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Bosnia and Herzegovina: Fourth and Fifth Reviews Under the Stand-By Arrangement and Requests for Extension and Rephasing of the Arrangement--Staff Report and Press Release on the Executive Board Discussion

In the context of the fourth and fifth reviews under the Stand-By Arrangement with Bosnia and Herzegovina, and requests for extension and rephasing of the arrangement, the following documents have been released and are included in this package:

- the staff report, prepared by a staff team of the IMF, following discussions that ended on **October 15, 2000**, with 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 December 8, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the **views of the Executive Board as expressed during its December 22, 2000, discussion** of the staff report.

The document listed below has been or will be released separately also.

Letter of Intent sent to the IMF by the country authorities

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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BOSNIA AND HERZEGOVINA

Fourth and Fifth Reviews Under the Stand-By Arrangement and Requests for Extension and Rephasing of the Arrangement

Prepared by the European I and the
Policy Development and Review Departments

(In consultation with other departments)

Approved by Susan Schadler and G. Russell Kincaid

December 8, 2000

- Discussions for the fourth and fifth reviews under the stand-by arrangement were conducted in Sarajevo, Banja Luka, Pale, and Mostar during April 26–May 11, June 14–28, 2000, and October 2–15, 2000 by staff teams consisting of Juan J. Fernández-Ansola, Franek Rozwadowski, Geoffrey Oestreicher, Dawn Rehm, Kori Udovicki (all EU1), Jenny Ligthart (FAD), and Bhaswar Mukhopadhyay (PDR). Bruno de Schaetzen (Resident Representative), Berina Selimovic-Mehmedbasic, and Marijana Milic (both local advisors) assisted the mission.
- Meetings were held with the three members of Bosnia and Herzegovina's Presidency, the Council of Ministers, the Governor of the central bank, Prime Ministers, Ministers of Finance, leading members of Parliament, members of the political opposition, and other key officials.
- The constitution of Bosnia and Herzegovina, which is a part of the Dayton Peace Agreement (DPA), provides for a decentralized governmental structure. The central ("State") government has limited powers and a balanced ethnic composition, with consensus required for most decisions. Other functions are devolved to the two Entities (the Federation of Bosnia and Herzegovina and the Republika Srpska) or their subunits. Functions not explicitly assigned to the State are reserved for the Entities or their subunits. Bosnia and Herzegovina's governmental structure also includes the Office of the High Representative which was established in December 1995 to oversee implementation of the DPA. The High Representative is the final authority regarding interpretation of the DPA in the area of civilian implementation, and also plays a role in the economic sphere by coordinating economic policy through the Economic Task Force.

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I. Introduction

1. ***The stand-by arrangement with Bosnia and Herzegovina was approved on May 29, 1998 and extended on two occasions, May 28, 1999 and March 31, 2000. The second and third reviews under the stand-by arrangement were completed on March 31, 2000, upon which a third purchase was made***. The outstanding use of Fund credit is shown in Table 1.

2. ***In the attached Letter of Intent dated December 4, 2000 (Appendix I) the Bosnian authorities request completion of the fourth and fifth reviews, an extension of the stand-by arrangement by two months and a rephasing of the remaining disbursements***. The proposed rephasing is shown in Table 2 and Annex I of the attached letter. In the letter, the authorities also report on progress thus far, and set out policies for the remainder of the program.

3. ***During the last Board discussion on March 8, 2000, Executive Directors commended Bosnia and Herzegovina for the maintenance of macroeconomic stability despite the adverse impact of the Kosovo crisis, and for the rapid increase in the acceptance of the convertible marka (KM)***. They noted that this had largely been due to the successful implementation of the currency board and firm fiscal discipline. Directors cautioned, though, that in light of the anticipated decline in donor assistance, the present stance of fiscal policy was not sustainable. They noted the need to lower both military expenditure and transfers to war invalids to levels consistent with fiscal sustainability. Directors, however, expressed disappointment with the slow pace of structural reform. They observed that in the period ahead, priorities for structural reform should be an acceleration of the privatization of banks and enterprises, and the reform of the payments and tax systems, as well as the labor market. Directors were also concerned about the emergence of governance problems in Bosnia.

II. Recent Developments

4. ***Although political pressures, particularly those related to the general elections in November have complicated policymaking in Bosnia and Herzegovina, some recent developments indicate a growing ability of the ethnic groups to work together***. Following an impasse of some three months that delayed the implementation of important policies, decisions were finally taken in June on the composition of the Council of Ministers and the expansion of the State government, from three to six ministries.[1] Moreover, in implementing policies required under the program, the Entity authorities have shown skill and determination in traversing Bosnia and Herzegovina's hazardous political terrain. Also, significant measures were carried out in October and November despite the approach of elections.

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[1] Three new ministries were added to the existing ministries of Foreign Trade and Economic Relations, Foreign Affairs, and Civil Affairs and Telecommunications. These are the ministries of Treasury, Human Rights and Refugees, and European Union Affairs.

5. ***Aided by large inflows of foreign assistance, the economy is continuing its recovery from the devastation of the war and overcoming the adverse effects of the Kosovo conflict.*** Real GDP growth is estimated to have been 9 percent in 1999 and, despite the adverse effects of a severe drought on agricultural production, is projected to reach about 10 percent this year (Figure 1).[2] Industrial production, which fell in 1999 in the Republika Srpska and showed modest growth in the Federation, has been exhibiting a sustained and broad recovery in the first half of 2000 in both Entities. Nevertheless, production in most traditional industries remains at less than half its pre-war level. For this reason, as well as because of weak legal frameworks for the labor and financial markets, widespread unemployment continues to characterize the economy.

6. ***Inflation, which was low in both Entities in the first half of 2000, rose in the third quarter, reflecting the severe drought in the region.*** In the Federation, inflation over the 12-month period ending in September 2000 was just 3.5 percent. In the Republika Srpska, which has a greater share of GDP devoted to agriculture, and was therefore more affected by the drought, the 12-month inflation rate rose to 16.9 percent by September 2000. The existence of a continued differential in the inflation rate between the two Entities in part reflects the catch-up of the Republika Srpska price level to that in the Federation.

7. ***Both Entities experienced considerable difficulties in implementing the approved budgets for 2000, and substantial financing gaps would have emerged under policies implemented during the first half of 2000.*** These difficulties were the result of wage increases that were not in line with the budgets, larger transfers to the pension fund (Republika Srpska), increased foreign debt service owing to the depreciation of the convertible marka against the U.S. dollar (Federation) and higher spending on refugees and displaced persons (both Entities). The additional expenditure pressures were compounded by lower-than-expected tax revenues in the Federation, as increased tax evasion contributed to a decline in the collection of excise taxes. By contrast, revenue growth in the Republika Srpska was broadly in line with projections, and the government's resources were boosted by the collection of some tax arrears from 1999. On the basis of these developments and unchanged policies, the financing gaps for 2000, in the absence of corrective measures, were projected to reach KM 139 million (2.2 percent of GDP) in the Federation, and KM 196 million (7.4 percent of GDP) in the Republika Srpska, in spite of an upward revision in projections of donor support.[3]

8. ***The financial situation during the first half of the year was managed in each Entity by delaying payments on some spending commitments.*** Part of this delay was normal practice, since the injunction against domestic borrowing precludes smoothing the seasonality of revenue collections and lumpy disbursements of donor assistance. In addition, however, without a correction, spending commitments incurred in the first half of 2000 would not have allowed the governments to meet their expenditure obligations on an annual

[2] Agricultural production is expected to decline by as much as 15 percent in 2000.

[3] Several disbursements originally expected in late 1999 were made early in 2000. Percent of GDP refers to percent of respective Entity GDP.

basis. Under these circumstances, the government would have been forced to resort to crude cash management through a feature of the Entity and State budget execution laws that prevents expenditure commitments that cannot be met out of current resources to be carried over to the following year.[4] However, the use of such provisions of the budget execution laws to cancel large obligations, particularly as regards wages, would likely have met significant resistance. Accordingly, it was essential for the authorities to take immediate action to correct expenditure policy.

9. ***At the State level, restrained spending yielded a broadly balanced budget during the first half of the year***. Expenditures on wages were lower than budgeted, compensating for delays in transfers from the Federation and lower revenues from fees. However, in view of additional wage payments and expenditures on goods and services associated with the expansion of the number of ministries, and higher than budgeted spending on foreign debt service,[5] a financing gap of about KM 10 million would have emerged in 2000 in the absence of a change in the fiscal stance. Thus, a revision of the 2000 State budget was also necessary.

10. ***The complications in the fiscal area were compounded by imbalances in the pension funds***. In the Republika Srpska, budget transfers to the pension funds were sufficient to cover those funds' financial gaps until mid-1999. Subsequently, unfinanced gaps resulted from a parliamentary decision that increased pensions cumulatively by about 80 percent through end-July 2000, while the collection of pension contributions rose by about 16 percent over the same period. In the Federation, the gap between contributions and benefit entitlements has been narrowing. However, the improvement in the financial position of the Sarajevo and Mostar pension funds will be threatened by the transfer to these three funds of some 20,000 pensioners who until recently had been receiving pensions from the Republic of Croatia.

11. ***Monetary developments in 1999 and the first nine months of 2000 reflected increasing acceptance of the convertible marka as well as continued sluggishness of private sector credit.*** During 1999, broad money grew by 40 percent, with the bulk of this increase resulting from a build up of net foreign assets (NFA). The increase in NFA reflected a marked increase in the demand for domestic currency at the expense of foreign currencies, evidenced both by the replacement of foreign currency in circulation and by the shift in the composition of bank deposits in favor of the convertible marka. The increase in the demand for the convertible marka was particularly rapid in the second half of 1999 following the elimination of the use of foreign currencies from the internal payments system. The level of NFA stabilized in 2000, however, as this portfolio adjustment neared completion. Monetary

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[4] As an example, if in 2000 resources are available to pay only 10 months' of wages, according to the law, workers would have to forgo forever their claim on the remaining two months' wages.

[5] Although the State is nominally responsible for servicing all foreign debt of the Entity governments, debt service payments are entirely met by transfers from Entities on a monthly basis. Thus, the higher external debt service is met by larger transfers from the Entities.

growth decelerated, and the impetus for growth shifted from NFA to moderate increases in NDA. In the first nine months of 2000, private sector credit grew by less than the increase in nominal GDP, reflecting weaknesses in the legal and institutional environment, which magnify the risk associated with bank lending; as well as banks' continued inability to provide financial intermediation services.[6] Several donor agencies are taking steps to address these inadequacies through the design of legal and institutional reforms, but these efforts are still at a diagnostic stage.

12. ***The growth in gross official reserves moderated during the first three quarters of 2000.*** Taking account of the seasonality of foreign flows, gross reserves are now projected to grow in 2000 by about US$40 million. This amounts to an increase of reserves to some 2¼ months of import cover at end-2000 from 2 months at end-1999, which reflects the stronger demand for the convertible marka that led people to transform their foreign currency holdings to domestic currency, as well as a projected decline in the external current account deficit.

13. ***Enhancing competitiveness is crucial for sustaining the recovery in Bosnia and Herzegovina's exports, and available indicators suggest that developments on this front will need to be closely monitored.*** The external current account deficit excluding official transfers remains large, and the inflows of concessional foreign assistance related to the reconstruction of the country continue to play a significant role in supporting the balance of payments. The last Staff Report (EBS/00/27, 2/18/00) discussed at length the evidence from various competitiveness indicators in Bosnia and Herzegovina. The real effective exchange rate (REER) for both Entities has depreciated considerably since 1996, but has edged up during 1999 in the Republika Srpska because of the high inflation resulting from the Kosovo crisis. Since then, aided by the sharp depreciation of the convertible marka (relative to the U.S. dollar) the REER in the Republika Srpska has remained broadly unchanged. In the Federation, the depreciation of the convertible marka and lower inflation rates than in the major trading partners, has contributed to a depreciation of the REER. By contrast, the ratio of the price of nontradables to tradables had increased substantially in both Entities. Dollar wages in the Republika Srpska were low in 1999 compared to other countries in the region, while in the Federation, dollar wages were broadly comparable to those in the Baltic and more advanced transition countries (Figure 2).[7]

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[6] Historically, banks in Bosnia and Herzegovina were typically established by or associated with state-owned enterprises. They served predominantly as a source of directed credit for these enterprises, with little effort devoted to seeking out other clients. This situation was aggravated by the payments bureaus, whose presence at the center of the financial system severely impeded the banks' ability to build the close relations with customers that typically underpin the development of successful lending operations.

[7] It should be noted that reporting methods in Bosnia and Herzegovina bias upwards the wage rates in both Entities.

14. ***On the structural front, significant progress was made during the first half of the year, particularly on overhauling the payments system and strengthening bank supervision, while enterprise privatization gathered momentum.*** Work to reform the payments system has focused on developing a modern system for interbank transactions that does not use the payments bureaus, which are scheduled to be eliminated by end-2000. Bank supervision has continued to improve, especially in the area of off-site supervision to identify problem banks. Following concerted pressure by the international community, preparations for voucher privatization accelerated in the Federation, while in the Republika Srpska the process began in earnest once the resource-intensive voucher registration was completed in May 2000. With respect to the tenders of large enterprises, the authorities worked closely with the international community to modify the tendering process to address shortcomings that were uncovered during early tenders. A detailed discussion of progress on the agenda for structural reforms is contained in Section III.

15. ***All quantitative performance criteria under the program were met as of end-June 2000.***[8] All levels of government refrained from borrowing from the domestic banking system; the ceilings on contracting or guaranteeing nonconcessional external debt were also observed; and no external payments arrears were accumulated. The central bank exceeded the minimum level of free reserves required under the program.[9]

III. Program Objectives and Report on the Discussions

16. ***The main program objectives remain to (i) move toward fiscal sustainability through tax and expenditure reform; and (ii) foster market development.*** The policy strategy envisages strict implementation of currency board rules, reform of the payments and banking systems, acceleration of the privatization of banks and enterprises, and the putting in place of an appropriate legal framework for the labor market. The main program targets for 2000 are a real GDP growth rate of 10 percent, a 12-month inflation rate of under 5 percent in both Entities, and a strengthening of the external position, with an increase in official reserves to the equivalent of 2.3 months of imports, including a substantial rise in the free reserves of the central bank. For 2001, it is expected that growth will accelerate to 14 percent, as the economy recovers from the drought, inflation will remain moderate, and reserve cover will increase to 2½ months of imports.

17. ***Discussions focused on corrective fiscal policies for 2000, the budgets for 2001, and the agenda for structural reform.*** As noted in the background section, it became apparent in mid-2000 that the serious deterioration of the public finances would lead to the emergence of substantial financing gaps in 2000 unless corrective actions were taken. Therefore, discussions were held on how to contain budget and pension fund imbalances and thus attain

[8] At the time of the last Board meeting in March, it was envisaged that a subsequent review would be completed before September, at which time performance criteria for end-September would have been set.

[9] Free reserves are defined to be the difference between the net foreign exchange reserves of the Central Bank of Bosnia and Herzegovina and its domestic monetary liabilities.

the authorities' economic objectives. Discussions during the October 2000 mission established budgets for 2001 that maintained a fiscal stance compatible with the program's prohibition on domestic borrowing. The missions also stressed the need to closely monitor competitiveness indicators, since they are key to sustaining macroeconomic stability. Indeed, at the last meeting of the Executive Board, Directors emphasized the importance of accelerating the pace of structural reform so as to enable Bosnia to sustain high real GDP growth rates. Thus, the mission also discussed progress in the implementation of structural reforms in 2000 and a program of reforms for the next 12 months, discussed below. Because of the sensitive nature of some of these reforms, the mission met—in addition to its usual counterparts—with the three members of the Bosnian Presidency. Moreover, the staff engaged in discussions with the wider community in Bosnia, including leading members of parliament and opposition leaders. As on other visits, the mission coordinated its efforts with the large international community in Bosnia, particularly the World Bank.

A. Fiscal Policy in 2000

18. ***The revised 2000 Entity budgets aim to maintain macroeconomic stability while supporting the return of refugees.***[10] The revised budgets, passed by the respective parliaments in August, are consistent with the injunction not to borrow domestically and to limit external borrowing to loans on concessional terms. They are based on conservative revenue estimates and conservative projections of foreign grants and loans. Expenditures on wages and goods and services were lowered—compared with the projected outcome under policies implemented in the first half of 2000—to make room for increased spending on refugees and displaced persons (both Entities), foreign debt-service transfers to the State (Federation), and transfers to social funds and war invalids (Republika Srpska).

19. ***The key issue discussed in revising the 2000 budgets was the expenditure policy required to contain spending commitments within available resources.*** While assuming commitments beyond available resources had been a fairly common feature of the country's economic policy in the past, during the last year the authorities made some progress in breaking this practice. The authorities agreed that the unrealistic pension and wage increases granted over the last 12 months would not allow them to meet all their commitments without resort to the harsh features of the budget execution law. They also agreed that such a development would undermine the credibility of the budgets and the governments themselves, and threaten macroeconomic stability. They concurred with the staff on the urgent need to adopt corrective measures.

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[10] Each mid-year, on the basis of developments in revenue, expenditure, and foreign financing during the first half of the year, the authorities revise their projections of the main fiscal aggregates for the year as a whole. Planned expenditure commitments are revised to ensure that they are maintained within the overall resource constraint, and become the basis for revised budgets, which are then submitted for parliamentary approval.

20. ***The corrective fiscal measures, focused on the expenditure side, will close the budget gaps for 2000, while allowing for higher-than-originally-budgeted expenditures on refugees and displaced persons[11]—a key policy objective of the authorities, which the staff supports.*** All the measures were approved in conjunction with the revised 2000 Entity budgets, which were passed by the respective parliaments (paragraph 7 of Appendix I). They include a temporary freeze in public sector employment and a rollback of over one half of the public sector wage increases granted in December 1999 (Federation) and February 2000 (Republika Srpska). This allowed savings of, respectively, KM 25 million and KM 63 million relative to unchanged policies. In order to improve expenditure control during the remainder of the year, both Entities also agreed to set monthly limits on spending commitments in each ministry and to impose sanctions against ministries not observing these limits.

21. ***Revenue measures included in the revised 2000 budgets concentrated on enhancing tax enforcement.*** In light of the prevailing high level of tax evasion in both Entities, efforts concentrated on enhancing tax collection rather than on increasing tax rates (paragraphs 8 and 9 of Appendix I). A key component of the authorities' policy in this area was to improve excise tax collections through the removal from the market of smuggled alcoholic beverages and cigarettes. In addition, the authorities reduced the number of border crossing points where high-duty goods can enter the country and set up an information exchange between the customs and tax administrations on the imports of high-duty goods. As a final step in the harmonization of excises between the two Entities, the Republika Srpska raised the effective tax rate on tobacco products and included excise taxes in the sales tax base to bring it into line with the practice in the Federation.

