

**BOSNA I HERCEGOVINA
VIJEĆE MINISTARA
DIREKCIJA ZA EKONOMSKO PLANIRANJE**



**БОСНА И ХЕРЦЕГОВИНА
САВЈЕТ МИНИСТАРА
ДИРЕКЦИЈА ЗА ЕКОНОМСКО ПЛАНИРАЊЕ**

**BOSNIA AND HERZEGOVINA
COUNCIL OF MINISTERS
DIRECTORATE FOR ECONOMIC PLANNING**

ECONOMIC AND FISCAL PROGRAMME 2011 – 2013

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1. GENERAL FRAMEWORK AND POLICY OBJECTIVES

As requested by the European Commission in 2010, the relevant institutions in Bosnia and Herzegovina (BiH) prepared the Economic and Fiscal Programme for 2011 (EFP 2011). This years' programme is the fifth in a row being submitted by BiH to the European Commission, and is also the second since the signing of the Stabilisation and Accession Agreement in June 2008 and the Interim Agreement came into force. The Economic and Fiscal Programme is seen as preparation for the Pre-accession Economic Programme (PEP), which is a mandatory document for candidate countries for EU membership, and in particular is considered to be preparation for the revised Lisbon Strategy and the Convergence Programmes that, upon accession, will need to be submitted each year.

As in previous years, the EFP 2011 has been drafted in accordance with the special methodology set by the European Commission for the purpose of facilitating comparison with other countries. In view of the fact that the previous years' programme served as a basis for this EFP, it was not necessary to provide a detailed description of the policies that have remained unchanged. Nevertheless, the outcomes will be comparable with anticipated trends and objectives, although explanations will be provided for all unexpected economic developments and policy changes.

Activities on the drafting of the Economic and Fiscal Programme for 2011 were coordinated by the Directorate for Economic Planning in accordance with its responsibilities. The programme was prepared on the basis of contributions submitted by the relevant institutions, and it was reviewed and approved by the Working Group. In accordance with the Conclusion of the Council of Ministers of Bosnia and Herzegovina, reached at its session held on 14 September 2010, the Working Group was established in order to carry out professional editing of documents and develop the final version of the Economic and Fiscal Programme for 2011. In line with the aforementioned conclusion, representatives – experts of the Council of Ministers of BiH member ministries, experts from entity ministries and Brčko District ministries, the Directorate for Economic Planning and the Directorate for European Integration, all took part in the Working Group. Finally, the Economic and Fiscal Programme for 2011 was adopted by the Council of Ministers of BiH at its session held

2. ECONOMIC OUTLOOK

2.1 Recent economic developments and the medium-term macroeconomic scenario

Given the high degree of openness of the economy of Bosnia and Herzegovina (BiH), in 2009 the world recession significantly affected BiH, above all else through a fall in export demand and inflow of foreign funds. The effects of these factors brought on a strong decline in exports (13.9%), final consumption (3.2%) and, in particular, investments (29.2%). Despite a double-digit fall in imports (21%) and a foreign-trade deficit of 30% (mostly due to the reduction in imports of consumer and investment goods), the BiH economy recorded a negative real growth of 2.8%¹ in 2009. This came about as a consequence of the fact that almost all manufacturing and service industries were in decline throughout the year. Such a general slowdown in economic activity was accompanied by an accelerated decrease in the number of employed persons and a fall in consumer prices (deflation). The intensity of these negative trends did not abate even at the end of 2009, despite the fact that the world's largest economies returned to positive growth in the second half of 2009. This was as expected considering that the crisis arrived in BiH at least three months later than in the other countries in the region. The gradual recovery of the European economy in the first nine months of 2010 was enough only to halt the decline that BiH's economy had been experiencing since the preceding year. Namely, in spite of the fact that exports have started to recover, judging by everything² BiH's economy achieved only modest economic growth in 2010. According to short-term indicators³, this is the result of the stagnation (or even a possible slight increase) in final consumption, and decline in investments and exports on the one hand, and the previously mentioned rise in exports on the other. Negative labour market trends and a drop in the inflow of foreign funds were mainly responsible for the decrease in disposable household income. As a result the fall in private consumption that started during the previous year was halted, while at the same time the slight increase in public revenues lead to a modest rise in public consumption. At the same time, funding problems and an increased risk of investing in new capacities arose due to the decrease in investment that has continued over from 2009⁴. Even though such a contraction in domestic demand directly threatened economic growth, it also meant a decrease in import demand that, in the end, resulted in a real decline in imports. Still, the drop in imports, even despite the partial recovery in exports, was not enough to override the negative contributions to the growth of domestic demand. The stagnation of economic activity is also supported by the real sector indicators. Namely, during the first nine months of 2010 only a slight increase in industrial production (0.8%) was recorded, as was a drop in construction works (22%), retail sales stagnated in real terms, and growth was noted in the tourism and hospitality industries. The negative savings rate of the enterprise and government sectors, as well as the stagnation (or even a possible decrease) in household savings, led to decreased gross national savings in 2010. In spite of that, the significantly stronger fall in investments as compared to savings, caused the current account deficit to drop by more than one-third in comparison to the same period in the previous year⁵. The fall in the current account deficit in the first half of the year⁶ is above all else characterized by a significant 16.4% drop

¹ Preliminary data received from the Agency for Statistics of BiH (BHAS).

² DEP estimate.

³ Considering the fact that the Agency for Statistics of BiH does not produce national accounts on a quarterly basis, DEP was forced to base its findings on economic growth trends on available short-term data on the balance of payments, foreign trade of goods, prices, the labour market, loans and deposits trends, fiscal statistics and similar.

⁴ The nine-month 22% drop in construction works and the 7.1% fall in import of capital goods point to a severe drop in investments in 2010. This is in actual fact a continuation of the 2009 trend of intense decline.

⁵ According to the official data of the Central Bank of BiH (CBBH), a 37% fall in the current account deficit was noted in the first half of the year.

⁶ The balance of payments for the third quarter of 2010 was not available at the time of writing.

in the foreign trade deficit in goods, despite the double-digit decrease of current inflows from transfers and income. The nine-month goods deficit fall of 7.6% was the result of a strong nine-month 29.1% increase in the value of goods exports and the modest 8.7% growth of imports. Nevertheless, bearing in mind the jump in prices of energy-generating products and metals, and in part, the prices of food, as well as the dominant role of these categories in the overall growth of exports and imports, it is assumed that real growth in the export of goods was between 5-10%, while there was a 3-5% decline in real imports. Therefore, the quicker pace of recovery of exports compared to that of imports meant that the external sector positively contributed to overall economic growth during the first half of the year.

Medium-term macroeconomic scenario

Although no greatly significant changes occurred in the third quarter of 2010 regarding economic recovery, certain positive improvements that indicated the possibility that domestic demand could strengthen in the last six months of the year were nevertheless noticeable. The most encouraging sign so far is that for the first time since the start of the recession growth was noted in the import of capital goods, to be specific, capital goods import increased by 8.7% in the third trimester. Even though it is still too early to talk about recovery, this could be the first more significant indication that the fall in investments is coming to a halt. In addition, the gradual recovery of production and the import of consumer nondurables, and in particular durable consumer goods – resulting from the weakening negative employment trend and the drop in transfers from abroad and pensions - as well as stronger wage growth, point to steady recovery of private consumption in the second half of 2010. The beginning of recovery of domestic demand in the third trimester led to the strengthening of import of goods (16% growth y/y), which in turn resulted in an increase in the value of the foreign trade deficit in goods (10% y/y) after a long time. With the assumption that the aforementioned ascending trends will continue to strengthen, in addition to the already ongoing slight growth, it is estimated that the BiH economy could record a moderate real growth of 0.5% at the end of 2010.

The start of BiH economic recovery in 2011

In 2011 it is expected that positive trends in BiH, above all else those from the second half of 2010, will intensify. The expected EU economic growth of 1.8%⁷ in 2010, as well as its continuation in 2011 (expected growth of 1.7%) should, for the first time, have a more significant effect on BiH exports and the inflow of foreign funds both through current and financial transactions. Although full EU economic recovery cannot be assumed in view of the relatively low projected growth rates following the severe recession, there should still be reason enough for a real growth of almost 10% to be achieved in BiH exports and imports, as the basis was significantly reduced due to earlier decline. An increase in export demand and exports through industrial production growth should lead to employment increasing again, which should, along with an increase of the inflow of foreign transfers and foreign earned income, significantly strengthen disposable income and private consumption. In addition, in 2011 it is expected that following a two-year decline, investments should begin to recover. All of this should be the first serious sign of progress in domestic demand and import, and therefore, in view of the ascending trend in export, and for the first time in two years, BiH's economy should record a somewhat more substantial economic growth of 3.2%.

Despite the escalation of growth in 2012, economic activity remains below pre-crisis levels

Although far from impressive, EU economic growth of 2% in 2012 (as projected by DG ECFIN) was a basis good enough for the trends projected for BiH for 2011 to not only continue but to also be further strengthened. Above all else, this is in reference to the strengthening of export demand and exports, and continued recovery in the area of investments. This should have positive implications on the labour market, primarily through increasing employment, and also, in part, wages. As a result

⁷ Assumptions regarding economic growth in the EU-27 were taken from the autumn projections of the DG ECFIN – „European Economic Forecast“, Autumn 2010.

private consumption should be additionally strengthened, and this should, together with the aforementioned strengthening of exports, serve to further strengthen economic growth in BiH in 2012, which should, for the first time, come close to attaining its pre-crisis pace with a rate of 5.5%. Nevertheless, it is necessary to emphasise that any talk of full economic recovery is out of the question, as even then the level of economic activity would still be significantly below the 2008 level.

Positive trends continue in 2013

This is the period during which the 2009 economic crisis is gradually becoming a thing of the past and this is when things should slowly start returning to normal. The majority of positive trends from 2012 are continuing and in general the economy is continuing to develop at pre-crisis pace. Thereby, a real growth of 5.4% is anticipated, and exports and domestic demand are expected to once again play a key role in such growth.

Industrial production in BiH in 2010 -2013

Research to-date has shown that BiH industrial production, and in particular the processing industry is in great part export-oriented, and therefore developments on the export markets practically determine the dynamic of the industry in BiH, while changes in domestic demand are less significant and are reflected mostly in electricity and mining, and a very small part of the processing industry. This was most apparent during the previous year which was marked by the global economic crisis that, although with a delay, spread to and fully unfolded in BiH. As the structure of BiH exports is dominated by raw materials and semi-finished products, as a result of the decline in economic activity in countries in the EU and the region during 2009, a 3.3% annual decline in BiH industrial production was noted. However, the available statistical indicators for 2010 are quite encouraging and indicate that recovery is underway in the EU, and that it is in fact led by export-oriented industrial production, which experienced a 7.5% rise in production in August 2010. Recovery that is already underway in EU industries, along with recovery in countries in the region that is still not at the expected level, will undoubtedly positively impact industrial production in BiH and should result in a more significant increase in production and exports in the coming period.

Industrial production assumptions for 2010

Following the crisis year, statistical indicators for the period January-September 2010 show that industrial production in BiH is now quite stable and has embarked on the path to recovery, but recovery is still not at the level of EU countries.⁸ However, the positive growth trend noted in production in industries in EU countries has also continued in the third quarter of the year, and should also be felt in BiH, albeit with a delay, but the negative effects of the crisis were also late coming to BiH and were not registered until almost 2 quarters later than in the EU. Especially encouraging is the fact that the fastest recovery is being made by BiH's main trading partners, such as Germany, Italy and Slovenia, which in August 2010 recorded an increase in industrial production of more than 10%.⁹ It is also necessary to note that industrial production in countries in the region is lagging behind that of countries in the EU, and this in turn also influenced the pace of industrial production recovery and growth in Bosnia and Herzegovina.¹⁰

According to BHAS (Agency for Statistics of BiH) data, during the first nine months of 2010 industrial production in BiH stabilized to a certain extent and recorded a moderate production growth of 0.8% compared to the same period of the previous year.¹¹ The principal reason for the stabilization of industrial production in BiH in the period January-September 2010 was the recovery of the export

⁸ Eurostat and the national bureaus of statistics, „Industrial production indices for the period January-September 2010”.

⁹ DG Enterprise and Industry, “The economic recovery in industry” 25 October 2010

¹⁰ DG ECFIN, “EU candidate and pre-accession countries economic quarterly”, 8 October 2010

¹¹ The Agency for Statistics of BiH, “Volume index of industrial production in Bosnia and Herzegovina in September 2010”.

markets for certain products, which in turn resulted in increased demand for BiH export products, such as base metals, energy-generating products and furniture. This increase in foreign demand quite positively affected the processing industry in BiH, which recorded a 2.5% increase in production in the first nine months of the year, and its contribution to overall industrial production growth was 1.5%. With regard to industries, recovery is evident in the sectors that are integrated with world production trends to a greater extent and are therefore more export-oriented. In that respect, the base metals industry stands out the most, and in the previous period it proved to be the bearer of the processing industry and overall industrial production in BiH. In the period January-September 2010, as a result of the recovery of foreign markets and the higher prices of metals, the base metals industry recorded an increase in production and export of 3.5%, that is, 60% compared to the previous year, while it contributed by 0.7% to the overall growth of industrial production. Beside the production of base metals, several other export-oriented branches of the processing industry, such as the furniture, automobile, machinery, textile and oil and oil derivatives industries also contributed positively to overall industrial production growth.

On the other hand certain industrial branches, which in previous years greatly contributed to industrial production in BiH, are still experiencing the negative repercussions of the crisis and have not seen significant improvement in production in the period from January to September 2010. This category includes the food industry, wood and chemical industry, and the production of non-metallic minerals. The pace of recovery of industrial production was largely affected by the results of the BiH energy sector, which includes the mining and electricity generation sectors that performed somewhat weaker this year than in previous years. In the period January-September 2010, the mining sector also fared less well and experienced a 7.5% decline in production when compared to the same period in the previous year. The situation is also similar in the electricity generation sector, which after experiencing steady growth during the third quarter of the year entered a phase of stagnation. As a result, in the period January-September 2010, this extremely important sector failed to contribute in any significant way to the total increase in industrial production. However, it is expected that by the end of the year the energy sector, and in particular the generation of electricity in thermal power plants, should see an increase in the level of production, which will in turn spur the growth of industrial production in BiH by the end of the year. The trend of positive growth in production in the EU, along with already apparent signs of recovery in certain countries in the region, will to a great extent determine the total growth of industrial production in 2010, which should, according to DEP estimates, be around 2% considering its low basis from the previous year.

Industrial production assumptions for 2011

Gong on the assumption that the positive trend of production growth in countries in the EU and the region will persist, it is expected that industrial production in BiH will make a strong recovery during 2011. Certainly, most of the credit for this recovery belongs to the processing industry of BiH, and above all else, the export-oriented sectors of the processing industry in BiH. The most important role should of course be played by companies in the metal sector, such as "ArcelorMittal Zenica", "Aluminijum Mostar", and "Birač Zvornik", which could, provided the prices of metals on the global market remain stable, utilize their production capacities in a significantly better way. This could also have a positive influence on various smaller enterprises in the metal industry that are directly associated with production in the above mentioned major companies. It is also expected that the Oil Refinery in Bosanski Brod will positively contribute to the processing industry, as it is anticipated that it will see substantial improvements in its level and quality of production during 2011. Investments towards raising the quality of fuel produced in the refinery should improve the quality of the fuel, which will in turn contribute to improving BiH's export status to a great extent. It is expected that the chemical industry, which has continued to impose itself as an important factor in BiH's industry even in the crisis years, could achieve positive growth in production and significantly contribute to improving industrial production in BiH. During this period it is also expected that the construction sector, which has been stagnating for some time, will make a recovery. A rise in construction works both in the area of infrastructure and housing construction will certainly have a positive effect on

the production of building materials, which will in turn help improve industrial production in BiH. It is also necessary to mention the BiH wood-processing industry, which has significant export potential, as well as improvement in the food industry throughout BiH, both of which are expected to more significantly contribute to the growth of the processing industry in BiH. If we add the improved situation in the electricity sector to the overall recovery of the processing industry in BiH, DEP projects that an industrial production growth rate of around 5% is possible in 2011.

Industrial production assumptions for the period 2012-2013

Since full recovery of the majority of industries in the EU is expected in the period 2012-2013, it is reasonable to expect that such developments will also enable the full recovery of industrial production in BiH. In this period the full consolidation of EU markets is anticipated, as is the recovery of private consumption, the overcoming of problems related to company funding, and an increase in foreign trade exchange among EU countries, which will have a positive effect on the entire region, and ultimately BiH.¹² Greater utilisation of capacities and an increase in employment will result in increased production in the processing industry of BiH, bringing it back up to pre-crisis levels - when BiH had record growth rates in the region. Planned investments in infrastructure and energy should also significantly contribute to strengthening both the construction sector in BiH, as well as those branches of the processing industry that are closely tied to the construction industry. It is also expected that the energy sector, which was one of the bearers of industrial production in the previous period, continues to experience positive growth in production and helps further strengthen industrial production in BiH during the period 2012-2013. According to DEP projections, this should result in an increase in BiH exports of around 15%, while the expected growth of industrial production is over 7% compared to the previous year.

Labour market – current developments

Despite the fact that in 2010 slight economic recovery was noticeable in BiH through a growth in exports and the fact that fall in the volume of industrial production came to a stop, no significant positive changes were felt in the labour market. Hence, in the period I-IX 2010 in BiH, 677.4 thousand employed persons were registered, which is 2.3% less than in the previous year. However, it is obvious that the negative employment growth rate is slowing, that is, the rate of reduction of the number of employed persons in the third quarter of 2010 is somewhat slower compared to the first and second quarter of 2010. The sectors most affected by rising unemployment are the processing industry, and the construction, hospitality and trade industries. The minor increase in the volume of production in the processing industry was accompanied by a 6.6% fall in employment in the period I-IX 2010. The decreased volume of construction works in BiH in the first nine months of 2010 was followed by downsizing in this branch of the economy, as a result of which the number of persons employed in the construction industry fell by 9.9% y/y. Real growth in the retail trade volume also decreased, and therefore the number of persons employed in this industry dropped by 5% y/y (nine-month comparison). The number of employed persons in the public sector increased at an annual level by 1% in the first nine months of 2010. However, even though the number of employed persons in BiH increased, so did the number of unemployed persons. The average number of unemployed persons in BiH in the period I-IX 2010 was 516.2 thousand, which is 4.4% more than in the same period in 2009. The registered unemployment rate in BiH for the period I-IX 2010 was 43.3%, while the survey unemployment rate in 2010 was 27.1%. The slowdown of economic activity in BiH led to stagnation, that is, a minor increase in wages in BiH. The average net wage in BiH in the period I-IX 2010 was BAM 796, which is 0.9% more than in the same period in the previous year. The 2% rise in consumer prices influenced the significant reduction of real net wages in almost all areas of the economy. The real net wage in BiH in the period I-IX 2010 was lower by 1% y/y, which further lessened the purchasing power in BiH. The average pension in BiH was 333¹³ BAM in the period I-IX

¹² DG ECFIN, „European Economic Forecast“, Autumn 2010.

¹³ The average pension in BiH is calculated on the basis of average monthly pensions weighted by the share in the total number of pensioners in each of the entities of BiH in the total number of pensioners.

2010, which is 1.2% less compared to the same period in 2009. The influx of newly retired persons, that is, new pensioners, and the drop in the number of employed persons are the main reasons for the reduction in pensions in BiH.

Labour market – projections

According to the projections of the DEP in BiH, in 2011 real GDP growth of 3.2% is expected. The aforementioned progress made in BiH's economy should have a positive effect on the labour market, that is, the number of persons employed in sectors that were the most severely affected by negative business dealing and results in 2010 (primarily industry and construction). The recovery of BiH's industry in 2011 would induce an increase in the number of persons employed in this field, in which it was registered that the greatest number of workers was laid off during the economic crisis. The decrease in the number of persons employed in construction should also come to a halt during 2011 through the inflow of investments in BiH. The above-stated changes will have a positive effect on the total number of employed persons in BiH, that is, they will contribute to stopping the growth of unemployment in the first half of the year. The public sector in BiH should record an increase in the number of employed persons of up to 1% in line with (IMF-induced) budget restrictions. As a result, in 2011 the total number of employed persons in BiH would be greater by 1.3%. Real GDP growth should also have a positive effect on wages in BiH. Since the average nominal net wages in BiH did not decrease in 2010, it can be expected that the wages in BiH will be increased during 2011. The main accelerator of wages should be the private sector, while wages in the public sector will most probably stagnate, that is, only slightly increase, due to the aforementioned budget restrictions. It is anticipated that the average net wage in BiH in 2011 will increase by approximately 2.9%. With regard to pensions, employment growth in BiH (that is, increasing revenue from contributions paid to pension funds in BiH), along with an increase in wages during 2011, should be enough to keep pensions at the 2010 levels, that is, bring about a slight rise in pensions in 2011 (up to 1.5%). Slow reform of the pension system in BiH is one of the reasons why a greater increase in pensions in BiH is not possible.

The fact that a full recovery and somewhat stronger growth of BiH's economy is expected in 2012 should have positive implications on the labour market. The strong growth in exports and investments in BiH will lead to the creation of new jobs, that is, an increase in the number of employed persons of about 4.2%. Within the framework of the private sector, a significant increase in the number of employed persons is expected in the processing industry and construction, induced by an increase in the volume of industrial production and construction works in BiH. In the public sector the number of employed persons should continue to rise by 1.8%. Nominal wages should increase significantly by around 5% in 2012, and this is a direct consequence of a more favourable business climate and the improved business operations of BiH companies. With regard to pensions, the substantial growth in wages accompanied by rising employment should have positive consequences for pensions in BiH, which could see a nominal increase of 3.5-4% during 2012. The development of labour market projections for 2013 is mainly based on the same assumptions used for 2012, and therefore a substantial increase in employment of 4.9%, accompanied by a 5.1% wage increase is expected in BiH.

Prices – current developments

Unlike in 2009 when deflation was recorded in BiH, in 2010 a growth in prices was noted, prompted by the growth of oil and oil derivatives on the world market and the excise duties on tobacco and tobacco products in BiH. The mentioned changes contributed to the fact that inflation in BiH in the period I-IX 2010 was 2%. The categories of housing, energy-generating products, transport, as well as alcohol and tobacco contributed the most to the price growth in BiH. Although world food prices are rising, prices in the category of food and non-alcoholic beverages in BiH in 2010 are still lower than in previous years. In the first nine months of 2010 they were decreased by 1.8% compared to the same period in 2009. A decrease in prices was recorded for all main subcategories of food in the same period. Oil derivatives (petrol) in BiH contributed to bringing the increase in prices in the

transport category to 7.8% in the period I-IX 2010. On the other hand, as a result of the increase of excise duties on tobacco and tobacco products from 2009 and 2010, the prices of these products in that period significantly rose (34% y/y).

Prices - projections

Considering the fact that prices in BiH are tied to changes in world prices of energy-generating products (especially oil and gas) and food, the basic assumptions for price fluctuations are primarily connected to external factors that influence the setting of prices in BiH. According to the projections of the European Commission, the price of oil in 2011 will be greater by 11.3%¹⁴ and world food prices in the same period, according to the IMF should be lower by 2.2%¹⁵. In addition to external factors that could influence prices in BiH, internal factors also play a significant role. The announced rise in prices of telephone services in BiH in 2011, and the higher price of tobacco products (the introduction of special excise duties as of 1 January 2011) are internal factors that determine domestic prices. The higher price of animal feed as a result of the droughts in 2010 could also have an influence on stopping the drop in food prices from 2010 by causing the price of meat and meat derivatives to rise. The higher price of oil on the world and BiH market could also impact the price rises of related services such as transport, utilities and similar. On the basis of the aforementioned arguments, it is expected that inflation in BiH in 2011 will be around 2.4%.

The development of projections for prices in BiH for the period 2012-2013 depends on world oil and food price developments as the principle external factors that could significantly influence the setting of domestic prices. According to the IMF, the price of oil in 2012 and 2013 should be greater by 3.1%, that is, 1.4% respectively, while world food prices will still be falling (2-3%). With regard to internal factors, there are no pre-planned changes in electricity and utility prices that could influence the general price level. According to EC estimates, it is assumed that inflation in the EU in that period will be more moderate, that is, around 1.7%. Based on the above stated, in 2012 inflation in BiH could be approximately 1.9%, that is, 1.7% in 2013.

Monetary aggregates in the period 2010 – 2011

The total value of the gross foreign exchange reserves of the Central Bank of BiH at the end of October 2010 was approximately BAM 6.4 billion, which means that they had an annual growth of only 3%. As in previous years, during the third quarter of this year the greatest growth as compared to the previous quarter was recorded.¹⁶ This growth rate of foreign exchange reserves is the result of the slow recovery (stagnation) of BiH's economy. From the aspect of foreign exchange reserves, the most significant trends were noted in foreign-trade exchange. Accordingly, the growth of, above all else, exports, but also imports during the period in question, significantly contributed to the positive growth rate of foreign exchange reserves. On the basis of available data, a decline in all forms of investments is noticeable during this period. In connection to that, a fall in foreign direct investments, continuing over from previous years, is apparent. Also, within the framework of other investments, slower inflows, through commercial banks and trade credits (foreign assets), are evident. No significant developments were noted with regard to liabilities, that is, obligations. Furthermore, it is necessary to point out that no new loans were disbursed (even though that was expected), and the only disbursements were of funds under the Stand-By Arrangement with the IMF. On the basis of available data, regarding the current year, it is noticeable that there was no substantial increase in deposits and cash that foreign banks invest in their branch offices in BiH. In view of all of the aforementioned, and according to available data, it can be assumed that there will be no changes in foreign exchange reserves before the end of the year.

¹⁴ Source: European Economic Forecast, Autumn 2010.

¹⁵ Source: IMF, WEO October 2010

¹⁶ In 2009 and 2010 positive growth was achieved only at the end of the third quarter of the year, while decrease was registered during the other quarters of the year.

In **2011**, our economy is expected to make a full recovery, which it started in the previous year. It is also to be expected that foreign trade makes a significant recovery. In that context, a significantly faster growth in exports in comparison to the previous year will be present, as well as a growth in imports. In 2011 increased investments in our economy are expected. That is, there should be substantial inflows from foreign direct investment. Foreign assets will once again increase, also new financial products will appear and regained public confidence in the banking sector will be strengthened. With regard to liabilities, changes will occur – obligations will once again start to increase. In this category, other investments will increase, assuming that the State will increase its loans and borrowings from various sources from abroad, and that cash and deposits of foreign banks that banks invest in their branches in BiH will increase. Of course, it is important to point out that the inflow of funds to citizens is expected in the form of inflows of foreign funds, but much slower. In addition to the recovery of our economy, accompanied by the recovery of the world economy, as well as positive growth, the growth of foreign exchange reserves is also expected. The growth of foreign exchange reserves in 2011 would not go exceed 15%.

