

**Regeneration & Development of the Enterprise Sector  
Labour Issues**

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# 1 Introduction

The key aim of this paper is to recommend a set of measures that can be used to enable downsizing of the work force of enterprises in the framework of restructuring programmes. Labour costs of downsizing form a major financial blockage to enterprise restructuring. Anecdotal evidence and some case studies suggest that labour related liabilities might form the major part of liabilities in BiH. The options formulated below are to be considered within the framework of a Voluntary Conciliation Scheme (VCS) scheme as designed in a draft discussion paper by DFID on 26.03.2004. A VCS scheme operates on the principles of an agreement between the enterprise and its creditors for a grace period and a financial restructuring plan of an enterprise in relation to a business restructuring and recovery programme. The financial restructuring plan implies a debt repayment schedule of a limited time period that is laid down in a formalised contract with all creditors (a suspension agreement). A VCS scheme can be considered an alternative to a policy where company liabilities are written off for sake of forgiveness as well as for a bankruptcy or liquidation procedure. A VCS scheme may be applicable to the state owned enterprises that still await privatisation as well as already privatised enterprises that need further restructuring and labour force downsizing.

A VCS scheme has certain advantages above a bankruptcy procedure as it offers more flexibility for creditors and owners and management of an enterprise to define an adequate economic recovery programme for at least those companies that have potential economic viability. The proposals mentioned in chapter 4 of this report are explicitly meant to be integrated into a VCS policy of company restructuring, but elements can also be used for companies that will enter a bankruptcy procedure.

## 2 Analysis

### 2.1 Introduction

According to World Bank documents and the PRSP the labour market developments in BiH are characterised by the following:

- a privatisation process has started after the war, is still ongoing and has been implemented in various phases and through different methods, that did not yet result in significant employment growth. The lack of employment growth has various causes, among which slowness of privatisation of strategic enterprises due to inflexible legislation, inexperience of the privatisation agencies, non transparency of the privatisation process and insufficient enterprise restructuring and investment;
- enterprise restructuring has usually not taken place before state enterprises were privatised. Many privatised enterprises need further restructuring to make them economically viable;
- a low degree of job growth and destruction, at least in the formal sector of the economy. The institutional causes for this are found in rigid wage determination systems (see below). Until 2000 a restrictive employment legislation system and an inefficient income support system have also contributed to the lack of job creation and destruction;

- a low degree of labour mobility, both geographically and professionally, caused by the rigid wage system, ethnical tensions and discrimination, deficiencies in the housing system, elaborate informal family support for social protection that binds families to one place, lack of capacity and expertise in the employment services, and underdeveloped active labour market support programmes;
- huge liabilities of to be privatised or already privatised enterprises. Labour related liabilities may be predominant among these liabilities to the extent that they block further enterprise restructuring. These liabilities are due to lack of financial capacity and discipline (in previously state owned) enterprises, a historical tradition in lack of willingness to shed labour in enterprises, and complicated legislation that prevents collective dismissals for the sake of enterprise restructuring.
- a growing informal labour market that consists of various segments. Estimates indicate a percentage of 36% in 2001 (based on LSMS survey). Emergence of an informal or black labour market is a phenomenon usually accompanying the transition process of ex-socialist economies. It is in the first place to be considered a coping strategy to deal with de facto unemployment and poverty resulting from the transition process for large parts of the population. Several segments can be distinguished in BiH: purely criminal activities, unregistered self-employment by physical persons, subsistence activities in agriculture, a widely applied practice of hiring employees who are informally paid out by the private sector and a wide scale practices of underreporting wages for employees who are formally on the payroll of companies;

Apart from the economic effects of an informal sector, the consequences are serious for the loss of tax and insurance revenues due to reduced tax and insurance bases. Huge parts of the population are no longer sufficiently covered by social insurance. On the other hand many workers are stimulated to at least maintain their official status as an employee with a company without actively contributing to production in order to maintain part of their social insurance rights;

- Part of the informal employment can thus be found with employees who are officially still employed in a company, but who are de facto permanently or regularly inactive. Until the year 2000 their inactivity was officially regulated through the status of being “waitlisted” which implied various employment protection, insurance rights and compensations. Official waitlisting has been abolished in both entities in 2000, but the practice of putting employees on inactivity continues as long as obstacles for dismissals are not removed. Among these obstacles are unsettled claims of formerly waitlisted workers for at least the period until 2000.
- a high – and growing - official unemployment rate, of about 40% as registered by the employment offices, that after correction for informal activities was estimated to be about 16% in 2001, to which a large group of discouraged workers or unemployed “for personal reasons” (22%). The latter groups are much less attached to the labour market than the first group. Unemployment affects mainly the first time job seekers, the youngest and less skilled parts of the population, and, to a lesser extent, women. Apart from women, these categories are more and more forced into the informal sector;
- the wage setting system has been discussed in various documents. The conclusion is that it leads to labour market rigidities, especially in FBiH, that will not be analysed in this report. However, the wage structure is linked to the problems dealt with in this report, not only

through its influence on the net wage arrears, but especially given the legislative rules with regard to the contribution base in the social insurance systems. Apart from that the rigidities are the following. In the FBIH a minimum wage is regulated in the General Collective Agreement (GCA) as 55% of the average wage in the entity. This minimum wage level is not based on productivity considerations for low skilled employees. The GCA applies to the state enterprise sector only (enterprises with a majority share for the state), and defines minimum rights for employees that are to be specified in branch collective agreements (some of which have wage scales far above what is prescribed in the GCA). Since no GCA has been concluded for the private sector it probably influences strongly the wage setting mechanism in the private sector as well. The mentioned minimum wage is not paid out as the GCA prescribes a rigid system of coefficients for categories of jobs that are to be applied on the mentioned minimum wage (up to 3.00). The basic wage to be paid lies, hence, above 55% of the average wage in FBIH. Other rigidities concern the automatic annual wage increase for seniority (0,6% per year to a maximum of 20%), minimum fixed allowances (in percentages) on overtime work (high: 50%) and night work (30%), etc. Moreover a minimum ration is prescribed of 25% of the average FBIH salary for food, transport, etc. It is to be noted that, contrary to the RS, these allowances are not included in the base for wage taxation and social contributions, thus narrowing the base substantially. This leads to relatively high taxation and contribution costs in the FBIH compared to the RS: respectively 69% and 52% if calculated on the basis of net wages. Moreover, minimum and net wage levels are much lower in the RS than in the FBIH. Hence, the labour cost levels are lower in the RS and probably more in correspondence with productivity as has been shown in a World Bank study that compared the wage profiles of the formal and the informal sectors. (Another labour market rigidity concerns the minimum level of the contribution base for social insurance (in both entities). This leads to relatively high contribution costs for those who only receive a compensation below the minimum wage (see below)). Finally, the legislation lacks the concept of the hourly wage, thus creating hindrances (or at least unclearness) for the conclusion of part time contracts.

