

BOSNIA AND HERZEGOVINA

2015 National Economic Reform Programme (NERP)

Sarajevo, January 2015

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NATIONAL ECONOMIC REFORM PROGRAMME

PART I

(FORMERLY PRE-ACCESSION ECONOMIC PROGRAMME / ECONOMIC AND FISCAL
PROGRAMME)

NATIONAL ECONOMIC REFORM PROGRAMME – PART I

1 OVERALL POLICY FRAMEWORK AND OBJECTIVES

Following the requirements of the European Commission from 2014, the relevant institutions in BiH have prepared the 2015 National Economic Reform Programme (NERP 2015). This year's Programme is the first one to be submitted to the European Commission. The 2015 National Economic Reform Programme is an enhanced version of the existing Economic and Fiscal Programme (EFP), submitted by potential candidate countries. While the key objectives and content of Part I of the NERP remain very similar to the previous EFP, Part II of the document covers sectoral structural reform measures aimed at improving competitiveness of the country.

NERP 2015 has been designed based on a special methodology, submitted by the European Commission, for the purpose of easier comparability with other countries. The activities of the development of the 2015 National Economic Reform Programme were coordinated by the Directorate for Economic Planning in line with its authorities. The Programme was designed based on the contributions submitted by the relevant institutions, and it was reviewed at the meeting with the representatives of competent institutions and the entity coordinators. The preparation of this document involved representatives of the Ministries of the BiH Council of Ministers, the BiH Central Bank, the entity level and Brcko District ministries, the Directorate for Economic Planning and the Directorate for European Integrations. Finally, the 2015 National Economic Reform Programme was adopted by the BiH Council of Ministers at its 123rd session held on 11 February 2015.

2 MACROECONOMIC FRAMEWORK

2.1 Recent economic developments and medium-term macroeconomic scenario

Table 1. Main macroeconomic indicators

Indicator	Official data		Projections		
	2013	2014	2015	2016	2017
Nominal GDP in million KM	28,027	28,738	30,008	31,649	33,682
Nominal growth in %	2.6	2.5	4.4	5.5	6.4
GDP deflator (previous year = 100)	101.9	101.4	101.0	101.4	102.0
Real GDP in million KM (previous year = 100)	27,501	28,328	29,725	31,216	33,032
Real growth in %	0.7	1.1	3.4	4.0	4.4
Inflation measured by consumer price index in %	-0.1	-0.7	1	0.9	1.2
Consumption in million KM	28,815	29,477	30,234	31,040	32,138
Government consumption in million KM	5,986	6,457	6,560	6,691	6,892
Private consumption in million KM	22,829	23,020	23,674	24,348	25,246
Investments in mil KM	4,703	5,256	5,740	6,539	7,356
Government investments in million KM	1,041	1,302	1,497	1,871	2,189
Private investments in million KM	3,662	3,954	4,243	4,667	5,167
National Gross savings in % of GDP	11.9	12.0	13.3	15.0	16.6
Current account balance in million KM	-1,435	-1,924	-1,911	-1,816	-1,692
Current account balance in % of GDP	-5.1	-6.7	-6.4	-5.7	-5.0
Nominal imports growth in %	-1.8	6.5	4.9	3.1	3.7
Nominal exports growth in %	5.8	4.1	8.0	6.9	8.1

BiH economic growth in the first half of 2014 has been marked by two totally different quarters. Relatively good start of the year with economic growth of 2.7% (y-o-y) in the first quarter gave way to an annual 1.2% decline in the second quarter. Growth in the first quarter has primarily been driven by expansion of exports, but also domestic demand mainly as a consequence of gradual improvements in external environment. Strengthening of export demand, on the one hand, has lead to significant growth in exports (8.2%) and processing industry (10.6%). On the other hand, the increasing current cash inflows to population (1.5%) from abroad have encouraged rise in final consumption and imports (7.6%). Rise in exports during the first quarter would have been considerably higher (approximately two percentage points) had it not been for unfavourable hydrological situation which mostly lead to decline in generation of electricity (13.3%), as well as 27.5% fall in value of exports. Unfortunately, relative to the first quarter, the second quarter was marked by deceleration of economic activity in Germany, Italy and Croatia, and modest growth in Austria.

On the other hand, Slovenia has recorded a significant 1% growth relative to the first quarter. This has lead to reduction of the BiH export demand, primarily through the processing industry fall at the level of EU28, particularly Germany, Italy and Austria that make up the largest share of the BiH commodity exports market and finishing services (exports after internal processing). Situation has additionally aggravated by natural disasters (floods) in May, which have predominantly affected the exports (4.7% y-o-y fall of K2), processing industry (stagnation of K2 y-o-y), and investments (contraction in construction works and halved growth of capital goods imports). On the other hand, it appears that final consumption and imports have mainly kept the upward trend from the first quarter which, given the exports decline, have lead to 29% (y-o-y) increase in foreign trade deficit in the second quarter. This deficit hike, as well as decelerated growth of domestic demand (primarily in terms of investments) have fully halted the economic growth achieved in the first quarter.

Available foreign trade indicators point at a mild situation improvement in the third quarter. Namely, rise in value of exports of approximately 6% (y-o-y) has been at the level of the first quarter despite the stagnating industrial production, which after nine months has managed to maintain a slight 0.4% increase from the first half of the year. On the other hand, accelerating growth of imports in the third quarter may indicate to strengthening of domestic demand and/or export of services of (internal) finishing. Having all this in mind, economic growth is expected to reach 1.1% increase in 2014, driven by 2.7% expansion of domestic demand, despite an 11.4% increase in foreign trade deficit. Gradual continuation of upward trends is expected in 2015 too, with similar growth of domestic demand and slight 1.1% decrease in foreign trade deficit.

Growth 2016-17

Further gradual weakening of foreign trade deficit is expected to continue over the period 2016-2017 as a consequence of strengthening of export demand as well as gradual strengthening of competitiveness of the BiH exports. Thus, acceleration of gradual recovery of economies from the neighbourhood throughout 2016-2017 should ensure further incentives to rise in BiH exports and domestic demand, which should lead to 4.1% growth in 2016 and 4.4% in 2017.

Industrial production in BiH 2015-2017

2014 is going to be a year of great challenge when it comes to BiH economy, particularly the industrial production. Namely, the latest available DG ECFIN November projections for 2014 forecast only partial improvement of economic activity and mild 1.3% economic growth in EU countries as compared to the previous year.¹ Specific short-term indicators already indicate that the process of economic recovery is quite weakened primarily due to the crisis in Ukraine and sanctions in trade relations with Russia.² Thus, according to the Eurostat data, during the second quarter of 2014, there has been a weakening of industrial production in most of the EU countries, particularly in Italy and Germany where industrial growth has halved down.³ If we take into account that international economic environment is the main determinant of the BiH industrial production trends, these developments could have negative effects on the industrial production in BiH in the course of 2014.

The second, and perhaps even greater challenge is damage caused by floods that have swept Bosnia and Herzegovina and largely hindered the last year's industrial production recovery trend. Although official data on flood damage assessments have still not been fully quantified, it is evident that the BiH processing industry that makes up 2/3 of overall industrial production would be most heavily affected. A large number of companies operating within the processing industry, along with already traditional problems and economic crisis, will be additionally exposed to flood consequences this year. However, despite sustained damages, according to the BHAS data, the processing industry has achieved a 4.8% semi-annual production growth.⁴ In addition to export-oriented branches of processing industry, the increased production is also expected in the other branches driven by domestic demand. This particularly applies to the industries related to the construction sector in BiH (production of construction materials and finished metal outputs). On the other hand, in 2014 the energy sector (mines, electricity generation, petroleum products and coke) is expected to achieve results below the last year's level due to the pronounced base effect. The 2014 production growth rates in the energy generation sector will be largely determined by a relatively high base from the previous year as well as uncertain weather conditions. New circumstances in Bosnia and Herzegovina

¹ European Commission, Directorate –General for Economic and Financial Affairs, “European Economic Forecast”, Autumn 2014

² European Commission, Directorate –General for Enterprise and Industry, “Industrial Policy Indicators and Analysis”, n.6/ 2014

³ Eurostat, News release euroindicators, “Industrial production in EU for June 2014”. 124/2014, 13 August 2014.

⁴ Agency for Statistics BiH, “Index of industrial production volume in Bosnia and Herzegovina for June 2014”, Sarajevo, 29 July 2014

have conditioned the deceleration of the estimated growth of physical volume of industrial production in 2014 to approximately 2.3% as compared to the previous year.⁵

Assumptions of industrial production in 2015

Gradual recovery of the BiH economy is expected in the course of 2015. During the year, BiH is expected to remedy damages caused by floods to a large extent so as to make the overall business environment more favourable relative to the previous year. On the other hand, the industrial production in BiH, which is mainly export-oriented, should be supported by positive developments in international economic environment, particularly trade partners from the EU.⁶ Thus, according to the DG ECFIN projections for 2015, positive trend of economic growth in the EU countries is expected to continue at around 2%, supported by strengthening of investments with an annual growth rate of around 2.9%.⁷ Recovery of almost all sectors of the EU economy will reflect positively on production processes in the broader region and in Bosnia and Herzegovina as well. Increased level of export demand will result in improving production in all BiH sectors of industrial production where, according to DEP projections, the expected annual growth of production is set at around 5%. Branches of industry with highest share in the structure of processing industry of BiH and which are mainly export-oriented (metal industry, machine and automotive industry, wood industry and production of furniture, and chemical industry) should additionally use their export potential during 2015. On the other hand, process of reconstruction of the flooded areas and continuation of the investment cycle in infrastructure throughout 2015 should result in significant expansion of production in the industries driven by domestic demand (production of construction materials and metal outputs).

In 2015, the energy sector, which plays an important role in overall industrial production and includes mines, energy generation sector and production of petroleum products, is expected to achieve an increase in production of over 5% and additionally improve the level of overall industrial production in BiH.

Assumptions of industrial production in the period 2016-2017

Given that full recovery of most industries in the EU is expected in the period 2016-2017, it is realistic to expect that these developments will enable full recovery of industrial production in BiH too. Full consolidation of the EU market is expected in this period, recovery of private consumption, overcoming of problems regarding financing of companies and more intense foreign trade among the EU countries. Positive contribution to industrial production in the EU should also be expected from the measures contained in the EC document „*Communication for a European Industrial Renaissance*“ concerning the strengthening of the industrial base and competitiveness in the EU countries.⁸ These positive developments in the immediate neighbourhood should result in better utilisation of industrial capacities in BiH.

It is expected that this better utilisation of capacities will lead to increased number of employees and ultimately to increased production in the BiH processing industry reaching the level of the pre-crisis period when BiH achieved record growth rates in the region.

Planned investments in infrastructure and energy sector should also significantly contribute to strengthening of the BiH construction sector and those branches of the processing industry that are closely related to construction sector. It is also expected that the energy sector, as one of the drivers

⁵ DEP Projection, September 2014

⁶ IMF, World Economic Outlook, "An update of key WEO projections", 14 January 2014.

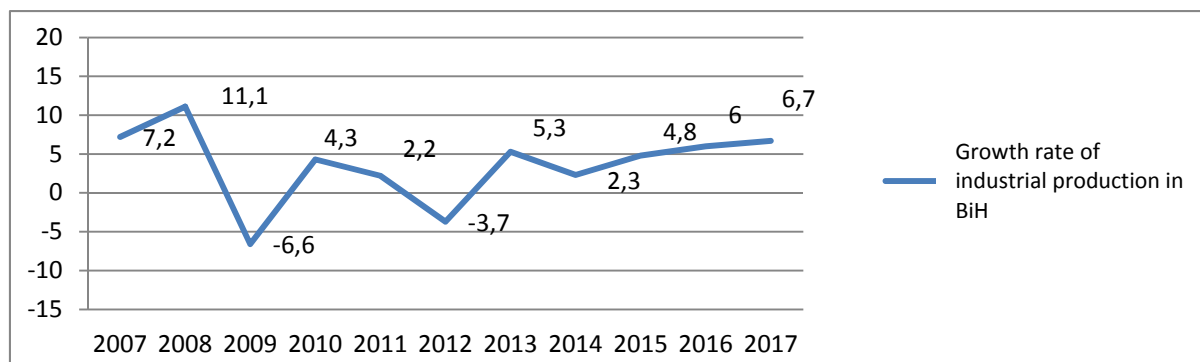
⁷ European Commission, Directorate –General for Economic and Financial Affairs, "European Economic Forecast", Autumn 2014

⁸ European Commission, "Communication from the EC to the European Parliament, The Council and The European and Social Committee of the Regions, "For a European Industrial Renaissance", Brussels, February 2014

of industrial production in the previous period, will continue an upward trend of output growth and additionally strengthen the BiH industrial production in the aforementioned period.⁹

Important contribution to improvement of industrial production in BiH and strengthening its competitive position should be given by concrete measures of the entity governments contained in the sector-based strategies.¹⁰ According to DEP estimates, this should result in annual increase in industrial production of over 6% as compared to the previous year.

Graph 1. Industrial production growth in BiH in the period 2007-2017



Risks

Potential risk for the aforementioned situation is uncertainty and still fragile economic recovery in immediate and broader international economic environment. High level of integration with the EU and countries in the region both through trade and financial flows practically determines the developments in the BiH industrial production. Possible deterioration of situation in the EU market, particularly in case of countries which are the main trade partners of BiH, is the highest risk for recovery of industrial production in BiH.

Labour market – projections 2014-2017

Although significant positive developments in the BiH labour market are not likely to occur, reduction in number of unemployed persons in the period January-September 2014 (0.4% y-o-y) points to the beginning of gradual increase in the number of employed persons in 2014. In the period January-August, the number of the employed persons has increased by 1.2%¹¹ y-o-y, with the highest increase of employment in the sectors of processing industry, accommodation and food catering services.¹² In the domain of net wages in BiH, moderate growth is expected relative to 2013, since wages in public administration should not change significantly (budgetary restrictions). Thus, the volume of business activity in other¹³ areas of activity would determine the level of wages in BiH as well as volume of employment. Average wage in 2014 and number of employed persons in BiH could increase by 0.7% and 1% y-o-y respectively.

Positive developments in the BiH labour market can be expected in 2015 when the number of the employed persons in BiH could increase relative to 2014 and the unemployment rate could be somewhat lower. EC foresees a decrease in unemployment rate and the increased number of

⁹ In the period 2016-2017, it is planned to put into operation new production capacities in the energy generation sector.

¹⁰ For an overview of the planned measures see: Federation of Bosnia and Herzegovina, Federal Ministry of Energy, Mining and Industry, Consolidated text of the Action Plan for Implementation of Projects – Development of Industrial Policy in FBiH 2011-2015”, Mostar, December 2013. Ministry of Industry, Energy and Mining of RS, “Sectoral strategy for industry development in RS”, Banja Luka 2009.

¹¹ Provisional data. Source: BHAS

¹² Source: BHAS. All data for 2014 are administrative, not from Labour Force Survey.

¹³ Other activities in the analysis include all areas of activities except public administration, health and education

employed persons in the EU, with faster economic growth relative to the previous year.¹⁴ Somewhat faster economic growth is expected in BiH too¹⁵ as compared to the previous year, which would contribute to increased number of employed persons (1.3%). Better business climate would reflect positively on net wages, which could grow in the observed year to around 1.8% y-o-y.¹⁶

According to DEP projections, better developments in BiH are expected in 2016 and 2017. Rising volume of investments, industrial production and trade should have positive effects on the labour market, specifically new jobs and average net wages increase. The number of employed persons in industrial production (processing industry), construction, as well as services (trade, catering, etc.) should be increasing, which is very important since these areas employ a large number of the employees in BiH. Based on the aforementioned, it is expected that in 2016 the total number of employed persons in BiH should increase by 1.6%, and 2.1% in 2017. Growth in volume of work should positively reflect on wages of the employed persons. The average net wage is assumed to rise by 2.5% in 2016 and 3.2% in 2017.

Risks

The main risks for attainment of the labour market projections are primarily the level of demand, investments and trade not only in BiH but the EU as well. Less than favourable business environment could affect the overall economic growth and protract positive developments in the labour market, namely the increase in number of employed persons and net wages.

Prices – projections 2014-2017

The same as in previous years, changes in prices in BiH are determined by movements of global prices of food and energy products (primarily oil and gas), as well as changes in prices of utilities, excise duties, etc. In developing BiH projections of prices for the period 2014-2017 we primarily analysed the aforementioned categories. According to the latest EC projections¹⁷ prices of oil in the global markets in 2014 should be somewhat lower than in 2013. It is similar with prices of food and gas, which should also be lower in the observed year.¹⁸ In accordance with this, EC foresees that inflation in the EU in 2014 should be somewhat lower than in 2013. General level of prices in BiH is not expected to rise if we take into account changes in prices of energy and food in the global markets. In the period January-September 2014, the recorded deflation in BiH stood at 1.2% y-o-y, whereas the prices mostly fell in items of food and non-alcoholic beverages, transport, clothing and footwear. Of domestic components contributing to rise in prices, we took into account new increase in excise duties¹⁹ on tobacco products in BiH, which is a continuation of excise harmonisation with the EU regulations. In the period of development of projections there were no announcements of rise in prices of electricity and other utilities, so increases in this category have not been taken into account. Based on the analysis of global prices, as well as domestic components, the deflation of 0.7% y-o-y is expected in BiH in 2014.

In 2015, according to projections of EC and IMF, prices of energy products in global markets should be lower relative to 2014. It is similar with the prices of food. BiH is expected to record a moderate rise in prices in 2015 relative to 2014. In developing projections, a continuation of increase in excise

¹⁴ Source: EC, European Economic Forecast, Autumn 2014

¹⁵ DEP projections

¹⁶ With larger volume of business activities of BiH companies the average net wage and number of employed persons could growth at a higher rate than the assumed one and vice versa.

¹⁷ Source: EC, European Economic Forecast, Autumn 2014

¹⁸ Source for projections of gas prices, IMF, Price forecast, November 2014. For prices of food, EC forecasts

¹⁹ Decision on Determination of special and minimum excise duty on cigarettes for 2014 stipulates that special excise should increase to KM 0.90 per pack of cigarettes whereas the minimum excise on cigarettes should equal KM 2.09 per pack of cigarettes. Source: Indirect Taxation Authority. As of August 2014, according to the Law on Excise Duties in BiH, excise duty on smoking tobacco is determined in the amount of at least 80% of the minimum excise duty on cigarettes.

duties on cigarettes was taken into account (harmonisation with the EU excise duties) so the inflation of 1% is expected in BiH in 2015. Similar movements in prices are foreseen for the period 2016-2017, i.e. inflation in BiH could reach between 0.9% and 1.2%.

Risks

Main risks identified for projections of prices are divided into two groups: external and domestic. External risks concern reduction of energy and food prices in global markets, which would contribute to slower rise in general level of prices and, in extreme case, continuation of deflation. Domestic risks primarily relate to unforeseen changes in utility prices.

Monetary sector 2014 - 2017

Central Bank BiH is functioning as a currency board, so its activities in terms of monetary policy are very limited. The only monetary policy instrument that CBBiH uses is determination of reserve requirements of commercial banks. The policy of required reserves has not changed since 2011. As of 2011, the rate of required reserve on deposits and loans with contracted maturity up to one year has reduced from 14% to 10%, whereas the rate of required reserve on deposits and loans with contracted maturity of over one year has remained unchanged since 2009 and equals 7%²⁰. Changes in rates of the required reserves have not significantly affect the behaviour of commercial banks. One of the characteristics of commercial banks' operations in BiH is keeping excessively high reserves with the CB BiH. Excess above the required reserves for the period January-September 2014 stands at KM 2.4 billion, whereas the average required reserves equal KM 1.4 billion.

The currency board rules state that reserve money (monetary base) always has to be covered 100% by foreign currency reserves. This ratio for nine months of 2014 stands at 109.3%, i.e. the currency board rules have been complied with.

Total money supply – broad money (M2) in nine months of 2014 has reached KM 17.0 billion and exceeds the level of previous year by 7.9%. All deposits comprising the money supply, as well as the currency outside the banks, recorded positive growth y-o-y. Table below provides a detailed overview of monetary aggregates movements.

Table 2. Movements in monetary aggregates in BiH (in million KM at the end of period)

Year	Currency outside banks	Transferable deposits in domestic currency	M1	Other deposits in domestic currency	Transferable deposits in foreign currency	Other deposits in foreign currency	QM	M2
	1	2	3=1+2	4	5	6	7=4+5+6	8=3+7
I-IX 2013	2,507	4,124	6,631	2,888	1,133	5,081	9,103	15,734
I-IX 2014	2,753	4,525	7,278	3,166	1,259	5,275	9,700	16,978
	Growth rate y-o-y							
I-IX 2013	3.5%	8.9%	6.8%	14.8%	9.2%	2.1%	6.7%	6.7%
I-IX 2014	9.8%	9.7%	9.8%	9.6%	11.1%	3.8%	6.6%	7.9%

Source: Central Bank BiH

With the assumption of further gradual recovery of the BiH economy, the expected total money supply growth rate by the end of 2014 could reach around 4% y-o-y. Reason for possible deceleration of growth is the expected slowdown in growth of total deposits²¹. In 2013, total deposits recorded a

²⁰ Source: www.cbbh.ba

²¹ In the period January-September 2014, 83.8% of total money supply comprised deposits, and 16.2% cash outside banks.

6.9% growth, which is the fastest growth in the past five years, namely since the economic crisis in 2008. This growth is primarily generated by the household sector, which has shown higher propensity to saving than to spending for a number of years. However, although the BiH economy is moving towards modest recovery, situation in the labour market is still far from any significant recovery. If we additionally take into account the floods that have destroyed many estates in 2014, growth in household savings will probably be lower, since they will have to direct part of their income on reconstruction of houses and estates. This should largely reflect on growth of total deposits.

Economic growth in BiH is expected to continue in the period 2015 – 2017, thereby its positive effects on development of monetary sector, i.e. continued growth of deposits (comprising M2) is expected, as well as cash outside banks. Growth rate of M2 could move from 5.5% - 7% y-o-y.

Foreign currency reserves in the period 2014 – 2017

Foreign currency reserves in the period January-September 2014 achieved growth of 12.1% year-on-year and reached the level of KM 7.7 billion. Although exports are expected to grow by the end of the year, imports are expected to rise too, which could decelerate growth in foreign currency reserves as compared to the previous year when BiH recorded positive annual exports and negative imports. It is also projected that remittances from abroad would decline, as well as inflows based on foreign direct investments, which would reflect positively on the state of the foreign currency reserves.

Economic recovery of the EU as our main trading partner is expected to continue in the period **2015. – 2017**, but at a slower pace.²² Therefore, the BiH foreign trade is expected to grow too. Growth of exports, as well as imports, followed by contraction in growth of remittances from abroad, inflows based on foreign direct investments and other cash inflows from abroad, will have positive effects on foreign currency reserves, whose average annual growth could reach up to 5%.

Risks

The aforementioned developments can be expected only if there is no significant external turmoil in terms of economic disruptions of the BiH main foreign trade partners, which would affect poor performance in the foreign trade sector, weakening of industrial production, investment and final consumption.

Forecast of banking loans and deposits growth trends for the period 2014– 2017

Since financial market in BiH is underdeveloped, the most important financial mediators are the commercial banks, so this section contains data for the banking sector. The assets of the banking sector have made up for 86.9% of the overall financial sector's assets in the first half of 2014.

Economic recovery of the BiH economy is expected to continue by the end of 2014 (foreign trade growth, final consumption and investments)²³. However, due to heavy floods that have swept BiH in May 2014, the GDP growth is most probably going to be somewhat lower than projected in the first quarter due to changed economic expectations, primarily in the area of foreign trade exchange²⁴.

In the labour market, a slight increase in the number of employed persons and net wages is still expected (in nominal terms), whereas, due to the process of reconstruction of the country, there could be a slight fall in the number of unemployed persons. However, pressure on household income

²² Source: European Commission, "European Economic Forecast – Autumn 2014", July 2014, p. 144, 167; International Monetary Fund, "World Economic Outlook", October 2014

²³ DEP projection

²⁴ DEP projection. See section entitled "Real sector" and "External sector".

could be even greater in 2014 because of the reconstruction process, which will reflect on savings of this sector. For this reason, it is expected that, by the end of the year, there will be a slight deceleration of the growth rate of the household sector deposits that make the highest share of the total deposits and, during the previous years, generated their growth. In 2014, total deposit growth rate can be expected to reach up to 5%.

On the other hand, a feeble final consumption growth is expected in 2014, partly financed by bank loans. Loan supply will largely depend on the domestic deposits developments, since there is a trend of decreasing of foreign liabilities of the banks in the course of the past several years, i.e. there is a trend of reduced exposure of foreign banking groups in BiH.²⁵ The supply will also depend on the quality of the loan portfolio, which has worsened in the past several years. On the other hand, due to the reconstruction process, demand for loans will most probably be somewhat higher relative to the previous years. By the end of 2014, total loans could grow up to 4.5% year-on-year.

Although the process of the BiH recovery will take many years, BiH is expected to record positive economic growth in the period 2015-2017. Increased demand for the BiH products by its foreign trade partners, as well as strengthened domestic demand in the coming period will have positive effects on the BiH foreign trade exchange. This period is expected to bring growth in industrial production and investments as well as further labour market stabilisation. These developments should positively reflect on the activities of the banking sector too. In the period 2015-2017, growth of loans could reach between 5% and 6%. Similar annual growth rates can be expected on the deposit side too (6% - 8%), whereas privatisation of strategic companies in BiH could bring particularly positive effects on growth of deposits.

Risks

The aforementioned developments can be expected only if there is no significant external turmoil in terms of economic disruptions of the BiH main foreign trade partners, which would affect poor performance in the foreign trade sector, weakening of industrial production, investments and final consumption. Such negative developments would reflect on the BiH banking sector in a form of further increase in irrecoverable assets, i.e. loans, fall in demand for new loans, increase in interest rates on loans, and in extreme case, outflow of domestic deposits.

Projections of BiH external sector 2014 – 2017

According to data of BHAS, the exports of goods in 2013 recorded a nominal increase of 6.6%, whereas the imports recorded a decrease of 0.5% (see the explanation in the text box).

For the purpose of developing the macroeconomic projections and preparation of this document, we have used data from the Central Bank (Balance of Payments) and BHAS (National Accounts). The numbers stated in these sources differ from the data published by BHAS within the Foreign trade statistics. Foreign trade statistics publishes total exports, disaggregated on regular exports, exports after internal processing and exports for final processing. The same applies for the imports. In the balance of payments, regular exports (according to BHAS), with some adjustments, refer to exports of goods, whereas the exports after internal processing refer to exports of services. Deviations based on these two approaches are insignificant, whereas the growth rates, observed historically, show the same trend with only minimum difference in value. For instance:

BHAS:

Total exports of goods: KM 8.3 billion
 Regular export of goods: KM 5.3 billion
 Export after internal processing: KM 3.1 billion
 Export for external processing: KM 0.01 billion

BoP:

Export of goods and services: KM 8.4 bill
 Export of goods: KM 5.4 billion
 Export of services: KM 3.0 billion

²⁵ Source: "Financial Stability Report 2012", Central Bank BiH, p. 49 data on foreign assets and liabilities of commercial banks in BiH.

Based on available data for 2014, exports of goods and services at the end of the year are assumed to achieve somewhat lower growth than the year before (5.0% real growth), whereas real exports of goods will reach approximately 7.9%. This exports growth will be mainly affected by reduced export of electricity, which is assumed to decelerate its decrease by the end of the year. On the other hand, the reduced export of aluminium and other base metals also affects the decrease in exports, which is present all around the year, as well as a natural disaster that affected BiH. Domestic demand is expected to rise by the end of the year, which will directly reflect on increase in demand for imported products. Along with the rise in demand and price reduction of the leading import products, growth of import of goods and services is expected to reach as high as 7.5% in real terms, whereas the export of goods will amount to 7.8%. Such a movement of imports and exports should lead to an increase in the foreign trade deficit whose share in GDP would thereby rise too.

Economic growth is expected to take a somewhat faster pace in the period **2015-2017**, followed by an increase in both domestic and foreign demand for goods. This growth should speed up a rise in exports of goods, as well as keep the imports rate at some steady level (after a significant imports increase in 2014). The main BiH trade partner (EU) is expected to increase the imports rate in 2015, resulting in an increase of demand for our products. Exports of electricity, our main export product, are expected to rise in the same period. This is assumed to be followed by the export of other important products such as aluminium, iron and steel, machines and appliances, spare parts for motor vehicles, and furniture. All the aforementioned should lead to growth in real export of goods of approximately 8.4%. On the other hand, rising domestic demand, followed by increased employment and wages, would lead to growth in imports of goods. The growth rate of imports of goods would move around 3.5% in real terms. Somewhat lower growth rate of imports is expected as compared to the previous year due to the assumption of rise in the import prices. The foreign trade deficit is expected to slightly increase over this year, whereas over the subsequent years it should decrease. The share of exports in GDP is expected to rise in the period 2015- 2017 at the expense of reduction in the share of imports and foreign trade deficit. Steady economic growth is expected in 2016 and 2017, followed by faster expansion of exports relative to imports, which would result in improved foreign trade sector developments.

Risks

The aforementioned developments can be expected only if there are no downside developments such as: new fall in electricity exports; abrupt rise in export and import prices of the main export and imports commodity categories; problems in functioning of the economies of the BiH main trade partners; reduction in industrial production, investments, consumption, as well as new natural disasters, or any other developments that could exacerbate foreign trade exchange.

Projections of foreign direct investments for the period 2014-2017

The total expected foreign investments in 2014 will amount to KM 540-600 million. Out of this amount, around KM 200 to 260 million would account for the usual investments based on the average of the previous three years and the forecasts of mild economic growth in the European Union and weak growth in the neighbouring countries. Foreign investments in electrical energy sector are expected to amount to KM 340 million (EFT Group would invest around KM 290 million; Comsar Energy Group Ltd. around KM 50 million).

In July 2013, KTG Zenica signed a contract with the Chinese company SEPCO III for the construction of the Heat and Thermal Power Plant Zenica. SEPCO III should finalise the HTP Zenica according to the turnkey system within 29 months, with the overall planned investments in the project of KM 500 million (EUR 250 million). According to the latest available data, the construction of the HTP Zenica is not going to start this year.

The EFT Group (Energy Financing Team) signed the concession contracts for the construction of TPP Stanari and the expansion of the existing mine as well as the construction of the Hydro Power Plant - HPP Ulog (construction is entrusted to the Chinese company Sinohydro). The total investments in these projects will reach KM 1.2 billion by the end of 2017. Following the existing dynamics of investments, the EFT Group would secure around KM 290 million in 2014.

In RS, the beginning of the construction of the TPP Ugljevik 3 is planned in the total amount of around KM 1.4 billion over the period of 3-4 years, while the works should be carried out by a jointly established company "Comsar Energy RS" where the 90% owner is the "Comsar Energy Ltd" and the 10% owner is the "Mine and Thermal Power Plant Ugljevik". The construction contract is signed with the Chinese "China Power Engineering Consulting Group Corporation (CPECC)", whereas, according to the plan, the full technological and engineering process of the construction will be managed by the American company "Black and Veatch". The beginning of the construction works is planned in the second half of the year, while the assumed investments for this year would amount to around KM 50 million.

Preconditions for the beginning of privatization were not created by the end of 2013, so this process is expected to resume in 2014 according to the already adopted plan.

Foreign direct investments in 2015 are expected to reach the amount of KM 880-940 million.

Investments in energy generation sector could amount to KM 690 million in total (company EFT up to KM 340 million, Comsar Energy Ltd. up to KM 200 million and HTP Zenica up to KM 150 million), and investments in other sectors will range between KM 190-250 million.

The investments of the "EFT group" in "TPP Stanari" amount to KM 300 million, and it is expected that the construction of "HPP Ulog" by the same Group would start too with the average annual investment of up to KM 40 million. Comsar Energy Ltd. has planned to start the construction of the "HPP Mršovo" (37.3 MW) in the total value of KM 200 million. The construction would take three to four years and bring annually around KM 50 million on average. There is also the continued investment in "TPP Ugljevik 3" in the amount of KM 150 million. In 2015, the construction of "HTP Zenica" will continue with the assumed investment of up to KM 150 million.

Possible beginning of the construction of "TPP Tuzla Block 7" with total capacity of 450 MW in the total amount of KM 1.647 billion has not been taken into account since currently the option of financing through loans is being under consideration (not foreign direct investment). We have not taken into account the announced investment in the amount of KM 20 million for gasification of the facilities in the "Oil Refinery Bosanski Brod" d.o.o. Bosanski Brod, which should be finalised by the end of 2015.

The beginning of the implementation of the project of construction of electricity system "Hydro Power System Gornja Drina" is uncertain (contract on strategic partnership in research, development, construction and utilisation of hydro power potentials of the upper basin of the Drina, concluded between "Elektroprivreda RS" and a German company "RWE-Innogy" has been terminated; they are currently trying to find a new partner). The investment during the first year of construction of HPS Gornja Drina was originally planned to amount to KM 50 million, whereas subsequent average annual investments were planned to reach around KM 150 million.

There is a plan for the construction of the highway section between Doboj Jug and Žepče where, on the basis of the awarded concession (according to the D-B system –Design and Build) the needed funds could be secured in the total amount of EUR 380 million, which would be successively paid in line with the construction of the sections in the coming period. The construction of the highway section between Doboj and Vukosavlje has been planned where the needed funds in the amount of around EUR 350 million would be secured on the principle of the public-private partnership.

Foreign direct investments in 2016 are expected to reach KM 980-1,080 million. Investments in the BiH energy generation sector would amount to around KM 680 million (investment of the EFT Group of around KM 230 million and investment of Comsar Energy Ltd. in the amount of KM 200 million and HTP Zenica of KM 250 million). Investments in the construction of the two highway sections on the Corridor 5c would bring KM 100 million, whereas the average investments in other sectors would range from KM 200 million to KM 300 million.

In addition to the "EFT Group" investments ("TPP Stanari" up to KM 200 million and "HPP Ulog" up to KM 30 million) and "Comsar Energy Ltd" ("TPP Ugljevik 3" up to KM 150 million and continuation of "HPP Mršovo" with the investment of around KM 50 million), there is also finalisation of the main works on "HTP Zenica" with KM 250 million.

The beginning of the construction of the highway section Doboj-Vukosavlje is certain, which would bring KM 50 million, as well as the section Doboj Jug-Žepče with KM 50 million too.

Possible investments in "HPS Gornja Drina" that would bring approximately KM 100 million in the coming period have not been taken into consideration in these projections. There are also good chances for beginning of investments in the project "HPS Srednja Drina" with investments during the first year of around KM 50 million and average investments of around KM 100 million in the subsequent period.

A project of gas supply and transmission in RS through connection to the gas pipeline network "South Stream", whose one section should come to Zvornik at the beginning of 2016 is still uncertain. The project in the total amount of EUR 500 million would be implemented by a joint company "Gas-Res" and "Gasprom". Within the project, there are plans to construct two gas plants with the total capacity 600 MW with gas supply system for municipalities while the town of Banja Luka would get a heating plant with the capacity 150 MW.

Foreign direct investments in 2017 are expected to reach KM 940 - 1,040 million. Investments in energy generation sector would amount to KM 440 million (TPP Ugljevik 3 with KM 250 million, and HPP Mršovo with KM 50 million as well as final works on HTP Zenica with KM 90 million, with the investment in HPS Gornja Drina of KM 50 million). Foreign investments in highways are set at KM 200 million while the other investments would range between KM 300 million and KM 400 million.

The investments in the section of the South Stream gas pipeline passing through RS, which would bring around KM 50 million in the first year, have not been taken into consideration in this projection. Neither have been considered the further investments in the project HPS Srednja Drina nor the possible investments in TPP Kakanj Block 8.

The continued construction of the highway section Doboj Jug – Žepče would bring KM 100 million, as well as the section Doboj – Vukosavlje with KM 100 million too.

Investments in the project HPS Donja Drina have not been considered either. So far, the RS Government has signed an agreement with the American company NGP on research and development of feasibility study on hydro potentials of the lower basin of the river Drina (HPS Donja Drina with hydro power plants Kozluk, Drina 1, Drina 2 and Drina 3 with the total installed capacity 365 MW and the overall investment in the amount of EUR 1.3 billion).

Risks

According to the existing estimates, the risk would mostly reflect in reduced investments in oil sector and partly in energy generation sector, and loss of interest of foreign investors in carrying out the privatisation process of the remaining state-owned capital. Finding a strategic partner and ways of

funding for the inevitable reconstruction of the FBiH energy generating system are still uncertain for the projects HTP Zenica, TPP Tuzla and TPP Kakanj, as well as strategic partners for the projects HPS Gornja Drina and HPS Srednja Drina, which also require approval from the governments of the neighbouring countries. Partners, or rather the concessioner for construction of the highway sections on the Corridor 5c have not been found yet, whereas the construction of the section of the South Stream gas pipeline passing through RS is currently on a standstill. In addition to lower interest of foreign partners due to lack of funding (mostly loans), one obstacle could be possible reduced need for electricity in the region caused by reduced economic activity, or rather a low price of electricity. A realistic option is more frequent cooperation with Chinese companies that use the turnkey system, which, in addition to implementation of construction works, also offer loans by Chinese (mostly state-owned) development banks. Further investments in expansion of production capacities of the Oil Refinery Brod are also uncertain due to a new competitor Gasprom (Oil Refinery Pančevo) on the market, which is also mainly in state ownership (Russian Federation). Privatisation process in BiH can also come under question mark, and it can be expected that the companies planned for privatisation such as Energopetrol d.d. Sarajevo, Hidrogradnja d.d., Šipad export-import d.d. Sarajevo, do not find interested buyers. Reduced direct investments would also manifest through contracted investments in other sectors relative to the average by now.

2.2 Alternative scenario and risks

Table 3. Main macroeconomic indicators

Indicator	Official data	Projections				
	2013	2014	2015	2016	2017	
Nominal GDP in million KM	28,027	28,738	29,447	30,632	32,190	
Nominal growth in %	2.6	2.5	2.5	4.0	5.1	
GDP deflator (previous year = 100)	101.9	101.4	101.2	101.3	101.8	
Real GDP in million KM (previous year = 100)	27,501	28,328	29,107	30,250	31,612	
Real growth in %	0.7	1.1	1.3	2.7	3.2	
Inflation measured by consumer price index in %	-0.1	-0.7	0.8	0.6	1	
Consumption in million KM	28,815	29,477	29,982	30,544	31,432	
Government consumption in million KM	5,986	6,457	6,534	6,665	6,865	
Private consumption in million KM	22,829	23,020	23,448	23,879	24,567	
(Gross) fixed capital formation in million KM	4,703	5,256	5,610	6,390	7,188	
Government investments in million KM	1,041	1,302	1,458	1,822	2,132	
Private investments in million KM	3,662	3,954	4,152	4,567	5,056	
National Gross savings in % of GDP	11.9	12.0	12.4	13.7	14.9	
Current account balance in million KM	-1,435	-1,924	-2,115	-2,214	-2,337	
Current account balance in % of GDP	-5.1	-6.7	-7.2	-7.2	-7.3	
Nominal imports growth in %	-1.8	6.5	4.4	3.3	4.0	
Nominal exports growth in %	5.8	4.1	5.0	5.4	6.4	

Given that DG ECFIN projections used as the main external assumptions of the baseline macroeconomic scenario for BiH forecast the risks tilted to the downside, this has prominently determined the BiH alternative scenario as well. The uncertainty of trends in the neighbourhood has been clearly indicated in significant lowering in the autumn economic forecasts of the Euro area relative to the spring projections. Materialisation of some of the potential growth risks in the neighbourhood could hamper the projected BiH economic growth, primarily by weakened growth of export demand and weaker (than expected) current and financial cash inflows from abroad. In this event, according to the alternative scenario, growth in domestic demand would be almost halved in 2015 while the exports would be more than halved relative to the baseline scenario. Weaker growth

of domestic demand is primarily caused by private consumption whose growth declined from 1.8% to 1% in the alternative scenario. This is a consequence (relative to the baseline scenario) of slower employment growth due to decelerated exports growth, as well as weak increase in foreign inflows that finance a significant portion of consumption.

Result of these movements is low economic growth in 2015 set at 1.3% according to the alternative scenario, which is only a third of the baseline scenario projections. Downside risks are predominant in the coming period as well, without changes in modality of action but with gradual weakening of intensity. Thus the economic growth according to the alternative scenario in the period 2016-2017 would be almost a third lower relative to the baseline assumptions.

In the past several years, **industrial production trends in** Bosnia and Herzegovina were determined by intertwined effects of a series of internal and external factors. Changes in domestic demand were less significant and mainly reflected through the energy sector, mining and a very small portion of the processing industry whereas the developments in the export markets played a primary role and practically fully determined the trends in the BiH industrial production. This is especially true of the processing industry, which is mainly export oriented and whose developments are determined by demand for the BiH products in the market of our main trade partners. It is weakening of the export demand and high concentration of the BiH exports in the markets of the EU and countries of the region that poses the greatest risk when it comes to industrial production developments in Bosnia and Herzegovina in the course of 2015. Namely, some preliminary data of Eurostat²⁶ and research conducted by DG Enterprise and Industry²⁷ already indicate that the trend of relative recovery in industries could come to a stop. Such developments in the export markets could reflect negatively on the countries in the region and subsequently the BiH processing industry as well.

On the other hand, obsolete thermal energy plants and high dependence on hydro-meteorological impacts in the energy generation sector also poses a risk when it comes to industrial production developments in BiH. Consequently, we can state that the external risks in the processing industry combined with the internal risks in the energy sector could result in feeble growth of physical volume of industrial production at the end of 2015.²⁸ In the period 2016-2017, partial improvement of economic activity is foreseen in the international economic environment, which will result in improvement of the BiH processing industry output. Electricity generation sector is expected to put into operation new thermal energy plants in this period and thereby additionally strengthen the overall industrial production in BiH. However, the projected growth rates are not on the pre-crisis level when BiH achieved the highest growth rates in the region.