22. ***The State parliament approved a revised 2000 budget with accompanying measures in line with staff recommendations.*** Among the measures to support the revised budget, the State wage bill has been lowered; this was made possible in part by savings stemming from the hiatus in the operation of some State institutions in the first half of the year. Also, all expenditures related to the operation of the State border service—financed by foreign grants—have been brought on budget.

23. ***The authorities have made some progress in the area of fiscal transparency (paragraph 12 of Appendix I).*** In appointing Auditors General, the Entities have overcome pressure from ethnic interest groups and an environment beset by low levels of trust. In the Republika Srpska, regulatory changes were made to ensure that all own-revenues from ministries and budgetary institutions are included in the budget. In particular, this has contributed an estimated KM 21 million of revenues from Customs Administration fees, KM 2 million from the Financial Police, and KM 2 million from the Tax Administration. In addition, the Republika Srpska budget for 2000 contains, for the first time, the budgeted amounts of previously off-budget, foreign-financed projects.

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[11] Refugees and displaced persons are returning to their homes at a faster pace than contemplated in the Entity budgets, which bodes well for the implementation of the Dayton Peace Agreement.

24. ***The authorities have also intensified their efforts to reform the sales tax system.*** Entity authorities have made substantial progress in their joint efforts to map out a plan for the reform of the sales tax system. They reached agreement on, and intend to implement by January 2001, a two-rate, single-stage sales tax at the retail level, allowing for only a limited set of exemptions (paragraph 10 of Appendix I), so as to broaden the tax base. The new sales tax system will be implemented taking into account the recommendations of a Fund technical assistance mission that visited Bosnia and Herzegovina in late September.

25. ***The budget consolidation is being accompanied by a rationalization of the operations of the pension funds to bring pension entitlements into line with available resources (paragraph 18 of Appendix I).*** Legislation on pension benefits has been amended in both Entities in line with World Bank recommendations. The amendments are intended to improve pension fund finances over the medium term. They introduce a cash rationing mechanism that precludes further accumulation of pension fund debt by ensuring that pension payments are in line with available pension fund resources. Instead of payments being delayed until they can be paid in full, payments will now be made every month. The available resources will first be allocated to providing all recipients with a minimum pension; and then additional payments to those with higher entitlements will be paid until available resources are exhausted. As a consequence, the welfare of the most vulnerable pensioners has been improved because they are now assured of receiving their pension payments on a timely basis and, in the event of resource shortfalls, those with smaller pensions will receive a larger proportion of the available funds than they would have under the previous system. The amendments also include measures to improve pension fund finances over the long term, such as instituting a gradual increase in the retirement age. Further reform of the pension system may be needed, however, to ensure that pension funds are able to attain balance between statutory benefits and contributions in the near term, thus enabling them to dispense with the cash rationing mechanism.

B. The Budgets for 2001

26. ***The October 2000 mission agreed on budgets for 2001 with the Entity and State governments.*** These budgets are directed towards maintaining a fiscal stance compatible with the zero domestic borrowing requirement, while beginning the reforms necessary to place Bosnia and Herzegovina's medium-term public finances on a firm footing. The budgets are based on: (i) assumptions of real GDP growth of 14.5 percent in the Republika Srpska and 13.5 percent in the Federation; (ii) assumptions of 4 percent inflation in the Republika Srpska and 2.3 percent inflation in the Federation; (iii) conservative revenue growth projections—7.2 percent in the Federation and 11 percent (after adjusting for offsets in 2000)[12] in the Republika Srpska; and (iv) on a projected decline in 2001 of foreign grants and concessional loans. Overall deficit-to-GDP ratios in the Federation and the Republika Srpska are projected at 1.5 percent and 2.5 percent, respectively, in line with available foreign financing. If

[12] Offsets amounted to KM 23.4 million in 2000, which was a one-off transaction relating to tax arrears from 1998 and 1999. The Republika Srpska government remains committed not to carry out tax offsetting transactions.

necessary, the budgets will be adjusted during the annual mid-year rebalancing exercise to maintain the overall fiscal objectives.

27. ***To increase the resources available for investment and reconstruction, efforts will focus on shifting the composition of overall spending away from recurrent and nonproductive expenditure.***[13] Specifically, military expenditure has been reduced by 5 percent in each Entity—supported by a reduction in military employment of 15 percent by December 1999 and a further reduction of 15 percent in December 2000[14]—and efforts have begun to reform social welfare spending. In addition, the rise in the wage bill will be contained to 10 percent in both Entities,[15] taking into account resource availability and the projected wage and inflation rates.

28. ***Overall resources of the 2001 State budget are projected to increase by 10 percent, mainly reflecting increased transfers from the Entities to the State administrative budget to cover increased expenditures related to the establishment of the State Border Police (KM 20 million in 2001 compared to KM 8 million in 2000).*** To fund the State Border Service, the Federation has agreed to increase its transfer to the State by KM 7.3 million and the Republika Srpska by KM 3.7 million, while the remaining KM 9 million will be financed from external grants. Own revenues of the State—consisting of various administrative fees with very low buoyancy—are projected to remain at the 2000 budget level as no new revenue sources for the State are being contemplated.

C. Monetary Issues

29. ***The authorities' key objective in 2000 is to maintain the credibility of the currency board arrangement.*** The growth of broad money in 2000 is projected to slow to 13 percent, as the growth of net foreign assets of the banking system stabilizes, largely reflecting the completion of the portfolio shift from foreign currencies to the convertible marka in the second half of 1999. The growth of net domestic assets (NDA) is projected to remain modest—credit to the private sector from the commercial banks will grow, but by less than nominal GDP. At the same time, credit to the public sector (excluding the Treasury IMF account) is expected to remain broadly unchanged, since the authorities will continue to

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[13] Budgetary resources devoted to reconstruction and investment are small (0.5 percent of GDP in the Federation and 2.1 percent of GDP in the Republika Srpska) given that most capital expenditure is recorded off-budget and financed by international donors. In 2001, budgeted expenditure on capital projects will rise by 3 percent in the Republika Srpska and by 18 percent in the Federation.

[14] Under the Labor Law, ex-soldiers are eligible to receive several months of severance pay, which would be paid from the military budget. The World Bank provides a program of active labor market measures to help ex-soldiers find new employment.

[15] The Entities agreed to limit any expansion in civil service employment. Lower level posts will be filled through internal relocations, while additional employment is only permitted for high level positions.

enforce the injunction against borrowing from the banking system by any level of government, so as to preserve the stability of the currency board arrangement. To the same end, the authorities will seek to boost the free reserves of the central bank—a performance criterion under the program—to provide greater coverage of the central bank's domestic liabilities. In 2001, broad money growth is projected to rise to 17 percent, in line with the growth of nominal GDP.

D. Structural Issues

30. ***The implementation of the reform agenda is gaining some momentum—although reform in some areas continues to be slow.*** As regards the payments system, preparations for the establishment of clearing systems are well underway and should be completed by end-2000. Work on developing treasury systems is progressing after considerable delay and is tentatively scheduled for completion in the first quarter of 2001. Enterprise and bank privatization, particularly in the Federation, has moved along in fits and starts. Implementation of important measures in the area of labor market reform were also delayed, but were completed in October in the Republika Srpska and in August in the Federation. To a large degree, the progress achieved to date was due to the linking of up-front action in key areas of reform to completion of the program reviews, which succeeded in pushing ahead the reform agenda on a broad front. This strategy was in line with the need to accelerate reform and with the emphasis by Directors at the last Board meeting on the importance of structural reform for growth prospects.

31. ***The authorities have intensified their efforts to accelerate enterprise privatization, but the technical complexities involved have slowed progress.*** Small enterprise privatization has progressed in both Entities, although it lags in a few cantons in the Federation.[16] Important stumbling blocks for the preparation of mass privatization were eliminated by the adoption of international tender regulations in both Entities and the appointment of a securities commission and share registrar in the Republika Srpska. After a hiatus that reflected a reorganization of tendering procedures initiated by the international community, tenders of large enterprises are expected to begin in earnest at year-end.[17] The authorities hope that the close involvement of international experts in the tender process will enhance the transparency of the tenders and attract the interest of international investors. With regard to Air Bosnia, the authorities have identified its privatization as a key priority. A pre-feasibility study is underway and an expert to prepare the company for privatization is expected to be engaged by year end.

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[16] In the Republika Srpska and some cantons of the Federation nearly all of the small enterprises have been offered for sale at least once, and more than half have been sold. In three Federation cantons, however, small enterprise sales have barely started.

[17] Both Entities have adopted international tendering rules and reorganized the large enterprise tendering process to allow for close involvement of experts from international agencies, such as the World Bank, and interested bilateral assistance agencies such as USAID.

32. ***Despite high unemployment, major strides have been made in labor market reform, an area that has been difficult to tackle until now.*** In close cooperation with the World Bank, the authorities prepared a package of amendments to labor legislation in both Entities, aimed at fostering an environment conducive to private sector activities and balancing the protection of workers' rights with the need to create employment. The proposed amendments enhance the flexibility for dismissal of excess labor, facilitate fixed-term and part-time employment, lower unemployment benefit entitlements to more affordable levels, and increase competition and flexibility in new employment. The Federation and Republika Srpska parliaments approved the appropriate amendments to labor legislation in August and October. Further legislation is due from the Federation by end-December.[18] The passage of the amendments was particularly important, since they eliminated features of the labor market that were major disincentives for potential buyers of state enterprises.

33. ***Reform of the social protection system is needed, particularly to provide an adequate social safety net for workers who are vulnerable to the retrenchments that will follow the privatization of state-owned enterprises.*** The authorities consider this to be an important area of reform, since public support for the privatization of state-owned enterprises could be jeopardized by the absence of progress in establishing a suitable social safety net. They are presently drafting social protection strategies for the period 2000–03, which will be implemented, together with labor market reform, with the support of a World Bank adjustment credit. The strategy will aim to increase the effectiveness of resources currently allocated to social protection, provide more equitable benefits through greater pooling of resources, and raise the credibility of the system by committing to affordable levels of protection.

34. ***Preparations to close the payments bureaus and transfer their clearing functions to commercial banks remain on track.*** Two new clearing systems, a Real Time Gross Settlements System (RTGS) and a Bulk Clearing System (BCS) are in the final stages of development. Both systems will be cleared through the central bank. The RTGS is intended for large transactions and operates on a gross settlement basis. The BCS is designed for smaller transactions (KM 20,000 or less). As it will provide clearance on a net basis, the criteria governing its operation are particularly stringent, in order to avoid the possibility that the central bank might inadvertently grant "daylight credit" to clearing participants and thereby violate the currency board regulations. Preparations for the installation of both systems are well advanced. So far, 25 banks have qualified to participate in the new systems, 7 from the Republika Srpska and 18 from the Federation, enough to provide sufficient coverage for the country. The necessary hardware and software are being installed, decisions on the design of payment orders have been adopted, and training of central bank and commercial bank staff has begun. Tests of the new clearing systems began in mid-November and will continue through to late December. It is anticipated that both the RTGS and the BCS

[18] In the Republika Srpska, amendments to the law on Worker Relations and the Law on Employed and Rights of the Unemployed were passed in October. In the Federation, amendments to the Labor Law were passed in August, and the Law on Job Placement will be imposed by the Office of the High Representative in December.

will be established in a timely manner, so as to permit closing down the payments bureaus by end-2000.

35. ***A major concern is that the treasury functions currently performed by the payment bureaus should not be lost when they are closed at end-2000.*** These functions consist mainly of recording revenues and distributing the proceeds of shared taxes to the appropriate level of government, although the bureaus also have a statistical function and perform data entry services for tax administration purposes. The measures that have been designed to take over these functions appear sufficient. However, they will require extensive testing, which is scheduled to be performed simultaneously with the testing of the clearing systems. The Fund has obtained assurances from the donor agencies coordinating the closure of the payments bureaus that the bureaus will not be closed until these tests show that the treasury functions in question will be preserved under the new system.

36. ***In the area of banking, much progress has been made in strengthening bank regulation and supervision.*** The quality of bank supervision continues to improve in both Entities. The banking agencies have made progress in enforcing regular reporting of core financial data by banks. With the help of technical assistance, mainly from USAID, efforts are ongoing to train staff to use off-site supervision effectively to identify problem banks. These efforts are beginning to pay dividends in the form of an improved ability to target their scarce resources for on-site examinations. The banking supervision agency in the Federation continues to be active in closing insolvent banks, and intervening in banks with identified problems. As a result of these measures, the licenses of 18 privately-owned banks in the Federation were withdrawn, leaving 38 operating banks. Virtually all of the banks with a majority of privately owned shares are in the Federation. In view of the nature of their work, the independence of the banking agencies in both Entities has been protected by granting immunity to banking agency staff from prosecution for actions related to the conduct of their official duties. Both Entities have also sought to strengthen the regulatory environment for banking with the passage in August of amendments to the banking laws, which increase in stages the minimum capital requirements for banks. The authorities are also trying to broaden and diversify the banking market, and the banking supervision agencies of the two Entities have made progress in constructing a regulatory framework for branches of other-Entity banks. Another welcome development is the decision of two Austrian banks to enter the market in Bosnia and Herzegovina.

37. ***Progress in privatizing or liquidating state-owned banks has been patchy.*** Although the privatization process started later in the Republika Srpska, rapid recent progress has helped it to catch up with the Federation. As a consequence, on the basis of their opening balance sheets all state-owned banks have been found to be solvent, and thus eligible for privatization. By end-October, five such banks had been offered for sale in the Republika Srpska. All but one of the remaining state-owned banks are expected to be offered for sale by end-2000. In the Federation, tenders for two state-owned banks have been offered for sale, while discussions with a potential buyer for a third are ongoing. The question whether the Privredna Banka Sarajevo (PBS) bank group was solvent has now been resolved: the group has been found to be solvent by a small margin. A Divestiture Strategy Plan was agreed in October between the Federation government and the World Bank that will allow parts of the banking group to continue functioning. Implementation of the plan is a condition for the disbursement of the second tranche of a World Bank's adjustment credit. Preparation of the

Federation Investment Bank (FIB) for privatization has also progress slowly. World Bank conditionality requires the authorities to have received a significant deposit from a private investor or to appoint, in consultation with the World Bank, a new management team for the FIB.

38. ***The authorities have continued to make progress toward implementing their program of trade reform in 2000.*** The amended State Customs Policy Law, which strictly curtails exemptions from the payment of import duties, will be imposed by the Office of the High Representative in December 2000. The authorities also intend to begin lowering in steps the rates of the specific customs surcharges over a two-year period. A detailed plan will be formulated once data on customs collections from each commodity is received from the customs administration departments. Finally, with a view to enhancing Bosnia and Herzegovina's export growth potential, the authorities have replaced the ban on exports of raw timber with an export tax as an intermediate step toward the introduction of a stumpage tax.

IV. External Financing, Monitoring and Capacity to Repay the Fund

39. ***The large external financing requirements for 2000 are expected to be fully met, mainly through generous donor support of Bosnia and Herzegovina's reconstruction efforts, and direct external budget support, including from the Fund.*** The gross external financing requirement for 2000, which amount to about US$870 million,[19] is largely explained by the large merchandise trade deficit of some US$1.5 billion. This reflects the country's general import dependency, including for the ongoing reconstruction of the country. Some US$750 million of this gap is expected to be filled by donor support of reconstruction efforts and inflows of private capital, including foreign direct investment, while support for the budgets of the State and the Entities from the World Bank and bilateral donors is expected to cover about US$80 million. Resources from the Fund amounting to some US$37 million will be required to cover the remaining gap. Fund disbursements will also be necessary in order for the World Bank and some bilateral donors to activate their disbursements.

40. ***Although there is no external financing gap for 2000, or during the program period in 2001 (following programmed disbursements from the Fund), the potentially large financing gaps for the remainder of 2001 and for 2002 indicate an urgent need to strengthen the adjustment effort and to mobilize donors at an early stage.*** To this end, a donor conference is expected to take place in early 2001 to confirm existing financing commitments and to mobilize further official bilateral support for the period ahead. Preliminary estimates by the World Bank indicate that the gap will likely be closed.

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[19] This figure includes repurchases from the Fund. It excludes financing requirements to clear arrears on debt arising out of bank guarantees for construction work that was not completed, unallocated suppliers credits, and debt acquired in non-convertible currency. In the presentation of the balance of payments and the external financing requirements it is assumed that this debt will be rescheduled.

41. ***Bosnia and Herzegovina should be able to discharge its obligations to the Fund in a timely manner.*** During the first half of 2000, aside from some technical delays in making payments to a bilateral creditor, Bosnia and Herzegovina has remained current on its external debt-service obligations and the revised budgets cover fully all remaining obligations for the year. As regards servicing obligations to the Fund, these are met mostly out of deposits held in Bosnia and Herzegovina's SDR account. The Bosnian authorities have agreed to continue holding half of each disbursement in this account.

42. ***A favorable medium-term external outlook depends critically on Bosnia and Herzegovina's ability to improve international competitiveness.*** Bosnia and Herzegovina has a narrow export base and remains highly dependent on imports and generous, though declining, external donor support. In the period ahead, rapid export growth will be needed to ensure a viable balance of payments position and to serve as an engine of growth for the country. To this end, the large ongoing investments under the Priority Reconstruction Program, and the steadfast implementation of structural reforms should help sustain productivity growth, and thus improve Bosnia and Herzegovina's international competitiveness. Earlier in 2000, gains on this front were seriously threatened by the granting of unrealistic wage increases, and labor and social benefits that could not be afforded. Reversal of these decisions was painful and time consuming. Consequently, the authorities will have to be steadfast in their determination to resist these pressures in the future, and particularly to avoid fueling unrealistic expectations in the private sector by granting government wage increases that are out of line with available resources. The authorities have agreed to consult with the Fund prior to granting any further wage increases in the future.

43. ***The staff's decision on whether to recommend completion of the fourth and fifth reviews was based on the implementation of a number of key prior actions*** (see Box 1).

