butler asked the Prime Ministers to undertake coordinated activities with the Federal and State authorities in order to prevent further outbreaks of brucellosis, and called for improved cooperation between veterinary inspections at the Entity, Federation and State level.

The chart below shows further details.

SBK – Central Bosnia Canton
ZE – DO – Zenica-Doboj Canton
HNK – Herzegovina-Neretva Canton
KSA – Canton Sarajevo

Time period: 2004 - June 2005





Food safety and plant health protection

In September 2005, the Council of Ministers finally appointed the Director and the members of the Steering Committee of the BiH Food Safety Agency. With regard to the BiH Agency for Plant Health Protection, the Council of Ministers still has to appoint a director and advisor to the director.

STATISTICS

BH Statistics?

A pattern of delay in fully implementing the Law on Statistics has continued during the third quarter. Instead of merging the statistical institutes' countrywide data collection operations - while leaving the Entity Institutes for specific Entity issues, as stipulated in the Law of 2002 – the RS Government has raised objections to all proposed steps in this respect. An Agreement to improve the work of the single professional statistical structure in Bosnia and Herzegovina has been prepared, but the RS has withheld formal approval.

Despite these political obstacles, some operational progress has been made with regard to the implementation of the BH Action plan on priority statistical activities in 2005. The Statistical System of Bosnia and Herzegovina has initiated the preparatory phase of the BH Labour Force Survey (LFS). This means that for the first time

since 1991, Bosnia and Herzegovina will be in position to obtain information on the labour market and related issues, fully in compliance with the International Labour Organisation (ILO)/ EU Statistical Office (Eurostat) standards. The BH LFS pilot survey is planned to be held between 3 and 12 October, on a sample of 2,000 - 2,400 randomly selected BH households. The pilot survey will produce the very first information on certain labour market characteristics not normally available from other statistical sources. The second wave of the BH LFS should be held on April 2006, during which between 11,000 and 12,000 BH households will be interviewed. Both surveys will be financed through the United Nations Development Programme (UNDP) at a cost of around 600,000 USD.

The main statistical objective of the Labour Force Survey is to divide the working age population (15 years and above) into three mutually exclusive groups – employed, unemployed and inactive persons, and to provide descriptive data on each of these categories. Respondents are categorised according to information obtained through the survey questionnaire, relating to their actual activity within a particular reference week.

It is worth mentioning that activities for the CARDS twinning project are ongoing and could be started at the beginning of 2006. The general objective of this project is to assist the relevant authorities in the formulation and implementation of macroeconomic and fiscal policies, through the provision of timely, reliable and harmonized statistical data for the country as a whole. This project will contain several different statistical components, including National accounts, Business statistics, Agricultural statistics, and External trade statistics. It remains to be seen whether this project, which is worth around 1.5 million KM, will actually get underway in view of continuing political obstructionism.



UTILITIES SECTOR

Energy

In the third quarter, further progress in the formation of the Independent System Operator (ISO) has been made. Subsequent to the appointment of the Board and General Management and the completion of necessary documentation, the ISO was legally registered at the authorized BiH Ministry of Justice. Activities related to technical improvements and development which are required so that the ISO can fully fulfill its responsibilities are in progress.

The formation of the Transmission Company (Transco) is also underway but at a slower pace. The procedure to appoint the General Director has not been completed and preparation of the Statute and other internal documents is ongoing.

In August 2005, the RS Supreme Auditor published an audit of Elektroprivreda RS. The report reveals gross mismanagement and corrupt practices, many of which had already been identified in the 2003 report prepared by the OSCE Special Auditor. Despite some improvements, the report revealed a very grave situation at EPRS. The Supreme Auditor estimated that the value of potential earnings squandered by EPRS through mismanagement and corruption comes to more than 226 million KM for 2003 and 2004 combined. The Supreme Auditor also uncovered a series of investments made by EPRS that are unrelated to its business and are impossible to justify, for example the unfinished football stadium in Ugljevik, which has already swallowed up 6 million KM of EPRS funds.



ECONOMIC TRANSITION

Privatization

FBH Privatization Activities

Encouragingly, tenders for Agrokomerc, Velika Kladusa, and Energoinvest will likely be published by the end of this year, while tenders for several other strategic state-owned enterprises, such as Krivaja, Zavidovici, and KTK Visoko, are currently underway. A tender for Aluminij Mostar, the largest exporter in the country, is likely to be launched after all legal ownership issues have been formally reviewed by the FBH Parliament.

At the same time, there remain a significant number of state-owned enterprises that are plagued by poor operating and market conditions and are unlikely to be attractive to investors. These companies should undergo bankruptcy proceedings.

Several months after completion of the tender, a decision regarding offers for Energopetrol has not been made, and the FBiH Government seems unable to move the process forward. Energopetrol is burdened with tens of millions of KM in debt, including a 20-million KM bank loan. Its liabilities are increasing daily. Unfortunately, the FBiH Government appears unable to provide adequate guidance and ensure effective management of the firm; finding a white knight is unlikely. The FBiH Government should make a decision on this very quickly, before Energopetrol reaches a threshold beyond which it cannot be salvaged.

