

**Bosnia and Herzegovina: 2001 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bosnia and Herzegovina**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV Consultation with Bosnia and Herzegovina, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV Consultation, prepared by a staff team of the IMF, following discussions that ended on **December 14, 2001** with the officials of Bosnia and Herzegovina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 11, 2002.** 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 staff supplement of **February 22, 2002** updating information on recent economic developments;
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its February 25, 2002 discussion** of the staff report that concluded the Article IV consultation;
- a statement by the Executive Director for Bosnia and Herzegovina.

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**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

**Staff Report for the 2001 Article IV Consultation**

Prepared by the Staff Representatives for the 2001 Consultation  
with Bosnia and Herzegovina

Approved by Carlo Cottarelli and G. Russell Kincaid

February 11, 2002

The Article IV discussions that took place during May 31–June 15, July 16–26, October 3–18, and December 10–14 2001, were combined with discussions of a program to be supported by a second Stand-By Arrangement (SBA). The discussions were conducted in Sarajevo and Banja Luka by a staff team consisting of Mr. Rozwadowski (head), Mr. Lazar, Mr. McHugh, Mr. Oestreicher (all EU1), Mr. Stern (PDR), Ms. Ligthart, Ms. Allard and Mr. Krelove (all FAD). Mr. de Schetzen (Resident Representative), Mr. Last (FAD panel of experts), Ms. Selimovic-Mehmedbasic, and Ms. Milic (local advisors), assisted the mission. Meetings were held with the Governor of the Central Bank, Prime Ministers, Ministers of Finance and other key officials.

The Executive Board completed the sixth and seventh reviews under the Stand-By Arrangement on May 25, 2001. Executive Directors observed that although Bosnia and Herzegovina had made considerable progress towards macroeconomic stability, and structural reform was proceeding, real output remained approximately half of the pre-war level and unemployment was still high. Directors added that strict implementation of the currency board arrangement, the establishment of modern treasuries to strengthen budgetary control, strengthened tax collection and avoidance of arrears were prerequisites for macroeconomic stability and sustained growth. The transition to a market oriented economy and further structural reforms to attract foreign investment were also essential. These reforms included privatizing large state-owned enterprises and banks, improving bank supervision, and adopting measures to establish a stable and transparent business environment.

Contents

	Page
Executive Summary .....	5
I. Background.....	6
II. Recent Economic Developments .....	7
A. Macroeconomic Developments .....	7
B. Fiscal Developments in 2001.....	9
C. Monetary and Financial Sector Trends and Policies.....	12
III. Discussions with the Authorities .....	12
A. Medium-Term Scenario.....	13
B. Budget Discussions.....	14
C. Medium-Term Fiscal Issues.....	17
D. Structural Policies .....	18
E. Financial Sector Issues.....	19
F. Other Issues.....	20
IV. Staff Appraisal .....	20
Text Boxes	
1. Relations with External Creditors.....	9
2. Brčko Special District.....	11
Figures	
1. Real GDP Growth, 1998–2001 .....	7
2. Average Inflation By Entity, 1997–2001.....	7
3. Nominal Gross Wages by Entity (KMs), 1997–2001 .....	8
4. Indicators of Competitiveness, 1998–2001.....	23
5. Selected Financial and Economic Indicators, 1996–2001 .....	24
Tables	
1. Main Economic and Financial Indicators, 1997–2002 .....	25
2. Consolidated General Government, 1998–2001.....	26
3. Federation Fiscal Operations, 1997–2002 .....	27
4A. Republika Srpska Fiscal Operations, 1997–2001 .....	28
4B. Republika Srpska Fiscal Operations, 2001–2002 .....	29
5. State Fiscal Operations, 1997–2002 .....	30
6. Consolidated Central Government, 1998–2002.....	31
7. Balance of Payments 1998–2006.....	32
8. External Financing Requirements and Possible Sources of Financing, 1998–2002.....	33
9. External Debt at end-2000 and Debt Service 2001–2005.....	34
10. Monetary Survey, 1997–2001.....	35

11. Medium-Term Scenarios, 2000–2006 .....	36
12. Vulnerability Indicators, 2000-2001 .....	37

Appendices

I. Relations with the Fund .....	38
II. Relations with the World Bank.....	41
III. Statistical Issues .....	45

ACRONYMS

BiH	Bosnia and Herzegovina
CAFAO	Customs and Fiscal Assistance Organization
CBBiH	Central Bank of Bosnia and Herzegovina
EC	European Commission
EFF	Extended Fund Facility
EU	European Union
LAGP	International Advisory Group for Privatization
MIGA	Multilateral Investment Guarantee Agency
OHR	Office of the High Representative
PBS	Privredna Banka Sarajevo
PEIR	Public Expenditure and Institutional Review
PRGF	Poverty Reduction and Growth Facility
RS	Republika Srpska
SFRY	Socialist Federal Republic of Yugoslavia
SSE	small-scale enterprises
TSA	treasury single account
VAT	value added tax
WTO	World Trade Organization

## EXECUTIVE SUMMARY

**In recent years, Bosnia and Herzegovina has achieved a number of important successes:** ethnic tensions have been reduced, much of the physical infrastructure destroyed during the war has been replaced, the currency board arrangement continues to work well, and several important structural reforms have been introduced. Nonetheless, the post-war economic rebound is drawing to a close. The challenge is how to make the transition from post-conflict aid-dependence to durable growth based upon a dynamic private sector.

**As foreign aid flows have declined, the post-war reconstruction boom has subsided.** After several years in double-digits, the growth rate slipped to 5½–6 percent in 2000–01. Reflecting a sharp reduction in aid-financed imports the external current account deficit shrank to 17 percent of GDP in 2001, a cumulative 7 percent drop with respect to 1999. Although the current account continues to be largely financed by non-debt creating flows, primarily grants. Moreover, due to a debt cancellation operation, the external debt position improved, with the external public debt ratio declining to 54 percent of GDP at end 2001.

**The currency board arrangement has continued to deliver low inflation.** Even before the end-year abandonment of deutsche marks in the run-up to the introduction of euro notes, the demand for local currency vis-à-vis foreign currency increased significantly. Through the year the gross foreign assets of the central bank more than doubled.

**The new Entity governments, elected in late 2000, made a good start towards reversing the fiscal imbalances that had built up in previous years.** For the first time in four years, the Entities reduced the stock of budgetary arrears. The authorities also harmonized indirect tax rates, and introduced new treasury systems.

**Much still needs to be done to secure medium-term fiscal sustainability:** the sales tax should be replaced by a VAT; expensive entitlement programs need to be focused on the most vulnerable; reforms of the treasuries and tax administrations need to be brought to conclusion; and important issues in fiscal federalism need to be addressed, including by putting the finances of the State on a sound basis.

**BiH needs also to complete the privatization of strategic enterprises and strengthen the business environment.** Private sector development has lagged, owing in part to complex and burdensome administrative structures, weaknesses in the legislative environment, and inefficient courts and legal institutions. Reforms in these areas are essential if the private sector is to step into the leading role in the BiH economy.

**Discussions on a new stand-by arrangement are on-going.** The authorities hope that a new arrangement will provide a framework for further fiscal and structural reform, serve as a catalyst for continued external financing, and create a track record in anticipation of a medium-term program supported by a PRGF and/or an EFF.

## I. BACKGROUND

1. **Six years after the Dayton Accords, the challenge facing Bosnia and Herzegovina is to make the transition from a post-conflict rebound, spurred by massive aid inflows, to durable growth spurred by a dynamic private sector.** A lot has already been achieved: ethnic tensions have been reduced; much of the physical infrastructure has been rebuilt; the currency board arrangement has brought macroeconomic stability. The next steps are to lock in the macroeconomic stabilization by securing sustainable fiscal adjustment, and to create a business friendly environment by further structural reforms.

2. **The governments that took power in early 2001 have made progress in macroeconomic stabilization and structural reforms.**<sup>1</sup> Nonetheless, their freedom of action is constrained by their weak positions in parliament. In the Federation, the Alliance for Change is a coalition with a razor-thin majority in parliament, while in the Republika Srpska (RS) the ruling coalition relies on the support of nationalist parties to secure a majority in parliament. In addition, the two-year electoral cycle makes for a short policy horizon: the next elections are scheduled for October 2002. The ethnic factor still interferes with policy-making.

3. **BiH's first stand-by arrangement expired shortly after the completion, on May 25, 2001, of the sixth and seventh reviews.** A prior action for these reviews was misreported; on November 2, 2001, in light of the corrective measures taken by the authorities, the Executive Board granted a waiver which brought the purchases under the sixth and seventh reviews into compliance.

4. **Article IV discussions overlapped with discussions of a possible program to be supported by a stand-by arrangement.** The authorities hope that a second SBA-supported program will provide a framework for continued fiscal and structural reforms, serve as a catalyst for continued external finance, and help create a track record to allow an eventual move to a medium-term program supported by the PRGF and/or EFF. Program discussions have not yet been concluded because the RS authorities have not committed to keep the harmonized sales tax in place, potentially undermining a key reform under the previous program, and because the draft 2002 budget of the Federation is based on revenue estimates that the staff views as unrealistic and expenditure measures that have not yet been defined in sufficient detail. Discussions of these issues are ongoing. Agreement will also need to be reached on the next phases of the reform of treasuries and tax administration as well as other structural reforms.

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<sup>1</sup> The 1995 Dayton Agreements provide for four levels of government. At the highest level is the State of Bosnia and Herzegovina (hereinafter the State). At the next level there are two constituent political Entities, the Federation of Bosnia and Herzegovina (Federation) and the Republika Srpska (RS). The Federation is divided into ten cantons which in turn are divided into municipalities. In RS there are no cantons, with local government being assumed directly by municipalities.

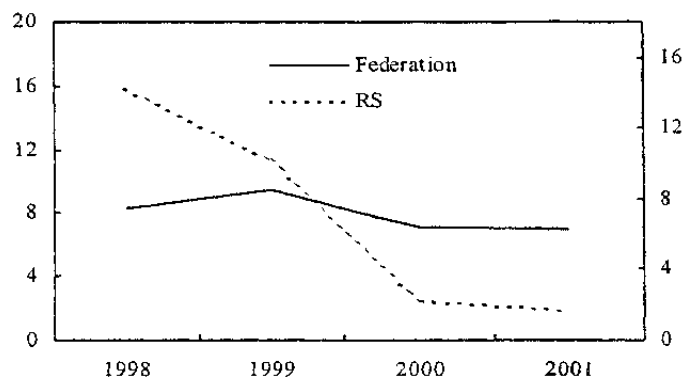
## II. RECENT ECONOMIC DEVELOPMENTS

### A. Macroeconomic Developments

5. **Real GDP growth slowed sharply in both Entities in 2000–2001 (Figure 1).** For the country as a whole, the staff estimates that real GDP growth decelerated from 10 percent in 1999 to 6 percent in 2000 and 5½ percent in 2001. This slowdown appears to mark the end

of the post-war economic rebound even though measured GDP is still little more than half its pre-war level. In 2000, the slowdown was exacerbated by a severe drought, which affected hydroelectricity generation and agricultural output. In 2001, agricultural production revived but growth slowed in both Entities. The RS suffered a more pronounced slowdown than the Federation—a development confirmed by industrial production data, which strengthened in the Federation but declined sharply in the RS (Figure 1 and Table 1).

Figure 1. Real GDP Growth, 1998-2001



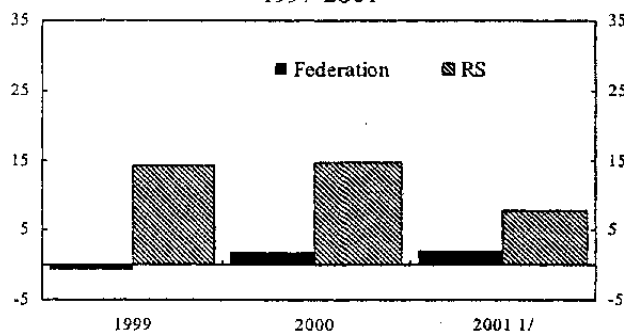
Sources: Entity statistics agencies; and IMF staff estimates.

6. **Official statistics on production and employment are unreliable (Appendix III) and, owing to the pervasiveness of the gray economy, may underestimate the level of output and employment.** Available data put the unemployment rate at about 40 percent but a large body of anecdotal information suggests that this figure substantially overstates the true unemployment rate. High social contributions and taxes are strong incentives to underreport employment and wages: in many establishments more than half the employees are in the gray economy.

7. **The inflation rates in the two Entities are converging at a low level.** In the Federation, inflation has been well below 2 percent for the last three years, while in the RS, inflation has steadily decelerated, reaching single digits in 2001 (Figure 2). Overall countrywide inflation rate declined from 5½ percent in 2000 to 3 percent in 2001, undoubtedly reflecting the stabilizing effect of the currency board.

8. **A factor in the narrowing inflation differential and convergence of price levels is increased economic integration between the Entities.** In 1998, prices for basic foodstuffs were 20 percent higher in the Federation than in the RS. By 2001, the

Figure 2. Average Inflation by Entity 1997-2001



Source: BiH authorities.  
1/ Through September 2001.



difference had been nearly eliminated. Over the same period, the nominal gross wage differential declined from 98 percent to 50 percent (Figure 3). Other evidence of closer integration is the widespread use of the KM in the RS, where the currency was initially accepted only slowly.

**9. Real effective exchange rates for 1998–2001 indicate a modest gain in competitiveness in the Federation and a more pronounced loss of competitiveness in RS.**

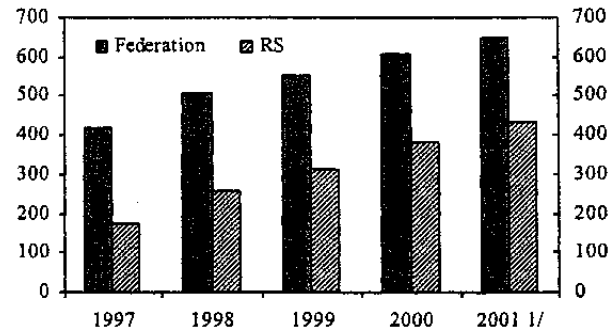
These trends are confirmed by wage data: during the same period, average gross wages, expressed in U.S. dollars, declined in the Federation and edged up in the RS. In 2001, dollar wages in the Federation were about 20 percent lower than in the advanced transition countries. The loss of competitiveness in the RS needs to be understood in light of the exceptionally low prices and wages at the beginning of the period and the catch-up in prices and wages described above. Indeed, even after significant rises, dollar wages in RS in 2001 were still 50 percent lower than in the Federation and were in-between those in Latvia and in Romania.

**10. Exports grew strongly and aid-related imports contracted but there are conflicting data on overall imports and hence on the current account deficit in 2000-01.**

Following the end of the Kosovo war, export growth picked up strongly, from a low base, and strengthened further in 2001 as the free trade agreements with neighboring countries came into effect and the European Union granted free entry of goods (see below). Import figures provided by the authorities show a significant decline relative to GDP, while partner country data suggest continued buoyancy, in spite of reduced imports for donor-financed reconstruction. Estimates based on the authorities' figures suggest that the current account deficit (excluding transfers) declined to 18 percent of GDP in 2001 (Table 7) while partner country data implies that the current account deficit was roughly unchanged at 24 to 25 percent of GDP. By either measure the current account deficit remained large. It is likely, however, that the deficit is overstated, possibly by a large amount, owing to unreported transactions.<sup>2</sup>

**11. The external public debt ratio declined in 2001, owing to debt cancellation (Box1).** The stock of public sector external debt at the end of 2001 was estimated at

Figure 3. Nominal Gross Wages by Entity (KMs) 1997-2001



Sources: BiH authorities; and IMF staff estimates.  
i/ Through September 2001.

<sup>2</sup> A significant part of "other capital" in the balance of payments may be misclassified current account transactions. Trade data is known to be weak: import data is customs-based and reflects under-invoicing while exports are based on a survey with a very low response rate. Household remittances and external grants are estimates based on incomplete information.

56 percent of BiH GDP. At end-2000 the largest creditor was the World Bank, which accounted for 42 percent of the debt stock (Table 9). Another 10 percent was owed to other international financial institutions including the IMF. The remainder was owed to Paris Club creditors (18 percent of the total), London Club creditors (4 percent) and "other" creditors (27 percent). External debt service, which is almost all on concessional terms, remains manageable, but it is projected to rise significantly in the next few years (Table 9).

### **Box 1. Relations with External Creditors**

#### **Paris Club**

The only Paris Club issue still outstanding is the signing of the bilateral agreement with Japan. The interest rate applied to debt service and the amount of penalty interest are both still under negotiation. It is expected that negotiations will be completed, and debt service resumed, in 2002.

#### **London Club**

The London Club agreement covers US\$262 million of commercial bank debt. The agreement stipulates that if BiH's per capita GDP reaches US\$2,800 by 2006, an additional US\$436 million in commercial debt will be rescheduled; otherwise, negotiations will begin for a debt write-off in 2007.

#### **Other Debt**

This consists of debt to former COMECON countries, mainly former Czechoslovakia, as well as trade credit and unassigned debt inherited from the former SFRY. The amount outstanding was estimated to be US\$946 million at end-2000. The liability for "other debts" was allocated among the successor states on the basis of the geographical location of the end-user. A rescheduling or cancellation of such debt was to have taken place in 2000. By end-2000, only around US\$350 million had been cancelled. To date, the debt owed by the Federation has been identified and is under discussion. The amount owed by the RS is estimated at US\$300 million. Many of these credits were extended by now non-existent state-owned enterprises in former COMECON countries, which complicates their settlement.

