IMF Country Report No. 18/39

BOSNIA AND HERZEGOVINA

February 2018

2017 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUESTS FOR EXTENSION OF THE ARRANGEMENT, REPHASING OF PURCHASES, AND WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BOSNIA AND HERZEGOVINA

In the context of the 2017 Article IV Consultation, First Review Under the Extended Arrangement Under the Extended Fund Facility, Requests for Extension of the Arrangement, Rephasing of Purchases, and Waiver of Nonobservance of Performance Criterion, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Press Release** summarizing the views of the Executive Board as expressed during its February 9, 2018 consideration of the staff report that concluded the Article IV consultation with Bosnia and Herzegovina.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 9, 2018, following discussions that ended on December 22, 2017, with the officials of Bosnia and Herzegovina on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 29, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Bosnia and Herzegovina.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bosnia and Herzegovina*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 18/46
FOR IMMEDIATE RELEASE
February 13, 2018

International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with Bosnia and Herzegovina

On February 9, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Bosnia and Herzegovina.

Macroeconomic conditions in Bosnia and Herzegovina have remained stable. BiH has made progress in reducing internal and external imbalances in recent years, thanks to a prudent fiscal position, and a strong monetary anchor provided by the currency board. However, job creation has been limited, unemployment has remained high, particularly among the youth, and the income convergence with the EU has stalled.

Fiscal stability has been maintained, mainly through continued restraint on current government spending. Progress in improving budget composition has been limited and reforms of state enterprises have not progressed as envisaged. While current spending has declined as share of GDP, capital spending has not risen as expected, largely due to financing constraints. The authorities have also undertaken measures to strengthen and safeguard financial stability include modernization of banking sector legislations and addressing banking weakness indicated by asset quality reviews.

The authorities have made some progress in improving the business environment and enhancing the functioning of labor market. However, institutional weaknesses and weak coverage and quality of public infrastructure remain the key factors undermining private sector development and foreign investment. The recent increase in excise duties will facilitate the implementation of key infrastructure projects.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the progress under the Fund-supported program, which has contributed to macroeconomic and financial stability. However, Directors noted that significant challenges and risks remain. They emphasized that strong ownership and commitment to the program objectives and targets is essential to enhance job creation, boost growth, and achieve income convergence with the European Union.

Directors welcomed the progress in strengthening the business environment and reforming the labor market. However, they noted that stronger reforms are needed to address the remaining weaknesses. They underscored that priority should be given to upgrading physical infrastructure, lowering the fiscal and administrative burden on businesses, further reforming the labor market, improving governance of State-Owned-Enterprises, and enhancing competition.

Directors welcomed the authorities' efforts to maintain a prudent fiscal position. They welcomed the plan to scale up public investment and emphasized that fiscal policy should continue to focus on rebalancing current spending to growth-enhancing capital expenditures in a sustainable manner. Directors emphasized the importance of strengthening the public finance management framework to mitigate fiscal risks and agreed that decisive measures are needed to tackle the issue of public sector arrears.

Directors commended the authorities for the progress in modernizing and harmonizing banking sector legislations. They underscored that continued efforts are needed to safeguard financial stability and to improve the regulatory framework. In this context, Directors encouraged prompt passage of the new deposit insurance law. They also highlighted the need to reform development banks.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Bosnia and Herzegovina: Selected Economic Indicators

	2014	2015	2016	2017	2018
				Proj.	
Nominal GDP (KM million)	27,304	28,586	29,899	31,283	32,795
Gross national saving (in percent of GDP)	10.4	10.3	10.9	11.0	11.8
Gross investment (in percent of GDP)	17.8	15.9	16.0	16.3	17.7
		(Percent change)			
Real GDP	1.1	3.1	3.2	2.7	3.2
CPI (period average)	-0.9	-1.0	-1.1	1.7	1.6
Money and credit (end of period)					
Broad money	7.3	8.0	8.3	8.6	9.4
Credit to the private sector	1.8	2.6	3.7	6.0	6.3
		(In percent of GDP)			
Operations of the general government					
Revenue	43.4	43.2	42.7	43.5	43.9
Of which: grants	1.0	0.8	0.7	0.7	0.7
Expenditure	46.3	43.4	42.3	41.4	42.6
Of which: investment expenditure	5.3	3.6	3.8	3.9	5.5
Net lending	-2.9	-0.2	0.3	2.1	1.2
Net lending, excluding interest payment	-2.1	0.6	1.2	3.0	2.1
Total public debt	45.0	45.5	43.7	40.5	38.9
Domestic public debt	14.9	15.1	14.4	13.3	11.7
External public debt	30.1	30.4	29.4	27.2	27.1
		(In millions of euros)			
Balance of payments					
Exports of goods and services	4,754	5,056	5,372	6,208	6,581
Imports of goods and services	7,927	7,801	7,993	8,935	9,516
Current transfers, net	2,029	1,825	1,826	1,876	1,946
Current account balance	-1,033	-826	-776	-834	-997
(In percent of GDP)	-7.4	-5.7	-5.1	-5.2	-5.9
Foreign direct investment (+=inflow)	400.8	248.9	240.5	351.4	365.6
(In percent of GDP)	2.9	1.7	1.6	2.2	2.2
Gross official reserves	4,013	4,413	4,886	5,288	5,739
(In months of imports)	6.2	6.6	6.6	6.7	6.8
(In percent of monetary base)	112.1	113.3	113.9	115.7	116.1
External debt, percent of GDP	63.7	62.9	63.8	61.1	61.0

Sources: BiH authorities; and IMF staff estimates and projections.

Press Release No. 18/43
FOR IMMEDIATE RELEASE
February 9, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation and Completes First Review of EFF Arrangement with Bosnia and Herzegovina

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Bosnia and Herzegovina's (BiH) economic performance under the Extended Fund Facility (EFF). The completion of the review will make available SDR 63.4 million (€74.6 million) to BiH under the EFF, bringing the total funds available to SDR 126.8 million (€149.3 million).

The Executive Board today also concluded the 2017 Article IV consultation with BiH. A respective press release will be issued separately.

The Executive Board approved the 36-month, SDR 443.042 million (about €553.3 million at the time of approval) arrangement under the EFF for BiH on September 7, 2016 (see Press Release No. 16/396).

Following the Executive Board's decision, Mr. Tao Zhang, Deputy Managing Director and Acting Chair issued the following statement:

"Bosnia and Herzegovina has continued to make progress in lowering internal and external imbalances in recent years. The authorities have also implemented economic policies and structural reforms under the Fund-supported program, including maintaining fiscal discipline, safeguarding financial stability, and improving the business environment. It is important that the authorities continue with efforts to enhance growth potential and address structural weakness, while maintaining economic and financial stability.

"There has been progress in advancing structural reforms, including harmonizing tax laws across the entities and improving corporate governance in State-Owned-Enterprise. The recent increase in excise rates on fuel products is expected to unlock external financing for significant growth-enhancing infrastructure investment. Going forward, the authorities need to continue their efforts to improve the business environment, by reforming the labor market and reducing para-fiscal fees.

"The budgets for 2018 envisage continued lowering of the wage bill in relation to GDP through a general wage freeze and hiring restraint. The authorities are encouraged to continue with public sector employment reforms, including by conducting functional reviews. Wage bill savings should be channeled to boost growth-enhancing capital spending. Addressing the issue of public sector arrears is key to mitigating potential fiscal risks, and reforms that help lower arrear accumulation should commence promptly.

"The banking sector remains broadly stable, but vulnerabilities remain and vigilance is warranted. Commendable progress has been made in modernizing the legal and regulatory environment of the financial sector by adopting new banking laws and amending the banking agency laws. Prompt passage of the new deposit insurance law will be important. Sustained efforts are needed to improve coordination, cooperation, and information exchange among various financial sector authorities to safeguard financial sector stability."

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

January 29, 2018

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER EXTENDED FUND FACILITY, REQUESTS FOR EXTENSION OF THE ARRANGEMENT, REPHASING OF PURCHASES, AND WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION

EXECUTIVE SUMMARY

Macroeconomic conditions in Bosnia and Herzegovina (BiH) are stable but growth has been insufficient for lowering unemployment and achieving income convergence with EU. Internal and external imbalances have been lowered in recent years. Economic activity has begun recovering with the turnaround in Europe and is expected to pick up further over the medium term, driven by public infrastructure investment and implementation of structural reforms. Job creation is key to reducing high unemployment and achieving income convergence with the EU. Domestic politics poses downside risks while external risks are more balanced.

Policies should aim to enhance growth potential and address structural weakness, while maintaining economic and financial stability: these include (i) structural reforms to boost growth potential and employment by improving investment climate; (ii) reorienting the composition of public spending from wage bill to capital investments; and (iii) improving financial regulation framework and enhancing financial stability, and (iv) strengthening the country's single economic space.

The authorities have made progress in implementing policies under the extended arrangement (EFF), notwithstanding a delay in completing the first review. The extended arrangement, approved in September 2016 (SDR 443.042 million; 167.06 percent of quota) focuses on raising BiH's growth potential while maintaining macroeconomic stability. The authorities request waivers of nonobservance of the end-June 2017 PC on net lending (budget balance) for the Institutions of Bosnia and Herzegovina (IBiH) and the Federation (FBiH) central government. They have completed several prior actions for the first review and progressed with implementing structural benchmarks, though several are delayed because of technical or capacity reasons.

Based on performance thus far, and the authorities' proposed policies in the period ahead, staff recommends completion of the first review. Staff supports the authorities' request for a 12-month extension in the period of the EFF and rephasing of purchases. SDR 63.4125 million would be available upon completion of this review, bringing total purchases under the EFF to SDR 126.8250 million. Staff also supports the request for waivers of nonobservance of the PC as the deviations were temporary and/or small.

Approved By
Jörg Decressin (EUR) and Yan Sun (SPR)

A staff team comprising Ilahi (head), Cipollone, Qu and Zhang (all EUR), de Carvalho-Filho (SPR), and Gottschalk (FAD) visited Sarajevo and Banja Luka during November 7–21 and December 19–22, 2017. Parodi (Resident Representative), Mrkonja and Cegar (local economists) assisted the mission. Kalezic (OED) attended the policy discussions. The team met with: Member of the Presidency, Covic, Chairman of the Council of Ministers, Zvizdic, Minister of Finance, Bevanda, Central Bank Governor Softic; in the Federation of BiH: Prime Minister Novalic and Finance Minister Milicevic; and in the Republika Srpska: President Dodik, Prime Minister Cvijanovic and Finance Minister Tegeltija. Staff also met with representatives of business and diplomatic communities. C. Borisova, C. Batog and N. Samuel (both EUR) assisted with the preparation of this report.

CONTENTS

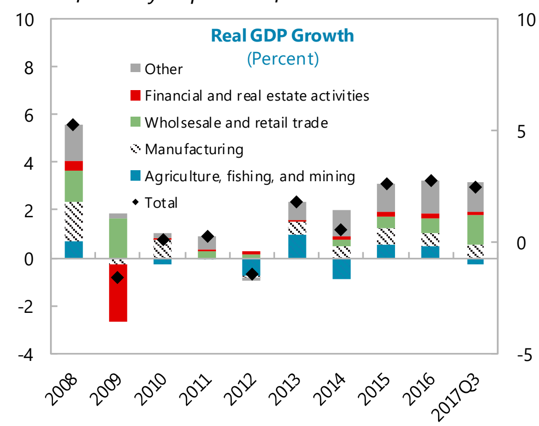
TABLES

ANNEXES

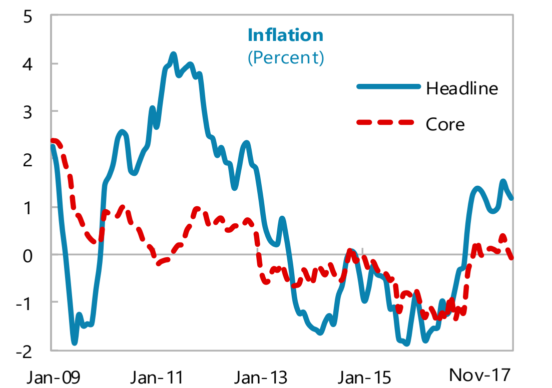
APPENDIX

Figure 1. Bosnia and Herzegovina: Selected Economic Indicators

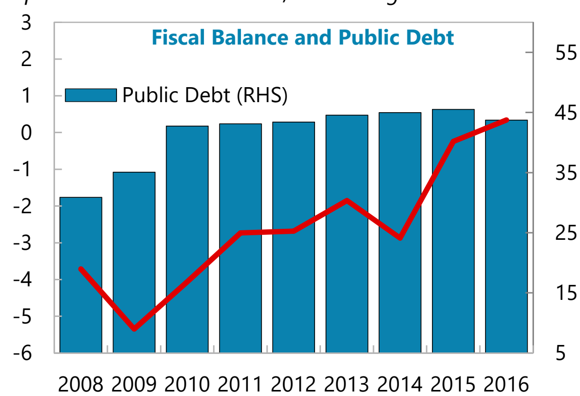
The 2015-16 cyclical economic recovery, driven by spillovers from pickup in advanced Europe, eased in 2017, because of a delay in public infrastructure investment.



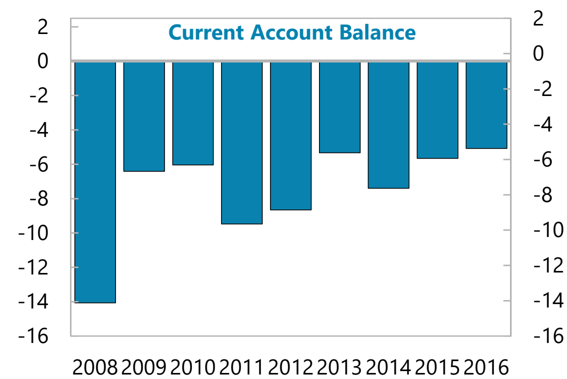
Inflation turned positive in 2017 thanks to the recovery of global oil price and imported inflation.



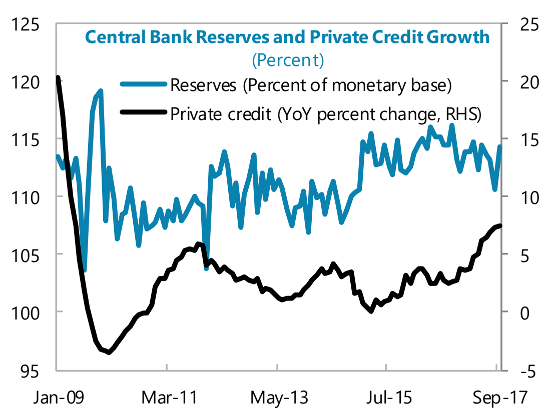
Internal imbalances continue to ease, reflecting fiscal consolidation through current spending restraint, capital expenditure under-execution, and strong revenues...



...while external imbalances have been corrected through investment restraint and strong export growth.



Central bank international reserves have been growing, in line with the monetary base. Credit growth has also picked up recently.



NEER has appreciated in line with the euro, and inflation pickup has also contributed to a real appreciation. Exchange rate assessment reveals no issue with external stability.

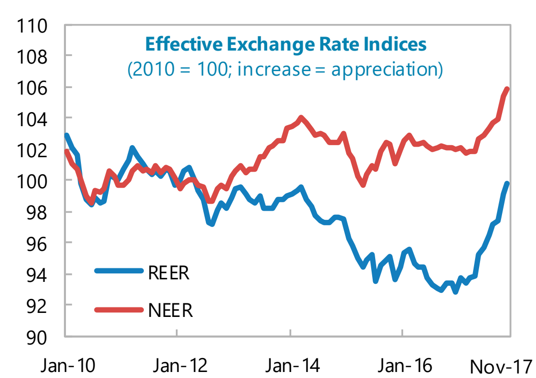
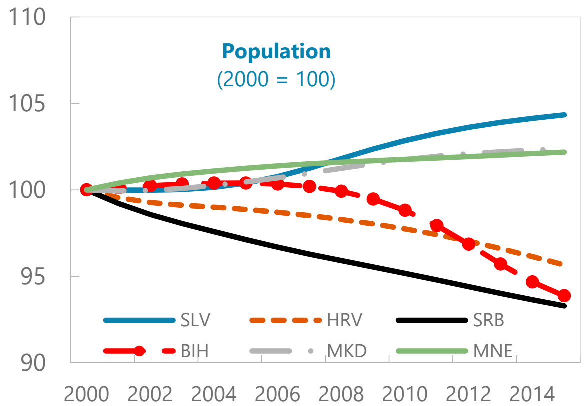
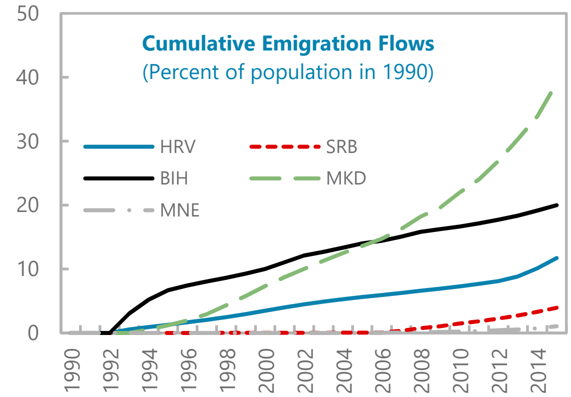


Figure 2. Bosnia and Herzegovina: Jobs and Growth

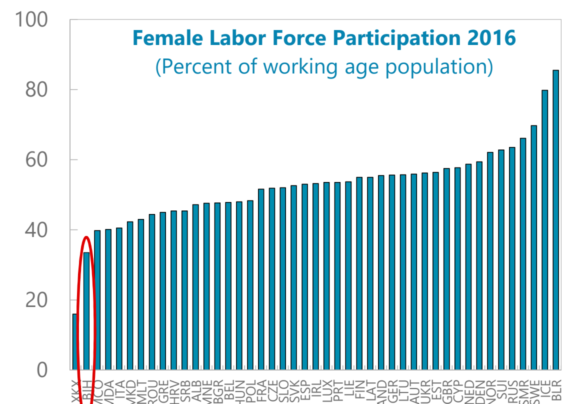
Population has been declining rapidly, particularly over the last 10 years…



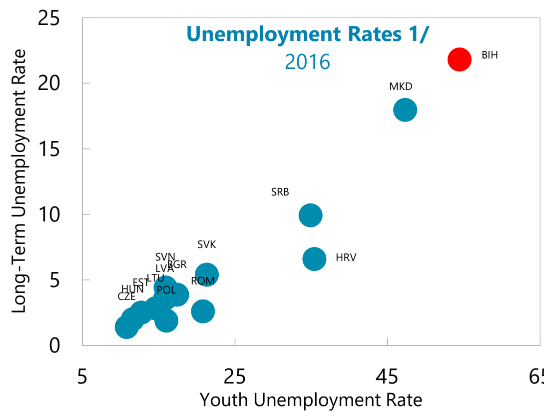
…partly because of emigration to advanced economies.



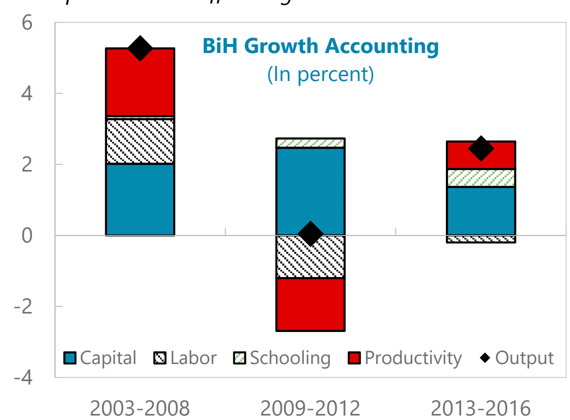
Female labor force participation is very low…



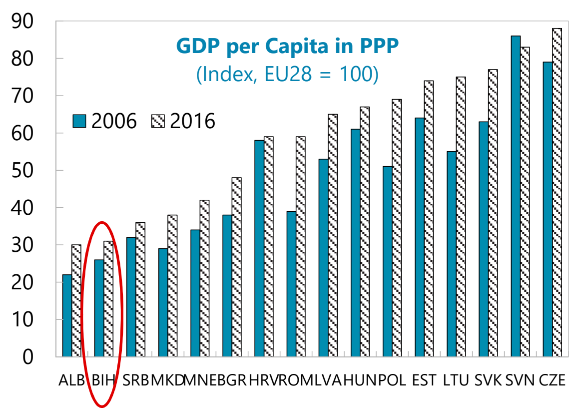
…and job creation has been sluggish; unemployment remains high.



Labor's declining share and adverse productivity developments have affected growth…



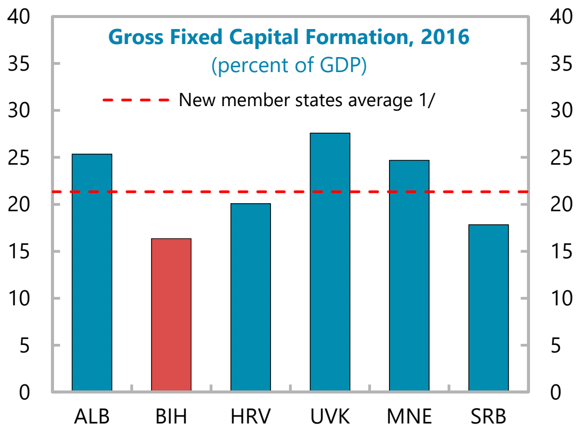
…income convergence with advanced Europe has stalled, as a result.



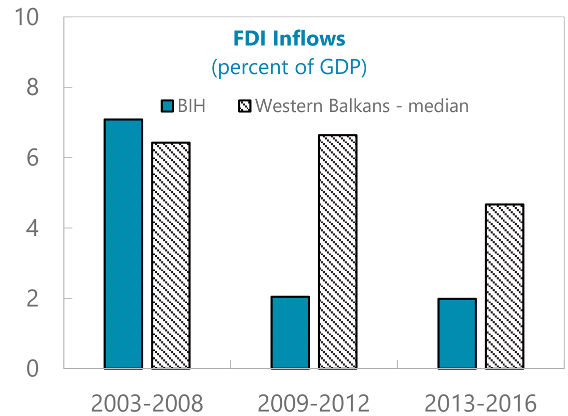
Sources: Eurostat; country authorities; ILOSTAT; OECD International Migration Database; and UN population estimates.
1/ Youth unemployment rate is unemployed (15-24) in percent of active population (15-24). Long-term unemployment is defined as unemployment longer than 1 year in percent of active population.

Figure 3. Bosnia and Herzegovina: Investment and Business Environment

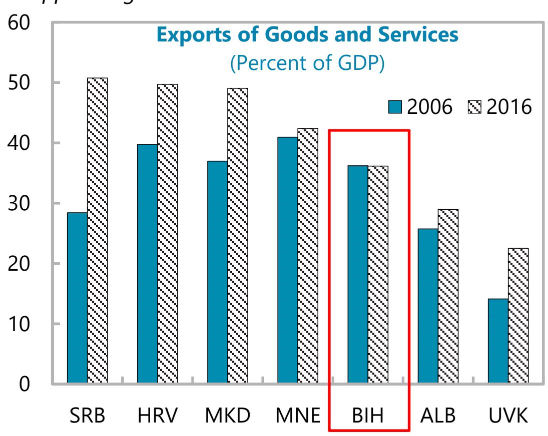
Sluggish investment has affected growth potential...



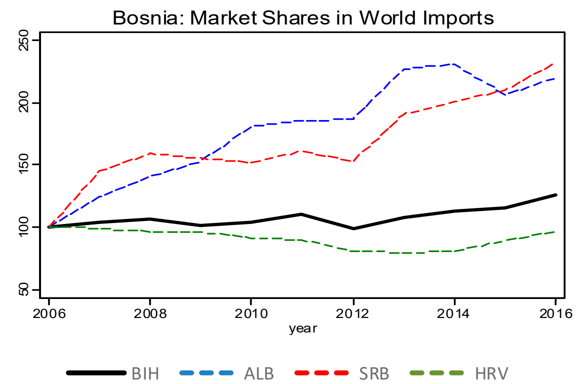
...FDI inflows have been particularly low since the global financial crisis, compared to regional peers.



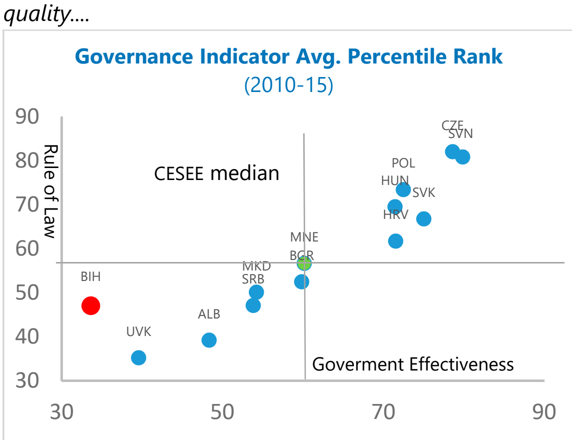
Export performance over the last decade has also been disappointing...



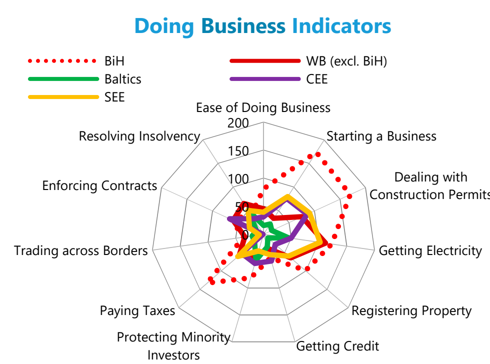
...as BiH has gained significantly less market share in world imports than many of its regional peers.



BiH's low investment rate reflects poor institutional quality....



...and the lack of a conducive business environment.



1/ Unweighted average of Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
Sources: BiH authorities; World Bank, World Development Indicators; and IMF WEO.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Context

1. **Macroeconomic conditions in Bosnia and Herzegovina (BiH) remain stable, but job creation is inadequate and the income gap with the EU remains wide.** BiH has been making progress in reducing internal and external imbalances in recent years, thanks to a prudent fiscal position, driven in part by financing constraints, and a strong monetary anchor provided by the currency board. However, job creation in the private sector has been limited, and unemployment remains high—particularly among the youth. A slowdown in productivity growth since the global economic crisis, and continued emigration, particularly of the young and educated—driven, in large part, by limited job opportunities at home—affect the country's economic potential. BiH has one of the widest income gaps with EU among the countries in Eastern Europe; the gap has not narrowed significantly over the past decade and a half.

2. **The authorities have recently made efforts to undertake structural reforms and advance on the path to EU accession.** In 2015, the governments adopted a comprehensive Reform Agenda which sets out the main plans for socio-economic and related reforms of all levels of government. In September 2016, the EU Council accepted BiH's formal application to become a candidate for EU membership. However, implementation of the Reform Agenda and progress toward EU accession (candidacy) have been slower than expected.

3. **The first review of EFF has been delayed by a year, though the extended arrangement has been an anchor for the authorities' economic policies during this period.** In September 2016, the Executive Board approved a three-year extended arrangement under the EFF with BiH for an amount equivalent to SDR 443.042 million (167.06 percent of quota) to support the country's economic program. The objective of the program is to raise BiH's growth potential while maintaining macroeconomic stability. The lack of passage of the excise law amendment, which was to unlock external financing for significant multiyear growth enhancing infrastructure investment, became an important reason for the delay in completing the first review, till it was eventually passed in late 2017. While the implementation of some key policies has been slower than envisaged at the time of program request, the authorities have made notable progress in maintaining fiscal discipline, safeguarding financial stability, and improving the business environment.

4. **The difficult political situation continues to hinder policy implementation and inter-governmental cooperation.** Political gridlock in 2017 combined with BiH's complex constitutional set-up and weak inter-government cooperation have made it difficult to effect policy changes and implement reforms. The IBiH and FBiH parliaments met sporadically in 2017 due to coalition infighting and ethno-nationalist tensions, slowing the reform momentum. The upcoming general election in late 2018 poses uncertainties.

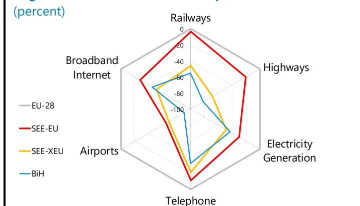
B. Outlook and Risks

5. Economic growth is expected to pick up over the medium term. While private consumption will continue to be the main contributor to GDP growth over the medium term, public investment is expected to pick up significantly, and this combined with continued implementation of structural reforms are expected to promote private sector activity, allowing growth to rise to around 4 percent by 2022. The recent passage of the amendments to the excise law that increases the duty on fuel products is expected to unlock external financing for significant growth-enhancing infrastructure construction (Box 1). Inflation should moderate slightly to 1.6 percent in 2018 once second-round effects from higher commodity prices in 2017 dissipate, but is expected to pick up to about 2 percent with gradual narrowing of the output gap in medium term. While the current account deficit is expected to increase in 2018–2019 reflecting import needs of the heavy public investment, it should stabilize at around 5 percent of GDP by 2022. The external sector assessment suggests that developments are broadly in line with fundamentals (see Annex II).

Box 1. Infrastructure Quality and Recent Measures to Unlock Public Infrastructure Investments[1]

Infrastructure quality in BiH has been lagging regional peers and there is substantial gap compared to the EU. Survey-based indicators suggest that infrastructure in BiH today is of the poorest quality in the region, and that the country saw relatively limited improvement over the past decade. Quantitative indicators show that BiH's infrastructure gap is substantial, particularly in the areas of transportation—highways and railways—and communication—broadband internet and telecommunications.

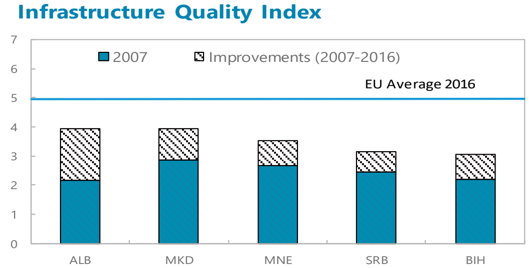
Regional Peers: Infrastructure Gaps, 2015
(percent)



Sources: WDI, EIA, IRF, Eurostat, and IMF staff calculations.
Note: Infrastructure Gap Index calculates the gap between a country's infrastructure and that of an average EU member. A value of Zero reflecting EU-28 average.

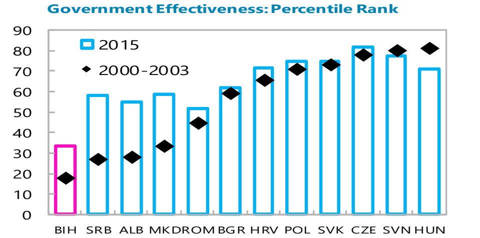
The declining share of public investment and weak governance affect infrastructure quality. Since the global financial crisis, public investment in BiH has dropped below the regional average. BiH's government effectiveness is also much lower compared with regional peers, as per the World Bank's Worldwide Governance Indicators. There has not been much improvement in these indicators over the past 15 years either and the gap with regional peers has widened.

Infrastructure Quality Index



Sources: World Economic Forum.

Government Effectiveness: Percentile Rank



Source: Worldwide Governance Indicators
Note: Higher rank indicates better outcome.

