Folder Title:	President Wolfensohn - Briefing Book for President's Meetings and Events - Prime Minister Hasan Muratovic - Bosnia - July 17, 1996
Folder ID:	30485528
Series:	Meeting and event briefing materials
Dates:	07/06/1996 - 07/17/1996
Subfonds:	Records of President James D. Wolfensohn
Fonds:	Records of the Office of the President
ISAD Reference Code:	WB IBRD/IDA EXC-13-08
Digitized:	04/09/2025

Meeting: P.M. Hasan Muratovic, Bosnia

Wednesday, July 17, 1996

2:45 - 3:15 pm

E1227 Conference Room

- Sklar
- Contributions - not apparent

~~EU .. PO~~

VS. is better now - housing

- help to municipalities

SKLAR

open airport
open railway

Big improvement

Islamic Countries - Brunei . Malaysia . Kuwait

$20 mill
15 employment funds

Credit lines for companies - Islamic Investment Corp.

put some money in it -
reallocate or borrow

$5 → 10 million

$33 million. state budget. to implement payment system.

- Dinar vs DM. Bosnian dinar →

Archive Management for the President's Office

Document Log

Reference # : Archive-00698

1 R 05

Edit   Print

A. CLASSIFICATION

- [x] Meeting Material
- [ ] Trips
- [ ] Speeches
- [ ] Annual Meetings
- [ ] Corporate Management
- [ ] Communications with Staff
- [ ] Phone Logs
- [ ] Calendar
- [ ] Press Clippings/Photos
- [ ] JDW Transcripts
- [ ] Social Events
- [ ] Other

B. SUBJECT: PRIME MINISTER HASAN MURATOVIC, BOSNIA

VENUE: E1227 (CONF. RM.)

CONTACT: MARJOLEIN (HERFKENS) @ 82052

IN ATTENDANCE: JDW, KOCH-WESER, WALLICH, SEVERINO, HERFKENS, JOSIE, (LINN - TRAVELLING)

BOSNIA DELEGATION ATTENDEES:

PRIME MINISTER HASAN MURATOVIC

MR. SVEN ALKALAJ, AMBASSADOR

MR. MALIK SKALJIC, COUNSELOR AND DEP. CHIEF OF MISSION

(B) WALLICH

EXC: JOSIE // ALI (7/15/96 3:21p)

DATE: 07/17/96

C. VPU

Corporate

- [ ] CTR
- [ ] EXT
- [ ] LEG
- [ ] MPS
- [ ] OED
- [ ] SEC/Board
- [ ] TRE

Regional

- [ ] AFR
- [ ] EAP
- [x] ECA
- [ ] LAC
- [ ] MNA
- [ ] SAS

Central

- [ ] CFS
- [ ] DEC
- [ ] ESD
- [ ] FPD
- [ ] FPR
- [ ] HRO

Affilliates

- [ ] GEF
- [ ] ICSID
- [ ] IFC
- [ ] Inspection Panel
- [ ] Kennedy Center
- [ ] MIGA

D. EXTERNAL PARTNER

- [ ] IMF
- [ ] UN
- [ ] MDB/Other IO
- [ ] NGO
- [ ] Private Sector

- [ ] Part I
- [x] Part II
- [ ] Other

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: July 17, 1996 **STRICTLY CONFIDENTIAL**

TO: Mr. James D. Wolfensohn, EXC

THROUGH: Mr. Caio K. Koch-Weser, EXC CKW

FROM: Christine Wallich, Acting Director, Bosnia and Herzegovina

EXTENSION: 37686 CW

SUBJECT: Your Meeting with Dr. Hasan Muratovic, Prime Minister of Bosnia and Herzegovina, July 17, 1996, at 2:45 p.m.

1. The Prime Minister requested the meeting. Eveline Herfkens, Caio Koch-Weser, Jean-Michel Severino and Christine Wallich will also attend. A one-on-one meeting took place this morning with Mr. Koch-Weser, and a dinner with Mrs. Herfkens last night. **(He has thus far refused to meet with the region)**.

2. You know that the meeting was requested after an unfortunate incident. With a fait accompli, and after internal discussion, **the Embassy was told the copy was intentionally sent** to give the background to our decision. (You could tell the Prime Minister that "you value transparency and openness in Bank-client relations; and it should have been done very differently. Now, however -- and we all regret very much that the Prime Minister was offended -- let us see how we can move ahead and improve things for Bosnia.")

3. Although the conclusion of the memo could not have been a surprise, **he is rightly upset**. **(We should let him let off steam before getting into any substantive discussion on the TAC.)**

4. On substance, assuming he says they fully intend to meet the conditionality, **we will want to "hold tight" until the condition unifying the payment system is fully met** (including the two-week monitoring period) before the TAC documents are distributed to the Board. **We will go for the first meeting after Board recess.** If we **were to agree** to distribute documents before the condition was met, the Bank would face very strong pressure to "overlook" the actual compliance. Given the elections, there is not much time left for action.

> [FYI: **IF** the Prime Minister indicates budgetary urgency, or says the condition will not be met, the Region **could rethink the operation, on a much-reduced scale --say $30 million -- in light of the great importance we attach to the remaining unfulfilled condition on the payments system, critical to Dayton].**

●●● ***We should NOT offer or decide this in this meeting, even if the Prime Minister explicitly requests the "reduced TAC option" and says they will not meet the conditionality: Many donors are looking for us to be firm, so we would need to prepare the ground for this change very carefully with our partners in the international arena -- the US, the Germans, Bildt, etc.***

Revised Version
7/17
11:30 am
Caio & Christine will be available before the meeting to brief you orally.

●●● ***Rather, you could say that the Region/Country Director will consider the request in light of the many considerations, and make a recommendation to you. You may also advise them that, before leaving Washington, the PM should meet with the region to directly exchange views. The region would only then be in a position to make a recommendation to you.***

●●● *Finally, we should advise them that we will agree to a renegotiation of the proportions* ***only if all original parties to the negotiation agree (including the Finance Ministers of the Federation and State)****: our assessment is that the Federation will not agree, making this long, painful and fruitless.* ***Instead****, the Dutch co-financing could be split (say 50/50) so as to give them the State budget the resources it needs to service their debt on the consolidation loan.*

5. Time is short, given the September 14 elections. Republika Srpska will be in the new Government, which might raise questions of why we are doing a "Federation-only TAC" after the elections. The bottom line is that **we have to, in one way or another (ie, US$90 million or reduced), get the TAC out of the way during the next few weeks**.