## **B. Fiscal Developments in 2001**

12. **On the basis of projections made at the end of 2001, the general government deficit (on a commitment basis) declined from 20 percent of GDP in 2000 to 13 percent in 2001 (Table 2).** Revenues are estimated to have declined by 2 ½ percentage points of GDP (owing mainly to lower sales tax rates), but expenditure commitments are estimated to have dropped by as much as 11 percentage points, through belt-tightening by the Federation cantons and the RS government, a scale-back of pension entitlements, and a decline in (foreign financed) spending on reconstruction. A definitive assessment of the 2001 outcome

is not yet possible, pending further information on budget execution by the Entities. Preliminary data received since December suggest that a significant part of the projected adjustment has in fact taken place but that the cantons, whose budgets were put under considerable strain in 2001, have accumulated arrears equivalent to 1-1½ percent of GDP.<sup>3</sup>

**13. The cut-back in expenditures in 2001 was intended to halt the accumulation of arrears—which had reached 4 percent of GDP in 2000—and to free up resources to start repaying arrears accumulated in previous years.** In the Entities, large amounts of unfinanced and unbudgeted spending—counter to understandings under the Fund program—had led to a sharp increase in budgetary arrears in 2000.<sup>4</sup> At the same time, pension arrears had swelled because benefit entitlements far exceeded the resources of the pension funds. The governments that took office in 2001 were determined to reverse this trend by implementing their budgets as passed and by enforcing laws which adjust pension entitlements to the amount of cash available. In addition, the RS budget and the Federation revised budget set aside resources to clear arrears equivalent to more than 1½ percent of BiH GDP.

**14. The commitment to clear arrears was underpinned by strengthened control over budget execution in the Entities.** The Ministries of Finance began to control budgetary commitments. In the Federation, the practice of implementing the budget on ethnic lines was ended (except in the military), while the RS authorities stopped using tax offsets and operations of the Goods Reserve Directorate to circumvent budget ceilings. Finally, the new Supreme Audit Institutions, which began operation in 2001, assessed the stocks of arrears and provided an effective basis for improved parliamentary oversight of budget execution.

**15. In spite of generally tight spending policies, tensions on the spending side remained:** (i) both Entity authorities found it difficult to resist political pressures for increased wages; (ii) large unbudgeted commitments (notably for the State Border Service) distorted the execution of the State budget; and (iii) pension entitlements, which are a major indirect threat to the Entity budgets, were brought down only with difficulty.<sup>5</sup>

**16. In addition, as in previous years, the seasonality of tax revenues and delays in policy-linked disbursements by international financial institutions further complicated**

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<sup>3</sup> The cuts in sales tax and wage withholding tax in the Federation fell entirely on cantons and municipalities.

<sup>4</sup> See EBS/01/71 (10/5/01) for further information on the accumulation of arrears in 2000. The LOI (EBS/98/76, 4/27/98) included a commitment not to accumulate further arrears but there was no quantitative performance criterion because of difficulties in defining and monitoring arrears.

<sup>5</sup> In order to prevent pension payments from falling below a target threshold the Federation government provided the Sarajevo Pension Fund with supplementary budgetary resources.

**the execution of the Entity budgets.** For the most part, adjustments were made on the expenditure side. The RS authorities scaled back expenditures in some areas and cleared fewer expenditure arrears than budgeted. In the Federation, a resource shortfall relative to the amounts in the revised budget was covered by clearing fewer pension arrears than planned.

17. **Next to improved budgetary discipline, the most significant fiscal development in 2001 was a sales tax reform that completed the unification of indirect taxes across the Entities.**<sup>6</sup> The sales tax was simplified, virtually all exemptions were eliminated, and effective tax rates were lowered from an excessively high level. The two Entity sales taxes now have a simple rate structure (20 percent and 10 percent), nearly identical bases, and a small number of exemptions. The reform was put in question in late 2001 when discussions were reopened with proposals for deeper cuts in tax rates, changes in the point of collection, and changes in excise taxation. Progress towards full harmonization was also marred by the Entities' double imposition of excise taxes on inter-Entity trade and delays by the RS authorities in implementing a mechanism that allocates excise tax revenues to the Entity of final consumption.<sup>7</sup> Finally, divergences in customs valuation and differences in taxation between the Entities and Brčko District have been a source of friction (Box 2).

#### **Box 2. Brčko Special District**

Brčko District (90,000 inhabitants), a small special administrative unit under international supervision, has become a focal point of discontent for the Entity authorities. One issue stems from the fact that a significant amount of imports clears customs in Brčko, channeling revenues to the Brčko budget. Allegations of customs under-valuation in Brčko are widespread, and increase the incentive to route trade through the District. The Brčko customs authorities assert that the high customs revenues are due to the District's location at a transport node and the efficient District customs administration. Other areas of dispute include the District's unregulated and untaxed "Arizona" trading area (the District authorities are gradually bringing "Arizona" into the tax net), privatization receipts and pension contributions.

Regarding sales tax reforms, the Brčko District authorities have agreed in principle to full harmonization but have put their reform on hold, pending finalization of the Entity sales taxes.

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<sup>6</sup> Customs and excise taxes were already harmonized.

<sup>7</sup> The framework for the excise allocation mechanism, agreed with the World Bank, has now been enacted in the Federation and approved by decree in the RS. Preparations are under way for the implementation of the mechanism.

### C. Monetary and Financial Sector Trends and Policies

18. **At the beginning of 2001 BiH's payments bureaus (government-run interbank clearing systems inherited from the former SFRY) were shut down and replaced by a commercial bank-based clearing system, the first in any successor state of the former SFRY.** Teething problems were quickly overcome and the system is now functioning well, though transactions fees are higher than had been anticipated and role of the payments bureaus in compiling statistics has not been replicated.

19. **The gross foreign assets of the central bank increased further in 2001, as residents continued to move their cash holdings from deutsche marks into KM.** This trend, which reflects growing confidence in the KM, was mirrored and reinforced by a gradually diminishing role of the deutsche mark as a medium of exchange. The shift from deutsche mark cash into KM cash accelerated strongly late in the year in the run-up to the introduction of euro notes; consequently, gross reserves more than doubled from June to December.<sup>8</sup> It is too early to say whether the shift into KM will continue in 2002 or be partly reversed. Since the euro is not one-to-one against the KM, however, it is unlikely to have as important a role in BiH as the deutsche mark once did.

20. **The development of private sector banking is well advanced in the Federation, but still at an early stage in the RS.** Since 1999, foreign banks have opened branches in the Federation and become dominant in the markets for deposits and consumer loans. In addition, the privatization of large state-owned banks is moving ahead. An agreement on the privatization of PBS, the largest banking group in the Federation, was signed in December 2001. After the PBS privatization is completed, an estimated 90 percent of the Federation banking sector (by assets) will be privately held, with 70 percent foreign-owned. In the RS, the financial condition of the three largest state-owned banks deteriorated in 2000 and 2001 owing in part to the poor performance of loans to the public sector. Two of the three became illiquid in September 2001 and were suspended by the RS Banking Agency. The authorities have since been working with the World Bank on a plan to privatize or liquidate these banks.

### III. DISCUSSIONS WITH THE AUTHORITIES

21. **The authorities see rapid economic growth as the key to their fundamental goals of reducing poverty and unemployment, but delays in reforms to improve the business environment have put growth at risk just when the aid-driven post-war economic boom is coming to a close.** There are significant administrative and legal hurdles to starting a business in BiH. New businesses find it difficult to navigate the legal and administrative systems of the State, two Entities, and ten cantons (plus Brčko District). The fragmented regulatory system offers incentives for corruption by government officials. The courts and other institutions do not have sufficient resources to apply commercial law quickly and

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<sup>8</sup> There was also a modest shift from KM cash to euro bank deposits in the last quarter of 2001.

efficiently. Finally, the market for land does not function well, which discourages green field investment and prevents enterprises from using property as collateral for loans.

22. **The growth outlook is also undermined by demands on public resources which, if not contained, may threaten macroeconomic stability.**<sup>9</sup> New and growing State institutions are absorbing resources but offsetting spending cuts are not always made at lower levels of government. Foreign aid for reconstruction is declining but the public sector has not yet taken over development efforts. The Entities are burdened with multiple financial obligations, including frozen foreign currency deposits, domestic expenditure arrears and war debts, but they have not yet decided how much they can afford to pay. Finally, large entitlements to pensioners and veterans have not yet been scaled back in a definitive manner. Public debt (including domestic arrears) is estimated at 62 percent of GDP at end-2001; in addition, frozen foreign currency deposits are equivalent to about 30 percent of GDP.

23. **BiH's decentralized governmental structure and the sometimes divergent views of Entity governments on the role of State institutions have also been obstacles to reform.** The difference of views has delayed the introduction of a value added tax (VAT) and the identification of a reliable source of revenues for the State budget. It also limits the scope for creating country-wide regulatory and supervisory agencies.

24. **Against this background, discussions focused on the need to speed up structural reforms that enhance the development of the private sector, put government finances on a sounder footing, and allow the attainment of sustainable high rates of growth over the medium term.**

#### A. Medium-Term Scenario

25. **Staff and the authorities agreed that private investment would have to increase strongly in order to keep real GDP growth at 5 or 6 percent per year.** In turn, the investment take-off would require both a stable macroeconomic environment and far-reaching structural reforms to remove impediments to private sector activity. On this basis, the staff prepared an illustrative medium-term scenario covering 2002–06 (Table 11). In this “reform” scenario, reduced foreign-financed reconstruction is replaced by strongly growing private investment and domestically financed government investment. The external current account deficit shrinks significantly owing to a rise in domestic savings, roughly equally divided between the public and private sectors. Increased competitiveness of domestic producers, improved access to the EU markets, the completion of the Balkan free-trade area, and various structural reforms enhance profitability and hence corporate savings. The “reform” scenario envisions a modest reduction in the public debt ratio during the period. The authorities largely agreed with the overall framework but worried that domestic savings could not rise so sharply and felt therefore that BiH would need a larger inflow of foreign

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<sup>9</sup> The World Bank is undertaking a Public Expenditure and Institutional Review which will set out reforms needed to rationalize and prioritize expenditure policies.

savings. The staff preferred conservative projections for official flows and noted that private flows would depend on the progress in improving the business environment.

26. **The “reform” scenario underscores the need for further fiscal adjustment.** The government will have to mobilize domestic resources to replace, in part, aid flows that have in the past financed reconstruction and infrastructure investment. Given the already high public debt ratio, however, BiH’s capacity to borrow commercially during the projection period will be severely limited.<sup>10</sup> The needed financial resources will therefore have to be released by restraining current spending. At the same time, tax reforms will be necessary to ensure high levels of revenue on a sustained basis.

27. **An alternative, “status quo”, scenario illustrates how delays in reform could reduce the growth rate and lead to an unsustainable fiscal position (Table 11).** In the “status quo” scenario it is assumed that private investment remains sluggish owing to inadequate measures to improve the business environment. At the same time public investment declines since falling aid-financed investment is not replaced by domestically funded investment. Consequently the growth rate would be lower than in the reform scenario and the public debt ratio would rise unsustainably.

#### **B. Budget Discussions<sup>11</sup>**

28. **Budgetary policy in BiH is made against the backdrop of unresolved issues in taxation, including the distribution of revenues among the levels of government, and changes in the structure of spending.** The creation of new State institutions (such as the State Border Service) is causing a rapid expansion of spending but the State does not yet have a reliable source of own revenues and thus remains dependent on grants from donors and transfers from the Entities. The finances of the State will remain fragile until the size of the State budget has stabilized and a reliable source of own revenue has been secured. The Entity budgets are burdened by high spending on defense and veterans’ benefits. They are coming under further pressure from rising administrative transfers to the State and rising external debt service and will eventually need to take on a larger part of infrastructure investment and maintenance. The Entity governments therefore need to resist expenditure pressures; they must also improve tax administration and put a VAT in place in order to strengthen their revenue base. They also need to take difficult decisions on the clearance of arrears. Finally, the Federation cantons and municipalities, which came under pressure in 2001 from a mid-year cut in tax rates, will feel the full year effect of those cuts this year. The cantons will thus need to implement difficult spending measures.

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<sup>10</sup> This conclusion is also supported by the World Bank’s recent creditworthiness report.

<sup>11</sup> This section is based on draft budgets approved by the Entity and State governments in December 2001 and January 2002 but not yet enacted.

29. **The three draft 2002 budgets currently under discussion maintain a tight fiscal stance (Tables 3–6).** The budgets bring a slight reduction in the debt ratio but they do not make the needed start in shifting budgetary resources from recurrent spending to investment. Taken together, the 2002 budgets of the State and the Entities—the consolidated central government—show a deficit of 0.9 percent of GDP on a commitment basis compared with 1.3 percent in 2001.<sup>12</sup> The three budget deficits are roughly equal in size; each is equivalent to about 0.3 percentage points of BIH GDP.

30. **As in 2001, the tighter fiscal stance reflects a decision not to borrow from private financial markets and the resolve to repay expenditure arrears.** External financing is thus limited to borrowing from selected international financial institutions, while domestic financing is limited to privatization receipts. The authorities explored the possibility of issuing government bonds to finance the budget but it was agreed that commercial borrowing should wait until modern treasuries were functioning and a broader debt strategy had been agreed.

31. **Staff noted that revenue projections in the Federation 2002 budget were optimistic, raising concerns that the deficit target may be exceeded.** The budget assumes that indirect tax revenues will rise twice as fast as nominal GDP (Table 3).<sup>13</sup> The staff urged the Federation authorities to project revenues more conservatively, as in the past, to create a safety margin for errors in forecasting. The authorities preferred to base their budgets on high, possibly unrealistic, revenue estimates. In the staff's view this approach is risky, particularly in an election year and in light of a past history of accumulating arrears.

32. **On the expenditure side, the draft Federation budget incorporates a 40 percent demobilization of the army but also sets up costly and ill-advised incentives for employment, small enterprises, and agriculture.** The reform of the military, which has not yet been fully articulated by the authorities, would have its main financial impact in future years since part of the wage savings would be spent on severance packages. As regards the proposed incentive schemes, the staff viewed them as too costly (1½ percent of Federation GDP), and noted that the proposed subsidies and tax credits are unlikely to have a durable effect on employment and will therefore prove difficult to reverse in the future. The staff urged the authorities to consider reallocating these resources to finance severance packages for military demobilization or to increasing the amount of arrears clearance. In other areas, the draft budget freezes the government salary scale but the wage bill rises owing to larger employment. The budgeted increase in capital expenditure is modest and is viewed by the staff as insufficient.

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<sup>12</sup> Figures on the consolidated central government, are not comparable with the figures on the consolidated general government (Table 2) since the latter include cantons, extrabudgetary funds and foreign financed investment.

<sup>13</sup> Discussions in both Entities were based on projected GDP growth of 5 percent and inflation of 2 percent.



33. **Overall, the projected increase in revenues in the proposed RS budget for 2002 is smaller than GDP growth.** The projections are subject to exceptional uncertainty, however, because a complete overhaul of direct taxes and social contributions—in late 2001—entails a large cut in rates and a large assumed base-broadening effect. In light of the staff's concerns in this area, the authorities agreed to review revenue collection six months after the reform and to raise the tax and contribution rates if revenue is less than projected.

34. **In discussing expenditures in the 2002 budget, the staff agreed with the broad outlines of the authorities' proposals but considered that capital spending was too low.** The authorities responded that expenditure ceilings throughout the budget were tight. The wage bill would be reduced by freezing the wage rate and cutting employment, including by a 10 percent reduction in military personnel. The limit on wages would help make room for a significant rise in debt service obligations and an increase in the budgetary transfer to the State. Military spending on goods and services would also rise above the 2001 level: the authorities explained that they viewed that level as grossly insufficient. In other areas, the draft 2002 budget was not significantly different from the 2001 budget.

35. **The 2002 draft State budget provides for a steep rise in spending but the State lacks the recurrent revenues it needs for its new, larger, role.** State spending, other than external debt service, nearly doubled in 2001 and is projected to increase by a further 45 percent in 2002.<sup>14</sup> In spite of rising transfers from the Entities, however, resources have been found for only 85 percent of the State's proposed spending, and the authorities have made the rest contingent on receiving additional external grants. Since the State budget is already highly dependent on nonrecurrent external grants, the present level of spending is unsustainable unless new revenue sources are found. The authorities and staff agreed that the difficulties in financing the 2001 budget underline the need for an overhaul of intergovernmental finances which would put the State budget on a secure footing. In the interim, the State authorities proposed introducing new taxes or fees to finance the higher levels of spending but the staff argued that it was important first to identify cuts in areas where known redundancy and overstaffing exist.

36. **The 2002 budgets will be the first to be executed through the Entities' newly created treasury systems.** The new treasuries, which began operations in January 2002, give the authorities control over budget commitments and expenditures through the use of a treasury general ledger and treasury single account (TSA).<sup>15</sup> The staff urged the authorities to put their TSAs in the central bank, mainly for prudential reasons. The accounts were initially opened in commercial banks, however, since the authorities were concerned about the impact on banks of loss of government business and since discussions were still underway on the terms and conditions for opening TSAs in the central bank. The mission urged the State to

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<sup>14</sup> The State acts as an intermediary through which the Entities service BiH's external debt.

<sup>15</sup> The TSAs, which initially cover only the main budget users, will be extended to lower-level budget users in the course of the year.

press ahead with the implementation of its own TSA, projected for mid-2002. In the Federation, it is also important that treasury reform be extended to the cantons.

### C. Medium-Term Fiscal Issues

37. **Expenditure pressures in a number of areas make it important to set medium-term spending priorities, including in the context of the World Bank Public Expenditure and Institutional Review (PEIR).** Areas where the fiscal position is subject to pressures include:

- Veterans' benefits. The existing benefits are unaffordable. A reform underway, with World Bank support, should set up a well targeted and affordable veterans' benefits.
- Pensions. The indexing of pension entitlements under the existing pension laws should be strictly implemented. Consideration should be given to a next stage of pension reform in which entitlements and funding are defined in a definitive and transparent way.
- Public investment. The authorities may need to increase their public investment programs in light of the decline in external assistance.
- Debt management. The Entities need a strategy to repay arrears and meet obligations arising from war damages and frozen foreign exchange deposits.