Box 1. Bosnia and Herzegovina: Prior Actions to Conclude the Fourth and Fifth Reviews of the Stand-By Arrangement [1/]

		Status
1.	Entity and State Parliaments to pass the revised 2000 budgets agreed with the IMF.	Fed.: Done RS: Done State: Done
2.	Government to adopt and implement measures addressing key sources of tax evasion as agreed with IMF staff.	Fed: Done RS: Done
3.	RS to include excise taxes in the sales tax base and to increase the effective excise tax on tobacco products.	Done
4.	Entities to be current on transfers to State institutions for administrative expenditures.	Fed: Done RS: Done
5.	Freeze employment of the Entity governments and roll back government employee wages to effect savings of 9 percent and 15 percent, respectively, in the Federation and RS governments' monthly wage bills.	Fed: Done RS: Done
6.	Governments to begin setting monthly spending limits (on a commitment basis) to each ministry based on Ministry of Finance recommendations, and to impose sanctions against ministries that do not observe these limits.	Fed: Done RS: Done
7.	RS to set pensions for May 2000 onward to no more than 33 percent above pensions in May 1999.	Done
8.	RS to reverse the February 2000 pension contribution rate reduction.	Done
9.	Federation Parliament to confirm the director, deputy director, and managing board of the Banking Agency.	Done

[1/] Unless specified otherwise, measures refer to the institutions of the two Entity Governments.

44. ***Performance criteria to monitor the program are specified in the attached letter of intent***. The letter of intent for the completion of the second and third reviews had specified indicative targets for end-September and end-December 2000 to monitor the performance under the program. The targets were related to ceilings on domestic borrowing by governments, on the contracting or guaranteeing of nonconcessional external debt by governments, on the accumulation of external payments arrears, and on minimum "free reserves" of the central bank. While September 2000 remains an indicative target, the staff supports the requests made in the attached letter of intent to set performance criteria for

December 2000 and March 2001, extend the program to May 29, 2001 and rephase the disbursements (Table 2). The relatively large number and wide coverage of structural reform measures in Table 2 and Table 3 of the letter of intent, reflect the complexity of institution building in Bosnia and Herzegovina. Drawing on the authorities' reform agenda, it was agreed to set structural benchmarks on key measures related to the fiscal position and the development of a sound banking system. The sixth and seventh reviews under the arrangement will cover the enactment of budgets for 2001, tax reform measures and progress in the implementation of structural reforms.

V. Staff Appraisal

45. ***Bosnia and Herzegovina has continued to make progress toward achieving macroeconomic stability.*** Inflation has remained low and real GDP has continued to grow rapidly, albeit from a low base that reflected the devastation of war. Official reserves have increased, mirroring the growing acceptance of the convertible marka. Strict adherence to currency board rules backed by fiscal restraint was instrumental in the progress toward macroeconomic stability.

46. ***While most macroeconomic indicators have evolved favorably, the emergence of serious difficulties in the public finances poses a major risk.*** Early in the year, the large increases in wages, the sharp increase of pension entitlements, and spending by ministries at a faster rate than consistent with their budget allocations were a significant step back from the gains achieved toward establishing responsible budget execution practices, and were a threat to macroeconomic stability over the medium term. These developments also jeopardized the policy credibility of the governments, as expenditure commitments exceed available resources.

47. ***Recognizing that regressing to harsh expenditure control mechanisms, such as the Budget Execution Laws, would have set a bad precedent, the authorities implemented a strong package of corrective measures.*** These measures focused primarily on expenditure control; enhancement of revenue collection; and correction of pension imbalances through improved collection of contributions and the imposition of a cash rationing mechanism that linked pension entitlements to the level of available resources (paragraph 25). The continued implementation of these measures in the face of the prevailing political pressures is necessary in order to achieve policy credibility and to signal the authorities' commitment to prudent macroeconomic policies.

48. ***To ensure that Bosnia and Herzegovina remains competitive in international markets and addresses its unemployment problem, the authorities should exercise restraint over the rise in government wages and undertake a comprehensive reform of the tax system to lower the labor tax burden.*** The government should take the lead in providing an appropriate signal to the private sector regarding the level of wage increases consistent with maintaining Bosnia's competitive position. The unrealistic wage hikes granted by the Entity governments in early 2000 were particularly regrettable and had to be reversed. The authorities should ensure that future wage increases are in line with gains in productivity. The high tax rates in Bosnia and Herzegovina encourage tax evasion and constitute a significant disincentive for the establishment of competitive domestic industries. Contribution rates for social security are also high. Therefore, the authorities in both Entities

are encouraged to follow through with their intention to reform the tax system by broadening the tax bases, including through greater enforcement, while lowering and rationalizing tax rates, particularly on labor.

49. ***Timely implementation of the structural reform agenda on a broad front will be critical to laying the basis for durable growth.*** Implementation of structural reforms has progressed fitfully, and the unfinished reform agenda remains challenging. The pace of reform must now quicken if the growth of private initiative and the inflow of foreign direct investment are to replace the economic impetus provided by reconstruction assistance. In particular, efforts must be intensified to eliminate structural impediments to private initiative and foreign direct investment. In sequencing structural reforms, it is important that delays in implementing some reforms does not hold back progress in other areas. For instance, delays in reforming the labor market would dampen investors' interest in the purchase of state-owned enterprises, and delays in establishing adequate interim treasury arrangements would postpone the elimination of the payments bureaus.

50. ***Completing the privatization of state enterprises, financial sector reform, and labor market reform, while improving the weak legal and judicial system, remain the key priorities for structural reform.*** After lengthy delays, the groundwork for the privatization of medium-sized and large state-owned enterprises has essentially been completed. The authorities should start expeditiously offering such enterprises for sale. The pace of financial sector reform has picked up considerably. The privatization of state-owned banks has also gathered momentum, notably in the Republika Srpska, while bank supervision continues to improve in both Entities. The recent entry of two international banks into Bosnia and Herzegovina is a particularly welcome development. As regards labor market reform, the completion of the revisions to the labor laws has eliminated a key impediment to the privatization of large enterprises and also to foreign direct investment. Improvements to the legal and judicial system are also urgently needed.

51. ***The elimination of payments bureaus before the establishment of adequate alternate treasury and tax administration services would have significant adverse effects on revenue collection and fiscal discipline.*** It is therefore of the utmost importance that thorough tests of these alternate systems be carried out to ensure that the closure of the payments bureaus does not result in a loss of budgetary control and monitoring capacity. Consequently, a precondition for adhering to the end-year schedule for closure of payments bureaus is the development and installation of an adequate interim treasury arrangement. If the testing process indicates that risks exist in this regard, closure of the payments bureaus should be delayed until these risks can be eliminated.

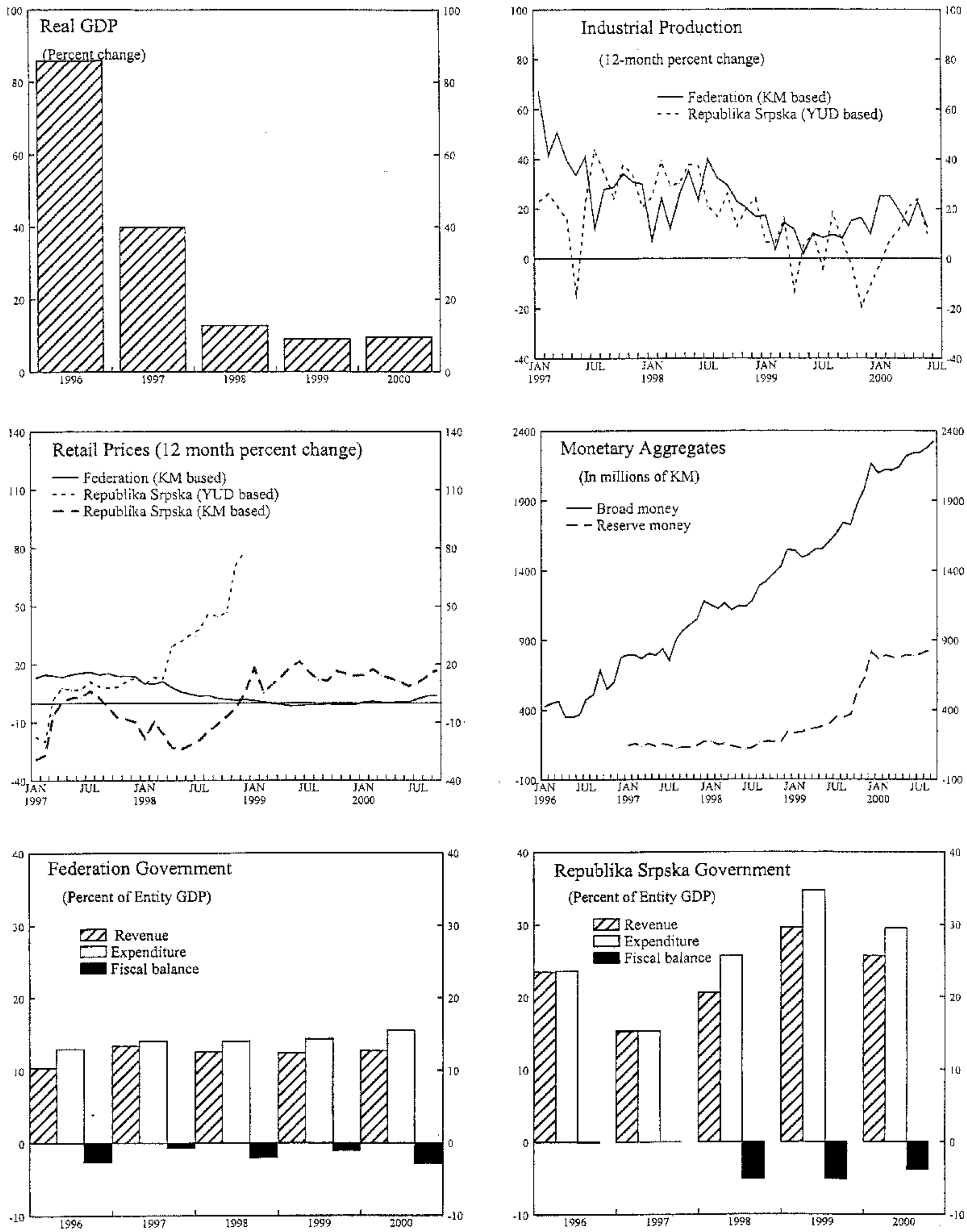
52. ***Although deep ethnic divisions characterizing Bosnia and Herzegovina's political landscape represent a risk to the program, the reform inertia stemming from such divisions may be beginning to wane.*** In reaching a consensus on the need to undertake politically difficult corrective measures in an election year, the authorities have clearly demonstrated their willingness to put aside their differences. This represents a marked change from the lengthy policy impasse that characterized the period surrounding the 1998 national elections. To mitigate the risk represented by Bosnia's ethnic divisions, the program includes prior actions in the politically most difficult areas of reform. The staff will continue to work closely with the World Bank and the large international community in Bosnia to

ensure that the authorities receive a clear and consistent message regarding the key reform priorities and the consequences of delays in implementation. This approach has been successful thus far in moving ahead the process of reform. Moreover, the staff will intensify contact with the wider community in Bosnia in an effort to secure its support for the program.

53. ***Given the implementation of all structural conditionality to date and the adoption of policies aimed at ensuring continued progress, completion of the fourth and fifth reviews and the extension and rephasing of the stand-by arrangement is recommended.*** The strengthening of the fiscal framework and the implementation of measures aimed at containing pension fund imbalances and accelerating structural reform should, at the moment, be sufficient to address the increased risks to macroeconomic stability. The authorities' strong up-front action to resolve their fiscal difficulties, together with their renewed commitment to take additional measures, if needed, deserve continued Fund support.

Figure 1. Bosnia and Herzegovina: Selected Financial and Economic Indicators

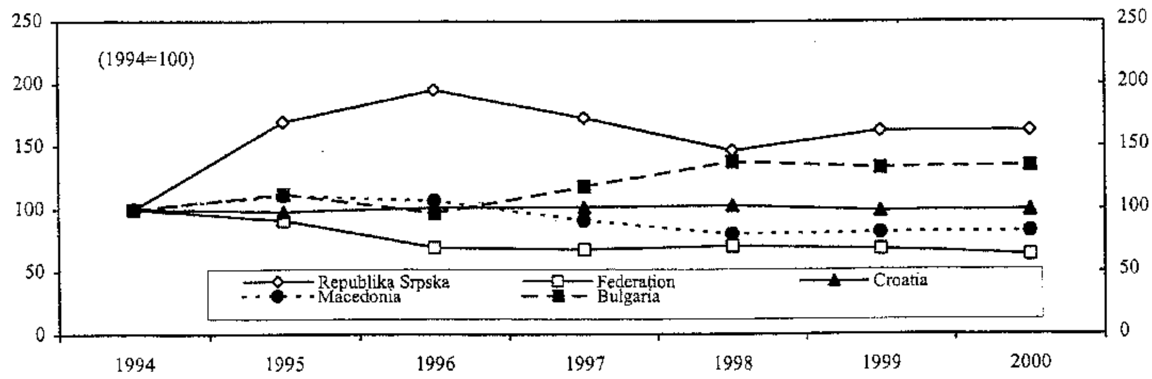
(1996-2000)



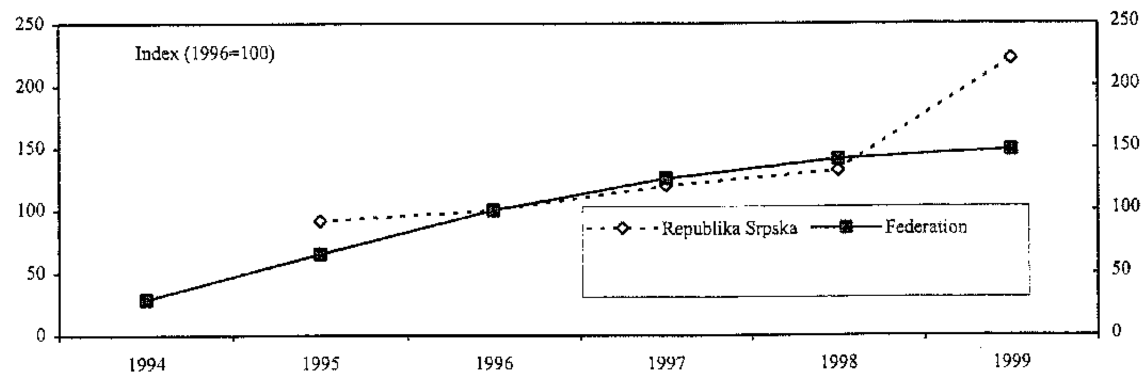
Sources: Data provided by Bosnian authorities; and Fund staff estimates.

Figure 2. Bosnia and Herzegovina: Indicators of Competitiveness, 1994-2000

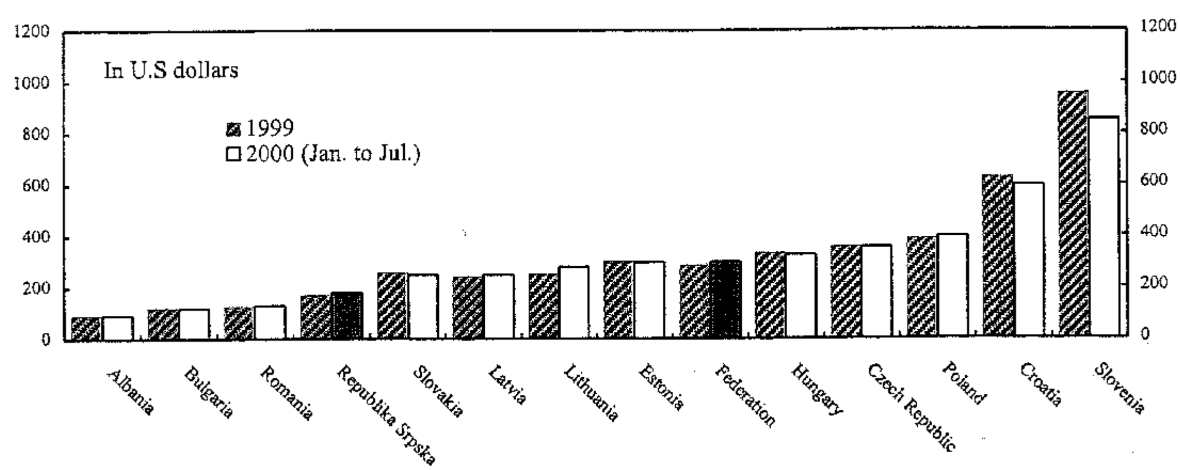
Real Effective Exchange Rates 1/



Price of Nontradable Relative to Tradable Commodities 2/



Average Gross Monthly Wages



Sources: IFS, and IMF staff estimates.

1/ Data on real effective exchange rate (REER) for Bulgaria, Croatia, and Macedonia are from the IFS. For the Republika Srpska and the Federation, the REER is calculated using cost of living indices and bilateral trade data reported in the statistical bulletins of the two Entities, and CPI and bilateral exchange rate data from the IFS. Estimates for 2000 are based on January to July data.

2/ Ratio of cost of living based price of services to price of goods. Data on the cost of living index is taken from the statistical bulletins of the two Entities. Estimates for 2000 are based on January to July data.

Table 1. Bosnia and Herzegovina: Projected IMF Position During the Stand-By Arrangement, December 1998-May 2001 1/

	1998	1999				2000				2001	
	Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-May
	(In millions of SDRs)										
Purchases	0.0	0.0	14.5	14.5	0.0	0.0	11.0	0.0	16.2	8.1	5.9
Repurchases	0.0	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	0.0	0.0
Total Fund credit outstanding	54.5	50.7	61.4	72.1	68.4	64.6	71.8	68.0	80.4	88.4	94.4
	(In percent of quota) 2/										
Total IMF credit outstanding	32.2	30.0	36.3	42.7	40.4	38.2	42.4	40.2	47.5	52.3	55.8

Source: IMF staff estimates and projections.

1/ Position under tranche policies.
2/ The new quota for Bosnia is SDR 169.1 million.

Table 2. Bosnia and Herzegovina: Schedule of Proposed Purchases
Under Stand-by Arrangement

	Amount of Purchase	Availability	Conditions include:
1.	SDR 8.08 million	May 15, 2000	Completion of fourth review and observance of end-March 2000 performance criteria
2.	SDR 8.08 million	August 15, 2000	Completion of fifth review and observance of end-June 2000 performance criteria
3.	SDR 8.08 million	February 15, 2001	Completion of sixth review and observance of end-December 2000 performance criteria
4.	SDR 5.91 million	May 15, 2001	Completion of seventh review and observance of end-March 2001 performance criteria [1]

Source: Staff estimates.

[1] The stand-by arrangement expires on May 29, 2001.

