

Bosnia and Herzegovina: First Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria

In the context of the first review under the Stand-By Arrangement and request for waiver of performance criteria of **Bosnia and Herzegovina**, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **November 13, 2002** with the officials of Bosnia and Herzegovina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 3, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **December 18, 2002** updating information on recent economic developments.
- a News Brief summarizing the views of the Executive Board as expressed during its **December 20, 2002** discussion of the staff report.

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

Letter of Intent by the authorities of Bosnia and Herzegovina of December 4, 2002*
Supplementary Memorandum of Economic and Financial Policies by the authorities of
Bosnia and Herzegovina*
Supplementary Technical Memorandum of Understanding*

*May also be included in Staff Report.

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund ☎ Publication Services
700 19th Street, N.W. ☎ Washington, D.C. 20431
Telephone: (202) 623 7430 ☎ Telefax: (202) 623 7201
E-mail: publications@imf.org ☎ Internet: <http://www.imf.org>

Price: \$15.00 a copy

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

BOSNIA AND HERZEGOVINA

**First Review Under the Stand-By Arrangement and Request for Waiver of
Performance Criteria**

Prepared by the European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Carlo Cottarelli and G. Russell Kincaid

December 3, 2002

The Fund staff met: (a) at the State level, Members of the Presidency: Messrs. Tihic, Covic, and Sarovic; Minister of Treasury, Mr. Domazet; Minister of Foreign Economic Relations Ms. Hadziahmetovic; Central Bank Governor Mr. Nicholl; (b) in the Federation of Bosnia and Herzegovina: Prime Minister Behmen; Deputy Minister and Acting Minister of Finance Hafizovic; Defense Minister Anic; Minister of Justice Mijan; and Veterans' Affairs Minister Hadzovic; and (c) in the Republika Srpska: President Cavic, Prime Minister Ivanic; Finance Minister Vilendecic; Defense Minister Bilic, Agriculture Minister Trkulja, and Deputy Minister of Justice Mandic. The Fund staff also met with High Representative Lord Ashdown, and representatives of all major political parties in both Entities, representatives of the international community, and representatives of business and labor.

The staff team comprised by Messrs. Doyle (Head), Lazar, and Kanda (all EU1), Mr. Taube (FAD), and Mr. Almekinders (PDR), and was assisted by Ms. Fichera, Ms. Selimovic-Mehmedbasic, and Ms. Milic in the Resident Representative's office.

Table of Contents

	Page
Executive Summary	5
I. Introduction.....	6
II. Background.....	6
III. Report on the Discussions.....	10
A. Fiscal Policy and Performance Criteria for 2002.....	10
B. Macroeconomic Framework for 2003 and the Medium Term.....	13
C. Fiscal Policy for 2003	13
D. Strengthening the Fiscal System.....	15
E. Monetary and Financial Sector Policies	16
F. Structural Reforms	18
IV. Staff Appraisal	20
Text Tables	
1. Output, Bank Credit, and Inflation, 2001–2003	7
2. External Accounts, 2001–2002.....	7
3. Manufacturing Trends, 2000–2002.....	8
4. Fiscal Outturn, 2001–2002.....	8
5. Republika Srspska Central Government, 2002	10
6. Federation Central Government, 2002.....	11
7. State Government, 2002.....	12
8. Escrow Flows and Balances, end-September 2002	12
9. Macro Framework, 2002–2003.....	13
10. Medium-Term Adjustment, 2000–2006	13
11. Revenue of General Government, 2002–2003.....	14
12. Expenditure of the General Government, 2002–2003	14
13. Financing of the General Government, 2002–2003.....	14
Figures	
1. Selected Financial and Economic Indicators, 1998–2002	23
2. Selected Indicators by Entity, 1997–2002	24
3a. Indicators of Manufacturing, 1999–2002	25
3b. Real Effective Exchange Rate, 1999–2002	26
4a. Central Government Tax Revenue, 2000–2003.....	27
4b. Government Revenue, 2001–2003.....	28
Text Boxes	
1. The Dayton Constitutional Arrangements	6
2. Tax Administration Requirements.....	15
3. Public Expenditure Reform.....	16

4.	Strengthening the Business Environment	18
----	--	----

Tables

1a.	Selected Economic Indicators, 1998–2003	29
1b.	Selected Economic Indicators for the Entities, 1998–2003	30
2.	Monetary Survey, 1997–2002	31
3.	Balance of Payments, 2000–2006	32
4a.	General Government, 1998–2003	33
4b.	General Government, 1998–2003	34
4c.	General Government, 1998–2003	35
4d.	General Government, 1998–2003	36
4e.	General Government, 1998–2003	37
4f.	General Government, 1998–2003	38
4g.	Federation Fiscal Operations, 2000–2003	39
4h.	Republika Srpska Fiscal Operations, 2001–2003	40
4i.	State Fiscal Operations, 2000–2003	41
5a.	Quantitative and Structural Performance Criteria Under the 2000–2003 Stand-By Arrangement	42
5b.	Prior Actions and Structural Benchmarks, March 2002–March 2003	43
6.	Medium-Term Reform Scenario, 2000–2006	44
7.	External Financing Requirements and Possible Sources of Financing, 2000–2003	45
8.	Vulnerability Indicators, 2000–2006	46

Appendices

I.	Fund Relations	47
II.	IMF-World Bank Relations	50
III.	Statistical Issues	59
IV.	Letter of Intent and Supplementary Memorandum on Economic and Financial Policies	62
	Table 1. State Fiscal Operations, 2002–2003	73
	Table 2a. Federation Fiscal Operations, 2002–2003	74
	Table 2b. Federation Pension Fund, 2002–2003	75
	Table 3a. Republika Srpska Fiscal Operations, 2002–2003	76
	Table 3b. Republika Srpska Pension Fund, 2002–2003	77
	Table 4. Quantitative and Structural Performance Criteria Under the 2002–2003 SBA	78
	Table 5. Structural Benchmarks, September 2002–June 2003	79
V.	Supplementary Technical Memorandum of Understanding on Definitions and Reporting Under the 2002–2003 Economic Program	80
VI.	Robustness of Key Policy Recommendations to Data Deficiencies	87

ABBREVIATIONS AND ACRONYMS

BiH	Bosnia and Herzegovina
BEAC	Business Environment Adjustment Credit
CBBH	Central Bank of Bosnia and Herzegovina
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign Direct Investment
FIPA	Foreign Investment Promotion Agency
GDFI	Gross Domestic Fixed Investment
GDP	Gross Domestic Product
HR	High Representative
IBRD	International Bank for Reconstruction and Development
IDA	International Development Assistance
IMF	International Monetary Fund
MAE	Monetary Affairs and Exchange
OSCE	Organization for Security and Cooperation in Europe
PC	Performance Criteria
PRSP	Poverty Reduction Strategy Paper
RS	Republika Srpska
SME	Small and Medium Enterprises
TIN	Tax Payer Identification Number
USAID	United States Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization

Executive Summary

A Stand-By Arrangement (SBA), amounting to SDR 67.6 million (40 percent of quota), was approved on August 2, 2002 and will expire in November 2003. In approving the arrangement, Directors noted the need for action in view of decelerating economic activity, high unemployment, and a large external current account deficit and welcomed the program's focus on fiscal discipline, the currency board, and further structural reform.

A staff team visited Banja Luka and Sarajevo during October 29–November 15, 2002, and reached understandings with the authorities on the completion of the first review of the SBA.

Good progress has been made under the program. Economic activity and fiscal consolidation have exceeded expectations, inflation is very low, and fiscal and structural reforms proceed apace. GDP is expected to grow 4 percent in 2002, up from the programmed 2¼ percent, reflecting strengthened industrial activity and good harvests, buoyed by booming bank credit to households. Reflecting both stronger tax administration and expenditure restraint, the consolidated fiscal deficit is expected to be 1½ percentage points of GDP lower than the programmed 5½ percent of GDP in 2002. Anchored by the currency board, CPI inflation has declined to about ¼ percent for 2002, with slightly negative inflation in the Federation, and a further decline of RS inflation towards Federation levels.

However, there have been slippages relative to program conditionality. The performance criteria on ceilings on gross borrowing by Federation cantons and municipalities, and RS extra budgetary funds were breached. These were not symptomatic of significant macroeconomic problems, and corrective action has been taken in every case. Accordingly, the **staff is recommending waivers** for the breaches of performance criteria, and completion of the first review.

Immediate risks to the macro framework relate to the passage of 2003 budgets for both entities. Given the long delays in forming new governments following the October elections, senior political leaders from all parties have pledged to support the passage by early December of budgets for 2003 which are based on unchanged wage, tax, pension, and benefit rates and eligibilities from those prevailing at end-2002. When the new administrations form they can adjust those budgets in consultation with staff. However there is a clear understanding across all parties of the need for fiscal discipline.

Notwithstanding the progress, **self-sustained growth is yet to take hold**, and private sector activity has been held back by slow progress in large scale privatization and bureaucratic impediments to entry, exit, and restructuring of businesses. The passage of a strong bankruptcy law in the RS in September, and presentation of a similar law to the Federation parliament represent significant steps in the right direction. However, passage of the Federation law has been hampered by concerns over increased unemployment. Thus a substantial structural agenda lies ahead in improving the business environment, privatization, and enterprise restructuring, in order to stimulate investment and exports.

I. INTRODUCTION

1. **A Stand-By Arrangement (SBA) for SDR 67.6 million that expires on November 1, 2003 (40 percent of quota) was approved on August 2, 2002 and the first purchase of SDR 19.6 million was made shortly thereafter.** Discussions for the first review were held in Banja Luka and Sarajevo during October 29–November 15, 2002.

2. At the August Board meeting, Directors welcomed strengthened policies to support economic and employment growth and low inflation. Given contracting external aid inflows, the program targets a fiscal consolidation of 3½ percentage points of GDP from 2001–2003, largely underpinned by stronger tax administration and expenditure control, and military demobilization. Placement of one-off receipts into escrow supports this stance and anticipates a write-down of unsustainable domestic claims on government. Alongside, activity will be stimulated through a strengthened business environment and privatization.

3. In the October parliamentary and presidential elections held under the complex Dayton constitutional arrangements, the incumbent coalitions fared poorly (Box 1). Replacement coalitions—which will enjoy four-year terms, up from two hitherto—may not form for some time and their likely composition, even almost two months after the elections, remains unclear. Meanwhile, the High Representative (HR), Lord Ashdown, has mandated a raft of economic laws, including on national statistics, telecoms, treasury operations in the Federation, and banking. He has also committed BiH to adopt a state-level-administered VAT by 2004, is exploring options to strengthen customs administration, and has proposed mechanisms to strengthen State political functions. As these initiatives are perceived as harbingers of greater centralization, they have elicited resistance, notably in the RS.

Box 1. The Dayton Constitutional Arrangements

Bosnia and Herzegovina comprises of two Entities: the Republika Srpska (RS) and the Federation. The RS is highly centralized and predominantly Serb, accounting for 1/3 of the BiH population. The Federation is highly devolved with 10 autonomous ethnically based cantons. It is mainly Bosniac and Croat and accounts for the remaining 2/3 of the population. The Entities have co-dominion over the tiny Brcko district, which abuts both.

The Entities and Brcko enjoy significant autonomy including on key aspects of fiscal policy. The State Government has limited responsibilities, including customs, foreign affairs, and foreign debt service.

On behalf of the main powers party to Dayton, the High Representative oversees the political aspects of the Dayton Peace Agreement. He enjoys sweeping powers to pass or veto laws, ban political parties, and remove individuals from elected office and the civil service. These powers have been extensively used.

II. BACKGROUND

4. **Bosnia and Herzegovina has made good economic progress under the program.** Real activity growth and fiscal consolidation have exceeded expectations, and fiscal and structural reforms proceed apace.

5. **Industrial output data indicate growth through the year while inflation remains subdued (Text Table 1, Table 1, and Figure 1).** Good harvests after two poor years and the stimulus to household spending of rising incomes and strong bank consumer credit have lifted output, offsetting a negative fiscal stimulus and (as signaled by bank credit to firms) moribund enterprise investment (Table 2). These factors attenuate the negative carry-over effect of weakening activity through 2001, and accordingly annual GDP growth looks set to show a moderate decline to 4 percent in 2002, from 4½ percent in 2001. Anchored by the currency board, inflation has been lower than programmed—roughly zero in the first 9 months of 2002 in the Federation, while RS prices continue to converge to those of the Federation (Figure 2). Reflecting the lower-than-expected inflation, nominal GDP growth is slightly lower than programmed.

	2001	2002		2003
	Est.	Program	Rev.	Proj.
Industrial production growth				
Federation	12.2	...	7.5 ^{1/}	...
RS	-17.8	...	-7.0 ^{1/}	...
Bank credit to households				
BiH	77.5	...	106.7 ^{2/}	
Federation	80.7	...	99.8 ^{2/}	
RS	18.6	...	265.0 ^{2/}	
Bank credit to enterprises				
BiH	0.9	...	2.3 ^{2/}	
Federation	0.6	...	2.9 ^{2/}	
RS	1.3	...	1.2 ^{2/}	
Real GDP growth				
BiH	4.5	2.3	3.9	4.7
Federation	6.0	3.2	4.7	5.6
RS	-2.5	0.0	1.5	2.0
12-month CPI (p.a.)				
BiH	3.1	2.3	0.3	0.5
Federation	1.9	1.5	-0.2	0.5
RS	7.0	4.4	1.9	0.7

1/ Q1-3 2002 over Q1-3 2001.
2/ 12-month growth to September 2002.

6. **Nevertheless, the external deficit remains high, international reserves have declined modestly, and increases in employment and wages may not be sustainable:**

- Export and import growth rates for 2002 remain below earlier post conflict highs, partly reflecting the weakening external environment, at around 8½ and 4 percent respectively in US\$ terms (Text Table 2 and Table 3). On the financial account, delays in implementation and approval of donor programs are reflected in lower than originally projected official inflows. Accordingly, gross official international reserves have declined from their

	2001	2002	
		Prog.	Rev.
Growth of US\$ Exports (%)	2½	16	8½
Growth of US\$ Imports (%)	5½	3½	4
(In millions of U.S. dollars)			
Current account balance	-1,126	-986	1,172
Increase in reserves (-)	-766	-319	50
Amortization	-15	-46	-33
Disbursements			
World Bank program loans	42	78	63
EU macro assistance (loans)	9	11	0
Donor's capital projects	486	375	375
FDI	130	240	240
Other net inflows ^{1/}	1,228	625	456
Net use of IMF resources	11	22	21

^{1/} Incl. DMs swapped for KMs when euros were introduced.

end-2001 peaks, albeit remaining at 4½ months of imports and more than covering base money.

- The number of workers paid—as distinct from those officially employed but not paid—has risen markedly during 2002, making a dent in unemployment estimated by the World Bank at 16 percent strictly defined, rising to around 30 percent when returning refugees and “discouraged workers” are taken into account (Text Table 3 and Figure 3). But with average wages paid—as opposed to wages accrued—rising alongside, notably in the Federation, unit labor costs have risen well in excess of output prices. Thus, these job and wage gains have come at the expense of already weak corporate profitability.

	2000	2001	2002
Growth in paid employment (manuf'g and mining)			
Federation	10	11	18 ^{1/}
RS	-7	-18	5 ^{2/}
Nominal gross wage growth (manuf'g)			
Federation	12	6	12 ^{3/}
RS	11	12	2 ^{2/}
Manufacturing prices / Unit Labor Costs			
Federation	100	96	81 ^{1/}
RS	100	87	78 ^{3/}

1/ Jan.-June 2002 over Jan.-June 2001.
 2/ Jan.-Sep. 2002 over Jan.-Sep. 2001.
 3/ Jan.-Aug. 2002 over Jan.-Aug. 2001.

7. **On the policy front, significant progress has been made, notably with respect to the fiscal stance (Text Table 4 and Table 4).** With output and demand rising faster than programmed, the consolidated fiscal deficit is projected to be 1½ percentage points of GDP smaller than programmed (Text Table 4). Overall, performance reflects the impact of higher activity on revenue, strengthened tax administration, and tight control on spending, and it is concentrated in the Federation. It occurs despite the one-off costs of demobilization in 2002, which will yield annual future savings of around 1 percent of GDP. This progress is matched in structural fiscal reforms, including initiation of the Treasury systems and overall harmonization of indirect taxes (Table 5).

	2001	2002	2002
		Prog.	Proj.
BIH			
Revenue (incl. grants)	51.8	53.0	52.2
Expenditure	57.5	58.6	56.2
Balance	-5.8	-5.5	-4.0
<i>Of which:</i>			
Federation	-1.2	-1.8	-0.8
RS	-1.2	-0.2	-0.2
State	0.0	-0.1	-0.0
Foreign projects	-3.4	-3.4	-3.0

8. **Other structural reforms have also advanced.** Free trade agreements are now in effect with regional partners and WTO accession is anticipated by January 2004. The business environment has been strengthened with the adoption of a strong IBRD-approved bankruptcy law in the RS and a new State Level FDI law, the establishment of an Investment Promotion Agency, and IBRD-supported action to cut bureaucratic burdens on business. New banking laws tighten corporate governance rules and increase the independence of the banking supervision agency. Though large scale privatization stalled, small scale, voucher,

and bank privatization has been all but completed in both Entities; only some 10 percent of bank capital remains in state hands. Rules restricting mutual funds were liberalized in the RS allowing funds to obtain majority stakes in individual companies.

9. Despite this progress, there has been slippage relative to program conditionality (Table 5)¹:

- Staff was informed in September that the prior action requiring timely transfer of funds from Entities to the State had not been observed in June. Consequently, the first purchase under the arrangement was noncompliant and from July 1, arrears on external debt were accrued to two official German creditors amounting to US\$2.5 million by end-July. All arrears were cleared by September 25, 2002 (¶10, bullet 1). This breach is discussed in the report on Noncomplying Purchase and Recommendation for Waiver of Non Observance of a prior action (EBS/02/193). In addition, the text of the SBA will be amended in regard to external payments arrears to provide for a continuous zero ceiling on the outstanding stock of such arrears. This brings the text into line with the authorities' letter of intent and Memorandum of Economic and Financial Policies (MEFP) and the supplementary MEFP (SMEFP)
- Ceilings on gross borrowing from banks which were established as performance criteria for Cantons and Municipalities in the Federation, and for the extra budgetary funds (EBFs) in the RS, were exceeded (¶10, bullets 2–4). Cantons and Municipalities had borrowed prior to the program to fund current activities and arrears clearance, as had the RS EBFs. Subsequently, in the first and third of these cases, the debtors held bank deposits which, for various technical and logistical reasons, they were unable to withdraw to repay their gross bank debt until after the test date. These ceilings on gross bank debts are intended to check borrowing ahead of a possible restructuring of domestic claims on government, to ensure effective discipline on the sub-components of general government, and along with program restrictions on use of other funding, to maintain control of the overall fiscal deficit. As described in the attached SMEFP, corrective actions have been taken in each case.
- The RS and the Federation cut oil taxes in November in protest at the Breko district's failure to introduce the tax, thereby breaching the commitment to maintain or increase harmonization of indirect taxation. The dispute was rapidly resolved, both Entities have restored their prior tax rates, and Breko will introduce the tax by end-year.
- The RS has not yet secured passage of amendments to its budget law to prevent further municipal indebtedness to commercial banks as anticipated in an end-June structural benchmark. But existing controls on this are tight—with borrowing subject to strict limits and to investment and within year cash-flow purposes, and subject to

¹ Paragraph numbers refer to paragraphs in the attached Supplementary Memorandum of Economic and Financial Policies (SMEFP).

full reporting—and it remains low. Further efforts to secure passage of the amendments will be made.

III. REPORT ON THE DISCUSSIONS

10. **Much has been accomplished but a daunting triple agenda awaits the incoming administrations:** (i) to reduce the current account deficit as aid flows decline; (ii) to implement deep enterprise restructuring, the last and most socially challenging of the “transition” reforms; and (iii) to rationalize government structures without inflaming the sensitivities which current arrangements reflect. In anticipation of this, discussions during the mission focused on securing a smooth economic transition to the new administrations and a review with all major political parties of economic challenges ahead.

A. Fiscal Policy and Performance Criteria for 2002

11. **The authorities noted that more progress than expected under the program was made in reducing fiscal imbalances, even as major one-off costs of military demobilization were incurred:**

- The RS authorities noted that excises and sales tax performed particularly strongly, primarily due to better tax administration—pursuing tax defaulters, applying EU customs valuation procedures, and harmonizing TINs with the Federation (Text Table 5). Revenue gains and lower-than-projected debt service payments had prevented pension cuts, and had financed the clearance of benefit and supplier arrears, part of a severance package for 1,000 military service personnel (alongside succession monies), and other items. The pensions’ allocation was aimed to strengthen the social safety net, while fiscal and military efficiency concerns motivated the demobilization. And looking ahead:

(In percent of BiH GDP)	2002		
	Budget	Prog.	Proj.
Revenue	7.5	7.4	8.5
Expenditure	8.6	8.4	9.4
<i>Of which:</i>			
Transfer to pensions	0.1	0.1	0.9
Transfer to Electroprivredna	0	0.1	0.1
Military severance	0	0.2	0.2
Arrears clearance	0	0.1	0.3
Other	8.5	7.9	8.0
Balance (before grants)	-1.1	-1.0	-0.9
New spending arrears	0	0	0

(a) Allocations from the central budget to pensions and other key items have been increased so as to ensure adherence to the end-December performance criteria on bank borrowing, and to avoid arrears.

(b) In order to move the pension system towards self-sustainability, the authorities agreed to lower budget and other support for pensions from the 2002 outturn, and to split savings gained through structural reforms to the scheme between increased average pensions and reduced budgetary support for pensions (¶17).

(c) They also indicated that resource constraints meant that future severance payouts would have to be restricted to levels consistent with labor laws (¶18).

(d) Following the action to lower the Pension Fund gross bank debt, the central government will provide resources to the health fund to lower its debt before end-year.

In the context of these undertakings, the authorities were confident that the end-December and end-March performance criteria on RS central government and extra budgetary fund borrowing would be met.

- Revenue in the Federation, though well below budgeted levels is expected to be close to the program target due primarily to the impact of strengthened tax administration (Text Table 6). Steps

included passage and implementation of the new Tax Administration Law in May 2002 and application of tax stamps on cigarettes from August 2002. Spending of some 2.2 percent of BiH GDP in the 2002 budget that had been frozen pending a mid-year assessment of revenue—the delayed spending list (EBS/02/91 (5/30/02), para. 19, 2nd bullet)—was cancelled and other spending on goods,

	Budget	Prog.	Proj.
Total Revenue	12.0	10.0	9.5
Total Spending	15.0	12.8	11.4
<i>Of which:</i>			
Severance pay	1.0	1.0	0.9
Operations/Maintenance	0.5	0.5	0.4
Delayed spending list	0.0	2.2	0
Balance (after grants)	-2.9	-2.7	-1.6
Use of succession money	0.7	0.7	0.7
Reconstitution succession money	0	0	0.3
New spending arrears	0	0	0

services, and capital items was compressed below program estimates. But the demobilization of about 10,000 military service personnel (who each received KM 10,000, largely funded from succession monies) proceeded smoothly. And the spending containment on other items allowed reconstitution of succession monies of 0.3 percent of BiH GDP, ahead of program commitments to reconstitute in 2002 only out of stronger-than-programmed revenues (EBS/02/91 (5/30/02), page 59 para. 13 second bullet, and para. 14). While staff welcomed the strong fiscal deficit outturn, the steps on spending, and the early reconstitution of succession monies, they noted that cuts in operations and capital spending had raised sustainability concerns.

- The cantonal authorities reported that expenditure restraint had kept fiscal performance on track even as the stock of spending arrears was lowered. The nonobservance of the ceiling on cantonal bank borrowing occurred because coordination problems had delayed the clearance of the loans by use of privatization receipts until October. Staff welcomed the inter canton lending operations, the commitment to replace those funds in escrow when repaid, and to amortize remaining bank debt which would bring borrowing within the ceiling by end-December.

- The State authorities reported that the budget outturn excluding debt service payments is expected to be broadly in line with the program (Text Table 7). Staff welcomed the clearance in September of the mid-year external payments arrears and the undertaking to report to the Fund in writing monthly on transfers by the Entities for administrative and debt service purposes.

Text Table 7. State Government, 2002
(In percent of BiH GDP)

	Budget	Prog.	Outturn
Total Revenue	4.2	4.2	3.3
Total Spending	4.7	4.7	3.6
<i>Of which:</i>			
State Border Service	0.5	0.6	0.5
Debt service	2.8	2.9	2.1
Other	1.4	1.2	1.1
Balance (before grants)	-0.5	-0.5	-0.3
EU finance	0.1	0.1	0.1

12. **These gains on the fiscal balance are effectively locked in under the existing performance criteria through the end of 2002.** This is secured by the shortfall in external financing relative to program projections, and the program restrictions on domestic financing, including arrears and the placement of privatization receipts into escrow.

13. **Escrow accounts have been established pending a domestic debt settlement (Text Table 8) (§21).** The RS

escrow account includes privatization receipts since 1999, thereby exceeding formal program undertakings. Federation cantons—the beneficiaries of the bulk of Federation privatization receipts—opened escrow accounts in mid-year, placing all subsequent receipts there. These receipts anticipate a domestic debt settlement, preparations for which have included the initiation of registration of war-related claims in both entities.

Text Table 8. Escrow Flows and Balances, (End-September, 2002)
(In million KMs)

	Receipts	Uses	Recon.	Balance
RS				
Privatization (pre-Aug 2, 2002)	23.5	15.2	0	8.3
Privatization (post Aug 2, 2002)	4.7	0	4.5	17.5
Succession monies	38.5	10.2	0	28.3
Federation (Central Government)				
Privatization (pre-Aug 2, 2002)	...	...	...	...
Privatization (post Aug 2, 2002)	...	...	...	...
Succession monies	71.5	71.5	15.0 ¹	15.0 ¹
Cantons				
Privatization (pre-Aug 2, 2002)	0	0		0
Privatization (post Aug 2, 2002)	3.5	0		3.5

¹ Paid in November.