38. **In discussing the size of State institutions, the staff emphasized the need to identify a stable and predictable source of finance for the State.** In the next year or two, while the State institutions are growing, the existing mechanism of a negotiated transfer from the Entities provides a natural way to ensure that the increased spending by the State is offset by expenditure restraint in the Entities. Transfers are not, however, a good basis for State financing over the medium term. Instead, the State will need a predictable source of own revenue to serve as a basis for rational, medium-term, budget planning. In addition, Entity transfers to the State are frequently late, which makes budget execution by the State difficult. Both problems would be solved by remitting a fixed share of one or more taxes directly to the State budget.

39. **A future VAT could at one stroke resolve the issue of financing the State and place BiH's indirect tax system on a sound footing, but preparations have stalled over a fundamental design issue—whether the tax should be at the Entity or at the State level.** Federation and State authorities favor a State-level VAT while the RS authorities consider that the Dayton Accords place taxation under the authority of the Entities. The staff emphasized two points. First, a well functioning VAT system would be a more reliable revenue source for the State as well as the Entities than the existing sales tax system.<sup>16</sup>

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<sup>16</sup> While the recent reforms have strengthened the sales tax considerably, the 20 percent standard rate is too high for a single-stage sales tax.

Second, robust enforcement of a VAT would require an integrated tax administration or closely cooperating tax administrations with access to a common database. The staff urged the authorities to try and agree on a model for an integrated country-wide VAT that meets the political and constitutional concerns of both Entities.

40. **In the area of direct taxation, the RS has moved ahead with a reform that is based on tax rates that the staff argued are too low.** Rates were lowered to 10 percent for both personal and corporate income tax, while the base for the personal income tax was broadened to include non-wage compensation.<sup>17</sup> The staff argued that the low tax rates would reduce revenues and, in the case of the corporate income tax, provoke tax competition with the Federation and neighboring countries. The staff urged the RS authorities to take advantage of the upcoming income tax reform in the Federation to review its own income tax rates. In the Federation where comprehensive new income tax legislation is still under preparation, the corporate income tax rate is still at 30 percent. However, the Federation did reduce the wage withholding tax rate, in stages, from 15 percent in 1999 to 5 percent in 2001.

41. **Given the weak collection of customs, excises, and sales taxes, the staff welcomed the restructuring of the tax and customs administrations underway in both Entities.**<sup>18</sup> The staff urged the Federation authorities to move for rapid enactment of the new tax administration law (already approved in the RS), and urged both Entities to appoint, on the basis of merit, strong directors and regional directors, to issue unique taxpayer identification numbers, and to take steps to improve the cooperation between and within revenue and tax administrations.

42. **The staff also urged the authorities to strengthen tax collection, particularly in the RS where customs and excise collections were disappointing.** The authorities agreed to intensify efforts to control contraband trade in excisables. In the area of customs, the authorities in both Entities cited customs under-valuation by Brčko District as a main source of losses (Box 2). The staff noted that recent studies by the EC's Customs and Fiscal Assistance Organization (CAFAO) suggested that under-valuation was also a problem in the two Entities and urged all the authorities to tighten controls.

#### D. Structural Policies

43. **The staff emphasized the importance of promoting the private sector by improving the business environment rather than by fiscal incentives.** The staff supported the authorities' efforts to develop, with the support of the World Bank, institutions that would

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<sup>17</sup> The rates of social contributions were also lowered (and the base broadened) and a large number of taxes and fees were abolished.

<sup>18</sup> The new tax administrations will be organized on modern lines, with large tax payer units, investigation units and debt collection units. The two entities have agreed to introduce compatible taxpayer identification numbers.

encourage new entrants and reduce obstacles to day-to-day operations. Key steps needed are to introduce a country-wide business registration system, harmonize company law, eliminate duplication over the different levels of government, modernize bankruptcy and liquidation laws, and strengthen the courts. The authorities understand the importance of fundamental reforms of the business environment, but emphasized that they also feel under pressure to introduce quick-acting fiscal measures to cut unemployment and support agriculture.

44. **The staff stressed the need to remove the obstacles that remain to completing the privatization of non-financial public enterprises.** The authorities reported that mass privatization—the sale of small-scale enterprises (SSE) for cash or vouchers—had progressed satisfactorily, though the management of these enterprises was hampered by diffuse or ill-defined ownership rights. The first privatizations of strategic enterprises were completed in 2001, after enterprise-specific technical assistance had been mobilized in 2000 through the International Advisory Group for Privatization (IAGP).<sup>19</sup> In discussions with the authorities it emerged that nontransparent bidding practices and the absence of up-to-date information on enterprise debts have often delayed or blocked privatization. Another obstacle has been unrealistic expectations on the part of the authorities. The staff urged the authorities to move quickly to privatize key enterprises in the manufacturing and public utilities sectors.

45. **Staff and the authorities agreed that the creation of a viable private sector had to be supported by broader institution building, including a strengthening of social safety nets.** While work on BiH's poverty profile is still underway, the authorities' view is that the main causes of poverty are high unemployment and the lasting repercussions of the war. The staff urged the authorities to create social safety nets that were well targeted and affordable. To that end, the authorities were encouraged to continue implementing the assistance programs supported by the World Bank which help building social sustainability by reforming health and social protection programs, (Appendix II).

#### **E. Financial Sector Issues**

46. **The Central Bank of Bosnia and Herzegovina (CBBiH), as well as the State and Entity authorities, reaffirmed their commitment to the currency board arrangement.** The staff concurred. Given BiH's underlying fiscal problems and its complex politics the discipline of the currency board was needed in order to resist pressures to monetize fiscal deficits. Over the medium term, however, the currency board arrangement would only be sustainable if fiscal policy was disciplined: from this perspective the maintenance of fiscal adjustment and the freeze in wages were welcome features of the proposed 2002 budgets. The staff endorsed the continued strict adherence to currency board rules and urged the central bank to continue building its capital up to 10 percent of liabilities, in line with the Central Bank Law.

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<sup>19</sup> The IAGP includes the World Bank, the European Union and USAID. It is managing the privatization of 86 strategic enterprises in the Federation and 52 in the RS.

47. **The staff urged the RS authorities to move quickly, with the support of the World Bank, to privatize or close the three largest state-owned banks.** Negotiations are now underway for the privatization of two of the three banks; the third has been placed under conservatorship and will be liquidated or privatized. In the Federation, where the banking system has been strengthened by far-reaching privatization, the staff noted that the amount of commercial lending was still negligible in spite of the liquid position of many banks. Staff noted that the dearth of viable commercial borrowing proposals underscored the need to strengthen the enforcement of creditors' rights.

48. **The staff urged the CBBiH and the Entities to strengthen the central bank's role in bank supervision.** At present, supervision is carried out by Entity-level banking agencies. The mission took the view that centralizing bank supervision would bring economies of scale, greater independence, and a better capacity to supervise banks with branches in both Entities. The RS authorities expressed reservations regarding centralizing bank supervision, however, and considered that the RS Banking Agency was capable of effective supervision.

#### F. Other Issues

49. **Under the framework of the June 2001 memorandum of understanding signed by the countries in South East Europe, BiH has concluded free trade agreements with Macedonia, Slovenia, and FRY.** It had previously negotiated a free trade agreement with Croatia. An agreement with the European Union in 2000 has led to free access of BiH goods into the European Economic Area. BiH is currently involved in WTO accession negotiations, and appears to have the strong support of the European Union and the United States. The authorities explained that they expect to enter the WTO in the first half of 2002.

50. **As is the case with other successor republics of the former SFRY, BiH, at the time of independence, imposed restrictions on withdrawals and transfers from certain foreign exchange accounts held by residents and non-residents.** The staff has now clarified that the rules which presently apply to these accounts give rise to exchange restrictions subject to approval under Article VIII. The authorities, in consultation with Fund staff, are currently considering ways to address the problems that arise from these accounts.

51. **The staff urged the authorities to focus on improving the quality and coverage of basic economic data.** The authorities agreed that the statistical base was weak (see Appendix III), and said that they had allocated more resources to the statistical institutes in the 2002 budgets. The staff welcomed that decision and urged that priority be given to producing, quickly, reliable data on the national income and product accounts, consumer and producer prices, and the balance of payments. The staff also urged the authorities to improve coordination among the three statistical institutes.

#### IV. STAFF APPRAISAL

52. **Progress was made on several fronts in 2001, particularly in the area of fiscal discipline and transparency.** Budget implementation was improved, the growth of the stock

of arrears was halted and important steps were taken in the areas of treasury reform and tax administration reform. These gains now need to be consolidated and extended.

**53. Looking forward, the priority is now to allow the private sector to become the main engine of growth.** Privatization of strategic enterprises needs to be accelerated in both entities. In the RS the privatization of the largest state-owned banks should be brought to a rapid conclusion. More broadly, BiH should move ahead quickly with reforms—supported by the World Bank—to remove impediments to investment and business registration and improve the environment for day-to-day business activities. Budgets should provide sufficient resources to the courts and other legal institutions affecting economic structures.

**54. The authorities at all levels should resist pressures to try and jump start the economy with subsidies or employment incentives.** Such schemes are typically ineffective, costly, and prone to mismanagement.

**55. The currency board arrangement has served BiH well and remains the best way to maintain a low inflation environment.** By removing monetary policy from the political arena, the arrangement has brought inflation down and fostered a remarkable degree of confidence in the KM. BiH's stable currency is now possibly the most positive feature of its business climate. The currency board rules should therefore continue to be implemented strictly.

**56. A sustainable fiscal position is a second essential precondition for low inflation in the long run.** The fiscal adjustment that began in 2001, if sustained and extended in 2002 (as planned), would be a welcome first step, but large debts (including domestic expenditure arrears) and entitlements, declining donor support, and weaknesses in the tax system cloud the medium-term fiscal outlook. For 2002, if revenues fall short of optimistic estimates, governments will have to hold expenditures below the approved budgetary ceilings in order to prevent the emergence of new arrears.

**57. A broader public finance reform agenda also requires the Entities' attention. This could include:**

- Ending permanently the double-imposition of excise taxes and fully implementing a mechanism to allocate excise revenues to the Entity of consumption.
- The Federation moving quickly to enact legislation for a well designed, modern, tax administration, and both Entities providing their new tax administrations with adequate resources and effective, independent, leadership.
- Making every effort to reduce customs under-valuation and launching sustained campaigns to remove smuggled excisable goods from the market.
- Using the new treasury systems to further strengthen fiscal control. In the Federation, the cantons reinforcing their treasuries and providing full and timely reports of budget execution to the Federation authorities.

- Indexing pension entitlements strictly to available resources.

58. **The composition of public spending should be reviewed in light of the decline in aid-financed investment.** BiH will need to increase the share of its budgetary resources devoted to capital spending and identify areas where recurrent spending can be restrained.

59. **On the revenue side, the authorities are strongly urged to overcome the political and constitutional obstacles to implementing a harmonized VAT, collected by an integrated tax administration.** The alternative options—Entity-level VATs or another round of reforms of the sales tax—would also be difficult to agree, and would be a weaker basis for providing revenues over the medium term.

60. **Outstanding fiscal federalism issues need to be addressed.** Once definitive decisions have been made about the relative size and financial needs of the State the present system of Entity transfers to the State should be replaced by a more stable and predictable source of “own” revenues. In addition, the State authorities need to strengthen budget management and eliminate wasteful expenditures.

61. **The overhangs of expenditure arrears and frozen deposits seriously threaten medium-term fiscal sustainability.** Efforts are needed to put an end to the accumulation of new arrears, including by local governments. In clearing existing arrears, it will be important to recognize only claims that are documented and supported by law or contract, and repay the claims on terms that do not overburden the budget.

62. **Although bank supervision has improved over recent years, it is weakened by the fact that supervision is based at the level of the Entities.** Centralizing supervisory responsibility at the central bank would strengthen the financial system.

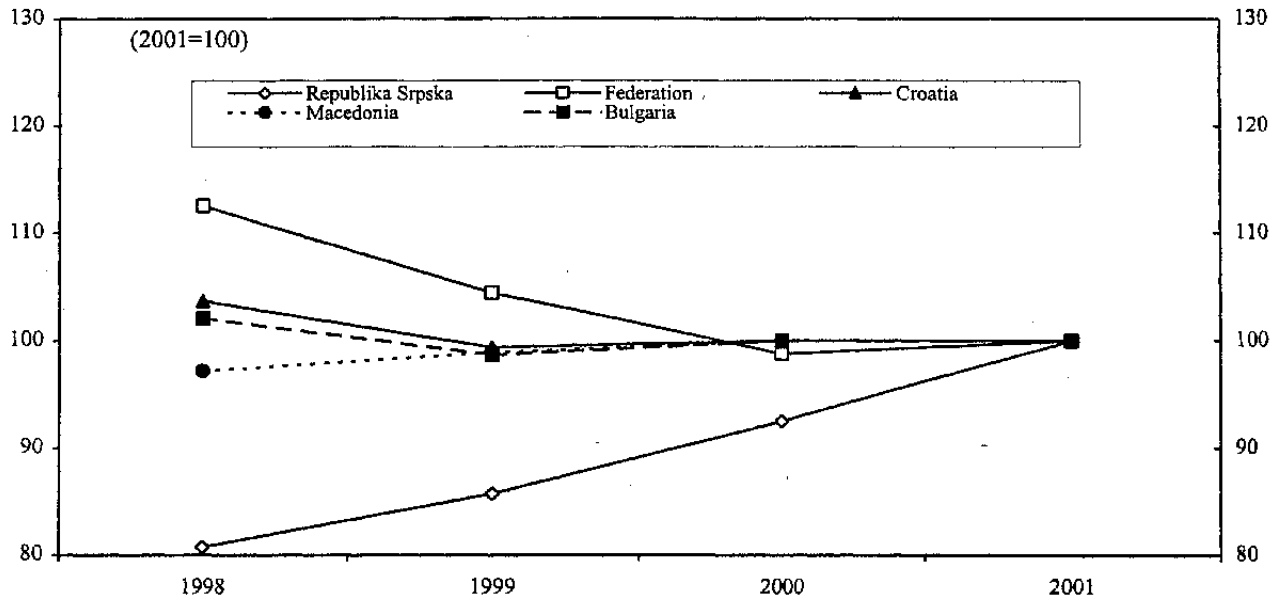
63. **Published economic data on BiH is still too weak to provide a sound basis for policymaking.** The three statistical institutes should improve coordination and cooperation. The strengthened statistical institutes should focus, in priority, on producing reliable and timely data on the main macroeconomic aggregates and prices.

64. **The staff does not recommend approval of the exchange restrictions arising from the rules governing frozen foreign currency deposits, since there is at present no clear time-table for the removal of these restrictions.**

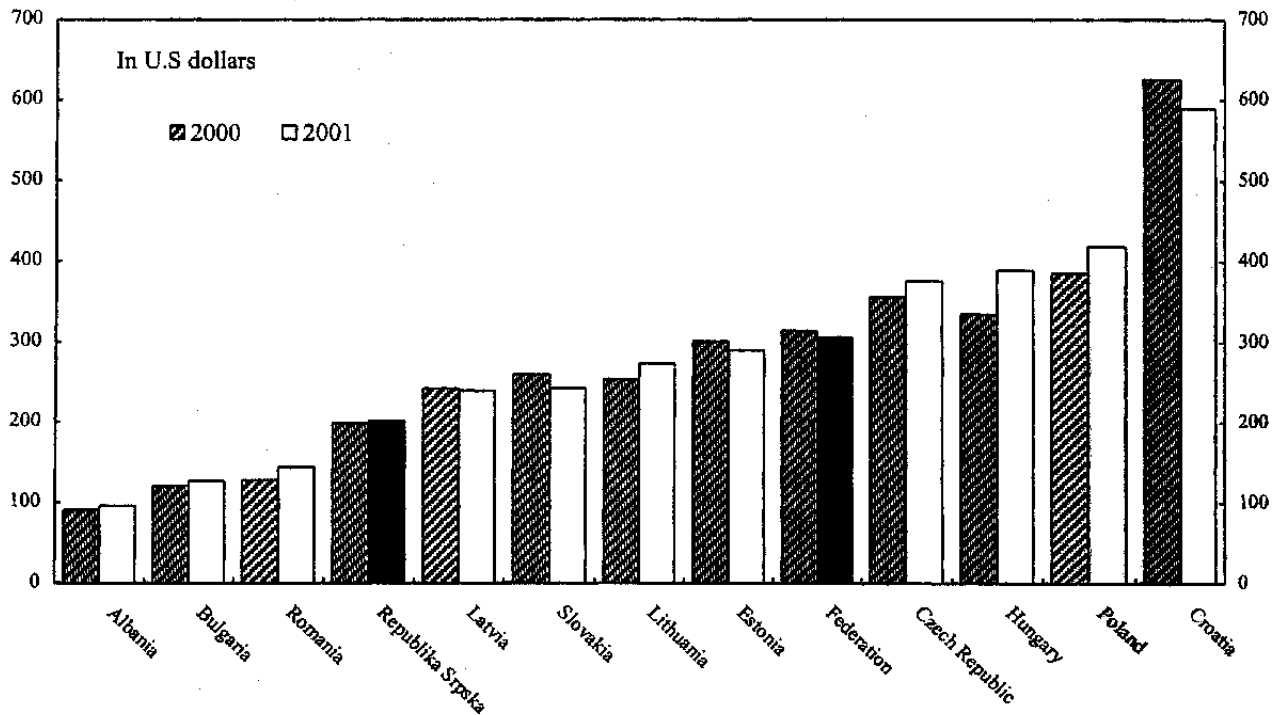
65. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle.**

