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Bosnia and Herzegovina: Selected Issues and Statistical Appendix

This Selected Issues and Statistical Appendix report on Bosnia and Herzegovina was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with this member country. As such, the views expressed in this document are those of the staff team and do not necessarily reflect the views of the Government of Bosnia and Herzegovina or the Executive Board of the IMF.

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BOSNIA AND HERZEGOVINA

Selected Issues and Statistical Appendix

Prepared by Juan J. Fernández-Ansola, Jenny Ligthart (FAD), Jun Ma (FAD), Philippe Marciniak, Bhaswar Mukhopadhyay (PDR), Dawn Rehm, and Kori Udovicki

Approved by the European I Department

June 26, 2000

Selected issues papers are usually retrospective. This one, however, contains a substantial forward-looking component. This approach has been adopted in light of the special characteristics of Bosnia and Herzegovina. Although the region has a long and rich history, the country itself was only created in late 1995, as part of the Dayton Peace Agreement. Thus, its short history limits the scope for inference of policy prescription based on historical analysis. At the same time, the country finds itself at an economic crossroads, and therefore, the wide-ranging, forward-looking reform agenda warrants in-depth study. The structure of this paper mirrors this reality. Accordingly, each chapter presents a streamlined review of events that serve as background for a forward-looking assessment focused on a program of reforms.

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ABBREVIATIONS AND ACRONYMS

BiH	-	Bosnia and Herzegovina
CAMEL	-	Capital Asset Quality, Management, Earnings and Liquidity
CBBH	-	Central Bank of Bosnia and Herzegovina
CBL	-	Commercial Bank Law
CPA	-	Cantonal Privatization Agencies
DPA	-	Dayton Peace Agreement
EBPC	-	Enterprise and Bank Privatization Credit
FBA	-	Federation Banking Agency
Federation	-	Federation of Bosnia and Herzegovina
FPA	-	Federation Privatization Agency
FRY	-	Federal Republic of Yugoslavia
HrK	-	Croatian kuna
HVO	-	Federation Army units associated with the former Republic of Herceg-Bosna
IPL	-	Internal Payments Laws
KM	-	Convertible marka
LoBS	-	Law on Opening Balance Sheets
LPB	-	Law on Privatization of Banks
MIO	-	Croat-majority area
MoF	-	Ministries of Finance
NBY	-	National Bank of Yugoslavia
OBS	-	Opening Balance Sheets
OHR	-	Office of the High Representative
PAYG	-	Pay-as-you-go
PBS	-	Privredna Banka Sarajevo
PHARE	-	Poland-Hungary Aid for Reconstruction of the Economy
PIO	-	Bosniac-majority area
RS	-	Republika Srpska
SFRY	-	Socialist Federal Republic of Yugoslavia
SITC	-	Standard International Trade Code
SOE	-	State/Socially-Owned Enterprises
TAL	-	Tax Administration Law
USAID	-	U.S. Agency for International Development
WTO	-	World Trade Organization
YUD	-	Yugoslav dinar

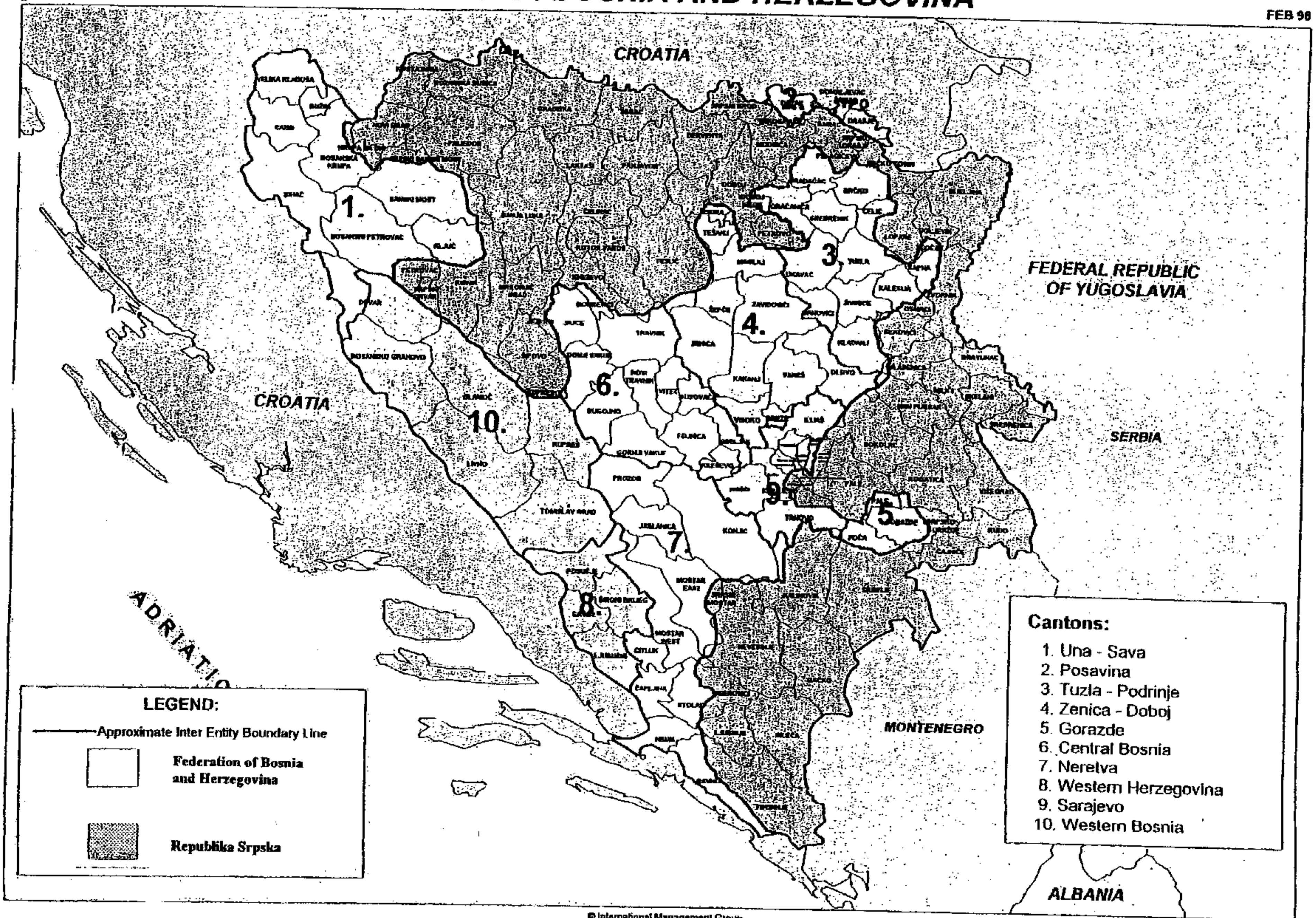
Bosnia and Herzegovina: Basic Economic Indicators, 1995-99

	1995	1996	1997	1998	1999
Population	...	...	...	3.7	...
Land area (in sq. km.)	51,129	51,129	51,129	51,129	51,129
Per capita GDP (1998, estimate, in US dollars)	...	...	...	1054	...
GDP (millions of U.S. dollars)	1,867	2,741	3,423	3,899	4,418
Industrial production (percent change) 2/					
Federation	18	88	36	24	11
Republika Srpska	18	39	27	23	2
Employment, end-period 3/	...	...	287,580	336,062	344,345
Wages (DM/month) 4/					
Federation	76	296	493	524	549
Republika Srpska 5/	60	85	138	...	...
Real GDP (annual average)	21	69	30	12	10
CPI 5/					
Federation (DM)	-4	-25	14	5	0
Republika Srpska (YUD)	118	66	3	38	...
Republika Srpska (KM-based index) 6/	21	17	-7	2	14
Money and credit 7/					
Broad money	8	96	52	31	32
Domestic credit	-9	13	22	10	7
			(In millions of KM)		
Consolidated government 8/					
Revenue (including grants)	1,051	2,173	2,398	3,148	3,628
Expenditure	-9	-182	2,429	3,658	4,094
Balance 9/	1,060	2,355	-31	-510	-466
			(In millions of U.S. dollars)		
External current account balance 10/ 11/	-570	-1,306	-1,482	-1,234	-947
Exports 11/	152	336	575	817	973
Imports 11/	1,082	0	2,333	2,526	2,388
Net invisibles 10/ 11/	360	-1,642	276	475	468
CBBH Gross Reserves 12/					
In millions of U.S. dollars	207	235	80	175	475
In months of next year's merchandise imports	2.3	1.2	0.4	0.7	2
External debt					
(In millions of U.S. dollars)	3,361	3,620	4,076	2,981	3,226
(In percent of GDP)	177	132	119	76	73
Debt service (in percent of exports of goods and nonfactor services)	118	53	16	17	8
Memorandum items:					
Exchange rates (period average)					
Convertible marka (KM) per deutsche mark	...	...	1.0	1.0	1.0
BiH dinar per Deutsche mark 13/	100	100	100	...	...
FR Yugoslav dinar per Deutsche mark 14/	2.4	3.5	3.9	6.4	...
Croatia kuna per Deutsche mark	3.6	3.6	3.5	3.3	4.1

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

1/ Data refer to the entire country, unless otherwise indicated.
2/ Growth in 1995 is given for BIH territory as a whole.
3/ Data coverage not comparable before and after 1997. For estimated annual growth rates, see Table 21.
4/ Data refer to average net wages paid in a particular period, not average earnings in that period; only firms paying wages in a particular month are included in the data.
5/ Period average retail price index. Data for both Entities are affected by post-war adjustments to market pricing.
6/ Up to June 1998, prices observed in Yugoslav dinars and converted to DM using the parallel market rate described in footnote 14.
7/ Change in percent of opening M2.
8/ Excludes municipal government operations for Republika Srpska. Data for 1996 and subsequent years exclude military expenditures financed by external grants.
9/ No net domestic financing of the budget deficit, other than arrears, in 1996-99.
10/ Excluding official transfers.
11/ Data for 1995-99 are rough estimates for the whole territory of Bosnia and Herzegovina.
12/ Excluding earmarked funds and blocked accounts; including foreign exchange held by the CBBH in Payments Bureaus.
13/ Official rate. Parallel rate not collected by the National Bank of BiH.
14/ YUD/DM exchange rate in the parallel market collected by National Bank of Yugoslavia. The official rate exchange rate in FR Yugoslavia was set at YUD 3.3=DM 1 from December 1995 - March 1998, and YUD 6.0=DM 1 since March 31, 1998.

MAP 1 : BOSNIA AND HERZEGOVINA



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This map is not to be taken as necessarily representing IMG views on boundaries or political status

I. Introduction and Overview[1]

1. This document provides background information for the 1999 Article IV consultation with Bosnia and Herzegovina. The first chapter contains an overview of economic developments, particularly those since the last consultation in 1998, and outlines the authorities' economic reform strategy in key areas. Subsequent chapters elaborate this reform strategy for the financial sector, privatization, fiscal sustainability, devolution of fiscal responsibilities, social benefits, and trade.

2. The country of Bosnia and Herzegovina is at an economic crossroads. During the last four years it has undertaken a massive reconstruction effort supported by substantial financial assistance from the international community. However, the international community's financial commitment has not been matched by a similar commitment to structural reform from the authorities. This, combined with sustained high unemployment, has kept increases in public and private savings below the pace required to replace the anticipated decline in external assistance. These developments call into question the viability of the country's economy in the medium term. In this context, the following chapters are a mix of retrospective and prospective components. The retrospective component intends to provide a succinct summary of where policy reforms stand in key areas. The prospective component assesses the agenda of unfinished business in each of these areas. This agenda will provide elements for discussion of a medium-term reform program with the authorities in Bosnia and Herzegovina.

3. In evaluating the progress of reform and assessing the prospects for Bosnia and Herzegovina, including required further reforms, the most striking conclusions of the paper are as follows:

- **The current fiscal policy stance is not sustainable.** Under unchanged policies the public debt-to-GDP ratio could reach over 180 percent of GDP by 2014.

- **The government is too large.** The tax burden is considerably larger than in comparable countries. Expenditures as percentage of GDP are similarly high and concentrate on the military, and on benefits for military invalids and their families. Allocations to priorities, such as health and education, are low.

- **Fiscal reform over the next 3–4 years has to be directed to rationalizing and lowering taxes and social contributions drastically, curtailing spending on the military and military benefits, and streamlining a complex government structure.**

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[1]Prepared by Juan J. Fernández-Ansola, Bhaswar Mukhopadhyay, and Kori Udovički.

- **Entitlements at current levels for social insurance and social assistance programs are not affordable.** The social benefit systems in both Entities are caught between overly generous entitlements and a narrow resource base. Urgent measures are needed to simplify the systems, restrict the present scope for abuse, and bring entitlements in line with resources.

- **The sustainability of economic growth will require urgent private market development.** This in turn will require an acceleration of financial sector reform and privatization. Although a well-defined strategy is in place, privatizations thus far have been confined to small enterprises, and the authorities must take immediate steps to privatize large enterprises.

- **Harmonization of economic policies in the two Entities to promote the development of a unified economic space in all of Bosnia and Herzegovina is critical to encourage private investment**. In this regard, tax harmonization is essential to avoid wasteful fiscal competition between the Entities and eliminate opportunities for tax evasion.

- **Trade reform should be deepened.** The strategy should contemplate the elimination of import surcharges, and lowering of tariff dispersion so as to converge to a low and fairly uniform tariff regime over the medium term.

A. Background[2]

4. The pre-war economy of Bosnia and Herzegovina was fairly diversified, with a large industrial base and a highly educated labor force. The annual per capita GDP in 1990 was US$2,446, and nearly half the annual GDP was produced in the industrial sector of the economy, notably in energy and raw materials (electricity generation, wood production, and mining), and manufactured goods (textiles, footwear, machinery, and electrical equipment). Agriculture accounted for just about 10 percent of GDP. International trade was an important factor, with exports and imports accounting for 24 percent of GDP and 19 percent of GDP, respectively. Although closely integrated with the former Socialist Federal Republic of Yugoslavia (SFRY), and to a lesser extent with the socialist bloc, Bosnia and Herzegovina also exported a wide variety of goods, constituting nearly half of its total exports, to "hard currency" Western countries.

5. However, by the end of the war in 1995, GDP had contracted by about 80 percent from its pre-war level, and the annual per capita GDP had shrunk to just about US$500. The physical infrastructure of the country had been almost completely destroyed, and industrial activity in the country had contracted by 90 percent from its pre-war level. Trade had been

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[2]Box 1 presents a chronology of key events in Bosnia and Herzegovina since 1992.

Box 1. Bosnia and Herzegovina: Chronology of Key Events, 1992–1999

March 1992—Bosnia and Herzegovina declares independence from the Socialist Federative Republic of Yugoslavia (SFRY) and gains international recognition. A month later, armed conflict with the Yugoslav National Army and other internal and external forces begins.

March 1994—The Washington Agreement ends hostilities between the Croat forces and the BH Army, which had begun in early 1993, and creates the Federation of Bosnia and Herzegovina, a political union of the Bosniac- and Croat-majority regions.

November 1995—The Dayton Peace Agreement is initialed by representatives of Bosnia and Herzegovina, Croatia, and FR Yugoslavia, establishing peace and new constitutional foundations for the country (see Box 6 in Chapter VII). This is followed, by year's end, with the country's succession to a portion of the membership of the former SFRY in the international financial institutions. SDR 30.3 million were disbursed by the IMF, under the policy on post-conflict emergency assistance.

September 1996—First country-wide elections since secession from SFRY. Results legitimize war-time leaderships of all three ethnic groups.

January 1997—First meeting of the Bosnia and Herzegovina (State) Parliament at which it appoints a Council of Ministers, hence completing the establishment of key State-level government institutions. The three-member Presidency had begun regular meetings the previous October, and the governor of the new central bank, a foreign citizen, had been appointed the previous November.

June 1997—"Quick-start package" of economic laws on the central bank, the 1997 budget, external debt, trade and customs tariff policies is adopted by the State Parliament. A new Bosnian currency—the convertible marka—begins to be used as unit of account but not as unit of payment yet.

July 1997-January 1998—Republika Srpska (RS) institutions are essentially paralyzed by a political crisis that commenced with RS President Plavsic's dissolution of the RS National Assembly and ended with election of Milorad Dodik for Prime Minister by new Assembly elected in November. New leadership ends RS isolationist policy, begins economic reform, and foreign assistance to the RS intensifies.

December 1997—Rescheduling agreement with commercial bank creditors is signed.

June 1998—The convertible marka is put into circulation. A stand-by arrangement for BiH is approved by IMF Board.

September 12–13, 1998—General elections in BiH, which result in ethnically based parties maintaining substantial control of the political institutions in both Entities. In the RS, nationalists capture the presidency, but fail to secure the parliamentary majority required to form a government. After major delays in the formation of the Federation and State Governments, they assume office in December 1998 and February 1999, respectively.

October 1998—Rescheduling and debt-reduction agreement with the Paris Club is signed.

March 1999—High Representative removes Nikola Poplasen as President of RS. Position not filled to date. Dodik's government continues to function, based on slender parliamentary majority support.

March–June 1999—NATO air campaign against FR Yugoslavia.

June 1999—The IMF Board approves completion of the first review under the stand-by arrangement.

July 30, 1999—The summit of the Stability Pact for South-Eastern Europe is held in Sarajevo, with the participation of heads of state and governments of 40 countries, and principals of international organizations, agencies, and regional initiatives. The main objective of the summit is to adopt a common agenda for stability and prosperity in South-Eastern Europe.

virtually paralyzed during the war, and by the end of the war exports of nearly all products had dried up.

6. Growth in the period immediately following the war reflected primarily reconstruction of the country financed by the exceptionally large levels of donor assistance. In December 1995 the international donor community pledged nearly US$5.1 billion over a three- to four-year period to enable implementation of the Priority Reconstruction Program, and in 1996 alone donor disbursements for this purpose amounted to some US$1.9 billion. Donor support in the period 1997–98 averaged nearly US$1 billion annually. Jump-started by the reconstruction effort, real GDP grew at an annual average rate of some 36 percent during the period 1996–98. Industrial production nearly doubled, and was mainly concentrated in the production of wood products, textiles and apparel, and foodstuffs and beverages. Agricultural activity also recovered, with the production of food crops (mainly wheat) rising to about 80 percent of its pre-war levels. In the initial post-war period, growth was largely restricted to the Federation of Bosnia and Herzegovina, which began receiving donor assistance earlier, and in larger amounts, than the Republika Srpska (RS). During this period, growth in the Republika Srpska was generally less rapid than that experienced in the Federation, partly because it had a higher base owing to considerably less war devastation and dislocation experienced by the Republika Srpska than in the Bosniac areas of the Federation.

7. In the spring of 1999, the momentum of recovery that had been established in both Entities of Bosnia and Herzegovina was interrupted by the conflict in the former Republic of Yugoslavia (FRY). In particular, the disruption of economic links with the FRY had a severe impact on the economy of the Republika Srpska, which was heavily dependent on the FRY as a source of raw materials, and also as its chief market for finished goods. The recent, gradual emergence of inter-Entity trade has partially mitigated the adverse consequences of the Kosovo conflict on the Republika Srpska.

B. Policy Framework for Medium-Term Growth

8. Against this background the key challenges facing the economy of Bosnia and Herzegovina are to regenerate the momentum of growth that was interrupted by the crisis in the FRY, and to foster a favorable environment for private investment. Such an environment, and a substantial rise in private domestic savings, are necessary to compensate for the anticipated decline in donor assistance over the medium term.

Macroeconomic framework

9. The medium-term macroeconomic framework for Bosnia and Herzegovina is designed with a view to achieving annual average real GDP growth of more than 9 percent over the period 2000–05 (Table 1). Attaining such growth rates will entail nongovernment investment ratios to be maintained at about 16 percent of GDP during this period. Such investment ratios will have to be financed by an increase in private savings—excluding current official transfers—from 12 percent of GDP in 2000 to 16 percent in 2005. Reflecting the decline in

external assistance, Bosnia and Herzegovina's current account deficit will need to drop from about 17 percent of GDP to 8 percent over the same period. To facilitate such a sharp adjustment in the current account, Bosnia's exports will have to grow at an average rate of 14 percent during 2000–05. At the same time, non-reconstruction imports will have to grow by some 10 percent in order to support the rapid growth of private investment. However, imports of consumption goods will decline as the domestic industry recovers, and imports for reconstruction, that are projected to reach nearly $530 million in 2001, are expected to decline sharply to just about $150 million by 2005. Moreover, such an adjustment will be facilitated by radical fiscal reform (see Chapter VI). These parameters of macroeconomic adjustment imply that the savings rate of the public sector—excluding current official transfers—will have to rise from 2 percent of GDP to 5 percent on average over the period 2000–05.

10. If Bosnia and Herzegovina is successful in growing at the targeted rates over the period 1998–2005, it will double its annual per capita GDP to US$2,000 in 2005, about 20 percent below its pre-war level. A recent study of 25 transition economies in East Europe and Central Asia provides some evidence that achieving such growth rates need not be beyond the country's capacity.[3] The study finds that beyond an output decline in the initial transition period of three to five years, the majority of countries experienced strong and sustained recovery. The study also finds that the impact of initial conditions recedes over time, and that macroeconomic stabilization and progress on market-oriented reforms are dominant determinants of recovery during the transition period.

11. For Bosnia and Herzegovina to realize its full potential, both the agricultural and the industrial sectors of the economy will have to experience sustained growth in the period ahead. This will entail the implementation of sound macroeconomic policies, and a determined effort to ease several structural impediments to private investment and real GDP growth.

Policies to promote growth

Macroeconomic policies

12. The key element of the macroeconomic strategy is based on the use of a currency board arrangement to establish a nominal anchor, with the use of supporting fiscal policies to prevent the need for domestic borrowing by the Entity governments. The currency board that was introduced in Bosnia and Herzegovina in August 1997 has been instrumental in lowering inflation to single digits in both Entities and in facilitating the rapid acceptance of the

[3]Havrylyshyn, Oleh, Ivailo Izvorski, and Ron van Rooden, 1998, "Recovery and Growth in Transition Economies 1990–97: A Stylized Regression Analysis," IMF Working Papers WP/98/141. Also see Berg, A., E. Borenzstein, R. Sahay, and J. Zettlemeyer (1999), "The Evolution of Output in Transition Economies—Explaining the Differences," IMF Working Papers WP/99/73.

convertible marka throughout the country. Thus far, the fiscal policies adopted by the authorities and the generous donor support that Bosnia has received have been key to the successful implementation of the currency board. Given the ongoing structural constraints on fiscal policy, Bosnia and Herzegovina must meet its fiscal targets in the period ahead without borrowing domestically, which will entail continued high levels of donor support for budgetary operations.

13. Bosnia and Herzegovina's present fiscal stance cannot be sustained without such donor support. Although revenue-to-GDP ratios are very high, Bosnia's recurrent spending requirements under existing institutional arrangements far exceed available resources, owing in part to continued high levels of unemployment. The high tax burden in Bosnia discourages tax compliance and is a strong disincentive for private investment. Thus, immediate reforms directed at lowering the tax burden are essential to achieve the authorities' real GDP growth target. In this setting, and faced with declining levels of donor support, the authorities can attain medium-term fiscal sustainability only by implementing politically difficult expenditure cuts, notably the demobilization of a large part of the military.

Structural reform

14. The viability of the social benefits system is threatened by overly generous entitlements and a narrow resource base resulting from the prevailing high rates of unemployment.[4] The pressures on resources could intensify as a result of the emigration of a large number of working age citizens, and the return of older displaced persons. Moreover, an increasing amount of domestic resources will also be required to support a viable health care system and education requirements, as external reconstruction support declines. In particular, reforms will have to address the existing imbalance between benefits granted to military and war invalids, and to other vulnerable groups. In this regard, legislation recently adopted in the RS, and under consideration in the Federation, which seeks to expand benefits to military invalids and their families, is a step in the wrong direction. Neither Entity has been able to meet the entitlements provided by the previous legislation, and an expansion of entitlements only serves to undermine the credibility of the respective governments.

15. In the fiscal area, a complex set of issues arises out of the structure of fiscal federalism in Bosnia and Herzegovina. The present assignment of revenue sources and expenditure responsibilities are mismatched across local governments, and between local and Entity governments. The Entities' autonomy in tax policy also causes problems in coordinating fiscal policy between the two Entities. In the last year, the emergence of harmful fiscal competition

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[4]As an example, pending legislation in the Federation would link disability benefits for military invalids and surviving family to prevailing military wages, which are well above average wages. These benefits could instead be aligned to benefits provided for civilian work-related injuries or disabilities.

among the Entities has contributed to instability of the structure of domestic taxes, and because of a failure to implement uniform tax systems, has slowed the development of a unified domestic market. The Entities are aware that both of these developments are detrimental to the growth of private investment. For this reason they have requested assistance to develop simple and transparent tax systems that will prevent such competition in the future.

16. The establishment of a sound and modern financial sector in Bosnia and Herzegovina is a priority of the structural reform program. Bosnia's financial sector has been dominated traditionally by the payments bureaus that have had a monopoly on clearing all banking sector payments, collecting and processing tax revenues, maintaining a wide range of public sector accounts, and collecting statistics. The presence of the payments bureaus has curtailed the flow of funds to the banking system, thus preventing the emergence of banking institutions capable of financial intermediation.[5] These constraints have been exacerbated by some recent bank failures, and the freezing of some assets held in the banking system. Thus, the public at large has lost confidence in the banking system. As a result of these constraints, the industrial sector of the economy has been faced with high interest rates, often as high as 3 percent a month, while loans exceeding three months in duration are uncommon.

17. To address these problems, financial sector reform—based on a two-pronged strategy—has been initiated in both Entities. In the first instance, reforms are underway to eliminate the payments monopoly of the payments bureaus, with a view to phasing out the bureaus entirely by end-2000. At the same time, efforts to place sound private banks at the core of the financial system are also in progress. In this regard, the strategy is to reduce the number of banks in Bosnia and Herzegovina through mergers, or to liquidate insolvent banks. In addition, all state-owned banks are to be privatized or liquidated by August 2000. Finally, there has been a significant improvement in the quality of bank supervision, and efforts to introduce deposit insurance are currently proceeding.[6]

18. A key means of encouraging private investment is to accelerate the privatization of the public sector enterprises that still dominate the economy. These enterprises are inefficient almost across-the-board, drain resources that could be utilized more efficiently, and are resented by private entrepreneurs that view the state sector as not subject to the same level of market discipline. In addition, the privatization of the main utilities, which remain in the state sector, is an important step to complement efforts under the reconstruction program to

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[5]Money (narrow) amounted to 14 percent of GDP at end-1999, 50 percent of which was held in the form of cash outside the banking system. Domestic currency demand deposits held by households, private enterprises and other were equivalent to only 1 percent of GDP.

[6]The authorities will need to ensure that the banking system is suitably strengthened before the introduction of deposit insurance.

modernize economic infrastructure. To this end the program to privatize state enterprises has been initiated in both Entities. A well-structured legal framework has been adopted, and some small enterprises have already been privatized. The goal set under the World Bank's Enterprise and Bank Privatization Credit (EBPC) is to complete the privatization of small enterprises by end-June 2000.[7] The take-off of large enterprise privatization, originally envisaged by end-1999, is unlikely to take place before mid-2000. The privatization of the largest enterprises, including utilities, is envisaged for 2001.

19. The role of an open and liberal trading system in promoting the development of competitive, outward-oriented domestic industries, and in promoting the growth of foreign direct investment is now well understood. In Bosnia and Herzegovina, good progress has been made recently toward establishing a liberal and transparent trade regime (see Chapter IX). Further trade reform has to be directed at an early stage to unifying the specific import tariff surcharges at a single ad valorem rate. Thereafter, import tariff surcharges will have to be eliminated according to a well-specified timetable.

20. In other areas, important impediments to growth include the weak judicial system that precludes the timely enforcement of contracts and agreements. The court system is viewed as slow and inefficient, and since court decisions are often not based on precedent, skepticism exists as to whether decisions are fair or just. Furthermore, high taxes on civil suits discourage bringing claims to court. Reform efforts in this area have been led by the Office of the High Representative and some donors. However, a comprehensive strategy to address these problems still remains to be formulated.

21. Against the background of the generous labor policy of the socialist era, the absence of a new, clearly articulated, labor policy constitutes not only an obstacle for the privatization process, but also a significant disincentive for private investment. The existing labor laws in both Entities provide for generous vacation and maternity leave benefits, and extensive sick leave, while mandatory payroll contributions for pension, health, and unemployment insurance are high by international standards. Moreover, the process of hiring and terminating workers is cumbersome and expensive.[8] In the absence of quick and decisive reform, all these factors are likely to emerge as a major impediment to the smooth functioning of the privatization process and the growth of private investment.

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[7]Large enterprise privatization, originally envisaged to begin by end-1999, is unlikely to start before mid-2000.

[8]In the Federation, a major issue in this regard concerns the existence of "waiting lists" for employees that were declared redundant by their employers as a result of the effects of the war. As the Federation Labor Law stands, it places a burden on employers equivalent to a severance payment of at least nine months for each of the 70,000 workers on waiting lists.

22. For these reasons, a new labor law was approved in October 1999 by the parliament in the Federation of Bosnia and Herzegovina. However, the new law is inappropriate for labor market conditions in Bosnia. The law would not further the goal of promoting employment in the formal sector, but would undermine workers' rights by making compliance virtually impossible. Specifically, the law offers vastly more generous maternity benefits than even the most protective labor laws in the European Union. It also sets forth a procedure to terminate surplus workers that would be prohibitively expensive. Among other changes, modifications of these two key aspects of the labor policy should be undertaken before it is enacted into law. In the Republika Srpska, labor policy is still governed by the old law inherited from the FRY. As a priority, it would need to be replaced by a modern labor law. The donor community is working with the governments of both Entities to ensure that the needed reforms are taken at an early date. In the Federation, a working group comprising government officials and experts in the area of labor legislation has been appointed to prepare amendments to the law. In view of the high unemployment, the final labor laws in the two Entities should be positioned at the lower end of the EU protection-spectrum to enable more flexibility in the hiring and firing of workers by the developing private sector.

23. A strategy to renew growth in the agricultural sector has been developed with the assistance of the Food and Agriculture Organization of the United Nations (FAO).With the recovery of food production to close to its pre-war levels, policies should be directed at returning industrial crop production—oilseeds, tobacco, and sugar beets, whose recovery is lagging—as well as livestock production, to their pre-war levels. Furthermore, some agricultural products could have good prospects for export. In this regard, the production of medicinal crops and fruits needs to be encouraged, because of the high international demand for these products as well as of the favorable soil and climatic conditions in Bosnia and Herzegovina. The strategy for the agricultural sector, in addition to technical steps to raise the profitability and efficiency of production, should improve the marketing and processing of agricultural products, land use, and inter-Entity trade and cooperation. The agricultural strategy shares some key elements with the strategy for industrial growth. In particular, it is based on the swift privatization of state-owned marketing agencies and agro-processors, the creation of market-oriented rural credit institutions, and the promotion of inter-Entity trade. In addition, the reclamation of agricultural land through landmine removal programs needs to continue, in the process offsetting to some degree the impact of the currently fragmented land holdings.

Table 1. Bosnia and Herzegovina: Macroeconomic Scenario, 1996-2005

	1996	1997	1998	1999 Est.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	Average 2001-05
GDP, millions of U.S. dollars	2,741	3,423	3,899	4,418	5,233	6,145	6,962	7,601	8,220	8,890	7,564
Real GDP growth, in percent	86	32	15	10	15	14	10	6	5	5	8
					(In percent of GDP)						
Foreign savings 1/	27	31	28	17	17	15	10	7	5	4	8
Gross national savings (including grants) 2/	15	10	10	16	15	17	18	19	20	21	19
Government 3/	...	...	1	1	2	3	4	4	5	5	4
Non-government	...	...	9	15	13	15	15	15	15	16	15
Gross national savings (excluding grants) 4/	-6	-2	5	12	14	16	18	19	20	21	19
Government 5/	...	...	0	1	2	2	3	4	4	5	4
Non-government	...	...	5	11	12	14	14	15	15	16	15
Gross domestic investment	42	41	38	33	32	32	28	26	25	25	27
Government	...	...	13	12	12	11	11	11	11	11	11
Non-government	...	...	25	22	20	21	17	15	14	14	16
Total resource transfers 6/	59	47	38	25	20	17	11	8	5	3	9

Source: IMF staff estimates.

1/ Negative of current account.
2/ National disposable income includes net official current and private transfers.
3/ General government revenue including grants for budget support less current general government expenditure.
4/ Disposable national income excludes all official transfers (but includes private).
5/ General government revenue excluding grants for budget support less current general government expenditure.
6/ Imports of goods and non-factor services minus exports of goods and non-factor services

II. Financial Sector Reform[1]

A. Background

24. Although there are some 70 banks operating in Bosnia and Herzegovina, 55 in the Federation and 15 in the Republika Srpska (RS), there is a heavy concentration of the total assets in a handful of majority-owned public banks. In the Federation, 13 majority-owned public banks control nearly 77 percent of total banking assets. In the RS, the extent of concentration is still greater, as the 4 largest of the 11 majority-owned public banks control nearly two-thirds of all assets. Most of the country's majority owned state banks are in a weak financial condition and plagued with nonperforming and unrecoverable assets, foreign-currency-denominated liabilities that cannot be serviced or repaid, and an extremely low level of deposits (see Box 2). The country's nearly 50 private banks, which were established during or after the war, are generally small and undercapitalized, and lack adequate commercial or retail banking experience to meet the deposit and lending needs for economic recovery.

25. The origins of the weaknesses characterizing the banking system in Bosnia and Herzegovina are rooted in the legacy of the former Socialist Federal Republic of Yugoslavia (SFRY). Prior to independence, banks were captive finance companies of their public enterprise owners, providing them with lending, deposit, and other routine banking services, with most payments functions and services relegated to payments bureaus. This situation was exacerbated by the war, when the foreign currency deposits held in Belgrade by BiH banks were seized by the National Bank of Yugoslavia (NBY). In turn, the banks were forced to freeze foreign currency deposits held with them. The wartime interruption of international lending flows to public enterprises, which were usually intermediated through banks, aggravated the illiquidity of banks initially created by a loss of public confidence. To date, banks have been virtually unable to undertake lending operations, a situation that is reflected in market interest rates of up to 3 percent per month on DM-based short-term loans.[2] Also, banks continue to lack a commercial orientation, they have limited skills or experience in the areas of financial analysis or risk assessment, and it remains virtually impossible to control collateralized properties. The judicial structure is not set up to enforce contracts or resolve disputes in favor of creditors.

26. The impact of these developments in weakening the banking sector was reinforced by the marginalization of the banking system in the pre-reform financial system. Until recently,

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[1]Prepared by Bhaswar Mukhopadhyay, Philippe Marciniak, and Dawn Rehm.

[2]There are four currencies in use in BiH: the Convertible Marka (KM), the Deutsche mark (DM), the Croatian kuna (HRK), and the Yugoslav dinar (YUD), with the first two dominating the rest.

Box 2. Status of Consolidated Commercial Banks in the Federation of Bosnia and Herzegovina - 1998

Table 1. Federation Commercial Banks: Net Capital, 1998

(Millions of KM)

Capital (A) 1/	845
Adjustments (B) 2/	61
Banks' capital (C=A-B)	784
Required reserves for potential losses (D) 3/	5,325
Banks' net capital (C-D)	-4,541

Sources: Federation Banking Agency; and staff estimates.

1/ Includes KM 580 million in share capital; long term provisioning (KM 62 million) and reserves (KM 84 million).
2/ Adjustments for investments, losses on current operations.
3/ Includes balance sheet and off-balance sheet risk items prior to preparation of opening balance sheets. A substantial part of banks' bad assets under D have been taken off their balance sheets as part of the opening balance sheet exercise (see footnote 5 in this chapter).

Table 2. Federation Commercial Banks: Consolidated Balance Sheet, 1998

	1998 KM million
Assets	7,183
Loans	3,803
Other receivables	2,378
Fixed assets and other	1,002
Liabilities	
Deposits	3,417
Loans	2,672
Other	249
Capital	845
Total Liabilities and Capital	7,183

Sources: Federation Banking Agency; and staff estimates.

Bank capital, including adjustments for losses on current operations, amounted to KM 784 million for consolidated commercial banks operating in the Federation of BiH at end-1998. ***Net bank capital***, however, amounted to KM -4.5 billion (Table 1), reflecting in part poor quality of on and off balance sheet assets held by the large state-owned banks. A substantial share of of these assets including, inter alia, frozen foreign currency savings, foreign currency loans, and placements prior to March 1992, will be transferred to the Federation government--along with the corresponding liabilities--prior to privatization. Overall, ***poor assets*** (rated C-E) (Table 3) represented 63 percent of all on- and off-balance sheet assets for Federation commercial banks.

Taken separately, poor assets held by ***private banks*** operating in the Federation accounted for only about 22 percent of on- and off-balance sheet assets. Only one private bank has negative net capital; others are generally characterized by limited risk assets (attributable to a small loan portfolio), and a relatively large share of liquid assets.

The return on assets for all banks was only 0.21 percent (0.49 percent for private banks), well below the international standard of 1 percent. The ***return on share capital*** amounted to 2.09 percent for all banks during 1998 (3.17 percent for private banks).