The main risks to the **labour market** projections primarily relate to the level of demand, investments and trade in the EU and neighbouring countries.

Less than satisfactory level of foreign trade and investments in 2015-2017 would decelerate economic growth and some major positive developments in the labour market would fail to appear. Low or even negative economic growth in the EU (in extreme case) would poorly reflect on trade volume of the BiH companies. Possibilities of job creation and employment, both in BiH and on international scale, would be uncertain. The alternative macroeconomic scenario would limit the number of employed persons since the employers would try to do business with lower labour costs (due to poor business opportunities). Modest volume of work would make growth of average net wages extremely low, even negative in some industries. Generally, the above mentioned scenario would postpone the BiH labour market recovery.

²⁶ Eurostat, Newsrelease euroindicators, 152/2014-14 October 2014.

²⁷ DG Enterprise and Industry, Industrial policy indicators and analysis, n. 9/2014.

²⁸ DEP Projections, November 2014

The main risks identified for projections of **prices** in the baseline scenario have been divided into two groups: external and domestic. External risks concern contrary to the projected changes in prices of energy and food in global markets. Domestic risks primarily relate to unforeseen and unannounced changes in utility prices.

The alternative scenario assumes somewhat lower inflation (as compared to the baseline scenario) if there are no significant changes in 2015 in prices of food and transport compared to 2014 (with stagnation of utility prices). In the extreme case, a new fall in prices of oil and food could again result in deflation in BiH. Since Bosnia and Herzegovina is a small and open country, the impacts from broader environment strongly affect the economic developments in the country. In case of significant economic turmoil in the period 2015-2017 such as a new recession in the Euro area countries that BiH mostly trades with, as well as in the countries in the close neighbourhood, BiH would feel the consequences primarily in its foreign trade sector, which would result in a slowdown of industrial production and investments, which are already at a low level. Further stagnation in the labour market and reduction of disposable income would lead to deceleration of final consumption again.

Since **credit activity** has already been weak from several years back, the aforementioned scenario would lead to further weakening, possibly even negative growth of credit activity. On the other hand, the aforementioned scenario combined with the natural disaster from 2014, which will make the country recover for years, would certainly lead to a significant slowdown in domestic deposits growth due to deceleration of growth in deposits of households and negative growth in deposits of non-financial companies, with further consequences in deceleration of money supply growth.

The main assumption for development of alternative scenario for the **foreign trade** has been negative economic growth in the EU, accompanied by a decrease in production processes in the European economy, reduced investments, as well as decline in demand for import of products. As over 70% of the BiH exports is directed to the markets of the European Union, developments in the EU would directly reflect on the BiH economy, namely through: slower inflow or even reduced inflow of investments; decrease in remittances from abroad, and increase in trade deficit. In case of reduced production in the EU, particularly in the area of processing industry, this would lead to lower need for imports of the BiH products, particularly in the categories of intermediary goods (various raw materials, aluminium, iron), capital goods (machines, appliances, equipment), with dominant spare parts for automotive industry. All the aforementioned would lead to a significant slowdown of the exports growth (twice slower than in the baseline scenario).

On the other hand, the above mentioned external developments would significantly reflect on domestic demand too. With low investments and cash inflows, the needs for consumption of specific products would shrink, which would lead to somewhat lower imports than assumed in the baseline scenario. Imports of capital goods, namely machines, appliances and equipment, due to insufficient investments and weak business activity of domestic companies would affect the significantly lower growth rate than projected in the baseline scenario. The same would happen with the imports of intermediary products (various industrial raw materials) as well as consumer goods (household appliances, furniture, consumer electronics...).

In case of the foreseen recovery of the EU economy in 2016 and 2017, accompanied by somewhat faster economic growth, than we can expect faster economic growth in BiH than the one achieved previous year. This growth should be accompanied by an increase in investments, incomes, and accordingly, consumption. In the stated period, the main BiH trade partner (EU) foresees an increase in the imports rate, resulting in an increased demand for our products. Our main export products should be: electricity, aluminium, iron and steel, machines and appliances, spare parts for motor vehicles, and furniture.

The domestic demand side is expected to increase too, primarily driven by consumption growth. Consumption growth would be driven by an increase in the number of employed persons and their incomes, inflow of investments as well as investments in manufacturing processes. This should lead to rise in imports (at a somewhat lower rate) of foodstuffs, products for the needs of processing industry, construction, and other products. Exports are expected to grow faster than imports in this period, which should lead to reduction of the foreign trade deficit.

Possible economic slowdown accompanied by contracted **direct investments** from the European Union and the countries from the neighbourhood would inevitably reflect on BiH as well. The risk of prolonged period of reaching a political consensus for forming the government at all levels would also have negative impact on political and economic stability of the country, as well as business environment, which could ultimately result in worse credit rating of the country. This would reflect in reduced interest of foreign investors to invest in electricity generation sector, infrastructural projects and process of privatisation of the remaining state-owned capital.

An obstacle could also be a falling demand for electricity in the region caused by lower economic activity and drop in prices of electricity in the market. This would also put into question the process of finding a strategic partner and ways of funding for the inevitable reconstruction and construction of new capacities.

3 FISCAL FRAMEWORK

Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2015-2017 was prepared on the basis of the Law on Fiscal Council in Bosnia and Herzegovina ("Official Gazette of Bosnia and Herzegovina", No.: 63/08), defining the contents of the document. In this regard, the document contains all the necessary elements, enabling the competent fiscal policy authorities in Bosnia and Herzegovina to prepare their framework budget documents for the period 2015-2017, as well as their annual budgets for 2015. These elements are represented by fiscal goals defined as primary fiscal balance (primary surplus or primary deficit), projections of total indirect taxes based on macroeconomic projections and their distribution for the following fiscal year, as well as upper limits of borrowings of the budgets of the institutions of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina, Republika Srpska and Brčko District.

Grounds for determining the fiscal goal are represented by projections of basic macroeconomic indicators, with special emphasis on macroeconomic measures directly influencing fiscal policy elements, primarily public revenues and projections of direct tax revenues representing about 80 per cent of tax revenues.

Disbursement of revenues will be performed in accordance with applicable provisions, while the amount of KM750 million from the Indirect Taxation Authority Single Account will be used for financing institutions of Bosnia and Herzegovina in 2015. The remaining amount of indirect taxes will be distributed between the Entities and Brčko District in accordance with legal provisions and by-laws adopted by the Management Board of the Indirect Taxation Authority.

The determined amount of KM750 million for financing the institutions of Bosnia and Herzegovina in 2016 and 2017 will be adjusted in accordance with changes in total indirect tax revenues during the procedure of reviewing the Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2015-2017, in accordance with Article 5, paragraph (3), point d) and Article 6 of the Law on Fiscal Council of Bosnia and Herzegovina.

In 2015, the primary fiscal balance, defined in accordance with Article 1, paragraph (2) of the Law on Fiscal Council of Bosnia and Herzegovina, is planned as a deficit in the amount of KM324.8 million or 1.1 per cent of projected GDP for 2015. New projections of macroeconomic indicators and indirect taxes revenues projections based on projections of macroeconomic indicators, as well as consolidated projections of revenues and expenditures (budget draft for 2015²⁹) of all levels of government in Bosnia and Herzegovina, suggest successful achievement of this goal.

Public expenditures level, as part of GDP, should be lowered during the 2015-2017 period with the aim to achieve the lower consolidated level of public expenditures at the level of Bosnia and Herzegovina, i.e. below 40 per cent of GDP as of 2015. During the 2015-2017 period, additional efforts are required in order for the structure of public expenditures to be changed with the aim of strengthening capital investments at the expense of current expenditures. In accordance with adopted policies, each level of government determines the final structure of expenditures and revenues in its Framework Budget Document and in the annual budget.

Consolidated general government budget data, enclosed herein (Table 2) and prepared on the basis of inputs submitted by the Entities, Brčko District and the institutions of Bosnia and Herzegovina, suggest that the level of public spending in 2015 will reach 40.6 per cent of GDP and decrease to the level of 35.6 per cent of GDP by the end of the concerned period. For the most part, fiscal adjustment pertains to expenditures where it is planned for the adjustments to be achieved through a series of measures and policies related to strict control of current expenditures. In this regard, the predicted level of lowering the spending in the 2015-2017 period is 5 index points. Main policies to be implemented on all levels of government still relate to limitations in new employment, limitations/reductions and strict control of execution of current expenditures (salaries and material costs), as well as limitations of social transfers growth. When it comes to revenues, top priorities relate to improvement of collection of taxes and strengthening Indirect Taxation Authority and Entity Tax Administrations capacities.

It is planned for the uncovered excess of expenditures over revenues in the budget of the institutions of Bosnia and Herzegovina to be financed from the Stand-by Arrangement funds transferred from previous periods, cash flows under dividends of public enterprises and issuance of short-term and long-term securities.

Fiscal positions of the institutions of Bosnia and Herzegovina and Entities in accordance with constitutional settlement in Bosnia and Herzegovina and policies described in the Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina adopted in Framework Budget Documents of the institutions of Bosnia and Herzegovina, Entities and Brčko District and in accordance with policies adopted by all levels of government are described in the following text.

3.1 Policy strategy and medium-term objectives

Indirect taxes

In 2014, amendments to the Law on Excise Duties came into force. Amendments related to taxation of tobacco came into force on 1 August 2014, while amendments related to beer came into force on 1 September 2014. Changes of tobacco taxation policy have a twofold aim: further adjustments of excise policy with the aim of harmonisation with EU standards and stabilisation of tobacco market and revenues from excise duties on tobacco.

²⁹ Only Republika Srpska adopted its budget for 2015 before the prescribed deadline.

In this regard, the new policy implies accepting the minimum excise duty of EUR90 for 1000 cigarettes and introducing the concept of weighted average cigarette price instead of the most popular price category ("MPPC") concept. The dynamics of increase in the amount of KM7.50 for 1000 cigarettes in the specific excise duty on cigarettes will be maintained, until the total excise duty (ad valorem and specific) for each cigarette brand reaches the minimum EU standard of EUR90 for 1000 cigarettes. Minimum excise duty on cigarettes is at least 60 per cent of the weighted retail sale price of cigarettes. When it comes to taxation of fine cut tobacco, ad valorem excise duty for 2014 has been abolished and specific excise duty has been introduced in the amount of KM78.00 for 1 kg. For each following year the specific excise duty on fine cut tobacco may amount to 80 per cent of minimum excise duty on cigarettes. The aim of tying growth of excise duty burden on cut tobacco to growth of excise duties burden on cigarettes is to de-stimulate growing substitution of cigarettes with cut tobacco and to stop further erosion of revenues. In addition to tax measures for stabilising tobacco market and revenues from excise duties, coordinated operative measures of competent institutions at the level of Bosnia and Herzegovina aimed at combating black-marketing and smuggling, as well as of competent Entity institutions with the aim of exposing illegal domestic production and turnover of tobacco and cigarettes are necessary.

Amendments to the Law on Excise Duties related to taxation of beer includes introduction of a differentiated excise duty rate, i.e. KM0.25 for 1 litre for tax payers whose annual production amounts to more than 400.000.00 hectolitres and a lower rate of KM0.20/l for tax payers below the prescribed threshold.

Federation of Bosnia and Herzegovina

Fiscal policy of the Government of the Federation of Bosnia and Herzegovina in the future period will be aimed at:

- Securing macro-economic and fiscal stability;
- Improving fiscal transparency with emphasis on increased fiscal responsibility of all budget users;
- Securing fiscal sector stability;
- Restructuring public spending and maintaining social stability and social justice;
- Maintaining labour market and increasing employment through initiation of public works;
- Public administration reform.

In the domain of fiscal policy, the Government of the Federation of Bosnia and Herzegovina, due to the decentralised system in the Federation of Bosnia and Herzegovina, has a limited capacity regarding lower levels of government (without the possibility of ordering direct measures and policies except through adoption of laws in particular domains).

The new Law on Income Tax prepared with IMF technical assistance and containing solutions based on protection of cost basis has been submitted for consideration under the Parliamentary procedure. Among other things, the method of recognition and repudiation for tax purposes of reserves the banks are obliged to form in accordance with the Decision of the Banking Agency of Bosnia and Herzegovina has been prescribed. Proposed modifications of this Law gave a more precise definition of transfer prices in accordance with OECD model, simplified taxation of legal persons through implementation of International Accounting Standards and adjusted criminal provisions of this Law to the Law on Misdemeanours.

Due to the existing need for comprehensive legal regulation of games of chance, as well as with the aim of creating conditions for achieving effects of multiple increases of revenues to be collected on the basis of fees derived from games of chance, the new Law on Games of Chance has been drafted and submitted to the Parliament in 2014.

Adoption of the new Law on Games of Chance as a systematic law in this area would enable for the following aims to be achieved:

- Games of chance market would be regulated and all preconditions for improvement of fiscal discipline of subjects operating in this domain would be in place;
- Preconditions for multiple increases of revenues to be collected on the basis of fees derived from games of chance;
- Complete procedure and conditions for giving approvals would be regulated in more detail, enabling more precise financial, spatial, technical and other conditions to be fulfilled in order to obtain approval;
- Establishment of efficient and reliable system of supervision and control of entire operation and turnover realised by organisers of games of chance;
- Fulfil obligations for harmonising certain provisions of this law with EU regulations in the domain of prevention of money laundering and financing terrorism;
- Create preconditions for significant increase of total amount of funds to be distributed for financing projects and programs in the field of labour and social policy, culture and sport, health care, science and education, as well as development of technical culture and innovations.

Provisions on the Law on Tax Administration will be adjusted to initiatives and proposals for amendments to the Law regulating direct taxes, administrative fees and other public revenues, with the aim of more efficient implementation of these Laws. Likewise, possibilities of adopting the Law on Tax Procedure in accordance with the principles used in the new Law in Republika Srpska are currently being considered. In this regard, during the following period, efforts regarding human resources, technical and financial conditions will be intensified in order to improve operations and efficiency of the Tax Administration of the Federation of Bosnia and Herzegovina. This could result in increase of revenues controlled by the Tax Administration by 2 per cent, i.e. KM64 million.

In this regard, the Protocol on exchange of information between the Indirect Taxation Authority (UIO) and the Government of the Federation of Bosnia and Herzegovina has been approved. The Protocol defines instruments for regulating methods and extent of mutual exchange of information in data bases of the Indirect Taxation Authority and the Government of the Federation of Bosnia and Herzegovina and confidentiality of information. The Protocol also envisages for the data to be used exclusively for the needs of performing operations under the competency of the Indirect Taxation Authority and the Government of the Federation of Bosnia and Herzegovina and may not be disclosed publicly.

In the following period, fiscal policy of the Government of the Federation of Bosnia and Herzegovina will be based on strengthening the Taxation Authority of the Federation of Bosnia and Herzegovina, with the aim of improving revenues collection and decreasing fiscal evasion, i.e. increasing tax payers' discipline. In accordance with the stated, the Government of the Federation of Bosnia and Herzegovina adopted a strategic plan of the Tax Administration of Bosnia and Herzegovina for the 2014-2018 period, the implementation of which will be performed in accordance with available budget funds. Implementation of the strategic plan implies significant human resources and infrastructural capacities, resulting in increase in the number of tax inspectors in the Tax Administration and Federal Directorate for Inspection. The primary aim of the strategic plan is to increase and improve tax collection from tax payers. Modernisation of the Tax Administration of the Federation of Bosnia and Herzegovina requires detailed planning, clear identification of responsibilities, coordination of employment and educational activities, changes to work methods, improvement of services provided to tax payers and citizens and improvement of information technology. The Government of the Federation of Bosnia and Herzegovina will make an effort to secure necessary budget funds in order to support this reform of great significance to the Federation of Bosnia and Herzegovina. We would like to emphasize that most of revenues collected by the Tax

Administration of the Federation of Bosnia and Herzegovina is spent by the lower levels of government (cantons and municipalities) and non-budget funds, with the exception of tax on corporate income of public enterprises owned by the Federation of Bosnia and Herzegovina.

When it comes to taxation of income of private persons in the Federation of Bosnia and Herzegovina, amendments to the Law on the basis of proposals defined by tax payers and competent institutions will be implemented with the aim of securing necessary balance of satisfying social aspect of this Law through fair distribution of tax burden between different tax payer categories, economic aspect in view of creating more favourable conditions for economic activities and fiscal aspect represented by stable cost basis for fiscal sustainability.

With the aim of rationalisation of burden borne by the economy, the following period will see initiation of activities aimed at implementation of project focused on simplification of public revenues payment procedure. Implementation of the said Project would result in multiple benefits for tax payers and the Tax Administration of the Federation of Bosnia and Herzegovina in view of more expedient process and decreased costs, decrease of average collection costs, as well as increase in view of the rate of voluntary settlement of tax obligation, thus encouraging tax payers to timely settle their obligations.

Other activities in the domain of tax policy should affirm:

- Transparency of collection of all public revenues, especially improvement in collection of tax debts;
- Modernisation of the Tax Administration of the Federation of Bosnia and Herzegovina;
- Exchange of information on tax payers and tax debtors between the Indirect Taxation Authority, Entity tax administrations and Tax Administration of Brčko District;
- Fiscal reporting;
- More efficient management of public revenues;
- Defining solutions with the aim of decreasing burden borne by employers, with maintaining fiscal sustainability of non-budget funds;
- Creating conditions for faster economy growth, upgrading and improvement of tax system in the domain of direct taxes.

During the following period, it is expected for the Parliament of the Federation of Bosnia and Herzegovina to adopt the following laws submitted for Parliamentary procedure in 2014:

- The new Law on Corporate Income Tax with neutral influence on revenues;
- The new Law on Games of Chance with the aim of securing additional funds for the budget of the Federation of Bosnia and Herzegovina estimated in the additional funds in amount of KM30 million in 2015 and KM20 million in 2016.

Likewise, it is expected for the Law on Amendments to the Law on Fiscal Systems to be submitted for the Parliamentary procedure.

On the basis of analysis of existing regulations in the domain of public revenues and direct taxes, it is expected for the following to be prepared:

- The new Law on Determining Public Revenues in the Territory of the Federation of Bosnia and Herzegovina;
- Law on Amendments to the Law on Income Tax;
- Law on Amendments to the Law on the Tax Administration of the Federation of Bosnia and Herzegovina or new Law on Tax Administration of the Federation of Bosnia and Herzegovina.

Realisation of mid-term goals in the domain of taxation and public revenues policies primarily depends on adjusting priorities of economic policy of the new legislative and executive bodies in the Federation of Bosnia and Herzegovina to the existing policies, since 2014 was an election year in Bosnia and Herzegovina.

In addition, unforeseen events such as the natural disaster in 2014 may delay realisation of certain policies through re-direction of activities and funds to implementation of other, unforeseen policy measures.

Realisation of planned activities will also depend on political stability and institutional readiness of activity bearers. Collection of indirect tax revenues will also depend on quality coordination of all users, institutions of Bosnia and Herzegovina, Entities and Brčko District on one part and all users of indirect tax revenues in the Federation of Bosnia and Herzegovina on the other part, with emphasis on continuous adjustment of coefficients for distribution of these revenues to users.

In the Federation of Bosnia and Herzegovina, public revenues derived from taxes, duties, fees, contributions and other revenues are collected and distributed in accordance with applicable provisions in the territory of the Federation of Bosnia and Herzegovina, and are used for financing operations of the Federation of Bosnia and Herzegovina, cantons, local self-government units and roads Directorates, as well as other users of public revenues. In accordance with projections for 2015, total public revenues amount to KM6.866.700.00 million, and to KM6.899.700.00 and KM6.997.000.00 million in 2016 and 2017, respectively.

Bearing in mind that these projections are based on macroeconomic projections and tied closely to economic growth, one of the risks pertains to macroeconomic projections highly dependent on external factors and changes to the taxation policies expected in the following period. In case growth and other macroeconomic indicators are below the estimated level, this will result in different developments of revenues projections.

Republika Srpska

In the aftermath of floods, in July 2014, the Government of Republika Srpska adopted the Framework Budget Document for the 2015-2017 period, defining the planned framework budget for the said period and characterised by very conservative projections of revenues. It also estimates additional expenditures and projections of financing and indebtedness of all levels of government in Republika Srpska.

In late 2014 and on the basis of analysis of conditions in all domains, the Government of Republika Srpske determined the following key goals for 2015 in a document called "Economic policy of Republika Srpska for 2015: economic recovery and economic growth, public sector reform, fiscal consolidation, preserving social security and the EU path of Republika Srpska, described in the other part of the Document.

As for the data on which consolidation for Republika Srpska is based in this document, data for 2013 represent budget execution in all analysed levels of government; data for 2014 have been corrected in accordance with adopted rebalances, while the data for 2015 are stated in accordance with budgets adopted at all levels of government. Data for 2016 and 2017 are the data from the Framework Budget Document and are corrected only in certain positions on the basis of known indicators. It should be stated that planned analysis and changes to fiscal policies are yet to be defined in 2015. These will be included into 2015 budget through rebalance.

When it comes to Republika Srpska fiscal policy goals, it is important to note that the consolidated current deficit at the level of General Government (including Central Government deficit with included "escrow" account and investment projects financed from abroad, of local self-government units and social security funds) may not exceed 3 per cent of GDP. Therefore, the consolidated deficit

of the general government of Republika Srpska in comparison with GDP of Republika Srpska amounted to 0.1 per cent in 2013; at the same time and in accordance with projections throughout years, it is planned for the deficit of 3 per cent in 2014 to develop into surplus of 0.6 per cent of GDP in 2017. Low deficit in 2013 was the result of the Republika Srpska budget, the main element of the consolidate balance, realising 0.3 per cent of GDP surplus, while deficit growth in 2014 was mainly the result of disastrous floods.

Fiscal framework for the 2015-2017 period under basic scenario

Fiscal indicators	2012	2013	2014	2015	2016	2017
(% GDP)	Execution	Execution	Rebalance	Plan	Plan	Plan
Total revenues	41.8	40.6	41.4	42.3	39.5	39.1
Total spending	43.9	40.7	44.4	43.5	41.1	38.5
Net debt/crediting	-2.1	-0.1	-3.0	-1.2	-1.6	0.6
Expenditures for interest	1.0	0.9	1.1	1.4	1.4	1.4
Primary balance	-1.2	0.7	-1.9	0.2	-0.2	2.1

Source: Ministry of Finance of Republika Srpska

Republika Srpska remains dedicated to strengthening fiscal stability through preventing increase of total spending in addition to increasing expenditures for interest over the years. Therefore, in addition to projected growth of GDP of Republika Srpska, continuous decrease of participation of spending of analysed levels of government of Republika Srpska in GDP from 44.4 per cent in 2014 to 38.5 per cent in 2017 is expected.

When it comes to debt policy, the main goal of Republika Srpska is certainly tied to the process of joining the EU. Therefore, the long-term commitment of Republika Srpska is to maintain public debt below 60 per cent of GDP of Republika Srpska.

3.2 Budget implementation in 2014

Collection of indirect taxes

In accordance with the preliminary report, the Indirect Taxation Authority collected in 2014 the amount of KM4.575.000.000.00 of gross revenues, representing increase of 4.8 per cent in comparison with the same period in 2013. Due to lower growth of tax returns in the amount of KM116.700.000.00, net effects of collection amounted to KM92.100.000.00. Comparison of collection over months and trimesters points to sharp oscillations in collection of indirect taxes in 2014. After strong increase of revenues of 8.4 per cent in the first trimester, the second trimester brought decrease of 6 per cent, while increase by 6.6 per cent was recorded in the third semester. Increase in net revenues in the first and the third semester was influenced by the growth of investments in energy sector (Thermal Power Plant Stanari) and changes in the customs and VAT regime in certain enterprises in the domain of internal processing, which assumed the standard procedure of VAT calculation for import. Both factors led to strong growth of returns, but due to delays in payments of tax returns caused by legal deadlines (maximum 60 days from submission of the VAT return) in comparison with gross collection, effects of return to net collection became obvious only in March. In addition, collection growth was also influenced by collection of old debts based on VAT and excise duties. The effects of collection of old debts and its influence on collection growth amounted to 2.3 per cent in the first trimester. Decrease of revenues in the second trimester was the result of high statistical basis for comparison in 2013 which saw enormous growth of revenues derived from excise duties and respective VAT share before Croatia entered the EU. The growth of revenues in the third trimester was also influenced by amendments to the Law on Excise Duties in the domain of tobacco taxation, in view of stockpiling fine cut tobacco before increase of excise duties, followed by increase in import and production of cigarettes after coming into force of

amendments to the Law. In total, positive trends in the period between January and September resulted in growth of revenues from indirect taxes by 2.5 per cent.

At the level of nine months, revenues derived from customs increased by 10.3 per cent. Growth of revenues from customs is related to strong growth of import from China, mostly investments in the energy sector. Analysis of components of gross VAT indicates the continuity of trends in collection of VAT on import and VAT in the country. VAT on import grows almost each month by several percentage points above the growth of import of goods, indicating increase of VAT basis. It is assumed that these unusual developments are caused by changes in customs and VAT regime for import for internal processing. Although collection of VAT in the country is continuously positive, isolation of one-time basis effect of collection of old debts leads to an opposite conclusion, i.e. domestic VAT recorded negative growth over the past six months. VAT refunds to tax payers during the period between January and September of 2014 are 11.1 per cent higher in comparison with the same period of 2013, while refunds to international organisations and projects are by 49.4 per cent higher than in the same period of 2013. The share of cumulative refund in cumulative gross collection of VAT exceeded 26 per cent, representing the maximum value recorded from VAT introduction. However, despite negative refund trend, cumulative VAT collection remains at the level of 2 per cent of growth. Revenues from excise duties recorded growth of 1.5 per cent over the first nine months of 2014 as the result of increase in excise duties on tobacco in the third semester.

Institutions of Bosnia and Herzegovina

The Law on the Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014 was adopted by the Parliamentary Assembly of Bosnia and Herzegovina on 30 December 2013. This Law is based on the following:

- Provisions of the Law on Financing the Institutions of Bosnia and Herzegovina pertaining to budget preparation, contents and adoption;
- Savings measures of the institutions of Bosnia and Herzegovina agreed upon by the Fiscal Council of Bosnia and Herzegovina under the framework of the Stand-by Arrangement with the International Monetary Fund;
- Operative instructions for preparation of requests for assignment of budget funds defined in guidelines for preparation of budget requests for 2014, delivered to all institutions of Bosnia and Herzegovina by the Ministry of Finance and Treasury of Bosnia and Herzegovina in late July 2013;
- Expenditures of budget users in the framework of the adopted Law on Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2013;
- Proposals of requests for approval of expenditures of the institutions of Bosnia and Herzegovina for 2014;
- Conclusion adopted at the 17 September 2013 session of the Fiscal Council on defining the Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2014-2016, determining the framework for the institutions of Bosnia and Herzegovina in the total amount of KM950 million as well as assignment of financing funds from the Single Account of the Indirect Taxation Authority in the amount of KM750 million;
- Calculation of salary at the basis of KM475.69, except for employees in diplomatic and consular posts whose salaries are calculated in accordance with the Rulebook on salaries, bonuses and compensations of personnel in diplomatic and consular posts, including daily meal allowance in the amount of KM6.00, vacation allowance in the amount of KM300.00 for personnel with coefficient for salary calculation below 4 and KM1.00 for personnel with salary calculation coefficient above 4, accommodation allowance and family separation allowance in accordance with applicable Decisions of the Council of Ministers, etc.

- Framework Budget Document was adopted on 28 October 2013 at the 62nd session of the Council of Ministers of Bosnia and Herzegovina.
- The Guidelines were adopted at the 71st session of the Council of Ministers of Bosnia and Herzegovina held on 19 November 2013. During the same session, draft of the Law on Budget of Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014 was determined.

Revenues, proceeds and financing for 2014 encompass the following:

- KM750 million from indirect taxes, at the level of 2012,
- KM165.6 million of non-tax revenues, representing growth of KM25.6 million or 18 per cent in comparison with 2013,
- KM3.2 million from current financial assistance, representing decrease of KM3.9 million or 55 per cent in comparison with 2013,
- KM0.5 million for financing the institutions of Bosnia and Herzegovina by lower levels of government (Entities and Brčko District).

In the budget for 2014, in the item pertaining to financing and proceeds, funds in the amount of KM30.6 million have been planned. Their structure is as follows:

- KM14.6 million of funds transferred from the previous period, representing increase of 144 per cent in comparison with 2013 and pertaining to earlier transfer of excess revenues over expenditures under report on financial operations of the institutions of Bosnia and Herzegovina and international obligations of Bosnia and Herzegovina for 2012;
- KM0.6 million from proceeds derived from fixed assets disposal, representing growth of KM0.06 million or 10 per cent in comparison with 2013;
- KM15.2 million of credit funds for uncovered deficit
- KM0.17 million of proceeds from succession.

Structure of expenditures of the institutions of Bosnia and Herzegovina is the following:

- Current expenditures in the amount of KM845.2 million, representing growth of KM16.2 million or 2 per cent in comparison with 2013;
- Current grants in the amount of KM26.1 million, including, inter alia, funds assigned for withdrawal of IPA funds;
- Capital grants in the amount of KM2.7 million, representing decrease of KM0.7 or 19 per cent in comparison with 2013 and pertaining to grants within the framework of multiannual investments for strengthening the information system of the judicial institutions of Bosnia and Herzegovina with the High Judicial and Prosecutorial Council, for exhumation and grants to prosecutor's offices at lower levels of government with the Institute for Missing Persons and for implementation of "Perspective" program with the Ministry of Defence;
- Current reserve funds in the amount of KM3.8 million, representing decrease of KM5.2 million or 58 per cent in comparison with 2013;
- Expenditures for foreign interest in the amount of KM0.7 million, KM0.18 million less than in 2013, with the same pertaining to interest for credit with the Council of Europe Development Bank for construction of State Prison and interest for macro-financial assistance under European Commission credit.
- Capital expenditures in the amount of KM71.5 million.

The largest item within the framework of current expenditures is represented by gross salaries and remunerations planned in the amount of KM528.3 million, representing increase of KM6.1 million or 1 per cent in comparison with 2013 as the result of slight increase of the number of employees

during 2013 in accordance with decisions adopted by the Council of Ministers and as the result of previous employment (especially in the Ministry of Defence due to a large number of employees) and approval of new employment in the Central Election Commission.

Remunerations for employees costs in 2014 were planned in the amount of KM115.5 million, representing increase of KM1.5 million in comparison with the 2013 Budget.

Total material costs in the 2014 Budget amount to KM201.4 million, representing increase of KM8.6 million or 5 per cent in comparison with the 2013 Budget. More significant increase in material costs is evident in the case of the Agency for Identification Documents, Records and Exchange of Information, in the amount of KM15.8 million as the result of planning personalisation of greater number of documents in comparison with 2013 (issuing a larger number of personal documents in accordance with the dynamics of substitution of old documents) and Central Election Commission in the amount of KM8.4 due to general elections.

Capital grants in the 2014 Budget were planned in the amount of KM2.7 million, representing decrease of KM0.7 million or 19 per cent in comparison with 2013, mainly due to decrease in the amount of the capital grant for the High Judicial and Prosecutorial Council of Bosnia and Herzegovina.

Expenditures for foreign interest are planned in the amount of KM0.7 million, or KM0.18 million less than in 2013, due to the amount of interest for a credit by the Council of Europe Development Bank for construction of State Prison and interest for macro-financial assistance under the European Commission credit.

Current reserve funds are planned in the amount of KM3.8 million, representing decrease of KM5.2 million or 48 per cent in comparison with 2013.

With the aim of securing funds for assistance to areas endangered by floods in May 2014, on 25 July 2014 the Parliamentary Assembly of Bosnia and Herzegovina adopted the Law on Amendments to the Law on the Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014. Amendments to the said law result in the following structure of expenditures of the institutions of Bosnia and Herzegovina:

- Gross salaries and remunerations in the amount of KM525.4 million (decrease in the amount of KM2.9 million);
- Remunerations for employees' costs in the amount of KM114.9 million (decrease in the amount of KM0.6 million);
- Material costs in the amount of KM197.6 million (decrease in the amount of KM3.8 million);
- Current grants in the amount of KM33 million (increase in the amount of KM6.9 million);
- Capital grants in the amount of KM2.7 million;
- Expenditures for foreign interest in the amount of KM0.7 million;
- Capital expenditures in the amount of KM71.9 million (increase in the amount of KM0.4 million);
- Current reserves KM3.8 million.

Amendments to the Law on Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014 resulted in securing assistance for areas endangered by floods in May 2014 in the amount of KM7.1 million. In accordance with the Decision of the Council of Ministers on distribution, allocation of funds was performed in the following proportion: Federation of Bosnia and Herzegovina (49 per cent), Republika Srpska (49 per cent) and Brčko District

(2 per cent). This represents one-time measures of the institutions of Bosnia and Herzegovina in 2014.

In accordance with estimates of the Ministry of Finance and Treasury, the institutions of Bosnia and Herzegovina will realize savings related to gross salaries and remunerations in accordance with measures agreed upon in the Letter of Intent for realisation of the Stand-by Arrangement with IMF, including additional savings on material costs of the institutions of Bosnia and Herzegovina. This will enable compensation of the lack of funds planned in the Law on Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014 (financing expenditures from credit funds in the amount of KM15.2 million). The remaining planned funds for financing the institutions of Bosnia and Herzegovina in the amount of KM14.6 million represent transferred accumulated excess of revenues from previous years available to the institutions of Bosnia and Herzegovina by the end of 2014. In addition, when it comes to revenues, the institutions of Bosnia and Herzegovina realised additional funds derived from non-taxable revenues, namely from profit of the Central Bank of Bosnia and Herzegovina in the amount of KM8 million.

The institutions of Bosnia and Herzegovina will also realise additional funds derived from designated donations (e.g. donations related to assistance to flooded areas in Bosnia and Herzegovina and alike), as well as designated funds derived from UMTS licences. However, these funds will have to be designated and transferred in 2015 if not spent by the end of 2014.

Federation of Bosnia and Herzegovina³⁰

Budget of the Federation of Bosnia and Herzegovina was adopted in early December 2013. Bosnia and Herzegovina's Stand-by Arrangement with the International Monetary Fund implies compliance with agreed structural guidelines defined in the Agreement. However, in the early second trimester of 2014, there was a suspension of fulfilment of obligations assumed from the Letter of Intent delivered to the International Monetary fund. This could have jeopardised allocation of two planned tranches from IMF in the amount of KM 124 million and put the budget of the Federation of Bosnia and Herzegovina in a difficult position. In the meantime, disastrous floods and landslides endangered the Federation of Bosnia and Herzegovina and it was necessary to take certain actions and activities.

With the aim of securing funds on the revenues side of the budget of the institutions of Bosnia and Herzegovina for 2014, the Federal Ministry of Finance prepared amendments to the budget of the Federation of Bosnia and Herzegovina for 2014. This activity of the Government of the Federation of Bosnia and Herzegovina was aimed at defining alternative sources of financing, primarily through emission of securities, in order to secure the lack of planned funds from the International Monetary Fund as well as funds for rehabilitation of damages caused by floods and landslides.

After the amendments to the budget of the Federation of Bosnia and Herzegovina for 2014 were adopted, the International Monetary Fund continued its analysis and approved the planned tranches to Bosnia and Herzegovina, including additional funds in form of assistance to the budgets in Bosnia and Herzegovina for covering significant losses caused by the said natural disaster. In this regard, the Federation of Bosnia and Herzegovina was allocated funds in the amount of KM215.9 million. The government of the Federation of Bosnia and Herzegovina decided to prepare another amendment to the budget of the Federation of Bosnia and Herzegovina for 2014 with the aim of substituting proceeds from domestic borrowing with IMF funds. Additional funds in the amount of KM92 million received from the International Monetary Fund have been distributed so as for the amount of KM27 million to be used for covering the lowered collection of revenues from indirect taxes in the Federal

³⁰ Execution of the 2014 Budget of the Institutions of Bosnia and Herzegovina pertains only to the level of the Federation of Bosnia and Herzegovina without cantons, municipalities/cities and non-budget funds.

budget; the amount of KM25 million was planned to be used to verify the debt toward the Federal Pension and Disability Insurance fund, while KM40 million were planned to be used as credit funds allocated to cantons to be realised on credit basis and under the same conditions applied to the Federation's borrowing from the International Monetary Fund.

Continuation of execution of the budget of the Federation of Bosnia and Herzegovina for 2014 is currently being performed in accordance with the planned dynamics, without noticeable exceptions under particular categories representing the total budget structure.

On the basis of execution in the first eleven months and projections for the twelfth month, the Federal Ministry of Finance projected for the realisation of revenues and proceeds in the budget of the Federation of Bosnia and Herzegovina for 2014 to amount to KM2.300.000.000, i.e. 95 per cent of the adopted plan.

Realisation of revenues in the total budget structure in accordance with available records will amount to KM1.700.000.000.00, i.e. 95 per cent of the planned revenues.

According to data available to the Federal Ministry of Finance, revenues derived from taxes are expected in the amount of KM1.300.000.000.00, representing 96 per cent of the amount planned for 2014. In comparison with the previous year, tax revenues should grow by more than 4 per cent.

In the total structure of revenues, primary source of revenues are indirect taxes the execution of which will exceed projections of the Department for macroeconomic analysis of the Indirect Taxation Authority of Bosnia and Herzegovina. These revised projections were not optimistic due to consequences of floods and landslides. On the basis of execution in the first eleven months and projections for the twelfth month and in accordance with projections of the Federal Ministry of Finance, the share of indirect taxes is expected to amount to KM1.027.000.000.00. Revenues derived from indirect taxes to be distributed to the Federation of Bosnia and Herzegovina are expected in the amount of KM0.8 billion, while the remaining funds in the amount of KM0.47 billion pertain to revenues from indirect taxes in the name of financing the relevant debt.

Non-tax revenues are expected to be executed in the amount of KM0.38 billion, since records on their execution during the first eleven months show growth in the amount of KM111.4 million, i.e. 40.5 per cent in comparison with the previous year. These revenues are included in revenues from entrepreneurial activities and assets and revenues from positive foreign exchange, fees and duties and revenues from public services, as well as fines.

In accordance with the dynamics of implementation of proceeds, their execution in 2014 is expected in the amount of KM678.3 million, with the following most important items:

- Funds from the Fourth Stand-by Arrangement approved by IMF in the amount of KM278.2 million;
- Foreign debt-direct obligations of the Federation of Bosnia and Herzegovina in the amount of KM0.05 million;
- Emission of long-term securities in the amount of KM140.0 million;
- Emission of treasury bills in the amount of KM260.0 million.

Total collected revenues and proceeds will suffice, and the Government of the Federation of Bosnia and Herzegovina will be able to execute planned expenditures in 2014.

It should be noted that the above data represent projections, since execution of the budget and expenditures for the previous year is to be realised up to 31 January of the current year. The

Government of the Federation of Bosnia and Herzegovina will continue its efforts with the aim of realising further savings in all positions.

Republika Srpska

The largest part of the fiscal framework of the General Government of Republika Srpska is represented by the budget of Republika Srpska. Republika Srpska 2014 budget was adopted by the National Assembly of Republika Srpska on 7 December 2013 in the budget framework amount of KM2.025.000.00.

Due to disastrous floods in late May 2014, rebalance of Republika Srpska budget for 2014 was adopted in the amount of KM2.156.000.00, representing an increase of 6.5 per cent. In order to at least partially resolve this situation, the Government of Republika Srpska adopted a set of laws defining a series of assistance measures and utilisation of budget and other, new sources of funds (Solidarity Fund for the Republika Srpska Recovery) for rehabilitation of damages. Likewise, additional funds for social security funds have been secured in the budget due to unfavourable developments regarding collection of revenues derived from contributions. Implementation of significant projects for capital investments from loan proceeds from domestic banks has also been planned.

The most important changes to budget positions realised through 2014 budget rebalance:

Total tax and non-tax revenues in 2014 decreased by KM24.9 million (1.6 per cent) in comparison to the same planned in 2014 Republika Srpska budget, while proceeds for non-financial assets in the amount of KM40.0 million by the same amount. Proceeds in part of financing planned in the budget rebalance increased by KM195.9 million in comparison with the planned budget for 2014.

- Expenditures for personal income of employees increased by KM37.5 million (5.7 per cent) as the result of amendments to the laws from 2014 regulating salaries of employees in the institutions of Republika Srpska and the Decision on determining labour costs;
- Expenditures on the basis of usage of goods and services decreased by KM8.4 million (8.2 per cent) as the result of redistribution of funds among budget users, i.e. savings;
- Expenditures for financing and other financial costs decreased by KM7 million (13.3 per cent) in accordance with the plan for repayment of foreign and domestic debt;
- Allocations under social protection being paid out of the budget of Republika Srpska remained at the same level, but this group of expenditures was redistributed. Position of capital allocations for housing of families of fallen soldiers and soldiers disabled in war from the first to the fourth category, in the amount of KM8.1 million, thus securing complete housing of these categories. In the same time, certain positions of allocations, such as funds for Workers social security program, decreased by KM7 million;
- Transfers between budget units of different levels of government increased by KM18.1 million (60.5 per cent)-increase in transfers to the Pension and Disability Insurance Fund by KM15 million and transfers to the Health Security Fund by KM15 million;
- Expenditures for non-financial assets increased by KM50.9 million for financing the final stage of Program of Complete Housing of Families of Fallen Soldiers and Soldiers Disabled in War from the first to the fourth category (KM25 million): financing capital investments in the Ministry of the Interior (KM14 million + KM5.5 million); realisation of "Dositej" Project in the Ministry of Education and Culture (KM9 million) and construction of Pavilion 4 in the Banja Luka University Campus (KM6.2 million).
- Expenditures for repayment of debts increased by KM9.4 million (1.9 per cent).

Proceeds derived from borrowing increased by KM195.9 million as the result of increase in proceeds from borrowing by KM205 million (KM47.3 million short-term and + KM157.7 million long-term debt) and decrease in proceeds from refunds of repaid loans in the amount of KM9.1 million.