In the RS a more detailed GCA governs the work relations for both the private and the public sector. It does not define a minimum wage level, this being left to the parties concluding a collective (branch) agreement, or eventually by the government. It has similar arrangements for wage scale coefficients (ranging from 1 to 6), and for overtime payment as the GCA in FBIH. It acknowledges the right of employers to put workers on waitlist for economic reasons, and then formulates a high fall back wage of 65% of the individual wage (up to a maximum of 6 months). In practice this fall back wage is often not paid out;

- Employment protection legislation provides now sufficient flexibility for hiring and firing employees and can be considered to be in line with international practice in both entities (apart from blockages resulting from arrears: these are, however, of financial, not of legal, nature) Employment protection legislation concerns rules for hiring and firing, and also regulates possibilities for concluding flexible labour contracts. A major element in employment protection legislation are the severance payments (see below)

## 2.2 Regulatory framework

This section gives an overview of the regulatory framework for the social insurance systems, severance payments and the wage taxes.

Both entities have a social insurance system of which the major characteristics are outlined below.

### *Unemployment insurance*

Unemployment insurance systems exist in FBIH and RS. They differ in details with regard to insurance conditions and rights. In the RS Law on job placement those who are insured for unemployment insurance are defined. A similar definition cannot be found in the FBIH law (the FBIH law just assigns benefit rights to “unemployed persons” under certain conditions). Article 8 of the Law on Contributions FBIH, however, implicitly defines that employees have unemployment insurance rights. A distinction is made between mandatory and voluntary insurance in the RS, but not found in the FBIH Law. In both entities the unemployment benefits can only be awarded if the eligibility requirements are met. A key requirement is the payment for the individual insurance history of employees. However, in practice health insurance rights, assigned to them in the Laws on Job placement, are awarded to unemployed persons even if there are gaps in their unemployment and health insurance history as an employee. This may explain that the number of (monetary) unemployment beneficiaries is much lower than the number of unemployed who receive health insurance rights in both entities.

The following scheme applies for unemployment benefit rights in the entities.

	FBIH		RS	
minimum reference/ insurance period	8 months continuously during past 12 months or:	8 months during past 18 months	8 months continuously during past 12 months or:	12 months during past 18 months
benefit levels and duration	8 months – 10 years insurance	6 months; 30% of average FBIH salary*	< 5 years insurance	3 months; 35% of average salary** earned
	10 – 25 years insurance	9 months; 35% of average FBIH salary*	5- 10 years insurance	6 months; 35% of average salary** earned
	> 25 years insurance	12 months; 40% of average FBIH salary*	10-15 years insurance	6 months; 40 % of average salary** earned
			15-25 years insurance	9 months; 40% of average salary** earned
			> 25 years	12 months; 40% of average salary** earned

\* during the last quarter before becoming unemployed

\*\* the average salary earned in the last three months by the unemployed person before he/she became unemployed

The unemployment benefit durations are to be considered reasonable in comparison with other transition countries. The replacement rates (which are net replacement rates) are relatively low compared to other countries. Benefit rights anyway imply a strong incentive to find work.

The levies on the contribution bases are defined according to the Laws on contributions. In RS it is 1% on the net wage and in FBIH 2.5% of the gross wage (2% for the employer and 0.5% for the employee). The contribution base is in principle the individually earned wage, but provisions for minimal wages are laid down in both entity laws. These provisions create complications, especially for inactive persons with a small compensation below the minimum level. In the FBIH according to the Law on Contributions the contribution base is in principle the wage earned by the employee, but with a minimum of the average monthly salary earned in the FBIH for the non-governmental sector. Compensations for inactive and waitlisted workers are included in the contribution base which then is interpreted to be minimally at the just mentioned average wage. This rule is at least applied for the minimum insurance period (of 8 months) mentioned in the table above. It is unclear whether employment offices also apply it in practice for the assessment of the total historical insurance period of an applicant. The contribution requirement is, moreover, in practice not assessed on an individual basis but on the basis of enterprise compliance with contribution payments for all its work force during a certain undefined period. Whatever the usual practice, the minimum level in the contribution base raises the financial burden on enterprises, especially for its inactive workers, since their actual compensations are usually far below the mentioned minimum contribution base. The more employees are on a “waiting list” the higher the contribution burden will be.

Since it is laid down in the Law on Contributions the same minimum rule applies to health insurance and pension/disability insurance. The contribution gap between levels based on actually earned wages/compensations and prescribed minimum bases is bigger for health and pension insurance in absolute terms. Obviously in the sphere of unemployment insurance the minimum contribution base is justified by the fact that the benefit level is not based on the earned wage by the unemployed person, but on the average wage earned in the FBIH. However, the system raises the labour costs and gives scope for strategic behaviour of employers and inactive workers in view of unemployment benefit rights (which has not yet become manifest, however). The issue has to be assessed in relation with the labour market rigidities resulting from a wage setting system in the FBIH that not only creates mechanisms for discrepancies between labour productivity and (minimum) wages, but also indirectly raises labour costs due to the linking of the minimum contribution base to an average wage. Besides that it creates a kind of flat rate benefit system that is not consequently reflected in the contribution system.

In the RS a similar minimum contribution base is explicitly defined in article 9 of the Law on Contributions for most categories of insured persons, among which employees: the minimum cost of labour in the RS in the month for which the contribution is paid.

Although a minimum contribution base provides for administrative simplicity, it is from a labour market point of view desirable to remove the minimum levels for the contribution base and to replace them by the really earned wages/compensations. The unemployment benefit level should then be based on the earned wage as well. This might be combined with an extended period (e.g. the minimum reference period of 8 months or longer) for calculation of the average monthly wage/compensation earned, also to cover for the rotating periods of activity and inactivity for certain categories of workers.

The number of beneficiaries in both entities is reflected in the table below. Distinction is made between those who receive an unemployment benefit, those who are eligible towards health insurance, and those who are just entitled to mediation services and other active labour market measures.

It is widely assumed that many of those who register for unemployment are in the first place interested in getting access to health insurance for which the contributions are paid by the employment offices, and that they are less interested to be assisted by the Employment Offices in searching for a job. This puts a high burden on the administrative capacity of the offices. If a mass enterprise restructuring programme will be accompanied with strong downsizing of work forces this may lead to substantial lack of capacity to implement the required job brokerage and active labour market measures.

The share of the registered unemployed who receive an unemployment benefit is extremely low. On the average in 2003 there were monthly 4759 unemployed who received an unemployment benefit against 175175 registered unemployed with health insurance in the FBIH. The total number of registered was about 300.000. Similar figures are found in the RS. Of the total number of registered unemployment (24366) in June 2003 only 1556<sup>1</sup> received an unemployment benefit and 85684 were insured for health insurance.

The low share of unemployment beneficiaries is on the one hand due to the fact that many registered unemployed consist of young schoolleavers or other categories without a benefit entitlement (ex-farmers and self-employed). A second major cause is, reportedly, that for many ex-employees the insurance contributions have not been paid. In other words: the arrears in contributions lead to low coverage of the unemployment benefit system.

This fact is also reflected in the expenditure structure of the Employment Funds in both entities. These are characterised by low expenditure on insurance benefits, more on health insurance, a high share on mediation and active labour market measures, and a very high share on operational cost.

### *Health insurance*

According to the health insurance laws employees, including inactive and waitlisted workers, are in principle insured for health insurance, again provided that contributions have been paid according to the rules of the Laws on Contributions and the Health Insurance Laws. Besides that, other categories

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<sup>1</sup> This number is growing. reportedly it was about 3000 at the end of February 2004.

of the population (self-employed, students, pensioners, etc.) are covered by health insurance as well under specified contribution conditions, be it of voluntary or mandatory nature.

