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Bosnia and Herzegovina – Meeting Copenhagen economic criteria for accession to the EU

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List of acronyms and abbreviations

A&S	Albania and Serbia
BH	Bosnia and Herzegovina
BHAS	Bosnia and Herzegovina Agency for Statistics
BIRS	Stock Exchange Index of the Republika Srpska
BLSE	The Banja Luka Stock Exchange
BRCMT	Bulgaria, Romania, Croatia, Former Yugoslav Republic of Macedonia, Turkey
CBBH	Central Bank of Bosnia and Herzegovina
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
DPA	Dayton Peace Accord
EBIT	Earnings before taxation
EU	European Union
FBH	Federation of Bosnia and Herzegovina (BH entity)
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GFS	Government Finance Statistics
HDI	Human Development Index
IFS	International Financial Statistics
KM	Convertible Mark
MoF	Ministry of Finance
MTDS	Mid-Term Development Strategy
NEER	Nominal Effective Exchange Rate
NMS8	Eighth New Member States (Poland, Czech Republic, Slovak Republic, Hungary, Lithuania, Latvia, Estonia, Slovenia)
NOE	Non-Observed Economy
PIFs	Privatisation Investment Funds
PPP	Purchasing Power Parity
REER	Real Effective Exchange Rate
ROA	Return on assets
ROE	Return on Equity
RS	Republika Srpska (BH entity)
SAA	Stabilization and Association Agreement
SAP	Stabilization and Association Process
SEE	South Eastern Europe
SME	Small and Medium Size Enterprises
SSE	The Sarajevo Stock Exchange

Introduction

Delegation of the European Commission based in Sarajevo, Bosnia and Herzegovina (BH) granted the consortium represented by ECORYS a contract for EU support to the Economic Policy Research Unit, a subdivision of the Economic Policy Planning Unit of the Council of Ministers of Bosnia and Herzegovina. As part of this project activities a subproject was designed trying to assess the position of BH against the benchmarks of the Copenhagen economic criteria and to identify policy measures for meeting the criteria. The issues of particular relevance to the project included: presentation of the Copenhagen economic criteria, analysis of the existing situation in the country, strategic and policy documents addressing the subject, identification of gaps to be filled in order to achieve the benchmark, and policy recommendations. In July, 2006 ECORYS appointed the Center for Social and Economic Research (CASE), an international, non-profit research and advisory institution, to research on the subject. The research project team comprised experts: Messrs. Rafał Antczak (team leader), Wojciech Paczyński, and Ranko Markuš, Mmes. Małgorzata Antczak and Karina Kostrzewa, assisted by Mr. Erol Mujanovic.

The report was based on available national account and microeconomic data, strategic and policy documents of the BH governmental bodies, relevant reports by international organisations, EU institutions, academic and research centres and opinions of key stakeholders. The analytical research on the economic developments in BH by international financial institutions, especially the IMF and World Bank, as well as domestic bodies, especially the Economic Policy Research Unit, was extensively exploited in the research. However, the primary focus of the research was on structural and institutional aspects facilitating or impeding functioning of a market economy in the BH and country's capacity to cope with competitive pressure and market forces within the EU. Therefore, the report focuses on background analysis of economic factors influencing the functioning of market economy and the capacity to withstand the competition in the EU market.

The research consists of four main parts. In Part 1, the Copenhagen economic criteria are presented in a comparative perspective of the recent experiences of the new member states and acceding countries to allow diagnosing of the most important gaps to be filled by BH. Part 2 analyses macroeconomic developments in BH, presenting them in a comparative perspective relative to EU candidate countries. The special focus is on two fields where BH faces particularly difficult challenges: labour market and foreign trade. Also, the three scenarios of BH catching-up with the EU are presented. Privatisation process which is one of the most important institutional and structural features of every transition economy and especially relevant from the perspective of meeting the Copenhagen criteria is analysed in Part 3. Part 4 comprises analysis of microeconomic developments in BH with the elements of the financial analysis of enterprises, both state and private. The financial analysis of enterprises concentrates on current situation and identification of trends in microeconomic developments to identify comparative advantages, assess productivity, and to position the BH enterprise sector towards the potential competition on the EU markets. Finally, Part 5 includes policy recommendations for decision makers both from the BH government and the EC. The research is supplemented by the Annexes providing background pieces of information on the analysed topics.

The project team established contacts with representatives of international organizations, the BH governmental bodies, and research community in BH to collect pieces of information and consult on research topics. However, the authors of the researchers bear the sole responsibility for the pieces of information and opinions presented in the report.

1. The Economic Copenhagen Criteria

The basic conditions for enlargement of the European Union are laid out in article 49 of the EC Treaty, which stipulates that "any European state may apply to become a member of the Union. It shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the assent of the European Parliament (...)". In principle, the only material condition relating to the accession of a new state to the European Union is that the applicant is a "European state". The term "European" has not been officially defined. It is therefore interpreted in terms of geography, culture and history. These are the factors that are believed to contribute to the forging of a European identity which formed the basis for the past waves of EU enlargements. However, once the former communist countries from Central and Eastern Europe expressed their intentions to become member states, the EU had to identify the political and economic values common to all "European countries".

The conditions that pre-accession candidates have to fulfil are specified in the European Commission report from 1993 entitled "Europe and the challenge of enlargement". They were made formal by the member states at the Copenhagen European Council[1] in June 1993. The Council concluded that "the associated countries in Central and Eastern Europe that so desire shall become members of the Union". Accession could take place as soon as an applicant was able to "assume the obligations of membership by satisfying the economic and political conditions". Member states also set out the qualifying criteria for EU membership, the so-called Copenhagen criteria. According to the conclusions of the Copenhagen summit, the EU membership requires:

1. The achievement of stable institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities (political criterion);
2. The existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union (economic criterion);
3. The ability to take on the obligations of membership, that is to adopt the common rules, standards and policies that make up the body of EU law, including adherence to the aims of political, economic and monetary union (acquis criterion).

[1] Conclusions of the Presidency, European Council, Copenhagen, 21-22 June, 1993, SN 180/93.

Even with the briefest of analyses it is noticeable that the Copenhagen criteria are formulated in a very general way. This may suggest that it will be easier to fulfil them, as compared to the Maastricht criteria that are defined in terms of strict economic indices. On the other hand, the way the Copenhagen criteria allow various interpretations and might be employed to postpone any particular EU enlargement even if reforms are advanced and the requirements have been fulfilled by the applicant countries. It is worth remembering that the EU has the right to revise and change accession conditions. Although there is a single common aim of enlargement for both applicant and member states, there is no doubt that members of the EU have the final word on any particular enlargement process.

There are a number of interpretation problems[2] with the Copenhagen criteria. First of all, *the cr*iteria are formulated in such a way that they are considered to be a "moving target problem", i.e. meeting the accession conditions is made more difficult because their specific content keeps changing. This perception tends to generate frustration in the candidate states and further suspicions about the EU's commitment to enlargement in general and a transparent criteria-based approach in particular. Partly, this problem arises from the development of and amendments to the acquis itself. However, the large scope of the accession conditions has also allowed the EU to stress different issues at different times for the candidates. Particularly, over a long accession process amid rapidly changing conditions – and when the EU is engaged in a steep learning process related to its future members – flexibility has considerable advantages. There may be a political rationale for focusing on key demands early in the process so as not to discourage candidates before moving on to more challenging requirements for more advanced applicants.

Furthermore, a measurement problem arises. Many of the requirements falling both under political and economic criteria are difficult to measure in any objective sense. Where quantitative measures may be available for assessment under the political criterion, the EU has chosen not to develop or use them. No strict quantitative minimum is also established for economic criteria to enter the EU. The application of conditionality is not transparent and consistent.

Another issue is the consistency problem. This applies to the way in which the EU has linked membership conditions to progress in accession, between both enlargement "waves" – the southern enlargement of the 1980s and the 2004 enlargement. In particular, whereas the EU has made the minority rights issue a key reason not to open accession negotiations with Turkey for a long time, some have contended that the minority rights question is far from being resolved in Estonia or Latvia. Apart from the possibility that inconsistency could undermine the system of

[2] "Assessing the Accession Criteria", report from workshop: Political Dimensions of the Accession Criteria, European Research Institute, University of Birmingham, 30 November 2002.

conditionality in general, there is a risk of uneven use of conditionality in the case of the Balkan states.

The sufficiency problem is also specific to the Copenhagen criteria. A particular aspect of the consistency issue is the question of the minimum degree of fulfilment of the criteria necessary and sufficient for the attainment of each stage in the accession process, especially accession itself. There is no need to mention that the scale of the requirements is changing, i.e. there was a general agreement that the Helsinki 1999 summit decision represented the key shift away from the previous practice that the political criterion had to be fully satisfied before accession negotiations could begin, as demonstrated in the 1997 Luxembourg Council's decision to exclude Slovakia from initial accession talks. This is a problem of establishing minimum sufficient entry conditions.

These issues all relate to the three criteria set for candidate countries. However, apart from the fulfilment of accession conditions, other sets of considerations might be well regarded as legitimate factors in enlargement decisions, such as WTO, Council of Europe or OSCE membership.

It is worth mentioning that from the EU side, the Copenhagen criteria are considered an instrument encouraging further transformation and democratisation processes. Through the progressive development and deployment of accession conditionality, the EU is effectively using the prospect of membership as its main foreign policy instrument in its immediate backyard. However, where the reforms in aspirant states face difficulties, it can be argued that an early "reward", such as progress through the accession process even where conditions have not been satisfactorily fulfilled, can benefit reformers. Although there is the counter-argument that an even more rigid adherence to conditionality will in fact yield greater reform results. Either way, enlargement decisions can become prospective tools for influencing the domestic balance of forces, rather than retrospective reflections on fulfilment of conditionality.

1.1. Benchmark Selection for Bosnia and Herzegovina

To set the stage for further discussion it seems necessary to compare past and present economic indicators of BH with NMS8 of the EU that joined in 2004 (Poland, Czech Republic, Slovakia, Hung*ary, Lithuania, Latvia, Estonia, Slovenia)* and with the group of countries with formal candidate status in 2006 (Turkey, Croatia, Former Yugoslav Republic of Macedonia and the two acceding countries Bulgaria and Romania), as well as other economies in the South Eastern Europe (SEE) region.

However, before proceeding with analysis on recent developments and discussion on the medium-term prospects it may be useful to take a historical perspective and check how BH compared to other European countries at the beginning of 20th century (Table 1). This confirms that a century ago BH was at the similar development level as Italy, and ahead of Greece for example. It lagged somewhat behind Central European countries, such as Austria and Hungary, but the gap was not dramatic. This could be viewed as an indication that divergence and convergence in levels of economic developments may take place in relatively short periods; a few decades can make a major difference.

Table 1: National product per capita in selected European countries in 1910 (1970 US$)

Germany	958	**Bosnia**	**546**
Austria	810	Croatia	542
Czech lands	819	Serbia	462
Hungary	616	Greece	455
Italy	546	Russia	398

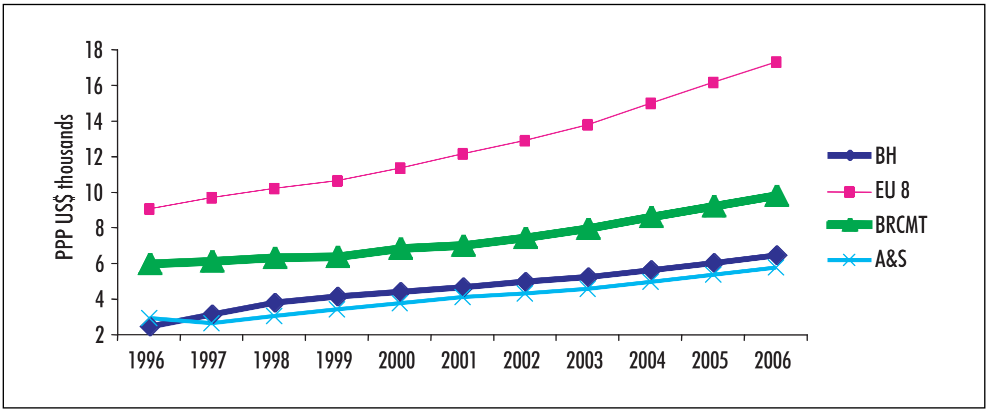
Source: Palairet (1997), cited in Gligorov (2002).

Judging by current GDP per capita levels and changes in these levels over the past decade, BH today is at a stage comparable to those of the five current candidate and accession countries (Bulgaria, Romania, Croatia, the Former Yugoslav Republic of Macedonia and Turkey – BRCMT) roughly a decade ago (Figure 1). On the other hand, NMS8 had a visibly higher average GDP per capita back in 1996 (in fact, even in 1993) than BH in 2005-2006. Among this group of countries only 1997-1998 Latvian GDP per capita was comparable to the 2005-2006 BH level. However, the gap to Bulgaria and Romania (joining the EU in January 2007) is visibly smaller – BH's 2005-2006 GDP per capita level is comparable to Bulgaria and Romania in 2000-2001 (i.e. 5-6 years before accession). BH's development level (as proxied by GDP per capita) is comparable to other Balkan countries that have not yet started negotiations on EU accession (Albania and Serbia[3]).

In terms of speed of convergence, BH recorded very high growth rates just after the war, although these can be attributed to post-conflict reconstruction activities. Growth rates after 2000 appear to be more in line with BH's current growth potential. Here, one can observe that BH has experienced similar GDP per capita growth rates as is also the case for the NMS8 or BRCMT and A&S groups. Over the period 2000-2006 BH recorded average annual growth rates of around 6.6% per annum, while for the three comparative groups this oscillated between 6.2% and 7.3%[4]. This indicates

[3] Historical data for Montenegro are not available from the IMF. The *de facto* economic partition of Serbia an Montenegro has had a negative impact on the quality of economic data for the country. The development level o

Figure 1: GDP per capita: Bosnia and Herzegovina compared with other groups of countries (in US$ thousands at PPP exchange rates)



Note: Simple averages are presented for all country groupings: NMS8 – the eight countries that joined the EU in 2004; BRCMT - Bulgaria, Romania, Croatia, Macedonia and Turkey; A&S – Albania and Serbia. 2006 values are the IMF forecasts.
Source: IMF, World Economic Outlook database, September 2006.

that while BH has been recently catching up with the more developed EU countries (for example the EU15 group), there was hardly any convergence, even a divergence, with other European economies – NMS8 and the Balkan accession and candidate countries. Given its very low development level, its human capital and other characteristics and the experience of other transition economies it would appear that BH might be able to boost its potential economic growth to higher levels. The key to improving development potential lies in domestic reforms.

1.1.1. The Issues of Measurement

The Dayton Peace Accord (DPA) implicitly gave responsibility for statistical functions to both the Federation of Bosnia and Herzegovina and Republika Srpska and in August 1998 the state created its own statistical institute, the Bosnia and Herzegovina Agency for Statistics (BHAS), with a view to compiling country-wide statistics in accordance with internationally accepted methodologies and acting as the primary coordinating agency for contacts with international agencies. Significant technical assistance has been provided in recent years, mainly by the European Union and the IMF, in the development of all areas of macroeconomic statistics. However, the results of compilation of FBH and RS statistics and the technical assistance have

[4] Other measures of GDP per capita could produce slightly different results but are unlikely to change the qualitative assessment presented in this and previous paragraphs. Eurostat does not currently publish GDP per capita expressed in PPS for Bosnia and Herzegovina.

been mixed. Both have published nominal GDP estimates using the production approach based on international standards, since 1998 and 1999, respectively. However, in both cases, production estimates at constant prices and GDP by expenditure are still unavailable and informal sector activities are under-recorded (see below). A household budget survey (serving as the basis for revising price indices and facilitating the compilation of GDP by the expenditure approach) has been completed. However, there are still no meaningful short-term business and consumer surveys. Both statistical offices compile price indices using outdated methodologies and consistent time series are not available. Industrial production indices are prepared in both FBH and RS but there is no index at the country level and consistent time series are not available. Labour statistics are the weakest area and data on employment, unemployment and wage rates are based on deficient methodologies.

The quality of trade and the balance of payments data published by the BHAS and Central Bank of Bosnia and Herzegovina (CBBH) is generally poor, in particular with regard to coverage both of current and capital account positions, especially foreign grants, employees' remittances, income residents receive from working for international organisations in BH and spending by their non-resident staff, as well as trade credit by suppliers.

The CBBH, in accord with both finance ministers and governments, has been working on compiling Government Finance Statistics (GFS) on a countrywide basis. In 2005, Bosnia reported GFS for the first time for publication in the Government Finance Statistics Yearbook covering central government operations for 2003 and 2004.

Probably the most reliable statistics at the national level are the monetary accounts by the CBBH reported on both a countrywide and individual territorial unit basis. Weighted average interest rate data for bank deposits and loans are available from January 2002 onward for publication in the International Financial Statistics (IFS)[5].

National accounts data for BH are not adjusted for the non-observed economy (NOE)[6] in contrast to EU countries, including NMS8 and countries of the Commonwealth of Independent States (CIS). The adjustments for the NOE are significant and range from 12% of the observed economy for the NMS8 to over 30% for the CIS. A number of studies have estimated the NOE for BH: an OECD report estimated it from 57.7% to 52.6% of officially estimated GDP during 2001-2003[7], while an IMF report based on regression analysis estimated it at 30% of official GDP[8].

[5] IMF, 2006, *Country Report No. 06/371*.

[6] The NOE comprises underground, informal and illegal production according to OECD methodology – see, *Handbook for Measurement of the Non-Observed Economy, 2004*.

[7] Dell'Anno, Roberto and Marje Piirisild, 2004, *Estimates of the Non-Observed Economy in Bosnia and Herzegovina*, OECD.

[8] IMF, 2005, *Selected Issues*, Report 05/158.

Therefore, ratios to GDP – important comparative and informative indicators for any economy, may appear less accurate for BH than for any other EU country[9].

In 2005-2006, BH presented a similar level of GDP per capita PPP as Lithuania and Latvia in 1996-1997 and Bulgaria and Romania in 2000-2001, which in both cases was 7 years before accession to the EU, respectively in 2004 and in 2007 (compare the shaded cells in). A "conservative" 30% adjustment for the NOE would obviously improve the benchmark level for BH and situate the country at the level of NMS 2-3 years before EU accession.

Table 2: GDP per capita PPP in accession countries, 1995-2006 (US$)

	1995	**1997**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
BH	n/a	**3 149**	**4 137**	**4 394**	**4 673**	**4 969**	**5 232**	**5 631**	**6 035**	**6 456**
Slovenia	12 391	13 973	15 658	16 604	17 423	18 307	19 137	20 537	21 808	23 159
Malta	13 263	14 761	16 136	18 017	18 253	18 667	18 555	19 100	19 739	20 365
Czech	12 041	12 943	13 226	13 968	14 750	15 266	16 074	17 220	18 341	19 428
Hungary	9 322	10 267	11 555	12 460	13 277	14 016	14 769	15 838	16 823	17 821
Estonia	6 831	8 453	9 260	10 258	11 225	12 300	13 440	14 926	16 414	17 802
Lithuania	6 172	7 440	8 164	8 699	9 544	10 401	11 685	12 856	14 158	15 443
Latvia	5 121	6 098	6 895	7 600	8 452	9 226	10 177	11 396	12 666	13 875
Poland	7 128	8 346	9 340	9 914	10 384	10 719	11 359	12 293	12 994	13 797
Slovakia	8 870	10 165	10 985	11 453	12 161	12 934	13 775	14 904	16 041	17 239
Croatia	6 957	7 940	8 310	9 079	9 587	10 249	10 907	11 626	12 325	13 062
Bulgaria	5 724	5 234	5 791	6 278	6 736	7 238	7 756	8 464	9 223	10 003
Romania	5 550	5 676	5 531	5 799	6 306	6 769	7 291	8 132	8 785	9 446
Macedonia	5 394	5 677	6 225	6 623	6 454	6 608	6 962	7 302	7 748	8 175
Turkey	5 281	6 145	6 074	6 364	5 928	6 407	6 807	7 494	7 950	8 385
Albania	2 670	2 665	3 435	3 754	4 115	4 300	4 622	4 997	5 405	5 818
Serbia	n/a	n/a	n/a	3 795	4 105	4 341	4 543	4 992	5 348	5 713

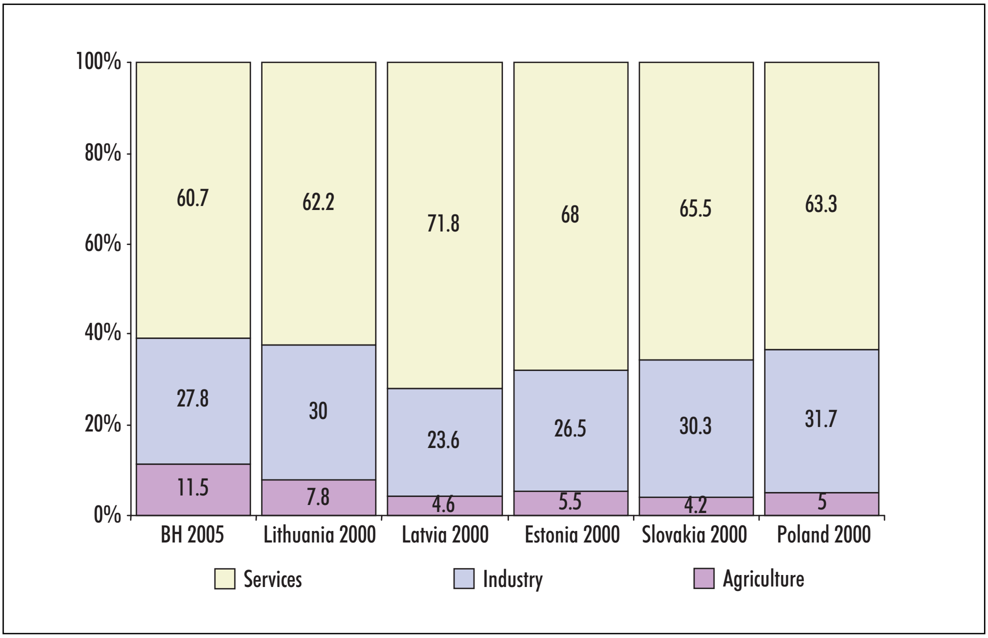
Note: 2006 values are the IMF forecasts.
Source: IMF WEO database, September 2006.

Lithuania and Latvia may set the proper benchmark for BH across several other economic and political aspects. Both Lithuania and Latvia and BH faced a difficult external situation at the beginning of their transitions, including the collapse of the political system, trade flows, and complicated relations with their neighbours – Russia and Serbia, respectively. On the other hand, the economies of Lithuania and Latvia and BH were gravitating economically and politically towards the prosperous EU, which became a neighbour. The similar exchange rate regimes (currency board arrangements) of Lithuania and Latvia and BH make possible comparison of the conditions for economic policy, including monetary policy, fiscal policy and foreign trade. There are also other similarities between Lithuania and Latvia and BH, including population size, level of social security contributions (35% of the gross wage), and the significant size of

[9] World Bank, 2006, *Bosnia and Herzegovina: Addressing Fiscal Challenges and Enhancing Growth Prospects. A Public Expenditure and Institutional Review*, Report No. 36156-BiH.

NOE. Similarly to NMS8 (notably Lithuania, Latvia, Slovakia and Poland) at the beginning of the transition, the structure of the industrial sector in BH was dominated by a small number of large companies and a weak SME sector. The level of economic freedom in Lithuania and Latvia (as well as in Poland and Slovakia) in 1999 and BH – now – also seems comparable. Finally, bearing in mind the conflicts in BH, which devastated economic activity (especially production of higher value added goods and services) BH's structure of output in 2005 is similar to the majority of NMS8 in 2000.

Figure 2: Value added by sector (as a percentage of GDP)



Source: IMF WEO database, September 2006.

The GDP per capita is not the only comparative and informative indicator for an economy. The human development index published in the Human Development Report looks beyond GDP to a broader definition of well-being. The HDI provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary level) and having a decent standard of living (measured by purchasing power parity income). However, the index is not in any sense a comprehensive measure of human development and it does not, for example, include important indicators such as inequality, respect for human rights or political freedoms. What it does provide is a broadened prism for viewing human progress and the complex relationship between income and well-being.