Figure 4. Bosnia and Herzegovina: Indicators of Competitiveness, 1998-2001

A. Real Effective Exchange Rates 1/



B. Average Gross Monthly Wages

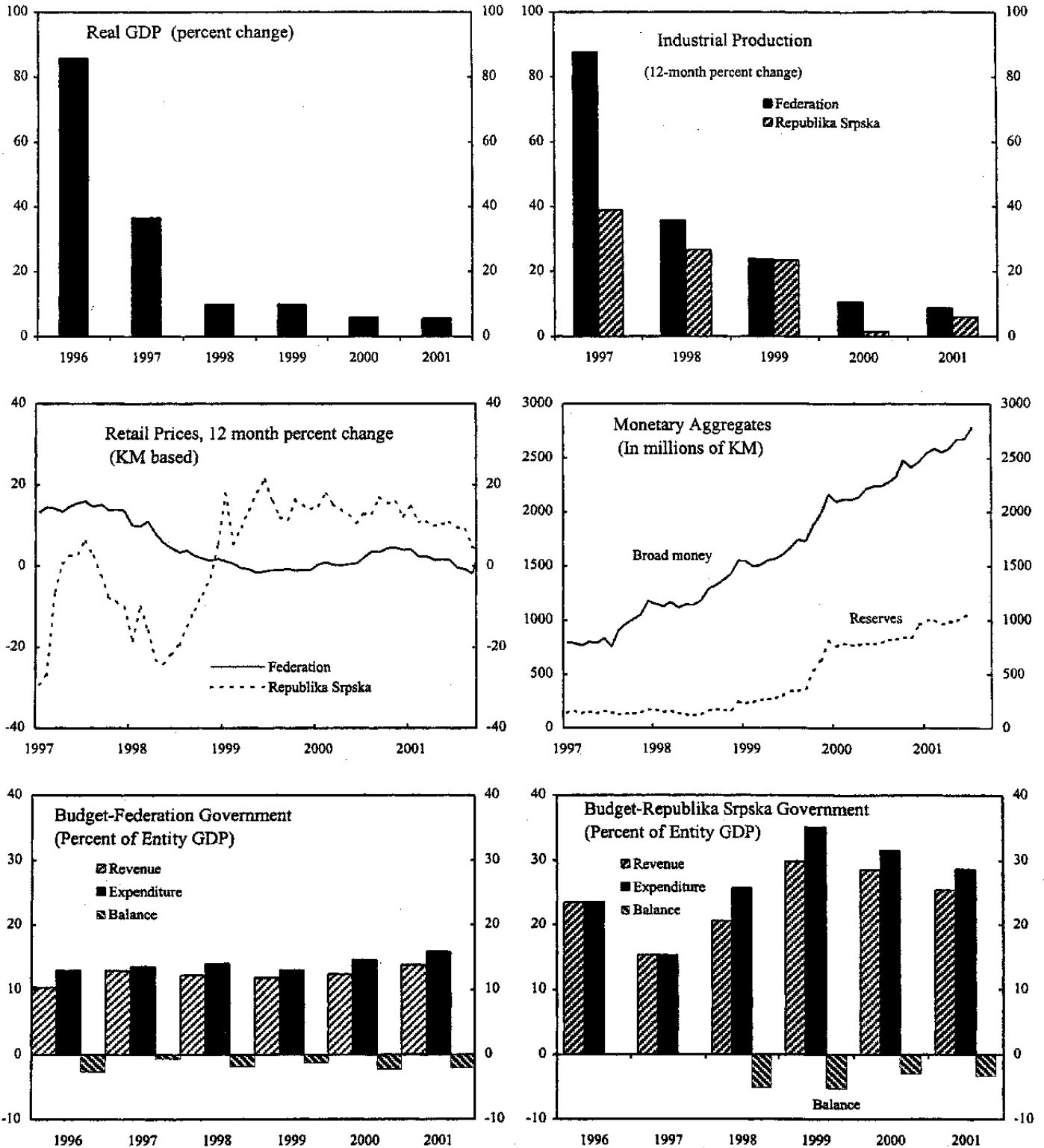


Sources: International Financial Statistics (IFS); and IMF staff estimates.

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 2001 are based on January to September data.



Figure 5. Bosnia and Herzegovina: Selected Financial and Economic Indicators (1996-2001)



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

Table 1. Bosnia and Herzegovina: Main Economic and Financial Indicators, 1997-2002 1/

	1997	1998	1999	2000 Est.	2001 Est.	2002 Proj.
Population (millions)	4.2	4.2	4.3	4.3	...	...
Nominal GDP (millions of KM) 2/						
BiH 2/	6,116	7,336	8,323	9,260	10,077	10,806
Federation 2/	4,748	5,602	6,142	6,699	7,309	7,853
Republika Srpska 2/	1,368	1,734	2,181	2,562	2,768	2,954
Nominal GDP growth (in percent)/						
BiH 2/	48.3	77.8	13.5	11.3	8.8	7.2
Federation 2/	55.7	83.7	9.6	9.1	9.1	7.4
Republika Srpska 2/	27.1	61.2	25.8	17.5	8.1	6.7
Real GDP growth (annual average)						
Federation	36.6	9.9	9.9	5.9	5.6	5.1
Republika Srpska	36.2	8.3	9.5	7.0	7.0	5.6
Republika Srpska	37.9	15.8	11.3	2.5	1.9	3.9
Industrial production (percent change) 3/						
Federation	36	24	11	9	12	...
Republika Srpska	27	23	2	6	-12	...
Wages (KM/month) 4/						
Federation	493	506	551	607	649	...
Republika Srpska	174	256	314	384	429	...
CPI (twelve-month average)						
Federation 5/	14.4	5.2	-0.7	1.9	1.7	1.8
Republika Srpska 5/	-7.3	-14.0	14.1	14.6	8.0	2.0
	(Change in percent of opening broad money)					
Money and credit 6/						
Broad money	52	31	40	14	79	22
Foreign assets (net)	-11	6	-2	12	18	10
Domestic assets (net)	63	30	41	11	73	19
Other items (net)	0	-4	1	-9	-12	-7
	(in percent of GDP)					
Federation						
Revenue	12.9	12.2	11.8	12.4	13.8	14.5
Expenditure	13.8	13.8	12.8	13.7	14.7	16.9
Balance 7/	-0.9	-1.6	-1.0	-1.3	-0.9	-2.4
Republika Srpska 8/						
Revenue	15	20.6	30.0	28.5	26.3	26.3
Expenditure	15	25.7	33.9	29.6	28.2	30.0
Balance 7/ 8	0	-3.3	-3.9	-1.1	-1.9	-3.7
	(In millions of U.S. dollars; unless otherwise indicated)					
External current account balance (excluding official transfers)	-1,482	-986	-1,058	-962	-827	-849
As a percentage of GDP	-43.3	-23	-24.6	-21.8	-18.0	-17.2
Exports	575	697	649	732	857	977
Imports	-2,333	-2,656	-2,502	-2,348	-2,299	-2,409
CBBH gross reserves	80	175	455	488	1,193	1,570
In months of merchandise imports	0.4	0.8	2.2	2.3	5.7	7.3
External debt						
(In percent of GDP)	119.0	68.1	71.9	68.7	55.7	54.9
Debt service (in percent of exports of goods and nonfactor services)	16.0	12.0	11.5	6.2	6.6	8.2

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

1/ Data refer to the entire country, unless otherwise indicated.

2/ Staff estimates until 2000.

3/ Annual production, percent change over previous year. In 2001, estimates for the RS are up to September 2001.

4/ Gross wages. In 2001 data for the Federation are up to November and in the RS up to July.

5/ Data as of October 2001 for the Federation and up to September 2001 in the RS.

6/ Country-wide monetary aggregates. In percent of beginning of year broad money stock.

7/ Cash basis, after grants.

8/ Excludes municipal government operations. Ratios for 2001 are based on budget.

Table 2. Bosnia and Herzegovina: Consolidated General Government, 1998-2001

	1998	1999	2000	2001 1/
	(In percent of GDP)			
General government revenue	3,179.9	3,922.5	4,213.3	4,364.4
Federation	2,477.6	2,788.4	2,927.0	2,965.4
Federation budget	682.0	723.7	828.5	1,009.0
Cantons and municipalities 2/	1,106.4	1,288.9	1,252.9	1,023.4
Extrabudgetary funds 2/ 3/	879.3	984.3	1,117.9	1,219.6
Republika Srpska	598.3	961.8	1,038.2	1,061.3
Republic budget	357.1	653.8	717.3	703.5
Municipalities 4/	41.9	62.9	69.2	69.2
Extrabudgetary funds 2/ 3/	261.4	358.7	392.6	433.2
State	138.0	218.3	274.8	319.6
Brcko District 5/	0.0	0.0	23.5	98.1
Consolidated expenditures on a commitment basis	4,598.0	5,755.1	6,099.3	5,649.1
Consolidated expenditures on a cash basis				
Balance on a commitment basis	-1,418.1	-1,832.5	-1,902.5	-1,297.2
Domestic financing	0.0	63.0	126.0	155.7
Privatization proceeds	0.0	63.0	126.0	100.1
Succession monies	0.0	0.0	0.0	55.6
Foreign financing	1,270.4	1,528.9	1,398.3	1,298.4
Budgetary loans and grants	188.8	138.5	177.3	163.9
Foreign financed investment projects	1,081.7	1,390.4	1,221.0	1,134.5
Accumulation of arrears	147.6	240.6	378.2	-156.9
	(In percent of GDP)			
General government revenues	43.3	47.1	45.5	43.3
Consolidated expenditures on a commitment basis	62.7	69.1	65.9	56.1
Balance on a commitment basis	-19.3	-22.0	-20.5	-12.9
Domestic financing	0.0	0.8	1.4	1.5
Foreign financing		18.4	15.1	12.9
Budgetary loans	2.6	1.7	1.9	1.6
Foreign financed investment projects	14.7	16.7	13.2	11.3
Accumulation of arrears	2.0	2.9	4.1	-1.6
Memorandum item:				
Debt stock (in percent of GDP) 6/	...	...	75.3	62.3

Sources: Ministries of Finance; and IMF staff estimates.

1/ Authorities' Revised Plans, projected before the end of the year. Therefore, foreign financing numbers are subject to change, with a shortfall of 31.4 million KM for the Federation and 15.7 million KM for the RS.

2/ For 2001, IMF staff estimate.

3/ Pension Fund, Health Fund, and Employment Fund.

4/ IMF staff estimates.

5/ Data for 2000 are incomplete. The Brcko District started collecting revenue in March 2000.

6/ External debt and stock of arrears. The decrease in 2001 is related to a large debt-relief operation.

Table 3. Bosnia and Herzegovina: Federation Fiscal Operations, 1997-2002

	1997	1998	1999 Est. Outcome	2000	2001			2002		Growth Rate (10)=(9)/(7)
					Budget	Jan.-Nov.	Revised Budget	IMF Proj.	Draft Budget	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)=(9)/(7)
(In millions of KM)										
Total revenue	610.4	682.0	723.7	828.5	872.7	934.5	1009.0	1085.2	1135.9	12.6
Tax revenue	565.3	645.1	676.5	768.0	813.3	843.6	914.7	990.9	1052.1	15.0
Indirect taxes	565.3	634.7	658.8	745.5	788.4	799.7	866.2	942.4	1008.6	16.4
Profit tax	0.0	10.4	17.7	22.5	24.9	43.8	48.5	48.5	43.5	-10.3
Nontax revenue	45.2	36.9	47.2	60.5	59.3	91.0	94.3	94.3	83.8	-11.1
Of which: Dividends of public enterprises 1/				-	-	27.7	28.5	28.5	40.0	40.4
Total expenditure	657.2	803.7	800.5	976.4	997.6	977.9	1193.4	1236.6	1335.0	11.9
Wages and contributions 2/	69.6	77.3	92.5	103.0	108.2	99.2	119.4	122.4	126.2	5.7
Goods and services	21.4	37.0	32.4	29.8	32.3	27.6	29.5	29.0	47.6	61.1
Military 3/	253.5	276.0	291.4	309.6	290.2	274.5	297.0	275.7	256.0	-13.8
Reconstruction and capital expenditure 4/	17.5	42.6	26.0	47.2	46.6	51.4	60.7	60.3	66.7	9.8
Subsidies	3.2	20.4	14.1	14.0	11.2	9.8	11.2	16.1	126.6	1026.6
Other transfers to households	226.7	257.7	215.9	255.0	278.6	314.6	372.2	326.2	305.8	-17.8
Transfers to pension funds	15.8	21.9	6.5	8.8	8.8	59.7	102.2	50.8	20.0	-80.4
Regular transfers	15.8	21.9	6.5	8.8	8.8	17.7	18.2	8.8	20.0	9.9
Extraordinary transfers 5/	-	-	-	-	-	42.0	84.0	42.0	0.0	-100.0
Transfers for health	1.4	1.3	0.1	0.7	1.0	1.0	1.0	1.7	1.2	20.0
Transfers for education	10.4	3.3	1.4	4.9	4.9	4.9	5.1	5.0	3.6	9.0
Transfers to war invalids	175.5	209.3	207.9	240.7	263.9	249.0	263.9	268.7	279.0	5.7
Transfers to the state government	29.9	65.0	84.0	153.5	167.8	99.3	165.5	235.7	235.7	42.4
Administration	15.4	20.6	18.3	30.0	37.0	31.1	43.0	51.5	51.5	19.8
Debt service	14.5	44.4	65.7	123.5	130.8	68.2	122.5	184.2	184.2	50.4
Transfers to cantons and municipalities	3.7	7.0	15.9	25.1	10.0	13.9	18.0	40.0	13.0	-27.8
Net lending	-	-	-	-7.0	-	3.7	3.7	0.0	0.0	-100.0
Clearance of Federation budgetary arrears	-	-	-	-	-	34.1	47.8	29.4	77.6	62.3
Transfer to pension funds	-	-	-	-	-	12.0	12.0	0.0	0.0	-
Transfers to war invalids	-	-	-	-	-	17.5	23.0	-	23.0	-
Other	-	-	-	-	-	4.6	12.8	29.4	54.6	326.6
Contingency 6/	-	-	-	-	-	-	-	42.0	0.0	-
Other expenditure and unallocated	31.7	20.8	28.4	46.2	52.7	49.9	68.2	60.0	79.9	17.0
Refugees	2.5	6.4	3.8	23.3	25.0	18.0	28.0	25.5	30.0	7.1
Refund of prelevmani duties	-	-	-	-	4.0	0.0	-	4.1	5.0	-
World Bank financed projects	-	-	-	-	-	-	-	9.8	5.0	-
Intelligence Service	-	-	10.0	13.5	5.0	8.1	12.0	5.0	15.6	30.2
Budgetary reserve	12.8	-	-	-	11.2	12.1	15.4	7.7	14.2	-7.8
Other	29.2	14.4	24.6	9.4	7.5	11.7	12.9	8.0	10.1	-21.6
Overall balance (cash basis, before grants)	-46.8	-121.8	-76.8	-147.9	-124.9	-43.4	-184.4	-151.4	-199.1	-
Foreign grants for budget support	2.0	34.9	14.7	61.1	0.0	0.0	11.2	11.9	11.9	-
Overall balance (cash basis, after grants)	-44.8	-86.9	-62.2	-86.8	-124.9	-43.4	-173.2	-139.5	-187.2	-
Financing	44.8	86.9	62.2	86.8	124.9	43.4	173.2	139.5	187.2	8.1
Domestic financing 7/	0.0	0.0	0.0	-16.4	14.0	-13.5	-3.7	0.0	17.7	-572.1
Foreign loans for budget support 8/	44.8	86.9	62.2	103.2	111.0	56.9	119.5	119.5	119.5	0.0
Privatization	-	-	-	-	-	0.0	23.4	20.0	50.0	-
Succession money	-	-	-	-	-	-	34.0	-	0.0	-
Memorandum items:	(In percent of GDP)									
Revenue	12.9	12.2	11.8	12.4	11.9		13.8	13.8	14.5	-
Balance (cash basis, after grants)	-0.9	-1.6	-1.0	-1.3	-1.7		-2.4	-1.8	-2.4	-
Fed. Budget consolidated with pension funds 9/	(In millions of KM)									
Net clearance of arrears	-	-	-	-	-	64.1	119.8	113.4	77.6	-

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

1/ For 2002, contribution from PTT to roads construction brought on budget.

2/ Does not include wages from the Army, the Ministry of Defense and the Intelligence service, counted elsewhere in the table.

3/ Army and Ministry of Defense. Does not include off-budget assistance from other countries. Includes 50 million KM of severance payments in 2002.

4/ Includes allocation for railroads and other capital expenditures.

5/ Transfers from the Federation budget to clear pension arrears of previous years.

6/ In 2002, to be used to clear budgetary arrears or make an extraordinary transfer to the pension funds.

7/ In 2001, includes KM 17.7 million of revenues frozen in Hercegovacka Bank, and got back in 2002.

8/ Disbursement. Amortization is included in the debt service transfers to the State.

9/ Excludes the clearance of budgetary arrears to the pension fund, includes extraordinary transfers to the pension funds to clear arrears.