6. If we manage to get it to the Board, it will be very close to the election date, and there will be obvious questions about the timing of the operation. **The Prime Minister should be aware of this dilemma. We should, though, take the risk of presenting the TAC to the Board almost until the day of elections on the ground that the credit will be disbursed against actions agreed and taken before Board.**

7. **Suggested other messages**:

The Bank is with them.

We regret the Prime Minister was offended by the openness of the memo.

We have so far delivered, as promised, seven projects (US$150 million from the Trust Fund, and another US$10 million from IDA -- not signed yet, since he cancelled the signing).

Another five projects, (demobilization support, public works, housing, power, and land-mine clearance) **totalling US$75 million in IDA, are scheduled for the July 30 Board meeting**.

Overall, implementation is proceeding well. US$70 million in contracts awarded (to be financed by the Bank or Bank-administered trust funds) **as of July,** with **US$140 million** expected by end-September.

Background:

8. **The Prime Minister could well be offensive**. He may

(i) **question the Bank's lack of trust in them delivering on their promises.** The unification of the payment system has been the subject of several prior agreements under the sponsorship of the US and Germany, and has not been carried out, there is a good reason for being cautious and insisting on the two-week monitoring period.

(ii) **suggest that we are rigid and unresponsive to their severe budgetary needs.** The needs are indeed huge, and this is precisely why we are proceeding with an unusually high amount (which would also assist them in making timely debt service). We hope to go ahead soon.

(iii) **remind you that the TAC was part of the "deal" on arrears resolution.** We did promise a significant net transfer in 1996-98, and we could disburse as much as US$160-180 million in 1996, TAC ($90m) included. To make this a possibility, we had reduced the conditionality to such an extent that we can even expect concerns at the Board about the "strength" of the program, given the credit's US$ 90 million size.

(iv) **argue that we should distribute documents as soon as possible. We do not want to take the risk of withdrawing the documents if the condition is not met.**

(v) **accuse the Bank of "meddling in their internal matters".** If all parties to original negotiation agree (including the Federation Finance Minister who is in charge of the Federation budget), **we would have no objection to the revised allocation of the credit proceeds between the two budgets**, as long as all agree. But, better to use the Dutch cofinancing as "swing financing".

(vi) **he may propose the second option** discussed in the memo. **We should not make a decision in this meeting.** [We could support a "reduced TAC", although the price tag (reduction) should be significant, because the conditionality remains critical for Dayton, and the international community has looked to us to carry the ball on this].

Attachments:

- Memo from Mr. Koch-Weser to you regarding the TAC
- Your letters to Messrs. Izetbegovic and Muratovic
- The incoming letters
- Lending Program
- Basic Data on Bosnia

Distribution:

Messrs./Mme. Linn (o/r) (ECAVP); Severino, Sheehan, Horvai (EC2DR); Noel, Ding (EC2CO).

AHorvai:ah
m:\bosnia\murat.jdw

JDW
Note from Christine W. on the letters sent to the Bosnia PM.

A L L - I N - 1   N O T E

DATE: 17-Jul-1996 11:07am

TO: Josie Bassinette (JOSIE BASSINETTE)

FROM: Christine Wallich, EC2DR (CHRISTINE WALLICH)

EXT.: 37686

SUBJECT: **Bosnia and unfortunate incident**
Response to Mr. Wolfensohn

Josie;

Per our conversation, I would very much appreciate your passing the following message on to Mr Wolfensohn:

I fully understand his outrage over the situation regarding the internal memo which was unfortunately sent to Ambassador Alkalaj. It is totally unacceptable and I have put in place all necessary measures and administrative procedures.

A meeting of all Administrative Secretaries and the Executive Assistant in the Department has taken place today to stress and underline the importance of following these procedures.

I will ensure that these procedures are fully understood and followed by everybody in the Department on the Bosnia Team.

I appreciate the serious implications and regret the consequences, which are also, actively being repaired.

Best regards,

Christine

CC: Caio Koch-Weser (CAIO KOCH-WESER)
CC: Jean-Michel Severino (JEAN-MICHEL SEVERINO)

DECLASSIFIED
MAR 0 6 2025
WBG ARCHIVES

THE WORLD BANK/IFC/MIGA
OFFICE MEMORANDUM

DATE: July 16, 1996 **STRICTLY CONFIDENTIAL**

TO: Mr. James D. Wolfensohn, EXC

THROUGH: Mr. Caio K. Koch-Weser, EXC

FROM: Christine Wallich, Acting Director, Bosnia and Herzegovina

EXTENSION: 37686

SUBJECT: Your Meeting with Dr. Hasan Muratovic, Prime Minister of Bosnia and Herzegovina, July 17, 1996, at 2:45 p.m.

1. The meeting is at the request of the Prime Minister. Eveline Herfkens, Caio Koch-Weser, Jean-Michel Severino and Christine Wallich will also attend.

2. You are aware that the meeting was requested after an unfortunate incident. With a fait accompli, and following internal discussions in the department, **I told the Embassy as well as Eveline Herfkens that we sent the copy deliberately** to give them the background of our decision. (You could tell the Prime Minister that "you value transparency and openness in Bank-client relations; and it should have been done very differently. Now, however -- and we all regret very much that the Prime Minister was offended -- let us see how we can move ahead and improve things for Bosnia.")

3. Although the conclusion of this memo could not have taken the Prime Minister by surprise, **he is rightly upset**. **(We should let him let off steam before getting into any substantive discussion on the TAC.)**

4. On substance, in principle, and assuming he continues to say that they fully intend to meet the conditionality, **we still want to "hold tight" and wait until the condition regarding the unification of the payment system is fully met** (including the two-week monitoring period) before the TAC documents are distributed to the Board.

> FYI: HOWEVER - **IF** the Prime Minister indicates budgetary urgency, and, reading between the lines in the meeting, you sense that really, the conditionality will not be met, we **could "rethink" the operation, on a much-reduced scale --say $30-40 million -- in light of the great importance we attach to the remaining unfulfilled condition on the payments system.** We should NOT offer this in this meeting, however, UNLESS the Prime Minister explicitly

requests the "reduced TAC option" and states that they will **not** meet the conditionality: Many donors are looking for us to be firm, so we would need to prepare the ground for this very carefully with other donors in the international arena -- the US, the Germans, Bildt, etc.