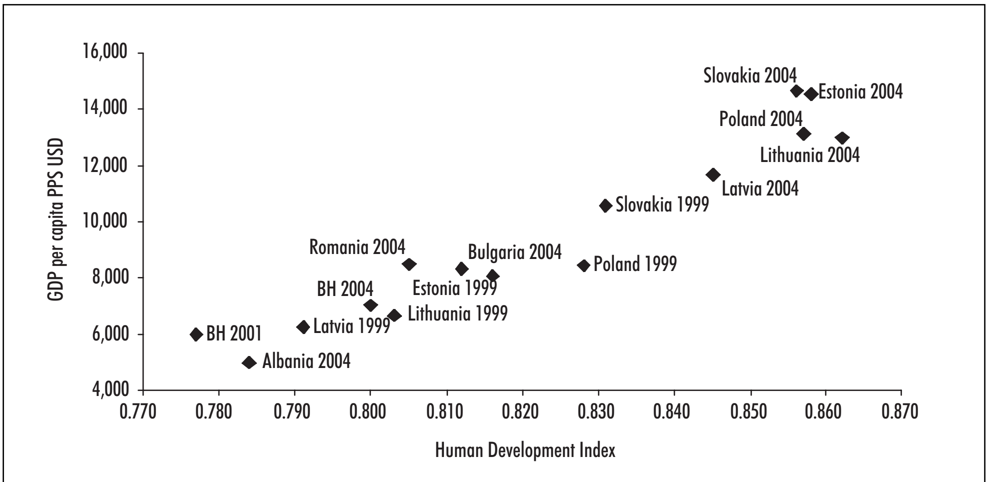
Table 3: Human development index 2004

	HDI		Life expectancy at birth		Adult literacy		Combined primary secondary and tertiary gross enrolment ratio		GDP per capita	
	rank	value	rank	years	rank	(% ages 15 and older)	rank	%	rank	PPP USD
Poland	37	0.862	45	74.6	.	.	38	86.0	48	12974
Lithuania	41	0.857	66	72.5	6	99.6	20	91.8	47	13107
Estonia	40	0.858	75	71.6	4	99.8	21	91.6	44	14555.0
Slovakia	42	0.856	50	74.3	2	100.0	64	76.7	43	14623
Croatia	44	0.846	42	75.2	21	98.1	84	73.5	51	12191
Latvia	45	0.845	73	71.8	5	92.6	24	90.1	54	11653
Bulgaria	54	0.816	67	72.4	20	98.2	52	80.9	66	8078
Romania	60	0.805	78	71.5	26	97.3	74	75.3	63	8480
BH	**62**	**0.800**	**49**	**74.3**	**31**	**96.7**	**111**	**67.3**	**78**	**7032**
Albania	73	0.784	53	73.9	16	98.7	109	68.0	97	4978

Source: Human Development Report, 2006.

In 2004, BH presented a similar level of human development as Lithuania and Latvia in 1999, which was 5 years before these two countries joined the EU (see Table 3 and Figure 3). The progress in human development in BH was noticeable comparing HDI in 2001 and 2004. However, during 1999-2004, just before the EU accession Lithuania and Latvia (together with Estonia) achieved a very substantial progress in development that resulted from a broadening and deepening of economic reforms. The Baltic countries were the first countries from NMS8 that finalised accession negotiations with the EU. Following the case of the Baltic countries by BH would require not only designing of broad scale economic and political reform agenda, but most of all fast and comprehensive implementation of these reforms.

Figure 3: HDI and GDP per capita in selected countries in 1999-2004



Source: Human Development Reports 2001-2006, UNDP

1.2. Interpretation of the Economic Copenhagen Criteria

The EU established a twofold set of economic criteria to examine the economic readiness for membership of an applicant country. It requires the candidate to have:

- a functioning market economy;
- the capacity to be competitive on the EU market.

The former requires the functioning of a viable market economy, with free and open competition, price and trade liberalisation and a developed financial services sector. The latter consists of two dimensions of the environment of competitiveness according to the definition recognised by the European Commission, namely that enterprises are obliged to develop their ability to cope with competitive pressures and forces in the European Union's internal market, as well as the whole economy of the applicant country compared to the economies of EU members.

These sub-criteria are linked. Firstly, only a functioning market economy will be better able to cope with competitive pressure. Secondly, in the EU, the functioning market is the internal market. Without integration with the internal market, EU membership would lose its economic significance, both for the applicant country and for its partners. The adoption of the *acquis communautaire,* which is the third Copenhagen criterion, and in particular the internal market *acquis*, is therefore essential for a candidate country, which must commit itself permanently to the economic obligations of membership. This commitment is needed to provide the certainty that every part of the enlarged EU market will continue to operate by common rules. At the level of the public authorities, membership of the EU requires the administrative and legal capacity to transpose and implement the wide range of technical legislation needed to remove obstacles to freedom of movement within the Union and so ensure the working of the single market. At the level of individual firms, the impact on their competitiveness of adopting the *acquis* depends on their capacity to adapt to the new economic environment.

Despite the exclusive right of the EU member states to a free interpretation of the criteria, the definition of a free market economy is essentially based on concrete indicators taken into account by the European Commission[10] such as:

- overall assessment of the transformation process, including privatisation progress, the role of the state in the economy and economic structure;
- liberalisation of prices and external liberalisation (elimination of all trade barriers; complete convertibility of the national currency);

[10] "Agenda 2000 communication, volume I: for wider and stronger Union", European Commission, Strasbourg, 15 July 1997, DOC/97/6.

- establishment of a sound legal system and institutional infrastructure of the market, including the regulation of property rights, absence of significant barriers to market entries (the establishment of new companies) and exits (bankruptcies and liquidations) and free competition;
- macroeconomic stability (i.e. stabilisation of prices, reducing inflation, GDP growth, FDI inflows, foreign trade, sustainable public finance);
- broad consensus about the fundamentals of economic policy;
- a well-developed financial sector to channel savings towards productive investment.

The existence of a market economy requires that equilibrium between supply and demand is established by the free interplay of market forces. In particular, the existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus on economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

According to the European Commission the capacity to cope with competitive pressure and market forces within the Union requires:

- a stable macroeconomic framework, but allowing economic agents to make decisions in a climate of predictability;
- a sufficient amount, at appropriate costs, of human and physical capital, including infrastructure, education and research, and future developments in this field;
- the extent to which government policy and legislation influence competitiveness through trade policy, competition policy, state aids, support for SMEs, etc.;
- the proportion of small firms in the economy, partly because small firms tend to benefit more from improved market access, and partly because a dominance of large firms could indicate a greater reluctance to adjust;
- the degree and the pace of trade integration a country achieves with the Union before enlargement. This applies both to the volume and the nature of goods already traded with member states. According to the Commission an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union before accession;
- State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to

outside finance and the more successful they are at restructuring and innovating, the greater their capacity will be to adapt.

1.2.1. Tracking Points in the Process of Candidates States Fulfilling the Economic Criteria

This part analyses the economic criteria for EU membership and evaluates the conditions for their fulfilment. It also deciphers the economic criteria, looking in detail into the economic sub-criteria, explaining the important elements of each and their role in the overall preparation of the candidate countries for EU membership. Reviews of the evaluation of the economic criteria within a certain timeframe are then presented. The key stance here is the "Opinion[11] on potential candidates" provided by the European Commission.

Analysis covers the period up to the year when Progress Reports[12] positively assessed the fulfilment of the economic criteria of the candidate countries and qualified them as ready to eventually become members of the EU (as in the case of Poland, Lithuania and Romania). Croatia and BH are analysed up till present (2006). Within this timeframe we have attempted to point out the steps, both in terms of the achievements and weaknesses of the analysed countries in the area of economic sub-criteria. For examination purposes, we have chosen Poland, Romania, Lithuania and Croatia as benchmarks for BH, taking into account their record, progress in economic transformation, and other characteristics (see Benchmark Selection for Bosnia and Herzegovina).

The preconditions of the economic sub-criteria should not be regarded as a simple checklist. It is the interplay and interaction of all the conditions and their mutually reinforcing effects on the economy that are pertinent. There is also an important time dimension involved here; meeting the economic criteria requires, certainly in the case of transition economies, deep and lasting structural reforms that take time to be accomplished. The issue of track record, which was one of the factors considered by the European Commission, becomes then highly relevant. In this context, track record means the irreversible, sustained and verifiable implementation of reforms and policies over a period long enough to allow for a permanent change in the expectations and behaviour of economic agents and the assessment that the achievements will be lasting.

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[11] French: *Avis*; regarding Opinions on Poland's, Lithuania's, Romania's and Croatia's EU Membership Applications".

[12] See the list of Regular Reports and Progress Reports in the references to the report.

Regarding the economic criteria, the Commission follows the same methodology in each Opinion and Regular Report on candidate countries. Opinions contain the first assessment of the candidate countries with respect to the criteria set by the European Council in 1993 and methodology implied by the European Commission in Agenda 2000[13]. The method used in preparing the Opinions is to analyse the situation in each candidate country in the medium term perspective, taking into account progress accomplished and reforms already under way. The Commission then examines progress achieved during each year in order to arrive at an evaluation of the total achievement. In other words, in contrast to the Avis, which examined all Copenhagen criteria in detail and looked at developments over several years in order to assess readiness for accession, the annual Progress Reports focus on those areas where some improvements could still be made and on the economic developments of the last twelve months, using the previous year's assessment as a base.

In Agenda 2000 the Commission sets out its methodology for assessing the Copenhagen economic criteria, although not including any quantitative benchmarks, together with detailed Opinions (Avis) on each of the future candidate countries[14]. We may assume that the sub-criterion for the existence of a market economy has to be met to gain acceptance to join the EU, whereas the second criterion – the capacity to withstand competitive pressures and market forces within the Union – must be met after accession. The necessary evaluation of the latter is more difficult than for the first sub-criterion. Taking into account Commission understanding it is assessed on the basis of the following factors: on the one hand, a comprehensive view needs to be taken including a considerable number of factors and on the other hand, an assessment of future developments needs to be made. A key question is whether firms have the necessary capacity to adapt, and whether their environment supports further adaptation.

In this part of the report we want to present the economic situation of Poland, Lithuania, Romania and Croatia in a year when, for the first time, the evaluation according to Copenhagen criteria was made to show the stage of advancement when comparing to the BH case. The table represents the benchmark analysis of economic criteria fulfilment and main obstacles according to specific country assessment of the European Commission included in Opinions. None of the applicant countries fully met the two economic conditions of Copenhagen at its first assessment year, although it was stated that Poland and Croatia should be able to do so in medium term perspective if the reform track and tight economic policy would have been continued. The Commission found that only Poland and Croatia could be considered functioning market economies, even if some important features, such as capital markets, still needed

[13] "Agenda 2000 communication, volume I: for wider and stronger Union", European Commission, Strasbourg, 15 July 1997, DOC/97/6.

[14] Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

to mature and develop further. Lithuania and Romania made substantial progress and should have been able to meet the first economic criterion within 4-5 years. For both countries, the main challenge was to strengthen the implementation of their legal and institutional reforms and to avert the risk of further macroeconomic instability.

The analysis conducted by the Commission based the Opinions led to the following overall picture that is common to all the benchmark countries:

- Trade integration and FDI have progressed substantially (except for Romania and BH). However, in Romania, there has been a reversal from initial trade liberalisation, mainly for macroeconomic reasons;
- The functioning of capital markets and competition rules has been improving everywhere, but is generally still far from satisfactory;
- The state of infrastructure remained poor (except for Croatia);
- Wage levels were still well below EU levels;
- Privatisation has progressed at different rates and the process remains to be completed.
- Most applicants needed or still need to restructure large state-owned industries, which dominate local economies and tend to be very hard to reform for both social and economic reasons.

Table 4: Timeframe of economic criteria fulfilment by Poland, Lithuania, Romania, Croatia as a benchmark to Bosnia and Herzegovina and their main obstacles indicated

Copenhagen's economic criteria	Poland	Lithuania	Romania	Croatia	BH
Country specific (main obstacles)	Economic structure: (1) substantial informal sector; (2) disparity between the contribution of the agricultural sector to GDP and its share in total employment	Social developments: (1) high unemployment rate of over 16% in 1996; (2) low level of enterprise restructuring and slow privatisation as a consequence of a lack of capital, resulting from the relatively low level of foreign direct investment and the weakness of the banking sector	In general difficulty in fulfilling sub-criterion: Capacity to withstand competitive pressure and market forces within the Union: as well as (1) regional and sector disparities in development; (2) low FDI inflow	(1) Unemployment; (2) significant shadow economy after 1995 armed conflict	1) Disparities in laws and economic policies between two Entities; (2) macroeconomic stability: policy making remains strongly influenced by the international community; (3) trade deficit of over 50% of GDP in 2005; (4) high unemployment of 44% in 2005
Sub-criterion: regarded as functioning market economy, including	First year of assessment (Avis 1997)	4th year of assessment (Regular Report 2000)	4th year of assessment (Regular Report 2000)	First year of assessmen (Avis 2004)	Not yet (SAP Progress Report 2005)
price liberalisation	!	Some prices still administered	!	Administered prices continue to play a role	Regulated prices largely prevail for utilities and infrastructure
trade liberalisation	!	!	In 1996 substantial trade restrictions introduced	!	!
market entry and exit	!	Bankruptcy and competition law, property law	Severe limits to free entry and exit in specific economic activities	Barriers remain	Enterprises are still hampered by boundaries between the entities, a weak entrepreneurial climate and bureaucratic procedures

Table 4 (continued): Timeframe of economic criteria fulfilment by Poland, Lithuania, Romania, Croatia as a benchmark to Bosnia and Herzegovina and their main obstacles indicated

Copenhagen's economic criteria	Poland	Lithuania	Romania	Croatia	BH
legal system	!	!Not adequate	Not adequate	(1) slow and inefficient ourt proceedings; (2) low administrative and professional capacity	!
macroeconomic stability	!	Low budget constraints (large current account deficit !12.1% of GDP in 1998)	Not stable; widely fluctuating performances in term of growth, inflation and unemployment	!	!
consensus on economic policy	!	!	!	Increasing political consensus	Increasing political consensus
financial sector	!	Undercapitalized and state-owned bank sector	Dominated by state-owned banks	!	!
transformation/ privatisation process	!	Large number of enterprises still partly state-owned; low level of enterprise restructuring	Slow development of private sector	State is still predominant in several sectors of the economy	Slow pace reflecting weak political will and poor financial situation of many companies (private sector activity reached 55% of GDP in 2005)
Sub-criterion: capacity to withstand competitive pressure and market forces within the EU, including	6th year of assessment (Regular report 2002)	6th year of assessment (Regular report 2002)	9th year of assessment (Regular report 2005)	Not yet (Progress Report 2006)	Not yet (SAP Progress Report 2006)
macroeconomic stability for economic agents	!	!Low predictability	Low stability and predictability	The level of state aid and support to specific sectors is still considerable while transparency remains low	Threats to macroeconomic stability are mounting
human and physical capital	(1) increase R&D public expenditure, (2) no program for technology transfer; (3) agriculture structure reform; (4) transport infrastructure development	Agriculture reform	!	Shortcomings such as outdated curricula, low quality teaching and poor equipments	(1) only 43% of the population being employed in the formal economy; (2) substantial mismatches between the labour market and the knowledge provided by education
government policy and legislation influence on competitiveness	!	!	Significant degree of government interference	!	State involvement remains substantial
proportion of small firms trade integration	!	Low level of entrepreneurship	!	!	SME sector still small

Source: On the basis of EC Opinions and Regular/Progress Reports on Poland, Lithuania, Romania, Croatia and Bosnia and Herzegovina.

In the Opinion, **Poland** was defined as a functioning market economy due to its widespread price and trade liberalisation, with an economy that had been successfully stabilised[15] and its full commitment to this policy line maintained throughout changes in government. Still, in order to guarantee longer-term stability, pension and social security systems needed to be reformed and a continuation of the progress made in key

[15] By 1992 the GDP growth had already started and has continued since (6.0% in 1996). The budget deficit was reduced to below 3% of GDP and the debt-servicing burden, after rescheduling agreed in 1991, was being steadily reduced. Inflation rates declined, but still stood at 19.9% in 1996. GDP *per capita* was about 31% of the EU average in 1996, for a population of 38.6 million.

areas of the economic transformation, as well as economic and social development, was necessary. Financial services were largely underdeveloped until 1997. The capacity to cope with competitive pressure required a more stable macroeconomic framework within which individual enterprises could make independent decisions in a climate of a reasonable level of predictability. The main indicators of Poland's competitiveness achieved already by then were: a high percentage of trade integration with the EU and good performance of enterprises, especially of SMEs. Further improvements were needed in restructuring more state enterprises, such as shipyards and chemical plants as well as those operating in the coal, steel and defence industries. Although Poland's workforce was relatively highly educated, an increase in R&D public expenditure was needed, as was the establishment of a programme of technology transfers and reductions in the percentage of the labour force employed in the agricultural sector, as its productivity per capita was low.

To sum up, according to the 1997 Avis, "Poland should be well able to cope with competitive pressure and market forces within the Union in the medium term starting from 1997[16], provided that it would maintain the pace of restructuring and keep the economy open". Growth and investment were strong. The rise in unit labour costs in the manufacturing sector was moderate. Inflows of foreign direct investment accelerated. However, the privatisation process was not over. The main problem was that of the larger state-owned companies, where management failure in the face of foreign competition could have serious negative consequences. The agriculture sector also needed to be modernised[17] and there were some reversals in trade policy[18].

In the case of **Lithuania**, the Commission gave no positive assessment as far as being a market economy in the first year. Improvements should be made to the labour market by addressing the high unemployment. The management of public finances should be improved, in particular by addressing, at the municipal level, the accumulation of expenditure arrears. Furthermore, the completion of pension reform, with the planned introduction of a funded compulsory pension scheme, should make public finances more sustainable in the long term and support the development of financial markets. In addition, strengthening administrative and judicial capacity and simplifying procedures in areas relevant for the business sector, including in bankruptcy and enterprise restructuring, would enhance market entry and exit of companies. Worth mentioning is the fact that irrespective of the rather negative first judgment of the Commission on Lithuania's economic development, the country managed to catch up with reforms and improve its macroeconomic situation sufficiently to join the EU in 2004 together with Poland.

[16] *Avis* on Poland's political and economic situation; Agenda 2000, 1997, p. 32.

[17] In 1997 the agricultural sector employed 27% of the labour force, and accounted for 6.6% of Gross Value Added, *ibidem*, p. 21.

[18] In 1997, 70% of Poland's exports were directed to the EU, and 65% of its import originated in the EU, *ibidem*, p. 22.

In the case of **Romania**, the Commission was reluctant to form a definitive judgment on the country's ability to fulfil the economic criteria some years ahead of prospe*ctive* membership. Evaluation of competitiveness was made difficult because the major reforms had been launched shortly before assessment, which, according to Commission rules, could not yet be taken into account. In this respect, Romania offered a contrasting situation: the existing economic structure pointed to very important structural weaknesses, while the reforms that were announced at the beginning of 1997 could have had a very positive impact in a relatively short period of time, especially if rapid privatisation could be achieved and FDIs be forthcoming. Nevertheless, the Commission identified a number of features of Romania's development that provided some indications of its probable capacity to cope with competitive pressure and market forces within the EU. Both the industrial and agricultural sectors needed to undergo major structural transformation. The production base in industry in 1997 relied to a large extent, although not exclusively, on sectors with very high energy intensity, or which were strongly dependent on imported raw materials, or were the object of exercises of capacity reduction within the EU. Given Romania's labour costs and skilled workforce, specialisation in these sectors (metal-working, chemicals, shipbuilding, machine building) was not necessarily a bad strategy, provided of course that products were adapted to the needs, standards and quality requirements of Western markets. Furthermore, many of the large state-owned enterprises benefited from direct and indirect subsidies, which have slowed or even hampered their necessary adaptation and modernisation. A diversification of the industrial base towards lighter industries, entailing the creation of a large number of new SMEs and increased participation of foreign capital and know-how, was strongly recommended to Romania to adjust to the restructuring of large enterprises. As for agriculture, though it was neglected in recent decades, already represented in 1997 a potentially important source of comparative advantage for Romania, which was a substantial exporter to European and world markets before the second World War. However, the process of modernisation of the agricultural sector required a policy aimed at stimulating investments both in the farming sector and in the food industry. FDI was low for a country the size of Romania: increasing the chances that Romanian producers will be able to withstand competition from high-quality, high-standard EU goods and improving the level of skills in the economy calls for much bigger inflows of FDI.

In 2004, observing progress made in development, the Commission acknowledged that since the Opinion's publication economic structure and performance had improved significantly, although Romania was allowed to join the EU no earlier than three years after the first wave of CEE enlargement. Macroeconomic stability was achieved and fundamental economic reforms were carried out, while the Romanian authorities' commitment to the economic requirements of EU accession was eventually sustained. Nevertheless, further improvements could have been made in sustaining macroeconomic stability and in deepening structural reforms. Priority should have been given to enforcing financial discipline and improving the financial performance of public enterprises. The privatisation process should be accomplished. Substantial progress in the functioning of the judiciary and the public administration, including an even and predictable application of law, was still required to create an enabling business environment with a level playing field.

As for **Croatia**, when first assessed in 2004 it was particularly important to acknowledge the increasing political consensus on the essentials of economic policy (which is also the case in BH). According to the Commission, the Croatian economy had achieved a considerable degree of macroeconomic stability with low inflation. Enhanced economic stability and structural reforms undertaken to date had permitted market mechanisms to operate. This went in particular for the liberalisation of prices and trade as well as for privatisation, albeit to a lesser extent. Croatia was characterised by a relatively well-educated labour force and good road transport and telecommunications infrastructure. The country had a well developed banking sector and a competitive tourism industry. Croatia's economy was already well integrated with that of the EU. However, the working of market mechanisms still needed some improvement. In particular, the performance of the judicial sector needed to be enhanced and high administrative burdens as well as incomplete systems of cadastre and land registry need to be addressed. Enterprise restructuring and privatisation were slower than expected and some large state and formerly socially-owned enterprises still played an important role in the economy. In particular, the shipbuilding and agriculture sectors needed to be modernised. The necessary reforms of the fiscal and social security systems as well as the public administration were not completed and fiscal consolidation needed to be pursued. Full integration in the single market and the adoption of the acquis would, at this stage, cause difficulties for a number of sectors in withstanding competition within the single market.

Although **Bosnia and Herzegovina** does not yet have a formal candidate country status and therefore no Opinion has been developed by the Commission, it is assessed according to the Copenhagen criteria within Stabilization and Association Process (SAP) starting from the 2005 Progress Report. According to the Commission in 2005 the BH economy operated only to a limited degree within the framework of functioning market principles. Further reform efforts were called for as necessary to address the serious shortcomings in the competitiveness of the economy. To maintain macroeconomic stability and safeguard the sustainability of the currency board, a prudent macroeconomic policy mix is a priority. In order to strengthen the productive base of the economy, the largely loss-making corporate sector must be urgently and fundamentally restructured and privatisation accelerated. In addition, actions to reduce overall government interference in the economy and improve the business climate are essential. The flexibility of the labour market should be enhanced and the judicial system, in particular the handling of bankruptcies and property rights, strengthened. To successfully manage the fiscal challenges, coordination and analytical capabilities need to be improved and the size of public expenditures be reduced in real terms. These demanding tasks require firm political commitment and cooperation between different levels of government. In general, the functioning of market forces is hampered by the strong influence of the public sector in the economy and the weak business environment and legal climate. Despite some improvements, markets are also sometimes fragmented between entities.

2. Economic Situation and Trends in Bosnia and Herzegovina

A notable achievement of the period since the end of the conflict in 1995 was macroeconomic stabilisation. The currency board system allowed inflation to be reduced and subsequently kept at very low levels, and the fiscal position has improved considerably over the last couple of years (though the starting point was very far from any kind of sustainable fiscal deficit). The significant acceleration in inflation in 2006 is partly explained by the one-off effects of VAT introdu*ction i*n January 2006 and thus should not be a source of major concern, although some vigilance is needed.

Table 5 presents selected economic indicators for BH between 2002 and 2006. One should remember that the very low quality of available statistics and unavailability of some key indicators makes the reported figures only indicative and subject to substantial margins of error. In particular, the level of unrecorded economic activity

Table 5: Selected Economic Indicators for Bosnia and Herzegovina, 2002-2005

!	!2002	2003	2004	2005	2006 (proj.)
General macroeconomic indicators	!	!	!	!	!
GDP growth (%)	5.3	4.4	6.2	5.0	5.5
CPI (period average)	0.3	0.6	0.3	1.9	6
Index of industrial production growth (%)	11.6	5.0	13.6	11.0	7.4
Unemployment rate	21.4	!.	!.	!.	!.
Self reported unemployment rate	31.2	30.4	!.	!.	!.
!	!	!	!	!	!
Fiscal indicators	!	!	!	!	!
General government overall balance (% GDP)	!3.3	!2	!0.4	0.9	0.7
Public debt	34.8	30.6	28.1	31.7	48.2 (*)
!	!	!	!	!	!
Balance of Payments	!	!	!	!	!
Current account balance (% GDP)	!19.1	!20.9	!19.3	!21.3	!17
Current account balance (million US $)	!1252	!1444	!1437	!1695	!1523
Trade balance (million US $)	!3291	!3378	!3306	!3558	!3426

Notes: Unemployment data are available as estimates for specific periods only and are subject to wide margins of error (labour force surveys comparable to those carried out in EU countries have not yet been implemented in BH).
* This assumes 17% of GDP of debt to settle domestic claims against the government.
Sources: IMF World Economic Outlook database, Sept. 2006, IMF (2006), World Bank (2005a).

remains large in comparison with other European transition countries, though it may be similar to some of the CIS economies (see 1.1.1 The Issues of Measurement).