Table 4A. Bosnia and Herzegovina: Republika Srpska Fiscal Operations (Old presentation), 1997-2001

	1997	1998	1999	2000	2001	
	(1)	(2)	(3)	Actual 1/ (4)	Approved Budget (5)	Jan.-Nov. Actual (6)
(In millions of KM)						
Total revenue	209.3	357.1	653.8	717.3	727.7	638.1
Tax revenue	197.0	294.8	560.9	612.9	631.7	554.3
Taxes on goods and services	100.1	148.7	251.6	317.1	304.6	291.0
Sales tax 2/	90.4	97.8	146.7	170.3	181.1	180.2
Excises	9.8	50.9	104.9	146.9	123.5	110.8
Trade taxes	63.0	95.0	144.9	167.1	187.3	138.2
Taxes on income	28.2	38.4	62.8	70.8	75.5	73.7
Personal income tax	5.4	6.3	10.5	7.9	8.3	10.2
Wage withholding	21.7	30.4	42.5	47.2	49.8	48.9
Corporate income tax	1.2	1.4	9.9	15.7	17.4	14.5
Other taxes and revenues	5.6	12.7	101.6	57.9	64.3	51.4
Nontax revenue 3/	12.3	62.3	93.0	104.5	96.0	83.9
Total expenditure	209.3	446.0	765.8	793.0	824.6	661.2
Wages and contributions	24.9	154.6	209.0	206.1	248.2	219.7
Goods and services	30.5	49.5	162.0	153.3	100.5	80.1
Goods reserve	6.6	9.2	58.2	33.9	0.0	0.0
Other 4/	23.9	40.3	103.7	119.4	100.5	80.1
Military	73.4	70.0	89.2	70.3	66.9	51.0
Banking fees	0.4	0.6	1.8	1.1	0.3	0.4
Transfers to social funds	6.1	0.1	28.1	36.7	16.0	12.8
Capital and reconstruction expenditure 5/	9.3	12.0	42.3	73.3	56.9	62.0
Of which: Railways	9.3	12.0	20.3	29.4	29.4	24.2
Subsidies	0.0	0.0	12.0	36.6	24.5	18.1
Other transfers to households	15.1	79.1	94.5	94.3	140.1	111.4
War invalids	14.8	40.1	72.6	80.0	105.2	92.6
Refugees	-	-	18.2	9.3	28.0	12.8
Other 6/	0.3	39.0	3.6	5.0	6.9	6.0
Transfers to other levels of government	1.2	55.6	94.4	91.6	103.5	64.9
Transfers to the State	-	55.0	92.5	89.1	101.0	62.3
Administration	-	10.0	10.1	14.9	19.0	15.4
Debt service	-	45.0	82.4	74.2	82.0	46.9
Transfers to municipalities	1.2	0.6	2.0	2.5	2.5	2.6
Net lending	-	-	-	7.0	0.0	-0.2
Clearance of expenditure arrears (net)	-	-	-	-	35.0	11.3
Pension and Health Funds	-	-	-	-	0.0	11.3
Other	-	-	-	-	35.0	0.0
Other expenditures and unallocated	48.6	24.5	32.4	29.7	32.7	29.6
Budgetary reserve	21.6	12.0	14.0	11.6	12.0	8.4
World Bank financed projects	-	-	-	-	-	0.4
Other	27.0	12.5	18.4	18.1	20.7	21.3
Overall balance (cash basis, before grants)	0.0	-88.9	-112.0	-75.7	-96.9	-23.0
Foreign grants for budget support	0.0	31.1	27.7	48.2	0.0	1.1
Overall balance (cash basis, after grants)	-	-57.8	-84.3	-27.5	-97.0	-21.9
Change in expenditure arrears (increase +)	-	-	-	114.8	-35.0	-11.3
Overall balance (commitment basis, after grants)	0.0	-57.8	-84.3	-142.3	-62.0	-10.6
Financing	0.0	57.8	84.3	27.5	97.0	21.9
Domestic	0.0	0.0	0.0	1.6	0.0	-46.4
External loans for budget support 7/	0.0	57.8	84.3	25.9	97.0	59.3
Privatization revenues	-	-	-	-	-	9.0
(In percent of GDP)						
Memorandum items:						
Revenue	15.3	20.6	30.0	28.5	26.3	23.1
Balance (cash basis, after grants)	0.0	-3.3	-3.9	-1.1	-3.5	-0.8

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

1/ Adjustments made to the cash outcome comprise: (i) elimination of unrealized revenue gains (losses) due to a depreciation (appreciation) of the domestic currency (KM 16.3 million and KM 34.9 million, respectively); (ii) inclusion of expenditures related to government lending (KM 7 million); and (iii) removal of a KM 84 million item recorded under expenditure, but which was in fact an accounting error with no correspondence to real or committed expenditure.

2/ Including railway surcharges.

3/ Including fees, fines, and other special revenues (excluding railways).

4/ Including materials costs and investment maintenance.

5/ Including railway and other capital expenditure.

6/ Including transfers to health insurance funds, refugees and displaced persons, students, and social institutions.

7/ Disbursement. Amortization is included in the debt service transfers to the State.

Table 4B. Bosnia and Herzegovina: Republika Srpska Fiscal Operations (New presentation), 2001-2002

	2001		2002	
	Budget (1)	Authorities' Est. Outcome (2)	Draft Budget (3)	Growth Rate (4)=(3)/(2)
	(In millions of KM)			
Total Revenues	727.7	730.1	776.9	6.4
Tax revenues	631.7	626.9	683.7	9.1
Taxes on goods and services	304.6	336.9	363.9	8.0
Sales tax	151.7	156.5	188.6	20.5
Railway surcharge	29.4	42.7	42.0	-1.7
Excises	123.5	137.7	133.3	-3.2
Property tax on special goods 1/	-	4.5	20.8	-
Trade taxes	187.3	156.6	173.7	10.9
Customs duties	131.4	107.2	121.7	-
Import duties	55.9	49.4	52.0	-
Taxes on income	75.5	83.7	80.4	-3.9
Wage withholding	49.8	63.5	67.7	6.5
Personal income tax	8.3	3.9	4.0	1.8
Corporate income tax	17.4	16.2	8.7	-46.3
Other taxes and revenues	64.3	45.2	45.0	-0.6
Non-tax revenues	47.8	47.0	46.5	-1.1
Fees and charges	40.7	38.9	38.5	-
Fines	7.0	8.1	8.0	-
Special revenues 2/	48.2	56.1	46.6	-16.9
Total expenditures	824.6	783.2	886.5	-
Wage bill	346.0	-	335.7	-
Gross salaries and compensation	289.2	-	-	-
Gross salaries	242.7	-	-	-
Compensations	46.4	-	-	-
Employers contributions	56.9	-	-	-
Goods and services	85.8	-	137.6	-
Subsidies to public enterprises 3/	18.7	-	16.3	-
Transfers to the social funds	16.0	-	15.2	-
Transfers to households	141.6	-	140.2	-
War invalids	105.2	-	109.0	-
Refugees	28.0	-	18.7	-
Other	8.4	-	12.5	-
Transfers to municipalities	2.5	-	2.0	-
Transfers to the State	101.0	-	135.4	-
Debt service	82.0	-	109.6	-
Administration	19.0	-	25.8	-
Clearance of arrears	34.8	-	24.5	-
Capital and reconstruction expenditures	59.7	-	56.1	-
Of which: Railway	29.4	-	29.4	-
Other expenditures and unallocated	18.5	-	23.6	-
Budgetary reserve	12.0	-	-	-
World Bank co-financing	1.2	-	-	-
Other transfers	5.3	-	-	-
Overall balance (cash basis, before grants)	-96.9	-53.1	-109.7	-
Foreign grants for budget support	0.0	1.1	16.5	-
Overall balance (cash basis, after grants)	-96.9	-52.0	-93.2	-
Financing	96.9	52.0	97.7	-
Domestic	-	-7.3	-	-
External loans for budget support 4/	96.9	59.3	65.7	-
Privatization revenues	0.0	-	32.0	-
Financing gap	0.0	-	-4.5	-
Memorandum items		(In millions of KM)		
Military spending	62.4	-	80.5	-
Wage bill	53.9	-	39.9	-
Other	8.5	(In percent of RS GDP)		40.6
Revenues	26.3	26.4	26.3	-
Balance (cash basis, after grants)	-3.5	-1.9	-3.7	-

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

1/ Taxes on the personal use of special goods such as motor vehicles, mobile phones, boats, aircrafts and weapons.

2/ Includes other fees (on water, on use of forests), own revenues from administrations and other non-tax revenues.

3/ Outside subsidies to the railroads.

4/ Disbursement. Amortization is included in the debt service transfers to the State.

Table 5. Bosnia and Herzegovina: State Fiscal Operations, 1997-2002

	1997	1998	1999	2000	2001			2002		
					Budget	Jan.-Sep. 1/	Revised	IMF	Draft	Growth
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)=(9)/(7)
(In millions of KM)										
Revenues	50.0	138.0	218.3	274.8	295.3	171.8	319.6	410.8	438.4	31.9%
Own revenues 2/	20.0	20.0	31.4	32.4	27.6	12.7	27.6	37.7	55.7	47.5%
Transfers from entities	30.0	118.0	186.9	242.4	267.7	157.7	269.1	373.1	369.7	37.4%
Administrative budget	15.0	30.0	28.2	44.6	55.6	38.6	64.6	77.3	77.3	19.7%
Federation	15.0	21.0	18.3	29.7	37.1	27.5	43.1	51.5	51.5	19.6%
Republika Srpska	0.0	10.0	9.9	14.9	18.5	11.1	21.5	25.8	25.8	19.8%
Debt service	15.0	89.0	158.7	197.8	212.1	119.1	204.5	295.8	292.4	43.0%
Federation	15.0	44.0	70.7	123.8	130.2	71.3	122.5	184.2	181.9	48.5%
Republika Srpska	0.0	45.0	53.5	74.0	81.9	47.8	82.0	111.6	110.5	34.7%
Direct repayments	-	-	34.5	-	-	-	0.0	0.0	1.0	-
Extraordinary revenues	-	-	-	-	-	1.4	22.9	0.0	13.0	-50.8%
Succession	-	-	-	-	-	0	21.6	0.0	0.4	-
Compensation for war damage	-	-	-	-	-	1.4	1.3	0.0	0.7	-
Transfers to finance elections	-	-	-	-	-	-	-	-	11.9	-
Expenditures	110.0	138.0	216.5	273.9	304.3	187.9	351.5	442.7	478.0	31.2%
State Border Service	-	-	-	6.0	20.0	16.9	43.0	63.0	55.6	30.2%
Wages	-	-	-	-	9.8	15.1	24.4	51.6	0.0	69.1%
Other	-	-	-	-	10.2	1.8	18.7	11.4	0.0	-20.6%
New BiH institutions 3/	-	-	-	-	0.3	1.2	7.2	2.5	7.7	17.4%
Clearance of arrears 4/	-	-	-	-	1.8	0.0	10.6	0.0	0.0	-
BiH ministries and institutions 5/	35.0	51.0	57.8	70.1	70.1	50.7	86.2	81.4	122.4	21.1%
Debt service	75.0	87.0	158.7	197.8	212.1	119.1	204.5	295.8	292.4	43.0%
Foreign grants	60.0	0.0	0.0	5.3	9.0	9.0	31.9	31.9	39.6	24.2%
Overall balance (cash basis, after grants)	0.0	0.0	1.8	6.2	0.0	-7.1	0.0	0.0	0.0	-
Financing	0.0	0.0	-1.8	-6.2	0.0	7.1	0.0	0.0	0.0	-
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-
(In millions of GDP)										
Memorandum items:										
Revenues and grants excluding debt-service	95.0	49.0	59.6	82.4	92.2	61.7	147.0	146.9	185.6	-
Expenditures excluding debt-service	35.0	51.0	57.8	76.1	92.2	68.8	147.0	146.9	135.6	-
Contingency line 6/									29.0	

Sources: State Ministry of Treasury; and IMF staff estimates.

1/ Does not include non-cash grants.

2/ Includes new sources of revenues from the institute for standards, institute for accreditation, regulatory agency, department of civil aviation and CRA.

3/ Communication Regulatory Agency, Archives, Civil Aviation, Institute for Standards and Measures, Institute for Accreditation, Veterinary Services, and Foreign Investment Promotion Agency.

4/ Includes 6.2 million KM of arrears to international organizations in CoM Rebalanced budget in 2001.

5/ Includes 11.4 million KM for the Commission in charge of elections in 2002

6/ Projects that would be implemented only if additional resources are found during the budgetary year ( among which 7.4 million KM for the State Border Service, 11.3 million KM for refugees, and 7.7 million KM for the Information Agency)

Table 6. Bosnia and Herzegovina: Consolidated Central Government, 1998-2002  
(In millions of KM)

	1998	1999	2000	2001 4/	2002 5/
Revenues 1/	1,064.6	1,403.1	1,578.2	1,740.1	1,953.5
Expenditures (on a commitment basis)	1,401.0	1,782.2	2,133.7	1,835.2	2,050.7
Balance (on a commitment basis)	-336.4	-379.2	-555.5	-95.0	-97.2
Financing (on a commitment basis) 2/	336.4	379.2	555.5	95.0	97.2
Foreign budgetary grants	66.0	47.7	113.2	53.1	68.0
Net foreign budgetary loans	122.8	90.8	64.1	110.8	48.9
Disbursement	122.8	146.4	130.7	166.8	185.2
Amortization	0.0	-55.6	-66.6	-56.0	-136.3
Net arrears accumulation 3/	147.6	240.6	378.2	-156.9	-102.1
Privatization	0.0	0.0	0.0	32.4	82.0
Succession money	0.0	0.0	0.0	55.6	0.4
Memorandum items:					
Balance on a commitment basis (in percent of GDP)	-4.6	-4.6	-6.0	-0.9	-0.9
Primary surplus (in percent of GDP)	-3.4	-3.3	-4.6	0.5	0.5
Foreign financed investment projects (in millions of KM)	1,081.7	1,390.4	1,221.0	1,134.5	904.9
Foreign financed investment projects (in percent of GD	14.7	16.7	13.2	11.3	8.4
Nominal BiH GDP	7,336.0	8,323.0	9,260.5	10,077.2	10,806.2

Sources: Ministries of Finance; and IMF staff estimates.

1/ Own revenues for the State, outside transfers from the Entities.

2/ Does not include the foreign financed investment projects.

3/ If arrears are accumulated on a net basis, this corresponds to a positive financing on a commitment basis.

Includes Extrabudgetary Funds' arrears, as the central government authorities started making transfers to the Funds to have them clear their a

4/ Authorities' Revised Plans, projected before the end of the year. Therefore, foreign financing numbers are subject to change, with a shortfall of 31.4 million KM for the Federation and 15.7 million KM for the RS.

5/ Budget agreed with the authorities for the RS, authorities' draft budget for the State and the Federation.



Table 7. Bosnia and Herzegovina: Balance of Payments, 1998-2006  
(in millions of U.S. dollars; unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
			Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Trade balance	-1,959	-1,852	-1,616	-1,442	-1,431	-1,423	-1,340	-1,335	-1,332
Exports, f.o.b.	697	649	732	857	977	1,133	1,348	1,569	1,799
Imports, f.o.b.	-2,656	-2,502	-2,348	-2,299	-2,409	-2,557	-2,688	-2,904	-3,131
Reconstruction	-479	-516	-437	-400	-311	-259	-195	-178	-105
Humanitarian (in-kind)	-26	0	0	0	0	0	0	0	0
Other	-2,151	-1,986	-1,911	-1,899	-2,098	-2,298	-2,493	-2,727	-3,026
Services, net	378	324	264	226	203	188	141	108	92
Receipts	563	552	460	424	388	382	368	354	348
Expenditure	-185	-228	-196	-198	-185	-194	-227	-245	-256
Net factor income	330	273	225	234	230	228	214	239	318
Earnings	409	353	318	302	301	318	325	361	399
Interest payments	-79	-81	-63	-68	-72	-90	-111	-122	-80
Unrequited transfers, net	461	284	218	192	178	175	178	176	177
Receipts	468	292	225	199	186	183	185	183	185
Official grants	197	86	53	38	29	20	20	15	15
Budget support	38	25	53	38	29	20	20	15	15
Private	271	206	172	161	157	163	165	168	170
Outflows	-7	-8	-8	-7	-7	-7	-7	-7	-8
Excluding official transfers	-789	-971	-909	-789	-820	-832	-807	-812	-745
Foreign investment (net)	100	90	150	130	180	230	300	350	400
Capital transfers for reconstruction	492	548	396	346	252	190	150	90	80
Foreign loans (net)	122	147	237	195	184	152	147	148	130
Disbursements	194	205	248	212	224	195	190	187	170
Reconstruction	147	140	186	171	162	155	150	147	130
Other 1/	47	65	62	42	62	40	40	40	40
Amortization	-73	-58	-12	-17	-40	-43	-43	-39	-40
Multilateral and Paris Club creditors	-30	-15	-10	-17	-40	-43	-43	-39	-40
Others 2/	-42	-42	-2	0	0	0	0	0	0
Commercial banks	129	-203	-146	-92	-34	-66	-23	-24	-25
Other capital 3/	0	400	266	895	555	261	183	163	98
Capital account balance	843	983	902	1,474	1,137	767	757	727	683
Errors and omissions	-101	239	24	8	0	0	0	0	0
Of which: Valuation adjustment	-82	165	73	0	0	0	0	0	0
Overall balance	-47	251	-6	685	318	-65	-50	-85	-62
Financing	47	-251	-18	-693	-373	-70	-85	-50	-73
Change foreign assets (increase, -)	-61	-262	-26	-695	-377	-74	-90	-58	-81
Of which: Gross foreign assets of the central bank	-94	-281	-43	-706	-377	-50	-50	-50	-50
Net use of Fund resources	33	18	17	10	0	-24	-40	-8	-31
Purchases/loans	33	39	37	18	22	22	0	0	0
Repurchases/repayments	0	-21	-20	-8	-22	-46	-40	-8	-31
Short-term liabilities (reduction, -)	0	0	0	0	0	0	0	0	0
Arrears (reduction, -)	-815	-20	-342	-604	0	0	0	0	0
Multilateral creditors	0	-20	0	0	0	0	0	0	0
Paris Club creditors	-815	0	0	0	0	0	0	0	0
London Club	0	0	0	0	0	0	0	0	0
Other creditors	0	0	-342	-604	0	0	0	0	0
Debt rescheduling or cancellation (of arrears)	815	20	342	604	0	0	0	0	0
Multilateral creditors (rescheduling)	0	20	0	0	0	0	0	0	0
Paris Club creditors (rescheduling) 4/	815	0	0	0	0	0	0	0	0
London Club (rescheduling) 5/	0	0	0	0	0	0	0	0	0
Other creditors (cancellation) 2/	0	0	342	604	0	0	0	0	0
Debt relief, current maturities (cashflow)	108	12	8	2	4	5	5	8	8
Multilateral creditors	0	0	0	0	0	0	0	0	0
Paris Club creditors 4/	36	8	0	0	0	0	0	0	0
London Club 6/	73	4	8	2	4	5	5	8	8
Total financing gap	0	0	0	0	-56	-135	-135	-135	-135
Memorandum items:									
Primary current account balance (percent of GDP) 7/	-17.0	-19.6	-19.2	-15.7	-15.1	-13.9	-12.1	-11.0	-9.8
Current account balance (in percent of GDP)	-18.9	-21.4	-20.6	-17.2	-16.6	-15.6	-14.0	-13.0	-11.0
Excluding official transfers	-22.5	-24.6	-21.8	-18.0	-17.2	-16.0	-14.3	-13.2	-11.2
External public debt/GDP (in percent)	68.1	71.9	68.7	55.7	54.9	55.8	55.8	55.8	54.9
External debt service/GNFS (in percent)	12.0	11.5	6.2	6.6	8.2	8.8	8.9	8.3	5.6
Gross official reserves (in months of imports)	0.7	2.0	2.3	5.7	7.3	7.1	6.9	6.6	6.3

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

1/ Disbursement for budget finance and includes the World Bank and EU loans. The level of EU loans in 2002 is provisional.