14. **Negotiations to resolve outstanding issues on external public debt continue.** The authorities await a response from Japanese representatives in regard to resolution of the outstanding issues pertaining to Paris Club debt. And negotiations on the nexus of issues relating to debts to Russia—including for 1992–95 gas imports and transferable ruble balances—continue.

B. Macroeconomic Framework for 2003 and the Medium Term

15. **The macro and fiscal outlooks for 2003 were assessed in light of developments in 2002 and revised medium-term projections (Table 6 and Text Table 9).** Given continued fiscal consolidation and maintenance of the currency board, the authorities agreed that output trends in 2002 and the prospect for a modest strengthening in external demand set the stage for activity growth of some 4¾ percent in 2003. But they acknowledged that the weakness and negative trends in corporate profitability would hold back the recovery and buoy the current account deficit. Inflation would remain broadly stable, with a further decline in the RS—reflecting further convergence of price levels between the Entities.

	2002		2003	
	Prog.	Rev.	Prog.	Rev.
GDP	2.3	3.9	4.1	4.7
RS	0.0	1.5	0.5	2.0
Federation	3.2	4.7	5.6	5.6
CPI	2.3	0.3	1.8	0.5
RS	4.4	1.9	2.5	0.7
Federation	1.5	-0.2	1.6	0.5
Current Account balance	-20.7	-22.4	-18.4	-19.5

16. **The fiscal deficit targets required to support this outturn in 2003 were discussed in the context of an assessment of medium-term prospects.** Given declining aid flows, fiscal adjustment is critical (Text Table 10). Even assuming a significant strengthening of the policy environment for corporate investment and savings—yielding increased growth of labor and total factor productivity, employment, and output—large rises in public savings will be essential to secure external adjustment on the scale required. These conclusions are robust to the main (and sizeable) uncertainties about the macro data for 2002

	2002	2003	2006
Capital and credit for reconstruction	7.7	6.0	2.9
Other capital flows	14.6	13.5	8.0
Current account balance	-22.3	-19.5	-10.9
Total Investment	19.1	20.5	22.5
Domestic savings	-11.5	-7.0	4.4
<i>Of which:</i>			
Private	-11.5	-9.4	-1.0
Public	0.0	2.5	5.4
Memorandum Items			
Fiscal Revenue	52.2	50.7	46.9
Fiscal Expenditure (KM millions)	6,127	6,053	6,939
Fiscal balance	-4.0	-2.1	-1.6
GDP growth rate	3.9	4.7	5.9

(Appendix VI). Accordingly, the authorities agreed that a consolidated fiscal deficit of 2.1 percent of GDP for 2003 was appropriate. In this context, they proposed that full reconstitution of succession monies would be secured during 2003 (¶15).

C. Fiscal Policy for 2003

17. **While new administrations form, the caretaker administrations and leaders of the main political parties agreed on provisional budget frameworks for 2003 (¶14).** Thus, within the agreed fiscal deficit targets, budgets for 2003 approved by parliaments

before end-2002 will be based on the understanding that these may be reviewed by the incoming administrations. This maintains fiscal order in the transition and allows new administrations to refocus budget priorities for 2003 so long as the budgets remain consistent with program objectives.

18. The budget frameworks for 2003, reflecting estimates discussed with staff, will be approved by the newly elected parliaments during December 2002.

- On the revenue side, the authorities agreed in the context of declining grants, that the full year effects of tax administration reforms during 2002 would raise revenue ratios moderately, offset by some declines in the average import tariff as past agreements on reductions come into effect (Text Table 11).

	2002	2003
Revenue	52.2	50.7
Indirect taxes	14.4	14.9
Trade taxes	9.0	8.8
Direct taxes	3.5	3.6
Social security contrib's	15.0	14.8
Grants	5.4	4.0

- Given the deficit target and revenue, non military and non-interest spending has to be broadly frozen in nominal terms (Text Table 12). This essentially implies maintaining pension, wages, and social benefit payments at 2002 nominal levels. Transfers to the State by the Entities have to rise moderately to ensure the financing of spending commitments for existing institutions. The agreed budget frameworks are reported in Tables 4a to 4i. With cantons prohibited from bank, arrears, and privatization finance, an overall balanced budget is anticipated.

	2002	2003
Expenditure	56.2	52.8
Interest	1.1	1.1
Military	4.4	3.1
Other	50.7	48.6
Other (in KM million)	5,527	5,570

- External financing comes from the World Bank and the EU (Text Table 13). International Development Assistance (IDA) adjustment credits which support improvements in the business environment and the social sector. The EU has split its anticipated program assistance of US\$60 million into three tranches, with the first disbursing in 2002 and with US\$20 million in loans anticipated for 2003,

	2002		2003	
	Proj.	Prog.	Prog.	Rev.
Foreign	4.0	3.0	2.9	
Budget support	2.0	1.6	1.7	
<i>Of which:</i>				
World Bank	1.2	0.6	0.5	
EU macro assistance	0	0.2	0.3	
Foreign investment projects	3.0	3.0	2.8	
Amortization	-1.0	-1.7	-1.7	
Privatization proceeds	0.1	1.5	0.1	
Domestic	0.4	-1.5	-0.5	
<i>Of which:</i> Succession money	0.4	-0.6	-0.4	
Change in stocks of arrears	-0.4	0	-0.2	
Fiscal balance	-4.0	-3.0	-2.1	

contingent on successful negotiations with the incoming administrations.

19. **In this light, the authorities intend to adopt budgets aimed to secure this further consolidation and propose to adopt as PCs the former indicative limits to end-March.** The caretaker authorities noted the importance of proceeding with budget preparation for 2003 and for associated early completion of the review under the SBA in order to ensure the smooth execution of budgets in early 2003 when tax revenues were seasonally low and accordingly the need for budget financing was at its seasonal peak. The risks that the formation of new administrations could be delayed well into 2003 underscored their sense of urgency on these issues. (¶ 21).

20. **But the authorities noted that some difficulties lay ahead when the 2003 budgets are adjusted.** Key amongst these would be the likely need for additional financing from the Entities to the State. While many new state institutions have been legislated, their inauguration has been postponed pending the formation of new administrations and the adoption associated of new budgets for 2003. These new institutions may place heavy demands on Entity funding for the State, requiring offsetting adjustments to Entity level spending, a task that will require determined technical and political coordination between the three budgets.

D. Strengthening the Fiscal System

21. **On tax policy and administration, commitments to maintain harmonization of indirect taxes remain and further actions are envisaged**

(¶20). Following the HR's initiative, the authorities are discussing how to move towards a VAT, with discussion focusing on a single rate state-administered VAT. Staff pointed out the technical advantages of the VAT over the existing sales taxes while noting that formal

Box 2. Tax Administration Requirements

Drawing on EU advice, the authorities are working towards several specific improvements, including: enforcement of uniform valuation methodology at all customs posts; (i) full implementation of Customs Policy Law (Federation and RS);(ii) developing proposals for better post-clearance controls; (iii) improving cooperation between Entity administrations; (iv) increasing the number of staff in the customs valuation unit at headquarters; and (v) strengthening audit.

incorporation of these initiatives into the program should await a domestic consensus on the issue. Until then, the authorities undertook to continue strengthening tax and customs administration (Box 2).

22. **The authorities recognized that the large stock of claims on government—which could exceed 150 percent of GDP—were unsustainable given the fiscal deficit and spending adjustments necessitated by prospective declines in aid flows.** These claims include war-related damages and spending arrears—which do not yet have established amortization schedules or interest payments—as well as external debt and debts to domestic banks. On the basis of the medium-term scenario outlined above, staff suggested that the need for deep expenditure reduction counseled against adding obligations through

recognition of domestic claims in full. The authorities indicated that while external claims would be paid in full, domestic claims may need to be reduced in order to establish sustainability, and they noted that funds are accruing in escrow to help finance such adjustments. The political, legal, and logistical challenges are many, but preparations continue.

23. **Public expenditure reform is critical to delivering fiscal sustainability, given the projected decline in donor support and the need for further fiscal adjustment.** The authorities concurred that given the revenue ratio already high at around 45 percent of GDP and excessive tax rates (especially on labor), stress should be placed on expenditure restraint. Accordingly, an early review of public spending, including off-budget fiscal activities, would be an essential task of the incoming administrations. (Box 3).

24. **Treasuries are being extended (¶21).** The authorities noted that treasury operations are scheduled to commence in three key Cantons in early 2003, with USAID assistance, and the RS authorities are laying the groundwork for municipality pilot projects. Staff welcomed this faster-than-targeted progress and commended the authorities' plans to begin publishing quarterly budget execution data from the first quarter of 2003.

Box 3. Public Expenditure Reform

Given the medium-term fiscal targets, there is need to lower total spending, change its composition, and increase its efficiency.

Donors have identified scope for spending reductions in various sectors and at all levels of government, but with the exception of military spending (OSCE) detailed proposals are yet to be prepared.

Proposals for rationalization, rather than cuts, are ready. The IBRD proposes to eliminate parallel benefits, harmonize eligibility criteria, thereby funding increased benefits for priority war veterans. They also propose to limit pension rises, and increase transparency and accountability. Alongside OSCE, they also propose to lower spending on tertiary education in favor of secondary and primary spending.

Other initiatives are at an earlier stage. The EU is reviewing police operations and the IBRD is examining scope for stricter cost containment in health.

At the same time, increased spending is required in operations and maintenance and in on-budget investment spending as donor-funded off budget capital spending declines.

E. Monetary and Financial Sector Policies

25. **The broad—but not universal—consensus among parties likely to be included in new administrations was that the currency board remained the appropriate framework for monetary policy.** It had secured disinflation, encouraged widespread adoption of the KM, and shielded monetary policy from the complex political environment. All parties agreed that confidence in the monetary framework was essential. In that regard, the authorities agreed with staff that even developments such as the introduction of central bank bills, which might aid interbank activity, should be avoided lest these unintentionally raise concerns in the public's mind about the credibility of the currency board (¶24).

26. **Rapid growth of credit to households reflected financial deepening but was putting upward pressure on the current account deficit.** Given the currency board arrangement, staff agreed that the macroeconomic implications would be addressed through

adjustments in KM interest rates and through fiscal policy—and this provided added reason to welcome the strong fiscal outturn in 2002. The authorities also intend to examine the lending practices of the main banks concerned to confirm that the lending does not raise prudential concerns.

27. **The authorities proposed to complete the privatization of banks by end 2002, liquidating any remaining state-owned banks thereafter.** With increased competition and the minimum capital requirement of KM 15 million also coming into effect at end-2002, many banks will either need to merge or face liquidation during 2003. The authorities anticipated the banking system to consolidate further, reducing the total number of banks to some 25 from 44 by the end-2003, maintaining competition and easing the supervisory task.

28. **The authorities argued that prudential concerns in banks and corporates were minimal but acknowledged that improvements in the regulatory framework were needed.** Despite booming household credit, most of the individual loans are small and well secured, moderating risk. The staff, however, pointed out that legal difficulties in enforcing collateral claims increased the risks associated with banks' loan portfolios. Banks' foreign exchange exposures are subject to limits relative to core capital and banks are highly capitalized. The average risk-weighted capital was 20 percent of liabilities in June 2002 (though calculation of core capital is generous relative to EU standards), and corporate risk is limited by the small portfolio of loans to firms. Nevertheless, the authorities recognized rapid growth of consumer credit raised concerns if the economy were to slow, they regarded the maturity mismatch between liabilities and assets as excessive, and were concerned that weaknesses in banks' internal control systems posed problems for effective implementation of the new banking law, notably its anti-money laundering provisions. Accordingly, guidelines on internal controls and on enhancing training of bank personnel were being prepared. The authorities accepted that standards applied did not fully accord with international best practice—including in regard to consolidated supervision, capital requirements for market risks and cross border transactions, and accounting standards—but they noted that bank capital remained strong even allowing for these corrections. Staff urged early adoption of best practice—indicating that this would form a focus of the second review under the SBA—and they noted developmental concerns. In particular, balance sheet strength partly reflected the limited extent of bank lending to corporates and bank dependence on charges for revenue and profits. The authorities argued that these concerns would be addressed once the legal basis for collateral had been strengthened. In the meantime, the main concern was to strengthen banking resilience as competition among banks increased.

29. **The authorities are investigating how to further strengthen bank supervision at the BiH level.** Bank supervisory structures were reviewed by MAE concurrently with this mission, including discussion of the options for a more centralized and country-wide supervisory structure to replace the current Entity-based system.

30. **The Central Bank will become the fiscal agent for the Fund by mid-December and will implement recommendations on the safeguards assessment.** Safeguards were assessed as generally adequate but certain weaknesses were identified in the internal audit

function and control systems. Corrective measures were recommended—although, not critical under the safeguards framework—to strength CBBH financial reporting. The authorities indicated that they will complete their assessment of risks in all of their operations by end-March 2003 and strengthen staff expertise.

F. Structural Reforms

31. **Given the fiscal and monetary frameworks, increased corporate investment will be critical to stimulating growth and jobs.** In this regard, the authorities observed that rates of profitability in enterprises seemed to be low—often negative—and, while questioning elements of the data, they recognized that it appeared to be deteriorating. In their view, these problems reflected problems in state-owned and privatized companies where deep restructuring had not begun. New private companies seemed strong, though data were unavailable on this. The discussions therefore focused on three areas where actions have been taken and where further steps will be needed under the new administrations: (i) increased competition in goods markets to rationalize production; (ii) better representation of equity interests in firms' decision-making; and (iii) improved payments discipline.

32. **Trade liberalization and eased business entry is stimulating competition.** The authorities noted that regional trade liberalization was pursued vigorously and business entry conditions and bureaucratic burdens were being eased through the IBRD Business Environment Adjustment Credit (BEAC) (Box 4).

33. **Progress was also being made with enterprise restructuring:**

- The authorities observed that medium and large-scale privatization had been delayed by ownership disputes, protracted tender preparation, and unclear management of sales. Accordingly, tender rules were streamlined and half of all the tenders issued since 1999 were issued in 2002. Staff urged further action, notably in the case of the RS petroleum refineries and the telecoms utilities.

Box 4. Strengthening the Business Environment

Actions already undertaken (November 2002):

- The Foreign Investment Promotion Agency (FIPA) has been founded and the Entities have harmonized Foreign Investment Laws.
- Entities have planned common procedures and a single database for a collateral registry, and for pledges on movables.
- The State and the Entities have drafted an anti-corruption action plan, including in respect of public procurement.
- The Entities have eliminated the overlapping authorities of financial police and tax administration
- RS adopted a strong Law on Bankruptcy and amendments to Bankruptcy Law presented to Federation government.
- State adopted Law on Associations and Foundations of BiH.

Targets yet to be achieved:

- FIPA has not begun operations.
- Reduce the time for business registration from 80 to 30 days or less in the Federation and from 31 to 23 days or less in the RS.
- Introduce a pilot collateral registry system and adopt a plan for full implementation, and reduce on-site inspector days per inspected business from 28 days to 15 days or less in the RS and from 18 days to 12 days or less in the Federation per annum.
- Eliminate mandatory membership in the Chamber of Commerce.

- The authorities noted that limited bank credit to enterprises reflected inadequate projects and weak collateral and bankruptcy laws. Privatization would help to strengthen management, and collateral laws were being addressed through the BEAC (Box 4). Staff also urged removal on limits barring Mutual Funds' from acquiring majority stakes in firms in the Federation and for a strengthening of the stock exchange to allow them to trade so as to acquire majority stakes.
- A strong bankruptcy law was passed in the RS in September while similar legislation had been held up in the Federation parliament by concerns over its implications for unemployment. The authorities pointed out that implementation in both Entities would be significantly impeded by weaknesses in the judicial system. The authorities (including the High Representative, who has taken formal responsibility for legal matters) understood the importance of removing this blockage.

34. **Payments discipline is also improving, notably on taxes, though inter-enterprise and wage arrears remain pervasive.** This indiscipline both reflected and compounded enterprise weaknesses by allowing soft-budget constraints to persist and—by clouding price signals—impeding the effective operation of factor markets. The authorities acknowledged that more progress was needed:

- **On tax discipline**, they noted the evidence from revenue trends that the accrual of tax arrears had slowed during 2002, notably in customs, in the wake of reforms to tax administration, and were committed to further action.
- **On inter-enterprise arrears**, the authorities argued that the accrual of arrears would be arrested by the various steps taken to strengthen capital in firms, including privatization and bankruptcy procedures.
- The remaining and perhaps most difficult challenge remaining concerned **wages and wage arrears**. They noted that workers' tolerance of wage arrears when their firms were in financial difficulty was a key flexibility supporting employment. But they concurred that this form of flexibility obscured price signals in the labor market, left unemployment at excessive levels, and compounded obstacles to restructuring through the accumulation of added enterprise liabilities to workers. Staff suggested that accrued wages should be set no higher than paid wages, and that wage setting and other labor market mechanisms should be reviewed with a view to securing this goal. In this context, the authorities agreed that faster and better privatization would strengthen wage discipline in large state companies, while relaxation of limits on Mutual Funds' holdings would strengthen such discipline in privatized companies. They also suggested that initiation of bankruptcies would help align accrued to paid wages, but were very concerned at the social implications, even given the social safety net in place.

35. **The authorities aimed to insulate, as far as possible, the poorer segments of society from the shocks of reform.** They universally expressed strong concerns about the social implications of the prospective economic reforms, but acknowledged that the need to

respond to declining international financial support was unavoidable. Their draft on Poverty Reduction Strategy Paper (PRSP) preparations indicated that poverty was already prevalent among working people. Basic pensions, unemployment, and veterans benefits provided a safety net but consideration was given to extending access to unemployment benefit, within fiscal constraints. Staff noted the IBRD assessment that unemployment benefits were appropriately structured while pensions and veterans' benefits needed rationalization. But all agreed that the most effective safety net was new jobs. This underscored the importance of credible implementation of the structural and fiscal reform agendas to rapidly elicit new job-creating investment. And accordingly, a way needed to be found to render this objective consistent with social consensus, a task the authorities were unsure how to achieve.

36. **Inadequacies in statistics continued to impede policymaking but the recently imposed State-level Statistics Law will help.** This law empowers the state level Agency for Statistics of Bosnia and Herzegovina to collect and disseminate country-wide statistics for the country in accordance with internationally accepted standards, and to require the entity institutes of statistics to collect and provide any data it deems necessary to fulfill its functions. Given this advance, staff and the authorities regretted that an ambitious assistance program to be funded by the EU—to improve national accounts, employment, foreign trade, and price data—would be delayed up to a year further, pending completion of internal EU procedures.

IV. STAFF APPRAISAL

37. **Progress under the program has been strong:**

- Fiscal consolidation in 2002 has been considerably larger than programmed. On the RS side, this largely reflects vigorous tax administration, while on the Federation side strict expenditure control has been the main instrument. In both entities, the hitherto persistent accrual of arrears of wages, pensions, and social benefits has stopped.
- In a reflection of—and boost to—eased social tensions, both Entities implemented military demobilizations, for about one-third of end-2001 military personnel. The severance payouts raised the headline deficit in 2002 but will yield large permanent annual savings to spending. Accordingly, staff approval for use of succession monies were granted, a quarter of which has already been reconstituted.
- In addition, customs controls have improved the new central government Treasury systems are up and running, the national audit offices are fully operational, and central control over sub-national government bank borrowing has been significantly strengthened.
- Bank, Small and Medium Enterprises (SME), and voucher privatization has been all but completed. Large scale privatization remains slow, however, notwithstanding a significant increase in tender issues this year.

38. **But, as anticipated, the road has been bumpy—a number of program undertakings have not been observed—but corrective actions have been taken.** The

Entity transfers to the State were regularized in September and reporting on these matters to the Fund has been formalized. Cantonal bank debts have been lowered through the inter-canton lending in October and they will fall below the ceiling as remaining bank debts are amortized. The RS pension fund has unfrozen its bank deposit and cleared bank debts with it and the health fund will receive funding from central government to clear its debts. And the central government monitoring of Federation municipalities borrowing has strengthened. The oil-fee dispute has been resolved and harmonization will be secured by end-year.

39. Actions to address the immediate uncertainties for the macro framework arising from the delays in forming new administrations after the October elections are in train.

Key among these is the adjustment of the RS budget for end-2002 and preparation of the 2003 budgets. The former is scheduled for early approval by the new Assembly. On the latter, senior political leaders have proposed to support in the new parliaments and assemblies' budgets for 2003 which are based on unchanged wage, tax, benefit, and pension rates and eligibilities from those prevailing at end-2002. These freezes imply some contraction in spending on these items relative to GDP, and modest real declines given low inflation. Passage of these budgets, expected in December, alongside finance from external sources will ensure smooth execution of the budgets in the early months of 2003 on parameters which are consistent with program undertakings. When the new administrations eventually form, they will be at liberty to adjust those 2003 budgets in consultation with staff. But the uncertainties this prospect undoubtedly raises for fiscal and other policies are attenuated somewhat by the understanding across parties of the need for discipline in the fiscal accounts and the urgency of structural reform.

40. Fiscal and other structural reforms have advanced. Progress in the treasury systems, audit procedures, tax harmonization and administration, and preparations for the settlement of domestic claims is impressive. And with bank and SME privatization all but completed and initiatives underway to cut bureaucracy, the business environment is improving. All these initiatives will continue under the auspices of the caretaker administrations, as will intensive debates that have been sparked by the HR's commitment to a VAT and to strengthen customs administration, both of which are likely to imply a significant transfer of tax functions from the Entities to the state.

41. These efforts will buttress—and be supported by—continued adherence to the currency board as currently constituted. It remains an effective nominal anchor, backed by a healthy banking system, effective financial regulation—albeit with further improvements needed to bring capital adequacy and accounting rules fully into line with international standards—and an appropriate framework of fiscal and structural policies. The safeguards assessment was favorable and the Central Bank will become Bosnia and Herzegovina's fiscal agent for the IMF.

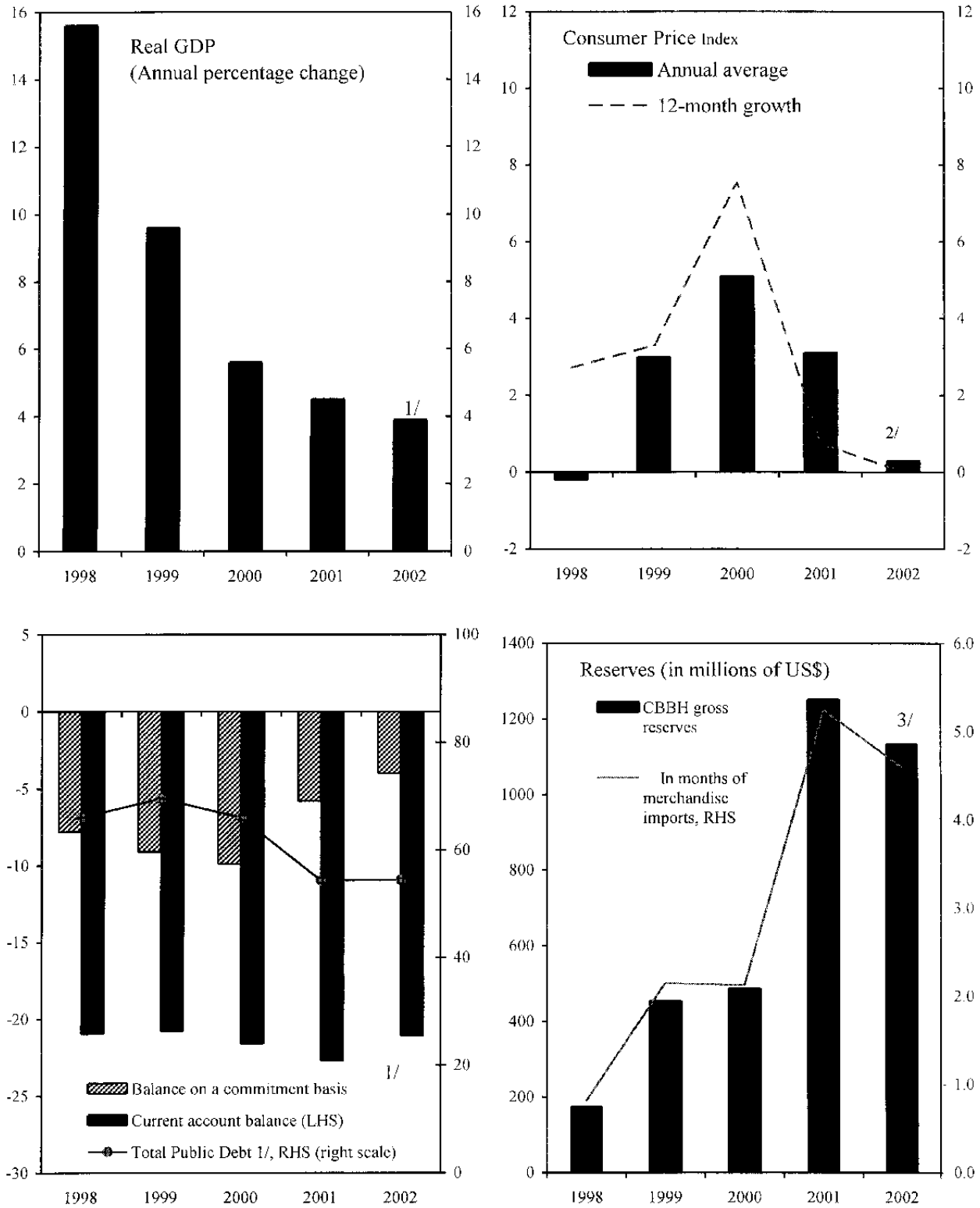
42. But large-scale privatization has lagged and a substantial agenda lies ahead in enterprise restructuring in order to stimulate exports as aid inflows decline. This will require a package of measures, including better and faster privatization, bankruptcy, strengthened domestic credit markets, and reform of the mutual funds managing the voucher privatization assets. There will be an important role for further reduction of import tariffs—

perhaps as part of the World Trade Organization commitments—and fiscal consolidation to support these initiatives. These challenges will fall to the incoming administrations, building on the good progress so far.