From the perspective of meeting the Copenhagen criteria, the following macroeconomic issues have been identified as requiring more attention and are discussed in more detail in the subsequent sections:

- labour market developments
- foreign trade performance
- structural reforms, including privatisation

Clearly, this list is not exhaustive. There are several other issues that may turn out to be crucial for BH's ability to strengthen the functioning of its market economy and cope with the competitive pressure and market forces within the EU in an environment defined by the internal market acquis. There are also very strong inter-linkages between various spheres of economic institutions, policies and segments of the economy and slippages in some dimensions have repercussions elsewhere. The above list is therefore best understood as indicating identified bottlenecks at the current stage of BH's macroeconomic development. Key microeconomic issues are discussed in Part 4 of the report. Finally it is worth recalling that the political structure of the country and political dynamics may turn out to be crucial for both microeconomic and macroeconomic developments. However, these issues lie outside the scope of this report[19].

[19] The current political system of the country (which played a decisive role in ensuring peaceful development during the decade after Dayton) creates problems and likely increases the costs of further reforms needed on the road to integration with EU structures. This assessment is shared by most observers and has also been acknowledged in official EU documents. The European Commission (2005, pp. 9-10) states that: "(...) the adequacy of the Dayton constitutional system to the present circumstances is frequently questioned both within and outside the country. It is widely considered that the structures deriving from the DPA are too complex and fiscally unsustainable. (...) The current set-up does not support swift decision-making and hampers reform implementation. This undermines Bosnia and Herzegovina's possibilities to make rapid progress on its way towards the EU. Despite considerable achievements towards the strengthening of state institutions, major reforms continue to be delayed by divergences within state institutions and between the central state and the Entities (FBH and RS). Attempts to create new state structures or to transfer competences to the state level are often perceived as undermining the Entities and their sustainability. This **mistrust towards any transfer of responsibilities from the FBH and RS level or canton level to the central authorities is a major obstacle to any serious move towards a comprehensive and sustainable reform of the institutions** and the constitutional order. " See also, "Bosnia and Herzegovina: Addressing Fiscal Challenges and Enhancing Growth Prospects" by the World Bank, September 2006.

2.1. Labour Market

The World Bank's (2005a) most comprehensive recent review of labour market issues in BH concludes that the three key challenges in this field are low productivity and relatively high wages in the formal sector of the economy, large (and according to some sources growing) informal employment and high unemployment. This list could be extended by adding the low overall employment rate (taking the formal and informal sectors together) and possibly also the problem of the (in)adequate labour market-related skills of recent graduates and in the population at large.

Sustained economic growth in recent years has led to gradual job creation, which – on the basis of very incomplete data – is estimated at around 4% per annum between 2001 and 2004 (World Bank, 2005a). However, the employment rate appears still low by international standards (although probably higher than in Turkey, for instance, and not much lower than in the worst performers among the NMS8 and other candidate countries groups). Moreover, much of job creation appears to have occurred in the informal sector. Informal employment accounted for up to as much as 42% of total employment, with somewhat higher rates in Republika Srpska. While these figures may look very bad, one should bear in mind that much of this informal employment is concentrated in agriculture. From this perspective the experience of BH is not that different from trends observed for example in Romania (Paczynski et al, 2007). In Romania, delayed economic restructuring leading to job losses of less skilled and older workers, coupled with availability of land (small plots), have resulted in migration flows from urban to rural areas and increasing employment in subsistence agriculture. This survival strategy has helped to fend off unemployment rises in urban areas. The hypothesis that a somewhat similar trend might have occurred in BH may be very difficult to test given the inadequacies of statistical information on the labour market in BH, however. Still, during the 2001-2004 period substantial job shedding from state owned enterprises (SOE) took place. According to the same source, the SOE share of total employment fell from 37% to around 20%.

The CBBH (2006) reported the results of a labour force survey (LFS) carried in April 2006. An estimated 811,000 people were employed and 366,000 unemployed, according to the survey. This implies an activity rate close to 75%, and employment rate of just above 51% (both calculated relative to the 15-64 population) and a 31% unemployment rate[20]. While these estimates should be treated with caution they nevertheless allow a comparison with EU countries. BH's activity rate reported in the survey appears very high by EU standards, well above EU25 or EU15 averages

[20] The CBBH (2006) instead reported employment rates for the whole population, which is a rather unusual practice. Data on the total population aged 15-64 at end June 2006 (1,576,800 people) were taken from the BH Federal Statistical Office.

of 70.4% and 71.5%, respectively. In contrast, the employment rate is far higher than average levels of 64.6% in EU25 and 65.9% in EU15 in the same quarter. The two EU countries with lowest employment rates (Poland and Malta) still had employment rates at around 54%, 3 percentage points above the BH level. However, Turkey, a EU candidate country is characterised by an even lower employment rate – in 2005, it averaged at around 46%. While the low employment rate in BH estimated in the survey is not surprising, the estimated unemployment rate and thus also activity rates, appear suspiciously high. Lack of detailed information on the construction of the LFS make any comments highly speculative here, but it may be that the definition of unemployment was set rather broadly, thus encompassing people who in fact are not actively seeking employment. Interestingly, LFS-based unemployment was very close to registered unemployment in 2Q 2006 (around 351,000 people). This may suggest that all people who are registered as unemployed declared themselves as de facto unemployed in the survey irrespective of the their actual status. An in-depth analysis of this problem may be very interesting to pursue but is beyond the scope of this report.

Nominal (euro) wages in BH are high in a regional comparison. In particular, they are higher than wages in Bulgaria and Romania. BH has also seen continuous, albeit not very fast, real wage growth in recent years. With relatively low productivity levels this makes it very difficult for BH producers to compete with companies relying on production based elsewhere in the region. However, one should note that analysis of company-level data carried in Part IV draws a more optimistic picture (bearing in mind that the quality of data is a problem the decisive assessment may require more detailed analysis). The recent IMF country report (IMF, 2006) also confirms that signals related to productivity – real wage trends are mixed.

Another problem (which applies to several other dimensions of economic development) relates to diverging patterns of labour market legislation and regulations in RS and FBH, which risk maintaining a de-facto dual labour market in the country.

2.2. International Competitiveness and Export Performance

BH economic growth has in the past been driven by domestic demand, with consumption and investment substantially supported by foreign aid flows. International competitiveness has been weak, with strongly rising imports and a lacklustre export performance. The export/import ratio declined to only 25% in 2002, with the trade deficit close to 55% of GDP (excluding estimates of unregistered economic activities).

Since 2003, the situation has started to gradually improve. Exports have visibly accelerated, expanding by more than 20% annually since 2004 (see Table 6). This has coincided with a stabilisation of imports. Consequently, the export/import ratio improved to 34% in 2005 and around 45% in 2006. An important caveat concerning foreign trade data for 2005 and 2006 is that the introduction of VAT in January 2006 significantly changed the incentives to report exports and imports. VAT introduction induced a shift in registered imports from early 2006 to end-2005 and a delay in reporting exports – from end-2005 to early 2006. Also, since 2006 incentives to report exports have generally been higher than before. This implies that analysis of the relevant data requires caution and a comparison of broad trends in 2005-2006 with 2004 is more appropriate. This still suggests an ongoing improvement in exports and moderation of import growth.

Table 6: Selected indicators for BH foreign trade based on BoP statistics, 2001-2006

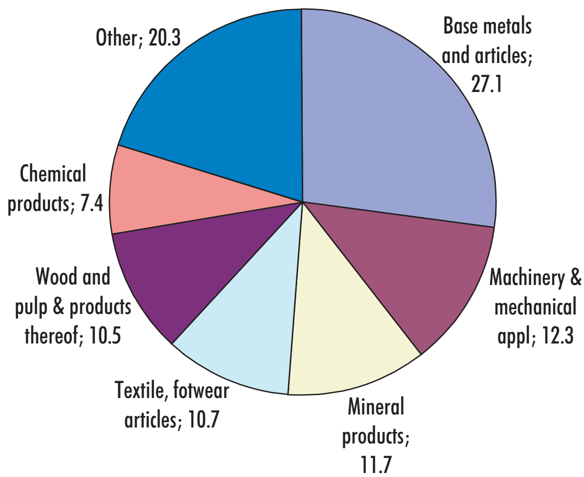
	2001	**2002**	**2003**	**2004**	**2005**	**1-3Q 2006**
Imports of goods (billions, euro)	4.58	4.69	4.97	5.35	6.09	4.32
Imports – annual growth rate (%)	8.3	2.5	6.0	7.6	13.8	0.6
Exports of goods (billions, euro)	1.27	1.17	1.30	1.68	2.09	1.98
Exports – annual growth rate (%)	3.4	-7.9	11.5	28.7	24.5	31.3
Trade balance (millions, euro)	-3.31	-3.52	-3.67	-3.68	-4.01	-2.34
Trade balance (% GDP)	-54.3	-54.5	-53.9	-49.1	-49.7	
Current account balance (% GDP)	-13.6	-19.4	-21.2	-19.2	-21.1	

Note: GDP values taken for calculations of GDP shares exclude estimates of unregistered economy. Additionally, current account data likely underestimate the inflow of remittances. The IMF (2006) concluded that true current account deficits have likely been in the range 6-14% of GDP for the last few years.
Source: CBBH.

The recent improvement in export performance is certainly encouraging. Moreover, it is likely to continue at least in the near to medium term (up to 2-3 years), due to recent large investments in the production capacity of the metal sector. However, problematic issues for BH's exports are the narrowness of the export base and an over-reliance on metals, the global market for which may be very volatile (Figure 4). Exports are concentrated on exploitation of natural resources and low-skill labour intensive goods (mineral products, wood and wood products, clothes, footwear, etc.). Exports are typically little processed and characterised by low value added and low technology content.

One positive impulse comes from increasing evidence of the incorporation of BH companies in EU-based supply chains. This is discussed in detail in World Bank (2005b). The EU is BH's largest trade partner. The EU has already granted BH production largely free access for industrial products and negotiations on a SAA were started in early 2006. The experience of other European transition countries suggests that the EU will continue to be the dominant foreign trade partner for BH and that

Figure 4: Structure of Bosnia and Herzegovina exports, 3 quarters 2006 (percentage share in total exports)



Source: Own calculations based on CBBH data.

closer integration with the EU, rising competition with EU-based companies, transfers of know-how and technologies resulting from FDI of EU-based companies into BH and co-operation within supply chains of large European companies may act as important catalysts of company restructuring and improvements in the competitiveness of the overall BH corporate sector. BH also trades heavily with its neighbours, Croatia and Serbia and Montenegro. Analysis and recommendations concerning trade relations with BH's partners in CEFTA 2006 can be found in Hadziomeragic et al (2007).

Much of the internal political debate in BH has concentrated on trade deficit problem with the implicit or explicit policy objective of reducing the trade deficit. Such a view should be considered as somewhat simplistic. In particular, BH exports are highly dependent on imported inputs and a high level of processing takes place in BH before re-export to the EU and other regions. This is not a negative phenomenon and given the small size of he country, increasing openness (both for imports and exports) is a natural trend. What is of importance is that BH enterprises successfully compete with European and global players. Only improved competitiveness can help spur exports and induce consumers to choose domestically produced rather than imported goods.

One general conclusion emerging from analysis of BH foreign trade is that impediments to its development are primarily of a domestic nature, rather than related to foreign trade policies. In other words, poor export performance can be linked to a sub-par investment climate, difficult conditions for doing business, a rigid labour market, high taxation on registered economic activity (and a large unregistered economy), limited know-how and outdated technology in BH companies, etc. Such a view can also be supported by the experience of the EU new member states (NMS8) over the last decade. Damijan et al (2006) analyse the outstanding export performance of the NMS during 1990-2004 and suggest that this can be explained by improving domestic supply capacity, which in turn was most strongly boosted by building a stable institutional set-up, structural reforms and FDI inflows. Hadziomeragic et al (2007) discuss these issues in more detail.

2.3. Macroeconomic Outlook – a Comparative Perspective

This section speculates on the macroeconomic parameters that BH would need to achieve at the moment of its eventual EU accession and the policies that could lead to such macroeconomic outcomes. The analysis builds on analogies with the history of the 2004 and 2007 waves of EU enlargement.

Firstly, maintaining a sustainable macroeconomic stability is a necessary precondition on the road to EU accession. The currency board arrangement in BH has allowed for inflation stabilisation. It has also strongly reduced the real effective exchange volatility in the past and is likely to play such a role in the future – possibly until adoption of the euro at some stage. This is not synonymous with stating that the currency board does not cause any problems for the BH economy. No single exchange rate and monetary regime is free from drawbacks. The point is rather that for a small, open, European economy trading mostly with euro-zone countries or countries with stable currencies against the euro, maintaining a peg is the best option. The experiences of the Baltic countries, which have opted for a similar exchange rate arrangement since early 1990s, and the experience of Bulgaria - which switched to a currency board after a major crisis in 1996-1997 - is quite encouraging in this respect.

The experience of the NMS also highlights the role of the fiscal position, which is particularly important in smaller countries with fixed exchange rate regimes. Of key concern is not only keeping the fiscal position close to balance in the medium term, but the size and structure of fiscal expenditures. The example of Lithuanian fiscal reforms during 1999-2002 can be particularly interesting from the BH perspective. In the aftermath of the Russian financial crisis of August 1998, Lithuania (then operating a dollar-based currency board) found itself on the verge of a financial crisis. The authorities reacted with a significant tightening of fiscal policy – mostly via expenditure cuts and not tax rises. The introduced measures were quite exceptional in some instances – for example, forced unpaid holidays in the government sector. This fiscal contraction arguably played a role in the strong rebound of economic growth in the subsequent period, which was driven by private demand and exports. Christensen (2005) notes that supply-side factors, such as wage moderation following the public sector wage freeze and cuts in social benefits, played an important role in spurring both investments and exports.

An important element of the overall reform package is privatisation. At present, BH has the lowest private sector share of GDP among non-CIS transition countries (EBRD, 2006). However, the experience of other transition countries suggests that the privatisation process can be relatively fast provided there is sufficient political will. Thus, in the 5-10 year horizon, the currently little advanced privatisation agenda may not matter that much.

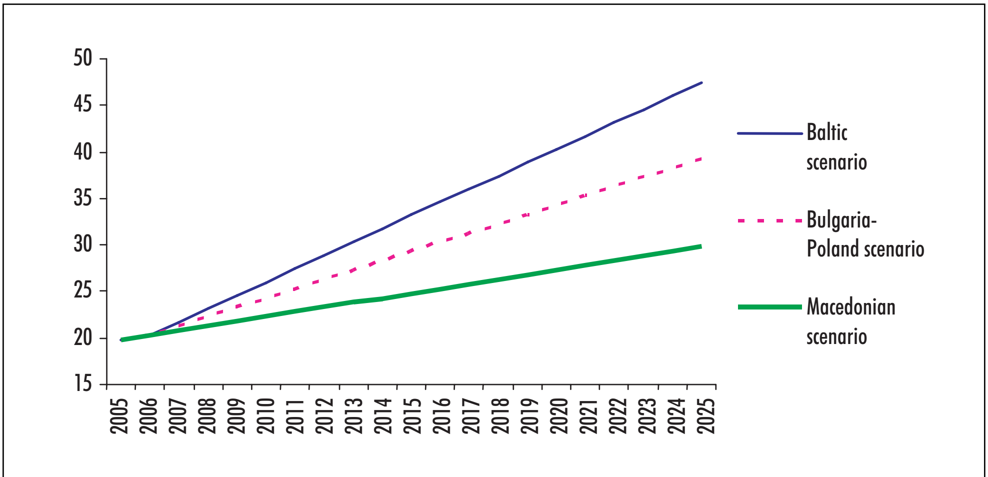
The conditions for running business need to be substantially improved so that domestic and foreign investors will choose to set-up and run businesses in BH rather than invest elsewhere in Europe or give up entrepreneurial activities. One important dimension of the business climate is the existence of a transparent and stable legal and regulatory framework. In this field, the challenge for BH is made more difficult by the very complicated internal political and institutional set-up of the country. A comparison of the experience of NMS and EU accession countries with other transition economies confirms that institutional reforms are often much more difficult to implement than liberalisation and macroeconomic stabilisation.

The EU provides a very useful benchmark for aligning the legal and institutional framework for market functioning. Perhaps the most important factor is that requirements related to the EU accession have served as an external force motivating authorities to carry unpopular reforms. In BH, two issues are worth highlighting. Firstly, BH is relatively less developed than other countries when they started institutional reforms aimed at supporting EU integration. Secondly, BH has one of the most complicated political and institutional structures of these countries. This implies that if new and reformed institutions are to be given a chance of effective functioning the applied solutions need to be as simple as possible.

So, what are BH's macroeconomic prospects for the next 5-10 years? The arguments presented above and elsewhere in this report point to the key role of domestic reforms in determining the pace of development and catch-up with the EU. The optimistic scenario assumes a coherent set of economic policies maintaining macroeconomic stability (in particular improving medium-term fiscal prospects), reducing the tax and regulatory burden on the economy, thus allowing for a reduction in the scale of unregistered economic activity. Easing of conditions for doing business, coupled with productivity gains and real wage restraints, could provide a major boost to the external competitiveness of BH production and a surge in exports. This would be supported by rising FDI inflows further encouraged by the prospects of eventual EU accession. In such an environment, BH could perhaps reach potential growth similar to levels observed in the Baltic countries over the recent period. One could further assume that the minimum development threshold where a country can contemplate EU accession (provided other conditions are met) is around 35% of GDP per capita calculated in PPP terms – this roughly coincides with the forecast level in Bulgaria for 2007.

Taking some additional assumptions on the current values of GDP per capita in BH measured at purchasing power standards (PPS), one can then observe that in the optimistic scenario BH could reach a GDP per capital level in PPS equal to around 35% of the EU25 average by 2017, a decade from now (Figure 5)[21]. The Baltic countries experienced very fast convergence in GDP per capita levels, as they needed around seven years to close the gap between their position and the EU25 average by 10 percentage points (e.g. Latvia and Lithuania between 1997 and 2004, Estonia between 1997 and 2003)[22]. In other countries, such as Bulgaria and Poland, this

Figure 5: Hypothetical convergence paths: Bosnia and Herzegovina GDP per capita as a percentage of EU25 GDP per capita in PPS



Note: Scenarios are based on the historical speed of GDP per capita at PPS convergence in the Baltic countries (an around 10 percentage point increase over around seven years), Bulgaria and Poland (an around 10 percentage point increase over around 10 years) and Macedonia in the period after the 2001 crisis (an around 3 percentage point increase over around six years).See text for more discussion.

Source: Simulations based on the IMF World Economic Outlook database (Sept. 2006) and Eurostat starting values.

[21] The starting values of GDP per capita in PPS (not provided by Eurostat) were calculated using the assumption that relative position of BH and Macedonia in the IMF World Economic Outlook database (GDP per capita at PPP) is identical to the relative position of these two countries in the Eurostat series. This assumption gives BH GDP per capita in PPS at around 20 percent of EU25 average in 2005-2006.

[22] The speed of convergence in GDP per capita measured in purchasing power standards depends not only on economic growth dynamics but also on price level developments.

process took around 10 years. This gives a basis for the second scenario (the "Bulgaria-Poland scenario" in). In this case, BH reaches around 35% of the EU25's GDP per capita by 2021, 15 years from now. The third scenario can be based on the recent experience of another ex-Yugoslavia country that recently acquired EU candidate status – Macedonia. The modest growth rates that have been registered in this country since 2003 imply that that its GDP per capita in PPS is expected to increase from just above 24% of the EU25 average in 2003 to 27% in 2008. Assuming a similar pace of convergence for BH (the "Macedonian scenario") implies that by 2025 BH would not even reach a level of 30% of average EU25 GDP per capita.

3. Privatisation process

Privatisation process is one of the most important institutional and structural features of every transition economy and especially relevant from the perspective of meeting the Copenhagen criteria.

The main institutions in the privatisation process, investment realisation and aftercare activities include line ministries, the Federation of Bosnia and Herzegovina's Agency for Privatisation, the Republic of Srpska's Directorate for Privatisation and the Foreign Investment Promotion Agency of BiH. All these report to the respective parliaments and governments.

Before 1991, before the ownership transition was initiated in Bosnia-Herzegovina, the number of entities owned by the state or with state shareholding stood at 2,508 companies[23] and 40 banks[24].

The privatisation process officially started with the adoption of a set of laws (e.g. in the RS, eight relevant laws were adopted in 1998)[25]. It is important to underline here that the Privatisation Agencies are responsible exclusively for companies operating in the economy (excluding banks and financial sector companies). In the RS, the Privatization Agency is responsible for a total of 1,113 companies, of which 181 are regarded as "strategic."

The total estimated value of companies in the process of privatisation has been put at EUR 11.86 billion (KM 23.3 billion). Privatisation has been carried in parallel in both the FBH and the RS using somewhat different methods. Both privatisation processes have been conducted on three levels: small-scale privatisation (up to EUR 150,000, that is KM 300,000); privatisation of large state-owned companies (over KM 300,000) and strategic companies. BH has kept in its possession a large portfolio of state-owned companies and the privatisation of strategic firms has continued to be slow.

If one takes 2004 as a base year (six years after official start of privatisation), the following results were achieved: the total value of privatised companies stands at 50% of total registered companies slated for privatisation. In the RS, KM 4.5 billion worth,

[23] 1,395 in the FBH and 1,113 in the RS.
[24] 27 in the FBH and 13 in the RS.
[25] Researchers" interview with Deputy Director of the Directorate for Privatisation of the RS.

or 53% of earmarked companies, were privatised. In the FBH the results were even poorer, with privatisation bringing in KM 5.3 billion, 39% of the planned level.

3.1. Mass-Privatisation Impeding Economic Recovery

Voucher privatisation, also known as "mass privatisation," was based on the issuance of government vouchers and certificates, which were used as a means of payment[26] in the privatisation process. Each citizen was given certificates based on a variety of criteria: citizenship, previous working experience in state-owned companies and war veteran status. The real value of vouchers was reflected on the black market, selling at only 2-7% of their nominal value.

On one hand, this system left the FBH without revenues from privatisation and on the other hand in most cases the buyers turned out to be local businessmen (in many cases the old management, which brought companies on the edge of bankruptcy), who neither had sufficient capital to cover their debts, any experience in corporate restructuring nor a clear strategy for further development of the companies. Voucher privatisation thus did not lead to realisation of the state's goals. There was no significant restructuring effort, as most companies were divided up into smaller pieces and sold off separately, predominantly as real estate. A good example is that of the transportation company Autoprevoz Prijedor, which was privatised via a voucher privatisation scheme back to the old management, which had already failed in managing the company and continued to do so. The transaction had disastrous results – all its real estate was now heavily mortgaged, its 183 workers were not receiving salaries and their social contributions have not paid for the last four years (a sum amounting to over KM 3 million). In May 2006, the company's employees went on strike, which also failed to yield any concrete results, and led in November 2006 to some of them starting a hunger strike, which then brought the RS government back in to resolve the problem. The government is thought likely to assess the possibilities for company restructuring in terms of either repurchasing a majority stake in the company or initiating bankruptcy procedures[27].

Privatisation via tendering procedure has produced radically different results from those achieved under the voucher system. Companies which had won tenders have tended to invest in equipment, technology, product development, capacity building, settling debts and corporate restructuring. Statistical data show growth in

[26] Purchase of the assets, stake or total state capital of the enterprise.
[27] Media reports and this researcher's interview with a representative of the syndicate of the RS.

privatised companies, especially among those sold to large foreign companies or by local export-oriented ones. In some cases investors have obtained financial support from the state for debt servicing or improving their working capital (indirect stock buying) or have formed joint ventures as vehicles to takeover the business. One of the reasons for this type of decision has been the wish to avoid responsibility for social issues and old debts.

Initial public offerings (IPOs) of state-owned companies were concluded on November 5, 2002. Some of larger companies, both state-owned and syndicated, requested special status, i.e. that of a strategic company. The major difference in approach to the privatisation of strategic and other companies was in the criteria that were applied. In the privatisation of a strategic company, the financial offer is not usually ranked as the most important factor in evaluation of offers. Instead, the agency tends to assess the sustainability of the business, including the seriousness of the partner and his market position.

3.2. Privatization of Strategic Companies

Both governments recognise the importance of strategic companies and have sought to make decisions to speed up their privatisation in the FBH and the RS. However, there is still slow progress in preparations for the privatisation of infrastructure and utility companies, as well as electronic media companies (see Tables 7 and 8).

Before 2004, the FBH laid out a list of 56 strategic companies and by the end of 2004 had privatised 28, or 50%, of them. The RS, likewise, set out a list of 52 strategic companies for privatisation and by the end of 2004 had privatised 43, or 82%, of them.

Table 7: The announced tenders for privatisation of strategic companies

	Year	2001-2002	2003	2004
Number of Announced Tenders for Privatisation	RS	21	17	3
	FBH	15	3	10
Total	BH	36	20	13

Source: Agency for Privatisation of the FBH and the RS's Directorate for Privatisation.

Table 8: The annual breakdown of strategic companies' privatisation

	Year	2001	2002	2003	2004
Number of Privatized Companies	RS	2	21	17	3
	FBH	6	9	3	10
Total	BH	8	30	20	13

Source: Agency for Privatisation of the FBH and the RS's Directorate for Privatisation.