5. Time is short, given the September 14 elections. Republika Srpska will be in the new Government, which might raise questions of why we are doing a "Federation-only TAC" after the elections. The bottom line is that **we have to, in one way or another (ie $90 million or reduced), get the TAC out of the way during the next few weeks.**

6. If we manage to get it to the Board, it will be very close to the election date, and there will be obvious questions about the timing of the operation. **The Prime Minister should be aware of this dilemma. We should, though, take the risk of presenting the TAC to the Board almost until the day of elections on the ground that the credit will be disbursed against actions agreed and taken before Board.**

Background:

7. **The Prime Minister will likely be offensive**. He may

(i) **question the Bank's lack of trust in them delivering on their promises.** The unification of the payment system has been the subject of several prior agreements under the sponsorship of the US and Germany, and has not been carried out, there is a good reason for being cautious and insisting on the two-week monitoring period.

(ii) **suggest that we are rigid and unresponsive to their severe budgetary needs.** The needs are indeed huge, and this is precisely why we are proceeding with an unusually high amount (which would also assist them in making timely debt service). We hope to go ahead soon.

(iii) **remind you that the TAC was part of the "deal" on arrears resolution.** We did promise a significant net transfer in 1996-98, and we could disburse as much as US$160-180 million in 1996, TAC included. To make this a possibility, we had reduced the conditionality to such an extent that we can even expect concerns at the Board about the "strength" of the program, given the credit's US$ 90 million size.

(iv) **argue that we should distribute documents as soon as possible. We do not want to take the risk of withdrawing the document if the condition is not met.**

(v) **accuse the Bank of "meddling in their internal matters".** If all parties to original negotiation agree (including the Federation Finance Minister who is in charge of the Federation budget), **we would have no objection to the revised allocation of the credit proceeds between the two budgets.**

(vi) **he may try to get a deal along one of the two options** discussed in the memo. We should not make a decision in this meeting, unless he explicitly asks. If he asks about the "reduced TAC", we could support it, although the price (reduction) should be significant. The conditionality remains critical for Dayton, which we continue to support.

8. **Suggested messages:**

The Bank is with them.

We regret the Prime Minister was offended by the openness of the memo. (He will want to let off steam).

We have so far delivered, as promised, seven projects (US$150 million from the Trust Fund, and another US$10 million from IDA).

Another five projects, (demobilization support, public works, housing, power and land-mine clearance) **totalling US$75 million in IDA, are scheduled for the July 30 Board meeting**.

Overall, implementation is proceeding well. US$70 million in contracts awarded (to be financed by the Bank or Bank-administered trust funds) **as of July,** with **US$140 million** expected by end-September.

TAC

Timing. Let them deliver by mid-July, as promised, and we will go for the first meeting after Board recess. Given the forthcoming elections, there is not much time left for action. **They need to deliver (i.e., unify the payment system) in the next two weeks or so.**

(FYI: Alternatively, we could think of a downsized operation -- if they specifically ask).

Allocation of proceeds. If they agree among themselves, including the Finance Ministers of the State and the Federation, we would agree to modify the agreed 30/70 (State/Federation) allocation. Nevertheless, in our judgement, this change would not be justified on a "financing needs basis".

Attachments:

- Memo from Mr. Koch-Weser to you regarding the TAC
- Your letters to Messrs. Izetbegovic and Muratovic
- The incoming letters

Distribution:

Messrs./Mme. Linn (o/r) (ECAVP); Severino, Sheehan, Horvai (EC2DR); Noel, Ding (EC2CO).

CWallich/AHorvai
m:\bosnia\murat.jdw

Correspondence

. THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: July 8, 1996

TO: Mr. James D. Wolfensohn, EXC

FROM: Mr. Caio K. Koch-Weser, EXC CKW

SUBJECT: Bosnia Transition Assistance Credit (TAC) - Requests for Early Board Consideration

The Prime Minister (Dr. Hasan Muratović) and the President of the Presidency (Alija Izetbegović) have written to you requesting an early distribution to the Board of the TAC documentation --before the final condition on unification of the payments system has been met and the Bank has been able to monitor/verify it-- so as to enable the Board to consider the TAC before the Board recess, and give Bosnia early access to the TAC resources ($90m). You may wish to note that the President's letter indicated that *his decision to unify the payment system will be made "in the next days", and "the system will be functioning before the end of July", where the Prime Minister's letter says it will be functioning "by mid-July".*

As you may know, there are no technical impediments to meeting this final condition to unify the payment system, and there have not been any for some months. The decision is --and has long been-- purely political.

Because of the difficulty[1] of reaching agreement hitherto (payments system unification has been the subject of prior agreements reached --but never fulfilled-- under the sponsorship of the US and Germany in the Sarajevo Agreement, Geneva Agreement, Bonn/Petersberg Agreement, Washington Federation Forum Agreement etc), we have been very precise about the requirements to meet this condition, and have required third party evidence (EU monitors) to be brought to bear that the condition has been fulfilled, uninterruptedly, for at least two weeks, before distributing the TAC documents to the Board (see attachment). (All other conditions of the TAC have been met).

We have required this third party evidence and a 2 week performance period **prior to Board distribution** because we feel it would be:

(i) a major embarrassment to the Bosnians, with significant cost to their future credibility with donors and for our ability to present future adjustment operations, if

1/ The difficulties relate, inter alia, to how many currencies will circulate in the payments system – DM alone, as some prefer, or DM, Dinar and Croatian Kuna), and (ii) whether the central bank will guarantee to convert dinar revenues to the budget to DM the credit were to be presented to the Board, and due to failure to fulfil the condition, the documents had to be withdrawn (the Region places a high probability on this outcome);

(ii) put the Bank in a very awkward position to be potentially pushed to agree that the conditionality had been met, even if we had not been able to do the necessary due diligence to ensure it had been met, and we were not fully convinced that it had been met, simply because the TAC was already on the Board agenda (see below); and,

(iii) highly problematical for the Bank if the Board were to approve the credit based on a "rush assessment" of the conditionality, and if payments system unification were to be unwound shortly after Board presentation. Our approach will not rule the latter out, but the 2-week period (plus the 18 days for Board to review documents) will make it substantially more difficult and highly visible to unwind.

Recommendation:

The Region's recommendation is to "hold tight". Our credibility --with the Bosnians for the future, and with the international community, all too familiar with the challenges of federation-building-- is at stake. We propose:

- to require the actual fulfillment of the conditions, (as per the documentation attached), as a condition of **distributing the documents** to the Board, and
- this includes requiring two weeks (we had earlier proposed four weeks) of uninterrupted unified activity, as certified by the third-party (EU) monitors.

Assuming unification takes effect on July 15, as per the Prime Minister's letter, this would allow us to distribute documents to the Board at end July, for Board consideration on August 20, the first Board date after the Board recess -- just under a month before the elections. The Bosnians' preferred alternative is to go with a Board date of August 1.