43. **And risks undoubtedly remain.** The specific policy objectives of the new administrations, including for their 2003 budgets, will only become clear once they form. The triple task awaiting them—current account adjustment, transition structural reform, and rationalizing government—will generate considerable political and social strains and these may be magnified if economic growth turns out lower than projected. More immediately, the pressure to add new spending commitments at state level in the revised 2003 budgets may put the new 2003 Entity budgets under pressure. The current account deficit remains high (and higher than programmed) and trends on corporate profitability appear—if data are to be believed—to be indicating that a bad situation may be deteriorating. Data weaknesses continue to impede diagnosis and accurate monitoring of economic developments. Set against these, however, are the facts that policy progress to date under the program has significantly exceeded expectations, slippages notwithstanding, and that understanding of the fundamental economic tasks ahead amongst senior political leaders is good.

44. **In this context, the program remains an appropriate framework for policies, and deserves the continued support of the Fund. Waivers for nonobservance of the performance criteria are accordingly recommended.**

Figure 1. Bosnia and Herzegovina: Selected Financial and Economic Indicators 1/ (1998-2002)



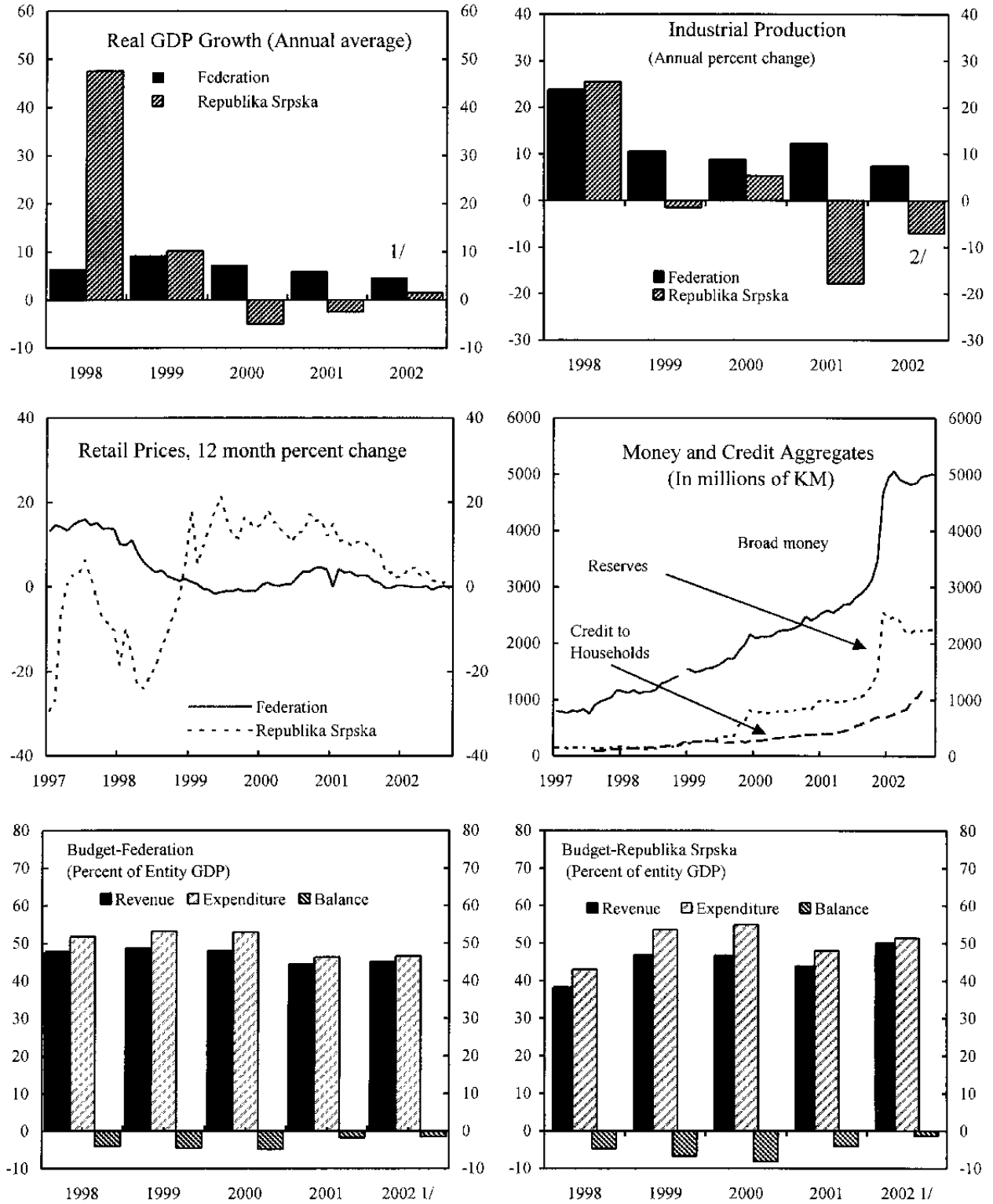
Sources: Data provided by Bosnian authorities; and IMF staff estimates.

1/ IMF projections.

2/ Twelve month CPI through August 2002.

3/ September 2002.

Figure 2. Bosnia and Herzegovina: Selected Indicators by Entity (1997-2002)

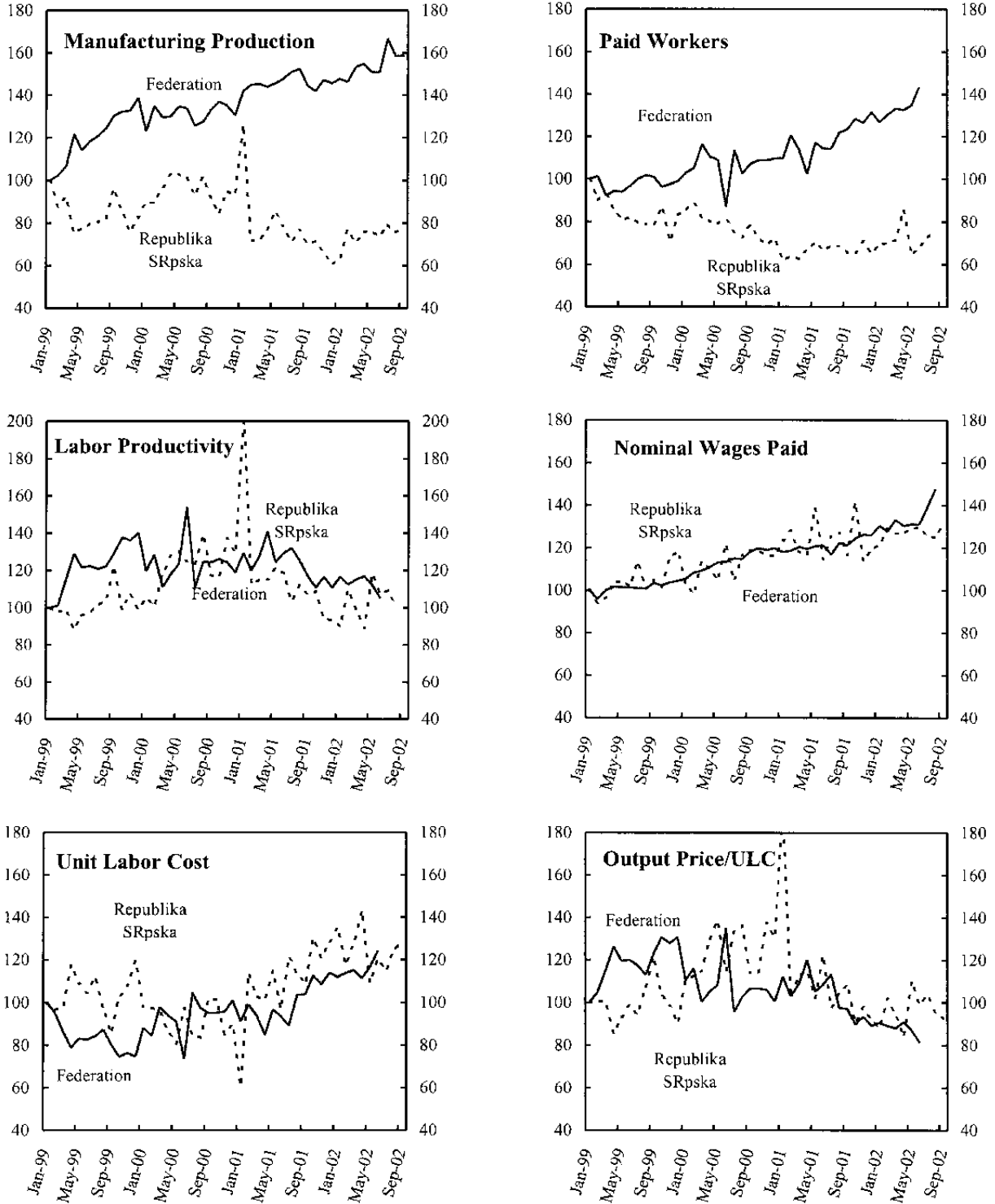


Sources: Data provided by Bosnian authorities; and IMF staff estimates.

1/ IMF projections.

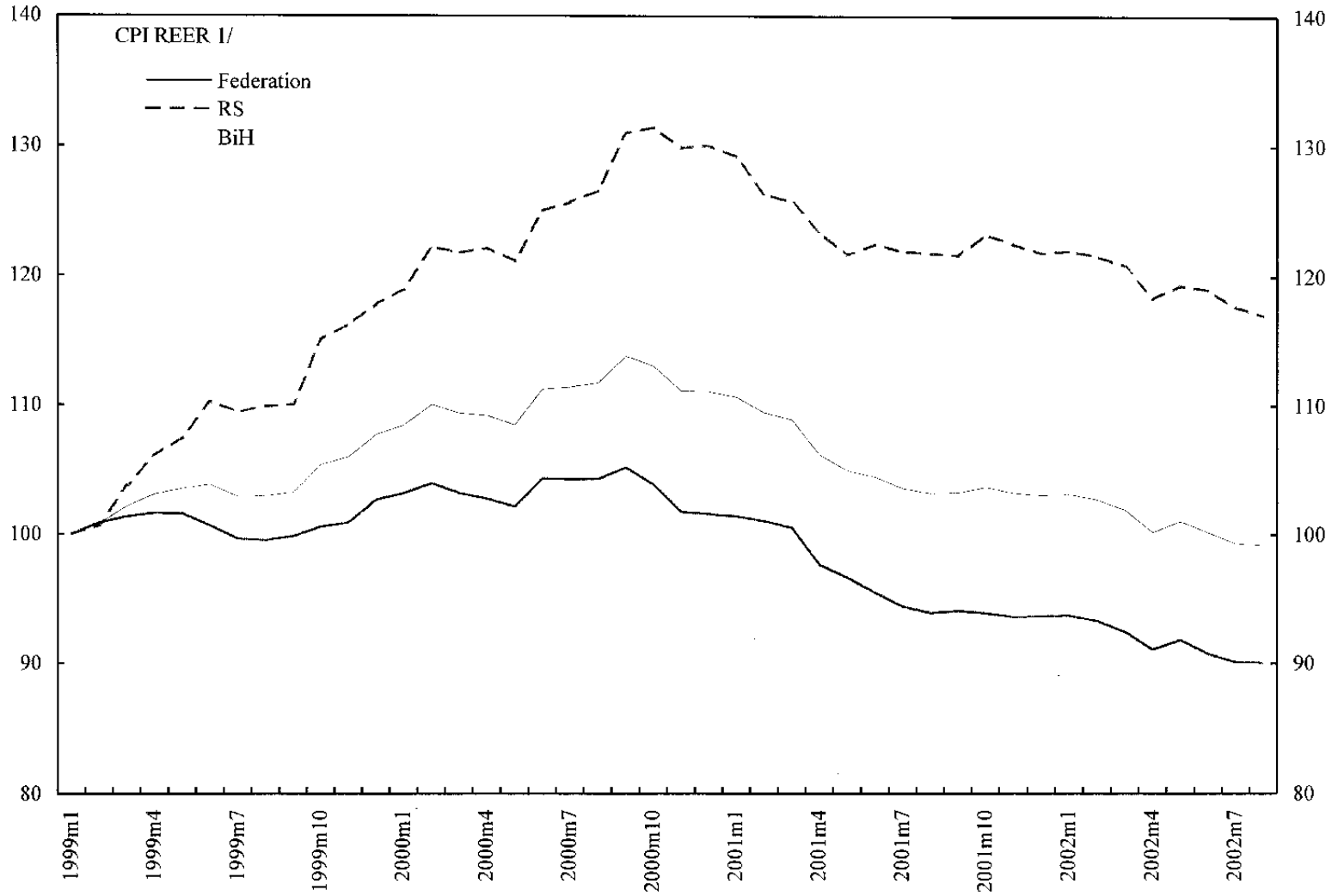
2/ Through September 2002.

Figure 3a. Bosnia and Herzegovina: Indicators of Manufacturing, 1999-2002
(Seasonally Adjusted, January 1999=100)



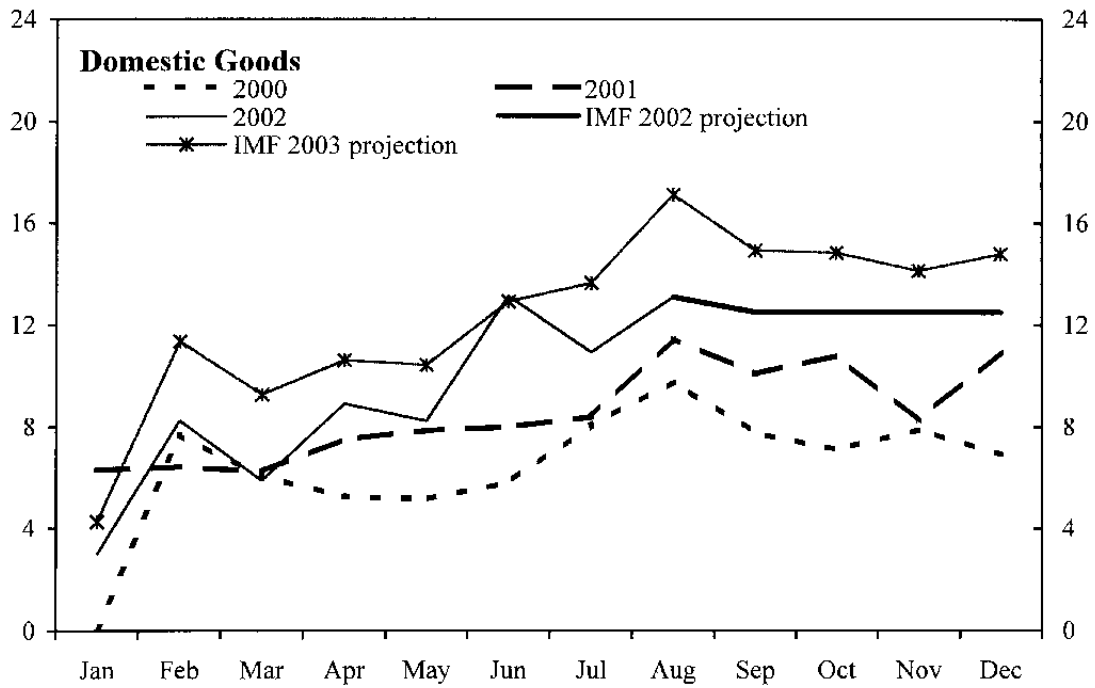
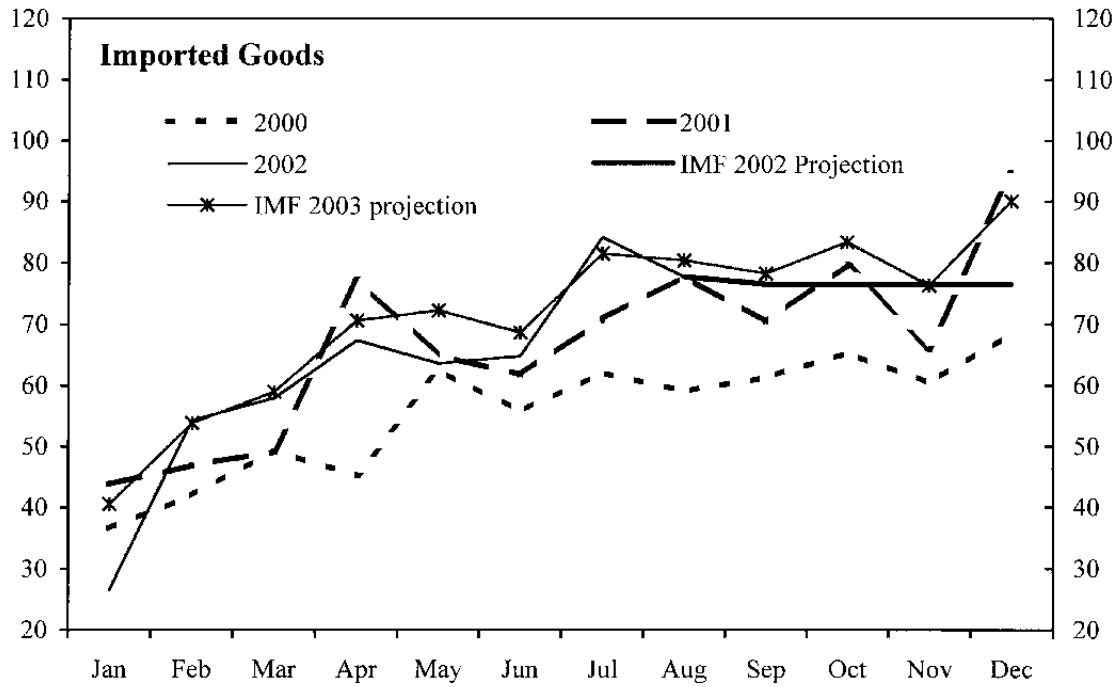
Source: Data provided by Bosnian authorities.

Figure 3b. Bosnia and Herzegovina: Real Effective Exchange Rate, 1999-2002



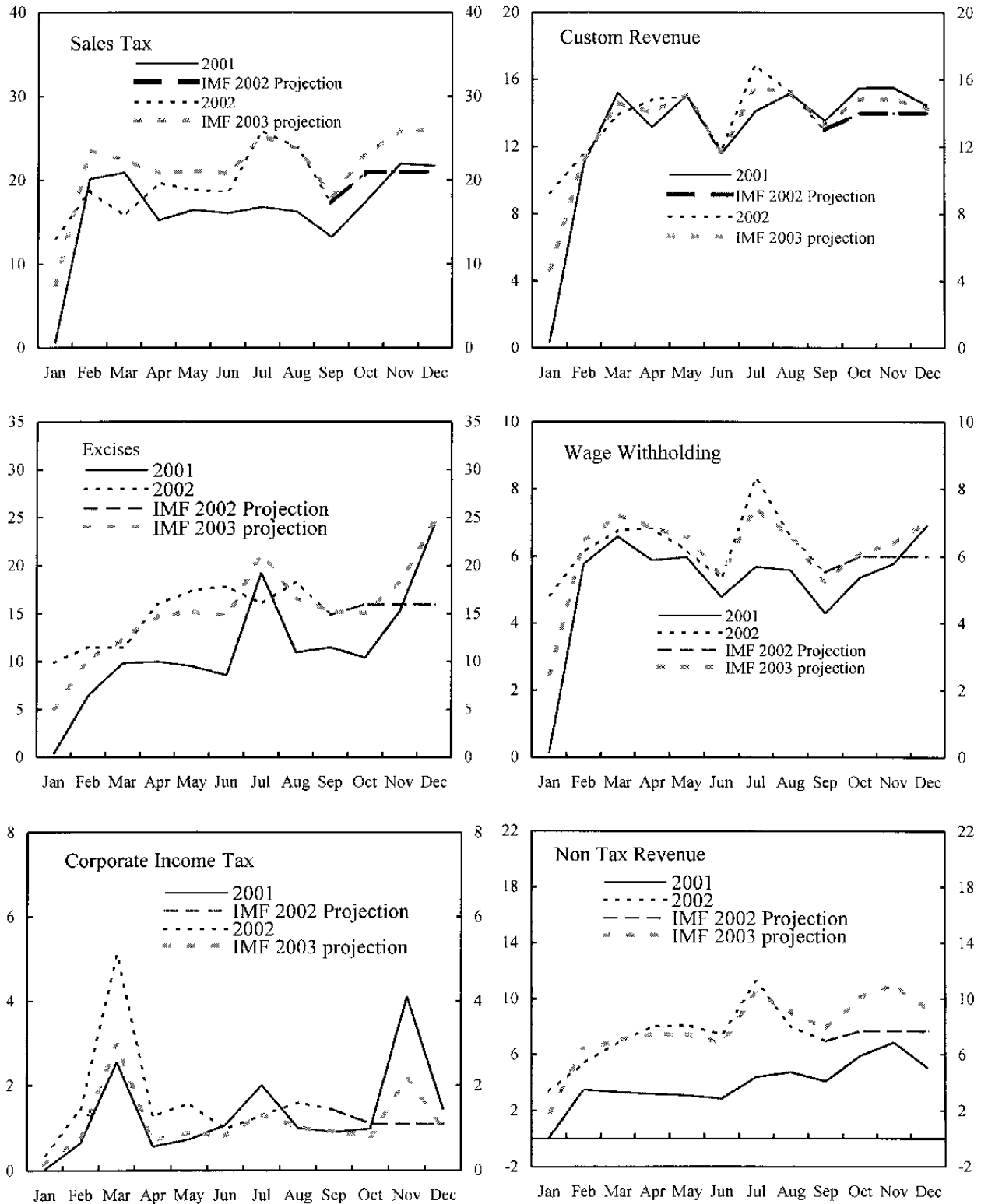
Sources: Provided by the authorities; and IMF staff estimates.

Figure 4a. Federation: Central Government Tax Revenue, 2000-2003
(In millions of KM)



Sources: Provided by the authorities; and IMF staff estimates.

Figure 4b. Republika Srpska: Government Revenue, 2001-2003
(In millions of KM)



Sources: Provided by the authorities; and IMF staff estimates.

Table 1a. Bosnia and Herzegovina: Selected Economic Indicators, 1998-2003 1/

Population (2000, est.): 3.78 million
 GDP per capita (2000, est.): \$1,210
 Quota: SDR 169 million

	1998	1999	2000	2001	2002	2002	2003	2003
				Est.	Program	Revised	Program	Revised
Nominal GDP (KM million)	7,559	8,603	9,629	10,493	10,402	10,902	11,033	11,462
Gross national saving (percent of GDP)	7.4	3.1	0.4	-3.7	-1.9	-3.2	1.2	1.0
Gross investment (percent of GDP)	25.9	21.0	21.2	19.3	18.8	19.1	19.7	20.5
	(Percent change)							
Real GDP	15.6	9.6	5.6	4.5	2.3	3.9	4.1	4.7
Index of industrial production (period average) 2/	25.1	6.9	7.9	5.0	...	5.0	...	...
Gross wages (period average) 2/	3.1	11.0	13.6	9.4	8.4	9.2	...	...
CPI (period average) 2/	-0.3	3.4	5.1	3.1	2.3	0.3	1.8	0.5
Money and credit								
Broad money (end-of-period) 3/	29.7	39.4	14.0	88.5	11.0	9.8	14.0	5.1
Net domestic assets (percent contribution to broad money growth)	24.3	-1.0	3.4	3.2	...	14.4	...	4.1
Of which: credit to the public sector	0.9	1.9	1.0	-7.0	...	-1.2	...	-0.7
Net foreign assets (percent contribution to broad money growth)	5.4	40.4	10.7	85.4	...	-4.5	...	1.0
	(Percent of GDP)							
General government budget								
Revenue	56.7	61.3	56.0	51.8	53.0	52.2	52.0	50.5
Of which: grants	12.1	13.3	9.8	7.4	6.0	5.4	4.1	4.0
Expenditure (on a commitment basis)	64.5	70.4	65.9	57.5	58.6	56.2	54.9	52.6
Of which: change in stock of arrears	2.7	3.4	4.0	0.9	-0.2	-0.5	0.0	-0.2
Of which: investment expenditure	15.5	17.5	13.9	11.8	10.0	8.7	8.1	7.6
Overall balance	-7.8	-9.1	-9.9	-5.8	-5.5	-4.0	-3.0	-2.1
Total public debt 4/	105.1	107.1	103.3	89.7	98.5	86.6	96.2	83.7
Debt to domestic banks	0.4	0.4	0.3	0.3	0.5	0.6	0.5	0.6
Stock of domestic spending arrears	2.7	5.7	9.2	9.3	9.1	8.5	8.6	7.8
External public debt	64.7	68.2	64.5	53.2	62.0	51.6	61.7	50.6
Stock of frozen foreign currency deposits	37.3	32.8	29.3	26.9	26.9	25.9	25.4	24.6
	(Millions of U.S. dollars)							
Balance of payments								
Exports of goods and services	1,375	1,404	1,393	1,391	1,553	1,459	1,770	1,616
Imports of goods and services	2,997	2,828	2,806	2,952	2,949	3,061	3,098	3,192
Official current grants	197	86	36	28	29	33	16	24
Of which: budget support	38	25	36	28	29	33	16	24
Current account balance	-794	-839	-957	-1,126	-986	-1,166	-931	-1,120
(percent of GDP)	-18.5	-17.9	-20.8	-23.1	-20.7	-22.3	-18.4	-19.5
Gross official reserves	169	448	488	1,253	1,567	1,203	1,622	1,253
(in months of imports)	0.7	1.9	2.1	5.1	6.4	4.7	6.3	4.7
External debt service	116	131	94	81	116	121	135	162
(percent of exports of goods and services)	8.4	9.4	6.8	5.8	7.5	8.3	7.6	10.0

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

1/ Data refer to the entire country. 2002-03 program projections reflect the already negotiated SBA.