It is to be noted that health insurance not only covers the costs of medical services, but also insures for (in both entities) income loss due to (long term) illness of employees. This has to be taken into account when considering repair measures for contribution arrears.

The contribution percentages are as follows in the FBIH: 13% for the employee and 5% for the employer (on the gross wage). In the RS the percentage is 14,50 % (on the net wage). Due to contribution arrears to the cantonal, regional and federal health insurance funds parts of the employees are not covered by health insurance, probably not incidental (for one month) but for longer periods. This will certainly apply to the inactive workers in the RS for whom reportedly contributions are not paid at all. The share of the population that is not covered by health insurance is about 25% in the RS, of which three quarters due to non-payment of contributions.

The latest consolidated financial statement 2002 FBIH shows that about 73% of the revenues are generated by contributions for mandatory insurance, about 15% from direct payments by patients. Contributions from cantonal and federal budgets amount to about 3%. The total budgets for the FBIH health insurance funds show a deficit of about 12 mln KMB in 2002, being about 2,5% of total expenditure (almost the same figure applies to the health institutions served by the insurance system), Expenditure per insured person was 259 KMB in 2002.

#### *Pension insurance*

According to the Pension and Disability Laws of both entities insured are a.o. employees for whom the insurance contributions have been paid. The system covers old age, disability and survival pensions. There are some differences between the old age pension systems of the RS and FBIH. The old age pension levels differ between the two entities with regard to insurance base, definition and level of the contribution base, contribution percentages, regulations for minimum and maximum pensions. There are also differences in the effects of the cash rationing system. The latter has in 2000 been introduced in BiH as a correction mechanism to on the one hand avoid growing arrears in pension delivery to pensioners and on the other hand to adapt the pension levels monthly to the available means in the funds. The old age pension systems are in both entities in principle based on an average wage system (FBIH is moving from a pension level based on the best 15 years of wages earned to a system of average of wages earned over life time).

The cash rationing system, introduced at initiative of the World Bank and IMF, had to be introduced in order to avoid administrative and financial blockage of the system. Revenues had drastically gone down in the years preceding the introduction of the cash-rationing system. With the introduction of the system the legally defined old age pension levels were cut with about 50% in RS and more than 50% in FBIH. In the RS this percentage has gradually increased to about 70% recently. In the RS the governmental budget contributes for about 25 % to the revenues of the Pension Fund, in the FBIH for



only 1%<sup>2</sup> (2003). The deteriorating financial basis of the pension funds is mainly caused by the constantly narrowing of the contribution base, reflected in a growing dependency ratio. The second factor is formed by the arrears in contributions from the side of the enterprises. Although there is no legal obligation to make up for unpaid contributions, the cash rationing system works in such a way that old age pensions could be raised if companies would pay off their liabilities towards the pension funds.

The contribution base for the insurance is for employees in principle the earned gross wage in the FBIH and the earned net wage in the RS. Contribution percentages are as follows: 24% in the RS, 17% as employee contribution and 7% as employer contribution in the FBIH. Minimum contribution base rules apply as explained above under unemployment insurance.

#### *Child welfare fund*

In the RS a Child welfare fund at entity level exists that is financed on the base of employee contributions: 2% of the net wage. Child benefits are awarded by the funds to the poorest part of the population on the basis of a family income criterion and the number of children (up to 18 years of age). In general an employee with a family, if having a regular wage, will not be eligible to receive these benefits. Hence, the contribution can be considered more a specific tax than an insurance contribution. From this point of view contribution arrears are to be dealt with in a similar way as wage tax arrears. In the FBIH a similar fund does not exist although it has been debated publicly. Child protection is in principle organised in the FBIH through the Centres for Social Work from the cantonal budgets. The system shows many deficiencies, especially in the poorer cantons, due to lack of public budget.

#### *Severance payments*

These are regulated in the Laws of Labour for both entities. A distinction is made in legislation between payments for active workers who will be dismissed and for waitlisted workers at date of introduction of the new Labour Laws (2000) (art. 100 in the FBIH law and 127 in the RS Law). Minimum severance rules are formulated under almost the same conditions and according to the same calculation rules in the FBIH and RS for active workers: a minimum of one third of an average monthly salary for each full year of service with the employer, thus maximally leading to an amount of about 13 months average. It is to be mentioned that the average duration of service is usually rather long given the lack of labour mobility (no data is available). For waitlisted workers at date of adopting the Law a minimum of resp. 3 months severance pay is formulated in both labour laws under certain conditions. Specific for the FBIH is the formulation that those who were working in the enterprise on 31<sup>st</sup> December 1991 are also eligible to the severance payment for waitlisted workers under condition of timely application.

The option is mentioned in the labour laws that the severance payment may be transformed in another type of compensation upon agreement between employee and employer. It is unknown to what extent

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<sup>2</sup> However, an amount of 103 Mln KMB was budgeted as extra payment from the public budget for the health insurance of pensioners. According to the financial statement of 2003 of the Pension Fund this amount was not received.

this option has been used. In general no data on number and size of severance payments under the various articles of the laws has been found.

Severance payments for waitlisted workers are subject to lengthy appeal and court procedures in FBIH, reportedly for several thousands of applicants<sup>3</sup>. Cases have been reported that waitlisted employees have applied for higher than the minimum mentioned above. Positive decisions by appeal committees or courts seem to place a high burden on some companies that are not capable to actually comply with these decisions.

### *Wage tax*

In FBIH the wage tax is defined as 5% of the earned net wage, in the RS at 10% of the net wage. As mentioned before the RS applies a broader definition of the wage concept than the FBIH.

## 2.3 Labour related payment arrears

No sound statistical information is available on the size and composition of the various labour related arrears. Anecdotal information was presented that arrears to public bodies may amount to about 150 to 200 Mln KM in FBIH, but they would also include profit and other taxes that are not labour related. A survey is underway to investigate for a sample of 50 strategic companies in BIH a.o. their arrear structure. The debt incurred by 39 (strategic) enterprises according to the draft PRSP in FBIH was 203 Mln KM, of which 45 KM million back wages and 112 Mln back taxes and social contributions.

In the RS the liabilities towards the Pension Fund are currently estimated at 155 Mln KM. of which 25% is owed by the 10 largest companies. Total tax arrears in the RS (of which wage taxes) amounts to 450 Mln Km (including private taxpayers).