In the region's view, 19 days do not justify the possibility that there will be less than full due diligence in ensuring compliance with all conditions. (Assuming unification at end-July, a 2-week performance period would give us a Board date in early-September --very late in the Region's view-- politically to be supporting the old Government).

The implication of this recommendation, in the event that the conditionality is *not* fulfilled in time to support the outgoing government before the elections is that we would revisit our policy dialog with the *new* government, after the elections, on the basis of a broader, nation-wide agenda.

Based on the above, attached are the proposed responses, for your signature, to the incoming letters from the Prime Minister and the President of the Presidency.

Other options include:

(a) **Tranching the credit** -- and disbursing the first tranche, now, in recognition of the 3 conditions already met. This approach could help provide some stability over the election cycle, since the second tranche would be disbursed after the elections, on fulfillment of the 4th condition. This option would set an unfortunate precedent for future negotiations with the Bank, especially on adjustment operations, with the Bank perceived as a lender willing to trade conditionality for money, with concomitant loss of credibility. In addition, post-election, we will aim to support the overall nation-building effort --the State and **both entities**-- -- not just the Federation-- and the two-tranche approach would be inconsistent with this.

(b) **Downsizing the Credit**, say to $30m, in recognition of the accomplishments to date, and the three conditions having been met. This option suffers from the same disadvantage as the above -- the Bank will be seen as horse-trading. On the other hand, it **would** enable us to broaden our dialog with the new government, and give the new government quick support after the elections. (But our ability to negotiate would certainly be impaired by the "horse-trading" that had preceded). The credit would also have to be renegotiated

Neither of these options, therefore, is good. Option (b) is probably less bad. *If* option (b) is taken, there should, prima facie, be *no* reallocation of TAC proceeds between State and Federation budgets (see below).

Reallocating shares, 50/50 between Federation and State.

The President's letter requests an increase in the State share of the TAC from 30% ($33m) to 50% ($45 mil). In responding to this, we should recall that the TAC has been conceived as a "Federation-building" instrument. The proposed reallocation has almost certainly been requested without the knowledge of, and without the concurrence of the Federation authorities/both Federation partners. TAC conditionality is all on the side of the Federation, and most of it *has* been met. The payment system conditionality that has *not* been met has been impeded by the only State-level institution involved in the TAC -- the Central Bank. Prima-facie, the reallocation is not justified. But, it *is* a matter for the parties to negotiate, in the end.

If we re-enter into such a renegotiation, it will be essential that we involve *both Federation partners in the renegotiation, and the State and Federation Ministries of Finance,* whose budgetary programs are to be supported. This cannot be a re-negotiation (deal cut) between the Federation and State Prime Ministers (both Bonsiac, and from the same party) alone --although this is what the authors of the letters are likely to propose, cautioning the Bank "not to meddle in Bosnia's internal affairs". We ignore these internal affairs at our peril.

Christine Wallich

cw

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

July 9, 1996

Mr. Hasan Muratovic
Prime Minister
Government of Bosnia and Herzegovina

Dear Prime Minister:

I was very pleased to receive your letter of July 5, 1996 with its complimentary remarks regarding our joint work supporting reconstruction and economic recovery in Bosnia and Herzegovina. I have been following events in Bosnia with great interest and watching very closely progress in the implementation of the reconstruction program. As you know, I returned just a few days ago from the G7 Summit in Lyon, where I urged G7 leaders to ensure coordinated and flexible funding for Bosnia, to accelerate their disbursements, and to plan now for a future donor conference after the elections.

I am also pleased with the important progress already made in many of the areas covered by the Transition Assistance Credit (TAC). The unification of the Federation customs administration, the recent passage of legislation creating the Federation Bank Supervision Agency, and the presentation of legislation creating the Federation Privatization Agency are essential steps towards strengthening the Federation that the TAC is designed to support.

I was also encouraged by your letter noting that preparations for the unification of the Federation payment system are well advanced, and that the physical unification of the system is expected to take place by mid-July, now that all the technical aspects are fully resolved. This unification will greatly strengthen integration and promote economic growth, commerce, and trade. A unified system will also significantly smooth the operations of the Federation budget, tax administration, and customs administration, institutions essential to the effective functioning of the Federation, which is an essential building block of Bosnia and Herzegovina.

I hope that this unification can be accomplished soon, so that we can present this credit to our Board of Directors, and gain their support. As you know from your earlier discussions with Mr. Caio Koch-Weser and Ms. Christine Wallich, certain key steps (summarized in the attachment), are still to be taken. Once completed, and following a two-week uninterrupted functioning of the unified system, I will be very pleased to immediately send the project to the Board. Following the timetable laid out in your letter, the technical unification in mid-July, followed by a two-week performance monitoring period, would lead me to submit the project documents to our Board in late July, for decision in mid-August. Thus, no time would be lost because of the Board recess, since as you know, the Board requires about three weeks to examine projects. If the conditions are met, I would be happy to submit the TAC documents to the Board right before the recess (July 31) and have a Board discussion at the first Board date (August 20) following the recess.

The memories from my visit to Sarajevo are still very much alive. I was then both shocked by the devastation and human tragedy and encouraged by the determination of the people of Bosnia and Herzegovina to make peace sustainable. I wish to reassure you, Mr. Prime Minister, that the World Bank will continue its strong support to make a better life for the Bosnian people a reality as soon as possible.

With best wishes

Sincerely yours,

James D. Wolfensohn

Attachment

cc: Mrs. Eveline Herfkens, Executive Director, Bosnia and Herzegovina

Attachment

<u>Transition Assistance Credit: Unification of the Federation Payments System</u>

Steps to be Taken Prior to Submission of Documents to the Board

As outlined in the Memorandum of the President (MOP) for the Transition Assistance Credit negotiated with the Bosnian Authorities on May 15, 1996, the Board condition with respect to the unification of the Federation payments system reads as follows: "Full unification of the Federation payments bureau, including appointment of the Director and deputy Director *(done)*, and development of a checklist of measures for unification of a single Federation payments bureau *(to be done --see below)*, as demonstrated by the lack of a need for periodic settlement and clearance between the two payments bureaus for transactions balances *(to be done --see below)*."

As evidence of the completed actions with respect to the Federation payments system, we would need, as part of the "checklist",

1. An Agreement to be signed by all parties concerned in the TAC negotiations (signatories to the Letter of Developmental Policy) outlining the manner in which unification is to take place (i.e, how many currencies will be involved, what is the mechanism for conversion of currencies for use by the Federation budget, etc.) and the date on which the unification is to become effective. (A draft agreement was provided to the authorities on June 10, 1996 that could serve as a model.)