Between end-1998 and mid-1999, ***the number of licensed banks*** operating in the Federation declined from 55 (44 private, 11 state owned) to 47 (11 state-owned, 36 private). During the same period, the ***Federation Banking Agency (FBA)*** revoked licenses of five banks that merged following the April 1999 increase in required bank capital from KM 2.5 million to KM 5 million; (ii) two banks for failing to follow prescribed registration procedures; and (iii) one bank due to insolvency. The FBA also introduced temporary management for five banks; within similar plans for an additional five banks in the coming period.

Table 3. Federation Commercial Banks: Potential Risk-Related Losses, 1998 1/

Receivables	Classification of assets - all banks A	B	C	D	E	Total	Total KM million All banks	Private
	(Percent of asset category)							
Loans	21	4	4	2	69	100	3,803	924
Interest	47	11	13	8	22	100	53	45
Other risk assets	17	0	0	0	83	100	2,741	436
Non-risk assets	100					100	572	449
Off-balance sheet risk items	64	15	2	1	18	100	1,455	284
Total (percent of all assets)	32	5	2	1	60	100	8,624	2,139
	(Millions of KM)							
Potential loss	15	39	46	62	5,164		5,325	424.9

Sources: Federation Banking Agency; and staff estimates.

1/ Includes potential losses from off balance sheet risk items.

the central role in this system belongs to the payments bureaus, through which all noncash transactions were made.[3] In addition, banks have been deprived of potential deposits that could be used for productive lending, as liquid resources have been redirected to giro accounts in the payments bureaus. The dependence of banks on payment bureaus has also limited the scope for standard banking activities, and complicated their liquidity management.[4] In the absence of central bank credit to cover all payments accepted by the payments bureau during the day, banks are unable to finalize payments until the end of the day or even the next day. This problem is further exacerbated by regulations that require enterprises to maintain their cash with, and conduct all payments through, the payments bureaus to ensure tax compliance.

27. The resulting illiquidity of banks and lack of depositor confidence have prevented banks from engaging in meaningful domestic lending. Until recently, they were completely excluded from the payments loop, and were prevented from offering routine financial services to their customers. The ensuing absence of a direct relation between banks and their depositors exacerbated the low level of confidence in the banking system, and prevented the development of new and/or improved payment instruments and services.

28. An important by-product of this system is a very high concentration of business information in the hands of the payments bureaus. Such information and the monopoly power of these bureaus provides them with significant control over enterprises and seriously undercuts the position of banks in the financial system.

B. Reform Strategy

Bank reform

29. Against this background, the reform strategy, prepared by the authorities in cooperation with the World Bank, USAID, and other donors, envisages a two-pronged approach to revive the financial sector. First, the existing banking sector is to be strengthened through improvements in the institutional and regulatory banking frameworks, liquidation of insolvent banks, privatization of all other state owned banks, enhanced bank supervision, and

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[3]Economic agents hold giro accounts with the payments bureaus. These accounts are assigned to the payments bureau account of the commercial bank with which the agent has a deposit contract. Deposits are transferred on the basis of "payment orders" submitted by bank customers directly to the payment bureau office in which they have a giro account. To make a noncash payment a person or legal entity is required to have the necessary funds in the giro account at the regional payment bureau. In serving as the clearinghouse for the financial system, the payments bureaus are virtually insulated from risk, since they have no deposit liabilities of their own and no assets against the giro account balances they maintain.

[4]Typically banks do not know the impact of domestic payments on reserve accounts until net clearing at the end of the day.

the establishment of deposit insurance mechanisms.[5] Second, the banking sector is to be placed at the center of the financial system through a phased elimination of the payments bureaus.

30. Improvements in the **institutional and regulatory banking frameworks** have been given priority not only to establish the legal basis of banking sector operations, but also to provide the legal basis for liquidating and privatizing state-owned banks. To this end, key pieces of legislation adopted in both Entities included the Commercial Bank Law (CBL), the Law on Opening Balance Sheets (LOBS), and the Law on Privatization of Banks (LPB). The CBLs define (i) permissible activities; (ii) prohibited transactions; (iii) prudential standards; and (iv) insider relationships. They also define the authority of the Entities' banking agencies to supervise, rehabilitate, and liquidate banks and include, notably, the definition of bank insolvency. The LOBS is equally important, as it establishes the basis for determining banks' solvency. In particular, in preparation for privatization, it provides the framework for removing from the state-owned banks' balance sheets pre-war loans to public enterprises that suffered heavily during the war, and banks' claims on the former NBY. The LOBS also determines which of the end-1997 assets and liabilities will be removed from state-owned banks' balance sheets.[6] Paris and London Club liabilities have been rescheduled at the State level and are being serviced by the concerned Entity. Claims by households for the foreign exchange deposits frozen in the war are being settled with vouchers issued in the enterprise privatization process (see Chapter III). Finally, the LPB sets criteria by which publicly owned banks will be selected for privatization or liquidation, and it defines the role of the Entities' bank supervision agencies and Ministries of Finance (MOF) in that process. All three pieces of legislation have been adopted in both Entities.

31. To implement the **bank privatization** program, banking agencies and bank privatization units have been established in both Entities. In order to qualify for privatization under the LPB, state banks must be certified as solvent by the banking agencies on the basis of their audited opening balance sheets, which in turn must be approved by the bank privatization units and MOFs: these institutions must also submit privatization plans for approval. Banks that are determined to be insolvent on the basis of their opening balance sheet will have their banking license revoked and be liquidated. Solvent banks will be

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[5]A key element of the bank privatization program is that it limits the financial liability of the government to items on the banks sub-passive balance-sheet (see below). In particular, the government will not recapitalize any banks.

[6]These comprise "neutral" assets, such as apartments, and other fixed assets subject to restitution, and "passive" assets and liabilities, including (i) pre-war liabilities which originated through foreign borrowing and guarantees, households' frozen deposits in foreign currency, and prewar assets and liabilities in the former territories of the SFRY; (ii) assets and liabilities of the State and state-owned enterprises; (iii) unpaid equity capital; and (iv) war-related damages to fixed assets.

privatized, exclusively for cash, and on condition of a capital infusion by the buyers. The privatization of all state-owned banks is to be completed by August 2, 2000 in the Federation, and by end-2000 in the RS. Any state-owned bank that has not been privatized by this date will be liquidated.

32. Progress in implementing the strategy for bank privatization has been slow. Presentation of opening balance sheets to the bank privatization unit and completion of the solvency tests has been delayed in both Entities. Hence, the sale of banks, envisaged to begin in August 1999 in the Federation, and in October 1999 in the RS, has been delayed as well. In the Federation, all the majority state-owned banks submitted their opening balance sheets to the bank privatization unit by end-August 1999. Of these, the opening balance sheets for the five banks in the Privredna Banka Sarajevo (PBS) family have not been approved.[7] None of the other banks have been found insolvent, conditional on the removal of assets described in footnote 5. In the RS, where the privatization process started later, all but three majority state-owned banks had presented their opening balance sheets to the bank privatization unit by end-1999. For two of these banks the opening balance sheets will be prepared by the bank privatization unit. In both Entities all banks in which the state has minority shares are solvent, conditional on the removal of assets described in footnote 5. In the Federation, the offering of such shares has just begun.[8] In a worrying development, the shares of even the stronger banks have not been sold.

33. In addition to the passage of the CBLs, the key reforms aimed at improving **bank supervision** have been the establishment of the banking supervision agencies in both Entities. In particular, good progress has been made in the Federation, where the Federation Banking Agency (FBA), established in mid-1996, has implemented a comprehensive system of supervision and is actively examining and monitoring banks. In the RS, the bank supervision agency was legally established only in early 1998. Although it has made some progress since that time, important issues still remain to be resolved, including those related to the resolution of the agency's funding structure and the implementation of a plan that provides for financial independence.[9] Other outstanding issues in the area of bank

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[7]The PBS family of banks is the largest publicly owned bank in the Federation. Its case is illustrative of the difficulties associated with privatizing large public banks. Differences of view as regards liquidation or privatization of the PBS have manifested themselves in a conflict about the treatment of certain liabilities in the opening balance sheet. The bank privatization unit has taken the view that under the LOBS such liabilities should be taken over by the Federation government. The MOF disagrees with this view. The resulting impasse has delayed preparation of an approved opening balance sheet.

[8]A complication for some of these banks is that some of them have unsold shares from a previous issue.

[9]Both banking agencies monitor the liquidity and solvency of banks, as well as their capital adequacy levels. Several inferior banks have been placed under temporary administrations on

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supervision are, in both Entities, a need to clarify conservatorship powers as well as problem bank enforcement authority. Moreover, off-site supervision capabilities, bank accounting standards, establishment of an integrated supervisory approach, licensing procedures, and agency enforcement authority, also warrant attention. These issues are being addressed in the context of continued technical assistance to both banking agencies.

34. The establishment of a **deposit insurance** scheme mainly to protect small depositors is an important element of the banking sector reform strategy, and will help restore depositor confidence. The structure of the proposed deposit insurance scheme is designed to address two potential pitfalls of such a mechanism: (i) excessive risk-taking by banks resulting from the erosion of depositor oversight; and (ii) the financial burden on healthy banks or taxpayers. As a result, deposit insurance would initially be limited to KM 5,000 per depositor (about two and a half times the current per capita GDP). In addition, deposit insurance would only be provided to private banks, and they would need to meet higher capital requirements to receive coverage.[10] Insured banks that subsequently fail to meet capital requirements would be subject to restrictions on their expansion of insured deposits, and insured depositor preference in the event of bank failure would in most instances limit the burden on the deposit insurer. The proposed deposit insurance scheme would be established by an initial seed capital contribution from donors of KM 14 million in the Federation and KM 6 million in the RS. In addition, there would be a levy on deposits of insured banks of 0.25 percent a year. The deposit insurer would enjoy substantial independence. Progress in establishing the deposit insurance agencies has been limited. The deposit insurance law has been passed only in the Federation, and there have been no firm commitments by donors regarding the initial seed capital contribution. Moreover, several important details of the proposed plan remain to be finalized.

Payments system reform

35. The main objectives of the **payments system reform** strategy are to create the conditions for the emergence of a market-based payments system that would be fully integrated with the banking sector to underpin the development of an efficient and sound financial system. Such a system would increase the speed and ease of making payments within the country, while reducing the cost of these transactions. It would also be able to

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the basis of these criteria. If performance does not improve, the banks' licenses will be withdrawn. As a result of these measures it is anticipated that the number of banks in operation will be significantly lowered over the next 12 months. In addition, the banking agency in the federation has also begun to rank banks on the basis of a modified CAMEL system.

[10]Deposit insurance is to be provided only to private banks because the banking sector reform strategy envisages all state-owned banks to be either privatized or liquidated by end-2000.

better cope with the risks to the payments system, and facilitate integration of the BiH economy with the world economy.

36. The objective of the reform strategy is the elimination of payments bureaus in both Entities by end-2000. As intermediate steps toward this goal, the reform strategy calls for measures to improve the efficiency of the payments bureaus, and the establishment of institutions to facilitate the transfer of the assets from payments bureaus to commercial banks. As noted, the payments bureaus have been a key source of information used by tax and fiscal authorities. A critical element of the payments system reform strategy, therefore, is the establishment of alternative mechanisms to collect the required information prior to the elimination of the payments bureaus.

37. Both Entities have made good progress in payments system reform. To prepare the ground for eliminating the payments bureaus from the payments system, the authorities in both Entities have adopted Internal Payments Laws (IPL) that establish the rights and obligations of depositors, banks, and the central bank. They have also eliminated the monopoly of the payments bureaus in carrying out internal payments transactions by eliminating the legal barriers that have excluded commercial banks from these operations. The Central Bank of Bosnia and Herzegovina (CBBH), in cooperation with the banking agencies, has developed and published standards regarding bank provision of services. Only banks that meet these standards will be licensed to offer payments services. Banking agencies in both Entities have developed criteria that will be used to license commercial banks to offer internal payments services to their customers. The first licenses in the Federation are expected by March 2000. Licensing for high risk transactions will take longer, however, as banks are not likely to meet the more stringent prudential requirements for a while. In both Entities, a functional analysis of the payments bureaus activities has been prepared, and recommendations have been made regarding the transfer of functions to other institutions.[11] Finally, in the RS, progress is being made to separate the operations of the payments bureau from the commercial bank operations of the Development Bank, a pre-condition for eliminating the bureau.

38. In the interim, the payments reform strategy seeks to improve the efficiency of the payments system and enhance financial sector transparency. To this end, the relevant laws in both the Entities have been amended to establish new supervisory boards for the payments bureaus. In addition, a fee structure for transactions will be implemented that is consistent with full cost recovery. The payments system reform will also require the verification of payments bureaus' accounts by internationally reputed auditing firms. The audit has been completed in the RS, and in the Federation, a tender to appoint the auditing firm has been issued.

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[11]Fiscal functions will be transferred to the Entities' tax administrations and treasuries to be shortly established. Nontax information gathering will be transferred to the Entities' statistical institutes.

39. To ensure that adequate information is provided in the new payments environment, the Tax Administration Law (TAL) was to have been amended and new tax reporting and other relevant instructions were to have been issued by end-June 1999. Implementation of this measure is taking place more slowly than envisaged. Steps to transfer the statistical functions performed by the bureaus to the relevant Entity statistical institutions have also begun.

III. PRIVATIZATION OF STATE ENTERPRISES[1]

A. Background

40. The economy has been dominated by a small number of large state-owned enterprises. While only 9 percent of enterprises in the Federation are publicly owned, over half of them are classified as large enterprises. The situation is similar in the RS, where 6.3 percent (700 of the 11,000 enterprises registered in 1996) are publicly owned, but account for about 80 percent of total output. In both Entities publicly owned enterprises dominate the energy, utility, construction and engineering, metal fabrication, wood products, food processing, light manufacturing, trade, and services sectors. As in other transition economies, public ownership of enterprises has led to a situation in which managers and workers have few incentives to preserve capital or to ensure healthy profits.[2] Instead, the incentive structure has prompted managers to maximize wages and company indebtedness. A broad consensus exists that this type of economic environment is not conducive to the development of a market-based economy and a vibrant private sector. Moreover, the control of key sectors of the economy by inefficient public enterprises, notably the energy and utility sectors, impedes the development of a competitive private sector in the country. For all of these reasons, a critical element of the reform program is the expeditious privatization of state enterprises.

B. The Voucher Privatization Scheme

41. A central policy issue was settled during the preparation of the privatization framework under which the competence to privatize was assigned to the Entities.[3] The respective Entities would enjoy the proceeds from the privatization of all public enterprises physically located on their territory, and also acquire the corresponding liabilities.[4] This decision also influenced the choice of a voucher-based approach for enterprise privatization, which could be used both to settle the large outstanding debts of the respective Entity governments against their citizens, and to recognize the citizens' claim on socially-owned property.[5]

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[1]Prepared by Bhaswar Mukhopadhyay, Philippe Marciniak, and Juan J. Fernández-Ansola.

[2]In Bosnia and Herzegovina, public or social ownership implied effective control of enterprises by management, workers, or other enterprises.

[3]Public property in the SFRY was owned by enterprises and worker-managed councils; the new constitution did not explicitly deal with the ownership of public property in Bosnia and Herzegovina.

[4]Cross-Entity claims were to be settled by arbitration.

[5]Preliminary estimates indicate that the debt of the Federation government to its citizens could be as high as KM 15 billion (nearly threefold the Federation's 1998 GDP), while the

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42. In the Federation, vouchers were issued in July 1999 to cover claims related to four specific categories of government liabilities: frozen foreign currency deposits in Federation banks, unpaid wages of soldiers, unpaid pensions, and restitution. In addition, vouchers were issued to all citizens, adjusted for the number of years of working life. The system implemented in the RS since 1998 is slightly more complicated.[6] The claims currently being issued against frozen foreign currency deposits in RS banks are known as coupons, and will be eligible for use in cash sale enterprise privatizations. Other claims—known as vouchers—are being issued to veterans and families of soldiers who died in the war, along with a general voucher for all citizens.[7] The two types of vouchers are identical in character and usage, which is more restricted than that of coupons.

43. The mechanics of the voucher privatization scheme in Bosnia and Herzegovina have been designed with a view to addressing the need for fresh capital, the insufficient development of capital markets, and weak corporate governance (Box 3). In particular, to ensure a cash injection, in the Federation, the use of vouchers is limited to 65 percent of the value of small firms, with the remaining 35 percent to be paid in cash. In the RS, only cash or cash equivalents may be used for small scale privatizations.[8] It is anticipated that the purchase of apartments will absorb a significant share of claims in the Federation, and coupons in the RS, thereby permitting a relatively larger share of cash for the privatization of small enterprises.

44. In each Entity, large enterprises are required to prepare privatization plans that give due attention to the need to increase capitalization and attract strategic foreign investment. In view of this objective, in the Federation, the use of claims in large enterprise privatization is to be approved on a case-by-case basis. In the RS, although the main use of vouchers is expected to be in the privatization of large enterprises, a strategic stake of up to 30 percent can be provided for in cash.[9] To facilitate the privatization of large enterprises and promote capital market development, claim holders may freely trade such claims, or use them to

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RS government may owe its citizens another KM 2 billion (somewhat more than the RS 1998 GDP).

[6]This system replaced the less transparent system adopted in 1997.

[7]State and Entity laws require that citizens resident in the territory of an Entity as of end-March 1991 (the date of the final pre-war census) be entitled to receive general claims from that Entity, regardless of their present residency. The laws provide for equal treatment of all citizens and, in particular, safeguard the rights of displaced persons and refugees in the issuance of general claims.

[8]Cash equivalents in the RS are the coupons issued against frozen foreign currency deposits.

[9]Specifically, 55 percent of the share value of large enterprises has to be put up through claims, 10 percent of the shares will be allocated to the RS Pension Fund, and a further 5 percent to the Restitution Fund.

purchase shares in investment funds. To curtail the abuses of investment funds experienced in other countries, Entity laws have been enacted to strictly regulate the conduct and governance of these funds, by eliminating potential conflicts of interest and ensuring appropriate disclosure (see Box 3 on how Bosnia is addressing the problems that other countries encountered with voucher privatization).

Box 3. Addressing the Problems with Voucher Privatization[1]

- Mass privatization programs through vouchers have the potential to promote control of the privatized firms by "insiders"—managers and workers combined. This in turn may produce ownership structures that impede efficient corporate governance and restructuring.

- Insufficiently regulated privatization investment funds may end up owning large or controlling stakes in many firms privatized through vouchers. Many of these are owned by major domestic banks that are reluctant to close poorly performing firms, because that would force the funds' bank owners to write off the loans they had made to these firms.

- The lack of prudential regulation and enforcement mechanisms in the capital markets can open the door to a variety of dubious and some overtly illegal actions that enrich fund managers at the expense of minority shareholders and harm firms' financial health.

- In cases like Russia and the Czech Republic outside investors were discouraged by an acute lack of defined property rights, institutional underpinnings, and safeguards for transparent secondary trading. Moreover, the bankruptcy framework was weak and the process lengthy, diminishing financial market discipline.

- Bosnia and Herzegovina has attempted to address these issues primarily by passing a Law on the securities Commission and Share Registry before the privatization process was initiated. The law has a number of features on disclosure and insider trading that make it superior to similar laws in Russia and the Czech Republic. This law, however, has not been tested yet, and the legal framework in the country remains weak.

- Also, to ensure an injection of cash and the participation of strategic investors that would improve governance and efficiency, both Entities have limited the amount of vouchers that can be used in the privatization of small firms. In the Federation, at least 35 percent of the shares must be sold for cash, while in the RS, all shares of small enterprises must be sold for cash or cash equivalent.[2] The RS has allowed for a strategic stake of up to 30 percent to be provided in cash in the privatization of large enterprises, and both Entities limit or exclude the use of vouchers for the privatization of strategic enterprises.

[1]Based on Nellis, J., "Time to Rethink Privatization in Transition Economies?," Finance and Development, June 1999.
[2]Coupons issued for frozen foreign exchange claims.

C. Timing of Actions

45. The privatization strategy recognizes that speedy privatization is of the utmost importance to prevent further deterioration of war-damaged assets, to minimize illegal or spontaneous privatization, and—above all—rapidly create conditions conducive to sustained private-sector-led growth. The need to proceed quickly has been underscored by the inability of Entity governments to undertake any investment in public enterprises or to effectively control enterprise management prior to privatization. For these reasons, the program envisages that the privatization of small enterprises will be completed by end-June 2000. The privatization of large enterprises, which will be initiated only after the small enterprise privatization program is underway, is targeted to be completed by end-2000. As regards utilities, a prior condition for their privatization is the establishment of appropriate regulatory frameworks, which will have to be harmonized across Entities to ensure that regulatory bottlenecks do not hamper the development of countrywide networks in communication, transportation, and other services. The first utilities are not expected to be privatized before end-2001.

D. Legislative and Institutional Framework

46. Significant progress has been achieved in establishing a sound legislative and institutional framework for the privatization program. A State-level Privatization Law was promulgated by the Office of the High Representative (OHR) in August 1998, and both Entities have adopted Laws on Enterprise Privatization and Opening Balance Sheets (OBS). Parliaments in both Entities have also passed Laws on Securities, on Privatization Investment Funds, on Management Companies, and on the Central Registry of Shares. As regards the institutional framework, the Federation Privatization Agency (FPA) was established in May 1997. All of the Cantonal Privatization Agencies (CPA) have also been established, and are fully operationalized in all but two cantons.[10] The RS Privatization Agency has also been activated.

47. Two other important intermediate steps in operationalizing the privatization of enterprises are the identification and issuance of claims to eligible citizens, and the preparation of opening balance sheets and privatization plans by the enterprises. As regards the claims, in the Federation, after reaching agreement on the magnitude of claims arising from back pay and on the identification of general claims, a claims registry was compiled on the basis of existing databases. Individual citizens' input was needed to match databases for frozen foreign exchange deposits and for general claims. Once the statements on claims were distributed, citizens were given the opportunity to effect corrections, and the registry is now

[10]In this regard, Mostar is the only canton to not have effected any small enterprise sales to date.

fully operational.[11] The identification and issuance of restitution claims will be done at a later stage of privatization. In the RS, where the legislative framework was completed considerably later than in the Federation, the privatization process is catching up. Because of the lack of data, claims registration requires the citizens' appearance at centers opened for this purpose throughout the RS and in selected locations in the Federation. Citizen turnout for the registration in January and February 2000 was low (about 325,000) and the registration period will need to be extended. Problems with access of all eligible citizens to registration centers will also need to be resolved.

48. The preparation of the OBS is essential for determining the value of an enterprise and is a critical step in the privatization process.[12] Once enterprises have completed this step, they are then required to prepare privatization plans. Enterprises are given a considerable degree of freedom in designing these plans, and are allowed to choose the mode of sale (auction or tender), and the relationship between cash and claims.[13] Precautions are being taken to prevent insider transactions, and the final privatization plan is subject to approval by the relevant privatization agency. In the Federation, progress has been slow and, for some cantons, lists of enterprises to be privatized have not been prepared. In some others, the submission of OBS and privatization plans have been delayed for a variety of reasons, including legal bottlenecks such as delays in registering and receiving land titles.[14] The relevant authorities have developed a plan for the registration process that is to be reviewed shortly by the OHR to ensure that it conforms with the relevant State laws. In addition, problems associated with incorporating joint stock companies and in registering enterprises have also delayed the preparation of enterprises for privatization. Problems with land title registration have also been plaguing the preparation of OBS in the RS. By end-January 2000, two thirds of all enterprises had prepared their OBS.

E. Progress Toward Privatization and Next Steps

49. The privatization of small enterprises in the Federation started in the fall of 1999. By mid-December, 188 enterprises or plants and 261 business premises were sold—about two-thirds by auction and the remainder by tender—generating about KM 46 million in cash or voucher receipts. However, the privatization process suffered a major setback with the suspension in late December 1999 of the U.S. Agency for International Development

[11] As of end-October, the claims registry had a database of more than 2 million citizen claim records. By that time more than 17,000 transactions had been processed, including some 9,500 transactions transferring claims from one citizen to another.

[12] The Law on Opening Balance Sheets divests enterprises of their foreign loan liabilities that have been subject to Paris and London Club deals.

[13] In the RS, the cash-claims composition of sales is more strictly regulated than in the Federation.

[14] Land registers are incomplete, with many ill-defined or overlapping claims.

(USAID)'s program of assistance because of inadequate progress, particularly in the preparation of large enterprise sales. The public offering of shares in large enterprises, at the center of the mass privatization process, originally envisaged for December 1999, is now unlikely to be ready before mid-2000. In the RS, only one pilot cash auction has been conducted (in July 1999), in which 9 out of 22 enterprises were sold for KM 1 million. The auction of the remaining enterprises is currently being repeated.[15]

50. As is evident, the enterprise privatization process is at a critical juncture in the Federation, and is still facing serious challenges in the RS. Furthermore, privatizations thus far have been confined to small enterprises. While it is important to accelerate the privatization of these enterprises, the most important tasks facing the authorities concern the early establishment of a sound basis for the privatization of large enterprises. Specifically, governments should adopt suitable legislation that provides the basis for an unambiguous assignment of land titles. Similarly, without an early registration of claims in the RS, the large enterprise privatization cannot begin. A wide range of measures to facilitate the development of capital markets is also necessary to permit the privatization process to function in an efficient manner.

[15] A total of 170 enterprises are eligible to be auctioned.

IV. THE SIZE AND STRUCTURE OF PUBLIC FINANCE[1]

A. Introduction

51. A comparison with many developing and transition countries shows that the overall tax burden on Bosnia and Herzegovina's economy is very high. As such, it creates strong disincentives for taxpayer compliance, encourages informal economic activities, and is inconsistent with a growth-oriented development strategy. The revenue structure of both Entities suffers from the problems of narrow bases and high rates. In terms of the structure of government expenditure, the Entity budgets have disproportionately high shares of military expenditure and benefits for military invalids, and relatively low shares for basic public services (e.g., education and health) and growth-enhancing expenditures (e.g., infrastructure). This reflects, in part, the role of off-budget reconstruction assistance in the areas of health, education, and infrastructure.

B. Size of the Government

52. The government structure of Bosnia and Herzegovina consists of the Common Institutions (the State government), the two Entity governments, and the local governments (cantons and municipalities in the Federation and municipalities in the RS).[2] In addition to government activities that are formally in the budget process, both Entities operate a number of extra-budgetary social funds—pension and disability insurance funds, health insurance funds, unemployment insurance funds[3]—which, together with foreign assistance for reconstruction projects and part of military expenditure, are currently recorded off-budget. This chapter estimates the size of the general government and provides a description of its revenue and expenditure structure based on limited data coverage.

53. The estimated total revenue-to-GDP ratio of the consolidated government as presented in Table 2—including both Entity governments, social funds, foreign project loans, and the Federation's local governments, but excluding RS local governments—was about 46 percent in 1998, and the total expenditure-to-GDP ratio stood at about 53 percent. If most off-budget revenues from domestic sources and RS local governments were included in the calculation, the total revenue-to-GDP ratio could be as high as 50 percent in 1998. If all off-budget expenditure—financed by domestic and external sources—were included, the total expenditure-to-GDP ratio could exceed 60 percent in 1998.

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[1]Prepared by Jun Ma and Jenny Ligthart.

[2]For a detailed discussion on intergovernmental relations, see Chapter VII on devolution of fiscal responsibilities.

[3]In addition to these three funds, the RS also has a Children's Fund that finances a portion of maternity benefits and social security for children.

54. The size of Bosnia and Herzegovina's consolidated government, measured either by the revenue-to-GDP ratio or expenditure-to-GDP ratio, is very high in comparison with many transition economies and most developing countries (Table 3).[4] While this high concentration of the country's resources within the government sector reflects the persistent military and political tensions, further economic recovery requires a reduction in the size of the government over the medium term to make room for private sector development.

C. Revenues

55. In 1998, tax revenues accounted for 92 percent of the country's consolidated government revenue. The three largest sources of revenue were the sales taxes (37 percent), excises (17 percent), and customs duties and surcharges (18 percent). Revenue from income taxes was relatively small, accounting for about 17 percent of total revenue. In both Entities, the main source of income tax revenue was the wage withholding tax, while the citizen income taxes—levied on individuals, partnerships, and sole proprietorships—and corporate income tax yielded insignificant revenues (Table 4).

56. Significant progress was made over the past few years in several areas of tax reform, including the adoption of a unified tariff policy at the State level, partial harmonization of sales taxes between Entities, unification of tax policies for the Croat- and Bosniac-majority areas in the Federation, a reduction of the corporate income tax rate in the Federation, and reductions in social insurance contribution rates. Nevertheless, the current system continues to be characterized by a number of serious deficiencies: (1) a high tax burden on labor income and consumption; (2) narrow tax bases; (3) remaining inter-Entity policy differentials; and (4) low compliance.

Sales taxes

57. In 1998, the RS lowered its general sales tax rate on goods from 24 percent to 20 percent, the same level as in the Federation.[5] Other sales tax rates (5, 10, and 15 percent) in the Federation, and a 10 percent sales tax rate in the RS, are applied to selected goods (see Appendix I on tax summary). Both the Federation and the RS levy a 10 percent general sales

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[4]The RS revenue-to-GDP ratio shown in the consolidated fiscal table (26 percent in 1998), as it stands, was substantially lower than that in the Federation (52 percent). This can be explained by several factors. First, the RS fiscal accounts exclude local governments, which generate about 20 percent of total government revenue. Second, a significant portion of RS revenues remain outside the budget. And third, duty-free imports account for a larger share in total imports in the RS than in the Federation. Correcting for factors (i) to (iii), the actual revenue-to-GDP ratio in the RS would be much closer to that of the Federation than suggested by Table 2.

[5]The sales tax rate in the RS includes a 2 percent surcharge earmarked for railways.

tax on services, but the bases of these taxes differ significantly between the two Entities for retail sales of goods. The Federation's service sales tax is levied on the retail price of goods (inclusive of the sales tax on goods), effectively raising the general sales tax to 32 percent. In the RS, service sales tax on retailers is levied only on the price markup. Most of the sales tax revenues are raised from goods and services in the general rate category. Despite the recent reduction in the RS rates, the general sales tax rates in Bosnia and Herzegovina are still high compared with the sales tax or value added tax (VAT) rates in most developing countries (Table 5), creating significant problems with evasion.[6] The administration of the sales taxes is also complicated by the multiplicity and wide dispersion of tax rates (e.g., four rates in the Federation), which has a negative impact on taxpayer compliance. In addition, the large number of exemptions create opportunities for abuse and erode the sales tax base.

Excise taxes

58. Currently, the two Entities levy excise taxes on tobacco, alcohol, and oil products, as well as coffee and beverages. In mid-1998, the RS replaced extremely low Yugoslav dinar charges with KM-based excise taxes at higher rates closer to those levied by the Federation. However, continued rate differences—between the two Entities and between imported and domestically produced goods—created strong incentives for inter-Entity trade diversion and opportunities for tax evasion. In June 1999, the two Entities reached agreement on harmonizing excise rates between Entities and between imported and domestically produced goods. To implement the agreement, each Entity needs to amend its tax law covering excise taxes. To date, this has been done for all but tobacco taxes in the Federation (in December 1999).[7] In the RS, the agreement has been implemented for all products by government decree (in February 2000).[8] Parliament consideration of the amendments to the law is expected in late March.

Income taxes

59. Although major progress has been made in harmonizing sales taxes and customs duties between the two Entities, income tax policies have diverged, owing to the RS's decision to introduce regressive corporate income and citizen taxes in 1998. Currently, the RS levies a corporate income tax at four rates (20, 15, 12, and 10 percent), with higher

[6]Rates in many transition economies are considerably higher than average rates in developing economies.

[7]Also, the Federation excise tax on imported automobiles was eliminated in December 1999.

[8]In addition, ad valorem excises on luxury products and timber have been abolished by decree pending amendments to the respective legislations.

marginal rates applied to lower income brackets.[9] A similar rate structure is used for the RS's citizen income tax, with three regressive marginal rates (25, 20, and 15 percent). In the absence of strong evidence of improved compliance, there is no visible benefit to offset the flaws of such a system. First, regressive income taxes are unlikely to help improve compliance, as a high marginal rate for the low income bracket may deter the reporting of all incomes in the first place. Second, a regressive corporate income tax system discriminates against small corporations, and may encourage inefficient consolidation of enterprises. Third, a regressive personal income tax is inconsistent with redistributive objectives of other tax and expenditure policies. Finally, the lower effective tax rates in the RS will induce tax evasion of some corporations in the Federation by registering in the RS. As for the corporate income tax bases, both the Federation and RS provide generous exemptions and concessions for newly registered enterprises and foreign invested companies, and tax credit for investment.

Social insurance contributions and labor income taxes

60. Labor income in the Federation is subject to a 15 percent wage tax—a withholding tax on wages net of social insurance contributions—a cantonal personal income tax at a rate of up to 50 percent of the Federation personal income tax rate,[10] and a 45 percent social insurance contribution. In the RS, a wage withholding tax, a 25–15 percent citizen income tax, and a 44 percent of social security contribution rate are levied on labor income. The cumulative tax burden on an average worker's gross income could be as high as 55 percent, the bulk of which is due to social insurance contributions. Table 6 shows that despite significant reductions in recent years, Bosnia and Herzegovina's contribution rates remain higher than those in many transition countries and most developing countries. A very high tax rate on labor income entails great incentives for evasion, thus eroding the contribution base for the social insurance funds. Indeed, typical effects of the current system are that employers report only minimum wages for their employees, and potential labor suppliers seek employment in the informal labor market.

Trade taxes

61. Customs duties levied by the two Entities were unified under the 1998 State Customs Tariff Law, and the rate setting authority has been with the State since then. Currently, customs duties are charged at four different rates: 0, 5, 10, and 15 percent. In addition, there are temporary surcharges on most agricultural products. The surcharge levels are high and, until mid-1999, widespread evasion owing to the lack of border control constrained the actual revenue receipts from customs. The implementation of a common country-wide surcharge resulted in a substantial increase in revenues from this source.

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[9]The Federation levies a 30 percent corporate income tax.

[10]The Federation levies a personal income tax with two marginal rates (15 and 25 percent).

D. Expenditures

62. Government expenditure at the Entity level is characterized by very high shares for military expenditure and social benefits to military invalids. Outlays for education, health, and infrastructure expenditures account for relatively small shares, owing in part to substantial off-budget donor assistance in these areas.

Military expenditure

63. In 1998, military expenditure recorded in the consolidated government budget accounted for 5.4 percent of GDP, or 10 percent of consolidated government expenditure. Even this on-budget military expenditure figure exceeds those in most other countries. In addition to budgetary expenditure, there have been substantial foreign grants used by armies in the Federation, as well as additional support from some local governments. It is estimated that the total Federation military expenditure was at least double the KM 368 million recorded on the Federation budget.[11] Three quarters of the on-budget allocations in the Federation are devoted to the Federation army and one quarter to the armed forces operating in the Croat-majority area.

64. The Federation's military expenditure is much higher than that in the RS. In 1998, military expenditure recorded in the budget was about 5.9 percent of Entity GDP in the Federation, and about 4.1 percent of entity GDP in the RS (Table 7). The higher military spending in the Federation is due to the existence of two independent military forces within the Entity, one in the Croat majority area and the other in the Bosniac majority area. Although the total number of military personnel in the Federation declined from about 200,000 during the height of the war to about 33,000 in mid-1999 as a result of the post-war demobilization, the current size of the armies is difficult to afford. The large military expenditure absorbs resources much-needed for basic social services and economic construction, and increases the perceived risks by investors.[12]

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[11]Estimates indicate that adequate support for the current complement of troops in the Federation would amount to at least KM 1 billion.

[12]While some cross-country studies have reported a positive correlation between military expenditures and economic growth, this positive correlation reflects to a large extent the effects of an increase in military outlays on aggregate demand during recessions. When resources are fully employed, the simple theory of opportunity costs implies that military expenditures will crowd out other expenditures, including private investment. Several recent studies suggest that this effect dominates any positive impact of military outlays on growth. See Sandler and Hartley (1995) for a discussion of various studies.

Social fund expenditure and Entity government transfers to households

65. In 1998, Bosnia and Herzegovina's social fund expenditure and Entity government transfers to households accounted for about 18 percent of GDP, or 59 percent of the consolidated expenditure of entity governments and social funds. By either measure, these outlays are higher than those in most developing countries (Table 7). BiH's social fund expenditures mainly include payments by the pension and invalid insurance, health insurance, and unemployment insurance funds. These funds receive limited amounts of additional financing in the form of transfers from the Federation and RS budgets. The Entity budgets are fully responsible for financing the benefits of an estimated 226,000 war invalids and survivors of deceased soldiers. In 1998, benefits for war invalids and survivors alone amounted to nearly 10 percent of total government expenditure.

66. The very high social fund expenditures and government transfers to individuals in relation to GDP reflect the extremely unfavorable post-war demographic structure of the country, as a large proportion of the working age population left the country during the war, with a concomitant increase in the population share of invalids and disabled. Sustained high unemployment has contributed to further outflows of the young and increased the share of the elderly among returning refugees. These factors have placed substantial pressure on the pension, health, and unemployment funds. While the disproportionately high level of government transfers to war invalids and survivors of deceased soldiers in part reflects the large number of war victims, entitlements for these groups are also particularly generous compared with those of other vulnerable groups.