In accordance with reports on execution of the budget of the Central Government of Republika Srpska over the first ten months of 2014, total revenues were realised in the amount of 96.8 per cent in comparison to what has been planned, while taxes and non-tax revenues were realised in the amount of 92.9 per cent and 96.3 per cent, respectively. On the expenditure side, execution of total expenditures amounts to 88.8 per cent, while current expenditures and expenditures for non-financial assets amount to 90.9 per cent and 70.1 per cent, respectively. In the framework of current expenditures, employees cost have been executed in the amount of 91.5 per cent, while material costs, interest, social remittances and transfers have been executed in the amount of 85.5 per cent, 82.8 per cent, 108.3 per cent and 90.2 per cent, respectively.

3.3 Medium-term budgetary outlook

Projections of indirect taxes

Revised projections of revenues from indirect taxes for the period between 2015 and 2017 are based on the following assumptions: (i) prognosis of macroeconomic indicators of the Directorate for Economic Planning (DEP) for the stated period, revised in September 2014; (ii) changes in excise duties policy related to tobacco, applicable as of 1 August 2014; (iii) changes in excise duties policy related to beer, applicable as of 1 September 2014; (iv) effects of amendments to the Agreement³¹ on Free Trade between Bosnia and Herzegovina and EFTA and (v) current trends in collection of indirect taxes.

Projections of the growth rate of the revenues from indirect taxes amount to 2.1 per cent, 2.0 per cent and 2.4 per cent in 2015, 2016 and 2017, respectively.

Basic scenario of projections of indirect tax revenues, October 2014

Type of revenue (net)	in million KM					Projected growth rate			
	execution		projection						
	2013	2014	2015	2016	2017	2014	2015	2016	2017
VAT	3,102.9	3,173.3	3,238.4	3,303.2	3,385.0	2.3%	2.1%	2.0%	2.5%
Excise duties	1,267.1	1,293.1	1,317.3	1,336.9	1,360.2	2.1%	1.9%	1.5%	1.7%
Custom duties	211.0	229.1	236.6	243.1	251.2	8.6%	3.3%	2.7%	3.3%
Pay toll	285.3	293.2	303.1	315.3	329.1	2.8%	3.4%	4.0%	4.4%
Other	19.9	20.5	20.7	20.9	21.1	3.4%	0.9%	0.9%	0.9%
TOTAL	4,886.2	5,009.2	5,116.2	5,219.3	5,346.6	2.5%	2.1%	2.0%	2.4%
Pay toll (KM0.10/l)	-114.0	-117.3	-121.3	-126.1	-131.7	2.8%	3.4%	4.0%	4.4%
For distribution	4,772.2	4,891.9	4,994.9	5,093.2	5,214.9	2.5%	2.1%	2.0%	2.4%

Projections of excise duties on tobacco in the 2015-2017 periods include annual increase of the specific excise duty on cigarettes in the amount of KM0.15/per pack and gradual increase of excise duties on cut tobacco. Increase of excise duty burden should bring increase of retail sale prices and of monthly weighted price of cigarettes, representing a reference variable for calculation of minimum excise duty on cigarettes and specific excise duty on cut tobacco. It is expected for the drastic initial growth of excise duties on cut tobacco and continuous adjustment to the growth of minimum excise

³¹ "Official Gazette of Bosnia and Herzegovina-International Agreements", No. 18/14.

duty on cigarettes to stop legal and illegal substitution of cigarettes with cut tobacco. In addition and through implementation of adequate operative measures, it is expected for the cigarette market to stabilise during the following years and for the consumption of cut tobacco to decrease, resulting in increase in excise duties revenues. The biggest growth is expected in 2015, by 2.2 per cent, even with effects being obvious for only seven months³², and in 2016 and 2017 1.4 per cent and 1.3 per cent, respectively. Effects of the new tobacco taxation policy in 2015 are estimated at the level of 0.05 per cent of GDP, and in 2016 and 2017 0.03 per cent of GDP. The slower growth is the result of continuation of harmonisation of excise duties on cigarettes in Bosnia and Herzegovina with the minimum excise duty in EU leading to growth of retail sale prices, and consequently leads to lower consumption of cigarettes. The other reason lies in the minimum excise duty on cigarettes for 2015, representing the basis for calculation of excise duty on cut tobacco³³. The third reason is methodological in character and pertains to the reference period for calculation of average weighted price of cigarettes. Instead of encompassing the previous fiscal year in comparison with the year in which the minimum excise duty is being applied, as is the case in the EU, the reference period in Bosnia and Herzegovina covers two previous fiscal years³⁴. Implementation of the stated methodology leads to a slower growth of minimum excise duty on cigarettes and consequently that of excise duty on tobacco.

The Agreement on Free Trade between Bosnia and Herzegovina and EFTA implies gradual annulment of custom duties and other duties with fiscal effects on import from EFTA members from the date of coming into force of the Agreement until 2017. Import from EFTA members in 2013 represented only 0.6 per cent of import in Bosnia and Herzegovina³⁵. However, since custom duties are only charged on import from third countries, the share of collected custom duties from EFTA members in revenues derived from custom duties amounted to 2.3 per cent. In accordance with the dynamics defined in the Agreement, effects of custom duties elimination will mostly result in decrease of custom duties in 2015, while the remaining effects will be visible in the following two years.

Due to constant downward trend in consumption of beer over the last three years, it is expected for the differentiated excise duties on beer to result in minimum effects on revenues from excise duties, in the maximum amount of KM4.3 million in comparison with collection in 2013. However, due to high basis for comparison in 2014, including collection of old debts, revenues in 2015 are expected to show a negative growth, while in the following two years these are expected to grow at the minimum rate of 1 per cent.

Institutions of Bosnia and Herzegovina

On 17 July 2014, the Fiscal Council of Bosnia and Herzegovina adopted the Global Framework of Fiscal Balance and Policies of Bosnia and Herzegovina for the 2015-2017 period. In this regard, the Ministry of Finance and Treasury of Bosnia and Herzegovina prepared the draft of Framework Budget of the Institutions of Bosnia and Herzegovina and submitted the same to the Council of Ministers of Bosnia and Herzegovina. The Ministry of Finance and Treasury of Bosnia and Herzegovina prepared the draft of the Law on Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2015 in accordance with legal provisions on financing the institutions of Bosnia and Herzegovina. The said document was submitted to the Council of Ministers.

³² The reason lies in the implementation of the Law on Excise Duties as of 1 August 2014.

³³ In accordance with the Decision of the Management Board of the Indirect Taxation Authority ("Official Gazette of Bosnia and Herzegovina", No. 80/14), the minimum excise duty on cigarettes in 2015 is below the minimum excise duty on cigarettes determined in 2014.

³⁴ The minimum excise duty on cigarettes in a fiscal year (Y) amounts to 60 per cent of average weighted retail sale price of cigarettes calculated on the basis of excise duty stamps issued in the other half of Yt-2 and the first half of Yt-1.

³⁵ Source: Agency for Statistics of Bosnia and Herzegovina, www.bhas.ba.

The basis for preparation of the draft budget of the institutions of Bosnia and Herzegovina for 2015 is as follows:

- Provisions of the Law on Financing the Institutions of Bosnia and Herzegovina pertaining to preparation, contents and adoption of budget;
- Savings measures of the institutions of Bosnia and Herzegovina agreed upon by the Fiscal Council of Bosnia and Herzegovina under the framework of the Stand-by Arrangement with the International Monetary Fund;
- Operative instructions for preparation of requests for assignment of budget funds defined in guidelines for preparation of budget requests for 2015, delivered to all institutions of Bosnia and Herzegovina by the Ministry of Finance and Treasury of Bosnia and Herzegovina in late July 2014;
- expenditures of budget users in the framework of the adopted Law on Budget of the Institutions of Bosnia and Herzegovina and International Obligations of Bosnia and Herzegovina for 2014;
- Submission of request of the institutions of Bosnia and Herzegovina for allocation of budget funds for 2015;
- Conclusion adopted at the session of the Fiscal Council held on 17 July 2014 defining the Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2015-2017, and determining the framework for the institutions of Bosnia and Herzegovina in the total amount of KM950 million, as well as assignment of financing funds from the Single Account of the Indirect Taxation Authority in the amount of KM750 million;
- Calculation of salary at the basis of KM475.69, except for employees in diplomatic and consular posts whose salaries are calculated in accordance with the Rulebook on salaries, bonuses and compensations of personnel in diplomatic and consular posts, including daily meal allowance in the amount of KM6.00, vacation allowance in the amount of KM300.00 for personnel with coefficient for salary calculation below 4 and KM1.00 for personnel with salary calculation coefficient above 4, accommodation allowance and family separation allowance in accordance with applicable Decisions of the Council of Ministers, etc.;
- Upper limits of expenditures derived from the preliminary draft of the Framework Budget Document, prepared by the Ministry of Finance and Treasury of Bosnia and Herzegovina on the basis of the adopted Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina for the 2015-2017 period.

Total revenues, proceeds and financing of the institutions of Bosnia and Herzegovina in 2015 amount to KM950 million and remain at the level of 2014, while servicing of foreign debt of Bosnia and Herzegovina amounts to KM613.6 million, representing a decrease in the amount of KM232.8 million or 28 per cent in comparison with the budget of the institutions of Bosnia and Herzegovina for 2014. In accordance with the plan of repayment for servicing the foreign debt in the amount of KM614 million and since the same has been decreased in the amount of KM0.4 million (interest pertaining to the Council of Europe Development Bank credit for construction of the State Prison), recorded under expenditures of budget user Unit for Implementation of Construction of the State prison and Implementation of Criminal Sanctions and Other Measures of Bosnia and Herzegovina) in the table "Overview of revenues, proceeds and financing under sources and purposes" and in the table "Cumulative overview of expenditures under economic categories and sources of financing". The total amount of foreign debt also covers potential obligations under guarantees issued for the Federation of Bosnia and Herzegovina in the amount of KM1.2 million.

Revenues, proceeds and financing for 2015 encompass amount to KM908.7 million and include the following:

- KM750 million from indirect taxes, at the level of 2014;

- KM155.5 million from non-tax revenues;
- KM2.8 million from current financial assistance;
- KM0.4 million for financing the institutions of Bosnia and Herzegovina by lower levels of government.

In the draft budget for 2015, in the item pertaining to financing and proceeds, funds in the amount of KM41.3 million have been planned. Their structure is as follows:

- KM40.7 million of funds transferred from the previous period, pertaining to transferred excess revenues over expenditures under the report on financial operations of the institutions of Bosnia and Herzegovina and international obligations of Bosnia and Herzegovina for 2013;
- KM0.6 million from disposal of fixed assets;

Total expenditures of Bosnia and Herzegovina and servicing of foreign debt of Bosnia and Herzegovina amount to KM949.2 million in the draft budget for 2015. Their structure is as follows:

- Current expenditures in the amount of KM840 million, representing growth of KM2 million or 0.2 per cent in comparison with 2014;
- Capital expenditures in the amount of KM71.7 million, representing decrease in the amount of KM0.2 million;
- Current transfers and grants in the amount of KM30.5 million;
- Capital grants and transfers in the amount of KM2.7 million;
- Expenditures for foreign interest in the amount of KM0.8 million,
- Capital expenditures in the amount of KM71.7 million;
- Current reserve is planned in the amount of KM4.3 million.

Gross salaries and remunerations are planned in the amount of KM539.2 million, and represent an increase by KM13.8 million or 3 per cent in comparison with 2014, as the result of slight increase in the number of employees during 2014, in accordance with decisions adopted by the Council of Ministers and decisions currently being adopted, on the basis of implementation of the provisions of the Law on Special Solidarity Contribution in Republika Srpska, defining special allocations of 1.5 per cent of contributions during the period between 23 June 2014 and 31 May 2015, mostly affecting budget users with a large number of employees, and planned funds for the extended legal employment status.

Remunerations for employees costs in 2015 were planned in the amount of KM114.6 million, representing increase of KM0.4 million in comparison with the 2014 Budget. Decrease in the amounts for remunerations of employees costs were the major result of accounting rules.

Total material costs in the 2015 Budget amount to KM186.2 million, representing decrease of KM11.4 million or 6 per cent in comparison with the 2014 Budget.

Basic assumptions/ policies of expenditures for 2016 and 2017 from the draft Framework Budget Document for the period between 2015 and 2017.

In 2016 and 2017, in accordance with the adopted Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina, the framework of financing the institutions of Bosnia and Herzegovina has been determined in the amount of KM950 million, including allocations from the Single Account of the Indirect Taxation Authority in the amount of KM750 million in each year. It should be noted that the determined amount of KM750 million for financing the institutions of Bosnia and Herzegovina in 2016 and 2017 will be corrected in accordance with changes in total indirect tax revenues during the process of revision of Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina

2015-2017, in accordance with Article 5, paragraph (3), point d) and Article 6 of the Law on the Fiscal Council of Bosnia and Herzegovina.

Revenues and proceeds have been planned in accordance with the following:

- Tax revenues in 2016 and 2017 in the amount of KM750 million;
- Non-tax revenues in 2016 and 2017 in the amount of KM127.7 million and KM124.9 million, respectively;
- Transfers from other levels of government in 2016 and 2017 in the amount of KM0.4;
- Current financial assistance in 2016 and 2017 in the amount of KM0.6 million;
- Financing and proceeds in 2016 and 2017 in the amount of KM71.3 million and KM74.1 million, respectively.

Expenditures structure in 2016 and 2017 is as follows:

- In 2016 and 2017, gross salaries and remunerations are projected in the amount of KM538.4 million and KM547 million, respectively;
- In 2016 and 2017, remunerations for employees costs are projected in the amount of KM116.3 million and KM118.5 million, respectively;
- Material costs in 2015 and 2017 are projected in the amount of KM184.5 million and KM182.2 million, respectively;
- Current grants in 2016 and 2017 are projected in the amount of KM26.1 million and KM28.1 million, respectively;
- Capital grants in 2016 and 2017 are projected in the amount of KM3.3 million and KM2.6 million, respectively;
- Expenditures for foreign interest in 2016 and 2017 are projected in the amount of KM0.9 million and KM0.4 million, respectively;
- Current reserves in 2016 and 2017 is projected in the amount of KM24.1 million and KM25.5 million, respectively;
- Capital investments in 2016 and 2017 are projected in the amount of KM56.3 million and KM45.7 million, respectively.

Federation of Bosnia and Herzegovina

The Government of the Federation of Bosnia and Herzegovina is determined to continue with implementing restrictive public spending in the 2015-2017 period, with the aim of maintaining stable fiscal system and budget balance, as well as stronger control of public spending.

Total expenditures in 2014 amount to KM2.148.700.00 and include repayment of debts, borrowing and expenditures for interest. In case of analysis of only public expenditures in the amount of KM1.268.300.00 (without amounts for repayment of debts, borrowing and interest), the largest portion pertains to transfers (current and capital) at the level of 78.1 per cent (KM990.8 million), gross salaries, remunerations and contributions, at the level of 17.1 per cent (KM217.2 million), expenditures for material and services at the level of 4.2 per cent (KM52.5 million).

The Government defined the draft budget of the Federation of Bosnia and Herzegovina for 2015 in the amount of KM2.345.200.00, representing 7.9 per cent of the planned real GDP of Bosnia and Herzegovina. Bearing in mind the complicated procedure of constituting the government in Bosnia and Herzegovina after October elections, it is likely that the Decision on temporary financing will be implemented in the first quarter of 2015.

Economic activities during previous years directly affected the structure of revenues, and when we consider the fact that Bosnia and Herzegovina will repay the third Stand-by Arrangement with IMF

and that repayment for the fourth Stand-by Arrangement with IMF is not yet due, net revenues from indirect taxes are represented by an increase in the budget of the Federation of Bosnia and Herzegovina for 2015. Implementation of measures of restrictive public spending by the Government of the Federation of Bosnia and Herzegovina, representing one of the priorities of the economic policy in the following years, directly affected the structure of revenues, since it is still planned for the rational planning of funds for key activities contributing to economic and social strengthening of the Federation of Bosnia and Herzegovina.

In 2016, the budget is projected at the level of KM2.450.700.00 or 11.9 per cent of the planned GDP of the Federation of Bosnia and Herzegovina or 7.9 per cent of real GDP of Bosnia and Herzegovina, while in 2017 the same is planned at the level of KM2.411.500.00 or 11 per cent of the planned real GDP of the Federation of Bosnia and Herzegovina or 7.3 per cent of planned real GDP of Bosnia and Herzegovina. Budget spending structure for the 2015-2017 period under economic categories is as follows:

- Gross salaries, contributions and remunerations in 2015 are projected at the level of KM249.1 million, representing a 2 per cent increase in comparison with the planned budget from 2014. In this regard, the decision of the Government on limitations to the growth of the number of employees is being strictly complied with. The increase is the result of compliance with the legal obligation of payment of salaries and remunerations to officials and realisation of anti-corruption set of laws resulting in formation of special authorities under the Federal Prosecutor's Office and the Supreme Court of the Federation of Bosnia and Herzegovina. The amount for this category in 2016 and 2017 is projected in the amount of KM250.4 million and KM251.8 million, respectively;
- Expenditures for material costs and services for 2015 are projected at the level of KM100.4 million, representing increase in the amount of 31.2 per cent in comparison with the 2014 budget. The biggest increase in the structure of planned funds pertains to procurement of vaccines, costs of proceedings related to salaries in the Army of the Federation of Bosnia and Herzegovina and costs of medical expertise. Significant portion of funds pertains to funds to be financed from subaccounts, i.e. designated funds on the revenues side have been secured for financing of these funds. The amount planned for these expenditures for material costs and services in 2016 is projected in the amount of KM101.5 million, while the same amount is projected in the amount of KM95.3 million in 2017.
- Current transfers in 2015 are projected at the level of KM965.4 million, representing decrease of 5 per cent in comparison with the budget for the previous year. The Government of the Federation of Bosnia and Herzegovina is determined to implement reforms in the domain of remunerations to the population of soldiers and revise rights to early retirement realised under favourable conditions, elimination of unlawful users of soldiers' remunerations and decreasing the amount of non-designated allocations on one side, and assistance to areas affected by floods and landslides on the other side. Amount of transfers envisaged for 2016 amounts to KM926.3 million. In 2017, it is expected for this category to decrease gradually, and is projected in the amount of KM916.6.
- Capital transfers in 2015 are projected in the amount of KM12.7 million, and represent an increase of 31 per cent in comparison with the 2014 budget, since a significant portion of funds executed in 2014 is executed from subaccounts, i.e. their financing is covered by designated funds on the revenues side, as it will be the case in the following years. In 2016 and 2017, capital expenditures are projected in the amount do KM11.5 million and 12.3 million, respectively;
- Repayment of debts and interest in 2015 are projected in the amount of KM966.5 million or 1.8 per cent less in comparison with the 2014 budget. Please note that the 36.75 per cent of total planned funds pertains to foreign debt, 53.13 per cent of which represent indebtedness of other users who are obliged to return the repaid amount to the budget of the Federation of Bosnia and Herzegovina, while 63.25 per cent of planned funds pertains to domestic debt,

53.13 per cent of which pertains to short-term securities-treasury securities whose emission and repayment is planned in the current year. Repayment of debt and interest in 2016 and 2017 amounts to KM1.075.800.00 and KM1.144.400.00, respectively, with a structure similar to that in 2015.

The main aims of the macroeconomic policy of the Government of the Federation of Bosnia and Herzegovina relate to maintaining macroeconomic stability and improvement of economic competitiveness. Fiscal policy is based on these priorities and aims at achieving stable and sustainable budget system in the Federation of Bosnia and Herzegovina. This implies continuation of restrictive budget spending, strengthening budget discipline and fiscal responsibility, improvement of collection of public revenues and implementation of structural reforms.

Republika Srpska

Table 2 "Outlooks of the General Government of Republika Srpska" shows consolidated data on planned funds of the General Government.

2015 Budget of Republika Srpska was adopted by the National Assembly of Republika Srpska in the amount of KM2.033.000.00, representing a decrease in the amount of KM123 million (5.7 per cent) in comparison with the rebalance of the budget for 2014.

In the budget of Republika Srpska for 2015, surplus in the amount of KM24 million has been planned, while at the level of the Central Government and the General Government, planned deficits amount to KM77.3 million and KM105.9 million, respectively. The planned budget deficit of the General Government in 2016 amounts to KM146.1 million, and represents the result of very conservative estimations following the floods in 2014, while in 2017 surplus of budget is expected at the level of General Government in the amount of KM58.7 million.

Planned budgets are based on a mid-term macroeconomic scenario and current trends and known policy changes, while certain part of planned policies is yet to be realised and included through budget rebalance.

Estimated tax revenues in 2015 amount to KM1.419.000.00, representing an increase of KM80.9 million (6 per cent) in comparison with funds planed in 2014 budget rebalance. Revenues are expected to grow on the basis of payments of previously approved reprograms.

- Revenues from indirect taxes are planned in the amount of KM1.049.000.00 (including foreign debt), representing growth of 2.7 per cent.
- Revenues from taxes on income amount to KM128 million, representing an increase in the amount of KM6.2 million (5.1 per cent). Gradual recovery of payments under this category is expected.
- Revenues from taxes on income amount to KM179.6 million, representing an increase in the amount of KM6.6 million (3.8 per cent).
- Non-tax revenues amount to KM169.6 million, representing a decrease in the amount of KM32.8 million (16.2 per cent) due to expectedly lower income from dividends and shares in the profit of public enterprises and financial institutions.
- Proceeds in the part of financing amount to KM444.4 million and represent decrease in the amount of KM171 million, pertaining to proceeds from short-term and long-term debt.

Total budget expenditures for non-financial assets in 2015 amount to KM1.555.700.00, representing a decrease in the amount of KM81.3 million (5 per cent) in comparison with funds planed in 2014 budget rebalance:

- Expenditures for personal income amount to KM701.6 million, representing an increase in the amount of KM7.5 million (1.1 per cent). It should be noted that amount of salaries remains at the level of executed raise in salaries from April 2014.
- Expenditures on the basis of usage of goods and services decreased by KM87.8 million, representing decrease in the amount of KM6.2 million (6.6 per cent). Planned decrease is the result of decrease in funds for expenditures under travels and housing, expenditures for entertainment, expenditures for professional services as well as expenditures under special contribution for solidarity at the expense of the employer. The Law on Special Solidarity Contribution came into force on 31 May 2015.
- Expenditures for financing and other financial costs decreased amount to KM61.2 million, representing increase in the amount of KM15.6 million (34.2 per cent). Projection of the same is in accordance with foreign debt repayment plan and domestic indebtedness, upgraded plan of withdrawal under investment credits in 2015, planned budget financing for 2015 and calendar of treasury bills emission and long-term securities.
- Subventions amount to KM99.8 million, representing an increase in the amount of KM1.6 million (1.6 per cent). This increase is mainly the result of opening of a new budget position Subventions for development of processing industry, in the amount of KM 1.5 million.
- Grants amount to KM19.8 million, representing decrease in the amount of KM5.6 million (22.2 per cent). Planned decrease is the result of transfers of allocations from the position Current grants to the position Transfers with the aim of appropriate bookkeeping evidencing.
- Remittances under social protection paid from the budget of Republika Srpska amount to KM243 million, representing decrease in the amount of KM8.6 million (3.4 per cent) and mainly pertain to the category of Capital remittances for housing of families of fallen soldiers and people disabled in war from the first to the fourth category, completed in 2014. Therefore, no funds are planned for this position.
- Transfers between budget units of different levels of government amount to KM290.9 million, representing decrease in the amount of KM6 million (2 per cent) as the result of decreases of transfers to the Fund for Health Insurance in the amount of KM11.5 million and increase of transfers to the Fund for Pension and Disability Insurance by KM5 million, as well as increase in the amount of transfers to local self-government units under the framework of Public Investments in the amount of KM1.4 million.
- Transfers between budget units of the same levels of government amount to KM32 million, representing decrease in the amount of KM16.2 million (33.7 per cent), and the basic reason is that in 2015 budget funds on the position Transfers to the Solidarity Fund for reconstruction of Republika Srpska have not been planned. This amount has been planned in the amount of KM18 million in the budget rebalance for 2014.
- Expenditures for non-financial assets amount to KM16.7 million, representing increase in the amount of KM63.3 million (79.2 per cent). Planned decrease is the result of realisation of projects for which the funds have been secured under budget 2014 rebalance.
- Expenditures for repayment of debts amounting to KM477 million in 2015 representing decrease in the amount of KM41.5 million (8 per cent) in comparison with funds planed in 2014 budget rebalance.

Budgets of the local self-government units for 2015 are planned at the level of 2014, with spending of about 6 per cent of projected GDP of Republika Srpska and projected surplus in the amount of KM24.5 million. Financial plans of social security funds in 2015 envisage decrease of social contributions. Spending of social security funds budget is around 20 per cent of projected GDP of Republika Srpska, while the projected deficit amounts to KM53.1 million.

3.4 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

Total public debt of Bosnia and Herzegovina as of 30 September 2014 amounted to KM 10.234,1million and was by 7.6 index points higher in comparison with the state recorded in 2013. In the structure of this debt, 55 per cent or KM 5.667,5 million represents foreign debt, while domestic debt amounts to 45 per cent or KM 4.566,5 million. In the structure of foreign debt, the "old debt" amounts to 19.6 per cent, while the "new debt" amounts to 80.4 per cent. It is estimated that the state of public debt in Bosnia and Herzegovina in the end of 2014 will amount to KM 10.604,1 million. Issued guarantees as of 30 September 2014 amount to KM403.8 million, of which KM97.8 million, KM99.7 million and KM206.3 million pertain to the institutions of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina and Republika Srpska, respectively.

Status of public debt and projections (in million KM)

	2013	2014	2015	2016	2017
1. Foreign debt	6,489.9	7,338.7	7,378.1	7,481.6	7,173.7
Institutions of BiH	45.0	59.0	66.1	73.1	69.9
Federation of BiH	4,671.2	5,374.0	5,283.7	4,989.1	4,484.0
Republika Srpska	1,763.5	1,890.2	2,012.8	2,404.4	2,604.6
Brčko District	10.2	15.5	15.5	15.0	14.2
2. Domestic debt	3,020.7	3,265.4	3,114.2	2,675.5	2,175.9
Federation of BiH	957.5	1,094.6	977.9	809.8	615.0
Republika Srpska	2,029.3	2,148.4	2,125.6	1,860.1	1,556.0
Brčko District	33.9	22.4	10.7	5.6	4.9
TOTAL (1+2)	9,510.6	10,604.1	10,492.3	10,157.1	9,349.6
GDP in million KM	28,027.0	28,738.0	30,008.0	31,649.0	33,682.0
Total public debt/BDP (%)	33.9	36.9	35.0	32.1	27.8

Repayment of public debt and projections (in million KM)

	2013	2014	2015	2016	2017
Foreign debt	448.2	508.9	396.5	480.2	578.4
Domestic debt	222.4	366.0	570.1	595.6	566.1
Total Federation of BiH	670.6	874.9	966.6	1,075.8	1,144.5
Foreign debt	187.1	202.1	141.1	186.8	277.8
Domestic debt	246.0	335.2	392.1	415.1	460.5
Total RS	433.2	537.4	533.2	601.9	738.3
Foreign debt	0.8	1.5	2.8	1.7	2.2
Domestic debt	11.6	13.2	14.0	8.6	0.7
Total Brčko District	12.4	14.7	16.8	10.3	2.9
Foreign debt of the institutions of BiH	3.6	4.5	4.3	4.4	4.4
TOTAL BiH	1,119.8	1,431.5	1,520.9	1,692.4	1,890.1
Foreign debt	639.7	717.0	544.7	673.1	862.8
Domestic debt	480.1	714.5	976.2	1,019.3	1,027.3
Debt repayment/BDP (%)	4.0	5.0	5.1	5.3	5.6

The structure of purpose of investments remains unchanged and is characterised by increased investments into infrastructure and public sector in comparison with investments into economic operations. Out of total engaged credits, 66.75 per cent are being repaid, while 38.3% of the engaged amount is still under grace period. The credits are characterised by favourable conditions, with

average interest rate of 1.45 per cent (51.2 per cent with fixed interest, and 48.8 per cent with variable rate) and average maturity of 8 years.

Credit currency structure during the 2010-30 September 2014 period

Currency	Participation of currencies in foreign debt in (%)				
	31/12/2010	31/12/2011	31/12/2012	31/12/2013	30/09/2014
EUR	42.48	44.45	46.95	52.21	51.65
SDR	38.23	37.43	36.76	33.25	34.31
USD	10.26	9.41	8.20	7.24	6.87
CPU	4.68	4.28	3.52	2.86	2.64
Other currencies	4.35	4.43	4.57	4.44	4.53
TOTAL	100.00	100.00	100.00	100.00	100.00

All matured obligations under foreign public debt between 1 January and 30 September 2014, with Bosnia and Herzegovina as the bearer of obligations, have been settled in total, in the total amount of KM559.7 million Bearing in mind that most credits approved to Bosnia and Herzegovina and matured, i.e. for which the credit period has expired, participation of paid principal in the structure of total serviced obligations in comparison with paid interest, service and other costs, records the growth tendency.

In the structure of total paid amount, paid principal amounts to 87.35 per cent or KM489.2 million, while the amount of KM70.49 million or 12.65% pertains to repayment of interest, service and other costs. In the stated amount of obligations, the Federation of Bosnia and Herzegovina participates with KM360.09 million, while Republika Srpska, Brčko District and the institutions of Bosnia and Herzegovina participate with KM195.2 million, KM0.78 million and KM3.66 million, respectively. The amount of KM81.91 million or 14.7 per cent has been spent for repayment of "old debt", while repayment of new debt amounts to KM475.26 million or 85.30 %.

When it comes to creditors, the largest amount, i.e. KM33.71 million has been paid to the London Club, while the World Bank-IBRD and the Paris Club of creditors were paid the amount of KM30.9 million and KM17.3 million, respectively.

In the amount pertaining to the paid obligations, the following participate: IMF KM290.84 EBRD KM66.18 million, EIB KM45.50 million, WB KM36.68 million, etc.

Indicators of foreign debt sustainability

	2013	2014	2015	2016	2017
GDP (million KM)	28,027.0	28,738.0	30,008.0	31,649.0	33,682.0
Export of goods and services (in million KM)	8,406.0	8,751.0	9,188.0	9,684.0	10,304.0
Foreign debt (million KM)	6,489.9	7,338.7	7,378.1	7,481.6	7,173.7
Foreign debt servicing (million KM)	639.7	717.0	544.7	673.1	862.8
Net indirect tax revenues (million KM)	4,772.2	4,891.9	4,994.9	5,093.2	5,214.9
Foreign debt/GDP (%)	23.2	25.5	24.6	23.6	21.3
Foreign debt servicing/GDP (%)	2.3	2.5	1.8	2.1	2.6
Foreign debt/Export of goods and services (%)	77.2	83.9	80.3	77.3	69.6
Foreign debt servicing/Indirect tax revenues (%)	13.4	14.7	10.9	13.2	16.5

In accordance with previous records and given projections, public indebtedness of Bosnia and Herzegovina remains within the framework of Maastricht criteria and Bosnia and Herzegovina remains moderately indebted country. Standard indicators of public debt sustainability indicate that

public debt of Bosnia and Herzegovina still poses no danger to the fiscal sustainability of Bosnia and Herzegovina and the Entities.

Federation of BiH

As of 30 September 2014, the state of public debt in the Federation of Bosnia and Herzegovina, bearing in mind the amount of foreign debt transferred to final users (FU), as well as domestic debt of cantons, cities and municipalities, amounts to KM6.153.83 million, of which KM3.675.640.00 pertains to the Government of the Federation of Bosnia and Herzegovina, while the amount of KM2.478.190.00 pertains to debt of cantons, cities, municipalities, public enterprises and other users. It is estimated that this debt will amount to KM6.468.610.00 at the end of 2014.

The state of public debt and projections in the Federation of Bosnia and Herzegovina (in million KM)

Debt category	2013	2014	2015	2016	2017
Domestic debt	957.59	1,094.61	977.94	809.75	614.97
-Government of the Federation of BiH	795.80	908.00	837.90	677.90	546.79
-Cantons	113.88	138.74	108.68	108.02	50.10
-Cities and municipalities	47.91	47.87	31.36	23.83	18.08
Foreign debt	4,671.20	5,374.00	5,283.70	4,989.11	4,483.97
-Government of the Federation of BiH	2,652.30	2,780.50	2,659.70	2,438.29	2,121.51
-Cantons	233.10	260.60	212.90	163.97	115.04
-Cities and municipalities	53.50	102.90	127.80	136.28	131.05
-Public enterprises	1,732.30	2,230.00	2,283.30	2,250.57	2,116.37
Total:	5,628.79	6,468.61	6,261.64	5,798.86	5,098.94

Repayment of public debt and projections in the Federation of Bosnia and Herzegovina (in million KM)

Debt category	2013	2014	2015	2016	2017
Domestic debt	222.45	366.03	570.14	595.58	566.07
-Government of the Federation of BiH	222.45	366.03	570.14	595.58	566.07
-Cantons	0.00	0.00	0.00	0.00	0.00
-Cities and municipalities	0.00	0.00	0.00	0.00	0.00
Foreign debt of the Federation of BiH	448.18	508.88	396.45	480.18	578.37
-Government of the Federation of BiH	327.77	225.31	185.66	279.29	362.71
-Cantons*	120.41	283.57	60.57	58.69	56.01
-Cities and municipalities*			3.67	4.30	5.99
-Public enterprises and other			146.56	137.90	153.66
Total:	670.63	874.91	966.59	1,075.76	1,144.44

*Data for 2013 and 2014 pertain to total repayment of debts of cantons, cities, municipalities, public enterprises and other

State of potential obligations under guarantees (in million KM)

Debtor	2014	2015	2016	2017
Federation of BiH	57.2	39.2	21.3	3.3
Cantons	31.3	26	20.8	15.5
Municipalities	8	9.3	6.7	5.6
Total guarantees	96.5	74.5	48.8	24.4

Debt of the Government of the Federation of Bosnia and Herzegovina

Total foreign and domestic debt of the Federation of Bosnia and Herzegovina, as of 30 September 2014, amounts to KM3.675.640.00, of which the amount of KM2.831.130.00 pertains to the foreign

debt, while the amount of KM844.510.000.00 pertains to the domestic debt. This state of debt of the Federation of Bosnia and Herzegovina does not include debt that has been subsidiary transferred to end users.

State of debt of the Federation of Bosnia and Herzegovina (in million KM)

Year	GDP Federation of BiH	State of debt			Debt to GDP ratio		
		Foreign debt	Domestic debt	Total	Foreign debt	Domestic debt	Total
	1	2	3	4 (2+3)	5	6	7
30/09/2014	17,728	2,831.13	844.51	3,675.64	15.97%	4.76%	20.74%
31/12/2013	17,728	2,652.32	795.83	3,448.15	14.96%	4.49%	19.45%
31/12/2012	17,031	2,774.61	870.16	3,644.77	16.29%	5.11%	21.40%

Increase of debt in comparison with 2013 is the result of unplanned indebtedness due to the natural disaster.

Domestic debt of the Federation of Bosnia and Herzegovina is in accordance with the law, as well as the debt created through emission of loan stocks. The basis for settling domestic debt prescribed by the law is represented by judicial decisions or verification. Domestic debt prescribed by law is settled through payments in cash or emission of loan stocks.

As of 30 September 2014, payments in cash were effected toward suppliers in the amount of KM17.670.423, military salaries and remunerations in the amount of KM32.565.264, war claims in the amount of KM14.608.832 and old foreign savings in the amount of KM102.041.092.

Obligations under old foreign savings and war claims, except in cash, are also settled through emission of loan stocks. For settling obligations under old foreign savings, six emissions have been effected in the total amount of KM784.473.553, of which, as of 30 September 2014, the amount of KM532.800.753 has been paid. For settling obligations under war claims, three emissions have been effected in the total amount of KM194.407.869. Settling principals for war claims³⁶ for which the emission has been effected starts upon expiration of the grace period, 9 years from the date of emission.³⁷

Since annual verification of old foreign savings is lowered each year and since verification of war claims has been completed, and bearing in mind the dynamics and amounts of delivery of judicial decisions for war claims, it is not expected for these obligations to increase significantly. Total claims in the Federation of Bosnia and Herzegovina under old foreign savings and war claims will be smaller than estimated KM1.150 million, i.e. KM500.00 million. Therefore, the domestic debt is only analysed as per the verified amount.

In the first nine months of 2014, the amount of KM266.8 million of principal and KM19.1 million of interest has been paid for settling the domestic debt. Until 30 September 2014, the amount of KM829.1 million of principal has been paid for settling the domestic debt. Therefore, the state of verified debt is KM846.2 million.

³⁶ In accordance with the judicial decision of the European Court for Human Rights, owners of debentures who rely on the judicial decision as the basis for emission of debentures, received payments of claimed amounts, while the owner of debentures in the amount of KM7.597.727 became the Federal Ministry of Finance.

³⁷ Repayment of principal for tranche 1 begins in 2019, for tranche 2 in 2021 and for tranche 3 in 2023.

Outstanding domestic debt of the Federation of Bosnia and Herzegovina in the form of securities

	Securities	Outstanding debt as of 30 September 2014	Outstanding debt as of 31 December 2014 (estimation)
1	Short-term securities Treasury bills	160,000,000	100,000,000
2	Long-term VP-Debentures, of which	646,006,324	736,006,324
2.1	Market debentures	200,000,000	290,000,000
2.2	Old foreign savings and RT	446,006,324	446,006,324
TOTAL		806,006,324	806,006,324

Projections of repayment of domestic and foreign debt of the Government of the Federation of Bosnia and Herzegovina until 2017 (in million KM)

Debt category	2015		2016		2017	
	principal	interest	principal	interest	principal	interest
1.1 Internal debt of the Government of Federation of BiH	537.6	32.5	562.0	33.6	537.1	29.0
1.1.1 Securities	527.8	28.3	553.8	28.9	530.0	24.6
a) Long-term securities	207.8	25.5	193.8	25.6	230.0	21.9
Old foreign savings	127.8	6.4	153.8	5.0	30.0	2.3
War claims	0	4.9	0	5.1	0	5.1
Debentures of the Federation of BiH	80.0	14.2	40.0	15.6	200.0	14.5
b) Short-term securities (TZ)	320.0	2.8	360.0	3.2	300.0	2.7
1.1.2 Bank credits	0	0	0	0	0	0
1.1.3 Obligations of the former FMO, of which	3.3	0.2	1.2	0.7	1.1	0.4
1.1.4 Verified domestic debt for which debentures were not emitted	6.5	4.0	7.0	4.0	6.0	4.0
2.1 Foreign debt of the Government of Federation of BiH*	146.3	56.6	226.5	52.7	316.8	49.3
TOTAL	683.9	89.2	788.5	86.4	853.9	78.3

**Projection of repayment without lower levels of government*

Indebtedness in the Federation of Bosnia and Herzegovina remains within the framework of Maastricht criteria. Obligations for debt servicing are increasing due to servicing of foreign debt, in most part due to obligations toward IMF.

Servicing of debt³⁸ of the Federation of Bosnia and Herzegovina and cantons (long-term obligations) does not exceed 18% of consolidated revenues realised in the previous year, i.e. servicing of the debt of cantons, municipalities and cities is below 10% of related revenues realised in the previous year. Participation of foreign debt servicing transferred to end users in total obligations of Bosnia and Herzegovina is gradually increasing.

Servicing of long-term domestic debt of the Federation of Bosnia and Herzegovina significantly participates in total annual obligations, of which majority of obligations pertains to repayment of debt under old foreign savings. In addition, until the end of 2016, all obligations under old foreign savings verified until 31 December 2013 will be settled.

Dynamics of indebtedness, credit purpose and the standing problem of the deficit of the balance of payments implies the need for continuous monitoring of debt, including borrowing from

³⁸ Servicing of the debt of cantons, cities and municipalities may amount up to 10 per cent of related revenues realised in the previous fiscal year. The amount of servicing of the debt of the Federation of Bosnia and Herzegovina, including limitations to debt amounts of cantons may not exceed 18 per cent of consolidated revenues of the Federation of Bosnia and Herzegovina and cantons realised in the previous fiscal year.

international financial institutions under concessional conditions (low interest rate, longer repayment period and grace period between 4 and 6 years). Likewise, new borrowing should be related to projects contributing to the dynamics of reform implementation, as the basis for further economic growth. Adopting each separate decision on new borrowing is subjected to necessary analysis of macroeconomic developments and their susceptibility to each new borrowing and their implications on GDP.

Projections of domestic borrowing of the Government of the Federation of Bosnia and Herzegovina under emission of securities (in 000 KM)

	2015	2016	2017
emission of debentures of the Federation of BiH	80,000	40,000	100,000
emission of treasury bills of the Federation of BiH	320,000	360,000	300,000

Under the state of domestic and foreign debt, the ratio of total debt of the Federation of Bosnia and Herzegovina and GDP (pertaining to the Federation of Bosnia and Herzegovina) decreased between 2005 and 2008, i.e. from 48.09 per cent in 2005 it decreased to 27.52 per cent in 2007 and to 27.11 per cent in 2008. The ratio constantly increased since 2009 (27.70 per cent), only to reach 34.71 per cent on 30 September 2014.

Since the portion of domestic debt pertains to legally assumed obligations to be settled in accordance with submitted judicial decisions (military salaries and suppliers of the former Federal Ministry of Defence and the Army of the Federation of Bosnia and Herzegovina, as well as war claims) or the period of verification (old foreign savings), the projection of servicing the domestic debt does not include cash payment of these obligations.

Debt management, with the aim of maintaining the debt on the same level or decreasing its participation in GDP, increased participation of borrowing in form of guarantees and continuous development and improvement of domestic securities market, should represent the future priority in the Federation of Bosnia and Herzegovina.