Tackling BiH's infrastructure gap through improvements in the efficiency of public investment should lead to higher growth potential. A concerted effort is needed for removing bottlenecks to enhancing domestically-financed capital spending, including through strengthening public investment management

Box 1. Infrastructure Quality and Recent Measures to Unlock Public Infrastructure Investments (concluded)

frameworks—i.e., to improve planning, allocation, implementation, and monitoring capacities. These measures would ultimately reduce waste and improve efficiency of investments. Budget planning could also be strengthened by using a medium-term approach to public investment, to ensure there is adequate and sustained funding for capital spending.

Recent amendments to the excise law would help mobilize resources for critical growth-enhancing infrastructure investments. Construction of highway Corridor 5C over the next 9 years, at a total cost of about 12 percent of 2017 GDP, will significantly improve transport connectivity within the country as well as with neighbors. The investment would significantly increase GDP growth in short term, with attendant job creation in the construction sector, while also expanding productive capacity and economic potential in the long-run. The excise amendments entail an increase in excise rates on fuel products, including LPG and biofuel, by 15 fenings per liter. The resulting additional tax revenue will be split between entities—FBiH (0.4 percent of GDP) and the RS (0.2 percent)—and would be earmarked to the entities' highway and road funds to enhance their debt service capacity. A significant portion of the investment is expected to be financed by EBRD and EIB. While most of the 5C investment is expected in the geographical area of the FBiH, the additional revenue from excise tax would strengthen the financial position of the RS Highway Fund to carry out works on the RS sections of that highway, as well as on other roads.

[1]"Public Infrastructure in the Western Balkans: Shifting Gears—Opportunities and Challenges," European Department Paper Series, IMF (forthcoming).

6. **Domestic politics poses downside risks while external risks are more balanced.** There are elevated risks that political support for sound policies may falter in the run up to general elections in October 2018. With ethno-nationalist politics expected to continue to take center stage in the election season, the risk of a widening chasm in the single economic space and deterioration of regulatory coherence cannot be discounted. Uncertainties surrounding the electoral law in the Federation (FBiH) and formation of governments in the post-election period exacerbate the downside risks. As the extended arrangement serves as an external anchor of economic policies and reforms, a lack of progress in program implementation could lead to deterioration in budget quality and slippages in implementation of structural reforms to reorient the economy toward the private sector, and ultimately compromise BiH's ability to achieve the medium-term growth objective. On the external front, adverse shocks in Europe could pose spillover risks to BiH, though conversely, a stronger-than-projected growth in Europe or the US would have an upside in BiH (Annex I).

ARTICLE IV POLICY DISCUSSIONS

7. **Macroeconomic and financial policies should aim to enhance growth potential and address structural weakness, while maintaining economic and financial stability**. The economy is experiencing a cyclical recovery but a poor business environment and inadequate infrastructure investment continue to be constraints on private sector development and job creation. Discussions focused on overcoming BiH's key economic and structural weaknesses with an overarching objective of strengthening the country's single economic space:

- structural reforms to boost growth potential and employment by improving the investment climate;
- reorienting the composition of public spending from wage bill to capital investments;
- and improving financial regulation framework and enhancing financial stability.

Box 2. Implementation of Past Fund Surveillance Advice

The 2015 Article IV consultation focused on policies and structural reforms needed to accelerate private sector-led growth and job creation, while ensuring macroeconomic sustainability. The objectives of the extended arrangement under the EFF, approved in 2016, were also consistent with these policy recommendations.

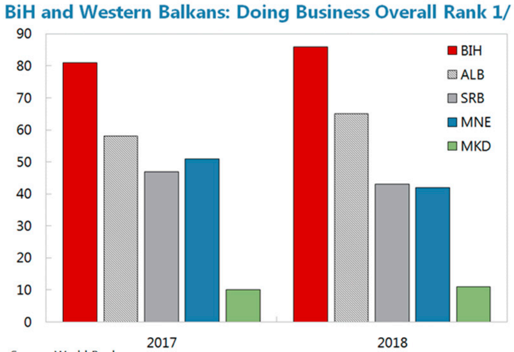
- **Structural Reforms.** The authorities have made some progress in improving the business environment and enhancing the functioning of labor market, including by lowering the regulatory burden on enterprises and harmonization of tax laws across the entities. However, the reduction of high labor tax wedge is delayed, and progress in SOE reforms has been slower than expected.
- **Fiscal Policies.** Fiscal stability has been maintained, mainly through continued restraint on current government spending. However, progress in improving the composition of government spending has been mixed. There has been limited progress in strengthening controls and quality of spending in lower levels of government, and the problem of arrears has come to light recently.
- **Financial Sector Policies.** Measures undertaken to strengthen and safeguard financial stability include modernization of banking sector legislations and addressing banking weakness indicated by asset quality reviews. Coordination and cooperation, including information sharing among financial sector regulators and supervisors has also been enhanced. However, the adoption of the new deposit insurance law is delayed, and reforms of entity development banks has lagged.

A. Structural Reforms to Improve Investment Climate

Background

8. **BiH has significant structural deficiencies that put a drag on growth and economic convergence.** BiH's low rate of investment reflects its poor business environment and institution quality. Infrastructure bottlenecks are particularly severe and undermine the country's attractiveness to foreign investment and private sector development, and thus pose constraints on growth potential (Box 1). Complex and inefficient administrative structures, a fragmented economic space, and high political and regulatory uncertainty exacerbate the high cost of doing business. Unless these structural deficiencies are effectively addressed, the economy's medium and long term growth prospects will remain weak, and the population's living standards are unlikely to catch up with those in Western Europe.

BiH and Western Balkans: Doing Business Overall Rank 1/



Source: World Bank
1/ Ranking out of 190 countries. The higher the rank - the less business-friendly the country.

9. **Not surprisingly, job creation is weak and emigration has affected economic potential.** Despite emigration, the unemployment rate is persistently high (over 20 percent), with youth

unemployment above 40 percent. Female labor participation rate is among the lowest in the region, particularly in rural BiH. The low fertility rate, coupled with high rate of emigration of the young and skilled to advanced Europe, worsen demographic pressures and seriously affect economic potential and costs of service delivery (Figures 2 and 3).

10. There has been some progress toward strengthening the business environment and reforming the labor market. Harmonization of tax laws across the entities with the aim to improve the business climate has been progressing. To foster inter-entity consistency, the Republika Srpska (RS) parliament adopted amendments to the Corporate Income Tax Law, after the FBiH parliament had done so earlier. The FBiH government has submitted to parliament amendments to the laws personal income tax (PIT) and social security contributions (SSC), which is expected to more closely align labor tax laws with that in RS and reduce the high tax wedge on labor. A new general collective agreement, consistent with the new labor laws adopted in 2015, has been reached in FBiH, and most branch agreements have been concluded in both entities. There has been some effort to improve corporate governance in SOEs, with the FBiH government selling its minority shares in pharmaceutical and tobacco companies and the RS government adopting a restructuring plan for the troubled railway company, in line with World Bank advice. The FBiH government has taken measures to improve the management and cut the operational cost of its railway company, including by reducing employment. Progress in restructuring and/or privatizing large telecom SOEs in FBiH has been slow. Both entities also published the lists of para-fiscal fees, with the aim of reducing the fees and lowering the burden of enterprises.

Policy Advice

11. Achieving high sustained economic growth is critical for job creation and economic convergence, and strong structural reform efforts are needed to achieve these objectives.

- **Upgrading physical infrastructure, particularly in transportation, to address perhaps the biggest constraint on BiH's economic growth.** There is need to reverse the declining trend of public investment in highways and roads infrastructure, including by ensuring timely implementation of the Highway 5C project (Box 1). While financing constraints are binding for public infrastructure investment in BiH, strengthening the efficiency of public investment, and overcoming implementation-capacity bottlenecks to public capital investments could also yield substantial benefits. An improvement in the mechanism of coordinating infrastructure investments within FBiH—central government, cantons and municipalities would be welcome.
- **Lowering the fiscal and administrative burden on businesses.** The fragmented administration structure in BiH puts an added burden on businesses through excessive regulation, taxes and local fees. The authorities are encouraged to continue to strengthen the single economic space—through harmonizing regulations and tax laws and better policy coordination between the two entities and lowering the burden of para fiscal fees emanating from overlapping administrations. There is an important need to streamline the process of starting and running a business, an aspect in which BiH fares particularly poorly.

- **Notwithstanding the progress made in reforming the labor market, further measures are needed.** The tax on employment, or tax wedge, is a major deterrent in enhancing employment in the formal sector and is ultimately harmful for growth. The FBiH government's plans to lower the excessively high tax wedge on labor and align it with that in the RS is welcome, and both entities should aim to reduce these taxes further over the medium term. Swift implementation of the bylaws of the new labor laws would also help boost employment. Lastly, the demographic crunch in the labor market is a real threat to BiH's long term growth prospects. The authorities are encouraged to formulate policies to boost female labor force participation.
- **Improving governance of SOEs and enhancing competition**, by advancing SOE reforms including reviving the restructuring process and/or privatizing them.

Authorities' Views

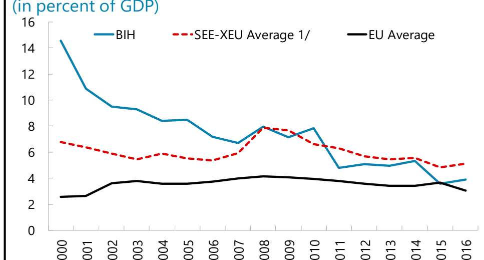
12. **The authorities agreed that structural reforms were critical to enhance growth prospects and recognized the importance of boosting private sector development.** They are mindful of the time needed to generate consensus over these reforms, considering the fragmented political and administrative systems and uncertainties related to the upcoming general elections. They reaffirmed their commitment to deepen reforms and address infrastructure gaps and pointed to their recent efforts to boost domestically financed spending on roads and highways. To enhance public investment efficiency, IBiH and FBiH authorities also requested Fund TA on Public Investment Management Assessment. On strengthening the single economic space, they underscored the need to respect constitutional competencies of entities and subnational governments. On SOE reforms, the authorities pointed out that measures to improve governance and management in some companies had started to bear fruit.

B. Making Fiscal Policy More Growth Enhancing

Background

13. **There has been larger-than-expected fiscal consolidation since 2014, but progress toward improving the quality of public spending has been mixed**. A strong revenue performance helped reach an overall fiscal balance in 2015, compared to a deficit close to 3 percent of GDP in 2014 (Table 4). Since then the fiscal position has turned into surplus, largely a consequence of external financing constraint. Current expenditure has been on a declining trend as a share of GDP, thanks to a general wage freeze and continued hiring restraint (agreed under the EFF). However, capital spending at the entity level has not risen as envisaged mainly reflecting financing constraints. In the RS, fiscal resources were devoted to bringing the pension funds into the treasury system. In FBiH, capital spending has been constrained as the bulk of it is undertaken by the

Public Investment
(in percent of GDP)



1/ SEE-XEU includes ALB, MKD, MNE, SRB, and UVK.
Sources: WEO and IMF staff calculations.

highway company which, until the recent increase in excise revenues earmarked for it, had exhausted its borrowing capacity.

14. The 2018 budgets envisage continued current spending restraint and measures to boost public capital spending. These budgets continue to maintain fiscal discipline and move away from current spending—the wage bill will continue to fall as share of GDP—and, in the case of FBiH, move towards raising growth-enhancing capital spending. As part of the FBiH government's objective to increase domestically-financed investment in public infrastructure, the authorities plan to allocate resources towards investment in high-use roads and highway projects. Financing for these projects will come mainly from special dividends of a few SOEs with accumulated surplus.

15. Near term fiscal risks appear limited, but public sector arrears pose significant challenges. The BiH public sector is accumulating sizable arrears. In the RS these stem mainly from the health sector. The documentation of arrears in FBiH is more difficult because of its heavily decentralized fiscal structure (Box 3). While BiH's overall public debt level is relatively low, health sector and SOE arrears ultimately pose large contingent claims on budget resources.

Policy Discussions

16. A broadly balanced structural fiscal position over the medium term is warranted. As the output gap closes, this will also enable the debt-to-GDP ratio to stay comfortably below 40 percent over the medium term, thus rebuilding fiscal buffers. During 2018–19 this would entail running down part of the modest fiscal surpluses, with domestically-financed public investment starting to scale up in line with implementation capacity limitations. The unused fiscal space should be preserved in the form of a temporary structural surplus.

17. Fiscal policy should continue to focus on further lowering current spending and raising growth-enhancing capital expenditures in a sustainable manner. The government is encouraged to continue with public sector employment reforms, including by conducting functional reviews of employment at ministerial and departmental levels. Wage bill savings should be channeled to boost capital spending (Annex III). Unlocking the external financing for highway construction, through the recently adopted increase in the excise tax on fuels, is essential to upgrade infrastructure. The sweeping of surplus of SOEs in FBiH to finance such investment in 2018 provides a welcome infrastructure boost. But the lack of clarity about maintaining such funding beyond 2018 and the administration of these funds outside the single treasury account, argue for caution when implementing this approach.

18. Strengthening PFM framework will be crucial for mitigating fiscal risks and ensuring fiscal sustainability. Arrear accumulation in the public-sector reflects a lack of fiscal discipline and accountability in subnational governments, extra-budgetary funds, healthcare systems, and SOEs. The authorities should strengthen the PFM framework to tackle these issues. Measures in RS should include cutting cost, improving efficiency, and rationing the health network. The FBiH should enhance its capacity to document and monitor arrears, improve the treasury system, and strengthening implementation of commitment control. While bringing arrears accumulation to a stop and clearing existing arrears is likely to be a multi-year process, reforms should commence promptly.

Box 3. Public Sector Arrears

The ongoing arrear accumulation reflects structural problems in the health sector and weakness in the public financing management (PFM). In the RS, spending on public health is high and is not yielding good value-for-money. Improving efficiency is therefore high priority. While the RS Health Insurance Fund has already made progress in reducing outstanding arrears, the main underlying cause of health facility arrears is fragmented accountability, and lack of incentives for and monitoring of facility and manager performance. Moreover, the network of facilities is inefficient and has overlaps in service provision while health facilities are overstaffed with an excess of nonmedical workers. In FBiH, SOE reform should be the cornerstone of arrears reduction. In the FBiH general government, the starting point is improving arrear reporting and monitoring, followed by PFM reforms that strengthen commitment controls, improve cash management, upgrade the treasury financial management information system, reduce delays in processing of payments, and close gaps in the PFM legal framework and regulations.

The authorities have initiated various measures. The RS authorities have undertaken substantial work that aims at expanding the treasury system to health centers, thereby improving commitment controls in the health sector. In the Federation, the authorities are introducing budget information systems at the cantonal and municipal level, and the focus is currently on improving documentation and reporting of the stock and flow of overall public sector arrears.

Authorities' Views

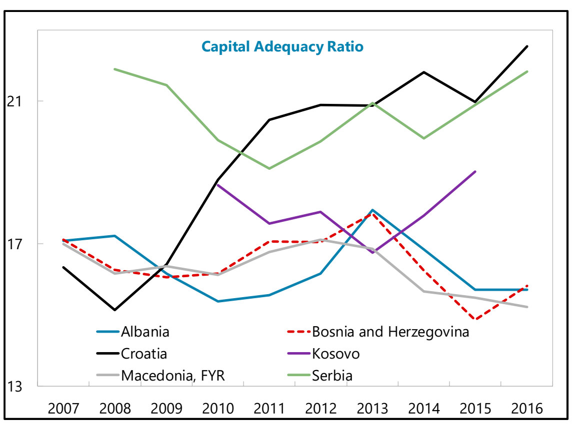
19. The authorities reconfirmed their commitments to maintain a prudent fiscal position and improve the composition of fiscal expenditure. The FBiH government emphasized that the planned domestically-financed road projects reflect its commitment to reduce the infrastructure gap. The authorities view the risks of using SOEs retained earnings to finance the projects as manageable and do not expect the operation to affect the financial health of SOEs. Regarding the administration of these funds outside the single treasury system, these funds will be subject to audits and be handled similar to externally-financed project accounts.

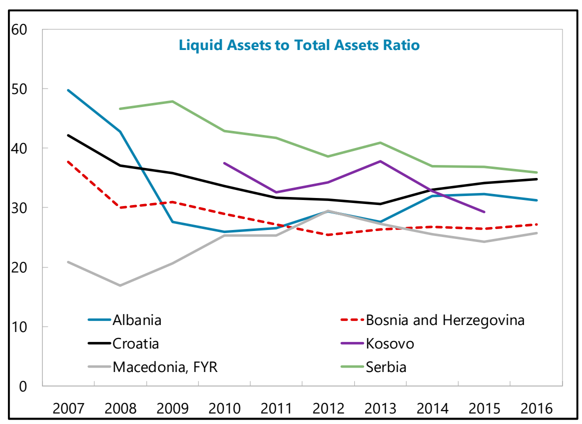
20. The authorities also agreed that decisive measures are needed to tackle the issue of public sector arrears. The RS government recognized that the arrears of the health sector are serious and could pose significant fiscal risks, but see a solution to the problem as part of larger health sector reform. The FBiH government views the arrears problem as outside its immediate mandate, since the majority of arrears is in public enterprises of cantons on which it has limited control. They also emphasized that the documentation of arrears, which is difficult for the FBiH, should be completed with IMF and WB assistance before a strategy to lower arrears creation can be formulated.

C. Safeguarding Financial Stability and Improving Regulatory Framework

Background

21. The banking system is broadly stable, but vulnerabilities remain. The sector is adequately capitalized and liquid at the aggregate level. Credit to the private sector has grown strongly at 7.5 percent in 2017 (to October), with a pickup in lending to corporates as well. The quality of bank loan portfolios continues to improve, but the non-performing loans (NPLs) to total loan ratio remains elevated at about 11 percent in 2017:Q3. The recently completed detailed bank AQRs revealed some shortcomings in banks' risk management and supervisory practices. A fragmented market and high regulatory costs also pose constraints on the country's banking sector; not surprisingly, bank profitability is the lowest in the region. Low profitability and balance sheet weakness have hindered banks' ability to support economic recovery (Annex IV).





22. The authorities have progressed with modernizing and harmonizing banking sector legislations, though reforms are incomplete. Both entities adopted in 2017 banking laws and amendments to the banking agency laws, which have strengthened supervisory powers of banking agencies and introduced a modern bank resolution framework. However, the amendments to the Law on Deposit Insurance remain outstanding, which renders inoperable the use of the deposit insurance fund for resolution purposes—an essential feature of the new resolution framework. Recent IMF and World Bank TA has revealed deficiencies in the mandate, objectives, governance, operational transparency, and risk management practices of the entity development banks. The entity governments are preparing draft legislations for their respective development banks to address the identified deficiencies.

23. To strengthen the single financial space, the authorities are also enhancing coordination, cooperation and information sharing among the financial sector authorities. Regular exchange of information and joint on-site inspections of systemically important bank are taking place. The authorities have advanced well with drafting the Financial Stability Memorandum of Understanding (FSMoU), which aims to improve cooperation and information sharing in the areas of bank supervision (Pillar I), crisis preparedness and management (Pillar II), and systemic risk oversight (Pillar III). However, the delay in adopting the new Deposit Insurance Law is preventing the adoption of Pillar II. The authorities are also advancing the work on a common methodology for determination of systemically important banks (SIBs), with the assistance of recent IMF TA missions.

24. The authorities have made significant progress in addressing strategic deficiencies in the AML/CFT framework. In November 2017, Financial Action Task Force (FATF) stated that BiH has substantially addressed its action plan to improve AML/CFT framework at a technical level. The authorities remain committed to work with FATF and Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), including an onsite visit from the FATF to confirm that the process of implementing the required reforms and actions is underway to address previously identified deficiencies.

25. The Currency Board Arrangement (CBA) continues to anchor macroeconomic stability. The Central Bank of Bosnia and Herzegovina (CBBH) foreign reserves remain adequate and the CBBH has taken effective measures to improve its reserve management framework by adopting new investment guidelines and operative rules and streamlining reporting to its Board. The CBBH also adopted an action plan in line with the recommendations of the 2016 IMF Safeguard Assessment mission.

Policy Discussion

26. Intra-country regulatory cooperation and coordination should continue to be enhanced to safeguard financial stability and reinforce the single financial space. The current good practice of joint on-site inspections could be strengthened further by expanding coverage to all SIBs. A comprehensive FSMoU is needed to enhance regulatory cooperation and should be signed after the expected adoption of the Law on Deposit Insurance. The methodology for determination of SIBs is an important prerequisite for effective supervisory cooperation and systemic risk oversight and a common methodology should be adopted, in line with IMF TA recommendations. Regulation should be further harmonized and implemented in a consistent way between entities to curb potential regulatory arbitrage.

27. Deficiencies in the regulatory framework need to be tackled. Capacity building of financial sector regulators should continue, especially given the banking agencies' assumption of the new bank resolution mandate. Given the importance of entity development banks' operations in banking sector, reforms are needed to address deficiencies in their mandate, objectives, governance, operational transparency, and risk management practices. The development banks should also be subject to appropriate supervision and regulation by the entity banking agencies. The framework of recovering and resolving NPLs needs to be improved to facilitate cleanup of bank balance sheet. Going forward, efforts on AML/CFT should focus on effective implementation of the improved framework to help support efforts to tackle corruption, financial crimes and laundering of proceeds of illegal activities.

Authorities' Views

28. The authorities agreed with staff's overall assessment of the banking sector and plan to remain vigilant about vulnerabilities. The banking agencies are determined to take necessary actions on banks that fail to comply with supervisory orders based on the AQR findings. The authorities are also committed to continue their efforts on modernizing the regulatory framework, including capacity development related to the new bank resolution mandates assumed by the banking agencies. In general, the authorities recognized the importance of enhancing financial cooperation and coordination, in line with constitutional competencies.

29. The authorities remain committed to adhering to the CBA and preserving the autonomy of the CBBH.

PROGRAM DISCUSSIONS

The first review has been delayed by nearly one year, largely because the authorities could not complete a key prior action that staff deemed critical for achieving the program's medium term growth objective—the passage of excise tax amendments that unlock external financing for growth-enhancing infrastructure investments. During the period, macroeconomic stability was maintained and budgetary performance was prudent, though the objective of reorienting public spending was partially met. Several important structural measures were completed, though many remained unfinished because of technical and capacity reasons or parliamentary gridlock. BiH continues to face a BoP financing need and staff expects EFF program objectives to be met in the period ahead, including in meeting the structural and quantitative targets for the second review.

A. Performance Under the Program

30. The authorities have made progress in achieving program objectives and targets, notwithstanding the protracted delay in completing the first review.

- All quarterly quantitative performance criteria (PCs) for 2016 were met. The PC on net lending (overall fiscal balance) for end June 2017 was missed because of higher capital spending stemming from previously delayed projects having reached the execution stage in IBiH, and a temporary revenue underperformance in FBiH. It is worth noting that the fiscal performance for end 2017 (for which PC were not set), was significantly stronger than that envisaged at the time of the program request. All continuous quantitative PCs were also met.

- All 2017 ITs were met except for those on current expenses in IBiH, which partly reflects extraordinarily-high other expenses in the first quarter and partly a higher wage bill in 2017 than that expected at time of the EFF request.

Bosnia and Herzegovina: General Government Statement of Operations, 2014-17

(Percent of GDP)

	2014	2015	2016		2017	
			EBS/16/291	Act.	EBS/16/291	Proj.
Revenue	43.4	43.2	43.4	42.7	43.5	43.5
Expenditure	46.3	43.4	44.2	42.3	44.3	41.4
Expense (current expenditure)	40.9	39.8	39.8	38.5	39.2	37.5
Net acquisition of nonfinancial assets	5.3	3.6	4.4	3.8	5.1	3.9
o/w Foreign financed capital spending	3.2	2.1	2.5	2.4	2.7	2.0
Net lending/borrowing (revenue minus expenditure)	-2.9	-0.2	-0.8	0.3	-0.8	2.1
Memorandum items						
Net lending excluding externally-financed operations	-0.5	1.2	0.9	2.1	1.0	3.6
Structural balance (% of potential GDP)	-1.4	0.8	0.0	1.0	-0.2	2.7

Sources: BiH authorities; and IMF staff estimates and projections.

31. All four prior actions for the completion of this review have been implemented, despite considerable political and technical challenges. The long delay in the parliamentary passage of the excise tax amendments was the main reason for the protracted delay in completing the first review. The prior actions were:

- FBiH parliament to adopt budget for 2018 in line with IMF staff recommendations;
- RS parliament to adopt budget for 2018 in line with IMF staff recommendations;
- FBiH authorities to initiate, in a letter to the EU, a request to finance the financial and operational due diligence of the two Federation telecom companies, with the objective of improving corporate governance, restructuring, and/or selling of shares, and based on the terms of reference drafted in consultation with IMF staff.
- The BiH parliament to adopt an increase in excise rates on fuel products including LPG, biofuel, and heating oil, by 15 fenings per liter and channel the additional revenues to ensure highway and road infrastructure financing.

In addition, other important actions were completed earlier, including parliamentary adoption of the 2017 budgets for the IBiH, FBiH, and RS.

32. There has also been noteworthy progress on important program-related policies and structural reforms. The authorities have maintained macroeconomic stability and fiscal discipline. The restraint on public wage bill continues. Of the 24 structural benchmarks (SB), nine have been met; and one was elevated to a prior action for this review (The authorities propose to drop several SBs because they were deemed no longer relevant, see below and Table 2 in the Supplementary

Letter of Intent). The two entities have passed a core package of modern banking laws and commercial banks are taking corrective measures following AQRs (existing SBs # 5, 7, 8, and 10). Corporate tax laws have been harmonized (existing SB #18) and FBiH government has tabled legislation to reduce the high labor tax wedge. Social partners have contracted new collective agreements based on modern labor laws. To strengthen control over borrowing in lower levels of government in the Federation, the FBiH government adopted a draft of the new Law on Debt, Borrowing, and Guarantees and has submitted it to parliament (existing SB #13). The FBiH parliament adopted the Law on Pension and Disability Insurance, which aims to improve the pension system. Small scale privatization and restructuring of some SOEs has progressed. CBBH has completed most of the recommendations of the 2017 Safeguards Assessment and implementation of the remaining two is in progress. Key recommendations included comprehensive overhaul of its reserve management and investment frameworks and the removal of difficult conflict of interest on its governing board. There was technical delay in setting up employment registries, and adoption of treasury in RS and FBiH was delayed because of a delay in procurement by the donor. The authorities propose to reset the incomplete SBs for later.

B. Policy Priorities in the Period Ahead

Structural Reforms

33. The authorities need to continue efforts to improve the business environment. FBiH government intends to submit a draft PIT/SSC law, drafted in line with IMF staff recommendations, for second parliamentary reading by May 2018 (new SB #2). In both entities, most of the sectoral branch agreements were agreed, those still outstanding are expected to be completed by June 2018. Both entities are also expected to adopt plans to reduce para-fiscal fees by end-June 2018, complying with constitutional competencies of individual levels of government. On SOE reform, the authorities intend to complete the financial and operational due diligence of BH Telecom and HT Mostar by September 2018. Improving court performance and the efficiency of processing commercial cases are also essential for enhancing the business climate.

Fiscal Policy

34. The 2018 budgets are consistent with the current spending envelope envisaged at the time of the EFF request. The entity central governments will lower their wage bill in relation to GDP by continuing the general wage freeze and hiring restraint. There would also be a limited reduction in the surplus for 2018, in line with the narrowing output gap and increased capital spending. Staff has proposed quarterly PCs and ITs for 2018 (Table 1 in the Supplementary Letter of Intent).

35. Efforts to strengthen public finances are expected to redouble under the program in the period ahead. Public sector employment reform should proceed to the next stage with a focus on rebalancing staffing and pay; this warrants further TA to conduct functional reviews in selected ministries and cantons as well as wage benchmarking. Based on the functional reviews, the operational plans to reduce overall employment in public sector are expected to be adopted by end

2018 (existing SBs #22, 23, and 24). The authorities are progressing with the audit process to verify the eligibility of the existing beneficiaries for all categories of war veterans, and remain committed to prepare a report and plan to improve the targeting of social transfers based on a centralized database of beneficiaries. Given the low fiscal risk in these areas because privileged pensions and veterans' benefits payouts remain limited to budgetary allocation, the authorities request dropping the existing SBs (# 14 and 21).

36. Addressing the issue of public sector arrears to mitigate fiscal risks will be a focus of the program going forward. FBiH will collect data on arrears at all the levels of FBiH government (new SB #4 for end-June 2018), and adopt a time-bound action plan to address the arrears situation (new SB #5 for end-September 2018). RS will require health centers to prepare budgets with hard budget constraints to prevent accumulation of new arrears (new SB #6 for end-September 2018). The RS cabinet is expected to adopt a plan to restore the financial sustainability of health institutions (new SB #7 for end-December 2018). The authorities will continue the work on the expansion of the treasury system to budget management systems in cantons in FBiH and to health centers in RS.

Financial Sector Policies

37. Further modernization and harmonization of banking sector legislations will continue. The new Deposit Insurance Law, which the BIH parliament is expected to adopt by end-March 2018 (existing SB #9), will allow the use of the Deposit Insurance Fund for support to financing bank resolution. The authorities will continue to work on banking agency bylaws and organizational structures emanating from the new bank resolution mandate, and will draft the appropriate secondary legislations. Governance structure and decision-making of banking agencies and the DIA would also need to be improved, and the authorities also plan to further develop needed amendments to the Banking Agency Laws and the Law on Deposit Insurance.

38. Adoption of the FSMoU will strengthen cooperation and information exchange among the financial sector authorities. The banking agencies, the CBBH, and the Deposit Insurance Agency should adopt the identical methodology for determining domestic systemically important banks by March 2018 (new SB #1), which is an important prerequisite for the effective implementation of FSMoU Pillar I. A comprehensive FSMoU is expected to be adopted by June 2018 (new SB #3).

39. Reform of development banks is expected. The entity governments are preparing draft legislations for their respective development banks to address the identified deficiencies that were revealed by IMF and World Bank TA. The entity governments will adopt strategic statements for the development banks, with the assistance of the World Bank. The new legislations are expected to be approved by entity parliaments by end-June 2018 (existing SBs #11 and 12).

C. Financing, Capacity to Repay, and Safeguards

40. BiH continues to face balance of payments needs (Tables 3 and 9). The extended arrangement helps address BiH's balance of payments needs, allows the release of compression in public capital spending and supports policies for boosting economic potential and maintaining macroeconomic stability. The rise in the level of gross international reserves in 2017, compared to that envisaged at the time of program request, was because of a combination of tighter fiscal policy in the context of currency board—largely because of the capital expenditure restraint—and higher short term external inflows driven by higher interest rates in BiH. Fund disbursements in the period ahead are expected to help release some of the expenditure restraint and provide adequate reserves coverage of monetary base. Financing from other sources, including the World Bank and EU, are expected to fill the remaining financing gap.

41. BiH has sufficient capacity to discharge its obligations to the Fund in a timely manner. Debt sustainability analysis suggests that with the economic growth as envisaged under the program and the continuation of prudent fiscal policies, public and external debt will continue to decline and debt servicing obligations will be manageable. By the time of expiration of the extended arrangement, the level of Fund credit outstanding is projected to be around 2.9 percent of GDP (8.5percent of GIR) (Table 8). Fund repurchases and charges peaked in 2017 at 41 percent of total debt service. Fiscal shocks, including those stemming from contingent liabilities, could pose risks (Annex V). The country has an excellent record of meeting Fund financial obligations.