Experience has shown that a number of companies of strategic importance for the government have been the subject of change, and this will increase with time. During 2005-06, progress was made in privatisation and corporate restructuring in the RS, mostly because of the new government, which has been dedicated to the implementing further economic transition. Important laws have been adopted by the RS parliament, including a Securities Law and Investment Fund Law.

3.3. Foreign Direct Investments

BH attracted FDI of EUR 250 million in the first nine months of 2006 (according to the latest available data[28]) and FDI is expected to reach EUR 400 million by the end of the year, up from EUR 330 million in 2005. Aggregate FDI stock per capita should reach EUR 495 in 2006, 58% went to industry and 16% to the banking sector[29]. This level is unsatisfactory, particularly because of the inadequate level of greenfield investments and slow privatisation process[30].

FDI inflows decreased from 7% of GDP in 2005 to 4% of GDP in mid-2006[31], mainly as a result of lower privatisation-related inflows. Although from the beginning of 2006 no significant greenfield investments have been recorded, there are several projects in contracting phase and one can expect that the mid-term realization of several strategic investment projects will start in the near future. FDI is likely to rise to some EUR 1.0 billion in 2007 as stalled privatisations are expected to be restarted after the election of November 2006 and the formation of a new government[32].

During 2006, after the appointment of the new government run by the Independent Social Democrats (SNSD), the RS started several large-scale energy projects and key industry privatisations, which are expected to bring significant growth to the economy. The RS initiated long-term projects in the energy sector and the privatisation of Telekom Srpske, oil refineries at Brod and Modrica and fuel retailer Petrol, which would radically change the entire economic environment.

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[28] The Ministry of Foreign Trade and Economic Relations publishes FDI statistics every three months and on annual bases.

[29] Bosnia and Herzegovina 2006 Progress Report. Commission of the European Communities, Brussels, 08.11.2006, SEC (2006) 1384.

[30] Researcher's interview with representative of the Foreign Investment Promotion Agency of BH.

[31] Bosnia and Herzegovina 2006 Progress Report. Commission of the European Communities, Brussels, 08.11.2006, SEC (2006) 1384.

[32] Researcher's interview with a representative of the Foreign Investment Promotion Agency in BH.

3.4. Effects of the Privatisation Process

In 2005, private sector activity reached 55% of GDP from around 50% in 2004, as the privatisation process continues to reshape the overall structure of the economy.

As result of restructuring, privatisation and FDI inflows, the BH economy has recorded high growth rates in the processing and mining industries. Again, as in the banking sector, only a handful of big companies have impacted on aggregate changes in the overall economic system, indicative of how sensitive the BH economy is to economic shocks. For example, industrial output in the RS in January–September 2006 rose by 10.7% year-on-year[33], the increase taking place mainly in wood processing, coal and ore mining[34]. There is also a strong correlation between the privatisation process and growth in industrial production. A significant increase of industrial production in BH was generated by the following companies: Volkswagen (Sarajevo), Balkala (Jelšingrad), Mital Steel (Zenica), Global Ispat Coke Industrije (Lukavac), Novi Rudnici (Ljubija) and Vitaminka (Banja Luka). All these companies were privatized and restructured. As result of the privatization of Meggle, Dukat, Vegafruit and Vitaminka production of food and beverages increased 1.3% in the FBH and 37% in the RS. Production in the leather sector increased 98% in the RS, above all because of the clustering of privately owned SMEs: Bema Banja Luka, Odesa Kotor Varoš, Sanino Derventa (which cooperates with Adidas) and Baja Company Derventa. In the RS, the tobacco industry registered an increase of 18.3%, mainly due to the privatisation of and investment in the Tobacco Factory Banjaluka[35].

Attempts to increase efficiency are visible in the energy sector, too. BH, together with the EU, Croatia, Serbia, Montenegro, Macedonia, Albania, Romania, Bulgaria and the UNMIK (on behalf of Serbia's southern province of Kosovo) signed a treaty obliging them to work toward integration of the energy market into the SEE and EU energy markets. In June 2006, the EFT Group became the first private company to receive an electricity sales license in BH. Both of these agreements will help integrate the energy market, as well as increase its competitiveness, with knock on effects for BH's industry.

3.5. Political Issues Related to Privatisation in 2006

In April 2006, the FBH government analysed and adopted a report by the FBH Privatisation Agency "Progress and the Results of Privatisation in FBH, 1999-2005".

[33] Statistical Office of RS; Statistical Agency of BH.
[34] Researcher's interview with the Ministry of Energy, Economy and Development.
[35] Bosnia and Herzegovina, The Economic Report 2005 (and draft report for 2006 - unpublished), Economic Policy Research Unit, 2005-2006.

Revenues reached KM 8.9 billion, including KM 8.5 billion in certificates and KM 0.425 billion in cash.

In the so-called small privatisation, 258 companies were sold for a combined KM 424 million, while large privatisation of 323 companies yielded revenues of KM 674 million (a total of 1,032 companies). 451 companies were sold by public offer, which earned KM 7.83 billion in revenue. It meant, 71% realization of the privatisation plan, or about 40% of total state capital. The remaining state capital amounts to KM 11.16 billion spread over in 348 companies. During 2005, 55 companies and 6,628 employees got new foreign owners.

The Mid-Term Development Strategy's (MTDS) working groups have defined timeframes for further development in the privatisation process. The Economic Policy Planning Unit (which worked out the MTDS), will be part of the Council of Ministers as of January 1, 2007, which gives weight to its recommendations. According to the MTDS document, it is expected that privatisation of strategic companies will be finished by the end of 2007. Furthermore, the same deadline is for defining the strategy for privatisation of the infrastructure sector. This is particularly important because companies belonging to this sector require serious restructuring. For example, out of 130 remaining strategic companies in the RS, 50 are public-communal companies for which privatisation has been halted (the Working Group should provide an opinion on whether these companies should be privatised and, if so, in which way)[36].

One of the problematic issues for the government was the opening of criminal charges against a previous government that had privatised one of the state owned banks (Kristal Bank) for a price of EUR 1. The first buyers restructured the bank and sold it for much higher price to the Austrian state-owned Hypo-Alpe-Adria Bank. Reopening previous privatisations might tarnish BH's image abroad and impact on investors' risk calculations for further BH investments.

The economy is still encumbered with some legacies of the war, in particular significant corporate debts, lost markets, inadequate product quality, the non-existent introduction of new technologies and lack of capacity building. In addition to this, various lobbies put pressures on the government to accelerate privatisation (an example of this is Energopetrol's sale to the INA/MOL consortium). There are still many (large) state-owned loss-making companies and many privatized companies have not yet recovered (see Tables 11-13). Privatisation was not successfully completed and must be aggressively addressed in the coming years.

In 2006, the privatisation process was continued irrespective of the political debates during the political campaign. In the RS, the Privatisation Directorate has finalised the privatisation of 38 larger companies. 40% of state owned nominal capital

[36] Researchers' interview with Deputy Director of the Directorate for Privatisation of RS.

intended for privatisation remains to be privatised, mostly in the utilities and infrastructure sectors (strategic companies). In the FBH, the results have been less favourable, with only 13 companies sold. However, approximately 40% of nominal capital for privatisation remains in the state's hands – a level similar to the RS.

In order to speed-up the privatisation process, both governments have been introducing legislative amendments. The RS government's amendments allow the sale of companies through direct negotiations with potential buyers rather than via tenders. The new law permits enterprises scheduled for privatisation to reschedule their debt. The companies would be allowed to write-off part of their interest payments and repay the principal figure in instalments over five years with a two-year grace period. Debt has highlighted as the biggest problem in the privatisation process to date. Amendments reflecting changes in the Privatisation Investment Funds have tended to fix problems created in the past during the voucher privatisation. The new law might give a stimulus for ownership structure improvement and offers incentives for restructuring of voucher-privatised companies. Overall, progress in enterprise restructuring has continued to be slow, although some improvements have been made to the regulatory framework. In the FBH, the prescribed legal changes have implied that debt can be rescheduled without any real restructuring of the company, although the corporate sector strongly needs restructuring, including bankruptcy and liquidation[37].

As stock-markets become stronger some regular ownership transfers were occurring there. For example, in June 2006, the International Investment Fund Poteza Adriatic Fund from Slovenia and the Pension Fund Prva Pokojninska Druzba Slovenia took over 41.31% and 5.56%, respectively, of privately owned Nova Banka. In total, their ownership amounted 50% plus one share in the bank.

During 2006, the FBH parliament adopted rules and regulations governing bourse listings. Based on this decision, the FBH government decided in September 2006 to start offering stakes of local companies on the SEE. As a crucial stakeholder in this process, the FBH's Agency for Privatisation has also approved a set of rules for the sale of state-owned companies on stock exchanges and other public markets. According to decision-makers, in some cases, for example when state-owned stakes are very small in a particular company, this is the only possible way of privatisation. Only one strategic company has been offered via IPO – a 12% of the strategic company Intersped.

The FBH public sector remains significant (KM 11.16 billion in 348 companies), this being partially influenced by lack of political will, a complex institutional decision-making structure and an inadequate legal framework. In January 2006, the FBH's Privatisation Agency approved a plan (for the second time in two years) for the

[37] IMF, Bosnia and Herzegovina: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bosnia, IMF Country Report No. 06/371, October 2006.

sale of state-owned stakes in 23 (or 24, as stated in some documents) big companies during 2006[38]. When talking about the privatisation of bigger companies, as originally planned, most of the companies was supposed to be sold during 2006, but due to significant delays in the adoption of laws (regulations for full implementation of amendments on the Law on Privatisation in the FBH) this has been prolonged for the next 12 months. The basic problem here is regulation of corporate restructuring, without which privatisation cannot be successfully implemented. Some companies, e.g. Krivaja (prefabricated houses) and Hepok (agriculture and food production) would attract investors, but the FBH's Ministry of Energy, Mining and Industry has not fulfilled its obligations, failing to pass draft regulations to the government[39].

The privatisation process has been rescheduled for the following companies: Zenit BRO Neum, Šipad eksport-import Sarajevo, Agrokomerc Velika Kladuša, Krivaja Zavidovići, Aida Tuzla, Željezara Zenica, Hepok Mostar and Tobacco and Cigarettes Factory Sarajevo. Privatisation has been postponed for the following companies: Stela Neum, Vitezit Vitez, Soda-so holding Tuzla, veterinary stations in the FBH.

For this year, the FBH's Privatisation Agency should privatise the following companies: Aluminij Mostar, UNIS Sarajevo, Energoinvest Sarajevo, Energoinvest TDS, Tobacco and Cigarettes Factory Mostar (planned capital support privatization, characteristic of many companies based on territories with Croatian ruling parties), KTK Visoko, Hidrogradnja, and Sodium Factory Lukavac (a joint venture, or merging with another company). Besides these companies, a new schedule anticipating tenders has been published for the following companies: Žica Sarajevo, Factory of Cardboard Cazin, Carton Print Stolac and Sarajevo Insurance (awaiting the government's decision on method of privatisation – via capital support or some other method).

Based on the above mentioned documents and decisions, the FBH's Privatisation Agency has started preparation of privatisation plans for five companies based on the new legislation, including engineering group Energoinvest, civil engineering company Hidrogradnja, the Zenica Mill, the Stella Hotel and cardboard producer Carton Print Stolac. The complexity of this process, including possible political blocks, has motivated the agency not to define any timeframes for conducting these processes (see Annex 1).

Faced with slow realisation of its privatisation plans for strategic companies the agency recently rescheduled strategic companies' privatisation and decided to privatise only 12 companies during 2006. Even this plan may be over ambitious given that some companies are subject to court disputes (for example, wood processing industry Sipad owns the port in Croatian town of Sibenik, although after several disputed decisions it is questionable that this is in fact the case).

[38] For a full list and detailed descriptions see Annex 3.

[39] A media interview with the director of the FBH's Agency for Privatization, Rešad Žutić, in Nezavisne Novine Banja Luka on November 6, 2006. For more see business web portal: www.investitor.ba

4. Capacity of enterprises to cope with the competitive pressure and market forces

The Copenhagen criteria requires that the candidate country enterprises would to develop ability to cope with competitive pressures and forces in the European Union's internal market, as well as the whole economy of the applicant country compared to the economies of EU members. The financial analysis of enterprises provided in this part of the report concentrates on current situation and identification of the main trends in microeconomic developments to identify comparative advantages, assess productivity, and to position the BH enterprise sector towards the potential competition on the EU markets.

The financial analysis is detached on the data of 45 enterprises in the FBH and 266 firms listed on the Banja Luka Stock Exchange (BLSE) identified by branches. Due to serious data availability limits, the period of analysis for companies listed at BLSE is much shorter (2004 and 2005) than was in the case of the FBH enterprises' sample covering the period of 2002-05. Given the various differences in data reporting, analysed financial indicators for both sets of companies could only be compared with some caution. Generally speaking, the microeconomic data for BH face similar problems as national accounts data, which undermines the quality of any statistical or financial analysis.

4.1. The Enterprise Sector in the Federation of Bosnia and Herzegovina

The financial data of 45 enterprises in the FBH (34 private companies and 11 public ones) covers the period 2002-2005 (see Annex 4). The analysed enterprises are relatively big in terms of employment, with 42% of them (19 units) having over 250 employees. Average employment in 2005 in the analysed enterprises was 410 workers

(1,268 in the public sector and 165 in the private sector). Average employment in the analysed firms declined in the relation to 2002, when it was 443 workers (1,327 in the public sector and 190 in the private sector). The study was of a pioneer character: to date only analyses of SMEs in BH have been undertaken (by Broadman et al, 2004). In the sample we still had 60% of medium sized enterprises, which also provided us with information on business development of smaller size companies.

The analysed firms have been aggregated by 9 branches: industry (14 units), mining and quarrying (4), electricity, gas and water supply (2), manufacturing (5), construction (6), trade and repairs (5), services (5), transportation (3), and telecommunications (1)[40]. In 2005, the biggest firms were registered in the public sector, in electricity, gas and water supply (average employment 3,835 workers) and in BH Telecom (3,042), which is also publicly owned. We also analysed big enterprises in the construction sector (average employment in 2005 in public construction was 1,016 and in private construction 348). The smallest (in terms of employment) enterprises were traditionally registered in services (average employment in 2005 was 37) and in trade and repairs (45). Thus, as regards the size of enterprise, the sample indicated many differences among the firms. Concerning ownership, the sample covered only public firms in the electricity, gas and water supply sector and telecommunications and only private firms in manufacturing and trade and repairs sectors.

4.1.1. Effectiveness Analysis

The sample of analysed enterprises in the FBH is quite effective in terms of EBIT (earnings before taxation) and not very effective in terms of net income. Only 40% of firms indicated a positive net income in 2005 (20% in the public sector and 45% in the private sector), less than in 2002. All manufacturing firms obtained positive net income in the whole period under analysis, as did also BH Telecom. There were also very impressive shares for strong performing firms in construction (two thirds in 2005). A much smaller number of profitable firms was observed in industry (35.5%), trade (40% - the sample average) and services (only 20%). In mining and quarrying, electricity and water supply and transportation, as well as public construction and public services, there was not one profitable firm observed in 2005.

Looking at the rate of return of the group (EBIT to revenues ratio), performances of firms appear to be much better, however. The average rate of return was set at a very impressive level of 11% in 2002 and 9.6% in 2005. In the last three years, the public sector has been more effective than the private one in terms of this indicator (an annual average of 10%). However, the most effective was BH Telecom, which as

[40] Full specification of the names of the companies is enclosed in Annex 4.

Table 9: Profitable companies and rate of return (in percent)

	Profitable enterprises				EBIT to revenues ratio			
	2002	2003	2004	2005	2002	2003	2004	2005
Enterprises in FBH	44.4	40.0	42.2	40.0	11.0	9.6	10.4	9.6
public sector	40.0	40.0	30.0	20.0	10.1	10.3	11.4	10.1
private sector	45.7	40.0	45.7	45.7	13.9	7.5	7.3	7.9
Industry	42.9	35.7	35.7	35.7	5.1	7.1	9.0	6.3
public sector	33.3	33.3	33.3	33.3	1.0	3.7	7.1	3.0
private sector	45.5	36.4	36.4	36.4	9.4	10.7	11.7	11.5
Mining and quarrying	25.0	0.0	0.0	0.0	..	0.0	0.0	0.0
public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
private sector	33.3	0.0	0.0	0.0	..	0.0	0.0	0.0
Electricity, gas and water supply (public sector)	50.0	0.0	50.0	0.0	0.1	0.0	0.7	0.0
Manufacturing (private sector)	100.0	100.0	100.0	100.0	9.8	7.5	7.2	10.3
Construction	50.0	83.3	83.3	66.7	1.1	0.9	1.0	1.1
public sector	0.0	100.0	0.0	0.0	0.0	0.1	0.0	0.0
private sector	60.0	80.0	100.0	80.0	1.6	1.3	1.2	1.2
Trade and repair (private sector)	20.0	20.0	20.0	40.0	0.1	0.1	0.1	2.6
Services	20.0	0.0	20.0	20.0	1.5	0.0	0.0	0.1
public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
private sector	25.0	0.0	25.0	25.0	1.7	0.0	0.1	0.1
Transportation	33.3	33.3	0.0	0.0	0.2	0.1	0.0	0.0
public sector	100.0	100.0	0.0	0.0	0.5	0.1	0.0	0.0
private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Telecommunications (public sector)	100.0	100.0	100.0	100.0	29.7	28.4	31.4	31.6

Source: Own calculations on the basis of financial dataset.

a monopoly affected the results of the whole sample. When we exclude it from the analysis, the average rate of return for the public sector is only 0.5% in 2005, much lower than in the private sector (7.9% in 2005). The most effective firms are registered in the private industry and private manufacturing sectors. Private construction firms also showed reasonably strong effectiveness (a slightly positive annual average at a level of 1.2%) considering their big size (four out of five private construction firms employed more than 250 workers). In public industry firms, the efficiency of economic activity was also positive and even better than among private construction firms (an annual average of 3%). In mining, electricity, gas and water supply, public construction, trade and repairs (with the exception of 2005) and services and transportation there were no positive rates of return observed[41].

[41] On the available financial statement the enterprises did not indicate a negative EBIT. Even if they have losses they were indicated as zero instead of a negative number. In contrast to the Srpska Republic sample, where enterprises listed on the Stock Exchange had to report their losses, this practice in the FBH improved the total rate of return in a statistical sense.

Given the effectiveness measure results we are obliged to state that enterprises in the FBH performed very well. The very effective BH Telecom had the biggest impact on the obtained results, as did the non-reporting of losses by the analysed firms. In 2005, the effectiveness of analysed firms declined slightly (from 10.4% in 2004 to 9.6% in 2005), influenced by a decline in public industry's rate of return (by 4.1 percentage points). The percent of profitable firms also diminished, from 42.2% in 2004 to 40% in 2005.

4.1.2. Cost Analysis

The analysed firms reported a very strict policy of cost control. The cost level indicator (the ratio of total costs to total revenues in percent) was very low and declining in the period under analysis.

Private sector firms were more effective in terms of reducing the cost level indicator than public ones (from 85.6% in 2002 to 79.5% in 2005 in the private sector and for public sector from 84.5% in 2002 to 85.4% in 2005). The biggest reduction in the cost level indicator was observed in private manufacturing, by 15 percentage points.

Table 10: The cost level indicator and the share of labour costs (in percent)

	Cost level indicator				Labour costs in total costs			
	2002	**2003**	**2004**	**2005**	**2002**	**2003**	**2004**	**2005**
Enterprises in FBH	84.8	96.4	85.9	83.9	11.9	10.4	10.8	11.1
public sector	84.5	84.2	87.2	85.4	11.8	11.6	10.2	10.7
private sector	85.6	134.5	81.5	79.5	12.4	8.1	12.8	12.2
Industry	77.4	147.9	100.6	92.3	10.8	6.0	8.5	9.0
public sector	70.9	99.8	113.8	99.1	9.3	6.6	5.7	6.5
private sector	84.2	199.4	82.2	81.9	12.1	5.7	13.8	13.5
Mining and quarrying	185.9	120.1	151.5	157.0	10.4	18.5	29.5	17.2
public sector	521.6	2.8	220.0	..	46.0	..	59.4	..
private sector	184.1	120.4	148.4	157.0	9.9	15.1	27.5	17.2
Electricity, gas and water supply (public sector)	107.9	111.7	105.3	107.9	10.0	9.5	8.5	8.4
Manufacturing (private sector)	80.5	84.8	71.4	65.6	11.4	10.4	12.3	12.7
Construction	70.6	73.9	116.0	95.6	21.1	18.6	10.7	9.8
public sector	27.6	36.5	187.9	111.0	70.7	46.8	12.8	22.5
private sector	91.3	93.3	96.6	93.4	13.9	12.8	9.6	7.6
Trade and repair (private sector)	70.0	60.1	39.9	51.5	35.2	37.9	57.2	25.5
Services	114.4	107.9	101.5	99.7	14.6	19.5	16.3	55.6
public sector	30.4	26.5	29.5	39.2	54.2	67.8	50.9	49.4
private sector	126.2	120.1	111.4	108.2	13.3	17.9	15.1	55.9
Transportation	104.7	122.0	119.7	126.3	16.7	14.6	14.4	12.2
public sector	99.4	98.7	119.7	177.0	14.5	15.4	15.5	16.7
private sector	108.4	142.9	119.7	112.2	18.1	14.2	13.7	10.2
Telecommunication (public sector)	59.1	42.6	39.8	38.6	15.6	21.8	23.0	26.0

Source: Own calculations on the basis of financial dataset.

Firms in the FBH also reported a very low share of wages in total costs. This was approximately 11% in the public sector (annual average) and 10% in the private sector. This small share of labour costs indicates that costs other than wages were more important in the production process and in services in the FBH economy as a whole[42]. Probably, the costs of materials or energy costs for industry (where an extremely low share of wages in total costs were noted) are more significant than wages. Unfortunately, there were no cost breakdowns available for FBH enterprises.

Given the ability of FBH enterprises to reduce the cost level indicator to such a low level and the low share of wages in total costs, one can conclude that great potential exists here in the area of improving international competitiveness. Further analysis of wages and productivity confirms their comparative advantage with partner countries in terms of low labour costs in the FBH.

4.1.3. Average Wage and Labour Productivity Analysis

The average monthly wage was increasing in FBH firms in nominal terms throughout the whole period under analysis, from KM 698 (EUR 358) in 2002 to KM 816 (EUR 418) in 2005. The nominal wage increase amounted to 17%. The highest wages were observed in the public sector as a result of very high wages at BH Telecom. An elimination of the company from the analysis reduces the average wage in the public sector to a level of KM 654 (EUR 335) in 2005, which is closer to the private sector's level (KM 551, EUR 282). Very high wages were observed in 2005 in mining (KM 1,096), private services (KM 1,342) and public electricity, gas, and water supply (KM 941). The lowest wages were observed in public transportation (KM 372) and public services (KM 446).

The nominal wage increase was supported by impressive labour productivity growth (total revenues to employment ratio). The total productivity level grew by 27% (a bigger increase than the nominal wage increase of 14%). Labour productivity was higher in the public sector thanks to a significantly higher level of labour productivity in public industry (KM 120,000 in 2005 and in private industry only KM 46,000) and high productivity in BH Telecom. The labour productivity growth observed in public industry amounted to 57%. In private manufacturing, productivity grew by almost 8%, in line with impressive employment increases (year on year growth amounted to 35% in 2005). Wages in manufacturing decreased in nominal terms (by 2.6%), which may suggest that manufacturing entrepreneurs kept their wages more or less stable and built up their capacity to accumulate for future wage increases.

[42] For example, in Poland, the share of wages to total costs ranged from 14% in the private sector to 16% in the public sector in 2005.