On the basis of the data available for the first ten months of this year, it can be noted that an annual growth of 8.8% was recorded for the total money supply (M2), which therefore attained the level of around BAM 13.8 billion. Deposit trends, which make up over 80% of the money supply, were used to form money supply assumptions. A significant category of deposits within the framework of money supply are long-term deposits. On the other hand, at the end of October 2010 positive growth was noted in the other category that is one of the components of money supply – cash outside banks, and this is also an indicator of trust in the banking sector. In accordance with the expected trends in total deposits, which have experienced a slight increase, by the end of 2010 it is anticipated that money supply will grow in almost the same proportion. Accordingly, the money supply will continue to grow, but its growth will be around 6% compared to the preceding year. As previously mentioned, it is expected that our economy will make a full recovery in 2011. That recovery is attached to the recovery on world markets, which resulted in increased investments in our banking system, as well as the expected inflow of funds from investments, which will also lead to an increase in total deposits, albeit still at minimum rates, and to an increase in cash outside banks. And, as we already know, the rise in deposits will lead to an increase in money supply, as well as to the increase of cash outside banks, albeit to a lesser extent. On the other hand, during this year it is expected that the growth of foreign exchange reserves will accelerate, and therefore it is safe to expect that money supply will continue to grow, although at a lower rate than in previous years, to be specific, at a rate of no more than 10%. As a result of the public's confidence in the banking system being restored, in the course of this year a small change to the structure of the money supply should take place, specifically, the share of deposits should be minimally reduced in favour of increasing the share of cash.

Monetary aggregates in the period 2012 - 2013

It is anticipated that the world economies will fully recover in 2012 and 2013, and that all economic activities in BiH will experience accelerated growth. During this period foreign trade should pick-up considerably, and this could in one part influence shifts in foreign exchange reserves. The continued growth of inflows of funds and various sources of funding in the economy of BiH is also expected. One form of inflow of funds is the increase of funds received from investments through the privatisation of companies (postponed in previous years) and the construction of power plants. Also, for the purpose of promoting BiH export, BiH exporters should find themselves in a better position through the increase of trade credits with favourable repayment conditions. All forms of inflows would affect the shifts in foreign exchange reserves in the specified period. Hence, the assumption is that foreign exchange reserves would, accordingly, return to the level from previous, stable years and the grow by around 9% compared to 2011 and around 10% compared to 2012. Along with the recovery of our economy, all economic activities will resume growth, and in turn the money supply

should also grow during 2012 and 2013. That growth would be the result of the consistent inflow of funds to the banking sector in the form of private sector deposits (which are the main category of deposits), as well as the inflow of deposits from the public sector. An increased money supply would also result from the inflow of funds from the privatisation process, as well as inflows from the aforementioned investments and new loans. In accordance with the said growth in deposits and other means of inflow of funds, slow but steady money-supply growth, which would not exceed 12%, that is, 15% is expected.

The banking sector in 2010

In 2010 the BiH banking sector finds itself in a significantly worse situation than in 2009. The total financial result achieved in nine months in 2010 was –77.1 million BAM. Such a poor result was, on the one hand, caused by the fall in total revenues due to the drop in credit activity¹⁷, and on the other hand, by the increase in total expenditure.

In **2010** the quality of credits granted to natural and legal persons worsened. Credits granted to natural and legal persons, classified as category “A” credits, amounted to 76.5%¹⁸ for a nine-month period in 2010, while in the same period the previous year that figure was 86.1%. Of course, on the other hand the number of credits classified in weaker categories (B-E) increased. In view of the fact that in the first nine months there was an increase in outstanding credit and leasing debts of 24.7% y/y, it is apparent that banks are encountering problems in collecting payments, which has reflected poorly on the quality of the credit portfolio. According to the CBBiH’s latest available data, total credits¹⁹ for the first ten months of 2010 amounted to BAM 14.3 billion, which presents a growth of only 0.8% y/y. Such growth in actual fact represents stagnation in lending activity, following the fall noted in the first seven months of 2010. The largest share in total credits is made up of credits granted to non-financial companies (52.4%), followed by credits granted to citizens (43.9%). While a modest growth of 1.8% y/y was noted with regard to credits granted to non-financial companies, credits granted to citizens have a negative growth rate of 2.1% y/y.

On the other hand, total deposits in accounts in banks in BiH increased in comparison to the previous year. In nine months in 2010 they increased by BAM 790.4 million, that is, 6.6% when compared to the same period of the previous year and reached an amount of BAM 12.7 billion. The largest contribution to the increase of total deposits were deposits made by citizens, which at a time marked by a rise in unemployment and drop in employment, as well as the stagnation of wages, show the exercise of increased caution in managing funds. Deposits made by citizens at the end of October 2010 were BAM 6.2 billion and were greater by 14.6% y/y. However, the situation concerning the non-financial companies sector is different. The deposits of this sector during a period of nine-months in 2010 were BAM 3.7 billion, which is only slightly less than compared to the same period in 2009. On the basis of trends and shifts to date in 2010, it can be expected that the growth rate of total deposits will be around 5% y/y, and of total credits around 1% y/y, by the end of the year.

Growth of credits and deposits in 2011

In 2011 it is expected that stagnation will come to an end and the economy of BiH will gradually start recovering. Growth in foreign trade exchange, final consumption and investment should also result

¹⁷ By summarising items of the profit and loss statements of the banking sectors in the Federation of BiH and RS, a profit and loss statement for the banking sector of BiH (unconsolidated) was obtained. According to that statement, the greatest share in total revenue is made up of revenues from interests and other revenues from granted credits and leasing activities. It is assumed that leasing activities make up only a modest share of banks' business activities, therefore that item can be taken as an indicator of trends in the credit activities of banks.

¹⁸ Data on credit quality and amount of outstanding debts in the banking sector of BiH was obtained on the basis of data for the banking sector of the Federation of BiH and RS published by entity banking agencies.

¹⁹ Data on credits and deposits provided by the CBBiH.

in a 3.2% GDP growth²⁰. Positive developments are also expected on the labour market, that is, the number of employed persons will stop dropping and gradual grow, unemployment will fall, and wages will increase. As economic recovery is continuing both in the EU and in the world²¹, it is also reasonable to expect smaller growth in transfers from abroad in 2011, which make up a significant portion of the funds of citizens in BiH. As a result of the aforementioned, higher growth rates of total credits (up to 5% y/y) and deposits (5% - 10% y/y) can be anticipated.

As a result of practice to-date, specifically, rigid terms and conditions for credits to the private sector and the reluctance to undertake business risks, no growth was recorded in the banking sector, and in 2010 neither was a positive financial result²², also it did not provide support to the private sector during the recession and stagnation. Above all else, the enterprise sector lacked funds for maintaining/expanding business operations in 2009 and 2010, which, had they had available funds, would have certainly had a positive effect on BiH's economy during this time, as well as on the banking sector. Banks need to work on strengthening and expanding capacities for more accurate risk assessments of business operations and more adequate market analysis, as well as financial analyses of individual clients. Also, together with the relevant institutions, and drawing from international practices, they should work on introducing new types of collateral and security from credit risks.

Growth of credits and loans in the period 2012 – 2013

Further economic recovery in BiH is expected in the period 2012–2013. As the economy recovers and economic activities increase, so will the activities of banks. Due to increased economic activity both in BiH and countries in the region and the EU, foreign-trade exchange in BiH will also increase, as will final consumption and an increase in investments is also expected. During this period it is anticipated that total credits will have a growth rate of over 10% y/y. Deposits will also grow, as enterprises expect more profitable business dealings, and a higher employment rate and lower unemployment rate, also an increase in the wage growth rate is expected. The sale of state shares in the ownership of enterprises could be realised during this period. The growth rate of total deposits in 2012 could be somewhere between 10% - 12% y/y, and in 2013 it could be more than 15% y/y.

External sector

Recent macroeconomic developments

Global economic recovery, following encouraging data on the growth of key economic indicators (GDP and export) in the first half of 2010, stated to slow in the second half of 2010 due to the fact that the US economy is recovering at a lesser rate than expected, while growth in developing countries is becoming more moderate. The predicted growth of world GDP could be further reduced due to global currency tension and the possibility of debt crisis in certain countries in Europe. In the second half of the year the reduced effect of financial incentives and the cycle of procurement of expired stock (oversupply) is staring to become noticeable. The central banks continued their policy of maintaining record low reference interest rates in order to incite growth, but in view of the fact that the risks prevail, crediting is significantly slower.

Observing the growth dynamic of surrounding countries, BiH's important trading and investment partners - EU and Croatia and Serbia, we can establish that almost all of the countries, except for Croatia, have a similar growth trend that corresponds to the statements made in the opening of this chapter (recovery in the first and second quarters of 2010, and slowdown in the third quarter of

²⁰ DEP estimate.

²¹ Source: European Economic Forecast, Autumn 2010; World Economic Outlook, October 2010.

²² In 2009 the banking sector in BiH achieved a total financial result of BAM 24.7 million, which is 70% less than the result that was achieved the previous year; in the first nine months of 2010 the BiH banking sector had a negative financial result of BAM 77.1 million. The data was received from the financial statements of the FBiH and RS banking sectors produced by the entity banking agencies.

2010). Germany, with its strong export industry, was certainly the leader when it comes to growth, but Austria also recorded a higher GDP growth rate than the EU-27 average. Following six successive quarters of decline, in the third quarter of 2010 Croatia came out of the recession with a 0.2% growth, while Serbia kept up with the EU-27 average and came out of recession already in the first quarter of 2010.

The mentioned uncertainty in respect of currency exchange rates is particularly apparent in the case of the two major currencies – the euro and the U.S. dollar – because of large oscillations in 2010 that were influenced by the growth prospects of the two countries, and especially by the frequent mention of the possibility of a debt crisis in the EU. All of this had a direct effect on the competitiveness of the two economies, and indirectly affected the economy of BiH due to the BAM being pegged to the euro. From January to June 2010 the values of the euro against the U.S. dollar were constantly dropping from a level of 1.45 (as a result of speculations that a sovereign debt crisis would arise in the EU), and in June 2010 reached a low of USD 1.2 for EUR 1, after which the rate started to grow (1.3) with the growth of confidence in the euro.

Comparing world prices of the main products (food and beverages, metals and oil), a gradual increase in almost all categories compared to 2007 levels is noticeable, and especially evident is the growth of prices of metals (iron and aluminium) which reached pre-crisis levels. The said price rises substantially influenced high nominal import and export growth rates during the specified period, however, the effects of the prices will dissolve by the end of 2010.

The balance of payments in Bosnia and Herzegovina

The **current account** balance in the first nine months of 2010 (including the DEP's estimate for the third quarter of 2010) amounted to BAM 1.1 billion, which is 4% less than it was in the same period in 2009, but that is also its lowest nominal amount since 2006. The largest contribution to the narrowing of the said deficit is the more favourable ratio in goods exchange, that is, the lowest registered deficit since measuring of the balance of payments of BiH on quarterly basis began.

The surplus in the balance of **services** in the amount of BAM 774.8 million, after seven successive quarters of negative growth rates, in the second and third quarter of 2010 started to experience slight positive growth (on the basis of the increase of inflows from tourism and international transport, as well as, though less significantly, from financial and insurance services), which was not enough to surpass the values from 2009. Revenues from other services are still falling; especially interesting are construction services abroad which were hit the hardest by the recession. The inflow of funds into the **income** account, in the period in question, was BAM 493,4 million, which is an even greater fall than recorded in the same period in 2009 (20% vs. 13%). Employee compensations are dropping, and income from investments is decreasing as a result of layoffs, decrease in wages and company losses, as well as low foreign interest rates that do not bring significant funds to investors.

Current transfers (BAM 2.2 billion), which are a significant source of funds for financing the goods deficit, in light of the recession trends and uncertainty, are still dropping (9%), but at a lower rate compared to the 2009 average (-16%). No significant changes are expected before the end of the year, and basically until the labour market stabilizes within international frameworks (especially the EU) and the perceived risks to global economic recovery decrease.

The **capital and financial account** balance (BAM 1.1 billion) is significantly reduced considering the decreased need for financing the current account deficit, but also as a result of negative inflow of FDIs and poor accessibility of foreign sources of funding. Within the framework of the Stand-By Arrangement (SBA) that was agreed with the International Monetary Fund (IMF), in the period in question the second and third instalments of the credit, in the amount of around BAM 271 million, were disbursed in the first quarter of 2010. Other new debt of the government sector and other nongovernmental sectors amounted to around BAM 510 million, which is 20% less than in the same

period in 2009. Commercial banks in BiH continued to decrease their foreign assets and liabilities in order to decrease foreign debt and improve liquidity. The previously mentioned liabilities/outflows, as well as significantly lower foreign inflows, lead to a significant decrease in **foreign exchange reserves** in the account of the Central Bank of BiH (in order to fund the current account deficit) of BAM 584 million at the end of September 2010 (compared to the end of December 2009).

Medium-term macroeconomic scenario

Following the fragile and uneven global recovery in 2010, mid-term forecasts (2011-2013) suggest that world GDP growth will be headed by developing countries (Brazil, India and China), and it will be around 3-4.5% (slower growth in 2011 and somewhat faster in 2012 and 2013). The assumptions regarding Bosnia and Herzegovina's main trading partners are that in countries in the EU, following GDP growth of 1.8% in 2010, GDP growth will slow down in 2011 to a rate of 1.7%, but in 2012 will gain impetus with a growth rate of 2%. Croatia will come out of 2010 with negative growth, and will not experience positive GDP growth until 2011, which is expected to be 1.5%, while in 2012 a somewhat more accelerated growth of 2.1% is anticipated. In Serbia GDP growth of 3% is expected by 2012. The prospects of BiH's economic growth will match the growth in demand and the inflow of capital from EU countries, as domestic demand and investments are still weak. The drop in domestic demand was one of the main reasons for the reduction of the current account deficit in 2010 (the other reason were the low prices of imported goods).

The widening of the **current account** deficit in **2011** will come as a result of the 15% nominal increase in the import of goods, which can be justified in part by higher projected prices of oil, food and other stock-market goods, as well as the gradual recovery of BiH's industry for exporting and, in part, domestic consumption growth. Surplus on the **services** account will increase spurred on by economic growth in the surrounding countries, and the growth of net inflows in 2011 will be around 20%. It will thereby regain the significance it had in financing the deficit in goods trade. **Income and current transfers**, following a sharp drop in 2009 and 2010, will gradually grow starting from 2011 and recover from the crisis that had a pronounced negative effect on those categories. The increase in net transfers will be a reflection of EU economic recovery (where the majority of our Diaspora and seasonal workers live and work) and greater labour mobility in the region. In 2011 the recovery of **financial inflows** is expected, mostly as a result of the increase of foreign direct investment in privatisation or recapitalization of existing enterprises. Financing via external debts in the government sector will remain within the planned scope in accordance with the Stand-By Arrangement with the IMF and the other planned projects funded by the World Bank, the European Bank for Reconstruction and Development (EBRD), European Union, etc. The gradual increase in domestic consumption and growth of investments will increase private sector demand for foreign loans, and the so-called Vienna Initiative will enable the possibility of increasing liabilities in the banking sector.

An increase in **foreign exchange reserves** will continue to represent a guarantee of the stable functioning of the Currency Board with over 100% coverage of monetary liabilities. Projections concerning the balance of payments for the period **2012-2013** indicate that the **current account** deficit will remain at a level of -7.6% to -7.2% share in the GDP of BiH due to the gradual recovery of import of goods, which was induced by both real growth and price rises (particularly oil and gas). The export of goods will increase in accordance with increased demand and higher prices, but due to a low basis, trade deficit will increasingly widen. With the recovery of the world economy, revenue from **tourism and travel** in BiH will increase, as will revenue from the provision of **construction services**, which were hit the hardest by the recession. The growth of inflows of funds from the provision of services will be 21% in 2012, and 19% in 2013. The import of services will rise by 11% for both 2012 and 2013. In line with the growth of foreign revenue, **current transfers** will increase in BiH by 7% and 6% (in 2012 and 2013), while income will grow by only 1% by 2013.

Funding from **foreign direct investments** will increase not only due to the purchasing of companies (or parts of companies) through the privatization process, but also as a result of the improved business climate that will lead to an increase in Greenfield investments. Funding from **other investments** will record increasingly lower growth rates, while the increased servicing of debts in 2013 is related to the start of the debt repayment in accordance with the Stand-By Arrangement agreed with the IMF, which will limit the possibilities of taking out or servicing of any new debts. In its most recent report on Article IV consultation from 2010, the IMF estimates that the total foreign debt of BiH increased to 60% of GDP in 2012 from the pre-crisis level of 48% of GDP, which is nevertheless low in comparison to other countries in the region. In the same report it is noted that BiH's external position is especially vulnerable to shocks from real depreciation of the BAM, non-interest shocks on the current account and slow GDP growth.

Foreign-trade balance

Existing situation

In 2010 in BiH weak economic growth should be expected, as turbulence on the financial market last year had a strong effect on real economies throughout the world. Developing countries whose economic growth relies on foreign direct investments and which have an import-dependant economy will be faced with the following: difficult access to foreign funding sources, decreased inflow of foreign direct investments and lower foreign demand, more demanding requirements for receiving consumer and investment credits, and all of that put together will cause slower economic growth in the forthcoming period. The weakening of the recession in the EU and neighbouring countries in 2010 should to some extent help rehabilitate BiH export which should once again start to grow, and with it the entire economy (GDP). According to DEP estimates, **export of goods and services** in 2010 will grow at a rate of 14.9% (exports of goods only will increase by 22.4%), while the **import of goods and services** will grow at a rate of around 4.1%. It is expected that the export of aluminium will grow at a greater rate, that is, around 18%, and iron and steel exports will increase even up to 60% as a result of the low basis for growth in the previous year, the rise in prices and the partial growth of exports demand. A remarkable 97.5% growth in the production of products is also expected as a result of the fact that "Soda-so Lukavac" expanded its capacities in the fourth quarter of 2009. With regard to imports, significant growth is expected in mineral products, which are dominated by oil and oil derivatives, which will grow by 25%, and inorganic chemical products that will grow by 22%. Wood industry exports in 2010 will drop by 1.4%. However, an encouraging fact is that the export of furniture will grow at a rate of 30.1% and it is expected that production and exports will be restructured so that instead of on the wood industry, they concentrate on manufacturing and export of furniture, as these have a more significant value, and furniture belongs to the category of consumer durables, the demand for which will certainly grow in parallel to the recovery of the economies of countries in the EU and countries that are BiH's trading partners.

BiH external sector projections for 2011

It is assumed that BiH's economy will recover in 2011, and that as a result, the nominal GDP will increase by 5.64%. It is expected that a nominal growth of 14.9% will be recorded in the area of **export of goods and services** during 2011 (export of goods only will increase by 14.3%). The result of such a significant growth in exports will be the full recovery of the economies of countries in the EU and the growth of their demand for intermediate goods, among which are metals, which are the most significant category of exports in BiH. The metals that BiH will export in the greatest amount are iron and steel, their products and aluminium. The **import of goods and services** will grow at a rate of 15.3%.

According to DEP estimates, the export of iron and steel will increase in 2011 at a rate of 30%. Such substantial growth of the export of iron and steel will be the result of integral production in the company "Mittal Steel - Zenica" that bought the mine "Arcelor Mittal" in Prijedor from which it will

purchase metal ores , and there will be no need to import metal ores, but the export of metal ores will also significantly decrease. The import of steel and iron will see a small growth of 1%, which will contribute to narrowing the trade deficit in this category of products. The export of iron and steel products will keep up with the iron and steel growth rate, but in a somewhat lesser volume, and in 2011 it will amount to 15%, and the import of these products will grow at the same rate of 15%.

The export of aluminium will grow at a rate of 18% due to increased production and the rise of prices on the world market. The company "Aluminij Mostar" has signed a contract with the "DaimlerChrysler" company that is an automobile manufacturer, and it is expected that the automotive industry will make a full recovery by 2011, which will be one of the reasons for the increase in the export of aluminium. The aluminium import rate will keep pace with the export rate, but in a somewhat more modest volume, and will amount to 16%. Exports in the machines, appliances and equipment sector will slightly increase in 2011 up to 4%, while imports of machines, appliances and equipment will also grow, but at much higher rates of over 20% in 2011. Such significant growth in imports of this product category can be attributed to the recovery of BiH's economy from the economic crisis and the need for new machines and equipment for the purpose of satisfying the needs of foreign partners, the buyers of our products, in a timely manner and the best way possible. The export of mineral products, dominated by the export of electricity and oil, will increase by 12%, while the import of mineral products, dominated by oil and oil derivatives, will grow at a rate of 15.5%.

BiH external sector projections for 2012

In 2012 BiH's economy will fully recover. Nominal GDP will grow at a rate of 8.04%. The **export of goods and services** will grow at a rate of 14.5% (export of goods only will increase by 12.8%), while the **import of goods and services** will grow at a somewhat lower rate of 11.9%, which will contribute to reducing the trade deficit that in recent years has been one of the main problems in BiH's economy. In 2012 the export of electricity will increase the most, at a rate of 18%, and provided that the thermal power station in Stanari begins operation, as it will operate solely for the purpose of export of electricity. As regards imports, the greatest growth will be recorded in the import of machines, appliances and equipment at a rate of 18%. Such significant growth in imports of this product category will be the result of increased demand for domestic products due to a 12% increase in investments. The export of iron and steel in 2012 will have a growth rate of 14.5% as a result of the aforementioned integral production that „Mitall Steel“ will initiate in 2011, and the export of iron and steel products will increase at a somewhat lower rate of 11%. The import of iron and steel should grow at a rate of 1%, that is, maintain the same growth levels as in 2011, and the trend of reducing, possibly even eliminating, the trade deficit in this product category will continue, but it is predicted that iron and steel products will be imported at a rate of 14%. The positive growth trend in the export of aluminium will continue in 2012, increasing at a rate of 8%, while a point of concern is that the import of aluminium, according to DEP projections, will grow at a rate of 12%, primarily due to the higher price of hydrated alumina, which is essential for the production of aluminium.

It is thought that furniture, as a result of restructuring production from the wood industry to furniture manufacturing, will be one of the most significant export potentials of BiH and it is expected that it will grow at a rate of 12% in 2012. A significant import growth rate in 2012 will be recorded for oil and oil derivatives, specifically a rate of 12%, and this increase in the import of oil will be brought on by the growth of industrial production in BiH, as well as a 5.1% rise in prices. The import of inorganic products will also continue to grow, and in 2012 it will amount to 15%, however export will grow at the same rate and therefore, this product category will not cause any significant changes to the structure of the trade deficit.

BiH external sector projections for 2013

2013 will be the year in which BiH's economy "calms down" following the turbulent changes caused by the economic crisis at the end of 2008, during 2009 and the beginning of 2010, while economic activity will bloom during 2011 and 2012, marked by significant GDP growth rates, changes in export, import, trade deficit and many other no less significant economic indicators. It is expected that in 2013 the **export of goods and services** will grow by 15.4% (export of goods only will increase by 14.3%) and that exports will increasingly be oriented towards EU markets. The **import of goods and services** will also grow at a rate of 11.6%. It is expected that in 2013 electricity will be the largest export, in the amount of BAM 1.3 billion and at a growth rate of 22%. Such significant export of electricity will mainly be possible due to the thermal power plant in Stanari, which is expected to start operating in 2012, and to operate in full capacity in 2013. Oil and oil derivatives will dominate imports, in a value of BAM 3.4 billion and a growth rate of 10%. As in 2012, the increase in investments, which in 2013 will be 17%, will lead to greater need for the consumption of oil and oil derivatives, and the continued growth of the import of vehicles of 10% will contribute to increasing the necessity of consumption of oil and its derivatives. The price of oil and oil derivatives will also grow at a rate of 5.1%.

With regard to intermediate products, just as in previous years, most trading will be conducted with iron, steel and aluminium, and their by-products. In 2013 a 12% growth in the export of iron and steel is expected as a result of the aforementioned integral production in the company "Mittal Steel" Zenica, and a 4.6% growth in export prices is also anticipated, while on the other hand, the growth rate of import of iron and steel will stagnate and see only a slight increase of only 1%. Aluminium imports will significantly increase in 2013 and grow at a rate of 15%. The export and import growth rates hugely differ for iron and steel, but this is not the case for aluminium and the export growth rate of aluminium will be also be 15%. A substantial deficit will lead to significant import of machines, appliances and equipment, which will be in great demand as a result of the aforementioned growth of investments. The expected value of imports of this product category will be BAM 3.3 billion with a growth rate of even 18%, and prices will grow at a rate of 3.1%, while exports will amount to BAM 892 million and grow at a rate of 15%. In this product category, spare parts for world renowned automobile manufacturers are exported the most.

Projections of FDI and privatisation in 2010-2013

In 2010 total foreign investments in the amount of BAM 200-400 million are expected.

According to the Ministry of Foreign Trade and Economic Relations of BiH's data, in the first nine months of 2010, foreign direct investments amounted to BAM 87.4 million, which is 69.7% less than in the same period in 2009. Taking into account investments to-date and the average decrease in investments of 69.7% in this year, in the fourth quarter of the year around BAM 60-100 million can be expected, that is, a total of up to BAM 150 million in 2010.

Also, total foreign investments could increase by a further BAM 150-200 million as a result of investments made by the ETF group (Energy Financing Team) that signed the concession contracts for the construction of the thermal power station "Stanari", the expansion of the existing mine, and the construction of the hydroelectric power plant "Ulog". Total investments in these two projects will amount to BAM 1.4 billion by the end of 2016²³. With its current investing dynamic, ETF would annually provide, from the end of 2010 to 2014, an average of around BAM 100-300 million foreign direct investments. "KaztransGas" from Kazakhstan, as the foreign partner (75% of investment), together with the Municipality of Zenica (35% of investment) is expected to invest around BAM 500 million over a period of 5 years. Thereby, depending on the pace of construction, annual

²³ Of which: investments in the thermal power station "Stanari" (u roku od 46 months od 2010-2014) - BAM 1.1 billion; investments towards the accompanying expansion of the capacity of the existing coal mine "Stanari" - around BAM 230 million; and investments in the hydroelectric power plant "Ulog" (by 2016) - BAM 130 million per year.

foreign direct investments in the thermal power station “Zenica” would in average be approximately BAM 100 million. The Government of the Federation of BiH (March 2010) gave its approval for finding a strategic partner that will participate with up to 70% foreign direct investments for the construction of: the thermal power station “Tuzla Blok 7”, in the total amount of BAM 1.15 billion FDI; the mine and thermal power station “Kongora” in the total amount of BAM 1.5 billion FDI.²⁴

Therefore, total foreign investments by the end of 2017 (for a six-year period), by when construction of the two thermal power stations is expected to be completed, would amount to around BAM 2.6-3 billion. This would provide an annual average of FDI of around BAM 500-600 million. No results have been achieved in the process of privatizing state-owned shares in enterprises so far this year.