67. As a result of the very high military and welfare expenditures, basic social services—such as education and health—appear to be under-funded,[13] with virtually all capital projects financed by donors. In the Federation, health and education devolve to lower levels of government. The discussion in Chapter VII highlights issues related to variations in local capacity and the absence of a viable mechanism to equalize services across cantons.[14] As reconstruction assistance ceases to play a dominant role in financing health and education, it will be important to identify carefully the appropriate levels of budget expenditure in these areas, particularly for recurrent expenditures.[15]

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[13]For more detailed discussions on health and education, see the World Bank's Public Expenditure Review (1997), and the two Entities' Budget Framework Papers (1999).

[14]Federation health and education outlays are concentrated, respectively, at the cantonal and local government level, where systematic reporting has been fully implemented only recently.

[15]Donor support has included substantial amounts of medical supplies and essential drugs.

References

Sandler, T., and K. Hartley, 1995, *The Economics of Defense* (New York: Cambridge University Press).

Table 2. Bosnia and Herzegovina: Fiscal Operations of the Consolidated Government, 1998

	State Act.	Federation 1/ Est.	RS 2/ Est.	Consolidated BIH (Est.)
		(In percent of GDP)		
Total Revenue	2.0	52.2	26.0	45.9
Tax revenue	0.0	33.9	17.1	29.7
Taxes on goods and services	0.0	20.3	8.6	17.4
Trade taxes	0.0	6.1	5.5	5.9
Taxes on income	0.0	6.6	2.2	5.5
Other taxes	0.0	0.9	0.8	0.9
Nontax revenue	2.0	18.3	9.0	16.2
Transfers from other levels of government	1.7	0.0	0.0	0.0
Other	0.3	18.3	9.0	16.2
Total Expenditure	2.0	59.1	34.9	53.3
Wages and contributions	0.5	5.3	9.0	6.7
Goods and services	0.3	1.2	2.9	1.9
Military	0.0	5.9	4.1	5.4
Interest	1.3	0.0	0.0	1.3
Reconstruction expenditure	0.0	2.7	0.7	2.2
Social fund expenditure	0.0	16.0	5.4	13.3
Subsidies	0.0	0.4	0.0	0.3
Other transfers to households	0.0	6.5	2.3	5.4
Of which: Transfers to war invalids	0.0	6.0	2.3	5.0
Transfers to other levels of government	0.0	1.3	3.2	...
Other expenditures and unallocated 3/	0.0	14.9	3.7	12.1
Foreign loan financed projects	0.0	5.0	3.7	4.7
Overall Fiscal Balance	0.0	-6.9	-8.9	-7.4
Financing	0.0	6.9	8.9	7.4
Net domestic financing	0.0	0.0	0.0	0.0
Net foreign financing	0.0	6.9	8.9	7.4
Of which: foreign project loans	0.0	5.0	3.7	4.7

Source: Data provided by authorities; and staff estimates.

1/ Includes Entity government (on-budget), cantonal/municipal governments (on-budget), social funds, and foreign loan financed projects (off-budget).

2/ Includes Entity government (on-budget), social funds, and foreign financed loans (off-budget). Data for municipal governments are not available.

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

Table 3. Size of Government for Selected Countries, 1997 1/

(In percent of GDP)

	Revenue	Expenditure	Real GDP growth 2/
Bosnia and Herzegovina	45.8	52.7	...
Federation, 1998 3/	52.1	59.1	...
Republic, 1998 4/	26.0	31.7	...
Transition countries			
Czech Republic	40.7	42.9	-0.2
Hungary	45.0	49.7	-1.1
Romania	27.7	31.3	-2.5
Bulgaria	31.1	33.6	-5.4
Croatia	48.6	49.8	-2.5
Slovenia	44.6	45.7	-0.2
FYR Macedonia	38.9	39.4	-6.1
Russia	32.0	39.7	-6.5
China	12.0	13.6	10.3
Developing countries			
Chile	23.4	21.0	7.7
Mexico	22.7	24.1	3.2
Malaysia	39.0	33.0	8.7
Thailand	17.0	18.6	7.4
Ethiopia	22.9	24.3	4.2
Kenya	28.8	29.4	2.4
OECD countries			
United States	31.9	31.6	2.3
United Kingdom	37.5	39.4	1.8
Norway	51.8	44.4	3.7
Austria	48.0	49.8	2.3

Sources: IMF, WEO database; and various IMF country documents.

1/ Consolidated general government data. Consolidated central government for Chile, Thailand, Ethiopia, and Kenya.
2/ Arithmetic average for 1990-97.
3/ Includes Entity and cantonal governments, social funds and foreign project loans. Does not include foreign project grants and off-budget military expenditure.
4/ Includes Entity government, social funds, and foreign project loans. Does not include local governments, foreign project grants, and off-budget military expenditure.

Table 4. Bosnia and Herzegovina: Government Revenues in the Federation and RS, 1998

	Federation 1/		RS 2/		Consoliated BiH 3/	
	Amount (mil KM)	Share (percent)	Amount (mil KM)	Share (percent)	Amount (mil KM)	Share (percent)
Total revenue	1,866	100.0	357	100.0	2,223	100.0
Tax revenue	1,740	93.2	295	82.6	2,034	91.5
Taxes on goods and services	1,041	55.8	149	41.7	1,190	53.5
Sales tax 4/	718	38.5	98	27.4	816	36.7
Excises	323	17.3	51	14.3	374	16.8
Trade taxes	312	16.7	95	26.6	406	18.3
Customs tariffs	312	16.7	91	25.4	402	18.1
Export tax on timber	0	0.0	4	1.2	4	0.2
Taxes on income	339	18.2	38	10.8	377	17.0
Personal income tax	47	2.5	6	1.8	53	2.4
Wage withholding	202	10.8	30	8.5	232	10.5
Corporate income tax	90	4.8	1	0.4	91	4.1
Other taxes	47	2.5	13	3.6	60	2.7
Nontax revenues	127	6.8	62	17.4	189	8.5
Fees	79	4.2	39	11.0	118	5.3
Fines	14	0.8	2	0.5	16	0.7
Others	34	1.8	21	5.8	55	2.5

Source: Federation and RS Ministries of Finance and IMF staff estimates.

1/ Including both Federation and cantonal revenues, but excluding social fund revenues.
2/ Excluding municipal governments. It is estimated that municipal government revenue is about 20 percent of Entity level government revenue.
3/ Including Federation and cantonal revenues, and RS revenues.
4/ 30 percent of sales tax proceeds in the RS accrue to the municipal budgets, and are not included in this presentation.

Table 5. Bosnia and Other Countries: Sales Tax/VAT Rates, Late 1990s

	General Rate	Other Rates
Bosnia and Herzegovina		
Federation (sales tax) 1/	20	15, 10, 5
Republic (sales tax) 2/	18+2	8+2
Transition countries		
Czech Republic (VAT)	22	5
Hungary (VAT)	25	12
Romania (VAT)	18	11, 9
Bulgaria (VAT)	20	...
Croatia (VAT)	22	...
Slovenia (sales tax)	20	32, 10, 5
FYR Macedonia (sales tax)	25	10, 5
Russia (VAT)	20	10
China (VAT)	17	13
Developing countries		
Chile (VAT)	18	...
Mexico (VAT)	15	10
Indonesia (VAT)	10	35, 20, 5
Thailand (VAT)	10	7
Nigeria (VAT)	5	...
Kenya (VAT)	16	12
Bostwana (sales tax)	10	...
Sudan (sales tax)	10	...
OECD countries		
United States (sales tax)	0-10	...
Canada (VAT)	7	...
United Kingdom (VAT)	17.5	...
Norway (VAT)	23	...
Austria (VAT)	20	32, 12, 10

Source: IMF, Summary of Tax Systems, 1998.
1/ Note that the sales tax on services in the Federation is also levied on the value of goods sold at the retail stage, making the total sales tax rate on goods 32 percent.
2/ The RS levies a 2 percent surcharge earmarked for railways.

Table 6. Social Insurance Contribution Rates for Selected Countries, 1997-99 1/

	Year	Total 2/	Pension and disability	Health	Unemployment
Bosnia and Herzegovina					
Federation	1999	45.0	24.0	18.0	3.0
Republic 3/	1999	44.0	22.0	21.0	1.0
Transition countries					
Czech Republic	1997	41.1	24.0	13.5	3.6
Hungary	1998	54.5	31.0	18.0	5.5
Romania	1997	36.0	28.0	2.0	6.0
Bulgaria 4/	1997	44.0	39.0	0.0	5.0
Croatia 3/	1998	43.4	21.5	20.2	1.7
Slovenia	1997	38.0	24.9	12.9	0.2
Poland	1997	48.0	45.0	0.0	3.0
Russia	1997	34.6	29.0	3.6	2.0
China	1998	20-28	15-20	2-5	3.0
Mongolia	1998	26.0	19.0	6.0	1.0
Developing countries					
Chile	1997	25.7-27.7	18.8-20.7	7.0	0.0
Mexico	1997	19.7	7.9	11.8	0.0
Malaysia	1997	24.0	24.0	0.0	0.0
The Phillipines 4/	1997	9.3	8.0	1.3	0.0
Nigeria 4/	1997	7.5	7.5	0.0	0.0
OECD countries					
United States	1997	14.7-20.1	12.4	1.5	0.8-6.2
United Kingdom 4/	1997	7-30	5-20	0	2-10
Norway 4/	1997	21.9	21.9	0	0
Germany	1997	40.5	20.4	13.6	6.5

Sources: United States Social Security Administration, 1997, Social Security Programs Throughout the World – 1997; various IMF country documents; and Deloitte Touche Tohmatsu International, 1997, Taxation in Eastern Europe (New York).

1/ All contributions are in percentages and based on gross wages/salaries

2/ Sum of the contribution rates for the pension, health, and unemployment funds. Some countries also have separate work injury funds or social benefit funds.

3/ Contributions to the health fund include those to the Children's Fund (3 percent in case of BiH and 2.2 percent in case of Croatia).

4/ Contributions to health insurance are included in pension contributions.

Table 7. Military and Welfare Expenditures for Selected Countries, 1996-98 1/

(In percent of GDP)

	Year	Military	Social fund expenditure and transfers to households	Total Expenditure
Bosnia and Herzegovina	1998	5.4	17.9	30.2
Federation	1998	5.9	20.6	31.0
Republic	1998	4.1	10.0	28.0
Transition countries				
Czech Republic	1997	1.7	13.1	35.9
Hungary	1997	0.8	13.1	42.7
Romania	1996	1.9	9.0	31.1
Bulgaria	1997	2.7	9.1	33.5
Croatia	1997	5.1	15.8	43.5
Slovenia	1997	1.1	9.4	40.9
FYR Macedonia	1997	...	14.2	30.5
Russia	1995	3.0	6.8	24.7
China	1996	1.1	n/a	8.0
Developing countries				
Chile	1997	1.7	6.9	20.7
Mexico	1996	0.6	3.0	15.5
Malaysia	1997	2.2	1.5	20.1
Thailand	1997	2.2	0.7	18.7
Ethiopia	1995	2.2	1.4	23.8
Kenya	1996	1.7	0.0	29.3
OECD countries				
United States	1997	3.3	6.0	20.9
United Kingdom	1995	3.2	12.8	41.1
Norway	1996	2.4	13.9	36.8
Austria	1996	0.8	17.2	41.8

Sources: IMF, country documents; IMF, database; and Staff estimates.

1/ For BIH, data refer to budgetary operations of Entity level governments and social funds. For other countries, data refer to central governments and social security funds.

V. Fiscal Sustainability—Current Policies[1]

A. Introduction

68. The previous chapter presented a broad picture of the size and structure of Bosnia and Herzegovina's government, and a comparison with other transition and developing countries, setting the stage for arguing that a significant reduction in the size of government will be necessary for the country's sustainable growth. This chapter assesses the medium-term implications of current fiscal policies and institutions for fiscal sustainability through a simulation exercise.

B. Sustainability of Current Policies

69. Box 4 presents the methodologies used to analyze the medium-term implications of the current fiscal policy, including the primary gap measure and debt simulation.

Primary gaps

70. A major complication facing this exercise is the large size of off-budget expenditure, particularly for the military (see Chapter IV on the size of government). A conservative estimate of the additional financing, beyond amounts allocated in Entity budgets, required to support the current military forces would amount to at least KM 500 million, or 7.3 percent of GDP.[2] Excluding this expenditure from the general government would significantly understate the current budget reliance on foreign financing, the resources needed to finance the military, and therefore the need for fiscal adjustment to achieve sustainability. In this chapter, we calculate primary gaps under two scenarios, one including the estimated off-budget military expenditure, and another excluding the off-budget military expenditure.

71. The standard formula for calculating the primary gap requires both the GDP growth rate and the interest rate to be stable during the period concerned. However, this requirement is not met in the case of Bosnia and Herzegovina. GDP growth is likely to be relatively high in the next few years, reflecting the potential for continued strong recovery from a very low post-conflict base, and the average interest rate is likely to be low in the coming years, owing to the availability of concessional loans. Thereafter, it is reasonable to assume that as the country returns to a more normal development path, GDP growth will decline and the average interest rate will rise as the bulk of external borrowing shifts to nonconcessional sources. Therefore, we will not use the standard sustainability formula, but will calculate the primary gaps for three different periods (5, 15, and 30 years) under the assumption that the

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[1]Prepared by Jun Ma and Jenny Ligthart.

[2]Military expenditures through 1999 have benefited from substantial foreign off-budget resources.

profiles of GDP growth and interest rate movements will reflect Bosnia and Herzegovina's postwar characteristics.

Box 4. Measures of Fiscal Sustainability

Fiscal sustainability depends on a set of policies to ensure the eventual solvency of the government under most reasonable conditions. However, in practice, data limitations prevent all but a few countries from compiling a government balance sheet and assessing government solvency.[1] An alternative approach used in most country studies on fiscal sustainability is to define sustainable fiscal policies as those leading to a stable or declining government debt-to-GDP ratio in the long run. Alternatively, a fiscal policy is called unsustainable if it results in a continuous increase in the government-debt-to-GDP ratio.

Two practical methods are used in this chapter to assess the sustainability of fiscal policy in Bosnia and Herzegovina: the primary gap (Blanchard, et al, 1990) and debt simulation. Assuming all indicators as a percent of GDP remain constant over time, the primary gap (pg) is defined as the difference between the actual primary deficit (pd^a) and the "sustainable primary fiscal deficit (pd^s)"—the deficit level that could be financed without adding to the debt burden (debt-to-GDP ratio) and without recourse to inflation financing:

$$pg = pd^a - pd^s = pd^a - (g - r)\ d$$

where g is the rate of real GDP growth, and r is the real interest rate, and d is the current debt-to-GDP ratio. A positive pg indicates that the primary deficit exceeds the sustainable level and will result in an increase in the debt-to-GDP ratio, while a negative pg implies a decline in the ratio. An intuitive explanation of the primary gap is that, holding the non-interest expenditure-to-GDP ratio constant, it measures the increase in the revenue-to-GDP ratio relative to the current year needed to achieve sustainability. Alternatively, if the revenue-to-GDP ratio is to be held constant, the primary gap implies the required magnitude of a permanent reduction in the non-interest expenditure-to-GDP ratio from the current year for sustainability.

Another method to assess sustainability is to simulate the future path of government debt over a specific period of time. By postulating assumptions about alternative fiscal policies (e.g., continuation of the current policy, rapid fiscal adjustment, and slow fiscal adjustment) the potential paths of the government debt-to-GDP ratio can be obtained and compared. If a certain policy—characterized in terms of the primary fiscal balance—yields an increasing government debt-to-GDP ratio, it indicates the need for policy adjustment to bring the fiscal position back to a sustainable path.

[1]Bascand and Razin (1997) presented a methodology for determining the maximum debt level that can be sustained (to keep fiscal solvency) under a given fiscal policy (primary balance-to-GDP ratio). Gerson and Nellor (1997) applied a formal statistical test of fiscal solvency to the Philippines, based on the notion that if the current fiscal policy is sustainable, the expectation of the discounted government debt should be zero.

72. The primary gap analysis is sensitive to macroeconomic assumptions, especially to the assumed GDP growth rates. Table 8 shows the results of the calculations under conservative and optimistic growth assumptions. Both sets of growth assumptions envisage a pattern of relatively high real GDP growth rates during 1999-2004 and a gradual decline thereafter, consistent with a post-conflict recovery from a very low GDP base. Given the country's currency board system, inflation is assumed to be low and stable throughout the projection period.[3] The average interest rates for the next five years are based on the high projected levels of concessional financing. Beyond that period, interest rate assumptions reflect the more commercial orientation of Bosnia and Herzegovina 's borrowing.[4]

73. The calculations show that with the inclusion of off-budget military expenditure in the general government, the current fiscal policy is clearly unsustainable. The primary gaps calculated for 5, 15, and 30 years range from 4.3 percent to 10.7 percent of GDP under optimistic growth assumptions, and from 5.6 percent of GDP to 11.2 percent of GDP under conservative growth assumptions. Analysis of the five year primary gap indicates that in order to contain the debt-to-GDP ratio at end-2004 to its level in 1999, the total fiscal adjustment starting in 1999 has to be of the order of magnitude of 4.3 percent of GDP under optimistic growth assumptions.[5] Long-term (15- or 30-year) primary gaps are larger than the medium-term (five-year) gap, given the gradual increase in interest rates and the reduction in real GDP growth. The 30-year primary gap implies that to limit the debt-to-GDP ratio in 2034 to its 1999 level, starting in 1999 a fiscal adjustment of 10.7 percent of GDP (11.2 percent under conservative assumptions) would be needed.

74. If off-budget military expenditure is excluded from the general government—which implicitly assumes a drastic scaling back of military forces as off-budget foreign financing dries up—the picture is somewhat mixed. The five-year primary gap ranges from -1.5 to -0.2 percent of GDP, depending on growth assumptions, suggesting that the current policy would not lead to an increase in the government debt-to-GDP ratio over the next five years under the very concessional terms of foreign financing. The 15- and 30-year primary gaps are higher, however, reflecting the increase in the average interest rate and a decline in GDP growth rate in the long run. To maintain an unchanged debt-to-GDP ratio over the 30-year period, fiscal adjustment of 3.8 to 4.3 percent of GDP would be necessary, if it were to take place in 1999.

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[3]The currency board framework is assumed to remain in place throughout the simulation period.

[4]From 1999-2004, BiH will borrow mainly from concessional sources and therefore interest payments will be relatively low; after 2004, the country will have more limited access to concessional sources and will need to borrow more on commercial terms.

[5]An adjustment of 5.6 percent of GDP would be required under conservative growth assumptions.

75. The difference between the two scenarios in terms of the primary gap suggests that the extremely high military expenditure in Bosnia and Herzegovina poses the single most important risk to fiscal sustainability. About two-thirds of the fiscal adjustment needed to close the 30-year primary gap reflects the impact of the future reduction in external grants for the military.[6] To maintain the military outlays at their current level, while external grants for military support decline sharply over the next few years, the country would have to borrow on commercial terms or make unsustainable cuts in other, more productive expenditures. If borrowing is the only option, it will lead to a rapid increase in government debt and the debt-service burden, as indicated in the following debt simulation.

Debt simulation under current policy

76. The debt simulation results are largely consistent with the stories told by the primary gap measures. As in the primary gap analysis, we consider two scenarios, one including off-budget military expenditure in the general government, and another excluding such expenditure. The simulations presented in this section are based on conservative growth assumptions (see footnote of Table 8). Even optimistic growth assumptions do not alter the conclusions.

Including off-budget military expenditure

77. We assume (i) that off-budget military expenditures of KM 500 million are included in the general government, financed by off-budget external grants; and (ii) that the current revenue and expenditure policies will hold the revenue-to-GDP ratio and the ratio of total noninterest expenditure (now including off-budget military expenditure) to GDP at current levels. These policies would generate a continuous rise in the government-debt-to-GDP ratio from the level in 1999 (Table 9). By 2014 and 2034, the debt-to-GDP ratio would reach 181 percent and 647 percent, respectively—an obviously unsustainable path of debt dynamics.

Excluding off-budget military expenditure

78. Assuming a continuation of the current revenue and expenditure policies, our simulation shows that the government debt-to-GDP ratio will initially decline slightly through 2002, and then begin to increase gradually (Table 10). In 2014 and 2034, the debt-to-GDP ratio will reach 95 percent and 246 percent, respectively. Here, the initial decline and the increase thereafter in the debt-to-GDP ratio is largely explained by an increase in the average interest rate and reduction in GDP growth rate over the long run.

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[6] Table 8 shows that the total adjustment needed for closing the 30-year primary gap is about 11 percent of GDP, while the difference between the primary gaps in the two scenarios—which reflects the need to adjust for the future reduction in foreign-financed military expenditure—amounts to about 7 percent of GDP.

Contingent liabilities

79. In addition to the current liability to finance nondiscretionary expenditures, governments in BiH also face several potentially large contingent liabilities, which could pose additional threats to fiscal sustainability (see Box 5). These contingent liabilities include: potential pressures on the Entity Governments to cover part of the bank restructuring costs; the need to finance large-scale labor retrenchment from state-owned and socially owned enterprises; and the need to fund the transition of the PAYG pension systems toward partially funded pension systems. Although the staff has strongly discouraged the authorities from assuming any contingent liabilities, and there is no scope within the program for this to be included in the budget, these contingent liabilities may become actual liabilities in the future, requiring substantial financing from, and/or debt accumulation by, the government.

C. Conclusions

80. Both the primary gap analysis and debt simulations highlight the fact that current fiscal policies are unsustainable over the medium and long term. If the large off-budget financing and the associated expenditures—mainly military—are taken into account, the magnitude of needed fiscal adjustment to achieve sustainability becomes strikingly large. The need for early adjustment is underscored by the prospect that concessional foreign financing is likely to decline significantly over the medium term, and the cost of delaying adjustment will increase along with the interest rates for future borrowing.

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Box 5. Contingent Government Liabilities

Bosnia and Herzegovina's *banking system* is dominated by state owned banks, most of which are deeply insolvent. The substantial share of nonperforming assets includes, inter alia, foreign currency claims on the National Bank of Yugoslavia, foreign currency loans, and loans extended prior to March 1992, which will be removed from bank balance sheets—along with the corresponding liabilities—prior to privatization (see Chapter II). The authorities' strategy for privatizing solvent banks and liquidating insolvent ones rightly envisages no recourse to public funds, and plans to compensate household claims, such as lost foreign exchange deposits, through enterprise privatization vouchers (see Chapter III). Nevertheless, there is a risk that solvent banks will be unable to identify acceptable investors in the near term, leading to a further deterioration of the financial position of these banks. Entity Governments may eventually be forced to assist some large state banks before they find buyers. In addition, the privatization and liquidation of banks will certainly lead to substantial layoffs of bank employees, and the financing of their redundancy packages may become a government obligation. Finally, it remains uncertain whether the proposed self-financed deposit insurance systems are able to provide sufficient coverage of bank deposits without generating pressures for deposit payoffs by government.

Another legacy of the socialist system in the former Yugoslavia is that most enterprises are either *state-owned enterprises or socially-owned enterprises* (SOEs). A large number of these enterprises are in financial distress or even insolvent. The Entity Governments have committed to reforming the enterprise system by privatizing many SOEs through the voucher system, allowing those that are not viable to go bankrupt, while restructuring the ones that should remain in public hands (see Chapter III). However, each of these options may involve budgetary costs for mitigating the pressures arising from labor shedding. For example, the government may have to provide severance packages to employees of some SOEs who are made redundant, or to subsidize the unemployment insurance funds to cover the additional benefit payments needed for SOE reform.

The *pension funds'* own resources are not able to cover entitlements primarily due to an extremely low contribution base and a large number of beneficiaries, low retirement ages,[1] unrealistic benefit entitlements, and administrative problems such as double dipping exacerbate these problems (see Chapter VIII).[2] Even though some of these problems can be mitigated over the medium term by a recovery in the employment base and the proportion of working age population, an increase in retirement ages and tightening of other eligibility criteria for benefits, the systems may not be financially sustainable over the long run due to pressures from the aging population. A long-term solution to the sustainability of the pension systems is to move towards a partially or even fully funded system. However, as evidenced by many other countries' experiences such a transition may require substantial budgetary support, in the form of either direct budgetary transfers or issuing new government debt, to cover the benefits of existing pensioners.

[1]The Federation has already raised the legal retirement ages to 65 to be reached in 2003. Before 2003, the retirement ages will be adjusted upwards incrementally.
[2]Pensioners claiming benefits in both Entities.

Table 8. Bosnia and Herzegovina: Medium- and Long-Term Fiscal Sustainability Measures 1/

(In percent of GDP)

	5-year primary gap 1999-2004	15-year primary gap 1999-2014	30-year primary gap 1999-2029
Including off-budget military expenditure			
Conservative growth assumptions 2/	5.6	8.8	11.2
Optimistic growth assumptions 3/	4.3	8.4	10.7
Excluding off-budget military expenditure			
Conservative growth assumptions 2/	-0.2	2.3	4.3
Optimistic growth assumptions 3/	-1.5	1.8	3.8

Source: IMF staff estimates.

1/ A n-year primary gap is defined as the difference between the sustainable primary surplus--which keeps the debt-to-GDP-ratio unchanged during the n-year period and the actual primary surplus in the beginning of the period.
2/ GDP growth rate declines gradually from 8 percent in 1999 to 5 precent in 2004, and to 4 percent in 2014.
3/ GDP growth rate declines gradually from 10 percent in 1999 to 7 precent in 2004, and to 5 percent in 2014.

Table 9. Bosnia and Herzegovina: Government Debt Dynamics (current policy, including off-budget military expenditure), 1998-2034 1/

	1998 Est.	1999 Proj.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2009 Proj.	2014 Proj.	2034 Proj.
	(In percent of GDP)									
Total Revenue	45.9	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0
Total Expenditure	60.6	57.0	57.0	57.0	57.1	57.3	57.6	60.4	68.4	105.4
Interest payments	0.6	0.9	0.9	0.9	0.9	1.2	1.5	4.2	12.3	49.3
Non-interest expenditure	60.0	56.1	56.1	56.1	56.1	56.1	56.1	56.1	56.1	56.1
Overall Fiscal Balance	-14.7	-12.0	-12.0	-12.0	-12.0	-12.3	-12.6	-15.3	-23.4	-60.4
Primary Fiscal Balance	-14.1	-11.1	-11.1	-11.1	-11.1	-11.1	-11.1	-11.1	-11.1	-11.1
Financing	14.7	12.0	12.0	12.0	12.0	12.3	12.6	15.3	23.4	60.4
Domestic financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	14.7	12.0	12.0	12.0	12.0	12.3	12.6	15.3	23.4	60.4
Net foreign borrowing	5.9	5.1	8.4	10.0	10.9	11.6	12.2	15.3	23.4	60.4
On-budget grants	1.0	0.7	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.0
Off-budget grants 2/	7.3	6.2	3.1	1.6	0.9	0.5	0.3	0.0	0.0	0.0
Memorandum Items:										
Average interest rate (in percent)	0.9	1.4	1.4	1.4	1.4	1.6	1.8	3.6	7.3	8.0
Government debt-to-GDP ratio (in percent)	67	71	68	70	75	82	89	125	181	647
Real GDP growth (in percent)	15.0	10.0	15.0	14.0	10.0	6.0	5.0	5.0	3.0	3.0
Change in deflator (in percent)	0.6	7.4	4.3	1.8	1.6	1.5	1.5	2.0	2.0	2.0
Nominal GDP (in millions of KM)	6,861	8,057	9,665	11,220	12,540	13,496	14,389	20,505	27,542	73,916

Source: Data provided by authorities; and staff estimates.

1/ General government includes the State Government, Entity Governments, Federation local governments, social funds, foreign project loans, and an estimated amount of foreign grants for military support.
2/ For military support.

Table 10. Bosnia and Herzegovina: Government Debt Dynamics (current policy, excluding off-budget military expenditure), 1998-2034 1/

	1998 Est.	1999 Proj.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2009 Proj.	2014 Proj.	2034 Proj.
	(In percent of GDP)									
Total Revenue	45.9	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0	45.0
Total Expenditure	53.3	50.8	50.8	50.7	50.7	50.9	51.0	52.3	55.1	65.1
Interest payments	0.6	0.9	0.8	0.8	0.8	0.9	1.1	2.3	5.2	15.2
Non-interest expenditure	52.7	49.9	49.9	49.9	49.9	49.9	49.9	49.9	49.9	49.9
Overall Fiscal Balance	-7.4	-5.8	-5.8	-5.7	-5.7	-5.8	-6.0	-7.2	-10.1	-20.1
Primary Fiscal Balance	-6.9	-4.9	-4.9	-4.9	-4.9	-4.9	-4.9	-4.9	-4.9	-4.9
Financing	6.9	5.8	5.8	5.7	5.7	5.8	6.0	7.2	10.1	20.1
Domestic financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	6.9	5.8	5.8	5.7	5.7	5.8	6.0	7.2	10.1	20.1
Net foreign borrowing	0.0	1.3	5.3	5.4	5.5	5.7	5.9	7.2	10.1	20.1
Grants	1.0	0.7	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.0
Memorandum Items:										
Average interest rate (in percent)	0.9	1.4	1.4	1.4	1.4	1.6	1.8	3.3	5.7	6.4
Government debt-to-GDP ratio (in percent)	67	71	65	62	61	63	65	75	95	246
Real GDP growth (in percent)	15.0	10.0	15.0	14.0	10.0	6.0	5.0	5.0	3.0	3.0
Change in deflator (in percent)	...	7.4	4.3	1.8	1.6	1.5	1.5	2.0	2.0	2.0
Nominal GDP (in millions of KM)	6,861	8,057	9,613	11,135	12,427	13,363	14,237	20,259	27,211	73,029

Source: Data provided by authorities; and staff estimates.

1/ General government includes the State Government, Entity Governments, Federation local governments, social funds, and foreign project loans.

VI. Fiscal Sustainability—Medium-Term Adjustment[1]

A. Introduction

81. The analysis in the previous chapter indicated that the current fiscal policies, especially when taking into account the large off-budget expenditures and contingent liabilities, will not be sustainable in the medium and long term. Decisive actions are needed in the near term to reduce government expenditure, particularly military outlays, and to contain and rationalize the fiscal costs of providing social benefits. Steps should also be taken to reduce the overall tax burden on the economy and to minimize distortions in support of private-sector-led economic growth.

82. This chapter presents the results of a debt simulation under an assumed fiscal adjustment path. It then discusses the specific elements of a possible tax and expenditure policy reform agenda for the next 3–4 years with a view to moving toward a sustainable fiscal position in the long run.

B. Debt Dynamics Under an Adjustment Scenario

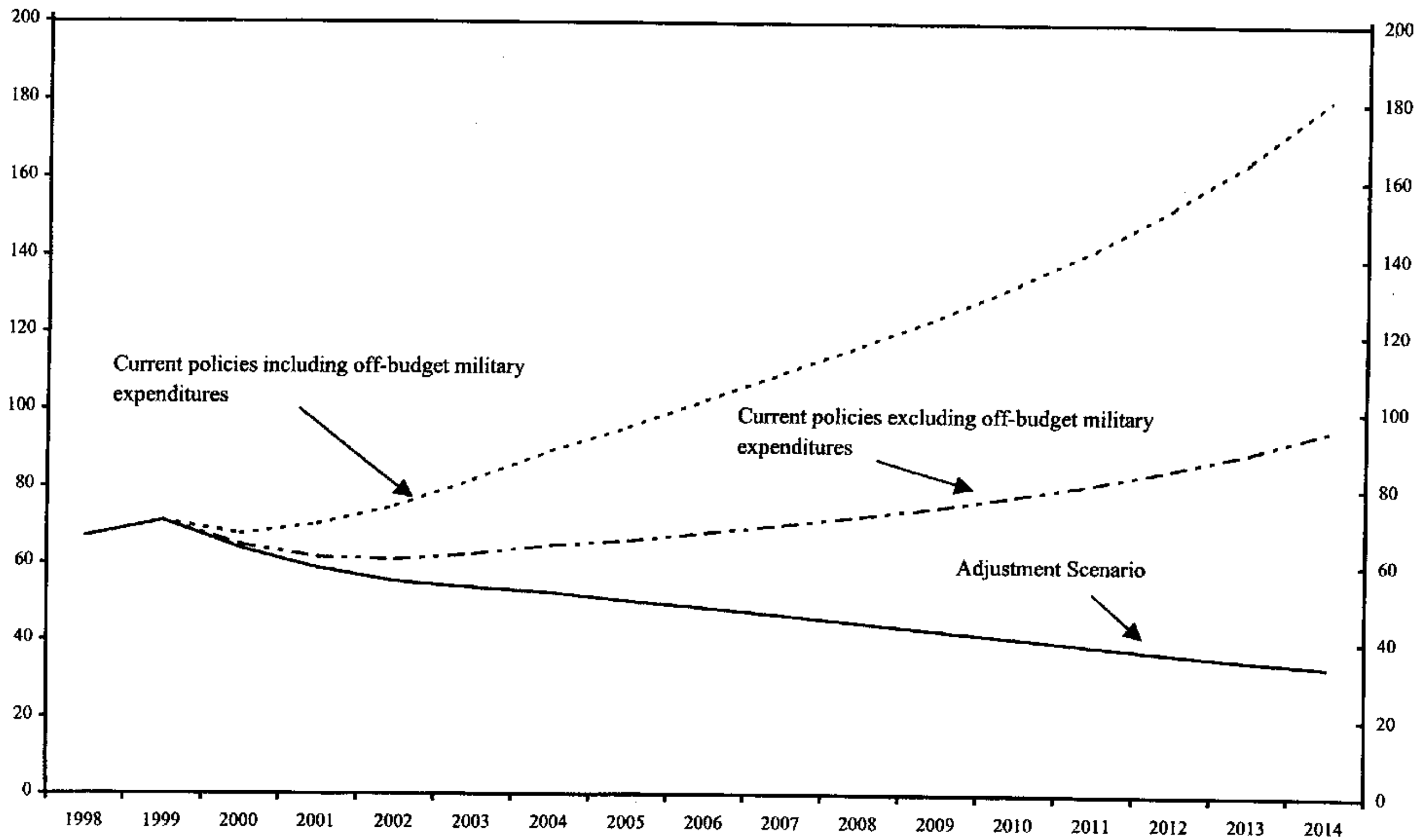
83. The present fiscal situation in Bosnia and Herzegovina points to the need for significant medium-term adjustment in order to achieve revenue and expenditure policies consistent with fiscal sustainability. One possible adjustment path is presented in Table 11. This scenario assumes successful implementation of tax policy reform aimed at reducing the overall tax burden on the economy, especially on labor income. Expenditure policy reform would be geared to cut military expenditures significantly, and to reduce the fiscal costs and improve the targeting of the social safety net. These reforms would result in a steady increase in the primary surplus of the general government, and a decline in the government debt-to-GDP ratio from 71 percent in 1999 to 52 percent in 2004, and to 34 percent in 2014 (see Figure 1).

84. Under this scenario, the general government deficit (including foreign project loans) would decline from 5.8 percent of GDP in 1999 to 2.1 percent in 2004, during which period the availability of foreign grants and concessional loans is likely to decline sharply. Tax reforms will reduce the revenue-to-GDP ratio from 45 percent in 1999 to 40 percent in 2004, still higher than, but closer to, the European transitional country average. General government expenditure as a percentage of GDP will fall from 51 percent to 42 percent in 2004. The most important expenditure reductions include those in military outlays and foreign loan-financed projects.

85. The reduction in the revenue-to-GDP ratio reflects the impact of two conflicting forces. On the one hand, the reduction in some tax rates and social insurance contribution

[1]Prepared by Jun Ma and Jenny Ligthart.

Figure 1. Bosnia and Herzegovina: Evolution of the Debt-to-GDP ratio, 1998-2014



Source: IMF staff estimates based on information provided by the Bosnia and Herzegovina authorities.

1/ Adjustment discussed in the text is based on a scenario that excludes off-budget military spending.

rates will reduce the revenue-to-GDP ratio. On the other hand, the tax and social insurance contribution bases may rise more quickly than GDP growth—a typical postwar phenomenon—thanks to higher employment and income growth, improved compliance, and a smaller gray economy. As a result, the total decline in the revenue-to-GDP ratio is likely to be smaller than the average decline in tax rates.

86. The projected decline in the revenue-to-GDP ratio and reduced reliance on foreign financing does not necessarily imply a compression of all categories of expenditure. During the period 1999-2002, although the revenue-to-GDP ratio falls from 45 percent to 42 percent, owing to a high GDP growth, per capita revenue would grow by about 4 percent per annum. Military expenditure could be substantially retrenched, and the level and coverage of benefits for war invalids and deceased soldiers be reasonably curtailed, to provide room for a modest increase in expenditure on education, health, employment generating programs, and even infrastructure projects.

C. Tax Policy Reform

87. Major tax policy reforms will be needed over the medium term to address the deficiencies of the present tax system, and to lay the foundation for long-term economic growth, driven mainly by private sector development. Medium-term sustainability of public finance and requisite economic growth will require other adjustments, including a reduction in military outlays, the reform of the social insurance system, and the rationalization of the government structure. This subsection, however, focuses on the key elements of the tax policy reform agenda for the next 3–4 years.