2/ Based on weighted averages for the Federation and Republika Srpska.

3/ Broad money includes currency, demand deposits, time and savings deposits, bonds and money market instruments, restricted deposits, counterpart funds, and government lending funds.

4/ Excludes any liabilities arising from war damage claims.

Table 1b. Bosnia and Herzegovina: Selected Economic Indicators for the Entities, 1998-2003 1/

	1998	1999	2000	2001	2002	2002	2003	2003
				Est.	Program	Revised	Program	Revised
Federation								
Nominal GDP (KM million)	5,602	6,141	6,723	7,255	7,421	7,592	7,978	8,057
	(Percent change)							
Real GDP	6.5	9.3	7.3	6.0	3.2	4.7	5.6	5.6
Index of industrial production (period average)	23.8	10.6	8.8	12.2	...	7.5	...	...
Gross wages (period average)	2.7	8.8	10.2	7.4	4.3	6.9	...	...
CPI (period average)	5.1	-0.9	1.9	1.9	1.5	-0.2	1.6	0.5
	(Percent of Federation GDP)							
Central government budget								
Revenue	12.8	12.0	13.2	15.0	14.2	14.0	14.9	14.1
Expenditure (on a commitment basis)	15.4	13.7	15.0	15.5	16.7	15.3	14.9	13.5
Of which: change in stock of arrears	1.4	1.3	1.2	-0.1	0.0	0.0	0.0	0.0
Overall balance	-2.6	-1.7	-1.8	-0.6	-2.5	-1.3	0.1	0.6
Overall balance (percentage of BiH GDP)	-1.9	-1.2	-1.3	-0.4	-1.8	-0.9	0.1	0.4
Budget for cantonal governments and extra budgetary funds								
Revenue	35.4	37.0	35.3	30.9	33.1	31.1	33.1	30.2
Expenditure (on a commitment basis)	36.9	39.9	38.3	32.1	33.1	31.0	33.1	30.2
Of which: change in stock of arrears	4.3	4.5	3.0	0.4	0.0	-0.6	0.0	0.0
Overall balance	-1.5	-2.8	-3.1	-1.2	0.0	0.1	0.0	0.0
Overall balance (percentage of BiH GDP)	-1.1	-2.0	-2.1	-0.9	0.0	0.1	0.0	0.0
Republika Srpska								
Nominal GDP (KM million)	1,957	2,462	2,734	2,978	2,981	3,043	3,056	3,126
	(Percent change)							
Real GDP	47.5	10.2	-5.0	-2.5	0.0	1.5	0.5	2.0
Index of industrial production (period average)	25.5	-1.5	5.3	-17.8	...	-7.0	...	...
Gross wages (period average)	47.1	22.7	22.3	15.3	16.7	18.4	...	...
CPI (period average)	-14.0	14.1	14.0	7.0	4.4	1.9	2.5	0.7
	(Percent of Republika Srpska GDP)							
Budget for central government and municipalities								
Revenue	24.9	33.4	33.7	30.1	29.1	38.4	28.7	37.5
Expenditure (on a commitment basis)	29.6	39.2	37.7	32.1	30.2	39.2	28.6	36.2
Of which: change in stock of arrears	1.8	3.2	3.9	0.8	-0.5	-1.1	0.0	-0.8
Overall balance	-4.7	-5.9	-4.1	-2.0	-1.1	-0.8	0.1	1.2
Overall balance (percentage of BiH GDP)	-1.2	-1.7	-1.2	-0.6	-0.3	-0.2	0.0	0.3
Budget for extra budgetary funds								
Revenue	13.4	14.6	14.4	14.3	14.5	17.0	15.2	16.9
Expenditure (on a commitment basis)	13.4	15.5	18.5	16.4	14.5	17.0	15.2	16.9
Of which: change in stock of arrears	0.0	0.9	4.1	2.1	-0.3	0.0	0.0	0.0
Overall balance	0.0	-0.9	-4.1	-2.1	0.3	0.0	0.0	0.0
Overall balance (percentage of BiH GDP)	0.0	-0.3	-1.2	-0.6	0.1	0.0	0.0	0.0

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

1/ 2002-03 program projections reflect the already negotiated SBA.

Table 2. Bosnia and Herzegovina: Monetary Survey, 1997-2002
(In millions of KM)

	1997	1998	1999	2000	2001	2002				
						March	June	July	August	September
Net foreign assets	-500	-435	195	427	2,543	2,568	2,392	2,370	2,369	2,331
Foreign assets (MA)	144	283	866	1,045	2,737	2,569	2,443	2,420	2,427	2,454
Foreign assets (DMB)	1,014	887	848	961	1,364	1,540	1,581	1,670	1,674	1,637
Foreign liabilities (MA)	0	0	0	-1	-31	-2	-1	-2	-2	-2
Foreign liabilities (DMB)	-1,658	-1,606	-1,519	-1,577	-1,527	-1,540	-1,630	-1,718	-1,730	-1,758
Domestic credit	2,267	2,635	2,602	2,863	3,016	3,124	3,283	3,405	3,459	3,555
Claims on central government (net)	-188	-181	-159	-129	-319	-326	-396	-405	-435	-429
Claims on noncentral government	5	9	17	9	25	37	36	39	41	40
Claims on private sector	2,450	2,808	2,744	2,983	3,309	3,413	3,642	3,771	3,853	3,944
Non-financial enterprises and cooperatives	2,315	2,547	2,467	2,564	2,587	2,576	2,557	2,578	2,599	2,618
Households	121	248	268	384	682	789	1,040	1,147	1,199	1,267
Other	14	13	9	35	40	49	45	46	55	59
Broad money	1,178	1,547	2,165	2,467	4,669	4,913	4,852	4,960	4,986	5,011
Money	252	310	1,100	1,402	2,692	2,916	2,943	3,035	3,028	3,029
Currency outside banks	113	162	515	652	1,674	1,848	1,776	1,835	1,813	1,768
Demand deposits of noncentral government	26	21	85	97	178	178	177	155	168	177
Demand deposits of the private sector	113	127	499	653	841	889	990	1,045	1,047	1,084
Non-financial enterprises and cooperatives	94	103	387	454	634	652	666	699	707	732
Households	5	8	34	79	147	179	265	286	278	282
Other	14	15	78	119	60	58	58	61	62	70
Quasi-money	926	1,237	1,065	1,066	1,977	1,998	1,909	1,925	1,958	1,983
Time and savings deposits in domestic currency	10	8	22	78	141	165	206	215	226	243
Foreign currency deposits	917	1,229	1,043	988	1,836	1,833	1,703	1,709	1,732	1,739
Other items (net)	589	653	632	823	889	779	823	815	842	875
Memorandum items:										
NFA of the central bank	144	283	866	1,046	2,768	2,571	2,445	2,422	2,429	2,456
NFA of the central bank in percent of currency outside the banks	128	174	168	161	165	139	138	132	134	139
NFA of the central bank in percent of broad money	12	18	40	42	59	52	50	49	49	49
Broad money growth (year-on-year)	-99.8	31.3	40.0	14.0	89.2	92.6	79.8	76.4	72.7	68.2
NDA contribution to broad money growth (year-on-year)	-384.8	31.3	-2.2	12.1	6.2	6.2	8.9	10.8	12.6	14.2
NFA contribution to broad money growth (year-on-year)	254.5	5.5	40.7	10.7	85.8	80.7	64.3	59.1	54.7	49.3
Other items net contribution to broad money growth (year-on-year)	-45.4	-5.5	1.4	-8.8	-2.7	5.8	6.7	6.5	5.5	4.7
Private sector credit growth	-99.9	14.6	-2.3	8.7	10.9	10.5	12.7	15.1	16.8	18.2
Credit to the household sector (percent growth, year-on-year)	252.7	104.6	8.3	43.3	77.5	98.0	116.7	117.3	111.4	106.7
Credit to household sector (in percent of GDP)	2.0	3.4	3.1	4.1	6.5	7.2	9.5	10.5	11.0	11.6
Broad money (in percent of GDP)	19.3	21.1	25.2	26.2	44.5	45.1	44.5	45.5	45.7	46.0
Domestic credit (in percent of GDP)	37.1	35.9	30.2	30.4	28.7	28.7	30.1	31.2	31.7	32.6
Private sector credit (in percent of GDP)	40.1	38.3	31.9	31.6	31.5	31.3	33.4	34.6	35.3	36.2

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

Table 3. Bosnia and Herzegovina: Balance of Payments 2000-2006
(In millions of U.S. dollars; unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006
		Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Merchandise trade balance 1/	-1,678	-1,793	-1,828	-1,794	-1,721	-1,594	-1,471
Exports, f.o.b.	932	957	1,038	1,194	1,397	1,677	1,962
Imports, f.o.b. 2/	-2,610	-2,750	-2,866	-2,988	-3,118	-3,271	-3,433
Reconstruction	-584	-506	-403	-345	-280	-220	-210
Other	-2,026	-2,244	-2,464	-2,643	-2,838	-3,051	-3,223
Services, net	264	231	226	217	174	149	161
Receipts	460	434	420	422	414	407	431
Expenditure	-196	-202	-194	-204	-240	-258	-271
Net factor income	256	250	246	269	270	296	336
Earnings	318	309	316	332	338	373	412
Interest payments	-63	-59	-70	-63	-68	-77	-76
Unrequited transfers, net	201	185	190	187	174	181	182
Receipts	208	193	197	195	182	189	190
Official grants	36	28	33	24	10	15	15
Private	172	165	164	170	172	174	175
Outflows	-8	-7	-8	-8	-8	-7	-8
Current account balance	-957	-1,126	-1,166	-1,120	-1,103	-968	-792
Excluding official transfers	-993	-1,154	-1,199	-1,145	-1,112	-983	-807
Foreign investment (net)	150	130	240	320	380	500	580
Capital transfers for reconstruction	396	346	252	190	150	90	80
Foreign loans (net)	192	197	181	151	133	142	140
Disbursements	204	211	214	205	175	180	180
Reconstruction	188	160	151	155	130	130	130
Other 3/	15	51	63	50	45	50	50
Amortization	-12	-15	-33	-54	-42	-38	-40
Commercial banks	-146	-213	-15	23	-10	-10	-10
Other capital 4/	383	1,419	433	468	543	335	80
Capital account balance	975	1,878	1,091	1,153	1,196	1,057	870
Errors and omissions	0	0	0	0	0	0	0
Overall balance	18	752	-75	32	93	89	78
Financing	-18	-753	75	-44	-93	-89	-78
Change foreign assets (increase, -)	-26	-755	72	-49	-98	-97	-87
of which:							
Gross foreign assets of the central bank	-43	-766	50	-50	-50	-50	-50
Net use of Fund resources	17	11	21	1	-48	-47	-37
Purchases/loans	37	18	40	48	0	0	0
Repurchases/repayments	-20	-8	-19	-46	-48	-47	-37
Short-term liabilities (reduction, -)	0	0	0	0	0	0	0
Arrears (reduction, -)	-342	-550	0	0	0	0	0
Multilateral creditors	0	0	0	0	0	0	0
Paris Club creditors	0	0	0	0	0	0	0
London Club	0	0	0	0	0	0	0
Other creditors	-342	-550	0	0	0	0	0
Debt rescheduling or cancellation (of arrears)	342	550	0	0	0	0	0
Multilateral creditors (rescheduling)	0	0	0	0	0	0	0
Paris Club creditors (rescheduling) 5/	0	0	0	0	0	0	0
London Club (rescheduling) 6/	0	0	0	0	0	0	0
Other creditors (cancellation)	342	550	0	0	0	0	0
Debt relief, current maturities (cashflow)	8	2	4	5	5	8	8
Multilateral creditors	0	0	0	0	0	0	0
Paris Club creditors 5/	0	0	0	0	0	0	0
London Club 6/	8	2	4	5	5	8	8
Total financing gap (-) 7/	0	0	0	-12	0	0	0
Memorandum items:							
Change in volume of non-oil imports into the EU	11.3	2.1	1.9	5.9	6.1	6.3	6.4
Current account balance (in percent of GDP)	-20.8	-23.1	-22.3	-19.5	-17.8	-14.4	-10.9
Excluding official transfers	-21.6	-23.6	-22.9	-20.0	-18.0	-14.7	-11.1
External Public debt/GDP (in percent)	64.5	53.2	51.6	50.6	48.3	46.1	44.0
External debt service/GNFS	6.8	5.8	8.3	10.0	8.7	7.8	6.3
Gross official reserves (in millions of U.S. dollars)	488	1,253	1,203	1,253	1,303	1,353	1,403
(in months of imports of goods and services)	2.1	5.1	4.7	4.7	4.7	4.6	4.5

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

1/ Estimates for merchandise trade are based on partner country reporting.

2/ Partner country data (see footnote 1) for non-reconstruction imports are lowered by 5 percent to reflect imports of non-residents to BiH.

3/ Disbursement for budget finance and includes the World Bank and EU loans.

4/ These are non-debt-creating capital inflows. The figures for 2001 reflect the effects of the introduction of the euro.

The amounts may be overstated and may in fact reflect private transfers from abroad.

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

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

7/ The fiscal program for 2003 is fully financed. However, the EU's macroassistance of Euro 60 million in 2002-03 is conditional on the identification of an additional US\$12 million in associated bilateral program financing.

Table 4a. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
	(in millions of KM)					
Revenue	4,285.4	5,275.0	5,389.8	5,433.2	5,692.2	5,812.6
Tax revenue	3,099.2	3,660.9	4,094.8	4,209.2	4,571.2	4,817.1
Indirect taxes	1,198.8	1,474.6	1,554.6	1,470.3	1,573.9	1,703.6
Trade taxes	406.6	491.6	599.0	840.0	985.1	1,012.1
Direct taxes	323.5	336.1	415.3	362.4	378.9	407.1
Social Security contributions	1,170.2	1,358.7	1,526.0	1,536.5	1,633.4	1,694.3
Non- tax revenue	272.1	470.7	355.1	446.7	533.9	542.2
Grants	914.1	1,143.4	939.8	777.3	587.1	453.3
Budget support	66.0	47.7	114.7	39.5	74.8	69.9
Foreign investment projects	848.1	1,095.7	825.2	737.9	512.2	383.4
Consolidated expenditure on a commitment basis	4,877.8	6,060.4	6,346.9	6,038.4	6,126.8	6,055.6
<i>of which</i> change in stock of domestic arrears	203.1	290.2	388.3	91.0	-49.4	-25.8
Consolidated expenditure on a cash basis	4,674.7	5,770.3	5,958.5	5,947.4	6,176.2	6,081.4
Interest payments	87.0	103.1	131.2	129.3	124.0	129.4
Subsidies and transfers to non-public agents 2/	1,437.2	1,631.2	1,918.9	2,011.1	2,268.7	2,307.0
Other current spending	1,981.3	2,530.5	2,567.6	2,571.6	2,831.5	2,806.1
Investment expenditure	1,169.2	1,505.5	1,340.8	1,235.4	952.0	838.9
Foreign financed investment projects	1,114.6	1,437.1	1,220.3	1,089.5	841.2	699.5
Other investment expenditure	54.6	68.4	120.5	145.9	110.8	139.4
Balance on a commitment basis	-592.4	-785.5	-957.0	-605.2	-434.6	-243.0
Balance on a cash basis	-389.3	-495.3	-568.7	-514.2	-484.0	-268.8
Financing on a commitment basis	592.4	785.5	957.0	605.2	434.6	243.0
Privatization proceeds	0.0	63.0	126.0	80.6	13.0	8.6
Foreign loans	389.3	432.3	459.2	437.0	433.3	316.9
Budget support	122.8	146.4	130.7	134.1	212.6	195.8
Foreign investment projects	266.5	341.5	395.1	351.6	328.9	316.1
Amortization	0.0	-55.6	-66.6	-48.8	-108.2	-195.0
Domestic financing 3/	0.0	0.0	-16.4	-3.4	37.7	-56.6
Change in stock of domestic arrears (+ = increase)	203.1	290.2	388.3	91.0	-49.4	-25.8
Memorandum items:						
Stock of domestic spending arrears 4/	3	6	882	973	923	897
External public debt 5/	5,302	7,400	6,083	5,735	5,604	5,742
Primary balance	-505	-682	-826	-476	-311	-114
Public consumption	3,709	4,555	5,006	4,803	5,175	5,217
Public saving	-271	-376	-441	-108	5	212
Nominal BiH GDP	7,559	8,603	9,629	10,493	10,902	11,462

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; prel. actual for the State; staff estimates for extrabudgetary funds.

2/ Excludes transfers by Federation Cantons due to lack of data.

3/ Including use and reconstitution of succession monies.

4/ Excludes war damage claims and frozen foreign currency deposits.

5/ Decrease in 2001 is due to debt-relief operation.

Table 4b. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
	(In percent of BiH GDP)					
Revenue	56.7	61.3	56.0	51.8	52.2	50.7
Tax revenue	41.0	42.6	42.5	40.1	41.9	42.0
Indirect taxes	15.9	17.1	16.1	14.0	14.4	14.9
Trade taxes	5.4	5.7	6.2	8.0	9.0	8.8
Direct taxes	4.3	3.9	4.3	3.5	3.5	3.6
Social Security contributions	15.5	15.8	15.8	14.6	15.0	14.8
Non-tax revenue	3.6	5.5	3.7	4.3	4.9	4.7
Grants	12.1	13.3	9.8	7.4	5.4	4.0
Budget support	0.9	0.6	1.2	0.4	0.7	0.6
Foreign investment projects	11.2	12.7	8.6	7.0	4.7	3.3
Consolidated expenditure on a commitment basis	64.5	70.4	65.9	57.5	56.2	52.8
<i>of which</i> change in stock of domestic arrears	2.7	3.4	4.0	0.9	-0.5	-0.2
Consolidated expenditure on a cash basis	61.8	67.1	61.9	56.7	56.7	53.1
Interest payments	1.2	1.2	1.4	1.2	1.1	1.1
Subsidies and transfers to non-public agents 2/	19.0	19.0	19.9	19.2	20.8	20.1
Other current spending	26.2	29.4	26.7	24.5	26.0	24.5
Investment expenditure	15.5	17.5	13.9	11.8	8.7	7.3
Foreign financed investment projects	14.7	16.7	12.7	10.4	7.7	6.1
Other investment expenditure	0.7	0.8	1.3	1.4	1.0	1.2
Balance on a commitment basis	-7.8	-9.1	-9.9	-5.8	-4.0	-2.1
Balance on a cash basis	-5.1	-5.8	-5.9	-4.9	-4.4	-2.3
Financing on a commitment basis	7.8	9.1	9.9	5.8	4.0	2.1
Privatization proceeds	0.0	0.7	1.3	0.8	0.1	0.1
Foreign loans	5.1	5.0	4.8	4.2	4.0	2.8
Budget support	1.6	1.7	1.4	1.3	2.0	1.7
Foreign investment projects	3.5	4.0	4.1	3.4	3.0	2.8
Amortization	0.0	-0.6	-0.7	-0.5	-1.0	-1.7
Domestic financing 3/	0.0	0.0	-0.2	0.0	0.3	-0.5
Change in stock of domestic arrears (+ = increase)	2.7	3.4	4.0	0.9	-0.5	-0.2
Memorandum items:						
Stock of domestic spending arrears 4/	2.7	5.7	9.2	9.3	8.5	7.8
External public debt 5/	64.7	68.2	64.5	54.3	54.7	53.7
Primary balance	-6.7	-7.9	-8.6	-4.5	-2.8	-1.0
Public consumption	49.1	52.9	52.0	45.8	47.5	45.5
Public saving	-3.6	-4.4	-4.6	-1.0	0.0	1.9
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,629	10,493	10,902	11,462

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; prel. actual for the State; staff estimates for extrabudgetary funds.

2/ Excludes transfers by Federation Cantons due to lack of data.

3/ Including use and reconstitution of succession monies.

4/ Excludes war damage claims and frozen foreign currency deposits.

5/ Decrease in 2001 is due to debt-relief operation.

Table 4c. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
(In millions of KM)						
Federation budget						
Revenue (including grants)	716.9	738.3	889.6	1085.0	1066.3	1138.4
Expenditure on a commitment basis 2/	860.0	841.6	1010.1	1126.1	1162.8	1087.4
<i>of which</i> change in stock of domestic arrears	78.2	78.2	78.2	-10.5	0.0	0.0
<i>of which</i> transfers to the State	65.0	110.8	153.5	143.6	191.4	262.3
Balance on a commitment basis	-143.2	-103.2	-120.5	-41.1	-96.5	51.0
Cantonal budget						
Revenue	1106.4	1288.9	1252.9	1036.6	1113.8	1170.3
<i>of which</i> transfers from the Federation budget	7.0	15.9	25.1	18.0	14.5	13.0
Expenditure on a commitment basis	1106.4	1378.9	1400.9	1214.1	1122.3	1170.3
<i>of which</i> change in stock of domestic arrears	0.0	27.0	22.0	100.8	0.0	0.0
Balance on a commitment basis	0.0	-90.0	-148.0	-177.4	-8.5	0.0
Federation extra-budgetary Funds 3/						
Revenue	879.3	984.3	1117.9	1203.4	1248.0	1266.7
<i>of which</i> transfers from the Federation budget	24.3	6.9	8.8	84.0	25.8	19.0
Expenditure on a commitment basis	963.3	1068.3	1176.9	1115.4	1230.6	1266.7
<i>of which</i> change in stock of domestic arrears	84.0	84.0	59.0	-88.0	-17.4	0.0
Balance on a commitment basis	-84.0	-84.0	-59.0	88.0	17.4	0.0
RS budget and municipalities						
Revenue (including grants) 4/	486.7	821.5	921.0	896.3	1169.2	1184.1
Expenditure on a commitment basis	579.5	966.2	1031.9	955.6	1192.3	1149.4
<i>of which</i> change in stock of domestic arrears	35.0	79.0	105.7	25.0	-32.0	-25.8
<i>of which</i> transfers to the State	55.0	74.3	88.9	82.3	129.0	120.1
Balance on a commitment basis	-92.8	-144.7	-110.9	-59.3	-23.1	34.6
RS extra-budgetary funds 3/						
Revenue	261.4	358.7	392.6	425.1	517.9	528.4
<i>of which</i> transfers from the RS budget	0.1	28.1	36.7	16.0	115.3	91.0
Expenditure on a commitment basis	261.4	380.7	505.1	488.6	517.9	528.4
<i>of which</i> change in stock of domestic arrears	0.0	22.0	112.5	63.5	0.0	0.0
Balance on a commitment basis	0.0	-22.0	-112.5	-63.5	0.0	0.0
State budget						
Revenue (including grants)	138.0	223.6	280.2	294.7	402.0	496.7
<i>of which</i> transfers from the Federation and RS budgets	120.0	185.1	242.4	225.9	320.4	382.4
Expenditure on a commitment basis	143.9	223.6	291.2	294.9	397.0	509.3
<i>of which</i> change in stock of domestic arrears	5.9	0.0	11.0	0.2	0.0	0.0
Balance on a commitment basis	-5.9	0.0	-11.0	-0.2	5.0	-12.6
Brcko District budget 5/						
Revenue	0.0	0.0	23.5	98.1	138.7	150.0
Expenditure on a commitment basis	0.0	0.0	23.5	98.1	138.7	150.0
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects						
Grants	848.1	1095.7	825.2	737.9	512.2	383.4
Expenditure on a commitment basis	1114.6	1437.1	1220.3	1089.5	841.2	699.5
Balance on a commitment basis	-266.5	-341.5	-395.1	-351.6	-328.9	-316.1

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; prel. actual for the State; staff estimates for extrabudgetary funds.

2/ Includes transfers to Cantons and extrabudgetary funds.

3/ Pension Fund, Health Fund, and Employment Fund. Also includes the Children's Fund in the RS.

4/ Includes transfers to extrabudgetary funds.

5/ Data for 2000 are incomplete.