Cantonal Activities

Cantonal Privatization Agencies have been struggling with a whole series of challenges, including lack of funding and other resources, inadequately trained staff, an increasing number of court cases initiated by the agencies themselves as well as by buyers, and compliance with resource-demanding contract monitoring activities. Cantonal agencies should consider



ways of pooling their resources in order to improve the quality of their work, and (potentially) reduce their budgets. This could be done by establishing specialized consultative groups to deal with preparing remaining tenders or deal with outstanding lawsuit, or focus on various aspects of contract enforcement.

Significant savings could be realized if these consolidated groups were to take over the entire cantonal privatization portfolio. Current resources seem particularly insufficient in the area of contract compliance and monitoring, which leads to inconsistent application of standards.

RS Activities

Developments in the RS have been dominated by the actions of the representative of the public stake in RS Poste and Tobacco Factory Banja Luka, RS Minister for Social Affairs and Veterans Miodrag Deretic. Although not the responsible line minister he initiated replacement of the management of both companies and the appointment of temporary Boards. These actions highlighted several deficiencies and ambiguities in current practices regarding the supervision of public companies. The most recent audit reports of the RS Supreme Auditor, particularly on Srpske Sume and Elektroprivreda RS, will hopefully lead to criminal indictments and to an increased awareness – on the part of the public of politicians and of managers – regarding basic standards of corporate governance.

Business Environment

The third quarter of the year was characterized by a slow pace of reform aimed at improving the business environment. This refers not only to progress in implementing the laws adopted at the end of 2004, or earlier this year, but also to the BiH authorities' readiness to open, continue or finalize discussions on new reforms that may be beneficial to doing business in Bosnia and Herzegovina.

On the implementation side, particularly worrying is the situation with regard to the new **Business**

Registration Laws. As already reported, the new Laws - the objective of which is to make it easier and faster to register a business - have been adopted and are in force at all levels in BiH. Apart from ensuring identical business registration procedures, application forms and certificates throughout the country for all companies regardless of their founder, the laws significantly reduce the time needed to register a company. They also foresee a single business registry/business registration system, as well as a flow of information on registered companies among various governmental bodies.

However, an excessive delay in developing and installing the business registration software has held up the start of the new laws' application. A recent Action Plan, prepared by DfID and its contractor Bannock, indicates that the implementation phase, including training of court staff and installation of hardware, will be completed by the end of March 2006 and that the new Business Registration Laws' application will be possible as of April.

Implementation of the new **Laws on Accounting and Auditing** appears to be progressing more satisfactorily. The newly established State Commission for Accounting and Auditing is now making progress with activities within its responsibility.

Implementation must also move forward in the field of public procurement. Although adopted a year ago, the **BiH Public Procurement Law** has not yet been implemented in its entirety. Major problems are evident in the establishment of a Public Procurement Agency and a Procurement Review Body, both of which were supposed to be up and running within three months of the Law's entry into force, i.e. by February this year.

The recent appointment of the Public Procurement Agency's Director and Governing Board and the nomination of the Procurement Review Body's members suggest that the BiH Council of Ministers has realized the importance of the matter and that it is willing to accelerate the process.



While these examples indicate failures in the implementation phase, there are other issues that are still awaiting proper legal regulation. These include obligation relations, pharmaceuticals and medical devices, and consumer protection.

The new legislation on **obligation relations**, which is aimed at modernizing the BiH business environment and encouraging investment and job creation, is currently under public debate. The first roundtable on the Draft Law on Obligation Relations, prepared in conjunction with GTZ, took place on 21 September in Dobož and it will be followed by roundtables in Banja Luka, Sarajevo, Mostar and Brčko. The organizer of the roundtables is the BiH Ministry of Justice.

The issue of **pharmaceuticals and medical devices** is being tackled within a working group composed of the relevant BiH authorities and representatives of the International Community. The objective of the working group is to formulate a proposal that would establish uniform conditions for the production and inspection of, trade with, and oversight of pharmaceuticals and medical devices available on the BiH market, while also establishing a BiH Pharmaceutical Agency. If properly formulated, the proposal would guarantee the establishment of a single regulatory framework for pharmaceuticals and medical devices in BiH and thus greater protection of the public.

Finally, it is encouraging that the new **Consumer Protection Law** has recently been adopted by the BiH Council of Ministers and that it is currently awaiting parliamentary debate. An important innovation foreseen under the Draft Law concerns the establishment of an Office of the Consumer Ombudsman, the role of which would be to promote effective implementation of consumer protection policy and thus offer an improved service to consumers and traders throughout the country.

Whether or when Bosnia and Herzegovina and its citizens will be able to enjoy the benefits of already adopted or proposed legislation remains

to be seen. Responsibility for completing these reforms rests firmly with the BiH authorities.





BIH ECONOMIC UPDATE

BiH Economic Data January – August 2005

Source: Statistical Offices of CBBH, FBiH and RS

Indicator	BIH (CBBH estimate)
GDP nominal 2003 (Million KM)	12,170
GDP nominal 2004 (Million KM)	12,980
Nominal increase 2003-2004	+ 6.24%
Retail Price Index 08/05 compared to Ø 2004 08/05 compared to 12/04 08/05 compared to 08/04	0.5% (year end 2004)
Number People Registered as Unemployed* 08/05	FBiH 344,025 RS 155,050
Imports 01/05 - 08/05 (Million KM)	8,634,596
Exports 01/05 - 08/05 (Million KM)	2,939,605
Balance 01/05 - 08/05 (Million KM)	(-5,424,911)

* Data source: RS Employment Bureau

Symbol: Ø-average