Table 11: Average monthly wages and labour productivity in enterprises in the FBH

!	Average monthly wage in KM				Labour productivity in ths. KM			
!	2002	2003	2004	2005	2002	2003	2004	2005
Enterprises in the FBH	698.4	712.7	767.2	816.5	83.1	85.2	99.5	105.3
public sector	794.4	845.5	922.5	983.3	95.9	103.7	124.2	128.6
private sector	508.6	494.4	516.4	551.0	57.6	54.7	59.5	68.1
Industry	496.0	448.1	491.7	504.8	71.5	60.3	69.3	73.2
public sector	419.4	434.9	586.2	647.7	76.2	79.6	108.2	120.0
private sector	567.5	456.6	435.4	421.1	67.1	47.9	46.1	45.8
Mining and quarrying	350.8	483.2	907.9	1096.2	21.7	26.1	24.4	48.7
public sector	248.1	728.6	841.2	!	1.2	0.6	7.7	!
private sector	361.2	449.0	918.4	1096.2	23.8	29.6	27.0	48.7
Electricity, gas and water supply (public sector)	773.8	828.2	894.7	940.8	86.0	93.7	120.1	124.8
Manufacturing (private sector)	674.1	685.2	674.5	659.5	88.4	93.4	92.0	95.3
Construction	423.5	458.4	496.9	517.6	34.1	40.0	48.0	66.2
public sector	649.6	602.5	542.5	479.8	39.9	42.3	27.1	23.1
private sector	337.1	389.3	469.3	539.7	31.8	39.0	60.6	91.4
Trade and repair (private sector)	340.7	357.7	684.1	560.7	16.6	18.9	36.0	51.3
Services	580.1	621.4	418.5	1341.6	41.7	35.5	30.3	29.0
public sector	345.8	356.7	375.4	445.9	25.2	23.8	30.0	27.6
private sector	640.4	685.3	424.5	1474.3	45.9	38.3	30.3	29.2
Transportation	428.7	429.9	382.8	376.2	29.4	28.9	26.6	29.2
public sector	330.0	370.8	342.7	372.0	27.4	29.3	22.1	15.1
private sector	508.8	481.7	417.8	379.4	31.1	28.5	30.5	39.7
Telecommunication (public sector)	1243.1	1368.4	1429.6	1538.7	162.2	176.5	187.4	183.9

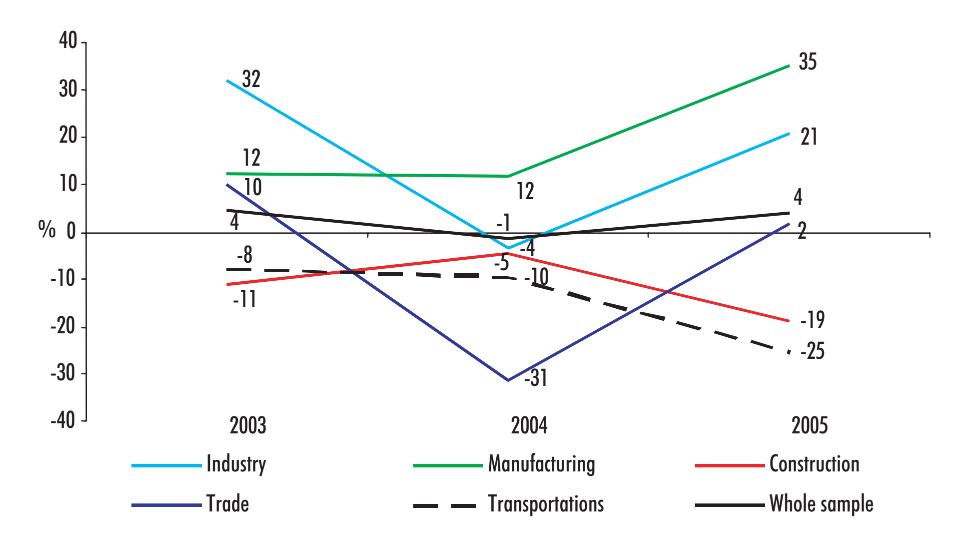
Source: Own calculations on the basis of financial dataset.

Entrepreneurs probably allocate profits for the purpose of investment rather than current wage increases. This approach is highly required in transition economies in the early process of building a market economy. This was confirmed by very strong investment outlay growth and impressive employment growth in manufacturing in 2005. The return of this investment may strongly improve manufacturing and wage increases in the future[43].

Labour productivity was increasing in each sector of the economy with the exception of services, transportation (in the public sector only) and public construction. Wage reductions in public construction was rightly supported by a collapse in labour productivity, which may be considered a reflection of the strong functioning of market forces in this sector in the FBH.

[43] In the transition economies the average period of positive return of investment and the financial effects on net income and wages amounted approximately to 2-3 years.

Figure 6: Year on year percentage changes in employment in selected sectors of the analysed enterprises in the FBH



Source: Own calculations on the basis of financial dataset.

4.1.4. Sales Revenues and Investment Outlay Dynamics

2003 and 2004 showed quite impressive sales revenue and investment outlay dynamics across the whole sample. In 2004, sales revenues increased by 23% and investment outlays by 32%. In line with the decline in effectiveness, in 2005 reductions in both dynamics were observed, although they remained positive.

Looking at sectors in terms of ownership, sales revenues and investment dynamics are the most confusing of the whole analysis. It is hard to discern the right relationship in each particular sector, with the exception of private construction, private industry and electricity, gas, and water supply firms, where both sales and investment dynamics in 2005 were positive and quite impressive.

Table 12: Year on year dynamics of sales revenue and investment outlays (in percent)

!	Sales revenue dynamics			Investment dynamics		
!	2003	2004	2005	2003	2004	2005
Enterprises in FBH	9.9	22.9	3.0	13.5	32.1	7.6
public sector	7.5	21.1	1.6	14.4	33.4	2.8
private sector	18.2	28.8	7.8	!1.6	0.6	186.0
Industry	20.8	71.2	18.3	9.8	41.6	100.6
public sector	24.4	96.9	13.8	!60.3	791.2	!95.7
private sector	18.3	48.5	24.7	19.9	3.7	198.8
Mining and quarrying	12.5	!1.6	60.9	0.0	0.0	313.9
public sector	!8.8	!	!	!	!	!
private sector	12.6	!6.8	70.6	0.0	0.0	313.9

Table 12 (continued): Year on year dynamics of sales revenue and investment outlays (in percent)

	Sales revenue dynamics			Investment dynamics		
	2003	2004	2005	2003	2004	2005
Electricity, gas and water supply (public sector)	3.0	22.6	2.7	14.7	33.0	4.1
Manufacturing (private sector)	20.0	9.6	24.7	47.6	56.4	298.3
Construction	19.7	18.9	26.8	56.3	32.0	25.4
public sector	39.3	24.6	20.2			
private sector	11.4	42.1	40.1	56.3	32.0	16.6
Trade and repair (private sector)	34.1	39.3	91.5	0.0	94.4	96.3
Services	118.1	114.1	47.5	0.0		
public sector	5.9	9.8	13.3	0.0		
private sector	187.6	148.0	63.9			
Transportation	10.7	24.2	2.6	0.0		
public sector	1.3	45.9	28.5			
private sector	17.7	4.6	18.6	0.0		
Telecommunication (public sector)	8.3	6.0	3.5	22.7	39.2	45.0

Source: Own calculations on the basis of financial dataset.

4.1.5. Return on Assets and Company Liquidity Assessment

Return on assets (ROA) analysis does not show any important message, apart from its positive level and increasing character across the three sectors outlined in the previous analysis: manufacturing, public industry and private construction. A positive ROA in the sample (the ratio of EBIT to total assets in percent) is to a large extent supported by the fact that companies did not report their losses, giving zero instead of negative EBIT values. We noted this above in the effectiveness analysis and indicated there that the results cannot be fully comparable with other samples in this respect. However, the objective of the ROA analysis, as well as analysis of efficiency, was observation of trends in the particular sectors. Only in the indicated sectors (industry, manufacturing, BH Telecom and private construction) were assets utilised effectively and the advantages stemming from this increased throughout the analysed period. This also confirms the effectiveness analysis.

Our sample does not indicate a strong current ratio[44] (bigger than 2) in any of the analysed sections, with the exception of public transportation (a very high level of current assets in this sector in comparison to a low level of current liabilities is the result of this type of economic activity) and public construction in 2005 (current ratio

[44] A current ratio (of current assets to current liabilities) is an indication of a company's ability to meet short-term debt obligations. The higher the ratio, the more liquid the company. If the current assets of a company are more than twice its current liabilities, then that company is generally considered to have good short-term financial strength. If current liabilities exceed current assets, then the company may have problems meeting its short-term obligations.

Table 13: Return on assets and current ratio (in percent)

	ROA				Current Ratio			
	2002	2003	2004	2005	2002	2003	2004	2005
Enterprises in the FBH	2.7	2.6	3.1	2.8	0.9	1.0	0.8	0.9
public sector	2.2	2.4	3.1	2.6	0.9	1.0	0.9	0.9
private sector	5.5	3.5	3.2	4.2	0.9	1.0	0.7	0.8
Industry	1.6	3.1	4.1	3.3	0.8	0.9	0.7	0.8
public sector	0.4	1.7	4.2	1.8	0.9	0.9	0.8	0.8
private sector	2.6	4.4	4.1	4.8	0.7	0.9	0.6	0.8
Mining and quarrying	..	0.0	0.0	0.0	4.6	1.1	0.9	0.7
public sector	0.0	0.0	0.0	..	0.3	0.3	0.3	..
private sector	..	0.0	0.0	0.0	6.3	1.2	1.0	0.7
Electricity, gas and water supply (public sector)	0.0	0.0	0.1	0.0	0.8	0.8	0.7	0.8
Manufacturing (private sector)	7.1	6.1	5.4	7.4	1.1	1.2	0.8	0.8
Construction	0.4	0.4	0.5	0.8	0.8	0.9	1.3	1.5
public sector	0.0	0.0	0.0	0.0	0.6	0.9	1.9	2.1
private sector	1.0	0.8	1.0	1.4	1.0	1.0	1.1	1.2
Trade and repair (private sector)	0.0	0.0	0.0	0.4	0.9	0.3	0.4	0.2
Services	0.0	0.0	0.0	0.0	0.4	0.5	0.2	0.1
public sector	0.0	0.0	0.0	0.0	0.5	0.5	0.2	0.2
private sector	0.0	0.0	0.0	0.0	0.3	0.4	0.2	0.1
Transportation	0.1	0.0	0.0	0.0	3.1	3.5	3.4	2.5
public sector	0.2	0.1	0.0	0.0	3.9	6.0	9.0	5.9
private sector	0.0	0.0	0.0	0.0	1.5	0.7	0.5	0.5
Telecommunication (public sector)	16.8	15.5	15.0	14.6	2.2	3.7	1.3	1.5

Source: Own calculations on the basis of financial dataset.

2.1). The analysed companies in the FBH also do not present strong liquidity and short-term financial strength in this respect. In very many cases firms may have trouble covering their short terms obligations due to a high level of short term liabilities (this can be a reason for inter-enterprise charges or obligations for the state – taxes or social security contributions) or limited access to finance their duties. The worst hit sectors in this respect in 2005 were: services (current ratio 0.1), trade and repairs (current ratio 0.2), and mining and quarrying (current ratio 0.7).

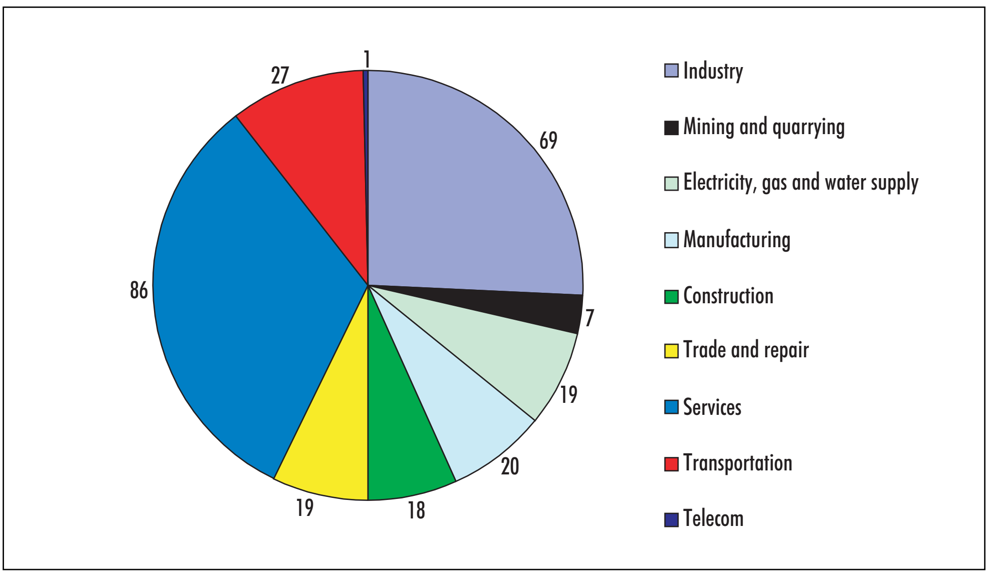
4.2. Enterprise Sector Performance at the Banja Luka Stock Exchange

The financial analysis of 266 firms (out of 644 listed at the Banja Luka Stock Exchange) identified by branch is provided (see Figures 7-9, Table 14). Also, the financial conditions of the whole group of enterprises listed on the BLSE, though not broken down by branch, are provided in this part. Due to serious data availability limits, the period of analysis is much shorter (2004 and 2005) than was in the case of the FBH enterprises' sample and the financial data are also more incomplete. Given the various differences in data reporting, analysed financial indicators (those which include EBIT) cannot be compared between the two groups. There is also lack in employment and wage data in the SR sample, which makes this analysis much weaker than the previous one.

Despite these shortages, we could investigate some trends in enterprise sector development in the SR. The BLSE enterprise sample has two important advantages over the FBH one; firstly, it is much bigger, which give us greater representative ness for the overall analysis, and secondly the analysed enterprises (listed on the stock exchange) are benchmarks for other companies in the region to meet in terms of their behaviour and financial results. To obtain common recommendations for branches across the whole country, we decided to identify the BLSE firms by type of activity using the same division by branches as was used in the FBH enterprises' analysis. We managed to identify 41% of the group (266 units), for which financial analysis by branch is provided. The full specification of the company names and symbols used on the stock exchange is included in Annex 5. The biggest groups in the sample are services firms (86 units) and industry firms (69 units). The groups of transportation (27 units), manufacturing (20), trade (19), construction (18) and electricity, gas and water supply (19) are also numerous.

The average revenues of the sample from BLSE companies amounted to KM 8.3 million in 2005, six-fold lower than in the case of the FBH (the significant

Figure 7: Firms by branch listed on the Banja Luka Stock Exchange



Source: Own calculations on the basis of the Banja Luka Stock Exchange dataset.

Table 14: Financial indicators by branches of listed companies on the Banja Luka Stock Exchange

	Cost level indicator		Rate of return		ROA		ROE		Current ratio		Working capital to revenues ratio	
	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005
644 firms listed on the Stock Exchange	105.8	107.7	-5.8	-0.1	-1.2	-1.9	-1.6	-2.6	1.0	0.9	-1.9	-7.1
266 identified firms	102.2	104.2	-2.2	-4.2	-0.6	-1.2	-0.6	-1.4	1.1	1.0	7.0	1.4
O/w Industry	118.5	129.7	-18.5	-29.7	-4.6	-8.6	-5.6	-11.4	0.9	0.7	-12.0	-30.1
Mining and quarrying	106.1	145.5	-6.1	-45.5	-2.4	-21.4	-3.0	-28.7	0.7	0.7	-21.0	-22.2
Electricity, gas and water supply	99.6	95.9	0.4	4.1	0.1	0.7	0.1	0.8	1.7	2.4	32.3	56.0
Manufacturing	122.0	115.4	-21.9	-15.3	-5.6	-4.2	-7.3	-6.5	0.5	0.3	-67.1	-101.8
Construction	107.3	98.7	-7.3	1.3	-10.4	1.9	-10.9	1.9	1.1	1.2	5.6	8.8
Trade and repair	104.1	103.4	-4.1	-3.4	-4.7	-3.5	-6.0	-5.2	0.8	0.4	-8.0	-23.2
Services	104.9	115.3	-4.9	-15.3	-2.4	-7.6	-2.6	-9.2	1.0	0.9	1.0	-5.7
Transportation	112.7	99.6	-12.7	0.4	-4.6	0.2	-5.2	0.2	1.0	1.1	-0.8	2.7
Telecom	74.7	76.6	25.3	23.4	12.6	11.1	15.6	13.8	1.4	1.1	6.8	1.3

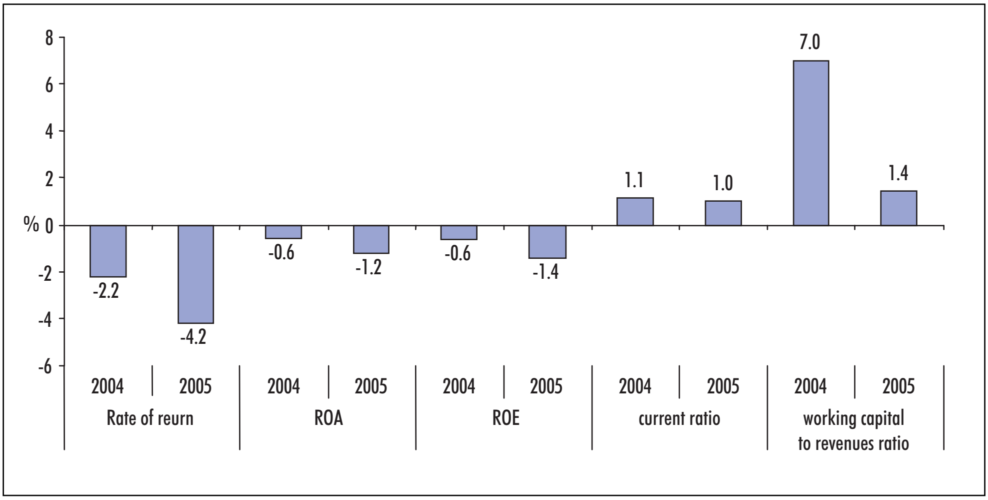
Source: Own calculations on the basis of financial dataset.

difference comes from BH telecom). Total income before taxes accumulated a negative value of minus KM 46.6 million in 2004 and doubled to minus KM 93.1 million in 2005. The total value of assets, fixed assts and current assets declined in line with negative profits. Due to negative profits, rates of return (income before taxes to revenues in percentages) remained negative and declined from -2.2% in 2004 to -4.2% in 2005. Enterprises losses also influenced the negative values of ROA (Return on Assets) and ROE (Return on Equity) indicators, which also decreased, reflecting the analysed firms' poor financing possibilities. Current ratio levels were also very low, which suggested their very weak short-term financial strength. The cost level indicator acceded 100%, which reflects costs higher than revenues in the analysed companies (102% in 2004 and 104% in 2005). Increases in this indicator tend to be evidence of deep-seated ignorance of cost growth control. Unfortunately, we do not know the reasons of these costs increases; most likely it was due to bad corporate governance.

Average revenues of all companies listed on the BLSE amounted to KM 4.2 million in 2005, two-fold smaller than in the selected group of firms identified by branch and 13-fold less than in the case of FBH firms. Selected financial indicators for the whole group are also very poor and even worse than in the selected group. This may suggest either much poorer financial condition of the whole enterprise sector in the SR or much weaker coverage by statistics.

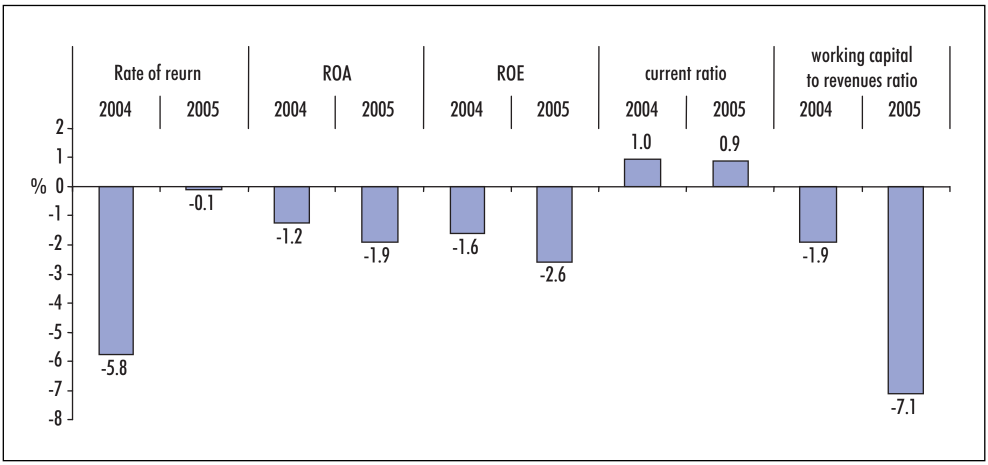
All sectors have a very poor financial stance, with the exception of electricity, gas and water supply and telecommunications (one company – Telecom Srpske AD Banja

Figure 8: Financial indicators of enterprises listed on the Banja Luka Stock Exchange in 2004-2005 (the sample of 266 firms identified by branch)



Source: Own calculations on the basis of the Banja Luka Stock Exchange dataset

Figure 9: Financial indicators of enterprises listed on the Banja Luka Stock Exchange in 2004-2005 (all 644 companies listed)



Source: Own calculations on the basis of the Banja Luka Stock Exchange dataset

Luka). Construction and transportation firms noted an effectiveness improvement in 2005 in comparison to very bad results in 2004. Industry, mining, manufacturing, trade and services firms noted a very bad financial stance in 2004 and 2005.

4.3. Obstacles in Business Environment in Bosnia and Herzegovina

Business in poor countries usually face much larger regulatory burden than those in developed countries, including administrative costs, bureaucratic procedures and delays associated with them. Heavy business regulations and weak property rights have damaging effects on SME and big enterprises, and especially private ones. With burdensome regulations, high taxes few businesses bother to register all economic activities preferring to operate in NOE. The significant size of NOE in BH (BH (see The Issues of Measurement) might be the evidence of existence of obstacles in business environment. Another confirmation of the very serious problems faced by the BH's companies was indicated by surveys conducted by EBRD and the World Bank in the form of BEEPS surveys and Doing Business reports. In this part, comparisons of crucial obstacles in business development in BH compared to the benchmark countries (countries (see Benchmark Selection for Bosnia and Herzegovina) will be provided.

4.3.1. BEEPS Surveys

The BEEPS surveys by EBRD have been carried out in three rounds but in the first round (in 1999) BH was not yet included. The BEEPS surveyed 200 BH's firms about their business environment and interactions with the state in 2002 and 2005. The BEEPS can be thought of as a compilation of indicators about what firms are saying about the ways the government policies, rules, and procedures are implemented in practice. The most important obstacles to business expansion in BH in 2002 and 2005 comparing to benchmark countries (Lithuania, Latvia, Slovakia and Poland) in 1999 were similar, but the level of their significance differentiated.

We separated two categories of obstacles to business development. One group was composed of those obstacles, which were referred in benchmark countries in 1999 to be almost as strong as in BH in 2002 and 2005. These obstacles were: financing firms' activities[45] (the biggest similarities to Slovakia and Lithuania in 1999), taxes (in 2002 in BH as strong as Lithuania, in 2005 as strong as in Slovakia in 1999), street crime (stronger in Lithuania in 1999 than in BH in 2002 and 2005),

[45] Questions in the BEEPS 1999 round survey differed slightly from 2002 and 2005 rounds. Some questions in the further rounds (of 2002 and 2005) were more detailed than it was in 1999 round. In order to asses the development in business environment in all 3 rounds of the survey (only for the needs of this analysis) the small adjustment in questions was necessary. The detailed questions from the further rounds were combined to the bigger category question from the former round. For financing (1999 category) we analyzed cost of financing and access to financing – more detailed categories from further rounds. For taxes we took tax administration and tax rates, for infrastructure we took transportation, electricity and telecommunication, and for policy instability we took macroeconomic instability and uncertainty about regulatory policies. Other categories of obstacles (corruption, street crime, organized crime/mafia, anti-competitive practice, and functioning of judiciary) remained unchanged in all BEEPS rounds, that we did not change them.

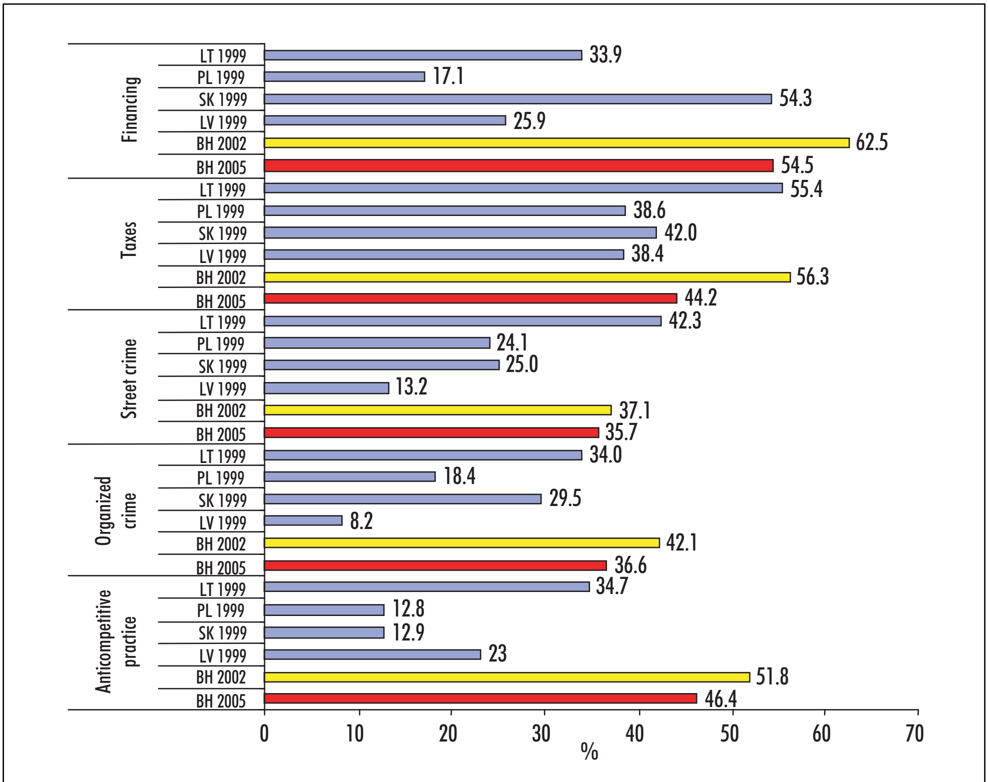
organized crime (in BH 2005 as strong as in Lithuania in 1999), anti-competitive practice (most likely Lithuanian level).