2. The signature of the NBBH as one of the parties to the above agreement, as it relates to the conversion of currency, would be required. Alternatively, the proposed substitute for this, issuance of an executive order of the President instructing the National Bank of Bosnia and Herzegovina to implement the currency conversions required by the agreement mentioned above would also be acceptable.

3. Certification by the Director and Deputy Director of the Federation Payments Bureau that the unification *has taken place*, on the effective date.

As evidence of effective unification, demonstrated by the lack of a need for periodic settlement and clearance between the two payments bureaus for transactions balances,

4. Certification (two weeks after the date of effectiveness) from the EU monitors, in Mostar, that there is full unification and no paper-based transfers have taken place since the date of unification specified by the Agreement and the Directors and Deputy Directors certification. (These monitors would continue to certify to the World Bank that full unification has been maintained, up to the Board date, and until the effectiveness of the Credit. Any reversals would lead to withdrawal of the credit from Board consideration.)

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

July 9, 1996

H.E. Alija Izetbegovic
President
Bosnia and Herzegovina
Presidency Building
Marsala Tita 16
71000 Sarajevo

Dear Mr. President,

Re: Transition Assistance Credit (TAC) and Payments System Unification

I was very pleased to receive your letter of July 6, 1996, and your complimentary remarks about the Bank's close partnership with your country to support reconstruction and economic recovery. I have been following events in Bosnia closely, and am very pleased with progress in reconstruction. I am also very encouraged by the priority your government has accorded to smooth and efficient implementation. As you know, I returned just a few days ago from the G7 Summit in Lyon, where I urged G7 leaders to ensure coordinated and flexible funding for Bosnia, to accelerate their disbursements, and to plan now for a future donor conference after the elections.

I was also encouraged by your letter noting that you will make a decision on the payments system within the next days. This is excellent news, now that the technical aspects are fully resolved. This unification will promote economic growth and significantly smooth the operations of the Federation tax administration, customs administration, and Federation budget, institutions that the TAC is also designed to support.

I hope that your decision will be implemented soon, so that we can present this credit to our Board of Directors, and gain their support. As you know from your earlier discussions with Mr. Caio Koch-Weser, once the unification has taken place, and following a two-week uninterrupted functioning of the unified system, I will be very pleased to immediately send the project to the Board. Were your decision to be effected in the next days, so that unification would take effect on July 15, as outlined in Prime Minister Muratovic's letter to me of July 5, I would be happy to submit the TAC documents to the Board before the recess (July 31) for a Board discussion on the first available Board date thereafter(August 20).

With respect to the allocation of resources under the TAC, between the Federation budget and the State Budget, this has been negotiated between the Federation Ministry of Finance and the State Ministry of Finance and the World Bank, based on the respective budgetary responsibilities of the Federation and the State, and the expenditure programs the TAC is designed to support (e.g., recurrent expenditures relating to the agreed Federation pension reform, Federation health system reform, demobilization support, and Federation social fund outlays.) This could be renegotiated, in the event that all the signatories to the previous negotiation agree.

Mr. President, my memories from my visit to Sarajevo are still very much alive. Moved by the human tragedy, I remain encouraged by the determination of the people of Bosnia and Herzegovina to make peace sustainable. I wish to reassure you that the World Bank will continue its strong support to make a better life for the Bosnian people a reality as soon as possible.

With my best wishes

Sincerely yours,

James D. Wolfensohn

Attachment

cc: Ms. Eveline Herfkens, Executive Director, Bosnia and Herzegovina

Attachment

Transition Assistance Credit: Unification of the Federation Payments System

Steps to be Taken Prior to Submission of Documents to the Board

As outlined in the Memorandum of the President (MOP) for the Transition Assistance Credit negotiated with the Bosnian Authorities on May 15, 1996, the Board condition with respect to the unification of the Federation payments system reads as follows: "Full unification of the Federation payments bureau, including appointment of the Director and deputy Director *(done)*, and development of a checklist of measures for unification of a single Federation payments bureau *(to be done --see below)*, as demonstrated by the lack of a need for periodic settlement and clearance between the two payments bureaus for transactions balances *(to be done --see below)*."

As evidence of the completed actions with respect to the Federation payments system, we would need, as part of the "checklist",

1. An Agreement to be signed by all parties concerned in the TAC negotiations (signatories to the Letter of Developmental Policy) outlining the manner in which unification is to take place (i.e., how many currencies will be involved, what is the mechanism for conversion of currencies for use by the Federation budget, etc.) and the date on which the unification is to become effective. (A draft agreement was provided to the authorities on June 10, 1996 that could serve as a model.)

2. The signature of the NBBH as one of the parties to the above agreement, as it relates to the conversion of currency, would be required. Alternatively, the proposed substitute for this, issuance of an executive order of the President instructing the National Bank of Bosnia and Herzegovina to implement the currency conversions required by the agreement mentioned above would also be acceptable.

3. Certification by the Director and Deputy Director of the Federation Payments Bureau that the unification *has taken place*, on the effective date.

As evidence of effective unification, demonstrated by the lack of a need for periodic settlement and clearance between the two payments bureaus for transactions balances,

4. Certification (two weeks after the date of effectiveness) from the EU monitors, in Mostar, that there is full unification and no paper-based transfers have taken place since the date of unification specified by the Agreement and the Directors and Deputy Directors certification. (These monitors would continue to certify to the World Bank that full unification has been maintained, up to the Board date, and until the effectiveness of the Credit. Any reversals would lead to withdrawal of the credit from Board consideration.)

BOSNIA AND HERZEGOVINA
PRIME MINISTER

Sarajevo, 05 July 1996

Mr. James D. Wolfensohn, President
THE WORLD BANK
Washington, D. C. 20433
U. S. A.

Dear Mr. Wolfensohn,

I am pleased to have this opportunity to express one more time our gratefulness for the support of the World Bank and reiterate our satisfaction with the excellent cooperation accorded to us by your associates.

In reference to fulfilling the conditionality for presentation of the Transition Assistance Credit to the Board of Directors, I am in position to inform you that preparations for setting up the unified payment system are at an advanced stage. The technical and software problems require several more days before the system can begin to operate. The system is expected to be operational by mid-July at the latest.

I was informed that the documents for the Board presentation need to be forwarded on Monday, 8 July 1996, in order to be processed in time for the Board meeting before the August recess. To make this very important deadline, I would like to ask that this procedure be initiated on Monday.

Let me conclude by stating my conviction that our joint effort will grow ever more successful with the passage of time and gradual revitalization of society and economy of Bosnia and Herzegovina. Our excellent mutual understanding is of highest importance in achieving our common goal of providing regeneration to this devastated country and relief to its suffering people. The vast effort of your organization makes us all feel that this goal is within reach.