In 2011 approximately BAM 950 million – 1.5 billion is expected in foreign direct investments.

In 2011 the start of the prolonged process of privatisation of state-owned companies is expected and it will be carried out in accordance with the privatisation plan of 2010²⁵, which could bring up to BAM 150 million FDIs in companies with majority state ownership.

It is expected that the completion of the privatisation of “Bosnalijek dd Sarajevo” will be a priority (around BAM 26.7 million). According to the 2010 plan it is realistic to expect BAM 350.64 million from privatisation of state-owned companies (according to book value: “Aluminij d.d. Mostar” – BAM 75.1 million, “Hidrogradnja d.d. Sarajevo” - BAM 47.4 million, “Energoinvest - d.d. Sarajevo” – BAM 147.9, “Šipad export-import d.d. Sarajevo” BAM - 8.5 million, “Remontni zavod Travnik d.d. Travnik” – BAM 6.9 million, “Unis d.d. Sarajevo” BAM - 32.41 million). FDI in other sectors, based on previous years averages, could amount to about BAM 600 million (taking into account the construction of the thermal power station “Zenica” which is already underway – BAM 100 million FDI for this year). The construction of the mine and thermal power station “Stanari” should secure around BAM 200-300 million in FDIs. A foreign partner for projects concerning the thermal power station “Tuzla Blok 7” and the mine and thermal power station “Kongora” has still not been found, and these projects should have an average of BAM 500-600 million FDIs per year.

Foreign direct investments in the amount of BAM 1.2-1.63 billion are anticipated in 2012.

In 2012 privatisation of the following state-owned companies, in the amount of BAM 216 million²⁶, is expected to continue:

- “Sarajevo-osiguranje – d.d. Sarajevo” in the amount of BAM 26.93 million;
- “Energopetrol - d.d. Sarajevo” in the amount of BAM 15.19 million;
- “Fabrika duhana Sarajevo - d.d. Sarajevo” in the amount of BAM 51.15 million (government decision)
- “KTK d.d. Visoko” in the amount of BAM 69.63 million, following the decision of the Government of the Federation of BiH;
- “Željezara Zenica - d.o.o. Zenica” in the amount of BAM 53.11 million (the amount of BAM 103 million reduced by BAM 50 million in order to resolve the amount of outstanding debt).

The amount received from the possible sale of “BH Telekom dd Sarajevo” (BAM 780 million book value) in the event of growth of the market value of this company of 20-50% on the stock market (as a result of overall economic recovery) could be up to BAM 1.5-2 billion. Continued investment in the

²⁴ If it proves to be successful in terms of finding a strategic partner, this model would also be applied the next year for: thermal power station “Kakanj Blok 8” in the amount of around BAM 1 billion FDI, the mine and thermal power station “Bugojno” in the amount of around BAM 800 million FDI, and the mine and thermal power station “Banovići” in the amount of around 1 billion FDI.

²⁵ The planned pace of privatisation from the previous year is slowed due to ongoing court disputes, the formation of a new government and the continuation of the world economic crisis.

²⁶ However, if privatisation of “BH Telekom BiH” is carried out in 2012, the total amount would be BAM 1-2 billion.

electricity sector should come to around BAM 500-1000 million, depending on the investing dynamic realised in previous years (in case of delays in previous years, it would be BAM 1 billion FDI). If “regular” FDIs were to rise to the average in previous years, before the crisis, to be specific, 2006/2007 levels, they would amount to around BAM 970 million. Here we also have the investments of the ETF group in the thermal power station “Stanari” in the amount of BAM 250-300 million and FDI in other sectors averaging at around BAM 600 million.

The construction of the two aforementioned thermal power stations would also begin at this time. If foreign partners are found, initial investments of a total of approximately BAM 500 million in both of those projects could be expected.²⁷

Foreign direct investments in 2013 would be around BAM 1.5-1.8 billion.

Investments in the energy sector in the Federation of BiH would be around BAM 350 million (average annual investments of the ETF group would be around BAM 300 million), in addition to investments in other sectors averaging at around BAM 500-700 million. Continued average investments in the two thermal power stations would be around BAM 800 million. The continuation of privatisation would secure an additional BAM 100-200 million.

Table 1: Plan of investment in the energy sector of BiH

	Energy sectors	Amounts in BAM millions				
		Investing period				
		till	2011-	2016-	Total	%
		2010	2015	2020	investments	
1.	Electricity sector	2.87	2.932	2.038	7.84	73.2%
1.1.	EP BiH	1.056	972	812	2.84	26.5%
1.2.	EP HZHB	991	826	299	2.116	19.7%
1.3.	EP RS	665	993	776	2.434	22.7%
1.4.	Elektroprijenos BiH	146	137	150	433	4.0%
1.5.	NOS BiH	12	4	0	16	0.1%
2.	Coal Mines	526	682	417	1.624	15.1%
2.1.	Federation of BiH	314	282	137	732	6.8%
2.2.	Republika Srpska	212	400	280	892	8.3%
3.	Gas sector	162	167	23	352	3.3%
4.	Oil sector	629	271	0	900	8.4%
	Total investments	4 187	4 051	2 478	10 716	100.0%

Source: Energy Sector Study in BiH (ESSBiH funded by the World Bank)

3. PUBLIC FINANCE

Indirect tax revenue – current trends

The first effects of the global economic crisis were felt in Bosnia and Herzegovina at the end of 2008. The decline in economic activity and household consumption also had an impact on public revenues in BiH. In the last quarter of 2008 a drop in indirect tax revenues was recorded, and it continued

²⁷ According to the Energy Sector Study in BiH (ESSBiH funded by the World Bank), foreign direct investments (FDI) in the energy sector should amount to around BAM 1-1.5 billion by the end of 2012, and in the period 2011-2015 a further BAM 1.5-2 billion is possible. As no investments were made in 2009 and 2010 due to the economic crisis and restructuring of the electricity sector in FBiH, the implementation of this plan was postponed, and therefore, investing using credit funds is expected to begin in 2010 and 2011.

throughout 2009. The largest decline noted in 2009 concerned revenues from customs duties, which came as a result of not only the sharp drop in imports, but also the continued application of the provisions of the Stabilisation and Association Agreement. Despite the effects of policy changes in the area of excise duties and road tolls in the second half of the year, as a result of the decrease noted for almost all components of the gross domestic product, a 9.9% fall in revenue from indirect taxes was noted at the end of 2009. In 2010 revenues resumed growth. According to the Indirect Taxation Authority's (ITA) preliminary report, in the period I-X 2010, net revenue from indirect taxes in the amount of BAM 3 944.78 million was collected, which is 6.86% more than in the same period the previous year. An end to the negative trend from 2009 comes as a result of gradual economic stabilization and recovery, as well as the effects of policy changes in the area of indirect taxation. According to the projections of the Directorate for Economic Planning, a modest nominal growth of the GDP of 2.2% is expected in 2010. Apart from that, revenue growth was in large part the result of the effects of the new special excise tax rate on tobacco, starting 1 January 2010. It is also necessary to keep in mind the delayed effects of the changed toll rates, as well as the effects of the changed excise duty rate on tobacco, the application of which started on 1 July 2009, and which revealed themselves during the first two quarters of 2010.²⁸

Indirect tax revenue projections for the period 2011-2013

In the process of developing projections for indirect tax revenues, two scenarios were developed – the basic and the programme scenario.

The **basic scenario** of indirect tax revenue projections for the period from 2010 to 2013 is based on the following:

- a) Forecasts based on macroeconomic indicators developed by the Directorate for Economic Planning (DEP) for the aforementioned period,
- b) Continued application of the Stabilisation and Association Agreement (SAA) in accordance with the dynamic of the reduction and abolishing of customs duties on the import of goods of EU-origin,
- c) The application of Article 21 of the Law on Excise Duties, which involves continuous harmonisation of excise rates in BiH with EU minimum standards.

Projections include the effects of the increase in the special excise duty on tobacco in 2011 from BAM 0.30 to 0.45 per pack, as well as the planned continual increase of that excise duty each year by BAM 0.15 per cigarette pack. Bearing in mind current trends, past fluctuations and seasonal patterns, it is expected that in 2010 indirect tax revenue in the amount of BAM 4 708.1 billion will be collected, which is 6.1% more than in 2009. Considering the expectations that during the next three years the economy of Bosnia and Herzegovina will slowly come out of recession and register continued growth, the growth of indirect tax revenue in 2011, 2012 and 2013 is projected as 6.2%, 7.3% and 6.5%, respectively (Table 1).

The **Programme scenario** is based on the assumption that the customs record-keeping fee, which is charged for all imported goods, and in the amount of 1% of the customs duty base rate, will be abolished starting from the second quarter of 2011, which is an idea supported by the Management Board of the ITA. As a result of this measure, all companies doing business in BiH would be in an equal position, and relieving the burden of input expenses allows for the positive effects of economy of scale to be revealed. In view of the fact that in order to abolish the customs record-keeping fee it is first necessary to amend the Law on Customs Policy of BiH, when and if this measure is implemented depends on the pace at which the new government in BiH will be formed. It is

²⁸ In order to isolate all of the effects of the amended laws and regulations on the collection of indirect taxes in 2010, it is also necessary to exclude the delayed effects of other amended provisions in the area of excise duties, the effects of new customs duty rates amended in accordance with the provisions of the SAA, and the effects of all legal amendments regarding the collection of revenue from VAT, in view of the fact that excise duties, road tolls and customs duties are taken into account for determining the base rate for calculating VAT.

estimated that the effects of the aforementioned amendments to laws, if their application begins as of the second quarter of 2011, caused losses in the amount of ca. BAM 35 million in 2011 (30 million in customs duties and 5 million in VAT), that is, 0.12% of the GDP.

VAT

According to the preliminary report of the Indirect Taxation Authority (ITA), in the first nine months of 2010, BAM 3 034.41 million gross revenues from VAT was collected, which is 3.19% more than in the same period of the previous year. An analysis of the structure of those revenues reveals that revenues from VAT on imports grew by 6.65% during that same period, while a drop of 1.65% was recorded for VAT collected on the basis of tax returns. The sum of all other categories of gross VAT revenue (automatic assessment, one-off payments, etc) increased by 11.18%. The growth of net revenue from VAT was stable during the last five months of 2010, and is 3-5%. This growth rate includes VAT revenue from additionally collected excise on tobacco and road tolls. It is projected that BAM 2 941.6 million net VAT revenues will be collected by the end of the year, which is 4% more than collected in 2009. VAT projections for the period 2011-2013 are in line with the projected consumption growth (DEP), that is, 6.0%, 6.5% and 6.4% respectively.

Excise duties

According to the preliminary report for October 2010, in the first ten months of 2010 13.7% more excise duties were collected than in the same period of the previous year. Due to the unequal distribution of the effects of the new Law on Excise Duties in 2010, there was a gradual slowdown in the growth of those revenues. The substantial growth of excise duties comes primarily from the growth in revenue from tobacco excise duties (32.19 % in the first ten months of 2010), due to the increase of the special excise duty rate. During the same period, excise duties on oil derivatives recorded an insignificant increase of 0.31%, while a decrease in collection was noted in the other excise duty categories. It is expected that BAM 1 149.3 million will be collected by the end of the year, which is 15.2% more than in the previous year. Projections of revenue from excise duties in coming years (2011-2013) are based on DEP's projections of macroeconomic indicators, primarily real growth rate of consumption and GDP. The projections include effects of increasing the special excise duty on tobacco by BAM 0.15 per cigarette pack each year.

Road tolls

In the first ten months of the year a 24.46% growth in revenue from road tolls was recorded. Following the marked increase in these revenues in the first two quarters of 2010, 58.2% in the first and 69.7% in the second quarter of the year, caused primarily by delayed effects of the increase of the rate from 0.15 to 0.25 BAM /l as of 1 July 2009, in the third quarter of the year a growth of only 2.5% was noted. A decreased collection trend is expected in the last quarter of the year. The projections for 2010 amount to BAM 306.4 million, which is 22.5% more than what was collected in the previous year. Since there are no plans of further harmonization of excise rates on oil derivatives with EU standards in the foreseeable future, the effects of new Law are limited only to the first half of 2010, while the projection for 2011-2013 is based on DEP estimate of GDP growth.

Customs duties

Provisions of the Interim Stabilisation and Association Agreement BiH (SAA) with the European Union that came into force on 1 July 2008 largely contributed to the collection of indirect tax revenues, since they stipulate the simultaneous or gradual (until 2013) abolition of customs duties on imports of goods originating in the EU. In 2009 a 46.8% fall in such revenue was noted, compared to 2008, while in the period I-X 2010, a fall of 15% as compared to the same period in 2009 was recorded. In line with current trends and import and export forecasts, including obvious changes in export markets compared to the EU market, it is projected that BAM 292.3 million of such revenue will be collected by the end of the year. In the coming years a more moderate process for decreasing customs duty rates is planned in view of the fact that customs duties have already been abolished for a significant portion of imports originating in the EU. For that reason, as well as because of

import growth rates projected for the period 2011-2013, that is, 15.3%, 11.9% and 11.6% respectively, a severe decline, such as in the previous period, in this category of revenue cannot be expected.

Total

In view of the above, following the drop in indirect tax revenues in 2009, and slight growth in 2010, in the following period the gradual recovery of the economy and consumption is expected, and therefore, so is greater indirect tax revenue. The process of abolishing customs duties on imported goods originating in the EU has already been completed for most goods, and therefore, the effects of reducing or abolishing customs duties in the coming years will not have any greater negative effects on revenues from customs duties. On the other hand, revenue growth will significantly benefit from the continuous increase of the rate of the special excise duty on cigarettes, that is, the alignment of excise duty rates in BiH with current EU minimum standards. Nevertheless, it is necessary to point out that, in view of the basic assumptions used for indirect tax projections and the overall economic conditions in BiH and the world, realisation of the projected level of indirect tax revenue in the period 2010-2013 is susceptible to certain risks:

- Indirect tax revenue projections are closely tied to the execution of the macroeconomic indicator projections of the Directorate for Economic Planning. Any derogation of these parameters from the projected values represents a risk for revenue projections.
- The dynamic and pace of recovery of BiH's main trading partners (EU, zemlje CEFTA) are still highly uncertain, and this increases the risks in respect of the realisation of macroeconomic projections, and consequently, also increases the risks related to realising indirect tax revenue projections as a whole.
- The continuous increase of the special excise duty rate for the purpose of attaining EU minimum standards, will bring further growth in revenue from excise duties on cigarettes, however, the growth will be much slighter than it was in the initial period because of the convergence process (narrowing of the cigarette price range). On the other hand, as the retail prices of cigarettes rise, so does the risk of illegal trade and smuggling, which, if effective operational measures are not taken, could threaten the planned volume of revenue from this excise duty.

3.1. Balance and government debt

3.1.1. Strategy and medium-term policy objectives

Certain harmonisation in the segment of VAT taxation in BiH with the EU legal framework, though planned for 2010, has been postponed due to the fact that this was an election year and as a result of constant pressure to derogate existing elements of the VAT policies (a wider scope of zero rate and exemption, differentiated rates). It is expected that as of 2011 the process of continuous harmonisation of the Law on VAT in BiH with the redesigned EU legal framework for VAT taxation, particularly the taxation of services, will begin. In addition, the Indirect Taxation Authority has initiated activities on the modernisation and improvement of VAT administration. An important part of those activities is also the "e-VAT" (electronic VAT forms) project. The introduction of electronic VAT forms should help reduce administrative costs for taxpayers and the Indirect Taxation Authority.

Implementation of the Stabilisation and Association Agreement with the EU in the part concerning the Trade Agreement is proceeding without any greater difficulty. One of the main new developments is the application of the TIR Convention starting 1 January 2010, and the signing of the A.T.A. Convention. The TIR system was introduced in order to facilitate, as much as possible, the international movement of goods with customs markings, eliminating extensive checks and waiting at borders. According to the Draft Work Plan of the Indirect Taxation Authority of BiH for 2011, the following activities in the area of customs and customs policy are planned:

- redesign of the Law on Customs Policy
- development of implementing legislation related to the Law on Customs Policy
- drafting of instructions in the area of customs policy
- continuation of work on the introduction of other simplified customs procedures, such as the issuing of permits (authorisation), which involves amending existing procedures (simplified customs procedure based on invoices, custom warehouses, local procedure for export customs clearance)

3.1.2. Current balances and medium-term perspective

The strategy of gradual harmonisation of excise rates with the minimal rate in EU should contribute to the achievement of set EU standards without any major negative macroeconomic implications for the general level of prices and function of the market and competitiveness. The expectation that the increased rate of special excise duties on cigarettes will discourage consumption of cheap and low-quality cigarettes and reduce the total consumption by 10% by 2012 has already become a reality in 2010. In the first ten months of 2010, 10% less cigarettes were consumed than in the same period in previous years. The fiscal effects of the increased excise duty rate on energy-generating products and cigarettes in 2009 are significant, especially as additional revenue did not sufficiently compensate for indirect tax revenue losses incurred as a result of the effects of the global economic crisis, contraction in consumption and economic activities. The overall fiscal effects of policy changes regarding excise duties, also including the relevant VAT, amounted to around 0.63% GDP in 2009. It is estimated that in 2010 the effects will be 0.75% of GDP, and 0.55% of GDP in 2011.

3.2. Quality of public finances

In accordance with Item 27 of the Letter of Intent addressed to International Monetary Fund, the fiscal authorities of Bosnia and Herzegovina initiated extensive activities to improve the quality of fiscal statistics, with an ultimate goal to develop consolidated reports in accordance with EuroStat and IMF's government finance statistics (GFS) methodology. In the first phase emphasis was placed on the formalization and institutionalization of the collection of financial statistics (see under 3.3), and ensuring timely reporting at all levels of government in BiH. In 2010 the transparent and regular publishing of consolidated reports on the web site of the State agency (see 3.3) was achieved by the general government of BiH. The second phase of harmonisation of fiscal statistics includes activities on harmonizing entity charts of accounts with IMF presentation standards. In the third quarter of 2010, Republika Srpska published a new Chart of Accounts (CoA) for reporting to budget beneficiaries, which complied with IMF standards and used the UN Classification of the Functions of Government (COFOG). Application of the new Rulebook on reporting to budget beneficiaries should begin in the RS on 1 January 2011. In the Federation of BiH activities are currently underway on the drafting of a new Rulebook on the drafting and submission of reports to budget beneficiaries, which should ultimately be brought into line with the new RS Chart of Accounts. The harmonisation of standards for reporting on government operations within BiH would enable the Macroeconomic Analysis Unit of the Management Board of the Indirect Taxation Authority to, in the course of 2011, prepare a harmonised reporting templates, redesign the existing database of fiscal statistics in BiH, and create an *interface* between national financial statistics and the IMF format of statistics. As a result of employing an IT expert in the Macroeconomic Analysis Unit, the technical preconditions for the operationalisation of the second phase of harmonisation are now in place. In the next phase the full harmonisation of domestic practices and reporting methodology with GFS methodology is expected, as is the beginning of the project for adopting ESA95 standards.

3.3. Institutional characteristics of public finances

Work of the Coordination Group for Fiscal Statistics

In view of the stated obligations undertaken by the BiH authorities in the Letter of Intent mentioned in the previous Chapter, in October 2009 the Fiscal Council established the Group for the Coordination of Fiscal Statistical Data for Monitoring the Implementation of the Stand-By Arrangement. The Group is made up of representatives of the State and Entity ministries of finance, the Brčko District Finance Directorate, the Macroeconomic Analysis Unit (OMA) of the Management Board of the Indirect Taxation Authority and the Department of Statistics of the Central Bank of BiH. The main task of the Group is to ensure collection and consolidation of fiscal data, submit them in a timely manner to the Fiscal Council and the IMF, and publish them on the web site. The decisions of the Fiscal Council that followed in the spring of 2010, defined the coordination mechanisms within the Group, which are a basic precondition for the efficient functioning of the complex fiscal structure of BiH. In 2010 certain progress was achieved regarding the timely submission of execution reports, quality of data and harmonising the method of presentation with GFS standards. Consolidated reports on government revenues, expenditures and financing are regularly published on the Macroeconomic Analysis Unit's web page²⁹, in accordance with the reporting deadlines stipulated in the Stand-By Arrangement.

Measures for increasing the efficiency of indirect tax collection

Signs of slight recovery in 2010 did not significantly influence improvement of taxpayer liquidity. The problem of maintaining the liquidity of taxpayers who regularly submit their VAT forms, which arose at the end of 2008, became more serious in 2009 and remains just as serious in 2010. With the aim of strengthening the liquidity of taxpayers who regularly exercise their right to VAT refunds (exporters, investors), the Indirect Taxation Authority accelerated the VAT refund procedure as much as possible. With respect to taxpayers that have a history of having difficulty paying VAT regularly, in 2010 the Indirect Taxation Authority intensified the application of a special scheme for VAT debtors (*withholding tax regime*).

3.4. Institutions of BiH

Bosnia and Herzegovina falls into the category of small open economies whose growth model is based on consumption financed, in large part, through credit expansion and transfers from abroad. As a result, the economy of BiH is very sensitive to global economic trends and has weak absorption capacity in respect of outside shocks. The global economic crisis, the effects of which were visible in the last quarter of 2008 and throughout 2009, caused a decline in economic activity and aggregate demand, worsening the financial situation in the country. Indirect tax revenue is 9.9% less than it was in 2008, and the positive effects of the application of the new Law on Excise Duties and the increased revenue from road tolls have not significantly compensated for the losses caused by the drop in imports (consumption) and the application of the Stabilisation and Association Agreement.

Balances and broader government debt

In mid 2009 Bosnia and Herzegovina agreed a three-year Stand-By Arrangement with the IMF in the value of EUR 1.2 billion, which stipulates that public expenditure savings measures are carried out and structural reforms that will contribute to the further consolidation of public finances and sustaining of macroeconomic stability are implemented. Thereby, Bosnia and Herzegovina reduced the initially projected deficit of 6.8% for 2009 to 4.5% of GDP³⁰. A deficit of 3.8% of GDP is predicted in 2010, and the IMF Mission and the outgoing government that is currently acting in caretaker

²⁹ www.oma.uino.gov.ba

³⁰ According to the IMF, due to use of GDP on the principle of production, the initially projected deficit of 7.8% was reduced to 5.4% GDP in 2009.

capacity (caretaker government) have agreed to restrict the consolidated fiscal deficit in 2011 to 2.3% (3%) of GDP.

The gradual recovery of the European economy in the first nine months of 2010 was enough to bring the decline of BiH's economy from the previous year to a standstill, and due to certain positive steps towards increasing domestic demand in the second half of the year, it is estimated that BiH's economy could, at the end of 2010, record a modest real growth of 0.5%. The expected positive trend of EU economic growth is a positive signal for the recovery of the economy of BiH, and the strengthening of disposable income and private consumption, which the majority of public revenues are based on. The basic scenario for indirect tax revenue projections for the period 2010-2013 is based on the following:

Table 1 - Indirect tax revenue projections (2010-2013)- basic scenario

		2008	2009	2010	2011	2012	2013
I	VAT	3 119.4	2 827.8	2 941.6	3 117.7	3 321.5	3 535.4
II	Tax on revenues in ITA Single Account	0.1	0,0				
III	Excise duties	937.3	997.4	1 149.3	1 286.0	1 448.6	1 593.7
IV	Customs duties	651.3	346.8	292.3	260.9	243.3	214.9
V	Tolls	189.5	250.2	306.4	316.2	333.6	351.7
VI	Other	29.3	14.9	18.4	18.6	18.8	19.0
VII	TOTAL	4 927.0	4 437.0	4 708.1	4 999.5	5 365.8	5 714.5
VIII	Tolls (0.10 BAM/1)		-65.8	-122.6	-126.5	-133.5	-140.7
IX	FUNDS FOR ALLOCATION	4 927.0	4 371.3	4 585.5	4 873.0	5 232.3	5 573.8

Strategy and medium-term policy objectives

Since mid 2009 Bosnia and Herzegovina has been party to a Stand-By Arrangement in the framework of which the fundamental fiscal policies of the country are defined, and the need for the further consolidation of public finances and the promotion of structural reforms is recognised. The fundamental objectives of the Stand-By Arrangement are as follows:

- Safeguard the currency board and cushion effects of the adverse external environment
- Consolidate public finances and bring them on a sustainable medium-term path
- Maintain adequate liquidity and capitalization of banks
- Secure sufficient external financing and improve public confidence

In the period up to November 2010, the results of policies undertaken under the Stand-By Arrangement include:

- The economic situation is stabilizing,
- Decline in economic activity has been halted,
- Confidence is recovering: deposits increasing; foreign exchange reserves are stable; overall foreign bank exposure has been maintained,
- Performance under the Stand-By Arrangement (SBA) with the IMF has been satisfactory. The quantitative targets for end-March, end-June and end-September 2010 have been met.

In October 2010 the IMF Executive Board completed the second and third reviews of BiH's economic performance and approved the disbursement of around BAM 254 million. Of this amount, the authorities withdrew around BAM 74 million for support to entity budgets. Considering that the foreign exchange reserves are strong, the Central Bank did not disburse the remaining amount that is intended for increasing foreign exchange reserves. Therefore, up till November 2010, under the Stand-By Arrangement a total of BAM 750 million (338.2 million SDR) have been disbursed, and all of the funds were used in the Entity budgets. Within the framework of the Stand-By Arrangement,

expenditure savings measures were agreed (including employee income, social-veteran transfers, as well as material expenses and other current expenditure), as was a slight increase in revenue through the new Law on Exise Duties.