Table 4d. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
(In percent of BiH GDP, unless stated otherwise)						
Federation budget						
Revenue (including grants)	9.5	8.6	9.2	10.3	9.8	9.9
Expenditures on a commitment basis 2/	11.4	9.8	10.5	10.7	10.7	9.5
<i>of which</i> change in stock of domestic arrears	1.0	0.9	0.8	-0.1	0.0	0.0
<i>of which</i> transfers to the State	0.9	1.3	1.6	1.4	1.8	2.3
Balance on a commitment basis	-1.9	-1.2	-1.3	-0.4	-0.9	0.4
Cantonal budget						
Revenue	14.6	15.0	13.0	9.9	10.2	10.2
<i>of which</i> transfers from the Federation budget	0.1	0.2	0.3	0.2	0.1	0.1
Expenditure on a commitment basis	14.6	16.0	14.5	11.6	10.3	10.2
<i>of which</i> change in stock of domestic arrears	0.0	0.3	0.2	1.0	0.0	0.0
Balance on a commitment basis	0.0	-1.0	-1.5	-1.7	-0.1	0.0
Federation extra-budgetary Funds 3/						
Revenue	11.6	11.4	11.6	11.5	11.4	11.1
<i>of which</i> transfers from the Federation budget	0.3	0.1	0.1	0.8	0.2	0.2
Expenditure on a commitment basis	12.7	12.4	12.2	10.6	11.3	11.1
<i>of which</i> change in stock of domestic arrears	1.1	1.0	0.6	-0.8	-0.2	0.0
Balance on a commitment basis	-1.1	-1.0	-0.6	0.8	0.2	0.0
RS budget and municipalities						
Revenue (including grants) 4/	6.4	9.5	9.6	8.5	10.7	10.3
Expenditure on a commitment basis	7.7	11.2	10.7	9.1	10.9	10.0
<i>of which</i> change in stock of domestic arrears	0.5	0.9	1.1	0.2	-0.3	-0.2
<i>of which</i> transfers to the State	0.7	0.9	0.9	0.8	1.2	1.0
Balance on a commitment basis	-1.2	-1.7	-1.2	-0.6	-0.2	0.3
RS extra-budgetary funds 3/						
Revenue	3.5	4.2	4.1	4.1	4.8	4.6
<i>of which</i> transfers from the RS budget	0.0	0.3	0.4	0.2	1.1	0.8
Expenditure on a commitment basis	3.5	4.4	5.2	4.7	4.8	4.6
<i>of which</i> change in stock of domestic arrears	0.0	0.3	1.2	0.6	0.0	0.0
Balance on a commitment basis	0.0	-0.3	-1.2	-0.6	0.0	0.0
State budget						
Revenue (including grants)	1.8	2.6	2.9	2.8	3.7	4.3
<i>of which</i> transfers from the Federation and RS budgets	1.6	2.2	2.5	2.2	2.9	3.3
Expenditure on a commitment basis	1.9	2.6	3.0	2.8	3.6	4.4
<i>of which</i> change in stock of domestic arrears	0.1	0.0	0.1	0.0	0.0	0.0
Balance on a commitment basis	-0.1	0.0	-0.1	0.0	0.0	-0.1
Brcko District budget 5/						
Revenue	0.0	0.0	0.2	0.9	1.3	1.3
Expenditure on a commitment basis	0.0	0.0	0.2	0.9	1.3	1.3
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects						
Grants	11.2	12.7	8.6	7.0	4.7	3.3
Expenditure on a commitment basis	14.7	16.7	12.7	10.4	7.7	6.1
Balance on a commitment basis	-3.5	-4.0	-4.1	-3.4	-3.0	-2.8
Memorandum item:						
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,629	10,493	10,902	11,462

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; prel. actual for the State; staff estimates for extrabudgetary funds.

2/ Includes transfers to Cantons and extrabudgetary funds.

3/ Pension Fund, Health Fund, and Employment Fund . Also includes the Children's Fund in the RS

4/ Includes transfers to extrabudgetary funds.

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

Table 4e. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
	(In millions of KM)					
Federation						
Consolidated revenue (including grants)	2,671.3	2,988.7	3,226.5	3,223.1	3,387.8	3,543.4
Consolidated expenditure on a commitment basis	2,898.5	3,266.0	3,554.0	3,353.7	3,475.5	3,492.4
<i>of which</i> change in stock of domestic arrears	162.2	189.2	152.2	6.3	-17.4	0.0
<i>of which</i> transfers to the State	65.0	110.8	153.5	143.6	191.4	262.3
Consolidated balance on a commitment basis	-227.2	-277.2	-327.5	-130.6	-87.6	51.0
RS						
Consolidated revenue (including grants)	748.0	1,152.0	1,276.9	1,305.4	1,571.8	1,621.5
Consolidated expenditure on a commitment basis	840.8	1,318.8	1,500.3	1,428.2	1,594.9	1,586.8
<i>of which</i> change in stock of domestic arrears	35.0	101.0	218.2	88.5	-32.0	-25.8
<i>of which</i> transfers to the State	55.0	74.3	88.9	82.3	129.0	120.1
Consolidated balance on a commitment basis	-92.8	-166.7	-223.4	-122.8	-23.1	34.6
State budget						
Revenue (including grants)	138.0	223.6	280.2	294.7	402.0	496.7
<i>of which</i> transfers from the Federation and RS budgets	120.0	185.1	242.4	225.9	320.4	382.4
Expenditure on a commitment basis	143.9	223.6	291.2	294.9	397.0	509.3
<i>of which</i> change in stock of domestic arrears	5.9	0.0	11.0	0.2	0.0	0.0
Balance on a commitment basis	-5.9	0.0	-11.0	-0.2	5.0	-12.6
Brcko District budget 2/						
Revenue	0.0	0.0	23.5	98.1	138.7	150.0
Expenditure on a commitment basis	0.0	0.0	23.5	98.1	138.7	150.0
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects						
Grants	848.1	1,095.7	825.2	737.9	512.2	383.4
Expenditure on a commitment basis	1,114.6	1,437.1	1,220.3	1,089.5	841.2	699.5
Balance on a commitment basis	-266.5	-341.5	-395.1	-351.6	-328.9	-316.1

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; prel. actual for the State; staff estimates for extrabudgetary funds.

2/ Data for 2000 are incomplete.

Table 4f. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2003 Proj.
	(In percent of BiH GDP)					
Federation						
Consolidated revenue (including grants)	35.3	34.7	33.5	30.7	31.1	30.9
Consolidated expenditure on a commitment basis	38.3	38.0	36.9	32.0	31.9	30.5
<i>of which</i> change in stock of domestic arrears	2.1	2.2	1.6	0.1	-0.2	0.0
<i>of which</i> transfers to the State	0.9	1.3	1.6	1.4	1.8	2.3
Consolidated balance on a commitment basis	-3.0	-3.2	-3.4	-1.2	-0.8	0.4
RS						
Consolidated revenue (including grants)	9.9	13.4	13.3	12.4	14.4	14.1
Consolidated expenditure on a commitment basis	11.1	15.3	15.6	13.6	14.6	13.8
<i>of which</i> change in stock of domestic arrears	0.5	1.2	2.3	0.8	-0.3	-0.2
<i>of which</i> transfers to the State	0.7	0.9	0.9	0.8	1.2	1.0
Consolidated balance on a commitment basis	-1.2	-1.9	-2.3	-1.2	-0.2	0.3
State budget						
Revenue (including grants)	1.8	2.6	2.9	2.8	3.7	4.3
<i>of which</i> transfers from the Federation and RS budgets	1.6	2.2	2.5	2.2	2.9	3.3
Expenditure on a commitment basis	1.9	2.6	3.0	2.8	3.6	4.4
<i>of which</i> change in stock of domestic arrears	0.1	0.0	0.1	0.0	0.0	0.0
Balance on a commitment basis	-0.1	0.0	-0.1	0.0	0.0	-0.1
Breko District budget 2/						
Revenue	0.0	0.0	0.2	0.9	1.3	1.3
Expenditure on a commitment basis	0.0	0.0	0.2	0.9	1.3	1.3
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects						
Grants	11.2	12.7	8.6	7.0	4.7	3.3
Expenditure on a commitment basis	14.7	16.7	12.7	10.4	7.7	6.1
Balance on a commitment basis	-3.5	-4.0	-4.1	-3.4	-3.0	-2.8
	(In percent of Federation GDP)					
Federation						
Consolidated revenue (including grants)	47.7	48.7	48.0	44.4	44.6	44.0
Consolidated expenditure on a commitment basis	51.7	53.2	52.9	46.2	45.8	43.3
<i>of which</i> change in stock of domestic arrears	2.9	3.1	2.3	0.1	-0.2	0.0
<i>of which</i> transfers to the State	1.2	1.8	2.3	2.0	2.5	3.3
Consolidated balance on a commitment basis	-4.1	-4.5	-4.9	-1.8	-1.2	0.6
	(In percent of RS GDP)					
RS						
Consolidated revenue (including grants)	38.2	46.8	46.7	43.8	51.7	51.9
Consolidated expenditure on a commitment basis	43.0	53.6	54.9	48.0	52.4	50.8
<i>of which</i> change in stock of domestic arrears	1.8	4.1	8.0	3.0	-1.1	-0.8
<i>of which</i> transfers to the State	2.8	3.0	3.3	2.8	4.2	3.8
Consolidated balance on a commitment basis	-4.7	-6.8	-8.2	-4.1	-0.8	1.1
Memorandum items:						
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,629	10,493	10,902	11,462
Nominal Federation GDP (in millions of KM)	5,602	6,141	6,723	7,255	7,592	8,057
Nominal RS GDP (in millions of KM)	1,957	2,462	2,734	2,978	3,043	3,126

Sources: Ministries of Finance; and IMF staff estimates.

1/ Finalized budget outcomes in the Federation, the Cantons and the RS; preliminary actual for the State; staff estimates for extrabudgetary funds.

2/ Data for 2000 are incomplete.

Table 4g. Bosnia and Herzegovina: Federation Fiscal Operations, 2000-03

	2000	2001		2002			2003	
		Budget	Est. 1/	Budget	Prel. Act Jan-Sep	Proj. Oct-Dec		Proj. Year	Proj. Year
(in millions of KM, unless otherwise specified)								
Revenue	828.5	872.7	1,068.7	1,245.0	749.0	289.0	1,038.0	1,112.3
Tax revenue	768.0	813.3	949.6	1,153.3	660.7	268.9	929.6	1,009.3
Indirect taxes	745.5	788.4	905.5	1,103.9	654.8	267.0	921.8	991.3
Profit tax	22.5	24.9	44.1	49.4	5.9	1.8	7.7	18.0
Nontax revenue	60.5	59.3	119.1	91.7	88.3	20.1	108.4	103.0
<i>Of which: Dividends of public enterprises 2/</i>	0.0	0.0	27.7	40.0	36.5	0.0	36.5	25.0
Expenditure	976.4	997.6	1,169.2	1,559.4	891.7	352.6	1,244.3	1,217.4
Wages and contributions 3/	103.0	108.2	122.1	135.9	88.2	42.9	131.2	133.7
Goods and services	29.8	32.3	29.0	54.1	25.9	17.1	43.1	67.0
Military	309.6	290.2	296.8	393.8	302.6	84.1	386.7	270.0
Reconstruction and capital expenditure 4/	47.2	46.6	61.9	83.8	26.7	26.8	53.5	70.5
Subsidies	14.0	11.2	11.2	126.6	11.4	8.6	20.0	20.0
Other transfers to households	255.0	278.6	354.6	359.9	240.0	82.2	322.2	295.5
Transfers to pension funds	8.8	8.8	83.0	45.0	13.0	8.0	21.0	10.0
Regular transfers	8.8	8.8	19.0	25.0	13.0	2.0	15.0	10.0
Extraordinary transfers 5/	0.0	0.0	64.0	20.0	0.0	6.0	6.0	0.0
Transfers for health	0.7	1.0	1.0	1.2	4.8	0.0	4.8	9.0
Transfers for education	4.9	4.9	5.1	5.6	0.8	0.4	1.2	1.5
Transfers to war invalids	240.7	263.9	265.5	308.1	221.4	73.8	295.2	275.0
Transfers to the state government	153.5	167.8	143.6	235.7	120.2	71.2	191.4	262.3
Administration	30.0	37.0	37.0	51.5	34.1	23.2	57.3	58.0
Debt service	123.5	130.8	106.6	184.2	86.1	48.0	134.1	204.3
Transfers to cantons and municipalities	25.1	10.0	18.0	13.0	10.9	3.6	14.5	13.0
Net lending	-7.0	0.0	3.7	0.0	0.0	0.0	0.0	0.0
Clearance of domestic arrears	0.0	0.0	46.6	72.3	10.2	0.0	10.2	0.0
Other expenditure	46.2	52.7	81.6	84.4	55.6	16.1	71.6	85.4
Refugees	23.3	25.0	28.0	32.0	28.5	7.5	36.0	32.0
Refund of prelevmani duties	0.0	4.0	0.0	5.0	0.1	2.9	3.0	4.0
Intelligence Service	13.5	5.0	12.0	15.6	10.2	2.1	12.3	14.8
Budgetary reserve	0.0	11.2	15.1	14.0	2.6	0.9	3.5	10.0
Other	9.4	7.5	26.5	17.8	2.6	0.9	3.5	14.8
Overall balance (cash basis, before grants)	-147.9	-124.9	-100.4	-314.4	-142.7	-63.6	-206.3	-105.1
Foreign grants for budget support	61.1	0.0	16.3	13.2	0.0	28.3	28.3	26.1
Overall balance (cash basis, after grants)	-86.8	-124.9	-84.1	-301.2	-142.7	-35.3	-178.0	-79.0
Financing	86.8	124.9	84.1	301.2	142.7	35.3	178.0	79.0
Domestic financing 6/	-16.4	14.0	4.5	92.7	-23.9	-13.8	-37.7	-52.6
<i>of which</i> reconstitution of succession money	0.0	0.0	0.0	0.0			-31.5	-40.0
Foreign loans for budget support 7/	103.2	111.0	79.6	119.5	85.7	46.1	131.8	131.6
Privatization receipts	0.0	0.0	0.0	55.0	0.0	3.0	3.0	0.0
Succession money	0.0	0.0	0.0	34.0	71.5	0.0	71.5	0.0
Discrepancy					9.4			
Memorandum items:								
Revenue (in percent of GDP)	12.4	12.0	14.7	16.4	9.9	3.8	13.7	13.8
Expenditure (in percent of GDP)	14.6	13.8	16.1	20.5	11.7	4.6	16.4	15.1
Balance (cash, before grants, in percent of GDP)	-2.2	-1.7	-1.4	-4.1	-1.9	-0.8	-2.7	-1.3
Balance (cash, after grants, in percent of GDP)	-1.3	-1.7	-1.2	-4.0	-1.9	-0.5	-2.3	-1.0
Balance (commitment, after grants, in percent of GDP)	-1.3	-1.7	-0.5	-3.0	-1.7	-0.5	-2.2	-1.0
Military expenditure (in percent of GDP)	4.6	4.0	4.1	5.2	4.0	1.1	5.1	3.4
<i>of which</i> demobilization (in percent of GDP)	0.0	0.0	0.0	0.0	1.2	0.0	1.2	0.0
Debt service (in percent of GDP)	1.8	1.8	1.5	2.4	1.1	0.6	1.8	2.5
Expenditure excluding military and debt service	543.4	576.6	765.7	981.4	503.1	220.5	723.6	743.1
(in percent of GDP)	8.1	7.9	10.6	12.9	6.6	2.9	9.5	9.2
Nominal GDP	6,723	7,255	7,255	7,592	7,592	7,592	7,592	8,057

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

1/ Includes KM 40 million customs revenue collected in January and brought forward in 2001 outcome.

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

3/ Excludes wages of military and intelligence service staff.

4/ Includes railways.

5/ Transfers to clear pension arrears of previous years.

6/ In 2001, includes KM 17.7 million of revenue frozen in Hercegovacka Bank.

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

Table 4h. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 2001-03

	2001	2002			2003	
		Budget	Prél. Act. Jan-Sep	Proj. Oct-Dec		Proj. Year
(In millions of KM)						
Revenue	727.7	780.4	652.6	276.3	929.0	926.9
Tax revenue	631.7	687.2	542.7	235.6	778.3	793.6
Taxes on goods and services	304.6	367.4	315.1	128.5	443.6	456.7
Sales tax	151.7	204.7	135.1	58.0	193.1	231.6
Railway surcharge	29.4	29.4	41.9	16.5	58.4	28.4
Excises	123.5	133.3	138.2	53.9	192.1	196.7
Property tax on special goods 1/	-	20.8	11.5	4.6	16.1	16.5
Trade taxes	187.3	173.7	122.7	48.1	170.8	158.7
Customs duties	131.4	121.7	89.5	-89.5	-	117.1
Import duties	55.9	52.0	33.2	-33.2	-	41.6
Taxes on income	75.5	80.4	76.0	28.1	104.0	102.9
Other tax revenue	64.3	45.0	17.4	26.4	43.8	58.8
Non-tax revenue	47.8	46.5	64.9	23.4	88.3	91.1
Special revenue 2/	48.2	46.6	45.0	17.4	62.4	42.2
Expenditure	824.6	890.0	747.3	280.5	1027.8	979.7
Wages	346.0	346.3	243.4	113.3	356.7	354.0
Of which: Severance package	-	-	9.1	7.5	16.6	0.0
Goods and services	85.8	113.4	60.7	21.2	81.9	104.7
Subsidies to public enterprises 3/	18.7	17.8	29.9	8.5	38.4	18.0
Transfers to the social funds	16.0	20.2	93.1	22.2	115.3	91.0
Transfers to households	141.6	147.2	85.4	20.1	105.5	128.1
War invalids	105.2	110.5	57.8	21.3	79.1	103.2
Refugees	28.0	25.0	17.1	7.9	25.0	22.0
Other	8.4	11.7	10.5	-9.1	1.4	2.9
Transfers to municipalities	2.5	3.0	1.3	0.7	2.0	2.0
Transfers to the State	101.0	135.4	77.1	51.9	129.0	149.1
Debt service	82.0	109.6	59.2	41.0	100.2	120.1
Administration	19.0	25.8	17.9	10.9	28.8	29.0
Clearance of arrears	34.8	24.5	63.2	0.0	63.2	25.8
Capital and reconstruction expenditure	59.7	57.1	35.7	21.6	57.3	68.9
Of which: Railway	29.4	29.4	22.1	8.5	30.5	28.4
Other expenditure and unallocated 4/	18.5	25.2	57.6	20.9	78.5	38.1
Overall balance (cash basis, before grants)	-96.9	-109.6	-94.7	-4.2	-98.8	-52.8
Foreign grants for budget support	0.0	11.9	0.0	7.7	7.7	13.0
Overall balance (cash basis, after grants)	-96.9	-97.7	-94.7	3.5	-91.1	-39.8
Change in expenditure arrears (increase +)	-34.8	0.0	-30.7	-1.3	-32.0	-25.8
Overall balance (commitment basis, after grants)	-62.1	-97.7	-64.0	4.8	-59.1	-14.0
Financing	96.9	97.7	94.7	-3.5	91.1	39.8
Domestic financing 5/	-	-	-6.7	-31.4	-38.2	-33.0
o/w reconstitution of succession money	-	-	0.0	-8.3	-8.3	-8.3
External loans for budget support 6/	96.9	65.7	53.7	27.1	80.8	64.2
Privatization receipts	0.0	32.0	9.2	0.8	10.0	8.6
Succession money	-	-	38.5	0.0	38.5	0.0
Memorandum items:						
Military spending	62.4	75.3	84.2	20.8	105.0	89.6
Wage bill	53.9	47.9	43.5	30.3	73.8	66.5
Other	8.5	27.4	40.7	-9.5	31.2	23.1
Nominal GDP	2,978	3,043	3,043	3,043	3,043	3,126
(in percent of RS GDP)						
Revenue	24.4	25.6	21.4	9.1	30.5	29.7
Expenditure	27.7	29.2	24.6	9.2	33.8	31.3
Balance (cash basis, before grants)	-3.3	-3.6	-3.1	-0.1	-3.2	-1.7
Balance (cash basis, after grants)	-3.3	-3.2	-3.1	0.1	-3.0	-1.3
Balance (commitment basis, after grants)	-2.1	-3.2	-2.1	0.2	-1.9	-0.4
Military spending	2.1	2.5	2.8	0.7	3.5	2.9
excluding demobilization	2.1	2.5	2.5	0.4	2.9	2.9

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

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

2/ Includes other fees (on water, use of forests), own revenue from administrations, and other nontax revenue.

3/ Excludes railway subsidy.

4/ Includes transfers to cultural institutions and non profit organizations, and in 2003 transfers to UNDP project for Srebrenica.

5/ All privatization proceeds and succession money placed in escrow, unless otherwise specified.

6/ Disbursements only. Amortization included in debt service transfers to the State.

Table 4i. Bosnia and Herzegovina: State Fiscal Operations, 2000-03

	2000	2001	2002				2003 Proj.
			Budget	Prel. Act. Jan-Sep	Proj. Oct-Dec	Proj. Year	
(in millions of KM, unless otherwise specified)							
Revenue	274.8	272.7	432.3	230.7	132.5	363.2	465.9
Own revenue 1/	32.4	37.6	49.7	32.1	9.0	41.0	50.6
Transfers from entities	242.4	233.7	369.7	197.3	121.0	318.3	411.4
Administrative transfers	44.6	55.6	77.3	52.0	34.1	86.1	87.0
Federation	29.7	37.1	51.5	34.1	23.2	57.3	58.0
Republika Srpska	14.9	18.5	25.8	17.9	10.9	28.8	29.0
Debt service	197.8	178.1	292.4	145.3	86.9	232.2	324.4
Federation	123.8	107.2	181.9	86.1	48.0	134.1	204.3
Republika Srpska	74.0	70.9	110.5	59.2	38.9	98.1	120.1
Extraordinary revenue 2/	-	1.4	12.9	1.4	2.5	3.9	3.9
Expenditure	273.9	294.5	483.8	265.7	131.4	397.0	509.3
State Border Service	6.0	30.8	51.3	37.3	13.4	50.7	54.0
Wages	-	22.0	-	25.9	11.4	37.3	48.0
Other	-	8.8	-	11.4	2.0	13.4	6.0
New BiH institutions 3/	-	5.5	8.1	5.9	1.5	7.4	8.5
Clearance of domestic arrears	-	0.0	9.7	0.0	0.0	0.0	0.0
BiH ministries and institutions 4/	70.1	80.0	122.3	77.2	29.6	106.8	122.4
Debt service	197.8	178.1	292.4	145.3	86.9	232.2	324.4
Overall balance (cash basis, before grants)	0.9	-21.8	-51.5	-34.9	1.1	-33.8	-43.4
Foreign grants	5.3	21.9	41.0	32.6	6.3	38.8	30.8
Overall balance (cash basis, after grants)	6.2	0.2	-10.5	-2.4	7.4	5.0	-12.6
Financing	-6.2	-0.2	10.5	2.4	-7.4	-5.0	12.6
Domestic 5/	-6.2	-0.2	0.0	-16.5	-0.5	-17.0	12.6
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Succession money	0.0	0.0	19.6	19.6	0.0	19.6	0.0
Purchase of shares in IBRD and EBRD	0.0	0.0	-9.1	-0.8	-6.9	-7.6	0.0
Memorandum items:							
Revenue and grants excluding debt-service	82.4	116.5	180.8	118.0	51.9	169.8	172.3
Expenditure excluding debt-service	76.1	116.4	191.4	120.4	44.5	164.8	184.9

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

1/ In 2003, includes KM 10 million of CIPS revenue. Excludes revenue transferred from 2002.

1/ In 2003, transfer from Brcko District.

3/ In 2003, includes KM 5 million for SIPA, KM 2.4 million for Prosecutor's Office, and 0.6 million for Competition Committee.

4/ In 2003, includes KM 15 million for CIPS.

5/ In 2003, borrowing only for CIPS project.

Table 5a. Bosnia and Herzegovina: Quantitative and Structural Performance Criteria Under the 2002-2003 Stand-By Arrangement
(In millions of KM, unless otherwise noted)

	2002					
	End-Mar.		End-June		End-Sep.	
	Prog 1/ ^{1/}	Est.	Prog 1/ ^{1/}	Est.	Prog 2/ ^{2/}	Est.
A. Quantitative performance criteria						
Ceiling on gross credit of the banking system to the consolidated general government						
the State government ^{3/}	0	0	0	0	0	0
the RS government and municipalities	10	1	10	1	10	6
the RS extra-budgetary funds	2	4	2	6	2	10
the Federation government	20	18	20	19	20	19
the Federation cantons	10	23	10	22	10	21
the Federation municipalities	8	9	8	8	8	9
the Federation extra-budgetary funds	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more than one year by the public sector	0	0	445	0	445	187
Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government or the public sector ^{3/}	0	0	0	0	0	0
Ceiling on new external debt owed by the consolidated general government or guaranteed by the public sector with an original maturity of up to and including one year	0	0	0	0	0	0
Ceiling on outstanding external payments arrears ^{4/}	0	0	0	0 ^{5/}	0	0
B. Structural Performance Criteria						
Continued adherence of the Currency Board Arrangement as constituted under the law, incorporating the amendments described in paragraph 10 of the MEFP (EBS/02/91)		Met		Met		Met

Sources: BiH Authorities and IMF staff estimates.

^{1/} Targets are indicative.

^{2/} Targets for end-September, end-December 2002 are performance criteria and those for March 2003 are proposed performance criteria.

^{3/} Excluding letters of credit at the state level for CIPS financing up to KM 40 million. Actual borrowing for CIPS was Km 3 million at end-September 2002.

^{4/} This will apply on a continuous basis.

^{5/} BiH was in external arrears in the amount of US\$ 1.2 million as of July 1, 2002, and in the amount of US\$ 2.5 million as of July 30, 2002.

These arrears were cleared as of September 25, 2002.