Republika Srpska

The Law on Borrowing, Debt and Guarantees of Republika Srpska defines in detail the domain of borrowing and guarantees of Republika Srpska and municipalities, as well as methods and procedures of borrowing. This and applicable laws in the domain of budget system represent a complete legal framework for improvement and control of budget discipline. This law defines limitations to borrowing amounts, thus preventing the total debt of Republika Srpska exceeding 60 per cent in the end of a fiscal year, while public debt of Republika Srpska may not exceed 55 per cent of GDP realised in the same year.

The debt of Republika Srpska under borrowing for financing rehabilitation recorded in the Single Registry of Damages, prescribed by the Law on Solidarity Fund of Republika Srpska, is singled out from the limitations prescribed for the total public debt of Republika Srpska.

As of 31 December 2013, debt of Republika Srpska being serviced from the budget of Republika Srpska amounted to KM4.335.500.00, of which the amount of KM2.675.400.00 (61.71 per cent) pertains to the foreign debt, while the amount of KM1.660.100.00 (38.29) pertains to domestic debt.

Debt currency structure is characterised by 4 dominant currencies: KM, EUR, SDR and USD. The currency structure is dominated by KM (38.29 per cent) since total domestic debt is denominated in KM. Since the Central Bank of Bosnia and Herzegovina reflects monetary stability in accordance with currency board arrangement, participation of EUR in the debt currency structure (33.08%) may be regarded as favourable. High participation of EUR and KM insures high level of predictability of future

obligations, and in this regard, Republika Srpska is exposed to low currency risk. However, due to significant participation of USD in debt currency structure (3.74 per cent) and bearing in mind its domination in SDR structure, strengthening of USD could result in foreign debt increase. This would result in larger sums of domestic currency for servicing the foreign debt.

When it comes to debt structure in view of maturity, it is very important to note that debt of Republika Srpska is almost entirely long-term. Of total debt of Republika Srpska, only 2.8 per cent pertains to short-term debt, while the remaining portion of debt, i.e. 97.20 per cent is a long-term debt.

58.29 per cent of total debt of Republika Srpska is currently being repaid, while 41.71 per cent of the debt is still under the grace period. In total, 64.85 per cent of foreign debt is currently being repaid, with 94.68 and 55.13 per cent of old and new debt, respectively, is being repaid. 47.73 per cent of total domestic debt is being repaid, while 52.27 per cent is still under the grace period.

The larger part, i.e. 61.66 per cent of total debt is being repaid under fixed interest rates. While foreign debt is mostly being repaid under variable conditions (52.28 per cent), domestic debt is mostly being repaid under fixed conditions (84.68 per cent).

When it comes to debt structure in view of instruments, marketable portion of debt (debentures and treasury bills) amounts to 29.58 per cent, while the non-marketable portion of debt (credits and debt being settled through action plan or in cash) amounts to 70.42 per cent of total debt. Marketable portion of debt enables for all advantages of debt management to be used since these are openly traded at the capital market.

Conditioned financial obligations

As of 31 December 2013, the state of debt under all credits for which the Government of Republika Srpska issued their guarantees amounts to KM167.53 million. In the framework of the budget of Republika Srpska, funds for repayment of obligations under activated and non-activated guarantees, characterised as risky, is planned.

Servicing of total and public debt of Republika Srpska and servicing of debt from the budget of Republika Srpska

Category	2013	including 30 Sept. 2014	2014	2015	2016	2017
1 Foreign debt servicing	241.9	195.2	263.0	208.5	276.7	373.2
1.1 Republika Srpska	184.7	151.5	198.0	133.5	178.7	269.1
1.2 Local self-government units	2.4	1.5	4.2	7.5	8.1	8.7
1.3 Public Enterprises and IRB	54.8	42.2	60.9	67.5	89.9	95.4
2 Domestic debt servicing	246.0	281.5	335.2	392.1	415.1	460.5
2.1 Republika Srpska	148.0	194.1	222.1	265.5	300.2	353.6
2.2 Local self-government units	52.2	49.7	57.5	57.3	64.5	61.8
2.3 Social security funds:	45.8	37.7	55.6	69.3	50.4	45.1
2.3.1 direct	18.0	10.4	11.1	20.4	4.2	1.0
2.3.2 indirect	27.9	27.3	44.5	48.9	46.3	44.1
3 Republika Srpska public debt servicing	433.2	434.5	537.4	533.2	601.9	738.3
3.1 Foreign debt (1.1+1.2)	187.1	153.0	202.1	141.1	186.8	277.8
3.2 Domestic debt (2.1+2.2+2.3)	246.0	281.5	335.2	392.1	415.1	460.5
4 Republika Srpska total debt servicing	487.9	476.7	598.2	600.6	691.9	833.7
4.1 Foreign debt (1.1+1.2+1.3)	241.9	195.2	263.0	208.5	276.7	373.2
4.2 Domestic debt (2.1+2.2+2.3)	246.0	281.5	335.2	392.1	415.1	460.5
5 Debt servicing from budget of Republika Srpska	417.7	416.6	529.6	522.9	623.2	770.9
5.1 Foreign debt (1.1+1.2+1.3)	241.9	195.2	263.0	208.5	276.7	373.2
5.2 Domestic debt (2.1+2.32)	175.8	221.4	266.6	314.4	346.4	397.7

State of total and public debt of Republika Srpska and the state of debt under obligations financed from the budget of Republika Srpska

Category	2013	including 30 Sept. 2014	2014	2015	2016	2017
1 Foreign debt servicing	2,675.4	2,897.0	2,929.9	3,208.1	3,651.5	3,918.1
1.1 Republika Srpska	1,715.3	1,869.3	1,829.6	1,927.3	2,293.4	2,481.2
1.2 Local self-government units	48.2	49.9	60.7	85.5	110.9	123.4
1.3 Public Enterprises and IRB	911.9	977.8	1,039.6	1,195.3	1,247.2	1,313.5
2 Domestic debt state	2,029.3	2,088.4	2,148.4	2,125.6	1,860.1	1,556.0
2.1 Republika Srpska	1,405.7	1,498.9	1,529.8	1,598.1	1,431.3	1,206.4
2.2 Local self-government units	345.9	334.7	339.2	299.7	268.2	223.9
2.3 Social security funds	277.6	254.8	279.5	227.8	160.6	125.8
2.3.1 direct	23.3	15.2	52.8	35.2	0.9	0.0
2.3.2 indirect	254.4	239.6	226.7	192.6	159.7	125.8
3 Republika Srpska public debt state	3,792.8	4,007.6	4,038.7	4,138.4	4,264.5	4,160.6
3.1 Foreign debt (1.1+1.2)	1,763.5	1,919.2	1,890.2	2,012.8	2,404.4	2,604.6
3.2 Domestic debt (2.1+2.2+2.3)	2,029.3	2,088.4	2,148.4	2,125.6	1,860.1	1,556.0
4 Republika Srpska total debt state	4,704.7	4,985.4	5,078.3	5,333.7	5,511.7	5,474.1
4.1 Foreign debt (1.1+1.21.3)	2,675.4	2,897.0	2,929.9	3,208.1	3,651.5	3,918.1
4.2 Domestic debt (2.1+2.2+2.3)	2,029.3	2,088.4	2,148.4	2,125.6	1,860.1	1,556.0
5 State of debt financed from the budget of Republika Srpska	4,335.5	4,635.5	4,686.3	4,998.8	5,242.5	5,250.2
5.1 Foreign debt (1.1+1.21.3)	2,675.4	2,897.0	2,929.9	3,208.1	3,651.5	3,918.1
5.2 Domestic debt (2.1+2.32)	1,660.1	1,738.5	1,756.5	1,790.7	1,591.0	1,332.1

The Law on Borrowing, Debt and Guarantees of Republika Srpska ("Official Gazette of Republika Srpska", No. 71/12, 52/14) differentiates between the terms of total and public debt. In accordance with the above law, the total debt of the Republika Srpska includes public debt of the Republika Srpska, debt of public enterprises, the Investment Development Bank of the Republika Srpska and public sector institutions. Public debt is the debt of the Republika Srpska, local government units debt and the debt of social security funds.

3.5 Sensitivity analysis and comparison with the previous programme

Indirect taxes

Considering basic settings of indirect tax projections and total economic conditions in Bosnia and Herzegovina and in the world, realisation of the projected level of indirect tax revenues between 2015 and 2017 is susceptible to following risks of economic (internal and external) and fiscal character, in view of effects of changes to indirect taxation policy:

- i. Projections of indirect tax revenues are closely tied to projections of macroeconomic indicators of DEP. Every deviation of these parameters from projected values represents a risk to revenues projections;
- ii. Slower economic recovery of main export partners of Bosnia and Herzegovina (EU, CEFTA members) increases the risk to realisation of macroeconomic projections and projections of indirect tax revenues in total. Likewise, slower dynamics of recuperating from floods and slower inflow of financial assistance in comparison with DEP projections may slower the rate of recovery of affected areas and revitalisation of agricultural and industrial production and expected growth of consumption and economy, as well as endanger realisation of projections of revenues collection;

- iii. Important fiscal risk represents the effects of derogation in the VAT system pertaining to VAT exemptions for projects financed from IPA Funds and refunds under international assistance projects. Both derogations, save for their effect on collection of net VAT, also lead to increase of discrepancies between taxable and total spending, representing basis for projections of revenues. Effects of VAT exemptions under IPA funds are difficult to estimate, while for refunds under international project in 2014 are expected to exceed 0.5 per cent of GDP. Higher growth of international projects in comparison with previous trends and re-inclusion of Bosnia and Herzegovina in IPA program may lead to increase of mentioned discrepancy, thus resulting in decrease in execution of VAT revenues in comparison with the projected;
- iv. Expected effects of implementation of the Law on Excise Duties in the domain of tobacco taxation may decrease or be neutralised by inefficient political and operative measures aimed at combating fiscal evasion, illegal import of tobacco and illegal production of cigarettes;
- v. Possible changes to policies in the domain of indirect taxes, e.g. in view of differentiated VAT rates, introduction of blue diesel or increase of pay tolls resulting in increased gap in taxation of substitutes, in addition to fiscal losses and macroeconomic implications in view of market distortions, may destabilise the existing VAT system and collection of revenues, lower the efficiency of the Indirect Taxation Authority and burden business entities, as well as significantly increase the risk of frauds.

In addition to basic scenario, an alternative scenario of projections of revenues from indirect taxes has been prepared, based on the alternative scenario of macroeconomic indicators of the Directorate for economic planning.

Alternative scenario of projections of indirect tax revenues, October 2014

Type of revenue (net)	in million KM					Projected growth rate			
	execution		projection						
	2013	2014	2015	2016	2017	2014	2015	2016	2017
VAT	3,102.9	3,173.3	3,216.7	3,262.0	3,328.4	2.3%	1.4%	1.4%	2.0%
Excise duties	1,267.1	1,293.1	1,313.3	1,329.2	1,349.1	2.1%	1.6%	1.2%	1.5%
Custom duties	211.0	229.1	235.4	242.4	251.2	8.6%	2.8%	2.9%	3.6%
Pay toll	285.3	293.2	297.0	305.0	314.8	2.8%	1.3%	2.7%	3.2%
Other	19.9	20.5	20.7	20.9	21.1	3.4%	0.9%	0.9%	0.9%
TOTAL	4,886.2	5,009.2	5,083.2	5,159.5	5,264.5	2.5%	1.5%	1.5%	2.0%
Pay toll (KM0.10/l)	-114.0	-117.3	-118.8	-122.0	-125.9	2.8%	1.3%	2.7%	3.2%
For distribution	4,772.2	4,891.9	4,964.4	5,037.5	5,138.6	2.5%	1.5%	1.5%	2.0%

Considering that indirect tax revenues projections are closely tied to projections of macroeconomic indicators, their corrections in the alternative scenario have a significant impact on projected revenues amounts, except for the revenues from excise duties on tobacco, the execution of which is affected by excise duties on cigarettes and cut tobacco between 2015 and 2017. The most important corrections pertain to VAT revenues that could be explained by corrections of spending projections, as well as significant participation of these revenues in total indirect taxes (more than 63 per cent). Considering that projections of real indicators have been corrected in the alternative scenario of macroeconomic projections, revenues from pay tolls and excise duties on oil derivatives and other excise duties products have also been corrected. Custom duties have not been significantly revised since projections of import in the alternative scenario have not been significantly changed. Expressed in million KM, projections in the alternative scenario have been corrected in the amount of KM-33 million, KM-59.8 million and KM-82.1 million in 2015, 2016 and 2017, respectively.

It is necessary to pay attention to used assumptions on changes to taxation policy in comparing projections with the mentioned. Projections of indirect taxes represented in EFP 2014 did not include estimates of effects of proposed amendments to the Law on Excise Duties. There are separately

represented in part 4.2.2. Tax reform³⁹. In addition, projections in EFP 2014 did not include effects of implementation of the Agreement on Free Trade between Bosnia and Herzegovina and EFTA. These are now included, as of 2015. Likewise, in addition to projections of changes to taxation policy, in comparison of projections, it is necessary to bear in mind changes to projections of macroeconomic indicators on which these are based.⁴⁰

Table 3. Difference between projections in EFP 2014

Document	Drafting period	Projections of indirect taxes (in million KM)			
		2014	2015	2016	2017
EFP 2014	November 2013	5,017.7	5,176.3	5,379.9	n/a
NERP 2015	October 2014	5,009.2	5,116.2	5,219.3	5,346.6
Correction (in %)		-0.17%	-1.16%	-2.99%	n/a

Table 3 leads to a conclusion that projections for 2014 have not been significantly corrected (correction KM-8.5 million or -0.17 per cent), while projections for 2015 and 2016 are corrected by -1.16 and -2.99 per cent, respectively. The most important reasons for corrections in 2015 and 2016 pertain to changes in projections of macroeconomic indicators, particularly of spending and import.⁴¹

It is necessary to note that, after projections represented in EFP 2014 and up to preparation of NERP 2015, the Department for Macroeconomic Analysis of the Indirect Taxation Authority prepared projections in April 2014⁴², in accordance with obligations under budget calendar of the institutions of Bosnia and Herzegovina⁴³ and separate projections in June 2014 in order for effects of disastrous floods in May 2014 to be assessed⁴⁴.

Federation of Bosnia and Herzegovina

Realisation of mid-term goals in the domain of taxation policy and public revenues policy primarily depends on adjusting priorities of economic policy of new legislative and executive bodies in the Federation of Bosnia and Herzegovina to existing policies, since 2014 was an election year in Bosnia and Herzegovina. In addition, unforeseen events such as the natural disaster in 2014 may delay realisation of certain policies through re-direction of activities and funds to realisation of other, unforeseen policy measures. Realisation of planned activities will also depend on political stability and institutional readiness of activity bearers.

Republika Srpska

Susceptibility of budget projections on alternative scenarios and risks

Fiscal projections are based on developments of execution of revenues and flows in previous years and in the first eleven months of 2014, and in part on planned amendments to the law and on the macroeconomic framework for the following year. For each individual type of revenues, trends in the realisation in the previous period have been analysed and one-time effects during the following

³⁹ Considering that during preparation of projections represented in EFP 2014 the Department had no available information on coming into force of the Law on Excise Duties in the domain of tobacco and beer, it was presumed this would be 1 January 2014. Projections represented in NERP 2015 include effects as of the actual date of coming into force of these amendments, as of 1 August 2014 for tobacco and 1 September 2014 for beer.

⁴⁰ Projections of indirect taxes represented in EFP 2014 were prepared on the basis of macroeconomic projections of DEP from November 2013, while projections represented in this documents were based on DEP projections of macroeconomic indicators from September 2014

⁴¹ In relation to projections of DEP from November 2013, projections of nominal growth of total spending have been corrected by -1.6 and -2.0 per cent in 2015 and 2016, respectively, while projections of import growth in the stated years were corrected by -3.2 and -8 per cent.

⁴² Projections are available at http://www.oma.uino.gov.ba/bilteni/Oma_Bilten_eng_106.pdf

⁴³ The Law on Financing the Institutions of Bosnia and Herzegovina ("Official Gazette of Bosnia and Herzegovina", No. 49/09).

⁴⁴ Projections are available at http://www.oma.uino.gov.ba/bilteni/Oma_Bilten_eng_108_109.pdf.

period have also been included and the level of co-relation of certain revenues with developments of macroeconomic aggregates. All revenues are denominated in current prices, while the level of elasticity of tax revenues is calculated on the basis of changed of real and nominal values of pertaining macroeconomic aggregates, particularly of gross domestic product.

Risks to execution rest in realisation, or failure in realisation of macroeconomic and other assumptions as the basis of the projection. Likewise, risks in the real sector would reflect on the expected economic growth and the number of employees.

Comparison with the previous program

If 2015 program is compared to the 2014 program, the smaller or the bigger increase of the deficit is obvious.

Due to realisation of lower GDP growth rates in 2014, mostly the result of floods in the region and conservative revenues projection, the level of revenues for 2014 is at slightly lower level than in the previous program. At the same time, expenditures also increased for 2014 led to increased deficit. These developments also affected projections for future years, so in the 2015 plan, there is a slight increase of revenues, but also somewhat significant of expenditures, resulting in increase of projected deficit.

3.6 Sustainability of public finance

Federation of BiH

During 2014, in the domain of tax policy and public revenues were directed toward realisation of planned policies defined in EFP 2014-2016. This primarily relates to the analysis of implementation of tax regulations and regulations determining other public revenues, as well as implementation of new legal solutions with the aim of improvement of this domain and harmonisation of regulations with EU directives.

Efforts have been invested into determining the solution regarding the burden of employers in order to stimulate the growth rate, as well as increase in new investments in economy. Due to a large number of parafiscal charges representing a significant burden to the economy of the Federation of Bosnia and Herzegovina, the Government of Bosnia and Herzegovina, on the basis of analysis of fiscal burden to tax payers, adopted the conclusion with the proposal of measures for decreasing parafiscal charges. The basis of stated measures pertained to lowering of mandatory payments under general water tariff, general useful function of forests and memberships of tourist boards and includes payers, basis and calculation rates. In this regard, the competent Ministries (Federal Ministry of Agriculture, Water Management and Forestry and the Federal Ministry of Ecology and Tourism) were instructed to prepare changes to the regulations in view of the stated revenues and in accordance with principles adopted by the Government of the Federation of Bosnia and Herzegovina.

In view of finding solutions for decreasing the burden on economy, 2013 saw implementation of the temporary Law on Amendments to the Law on the Default Interest Rate, adopted with the aim of partial decrease of burden on entrepreneurs as the result of accumulation of obligations under public revenues debt. This Law pertained to write-off of interest on matured and outstanding public revenues and temporary exemption from default interest for economic entities which settled their obligation (principal) in due time. Due to positive effects of this Law, 2014 saw adoption of additional amendments to the Law on Default Interest Rate, extending the deadline for settling tax payer obligations under public revenues to 20 June 2014, including the possibility of default interest write-off under certain conditions. On the basis of stated amendments to this Law, in 2014 and 2015 inflow under settling of principal of matured but outstanding public revenues is expected. The real results will be obvious only after expiration of legally defined deadlines for payment of principal debt, i.e. after 31 December 2014 and 30 June 2015.

The process of introducing fiscal systems and implementation of the Law on Fiscal Systems during its four year long period of implementation was justified due to higher degree of control in evidencing turnover, resulting in discipline in calculating, reporting and payment of taxes and encouraged improved inspection surveillance activities. With the aim of further improvement of this area, the need arose for amendments to certain legal solutions. 2014 saw preparation of draft of the amendment to the Law on Fiscal System that defines in more detail certain provisions of the existing Law. The same was adjusted to the new Law on Misdemeanours in the Federation of Bosnia and Herzegovina. Implementation of these amendments would, inter alia, be aimed at improving the discipline of subjects in the process of fiscalisation, thus facilitating the work of inspection authorities and finally in increased revenues from taxation of spending and revenues from direct taxes.

Effects of previous implementation of the Law on Fiscal System mainly affected the monitoring of spending represented by VAT returns, which in turn directly conditions the coefficient of distribution of revenues from indirect taxes between Entities. In 2014, these recorded growth to the advantage of the Federation of Bosnia and Herzegovina started in 2011.

On the basis of performed analysis of previous legal solutions in the domain of qualification of public revenues, adjusted with implemented reforms in the area of indirect taxes, direct taxes, principles of the European Charter on Local Self-Government (signed by Bosnia and Herzegovina), principles of modern public finances, in particular principles pertaining to fiscal equalisation between units of government at the same level (horizontal equalisation), the need arose for strengthening fiscal capacity of certain cantons/municipalities in comparison with other users of public revenues. In 2014, this resulted in adoption and coming into force of the Law on Amendments to the Law on Qualification of Public Revenues in the Federation of Bosnia and Herzegovina, as a temporary solution before adoption of the new law following the announcement of results of census, resulting in improvement of financial position of certain, underdeveloped cantons/municipalities, with slight financial influence on other users of public revenues.

During the following period, in addition to measures of the Government of the Federation of Bosnia and Herzegovina with the aim of coming out of the economic crisis and improvement of business environment, enabling efficient economy and economic development, additional activities should be directed toward monitoring policies implementation and implementation of obligations assumed under the Letter of Intent, signed between Bosnia and Herzegovina and the International Monetary Fund.

Improvement in collection of tax revenues should be among the top priorities, in addition of fulfilment of obligations of completion of modernisation of the Indirect Taxation Authority and Tax Administration of the Federation of Bosnia and Herzegovina and improvement of coordination between the Indirect Taxation Authority, Entity tax administrations and Brčko District Tax Administration, resulting in more transparent collection of all public revenues, especially in improvement of tax debt collection.

In the domain of public revenues, further activities will pertain to revision of total fiscal conditions in the Federation of Bosnia and Herzegovina, with special emphasis on defining proposals for improvement of existing vertical and horizontal adjustment of indirect taxes revenues distribution as the basis for determining the new Law on Qualification of Public Revenues.

Considering macroeconomic and fiscal indicators for this mid-term period, it is expected for revenues from indirect and direct taxes to increase slightly, as well as other non-taxable revenues. However, limitations of fiscal capacities regarding budget operations on all levels of government in this period should not be overlooked.

It is necessary to note that collection of indirect tax revenues, representing the largest share in tax and total income of all levels of government, will depend on the level of foreign debt repayment-of total amount of revenues from the Single Account belonging to the Federation of Bosnia and Herzegovina in accordance with Article 21 of the Law on Indirect Taxation System ("Official Gazette of Bosnia and Herzegovina", No. 44/03), funds for servicing of foreign debt of the Federation of

Bosnia and Herzegovina are deducted. Limited capacities of revenues will remain under pressure due to assignment in the name of foreign debt servicing, reflecting on budgets of all levels of government, especially in 2016 and 2017 due to larger assignments for foreign debt repayment.

Republika Srpska

Achievement of goals of the Economic policy of Republika Srpska in 2015 will enable additional support to economy and employment growth and consequently ensure sustainable economic and fiscal stability and improve positions of all categories of the society. Plan of reforms to be implemented in the following year will lead to stronger encouragement of economic activities on the basis of increase of investments, export and employment. With the aim of certain policies and measures, planned fiscal and structural adjustments will be implemented, resulting in creating basics for stronger economic growth and increase in employment and living standards.

Stability of public finances and creating conditions for decreasing illiquidity of economy will result in increased activities regarding additional stability of total public finances, realising additional savings on unproductive budget spending, continuous work on stabilisation of participation of total debt in GDP; introducing treasury system of business operations in the health sector and lowering illiquidity of economy.

In addition to primary restrictive policy of public spending implemented by Republika Srpska, the restrictive public spending will be a continuous activity of all parties to the budget system of Republika Srpska, i.e. local self-government units, social security funds and public enterprises. In this way, total system deficit and public debt of the Republic will decrease. Through additional reforms of the total budget system of Republika Srpska, additional decrease of unproductive budget spending is planned, with simultaneous increase of investment spending.

Social protection reforms must be continuous, with the aim of monitoring the state of proposing timely, efficient and effective measures, in order for the stated systems to maintain fiscal stability. In this regard, special attention in 2015 will be dedicated to activities on introduction of treasury system of business operations in the health sector, in order to improve control of spending funds.

More detail on measures to be taken with the aim of achieving sustainable public finances can be found in Point 4 of the first part of the document and in part relating to sector structural reforms in the other part of this document.

3.7 Institutional features

Federation of BiH

Implementation of the Law on Budget of the Federation of Bosnia and Herzegovina started in 1 January 2014. It is expected for this to contribute to significant strengthening of coordination of fiscal policies in the Federation of Bosnia and Herzegovina, to promoting stronger fiscal discipline and to strengthen monitoring by the Government of the Federation of Bosnia and Herzegovina of lower levels of government, non-budget funds and public enterprises and improve timeliness and accurateness of fiscal reporting. The final goals of its implementation should be cost-effective and purposeful budget planning, more efficient and effective spending of budget funds, improvement and increase in control of spending of budget funds, increase of fiscal responsibility, improvement of coordination of fiscal policies in the Federation of Bosnia and Herzegovina and adjustments of inflow and outflow from the Single Treasury Account. The new Law on Budgets of the Federation of Bosnia and Herzegovina introduced the following: (i) budget calendar with precisely determined deadlines for each of so called 10 steps of budget process; the same is adjusted and adapted to adoption of documents under the competency of other authorities closely tied to budget cycle, (ii) fiscal coordination body of the Federation of Bosnia and Herzegovina with the aim of coordinating fiscal policies in the Federation of Bosnia and Herzegovina and maintaining fiscal stability and fiscal

sustainability of the Federation of Bosnia and Herzegovina, (iii) fiscal rules, (iv) establishment of Liquidity Board, (v) budget inspection.

In accordance with the new Law on Budgets of the Federation of Bosnia and Herzegovina, the following by-laws have been adopted:

- Rulebook on determination and procedures of maintaining the register of budget users in the Federation of Bosnia and Herzegovina determining criteria on the basis of which the criteria for acquiring the status of budget user, and the method of managing the Registry of budget users;
- Rulebook on the form, method and procedures and submission of the Statement on fiscal responsibility prescribing the form and content of the Statement on fiscal responsibility, the method and deadlines for drafting and submitting the Statement and methods and deadlines for reporting of the Federal Ministry of Finance, i.e. cantonal Ministries of finance, as well as finances of cities and municipalities on noting irregularities;
- Directive on accounting of budgets in the Federation of Bosnia and Herzegovina determining budget accounting, business ledgers, bookkeeping documents, internal accounting supervision, acceptance of revenues and proceeds, expenditures, estimations of balance positions, re-valorisation and financial reporting;
- Directive on budget supervision in the Federation of Bosnia and Herzegovina determining goals and scope of budget supervision of spending the budget funds of the Federation of Bosnia and Herzegovina, cantons, cities, municipalities and non-budget funds, the method of budget supervision, performance, authorisations and characteristics of authorised persons.

The new Law on Pensions under More Favourable conditions in the Federation of Bosnia and Herzegovina, significantly adjusting pensions under more favourable conditions and pensions from regular employment, came into force.

Draft Law on Single Registry of Beneficiaries of Cash Remunerations Exempted from Contributions has been submitted for the Parliamentary procedure. This Law will define the method of establishment of the Single Registry of Beneficiaries to whom remunerations are paid at the expense of Federal, cantonal, municipal and city budgets and financial plans of non-budget funds, as well as the method of collecting and classifying the records. Adoption of this Law would enable better determination of goals when it comes to social allocations; the system of social allocation would be significantly improved in view of allocations in accordance with needs, not rights.

Republika Srpska

Fiscal consolidation will be enabled, inter alia, through adoption of principles of fiscal responsibility and the new Law on Financial Management and Control in the Public Sector. This will enable creation of obligations of budget users above level of funds provided in the budget, as well as increased transparency and responsibility in spending public funds, with the aim of additional fiscal strengthening of total budget system of Republika Srpska.

In addition, in the process of public finances management reform, preconditions will be created for additional savings through introduction of program budgeting in the following mid-term period. Clear definition of goals, programs and activities will enable directing public funds to realisation of determined goals, with defined effects and measurable results. In this was, responsibility for performing or failure in performing certain determined goals and responsibility regarding spending of public funds will be clearly defined.

When it comes to activities of supervisory bodies, as it has already been said, Tax Administration of Republika Srpska will direct its activities toward control of tax on income of private persons and profit of legal persons, in addition to strengthened implementation of indirect methods of

determining cost basis; activities of the Tax Administration related to compulsory collection will also be intensified.

Adjustments of the domestic and EU regulations in the domain of accounting and audit are constantly being monitored and activities are being taken, while considerable contribution may be ascribed to the Council for Accounting and Audit of Republika Srpska, as the consultative body in this domain. Key activities in the domain of accounting and audit will be directed towards improvement of the tax accounting system, more functional public supervision and quality control of accounting and audit profession, improvement of legal framework on accounting and audit; strengthening of discipline related to submission of financial reports; more efficient approach of the Ministry of Finance and the public to financial reports, on the basis of which various analysis could be performed.

In the domain of financial reporting and consolidation of financial reports of public sector, activities will be taken with the aim of further improvement of reporting system through steps directed toward development of statistical basics of financial reporting adjusted to internationally acknowledged standards of macroeconomic statistical systems (ESA and GFS) and strengthening of efficiency, comprehensiveness and transparency of consolidated financial reports of budget users and controlled entities of public sector. Stated activities should contribute to increasing quality of financial and audit reports, i.e. to increased confidence of public interested in information presented in these reports, as well as continued adjustment of domestic legal and professional regulations to changes in relevant parts of European regulations and international accounting and financial reporting standards.

4 REFORMS UNDERPINNING THE MACRO/FISCAL STRATEGY

Key structural reforms to be implemented in 2015 primarily aim at overcoming the obstacles to growth, which is planned to be achieved by measures of economic activity revival, incentives to real sector and employment, creation of better business environment and improving domestic economy competitiveness as well as fiscal stability, along with the preservation of social security.

Throughout 2015, Republika Srpska is going to continue implementing the already started reforms, whereas particular attention this year will be paid to those reforms that provide additional support to economy and increase in employment and thus ensure sustainable economic and financial stability, thereby improving the position of all categories in the society. The following is the overview of the main obstacles to growth and the key policies and measures contributing to implementation of the set goals.

4.1 Obstacles to growth and the macroeconomic structural reform agenda

Republika Srpska

Republika Srpska has identified the key obstacles to growth in the coming period:

- Reduced economic activity caused by the floods that hit the region, and lack of foreign demand, which would, at the same time, cause rising unemployment;
- Low efficiency of the public sector and inspection bodies, increased needs for health sector financing, unprofitability of public companies and administrative barriers;
- Growth of public spending, lack of competitiveness and illiquidity of domestic economy, increase in non-performing loans in the banking sector and reduced investment opportunities;
- Problems for long-term sustainability of the pension and health systems, problems in improving social, family and child protection;
- The problem of withdrawal of the EU funds.

In this regard, the economic policy objectives of Republika Srpska that the Government of Republika Srpska is going to work on intensely through its measures in 2015 are:

- Economic recovery and growth;
- Public sector reform;
- Fiscal consolidation;
- Preservation of social security;
- European path of Republika Srpska.

4.2 Key areas of macroeconomic structural reforms

4.2.1 Product market and business environment

Federation BiH

The global economic crisis has had a significant impact on operations of business entities in the Federation BiH both in the area of economy and the area of financial sector. Due to reduction of low-cost funding sources, financial sector increased the cost of capital, which consequently affected the rise in interest rates in the Federation BiH. On the other hand, the demand for goods and services in the real sector is decreasing, resulting in a reduction in production volume, which along with difficulties in obtaining capital due to its higher price, leads to deterioration in liquidity of companies in the Federation BiH.

Debts due to insolvency significantly burden the operations of business entities and threaten to completely stop their operations, which poses a direct risk to the collection of public revenues, economic growth and employment. Such a situation encourages gray economy as it forces employers to engage in arrangements hidden from tax authorities.

Most goods and services of business companies that are supplied to other companies and public bodies in the internal market are not paid within the time limits as specified in the signed contracts, signed or liabilities from deliveries of goods and services are paid after the expiry of the agreed period which negatively affects the liquidity and solvency of companies and complicates the financial management of the companies. This also affects the competitiveness and profitability of companies, especially when the company seeks external financing. Delays in payments have negative effects on operations of business companies and lead to greater risk, particularly increased in the periods of economic crisis when financing or paying is more difficult.

In order to eliminate problems related to the business environment in the coming period, it is necessary to take certain actions for the smooth functioning of the market and the economic system.

It is of critical importance for each of its subsystems, enterprises, business companies and entrepreneurs to be liquid and solvent. It is very important that maintaining the continuity of liquidity and solvency of companies also enables the achievement of the objectives of the economic system as a whole.

In this context, it is necessary to take measures to eliminate the problem of illiquidity and insolvency by adopting the legislation that will improve the internal payment system and strengthen financial discipline and provide for financial operations of business companies and public bodies, with the set deadlines for settlements of financial obligations as well as prescribing legal consequences for delays in payments arising under the contracts that companies concluded among themselves or with public bodies in carrying out the activities which are part of business operations. The legal instrument for achieving this is the Law on Financial Operations, expected to be adopted in 2015.

In order to create conditions for increasing the liquidity of the economy of the Federation of BiH, for the purpose of resolving the accumulated internal debts, it is necessary to define the possibility of

compensating commercial transactions as well as to define participants who have the right and obligation to report the undisputed financial obligations that they can compensate. The legal basis for this is the Law on Multilateral Compensation whose adoption is planned for the end of 2015 and beginning of 2016.

There is no specific regulation on factoring either at the level of Bosnia and Herzegovina or the Federation, which would specify the rights and obligations of all actors of this, for the economy and particularly for export-oriented companies, extremely significant unconventional source of working capital financing. Based on this, business practices should define this area and lay down rules and procedures, followed by the planned adoption of the Law on Factoring, which should be passed in the course of 2015.

In order to enable easier and faster access to funds for financing the sector of small and medium-sized enterprises, to increase the level of trading in the securities market, as well as developing and strengthening the single economic space in BiH through ensuring and enhancing public confidence in corporate financial reporting in BiH and compliance with the standards applied in the EU, it is necessary to further harmonise the entity level regulations and align them with the new Directive on Accounting and the new Directive on Auditing. The legal basis for this is the Law on Accounting and Auditing in the Federation BiH, whereas the implementation of this project is planned for the end of 2015 and beginning of 2016.

Privatization in FBiH

Work Programme with the Privatization Plan for 2015 was discussed and adopted by the Steering Board of the Agency for Privatization FBiH at its 7th session held on 22 December 2014. It will be forwarded to the Government of the Federation BiH for adoption in the coming period.

The Plan for 2015 envisages privatization of the following companies:

- Bosnalijek d.d. Sarajevo. Sale of total state-owned capital in the amount of KM 15,077,240 i.e. 19.25% of the shares through the stock-exchange. Federal Ministry of Energy, Mining and Industry, by its letter number: 08-19-2844/14 dated 28 November 2014, gave approval for the sale of the said capital.
- Energopetrol d.d. Sarajevo. Sale of total state-owned capital in the amount of KM 15,188,891 i.e. 22.12% of the shares through the stock-exchange. The Government of the Federation BiH, at its session held on 19 November 2013, issued a Decision on the manner and the method of privatization of the state-owned capital in the business company Energopetrol d.d. Sarajevo, which established that the state-owned capital, comprising 1,215,111 shares or 22.1214% of the total shares, would be sold through the stock-exchange.
- Energoinvest d.d. Sarajevo. Sale of total state-owned capital in the amount of KM 147,897,500 or 67% of the total state-owned capital. On 6 September 2012, the Agency for Privatization in FBiH submitted to the Government of the Federation BiH a proposal of the Decision on the manner and the method of privatization of the state-owned capital in the company Energoinvest d.d. Sarajevo, which the Government of FBiH has not considered as yet. Hence, it is necessary to issue a Decision on the manner and the method of privatization of the aforementioned company.
- Aluminij d.d. Mostar. Sale of total state-owned capital in the amount of KM 83,648,000 or 44% of the total shares through the stock-exchange or sale of the state-owned capital by the method of tender with previously conducted procedure of recapitalisation by the strategic partner. The Government of FBiH needs to issue the necessary Decisions on the manner and the method of privatization.
- Hidrogradnja d.d. Sarajevo. Sale of total state-owned capital in the amount of KM 47,406,998 or 67% of the shares of the state-owned capital. The Government of FBiH, at its 57th session held on 26 July 2012, issued a Decision on the manner and the method of privatization of the state-owned capital of the aforementioned company and determined the method of direct

- negotiations, provided that financial consolidation of the company is conducted prior to privatization, and that, after conducted consolidation, a joint position on further privatization activities will be taken in cooperation with the line ministry.
- Remontni zavod d.d. Travnik. Sale of total state-owned capital in the amount of KM 2,595,340 or 51% of the shares of the total state-owned capital of the company. After the unsuccessful sale by the method of public tender, the Government of FBiH, at its 75th session held on 11 March 2013, issued a Decision on the manner and the method of privatization by the method of direct negotiations. The said sale was unsuccessful, therefore further privatization activities should be carried out in cooperation with the line ministry.
 - Šipad export-import d.d. Sarajevo. Sale of total state-owned capital in the amount of KM 8,350,287 or 66.56% of the shares of the total state-owned capital of the company. The Agency for Privatization in FBiH published three public invitations in the previous period and all three of them were unsuccessful. In the previous period the Agency also conducted the sale procedure of the commercial building in 15 Marsala Tita Street in Sarajevo, but also unsuccessfully. The Supervisory Board of the Šipad export-import d.d. Sarajevo issued a Decision on the sale of property in the process of small-scale privatization, which has to be approved by the Government of FBiH, after which the Agency for Privatization in FBiH will announce a new sale again.
 - Željezara Zenica d.o.o. Zenica. Sale of total state-owned capital in the amount of KM 54,545,165 or 100% of the shares of the total state-owned capital of the company. After settling the issues of disputed property with the Arcelor Mittal, the issue of claims from the state in the amount of approximately KM 50 million, which occurred in forming the joint company BH Steel, it is necessary to submit, in cooperation with the line ministry, a proposal of the Decision on the manner and the method of privatization of the state-owned capital in the company Željezara Zenica d.o.o. Zenica to the Government of the FBiH.
 - KTK d.d. Visoko. Sale of total state-owned capital in the amount of KM 69,629,267 or 67% of the shares of the total state-owned capital of the company. After completion of the sale of assets through small-scale privatization, a joint position on further privatization activities will be taken in cooperation with the line ministry.
 - Agrokomerc d.d. Velika Kladuša. Sale of total state-owned capital in the amount of KM 280,247,684 or 90.33% of the shares of the total state-owned capital of the company. The Government of FBiH, at its 142nd session held on 4 December 2014 issued a Decision on approval of initiating the procedure of financial consolidation of the company Agrokomerc d.d. Velika Kladuša. Having in mind the aforementioned Decision, the question arises of the possibility of continuing the privatization activities prior to financial consolidation completion.
 - Konfekcija Borac d.d. Travnik. Sale of total state-owned capital in the amount of KM 10,314,807 or 60.42% of the shares of the total state-owned capital of the company. It is necessary to complete the procedure of transfer of ownership based on the signed Agreement on the termination of the Contract on purchase of shares of the company Konfekcija Borac d.d. Travnik, and proceed with the sale of assets in the small-scale privatization procedure and sale of assets in the enforcement proceedings, and take a joint position on further privatization activities in cooperation with the line ministry.
 - Fabrika duhana Mostar d.d. Mostar. Sale of total state-owned capital in the amount of KM 6,951,817 or 67% of the shares of the total state-owned capital of the company. Given the situation in the company, prior to privatization it is necessary to appoint the Supervisory Board and the Management of the company as well as prepare financial reports. The Government of FBiH, at its 60th session held on 11 September 2012 issued a Decision on the manner and the method of privatization, determining that privatization would be conducted by the method of direct negotiations, and that the possibility of continuing the privatization activities would be considered in cooperation with the line ministry.
 - PS Vitezit d.o.o. Vitez. Sale of total state-owned capital in the amount of 30,891,362 or 100% of the shares of the total state-owned capital of the company. It is necessary to resolve the issue of

relations of the firms established or co-established by the PS Vitezit ("daughters") and to adopt the programme and opening balance of the company.

- Holding company Putevi BiH d.d. Sarajevo is a company with the stated loss above the capital in the amount of KM 31,440.00 as at 31 December 2013. The question arises of the possibility of privatization activities, or if there is a capital in the company which would be subject to privatization.

Republika Srpska

In order to create more favourable conditions for domestic and foreign investments, we completed the process of business start-up reform. The time needed for business registration was reduced from 23 to 3 days; the number of procedures was reduced from 11 to 5; the business start-up costs decreased several times, depending on the legal form of the registered business entity; whereas creation of a single register of business entities in Republika Srpska is in its final phase. The result of these activities is that in the first six months after the reform started the number of registered businesses increased by about 50%.

In 2015, we intend to maintain stimulative tax policy, i.e. the lowest tax rates in the domain of taxation of property and income of citizens and businesses. Furthermore, we plan to cut down the operational costs and relieve the economy, primarily through relieving corporate taxes for work of new employees hired for a fixed term. This is expected to reduce the unemployment.

The adoption of the Law on the Tax System of Republika Srpska will create the legal basis for establishing of a register of all fiscal and para-fiscal levies, as well as the basis for unique control of the introduction, amount, and type of fiscal and para-fiscal payments. This means that it will not be possible to introduce additional or abolish some obligations without the consent of the Ministry of Finance and approval of the Government of Republika Srpska.

In order to ease the burden of the economy, the Law on Administrative Taxes will be amended too, so as to include in this Law all forms of public payments that present administrative taxes by their nature, which will result in repealing all other regulations providing for public payments (in a form of compensation), which are, in fact, administrative taxes. The amount of each individual administrative tax will be considered and the optimal amount of the tax burden in relation to the service for which the tax is paid.

In addition, in order to improve the liquidity of the economy, the Law on Deadlines for the Settlement of Financial Obligations will be passed too, which will clearly specify the deadlines for payments of liabilities. Furthermore, the Law on Unified System of Multilateral Compensation and Cession will be implemented with the same goal, whose implementation, due to very demanding preparatory activities, did not commence in 2014.