Structural benchmarks agreed with the IMF also include continuous maintenance of the currency board arrangement, reform of social-veteran transfers in both entities, the adoption of a strategy for pension system reform in both entities, the adoption of laws on fiscal responsibility, the preparation and publishing of consolidated quarterly fiscal data for BiH, as well as the establishment and work of the Standing Committee for Financial Stability.

In November 2010 the IMF Mission carried out the fourth review under the Stand-By Arrangement, which showed that all quantitative performance criteria for end-September 2010 have been met. The Mission and the caretaker government agreed that to limit the consolidated fiscal deficit in 2011 to 2.3% (3%) of GDP. They also identified a series of measures that are essential in order for that objective to be fulfilled and to close the large financial deficits. However, the representatives of the authorities failed to reach an agreement on the Global Fiscal Framework for 2011-2013 in order for the discussed measures to be adopted after the new governments are formed (necessary as a result of the general elections that were held in October 2010). Therefore it is imperative that all decisions on fiscal policy that the new governments adopt in the future be in line with the consolidation trajectory that is planned under the programme.

Once the new governments are formed, it is expected that the Fiscal Council of BiH will adopt the Global Framework for Fiscal Balance and Policies for the period from 2011 to 2013, and conduct further negotiations on the next installments and the further progression of the Stand-By Arrangement agreed with the IMF. In light of the significant fall in budget funding from international financial institutions and funds available from escrow accounts, which will not be supplemented by an increase in revenue, the covering of the substantial shortage of funds will require full implementation of the expenditure savings measures that were discussed under the Stand-By Arrangement.

Further measures discussed under the Stand-By Arrangement in the Federation of BiH include the following:

- complete adjustment and implementation of legislation in the area wages and social benefits, in line with what was agreed under the Stand-By Arrangement;
- complete adjustment and implementation of legislation in the area of war disability benefits, including efficient eligibility audits of war disability benefit recipients
- settlement of arrears to demobilised soldiers, non-war invalids and the pension fund
- pension reform, including reform of privileged pensions
- implementation of the agreed savings measures by lower levels of government in the Federation of BiH

Further measures discussed under the Stand-By Arrangement in the RS include:

- pension reform, including reform of privileged pensions
- complete adjustment and implementation of legislation in the area of war disability benefits, including effective eligibility audits of privileged pension and war disability benefit recipients

Implementation of the above-mentioned and other structural fiscal reforms, together with the reduction of other current expenditures should help plug fiscal deficits. Policies should focus on ending the growth of current expenditure through more intensive reforms in the area of rights-based benefits, the containment of wages in the public sector and putting the pension system on a sustainable footing. In addition, it is also necessary to ensure that fiscal consolidation in the medium-term is accompanied by changes to the structure of expenditure, with the increased participation of capital expenditures and reduced current expenditures. Therefore, fiscal

consolidation will ensure that public finances are brought back onto the path toward sustainability, and this will support the stability of the currency board and make room for capital expenditures, help protect vulnerable groups, aid the private sector, and strengthen prospects of medium-term growth in BiH.

Tied to the Stand-By Arrangement are also other arrangements that BiH has with other international financial institutions, specifically World Bank budget support loans (DPL - Development Policy Loans) and macrofinancial aid from the European Commission, and all of the arrangements require compatible fiscal policies. Arrangements with international financial organisations (IMF and World Bank) guarantee improved control, fiscal discipline and policy coordination at the State level. This is of particular importance for BiH in view of the currency board arrangement, which minimises monetary policy actions.

Current balances and medium-term prospects

According to the Law on the Fiscal Council of BiH ("Official Gazette of BiH" no. 63/08), the decision on determining the amount of indirect tax revenue that will be allocated for financing the institutions of BiH should be made by the Fiscal Council of BiH under the Global Framework for Fiscal Balance and Policies in BiH, which the Fiscal Council is required to adopt no later than 31 May of each year.

By mid-July 2010 the Fiscal Council of BiH had still not adopted the Global Framework for Fiscal Balance and Policies in BiH for 2011-2013, but at its 17th session held on 16 June 2010 the Fiscal Council adopted a conclusion defining that the 2010 levels will be the starting basis for determining the framework of total public consumption in BiH for 2011. On the basis of that conclusion a Budget Framework Paper was prepared, in which the expenditures of the institutions of BiH for 2011 were at the level of expenditures in the budget of the institutions of BiH for 2010. Revenues of the institutions of BiH from indirect taxes (revenues from the the Single Account of the Indirect Taxation Authority of BiH) for 2011 are established in the Paper as the difference between the minimum level of the expenditure of the institutions of BiH on the one hand, and the own resources of the institutions of BiH and the projected surplus funds carried over from the previous period on the other hand. At the moment it is not projected that any funds from 2010 will be carried over to 2011 in view of the fact that the budget of the institutions of BiH for 2010 was planned with strict savings measures. Total expenditures for 2011 are, in line with the above mentioned conclusion of the Fiscal Council, planned at the level of the budget of the institutions of BiH for 2010. If during the preparation of the draft budget of the institutions of BiH for 2011 any changes arise in the projections of own revenue of the institutions of BiH or the transfer of funds, then changes will be made accordingly to the amount of revenue needed from the Single Account of the the Indirect Taxation Authority for the financing of the institutions of BiH in 2011.

The institutions of BiH have fulfilled all of their obligations arising from the Stand-By Arrangement. Incomes were cut by approximately 10% back in July 2009, and additional funds were saved by instructing beneficiaries to make further savings in the second half of 2009, and this practice was continued in 2010. Also, the structural benchmark regarding regular publishing of consolidated data on budget execution (published by the Macroeconomic Analysis Unit of the Management Board of the Indirect Taxation Authority of BiH) was fulfilled.

So far the execution of the budget of the institutions of BiH for 2010 is progressing as planned, although the Ministry of Finance and Treasury of BiH instructed beneficiaries to make additional savings, especially with regard to benefits and material costs. On the other hand, a shortage of European Commission macro-financial assistance funds is expected in view of the fact that BAM 40 million macro-financial assistance funds were planned in the adopted budget of the institutions of BiH, but the Fiscal Council of BiH later passed a decision that allocating only BAM 20 million of such funds to the institutions of BiH. Apart from that, it is expected that the non-tax revenues of the the

institutions of BiH (revenues from profits of the Central Bank of BiH and administrative taxes of the the institutions of BiH) will also be less than planned.

In accordance with the above, and on the basis of detailed analysis and constant contact with budget beneficiaries, the Ministry of Finance and Treasury of BiH estimates that expenditure savings that will be made in 2010 will be sufficient to compensate for the smaller revenues and funding shortages in the 2010 budget, and that it is not realistic to plan for possible surplus funds from the 2010 budget that could be carried over to the 2011 budget as funding.

As the Fiscal Council of BiH failed to adopt the Global Framework for Fiscal Balance and Policies in BiH for the period 2011 to 2013, the Draft Budget of the Institutions of BiH for 2011 was prepared in accordance with the conclusions of the Fiscal Council regarding the keeping of expenditures in 2011 at the 2010 levels, and in line with the savings measures of the institutions of BiH that the Fiscal Council of BiH agreed with the International Monetary Fund under the Stand-By Arrangement (retaining the wage, meal allowance and reimbursement base). In addition, in the Letter of Intent for the Stand-By Arrangement with the IMF, signed by the Fiscal Council of BiH, it is stated that efforts should be made to ensure that the 2011 State budget expenditures remain at the 2010 level, and this is also stipulated in the Draft Budget of the Institutions of BiH for 2011.

The initial budget requests made by budget beneficiaries, institutions of BiH, amounted to almost BAM 500 million, which is 50% over the upper limit for expenditures, that is, compared to expenditures in 2010. Following consultations between the Ministry of Finance and Treasury of BiH and budget beneficiaries (over 90 meetings were held), amended requests were submitted, and it could be seen that eight beneficiaries submitted final requests that were in excess of the agreed limit (in the total amount of around BAM 352 million), among which were the following: the Return Fund requested approximately BAM 308 million for the revised Strategy for the Return of Refugees and Displaced Persons; the Agency for Statistics of BiH asked for around 36 million for the population census, and the Ministry of Defense wanted around BAM 5 million for equipment. In addition to these requests, in the total value of BAM 352 million, which could not be funded within the framework of the Draft Budget due to lack of funds, another BAM 11 million is needed for retired soldiers pursuant to the adopted Law on Amendments to the Law on the Armed Forces (these funds were not formally included in the request submitted by the Ministry of Defense). Therefore, the total requests for which funding could not be provided in the Draft Budget amount to BAM 363 million.

It is necessary to point out that the Ministry of Finance and Treasury of BiH, together with the budget beneficiaries at this level of government, had to exert great efforts in order to prepare the Draft Budget of the Institutions of BiH so that the level of expenditure would remain the same as in 2010, especially considering the fact that new state institutions will be established due to EU integration, and existing institutions will be given new obligations that cannot be successfully fulfilled without sufficient funds (the same conclusion was also reached by the European Commission in its Progress Report on Bosnia and Herzegovina).

When preparing the budget for 2011, the Ministry of Finance and Treasury of BiH was guided by the following priorities:

1. Developing state functions related to fulfilling the *European Partnership* requirements;
2. Adapting the programmes and activities of the Ministry of Defense and other relevant ministries involved in realizing Bosnia and Herzegovina's membership in the Partnership for Peace (PfP) and NATO accession;
3. Retaining hiring at the level of the budget approved for 2010, due to the limited fiscal framework of the institutions of BiH, except in the case of the following institutions (the total number of new employees approved and provided for in the 2011 budget is greater by

336 employees compared to the number of new employees planned and provided for in the 2010 budget):

- a. the Ministry of Defense has been approved employment of a minimal number of soldiers (99 new employees compared to the approved 2010 budget), considering the fact that in the 2010 budget the number of employees provided for was substantially less than in 2009 (pursuant to the decisions of the Presidency of BiH and BiH's international obligations),
 - b. the Directorate of Civil Aviation of Bosnia and Herzegovina (40 new employees compared to the approved 2010 budget), which in 2010 accepted 23 employees from the Federal Directorate of Civil Aviation and the RS Directorate of Civil Aviation, and in 2011 must fund an additional 17 employees that will work in the newly established company, that is the Agency for Provision of Aviation Services BiH,
 - c. judicial institutions in the part concerning the transfer of funding from foreign sources to the budget of the institutions of BiH, or in the part that concerns employees that are still financed through donations, which are shown in the budget for 2011 as coming from the Treasury's Single Account (of which 49 are employed in the HJPC),
 - d. the Agency for Statistics, which received approval for hiring a minimum of 13 persons, necessary for preparing the implementation of the population census,
 - e. the Audit Office, in accordance with the Law on the Auditing of the Financial Operations of the Institutions of BiH (9 new employees),
 - f. new institutions that have pressing responsibilities relating to EU integration have been granted approval for the hiring of a minimal number of new employees in 2010 and 2011 (97 new employees in the Directorate for the Coordination of Police Bodies, 9 new employees in the Central Harmonisation Unit and 15 new employees in the Anti-Corruption Agency).
4. Securing a part of the funds necessary for multi-year investments of budget beneficiaries;
 5. Securing reserve funds for new budget beneficiaries.

In accordance with the above conclusions of the Fiscal Council and the Letter of Intent, the Draft Budget for 2011 is at the 2010 level (BAM 1 028 million), notwithstanding funds for GSM licenses, which are planned for in the budget annex, not the State budget. However, due to the fact that according to IMF's GFS methodology, revenue from GSM licenses and accompanying expenditures (transport infrastructure capital expenditures) needs to be displayed in the fiscal tables of the institutions of BiH, expenditures in the Draft Budget for 2011, drafted in accordance with GFS methodology, are greater by BAM 16 million than the expenditures of the institutions of BiH for 2010. The reason for this seeming increase is that in 2011 GSM operators will, for the first time in BiH, be charged for licences for Universal Mobile Telecommunications Systems (UMTS). Funds received from those licenses will, pursuant to the decision of the Council of Ministers and Entity governments, continue to be used for Corridor Vc, but also for the development of the telecommunications sector in BiH (therefore, this does not concern only the expenses of the State level of government). The specific purposes of this additional planned transfer of funds that GSM operators are depositing for licences issued for Universal Mobile Telecommunications Systems in 2011 are as follows:

- Participation in financing the preparations for, construction and supervision of the Svilaj inter-state bridge,
- Drafting of planning and design documentation for the Gradiška inter-state bridge,
- Participation in financing the preparations and construction of the Bijača border-crossing,
- Participation in financing preparations for the construction of the Gradiška border-crossing,
- Participation in financing preparations for the construction of the Svila border-crossing,

- Drafting of planning-study documentation for the BiH section of the Adriatic–Ionian motorway,
- Telecommunications sector development – the specific purpose will be determined by special decision of the Council of Ministers at the proposal of the Ministry of Communications and Transport of Bosnia and Herzegovina.

By way of restrictive measures, the planned expenditures for 2011 were reduced by around BAM 500 million compared to the requests of the budget beneficiaries. Despite the restrictive measures stipulating employment limits and the approval of only absolutely essential material and capital expenses in the Draft Budget of the Institutions of BiH, significant growth of planned revenues from indirect taxation is projected in the Draft Budget of the Institutions of BiH for 2011, to be specific, an increase of BAM 191 million is projected, which is 28% more than in 2010.

Hence this increase in the requested funds for the financing of the institutions of BiH from the Single Account of the Indirect taxation Authority in 2011 compared to 2010 is not due to increased expenditures, but is a result of the fact that the following funds (in the total amount of BAM 191 million) were available to the institutions of BiH for revenue and financing in 2010, and such funds will not be available in 2011:

- BAM 121 million surplus carried over from previous years,
- BAM 40 million that were initially planned to come from the budget support credit (the Fiscal Council later issued a decision allocating BAM 20 million of the total macrofinancial assistance funds to the institutions of BiH),
- BAM 13 million decline in direct revenues of the institutions of BiH,
- BAM 17 million received from succession.

In accordance with the above, revenues of the institutions of BiH from indirect taxes for 2011 in the Draft Budget of the Institutions of BiH for 2011 are established as the difference between the minimum level of the expenditures of the institutions of BiH on the one hand (level of expenditures in the 2010 budget), and own revenues of the institutions of BiH on the other hand.

What follows is an explanation of the assumptions of the policies on the basis of which the expenditures of the institutions of BiH were planned in the Draft Budget of the Institutions of BiH for 2011 (excluding the above explained funds received from GSM licenses and the accompanying capital expenditures, which are planned in budget annexes) and a comparison with the 2010 budget.

Gross wages are larger than in 2010 by BAM 1 162 000, that is 0.2%. The change in gross wages compared to the adopted budget for 2010 was influenced by the following:

- The hiring freeze, keeping employment at the level of the budget approved for 2010, resulting from the limited fiscal framework of the institutions of BiH (the total number of hirings approved in the 2011 budget is greater than the number of hirings planned in the 2010 budget by 334 employees):
- Decreased gross wages at the Ministry of Defense compared to 2010, which are a result of the discharging of soldiers (restriction due to age limit) during 2010 and 2011, as well as the retirement of military personnel (high-ranking) pursuant to the Law on Service in the Armed Forces of BiH. When compared to the approved number of employees in the budget for 2010 it is apparent that as at 31 December 2010 the number of employees is lesser by 627 persons. Furthermore, 222 military personnel are planned to be discharged in 2011. Taking the above facts into account, as well as the fact that the Ministry of Defense, in order to fill military positions with younger soldiers, planned to hire 948 persons, of which 900 would be soldiers, the number of employees in the Ministry of Defense is greater by 99 persons than the number of employees approved and provided for in the 2010 budget.

Employee expense reimbursements in 2011 are less than in 2010 by BAM 1 628 000, that is, 1%. The drop in the amount of employee expense reimbursements planned within the scope of current expenditures was mainly influenced by the strengthening of discipline of beneficiaries regarding the planning of funds, which, as a result of the strengthening of the capacities of the Ministry of Finance and Treasury, is the consequence of a stricter approach to planning reimbursements, especially extraordinary reimbursements, that was taken even by the larger budget beneficiaries.

When comparing total material expenses a 4% increase is apparent in the 2011 budget compared to the 2010 budget (increase of BAM 8 783 000), which is in most part due to the increase in current operating expenses, which are greater than in 2010 by 45%, that is BAM 9 848 000 (due to the BAM 8 879 000 increase of such expenses for the Ministry of Defense, which was necessary as the majority of funds and equipment is inherited, old and deteriorated, and this increases maintenance expenses, and also considering that the issues of surplus arms and military equipment and non-prospective sites have still not been resolved, hence expenses continuously increase, especially for services of repair and maintenance of: aviation equipment, electrical power devices, demining equipment, telecommunications, IT and office equipment, and vehicles), and the increase in energy and utility expenses in the amount of BAM 3 537 000, which is 20% more than in 2010 (due to the BAM 2 110 000 increase of such expenses for the Ministry of Defense, resulting from the planning of ISAF expenses that were previously financed by donors and the financing of expenses of non-prospective sites where the installation networks are outdated, and also due to the increase of the BAM 623 000 of such expenses in the Ministry of Foreign Affairs caused by changes in the foreign currency exchange rate and the rise of prices of energy-generating products in countries in which Bosnia and Herzegovina has diplomatic missions or consulates). On the other hand, within the framework of material expenses, the transportation and fuel expenses planned for 2011 are less by BAM 5 412 000, that is 27%, compared to 2010, which is a result of the decrease in such expenses in the Ministry of Defense by BAM 6 271 000 caused by the fact that the Ministry of Defense planned for the transport of employees of the Ministry of Defense and the Armed Forces of BiH in the 2010 budget under material expenses, while in the 2011 budget the transport of employees is provided for under employee expense reimbursements.

If we compare total current grants, in the budget for 2011 they amount to BAM 15 838 000 and have decreased by BAM 34 640 000, that is 69%, and this is due to the fact that in the 2011 budget the amount of BAM 3 233 000 was planned for the grant "The Return of Refugees and Displaced Persons" (concerning electrification urgently needed in areas of accomplished return), while in the 2010 budget a total of BAM 38 233 000 was approved for those purposes. Namely, BAM 311 353 000 were requested for the 2011 budget for these purposes, but only the amount of BAM 3 233 000 for the electrification required for realised return (on the basis of the Decision of the Council of Ministers of BiH) was covered in the budget. The remaining BAM 308 120 000 were not included in the budget in view of the fact that a detailed assessment of funds required for compensation of damages was not performed within the framework of the adopted Strategy (although it was included in the Strategy, but no amounts were specified) and considering the fact that the adopted Strategy also did not define the source of funds for return (only the total required funds for return were specified). At the meeting held between representatives of the Ministry of Finance and Treasury, the Return Fund and the Ministry of Human Rights and Refugees it was agreed that the Ministry of Human Rights and Refugees, in cooperation with the Commission and Fund for Return, should develop a detailed Action Plan for the financial implementation of the Strategy, specifying the sources of funds for return and compensation for property (including funds spent to-date, as well as funds secured in previous years and the current year that have remained unspent, while the sources of funds for the coming period should be defined, including funds from the budgets of all levels of government, donations, loans), which would be adopted by the Council of Ministers of BiH, and possibly the relevant entity organs. Within the framework of the Action Plan it is necessary to define, in detail, a long-term mechanism for planning and implementing grants for Return (including funds for compensation of damages in the future) and grants for electrification.

When comparing total capital expenses, an increase of 4% as compared to 2010 (BAM 2 696 000 increase) is noticeable, and it comes as a result of efforts to improve the quality of public finances at the level of the institutions of BiH, that is, efforts to increase the amount of capital investments in the budget.

Apart from the above explained capital investments that are financed using funds received from GSM licenses, the multi-year projects listed in the Draft Budget of the Institutions of BiH for 2011 include multi-year capital investments (public investments) in the amount of BAM 31 709 000, planned as follows:

- BAM 2 000 000 for the Ministry of Defense of BiH for the projects Network Information Systems (1 200 000) and Tactical Communications Systems (BAM 800 000)
- BAM 1 000 000 for the High Judicial and Prosecutorial Council for computerisation and strengthening the capacities of judicial institutions in Bosnia and Herzegovina
- BAM 2 900 000 for the Ministry of Foreign Affairs for purchasing buildings in the network of diplomatic missions and consulates (Ljubljana)
- BAM 5 900 000 for Indirect Taxation Authority for the construction of regional headquarters (BAM 4 700 000 for the construction of regional headquarters in Sarajevo, Tuzla, Banja Luka and Mostar, and BAM 1 200 000 for the construction of border crossings in accordance with Schengen standards)
- BAM 245 000 for the Ministry of Justice for reconstruction of the building currently being used by the Special Police of the Federation of BiH for the purpose of relocating the Prosecutor's Office of BiH
- BAM 1 000 000 for the Ministry of Security for establishing an operational-communications center - 112)
- BAM 3 000 000 for the Border Police of BiH for construction of Field Office buildings (Field Office South - Čapljina, Field Office West - Bosansko Grahovo and Field Office North-West - Gradiška)
- BAM 350 000 for the Ministry of Civil Affairs for Spatial Data Infrastructure in BiH - Phase I Establishing a Network of Permanent GPS (GNSS) Stations BiH-BIHPOS
- BAM 2 260 000 for the Agency for Identification Documents, Registers and Data Exchange of BiH for the project SDH Transmission System
- BAM 754 000 for the Central Election Commission for the project The Development of a Unified Election Information System in Bosnia and Herzegovina
- BAM 4 500 000 for the Intelligence and Security Agency (BAM 2 000 000 for the purchase of special equipment, BAM 1 500 000 for renewing the vehicle fleet and BAM 1 000 000 for the renovation and equipping of the building "Zrak")
- BAM 4 200 000 for the Service for Foreigners' Affairs, of which BAM 3 800 000 for construction of the main headquarters of the Service and the field center in Sarajevo, and BAM 400 000 for construction of the Center (shelter) for housing foreign nationals that are victims of human trafficking (the project for the construction of the Centre for housing foreign victims of human trafficking was till now a part of the multi-year projects of the Ministry of Security of BiH)
- BAM 3 600 000 for the Agency for the Education and Professional Training of Staff for the procurement of land and the construction of the Agency building.

Debt level and developments

Bosnia and Herzegovina's total external debt as at 30 September 2010 was BAM 5 776.3 million, which is 20,61% of the estimated GDP for 2010. Compared to the situation at the end of 2009, the external debt has increased by 11.1% due to disbursement of instalments under the Stand-By Arrangement and the disbursement of uncommitted funds provided under signed agreements. The status of uncommitted funds based on external debt, as at 30 September 2010 was BAM 2 288 201.161, that is, 26.04% compared to the total agreed credit arrangements that amount to

BAM 8 788 048 864. The above amounts do not include debt obligations directly contracted by the Entities, but only credits granted to the State. The status of uncommitted funds based on external debt as at the above date, including debt obligations directly contracted by the Entities, is BAM 2 288 216 807, that is 25.61% compared to the total concluded arrangements, which amount to BAM 8 935 570 760.

In the structure of the external debt, under new borrowings, the largest amount pertains to obligations towards respectable multilateral financial institutions, such as the WB, IMF EIB, EBRD. By signing and using the Stand-By Arrangement in the sectoral structure of credit use there was an increase in the use of credits for public consumption. However, new credits for financing infrastructure works, energy, agriculture, public works and employment, health, education and structural reforms serve to confirm the commitment of BiH authorities to, with regard to borrowing, conduct a sectoral policy that supports growth and development. The majority of Bosnia and Herzegovina's debt was contracted in the most commonly used world currencies: EUR, USD, SDR (Special Drawing Rights) and CPU (Currency Poll Unit).

Projections for the repayment of external debt are based on known indicators and contracted credit conditions. The external debt service projections include reserves of 5% that would cover risks related to the floating interest rate, changes in foreign exchange rates, repayment of interest rates on the basis of taking out new credits and new allocations of old debt.

External debt liabilities service plan

External debt obligations service plan									
in 000 BAM									
Description	2011			2012			2013		
	Interests and			Interests and			Interests and		
	Principal repayment	service costs	Total	Principal repayment	service costs	Total	Principal repayment	service costs	Total
Liabilities of BiH	256 560	111 266	367 826	300 464	149 087	449 551	591 911	148 951	740 862
<i>Of which for the Federation of BiH</i>	158 707	72 543	231 250	189 544	96 752	286 296	387 569	97 113	484 682
<i>O/w for Republika Srpska</i>	94 864	37 430	132 294	107 826	50 613	158 439	200 579	49 823	250 402
<i>O/w for Brčko District</i>	0	122	122	51	145	196	720	142	862
<i>O/w for State institutions</i>	2 989	1 171	4 160	3 043	1 577	4 620	3 043	1 873	4 916
Debt of BiH	3 457	3 286	6 743	5 064	3 379	8 443	5 757	3 327	9 084
<i>Of which for Federation of BiH</i>	3 457	3 036	6 493	3 005	2 783	5 788	3 005	2 707	5 712
<i>O/w for Republika Srpska</i>	0	250	250	2 059	596	2 655	2 752	620	3 372
Total	260 017	114 552	374 569	305 528	152 466	457 994	597 668	152 278	749 946

The majority of credits (ca. 90%) are being repaid in EUR and USD, while a relatively small number of credits are being paid off in other currencies (certain countries of the Paris Club, credits from bilateral agreements, etc.). Compared to the planned values, the servicing of external debt liabilities in 2010 was carried out in a somewhat lesser amount due to the slow disbursement of pre-approved funds, as well as the lower interest rates of floating-rate credits.

Estimate of external debt for the reference period

	2008	2009	Estimate	Forecast		
			2010	2011	2012	2013
External debt	4 194	5 199	6 000	7 769	7 875	7 470
% GDP	15%	18.6%	20.3%	25.7%	24.1%	21%

Future developments in the area of external debt are characterised by:

- Settling unallocated debt toward Italy on the basis of the Paris Club.

- Activities on the realisation of credit contracts under approval and u procesu odobravanja the realisation of credit contracts under preparation.
- The fulfilment of the requirements for activating the remaining instalments under the IMF Stand-By Arrangement

In the above table showing external debt projections a strong increase (33%) of external debt compared to the status of external debt as at 30 September 2010 is noticeable. This is due to the fact that the deadline for the disbursement of uncommitted credit funds, for most projects, is in 2011 and the above projections do not include a scenario that involves an extension of the time limit for the disbursement of the remaining uncommitted credit monies.

Projects under approval

Projects that are in the process of being approved include projects regarding which negotiations with creditors are underway, projects that are being considered for approval by creditors and the relevant domestic institutions as provided by law, as well as projects that have been agreed and are in the process of being ratified.