The second group of obstacles to business expansion was composed of those with a significantly bigger importance for BH in 2002 and 2005 than it was in the benchmark countries in 1999. In 2002 and 2005, BH's enterprises referred to face more difficulties in business expansion in the area of infrastructure, corruption, policy instability, and functioning of judiciary then the benchmark countries in 1999.

The most annoying problem category of doing business was high level of policy instability in BH. This category was reported to be more than twice as strong in BH in 2002 and 2005 as in Lithuania, Poland and Latvia, and almost 10 times higher than in Slovakia in 1999. It is worth mentioning that for the high level of policy instability this category was more responsible than uncertainty about regulatory policies component or macroeconomic instability component (about 60% versus 50%, respectively).

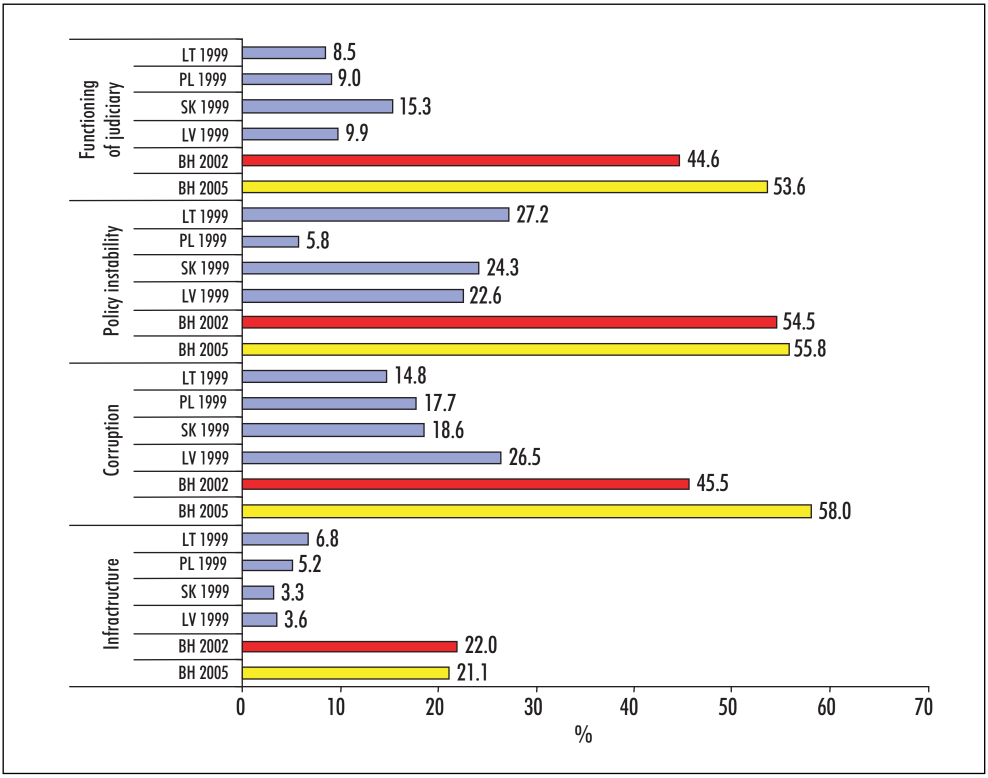
Corruption is another important element for the business environment which negatively affects business expansion in BH. Over 45% of questioned enterprises

Figure 10: Business obstacles in Slovakia, Poland, Lithuania, and Latvia in 1999, entrepreneurs respond (in percent)



Source: EBRD-World Bank Business Environment & Enterprise Performance Surveys 1999, 2002, 2005 (BEEPS)

Figure 11: Business in Slovakia, Poland, Lithuania, and Latvia in 1999, entrepreneurs respond (in percent)



Source: EBRD-World Bank Business Environment & Enterprise Performance Surveys 1999, 2002, 2005 (BEEPS)

indicated corruption as an important obstacle in doing business in 2005. In 2002, there were even more entrepreneurs claiming this (58%). In the benchmark countries the problem of corruption in 1999 was much less important (2-3 times smaller) than in BH in 2002 and 2005[46].

Infrastructure (a combined indicator for transportation, electricity, and telecommunications) also remained stronger obstacle in business expansion in BH in 2002 and 2005 as well as in the benchmark countries in 1999. And a very significant improvement is required in this area to face any major improvement.

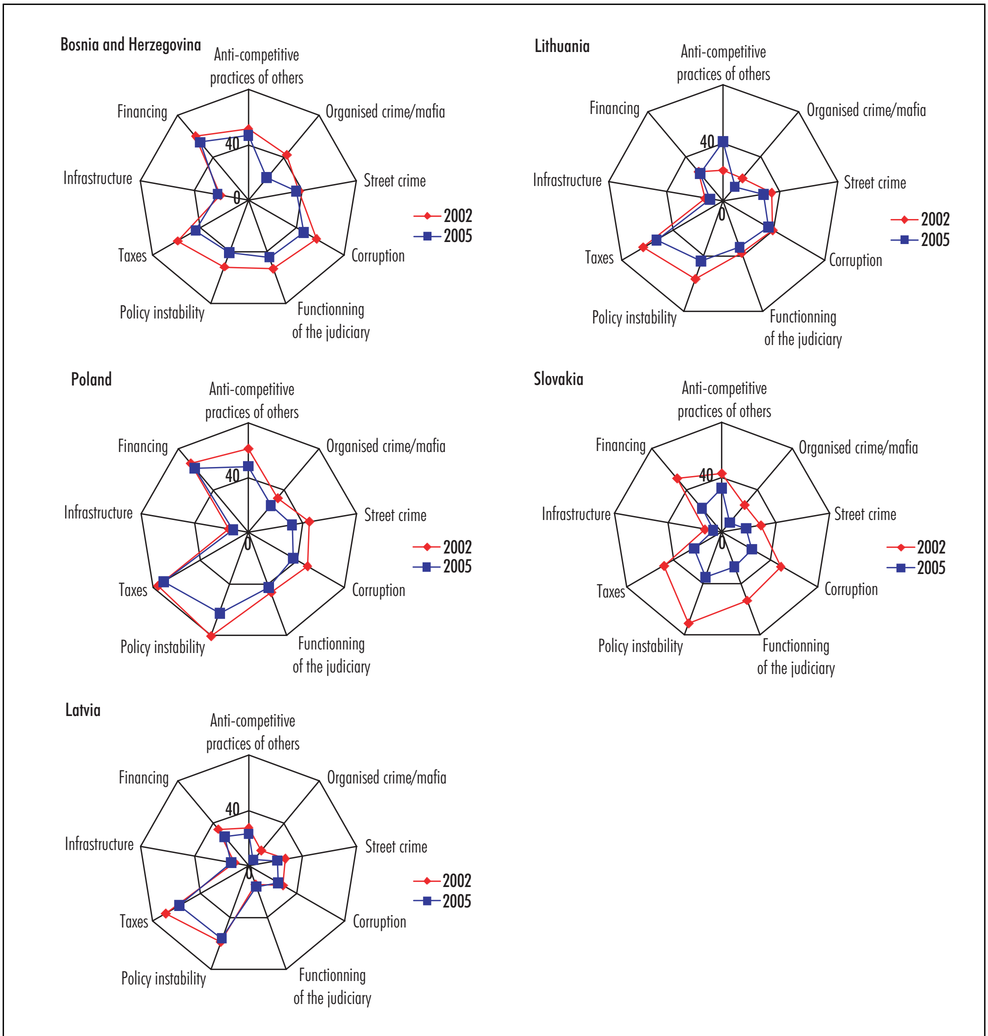
Elimination of the majority of those obstacles and improvement business environment lies in hands of the government. The major policy challenge for the authorities should be to ensure dynamic inter-enterprise competition and

[46] In a very recent (2005) analysis of public perception of the level of corruption, conducted by the Transparency International (which derives this indicator from a range of existing surveys), BH was rated 93 of 163 countries. Other countries with the equal ranking as BH were Armenia, Argentina, Eritrea, Syria and Tanzania. According to the study, this indicator has not changed in BH significantly since 2004.

development friendly business environment. To achieve these goals, the government needs to provide the proper incentives and market signals by reforming its own actions especially in the indicated areas.

Looking at the process of reduction of business obstacles in the benchmark countries (in the period of 2002-05), we can assume that BH government is able to achieve significant improvements. Some of the obstacles to business development in BH have already been reduced in the analysed period in the area of taxes, policy instability, functioning of judiciary, corruption, and organized crime. More

Figure 12: The main obstacles in business environment in Bosnia and Herzegovina, Lithuania, Slovakia, Poland, and Latvia in 2002 and 2005



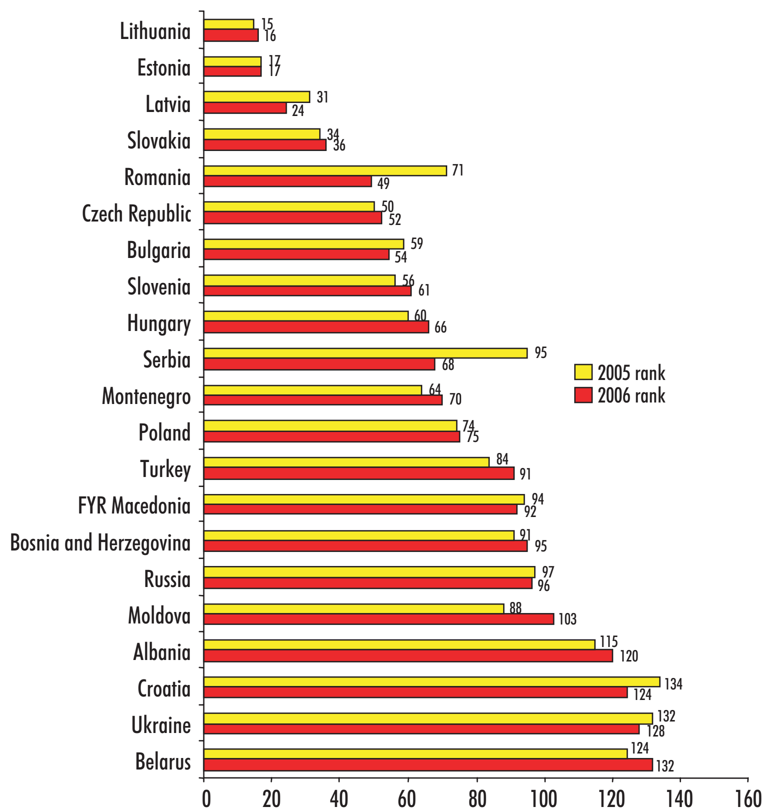
Source: EBRD-World Bank Business Environment & Enterprise Performance Surveys 2005 (BEEPS) improvements are still required in infrastructure, firm financing, and street crime, where no progress was made since 2002.

4.3.2. Doing Business Ranking

Most of the indicators from Doing Business reports by the World Bank, in contrast to BEEPS surveys are generated by asking not entrepreneurs, but lawyers, accountants, and other professionals in each surveyed country about the details of the laws, rules, and procedures that govern various aspects of business activities.

The Doing Business methodology presents hypothetical cases or situations that are the same for each country. Doing Business ranking can be thought of as a compilation of indicators about various government policies, rules, and procedures. This part of analysis is based on the findings of the Doing Business in 2007 survey.

Figure 13: Ranks in Doing Business in South Eastern European Economies and Western Balkans in 2005 and 2006



Source: Doing Business 2006, World Bank.

Separated by main categories, the performance of BH shows practically no significant improvement comparing to the previous years with the exception of employing workers category (+1 rank) and registering property category (+3 ranks). The most significant drop in ratings (-13 ranks) was registered at paying taxes category (that would party contradict findings of the BEEPS). However, tax reforms in BH took place only after the report was prepared. The most important improvements in BH were required in the following areas: starting a business, dealing with licenses, and registering property.

4.3.3. Investment Reform Index 2006 (IRI)

IRI[47] points out several sectors in which the most significant business barriers exist. In this context, the following areas are among the problematic ones in BH: regulatory reform, tax policy, human capital, investment promotion and facilitation.

In the field of regulatory reforms, BH has the lowest ranking in the region, measured by the four main sub-dimensions (regulatory reform strategy, performance of the regulatory oversight body, regulatory impact analysis and transparency). According to IRI, BH has not yet formalized its regulatory reform strategy and it has introduced only a small number of programmes aimed at improving the quality of the regulatory framework in the business sector. There are only two programmes ongoing in this sector, both of them donor driven. The "regulatory guillotine" in Republika Srpska, funded by FIAS and USAID originally until September 2006, regulates the issuing of business licenses to enterprises. Another USAID funded project in this area, SPIRA – Streamlining permits and inspection regimes activity, is engaged in reducing the administrative barriers for the operations of SMEs. The only oversight body in this respect in BH is the Task Force for the Reduction of Administration Barriers, with very limited powers. This is also the reason why the BH ranks as low on the index of the regulatory oversight body performance, when compared to other countries in the region.

In many countries tax policy is one of the most important elements for boosting business activities through domestic investments and FDI inflow. According to the IRI, even though if SEE countries are at different stages of development, the SEE region has one of world lowest statutory corporate tax rates. The only exception is BH, more specifically the FBH entity, where the corporate tax rate lies at 30%. In RS the rate remains similar to the SEE average (10%). Two problems are evident here: high tax rates in the FBIH, and fragmentation of the single market due to the differentiated

[47] The study was undertaken by the OECD Investment Compact Project Team. The Investment compact is a regional programme designed to improve the investment environment and encourage private sector development in South East Europe (SEE).

tax rates in the two entities. One encouraging sign is a planned introduction of one unified 15% tax rate throughout the country.

In the area of investment promotion and facilitation BH is still particularly weak. On the overall score, BH ranks the lowest out of all examined countries in the region, Moldova being the only country with similarly poor performance. Measured by the quality of its Investment Promotion and Facilitation Strategy, together with Macedonia, BH occupies the last position. The two remaining sub-dimensions that have been assessed in the study, namely the performance of the Investment Promotion Agency and the transparency of business environment, rank below the average.

According to the Stability Pact estimates, 70% of the educational infrastructure in BH was destroyed during the war. In Bosnia, there is no countrywide comprehensive education policy. The education policy is the competence of the entities, and in the FBH of the cantons. There are twelve effective education laws in FBiH, one in the RS and one in Brcko District, yielding a complex and fragmented legislative framework and no coherent education strategy. The fragmentation of the education policy among the entities and ten cantons is exacerbated by poor coordination among these numerous levels of government. The teaching curriculum is outdated, and there is no strategic link between the government's education policy and private sector needs. The statistical information about the needs of the labour market is generally poor. While no link exists between the education curricula and the labour market needs, the vocational training is weak.

5. Conclusions and policy recommendations

1. Within Copenhagen criteria, the EU established a twofold set of economic conditions to examine the economic readiness for membership of an applicant country. It requires the candidate to have a functioning market economy with free and open competition, price and trade liberalisation and a developed financial services sector as well as the capacity to withstand the competition in the EU market, namely that enterprises are obliged to develop their ability to cope with competitive pressures and forces in the European Union's internal market, as well as the whole economy of the applicant country compared to the economies of EU members.

2. The economic criteria are formulated to be a "moving target". This perception tends to generate frustration in the candidate states and further suspicions about the EU's commitment to enlargement in general. However, over a long accession process amid rapidly changing conditions flexibility has considerable advantages. Nevertheless, the application of conditionality is not transparent and consistent.

3. The Commission follows its methodology on the economic criteria in each Opinion and Regular Report on candidate countries. Opinions contain the first assessment of the candidate countries with respect to the criteria set by the European Council in 1993 and methodology implied by the European Commission in Agenda 2000. the annual Progress Reports focus on those areas where some improvements could still be made and on the economic developments of the last twelve months, using the previous year's assessment as a base. The EC document that combines the knowledge of Opinions and Regular Reports is the Avis, which examines all Copenhagen criteria in detail and looked at developments over several years in order to assess readiness for accession.

4. Comparison of past and present economic indicators of BH with new Member States of the EU that joined in 2004 (Poland, Czech Republic, Slovak Republic, Hungary, Lithuania, Latvia, Estonia, Slovenia) and with the group of countries

with formal candidate status in 2006 (Turkey, Croatia, Former Yugoslav Republic of Macedonia as well as two acceding countries Bulgaria and Romania), as well as other economies in the South Eastern Europe region set the proper benchmark for the analysis of economic policy.

5. Judging by current GDP per capita levels and changes in these levels over the past decade, BH today is at a stage comparable to those of the five current candidate and accession countries (Bulgaria, Romania, Croatia, the Former Yugoslav Republic of Macedonia and Turkey) roughly a decade ago. On the other hand, NMS8 had a visibly higher average GDP per capita back in 1996 (in fact, even in 1993) than BH in 2005-2006. Among this group of countries only 1997-1998 Latvian GDP per capita was comparable to the 2005-2006 BH level. However, the gap to Bulgaria and Romania (joining the EU in January 2007) is visibly smaller – BH's 2005-2006 GDP per capita level is comparable to Bulgaria and Romania in 2000-2001. BH's development level (GDP per capita as proxy) is comparable to other Balkan countries that have not yet started negotiations on EU accession (Albania and Serbia).

6. National accounts data for BH are not adjusted for the non-observed economy (NOE). A number of studies have estimated the NOE for BH from over 57% to 30% of officially estimated GDP during 2001-2003. Therefore, ratios to GDP – important comparative and informative indicators for any economy, may appear less accurate for BH than for other countries, especially from the EU. In 2005-2006, BH presented a similar level of GDP per capita PPP as Lithuania and Latvia in 1996-1997 and Bulgaria and Romania in 2000-2001, which in both cases was 7 years before accession to the EU, respectively in 2004 and in 2007. A "conservative" 30-% adjustment for the NOE would obviously improve the benchmark level for BH and situate the country at the level of new Member States 2-3 years before EU accession.

7. The GDP per capita is not the only comparative and informative indicator for an economy. Taking into account the he human development index BH in 2004 presented a similar level of human development as Lithuania and Latvia in 1999, which was 5 years before these two countries joined the EU. However, during 1999-2004, just before the EU accession Lithuania and Latvia (together with Estonia) achieved a very substantial progress in development that resulted from a broadening and deepening of economic reforms. The Baltic countries were the first countries from NMS8 that finalised accession negotiations with the EU.

8. The analysis conducted by the Commission in the Opinions led to the following overall picture common to all countries (Poland, Lithuania, Romania and Croatia) chosen for comparative reasons for BH:
   - Trade integration and FDI have progressed substantially (except for Romania and BH). However, in Romania, there has been a reversal from initial trade liberalisation, mainly for macroeconomic reasons;
   - The functioning of capital markets and competition rules has been improving everywhere, but is generally still far from satisfactory;
   - The state of infrastructure remained poor (except for Croatia);
   - Wage levels were still well below EU levels;
   - Privatisation has progressed at different rates and the process remains to be completed.
   - Most applicants needed or still need to restructure large state-owned industries, which dominate local economies and tend to be very hard to reform for both social and economic reasons.

9. Although BH does not yet have a formal candidate country status and therefore no Opinion has been developed by the Commission, it is assessed according to the Copenhagen criteria within Stabilization and Association Process (SAP) starting from the 2005 Progress Report. According to the Commission in 2005 the BH economy operated only to a limited degree within the framework of functioning market principles. Further reform efforts were called for as necessary to address the serious shortcomings in the competitiveness of the economy. To maintain macroeconomic stability and safeguard the sustainability of the currency board, a prudent macroeconomic policy mix is a priority. In order to strengthen the productive base of the economy, the largely loss-making corporate sector must be urgently and fundamentally restructured and privatisation accelerated. In addition, actions to reduce overall government interference in the economy and improve the business climate are essential. The flexibility of the labour market should be enhanced and the judicial system, in particular the handling of bankruptcies and property rights, strengthened. To successfully manage the fiscal challenges, coordination and analytical capabilities need to be improved and the size of public expenditures be reduced in real terms. These demanding tasks require firm political commitment and cooperation between different levels of government. In general, the functioning of market forces is hampered by the strong influence of the public sector in the economy and the weak business environment and legal climate. Despite some improvements, markets are also sometimes fragmented between entities.

10. BH arguably had some of the most difficult starting conditions for economic, political and social transformation among the countries emerging from the dissolution of the former socialist block. Violent military conflict of early 1990s brought large losses of human life, destruction of a physical infrastructure and institutions, and led to an extremely difficult and tense political environment and social relations in which the subsequent state building and political, social and economic reforms needed to take place. This perspective is important for understanding developments leading to eventual fulfilment of the Copenhagen criteria and integration with the EU.

11. Dayton agreement (1995) brought an end to the war period establishing the present political divisions and structure of government and allowed the international community to get more seriously involved in supporting BH. In late 1990s, the country recorded a period of strong post-conflict recovery. During 1996-1999, reconstruction activity buoyed economic growth, which averaged above 30 percent per annum. Over the period 2000-2006 BH recorded average annual growth rates of around 6.6% per annum, while for the three comparative groups this oscillated between 6.2% and 7.3%. This indicates that while BH has been recently catching up with the more developed EU countries (for example the EU15 group), there was hardly any convergence, even a divergence, with other European economies – NMS8 and the Balkan accession and candidate countries. It signals a very long and relatively slow catch up process for BH. Overall, 10 years after Dayton the GDP roughly tripled in size, though was still below the pre-war levels.

12. Given its very low development level, its human capital and other characteristics and the experience of other transition economies it would appear that BH might be able to boost its potential economic growth to higher levels. The key to improving development potential lies in domestic reforms.

13. Labour market is one sector where several shortcomings of BH economy are visible. The three key challenges in this field are low productivity and relatively high wages in the formal sector of the economy, large (and according to some sources growing) informal employment and high unemployment. This list could be extended by adding the low overall employment rate (taking the formal and informal sectors together) and possibly also the problem of the (in)adequate labour market-related skills of recent graduates and in the population at large.

14. Another set of problems demonstrates itself in foreign trade performance. Up till 2003 trends were quite discouraging with foreign aid flows driving demand for

imports and very weak export performance. Since 2003 export dynamics improved considerably and this trend is likely to continue. One general conclusion emerging from analysis of BH foreign trade is that impediments to its development are primarily of a domestic nature, rather than related to foreign trade policies. In other words, poor export performance can be linked to a sub-par investment climate, difficult conditions for doing business, a rigid labour market, high taxation on registered economic activity (and a large unregistered economy), limited know-how and outdated technology in BH companies. Such a view can also be supported by the experience of the EU new Member States over the last decade.

15. In the case of BH specifically it seems that the Commission puts pressure on macroeconomic stability and broad consensus about economic policy as key elements to enhance the performance of a market economy. Maintaining a sustainable macroeconomic stability is a necessary precondition on the road to EU accession. The currency board arrangement in BH has allowed for inflation stabilisation. It has also strongly reduced the real effective exchange volatility in the past and is likely to play such a role in the future – possibly until adoption of the Euro at some stage. This is not synonymous with stating that the currency board does not cause any problems for the BH economy. No single exchange rate and monetary regime is free from drawbacks. The point is rather that for a small, open, European economy trading mostly with Euro-zone countries or countries with stable currencies against the Euro, maintaining a peg is the best option. The experiences of the Baltic countries, which have opted for a similar exchange rate arrangement since early 1990s, and the experience of Bulgaria - which switched to a currency board after a major crisis in 1996-1997 - is quite encouraging in this respect.

16. The experience of the NMS also highlights the role of the fiscal position, which is particularly important in smaller countries with fixed exchange rate regimes. Of key concern is not only keeping the fiscal position close to balance in the medium term, but the size and structure of fiscal expenditures.

17. Much of the internal political debate in BH has concentrated on the trade balance "problem", with the implicit or explicit policy objective of reducing the trade deficit. Such a view should be considered as somewhat simplistic. In particular, BH exports are very dependent on imported inputs and a high level of processing takes place in BH before re-export to the EU and other regions. This is not a negative phenomenon and given the small size of he country, increasing openness (both for imports and exports) is a natural trend. What is of importance is that BH

enterprises successfully compete with European and global players. Only improved competitiveness can help spur exports and induce consumers to choose domestically produced rather than imported goods.

18. BH's macroeconomic prospects for the next 5-10 years strongly depend on domestic reforms, which would determine the pace of development and catch-up with the EU. The three scenarios can be drawn.