Table 5b. Bosnia and Herzegovina: Prior Actions and Structural Benchmarks, March 2002-March 2003

	Implementation Date	Lead Institution	Status
I. Prior Actions			
1. The Entities will make transfers to the State, at least according to the agreed cumulative monthly schedule reported in Annex 3 of the MEFP.		IMF	Completed- subject to misreporting review (EBS/02/193)
2. (a) All privatization receipts accruing to the central governments of the RS and the Federation, and to the Cantons in the Federation will be placed in escrow accounts alongside all succession monies pending a comprehensive strategy to clear arrears.		IMF	Completed
(b) This is reflected in state law governing the use of succession assets, and Federation laws on privatization will be amended accordingly.		IMF	Completed
3. The Entities will formulate a plan to complete the introduction of modern Treasury Systems at their central government levels, and introduce modern Treasury Systems in local governments. The State will develop a plan to introduce a modern Treasury system.		World Bank USAID	Completed
4. The Federation will pass a strengthened tax administration law on the basis of a draft proposed by the U.S. Treasury.		IMF	Completed
5. Distribution of the first tranche of the succession monies to the entities and the state budget will take place in accordance with Annex 4 of Appendix V of EBS/02/91.		IMF	Completed
II. Structural Benchmarks			
A. Fiscal Sector			
1. (a) The Entities and the Brcko District will pass laws establishing the excise attribution mechanism as previously agreed with the World Bank.	End-July 2002	World Bank	Implemented
(b) The Entities and the Brcko District will implement these laws and stop double taxation on excises.	continuous	World Bank	Implemented
2. The customs administration in both Entities and the Brcko District will introduce the ASYCUDA++ information system.	End-July 2002	EU	Implemented
3. There will be no new free trade zones.	continuous	IMF	Implemented
4. Any changes to the current indirect tax system should retain or strengthen the principle of harmonization.	continuous	IMF	Implemented
5. The Federation pension fund will adhere to the cut-off dates for contribution collections at the end of each month as specified in the 2000 pension law. The RS pension fund will adhere to the cut-off date of the 10th of each month for contributions collec	continuous	IMF	Implemented
6. (a) The Brcko District will amend its legislation to include excise taxes in the base for calculating the sales tax.	End-Sept 2002	IMF	Implemented
(b) The base of the Brcko District sales tax will be aligned with that in the Entities.	End-Sept 2002	IMF	Implemented
(c) The two rates of sales tax in the Brcko District will be 8 and 18 percent unless changes are agreed with IMF staff.	End-Sept 2002	IMF	Implemented
(d) The Brcko District will bring the retail units in the "Arizona" market into the tax net.	End-Sept 2002	IMF	Implemented
7. A comprehensive strategy to clear arrears will be prepared. All arrears, including frozen foreign currency deposits, will be audited by the Supreme Auditor Institutions.	End-June-2003	IMF	To be monitored
8. Bosnia and Herzegovina will not clear domestic arrears that were accrued before end-2000, pending a comprehensive strategy to clear arrears.	continuous	IMF	Implemented
9. The RS, and the Federation will amend their budget laws to give effect to the requirement that cantons, municipalities, and extra-budgetary funds individually shall not increase their indebtedness to commercial banks or development banks except for borrow	End-June 2002	IMF	Not observed in the RS, observed in the Federation
10. There will be no offset operations for tax liabilities that are incurred after 2001.	continuous	IMF	Implemented
B. Financial Sector			
1. Banking supervision will be strengthened by enforcing the current prudential regulations.	continuous	IMF/World Bank	Implemented

Table 6. Bosnia and Herzegovina: Medium-Term Reform Scenario, 2000-2006

	2000	2001	2002	2003	2004	2005	2006
	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Real sector							
Nominal GDP (millions of KM)	9,629	10,493	10,902	11,462	12,303	13,256	14,316
(Percentage change)	11.9	9.0	3.9	5.1	7.3	7.7	8.0
Real GDP (millions of 1999 KM)	9,087	9,498	9,866	10,331	10,899	11,530	12,213
(Percentage change)	5.6	4.5	3.9	4.7	5.5	5.8	5.9
CPI, period average percentage change	5.1	3.1	0.3	0.5	1.9	2.0	2.1
Savings and investment (percent of GDP)							
Consumption	109.6	112.7	111.5	107.0	103.2	99.4	95.6
Public consumption	26.7	24.5	26.0	24.0	22.8	21.6	20.5
Private consumption	82.9	88.1	85.5	83.0	80.4	77.8	75.0
Investment	21.2	19.3	19.1	20.5	21.8	22.2	22.5
Public investment	13.9	11.8	8.7	7.6	8.5	8.1	7.8
Private investment	7.3	7.6	10.4	12.9	13.3	14.1	14.6
National savings	0.4	-3.7	-3.2	1.0	4.0	7.7	11.6
Public savings	0.4	1.3	0.7	2.9	3.5	4.6	5.5
Private savings	0.0	-5.0	-3.8	-1.9	0.4	3.1	6.0
Foreign savings	20.8	23.1	22.3	19.5	17.8	14.4	10.9
General government (percent of GDP)							
Total revenue and grants	56	52	52	51	49	47	47
Grants	10	7	5	4	3	2	1
Total expenditure	66	58	56	53	52	50	48
Current expenditure	52	46	47	45	43	42	41
Capital expenditure	14	12	9	8	8	8	8
Own-financed capital expenditure	1	1	1	1	2	2	2
Foreign financed capital expenditure	13	10	8	6	6	6	5
Overall balance	-10	-6	-4	-2	-3	-3	-2
Overall balance excl. grants	-20	-13	-9	-6	-5	-4	-3
Accumulation of arrears	4	1	0	0	-1	-1	-1
Overall balance on a cash basis	-6	-5	-4	-2	-4	-3	-2
Financing	6	5	4	2	4	3	2
Domestic financing	1	1	0	-1	1	1	0
Foreign financing	5	4	4	3	2	2	2
Total foreign assistance 1/ (In millions of US dollars)	15	12	10	9	5	4	4
	699	588	542	492	335	285	275
Balance of payments (US\$ millions.)							
Current account balance (including official transfers)	-957	-1,126	-1,166	-1,120	-1,103	-968	-792
(Percent of GDP)	-21	-23	-22	-20	-18	-14	-11
Export growth rate (in %)	10	3	9	15	17	20	17
Import growth rate (in %)	0	5	4	4	4	5	5
Gross reserves	488	1,253	1,203	1,253	1,303	1,353	1,403
(Months of imports of goods and n.f. services)	2.1	5.1	4.7	4.7	4.7	4.6	4.5
Total public debt 2/ (In millions of US\$)	4,643	4,311	4,628	4,812	4,855	4,917	4,986
(In percent of GDP)	103.3	89.7	86.6	83.7	78.3	73.3	68.6
Total external debt service in percent of exports of goods and non-factor services	6.8	5.8	8.3	10.0	8.7	7.8	6.3
Memorandum item:							
Percentage change in real current public expenditure	4.6	-7.0	7.4	-0.9	1.3	2.4	2.6

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

1/ Includes disbursements of foreign loans, and grants.

2/ Includes external public debt, stock of expenditure arrears, debt to domestic banks, and frozen foreign currency deposits. Excludes any liabilities arising out of war damage claims.

Table 7. Bosnia and Herzegovina: External Financing Requirements and Possible Sources of Financing, 2000-2003
(In millions of U.S. dollars)

	2000	2001	2002 Proj.	2003 Proj.
Merchandise trade balance	-1,678	-1,793	-1,828	-1,794
Services balance	264	231	226	217
Net factor income	256	250	246	269
<i>of which:</i> Interest due	-63	-59	-70	-63
Private transfers, net	164	157	157	163
Current account balance, excluding official transfers	-993	-1,154	-1,199	-1,145
Amortization of medium and long term obligations 1/	-12	-15	-33	-54
Repurchases of IMF resources	-20	-8	-19	-46
Changes in arrears (- is reduction)	-342	-550	0	0
<i>Of which:</i> Multilateral	0	0	0	0
London Club	0	0	0	0
Paris Club	0	0	0	0
Other 2/	-342	-550	0	0
London Club rescheduling and debt relief	8	2	4	5
Change in official reserves (a "-" sign indicates an increase)	-43	-766	50	-50
Change in NFA of commercial banks (a "-" sign indicates an increase)	-146	-213	-15	23
Gross external financing requirement	-1,549	-2,703	-1,212	-1,266
Official transfers	27	15	13	0
Capital transfers for reconstruction	396	346	252	190
Disbursement for reconstruction	188	160	151	155
Foreign direct investment	150	130	240	320
Other capital	383	1,419	433	468
Financing gap after project and humanitarian flows	-404	-633	-123	-133
Other rescheduling and debt relief 2/	342	550	0	0
Remaining financing gap	-62	-83	-123	-133
Identified program support	62	83	123	121
Disbursements under the IMF Stand-By Arrangement	37	18	40	48
World Bank adjustment lending	15	42	63	30
European Union (loans and grants) and other program financing	9	22	20	44
Remaining financing gap (-) 3/	0	0	0	-12

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

1/ Includes IMF repurchases.

2/ Mainly reflects rescheduling of debt arising out from bank guarantees for construction work that was not completed, unallocated suppliers credits, and debt acquired in non-convertible currency.

3/ See footnote 7 in Table 3

Table 8. Bosnia and Herzegovina: Vulnerability Indicators, 2000-2006

	2000	2001	2002	2003	2004	2005	2006
Exports (annual percent change, US\$ basis)	9.5	2.6	8.5	15.0	17.0	20.0	17.0
Imports (annual percent change, US\$ basis)	0.4	5.4	4.2	4.2	4.4	4.9	5.0
Current account balance (in percent of GDP) 1/	-20.8	-23.1	-22.3	-19.5	-17.8	-14.4	-10.9
Capital and financial account (in percent of GDP)	21.2	38.5	20.8	20.1	19.3	15.8	12.0
Gross official reserves (end-of-period, in millions of U.S. dollars)	488	1,253	1,203	1,253	1,303	1,353	1,403
In months of imports of goods and nonfactor services (GNFS)	2.1	5.1	4.7	4.7	4.7	4.6	4.5
Broad money/NFA (end-of-period)	5.8	1.8	2.1	2.1	...	...	...
Foreign exchange deposits/reserves (percent, end-of-period)	94.5	67.1	72.1	79.8	...	...	...
Total external debt (percent of GDP)	64.5	53.2	51.6	50.6	48.3	46.1	44.0
External debt service/exports of GNFS (in percent) 2/	6.8	5.8	8.3	10.0	8.7	7.8	6.3
External debt service to multilateral creditors/exports of GNFS (in percent)	5.3	4.1	6.8	6.8	6.2	5.9	4.5
External debt service to multilateral creditors (in percent of total debt service)	79.0	70.4	81.2	67.2	71.5	75.8	71.6
External debt service to the IMF (in percent of total debt service)	27.0	19.4	18.9	31.5	33.1	30.9	25.1
Exchange rate (per U.S. dollar, period average)	2.1	2.2	...	...	...	...	...
REER depreciation, end-of-period (-) (annual percent change)							
Republika Srpska	10.4	-5.5	...	...	...	...	...
Federation	-1.1	-7.7	...	...	...	...	...

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

1/ Includes transfers.

2/ Includes repayment of IMF loans.

Bosnia and Herzegovina: Fund Relations

As of October 31, 2002

I. <u>Membership Status</u> : Succeeded to the membership of former SFR of Yugoslavia effective 12/14/1992; Article XIV						
II. <u>General Resources Account</u> :						
			<u>SDR Million</u>		<u>%Quota</u>	
Quota			169.10		100.0	
Fund Holdings of Currency			264.35		156.33	
III. <u>SDR Department</u> :						
			<u>SDR Million</u>		<u>%Allocation</u>	
Net cumulative allocation			20.48		100.0	
Holdings			0.43		2.08	
IV. <u>Outstanding Purchases and Loans</u> :						
			<u>SDR Million</u>		<u>%Quota</u>	
Stand-by arrangements			95.24		56.32	
V. <u>Latest Financial Arrangements</u> :						
	<u>Approval</u>	<u>Expiration</u>	<u>Amount Approved</u>	<u>Amount Drawn</u>		
<u>Type</u>	<u>Date</u>	<u>Date</u>	<u>(SDR Million)</u>	<u>(SDR Million)</u>		
Stand-by	8/02/2002	11/01/2003	67.60	19.60		
Stand-by	5/29/1998	5/29/2001	94.42	94.42		
VI. <u>Projected Obligations to Fund</u> :(SDR Million; based on existing use of resources and present holdings of SDRs):						
		<u>Forthcoming</u>				
		<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal		4.84	34.90	32.10	16.05	7.35
Charges/Interest		<u>0.83</u>	<u>2.76</u>	<u>1.74</u>	<u>0.92</u>	<u>0.55</u>
Total		<u>5.67</u>	<u>37.66</u>	<u>33.84</u>	<u>16.97</u>	<u>7.90</u>

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, Central Bank of Bosnia and Herzegovina (CBBH) is subject to a full safeguards assessment with respect to the new Stand-By arrangement. A safeguard assessment report was approved by IMF management on October 31, 2002. The report concludes that the safeguard in place is generally adequate but certain weaknesses were identified in the internal audit function and internal controls. The authorities indicated their broad agreement with the recommendations of the report.

VIII. Exchange Rate Arrangements

The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. On September 5, 2002, the State parliament approved an amendment to the

CBBH law that changes the peg of the KM from the DM to the Euro, under a currency board arrangement. The KM is pegged to the euro at KM 1 = 0.5113 euro. Small denominations of KM notes have been in circulation since June 22, 1998; large denominations and coins were introduced in August 1998, and December 1998, respectively. The convertible marka (KM) is the currency used for operations and transactions with the Fund for Bosnia and Herzegovina.

Bosnia and Herzegovina maintains restrictions on payments for current international transactions and transfers resulting from measures taken with respect to frozen foreign currency deposits.

IX. Last Article IV Consultation

Bosnia and Herzegovina is on the twenty-four month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The last Article IV consultation was concluded on February 25, 2002.

X. Resident Representative

Ms. Valeria Fichera has been the Fund's resident representative in Bosnia and Herzegovina since July 6, 2002.

XI. Technical Assistance, 1999- April 2002

Department	Timing	Purpose
FAD	December 1995	Diagnostic
	February 1996	Income tax policy
	February 1996	Customs and tax administrations
	April-May 1996	Tax administration
	November 1996	Diagnostic mission to Repub. Srpska
	December 1998	Fiscal management at the State level
	November 1999	Consumption and inter-Entity trade taxation and policy
	August 2000	Treasury systems
	September-October 2000	Value-added tax
	July 2001	Treasury Systems
April 2002	Value-added Tax	
LEG	May 1996	Tax administration law
LEG/TRE/SEC	December 1995	Assistance with succession to membership
MAE	December 1995	Institution-building and banking legislation
	October 1996	Payments bureaus
	February 1997	Payments, accounting, and information systems
	June 1997	Central bank establishment and payments system
	July 1997	Central bank accounts and administration

	March 1998	Further development of the central bank and payments system and introduction of currency notes
	July 1998	Accounting
	November 1998	Central bank activities in foreign exchange, accounting, information technology, and administration
	January 1999	Central bank operations in foreign exchange, currency board, accounting and auditing. Reforming and modernizing the payments system.
	January 1999	Advisor on payments bureau reform.
	September 2000	Advisor on payments system.
	March-April 2001	Payments system, currency management, accounting and research
	October-November 2002	Strengthening Banking Supervision
MAE/EU1	June 1996	Discussion of new central bank
MAE/LEG	January/February 1996	Assistance from headquarters drafting legislation for new central bank and bank agency
	November 1996	Refinement of new central bank and bank agency legislation
STA	November 1995	Diagnostic participation in pre-membership mission
	April 1996	Money and banking statistics
	June 1996	Money and banking statistics
	November 1996	Money and banking statistics
	August 1997	Money and banking statistics
	January 1998	Multi-sector statistics
	September 1998	Money and banking statistics
	November 1998	Balance of payments statistics
	May 1999	Statistical advisor
	June 1999	Money and banking statistics
	September 1999	Balance of payments statistics
	October 2000	Money and banking statistics
	December 2001	Money and banking statistics

BOSNIA AND HERZEGOVINA—IMF-WORLD BANK RELATIONS

PARTNERSHIP IN BOSNIA AND HERZEGOVINA'S DEVELOPMENT STRATEGY

Bosnia and Herzegovina's Development Agenda

1. The authorities of Bosnia and Herzegovina recognize the importance of maintaining satisfactory macroeconomic performance while accelerating structural reforms. As demonstrated through the PRSP preparation process, Government has embarked on reforms to address several key economic challenges, including: (i) creating a predictable and coherent investment environment within a single economic space; (ii) promoting private sector activity within an improved business environment; and (iii) strengthening governance whilst combating corruption.
2. Submitted to the World Bank and the IMF in December 2001 for information, not linked to any Bank or IMF operation, the Government's I-PRSP emphasized the development of an entrepreneurial society within a single economic space while combating corruption and strengthening governance. As with the I-PRSP, the major focus of the ongoing full PRSP preparation process is the economy's heavy reliance on foreign assistance, high formal unemployment and the low level of domestic production. It further emphasizes corruption problems across many sectors and the poor quality of public services. The strategy also points to greater cooperation between the Entities if progress is to be made on expanding the economy and integrating BH's political and economic structures into a wider Europe. The central theme of the strategy is that poverty can only be effectively combated through greatly expanded private sector activity.
3. BH's recently completed poverty profile, developed on the basis of the recently completed Living Standards Measurement Study, confirms the importance of generating new private sector jobs to poverty alleviation and improving employment prospects for the young and secondary household earners; but also points to the need to raise wages among the working poor and general skills levels in the workforce, while protecting children and households headed by inactive adults. As a result, the upcoming PRSP is expected to address issues covering the effective implementation of pension and health reform, the reorientation of the social safety net to protect children and the non-pensioned elderly, a strengthened education system and improved productivity in the productive sectors.
4. The Coordination Board for Economic Transition and EU Association, charged with overseeing the implementation of the I-PRSP and the preparation of the PRSP, earlier this year adopted an action plan to improve the business environment. The action plan covers a wide variety of areas which impact on both new and existing investment, ranging from judicial reform to institutional changes to rationalize and improve processes governing business entry, operation and exit. Its aim is to create discernible changes in the business environment in the short term so as to ameliorate investor attitudes to BH.
5. Mindful that perceptions of wide spread corruption not only discourages sound investment but constitutes a serious problem for the most vulnerable in society, the

Coordination Board earlier this year also adopted a comprehensive anti-corruption action plan. The plan covers: (i) legislative improvements; (ii) institutional strengthening activities; and, (iii) educative activities. The plan is under implementation with notable achievements having been made in improved tax and customs collections.

6. Some steps have also recently been taken to further strengthen key BH State institutions and activities. This in large part has been undertaken in the context of the SAP with the European Union. A State Border Service has been operational for some time as has a Communications Regulatory Authority (CRA). Legislation has also been passed which provides for a State deposit insurance agency and a State body to regulate energy transmission. In addition, the State has played an aggressive role to liberalize external trade and open up regional markets. Trade agreements have been signed with Slovenia, Croatia, FYR Macedonia, FRY and Turkey and are under negotiation with Albania, Bulgaria and Romania, while WTO membership is being actively pursued.

7. The I-PRSP also stresses the importance of comprehensive public administration reform to reduce the size of government in the face of declining external assistance, the sustainability of the social protection system and the need to strengthen human capital by reinforcing family and community life and improving education and health services. Government has been advised that follow-through is necessary, however, to successfully deepen policy reform in these areas, particularly as concerns the determination of the best administrative structure for BH consistent with both the Dayton Peace Agreements and a country aspiring to become a member of the EU.

8. The Bank and the IMF concluded in their joint letter to Government that BH's I-PRSP provided a satisfactory initial framework to help spearhead the country's transition to a self-sustaining economy, and to fight poverty. However, Government was urged to provide greater clarity on strategic priorities and modalities for the implementation of policy reforms against a hard budget constraint. In this regard, the authorities are paying special attention to integrating the policies and priorities being developed under the PRSP into medium term expenditure frameworks of State and Entity governments. Other issues cited in the I-PRSP are being taken up in the preparation of the full PRSP.

9. Preparation of the full PRSP started in early 2002. After extensive consultation across both Entities the authorities have completed the first draft of their full PRSP. This draft document will form the basis of a further round of consultation. The PRSP is expected to be finalized early next year following the October 2002 elections, once new State and Entity governments are in place.

10. The IMF has taken the lead in assisting BH in maintaining macroeconomic stability and ensuring fiscal sustainability. A new Stand-by Arrangement (SBA) was approved by the IMF's Board of Directors in August 2002. As a matter of priority, structural conditionality has focused on issues related to fiscal consolidation.

11. The World Bank has taken the lead in policy dialogue on structural and institutional reforms in several select sectors. Bank assistance focuses on assisting the

authorities: (i) reach agreement on a medium-term strategy for further public finance reform, which reduces the size of the public sector, ensures minimum capacities and competencies are developed at the State level for effective policy formulation and execution, and promotes the efficient delivery of services at the local level; (ii) follow through on their ongoing efforts to create an investor-friendly economy that promotes SME development; (iii) complete long delayed reforms to the social safety net, to ensure that scarce public resources are used efficiently to protect the most vulnerable in society. Specific assistance has been designed to support BH in the finalization of its PRSP.

12. Progress is being made especially in areas (i) and (ii) above. A US \$44 million *Business Environment Adjustment Credit (BAC)* was approved by the World Bank in May 2002. The third and final tranche of the *Second Public Finance Adjustment Credit (PFSAC II)* was recently disbursed. A *Public Expenditure and Institutional Review (PEIR)* was completed in May 2002. Each of these instruments were key elements of the Bank's program as outlined in the full, June 2000, Country Assistance Strategy.

IMF-World Bank Collaboration in Specific Areas

13. The IMF and the World Bank maintain a close collaborative relationship in supporting the Government's structural reforms. The IMF focuses on fiscal sustainability, monetary policy and bank supervision, while the Bank Group focuses increasingly on structural issues related to private sector development, strengthening governance and institution building. During PRSP finalization stages in the coming six months, effective collaboration between the Bretton Woods organizations will become increasingly important in assisting BH conclude its strategy paper.

Strengthening Institutions and Governance

14. The consolidated State and Entity budget deficit contracted by three percentage points of GDP over 2001 and net arrears accumulation slowed dramatically largely as a result of initial reforms in the pension system. Nevertheless with public spending at 60 percent of GDP the size of government is not sustainable in the context of BH's future resource availability. A further fiscal consolidation of four percentage points of GDP is expected by 2003 through a combination of measures supported in the near term by the ongoing SBA. Medium-term fiscal consolidation will be taken up in new Bank operations targeted at: (i) rationalizing and improving the efficiency of public expenditure in the current multi-layered and fragmented governance structure; (ii) reducing the proportion of public expenditure spent on wages and salaries—by restricting overall recruitment and compensation in the context of a broader public administration reform agenda; (iii) limiting extensive and generous veterans' entitlements; (iv) reducing expenditures in the defense and public order and safety sectors (over and above the reductions already achieved in 2001); and (v) significantly increasing the efficiency of expenditures in the education, health and social welfare sectors.

15. Recent Bank sponsored reviews are now helping BH in defining these medium-term policy directions. The *PEIR (FY02)* entitled *From Aid Dependency to Fiscal Self*

Reliance pays particular attention to: (i) fiscal policy and expenditure challenges if growth and stability are to be assured in the medium term; (ii) inter-government relationships from municipalities up to State government; (iii) fiscal balance between these various levels of public administration; (iv) financial management and public procurement capabilities; and (v) social service spending - particularly in the areas of social welfare, education and health. The PEIR is the capstone study to the subsidiary and self standing *Country Procurement Assessment Report (CPAR) (FY02)*, *Country Financial Accountability Assessment (CFAA) (FY03)*; and a local government finance study entitled *Creating a Stable Decentralized Fiscal System (FY03)*.

16. The PEIR emphasizes that: (a) while notable achievements have been made in improving the performance of certain public institutions, fragmented governance structures with ill-defined goals, hamper nation building and efficiency benefits from decentralization. The costs, both economic and social are substantial because fragmentation hinders the efficient use of public resources; and, (b) in order to achieve more coherent and harmonized policy formulation and implementation, the State's role as an integrative force needs to be strengthened, while rationalizing the public sector's overall role in the economy.

17. Support is ongoing to: (i) facilitate BH's efforts to reduce military expenditures through a *Pilot Labor Redeployment Project (FY00)*; (ii) strengthen local government through a *Local Development Project (FY00)* and the *Mostar Water Project (FY00)*; (iii) strengthen public management of the power sector, providing for a State regulator for the transmission of electricity under a *Power III Project (FY01)*; and (iv) improve trade and transport infrastructure and services through a *Trade and Transport Facilitation Project (FY01)* and a *Road Management and Safety Project (FY02)*.

Fostering Private Sector-Led Growth

18. Accelerating restructuring reforms remains the central challenge to BH becoming a self-sustaining economy. Current projections call for a redoubling of reform efforts in order to achieve financial sustainability by the end of the decade. Moreover, even though significant fiscal consolidation has recently been achieved, a substantial reduction in the public sector is still required if BH to remain on the sustainable fiscal path. For its part, the Bank will follow through with detailed discussions with Government on the recommendations set forth in the PEIR.

19. The World Bank closely coordinates with the IMF through discussions on issues of private sector development. Most notably, collaborative efforts have focused on ensuring that bankruptcy laws are modernized. With initial rounds of labor market and banking reform completed (supported by two recently closed IDA adjustment credits), such collaboration proved integral to the successful implementation of Bank assistance over the short term period. During the period July 2002 to December 2003 the Bank will focus on helping the authorities follow through on the remaining three elements of their strategy for private sector development: (i) privatization; (ii) improving the business enabling environment; and (iii) SME development.

20. Given that SME and voucher privatization in non-strategic industries have largely been completed, the Bank, along with other donors, is focusing its assistance on the **privatization** of the larger strategic state-owned enterprises through a *Privatization Technical Assistance Project (FY01)*. While privatization of these enterprises has taken longer than expected and needs to be accelerated, careful attention is required to ensure that: enterprises are privatized into a competitive environment (in the case of utilities and transport, this often involves the elaboration of a regulatory framework within the context of a well developed sector strategy); competent strategic investors/managers are found; and, ownership and labor issues are resolved. Sustained assistance into the medium term will, therefore, be required.

21. The centerpiece of Bank assistance over the period to end-December 2003, will be to help BH achieve short-term results in implementation of key parts of its action plan to improve the business environment. The objective is not only to **mobilize new investment** but to initiate a critical change in investor perceptions of BH. Attainment of targets specified for second and final tranche release of the *Business Environment Adjustment Credit (BAC) (FY02)* will be the particular focus of Bank assistance. This includes: (i) the development of a common (inter-Entity) business registration system and attainment of reduced business registration-time targets; (ii) introduction of a new collateral registry system; (iii) the rationalization of business inspections, and, to this end, the attainment of key outcome targets; and (iv) the adoption of new bankruptcy and liquidation legislation.

22. **SME development** is critical to expanding private sector activity and job opportunities. Increased competition in the banking sector and falling interests rates are improving SME access to finance in the FBiH. Banking sector reforms in the RS, however, started later than those in FBiH and are less advanced. A recently approved *Private Sector Development Project (FY02)* will, therefore, provide much needed project financing to SME's in the RS. Several donor programs provide firm-based technical assistance for private sector development throughout BH, such as the IFC sponsored SEED initiative. Small-scale operators in the agriculture and forestry sectors have less access to these programs because of the risks associated with their operations. At the same time they are a vulnerable population group in terms of the country's poverty profile requiring sustained assistance. Further lending, leveraging other donor assistance, for a *Forestry Learning and Innovation Loan (LIL)* and a new *Small Scale Commercial Agriculture Development Project* are, therefore, planned for the period up to December-2003.