Sales taxes[2]

88. As an immediate measure, most non-standard exemptions should be eliminated from the current sales tax system.[3] In the next year, the system of sales taxes should be rationalized in both the Federation and the RS with the aim of establishing a single-stage, single-rate sales tax to be collected at the retail level starting in 2001.[4] A sales tax collected at the retail level has the widest possible tax base and minimizes cascading, and is also an important

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[2]This section reflects recommendations provided by recent technical assistance on consumption taxation from the Fiscal Affairs Department.

[3]The first step to this end is to amend the State Customs Policy Law to remove the discretionary power of the Council of Ministers to grant exemptions and to eliminate most exemptions from customs duties. As the Entity sales tax laws largely follow the State Customs Policy Law on exemptions, this amendment will significantly broaden the bases for both domestic and trade taxes.

[4]The sales tax rates should be set in such a way as to maintain revenue neutrality.

preparatory step toward a VAT. Experiences from more than 100 countries that have adopted a VAT system suggest that it is superior to sales taxes in many respects, including the avoidance of the cascading effects and increased incentives for compliance. Nevertheless, the implementation of a VAT is technically complicated, and the preparation typically takes 18 months or longer. Furthermore, the extremely complex intergovernmental relations in Bosnia and Herzegovina requires a very careful design of the VAT system, including arrangements for revenue distribution between Entities and among cantons/municipalities. For these reasons, implementation of a VAT will have to be postponed until all the preparatory work is completed.[5]

Excise taxes

89. The harmonization of excise rates will be completed in the near future, as preparations have been completed and there are no major technical difficulties. Over the medium term, the excise rates should be reexamined with the objective of increasing the revenue potential, controlling undesirable social and environmental consequences of certain types of consumption or production, and reducing incentives for tax evasion/smuggling owing to cross-country rate differentials.

Corporate income taxes

90. The Federation's current rate structure for the corporate income tax—a 30 percent flat rate—appears to be at an appropriate level[6] and is consistent with the principle of administrative simplicity. The RS should revoke the regressive corporate income tax structure, and move to align its tax structure with the Federation to eliminate inter-Entity distortions and internal inefficiencies arising from the regressive system. In both Entities, consideration should be given to limiting exemptions and concessions for new enterprises and joint venture firms—including those contained in separate laws on foreign investment—and to replacing tax credits with tax allowances for investment.[7] Presumptive taxes should be introduced as the main form of corporate income tax on small enterprises. For larger enterprises, a minimum assets tax should be considered as a way to control corporate income tax evasion.

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[5]We do not expect a VAT to be introduced before 2003, at the earliest.

[6]The rate is appropriate in light of an average rate for the OECD countries of 32 percent in 1995.

[7]As an investment incentive, accelerated depreciation of assets is both a better focused and a more narrowly targeted instrument, compared with tax holidays.

Personal income taxes

91. On personal income tax, the RS's regressive rate structure should be replaced with either a flat rate or a modestly progressive structure with few rates.[8] Over the longer term, personal income taxes in both Entities could move toward a global tax structure, reconciling wage taxes with taxes on other incomes. However, during the next few years a final wage withholding tax, with a global income tax structure for all other sources of income, will be appropriate given the authorities' limited tax administration capacity.

Social insurance contributions

92. Contributions to social insurance funds can be raised substantially (by about 20 percent) by increasing the social insurance contribution rates for military personnel and miners to the standard rates. This can be done in several phases over the next 2–3 years, considering its potential impact on the budget and pension fund operations. Over the medium term, the contribution rates could be reduced, as the contribution base expands and a tightening of eligibility criteria for benefits is implemented.

Trade taxes

93. The elimination of free trade agreements with neighboring countries is likely to increase substantially customs revenue. This, together with improvement in customs administration, will permit the reduction of surcharges (preferably toward a low and uniform surcharge) and their eventual removal. In the medium term, customs tariff policy should move toward a low and uniform tariff rate, or fewer tariff rates with low variance of rates and minimum exemptions. These reforms will simplify administration, enhance transparency, improve compliance, and reduce opportunities for rent-seeking. The export tax on timber in the RS should be replaced with a domestic stumpage tax, preferably levied at the production stage.

D. Expenditure Policies

94. Given that private sector development and improvement in tax compliance entail a reduction in the revenue-to-GDP ratio over the medium-term, fiscal sustainability will require a concurrent reduction in government expenditures. Expenditure adjustment over the next 3–4 years should focus primarily on budgetary savings from: (i) significant military retrenchment; and (ii) reform of the social insurance and social benefits system (including social funds and transfers to war invalids and survivors of deceased soldiers) to reduce the need for budgetary transfers and to permit a reduction in social insurance contribution rates. In addition, public administration reforms will be needed to rationalize the structure of the

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[8] The number of rates should not exceed more than three and the top marginal rate should be similar to the rate of the corporate income tax.

governments and to ensure adequate and equitable provision of basic services such as education and health care. Privatization and corporatization of state-owned and socially owned enterprises should also proceed relatively quickly to minimize prospects for a negative impact on government budgets.

Military expenditure

95. The number one priority of a sustainable expenditure policy for Bosnia and Herzegovina is to reduce military spending to an affordable level. Off-budget military expenditure, and the associated military personnel costs, will have to be cut almost entirely as soon as the off-budget financing is no longer available. In this context, fiscal sustainability would also require that on-budget military expenditure as a share of GDP should also be cut from 6.3 percent in 1999 to less than 3 percent in 2004. To this end, a concrete army reduction plan agreed by all ethnic groups is needed. Budgetary allocations for all remaining military forces should be consistent with the medium-term fiscal framework.

Pension reform

96. Pension reforms in the immediate future should involve (i) adjustment of the benefit formulas to provide a transparent alignment between benefits and available resources, and (ii) consolidation of the two pension funds within the Federation. Over the next 3–4 years, the following reforms should proceed: (i) a gradual increase in the retirement age to 65 (to be achieved by 2003 under new legislation adopted by the Federation); (ii) a tightening of the eligibility criteria for disability and death benefits; and (iii) reform of the pension contribution collection mechanism to improve compliance. With these reforms, as well as a gradual reduction in the unemployment rate and an increase in the ratio of the working age population to the nonworking age population, the pension funds' financial position is likely to improve significantly over the medium term. Then, consideration can be given to moving toward partially funded pension systems over the longer term.

Reform of benefits for military invalids and survivors of deceased soldiers

97. Several measures should be taken to limit the budgetary burden: (i) the benefit levels for military invalids and surviving families should be adjusted to narrow the difference between this program and other social benefit programs; and (ii) the eligibility criteria for benefits should be tightened.

Public administration

98. The government wage bill and expenditure on goods and services in the consolidated general government budget do not seem to be excessively high,[9] although some expenditures

[9]Civil service employment as percentage of the population for comparator countries is as follows: Albania (4.6 percent), Bulgaria (6.4 percent), Croatia (5.2 percent), Hungary

(continued…)

on government administration may have been included in "other and unallocated expenditure." The number of civil servants, currently at about 3.6 percent of total population, is also lower than those in neighboring countries, although higher than the developing country average. Reduction in the size of civil service therefore does not appear to be the top priority in public administration reform, but an expansion of the civil service should also be resisted, especially in light of the added pressures for increasing job creation in the public sector by army demobilization and the return of refugees. To improve cost efficiency and rationalize government structures, wage policies should be set by reference to the labor market, and over the medium-term the budget process should take into account measures of budgetary organizations' output and/or performance. Special attention should be given to the reform of intergovernmental fiscal relations within the Entities (especially in the Federation), in light of the large regional disparities in the level and quality of basic public services such as education and health.

Public enterprises

99. Public enterprises dominate the energy, metal fabrication, wood products, food processing, construction and engineering, light manufacturing, trade, services, and utility sectors. These enterprises now receive few direct transfers from the budgets, but some continue to rely on quasi-fiscal transfers, such as tax arrears, tax exemptions, and tax-offsetting transactions with the government. In the next few years, most of these public enterprises should be privatized, and those remaining, mainly in the utilities sector, should be restructured to improve corporate behavior. To facilitate the privatization and corporatization process, a legal framework for foreign investment, bankruptcy, accounting and auditing, and commercial transactions should be established. Given the one-time nature of the privatization proceeds from enterprise sales to strategic investors, their use should be restricted to retiring government debt or providing redundancy benefits for retrenched workers during the privatization process.

(8.1 percent), Macedonia (3.2 percent), Poland (4.2 percent), and Slovakia (7.7 percent). See World Bank, 1997, Bosnia and Herzegovina: Public Expenditure Review (Washington: The World Bank).

Table 11. Bosnia and Herzegovina: Government Debt Dynamics (adjustment scenario, excluding off-budget military expenditure), 1998-2014 1/

	1998 Est.	1999 Proj.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.	2009 Proj.	2014 Proj.
					(In percent of GDP)				
Total Revenue	45.9	45.0	43.9	42.8	41.8	40.9	40.1	37.0	37.0
Total Expenditure	53.3	50.8	48.7	46.7	44.7	43.4	42.3	38.0	37.3
Interest payments	0.6	0.9	0.8	0.8	0.7	0.8	0.9	1.1	1.1
Non-interest expenditure	52.7	49.9	47.8	45.9	44.0	42.6	41.3	36.9	36.2
o/w: military expenditure	5.4	6.1	5.2	4.4	3.8	3.2	2.7	1.4	1.4
o/w: foreign loan financed projects	4.7	3.8	3.5	2.7	2.2	1.9	1.7	0.8	0.0
Overall Fiscal Balance	-7.4	-5.8	-4.8	-3.9	-2.9	-2.5	-2.1	-1.0	-0.2
Primary Fiscal Balance	-6.9	-4.9	-4.0	-3.1	-2.2	-1.6	-1.2	0.1	0.8
Financing	6.9	5.8	4.8	3.9	2.9	2.5	2.1	1.0	0.2
Domestic financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing	6.9	5.8	4.8	3.9	2.9	2.5	2.1	1.0	0.2
o/w: foreign project loans	4.7	3.8	3.5	2.7	2.2	1.9	1.7	0.8	0.0
Memorandum Items:									
Average interest rate (in percent)	0.9	1.4	1.4	1.4	1.4	1.6	1.8	2.5	3.2
Government debt-to-GDP ratio (in percent)	67	71	64	59	55	54	52	43	34
Real GDP growth (in percent)	15.0	10.0	15.0	14.0	10.0	6.0	5.0	5.0	3.0
Change in deflator (in percent)	...	7.4	4.3	1.8	1.6	1.5	1.5	2.0	2.0
Nominal GDP (million KM)	6,861	8,057	9,613	11,135	12,427	13,363	14,237	20,259	27,211

Source: Data provided by authorities; and staff estimates.

1/ General government includes the State government, Entity governments, Federation local governments, social funds, and foreign project loans.

VII. Devolution of Fiscal Responsibilities[1]

A. Introduction

100. The government structure of Bosnia and Herzegovina is defined by its Constitution—which is part of the Dayton Peace Agreement (DPA)—and the constitutions and implementing legislation of the two Entities (Box 6). Responsibilities of the State (Common Institutions)[2] are quite restricted under the Constitution of Bosnia and Herzegovina. As a result, most responsibilities—including those for defense—fall to the Entity governments and their sub-units. The Federation has a highly decentralized government structure, with the responsibility for major public services delegated to 10 cantons and 82 municipalities. In contrast, the RS has a relatively centralized government structure in terms of both revenue and expenditure assignments.

101. A striking aspect of the forms of fiscal federalism implemented in Bosnia and Herzegovina concerns the lack of provisions for the relationships between the Entities and among the various layers of government. In particular, tax policy coordination between the two Entities has proved difficult, resulting in opportunities for distortions from tax competition and opportunities for evasion. In addition, only limited mechanisms are available to bridge horizontal imbalances in the level and quality of public services.[3] A more comprehensive review of the current intergovernmental relations is called for and a systematic approach to its reform should be developed over the medium term.

B. The Common Institutions of Bosnia and Herzegovina

102. The Common Institutions have limited responsibilities, and depend on transfers from the Entities to cover administrative expenditures and external debt-service obligations. The State has no constitutional prerogative to set policies (other than trade and customs) for the Entities, or to provide for any redistribution of resources across Entities.

103. The responsibilities of the State are limited to monetary policy (the CBBH), foreign affairs, foreign trade and customs policies, external debt management, immigration and international communications and transportation. With regard to monetary policy, the Constitution mandates that the currency board arrangement remain until at least end-2003. While these responsibilities resemble those normally assigned to a central government, several items are notably absent, including fiscal policy, social policy, and defense.

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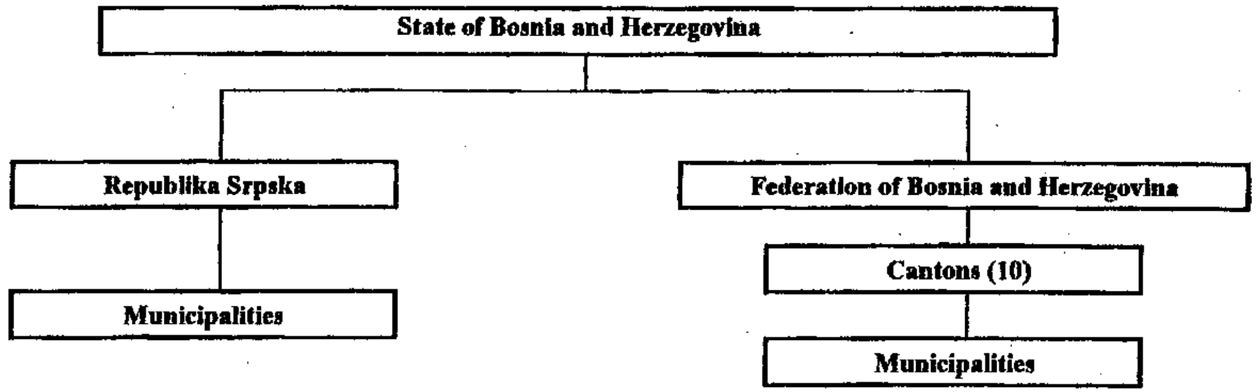
[1]Prepared by Dawn Rehm and Jun Ma.

[2]The Common Institutions include the State Government, described in Box 6, and the CBBH.

[3]A horizontal imbalance occurs when the fiscal capacities of subnational governments of the same level differ. A vertical imbalance occurs when the own revenues and expenditures of various levels of government within a federation are unequal.

Box 6. Governmental Structure [1/]



The constitution of Bosnia and Herzegovina, which is part of the DPA, provides for a decentralized governmental structure. The central ("State") government has limited powers and a balanced ethnic composition, with consensus required for most decisions. Other functions are devolved to the two Entities (the Federation of Bosnia and Herzegovina and the Republika Srpska) or their submits. Functions not explicitly assigned to the State are reserved for Entities or their subunits. The Entities, by consent, may agree to expand the powers of the State.

State of Bosnia and Herzegovina

Composition	The BiH government is small, reflecting its limited responsibilities. Includes a Presidency (comprising three members representing the three ethnic groups), Council of Ministers (Ministry of Foreign Trade and Economic Relations, Ministry of Civil Affairs and Communications, Ministry of Foreign Affairs), Constitutional Court, and a State Parliament.
Responsibilities	Monetary policy, customs and tariff policy, trade policy, and external debt.
Financing	Own revenues are presently limited to administrative fees. Debt-service obligations are funded by automatic transfers from Entity budgets. Administrative expenditures not covered by own revenues are met by automatic transfers from the budgets of the Federation (two-thirds) and Republika Srpska (one-third).

Entity Governments (The Federation of Bosnia and Herzegovina, and The Republika Srpska)

Composition	Both Entities have a President, Prime Minister, Ministries (including Finance, Defense, Interior, Energy, Agriculture, Industry), and a respective Parliament.

Federation of Bosnia and Herzegovina

Territory	Comprises the postwar Bosniac- and Croat-majority areas of Bosnia and Herzegovina. The Federation has a decentralized government under which many responsibilities fall to the Cantons (10) and constituent municipalities.
Responsibilities	The Federation government is responsible for transfers to finance the State institutions, for financing defense-related activities, internal security, and tax and customs administration for the Federation; and for formulating fiscal and aspects of social policies. The responsibility for financing and implementing most social expenditures, notably education and health, is allocated to cantons and municipalities.
Financing	The Federation budget is allocated revenues from customs duties, excise taxes, and a portion of corporate profit taxes. Other revenue sources are allocated to cantons and municipalities.

Republika Srpska

Territory	Comprises the postwar Serb-majority area of Bosnia and Herzegovina.
Responsibilities	The government of Republika Srpska is relatively centralized, with responsibility for transfers to finance State institutions, defense-related activities, internal security, tax and customs administration for Republika Srpska, as well as most social expenditure, particularly for health and education; and for formulating fiscal and social policies.
Financing	Revenues from customs and excise taxes, taxes on the sale of goods and services and income taxes are allocated between the government of Republika Srpska and municipalities according to a revenue-sharing scheme.

1/ Bosnia's governmental structure includes the Office of the High Representative (OHR), which was established in December 1995 to oversee the implementation of the Dayton Peace Agreement (DPA). The High Representative is the final authority regarding the interpretation of the DPA in the area of civilian implementation. OHR also plays a role in the economic area, mainly by coordinating economic policy advice through the economic task force (ETF).

Their absence is significant, as the Constitution specifically provides for responsibilities that are not explicitly granted to the State to automatically devolve to the Entity governments. While the State has the prerogative to set customs duties and policies, the implementation of these policies and responsibility for other fiscal policies automatically belong to lower levels of government.

104. For most revenue resources, the State institutions depend on Entity governments. While parliament has the right to determine the amount and sources of financing to meet administrative costs and external debt-service obligations of the State, the responsibility for fiscal policy (other than customs duties and trade policy) and revenue administration automatically devolves to Entity governments.[4] As a result, revenue sources for the State are largely limited to consular and administrative fees. The remainder of the State administrative budget and the external debt service obligations are financed by transfers from the Federation (about two-thirds) and Republika Srpska (about one-third).

105. The revenue structure of the State government has several implications. First, the State has no independent authority to implement revenue policies. Second, the State has only limited powers to ensure that policies within its purview are fully implemented by Entity governments, as has been evidenced by substantial delays in full implementation by Entity governments of the State Customs Tariff Law. Third, any increase in responsibilities for the State will need to be initiated by Entity governments. In principle, there are to be automatic transfers from the Entity revenue accounts for both the State administrative budget and to cover debt-service obligations. In practice, transfers to the State Administrative Budget during 1999 involved frequent delays, reflecting both lower-than-anticipated revenues for both Entities, and the effect of delays in forming post-election governments. Cooperation between external debt management units at the State and Entity levels, however, has resulted in generally smooth transfers to meet external payment obligations.

C. The Federation of Bosnia and Herzegovina

106. All responsibilities not explicitly assigned to the Federation government automatically devolve to the cantons.[5] Unlike the relationship between the State and Entity governments, there are clearly defined areas where responsibilities are jointly shared by the

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[4]The assignment of all tax bases to subnational jurisdictions, with a subsequent upward transfer of revenues to support the national government, limits the capacity for redistribution, and the ability of the national government to undertake fiscal stabilization. See Norregaard, John, 1997, "Tax Assignment" in *Fiscal Federalism in Theory and Practice*, ed. by Teresa Ter-Minassian (Washington: International Monetary Fund).

[5]The basic allocation of responsibilities between the Federation and cantonal governments is set out in the Federation Constitution. These were clarified and refined in the Law on the Allocation of Public Revenues (1996; 1998), which also lists areas to be financed from the respective budgets.

Federation and cantonal governments. According to the Federation Constitution, the Federation government has the responsibility for, inter alia, financing defense, and determining Federation-wide economic, health, and welfare policies, and regulating of commerce and financial institutions. The cantonal and municipal governments are mainly responsible for financing and providing basic social services, including education, health, transportation, social welfare, police, housing, environmental protection, and the use of natural resources (see Box 7).[6] The allocation of responsibilities between cantonal and municipal governments is set under local self-management laws. In general, municipalities bear the sole responsibility for road and land use, and share with the cantons the responsibility for social welfare services.

107. Revenue resources available to the Federation government are limited to customs and excise revenues, revenue from corporate profit taxes (from specific enterprises),[7] and own administrative fees and charges. In 1998, revenues accrued to the Federation budget accounted for about 38 percent of the total of Federal, cantonal, and municipal revenues. All other resources belong entirely to the cantons, and are shared with municipalities under local self-management laws (Box 8 and Table 12). There is no provision for revenue-sharing or formula-based equalization transfers from the Entity to cantons. As a result, cantons rely entirely on their respective revenue bases.

108. The variation in the consolidated revenues of cantons and their constituent municipalities reflect both variations in the average wage and in the share of the population with employment. In per capita terms, revenue resources for 1998 ranged from KM 1,020 per year in Sarajevo canton to KM 259 per year in Herceg-Bosna (Table 13).[8] This is reflected in a similar variation in per capita outlays for education—ranging from KM 246 per capita in Sarajevo canton to KM 120 per capita in Herceg Bosna.[9] Social welfare expenditures per capita show a similar pattern of variation.

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[6]In practice, there are many areas of overlapping responsibilities in policymaking between the Federation and cantons. The Federation enacts certain laws and regulations that issue unfunded mandates to lower level governments.

[7]In 1998, the Law on the Allocation of Public Revenues was amended to shift corporate profit tax revenues from banks and financial institutions, insurance and reinsurance companies, the electric power industry, Post and Telecommunications (PTT), and gambling to the Federation government.

[8]Amounts do not include social fund contributions as these are not consistently treated across cantons for 1998.

[9]Cantonal expenditures per capita do not capture municipal outlays for social assistance, education, and other public services owing to the lack of functional data for municipalities for 1998. Also, donor financed expenditures are not included in the revenue totals.

Box 7. Federation of Bosnia and Herzegovina: Governmental Structure

Federation government

Presidency
Prime Minister
Cabinet
Constitutional Courts
Supreme Court
Public Defender and Prosecutors Offices

Ministries
- Finance
  - Customs Administration
  - Tax Administration
  - Financial Police
- Defense
- Internal Affairs
- Justice
- Energy
- Transport and Communications
- Social Affairs and Refugees
- Health
- Education, Science, Culture and Sports
- Labor
- Agency for Pension and Invalid Insurance

Resources

Customs duty revenues
Excise tax receipts
Corporate profit taxes 1/
  Banks and financial enterprises, electricity, post and telecommunications, and insurance.
Fees, charges under Federation regulations
External assistance

Economic Responsibilities

Defense
Fiscal policy
Revenue collection and administration
Regulation of Financial Institutions
Energy Policy
Economic Policy
Regulation of commerce, including customs, international trade and finance, securities
Health and social welfare policies 2/

Cantons and Municipalities

Resources 3/

Sales taxes 3/
Wage taxes 3/
Other corporate profit taxes 3/
Citizen's tax 3/ 4/
Capital transfer taxes
Fees, charges under canton regulations

Economic Responsibilities

Health and social welfare policies 2/
Environmental policies, use of natural resources 2/
Infrastructure for communications and transportation 2/
Police
Education and cultural policeis
Housing policy, local land use
Policy, provision, regulation of public services
Regulation, promotion of small businesses
Implementation of social welfare, education

1/ Amendments to the Law on the Allocation of Public Revenue gave corporate profits tax revenues from banks, insurance and reinsurance, electricity production, PTT and telecommunications, and gambling to the Federation government. All other corporate profit tax revenues belong to the cantons and municipalities.

2/ Responsibility for policy making in the areas of health, environmental policy, use of natural resources, and education are shared between the Federation and cantons.

3/ Resource sharing between cantons and municipalities is determined at the cantonal level. Most cantons allocate some portion of sales taxes, wage taxes, profits taxes, and citizen's taxes to municipalities.

4/ The citizen's tax covers nonwage income, and is the sole tax rate left to the discretion of municipalities.

Box 8. Bosnia and Herzegovina: Allocation of Revenues by Federation Cantons to Constituent Municipalities, 1998

Canton	Sales tax	Wage tax	Profit tax	Citizen Tax
	(In percent of cantonal own revenues)			
Tuzla 1/	15	20	0	95
Zenica-Doboj 1/	20	20	0	100
Central Bosnia	25	27	3	100
Una-Sanska 2/	25	20	50	100
Gorazde 2/	13	12	40	25
Sarajevo 3/	...	...	...	...
Posavina 1/	20	20	0	0
West Herzegovina 1/	25	50	0	25
Herzeg-Bosanska	25	40	15	50
Bosanska-Neretva	30	50	0	100
Croat-Neretva 1/	25	46	0	27

1/ Sales tax revenues on excisable goods are reserved for the cantonal government; only sales tax revenues from services and non-excisable goods are allocated according to the indicated percentage.
2/ Sales tax revenues from imported excisable goods are reserved for the cantonal government; sales tax revenues from domestically produced excisable goods and on other goods and services are shared according to the indicated percentages.
3/ The Sarajevo canton allocates 2.8 percent of all revenues collected to municipalities.

109. The system of fiscal federalism currently implemented in the Federation contains no mechanisms for revenue sharing among cantons or for systematic transfers from the Federation government to offset variations in the revenue base. Moreover, the relatively limited revenue base for the Federation government has restricted ad hoc transfers to cantons and municipalities to less than 1 percent of consolidated cantonal and municipal outlays. There are only two effective sources of inter-cantonal burden sharing: (i) implicit subsidies provided to neighboring cantons by hospitals and universities located in the relatively wealthy cantons; and (ii) the provision of pension and invalid insurance from social insurance funds operating on a cross-cantonal basis.[10] Other public and social expenditures are financed solely from cantonal resources. In this context, it is difficult to envisage the implementation of basic standards for public and social services within the Federation in the absence of some mechanism to monitor and at least partially offset horizontal imbalances.

D. Republika Srpska

110. Intergovernmental fiscal relations in the RS are defined by the Constitution of Republika Srpska (1994) and the Law on Public Revenues and Public Expenditures (1996). It is significantly more centralized, compared with the allocation of responsibilities in the Federation (Box 9). In contrast to the Federation's relationship with the cantons, responsibilities not specifically assigned to municipalities generally belong to the RS government.

111. The RS government retains all revenues from customs duties, excise taxes, and corporate profit taxes. Revenues from sales taxes and citizen's taxes (which includes personal income taxes) are shared with municipalities according to percentages prescribed in the respective laws (Box 10). In 1998, revenues available to the RS budget are estimated to be about 80-85 percent of the total collected by the RS and municipal governments. The Constitution requires the RS government to transfer additional resources to municipalities, in the event that the assigned shares are not sufficient. To meet these needs, 10 percent of sales tax revenues are withheld from the Entity government share for additional assistance to municipalities.

112. In addition to having the same responsibilities as allocated to the Federation government, the RS government is assigned explicit responsibility for (i) financing primary education, (ii) health care for children, students, and the elderly; (iii) basic social security for those lacking alternative resources; and (iv) providing supplemental resources to municipalities and health and employment social insurance funds. Other spending for social security, secondary education, and special assistance for war victims is shared with municipalities. In addition to the shared responsibilities, municipalities are also charged with

[10] At present there are two pension funds operating within the Federation, with unified benefit entitlements under legislation enacted in 1998. Pending legislation covering benefits for military invalids (financed from the Federation budget) would unify these benefits as well.

Box 9. Republika Srpska: Structure of Governments

Government of Republika Srpska

Resources	Economic Responsibilities
Customs duties	Defense
Excise tax receipts	International obligations
Profit tax receipts	Economic and social policy
Sales taxes (70 percent)	Regulation of financial system
Individual income tax (74 percent)	Fiscal policy
Capital gains tax	Education 1/ 2/
Capital and real estate income taxes	Primary social welfare 1/ 2/
Copy right and patent income taxes	Infrastructure financing
Administrative fees and fines	Obligations to public enterprises
	Funds for municipalities 3/
	Financing for health,employment funds

Municipalities

Resources	Economic Responsibilities
Sales taxes (30 percent)	Culture, physical education
Citizen tax (24 percent)	Social protection 2/
Inheritance and gift taxes	Supplemental health insurance
Capital transfer tax	Local transportation
Gambling tax	Sports
Agriculture, forests	Tourism
Administrative fees and fines	Urban planning

Sources: Constitution of Republika Srpska and the Law on Public Revenues and Public Expenditures.

1/ Under the Constitution, the RS government is responsible for financing primary education, for providing primary health care for individuals below the age of 15 and for the elderly, and for social security for those unable to work or lacking alternative resources.
2/ General social welfare responsibilities are shared with municipalities, as are responsibilities for special benefits, including war veterans and secondary education.
3/ The RS government is also responsible for ensuring municipalities have adequate funding.

Box 10. Bosnia and Herzegovina: Allocation of Tax Revenues between the Entity and Municipal Governments of the Republika Srpska, 1998

	Republika Srpska	Municipalities
	(Percentage of total receipts)	
Customs	100	0
Excise	100	0
Sales tax [1]	70	30
Individual income tax	74	26
Profit tax	100	0
Agriculture, forests income	0	100
Other income taxes	100	0
Taxes on capital transfers, inheritance, gifts, gambling	0	100

Sources: Republika Srpska laws on: Changes and Amendments to the Law on Sales and Excise Tax (1998); Citizen Tax (1998); Allocation of Public Revenues and Expenditure (1996); Changes and Amendments to the Law on the Corporate Profits Tax (1998).

[1] 10 percent of sales tax revenues—included in the allocation to the Entity government—are set aside for grants from the RS government to municipalities.

the tasks of providing local transportation, facilities for culture activities and sports, and urban planning.

E. Issues and Future Reforms

Financing the State Government

113. Stable inter-governmental relations will require a reduction in regional disparities and the avoidance of fiscal policy competition. This section highlights the institutional factors required for achieving such relations.

114. Financing the State will remain challenging in the years ahead as the debt service burden increases and the administrative institutions take on their full range of responsibilities. Regarding the latter, the issuing of new passports provided a windfall gain used to finance consular operations during 1998–99, but revenue prospects from newly

enacted administrative fees are highly uncertain.[11] The need to provide adequate resources for consular operations,[12] administrative costs associated with the courts, implementation of treasury operations (and audit capacity) at the level of the State, and the new State Border Service, can be expected to put considerable pressure on the administrative budget.[13] At the same time, increases in the debt service burden over the medium term associated with reconstruction will increase the pressure on Entity budgets.

115. Three actions should be given priority. First, the current system of transfers from the Entities to the State budget need to become fully automatic and impervious to revenue fluctuations at the Entity level.[14] Second, the State institutions must produce full information on the execution of the budget and the finances of related agencies in a timely and transparent manner. To date, the State government has been unable to provide budget execution information with the standards met by Entity and cantonal governments. For this reason, the implementation of the Supreme Audit Institutions mandated under current assistance from the World Bank should be accelerated. Third, a realistic plan for the development of State institutions should be provided as part of ongoing consultations with the Entity governments. Over the medium term, budget planning at the level of the State will need to be coordinated with lower levels of government to ensure an efficient allocation of available resources across all levels of government. Finally, the allocation of an own revenue source for the State institutions should, at a minimum, be delayed until the institutional capacity necessary for transparency is fully in place. Moreover, even then, such a step should be taken only after consideration of the cross effects on the resource base available to Entity and lower levels of government.

Fiscal imbalances between Entity governments and lower level jurisdictions

116. There are large differences in average income and in the revenue base for the two Entities. In 1998, the per capita GDP in the Federation was about KM 2,300, while that in the RS was only about KM 1,200. While information on local government revenue in the RS is

[11]These cover transit documents for goods and persons, passports, and other fees.

[12]Potential gains from new administrative fees enacted during 1999 are uncertain. These fees cover, inter alia, travel documents for goods and persons, passports, and other fees.

[13]Entity transfers to the State administrative budget have remained relatively stable at 2–3 percent of Entity budgetary revenues during 1998–99, and are projected to remain at that level for 2000. Transfers to meet the debt service burden are expected to increase from 6 and 13 percent of budgetary expenditures for the Federation and Republika Srpska, respectively, during 1998 to 14 percent and 12 percent, respectively for 2000.

[14]The annual budget execution laws for both Entities contain provisions mandating a compression of all levels of expenditure—other than transfers to the State—to hold outlays in line with available resources on a cash basis.

incomplete, rough estimates indicate that per capita revenue (covering Entity and lower level governments and social insurance contributions) in the RS is about one-third of that in the Federation. In the absence of inter-entity revenue redistribution, per capita expenditure financed by the domestic revenues will be characterized by the same magnitude of inter-entity disparity. In this regard, inter-Entity coordination in setting basic standards for health care and education will be important to support an increasingly mobile labor force. Inter-Entity cooperation in areas where economies of scale are important—particularly for public goods and services will also be important for the efficiency of both governments.

117. Regional fiscal disparities between lower level jurisdictions within Entities are substantial, owing to the absence of an equalization mechanism, and inadequate budget resources for all levels of government. For example, the gap in per capita outlays for education varies between KM 246 per capita in Sarajevo and KM 84 in the Bosansko-Podrinjski canton (Gorazde). The differential in resources available across cantons could even increase over time, particularly as refugees return. While data on RS municipal finances are not available, it is probable that fiscal inequality among RS municipalities is somewhat less severe, as most public services are financed directly from the Entity budget, and some provisions exist for channeling additional revenues to the poorer municipalities. Nevertheless, to ensure the availability of basic public services to all citizens, it is important for both Entities to consider a formal and transparent mechanism—e.g., a formula-based equalization grants system—to reduce horizontal fiscal imbalances over the medium term.

118. Several other actions should be given priority for the near term. First, within the Federation there is a clear need for a thorough assessment of resources and outlays across cantons and municipalities that reflects all donor support and off-budget expenditure items. A similar effort is needed in Republika Srpska as a basis for assessing inter-regional distribution issues. Second, the Federation will need to put into place formal mechanisms involving Federation and local government representatives to evaluate inter-regional disparities, particularly in the areas of health, education, social welfare, and to establish a consensus regarding potential solutions. Finally, Entity revenue policies should aim to facilitate a sustained expansion of inter-Entity trade. Policies that give rise to inter-Entity tax competition or administrative inefficiencies will only undermine the credibility of both governments.

Inter-Entity policy harmonization

119. Inter-Entity coordination in the area of tax policies will be critical for an expansion of inter-Entity trade. As the harmonization of excise taxes is being completed, other issues need to be addressed in the very short-term. First, in the Federation, sales taxes on excisable goods are collected at customs for imported goods, and at first sale for domestically produced excisable goods. In the RS, however, sales taxes on excisable goods are collected at the retail level. The difference in collection points has resulted in a situation in which goods traded between Entities are either subject to double taxation or no taxation at all. Both Entities should collect sales taxes on excisable goods at the same point of collection. Second, the regressive rates implemented by the RS in 1998 for personal income and corporate profit taxes—in an attempt to improve compliance—have not had the desired effect and, at the

same time, have pushed average income tax rates in Republika Srpska well below Federation rates. These rates should be brought broadly into line between Entities. Third, the number of rates and definition of bases for the sales tax differ in the two Entities, and the resulting divergence in effective tax rates on consumption create incentives for inefficient cross border purchases. Both the number of rates and the definition of the sales tax basis should be harmonized between the Entities.

Fiscal reporting system for analyzing intergovernmental relations

120. A comprehensive understanding of the extent of vertical and horizontal imbalances between and within the two Entities will depend on the full implementation of organic budget laws for all levels of government. These call for all expenditures by budget beneficiaries to be brought on budget, financial plans for social insurance funds to be presented with annual budget proposals, and for comparable consolidated budgets for all levels of government in the two Entities.[15] For the State government, the implementation of treasury functions is critical for providing meaningful information on budgetary operations and a necessary precondition for a dedicated revenue source for the State.

F. Conclusions

121. The evolution of the economy from a post-war environment to a more market-based system with an expanding private sector has already highlighted a range of issues that require the development of mechanisms to facilitate coordination and cooperation between the various components of the system of fiscal federalism implemented in Bosnia and Herzegovina. While the national and Entity constitutions and related legislation contain specific allocations of responsibility, they do not exempt the various layers of government from responsibility to coordinate and avoid inefficient or destructive policy conflicts. The gains from policy harmonization have already been established: the narrowing of the gap between excise rates in the two Entities in mid-1998 and the elimination of the general Federation import surcharge, effectively boosted revenues for both Entities.

122. Inter-Entity issues have become increasingly important with the resumption of inter-Entity trade and labor mobility. Existing revenue collection and allocation mechanisms will need to be reviewed and revised, where necessary, to ensure that both Entities benefit from increased flows of goods and people. Social insurance programs—particularly for pensions and health care—will need to be adapted to meet the needs of a more mobile population. To the extent possible, standards for health care, education, and most public services should be brought into broad alignment. Overarching all of these is the need to develop sufficient cooperation and flexibility to meet the needs of a rapidly changing economic environment. As a case in point, both Entities face high levels of unemployment. Employment policies are

[15]The State Treasury Law was approved by the Council of Ministers at end-1999, and has been passed to the State parliament for consideration. Organic budget laws call for the full range of treasury functions to be transferred to the respective Ministries of Finance.

likely to be more effective and less costly if implemented on a coordinated basis, that allows both Entities to benefit from the attendant economies of scale.