It is also planned to make changes in legislation providing for the incentives in 2015.

Given that the efficient system of quality infrastructure is one of the pre-requisites for elimination of administrative barriers, as well as provision of free trade, consumer protection and increase in competitiveness of domestic economy, the activities on adopting modern technical regulations of Republika Srpska will be continued in the course of 2015, which will be aligned with technical regulations of the EU and the European methods of standardization, metrology, accreditation and conformity assessment. To this end, the activities of improving the efficiency of communication and cooperation with all the quality infrastructure institutions, businesses, certification bodies, laboratories, chambers of commerce etc. will be continued.

In 2015, in a role of a legally authorised seller of the state-owned capital, the Investment-Development Bank of Republika Srpska (IDBRS) will continue to offer for sale the remaining state-owned capital in the companies with fulfilled assumptions for privatization, applying the methods foreseen under the law. Furthermore, IDBRS will analyse all financial restructuring programs that are

received during the year and, together with its opinion, submit them to the Government of Republika Srpska for final decision.

4.2.2 Financial stability

Activities of the Standing Committee for Financial Stability

In 2014, the meetings of the Standing Committee for Financial Stability (SCFS) were held regularly. In line with policies of the institutions members of the SCFS for financial sector, in order to preserve stability of financial system through improving the set of instruments for planning activities in crisis and crisis preparedness, at the end of 2013 all the members developed individual plans of activities in financial crisis (the Plans) with detailed description of the responsibilities of relevant institutions within the mandate and powers of every individual member. The Plans were submitted to the SCFS, and the institutions agreed that it is necessary to develop a comprehensive plan of activities in crisis, which would be based on the adopted individual plans. The Working Group formed in August 2014 comprising representatives of all SCFS members was in charge of this task, with the coordination of the Central Bank of Bosnia and Herzegovina. The Working Group developed the Draft of the comprehensive plan of activities in crisis and submitted it to the SCFS (Comprehensive Plan) in October 2014. Given that the development of the Comprehensive Plan is one of structural benchmarks from the Supplementary Letter of Intent within the Stand-By Arrangement with the International Monetary Fund dated 13 June 2014, this document was submitted to the IMF too and, after positive assessment of the IMF, it was adopted at the 10th meeting of the SCFS held in December 2014, with the obligation to revise it after the adoption of the Law on Banks.

After the floods that heavily struck the area of Bosnia and Herzegovina (BiH) in May 2014, SCFS held a meeting to consider the proposal of potential measures within the financial sector was discussed in order to help the clients who have been affected by natural disaster.

The Banking Agency of the Federation BiH (FBA) and the Banking Agency of Republika Srpska (ABRS) have proposed a common set of measures to help the clients of the banks from the areas affected by natural disasters, which have been supported by the SCFS, with the recommendation for them to be implemented in the shortest possible period, no later than 30 June 2014, in order to allow banks to provide assistance to the clients who have presented the appropriate documentation of the suffered damage in the form of relaxing the obligations in order to safeguard financial health of these clients and their ability to continue servicing their obligations in the future. The foreseen deadline for making the appropriate decisions of the entity Banking Agencies was respected. These decisions define the possibility of a moratorium on credit obligations and restructuring of loan commitments. In case of approval and negotiation of moratorium or delay of payments, the decisions define the maximum duration of moratorium of up to 12 months, as well as the maximum amount of interest that the bank may charge during the period of the moratorium. The restructuring of loan commitments implies new claims that replace the existing loan commitments of the client in the bank, which may include the extension of the repayment of principal and/or interest, the reduction of the interest rate, write-off of part of the claims, the capitalization of interest, approval of new credit funds to overhaul the damages or to continue business process, or other significant changes to ease the position of the client. The decisions also define the minimum required documents that the client has to submit along with the request for approval of a moratorium or restructuring of loan commitments.

Throughout 2014, the SCFS regularly reviewed relevant information and risks for financial stability by analysing the results of the stress tests and indicators of financial stability. These analyses indicate that the banking sector in BiH is stable, liquid and well-capitalized and that it is capable to absorb the unlikely but possible shocks in macroeconomic environment. In light of the potential systemic impact on financial stability, SCFS reviewed information on the present situation in the banks with problems in current operations, and assessed that the problems identified in individual banks would not undermine the stability of financial system.

Role and activities of CBBiH with regards to financial stability

CBBiH plays an active role in the development and implementation of the stability policy and in the sustainable economic growth of Bosnia and Herzegovina through ensuring the stability of the local currency and the overall financial and economic stability in the country. One of the main tasks of the CBBiH is to establish and maintain appropriate payment and settlement systems as part of the financial infrastructure, in cooperation with the entities, which are authorised for arrangement of payments under the constitution. The CBBiH contributes to the preservation of the financial stability through legally established authority to coordinate the activities of the entities' Banking Agencies. The CBBiH, in accordance with the decision of the Governing Board, participates in work of international organizations, making efforts on strengthening the financial and economic stability through international monetary cooperation. The CBBiH activities in the field of monitoring the stability of the financial system also include specialized communication with relevant international and local institutions, to ensure continuity of the process of monitoring the systemic risks. The CBBiH contributes to the preservation of the financial stability as being the member of the BiH Standing Committee for Financial Stability. In order to improve financial stability, the formal channels of communication have been established with general public, through publishing the CBBiH's annual Financial Stability Report, as well as quarterly publishing of financial soundness indicators on its web site.

In order to comply with the best international practices, the CBBiH has continued the activities on improving the process of compiling the financial soundness indicators through participation in the IMF Pilot Exercise on concentration and distribution measures, as well as on expanding the set of financial soundness indicators monitored by the CBBiH.

The CBBiH has continued with the ongoing implementation of the quarterly stress tests for the banking system of Bosnia and Herzegovina throughout 2013 and 2014. In 2013, the Guidelines for Preparation of Stress Tests and Use of Prudential Instruments were signed by the CBBiH, FBA and ABRS, thus formalizing the process of stress tests implementation for the BiH banking system. This formalization defines the obligations and responsibilities of all the institutions included in the stress tests implementation, and establishes relations among macroprudential monitoring, continued supervision and process of management and mitigation of risk. The Guidelines define: internal procedures required for implementation of stress tests in CBBiH, FBA and ABRS; calculation and use of results and potential micro and macro prudential tools that can be used to mitigate the identified risks. Framework for implementation of stress tests will be continuously adjusted and aligned with the regulatory changes that may affect the capitalization of the banking system.

In June 2013, the CBBiH and the Banking Agencies adopted the Methodology for identification of the list of systemically important banks in BiH. In accordance with the Methodology, the CBBiH updates the list of systemically important banks in BiH once or year or more often when needed.

The aforementioned activities of the CBBiH aimed at improving the financial stability monitoring inevitably result in increasingly stronger and more intensive cooperation achieved between the CBBiH and the entities' Banking Agencies both in terms of information exchange and in terms of analysing the systemic effects of the measures taken by regulators.

Since the required reserve is the only monetary policy instrument of the CBBiH used in macroprudential purposes as well, the CBBiH continued with active management of this instrument in 2014. After the introduction of the ECB negative interest rate, which is directly related to the calculation of fees on the commercial banks' reserve accounts with the CBBiH, by the prompt modification of the Decision on calculation of fees, the CBBiH protected the funds on the reserve account from potential losses that could trigger rise in interest rates on loans in BiH and other adverse effects to the banking sector.

In the previous period, the CBBiH continuously implemented activities on strengthening the analytical capacities of the Financial Stability Department. In collaboration with the World Bank's

FinSAC centre, the internal econometric models of credit growth, credit risk and early warning indicators were developed.

Amendments and supplements of the regulatory framework for operations of the banking sector in BiH during 2013 and the first half of 2014 are stated below.

As the result of activities that were implemented with technical assistance of USAID PARE project, in the second half of 2013, entity Banking Agencies passed a Decision on the Remuneration Policy and Practice for Bank Employees. According to this Decision, all banks in BiH have to define and apply a remuneration policy compatible with the bank's business strategy and efficient risk management. The aim is to ensure that variable fees of employees depend on the achieved objectives linked with their functions. Along with this Decision, the Decision on Suitability Assessment of Bank's Bodies and the Decision on Diligent Behaviour of Members of Bank's Bodies were also adopted.

After establishment of the ombudsman institution in the banking sector with appropriate amendments to the Law on the FBiH Banking Agency (FBA), aiming at protection of interests of users of financial services and maintaining confidence in the financial system, the FBiH Banking Agency (FBA) also passed a Decision on Conditions and Manner of Customer Complaints Management in Banks, MCOs and Leasing Companies, when the client feels that the creditor does not follow legal provisions, by-laws, a signed contract or general business terms, as well as actions of ombudsman in the FBA upon the client's notification.

The Law on Guarantors Protection in FBiH came into force in December 2013. The Law, *inter alia*, abolished the category of a guarantor for approval of loans exceeding KM 20,000 and with repayment conditions longer than three years, and prohibited for persons above the age of 65 to act as guarantors. For loan security, instead of guarantors, the law envisages promissory notes, mortgage on real property, term cash deposits, a guarantee from another bank, shares, insurance policies and co-debtors. At the beginning of 2014, FBA passed a Decision on Conditions and Manner of Handling Guarantors' Requests for Release of the Guarantee Obligation and a Decision on Conditions for Assessing and Documenting a Credit Standing, as by-laws foreseen under the Law on Guarantors Protection. The Decision on Conditions and Manner of Handling Guarantors' Requests for Release of the Guarantee Obligation defines conditions and manner of handling requests of guarantors in banks, microcredit organizations and leasing companies by the FBA ombudsman, in order to protect guarantors' interests and ensure implementation of provisions of the Law on Guarantors Protection.

The Decision on Conditions for Assessing and Documenting a Credit Standing defines the guarantor's obligation to assess credit standing and credit history of the main debtor, co-debtors and the guarantor before signing of a loan agreement, based on adequate documents and data obtained from all participants in the lending relationship, and based on the insight in CRC.

At the end of 2013, FBA adopted several regulations on foreign currency operations that arise from the Law on Foreign Currency Operations, including: a Decision on Conditions and Manner of Performing International Payments, a Decision on Minimum Standards for Currency Exchange Operations and a Decision on Examination of Foreign Currency Operations in Banks – Payment Transactions, defining the procedure of control of foreign currency operations that the FBA performs at banks and with the authorised currency exchange offices, in order to ensure the implementation of the Law on Foreign Currency Operations and other regulations applicable in this area.

At the beginning of 2014, draft Decisions on Minimum Standards for Capital Management in Banks were sent for public debates in both entities. These Decisions introduce an innovative concept of regulatory capital compared to the existing legal and regulatory framework, as it includes a part of elements from Basel III that was created and serves as qualitative and quantitative upgrade on the previous agreements on capital measurements and standards – Basel I and Basel II. In mid 2014, these Decisions were adopted by the Entity banking Agencies, and banks have to meet the new capital requirements by 31 December 2015 and 31 December 2016 respectively.

During 2014, the FBA passed a Decision on Amendments to the Decision on Minimum Standards for Liquidity Risk Management in Banks, reducing the maintenance of average ten-day liquidity minimum in cash from 20% to 10% of the amount of short-term sources of funds as per book records on the last day of the previous calendar month, wherein this level may not fall below 5% at any of the days. The amendments to the FBA Decision recognized stability of a portion of a vista deposits and a vista household savings (maximum up to 15% of the amount of average balance in the previous month) that a bank may use as a corrective amount during the process of determining the maturity matching of financial assets and liabilities in maturity periods of up to 180 days. In this way, banks are enabled to use additional liquid assets for lending to households and economy in BiH, recognizing all liquidity frameworks and credit risk management standards, which will have positive effects on the increase of efficiency and profitability of the banking sector. By passing the aforementioned Decision, the FBA harmonized maintenance of average ten-day liquidity minimum in cash with ABRS provisions.

The most important structural reforms, directly or indirectly applicable to the financial sector that were realised during 2013 and at the beginning of 2014 with the purpose of meeting the obligations taken over by the Letter of Intent as a condition for the approval of the IMF's financial assistance in 2012 are specified below.

In July 2013, Laws on Amendments to the Law on Banks were adopted in both entities. The Amendments to the Laws are primarily aimed at restricting the period of duration of provisional administration in banks to 12 months, with the possibility of extension for another 6 months, within which it is possible to evaluate the probability of bank recovery and bank's functioning in the usual regime of operations. The Law envisages the introduction of efficient instruments and preventive measures in case when liquidity and solvency of banks are jeopardised for the purpose of protecting interests of depositors, and preserving confidence in the financial sector as a whole. The Amendments to the Laws more precisely define mechanisms of regulator activities, i.e. much greater powers are given for activities in case of banks in problems. Among other, the FBA and ABRS will be able, according to their estimates, to convene an assembly of bank shareholders and carry out the control of financial standing and legality of bank operations and legal entities connected with banks by property, management, and business relations. The new Laws on Banks are in the process of preparation in both entities as well as amendments to the Law on the BiH Deposit Insurance Agency, which would be aligned with the EU *acquis*. With the assistance of the IMF technical mission in December 2014, representatives of the Banking Agencies, Ministries of Finance and the CBBiH actively participate in preparation of the draft Law on Banks and the draft Law on the BiH Deposit Insurance Agency.

At the beginning of 2014, the Government of FBiH established the Draft Law on Corporate Income Tax in FBiH, which aims to clarify tax treatment of depreciation and reservations for credit losses of banks in order to encourage banks to make reservations.

In order to increase depositors' confidence, the Governing Board of the Deposit Insurance Agency (DIA) passed a Decision on increasing the maximum amount of the insured deposit to KM 50,000 instead of the previous KM 35,000, applicable as of 1 January 2014. The Decision was based on an analysis of insurance limit assessment that is regularly performed at the DIA.

At the end of 2013, the Draft Law on Amendments to the Law on Indirect Taxation Procedure was adopted, which stipulates publication of data on tax debtors and the amount of their debt, because data on overdue debts of indirect tax payers will no longer be deemed confidential if they are sent to the media or posted on a website. The goal is to increase the level of accountability of indirect tax payers and influence strengthening of tax discipline at the same time.

At the beginning of 2014, the Draft Law on Amendments to the Law on Budgets in FBiH was adopted, with the purpose to promote fiscal discipline and to strengthen the FBiH Government's supervision over lower government levels as well as to improve fiscal reporting. With the adoption of the new Law, the foreign funded projects and public companies for roads and highways will be included in the reporting of the consolidated general Government of the Federation BiH. The RS Government has

already started including projects with foreign funding in their reporting on finances of the consolidated general Government, and aims to finalise this process in 2014.

In June 2014, the House of Peoples of the Parliamentary Assembly of BiH adopted the Law on Prevention of Money laundering and Financing Terrorist Activities. This Law is aligned with the EU requirements and standards in this field and aims at preventing negative labelling of BiH in terms of fight against money laundering and financing terrorist activities.

In the previous period, the activities on reinforcing the supervision in the banking field in Republika Srpska have continued, as well as on implementing the activities and tasks of the Banking Agency of Republika Srpska according to the Law on Prevention of Money Laundering and Financing Terrorist Activities, implementation of regulations and standards related to protection of the rights of users of financial services aligned with the EU Directives.

Along with the aforementioned changes in laws in both entities, in 2013, Republika Srpska adopted a new **Law on the Banking Agency of Republika Srpska**⁴⁵, which defines a trade secret and handling of classified information that the Banking Agency of Republika Srpska is coming to in the course of performing supervision and other tasks within its scope of competencies, which was necessary to regulate both for the sake of stability of domestic financial sector and international cooperation in the field of banking sector supervision.

Framework for resolving the problem of non-performing loans

In March 2013, a mission of the International Monetary Fund (IMF), in cooperation with relevant domestic and international institutions, conducted an overview of the state of affairs and developed a framework plan with actions required for efficient resolution of the problem of non-performing loans. Several recommendations were created in accordance with the best international practices in resolving the problem of non-performing loans, recognising the specific structure of BiH and multiple divisions of powers in most issues. They primarily include corrections of the existing legal framework providing for transfer of claims, issues of collateral, taxes and collection of claims. The assessment of the IMF mission in the form of recommendations indicates that debtors have the option to use the existing legal framework and postpone repayment of the assumed liabilities, thus putting the entire system in danger, primarily debtors and guarantors. The issued recommendations could improve the position of creditors, ensure faster collection of claims and enable prevention of debtor's further business activities until the repayment of the debtor's assumed liabilities.

The Framework action plan is divided into five sets of recommendations:

- The first set of recommendations pertains to establishment of an adequate legal framework for resolving the issue of transfer of non-performing loans, which would imply the establishment of Asset management Companies – AMC, that would mediate in sale and management of non-performing claims. BiH does not have a developed legal framework in this area and this issue needs to be precisely defined in the near future. To-date experiences of domestic regulators in transfer of non-performing loans to other legal entities opened several issues, including transfer of collateral, accounting treatment of collected funds, needs for consolidation of financial reports, method of foundation and owners' connections. The IMF mission recommended for such legal entities that manage non-performing claims to be established with strict control, applying regulations defined by the supervisor of the banking sector, taking care of the level of required capital, expertise, reputation and legal obstacles of the authorised persons, and issues pertaining to conflicts of interest that may occur in such cases.
- The second set of recommendations pertains to crisis management and development of banks' crisis action plans, and implementation of stress tests and their submission to the relevant supervisor.
- The third set of recommendations accounts for development of new legislation or upgrade of the existing legislation that will facilitate the process of restructuring and out-of-court settlement

⁴⁵ "Official Gazette of Republika Srpska", No. 59/13.

procedures. In order to avoid lengthy court proceedings, high expenses and decrease the creditor's risk in collection of claims, it was recommended to introduce a framework for out-of-court restructuring of liabilities of over indebted legal entities. This set of recommendations also foresees resolution of the issue of tax treatment of non-performing claims and, related to it, the existing legislation should be revised, in order to introduce tax incentives that will encourage restructuring, write-off or sale of such claims, given that the transactions of this type are currently exposed to inadequate tax burdens.

- The fourth set of recommendations is linked to enforced debt collection and the required upgrade of legislation treating this area.
- The fifth set of recommendations is related to introduction and revision of the laws on bankruptcy and liquidation. One of the recommendations of the IMF mission pertains to introduction of a concept of personal bankruptcy, which has not been regulated by the BiH legislation so far. According to the assessment of the IMF mission, bankruptcy and liquidation procedures and inefficient laws on bankruptcy and liquidation should be revised.

According to the available information, legislation is under preparation that will regulate transactions of purchase and sale of placed loans, through the new Law on Banks, as well as reinforcing the provisions of this law in the segment of consolidated supervision as the key component of the framework for resolution of non-performing loans, as well as revision of tax legislation with the purpose of easier selling of loans. Strategy for resolving the issue of non-performing loans should be additionally fortified by establishing a voluntary system of out-of-court restructuring in order to facilitate the operationally sustainable companies restore the level of debt that are able to service. Both entities will revise their laws on bankruptcy in order to rationalise and shorten the bankruptcy procedure.

Federation BiH

Financial sector reform and resolution of the issue of non-performing loans

Financial sector development is limited by weak domestic demand, high requirements in terms of collaterals, relatively high rate of NLPs (non-performing loans) and obstacles to growth of micro financing and leasing. Unfavourable trends in real sector, due to extended effects of global financial crisis and subsequent debt crisis in the Euro area had negative impact on credit activities of banks, activities of micro crediting and financing through leasing, as well as underdeveloped capital market, resulting in insufficient investments and illiquidity of shares.

Some legal solutions are partly a cause, or the obstacle to financial sector growth. This primarily refers to regulations pertaining to banking sector, leasing, microcredit organisations (MCOs) and insurance.

Particular shortcomings of the existing regulations include:

- Mismatch of the Law on Banks with the relevant EU Directives, which results in: insufficient supervisory authorities of the Banking Agency (FBA), non-implementation of the principles of Basel II, insufficiently regulated capital requirements and risk management, unresolved current problems pertaining to early intervention measures and bank resolution, non-regulated consolidated supervision, as well as unclearly defined authorities and responsibilities of the bank management bodies.
- Non-existence of clear regulation of microcredit organisations (MCOs) in terms of transformation of microcredit foundation (MCF) as a non-profit organisation to a microcredit company (MCC) as a profit organisation operating following the corporate management criteria, as well as unresolved issue of donors' funds during this transformation, resulting in impossibility of this transformation.
- Legal solutions for leasing sector.

- Mismatch of regulations pertaining to insurance area with the EU Directives.
- Non-existence of regulations enabling transformation of closed-end investment funds (IF) – (formerly Privatisation Investment Funds – PIFs) – in open-end investment funds, which would contribute to increasing investments in companies where these funds have shares.

In order to maintain systemic and financial stability and remove obstacles to economic growth, the following objectives, which are to contribute to financial market development, are determined by sectors, as follows:

a) for the banking sector:

- Resolving the issue of non-performing loans (NPL);
- Strengthening liquidity of solvent banks with vulnerable liquidity;
- Resolving the problem banks;
- Remediation of shortcomings in terms of supervisory powers, consolidated supervision and identification of beneficial owner;
- Modification of criteria for selecting the Supervisory Board members, management of public banks – commercial and Development Bank in order to ensure management accountability;
- Responsibility of supervisory boards in terms of strengthening the audit function;
- Increasing supervisory powers of the FBiH Banking Agency (FBA)
- Introducing harmonised procedures of debt restructuring as an alternative to bankruptcy, as well as passing guidelines for out-of-court settlement.

b) for the non-banking sector:

- Strengthening microcredit sector by through greater supervisory and executive powers of FBA, and enabling transformation of microcredit foundations (MCF) to microcredit companies (MCC) and resolving the issue of donated capital in MCF;
- Strengthening the leasing sector

c) for the insurance sector

- Further development of the insurance market through the strengthening of capital requirements, gradual harmonisation with the EU Directives, the strengthening of cooperation between the entity regulators, and education and improving financial literacy of the population.

d) for the capital market

- Transformation of investment funds (IF) – (formerly PIFs) into open-end funds, which would facilitate restructuring of companies where Ifs have shares;
- Establishment of the so called "passport", which would enable issuers, investors and intermediaries doing business in the common market without sacrificing any institution or independence;
- Harmonisation of regulations on takeover of joint stock companies with relevant EU *acquis*.

Responsibilities of the BiH institutions for financial stability and macroprudential supervision

In Bosnia and Herzegovina, the entity level Banking Agencies are responsible for maintaining and improving safety, quality, and legal operations of the market oriented and sound banking, microcredit and leasing sector. Although bank supervision is performed by two Entity Banking Agencies, there is a high level of harmonisation of regulatory requirements and exchange of supervisory experiences, as well as joint work on preparation of the new regulatory framework.

The Banking Agency of the Federation of Bosnia and Herzegovina (FBA), in performing its duties, continuously cooperates with domestic financial institutions, primarily the Banking Agency of

Republika Srpska (ABRS), Central Bank of Bosnia and Herzegovina (CBBiH), Deposit Insurance Agency (DIA), as well as relevant ministries at the state and entity level.

A particularly important aspect of cooperation of FBA with domestic financial institutions reflects in the work of the Standing Committee on Financial Stability (SCFS), which was established in 2009, based on the Memorandum signed among the BiH Fiscal Council, CBBiH, FBA, ABRS and DIA. In accordance with the signed Memorandum, the SCFS regularly considers risks in the macroeconomic environment, their impact on financial stability in BiH, and acts in coordination when required by specific situations that can cause systemic risk and threaten financial stability. Although the provisions of the Memorandum are not legally binding, the Memorandum complements the existing forms of cooperation and joint activities and represents a basis for future arrangements among relevant institutions – signatories of the Memorandum.

During the work of SCFS, initiated by current financial developments in the country and broader environment, the need was identified to improve cooperation of all bodies and institutions traditionally involved in resolving the systemic disturbances and preservation of financial stability, and identification of mechanisms for efficient risk management and coordination of activities of competent institutions in terms of preventing risks that can pose a threat to financial stability, as well as for evident efforts towards improvement of the efficiency of supervision and harmonisation of regulatory framework with international standards and best supervisory practices to be supported by setting up a sustainable macroeconomic policy, as a precondition for maintaining the stability of the country's financial system.

On the Basis of the Constitution and legally established competencies, and in line with the commitments contained in the Letter of Intent signed with the International Monetary Fund, the members of the SCFS, as explained above, developed the crisis action plans, with the consensus of all the members on the need to respect and act within the constitutional and legal order of BiH and its entities, as well as legal authorities of the SCFS members.

Macprudential instruments in use

In connection with the aforementioned regarding macroprudential framework, there is a need to formalise and clearly regulate institutional authorities in terms of the application of macroprudential instruments. According to the present state-of-play, the institutions included in the framework for financial stability and macroprudential framework within the scope of their legal authorities, undertake activities and measures in line with their legal responsibilities and exercise inter-institutional cooperation at bilateral and multilateral level based on the signed Memoranda on cooperation.

Changes concerning the application of individual macroprudential instruments, from the supervisory perspective

Within the new Decision on Minimum Standards for Capital Management in Banks and protection of capital, the Entity Banking Agencies prescribed regulatory requirements regarding the obligation of banks to:

- Ensure and maintain the ratio of financial leverage;
- Introduce capital conservation buffers, while the systemic risk conservation buffers and countercyclical buffer have been introduced, whose changes and level will be prescribed, when needed, by the special decision of the FBA.

With regards to use of the macroprudential instrument – liquidity buffer requirements, in the framework of implementation of Strategy for implementation of Basel III, which represents alignment with international standards and regulatory framework at the EU level, the FBA has planned to prepare new regulatory requirements related to liquidity risk in line with Basel III, including the introduction of LCR and NSFR liquidity ratios.

As for concentration limits, i.e. concentration risk management, within the implementation of activities included in the aforementioned Strategy, draft decisions in the domain of Pillar II have been made.

Method of monitoring the effectiveness of applying the macroprudential instruments in use

Relevant institutions perform monitoring of efficiency of the implemented macroprudential instruments as part of their regular activities. Within regular cooperation between individual institutions, based on the signed memoranda on cooperation, relevant institutions share information and act in a harmonised and coordinated way in order to preserve financial stability.

As part of its regular supervisory process, the FBA monitors the implementation of the prescribed regulatory requirements by the banks through individual macroprudential instruments such as:

- Fulfilment of regulatory capital requirements (capital adequacy ratio and other risk limits relative to the tier I capital of the bank);
- Established liquidity limits and credit risk concentration;
- Constraints in terms of individual and total foreign currency position of a bank, etc.

In case when non-compliance with prescribed regulatory requirements is established, the FBA imposes corrective measures in accordance with its legal supervisory authorities. The FBA monitors if the bank acts according to the ordered corrective measures through targeted controls of the execution of orders in banks or targeted inspection of this segment of operations in the bank, as well as a continuous off-site supervision.

The existing macroprudential framework does not include institutional and formalised analytical monitoring of the efficiency of macroprudential instruments at the level of BiH, although their assessment is to some extent monitored through annual financial stability reports as well as within the scope of SCFS activities.

Potential sources of systemic risks, priorities for monitoring and supervision

The CBBiH's 2013 Financial Stability Report indicates that during 2013 and the first half of 2014, the financial system of Bosnia and Herzegovina showed resilience to the current risks from domestic and international environment. Positive developments in domestic economy, reflecting in growth of imports and trade deficit contraction, as well as deceleration of the decreasing trend in the banking sector's foreign liabilities in 2013, had positive effect on balance of foreign currency reserves, which is the highest value of foreign currency reserves ever recorded since the establishment of the CBBiH.

The results of the implemented stress tests lead to conclusion that the banking sector is still stable and able to absorb unlikely but possible shocks assumed in the extreme scenario.

Weak domestic demand is still standing out as the most important risk in the country that affects financial sector primarily through still feeble demand for household loans. Indirect effect of weak domestic demand is expressed through decelerated credit growth in the sector of legal entities, particularly in activities oriented towards domestic markets. Consequently, growth trend of non-performing claims that pose the most significant risk for the banking sector in the country has continued this year, particularly in activities that depend on domestic demand.

According to its responsibilities, the FBA regularly publishes annual and quarterly information on the FBiH banking system, thus identifying the key risks and trend in operations of banks. According to the Information on the FBiH banking system dated 30 June 2014, the key indicators of the banking system operations, with some small oscillations, have been maintained at approximately the same level for the last two years.

In conditions of crisis and credit risk growth caused by decline in quality of loan portfolio through growth of non-performing loans, the segment of bank capital is under continuously increased supervisory surveillance, in order to avoid threats to stability of banks and erosion of capital base to

the level that would jeopardise not only bank operations but also affect the stability of the overall banking system in FBiH.

Use of macroprudential instruments/ framework directions of future developments

The need to improve regulatory and institutional macroprudential framework has been identified in order to enhance the use of macroprudential instruments and efficiency in risk management to financial stability.

Along with the current implementation of stress tests (top-down approach), it is also necessary to set up a framework for implementation of bottom-up stress tests, which includes defining regulatory requirements towards banks, development of institutional capacities and supervisory procedures in this segment, exchange of experiences with regulators from our environment, i.e. the best supervisory practices.

For implementation and monitoring of the efficiency of application of macroprudential instruments, it is important to additionally reinforce the activities of the SCFS in line with the legal authorities of the SCFS members and the Memorandum on Establishment of the SCFS, as well as the framework of supervisory activities towards the systemically important banks, so as to adequately manage the systemic risk and undertake the required measures in a timely manner.

The planned preparation of the new legislation providing for resolution of banks in compliance with relevant EU Directives is important for macroprudential framework, and the efficient systemic risk management, to the extent applicable in FBiH, which would establish regulatory and institutional framework for resolving the issue of problem banks.

Regulatory framework

Amendments and supplements of the regulatory framework for operations of the banking sector in BiH were continued during 2013 and the first half of 2014.

At the end of 2013, the FBA prolonged the application of provisional measures for rescheduling of loan liabilities of physical persons and legal entities in banks, in order to make it easier for debtors to repay their liabilities. The deadline for submission of requests for rescheduling was extended until the end of 2014.

In order to mitigate negative effects of the floods that affected a large area in BiH in May 2014, and facilitate repayment of loan liabilities of physical persons and legal entities from affected areas, the FBA passed a Decision in mid 2014 on provisional measures for treatment of loan liabilities of bank clients that were affected by natural disasters. The Decision defines special measures pertaining to the possibility of introducing moratorium on loan repayments and rescheduling of loans. At the end of October 2014, the FBA also passed a Decision on provisional measures for treatment of liabilities based on leasing contracts of the clients of leasing companies that were affected by natural disasters.

After establishment of the ombudsman institution in the banking sector with appropriate amendments to the Law on FBiH Banking Agency in 2012, aiming at protection of interests of users of financial services and maintaining confidence in the financial system, the FBA, in March 2014, also passed a Decision on Conditions and Manner of Customer Complaints Management in Banks, MCOs and Leasing Companies, when the client feels that the creditor does not follow legal provisions, by-laws, a signed contract or general business conditions and terms, as well as actions of ombudsman in FBA, upon the client's notification.

By the entry into force of the Law on protection of Consumers of Financial Services, a system of consumer protection – clients of financial services was established as well as the scope of activities of the Independent Department of the Ombudsman for the banking system. The Law defined professional and unbiased assistance for users of services, simpler and easier access to dispute resolution arising from services provided by financial institutions and thereby ensure greater

confidence of clients in the financial system. Providing for protection of clients this way, legislation in FBiH was harmonised with the EU *acquis* regulating this issue.

The FBA Management Board passed the Rules of Procedure of the Ombudsman for Banking System of the Federation of Bosnia and Herzegovina ("Official Gazette FBiH", No.62/14), providing for the conditions and manner of proceeding after written notification, i.e. the client's complaint – user of financial services, if the bank, MCO and leasing company in FBiH – service provider, did not reply to the client's complaint in writing within the time limit prescribed under the law or FBA regulations, or the client is not satisfied with the reply of the service provider or other outcome of the procedure upon the complaint, as well as conditions and manner of procedure upon the request of the guarantor to be released from the guarantee obligation.

Protection of consumers of financial services was regulated by the Law on Protection of Consumers of Financial Services ("Official Gazette FBiH", No 31/14) and the Law on Protection of Guarantors in the Federation of Bosnia and Herzegovina ("Official Gazette FBiH", No 100/13).

By-laws passed by the FBA with regards to protection of consumers of financial services are the following:

- Decision on conditions and procedure of the bank, MCO and leasing company upon the client's complaint ("Official Gazette FBiH", No. 23/14, 26/14-corr. and 62/14);
- Decision on conditions and manner of handling guarantor's request for release of the guarantee obligation ("Official Gazette FBiH", No. 23/14 and 62/14);
- Rules of Procedure of the Ombudsman for Banking System of the Federation of Bosnia and Herzegovina ("Official Gazette FBiH", No. 62/14);
- The decision on the minimum requirements in terms of content, user-friendliness and accessibility of general and special conditions of operations of financial services provider ("Official Gazette FBiH", No. 62/14).

In 2013, within the stand-by arrangement, the IMF conducted several technical missions in BiH in order to establish a systemic framework for recovery and resolution with regards to crisis preparedness and contingency financial planning, strengthening banking supervision and stress tests.

As for the activities taken with the goal of strengthening the resilience of financial system and coordination among the members of SCFS, all the members of the SCFS developed their crisis action plans, which describe in detail the responsibilities of relevant institutions within their mandate and individual authorities. The FBA prepared its own plan of activities in crisis, which was approved by the IMF's technical mission. At the SCFS meeting held on 9 December 2014, the comprehensive plan of activities in crisis at the level of Bosnia and Herzegovina was adopted.

From the standpoint of powers of the FBA, the Crisis Preparedness and Contingency Plan represents a set of measures and procedures that the FBA, independently or in cooperation with other members of the SCFS and other regulatory institutions, undertakes in order to prevent and avoid crises. The Plan foresees management and activities in crises, when they take place, in a response to the occurred crisis in the banking system or the unexpected destabilising events, in order to prevent or mitigate negative effects that they may have on financial stability. The contingency plan contains measures and procedures, whose objective is to enable quick action in terms of the banking system capitalization, identification and resolving of the problem banks and other problems before they get worse, if and when they are struck by the crisis.

Implementation of the Strategy for introducing the "International convergence of capital measurement and capital standards"

With regards to structural reforms, within the scope of its legal powers, the FBA has been carrying out the activities on implementation of the Strategy in the period 2012-2016. Due to its systemic importance and the need for a multi-institutional approach in implementation of the Strategy at the level of Bosnia and Herzegovina, entity Banking Agencies and CBBiH, as being competent for coordination of banking supervision in BiH, are included in the process.

The Strategy presents general guidelines for implementation of the international standards for managing risks and capital of banks, and it is aligned with the Strategy of the ABRS.

The activities covered by the Strategy cover the period up to 2018, and have been implemented through annual operational plans.

1. Draft by-law framework in the domain of Pillar I

In accordance with the Strategy for introducing the "International convergence of capital measurement and capital standards" and the Operational plan of the FBA, draft by-law framework in the domain of Pillar 1 was developed in relation to calculation of capital requirements for loan, market and operational risks by standardised approaches. The analysis of alignment and adjustment to the latest changes in international regulatory framework was conducted – CRD IV (Capital Requirements Directive) / CRR – (Capital Requirements Regulation/Decree) of 26 June 2013, and incorporated into one act – draft Decision on calculation of bank capital.

2. Draft by-law framework in terms of reporting on capital and capital requirements of banks

At the end of 2013, the activities of the project Team of the FBiH Banking Agency commenced on drafting the implementing framework in the domain of reporting on capital and capital requirements of banks through a single reporting framework – COREP in line with technical standards, instructions, and guidelines prescribed by the European Banking Authority – EBA, as well as practices implemented in the neighbouring countries.

3. Preliminary draft of by-law framework in the domain of Pillar II

In the second half of 2014, within the implementation of the Agency's strategy, the teams were appointed to devise a preliminary draft of the implementing framework in the domain of Pillar 2 for risk management, internal capital adequacy assessment (ICAAP), interest rate risk in banking book and great exposure of banks. By the end of October 2014, the teams have completed their preliminary drafts of the said decisions pertaining to Pillar 2.

Preliminary draft of the Decision on risk management represents a Pillar 2 segment – Supervisory Procedure, pertaining to qualitative requirements that a bank has to apply in risk management as a component of sound corporate management and it is closely related to the implementation of the process of banks' internal capital adequacy assessment.

Preliminary draft of the Decision on internal capital adequacy assessment (ICAAP) prescribes strategies, plans, assessment procedure, as well as manner of reporting to the FBA on the banks' internal capital adequacy assessment.

Preliminary draft of the Decision on management of interest rate risk in banking book prescribes minimum requirements for setting up a system of management of interest rate risk in banking book, which would be appropriate to the type, form and sophistication of operations and in line with the risk profile of the bank, and which would include significant sources of interest rate risk. The Decision also established a system of reporting on interest rate risk exposure in the banking book, as well as the bank's obligation to carry out stress tests related to interest rate risk in banking book, taking into account the significant sources of interest rate risk.

In this process, a preliminary draft of the Decision on great bank exposures.

Non-banking financial sector

Low level of economic activity and weak domestic demand determined trends in non-banking financial sector throughout 2014.

Data on operations of the MCO sector indicate to mild recovery, however further efforts are needed to stabilise and improve the efficiency of operations. The MCO sector continues to display needs for consolidation within the sector, which would create a smaller number of stronger and sounder

MCOs. The main purpose of consolidation is strengthening the capital base, stability and quality of institutions' portfolio, in order to ensure better accessibility of funding and enable provision of more favourable and better-quality services to clients.

MCOs continued decreasing effective interest rates on micro loans, but they are still very high, due to unduly high operating costs and high prices of capital used to finance the credit portfolio. On the other hand, provisions for credit losses are by 30% lower, which indicates improvement in the quality of assets, but also that the activities were taken to improve collection and restructuring of non-performing loans.

Of the total amount of micro credit loans, the largest portion was approved to physical persons (over 95%), most of which was approved for financing the agricultural sector.

In view of the sectoral structure of extended loans, after the natural disasters that affected a large area of BiH in May 2014, deterioration in the quality of the MCO credit portfolio can be expected in the period ahead.

The FBiH Banking Agency sent an Instruction to MCOs for their actions with regard to natural disasters, in order to develop mitigating measures for clients with jeopardised creditworthiness due to suffered damages.

Within the scope of its authorities pertaining to supervision of leasing companies, the FBA is guided by the principles of transparency, building confidence with the leasing companies, and adequate protection of users of financial services funded through leasing, with the goal of achieving financial stability of individual leasing companies and leasing activities at the level of FBiH.

Apart from continued decline of the volume of financial leasing, the leasing sector achieved negative financial result in 2014 as well. The recorded loss mostly resulted from inadequate operation practices in the previous periods that led to deterioration in the quality of leasing claims and the negative financial result influenced the fall in assets and decrease of overall capital of leasing companies. In the forthcoming period, the leasing companies should additionally focus on improvements in the system of collection of due claims as well as promotion of sale capacities and channels.

In the structure of newly approved leasing contracts, according to the type of user, leasing contracts placed on legal entities are dominant (88% of total financing in the first half of 2014), which is mainly caused by the fact that financing through leasing is less favourable for physical persons since it includes paying VAT on interest thus imposing additional cost for the clients who are not VAT payers.

In October 2014, the FBA passed a Decision on provisional measures for treatment of liabilities based on leasing contracts of the clients of leasing companies affected by natural disasters.

Republika Srpska

After the modernisation of regulations governing the protection of users of financial services, as well as regulations governing the blocking of the debtor's accounts, which was conducted in 2012, the reform activities in the banking sector were continued in 2013 - 2014 too.

In the previous period, the activities on reinforcing the supervision in the banking field in Republika Srpska have continued, as well as on implementing the activities and tasks of the Banking Agency of Republika Srpska according to the Law on Prevention of Money Laundering and Financing Terrorist Activities, implementation of regulations and standards related to protection of the rights of users of financial services aligned with the EU Directives.

Furthermore, after modernisation of the laws governing the securities market, and harmonisation with the Directives of the European Union and international standards carried out in 2012, the reform activities in this sector were continued in 2013 – 2014 too.

In 2013 and 2014 the following laws were adopted in Republika Srpska:

Law on Special Modalities for Tax Debt Servicing ("Official Gazette of Republika Srpska", No. 66/13), which relieves the financial position of legal entities affected by the economic crisis, maintains the liquidity and encourages employment in the economy, and enables rescheduling of tax obligations, converting the tax debt into equity in the company, as well as foresees write-off of the interest if the entire debt is settled in cash.

Law on the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", No. 59/13), which defines a trade secret and handling of classified information that the Banking Agency of Republika Srpska is coming to in the course of performing supervision and other tasks within its scope of competencies, which was necessary to regulate both for the sake of stability of domestic financial sector and international cooperation in the field of banking sector supervision.

Law on Modifications and Amendments to the Law on Banks of Republika Srpska ("Official Gazette of Republika Srpska", No. 59/13), which regulates the procedures of provisional administration and liquidation, for the purpose of more precise establishing of competencies of provisional and liquidation administrators, as well as the authorities of the RS Banking Agency in these procedures. The Law prescribes a time limit for the duration of provisional administration of up to one year, over which it is possible to assess the probability for a bank recovery and its functioning in the regular regime of operations.

Law on Modifications and Amendments to the Law on Securities Market ("Official Gazette of Republika Srpska", No. 59/13), which aims at: systemic and harmonised regulation of conditional increase of stock capital by conversion of debt into equity, that was defined in the Law on Business Companies and the Law on Modalities for Tax Debt Servicing; more precise defining of the absolute statute of limitation of six years from the date when the offence was committed which is in accordance with the Law on Misdemeanours of Republika Srpska and defining the deadline during which securities issued by public offering are listed on the stock exchange or other regulated public market.

Law on Modifications and Amendments to the Law on Securities Market ("Official Gazette of Republika Srpska", No. 108/13), which established the adequate immunity of the members of the Republika Srpska's Securities Commission and other authorised persons in the Commission.