2/ Other debt refers to non-convertible currency debt, unallocated debt from Yugoslavia, and other commercial (mainly trade credits), i.e., non-Paris Club and non-London Club debt. Part of this was rescheduled in 2000; the remainder is expected to be rescheduled by end-2001.

3/ Figures for 2001 and 2002 reflect the effects of the conversion of the peg from the DM to the euro.

4/ Reflects Paris Club debt consolidation and rescheduling on Naples Terms agreed in October 1998.

5/ Reflects London Club debt consolidation agreed in December 1997.

6/ Principal and interest payments due on original maturities, less payments due on rescheduled debt.

7/ Primary current account is current account minus interest payments on foreign debt.

Table 8. Bosnia and Herzegovina: External Financing Requirements and Possible Sources of Financing, 1998-2002

(In millions of U.S. dollars)

	1998	1999	2000	2001	2002
Merchandise trade balance	-1,959	-1,852	-1,616	-1,442	-1,431
Services balance	378	324	264	226	203
Net factor income	330	273	225	234	230
<i>Of which:</i> Interest due	-79	-81	-63	-68	-72
Private transfers, net	264	198	164	154	149
<b>Current account balance, excluding official transfers</b>	<b>-986</b>	<b>-1,058</b>	<b>-962</b>	<b>-827</b>	<b>-849</b>
Amortization of medium and long term obligations 1/	-73	-58	-12	-17	-40
Changes in arrears (- is reduction)	-815	-20	-342	-604	0
<i>Of which:</i> Multilateral	0	-20	0	0	0
London Club	0	0	0	0	0
Paris Club	-815	0	0	0	0
Other 2/	0	0	-342	-604	0
London Club rescheduling and debt relief	73	4	8	2	4
Paris Club rescheduling and debt relief	851	8	0	0	0
Multilateral rescheduling and debt relief	0	20	0	0	0
Change in official reserves (- is increase)	-94	-281	-43	-706	-377
Change in commercial bank NFA (- is increase)	129	-203	-146	-92	-34
Errors and omissions	-101	239	24	8	0
<b>Gross external financing requirement</b>	<b>-1,017</b>	<b>-1,348</b>	<b>-1,473</b>	<b>-2,235</b>	<b>-1,296</b>
Official transfers	197	86	53	38	29
Capital transfers for reconstruction	492	548	396	346	252
Official loans for balance of payments support 3/	0	11	4	-15	20
Disbursement for reconstruction	147	140	186	171	162
Foreign direct investment	100	90	150	130	180
Other capital	0	400	266	895	555
<b>Financing gap after project and humanitarian flows</b>	<b>-80</b>	<b>-73</b>	<b>-418</b>	<b>-671</b>	<b>-98</b>
IMF	33	18	17	10	0
World Bank adjustment lending	47	54	58	57	43
<b>Gross financing gap (-)</b>	<b>0</b>	<b>0</b>	<b>-342</b>	<b>-604</b>	<b>-56</b>
Other rescheduling and debt relief 2/	0	0	342	604	0
<b>Remaining gap</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-56</b>

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

1/ Includes IMF repurchases.

2/ Mainly reflects rescheduling of debt arising out from bank guarantees for construction work that was not completed, unallocated suppliers credits, and debt acquired in non-convertible currency. The State began rescheduling in 2000 and is expected to complete the process in 2001.

3/ Excludes multilateral creditors.

Table 9. Bosnia and Herzegovina: External Debt at end-2000 and Debt Service in 2001-2005 1/ 2/  
(In millions of US dollars)

	Stock of Debt	Projected Debt Service Payments				
	2000	2001	2002	2003	2004	2005
Total debt outstanding	2,969.4	...	...	...	...	...
Total debt service	...	93.1	133.9	179.9	192.8	168.5
Amortization	...	25.5	62.4	89.6	82.2	46.9
<i>Of which:</i>						
Multilateral	1,520.8	17.3	52.0	78.7	71.5	39.5
IMF	105.6	8.0	22.3	46.4	39.6	8.3
World Bank 3/	1,256.4	5.5	24.8	24.2	23.9	23.1
Other	158.9	3.7	4.9	8.1	8.1	8.1
Paris Club 4/	521.9	4.8	9.3	8.9	8.6	2.4
London Club 4/	124.3	0.0	0.0	0.0	0.0	3.0
Other creditors 5/	802.3	3.4	1.1	2.0	2.0	2.0
Interest	...	67.6	71.5	90.3	110.6	121.6
Multilateral	...	42.7	40.9	56.5	72.6	82.0
IMF	...	8.0	4.2	3.9	1.9	0.5
World Bank 3/	...	26.1	33.4	49.7	68.2	81.5
Other	...	6.0	8.6	3.3	2.9	2.5
Paris Club 4/	...	14.9	24.7	18.8	18.5	18.3
London Club 4/	...	2.3	3.6	4.5	4.5	5.2
Other creditors 4/ 5/	...	7.7	2.3	10.5	15.0	16.2

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

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

2/ Excludes an estimated US\$54 million 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); before 2000 this included non-convertible currency debt. Rescheduling of these debts began in 2000 and is expected to be completed in 2001.

Table 10. Bosnia and Herzegovina: Monetary Survey, 1997-2001  
(In millions of KM)

	1997	1998	1999	2000	2001			
					March	June	Oct.	Dec. Proj.
<b>Net foreign assets</b>	<b>-500</b>	<b>-435</b>	<b>195</b>	<b>427</b>	<b>510</b>	<b>657</b>	<b>969</b>	<b>2,236</b>
Foreign assets (MA)	144	283	866	1,045	1,059	1,173	1,438	2,666
Foreign assets (DMB)	1,014	887	848	961	1,099	1,157	1,248	1,887
Foreign liabilities (MA)	0	0	0	-1	-1	-1	-1	-1
Foreign liabilities (DMB)	-1,658	-1,606	-1,519	-1,577	-1,646	-1,671	-1,716	-2,316
<b>Domestic Credit</b>	<b>2,267</b>	<b>2,635</b>	<b>2,602</b>	<b>2,863</b>	<b>2,967</b>	<b>3,044</b>	<b>3,214</b>	<b>3,250</b>
Claims on central government (net)	-188	-181	-159	-129	-137	-206	-223	-306
Claims on noncentral government	5	9	17	9	16	19	23	24
Claims on private sector	2,450	2,808	2,744	2,983	3,088	3,231	3,414	3,531
Non-financial enterprises and cooperatives	2,315	2,547	2,467	2,564	2,652	2,714	2,723	2,787
Households	121	248	268	384	398	480	654	706
Other	14	13	9	35	37	37	37	38
<b>Broad Money</b>	<b>1,178</b>	<b>1,547</b>	<b>2,165</b>	<b>2,467</b>	<b>2,551</b>	<b>2,698</b>	<b>3,135</b>	<b>4,427</b>
Money	252	310	1,100	1,402	1,432	1,571	1,885	2,634
Currency outside banks	113	162	515	652	655	688	878	1,640
Demand deposits of noncentral government	26	21	85	97	154	163	178	178
Demand deposits of the private sector	113	127	499	653	623	720	829	816
Non-financial enterprises and cooperatives	94	103	387	454	494	557	654	655
Households	5	8	34	79	81	94	120	106
Other	14	15	78	119	49	69	55	55
Quasi-Money	926	1,237	1,065	1,066	1,119	1,128	1,250	1,793
Time and Savings Deposits in Domestic Currency	10	8	22	78	83	89	104	104
Foreign currency deposits	917	1,229	1,043	988	1,036	1,038	1,147	1,690
Other items (net)	589	653	632	823	926	1,003	1,048	1,125
<b>Memorandum items:</b>								
NFA of the central bank	144	283	866	1,046	1,060	1,175	1,439	2,667
NFA of the central bank in percent of currency outside the bank	128	174	168	161	162	171	164	163
NFA of the central bank in percent of broad money	12	18	40	42	42	44	46	60
Broad money growth (year-on-year)	-99.8	31.3	40.0	14.0	20.6	20.5	26.4	79.4
NDA contribution to broad money growth (year-on-year)	-384.8	31.3	-2.2	12.1	14.8	11.0	11.0	15.6
NFA contribution to broad money growth (year-on-year)	254.5	5.5	40.7	10.7	19.4	22.4	28.0	73.3
Other items net contribution to broad money growth (year-on-year)	30.5	-5.5	1.4	-8.8	-13.6	-12.9	-12.6	-12.2
NFA growth (year-on-year)	-100.0	-13.0	-144.8	119.0	411.3	322.0	252.9	423.8
NDA growth (year-on-year)	-99.9	16.2	-1.3	10.0	11.8	8.8	9.3	13.5
Private sector credit growth	-99.9	14.6	-2.3	8.7	9.6	10.0	11.0	18.4
Credit to the household sector (percent growth, year-on-year)	252.7	104.6	8.3	43.3	38.5	45.0	75.7	83.9
Credit to household sector (in percent of GDP)	2.0	3.4	3.2	4.2	4.0	4.8	6.5	7.0
Broad money in percent of GDP	19.3	21.1	26.0	26.8	25.3	26.8	31.1	43.6
Domestic Credit (in percent of GDP)	37.1	35.9	31.3	31.1	29.4	30.2	31.9	32.0
Private sector credit (in percent of GDP)	40.1	38.3	33.0	32.4	30.6	32.1	33.9	34.8

Sources: Central Bank of Bosnia and Herzegovina; and IMF staff estimates.

Table 11. Bosnia and Herzegovina: Medium-Term Scenarios, 2000-2006  
(In percent of GDP, unless otherwise specified)

	2000	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.
<b>Reform Scenario</b>							
<b>Real GDP growth (in percent)</b>	5.9	5.6	5.1	6.0	6.0	6.0	6.0
<b>Savings and investment</b>							
Investment	23	21	19	21	21	22	21
Public investment	15	13	10	10	9	9	9
Private investment	7	8	9	11	12	13	13
National savings	2	4	3	5	7	9	10
Public savings	-5	0	0	1	2	4	4
Private savings	7	4	3	4	5	5	6
Foreign savings	21	17	17	16	14	13	11
<b>General government</b>							
Total revenue	45	42	44	44	44	44	43
Total expenditure	66	55	54	53	51	49	47
Current expenditure	51	42	44	43	42	40	38
Capital expenditure	15	13	10	10	9	9	9
Own-financed capital expenditure	2	1	2	4	4	5	5
Foreign-financed capital expenditure	13	11	8	6	5	4	3
Overall balance	-21	-13	-10	-9	-7	-5	-4
Gross public debt (foreign and domestic) 1/	75	62	59	58	55	53	51
<b>Status Quo</b>							
<b>Real GDP growth (in percent)</b>	5.9	5.6	4.0	3.5	3.5	3.5	3.5
<b>Savings and investment</b>							
Investment	23	21	18	17	17	17	16
Public investment	15	13	10	9	8	7	7
Private investment	7	8	8	8	8	9	8
National savings	2	3	1	1	2	2	2
Public savings	-5	0	-2	-2	-2	-2	-2
Private savings	7	4	3	3	5	5	4
Foreign savings	21	17	17	16	15	15	14
<b>General government</b>							
Total revenue	45	42	42	42	42	42	42
Total expenditure	66	55	55	53	52	51	51
Current expenditure	51	43	44	44	44	44	44
Capital expenditure	15	13	10	9	8	7	7
Own-financed capital expenditure	2	1	2	2	2	3	3
Foreign-financed capital expenditure	13	11	8	7	6	4	4
Overall balance	-21	-13	-13	-11	-10	-9	-9
Gross public debt (foreign and domestic) 1/	75	62	60	62	63	66	69

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

1/ Based on the authorities budgetary disbursement projections for 2001 made in December 2001.

Table 12. Bosnia and Herzegovina: Vulnerability Indicators, 2000-2001

	2000	2001
Exports (annual percent change, US\$ basis)	12.7	16.1
Imports (annual percent change, US\$ basis)	-6.2	-2.1
Current account balance (percent of GDP) 1/	-20.6	-17.2
Capital and financial account (percent of GDP)	19.3	32.3
Gross official reserves (end-of-period) in US\$	936.4	2,057.7
In months of prospective GNFS imports	2.3	5.7
Broad money/NFA (end-of-period) 2/	578.0	275.2
Foreign exchange deposits/reserves (percent, end-of-period)	94.5	75.6
Total external debt (percent of GDP)	68.7	55.7
External debt service/ exports of GNFS (in percent)	6.2	6.7
Exchange rate (per U.S. dollar, period average) 2/	2.1	2.2
REER depreciation, end-of-period (-) ( annual percent change)		
Republika Srpska	8.1	8.0
Federation	-5.4	1.2

Source: IMF staff estimates.

1/ Includes transfers.

2/ 2001 monetary data as of end-November 2001.

**Bosnia and Herzegovina: Fund Relations**

As of December 31, 2001

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

II. <u>General Resources Account</u> :	<u>SDR Million</u>	<u>%Quota</u>
Quota	169.10	100.0
Fund Holdings of Currency	257.46	152.26

III. <u>SDR Department</u> :	<u>SDR Million</u>	<u>%Allocation</u>
Net cumulative allocation	20.48	100.0
Holdings	4.86	23.75

IV. <u>Outstanding Purchases and Loans</u> :	<u>SDR Million</u>	<u>%Quota</u>
Stand-by arrangements	88.36	52.25

V. Latest Financial Arrangements:

	<u>Approval</u>	<u>Expiration</u>	<u>Amount Approved</u>	<u>Amount Drawn</u>
<u>Type</u>	<u>Date</u>	<u>Date</u>	<u>(SDR Million)</u>	<u>(SDR Million)</u>
Stand-by	05/29/1998	05/28/2001	94.42	94.42

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

	<u>Forthcoming</u>				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	17.6	23.3	29.2	17.8	3.5
Charges/Interest	2.7	2.1	1.4	0.8	0.4
Total	20.3	25.4	27.6	18.6	3.9

VII. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, Central Bank of Bosnia and Herzegovina (CBBH) is subject to a full Stage One safeguards assessment with respect to the Stand-By arrangement. A Stage One safeguards assessment of the CBBH is underway. The transitional assessment of the CBBH, with respect to the arrangement which expired on May 29, 2001, was completed on April 12, 2001. The transitional assessment concluded that CBBH's external audit mechanism was adequate.

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**

Bosnia and Herzegovina is on the standard twelve-month cycle. The last Article IV consultation was concluded on March 8, 2000.

**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**

<b>Department</b>	<b>Timing</b>	<b>Purpose</b>
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
FAD	August 2000	Treasury systems
	September-October 2000	Value-added tax
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.
	March-April 2001	Payments system, currency management, accounting and research
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);<sup>1</sup> and having agreed with the Bank on a plan to eliminate arrears on those loans.<sup>2</sup>
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. An updated assessment of donor pledges as of December 1999 indicates pledges having risen to US\$5.4 billion.
3. As of October 31, 2001, the World Bank Group had committed US\$860 million, in support of 42 IDA credits/World Bank Trust Funds and disbursed US\$635 million. As of February 2001 US\$39 million had been committed in 17 IFC operations, and US\$30 million disbursed. 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, for which a Progress report was presented to, and approved by, the Bank's Board on October 18, 2001, 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

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<sup>1</sup> 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.

<sup>2</sup> 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.

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 was approved by the World Bank's Board in February 2001. According to the country assistance progress report, and based on reform performance to date, the Bank's program remains in the low range of the base case. The program would only move to the high range of the base case once the two ongoing adjustment credits mentioned above are completed and agreement reached on the measures to be supported in the two adjustment credits now under preparation, one to improve the business enabling environment and the other to follow-up on the original social adjustment credit.

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.

## STATUS OF BANK GROUP OPERATIONS IN BOSNIA AND HERZEGOVINA

A. STATEMENT OF BANK LOANS <sup>a/</sup>

(As of Nov 1, 2001)

Loan No.	Fiscal Year	Borrower	Project	US\$ Million (Less Cancellations)	
				Loan	Undisbursed
<b>Loan/Credits/ Grants</b>					
<b>IBRD <sup>b/</sup></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
			<b>Total</b>	<b>620.6</b>	<b>0.0</b>
			Of which: Repaid	24.9	
			<b>Total Now Held by the Bank</b>	<b>595.7</b>	<b>0.0</b>
<b>TFBH <sup>c/</sup> (Under Disbursement)</b>					
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
			<b>Total</b>	<b>150.0</b>	<b>0.7</b>
<b>IDA</b>					
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	0.0
2902-BOS	1997	Bosnia and Herzegovina	Emergency Housing Repair	15.0	0.0
2903-BOS	1997	Bosnia and Herzegovina	Emergency Power Reconstruction	35.6	0.0
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	0.3
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	0.3
N003-BOS	1997	Bosnia and Herzegovina	Essential Hospital Services	15.0	1.3
N032-BOS	1998	Bosnia and Herzegovina	Transport Reconstruction II	39.0	0.0
N035-BOS	1998	Bosnia and Herzegovina	Education Reconstruction II	11.0	0.0
3028-BOS	1998	Bosnia and Herzegovina	Reconstruction Assistance Project	17.0	0.0
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	0.0
3071-BOS	1998	Bosnia and Herzegovina	Power II	25.0	3.2
N040-BOS	1998	Bosnia and Herzegovina	Forestry	7.0	2.3
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	13.6
3202-BOS	1999	Bosnia and Herzegovina	Basic Health	10.0	7.6
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	8.4
3269-BOS	1999	Bosnia and Herzegovina	Pilot Cultural Heritage Project (LIL)	4.0	2.6
3258-BOS	1999	Bosnia and Herzegovina	Second Public Finance (Structural Adjustment)	72.0	20.4
3351-BOS	2000	Bosnia and Herzegovina	Education Development Project III	10.6	8.8
3400-BOS	2000	Bosnia and Herzegovina	Mostar Water and Sanitation	12.0	10.0
3385-BOS	2000	Bosnia and Herzegovina	Emergency Labor Redeployment	15.0	14.1
3439-BOS	2000	Bosnia and Herzegovina	Social Sector Structural Adjustment Credit - TA	3.55	3.3
Q2370-BOS	2001	Bosnia and Herzegovina	Trade and Transport Facilitation in SEE	11.0	10.9
34650-BOS	2001	Bosnia and Herzegovina	Social Sector SAC(SOSAC I)	20.0	0.9
35330-BOS	2001	Bosnia and Herzegovina	Local Initiative II	20.0	20.0
35340-BOS	2001	Bosnia and Herzegovina	Electric Power 3	35.0	35.0
35380-BOS	2001	Bosnia and Herzegovina	Community Development	15.0	15.0
3531-BOS	2001	Bosnia and Herzegovina	Privatization TA	19.8	19.8
			<b>Total</b>	<b>709.6</b>	<b>223.0</b>
			<b>Grand Total</b>	<b>859.6</b>	<b>223.7</b>

<sup>a/</sup> 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.

