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INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. **MANOJLO CORIC**,
Governor of the Fund for **BOSNIA AND HERZEGOVINA**,
at the Joint Annual Discussion

**IMF/WB ANNUAL MEETINGS
HONG KONG**

**STATEMENT BY MANOJLO CORIC, THE GOVERNOR
OF BOSNIA AND HERZEGOVINA TO IMF**

According to the Dayton agreement, Bosnia and Herzegovina is within its internationally recognized borders. It consists of two Entities, that is, the Federation of Bosnia and Herzegovina, and the Republika Srpska.

For the time being, the Council of Ministers of Bosnia and Herzegovina has very limited authority. Its composition is nationally balanced, ensuring, in that way, the equity of all nations from Bosnia and Herzegovina.

The State institutions of Bosnia and Herzegovina are in charge of the following fundamental economic responsibilities: monetary policy (carried out by the Central Bank which was established on August 11, 1997 and which acts as the currency board), foreign debt management and payment of foreign debt, foreign trade and customs policy. Other economic functions are mainly under the charge of the two Entities.

It is very important that peace has been implemented during the past 21 months, which has become now stable and sustainable. This has created the basic presumption for September elections which were held last year, as well as for the local elections which were held ten days ago, by which we finalized the process of establishing the democratic institutions on all levels of authority.

Although with some obstacles and delays, the institutions of Bosnia and Herzegovina have become operational. Namely, this refers to the Presidency of Bosnia and Herzegovina, the Parliamentary Assembly of Bosnia and Herzegovina, the Council of Ministers and recently established Central Bank.

In June 1997, a package of laws was adopted, among which the most important ones are the Law on the Central Bank of Bosnia and Herzegovina, Law on the Budget of Bosnia and Herzegovina, laws on foreign trade, customs tariffs and external debt of Bosnia and Herzegovina.

Industrial production, good market supply, stabilized prices, salaries and other indicators of economic progress in the Federation of Bosnia and Herzegovina point to constant improvement, and certain progress, although to less extent, has been registered in the Republika Srpska. It is estimated that the GDP rate in 1996 was 50%, but due to

the slow inflow of the international assistance this increase in GDP will be much lower in 1997.

Immediately after signing the Dayton agreement, Bosnia and Herzegovina became a member of the IMF, and, later, of the World Bank and EBRD.

Economy devastated by the war practically ruined the import capacity of the country. From a country which, before the war, had a continuity in payment surplus, Bosnia and Herzegovina has become a country with very high deficits on its current accounts. These deficits are mainly covered by the donations of the international community. Donors assistance has been mobilized for the needs of reconstruction by having three Donors conferences held in December 1995, March 1996 and July 1997, which were organized by the World Bank and EU.

A total program for the period of three-four years amounts to US\$ 5,1 billion. We got promises for 1996 in the amount of US\$ 1,8 billion, but up to now 2/3 of the commitments have been realized. The Donors Conference for 1997 was held with delay - we expected the commitments in the amount of US\$ 1,4 billion, but the finally promised amount is US\$ 1,1 billion. Bosnia and Herzegovina expects continuation in implementing the promises from the last year and beginning of realization of given commitments for this year.

The World Bank stands for a very efficient partner of Bosnia and Herzegovina, both in providing the technical assistance, organization and mobilization of the assistance from the large group of international donors and in approving a number of programs for reconstruction (18 programs), which have been successfully realized on the field. This programs cover almost all sectors: economy, infrastructure, education, health, housing, pensions, including the support to the reforms of macro economic policies.

Bosnia and Herzegovina has taken a part of the external debt of ex Yugoslavia with international financial institutions and it has started to service this debt regularly.

Both Entities have carried out quite solid fiscal policy. The Entities finance its public expenditures by relying on collection of their own revenues, and trying to avoid the borrowing of the domestic sector. It is very important to pay attention to constant increase of these revenues, which is the result of an increase of the economic activities and more efficient work of tax and customs administration. It is true that these revenues are not enough to fully finance extremely raised needs, specially those in social sector.

For three years on, monetary policy has been carried on by applying the currency board arrangement or by using foreign currencies. Monetary institutions have mainly avoided to credit the banking and private sector. The increase of the money during this period has been based on the inflow of foreign exchange currencies, either from the current inflows or international assistance.

An important success has been made in creation and work of the Central Bank of Bosnia and Herzegovina.

The Parliamentary Assembly of Bosnia and Herzegovina adopted the CBBH Law on June 20. That Law establishes the functions and governance architecture of the CBBH.