Table 3. Bosnia and Herzegovina: Quantitative Performance Criteria Under the IMF Stand-By Arrangement, December 1999-March 2001

(In millions of convertible marka)

	Stock as of Dec. 31, 1999	2000				Indicative targets		Performance criteria	
		Mar. 31		Jun. 30		Sep. 30		Dec. 31	2001 Mar. 31
	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Target
Cumulative change from end-December 1999									
Ceiling on gross domestic banking system credit 1/									
General government	22	13	3	11	0	15	4	6	-2
State 2/	-15	13	13	11	11	15	15	6	-2
Federation	34	0	-7	0	-8	0	-8	0	0
Republic Srpska adjusted for NBRS	3	0	-3	0	-3	0	-3	0	0
Stocks, end of period									
Minimum stock of free reserves of the CBBH 3/	30	25	33	25	36	40	42	43	43
Cumulative change from end-December 1999									
Ceilings on contracting or guaranteeing of new official non-concessional external debt 4/									
One year and under	0	0	0	0	0	0	0	0	0
Over one year	0	0	0	0	0	0	0	0	0
Of which : 1-5 years	0	0	0	0	0	0	0	0	0
Nonaccumulation of external payments arrears					Continuous				
Memorandum item:									
Accumulation of SDR deposits by State government 5/	15	...	-13	...	-11	...	-15	-6	2

Sources: Letter of Intent; monetary and fiscal data from the CBBH and Entity Ministries of Finance, creditor data; and IMF staff estimates.

1/ Including credit extended by National Bank of Bosnia Herzegovina; and excluding Treasury IMF account.
2/ Target for State holdings of banking system credit is adjusted for timing and volume of IMF SDR disbursements in 2000. SDR holdings are evaluated at the program exchange rate of SDR 0.37037/KM.
3/ Defined as total foreign exchange assets minus monetary liabilities minus liabilities to nonresidents.
4/ Subject to exceptions as noted in Annex IV of the MEFP.
5/ Converted using the program SDR/KM exchange rate of SDR 3.7037/KM.

Table 4. Bosnia and Herzegovina: Main Economic and Financial Indicators, 1996-2001 1/

	1996	1997	1998	1999 Prel.	2000 Prog.	2001 Proj.
Population (millions)	...	...	3.7	...	...	...
Nominal GDP (millions of KM) 2/						
BiH 2/	4125	6116	7,141	8,043	9,075	10,609
Federation 2/	3049	4748	5,407	5,833	6,434	7,465
Republika Srpska 2/	1076	1368	1,734	2,210	2,641	3,144
Industrial production (percent change) 3/						
Federation	88	36	24	11	15 8/	...
Republika Srpska	39	27	23	2	12 8/	...
Federation employment (end-period, thousands) 4/	244	288	336	356	360 8/	...
Wages (KM/month) 5/						
Federation	296	493	524	551	597 8/	...
Republika Srpska 6/	85	138	...	...	392 8/	...
			(Percent change)			
Real GDP (annual average)	86	40	13	9	10	14
CPI (twelve-month average)						
Federation (In KM terms)	-25	14	5	0	2 8/	2
Republika Srpska (In YUD terms)	66	3	38	...	...	...
Republika Srpska (DM/KM-based index) 7/	17	-7	2	14	10 8/	4
			(Change in percent of opening broad money)			
Money and credit 9/						
Broad money	96	52	31	40	13	17
Foreign assets (net)	60	-11	1	38	-3	6
Domestic assets (net)	36	63	30	2	16	11
			(In percent of GDP)			
Fiscal balances						
Federation						
Revenue	10	13	13	12	13	12
Expenditure	13	14	14	14	16	13
Balance 10/	-3	-1	-2	-1	-3	-2
Republika Srpska 11/						
Revenue	24	15	21	30	26	23
Expenditure	24	15	26	35	30	26
Balance 10/	0	0	-5	-5	-4	-3
			(In millions of U.S. dollars; unless otherwise indicated)			
External current account balance 12/ 13/	-1,306	-1,482	-986	-1,058	-942	-1,022
Exports 13/	336	575	697	649	732	877
Imports 13/	-1,882	-2,333	-2,656	-2,502	-2,338	-2,495
CBBH gross reserves 14/						
In millions of U.S. dollars	235	80	175	455	488	538
In months of merchandise imports	1.2	0.4	0.7	2.0	2.3	2.4
External debt 15/						
(In millions of U.S. dollars)	3,620	4,076	2,985	3,095	2,632	2,763
(In percent of GDP)	132	119	74	71	62	61
Short-term debt	...	...	...	...	...	...
Debt service (in percent of exports of goods and nonfactor services)	53	16	-12	-12	-11	-12
Memorandum items:						
Exchange rates (period average)						
Convertible marka (KM) per deutsche mark	...	1.0	1.0	1.0	1.0	1.0
BiH dinar per deutsche mark 16/	100	100	...	...	...	...
FR Yugoslav dinar per deutsche mark 17/	3.5	3.9	6.4	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Data refer to the entire country, unless otherwise indicated. Intrayear data refer to flows cumulative in the year unless otherwise noted.
2/ The GDP series since 1994 has been revised compared to SM 98/96 as more reliable figures produced by the entity statistics institutes became available.
3/ Annual production, percent change over previous year. Figure for 1995 refers to the entire country.
4/ Excludes people formally employed but not working ("waiting"). Data for 1997 and 1998 include military personnel.
5/ Data refer to average of monthly gross wages paid in the year (first eleven months of 1999), not to average earnings in the period; only firms paying wages in a particular month are included in the data.
6/ Until end-1997 FR Yugoslav dinar (YUD) wages converted into DM using the parallel market exchange rate described in footnote 17. Thereafter, reliable estimates are not available owing to problems with exchange rate conversion.
7/ Until mid-1998 prices were observed in YUD and converted into DM/KM at exchange rates described in footnote 17.
8/ Data as of June 2000; industrial growth in the first six months of 2000 relative to same period a year before; employment and wages for the Federation as of May 2000; 12-month inflation as of July 2000.
9/ Country-wide monetary aggregates. In percent of beginning of year broad money stock.
10/ Before grants.
11/ Excludes municipal government operations. Data for 1996 exclude military expenditures financed by external grants.
12/ Excluding official transfers.
13/ Data for 1994-99 are rough estimates for the whole territory of Bosnia and Herzegovina.
14/ Excluding earmarked funds and blocked accounts as well as foreign exchange held by Payments Bureaus.
15/ Projected external debt and debt service for 1998 exclude debt relief.
16/ Official rate. Parallel rate not collected by the Central Bank of BiH. The BH dinar was replaced by the convertible marka (KM) in mid-1998.
17/ YUD/DM exchange rate in the parallel market in the Belgrade, as reported by the National Bank of FRY through end-1998.

Table 5. Bosnia and Herzegovina: Consolidated General Government and Entities, 1997-1999 1/

	1997	1998	1999					
			Consolidated BiH	State	Federation			Republika Srpska
					Consolidated	Federal Government	Cantons Municipalities, and Social Funds2/	
			(In millions of KM)					
Total revenue	2,398	3,148	3,987	216	2,973	724	2,265	983
Tax revenue	1,615	2,035	2,274	0	1,713	677	1,037	561
Taxes on goods and services	976	1,190	1,309	0	1,057	312	745	252
Sales tax	687	816	892	0	745	0	745	147
Excises	289	374	417	0	312	312	0	105
Trade taxes	349	407	492	0	347	347	0	145
Taxes on income	284	377	310	0	248	18	230	63
Other taxes	7	60	164	0	62	0	62	102
Budgetary non-tax revenues	109	201	396	216	272	47	241	93
Transfers from other levels of government	0	0	0	185	0	0	16	0
Other	109	201	396	31	272	47	225	93
Extra-budgetary social funds	674	912	1,317	0	987	0	987	330
Total expenditure	2,429	3,657	4,568	216	3,327	1,078	2,264	1,204
Wages and contributions	293	679	898	33	656	92	564	209
Goods and services	73	240	439	25	252	32	220	162
Military	348	371	395	0	292	291	0	104
Debt service	75	87	157	157	0	0	0	0
Reconstruction expenditure	109	149	150	0	108	26	82	42
Subsidies	8	20	26	0	14	14	0	12
Other transfers to households	745	373	439	0	338	216	122	101
Of which: Transfers to war invalids	271	346	281	0	208	208	0	73
Transfers to the state government	...	...	0	0	84	84	0	92
Transfers to cantons or municipalities	9	...	0	0	0	16	0	2
Social fund expenditure	...	912	1,345	0	987	0	987	358
Other expenditure and unallocated 3/	770	505	360	0	318	28	290	42
Foreign loan financed projects	...	320	359	0	278	278	0	81
Balance	-31	-509	-581	0	-354	-355	1	-221
Financing	31	509	581	0	354	355	0	221
Domestic financing	0	0	0	0	0	0	0	0
Foreign financing	31	509	581	0	354	355	0	221

Sources: Data provided by authorities; and IMF staff estimates.

1/ Including State, both Entity level governments, the Federation's local governments (cantons and municipalities), extra-budgetary social funds, and off-budget foreign project loans, but excluding Republika Srpska local governments.

2/ Cantonal and municipal data are preliminary.

3/ Includes district, canton, and municipal expenditures for which insufficient data is available to permit allocation among the categories.

Table 6. Bosnia and Herzegovina: State Fiscal Operations, 1997-2001

	1997	1998	1999	2000 Revised Budget	2000 Jan-Sep Actual	2000 Jan-Dec Proj.	2001 Proj.
	(In millions of KM)						
Revenues	50.0	138.0	218.3	269.9	92.8	269.9	295.3
Own revenues	20.0	20.0	31.4	27.6	10.9	27.6	27.6
Transfers from entities	30.0	118.0	186.9	242.3	81.9	242.3	267.7
Administrative budget	15.0	30.0	28.2	44.6	14.6	44.6	55.6
Federation	15.0	21.0	18.3	29.7	8.4	29.7	37.1
Republika Srpska	0.0	10.0	9.9	14.9	6.2	14.9	18.5
Debt service	15.0	89.0	158.7	197.7	67.2	197.7	212.1
Federation	15.0	44.0	...	123.6	45.4	123.6	130.2
Republika Srpska	0.0	45.0	...	74.1	21.8	74.1	81.9
Expenditures	110.0	138.0	216.5	280.9	92.8	271.9	304.3
Administrative	35.0	51.0	57.8	66.2	24.0	66.2	72.2
Salaries	...	...	32.6	25.0	8.8	25.0	32.4
Materials and other expenses	...	...	25.2	41.2	15.2	41.2	39.8
Refugees	...	...	...	1.4	0.7	1.4	4.3
Other	...	...	...	39.8	14.5	39.8	35.5
Border service	...	...	...	17.0	1.5	8.0	20.0
Wages	...	...	...	...	...	6.0	12.6
Other	...	...	...	...	...	2.0	7.4
Debt service	75.0	87.0	158.7	197.7	67.2	197.7	212.1
Foreign grants 1/	60.0	0.0	0.0	11.0	0.0	2.0	9.0
Financing gap	0.0	0.0	-1.9	0.0	0.0	0.0	0.0

Sources: Council of Ministers of Bosnia and Herzegovina; and IMF staff estimates.

1/ Includesa KM 6 million from the Dutch government and KM 3 million from the U.S. government in 2001.

Table 7. Bosnia and Herzegovina: Federation Fiscal Operations, 1997-2001

	1997	1998	1999	2000			2001
				Revised Budget	Jan-Sep Actual	Jan-Dec Proj.	Proj.
Total revenue	610.4	682.0	723.7	837.3	586.8	814.2	872.7
Tax revenue	565.3	645.1	676.5	785.0	546.9	761.9	813.3
Excises	279.8	323.1	312.1	371.0	227.6	318.8	335.0
Trade taxes	285.5	311.6	346.7	386.5	301.6	419.8	453.4
Profit tax	0.0	10.4	17.7	27.5	17.6	23.3	24.9
Nontax revenue	45.2	36.9	47.2	52.3	40.0	52.3	59.3
Total expenditure	641.1	781.8	800.5	954.5	670.2	996.2	983.7
Wages and contributions	69.6	77.3	92.5	94.5	70.4	94.5	105.0
Goods and services 1/	21.4	37.0	32.4	24.3	21.5	26.4	32.0
Military 2/	253.5	276.0	291.4	305.5	226.3	305.5	290.2
Reconstruction expenditure 3/	17.5	42.6	26.0	30.9	29.5	30.9	36.5
Subsidies	3.2	20.4	14.1	11.7	7.3	11.7	12.3
Other transfers to households	226.7	235.8	215.9	269.0	177.3	269.0	275.3
Transfers to pension fund	15.8	21.9	6.5	8.6	3.8	8.6	8.8
Transfers for health	1.4	1.3	0.1	1.0	0.2	1.0	1.0
Transfers for education	10.4	3.3	1.4	1.5	0.2	1.5	1.6
Transfers to war invalids	175.5	209.3	207.9	258.0	173.2	258.0	263.9
Transfers to the state government	29.9	65.0	84.0	153.3	88.9	159.7	167.8
Administration	15.4	20.6	18.3	29.7	17.5	29.7	37.0
of which : Border service	...	...	...	...	...	...	7.3
Debt service	14.5	44.4	65.7	123.6	71.4	130.0	130.8
Transfers to cantons and municipalities	3.7	7.0	15.9	15.0	15.4	15.0	10.0
Other expenditure and unallocated	15.6	20.8	28.4	50.3	33.7	83.6	54.7
Of which : refugees	...	...	...	23.5	14.5	23.5	25.0
potential reserve	...	...	...	...	...	33.3	...
Foreign grants for budget support	2.0	34.9	14.7	51.0	47.5	62.5	0.0
Overall balance (before grants)	-30.7	-99.9	-76.8	-117.2	-83.3	-181.9	-111.0
Overall balance (after grants)	-28.7	-65.0	-62.2	-66.2	-35.8	-119.4	-111.0
Financing	28.7	65.0	62.2	66.2	35.8	119.4	111.0
Domestic financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign loans for budget support	28.7	65.0	62.2	66.2	35.8	119.4	111.0
				(In percent of GDP)			
Memorandum items							
Revenue	12.9	12.6	12.4	13.0	9.1	12.7	11.7
Expenditure	13.5	14.5	13.7	14.8	10.4	15.5	13.2
Balance (before grants)	-0.6	-1.8	-1.3	-1.8	-1.3	-2.8	-1.5
Balance (after grants)	...	-1.2	-1.1	-1.0	-0.6	-1.9	-1.5
Foreign project loans (million KM)	...	256.0	278.0	218.6	...	...	343.0

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Includes goods reserve.

2/ Does not include off-budget assistance from other countries.

3/ Includes allocation for railroads and other capital expenditures.

Table 8. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 1997-2001

	1997	1998	1999	2000 Revised Budget	2000 Jan-Sep Actual	2000 Jan-Dec Proj.	2001 Proj.
				(In millions of KM)			
Total revenue	209.3	356.8	652.3	678.7	471.6	678.5	727.5
Tax revenue	197.0	294.5	559.3	581.2	411.2	588.5	632.6
Taxes on goods and services	100.1	148.7	251.6	286.9	198.3	281.5	304.6
Sales tax 1/	90.4	97.8	146.7	166.0	120.8	166.1	181.1
Excises	9.8	50.9	104.9	120.9	77.5	115.4	123.5
Trade taxes	63.0	95.0	144.9	164.3	121.4	173.1	187.3
Taxes on income 2/	28.2	38.1	62.9	67.6	51.2	69.9	75.5
Personal income tax	5.4	6.3	10.5	5.6	5.8	7.8	8.3
Wage withholding	21.7	30.4	42.5	50.0	33.9	46.1	49.8
Corporate income tax	1.2	1.4	9.9	12.0	11.6	16.0	17.4
Other taxes and revenues	5.6	12.7	100.0	62.4	40.2	64.0	65.3
Nontax revenue 3/	12.3	62.3	93.0	97.5	60.4	90.0	95.0
Total expenditure	209.3	446.0	765.8	778.0	517.8	777.8	806.5
Wages and contributions	24.9	154.6	209.0	228.4	135.7	228.4	251.2
Goods and services	30.5	49.5	162.0	112.2	75.2	120.0	114.7
Goods reserve 4/	6.6	9.2	58.2	6.0	13.8	13.8	6.0
Other 5/	23.9	40.3	103.7	106.2	61.5	106.2	108.7
Military	73.4	70.0	89.2	69.9	52.1	69.9	62.9
Banking fees	0.4	0.6	1.8	1.0	0.8	1.0	0.3
Transfers to social funds	6.1	0.1	28.1	26.3	26.8	26.8	27.4
Reconstruction expenditure 6/	9.3	12.0	42.3	51.0	49.8	55.0	56.7
Of which: Railways	9.3	12.0	20.3	20.0	22.6	22.6	22.0
Subsidies 7/	0.0	0.0	12.0	26.0	17.1	27.0	27.0
Other transfers to households	15.1	79.1	94.5	110.0	62.3	106.0	116.4
War invalids	14.8	40.1	72.6	99.0	51.2	95.0	99.0
Other 8/	0.3	39.0	21.9	11.0	11.0	11.0	17.4
Transfers to other levels of government	1.2	55.6	94.4	91.0	64.4	93.5	103.6
Transfers to the State	0.0	55.0	92.5	89.0	63.3	91.5	101.0
Administration	0.0	10.0	10.1	14.9	9.5	14.9	19.0
of which: Border service	...	...	...	...	...	...	3.7
Debt service	0.0	45.0	82.4	74.1	53.8	76.6	82.0
Transfers to municipalities	1.2	0.6	2.0	2.0	1.1	2.0	2.6
Other expenditure and unallocated	48.6	24.5	32.4	62.3	33.6	50.3	46.3
Of which: Budgetary reserve	21.6	12.0	14.0	12.0	7.5	12.0	12.0
Offsets	...	...	...	16.8	23.4	23.4	...
Foreign grants for budget support	0.0	31.1	27.7	61.6	42.7	47.2	0.0
Overall balance (before grants)	0.0	-89.2	-113.5	-99.3	-46.2	-99.3	-79.0
Overall balance (after grants)	0.0	-58.1	-85.8	-37.7	-3.5	-52.1	-79.0
Financing	0.0	58.1	85.8	37.7	3.5	52.1	79.0
Domestic	0.0	0.0	0.0	0.0	-6.7	0.0	0.0
External loans for budget support	0.0	58.1	85.8	37.7	10.3	52.1	79.0
				(In percent of GDP)			
Memorandum items							
Revenue	15.3	20.6	29.5	25.7	17.9	25.7	23.1
Expenditure	15.3	25.7	34.7	29.5	19.6	29.5	25.7
Balance (before grants)	0.0	-5.1	-5.1	-3.8	-1.7	-3.8	-2.5
Balance (after grants)	0.0	-3.3	-3.9	-1.4	-0.1	-2.0	-2.5
Foreign financed project loans (million KM)	52.2	64.4	80.9	135.3	...	...	113.1

Sources: Data provided by authorities; and IMF staff projections.