Table 12. Allocation of Federation Revenue, 1998

	Federation	Cantons	Municipalities	Total
	(In millions of KM)			
Customs tariffs	312	...	...	312
Import excises	266	...	...	266
Domestic excises	58	...		58
Sales tax - services	...	644	66	710
High duty goods	...	186	2	189
Services	...	271	43	314
Other goods	...	187	20	208
Wages taxes	...	167	35	202
Company profit taxes	10	66	3	79
Property taxes	...	14	33	47
Other	...	6	3	9
Total	645	897	139	1,682

Sources: Federation Ministry of Finance; and staff estimates.

Table 13. Bosnia and Herzegovina: Indicators of Per Capita Fiscal Capacity Among Federation Cantons, 1998

	Una-Sanska	Posavska	Tuzla	Zenica-Doboj	Bosansko-Podrinjska	Central Bosnia	Herzeg-Neretva	West Hercegovina	Sarajevo	Herceg-Bosna
Population (end-1998)	290,420	40,738	528,146	385,993	34,566	223,373	210,404	81,087	368,369	80,693
Revenue per capita (KM/year)	400	462	411	364	345	400	487	643	1,020	259
***Of which* : Municipalities 1/**	91	67	69	71	48	92	116	112	28	74
Cantonal expenditure per capita 2/ 3/										
Education	117	152	131	132	84	133	162	201	246	120
Social assistance	37	0	66	41	0	12	15	0	87	4
General government	25	122	25	29	144	10	65	114	54	36
Security	79	175	74	68	128	108	142	108	119	109
Average net wage (1998)	359	453	300	262	302	273	375	328	396	348
Percent of population employed	11	10	14	17	12	14	24	12	21	14
Indicators of social benefit and welfare needs 4/	21	20	22	25	19	21	23	19	27	20
Share of population over ag 65 5/	11	11	10	11	11	10	13	11	14	13
Share of population registered as unemployed 6/	10	10	12	14	8	11	10	8	13	7

Sources: Federation Ministry of Finance, Federation Statitics Agency Bulletins; and staff estimates.

1/ Allocation of municipal revenues is not systematically available for 1998; amounts indicated would generally cover general government and local police, as well as municipal responsibilities for roads in public services, and their contribution to health, education, and social service outlays.
2/ Amounts are indicative, due to inconsistencies in the data through 1998. Amounts do not include financial resources allocated through municipal budgets.
3/ Because health insurance contributions and benefits are outside the budgets for some cantons, indicative amounts are not readily available.
4/ The combined percentage of those unemployed and those over age 65 provide a rough indication of the relative demand for some social benefits; this does not include individuals seeking social assistance for other reasons, including physical and mental disabilities, children requiring assistance, and others below the poverty line.
5/ This provides an indication of the share of the population dependent either on social insurance pension benefits, or on social welfare benefits.
6/ Unemployment benefits are limited to short-term assistance for the newly employed. As a result, registered unemployment underestimates the unemployed.

VIII. Social Insurance and Social Assistance Programs[1]

A. Introduction

123. The social protection programs provided in both Entities fall into three broad categories: (i) social insurance schemes, including pension and disability insurance, health insurance, and unemployment insurance; (ii) exceptional benefits, such as post-war provisions for military invalids and families of soldiers killed in the war; and (iii) social assistance to cover the basic needs of those outside the provisions of other programs. The overall structure of social protection programs is largely a legacy of the pre-war system and—like the earlier system—depends on continuous high levels of employment for sustainability.[2] Within this system, social insurance programs funded from wage contributions on a pay-as-you-go basis are expected to provide for pension and disability benefits, health care, and short-term coverage for frictional unemployment. Social assistance for those outside this net remains severely constrained.

124. The demands placed by a post-conflict economy have overwhelmed these programs. Social insurance programs are faced with the problem of providing benefits for pensioners and the disabled who qualified under pre-war provisions. At the same time, the contribution base is considerably smaller than envisaged as a result of high post-conflict levels of unemployment, a higher concentration of elderly and disabled—a problem that is expected to intensify with the return of more ex-refugees—and a considerable gray economy. Exceptional benefits for military invalids and the families of soldiers killed in the war are financed from Entity budgets, with some supplemental resources from lower levels of government. In general, benefits paid are considerably smaller than legal entitlements. In the Federation, most other social assistance provisions are left to the cantons and municipalities, and the more centralized RS government also delegates a share of these responsibilities to municipal governments.

125. The rest of this chapter provides a description of the basic features of the social insurance and social assistance programs in BiH, and points out the fundamental weaknesses of these programs. In general, the chapter points to an over-allocation of resources to military invalids and civilian war victims, at the expense of the most vulnerable. A reallocation of resources to ensure adequate social safety net provisions and potentially to offset the impact of high levels of unemployment on social insurance programs will be needed in both Entities.[3]

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[1]Prepared by Dawn Rehm, Jun Ma, and Jenny Ligthart.

[2]The pre-war economic slowdown had already placed a severe strain on these programs.

[3]Gupta, Sanjeev, Christian Schiller, and Henry Ma, 1999, "Privatization, Social Impact, and Social Safety Nets," IMF Working Papers WP/99/68.

B. Social Insurance Funds

126. Public social insurance funds in the Federation and Republika Srpska cover (i) pension and disability benefits; (ii) health care; and (iii) unemployment benefits.[4] Within the Federation, separate contribution rates for areas previously under the Bosniac- and HVO military control were unified under new legislation adopted in July 1998. Currently, the combined contributions for social insurance amount to 45 percent of gross wages, including 24 percent for pension and disability insurance, 18 percent for health insurance, and 3 percent for unemployment insurance. The total contribution rate is 44 percent in the Republika Srpska, including 22 percent for pension and disability insurance, 18 percent for health insurance, 1 percent for unemployment insurance, and 3 percent for the children's fund (Box 11). Within the Federation, contributions in the Bosniac- and Croat-majority areas were unified at lower rates—particularly for employer contributions—in 1998; somewhat lower rates were also adopted by Republika Srpska in 1998. In both cases, the reduction in rates was accompanied by intensified efforts to collect amounts owed and to improve compliance. Despite some improvement in collections, however, the substantial gray market and high unemployment continue to constrain the contribution base.

Pension and disability insurance funds

127. In the pre-war period, pension and disability insurance benefits were provided through a single social fund seated in Sarajevo with eight regional offices. During the war, separate funds split off to serve Republika Srpska and Herceg-Bosna (Mostar) and, in the post-war period, the three separate funds took over payment of benefit entitlements to pensioners now residing in their respective territories, including refugees and displaced persons. All three pension insurance plans envisaged the implementation of entitlement schemes similar to those employed under the original system. During the immediate post-conflict period, however, only the Sarajevo fund had sufficient records to implement an entitlement system based on historical earnings. As an interim measure, the Mostar-based fund introduced flat rate pensions until such time as appropriate records regarding work history and pension contributions could be obtained, and the RS pension fund shifted to education levels as a proxy for historical wage rates and linked the base to the legal minimum wage.

128. Pensions paid by all three funds have risen from exceedingly low levels available in the immediate post-conflict period. Within the Federation, average benefits during 1996 of KM 60 per month were less than half their pre-war levels—although substantially higher than the KM 4–5 a month paid during mid-1994. By mid-1999, average benefits had risen to KM 202 per month, equal to about 54 percent of the prevailing average net wage. The rebound in average benefits also has been substantial in Republika Srpska: in early 1996 benefits averaged KM 14 per month, rising to KM 70 per month during 1998 (Box 12).

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[4]In Republika Srpska, an additional fund provides protection for children.

Box 11. Bosnia and Herzegovina: Social Insurance Contribution Rates in the Federation and Republika Srpska, 1997 and 1999

	1997		1999	
	Employee	Employer	Employee	Employer
	(Contributions as a percent of gross salary)			
Federation				
Pension 1/ 2/	...	...	17.00	7.00
Bosniac-majority area (PIO)	17.00	17.00	...	...
Croat-majority area (MIO)	19.77	...	...	...
Health 2/	...	...	13.00	5.00
Bosniac-majority area	14.00	14.00	...	...
Croat-majority area	14.10	...	...	...
Employment	...	...	2.00	1.00
Bosniac-majority area	2.00	2.00	...	...
Croat-majority area	1.13	...	...	...
Republika Srpska 3/				
Pension and disability	11.00	11.00	11.00	11.00
Health	10.50	10.50	9.00	9.00
Employment	0.75	0.75	0.50	0.50
Protection for children	1.50	1.50	1.50	1.50

Sources: Law on Contributions for the Federation and Republika Srpska.

1/ Contribution rates throughout the Federation were unified in June 1998, and entitlements for pension and disability benefits were unified under new legislation adopted in July 1998.

2/ Contribution rates for military personnel and mine workers in the Federation are set at 9 percent of net wages for pension and invalid insurance, and 3 percent for health insurance.

3/ In 1996, contribution rates in Republika Srpska were reduced from 23 percent and 28 percent for pension and health insurance, respectively, both of which were evenly split between the employee and employer.

Box 12. Bosnia and Herzegovina: Pension and Disability Benefits Paid during 1996-98

	1996			1997			1998		
	Federation 1/		Republika	Federation 1/		Republika	Federation 1/		Republika
	PIO-Sarajevo	Mostar	Srpska 2/	PIO-Sarajevo	Mostar	Srpska 2/	PIO-Sarajevo	Mostar	Srpska 2/
Number of beneficiaries	185,190	44,561	156,688	197,385	43,435	157,052	218,277	44,092	163,717
Number of contributors	243,927	45,620	160,000	259,962	55,043	200,000	283,884	56,902	250,000
	1.3	1.0	1.0	1.3	1.3	1.3	1.3	1.3	1.5
Average pension paid (KM per month) 3/	66	78	20	102	100	46	130	133	57
Legally mandated average pension (KM per month) 4/	126	78	49	213	100	57	264	133	63
Implied accumulation of arreas (millions of KM) 5/	134	0	54	292	0	20	175	0	12
Average net wage (KM per month) 6/	154	280	50	260	264	89	329	318	144
Memorandum items									
Statutory lowest pension (end-year) 7/	40	...	13	57	...	11	105	...	230
Statutory highest pension (end-year) 8/	420	...	111	625	...	92	548	...	27
Average pension as percent of average wage	43	28	40	39	38	52	40	42	40
Legally mandated average pension as percent of average wage	82	...	...	82	...	...	80	...	...

Sources: Statistical Bulletins for the Federation and Republika Srpska and information provided by the Public Fund for Pension and Invalid Insurance-Sarajevo and the Public Fund for Pension and Invalid Insurance-Republika Srpska.

1/ Calculations for the Federation Sarajevo fund are based on the previous version of Law on Pension and Invalid Insurance; calculations for the Mostar Fund reflect separate legislation that provided for more limited coverage on a flat rate basis consistent with available resources. Obligations of the Mostar Fund the new Federation Law on Pension and Invalid Insurance were not applied until mid-1999.
2/ Values for Republika Srpska for 1996-98 are converted from Yugoslav dinars at the average market exchange rates.
3/ Average pensions paid in the Federation cover only 10 payments for 1998. Payments for January-June 1999 cover amounts owed on entitlements for October -December 1998, and January 1999.
4/ Legally-mandated average pension rates for the Sarajevo Fund were set at 82 percent of the average wage from the preceding month until new legislation was implemented in mid-1998. Values for the RS are indicative, and are based on the pension entitlement of someone with a secondary education and 35 years of contributions. Amounts owed for 1996 and covered in 1997 included provisions of materials, rent and utilities.
5/ This reflects only the average gap during the year between pensions due and pensions paid, and an estimated average number of beneficiaries.
6/ For PIO-Sarajevo the average is calculated with a one-month lag, reflecting the link between pension entitlements and average wages for the preceding month. However, because wages were often paid at less frequency than monthly, the average wage for a particular month is likely to be overstated.
7/ Until mid-1998, the lowest statutory pension for the region covered by PIO-Sarajevo was 20 percent of the average wage from the previous month
8/ For the Federation, the maximum pension was reduced in April 1998 to 2 times the average monthly net wage for the preceding December, compared with 3.5 times the average net wage under earlier legislation. For the RS, the maximum pension is set at approximately 380 percent of the lowest labor price for those with the highest education levels (4.5 times the maximum entitlement of 85 percent of the lowest labor price).

Despite these increases, most pensions in both Entities remain generally quite low in terms of the implied standard of living.

129. The Federation Law on Pension and Disability Insurance adopted in July 1998 significantly modified entitlements and eligibility criteria, with the aim of bringing future obligations into line with anticipated resource flows. Provisions for early retirement were reduced for a transition period, and then eliminated.[5] The retirement age increases in steps to age 65 by 2003 from 60 in 1998, and pension benefits reflect a longer wage history. More importantly, pension and disability benefit increases are to be linked to available resources—a step intended to eliminate automatic indexation to increases in the average nominal wage. Minimum and average pension levels are now linked to average pension levels for the previous year, instead of prevailing average wages. The differential between minimum and maximum benefit entitlements has been narrowed: the maximum pension has been reduced from 350 percent of the prevailing average wage to 200 percent, while minimum pensions have increased from 20 percent of the average wage for the previous year to 60 percent of the average pension for the previous year. Provisions for other forms of assistance, including additional monetary compensation for those requiring assistance, have been dropped, and these benefits were eliminated as of January 1999—six months after the enactment of new legislation (Box 12).

130. Legislation that would merge the two pension funds operating in the territory of the Federation was submitted to the Federation Parliament in August 1999. A key requirement is that all outstanding claims (unpaid contributions from enterprises and the military, as well as unpaid pensions) be cleared prior to the establishment of a new Federation-wide pension fund. To address the accumulation of arrears, legislation adopted by the Federation in October 1998 under which unpaid pension obligations accumulated during April 1992 – June 30, 1998 are to be settled within the privatization process. Vouchers equivalent to KM 734 million are to be issued—KM 577 million for the Sarajevo fund and KM 177 million for the Mostar fund—based on average salaries and regulations in force at the time.

131. Even with further revisions to benefit entitlements, the continued high rate of unemployment and high dependency rate are likely to pose additional problems in achieving an alignment between commitments and resources. Box 13 and Table 14 provide a summary of issues relevant for the short-term viability and medium-term sustainability of the Federation pension funds.

132. Reforms to the Republika Srpska Fund for Pension and Invalid Insurance have proceeded more slowly, compared with the Federation. As an interim measure, the pension base was linked to the minimum wage, and education levels are used to approximate the

[5]The age for early retirement for men (women) was increased from 55 (50) to 60 (55) with 35 (30) years of pension contributions, with a modest reduction in benefit entitlements. After 2005, this option is no longer available.

Box 13. Financial Sustainability of the Federation Pension Funds[1]

The staff has conducted a simple simulation exercise on the medium-term sustainability of the consolidated Federation Pension Fund (Table 14). The major findings and conclusions from this study are summarized below.

- The Pension Fund is not—and will not be for the next 4 years—self-financing, reflecting the post-war demographic structure characterized by very high proportions of young and old population relative to the working-age population. In addition, the expected return of a large number of old-age refugees is putting further pressure on the expenditures of the Pension Fund in the next few years. Continued real sector growth, increased labor force participation, reduced unemployment rates, however, will help reduce the size of the deficit.

- From 2004 to 2018, the net balance of the Pension Fund is projected to turn into a surplus (on average 2 percent of GDP), owing to a further reduction in the unemployment rate, an increase in the ratio of working-age population to non-working-age population (i.e., the old-age dependency ratio), and an improvement in contribution compliance. This will permit a reduction in the pension contribution rate from the current 24 percent to 22 percent in 2005, and a gradual further reduction to about 16 percent in 2016.

- Aside from the assumptions regarding demographic changes and continued economic growth, several key structural reforms are necessary to achieve the Pension Fund's medium-term financial sustainability. These include, inter alia, an increase in retirement age from the current levels to 65 in 2002, a tightening of the eligibility criteria for disability and death benefits during the next 3–4 years, an introduction of nationally defined individual accounts, and reform of the pension contribution collection mechanism to ensure better compliance.

- The projection results are very sensitive to key assumptions and should be used with extreme caution. In particular, if the number of returned refugees over the next two years is larger-than-expected, unemployment falls by less-than-expected, and the above mentioned structural reforms are not fully implemented, the Pension Fund's financial position will not be sustainable during the entire projection period. For example, an average unemployment rate of about 40 percent during the next 10 years will give rise to an average deficit of 2 percent during 2004–2018 and of 4 percent during the whole period.

- Over the period 2013–18, when the Pension Fund's financial position becomes sufficiently strong to absorb the transition costs, a switch from the current pay-as-you-go system to a partially funded system should be considered.

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[1]The simulation exercise consolidates the two pension funds operating in the Federation in anticipation of their pending unification

distribution of benefit entitlements. Owing to the absence of records on employment history, the level of benefits is jointly determined by an individual's education level and retirement age, with entitlements ranging between 45 percent and 380 percent of the minimum wage.[6] Changes similar to those implemented in the Federation to increase retirement age, reduce the gap between minimum and maximum pensions, and lengthen the contribution period, have not yet been introduced (Box 14).

133. While the pension funds operating in the Federation are independent of the Entity budget, the Public Expenditure Law for Republika Srpska requires the Entity government to cover any shortfall between benefits provided by the extrabudgetary funds and the level of entitlements. At the same time, government is prohibited from taking on obligations that cannot be met, and the government liability to the pension fund—and on the part of the pension fund for payments lower than entitlements—is limited by commitments of the RS government in the annual budget execution laws. During 1997 and 1998, the RS government contributed an estimated KM 39 million and KM 32 million, respectively. The growth in benefits in the RS during the period 1997-99 has been held down by the link between entitlements and minimum wages. At its inception, this was viewed as a temporary measure, and proposals have been put forward to restore the link to average wage rates, owing in part to the fact that average wages have increased considerably more rapidly than minimum wages.

Health Insurance

134. In the Federation, implementation of basic or obligatory health insurance is delegated to the cantonal governments, without direct financial support from the Federation government. Benefits are financed from wage and salary contributions automatically withheld by the payments bureaus, supplementary resources from cantonal and municipal budgets, and co-payments from beneficiaries. Benefit entitlements under the Law on Health Insurance include health care, compensation for lost wages and traveling costs related to securing health care; in some cases, the law provides for financial assistance for newborns and death benefits. Guaranteed benefits without co-payment are limited to children under the age of 15 and elderly over the age of 65. The role of the Federation Ministry for Health is presently largely limited to that of establishing norms and standards for obligatory health insurance.

135. Until recently, health care in Republika Srpska was relatively decentralized, with most insurance contributions and fee-based revenues automatically allocated to eight local

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[6]Benefit entitlements range between 130 percent and 450 percent of the pension base, depending on the level of education. The pension base ranges between 45 and 85 percent of the prevailing minimum wage, depending on years of contributions. The pension base is the minimum wage prevailing in the month benefits begin, adjusted for increases in the average wage.

Box 14. Pension and Disability Benefits in the Federation and Republika Srpska, 1999

Benefit	Federation	Republika Srpska
Old age pension		
Minimum contribution period	20 years	15 years
Retirement age	60, increasing to 65 by 2003, or 40 years of contributions	20 years of contributions: men age 60, women age 55 15 years of contributions: men age 65; women age 60, or 40 years of contributions
Pension base	Wages during continuous 15 year period adjusted to current prices according to increases in average pensions during relevant period.	Legal minimum wage in Republika Srpska adjusted by a factor of 1.3-4.5 for level of education.
Entitlement	45-85 percent of pension base for 20-40 years of contributions.	35-85 percent of pension base for 15-40 years of contributions.
Maximum entitlement	Capped at 200 percent of average Federation wage	380 percent of minimum wage
Minimum entitlement	Floor equal to 60 percent of average pension	Floor of 45 percent of minimum wage
Guaranteed pension	80 percent of average pension: applies to those eligible for 85 percent of the pension base.	...
Exceptional provisions	Contribution period reduced by 50 percent for jobs designated as hazerdous; Each year of participation in defense of Bosnia dueing 1992-95 counted as two years of contributions.	Each year (i) of contributions by military/civilian war invalids or employment in hazardous jobs jobs counted as 1.5 yrs; (ii) served in military, police during the war counted as two. War years included for those who lost jobs as a result of the war.
Disability benefits - work related injuries		
Minimum contribution period	No restriction	No restriction
Pension base	Pension base; or average wage while employed for those with less than 15 years of contibutions.	
Entitlement		
Unable to work full time	Maximum of 85 percent of the pension base or guaranteed pension	
Able to work full time	Employment in another position; new/additional training until age 55 Compensation equal to at least 30 percent of the average Federation salary during period of disability, retraining (covered by employer) Compensation for reduced salary in post-disability employment (Benefits paid by employer)	Re-employment until conditions for old age pension satisfied Previous wage (covered by employer) during disability and retraining periods; Compensation for lower salary in post-disability employment (paid by employer)
Care and assistance	Allowance eliminated.	35 percent of lowest wage available tothose (employed and unemployed) receiving disability benefits.
Disability benefits - injuries not related to employment		
Minimum contribution period	Minimum one year of insurance contributions Contribution period equal to at least 30 percent of period since age 20	Contribution period equal to at least 33 percent of period after age 20; 25 percent for beneficiaries younger than 30.
Pension base	Average wage over 15-year period; or average wage for years worked if disability pre-dates 15 years of contributions.	Legal minimum wage in Republika Srpska adjusted by a factor of 1.3-4.5 for level of education.
Entitlement		
Unable to work full time	57 percent of pension base for less than 20 years of contributions or old age benefit for same contribution period.	57 percent of pension base for less than 20 years of contributions or old age benefit for same contribution period.
Able to work full time	Compensation equal to at least 30 percent of the average Federation salary during period of disability, retraining (covered by employer); Compensation for reduced salary in post-disability employment (covered by employer); retraining and re-employment.	Re-employment until conditions for old age pension satisfied Equal to at least 70 percent of previous wage wage (covered by employer) during disability and retraining periods; Compensation for lower salary in post-disability employment (employer paid)
Care and assistance	Allowance eliminated.	35 percent of lowest wage available to (employed or unemployed) receiving disability benefits.
Survivor pension		
Beneficiaries	Spouses, children of deceased beneficiaries	Spouses, children, parents of deceased beneficiaries
Entitlement	70 percent (one beneficiary) -100 percent (four or more beneficiaries) of the pension base under which original benefits were realized.	70 percent (one beneficiary) -100 percent (four or more beneficiaries) of the pension base under which original benefits were realized.

Sources: Federation Law on Pension and Disabilty Insurance, July 1998; RS Law on Pension and Disability Insurance and Amendments, 1993-96.

branches of the health insurance fund, which in turn were responsible for financing all levels of health care. Substantial differences in the level of care and the need for a single accounting system resulted in a greater centralization of the health insurance fund in 1998, with most resources flowing directly to the central fund for reallocation to the respective branches. Basic benefits include health care, and salary compensation for temporary disability, at a rate equivalent to at least 70 percent of net salary, and not more than 90 percent of net salary.[7]

136. Republika Srpska adopted new legislation in mid-1999 that provides the basis for health care. The Law on Health Protection establishes basic standards for the health care sector. The Law on Health Insurance is intended to establish the basics for universal insurance for basic health care, as well as the schedule of fees and charges for beneficiary co-payments. The Health Insurance Fund is permitted to provide extended health insurance and outlines arrangements for individuals with private insurance. Under the new laws, basic (obligatory) health care is to be financed by the Health Insurance Fund from automatic contributions from wages, allocations from the budget of Republika Srpska, and co-payments. Health care costs incurred by refugees, military invalids and surviving families, and demobilized soldiers are to be financed from the budget of Republika Srpska.

137. The health funds in both Entities face significant financing problems, and have incurred arrears to various health institutions.[8] First, as in the case of pension funds, the contribution base is limited by high unemployment, a substantial gray economy, and a tendency to underreport the actual wage rate paid to workers. At the same time, war and the demographic shifts have increased the number of invalids, elderly, and indigent. Second, required contributions from local governments (cantons or municipalities) and transfers from the Entity budget were not always made on time or in full, placing additional strains on the health insurance funds.

Unemployment Insurance

138. Unemployment insurance funds in the Federation and the RS provide some basic unemployment benefits, financed from salary-based contributions. Contribution rates are the smallest of all the contribution-based funds, and are patterned after their counterparts in the former Socialist Republic of Yugoslavia. Benefits include financial support for relatively limited periods of time (typically less than six months), and health and pension insurance

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[7] Wage compensation for temporary disability is to be provided by the employer for disabilities of up to 120 days; longer periods of temporary disability are to be financed from the Health Insurance Fund.

[8] For example, the Health Insurance Fund in the RS reported arrears of KM 5 million at end-1998.

Box 15. Federation of Bosnia and Herzegovina: Unemployment Benefits, 1998

Canton	Registered		Beneficiaries	
	Employment 1/	Unemployment 2/	Health welfare	Unemployment compensation
	(As percent of working age population)		(As percent of registered unemployment)	
Una-Sanski	99.0	94.0	0.0	1.9
Posavina	89.3	79.4	0.0	5.0
Tuzla	141.7	124.7	0.0	1.7
Zenica-Doboj	160.3	126.4	0.0	1.4
Bosanska-Podrinska	108.5	74.3	0.0	1.2
Central Bosnia	130.7	101.2	0.0	1.2
Mostar	179.6	72.6	0.0	1.5
West Herzegovina	110.1	71.4	0.0	0.7
Sarajevo	147.6	88.2	0.0	1.6
Herceg-Bosnia	109.2	58.2	0.0	0.9

Sources: Statistical Bulletins issued by the Institute for Employment (Sarajevo), the Federation Statistics Agency; and staff estimates.

1/ Employment covers only registered employment: no adjustment is made to capture gray market activity.
2/ Data on the number of unemployed reflect only those individuals registered with the Employment Institute.

contributions (Federation), determined by the individual's previous employment history[9] (Boxes 15–16).

Box 16. Republika Srpska: Unemployment Benefits, 1997–99 1/

	1997	1998	1999
Registered unemployment 1/	142,524	142,152	146,247
Beneficiaries of unemployment benefits 2/	3,274	7,422	4,100
(percent of unemployed)	2.3	5.2	2.8
Average benefit (KM per month) 3/	45.8	20.2	36.6

Sources: Data provided by the Republika Srpska Employment Institute and the Republika Srpska Statistics Agency.

1/ Data for 1999 cover only January-June 1999.
2/ Includes only those individuals registered with the Employment Institute and does not reflect total unemployment.
3/ No disaggregation regarding the type of benefit provided was included.
4/ Value of nonadministrative expenditures divided by total number of recipients.

139. The number of registered unemployed is quite small, compared with actual levels of unemployment in both Entities. This reflects, in part, the fact that registered unemployment is largely confined to individuals registered with the employment institute for the purpose of receiving benefits or for assistance in seeking employment. The benefits are available for only limited periods, and once the period of monetary benefits has been exhausted, the motivation for registering with the employment institutes declines sharply. Registered unemployment and employment combined account for 20-35 percent of the working age

[9]For the Federation, unemployment benefits for periods greater than six months are available only to those who have been continuously employed for five years or more.

population in most cantons: only for Sarajevo do the two combined amount to 50 percent of the working age population.

140. The number of benefit recipients of the unemployment insurance funds amount to a scant 2–5 percent of registered unemployment. The limited benefit entitlements have, however, contributed to the absence of arrears for these funds.

C. Benefits for Military Invalids and Families of Soldiers Killed in the War

141. The Federation and Republika Srpska governments are responsible for financing social benefits for military invalids and surviving families of those killed in the war. The number of beneficiaries is considerable for both Entities. There are an estimated 46,000 disabled war veterans in the Federation, and an additional 38,000 in Republika Srpska. Benefits for the families of soldiers killed in the war account for an additional 90,000 beneficiaries in the Federation and 50,000 in Republika Srpska (Box 17).

142. During 1997-98, outlays for military invalids in the Federation have accounted for 10–12 percent of consolidated Federation revenues (including cantons and municipalities). Most of the burden is met from the Federation budget, with some supplemental support from local governments. Taken as a share of the Federation budget, outlays for military invalids increased from 28 percent of own revenues in 1997 to a projected 32 percent for 1999, exerting a disproportionately large impact on Federation fiscal priorities.[10]

143. During 1998, average benefits for military invalids and surviving families in the Federation amounted to KM 167 per month, about 83 percent of average pensions paid during 1998.[11] Had existing entitlements been met, the bill to the Federation budget would have been on the order of KM 800 million, in contrast to the total budget allocation of KM209 million. The Draft Law on the Rights of Soldiers and Their Families placed before the Federation parliament in July 1998 was intended to constrain entitlements to amounts that can be afforded within the budget. The draft law has been under discussion for a considerable period and, despite some significant revisions to entitlements and obligations that were made, the new legislation would imply costs that would continue to exceed available resources (Box 18).

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[10]The continued existence of parallel institutions in the Federation is reflected in benefits for military invalids as well. Amounts included in the budget are divided on a 70–30 basis between the Bosniac- and Croat-majority areas. Extrabudgetary support to the Federation from Croatia—estimated at KM 164 million for 1999—is allocated by the Ministry of Defense between army units previously associated with the Republic of Herceg-Bosna (HVO), and the associated military invalids and surviving families.

[11]Only 10 monthly pension payments were made in 1998.

Box 17. Federation and Republika Srpska: Pension and Benefits Payments, 1998

	Federation	Republika Srpska
Aid to military invalids and surviving families		
Number of beneficiaries		
Military invalids	46,000	37,592
Families	90,000	49,236
Civilian war victims		3,385
Total benefits 1998	257	40
Average benefit -military invalid and families (KM per month)	157	36
Pension and invalid Insurance		
Number of beneficiarles	195,552	159,491
Average pension (KM per month)	130	57
Average net wage (KM per month)	329	139
Population	2,444,665	1,475,288
	(Percent of respective population)	
Pensioners	8	11
Military invalids	6	6
Employed	15	17

Sources: Statistical Bulletins published by the Federation and Republika Srpska Statistical Institutes and the Employment Service of BiH-Sarajevo; data provided by the Public Fund for Pension and Invalid Insurance-Sarajevo Agency for Pension Insurance-Republika Srpska; Professor Mikerevice, Centralized Data Collection and Efficiency of Pension and Health Insurance in Republika Srpska, 1999.

Box 18. Federation of Bosnia and Herzegovina: Benefits for Military Invalids, Surviving Families and Demobilized Soldiers Under the Draft Law on the Rights of Soldiers and their Families

Financial responsibility	Beneficiary	Entitlement
Federation government		
* Disability benefits	Military invalids	20-160 percent of average Federation wage
	Surviving family members	One beneficiary-45 percent of average Federation wage increased by: 30 percent per co-beneficiary; 80 percent per child; 100 percent per disabled child
* Disability pension	Military invalids	Average wage for military personnel of comparable rank
	Surviving families	Four or more people: 100 percent; Three people: 90 percent; One-two people: 70 percent
* Severe disability supplement 1/		100-160 percent of average Federation wage
* Orthopedic supplement		11-44 percent of average Federation wage
* Dealth allowance		Single payment of 3 times the average Federation wage
* Customs, tax exemption	Military invalids Surviving families	Customs and tax exemptions on imports of cars and equipment; or equivalent compensation.
Cantonal governments		
* Rehabilitation support	Military invalids	50 percent of average Federation salary
* Housing	Severely disabled; orphans	Within 1 year
	Other disabled and surviving families	Within 2-5 years
	Demobilized soldiers	Within 7 years
* Education	Military invalids Surviving families	Priority for scholarships; free textboods
Employment Fund		
Unemployment benefits	Demobilized soldiers	30 percent of average Federation wage until offer of a suitable job received.
Health insurance fund	Military invalids Surviving families Demobilized soldiers	Full health care benefits free of charge
Enterprises	Military invalids	Must hire one military invalid per 10 employees

Source: Federation Draft Law on Rights of Soldiers and their Families, 1998

1/ Available for severly disabled military invalids requiring care and assistance.

144. The draft Law on the Rights of Soldiers and their Families in the Federation, which is before parliament, maintains disability and pension entitlements that are considerably more generous than those available from the Pension and Invalid Insurance Funds, and entitlements are independent of any means testing. Disability payments are indexed to the average Federation wage—without reference to past earnings—while disability pensions are linked to the average wage for military personnel of comparable rank.[12] Benefits for families and children of soldiers killed in the war are also higher than provisions under the Law on Pension and Invalid Insurance. For those eligible for benefits under the Law on Pension and Invalid Insurance, the Federation government liability is at least equal to the supplementary payments to bring total benefits into line with the higher entitlement levels for military invalids. Additional benefits—including allocations to cover the cost of caregivers for the severely disabled, which were eliminated from the Law on Pension and Invalid Insurance—are retained for military invalids.

145. For Republika Srpska, outlays for military invalids accounted for about 11 percent of total revenue in 1998. This notwithstanding, average benefits have remained small, averaging KM 36 per month during 1998, well below average pensions of KM 56 per month. The lower level of benefits reflects two features of entitlements contained in the Law on the Rights of Soldiers, Military Invalids, and Families of Soldiers (1996). First, existing entitlements—as with benefits under social insurance for pensioners and invalids—have been linked to the lowest labor price, not to average wages or prevailing military wages. Second, the law contains provisions that allow the RS government to determine which entitlements are to be given priority in the event that resources fall short of entitlements.

146. As with the Federation, overall entitlements are considerably more generous than other social safety net provisions. The law provides for allowances to boost soldiers' income (after demobilization), effectively providing a guaranteed wage rate; permanent monthly allowances for unemployed soldiers, as well as pension entitlements and supplements, and allowances for care and aid; and benefits for the families of military invalids and soldiers killed in the war (Box 19). The lower average level of benefits paid reflect not only the link to a lower minimum wage, but also the fact that soldiers' allowances and provisions for permanent support were suspended owing to the lack of resources.

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[12]Depending on the degree of impairment, disability benefits range from 20–160 percent of the average wage from the previous December. The gap between disability pensions granted under the Law on the Rights of Soldiers and their Families and entitlements provided under the Law on Pension and Invalid Insurance is likely to be considerably wider. Gross military wages are estimated to be at least double average wages in the Federation. Moreover, contributions for health and pension insurance account for only 11 percent of net salary, compared with 24 percent of gross wages for other individuals. Moreover, disability pensions under the Law on Pension and Invalid Insurance are linked to average pension levels from the previous year.

Box 19. Republika Srpska: Benefits for Military Invalids, Surviving Families and De-Mobilized Soldiers Under the Draft Law on the Rights of Soldiers, Military Invalids, and Families of Killed Soldiers

Benefit	Beneficiary	Entitlement
A. Benefit base		274 percent of the minimum wage ; proposal to rebase to 274 percent of average net wage.
B. Soldiers' rights	Soldiers serving at least 36 months after May 1992	Benefit base: 274 percent of average net wage.
* Soldier's allowance 1/		100-130 percent of the gap between earnings or income from other benefits benefits and the benefit base.
* Pension supplement	All soldiers serving August 1990	* Equal to gap between pension benefits and average salary during last 12 months in army Topping off to tensure pension benefits equal 350 percent of average net wage. * Limited tp 300 percent og avg. net wage for beneficiaries with less than 15 years of servicer,
* *Permanent monthly income 1/*	*Unemployed soldiers without pension/invalid insurance benefits; medal holders*	Permanent income equal to at least 70 percent of minimum wage Permanent income of 350 percent of average net wage.
* Income tax benefits	Soldiers	At least 30-100 percent for one year
* Agricultural tax	Soldiers	20-50 percent without time limit.
* Customs exemption	Soldiers	30-50 percent
* Ordinary pension benefits	Soldiers	All years of service, each year of contributions counts double.
* Health care	Soldiers and their families	Benefits equal to those paying contributions for health insurance
* Travel	Soldiers	Reduced cost tickets
* Employment priority	Soldiers	All government authorities; public organizations, institutions and enterprises
* Housing priority	Soldiers; surviving family members	Unspecified.
C. Military invalids and surviving families		
Monthly pension	* Military personnel, civilan defense workers with war-related physical damage/disability of at least 20 percent.	6% -100% of the base (274 percent of average net wage)
Monthly pension	* Children, spouse, parents or grandparents supported by deceased soldier, or soldier receiving military invalid benefits: Widow (>45), widower (>50) Children <15 ; <27 for students	55 percent of minimum wage after the death of military invalid 100 percent of minimum wage for survivors of soldier killed in the war Increased by 50 percent for each additional beneficiary.
Care, assistance allowance	Severely disabled military invalids	126-235 percent of the average wage
Orthopedic allowance	Severely disabled military invalids	20-80 percent of average wage
Transportation subsidies	Military invalids; surviving families	Monthly subsidy for public transportation
Duty-free auto imports	Severely disabled/surviving family members	100 percent concession/ 50 percent concession
Income tax benefits	Families of soldiers killed in the war; military invalids	40 - 100 percent reduction
Customs exemption	Families of soldiers killed in the war; military invalids	50-100 percent exemption on equipment imports to establish workshop, enterprise, agricultural activity
Rehabilitation	Families of soldiers killed in the war; military invalids	Terms from pension and invalid insurance
Death benefits	Families of soldiers killed in the war; military invalids	300 percent of the benefit base (equal to 820 percent of average net wage).

Source: RS Draft Law on the Rights of Soldiers, Military Invalids and Families of Killed Soldiers.

1/ Benefits included in existing legislation, but not designated as a priority for payment.