The CBBH is responsible for issuing the currency and monetary policy in BH. Its discretion in policy making is very limited during the first six years since the CBBH will operate as a currency board, that is domestic money (the KM) can only be issued in exchange for foreign exchange - in practice DM.

A corollary to this statement is that the CBBH cannot grant credit to anyone. This is a desirable feature for three reasons:

1. It guarantees that inflationary monetary expansion will not occur again,
2. It avoids the frequent need for politically sensitive decisions on monetary management; and
3. It strengthens the credibility of the new institution and supports public confidence in the new domestic currency.

The governance structure of the CBBH involves at the top Governing Board which is in charge of board policy making decisions, but without executive responsibilities. The Governing Board is headed by the Governor - during the first six years, a foreigner appointed by the IMF in consultations with the Presidency of BH. (The Dayton Accord spells out these details as well as others concerning the voting procedures within the Governing Board).

The Governor is also the Chief Executive Officer and in this capacity he is aided by three Vice-Governor appointed by the Governing Board.

Internal controls are carried out by a General Comptroller and three Deputies Comptrollers similarly appointed by the Governing Board.

The operations of the CBBH are to be carried out by a Head office which is located in Sarajevo and Pale, and by main Units of the CBBH located in Sarajevo, Mostar and Pale.

The Head Office consists of the Office of the Governor, the Office of the Comptroller General and three functional departments (Banking Services, Administration and Finance Services, and research.) These departments perform a coordination role with respect to the activities of the three main Units. They also carry out some decentralized functions, such executing the directives of the Governing Board with reference to the investment of foreign reserves, or provide statistical analysis of economic data and balance of payment projections.

Without getting into too much detail, the general picture is that the CBBH is a central bank with a decentralized approach to discharging its functions. This strategy is both workable and realistic in light of the current situation in Bosnia and Herzegovina.

Of course, the CBBH has jurisdiction only in KM transactions, for example it sets (remunerated) reserve requirements against KM deposits in the banking system Other foreign currencies continue to be used in Bosnia and Herzegovina, although the Presidency of BH and the Governments of the two entities - the Federation of BH and the Republika Srpska - will take active steps to encourage the use of KM, e.g. in the State and Entity budgets.

Unlike other central banks, the CBBH is not directly involved in banking supervision, which is the responsibility of the Entity-level banking Agencies. The CBBH law however does call for a coordination role of the CBBH to ensure a harmonized supervision framework throughout Bosnia and Herzegovina.

The CBBH stands ready to convert on demand KM for DM and vice versa at a 1 for 1 fixed rate. Thus, the exchange rate regime of Bosnia and Herzegovina is completely liberal: there is guaranteed, unrestricted convertibility of the KM for both current account (=export, import, transfers and interest payments) and capital account (=foreign investment and debt servicing) transactions.

The CBBH started operations on a limited scale on August 11, 1997, as required by the Law. In this initial phase, the CBBH has taken over from the previous central bank, the NBBH, all and only the monetary liabilities that the CBBH Law allowed it to take over, namely Bosnian dinars in circulation and deposits of commercial banks at the NBBH. These have all been converted into the new monetary unit, the KM, and fully backed by liquid DM assets. The NBBH and the NBRS have ceased to act as central banks.

Banks that used to do business in Bosnian dinars now transact in KM and settlements among them occur daily in the books of the CBBH. This has required substantial coordination with the Payment Bureau in what was the Bosnian dinar area.

A Main Unit has also been open in Pale and Research Department of the CBBH - which is located there - is in the process of becoming operational.

I. What remains to be done

Among the many tasks ahead to improve the operations of the CBBH three stand out.

First, the geographical area where KM transactions are routine must be enlarged. This requires:

1. Passing appropriate legislation to allow such transactions that now are not permitted under the current Payment System law;
2. Establish the Main Unit in Mostar.

Both tasks have a political dimension that renders them complicate - but not impossible.

Second, while the KM exists for now only as a means of non-cash payment (=electronic money), we need to introduce banknote. These notes will be called Kupons and will bear different Entity design variants (one for each Entity) although they will be legal tender throughout Bosnia and Herzegovina.

The choice of the design has been a complicated political issue in the hands of the Presidency of Bosnia and Herzegovina. Some progress is being made on this front and that a resolution may be near.

Finally, the NBBH will have to be liquidated. This will require bold action on the part of Federation, since in the past the NBBH has acted as a Federation Central bank - to a limit extent - a provider of credit to public institutions in part of the Federation.

Similarly, the NBRS transformation into a different financial institution - mostly specializing in Yugoslav dinar transactions - will have to be completed.