19. The optimistic scenario (the "Baltic scenario") assumes a coherent set of economic policies maintaining macroeconomic stability (in particular improving medium-term fiscal prospects), reducing the tax and regulatory burden on the economy, thus allowing for a reduction in the scale of unregistered economic activity. Easing of conditions for doing business, coupled with productivity gains and real wage restraints, could provide a major boost to the external competitiveness of BH production and a surge in exports. This would be supported by rising FDI inflows further encouraged by the prospects of eventual EU accession. The Baltic countries experienced very fast convergence in GDP per capita levels, as they needed around seven years to close the gap between their position and the EU25 average by 10 percentage points. Therefore, in the optimistic scenario BH could reach a GDP per capital level in PPS equal to around 35% of the EU25 average before 2017, no more than a decade from now.

20. The second scenario (the "Bulgaria-Poland scenario") forecasts BH to reach around 35% of the EU25's GDP per capita by 2021, 15 years from now following path of stop-and-go reforms of Poland and Bulgaria.

21. The third scenario can be based on the recent experience of another ex-Yugoslavia country that recently acquired EU candidate status – Macedonia. The modest growth rates that have been registered in this country since 2003 imply that that its GDP per capita in PPS is expected to increase from just above 24% of the EU25 average in 2003 to 27% in 2008. Assuming a similar pace of convergence for BH (the "Macedonian scenario") implies that by 2025 BH would not even reach a level of 30% of average EU25 GDP per capita.

22. Meeting the economic criteria requires, certainly in the case of transition economies, deep and lasting structural reforms that take time to be accomplished. The issue of track record, which was one of the factors considered by the Commission, becomes then highly relevant. In this context, track record means the irreversible, sustained

and verifiable implementation of reforms and policies over a period long enough to allow for a permanent change in the expectations and behaviour of economic agents and the assessment that the achievements will be lasting.

23. Privatisation process is one of the most important institutional and structural features of every transition economy and especially relevant from the perspective of meeting the Copenhagen criteria. Before 1991, before the ownership transition was initiated in Bosnia-Herzegovina, the number of entities owned by the state or with state shareholding stood at 2,508 companies and 40 banks. Privatisation has been carried in parallel in both the FBH and the RS using somewhat different methods. Both privatisation processes have been conducted on three levels: small-scale privatisation, privatisation of large state-owned companies and strategic companies. BH has kept in its possession a large portfolio of state-owned companies and the privatisation of strategic firms has continued to be slow.

24. If one takes 2004 as a base year (six years after official start of privatisation), the following results were achieved: the total value of privatised companies stands at 50% of total registered companies slated for privatisation. In the RS, KM 4.5 billion worth, or 53% of earmarked companies, were privatised. In the FBH the results were even poorer, with privatisation bringing in KM 5.3 billion, 39% of the planned level.

25. Small-scale privatisation was completed within only a few years. Public share offerings for privatisation of state-owned companies were concluded on November 5, 2002. Some of larger companies, both state-owned and syndicated, requested special status, i.e. that of a strategic company. The major difference in approach to the privatisation of strategic and other companies was in the criteria that were applied. In the privatisation of a strategic company, the financial offer is not usually ranked as the most important factor in evaluation of offers. Instead, the agency tends to assess the sustainability of the business, including the seriousness of the partner and his market position.

26. Before 2004, the FBH laid out a list of 56 strategic companies and by the end of 2004 had privatised 28, or 50%, of them. The RS, likewise, set out a list of 52 strategic companies for privatisation and by the end of 2004 had privatised 43, or 82%, of them. Experience has shown that a number of companies of strategic importance for the government have been the subject of change, and this will increase with time. During 2005-06, progress was made in privatisation and corporate restructuring in the RS, mostly because of the new government, which

has been dedicated to the implementing further economic transition. Important laws have been adopted by the RS parliament, including a Securities Law and Investment Fund Law.

27. BH attracted FDI of EUR 250 million in the first nine months of 2006 and FDI is expected to reach EUR 400 million by the end of the year, up from EUR 330 million in 2005. Aggregate FDI stock per capita should reach EUR 495 in 2006, 58% went to industry and 16% to the banking sector. FDI is likely to rise to some EUR 1.0 billion in 2007 as stalled privatisations are expected to be restarted after the election of November 2006 and the formation of a new government. This level still could be regarded as unsatisfactory, particularly because of the inadequate level of greenfield investments and slow privatisation process.

28. In 2005, private sector activity reached 55% of GDP from around 50% in 2004. The privatisation process continues to reshape the overall structure of the economy. However, one of the problematic issues for the government is the opening of criminal charges against a previous government that had privatised one of the state owned banks. Reopening previous privatisations if considered a friction fight in politics might tarnish BH's image abroad and impact on investors" risk calculations for further BH investments.

29. In 2006, the privatisation process was continued irrespective of the political debates during the political campaign. In the RS, the Privatisation Directorate has finalised the privatisation of 38 larger companies. 40% of state owned nominal capital intended for privatisation remains to be privatised, mostly in the utilities and infrastructure sectors (strategic companies). In the FBH, the results have been less favourable, with only 13 companies sold. However, approximately 40% of nominal capital for privatisation remains in the state's hands – a level similar to the RS.

30. Microeconomic analysis of the BH companies concentrates on identification of the comparative advantages, assess productivity, and to position the BH enterprise sector towards the potential competition on the EU markets. The financial analysis of enterprises is detached on the data of 45 enterprises in the FBH and 266 firms listed at the Banja Luka Stock Exchange (BLSE) identified by branches. Due to serious data availability limits, the period of analysis for companies listed at BLSE is much shorter (2004 and 2005) than was in the case of the FBH enterprises' sample covering the period of 2002-05. Given the various differences in data reporting, analysed financial indicators for both sets of companies could only be

compared with some caution. Generally speaking, the microeconomic data for BH face similar problems as national accounts data, which undermines the quality of any statistical or financial analysis.

31. The sample of analysed enterprises in the FBH is quite effective in terms of earnings before taxation (EBIT) and not very effective in terms of net income. Only 40% of firms indicated a positive net income in 2005 (20% in the public sector and 45% in the private sector), less than in 2002. All manufacturing firms obtained positive net income in the whole period under analysis. There were also very impressive shares for strong performing firms in construction. A much smaller number of profitable firms was observed in industry (35.5%), trade (40% - the sample average) and services (only 20%). In mining and quarrying, electricity and water supply and transportation, as well as public construction and public services, there was not one profitable firm observed in 2005. Looking at the rate of return of the group (EBIT to revenues ratio), firms' performances appear to be much better, however. The average rate of return was set at a very impressive level of 11% in 2002 and 9.6% in 2005. In the last three years, the public sector has been more effective than the private one in terms of this indicator (an annual average of 10%). The most effective was BH Telecom, which as a monopoly affected the results of the whole sample. When we exclude it from the analysis, the average rate of return for the public sector is only 0.5% in 2005, much lower than in the private sector (7.9% in 2005).

32. The analysed firms in the FBH reported a very strict policy of cost control. The cost level indicator (the ratio of total costs to total revenues in percent) was very low and declining in the period under analysis. Private sector firms were more effective in terms of reducing the cost level indicator than public ones (from 85.6% in 2002 to 79.5% in 2005 in the private sector and for public sector 84.5% in 2002 to 85.4% in 2005). The biggest reduction in the cost level indicator was observed in private manufacturing, by 15 percentage points. Firms in the FBH also reported a very low share of wages in total costs. This was approximately 11% in the public sector (annual average) and 10% in the private sector. This small share of labour costs indicates that costs other than wages were more important in the production process and in services in the FBH economy as a whole.

33. The average monthly wage was increasing in FBH firms in nominal terms throughout the whole period under analysis, from KM 698 (EUR 358) in 2002 to KM 816 (EUR 418) in 2005. The nominal wage increase amounted to 17%. The nominal wage increase was supported by impressive labour productivity growth (total

revenues to employment ratio). The total productivity level grew by 27% (a bigger increase than the nominal wage increase of 14%). Labour productivity was higher in the public sector thanks to a significantly higher level of labour productivity in public industry and high productivity in BH Telecom. The labour productivity growth observed in public industry amounted to 57%. In private manufacturing, productivity grew by almost 8%, in line with impressive employment increases (year on year growth amounted to 35% in 2005). Wages in manufacturing decreased in nominal terms (by 2.6%), which may suggest that manufacturing entrepreneurs kept their wages more or less stable. Entrepreneurs probably allocate profits for the purpose of investment rather than current wage increases. This approach is highly required in transition economies in the early process of building a market economy. This was confirmed by very strong investment outlay growth and impressive employment growth in manufacturing in 2005. The return of this investment may strongly improve manufacturing and wage increases in the future.

34. A positive return on assets in the sample (the ratio of EBIT to total assets in percent) is to a large extent supported by the fact that companies did not report their losses, giving zero instead of negative EBIT values. However, the objective of the ROA analysis, as well as analysis of efficiency, was observation of trends in the particular sectors. Only in the indicated sectors (industry, manufacturing, BH Telecom and private construction) were assets utilised effectively. Our sample does not indicate a strong current ratio (bigger than 2) in any of the analysed sections, with the exception of public transportation (a very high level of current assets in this sector in comparison to a low level of current liabilities is the result of this type of economic activity) and public construction in 2005 (current ratio 2.1). The analysed companies in the FBH also do not present strong liquidity and short-term financial strength in this respect. In very many cases firms may have trouble covering their short terms obligations due to a high level of short term liabilities (this can be a reason for inter-enterprise charges or obligations for the state – taxes or social security contributions) or limited access to finance their duties. The worst hit sectors in this respect in 2005 were: services (current ratio 0.1), trade and repairs (current ratio 0.2), and mining and quarrying (current ratio 0.7).

35. Total income before taxes in the sample of BLSE companies accumulated a negative value of minus KM 46.6 million in 2004 and doubled to minus KM 93.1 million in 2005. The total value of assets, fixed assts and current assets declined in line with negative profits. Due to negative profits, rates of return (income before taxes to revenues in percentages) remained negative and declined from -2.2% in 2002 to -4.2% in 2005. Enterprises losses also influenced the negative values of ROA

and ROE indicators, which also decreased, reflecting the analysed firms' poor financing possibilities. Current ratio levels were also very low, which suggested their very weak short-term financial strength. The cost level indicator acceded 100%, which reflects costs higher than revenues in the analysed companies (102% in 2004 and 104% in 2005). Increases in this indicator tend to be evidence of deep-seated ignorance of cost growth control. Unfortunately, we do not know the reasons of these costs increases; most likely it was due to bad corporate governance.

36. All sectors represented by the sample of BLSE companies have a very poor financial stance, with the exception of electricity, gas and water supply and telecommunications (one company – Telecom Srpske AD Banja Luka). Construction and transportation firms noted an effectiveness improvement in 2005 in comparison to very bad results in 2004. Industry, mining, manufacturing, trade and services firms noted a very bad financial stance in 2004 and 2005.

37. Business in poor countries usually face much larger regulatory burden than those in developed countries, including administrative costs, bureaucratic procedures and delays associated with them. Heavy business regulations and weak property rights have damaging effects on SME and big enterprises, and especially private ones.

38. The BEEPS surveys by EBRD identified that the most important obstacles in business expansion in BH in 2002 and 2005 and benchmark countries (Lithuania, Latvia, Slovakia and Poland) in 1999 were similar, but the level of their significance differentiated. We separated two categories of. One group was composed of those obstacles, which were referred in benchmark countries in 1999 to be almost as strong as in BH in 2002 and 2005. The same obstacles in business development in BH as in the benchmark countries were: financing firms' activities, taxes, street and organized crime, and anti-competitive practice. Significantly bigger importance for BH than for the benchmark countries were in the area of infrastructure, corruption, policy instability, and functioning of judiciary. However, the most annoying problem category of doing business was high level of policy instability in BH compared to the benchmark countries.

39. The indicators from Doing Business reports by the World Bank shows practically no significant improvement in BH comparing to the previous years with the exception of employing workers category and registering property category. The most significant drop in ratings was registered at paying taxes category (that would party contradict findings of the BEEPS). However, tax reforms in BH took

place only after the report was prepared. The most important improvements in BH were required in the following areas: starting a business, dealing with licenses, and registering property.

40. Elimination of the majority of business obstacles lies in hands of the BH government. The major policy challenge for the authorities should be to ensure dynamic inter-enterprise competition and development friendly business environment. To achieve these goals, the government needs to provide the proper incentives and market signals by reforming its own actions especially in the indicated areas. Looking at the process of reduction of business obstacles in the benchmark countries, we can expect that BH government is able to achieve significant improvements. Some of the obstacles to business development in BH have already been reduced in the analysed period in the area of taxes, policy instability, functioning of judiciary, corruption, and organized crime/mafia. More improvements are still required in infrastructure, firm financing and street crime, were no progress was made since 2002.

Annex 1: Privatisation Process of Strategic Sectors

Telecom Privatisation

BH has three telecom companies originally formed to cover ethnically divided territories, but later legally obliged to cover the whole country. The biggest Sarajevo-based telecom firm is BH Telekom; followed by Banja Luka-based Telekom Srpske and smallest is HT Mostar. All three companies have wireless units.

RS's main telecom company Telekom Srpske[48] saw gross profits rise in the first half of 2006 by 23% year-on-year to KM 41.25 million (EUR 21.08 million), on revenues of KM 169.66 million. The RS government published a tender for privatisation of 65% of the state's shares in Telekom Srpske in August 2006. The government decided that the starting price could not be lower than EUR 400 million. Deutsche Telekom's Hungarian unit Magyar Telekom, Telekom Austria, France Telecom, Norway's Telenor, Iceland's Novator, Russia's Sistema Telecom and Serbia's fixed-line monopoly Telekom Srbija bought tender documents, while Egypt's Orascom Telecom, Cyprus's PlanetSky, Switzerland's Valiva AG and Finland's Elisa Corporation submitted requests to obtain tender documents. The deadline for placing bids was November 20, 2006. According to the latest available data two companies have submitted bid documentations: Telecom Austria and Telekom Srbija. Telenor decided to pull out just before offer submission deadline[49].

Bearing in mind that Telekom Srpske is a strategic company, the government established special conditions for potential bidders, namely that they had at least 800,000 fixed-line and 1.5 million mobile phone subscribers and total revenues of no less than EUR 500 million in 2005. The guarantee to be paid by bidders was set at EUR 1.5 million. It is expected that the privatisation of Telekom Srpske will bring in receipts of 2% of GDP in 2006 and 2007.

[48] For more see: www.telekomsrpske.com
[49] Researcher's interview with representative of the RS government.

The RS government's decision to sell off Telecom Srpske effectively pushed the FBH government to go ahead with privatisation of BH Telekom and HT Mostar, due to justified fears that if one strong international company bought the main RS telecom company and then entered the BH market, the total value of the other two telecom providers' assets could fall significantly. The FBH parliament, however, voted to reject the proposal, saying it was too early to sell and requested the government prepare a privatisation strategy for the companies. The outcome of elections held in November will without doubt produce a change in government structure, and therefore such a strategy may have to wait a little longer before it sees the light of day.

Energy Sector Privatisation

BH has three state-owned power companies licensed to produce, distribute and sell electricity. The biggest utility, Elektroprivreda BH, and the smallest, Elektroprivreda HZ HB, are based in the FBH, while the mid-sized company Elektroprivreda RS is located in the RS.

The RS government has adopted an action plan for the restructuring and privatisation of the RS power sector that resulted in speeding up several key projects for the construction of coal-fired and hydropower plants using budgetary sources or via public-private partnership.

The RS government is the owner of majority stakes in the oil sector in BH: 65% of the Brod refinery[50]. 62.3% of the Modrica refinery[51], and 65% of fuel retailer Petrol[52]. In August 2006, the RS government agreed to sell its majority stakes in Brod, Modrica and Petrol to the state-owned Russian oil company Zarubezhneft for a total of EUR 979 million in cash and investments. Brod has outstanding debts and the government has opened talks with its major creditors in a bid to settle the issue. This is the key issue holding up realisation of the project. Brod's outstanding debt amounts to EUR 190 million. Another offer has been received from the Austrian company, Elvad Energy Vienna, which offered EUR 300 million for state-owned capital and EUR 190 million to cover the debts. The government is assessing both offers in accordance with legally prescribed procedures, although according to the preliminary due diligence conducted together with the Vienna Business Court it seems the latter of the two foreign companies will be unable to meet the requested goals.

[50] Brod is the only fuel-producing oil refinery in BH.

[51] Modrica is a small refinery producing motor and industrial oils, lubricants and paraffin.

[52] Petrol was previously called Energopetrol and was part of the socialist conglomerate Energoinvest. During Energoinvest's privatization it was decided that Energopetrol would be excluded from total Energoinvest assets because of its strategic importance.

In July 2006, the London-based Energy Financing Team (EFT Group) announced construction of a EUR 250 million coal-fired power plant near its lignite mine at Stanari (in the north-west of the RS) by 2010. The EFT Group has controlled the Stanari mine since 2005, holding 76%-24% (more precisely, in a stake of 76.11%, 23.89% is a joint venture with the mine). The EFT Group has pledged to secure EUR 14.1 million in equity capital for 76.11% of the joint venture and spend a total of EUR 14 million to cover the mine's existing debts and improve technical solutions in the production process.

In addition to this, Czech power utility CEZ is ready to invest EUR 1.4 billion in reconstruction of the Gacko thermal power plant. All these investment will result in changes in ownership structures.

The Slovenian state-owned power conglomerate Holding Slovenske Elektrarne (HSE)[53] in July 2006 concluded an agreement with the RS power utility (Elektroprivreda RS) to co-operate in the construction of power generation facilities estimated to be worth between EUR 600 and 700 million. The agreement covers the construction of a new 600 megawatt block in the Ugljevik thermal power plant and upgrading of the old thermal power plant at Ugljevik, as well as the construction of hydropower plants and technical co-operation. HSE has announced plans to double generation capacity in the medium term, mainly by expanding in the Balkans. In July 2006, the RS government announced that it would not seek to privatise its power utility Elektroprivreda RS, but instead aim to develop it as a company of regional importance.

The RS government plan is to restructure Elektroprivreda RS into a 100% state-owned holding company, which would hold 65% stakes in its sub-units: both the distribution companies and power plants. The decision was made aimed at concentrating capacities and resources before a shift towards larger investments[54]. The government is undertaking action to move forward with the construction of the Krupa and Krupa Niska hydropower plants on the Vrbas River near Banja Luka and will seek a private investor with whom to start building the Buk Bijela hydropower plant near Foca under a public-private partnership scheme. Both projects have been heavily criticised by NGOs and tourism and environmentally oriented independent organisations[55].

As explained previously, the two largest civil engineering companies majority owned by the FBH state are in the process of being sold: Energoinvest and Hidrogradnja. Moreover, in October 2006, the Croatian-Hungarian Consortium INA-MOL[56] bought 67% state-owned stakes in the biggest FBH state-owned fuel

[53] HSE is the largest electricity producer in Slovenia and it unites the hydro power plants located on the Drava, Sava and Soca rivers, the Velenje coal mine and the Brestanica and Sostanj coal-fired power plants.

[54] Researcher's interview with a sector-expert.

[55] Researcher's interview with scouts from Banjaluka and Greenvisions Sarajevo.

[56] MOL Group owns 25% of INA.

retailer Energopetrol[57]. Energopetrol has network of 65 fuel retail stations. The FBH government kept 22% of the company and small shareholders hold 11%. This agreement was the biggest privatization deal in 2006. INA-MOL will pay EUR 5.2 million, EUR 30 million to cover debts and invest an additional EUR 75 million in Energopetrol's aim of creating a modern, competitive and more client-oriented company. It is important to recall here that this privatisation deal has been passed to the FBH parliament many times before, over several years, and thrown out for politically motivated reasons.

The FBH government chose the Austrian government consortium APET (Varech, Port, Poyry, Alstom, Siemens, Voith, Alpine and Wew) as a partner to build four hydro-electric power plants: in Ustikolina, Vranduk, Rmanj, and Vrilo. The framework agreement additionally includes building of four thermo-power plants and reconstruction of two mines. The total value of investment should be around EUR 2.5 billion.

Financial Sector Development – Privatisation of Banks and Investment Funds

One of the major characteristics of the BH economy is the successfully completed process of banking sector privatisation and the transformation of Privatisation Investment Funds (PIFs) into investment funds. As a result, the banking sector is one of the most successful in the region and confidence in investment funds is growing in line with growing share prices on the stock markets in Banja Luka and Sarajevo.

Ownership structure in the banking sector is showing a downsizing trend in terms of governmental shares. At a beginning of 2001, 43% of the banking sector in the FBH was state-owned and around 60% in the RS. During 2002-2004, the majority of stakes in the banking sector were sold to foreign banks. In 2004, the FBH government was the owner of 18% of banks' shares, with foreign ownership at 65%. At the beginning of the privatisation process, the RS was slightly behind the FBH, but in 2004 its privatisation was almost completed, with 76% of shares becoming foreign owned, and the state holding only 1.5% of banks' shares. It is expected that foreign ownership will increase further to 75% of total capital in BH in 2006.

[57] Energopetrol is the same case as Petrol in the RS. Before the war, Energopetrol and Petrol were parts of one company, but during the war its mother company Energoinvest was divided into two parts, based on territory (the RS and FBH parts). After the collapse of Energoinvest, the only profitable part remained fuel retailer Petrol/Energopetrol, so both governments excluded it from Energoinvests" total assets and created an independent business entity.

After the privatisation, the number of banks increased only from 33[58] to 34 (two banks were merged and two new banks were registered). Privatisation increased concentration in the banking sector, with four dominant groups:

- Raiffeisen bank BH (privatised Market Bank),
- Hypo Alpe Adria Group (controlling two banks – one in RS/Banja Luka and one in FBH/Mostar)
- Unicredit Zagreb Bank BH, and
- Nova Ljubljanska bank (which controlled CBS bank Sarajevo, LHB bank Banja Luka, Development Bank Banja Luka and Tuzla bank Tuzla.)

The total assets of the four major banks at the beginning of 2006 amounted to KM 6.4 billion, which was 70% of overall market share, 72% of total deposits and 70% of total loans in the banking sector in BH.

Privatisation Investment Funds and insiders (previous management and employees), have become the largest ownership groups in a significant number of companies. The main characteristic of this process is the absence of strong and effective owners with capital, which is essential for enterprise restructuring and development. Essentially, privatization via PIF tends to contribute to a weakness of the corporate governance framework. There are more than 1,000 enterprises under PIF ownership and combined they represent the core of the real economy. Of 475 companies in the FBH and 551 in the RS, only in a small number of companies do individual PIFs hold a controlling stake package[59]. PIFs are comparatively small and their technical capacity is 3 to 4 investment specialists and from 50 to 100 companies in their portfolios. PIFs are not able to act as active owners to force changes in their portfolio companies[60]. PIFs are expected to convert themselves into Investment Funds, but the procedures for this conversion have not been prepared by the securities commissions and there is a lack of interest among PIFs due to several limitations, e.g. a 10% limit on share holding in a single company. Another solution for PIFs would be to register as joint stock companies. However, together with insiders, PIFs hold majority packages in more than 2,000 companies.

During 2006, key supporting factors for the development of the capital market in BH are the stability of the local currency, low inflation, the strong banking sector, existing capital market institutions, networking with regional bourses and planned issues of corporate bonds by commercial banks. The combined turnover of the two

[58] 24 banks in FBH; nine banks in the RS.

[59] PIFs are expected to reduce their ownership to the maximum level allowed by law (30% in the FBH and 20% in the RS).

[60] Researcher's interview with representatives of transportation company Vihor, Bratunac, in which PIF Jahorina is the main shareholder.

stock exchanges is EUR 148.8 million. The Sarajevo Stock Exchange's (SSE) share was 65% of turnover and the Stock Exchange Index of the Republika Srpska (BIRS) only 35%. On the SSE privatisation fund index, the Bosnian Investment Fund Index increased 151% during 2005. The major reason for this was inflows of foreign funds, mostly from Slovenia. The Stock Exchange Index of the Republika Srpska rose 15% between May 1, 2004, when it was launched, and the end of 2005. In total, both stock exchanges increased their market capitalisation by approximately 70% in 2005.

Annex 2: The Implementation of Privatisation Plans – Cases of Energoinvest and Hidrogradnja

Energoinvest is the biggest engineering group and the fifth largest BH exporter[61] (in 2005, Energoinvest reported revenues of KM 267.9 million and a net profit of KM 7.743 million, up from a KM 4.325 million in 2004). Although it was originally planned for a May 2006 bid (see Annex 3) it was eventually started only in October 2006, when FBH's Agency for Privatization invited international bids for a 67% stake in Energoinvest. 33% of the company's shares is controlled by private shareholders and investment funds. The agency decided not to set a minimum price, although the government valued its stake at KM 147.9 million (EUR 75.5 million). Energoinvest is a strategic company and therefore the agency set the following conditions buyers must fulfil: maintaining the core activity of the company and retaining its 733 employees for at least three years after the purchase.

The Privatization Agency, in cooperation with government, decides on the priorities for the development of the strategic company and in accordance with these priorities defines the bids' evaluation criteria. These do not necessary differ, but they should be decided independently in accordance to the development plan. In this case, the table below provides an explanation of the evaluation criteria used in more details.