## 2.4 Excess labour

The methodology of restructuring labour related arrears also requires a good insight into the size, wages, insurance contribution history structure and labour costs of the excess labour that will be made redundant. At aggregate level various estimates have been mentioned in some documents that widely vary: from only about ten thousand (for FBIH: in the social programme of FBIH to more than 100.000 by the trade unions). International evidence on the employment effects of privatisation and enterprise restructuring does not give sufficient indications as a wide diversity in scales of downsizing after restructuring have been reported. Moreover, it has to be considered that in BIH, probably more than in other countries dealing with privatisation, labour excesses have been brought about by legal employment protection resulting in a.o. the phenomenon of waitlisting and administrative leave. The mentioned sample survey among 50 companies will soon present indications of the size of excess labour. A preliminary result on the basis of 10 enterprises in the FBIH indicates an excess labour of

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<sup>3</sup> A legislative review on employment protection for waitlisted workers in FBIH is forthcoming, financed by the World Bank

about 25%. Another indicator is the number of (informally) waitlisted or inactive workers. However, it is to be understood that a) a rather huge, but unknown number of until 2000 officially waitlisted workers are still registered by their companies and/or claim backward insurance rights and unpaid compensations, and b) that the practice of rotating workers by putting them regularly or irregularly on inactivity complicates the assessment of the number who can be actually dismissed. This being said, the number of waitlisted workers for ultimo 2002 is 14230 in about 200 bigger companies (32% of total employment) as reported by the Statistical Agency (for women: 33%). According to recent figures of the Privatisation Agency the number of waitlisted workers is about 45 to 51% of total unemployment in non-privatised companies in FBiH (about 19000 waitlisted workers). Additionally a share of 32% (about 27000) waitlisted employees are found in partially privatised companies with a majority share for the state. In the RS figures of about 25000 waitlisted workers have been mentioned. Totally the number of waitlisted/inactive workers in BiH that may become redundant in a mass enterprise restructuring programme can be estimated at about 75000 employees.

The preliminary conclusion may be for FBiH that there is indeed a potential of about 100000 employees (of which a major part already inactive or waitlisted) to be laid off. However, international practice shows that the unemployment consequences may even in the short term be mitigated by three phenomena: 1) many laid off registered workers just continue their already existing work in the informal sector 2) during a restructuring process, before formally being dismissed, workers and managers grasp the spin off opportunities given to them, e.g. by taking over parts of the assets and company activities in a deal that can be (partly) seen as a buy out for existing company obligations towards them 3) fast rehiring of dismissed workers in case a restructuring is successful and leads to growth of production.

### 3 Policy initiatives in both entities

The governments of both entities have prepared measures to deal with a number of financial blockages resulting from labour related to arrears. In RS several measures have been adopted, but in the FBiH some measures are still under debate.

To be mentioned are the following for FBiH:

1) Recently (2004) the *Proposal for a programme of measures for social welfare of employees who are to lose their jobs in the process of bankruptcy, privatisation or liquidation* was drafted.

The programme focuses on measures for support for contribution arrears for pensions and disability, for arrears in employment contributions with a maximum of 8 months, for severance payments, and for incentives to find a new employer for an unemployed person or to stimulate self-employment. The programme is based on the assumption that in 2004 10,000 persons could lose their jobs due to privatisation, bankruptcy, etc. Whatever the justification for this number, it is based on a status quo development in the business sector, not on a plan for thorough enterprise restructuring. The aim of the programme is to provide means for fully covering the pension/disability insurance history of those who become unemployed, and means for enabling them to meet the minimum reference period of 8

months for receiving an unemployment benefit. The programme is to be applied in case employers are not capable to pay for the arrears. The latter is not specified in the programme itself, nor does it refer to other legislation for further specification

The programme relies for its implementation on the cantonal and federal employment services. For its financing it refers to the resources of the employment funds itself (with a solidarity clause for redistribution to cantons with not enough resources), to privatisation yields (estimated 84 Mln KMB in 2004) and to the Federal budget. In the first draft a budget has been attached that is not supported by a detailed assessment of the necessary financial means. It mentions that totally 8.0 Mln KMB are needed for (Employment) Agency operations and 15.2 mln to cover pension and disability insurance. Note that the programme does not deal with payment arrears for those (active and inactive workers) who will not be dismissed. For this reason arrears in health insurance are not covered either. The programme is still under discussion and not adopted.

2) Another proposal in FBIH concerns *the draft Law on collection of accrued but outstanding social insurance contributions* (December 2003). The scope of the draft is limited as it concerns only state owned enterprises. Its aim is to provide for resettlement of contribution debts through writing off, discounting and rescheduling of repayments. It covers all three types of social insurance: pension/disability, health and unemployment, for debts related to the period 1<sup>st</sup> January 1992 – 31<sup>st</sup> December 2001. It provides for writing off all interest and resettlement of the principal of debts through:

- 1) writing off all debts resulting from the war period (till 1996);
- 2) providing for a one-off payment with a progressive discount schedule for the years 1996 – 2001 (varying from 60% discount in 1996 - 10% in 2001);
- 3) an (undefined) grace period;
- 4) a rescheduling period between one and six years, depending on the size of the debt;
- 5) contractual and procedural arrangements;
- 6) conditions with regard to (bank) guarantees for the repayment.

The draft provides for completing writing off health insurance arrears for the period 1996 – 2001, and provide for restoring the insurance rights for a gap in the insurance history of an employee under an agreed repayment scheme. Similar applies to the insurance rights for unemployment.<sup>4</sup>

No financial paragraph is added to the draft Law. Hence, it cannot be assessed what the consequences for the budgets and balances of the various funds are. The law correctly differentiates between health insurance and other types of insurance. From the point of view of equal treatment the draft would require widening of scope to privatised enterprises that are facing similar contribution arrears.

Similar programmes have been drafted in the RS with some differences compared to the FBIH.

3) The RS social programme called “*Program bases of Social Support for Workers Who Will Lose Their Jobs in the Process of Privatization, Bankruptcy and Liquidation of Enterprises*” provides for

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<sup>4</sup> the formulation in the draft is less clear than for the pension and disability insurance rights as it does not specify the insurance period that should be restored. No reference is made to a minimum 8 months period for eligibility, neither to the full unemployment history. Probably also for the unemployment insurance the aim is to cover the whole insurance gap since 1992.

extension of the 2002 programme for preservation of social stability. It envisages for taking over the payment of pension and disability in case of bankruptcy, privatisation and liquidation of all enterprises notwithstanding the type of ownership, but only from 1998 onwards until the day of privatisation or bankruptcy. The programme only covers those who will lose their jobs due to privatisation, etc. All pension/disability and unemployment insurance rights for the mentioned period will be restored through payments to - in the first place – the Pension and Disability Fund and the Employment Fund. For financing these arrears a number of public resources are mentioned (funds generated through succession, through privatisation results, public budgets, grants, profits from state enterprises). A special purpose fund will be established. The programme is supposed to run for two years during which the privatisation and bankruptcy procedures should be finalised, but there is a possibility for prolongation.

Only in this programme a provision is made for early retirement by allowing to buy off three years of pension rights either by employers or by employees. Note that these payments are not to be done from the social fund and, hence, will raise the cost of redundancy. However, another article in the programme opens the possibility that also employers and employees may appeal to the social fund for payments. It is feasible that they apply for early retirement purposes.

The institutional set up of the social fund has not been arranged although the Ministry of Labour is given authority to implement the programme.

Some remarks have to be made. The Health Insurance Fund is not mentioned in the Programme. Obviously this is not considered necessary for workers who will become unemployed. Secondly, the arrears before 1998 are not taken into account (might already have been covered by other legislation?). Thirdly, the programme does not cover the arrears for all employees, only for those who will become unemployed (although an exception article in the programme might be used for other arrears). Fourthly, the programme does not cover redundancies during an enterprise restructuring period after privatisation, and thus assumes that collective dismissals will be made before privatisation. This, however, does not reflect the current reality in RS where already privatised enterprises do have substantial excess labour as well.