42. The 2017 update of the Safeguards Assessment found that the CBBH legal framework safeguards the central bank's autonomy. The bank's internal audit mechanism and financial reporting continue to adhere to international standards. The CBBH has started taking steps to strengthen oversight, in particular on the delineation between executive and non-executive functions for members of the Governing Board. Further steps are needed to address the recommendations of the 2017 assessment. The CBBH has implemented all recommendations from the 2014 assessment.

D. Program Modalities

43. The authorities request the waiver of nonobservance of the end-June 2017 performance criteria on the net lending (budget balances) for the IBiH and FBiH central government. The targets were missed mainly because of higher-than-expected capital spending and temporary revenue underperformance, due to an unexpectedly-high tax refund which was subsequently compensated by stronger-than-expected revenue, respectively. Staff deems the deviations from the target as small and temporary and supports the authorities' request for waivers.

44. The authorities request the modifications of two ITs on changes in the stock of "other accounts payable" for the general governments of the FBiH and the RS. Given that the lower levels of governments do not have the capacity to accurately report accounts payable data, the authorities request the deletion of these ITs. In the meantime, they are working on improving the fiscal reporting of lower levels of government, while also strengthening monitoring.

45. Given the delay in completing the first review, the authorities also request an extension of the extended arrangement by 12 months, and a rephasing of the remaining purchases (Table 7)**.**

46. Program performance would continue to be monitored on a quarterly basis. Quantitative PCs for 2018, as well as ITs and SBs are indicated in Tables 1 and 2, attached to the authorities' Supplementary Letter of Intent of January 29, 2018.

STAFF APPRAISAL

47. Macroeconomic conditions are stable and the pickup in economic activity is expected to continue. A prudent fiscal position, driven in part by financing constraints, and a strong monetary anchor underpinned by the currency board have enabled macroeconomic stability. The recent adoption of excise duty increase in fuel products, which is expected to unlock external financing for infrastructure investment, is welcome and should stimulate economic activity and job creation in the short term and enhance growth potential in the long run. The external balance is broadly in line with fundamentals. However, private sector-led growth, which is key to job creation, particularly among the youth, needs urgent attention.

48. The authorities are making good progress under the extended arrangement, despite the protracted delay in completing the first review. Fiscal policy has remained on track, and there was progress—albeit uneven—on structural reforms. Program performance is broadly satisfactory. Accelerating the pace of reforms is crucial to putting BiH on a sustainable path of economic growth, and the authorities should redouble efforts to ensure timely implementation of program targets. Following a heavy front-loaded push for reforms in the first year under the program, the number of structural conditions is expected to decline over the near future, as broadly envisaged at the time of the program request. Staff expects EFF program objectives to be met in the period ahead, including the structural and quantitative targets for the second review.

49. Reforms to improve the business environment and the functioning of the labor market are crucial to help make BiH a more attractive place to invest and create jobs. The planned reduction in the labor tax wedge and para fiscal fees would help with employment creation in the formal sector and improve the business environment. It is also crucial to improve the governance and efficiency of SOEs so resource allocation in the economy is enhanced and distortions in the labor market are addressed. The authorities have taken welcome first steps in putting the telecom sector on a path to sustainability by initiating due diligence for restructuring and/or sale of shares. Subsequent steps in the process, including completion of the due diligence followed by restructuring and/or privatization, would be important over the course of 2018. Of course, BiH's high political risk continues to be a deterrent to the country's ability to attract investment, and the effectiveness of policies to improve the business environment would be compromised if political risk remains high or worsens.

50. Fiscal policy should focus on further lowering current spending and raising growth-enhancing capital expenditures in a sustainable manner. BiH's public wage bill is still among the highest in the region. The government should conduct functional employment reviews to establish value for public money. This will help further lower the wage bill in a targeted and sustainable manner while improving the efficiency of public service. Wage bill savings should be channeled to boost public capital spending so as to address BiH's large infrastructure gap. The FBiH authorities' plan to scale up domestically-financed public investment in 2018 is a welcome step, but care is warranted in sweeping the financial surpluses of SOEs to finance such investment in 2018. Lack of clarity about maintaining such funding beyond 2018 and the administration of funds outside the single treasury account argue for caution when implementing this approach. Attention is needed in overcoming implementation-capacity bottlenecks that hinder efficient spending on public capital projects; reform of the public investment management framework would be welcome.

51. Strengthening the PFM framework will be crucial for mitigating fiscal risks and ensuring fiscal sustainability. Arrears accumulated by SOEs, through unpaid pension contributions, are in large part a legacy of the lack of past reforms. The stock of unpaid government liabilities need systematic documentation, and this should be followed by comprehensive SOE reforms, including by restructuring and/or privatization. The health sector poses significant fiscal risks, again with fiscal liabilities and arrears that are potentially large but also not comprehensively documented. The authorities' intention to address the sector's problems with World Bank help are welcome, but the success would depend on political will. Reforms that begin to reduce arrears accumulation should commence promptly.

52. BiH's banking sector remains broadly stable, but vulnerabilities remain and vigilance is warranted. The authorities have made commendable progress in modernizing the legal and regulatory environment of the financial sector by adopting new banking laws and amending the banking agency laws. They should urgently pass the new deposit insurance law so that the resolution function is complete. Continued efforts are needed to improve coordination, cooperation and information exchange among various financial sector authorities to safeguard financial sector stability. Furthermore, governance and decision making processes of the banking agencies and the DIA need to be aligned with international best practice. The supervisory agencies should continue to closely monitor the implementation of the remedial actions aimed at addressing the deficiencies revealed by the recent AQR exercise and should be prepared to take decisive measures. Prudential regulations should be strengthened to promote a more accurate recognition and prudent management of credit risk.

53. Close policy coordination between all levels of the authorities remains of crucial importance to achieve faster growth and speed up the economic integration with the rest of Europe. The recent harmonization of policies and tax and financial sector legislation across entities is a welcome step that will help reduce the cost of doing business and operating within BiH by strengthening the single economic space. These efforts need to be maintained, as without strong policy coordination and cooperation, BiH will be at risk of falling further behind its regional peers.

54. Domestic politics pose a continued risk to the timely and sustained implementation of program policies. Over the program horizon, there are risks that the authorities may not be able to sustain implementation of structural reforms, or such reforms may not be sufficient to induce an adequate private investment response, implying that growth could disappoint. The Reform Agenda, formulated as part of an integrated consultation process and in collaboration with international partners in 2015, provides a key platform to pursue future reforms and build support among the public.

55. Considering the authorities' performance to date and the policies planned for the period ahead—as summarized in the attached supplementary Letter of Intent of January 29, 2018—staff supports the authorities' request for the completion of the first review under the extended arrangement under the EFF. Staff also supports the authorities' request for a 12-month extension and rephasing of purchases under the extended arrangement (Table 7). Additionally, staff supports the authorities' request for waiver of nonobservance for the end-June 2017 PC on the floor of net lending because the deviation in IBiH and FBiH was small and temporary and did not affect the overall fiscal performance, which remained strong. Staff supports the authorities' request for the deletion of the indicative target on "other accounts payable" by the FBiH and RS general governments for end-March 2016 and going forward. Against this backdrop, staff encourages the authorities to step up their efforts to improve the quality and timeliness of fiscal reporting by lower levels of government, with assistance from the World Bank.

56. It is recommended that the next Article IV consultation take place on the 24-month cycle in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96) (9/28/2010).

Table 1. Bosnia and Herzegovina: Selected Economic Indicators, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Proj.			
Nominal GDP (KM million)	26,743	27,304	28,586	29,899	31,283	32,795	34,523	36,459	38,560	40,901
Gross national saving (in percent of GDP)	11.7	10.4	10.3	10.9	11.0	11.8	12.5	14.1	14.8	15.0
Gross investment (in percent of GDP)	17.0	17.8	15.9	16.0	16.3	17.7	19.0	19.8	20.0	20.0
					(Percent change)					
Real GDP	2.4	1.1	3.1	3.2	2.7	3.2	3.5	3.7	3.9	4.0
CPI (period average)	-0.1	-0.9	-1.0	-1.1	1.7	1.6	1.6	1.7	1.8	2.0
Money and credit (end of period)										
Broad money	7.9	7.3	8.0	8.3	8.6	9.4	9.7	9.4	9.7	10.1
Credit to the private sector	2.3	1.8	2.6	3.7	6.0	6.3	6.8	7.0	7.8	7.9
					(In percent of GDP)					
Operations of the general government										
Revenue	43.2	43.4	43.2	42.7	43.5	43.9	43.9	43.8	43.6	43.5
Of which: grants	0.9	1.0	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.6
Expenditure	45.0	46.3	43.4	42.3	41.4	42.6	43.7	44.0	43.8	43.7
Of which: investment expenditure	5.0	5.3	3.6	3.8	3.9	5.5	6.8	7.6	7.7	7.7
Net lending	-1.8	-2.9	-0.2	0.3	2.1	1.2	0.2	-0.2	-0.2	-0.2
Net lending, excluding interest payment	-1.1	-2.1	0.6	1.2	3.0	2.1	1.2	0.7	0.6	0.8
Total public debt	44.5	45.0	45.5	43.7	40.5	38.9	38.0	37.5	36.9	35.7
Domestic public debt	14.2	14.9	15.1	14.4	13.3	11.7	10.9	10.2	10.7	10.6
External public debt	30.4	30.1	30.4	29.4	27.2	27.1	27.1	27.3	26.2	25.0
					(In millions of euros)					
Balance of payments										
Exports of goods and services	4,620	4,754	5,056	5,372	6,208	6,581	6,957	7,380	7,842	8,308
Imports of goods and services	7,419	7,927	7,801	7,993	8,935	9,516	10,117	10,562	11,084	11,637
Current transfers, net	1,889	2,029	1,825	1,826	1,876	1,946	2,019	2,095	2,174	2,238
Current account balance	-728	-1,033	-826	-776	-834	-997	-1,161	-1,059	-1,017	-1,031
(In percent of GDP)	-5.3	-7.4	-5.7	-5.1	-5.2	-5.9	-6.6	-5.7	-5.2	-4.9
Foreign direct investment (+=inflow)	174.6	400.8	248.9	240.5	351.4	365.6	419.2	470.0	541.1	599.6
(In percent of GDP)	1.3	2.9	1.7	1.6	2.2	2.2	2.4	2.5	2.7	2.9
Gross official reserves	3,627	4,013	4,413	4,886	5,288	5,739	6,077	6,596	7,041	7,542
(In months of imports)	5.5	6.2	6.6	6.6	6.7	6.8	6.9	7.1	7.3	7.4
(In percent of monetary base)	113.3	112.1	113.3	113.9	115.7	116.1	113.5	114.8	112.5	111.0
External debt, percent of GDP	61.7	63.7	62.9	63.8	61.1	61.0	60.5	60.1	58.3	56.3

Sources: BiH authorities; and IMF staff estimates and projections.

Table 2. Bosnia and Herzegovina: Real Sector Developments, 2013–22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Proj.			
Real aggregates				(Percent change)						
Growth rates										
GDP at constant 2010 prices	2.4	1.1	3.1	3.2	2.7	3.2	3.5	3.7	3.9	4.0
Domestic demand	0.6	3.2	1.5	3.2	3.0	4.1	4.2	3.3	3.3	3.5
Private	0.9	3.2	3.1	3.1	3.4	2.5	2.9	2.3	3.1	3.5
Public	-0.8	2.9	-5.1	3.4	1.2	11.1	9.5	7.3	4.2	3.5
Consumption	1.3	2.5	2.8	3.0	2.8	2.3	2.6	2.2	2.9	3.3
Private	1.9	2.8	2.8	3.2	3.4	2.3	2.7	2.0	2.8	3.3
Public	-1.3	0.9	2.6	2.0	0.0	2.0	2.0	3.3	3.4	3.5
Gross capital formation	-3.4	7.0	-5.4	4.1	4.1	14.1	11.9	8.5	5.0	4.2
Private	-4.9	5.8	4.6	2.5	3.4	3.8	3.9	4.3	4.4	4.5
Public	0.7	9.8	-28.7	9.4	6.1	46.3	29.6	15.9	5.8	3.6
Net Exports										
Exports of goods and services	8.5	4.6	8.1	5.1	12.5	8.5	5.8	5.8	5.7	5.3
Imports of goods and services	1.4	8.6	2.2	4.3	9.9	8.8	6.5	4.3	3.9	3.8
Contributions to real GDP growth				(Year-on-year change over real GDP in previous year, in percent)						
GDP at constant 2010 prices	2.4	1.1	3.1	3.2	2.7	3.2	3.5	3.7	3.9	4.0
Domestic demand	0.7	3.7	1.7	3.7	3.5	4.8	4.9	4.0	3.9	4.1
Private	0.9	3.0	2.9	3.0	3.3	2.4	2.7	2.2	2.9	3.2
Public	-0.2	0.7	-1.2	0.7	0.3	2.4	2.2	1.8	1.1	0.9
Consumption	1.3	2.4	2.8	3.0	2.8	2.2	2.5	2.2	2.8	3.1
Private	1.5	2.3	2.3	2.6	2.8	1.9	2.2	1.6	2.3	2.6
Public	-0.2	0.2	0.5	0.4	0.0	0.3	0.3	0.5	0.6	0.6
Gross capital formation	-0.6	1.3	-1.0	0.7	0.7	2.5	2.4	1.8	1.1	1.0
Private	-0.7	0.7	0.6	0.3	0.5	0.5	0.5	0.6	0.6	0.6
Public	0.0	0.5	-1.7	0.4	0.3	2.0	1.8	1.2	0.5	0.3
Net Exports	1.7	-2.5	1.3	-0.5	-0.8	-1.6	-1.4	-0.3	0.0	-0.1
Exports of goods and services	2.3	1.3	2.4	1.6	4.0	2.9	2.1	2.2	2.2	2.0
Imports of goods and services	0.6	3.9	1.1	2.1	4.8	4.5	3.5	2.4	2.2	2.1
Deflators				(Percent Change)						
GDP	-0.2	0.9	1.6	1.3	1.9	1.6	1.7	1.8	1.8	2.0
Domestic demand	-0.9	0.8	-0.2	0.0	1.5	1.1	1.4	1.5	1.8	2.0
Consumption	-1.0	1.1	-0.2	-0.2	1.4	1.5	1.7	1.7	1.9	2.1
Investment	-1.1	0.1	-0.9	1.0	2.0	0.1	1.0	1.2	1.7	1.9
Exports of goods and services	-1.9	-1.5	-1.7	1.0	2.7	-2.3	0.0	0.3	0.6	0.6
Imports of goods and services	-2.2	-1.5	-3.8	-1.9	1.7	-2.1	-0.1	0.0	1.0	1.1
Nominal aggregates										
Nominal GDP (KM million)	26,743	27,304	28,586	29,899	31,283	32,795	34,523	36,459	38,560	40,901
				(In percent of GDP)						
Consumption	103.5	105.0	102.9	101.1	100.8	99.8	98.9	97.3	96.5	96.0
Private	82.8	84.6	83.1	82.1	82.3	81.5	80.8	79.4	78.7	78.2
Public	20.7	20.4	19.8	19.1	18.5	18.3	18.0	17.9	17.8	17.7
Gross capital formation	17.0	17.8	15.9	16.0	16.3	17.7	19.0	19.8	20.0	20.0
Private	12.0	12.5	12.3	12.2	12.3	12.2	12.2	12.2	12.2	12.3
Public	5.0	5.3	3.6	3.8	3.9	5.5	6.8	7.6	7.7	7.7
National Savings	11.7	10.4	10.3	10.9	11.0	11.8	12.5	14.1	14.8	15.0
Private	8.6	7.4	6.5	5.9	4.3	5.3	5.0	6.2	6.8	7.0
Public	3.1	3.0	3.8	5.0	6.7	6.5	7.5	7.9	8.0	8.0
Saving-Investment balance	-5.3	-7.4	-5.7	-5.1	-5.2	-5.9	-6.6	-5.7	-5.2	-4.9
Labor market				(In percent)						
Unemployment rate (ILO definition) [1]	27.5	27.5	27.7	25.4	20.5	…	…	…	…	…

Source: BiH, FBiH and RS Statistical Agencies, and Fund staff estimates.

Notes: Nominal and real GDP series are based on the production approach.

[1] Based on the BiH Labor Survey. The unemployment rate based on the number of unemployed persons registered in Unemployment Offices is significantly higher.

Table 3. Bosnia and Herzegovina: Balance of Payments, 2013–22 1/

(In millions of euros, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Proj.				
Current account	-728	-1,033	-826	-776	-834	-997	-1,161	-1,059	-1,017	-1,031
Trade balance	-2,799	-3,173	-2,745	-2,621	-2,727	-2,935	-3,160	-3,182	-3,242	-3,328
Goods	-3,630	-4,026	-3,677	-3,600	-3,811	-4,073	-4,355	-4,444	-4,575	-4,761
Export of goods (fob)	3,397	3,501	3,678	3,935	4,643	4,935	5,225	5,553	5,914	6,289
Import of goods (fob)	-7,027	-7,527	-7,355	-7,535	-8,454	-9,008	-9,580	-9,997	-10,488	-11,050
Services (net)	830	852	932	979	1,084	1,138	1,195	1,262	1,333	1,432
Exports	1,223	1,253	1,378	1,436	1,565	1,646	1,733	1,827	1,929	2,019
Imports	-392	-401	-445	-457	-481	-508	-537	-565	-596	-587
Primary Income (net)	182	111	93	19	18	-8	-20	27	51	59
Total credit	442	488	475	475	495	511	566	627	696	770
Total debit	-259	-378	-381	-456	-477	-519	-586	-599	-645	-711
Of which , Interest payments	-107	-112	-90	-94	-77	-101	-149	-141	-165	-207
Secondary Income (net)	1,889	2,029	1,825	1,826	1,876	1,946	2,019	2,095	2,174	2,238
Government (net)	169	211	180	173	168	180	194	208	224	241
Workers' remittances	1,082	1,150	1,170	1,199	1,297	1,337	1,379	1,423	1,468	1,515
Other (NGOs etc.)	720	761	572	558	599	626	654	683	714	728
Capital and Financial Accounts (excl. Reserves)	999	1,324	1,232	1,119	1,235	1,185	1,294	1,350	1,461	1,533
Capital account	172	226	184	179	178	181	184	186	189	192
Capital transfers (net)	172	226	184	179	178	181	184	186	189	192
General government	122	149	147	142	138	141	144	147	150	153
Other sectors	50	77	36	37	40	40	40	40	40	40
Financial account	-827	-1,098	-1,048	-939	-1,057	-1,004	-1,110	-1,163	-1,272	-1,341
Direct investment (net)	-175	-401	-249	-240	-351	-366	-419	-470	-541	-600
Assets	64	7	85	6	17	18	19	20	21	22
Liabilities	239	408	334	247	368	383	438	490	562	622
Portfolio investment (net)	74	54	56	82	98	5	5	-4	-7	-4
Other investment (net)	-726	-751	-855	-781	-803	-644	-696	-689	-724	-737
Assets (net)	-122	-302	-363	-221	-197	-237	-180	-146	-145	-124
Short-term	-122	-297	-287	-196	-68	-95	-51	-18	-17	0
Banks	18	-15	-80	49	284	68	107	122	79	82
Other sectors, excl. government and central bank	-147	-231	-180	-246	-352	-162	-158	-140	-96	-82
Medium and long-term	0	-5	-76	-25	-130	-143	-129	-128	-128	-124
Banks	14	-7	-14	-5	1	-5	-3	-2	-2	-2
Other sectors, excl. government and central bank	-14	2	-62	-20	-24	-32	-20	-20	-19	-16
Liabilities (net)	604	449	492	560	606	406	516	543	579	613
Short-term	176	332	391	449	614	186	158	136	132	117
General government	0	-13	-6	0	0	0	0	0	0	0
Banks	-77	15	18	141	237	8	10	10	11	12
Other sectors	253	330	379	308	377	179	148	125	121	105
Medium and long-term	428	120	109	111	-8	220	358	407	447	496
Monetary authority	0	0	0	0	0	0	0	0	0	0
General government	302	313	12	89	-144	-58	23	96	90	104
Disbursements of loans	574	619	225	360	278	391	408	420	425	431
Project	348	264	225	281	278	391	408	410	405	401
Budget	226	355	0	80	0	0	0	0	0	0
Amortization of loans	272	305	212	271	422	449	385	324	335	327
Banks	12	-204	-195	-213	35	100	126	136	141	157
Other sectors	114	11	292	235	101	179	208	175	216	235
Errors and omissions	92	74	45	134	0	0	0	0	0	0
Overall balance	-362	-364	-450	-476	-401	-188	-133	-291	-444	-502
Financing	362	364	450	476	401	188	133	291	444	502
Change in net international reserves ("+"=increase)	362	364	450	476	401	452	338	519	444	502
External financing gap (for budgets)	0	0	0	0	0	264	205	229	0	0
Memorandum items										
Current account balance (in percent of GDP)	-5.3	-7.4	-5.7	-5.1	-5.2	-5.9	-6.6	-5.7	-5.2	-4.9
Trade balance (in percent of GDP)	-26.5	-28.8	-25.2	-23.5	-23.8	-24.3	-24.7	-23.8	-23.2	-22.8
Import of goods (change, percent)	-0.7	7.1	-2.3	2.4	12.2	6.6	6.3	4.3	4.9	5.4
Export of goods (change, percent)	9.5	3.0	5.1	7.0	18.0	6.3	5.9	6.3	6.5	6.4
Transfers (in percent of GDP)	13.8	14.5	12.5	11.9	11.7	11.6	11.4	11.2	11.0	10.7
Net foreign direct investment (in percent of GDP)	-1.3	-2.9	-1.7	-1.6	-2.2	-2.2	-2.4	-2.5	-2.7	-2.9
External debt/GDP (in percent)	61.7	63.7	62.9	63.8	61.1	61.0	60.5	60.1	58.3	56.3
Private sector	31.2	34.0	32.5	34.4	33.9	33.8	33.4	32.8	32.1	31.2
Public sector	30.6	29.7	30.5	29.4	27.2	27.1	27.1	27.3	26.2	25.0
External debt service/GNFS exports (percent)	14.0	19.5	18.6	19.3	19.9	19.6	18.7	17.1	16.8	16.5
Gross official reserves (in millions of Euro)	3,627	4,013	4,413	4,886	5,288	5,739	6,077	6,596	7,041	7,542
(In months of prospective imports of goods and services)	5.5	6.2	6.6	6.6	6.7	6.8	6.9	7.1	7.3	7.4

Sources: BiH authorities; and IMF staff estimates and projections.

1/. Based on BPM6.

Table 4. Bosnia and Herzegovina: General Government Statement of Operations, 2013–22

(In percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Proj.			
Revenue	**43.2**	**43.4**	**43.2**	**42.7**	**43.5**	**43.9**	**43.9**	**43.8**	**43.6**	**43.5**
Taxes	22.0	21.9	22.1	22.1	22.7	23.3	23.3	23.3	23.1	23.0
Direct taxes	3.5	3.3	3.5	3.7	4.1	4.1	4.1	4.1	4.1	4.1
Indirect taxes	18.4	18.5	18.5	18.4	18.6	19.2	19.2	19.1	19.0	18.9
Other taxes	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.0	0.0
Social security contributions	15.3	15.7	15.4	14.9	15.2	15.1	15.1	15.1	15.1	15.1
Grants	0.9	1.0	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.6
Other revenue	5.1	4.8	4.9	4.8	4.9	4.8	4.7	4.7	4.7	4.7
Expenditure	**45.0**	**46.3**	**43.4**	**42.3**	**41.4**	**42.6**	**43.7**	**44.0**	**43.8**	**43.7**
Expense	**40.1**	**40.9**	**39.8**	**38.5**	**37.5**	**37.2**	**36.8**	**36.4**	**36.1**	**36.0**
Compensation of employees	12.0	12.0	11.7	11.2	10.8	10.6	10.4	10.3	10.2	10.1
Use of goods and services	10.1	9.7	9.4	9.2	9.0	8.9	8.9	8.9	8.8	8.8
Social benefits	14.2	15.4	14.8	14.2	13.7	13.7	13.6	13.4	13.3	13.2
Interest	0.7	0.8	0.8	0.9	0.9	0.9	1.0	0.8	0.8	1.0
Subsidies	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.1	1.0
Other expense	1.6	1.8	1.8	1.8	1.8	1.9	1.8	1.8	1.8	1.8
Net acquisition of nonfinancial assets	**5.0**	**5.3**	**3.6**	**3.8**	**3.9**	**5.5**	**6.8**	**7.6**	**7.7**	**7.7**
Acquisition of nonfinancial assets	5.1	5.5	3.8	3.9	4.1	5.6	6.9	7.7	7.8	7.8
Foreign financed capital spending	2.6	3.2	2.1	2.4	2.0	2.7	2.7	2.5	2.4	2.3
Domestically financed capital spending	2.5	2.4	1.7	1.5	2.1	2.9	4.3	5.1	5.4	5.5
Disposal of nonfinancial assets	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Gross / Net Operating Balance (revenue minus expense)	**3.2**	**2.5**	**3.4**	**4.1**	**6.1**	**6.7**	**7.0**	**7.4**	**7.5**	**7.5**
Net lending/borrowing (revenue minus expenditure)	**-1.8**	**-2.9**	**-0.2**	**0.3**	**2.1**	**1.2**	**0.2**	**-0.2**	**-0.2**	**-0.2**
Net acquisition of financial assets	**0.6**	**0.4**	**0.7**	**-0.1**	**0.3**	**1.5**	**1.3**	**1.7**	**0.9**	**0.7**
Domestic assets	0.5	0.4	0.7	-0.1	1.0	1.5	1.3	1.7	0.9	0.7
Currency and deposits	0.3	0.9	0.6	0.3	1.5	1.6	1.0	1.4	0.6	0.4
Loans	0.1	-0.3	-0.1	0.0	-0.1	0.3	0.3	0.3	0.3	0.3
Equity and investment fund shares	0.1	-0.1	0.0	0.0	-0.4	-0.4	0.0	0.0	0.0	0.0
Foreign assets	0.1	0.0	0.0	0.0	-0.7	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**1.6**	**2.7**	**1.3**	**-0.1**	**-1.8**	**-1.3**	**-0.1**	**0.7**	**1.1**	**0.9**
Domestic liabilities	-0.1	0.9	1.2	-0.5	-0.7	-1.0	-0.2	0.2	0.8	0.5
Debt securities	0.1	1.0	1.5	1.1	0.2	0.0	0.6	0.8	0.7	0.5
Government obligations under the Law on Internal Debt, issued guarantees, and other obligations from previous years	-0.9	-0.6	-0.4	-0.7	-0.5	-0.4	-0.4	-0.3	-0.3	-0.3
Loans	0.2	0.5	0.1	-0.4	-0.2	-0.5	-0.4	-0.3	0.3	0.3
Foreign liabilities	1.7	1.9	0.1	0.4	-1.1	-0.3	0.2	0.5	0.4	0.4
Loans	1.7	1.9	0.1	0.4	-1.0	-0.3	0.2	0.5	0.4	0.4
Drawings	4.0	4.3	1.8	2.6	1.6	2.3	2.3	2.2	2.1	1.9
Amortization	2.3	2.4	1.7	2.1	2.6	2.7	2.2	1.7	1.7	1.5
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**1.6**	**1.2**	**1.2**	**0.0**	**0.0**
Identified financing	0.0	0.0	0.0	0.0	0.0	1.6	1.2	1.2	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	1.2	0.9	0.6	0.0	0.0
WB	0.0	0.0	0.0	0.0	0.0	0.4	0.2	0.0	0.0	0.0
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	**0.8**	**0.6**	**-0.4**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items										
Net lending excluding externally-financed operations	0.1	-0.5	1.2	2.1	3.6	3.4	2.3	1.8	1.6	1.5
Structural balance (% of potential GDP)	-0.7	-1.4	0.8	1.0	2.7	1.7	0.5	0.0	-0.2	-0.3

Sources: BiH authorities; and IMF staff estimates and projections.