The total value of credit financed projects under approval, including multilateral and bilateral creditors, as at 30 September 2010 is EUR 622.04 million. This refers to projects in the fields of railway and utility infrastructure, energy, health, agriculture, banking, social policy and employment, as well as planned budget support and institutional strengthening projects, and the total number of projects is 22.

It is important to point out that in addition to the above-mentioned credit financed projects, 4 grants in the total value of EUR 6.86 million and two framework agreements with Germany and Austria in the total value of EUR 177.8 million, are in the process of being agreed.

Of the above projects, 8 projects, with a planned value of EUR 244.49 million, are currently in the final stages of ratification, which is significant to note in view of the fact that those funds will soon be available.

The greatest portion of the above amount is covered by the European Investment Bank (EIB) with EUR 150.0 million, that is, 24.11 % of the total amount of planned credit funds. EIB is currently funding two projects in Republika Srpska: the Water and Sanitation Project with EUR 50.0 million and the new Republika Srpska Hospitals Project with EUR 100.0 million, which is in the initiative phase.

The European Bank for Reconstruction and Development (EBRD) follows with EUR 120.0 million, that is 19.29 %, for five projects. EBRD provided a EUR 50.0 million creditline to the Deposit Insurance Agency of BiH aimed at increasing deposit insurance coverage, which will contribute to strengthening the financial sector, restoring the confidence of savings depositors in the banking sector, all in the aim of mitigating the consequences of the global economic and financial crisis. The contract was signed in January 2010 and is currently in the final phase of ratification. A guarantee for the Sarajevo International Airport Project in the amount of EUR 25.0 million was agreed in March 2010. The guarantee for the Bijeljina Phase II - Wastewater Treatment Plant project, in the amount of EUR 5.0 million, is in the process of being ratified. With regard to guarantees it is also important to point out that an EBRD grant, intended for the drafting of by-laws in the above-specified field, is also in the process of approval. Also pending signing is the Sarajevo Canton Water and Wastewater Project in the amount of EUR 30.0 million, while the Amendment to the Regional Railway Project in the amount of EUR 10.0 million, was signed on 1 October 2010.

Also in the process of being agreed is a loan from the European Union in the amount of EUR 100.0 million, that is 16.08 %, which is planned for Macro-Financial Assistance (MFA) to Bosnia and Herzegovina and is in compliance with the Stand-By Arrangement agreed with the International

Monetary Fund (IMF). As significant progress has been made in the reforms specified and provided for under the Stand-By Arrangement, a Memorandum of Understanding on Macro-Financial Assistance was signed in early November.

The World Bank is currently participating with USD 126.0 million, that is, 14.88 %. Most of those funds, specifically USD 111.0 million, are for budget support and include a 66 million credit from IDA sources (International Development Association) and a 45 million loan from IBRD sources (International Bank for Reconstruction and development), which is the first development policy loan (DPL-1) as part of the planned three-year budget support, and which accompanies the agreed Stand-By Arrangement with the IMF. It was signed and agreed and will come into force on 1 October 2010, and then use of the funds will be possible. The other is the Social Protection and Employment project, with USD 15.0 million from IDA, which was signed and agreed, and is expected to take effect on 7 October 2010, which is also when the funds will become spendable.

In 2010, under the Cooperation Framework Agreement with the Republic of Austria, the realisation of several projects, in the amount of EUR 25.0 million and an additional EUR 50.0 million, was initiated. The realisation of an additional amendment with the Republic of Austria, as a result of which a further EUR 45.0 million will be provided, was also initiated.

Among the individual projects financed under the cooperation framework, 7 projects in the total value of EUR 27.62 million, that is, 4.44 %, are currently in the process of being agreed and signed. The most important are the Project of procurement of medical equipment for the Cantonal Hospital Orašje with EUR 2.2 million which has been agreed and is currently in the process of being ratified, and the Gradiska Water Supply Project in the amount of EUR 2.48 million, which is in the process of being agreed.

In relation to the projects concerning the Clinical Center of the University in Sarajevo and the «Dr. Abdulah Nakaš» Hospital in the amount of EUR 3.23 million, the General Hospital in Nevesinje in the amount of 2.4 million, the University in Banja Luka in the amount of 6.0 million, the University in East Sarajevo in the amount of 7.0 million, and the Hospital in Goražde in the amount of 4.3 million euro, an initiative was adopted, and as a result conditions for negotiations were created, depending on the willingness of the Austrian party.

In the field of bilateral cooperation it is essential to mention cooperation with the Federal Republic of Germany in 2005, 2006, 2007 and 2008, and financial cooperation in the year 2009 that includes EUR 120.0 million credit funds and EUR 12.8 million to replace debt III, as well as that negotiations were successfully completed and the Agreement is in the process of being approved by the national institutions. It is important to note that the above financial cooperation is conducted under a Cooperation Framework, while the realisation of certain projects using the said funds will follow in cooperation with the German Development Bank (KfW). The projects being financed under the Cooperation Framework with Germany and implemented through KfW are listed in tables A and B.

Next is the German Development Bank KfW with EUR 71.0 million and 1.0 million grant funds, that is 11.41%, for the Windpark Mesihovina project, which was agreed in February 2010 and is currently in the final stages of ratification.

The OPEC Fund for International Development is participating with USD 13.0 million, that is 1.54 %, of which USD 7.0 million is for the Housing Reconstruction Project, which is in the final stages of agreement, and signing is expected soon. The Rural Livelihood Development Project in the amount of USD 6.0 million has been agreed and signed and is currently in the process of being ratified.

The Council of Europe Development Bank (CEB) is participating through the Construction of the State Prison Project with EUR 19.3 million. The project was signed and agreed at the end of June 2010 and is in the process of being ratified.

With regard to bilateral cooperation with Spain, implementation of the Talgo Trains project in Republika Srpska, in the amount of EUR 32.0 million, and regarding which an initiative was adopted, has begun.

Projects under preparation

This category includes projects under preparation as well as projects planned by domestic institutions and project beneficiaries, as well as creditors. According to information received to-date, the total value of projects that are under preparation is estimated at **EUR 689.50 million**. The above amount covers the financing of projects in the field of infrastructure, energy, SME development, agriculture, health, environmental protection, the social sector, and budgetary support.

The most significant portion of the above funds will be provided by the European Investment Bank - estimated at approximately EUR 485.0 million, most of which is funding for the construction of phase II of Corridor Vc, specifically the amount of EUR 205.0 million, as well as funding for renewable sources of energy – windmills and hydroelectricity in Mostar (West Balkan Energy Efficiency Fund Project) in the amount of EUR 170.0 million, financing of small and medium-scale projects carried out by SMEs in the Federation of BiH in the amount of EUR 50.0 million, and providing funds for the Emergency Flood Relief and Prevention Project in Republika Srpska in the amount of EUR 60 million.

Implementation of several projects in the planned amount of EUR 137.0 million is planned in cooperation with the German Development Bank (KfW). Also planned is the realisation of approved funds from previous cooperation with the Federal Republic of Germany for the SCADA project in the amount of EUR 11.0 million credit funds and EUR 6.0 million grant funds. Other projects funded by KfW include the Energy Sector Programme IV project in the amount of EUR 70.0 million, the Hydroelectric Power Plant Cijevna III Project in the amount of EUR 50.0 million, and participated in the funding of the Hydroelectric Power Plant Trebinje III Project with EUR 6.0 million credit funds and EUR 4.0 million grant funds. It is also important to mention the replacement of debt III, the condition for which is the implementation of the Framework Agreement signed with the Federal Republic of Germany for 2009.

The World Bank follows with budget support BiH for the period 2010-2011, for which an amount has not yet been specified, and the Sava Waterway Rehabilitation Project, as well as an additional healthcare project.

Next is the European Bank for Reconstruction and Development (EBRD) with a planned total of EUR 55.0 million, of which 45.0 million euro for the Sarajevo Roads Project and 10 million euro for the Plava Voda Zenica - Regional Water Supply Project.

It is planned that in the coming period the following projects will be realised in cooperation with the Saudi Fund for Development: the Zenica Bypass project, the Sustainable Refugee Return project and the construction of the Srebrenik municipality building.

According to the Cooperation Framework Agreement signed with Austria, several projects concerning the procurement of medical equipment and the modernisation of hospitals, as well as projects on solid waste and wastewater disposal, will be implemented.

In the coming period, the OPEC Fund for International Development (OFID) could finance the following two projects: the Mostar Bypass project and Tuzla Canton Education project.

However, it is important to note that the attached table in which projects under preparation are listed is only a framework, and therefore, changes are possible in respect of which projects will be financed, as well as changes to the amount of funding for individual projects, depending on the willingness of creditors.

Internal debt

The internal debt of Bosnia and Herzegovina includes the debt of the entities and Brčko District. The settling of internal debt liabilities is regulated by Entity laws and the Brčko District law. Internal debt remains a complex issue as a part of the internal debt liabilities remain subject to verification (old foreign currency savings, war claims, general liabilities), even though another part of the debt has still not been regulated by law (restitution), and therefore, internal debt management is (still) based on assumptions on the amount of debt.

According to the data of the Ministry of Finance and Treasury of BiH, the internal debt of Bosnia and Herzegovina as at 30 June 2010 is BAM 2 987 659 62831.

Internal debt of Bosnia and Herzegovina as at 30 June 2010

Status of the internal debt of Bosnia and Herzegovina as at 30 June 2010					in BAM
Claims	Total	Federation of BiH	Republika Srpska	Brčko District	State institutions
General liabilities	185 994 196	13 654 196	172 340 000	-	-
Old foreign currency savings	1 716 775 432	1 017 774 765	631 480 000	67 520 667	-
War claims	1 065 900 000	500 000 000	565 900 000	-	-
Liabilities to funds, municipalities (tax refunds)	18 990 000		18 990 000		
					-
Total	2 987 659 628	1 531 428 961	1 388 710 000	67 520 667	

Scheduled internal debt service of BiH in the period 2010-2013 (in BAM millions)

Type of claims	2010			2011			2012			2013		
	P	I	Total	P	I	Total	P	I	Total	P	I	Total
General liabilities	5.00	1.45	6.45	3.00	1.00	4.00	0.50	0.20	0.70	0.16	0.05	0.21
Old foreign currency savings	129.98	12.08	142.06	146.21	12.14	158.35	137.34	11.49	148.83	109.78	8.07	117.85
War claims	0.00	6.54	6.54	0	7.27	7.27	0	7.27	7.27	0.00	7.27	7.27
Total:	134.98	20.07	155.05	149.21	20.41	169.62	137.84	18.96	156.80	109.94	15.39	125.33

³¹ Data provided by the entity ministries of finance and the Brčko District Finance Directorate

Planned status of internal debt of BiH³²

(BAM million)

	2010	2011	2012	2013
Claims				
General liabilities	181.66	178.66	178.16	177.99
Old foreign currency savings	1 618.35	1 470.99	1 345.71	1 254.96
War claims	1 068.83	1 069.83	1 068.83	1 068.83
Total	2 868.84	2 718.48	2 592.70	2 501.78

The Law on Settlement of Debts Arising from Old Foreign Currency Savings („Official Gazette of BiH“ nos. 28/06,76/06 and 72/07) sets out a single method to be used in the entire country for settling this type of debt. In view of the circumstances that arose, the Entities and Brčko District regulated debt arising from old foreign currency savings in entity laws, that is, a law at the level of Brčko District, with different deadlines and debt amortisation models. Old foreign currency savings make up 58% of the internal debt (excluding restitution). The method of settling other internal debt categories (general liabilities, war claims) is also regulated by entity legislation and the settlement of debt through the issuing of bonds is provided for.

The latest data on confirmed claims, excluding cash payments, show significantly less amounts compared to the earlier projected amounts for all categories of internal debt. However, there remains a high degree of uncertainty regarding the final amount of internal debt of BiH, especially in view of the increasing number of tužbi and enforceable judicial decisions, which further increase the level of uncertainty. The matter of restitution has still not been regulated by law. Namely, activities on the passing of the law, which were being carried out at entity levels, have been suspended by decision of the High Representative. Activities related to the preparation of a Draft Law on Denationalisation at the state level are underway. Laws and regulations at State level must ensure the economic and fiscal sustainability of Bosnia and Herzegovina, including both entities and Brčko District, and that the proposed solutions are based on the common interests of Bosnia and Herzegovina, the Entities and Brčko District. It is planned that it will be possible to resolve the issue of restitution using any one of the following three methods: natural restitution, substitutional restitution and financial or monetary compensation, while fiscal sustainability will be a consideration with regard to financial compensation.

Institutional characteristics of public finances

Since 2005 the State, Entity and canton authorities have been implementing public finance reform. The three primary objectives of the reform are as follows:

1. Harmonisation of budget calendars and technical budget planning processes at all levels of government in BiH,
2. Introduction of medium-term budget planning,
3. Improve the link between the allocation of budgetary funds and government priority policies and the country's economic and social objectives.

The **first objective** of harmonising budget calendars and procedures within the framework of the budget cycle has been fulfilled and since 2005 the so-called “10-Step Budget Planning Process” has been applied at all levels of government.

The **second objective**, that is, the introduction of medium-term budget planning, has also been fulfilled and since 2005 the institutions of BiH, the Federation of BiH (for all levels of government in the Federation, including municipalities, funds and cantons), RS (for all levels of government,

³² Note: the end-of-year debt status is based on the assumptions of the entity ministries of finance and the Brčko District Finance Directorate

including municipalities and funds), and in recent years the Brčko District also (also including the Fund), have been preparing Budget Framework Papers, which cover a three-year period. And therefore, for example, in the summer of 2010 Budget Framework Papers for the period 2011-2013 were prepared at all levels of government. These Budget Framework Papers represent preliminary drafts of the annual budgets for 2011 (that were prepared in Autumn of 2010), together with the framework plans for the next two years.

The aim of Budget Framework Papers is to establish long-term priorities and increase the reliability of budget planning, which is of particular importance in the context of investment planning. Budget Framework Papers include medium-term macroeconomic projections, medium-term fiscal projections, an overview of budget priorities, an overview of expenditure management (according to economic categories, programmes, institutions and functional sectors), and an overview of the public debt status and projections.

The **third objective** of public finance reform, which is being carried out within the framework of the DFID-funded project “Strengthening Public Finance Management” project, is to better link the allocation of budgetary funds to government priority policies and the country’s economic and social objectives. This will be achieved through the implementation of programme budgeting that is based on the objectives and results of the activities of budget beneficiaries.

Programme budgeting is the most complex, yet most important objective of this reform, and its introduction took almost a decade even in some of the most developed countries. In the regional context, Bosnia and Herzegovina can be considered as advanced in the field of programme budgeting. In essence, programme budgeting is in fact budget planning based on the performance of taxpayers invested funds. Programme budgeting displays budget information in a manner that clearly links budget resources to the policy outcomes the government wishes to achieve.

Simply put, programme or results-based budgeting is the process of allocating funds for specific objectives and/or results that are expected to be achieved using the invested funds. Budget beneficiaries need to step away from the traditional budget planning process that allocates funds on the basis of inputs (estimate funds according to economic categories) and instead estimate funds on the basis of policy objectives and desired outcomes. In this budget cycle significant progress was made in that respect compared to previous years.

A programme is a group of similar services or activities undertaken by budget beneficiaries with a common strategic or operational objective. It enables budget beneficiaries to determine what actions they need to take to realise their objectives and achieve desired results. In traditional budgeting, decisions on budget allocations are made on the basis of inputs – amounts required for wages, material expenses, etc. In programme budgeting this information is also collected, but decisions on the allocation of funds are based on policy objectives and expected results.

Budget beneficiaries are required to define their strategic objectives (that is, define what their institution is aiming to achieve), establish programmes aimed at achieving those objectives and their operational objectives, determine required funds – sorted by economic classification, and define performance indicators and target levels in order to determine to what extent the objectives have been achieved (including outputs, outcomes and efficiency).

In addition to the Draft Budget of the Institutions of BiH for 2011, the Ministry of Finance and Treasury of BiH, pursuant to the Amendments to the Law on Amendments to the Law on the Financing of the Institutions of BiH, also submitted a review of the requests of budget beneficiaries, sorted according to programme classification, which is intended as additional information for the Council of Ministers of BiH and the Parliamentary Assembly of BiH to be used when adopting the 2011 budget.

Seeing as the principle of programme budgeting has only just been introduced in BiH, the quality of information submitted by beneficiaries is still not at an optimal level, particularly as regards the measuring of programme work results and performance. The beneficiaries of the budget will need several years to create databases, before that they will not be able to fully and accurately measure the effects and results of their activities. In coming years, further improvement of the quality of information submitted by budget beneficiaries at all levels of government in BiH is expected, especially in terms of defining and measuring the performance and cost-effectiveness of the programmes and activities of the budget beneficiaries – the institutions of BiH.

Due to the complexity of the aspect of reform that requires the introduction of the principle of programme budgeting in full, and the fact that in the next phase the ministries of finance will require additional technical assistance (which will be provided through IPA projects), and that the next phase of reform requires full implementation of the information system (GBMIS, which is being implemented through the Public Administration Reform Coordinator's Office, and funded through the Public Administration Reform Fund, including EC funds), and also considering the fact that it will take the budget beneficiaries several years to establish databases, the full introduction of programme budgeting, that is, the adoption of budgets in a programme format, should be implemented in the medium-term period (2014/2015). Furthermore, financial reporting (in accordance with the Stand-By Arrangement) has been improved.

In addition to the above-stated progress achieved with regard to programme budgeting and financial reporting, under the Letter of Intent agreed by the Fiscal Council of BiH with the IMF, it is planned that in the coming period the quality of public finances should be further improved by improving the quality of statistical data in the part involving transactions related to projects that receive foreign funding, and the introduction of accrual accounting in all government institutions (in accordance with EU standards). As part of efforts aimed at resolving these problems, technical assistance is provided by the IMF regional advisor for the purpose of completing the transition to GFS 2001 reporting standards and further decreasing any overstepping of reporting deadlines. With that purpose in mind, the Fiscal Council of BiH (according to the Letter of Intent) plans to establish a working group that will offer recommendations and propose guidelines and a schedule (time line) for the application of international accounting standards for the public sector and other international financial reporting standards, including a harmonised template for financial reporting, at all levels of government in BiH.

In 2009 in Bosnia and Herzegovina, the implementation of another complex reform that will significantly contribute to the improvement of the quality of the public finances system began – the establishment of Public Internal Financial Control (PIFC). The primary objective of this reform is to strengthen managerial accountability in the public sector at all levels. And that will be achieved through the implementation of a series of internal control and internal audit procedures, but also encouraging change in public administration culture that is focused on demanding that all activities be cost-efficient, efficient and effective, while at the same time maintaining full conformity with the law. Public Internal Financial Control (PIFC), based on recognised standards and good European practice, look at the entire integrated system that was established by the Council of Ministers of BiH and the entity governments, with the aim of controlling and auditing budgetary funds and EU funds, ensuring harmonisation with laws and regulations, as well as cost-efficient, effective and efficient management of public funds (state funds and EU funds), and also ensuring transparency in order to facilitate the controlling of such funds.

The PIFC framework includes all measures necessary for controlling all public revenues and expenses, and ensures the best possible management of funds and liabilities and encompasses all internal control systems and procedures in public institutions and helps create a secure environment

for public funds in order to enable that they be used in the manner as provided by law. PIFC consists of the following elements:

- financial management and control,
- functional independent internal audits, and
- harmonisation and coordination function in the form of “Central Harmonisation Units”.

The current project, which is financed using IPA funds, is focused on the harmonisation and coordination functional through the establishing and strengthening central harmonisation units in the Entity ministries of finance and at the State level, as well as the establishing and strengthening of functional independent internal audit units. Bearing in mind that the ultimate objectives of the reform are to enable the central harmonisation units to develop procedures and audit trails for Financial Management and Control (FMC), the development of risk assessment methodology that will be used by Entity and State institutions, analysis of the function of internal audit units and FMC within institutions, the coordination and provision of adequate training for the PIFC managerial structure and employees in Entity and State institutions, and the reporting on the development of the system, common weaknesses, and necessary measures and enhancements, and considering that the established independent internal audit units will perform independent, professional and systematic assessments of the financial management and control system established by the management, it is certain that this reform will require multi-year work and IPA assistance.

Since financial management and control, as an element of the PIFC system, covers the entire system of financial and other types of controls, including organisational structure, methods and procedures that do not apply only to financial systems, but also to the operational and strategic systems of the budget beneficiaries, supports managerial (administrative) accountability, and includes five interconnected components (control environment, risk management, control activities, information and communication and supervision/monitoring), in the coming period, IPA projects need to be focused on this element of the PIFC system considering the fact that the primary objective of PIFC reform is the strengthening of managerial accountability in the public sector across all levels.

With regard to improving the quality of public finances, in the future particular attention will be dedicated to the strengthening of public finance statistics. The IPA-funded project of support to economic and fiscal policy, the implementation of which should begin in the first quarter of 2011, is aimed at assisting ministries of finance (state and entity level) and the Brčko District Finance Directorate to enable the provision of reliable and inter-institutionally harmonised data on public finances on the basis of accrual accounting and in accordance with internationally recognised, and in particular, EU principles, standards and practice.

The main results of this project are focused on producing public finance statistics in accordance with the ESA95 Code, the establishment and development of a sustainable mechanism for cooperation between user institutions in producing the said statistics, amendments to the law on accounting, the preparation of accounting standards and reporting standards for reporting to the public sector, the preparation of methodology and instructions for producing public sector statistics, as well as the development and implementation of a training curriculum covering all essential aspects of fiscal statistics production.

Fiscal risks

The realisation of macroeconomic and fiscal projections could be susceptible to the effects the following factors:

- ***Slowdown of EU economic recovery*** – the economy of Bosnia and Herzegovina belongs to the group of small open economies and is highly susceptible to global market shifts, and is therefore extremely vulnerable to outside shocks. The projected gradual recovery and revival of BiH’s economy is directly dependant on the economic recovery of BiH’s trading

partners in the EU and region, and therefore any slowing of economic recovery in the EU and region would have a negative impact on the economy of BiH.

- **General uncertainty and insecurity** - economic recovery in the EU and region, and thereby also in BiH, could be undermined by the still present and growing general insecurity and uncertainty regarding the possibility that the crisis will deepen and a false bottom will occur. The most recent developments in the EU, resulting from the state of Greece's economy and the fear that other countries (Portugal, Spain, Ireland) might end up with the same problems may destabilise the prospects of wider regional growth and slow down economic recovery in the EU.
- **Situation in the banking sector** – as a result of the CBBiH's policy of mandatory reserves, the liquidity risks of banks in BiH caused by withdrawals of deposits have been decreased and stabilised. However, the losses incurred by banks and the increase in non-performing credits resulting from the decline in disposable income of the population, and the slow pace of BiH's economic recovery, hindered access to foreign capital, as well as general insecurity, have influenced changes to credit policy in the sense of establishing stricter terms and conditions for granting credits for financing domestic consumption. the insufficient supply of capital and burden of non-liquid funds indicate that crediting restrictions imposed by the banking sector will remain in place for some time yet. The contraction in investment activities due to reduced access to credits can slow the revival of BiH's economy.
- **Reduced aggregate demand** – As the economy of BiH is characterised by a consumer growth model, it is highly dependant on the status of aggregate demand. Public consumption makes up a substantial part of aggregate demand, and its restriction, which is necessary in order to sustain the fiscal position, if not compensated by structural reforms aimed at strengthening private enterprises, can lead to reduced aggregate demand and the slowing of growth.
- **Changes in tax policy** – Changes in tax policy in terms of increasing taxes and wage contributions, which are being implemented in Republika Srpska for the purpose of stabilising revenue, may result in increased evasion and unemployment, and thereby put further pressure on social transfers and destabilise the prospects of fiscal consolidation.
- **Natural disasters** – the prospects of the consolidation of public finances in Bosnia and Herzegovina will be significantly influenced by the floods that caused immense material damage both to the population of the regions affected by the floods and the economy.

3.5. The Federation of Bosnia and Herzegovina

Fiscal strategy and medium-term objectives

The economic crisis that affected the Federation of Bosnia and Herzegovina in 2008, had a direct effect on the fall in exports and domestic consumption. The fact that the revenues of the Federation of BiH decreased as a result of such trends, points to the necessity of applying a cautious fiscal policy aimed at limiting and cutting down public consumption.

For the purpose of preserving macroeconomic stability, Bosnia and Herzegovina signed a Stand-By Arrangement with the International Monetary Fund (IMF) in the amount of EUR 1.2 billion for a period of three years, of which EUR 800 million is for the Federation of Bosnia and Herzegovina. During negotiations with the IMF, the authorities of Bosnia and Herzegovina composed a Letter of Intent in which the Government of the Federation of Bosnia and Herzegovina undertook significant obligations in terms of reducing public consumption during the period covered by the arrangement. Specifically, fiscal policy on consumption in the Federation of BiH is based on the following:

- Principles contained in the revised Letter of Intent addressed to the IMF under the Stand-By Arrangement,
- The Law on the Method for Realizing Savings in the Federation of BiH,

- macroeconomic projections,
- revenue projections.

Continued restrictive public consumption at all levels is one of the priorities of economic policy for 2011-2013, with the primary objective of maintaining a stable fiscal system and control of consumption. During this period the Government of the Federation of BiH will also operate with limited fiscal capacity due to the effects of the global financial and economic crisis that has left a trace on BiH's economy, and the further worsening of the existing payments deficit and fiscal imbalance in the country – which directly effects the Federation of Bosnia and Herzegovina. It will therefore be necessary to: (i) strengthen fiscal policy in order to reduce the government's need for funding from the foreign or domestic banking sector and improve medium-term fiscal sustainability; (ii) restrict wages in the public sector; (iii) undertake structural fiscal reforms with the aim of reforming the social benefits system; and (iv) promote other structural reforms that will preserve competitiveness by redirecting public consumption to capital investments and development expenditure. In order to realise such a fiscal framework, it is of key importance that the Fiscal Council acts and works responsibly at the level of Federation of BiH. This is especially significant in view of the administrative complexity of the Federation of BiH, which includes a central level of government, cantons and municipalities.

This approach is reflected in the policies described in the revised Letter of Intent, as well as in the proposal for a Global Framework for Fiscal Balance and Policies in the Federation of BiH for the period 2011 to 2013, and as such they are of crucial importance for achieving the objectives of the economic programme of the Federation of BiH, including guidelines concerning fiscal policy, the proposed fiscal objectives of the budget, and macroeconomic projections in the Federation of BiH.