4) a draft Law on “Rescheduling, write-off, redemption and conversion of debt into shares for due and unpaid liabilities based at the public revenues and credits” has recently been proposed by the government of RS. It envisages a follow up on measures already taken in 2002 for rescheduling of liabilities towards public creditors (defined in article 4 on Tax revenues). A strong discount scheme for writing down debts for the period until 2001 is envisaged. Total liabilities covered by the Law are calculated to be 444 Mln KMB, of which in a rescheduling period of in general 60 months. The financial effect for the budget is calculated to be 66 Mln KMB. The draft law does not envisage any distinction between types of liabilities. Contrary to the idea of privatization it envisages that a debt may be converted into a state share. This may lead to an undesirable process of “renationalisation” of already privatised enterprises<sup>5</sup>.

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<sup>5</sup> The draft elaborates also an annual interest rate of 3% on liabilities during the rescheduling process. This rather low rate replaces the original idea of interest free rescheduling that was criticised by the Supreme Auditor.

The above shows that both governments have taken measures or are taking measures to deal with the social and economic consequences of labour related (and more general towards public bodies) liabilities. However, these programmes are not integral as they do not take into consideration all types of liabilities, and they insufficiently reflect upon the economic status of privatised enterprises which need further restructuring. Moreover, parts of the programme, especially labour market support programmes to bring back redundant employees into the labour market, are not yet elaborated. Supplementary measures to combat the informal sector and to expand the base for the social insurance funds will be necessary in order to solve the problems in a more structural way.

## 4 Outline of the recommendations

### 4.1 Introduction

The proposals below are designed without having a clear insight into the size and structure of the various arrears (see 2.3). This implies that they should be cautiously interpreted and seen as preliminary. They will require refinement and possibly modification on the basis of good statistical information.

Necessary for the assessment of the feasibility of these proposals is the following type of information:

- on the basis of administrative sources: the total size of the arrears per type and their yearly structure and matured debts at start of a restructuring plan, differentiated in the principal amounts and interest arrears. The yearly structure is especially important for those arrears where discounting percentages are considered that are differentiated according to year of emergence of arrears, or if the treatment of debts will be related to their consequences for an insurance title (as proposed for the unemployment benefits).
- for social insurance arrears data is additionally to be specified into number of insured employees according to age structure, length of service in an enterprise, last wage level and type (inactive vs. active).
- for the size of the arrears of companies additional information is necessary. This would apply to aggregate information on arrears per type and corresponding labour costs, value added and gross or net wage structures.
- the size of the labour excess through a thorough estimation by the owners or management of the companies, preferably on the basis of a restructuring plan, with corresponding estimates for the implied labour costs and the structure of the length of service and/or the age structure of employees to be made redundant. A clear distinction should be made between inactive/waitlisted and active workers.
- data should preferably be differentiated according to type of ownership and thus specify between state owned, privatised and private companies. Although a debt restructuring policy

for labour related arrears should aim at setting principles and recommendations that apply to both privatised and not yet privatised companies the details of labour restructuring will be different for downsizing state owned enterprises in order to prepare them for privatisation or not, for already privatised companies and for newly established private companies.

It is believed that administrative sources, especially the Tax administrations and the various social insurance funds of both entities, contain most of the necessary information, on company level and to some extent on the level of the individual employee. This would even include the possibility of an estimate of the net wage arrears to active and inactive workers without issuing a costly survey among companies or employees. However, the existing databases in these institutions need to be explored according to specific software programmes.

Alternatively more crude estimates may be made on the basis of readily available data on arrears and the current survey among 50 strategic enterprises now in process.

#### *Costs and benefits of redundancies*

The cost consequences of mass lay offs can be made at social level, at company level, at worker level and at the level of the government and other public bodies. Within this framework the consequences for the latter three categories are of relevance.

At worker level the cost for redundant workers are to be estimated in terms of net wage (or fall back wage for inactive persons) losses due to dismissal, minus the income that can be gained after dismissal plus the severance payment. The income that can be gained after dismissal will depend on the (restored) social insurance rights, the job chances in the labour market and the attainable wage level in a new job (of formal or informal nature). For the insurance rights it is to be taken into consideration that during unemployment according to the current system a limited unemployment benefit compensates for part of the wage loss, and that in general health insurance rights, but no pension rights, will be gained during the period of unemployment.<sup>6</sup> Social safety net arrangements after expiring of the unemployment period are low, rather non-transparent, and only focused on the poorest part of the population. In this cost benefit analysis the issue of the wage and social contribution arrears complicates in the sense that, as long as no system to repay or remove them has been created, they create uncertainty about the real value of wage arrears and insurance rights to the workers.

At company level the direct benefits of redundancies under a restructuring scheme are found in the reduction of labour costs. The costs of redundancies are to be defined in terms of severance payments, transaction costs of appeals and cost procedures, costs of hiring new staff, and costs of repaying outstanding labour related liabilities to redundant workers.

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<sup>6</sup> except for old age pension rights for those unemployed who are close (within 3 years) to retirement age in FBIH

At the level of public funds the costs and benefits of making workers redundant will mainly depend on the arrangements to be made for writing off or paying off liabilities, the activated (restored) insurance and benefit rights of redundant workers and additional operational and transaction costs.

#### *Types of liabilities and creditors*

The financial blockages to labour restructuring fall into four main categories:

- wage (and other direct) compensation arrears to employees
- severance payments to redundant employees who will be laid off
- wage tax arrears
- social contribution arrears, more specific arrears for pensions, unemployment and health

In large scale downsizing of companies the usual practice is that all direct and indirect obligations to workers are paid off before or at date of dismissal. Also, in BiH regulated provisions for payment of contribution arrears require that they be paid off before a redundant employee can be entitled to insurance rights and benefits.

Paying off labour related liabilities at occasion of redundancy contradicts the idea of a (suspended) repayment scheme under a VCS. It is proposed that a mixture of measures will be taken to mitigate this problem of financial blockage for effective downsizing. As far as possible it should be avoided that outstanding insurance rights of redundant employees will be removed. These measures should also meet the condition that they will not jeopardise the essential functions of the social insurance funds with regard to their current and future obligations, not only towards the redundant employees, but also towards others. On the other hand, there should be scope for negotiation and writing down of liabilities as employees and funds are to face the same trade-offs as the enterprise and other creditors when weighing the alternatives for restructuring and labour force downsizing under a VCS scheme: namely of bankruptcy, liquidation or further growth of arrears.

There are essentially three categories of creditors for the labour related liabilities: individual employees, insurance funds and the government. In a VCS scheme the financial claims of the last two categories can in principle be made subject to a restructured repayment schedule as far as current regulations allow. However, monetary claims of redundant employees should be settled before (or at) date of dismissal. This implies that a programme with a public account or a (social) fund should be established that will provide for payment of at least the claims of individual employees (wage arrears and severance payments). This programme or fund should be financed from public sources in the first place. Preferred are solutions that will minimize the funds needed.