<sup>b/</sup> Consolidation Loans A, B, and C were approved on June 13, 1996 and became effective on June 14, 1996.

<sup>c/</sup> Trust Fund for Bosnia and Herzegovina.

**B. STATEMENT OF IFC INVESTMENTS**

(As of June 30, 2000)

IFC Held

----- USD Million -----

<u>Obligor</u>	<u>Type of Business</u>	<u>Loan</u>	<u>Equity</u>	<u>Quasi</u>	<u>Total</u>
Tvornica Kartona i Ambalaze Cazin	Timber, Pulp and Paper	3.21	0.00	0.00	3.21
SOUR Energoinvest	Industrial Equipment and Machinery	7.64	0.00	0.00	7.64
Horizonte BiH Enterprise Fund	SME Investment	0.00	1.74	0.00	1.74
Microenterprise Bank	Microcredit	0.00	0.85	0.00	0.85
Sarajevska Pivara	Beverage Manufacturing	2.80	0.00	0.00	2.80
SEF Akova	Meat Packing and Processing	1.83	0.00	0.00	1.83
Wood Agency Credit Line	Furniture and Other Wood Products	4.30	0.00	0.00	4.30
SEF Lignosper	Furniture Manufacturing	2.00	0.00	0.00	2.00
SEF Kopex	Industrial and Consumer Services	1.86	0.00	0.00	1.86
SEF Lijanovici	Abattoir, Meat Processing	2.17	0.00	0.00	2.17
SEF Bosnalijek	Pharmaceutical	0.00	0.00	2.14	2.14
Wood Konjuh	Wood Products	2.17	0.00	0.00	2.17
Wood Kozara	Wood Products	1.52	0.00	0.00	1.52
Wood Podgradci	Wood Products	1.08	0.00	0.00	1.08
Wood Inga	Wood Products	1.52	0.00	0.00	1.52
Wood Vrbas	Wood Products	1.52	0.00	0.00	1.52
<b>Total Gross Investments</b>		<b>33.58</b>	<b>2.59</b>	<b>2.14</b>	<b>38.32</b>
Participations, Cancellations, Terminations, Exchange Adjustments, Repayments, and Arrears (Principal Only)		10.84	0.00	0.00	10.84
<b>Total Commitments Now Held by IFC</b>		<b>22.74</b>	<b>2.59</b>	<b>2.14</b>	<b>27.47</b>
<b>Total Undisbursed</b>		<b>7.66</b>	<b>1.01</b>	<b>0.00</b>	<b>8.67</b>
<b>Total Outstanding</b>		<b>15.08</b>	<b>1.58</b>	<b>2.14</b>	<b>18.80</b>

## BOSNIA AND HERZEGOVINA: STATISTICAL ISSUES

1. Since the last Article IV discussions, good progress has been made in compiling monetary statistics, but other macroeconomic statistics are still inadequate for policy-making.

2. The Dayton peace treaty, which ended the civil war implicitly gave responsibility for statistical functions to the two Entities (The Federation and RS). In August 1998, the State created its own statistical institute, the Bosnia and Herzegovina Agency for Statistics (BHAS) with a view to compiling country-wide statistics in accordance with internationally accepted methodologies, consolidating data produced by the Entity Statistical Institutes, and acting as the primary coordinating agency for contacts with international agencies. Significant technical assistance was provided in recent years, mainly by the European Union and essentially in the form of training seminars and study visits. 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 monetary and other 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. A country page for Bosnia and Herzegovina in *International Finance Statistics (IFS)* was introduced in July 2001.

### A. Real Sector

3. Since the last Article IV consultation, efforts have been made in both Entities to improve statistics on the real sector but results have been mixed. The Federation has published nominal GDP estimates on a production basis for 1999 and 2000, based on international standards recommended under the *SNA 1993*. In the RS, the estimate for nominal GDP in the year 2000 is still preliminary, in part because data collection was interrupted upon the closure of the payment bureaus. However, in both Entities, production and income aggregates at constant prices and compilation of GDP by final demand are still unavailable and informal sector activities are under-recorded. The preparation of a household income survey, which will serve as the basis of revising price indices and of national accounts on the demand side, has been delayed. There are still no meaningful short-term business and consumer surveys. Both statistical offices compile prices and production indices following sound methodological procedures, although the weights in the indices are seriously outdated. Industrial production indices are prepared in each Entity, but there is no index at the country level. In the RS, the industrial production index covers only public enterprises, which represent a declining share of economic activity. Labor statistics are the weakest area for both Institutes, and data on employment, unemployment, and wage rates are based on deficient methodologies, has been delayed.

### B. Balance of Payments

4. Trade data are published by Entities's Statistical Institutes and balance of payment statistics by the CBBH's Research Department. The quality of these data is generally poor. Foreign trade data are not based on international standards and suffer from serious undercoverage due to smuggling and undervaluation. The coverage of foreign aid data,

foreign investment, and workers remittances is inadequate. Work has been ongoing with the support of the EU's CAFAO to introduce the computerized customs data management system ASYCUDA++ (the introduction is now planned for June 2002) and it is expected that this will improve the quality of trade data. Continued technical assistance will be provided through the Fund's Resident Statistical Advisor.

### **C. Government Finance**

5. Until the last Article IV consultation, the operational responsibility for compiling countrywide GFS was unclear. The CBBH has since agreed to take responsibility for compiling countrywide GFS, even though the Ministry of Finance for the Federation of Bosnia and Herzegovina has been officially designated as the correspondent for submitting GFS to the Fund's Statistics Department. The RS authorities indicated that they also have adopted, in 2001, the 1986 GFS classification system. The Research and Development Department of the CBBH has started consolidating annual GFS data from both Ministries of Finance beginning with annual data for 2000 but results have not been published.

### **D. Monetary Accounts**

6. The CBBH reports monetary accounts to the Fund on both a countrywide and Entity basis. In 1996–1999, the Fund sent six missions to establish an integrated system of countrywide monetary statistics meeting Fund standards. Two follow-up monetary and financial statistics missions took place in October–November 2000 and in December 2001. The latest mission reviewed in particular the recent institutional changes and accounting developments arising from BiH's financial sector reform and assisted in revising and updating the current monetary data compilation procedures.

**Bosnia and Herzegovina: Core Statistical Indicators**  
(As of January 27, 2002)

	Exchange rates 1/	Inter-national Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance 2/	Government Balance	GDP	External Debt/ Debt Service
Date of Latest Observation	Dec 31, 2001	Dec 31, 2001	Dec 31, 2001	Nov. 30, 2001	Nov. 30, 2001	Nov. 30, 2001	Dec 31, 2001 3/	Sep 30, 2001 3/	...	Nov 28, 2001	2000	Dec 2001
Date Received	Jan 2002	Jan 2002	Jan 2002	Jan. 2002	Jan. 2002	Jan. 2002	Jan 2002	Dec 2001	...	Dec 21 2001	Dec 2001	Jan 2001
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	...	Monthly	Annual	Monthly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly/ On mission	Monthly	Quarterly	...	Monthly	Annual	...
Source of Update	CBBH 4/	CBBH 4/	CBBH 4/	CBBH 4/	CBBH 4/	CBBH 4/	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	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	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	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/ BiH Federation only. September for the RS.

4/ CBBH is the Central Bank of Bosnia and Herzegovina.



INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

**Staff Report for the 2001 Article IV Consultation**

Supplementary Information

Prepared by the Staff Representatives for the 2001 Consultation  
with Bosnia and Herzegovina

Approved by Carlo Cottarelli and G. Russell Kincaid  
February 22, 2002

1. This supplement provides information that has become available since the issuance of the Staff report for the Article IV consultation for Bosnia and Herzegovina (SM/02/44, 2/11/02). This information does not require changes in the staff appraisal.
2. **The 2002 Republika Srpska budget was adopted by parliament on February 1, 2002 (Table 1).** The revenue estimate has been increased by a small amount (a tenth of a percentage point of RS GDP) compared with the draft budget that was presented in the staff report, and the projected deficit is unchanged. On the expenditure side the allocations for refugee returns and for social funds have been increased slightly and there has been a reallocation—mostly within the military—from spending on goods and services into spending on wages.
3. **The Federation authorities have provided staff with new estimates for the 2001 budget outcome (Table 2).** Compared with the revised budget, tax revenues were higher and spending somewhat lower. The overall deficit (either including or excluding grants) was smaller than envisaged in the revised budget. Gross arrears clearance was equivalent to one percent of BiH GDP (slightly less than projected). As to other areas there was a KM 20 million shortfall in transfers to the State. Passage of the 2002 Federation budget has been delayed by a reassessment of the costs of a planned reduction in the number of military personnel.
4. **In the Federation there has been a new, albeit small, breach of a provision in the pension law introduced in early 2001 to stop the accumulation of pension arrears.** The authorities paid January 2002 pensions without indexing the entitlement to the contributions collected in January. This decision, which coincided with the unification of the two ethnically-based pension funds, entailed delaying the pension payment until February 7, by which time sufficient funds had accumulated. The lengthening of the collection period in order to achieve a target level of pensions runs counter to the pension law and could raise pensioners' expectations. This would make it more difficult to implement the pension legislation during the rest of the year, increasing the pressure for budget subsidies to the pension fund.

Table 1. Bosnia and Herzegovina: Republika Srpska Fiscal Operations (New presentation), 2001-2002

	2001		2002		Growth Rate (5)-(4)/(2)
	Budget	Authorities' Est. Outcome	Draft Budget	Approved Budget	
	(1)	(2)	(3)	(4)	
	(In millions of KM)				
Total Revenues	727.7	730.1	776.9	780.4	6.9
Tax revenues	631.7	626.9	683.7	687.2	9.6
Taxes on goods and services	304.6	336.9	363.9	367.4	9.0
Sales tax	151.7	156.5	188.6	204.7	30.8
Railway surcharge	29.4	42.7	42.0	29.4	-31.2
Excises	123.5	137.7	133.3	133.3	-3.2
Property tax on special goods 1/	-	4.5	20.8	20.8	-
Trade taxes	187.3	156.6	173.7	173.7	10.9
Customs duties	131.4	107.2	121.7	121.7	-
Import duties	55.9	49.4	52.0	52.0	-
Taxes on income	75.5	83.7	80.4	80.4	-3.9
Wage withholding	49.8	63.5	67.7	67.7	6.5
Personal income tax	8.3	3.9	4.0	4.0	1.8
Corporate income tax	17.4	16.2	8.7	8.7	-46.3
Other taxes and revenues	64.3	45.2	45.0	45.0	-0.6
Non-tax revenues	47.8	47.0	46.5	46.5	-1.1
Fees and charges	40.7	38.9	38.5	38.5	-
Fines	7.0	8.1	8.0	8.0	-
Special revenues 2/	48.2	56.1	46.6	46.6	-16.9
Total expenditures	824.6	783.2	886.5	890.0	-
Wage bill	346.0	-	335.7	346.3	-
Gross salaries and compensation	289.2	-	-	-	-
Gross salaries	242.7	-	-	-	-
Compensations	46.4	-	-	-	-
Employers contributions	56.9	-	-	-	-
Goods and services	85.8	-	137.6	113.4	-
Subsidies to public enterprises 3/	18.7	-	16.3	17.8	-
Transfers to the social funds	16.0	-	15.2	20.2	-
Transfers to households	141.6	-	140.2	147.2	-
War invalids	105.2	-	109.0	110.5	-
Refugees	28.0	-	18.7	25.0	-
Other	8.4	-	12.5	11.7	-
Transfers to municipalities	2.5	-	2.0	3.0	-
Transfers to the State	101.0	-	135.4	135.4	-
Debt service	82.0	-	109.6	109.6	-
Administration	19.0	-	25.8	25.8	-
Clearance of arrears	34.8	-	24.5	24.5	-
Capital and reconstruction expenditures	59.7	-	56.1	57.1	-
Of which: Railway	29.4	-	29.4	29.4	-
Other expenditures and unallocated	18.5	-	23.6	25.2	-
Budgetary reserve	12.0	-	-	10.0	-
World Bank co-financing	1.2	-	-	4.6	-
Other transfers	5.3	-	-	10.6	-
Overall balance (cash basis, before grants)	-96.9	-53.1	-109.7	-109.6	-
Foreign grants for budget support	0.0	1.1	16.5	11.9	-
Overall balance (cash basis, after grants)	-96.9	-52.0	-93.2	-97.7	-
Financing	96.9	52.0	97.7	97.7	-
Domestic financing 4/	-	-7.3	-	-	-
External loans for budget support 5/	96.9	59.3	65.7	65.7	-
Privatization revenues	0.0	-	32.0	32.0	-
Memorandum items	(In millions of KM)				
Military spending	62.4	-	80.5	75.3	-
Wage bill	53.9	-	39.9	47.9	-
Other	8.5	-	40.6	27.4	-
	(In percent of RS GDP)				
Revenues	26.3	26.4	26.3	26.4	-
Balance (cash basis, after grants)	-3.5	-1.9	-3.2	-3.3	-

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

1/ Taxes on the personal use of special goods such as motor vehicles, mobile phones, boats, aircrafts and weapons.

2/ Includes other fees (on water, on use of forests), own revenues from administrations and other non-tax revenues.

3/ Outside subsidies to the railroads.

4/ In IMF projections for 2003, privatizations receipts are placed in escrow, implying negative domestic financing.

5/ Disbursement. Amortization is included in the debt service transfers to the State.

Table 2. Bosnia and Herzegovina: Federation Fiscal Operations, 1997-2002

	1997	1998	1999	2000	2001		
	(1)	(2)	Est. Outcome (3)	(4)	Budget (5)	Revised Outcome 1/ Budget (6)	
(In millions of KM)							
Total revenue	610.4	682.0	723.7	828.5	872.7	1009.0	1068.7
Tax revenue	565.3	645.1	676.5	768.0	813.3	914.7	949.6
Indirect taxes	565.3	634.7	658.8	745.5	788.4	866.2	905.5
Profit tax	0.0	10.4	17.7	22.5	24.9	48.5	44.1
Nontax revenue	45.2	36.9	47.2	60.5	59.3	94.3	119.1
<i>Of which: Dividends of public enterprises 2/</i>						28.5	27.7
Total expenditure	657.2	803.7	800.5	976.4	997.6	1193.4	1169.2
Wages and contributions 3/	69.6	77.3	92.5	103.0	108.2	119.4	122.1
Goods and services	21.4	37.0	32.4	29.8	32.3	29.5	29.0
Military 4/	253.5	276.0	291.4	309.6	290.2	297.0	296.8
Reconstruction and capital expenditure 5/	17.5	42.6	26.0	47.2	46.6	60.7	61.9
Subsidies	3.2	20.4	14.1	14.0	11.2	11.2	11.2
Other transfers to households	226.7	257.7	215.9	255.0	278.6	372.2	354.6
Transfers to pension funds	15.8	21.9	6.5	8.8	8.8	102.2	83.0
Regular transfers	15.8	21.9	6.5	8.8	8.8	18.2	19.0
Extraordinary transfers 6/						84.0	64.0
Transfers for health	1.4	1.3	0.1	0.7	1.0	1.0	1.0
Transfers for education	10.4	3.3	1.4	4.9	4.9	5.1	5.1
Transfers to war invalids	175.5	209.3	207.9	240.7	263.9	263.9	265.5
Transfers to the state government	29.9	65.0	84.0	153.5	167.8	165.5	143.6
Administration	15.4	20.6	18.3	30.0	37.0	43.0	37.0
Debt service	14.5	44.4	65.7	123.5	130.8	122.5	106.6
Transfers to cantons and municipalities	3.7	7.0	15.9	25.1	10.0	18.0	18.0
Net lending	-	-	-	-7.0	-	3.7	3.7
Clearance of Federation budgetary arrears	-	-	-	-	-	47.8	46.6
Transfer to pension funds	-	-	-	-	-	12.0	12.0
Transfers to war invalids	-	-	-	-	-	23.0	23.0
Other	-	-	-	-	-	12.8	11.6
Contingency 7/	-	-	-	-	-	-	-
Other expenditure and unallocated	31.7	20.8	28.4	46.2	52.7	68.2	81.6
Refugees	2.5	6.4	3.8	23.3	25.0	28.0	28.0
Refund of prelevmani duties	-	-	-	-	4.0	-	-
World Bank financed projects	-	-	-	-	-	-	-
Intelligence Service	-	-	10.0	13.5	5.0	12.0	12.0
Budgetary reserve	12.8	-	-	-	11.2	15.4	15.1
Other	29.2	14.4	24.6	9.4	7.5	12.9	26.5
Overall balance (cash basis, before grants)	-46.8	-121.8	-76.8	-147.9	-124.9	-184.4	-100.4
Foreign grants for budget support	2.0	34.9	14.7	61.1	0.0	11.2	16.3
Overall balance (cash basis, after grants)	-44.8	-86.9	-62.2	-86.8	-124.9	-173.2	-84.1
Financing	44.8	86.9	62.2	86.8	124.9	173.2	84.1
Domestic financing 8/	0.0	0.0	0.0	-16.4	14.0	-3.7	4.5
Foreign loans for budget support 9/	44.8	86.9	62.2	103.2	111.0	119.5	79.6
Privatization	-	-	-	-	-	23.4	0.0
Succession money	-	-	-	-	-	34.0	0.0
Memorandum items:							
					(In percent of GDP)		
Revenue	12.9	12.2	11.8	12.4	11.9	13.8	14.6
Balance (cash basis, after grants)	-0.9	-1.6	-1.0	-1.3	-1.7	-2.4	-1.2
Fed. Budget consolidated with pension funds 10/					(In millions of KM)		
Net clearance of arrears	-	-	-	-	-	119.8	98.6

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

1/ Authorities' estimates. Includes 40 m KM of customs revenues collected in January and brought forward in 2001 outcome

2/ For 2002, contribution from PTT to roads construction brought on budget.