147. Despite the compression of actual benefits, new legislation adopted in October 1999 would substantially increase entitlements from existing levels. First, the base for most benefits would shift from the minimum wage to the average wage—which would at least triple most benefit entitlements. This change was prompted by the more rapid increase in average wages, and political issues associated with the linkage of military benefits to the lowest labor price. The new law—like the previous version—contains provisions allowing the RS Minister of Finance to determine which entitlements will be met under circumstances when resources are inadequate to meet entitlements. Unfortunately, the new legislation is likely to contribute to a far wider gap between entitlements and benefits actually provided—the reverse of what is needed for credibility and transparency.

148. Neither Entity has been able to provide the full range of legally mandated benefits, and new legislation in both cases provides for entitlements that would exacerbate existing strains on the Entity budgets. It will be important that benefits become appropriately targeted, with a greater emphasis on temporary, rather than permanent, support. The combination of complete indexation—and links to the average prevailing military wage in the case of the Federation—should also be reconsidered, as the gap in benefit levels compared with those available to other groups will become an increasing source of pressure on all levels of government.

D. Social Assistance Programs

149. In the Federation, all responsibilities for assisting the most vulnerable—other than for military invalids and surviving families—devolve to the cantons, with some guidance from Federation regulations. In July 1999, the Federation adopted the Law on the Basics of Social Care, Protection of Civilian War Victims, and Protection of Families with Children. In general, the law covers basic social safety net responsibilities, which remain assigned to cantons and lower levels of government. The law adds one new element, however, which is a direct link between benefits for civilian war victims and entitlements provided to military victims and their families—with financial responsibility assigned to the cantons and municipalities. With regard to social safety net provisions, the level of entitlements is left to the determination of cantons and municipalities. There are, however, no provisions for resource sharing to offset differences in cantonal revenue bases or to ensure broadly equitable benefits across cantons (Box 20).

150. The Federation's social care provisions are broadly targeted toward (i) children without adequate parental care; (ii) elderly without access to family support; (iii) people with special disabilities (vision, hearing, mental); (iv) those incapable of work or without alternative resources; and (v) persons in special circumstances, including forced migration. Under the law, these individuals are entitled to cash and material assistance; housing in a social institution or with another family; and social services and/or home care. The level of material or cash support consistent with subsistence living is left to the determination of the

Box 20. Bosnia and Herzegovina: Indicators of Per Capita Fiscal Capacity Among Federation Cantons, 1998

	Una-Sanska	Posavska	Tuzla	Zenica-Doboj	Bosanska-Podrinjska	Central Bosnia	Herzeg-Nevretna	West Hercegovina	Sarajevo	Herceg-Bosna
Population (end-1998)	290,420	40,738	528,146	385,993	34,566	223,373	218,404	81,087	368,369	80,693
Revenue per capita (KM/year)	310	395	316	293	298	308	371	531	992	172
Expenditure per capita C66 1/										
Education	117	152	131	132	84	133	162	201	246	120
Social assistance	37	0	66	41	0	12	15	0	87	4
General government	25	122	25	29	144	10	65	114	54	36
Security	79	175	74	68	128	108	142	108	119	109
Pension beneficiaries (percent population) 2/ 3/	6	...	10	12	11	6	5	...	18	...
Employed per pensioner	1.9	...	1.3	1.5	1.0	...	...	...	1.1	...
Old-age pensioners (percent of population)	2	...	4	5	4	2	2	...	7	...
Percent of population over the age of 65	11	11	10	11	11	10	13	11	14	13
Percent population employed	11	10	14	17	12	14	24	12	21	14
Percent registered as unemployed	10	10	12	14	8	11	10	8	13	7

Source: Federation Ministry of Finance, Federation Statistical Agency, and Federation Employment Fund.

1/ Because health insurance contributions and benefits are outside the budget of most cantons, indicative expenditure data for each canton are not readily available.
2/ Data apply only to beneficiaries covered by the Sarajevo-based Agency for Pension and Invalid Insurance (PIO), and therefore covers only a subset of Central Bosnia and Herceg-Nevretna. The remainder of the Federation is covered by the Mostar-based Agency for Pension and Invalid Insurance (MIO).
3/ The number of pensioners includes old age pensioners, beneficiaries from disability insurance and pensions, and beneficiaries of family pensions.

individual cantons; cantons are also free to determine which resources are taken into account in establishing eligibility for assistance or compensation.[13] In general, costs for accommodation in a social institution or with another family are to be borne by the individual or their family according to rates determined by the social institution or the canton: for those granted permanent social support, the cost is borne by the canton or municipality.

151. The law also elaborates the benefits to be provided by cantons and municipal governments to those designated as civilian war invalids. In broad terms, this extends the benefits available to military war invalids and surviving families to civilians (and their families) with moderate to severe disabilities incurred as a result of the war.[14] Cantons are required to provide benefits equal to 70 percent of entitlements of military invalids for (i) personal disability coverage; (ii) care and assistance; and (iii) orthopedic supplements. Family benefits are set as a percentage of benefits granted to the completely disabled.[15] Unlike provisions for social care and for families with children, no means testing is applied for benefits to civilian war victims.

152. In addition, the law outlines social support for the protection of families with children, when family income falls below the cantons' definitions of subsistence. Specific benefit entitlements include children's allowance, salary compensation while on maternity leave; pre- and post-natal care; meals for children in preschool and elementary school; tuition and scholarships for children. The conditions, methods, procedures, and financial support for these benefits are left to the determination of the cantons, as are any additional welfare benefits and the definitions of subsistence living.

153. As can be seen from Box 20, cantonal outlays for social assistance vary widely, as does the per capita revenue capacity. For the poorer cantons, the new mandatory levels of assistance for civilian war victims are linked to average wage rates in the Federation—affording little flexibility to areas with lower wages and standards of living. For other benefits, the determination of standards is left to the cantons, leaving no mechanism for ensuring that benefits are broadly equitable.

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[13]The law does prescribe, however, that the following sources of income are *not* to be taken into account: disability pay, monetary compensation received in return for care of another person; stipends for children; and scholarships.

[14]The law covers civilian war victims with a disability of 60 percent or more; the law extends coverage, however, to those who qualified for support prior to the enactment of this law.

[15]These percentages are as follows: 25 percent for one family member, increased by 50 percent for each additional family member; and 80 percent for children of civilian war victims without parents.

154. In the RS, the Law on Social Protection provides for social assistance to those who are unable to work and lack alternative means of support from family members; and those who, because of special circumstances, fall below minimum subsistence.[16] Social protection provisions are similar to those applied by the Federation: (i) children without adequate parental care; (ii) adults unable to work and the elderly, without family support; (iii) invalids and the mentally disabled; and (iv) persons requiring assistance owing to special circumstances. As in the Federation, these individuals are entitled to material provisions, allowances for care and aid, accommodation in a social protection institution or with another family, and social work services. Here, however, the law defines subsistence living for all municipalities, based on prevailing average wages; subsistence benefits may be provided either in the form of financial support or as material support. Benefits for those capable of working are reduced by 20 percent, and limited to a maximum duration of six months. Allowances for aid and care are limited to 25 percent of subsistence allowances. Families of beneficiaries accommodated in social institutions or with other families are obliged to contribute to their support, with the extent of support determined by the center for social work.

155. Financial and material resources for material assistance, allowances for aid and care, accommodation, and social work services are the responsibility of lower levels of government; the RS budget is responsible for building, maintaining, and furnishing social protection institutions (including children's homes, homes for the elderly), and resources to train the physically and mentally handicapped for employment.

E. Conclusions and Recommendations

156. The reform of social benefits will need to proceed on two tracks—one aimed at implementing urgently needed short-term reforms, and a second aimed at formulating and progressively implementing longer-term reforms consistent with a credible sustainable fiscal system and an equitable structure of benefits. Virtually all social benefit programs operating in BiH exhibit a marked gap between commitments and available resources. The structure of benefit entitlements, and the abnormally narrow resource base of a post-conflict economy, both account for this gap. In the absence of explicit adjustment rules, these programs rely on a range of ad hoc rationing mechanisms (delayed payments, in particular) to close the gap. In

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[16]In Republika Srpska, maternity benefits and children's allowances are covered by a separate social insurance fund supported by wage and salary contributions. The program covers salary compensation during maternity leave, maternity allowances for unemployed mothers, and a child allowance. The average number of beneficiaries in Republika Srpska declined from 104,000 in 1997 to about 88,715 during 1998 following amendments to the Law on Child Welfare aimed at improving the quality of benefits for those most in need. During the first six months of 1999, there were an estimated 70,000 beneficiaries. Average benefits per year are estimated to be KM 80–100 in each of the three years. By June 1999, the Fund was current in all benefit entitlements through April 1999.

the near term, measures that provide a transparent and equitable means of bridging these gaps are needed. For the medium term, a realistic, sustainable system of social benefits will need to be based on clearly articulated priorities consistent with a changing resource base.

157. Social insurance programs are likely to continue to be the main providers of health care and old-age and disability benefits, and it will be essential to ensure that benefit entitlements are consistent with the long run sustainability of these programs. Entitlement changes needed for medium-term viability, however, are unlikely to resolve all of the short-term problems arising from an unusually narrow contribution base. In the short-run, it will be important to implement transparent mechanisms capable of delivering an equitable allocation of benefits. With regard to pension and invalid insurance, simple solutions applicable for the short term could include (i) adoption of a simple rule that reduce higher entitlement levels as needed to guarantee timely payments on a monthly basis to all beneficiaries; and (ii) the cancellation of extraordinary benefits mandated by separate government legislation—unless they can be met from budgetary resources. These steps would enhance the credibility of the programs—which is essential to improve compliance. Over the longer term, contribution levels and benefit entitlements will need to be jointly determined to ensure sustainability under most economic conditions.

158. It will be important to establish clear priorities: disparate activities such as pension payments and health service provisions—which rely on wage-based contributions—are linked both by their direct effect on citizen's welfare and by their claim on the same limited pool of resources. In addition, disparities in regional resource bases will need to be taken into account. The marked disparities in cantonal revenue bases underscore the importance of establishing the broadest possible base for financing social insurance programs. The unification of the two Federation pension and invalid insurance funds within the Federation is overdue, and necessary for an efficient use of resources. For the same reasons, a purely cantonal organization for all health care protection and insurance is unlikely to support a sustainable, efficient health care system in either the short or medium term.

159. The need to close the gap between commitments and actual benefits paid to military invalids and surviving family members—which are financed directly from Entity budgets—is important for the credibility of both governments. Neither Entity has been able to cover entitlements, and the higher benefit standards contained in legislation recently adopted by the RS and under consideration by the Federation parliament will only further undermine government credibility and exacerbate the already marked imbalance, compared with benefits offered to other socially vulnerable groups.

160. In the short-term, these benefits commitments to military invalids and surviving family members need to be contained to levels consistent with timely, predictable payments to beneficiaries and the allocation of resources to other social needs. Short term measures would include: (i) aligning the level of disability benefits for military invalids and surviving family members with those provided for civilian work-related injuries or disabilities; (ii) replacing the link between disability pensions for military invalids and surviving family members to the prevailing military wage, and with a link to average pension benefits, even if

adjusted by a scale factor. Links to prevailing military wages—which are well above average wages—create a fiscal burden that cannot be afforded, and add an unneeded source of uncertainty to budget planning.

161. Over the medium term, it will be important to establish two types of benefit entitlements for de-mobilized soldiers, military invalids, and surviving family members. Beneficiaries capable of working would be best served by retraining and rehabilitation programs: these same programs would also serve the needs of those experiencing long-term unemployment. Permanent support should be targeted more narrowly to those incapable of returning to work.

162. Social safety net provisions for the most vulnerable—those outside the social insurance net or eligible for only insufficient benefits—have received scant attention. For the near term, it will be essential for Entity and local governments to agree on basic common standards and define some mechanism to offset severe regional variations inconsistent with the implementation of common basic standards for social benefits and public services. For both Entities, it will be important to consider a reallocation of benefits—including from military invalids and surviving families—to provide subsistence services to the most vulnerable. A further issue to be faced by both Entities is the absence of social safety net provisions for the long-term unemployed. The existing employment insurance schemes—which mainly provide short-term assistance to the newly unemployed—could be usefully redirected toward this group, and toward the development of viable training and rehabilitation programs.

Table 14. Medium-Term Sustainability of the Federation Pension Funds, 1999-2033

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2013	2018	2023	2028	2033
Pension Fund															
Total annual contributions (in millions of KM) 1/	420.9	521.2	646.1	765.4	903.1	1,075.3	1,163.1	1,360.5	1,587.5	1,666.0	2,671.0	3,456.2	4,722.3	6,615.0	9,213.5
Total expenditure (in millions of KM)	646.0	712.8	760.5	840.7	933.9	1,021.7	1,131.9	1,249.3	1,379.0	1,513.4	2,345.2	3,449.5	5,030.5	7,475.2	11,073.4
Total benefit entitlements	603.7	666.2	710.8	785.7	872.8	954.9	1,057.9	1,167.6	1,288.8	1,414.4	2,191.8	3,223.8	4,701.4	6,986.2	10,349.0
Administrative costs	42.3	46.6	49.8	55.0	61.1	66.8	74.1	81.7	90.2	99.0	153.4	225.7	329.1	489.0	724.4
Balance	-225.0	-191.6	-114.4	-75.3	-30.7	53.6	31.1	111.2	208.5	152.6	325.8	6.8	-308.2	-860.2	-1,859.9
In percent of GDP	-3.9	-3.1	-1.7	-1.1	-0.4	0.7	0.4	1.3	2.3	1.6	2.8	0.1	-2.0	-4.8	-9.0
Demographics															
Population (in thousands)	2,300.0	2,387.4	2,437.1	2,465.5	2,493.5	2,521.4	2,548.9	2,576.0	2,602.8	2,629.2	2,757.1	2,891.8	3,037.1	3,167.0	3,282.3
Annual population growth rate	1.22	3.80	2.08	1.16	1.14	1.12	1.09	1.07	1.04	1.01	0.94	1.07	0.93	0.78	0.70
Demographic structure (in percent) 2/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Age 0-17	25.0	24.3	24.0	23.8	23.5	23.3	23.1	22.8	22.6	22.4	21.3	20.2	19.2	18.3	17.4
Age 18-60	53.0	54.3	56.6	57.0	57.3	58.1	58.4	58.6	58.8	59.0	59.8	60.5	61.2	61.9	62.5
Age 61+	22.0	21.5	19.4	19.2	19.2	18.6	18.5	18.5	18.6	18.6	18.9	19.2	19.5	19.8	20.1
Old-age dependency ratio (in percent)	41.5	39.6	34.3	33.7	33.5	32.0	31.7	31.6	31.6	31.6	31.7	31.7	31.8	32.0	32.2
Pension System Parameters															
Contributors (in thousands)	332.8	384.2	436.8	474.7	513.8	560.9	606.8	656.7	708.8	769.3	1,023.3	1,154.5	1,226.6	1,326.5	1,417.7
Contribution participation rate current system (in percent)	65.0	67.0	69.0	71.0	73.2	75.4	77.6	79.9	82.3	84.8	90.0	90.0	90.0	90.0	90.0
Contribution participation rate 20 years ago (in percent)	32.0	33.7	35.4	37.1	38.8	40.5	42.1	43.8	45.5	47.2	55.7	64.1	72.6	81.0	89.5
Survival rate workers over past 20 years (in percent)	85.0	85.2	85.4	85.6	85.8	86.0	86.2	86.4	86.6	86.8	87.8	88.7	89.2	89.7	90.2
Total number of pensioners (in thousands)	271.7	280.6	277.9	283.5	290.5	293.8	300.2	308.3	316.5	326.0	375.3	424.3	477.5	543.8	615.0
Contributors to pensioners ratio	1.2	1.4	1.6	1.7	1.8	1.9	2.0	2.1	2.2	2.4	2.7	2.7	2.6	2.4	2.3
Contribution compliance rate (in percent)	80.0	80.8	81.6	82.4	83.2	84.1	84.9	85.8	86.6	86.9	88.2	88.8	89.3	89.7	90.2
Pension contribution rate (in percent)	0.24	0.24	0.24	0.24	0.24	0.24	0.22	0.22	0.22	0.20	0.18	0.16	0.16	0.16	0.16
Macroeconomic System															
Inflation	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Real GDP growth	8.0	7.0	7.0	6.0	6.0	6.0	6.0	5.0	5.0	4.0	3.0	3.0	3.0	3.0	3.0
Productivity growth	...	3.1	4.8	4.8	4.8	4.8	4.9	3.9	3.9	3.0	2.0	1.9	2.1	2.2	2.3
Real (gross) wage growth	...	6.2	8.0	7.9	8.0	8.0	8.0	7.0	7.0	6.0	5.1	5.0	5.1	5.3	5.4
Nominal gross monthly average wage (in KM)	549.0	582.9	629.3	679.2	733.2	791.7	855.0	914.9	979.3	1,038.5	1,370.1	1,755.5	2,246.4	2,895.1	3,754.2
Nominal net monthly average wage (KM)	368.0	390.7	421.8	455.3	491.5	530.7	573.1	613.3	656.5	696.1	918.4	1,176.7	1,505.8	1,940.6	2,516.5
Labor force (in thousands)	853.3	925.7	989.8	1,012.7	1,032.8	1,063.4	1,085.8	1,110.1	1,132.6	1,162.9	1,292.4	1,379.7	1,465.8	1,585.3	1,694.3
Labor participation rate	70.0	71.5	71.8	72.0	72.3	72.6	72.9	73.5	74.0	75.0	78.4	78.8	78.8	80.9	82.6
Employment rate	60.0	62.0	64.0	66.0	68.0	70.0	72.0	74.0	76.0	78.0	88.0	93.0	93.0	93.0	93.0
Unemployment rate	40.0	38.0	36.0	34.0	32.0	30.0	28.0	26.0	24.0	22.0	12.0	7.0	7.0	7.0	7.0

Sources: World Bank and Fund staff estimates.

1/ Working age: 18-61 (in 1999), 18-62 (in 2000), 18-63 (in 2001), 18-64 (in 2002/03), and 18-65 (in 2004).
2/ Up to 2004, this amounts to 24 percent of the gross wage. After that, it is reduced in steps to 16 percent in 2016.

IX. Trade Reform[1]

A. Background

163. Trade reform in Bosnia and Herzegovina has been implemented against the background of separate trade regimes for the two Entities, both of which were inherited from the socialist era. Trade laws in existence prior to 1996, the year after hostilities ended in Bosnia were, in the RS, based on those in the FRY, and in the Federation on those in Croatia. However, in view of the similar history of Croatia and FRY as subunits of the former SFRY, the laws and regulations governing external trade were broadly similar. Import tariffs in the Federation ranged from a low of 0 percent to a top rate of 25 percent, and a simple average tariff rate of 12.1 percent. In the RS, import tariffs were higher, with a simple average tariff rate of some 29 percent. In addition, the RS had a free trade agreement with the FRY, and the Federation with Croatia. Both Entities charged an import verification fee of 1 percent, including on imports from the countries with which they had free trade agreements.

164. Imports in both Entities were divided into 3 categories: (a) goods that could be imported without restriction; (b) goods whose imports were limited by quotas; and (c) goods requiring import licenses. There was also a small negative list of goods whose imports were banned for health, social, environmental, or security concerns. Over 90 percent of goods at the 6-digit SITC classification could be freely imported.

165. The export regime was relatively liberal, free of taxes and subsidies, and an absence of monopoly rights for any export activity. However, exports of a small group of goods deemed to have historical and cultural significance were subject to quantitative restrictions.

B. Current Status

166. With the implementation of trade reform in Bosnia and Herzegovina, the regimes of the two Entities were unified, and responsibility for customs tariffs was transferred to the State. At present, the customs tariff code of Bosnia and Herzegovina has four import tariff bands, 0, 5, 10, and 15 percent, with a simple average tariff rate of 6.2 percent. Bosnia and Herzegovina charges specific import tariff surcharges on a wide range of commodities. The main commodity groups include live animals, meat and meat products, edible oils and fats, dairy products, agricultural products, processed food, and some spirits. All imports are also subject to a 1 percent import verification fee.

167. Bosnia and Herzegovina imposes some quantitative restrictions on exports, whose economic impact is nevertheless limited. Notably, both Entities have recently introduced a temporary ban on the exports of unprocessed timber to stem the reckless cutting down of forests by the logging industry. In the meanwhile, legislation to regulate logging has been

[1]Prepared by Bhaswar Mukhopadhyay.

introduced in the parliaments of both Entities. Upon the passage of such legislation, it is anticipated that the export ban will be replaced by a BIH-wide domestic stumpage tax.

168. The Foreign Trade Law in Bosnia and Herzegovina permits the State to impose temporary restrictions on the import, export, and transit of certain commodities for public health and security reasons. There are no quantitative restrictions on imports in Bosnia and Herzegovina, and import licensing procedures, which are only required in the RS, are very liberal. Potential importers are simply required to be listed in the Business Register, and import licenses are typically granted in one day. Regulations in the Federation are similar, with prospective importers having to be listed in the Business Register, no formal import licenses are required.[2] In the RS, the imports of certain commodities that are important sources of customs revenue require special permission.[3] Such licenses are also granted without undue delay. An inconvenient feature of the trade regulations in Bosnia and Herzegovina is that traders whose import consignments use multiple entry points located in both Entities of Bosnia and Herzegovina, have to be separately registered in the two Entities.

C. Trade Reform Agenda

169. Although the customs tariff code in Bosnia and Herzegovina is relatively liberal, the import tariff surcharges contribute to both restricting trade, and distorting resource allocation. Thus the main focus of trade reform in the period ahead will be to initially implement an equalized ad valorem import tariff surcharge across all commodities, and then to eliminate the surcharge according to a well specified timetable. During this period, the implementation of fiscal reform would also have to occur to lower the dependence on trade revenues. Trade reform will also be directed to eliminating all remaining barriers to exports, and to lowering further the dispersion of tariffs. A suggestive timetable for trade reform is provided below.

First stage of trade reform

- The authorities should replace the country wide export tax on unprocessed timber with a stumpage tax during 2000.
- In 2000, the authorities should eliminate all quantitative restrictions on exports, particularly since their economic impact is considered to be small.
- Import tariff surcharges should be equalized at a single ad valorem rate to eliminate any distortions in resource allocation.

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[2]Business registration is a complex 14-step procedure that takes months to complete.

[3]These commodities include coffee, spirits, tobacco, and oil and oil derivatives. In addition, special permission is required for the import of narcotics and poisons.

- During 2000, the authorities should establish a timetable to reduce and eventually eliminate the import tariff surcharge.

Second stage of trade reform

- Over the next three to five years, lower and eliminate the import tariff surcharge according to the agreed timetable.

Third stage of trade reform

- By 2005, lower the maximum import tariff rate to 10 percent to achieve a 3-band (including zero) tariff regime.

- By 2005, reduce significantly the dispersion of tariffs, by moving virtually all commodities to an intermediate rate of 5 percent. The high rate of 10 percent should be reserved for selected luxury items, and the zero rate for exports.

D. Other Trade Reform Initiatives

170. The authorities of Bosnia and Herzegovina initiated in early July procedures to become members of the WTO. They were granted observer status on July 15, 1999. They expect to complete preparation of the Memorandum of Trade Policy Regime by the end of the year. To help them in this endeavor, technical assistance is being provided by PHARE. The membership application of Bosnia and Herzegovina is being sponsored by the United Kingdom.

Summary of Major Taxes in the Federation and the Republika Srpska (as of January 1, 2000)

	Federation	Republika Srpska
1. Corporate Income Tax	Law on Corporate Income Tax (1997)	Law on Taxes on Enterprise Profit (RS Gazette No. 14/92, No. 19/93, No. 8/84, No. 24/98).
1. Taxpayer	Corporations and organizations selling goods/ services for profit.	Corporations and organizations selling goods/services for profit.
2. Territorial scope		
Resident	Worldwide	Worldwide
Nonresident	Profit earned in Federation	Profit earned in the Republika Srpska
3. Tax rate		
a. General rate	30 percent	Taxable base / Tax rate up to KM 100,000 — 20 percent KM 100,000 - KM 300,000 — 15 percent KM 300,001 - KM 500,000 — 12 percent above KM 500,000 — 10 percent
b. Dividends	15 percent on payments to nonresidents.	15 percent on payments to nonresidents.
4. Taxable base	The taxable profit (as determined in the profit and loss statement) of corporations, financial organizations, insurance and organizations and institutions that make profits by selling goods.	Taxable profit as defined in the profit and loss statement.
a. Expenditure deductions	In addition to material costs (based on average price method), wages, and depreciation, the following rules apply to expenditure deductions:	In addition to material costs (based on average price method), wages, and depreciation, the following rules apply to expenditure deductions:
- Profit sharing	- disallowed;	- disallowed;
- Per diem	- allowed, up to regulated amount;	- not addressed in law;
- Entertainment	- allowed, up to 0.5 percent of total revenue;	- not addressed in law;

	Federation	Republika Srpska
- Asset revaluation	- as prescribed by Federation government;	- not addressed in law;
- Social and cultural expenses	- allowed, up to 0.5 percent of total revenue;	- allowed, up to 0.5 percent of total income (humanitarian organizations only);
- Scientific expenses	- allowed, up to 0.1 percent of total revenue;	- allowed, up to 0.5 percent of total income;
- Membership fees	- allowed;	- allowed, up to 0.1 percent of total income; political organizations excluded;
- Interest	- allowed (but may be reduced by adjustment for transfer pricing);	- allowed (but may be reduced by adjustment for transfer pricing);
- Fines and penalties	- not allowed;	- not allowed;
- Reserves/provisions	- loss provisions of up to 15 percent of profits of banks, financial institutions, and insurance companies apply to cover possible credit or business risks;	- allowed, up to 20 percent of permanent capital. Loss provisions of up to 15 percent of profits of banks, financial institutions, and insurance companies apply to cover possible credit or business risks;
- Other	- employer contributions and fees not related to income	- employer contributions and fees not related to income property taxes
b. Tax treatment of losses	May be carried forward for up to 5 years.	May be carried forward for up to 5 years.
c. Tax treatment of capital gains	--	Capital gains realized through sales of stocks and bonds (held for less than 12 months) are for 100 percent included in taxable income. Bonds and stocks held for one year or more are included in taxable income for only 50 percent. Capital losses can be cleared against gains in current year.
5. Incentives		
a. Accelerated depreciation	By law, up to 25 percent for fixed assets used for environmental protection, scientific, education and training purposes.	By law, up to 20 percent for fixed assets used for environmental protection, scientific, education and training purposes.
b. Reductions		
- Foreign capital	- If share is at least 20 percent, a 5-year tax reduction proportional to foreign equity participation applies;	If share is at least 20 percent, a 5-year tax reduction proportional to foreign equity participation applies.
- New corporations	- Tax relief for years 1-3 of 100, 70, 30 percent;	- tax relief for first 3 years in which a profit is earned of 100, 70, 30 percent, respectively;

	Federation	Republika Srpska
		- underdeveloped areas, 100 percent for 3 years from date of establishment, proportional reduction for branches in underdeveloped municipalities for 2 years.
- Free zones	- 100 percent for 5 years.	- 100 percent for 5 years.
c. Deductions	- investment in own activities – 100 percent; - investment in other personal activities – up to 75 percent of taxable profit.	- investment in own fixed capital -- 100 percent; - investment in own productive activities or other stocks, is entitled to a tax reduction equal to the investment, but up to 30 percent of taxable profit.
d. Exemptions	- 100 percent for corporations with a share of invalids of more than 50 percent of employees.	- new employees – 10 percent for 2 years; - 100 percent for enterprises dealing with professional training, rehabilitation, and employment of disabled persons; - 100 percent for institutions classified as "non-economic" where income from sale of goods is less than 25 percent of profit.
6. Special provisions		
a. Mergers and takeovers	--	Pre-merger losses disallowed.
b. Liquidation	Surplus treated as dividends.	Surplus treated as dividend.
c. Foreign taxes	Credit up to maximum Federation tax.	Credit up to maximum RS tax.
d. Groups	Optional consolidation if control exceeds 90 percent	Optional consolidation if control exceeds 90 percent.

	Federation	Republika Srpska
2. Personal Income Tax Structures	Law on Wage Tax (Federation Gazzette No. 26/96 and No. 27/97), Federation Personal Income Tax (1995), and Catonal Citizen tax laws (Sarajevo Canton Official Gazette No. 19/97, No. 21/97, and No. 2/98).	Law on Citizen Income Tax (RS Gazette No. 23/98)
I. Employment Income	Law on Wage Tax	Law on Citizen Income Tax
1. Taxpayer	Residents: wage income earned in the Federation or elsewhere. Non-residents: wage income earned in the Federation.	Residents: income earned in the RS or elsewhere. Nonresidents: wage income earned in the RS.
2. Tax rate	15 percent: general rate 30 or 50 percent: additional income (i.e., holiday grants, compensation for travel, per diem, etcetera).	Taxable income — Rate up to KM 10,000 — 0 percent KM 10,001 – KM 15,000 — 25 percent KM 15,001 – KM 25,000 — 20 percent above KM 25,000 — 15 percent
3. Tax base	The wage tax base is the gross wage net of social security contributions. The wage tax applies to the following sources of personal income: wages and salaries, income earned during vacation, holidays, training, education, compensation while waiting for a job, sick leave benefits, per diem, travel allowance, and compensation for meals within working hours.	Gross wages (including overtime, vacation, and sick leave) but excluding social security contributions.
4. Exemptions	- benefits for military invalids and families of soldiers killed in the war; - benefits to civilian war victims; - invalids employed by a company or rehabilitation facility; - children's allowance; - compensation while unemployed; - social welfare and related material benefits; - non-wage compensation from health insurance; - death and illness benefits; - personal and property insurance benefits;	- benefits for military invalids and families of soldiers killed in the war; - invalids employed by a company or rehabilitation facility; - children's allowance; - compensation while unemployed; - social welfare and related material benefits; - non-wage compensation from health insurance; - death benefits; - personal and property insurance benefits; - fellowships and credits to students (up to 75 percent of monthly net earnings);

	Federation	Republika Srpska
	- interest on public loans; - fellowships and credits to students; - disability benefits; - severance benefits; - compensation for technological innovations; - unpaid salaries of soldiers during the war; - employment income of foreign diplomats and officials of international organizations and non-resident staff.	- disability benefits; - retirement and severance benefits; - reimbursement for travel to work; - monthly compensation for meals within working hours; - per diem for travel; - daily compensation for increased work expenses; - employment income of foreign diplomats and officials of international organizations and non-resident staff.
5. Deductions		
a. Personal	None	15 percent of average annual gross earning.
b. Dependents	1 dependent: 4 percent of average (net) monthly wage. 2 or more dependents: 6 percent of average (net) monthly wage.	5 percent of annual average gross income per dependent. 5 percent of average gross income for persons over 65 or for those supporting disabled.
c. Foreigners	30 percent for nonresident experts employed by resident corporations.	50 percent for foreigners employed by resident Entity.
d. Residents employed abroad	--	60 percent.
e. Other	--	Non-standard deductions (allowed up to 10 percent of taxable income): - investment in housing, education, fine arts, and environmental protection; - purchase of equipment, books and magazines related to science, culture, and art; - membership fees (cultural and scientific organizations); - expenditures for medical problems; - property and other taxes; - obligatory social insurance contributions; - premiums for life and voluntary social insurance; - cash donations to educational, cultural, sports, and humanitarian organizations.

	Federation	Republika Srpska
	Note that in the Federation the Cantons levy a cantonal personal income tax at rates up to 50 percent of the Federation rates.	
II. Other Income	Catonal Citizen Tax Laws and Federation Law on the Personal IncomeTax (1995)	Law on Citizen Tax (RS Gazette No. 23/98)
1. Taxpayer	Individual or entrepreneur.	Individual or entrepreneur .
2. Tax base	Income of an individual entrepreneur (non-legal entity), property value, revenues from copyrights, inheritance/insurance income, interest, and dividends.	Income of an individual entrepreneur, rental income, revenues from copyrights, inheritance/insurance income, interest, and dividends.
3. Tax rate	Rates indicated by (*) apply to the Sarajevo Canton (Official Gazette No. 19/97, No. 21/97, No. 2/98).	
a. entrepreneurs: wage income	Federation personal income tax: up to KM 2,400: 0 percent excess over KM 2,400: 15 percent excess over KM 10,000: 25 percent	Rates of the Citizen Tax apply.
b. entrepreneurs: profit income	Cantonal Citizen Tax Laws	Rates of the RS Citizen Tax apply. Some businesses can apply for lump-sum taxation.
c. Rental income	15 percent (*)	15 percent
d. Property value	fixed annual amounts on property values determined by the cantonal property tax law (*).	--
e. Copy right and patent income	5 percent to 20 percent (*)	general business: 10 percent show business: 30 percent
f. Inheritance and insurance income	10 percent (*)	15 percent

	Federation	Republika Srpska
g. Gambling income	15 percent (*)	15 percent
h. Agriculture and forestry income	Depends on municipality; generally not to be implemented until 2003.	Citizen's tax rates (20, 15, 12, and 10 percent).
i. Interest, dividends, bonds, and loans	15 percent (*).	10 percent
3. Social Security Contributions	Contributions Law (Federation Gazette No. 35/98 and No. 17/99). Decree on the Rates of Contributions for BiH Army for 1999 (January 1999).	Law on Contributions (RS Gazette No. 2/95, No. 15/96, No. 2/1998)
1. Taxpayer	Employers and employees.	Employers and employees.
2. Tax rates	Employer / Employee	Employer / Employee
a. pensions/disability	7 percent / 17 percent	11 percent / 11 percent
b. health	5 percent / 13 percent	9 percent / 9 percent
c. employment	1 percent / 2 percent	0.5 percent / 0.5 percent
d. child protection	-- / --	1.5 percent / 1.5 percent
Total	13 percent / 32 percent	22 percent / 22 percent
	Contribution rates for military personnel are 7.48 percent of gross wages for pension and disability insurance and 2.72 percent of gross wages for health insurance. Contribution rates for miners are 9 percent for pension insurance and 3 percent for health insurance.	Health contribution rates on income from agricultural activities, pensioners and student associations amount to 16 percent, 4 percent, and 1 percent, respectively. The following categories are also subject to a 16 percent health insurance contribution: - shop owners and independent activities; - employed persons on unpaid leave; - family members of an RS resident who is employed abroad; - foreign nationals employed in the RS; - persons earning income in cultural (painters, musicians, writers) and scientific activities; - persons working in the entertainment business;

	Federation	Republika Srpska
3. Tax base	Gross wages and other forms of personal income (e.g., vacation money, sick leave, self-employment income etcetera). The contribution base for self-employed cannot be lower than the official average monthly gross salary for that type of activity. For self-employed in a field of low productive activity the contribution base cannot be lower than 60 percent of the official average monthly salary.	Gross wages and other forms of remuneration. For certain categories the contribution base cannot be lower than 100 percent of the official monthly minimum gross wage.
4. Exemptions	None.	Social security contributions are not paid on: - income of disabled veterans; - salary of invalids employed in enterprises; - child allowances; - social support; - receipts from insurance payments; - assistance for reconstruction of damaged properties; - scholarships; - disability compensation; - income of prisoners; - severance pay; - earnings of the members of cooperatives.
4. Sales Taxes	Law on Sales Tax of Goods and Services (Federation Gazette No. 6/95 and No. 25/97).	Republika Srpska Law on Sales and Excise Taxes (RS Gazette No. 25/98 and No. 40/98).
I. Sales Tax on Goods		
1. Taxpayer	- Excisable commodities: manufacturer or importer of the good. The tax is collected according to the first point of sale after importation (i.e., the tax is paid to the tax office where the buyer is registered); - Non-excisable commodities: retailer selling the commodity for final consumption.	Firm or person selling commodities for final consumption.

	Federation	Republika Srpska
2. Rates	20 percent: general rate; 15 percent: computers, electricity and fuel; 10 percent: building materials; 5 percent: basic food, children's clothing and footwear, hygiene products, baby products, and used automobiles. Most excisable commodities are taxed at the 20 percent rate.	18 (+2) percent: general rate; 8 (+2) percent: food stuff, basic agricultural and fishing products, electricity, hygiene products, baby care products, secondary raw materials, construction materials, and paper products. A 2 percent surcharge is levied, which is earmarked for railways.
3. Tax base	Sales price of the commodity inclusive of customs duties, surcharges, and excises.	Sales price of the good inclusive of customs duties but exclusive of excises.
4. Exemptions	- exported goods (including spare parts fitted in foreign vehicles); - reproduction material used in production activities; - agricultural machines, equipment and other tools, spare parts; - basic foodstuffs (bread, milk, butter, baby food based on milk, edible oil, and fat); - customs duty-free imports including products sold in duty-free shops and foreseen under international agreements; - products sold to diplomatic offices and staff on the basis of Ministry of Foreign Affairs certificate; - products acquired by Red Cross and humanitarian organizations to undertake their normal activities (except excisable products); - goods purchased through the Federation, cantonal or municipal budgets for the reconstruction of war damaged objects; - arms and equipment for the Federation Army and police; - ice, water, and water steam; - orthopedic appliances and devises for improving hearing and sight; - sale of used things directly between citizens (except vehicles) and the sale of agricultural products between citizens at market places; - special passenger cars for disabled persons;	- exported goods; - reproduction material used in production activities; - equipment for agricultural production; - sale of used goods between individuals; - all types of bread, milk and edible oil and fat; - feed for animals, fertilizers and pesticides, seed and plantation material; - customs duty-free importation based on customs law and products sold in duty-free shops; - products procured by diplomatic offices, staff and officials; - humanitarian aid products imported by and given to Red Cross and UNHCR; - humanitarian aid goods purchased by certain government agencies; - arms and equipment purchased by the armed forces and the police; - medicines and medical equipment as regulated and defined in Law; - baby gear excluding toys; - drinking water; - orthopedic aids; - trade of second-hand products directly between individuals except vehicles subject to annual registration; - agricultural and forestry products sold by individuals; - donations to the army; - special adapted cars for invalids;.