Law on Modifications and Amendments to the Law on Takeover of the Joint Stock Companies ("Official Gazette of Republika Srpska", No. 59/13), which was further aligned with the Directive of the European Parliament and the Council 2004/25/EC, harmonisation with the provisions of the Law on Business Companies (determination of the control influence through the equity and thus increasing the percentage of the voting shares, after whose acquisition occurs the obligation of the takeover, and deletion of the provisions related to enforced purchase and enforced sale of shares), specification of cases when acquirer is not obliged to announce a takeover offer, redefining the provisions governing the price in the takeover offer and more precise defining of the provisions on joint actions.

Law on Modifications and Amendments to the Law on Foreign Exchange Operations ("Official Gazette of Republika Srpska", No. 20/14) – continues the process of liberalisation of current and capital transactions with foreign countries, namely:

- in terms of current operations, payments, collecting and transferring by offsetting, cession and assumption of debt is enabled only on the basis of contracts (abolished granting of prior consent of the Ministry of Finance, and reduced administrative costs), whereas with the capital operations, the option is left for the Government to prescribe the conditions and manner of their performing;
- in order to reduce administration in implementation of foreign trade operations, deadlines were extended for exports and imports to one year, and the procedures of reporting on credit operations with foreign countries were simplified.

In addition to legislative activities, in order to undertake prevention measures so as to preserve financial stability, Republika Srpska, as one of the SCFS members, adopted its Banking Sector Crisis Action Plan, which is a part of the integral system of the Crisis Action Plans in BiH.

In Republika Srpska, in accordance with the Law on the Committee for Coordination of Financial Sector Supervision of Republika Srpska⁴⁶, the RS Committee for Coordination of Financial Sector Supervision had its regular meetings and considered all relevant issues for the stability of the Republika Srpska's financial sector stability, including the sector of banking, insurance and securities market.

Financial sector regulators (the Banking Agency of Republika Srpska, the Insurance Agency of Republika Srpska, and the Securities Commission of Republika Srpska), by carrying out their regulatory functions, have continuously upgraded their acts, i.e. passed the regulations within their scope of competencies that more closely govern the bank operations, operations of the insurance companies and participants in the securities market. Detailed reports for each segment of the financial market were included in annual reports of the relevant provisional sub-committees (Sub-Committee for Internal Market and Competition, and Sub-Committee for Economic and Financial Issues and Statistics) which monitor BiH progress in the alignment of domestic legislation with the EU acquis.

We draw particular attention to by-laws that the Banking Agency of Republika Srpska passed in order to implement the Strategy for Introducing the "International Convergence of Capital Measurement and Capital Standards" – Basel II (decisions regulating the minimum standards for credit risk management and classification of bank assets, management of the information systems in banks and management of outsourcing, due diligence of the members of the bank bodies, assessment of the members of the bank bodies, remuneration policy and practice for bank employees, etc.).

In addition to the aforementioned, in 2014, the Banking Agency of Republika Srpska passed a Decision on Temporary Measures for Loan Obligations of Clients Affected by Natural Disasters⁴⁷, which sets forth special measures related to loan obligations of the bank clients affected by natural disasters and consequences of natural disasters that occurred in May 2014, as well as special standards for credit risk management and classification of assets that the banks may implement if they approve special purposes to the clients.

Cooperation with supervisors of mother banks from the EU that have their subsidiary banks in RS

Banking Agency of Republika Srpska regularly participates in Supervisory Colleges organised by regulators from Slovenia and Serbia. The amendments to the Law on the Banking Agency of Republika Srpska, providing for a trade secret and handling of classified information, have removed the obstacles for signing a Memorandum with the Austrian supervisor.

Planned activities in 2015-2016

In 2015 a new Law on Banks will be prepared, based on recommendations of the Basel Committee, relevant directives and regulations of the EU, as well as recommendations of international financial institutions (IMF, OECD, etc.). In the process of modernisation of regulations, particular attention will be paid to: risk management in banking operations, improvement and strengthening of the control function of the Banking Agency, with the emphasis on development of a special regime of systemic and consolidated supervision, requirements for development of detailed plans for resolving the problem by the banks themselves, purchase and assumption of assets and liabilities of banks, process of bank liquidation, as well as other relevant issues for resolving the problems in banks. In order to resolve bad assets, the activities will be taken to create legal assumptions for restructuring non-performing loans, and sale and transfer of claims based on loans to other legal entities.

According to the Crisis action plan, the assessment will be performed of economic justification and fulfilment of criteria for taking specific actions foreseen in the Plan, in order to resolve identified

⁴⁶ "Official Gazette of Republika Srpska", No. 49/09.

⁴⁷ "Official Gazette of Republika Srpska", No. 57/14.

problems in operations of an individual bank and preserve the financial system stability. The activities envisaged in the Plan will be continuously reviewed and monitored, with a particular view of legal framework improvement, exchange and keeping track of information, taking measures for recovery of systemically important banks, analysis of effects of undertaken measures, etc.

According to its competencies established under the law, the Committee for Coordination of Financial Sector Supervision of Republika Srpska will monitor situation in the banking system and other segments of financial sector, propose measures for preservation of its stability and undertake activities in a view of strengthening supervision over the financial sector participants, as well as early detection of risks in the financial market. The Committee will also continue activities on improving the protection of rights and interests of users of financial services, and their education.

Due to unfavourable situation in the segment of collection of loans, which leads to increased credit risk and credit losses as well as fall in profitability, we will insist on capital strengthening of banks in the coming period, placing profit in the function of capital increase, as well as reinforcing control of the level of due claims, particularly as to the non-performing loans.

Strategy for managing banks in state ownership will also be prepared with clearly defined plans and exit strategies.

Recovery of the securities market was primarily driven by recovery and strengthening of the real sector, creation of favourable environment for attracting domestic and foreign investors, increase in credibility of individual issuers, and continuous education on the benefits of participating in the securities market, with parallel harmonisation with regulations and practices of developed markets, directives of the European Union, and international standards. The activities will also continue on adopting the Law on Amendments and Supplements to the Law on Investments Funds, which will ensure pre-requisites for transformation of the closed-end investment funds and affirmation of the investment fund industry in line with international practice.

With a view to further develop the insurance sector in Republika Srpska and create regulatory assumptions for gradual liberalisation of prices in compulsory insurance schemes in transport, the activities on the preparation of the Law on Compulsory Insurance in Transport will be continued, after which the necessary modifications and amendments to the Law on Insurance Companies will be introduced so as to prescribe measures for more efficient supervision of free determination of premiums, and align the minimum level of capital requirements with the relevant EU Directives. In 2015, the activities will also be taken to raise awareness on the benefits of property insurance against natural disasters, as well as to analyse possibilities and manner of encouraging the demand for this type of insurance in Republika Srpska.

In 2015, a new Development Strategy of the Investment-Development Bank of Republika Srpska and Development Strategy of the Guarantee Fund of Republika Srpska will be adopted, which will cut costs and adjust their organisational structure, in order to position the aforementioned institutions more clearly as the main pillars of economic development of Republika Srpska.

Namely, in the previous period, particularly in the period during and after the crisis, the Investment-Development Bank of Republika Srpska was the main pillar and support not only to economic, but also to financial sector of Republika Srpska. However, we believe that the IDBRS' strategy should be primarily directed towards creating a start-up business fund, which will play an important role in creating entrepreneurship, by enabling primarily young people with a wish and ideas for business to start their own business and become self-employed. At the same time, we need to work more intensely on restructuring of portfolio where IDBRS is a minority shareholder, and speed up privatisation of the non-privatised state-owned capital. The new IDBRS Strategy will require changes in the organisational structure of the IDBRS too through establishing simpler and more efficient organisational structure, with increased responsibilities of its employees and reduced costs. One of very important tasks of the IDBRS in the forthcoming period will also be to improve international cooperation with international financial institutions.

4.2.3 Labour market

The BiH labour market in 2014 was characterised by a very low rate of formal and high rate of informal employment, as well as high unemployment and inactivity of the working age population.

According to data of the BiH Agency for Statistics in September 2014, the number of employees in legal entities in BiH amounted to 704,724, of which 290,561 women. As compared to August 2014, the total number of employees in legal entities increased by 0.4%. The number of employed women increased too, specifically by 0.5%.

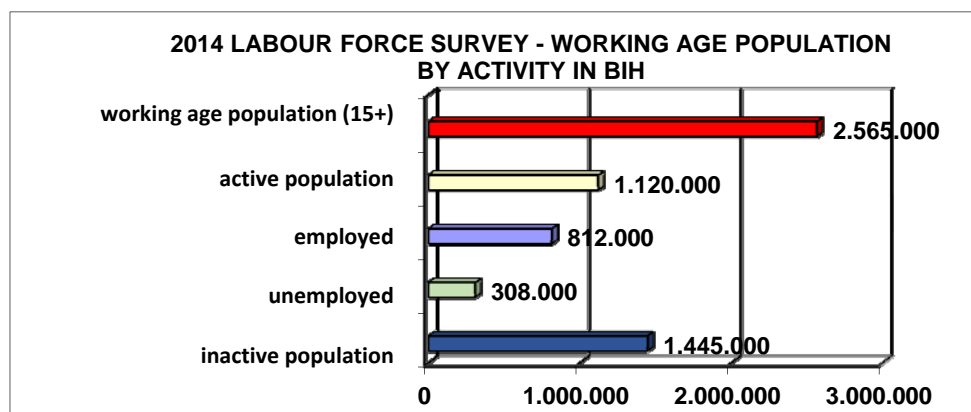
According to data of the institutes and employment bureaus in Bosnia and Herzegovina as by 31 October 2014, there were 547,900 unemployed persons registered in the records, which, as compared to 30 September 2014, represented a decrease by 347 persons or 0.06%. Out of the total number of job-seekers, there were 279,766 or 51.09% of women.

Table 4: Registered unemployment – BiH / entities – October 2014

	Bosnia and Herzegovina	Federation BiH	Republika Srpska	Brcko - District BiH
Registered unemployment – 31 October 2014	547,590	392,646	142,825	12,119
Registered unemployment – 30 September 2014	547,937	391,856	143,955	12,126
Index 31 October 2014/ 30 September 2014	99.94	100.20	99.21	99.94

In the structure of job-seekers up to 31 October 2014, there were 148,742 or 27.16% of non-skilled workers; 10,091 or 1.84% of semi-skilled workers; 3,219 or 0.59% of highly-skilled workers; 1,575 or 0.29% with completed primary school or less; 147,480 or 26.93% with secondary education; 7,493 or 1.37% with post-secondary college education; and 40,408 or 7.38% with university, master's and doctoral degrees. The largest share in total registered unemployment is made up by persons with third level of education, skilled workers with 34.44% and non-skilled workers with 27.16%. The registered unemployment rate in September 2014 stood at 43.7% and reduced relative to August by 0.3 percentage points.

According to 2014 Labour Force Survey⁴⁸, labour force in BiH (economically active population) comprised 1,120,000 persons, while the number of inactive persons stood at 1,445,000. As compared to 2013, the employment rate increased by 0.1% and stood at 31.7% in 2014. The unemployment rate remained unchanged in 2014 and stood at 27.5%.



⁴⁸ Source: Agency for Statistics BiH, Labour Force Survey.

According to this Survey, gender structure of the unemployed was the following: 55.8% men and 44.2% women.

Education structure of the unemployed shows that the highest share is made up by persons with completed secondary education – 68.3%; persons with primary or lower education make up 19.7%, whereas persons with higher education, college, academy, master's and doctoral degree account for 12.0%.

Proposals for strengthening labour supply and demand of labour force

- Harmonisation of educational system with the needs of labour market is a long term but necessary process. It is necessary to devise and harmonise the plan of activities in order to coordinate the enrolment policy in secondary and higher education with the needs of labour market (enrolment policy in secondary and higher education is not harmonised with the labour market needs and, for this reason, over 1/3 of the unemployed persons in the employment bureaus is unemployable);
- Future labour market prefers quality and flexible education system, flexibility in choosing jobs and employment. Quality of teaching should be harmonised with the needs of employers since the graduate students and pupils do not have sufficient stock of knowledge, skills and capacities;
- The world of labour as well as the needs are changing very fast – this is crucial for implementation of the lifelong learning concept and permanent acquiring of new knowledge and skills (vocational education and training);
- Active employment measures, as an instrument for regulation of labour market, should be improved and directly focused on reduction of unemployment;
- Establish a system for provision of necessary information on the labour market, training in needed knowledge and skills, professional guidance and counselling towards the expressed needs;

In order to improve labour market flexibility, the following progress may be achieved:

- Continue the process of improving the legislation pertaining to labour, employment, education and other regulations concerning the labour market policy.
- Systemically encourage and strengthen private initiative for small business start-up in the production sector, primarily based on the existing resources and services;
- Ensure exercise of every individual's rights in a way not to prevent them from job-seeking due to the fear that they may lose certain social rights.

In order to stabilise labour market, active employment policy in 2015 should be additionally intensified through:

- Strengthening mediation function in employment by institutional capacity building of the Institute for Employment;
- Continue activities on implementation of active employment measures initiated in 2014;
- Improve and upgrade the level of social dialogue and tripartite cooperation with the representative social partners.

Federation BiH

Burden of labour, i.e. relatively high contribution rates, mismatch between entity level legislation providing for this area and insufficient financial discipline have negative impact on business environment, and if we include other factors as well, result in non-competitive local economy, followed by high unemployment rate, failure to register employees for compulsory insurance, and unregistered work. In the Federation of Bosnia and Herzegovina, there is a significant number of employment benefits for which compulsory insurance contributions are not paid. The rights to

benefits arising from labour as well as their amount are regulated by collective agreements, where the amount of monthly benefits for which contributions and income tax are not paid is higher than the lowest monthly salary of an employee established under collective agreement.

Furthermore, at the level of the Federation BiH, all payers of social security contributions are not covered by one law, but only payers on the basis of employment, which results in differently regulated bases and rates for individual categories of insured persons from one canton to another.

The main goals are to create favourable business environment, to reduce burden of employers for costs of wages, to decrease unregistered work, to achieve fiscal stability of social security funds, to harmonise entity regulations, stimulate employment and strengthen discipline in payments of contributions.

In 2015, conduct a detailed analysis of applicable regulations, make assessment of situation and propose possible solutions.

In the period 2015 – 2017, we should monitor implementation of the proposed solutions and gradually introduce further measures in order to achieve the set objectives. Legal instrument for achieving the aforementioned objective is the Law on Contributions.

Risks:

- Sensitivity of the system of pension and disability protection, health protection, and protection in case of unemployment, requires the proposed measures to ensure stability and sustainability of extra budgetary funds as well as efficient implementation of reforms in these areas.
- Resistance by cross-sectoral groups and impossibility to change collective agreements and re-define the rights of employees.
- Economic situation in the country, i.e. the implementation of other measures leading to economic progress, attracting major investments and new employment.

Republika Srpska

In the area of labour and employment, the Government of Republika Srpska will, through dialogue and cooperation with social partners, work on creating favourable environment for business, improving collective bargaining, exercising and protecting the rights of employees by conventional and alternative methods of dispute resolution. The Government will fight for every job through programmes of support to business or more creative employment programmes, so that the funds allocated for this purpose have a clear and precise goal, and the results of support achieve measurable effects.

The main objectives of the labour market reform are: alleviation of the effects of economic crisis on the labour market, increase in labour market flexibility, strengthening branch-based social dialogue, contribution to maintaining stable environment for employers, and preservation of social peace. In order to achieve these objectives, we will actively work in increasing the lowest price of labour so as to improve economic and social position of workers.

With regards to labour market reforms, legal framework providing for labour issues will also be reformed and innovated. The new Law on Civil Servants and the Law on Labour will be prepared so as to achieve higher efficiency and accountability of the administration, including higher flexibility, *inter alia*, in terms of transfer and mobility of labour force.

For the purpose of determining the real labour force supply in the labour market, we will provide for records of the unemployed persons, registered in the Employment Institute of Republika Srpska only because of health insurance, to be kept in the Health Insurance Fund, since they do not make active supply of labour force.

In 2015, we plan to conduct a comprehensive analysis of the tax system and participation of tax income in GDP, with the assistance of the experts of the European Commission, the World Bank and the International Monetary Fund in this process, in order to create the optimum tax burden and thereby contribute to the expected economic growth, increase in employment and economic development of Republika Srpska. Particular attention will be paid to finding optimum tax burden for labour taxation (income tax and compulsory contributions). In implementation of these activities, we will certainly take into account the elimination of consequences of tax competition within Bosnia and Herzegovina.

4.2.4 Public finance reforms

Federation BiH

The Government of the Federation BiH continues with implementation of restrictive policy with federal budgetary users in the domain of wages through limiting the number of the employed while maintaining the basis for calculation of wages at the same level. It is important to emphasise that, in 2015, there will be an increase of amount in the wages position due to the legal right of the elected officials and advisors, in case they do not return to the position before the election or find a new job, to receive the same salary they used to receive during the previous four years for the next 12 months (officials), i.e. 6 months (advisors).

The adoption of the new Law on Budgets in the Federation of Bosnia and Herzegovina that introduced fiscal rules, budget supervision and statement of fiscal responsibility and entered into force on 1 January 2014, represents one of the most important steps in improving the budget process in the Federation of Bosnia and Herzegovina.

One of the measures of the Government of the Federation of Bosnia and Herzegovina presented in the 2014 EFP was finding the solution to reduce burden of employers within the non-tax levies and thereby improving business environment.

Various levels of government in the Federation of Bosnia and Herzegovina (mostly lower levels – cantons and municipalities) introduced a large number of non-tax levies, which are not under control of the central Government, which has no influence on their introduction.

Certain types of these levies directly increase costs of doing business, affect the financial result of the employer and as such, discourage new investments and thereby employment growth as well.

Commitment of the Government of the Federation BiH in 2014 was to conduct a detailed analysis of the existing number of non-tax incomes and other para-fiscal levies in the Federation BiH in a unified and comprehensive manner, in order to take specific measures to reduce them and bring them under control of the central Government.

It is for these reasons that the Government of the Federation BiH made a Conclusion with the proposal of measures towards changing the persons with obligation to pay basis for the calculation and accounting rate for forest fees, general water fees and fees for tourist boards, as the highest levies that directly affect the operations of enterprises.

The above mentioned activities will be followed by a change of regulations providing for these levies, thus the line ministries were given the task to prepare changes of regulations dealing with these issues.

Republika Srpska

As part of the process of public finance management, the introduction of programme budgeting in the coming medium-term period will create assumptions for additional savings. During 2014, in cooperation with the EU Project Team as technical assistance, a series of trainings were carried out

with the budget users that aimed at defining a clearer vision among budget programmes and strategic documents of the ministries. The same activities will be continued in 2015 as well. Namely, by clear defining of objectives, programmes and activities, public funds will be earmarked to implementation of the set objectives with the defined effects and measurable results. Thus, responsibility for implementation or non-implementation of the set objectives will be identified, as well as accountability for spent public funds.

Allocations for wages in the coming period are planned to remain at the same level. It should be pointed out that the amount of wages will be maintained at the level of the executed salary increase from April 2014. Significant savings were also planned on the position of expenditures for gross remunerations of expenses and other personal income of employees. Furthermore, the Government will, in the shortest possible period, define measures for public administration rationalisation, including the employment freeze, payroll restrictions, reduction of the number of employees by non-hiring of new employees after retirement of those who fulfilled the retirement conditions, etc.

Fiscal consolidation will be facilitated, among other things, by adopting the principle of fiscal accountability and the new Law on Financial Management and Public Sector Control. This will disable creation of obligations of budget users above the level of funds allocated from the budget, and introduce more transparent and responsible spending of public funds, with the goal of additional fiscal strengthening of the overall budgetary system of Republika Srpska.

In 2015, in cooperation with the Association of Municipalities and Cities, a Register of all incentives and subsidies from the budget of Republika Srpska and the budgets of local self-governance units will be established for the purpose of better control and monitoring of the intended use of the budget funds.

In 2015, particular attention will be paid to the activities of introducing the treasury system of operations in the health sector, in order to facilitate better control of spending of the funds.

4.3 Budgetary implications of major macroeconomic structural reforms

Total effects of measures and policies are been presented in Table 9 (Annex). In the Federation BiH, net effect is positive and reflects the implementation of laws that ensure additional revenues. Republika Srpska also achieves positive net effects of measures that provide additional revenues from the one side and additional savings in expenditures on the other.

5 ANNEX

Table 1a: Macroeconomic prospects

	ESA Code	Year 2013	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
		Level (bn €)	Rate of change				
1. Real GDP at market prices	B1*g	13,618	0,7	1,1	3,4	4,0	4,4
2. Current GDP at market prices	B1*g	13,962	2,6	2,5	4,4	5,5	6,4
Components of real GDP							
3. Private consumption expenditure	P3	11,266	0,2	1,6	1,8	2,0	2,4
4. Government consumption expenditure	P3	3,079	-0,5	0,3	0,8	1,2	1,0
5. Gross fixed capital formation	P51	2,482	-1,2	10,6	7,5	11,9	10,6
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	0,079	-62,3	95,6	46,7	-80,4	-295,5
7. Exports of goods and services	P6	4,023	7,0	5,0	6,6	5,3	5,6
8. Imports of goods and services	P7	7,310	1,6	7,5	3,4	2,6	2,7
Contribution to real GDP growth							
9. Final domestic demand		16,8	-0,2	3,1	3,0	4,1	4,3
10. Change in inventories and net acquisition of valuables	P52+P53	0,1	-0,3	0,2	0,2	-0,5	-0,3
11. External balance of goods/services	B11	-3,3	1,2	-2,3	0,2	0,3	0,4

Table 1b: Price developments

Percentage changes, annual averages	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. GDP deflator		1,9	1,4	1,0	1,4	2,0
2. Private consumption deflator		0,8	-0,7	1,0	0,8	1,2
3. HICP ⁴⁹		:	:	:	:	:
4. National CPI change		-0,1	-0,7	1,0	0,9	1,2
5. Public consumption deflator		0,0	7,5	0,8	0,8	2,0
6. Investment deflator		-0,5	1,0	1,6	1,8	1,7
7. Export price deflator (goods & services)		-1,1	-0,9	1,3	1,5	2,4
8. Import price deflator (goods & services)		-3,3	-1,0	1,4	0,5	1,0

⁴⁹ Agency for statistics of BiH does not publish HICP.

Table 1c: Labour market developments

	ESA Code	Year 2013	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
		Level	Level/Rate of change				
1. Population (thousands)			3.831,6	3.831,7	3.831,8	3.831,9	3.832,0
2. Population (growth rate in %)			-0,1	0,0	0,0	0,0	0,0
3. Working-age population (persons)			2.598,1	2.565,0	2.572,7	2.583,0	2.593,3
4. Participation rate			43,6	43,7	43,8	44,0	44,3
5. Employment, persons			821,6	812,0	822,6	835,7	853,3
6. Employment, hours worked			:	:	:	:	:
7. Employment (growth rate in %)			1,0	-1,2	1,3	1,6	2,1
8. Public sector employment (persons)			183,8	184,7	:	:	:
9. Public sector employment (growth in %)			1,4	0,5	:	:	:
10. Unemployment rate			27,5	27,5	27,0	26,4	25,6
11. Labour productivity, persons		33,5	-0,3	2,3	2,1	2,4	2,2
12. Labour productivity, hours worked			:	:	:	:	:
13. Compensation of employees	D1	13,2	0,7	:	:	:	:

Note: Data for working age population, employment and unemployment rate are taken from the 2013 and 2014 Labour Force Survey. BiH Agency for Statistic does not publish data on the number of employed per hours worked. Data on public sector employment are not published by the BiH Agency for Statistics. Data stated in Table 1c (line 8) is a sum of the number of employees in public administration, health and education. This piece of data includes not only employees in public schools and health but also employees in private schools and health. Hence, the given data do not fully present the number of employees in public sector (the same as in previous years). Growth rates of the number of employed and unemployed persons in 2014 presented in Table 1c are not equal to the rates given in the narrative part of NERP since the narrative part (Chapter 2) presents administrative data published by the Statistics, whereas Table 1c presents the survey data. Compensations of employees are taken from national accounts and expressed in billion KM (projections for this item are not available). Item 4 – Participation rate relates to participation of workforce in working age population (survey data).

Table 1d: Sectoral balances

Percentages of GDP	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-7,5	-3,9	-5,5	-5,2	-4,6
<i>of which:</i>						
- Balance of goods and services		-22,9	-19,8	-21,3	-20,4	-18,8
- Balance of primary incomes and transfers		14,2	14,7	14,6	14,1	13,1
- Capital account		1,2	1,2	1,2	1,2	1,1
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-6,0	-2,1	-3,8	-3,6	-4,0
3. Net lending/borrowing of general government		-1,5	-1,8	-1,7	-1,6	-0,6
4. Statistical discrepancy						

Table 1e: GDP, investment and gross value added

	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	28,0	28,7	30,0	31,6	33,7
Investment ratio (% of GDP)		16,8	18,3	19,1	20,7	21,8
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		16,1	:	:	:	:
2. Industry (excluding construction)		4,8	:	:	:	:
3. Construction		-3,3	:	:	:	:
4. Services		0,7	:	:	:	:

Table 1f: External sector developments

		Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Current account balance (% of GDP)	% of GDP	-5,5	-6,8	-6,4	-5,7	-5,0
2. Export of goods	Bn NCU	5,5	5,9	6,4	6,9	7,6
3. Import of goods	Bn NCU	13,3	14,2	14,9	15,4	15,9
4. Trade balance	Bn NCU	-7,8	-8,3	-8,5	-8,4	-8,4
5. Export of services	Bn NCU	2,9	2,9	3,0	3,2	3,4
6. Import of services	Bn NCU	0,7	0,7	0,7	0,7	0,7
7. Service balance	Bn NCU	2,3	2,2	2,3	2,5	2,6
8. Net interest payments from abroad	Bn NCU	-0,2	-0,2	:	:	:
9. Other net factor income from abroad	Bn NCU	0,5	0,5	0,4	0,4	0,4
10. Current transfers	Bn NCU	3,7	3,8	3,8	3,7	3,6
11. <i>Of which</i> from EU	Bn NCU	:	:	:	:	:
12. Current account balance	Bn NCU	-1,5	-2,0	-1,9	-1,8	-1,7
13. Capital and financial account	Bn NCU	1,3	2,0	:	:	:
14. Foreign direct investment	Bn NCU	0,4	0,8	:	:	:
15. Foreign reserves	Bn NCU	0,7	0,6	:	:	:
16. Foreign debt	Bn NCU	:	:	:	:	:
17. <i>Of which</i> : public	Bn NCU	:	:	:	:	:
18. <i>O/w</i> : foreign currency denominated	Bn NCU	:	:	:	:	:
19. <i>O/w</i> : repayments due	Bn NCU	:	:	:	:	:
20. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	1,96	1,96	1,96	1,96	1,96
21. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	1,96	1,96	1,96	1,96	1,96
22. Net foreign saving	% of GDP	:	:	:	:	:
23. Domestic private saving	% of GDP	:	:	:	:	:
24. Domestic private investment	% of GDP	:	:	:	:	:
25. Domestic public saving	% of GDP	:	:	:	:	:
26. Domestic public investment	% of GDP	:	:	:	:	:

Table 1g: Sustainability indicators

	Dimension	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. Current Account Balance	% of GDP	-5,9	-9,3	-8,6	-5,5	-6,8
2. Net International Investment Position	% of GDP	-55,5	-57,2	-58,0	-53,4	:
3. Export market shares	%, yoy	:	:	:	:	:
4. Real Effective Exchange Rate	%, yoy	-0,9	0,4	-0,8	-1,8	:
5. Nominal Unit Labour Costs	%, yoy	-1,1	-0,5	1,7	-4,5	:
6. Private sector credit flow	% of GDP	:	:	:	:	:
7. Private sector debt	% of GDP	:	:	:	:	:
8. General Government Debt	% of GDP	22,4	23,2	34	30	31,5

Note: Nominal unit labour costs are calculated in the following way: compensation of employees (national accounts) per one employee (Labour Force Survey)/Nominal GDP (current prices in KM) per the total number of the employed in BiH (LFS). Data for 2014 are not available since the BiH Agency for Statistics has not published compensation to employees yet (national accounts). Reference index base is 2008=100.

Table 2a: General government budgetary prospects – Consolidated BiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
% of GDP						
Net lending (B9) by sub-sectors						
1. General government	S13	-1,5	-1,8	-1,7	-1,6	-0,6
2. Central government	S1311	-1,2	-1,7	-1,6	-1,5	-0,6
3. State government	S1312					
4. Local government	S1313	0,1	0,2	0,2	0,1	0,1
5. Social security funds	S1314	-0,3	-0,3	-0,3	-0,3	-0,1
General government (S13)						
6. Total revenue	TR	40,8	40,2	38,9	36,5	35,0
7. Total expenditure	TE	42,3	42,1	40,6	38,1	35,6
8. Net borrowing/lending	EDP.B9	-1,5	-1,8	-1,7	-1,6	-0,6
9. Interest expenditure	EDP.D41 incl. FISIM	0,6	0,8	0,9	0,9	0,8
10. Primary balance		-0,8	-1,0	-0,8	-0,7	0,2
11. One-off and other temporary measures		0,0	0,0	0,0	0,0	0,0
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		20,7	20,2	19,7	18,9	18,2
12a. Taxes on production and imports	D2	17,4	17,0	16,6	16,0	15,3
12b. Current taxes on income and wealth	D5	3,2	3,0	2,9	2,8	2,8
12c. Capital taxes	D91	0,1	0,1	0,1	0,1	0,1
13. Social contributions	D61	14,6	14,5	13,9	13,0	12,4
14. Property income	D4	0,2	0,2	0,2	0,1	0,1
15. Other (15 = 16-(12+13+14))		5,3	5,4	5,2	4,5	4,3
16 = 6. Total revenue	TR	40,8	40,2	38,9	36,5	35,0
p.m.: Tax burden (D2+D5+D61+D91-D995)		35,3	34,7	33,6	31,9	30,6
Selected components of expenditure						
17. Collective consumption	P32	18,9	18,5	17,9	17,0	16,0
18. Total social transfers	D62 + D63	15,9	16,0	15,5	14,5	13,6
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	15,9	16,0	15,5	14,5	13,6
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,6	0,8	0,9	0,9	0,8
20. Subsidies	D3	1,3	1,1	1,1	1,0	0,9
21. Gross fixed capital formation	P51	3,8	4,0	3,7	3,3	2,9
22. Other (22 = 23-(17+18+19+20+21))		1,8	1,7	1,5	1,5	1,4
23. Total expenditures	TE	42,3	42,1	40,6	38,1	35,6
p.m. compensation of employees	D1	11,5	11,4	11,2	10,6	10,1

Table 2a: General government budgetary prospects – Institutions BiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
% of GDP						
Net lending (B9) by sub-sectors						
1. General government	S13	0,2	-0,1	-0,1	-0,2	-0,2
2. Central government	S1311	0,2	-0,1	-0,1	-0,2	-0,2
3. State government	S1312					
4. Local government	S1313					
5. Social security funds	S1314					
General government (S13)						
6. Total revenue	TR	3,5	3,2	3,0	2,8	2,6
7. Total expenditure	TE	3,2	3,3	3,2	3,0	2,8
8. Net borrowing/lending	EDP.B9	0,2	-0,1	-0,1	-0,2	-0,2
9. Interest expenditure	EDP.D41 incl. FISIM	0,0	0,0	0,0	0,0	0,0
10. Primary balance		0,2	-0,1	-0,1	-0,2	-0,2
11. One-off and other temporary measures		0,0	0,0	0,0	0,0	0,0
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		2,7	2,6	2,5	2,4	2,2
12a. Taxes on production and imports	D2	2,7	2,6	2,5	2,4	2,2
12b. Current taxes on income and wealth	D5					
12c. Capital taxes	D91					
13. Social contributions	D61					
14. Property income	D4					
15. Other (15 = 16-(12+13+14))		0,8	0,6	0,5	0,4	0,4
16 = 6. Total revenue	TR	3,5	3,2	3,0	2,8	2,6
p.m.: Tax burden (D2+D5+D61+D91-D995)		2,7	2,6	2,5	2,4	2,2
Selected components of expenditure						
17. Collective consumption	P32	2,9	3,0	2,8	2,7	2,5
18. Total social transfers	D62 + D63	0,0	0,0	0,0	0,0	0,0
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	0,0	0,0	0,0	0,0	0,0
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,0	0,0	0,0	0,0	0,0
20. Subsidies	D3					
21. Gross fixed capital formation	P51	0,2	0,2	0,2	0,2	0,1
22. Other (22 = 23-(17+18+19+20+21))		0,1	0,1	0,1	0,2	0,2
23. Total expenditures	TE	3,2	3,3	3,2	3,0	2,8
p.m. compensation of employees	D1	2,2	2,2	2,2	2,1	2,0

Table 2a: General government budgetary prospects – FBiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
% of GDP						
Net lending (B9) by sub-sectors						
1. General government	S13	-1,7	-0,8	-1,2	-0,9	-0,6
2. Central government	S1311	-1,6	-0,8	-1,2	-0,9	-0,5
3. State government	S1312					
4. Local government	S1313	0,1	0,1	0,1	0,1	0,1
5. Social security funds	S1314	-0,1	-0,1	-0,1	-0,1	-0,1
General government (S13)						
6. Total revenue	TR	24,0	24,0	22,9	21,8	20,8
7. Total expenditure	TE	25,6	24,8	24,1	22,7	21,3
8. Net borrowing/lending	EDP.B9	-1,7	-0,8	-1,2	-0,9	-0,6
9. Interest expenditure	EDP.D41 incl. FISIM	0,4	0,4	0,5	0,5	0,4
10. Primary balance		-1,3	-0,4	-0,7	-0,5	-0,1
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		11,2	11,0	10,7	10,3	9,9
12a. Taxes on production and imports	D2	9,5	9,3	9,1	8,7	8,3
12b. Current taxes on income and wealth	D5	1,7	1,7	1,7	1,6	1,6
12c. Capital taxes	D91	0,0	0,0	0,0	0,0	0,0
13. Social contributions	D61	9,7	9,6	9,1	8,6	8,1
14. Property income	D4	0,2	0,1	0,1	0,1	0,1
15. Other (15 = 16-(12+13+14))		3,0	3,4	3,0	2,8	2,7
16 = 6. Total revenue	TR	24,0	24,0	22,9	21,8	20,8
p.m.: Tax burden (D2+D5+D61+D91-D995)		20,9	20,6	19,8	18,9	18,0
Selected components of expenditure						
17. Collective consumption	P32	11,3	10,8	10,6	10,0	9,4
18. Total social transfers	D62 + D63	9,0	8,8	8,5	8,1	7,6
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	9,0	8,8	8,5	8,1	7,6
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,4	0,4	0,5	0,5	0,4
20. Subsidies	D3	0,8	0,7	0,7	0,6	0,6
21. Gross fixed capital formation	P51	3,0	2,9	2,8	2,6	2,5
22. Other (22 = 23-(17+18+19+20+21))		1,2	1,0	0,9	0,9	0,8
23. Total expenditures	TE	25,6	24,8	24,1	22,7	21,3
p.m. compensation of employees	D1	5,8	5,7	5,6	5,3	5,0

Table 2a: General government budgetary prospects – RS

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
% of GDP						
Net lending (B9) by sub-sectors						
1. General government	S13	0,0	-0,9	-0,4	-0,5	0,2
2. Central government	S1311	0,1	-0,8	-0,3	-0,4	0,1
3. State government	S1312					
4. Local government	S1313	0,0	0,1	0,1	0,1	0,1
5. Social security funds	S1314	-0,2	-0,2	-0,2	-0,2	0,0
General government (S13)						
6. Total revenue	TR	12,7	12,4	12,4	11,3	11,1
7. Total expenditure	TE	12,7	13,3	12,8	11,8	10,9
8. Net borrowing/lending	EDP.B9	0,0	-0,9	-0,4	-0,5	0,2
9. Interest expenditure	EDP.D41 incl. FISIM	0,3	0,3	0,4	0,4	0,4
10. Primary balance		0,2	-0,6	0,0	-0,1	0,6
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		6,2	6,0	5,9	5,7	5,5
12a. Taxes on production and imports	D2	4,7	4,6	4,6	4,4	4,3
12b. Current taxes on income and wealth	D5	1,4	1,2	1,2	1,2	1,2
12c. Capital taxes	D91	0,1	0,1	0,1	0,1	0,1
13. Social contributions	D61	4,9	4,9	4,8	4,4	4,3
14. Property income	D4	0,1	0,2	0,1	0,1	0,1
15. Other (15 = 16-(12+13+14))		1,5	1,3	1,6	1,2	1,2
16 = 6. Total revenue	TR	12,7	12,4	12,4	11,3	11,1
p.m.: Tax burden (D2+D5+D61+D91-D995)		11,1	10,9	10,7	10,1	9,8
Selected components of expenditure						
17. Collective consumption	P32	4,3	4,3	4,1	3,9	3,7
18. Total social transfers	D62 + D63	6,7	6,9	6,8	6,2	5,8
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	6,7	6,9	6,8	6,2	5,8
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,3	0,3	0,4	0,4	0,4
20. Subsidies	D3	0,4	0,4	0,4	0,3	0,3
21. Gross fixed capital formation	P51	0,6	0,8	0,6	0,5	0,2
22. Other (22 = 23-(17+18+19+20+21))		0,5	0,6	0,5	0,4	0,4
23. Total expenditures	TE	12,7	13,3	12,8	11,8	10,9
p.m. compensation of employees	D1	3,2	3,3	3,2	3,0	2,9

Table 2a: General government budgetary prospects – BD

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
% of GDP						
Net lending (B9) by sub-sectors						
1. General government	S13	0,0				
2. Central government	S1311					
3. State government	S1312					
4. Local government	S1313					
5. Social security funds	S1314					
General government (S13)						
6. Total revenue	TR	0,7	0,6	0,6	0,6	0,6
7. Total expenditure	TE	0,7	0,6	0,6	0,6	0,6
8. Net borrowing/lending	EDP.B9	0,0				
9. Interest expenditure	EDP.D41 incl. FISIM	0,0	0,0			
10. Primary balance		0,0	0,0			
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		0,6	0,6	0,6	0,5	0,5
12a. Taxes on production and imports	D2	0,5	0,5	0,5	0,5	0,5
12b. Current taxes on income and wealth	D5	0,1	0,1	0,1	0,1	0,1
12c. Capital taxes	D91					
13. Social contributions	D61					
14. Property income	D4					
15. Other (15 = 16-(12+13+14))		0,1	0,1	0,1	0,1	0,1
16 = 6. Total revenue	TR	0,7	0,6	0,6	0,6	0,6
p.m.: Tax burden (D2+D5+D61+D91-D995)		0,6	0,6	0,6	0,5	0,5
Selected components of expenditure						
17. Collective consumption	P32	0,4	0,4	0,4	0,4	0,3
18. Total social transfers	D62 + D63	0,3	0,2	0,2	0,2	0,2
18a. Social transfers in kind	P31 = D63	0,0	0,0	0,0	0,0	0,0
18b. Social transfers other than in kind	D62	0,3	0,2	0,2	0,2	0,2
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,0	0,0			
20. Subsidies	D3					
21. Gross fixed capital formation	P51	0,0	0,0	0,0	0,0	0,0
22. Other (22 = 23-(17+18+19+20+21))		0,0	0,0	0,0	0,0	0,0
23. Total expenditures	TE	0,7	0,6	0,6	0,6	0,6
p.m. compensation of employees	D1	0,3	0,2	0,2	0,2	0,2

Table 2b: General government budgetary prospects – Consolidated BiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Level mil. KM						
Net lending (B9) by sub-sectors						
1. General government	S13	-409,4	-525,2	-509,2	-511,4	-203,5
2. Central government	S1311	-342,1	-499,6	-479,9	-465,9	-205,6
3. State government	S1312					
4. Local government	S1313	15,0	54,4	46,6	44,8	43,3
5. Social security funds	S1314	-80,7	-80,0	-75,9	-90,3	-41,2
General government (S13)						
6. Total revenue	TR	11.442,3	11.562,1	11.684,9	11.556,2	11.790,8
7. Total expenditure	TE	11.851,7	12.087,2	12.194,2	12.067,6	11.994,4
8. Net borrowing/lending	EDP.B9	-409,5	-525,1	-509,3	-511,4	-203,6
9. Interest expenditure	EDP.D41 incl. FISIM	181,7	224,5	267,2	276,9	276,6
10. Primary balance		-227,8	-300,6	-242,2	-234,5	73,0
11. One-off and other temporary measures		11,5	7,1	0,0	0,0	0,0
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		5.808,8	5.800,7	5.901,8	5.982,5	6.129,9
12a. Taxes on production and imports	D2	4.863,4	4.891,6	4.986,5	5.055,5	5.146,9
12b. Current taxes on income and wealth	D5	908,6	867,7	878,3	894,3	949,3
12c. Capital taxes	D91	36,9	41,5	37,0	32,6	33,7
13. Social contributions	D61	4.082,6	4.159,7	4.167,9	4.106,7	4.180,3
14. Property income	D4	65,3	61,6	56,7	37,4	37,3
15. Other (15 = 16-(12+13+14))		1.485,3	1.540,0	1.558,5	1.429,6	1.443,3
16 = 6. Total revenue	TR	11.442,2	11.562,1	11.684,9	11.556,2	11.790,8
p.m.: Tax burden (D2+D5+D61+D91-D995)		9.891,5	9.960,4	10.069,7	10.089,2	10.310,2
Selected components of expenditure						
17. Collective consumption	P32	5.305,8	5.302,9	5.376,2	5.372,9	5.379,3
18. Total social transfers	D62 + D63	4.456,2	4.597,2	4.650,1	4.581,8	4.587,5
18a. Social transfers in kind	P31 = D63	0,0	0,0	0,0	0,0	0,0
18b. Social transfers other than in kind	D62	4.456,2	4.597,2	4.650,1	4.581,8	4.588,5
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	181,7	224,5	267,2	276,9	276,6
20. Subsidies	D3	358,9	323,7	333,5	313,1	309,8
21. Gross fixed capital formation	P51	1.051,2	1.157,7	1.106,5	1.060,2	962,5
22. Other (22 = 23-(17+18+19+20+21))		497,9	481,2	460,7	462,7	478,7
23. Total expenditures	TE	11.851,7	12.087,2	12.194,2	12.067,6	11.994,4
p.m. compensation of employees	D1	3.229,9	3.285,1	3.351,8	3.365,7	3.386,6