#### *Liabilities for redundant and non-redundant workers*

An issue of primary importance is whether in a VCS scheme a distinction should be made between liabilities towards redundant workers and other workers who will continue to be hired by the enterprise. Apart from the possibility that a restructuring plan may or may not imply dissolution of the contracts of all workers of which a part will be directly rehired (on new conditions), it would be elegant not to discriminate between redundant and non-redundant workers in eliminating arrears. However, to the extent that public resources will be needed to directly eliminate social contributions liabilities this may be a too heavy burden for public budgets. A distinction should then be made in the



sense that the repayment of liabilities towards employees who continue to work for an enterprise will be agreed upon in a repayment scheme between the company, the (representatives of) the workers and all creditors. Only for redundant workers specific measures will then be taken as proposed below at occasion of their dismissal in order to ensure their specific rights.

#### *A voluntary dismissal scheme?*

Another preliminary question is whether downsizing of the labour force can be reached by offering a voluntary scheme. A voluntary scheme may be successful if the total value of the compensation at dismissal offered to those workers who consider leaving the company will, in combination with the income that can be gained elsewhere after dismissal, be higher than the value of what they can expect to earn in their company, therewith including the value of their insurance rights before and after dismissal. A voluntary dismissal scheme may than be easier to implement and it may work out more successfully if the wages that can be earned after dismissal are relatively high and if insurance rights after dismissal will be not substantially lower than before. It is questionable whether these conditions exist in BiH. They would require an assessment of the job opportunities and (net) wage differences between the state owned, the privatised without restructuring, the privatised with restructuring and the newly created private sectors. The data for this analysis are not readily available.

Apart from that voluntary systems, although having the advantage of generating less social unrest (and thus less transaction cost for companies), have the disadvantage of working selectively in the sense that they may stimulate to leave just those workers and managers who need to be kept for the company because of their expertise, performance and productivity. This may be mitigated to some extent by restricting the eligibility for a voluntary scheme to certain categories of workers.

## 4.2 Recommendations

#### *Net wage arrears for active workers.*

The size of net wage arrears is not known. Problems in paying out wages to workers will exist more in economically non-viable companies and, presumably, more in state owned than in private companies. It is to be noted that wage arrears to informally deployed workers or the informal part of the wage to workers who entered into a contract with a low (often a minimum) salary are not relevant in this framework. These arrears will be low as it is not to be expected that workers will continue their informal working relationship with an employer if not paid regularly for their work.

Wages are of primary importance for the living conditions of workers and their families. They represent the compensation for value added by workers to the production of an enterprise. According to international practice and under BiH law they are to be paid off at least before dismissal of a worker. They should receive high priority in composing a package of measures to enable redundancies. However, workers may accept negotiations on the amount to be paid off when facing the alternative of bankruptcy of their company. In case the company lacks the resources to pay off the wage debts at dismissal it is recommended that public funds will be used for that purpose. In some market economies this obligation is legally laid upon an existing fund, usually the Employment Fund that pays out the unemployment benefits. This is not the case in BiH and would not be

recommendable as a structural measure given the lack of financial discipline and high economic risks in the enterprise sector. A provision in the form of a public account, or a separate fund fed from public sources, from which the companies to be restructured or privatised can borrow to pay off their debts is recommendable to enable companies to pay off their net wage arrears before they dismiss workers. This measure should apply only to workers with net wage arrears who are to be laid off through a collective dismissal procedure. Employers will usually give high priority themselves to paying off wage arrears of workers who will continue to be hired by the company during the restructuring process (or by the new owner after privatisation). These can be made subject of negotiation between employees and the employer within the framework of setting new labour conditions for the period during and after the restructuring process. These wage arrears are therefore not to be paid off from public funds.

What has been mentioned above for net wage arrears has its equivalent in fringe benefits like unpaid compensations for meals, transport, etc. These arrears should be dealt with in the same way.

*Net compensation arrears for waitlisted and inactive workers.*

As has been mentioned above, all kind of practices of waitlisting exist on the basis of agreements on periods of inactivity between employers and certain categories of employees. Compensations in FBIH have been mentioned between 5- 40 KM per month for occasionally large portions of the work force of an enterprise. These compensations are usually indeed paid out by the employer, especially when a rotating schedule was used in which activity and inactivity rotates between workers. It is also widely known that during (longer) periods of inactivity workers find work and income sources in the informal market. The welfare loss for periodically inactive workers is therefore lower than the income loss resulting from falling back on a compensation for inactivity. From this perspective it is proposed that also the compensation arrears for inactive workers dating from after 2000 will be written off, or in case they will be more substantial than expected, made subject to negotiation between employers and employees. The debts before 2000 may have accrued for a very long period, even since BiH became independent. Formal regulations with regard to administrative leave and waitlisting have been abolished in 2000 in both entities. However, many employers and employees have not settled the related compensations at date of expiration of legally regulated waitlisting. It is proposed that these compensations will be made part of a negotiation deal between employers and waitlisted workers in which also the outstanding severance payments will be included.

*Severance payments for active workers who are collectively to be laid off*

In both entities it is legally required to pay severance payments to those who will be laid off (see above). From an international perspective the regulations are since the changes in the Labor Laws reasonable. It is proposed that severance payments will be paid out directly to redundant workers. In case of shortage of liquid means employers are to be enabled to borrow money from a public account or fund on similar terms (interest, repayment schedule) as for a loan for net wage arrears.

*Severance payments for waitlisted and inactive workers*

Again a distinction should be made between outstanding claims resulting from the period before official waitlisting has been abolished. In FBIH various claims are still awaiting appeal or court decisions. Appeal and court practices of individuals indicate that many claims have been awarded to workers, be it with restrictions as to the size of the claims.

By law a maximum has now been set for severance payments in the RS for officially waitlisted workers: 3 months. In FBIH a schedule has been set that also leads to a maximum of 3 months. Severance payments for redundant inactive workers are to be abolished now that the legal title for waitlisting has been abolished already in 2000. Still existing claims are to be negotiated down between employers and employees, and – eventually – a public account or fund may be used to enable restructuring companies to borrow for paying off the remaining arrears. By nature a severance payment should compensate for the damage caused to the employee due to dissolving his contract. For inactive workers who will continuously no longer be deployed this damage is negligible. For others, for those who are periodically deployed by their employer, the severance payment resulting from their active working period, should be sufficient.

Given the practice of rotating workers for activity (with a wage) and inactivity (a small compensation), it is to be considered to change the rule for calculating the severance payment for both active and inactive periods by taking the average of the last twelve months (wages and compensations for inactive periods together) as the calculation basis, provided that workers have at least been actively working during this period. After a restructuring agreement has been made for a company inactivity and any kind compensations for inactivity should be avoided. This had best been done by legally obliging the employer (or to enforce an existing legal obligation) to pay out the contractually agreed wages anyhow, also in periods of low production. This requires an improved production planning and organisation of labour in many enterprises. It also requires strongly improved human resources management, including willingness of the management to take measures in case labour excesses are coming up (more flexible and part-time work arrangements, individual or collective dismissals and a wage policy that leaves scope for adaptation of labour costs to production fluctuations of companies).

#### *Arrears in social contributions*

##### *Introduction*

A distinction should be made between the various types of social contributions in dealing with the liabilities of enterprises. The reason is that the consequences of debts towards the various funds are different. Furthermore there are presumably huge differences in the size of debts for the various contributions. Finally the financial position of funds should be taken into consideration. Especially for the pension funds the value of long term obligations versus the current value of their assets is an important criterion for assessment how to deal with company liabilities.