1/ Including sales tax, military surcharges, and railway surcharges.

2/ Including personal income tax, wage withholding tax, and corporate income tax.

3/ Including fees, fines, and other special revenues.

4/ Includes gross spending of the goods reserve up to 1999. After 1999 includes only budgetary transfers to the Goods Reserve.

5/ Including education expenditure and other materials costs.

6/ Including railway and other capital expenditure.

7/ For water, forestry, and agriculture.

8/ As of 1999, includes transfers to health insurance funds, refugees and displaced persons, students, and social institutions.

Table 9. Bosnia and Herzegovina: Balance of Payments, 1998-2005

(In millions of U.S. dollars; unless otherwise indicated)

	1998	1999	2000 Proj.	2001 Proj.	2002 Proj.	2005 Proj.
Trade balance	-1,959	-1,852	-1,595	-1,608	-1,549	-1,114
Exports, f.o.b.	697	649	732	877	1,070	2,133
Imports, f.o.b.	-2,656	-2,502	-2,327	-2,485	-2,619	-3,247
Reconstruction	-499	-495	-431	-428	-330	-214
Humanitarian (in-kind)	-26	0	0	0	0	0
Other	-2,132	-2,007	-1,897	-2,057	-2,289	-3,033
Services, net	378	324	264	236	211	109
Receipts	563	552	460	435	401	352
Expenditure	-185	-228	-196	-199	-190	-244
Net factor income	330	273	235	203	193	178
Earnings	409	353	318	306	301	299
Interest payments	-79	-81	-83	-103	-108	-120
Unrequited transfers, net	461	284	218	182	180	176
Receipts	468	292	225	190	187	183
Official grants	197	86	53	24	25	15
Private	271	206	172	166	162	168
Outflows	-7	-8	-8	-8	-8	-7
Current account balance	-789	-971	-878	-987	-965	-651
Excluding official transfers	-986	-1,058	-922	-1,011	-990	-666
Foreign investment (net)	100	90	117	164	246	581
Capital transfers for reconstruction	517	520	388	347	254	143
Foreign loans (net)	122	147	178	230	138	62
Disbursements	194	205	231	289	222	143
Reconstruction	147	140	186	217	187	143
Other	47	65	45	72	35	0
Amortization	-73	-58	-52	-58	-83	-81
Multilateral and Paris Club creditors	-30	-15	-10	-15	-39	-33
Others	-42	-42	-43	-43	-44	-47
Other capital	0	400	70	30	0	0
Capital account balance	739	1,157	753	772	637	786
Errors and omissions	-197	167	73	0	0	0
of which: valuation adjustment	-82	165	73	0	0	0
Overall balance	-246	352	-52	-216	-328	134
Financing	246	-352	52	42	-7	-122
Net foreign assets (increase, -)	105	-448	-28	-28	-40	-150
Central bank 4/	-24	-245	-23	-18	-30	-85
Commercial banks	129	-203	-5	-10	-10	-65
Net use of Fund resources	33	18	17	10	-23	-18
Purchases/loans	33	39	37	18	0	0
Repurchases/repayments	0	-21	-20	-8	-23	-18
Short-term liabilities (reduction, -)	0	0	0	0	0	0
Arrears (reduction, -)	-815	-20	-946	0	0	0
Multilateral creditors	0	-20	0	0	0	0
Paris Club creditors	-815	0	0	0	0	0
London Club	0	0	0	0	0	0
Other creditors	0	0	-946	0	0	0
Debt Rescheduling (of Arrears)	815	20	946	0	0	0
Multilateral creditors	0	20	0	0	0	0
Paris Club creditors	815	0	0	0	0	0
London Club	0	0	0	0	0	0
Other creditors	0	0	946	0	0	0
Debt Relief, current maturities (cashflow)	108	78	63	59	56	46
Multilateral creditors	0	0	0	0	0	0
Paris Club creditors	36	8	0	0	0	0
London Club	73	69	63	59	56	46
Total financing gap	0	0	0	-174	-335	12
Memorandum items:						
Current account balance (in percent of GDP)	-19	-22	-20	-20	-17	-8
Excluding official transfers	-24	-24	-21	-20	-17	-8
External debt/GDP (in percent)	74	71	62	59	56	44
Debt service/Exports (in percent)	-12	-12	-11	-12	-13	-8
Gross official reserves (in months of imports)	1	2	2	2	2	3

Sources: Data provided by the authorities and Fund staff estimates.

Table 10. Bosnia and Herzegovina: External Financing Requirements and Possible Sources of Financing, 1998-2001

(In millions of U.S. dollars)

	1998	1999	2000	2001
Merchandise trade balance	-1,959	-1,852	-1,595	-1,608
Services balance	378	324	264	236
Net factor income	330	273	235	203
of which: Interest due	-79	-81	-83	-103
Private transfers, net	264	198	164	159
Current account balance, excluding official transfers	-986	-1,058	-931	-1,011
Amortization of medium and long term obligations 1/	-73	-58	-52	-58
Changes in arrears (- is reduction)	-815	-20	-946	0
Of which: Multilateral	0	-20	0	0
London Club	0	0	0	0
Paris Club	-815	0	0	0
Other	0	0	-946	0
London Club rescheduling and debt relief	73	69	63	59
Paris Club rescheduling and debt relief	851	8	0	0
Multilateral rescheduling and debt relief	0	20	0	0
Change in official reserves (- is increase)	-24	-245	-23	-18
Change in commercial bank NFA (- is increase)	129	-203	-5	-10
Errors and omissions	-197	167	73	0
Gross external financing requirement	-1,042	-1,319	-1,822	-1,038
Official transfers	197	86	53	24
Capital transfers for reconstruction	517	520	388	347
Official loans for balance of payments support 2/	0	11	0	31
Disbursement for reconstruction	147	140	186	217
Foreign direct investment	100	90	117	164
Other capital	0	400	70	30
Financing gap after project and humanitarian flows	-80	-73	-1,007	-225
IMF	33	18	17	10
World Bank adjustment lending	47	54	45	41
Gross financing gap (-)	0	0	-946	-174
Other rescheduling and debt relief 3/	0	0	946	0
Remaining gap	0	0	0	-174

Source: Data provided by Bosnian authorities; and IMF staff estimates.

1/ Excludes IMF repurchases.
2/ Excludes multilateral creditors.
3/ Mainly reflects an assumed rescheduling of debt arising out of bank guarantees for construction work that was not completed, unallocated suppliers credits, and debt acquired in non-convertible currency.

Table 11. Bosnia and Herzegovina: External Debt at end-1998 1/ 2/

(In millions of US dollars)

	Stock of Debt		Projected Debt Service						
	Arrears at End-1998	1998	1999	2000	2001	2002	2003	2004	2005
Total debt outstanding	927.4	2,985.0	...	...	...	...	...	...	...
Total debt service	...	...	159.1	155.5	169.3	214.5	236.2	240.7	219.2
Amortization	...	...	78.4	72.5	66.2	106.5	122.1	123.3	98.7
Multilateral	40.3	1,100.9	23.7	25.4	18.8	53.1	69.0	70.4	49.0
IMF	0.0	76.8	20.7	20.1	8.0	23.2	36.9	38.7	18.0
World Bank 3/	0.0	976.2	0.0	0.0	5.6	23.6	24.2	23.9	23.1
Other	40.3	47.9	3.0	5.4	5.1	6.3	7.9	7.9	7.9
Paris Club 4/	0.0	568.1	12.4	4.5	4.6	9.1	8.9	8.6	2.4
London Club 4/	0.0	428.9	42.3	42.3	42.3	42.3	42.3	42.3	45.3
Other creditors 5/	887.1	887.1	20.7	20.3	8.5	25.2	38.9	40.7	20.0
New Debt (disbursed after end-1999) 6/	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	...	...	80.7	82.9	103.0	108.0	114.0	117.4	120.5
Multilateral	...	...	44.7	47.5	49.5	49.1	48.7	45.6	41.8
IMF	...	...	5.0	5.5	6.0	5.6	4.2	2.5	1.1
World Bank 4/	...	...	36.5	38.1	39.7	40.1	41.5	40.6	40.8
Other	...	...	1.4	3.2	4.0	3.7	3.3	2.9	2.5
Paris Club 5/	...	...	6.9	10.4	10.3	10.2	9.8	9.5	9.3
London Club 5/	...	...	30.6	23.8	20.4	18.0	14.7	11.3	8.6
Other creditors 5/ 6/	...	...	0.3	2.0	21.1	21.1	21.1	21.2	21.2
New Debt (disbursed after end-1999) 7/	...	...	0.0	0.0	1.4	9.3	19.3	29.4	37.2

Source: Data provided by Bosnian authorities; and Fund staff estimates.

1/ Debt service to London Club and Paris Club after rescheduling.

2/ Excludes an estimated US$54 of payments arrears at end-1997 for gas supplied from the Russian Federation, which is in dispute. Includes non-allocated debt of the former SFRY allocated on the basis of the Fund key of 13.2 percent of the non-allocated debt of the former SFRY. Includes debt for which status of public liability has not been verified or finalized.

3/ Figures reflect clearance of IBRD arrears on June 14, 1996, and the prepayment of unmatured loans as part of the debt consolidation.

4/ A restructuring agreement with London Club creditors became effective as of January 1, 1998. An agreement on Naples terms was reached with the Paris Club in October, 1998. Bilateral agreements with all countries but Japan have been completed.

5/ Mainly commercial creditors (i.e., supplier and trade creditors).

6/ Includes prospective disbursements to fill financing gaps.

Table 12. Bosnia and Herzegovina: Monetary Survey, December 1996-December 2001

	1996	1997	1998	1999	2000				2001	
	Dec.	Dec.	Dec.	Dec.	Mar	Jun	Sep	Dec. Proj	Mar Proj	Dec. Proj
					(In millions of convertible marka) 1/					
Assets	775	1,178	1,547	2,165	2,115	2,237	2,322	2,443	2,546	2,856
Foreign assets (net)	-1,973	-2,056	-2,041	-1,458	-1,561	-1,521	-1,511	-1,517	-1,481	-1,374
Foreign assets	1,266	1,443	1,465	2,014	1,973	2,102	2,184	2,101	2,120	2,242
Foreign assets (MAs) 2/	365	144	292	881	858	884	943	1,044	1,052	1,139
Foreign assets (DMBs)	901	1,299	1,172	1,134	1,115	1,218	1,241	1,057	1,068	1,103
Foreign liabilities	-3,240	-3,499	-3,505	-3,472	-3,534	-3,624	-3,695	-3,613	-3,602	-3,611
Foreign liabilities (MA) 3/	-138	-71	-130	-183	-178	-197	-193	-186	-169	-184
Foreign liabilities (DMBs) 4/	-3,102	-3,428	-3,375	-3,289	-3,356	-3,427	-3,502	-3,427	-3,432	-3,427
Domestic assets (net)	2,749	3,234	3,588	3,623	3,676	3,759	3,833	3,960	4,028	4,230
Claims on central government (net) 2/ 5/	-278	-116	-60	9	2	46	75	52	65	80
Monetary authorities	-108	71	114	159	158	176	178	202	215	230
Deposit money banks	-170	-188	-174	-150	-156	-130	-103	-150	-150	-150
Other claims	3,263	3,840	4,201	4,147	4,213	4,330	4,432	4,583	4,637	4,824
Of which: Claims on private sector	3,260	3,835	4,192	4,130	4,204	4,321	4,419	4,566	4,620	4,807
Other items (net)	-237	-489	-553	-533	-539	-617	-674	-674	-674	-674
Liabilities										
Broad money	775	1,178	1,547	2,165	2,115	2,237	2,322	2,443	2,546	2,856
Money	187	252	310	1,100	1,141	1,205	1,295	1,315	1,371	1,538
Currency outside banks	96	113	162	515	504	531	546	580	604	677
Demand deposits 6/	91	139	147	585	637	674	749	736	767	860
Quasi-money	588	926	1,237	1,065	974	1,033	1,027	1,128	1,175	1,318
Time and saving deposits in domestic currency	7	10	8	22	37	55	64	61	63	71
Foreign currency deposits	581	917	1,229	1,043	937	977	963	1,067	1,112	1,248
Demand deposits	466	554	762	465	399	447	444	488	508	570
Time and saving deposits	115	363	467	577	538	531	519	580	604	678
					(Change in percent of opening broad money)					
Foreign assets (net)	60	-11	1	38	-5	-3	-2	-3	1	6
Foreign assets	131	23	2	36	-2	4	8	4	1	6
Foreign liabilities	-71	-33	0	2	-3	-7	-10	-7	0	0
Domestic assets (net)	36	63	30	2	2	6	10	16	3	11
Claims on central government (net) 5/	-46	21	5	4	0	2	3	2	1	1
Monetary authorities	-26	23	4	3	0	1	1	2	1	1
Deposit money banks	-20	-2	1	2	0	1	2	0	0	0
Other claims (net)	135	74	31	-4	3	8	13	20	2	10
Broad money	96	52	31	40	-2	3	7	13	4	17
Money	33	8	5	51	2	5	9	10	2	9
Quasi-money	63	44	26	-11	-4	-1	-2	3	2	8
Memorandum items:										
Broad money, annual percentage change	96	52	31	40	40	39	34	13	20	17
Claims on private sector, annual percentage change	19	18	9	-1	3	5	7	11	10	5
Foreign currency deposits as a percent of broad money	75	78	79	48	44	44	41	44	44	44

Sources: Data provided by the Central Bank of Bosnia and Herzegovina (CBBH); and IMF staff estimates.

1/ At the official or market exchange rates for the KM, the BH dinar, the YUD, and the kuna.

2/ Excluding USAID deposits.

3/ Foreign liabilities of the Monetary Authorities were transferred to the State in August 1997.

4/ Including transactions written off by Privredna Banka Sarajevo (PBS) in December 1997 without the approval of the Federation Banking Agency (FBA).

5/ Including net claims on Entity governments.

6/ Includes deposits of noncentral government and private sector.

December 4, 2000

Mr. Horst Kohler
The Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Kohler:

1. In the period since we wrote to Mr. Fischer, on February 23, 2000, the Bosnia and Herzegovina authorities have continued their efforts to consolidate financial stabilization and reinvigorate the structural reform process. Inflation has remained low and real GDP has continued to experience high rates of growth. Official reserves have continued to increase. In spite of these positive results, there is a substantial agenda of unfinished work. There is a need to accelerate structural reforms to underpin the achievements in the macroeconomic area on a durable basis and enhance Bosnia's growth prospects over the medium term. This letter outlines the progress made thus far, confirms our key policy goals, and sets out new macroeconomic and structural policy steps to accelerate the momentum of the adjustment process. To support our adjustment effort, we request the Fund to complete the fourth and fifth reviews of the stand-by arrangement, extend the arrangement by two months, and rephase the disbursements as set out in the attached Annex I.

A. Macroeconomic Developments

2. Macroeconomic developments were favorable in 1999 and in the first half of 2000. Following the adverse effects of the conflict in Kosovo, a recovery of economic activity in the second half of 1999 resulted in real GDP growth of about 9 percent for the year as a whole, while inflation remained low. Similar developments continued to characterize economic conditions in both Entities during the first half of 2000. Developments in the external current account were broadly as anticipated, but official reserves at end-1999 were significantly higher than targeted, owing to the remarkable increase in the demand for the Convertible Marka.

3. The favorable macroeconomic developments thus far have resulted principally from the stringent implementation of the currency board rules, supported by prudent cash management by the State and Entity Governments. The prospects for economic growth during the rest of 2000 remain positive, and inflation in both Entities is expected to remain low. In both Entities, the sharp public sector wage increases granted earlier in the year, which were substantially out of line with budget parameters, have been partially reversed and budget execution is now heading towards acceptable outcomes. In the Republika Srpska, both revenues and expenditures are expected to finish the year at targeted levels. In the Federation, revenues have performed less well. However, the anticipated underperformance

of excise revenue is expected to be more than compensated for by higher foreign financing, which will enable expenditure targets to be reached within the program constraint of zero domestic borrowing.

B. Macroeconomic Objectives and Policy Framework

4. The macroeconomic objectives for 2000 are to achieve a real GDP growth rate of 10 percent, a 12-month inflation rate of under 5 percent in both Entities, and a strengthening of the external position with an increase in reserves to the equivalent of 2¼ months of imports, including a substantial increase in the free reserves of the Central Bank. To achieve these objectives, we will continue to strictly implement the currency board rules and will reinforce fiscal restraint in order to observe the budgetary ceilings over the year. Large inflows of grants and concessional loans to support the reconstruction of the country will continue to exert a heavy influence on economic activity in 2000. Such assistance is expected to decline sharply over the medium term, and for this reason the policies envisaged under the program for 2000 are also intended to set the stage for rapid private-sector-led growth in the period ahead.

5. To this end, our medium-term economic strategy intends to establish the basis for fiscal stability, with a particular emphasis on making the tax system more efficient and on initiating measures to ensure continued financial discipline (Tables 1 and 2). In addition, the strategy calls for an acceleration of financial sector reform, privatization of state enterprises, enhancement of social policies, and labor market reform. We also believe that promoting good governance is key to generating public support and confidence in the reform program. Under the program, these issues will be addressed largely through efforts to enhance the transparency of fiscal operations and intensified efforts to fight corruption at all levels of government.

C. Fiscal Policies

6. During the first half of the year both Entities experienced considerable difficulties in implementing the approved budgets for 2000. Expenditure commitments in both Entities exceeded those envisaged in their budgets, notably because of larger than affordable wage adjustments. Such wage increases, in the Republika Srpska, were accompanied by large non-wage expenditures such as transfers to the pension fund. In addition, the very substantial depreciation of the euro against the dollar has significantly boosted the foreign debt service costs for 2000, and both Entities are facing higher expenditure requirements to fund refugee returns. In the Federation, the expenditure pressures have been compounded by adverse developments on the revenue side, as increased evasion has contributed to a decline in the collection of excise taxes. Aware that such developments should not be allowed to continue unchecked, we have been addressing these problems in both Entities with ambitious revenue and expenditure measures.