Table 5a. Bosnia and Herzegovina: General Government Statement of Operations, 2013–18

(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**11,563.9**	**11,849.4**	**12,362.0**	**12,755.1**	**3,043.2**	**6,467.1**	**10,045.1**	**13,610.2**	**3,280.1**	**6,809.1**	**10,576.0**	**14,395.9**
Taxes	5,892.7	5,976.2	6,314.2	6,620.3	1,555.8	3,363.3	5,278.1	7,105.9	1,757.4	3,639.1	5,636.5	7,654.1
Direct taxes	943.2	913.3	995.8	1,117.7	309.0	678.3	967.7	1,275.2	336.5	682.4	991.2	1,330.2
Indirect taxes	4,933.9	5,053.5	5,280.1	5,494.1	1,245.9	2,682.2	4,302.8	5,814.7	1,412.1	2,940.8	4,625.0	6,292.6
Other taxes	15.7	9.4	38.2	8.5	0.9	2.7	7.6	16.0	8.7	16.0	20.3	31.3
Social security contributions	4,084.5	4,285.3	4,407.9	4,466.6	1,071.1	2,270.4	3,469.3	4,768.6	1,129.0	2,350.3	3,615.2	4,965.7
Grants	234.1	269.7	242.1	223.6	52.4	103.0	152.3	206.0	52.1	105.6	158.4	216.2
For budget support	51.9	57.6	43.3	38.9	7.1	12.4	16.2	26.4	4.9	11.3	16.9	27.7
For investment projects	182.2	212.2	198.8	184.7	45.3	90.6	136.1	179.6	47.1	94.3	141.4	188.6
Other revenue	1,352.6	1,318.1	1,397.7	1,444.6	363.9	730.5	1,145.3	1,529.8	341.7	714.2	1,165.9	1,559.9
Expenditure	**12,046.5**	**12,633.6**	**12,418.2**	**12,651.7**	**2,749.7**	**5,892.4**	**9,009.1**	**12,947.0**	**3,052.0**	**6,404.3**	**9,853.1**	**13,986.3**
Expense	**10,721.1**	**11,178.1**	**11,390.0**	**11,515.0**	**2,609.5**	**5,463.0**	**8,307.8**	**11,716.4**	**2,773.4**	**5,723.2**	**8,711.0**	**12,183.4**
Compensation of employees	3,206.5	3,283.9	3,345.8	3,347.7	825.3	1,658.9	2,504.8	3,382.1	857.2	1,721.3	2,582.6	3,479.7
Use of goods and services	2,703.4	2,653.3	2,685.0	2,737.8	600.6	1,281.9	1,937.1	2,808.6	661.9	1,357.9	2,054.1	2,934.0
Social benefits	3,802.7	4,195.7	4,222.5	4,238.9	1,015.5	2,056.5	3,095.1	4,279.0	1,072.4	2,182.1	3,295.8	4,487.6
Interest	195.5	209.8	231.3	256.2	47.9	130.5	180.4	268.1	49.3	132.7	185.4	279.8
Subsidies	377.0	357.2	382.0	385.1	43.3	139.8	261.3	416.6	42.3	113.3	223.9	395.2
Grants	16.4	13.3	14.7	9.4	0.4	0.6	6.0	9.9	0.4	1.9	5.8	10.3
Other expense	436.0	478.2	523.2	549.0	76.7	195.5	329.1	562.0	90.2	215.8	369.2	607.0
Net acquisition of nonfinancial assets	**1,325.4**	**1,455.5**	**1,028.1**	**1,136.7**	**140.2**	**429.4**	**701.3**	**1,230.6**	**278.6**	**681.1**	**1,142.1**	**1,802.9**
Acquisition of nonfinancial assets	1,357.4	1,507.2	1,084.9	1,171.0	156.7	454.0	733.8	1,284.1	285.0	695.3	1,165.6	1,836.0
Foreign financed capital spending	699.4	860.2	595.7	717.0	118.8	281.1	449.9	630.5	159.6	386.6	638.8	878.9
Domestically financed capital spending	658.0	647.0	489.2	453.9	37.9	172.9	283.8	653.7	125.4	308.7	526.8	957.0
Disposal of nonfinancial assets	32.0	51.7	56.8	34.3	16.4	24.6	32.5	53.5	6.4	14.2	23.5	33.0
Gross / Net Operating Balance (revenue minus expense)	**842.9**	**671.3**	**972.0**	**1,240.1**	**433.7**	**1,004.1**	**1,737.3**	**1,893.8**	**506.7**	**1,086.0**	**1,865.0**	**2,212.5**
Net lending/borrowing (revenue minus expenditure)	**-482.5**	**-784.2**	**-56.2**	**103.4**	**293.5**	**574.7**	**1,036.0**	**663.2**	**228.1**	**404.8**	**722.9**	**409.6**
Net acquisition of financial assets	**151.6**	**117.0**	**202.5**	**-28.5**	**-22.7**	**49.0**	**-18.0**	**100.2**	**43.4**	**218.6**	**430.4**	**499.0**
Domestic assets	132.1	117.0	202.5	-28.5	-22.7	49.0	190.6	308.9	43.4	218.6	430.4	499.0
Currency and deposits	72.9	238.1	176.9	81.2	-61.6	1.3	233.2	478.1	36.2	252.7	365.1	537.9
Loans	19.1	-90.9	-41.9	6.6	67.0	43.9	-41.5	-35.8	18.9	-20.1	108.7	113.4
Equity and investment fund shares	16.4	-37.2	-3.6	5.0	-12.6	-11.3	-2.6	-128.1	-11.8	-14.0	-43.4	-146.5
Foreign assets	19.6	0.0	0.0	0.0	0.0	0.0	-208.6	-208.7	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**428.3**	**742.2**	**376.1**	**-27.1**	**-167.9**	**-208.3**	**-448.1**	**-563.0**	**-338.5**	**-554.5**	**-737.5**	**-426.8**
Domestic liabilities	-37.0	233.7	348.5	-152.6	-118.8	-6.7	-263.4	-229.1	-410.8	-667.9	-977.8	-320.2
Debt securities	21.6	268.1	427.6	331.5	55.2	173.8	67.4	61.9	-12.8	85.3	169.8	-15.3
Issuance	238.0	656.5	1,012.3	850.2	112.3	398.6	529.3	707.5	124.4	408.8	633.1	757.5
Short-term T-Bills	277.4	331.5	391.7	407.9	49.7	245.3	300.5	487.5	31.9	223.8	355.6	317.5
Long-term government bonds	47.2	324.9	557.7	420.2	62.4	137.8	197.7	220.0	92.5	185.0	277.5	440.0
Amortization	216.1	388.4	584.2	517.9	56.7	224.3	461.2	645.6	137.2	323.4	463.4	772.8
Short-term T-Bills	89.1	307.8	390.4	385.8	34.6	132.2	302.1	430.3	122.2	213.0	334.2	437.5
Long-term government bonds	0.0	80.9	194.0	132.5	22.3	92.3	159.5	215.3	15.0	110.5	129.2	335.3
Government obligations under the Law on Internal Debt, issued guarantees, and other obligations from previous years	-231.2	-159.2	-119.4	-215.1	-24.9	-36.2	-96.3	-148.4	-40.1	-67.5	-126.5	-147.1
Loans	56.3	133.4	35.5	-125.6	19.0	65.3	94.5	-46.9	-357.9	-685.7	-1,021.0	-157.8
Foreign liabilities	465.3	508.5	27.6	125.4	-49.1	-201.6	-184.7	-333.9	72.3	113.3	240.3	-106.6
Loans	465.3	508.5	29.6	125.4	-49.1	-188.9	-172.0	-321.2	72.3	113.3	240.3	-106.5
Drawings	1,076.6	1,173.7	526.9	764.6	89.9	198.8	359.8	498.3	159.3	356.9	581.1	762.9
Amortization	611.2	665.2	497.3	639.1	139.0	387.7	531.8	819.5	87.0	243.6	340.8	869.4
Other accounts payable	0.0	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**153.8**	**368.3**	**445.0**	**516.2**
Identified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	153.8	368.3	445.0	516.2
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	153.8	230.4	307.1	378.3
WB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	137.9	137.9	137.9
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	**205.8**	**159.0**	**-117.5**	**-104.8**	**-148.3**	**-317.4**	**-606.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items												
Indirect revenues	4,933.9	5,053.5	5,280.1	5,494.1	1,245.9	2,682.2	4,302.8	5,814.7	1,412.1	2,940.8	4,625.0	6,292.6
Net lending excluding externally-financed operations	34.7	-136.2	340.7	635.7	367.0	765.2	1,349.8	1,114.1	340.6	697.2	1,220.2	1,099.9

Sources: BiH authorities; and IMF staff estimates and projections.

Table 5b. Institutions of Bosnia and Herzegovina: Statement of Operations, 2013–18 1/
(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**968.6**	**971.6**	**965.5**	**934.7**	**224.7**	**466.2**	**692.0**	**922.7**	**218.5**	**460.7**	**686.6**	**925.2**
Taxes	750.0	750.0	750.0	750.0	186.8	370.6	560.3	750.0	186.8	370.6	560.3	750.0
Direct taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indirect taxes	750.0	750.0	750.0	750.0	186.8	370.6	560.3	750.0	186.8	370.6	560.3	750.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	39.5	31.7	29.2	17.7	5.1	8.6	9.4	12.5	1.7	4.3	6.2	13.0
Other revenue	179.0	190.0	186.3	167.0	32.8	87.0	122.3	160.2	30.0	85.8	120.1	162.2
Expenditure	**903.6**	**904.7**	**903.3**	**908.6**	**210.6**	**437.3**	**666.7**	**946.2**	**233.3**	**452.5**	**678.9**	**956.5**
Expense	**848.6**	**841.7**	**832.6**	**829.0**	**199.0**	**396.6**	**609.1**	**845.8**	**209.9**	**419.8**	**631.1**	**870.4**
Compensation of employees	626.4	627.9	638.8	642.8	157.4	315.1	477.6	642.8	166.5	329.5	497.5	663.0
Use of goods and services	172.3	175.1	151.6	153.9	29.2	64.9	110.3	164.9	34.0	74.5	112.2	175.0
Social benefits	5.3	3.2	2.3	1.0	0.3	0.7	0.9	2.1	0.4	1.0	1.6	2.2
Interest	0.0	0.5	0.7	0.7	0.2	0.3	0.6	1.1	0.2	0.5	0.9	1.1
Transfers to other general government units	13.1	16.5	9.4	6.4	1.4	2.7	4.0	7.0	0.5	1.1	2.6	5.5
Other expense	31.5	18.5	29.9	24.2	9.1	11.4	14.2	26.4	8.4	13.2	16.3	23.4
Net acquisition of nonfinancial assets	**55.0**	**63.0**	**70.6**	**79.6**	**11.6**	**40.7**	**57.6**	**100.4**	**23.4**	**32.7**	**47.9**	**86.1**
Acquisition of nonfinancial assets	56.3	64.8	72.7	80.9	12.0	41.7	58.6	101.2	23.4	32.7	47.9	86.1
Foreign financed capital spending	3.8	3.9	8.7	9.3	0.7	1.2	1.4	9.7	1.9	3.6	8.0	10.2
Domestically financed capital spending	52.5	60.9	64.0	71.7	11.3	40.4	57.2	91.5	21.5	29.1	39.9	75.9
Disposal of nonfinancial assets	1.4	1.8	2.0	1.4	0.4	1.0	1.0	0.8	0.0	0.0	0.0	0.0
Gross / Net Operating Balance (revenue minus expense)	**120.0**	**129.9**	**132.9**	**105.6**	**25.7**	**69.6**	**82.9**	**76.9**	**8.6**	**40.9**	**55.5**	**54.8**
Net lending/borrowing (revenue minus expenditure)	**65.0**	**66.9**	**62.3**	**26.0**	**14.1**	**28.8**	**25.3**	**-23.5**	**-14.8**	**8.3**	**7.7**	**-31.3**
Net acquisition of financial assets	**120.3**	**93.2**	**58.1**	**25.2**	**8.6**	**29.3**	**8.5**	**-23.5**	**-14.8**	**8.3**	**7.7**	**-31.3**
Domestic assets	100.8	93.2	58.1	25.2	8.6	29.3	29.2	-2.8	-14.8	8.3	7.7	-31.3
Foreign assets	19.6	0.0	0.0	0.0	0.0	0.0	-20.7	-20.7	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**56.2**	**26.5**	**-4.1**	**-2.1**	**-4.6**	**1.2**	**-16.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Domestic liabilities	36.7	9.3	-4.1	-2.1	-25.1	-19.3	-37.4	0.0	0.0	0.0	0.0	0.0
Foreign liabilities	19.5	17.2	0.0	0.0	20.5	20.5	20.5	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	19.5	17.2	0.0	0.0	20.5	20.5	20.5	0.0	0.0	0.0	0.0	0.0
Drawings	19.5	17.2	0.0	0.0	20.5	20.5	20.5	0.0	0.0	0.0	0.0	0.0
Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Identified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
WB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	**-0.8**	**0.0**	**-0.1**	**1.3**	**-0.9**	**-0.8**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items												
Net lending excluding externally-financed operations	68.8	70.8	71.0	35.3	14.7	30.1	26.6	-13.8	-12.9	11.9	15.6	-21.1

Sources: BiH authorities; and IMF staff estimates and projections.

1/ Tables 5a, 5c and 5e comprise central government according to international standards.

Table 5c. Federation of Bosnia and Herzegovina: General Government Statement of Operations, 2013–18 1/

(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**6,733.2**	**6,870.2**	**7,212.2**	**7,612.1**	**1,853.7**	**3,933.4**	**6,115.5**	**8,274.6**	**2,026.9**	**4,154.0**	**6,444.9**	**8,755.8**
Taxes	3,168.9	3,226.3	3,449.5	3,688.6	858.8	1,890.1	2,990.4	4,033.6	995.2	2,056.8	3,204.0	4,360.6
Direct taxes	485.4	493.0	555.9	657.0	185.0	416.3	597.1	787.2	211.1	415.8	609.7	822.9
Indirect taxes	2,671.7	2,729.8	2,889.7	3,028.2	673.4	1,472.8	2,391.9	3,243.2	782.0	1,639.6	2,592.3	3,534.3
Other taxes	11.8	3.4	3.9	3.5	0.4	1.0	1.4	3.2	2.1	1.4	2.1	3.4
Social security contributions	2,707.2	2,820.1	2,876.2	3,004.7	747.6	1,561.3	2,354.1	3,233.7	792.5	1,630.8	2,485.3	3,390.0
Grants	139.0	171.8	152.8	145.7	34.2	67.6	102.8	141.3	36.8	73.8	111.0	148.3
Other revenue	718.1	652.1	733.7	773.1	213.1	414.4	668.2	866.0	202.3	392.6	644.6	856.8
Expenditure	**7,129.7**	**7,314.7**	**7,210.9**	**7,381.4**	**1,648.5**	**3,547.3**	**5,408.7**	**7,696.2**	**1,859.7**	**3,949.4**	**6,056.6**	**8,538.1**
Expense	**6,247.3**	**6,436.9**	**6,670.8**	**6,825.0**	**1,570.5**	**3,294.0**	**4,996.7**	**7,007.2**	**1,660.8**	**3,447.0**	**5,231.2**	**7,281.2**
Compensation of employees	1,602.9	1,640.0	1,676.6	1,669.7	414.9	835.3	1,263.7	1,703.9	434.6	874.5	1,308.8	1,765.9
Use of goods and services	1,531.1	1,536.5	1,590.6	1,649.5	382.5	804.3	1,200.7	1,715.3	411.3	860.6	1,284.4	1,796.1
Social benefits	2,485.4	2,602.7	2,652.8	2,707.2	665.2	1,348.7	2,033.4	2,771.3	696.3	1,408.7	2,129.3	2,892.8
Interest	97.5	108.6	117.1	131.8	25.0	67.4	91.5	141.0	25.3	68.7	93.3	142.4
Subsidies	232.3	223.5	253.5	246.8	31.8	93.1	164.0	268.8	29.0	75.6	144.0	250.1
Other expense	298.2	325.5	380.2	420.0	51.1	145.1	243.4	406.8	64.3	158.9	271.5	433.9
Net acquisition of nonfinancial assets	**882.4**	**877.8**	**540.0**	**556.4**	**78.0**	**253.3**	**412.0**	**689.1**	**198.9**	**502.4**	**825.4**	**1,257.0**
Acquisition of nonfinancial assets	892.8	896.8	557.3	570.7	91.8	269.9	430.7	715.8	200.7	507.6	835.0	1,271.7
Foreign financed capital spending	509.1	590.5	344.1	364.5	81.1	186.6	292.2	373.2	129.3	312.0	492.1	646.9
Domestically financed capital spending	383.7	306.3	213.2	206.2	10.8	83.3	138.5	342.6	71.4	195.6	342.8	624.8
Disposal of nonfinancial assets	10.4	19.0	17.3	14.3	13.8	16.7	18.6	26.7	1.8	5.2	9.6	14.7
Gross / Net Operating Balance (revenue minus expense)	**485.9**	**433.3**	**541.4**	**787.1**	**283.2**	**639.4**	**1,118.8**	**1,267.4**	**366.1**	**707.0**	**1,213.7**	**1,474.6**
Net lending/borrowing (revenue minus expenditure)	**-396.5**	**-444.5**	**1.3**	**230.6**	**205.1**	**386.1**	**706.8**	**578.4**	**167.2**	**204.6**	**388.3**	**217.6**
Net acquisition of financial assets	**-95.0**	**-66.3**	**87.5**	**53.7**	**50.7**	**74.9**	**-28.4**	**148.2**	**49.5**	**75.5**	**188.9**	**268.8**
Domestic assets	-95.0	-66.3	87.5	53.7	50.7	74.9	99.6	276.1	49.5	75.5	188.9	268.8
Currency and deposits	-68.2	22.6	102.0	19.4	-34.9	-5.5	113.6	440.0	30.0	130.0	180.0	390.0
Net incurrence of liabilities	**119.2**	**297.6**	**232.6**	**-95.6**	**-39.4**	**-54.0**	**-229.0**	**-430.2**	**-220.2**	**-365.5**	**-486.8**	**-283.7**
Domestic liabilities	-144.7	10.5	293.4	-37.5	-0.4	71.6	-85.5	-140.2	-264.1	-456.2	-664.9	-224.1
Debt securities	30.1	169.9	307.4	142.4	0.0	90.4	-74.1	-41.2	-57.5	-15.0	27.5	-90.0
Foreign liabilities	263.9	287.1	-60.8	-58.1	-39.0	-125.6	-143.5	-289.9	43.9	90.7	178.1	-59.6
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	263.9	287.1	-60.8	-58.1	-39.0	-125.6	-143.5	-289.9	43.9	90.7	178.1	-59.6
Drawings	662.3	719.1	253.0	336.8	50.0	123.8	198.7	245.1	102.5	256.2	409.9	512.3
Amortization	398.4	432.0	313.8	394.9	89.0	249.4	342.2	535.0	58.6	165.4	231.7	571.9
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy / financing gap	**182.2**	**80.6**	**-146.4**	**-81.3**	**-115.1**	**-257.2**	**-506.2**	**0.0**	**102.5**	**236.3**	**287.4**	**335.0**

Sources: BiH authorities; and IMF staff estimates and projections.

1/ General Government statement of Operation includes entity central government, local governments and social security and other funds.

Table 5d. Federation of Bosnia and Herzegovina: Central Government Statement of Operations, 2013–18 1/

(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**1,595.6**	**1,673.9**	**1,646.7**	**1,774.7**	**394.3**	**862.7**	**1,441.9**	**1,985.8**	**412.0**	**872.5**	**1,397.3**	**2,058.7**
Taxes	1,262.5	1,310.4	1,303.0	1,430.9	328.5	732.2	1,167.6	1,598.4	341.8	730.4	1,125.2	1,702.1
Direct taxes	49.3	46.1	45.2	63.9	18.7	35.0	55.3	66.7	23.5	35.4	51.4	67.5
Indirect taxes	1,213.0	1,264.2	1,257.8	1,366.7	309.8	697.1	1,112.3	1,531.8	318.3	695.0	1,073.8	1,634.6
Other taxes	0.1	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	130.0	150.4	137.3	131.8	32.0	64.1	96.1	128.2	33.6	67.3	100.9	134.6
For budget support	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
For investment projects	130.0	150.3	137.3	131.8	32.0	64.1	96.1	128.2	33.6	67.3	100.9	134.6
Other revenue	203.1	213.1	206.4	211.9	33.7	66.5	178.2	259.2	36.5	74.9	171.1	222.0
Expenditure	**1,573.7**	**1,565.5**	**1,673.2**	**1,671.0**	**337.0**	**774.7**	**1,199.9**	**1,861.6**	**390.0**	**864.2**	**1,383.7**	**2,039.9**
Expense	**1,342.1**	**1,353.1**	**1,342.4**	**1,365.4**	**272.5**	**616.5**	**957.0**	**1,555.2**	**298.5**	**631.1**	**1,017.6**	**1,609.3**
excl. transfers to road & highway funds									286.7	617.2	974.2	1,462.9
Compensation of employees	224.9	231.1	225.3	220.7	54.1	108.3	164.7	228.8	57.3	114.9	172.2	236.2
Use of goods and services	73.4	57.9	71.5	79.5	11.2	30.3	45.6	83.4	14.8	33.5	51.5	87.8
Social benefits	460.6	465.4	466.2	466.4	109.7	221.6	335.7	472.7	110.1	224.2	342.0	473.3
Interest	84.2	92.3	95.0	108.0	18.9	56.1	74.8	116.1	19.4	57.9	76.5	116.3
Subsidies	126.2	116.3	123.1	117.5	10.9	44.9	84.0	138.2	5.4	22.6	59.2	118.2
Transfers to other general government units	317.0	321.0	313.5	315.8	62.7	143.3	224.5	324.6	69.9	145.6	232.7	357.2
Other expense	55.8	69.1	47.7	57.5	5.0	11.9	27.6	191.5	21.6	32.4	83.6	220.3
Net acquisition of nonfinancial assets	**231.6**	**212.4**	**330.8**	**305.6**	**64.4**	**158.2**	**242.9**	**306.3**	**91.5**	**233.1**	**366.1**	**430.6**
Acquisition of nonfinancial assets	231.7	217.8	330.9	305.7	64.4	158.3	243.1	306.3	91.5	233.1	366.1	430.6
Foreign financed capital spending	218.8	209.3	323.8	296.2	64.0	155.6	238.8	269.7	90.1	228.1	350.4	386.4
Domestically financed capital spending	12.9	8.5	7.1	9.4	0.4	2.7	4.3	36.7	1.4	4.9	15.7	44.1
Disposal of nonfinancial assets	0.0	5.4	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Gross / Net Operating Balance (revenue minus expense)	**253.5**	**320.8**	**304.3**	**409.3**	**121.7**	**246.3**	**485.0**	**430.6**	**113.5**	**241.4**	**379.6**	**449.3**
Net lending/borrowing (revenue minus expenditure)	**21.8**	**108.4**	**-26.5**	**103.7**	**57.3**	**88.1**	**242.0**	**124.2**	**22.0**	**8.3**	**13.6**	**18.8**
Net acquisition of financial assets	**-84.3**	**-2.6**	**-2.6**	**-134.5**	**-52.2**	**-70.1**	**-177.0**	**-343.7**	**-20.7**	**-53.2**	**-99.9**	**-145.5**
Domestic assets	-84.3	-2.6	-2.6	-134.5	-52.2	-70.1	-49.0	-215.7	-20.7	-53.2	-99.9	-145.5
Currency and deposits	-51.9	28.0	102.0	19.4	-34.9	-5.5	113.6	60.0	0.0	0.0	0.0	120.0
Foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	-128.0	-128.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**-105.8**	**-171.3**	**22.6**	**-238.1**	**-105.9**	**-151.9**	**-398.8**	**-467.9**	**-145.1**	**-297.9**	**-401.0**	**-499.2**
Domestic liabilities	-78.1	-77.1	104.5	-114.1	-50.3	3.7	-202.7	-77.7	-143.4	-295.0	-421.1	-182.5
Debt securities	30.1	169.6	230.3	120.7	0.0	75.1	-104.8	-41.2	-57.5	-15.0	27.5	-90.0
Foreign liabilities	-27.7	-94.2	-82.0	-124.0	-55.7	-155.6	-196.0	-390.3	-1.7	-2.8	20.2	-316.7
Loans	-27.7	-94.2	-82.0	-124.0	-55.7	-155.6	-196.0	-390.3	-1.7	-2.8	20.2	-316.7
Drawings	368.5	337.2	230.3	267.1	32.1	91.7	142.8	141.5	56.5	160.9	249.5	251.9
For budget support	279.8	278.2	43.8	102.7	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0
For investment projects	88.7	59.0	186.5	164.4	32.0	91.6	142.6	141.5	56.5	160.9	249.5	251.9
Amortization	396.2	431.4	312.3	391.1	87.7	247.3	338.8	531.8	58.2	163.7	229.3	568.6
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**102.5**	**236.3**	**287.5**	**334.9**
Identified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	102.5	236.3	287.5	334.9
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	102.5	153.6	204.7	252.2
WB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	82.7	82.7	82.7
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0	0.0
Statistical discrepancy	**-0.3**	**60.3**	**1.3**	**-0.1**	**-3.6**	**-6.2**	**-20.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items												
Net lending excluding externally-financed operations	110.6	167.4	160.0	268.1	89.3	179.6	384.7	265.7	78.4	169.2	263.0	270.6

Sources: BiH authorities; and IMF staff estimates and projections.

1/ Tables 5a, 5c and 5e comprise central government according to international standards.

Table 5e. Republika Srpska: General Government Statement of Operations, 2013–18 1/

(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**3,628.8**	**3,787.1**	**3,952.3**	**3,959.3**	**911.7**	**1,950.1**	**3,052.8**	**4,145.1**	**969.7**	**2,059.0**	**3,222.4**	**4,412.7**
Taxes	1,793.3	1,816.5	1,920.5	1,978.8	464.9	1,004.6	1,573.5	2,102.2	519.5	1,095.7	1,688.3	2,293.1
Direct taxes	434.9	399.4	416.0	435.1	118.8	250.7	353.0	461.1	118.3	253.0	360.4	479.2
Indirect taxes	1,355.6	1,412.5	1,471.5	1,539.9	346.0	752.8	1,215.2	1,629.6	394.9	828.6	1,310.6	1,787.4
Other taxes	2.9	4.6	33.0	3.8	0.2	1.1	5.2	11.5	6.3	14.1	17.3	26.6
Social security contributions	1,341.6	1,429.5	1,498.4	1,425.1	317.2	693.5	1,090.1	1,496.3	330.2	705.9	1,100.9	1,535.3
Grants	55.4	66.6	61.5	60.1	13.2	26.5	40.0	51.4	13.5	27.0	40.5	54.0
Other revenue	438.5	474.5	471.9	495.4	116.3	225.5	349.2	495.3	106.5	230.4	392.8	530.3
Expenditure	**3,774.9**	**4,183.8**	**4,069.4**	**4,160.0**	**862.2**	**1,832.4**	**2,802.0**	**4,094.7**	**921.5**	**1,915.5**	**2,971.0**	**4,269.8**
Expense	**3,409.3**	**3,687.8**	**3,668.6**	**3,666.9**	**812.7**	**1,700.1**	**2,576.0**	**3,661.5**	**865.9**	**1,772.5**	**2,707.9**	**3,818.2**
Compensation of employees	901.1	949.4	966.2	970.9	237.1	476.1	714.1	968.0	237.9	481.4	723.0	980.2
Use of goods and services	924.7	871.5	867.1	869.3	181.1	387.1	583.6	860.3	203.9	400.3	609.7	891.6
Social benefits	1,275.5	1,546.3	1,520.7	1,496.2	345.6	697.9	1,046.7	1,469.6	372.5	757.2	1,148.6	1,554.9
Interest	97.6	100.5	113.4	123.6	22.7	62.7	88.3	126.0	23.8	63.5	91.3	136.2
Subsidies	123.4	110.1	105.0	111.7	9.8	38.0	78.0	118.6	10.7	28.4	59.8	115.9
Other expense	86.9	110.1	96.2	94.9	16.1	38.3	65.4	118.9	17.1	41.7	75.6	139.4
Net acquisition of nonfinancial assets	**365.6**	**496.0**	**400.8**	**493.1**	**49.5**	**132.3**	**225.9**	**433.2**	**55.5**	**143.0**	**263.1**	**451.6**
Acquisition of nonfinancial assets	385.9	526.8	438.3	511.7	51.7	139.3	238.8	459.2	60.1	152.0	277.1	469.9
Foreign financed capital spending	186.5	265.8	242.9	343.3	37.1	93.3	156.4	247.5	28.4	71.1	138.6	221.9
Domestically financed capital spending	199.4	261.1	195.4	168.5	14.6	46.1	82.4	211.7	31.7	80.9	138.4	248.0
Disposal of nonfinancial assets	20.3	30.9	37.5	18.6	2.2	7.0	12.9	26.0	4.6	9.0	13.9	18.3
Gross / Net Operating Balance (revenue minus expense)	**219.5**	**99.3**	**283.6**	**292.5**	**99.0**	**250.0**	**476.7**	**483.6**	**103.8**	**286.5**	**514.6**	**594.4**
Net lending/borrowing (revenue minus expenditure)	**-146.1**	**-396.7**	**-117.2**	**-200.6**	**49.5**	**117.7**	**250.8**	**50.4**	**48.3**	**143.4**	**251.4**	**142.9**
Net acquisition of financial assets	**79.2**	**39.3**	**58.1**	**-106.5**	**-82.0**	**-54.4**	**2.6**	**-82.4**	**-18.7**	**86.4**	**158.3**	**181.1**
Domestic assets	79.2	39.3	58.1	-106.5	-82.0	-54.4	62.6	-22.4	-18.7	86.4	158.3	181.1
Currency and deposits	-5.3	81.6	15.8	30.8	-33.9	-15.9	94.7	0.1	0.1	80.1	125.1	130.5
Net incurrence of liabilities	**262.3**	**413.3**	**149.4**	**73.1**	**-124.1**	**-154.3**	**-199.6**	**-132.8**	**-118.3**	**-189.0**	**-250.7**	**-143.0**
Domestic liabilities	80.4	214.4	59.6	-112.5	-93.5	-58.8	-140.1	-88.8	-146.7	-211.6	-312.9	-96.1
Debt securities	-8.6	98.1	120.2	189.1	55.2	83.4	141.5	103.1	44.7	100.3	142.3	74.7
Government obligations under the Law on Internal Debt, issued guarantees, and other obligations from previous years	-109.6	-19.3	-4.5	-67.1	-24.4	-35.6	-67.8	-120.3	-25.2	-50.6	-83.9	-104.7
Loans	62.7	33.3	-76.2	-180.5	-31.5	12.5	7.5	3.5	-166.2	-261.3	-371.2	-66.2
Other accounts payable	135.9	102.2	20.2	-53.9	-92.8	-119.1	-221.3	-75.1	0.0	0.0	0.0	0.0
Loans	181.9	198.9	91.7	185.6	-30.7	-82.8	-46.8	-31.3	28.4	22.6	62.2	-46.9
Drawings	394.7	430.8	273.6	427.6	19.4	54.0	140.2	253.2	56.8	100.8	171.2	250.5
For budget support	179.4	154.3	29.3	51.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
For investment projects	215.3	276.5	244.4	376.1	19.4	54.0	140.2	253.2	56.8	100.8	171.2	250.5
Amortization	212.8	231.9	181.9	242.0	50.0	136.8	187.0	284.5	28.4	78.2	109.1	297.5
Other accounts payable	0.0	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy / financing gap	**-37.0**	**22.8**	**25.9**	**21.0**	**-7.4**	**-17.8**	**-48.6**	**0.0**	**51.3**	**131.9**	**157.5**	**181.2**

Sources: BiH authorities; and IMF staff estimates and projections.

1/ General Government statement of Operation includes entity central government, local governments and social security and other funds.