23. **IFC's strategy** in BH is multidimensional, encompassing all sectors of the economy, but particularly inherited competitive industries such as SMEs, wood, agribusiness, and areas of the economy identified as having potential in the aftermath of the conflict, such as banking and infrastructure. In the financial sector, IFC's focus has been to build and strengthen financial intermediaries, including assisting in privatization, establishing greenfield banks and working with local financial institutions in their efforts to develop into high quality banks. During FY01-02 six projects (US\$55 million) were approved to finance: (i) a pharmaceutical company to rebuild its manufacturing plant; (ii)

a micro enterprise to strengthen its position as a financial institution with broad international support; (iii) a micro enterprise bank to on-lend to micro and small enterprises on a long-term basis; (iv) a Special Purpose Vehicle, an innovative approach to facilitate governments' privatization of its share in Privredna Banka Sarajevo (PBS); (v) a foreign bank, enabling the refinancing of existing working capital loans and extension of term loans to SMEs, to support new investments, and grant loans to private individuals to refurbish or buy apartments/houses; and (vi) a post-privatization rehabilitation, modernization, and expansion project of a cement factory. IFC also assists the SME sector through a multi-donor South East Europe Enterprise Development (SEED) initiative, officially launched in September 2000 and operating in Albania, BH, FYR Macedonia, Federal Republic of Yugoslavia (FRY) and Kosovo (FRY). SEED provides firm-level support to the SME sector through investment advisory services and advice to address constraints in the business environment; capacity building programs for SMEs and Business Development Service Providers and information and knowledge relevant to the private sector.

Building Social Sustainability

24. The Bank is supporting a program of social reforms focused on four key issues: protecting the poor, strengthening human capital, social inclusion and ensuring environmentally sustainable development. The human cost to delayed social protection reform is starkly highlighted in the recent findings of the *Poverty Assessment* and *PEIR*. Both detail the failure of the **social safety net** to protect the poor, and significant inefficiencies in social assistance cash-transfer systems. Furthermore, the existing system is financially unsustainable without significant restructuring. A delayed second *Social Sector Adjustment Credit (SOSACII)* now planned for FY03 will support the authorities in their commitment to: (i) transform veterans benefits to reflect fiscal realities and European practice by targeting benefits on the most disabled veterans and dependent families of dead soldiers; (ii) support solidarity funds for social and child assistance in both Entities, to ensure pooling of financial resources and a reduction in regional disparities of benefits to the poorest; (iii) implementing minimum benefit standards for disabled civilians, to ensure cash benefits are directed to the most disabled, and public funds cover key aids; and (iv) promote participation from NGOs and other civil society actors in the social protection system.

25. The IMF has advised the World Bank regarding budget issues related to pensions payments and war veterans benefits over the short to medium term. The Bank has concentrated its efforts on identifying and promoting the structural changes in these systems necessary for fiscal sustainability, consistent with the IMF's own budget discussions with the BH authorities. The sustained public awareness and technical assistance needed to strengthen government and NGO capacities to detail and implement these and other reforms are being supported through an ongoing *Social Sector Technical Assistance Credit (SOTAC) (FY01)*.

26. A key element of Bank support over the period to December 2003 are to: to complete the process of follow-up assistance to the LSMS and the Bank's *Poverty*

Assessment; ensure that findings are effectively incorporated into the **PRSP**; realistic monitorable indicators are set; and, eventually, adequate evaluation and monitoring capacities are built up for sustainable PRSP implementation.

27. Initial feedback from consultations under the PRSP, confirmed by the findings of the PEIR, indicate that government capacities to implement recent **pension and health** reforms need be strengthened and severe inefficiencies in the education system need to be addressed. A *Social Insurance Technical Assistance Project* aimed at modernizing health and pension institutions, well advanced in its preparation, is planned for FY03.

28. The PEIR highlights wasteful expenditures and poor services and results in the **education** sector, particularly in tertiary education. Furthermore, BH's poverty profile—indicating a high correlation between poverty and level of education in any given household—underscores the need to ensure that access to an efficient and modernized education system is greatly improved. Nevertheless, the PEIR points to significant financing problems in the sector, largely associated with fragmented delivery and funding of services. The authorities, with the strong support of the international community, regard consolidation and rationalization of the sector as fundamental to quality improvements. To this end, a comprehensive education sector strategy is expected to be completed with Bank support by the end of this calendar year, and a new Education project is planned.

29. BH's poverty profile also indicates that the poor tend to be concentrated in particular semi-urban and rural communities which suffer from economic dislocation and social cleavages. Often these communities have a high concentration of IDPs and refugees. Bank assistance will continue to promote social **inclusion**, aimed at helping to ensure wider participation in post-conflict growth, ethnic reconciliation and improved delivery of services to disadvantaged groups through two projects approved by the Board over the last CAS period.

30. Strategic planning for the **environment** to safeguard sustainable development has witnessed consistent progress with the support of an *IDF grant (FY00)*. Through a process involving consultation with a wide range of stakeholders, an Environmental Action Plan (EAP) currently in draft form, is expected to be finalized and adopted before the need of this calendar year. An initiative to deal with one of BH's key environmental problems, the disposal of solid waste, resulted in the recent Board approval of a *Solid Waste Management Project (FY02)* which will help consolidate dump sites and encourage private sector activity in waste collection.

31. As part of a regional initiative in South East Europe (SEE), the Development Learning Center in BH is well advanced in its preparation and is expected to become fully operational in January 2003. It is expected to be a powerful tool in the training of civil servants and public policy makers in the context of BH's civil service reform program; and in conveying critically important skills in the areas of business management and policy to aspiring entrepreneurs and local businesses.

World Bank Group Strategy and Lending Operations

32. The Bank's Board discussed the Country Assistance Strategy Progress Report for BH on November 12, 2002. The progress report determined that, in terms of reform targets and lending triggers established in the 2000 CAS, BH ended the CAS period in the base case. The remaining public finance reform and enterprise and bank privatization detailed in the October 2001 progress report were completed, and a new program to strengthen the business environment was successfully launched. However restructuring of the social protection system in 2002 did not proceed according to government's original plan; as a result IDA assistance was not fully committed over the CAS period. Pending completion of the full PRSP, the second CAS Progress Report outlined the Bank assistance program up to December 2003. The CAS Progress Report, while adhering to the assistance objectives laid out in the last CAS, was designed to support BH in the preparation and finalization of its first PRSP.

33. Since 1996, forty-four IDA supported projects have been approved, in addition to fifteen IFC operations, and fourteen MIGA guarantees. Of the US\$962 million in IDA commitments, US\$671 million has been disbursed as of June 30, 2002. The BH project portfolio continues to perform better than the average Bankwide portfolio. There are no problem projects and no potential problem projects. All QAG project and ESW reviews to date have rated products as satisfactory or above, bar a rating for one adjustment operation of less-than satisfactory. Similarly all 25 closed projects have received a satisfactory or better than satisfactory rating from OED. There are, however, fundamental differences in the current portfolio of active projects with those of the first generation "emergency" type operations. World Bank financing no longer covers 100 percent of eligible project costs. The active portfolio is comprised of 20 projects, including 2 adjustment operations and 18 investment loans (Annex I).

34. Adjustment operations currently under preparation include the Second Social Sector Adjustment Credit (para. 26) and an Economic Management Structural Adjustment Credit (EMC) supporting further public administration reforms (para. 11) for approximately US\$36 million and US\$35 million respectively. Investment operations currently under preparation include: Social Insurance Technical Assistance (approximately US\$5 million); small Scale Agriculture (approximately US\$12 million); Education IV (approximately US\$12 million) and a Forestry (LIL) (approximately US\$2.0 million).

Questions may be referred to the following Bank staff: Simon Gray (ext. 34011) and Jean-Luc Bernasconi (+387 33 440 293).

Bosnia and Herzegovina: Status of Bank Group Operations
(Operations Portfolio)

<u>Active Projects</u>		<u>Last PSR</u>		Fiscal Year	IBRD	<u>Original Amount in US\$ Millions</u>			<u>Difference Between Expected and Actual Disbursements^{a/}</u>	
Project ID	Project Name	Supervision Rating				IDA	GRANT	Cancel.	Undisb.	Orig.	Frm Rev'd
		<u>Development Objectives</u>	<u>Implementation on Progress</u>							
P044523	BASIC HEALTH	S	S	1999		10		4.839819	5.1	
P071001	BUS ENABLG ENV SAC	S	S	2002		44		26.52597	-20	
P070995	COMM DEVT	S	S	2001		15		14.68383	4.1	
P059763	CULTL HERITAGE PILOT	S	S	1999		4		2.130402	2.2	
P058512	EDUC 3	HS	HS	2000		10.6		6.967193	0.3	
P058521	ELEC PWR 3 RECN	S	S	2001		35		34.98871	0	
P070146	EMG LABOR REDEPLOYM	S	S	2000		15		12.50314	9.7	
P045820	EMG INDUST. RESTART	S	S	1997		11		0	0.6	
P062936	ENT EXP FACIL (BEEF)	S	S	1999		12		4.238878	4.6	
P045134	FORESTRY	S	S	1998		7		0.897967	1.6	
P066169	LOC INIT 2	S	S	2001		20		19.6332	16.5	
P056192	LOCAL DEVT	S	S	1999		15		12.41329	10.4	
P057951	MOSTAR WS & SAN	S	S	2000		12		8.578457	1.7	
P055432	PFSAC 2	S	S	1999		72		19.56187	45.6	14.34955
P070917	PRIV TA	S	S	2001		19.8		20.00842	2.6	
P070243	PRIVATE SECTOR CREDITS		S	2002		10		10.06444	-0.1	
P071347	ROAD MGMT SAFETY	S	S	2002		30		32.43647	0	
P057950	SOLID WASTE MGMT	S	S	2002		18		18.80278	0	
P070650	SOTAC	S	S	2001		3.55		3.38314	2.2	
P070079	TRADE & TRANS FACIL R	S	S	2001		11		10.91813	9.2	
Overall result				Result		363.95		263.5761	95.7	14.34955

a/ Intended disbursements to date minus actual disbursements to date as projected at appraisal.

BOSNIA AND HERZEGOVINA: STATISTICAL ISSUES

1. The Dayton peace treaty, which ended the civil war implicitly gave responsibility for statistical functions to the two Entities (The Federation of Bosnia and Herzegovina and Republika Srpska). In August 1998, the State created its own statistical institute, the Bosnia and Herzegovina Agency for Statistics (BHAS) with a view to compiling country-wide statistics in accordance with internationally accepted methodologies, consolidating data produced by the Entities Statistical Institutes, and acting as the primary coordinating agency for contacts with international agencies. Significant technical assistance was provided in recent years, mainly by the European Union and essentially in the form of training seminars and study visits. A Fund resident statistical advisor was assigned to the Central Bank of Bosnia and Herzegovina (CBBH) in May 1999, to provide technical assistance in the development of all areas of macroeconomic statistics on the basis of the comprehensive review conducted in early 1998 by the Fund's Multisector Statistics mission and the recommendations of Fund missions in the areas of monetary and balance of payments statistics. A country page for Bosnia and Herzegovina in *International Finance Statistics (IFS)* was introduced in July 2001.

A. Real Sector

2. In recent years, efforts have been made in both Entities to improve statistics on the real sector but results have been mixed. The Federation has published nominal GDP estimates on a production basis since 1998, based on international standards recommended by the *1993 SNA*. Since 1999, RS has also published nominal GDP estimates on the production basis, based on the *1993 SNA*. However, in both Entities, production and income aggregates at constant prices and compilation of GDP by expenditure approach are still unavailable and informal sector activities are under-recorded. The preparation of a household income and expenditure survey, to serve as the basis for revising price indices and to facilitate the compilation of GDP by the expenditure approach, has been delayed. There are still no meaningful short-term business and consumer surveys. Both statistical offices compile prices and production indices using outdated methodologies, making multi-year comparisons very difficult. Industrial production indices are prepared in each Entity, but there is no index at the country level. Labor statistics are the weakest area for both Institutes, and data on employment, unemployment, and wage rates are based on deficient methodologies.

B. Balance of Payments

3. Trade data are published by Entities's Statistical Institutes and balance of payments statistics by the CBBH's Research Department. The quality of these data is generally poor. Merchandise trade data are not based on international standards and suffer from serious undercoverage due to smuggling and undervaluation. The coverage of foreign aid data, foreign investment, and workers remittances is inadequate. Work has been ongoing with the support of the EU's CAFAO to introduce the computerized customs data management system ASYCUDA++ (the introduction is almost complete in the Federation, but more than two thirds of RS border outposts have not yet introduced the system) and it is expected that

this will improve the quality of trade data. Continued technical assistance will be provided through the Fund's Resident Statistical Advisor.

C. Government Finance

4. The CBBH has agreed to take responsibility for compiling countrywide GFS and, this autumn, it has assigned a team of three staff to work mainly on GFS, while the position of section head is being advertised. A draft Action Plan on the development of GFS is currently being established, with an initial focus on debt statistics. Progress will require commitments by all parties (mainly various ministries of finance) to cooperate, the establishment of working relationships and understandings, and clarification of responsibilities. The Ministry of Finance for the Federation of Bosnia and Herzegovina is currently designated as the correspondent for submitting GFS to the Fund's Statistics Department. The RS authorities indicated that in 2001 they adopted the 1986 GFS classification system.

D. Monetary Accounts

5. The CBBH reports monetary accounts to the Fund on both a countrywide and Entity basis. In 1996–1999, the Fund sent six missions to establish an integrated system of countrywide monetary statistics meeting Fund standards. Two follow-up monetary and financial statistics missions took place in October–November 2000 and in December 2001. The latest mission reviewed in particular the recent institutional changes and accounting developments that have important implications for monetary statistics and assisted in revising and updating the current monetary data compilation procedures. The mission recommended improvements in, among other areas, the presentation of IMF-related accounts in monetary statistics.

Bosnia and Herzegovina: Core Statistical Indicators
(As of November 15, 2002)

	Exchange rates 1/	Inter-national Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance 2/	Government Balance	GDP	External Debt/ Debt Service
Date of Latest Observation	Nov 15, 2002	Sep 30, 2002	Sep 30, 2002	Sep 30, 2002	Sep 30, 2002	Sep 30, 2002	Sep 2002 3/	June 2002	q12002	2002	2001	Aug 2002
Date Received	Nov 15, 2002	Nov 2002	Nov 2002	Nov 2002	Nov 2002	Oct 2002	Nov 2002	Nov 2002	September 2002	September 2002	Nov 2002	Sept 2002
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annual	Monthly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly/ On mission	Monthly	Quarterly	Quarterly	Quarterly	Annual	
Source of Update	CBBH 5/	CBBH 5/	CBBH 5/	CBBH 5/	CBBH 5/	CBBH 5/	Entity Statistics Institutes	Partner country data from <i>Direction of Trade Statistics</i>	CBBH	Federation and RS Finance Ministries	Entity and State Statistics Institutes	States' Treasury
Mode of Reporting	Website	Report to the Fund via email	Report to the Fund via email	Report to the Fund via email	Report to the Fund via email	Report to the Fund	Report to the Fund	Internal Fund database	e-mail	Report to the Fund	Report to the Fund	Report to the Fund
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annual	N/A

1/ The convertible marka (KM) has been fixed vis-a-vis the DM at KM1 = DM1.

2/ Figures on the current account balance are rough staff estimates based on piecemeal data.

3/ BiH Federation only. July for the RS.

4/ Data for the State. Data for the Federation and RS was received in February 2002 and April 2002 respectively.

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

Sarajevo and Banja Luka, Bosnia and Herzegovina
December 4, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The overarching objective of Bosnia and Herzegovina's economic policies is to promote sustained economic growth and improved living standards through continued macroeconomic stability and further implementation of structural reforms necessary to create a fully-functioning market economy and enhance competitiveness. In this context, we view as central to our economic program the maintenance of the currency board arrangement, further fiscal consolidation, and continued structural reforms. In support of this program, we are requesting completion of the first review under the Stand-By Arrangement.

Based on discussions for the first review, the attached Supplementary Memorandum of Economic and Financial Policies assesses economic developments and policy implementation through September 2002 under the arrangement, and lays out the concrete policy measures to be taken during the remainder of 2002 and 2003.

As noted in the attached memorandum, overall policy implementation through September 2002 has been strong, but some requirements were not satisfied. In each case, corrective action has been taken. Accordingly, we are confident that the difficulties will not recur and that the end-December performance criteria will be fully adhered to. In that light, we request that the Executive Board of the IMF waive the non-observance of the quantitative performance criteria on the ceiling on credit from the banking system to the RS extra-budgetary funds, the Federation cantons, and the Federation municipalities for end-September 2002. The proposed performance criteria are set out in the attached Table 4 and further specified in the supplementary TMU, clarifying the definition of the performance criteria on external payments arrears and external debt.

To ensure smoother continuation of the Stand-By Arrangement while new administrations form following the October 5 elections, we have prepared budgets for 2003, which are consistent with the program. These will be submitted to the newly inaugurated parliaments and National Assembly for approval by early December 2002 and the details are described in the attached memorandum.

We expect the second, third, and fourth reviews under the arrangement to be conducted with the Fund as scheduled by mid-February 2003, mid-May 2003, and mid-August 2003, respectively. The second review will focus on the economic program for 2003 and beyond of the new administrations, in particular the budgets for 2003,

rationalization of public expenditure, preparations for a restructuring of domestic claims on government, and strengthening financial market regulatory structures.

We believe that the policies described in the memorandum are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures to meet these goals should the need arise. During the period of the arrangement, we will consult with the Fund on the adoption of any such measures that may be necessary in accordance with the Fund's rules on such consultations and we will provide the Fund with any information it requests for monitoring progress in program implementation.

We are committed to transparency in our economic policies, and we authorize the Fund to publish this letter and the SMEFP following Executive Board consideration of the first program review.

Sincerely yours

Dragan Mikerevic /s/
Chair
of the Council of Ministers
Bosnia and Herzegovina

Alija Behmen /s/
Prime Minister
Federation of Bosnia and
Herzegovina

Mladen Ivanic /s/
Prime Minister
Republika Srpska

Anto Domazet /s/
Minister of Treasury
of BiH Institutions
Bosnia and Herzegovina

Ms. Sefika Hafisovic /s/
Acting Minister of Finance
Federation of Bosnia and
Herzegovina

Simeun Vilendecic /s/
Minister of Finance
Republika Srpska

Peter Nicholl /s/
Governor
Central Bank of Bosnia and Herzegovina

Attachments: Supplementary Memorandum of Economic and Financial Policies of the State and Entity Governments of Bosnia and Herzegovina.

SUPPLEMENTARY MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. In our Memorandum of Economic Policies of May 31, 2002, we laid out our strategy for Bosnia's economic prosperity in the context of prospective declines in reconstruction aid inflows from the exceptional levels of recent years: fiscal consolidation to help spur domestic savings; structural reforms to stimulate private investment and exports; and stable inflation anchored by the currency board. We continue to see no alternative.
2. Progress this year towards those goals has been considerable: (i) the fiscal deficit has been lowered by significantly more than programmed; (ii) fiscal structures have strengthened; (iii) broader structural reforms have deepened; and (iv) the currency board remains firmly in place.
3. Much more remains to be done. Unemployment is high, a sizeable reduction in the external current account still lies ahead, and despite some signs of revived activity during 2002, output growth has yet to become self sustaining.
4. The burden of this medium-term agenda will fall to new administrations which are being formed after the October 5, 2002 elections. Given the deepening consensus on the medium-term agenda, we are confident that the new administrations, whatever their political complexion, will take up this challenge with determination. In that light, our immediate task, acting as the caretaker authorities, is to ensure that momentum of reform is maintained during the political interlude so that the legacy of progress achieved passes to them intact. This memorandum outlines our approach to that task.

II. DEVELOPMENTS UNDER THE STAND-BY ARRANGEMENT

5. Our key 2002 objectives were: fiscal consolidation, to strengthen the fiscal system; and action to spur private activity. We have met or exceeded our objectives in all these areas.
 6. The fiscal consolidation now projected in 2002 is 1.8 percentage points of GDP, 1½ percentage points of GDP stronger than programmed.
- In the RS general government, strong revenue performance has allowed additional spending allocations, while achieving the programmed fiscal consolidation of 1 percentage point of GDP (commitments, after grants). Vigorous tax administration underpinned revenue, allowing us to finance pensions fully, to clear some recent arrears, and to pay severance for the demobilization of almost 1,000 military personnel. These successes are reflected in our "rebalanced" 2002 budget proposals. If revenues are even stronger than our revised projections, we will clear additional recent pre-program arrears, and begin reconstitution of succession monies used in the demobilization.

- In the Federation general government, after a difficult start early in the year, revenues have strengthened considerably as the new Tax Administration Law and tax stamps on cigarettes went into effect and the impact of strengthened custom administration due to the full implementation of the ASYCUDA program. The strict spending discipline applied early in the year has continued—including placement of some 3 percent of GDP spending on the “delayed payments” list, and the subsequent cancellation of that spending. Accordingly, even with the severance costs of some 0.6 percentage points of GDP for 10,000 military personnel, the budget consolidation (commitments, after grants) is projected at 0.4 percent of GDP compared with the program target of -0.5 percentage point of GDP. This progress allows us to reconstitute before year end some 0.3 percent of GDP of the succession monies used to finance the demobilization.
 - Cantonal revenue also fell short of projections early in the year, subsequently strengthening significantly as tax administration improved. Spending adjustment relative to budget estimates kept the cantonal fiscal balance on track.
 - The state budget has also adhered to the program targets, and we have used succession monies and a grant to clear overdue to the European Bank for Reconstruction and Development (EBRD) and to the World Bank capital subscriptions.
7. And this understates the progress: the demobilizations increased spending in 2002 but they will save future budgets significant sums. And we are the first of the post-war administrations which have regularly paid wages, social benefits, and pensions on time and in full, even clearing some recent arrears.
8. Alongside, structural fiscal reforms have deepened:
- The Treasury system is installed in central governments and, with the USAID assistance, preparations to extend it to cantons and the municipalities are advancing.
 - The excise allocation mechanism began operating in July and we are committed to immediate acceleration of the issue of inter-Entity licenses to traders.
 - We remain committed to the harmonization of indirect taxes. In particular, the oil fee will be harmonized at mid-year Entity rates by end-2002.
 - To strengthen fiscal discipline, we have prohibited future bank borrowing by Federation cantons and municipalities, and borrowing by RS municipalities will remain restricted to investment and short-term purposes.
 - As well as placing all privatization proceeds since the start of the program in escrow accounts, previous receipts have also been escrowed in the RS thereby going beyond our formal program commitments.

- These funds in escrow are earmarked for use in a forthcoming comprehensive settlement of the unsustainable domestic claims on government, including war-related claims. Work to prepare that settlement continues apace, notably through initiatives to quantify war damage claims.
9. Broader structural, financial, and monetary policies have also advanced:
- Free trade agreements are now effective with all of the former Yugoslav republics and in August, we formally initiated WTO accession procedures.
 - The ASYCUDA++ customs information system was installed in the Federation by mid-year, and now covers 5 of 8 customs houses in the Republika Srpska.
 - Voucher privatization has been completed in both Entities. Under this program, government holdings in 900 Federation and over 350 RS SMEs have been sold since 1999.
 - In October 2002, 10 percent of the Federation electricity company was sold through vouchers. And though sales of other large firms have been below our expectations, we have greatly accelerated tender issues—half of the 200 issues since 1999 occurred this year.
 - A strong bankruptcy law was adopted in the RS in September and similar legislation is under discussion in the Federation. We have also adopted a new state law on Foreign Direct Investment and established a Foreign Investment Promotion Agency.
 - We have almost completed bank privatization. The three largest publicly owned RS banks remaining were privatized in 2002 raising the share of private capital in banks to 90 percent in 2002 from 25 percent in 2000. The share of private banks in Federation bank capital has risen to 88 percent from 53 percent at end-2000. Private banks with a majority share of foreign capital now dominate the system and bank competition has lowered spreads in both Entities. A growing number of banks in the Federation now satisfy the criteria for deposit insurance, thus strengthening confidence in bank depositing and the banking system as a whole.
 - Banking regulation has strengthened. The Entity banking laws were amended to strengthen governance and prevent insider lending. The minimum bank capital requirement of KM 10 million was enforced through merger or liquidation, and we have created the State Deposit Insurance Agency and opened a branch in both Entities.
 - The KM was repegged to the Euro in September, recognizing de facto practice.
 - The ASYCUDA++ system has already begun to yield strengthened trade statistics. And the state statistics agency has been empowered to collect and disseminate data according to international standards. Preparations for a household budget survey

scheduled for 2004 is the focal point of our efforts, alongside strengthened business registries.

10. Despite this stronger-than-projected performance, several difficulties prevented full compliance with the program. Corrective action has been taken in all cases.

- A prior action governing Entity transfers to the State was not observed in mid-year, giving rise to US\$ 2.5 million of external arrears. These difficulties were resolved in September, but in addition, the Ministry of Treasury for the BiH Institutions will henceforth inform the IMF monthly in writing on developments in Entity transfers.
- The program limit on RS extra-budgetary fund bank borrowing for end-September was exceeded by KM 8 million because the Health Fund borrowed to clear arrears and a bank prevented the Pension Fund from clearing debt from its bank deposits. We will allocate additional budget funds to lower health fund debt and we have reduced pension indebtedness by KM 3.7 million. Accordingly, we are confident that the end-December performance criterion for extra-budgetary fund borrowing will be met.
- Federation canton borrowing from banks also exceeded the end-September program ceiling by KM 11 million. But in October, cash rich cantons lent others KM 7 million to retire bank debt, reducing it to some KM 14 million. Amortization will reduce this further, bringing it well below the end-December ceiling.
- Federation Municipalities breached their ceiling on bank borrowing by KM 1 million. We are investigating this borrowing and will take necessary corrective action.