7. All levels of government reaffirm their commitment to run balanced budgets on a cash basis, without any recourse to borrowing from domestic sources, and to limit external borrowing exclusively to loans on concessional terms. To this end, the respective parliaments have adopted revised Entity budgets for 2000. In the Federation, to accommodate partially the higher expenditure requirements for the return of refugees and external debt service, allocations for goods and services and subsidies have been reduced. We are ensuring that these lower allocations are respected by implementing a tightened system of monthly spending ceilings for ministries, strictly enforced by the government. In addition, to keep wage spending within the budgeted amount, wages have been rolled back by 9 percent and a decision to freeze government employment has been taken. Similarly, in the Republika Srpska, a 33 percent wage increase has been reduced to 13 percent and government employment has been frozen. We will consult with the IMF before granting any future wage increases. In addition, budgeted Entity obligations for State administrative outlays and servicing of foreign debt will continue to be fully covered by monthly transfers that will be made no later than the end of the month for which they are due.

8. As regards revenue, in the Federation, we have already taken steps to strengthen tax and customs administrations by beginning the implementation of an action plan to remove smuggled alcoholic beverages and cigarettes from the market. In addition, tax collections from other high-duty goods will improve because we have increased the exchange of information between the tax and customs administrations and reduced the number of border crossings where high-duty goods can enter the country. In the Republika Srpska, although aggregate revenues have remained broadly on target, there is scope to improve further the collection of taxes during the remainder of the year. To this end, we have implemented measures to improve the collection of tax arrears and tax collections from high-duty goods such as cigarettes, alcoholic beverages, and oil. In addition, in the Republika Srpska, we have increased the effective tax on tobacco and included excise taxes in the sales tax base in order to harmonize them with those in the Federation.

9. The revenue measures noted above will be carried out in conjunction with the ongoing reform of tax administration. With technical assistance from the international community, we continue to streamline the organizational structure of tax administration in both Entities, enhance the exchange of information, and improve filing and payments procedures. In order to enhance tax compliance, we intend to intensify taxpayers' education campaigns and increase auditing efforts of the respective tax administrations.

10. Achieving medium-term fiscal sustainability will require a rationalization of the tax system and a major change in the structure of expenditure. These reforms have already been initiated. Specifically, as regards revenue, in the last year both Entities have implemented a common schedule of excise duties, reduced customs duties exemptions, and eliminated temporary sales tax exemptions. During the next 12 months we intend to build on these achievements. Specifically, by January 2001, the existing array of sales taxes on goods and services will have been replaced in both Entities by a single-stage, two-rate sales tax that will be collected at the retail level. We intend to curtail sales tax exemptions, broaden the base of

the sales tax to include construction materials and services, and harmonize sales tax exemptions and bases between the two Entities. Prior to implementation we will fully discuss our tax reform plans with the IMF. In the Federation, we will raise the social security contribution rates for military personnel to the standard rates. In addition, in 2001 both Entities will formulate and initiate implementation of a reform of the system of social contributions, to broaden their base and allow a reduction of rates without loss of revenues. We will also intensively monitor contribution payments and enforce compliance with such obligations. Other important measures for 2001 will include the reform of personal and corporate income taxes.

11. We are committed to lowering the share of GDP devoted to expenditures and to changing the composition of expenditures over the next 3-4 years, with measures focused in two areas. First, a comprehensive reform of the social welfare system will be launched to provide adequate and more equitable basic social benefits to the population. Second, military expenditure will be reduced significantly over the medium term, a process that is already underway. For 2001, on-budget military expenditure will decline by one percentage point of GDP (5 percent in nominal terms). The total decline will be even larger, however, as a result of anticipated reductions in off-budget expenditure. During 2001, the reduction in off-budget expenditures will be quantified on the basis of audits carried out in both entities by external auditors and, by 2002, all military revenues and expenditures will be brought on budget.

12. Both Entities are adopting measures to improve transparency and control over budget execution. An important step in this direction will be taken in early 2001 with the establishment of State, Entity and Canton Treasuries, incorporating the principle of a treasury single account held at the CBBH. To enhance the credibility of governments, draft laws that have expenditure implications will be submitted to the respective parliaments accompanied by an estimate of their budgetary cost. In the Republika Srpska, we have recently brought on budget the independent revenues of customs administration, tax administration, and the financial police. Entity governments will strive to include all fiscal operations within their budgets. In particular, donor-financed activities and external support for the military will be included in future budget documentation. Comprehensive external audits of military budget execution in 1999 and 2000 will be performed in order to provide a basis for assessing the restructuring of the military. Moreover, from 2001, the financial plans of extrabudgetary funds and the uses of privatization proceeds will require approval by the respective parliaments. In addition, we will ensure that the operations of the Goods Reserve Directorate in both Entities will be strictly limited to the core activities assigned to it by law.

D. Financial Sector Development and Reform

13. The banking system in both Entities remains fragile and beset by poor profitability and low capitalization. In response, we are continuing to strengthen banking supervision and we will enforce supervisory sanctions on banks that are not in compliance with regulations. In both Entities, Banking Agency officials, examiners, staff, and contract employees are now legally protected from prosecution in the performance of their legitimate duties. In the

Federation appropriate legislation to this end has been adopted by the parliament, while in Republika Srpska such legislation is currently before the National Assembly. In the meantime, the required law has been imposed by the High Representative. In order to deepen financial intermediation, the amended Banking Laws in both Entities now allow commercial banks to operate throughout the country, and Laws on Deposit Insurance have been adopted in both Entities. Net capital requirements for all banks will be increased in stages from KM 5 million to KM 10 million by end-June 2001 in the Federation and end-June 2002 in the RS.

14. Our banking sector reform strategy is being pursued through the liquidation of insolvent banks and the privatization of all other state-owned banks. To ensure that only sound private banks remain in the financial system, the governments will not recapitalize any banks and will liquidate at an early-stage some state-owned insolvent banks. In the Federation, tenders for the sale of Union Banka, and Postanska Banka have already been issued while discussions with a potential buyer for the sale of Sipad Banka are ongoing. In addition, either a substantial nonrefundable deposit will have been received for the sale of the Federation Investment Bank or it will be placed under foreign management. A Divestiture Strategy Plan was agreed in October between the Federation Government and the World Bank that will allow solvent banks from the Privredna Banka Sarajevo group to be sold as banking institutions, but those found to be insolvent will be closed and liquidated. In the Republika Srpska, privatization plans have been approved for all majority state-owned banks other than the Development Bank, and tenders for the sale of 5 state-owned banks have been published.

15. The development of a robust banking system has been hindered by the existence of payments bureaus, which until recently had a monopoly on domestic payments transfers among legal and physical persons, and relegated banks to a minor role in the financial system. In this context, a key objective for 2000 is the reform of the payments system, including the elimination of the three payments bureaus operating in Bosnia and Herzegovina by the end of the year. All activities currently performed by the payments bureaus will be transferred to commercial banks, government agencies, and statistical institutes, and a countrywide interbank clearing system will be put into place by December 2000. In this regard, we have made progress in preparing the commercial banks to carry out payments transactions. In addition, preparations are underway to establish systems to replace the limited treasury functions performed by the payments bureaus. We intend to intensify our efforts in this area, and we will ensure that adequate alternate treasury systems are in place before the payments bureaus are closed.

E. Enterprise Sector Restructuring

16. We are working closely with the World Bank, the Office of the High Representative, USAID, and other donors to accelerate the privatization of state enterprises. To that end, the Republika Srpska has implemented a key outstanding measure by appointing Securities Commission and Share Registrar officials. Also, both Entities have adopted international standard tender regulations and rules for tender registrations. With assistance from

international tender advisors, in each Entity at least three tenders for large enterprises will be brought to completion by end-2000. In addition, in both Entities, a list of enterprises—and the value of state equity therein, according to the opening balance sheet—has been published; and public offerings for up to 300 large enterprises are expected to be conducted by end-2000—with the full participation of privatization investment funds.

17. All levels of government, including cantons and municipalities, will abstain from assuming or guaranteeing any obligations of banks or enterprises that were not specified in the initial contracts as obligations of government. Moreover, the privatization process will be monitored closely to ensure that neither foreign nor domestic debts of enterprises or banks are transformed into explicit or implicit obligations of any level of Government. We will also ensure that all levels of government refrain from using privatization receipts until a framework for their utilization has been developed in agreement with the Fund. As regards the Privredna Banka Sarajevo, we will continue to ensure that the outstanding foreign liabilities do not generate any claims on the Federation budget, and seek, in the future, to treat in a comparable manner any similar liabilities of other public banks. We will also ensure that such liabilities are not absorbed by other public enterprises, and thus indirectly passed on to the Federation budget through lower privatization receipts.

F. Other Policies

18. Entity Governments intend to achieve over the medium term financial viability of the pension systems. In the Republika Srpska, the recently adopted pension benefit legislation includes the requirement that pension entitlements beyond a guaranteed minimum be made contingent on the availability of resources, precluding hence, further accumulation of debt to pensioners. In the Federation, the adoption of similar amendments to the benefit system is expected soon. Also, the financial demands placed by new pensioners resulting from the demobilization of soldiers, and also from the addition of pensioners that were previously receiving their pensions from Croatia will be met by increasing the level of contributions to the social funds by the military. Both Entities are committed to raising pension contribution collection through better enforcement, and to prudent pension fund management in order to ensure that full statutory benefits can be met from available resources in the near future.

19. Both Entities are also committed to not using any cash privatization revenues to recapitalize the pension funds before the financial situation of the funds has been permanently stabilized. Under no circumstance will privatization revenues be used for current pension payments.

20. Recent changes to labor legislation in both Entities, key to the reduction of unemployment and to the progress of enterprise restructuring, mark a turning point in labor market reform. Amendments to the Entity framework labor laws adopted in August in the Federation and in October in the Republika Srpska redefine important aspects of labor relations, including the role of the various levels of governments and of employment contracts as well as eliminating the institution of employment on "waiting lists." The changes

are aimed at increasing the flexibility of employment and termination of employment as well as bringing entitlements to more affordable levels. Legislative changes expected to be adopted before end-2000 in both Entities also redefine the role of employment bureaus and unemployment insurance, further increasing the flexibility of the employment process and conditioning unemployment benefit payments on the availability of resources in the employment funds.

21. In light of the rapid transformation of labor and social relations described above, we consider it essential to review the social benefit framework in order to ensure that adequate benefit coverage of the most vulnerable, and for workers displaced by privatization, is maintained. We consider this to be an important area of reform, since public support for the privatization of state-owned enterprises could be jeopardized by the absence of progress in establishing a suitable social safety net. We are, therefore, presently drafting social protection strategies for the period 2000-03, which will be implemented, together with labor market reform, with the support of a World Bank adjustment credit. The strategy will aim to reform existing programs to increase the effectiveness of resources currently allocated to social protection, provide more equitable benefits through greater pooling of resources, and raise the credibility of the system by committing to affordable levels of protection.

22. We have made progress toward implementing our program of trade liberalization and we intend to continue addressing any remaining obstacles to domestic competition. Our efforts to establish a transparent and non-discriminatory trade regime have continued in 2000. The amended State Customs Policy Law will become effective in December. We are committed to early elimination of the few remaining restrictive elements in our trade regime. To this end, we will begin to lower in steps the levels of the specific customs surcharges during 2001, with a view to eliminating the customs surcharge over a two-year period. Stimulating exports is critical to enhancing Bosnia and Herzegovina's growth potential. Accordingly, we have replaced the ban on the exports of raw timber with an export tax as an intermediate step towards the introduction of a stumpage tax.

23. We are in the process of negotiating a free trade agreement (FTA) with Croatia. In these discussions we will emphasize the need to phase the implementation of the FTA in a manner that is consistent with our objective of multilateral trade liberalization. A Working Group for our accession to the WTO has been formed, and in an effort to expedite the process, we are making good progress in preparing all the relevant documents.

24. We will ensure that the State and Entities refrain from borrowing on nonconcessional terms, including "in kind" loans. This prohibition on nonconcessional external borrowing will also apply to the granting of domestic or foreign payments guarantees or the assumption of liabilities under existing contracts that are not specifically identifiable as liabilities of the State, Entities, Cantons, or other levels of Government. These prohibitions will also apply to both Entities' Goods Reserves. The sole exception to this policy will be projects financed by the European Bank for Reconstruction and Development, the International Finance

Corporation, the European Investment Bank, the European Commission, or other donors in conjunction with World Bank lending.

G. Program Monitoring

25. Reflecting the importance of accelerating the momentum of structural reforms, some of them have been made into prior actions or structural benchmarks (Table 1 and 2). Quantitative performance criteria for end-December 2000 and end-March 2001 have been set on: (i) the floor for net free reserves of the central bank; (ii) the ceilings on the cumulative change in gross credit from the banking system to the general government, the State government, the government of the Federation and the government of Republika Srpska; (iii) the ceiling on the contracting or guaranteeing of new non-concessional external debt; and (iv) external payments arrears (Annexes II-V).

Sincerely yours,

The State of Bosnia and Herzegovina	The Federation of Bosnia and Herzegovina	Republika Srpska
/s/	/s/	/s/
Martin Raguz Chairman, Council of Ministers of Bosnia and Herzegovina	Edhem Bičakčić Prime Minister Federation of Bosnia and Herzegovina	Milorad Dodik Prime Minister Republika Srpska Bosnia and Herzegovina
/s/	/s/	/s/
Peter Nicholl Governor, Central Bank of Bosnia and Herzegovina	Dragan Čović Deputy Prime Minister and Minister of Finance Federation of Bosnia and Herzegovina	Novak Kondić Minister of Finance Republika Srpska Bosnia and Herzegovina

Table 1. Bosnia and Herzegovina: Prior Actions to Conclude the Fourth and Fifth Reviews of the Stand-By Arrangement [1/]

		Status
1.	Entity and State Parliaments to pass the revised 2000 budgets agreed with the IMF.	Fed.: Done RS: Done State: Done
2.	Government to adopt and implement measures addressing key sources of tax evasion as agreed with IMF staff.	Fed: Done RS: Done
3.	Republika Srpska to include excise taxes in the sales tax base, and increase the effective excise tax on tobacco products.	Done
4.	Entities to be current on transfers to State institutions for administrative expenditures.	Fed: Done RS: Done
5.	Freeze employment of the Entity governments and roll back government employee wages to effect savings of 9 percent and 15 percent, respectively, in the Federation and Republika Srpska governments' monthly wage bills.	Fed: Done RS: Done
6.	Governments to begin setting monthly spending limits (on a commitment basis) to each ministry based on Ministry of Finance recommendations, and to impose sanctions against ministries that do not observe these limits.	Fed: Done RS: Done
7.	Republika Srpska to set pensions for May 2000 onward to no more than 33 percent above pensions in May 1999.	Done
8.	Republika Srpska to reverse the February 2000 pension contribution rate. reduction.	Done
9.	Federation Parliament to confirm the director, deputy director, and managing board of the Banking Agency.	Done

[1/] Unless specified otherwise, measures refer to the institutions of the two Entity Governments.

Table 2. Bosnia and Herzegovina: Structural Benchmarks, November 2000-March 2001[1]

Fiscal Issues		
1.	Implement comprehensive excise and sales tax reform.	end-January 2001
2.	Prepare strategy to raise collections of social funds by broadening the contribution base while lowering rates.	end-March 2001
3.	Entity governments to forbid the use of privatization revenues: (a) for paying off debts of institutions that cannot meet their current obligations from current resources; (b) by any privatization agency before it has adopted regular reporting procedures on its receipts and their use.	end-November 2000 onwards (Done)
4.	Implement measures agreed with IMF staff to have interim Treasury functions in place prior to closure of the payments bureaus.	end-December 2000
Financial Sector		
1.	Real Time Gross Settlement System and clearinghouse to begin interbank settlement operations.	end-December 2000
2.	Enforce prudential regulations, mainly minimum net capitals requirements, and implement strategy to bring offending banks into compliance.	continuous

[1] Measures refer to institutions of both Entities.

Table 3. Bosnia and Herzegovina: Structural Reform Measures, September 2000–March 2001[1]

Fiscal Issues

1.	Based on technical assistance from the IMF, prepare draft legislation for comprehensive sales and excise tax reform.	end-November 2000 (Done)
2.	Federation to increase social security contribution rates for military personnel to the standard level.	end-March 2001
3.	Republika Srpska to bring on budget revenues of the customs administration, tax administration and financial police.	end-September 2000 (Done)
4.	Entity Parliaments to appoint Auditors General for a period of five years.	end-September 2000 (Done)

Financial Sector

1.	Submit amendments to the Law on Commercial Banks to the Parliament increasing the minimum net capital requirements for commercial banks to:	end-December 2000 (Federation: Done)

	Federation	RS
KM 7.5 million effective	end-Dec. 2000	end-June 2001
KM 10 million effective	end-June 2001	end-June 2002
KM 15 million effective	end-Dec. 2002	end-June 2003

2.	Adopt criteria harmonized between the two Entities for the supervision of out-of-Entity bank branches.	end-December 2000
3.	Federation to harmonize criteria in the Law on Deposit Insurance with the forthcoming minimum capital requirements in the Law on Commercial Banks.	end-September 2000 (Done)
4.	Republika Srpska to adopt Deposit Insurance Law and complete preparatory work to establish deposit insurance mechanism.	end-January 2001
5.	Federation to offer for sale Sipad, Union, and Postanska Banks.	end-September 2000 (Done)
6.	Adopt divestiture plans for state banks in the PBS bank group in the Federation.	end-October 2000 (Done)
7.	Amend legislation to provide limited immunity to Banking Agency officials, examiners, staff, and contract Employees, while performing duties pursuant to the law.	end-October 2000 (Federation: Done) (RS: imposed by OHR)

[1] Unless specifically stated otherwise, measures refer to institutions of both Entities.

Other Structural

1.	Observing international tender regulations, bring at least 6 large enterprises to the point of sales (3 in each Entity; the 6 Republika Srpska timber industry enterprises with IFC participation count as one).	end-December 2000
2.	Federation to appoint an international sales advisor for Air Bosnia.	end-December 2000
3.	Submit to parliaments amendments to legislation on labor relations and rights of the unemployed to create an environment conducive to private market development and employment growth.	end-November 2000 (Done)
4.	Amend legislation on veterans' and military invalids rights to ensure there is no accumulation of debt for unpaid benefits.	end-December 2000

External Sector

1.	Adopt and implement amendments to Customs Policy Law.	end-December 2000 (Done)
2.	Begin reduction of the specific import tariffs according to a schedule to be agreed with the IMF.	end-December 2000

Bosnia and Herzegovina: Schedule of Proposed Purchases
Under Stand-by Arrangement

	Amount of Purchase	Availability	Conditions include:
1.	SDR 8.08 million	May 15, 2000	Completion of fourth review and observance of end-March 2000 performance criteria
2.	SDR 8.08 million	August 15, 2000	Completion of fifth review and observance of end-June 2000 performance criteria
3.	SDR 8.08 million	February 15, 2001	Completion of sixth review and observance of end-December 2000 performance criteria
4.	SDR 5.91 million	May 15, 2001	Completion of seventh review and observance of end-March 2001 performance criteria [1]

Source: Staff estimates.