No sound liability data has become available to assess their size. Anecdotal evidence suggests that if companies do not differentiate much between types of contributions (and wage taxes) in case they do not pay them. However, there may be exceptions, e.g. if workers (active or inactive) press for maintaining their health insurance rights. Moreover the funds differ in enforcing payment procedures

and in proposing and managing rescheduled payment procedures. The tax administrations of both entities have the best overview of all types of public liabilities and seem to be more active in enforcement of payment of tax arrears than the funds are for contribution arrears. Therefore it cannot be assumed that liabilities are distributed according to the legal differences in contribution levels.

A fundamental question is whether the current principle that contributions should have been paid before an individual worker (and for health under conditions also his family members) will be considered insured should be abolished or not. Under the current economic conditions in the enterprise sector in BiH, and especially given the lack of financial discipline shown in dealing with tax and contribution obligations, this would give a wrong signal and probably lead to (further) undermining of the financial position of the funds. In the framework of a restructuring plan future payment obligations towards public creditors, including the social insurance funds, are to be more strictly met in order to avoid repeated debt problems. This will require a sound restructuring plan, more financial discipline from the side of (renewed) management and a more efficient inspection and control system from the side of the tax administrations and the funds.

However, a one time breaking of the payment condition (by declaring redundant workers for whom contributions have not been paid insured) in order to enable the implementation of a restructuring plan, should be considered, be it not unconditionally. A principle should be that the short term and long term obligations of the funds will not structurally be jeopardised by such an arrangement. This implies that, firstly, debts should not be written off or down to the extent that contributions are needed for short and long term obligations. Secondly, the short term financial consequences of a raised number of unemployed persons, due to downsizing of work forces, are to be taken into consideration. A sound restructuring plan should only release the insurance conditions if these principles can be met.

Theoretically, under an insurance system another solution exists that the company liabilities will be written off, but that all the related insurance rights will be restored anyhow (through legal changes). This could then be financed by (substantially) raising the contribution percentages for the various social insurance systems. Such a solution is highly undesirable, and therefore not proposed, for three reasons: 1) it would imply the introduction of strong forgiveness that gives a bad signal to the enterprise sector; 2) it would transfer liability burdens from companies that did not show enough financial discipline in the past to those companies that did comply with the contribution requirements, and 3) it would raise the labour costs in a situation that strengthening of competitiveness requires reduction of labour costs, certainly in FBIH.

#### *Liabilities towards the Employment Funds*

The Employment Funds have to finance unemployment benefits (passive labour market policy task) and labour market support programmes, including job brokerage, (active labour market policy task) from their resources. As long as the current legal conditions and business practices have avoided labour shedding, this has directly influenced the size and scope of activities of the Employment Funds. It can be assessed that the Funds in both entities have indeed low obligations towards a low number of unemployment beneficiaries, and have spent most of their resources on mediation and active labour market tasks (apart from very high operational costs in case of FBIH). Now that the enterprises with

excess labour have to some extent taken over the monetary compensation tasks of the Employment Funds (an “implicit” contribution), there is –under conditions - scope for writing off part of their liabilities towards the Funds. This should, however, be weighed against upcoming obligations of the funds as soon as collective dismissals resulting from labour restructuring will lead to raised unemployment: for unemployment benefit rights, and for health insurance rights. Calculations per company may show various outcomes in terms of the above “implicit” contributions and generation of costs for Employment Funds (and other social costs, e.g. for use of a social safety net beyond the duration of an unemployment benefit). This would call for company specific writing down of liabilities in the framework of a restructuring plan. Given the uncertainties (number of dismissed employees who may directly or soon find a job or even be rehired) and the administrative complications of company specific discounting of liabilities, it is proposed to use one of the following two principles: a) a fixed percentage in writing down liabilities, to be justified through calculations at aggregate level according to the above mentioned principles, will be awarded to all companies with liabilities that will be included into a restructuring plan, or: b) all liabilities will be written off up to a certain moment before date of collective dismissal, therewith also taking into consideration the consequences for level and duration of the benefit rights for those who will become unemployed. It will be clear that the first method assigns more responsibility to enterprises for their liabilities than the second method. Remaining liabilities in both methods would be made subject to a restructuring plan for which the Employment Fund as a creditor (together with all other creditors), and the enterprise commonly take responsibility. It would also need the consent of the representatives of the employees as the arrangement will directly influence their unemployment benefit rights. Repayment terms and schedules of the remaining liabilities should be strictly enforced during and after the restructuring period since the amount of liabilities to be written off is also to be based on full compliance with these schedules.

The above would enable a one time abolition of the linkage between eligibility to unemployment insurance (and related rights) and payment for this insurance for redundant workers, financial relief through writing down liabilities for enterprises, and manageable cost for Employment Funds. An additional point of consideration is, however, whether Employment offices do have enough capacity and expertise to deal with mass lay offs. In case a pilot VCS scheme will be implemented this, and its financial implications, can be tested at regional scale.

#### *Liabilities towards the Health Insurance Funds*

Company liabilities towards the Health Insurance Funds are probably far higher than towards the Employment Funds. However, non-payment of contributions by the employer has led directly to exclusion from health insurance for employees, and probably also exclusion from income compensation for the long term ill. Eventually, an uninsured worker will have paid himself for medical services, and under circumstances his family members as well. From this perspective there is reason to write off all company liabilities towards the Health Insurance Funds. On the other hand it has to be taken into consideration that in any health insurance system the principle of “insurance solidarity”, implying that the healthy persons pay for the less healthy ones, is integrated. Moreover the planning of the health care infrastructure (the supply structure) is based on financing principles that has to take the

availability of sufficient health insurance resources into account. How these principles can be weighed against each other should be based on further financial analysis of the use of resources by the health insurance funds and their financial position. For the sake of administrative simplicity it should be strived towards a writing off percentage for company liabilities that it is at least uniform at the regional level, but preferably uniform per entity.

Remaining liabilities are to be repaid through a schedule of which the terms are to be agreed upon between all actors in the rescheduling plan.

It is to be noted here that the issue of upcoming costs of health insurance rights of unemployed persons has been dealt with under the previous section on liabilities towards the Employment Funds.

Alternatively this could also be considered in defining the discount percentage for liabilities towards the Health Insurance Funds.

#### *Liabilities towards the Pension Funds*

The Pension Funds redistribute the collected contributions to the current pensioners, thus covering the risks of old age, disability and survival. Company liabilities towards the Pension Fund undermine the solvency of the funds. Of direct relevance are the consequences towards the beneficiaries of the funds, in the first place the old age pensioners. Reduced coverage and liabilities have led to a high dependency ratio in both entities of the country. This forced to introduce a cash-rationing system for old age pensions, therewith drastically reducing the rights of the pensioners. In the RS, with an even higher dependency ratio, the pension system is functioning under increasing transfers from the entity budget.

Given the Pay-as-you-go basis of the pension funds, the liabilities thus directly influence the financial basis for payment of pensions. Paying off liabilities will enable pension funds to raise the pension levels, be it not necessarily up to the initially defined rights (for which a.o. extension of coverage will be necessary, especially through reducing the informal sector).

The second effect of the liabilities is that workers for whom the contributions are not paid will not be insured and, hence, will eventually build up less pension rights. In order to repair for the existing insurance gaps its financial implications should be covered. Sound financing mechanisms will not allow the writing off of liabilities, unless the costs are covered from other sources.