Evaluation criteria for the bids in the privatisation of strategic company Energoinvest:

Criteria	Weight in bid evaluation
Offered price	50%
Planned investments	10%
Employment plans	10%
Proposed business plan	20%
Experience and the qualities of the candidate	10%

[61] Exporting to the United States, Mexico, Malaysia, Iraq, Libya, Nigeria, Ethiopia, Egypt, Algeria, Turkey, Slovenia and Croatia.

Evaluation criteria for bids in the privatisation of strategic company Hidrogradnja:

Criteria	Weight in bid evaluation
Offered price	25%
Planned investments	20%
Employment plans	25%
Proposed business plan	20%
Experience and the qualities of the candidate	10%

Immediately after publishing the bid for the privatisation of Energoinvest, a bid for the privatization of 67% stake in construction company Hidrogradnja was announced, with a three month delay from the original plan.

Hidrogradnja is one of the biggest construction companies in BH, active in the construction of roads, tunnels bridges, railways, dams, water supply and sewage systems[62]. Even though the company has developed the scope of its activities, its profits are downsizing, from KM 304,000 in 2004 to KM 161,000 (EUR 82,000) in 2005. If one take into consideration that in 2005 the company recorded revenue of KM 79.16 million, such a low profit cannot satisfy the management or the state, as a majority owner. Since the owners were unable to improve corporate management practices, it was decided to sell the company via direct negotiations and without setting a minimum price. Specific tender conditions for this strategic company require the same conditions as in the privatisation of Energoinvest: the potential buyer should retain the company's core activity and its 1,445 employees for at least three years after the purchase. Unlike Energoinvest, where the offered price is the most important criteria, the agency defined its evaluation criteria with priority to ensure the sustainable development of the company, while price was worth only 25% of the evaluation of the bid.

The bidding deadline for Energoinvest is December 5, 2006 and for Hidrogradnja December 13, 2006. The agency expects to announce the winning candidate by January 9, 2007 and February 27, 2007, respectively. Even these minor move are conditioned to some extent with political developments. Problems have arisen already after FBH's Minister for Energy, Mining and Industry (Vahid Heco) asked the government to cancel the tenders, without giving detailed explanations[63]. The agency's Executive Board has positively evaluated the privatisation procedure for the two companies, so only the government or parliament can cancel the privatisation procedure. This has not happened yet, but ongoing disputes created a somewhat unfavourable environment. In the week before the deadline (November 28, 2006) the FBH's Agency for Privatisation did not received any offers, and no interested party even sent a request to obtain tender documents.

[62] Researcher's interview with a Hidrogradnja representative confirmed that the company is working in various markets, such as in Africa, the Middle East, Greece and Croatia. In some projects it is a member of a consortium with U.S.'s Bechtel, Turkey's Enka and Greece's Aegek.

[63] Researcher's interview with representative of FBH Agency for Privatization.

Obviously, realisation of the privatisation plan for the 23 large companies is not being delayed by technical issues alone and as such no consolidated information on the realisation of the plan has yet been published, although available fragments of information indicate that the agency faces many problems, particularly with companies based in territories ruled by Croat-majority political parties in Western Herzegovina. Even during the preparation of the privatisation plan the agency did not have at its disposal all the relevant information on the targeted companies[64]. As a form of compromise in order to restart the privatisation process, in July 2006 the FBH parliament legalised the transfer of ownership through financial support, which has been the case in several collaborations to date between BH and Croatian companies (e.g. the largest BH exporter – Aluminij Mostar[65]).

[64] For more data about ongoing processes see: www.apf.com.ba

[65] The company was a subject of political and legal disputes in the last decade and the FBH Government finally decided to establish a team that will select a consultant to prepare its privatization.

Annex 3: The FBH's Privatization Agency's Approved Plan for Privatisation of Big Companies in 2006

No.	Company	Sector	Total assets (KM)	State-owned stake	Staff	Offer date
1	Energoinvest-TDS	engineering group	10,610,844	67%	259	January
2	UNIS Sarajevo	metal products, construction	52,042,505	67%	93	February
3	TKA Cazin	cardboard and packaging material	6,824,466	100%	n/a	February
4	KTK Visoko	leather processing, rubber	103,924,279	67%	1,812	February
5	Sarajevo Osiguranje	insurance	45,940,602	45.49%	500	March
6	Hidrogradnja Sarajevo	civil engineering	70,756,714	67%	1,256	July
7	Hotel Stella Neum	Tourism	n/a	n/a	n/a	March
8	Hotel Zenit-BRO Neum	Tourism	n/a	n/a	n/a	March
9	Carton Print Stolac	Cardboard	n/a	n/a	n/a	March
10	Energoinvest Sarajevo	civil engineering, power transmission	220,742,540	67%.	834	May
11	Sipad Export Import	forestry & wood processing	12,622,256	67%.	167	May
12	Agrokomerc Velika Kladusa	food processing	310,248,737	90.33%	3,826	June
13	Aida Tuzla	Footwear	11,525,537	98.81%	n/a	August
14	Fabrika Duhana Sarajevo	tobacco and cigarettes	103,747,370	39.91%	n/a	September
15	Krivaja Zavidovici	furniture	226,959,400	100%	n/a	June
16	Fabrika Duhana Mostar	Tobacco and cigarettes	19,038,250	67%	n/a	June
17	Vitezit Vitez	military industry	n/a	100%	n/a	October
18	Veterinarske Stanice	veterinary stations	n/a	n/a	n/a	September
19	Aluminij Mostar	aluminium smelter	n/a	48%	n/a	September
20	Zeljezara Zenica	steel products	317,053,277	100%	n/a	November
21	Fabrika Sode Lukavac	soda factory	36,721,234	95.52%	n/a	November
22	Hepok Mostar	winery	18,796,074	67%	n/a	year-end
23	Soda-So Holding Tuzla	(salt production)	n/a	n/a	n/a	year-end

Annex 4: The FBH Sample of Analysed Enterprises

	Public sector	Private sector
Industry	Energoinvest	Fabrika Cementa Lukavac
	Fabrika Duhana Mostar	Tvornica Cementa Kakanj
	Zrak Sarajevo	IGM Visoko
	KTK Visoko	KHK Lukavac
		Soko Mostar
		Soko RKT
		Inpek
		Astro
		Borac Travnik
		Solana Tuzla
Mining and quarrying	Rudnik Boksita Bosanska Krupa	RMU Banovic
		Rudnici Boksita Jajce
		Rudnik Zeljezne Rude Vares
Electricity, gas and water supply	Elektroprivreda Sarajevo	
	Elektroprivreda Mostar	
Manufacturing		Sarajevska Pivara
		Pivara Tuzla
		Bihacka Pivara
		Klas
		Sprind
Construction	Hidrogradnja	GP ZGP
		Vranica
		GP Put
		GP Bosna
		Asfaltgradnja
Trade and repair		Tuzla Remont
		DD Konjic
		Merkur Mostar
		Prehrana Promet Tuzla
		DC Sarajevo
Services	Hetmos Mostar	Hoteli Ilidza
		HUT Aduna Bihac
		Frizer
		Iris computers
Transportation	Autoprevoz Kreka	Autoprevoz Mostar
		Prevoz Cazin
Telecommunication	BH Telecom	

Annex 5: The Sample of the Banja Luka Stock Exchange Companies

Industry	Symbol	Industry	Symbol	Industry	Symbol
ALUMINKA AD ŠIPOVO	ALMN	FABRIKA MOTORA SPECIJALNE NAMJENE AD PALE	FMSN	METALNO AD ZVORNIK	MTNO
ALUMINA AD KNEŽEVO	ALUM	FABRIKA OTKOVAKA I ARMATU RE AD BILEĆA	FOIA	ENERGOINVEST RASK. OPREMA AD I. SARAJEVO	RAOP
ENERGOINVEST AUTOMATIKA AD SARAJEVO	ATMK	FABRIKA SPECIJALNIH VOZILA AD LUKAVICA	FSVS	RAFINERIJA ULJA AD MODRIČA	RFUM
BIRAČ AD ZVORNIK	BIRA	FABRIKA UPRAVLJAČA SISTEMA OZUBLJENA LETVA AD NEVESINJE	FUSO	RAFINERIJA NAFTE AD BOSANSKI BROD	RNAF
BANJALUČKA PIVARA AD BANJA LUKA	BLPV	FABRIKA VIJAKA AD MRKONJIĆ GRAD	FVMG	SOKO HOLDING AD LJUBINJE	SOKH
BIRAČ ENERGO AD ZVORNIK	BREN	FABRIKA ŽICE AD USTIPRAČA	FZIC	ŠIPAD AD DOBOJ	SPDO
ČAJAVEC ELEMENTI AUTOMATIKE AD ČELINAC	CELA	SODA SO HEMOPRODUKT AD DOBOJ	HMPR	ŠIPAD-STOLAR AD BIJELJINA	STLR
ČISTOĆA AD BANJA LUKA	CIST	INDUSTRIJSKA PEKARA AD TREBINJE	IPEK	ENERGOINVEST TDSK AD DOBOJ	TDSK
ČAJAVEC – ALATNICA AD BANJA LUKA	CJAL	INDUSTROPROJEKT AD PRIJEDOR	IPRJ	TVORNICA ZA OBRADU METALA EKSPLOZIJOM AD PRIJEDOR	TOME
ČAJAVEC SISTEMI UPRAVLJANJA AD BANJA LUKA	CJSU	JELŠINGRAD FAM AD BANJA LUKA	JFAM	UNIS FABRIKA CIJEVI AD DERVENTA	UNFC
ČAJAVEC ŠTAMPANE VEZE AD BANJA LUKA	CJSV	JELŠINGRAD FMD AD PRNJAVOR	JFMD	UNIS FABRIKA MAŠINA AD USTIPRAČA	UNFM
ČAJAVEC AD BANJA LUKA	CJVC	JELŠINGRAD FMG AD GRADIŠKA	JFMG	UNIS USHA AD VIŠEGRAD	USHA
ČAJAVEC MEGA AD BANJA LUKA	CMEG	JELŠINGRAD AD BANJA LUKA	JLLC	TVORNICA AUTOMOBILA AD PALE	UTAS
MIKROELEKTRONIKA AD BANJA LUKA	CMEL	FAMOS FABRIKA KORAN AD PALE	KORN	UNIS TSC AD PRNJAVOR	UTSC
HEMIJSKA INDUSTRIJA DESTILACIJE AD TESLIĆ	DEST	LIVNICA AD LJUBIJA	LIVN	UŽARIJA AD ŠAMAC	UZAR
DRVNA INDUSTRIJA AD KALINOVIK	DIKL	METAL BROD AD BOSANSKI BROD	METB	UZLOMAC AD KOTOR VAROŠ	UZLM
DRVOPRERADA AD ŠIPRAGE	DRVP	METAL EMAJL AD BOSANSKI BROD	METE	VAZDUŠNA BANJA AD KNEŽEVO	VAZB
FABRIKA AKUMULATORA AS AD SREBRENICA	FAAS	METAL AD GRADIŠKA	METL	VUČJAK AD BOSANSKI BROD	VCJK
FAMOS AD ISTOČNO SARAJEVO	FAMO	MIRA AD PRIJEDOR	MIRA	VUČEVO AD FOČ	VCVO
FABRIKA DIJELOVA I SKLOPOVA AD LJUBIJA	FDIS	MLJEKARSKA INDUSTRIJA AD BANJA LUKA	MLEK	VITAMINKA AD BANJA LUKA	VITA
VRBAS AD LAKTAŠI	VRLA	ZRAK OPTOMEHANIKA AD BILEĆA	ZOPM	DUBIČANKA AD KOZARSKA DUBICA	DUBI
VITINKA AD KOZLUK	VTNK	ŽITOPROMET DRINA AD ZVORNIK	ZPDR	JAVOR AD PRIJEDOR	JAVR
VETPRODUKT AD PRNJAVOR	VTPR	SHP CELEX AD BANJA LUKA	CELX	ZASTAVA AUTO AD BANJA LUKA	ZSTA

Services	Symbol	Services	Symbol	Services	Symbol
KRAJINA AUTO ŠKOLA AD BANJA LUKA	ASKR	INTERŠPED AD DOBOJ	INTE	TOPLANA AD BANJA LUKA	TPBL
BANJA LAKTAŠI AD LAKTAŠI	BLAK	INSTITUT ZA ELEKTROENERGETIKU AD SARAJEVO	IZEN	TOPLANA AD PRIJEDOR	TPPD
BOSNA TRGOVINA AD BANJA LUKA	BSNT	KRISTAL KONSALTING AD BANJA LUKA	KKON	TRANŠPED AD BANJA LUKA	TRAN
ZTC BANJA VRUĆICA AD TESLIĆ	BVRU	KOMUNALAC AD BIJELJINA	KMBJ	UGOSTITELJSTVO AD MRKONJIĆ GRAD	UGMG
ČAJAVEC CENTAR ZA KVALITET AD BANJA LUKA	CCZK	KOMUNALNO AD MILIĆI	KMLN	UGOTURS AD ČELINAC	UGOT
ČISTOĆA AD BANJA LUKA	CIST	KOMUNALAC MODRIČA AD MODRIČA	KMMD	UGOSTITELJ AD ŠAMAC	UGST
ČISTOĆA KP AD ŠAMAC	CSTC	KOMUNALAC AD KOZARSKA DUBICA	KMNC	UGOSTITELJSTVO I TURIZAM AD PRIJEDOR	UGTP
ČAJAVEC USLUŽNE DJELATNOSTI AD BANJA LUKA	CUSD	KOMUNALNO AD TREBINJE	KMTB	URBANISTIČKI ZAVOD RS AD BANJA LUKA	URBZ
CVJEĆAR AD BANJA LUKA	CVJR	KONZUM TP AD BANJA LUKA	KNZM	USLUGA AD BANJA LUKA	USLG
DOBOJINVEST AD DOBOJ	DOIN	PARK KP AD MRKONJIĆ GRAD	KPMG	TRANŠPED AD BANJA LUKA	TRAN
DISTRIBUTIVNI CENTAR AD BIJELJINA	DSTC	KRAJINAPROMET AD BANJA LUKA	KRJP	UGOSTITELJSTVO AD MRKONJIĆ GRAD	UGMG
EKONOMSKI INSTITUT AD BANJA LUKA	EKIN	KOZARATURIST UTP AD PRIJEDOR	KZTR	VETERINARSKA STANICA AD GACKO	VSGC
GRADSKA ČISTOĆA AD BRTUNAC	GCBR	INTERNACIONAL MOTEL AD BANJA LUKA	MTIN	VETERINARSKA STANICA AD ROGATICA	VSRG
GLAS SRPSKI – GRAFIKA AD BANJA LUKA	GLSG	OZRENTURIST AD DOBOJ	OZTU	VETERINARSKA STANICA AD FOČA	VTSS
GLAS SRPSKE AD BANJA LUKA	GLSS	SRPSKE POŠTE AD BANJA LUKA	POST	VETERINARSKA STANICA AD RUDO	VSRD
GLAS SRPSKI – TRGOVINA AD BANJA LUKA	GLST	PROJEKT AD BANJA LUKA	PROJ	VETERINARSKA STANICA AD BOSANSKI BROD	VTSB
ŠTAMPARIJA GRAFOKOMERC AD TREBINJE	GRFK	PROMET TP AD PRNJAVOR	PROM	VETERINARSKA STANICA AD BRATUNAC	VSBC
GRAFIČAR AD DOBOJ	G RFR	PUTNIK AD BANJA LUKA	PUTN	VETERINARSKA STANICA AD BANJA LUKA	VSBL
HOTEL BOSNA AD BANJALUKA	HBSN	REKREATURS AD BANJA LUKA	REKT	VETERINARSKA STANICA AD BIJELJINA	VSBN
HOTEL KRAJINA AD MRKONJIĆ GRAD	HTKR	RELAKS AD BANJA LUKA	RLKS	VETERINARSKA STANICA A.D. ČELINAC	VSCL
HOTEL PRIJEDOR AD PRIJEDOR	HTLP	SAMAČKI SMJEŠTAJ AD BANJA LUKA	SAMS	VETERINARSKA STANICA AD DOBOJ	VSDB
VETERINARSKA STANICA AD KNEŽEVO	VSKN	VETERINARSKA STANICA AD SREBRENICA	VSSB	VETERINARSKA STANICA AD ZVORNIK	
VETERINARSKA STANICA AD PETROVO	VSPT	VETERINARSKA STANICA AD VLASENICA	VSVL	VETERINARSKA STANICA AD PRNJAVOR	
VETERINARSKA STANICA AD LAKTAŠI	VSLA	VETERINARSKA STANICA AD ŠEKOVIĆI	VSSE	ŽITO AD VIŠEGRAD	ZITO
VETERINARSKA STANICA AD LUKAVICA	VSLK	VETERINARSKA STANICA AD SOKOLAC	VSSK	ŽITOPROMET DRINA AD ZVORNIK	ZPDR
VETERINARSKA STANICA AD MODRIČA	VSMD	VETERINARSKA STANICA AD ŠAMAC	VSSM	ŽITOPROMET AD BIJELJINA	ZTPR
VETERINARSKA STANICA AD MRKONJIĆ GRAD	VSMG	VETERINARSKA STANICA AD ŠIPOVO	VSSP	ŽITOPROMET AD PRIJEDOR	ZTPT

Services	Symbol	Services	Symbol	Services	Symbol
VETERINARSKA STANICA AD NOVI GRAD	VSNG	VETERINARSKA STANICA AD SRBAC	VSSR	ZAVOD ZA IZGRADNJU AD BANJA LUKA	ZIBL
VETERINARSKA STANICA AD PALE	VSPA	VETERINARSKA STANICA AD TESLIĆ	VSTS	ŽITO AD VIŠEGRAD	ZITO
VETERINARSKA STANICA AD PRIJEDOR	VSPD	VETERINARSKA STANICA AD UGLJEVIK	VSUG	ZAVOD ZA IZGRADNJU AD BANJA LUKA	ZIBL
Manufacturing	**Symbol**	**Manufacturing**	**Symbol**	**Manufacturing**	**Symbol**
BOSNA TRGOVINA AD BANJA LUKA	BSNT	MIRA AD PRIJEDOR	MIRA	TRIKO ITK AD GRADIŠKA	TRIK
FABRIKA KOŽE LAUŠ AD BANJA LUKA	FKLS	PEKARA AD BOSANSKI BROD	PKRA	UNIS TSC AD PRNJAVOR	UTSC
FABRIKA OBUĆE FOMG AD MRKONJIĆ GRAD	FOMG	PEKARSTVO AD VLASENICA	PKVL	UŽARIJA AD ŠAMAC	UZAR
HRANAPRODUKT AD ŠAMAC	HRPR	PROIZVODNJA OBUĆE BM AD BRONZA NI MAJDAN	POBM	VEZIONICA AD ZVORNIK	VEZN
KONFEKCIJA BORAC AD PRIJEDOR	KBRC	PREDIONICA AD TRNOVO	PRED	VEZIONICA-SREBRENICA AD SREBRENICA	VEZS
KLAS AD DERVENTA	KLAS	PRERADA SA HLADNJAČOM AD ZVORNIK	PSHL	KTK ALHOS AD SOKOLAC	KTKA
KLJUČ ŠIK AD ČAJNIČE	KSIK	ROMANINKA-SPRIND AD SOKOLAC	RMSP	TVORNICA DJEČIJE TRIKOTAŽE AD ŠIPOVO	TDTR
Electricity, gas and water supply	**Symbol**	**Trade and repair**	**Symbol**	**Construction**	**Symbol**
BIRAČ ENERGO AD ZVORNIK	BREN	AUTOSERVIS KRAJINA AD BANJA LUKA	ASRK	CIGLANA AD GRADIŠKA	CIGL
ELEKTRODISTRIBUCIJA AD PALE	EDPL	AUTOSERVIS CENTAR AD BANJA LUKA	ATSC	GRADNJA GP AD MRKONJIĆ GRAD	GRAD
ELEKTROKRAJINA AD BANJA LUKA	EKBL	AUTOSERVIS AD ŠAMAC	ATSR	GRAĐA AD BANJA LUKA	GRDA
ELEKTROHERCEGOVINA AD TREBINJE	EKHC	AUTOKOMERC AD DOBOJ	AUTK	GRAĐENJE AD UGLJEVIK	GRDE
ELEKTRO-BIJELJINA AD BIJELJINA	ELBJ	KRAJINAPROMET AD BANJA LUKA	KRJP	GRADNJAMONT AD PETROVO	GRDM
ELEKTRO DOBOJ AD DOBOJ	ELDO	KRAJINAPETROL AD BANJA LUKA	KRPT	GRADITELJ AD TESLIĆ	GRDT
ELEKTROPRENOS AD BANJA LUKA	ELPR	ZADRUŽNA TRGOVINA PPP AD MRKONJIČ GRAD	ZTRG	GRAĐEVINAR AD NOVI GRAD	GRNR
ELEKTROPRIVREDA REPUBLIKE SRPSKE AD TREBINJE	ERST	VELEPREHRANA AD BANJA LUKA	VLPH	GAS BETON CELKON AD BANJA LUKA	GSBT
HIDROELEKTRANE NA DRINI AD VIŠEGRAD	HEDR	VELEPROM AD PALE	VLPM	GRAĐEVINSKO ZANATSTVO AD TREBINJE	GZAN
HIDROELEKTRANE NA VRBASU AD MRKONJIĆ GRAD	HELV	VELEPROMET AD PRIJEDOR	VLPR	KRAJINA GP AD BANJA LUKA	KRJN
HIDROELEKTRANE NA TREBIŠNJICI AD TREBINJE	HETR	VELEPROMET AD ZVORNIK	VLPT	MRAKOVICA GP AD PRIJEDOR	MRKC
VODOVOD AD BANJA LUKA	VDBL	VELETRGOVINA AD GRADIŠKA	VLTG	NISKOGRADNJA AD TESLIĆ	NGRD
VODOVOD I KANALIZACIJA AD VLASENICA	VDKN	TRGOVINA LOPARE AD LOPARE	TRGL	PUT GP AD ISTOČNO SARAJEVO	PTSA
VODOVOD AD KOZARSKA DUBICA	VDKZ	TRGOPROM AD KOTOR VAROŠ	TRGP	RAD GP AD BIJELJINA	RADB
VODOVOD AD PRIJEDOR	VDPR	TRGOVINA AD LAKTAŠI	TRGV	VRBAS GP AD LAKTAZ	VRBS
R I TE UGLJEVIK AD UGLJEVIK	RTEU	TRGOPRODAJA AD PRIJEDOR	TRPD	ALPRO AD VLASENICA	ALPR

Electricity, gas and water supply	**Symbol**	**Trade and repair**	**Symbol**	**Construction**	**Symbol**
VODOVOD KP AD PRNJAVOR	VDPV	TRGOPROM AD BILEĆA	TRPR	INTAL AD MILIĆI	INTL
R I TE GACKO AD GACKO	RITE	PETROL AD BANJA LUKA	PTRL	ZLATIBOR GP AD BIJELJINA	ZLTB
VODOPRIVREDA DRINA AD ZVORNIK	VDRN	TRŽNICA AD BANJA LUKA	TRZN		
Mining and quarrying	**Symbol**	**Transportation**	**Symbol**	**Transportation**	**Symbol**
BOKSIT AD MILIĆI	BOKS	AERODROMI REPUBLIKE SRPSKE AD BANJA LUKA	AERD	JUGOPREVOZ AD BILEĆA	JGPB
GIPSARA VOLARI AD ŠIPOVO	GVLR	AUTOPREVOZ AD BANJA LUKA	APBL	JUGOPREVOZ-GACKO AD GACKO	JGPG
RUDNIK KAOLINA MOTAJICA AD SRBAC	MTKS	AUTOPREVOZ AD GRADIŠKA	APGD	JUGOPREVOZ TREBINJE AD TREBINJE	JGPR
RUDNIK BOKSITA SREBRENICA AD SREBRENICA	RBSC	AUTOPREVOZ KOZARSKA DUBICA AD KOZARSKA DUBICA	APKD	KOZARAPREVOZ AD NOVI GRAD	KZPR
RUDNIK OLOVA I CINKA SASE AD SREBRENICA	RSAS	AUTOPREVOZ PPP AD SRBAC	APSR	KOZARAPUTEVI AD BANJA LUKA	KZPT
RUDNIK KREÈNJAKA I TVORNICA KREČA AD DOBOJ	RUDK	AUTOTRANSPORT AD PRIJEDOR	ATPD	MRKONJIĆPUTEVI AD MRKONJIĆ GRAD	MGPT
STANARI RUDNIK LIGNITA AD STANARI	STNR	AUTOTRANSPORT AD TESLIĆ	ATRN	NEVESINJEPUTEVI AD NEVESINJE	NVPT
		BIJELJINA PUT AD BIJELJINA	BNPT	OZREN-TRANSPORT AD PETROVO	OTRN
		CENTROTRANS AD ISTOČNO SARAJEVO	CTRS	PREVOZ AD SREBRENICA	PREV
Telecom	**Symbol**	DOBOJPUTEVI AD DOBOJ	DOPT	PREVOZ AD NEVESINJE	PRVZ
TELEKOM SRPSKE AD BANJA LUKA	TLKM	DRINA TRANS AD ZVORNIK	DRTR		

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