[1] The stand-by arrangement expires on May 29, 2001.

Bosnia and Herzegovina: Ceilings on the Cumulative Change in Gross Credit from the Banking System to the General Government

	Limits			
	(In millions of convertible marka)			
	General Govt.	State Govt.	Entity Governments	
			Federation	Rep. Srpska
Cumulative change from level on December 31, 1999: 1/				
September 30, 2000 (indicative target)	15	15	0	0
December 31, 2000 (performance criteria)	6	6	0	0
March 31, 2001 (performance criteria)	-2	-2	0	0

1/ Negative flows indicate deposits to the SDR account or other accounts at IMF. The targeted deposits include half of the amounts disbursed under the stand-by arrangement less debt service to the Fund. The targeted deposits at September 30, 2000, December 31, 2000, and March 31, 2001 will be adjusted downward for delays in disbursements under the SBA. Flow increases of borrowing by the goods reserve are measured using September 30, 2000 as a base.

The general government is defined to include the State, Entity (Federation, and Republika Srpska), cantonal and municipal budgets, together with their respective extrabudgetary funds. From September 30, 2000 onwards, for the purposes of this performance criterion, it also includes the goods reserves of each entity. Extrabudgetary funds include, but are not limited to, the pension funds, health funds, unemployment funds, and invalids and surviving family insurance funds in the two Entities.

Banking system claims on the general government for the purposes of program monitoring are defined as the sum of: (i) claims from the monetary authorities (the Central Bank of Bosnia and Herzegovina and the payment bureaus); and (ii) loans, advances, securities or bills issued (or guaranteed) by the general government and held by commercial banks.

For program purposes, those components of gross claims on the general government that are denominated in foreign currencies will be converted into convertible marka at the agreed accounting exchange rate prevailing on December 31, 1999.

The limits will be monitored from the accounts of the banking system, supplemented by information provided monthly by the Entity Ministries of Finance, and payment bureaus.

Bosnia and Herzegovina: Currency Board Cover and Minimum Stock of Free Reserves of the Central Bank of Bosnia and Herzegovina

	Minimum
	(In millions of convertible marka)
Stock of minimum free reserves 1/	
September 30, 2000 (indicative target)	40
December 31, 2000 (performance criteria)	43
March 31, 2001 (performance criteria)	43

1/ Corresponds to the minimum capital of CBBH. The free reserves of CBBH stood at KM 42 million at end-September 2000.

Under the Central Banking Law and the program, the CBBH (acting as a currency board) is required to ensure that its domestic liabilities do not exceed the convertible marka counter-value of its net foreign exchange reserves. Net foreign exchange reserves of CBBH are defined as the difference of the following foreign assets and liabilities, both in convertible currencies and denominated in convertible marka.

Under the Central Banking Law and for the purposes of the program, foreign assets include: (i) gold, and other precious metal and stones; (ii) convertible foreign exchange notes held by the CBBH; (iii) credit balances in convertible foreign exchange--including SDRs--due to the CBBH on the books of foreign central banks or other financial institutions; (iv) liquid debt securities issued by the government and the central bank of the country in whose currency the securities are denominated and held by the CBBH on its own account; and (v) officially guaranteed forward and repurchase contracts of different types providing for future payments in convertible foreign exchange to the CBBH by non-residents.

Under the Central Banking Law and for the purposes of the program, foreign liabilities include: (i) foreign exchange and convertible marka balances on the books of the CBBH due to non-residents, including foreign central banks and international financial institutions; (ii) credit balances due to foreign central banks, governments, international organizations, and foreign financial institutions; (iii) forward and repurchase contracts of different types providing for future payments in foreign exchange by the CBBH to non-residents; and (iv) any other liabilities due to non-residents.

Free reserves of the CBBH are foreign exchange reserves not utilized as backing for the currency. They therefore consist of the CBBH net foreign exchange reserves in excess of the currency board liabilities. The program calls for quarterly minimum levels of free reserves. Foreign currency holdings will be converted into convertible marka at fixed exchange rates of December 31, 1999 (exchange rates other than that of the Deutsche mark will be those published in the IMF International Financial Statistics). Valuation changes will be excluded from cumulative changes in free reserves. The above limits will be cumulative from the actual level as of December 31, 1998 and will be monitored from the accounts of the CBBH, with information on net foreign assets provided monthly by the CBBH. The information will be made available to the Fund within two weeks following the end of each month throughout the program period. As the stock of free reserves as of December 31, 1998 is equivalent to the initial capital of the CBBH, the implication is that the capital cannot be drawn upon to finance operational expenditures or the acquisition of physical assets.

Bosnia and Herzegovina: Ceilings on Contracting or Guaranteeing of New Non-Concessional External Debt

Of which:	One year and under [1/3/]	Over 1 year [2/3/]	1-5 years [2/3/]
	(In millions of U.S. dollars)		
Cumulative change from December 31, 1999 [/4]			
September 30, 2000 (indicative target)	0	0	0
December 31, 2000 (performance criteria)	0	0	0
March 31, 2001 (performance criteria)	0	0	0

1/ The limit applies to the flow of short-term debt contracted or guaranteed by the general government or the CBBH with an original maturity of up to and including one year. After September 30, 2000, the term "debt" is defined to include all current liabilities, 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 general government 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. In effect, all instruments that share the characteristics of debt as described above (including loans, supplier's credits, and leases) will be subject to the ceiling. After September 30, 2000, for the purpose of monitoring the performance criterion, the definition of general government will include the goods reserves of each Entity. (The flow of short-term debt contracted or guaranteed by the goods reserve of each Entity will be measured using the stock as at September 30, 2000 as a base; the flow of leasing obligations will be calculated using September 30, 2000 as a base; and the stock of leases will be calculated as the present value, at the inception of the lease, of all lease payments expected to be made during the period of the leasing agreement, excluding those payments that cover the operation, repair or maintenance of the property being leased.) The stocks and limits exclude normal import-related financing. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantees become effective. Information on the stock of short-term debt will be reported monthly to the Fund.

2/ The limit applies to the contracting or guaranteeing of external debt by the State Government, the Entity Governments or the CBBH with maturity over one year. After September 30, 2000, the term "debt" is defined as in footnote 1, above. After September 30, 2000, for the purpose of monitoring the performance criterion, the definition of general government will include the goods reserves of each Entity. (The flow of debt contracted or guaranteed by the goods reserve of each Entity will be measured using the stock as at September 30, 2000 as a base; the flow of leasing obligations will be calculated using September 30, 2000 as a base; and the stock of leases will be calculated as in footnote 1, above.) The limits apply to all new nonconcessional foreign debt and leases with a maturity of more than a year, and within this limit with an original maturity of more than one year and up to including 5 years.

3/ For program purposes, the following will be excluded from the calculation of the amount of external debt contracted or guaranteed: (i) borrowing from the IMF, the World Bank, EBRD, EIB, IFC, or bilateral cofinancing of lending by these institutions; and (ii) concessional loans.

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). The average CIRRs over the last ten years—plus a margin reflecting the repayment period (1 percent for repayment period of 15–19 years; 1.15 percent for repayment period of 20–29 years; and 1.25 percent for repayment period of 30 years or more)—will be used as discount rates for assessing the concessionality of loans of a maturity of at least 15 years. For loans with shorter maturities, the average CIRRs of the preceding six-month period (plus a margin of 0.75 percent) will be used. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time of contracting or guaranteeing the debt. Information on the contracting and guaranteeing of new debt falling both inside and outside the limit will be reported monthly to the Fund.

4/ Except as noted in footnotes 2 and 3.

Bosnia and Herzegovina: Ceiling on External Payments Arrears [1/]

	Limits
	(In millions of U.S. dollars)
Outstanding as of:	
December 31, 1999 (estimated) [2/]	0
Cumulative reduction from level on December 31, 1999	
September 30, 2000 (indicative target)	0
December 31, 2000 (performance criteria)	0
March 31, 2001 (performance criteria)	0

1/ Arrears to multilaterals, excluding arrears to the IFC pending a determination as to whether these are government obligations.

2/ External payments arrears as of end-1998 to the Council of Europe Social Development Fund and the European Investment Bank were repaid during 1999.

The limit on the change in external payments arrears applies to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the State, the Federation, the Republika Srpska, and the CBBH. The limit 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. The limit excludes reductions in connection with rescheduling of official and commercial debt and debt buy back. Accumulation of new external arrears is prohibited.

Bosnia and Herzegovina: Fund Relations
As of September 30, 2000

I. Membership Status: Joined: 12/14/1992; Article XIV

II. General Resources Account:	SDR Million	%Quota
Quota	169.10	100.0
Fund Holdings of Currency	237.16	140.2

III. SDR Department:	SDR Million	%Allocation
Net cumulative allocation	20.48	100.0
Holdings	0.02	.01

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Stand-by arrangements	64.27	38.0
First Credit Tranche	3.79	2.2

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	05/29/1998	03/31/2001	94.42	64.27

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

	Overdue		Forthcoming			
	08/31/2000	2000	2001	2002	2003	2004
Principal		3.8	6.1	17.6	23.3	14.6
Charges/Interest		1.2	4.5	4.0	2.8	1.5
Total		5.0	10.6	21.6	26.1	16.1

VII. **Exchange Arrangement**

The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. The KM is pegged to the deutsche mark (DM) at KM 1 = DM 1 under a currency board arrangement. Small denominations of KM notes have been in circulation since June 22, 1998; large denominations and coins were introduced in August 1998, and December 1998, respectively. The DM continues to circulate in all areas of the country, the Croatian kuna continues to be used in the Croat-majority area, and the Yugoslav dinar is used in the Republika Srpska. The convertible marka (KM) is the currency used for operations and transactions with the Fund for Bosnia and Herzegovina.

The Central Bank of Bosnia and Herzegovina does not maintain restrictions on payments for current international transactions or capital account transactions, with the exception of restrictions on transactions related to internationally-mandated economic sanctions. Corresponding regulations have not, however, been issued by the Entities.

VIII. Last Article IV Consultation

The last Article IV consultation with Bosnia and Herzegovina was concluded on May 29, 1998. At that time, Directors warmly welcomed the progress that had been made in establishing the common institutions of Bosnia and Herzegovina and strongly supported the authorities' economic strategy. They considered that the new central bank, operating under a currency board arrangement, and the new domestic currency could play a major role in political and economic reintegration and establishing an environment conducive to economic recovery. Directors also stressed the need for further development of the new fiscal institutions called for under the Dayton Treaty; stronger mechanisms for inter-regional cooperation; and the adoption of growth oriented tax reforms, restructuring of pensions systems, and a more effective and targeted social safety net. They were of the view that governance issues posed risks to the program, and called upon the authorities to intensify their efforts to promote transparency, establish a more adequate legal framework, and detect and prosecute official corruption. Directors urged the authorities to implement the structural reform agenda in a comprehensive manner and establish a track record of policy implementation, to pave the way for the adoption of a program that could be supported under the ESAF.

IX. Resident Representative

Mr. Bruno de Schaetzen has been the Fund's resident representative in Bosnia and Herzegovina since July 6, 1998.

X. Technical Assistance, 1995–September 1999

Department	Timing	Purpose
FAD	December 1995	Diagnostic
	February 1996	Income tax policy
	February 1996	Customs and tax administrations
	April-May 1996	Tax administration
	November 1996	Diagnostic mission to Repub. Srpska
	December 1998	Fiscal management at the State level
	November 1999	Consumption and inter-Entity trade taxation and policy
	August 2000	Treasury systems
LEG	May 1996	Tax administration law
LEG/TRE/SEC	December 1995	Assistance with succession to membership
MAE	December 1995	Institution-building and banking legislation
	October 1996	Payments bureau
	February 1997	Payments, accounting, and information systems

	June 1997	Central bank establishment and payments system
	July 1997	Central bank accounts and administration
	March 1998	Further development of the central bank and payment system and introduction of currency notes
	July 1998	Accounting
	November 1998	Central bank activities in foreign exchange, accounting, information technology, and administration
	January 1999	Central bank operations in foreign exchange, currency board, accounting and auditing. Reforming and modernizing the payments system.
	January 1999	Advisor on payments bureau reform.
	September 2000	Advisor on payments system.
MAE/EU1	June 1996	Discussion of new central bank
MAE/LEG	January/February 1996	Assistance from headquarters drafting legislation for new central bank and bank agency
	November 1996	Refinement of new central bank and bank agency legislation
STA	November 1995	Diagnostic participation in pre-membership mission
	April 1996	Money and banking statistics
	June 1996	Money and banking statistics
	November 1996	Money and banking statistics
	August 1997	Money and banking statistics
	January 1998	Multi-sector statistics
	September 1998	Money and banking statistics
	November 1998	Balance of payments statistics
	May 1999	Statistical advisor
	June 1999	Money and banking statistics
	September 1999	Balance of payments statistics
	October 2000	Money and banking statistics.

BOSNIA AND HERZEGOVINA—RELATIONS WITH THE WORLD BANK GROUP

1. Bosnia and Herzegovina became a member of the World Bank Group on April 1, 1996, after having agreed to assume its share of the loans made by the Bank to, or with the guarantee of, the Socialist Federal Republic of Yugoslavia (SFRY);[1] and having agreed with the Bank on a plan to eliminate arrears on those loans.[2]

2. In parallel with efforts towards membership and resolution of arrears, the Bank initiated, in collaboration with the government of Bosnia and Herzegovina, the IMF and international donors, preparatory efforts for a program of post-war reconstruction and economic recovery. The external financing requirement of this program was estimated at US$5.1 billion over 3-4 years. At pledging conferences in December 1995, April 1996, July 1997, May 1998 and May 1999—co-chaired by the European Commission and the World Bank—some 60 donor countries, multilateral institutions and other donor agencies pledged over US$5.1 billion of assistance on highly concessional terms to support Bosnia and Herzegovina in the implementation of the Priority Reconstruction Program.

3. As of June 30, 2000, the World Bank Group had committed US$ 760 million, in support of 33 IDA credits and 16 IFC operations, and disbursed US$571 million. The IDA-financed projects/credits have supported rehabilitation and reconstruction in a wide range of sectors, including agriculture, industry, energy, water supply, transport, education and health, employment creation through demobilization support, micro-credit and public works; and structural adjustment through public sector reform and privatization.

4. The current Bank assistance program, presented to the Bank's Board on May 18, 2000 has the following objectives: (i) strengthening institutions and governance, in particular, in the area of public finance, macroeconomic management and the strengthening of local governments; (ii) fostering private sector-led growth and employment through the creation of a business-friendly enabling environment, privatization and ongoing banking and labor-market reforms; and (iii) building social sustainability through the development of a social protection strategy focused on the most needy, based on improved capacities for collating and analyzing poverty data, and strengthening human capital through education and health programs. After an initial post-war strategy aimed at reconstruction, the Bank's strategy has shifted to assisting Bosnia and Herzegovina in its move towards sustainable growth. In this context, a Second Public Finance Structural Adjustment Credit (PFSAC II) aimed at enhancing inter-entity coordination, priority setting for public spending and improving budget and debt management; and, an Enterprise and Bank Privatization Adjustment Credit (EBPAC) are under implementation; while a social sector adjustment operation focused on labor market reform and social protection is under preparation.

5. The Bank and the IMF have worked in very close partnership since the beginning of the reconstruction effort. Regular exchange of information, joint missions and joint chairmanship of the macroeconomic sector task force in Sarajevo have benefited both institutions.

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[1] Allocation of these loans among the successor republics of the SFRY is based on project benefits located within the internationally recognized territory of each republic. An apportionment formula has been used for unallocated debt, i.e., debt related to balance of payments support where single republics could not be identified as a beneficiary.

[2] The plan involved consolidation of outstanding balances plus arrears into a package of new IBRD loans (the consolidation loan package). The consolidation loan package became approved June 13, 1996 and effective in June 14, 1996, paving the way for regular IDA lending.