Given the legal restrictions the following options can be used:

- 1) the principle that pension contributions have been paid off before a work contract can be dissolved will be abolished, but insurance rights of laid off workers (and others for whom contributions have not been paid) will be suspended until debts have been paid back to the Pension Funds according to an agreed repayment schedule. This solution allows for labour downsizing of an enterprise, but puts the repayment risks on the shoulders of the redundant employees with regard to their future pension rights. It allows for gradual raising of the (part of the) debts resulting from the cash rationing system to the current pensioners in the near future, but

only to the extent that companies will be capable to meet the conditions of a repayment schedule under a restructuring programme.

- 2) similar to 1, with the difference of directly paying in for the liabilities from a public account or a social fund, under a repayment condition to be agreed upon between all creditors and the companies involved. This would make up for the gaps in pension insurance rights for redundant workers and moreover create possibilities to directly raise the pension levels of current pensioners. The financial burden and risks of such a measure are strongly placed on the governments of the entities. It is to be mentioned that there is no legal, only a moral, obligation to make up for reduced pension rights due to the introduction of the cash rationing system.
- 3) the principle that pension contributions have been paid off before a work contract can be dissolved will be abolished. Insurance rights of workers related to these liabilities will be retroactively and at dismissal fully restored. The companies will agree a repayment schedule for these liabilities with the Pension Funds under the condition of a public guarantee. This transfers the risks of non-fulfilment of the obligations from the workers to the other parties in the agreement. However, it would only gradually provide scope for raising the current levels of pensions (partial repayment of “debts” to the pensioners).

*Liabilities to the child welfare fund in the RS and wage tax arrears*

A 5% gross wage tax exists in the FBIH and a net 10 % wage tax in the RS. The 2% net contribution for the Child Welfare Fund can be dealt with according to the same principles as for wage tax arrears. Wage tax arrears belong to the category of liabilities towards the governmental bodies. These taxes do not influence the income or insurance position of employees, nor are collective dismissals of redundant employees conditional upon wage tax arrears having been paid off. Hence, no specific measures are to be taken to make labour restructuring possible. Repayment of the wage tax arrears can be agreed upon within the framework of a VCS scheme between all creditors.

The above mentioned proposals are summarised in the following scheme

Summary of packages of policy measures

1	non/redundant employees	wage and other compensation arrears	to be negotiated with representatives of employees** and reprogrammed in renewed labour contracts under a restructuring plan
2	non/redundant waitlisted and inactive workers*	compensation arrears	to be negotiated with representatives of employees** and reprogrammed in renewed labour contracts under a restructuring plan
3	redundant employees	wage and other compensation arrears	to be negotiated with representatives of employees**, eventually paid out from a public account or through a Social Fund
4	redundant employees	severance payments	to be paid out directly or from a public account or through a Social Fund
5	redundant waitlisted and inactive workers	compensation arrears	before 2000: to be negotiated down with representatives of employees** or eventually paid out through a public account

			or a Social Fund; after 2000: to be written off
6	redundant waitlisted and inactive workers	severance payments	before 2000: to be negotiated down with representatives of employees** or eventually paid out through a public account or a Social Fund; after 2000: to be written off
7	Employment Funds	employment contribution arrears	partially written off according to a general and legal rule and partially taken up into repayment scheme between company and EF
8	Health Insurance Funds	health contribution arrears	partially written off according to a general and legal rule and partially taken up into repayment scheme between company and HIF
9	Pension Funds	pension contribution arrear	three options: a) insurance rights of redundant workers are in principle restored, but suspended until companies have payed off their arrears under a repayment scheme;b) insurance rights of redundant workers are fully restored at date of dismissal, and arrears are directly paid off through a public account or Social Fund with a repayment obligation for companies; c) similar to b, but the Pension Funds are credited for repayment of arrears through repayment schemes with companies, under a public guarantee. a), b) and c) provide for different possibilities to raise the pension levels of the old aged.
10	Children welfare fund RS	welfare contribution arrears	to be negotiated for redundant workers between their representatives** and the Fund within framework of a repayment scheme
11	Tax administration	wage tax arrears	to be negotiated for redundant workers between their representatives** and the Tax administrations within framework of a repayment scheme

\* it is to be expected that this category will hardly exist. Those who were regularly inactive will presumably not be selected for a real labour contract under a restructuring plan.

\*\* trade unions or workers' councils



The size of the public funds necessary for those companies that cannot pay off their liabilities directly at date of dismissal will depend on final choices for settlement measures, on the number of employees to be dismissed, and on the part of the liability per company that can be agreed upon to be paid off directly at date of redundancy. The construction of a Social Fund (probably two funds will be needed: one for FBIH and one for RS) is useful if various types of creditors are to be involved in the labour restructuring schemes.

For resources for financing a Social Fund is referred to the ones mentioned in the RS Social Programme. Financial consequences for the public budgets are to be carefully taken into consideration together with an economic assessment of the benefits of a restructuring programme. If a VCS scheme will be implemented on a pilot scale good experience may be gained with regard to various uncertainties: chances for rehiring, extent of writing off liabilities through negotiations, etc. The institutional set up of a Social Fund and the way it should be managed is not elaborated in this report.

#### *Additional measures*

Additional measures for early retirement (above a certain age: for instance above 55 or 60) may be designed in order to provide for income support for the elder part of redundant employees who may not easily find another job. In the current legislation hardly any measures can be found to facilitate early retirement. The following alternatives are possible: an extended unemployment duration benefit above a certain age, assigning extra years of service to older redundant employees, reducing of the retirement age under condition of an adjusted pension level. All these measures will require additional finance depending on the number of elderly workers involved and their wage levels. Financing might be shared between companies, social insurance funds and the public budget.

A collective redundancy system should be integrated into appropriate active labour market schemes. They would focus on outplacement services, retraining, wage cost subsidies, advisory and - possibly - income support for starting up new businesses, and geographical mobility support. Neither the current legislation nor the capacities of the Employment Services seem to be appropriate for these support programmes. In a regionally implemented VCS scheme the requirements for these labour support schemes could be tested and capacity built up for it.

Other labour market rigidities have been mentioned in this report as well. It is necessary:

- to reform the wage setting systems in both RS and FBIH. Especially in the FBIH the setting of the minimum wage in the GCA is to be reconsidered;
- to expand the wage base for taxation and social insurance in the FBIH by including fringe employee benefits for meals, holiday leave, etc.
- to base the social insurance contributions not on prescribed minimum levels, but on actually earned wages; similar would apply to the benefit levels of the pension funds;
- to fully abolish the status of the inactive and waitlisted employees in all legislation as soon as companies have been enabled to dismiss them. This had best be done by abolishing fall back compensations and by obliging companies to fully pay out to their employees contracted wages regardless production fluctuations.
- to modify labour legislation in order to enable companies to conclude more flexible labour contracts, including part-time contracts.

- to strengthen the system of collection and inspection of wage taxes and insurance contributions as well as payment enforcement procedures. Database systems and information exchange between social insurance funds and the tax administrations are to be improved. This applies to operational information at company level as well as the generation and exchange of management information.



**Annex 1. LIST OF PERSONS MET**

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