Table 5f. Republika Srpska: Consolidated Central Government Statement of Operation, 2013–18 1/

(KM million)

	2013	2014	2015	2016	2017				2018			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
					Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	**1,670.2**	**1,754.6**	**1,826.7**	**2,606.3**	**604.1**	**1,284.3**	**1,992.4**	**2,690.9**	**629.2**	**1,327.5**	**2,055.4**	**2,846.3**
Taxes	1,360.7	1,374.3	1,433.5	1,515.7	360.1	765.5	1,200.1	1,612.0	386.1	816.3	1,241.4	1,721.9
Direct taxes	350.5	324.2	338.0	357.9	102.8	211.1	291.6	374.4	100.5	211.4	296.5	388.2
Indirect taxes	1,007.9	1,046.8	1,066.4	1,155.4	257.2	553.5	903.6	1,227.6	279.6	591.4	928.3	1,308.6
Other taxes	2.4	3.3	29.1	2.4	0.1	0.9	4.9	10.0	6.0	13.5	16.5	25.0
Social security contributions	0.0	42.6	73.9	779.4	176.2	383.5	587.2	800.6	176.7	377.7	589.0	821.4
Grants	52.2	60.3	55.1	52.9	12.9	25.7	38.6	51.4	13.5	27.0	40.5	54.0
For budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
For investment projects	52.2	60.3	55.1	52.9	12.9	25.7	38.6	51.4	13.5	27.0	40.5	54.0
Other revenue	257.1	267.0	261.7	257.0	55.0	108.8	164.6	226.9	52.9	106.6	184.6	249.0
Expenditure	**1,634.7**	**1,991.4**	**1,837.4**	**2,636.5**	**556.1**	**1,198.3**	**1,839.5**	**2,719.4**	**601.5**	**1,261.2**	**1,946.3**	**2,796.5**
Expense	**1,524.0**	**1,761.6**	**1,688.3**	**2,459.4**	**538.0**	**1,145.0**	**1,764.9**	**2,524.4**	**570.8**	**1,184.1**	**1,822.9**	**2,592.2**
excl. transfers to road & highway funds	1,524.0	1,750.1	1,688.3	2,459.4	538.0	1,145.0	1,764.9	2,524.4	570.8	1,184.1	1,822.9	2,592.2
Compensation of employees	677.7	718.0	735.2	746.8	180.9	362.3	542.1	740.5	182.8	368.1	551.1	746.8
Use of goods and services	156.9	163.0	155.1	148.3	17.8	55.5	87.8	156.0	20.4	51.2	85.4	155.1
Social benefits	230.6	327.5	271.1	1,227.6	300.7	601.7	902.7	1,259.2	318.1	638.8	960.7	1,298.5
Interest	64.6	68.4	80.5	94.5	17.0	48.8	69.2	99.0	18.4	49.6	70.4	107.9
Subsidies	112.8	99.8	94.4	98.9	7.7	32.5	63.2	105.1	6.8	21.3	47.0	101.8
Transfers to other general government units	242.7	320.3	310.8	104.2	9.1	32.2	77.7	110.1	19.1	39.1	74.3	111.8
Other expense	38.7	64.7	41.2	39.0	4.7	12.0	22.3	54.5	5.1	16.0	33.9	70.4
Net acquisition of nonfinancial assets	**110.7**	**229.8**	**149.1**	**177.1**	**18.1**	**53.3**	**74.6**	**195.0**	**30.8**	**77.2**	**123.4**	**204.3**
Acquisition of nonfinancial assets	117.4	243.3	167.8	182.1	19.0	55.2	78.4	206.7	31.7	79.1	126.5	207.6
Foreign financed capital spending	67.1	122.0	79.2	148.3	16.6	46.1	63.1	120.9	22.3	47.9	86.8	121.7
Domestically financed capital spending	50.4	121.4	88.7	33.7	2.4	9.1	15.3	85.7	9.4	31.2	39.7	85.9
Disposal of nonfinancial assets	6.7	13.6	18.7	4.9	0.9	1.9	3.8	11.7	0.9	2.0	3.1	3.3
Gross / Net Operating Balance (revenue minus expense)	**146.3**	**-7.0**	**138.4**	**147.0**	**66.1**	**139.3**	**227.5**	**166.5**	**58.4**	**143.5**	**232.6**	**254.2**
Net lending/borrowing (revenue minus expenditure)	**35.5**	**-236.8**	**-10.7**	**-30.2**	**48.0**	**86.0**	**152.9**	**-28.4**	**27.7**	**66.3**	**109.1**	**49.9**
Net acquisition of financial assets	**109.7**	**59.1**	**60.9**	**89.7**	**-57.0**	**-36.9**	**29.1**	**-2.3**	**19.0**	**104.4**	**125.9**	**101.6**
Domestic assets	109.7	59.1	60.9	89.7	-57.0	-36.9	89.1	57.7	19.0	104.4	125.9	101.6
Currency and deposits	12.7	69.0	2.1	-20.6	-19.4	16.8	79.7	0.0	0.0	80.0	80.0	35.4
Loans	93.5	42.9	-2.7	115.0	-32.7	-50.1	14.8	57.3	19.0	24.4	45.9	65.8
Equity and investment fund shares	4.3	-40.4	0.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**74.2**	**296.4**	**76.1**	**118.7**	**-101.0**	**-117.8**	**-118.6**	**26.1**	**-59.9**	**-93.9**	**-140.7**	**-129.6**
Domestic liabilities	-13.9	165.1	41.8	-23.5	-70.3	-37.5	-74.3	82.8	-88.2	-115.1	-198.4	-70.1
Debt securities	-3.9	101.6	123.6	193.2	55.4	84.3	134.3	103.1	44.7	100.3	142.3	74.7
Government obligations under the Law on Internal Debt, issued guarantees, and other obligations from previous years	-7.4	-19.3	-4.5	-67.1	-24.4	-35.5	-67.8	-115.1	-24.9	-50.0	-82.8	-99.1
Loans	11.5	15.2	-56.0	-140.1	-19.2	2.8	-12.3	94.8	-108.0	-165.5	-257.8	-45.7
Foreign liabilities	88.1	131.3	34.3	142.2	-30.7	-80.3	-44.3	-56.6	28.2	21.2	57.6	-59.5
Drawings	296.7	361.1	204.0	357.5	19.4	54.0	140.2	240.5	56.7	99.4	166.7	238.0
Amortization	208.6	229.8	169.7	215.3	50.0	121.6	171.8	284.5	28.4	78.2	109.1	297.5
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**51.3**	**132.0**	**157.5**	**181.3**
Identified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	51.3	132.0	157.5	181.3
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	51.3	76.8	102.4	126.1
WB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	55.2	55.2	55.2
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	**0.0**	**-0.5**	**-4.5**	**1.2**	**-4.1**	**-5.1**	**-5.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items												
Net lending excluding externally-financed operations	50.4	-175.1	13.4	65.3	51.8	106.4	177.4	41.1	36.5	87.2	155.4	117.5

Sources: BiH authorities; and IMF staff estimates and projections.

1/ Tables 5a, 5c and 5e comprise central government according to international standards.

Table 6. Bosnia and Herzegovina: Monetary Survey, 2014–17

	2014 Dec	2015 Dec	2016 Dec	2017 Proj.
	(Million KM, end of period)			
Net foreign assets	7,514	8,490	9,722	10,457
Foreign assets	10,475	11,104	12,197	12,982
Foreign liabilities	2,961	2,614	2,475	2,525
Net domestic assets	9,787	10,154	10,473	11,469
Domestic credit	16,039	16,500	16,962	17,923
Claims on general government (net)	580	697	620	620
Claims on nongovernment	15,459	15,803	16,342	17,303
Other items (net)	-6,253	-6,346	-6,489	-6,454
Broad money (M2)	17,269	18,647	20,198	21,926
Narrow money (M1)	7,310	8,181	9,301	9,588
Currency	2,814	3,055	3,401	4,060
Demand deposits	4,496	5,126	5,900	5,528
Quasi-money (M1)	9,959	10,466	10,897	12,337
Time and savings deposits	3,377	3,563	3,883	3,538
Foreign currency deposits	6,581	6,904	7,014	8,799
Net foreign assets	6.9	5.7	6.6	3.6
Net domestic assets	0.6	2.1	1.7	4.9
Domestic credit	2.7	2.7	2.5	4.8
Claims on general government (net)	1.1	0.7	-0.4	0.0
Claims on nongovernment	1.6	2.0	2.9	4.8
Other items (net)	-2.1	-0.5	-0.8	0.2
Broad money (M2)	7.3	8.0	8.3	8.6
Memorandum items:				
	(Annual percent change)			
Broad money (M2)	7.3	8.0	8.3	8.6
Reserve money (RM)	9.4	8.8	10.2	6.6
Credit to the private sector	1.8	2.6	3.7	6.0
	(Percent)			
Credit to the private sector (in percent of GDP)	55.0	53.9	53.4	54.1
Broad money (in percent of GDP)	63.2	65.2	67.6	70.1
Central bank net foreign assets (in percent of monetary base)	112.1	113.3	113.9	115.7
	(Ratio)			
Velocity (GDP/end-of-period M2)	1.5	1.4	1.5	1.4
Reserve money multiplier (M2/RM)	2.5	2.4	2.4	2.5

Source: CBBH and IMF staff estimates and projections.

Table 7. Bosnia and Herzegovina: Proposed Schedule of Purchases Under the Extended Fund Facility, 2016–20

	Available on or after	Amount of Purchase In millions of SDRs	In percent of quota [1]	Conditions
1	September 7, 2016	63.4125	23.911	Board approval of the arrangement.
2	December 25, 2016	63.4125	23.911	First review, end-June 2017 performance criteria
3	June 1, 2018	31.6217	11.924	Second review, end-March 2018 performance criteria
4	September 1, 2018	31.6217	11.924	Third review, end-June 2018 performance criteria
5	December 1, 2018	31.6217	11.924	Fourth review, end-September 2018 performance criteria
6	March 1, 2019	31.6217	11.924	Fifth review, end-December 2018 performance criteria
7	June 1, 2019	31.6217	11.924	Sixth review, end-March 2019 performance criteria
8	September 1, 2019	31.6217	11.924	Seventh review, end-June 2019 performance criteria
9	December 1, 2019	31.6217	11.924	Eighth review, end-September 2019 performance criteria
10	March 1, 2020	31.6217	11.924	Ninth review, end-December 2019 performance criteria
11	June 1, 2020	31.6217	11.924	Tenth review, end-March 2020 performance criteria
12	August 15, 2020	31.6217	11.924	Eleventh review, end-June 2020 performance criteria
	Total	**443.0420**	**167.060**	

[1] The quota is SDR 265.2 million.

Table 8. Bosnia and Herzegovina: Indicators of Capacity to Repay the Fund, 2015–27

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.			Proj.									
Fund repurchases and charges 1/													
In millions of SDRs	43.2	72.0	162.9	129.5	75.6	8.5	19.6	27.3	50.6	70.8	80.2	78.8	67.0
In millions of euros	54.5	90.4	201.9	160.5	93.7	10.6	24.3	33.9	62.7	87.8	99.4	97.7	83.1
In percent of exports of goods and NFS	1.1	1.7	3.3	2.4	1.3	0.1	0.3	0.4	0.7	1.0	1.0	1.0	0.8
In percent of external public debt service	18.0	23.9	41.1	30.1	18.6	2.0	4.8	6.6	12.2	17.1	19.3	19.0	16.2
In percent of general government revenues	0.9	1.4	2.9	2.2	1.2	0.1	0.3	0.4	0.7	0.9	1.4	1.7	1.7
In percent of gross official reserves	1.2	1.9	3.8	2.8	1.5	0.2	0.4	0.5	0.8	1.1	1.2	1.1	0.9
Fund credit outstanding 1/													
In millions of SDRs	416.4	412.2	254.7	290.4	348.2	443.0	432.5	414.0	371.8	308.5	234.6	160.8	97.5
In millions of euros	525.0	517.6	315.8	360.0	431.7	549.3	536.1	513.2	460.9	382.4	290.9	199.3	120.9
In percent of quota	246.2	155.4	96.0	109.5	131.3	167.1	163.1	156.1	140.2	116.3	88.5	60.6	36.8
In percent of GDP	3.6	3.4	2.0	2.1	2.4	2.9	2.6	2.4	2.0	1.6	1.2	0.7	0.4
In percent of gross official reserves	11.9	10.6	6.0	6.3	7.1	8.5	7.9	7.1	6.0	4.7	3.4	2.2	1.3
Memorandum items:													
Exports of goods and services (millions of euros)	5,056	5,372	6,208	6,581	6,957	7,355	7,776	8,221	8,691	9,188	9,714	10,270	10,857
External public debt service (millions of euros)	303	378	492	533	504	519	512	515	513	514	514	514	514
Quota (millions of SDRs)	169	265	265	265	265	265	265	265	265	265	265	265	265
Quota (millions of euros)	213	333	329	329	329	329	329	329	329	329	329	329	329
Gross official reserves (millions of euros)	4,413	4,886	5,288	5,739	6,077	6,435	6,814	7,215	7,640	8,090	8,567	9,071	9,606
GDP (millions of euros)	14,608	15,287	15,995	17,152	18,125	19,153	20,240	21,388	22,601	23,884	25,239	26,670	28,183
Euros per SDR	1.26	1.26	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24

Source: Fund staff estimates.

1/ Based on existing and prospective drawings (Table 7).

Table 9a. Bosnia and Herzegovina: Gross Financing Requirements 2015–20

(In millions of euros)

	2015	2016	2017	2018	2019	2020
Financing requirements	1,459	1,493	1,730	1,938	2,059	1,914
Current account deficit	826	776	834	997	1,161	1,059
Amortization	632	717	897	941	898	855
Government	249	313	422	449	385	324
Other	383	404	474	491	513	530
Financing	1,459	1,493	1,730	1,674	1,854	1,685
Capital transfers	184	179	178	181	184	186
FDI	249	240	351	366	419	470
Net bank financing	-83	-116	-13	44	31	26
Foreign loans	1,273	1,308	1,230	1,240	1,278	1,251
Government 1/	218	360	278	391	408	420
Other	1,055	947	952	849	870	831
Gross international reserves (- = increase)	-450	-476	-401	-452	-338	-519
Other 2/	286	358	385	295	280	271
Financing gap	0	0	0	264	205	229
IMF	0	0	0	193	154	116
EU	0	0	0	0	7	113
World Bank	0	0	0	71	44	0

Source: IMF staff projections and calculations.
1/ It includes actual disbursements under the Fund arrangements.
2/ It includes net errors and omissions, net portfolio flows and asset transations of general government and non-bank private sector.

Table 9b. Bosnia and Herzegovina: Gross Financing Requirements 2015–20

(In percent of GDP)

	2015	2016	2017	2018	2019	2020
Financing requirements	10.0	9.8	10.8	11.6	11.7	10.3
Current account deficit	5.7	5.1	5.2	5.9	6.6	5.7
Amortization	4.3	4.7	5.6	5.6	5.1	4.6
Government	1.7	2.0	2.6	2.7	2.2	1.7
Other	2.6	2.6	3.0	2.9	2.9	2.8
Financing	10.0	9.8	10.8	10.0	10.5	9.0
Capital transfers	1.3	1.2	1.1	1.1	1.0	1.0
FDI	1.7	1.6	2.2	2.2	2.4	2.5
Net bank financing	-0.6	-0.8	-0.1	0.3	0.2	0.1
Foreign loans	8.7	8.6	7.7	7.4	7.2	6.7
Government 1/	1.5	2.4	1.7	2.3	2.3	2.3
Other	7.2	6.2	6.0	5.1	4.9	4.5
Gross international reserves (- = increase)	-3.1	-3.1	-2.5	-2.7	-1.9	-2.8
Other 2/	2.0	2.3	2.4	1.8	1.6	1.5
Financing gap	0.0	0.0	0.0	1.6	1.2	1.2
IMF	0.0	0.0	0.0	1.2	0.9	0.6
EU	0.0	0.0	0.0	0.0	0.0	0.6
World Bank	0.0	0.0	0.0	0.4	0.2	0.0

Source: IMF staff projections and calculations.
1/ It includes actual disbursements under the Fund arrangements.
2/ It includes net errors and omissions, net portfolio flows and asset transations of general government and non-bank private sector.

Table 10. Bosnia and Herzegovina: Financial Soundness Indicators, 2012–17

(In percent)

	2012	2013	2014	2015	2016	2017 Q3
Capital						
Tier 1 capital to risk-weighted assets (RWA)	14.1	15.2	14.4	13.8	15.0	14.9
Net capital to RWA	17.0	17.8	16.3	14.9	15.8	15.6
Quality of assets [1]						
Nonperforming loans to total loans	13.5	15.1	14.0	13.7	11.8	10.8
Nonperforming assets (NPAs) to total assets	10.3	11.4	10.5	10.1	8.4	7.7
NPAs net of provisions to tier 1 capital	30.4	31.5	27.9	27.1	18.6	16.1
Provision to NPAs	67.4	68.0	71.3	72.8	75.8	77.1
Profitability						
Return on assets [2]	0.6	-0.2	0.7	0.1	0.8	0.4
Return on equity [2]	5.0	-1.4	5.7	1.1	5.3	2.7
Net interest income to gross income	63.7	62.3	61.5	62.0	60.4	58.0
Noninterest expenses to gross income	87.2	101.2	84.6	94.5	80.7	69.4
Liquidity						
Liquid assets to total assets	25.4	26.4	26.8	26.5	27.2	27.6
Liquid assets to short- term financial liabilities	44.1	46.2	46.1	44.0	44.1	43.8
Short- term financial liabilities to total financial liabiliti	67.9	67.3	68.5	70.7	72.8	74.4
Foreign exchange risk						
Foreign currency and indexed loans to total loans	63.1	62.9	62.3	60.8	62.6	59.9
Foreign currency liabilities to total financial liabilities	65.2	63.8	62.7	60.3	57.4	55.7
Net open position	5.4	6.7	10.6	9.0	1.7	0.8

Source: CBBH.

[1] Prior to 2010, assets classified as loss, alongside the provisions made against them, were held off-balance sheet by banks in B
This lowered the reported NPL ratios and coverage of nonperforming loans by provisions. Starting with the December 2010 c
in the RS, and the December 2011 data in the Federation, banks record on-balance sheet the "loss" loans and related accruec
interest and provisions, resulting in a structural break in the series.

[2] Interyear values obtained by summing up the quarterly net income in the current and the preceding three quarters.

Annex I. Risk Assessment Matrix[1]

Sources of Risks	Relative Likelihood	Possible Impact if Risk Realized	Policy Response
External Risks			
1. Tighter and more volatile global financial conditions, including from European bank distress	**Medium/High**	**Medium** Under the CBA, tightening availability of FX would constrain base money and spillovers could be immediate and correlated to external developments, particularly in EU. Given the heavy presence of European banks, spillovers to the banking sector could be disruptive also.	Sustained fiscal adjustment and progress in structural reforms will support BiH credit rating and safeguard the CBA. Building up capital buffers and advances in financial sector reforms would maintain financial sector stability.
2. A significant slowdown in China and other major EMs	**Medium**	**Medium** Slowdown in China and other major EMs could weaken prospects for external demand and FDI. Contagion to financial markets could raise risk aversion, causing capital outflows from emerging markets, including BiH.	Continue to restrain current spending and boost domestic demand through reallocating spending toward infrastructure investments. Strengthen banking regulation and maintain financial stability to weather external shocks.
3. Structurally weak growth in key advanced economies	**High**	**Medium** With limited buffers to cushion the impact, spillovers on BiH could be sizeable, notably through trade, services, remittances and financial channels.	Rationalizing public spending and taxation to make it more growth-friendly, while accelerating structural reforms to enhance competitiveness, boost private sector growth and FDI would be key measures to mitigate risks.
Domestic Risks			
4. Domestic political instability, including prolonged political impasse, delay in formation of government following the 2018 elections.	**High**	**Medium** Political instability would undermine economic activity and consumer confidence by creating policy uncertainty and could affect program implementation. Political support for reforms would falter and cause further policy slippage that will negatively impact investment and growth, particularly around the time of 2018 elections.	Need to build political consensus to prioritize reform efforts. Timely implementation of growth-and employment-enhancing structural reforms will build confidence and garner support from population.
5. Further deterioration in the health of commercial banks	**Medium**	**Medium** Banks face a challenging business environment and are already struggling with low profitability. A further deterioration in the already high NPLs could threaten solvency of some vulnerable banks, as raising fresh capital may prove difficult. There may also be a weakening of depositor confidence.	Need to safeguard financial sector stability and revamp regulatory and legislative frameworks, including for NPL resolution. Strengthen bank supervision.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex II. Balance of Payments Developments and External Sector Assessment

The current account balance has recently remained broadly stable as widening trade deficit in goods has been offset by strong performance in tourism exports and worker remittances. However, imports have been compressed by financing constraints affecting public infrastructure investment. Over the medium term, the current account is likely to deteriorate as public infrastructure investment surges. The external position and REER are broadly in line with fundamentals and desirable policies. The level of foreign exchange reserves is deemed adequate for external balance, but in the event of retrenchment of capital inflows, the sustainability of the Currency Board Arrangement may require measures to restrain domestic demand.

1. BOP Developments and Projections. The overall balance of payments (BOP) has averaged an annual surplus of 2.9 percent of GDP from 2014 to 2016. The current account deficit has narrowed to 5.1 percent of GDP in 2016, from 5.7 percent of GDP in 2015, due to weak import growth because of an unwarranted compression in public investment. It is likely to have remained broadly unchanged in 2017, as a widening of the trade deficit in goods is offset by strong performance in exports of travel services and workers' remittances.

2. Growth in world trade has supported BiH exports. Trade has expanded in 2017, with goods exports up 18.2 percent and imports rising by 13.5 percent, respectively up to November. Because of the higher magnitude of imports, the trade deficit in goods increased by 0.3 percentage points of GDP. The increase in exports was widespread and included some traditional export products which have underperformed in recent years. Export growth is likely to remain strong going forward, buoyed by faster external demand in advanced economies.

3. Tourism is increasingly driving the surplus in the service account. Tourism arrivals have grown on average in double digit numbers over the last 10 years, as the number of source countries has expanded. There is significant upside in expanding tourism as BiH still lags behind its regional peers.

4. On the financing side, FDI has recovered in the first half of 2017, but the main driver of reserve accumulation in the central bank has been other largely short term private inflows.

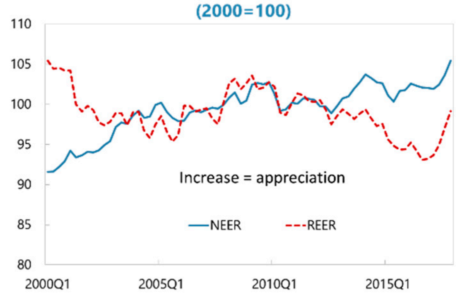
5. The current account deficit is projected to widen to about 6½ percent of GDP in 2019 before converging to about 5 percent of GDP by 2022. The increase in infrastructure investment, to be financed by external loans recently unblocked by the excise tax increase, will boost imports temporarily. Over the medium-term, more than ¾ of the current account deficit is expected to be financed by FDI and project finance.

6. Exchange Rate Developments and Assessment. The real effective exchange rate (REER) has appreciated recently in tandem with the euro, but is still about 4 percentage points weaker than its peak prior to the global financial crisis. An updates assessment using the Fund's pilot External Balance Assessment (EBA-lite) exercise did not reveal any issues with regards to external stability. Both external sustainability and the current account methods indicate that BiH external sector is in line with fundamentals.

BIH Reserve Adequacy Assessment
(In percent of GDP)

Stock of Reserves	32.8
Standard metrics	Threshold
100% of Short-term Debt	19.8
20% of Broad Money	15.0
3 Months of Imports	13.6
ARA EM Metric	23.6

Effective Exchange Rates
(2000=100)



Sources: Fund staff calculations

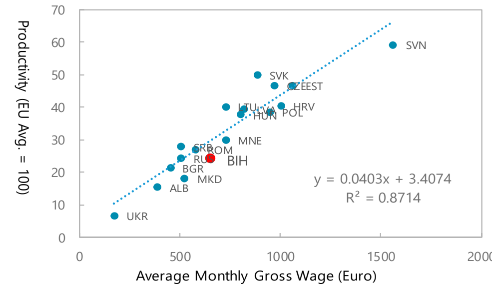
BIH Exchange Rate Assessment 1/

Methodology	Current account / GDP Norm	Underlying	REER misalignment
Current account model	-4.4	-4.5	-0.4
External sustainability	-4.1	-4.9	2.6
Equilibrium real exchange rate	...	...	

1/ Based on IMF EBA-lite methodology. External sustainability provides medium-term assessment of the current account, while the other two methods provide assessments of the projected current account balance and REER in 2017.

7. The level of foreign exchange reserves is also deemed adequate from an external assessment perspective. All standard reserve adequacy criteria are satisfied by a comfortable margin, as the stock of reserves is larger than each of the thresholds for reserve adequacy (see chart). Moreover, the reserve level is also adequate for the sustainability of the Currency Board Arrangement as it stands above 110 percent of monetary base under relatively conservative assumptions about capital inflows. However, in the event of retrenchment of capital inflows, the sustainability of the Currency Board Arrangement may require measures to restrain domestic demand.

Wage and Labor Productivity, 2015



Source: Haver and WEO.

8. Wages in BiH do not suggest competitiveness problems. Wages in BiH are low in absolute terms and are only slightly higher than what would be expected considering productivity (see chart). The average wage level has been pushed up by high wages in the public sector, but wage restraint under the current IMF program should help bring public sector wages down over the medium term, perhaps with some effect on dampening private wages also. At the same time, labor productivity is quite low by regional standards, amounting to just over 25 percent of average productivity in EU countries.

9. BiH has a diverse export composition and there is a revealed comparative advantage in a range of industrialized product lines. Among other product lines, BiH has strong revealed comparative advantage[1] in some wood products, aluminum alloys, arms and ammunition, some iron and steel and inorganic chemical products, in large part a legacy of the strong manufacturing base from the Yugoslav years. However, BiH still remains well behind the level of participation in Global Value Chains (GVCs) achieved by other small European transition economies.[2]

10. BiH's attractiveness as an investment destination is hindered by political uncertainty and regulatory weaknesses. Improving the business climate is a necessary condition for increasing investment, boosting employment and improving standards of living. There are severe labor market rigidities, including a sizable tax wedge on employment. There is a large and inefficient public sector and important sectors are dominated by state-owned enterprises that are either loss-making or witnessing a declining trend in profits. Stronger and sustainable growth may be achieved if BiH focuses on areas where its institutional framework lags further behind the frontier. These include hardships to businesses stemming from high taxes, red tape (starting a business, dealing with construction permits and registering property, access to electricity and transport connectivity).

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[1] The revealed comparative advantage (*rca*) of country i in product j is defined as the share of that country exports of product j on world exports of that product, divided by the share of country i exports in world exports.

$$rca_{ij} = \frac{X_{ij}}{X_{Wj}} \div \frac{X_i}{X_W}$$

A country has revealed comparative advantage in product j if X_{ij} is greater than one.

[2] Namely, Bulgaria, Croatia, Estonia, Latvia, Lithuania, Slovak Republic, and Slovenia (World Bank Group, 2017. The Western Balkans: Revving up the Engines of Growth and Prosperity).

Annex III. Economic Impact of Public Sector Employment Reform

Reform of the public wage bill and employment reform is a key policy envisaged under the EFF to improve the quality of the government spending and enhance growth potential. with. The analysis suggests that Bosnia and Herzegovina should include public employment reduction as a part of a reform thrust that aims to raise its growth performance to a higher level.

1. **Public sector employment restraint and eventual reduction is a central part of the strategy to raise economic growth on a sustainable basis under the EFF.** This is because the resulting reduction in the public wage bill is expected to enable pro-growth policies such as boosting public investment or lowering the tax wedge. Still, this policy requires assessment of distributional and social impacts, and economic prospects more generally.

2. **The analysis herein employs a heterogeneous agent model to examine macroeconomic and distributional implications of reforms within a general equilibrium setting**.[1] The model distinguishes between formal and informal sectors as well as different types of households, including one comprising public sector workers. While the model is calibrated to match key features of BiH economy, the analysis should be viewed as a thought experiment within a clearly defined economic context, as opposed to generating precise quantitative predictions. The analysis focuses on a scenario where public employment is reduced[2] and the resulting wage bill savings are used for implementing a pro-growth policy, namely a reduction in the tax wedge on labor.[3] The analysis only considers the long-run effects of this policy package, i.e., the effects after all adjustment processes have been completed.

3. **The exercise considers two states of the economy: a low-growth scenario or one where the economy has reached a state of high growth.** For the low-growth scenario, the model assumes that laid-off public sector workers are able to find new employment only in the low-skilled and low-productivity informal sector. This assumption is meant to capture the recent historical status quo where growth has been too low to enable significant employment creation or income convergence with the EU. For the high-growth scenario, the model assumes that laid-

[1] The analysis uses a modeling framework developed to examine macroeconomic and distributional effects of reform packages. See, for example, Stefania Fabrizio, Davide Furceri, Rodrigo Garcia-Verdu, Bin Grace Li, Sandra V Lizarazo Ruiz, Marina Mendes Tavares, Futoshi Narita and Adrian Peralta-Alva, 2017, "Macro-Structural Policies and Income Inequality in Low-Income Developing Countries," *IMF Staff Discussion Note*, 17/01, International Monetary Fund.

[2] Specifically, we model public sector employment as a reduction in hours worked by public sector workers in the public sector, which is offset by an increase in hours worked either in the informal or formal sector, depending on the state of the economy.

[3] We focused on tax wedge reduction because such a policy is currently under active consideration in FBiH. An alternative pro-growth policy is scaling up of public investment, which has been investigated elsewhere in this report.

off public sector workers can find new employment in the high-skilled, capital intensive formal sector of the economy. This scenario represents the vision underpinning both the authorities' Reform Agenda and the IMF program to move BiH to a higher growth trajectory through structural reforms.

4. The modelling analysis suggests that the effectiveness of the pro-growth policy package depends crucially on the state of the economy. In a high-growth environment, the policy package delivers very positive results across the board but in a low-growth situation, its effectiveness is modest at best, with clear winners and losers:

- In the high-growth scenario, the driving force is substantial private formal-sector employment creation on account of (i) former public sector workers seeking employment in this sector and (ii) relocation of informal sector workers to the formal sector because of a reduction in the tax wedge. The most striking difference between the two scenarios is a boom in capital formation in the high-growth one whereas capital formation in the low-growth scenario is negligible (Figure 1). Given the capital intensity of the formal sector, employment creation is accompanied by an investment boom. No such mechanism exists in the low-growth environment where laid-off public sector workers find new employment only in the informal sector, which is not capital intensive. In this scenario, a tax wedge reduction by itself is largely ineffective in boosting formal sector employment and investment.

- With respect to incomes of workers, all worker households gain in the high-growth scenario whereas in the low-growth scenario there are winners and losers (Figure 2). In principle, public sector households are most likely to be negatively affected by the policy package because some public-sector workers get laid off. In relative terms, it is indeed the case that public-sector households are worse off in both states of the economy. In absolute terms, public-sector households improve their incomes in the high-growth scenario because they can find well-paying new jobs in the formal sector. In the low-growth scenario, however, they experience substantial income losses because informal sector work does not pay well compared to public-sector employment. Other worker households tend to gain in income. Besides worker households, there is also an entrepreneur-type household that owns formal sector firms. The incomes of these households expand proportionally to the capital stock employed in the economy, which means they are the largest winners, especially in the high-growth scenario. Rapidly rising incomes for entrepreneurs are, in a sense, the flip side to the investment boom taking place in this scenario.

5. The findings suggest that a policy package that includes public employment reduction works best if it is part of a reform thrust that raises BiH growth performance to a higher level. Current conditions in BiH are favorable for public employment reform. Major progress has been made with the reform of the Labor Law, the recent passage of the excise increase is expected to unblock substantial increases in public investment, and reforms currently underway in the FBiH will lower the tax wedge significantly, while simultaneously putting the pension system on a more equitable and sustainable footing. Combined with the cyclical upswing in BiH, and the EU more broadly, this suggests that the timing is opportune for public employment reform. Regardless, it is important to ensure there is an adequate safety net to temporarily protect displaced workers.

Figure 1. Economic Output

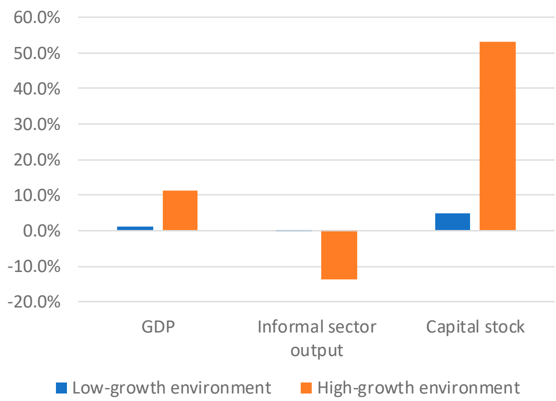
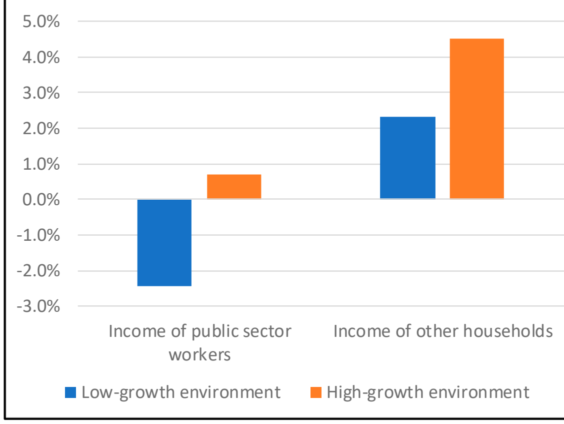


Figure 2. Household Income

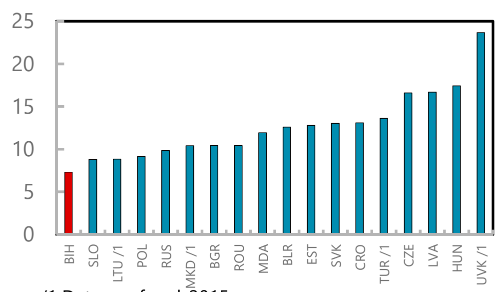


Annex IV. Financial Deepening and Reforms to Support Sustained Economic Growth[1]

A fragmented regulatory structure affects bank profitability and balance sheet weakness has hindered banks' ability to support economic recovery. High cost of doing business and persistently low profitability also runs the risk of withdrawal of foreign banks. BiH needs to develop domestic capital markets and expand institutional investor base to ensure system sustainability and risk mitigation.