Table 2b: General government budgetary prospects – Institutions BiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Level mil. KM						
Net lending (B9) by sub-sectors						
1. General government	S13	66,2	-29,8	-40,7	-71,0	-74,1
2. Central government	S1311	66,2	-29,8	-40,7	-71,0	-74,1
3. State government	S1312					
4. Local government	S1313					
5. Social security funds	S1314					
General government (S13)						
6. Total revenue	TR	969,5	919,4	908,7	878,7	875,8
7. Total expenditure	TE	903,3	949,2	949,4	949,7	949,9
8. Net borrowing/lending	EDP.B9	66,2	-29,8	-40,7	-71,0	-74,1
9. Interest expenditure	EDP.D41 incl. FISIM	0,0	0,7	0,8	0,9	0,4
10. Primary balance		66,2	-29,1	-39,9	-70,1	-73,7
11. One-off and other temporary measures		11,5	7,1			
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		750,0	750,0	750,0	750,0	750,0
12a. Taxes on production and imports	D2	750,0	750,0	750,0	750,0	750,0
12b. Current taxes on income and wealth	D5					
12c. Capital taxes	D91					
13. Social contributions	D61					
14. Property income	D4					
15. Other (15 = 16-(12+13+14))		219,5	169,4	158,7	128,7	125,8
16 = 6. Total revenue	TR	969,5	919,4	908,7	878,7	875,8
p.m.: Tax burden (D2+D5+D61+D91-D995)		750,0	750,0	750,0	750,0	750,0
Selected components of expenditure						
17. Collective consumption	P32	811,5	848,6	842,8	842,0	850,5
18. Total social transfers	D62 + D63	5,3	2,0	2,0	2,0	2,0
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	5,3	2,0	2,0	2,0	2,0
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,0	0,7	0,8	0,9	0,4
20. Subsidies	D3					
21. Gross fixed capital formation	P51	54,9	71,1	71,1	56,0	45,5
22. Other (22 = 23-(17+18+19+20+21))		31,6	26,8	32,7	48,8	51,5
23. Total expenditures	TE	903,3	949,2	949,4	949,7	949,9
p.m. compensation of employees	D1	626,3	640,3	653,7	654,7	665,5

Table 2b: General government budgetary prospects – FBiH

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Level mil. KM						
Net lending (B9) by sub-sectors						
1. General government	S13	-462,8	-236,6	-362,6	-294,3	-188,1
2. Central government	S1311	-443,8	-232,1	-361,9	-281,4	-177,4
3. State government	S1312					
4. Local government	S1313	17,4	25,0	22,1	21,3	18,5
5. Social security funds	S1314	-36,4	-29,5	-22,8	-34,2	-29,2
General government (S13)						
6. Total revenue	TR	6.718,6	6.893,9	6.866,7	6.899,7	6.997,0
7. Total expenditure	TE	7.181,4	7.130,5	7.229,4	7.194,0	7.185,2
8. Net borrowing/lending	EDP.B9	-462,8	-236,6	-362,7	-294,3	-188,2
9. Interest expenditure	EDP.D41 incl. FISIM	104,7	125,2	147,0	146,3	138,4
10. Primary balance		-358,1	-111,4	-215,7	-148,0	-49,8
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		3.141,7	3.164,1	3.214,5	3.262,6	3.347,8
12a. Taxes on production and imports	D2	2.655,3	2.671,8	2.716,7	2.758,5	2.809,5
12b. Current taxes on income and wealth	D5	485,3	491,2	496,7	503,0	537,2
12c. Capital taxes	D91	1,1	1,1	1,1	1,1	1,1
13. Social contributions	D61	2.707,0	2.748,1	2.725,7	2.720,3	2.725,7
14. Property income	D4	42,8	17,2	17,4	16,9	17,4
15. Other (15 = 16-(12+13+14))		827,0	964,5	909,1	899,9	906,1
16 = 6. Total revenue	TR	6.718,5	6.893,9	6.866,7	6.899,7	6.997,0
p.m.: Tax burden (D2+D5+D61+D91-D995)		5.848,7	5.912,2	5.940,2	5.982,9	6.073,5
Selected components of expenditure						
17. Collective consumption	P32	3.168,8	3.117,9	3.174,1	3.173,8	3.177,6
18. Total social transfers	D62 + D63	2.510,7	2.542,5	2.550,3	2.554,4	2.561,1
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	2.510,7	2.542,5	2.550,3	2.554,4	2.561,1
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	104,7	125,2	147,0	146,3	138,4
20. Subsidies	D3	235,3	212,6	222,7	203,4	204,2
21. Gross fixed capital formation	P51	832,8	838,6	851,0	833,2	825,8
22. Other (22 = 23-(17+18+19+20+21))		329,1	293,7	284,3	282,9	278,1
23. Total expenditures	TE	7.181,4	7.130,5	7.229,4	7.194,0	7.185,2
p.m. compensation of employees	D1	1.630,3	1.633,3	1.672,3	1.680,8	1.689,4

Table 2b: General government budgetary prospects – RS

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Level mil. KM						
Net lending (B9) by sub-sectors						
1. General government	S13	-11,2	-258,8	-105,9	-146,1	58,7
2. Central government	S1311	35,5	-237,7	-77,3	-113,5	45,9
3. State government	S1312					
4. Local government	S1313	-2,4	29,4	24,5	23,5	24,8
5. Social security funds	S1314	-44,3	-50,4	-53,1	-56,1	-12,0
General government (S13)						
6. Total revenue	TR	3.556,3	3.562,8	3.723,0	3.590,2	3.727,8
7. Total expenditure	TE	3.567,5	3.821,5	3.828,9	3.736,3	3.669,1
8. Net borrowing/lending	EDP.B9	-11,3	-258,7	-105,9	-146,1	58,7
9. Interest expenditure	EDP.D41 incl. FISIM	76,6	98,2	119,4	129,7	137,8
10. Primary balance		65,3	-160,5	13,4	-16,4	196,5
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		1.748,0	1.721,6	1.768,8	1.799,9	1.859,1
12a. Taxes on production and imports	D2	1.312,8	1.322,8	1.371,8	1.396,0	1.433,4
12b. Current taxes on income and wealth	D5	399,5	358,5	361,1	372,3	393,1
12c. Capital taxes	D91	35,8	40,4	35,9	31,5	32,6
13. Social contributions	D61	1.375,6	1.411,6	1.442,2	1.386,4	1.454,6
14. Property income	D4	22,5	44,4	39,3	20,5	19,9
15. Other (15 = 16-(12+13+14))		410,0	385,1	472,7	383,4	394,2
16 = 6. Total revenue	TR	3.556,3	3.562,8	3.723,0	3.590,2	3.727,8
p.m.: Tax burden (D2+D5+D61+D91-D995)		3.123,7	3.133,2	3.211,0	3.186,3	3.313,7
Selected components of expenditure						
17. Collective consumption	P32	1.201,6	1.226,6	1.238,8	1.240,5	1.242,7
18. Total social transfers	D62 + D63	1.869,6	1.981,9	2.031,8	1.955,4	1.954,4
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	1.869,6	1.981,9	2.031,8	1.955,4	1.954,4
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	76,6	98,2	119,4	129,7	137,8
20. Subsidies	D3	123,6	111,1	110,8	109,7	105,6
21. Gross fixed capital formation	P51	158,9	243,0	184,4	170,0	79,5
22. Other (22 = 23-(17+18+19+20+21))		137,2	160,7	143,7	131,0	149,1
23. Total expenditures	TE	3.567,5	3.821,5	3.828,9	3.736,3	3.669,1
p.m. compensation of employees	D1	898,5	941,6	954,5	958,9	960,4

Note: Table contains consolidated data for level of General Government of RS (RS budget, RS budget users in and outside the main treasury ledger having their own accounts, data on funds from foreign funded projects and escrow account funds), level of local self-government levels and social security funds).

Expenditure based on social transfers is not clearly marked off through types to Non-cash social transfers and Other social transfers than non-cash, thus the total amounts of social transfers in the tables are given in the position Other social transfers than non-cash.

Table 2b: General government budgetary prospects – BD

	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Level mil. KM						
Net lending (B9) by sub-sectors						
1. General government	S13	-1,6				
2. Central government	S1311					
3. State government	S1312					
4. Local government	S1313					
5. Social security funds	S1314					
General government (S13)						
6. Total revenue	TR	197,9	186,0	186,5	187,6	190,2
7. Total expenditure	TE	199,5	186,0	186,5	187,6	190,2
8. Net borrowing/lending	EDP.B9	-1,6				
9. Interest expenditure	EDP.D41 incl. FISIM	0,4	0,4			
10. Primary balance		-1,2	0,4			
11. One-off and other temporary measures						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		169,1	165,0	168,5	170,0	173,0
12a. Taxes on production and imports	D2	145,3	147,0	148,0	151,0	154,0
12b. Current taxes on income and wealth	D5	23,8	18,0	20,5	19,0	19,0
12c. Capital taxes	D91					
13. Social contributions	D61					
14. Property income	D4					
15. Other (15 = 16-(12+13+14))		28,8	21,0	18,0	17,6	17,2
16 = 6. Total revenue	TR	197,9	186,0	186,5	187,6	190,2
p.m.: Tax burden (D2+D5+D61+D91-D995)		169,1	165,0	168,5	170,0	173,0
Selected components of expenditure						
17. Collective consumption	P32	123,9	109,8	120,5	116,6	108,5
18. Total social transfers	D62 + D63	70,6	70,8	66,0	70,0	70,0
18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in kind	D62	70,6	70,8	66,0	70,0	70,0
19 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	0,4	0,4			
20. Subsidies	D3					
21. Gross fixed capital formation	P51	4,6	5,0		1,0	11,7
22. Other (22 = 23-(17+18+19+20+21))		0,0	0,0	0,0	0,0	0,0
23. Total expenditures	TE	199,5	186,0	186,5	187,6	190,2
p.m. compensation of employees	D1	74,8	69,9	71,3	71,3	71,3

Table 3: General government expenditure by functions**Consolidated BiH**

Level	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	1.479,2	1545,9	1.558,5	1.462,5	1.455,5
2. Defence	2	284,0	287,4	286,1	286,1	291,9
3. Public order and safety	3	1.151,1	1.187,3	1.199,4	1.232,9	1.218,8
4. Economic affairs	4	1.649,7	1.683,9	1.768,2	1.759,7	1.753,1
5. Environmental protection	5	11,6	11,5	10,8	10,3	9,9
6. Housing and community amenities	6	208,6	199,9	193,3	202,3	200,4
7. Health	7	1.881,3	1.940,9	1.989,4	1.931,6	1.922,9
8. Recreation, culture and religion	8	156,2	149,2	132,8	150,7	149,6
9. Education	9	1.351,7	1.344,1	1.352,2	1.362,3	1.354,2
10. Social protection	10	3.678,3	3.737,1	3.703,5	3.669,2	3.638,1
11. Total expenditure (item 7 = 23 in Table 2)	TE	11.851,7	12.087,2	12.194,2	12.067,6	11.994,4

%GDP	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	5,3	5,4	5,2	4,6	4,3
2. Defence	2	1,0	1,0	1,0	0,9	0,9
3. Public order and safety	3	4,1	4,1	4,0	3,9	3,6
4. Economic affairs	4	5,9	5,9	5,9	5,6	5,2
5. Environmental protection	5	0,0	0,0	0,0	0,0	0,0
6. Housing and community amenities	6	0,7	0,7	0,6	0,6	0,6
7. Health	7	6,7	6,8	6,6	6,1	5,7
8. Recreation, culture and religion	8	0,6	0,5	0,4	0,5	0,4
9. Education	9	4,8	4,7	4,5	4,3	4,0
10. Social protection	10	13,1	13,0	12,3	11,6	10,8
11. Total expenditure (item 7 = 23 in Table 2)	TE	42,3	42,1	40,6	38,1	35,6

Institutions BiH

Level	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	195,0	227,9	210,6	218,4	219,3
2. Defence	2	278,3	280,7	286,1	286,1	291,9
3. Public order and safety	3	333,1	352,9	366,1	359,6	350,2
4. Economic affairs	4	57,0	52,6	52,7	51,1	54,7
5. Environmental protection	5	0,0	0,0	0,0	0,0	0,0
6. Housing and community amenities	6	0,0	0,0	0,0	0,0	0,0
7. Health	7	5,4	5,2	6,1	5,7	5,8
8. Recreation, culture and religion	8	8,5	6,1	3,6	5,0	5,0
9. Education	9	5,6	7,8	7,9	7,7	6,9
10. Social protection	10	20,4	16,1	16,3	16,1	16,1
11. Total expenditure (item 7 = 23 in Table 2)	TE	903,3	949,2	949,4	949,7	949,9

%GDP	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	0,7	0,8	0,7	0,7	0,7
2. Defence	2	1,0	1,0	1,0	0,9	0,9
3. Public order and safety	3	1,2	1,2	1,2	1,1	1,0
4. Economic affairs	4	0,2	0,2	0,2	0,2	0,2
5. Environmental protection	5	0,0	0,0	0,0	0,0	0,0
6. Housing and community amenities	6	0,0	0,0	0,0	0,0	0,0
7. Health	7	0,0	0,0	0,0	0,0	0,0
8. Recreation, culture and religion	8	0,0	0,0	0,0	0,0	0,0
9. Education	9	0,0	0,0	0,0	0,0	0,0
10. Social protection	10	0,1	0,1	0,1	0,1	0,0
11. Total expenditure (item 7 = 23 in Table 2)	TE	3,2	3,3	3,2	3,0	2,8

Federation BiH

Level	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	770,5	778,1	786,0	793,8	801,7
2. Defence	2					
3. Public order and safety	3	534,4	539,7	548,0	545,1	544,3
4. Economic affairs	4	1.090,0	1.105,1	1.192,7	1.189,9	1.189,3
5. Environmental protection	5					
6. Housing and community amenities	6	140,0	137,7	139,8	139,1	138,9
7. Health	7	1.255,1	1.234,4	1.253,5	1.246,8	1.245,0
8. Recreation, culture and religion	8	71,2	70,0	71,1	70,7	70,6
9. Education	9	869,1	854,8	868,0	863,3	862,1
10. Social protection	10	2.451,1	2.410,7	2.370,3	2.345,3	2.333,3
11. Total expenditure (item 7 = 23 in Table 2)	TE	7.181,4	7.130,5	7.229,4	7.194,0	7.185,2

%GDP	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	2,7	2,7	2,6	2,5	2,4
2. Defence	2					
3. Public order and safety	3	1,9	1,9	1,8	1,7	1,6
4. Economic affairs	4	3,9	3,8	4,0	3,8	3,5
5. Environmental protection	5					
6. Housing and community amenities	6	0,5	0,5	0,5	0,4	0,4
7. Health	7	4,5	4,3	4,2	3,9	3,7
8. Recreation, culture and religion	8	0,3	0,2	0,2	0,2	0,2
9. Education	9	3,1	3,0	2,9	2,7	2,6
10. Social protection	10	8,7	8,4	7,9	7,4	6,9
11. Total expenditure (item 7 = 23 in Table 2)	TE	25,6	24,8	24,1	22,7	21,3

Republic of Srpska

Level	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	430,2	465,5	474,8	377,8	364,5
2. Defence	2	5,7	6,7	0,0	0,0	0,0
3. Public order and safety	3	269,7	281,2	269,0	312,4	308,1
4. Economic affairs	4	502,7	526,2	522,8	518,7	509,1
5. Environmental protection	5	11,6	11,5	10,8	10,3	9,9
6. Housing and community amenities	6	64,7	53,2	49,0	59,1	57,6
7. Health	7	605,6	692,3	722,8	672,2	661,1
8. Recreation, culture and religion	8	62,8	60,1	58,1	62,2	61,0
9. Education	9	442,8	448,5	440,5	455,5	448,8
10. Social protection	10	1.171,6	1.276,3	1.281,1	1.268,1	1.249,0
11. Total expenditure (item 7 = 23 in Table 2)	TE	3.567,5	3.821,5	3.828,9	3.736,3	3.669,1

%GDP	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	1,5	1,6	1,6	1,2	1,1
2. Defence	2	0,0	0,0	0,0	0,0	0,0
3. Public order and safety	3	1,0	1,0	0,9	1,0	0,9
4. Economic affairs	4	1,8	1,8	1,7	1,6	1,5
5. Environmental protection	5	0,0	0,0	0,0	0,0	0,0
6. Housing and community amenities	6	0,2	0,2	0,2	0,2	0,2
7. Health	7	2,2	2,4	2,4	2,1	2,0
8. Recreation, culture and religion	8	0,2	0,2	0,2	0,2	0,2
9. Education	9	1,6	1,6	1,5	1,4	1,3
10. Social protection	10	4,2	4,4	4,3	4,0	3,7
11. Total expenditure (item 7 = 23 in Table 2)	TE	12,7	13,3	12,8	11,8	10,9

Brčko District

Level	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	83,4	74,5	87,1	72,5	70,0
2. Defence	2					
3. Public order and safety	3	13,9	13,5	16,3	15,8	16,2
4. Economic affairs	4					
5. Environmental protection	5					
6. Housing and community amenities	6	3,9	9,0	4,5	4,1	3,9
7. Health	7	15,2	9,0	7,0	6,9	11,0
8. Recreation, culture and religion	8	13,7	13,0		12,8	13,0
9. Education	9	34,2	33,0	35,8	35,8	36,4
10. Social protection	10	35,2	34,0	35,8	39,7	39,7
11. Total expenditure (item 7 = 23 in Table 2)	TE	199,5	186,0	186,5	187,6	190,2

%GDP	COFOG Code	2013	2014	2015	2016	2017
1. General public services	1	0,3	0,3	0,3	0,2	0,2
2. Defence	2					
3. Public order and safety	3	0,0	0,0	0,1	0,0	0,0
4. Economic affairs	4					
5. Environmental protection	5					
6. Housing and community amenities	6	0,0	0,0	0,0	0,0	0,0
7. Health	7	0,1	0,0	0,0	0,0	0,0
8. Recreation, culture and religion	8	0,0	0,0	0,0	0,0	0,0
9. Education	9	0,1	0,1	0,1	0,1	0,1
10. Social protection	10	0,1	0,1	0,1	0,1	0,1
11. Total expenditure (item 7 = 23 in Table 2)	TE	0,7	0,6	0,6	0,6	0,6

Table 4: General government debt developments

% of GDP	ESA code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Gross debt ⁵⁰		33,9	36,9	35,0	32,1	27,8
2. Change in gross debt ratio		-3,5	3,0	-1,9	-2,9	-4,3
Contributions to change in gross debt						
3. Primary balance ⁵¹		-0,8	-1,0	-0,8	-0,7	0,2
4. Interest expenditure ⁵²	EDP D.41	0,6	0,8	0,9	0,9	0,8
5. Stock-flow adjustment		-4,9	1,1	-3,6	-4,5	-4,9
<i>of which:</i> - Differences between cash and accruals - Net accumulation of financial assets						
<i>of which:</i> - Privatisation proceeds - Valuation effects and other						
p.m. implicit interest rate on debt ⁵³		1,8	2,4	2,5	2,6	2,7
Other relevant variables						
6. Liquid financial assets						
7. Net financial debt (7 = 1 - 6)						

⁵⁰ As defined in Regulation 3605/93 (not an ESA concept).

⁵¹ Cf. item 10 in Table 2.

⁵² Cf. item 9 in Table 2.

⁵³ Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

Table 5: Cyclical developments

% of GDP	ESA Code	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. Real GDP growth (% , yoy)	B1g	0,7	1,1	3,4	4,0	4,4
2. Net lending of general government	EDP.B.9	-1,5	-1,8	-1,7	-1,6	-0,6
3. Interest expenditure	EDP.D.41	0,6	0,8	0,9	0,9	0,8
4. One-off and other temporary measures		:	:	:	:	:
5. Potential GDP growth (% , yoy)		:	:	:	:	:
Contributions:						
- labour		:	:	:	:	:
- capital		:	:	:	:	:
- total factor productivity		:	:	:	:	:
6. Output gap		:	:	:	:	:
7. Cyclical budgetary component		:	:	:	:	:
8. Cyclically-adjusted balance (2-7)		:	:	:	:	:
9. Cyclically-adjusted primary balance (8+3)		:	:	:	:	:
10. Structural balance (8-4)		:	:	:	:	:

Table 6: Divergence from previous programme

	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
1. GDP growth (% , yoy)					
Previous programme	1,5	2,3	2,8	3,5	:
Latest update	0,7	1,1	3,4	4,0	4,4
Difference (percentage points)	-0,8	-1,3	0,6	0,6	:
2. General government net lending (% of GDP)					
Previous programme	-1,0	-1,6	-2,0	-0,6	:
Latest update	-1,5	-1,8	-1,7	-1,6	-0,6
Difference	-0,5	-0,2	0,3	-1,0	:
3. General government gross debt (% of GDP)					
Previous programme	37,0	37,6	34,7	30,7	:
Latest update	33,9	36,9	35,0	32,1	27,8
Difference	-3,1	-0,7	0,3	1,4	:

Table 7: Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure							
of which:							
- Age-related expenditures							
- Pension expenditure							
- Social security pension							
- Old-age and early pensions							
- Other pensions (disability, survivors)							
- Occupational pensions (if in general government)							
- Health care							
- Long-term care (this was earlier included in the health care)							
Education expenditure							
Other age-related expenditures							
Interest expenditure							
Total revenues							
of which: property income							
of which: from pensions contributions (or social contributions, if appropriate)							
Pension reserve fund assets							
of which: consolidated public pension fund assets (assets other than government liabilities)							
Assumptions (%)							
Labour productivity growth	:	1,8	:	:	:	:	:
Real GDP growth	:	-0,191	:	:	:	:	:
Participation rate males (aged 20-64)	73,5	72,9	:	:	:	:	:
Participation rates females (aged 20-64)	41,1	44,2	:	:	:	:	:
Total participation rates (20-64)	52,2	54	:	:	:	:	:
Unemployment rate	29	27,2	:	:	:	:	:
Population aged 65+ over total population	14,8	15,8	:	:	:	:	:

Note: Projections for the part on assumptions for the period 2020-2060 are not available.

Table 7a: Contingent liabilities

% of GDP	Year 2014	Year 2015
Public guarantees	1,5	:
<i>Of which: linked to the financial sector</i>	:	:

Table 8: Basic assumptions on the external economic environment underlying the programme framework

	Dimension	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017
Short-term interest rate	Annual average	0,2	0,2	0,1	0,1	:
Long-term interest rate	Annual average	2,9	2	1,8	2,1	:
USD/EUR exchange rate	Annual average	1,33	1,36	1,34	1,34	:
Nominal effective exchange rate	Annual average	3,8	0,5	-2,8	0	:
Exchange rate vis-à-vis the EUR	Annual average	1,96	1,96	1,96	1,96	1,96
Global GDP growth, excluding EU	Annual average	3,7	3,6	4	4,2	:
EU GDP growth	Annual average	0	1,3	1,5	2	:
Growth of relevant foreign markets	Annual average	:	:	:	:	:
World import volumes, excluding EU	Annual average	3,4	2,7	3,9	5,2	:
Oil prices (Brent, USD/barrel)	Annual average	108,8	101,2	85,6	88,5	:

Source: for EU GDP, DG ECFIN Forecast Autumn 2014, Publication ECB staff macroeconomic projections for the euro area, December, 2014.

Table 9: Matrix of policy commitments

Federation BiH

Description of policy	2014.	2015.	2016.	2017.
Policy measures				
<i>New Law on Games of Chance</i>				
A. Implementation profile*		X		
B. Net direct budgetary impact (if any) – in mil. KM		15	15	
B.1. Direct impact on budgetary revenue – in mil. KM		15	15	
B.2. Direct impact on budgetary expenditure – in mil. KM		0	0	
<i>New Corporate Income Tax Law</i>				
A. Implementation profile*		X		
B. Net direct budgetary impact (if any) – in mil. KM		0		
B.1. Direct impact on budgetary revenue – in mil. KM		0		
B.2. Direct impact on budgetary expenditure – in mil. KM		0		
<i>Law on Amendments to the Law on Fiscal Systems</i>				
A. Implementation profile*		X		
B. Net direct budgetary impact (if any) – in mil. KM		0	20	5
B.1. Direct impact on budgetary revenue – in mil. KM		0	20	5
B.2. Direct impact on budgetary expenditure – in mil. KM		0	0	0
<i>Law on Amendments to the Law on the Amount of the Default Interest Rate</i>				
A. Implementation profile*	X			
B. Net direct budgetary impact (if any) – in mil. KM	45	15		
B.1. Direct impact on budgetary revenue – in mil. KM	45	15		
B.2. Direct impact on budgetary expenditure – in mil. KM	0	0		
<i>Law on Amendments to the Law on Personal Income Tax</i>				
A. Implementation profile*			X	
B. Net direct budgetary impact (if any) – in mil. KM			0	
B.1. Direct impact on budgetary revenue – in mil. KM			0	
B.2. Direct impact on budgetary expenditure – in mil. KM			0	
<i>Law on Amendments to the Law on Tax Administration FBiH/New Law on Tax Administration FBiH</i>				
A. Implementation profile*			X	
B. Net direct budgetary impact (if any) – in mil. KM				64
B.1. Direct impact on budgetary revenue – in mil. KM				64
B.2. Direct impact on budgetary expenditure – in mil. KM				0
<i>New Law on Allocation of Public Revenues in the Federation BiH</i>				
A. Implementation profile*				X
B. Net direct budgetary impact (if any) – in mil. KM				0
B.1. Direct impact on budgetary revenue – in mil. KM				0
B.2. Direct impact on budgetary expenditure – in mil. KM				0
<i>Total net budgetary impact</i>				
Total impact on budgetary revenue	45	30	35	64
Total impact on budgetary expenditure	0	0	0	0

* indicate start and, if needed, end with an “X” mark

Description of policy		Year 2014	Year 2015	Year 2016	Year 2017
1. Tax arrears					
A.	Implementation profile*	Based on the approved rescheduling of tax arrears, collection of KM 50.0 million is planned in position Other taxes.			
B.	Net direct budgetary impact (if any)	0,0	50,0		
B.1	Direct impact on budgetary revenue	0,0	50,0	X	X
B.2	Direct impact on budgetary expenditure	0,0	0,0	X	X
2. Savings on group of expenses - Social protection transfers paid from the budget of Republika Srpska					
A.	Implementation profile*	Savings on the group of expenses – Social protection transfers paid from the budget of Republika Srpska are a result, in addition to smaller redistribution of funds within this group of expenses, mostly of unplanned funds for the project Capital transfers for housing accommodation for families of fallen veterans and DWV from first to fourth category, which was completed in 2014.			
B.	Net direct budgetary impact (if any)	0,0	8,6		
B.1	Direct impact on budgetary revenue	0,0	0,0	X	X
B.2	Direct impact on budgetary expenditure	0,0	-8,6	X	X
3. Savings on the position – Transfers between budget units of different government levels					
A.	Implementation profile*	Transfers between budget units of different government levels were decreased by KM 6.0 mil. as a result of reduced transfer to Health Insurance Fund in the amount of KM 11.5 mil. and increase in transfer to Pension-Disability Fund by KM 5.0 mil., as well as increased transfer to local self-government units within Public investments in the amount of KM 1.4 million.			
B.	Net direct budgetary impact (if any)	0,0	6,0		
B.1	Direct impact on budgetary revenue	0,0	0,0	X	X
B.2	Direct impact on budgetary expenditure	0,0	-6,0	X	X
4. Savings on the position - Transfers between budget units of the same government levels					
A.	Implementation profile*	Transfers between budget units of the same government levels were decreased by KM 16.2 mil. The main reason is that Budget for 2015 did not include funds on the position Transfer to Solidarity Fund for Rehabilitation of Republika Srpska, which was planned in the amount in KM 18.0 million in the 2014 Budget revision.			
B.	Net direct budgetary impact (if any)	0,0	16,2		
B.1	Direct impact on budgetary revenue	0,0	0,0	X	X
B.2	Direct impact on budgetary expenditure	0,0	-16,2	X	X
5. Savings on the position – Outlays for non-financial assets					
A.	Implementation profile*	Savings on the position Outlays for non-financial assets amount to KM 63.3 million. Planned decrease is a result of implementation of projects for which funding was allocated by revision of Budget for 2014; hence they are not planned in 2015.			
B.	Net direct budgetary impact (if any)	0,0	63,3		
B.1	Direct impact on budgetary revenue	0,0	0,0	X	X
B.2	Direct impact on budgetary expenditure	0,0	-63,3	X	X
Total net budgetary impact					
	Total impact on budgetary revenue	0,0	50,0		
	Total impact on budgetary expenditure	0,0	-94,1		

NATIONAL ECONOMIC REFORM PROGRAMME

PART II

(SECTORAL STRUCTURAL REFORMS TO PROMOTE COMPETITIVENESS AND GROWTH)

REPUBLIKA SRPSKA

1 INTRODUCTION

Republika Srpska has identified the key obstacles to growth in the coming period:

- Reduced economic activity caused by the floods that hit the region, and lack of foreign demand, which would, at the same time, cause rising unemployment;
- Low efficiency of the public sector and inspection bodies, increased needs for health sector financing, unprofitability of public companies and administrative barriers;
- Growth of public spending, lack of competitiveness and illiquidity of domestic economy, increase in non-performing loans in the banking sector and reduced investment opportunities;
- Problems for long-term sustainability of the pension and health systems, problems in improving social, family and child protection;
- The problem of withdrawal of the EU funds.

In this regard, the economic policy objectives of Republika Srpska that the Government of Republika Srpska is going to work on intensely through its measures in 2015 are:

- 1 Economic recovery and growth;
- 2 Public sector reform;
- 3 Fiscal consolidation;
- 4 Preservation of social security;
- 5 European path of Republika Srpska.

The main sectoral priorities of economic reforms: labour market, relief of economy, fight against crime and corruption, improvement of secondary and higher education, public investments, agricultural policy, efficient work of public sector, financial sector and European integrations.

Comparing measures foreseen in this Document and the guidelines in the European Commission's BiH Progress Report, we can state that the comments presented in the BiH Progress Report have been taken into account. Namely, the improvements have been planned in the areas pertaining to: judiciary, solution of the "Sejdic-Finci" issue without change of competencies, public administration reform, improvement of the education system efficiency and more efficient economy.

2 MACROECONOMIC CONTEXT AND SCENARIO

Projection of Republika Srpska's macroeconomic indicators for 2015 is based upon their trends in the previous period, the assumptions on economic growth of the main foreign trade partners, the adopted and planned Government policies, macroeconomic forecasts of the international financial institutions, and objectives and policies of the Government of Republika Srpska for 2015.

Estimates of macroeconomic indicators for 2014 and 2014 are mindful. In 2014, it is foreseen that GDP will be positive and reach 0.1%. In 2015, we expect recovery of economic activity and GDP growth of 1.9%, which will be mainly contributed by increased exports through rise of foreign demand, due to recovery in the main foreign trade partners of Republika Srpska, and significant investments.

In accordance with the projected growth of economic activity, we expect positive growth in the labour market and decrease in the unemployment rate by 0.3 percentage points, so the unemployment rate in 2015 will reach 25.4%. The average salary is expected to increase by 1.5%.

Although, after a period of decline, prices of food in the global market have stabilised, deflationary pressures still persist, so the negative inflation rate of -1.1% is projected for 2014. Mild inflation of 0.7% is expected in 2015.

3 SECTORAL REFORM MEASURES BEING IMPLEMENTED AND PLANNED TO ACHIEVE ECONOMIC POLICY OBJECTIVES 2014-17

Economic reform concerning economic recovery and growth includes objectives pertaining to: achieving positive economic growth, improving competitiveness and liquidity of the economy and increasing the number of the employed persons.

Implementation of these objectives will be performed by relieving the economy, creating more favourable business environment, and reforming the labour market, thus enabling increased employment and greater economic growth. Key reforms and measures that will be undertaken are:

3.1 Measures for economic recovery, economic growth and competitiveness

Stimulating tax policy, disburdening and improving liquidity of economy

Within the framework of support to economy in 2015, we will maintain stimulative tax policy, i.e. the lowest tax rates in the domain of direct taxation of property and income of citizens and business entities. As stated in the part of structural reforms related to business environment and labour market, in 2015 we plan to conduct a comprehensive analysis of the tax system and participation of tax income in GDP, with the assistance of the experts of the European Commission, the World Bank and the International Monetary Fund in this process, in order to create the optimum tax burden. There is a commitment to carry out additional disburdening of the economy, primarily through reducing the obligations for labour of newly employed fixed-term workers. We expect this will motivate companies to hire new employees and therefore affect the reduction of the number of unemployed persons in Republika Srpska.

In addition, we will implement a number of measures in 2015 to facilitate setting up of "optimum tax burden" and pursue stimulating measures to increase competitiveness of business entities, starting with abolishing or reducing certain types of "parafiscal levies" to improving the liquidity of economy through implementation of multilateral compensations and cessions. Amending the Law on Value Added Tax will also be initiated, in order to extend deadlines for VAT payments and possible changing of the VAT rate, depending on the findings of the tax system analyses.

Investment activities in areas of energy sector, transport infrastructure and capital investments in health sector

With regards to new economic growth policies, the main driver will be the investment activities in the economy. Energy sector will continue to be one of the key levers of economic development of Republika Srpska. Construction of TPP Stanari, and the planned construction of TPP Ugljevik 3 currently represent the highest investments in the region. Implementation of the already started projects in the field of hydro-energy such as construction of HPP Mrsovo, HPP Dabar, HPP Ulog, and HPP Bocac 2 will be continued. In 2015 alone, we can realistically expect completion of construction of about 12 small hydro power plants and beginning of construction of at least 10 more. In the domain of other renewable energy sources, the first windfarm in Republika Srpska – Windfarm Trusina will be put into operation in the coming period.

In the field of transport infrastructure, along with the constructed highway Banja Luka – Gradiska, construction of highway Banja Luka – Doboj will be finalised too. These are the two priority routes

within the project "Building a road network in Republika Srpska" linking us with the European corridors, i.e. with the west and south-east of Europe. Our objective remains building a bridge on the Sava River close to Gradiska but this project depends on Croatia, namely its withdrawal of the EU funds. In addition, we will work on construction of the highway on Corridor Vc as one of the most important projects of transport infrastructure in the South-East Europe.

Within the framework of the key capital investments in the health sector, we will continue the project of reconstructing and equipping of the University Hospital of the Clinical Centre Banja Luka and secure funds for implementation of the projects of building hospitals in Doboј and Istocno Sarajevo, as well as reconstruction and rehabilitation of hospitals in Zvornik, Prijedor and Trebinje. These projects will bring a series of positive effects in terms of opening new jobs, hiring local labour force, construction operations and supporting activities, as well as filling the budgetary and extra budgetary funds.

Labour market reform and improving economic and social position of workers

With regards to labour market reforms, legal framework providing for labour issues will be reformed and innovated. The new Law on Civil Servants and the Law on Labour will be prepared so as to achieve higher efficiency and accountability of administration, as well as higher labour market flexibility, which will significantly increase labour productivity in all areas.

We will fight for every job through programmes of support to business or more creative employment programmes, so that the funds allocated for this purpose have a clear and precise objective and results of support achieve measurable results.

We will work on increasing the lowest price of labour so as to improve economic and social position of workers.

For the purpose of determining the real labour force supply in the labour market, we will provide for records of the unemployed persons, registered in the Employment Institute of Republika Srpska only because of health insurance, to be kept in the Health Insurance Fund, since they do not make active supply of labour force.

Sectoral policy development, particularly in the field of agriculture

Within sectoral policies, agriculture will take top priority and serve the economic development function, due to the opportunity to utilise available natural resources of Republika Srpska through agricultural production in the fastest and most efficient way, to create new value and raw material base for development of industry and other branches of economy, but also because development of agriculture contributes to rural development.

Systemic support to development of agriculture and rural development will be continued through reorganisation and strengthening of the agrarian system institutions of Republika Srpska and regulation reforms. All actors in the agricultural sector have to be connected to the unified agrarian system comprising public, business and civil sector. Family agricultural farms will develop as manufacturing, i.e. agricultural business units. With regards to support to these farms, social policy will be separated from the development one, so that farms producing and placing their products in the market, i.e. commercial holdings will be supported more strongly than the other ones that will be supported through rural development policy, social policy and other policies.

In the course of 2015, in line with the future RS Plan of Agricultural and Rural Development 2015-2020, we will define a multi-annual budget framework for implementation of financial incentives to agrarian and rural development through passing the Law on Incentives, which will set up the main

directions for streamlining the funding support. In order to stimulate development of agriculture and rural areas, incentives to agriculture and rural development will be focused on encouraging market-oriented primary agricultural production and processing of agricultural raw materials, so as to ensure positive effects and economic growth.

3.2 Public sector reform

Public sector reform includes measures related to: efficient public administration and local self-governance, profitable public companies, consolidated health care sector, sound financial sector, efficient judicial sector and quality education.

Reform of Government and the RS administration

The objective is reforming the Government and the RS administration and better positioning of departments so as to react more efficiently and faster in individual fields. Thereby, resources in public sector will be better allocated, non-functional agencies and administrative organisation will be abolished, while, at the same time, departments of the Government that are more directly linked to its priority actions will be formed. In connection to the above, public administration costs will be cut down, and efficient and professional administration will be set up to serve citizens and economy. Related to this, jobs in civil service structures will be analysed and classified, standardised terms of references will be devised for every work place, and systematisation of jobs will be aligned with it, capacities of human resources management in all bodies will be strengthened, work process will be modernised, accountability of the RS administration employees will be strengthened, and work of administrative inspection will be improved.

Local self-governance reform

In 2015, preparation of a new strategic development document will commence, which will define the directions of local self-governance development in Republika Srpska in the period 2016-2020. The vision of the development will include setting up of multi-type local self-government concept, examining possibilities for further functional decentralisation, developing a mechanism for inter-municipality cooperation, and strengthening the role of local communities in the local self-governance. A comprehensive analysis of the territorial organisation of RS will be conducted, particularly with consideration of the results of the census of population, households and dwellings from 2013 and the initiative for establishing new local self-government units.

Reform of public companies

Reform of public companies is aiming at establishing profitable companies, with full accountability of management authorities for the achieved results. Savings achieved by reducing the number of employees to the optimum level and equalising wages with the wages of public administration employees will open window for additional investments and more efficient and profitable business operations. The objective is efficient management and business operations of public companies, in order to make profit, which would be put into function of development of economy and RS.

Reform of health care sector

By reforming the health care sector, far stronger system of accountability will be established in every health care institution, where each founder and manager of the institution bears full responsibility for its operations without diminishing the quality of services for insured users. Moreover, we will start a reform of the network of primary health care institutions.

In 2015, the objective is to introduce a treasury operations system in the health care sector in order to facilitate better control of spending. Hospital sector will be introduced into the treasury system through the line ministry while the health care centres will be connected through the local self-government units, so that each level of government assumes full responsibility for fiscal sustainability of the system it runs.

Furthermore, in 2015, the reform of the Health Insurance Fund will also be carried out, as well as restructuring of its liabilities and ways sought for additional savings.

A detailed analysis of liabilities of the health care institutions will be carried out, their loan commitments will be restructured and due liabilities rescheduled where possible, the number of employed health care workers and associates will be harmonised with the standards and norms in health care services, effects of work and reported needs, the number of non-medical staff members will be harmonised, control and management of costs will be enhanced, measures of saving and rationalisation will be implemented in all health care institutions at all levels.

In order to provide additional funds for financing health protection, the Government of Republika Srpska supported setting aside a portion of funds from excise duties on tobacco and alcohol for this purpose, as harmful products that multiply the health insurance risks, and it will persist on this in 2015. Passing this legal provision is the authority of the BiH common institutions. At the same time, we will insist on increasing the coverage of population with compulsory health insurance, primarily through connecting the payment of subsidies in agriculture with payments of contributions.

Reform of financial sector

Within the financial sector reform, we will consider unifying the financial sector supervision with a view of more efficient control of one supervisory body as opposed to the current three bodies in the overall financial sector, as well as work on improving the regulations.

A new Law on Banks will be prepared based on the recommendations of the Basel Committee and international financial institutions, and the EU Directives. In the process of drafting of regulations, particular attention will be paid to: risk management in banking operations, strengthening of the control function of the Banking Agency, with the emphasis on development of a special regime of systemic and consolidated supervision.

In order to resolve bad assets, the activities will be undertaken to create legal assumptions for restructuring of non-performing loans, and sale and transfer of claims based on loans to other legal entities.

The Committee for Coordination of Financial Sector Supervision of Republika Srpska will monitor situation in the banking system and other segments of financial sector, propose measures for preservation of its stability and undertake activities in a view of strengthening supervision over the financial sector participants as well as early detection of risks in the financial market, etc.

The activities will be continued on the adoption of amendments to the Law on Investment Funds, which will provide pre-requisites for transformation of the closed-end investment funds and affirmation of the investment fund industry in line with international practice.

The insurance sector will be further developed and regulations drafted for gradual liberalisation of prices in compulsory insurance schemes in transport. The Law on Insurance Companies will be amended so as to prescribe measures for more efficient supervision of free determination of premiums, and align minimum level of capital requirements with the EU directives. The activities will also be taken to raise awareness on the benefits of property insurance against natural disasters, as well as to analyse possibilities of encouraging the demand for this type of insurance in Republika Srpska.