Sincerely,

Dr. Hasan Muratović
Prime Minister

Sarajevo, July 06, 1996

Dear Mr. Wolfensohn,

I would like to take this opportunity to express my most sincere gratefulness for the cooperation we have and the excellent understanding of our problems that you always show.

The information that the decision on the Transition Assistance Credit (TAC) will be postponed until the end of August has caused me grave concern. This credit was supposed to assist us to overcome our major budgetary problems in the June - September period. On the basis of the earlier planned date (end of June) we have already developed all our activities with other contributors.

I urge you to understand that this postponement will have irreparable consequences. Therefore I ask you to change this decision and submit the required credit documentation in time for the next meeting of the Board of Directors. It is of utmost importance for TAC to be approved before the end of July.

I am aware that we have so far failed to fulfill the condition of establishing a functioning payment system within the Federation of Bosnia and Herzegovina, and I assure you that within the next three days I shall make the decision on this contentious problem and ensure the functioning of the system before the end of July, which means before the Board session deciding about TAC.

Previously it was agreed that the credit funds will be split between the Government of Bosnia and Herzegovina and the Government of the Federation of Bosnia and Herzegovina on the basis of 30:70 ratio. Owing to recent problems with the liquidity of the State I am compelled to propose that this ratio be changed to 50:50.

You will surely understand that this letter would not have been written if this matter had not been of such an extreme importance for our State.

Let me assure you of continued determination of the State of Bosnia and Herzegovina to work together with the World Bank and the donor community on achieving our ultimate goal of restoring peace and normality to this country.

Sincerely,

Alija Izetbegović
President of the Presidency

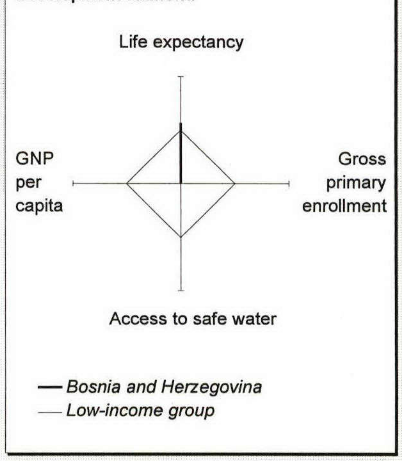
Mr. James D. Wolfensohn, President
THE WORLD BANK
Washington, D. C. 20433
U. S. A.

TOTAL P.02

Facts & Figures

Bosnia and Herzegovina at a glance

POVERTY and SOCIAL	Bosnia and Herzegovina	Europe & Central Asia	Low-income
Population mid-1994 *(millions)*	4.2	488	3,182
GNP per capita 1994 *(US$)* 1/	..	2,270	390
GNP 1994 *(billions US$)* 1/	..	1,108	1,241
Average annual growth, 1990-94			
Population *(%)*	-1.1	0.4	1.8
Labor force *(%)*	..	0.6	1.9
Most recent estimate *(latest year available since 1989)*			
Poverty: headcount index *(% of population)*	..	..	..
Urban population *(% of total population)*	49	65	28
Life expectancy at birth *(years)*	71	98	63
Infant mortality *(per 1,000 live births)*	19	23	68
Child malnutrition *(% of children under 5)*	..	..	38
Access to safe water *(% of population)*	..	..	67
Illiteracy *(% of population age 15+)*	..	..	35
Gross primary enrollment *(% of school-age population)*	..	97	105
Male	..	97	112
Female	..	97	98

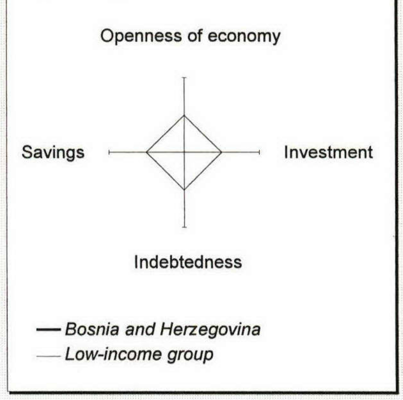


Development diamond*

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1975	1985	1994	1995
GDP *(billions US$)*	..	..	..	2.2
Gross domestic investment/GDP	..	..	..	..
Exports of goods and non-factor services/GDP	..	..	..	18.0
Gross domestic savings/GDP	..	..	..	..
Gross national savings/GDP	..	..	..	..
Current account balance/GDP	..	..	..	-10.0
Interest payments/GDP	..	..	..	..
Total debt/GDP	..	..	..	147.0
Total debt service/exports	..	..	..	130.0
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

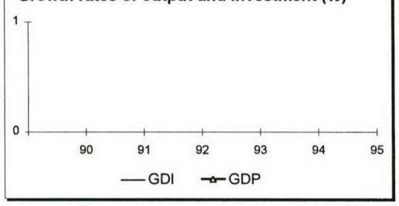
	1975-84	1985-95	1994	1995	1996-04
(average annual growth)					
GDP	..	..	..	..	15.5
GNP per capita	..	..	..	..	..
Exports of goods and nfs	..	..	..	..	28.8



Economic ratios*

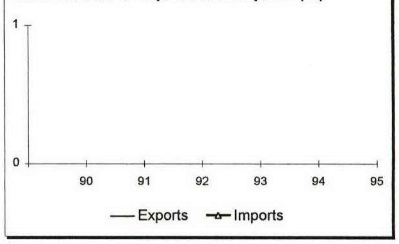
STRUCTURE of the ECONOMY

	1975	1991	1994	1995
(% of GDP)				
Agriculture	..	9.5	..	..
Industry	..	43.0	..	..
Manufacturing	..	..	..	..
Services	..	47.5	..	..
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Imports of goods and non-factor services	..	..	..	..



Growth rates of output and investment (%)

	1975-84	1985-95	1994	1995
(average annual growth)				
Agriculture	..	..	..	..
Industry	..	..	..	..
Manufacturing	..	..	..	..
Services	..	..	..	..
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Gross domestic investment	..	..	..	..
Imports of goods and non-factor services	..	..	..	..
Gross national product .	..	..	..	..



Growth rates of exports and imports (%)

Note: 1995 data are preliminary estimates.

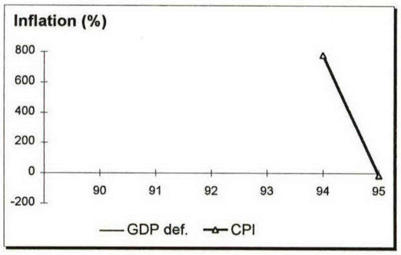
Large proportion of data are missing due to scant and partilal data in case of Bosnia and Herzegovina at this early stage of post-war period.