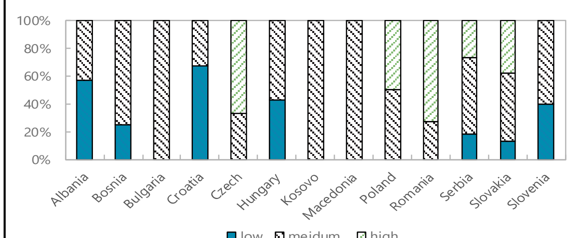
1. **BiH would need faster economic growth than envisaged to enable banks to grow out of their balance sheet problems and improve profitability of the sector.** NPLs have been on a declining trend recently, though they remain elevated at 11 percent in 2017Q3. Balance sheet weakness combined with high operational costs—associated with a fragmented regulatory and supervisory structure because of BiH's institutional setup—continue to put a drag on bank profits. Empirical analysis based on bank-level data shows that an annual GDP growth rate of 4.2 percent over three years (compared to the 3-percent growth recorded in 2016) would be needed to bring the NPL ratio back to its pre-crisis level[2]. A weaker-than-envisaged economic recovery would have more pronounced effects on domestically-owned banks, because of their relatively weaker balance sheets and lack of parent group backstop.

Commercial Bank Return on Equity
(in percent)



/1 Data as of end-2015
Source: IMF Financial Soundness Indicators

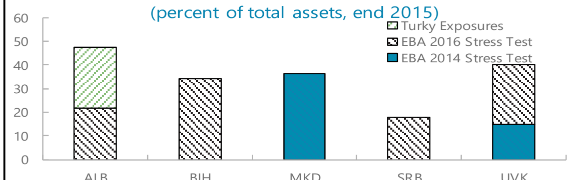
Perceived Market Potential



Source: EIB-CESEE Banking Lending Survey 2016H2.

2. **Low market potential relative to regional peers may continue to limit foreign investment in the sector.** Based on the latest EIB bank lending survey, one quarter of the respondents see low market potential in BiH and none sees it as high. This compares unfavorably with BiH's regional peers. In addition, some foreign-owned banks may pose systemic risk as their parent groups are struggling with low profitability and may

External Risk from Large Foreign Subsidiaries
(percent of total assets, end 2015)



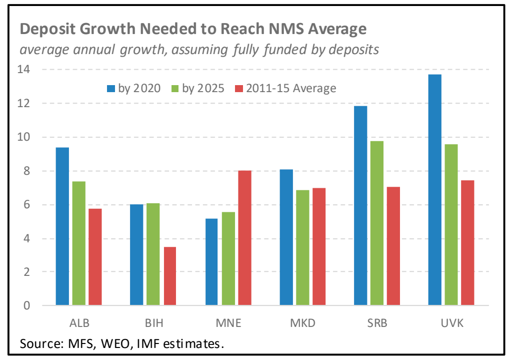
Note: Estimates are based on the three largest foreign subsidiaries by assets in respective countries.
Source: country authorities, and banks' annual reports.

[1] "Banking sectors in the Western Balkans: Prospects and Challenges", Regional Economic Issues, European Department, IMF.

[2] The analysis shows that it would take 5 years with an annual growth rate of 2.5 percent.

become selective and adopt an excessively prudent approach to managing exposure in the region. This could, in turn, lead to disruptive divestment from the BiH banking sector. The banks whose parent groups are vulnerable, based on the 2016 EBA stress test results, account for one third of the banking sector in BiH, among the largest ratios in the region.

3. The current funding model of banks may prove insufficient to support the needed credit deepening on a sustained basis. The funding model in BiH, as in several CESEE countries, has become increasingly dependent on domestic deposits since the global financial crisis. Notwithstanding their strong growth in recent years, deposits alone would be insufficient to reach close to the credit depth observed in the new EU member states. The difference between recent deposit growth (i.e., over 2011–15) and that needed to close the gap with new EU member states by 2025 is among the highest in BiH. Considering that increasing savings rate is difficult over the medium term and foreign funding is not likely to return in a meaningful way in the near-to-medium term, there is a need to explore alternatives, including by developing domestic capital markets and expanding the institutional investor base.



4. The entity development banks pose systemic risks. Despite the systemic importance of the RS development bank in the banking sector, through direct investments, the entity development banks are not subject to the same regulatory and supervisory standards as banks. Recent IMF and World Bank TA revealed deficiencies in the mandate, objectives, governance, operational transparency, and risk management practices of the two development banks.

5. Comprehensive policies are needed for the banking sector to support economic recovery and income convergence with EU. Given the still large stock of NPLs, the authorities should take steps to facilitate NPL recovery and resolution. Modernizing and harmonizing bank regulatory framework and standards will also help improve prospects of the banking sector with more efficient and effective supervision. Strengthening coordination and cooperation among relevant supervisory agencies will help ringfence and manage potential adverse external spillovers on the banking sector. Over the medium term, there is need to diversify bank funding sources and strive to improve the transparency and governance structure of the development banks in line with international best practice.

Annex V. Debt Sustainability Analysis

General government debt is projected to gradually decline to below 40 percent of GDP in the medium term. Arrears of SOEs and the health sector pose contingent risks.

Key assumptions in the DSA

The assumptions are fully in line with the macroeconomic framework baseline. Fiscal balance is expected to decline because of the increase in capital spending and turn to negative from 2020. IFI financing reflects the financial terms currently provided.

Public DSA

Public sector debt analysis only covers the general government. Debt stock contracted by SOEs are not included, given the lack of SOEs budgetary information. Domestic debt only accounts for about one-third of the total, and the rest is external debt that is largely owed to multilaterals.

General government debt is projected to gradually decline over the projection period to below 40 percent of GDP over the medium term. The debt stock is expected to decrease from 43.7 percent of GDP in 2016 to 35.7 percent of GDP by 2022. The main contributor to debt reduction is the primary balance, and, to a lesser extent, higher GDP growth.

Arrears of SOEs and the health sector pose contingent risks to the debt dynamics. While accurate documentation of arrears is lacking, preliminary analysis suggesting that SOE and the health sector are accumulating sizable arrears. Addressing the arrears issue could have fiscal impact, with the need for adjustment and/or financing.

External DSA

Total external debt, which covers both public and private debt, is also expected to decline over the medium term. Total externa debt is expected to be lower than 60 percent of GDP by 2022, mainly because of net non-debt creating capital inflows and higher GDP growth.

Gross external financing need is projected to increase. This mainly reflects high import demand and amortization of external debt.

Table 1. Bosnia and Herzegovina: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

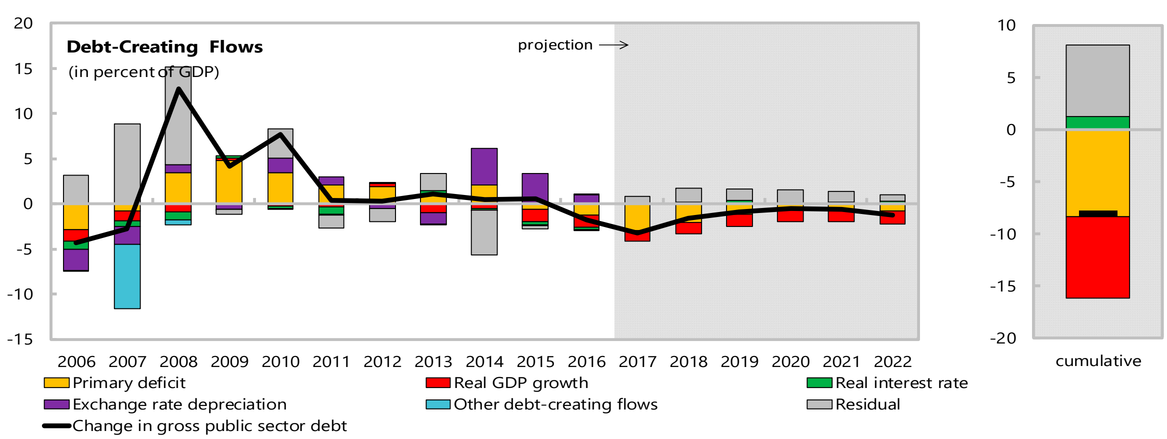
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	36.0	45.5	43.7	40.5	38.9	38.0	37.5	36.9	35.7
Public gross financing needs	4.1	4.8	4.6	3.1	4.2	4.6	4.2	4.4	4.4
Real GDP growth (in percent)	2.3	3.1	3.2	2.7	3.2	3.5	3.7	3.9	4.0
Inflation (GDP deflator, in percent)	3.0	1.6	1.3	1.9	1.6	1.7	1.8	1.8	2.0
Nominal GDP growth (in percent)	5.4	4.7	4.6	4.6	4.8	5.3	5.6	5.8	6.1
Effective interest rate (in percent) [4/]	2.2	1.9	2.0	2.1	2.2	2.7	2.3	2.3	2.9

As of October 18, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		n.a.
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B	B
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.2	0.5	-1.8	-3.3	-1.6	-0.9	-0.5	-0.6	-1.2	-8.1	
Identified debt-creating flows	0.0	0.9	-2.0	-4.1	-3.1	-2.1	-1.9	-1.8	-1.9	-14.9	
Primary deficit	1.7	-0.6	-1.2	-3.0	-2.1	-1.2	-0.7	-0.6	-0.8	-8.4	-1.1
Primary (noninterest) revenue and gra	44.9	43.2	42.7	43.5	43.9	43.9	43.8	43.6	43.5	262.2	
Primary (noninterest) expenditure	46.6	42.6	41.5	40.5	41.8	42.7	43.1	43.0	42.7	253.8	
Automatic debt dynamics [5/]	-0.8	1.6	-0.7	-1.1	-1.0	-0.9	-1.2	-1.2	-1.1	-6.6	
Interest rate/growth differential [6/]	-0.9	-1.7	-1.7	-1.1	-1.0	-0.9	-1.2	-1.2	-1.1	-6.6	
Of which: real interest rate	-0.3	-0.4	-0.3	0.1	0.2	0.3	0.1	0.2	0.3	1.2	
Of which: real GDP growth	-0.5	-1.3	-1.4	-1.1	-1.2	-1.3	-1.3	-1.4	-1.4	-7.8	
Exchange rate depreciation [7/]	0.1	3.3	1.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General Govt - Financing - Privatizati	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Eurc	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	2.2	-0.4	0.2	0.8	1.5	1.3	1.4	1.2	0.7	6.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

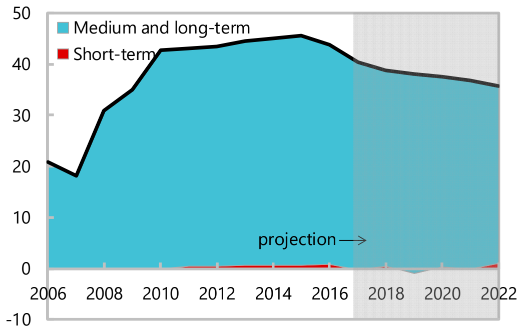
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

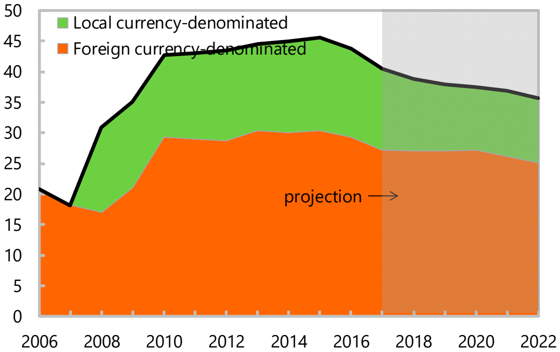
Figure 1. Bosnia and Herzegovina: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



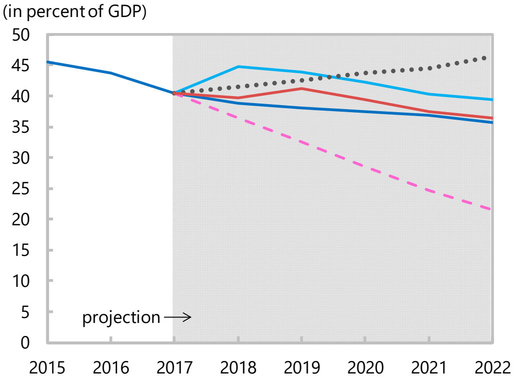
By Currency
(in percent of GDP)



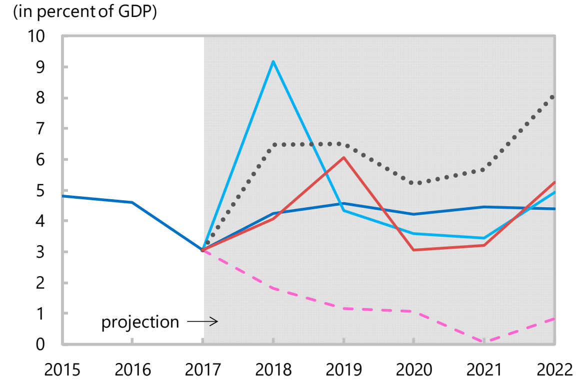
Alternative Scenarios

Baseline
Contingent Liability Shock
Historical
Real GDP Growth Shock
Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.7	3.2	3.5	3.7	3.9	4.0
Inflation	1.9	1.6	1.7	1.8	1.8	2.0
Primary Balance	3.0	2.1	1.2	0.7	0.6	0.8
Effective interest rate	2.1	2.2	2.7	2.3	2.3	2.9
Constant Primary Balance Scenario						
Real GDP growth	2.7	3.2	3.5	3.7	3.9	4.0
Inflation	1.9	1.6	1.7	1.8	1.8	2.0
Primary Balance	3.0	3.0	3.0	3.0	3.0	3.0
Effective interest rate	2.1	1.8	2.6	2.2	2.4	2.8
Real GDP Growth Shock						
Real GDP growth	2.7	0.8	1.1	3.7	3.9	4.0
Inflation	1.9	1.0	1.1	1.8	1.8	2.0
Primary balance	3.0	0.9	-1.3	0.7	0.6	0.8
Effective interest rate	2.1	1.8	2.7	2.7	3.1	3.7

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.7	2.2	2.2	2.2	2.2	2.2
Inflation	1.9	1.6	1.7	1.8	1.8	2.0
Primary Balance	3.0	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	2.1	1.8	2.6	2.6	2.9	3.5
Contingent Liability Shock						
Real GDP growth	2.7	0.8	1.1	3.7	3.9	4.0
Inflation	1.9	1.0	1.1	1.8	1.8	2.0
Primary Balance	3.0	-4.1	1.2	0.7	0.6	0.8
Effective interest rate	2.1	2.1	3.0	3.1	3.4	3.9

Source: IMF staff.

Table 2. Bosnia and Herzegovina: External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
		2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	62.7	61.7	63.7	62.9	63.8			**61.1**	**61.0**	**60.5**	**60.1**	**58.3**	**56.3**	**-4.2**
2	Change in external debt	0.9	-0.9	2.0	-0.8	0.9			-2.7	-0.1	-0.5	-0.4	-1.8	-2.0	
3	Identified external debt-creating flows (4+8+9)	11.8	0.8	3.3	13.0	0.9			1.4	1.9	2.2	1.0	0.2	-0.1	
4	Current account deficit, excluding interest payments	7.0	4.2	6.2	4.6	4.0			4.3	4.9	5.1	4.4	3.7	3.2	
5	Deficit in balance of goods and services	23.5	20.5	22.8	18.8	17.1			17.1	17.5	17.9	17.1	16.4	15.9	
6	Exports	32.4	33.8	34.1	34.6	35.1			38.8	39.2	39.4	39.6	39.8	39.7	
7	Imports	55.9	54.3	56.9	53.4	52.3			55.9	56.8	57.3	56.7	56.2	55.6	
8	Net non-debt creating capital inflows (negative)	-1.9	-1.3	-2.9	-1.7	-1.6			-2.2	-2.2	-2.4	-2.5	-2.7	-2.9	
9	Automatic debt dynamics 1/	6.8	-2.1	0.0	10.2	-1.5			-0.7	-0.8	-0.6	-0.8	-0.8	-0.5	
10	Contribution from nominal interest rate	1.7	1.2	1.2	1.1	1.1			0.9	1.0	1.5	1.3	1.4	1.7	
11	Contribution from real GDP growth	0.5	-1.4	-0.7	-2.2	-1.9			-1.6	-1.8	-2.0	-2.1	-2.2	-2.2	
12	Contribution from price and exchange rate changes 2/	4.6	-1.9	-0.5	11.3	-0.7			...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	-10.9	-1.7	-1.3	-13.8	0.0			-4.0	-2.1	-2.6	-1.4	-2.0	-1.9	
	External debt-to-exports ratio (in percent)	193.4	182.6	186.8	181.8	181.5			157.5	155.4	153.5	151.9	146.5	141.6	
	Gross external financing need (in billions of US dollars) 4/	3.5	3.6	3.9	3.4	3.8			4.5	5.3	5.5	5.3	5.3	5.4	
	in percent of GDP	20.3	19.9	20.8	20.9	22.4	10-Year	10-Year	25.3	28.0	27.2	24.9	23.8	22.8	
	Scenario with key variables at their historical averages 5/								**61.1**	**64.0**	**65.1**	**67.4**	**68.7**	**70.2**	**-3.5**
							Historical	Standard							
	Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
	Real GDP growth (in percent)	-0.7	2.4	1.1	3.1	3.2	2.2	2.4	2.7	3.2	3.5	3.7	3.9	4.0	
	GDP deflator in US dollars (change in percent)	-7.0	3.1	0.9	-15.1	1.1	1.4	9.8	2.1	3.9	2.1	1.9	1.4	1.5	
	Nominal external interest rate (in percent)	2.5	2.0	2.0	1.5	1.8	3.2	1.7	1.5	1.8	2.5	2.3	2.5	3.1	
	Growth of exports (US dollar terms, in percent)	-6.7	10.0	2.9	-11.2	6.0	3.5	12.4	15.8	8.4	6.1	6.2	5.9	5.5	
	Growth of imports (US dollar terms, in percent)	-7.6	2.5	6.9	-17.8	2.2	2.0	15.6	12.1	8.9	6.7	4.5	4.5	4.5	
	Current account balance, excluding interest payments	-7.0	-4.2	-6.2	-4.6	-4.0	-6.1	2.5	-4.3	-4.9	-5.1	-4.4	-3.7	-3.2	
	Net non-debt creating capital inflows	1.9	1.3	2.9	1.7	1.6	3.2	3.2	2.2	2.2	2.4	2.5	2.7	2.9	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

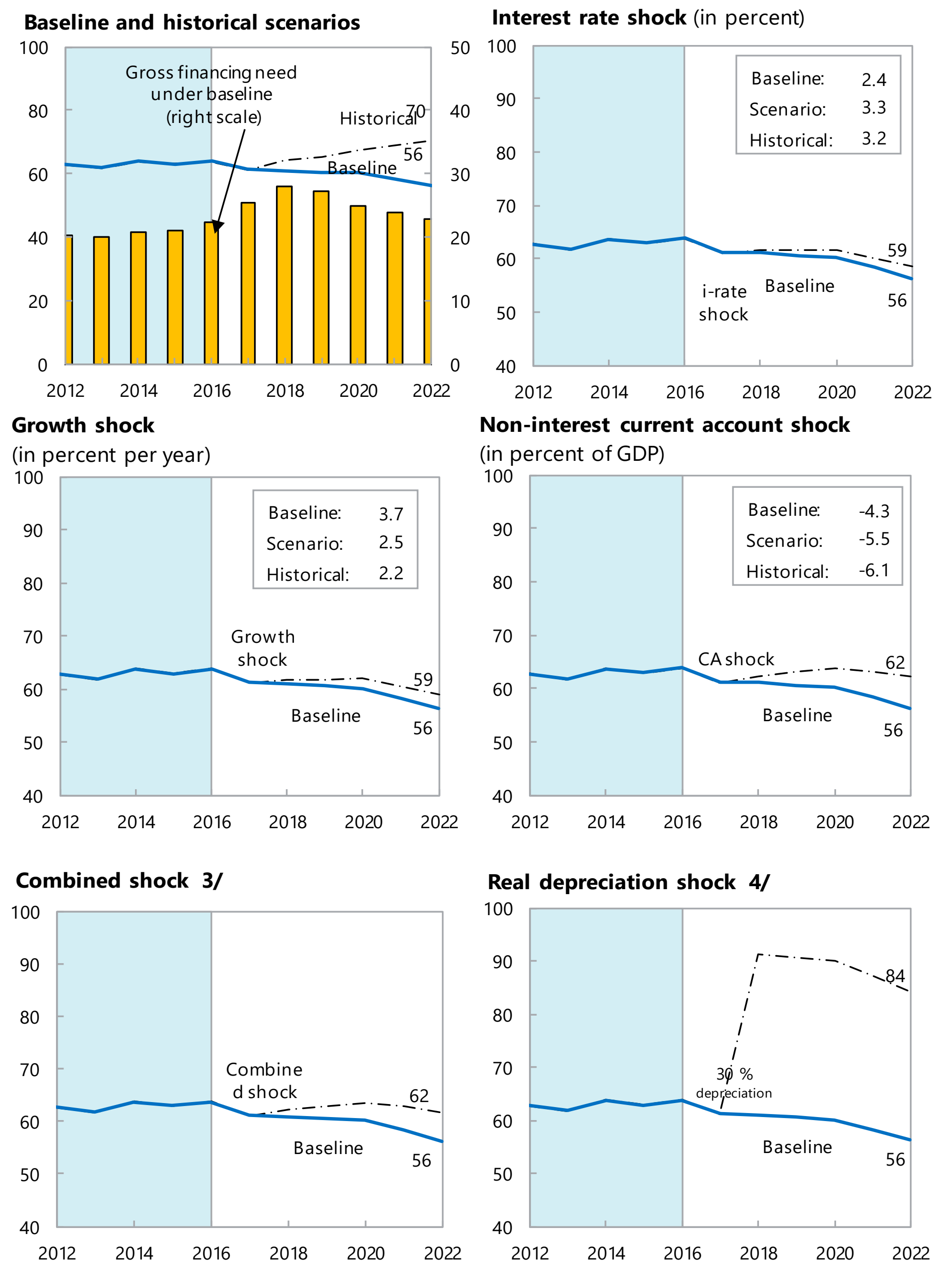
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 2. Bosnia and Herzegovina: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017.

Appendix I. Supplementary Letter of Intent

Sarajevo and Banja Luka, Bosnia and Herzegovina

January 29, 2018

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

1. The extended arrangement under the Extended Fund Facility (EFF) for Bosnia and Herzegovina (BiH), approved in September 2016 by the Executive Board of the International Monetary Fund (IMF), is an important anchor for our economic policies. We remain committed to implementing the policies described in our Letter of Intent dated July 31, 2016. The key objectives of our economic program are to: (i) improve the business environment to create private sector jobs and raise growth potential; (ii) ensure fiscal sustainability and improve the quality of government spending; and (iii) safeguard financial stability and revive bank lending. An important cross-cutting theme in the program are measures that strengthen the single economic space of BiH, in accordance with the constitutional setup and competencies of respective institutions. This Supplementary Letter of Intent provides information on our efforts and achievements since the approval of the arrangement, as well as on the additional policy measures we plan to undertake in 2018 to help ensure that the objectives of the program continue to be met.

2. The BiH authorities will consult with the IMF, at our own initiative or whenever the Managing Director of the IMF requests such a consultation, on the adoption of these measures and in advance of any revisions to the policies contained in our Letters of Intent (the one dated July 31, 2016 and this one), in accordance with the IMF's policies on such consultations.

3. The economic recovery gained momentum in 2016 with growth picking up to over 3 percent. Real GDP growth is estimated to be 2.7 percent in 2017. Execution of public infrastructure projects has been delayed, but we expect it to commence in 2018. Thus, we expect a pickup in growth starting in 2018, as implementation of structural reforms combines with heavy infrastructure investments. Of course, adverse shocks in Europe could pose uncertainties to the outlook. Following an average drop of consumer price level by 1.1 percent in 2016, we expect inflation to turn positive in 2017--with the continued recovery of domestic demand and pick up in global commodity prices--but to remain low, reflecting low Euro Area inflation forecast, imported through the currency board arrangement (CBA). The external current account deficit is projected to increase slightly to 5.2 percent in 2017 compared to 5.1 percent in 2016, and is

projected to further increase to about 6 percent at the time of end of the arrangement, reflecting higher public investment. The unemployment rate remains high, particularly among the youth.

Program Implementation

4. We have made good progress in implementing our program.

a. All quarterly quantitative performance criteria for 2016--on budget balances of the Institutions of BiH (IBiH) and the central governments of the Federation of BiH (FBiH) and Republika Srpska (RS)--were met. The performance in 2017 to date, however, is mixed. While the overall fiscal balance targets were met for the RS central government, the IBiH missed the target because of higher capital spending on account of previously delayed projects having reached the execution stage, and FBiH central government missed the targets due to temporary revenue underperformance. At the general government level, we expect the overall fiscal balance would be in an appreciable surplus by end 2017, exceeding the objective by some margin. We did not contract or guarantee any new non-concessional short-term external debt (Table 1).

b. All continuous quantitative performance criteria were also met. We did not accumulate external payment arrears. The foreign reserves at the Central Bank of Bosnia and Herzegovina (CBBH) were not used for any budgetary or public investment purposes.

c. All the indicative targets (IT) for 2016 were met, except for those on gross revenues, which were missed by a small margin. All 2017 ITs were met except for those on current expenses for IBiH, which partly reflects extraordinarily-high other expenses in the first quarter and partly a higher wage bill in 2017 than expected at time of the EFF request. We face considerable difficulties in monitoring the observance of the ITs on changes in the stock of "other accounts payable" for the entity general governments, because of weakness and delays in reporting by lower levels of governments. While we are confident that the central governments of the FBiH and RS did not exceed the ceiling on the changes in the stock of other accounts payable, data collection for lower levels of government, extra-budgetary funds, and road and highway funds is yet to be finalized and therefore the IT cannot be observed for the entity general governments. The lower levels of government do not have the capacity to accurately report the accounts payable data. As a result, we no longer feel confident that these ITs serve their intended purpose under the program. Going forward, we request a deletion of the ITs on changes in the stock of "other accounts payable" of the general governments for the FBiH and the RS. Regarding the IT on domestic arrears at the central government level, the FBiH has difficulties to measure the arrears related to court judgements. While substantial progress has been made on this issue by gaining the ability to measure the principal component of court-related arrears, the FBiH has not been able to measure the interest component. We discussed this with IMF staff and agreed that arrears relating to court judgements are not included in the stock of arrears, with a view to include them in the IT at a later stage. In the meantime, we remain committed to improving monitoring of arrears and related fiscal reporting of lower levels of government with the help of the World Bank. The rest of indicative targets for end-December 2016 were met (Table 1). However, the six SBs envisaged for 2017 were not met. There was technical delay in setting up employment registries, and adoption of treasury in RS and FBiH was delayed because of the delay in procurement by the donor (We propose to reset the SBs for later, see below). The fiscal risk underlying the auditing of veteran benefits is being addressed through budget ceiling (we propose to drop the SB).

5. To demonstrate our commitment to sound fiscal policies, the respective entity parliaments adopted budgets for 2018 for the central governments of the FBiH and the RS, in line with IMF staff advice (*prior actions for this review*). The IBiH budget that has been passed by the BiH parliament is in line with IMF staff recommendations. We will also comply with the fiscal targets for 2018 agreed with IMF staff. In these budgets, our overarching objective has been to maintain fiscal discipline, and to continue to move away from current spending and, in the case of FBiH, move towards raising growth-enhancing capital spending. As part of the FBiH government's objective to increase domestically-financed investment in public infrastructure, we plan to allocate resources towards investment in key fast roads projects in the Federation. These projects were chosen through prioritization based on road usage, and financing would be done through an extra budgetary special account. We will develop the framework for such spending in line with recommendations of IMF Staff. As envisaged in the 2018 budgets, the entity central governments will lower government wage bills in relation to GDP by continuing the general wage freeze and reducing government employment. In addition, we are proposing quarterly quantitative performance criteria for the fiscal balances and ITs for expenses of the IBiH and the central governments of the FBiH and the RS for 2018, consistent with this objective as presented in Table 1.

6. While the wages for police officers were increased at the IBiH level, the FBiH and the RS central governments have continued to refrain from increasing public sector wages including, by not increasing the wage base and wage coefficients (*a continuous structural benchmark*). The allowances in RS are slightly higher in 2017, in line with the Labor Code and branch collective agreements. Also, compensation for official travel has been classified as allowances since January 1, 2017. IBiH will continue to provide IMF staff with quarterly data on hiring and attrition, broken down by budget institutions. Additionally, the FBiH government has refrained from increasing war veterans' benefits to keep the cost of privileged pensions within budget targets.

7. The BiH parliament adopted an increase in excise rates on fuel products, including LPG, heating oil, and biofuel, by 15 fenings per liter, and it is expected that the additional revenues would be channeled to ensure highway and road infrastructure financing (*a prior action for this review*).

8. We have continued to adhere to the Currency Board Arrangement and have refrained from imposing mandatory conversion of any foreign currency denominated loans into local currency—both of which are *continuous structural benchmarks*. The current low interest rate environment around the globe and the loose monetary policy stance in Advanced Europe have been weighing on earnings for CBBH's foreign reserve investments, a challenge also faced by other central banks in the region. Nevertheless, our foreign reserve buffer at the CBBH is sufficient to cope with shocks. To avoid endangering the core functions of the central bank, CBBH will not cut costs for the purpose of generating higher profits. We are committed to the following hierarchy of reserve management objectives (in descending order of importance)—adequacy, capital preservation, liquidity, and optimal returns. Furthermore, with help from IMF

technical assistance (TA) mission on foreign reserve management, the CBBH has taken immediate measures to improve its reserve management framework. These include: (i) adoption of new Investment Guidelines and Operative Rules in line with the IMF staff recommendations; and (ii) streamlined regular reporting protocol to the Investment Committee and the Governing Board using improved reporting templates in line with IMF staff recommendations. The CBBH has also adopted an action plan for implementing other medium and long term recommendations of the mission and those from the October 2016 IMF Safeguards Assessment mission. The authorities have taken decisive measures in this regard. Consistent with our commitment to safeguard the CBA, the CBBH will continue to improve its reserve management practices by implementing, in a timely manner, the adopted action plan agreed with the IMF staff. We will consult with IMF staff when amending the Investment Guidelines and Operative Rules.