In 2015, the Development Strategy of the Investment-Development Bank of Republika Srpska and Development Strategy of the Guarantee Fund of Republika Srpska will be defined, in order to position the aforementioned institutions more clearly as the main pillars of economic development of Republika Srpska.

Reforms in judicial system and fight against organised crime and corruption

Being dissatisfied with the work of judicial institutions at the level of BiH, and the way of their establishment, as well as the work of High Judicial and Prosecutorial Council, and respecting the fact that, under the Constitution of Republika Srpska, judicial authority is a complete whole whose organisation and powers are regulated by law, Republika Srpska participates in the Structured Dialogue on Justice based on the agreement reached between the highest representatives of the Government of Republika Srpska and the EU.

Within the Structural Dialogue, the Government of Republika Srpska will insist on redefining the place and the role of the BiH Court and Prosecutor's Office as well as the High Judicial and Prosecutorial Council in the forthcoming period too, paying particular attention of the constitutional structure and authorities of Republika Srpska. To this end, Republika Srpska will insist on reorganisation of the selection of prosecutors, taking into account the experiences of the neighbouring countries.

Republika Srpska has demonstrated a clear commitment to fighting organised crime and corruption by establishing the Special Prosecutor's Office, Task Force to Combat Organised Crime and Corruption, Agency for Seized Property Management, and by adopting the Anti-Corruption Strategy as well as implementing Action Plan. Thereby, Republika Srpska, in line with Chapters 23 and 24 of Stabilisation and Association Agreement and the need to strengthen the institutions dealing with fight against corruption, improved and rounded up its legal and institutional framework for fight against organised crime and corruption.

In order to establish and strengthen the rule of law in the coming period, fight against organised crime and corruption will play a primary role, through creating the assumptions for undisturbed work of prosecutor's office and all institutions in charge of fighting organised crime and corruption. The responsible institutions will be required to engage their full capacities to reduce the level of organised crime and corruption to the lowest possible level. The activities on prevention of the above mentioned criminal acts will also be undertaken as well as education of citizens on their damaging effects.

Reforms in the education sector

Education plays a key role in development of every society, and hence it will hold a special place in the work of the Government of Republika Srpska. It should be observed as a whole, so that only a comprehensive reform of the education system can achieve successful results. However, only the Government's engagement is not sufficient for such a reform, it should also include broader community.

With regards to pre-school education, the Government of Republika Srpska will continue allocating funds to include as many children in preparatory programme prior to school enrolment, and create pre-requisites for pre-school education to become a true part of a comprehensive education system.

Primary and secondary education present the most important period in the development of the child and young person and a basic preparation for further education and employment. Education process has to respond to the requirements of the time we live in. This is why objectives of education and upbringing have to be modernised, and adequate standards in education established, to make sure

that the acquired knowledge is applicable. As part of modernisation of the education process, we will continue implementing the projects for introducing information technology equipment in schools.

Continuous analysis of primary and secondary school curricula will be ensured so as to adjust them to the needs of the modern society and future students and workers, and accordingly provide for adequate number of subjects, volume of materials, as well as studied themes and areas.

For a successful higher education it is necessary to carry out a series of interventions in this area, but also to reform primary and secondary education. Higher education has to set goals on students in line with contemporary social trends, needs of the market and societal development, which also requires redefining of the role of a professor, as well as the studying itself that has to prepare students for successful work on the one hand and encourage them to continuously learn and develop individually, on the other hand.

These objectives will be implemented, inter alia, by passing a new Law on Higher Education, which will bring our higher education closer to the European one and return it on track of successful and proven values. The Law will enhance the autonomy of higher education institutions but also increase social responsibility of all actors in higher education as well as closer explain and improve the solutions in terms of course of studies and transfer of ECTS credits, management of higher education institutions and status of academic faculty, licensing of study programmes, carrying out of doctoral studies and election to academic titles. Higher education quality assurance will be encouraged, such as development of criteria for ranking of higher education institutions in RS.

3.3 Fiscal consolidation

Fiscal consolidation includes measures relating to: cuts in public spending, improvements in collection of public revenues and more efficient work of control bodies.

By adopting the Law on Fiscal Responsibility and a new Law on Financial Management and Public Sector Control, **control of public spending will be strengthened**. This will prevent budget users to make commitments above the level of funds allocated from the budget, and introduce greater transparency and accountability in spending public funds, in order to achieve further fiscal strengthening of the overall budget system of Republika Srpska.

Furthermore, as part of the process of public finance management, the introduction of programme budgeting in the coming mid-term period will create assumptions for additional savings.

Trainings for the budget users will be continued with the technical assistance of the EU Project Team in order to connect budget programmes and strategic documents of the ministries more clearly so that public funds are used to implement the objectives with measurable results and to identify responsibility for implementation or non-implementation of the set objectives more clearly, as well as accountability for the spent public funds.

New borrowing policy will clearly define priorities for financing from loans, i.e. borrowing of Republika Srpska. The key criterion in defining the priority areas will be the impact of the said institutions on economic growth of Republika Srpska and additional employment. This way, it is possible to withdraw from some projects that we estimate at this moment not to bring the effects that we initially expected, or are not profitable enough.

For the purpose of establishing less expensive but efficient and productive public administration, all the public sector institutions will be required to **optimise the number of employees**. Thereby, through the achieved savings, we will cut down the necessary outlays for employees' wages, reduce potential indebtedness, create space for rewarding the best workers, stimulate employees to be more productive and, at the same time, release funds that can be used for additional investments or

support to the economy. Within the shortest possible period, we will define measures for rationalisation of public administration, including the employment freeze, payroll restrictions, reduction of the number of employees by non-hiring new employers after retirement of those who fulfilled the retirement conditions, etc.

By implementing the Law on Tax Procedure of Republika Srpska, particular attention of the competent authority will be devoted to the **activities of regular and enforced collection of all public revenues**, since implementation of enforced collection is not at the required level, as well as activities of indirect method of establishing tax base and "related controls" as insufficiently exploited so far, but may be a significant lever in filling the budget and extra budgetary funds as well as keeping the illegal activities in Republika Srpska down. Amendments to the Law on Tax Procedure will commit the Tax Administration, along with control of payments of taxes and contributions, to control the method of their calculation so as to avoid taxes and contributions being paid only for the lowest salary amount.

Fight against "Gray economy" will be one of the priorities. Programme for control of gray economy will be passed so as to impact reduction of the share of informal economy in the total gross domestic product and to contribute to better filling of the budget and extra budgetary funds and reducing unfair competition and unequal business conditions. Thereby, all the active measures to prevent unregistered labour will be undertaken too.

For more effective work of the Republika Srpska's Inspectorate, a new Law on Inspections will be passed and, as needed, other laws amended as well so as to create conditions for control performed by inspectors to be efficient.

3.4 Preservation and social security

With regards to the field of pension and disability insurance, after the adoption of a new Law, the situation has been gradually improving but it is still not satisfactory. Positive trends are noted in the structure of pensions since the percentage of old-age pension beneficiaries has been increasing as opposed to a decreasing number of disability pensioners, the number of recognised rights in a year has been decreasing, particularly as to the number of disability pensions, and the effective age of old-age pension beneficiaries on the day of exercising their rights has been gradually increasing. Material position of pensioners has been gradually improving, but not sufficiently. Although the previous reforms had positive effects in terms of deceleration of growth of the rights beneficiaries, the pension system is still vulnerable, since the most important indicator of the system, i.e. ratio of the number of insured persons and the number of beneficiaries of the rights is still not satisfactory, primarily as a consequence of demographic trends and informal economy and unregistered work. Positive effects are expected through disburdening of the economy to ease doing business of enterprises and thereby providing for their more regular payments of this obligation. Regular payment of pensions will be ensured in the coming period as well, and the Government will make further efforts to increase them.

With regards to veteran's-disability protection and protection of civilian victims of war, we will provide for regular payments of personal and survivors' disability pensions and other benefits pursuant to the law, and, in accordance with available funds, provide for increase of base for calculation of personal and survivors' disability pensions.

In order to finalise the Programme of providing permanent accommodation for families of fallen veterans and disabled war veterans from the first to the fourth category, which provides housing accommodation for 5,606 families, in the first half of 2015 we will finalise their accommodation with the delivery of their housing units. Afterwards, in accordance with our financial possibilities, and

agreement with these categories, we will continue the activities of their accommodation. This includes all those who were not covered by this Programme but meet the required conditions.

3.5 European path of Republika Srpska

The European path remains the commitment of the new Government of Republika Srpska and it will continue developing its institutional and human capacities to carry out its European obligations and to gradually align its legislation with the European Union's *acquis*.

European integrations include measures relating to: establishing a coordination mechanism in line with the constitutional capacities, tackling the issue of the "Sejdic – Fini" ruling without alterations of authorities, and improving regional cooperation.

The Government of Republika Srpska will, in the shortest possible period, develop an Action Plan for implementation of all the aforementioned measures and determine the dynamics for implementation of all activities through individual areas.

4 INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT

Document National Economic Reform Programme was prepared on the basis of the 2015 Economic Policy of Republika Srpska. All the ministries and institutions of Republika Srpska participate in preparation of the Economic Policy, in accordance with their line competencies, as well as acceptable policies and suggestions of social partners and all relevant institutions in Republika Srpska.

FEDERATION OF BOSNIA AND HERZEGOVINA

2 MACROECONOMIC CONTEXT

Trends of macroeconomic indicators of the Federation BiH in the previous period, macroeconomic projections of international financial institutions, economic growth of our main foreign trade partners, and objectives and policies of the Government of the Federation BiH represent a basis for development of macroeconomic projections.

In accordance with improvement of the situation in our neighbourhood, it is expected that in 2014 the economy of the Federation BiH will record a modest economic growth of 1.1%. With the assumption of slight strengthening of the export demand, there should be a modest real exports growth and consequently a mild increase in the employment, available household income, as well as real growth in private consumption. Only as by 2015, a more serious expansion of investments and economic activities is expected in the Federation BiH.

In the period 2016-2017, further gradual increase of economic growth is expected, mostly as a consequence of positive developments in the neighbourhood. The expected economic growth in the Federation BiH is expected to reach 4% in 2016, i.e. 4.4% in 2017, as a result of gradual strengthening of exports and real sector, as well as domestic demand. It is expected that real GDP growth in 2014 will amount to 0.9%, with further increase by 2.2% in 2015, 3.5% in 2016 and 4.2% in 2017. Public investments should become more important with the assumption of increasing access to funds of the international creditors. In this period, the Federation of BiH is expected to see the recovery of industrial production and strengthening of the energy sector.

The projected growth of economic activity will cause the continuation of positive developments in the labour market and reduction of the unemployment rate by about 0.3%, with a 1.5% rise in

average monthly salaries in the real sector, whereas the average wages in public sector will not change.

Prices of basic foodstuffs, energy products and transport could lower down, which will mainly depend on the prices of oil in the global market but, based on the current situation with the price of oil reaching the level of 60 dollars per barrel and the downward tendency, it is expected that the prices will fall further down.

Negative inflation rate of -0.7% in 2014 will extend to the first half of 2015 whereas, in the following years only a slight rise is expected of up to a maximum 1.2% in 2017.

3 SECTORAL REFORM MEASURES BEING IMPLEMENTED AND PLANNED TO ACHIEVE ECONOMIC POLICY OBJECTIVES 2014-17

Economic reform concerning economic recovery and growth includes objectives pertaining to: increased volume of industrial production, increased number of new employments, increased productivity, growth of exports, improved competitiveness and efficient use of natural resources and environmental protection.

3.1 Measures for economic recovery, growth and competitiveness

3.1.1 *Stimulating tax policy, disburdening and improving liquidity of economy*

- **Law on Companies ("Official Gazette of the Federation BiH", No. 75/13)**

Reasons for passing this Law lay in the need to create pre-requisites for improvement of the business environment that would allow easier establishment and operations of companies, define more clearly the roles and responsibilities of management structures in companies, as well as to improve and specify provisions related to establishment and functioning of the affiliated companies.

In the segment of business registration and start-up, Bosnia and Herzegovina, namely the Federation of Bosnia and Herzegovina, is amongst the lowest ranked countries in all surveys and indices on ease and costs of starting a business. In the World Bank's "Doing Business Report" Bosnia and Herzegovina has been ranked 162nd for two consecutive years, the second-last among the economies of the South-East Europe. The process of registration of a business entity into the Company Registry in the Federation of Bosnia and Herzegovina brings costs to the business sector of an average KM 3 million. Therefore, increasingly fewer foreign investors decide to start a business in the Federation of Bosnia and Herzegovina, due to a complicated process and unclear procedures.

In the field of corporate governance, the applicable legal framework foresees bicameral governance, i.e. separation between the supervisory board and the management. Despite certain developments and changes in the methods of governance in the neighbourhood, the Federation of Bosnia and Herzegovina should, with its bicameral system, according to recommendations of the Report on Regulatory Impact Assessment, in accordance with the continental-European standard type of governance, consider the need of clear division between strategic governance and supervision (supervisory board) and the management of the company. In this connection, it was necessary to upgrade the solutions contained within this Law.

Local authorities, in accordance with Articles 70 and 87 of the Stabilisation and Association Agreement with the EU, shall establish cooperation to ensure gradual harmonisation of the existing laws and future legislation with the EU *acquis*, as well as facilitate the implementation of economic reforms in order to strengthen its economy, business environment and economic policies. The objective is, *inter alia*, to enable free and easy start-up and registration of companies, to reinforce

efficiency and competitiveness of companies, to strengthen cross-border cooperation and to modernise legislation, principles of registration, doing business, and corporate governance.

- **Law on Financial Consolidation of Companies in the Federation BiH ("Official Gazette of the Federation BiH", No. 52/14)**

A large number of companies with a greater or lesser share of the state-owned capital as well as companies with a 100% state-owned capital, are facing a number of problems, the most pronounced one being maintaining the liquidity of operations.

Financial consolidation of companies creates pre-requisites for participation in public tenders for performing works and delivering services in the market, realisation of credit funds, resolution of liabilities based on unpaid contributions for a number of workers for which contributions were not paid, elimination of danger of initiating the bankruptcy or liquidation proceedings, etc.

- **Programme of permanent revolving fund with the Union banka d.d. Sarajevo of the Federal Ministry of Energy, Mining and Industry for the long-term financing of projects through loans ("Official Gazette of the Federation BiH", No. 27/14, 91/14 and 106/14)**

The purpose of placing these loans is to support the implementation of the development projects of the companies, to improve competitiveness, enhance technological equipment, to set up and maintain a quality system, to increase productivity and increase employment.

The above mentioned funds are loans with a grace period of up to 12 months, annual interest rate of 0.9% and a loan processing fee of 0.6% - one time only.

Users shall repay the allocated funds in the minimum 24 equal monthly annuities, and the maximum 60 annuities, depending on the amount of the allocated funds. The terms related to starting date of repayment, the dynamics of repayment as well as other important elements of the loan shall be defined by the contract.

The allocated funds shall be paid exclusively on the Bank accounts of the loan users so as to facilitate the control of spending of the allocated funds of the Programme.

3.1.2 Investment activities in the energy generation sector of the Federation BiH

Investment activities in the energy generation sector of the Federation BiH will be the main driver of economic development in the Federation of Bosnia and Herzegovina. Projects of construction of the TPP Tuzla Block 7 - 450 MW (planned beginning of construction in 2015, while the deadline for completion and putting into operation is 2019), TPP Banovici Block 1 - 300 MW (planned beginning of construction in 2016 while the deadline for completion and putting into operation is 2019), TPP Kakanj Block 8 - 300 MW (possible deadline for construction by 2022), HTP Zenica with the installed capacity of 390 MW electric and 170 MW of heat energy for heating the town of Zenica (planned beginning of construction in 2015, and putting into operation in 2017) represent the highest investments in the region. Furthermore, the implementation of the initiated projects in terms of hydro-electricity has to be mentioned too, such as construction of HPP Vranduk - 1963 MW (beginning of construction in 2015 while the deadline for putting in operation is 2019), HPP Janjici - 13.3 MW (beginning of construction in 2017 while the deadline for completion and putting into operation is 2020) HPPS Vrilo - 62 MW (framework for construction by 2022). In the period 2015-2020, it is realistic to expect implementation of the project of construction of about 36 small hydro-power plant (of which 20 would be implemented by private investors) with the total installed capacity of around 53 MW. With regards to other renewable energy sources in the Federation of BiH, in the upcoming period we expect to see the implementation of the project of construction of WF Podvezje - 48 MW (beginning of construction in 2015 with the completion deadline in 2016) and WF Mesihovina - 55 MW (beginning of construction in 2015 with the completion deadline in 2016).

Furthermore, private sector initiated the construction of the following windfarms: WF Debelo Brdo - 54.6 MW, WF Gradina - 70 MW (first phase 26 + second phase 44), WF Orlovaca - 42 MW, WF Pakline 1 - 48 MW, WF Pakline 2 - 48 MW, WF Kupres 1 - 48 MW, WF Baljci - 48 MW, WF Jelovaca - 36 MW, WF Mucevaca - 60 MW and WF Ivovik - 84 MW. In addition, in 2014, private investors were issued 75 energy permits for construction of solar photovoltaic plants with the total installed capacity of approximately 15.7 MW, and the implementation of most of these projects is expected in 2015.

3.1.3 Labour market reform, improving economic and social position of workers and adjusting education to labour market needs

Given that the current education system does not meet the needs of the economy, as established in the adopted strategic documents, the initiative will be sent to the competent federal and cantonal institutions to set up a new network of vocational secondary schools for occupations identified by the businesses as needed. To this end, one of the initiatives will concern closer cooperation of the economy with the scientific and educational institutions.

3.1.4 Development of sectoral policies in the field of industry

Sector-based policies in the field of industry will be paid particular attention to, through implementing and monitoring the measures and activities from the action plans of the already adopted strategies, and through development of new policies for individual industrial branches.

Action Plan for implementation of the FBiH Strategy for Development of Industry of Textile, Clothing, Leather Goods and Footwear for the period 2013-2018 foresees preparation of guidelines for development of the basic production and manufacturing of joint products, since it does not exist at the territory of FBiH/BiH, which would release a great deal of domestic manufacturers from being dependant on imports.

In 2015 and namely in 2016, it is planned for the Government of FBiH, i.e. the Parliament of FBiH to adopt the Strategy for Development of the Wood-Processing Industry, the Strategy for Development of the Construction Material Industry and the Strategy for Development of Metal and Electrical Manufacturing Sector in the Federation of BiH.

3.2 Reform in the health care sector of the Federation BiH

Reform processes in the health care sector are based on the document "**Strategic Plan for Health Care Development in the Federation BiH in the period 2008 - 2018**". This Strategic Plan has established adequate general and specific strategic objectives in the field of health care. The goal of this document is to set forth strategic courses of the health care development in the Federation BiH over a ten-year period. The Strategy is a framework for development and improvement of the health care based on which operational plans would be created in accordance with financial capacities for implementation of the solutions presented in the Strategy.

This means that, in the period 2015-2017, the health care sector activities will be targeting the implementation of the five strategic objectives as follows:

- Strengthening mechanisms necessary for the establishment of efficient and informed health care management and improvement of the health care system management;
- Making legislative framework more efficient by aligning it with the reform objectives of the Federation BiH and the EU regulations;
- Strengthening primary, specialist-consultative and hospital health care;
- Strengthening the role of public health; and
- Improving the pharmaceutical sector, area of chemicals and biocides.

Summary of priorities for each planned year can be represented through the established operational objectives with indications of the expected result for each year. Hence, an operational objective was defined for each strategic objective in the stated period in the following way:

- Improving efficiency of cooperation between participants in the health care sector;
- Enhancing the number of documents and regulations in the health care aligned with the reform objectives of the Federation BiH and the EU regulations;
- Improving access to quality and safe health care services;
- Ensuring and strengthening the implementation of the basic public health care functions so as to facilitate promotion of health and prevention of diseases;
- Increasing the access to efficient, safe, high- quality and cost-efficient medicines; and
- Improving regulations pertaining to chemicals and biocides.

By foregrounding the improvement of health status of population through comprehensive, accessible, high-quality and efficient health care system based on sustainability and solidarity at the whole territory of the Federation BiH, the activities of the Federal Ministry of Health in the period 2015-2017, through various programmes and their following activities as defined in accordance with the aforementioned objectives, will be, in brief, focused on:

- Sound management of the health care system, which is possible only in the conditions of stable and financially sustainable health care system;
- Sound financing of the health services;
- Adequate distribution of financial resources and system of payment to service providers within the authorities of cantons, with particular focus on the implementation of the Federal decisions on the basic health care rights package, and finding new sources of funding for the health care sector;
- Better development and allocation of resources (human resources, education, information technologies);
- Provision of higher quality services (primary health care – with particular attention to improving access to family medicine services both to population in urban and rural areas; specialist health care, hospital health care, public health services, etc.) as well as extending the scope and type of health care services based on up-to-date medical achievements and state-of-the-art health care technologies;
- Equalisation of the right of insured patients to medicines and drugs in all cantons, as well as the list of drugs in the Federation BiH, financed from the funds of compulsory health insurance; and
- monitoring and evaluation of the implementation of positive decisions on drugs (List of drugs from compulsory health insurance; Hospital list of drugs; and the List of the Federal Solidarity Fund).

Health care system reforms in the Federation BiH certainly need to be going on in parallel to the necessary reforms in health care funding, which means that for better methods of health care funding we need better organisation of health insurance as well as new sources of financing in the health care sector, used on the principle of cost-effectiveness, clear division of work and planned development of health care sector. New approaches to health care funding are, by all means, the greatest challenge for the upcoming period. The activities of the Ministry will be focused on improving the health status of population through efficient, accessible and transparent health care system, based on the principles of solidarity and equity. It is necessary to ensure that health care services and information may be obtained when and where they are needed. Furthermore, we will seek ways to ensure purchase, development and use of services and facilities that require the highest possible standards and safety throughout the entire health care system.

There are four main levers of the health care system: sound management, health care services, resources and funding, and it is based on them that the activities for the coming period have been planned.

3.3 Investment activities in the field of road infrastructure and Sector for Planning and Projects

In the field of transport infrastructure, implementation of the project of construction of the highway in Corridor Vc has continued. After opening to traffic of the sections Tarcin – Zenica and Zvirovici (Medjugorje) – the south border with the Republic of Croatia, the continuation of construction of the section Pocitelj – Zvirovici, sections Zenica South – Zenica North and Svilaj – Odzak at the north of BiH has been planned in 2015.

The activities are either ongoing or already planned to prepare project documentation and other preparatory activities for implementation of the projects for the highway Zepce – Tuzla – Brcko – Orasje and the Adriatic – Ionian highway through BiH as well as high-speed roads Lasva - Donji Vakuf and Mostar – Grude (JJ AC – Split).

In the field of transport infrastructure, implementation of the projects of the construction of the highway in the Corridor Vc has continued.

After opening to traffic of the sections Tarcin – Zenica and Zvirovici (Medjugorje) – the south border with the Republic of Croatia, in 2015 the construction will be continued of the: sub-section Pocitelj – Zvirovici (European Investment Bank – EIB loan) in the amount of KM 203.9 million without VAT, whereas the amount planned for 2015 equals KM 42.9 million without VAT; section Zenica South – Zenica North; sub-section Drivusa – Klopce (KFAED- the Kuwait fund) with the contracted value of KM 56 million whereas the amount planned for 2015 is KM 18.9 million; sub-section Klopce–D.Gracanica (next to the tunnel Pecuj) (loan with OFID-OPEC Fund and other financial institutions) with the contracted amount of KM 193.9 million and the amount planned for 2015 equals KM 40.8 million; Svilaj – Odzak (European Investment Bank - EIB loan) (including the loop Odzak and access road to Odzak and GP Svilaj rest area) with the contracted value of KM 140,1 million without VAT whereas the plan for the first phase in 2015 amounts KM 44.6 million without VAT.

The activities are either ongoing or already planned to prepare project documentation and other preparatory activities for implementation of the projects for the highway: Zepce – Tuzla – preliminary design of the highway with access to Corridor Vc (own funds) with the contracted value of services of KM 2.5 million with VAT included and planned KM 1.276.450 in 2015; as well as high-speed roads: Nevic Polje - Donji Vakuf (Preparation of preliminary design) (own funds) with the estimated value of services of KM 2.5 million with VAT included and planned amount of KM 1.25 million in 2015; Mostar – Siroki Brijeg – Croatian border (Main design and feasibility study) (own funds) with the estimated value of services of KM 3.5 million with VAT included and planned amount of KM 0.5 million in 2015.

3.4 Sector of railway, waterway and combined transport

Reconstruction project "Rehabilitation of Railways in BiH II" has been fully completed while a contract has been concluded for reconstruction of the section Bradina - Sarajevo in the length of 41 km, which has fully finalised the overhaul of tracks on the South part of the Corridor Vc through BiH.

The goal is to continue with investments in the rail infrastructure in line with the Investment Plan for railway infrastructure in Bosnia and Herzegovina for the period 2010 – 2014, with projections by 2020.

Implementation of the project "Rehabilitation and Modernisation of the Sava River Waterway" will be continued through the EU IPA funds (planning and demining), whereas construction works will be ensured through funds of the favourable World Bank loan.

3.5 Education sector reforms

The Government of the Federation of Bosnia and Herzegovina will continue to provide its strong support to the reform processes in the education sector in the upcoming period, including the reforms in the area of preschool, primary, secondary, higher and adult education. We identified the role and the function of negotiations as the key to securing efficient coordination of the education sector activities in the Federation of Bosnia and Herzegovina, as well as provision of professional and other assistance to cantons for successful implementation of the actions and policies agreed at the level of Bosnia and Herzegovina.

Among the reform activities targeted at increasing competitiveness and economic growth of the Federation and Bosnia and Herzegovina, those are particularly important that aim at better harmonisation of education with the labour market needs, with the emphasis on developing such skills and competencies of pupils, students and adults that would enable their successful integration in the labour market and facilitate long-term employability.

In the upcoming period, the focus will be on the following activities: development of the Draft Action Plan for implementation of the "Strategic Directions for Development of Career Orientation in FBiH for the period 2015-2020", and efforts on its implementation in partnership with the line ministries, employment services, pedagogical institutes, centres for vocational and adult education and training, schools and universities; development of the document "Analysis of possibilities for introducing a compulsory two-year secondary education in FBiH"; continuation of implementation of "Operational Action Plan for Implementation of Measures and Recommendations Contained in the Analysis of the Situation in Secondary Education with Proposal of Measures for Harmonisation of Education with the Needs of Economy"; continuation of support to gifted and talented students and pupils; continuation of support to programmes enabling the adults to complete primary education with focus on the female population; provision of support to education of pupils and students of Roma nationality and other national minorities; support to education of pupils and students with special educational needs; continuation of implementation of the project of procuring free textbooks for pupils in social need; continuation of implementation of the activities for the Strategy for Early Childhood Growth and Development 2013-2017 and the Pestalozzi Programme of Training of Educational Professionals and promotion of values of the Council of Europe; continuation of support for modernisation of curricula at all levels of education.

Development of higher education is of paramount importance for cultural, social and economic development of the country. Strengthening of higher education, or more precisely, application of the acquired knowledge and skills brings benefits both for the country and beyond. Strong academic community creates positive and proactive climate for attracting domestic and foreign investments thus resulting in a sustainable and balanced economic development.

In line with the Strategic Directions for the Development of Higher Education in the Federation BiH 2012-2022, which are aligned with the Bologna principles, we have foreseen the implementation of a series of activities, in accordance with our constitutional competencies, through advisory and coordinating role, by connecting higher education institutions, cantonal ministries of education and other relevant actors, for the purpose of developing the high quality staff as the main resource of the competitive and knowledge-based economy in the Federation BiH. We have planned to continue with active participation in the development of the Qualification Framework in Bosnia and Herzegovina for all education levels, including general education and lifelong learning. Application of the Qualification Framework in practice would improve the quality of studies in the country and facilitate mobility of teachers and students, which would ultimately lead to harmonisation of local practice with already advanced stage of legislation alignment with the European Higher Education Area.

In the upcoming period, we will ensure the continued support to the internationalization of higher education in the Federation of Bosnia and Herzegovina and the implementation of quality assurance

in higher education institutions through international participation, cooperation and networking in order to systematically meet the requirements for inclusion of domestic higher education in the European Higher Education Area as an equal partner, as well as sensitising the entire society for a knowledge-based society by improving flexibility and strengthening the education system, including better links between universities and businesses and projects focused on developing the capacities of human resources and reaching the critical mass of high-quality researchers for scientific and research activities, through training of a new generation of scientists for new technologies and new challenges.

3.6 Labour market reform and improving economic and social position of workers

In the field of the labour market reform, we will harmonise legal framework pertaining to labour and employment with the market economy requirements and the European standards in this area. To this end, we will draft a new Law on Labour and the Law on Amendments and Supplements to the Law on Mediation in Employment and Social Security of Unemployed Persons. One of the main objectives of this reform is achieving higher flexibility in the labour market and ultimately, higher labour productivity.

Funds allocated for active employment measures should be used so as to clearly establish the priorities in order to make the results of incentives to employers and unemployed job-seekers more visible and efficient.

In order to establish the real number of the unemployed persons and provide services to active job seekers, the Rulebook on the Employment Records will be changed. Therefore, the persons registered for the sake of exercising some other rights (e.g. right to health insurance) instead of active job search will not be registered in the unemployment records.

The efforts on increasing the lowest price of labour, which has not changed since 2008 despite the conditions met for this on the basis of the General Collective Agreement for the Territory of the Federation BiH ("Official Gazette of the Federation BiH", No. 54/05 and 62/08), will be continued. The efforts on increasing the lowest wage aim at improving the economic and social position of workers.

3.7 Fiscal consolidation

The main objective of the economic policy of the Government of the Federation BiH is based on maintaining and improving the macroeconomic stability with enhancing the business environment.

To this end, it will be necessary to:

- strengthen fiscal policy and improve medium-term fiscal sustainability in order to reduce the Government's needs for financing from the foreign or domestic banking sector;
- implement the agreed fiscal reforms;
- undertake structural fiscal reforms that would safeguard competitiveness through redirecting public spending in capital investments and development spending.

In order to achieve specific results of the set economic policy, we need to prepare and implement structural and other reforms to promote projects for more intensive economic development and strengthening of internal social stability of the Federation BiH. This means that it is necessary to initiate and implement reforms aligned with the needs of Bosnia and Herzegovina on its path to the EU accession, with efficient utilisation of all local creative capacities through harmonised action policies.

Respecting the economic policy measures, in terms of the medium-term tax policy, the activities will be continued towards more efficient public revenues management, finding solutions for reducing the burden of employers, along with fiscal sustainability of the extra budgetary funds and thereby creating

the conditions for faster economic growth, as well as upgrading and improving the system of direct taxation.

In this period, the Government will function with the high fiscal burden given the great fiscal pressures to settle domestic liabilities, repay foreign debt and costs of social benefits. Hence, the restrictive policy of public spending has to be continued at all levels, with the main goal to maintain fiscal stability and the spending control system. However, along with the implementation of these measures, in order to cover the deficit, we need to ensure the lacking funds from the international financial institutions (IMF, World Bank).

The Government of the Federation BiH will pay particular attention to the priorities for funding from loans, i.e. new borrowing of the Federation BiH, which means that we need to take into account that new investments relate to economic growth and thereby directly affect opening of new jobs on the one hand, and the analysis of effects of previous borrowing that did not produce the planned effects, on the other.

3.8 Public administration reform

Public administration reform in the Federation of Bosnia and Herzegovina will be based on documents adopted for Bosnia and Herzegovina as a whole, starting with the enlargement criteria adopted by the European Council in Copenhagen in 1993 and confirmed in Madrid in 1995, as well as the Enlargement Strategy and Main Challenges 2014 – 2015, where the public administration reform is highlighted as one of the three pillars of enlargement along with the rule of law and economic governance.

In this reform, the principles of development will be followed as foreseen in the regional South East Europe Strategy 2020, as well as Regional Action Plan for Dimension L "Effective public services" envisaging the following: 1) redesign of administration procedures; 2) promotion of end-users of the sector of public services; 3) anti corruption activities through e-administration, and 4) e-administration model for local governments.

Attention will be paid for continuation of the public administration reform to be aligned with the issues listed in the European Commission's Document "Enlargement Strategy and Main Challenges 2014 – 2015" and elaborated in more detail in the document SIGMA "The Principles of Public Administration", which will serve as a baseline/standards that all countries in the region, including Bosnia and Herzegovina, should strive to, as follows:

- **Strategic framework of public administration reform** – requires commitment of the governments for efficient public administration reform; strong and functioning coordination structures to monitor and steer the process at both the political and administrative level; a leading institution with capacity to manage the process and clear accountability and capacity for implementation; continuous monitoring of implementation.
- **Public service and human resource development** – requires the scope of public services which is adequate, clearly defined and applicable in practice; legal framework for a professional and coherent public service; direct or indirect political influence on senior managerial positions in the public service is prevented; fair and transparent remuneration system for public servants; measures for promoting integrity and preventing corruption and ensuring discipline in the public service are in place.
- **Policy development and coordination** – requires the institutions to fulfil all functions critical for a well organised, consistent and competent policy making system; clear horizontal procedures for governing the European integration process enforced under the coordination of the responsible body; medium-term policy planning harmonized with financial circumstances; sectoral policies

meet the Government objectives and are consistent with the budgetary framework; the Parliament scrutinises the Government policy making; regular use of the policy impact assessment methodology; active participation of society in policy making; legislation is made publically available.

- **Accountability** – requires transparency of public administration, including access to public information and administrative and legal protection of the individual as well as the public interest in place;
- **Service delivery** – requires citizen-oriented administration, including mechanisms for ensuring the quality of public services, better administrative procedures, BETTER accessibility of public services, particularly e-administration.
- **Public financial management (PFM)** – requires commitment to medium-term budgetary framework; clear debt management strategy; budget transparency; financial management and control policy in line with the policy documents of financial management and control; stronger internal audit; public procurement in compliance with the EU acquis; the independent mandate of the Supreme Audit Institution.

Taking into account the importance of continuing the public administration reforms for further progressing on the path to the EU, the efforts undertaken so far by the structures for public administration reform in developing the documents to serve as the basis for further progress in the public administration reform, as well as the need to upgrade these documents using the SIGMA principles of public administration, the following needs to be ensured in the upcoming period:

1. Continuation of the public administration reform process, based on the Public Administration Reform Strategy and the Revised Action Plan 1, and continuation of work on fulfilling the objectives and measures that were not achieved in the previous period, primarily through projects to be funded from the Fund for Public Administration Reform and other funds, such as IPA.
2. Further implementation of activities on the basis of the new framework for public administration reform, grounded on the existing documents, and results of the upcoming analysis of the reform implemented so far and evaluation of the Strategy, as well as SIGMA situation assessment.

3.9 Agriculture sector

2015 National Economic Reform Programme of Bosnia and Herzegovina (NERP) includes the following activities planned in the sector of agriculture:

- Adopting the Medium-Term Strategy for Agricultural Sector Development in the Federation BiH for the period 2015-2019
- Adopting the Programme of Rural Development of the Federation BiH for the period 2014-2020
- Passing the Law on Freshwater Fisheries of the Federation BiH
- Passing the Law on Organic Farming of the Federation BiH
- Passing the Law on Brandy and other Alcoholic Beverages of the Federation BiH
- Amendments to the Law on Land of the Federation BiH
- Preparing a new Law on Agriculture and Rural Development of the Federation BiH
- Preparing a new Law on Payments in Agriculture of the Federation BiH
- Preparing a new Law on Financial Incentives in Agriculture of the Federation BiH

- Preparing the establishment of the Agency for Payments in Agriculture and Rural Development
- Establishing GIS and LPIS.
- Strengthening the existing and establishing new institutions related to food safety
- Strengthening the existing and establishing new advisory services in the sector of agriculture and rural development
- Strengthening and compiling all registers into a single Register of Agricultural Farms and Register of Clients
- Adopting and implementing other legal and by-legal acts arising from the Medium -Term Strategy for Agricultural Sector Development (2015-2019) and the Programme of Rural Development of the Federation BiH (2014-2020).

Medium-Term Strategy for Agricultural Sector Development in the Federation of Bosnia and Herzegovina for the period 2015-2019

The Medium-Term Strategy is a result of intensive consultations with stakeholders in the agricultural sector and it reflects a clear commitment of the Federal Ministry of Agriculture, Water Management and Forestry to ensure different relationship of administration and society in general toward the agricultural sector, which will primarily be confirmed through planning significant allocations for support to its development.

The FBiH agrarian policy is resting upon three pillars containing the measures of market-price policy, i.e. measures of direct payments (1. Pillar); structural measures and measures of rural development policy (2. Pillar); and measures related to general services in agriculture (3. Pillar).

Due to globalisation, further intensification of regional and EU integration is opening new possibilities, but also shaping up a wide set of complex challenges for further development of this sector.

The structure of the sector imposes restrictions to capitalisation of the existing potentials and makes this sector the main generator of the trade deficit, which reflects in a low level of market orientation, insufficient quality, quantity and constancy (QQC), and underdeveloped value chains that hamper access to the market and have negative effects on the sector's competitiveness.

The FBiH agrarian policy (including the agrarian budget) in the previous period was characterised by insufficient allocations, variability, inconsistency, a great number of measures, complex implementation and absence of efficient monitoring mechanism. In this document, all these have been specified in detail including the ways to overcome them.

It is also planned to upgrade and strengthen the regulatory-institutional framework, modernise agricultural administration and management methods, as well as clearly change the relationship toward this sector as necessary pre-requisites for the sector to use rare development opportunities and remove its key weaknesses.

The vision, strategic objectives and priority action areas were defined for the stated period.

Programme of Rural Development of the Federation BiH for the period 2014-2020

Federal Ministry of Agriculture, Water Management and Forestry is passing a Programme which will, hopefully, play a key role in development of rural areas of the Federation of Bosnia and Herzegovina in the upcoming six year period.

Taking into account our commitments from the Stabilisation and Association Agreement, as well as provisions of the Law on Agriculture, Food and Rural Development of Bosnia and Herzegovina, we have started developing the Rural Development Programme.

Thus, we set out directly towards creating practical conditions for introduction of the principles of the EU rural development policy and fulfilling the EU standards, starting with the development through implementation to monitoring and evaluation of results of the Government's and the Ministry's policy. This approach will significantly increase the level of needed knowledge and

institutional arrangement of Bosnia and Herzegovina, particularly the Federation of Bosnia and Herzegovina, which can be of great importance for using the upcoming programmes of the EU funds. Of course, we are aware that this is only the beginning of the journey in the EU accession process and, in this Programme, we are trying to respect the existing conditions and level of legislative and institutional development, but also the knowledge and awareness of our final users so as to come up with an implementable document which will achieve the main objectives and really develop a high-quality environment for agricultural, processing and other economic activities in rural areas to improve their economic efficiency and open new jobs, facilitate development taking into account the needs of environmental protection, support development of rural communities and improve quality of life of rural population.

It is for this reason that within the Programme we plan to apply the principle of gradualness so that, in the beginning of implementation, we plan to implement simpler measures such as encouraging investments and supporting the introduction of new activities in farm holdings whereas the measures that are more complex and demanding in terms of legislative framework can gradually strengthen throughout the period of Programme implementation.

The Programme development has actively involved all the relevant Federal ministries, Committees for agriculture of the Parliament of the Federation BiH, institutions in charge of agriculture and rural development at the state, entity, cantonal and level of Brcko District, non-governmental organisations, various institutes, and scientific and professional institutions. It is their participation in this process that makes us sure that we are doing a good job and that this Programme will yield multiple fruits for the benefit of rural areas in Bosnia and Herzegovina.

REPORTING TABLE ON SECTORAL STRUCTURAL REFORM MEASURES

Recommendation / country-specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Qualitative elements
Further development and implementation of QFBIH (Qualification framework)	Structural reforms for human capital development - Education	Main policy objectives and relevance for competitiveness and growth (3) Enhance visibility and increase confidence in BiH qualifications; facilitate recognition of qualifications; facilitate mobility for continuation education and employment	Description of the measure (4) Establishing QFBIH website containing only recognised qualifications; designing and connecting all components/elements of QFBIH (learning outcomes; sets of learning outcomes; classification of qualifications; qualification standard; occupational standard; structure of educational/study programmes); defining processes and procedures, examples and instructions for work, training of relevant stakeholders	Legal/ Administrative instruments (5) Action Plan for implementation of QFBIH; Decision of the Council of Ministers on establishing the intersectoral commission for QFBIH; Conclusions of CME (Conference of Ministers of Education in BiH)	Timetable on progress achieved in the last 12 months (6) Developed Action Plan for implementation of QFBIH ; Developed standards of qualifications for occupations for the first VO cycle in 5 disciplines (engineering; ITC; agriculture and food processing; economy; teacher education); Standards developed for 6 VET occupations from three related groups of occupations (waiter, cook, upholsterer, wood technician, welder,	Timetable on upcoming steps (up to three years) (7) Adoption of Action Plan (2015) Establishment of QFBIH web page (2015) Designing and connecting all components/elements of QFBIH and defining processes and procedures, examples and instructions for work, training of relevant stakeholders (2015-2018)	Estimated contribution to SEE2020 national action plan (8) Harmonized development of QF is a priority in the so called "Smart growth" Dimension D SEE 2020	Specific challenges/ risks in implementing the measures (9) Implies shifting the paradigm and concept of education and training Requires strengthening of connections and joint planning with sector of labour and employment Requires developing capacities of institutions and stakeholders Lack of local expertise	Overall and yearly change in government revenue and expenditure (reported in mln. national currency) Contribution of IPA (source and amounts) (10) IPA 2012 (project QF in general education – KM 2 million for three components (QF is one component) Project QF in VET and AE - KM 1.5 in three components (QF is one component) BUDGET of BiH institutions In 2015 planned KM 100,000	Qualitative description of foreseen impacts and their timing (11) Enhanced visibility and increased confidence in BiH qualifications; Facilitated recognition of qualifications; Facilitated mobility for continuation education and employment