1/ 1994 GNP figures are not available. For 1995, EC2CO estimates GDP to be US$ 2.2 billion and GDP per capita to be US$ 520.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

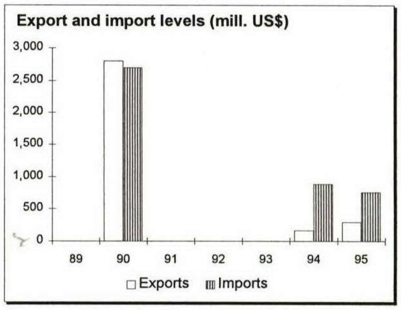
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	..	..	780.0	-11.7
Implicit GDP deflator	..	..	..	..
Government finance				
(% of GDP)				
Current revenue	..	..	..	..
Current budget balance	..	..	..	..
Overall surplus/deficit	..	..	..	..



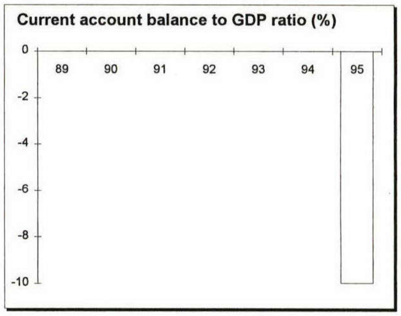
TRADE

	1975	1985	1994	1995
(millions US$)				
Total exports (fob)	..	..	164	295
n.a.	..	..	..	..
n.a.	..	..	..	..
Manufactures	..	..	..	..
Total imports (cif)	..	..	889	759
Food	..	..	..	..
Fuel and energy	..	..	..	..
Capital goods	..	..	..	..
Export price index *(1987=100)*	..	..	..	..
Import price index *(1987=100)*	..	..	..	..
Terms of trade *(1987=100)*	..	..	..	..



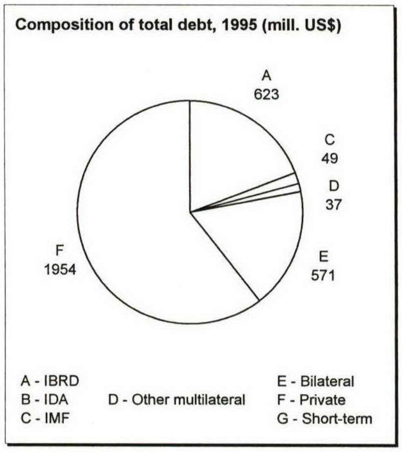
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US$)				
Exports of goods and non-factor services	..	..	262	395
Imports of goods and non-factor services	..	..	1,392	1,146
Resource balance	..	..	-1,130	-751
Net factor income	..	..	-221	-245
Net current transfers	..	..	603	394
Current account balance, before official transfers	..	..	-748	-602
Financing items (net)	..	..	717	644
Changes in net reserves	..	..	31	-42
Memo:				
Reserves including gold *(mill. US$)*	..	..	..	22
Conversion rate *(local/US$)*	..	..	..	..



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US$)				
Total debt outstanding and disbursed	..	..	2,960	3,234
IBRD	..	..	546	623
IDA	..	..	..	..
Total debt service	..	..	475	508
IBRD	..	..	60	73
IDA	..	..	..	..
Composition of net resource flows				
Official grants	..	..	..	..
Official creditors	..	..	..	..
Private creditors	..	..	..	..
Foreign direct investment	..	..	..	..
Portfolio equity	..	..	..	..
World Bank program				
Commitments	..	..	..	..
Disbursements	..	..	..	..
Principal repayments	..	..	..	..
Net flows	..	..	..	..
Interest payments	..	..	..	..
Net transfers	..	..	..	..



Bosnia - Revised Lending Program for Calendar 1996

(as of June 28, 1996)

	Project	Appraisal Date	One stop Review	Negotiations	Board *(tentative)*	Project Cost (US$)	Beneficiary[1] Project	Beneficiary[1] Bank Support	IDA	IDA Cumula-tive	RS Cumula-tive	Financing Gap[2]	Task Manager
TRUST FUND	Emergency Reconstruction (ERC) [E]		1/5a	1/22 a	2/29 a	160	S, F	F	45	45		26	WD
TRUST FUND	Emergency Farm Reconstruction [E]	1/8a	2/2 a	2/28 a	3/28 a	50	F, RS	F	20	65		13	MK
TRUST FUND	Emergency Water Supply [E]	10/95a	2/23 a	2/28 a	3/28 a	70	F	F	20	85		23	RMacE
TRUST FUND	Emergency Transport [E]	11/95a	2/13 a	2/28 a	3/29 a	161	S, F, RS	F	35	120		54	MD
TRUST FUND	Emer. War Victims Rehab.- Grant [E]	2/5a	3/31 a	4/15a	5/14a	30	F	F	5	125		8	MM
TRUST FUND	Emergency Education Recon.- Grant [E]	3/11a	4/4 a	4/15a	5/14a	33	F, RS	F, RS (0.5)	5	130	0.5	17	MM
TRUST FUND	Emergency District Heating Rehab.	1/9a	2/16a	4/15a	5/14a	58	F, RS	F, RS (0.5)	20	150	1.0	6	HB
IDA	Emer. War Victims - Credit	n.a.	n.a.	n.a.	6/28a		F	F	5	5		n.a.	
IDA	Emer. Education - Credit	n.a.	n.a.	n.a.	6/28a		F, RS	F, RS	5	10		n.a.	
	End FY 96 - Begin FY97												
IDA	Emergency Power Rehab	1/9a	4/2 a	5/20a	7/30	196	F, RS	F	35	45		70	HB
IDA	Demobilization & Training	4/26a	5/16a	6/10a	7/30	20	F, RS	F, RS (2.5)	7	52	3.5	12	DF
IDA	Local Public Works	5/1a	5/25a	6/10a	7/30	45	F,RS	F, RS (2.5)	10	62	6.0	31	SF
IDA	Emergency Mine Clearing	1/9a	4/26a	6/10a	7/30	67	F,RS	F,RS (2.0)	7	71	8.0	20	AE
IDA	Emergency Housing	4/24a	5/28a	6/10a	7/30	50	F	F	15	86		24	MT
IDA	TAC	4/15a	4/5 a	5/15a	7/30	110	S, F	F, S	90	176		0	WD
IDA	Industry	7/31	TBD	TBD	9/15	50	F, RS	F, RS (3.0)	10	186	11.0	40	PG
IDA	Essential Hospital Services	4/22a	8/28	9/26	10/10	95	F, RS	F, RS (5.0)	15	201	16.0	80	OA
IDA	Microbusiness/Local Initiatives	5/25a	TBD	TBD	9/15	15	F	F	7	208		4	MN
	End CY96 - Begin CY97												
IDA	Forestry	TBD	TBD	TBD	TBD	35	F, RS	F, RS (2.0)	7	215	20.0	28	FW
IDA	Education Reconstruction	6/17	TBD	TBD	TBD	60			20	235		40	MM
IDA	Emergency Gas	TBD	TBD	TBD	TBD	54	F, RS	F, RS (3.0)	20	255	23.0	TBD	IM
IDA	Water Management and Rehab.	TBD	TBD	TBD	TBD	80			15	270		65	RMacE
IDA	Transport II	TDB	TBD	TBD	TBD	158			20	290		138	MD
IDA	Government Services I	TBD	TBD	TBD	TBD	TBD			2	292		TBD	WD
IDA	SAC II	TBD	TBD	TBD	TBD	TBD			90	382		TBD	WD