9. We have made progress in advancing our structural reform agenda. Nine of the 24 structural benchmarks have been met, while one was elevated to a prior action. We are proposing new deadlines for some of the structural benchmarks that were not met, as they will take a longer time than expected to meet because of a heavy legislative agenda, and the need for adequate consultative processes. We are also proposing to drop four structural benchmarks, largely because the underlying risks are mitigated through other actions. More specifically:

a. The four tax agencies (ITA, FTA, RSTA, and BDTA), have continued regular exchange of taxpayer information. ITA and RSTA have started to use the combined database for risk analysis and assessment to improve audit selection.

b. In order to improve revenue collection, the ITA has continued to publish information about the largest tax debtors and the stock of indirect tax arrears, and FTA and RSTA have also been publishing the list of the largest debtors with the outstanding amounts. To improve risk assessment for audits and revenue collection the three tax agencies have appointed in July 2017 an external revenue administration advisor.

c. The RS parliament adopted amendments in December 2016 to the corporate income tax (CIT) law to foster consistency, avoid double taxation between the entities, and reduce tax incentives in line with IMF staff recommendations (*structural benchmark for end-December 2016*).

d. To promote job creation, we took steps to reduce the tax wedge on labor, while at the same time harmonizing the tax regulations between the two entities. The FBiH parliament has completed the first reading of a new Personal Income Tax (PIT) and Social Security Contributions (SSC) laws to reduce the SSC rate to 33 percent, from 41.5 percent. This entails broadening the base (effective as of January 1, 2019) of SSC and PIT by the previously untaxed hot meal, travel, and vacation allowances. In order to protect the lowest income earners in society from adverse effects of the changes in SSC system, the FBiH government proposed changes to the PIT law to alleviate the tax burden on this group. In addition, the solidarity contribution in the RS was eliminated effective January 1, 2017, though a new contribution to fund medical expenses, which is paid on a voluntary basis, was introduced.

e. The FBiH parliament adopted the Law on Pension and Disability Insurance (PIO) in January 2018. The Law on the Organization of the PIO Fund, developed with the assistance of the World Bank to help ensure the sustainability of the pension system, is expected to be adopted in June 2018.

f. To strengthen control over borrowing in lower levels of government in the Federation, the FBiH government adopted a draft of the new Law on Debt, Borrowing, and Guarantees in October 2017 and has submitted it to parliament recently (*structural benchmark for end-December 2016*).

g. We successfully disposed of our minority shares in Bosnalijek (a pharmaceutical company) and Fabrika Duhana Sarajevo (tobacco) in fall 2016. The FBiH government has initiated, in a letter to the EU, a request to finance the financial and operational due diligence of two Federation telecom companies (BH Telecom and HT Mostar), based on the terms of reference drafted in consultation with IMF staff, with the objective of improving corporate governance, restructuring and/or selling of shares (*a prior action for this review*).

h. The RS government adopted a restructuring plan for the railway company, developed with assistance of the World Bank (*structural benchmark for end-December 2016)*. The FBiH government appointed new management in the FBiH railways company in 2015, which has taken decisive actions to improve the operations of the company, including by reducing the headcount substantially in the past two years. It is expected that the company will achieve a small operating surplus in 2017, and the government and the company's management are discussing a restructuring of the company's liabilities to help achieve long-term solvency. In this context, we propose to drop the structural benchmark that called for the development of a strategic plan with WB assistance *(originally a structural benchmark for end-December 2016; we propose to drop)*.

i. We completed the entity registries of para-fiscal fees with the assistance of USAID. The registries, which cover entity central governments, cantons and municipalities, and the IBiH, will serve as a basis for the elimination of fees deemed harmful for the business environment. We have published the registries in both entities, and will adopt plans to reduce para-fiscal fees by end-June 2018, complying with constitutional competencies of individual levels of government.

j. Following adoption of the new bankruptcy law in RS in February 2016, the FBiH parliament adopted a draft bankruptcy law in first reading in December 2016, and initiated public consultations. However, the FBiH constitutional court rendered parts of the law unconstitutional, delaying further work on the new draft. Following consultations with and clarifications from the constitutional court, the FBiH cabinet endorsed a new draft legislation proposal in October 2017 that is now pending parliamentary approval. Both entity governments plan to focus on public awareness and capacity building—with the aim of raising qualifications and skills of the insolvency administrators, courts and other professionals directly involved in working with insolvency cases.

k. The amendments to the FBiH Law on Internal Trade, a key requirement for future WTO accession, were adopted in September 2017.

l. The quarterly structural benchmark on the adjustment of allocation coefficients and semi-annual settlement for end-December 2016 was not met because of concerns on the accuracy of final consumption data and disputes related to settlement of outstanding past debt, but we will adopt revised indirect tax allocation coefficients for the 3rd quarter of 2017 and settle all past indirect tax claims by March 2018.

m. In our continued efforts to address weaknesses in the banking sector, all banks have completed asset quality reviews (AQR). Based on the findings of the reviews, the banking agencies have approved plans to address provisioning and capital shortfalls as necessary, as well as risk management weaknesses (*structural benchmarks for end-November 2016)*.

n. Modernization and harmonization of banking sector legislations has progressed. The new entity banking laws and new entity banking agency laws, developed in accordance with recommendations of IMF and World Bank staff, were adopted by respective entity parliaments (*structural benchmarks for end-November 2016*). The new Law on Deposit Insurance, which the BiH parliament is expected to adopt by end-March 2018 (*original structural benchmark for end-November 2016, we propose to reset to end-March 2018),* will allow the use of the Deposit Insurance Fund for support to financing bank resolution, subject to clear safeguards for the Deposit Insurance Agency's main objective of protecting insured deposits. The new legislative package strengthens supervisors' corrective and enforcement powers, introduces consolidated supervision of banking groups and a comprehensive bank resolution framework, and promotes operational coordination among financial sector authorities in identifying and addressing systemic risks.

o. To strengthen supervisory coordination and cooperation, regular exchange of information and joint on-site inspections of systemically important bank are taking place, and are in accordance with the entities' banking and banking agency laws.

p. In their continued efforts of cooperation with foreign supervisory bodies, the banking agencies have signed MoUs with German Federal Financial Supervisory Authority and have progressed in negotiating the MoUs with the European Central Bank and the Russian Central Bank.

Further Reforms

Structural reforms to boost growth and job creation

10. We will continue our efforts to improve the functioning of the labor market. Following the adoption of new entity labor laws, a general collective agreement, consistent with the new law, was reached in the FBiH. In the RS, we will continue to negotiate the general collective agreement, consistent with the new labor law. In both entities, most of the sectoral branch agreements were agreed, with a few still outstanding; these are expected to be completed by June 2018. We will continue to make further efforts to step up labor inspections and to pursue active labor market programs. The entity governments rolled out employment support programs to provide support for the registered unemployed. These programs will be partly financed by the World Bank with a KM 100 million loan to support job creation in the two entities.

11. The FBiH government was not able to undertake a comprehensive privatization process due to technical delays in procuring due diligence reports and lack of buyer interest. Nevertheless, the authorities intend to complete the financial and operational due diligence of BH Telecom and HT Mostar, which has been initiated (prior action for this review), by September 2018.

12. We will take actions to improve the efficiency of processing commercial cases in the country, which is essential for enhancing the business climate. Court performance is poor, particularly in commercial cases. In the FBiH, we will implement measures with the assistance of the World Bank, EU and the Government of Netherlands. In the RS, we will also speed up the processing of commercial and labor disputes.

Making government finances sustainable and efficient

13. Recent IMF TA findings did not suggest major issues with existing *ad hoc* system of indirect revenue allocation. Therefore, we propose to drop the structural benchmark of adoption of automatic allocation system (*originally a structural benchmark for end-December 2016*).

14. We will continue to benchmark our tax collection efforts with ITs on the gross collection of indirect tax revenues by the ITA (Table 1).

15. The FBiH government will submit a draft PIT/SSC law for second reading by end-May 2018, in line with IMF staff recommendations (*a new structural benchmark*). The take-home-pay protection for public employment contracts in RS will be eliminated, effective as of January 1, 2019 following receipt of assistance from IMF staff and in line with the IMF staff recommendations.

16. In our continuing efforts to rein in the public sector wage bill in a sustainable manner, we are developing public employment registries with assistance of World Bank staff—the entity governments have initiated this work by sharing anonymized individual-level information in their respective payroll databases with the World Bank, and are now working on preparation of legislative framework for employee registries which should be completed by March 2018. The BiH Council of Ministers will conduct a functional review based on its payroll data and operationalize its strategic plan to restrain wages and reduce overall employment with assistance from the World Bank by December 2018 (*originally a structural benchmark for end-June 2017, we propose to reset this to end-December 2018*). The entity governments will also use their registries to conduct functional reviews of public sector employment and wages and operationalize their strategic plans to restrain wages and reduce overall employment in public sector with assistance from the World Bank by December 2018 (*originally structural benchmarks for end-June 2017, we propose to reset these to end-December 2018*) in order to achieve sustainable and effective reduction in public employment in 2019 and beyond.

17. To improve the targeting of social assistance and prevent abuse in the war veteran benefit system, the FBiH government will continue the audit process to verify the eligibility of the existing beneficiaries for all categories of war veterans (originally *a structural benchmark for end-June 2017, we propose to drop because fiscal risk is limited by a budget allocation ceiling*). The delay was partly because of longer-than-expected medical inspections during the audit process,

and court decisions that reversed audit procedure. In addition, the FBiH parliament adopted the *Law on Single Registry of Beneficiaries of Benefits without Contribution* in April 2017. We remain committed to establish a centralized database of beneficiaries of social transfers by June 2018 and to prepare a report and plan to improve the targeting of social transfers by end-September 2018. (*originally a structural benchmark for end-December 2016, we request to drop because fiscal risk is limited by a budget allocation ceiling*).

18. We are committed to helping improve public financial management practices in lower levels of governments, including lowering the wage bill:

a. We value the recommendations of IMF Technical Assistance, in drafting a law on Public Revenue Allocation. We remain committed to the simplification of the revenue allocation formula used by the FBiH central government, cantons, and municipalities, and the introduction of an incentive mechanism for cantons and municipalities that follow sound fiscal management practices.

b. We will take a number of measures to address the problem of arrears:

   i. The entity governments, with assistance from the World Bank, have made progress in documenting the stock of arrears including at lower levels of government. We have also requested TA from the IMF to collaborate in this effort. The FBiH Government will, with the assistance of the World Bank and the IMF, collect data on arrears at all the levels of government in FBiH (*a new structural benchmark for end-June 2018*). We will discuss with World Bank and IMF experts the results of the stocktaking, and aim to establish a database of public sector arrears with improved documentation/reporting of the stock and flow of arrears. By September 2018, the FBiH government will also adopt, in line with IMF staff recommendations, a time-bound action plan that aims to address the arrears situation in FBiH (*a new structural benchmark for end-September 2018*). In the RS, we have taken measures to improve the reporting system for capturing health sector arrears. The RS government will adopt a plan to restore the financial sustainability of health institutions by December 2018 *(a new structural benchmark for end-December 2018)*. The RS will also require health centers to prepare budgets with hard budget constraints to prevent new arrears accumulation by September 2018 (*a new structural benchmark for end-September 2018*).

   ii. In order to reduce costs in the health sector, the Council of Ministers adopted a revised Rulebook for defining maximum external reference medicine prices in November, 2016. We plan to further reduce costs and improve medicine availability.

   iii. We will continue our work with USAID on the expansion of the treasury systems to lower government, including budget management systems in cantons in FBiH *(originally a structural benchmark for end-March 2017; we propose to reset to end-March 2019)*. In the RS, we will expand the treasury system to cover health centers *(originally a structural benchmark for end-March 2017, we propose to reset to end-*

March 2019). We are taking intermediate steps including pilot programs before the work is finalized.

iv. Going forward, we remain committed to non-accumulation of external arrears in the entity general governments, the IBiH, and the CBBH (*continuous performance criteria*).

c. At the time the IMF Board considered our request for the program in September 2016, the FBiH government intended to address unpaid pension contributions covering state owned enterprises and public companies, which total about KM 500 million. We will work on developing a systemic solution to limit the negative impact on the budget with technical experts of the IMF and/or the World Bank

d. We will work with IMF technical expert staff to strengthen our public procurement standards for placing public deposits.

Safeguarding financial stability and supporting credit growth

19. Bosnia and Herzegovina's financial system is stable, with adequate capital and liquidity at the aggregate level. Nevertheless, we are vigilant as banks remain vulnerable to elevated NPLs. The AQRs revealed some common shortcomings across banks, which will be addressed in consultation with IMF staff. The banking agencies will review the prudential regulations in these areas. Based on the findings, the banking agencies will amend the relevant prudential regulations in line with IMF staff recommendations. A resident advisor assumed his duties in May 2017. With an aim of strengthening supervision and maintaining banking sector stability, the agencies adopted the strategy to introduce BASEL III and since 2013 they have been working on developing regulations consistent to requirements under EU directives, IMF recommendations and new banking laws.

20. In light of the recently adopted banking and banking agency legislations, we will continue to work on banking agency bylaws and organizational structures emanating from the new bank resolution mandate, and will draft the appropriate secondary legislations. We seek further assistance from IMF staff to strengthen the independence and improve the governance structure and decision-making process of the banking agencies and the Deposit Insurance Agency (DIA). We will discuss any needed amendments to the Banking Agency Laws and the Law on Deposit Insurance, developed in line with the IMF staff recommendations, by end-December 2018.

21. One of the key reforms aimed at strengthening the cooperation and information exchange among the financial sector authorities is the preparation of the Financial Stability Memorandum of Understanding (FSMoU) under the auspices of the Standing Committee for Financial Stability (SCFS). The SCFS has adopted an action plan and formed an inter-institution working group to draft improved information sharing and cooperation arrangements in the areas of supervision, crisis preparedness and management, and systemic risk oversight, all in line with recommendations of the IMF staff. A first draft of the FSMoU has been shared with IMF staff. The FSMoU will be signed by CBBH, DIA, FBA, RSBA, and other relevant parties by June 2018, in line with IMF staff recommendations (*a new structural benchmark*).

22. The CBBH, the DIA, and the two entity Banking Agencies will agree on an identical methodology for determination of systemically important banks (SIBs), agreed with IMF staff, which will be adopted by the relevant institutions in March 2018 (*a new structural benchmark for end-March 2018*). The identical methodology and data inputs are an important prerequisite for effective supervisory cooperation and systemic risk oversight.

23. To further facilitate the recovery and resolution of NPLs, we will focus on improving the bankruptcy framework in FBiH and the efficiency of the court systems in both entities (see paragraphs 9 and 12 above).

24. We remain committed to work with FATF and MONEYVAL. In light of the substantial progress made in this regard, an onsite visit from the FATF is expected in January 2018, of which the results will be discussed at the FATF plenary scheduled in February 2018.

25. The entity governments are preparing new legislations for the entity development banks. Recent TA missions from the IMF and the World Bank have revealed deficiencies in mandate and objectives, governance, operational transparency, and risk management practices. This warrants a comprehensive overhaul of the development bank legislations, including those under which the six funds managed by the RS Investment and Development Bank are established. The entity governments are preparing drafts of the new legislations on development banks to address the identified deficiencies in consultation with the IMF staff and the World Bank. The development banks will be subject to appropriate supervision and regulation by the entity banking agencies. The strategic statements of the development banks will be adopted in March 2018, and adoption of the laws by respective entity parliaments is now expected by end June 2018 (*originally structural benchmarks for end-November 2016, we propose to reset them to end-June 2018*).

Program modalities

26. We believe that our economic program continues to be on course and the policies set forth in our Letter of Intent of July 31, 2016, and this Supplementary Letter of Intent are adequate to achieve the objectives of our economic program. We stand ready, however, to take any additional measures that may be needed to achieve the objectives of our economic program. We will consult with the IMF on the adoption of additional policy measures and in advance of any revision to the policies contained in our economic program, in accordance with IMF policies on such consultation. We will continue to provide IMF staff with the necessary information for assessing progress in implementing our program and will maintain a close policy dialogue with IMF staff. We will also refrain from introducing or intensifying any exchange and trade restrictions and other measures or policies that could worsen balance of payments difficulties.

27. We request the IMF Executive Board's approval of waiver of nonobservance of the end-June 2017 performance criterion on net lending (budget balances), since the targets for IBiH and the central government of the FBiH were missed mainly because of higher-than-expected capital spending and temporary revenue underperformance, due to an unexpectedly-high tax refund which was subsequently compensated by stronger-than-expected revenue, respectively. In addition, we request the IMF Executive Board to approve the deletion of the ITs on changes in the stock of "other accounts payable" for the general governments of the FBiH and the RS. Furthermore, we request the IMF Executive Board to complete the first review, and approve a

disbursement in the amount of SDR 63.4125 million. Given the delay in completing the first review, we also request that the arrangement be extended by 12 months and the remaining access (SDR 316.217 million) be rephased over the remainder of the period of the extended arrangement.

28. The program will continue to be monitored through quarterly and continuous quantitative performance criteria, indicative targets, prior actions, and structural benchmarks. Quantitative performance criteria for 2018, continuous performance criteria, and ITs for 2018 are set out in Table 1; and prior actions and structural benchmarks are set out in Table 2. The second review of the program is expected to take place on or after June 1, 2018. Subsequent reviews will be conducted on a quarterly basis.

29. We authorize the IMF to publish this Supplementary Letter of Intent and its attachments, as well as the related staff report on the IMF's website following consideration of our requests by the IMF's Executive Board.

/s/
Denis Zvizdić
Chairman
of the Council of Ministers
Bosnia and Herzegovina

/s/
Fadil Novalić
Prime Minister
Federation of Bosnia
and Herzegovina

/s/
Željka Cvijanović
Prime Minister
Republika Srpska

/s/
Vjekoslav Bevanda
Minister of Finance
and Treasury of
Bosnia and Herzegovina

/s/
Jelka Milićević
Minister of Finance
Federation of Bosnia
and Herzegovina

/s/
Zoran Tegeltija
Minister of Finance
Republika Srpska

/s/
Senad Softić
Governor
Central Bank of Bosnia and Herzegovina

Table 1. Bosnia and Herzegovina: Proposed Quantitative Performance Criteria and Indicative Targets Under the 2016–20 Extended Fund Facility

(Cumulative flow since the end of the previous year; in millions of KM)

	2016				2017							2018			
	End September		End December		End March		End June			End September	End December	End March	End June	End September	End December
	IMF Country Report 16/291	Actual 7/	IMF Country Report 16/291	Actual 7/	IMF Country Report 16/291	Actual 7/	IMF Country Report 16/291	Actual 7/		Actual 7/	Actual 7/				
Performance Criteria															
Floor on the net lending of 1/									Not met						
Institutions of BiH	56.9	76.2	12.6	35.3	18.1	14.7	35.8	30.1	Not met	26.6	-13.8	-12.9	11.9	15.6	-21.1
Federation central government	203.2	285.1	178.6	268.1	107.1	89.3	252.0	179.6	Not met	384.7	261.7	77.8	167.9	261.0	267.9
RS central government	21.3	146.2	-39.9	65.3	30.6	51.8	70.7	106.4	Met	177.4	37.1	35.9	85.9	153.4	114.8
Ceiling on contracting and guaranteeing of new nonconcessional short-term external									Met						
Institutions of BiH	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Federation general government	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
RS general government	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
CBBH	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Ceiling on accumulation external payment arrears by 2/									Met						
Institutions of BiH	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Federation general government	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
RS general government	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
CBBH	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Ceiling on transfers and credits from the CBBH to the public sector (cumulative) 2/ 3/	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Indicative targets															
Ceiling on current expense 4/															
Institutions of BiH	611	603	845	829	193	199	395	397	Not met	609	846	210	420	631	870
Federation central government	1,021	916	1,469	1,365	292	273	637	616	Met	957	1,555	287	617	974	1,463
RS central government	1,827	1,726	2,525	2,459	555	538	1,171	1,145	Met	1,765	2,524	571	1,184	1,823	2,592
Ceiling on accumulation of domestic arrears by															
Institutions of BiH	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Federation central government 5/	0	n/a	0	n/a	0	n/a	0	n/a		0	0	0	0	0	0
RS central government	0	0	0	0	0	0	0	0	Met	0	0	0	0	0	0
Floor on the net lending of the general government of BiH 1/	432.9	834.8	254.2	635.7	171.2	367.0	390.1	765.2	Met	1,349.8	1,096.9	337.9	691.7	1,211.5	1,088.0
Ceiling on changes in the stock of "other accounts payable" 6/															
Federation general government	100.0	...	100.0	...	100.0	...	100.0	...		...	...	...	...	...	...
RS general government	100.0	...	100.0	...	100.0	...	100.0	...		...	...	...	...	...	...
Floor on the ITA gross revenue collection	4,917.1	4,864.5	6,651.8	6,638.3	1,484.1	1,542.9	3,133.8	3,290.1	Met	5,226.0	7,107.1	1,724.8	3,607.2	5,655.7	7,652.9

1/ Excluding foreign financed projects as defined in TMU.
2/ Continuous.
3/ Exclude transfers of the CBBH's annual net profit to the institution in charge of BiH budget upon the end of the CBBH financial year, as stipulated in the Law of the CBBH.
4/ As defined in TMU.
5/ FBiH central government arrears could not be measured due to court-related arrears that were not captured by the arrears-monitoring module of the treasury system. Significant progress has been made in addressing this weakness; going forward, arrears monitoring will resume, with court-related arrears excluded for an interim period in order to allow for sufficient testing of the improvements made to the treasury system.
6/ Not observable because of unavailability of data. Authorities request deletion of this indicative target in the period ahead.
7/ Not QPCs and ITs.

Table 2. Bosnia and Herzegovina: Structural Conditionality

Prior actions

	Actions	Test Date	Status
1	FBiH parliament to adopt budget for 2018 in line with IMF staff recommendations.		Completed
2	RS parliament to adopt budget for 2018 in line with IMF staff recommendations.		Completed
3	FBiH authorities to initiate, in a letter to the EU, a request to finance the financial and operational due diligence of the two Federation telecom companies, with the objective of improving corporate governance, restructuring, and/or selling of shares, and based on the terms of reference drafted in consultation with IMF staff.		Completed
4	The BiH parliament to adopt an increase in excise rates on fuel products including LPG, biofuel, and heating oil, by 15 fenings per liter and channel the additional revenues to ensure external financing for growth-enhancing highway and road infrastructure investments.		Completed

Existing structural benchmarks

	Actions	Date 2016 SR	Current Status	Proposed New Date/Remarks
1	Continue to adhere to the Currency Board Arrangement as constituted under the law.	Continuous	Met	
2	Refrain from increasing public sector wages including refraining from increases in the wage base, the wage coefficients, and allowances.	Continuous	Not met; FBiH and RS met, IBiH not met	
3	Refrain from imposing mandatory conversion of any foreign currency-denominated loans into local currency.	Continuous	Met	
4	Adjust the allocation coefficient for indirect tax revenue on a quarterly basis and settle indirect tax claims semi-annually.	Quarterly	Not met	Net inter-entity outstanding balance is small and allocations are continuing based on the old coefficient.
5	FBA to make final assessment of recapitalization plans for banks that reveal capital shortfalls based on their AQR results.	End-November 2016	Met	
6	FBiH government, in consultation with the World Bank Group and/or EBRD, will complete the financial and operational due diligence for BH Telecom and HT Mostar.	End-October 2016	Not met	Elevated to PA above. Change completing due diligence to initiating the request for EU to finance the due diligence, based on the TOR drafted in consultation with IMF staff

7	Federation parliament to adopt a new draft Law on Banks and amendments to Banking Agency Law in line with IMF staff recommendations.	End-November 2016	Met	
8	RS parliament to adopt a new draft Law on Banks and amendments to Banking Agency Law in line with IMF staff recommendations.	End-November 2016	Met	
9	State parliament to adopt amendments to the Law on Deposit Insurance in Banks in BiH in line with IMF staff recommendations.	End-November 2016	Not met	Reset to end-March 2018; parliamentary gridlock; a new law is envisaged
10	RSBA to make final assessment of recapitalization plans for banks that reveal capital shortfalls based on their AQR results.	End-November 2016	Met	
11	RS parliament to amend the law on IDBRS in line with IMF staff recommendations.	End-November 2016	Not met	Reset to end-June 2018; need more time for consultation and implementation
12	FBiH parliament to amend the law on Federation Development Bank in line with IMF staff recommendations.	End-November 2016	Not met	Reset to end-June 2018; need more time for consultation and implementation
13	FBiH government to submit to parliament amendments to the Law on Debt, Borrowing, and Guarantees to strengthen controls over lower level governments.	End-December 2016	Met	
14	FBiH government to prepare a report and plan to improve the targeting of social transfers based on the centralized database of beneficiaries.	End-December 2016	Not met	Drop; fiscal risks are covered by budgetary ceiling on this item
15	Adopt new automatic allocation system for ITA revenues in line with IMF staff recommendations.	End-December 2016	Not met	Drop; IMF TA did not find major issues with the existing ad hoc system.
16	FBiH government to adopt a restructuring plan for railways, developed with the assistance of the World Bank.	End-December 2016	Not met	Drop; FBiH government has proceeded with its own restructuring step
17	RS government to adopt a restructuring plan for railways, developed with the assistance of the World Bank.	End-December 2016	Met	
18	RS parliament to amend its corporate income tax law to foster consistency, avoid double taxation between the entities and reduce tax incentives, in line with IMF staff recommendations.	End-December 2016	Met	
19	FBiH to expand the treasury system to budget management systems in cantons.	End-March 2017	Not met	Reset to end-March 2019; delayed in procurement by the donor
20	RS government to expand the treasury system to health centers.	End-March 2017	Not met	Reset to end-March 2019; delayed in procurement by the donor
21	FBiH government to complete Phase III of the audit process for all categories of war veterans' benefits, including privileged pensions.	End-June 2017	Not met	Drop; fiscal risks are covered by budgetary ceiling on this item
22	FBiH government to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-June 2017	Not met	Reset to end-December 2018; technical delay in setting up employment registry

23	RS government to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-June 2017	Not met	Reset to end-December 2018; technical delay in setting up employment registry
24	Council of Ministers of BiH to adopt an operational plan to reduce overall employment in public sector based on the employment registry developed with the assistance of the World Bank.	End-June 2017	Not met	Reset to end-December 2018; need to conduct functional review of employment and wages

New proposed structural benchmarks

	Actions	Proposed date
1	RSBA, FBA, CBBH, and DIA to adopt the identical methodology for determining domestic systemically important banks, in consultation with IMF staff.	End-March 2018
2	FBiH government to submit a draft PIT/SSC law to FBiH parliament for second reading in line with IMF staff recommendations.	End-May 2018
3	CBBH, DIA, FBA, RSBA, and other relevant parties to sign a Financial Stability MoU, in line with IMF staff recommendations.	End-June 2018
4	FBiH, to collect data on arrears at all the levels of government in FBiH, in line with IMF and World Bank advice.	End-June 2018
5	FBiH government to adopt a time bound action plan to address the arrears situation in the Federation, in line with IMF staff recommendation.	End-September 2018
6	RS government to require health centers to prepare budgets with hard budget constraints to prevent new arrear accumulations.	End-September 2018
7	RS cabinet to adopt a plan to restore financial sustainability of health institutions, in line with IMF and World Bank advice.	End-December 2018

Attachment I. Technical Memorandum of Understanding on Definitions and Reporting Under the 2016–20 Extended Fund Facility

January 29, 2018

1. This Technical Memorandum of Understanding (TMU) sets out the understanding between the authorities of Bosnia and Herzegovina and the IMF mission regarding the definitions of quantitative performance criteria and indicative targets for the Extended Fund Facility (EFF) (Table 1) as well as data reporting requirements for program monitoring (Table 3).

I. PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. In the following definitions, the end-quarter test dates apply to the last working day of each quarter.

3. The definitions of all fiscal variables contained in this TMU are based, unless otherwise specified, on the IMF's *Manual on Government Finance Statistics 2001*, with revenues recorded on a cash basis and expenditures on an accrual basis. The exceptional one-off payments based on accumulated reserves or holding gains that will be classified as withdrawals of equity rather than dividends. Transfers to the pension fund related to the clearance of pension arrears by non-government entities (missing pension contributions) will be recorded (i) as capital transfers and (ii) on a cash-flow basis.

A. Floors on the Net Lending of (i) the Institutions of Bosnia and Herzegovina, (ii) Central Government of the Federation of Bosnia and Herzegovina, and (iii) Central Government of the Republika Srpska (Performance Criteria)

Definitions

4. The Institutions of Bosnia and Herzegovina comprise all spending units depending on its budget. The central government of the Federation of Bosnia and Herzegovina is defined to include all spending units depending on its budget whether these units are included or not in the treasury system, and the operations funded by escrow accounts. The central government of the Republika Srpska includes all spending units depending on its budget whether these units are included (entirely or partially) or not in the treasury system, and the operations funded by escrow accounts.

5. Net lending is defined as revenue minus expenditure.

Application of performance criteria

6. Program targets will be individually monitored quarterly through the respective accrual balances and measured as the cumulative change from the level existing on December 31 of the previous year.

7. For the purposes of program monitoring, compliance with the floors on the net lending will require that each of the three above-defined floors be observed independently.

Adjusters to performance criteria

8. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.

Reporting requirements

9. Data on quarterly execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the Institutions of BiH and respective Entities and no later than five weeks after the end of each quarter (six weeks for end-year numbers).

B. Ceilings on Contracting or Guaranteeing of New Nonconcessional Short-Term External Debt by Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criteria)

Definitions

10. ***Definition of debt.*** The term **"debt"** is defined to include all current liabilities to non-residents, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract[1] (Point 8, Guidelines on Public Debt Conditionality in Fund Arrangements, Executive Board Decision No. 15688-(14/107), adopted December 5, 2014). In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits and leases) will be included in the definition.

11. **New nonconcessional external debt** is defined as including all debt (as defined above) contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH during the program period that is not on concessional terms.

12. **Concessional loans** are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRS). For short-term loans, the average CIRRs of the proceeding six-month period (plus a margin of 0.75 percent) will be used.

13. **Short-term external debt** is defined as external debt contracted or guaranteed with an original maturity of up to and including one year.

Application of performance criteria

14. The zero ceilings on contracting new nonconcessional short-term external debt applies to obligations of the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general

[1] See Debt Limits in Fund-Supported Programs—Proposed New Guidelines 6230-(79/140)

governments, and CBBH. These criteria will be measured quarterly on the basis of end-of-quarter data.

Reporting requirements

15. Data on newly contracted or guaranteed nonconcessional short-term external debt will be provided by the Ministries of Finance of the Institutions of BiH and the respective Entities and by the CBBH on a quarterly basis within six weeks of the end of each quarter.

C. Ceilings on the Accumulation of External Payment Arrears by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criteria)

Definitions

16. ***External payment arrears*** are defined as overdue debt service arising in respect of debt obligations (as described above) incurred directly or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, and CBBH, except on debt subject to rescheduling or restructuring.

Application of performance criteria

17. The zero ceilings on accumulation of external payments arrears apply to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, or CBBH. These criteria will apply continuously.

18. The limit on the change in external payments arrears also applies to the change in the stock of overdue payments on short term debt in convertible currencies with an original maturity of up to and including one year.