Medium-term revenue and consumption projections

Medium-term projections for revenue were developed on the basis of projections for tax and non-tax revenues of the budget of the central government of the Federation of BiH, cantons and municipalities, the projections of the Macroeconomic Analysis Unit based on indirect revenues and the Federal Ministry of Finance for 2011–2013.

The displayed projections of indirect tax revenues were not adopted by the Fiscal Council, and may be amended in accordance with the final conclusions of the Fiscal Council.

What follows is the projection of total revenues, consumption, net debts, interest expense, and the primary balance for the broader government of the Federation of BiH:

	2010	2011	2012	2013
Total revenue	6 647.8	6 708.8	7 152.2	7 601.7
Total consumption	7 017.0	6 983.8	7 216.6	7 326.5
Net debts	-369.2	-275.0	-64.4	275.2
Interest expense	119.0	100.4	131.0	126.1
Primary balance	-217.7	-250.1	-174.7	66.5

Detailed projections are provided in the Annex.

It is also important to mention the consolidated debt of the Federation of BiH, which is significantly larger than it was the previous year. The repayment of debt and interests planned for 2011 is BAM 462.7 million (which is a 31.5% increase compared to the 2010 budget), while in 2012 that amount will be BAM 484.4 million and in 2013 it will be BAM 608.5 million. This growth is the result of increased repayment of external debt in the amount of BAM 22.2 million, the planned 1/3 repayment of confirmed debt towards the Federal Institute for Pension and Disability Insurance for the payments of pensions earned under more favorable terms (according to the Conclusion of the

Government of FBiH V. no. 367/2010), and increased internal debt repayments in the total amount of BAM 12.6 million.

The quality of public finances

Pursuant to the Letter of Intent addressed to the International Monetary Fund in relation to the Request for Approval of the Stand-By Arrangement, the Federation of Bosnia and Herzegovina made a commitment to improve the quality of fiscal statistics, with an ultimate goal to develop consolidated reports harmonised with IMF's methodology of Government Finance Statistics. The process of advancing the quality of fiscal statistics should contribute to better openness and transparency in reporting on fiscal operations of the governments and strengthening financial discipline at all levels of management when it comes to the public funds entrusted to them. It is expected that the process of full harmonization with international standards will gradually progress in the coming period. In the initial phase the focus will be on the improvement of the scope of fiscal statistics at all government levels including lower levels in both entities, as well as on ensuring regular and timely reporting at all levels of government in BiH, including the Federation of BiH, and the transparency and publishing of consolidated reports. For the purpose of improving the implementation and adherence of laws, the Government of the Federation of BiH established a centralised system for the registration, control and collection of taxes and contributions.

Institutional characteristics of public finances

In connection to the obligations that the BiH authorities undertook to fulfil by way of the Letter of Intent mentioned in the previous chapter, the Fiscal Council established the Group for the Coordination of Fiscal Statistical Data for Monitoring the Implementation of the Stand-By Arrangement in October 2009.

The global economic crisis has had a negative impact on the financial discipline of indirect taxpayers. The problem of maintaining current liquidity of taxpayers who regularly submit their VAT forms, which occurred at the end of 2008, became more serious in 2009. Although the level of debts as per reported but unpaid VAT is low when compared to other countries (2.5% of net paid VAT for nine months in 2009), in order to maintain the level of public revenues and increase efficiency of VAT collection, the Indirect Taxation Authority (ITA) set rules for the application of a special scheme (withholding tax regime) for taxpayers withholding VAT. The implementation of the special scheme for debtors started in mid-2009. At the same time, ITA intensified its efforts in the segment of forced collection of indirect taxes and issued instructions related to seizure and sale of debtors' property.

Public debt

The total external and internal debt of the Federation of BiH, determined pursuant to the Law, as at 30 September 2010 is **BAM 5 117.75 million**, of which **BAM 3 657.50 million** is external debt and **BAM 1 460.25 million** is internal debt (estimated). The total debt of the Federation of BiH, as compared to confirmed liabilities, is **BAM 4 398.08 million**.

Status of debt of the Federation of BiH as at 30 September 2010 (in BAM million):

Year (dd/mm/yyyy)	GDP	Debt status (pursuant to the Law)			Debt-to-GDP ratio			Debt status (after confirmation)		Debt-to-GDP ratio	
		External debt	Internal debt (Law)	Total	Total	External debt	Internal debt	Internal debt (confirmed liabilities)	Total	Total	Internal debt
	1	2	3	4 (2+3)	5 (4:1)	6 (2:1)	7 (3:1)	8	9 (2+8)	10 (9:1)	11 (8:1)
30.09.2010	18 700	3 657.50	1 460.25	5 117.75	27.37%	19.56%	7.81%	726.97	4 389.47	23.45%	3.89%
31.12.2009	15 886	3 308.50	1 533.27	4 841.77	30.29%	20.28%	10.01%	574.96	3 883.46	24.45%	3.62%

31.12.2008	13 855	2 901.64	1 589.41	4 491.05	32.41%	20.94%	11.47%	860.3	3 761.94	27.15%	6.21%
31.12.2007	13 855	2 456.71	1 639.58	4 096.29	29.57%	17.73%	11.83%				
31.12.2006	11 826	2 553.00	2 031.00	4 584.00	38.76%	21.59%	17.17%				

This status of the debt of the Federation of BiH also includes debt that was passed on to end users in on the basis of subsidiarity. Excluding the debt of end users, who are obliged to make payments on debt arising from credits, the status of the debt of the Federation of BiH as at 30 September 2010 (in BAM million) is given in the following table.

Year (dd/mm/yyyy)	GDP	Debt status			Debt-to-GDP ratio			Debt status (after verification and excluding debt transferred to end-users)			Debt-to-GDP ratio		
		External debt of FBIH (excluding the debt of end users)	Internal debt (Law)	Total	Total	External debt	Internal debt	External debt of FBIH (excluding the debt of end users)	Internal debt (confirmed liabilities)	Total	Total	External debt	Internal debt
	1	2	3	4 (2+3)	5 (4:1)	6 (2:1)	7 (3:1)	8	9	10 (8+9)	5 (10:1)	6 (8:1)	7 (9:1)
30.09.2010	18 700	2 644.10	1 460.25	4 104.35	21.95%	14.14%	7.81%	2 644.10	726.97	3 371.07	18.03%	14.14%	3.89%
31.12.2009	15 886	2 551.72	1 533.27	4 084.99	25.71%	16.06%	10.01%	2 551.72	574.96	3 126.68	19.68%	16.06%	3.62%
31.12.2008	13 855	2 344.50	1 639.58	3 984.08	28.76%	16.92%	11.83%	2 344.50	860.3	3 204.80	23.13%	16.92%	6.21%

Despite the fact that repayment of the internal debt of the Federation of BiH arising from liabilities to suppliers and employees of the former Federal Ministry of Defense and the Army of the Federation of BiH is planned to be completed by the end of 2010, and in view of the dynamic of issuing enforceable court decisions, the debt will not be settled within the planned deadline.

The status of internal debt as at 30 September 2010, in relation to estimated (established pursuant to the Law) liabilities, is **BAM 1 460 253 003**:

Debt	Total debt	Method of payment	Paid – by year					Principal paid Total	Debt status pursuant to the Law
			do 2006	2007	2008	2009	2010		
Suppliers	25 000 000	Judicial decisions	4 536 446	561 486	524 338	154 537	4 632	5 781 439	
		Invitation	0	7 964 423	3 843 049	0		11 807 473	
		TOTAL	4 536 446	8 525 909	4 367 387	154 537	4 632	17 588 912	7 411 088
Military wages		Judicial decisions	9 500 000	3 655 332	2 107 957	1 041 952	310 735	16 615 976	
	37 500 000	Public invitation	0	12 978 288	1 761 817	0	24 455	14 764 560	
		TOTAL	9 500 000	16 633 620	3 869 774	1 041 952	335 190	31 380 536	6 119 464
Old foreign currency savings *	Liabilities established pursuant to the Law: BAM 1 150 000 000;	Cash up to BAM 1000	6 168 813	35 980 495	1 662 152	6 132 761	15194663	49 944 221	
		up to BAM 100	0	0	177 658	55 035	3138	232 693	
		Unissued bonds	0	0	30 198 206	0	0	30 198 206	
		Judicial decisions	0	0	0	0	21 761	21 761	
		Bonds payable	0	0	0	50 224 612	57 458 600	50 224 612	
		TOTAL	6 168 813	35 980 495	32 038 016	56 412 408	72 678 162	130 621 493	946 722 451
claims **	Liabilities established pursuant to								

	the Law: BAM 500 000 000;	TOTAL	0	0	0	0	0	0	500 000 000
	OVERALL TOTAL		20 205 259	61 140 024	40 275 177	57 608 897	73 017 984	179 590 941	1 460 253 003

Internal debt as at 30 September 2010, in relation to confirmed liabilities, is **BAM 726 966 419**:

Debt	Total debt	Method of payment	Paid – by years					Principal paid Total	Debt status after verification
			Up till 2006	2007	2008	2009	2010		
Suppliers	25.000.000	Judicial decisions	4 536 446	561 486	524 338	154 537	4 632	5 781 439	
		Invitation	0	7 964 423	3 843 049	0		11 807 473	
		TOTAL	4 536 446	8 525 909	4 367 387	154 537	4 632	17 588 912	7 411 088
Military wages		Judicial decisions	9 500 000	3 655 332	2 107 957	1 041 952	310 735	16 615 976	
	37 500 000	Public invitation	0	12 978 288	1 761 817	0	24 455	14 764 560	
		TOTAL	9 500 000	16 633 620	3 869 774	1 041 952	335 190	31 380 536	6 119 464
Old foreign currency savings*	Confirmed: BAM 709 783 416	Cash up to BAM 1000	6 168 813	35 980 495	1 662 152	6 132 761	15194663	49 944 221	
		up to BAM 100	0	0	177 658	55 035	3138	232 693	
		Unissued bonds	0	0	30 198 206	0	0	30 198 206	
		Judicial decisions	0	0	0	0	21 761	21 761	
		Bonds payable	0	0	0	50 224 612	57 458 600	50 224 612	
		TOTAL	6 168 813	35 980 495	32 038 016	56 412 408	72 678 162	130 621 493	506 505 867
War claims**	Confirmed: BAM 206 930 000								
		TOTAL	0	0	0	0	0	0	206 930 000
	OVERALL TOTAL		20 205 259	61 140 024	40 275 177	57 608 897	73 017 984	179 590 941	726 966 419

The following liabilities were settled on the basis of court decisions:

- to suppliers: BAM 5 781 439
- for military wages and compensations: BAM 16 615 976 and
- for old foreign currency savings: BAM 21 761.

Bonds are used to settle debts arising from old foreign currency savings and war claims. By 30 September 2010 liabilities (principal) to account holders of old foreign currency savings in the amount of BAM 50 224 612 were settled using bonds.

The following liabilities were settled by cash payments:

- to suppliers (public invitation): BAM 11 807 473,
- for military wages and compensations: BAM 14 764 560 and
- old foreign currency savings: BAM 80 375 120, of which BAM 49 944 221 for up to BAM 1 000, BAM 30 198 206 on the basis of unissued bonds in 2008, and BAM 232 693 for up to BAM 100.

Even though bonds were issued for the settlement of liabilities arising from war claims, and in view of the set grace period of 9 years, principal repayment was not made by 30 September 2010. As the Constitutional Court of BiH, pursuant to the European Court of Human Rights judgement in the case of Čolić et al. vs. BiH, ordered the Government of the Federation of BiH to fulfil its constitutional

obligations and ensure the protection of human rights by undertaking appropriate legal measures to ensure that all creditors that possess enforceable judicial decisions at the expense of FBiH budget funds receive payment for their claims as soon as possible, all valid final judicial decisions will have to be paid in accordance with those judicial decisions.

Accordingly, it is expected that in the coming period all claims arising from such judicial decisions will be paid (in accordance with the dynamic set by the Government of the Federation of BiH). According to currently available data, the liabilities of the Federation of BiH arising from enforceable decisions amount to BAM 15.24 million, of which BAM 11.75 million is included in already issued bonds. It is necessary to provide BAM 3.10 million in the budget of the Federation of BiH for the purpose of settling liabilities arising from valid final judicial decisions, although judicial decisions that are not yet valid and final also exist (in the amount of BAM 2.10 million). Since old foreign currency savings are settled following the completion of the process of verification of old foreign currency savings accounts, on the basis of past experience concerning verifications carried out in the Federation of BiH it is reasonable to expect that the total claims in the Federation of BiH will be less than the projected BAM 1 150 000. **The total debt of cantons** (arising from credits) is 196.67 million, while potential liabilities arising from guarantees amount to BAM 30.60 million, while the debt of **municipalities** (arising from credits) is BAM 87.26 million, and their potential liabilities arising from guarantees amount to BAM 38.05 million (based on data submitted by 29 October 2010). Annual repayment of debts of cantons is within the limits set in the Law on Debt, Borrowings and Guarantees in the Federation of BiH (debt service in the current year cannot be more than 10% of the revenues from the previous year). **The debt of cities** (arising from credits) only refer to the debt of the City of Mostar, which is **BAM 14.52 million**, while the potential liabilities arising from guarantees amount to BAM 1.36 million (Attachment 5). The status of the external debt of public **enterprises** the majority owner of which is the Government of the Federation of BiH, as at 30 September 2010 is **BAM 657.68 million**.

3.6. Republika Srpska

In the coming period, the implementation of fiscal reforms will be continued. Through fiscal policies concerning revenues the funds required for financing public needs, with an emphasis on the social aspect, will be secured. At the same time extremely rigorous measures will also be implemented, and they will be aimed at reducing avoidance of fiscal responsibilities and expanding the coverage of taxpayers, that is, increasing fiscal discipline. In addition, the Government of Republika Srpska analysed all of the direct and indirect effects of the reduction of tax rates of direct taxes in the previous period and performed a detailed check of the realisation of planned objectives that should have been realised through the aforementioned reduction of tax rates, and conducted an analysis of the rates of contributions at the request of extra-budgetary funds. Based on the above-mentioned analyses, amendments to the Law on Income Tax and the Law on Contributions were proposed and adopted for the purpose of further strengthening the economic, fiscal and social stability of Republika Srpska. The proposed corrections and fiscal adjustments relating to income should decrease the amount of credit funds necessary for financing public needs in the future.

As of 1 January 2009 the calculation of income according to the gross principle began and a single income tax rate of 8% was introduced. By starting to calculate income according to the gross principle, the business environment in Republika Srpska became comparable to that in the region. If we compare the income tax rate with the rates of other countries in the region, and in Europe, it is apparent that RS has the lowest income tax rate. Due to all of the above, the Government of Republika Srpska proposed, and the National Assembly of Republika Srpska adopted the Amendments to the Law on Income Tax. As a result of the amendments non-taxable income was abolished, taxes on paid dividends and capital profit were introduced, and the income tax rate was increased from 8% to 10%. When comparing the contributions rates in Republika Srpska, which now

totals 30.6%, with the rates of countries in the region, it becomes obvious that the contributions rates in Republika Srpska are among the lowest in the region. As a result of all of the above, and taking into account the justified requests for increasing the rates of contributions for the purpose of sustaining the social policy and the status of socially vulnerable populations, the Government of Republika Srpska proposed, and the National Assembly of Republika Srpska adopted the Amendments to the Law on Contributions, and therefore, the total rate will be 33.0% on gross wages, of which 18.0% will be set aside for pension and disability insurance, 12.5% for health insurance, 1.5% for child protection and 1.0% for unemployment insurance.

In this year, amendments were made to the Law on Games of Chance. Application of this Law to-date has revealed the need for further regulating this field, and therefore, new types of betting games that are organised via SMS were introduced, procedural issues within the framework of inspection and supervision were better regulated, and fines for committed offenses were increased. Expectations that the said amendments will result in the growth of fees for organising games of chance, as well as the increase of collected fines, which in certain cases were increased from BAM 1 000 to BAM 5 000 and from BAM 1 500 to BAM 7 500, were justified, as in the first 11 months of this year revenues increased by 30.5% compared to the same period of the previous year. It is also expected that additional revenue will be made in the next year on the basis of awarding concessions for organising games of chance in casinos.

By way of application of the Law on Fiscal Cash Registers, which stipulates the obligation of registering turnover of goods and services using fiscal cash registers, efforts are made to realise the aims of this Law, which are the regulation of the market in Republika Srpska, reduction of illegal cash flows in goods and services transactions, the suppression of grey economy and disloyal competition, increasing fiscal discipline and ensuring more efficient control of tax revenues. The effects of this Law were noticeable even during 2010, through the apparent increase in turnover in retail sales and through the increase of final consumption in Republika Srpska, which is shown in VAT forms. The process of "fiscalisation" in the coming period will be focused on the controlling of the issuing of fiscal bills and increasing penalty provisions.

The charging of taxes for immovables at the market value of immovables will begin on 1 January 2012, at a rate that will be determined by the assemblies of municipalities and cities, and it will be in the range of 0.05-0.5%. Until then tax on immovables will be charged in accordance with the Law on Property Tax, that is, based on the surface area of immovables. One of the reasons for postponing the application of new law was, above all else, to enable entrepreneurs to get through the economic crisis as painlessly as possible. The new law allows for the reduction of the base rate for tax on all immovables that are in fact the residence of the taxpayer, and that further relieves some of the taxpayers burdens compared to the existing Law on Property Tax. In the next year activities will be carried out on the finalisation of the process of establishing a Fiscal registry of immovables and the establishment of a model for assessing the market value of immovables, also activities will be undertaken regarding the appropriate involvement of the municipalities in order to increase their involvement in the taxation of immovables. Also, through amendments to the Law on the Tax Authority of Republika Srpska it is necessary to improve the taxation procedure and rationalise all processes that are the responsibility of the Tax Authority of Republika Srpska. Particular attention will be devoted to procedures for the forced collection of taxes, improvement of procedures for controlling adherence to the law and accuracy of calculating and paying public revenue (concession fees, fees for organising games of chance, property tax, etc.), the consistency of tax records (tax cards), rationalisation of the procedure for small taxpayers and small tax amounts, the timely recording of all types of tax forms.

PUBLIC EXPENDITURES

The Government of Republika Srpska has devoted particular attention to the analysis of expenditures as set out in the budget. The aim of the Government of Republika Srpska was to examine the to what

extent the spending of certain budget beneficiaries was reasonable and justified and ensure the more efficient and more effective distribution of limited budget funds in the coming period, which will be steered to projects that will maximise their „use value“ and thereby contribute to the longterm development of Republika Srpska.

PUBLIC DEBT

The Law on Borrowings, Debt and Guarantees of Republika Srpska (“Official Gazette of Republika Srpska” nos. 30/07 and 29/10) thoroughly regulates the extremely important matter of short-term and long-term indebtedness and the issuing of guarantees by Republika Srpska and the municipalities, as well as the methods and procedures for borrowing, which together with the existing laws in the field of the budgetary system, form an integral legal framework for improving and controlling budget discipline, and decreasing the risk of over-indebtedness. In addition, through the establishment of clear quantitative and qualitative borrowing criteria, conditions are in place for bodies and organisations, as well as their heads, to take on the responsibility for debts. Also, a legal framework was established for debts based on the issuing of securities (debt securities), issued by Republika Srpska and the municipalities, which is already present in practice and is imperative for the further development of the financial market.

As a result of the adoption of the Law on Establishing and the Manner of Settling of Internal Debt of Republika Srpska (“Official Gazette of Republika Srpska” no. 7/10 – consolidated text), the Law on Settlement of Debts Arising from Old Foreign Currency Savings (“Official Gazette of BiH” broj: 28/06, 76/06 i 72/07) and the Law on the conditions and method of settling debt arising from old foreign currency savings by issuing bonds in Republika Srpska (“Official Gazette of Republika Srpska” no.1/08), the conditions were created for covering and reviewing debts from the previous period, a strategic approach to settling those obligations was provided, and thereby, budget stability was achieved. The regulation of this field and the successive settlement of debts contributes to increasing the confidence of both citizens and investors, and to a better business environment and credit rating. The policy of the Government of Republika Srpska requires the timely servicing of accrued debt, as well as debt from previous periods. Bearing in mind that in the previous period the estimated liabilities arising from internal debt were confirmed and registered, in 2010 activities on settling those obligations by the issuance of bonds were still ongoing. In 2011 the practice of verifying, recording and settling debt will continue. Accordingly, the payment of liabilities using budget funds, as well as privatisation and succession funds from specific-purpose accounts (escrow accounts) is a priority.

Total debt of Republika Srpska as at 31 Decmber 2009 and 30 September 2010

Total debt of Republika Srpska as of 31 December 2009 and 30 September 2010			
Stanje duga	31.12.2009	30.09.2010	Index
	BAM million		
External debt - Budget of Republika Srpska	1 857.6	2 052.1	110.5
Internal debt - Budget of Republika Srpska	1 421.9	1 350.2	95.0
Municipalities and extra-budgetary funds	218.0	308.5	141.5
Total debt of RS	3 497.5	3 710.8	106.1
	U %		
External debt – Budget of Republika Srpska	53.1%	55.3%	
Internal debt - Budget of Republika Srpska	40.7%	36.4%	
Municipalities and extra-budgetary funds	6.2%	8.3%	
Total debt of RS	100.0%	100.0%	

Source: The Ministry of Finance of Republika Srpska

The cooperation of Republika Srpska with international financial institutions (IMF, World Bank, EBRD, EIB, KfW and others) is intensive and will continue in the coming period. The external debt is regularly settled and there are no accrued, outstanding liabilities. In the following table external debt service in the period 2007-2011 is shown.

External debt service in the period 2007-2011

DESCRIPTION	2008	2009	2010	2011
	BAM million			
Interest	43.3	38.9	31.0	38.4
Principal repayment	47.2	58.1	80.0	76.6
Total	90.5	97.0	111.0	115.0

Source: The Ministry of Finance of Republika Srpska

The internal debt of the Budget of Republika Srpska as at 31 December 2009 was BAM 1 421.9 million, and as at 30 September 2010 was BAM 1 350.2 million. A total of BAM 209.3 million was settled in cash as at 30 September 2010, and a bond in the amount of BAM 488.5 million was issued. In addition to the above amount of BAM 209.3 million, bonds payable were settled in the amount of BAM 118.2 million (BAM 106.1 million principal repayment and BAM 12.1 million interest repayment). In 2011 the verification of internal debt and successive issuing of bonds will continue for all types of internal debt. Also continuing in 2011 is the repayment of internal debt according to adopted action plans for liabilities arising from enforceable judicial decisions regarding general unpaid budget liabilities accrued by 31 December 2002 and the repayment of liabilities arising from enforceable judicial decisions regarding old foreign currency savings accounts. The primary risks arising from the internal debt projections are:

- possible changes in provisions of laws that would regulate the obligation of settling internal debt using a method different to those provided for in the existing laws, and thereby making planning and controlling of repayment impossible,
- potential liabilities arising from the resolution of the problem of restitution, and which would be the obligation of the budget of Republika Srpska.

The servicing of the internal debt of the Budget of Republika Srpska

DESCRIPTION	2008	2009	2010	2011
<i>- BAM million -</i>				
Interest and other expenses	5.4	7.5	5.6	7.4
Principal repayment	23.4	46.9	56.4	85.6
Total	28.8	54.4	62.0	93.0

Source: The Ministry of Finance of Republika Srpska

The internal debt of municipalities and extrabudgetary funds as at 31 December 2009 was BAM 218.0 million, and as at 30 September 2010 it was BAM 308.5 million. The internal debt of municipalities and extra-budgetary funds is the debt arising from borrowings from commercial banks within the country and from the issuing of bonds. The debt service for municipalities and extrabudgetary funds for 2011 is shown in the following table.

The servicing of the debt of municipalities and extrabudgetary funds in 2011

DESCRIPTION	2011
<i>- BAM million -</i>	
Interest and other expenses	19.4
Principal repayment	71.8
Total	91.2

Source: The Ministry of Finance of Republika Srpska

Analysis of the sustainability of the public debt of Republika Srpska

	2005	2006	2007	2008	2009	2010	2011
GDP	5 763.0	6 544.0	7 351.0	8 489.0	8 223.0	8 445.0	8 850.0
External debt service – RS Budget	90.0	104.6	93.5	90.5	90.0	111.0	115.0
Internal debt service – RS Budget	26.8	57.2	71.4	28.8	54.4	62.0	93.0
Debt service of municipalities and funds							91.2
<i>Total debt service</i>	116.8	161.8	164.9	119.3	144.4	173.0	299.2
External debt status - RS Budget	1 689.6	1 584.8	1 544.7	1 612.7	1 857.6	2 305.0	2 383.0
Internal debt status duga - RS Budget	1 635.4	1 578.8	1 508.0	1 484.6	1 421.9	1 350.2	1 271.4
Debt status of municipalities and funds					218.0	308.5	283.4
Status of total debt	3 325.0	3 163.6	3 052.7	3 097.3	3 497.5	3 963.7	3 937.8
Total debt service / GDP	2.0%	2.5%	2.2%	1.4%	1.8%	2.0%	3.4%
Status of total debt / GDP	57.7%	48.3%	41.5%	36.5%	42.5%	46.9%	44.5%
Export of goods and services	1 130.5	1 540.2	1 671.6	1 921.8	1 672.9	2 208.0	2 415.0
External debt service / Exports	8.0%	6.8%	5.6%	4.7%	5.4%	5.0%	4.8%
External debt status / Exports	149.5%	102.9%	92.4%	83.9%	111.0%	104.4%	98.7%
Regular revenues gained	1 011.0	1 202.0	1 364.0	1 507.0	1 319.0	1 312.0	1 351.0
Debt service (internal and external government debt) / regular revenues gained in the previous year		16.0%	13.7%	8.7%	9.6%	13.1%	15.9%

Source: The Ministry of Finance of Republika Srpska

In the above table the projected status of the external debt for 2011 is displayed, and it is based on the amount of disbursed funds which is increased by the estimated disbursements credit funds, and reduced by the estimated external debt service amount. The amount of for the disbursement of credit funds was arrived at with the assumption that the majority of approved credit funds will be disbursed within the period of time planned for the implementation of the projects. By observing macroeconomic indicators and debt indicators for the period 2005-2011 it is obvious that the sustainability of the public debt of Republika Srpska is at a satisfactory level. On the other hand, taking into account the current world economic crisis, and the resulting possibility of stagnation of GDP and revenues of the Budget of Republika Srpska, as well as the fact that the settling of long-term liabilities (arising from international agreements, financing agreements, decisions on the issuing of bonds,...) is a priority, a greater amount of budget funds can be committed, but caution still needs to be exercised with regard to future debts, and in terms of contracting new debts under more favourable terms, adjusting the liability repayment schedule to the amount of revenues

expected in the coming years, selecting priority projects for which Republika Srpska would take on new debt, and selecting end users that are capable of repaying credits.