	Federation	Republika Srpska
	- ambulances; - fire brigade vehicles, water pumps, and other fire equipment; - goods provided, kept, and used as permanent reserves by entitled organizations; - coins, numismatic collections and gold coins; - tobacco stamps issued by the MoF; - museums' and archives' purchase of museum and archive value; - valid administrative and court stamps; - books for pre-school, primary, secondary, and higher education; - books, brochures, magazines, and publications of technical, scientific, cultural, and educational content and daily and weekly newspapers; - informational material used for health, educational and environmental protection purposes; - products to be replaced with no charge within the warranty period; - tourist advertising.	- fire fighting and firemen protection equipment and means; - goods purchased as reserves by authorized organizations; - coins issued by the Central Bank of BiH—main branch RS; - tax stamps issued by the MoF of the RS; - written-off of business equipment; - books for primary, secondary, and higher education; - school equipment, stationary notebooks, and drawing material; - exchange of products resulting from warranty obligations.
5. Temporary Exemptions and Reductions	Sales tax on the following products is temporarily abolished (Federation Gazette June 1999, No. 28/99 and No. 29/99): - all types of meat and fresh meat products; - diesel fuel for coal mines, thermo-electric power plants, the Federation Army, and sowing plants; - reduction of the sales tax rate on sold cars produced in the Federation.	Not applicable.
II. Sales Tax on Services		
1. Taxpayer	Seller of the service	Seller of the service
2. Tax rate	10 percent	10 percent: general rate. 15 percent: gambling games;

	Federation	Republika Srpska
		30 percent: special gambling games, e.g., roulette.
3. Tax base	The service tax is levied on: - the full price of goods (inclusive of import duties and excises) sold by retailers in the Federation (i.e., a retail service tax); - the sales price of services such as transport, insurance, and banking (i.e., a real services tax); - the margin of wholesalers.	The service tax is levied on: - real services: the compensation paid for the executed service; - wholesale margin;
4. Exemptions	- credit and savings deposit services; - services of maritime transportation, warehousing of shipload, and airport services; - health and welfare services; - educational and cultural services; - services of humanitarian organizations; - veterinary services; - services of administrative bodies; - services rendered by religious institutions; - scientific research; - life insurance and accident insurance; - export services rendered for foreign nationals; - international transport; - construction work on facilities damaged during the war; - services to diplomatic and consular representation offices; - services mentioned in international agreements; - cattle fattening; - Federation army, police, and the goods reserve Directorate.	- interest payments and receipts; - transportation of goods and passengers (by railway, bus, and trams) and international transportation; - health services and social care rendered by state budget funded bodies; - educational service rendered by state budget funded bodies; Services for cultural manifestations; - Red Cross; - veterinary services; - services provided by state organs; - communal services except for the services of public garages; r - religious institutions; - scientific services rendered by state budget funded bodies; - life insurance; - international freight service; - construction and reconstruction of buildings (not restricted to war damaged buildings); - agricultural and land cultivation; - services provided by companies for the training and employment of disabled persons; - wheat milling for own purpose and for the Goods Reserve Directorate; - service to the army and police; - exports of goods paid in hard currency.

	Federation	Republika Srpska
5. Excises	Law on the Excise Tax on Non-alcoholic Beverages, Law on the Excise Tax on Alcohol, Law on the Excise Tax on Oil and Oil derivatives, Law on the Excise Tax on Beer, Law on the Excise Tax on Imported Passenger Cars, Law on the Excise Tax on Coffee (Federation Gazette No. 6/95 and No. 51/99), and Law on the Excise Tax on Tobacco Products (Federation Gazette No. 6/95).	Republika Srpska Law on Sales and Excise Taxes (RS Gazette No. 25/98 and No. 40/98). RS Government Decree of 10 July 1998 (RS Gazette No. 22/98), 5 April 1999 (RS Gazette No. 9/99), and 21 July 1999 (RS Gazette No. 19/99) . Decree on Excise Harmonization. February 2000 (RS Gazette No. 9/00). (*)
1. Taxpayer	Manufacturer or importer.	Manufacturer or importer.
2. Tax rate		
a. Alcohol and spirits	KM 0.25/l (wine) KM 15.0/l (pure alcohol, one quality group) --	KM 0.20/l (wine) KM 5.00/l (strong alcohol, quality group I), KM 3.00/l (strong alcohol, quality group II),
b. Beer	KM 0.20/l	KM 0.15-0.20/l (depending on the packaging material),
c. Soft drinks	KM 0.10/l	KM 0.20/l
d. Coffee	KM 1.00/kg (raw coffee) KM 2.50/kg (roasted coffee) KM 3.50/kg (coffee extracts)	KM 0.80/kg (raw coffee) KM 2.50/kg (roasted coffee) KM 3.50/kg (coffee extracts)
e. Oil products	KM 0.40/l (leaded gasoline) KM 0.35/l (unleaded gasoline) KM 0.30/l (diesel) KM 0.09/l (heating oil) KM 0.20/l (petroleum). -- -- --	KM 0.30/l (leaded gasoline) KM 0.25/l (unleaded gasoline) KM 0.15/l (diesel), KM 0.09/l (heating oil) KM 0.20/l (petroleum), KM 0.20/l (domestic motor and airplane oils) KM 0.90/l (imported motor and airplane oils) KM 0.05/l (reused oils)
f. Tobacco products	KM 0.06/p.p. (cigars) KM 0.16/p.p. (cigarillos) KM 2.33/pack (imported cigarettes) KM 1.65/pack (imported light cigarettes) KM 0.88/pack (imported very light/extra strong domestic) KM 0.82-0.22/pack (domestic cigarettes) KM 15.0/kg (imported tobacco) KM 7.50/kg (domestic tobacco)	KM 0.05/p.p. (cigars) KM 0.05/p.p. (cigarillos) Cigarettes: Rates by quality groups: per pack KM 1.00, 0.70, 0.50, 0.40, and 0.25 KM 6.00/kg (tobacco)
g. Passenger cars	abolished	--

	Federation	Republika Srpska
h. Luxury products	--	10 percent (leather products, gem stones and products made out of precious metals).
i. Timber	--	10 percent (round) and 3 percent (sawed) on the export of timber.
3. Tax base	Quantity of imported/manufactured excisable goods.	Quantity of imported/manufactured excisable goods, except for luxury goods and timber, which feature excises levied on the value of the commodity. (*) In February 2000, the RS government issued a Decree, which adopts the June 8, 1999 excise rates for all specified commodities, except cigarettes, which are taxed at an ad valorem rate of 35 percent. The export tax on timber and the ad valorem excise on luxury products are abolished.
6. Special Fees on Excisables	--	Decree No. 180 and 512 on the Payment of Retail Fee for Specific Products (RS Gazette No. 9/99 and No. 19/99). Government Decree on Payment of Additional Taxes for Financing the Dissolution of Temporary Refugees Centers (RS Gazette No. 22/98). These decrees are valid for a period of up to 6 months.
a. Retail fee	--	The taxpayer is a retailer selling specific excisable goods. The tax base is the sales price of the excisable good. The levy amounts to KM 0.20 per liter on leaded gasoline, unleaded gasoline, and diesel,. and KM 0.10 per liter on heating oil.
b. Temporary levy on oil products	--	The tax is collected at the importer and manufacturer level. The levy amounts to KM 0.10 per liter and is levied on gasoline (leaded and unleaded), diesel, and heating oil. that is imported or produced in the RS. The revenues are earmarked for the financing of the dissolution of temporary refugees centers.

	Federation	Republika Srpska
7. Customs Duties	Law on Customs Policy of Bosnia and Herzegovina (February 1998) and Law on Special Duty on Imported Goods (Federation Gazette No. 2/95, No. 19/97, and No. 10/99). Applies to both the Federation of BiH and the RS.	
1. Taxpayer	Individuals and companies importing goods into BiH.	
2. Tax rates		
a. Customs duties	Rates are the same in the Federation of BiH and the RS. The (ad valorem) tariff rates are based on the Harmonized System Nomenclature of goods: - 0 percent: wood, wood pulp, animal skins, natural rubber, essential vegetable oils, oil seeds, newspapers, military weapons; - 5 percent: organic chemical elements, edible vegetables, natural stones, bricks, copper, explosives, iron; - 10 percent: woven fabrics, cosmetics, sugar, dairy products, meat, leather articles, certain metal articles, electrical equipment, tractors, transport vehicles, toys; - 15 percent: tobacco, spirits, beer, soft drinks, carpets, clothing, footwear, and arms other than military weapons;	
b. Customs fee	A levy of 1 percent of the customs value is charged for customs record keeping purposes.	
c. Surcharges	Specific levy on various agricultural commodities (e.g., live animals, fresh meat, vegetable oils, milk, eggs, sugar, juices, soft drinks, and wine).	
3. Tax base	The customs duties and customs fee apply to the value of imported commodities, c.i.f., and surcharges are levied on the quantity of goods imported.	
4. Main exemptions	- Council of Ministers has discretionary power to determine duty exemptions; - foreign direct investment; - equipment of the Army and Police; - equipment for rebuilding and reconstruction projects in BiH; - traveler allowances; - personal effects of travelers; - coffins with bodies and urns with ash; - imports of cars, orthopedic devices and other aids for personal use by disabled persons; - goods (excluding alcohol, tobacco, coffee, and motor vehicles) imported by charitable or philanthropic organizations; - capital goods and other equipment imported on the transfer of activities from a foreign country into BiH; - goods imported for trade promotion purposes; - personal property acquired by inheritance; - goods in transit.	

Table 15. Bosnia and Herzegovina: Gross Domestic Product by Sectoral Activity, 1995-98 1/

	1995			1996			1997			1998		
	Federation	RS	BiH	Federation	RS	BiH	Federation	RS	BiH	Federation	RS	BiH
							(Share in GDP)					
Agriculture, fisheries and forestry	22.6	30.2	24.6	16.4	32.1	20.5	13.0	32.6	17.5	12.1	26.6	16.0
Industry	21.1	31.3	23.8	19.4	26.6	21.3	22.5	22.3	22.4	22.4	22.4	22.4
Water management	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.1	0.1	0.1
Construction	3.6	1.8	3.1	4.3	4.2	4.3	5.4	4.5	5.2	6.4	3.8	5.7
Services	52.7	36.6	48.4	59.7	36.9	53.8	59.0	40.5	54.7	59.0	47.1	55.8
Transportation and communications	6.3	5.7	6.1	6.5	6.3	6.5	7.6	6.3	7.3	8.8	5.6	7.9
Trade	25.4	6.8	20.4	19.8	7.8	16.7	18.1	9.8	16.2	17.1	8.7	14.8
Catering and tourism	2.3	2.1	2.2	2.6	2.4	2.6	2.6	2.9	2.7	2.3	2.4	2.3
Crafts	1.8	0.8	1.5	3.0	0.8	2.4	2.2	0.8	1.9	2.0	0.8	1.7
Housing and public utilities	0.9	1.1	0.7	2.1	1.0	1.6	1.9	1.1	1.7	2.5	1.3	2.1
Education and research	2.1	3.8	2.5	5.8	2.3	4.9	6.5	3.5	5.8	6.7	4.3	6.0
Health Care	2.0	...	1.5	4.6	...	3.4	4.8	...	3.7	4.6	5.3	4.8
Banking and insurance	2.2	5.3	3.0	3.5	5.0	3.9	4.1	6.4	4.6	4.1	9.4	5.6
Government administration	6.0	11.2	7.4	7.1	11.4	8.2	8.5	9.7	8.7	8.3	9.4	8.6
Other services	3.6	0.0	2.9	4.7	0.0	3.7	2.7	0.0	2.1	2.7	0.0	2.0
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
							(Annual growth, percent change)					
Agriculture, fisheries and forestry	40.9	-48.1	-9.7	12.6	61.0	28.4	18.6	28.8	22.8	4.9	13.6	8.6
Industry	127.2	-24.8	33.0	43.3	28.4	38.1	73.2	6.4	51.4	12.0	40.1	18.5
Water management	100.0	-37.4	14.7	211.7	49.8	156.9	104.1	49.5	93.3	-51.2	41.0	-37.2
Construction	154.8	-30.9	80.5	88.1	257.1	113.9	86.5	37.0	73.8	34.0	17.8	30.8
Services	118.6	-14.7	68.3	76.1	52.3	71.3	48.0	39.5	46.5	12.4	62.0	20.8
Transportation and communications	108.0	-10.3	56.8	60.6	67.0	62.2	74.9	27.5	62.8	29.9	23.5	28.6
Trade	169.8	-38.5	107.6	21.2	74.0	25.8	36.6	60.1	39.4	6.4	22.8	8.7
Catering and tourism	133.0	-31.4	45.8	80.4	74.3	78.9	50.2	52.8	50.8	-3.2	15.0	1.3
Crafts	184.8	-22.6	109.4	163.0	49.6	147.7	8.7	29.5	10.4	4.0	44.4	7.9
Housing and public utilities	99.2	-22.0	99.2	265.9	37.2	265.9	35.0	52.5	59.6	45.5	53.5	46.8
Education and research	...	-12.0	124.3	324.8	-7.1	194.7	69.7	91.6	72.5	14.6	71.7	22.4
Health Care	...	...	...	252.3	...	252.3	56.4	...	56.4	7.5	...	54.1
Banking and insurance	66.9	41.4	54.0	141.6	42.0	95.6	77.2	63.9	72.8	13.4	104.3	42.3
Government administration	-0.8	-8.1	-3.9	81.9	53.9	70.7	79.0	7.7	53.2	9.7	35.1	16.2
Other services	66.9	...	84.5	102.0	...	95.9	-13.7	...	-19.4	11.4	...	11.4
GDP	96.6	-31.3	32.1	55.3	51.1	54.2	49.8	27.1	43.9	12.4	39.3	18.6

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

Table 16. Bosnia and Herzegovina: Gross Domestic Product by Aggregate Expenditure, 1994-98

(In millions of U.S. dollars; at current market prices)

	1994	1995	1996	1997	1998
Gross domestic product (GDP)	1,254	1,867	2,741	3,423	3,899
Total domestic demand	2,145	2,820	4,361	5,027	5,396
Consumption	1,894	2,446	3,237	3,589	3,914
Gross investment	251	373	1,124	1,438	1,481
Foreign balance	-891	-953	-1,620	-1,604	-1,497
Exports of goods and services	194	381	658	1,002	1,367
Imports of goods and services	-1,085	-1,334	-2,278	-2,606	-2,864
Income from abroad (net)	-165	-242	-222	-228	-110
Gross national income	1,089	1,625	2,519	3,195	3,789
Current transfers (net)	879	1,002	1,094	772	510
Gross national disposable income	1,968	2,627	3,613	3,967	4,299
Memorandum items:					
Per capita income					
GDP per capita		...	...	...	1,054
GNI per capita		...	...	...	1,024
Real growth (in percent)					
GDP	...	20.8	69.2	29.5	12.4
Domestic demand	...	10.3	68.7	25.0	6.9
Consumption	...	4.8	52.5	15.0	7.6
Gross investment	...	67.1	175.1	61.3	5.2
			(In percent of GDP)		
Consumption	151.1	131.1	118.1	104.9	100.4
Gross investment	20.0	20.0	41.0	42.0	38.0
Foreign balance	71.1	51.1	59.1	46.9	38.4
Gross national saving	5.9	9.7	13.7	11.0	9.9

Sources: Data provided by the Entity Statistical Institutes; and IMF staff estimates.

Table 17. Bosnia and Herzegovina: Monthly Index of Industrial Production, 1994-99

		Republika Srpska			Federation		
		Dec 1995 = 100	Monthly percent change	Percent change relative to year before	Dec. 1995=100	Monthly percent change	Percent change relative to year before
1994 1/		85	...	...	85	...	...
1995 2/		100	...	18.0	100	...	18.0
1996		139	...	38.9	188	...	87.6
1997		176	...	26.6	255	...	35.7
1998		217	...	23.5	315	...	23.8
1999		220	...	1.6	349	...	10.6
1997	Jan.	90	-28	23	146	-3	67.2
	Feb.	99	10	26	141	-4	41.6
	March	112	13	21	158	12	50.8
	April	110	-2	16	146	-7	39.7
	May	83	-25	-14	144	-1	33.5
	June	96	16	23	160	11	41.1
	July	114	18	44	143	-11	12.0
	Aug.	108	-5	35	157	10	27.8
	Sep.	128	18	24	166	6	28.8
	Oct.	153	20	38	178	7	34.2
	Nov.	145	-5	34	179	0	30.8
	Dec.	150	3	20	196	10	30.1
1998	Jan.	112	-25	25	157	-20	7.1
	Feb.	138	23	39	175	11	24.2
	March	145	5	29	177	1	12.0
	April	144	-1	30	184	4	25.9
	May	115	-20	38	195	6	35.2
	June	132	15	37	197	1	23.3
	July	138	4	21	200	1	39.9
	Aug.	126	-8	17	208	4	32.2
	Sep.	161	28	26	215	4	29.5
	Oct.	173	7	13	219	2	22.8
	Nov.	174	1	20	214	-2	20.1
	Dec.	186	7	24	228	6	16.5
1999	Jan.	119	-36	6	184	-19	17.2
	Feb.	147	23	6	181	-2	3.5
	March	168	15	16	202	12	14.4
	April	125	-26	-13	205	2	11.6
	May	120	-3	5	198	-3	1.7
	June	145	20	10	216	9	9.8
	July	132	-9	-4	216	0	8.2
	Aug.	149	13	18	227	5	9.5
	Sep.	180	21	12	233	2	8.1
	Oct.	173	-4	0	252	8	15.1
	Nov.	143	-17	-18	249	-1	16.3
	Dec.	172	20	-7	250	0	9.8

Sources: Data provided by Institute of Statistics of Bosnia and Herzegovina and Statistical Office of Republika Srpska.

1/ The index for 1994 is given for the BiH territory as a whole as production estimates for the Entities are unreliable owing to changes in coverage of territory in November of 1995.
2/ Base is average monthly production in 1995.

Table 18. Bosnia and Herzegovina: Selected Crop Production, 1995-98

	1995	1996	1997	1998	1998 relative to 1991	Share of RS in BIH 1998
	(Thousand of tons)				(Percent)	
Wheat	216,865	158,795	287,372	340,931	82.5	71.9
Barley, Oats and Rye	64,060	79,185	124,242	139,071	93.4	70.6
Maize	512,432	600,664	830,451	704,185	94.3	71.0
Soybean	2,094	5,776	6,504	7,165	60.5	100.0
Tobacco	3,113	2,914	2,807	4,566	69.2	60.0
Potatoes	299,258	379,060	423,849	413,440	124.7	44.0
Onions	23,763	33,470	40,163	42,850	176.2	26.7
Beans	11,282	13,889	14,303	14,322	68.8	61.2
Cabbage and Kale	55,849	73,239	97,953	96,042	133.5	34.3
Tomatoes	34,442	33,300	40,120	46,013	263.5	46.4
Green pepper	20,727	24,681	34,855	35,783	312.1	60.3
Clover	142,213	192,769	227,220	195,664	74.0	56.5
Lucerne	78,885	108,122	151,863	145,749	91.7	49.1
Maize for fodder	69,939	45,255	59,614	111,198	73.3	34.8
Mixture of grasses and legume	40,660	53,792	47,883	40,905	27.8	73.2
Apples	...	53,812	54,820	59,001	166.7	57.7
Plums	...	177,515	129,813	149,045	236.1	60.7
	(Growth Rates)					
	1995/94	1996/95	1997/96	1998/97	1998/95	
Wheat	6.2	-26.8	81.0	18.6	57.2	
Barley, Oats and Rye	-27.8	23.6	56.9	11.9	117.1	
Maize	-8.3	17.2	38.3	-15.2	37.4	
Soybean	-57.5	175.8	12.6	10.2	242.2	
Tobacco	6.5	-6.4	-3.7	62.7	46.7	
Potatoes	4.1	26.7	11.8	-2.5	38.2	
Onions	46.5	40.8	20.0	6.7	80.3	
Beans	9.5	23.1	3.0	0.1	26.9	
Cabbage and Kale	2.5	31.1	33.7	-2.0	72.0	
Tomatoes	-13.2	-3.3	20.5	14.7	33.6	
Green pepper	-16.2	19.1	41.2	2.7	72.6	
Clover	-5.2	35.5	17.9	-13.9	37.6	
Lucerne	-15.9	37.1	40.5	-4.0	84.8	
Maize for fodder	-23.3	-35.3	31.7	86.5	59.0	
Mixture of grasses and legume	-12.6	32.3	-11.0	-14.6	0.6	
Apples	...	...	1.9	7.6	...	
Plums	...	...	-26.9	14.8	...	

Sources: Federation and State Statistical Offices.

Table 19. Bosnia and Herzegovina: Construction, 1995-99

	Federation			Republika Srpska		
	Effective hours of production 1/	Monthly percent change	Percent change relative to year before	Effective hours of production 1/	Monthly percent change	Percent change relative to year before
1995	...	...	...	1,439,201	...	...
1996	13,910,772	...	...	4,849,352	...	236.9
1997	15,639,001	...	12.4	5,706,888	...	17.7
1998	18,377,737	...	17.5	7,698,398	...	34.9
1999 2/	15,550,940	...	-7.1	6,321,657	...	18.6
1997 January	952,580		...	222,750		...
February	998,977	4.9	...	298,029	33.8	...
March	1,245,278	24.7	...	425,802	42.9	...
April	1,247,702	0.2	...	393,523	-7.6	...
May	1,250,204	0.2	...	423,949	7.7	...
June	1,334,596	6.8	...	504,608	19.0	...
July	1,394,407	4.5	...	541,172	7.2	...
August	1,394,184	0.0	...	531,079	-1.9	...
September	1,366,173	-2.0	...	601,840	13.3	...
October	1,483,376	8.6	...	604,595	0.5	...
November	1,475,870	-0.5	...	578,215	-4.4	...
December	1,495,654	1.3	...	581,326	0.5	...
1998 January	1,006,121	-32.7	5.6	306,514	-47.3	37.6
February	1,083,516	7.7	8.5	387,038	26.3	29.9
March	1,129,430	4.2	-9.3	486,865	25.8	14.3
April	1,276,057	13.0	2.3	480,109	-1.4	22.0
May	1,476,373	15.7	18.1	554,103	15.4	30.7
June	1,573,074	6.5	17.9	708,389	27.8	40.4
July	1,713,340	8.9	22.9	770,157	8.7	42.3
August	1,677,348	-2.1	20.3	789,775	2.5	48.7
September	1,915,856	14.2	40.2	848,641	7.5	41.0
October	1,931,105	0.8	30.2	812,545	-4.3	34.4
November	1,952,739	1.1	32.3	809,940	-0.3	40.1
December	1,642,778	-15.9	9.8	744,322	-8.1	28.0
1999 January	952,437	-42.0	-5.3	288,309	-61.3	-5.9
February	1,052,811	10.5	-2.8	440,554	52.8	13.8
March	1,170,813	11.2	3.7	629,004	42.8	29.2
April	1,417,402	21.1	11.1	702,477	11.7	46.3
May	1,430,828	0.9	-3.1	762,201	8.5	37.6
June	1,432,134	0.1	-9.0	852,961	11.9	20.4
July	1,586,166	10.8	-7.4	876,390	2.7	13.8
August	1,673,959	5.5	-0.2	881,614	0.6	11.6
September	1,617,287	-3.4	-15.6	888,147	0.7	4.7
October	1,615,321	-0.1	-16.4	...	...	...
November	1,601,782	-0.8	-18.0	...	...	...

Sources: Federation and Republika Srpska Statistical Offices.

1/ Number of effective hours spent by construction workers on construction site. Does not include engineers and managers.
2/ January-November 1999 in the Federation and January-September in the RS relative to same period a year before.

Table 20. Bosnia and Herzegovina: Transportation and Communications, 1996-99

	Federation				Republika Srpska				Total
	1996	1997	1998	1999 Jan. - Nov.	1996	1997	1998	1999 Jan. - Nov.	BIH 98/91
Road transport									
Freight (thousands of ton-km)	128,638	223,632	273,431	223,694	86,741	99,151	119,744	84,639	17.8
Passengers (thousands of passenger-km)	467,804	551,133	675,053	508,741	447,727	491,466	674,181	437,188	91.2
Urban-Suburban Transport (thousands of passengers)	94,023	157,372	185,019	191,678	5,622	4,954	5,086	4,680	41.5
Rail Transport									
Freight (thousands of ton-km)	18,677	46,339	72,589	105,796	7,000	2,963	12,292	20,000	3.5
Passengers (thousands of passenger-km)	30,150	5,869	5,118	56,584	31,000	33,331	50,059	33,000	8.7
Post and Telecommunications Services									
Letters delivered and received (thousands)	11,577	16,940	27,810	37,403	4,069	6,053	10,366	8,875	38.2
				(Growth Rates)					
		1997/96	1998/97	1999/98 1/		1997/96	1998/97	1999/98 2/	
Road transport									
Freight, ton-km	...	73.8	22.3	-8.3	...	14.3	20.8	-3.5	
Passengers, passenger-km	...	17.8	22.5	-0.1	...	9.8	37.2	-9.9	
Urban-Suburban Transport, number of passengers	...	67.4	17.6	10.6	...	-11.9	2.7	39.3	
Rail Transport									
Freight, ton-km	...	148.1	56.6	59.0	...	-57.7	314.8	133.6	
Passengers, passenger-km	...	-80.5	-12.8	14.9	...	7.5	50.2	-15.4	
Post and Telecommunications Services									
Letters delivered and received	...	46.3	64.2	31.9	...	48.8	71.3	22.4	

Sources: Federation and Republicka Srpska Statistical Offices.

1/ Growth rate Jan-Nov 1999/ Jan-Nov 1998.
2/ Growth rate Jan-Sep 1999/Jan-Sep 1998.

Table 21. Bosnia and Herzegovina: Employment in the Federation, 1994-99 1/ 2/
(Annual average)

	Total		Material Sphere		Nonmaterial Sphere 3/	
	Employed	Waiting	Employed	Waiting	Employed	Waiting
Dec.1994	143,952	...	113,701	...	30,251	...
1995	199,659	...	156,048	...	43,611	...
1996 4/	248,994	...	194,225	...	54,767	...
1997	283,820	89,668	171,819	88,762	112,030	877
1998	318,927	76,518	190,019	75,939	128,908	579
Jan.-Nov.1999	341,490	66,051	214,611	65,703	126,879	348
			Estimated Annual Growth Rates			
1995 5/	58.5	...	56.5	...	66.3	...
1996 6/	24.7	...	24.5	...	25.6	...
1997 7/	17.4	-4.3	1.2	-4.0	55.5	-38.1
1998 8/	12.4	-14.7	10.6	-14.4	15.1	-33.9
Jan.-Nov.1999 9/	7.6	-14.2	13.7	-14.0	-1.4	-41.4

Sources: Federal Statistics Office; and IMF staff estimates.

1/ Data prior to September 1996 apply to the Bosniac-majority area only; data prior to January 1997 excludes employees of the Ministry of Defense and Ministry of Interior. Employed prior to 1997 include those "waiting"; figures for "waiting" not available before October 1996.

2/ The category of "waiting" applies to personnel formally on enterprise payrolls but not actually working or collecting wages. Figures for "employed" are exclusive of "waiting".

3/ Includes government administration, education, health care, and other social services.

4/ Estimated.

5/ Average of November-December 1995 over average of November-December 1994.

6/ Average of first eight months of 1996 over average of first eight months of 1995.

7/ Average of last quarter of 1997 over average of last quarter of 1996.

8/ Annual average 1998 over annual average 1997.

9/ First eleven months of 1999 over first nine months of 1998.

Table 22. Bosnia and Herzegovina: Employment in the Federation
Monthly Average, Actual and Waiting, 1997-99 1/

		Total		Material Sphere		Non-material Sphere 2/	
		Employed	Waiting	Employed	Waiting	Employed	Waiting
1997	Jan.	280,429	92,752	169,950	91,846	110,479	906
	Feb.	280,980	92,701	170,324	91,736	110,656	965
	March	282,155	90,705	171,475	89,716	110,680	989
	April	280,438	91,592	168,718	90,584	111,720	1,008
	May	281,165	90,706	170,137	89,708	111,028	998
	June	282,327	89,946	170,415	89,038	111,912	908
	July	285,030	87,354	172,866	86,480	112,164	874
	Aug.	285,383	87,010	173,168	86,140	112,215	870
	Sep.	286,382	88,411	173,673	87,615	112,709	796
	Oct.	287,755	87,768	174,551	86,890	113,547	535
	Nov.	286,217	89,287	172,695	88,416	113,522	871
	Dec.	287,580	87,781	173,857	86,979	113,723	802
1998	Jan.	295,277	86,884	173,244	86,084	122,033	800
	Feb.	302,510	84,119	176,553	83,440	125,957	679
	March	306,086	82,119	179,625	81,456	126,461	663
	April	312,466	78,758	184,860	78,160	127,606	598
	May	313,701	77,715	185,379	77,074	128,322	641
	June	319,854	75,584	189,866	74,995	129,988	589
	July	321,183	75,335	191,357	74,735	129,826	600
	Aug.	322,158	74,344	192,340	73,773	129,818	571
	Sep.	324,922	71,598	193,151	71,083	131,771	515
	Oct.	336,641	70,188	205,167	69,752	131,474	436
	Nov. 3/	336,262	70,587	204,570	70,154	131,692	433
	Dec.	336,062	70,985	204,117	70,556	131,945	429
1999	Jan.	338,664	68,387	212,745	68,027	125,919	360
	Feb. 3/	338,904	68,153	212,388	67,777	126,516	376
	March	339,145	67,919	212,495	67,527	126,650	392
	April	340,755	66,424	213,760	66,073	126,995	351
	May 3/	340,873	66,322	213,812	65,950	127,061	372
	June	340,993	66,219	213,870	65,826	127,123	393
	July 3/	341,754	65,471	214,772	65,113	126,982	358
	Aug.	343,282	64,722	216,266	64,399	127,016	323
	Sep.	343,761	64,325	216,747	63,994	127,014	331
	Oct.	343,917	64,250	216,865	63,955	127,052	295
	Nov.	344,345	64,366	217,000	64,094	127,345	272

Sources: Federal Statistics Office; and IMF staff estimates.

1/ The category of "waiting" applies to personnel formally on enterprise payrolls but not actually working, or collecting wages. Figures for employed are exclusive of those at waiting.

2/ Includes government administration, education, health care, and other social services.

3/ Data for "waiting" estimated by extrapolation.

Table 23. Bosnia and Herzegovina: Average Monthly Paid Wages in the Federation by Broad Type of Economic Activity, 1994-99 1/ 2/

(In convertible marka)

		Gross Monthly Wages Paid 3/			Net Monthly Wages		
		Total	Material Sphere	Nonmaterial Sphere 3/	Total	Material Sphere	Nonmaterial Sphere 4/
1994	Dec.	...	...	...	20.5	20.2	21.1
1995	Aug.	...	...	...	43.1	39.9	53.2
1996	Aug.	...	...	...	168.4	144.7	238.1
1997	Aug.	419.6	367.3	551.4	265.9	233.6	347.2
1998	Aug.	506.3	454.8	626.1	329.0	296.1	405.8
1999	Jan.- Nov.	549.0	503.3	640.9	373.3	342.3	435.8
1997	Jan.	375.2	330.6	514.6	238.1	209.7	326.8
	Feb.	383.0	331.8	518.2	244.4	211.8	330.5
	March	393.8	347.4	501.6	251.4	221.6	320.6
	April	406.7	348.0	537.6	257.9	222.1	337.8
	May	414.6	357.3	549.5	261.1	225.9	344.1
	June	408.1	351.5	553.4	257.9	223.2	347.0
	July	419.7	364.7	555.0	266.8	232.5	351.2
	Aug.	418.1	370.9	542.4	268.4	239.0	345.7
	Sep.	426.3	372.8	565.9	270.6	237.3	357.4
	Oct.	443.3	395.1	575.5	280.3	251.0	360.6
	Nov.	453.0	400.1	588.9	285.8	253.7	368.3
	Dec.	492.9	437.3	613.7	307.6	275.8	376.5
1998	Jan.	467.8	423.3	584.7	299.7	269.7	378.1
	Feb	494.4	444.3	603.4	314.0	282.9	381.7
	March	485.3	431.3	626.8	307.4	274.7	393.2
	April	518.0	467.0	631.4	324.4	293.0	394.1
	May	499.7	447.1	616.5	318.5	285.4	392.0
	June	502.9	447.8	641.0	319.1	285.3	403.8
	July	519.1	456.4	656.9	328.7	289.6	414.5
	Aug.	526.2	470.3	640.1	334.7	300.2	404.9
	Sep.	498.6	451.8	609.2	339.1	307.2	414.3
	Oct.	517.9	475.7	610.6	352.2	323.5	415.2
	Nov.	521.0	470.3	645.4	354.3	319.8	438.9
	Dec.	524.4	472.5	646.5	356.6	321.3	439.6
1999	Jan.	531.6	479.1	628.6	361.5	325.8	427.4
	Feb	546.9	501.9	633.3	371.9	341.4	430.7
	March	536.9	487.7	647.7	365.1	331.7	440.4
	April	552.2	507.3	636.6	375.5	344.9	432.9
	May	547.8	500.3	653.3	372.5	340.2	444.2
	June	542.0	501.9	630.7	368.5	341.3	428.9
	July	555.9	506.6	650.8	378.0	344.5	442.6
	Aug.	551.9	512.1	640.3	375.3	348.2	435.4
	Sep.	560.0	511.4	644.5	380.8	347.7	438.2
	Oct.	551.5	509.5	638.0	375.0	346.5	433.9
	Nov.	562.3	518.4	646.4	382.3	352.5	439.6

Source: Data provided by State Statistical Institute.

1/ Average of wages paid out in month, regardless of period to which wage refers to, or of number of employed who did not receive wage.

2/ Data for Republika Srpska have been omitted as an already methodologically weak indicator has been seriously affected by problems of conversion of currencies.

3/ Data were revised relative to SM/98/96 to reflect actual gross wages paid, rather than estimates based on contribution rates.

4/ Includes government administration, education, health care, and other social services.

Table 24. Bosnia and Herzegovina: Retail Price Developments, 1994-99

		Federation 1/			Republika Srpska 2/					
					In KM			In YUD		
		Dec. 1995 =100	Monthly percent change	Percent change relative to prev. year	Dec. 1995 =100	Monthly percent change	Percent change relative to prev. year	Dec. 1995 =100	Monthly percent change	Percent change relative to prev. year
1994	Avg. 3/	143.0	...	...	70.0	...	...	26.4	...	...
1995	Avg.	136.8	...	-4.4	79.0	...	12.9	57.4	...	117.6
1996	Avg.	103.3	...	-24.5	92.3	...	16.9	95.3	...	-65.9
1997	Avg.	114.5	...	10.8	85.6	...	-7.3	97.8	...	2.6
1998	Avg.	120.3	...	5.1	73.6	...	-14.0	135.2	...	38.2
1999	Avg.	119.9	...	-0.3	84.0	...	14.1	...	...	...
1996	Dec.	107.7	0.4	7.7	82.3	-5.4	-17.7	91.5		-8.5
1997	Jan.	111.8	3.8	13.2	81.4	-1.1	-29.2	96.0	4.9	-17.5
	Feb.	112.9	1.0	14.6	82.5	1.4	-26.9	96.6	0.7	-20.0
	March	112.8	-0.1	14.1	87.2	5.6	-6.2	98.5	1.9	2.0
	April	116.0	2.9	13.3	93.3	7.1	0.7	100.2	1.8	7.7
	May	119.4	2.9	14.7	92.2	-1.2	2.6	97.1	-3.1	6.8
	June	119.7	0.2	15.5	89.8	-2.6	3.0	95.3	-1.8	6.9
	July	119.3	-0.3	16.0	90.4	0.7	6.1	96.3	1.0	11.0
	Aug.	118.9	-0.4	14.5	89.0	-1.6	2.5	95.5	-0.8	8.4
	Sep.	120.9	1.7	15.2	86.0	-3.4	-2.3	96.3	0.9	7.9
	Oct.	121.5	0.4	13.8	81.6	-5.1	-7.6	97.2	0.9	8.2
	Nov.	122.2	0.6	13.9	79.5	-2.5	-8.6	101.3	4.2	11.2
	Dec.	122.3	0.1	13.6	74.0	-6.9	-10.0	103.2	1.9	12.8
1998	Jan.	123.0	0.5	10.0	66.5	-10.2	-18.3	105.4	2.1	9.8
	Feb.	123.9	0.8	9.8	74.3	11.8	-10.0	109.3	3.7	13.1
	March	125.2	1.0	11.0	73.3	-1.3	-15.9	110.2	0.8	12.0
	April	125.3	0.1	8.0	71.8	-2.0	-23.0	129.3	17.3	29.1
	May	126.4	0.9	5.8	70.1	-2.5	-24.0	127.8	-1.2	31.6
	June	125.0	-1.1	4.5	70.2	0.2	-21.8	128.8	0.8	35.1
	July	123.4	-1.3	3.4	73.0	4.0	-19.3	132.7	3.0	37.8
	Aug.	123.4	0.0	3.8	75.9	4.0	-14.7	139.3	5.0	45.8
	Sep.	123.9	0.4	2.5	76.7	1.0	-10.8	139.3	0.0	44.6
	Oct.	123.8	-0.1	1.9	75.9	-1.0	-7.0	142.4	2.2	46.6
	Nov.	123.9	0.1	1.4	77.4	2.0	-2.7	173.5	21.8	71.3
	Dec.	124.5	0.5	1.8	78.2	1.0	5.6	183.8	5.9	78.1
1999	Jan.	124.4	-0.1	1.2	78.4	0.2	17.9	...	...	...
	Feb.	124.7	0.2	0.6	78.4	0.0	5.4	...	...	...
	March	124.5	-0.1	-0.5	80.3	2.5	9.5	...	...	...
	April	124.3	-0.2	-0.8	81.8	1.8	13.8	...	...	...
	May	124.3	0.0	-1.6	82.8	1.3	18.2	...	...	...
	June	123.4	-0.7	-1.3	85.1	2.8	21.3	...	...	...
	July	122.2	-1.0	-1.0	84.5	-0.7	15.8	...	...	...
	Aug.	122.2	0.0	-1.0	85.0	0.5	11.9	...	...	...
	Sep.	123.1	0.8	-0.7	85.5	0.6	11.5	...	...	...
	Oct.	122.5	-0.5	-1.1	88.3	3.3	16.3	...	...	...
	Nov.	122.7	0.2	-1.0	89.1	0.9	15.1	...	...	...
	Dec.	123.4	0.5	-1.0	89.2	0.4	14.0	...	...	...