Notes: a - actual

1/ S is State, F is Federation and RS is the Serb Republic. For projects only benefiting S or S and F, support to RS is not excluded, however would depend on appropriate political climate and would be decided in coordination with the int.'l donor community and key institutions of the peace process.

2/ Tentative funding gaps, based on indicative commitments from donors.

[E] Credit/Grant is Effective.

KEY FACTS ON BOSNIA

- **BOSNIA BEFORE INDEPENDENCE (1991)**

Population:	4.4 million
GDP:	US$8.3 billion
GDP per capita:	US$1900
External Debt:	US$1.9 billion
External Debt to GDP ratio:	23.5%

- **INDEPENDENCE, WAR AND PEACE: KEY EVENTS**

Referendum and declaration of independence:	March, 1992
Start of hostilities:	Spring, 1992
UN membership:	May, 1992
Washington Agreements on creation of Bosniac-Croat Federation:	March, 1994
Dayton Peace Agreement:	November 21, 1995
Paris signing of Dayton Peace Agreement:	December 14, 1995

- **BOSNIA AFTER THE WAR (END DECEMBER, 1995)**

GDP:	US$2.2 billion
GDP per capita (approximately):	US$500
External Debt:	US$3.2 billion
External Debt to GDP Ratio:	147%

Note: legal issues regarding assets and liabilities of ex-Yugoslavia not resolved and may impact these figures

COUNTRY SUFFERS FROM THREE MAJOR HANDICAPS:

- **WAR DAMAGE IS EXTENSIVE**

HUMAN DAMAGE:

War-related deaths:	250,000
Wounded persons:	200,000 (about 50,000 of whom children)
Displaced persons inside Bosnia:	2 million
Refugees outside Bosnia:	1 million
Unemployed:	over 75% of labor force within the Federation

MATERIAL DAMAGE:

Agriculture:	80% of farm equipment destroyed
Industry:	1995 production is 5% of 1990 level
Power generation:	60% damaged or out of operation
Power distribution:	largely destroyed
Telecommunications:	30% of telephone connections destroyed or damaged, and 90% of international telephone lines destroyed
Transport:	30% of main and regional roads in need of immediate repair; 70 high priority bridges to be rebuilt, including all ten bridges connecting the Republic of Croatia and Bosnia and Herzegovina
Health:	35-50% of health infrastructure damaged or destroyed; 50% decrease in health personnel
Education facilities:	50% of school buildings damaged, destroyed, or seized by army for housing
Housing:	60% of housing stock damaged or destroyed
Land mines:	2-4 million mines lay uncleared

- **STATE AND REGIONAL/LOCAL INSTITUTIONS ARE YET TO BE ESTABLISHED OR ARE WEAK**

Cantons:	8, and possibly more, cantons to be established within the Federation (4 cantons have been established to date)
Central Bank:	to be established
Ministries:	State, and particularly Federation ministries are weak and need to be strengthened

- **THE TRANSITION FROM SOCIALISM TO THE MARKET HAS YET TO TAKE PLACE**

79% of enterprise capital in the Federation (and 97% of enterprise capital in Bosniac-majority areas of the Federation) is State-owned

80% of banking assets in the Federation (and 95% of banking assets in the Bosniac-majority areas of the Federation) are in State-owned banks

90-95% of banking assets in the Federation are non-performing

KEY ELEMENTS OF A RECOVERY PLAN FOR BOSNIA

(1) REPAIRING WAR DAMAGES AND REVIVING THE ECONOMY

RECONSTRUCTION PROGRAM	3-4 YEAR PROGRAM (US$ MILLION)[2]	REVISED 1-YEAR PROGRAM[1] (US$ MILLION)[2]
• Water and Waste Management	380	140
• Energy (power, district heating, natural gas and coal)	893	403
• Transport	698	317
• Telecommunications	567	160
• Agriculture and Rural Sector	330	97
• Employment Generation[3]	n/a	75
• Industry	400	120
• Education	275	72
• Health	540	145
• Housing	600	165
• Mine Clearing	200	70
• Other[4]	210	75
TOTAL FINANCING REQUIREMENT:	5,093	1,839
of which: Federation	3,700	
Republika Srpska	1,400	

(2) ESTABLISHING A VIABLE MACROECONOMIC FRAMEWORK

- Stabilizing the economy. Key provisions agreed with the IMF: Central Bank to operate as a currency board for 6 years, no domestic financing of the fiscal deficit, removal of price controls, removal of import restrictions and restrictions at internal borders

- Achieving financial normalization. Resolution of arrears and membership with IFIs; Paris Club and London Club integral part of priority recovery package

---

1/ The original one-year program (of US$2.1 billion) has been revised.

2/ All numbers on a commitment basis.

3/ Employment generation was not included as a separate sector inthe three- to four-year program in the December 1995 report. However, given the urgency of reintegrating demobilized soldiers and the unemployed into the economy, specific programs targeted at employment generation and labor redeployment are now being developed.

4/ Includes the emergency Solcial Fund, and salaries and other support for government institutions.

- Establishing and strengthening key institutions for macro management and control

    - Central Bank
    - State and Federation ministries
    - Customs and taxes administrations

- Structural Reform

    - Public finance reform
    - Pension system reform
    - Health system reform

(3) **MAKING THE TRANSITION TO A MARKET ECONOMY**

- Privatizing enterprises
- Carving out bad assets and privatizing banks
- Strengthening legal and regulatory frameworks:

    - for effective bank supervision
    - for clarifying ownership, property, contract and dispute resolution matters

JKeller:at
m:\bosnia\trips\bosfacts

Bosniak –