3.7. Brčko District

The tax system in Bosnia and Herzegovina and the taxation policy still exist at both State and local levels. Revenue from both levels flows to the budget of Brčko District of BiH. The State is responsible for customs duties, value-added tax, excise duties and road fees from oil derivative prices (indirect taxes), while Brčko District of BiH is responsible for all other taxes: income and profit tax, wage taxes, games of chance tax, as well as the property tax that was introduced in 2009. Brčko District of BiH is also responsible for prescribing, administering and collecting non-tax revenues, revenues arising from obligations, taxes and various benefits.

Projected total public revenue in Brčko District of BiH for the period 2011- 2013 (consolidated) Type of revenue	Realised	Planned	Forecast		
	2009 BAM	2010 BAM	2011 BAM	2012 BAM	2013 BAM
I Tax revenues	147 809 470	152 609 000.00	148 793 800	157 144 200	165 509 700
Indirect tax revenue	130 474 129	137 236 000.00	133 570 800	141 484 200	149 849 700
Direct taxation revenue	17 335 341	15 373 000.00	15 223 000	15 660 000	15 660 000
II Non-tax revenues	37 138 875	40 516 600.00	37 233 720	37 161 170	37 159 270
III Current grants	1 010 138	2 529 670.00	40 000	35 000	30 000
IV Extra-budgetary funds	27 698 581	24 564 922.00	24 399 489	24 149 489	24 149 489
Health Insurance fund	24 018 916	21 404 922.00	21 651 489	21 401 489	21 401 489
Employment Institute	3 679 665	3 160 000.00	2 748 000	2 748 000	2 748 000
TOTAL PUBLIC REVENUE I+II+III+IV	213 657 064	220 220 192.00	210 467 009	218 489 859	226 848 459
V FINANCING	1 770 918	8 262 368.30	0	0	0
TOTAL PUBLIC REVENUE I+II+III+IV+V	215 427 982	228 482 560.30	210 467 009	218 489 859	226 848 459

It is possible to conclude that it is expected that Brčko District will keep up with the fiscal income trends and the positive GDP growth trends in Bosnia and Herzegovina.

As regards public consumption, the situation is as follows:

Consolidated overview of the planned total public consumption in Brčko District of BiH for the period 2011-2013

DEPARTMENT/INSTITUTION	Realised 2009	Planned 2010	Estimate		
			2011	2012	2013
I TOTAL - DEPARTMENTS AND INSTITUTIONS	173 753 713.72	203 917 638.30	186 067 520.00	194 340 370.00	202 698 970.00
Health Insurance fund	24 018 916.00	21 404 922.00	21 651 489.00	21 401 489.00	21 401 489.00
Employment Institute	3 679 665.00	3 160 000.00	2 748 000.00	2 748 000.00	2 748 000.00
II TOTAL - EXTRA-BUDGETARY FUNDS	27 698 581.00	24 564 922.00	24 399 489.00	24 149 489.00	24 149 489.00

TOTAL - PUBLIC CONSUMPTION IN BRČKO DISTRICT OF BiH	201 452 294.72	228 482 560.30	210 467 009.00	218 489 859.00	226 848 459.00
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4. STRUCTURAL REFORM OBJECTIVES

4.1. The privatisation process in the Federation of Bosnia and Herzegovina

ENTERPRISE SECTOR

Slowed growth of real GDP, pronounced current account deficit, liabilities arising from social benefits at the expense of development, the general overburdening of public consumption, non-liquidity, poor credit lines, corruption, etc. result in weak microeconomic and macroeconomic indicators, which in turn results in diminished interest for domestic and foreign investments in BiH. The global financial crisis severely affected countries with under developed market mechanisms, among which is BiH, and as a result the interest of domestic, and especially foreign investors was diminished for all forms of investment. Due to the above, privatisation is established as an inevitable process. In actual fact, it is an economic-political process that, besides the offer of privatisation, requires numerous economic and political preconditions for the creation of an environment that appeals to investors, especially in strategic terms. In addition to the global financial crisis, other objective reasons that significantly affected overall privatisation and post-privatisation results include the up till now used method of mass privatisation using certificates (as means for purchasing property and state-owned) granted to BiH citizens, as well as entity privatisation and the decentralised privatisation system in the Federation of BiH.

It is important to point out that one of the possible ways to reduce the budget deficit is the realisation of monetary effects through the sale of state-owned.

RESULTS OF THE PRIVATISATION PROCESS TO DATE

The Agency for Privatisation in the Federation of BiH created a register of 1450 enterprises with a valid amount and structure of capital as at 31 December 1999.

- total capital of 1450 enterprises with state-owned shares: BAM 18.720 billion
- state-owned capital: BAM 17.3 billion
- private capital: BAM 1.4 billion
- BAM 13.5 billion planned for privatisation, of which BAM 6.3 billion for privatisation through public offering of shares
- ca. BAM 3.8 billion is planned to remain in state ownership

Results of privatisation as at 30 November 2010 broken down by the number of enterprises:

- Number of enterprises in Agency register - 1450
- Privatisation process initiated for 1371 enterprises (93.9%) – 0.66% more than in 2009
- 273 enterprises privatised using the small-scale privatisation method – 1.11% more than in 2009
- 351 enterprises privatised by tender procedure as part of large-scale privatisation – 1.52% more than in 2009
- 747 enterprises fully or partially privatised through public offering of shares –
- Privatisation completed for a total of 1075 enterprises – 5.2% more than in 2009
- under the conditions of small-scale privatisation a total of 2526 items were sold – 1.85% more than in 2009

After updating the privatisation register ca. 380 companies remain. That number could increase as a result of certain public institutions being reclassified as enterprises (for example, pharmacies, spa treatment centers, certain electronic media, culture and sports institutions...)

Results of privatisation as at 30 November 2010 broken down by values of capital:

- State-owned capital planned for privatisation	BAM 13.5 billion
- Privatised state-owned capital and property	BAM 5.632 billion
- Revenue gained in certificates	BAM 8.485 billion
- Revenue gained in cash	BAM 0.531 billion
- Capital that has not been privatised	BAM 7.9 billion.

The Government of the Federation of BiH passed a conclusion adopting the Development Strategy for the Federation of BiH for the period 2010-2020.

**PLAN FOR THE SALE OF ENTERPRISES AND PROPERTY
IN THE FEDERATION OF BIH IN 2011**

**THE SELLING OF ENTERPRISES
Sale by tender or direct negotiation**

No.	Enterprise	Total capital	State-owned capital (%)	Privatisation activities
1.	Aluminij d.d. Mostar	170 786 051 (status as at 31.12.2005)	75 145 862 (44.00)	- Decision of the the Government of the Federation of BiH no.482/10, of 1 June 2010, declaring the tender for selling 88% of <i>Aluminij's</i> capital unsuccessful - Annex 8 proposal for settling unresolved issues between the Government of the Federation of BiH and <i>Aluminij</i> and extending the agreement duration till 8 November 2011. - carry out necessary preparations of the enterprise and conduct the sale of 88% of its capital
2.	Hidrogradnja d.d. Sarajevo	70 734 263 (2009)	47 391 956 (67.00)	-develop and adopt the updated PP and PBS and repeat the sale of 67% of state-owned capital by the method of direct negotiation - the economic-financial situation in the enterprise has significantly worsened, and therefore diminished interest and lower offers compared t the previous sale are expected
3.	Energoinvest d.d. Sarajevo	220 721 250 (status as at 30.06.2006)	147 897 500 (67.00)	Update IM and other tender documentation
4.	Šipad export-import d.d. Sarajevo	12 544 125 (2009)	8 350 287 (66.56)	- by end-2010, the selected audit firm will draft the PP and PBS to include corrections in accordance with the results of the audit of financial statements, and ensure their adoption by the Supervisory Board - carry out preparations for the sale of 66.56% of the enterprise's capital by tender - The Government of the Federation of

				BiH issued a Decision on the sale of 16% of the enterprise's capital on the stock market. Pursuant to the Decision, 5 088 shares were sold - further sale needs to be stopped due to the extremely low market price
5.	Remontni zavod Travnik d.d. Travnik	5 088 690 (2009)	2 595 232 (51.00)	- Create conditions necessary for the privatisation of the enterprise - the enterprise's management is not interested in the privatisation and failed to comply with numerous requests for the submission of the PP and PBS
6.	Unis-udružena metalna industrija d.d. Sarajevo	48 377 383 (22.09.2010)	24 672 490 (51.00)	- the sale of the remaining 51% state-owned capital should be conducted by direct negotiation
7.	JP Hrvatske telekomunikacije d.d. Mostar	307 668 238 (31.12.2006)	154 151 017 (50.103)	-the Federal Ministry of Transport and Communications, in its Memorandum no. 07/2-02-2-2139/10 of 25 October 2010, presented its opinion that the remaining state-owned capital (50.103) should be privatised through a tender procedure - the sale of state-owned capital in "HT Mostar" and the initiated sale of "Telekom Srbija", which owns 63% of the shares of "Telekom Republika Srpska", imposes the need to conduct a detailed analysis of the privatization of telecommunications operators in the Federation of BiH

Plan for selling shares on the stock market

No.	Enterprise	Total capital	State-owned capital (%)	Privatisation activities
1.	Sarajevo Osiguranje d.d. Sarajevo	57 932 912 (capital after recapitalisation in 2008)	26 351 457 (45.49)	- the only insurance group with state-owned capital (minority share) - recapitalisation, in which the Government of the Federation of BiH participated, completed - the optimal method of sale is to sell the entire package of state-owned shares on the stock market - possible selling of capital by method of direct negotiation
2.	Energopetrol d.d. Sarajevo	68 661 525 (status as at 30.06.2007)	15 188 891 (22.12)	-under the condition that the problem of the fulfilment of contractual obligations by "Ina Mol" is resolved, the sale of the remaining state-owned capital by selling entire package of state shares on the stock market is justified
				- according to the Decision of the

3.	Bosnalijek d.d. Sarajevo	78 299 870 (status as at 2009)	15 077 240 (19.25)	Government of the Federation of BiH on the method of privatisation of state-owned capital, the extraordinary auction that was held for the purpose of selling a total of 1 507 724 shares at the starting price of BAM 23.05, was unsuccessful - the possibility of repeating the sale is disputed due to the provisions of Article VI of the Decision, which stipulate the signing of an agreement on the development of the business activities "Bosnalijek" with the buyer of the shares
4.	Fabrika duhana d.d. Sarajevo	128 171 200 (status as at 2009)	51 153 126 (39.91)	-in view of the fact that the State is only a minor shareholder in this enterprise and the interest in securing a strategic partner and best price for value, the optimal method of sale would be the sale of the entire package of state shares on the stock market
5.	JP B&H Airlines d.o.o. Sarajevo	18 773 272 (agreement signed on 22.12.2008)	9 561 227 (50.93)	- as a result of the recapitalisation process, the structure of ownership of the enterprise is as follows: 51% the Government of the Federation of BiH, and 49% Turkish Airlines. - The Federal Ministry of Transport and Communications, in its Memorandum no. 07/2-02-2-2139/10 of 25 October 2010, submitted its opinion that the conditions for changing the structure of the capital have been met, that is, that the Government of the Federation of BiH has only a minority share in the capital - the selling of committed capital through the sale of shares on the stock market.

The sale of state-owned capital, displayed as both property and capital (10 companies), in 2011 is conditioned by the completion of court disputes. The decisions of the Government of the Federation of BiH on the adoption of a programme for spending funds with allocation criteria as earmarked in the Budget of the Federation of BiH for 2010, the Federal Ministry of Development, Entrepreneurship and Crafts was granted funds for "Transfers for Promoting the Development of Entrepreneurship and Crafts" in the amount of BAM 5 000 000.00, as well as funds for the programme "Support in co-financing of investment projects that legal persons finance from their own funds and credit funds" in the amount of BAM 3 000 000.00. Also, by Decision of the Government of the Federation of BiH on the approval of spending of funds from the Budget of the Federation of BiH for 2010, BAM 3 000 000.00 were granted to the Federal Ministry of Development, Entrepreneurship and Crafts for the realisation of the programme „Credit incentives for the Development of Entrepreneurship and Crafts“. In accordance with the established criteria, the above specified funds will be placed through the Development bank of the Federation of BiH, on a revolving basis, with a 7 year repayment deadline, a grace period of up to 2 years, and an interest rate of up to 2%. According to projections for the budget of the ministries for 2011, 2012 and 2013, ca. BAM 8 870 000.00 is planned for the costs of transfers for the promotion of development of entrepreneurship and crafts, and BAM 3 000 000.00 for the costs of credit incentives for the development of entrepreneurship and crafts. The strategy of the Agency for Privatisation in the Federation of BiH is to support and initiate the implementation of small-scale privatisation considering the fact that funds gained from sales in prodajom small-scale privatisation belong to the seller (the enterprise) and serve for restructuring enterprises and settling liabilities to the State.

Within the framework of the project “Small and Medium-Sized Enterprise Development in the Federation of BiH” realisation of the following eight strategic objectives is planned:

1. reduce administrative barriers
2. promote entrepreneurship
3. establish a central agency for small and medium-sized enterprises
4. financial support
5. professional training of all relevant persons in the field of small and medium-sized entrepreneurship
6. strengthening entrepreneurial infrastructure
7. technological development, and
8. encourage entrepreneurship in target groups.

4.2. Public administration reform

The Public Administration Reform Coordinator's Office (PARCO) plans and implements projects with the aim of improving administrative capacities for the implementation of the relevant *Acquis*, and, in general, projects that will increase the transparency and efficiency of the relevant administrative institutions. For that purpose PARCO uses the funds of the Public Administration Reform Fund (PAR Fund), which the donor community (Great Britain, the Netherlands, Sweden and the European Commission) dedicated for the implementation of public administration reforms in BiH. The Management Board of the PAR Fund approved the implementation of 14 projects in the total value of BAM 9 504 551.61 (VAT not included). In the previous period the following projects were realised:

1. “Establishment of the Network of Info Stands”,
2. “Training for Public Relations Officers”,
3. “Strategic Communication”.

Implementation of the following projects is currently ongoing:

1. “A Blueprint for the Development of the Central Bodies of Government in BiH”,
2. “Improving the Rules and Procedures for Drafting Laws, Other Regulations and General Documents in BiH”
3. “Development of a Performance Management System for the Civil Service Structures in BiH”,
4. “Development of the Programme for Improved Quality of Administrative Decision-Making in BiH”.

It is planned for the following projects to be implemented in the coming period:

1. “The Transposition of EU Legislation into the Legal System of BiH”
2. “Training of Civil Servants for Application of Information Technologies and Work on Computers”,
3. “Establishment of Modern Departments for Human Resources Management in the Administration Bodies of BiH”,
4. “Publishing of Informative Materials of the Council of Ministers of BiH, the Government of the Federation of BiH, the RS Government and the Government of Brčko District of BiH”
5. “Development and Adoption of Interoperability Framework and Standards for Exchange of Data”.

In the next year PARCO plans to implement the following projects, which will improve administrative capacities for implementation of *acquis communautaire* in the **economic, fiscal and financial fields**:

1. "Budget Management Information System", the objective of which is increased efficiency and effectiveness of budget management in line with best European practice.
2. "Brčko District Treasury Information System", the improvement of the functions of the Brčko District of BiH Treasury through the introduction of a modern information system for treasury operations
3. "The Introduction of Public Internal Financial Controls in Accordance with Relevant EU Standards", the objective of which is accountable, transparent and efficient spending of public funds. This project is funded by the European Commission, and PARCO is involved in its implementation by way of its representative in the Project's Management Board.

The Public Administration Reform Coordinator's Office also monitors the progress of public administration reform, measured through the implementation of Action Plan 1 of the Strategy for Public Administration Reform (PAR Strategy) in BiH by horizontal reform areas. As of the second quarter of 2010 the following progress was achieved:

1. Development of policy making and coordination capacities	41.91 %
2. Public finances	48.47 %
3. Human resource management	47.39%
4. Administrative procedure	34.10%
5. Institutional communication	58.21%
6. Information technologies	32.26 %

PARCO is continuing with activities on the preparation of the Action Plan 2, that is, the sectoral reforms plan of the Strategy for Public Administration Reform in Bosnia and Herzegovina, with the support of the EU Technical Assistance to BiH Project. The implementation of sectoral reforms is the responsibility of institutions across all administrative levels in BiH, however, in order to ensure coherence of results in the area of sectoral capacities, it is necessary to link and coordinate the results of the reform process. In accordance with its competencies, the Public Administration Reform Coordinator's Office, in this part of the reform, aims to preserve the coherence of organizational models, in other words, to ensure that any possible restructuring of sectors is accompanied by appropriate organisational concepts in terms of the typology of institutions, their mutual relations and functional connection, and the ensuring of organizational change management, that is, coordination and guidance during the period of transition from the existing to the desired organizational system. An essential prerequisite for the start of these activities is the securing of political support through the adoption of a Common Platform on the method of preparation and drafting of Action Plan 2 across all levels of government in Bosnia and Herzegovina.

In cooperation with the relevant responsible institutions and experts of the EU Technical Assistance Team, the Public Administration Reform Coordinator's Office (PARCO) shall:

- initiate the drafting of a review of the structure of public administration across all levels of government in Bosnia and Herzegovina and the existing legislation with an overview of the competencies of institutions according to administrative levels,
- with the assistance of the Technical Assistance Team, develop guidelines (indicators of efficient and professional public administration) for the reform of sectoral capacities,
- analyse the administration structure in BiH according to the established guidelines,
- participate in the activities of the working groups with the aim of providing advice regarding the management of organisational changes during the development of Action Plan 2.

The outcome of this plan, besides the implementation of the Strategy for Public Administration Reform, will be a review of the structures of public administration institutions, their functionality, organisation and a proposal for models of organisation in sectors that require further capacity building. Particular attention will be devoted to the implementation of the results of horizontal reforms, that is, measures from Action Plan 1 of the Strategy for Public Administration Reform, in specific sectors of administration. All of these activities will lead to connecting the horizontal and

vertical public administration reform, the standardisation of the macro- and micro-organisational issues in public administration, and thereby, the rationalisation of expenses, increase in efficiency and reduction of structural rigidities. As a result an essential requirement for transposing and implementing the acquis will be fulfilled.

4.3. The labour market

According to the data of the Labour and Employment Agency of Bosnia and Herzegovina, a decreasing trend in the number of registered unemployed persons was apparent as of March 2010. In August 2010 unemployment rose by 0.26%. In Bosnia and Herzegovina, as at 31 August 2010, according to the records of the employment institutes, the number of registered unemployed persons was 517 508. Of the total said number of unemployed persons, 261 172, that is 50.47 %, are women. Of the total registered unemployed persons 35.42% are skilled labour, and 30.90% low-skilled workers. The registered unemployment rate for July 2010 was 43.2% , which is by 0.1%. more than in June 2010. In the communiqué of the Labour and Employment Agency of BiH it is stated that the relevant ministries and the employment institutes have committed to implementing a programme of active measures for the purpose of sustaining the attained level of employment. The programmes that have been implemented to-date were aimed at vulnerable target groups on the labour market, assistance to unemployed persons that have reduced chances for finding employment in the labour market through the provision of training in active seeking of employment and their placement with employers or self-employment, as well as adjustment to the needs and demands of employers. The Labour and Employment Agency of BiH submitted proposals for activities that need to be carried out in order to improve the quality of the of the labour market supply and activities and measures that need to be taken in order to improve the flexibility of the labour market. For the purpose of improving the quality of the labour market supply, progress can be achieved by:

- preparing for the labour market through formal and informal forms of education, and that the labour force active on the labour market is also active in seeking employment;
- education reform, accompanied by a survey of the needs of employers for specific profiles of workers, and efforts to align the education system with labour market needs to the greatest extent possible;
- continuously implementing reforms in the education, social policy, labour and employment, pension and disability insurance, and health insurance sectors; and
- in order to resolve structural unemployment problems, when preparing for a known employer it is necessary to intensify efforts toward the requalification and additional qualification training of unemployed persons.

With the aim of promoting flexibility on the labour market, it is necessary to take the following measures:

- ensure that individuals may exercise their rights without having to fear that they may lose those rights and therefore avoid seeking employment;
- take measures to eliminate the imbalance of qualifications on the labour market by developing a strategy and training system in accordance with EU standards;
- improve the flow of information on business opportunities and training possibilities outside of the local community in both entities;
- harmonise legislation in the area of contributions;
- reduce regional development discrepancies;
- create a better environment for investments for both domestic and foreign investors, which is realistically the best way to create new jobs and recruit a labour force with a wider range of occupations;
- systematically encourage and strengthen private initiative for start-up of small businesses in the production sector, primarily on the basis of existing resources and services.

The Labour and Employment Agency of Bosnia and Herzegovina also filled in and submitted Table 1c: Developments on the Labour Market, pursuant to the Guidelines, which we are submitting as an *attachment to this document*. According to Contribution A, Plan – Structural Reform Objectives, as concerning the labour market, it is stated that the author of the contribution is the Ministry of Civil Affairs of BiH, and the Entity ministries of labour and employment, and social protection are listed as the co-authors. Contributions for the drafting of Item 4.3. Labour market, of the “Economic and Fiscal Programme for 2011”, in accordance with the basic instructions provided in the document «Economic and Fiscal Programme for 2011: Guidelines», were submitted by the relevant Entity ministries and the Employment Institute of Brčko District of BiH.

The Ministry of Health and Social Protection of Republika Srpska in reply to the request for submission of information for the purpose of drafting the Economic and Fiscal Programme for 2011 submitted a memo in which it states that:

- according to Contribution A, Plan – Structural Reform Objectives in the area of the labour market, the Ministry of Health and Social Protection of Republika Srpska does not have the necessary competencies to participate in the drafting of the Economic and Fiscal Programme for 2011.
- regarding the proposal for improving the quality of the labour force that involves reform of the health insurance system, funds for the payment of health insurance benefits for unemployed persons should be provided in the budget of Republika Srpska and the exercising of rights to healthcare on the basis of unemployment cannot be removed from the competencies of the RS Employment Institute, as only the RS Employment Institute, by way of its general acts, can establish the criteria and procedure for determining real unemployed persons.

The Ministry of Health and Social Protection of Republika Srpska stated that activities on the passing of a new Law on Health Insurance in the RS are underway, and that the possibility of finding better quality solutions will be explored at this time. In relation to the request for submission of information for the purpose of drafting the 2011 Economic and Fiscal Programme, the *Federal Ministry of Labour and Social Policy* submitted a response to Item 4.3. Labour market, stating that:

- the Government of the Federation of BiH has adopted an Action Plan for Employment in the Federation of BiH for the period 2010-2013, based on the Employment Strategy of the Federation of BiH for 2009-2013.

The following four strategic objectives are defined in the Action Plan:

1. Prevention of long-term unemployment, inactivity, social exclusions and poverty of persons who are fit for work;
2. Alignment of labour market supply and demand;
3. Expansion and betterment of investments in human capital, and adjustment of the education and training system to suit labour market demand;
4. Strengthening social and territorial uniformity and interconnection through entrepreneurship.

Within the framework of the above listed strategic objectives from the Action Plan, sub-objectives have also been defined, as well as measures for fulfilling those sub-objectives, the implementation of which is aimed at reducing the number of long-term unemployed persons and other difficult to employ categories of unemployed persons, such as women, young people, disabled persons, and members of the Roma population. Among the proposed measures are additional and further education and training, inclusion on the labour market through training in job seeking and career guidance, and support for starting own business. Such measures should enable the establishing of a system for monitoring labour force demand, improvement of the internal capacities of employment services and cooperation with private agencies acting as employment intermediaries. In the

response to the questions under Item 4.5. – Additional Areas of Reform it is stated that the Federal Ministry of Labour and Social Policy has submitted information on the status of the Proposal for the Strategy for Pension System Reform in the Federation of BiH explaining, among other things, that the President of the Government of the Federation of BiH, withdrew the Proposal for the Strategy for Pension System Reform in the Federation of BiH from parliamentary procedure on 26 July 2010, for the purpose of additional public discussion. The President of the Government of the Federation of BiH tasked the Expert Group for Pension System Reform with conducting the additional discussions, following which the Expert Group must, through the Ministry of Labour and Social Policy of the Federation of BiH, submit the Proposal for the Strategy to the Government of the Federation of BiH for review and further procedure in the Parliament. This activity is currently ongoing.

The Employment Institute of Brčko District of BiH, in response to the request for submission of information for the development of the Economic and Fiscal Programme for 2011, submitted information concerning the labour market and stated that the Government of Brčko District had established a Working Group that was responsible for developing the Brčko District Employment Strategy and Action Plan for its implementation, for the period 2010-2013, and that these documents are currently being drafted and will define the following objectives:

- Incentives to existing and new businesses through the implementation of the Development Strategy of Brčko District of BiH for 2011;
- Prevention of long-term unemployment, promoting activity on the labour market, and prevention of social exclusion;
- Alignment of labour market supply and demand through career guidance and enrolment policy;
- Greater investment in raising the level of education of human resources through the secondary and post-secondary education system.

It was also mentioned that within the scope of the above strategic objectives, sub-objectives will be defined, as well as measures for fulfilling those sub-objectives, the implementation of which is aimed at reducing the number of long-term unemployed persons. Measures for the realisation of the sub-objectives include additional education, training in job seeking, career counseling and training for starting own business. Measures currently being prepared will strengthen the professional capacities of the Employment Institute of Brčko District of BiH and establish a system for monitoring labour force demand. *The Ministry of Labour and the Protection of Veterans and Disabled Persons of Republika Srpska* failed to submit the requested information necessary for the drafting of the Economic and Fiscal Programme for 2011. Improvement of work and management of employment policies can be realised in BD through: Improvement of the work organisation and strengthening of the capacities of the Employment Institute of Brčko District of BiH, Improvement of the legal framework – the Brčko District Law on Employment and Rights During Unemployment, Implementation of the Brčko District Development Strategy of BiH as planned in the Action Plan for FY 2011, Increasing social dialogue between social partners across all levels of government, with specific tasks – responsibilities assigned to each social partner.