STATUS OF BANK GROUP OPERATIONS IN BOSNIA AND HERZEGOVINA

STATEMENT OF BANK LOANS [a/]
(As of June 30, 2000)

Loan No.	Fiscal Year	Borrower	Project	US$ Million (Less Cancellations) Loan	Undisbursed
Loan/Credits/ Grants					
IBRD [b/]					
4038-BOS	1996	Bosnia and Herzegovina	Consolidation Loan A	28.6	0.0
4039-BOS	1996	Bosnia and Herzegovina	Consolidation Loan B	284.9	0.0
4040-BOS	1996	Bosnia and Herzegovina	Consolidation Loan C	307.1	0.0
			Total	**620.6**	**0.0**
			Of which: Repaid	24.9	
			Total Now Held by the Bank	**595.7**	**0.0**
TFBH [c/] **(Under Disbursement)**					
TF-024030	1996	Bosnia and Herzegovina	Emergency Recovery Credit	45.0	0.0
TF-024031	1996	Bosnia and Herzegovina	Emergency Farm Reconstruction	20.0	0.0
TF-024032	1996	Bosnia and Herzegovina	Emergency Water Supply	20.0	0.0
TF-024033	1996	Bosnia and Herzegovina	Emergency Transport	35.0	0.7
TF-024034	1996	Bosnia and Herzegovina	Emergency District Heating	20.0	0.0
TF-024035	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	0.0
TF-024040	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.0
			Total	**150.0**	**0.7**
IDA					
2897-BOS	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.0
2896-BOS	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	0.4
2902-BOS	1997	Bosnia and Herzegovina	Emergency Housing Repair	15.0	0.0
2903-BOS	1997	Bosnia and Herzegovina	Emergency Power Reconstruction	35.6	0.2
2904-BOS	1997	Bosnia and Herzegovina	Emergency Public Works and Employment	10.0	0.4
2905-BOS	1997	Bosnia and Herzegovina	Emergency Landmines Clearance	7.5	0.0
2906-BOS	1997	Bosnia and Herzegovina	Emergency Demobilization and Reintegration	7.5	0.3
2914-BOS	1997	Bosnia and Herzegovina	Transition Assistance Credit	90.0	0.0
N001-BOS	1997	Bosnia and Herzegovina	Emergency Industry Re-Start Guarantee	10.0	0.0
N002-BOS	1997	Bosnia and Herzegovina	Emergency Microenterprise/Local Initiatives	7.0	0.4
N003-BOS	1997	Bosnia and Herzegovina	Essential Hospital Services	15.0	2.2
N032-BOS	1998	Bosnia and Herzegovina	Transport Reconstruction II	39.0	3.9
N035-BOS	1998	Bosnia and Herzegovina	Education Reconstruction II	11.0	0.5
3028-BOS	1998	Bosnia and Herzegovina	Reconstruction Assistance Project	17.0	2.6
3029-BOS	1998	Bosnia and Herzegovina	Emergency Natural Gas	10.0	0.0
3070-BOS	1998	Bosnia and Herzegovina	Emergency Pilot Credit (RS)	5.0	0.3
3071-BOS	1998	Bosnia and Herzegovina	Power II	25.0	17.0
N040-BOS	1998	Bosnia and Herzegovina	Forestry	7.0	6.2
3090-BOS	1998	Bosnia and Herzegovina	Public Finance I (Structural Adjustment)	63.0	0.0
3191-BOS	1999	Bosnia and Herzegovina	Local Development	15.0	14.3
3202-BOS	1999	Bosnia and Herzegovina	Basic Health	10.0	9.4
3262-BOS	1999	Bosnia and Herzegovina	Enterprise and Bank Privatization Project	50.0	24.5
3257-BOS	1999	Bosnia and Herzegovina	Enterprise Export Facility Project	12.0	10.1
3269-BOS	1999	Bosnia and Herzegovina	Pilot Cultural Heritage Project (LIL)	4.0	3.9
3258-BOS	1999	Bosnia and Herzegovina	Second Public Finance (Structural Adjustment)	72.0	43.5
3351-BOS	2000	Bosnia and Herzegovina	Education Development Project III	10.6	14.6
3385-BOS	2000	Bosnia and Herzegovina	Mostar Water and Sanitation	12.0	13.2
3400-BOS	2000	Bosnia and Herzegovina	Emergency Labor Redeployment	15.0	15.0
			Total	**585.2**	**182.9**
			Grand Total	735.2	183.6

a/ The status of these projects is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.
b/ Consolidation Loans A, B, and C were approved on June 13, 1996 and became effective on June 14, 1996.
c/ Trust Fund for Bosnia and Herzegovina.

BOSNIA AND HERZEGOVINA: STATISTICAL ISSUES

1. The Dayton peace treaty, which ended the civil war implicitly gave responsibility for statistical functions to the two Entities (The Federation and RS). However, in response to the need to create a state agency with responsibilities for compiling country-wide statistics in accordance with internationally accepted methodologies, consolidating data produced by the Entity Statistical Institutes, and acting as primary coordinating agency for contacts with international agencies, the Bosnia and Herzegovina Agency for Statistics (BHAS) was established in August 1998. The BHAS started operating in late 1998 with limited budget resources, and EC and bilateral support. Inter-Entity cooperation has improved noticeably since then and progress toward restoring adequate statistical capabilities has been noticeable, especially in data dissemination and the compilation of monetary and balance of payments data. Under donor supervision, a comprehensive program of technical assistance in statistics is under implementation. A Fund resident statistical advisor was assigned to the Central Bank of Bosnia and Herzegovina (CBBH) in May 1999, to provide technical assistance in the development of a wide range of statistics on the basis of the comprehensive review of key macroeconomic statistics conducted in early 1998 by the Fund's Multisector Statistics mission and the recommendations of Fund missions in the areas of monetary and balance of payments statistics. Preparations are under way for introducing a country page for Bosnia and Herzegovina in *International Finance Statistics (IFS).*

A. Real Sector

2. Since the last Article IV discussions, noticeable efforts have been made in both Entities to prepare national accounts estimates based on international standards recommended under the 1993 SNA, although there are large differences in the Entities' relative capabilities. Production and income aggregates at constant prices and compilation of GDP by final demand are still unavailable and informal sector activities are under-recorded. Both statistical offices compile prices and production indices following sound methodological procedures, although the underlying weights for the indices are seriously outdated. Labor statistics are the weakest area for both Institutes, and data on employment, unemployment, and wage rates are based on deficient methodologies.

B. Balance of Payments

3. Information needed for country-wide balance of payment statements is assembled only at the time of EU1 missions using ad hoc basis data from donors or relevant Entity agencies. However, efforts are under way at the CBBH, with Fund technical assistance, to compile comprehensive balance of payments statistics at the Entity and State levels. Intensive technical assistance will be required in the short- to medium- term to compile reliable balance of payments statistics in accordance with international standards. Noticeable progress was achieved in recent months regarding the compilation of trade and debt data by both the Federation and Republika Srpska. Information on flows of services and unrequited

transfers remains deficient. A further technical assistance mission in balance of payments took place in September 1999.

C. Government Finance

4. No government finance statistics for the consolidated general government are compiled at present by either the Entity or State authorities. A new system of classification broadly consistent with the *Government Finance Statistics (GFS)* methodology was implemented by the Federation in 1998 and by the Republika Srpska in 1999. The quality and timeliness of Entity government data has improved significantly, reflecting continued assistance from U.S. Treasury experts. Government expenditure data, however, remain deficient as a result of timing of recording difficulties and the exclusion of expenditures financed from external sources. In addition, the exclusion of arrears from expenditures understates actual government payment commitments and the overall deficit. For lower levels of governments in the Federation (i.e., cantons and municipalities) that account for a major share of general government operations, the classification system is not harmonized with the Federation's and excessive reporting lags still prevail.

D. Monetary Accounts

5. Considerable efforts have been successfully devoted by the Fund during seven missions in 1996-00 to establishing an integrated system of country-wide monetary statistics meeting Fund standards. Currently, the CBBH reports regularly to the Fund monthly data on country-wide as well as regional monetary accounts. However, there is a need to review recent institutional and accounting developments in the financial sector, with a view to updating the data compilation procedures. A monetary and financial statistics mission took place in October 2000 to (1) review the implementation of new chart of accounts for commercial banks in Republika Srpska introduced in early 2000 and ensure accurate classification of the bank accounts in monetary statistics; (2) review the status of the bank privatization program and ensure the appropriate treatment of banks in liquidation in monetary statistics; and (3) review the implementation of recommendations made by the monetary statistics mission of June-July 1999 and further advance the preparatory work for the introduction of a country page for Bosnia and Herzegovina in *International Financial Statistics (IFS).*

Bosnia and Herzegovina: Core Statistical Indicators
(As of November 10, 2000)

	Exchange rates 1/	International Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance 2/	Central Government Balance	GDP	External Debt/ Debt Service
Date of Latest Observation	Nov. 10	Sept. 30, 2000	Sept. 30, 2000	Sept. 30, 2000	Sept. 30, 2000	May 30, 2000	Sept. 30, 2000	March 31, 2000	...	Sept. 30, 2000	1999	May 2000
Date Received	Nov. 10	Oct. 10, 2000	Oct. 10, 2000	Oct. 10, 2000	Oct. 10, 2000	June 2000	Nov. 2000	June 2000	...	Oct. 2000	...	June 2000
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	...	Monthly	Monthly	...	Monthly	Annual	Quarterly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	On mission	Monthly	Quarterly	...	Quarterly	Annual	On mission
Source of Update	CBBH 3/	CBBH 3/	CBBH 3/	CBBH 3/	CBBH 3/	CBBH 3/	Entity Statistics Institutes	Entity Statistics Institute	...	Federation and RS Finance Ministries	Entity Statistics Institutes	Min. of Foreign Trade & Econ. Relations
Mode of Reporting	Website	Report to the Fund	Website and Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	...	Report to the Fund	Report to the Fund	Report to the Fund
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	...	Public	Public	Public
Frequency of Publication	Daily	Quarterly	Quarterly	Quarterly	Quarterly	N/A	Monthly	Quarterly	N/A	N/A	Biannual	N/A

1/ The convertible marka (KM) has been fixed vis-à-vis the DM at KM1 = DM1.
2/ Figures on the current account balance are rough staff estimates based on piecemeal data.
3/ CBBH is the Central Bank of Bosnia and Herzegovina.

Press Release No. 00/82
FOR IMMEDIATE RELEASE
December 22, 2000

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves Extension of Bosnia and Herzegovina's Stand-By Credit and Completes Fourth and Fifth Reviews

The International Monetary Fund's (IMF) Executive Board today approved the extension of Bosnia and Herzegovina's stand-by credit by two months to May 29, 2001. This decision was made in conjunction with the completion of the fourth and fifth reviews of Bosnia and Herzegovina's economic program under the stand-by credit, and makes an amount equivalent to SDR 16.16 million (about US$21 million) available immediately.

The stand-by credit, which was approved May 29, 1998, totals an amount equivalent to SDR 94.42 million (about US$122 million), of which an amount equivalent to SDR 64.3 million (about US$83 million) has already been disbursed.

Following the Executive Board discussion on Bosnia and Herzegovina, Stanley Fischer, First Deputy Managing Director and Acting Chairman said:

"Bosnia and Herzegovina has made welcome progress toward macroeconomic stability and country-wide acceptance of the convertible marka, thanks to the policy of fiscal restraint and strict adherence to the rules of the currency board. The authorities have successfully implemented policies, following fiscal slippages earlier in 2000, to partially reverse the unsustainably-high wage and pension increases.

"Nevertheless, Bosnia and Herzegovina faces serious challenges in the period ahead, and it will be important to continue the stabilization effort into 2001. The overall fiscal stance adopted in the draft 2001 budgets is appropriate, and the Fund's Directors strongly supported the reduction of budgeted military expenditure. They also endorsed the authorities' medium-term goal of increasing capital expenditure while lowering the expenditure-to-GDP ratio, noting that this will take on increasing importance in the years ahead, when foreign-financed reconstruction spending declines, as envisaged.

"With regard to structural reforms, Directors warmly welcomed the major efforts made in the financial sector, labor market, and small-enterprise privatization, and the authorities commitment to increase transparency by bringing all military expenditure on-budget in 2002. However, Directors stressed that the Bosnia and Herzegovina authorities need to maintain the reform momentum in order to create an environment conducive to private sector activity. In particular the authorities need to follow through with the end year closure of the payments bureaus, improve financial management, implement tax and social welfare reform, complete the financial sector reform, and make significant progress with large-scale privatization." Mr. Fischer said.

ANNEX

Background

Bosnia and Herzegovina's economy is continuing its recovery from the devastation of war and overcoming the adverse effects of the Kosovo conflict with the aid of large inflows of foreign assistance. Real GDP growth is estimated to have been 9 percent in 1999 and, despite the adverse effects of a severe drought on agricultural production, is projected to reach about 10 percent in 2000 and about 14 percent in 2001. Industrial production, which fell in 1999 in the Republika Srpska and showed modest growth in the Federation, has been exhibiting a sustained and broad recovery in the first half of 2000. Nevertheless, production in most traditional industries remains at less than half its pre-war level which, combined with weak legal frameworks for the labor and financial markets, keeps unemployment high. Inflation, which was low in both Entities in the first half of 2000, rose in the third quarter, reflecting the severe drought in the region. In the Federation, inflation over the 12-month period ending in September 2000 was only 3.5 percent. In the Republika Srpska, which has a greater share of GDP devoted to agriculture and was therefore more affected by the drought, the 12-month inflation rate rose to 16.9 percent by September 2000.

The government's main objectives under the program remain to move toward fiscal sustainability through tax and expenditure reform and to foster market development.

Fiscal Policy

Faced with substantial financing gaps under policies implemented during the first half of 2000, both Entities' parliaments approved major revisions of the 2000 budgets in the third quarter. The revised budgets aim to maintain macroeconomic stability while supporting the return of refugees. They are consistent with the injunction not to borrow domestically and to limit external borrowing to loans on concessional terms. Expenditures on wages and goods and services were lowered to make room for increased spending on refugees and displaced persons, foreign debt-service transfers to the State (Federation), and transfers to social funds and war invalids (Republika Srpska). Revenue measures included in the revised 2000 budgets focused on enhancing tax enforcement. Those corrective fiscal measures will close the budget gaps for 2000, while allowing for higher than originally budgeted expenditures on refugees and displaced persons.

Furthermore, the authorities have made some progress in the area of fiscal transparency. They also intensified their efforts to reform the sales tax system and are planning to rationalize operations of the pension funds to bring pension entitlements in line with available resources. In the 2001 budgets, the authorities will focus their efforts on shifting the composition of overall spending away from recurrent and nonproductive expenditure.

Monetary Policy

The evolution of monetary aggregates in 1999-2000 continued to be governed by demand for foreign currencies, in line with currency board rules. Monetary developments in 1999 and the first nine months of 2000 therefore reflected the increasing acceptance of the convertible marka as well as continued slow growth of private sector credit. In 1999, a portfolio shift into convertible marka contributed to a 40 percent growth in broad money and a US$264 million increase in gross reserves. The shift from foreign to domestic currencies has since moderated, and gross reserve growth in 2000 is projected to slow to US$40 million. With continued modest growth in net domestic assets, broad money is expected to increase by only 13 percent by end-year.

Structural Policy

Significant progress was made during the first half of 2000, particularly in overhauling the payments system and strengthening bank supervision, while enterprise privatization gathered momentum. However, reform in some areas continues to be slow. The authorities have intensified their efforts to accelerate enterprise privatization, but the technical complexities involved have slowed progress. Despite high unemployment, major strides have been made in labor market reform. In this regard, the authorities have begun the reform of the social protection system in order to provide social safety net for workers who are vulnerable to retrenchments that will follow the privatization of state-owned enterprises.

In the area of banking, much progress has been made in strengthening bank regulation and supervision. Preparations to close the payments bureaus and transfer their clearing functions to commercial banks are well advanced. However, progress in privatizing or liquidating state-owned banks has been patchy. The authorities also continue to advance in implementing their trade reform program.

Bosnia and Herzegovina joined the IMF on December 14, 1992.The member's quota[1] is SDR 169.1 million (about US$218 million). Bosnia and Herzegovina's outstanding use of IMF credits totals SDR 68.1 million (about US$88million).

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Bosnia and Herzegovina: Main Economic and Financial Indicators, 1996-2001 1/

	1996	1997	1998	1999 Prel.	2000 Prog.	2001 Proj.
Population (millions)	...	...	3.7	...	...	...
Nominal GDP (millions of KM)						
BiH	4125	6116	7,141	8,043	9,075	10,609
Federation	3049	4748	5,407	5,833	6,434	7,465
Republika Srpska	1076	1368	1,734	2,210	2,641	3,144
Industrial production (percent change) 2/						
Federation	88	36	24	11	157/	...
Republika Srpska	39	27	23	2	127/	...
Federation employment (end-period, thousands) 3/	244	288	336	356	3607/	...
Wages (KM/month) 4/						
Federation	296	493	524	551	5977/	...
Republika Srpska 5/	85	138	...	...	3927/	...
			(Percent change)			
Real GDP (annual average)	86	40	13	9	10	14
CPI (twelve-month average)						
Federation (In KM terms)	-25	14	5	0	27/	2
Republika Srpska (In YUD terms)	66	3	38	...	...	...
Republika Srpska (DM/KM-based index) 6/	17	-7	2	14	107/	4
			(Change in percent of opening broad money)			
Money and credit 8/						
Broad money	96	52	31	40	13	17
Foreign assets (net)	60	-11	1	38	-3	6
Domestic assets (net)	36	63	30	2	16	11
			(In percent of GDP)			
Fiscal balances						
Federation						
Revenue	10	13	13	12	13	12
Expenditure	13	14	14	14	16	13
Balance 9/	-3	-1	-2	-1	-3	-2
Republika Srpska 10/						
Revenue	24	15	21	30	26	23
Expenditure	24	15	26	35	30	26
Balance 9/	0	0	-5	-5	-4	-3

	(In millions of U.S. dollars; unless otherwise indicated)					
External current account balance 11/ 12/	-1,306	-1,482	-986	-1,058	-942	-1,022
Exports 12/	336	575	697	649	732	877
Imports 12/	-1,882	-2,333	-2,656	-2,502	-2,338	-2,495
CBBH gross reserves 13/						
In millions of U.S. dollars	235	80	175	455	488	538
In months of merchandise imports	1.2	0.4	0.7	2.0	2.3	2.4
External debt 14/						
(In millions of U.S. dollars)	3,620	4,076	2,985	3,095	2,632	2,763
(In percent of GDP)	132	119	74	71	62	61
Short-term debt	...	...	...	...	...	...
Debt service (in percent of exports of goods and nonfactor services)	53	16	-12	-12	-11	-12
Memorandum items:						
Exchange rates (period average)						
Convertible marka (KM) per deutsche mark	...	1.0	1.0	1.0	1.0	1.0
BiH dinar per deutsche mark 15/	100	100	...	...	...	...
FR Yugoslav dinar per deutsche mark 16/	3.5	3.9	6.4	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Data refer to the entire country, unless otherwise indicated. Intrayear data refer to flows cumulative in the year unless otherwise noted.
2/ Annual production, percent change over previous year. Figure for 1995 refers to the entire country.
3/ Excludes people formally employed but not working ("waiting"). Data for 1997 and 1998 include military personnel.
4/ Data refer to average of monthly gross wages paid in the year (first eleven months of 1999), not to average earnings in the period; only firms paying wages in a particular month are included in the data.
5/ Until end-1997 FR Yugoslav dinar (YUD) wages converted into DM using the parallel market exchange rate described in footnote 16. Thereafter, reliable estimates are not available owing to problems with exchange rate conversion.
6/ Until mid-1998 prices were observed in YUD and converted into DM/KM at exchange rates described in footnote 16.
7/ Data as of June 2000; industrial growth in the first six months of 2000 relative to same period a year before; employment and wages for the Federation as of May 2000; 12-month inflation as of July 2000.
8/ Country-wide monetary aggregates. In percent of beginning of year broad money stock.
9/ Before grants.
10/ Excludes municipal government operations. Data for 1996 exclude military expenditures financed by external grants.
11/ Excluding official transfers.
12/ Data for 1994-99 are rough estimates for the whole territory of Bosnia and Herzegovina.
13/ Excluding earmarked funds and blocked accounts as well as foreign exchange held by Payments Bureaus.
14/ Projected external debt and debt service for 1998 exclude debt relief.
15/ Official rate. Parallel rate not collected by the Central Bank of BiH. The BH dinar was replaced by the convertible marka (KM) in mid-1998.
16/ YUD/DM exchange rate in the parallel market in the Belgrade, as reported by the National Bank of FRY through end-1998.