Sources: Federation and Republika Srpska Statistical Offices; and IMF staff estimates.

1/ The new domestic currency (convertible marka, KM) was introduced in August 1997 for noncash transactions, and became available for cash transactions from June 1998; under the currency board arrangement, KM 1 = DM 1.

2/ KM-based index based on parallel market DM/YUD rate observed in Belgrade, Yugoslavia until June 1998. Direct observations of KM prices thereafter.

3/ In RS 1994 average refers only to March-December 1994.

Table 25. Bosnia and Herzegovina: Consolidated General Government and Entities, 1996-1998 1/

	1996	1997	1998					
					Federation			
			Consolidated	State	Consolidated	Federal government	Cantons, Municipalities, and Social Funds	Republika Srpska 2/
	(In millions of KM)							
Total revenue	1,992	2,398	3,148	140	2,678	682	2,003	450
Tax revenue	1,381	1,615	2,035	0	1,740	645	1,095	295
Taxes on goods and services	767	976	1,190	0	1,042	323	719	149
Trade taxes	296	349	407	0	312	312	0	95
Taxes on income	296	284	377	0	339	10	329	38
Other taxes	22	7	60	0	47	0	47	13
Nontax revenue	609	783	1,113	140	938	37	908	155
Transfers from other levels of government	0	0	0	120	0	0	8	0
Other	609	783	1,113	20	938	37	900	155
Total expenditure	2,173	2,429	3,657	140	3,034	1,038	2,003	603
Wages and contributions	235	293	462	34	273	77	196	155
Goods and services	92	73	133	19	64	37	27	50
Military	188	348	371	0	301	276	25	70
Debt service	27	75	87	87	0	0	0	0
Reconstruction expenditure	24	109	149	0	137	43	94	12
Subsidies	46	8	20	0	20	20	0	0
Other transfers to households	402	745	373	0	333	236	97	40
Of which: Transfers to war invalids	198	271	347	0	306	209	97	40
Transfers to the state government	...	...	...	...	65	65	0	55
Transfers to cantons or municipalities	1	9	...	...	...	7	...	...
Social fund expenditure	...	...	912	0	819	...	819	93
Other expenditure and unallocated 3/	1,158	770	830	0	766	21	745	64
Foreign loan financed projects	...	...	320	0	256	256	0	64
Balance	-182	-31	-509	0	-356	-356	0	-153
Financing	182	31	509	0	356	356	0	153
Domestic financing	41	0	0	0	0	0	0	0
Foreign financing	136	31	509	0	356	356	0	153

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

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

2/ RS municipal government revenue is not included, which accounts approximately for 20 percent of Entity government revenue.

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

Table 26. Bosnia and Herzegovina: State Budgetary Operations, 1997-1999

	1997 Estimates	1998 Estimates	1999 Jan.-June Estimates
		(In millions of KM)	
Revenues	50.0	138.0	76.0
Own revenues	20.0	20.0	10.0
Transfers from entities	30.0	118.0	66.0
Expenditures	110.0	138.0	76.0
Administrative	35.0	51.0	22.0
Debt service 1/	75.0	87.0	54.0
External financing	60.0	0.0	0.0

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

1/ Does not include payments from the SDR account and direct servicing of new commitments by some projects.

Table 27. Bosnia and Herzegovina: Federation Fiscal Operations, 1996-99

	1996 Actual	1997 Estimates	1998 Estimates	1999 Prel.
		(In millions of KM)		
Total revenue	314.8	610.5	681.9	723.7
Tax revenue	312.3	565.3	645.0	676.5
Excises	149.0	279.8	323.1	312.1
Trade taxes	163.3	285.5	311.6	346.7
Profit tax	0.0	0.0	10.4	17.7
Nontax revenue	2.5	45.2	36.9	47.2
Total expenditure	394.3	641.1	781.8	800.5
Wages and contributions	62.4	69.6	77.3	92.5
Goods and services 1/	12.9	21.5	37.0	32.4
Military 2/	0.0	253.5	276.0	291.4
Reconstruction expenditure 3/	9.6	17.5	42.6	26.0
Subsidies	29.1	3.2	20.4	14.1
Other transfers to households	177.6	226.7	235.9	215.9
Transfers to pension fund	15.0	15.8	21.9	6.5
Transfers for health	42.3	1.4	1.3	0.1
Transfers for education	16.7	10.4	3.3	1.4
Transfers to war invalids	95.2	175.5	209.3	207.9
Transfers to the state government	28.9	29.9	65.0	84.0
Administration	28.9	15.4	20.6	18.3
Debt service	0.0	14.5	44.4	65.7
Transfers to cantons and municipalities	12.7	3.7	7.0	15.9
Other expenditure and unallocated	13.1	15.6	20.7	28.4
Foreign grants for budget support	...	...	34.9	14.7
Overall balance (before grants)	-79.5	-30.7	-99.9	-76.8
Overall balance (after grants)	...	...	-65.0	-62.1
Financing	79.5	30.7	65.0	62.1
Domestic financing	-14.9	0.0	0.0	0.0
Foreign loans for budget support 4/	94.4	30.7	65.0	79.4
Memorandum items:				
Revenue-to-GDP ratio (in percent)	10.3	13.4	13.3	12.4
Expenditure-to-GDP ratio (in percent)	12.9	14.0	15.2	13.8
Balance (before grants)-to-GDP ratio (in percent)	-2.6	-0.7	-1.9	-1.3
Foreign project loans (million KM)	0.0	...	256.0	...

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

1/ Includes goods reserve.

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

3/ Includes allocation for railroads and other capital expenditures.

4/ For 1999, includes KM 39.1 million of external financing received in December 1999.

Table 28. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 1996-99

	1996 Prel.	1997 Estimates	1998 Estimates	1999 Jan.-Aug. Prel.
		(In millions of KM)		
Total revenue	253.0	209.3	357.1	362.8
Tax revenue	246.0	197.0	294.8	272.7
Taxes on goods and services	76.7	100.1	148.7	153.5
Sales tax 1/	59.4	90.4	97.8	97.5
Excises	17.4	9.8	50.9	55.9
Trade taxes	94.9	63.0	94.9	48.7
Taxes on income 2/	72.3	28.2	38.5	36.3
Other taxes	2.1	5.6	12.7	34.2
Nontax revenue 3/	7.0	12.3	62.2	90.1
Total Expenditure	254.3	209.3	446.2	407.9
Wages and contributions	38.5	24.9	154.6	105.9
General administration	17.7	10.9	76.6	70.5
Education 4/	20.6	13.9	78.0	35.4
Goods and services	35.9	30.5	49.6	84.7
Goods reserve	...	6.6	9.2	12.7
Other 5/	0.0	0.0	40.3	71.9
Military	138.7	73.4	70.0	52.4
Banking fees	0.0	0.4	0.6	1.2
Transfers to social funds	...	6.1	0.1	11.3
Reconstruction expenditure 6/	4.6	9.3	12.0	17.1
Of which: Railways	2.5	9.3	12.0	12.0
Subsidies 7/	6.5	0.0	0.0	7.8
Other transfers to households	22.7	15.1	79.3	47.4
War invalids	21.6	14.8	40.3	37.5
Other 8/	1.1	0.3	39.0	9.9
Transfers to other levels of government	0.6	1.2	55.6	65.0
Transfers to the State	0.0	0.0	55.0	64.2
Administration	0.0	0.0	10.0	6.7
Debt service	0.0	0.0	45.0	57.5
Transfers to municipalities	0.6	1.2	0.6	0.8
Other expenditure and unallocated	6.9	48.6	24.5	15.2
Foreign grants for budget support	0.0	0.0	31.1	...
Overall Balance (before grants)	-1.3	0.0	-89.1	-45.2
Overall Balance (after grants)	0.0	0.0	-58.0	-45.2
Financing	1.3	0.0	58.0	32.1
Domestic	1.4	0.0	0.0	0.0
External financing for budget support	0.0	0.0	58.0	32.1
Memorandum items:	0.0	0.0	0.0	0.0
Revenue-to-GDP ratio (in percent)	23.5	12.9	20.7	18.5
Expenditure-to-GDP ratio (in percent)	23.6	12.9	25.8	20.8
Balance-to-GDP ratio (in percent)	-0.1	0.0	-5.2	-2.3
Foreign project assistance	...	158.3	195.3	...
Of which: Foreign financed project loans	...	52.2	64.4	...

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

1/ Including sales tax, military surcharges, and railway surcharges.
2/ Including personal income tax, wage withholding tax, and corporate income tax.
3/ Including fees, fines, and other special revenues.
4/ Estimated as 2/3 of total education expenditure.
5/ Including 1/3 of education expenditure and other materials costs.
6/ Including railway and other capital expenditure.
7/ For water, forestry, and agriculture.
8/ For 1999, includes transfers to health insurance funds, refugees and displaced persons, students, social institutions, and special urban projects.

Table 29. Bosnia and Herzegovina: Monetary Survey, December 1996-November 1999

(In millions of convertible marks; end of period) 1/

	1996	1997	1998	1999				
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Oct.	Nov.
Assets	775	1,178	1,547	1,509	1,608	1,727	1,874	1,980
Foreign assets (net)	-1,973	-2,056	-2,040	-1,962	-1,888	-1,825	-1,721	-1,713
Foreign assets	1,266	1,443	1,465	1,447	1,591	1,718	1,810	1,852
Foreign assets (MAs) 2/	365	144	292	309	384	444	619	727
Foreign assets (DMBs)	901	1,299	1,173	1,138	1,207	1,274	1,191	1,125
Foreign liabilities	-3,240	-3,499	-3,505	-3,409	-3,479	-3,543	-3,532	-3,564
Foreign liabilities (MA) 3/	-138	-72	-130	-117	-153	-185	-185	-185
Foreign liabilities (DMBs) 4/	-3,102	-3,428	-3,375	-3,292	-3,325	-3,358	-3,347	-3,380
Domestic assets (net)	2,749	3,235	3,587	3,471	3,496	3,552	3,596	3,693
Claims on central government (net) 2/ 5/	-278	-116	-60	-87	-71	-27	-15	0
Monetary authorities	-107,987	-132	-7,345	-7,416	-9,446	-4,948	-9,434	-9,164
Claims on central government	109,913	0	0	0	0	0	0	0
Deposits of central government	-217,900	-132	-7,345	-7,416	-9,446	-4,948	-9,434	-9,164
Deposit money banks	-169,608	-196,483	-185,978	-166,358	-148,177	-153,431	-138,584	-125,025
Claims on central government	14,644	21,046	22,786	22,885	22,806	15,323	16,303	12,317
Deposits of central government	-184,252	-217,529	-208,764	-189,243	-170,983	-168,754	-154,887	-137,342
Other claims	3,263	3,840	4,201	4,108	4,147	4,140	4,191	4,263
Other items (net)	-237	-489	-554	-551	-581	-561	-580	-570
Liabilities								
Broad money	775	1,178	1,547	1,509	1,608	1,727	1,874	1,980
Money	187	252	310	332	378	542	784	889
Currency outside banks	96	113	162	171	200	253	344	370
Demand deposits	91	139	147	161	178	289	440	519
Demand deposits of nonfinancial public enterprises	73	94	103	110	122	217	315	358
Other 6/	18	45	45	51	56	72	125	161
Quasi-money	588	926	1,237	1,177	1,229	1,184	1,090	1,092
Time and saving deposits in domestic currency	7	10	8	8	7	8	11	18
Foreign currency deposits	581	917	1,229	1,169	1,223	1,176	1,079	1,073
Demand deposits	466	554	762	554	631	577	466	493
Nonfinancial public entreprises	366	397	503	408	451	421	322	344
Other 6/	100	157	260	146	181	155	145	150
Time and saving deposits	115	363	467	615	591	600	613	580
Nonfinancial public entreprises	73	175	224	359	346	343	335	306
Other 6/	41	188	243	256	245	257	277	274
Memorandum items:				(Change in percent of opening M2)				
Foreign assets (net)	60	-11	1	5	10	14	21	21
Foreign assets	131	23	2	-1	8	16	22	25
Foreign liabilities	-71	-34	-1	6	2	-2	-2	-4
Domestic assets (net)	36	63	30	-8	-6	-2	1	7
Claims on central government (net) 5/	-46	21	5	-2	-1	2	3	4
Monetary authorities	-25,646	13,911	12,980	12,971	12,709	13,290	12,711	12,746
Claims on central government	3,433	-14,176	-14,176	-14,176	-14,176	-14,176	-14,176	-14,176
Deposits of central government	-29,079	28,087	27,157	27,147	26,886	27,466	26,887	26,922
Deposit money banks	-20,463	-3,466	-2,111	419	2,764	2,086	4,001	5,750
Claims on central government	1,124	826	1,050	1,063	1,053	88	214	-300
Deposits of central government	-21,587	-4,292	-3,161	-644	1,711	1,999	3,787	6,050
Other claims (net)	82	42	25	-6	-5	-4	-2	3
Broad money	96	52	31	-2	4	12	21	28
Money	33	8	5	1	4	15	31	37
Quasi-money	63	44	26	-4	0	-3	-9	-9

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

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

2/ Excluding USAID deposits.

3/ Foreign liabilities of the Monetary Authorities have been transferred to the State, as of August 1997.

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

5/ Including net claims on Entity governments. Excluding USAID deposits.

6/ Including noncentral government and private sector.

Table 30. Bosnia and Herzegovina: Summary Balance Sheet of the Central Bank, August 1997-December 1999 1/

(In millions of convertible marks; end of period)

	1997	1997	1998	1999					
	Aug. 11	Dec.	Dec.	Mar.	Jun.	Sept.	Oct.	Nov.	Dec.
Assets	133.7	162.0	284.6	310.6	349.6	420.7	599.1	711.5	877.3
Foreign exchange assets	132.6	144.1	283.3	309.4	347.8	418.6	595.8	705.2	865.8
Cash	4.3	6.2	32.7	11.3	31.2	37.1	49.0	126.5	83.5
Investment	128.3	138.0	250.6	298.1	316.4	381.4	546.7	578.6	782.2
Other	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Other assets	1.1	17.9	1.3	1.3	1.8	2.0	3.3	6.2	11.5
Liabilities	133.7	162.0	284.6	310.6	349.6	420.7	599.1	711.5	877.3
Monetary liabilities	133.7	160.3	253.9	280.5	318.7	388.3	566.0	675.9	836.1
Currency outside monetary authorities	100.9	114.6	167.5	177.3	208.0	263.9	358.4	390.8	538.4
Credit balances of resident banks	32.8	45.5	79.1	95.8	101.3	119.5	198.2	276.0	288.6
Other deposits of residents	0.0	0.1	7.3	7.4	9.4	4.9	9.4	9.2	9.1
Liabilities to nonresidents	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Other liabilities	0.0	0.4	1.2	0.9	1.2	1.4	1.7	3.4	7.5
Capital and reserves	0.0	1.4	29.5	29.1	29.7	31.0	31.4	32.1	33.8
Net free reserves 2/	-1.1	-16.1	29.4	28.8	29.0	30.3	29.8	29.3	29.7

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

1/ Excesses of monetary liabilities over foreign exchange assets at end-December 1997 and end-March 1998 reflect the extension of credit from the Central Bank to the National Bank of Bosnia and Herzegovina (NBBH), made possible by flows in the design and operation of the interbank settlement mechanism. The authorities subsequently put in place arrangements that prevented recurrence of this problem.

2/ Defined as total foreign exchange assets minus monetary liabilities and liabilities to nonresidents. Performance criterion under the Stand-by Arrangement.

Table 31. Bosnia and Herzegovina: Summary Balance Sheet of the Commercial Banks in Bosnia and Herzegovina, December 1994-November 1999 1/

(In millions of convertible marka; end of period)

	1994	1995	1996	1997	1998	1999			
	Dec.	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Nov.
Assets	3,510	3,449	4,251	5,080	5,426	5,353	5,447	5,560	5,654
Foreign assets	567	646	901	1,151	1,112	1,123	1,192	1,258	1,109
Short-term	265	356	585	806	803	816	882	936	787
Long-term	303	290	316	345	310	307	310	322	323
Domestic assets	2,943	2,802	3,350	3,929	4,313	4,230	4,255	4,301	4,545
Claims on general government	14	10	18	26	31	37	38	34	29
Central government	13	10	15	21	23	23	23	15	12
Other government	1	0	3	5	9	14	15	19	16
Claims on private sector 2/	2,886	2,730	3,260	3,832	4,192	4,094	4,131	4,121	4,247
Reserves	42	62	73	71	90	99	86	146	270
Liabilities	3,510	3,449	4,251	5,080	5,426	5,353	5,447	5,560	5,654
Foreign liabilities	2,824	2,860	3,102	3,344	3,326	3,287	3,320	3,353	3,374
Short-term	74	96	137	207	215	204	198	210	201
Long-term	2,749	2,765	2,965	3,137	3,110	3,083	3,122	3,143	3,173
Domestic liabilities	686	588	1,148	1,736	2,100	2,067	2,127	2,207	2,280
Demand deposits	237	324	582	696	938	763	856	917	1,064
General government	37	31	67	65	71	90	98	96	138
Central government	24	15	43	24	37	48	47	51	52
Other government	12	16	24	41	35	43	51	45	87
Other 2/	200	293	515	631	867	672	758	821	925
Time and savings deposits	2,902	6,572	263	566	647	764	722	726	684
General government	33	84	147	230	189	160	145	137	103
Central government	33	84	142	193	172	142	124	118	86
Other government	0	0	5	36	17	19	20	19	18
Other 2/	2,869	6,488	116	336	458	604	578	589	581
Credit from monetary authorities	11	17	38	0	0	0	0	0	0
Other items (net) 3/	-2,464	-6,325	266	474	515	540	549	565	532
Memorandum item								0	0
Total deposits	100	100	100	100	100	100	100	100	100
Demand deposits	61	71	69	55	59	50	54	56	61
Central government	6	3	5	2	2	3	3	3	3
Other	55	67	64	53	57	47	51	53	58
Of which : Foreign currency	52	62	55	43	48	36	40	35	28
Time, savings and foreign currency deposits	39	29	31	45	41	50	46	44	39
Central government	8	18	17	15	11	9	8	7	5
Other	31	11	14	30	30	41	38	37	34
Of which : Foreign currency	30	10	14	29	29	40	37	37	33

Sources: Data provided by the National Bank of Bosnia and Herzegovina (NBBH) and the National Bank of the Republika Srpska (NBRS) until July 1997 and the Central Bank of Bosnia and Herzegovina (CBBH) thereafter; and IMF staff estimates.

1/ Consolidated balance sheet of commercial banks operating in the Federation and the Republika Srpska. Excluding the National Bank of Bosnia and Herzegovina (NBBH) and the National Bank of the Republika Srpska (NBRS), classified among deposit money banks as of August 1997.

2/ Including nonfinancial enterprises, nonbank financial institutions, households, and other nongovernment sectors.

3/ Including assets and liabilities relating to frozen foreign exchange deposits.

Table 32. Bosnia and Herzegovina: Summary Balance Sheet of the Commercial Banks in the Republika Srpska, December 1994-November 1999 1/

(In millions of convertible marka; end of period)

	1994 Dec.	1995 Dec.	1996 Dec.	1997 Dec.	1998 Dec.	1999 Mar.	1999 Jun.	1999 Sep.	1999 Nov.
Assets	698	585	622	749	1,038	968	966	1,022	1,064
Foreign assets	40	51	39	63	128	116	86	78	90
Short-term	40	40	40	40	40	40	40	40	40
Long-term	0	0	0	0	0	0	0	0	0
Domestic assets	657	534	583	686	910	851	880	943	974
Claims on central government	2	2	1	2	2	3	5	4	3
Claims on private sector 2/	632	516	573	683	901	837	868	903	931
Reserves	23	15	7	0	5	10	6	34	38
Liabilities	698	585	622	749	1,038	968	966	1,022	1,064
Foreign liabilities	382	457	474	532	533	548	561	580	593
Short-term	1	1	4	7	25	18	17	24	27
Long-term	381	456	470	525	508	530	544	556	565
Domestic liabilities	316	128	148	217	505	419	405	441	471
Demand deposits	86	70	42	94	268	162	165	170	182
Central government	34	37	14	24	76	62	50	54	54
Other 2/	52	34	28	69	192	99	115	116	128
Time and saving deposits	92	44	31	60	182	179	160	167	168
Central government	17	31	10	20	63	35	26	28	27
Other 2/	76	12	21	40	119	144	133	140	141
Credit from monetary authorities	5	15	25	0	0	0	0	0	0
Bonds	0	0	0	14	10	10	9	9	9
Other items (net) 3/	132	-1	50	50	45	69	72	95	113
Memorandum item:				(In percent of total deposits)					
Total deposits	100	100	100	100	100	100	100	100	100
Demand deposits	43	47	50	55	53	41	47	46	48
Central government	11	6	6	4	3	9	8	9	8
Other	32	41	45	52	50	33	39	37	40
Of which: Foreign currency	32	41	45	52	50	33	39	17	13
Time, savings and foreign currency deposits	57	53	50	45	47	59	53	54	52
Central government	10	38	16	15	16	12	9	9	8
Other	47	15	34	30	31	47	45	45	44
Of which: Foreign currency	47	15	34	30	31	47	45	45	44

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

1/ Excluding the National Bank of Republika Srpska (NBRS) classified among deposit money banks as of August 1997. At the official exchange rate of Yugoslav dinar (YUD) 1 per DM until November 16, 1995, YUD 3.3 per DM through March 1998, and YUD 6.0 per DM for the remainder of 1998. Following the freeze on payment bureau transactions with Belgrade, the exchange rate deteriorated from YUD 8 per KM in January 1999 to YUD 18-20 per KM by end-year. By mid-1999, YUD balances had declined from 80 percent to 20 percent of commercial bank deposits and in November 1999 YUD payments were eliminated from the payment system.

2/ Including nonfinancial enterprises, nonbank financial institutions, households, and other nongovernment sectors.

3/ Including assets and liabilities relating to frozen foreign exchange deposits.

Table 33. Bosnia and Herzegovina: Summary Balance Sheet of the Commercial Banks Operating in the Federation, December 1994-November 1999 1/

(In millions of convertible marks; end of period)

	1994 Dec.	1995 Dec.	1996 Dec.	1997 Dec.	1998 Dec.	1999 Mar.	1999 Jun.	1999 Sep.	1999 Nov.
Assets	2,814	2,865	3,630	4,332	4,389	4,387	4,483	4,540	4,592
Foreign assets	527	595	862	1,088	984	1,007	1,106	1,180	1,019
Short-term	224	306	546	743	675	700	796	858	697
Long-term	303	290	316	345	310	307	310	322	323
Domestic assets	2,287	2,270	2,769	3,244	3,405	3,380	3,377	3,360	3,573
Claims on general government	13	8	16	24	29	34	33	30	25
Central government	12	8	13	19	20	20	18	11	9
Other government	1	0	3	5	9	14	15	19	16
Claims on private sector 2/	2,255	2,214	2,687	3,149	3,291	3,257	3,264	3,218	3,316
Reserves	20	47	66	71	85	89	80	112	231
Liabilities	2,814	2,865	3,630	4,332	4,389	4,387	4,483	4,540	4,592
Foreign liabilities	2,442	2,404	2,629	2,812	2,793	2,738	2,760	2,773	2,782
Short-term	73	95	133	200	190	186	182	186	173
Long-term	2,369	2,309	2,495	2,612	2,602	2,553	2,578	2,587	2,608
Domestic liabilities	372	462	1,002	1,520	1,596	1,649	1,723	1,767	1,810
Demand deposits	168	286	550	622	733	636	717	774	909
General government	19	26	63	61	58	63	74	69	111
Central government	7	10	39	19	23	21	23	24	24
Other government	12	16	24	41	35	43	51	45	87
Other 2/	148	259	487	562	675	573	643	705	798
Time and savings deposits	60	91	232	507	465	585	563	558	516
General government	16	53	137	210	127	125	119	109	76
Central government	16	53	132	174	110	106	98	91	59
Other government	0	0	5	36	17	19	20	19	18
Other 2/	44	39	95	296	338	460	444	449	439
Credit from monetary authorities	5	2	13	0	0	0	0	0	0
Other items (net) 3/	138	82	207	392	398	428	443	435	385
Memorandum items:				(In percent of total deposits)					
Total deposits	100	100	100	100	100	100	100	100	100
Demand deposits	74	76	70	55	61	52	56	58	64
Central government	3	3	5	2	2	2	2	2	2
Other	70	73	65	53	59	50	54	56	62
Of which: Foreign currency	66	67	56	42	47	37	40	39	32
Time, savings and foreign currency deposits	26	24	30	45	39	48	44	42	36
Central government	7	14	17	15	9	9	8	7	4
Other	19	10	13	29	30	39	36	35	32
Of which: Foreign currency	19	9	12	29	29	39	36	35	31
Claims on NBBH for frozen foreign exchange deposit	2,328	2,294	2,298	2,336	2,319	2,335	2,344	2,343	2,343

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

1/ Consolidated balance sheet of commercial banks operating in the Federation. Excluding the National Bank of Bosnia and Herzegovina (NBBH) classified among deposit money banks as of August 1997.

2/ Including nonfinancial enterprises, nonbank financial institutions, households, and other nongovernment sectors.

3/ Including assets and liabilities relating to frozen foreign exchange deposits.

Table 34. Bosnia and Herzegovina: Selected Interest Rates of Commercial Banks in Republika Srpska, June 1998-June 1999 1/

(In percent per annum) 1/

	1998						1999			
	June		September		December		March		June	
	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.
Lending										
Short-term										
KM	...	...	...	...	...	...	12.0	43.3	9.0	30.0
YUD	20.0	218.0	20.0	218.0	20.0	218.0	27.2	218.0	12.0	101.0
Long-term										
KM	...	...	...	...	...	...	6.0	27.2	8.0	20.0
YUD	6.0	218.0	6.0	218.0	5.0	218.0	5.0	218.0	6.0	43.0
Deposit										
Demand deposits										
KM	...	...	...	...	...	...	1.0	35.0	0.8	20.0
YUD	3.0	36.0	1.0	112.7	1.0	102.3	1.0	77.0	3.0	35.0
Time and Savings deposits										
KM	...	...	...	...	...	...	2.0	35.0	2.0	15.0
YUD	6.0	60.1	8.0	152.2	8.0	102.3	8.0	60.1	8.0	48.0

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

Table 35. Bosnia and Herzegovina: Selected Interest Rates of Commercial Banks in the Bosniac-Majority Area, June 1998-June 1999 1/

(In percent per annum) 1/

	1998						1999			
	Jun.		Sep.		Dec.		Mar.		Jun.	
	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.
Lending										
Short-term										
Nonfinancial public enterprises	18.0	44.3	18.0	48.0	16.7	43.8	16.8	43.8	16.2	42.6
Private enterprises and cooperatives	6.0	44.3	6.0	43.8	6.0	43.8	6.0	43.8	6.0	42.6
Households	9.4	42.6	9.4	42.6	9.4	42.6	6.0	42.6	6.0	42.6
Long-term										
Nonfinancial public enterprises	1.8	30.0	1.8	30.0	1.8	18.0	1.8	36.0	1.0	36.0
Private enterprises and cooperatives	2.0	30.0	2.0	30.0	2.0	24.0	2.0	36.0	2.0	36.0
Households	5.0	30.0	5.0	30.0	5.0	19.0	2.2	42.0	2.0	42.0
Deposit										
Demand deposits										
Nonfinancial public enterprises	1.5	26.0	1.5	13.5	1.0	12.0	1.0	12.1	0.5	11.0
Private enterprises and cooperatives	1.0	26.0	1.0	6.2	1.0	12.0	1.0	11.0	0.5	11.0
Households	1.0	30.0	1.4	12.0	1.0	12.0	1.0	15.0	0.5	15.0
Time and Savings deposits										
Nonfinancial public enterprises	3.0	16.1	3.0	15.9	3.0	16.1	3.0	15.0	3.0	16.8
Private enterprises and cooperatives	3.0	16.0	3.0	15.9	1.0	15.0	3.0	15.0	2.0	15.0
Households	2.5	20.6	3.0	19.0	1.5	19.8	2.0	19.8	2.0	15.0

Sources: Data provided by the National Bank of Bosnia and Herzegovina (NBBH) until August 1997, and by the Central Bank of Bosnia and Herzegovina (CBBH) thereafter.

1/ Annual interest rates as of end of period. Data for earlier periods are not available under the same format.

Table 36. Bosnia and Herzegovina: Balance of Payments, 1994-1999
(In millions of U.S. dollars)

	1994 Est.	1995 Est.	1996 Est.	1997 Est.	1998 Est.	1999 Est.
Trade balance	-803.0	-930.0	-1,546.0	-1,758.2	-1,756.4	-1,414.7
Exports, f.o.b.	91.0	152.0	336.0	575.0	816.8	972.8
Imports, f.o.b.	-894.0	-1,082.0	-1,882.0	-2,333.2	-2,573.2	-2,387.5
Reconstruction	0.0	0.0	-796.0	-573.5	-715.3	-563.5
Humanitarian (in-kind)	-561.0	-459.0	-246.0	-359.7	-136.1	-52.1
Other	-333.0	-623.0	-840.0	-1,400.0	-1,721.7	-1,771.9
Services, net	-88.0	-23.0	-74.0	154.0	258.5	329.9
Receipts	103.0	229.0	322.0	427.0	549.8	590.5
Expenditure	-191.0	-252.0	-396.0	-273.0	-291.3	-260.7
Income, net: Interest due 1/	-165.0	-242.0	-222.0	-228.0	-110.6	-79.4
Interest due 1/	-165.0	-242.0	-222.0	-228.0	-110.6	-79.4
Unrequited transfers, net	879.0	1,002.0	1,094.0	772.0	510.0	397.3
Receipts	888.0	1,073.0	1,251.0	852.0	550.0	397.3
Official	315.0	377.0	558.0	422.0	190.0	179.8
Private	573.0	696.0	693.0	430.0	360.0	217.4
Expenditure	-9.0	-71.0	-157.0	-80.0	-40.0	0.0
Current account balance	-177.0	-193.0	-748.0	-1,060.2	-1,098.4	-767.0
Excluding official transfers	-492.0	-570.0	-1,306.0	-1,482.2	-1,288.4	-946.9
Capital transfers for reconstruction	0.0	0.0	841.5	573.8	726.8	535.5
Foreign investment (net)	0.0	0.0	0.0	0.0	100.0	60.0
Multilateral and Paris Club creditors	-119.0	-144.0	628.0	126.3	180.8	255.2
Disbursements	0.0	0.0	865.0	176.3	223.3	266.5
Reconstruction	0.0	0.0	244.0	176.3	223.3	201.5
Other 2/	0.0	0.0	621.0	0.0	0.0	65.0
Amortization	-119.0	-144.0	-237.0	-50.0	-42.4	-11.2
Other creditors (net)	-139.0	-127.0	-114.0	-107.0	-74.5	-74.1 0.0
Capital account balance	-258.0	-271.0	1,355.5	593.0	933.1	1,203.9
Errors and omissions 3/	-1.0	-23.9	-211.0	252.1	-91.1	94.4
Overall Balance	-436.0	-487.9	396.5	-215.1	-256.5	531.2
Financing	436.0	487.9	-396.5	215.1	256.5	-531.2
Net foreign assets (increase, -)	6.0	-35.2	-292.5	-90.0	50.8	-602.0
Central bank 4/	15.0	-18.2	-163.6	154.4	-94.2	-300.2
Commercial banks	-9.0	-17.0	-128.9	-244.4	144.9	-301.8
Net use of Fund resources	0.0	17.7	-2.1	-1.0	34.1	18.6
Purchases/loans	0.0	45.0	0.0	0.0	34.1	38.9
Repurchases/repayments	0.0	-27.3	-2.1	-1.0	0.0	-20.3
Short-term liabilities (reduction, -)	7.0	19.2	23.0	0.0	0.0	0.0
Arrears (reduction, -)	423.0	486.2	-125.0	306.0	-1,489.0	-825.2
Multilateral creditors 5/	...	...	-475.0	8.0	24.8	-39.8
Paris Club creditors 6/	...	...	102.0	48.0	-815.3	0.0
London Club 7/	...	...	135.0	145.0	-740.6	0.0
Other creditors 8/	...	...	113.0	105.0	42.1	-785.4
Debt Rescheduling (of Arrears)	0.0	0.0	0.0	0.0	1,555.9	12.4
Multilateral creditors 5/	0.0	0.0	0.0	0.0	0.0	12.4
Paris Club creditors	0.0	0.0	0.0	0.0	815.3	0.0
London Club	0.0	0.0	0.0	0.0	740.6	0.0
Debt Relief, current maturities (cashflow)	0.0	0.0	0.0	0.0	104.8	59.2
Multilateral creditors 5/	0.0	0.0	0.0	0.0	0.0	0.0
Paris Club creditors 9/	0.0	0.0	0.0	0.0	35.5	-6.7
London Club 9/	0.0	0.0	0.0	0.0	69.3	65.9
Total financing gap 10/	0.0	0.0	0.0	0.0	0.0	805.8
Memorandum items:						
Current account balance	-14.1	-10.2	-27.3	-31.0	-28.2	-17.4
excluding official transfers	-39.2	-30.0	-47.6	-43.3	-33.0	-21.4
External debt/GDP (in percent)	...	...	...	...	73.7	70.6
Debt service/Exports (in percent)	...	...	...	...	16.6	7.9
Gross official reserves (in months of imports)	0.6	0.6	1.2	0.4	0.7	2.2

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

1/ Includes late interest through end-1997. Original maturities.

2/ Includes assistance committed at the May 1999 donors conference.

3/ Includes valuation adjustment of exchange rate changes.

4/ From August 1997, liabilities to the Fund are classified as liabilities of the State. Excludes foreign exchange held by Payments Bureaus.

5/ Clearance of IBRD arrears on June 14, 1996. Includes arrears to the Council of Europe Social Development Fund, the European Investment Bank, and the IFC.

6/ Reflects Paris Club debt consolidation agreed in October 1998.

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

8/ Assumes a debt restructuring agreement by end-1999 to clear arrears.

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

10/ The financing gap in 1999 is fully covered by other rescheduling and debt relief.

Table 37. Bosnia and Herzegovina: External Debt at End-1998 1/ 2/ 3/

(In millions of U.S. dollars)

	Debt	
	Arrears	Estimates
Total debt outstanding	809.0	2,981.4
Amortization	...	...
Multilateral	40.8	1,178.8
IMF	0.0	76.8
World Bank 4/	0.0	1,014.0
Other	40.8	88.0
Paris Club 5/	0.0	529.5
London Club 5/	0.0	400.4
Other creditors 5/ 6/	490.6	594.0
Non-convertible currency debt 5/	277.6	278.7
New Debt (disbursed after end-1997) 6/		

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

1/ Excludes an estimated US$54 of payments arrears at end-1997 for gas supplied from the Russian Federation, which is in dispute. Also excludes about US$200 million of claims on BiH banks for guarantees provided for construction work not completed, 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.

2/ The authorities reported that BiH had claims amounting to about US$1.2 billion at end-1991 on other countries (excluding states of the former SFRY) mainly in the Middle-East and North Africa. In addition, BiH has a claim on the foreign exchange reserves of the former SFRY.

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

4/ Includes late interest through end-1998 for other creditors and non-convertible debt creditors. 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; presentation is provisional, pending agreements with bilateral creditors.

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

6/ Bilateral debt database is incomplete; debt service projections are approximate.