Improvement of the work organisation and strengthening of the capacities of the Employment Institute requires the following:

Adequate business premises (realisation of this requirement is underway in the office building of the former “DOO Merkur”) for establishing the new organisation of work and strengthening the capacities of the Institute, which will enable the establishment/improvement of the following activities:

Technical tasks conducted in the ticket office hall where the following will take place: registering of unemployed persons seeking employment and employed persons seeking a change of employment; establishment of a statistical database on persons active on the labour market; regular checking-in of unemployed persons; advisory functions of the Institute through staffing upgrades; strengthening staff capacity through the training of instructors – advisors; active calling of and provision of advice

to unemployed persons for the purpose of active pursuit of employment, according to individual target groups of unemployed persons; development of job-clubs, development of the spirit of entrepreneurship, organisation of training and encouragement of unemployed persons to start their own businesses; provision of advice and assistance for starting a business, and material support through cofinancing employment for new businesses; strengthening communication with employers by increasing the level and quality of services provided to employers by employment intermediaries; establishment of advisory councils ; starting and developing social dialogue at the level of the activities and tasks performed by the Institute, through implementation of the Law on Employment; the creation of a database on labour force demand according to occupations, through notification of needs by employers, labour market surveys and similar, building awareness of the need for professional orientation and career counselling – career guidance for the target group of elementary school graduates and highschool graduates that intend to continue their education, the promotion of cooperation with education institutions both in the area of secondary and post-secondary education – adult education based on the principle of lifelong learning for the purpose of acquiring new knowledge and skills, requalification, additional qualification and training in accordance with labour market needs, and the prevention control and resolving of structural unemployment; continuation of active employment measures using available funds and aimed at target groups, also depending on the growth and development needs of Brčko District of BiH; implementation of passive measures – rights arising from unemployment pursuant to the Brčko District Law on Employment.

Improvement of the legal framework through amendments to the Brčko District Law on Employment and Rights During Unemployment:

Considering the solutions established in the laws of the entities of BiH, and the laws of countries in the region that have completed the reform of employment agencies – Croatia, Serbia, Montenegro, and pursuant to those solutions, the Brčko District Law on Employment and Rights During Unemployment could be improved through:

Amending provisions of the law so that registered holders of commercial agricultural estates are not considered unemployed, and should not be entered into the unemployment records of the Employment Institute. The exercising of rights arising from unemployment for persons that are not active job seekers – such as the right to health insurance, parental allowances, maternity allowance, continuous and one-off assistance, etc., needs to be made possible through amendments to special laws that will not require that persons be registered in Employment Institute unemployment records in order to exercise those rights. Regulate in more detail the issue of employment in business sectors that could be appealing for employment defined as public works. Expand and upgrade the Chapter entitled „Rights of unemployed persons“, especially in the part concerning legal provisions for exercising the right to monetary compensation, including foreign nationals employed in Brčko District of BiH, Harmonisation of laws concerning the labour market and employment with EU legislation.

5. ANNEXES

Table 1a: Macroeconomic prospects

Percentages unless otherwise indicated	2009	2009	2010	2011	2012	2013
	Level (€)	Rate of change				
1. Real GDP at market prices	13,964	-2.8%	0.5%	3.2%	5.5%	5.4%
2. GDP at market prices	14,023	-2.4%	2.3%	5.6%	8.0%	8.8%
Components of real GDP						
3. Private consumption expenditure	11,121	-4.2%	1.3%	3.7%	4.2%	3.9%
4. Government consumption expenditure	2,876	1.0%	1.5%	3.4%	3.4%	2.5%
5. Gross fixed capital formation	2,922	-24.0%	-18.8%	10.2%	10.2%	10.7%
6. Changes in inventories and net acquisition of valuables (% of GDP)	-59	-0.4%	-0.5%	-0.5%	-0.5%	-0.5%
7. Exports of goods and services	4,002	-13.9%	4.5%	10.3%	11.1%	11.3%
8. Imports of goods and services	-6,898	-21.4%	-3.9%	10.8%	8.0%	7.9%
Contribution to real GDP growth						
9. Final domestic demand	16,919	-9.64	-2.56	5.36	5.99	5.69
10. Change in inventories and net acquisition of valuables	-59	-1.79	-0.07	-0.04	-0.01	-0.01
11. External balance of goods/services	-2,896	8.60	3.16	-2.08	-0.52	-0.30

Table 1b: Price developments

Percentage changes, annual averages	2009	2010	2011	2012	2013
1. GDP deflator	0.4%	1.7%	2.3%	2.4%	3.2%
2. Private consumption deflator	0.1%	2.2%	2.5%	2.4%	2.9%
3. HICP	-	-	-	-	-
4. National CPI change	-0.5%	1.8%	2.1%	2.3%	2.5%
5. Public consumption deflator	2.2%	1.5%	1.5%	1.5%	1.5%
6. Investment deflator	-1.4%	2.7%	4.2%	5.6%	6.0%
7. Export price deflator (goods & services)	-2.2%	9.4%	4.2%	3.1%	3.6%
8. Import price deflator (goods & services)	-1.7%	7.6%	4.0%	3.6%	3.4%

Table 1c: Developments in the labour market³³

	ESA code	Year	Year	Year	Year	Year	Year
		2009	2009	2010	2011	2012	2013
		Level	Rate of change				
1. Population (in thousands) - LFS data		3,129	3,129	3,105	3,106	3,107	3,108
2. Population (growth rate in %)		-	-2.6%	-0.8%	0.0%	0.0%	0.0%
3. The working age population (in thousands) [1] - LFS data		2,594	-2.1%	0.1%	0.5%	0.2%	1%
4. The rate of participation of the working age population in total population		-	82.9%	83.6%	84.0%	84.2%	84.9%
5. Employment, persons in thousands [2] - LFS data		859	859	843	853	889	933
6. Employment, working hours [3]		n/a	n/a	n/a	n/a	n/a	n/a
7. Employment (growth rate in %)		-	-3.5%	-1.9%	1.2%	4.2%	4.9%
8. Employment in the public sector (persons in thousands) national statistics		197.8	197.8	200.0	202.3	205.9	209.5

³³DEPProjections

9. Employment in the public sector - the growth in %		-	2.4%	1.1%	1.2%	1.8%	1.7%
10. Unemployment rate [4]		24.1%	2.8%	13.1%	-2.6%	-12.8%	-7.8%
11. Labour productivity, persons in thousands [5]		31.7	7.9%	5.1%	3.7%	4.2%	2.8%
12. Labour productivity, working hours [6]		n/a	n/a	n/a	n/a	n/a	n/a
13. Compensation of employees (net wage in BAM)	D1	790	5.1%	1.0%	2.9%	4.9%	5.1%

1. 15-64 years age group
2. Employed population, domestic concept, national accounts definition
3. Definition of national accounts
4. Harmonised definition, Eurostat; levels
5. Real GDP per employed person
6. Real GDP per working hour

Table 1d: Sectoral Balances

Percentages of GDP	ESA code	Year X-1	Year X	Year X+1	Year X+2	Year X+3
1. Net lending / borrowing in relation to the rest of the world	B.9				nonbinding	nonbinding
Of which:						
- Balance of goods and services						
- Balance of primary revenues and transfers						
- Capital Account						
2. Net lending / borrowing of private sector	B.9/ EDP B.9					
3. Net lending / borrowing by broader government						
4. Statistical discrepancy			nonbinding	nonbinding	nonbinding	nonbinding

Table 1e: GDP, investment and gross value added

	2009	2010	2011	2012	2013
GDP and investment at current prices					
GDP level at current market prices (mil of KM)	27,427	28,050	29,631	32,014	34,823
Investment ratio (% of GDP)	20.1%	16.3%	17.7%	19.1%	20.6%
Growth of Gross Value Added, percentage changes at constant prices					
1. Agriculture	-0.76	-	-	-	-
2. Industry (excluding construction)	-5.25	-	-	-	-
3. Construction	-7.25	-	-	-	-
4. Services	-1.43	-	-	-	-

Table 1f: Developments in foreign trade sector

In millions of euros unless otherwise stated	Year	Year	Year	Year	Year
	2009	2010	2011	2012	2013
1. Current account balance (% of GDP)	-6.6	-5.9	-7.8	-7.9	-7.4
2. Exports of goods	2920.2	3575.8	4086.0	4608.9	5269.4
3. Imports of goods	-6,326.7	-6628.1	-7644.9	-8554.8	-9553.3

4. Balance of Trade in Goods	-3,406.4	-3052.3	-3558.9	-3945.9	-4284.0
5. Exports of services	1,002.4	897.9	1054.4	1278.1	1521.3
6. Imports of services	-453.3	-383.0	-436.7	-485.6	-537.1
7. Balance of services	549.1	514.9	617.6	792.5	984.2
8. Net interest payments from abroad					
9. Net income by other elements from abroad					
10. Current transfers	1,632.7	1473.2	1534.2	1642.3	1749.5
11. Of which: from EU					
12. Current Account Balance	-840.0	-845.4	-1186.1	-1288.0	-1324.9
13. Foreign Direct Investment	183.5	215.1	757.5	818.4	890.2
14. Reserves in foreign currency	53.5				
15. External debt					
16. Of which: public					
17. Of which: denominated in foreign currency					
18. Of which: received repayments					
19. Exchange rates for EUR (end of the year)					
20. Exchange rates for EUR (annual average)					
21. Net savings in foreign currencies (lines 21-25: percentages of GDP)					
22. Domestic private savings					
23. Domestic private investments					
24. Domestic public savings					
25. Domestic public investments					

Table 2: BiH Institutions

	ESA code	2008	2009	2010	2011	2012	2013
<i>In BAM million</i>		Level	Level	Level	Level	Level	Level
1. General Government	S13	25	11	-173	-35	-18	-18
2. Centre of Government	S1311	25	11	-173	-35	-18	-18
Broader Government (S13)							
6. Total revenue	TR	865	964	858	1027	1044	1017
7. Total spending [7]	TR	840	953	1031	1062	1062	1035
8. Net borrowing / crediting	EDP.B9	25	11	-173	-35	-18	-18
9. Interest Expenses	EDP.D41 incl. FISIM	0	1	1	0	0	0
p.m. 9a. FISIM							
10. Primary balance[8]		25	12	-172	-35	-18	-18
Components of revenue							
11. Total tax (11 = 11a +11 b +11 c)		675	729	689	880	902	862
11a. Taxes on production and imports	D2	675	729	689	880	902	862
11b. Current taxes on income and wealth	D5						
11c. Taxes on capital	D91						
12. Social contributions	D61						
13. Income from property	D4						
14. Other (14 = 15 - (11 +12 +13))		190	235	169	147	142	155
15 = 6. Total income	TR	865	964	858	1027	1044	1017
p.m.: Tax burden (D2+D5+D61+D91-D995)		675	729	689	880	902	862
Selected expenditure components							
16. Collective consumption	P32	772	881	951	963	970	963
17. Total social transfers	D62 + D63						
17a. Social transfers in kind	P31 = D63						
17b. Other than social transfers in-kind	D62						
18 = 9. Interest Expenses (incl. FISIM)	EDP.D41 + FISIM		1	1			
19. Subsidies	D3						
20. Gross fixed capital formation	P51	68	71	79	99	92	72
21. Other (21 = 22 - (16 +17 +18 +19 +20))							
17. Total social transfers	TE	840	953	1031	1062	1062	1035
p.m. Compensation of employees	D1	552	636	668	671	697	697
NOTES:							
1. The information on servicing external debt is excluded from this review, given it is shown in the entity budgets. In 2009 and 2010 the interest owed by a state-level agency, the Civil Aviation Authority, in the amount of BAM 1 million is shown (repayment of principal of this loan will be BAM 3 million in 2010).							
2. The 2008 and 2009 statistics are based on actual budget execution. The 2010 statistics are based on an assessment of budget execution in 2010, which was presented to the IMF in the November 2010 overview. The 2011 statistics are based on the draft budget of BiH institutions addressed to the Council of Ministers by the Ministry of Finance and Treasury in November 2010 (which was also presented to the IMF under November 2010 overview). The 2012 and 2013 statistics are based on the draft EFP of BiH institutions for the period 2011-2013.							
3. Collective consumption is a residual calculated as the difference of total consumption and other components included in the total consumption.							
4. In accordance with the IMF methodology, the table shows funds on the basis of GSM licences (as receivables on the financing account and as an expense on capital expenditures , given the funds are used for projects related to transport infrastructure), which (neither receivables nor expenditures) were planned within the regular budget, but in annexes to the budget.							
5. This 2010 deficit of BiH institutions will be funded by revenues transferred from the previous years (BAM 121 mil), in accordance with the savings agreed in the Stand By arrangements in 2009, receivables from the GSM licenses (BAM 18 mil), the means of succession (BAM 17 mil), funds from the sale of old cars (BAM 1 mil), and the means of macro-financial loan assistance of the European Commission (BAM 20 mil).							
6. The shown deficit of BiH institutions in 2011, 2012 and 2013 is only the receivables from GSM licenses.							

Table 2: Broader government budget prospects- Federation of BiH

	ESA code	Year X-1	Year X-1 2009	Year X 2010	Year X +1 2011	Year X +2 2012	Year X +3 2013
		Level	Million BAM				
Net lending/crediting (B9) by sub-sectors							
1. Broader Government (all the Federation)	S13		-290.7	-369.2	-275.0	-64.4	275.2
2. Centre of Government (Federation of BiH budget)	S1311						
3. State Government	S1312						
4. Local governments (cantons and municipalities)	S1313						
5. Social Security Funds	S1314						
Broader government (S13)							
6. Total revenue	TR		6,386.4	6,647.8	6,708.8	7,152.2	7,601.7
7. Total spending ³⁴	TE		6,677.1	7,017.0	6,983.8	7,216.6	7,326.5
8. Net borrowing / crediting	EDP.B9		-290.7	-369.2	-275.0	-64.4	275.2
9. Interest Expenses	EDP.D41 incl. FISIM		73.0	119.0	100.4	131.0	126.1
p.m. 9a. FISIM							
10. Primary balance ³⁵			-217.7	-250.1	-174.7	66.5	149.1
Components of revenue							
11. Total tax (11 = 11a +11 b +11 c)			2,811.7	3,037.0	3,078.2	3,316.0	3,547.1
11a. Taxes on production and imports	D2						
11b. Current taxes on income and wealth	D5						
11c. Taxes on capital	D91						
12. Social contributions	D61		2,718.8	2,729.0	2,729.0	2,874.0	3,024.0
13. Income from property	D4						
14. Other (14 = 15 - (11 +12 +13))			855.9	881.8	901.6	962.2	1,030.6
15 = 6. Total income	TR		6,386.4	6,647.8	6,708.8	7,152.2	7,601.7
FINANCING							
			290.7	369.2	275.0	64.4	-275.2
p.m.: Tax burden (D2+D5+D61+D91-D995) ³⁶							

³⁴ Correction for the next stream flows related to exchange (swap), so that TR-TE = EDP.B9.

³⁵ Primary balance is calculated as (EDP.B9, paragraph 8) plus (EDP D41+FISIM registered as a temporary spending, paragraph 9).

³⁶ Including those levied by the EU and including the necessary correction for the unpaid taxes and social contributions (D995).

Table 2 (continued)

	ESA code	Year X-1	Year X-1 2009	Year X 2010.	Year X +1 2011	Year X +2 2012	Year X +3 2013
		Level	BAM million				
Selected expenditure components							
16. Collective consumption (joint consumption expenditures)	P32		1.952,9	2.010,7	2.055,2	2.103,1	2.117,0
17. Total social transfers	D62 + D63		344,8	368,7	339,1	324,0	308,9
17a. Social transfers in kind	P31 = D63		0	0	0	0	0
17b. Other than social transfers in-kind	D62		344,8	368,7	339,1	324,0	308,9
18 = 9. Interest Expenses (incl. FISIM)	EDP.D41 + FISIM		73,0	119,0	100,4	131,0	126,1
19. Subsidies	D3		239,8	301,8	299,2	310,2	316,9
20. Gross fixed capital formation (fixed capital investment)	P51		215,8	280,2	263,7	262,9	264,3
21. Other (21 = 22 - (16 +17 +18 +19 +20))			3.850,8	3.936,6	3.926,2	4.085,4	4.193,3
22. Total consumption	TE		6.677,1	7.017,0	6.983,8	7.216,6	7.326,5
p.m. Compensation of employees	D1		1.542,6	1.535,5	1.564,2	1.581,3	1.589,3

LEGEND:

Item 6: total revenue + repayment of loans (net lending)

Item 7: total expenditure (excluding internal and external debt)

Item 8: difference between item 6 and item 7

Item 10: balance corrected by the amount of interest

Item 11: total direct and indirect taxes

Item 12: revenue from extra-budget funds

Item 14: item 11 + item 12 - item 6

Item 16: sum: gross salary + benefits + contributions + material costs

Item 17: same as 17 b, because we have no in-kind transfers

Item 19: subsidies for the economy and industry

Item 20: Total capital spending

p.m. Compensation of employees: sum: gross salary + benefits + contributions

NOTE: The table is filled in on the basis of the table that was considered by the Fiscal Council on the basis of which 2011 – 2013 DOB was made.

Table 2: General government budget prospects - Republika Srpska

Table 2: General government budget prospects - Republika Srpska								
		ESA code	Year	Year	Year	Year	Year	Year
			X-1	X-1	X	X +1	X +2	X +3
			Level	% of GDP				
	Net lending/crediting (B9) by sub-sectors							
1.	General Government	S13	-664,4	-2,4	-1,8	-1,0	-0,5	0,3
2.	Narrow Government	S1311						
3.	State Government	S1312	-495,4	-1,8	-1,6	-1,0	-0,6	0,2
4.	Local governments	S1313	-14,9	-0,1	0,1	0,0	0,0	0,1
5.	Social Security Funds	S1314	-154,1	-0,6	-0,2	0,0	0,0	0,0
	General government (S13)							
6.	Total revenue	TR	3.015,6	10,8	10,8	11,1	10,7	10,3
7.	Total spending	TE	3.680,0	13,2	12,6	12,0	11,2	10,0
8.	Net borrowing / crediting	EDP.B9	-664,4	-2,4	-1,8	-1,0	-0,5	0,3
9.	Interest expenses	EDP.D41 incl. FISIM	59,1	0,2	0,2	0,2	0,3	0,3
	p.m. 9a. FISIM							
10.	Primary balance		-605,3	-2,2	-1,6	-0,8	-0,3	0,6
	Components of revenue							
11.	Total tax (11 = 11a +11 b +11 c)		1.495,8	5,3	5,4	5,7	5,7	5,5
11.a	Taxes on production and imports	D2						
11.6	Current taxes on income and wealth	D5						
11u.	Taxes on capital	D91						
12.	Social contributions	D61	1.145,1	4,1	4,0	4,1	3,9	3,6
13.	Income from property	D4	51,3	0,2	0,1	0,1	0,1	0,1
14.	Other (14 = 15 - (11 +12 +13))		323,4	1,2	1,2	1,2	1,1	1,1
15=6	Total income	TR	3.015,6	10,8	10,8	11,1	10,7	10,3
p.m.: Tax burden (D2+D5+D61+D91-D995)			2.640,9	2.640,9	9,4	9,4	9,8	9,5
Selected expenditure components								
16.	Collective consumption	P32	1.727,8	6,2	5,6	5,2	4,8	4,0
17.	Total social transfers	D62 + D63	985,9	3,5	3,4	3,2	3,0	2,8
17a.	Social transfers in kind	P31 = D63						
176.	Other than social transfers in- kind	D62						
18=9.	Interest Expenses (incl. FISIM)	EDP.D41 + FISIM	59,1	0,2	0,2	0,2	0,2	0,3
19.	Subsidies	D3	163,3	0,6	0,6	0,4	0,4	0,4
20.	Gross fixed capital formation	P51	519,5	1,9	1,5	1,4	1,2	0,6
21.	Other (21 = 22- (16+17+18+19+20))		224,4	0,8	1,4	1,6	1,6	1,9
22.	Total consumption	TE	3.680,0	13,2	12,6	12,0	11,2	10,0
	p.m. Compensation of employees	D1	837,8	3,0	2,9	3,0	2,8	2,6

Table 3: General government expenditure by function – BiH institutions

BAM million	COFOG code	Year 2009	Year 2013
1. General public services	1	189	226
2. Defence	2	341	356
3. Public order and safety	3	305	333
4. Economic affairs	4	60	62
5. Environmental protection	5		
6. Housing and community facilities	6		
7. Health	7	2	7
8. Recreation, culture and religion	8	7	9
9. Education	9	3	9
10. Social protection	10	45	15
11. Total consumption (item 7 = 26 in Table 2)	TE	952	1017
<p>NOTE: The statistics in the functional classification do not comply with COFOG classification, but are approximate estimates by the Ministry of Finance and Treasury of BiH.</p>			

Table 3: General government expenditure by function – Federation of BiH

BAM million	COFOG code	Year X-2 2008	Year X+3 2013
1. General public services	1	853.0	1,076.7
2. Defence	2		
3. Public order and safety	3	502.0	546.1
4. Economic affairs	4	592.0	582.6
5. Environmental protection	5		
6. Housing and community facilities	6	222.0	211.8
7. Health	7	1,061.0	1,186.9
8. Recreation, culture and religion	8	106.0	78.0
9. Education	9	832.0	922.0
10. Social protection	10	2,419.0	2,722.4
11. Total consumption (item 7 = 22 in Table 2)	TE	6,587.0	7,147.8

Table 3: General government expenditure by function – Republika Srpska

Percentage of GDP		COFOG code	Year X-2	Year X+3
1.	1. General public services	1	1.4	1.1
2.	2. Defence	2	0.0	0.0
3.	3. Public order and safety	3	1.0	0.8
4.	4. Economic affairs	4	1.0	0.8
5.	5. Environmental protection	5	0.0	0.0
6.	6. Housing and community facilities	6	0.7	0.5
7.	7. Health	7	1.9	1.5
8.	8. Recreation, culture and religion	8	0.2	0.2
9.	9. Education	9	1.5	1.2
10.	10. Social protection	10	4.7	3.8
11.	11. Total consumption (item 7 = 26 in Table 2)	TE	12.4	10.0

Table 4: Developments in general government borrowing

Percentage of GDP	ESA code	Year X-1	Year X	Year X +1	Year X +2	Year X +3
1. Gross debt ³⁷						
2. Change in gross debt ratio						
Contributions to the change in gross debt						
3. Primary balance ³⁸						
4. Interest Expenses (incl. FISIM) ³⁹						
5. Correction of flows						
Of which:						
- Differences between cash and calculated cash ⁴⁰						
- Net accumulation of financial assets						
Of which:						
- Funds from the privatization						
- Effects of valuation and other ⁴¹						
p.m. implicit interest rate on debt ⁴²						
Other relevant variables						
6. Liquid funds ⁴³						
7. Net financial debt (7 = 1 - 6)						

³⁷ As defined in Regulation 3605/93 (not ESA concept).

³⁸ See item 10 in Table 2

³⁹ See item 9 of Table 2

⁴⁰ Differences related to expenses on interest and other expenditures and revenues could be separated if necessary.

⁴¹ Liquid assets, assets in third countries, companies controlled by the government and other differences between listed and unlisted funds could be separated if necessary

⁴² Changes due to movements in exchange rates, and operations in the secondary market could be separated if necessary.

⁴³ With the mediation of the interest expenses (incl. FISIM registered as consumption) divided by the level of debt from the previous year.

Table 5: Deviations from previous programme

	2009	2010	2011	2012
1. GDP growth (% points)				
Previous updates	-3.0%	0.5%	5.1%	6.7%
Latest updates	-2.8%	0.5%	3.2%	5.5%
Difference	0.2%	0.0%	-1.9%	-1.2%
2. Net lending by general government (% of GDP)				
Previous updates				
Latest updates				
Difference				
3. Gross borrowing by general government (% of GDP)				
Previous updates				
Latest updates				
Difference				

Table 6: Basic assumptions about the external economic environment underlying framework for the 2007 EFP.⁴⁴

VARIABLE	ASSUMPTIONS FOR								COMMENTS	
(annual growth rates in %, unless otherwise indicated)	Year X-1		Year X		Year X+1		Year X+2		Year X+3	
		chang e*		chang e*		chang e*		chang e*		
Interest rates (in % annually, annual average)										
- Short-term interest rate ⁴⁵ (annual average)										
- Long-term interest rate ⁴⁶ (annual average)										
Exchange rates (annual average“-“: depreciation)										
Exchange rates to €										
USD / €										
Nominal effective exchange rate										
Real effective exchange rate **										
GDP (real)										
- World, excluding EU										
- EU 25										
World trade (real)										
Export markets of the country										
Imports from the world										
International prices										
World import prices (commodities, in €)										
Oil prices (Brent – USD per barrel)										
*: Changes of the assumptions made in the last EFP										
**: Please, indicate the type of computation (number of currencies, type of price index for deflation)										

⁴⁴ If at all possible, this table should be included in the program, if not, these assumptions should be submitted to the Council and the Commission together with the program.

⁴⁵ As required, it is purely technical assumption

⁴⁶ As required, it is purely technical assumption

ANNEX 3 Liabilities matrix in accordance with policy

Description of policy	Year X	Year X +1	Year X +2	Year X +3
1. Policy measure				
A. Implementation profile *				
B. Net direct budgetary impact (potential)				
B.1 Direct impact on budgetary revenue				
B.2 Direct impact on budgetary expenditure				
2. Policy measure				
A. Implementation profile *				
B. (...)				
(...)				
Total net impact on the budget				
Total impact on budget revenues				
Total impact on budget revenues				
* Indicate the beginning and, as required, the end with "X"				

ANNEX 4 Assumptions about the external economic environment as a basis for predictions for 2009 autumn

VARIABLE	ASSUMPTIONS FOR				
	2009	2010		2011	
	(annual averages)		change*		change*
Interest rate (in % on a yearly base)					
- Eurozone: short-term (three-month interbank interest rate)					
- Eurozone: a long-term (ten-year government bonds)					
Exchange rates (" - ": devaluation of €)					
USD / € (level)					
GDP (on a real base, % changes)					
- World, excluding EU					
- USA					
- Japan					
- EU-27					
World trade exchange (% changes, commodities)					
EU export markets outside the EU (volume)					
World imports, excluding EU (volume)					
World import prices (in USD)					
Commodities prices					
Oil prices (Brent – USD per barrel)					
Oil prices (Brent – EUR per barrel)					
Prices of other commodities (in USD, % changes)					
Prices of other commodities (in EUR, % changes)					