3/ Does not include wages from the Army, the Ministry of Defense and the Intelligence service, counted elsewhere in the table.

4/ Army and Ministry of Defense. Does not include off-budget assistance from other countries. Includes 50 million KM of severance payments in 2

5/ Includes allocation for railroads and other capital expenditures.

6/ Transfers from the Federation budget to clear pension arrears of previous years.

7/ In 2002, to be used to clear budgetary arrears or make an extraordinary transfer to the pension funds.

8/ In 2001, includes KM 17.7 million of revenues frozen in Hercegovacka Bank, which the authorities plan to get back in 2002.

In IMF projections for 2002 and 2003, privatizations receipts are placed in escrow, implying negative domestic financing.

9/ Disbursement. Amortization is included in the debt service transfers to the State.

10/ Excludes the clearance of budgetary arrears to the pension fund, includes extraordinary transfers to the pension funds to clear arrears.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
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Public Information Notice (PIN) No. 02/29  
FOR IMMEDIATE RELEASE  
March 22, 2002

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2001 Article IV Consultation with Bosnia and Herzegovina**

On February 25, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bosnia and Herzegovina.<sup>1</sup>

### **Background**

After several years of double-digit growth rates, real GDP increased by about 5.5 percent in 2001. The growth slowdown was particularly marked in the Republika Srpska, where output grew by just 2 percent. The slowdown—which is partly due to lower aid-financed reconstruction spending—marks the end of the post war economic rebound. Industrial production is still less than half its pre-war level and measured unemployment remains high at 40 percent. Inflation, which has been close to zero in the Federation for several years, declined in the Republika Srpska in 2001, reaching 8 percent.

Strong export growth and a reduction in aid-financed imports helped reduce the external current account deficit in 2001. While the deficit remains large, it continues to be financed largely by non-debt creating flows, primarily grants. Debt cancellation in 2001 helped lower the external debt burden: the external public debt ratio declined to 54 percent of GDP at end-2001.

In 2001 the two entities started to reverse fiscal imbalances that had worsened in previous years. Fiscal discipline was improved in both entities. The net accumulation of arrears was halted in spite of lower-than-anticipated external assistance and some arrears were repaid,

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

although public sector wages rose more than planned. Pension entitlements were reduced to affordable levels in both entities, ending the accumulation of pension arrears, and a start was made in clearing pension arrears accumulated in the past. Lower sales tax rates put the canton budgets under pressure, however, and the cantons encountered expenditure arrears. Expenditure by the State budget increased significantly in 2001, to about 3 percent of GDP, reflecting an increase in the role of State institutions (including the State Border Service).

Tax and structural fiscal reforms moved ahead in 2001. A reform of the sales tax brought full harmonization of indirect taxes and was a step towards creating a single economic space. The reform also eliminated virtually all sales tax exemptions, and significantly reduced the effective indirect tax rates. However, the entities continue to impose excise taxes on inter-entity trade, and work on a VAT remains stalled. In the fall, the Republika Srpska overhauled the system of direct taxes. In both entities, new treasury systems came on line in January 2002 and the tax administrations are being modernized.

The currency board arrangement has continued to deliver low inflation. Confidence in the Konvertibilna Marka (KM) has continued to increase, as shown by the trend increase in demand for the KM at the expense of foreign currency. The prospect of the introduction of euro notes accelerated the increase in the demand for KM in late 2001, though this may be temporary. The changeover to the euro has been managed smoothly by the Central Bank of Bosnia and Herzegovina.

Banking sector development is well advanced in the Federation but still at an early stage in the Republika Srpska. In the last three years, foreign banks have opened branches in the Federation and bank privatization has moved ahead. An agreement reached in December 2001 sets the stage for the privatization of PBS, the Federation's largest banking group. In the Republika Srpska, three large state-owned banks experienced difficulties in 2001. One has been privatized and discussions on the resolution of the other two are ongoing.

Bosnia and Herzegovina has continued to liberalize its trade regime. Under the framework of the June 2001 Memorandum of Understanding signed by the countries of South East Europe, Bosnia and Herzegovina signed free trade agreements with Macedonia, Slovenia, and the Federal Republic of Yugoslavia. Moreover, an agreement with the European Union has given Bosnia and Herzegovina goods free access to the European Economic Area.

### **Executive Board Assessment**

Directors welcomed the continuing decline in inflation in Bosnia and Herzegovina the stability of, and increased demand for the local currency, the convertible marka, and the return of confidence in the banking system. However, they expressed concern about the slower real GDP growth and continued high unemployment. Noting the need to attain sufficient and sustainable growth and a reduction in poverty, and taking into account the anticipated decline in foreign aid, Directors urged the authorities to take further measures to strengthen the private sector, which would need to be the engine of growth in the future. In that connection, a dynamic private sector would require sustained macroeconomic stability with a sound fiscal footing. It would also

require a strengthened business environment, including a consistent and transparent legal framework in both entities that encouraged good governance and created a level playing field. Directors also considered such measures to be key to fostering foreign investment. The harmonization of the administrative and legislative rules and regulations between the two entities toward European Union and international standards, would help support the business environment, foster economic integration, and facilitate the country's eventual membership in the EU.

Director emphasized that the currency board arrangement remains important for macroeconomic stability. It had created a strong and stable currency, and important positive feature of the business climate. Directors therefore urged the authorities to continue to implement currency board rules strictly and to strengthen the capital of the Central Bank of Bosnia and Herzegovina.

The viability of the currency board depends crucially on a sound fiscal policy. Thus, Directors urged that fiscal consolidation be continued in 2002. The reduction in the general government deficit, the efforts to halt the accumulation of arrears, and the improvements in budget management and transparency should all be sustained. In this context, Directors urged the authorities to base their 2002 budgets on realistic projections of revenue and financing, and to take into account the likely short-term costs of the planned military demobilization. The entities' new treasuries needed to tightly control budgetary commitments, and local government budgets, including in the Federation cantons, needed to be monitored closely.

Directors noted that the medium-term public expenditure outlook was clouded by expensive entitlement programs, by sizeable public debts (including arrears and frozen foreign currency deposits), and by the need to substitute domestic resources for donor-financed reconstruction. They urged the authorities to reform veterans' benefits, and to develop plans to clear arrears and frozen deposits on terms that do not overburden the budget.

Directors stressed that an integrated, country-wide value-added tax was needed in order to put budget finances on a sound footing, and they urged the authorities to work with the staff in its design, including with technical assistance. The entities needed to end the double-imposition of excise taxes, and to begin allocating excise revenues to the entity in which the taxed product was consumed.

Directors welcomed the increasing role of State institutions, and noted that the system of intergovernmental transfers would need to be changed to accommodate a larger State. The present system of entity transfers to the State should be replaced by a more stable and predictable source of "own" revenues for the State. Meanwhile, the States authorities needed to strengthen budget management and eliminate redundancy and overstaffing.

Directors stressed the importance of modernizing the entity tax administrations, and ensuring they were adequately financed and given effective and independent leadership.

However, they noted that the Federation still needed to enact the relevant supporting legislation for those administrations. Also, a more forceful anti-smuggling effort on excisable goods was needed.

Directors urged the authorities to improve conditions for private sector-led growth, concluding removing administrative obstacles to running a business, enforcing property rights, and keeping labor markets flexible. Privatization of strategic enterprises in both entities should also be accelerated. Directors, urged the authorities to resist pressures to jump-start the economy with inefficient fiscal measures, such as subsidies or employment incentives.

Directors noted that the banking system in the Federation had been strengthened by privatization and the increasing presence of international banks. They urged the authorities of the Republika Srpska to close problem banks or sell them to qualified investors. Directors considered bank supervision would be strengthened by centralizing supervision at the national level. The authorities' efforts to eliminate funding sources for terrorism and to prevent money-laundering were welcomed, and further steps in this area were encouraged.

Directors expressed concern that published economic data, including basic macroeconomic data, was still too weak to form a good basis for policymaking. They urged the authorities to provide the statistical institutes with sufficient resources, to improve cooperation between the institutes, and to use available technical assistance effectively.

Directors welcomed the lowering of trade barriers through participation in free trade agreements in the region.

Directors encouraged the authorities to work closely with the staff to prepare the ground for a future Fund-supported program.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Bosnia and Herzegovina is also available.

Bosnia and Herzegovina: Selected Economic Indicators 1998-2002

	1998	1999	2000	2001 <sup>1/</sup>	2002 <sup>2/</sup>
Real GDP	9.9	9.9	5.9	5.6	5.1
Federation	8.3	9.5	7	7	5.6
Republika Srpska	15.8	11.3	2.5	1.9	3.9
CPI (twelve month average)					
Federation	5.2	-0.7	1.9	1.7	1.8
Republika Srpska	-14.0	14.1	14.6	8	2
As percentage of GDP					
Public Finances					
General Government balance					
Federation	-1.6	-1	-1.3	-0.9	-2.4
Republika Srpska	-3.3	-3.9	-1.1	-1.9	-3.7
External Debt	68.1	71.9	68.7	55.7	54.9
Money and Credit					
Broad Money	31	40	14	79	22
Credit to non-government sector	14.6	-2.3	8.7	13.6	12.6
Balance of payments					
Gross official reserves					
(in million of US dollars)	175	455	488	1193	1570
In months of merchandise imports	0.8	2.2	2.3	5.7	7.3
Current account balance					
(in percent of GDP)	-18.9	-21.4	-20.6	-17.2	-16.6
Trade balance (in percent of GDP)	-47.0	-41.0	-36.6	-31.4	-28.9
<b>Exchange rates</b>					
Exchange rate regime	Currency Board since August 1997 <sup>3/</sup>				
Present exchange rate	1KM = €1.955				
(February 10, 2002)					
Real effective exchange rate					
(1998=100) <sup>4/</sup>					
Federation	100	92.8	87.8	88.7	...
Republika Srpska	100	106.2	114.6	123.9	...

Sources: Bosnia and Herzegovina authorities, and IMF staff estimates.

1/ Preliminary estimates.

2/ Projections.

3/ The currency board fixed the exchange rate at 1KM=1DM through end-2001 and KM=0.51 Euro since January 1, 2002.

4/ Annual average level, CPI-Based.



**Statement by J. de Beaufort Wijnholds, Executive Director for Bosnia and Herzegovina  
February 25, 2002**

The Bosnian authorities are grateful for the lucid staff report and for the constructive discussions with staff and management. At the same time, the authorities regret that, despite their joint efforts with staff, negotiations for a new Fund arrangement could not be completed in 2001. However, the authorities believe that major progress has been achieved last year to develop a self-sustaining and integrated economy and they remain committed to forcefully implementing the remaining reform agenda. The key issue though remains the development of a reasonable timetable for the implementation of economic policies, which leaves adequate time to discuss policy measures with all stakeholders. The authorities also believe that, together with staff, they have prepared substantial groundwork for a new Fund arrangement, and they look forward to reaching final agreement on a program soon.

**Developing a Common Economic Area**

Substantial progress has been made in harmonizing policies and legislation of both sub-national entities and the role of the state has increased in developing a national economic strategy. Cooperation between both entities and the state governments has improved considerably, which was for instance visible from the joint visits that the prime ministers of both entities paid to Washington last year and early this year, to discuss economic policies with the IFI's and the US government.

There were several internal and external factors that facilitated these developments. Early 2001, the non-nationalistic governments took power for the first time. They are committed to facilitating the country's integration with the rest of the world and to transform the BiH economy to a market basis. Secondly, overall democratization of the Federal Republic of Yugoslavia (FRY), as well as the bilateral agreement with the state of BiH on free trade and several other decisions of FRY to weaken its influence in the Republika Srpska. Finally, the BiH authorities' ambitions and commitments towards European integration have played a significant role in the design of economic policy. Bosnia is in the final stage of becoming a member of the Council of Europe, as the Council of Europe's parliamentary assembly recommended approval of Bosnia's application to the organization.

**Economic Outlook**

Although economic growth is becoming more self-sustained, the authorities recognize that the domestic economy does not yet provide sufficient resources to address the remaining developmental and poverty reduction issues. They remain committed to forcefully implementing structural reforms and creating a better private business environment. At the same time, BiH will still have to seek support from the international donor community and the IFIs in the future to address remaining structural issues, large foreign debt obligations and the external financial gap of the BOP.

The authorities have prepared a Global Economic Strategy for BiH until 2004, which has been fully reflected in the I-PRSP. The macro-framework of this strategy has been agreed with the Fund staff and the presentation of the medium term framework in the staff report is what the authorities have reflected in the I-PRSP.

### **Fiscal Policy**

The results of 2001 demonstrate that the authorities remain committed to maintaining a tight fiscal policy stance and that they make a strong effort to harmonize the tax systems of the two entities. The Federation government has also succeeded in consolidating the cantons' fiscal operations. All fiscal issues that were raised at the time of the last Board discussion were either addressed or a sufficient basis for their resolution has been created. The authorities remain committed to fiscal reform, but they think that further concerted advice from IFI's and financial support from the donor community will be needed to complete this task and put the government finances on a sustainable basis.

The authorities of both entities have submitted their 2002 budgets to their parliaments. The Republika Srpska's budget has already been approved, whereas the Federation government is still discussing the budget with the staff.

The authorities agree with staff that a more cautious approach in targeting budget revenues is needed. However, they also think that there is room for increasing tax revenue, as sufficient measures to improve tax administration have already been implemented last year. At the same time, the higher target would create an appropriate incentive structure to enforce tax legislation effectively. In any case, the authorities remain committed to adjust the budgets if their expectations of tax revenue collections would not materialize.

Given revenue constraints and the authorities' commitment not to borrow domestically there remains some conflict between short- and long-term expenditure priorities. As staff notes in the report, the level of current expenditures remains high at present and there are costly incentive schemes following the authorities' ambitious plan of demobilization of the army, which leads to higher expenditures. Nevertheless, this no doubt will have a significant positive impact on medium-term expenditure structure and on the development of the private sector.

As regards introduction of a VAT in BiH, the authorities have applied for FAD-technical assistance. The authorities have reconfirmed their commitment to introducing a VAT, but note that implementation has been delayed pending resolution of the strategic question whether the VAT should be collected at the state level or at the level of two entities. Therefore, they have requested a follow-up FAD mission to address this issue, so that the VAT could be introduced on January 1, 2004.

## **Monetary Policy and Financial Sector Reform**

The authorities remain committed to the currency board arrangement, which has served them well, including a low inflation rate. Efforts toward harmonizing prices between entities have also produced positive results as price differentials have almost disappeared.

The central bank of BiH (CBBH) maintains more than 100 percent foreign reserve coverage of KM liabilities. KM use has risen rapidly within BiH and it is now the dominant transaction currency in all parts of the country. Total KM liabilities have risen from KM 132 million when it was introduced in 1997 to 1.55 billion at the end of November 2001. Thereafter liabilities of the banking sector have risen further due to the successful conversion of Deutsche mark (DM) into the euro. Some rough estimates show a more than 100 percent increase in KM deposits of the banking system in recent months. According to CBBH data, some 935 million DM currency was sent back to Germany in 1999, 842 million in 2000 and as of end-November over DM 1.9 billion in 2001.

The reform in the banking sector has gone further and faster than the reforms in any other sector. Confidence is returning, depositors are beginning to return to banks and banks are beginning to lend on more reasonable terms. Indeed, the improvements have been more rapid last year than they were in the preceding years. These improvements are:

- a) the payments system has been reformed and now matches best European practice;
- b) there have been significant increases in banks' minimum capital requirements imposed by the banking agencies;
- c) deposit insurance has been introduced and is having an impact on citizens' confidence in banks;
- d) more foreign banks have started operations in BiH;
- e) five banks now have branches in both entities;
- f) both entities are committed to complete banks' privatization and facilitate an adequate ownership structure in the near future.

## **The Future**

Achieving sufficient and sustainable growth rates and reducing poverty in BiH requires continued prudent fiscal and monetary policies and a sustained implementation of outstanding structural reforms, while significantly increasing the role of the private sector. In the BiH context, the latter would mean: (a) a full harmonization of legislation between entities and towards the EU standards; (b) implementation of the international best practices in all spheres of economic management and improvement of institutional capacity; (c) removing administrative barriers to new businesses and to foreign investment; (d) completion of privatization of public assets; (e) most importantly, fighting corruption at all levels of government.

All these issues are on the agenda of the authorities and they are addressed in the I-PRSP. The authorities endeavors to address these issues sometimes create new challenges.

To support these reform efforts and to comprehensively address the outstanding issues, the authorities will need technical advice and donor financial support for quite some time.

Therefore, the authorities hope to reach agreement on a new IMF-arrangement soon. The authorities remain committed to sustainable economic and financial policies and are striving to complete the full PRSP by the end of this year. The I-PRSP has already been circulated to all stakeholders, including civil society organizations, and has led to extensive discussions. A new Fund arrangement in the near future would help the present reform-minded governments to establish a sound basis for future governments and to ensure that reform efforts and an integrated economy in BiH become irreversible.