II. Conclusions

The fact that the CBBH has successfully been established is a remarkable accomplishment. It has required the cooperation of all parties involved and it shows that this cooperation has been possible.

As the CBBH expands its range of operations, the benefits of the new monetary regime will appear. It is expected that trade will be promoted both internationally and between the Entities, This will be a key factor in promoting economic recovery and lasting peace.

Peace is a definite orientation of Bosnia and Herzegovina and with the support of the international community we are ready to build and keep peace on a long term basis. At the same time, Bosnia and Herzegovina is fully aware that peace keeping is directly dependent on its successful economic recovery and prosperity. The chances for the economic recovery and opening the new roads leading to prosperity depend on:

- efficient building of the economic system based on transition to market economy without delays, rapid process of privatization, and creation of the necessary atmosphere for private investments,
- more efficient and rapid work of the institutions both of Bosnia and Herzegovina and two Entities and their mutual cooperation in the process of realization of the comprehensive economic program,
- scope and dynamics of international economic assistance inflow and private investment.

The key problem in Bosnia and Herzegovina is employment which can be only solved through economic reconstruction and economic growth. Therefore, the basic middle-term strategy in economics has to be based on stable macro economic policies, implementation and functioning of public and market institutions, entering the structural reforms and reconstruction of housing and infrastructure.

The solid ground for such a strategy is in:

1. using the fixed exchange rate and currency board arrangement,
2. financial discipline, primarily in preventing the State, Entities, and other levels of the authority to borrow from the domestic sector,
3. continuity in receiving the international assistance on broad basis and on good conditions.

The real increase of GDP in 1997 is estimated to 35%. Available domestic resources, supported by the international community and private foreign capital investments, especially into small and medium enterprises which will have a dominant role in realization of the program goals. The Central Bank of Bosnia and Herzegovina will, very soon, become fully operational and as we believe, it will be able to issue the new domestic currency. Further strengthening of the financial institutions will continue, which will help to make sustainable financial policy. Social protection for the most vulnerable categories and creation of the appropriate social programs is of high priority for us, and this will be a special concern of the Entity governments.

At the beginning, structural macro economic reforms will be directed to customs tariffs and further liberalization of trade, restructuring and privatization of enterprises and banks - on which certain legislature has already been adopted, while some of the laws have been submitted to the Parliament for their consideration and adoption, education, health, pension system reforms, and so on.

During the coming months, we will continue our very successful cooperation with the IMF and WB staff, as well as with the other institutions aimed to work out and finalize the comprehensive program of macroeconomics reforms which are necessary for the process of transition into market economy.

We expect that very soon we will be able to have the IMF arrangement, probably Stand by, as the support to our economic program, which could be transformed into ESAF during the first half of the next year, if the implementation of Stand by arrangement goes well.

The needs for the reconstruction, social program, and transition to market economy have to be consistent with the monetary and foreign exchange policy (currency board arrangement). All the budgets have to be balanced, relying only on their own, regular revenues, without domestic borrowing. Fiscal policy should be in the function of reconstruction and employment. Transition to fiscal reforms (fiscal federalism) and further strengthening of tax and customs administration in the Entities.

The budget of Bosnia and Herzegovina has been adopted in the amount of DM 136 million. The amount of DM 45 million will be allocated for the needs of administration, and DM 91 million is meant to service the external debt.

The Entities are in charge of financing the administration proportionally, that is, 2/3 will be financed by the Federation, and 1/3 of the resources will be financed by the Republika Srpska. Furthermore, foreign debt servicing will be allocated to the Entities, applying the criteria of the final user.

There is an office in the relevant Ministry which is in charge of external debt management.

The essential problem of the State budget is that the State of Bosnia and Herzegovina is responsible for its international obligations, and the whole fiscal capacity, according to the current fiscal arrangement, is within the Entities. We have been considering this problem together with the international financial institutions and in line with the Dayton treaty, trying to find the possibility of ensuring the regular revenues for the budget of Bosnia and Herzegovina.

Fiscal system in the Federation of Bosnia and Herzegovina and Republika Srpska is relatively good organized. The institutions of the fiscal sector have been established and they function in an acceptable way, the elements from the dual system have been liquidated, and the revenues that belong to the different levels of authorities have been separated. The expenditures are also separated with clear distinction what is financed out of each budget, no matter whether that financing refers to administration expenditures, health financing, financing of education or social programs.

In relation to this, a special attentions should be paid to the control of incoming and outcoming of goods on crossing borders, fight against gray economy and corruption and putting of all public financial courses under the strict control.