19. There are zero ceilings on accumulation of new external arrears under the program.

Reporting requirements

20. The Ministries of Finance of the Institutions of BiH and the respective Entities and the CBBH will inform Fund staff immediately of any accumulation of external debt service arrears.

D. Ceiling on transfers and credits from the Central Bank of Bosnia and Herzegovina to the public sector (Continuous Performance Criterion)

Definitions

21. Transfers and credits of the CBBH to the public sector is defined as transfers and payments from the CBBH to the general government and outstanding claims of the CBBH on the general government, including overdrafts, direct credit, and holdings of government securities.

Application of performance criterion

22. The zero ceiling applies to the cumulative sum of transfers and credits from the CBBH to the public sector since the beginning of the year. This criterion will apply continuously.

Reporting

23. Data will be provided by the CBBH to the Fund on a monthly basis with a lag of no more than 14 working days.

Adjuster

24. The ceiling on the transfers and credits of the CBBH to the public sector will exclude transfers of the CBBH's annual net profit to the institution in charge of BiH budget in the period of four months upon the end of the CBBH financial year, as stipulated in Article 27 of the Law of the CBBH.

E. Ceilings on the current expense by the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska Central Governments (Indicative Targets)

Definition

25. Current expense of the Institutions of Bosnia and Herzegovina, and Federation and RS Central Governments is defined as the sum of compensation of employees, use of goods and services, social benefits, interest, subsidies, transfers to other general government units, and other expense.

Application of the indicative targets

26. The ceilings on the current expense by the Institutions of Bosnia and Herzegovina, and Federation and RS Central Governments will be measured quarterly on the basis of cumulative end-of-quarter accrued KM amounts.

27. For the purposes of program monitoring, if at the end of any given quarter the cumulative KM amount of current expense since the beginning of the current year exceeds the corresponding ceilings, the indicative targets will be missed.

28. Compliance with the three above-defined ceilings on the current expense will require each of the ceilings be observed independently.

Reporting requirements:

29. Data on current expense by the Institutions of Bosnia and Herzegovina, and Federation and RS Central Governments will be contained in the data on quarterly central government execution, to be provided by the respective ministries of finance no later than five weeks after the end of each quarter (six weeks for end-year numbers).

Adjusters

30. The ceilings of the indicative targets will exclude capital transfers intended for financing specific highway construction projects in the Federation.

F. Ceilings on the Accumulation of Domestic Arrears by the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska Central Governments (Indicative Targets)

Definition

31. The indicative targets established on the stock of domestic payments arrears contemplates a zero ceiling on the increase in the stock of arrears compared with the stock as of December 31 of the previous year. The stock of arrears is defined as the sum of payments obligations (accounts payable) past the due date stipulated by the contractual or legal payment period for each expenditure item and are nondisputed. They can arise on any expenditure item, including transfers to individuals, debt service, wages, pensions, energy payments and goods and services. Past-due payments obligations on inter-governmental transfers (i.e., transfers between Entity central governments and local governments, and extrabudgetary funds) are not included in the stock of arrears. Arrears relating to court judgements are not included in the stock of arrears either.

Application of indicative targets

32. The zero ceilings on accumulation of domestic payment arrears apply to obligations of the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska general governments. This target will be measured quarterly on the basis of end-of-quarter data. Thus, if at the end of any given quarter any of the three governments exceeds the zero ceiling on the change in the stock of its arrears compared with the stock of the same government's arrears as of December 31 of the previous year, the indicative target will be missed.

Reporting requirements:

33. Data on domestic arrears will be transmitted on a quarterly basis by the Ministries of Finance of the Institutions of BiH and the respective Entities within five weeks of the end of each quarter. Separately, available data on arrears related to court judgments will be submitted on the same schedule.

G. Floor on the Net Lending of the General Government of Bosnia and Herzegovina (Indicative Target)

Definitions

34. ***The general government of Bosnia and Herzegovina*** is defined to include the Institutions of Bosnia and Herzegovina, and the general governments of Federation of Bosnia and Herzegovina Entity (Federation), Republika Srpska Entity (RS), and the District Brcko. The *Federation general government* is defined to include the central government, the cantonal governments, the municipal governments, the federal and cantonal extrabudgetary funds and the road and highways funds. The *RS general government* is defined to include the central government, the municipal governments,

the extrabudgetary funds and the road and highway funds. The *District Brcko* is defined to include the central government with all spending units depending on its budget and extrabudgetary funds. Extrabudgetary funds include, but are not limited to, pension funds, health funds, unemployment funds, and children's fund. Any new budgetary or extra budgetary fund, created during the program period will also be included in the definition of the general government. The BiH authorities will inform IMF staff of the creation of any such new funds. Any fund that uses public resources not included in the definitions above will be automatically allocated either to one of the entity general governments or to the Institutions of Bosnia and Herzegovina. The BiH authorities will promptly inform IMF staff of the existence of any of such funds.

35. The net lending of the General Government of Bosnia and Herzegovina is defined as revenue minus expenditure. The floor on the net lending of the General Government of Bosnia and Herzegovina will be defined, for each test date, as the cumulative change from the level existing on December 31 of the previous year.

Adjusters to indicative target

36. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.

Reporting requirements

37. Data on quarterly general government execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the respective Entities and District Brcko no later than six weeks after the end of each quarter. Data on quarterly general government execution for Bosnia and Herzegovina, including revenues, expenditure and financing, will be provided by Macroeconomic Analysis Unit no later than six weeks after the end of each quarter.

H. Floor on the collection of gross revenues by the Indirect Tax Authority (ITA) of Bosnia and Herzegovina (Indicative Target)

Definition

38. Gross revenues of the Indirect Tax Authority are defined as the sum of revenues collected from (i) value added tax; (ii) customs duties, customs registration fees and levies; (iii) excise duties on imported products; (iv) excise duties on domestic products; (v) levies (toll) on oil derivatives; (vi) other proceeds and fees; (vii) sales tax; and (viii) unclassified revenues. Gross revenue collection will be defined, for each test date, as the cumulative sum of gross revenues collected since the beginning of the current year.

Application of the indicative target

39. The floor on the collection of gross revenues by the ITA will be measured quarterly on the basis of cumulative end-of-quarter data. Thus, if at the end of any given quarter the cumulative amount of gross revenues collected since the beginning of the current year falls below the corresponding floor, the indicative target will be missed.

Reporting requirements:

40. Data on gross and net revenues will be transmitted on a monthly basis by the Indirect Tax Authority within two weeks of the end of each month.

II. OTHER DATA REPORTING REQUIREMENTS

41. The Bosnia and Herzegovina authorities will report the following data to the Fund within the time limits listed below (Table 3). In addition, the Fiscal Council will provide, no later than the fourth week of each quarter, a summary of key macroeconomic policy decisions taken during the previous quarter; a summary of regulatory changes in the area of banking and financial sector, report any amendments to the Entity and state budgets within a week after their government approval.

42. Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with necessary explanation. All data will be provided in an electronic form.

43. All magnitudes subject to performance criteria or indicative targets will be reported in millions of convertible marka (KM).

44. The Bosnia and Herzegovina authorities will supply the Fund with any additional information that the Fund requests in connection with monitoring performance under the program on a timely basis.

Table 3. Bosnia and Herzegovina: Data Reporting Requirements under the 2016–2020 Extended Arrangement Under the EFF

Data series	Data frequency	Periodicity of data reporting	Timeliness of data reporting (after the end of each reporting period)
I. Daily data reporting	**Daily**	**Weekly**	**Up to 14 working days, unless noted**
Gross international reserves			
CBBH foreign exchange purchases and sales			
II. Monthly data reporting	**Monthly**	**Monthly**	**Up to 4 weeks , unless noted**
Financial sector			
The balance sheet of the CBBH			
The commercial bank survey and monetary survey			
Weighted average interest rates by bank and by type of loans			
Banking sector credit to the general government (by level of government)			
Government deposits in the banking sector			
Government finances			
ITA revenues			**Up to 5 weeks 1/**
Debt service			
New external loans contracted or guaranteed by governments			
III. Quarterly data reporting	**Quarterly**	**Quarterly**	
Financial sector			
Banking supervision: financial soundness indicators			**Up to 6 weeks 2/**
Banking supervision: bank-by-bank commercial banks' summary balance sheets and income statements and prudential data on loan quality, liquidity, and			**Up to 8 weeks 2/**
Government finances			**Up to 6 weeks**
Revenues, expenditures and financing data for or Institutions of BiH and Entity central governments, municipalities (in both entities), and cantons (in the Federation), and Brcko District			
Revenues, expenditures and financing data for the road funds and highway funds in both entities			
Revenues, expenditures and financing data for the extrabudgetary funds in Federation, RS and Brcko District			
Revenues, expenditures and financing data for consolidated BiH, consolidated FBIH, and consolidated RS general governments			
End-period stock of outstanding arrears and float during the reference period by type of expenditure (wages, social benefits, pension, goods and services, etc.)			
Report on inflows into and outflows from escrow accounts (FBiH, RS)			
Debt service			
External debt service projections for current year; total, by creditor, by level of government, and in original currency			
Government guarantees on domestic loans contracted by public and private entities			
Newly contracted government short-term external loans and degree of concessionality (grant element); total, by creditor, by purpose (project/budget support), original currency, and maturity			
External debt service payments (interest, amortization) by level of government			
External loan and grants disbursements; by creditor, by level of government, by purpose (project/budget support) and original currency			
Stock of external debt for public sector and banking sector			
Stock of domestic government debt outstanding (by level of government, type of obligation, and holder (bank and non-bank sectors)); projected domestic government debt interest and amortization payments (by level of government, type of obligation, and holder)			

1/ Up to 6 weeks for end-year data.

2/ Up to 10 weeks for end-year data.

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

January 29, 2018

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER EXTENDED FUND FACILITY, REQUESTS FOR EXTENSION OF THE ARRANGEMENT, REPHASING OF PURCHASES, AND WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION—INFORMATIONAL ANNEX

Prepared By | The European Department

CONTENTS

FUND RELATIONS

(As of December 31, 2017)

Membership Status: Joined December 14, 1992; Article XIV

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	265.2	100.00
Fund holdings of currency	519.84	196.02
Reserve Tranche Position	0.09	0.03

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	160.89	100.00
Holdings	0.66	0.41

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
Stand-by Arrangements	191.29	72.13
Extended Arrangements	63.41	23.91

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Sep 07, 2016	Sep 07, 2019	443.04	63.41
Stand-By	Sep 26, 2012	Jun 30, 2015	558.03	422.75
Stand-By	Jul 08, 2009	Jun 30, 2012	1,014.60	338.20

Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	122.60	68.70		10.57	10.57
Charges/Interest	4.89	2.78	2.30	2.20	2.04
Total	127.49	71.48	2.30	12.79	12.61

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

Safeguards Assessment

The 2017 update of the safeguards assessment found that the CBBH legal framework safeguards the bank's autonomy. The bank's internal audit mechanism and financial reporting continue to adhere to international standards. The Governing Board is fully constituted, but the independence of its oversight needs to be strengthened. The CBBH has started taking steps to strengthen oversight, in particular on the delineation between executive and non-executive functions for members of the Governing Board. Further steps are needed to address the recommendations from the assessment. The CBBH has implemented all recommendations from the 2014 assessment.

Exchange Rate Arrangements

Bosnia and Herzegovina's exchange rate arrangement is a currency board. The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. On September 5, 2002, the Parliament of Bosnia and Herzegovina approved an amendment to the CBBH law that changes the peg of the KM from the Deutsch Mark to the Euro under a currency board arrangement. The KM is pegged to the euro at KM 1 = 0.5113 euro. Bosnia and Herzegovina (BiH) has not accepted the obligations under Article VIII Sections 2, 3, and 4 and therefore avails itself of the transitional arrangements under Article XIV. BiH no longer maintains restrictions under the transitional provisions of Article XIV. It maintains restrictions on the transferability of balances and interest accrued on frozen foreign-currency deposits, subject to Fund jurisdiction under Article VIII. An Article VIII mission by LEG and MCM took place in October 2012 to address pending Article VIII issues.

FSAP and ROSC Assessment

An FSAP mission took place in November 2014; and the Executive Board discussed the Financial System Stability Assessment in June 2015 (IMF Country Report No. 15/164). The authorities approved publishing the FSSA and all technical notes. A data ROSC mission was held in November 2007 and the ROSC Data Module was published in February 2008 (IMF Country Report No. 08/43).

Last Article IV Consultation

The last Article IV consultation was concluded on October 23, 2015 (IMF Country Report No. 15/298).

Resident Representative

The IMF has had a resident representative office in Bosnia and Herzegovina since 1996. Mr. Francisco Parodi assumed his position as a resident representative in August 2015.

Technical Assistance 2012–2017

Department	Timing	Purpose
FAD	September 2012	Revenue Administration
	February 2013	Public Financial Management
	April 2014, July–August 2014, September 2014	Revenue Administration (ongoing)
	April 2015	Tax Policy
	April 2015	Public Financial Management with regional peripatetic advisor
	July 2015	Macro-forecasts
	November 2015	Compliance Management
	March 2016	Deliver Training in Electronic Audit
	March 2016	Reform of the Fiscal Decentralization Framework
	March 2016	Improving the Intergovernmental Revenue Allocation and Public Financial Management System in the Federation
	March 2016	Improve Performance of ITA; Improve Performance of the FBiH Tax Administration
	April 2016, January 2017	Risk Management of ITA
	June, August 2016	PFM Reform Advisory
	October 2016	Improving Indirect Audit Methods
	October 2016	Fiscal Oversight of the Development Banks
	December 2016	Follow-up on FY15 General Tax Policy
	December 2016	Evaluation of Indirect Tax Revenue System and Sharing Mechanism
	January 2017	Supporting Tax Compliance with Rules-Based Risk Modeling
	April 2017	Reviewing Administration of Taxpayer Reporting on Final Consumption
	February, May, August 2017	IT Modernization of ITA
FIN	November 2012	Safeguard Assessment of the Central Bank of Bosnia and Herzegovina
	October 2016	Safeguard Assessment of the Central Bank of Bosnia and Herzegovina
LEG	April 2013	Non-performing loans
	October 2013	Corporate income legislation
	March 2014, June 2014, December 2014	Law on banks and banking resolution
	March 2014	Out of court restructuring

MCM	May 2012, September 2013, February 2014	
	January 2012	Stress Testing
	April 2013	Non-performing loans
	May 2013	Bank Resolution
	March 2014	Law on banks
	June 2014	FSAP (scoping mission)
	November 2014	FSAP (primary mission)
	May 2015	FSAP (report presentation)
	July 2016	Foreign Exchange Reserve Management
	September 2016	Supervisory Cooperation
	October 2016	Crisis Management
	September 2017	Crisis Prevention and Systemic Risk Oversight
STA	January 2012	Government Finance Statistics
	June 2012–2014	Real sector statistics advisor
	June 2013	Price statistics
	April 2014	Government Finance Statistics
	April 2015	Government Finance Statistics
	February, May, June, October 2016,	Government Finance Statistics
	February, March, April, August, September 2017	Government Finance Statistics

IMF-WORLD BANK COLLABORATION

The Bank and the Fund country teams in Bosnia and Herzegovina maintain close collaboration, coordinate the two institutions' activities and plans, and harmonize policy recommendations.

Key Areas of World Bank Involvement

- The World Bank's Country Partnership Framework (CPF) for Bosnia and Herzegovina for the period 2016-2020 was approved in December 2015 in support of reforms in three areas: (1) increasing public sector efficiency and effectiveness; (2) creating conditions for accelerated private sector growth; and (3) building resilience to natural shocks. The CPF includes a cross-cutting theme of inclusion that informs the choice and design of specific interventions under the strategy, to ensure that reforms are socially sustainable, and that vulnerable groups are not left behind as new opportunities open. The CPF was prepared on the basis of extensive consultations with a range of stakeholders at all levels of government and in civil society, academia, private sector and international community. It reflects a consensus of stakeholders on the reform process and a shared understanding of development priorities and challenges facing the country.

- The CPF envisions around US$ 750 million of new lending from the World Bank through 2020, depending on the scope and pace of reform implementation.

- The current portfolio of Bank-supported operations in Bosnia and Herzegovina consists of 10 projects totaling $496.08 million. Areas of support include public finances, irrigation development, energy efficiency, employment support, environment, local infrastructure and services, real estate registration and banking sector strengthening.

Bosnia and Herzegovina Bank Active Portfolio as of November 22, 2017

Project name	Effective	Closing	Original commitment (US $m)
Banking Sector Strengthening Project	Not yet effective	12/31/2020	60.00
BiH Employment Support Program	Not yet effective	10/01/2021	55.80
Federation Road Sector Modernization	10/04/2017	12/31/2021	64.60
Irrigation Development	03/29/2013	11/30/2019	40.00
Real Estate Registration	09/23/2013	01/31/2020	34.10
Sustainable Forest and Landscape Management	06/09/2014	05/31/2019	5.58

Bosnia and Herzegovina Bank Active Portfolio as of November 22, 2017 (Concluded)			
Floods Emergency Recovery	09/15/2014	12/31/2018	100.00
Drina Flood Protection	05/21/2015	12/31/2019	24.00
Energy Efficiency	05/27/2015	12/31/2019	32.00
Public Finances DPL	not yet effective	03/31/2018	80.00
10 ACTIVE PROJECTS			**496.08**

- Under the CPF, the Bank's planned activities in Bosnia and Herzegovina covering structural reform areas will be supported primarily through a series of three Development Policy Loans (DPLs). The first of these planned operations was approved in March 2017. The operation supported the policy efforts of the authorities to strengthen public finances, in particular to: (1) improve the management and transparency of public resources through reforms related to debt management, public investment management, public arrears and the financial sector; and (2) improve the efficiency of government spending by tackling labor rigidities in public employment and increasing the efficiency of health and social protection spending. The DPL under preparation deepens to focus on strengthening public finances. It provides continued support to the design and implementation of reforms targeting three key objectives: (1) improving the composition and quality of spending through measures to control the public wage bill and enhance the efficiency of social spending; (2) reducing fiscal risks and strengthening fiscal sustainability by better managing expenditure arrears, strengthened SOE performance and governance; and (3) increasing revenue potential and the efficiency of tax policy through interlinked reforms related to the legislative frameworks for social security and income tax.

- Bosnia and Herzegovina became a shareholder and member of IFC in 1996. Since then, IFC's long term finance investment in Bosnia and Herzegovina totaled $398.3 million, including $23.1 million mobilized from our partners, in 46 projects across a variety of sectors. In addition, IFC has supported trade flows of $52 million through its trade finance program. As of June 30, 2017, IFCs committed investment portfolio in Bosnia and Herzegovina is $60.70 million.

Indicative lending for FY18–FY19		
Project	**Total ($M)**	**Bank Approval**
BiH Business Environment (RBL)	60	FY19
Bosnia and Herzegovina: Public Finances (DPL)	80	FY18
Bosnia and Herzegovina Employment Support Program (IPF)	50	FY17
Federation Railways Sector Restructure Project in RS (IPF)	60.6	FY18
Bosnia and Herzegovina: Fiscal Reform (DPL)	50	FY19
Total	**300.6**	

STATISTICAL ISSUES

(As of November 30, 2017)

I. ASSESSMENT OF DATA ADEQUACY FOR SURVEILLANCE
General: Data provision has some shortcomings but is broadly adequate for surveillance. The accuracy, timeliness, and publication of economic statistics has improved, but weaknesses in national accounts, government finance, and balance of payment statistics need to be addressed.
Real Sector: BiH has made efforts to improve the real sector statistics. The country has benefited from extensive technical support from the IMF and the European Union. With the assistance of the IMF resident real sector statistics advisor, BiH started compiling and publishing quarterly national accounts as of mid-2014. Additional efforts have been invested into closing the gap between the production and expenditure-based GDP estimates and in the improvement of coverage of GDP, mainly with an ongoing review of the calculations of the non-observed economic activities (NOE). Outstanding issues are the need for further improvements to the annual and quarterly compilation of GDP by expenditure at the country level. **Price statistics:** A consumer price index (CPI), based on internationally-recommended practices, has been implemented. This CPI was released in 2007, and consistent series are available monthly countrywide and for each entity, with the series starting in January 2005. The CPI weights are derived from the household budget survey, conducted since 2004. Also, producer price indices (PPI) are available for both Entities and countrywide. The Industrial Production index at the country level has been made available in 2009 with historical time series going back till 2006. Both the industrial production index and the producer price index are compiled and disseminated at the national and entity level based on harmonized methodology. The annual Labor Force Survey follows international methodological standards and provides data for the country and the entities since 2006.
External Sector: Balance of payments statistics are compiled by the CBBH. Stating from 2012, BOP is completed in line with sixth edition of the *Balance of Payments Manual* (BPM6) and is of good quality. To improve the compilation of services the implementation of new surveys will be required that follow BPM6. The compilation of remittances relies heavily on estimates. Export and import data are produced from customs records, but on a special trade basis rather than on a general trade basis. Trade data may also be subject to incomplete coverage and under-invoicing.
Government Finance Statistics: The CBBH compiles government finance statistics (GFS) in accordance with the definitions and concepts of the *Government Finance Statistics Manual 2001*. While the institutional coverage of the GFS is broadly consistent with international

guidelines, its scope does not cover all economic stocks (balance sheet data) and flows. To address this issue and with help of the IMF TA, the CBBH has been preparing the balance sheet and debt data for general government. However, the data have not been published yet. In addition, the GFS does not include full transactions related to projects directly financed by international donors, and quarterly statistics exclude all transactions in financial assets and liabilities due to incomplete quarterly source data. Transactions are recorded on a mixed accrual/cash basis.[1] External government debt data are published quarterly; however, work remains to be done on compiling and publishing public sector debt statistics. Authorities have made an effort to improve the quality of the GFS prepared by ministries of finance. More work is required to improve the quality of consolidated general government data.

Monetary and Financial Statistics: The CBBH reports monetary accounts to the Fund on a countrywide and Entity basis. As of 2011, the CBBH reports monetary data to the Fund in the Standardized Report Forms developed by STA that embody the methodology of the *Monetary and Financial Statistics Manual*. The CBBH collects data using the standardized report forms. As of 2002, interest rate statistics compiled and published by the CBBH produces harmonized data on level of the average weighted lending and deposit nominal interest rates of commercial banks in BiH, presented at the annual level. Finally, the CBBH extended the coverage of its annual financial sector statistics to encompass approximately 98 financial institutions (investment funds, insurance companies, microcredit institutions, leasing companies, brokerage houses, and stock exchanges).

II. DATA STANDARDS AND QUALITY

BiH is subscriber to the Fund's General Data Dissemination Standard (GDDS) since April 2013.

[1] At the State level, some earmarked revenues are not recorded until the corresponding expenditure takes place. In the Federation, expenditures are not entered into the Treasury payment system if there are no available funds to pay them out or if obligations exceed the budgeted amounts.

Appendix Table 1. Bosnia and Herzegovina: Table of Common Indicators Required for Surveillance

(As of November 30, 2017)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	11/30/17	11/30/17	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	09/2017	10/2017	M	M	M		
Reserve/Base Money	09/2017	11/2017	M	M	M	O, O, LO, O	O, O, O, O, O
Broad Money	09/2017	11/2017	M	M	M		
Central Bank Balance Sheet	09/2017	10/2017	M	M	M		
Consolidated Balance Sheet of the Banking System	09/2017	11/2017	M	M	M		
Interest Rates[2]	10/2017	11/2017	M	M	M		
Consumer Price Index	09/2017	10/2017	M	M	M	LNO, NO, LNO, LO	LNO, LO, LNO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3/2017	11/2017	Q	Q	Q	O, LNO, LO, LO	LNO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government[5]	10/2017	11/2017	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Q3/2017	11/2017	Q	Q	Q		
External Current Account Balance	Q2/2017	10/2017	Q	Q	Q	O, O, LO, LO	LNO, O, LO, O, LO
Exports and Imports of Goods and Services	10/2017	11/2017	M	M	M		
GDP/GNP	Q2/2017	10/2017	Q	Q	Q	O, LNO, LO, LO	LNO, LNO, LO, LO, LO
Gross External Debt	Q3/2017	10/2017	Q	Q	Q		
International Investment Position	2016	09/2017	A	A	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. [2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. [3] Foreign, domestic bank, and domestic nonbank financing. [4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. [5] Only quarterly data is available for FBiH. [6] Including currency and maturity composition. [7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA). [8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on February 2008 and based on the findings of the mission that took place during March 13–28, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA). [9] Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

**Statement by Anthony De Lannoy, Executive Director for Bosnia and Herzegovina and Zorica Kalezic, Advisor to the Executive Director
February 9, 2018**

The authorities broadly agree with staff's assessment. They look forward to continuing the close and constructive policy dialogue with the Fund, as well as continuing to receive valuable technical assistance.

Program performance and economic outlook

The authorities admit that the complex institutional set-up and resulting fragile political situation has at times slowed down program implementation. They remain, however, strongly committed to the program and are determined to resist any pressures to backtrack. The EFF arrangement plays a pivotal role in supporting Bosnia and Herzegovina's economic policy and reform agenda. It also plays a catalytical role in fortifying the single economic space within Bosnia and Herzegovina, while boosting cooperation with other IFIs, and paving the way for eventual EU and WTO integration.

Albeit somewhat lower than expected, growth remained stable in 2017, as consumption, the inflow of remittances, and higher exports to neighboring countries, compensated for lower than expected investment levels. Going forward, the authorities share staff's assessment that at the current pace of reforms, growth is expected to reach 4 percent by 2022, supported by stronger investment and export growth as donor-financed capital projects and measures to improve competitiveness begin to bear fruit.

Fiscal policy

Gradual fiscal consolidation since 2014 is placing general government debt on a downward trajectory to below 40 percent of GDP by 2020. The 2018 budgets of the central governments of the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS), as well as the 2018 budgets of the State institutions, are in line with program targets. The authorities project a fiscal surplus of 1.4 percent of GDP for 2018, and will continue to run moderate fiscal surpluses over the medium term while preserving healthy margins of the temporary structural surplus.

The authorities managed to restrain current spending by introducing limits on hiring, as well as a wage freeze. They also better targeted social spending, veteran benefits, and agricultural subsidies. The authorities agree with staff that the current economic cycle is conducive for further reforms in terms of reducing public-sector employment. The authorities in the FBiH and the RS will finalize the Employee Register in early 2018. In addition, the completion of the functional review of public sector employment, scheduled for end 2018, will unveil organizational structures where further reductions in wages and/or employment are warranted.

Following the increase in fuel excises, important external financing resources will become available to finance long overdue public investment projects. Given the country's limited access to international financing, the authorities had to rely on limited available domestic resources, to address Bosnia and Herzegovina's development needs. To improve public investment efficiency, the authorities are working on an action plan to strengthen the public investment cycle from project allocation, to project appraisal and project implementation.

The authorities are taking decisive measures to address deficiencies in the PFM framework and to address the long-standing issue of public-sector arrears. Public-sector arrears are a legacy of twenty years of decentralized fiscal management. As a first step, the authorities have assessed the stock of arrears. Most arrears come from SOEs (primarily unpaid pension and health contributions spending), lower levels of government, and the health sector. In collaboration with the Fund and the World Bank, the authorities are working on a timetable and measures to address poor management, reporting, and the clearing of outstanding arrears. To avoid a further accumulation of arrears in SOEs, the authorities adopted the Law of Financial Operations, which prevents SOEs from paying salaries without making the necessary pension and health contributions. In addition, to strengthen control on borrowing at the cantonal and municipal level, the FBiH proposed a new Law on Debt, Borrowing, and Guarantees. The RS introduced a new reporting system to capture health sector arrears, and the authorities will develop an action plan to restore the financial sustainability of health institutions by the end of 2018.

Monetary policy framework and financial sector

The authorities continue to adhere to the Currency Board Arrangement (CBA). The CBA has served Bosnia and Herzegovina well as it represents a predictable, credible, and transparent anchor for economic policies. The authorities will also continue to uphold the independence and the credibility of the Central Bank of Bosnia and Herzegovina (CBBH). In line with IMF technical assistance recommendations, the CBBH enhanced the efficiency of foreign reserves management and related investment practices.

The authorities made significant strides in reforming and modernizing banking sector legislation. The authorities of the FBiH and the RS adopted a new Law on Banks, as well as amendments to the laws governing the banking supervisory agencies to strengthen their supervisory and resolution powers. The new legislation further enhances the single economic space as it is intended to strengthen cooperation, coordination, and information exchange between all financial sector regulators. To achieve such cooperation, coordination, and information exchange in practice, the authorities are finalizing a draft Financial Stability Memorandum of Understanding. Amendments to the Law on Deposit Insurance, have been submitted to Parliament, with the intention to have them adopted by end-March 2018.

The authorities have started addressing AML/CFT deficiencies. As the country is listed as a jurisdiction with strategic deficiencies, the authorities will continue to work closely with FATF and MONEYVAL. The authorities have made substantial progress with the criminalization of terrorist financing, developing an adequate AML/CFT supervisory framework, and establishing adequate cross-border currency controls. These efforts will be subjected to FATF verification.

Structural policy

The authorities remain committed to improve Bosnia and Herzegovina's business climate to unlock the country's growth potential. Existing structural bottlenecks prevent Bosnia and Herzegovina to make the most of its regional comparative advantages in wood processing, metal processing, and inorganic chemical industries. To this end, the authorities will focus on important infrastructure improvements to take advantage of the country's geographical position. The recent decision to increase excises on fuel products will have a catalytical effect on mobilizing external financing to support the construction of the strategically important highway "Cordor V", while two World Bank projects will support local road and railway connectivity. The new Law on Physical Planning at the cantonal level, adopted end 2017, simplifies the procedure for obtaining building permits. In addition, both the FBiH and the RS will lower parafiscal fees in 2018 and will, by June 2018, establish a one stop shop to simplify and shorten the time required to register business entities. The corporate resolution and insolvency frameworks are further fortified with the new Bankruptcy Laws (adopted in 2016 in the RS, and to be adopted in the FBiH in 2018), as it streamlines foreclosure procedures and introduces tools and incentives to facilitate corporate debt restructurings and resolution.

The authorities are gradually implementing structural reforms to stimulate job creation and address labor market rigidities. In line with their reform agenda, the authorities introduced a new Labor Code and the social partners have negotiated new, more flexible collective agreements. In order to spur wage competitiveness by lowering the robust tax wedge on labor, the FBiH plans to align legislation with the RS, by submitting to the Parliament amendments to the laws on personal income tax (introducing progressive taxation) and social security contributions (SSC). With World Bank assistance, the authorities launched a project providing financial incentives to promote formal private sector employment, and improve job retention rates and intermediation services. The project targets youth, women, and vulnerable groups such as long-term unemployed, as well as other disadvantaged groups at higher risks of being unemployed.

The pace of privatization remained satisfactory, although it proved to be more challenging than expected. At the same time the authorities will continue to address the governance problems of SOEs. The authorities are aware that the current SOE corporate governance policy frameworks and practices are not in line with international best practices. Progress has, however, been made in the largest loss-making companies. The RS, with World Bank support, has adopted an ownership and financial restructuring plan to achieve an operational transformation of the railway company of the RS. Similarly, the FBiH has taken bold measures to cut operational costs, and reduce staff of its railway company. The process to restructure and/or privatize the large SOEs in the telecom sector in the FBiH has started, and the finalization of the due diligence of these companies is scheduled for September 2018.