11. Though all highly regrettable, these difficulties reflect the structural weaknesses of our fiscal system. As is clear from the stronger-than-programmed fiscal outturn, none is symptomatic of a fundamental fiscal or macroeconomic malaise, and corrective actions have been taken.

12. In this strong policy context, economic growth also looks set to exceed our program projections. At the BiH level, real GDP is now expected to grow 4 percent in 2002, up from the programmed 2¼ percent boosted by strengthening industrial activity and good harvests in both entities. At close to zero, inflation has been lower than programmed, and average nominal wages paid have grown strongly as enterprise accumulation of wage arrears has slowed. Exports appear to be rising again after a weak second half in 2001, albeit slower than programmed. And with domestic demand buoying imports, the overall correction in the current account deficit is likely to be 0.7 percentage points of GDP, slightly below program projections.

III. MACROECONOMIC POLICY FRAMEWORK FOR 2003

A. Fiscal Policy

13. Fiscal policy lies at the heart of our approach to securing an effective transition to the new administrations.

14. In our view, the process of fiscal consolidation must continue during 2003 in order to anticipate declines in external assistance and to support the currency board. Accordingly, prior to the formation of new governments, we have prepared budgets for 2003 which anticipate a consolidated deficit (commitments, including grants) of 2.1 percentage points of GDP. This represents a reduction in the deficit of 1.9 percentage points of GDP from the expected 2002 outcome.

15. This further consolidation in 2003 is secured not by assuming major new policy actions by our successor administrations but by the full-year effects of the tax administration and spending reforms that we implemented during 2002. And these effects are sufficiently large, alongside unchanged tax, wage, employment, and benefit rates, to meet the program commitments to reconstitute all succession monies used during 2002 by end-2003.

16. We aim to secure passage of these budgets by early December 2002 on the basis that once new administrations form, they may adjust them to reflect their policy preferences. But we are confident that if those administrations make such adjustments, their budgets for 2003 will remain consistent with the fiscal stance as described above and the overall program objectives.

17. We have, again, programmed revenue and foreign financing deliberately cautiously in order to minimize the risks of spending arrears, and our proposals are outlined below in Tables 1–3 as follows:

- The RS will lower the commitments balance for general government including grants from the projected outturn of -0.2 percent of GDP in 2002 to a surplus of 0.3 percent of GDP in 2003. This, and projected increases in debt service and administrative transfers to the state, is secured by savings from demobilization and unchanged nominal wage and social benefit levels. The latter allows reduced transfers to the pension fund and further reductions may arise from structural reforms in the pension system. Deficit outturns stronger than projected will be applied to clearing arrears on veterans' benefits and reconstituting succession monies.
- The Federation anticipates a reduction in the commitments balance for general government including grants from -0.3 percent of GDP in 2002 to a surplus of 0.6 percent of GDP in 2003. The bulk of this reflects savings from the 2002 demobilization, but nominal wage and benefit levels will also be unchanged from current levels. This leaves scope for increased outlays on investment and increased administrative and debt service transfers to the State. We will complete the reconstitution of succession monies in 2003.
- The 2003 State budget benefits from higher administrative transfers from the Entities, including Brcko District. This allows full year financing of commitments initiated during 2002. We will fund new programs and institutions only to the extent that additional grant financing can be secured for such. Entity commitments to ensure timely administrative transfers from the Entities to the State during 2003 are outlined in Annex I.

- We also anticipate that the Cantons will target balanced budgets or small surpluses in 2003 as a result of their restricted financing options, but strengthening revenue will ease their spending constraints.

18. To ensure implementation of our commitments and maintain financial discipline, future severance packages for military and civil public employees will be paid according to the stipulations of the Labor Law. And we propose to set the levels of the performance criteria for government borrowing and the contracting of new external debt as outlined in the attached Table 4 as clarified in the Supplementary Technical Memorandum of Understanding (STMU). Overall, the implementation of the agreed budget frameworks for 2003 should result in a fall in public external debt from 51.6 percent to 50.6 percent of GDP by end-2003.

19. We will continue our good faith efforts to resolve the outstanding issues pertaining to Paris Club debts owed to Japan and the debts to Russia. We will also make efforts to track developments in non-government external indebtedness.

B. Structural Fiscal Reforms

20. We will maintain the strong momentum of structural fiscal reforms as reflected in the commitments in the attached Table 5. Harmonization of indirect taxes will be strengthened when Brcko District introduces the road fee by end-December and as inter-Entity licenses for the excise attribution mechanism are issued. Alongside, all import surcharges will be incorporated into tariffs effective January 1, 2003, and we are investigating how to strengthen customs administration further. To maintain payment discipline, we will continue to refrain from tax offsets and tax amnesties. And we will continue to abjure clearance of pre-end 2000 payment arrears until a comprehensive strategy to clear such arrears has been prepared. We have begun discussions to replace the sales tax with a VAT.

21. We will also continue to strengthen implementation of structural fiscal reforms to which we committed under the program.

- The Republika Srpska aims to implement the ASYCUDA++ customs information system in full by end-2002.
- Work on the treasuries according to our work plans will continue. The first cantonal pilot project in Sarajevo will commence on April 1, 2003, to be followed by further pilots in two other cantons shortly thereafter. We still remain committed to begin treasury operations in all cantons on January 1, 2004. In the RS, we will resume discussions with the municipalities, with the objective to get an agreement with 3 municipalities by February 1, 2003 on plans to introduce treasury pilot projects.
- Privatization receipts from banks and non-banks will continue to be placed in escrow, alongside any further succession monies.
- We intend to publish quarterly budget execution reports with a two-month lag during the next fiscal year and will commence technical preparations to allow the incoming governments to do so from the first quarter of 2003.

- We will continue to meet our program commitments on collection periods and to restrict total monthly spending to available resources as required under our pension laws. Health sector reform remains critical and we will facilitate continued investigation of the options for consideration by incoming governments.

22. In addition, we will establish a mechanism to collect data on public investment and prepare an investment program for 2003–06, covering domestic and donor-financed projects. And we will continue to develop proposals to rationalize veterans' benefits and our pensions systems in collaboration with the World Bank.

C. Other Structural Policies

23. Our broader programs of structural reform will also continue.
- In accord with our commitments to the World Bank, we will reduce the time and number of steps required for business registration, prepare an implementation plan for a collateral registry system and streamline business inspections.
 - By end-2002, at most two active banks will remain publicly owned in each Entity. We will raise the minimum capital requirement to KM 15 million at end-2002, and prepare regulations to implement the new banking laws, and strengthen banking supervisory agencies in line with MAE recommendations. Banks which do not meet the required minimum capital standard will be liquidated by mid-2003.
 - We will continue the privatization of SMEs and accelerate large-scale privatization with the support of the International Advisory Group for Privatization, and will encourage use of the bankruptcy laws. The privatization of some 50 remaining Federation strategic enterprises will be accelerated, including tobacco, electricity, and telecoms companies. Tenders for privatization of the RS petroleum refining companies will be issued and plans for new tender issues in 2003 will be advanced.
 - The free trade agreement with Turkey will go in to effect by January 1, 2003 and the government is working towards signing similar agreements with Albania, Bulgaria, Romania and Moldova by end 2002.
 - We will implement the new statistics law, including by amending entity statistical laws and will set up the required infrastructure for the State agency to carry out its mandate. We will continue our preparations for new national accounts, CPI data, the household survey, and for a comprehensive database for external trade.
 - We will present the first draft PRSP to donors by end-November. We will review the proposals to ensure consistency with medium-term public spending limits and will present affordable proposals to the State Parliament for ratification.

D. Exchange Rate and Monetary Policy

24. The steps outlined above will maintain strong support for the currency board in the post election period. As a structural performance criterion, we will continue to maintain the strict arrangement now in place. This will include the prohibition on lending to the government or to banks and other private agents. And we will continue to desist from issuing central bank securities in order to avoid any risks that such initiatives might pose for confidence in the future of the currency board, notwithstanding the advantages such issues might secure for the development of the interbank market. And we will maintain reserve requirements at 10 percent.

25. We agree with the favorable conclusion of the recent Safeguard Assessment Report and will address the areas highlighted in that assessment, notably in respect of internal audit and control systems. Specifically, we aim to complete our assessment of risks in all our operations by end-March, and will strengthen staff expertise.

26. We have taken all the steps necessary to transfer the function of the fiscal agent for our dealings with the IMF from the State Ministry of Treasury to the Central Bank in accordance with the currency board and this action will be completed by mid-December.

Pursuant to Chapter II, Article 7, Point 1 of the Law on Foreign Debt and Article 14, Point b of the Treasury Law, and in the context of the first review of the program supported by a Stand-By Arrangement from the IMF, the entity Ministers of Finance and the Minister of the Treasury of the BiH Institutions have reached the following

AGREEMENT ON THE TIME SCHEDULE FOR THE PAYMENT
OF RESPECTIVE AMOUNTS FOR FOREIGN DEBT SERVICING
AND ENTITY CONTRIBUTIONS FOR THE ADMINISTRATIVE
SEGMENT OF THE 2003 BUDGET OF THE BiH INSTITUTIONS

I

In order to ensure timely payment of foreign liabilities and 2003 liability projections arising from foreign debt, in a total amount of KM 324.4 million, out of which KM204.3 million is the Federation liability and KM 120 million is the Republika Srpska liability,

The Federation of Bosnia and Herzegovina and the Republika Srpska shall pay the required amounts against each due liability, 5 days ahead of the respective maturity date.

II

Total transfers in 2003 for the administrative segment of the budget of the BiH institutions amount to KM 87 million out of which KM 58 million is to be paid by the Federation and KM 29 million is to be paid by the Republika Srpska.

The transfer to the budget of the BiH institutions shall be paid on a monthly basis, ensuring that 1/12 (one twelfth) of the total transfer shall be remitted for every current month.

III

By the 15th day of each month, the Minister of the Treasury of the BiH Institutions will provide a written report to the IMF indicating developments in transfers from the Entities to the State for administrative and debt service purposes during the previous month, noting their consistency with the commitments made in this agreement.

In Sarajevo,

Anto Domazet /s/
Minister of the Treasury of BiH Institutions

Sefika Hafisovic /s/
Acting Minister of Finance
Federation of Bosnia and Herzegovina

Simeun Vilendecic /s/
Minister of Finance
Republika Srpska

Table 1. Bosnia and Herzegovina: State Fiscal Operations, 2002-2003
(In millions of KM)

	2002 Proj.	2003 Proj.
Revenue	363.2	465.9
Administrative transfers	86.1	87.0
Debt service	232.2	324.4
Other 1/	44.9	54.5
Expenditure	397.0	509.3
Debt service	232.2	324.4
Other	164.8	184.9
Balance (before grants)	-33.8	-43.4
Grants	38.8	30.8
Financing	-5.0	12.6
Domestic 2/	-17.0	12.6
Foreign loans	0.0	0.0
Succession money	19.6	0.0
Purchase of shares in IBRD and EBRD	-7.6	0.0

Sources: IMF Staff

1/ Includes transfers from Brcko District of KM 2.5 million in 2002 and KM 3.9 million in 2003.

2/ In 2003, borrowing for CIPS project.

Table 2a. Bosnia and Herzegovina: Federation Fiscal Operations, 2002-2003

(In millions KM)

	2002 Proj.	2003 Proj.
Revenue	1,038.0	1,112.3
Excises and trade tax	921.8	991.3
Other	116.1	121.0
Expenditure	1,244.3	1,217.4
Debt service	134.1	204.3
Administrative transfers to the State	57.3	58.0
Transfers to the Pension Fund	21.0	10.0
Other	1,031.9	945.1
Balance (before grants)	-206.3	-105.1
Grants	28.3	26.1
Financing	178.0	79.0
Domestic financing	-37.7	-52.6
<i>of which: reconstitution of succession money</i>	-31.5	-40.0
Foreign financing	131.8	131.6
Privatization proceeds	3.0	0.0
Succession money	71.5	0.0

Source: IMF Staff.

Table 2b. Bosnia and Herzegovina: Federation Pension Fund, 2002-2003
(In millions KM)

	2002	2003
Total receipts	723.1	705.7
Contributions	679.5	691.5
Transfers from the budget	41.0	10.0
Other	2.6	4.2
Total expenditures	718.1	702.2
Pensions 1/	687.7	670.3
Others	30.4	31.9
Balance	5.1	3.5
Financing	-5.1	-3.5

Source: IMF Staff.

Table 3a. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 2002-2003

(In millions KM)

	2002 Proj.	2003 Proj.
Revenue	929.0	926.9
Sales tax (including railways surcharge)	251.5	260.0
Excises	192.1	196.7
Trade tax	170.8	158.7
Other	314.6	311.5
Expenditure	1027.8	979.7
Debt service	100.2	120.1
Administrative transfers to the State	28.8	29.0
Transfers to the Pension and Health Funds 1/	115.3	91.0
Other	783.5	739.6
Balance (before grants)	-98.8	-52.8
Grants	7.7	13.0
Financing	91.1	39.8
Domestic financing	-38.2	-33.0
<i>of which: reconstitution of succession money</i>	-8.3	-8.3
Foreign financing	80.8	64.2
Privatization proceeds	10.0	8.6
Succession money	38.5	0.0

Source: IMF Staff.

1/ If contributions collected by the Pension Fund are higher, budget transfers will be reduced.

Table 3b. Bosnia and Herzegovina: Republika Srpska Pension Fund, 2002-2003

(In millions KM)

	2002	2003
Total receipts	331.0	332.2
Contributions	240.3	247.3
Transfers from the budget and public utilities 1/	90.7	84.0
Total expenditures	331.9	331.9
Pensions 2/	302.3	302.3
Others	29.5	29.5
Balance	-0.9	0.3
Financing	0.9	-0.3
Domestic Financing	0.9	-0.3

Source: IMF Staff.

1/ If contributions collected by the Pension Fund are higher, budget transfers will be reduced.

2/ Unchanged levels of pensions and number of pensioners in 2003 from August-2002 levels.

Table 4. Bosnia and Herzegovina: Quantitative and Structural Performance Criteria Under the 2002-2003 Stand-By Arrangement
(In millions of KM, unless otherwise noted)

	2002								2003	
	End-Mar.		End-June		End-Sep.		End-Dec.	End-Mar.	End-June	
	Prog 1/ ^{1/}	Est.	Prog 1/ ^{1/}	Est.	Prog 2/ ^{2/}	Est.	Prog 2/ ^{2/}	2/ ^{2/}	1/ ^{1/}	
A. Quantitative performance criteria										
Ceiling on gross credit of the banking system to the consolidated general government										
the State government 3/	0	0	0	0	0	0	0	0	0	0
the RS government and municipalities	10	1	10	1	10	6	10	10	10	10
the RS extra-budgetary funds	2	4	2	6	2	10	2	2	2	2
the Federation government	20	18	20	19	20	19	20	20	20	20
the Federation cantons	10	23	10	22	10	21	10	10	10	10
the Federation municipalities	8	9	8	8	8	9	8	8	8	8
the Federation extra-budgetary funds	0	0	0	0	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more than one year by the public sector 4/ 5/										
	0	0	445	0	445	187	445	445	445	445
Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government 3/ 4/										
	0	0	0	0	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new external debt by the general government with an original maturity of up to and including one year 4/										
	0	0	0	0	0	0	0	0	0	0
Ceiling on the outstanding stock of external payments arrears 6/										
	0	0	0	0 7/	0	0	0	0	0	0
B. Structural Performance Criteria										
Continued adherence of the Currency Board Arrangement as constituted under the law, incorporating the amendments described in paragraph 10 of the MEFP (EBS/02/91), and paragraph 24 of the SMEFP.	Met		Met		Met					

Sources: BiH Authorities and IMF staff estimates.

1/ Targets are indicative.

2/ Targets for end-September 2002 and end-December 2002 are performance criteria and those for March 2003 are proposed performance criteria.

3/ Excluding letters of credit at the state level for CIPS financing up to KM 40 million. Actual borrowing for CIPS was Km 3 million at end-September 2002.

4/ New refers to all operations taking place after August 2, 2002.

5/ The public sector is defined as general government and public enterprises.

6/ This will apply on a continuous basis.

7/ BiH was in external arrears in the amount of US\$ 1.2 million as of July 1, 2002, and in the amount of US\$ 2.5 million as of July 30, 2002.

These arrears were cleared as of September 25, 2002 (EBS/02/193).

Table 5. Bosnia and Herzegovina: Structural Benchmarks, September 2002-June 2003

	Implementation Date	Lead Institution
1. The Entities will make transfers to the State, at least according to the agreed cumulative monthly schedule reported in Annex 1 of the MEFP.	continuous	IMF
2. All privatization receipts accruing to the central governments of the RS and the Federation, and to the Cantons in the Federation will be placed in escrow accounts alongside all succession monies pending a comprehensive strategy to clear arrears.	continuous	IMF
3. The Entities and the Brcko District will implement laws establishing the excise attribution mechanism as previously agreed with the World Bank and thereby avoid the double taxation on excises.	continuous	World Bank
4. There will be no new free trade zones.	continuous	IMF
5. Any changes to the current indirect tax system should retain or strengthen the principle of harmonization.	continuous	IMF
6. The Federation pension fund will adhere to the cut-off dates for contribution collections at the end of each month as specified in the 2000 pension law. The RS pension fund will adhere to the cut-off date of the 10th of each month for contributions collections.	continuous	IMF
7. (a) The base of the Brcko District sales tax will remain aligned with that in the Entities.	continuous	IMF
(b) The two rates of sales tax in the Brcko District will be 8 and 18 percent unless changes are agreed with IMF staff.	continuous	IMF
8. A comprehensive strategy to clear arrears will be prepared. All arrears, including frozen foreign currency deposits, will be audited by the Supreme Auditor Institutions.	End-June-2003	IMF
9. Bosnia & Herzegovina will not clear domestic government payment arrears that were accrued before end-2000, pending a comprehensive strategy to clear arrears.	continuous	IMF
10. There will be no offset operations for tax liabilities that are incurred after 2001.	continuous	IMF
11. Banking supervision will be strengthened by enforcing the current prudential regulations.	continuous	IMF/World Bank

BOSNIA AND HERZEGOVINA

Supplementary Technical Memorandum of Understanding on Definitions and Reporting Under the 2002–2003 Economic Program

December 2002

This memorandum sets out the understanding between the Government of Bosnia and Herzegovina and the IMF mission regarding the definitions of quantitative and structural performance criteria and targets for the Stand-By Arrangement (Tables 1 and 2), as well as data reporting required for monitoring the implementation of the program.

I. DEFINITIONS

The following definitions are to be used in monitoring the program. In the following definitions, the end-quarter test dates apply to the last working day of each quarter for both banking and budgetary statistics.

A. Ceiling on the Stock of Gross Credit from the Banking System to the General Government

Definitions:

- *The general government* is defined to include the State, Entity (Federation, and Republika Srpska), cantonal (Federation) and municipal budgets, Brcko budget, together with their respective extrabudgetary funds. The definition also includes the Goods Reserve Directorates of each entity. Extrabudgetary funds include, but are not limited to, the pension funds, health funds, unemployment funds, and children's fund in the two Entities and the State.
- *The banking system consists* of the Central Bank of Bosnia and Herzegovina (CBBH) and the commercial banks in both Entities and the District of Brcko.
- *Gross credit* is defined as all claims (e.g. loans, securities, bills, and other claims in both convertible marka and foreign currencies). For program purposes, those components of gross claims that are denominated in foreign currencies will be converted into convertible marka at the agreed accounting exchange rate prevailing on December 31, 2001.

Application of performance criteria:

- The quantitative value of banking system claims on the general government will be monitored from the accounts of the banking system, as compiled by the CBBH, and supplemented by information provided by the Ministries of Finance of each Entity and the State.

- The ceilings on the stock of gross credit from the banking system to the general government will be defined in terms of seven sub-ceilings that sum to the ceiling for the general government. These seven sub-ceilings will be on the stock of gross credit from the banking system to the State government, the Federation of Bosnia and Herzegovina government, the Republika Srpska government and municipalities, the Federation Cantons, the Federation municipalities and the extrabudgetary funds. For the purposes of program monitoring, compliance with the ceiling on banking system credit to general government will require that each of these seven sub-ceilings be observed independently.

B. Operation of the Central Bank of Bosnia and Herzegovina

Under the Central Banking Law and the program, the CBBH is required to ensure that the value of its domestic liabilities does not exceed the convertible marka counter-value of its net foreign exchange reserves. Furthermore, the CBBH will not pay a dividend until its capital and reserves exceeds 10 percent of its monetary liabilities.

Definitions:

- *Net foreign exchange reserves* are defined as the value of foreign assets less the value of foreign liabilities, including assets and liabilities denominated in convertible currencies or convertible marka.
- *Foreign assets* are defined as (a) monetary gold and (b) monetary authorities claims on nonresidents including currency bank deposits, government securities, other bonds and notes, financial derivatives, equity securities, and nonmarketable claims arising from arrangements between central banks or governments.
- *Foreign liabilities* are defined to include: (i) foreign exchange and convertible marka balances on the books of the CBBH due to nonresidents, including foreign central banks (ii) credit balances due to foreign central banks, governments, and foreign financial institutions; (iii) forward and repurchase contracts of different types providing for future payments in foreign exchange by the CBBH to nonresidents; and (iv) any other liabilities due to nonresidents.
- *Monetary liabilities* are defined as the sum of (a) currency in circulation, (b) credit balances of resident banks at the CBBH, and (c) credit balances of other residents at the CBBH.
- *Capital and Reserves* are defined as (a) initial capital and reserves of the CBBH, (b) shares, and (c) accumulated profits of the CBBH since the beginning of its operation on August 11, 1997.
- *Free reserves of the CBBH* are defined as foreign exchange reserves not utilized as backing for the currency. They therefore consist of the stock of CBBH net foreign exchange reserves less the stock of CBBH monetary liabilities.

Application of performance criteria:

- Foreign currency holdings will be converted into convertible marka at the exchange rates of December 31, 2001, as published in the IMF *International Financial Statistics*. Valuation changes will therefore be monitored from the accounts of the CBBH, with information on net foreign assets provided monthly by the CBBH.

C. Ceiling on External Payments Arrears**Definitions:**

- *External payment arrears* are defined as overdue debt service arising in respect of debt obligations incurred directly or resulting from guarantees by the general government or the CBBH that have been called, except on debt subject to rescheduling or restructuring.
- *Debt obligations* are defined as follows. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of this program, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out in point (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

- *The general government* is defined as above in section “A”.

Application of performance criteria:

- The ceiling on external payments arrears applies to the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the general government or the CBBH.
- The ceiling on external payment arrears applies on a continuous basis.
- The limit on the stock of external payments arrears also applies to the stock of overdue payments on short-term debt in convertible currencies with an original maturity of up to and including one year contracted or guaranteed by the general government. The limit excludes reductions in connection with rescheduling of official and commercial debt and debt buy-back.

D. Ceiling on Contracting or Guaranteeing of New Non-Concessional External Debt

Definitions:

- *Debt obligations* are defined as above in section “C”.
- *Concessional loans* are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRS). The average CIRRS over the last ten years—plus a margin reflecting the repayment period (1 percent for repayment period of 15–19 years; 1.15 percent for repayment period of 20–29 years; and 1.25 percent for repayment period of 30 years or more)—will be used as discount rates for assessing the concessionality of loans of a maturity of at least 15 years. For loans with shorter maturities, the average CIRRS of the preceding six-month period (plus a margin of 0.75 percent) will be used.
- *Non-concessional external debt* refers to all debt creating instruments with a grant element of less than 35 percent (as defined above).
- *New non-concessional external debt* is defined as including all debt (as defined above) contracted or guaranteed during the program period. The ceiling will be on the increase in short-term, medium-term, and long-term new non-concessional external debt from August 2, 2002.
- *Short-term debt* is defined as debt contracted or guaranteed with an original maturity of up to and including one year.

- *Medium-term debt* is defined as debt contracted or guaranteed with an original maturity of greater than one year and up to and including five years.
- *Long-term debt* is defined as debt contracted or guaranteed with an original maturity of greater than five years.
- *The general government* is defined as above in section "A".

Application of performance criteria:

- The ceilings on the contracting or guaranteeing of new non-concessional external debt after August 2, 2002, will be defined for each test date. This excludes letters of credit at the State level for CIPS project financing up to 40 million KM.
- The value of the stock of leases will be calculated as the present value, at the inception of the lease, of all lease payments expected to be made during the period of the leasing arrangement, excluding those payments that cover the operation, repair or maintenance of the property being leased.
- Debt and leases will be valued in U.S. dollars at the exchange rates prevailing at the time the contract or guarantees become effective.
- For program purposes, the following are not considered as non-concessional debt and thus are excluded from the calculation of non-concessional debt contracted or guaranteed: (i) borrowing from the IMF, the World Bank, EBRD, EIB, IFC, or bilateral cofinancing of lending by these institutions; and (ii) concessional loans.
- The ceiling on contracting or guaranteeing of new non-concessional external debt excludes normal import-related financing.

E. Ceiling on Contracting or Guaranteeing of New Concessional Debt

Definitions:

- *Debt obligations* are defined as above in section "C".
- *Concessional loans* are defined as above in section "D".
- *The general government* is defined as above in section "A".
- *The public sector* is defined as general government and public enterprises.
- *A public enterprise* is defined as an enterprise which is more than 50 percent directly or indirectly owned by the state.

Application of performance criteria:

- Debt and leases will be valued in U.S. dollars at the exchange rates prevailing at the time the contract or guarantees become effective.
- For program purposes, the following will be included in the calculation of the amount of external debt contracted or guaranteed: (i) borrowing from the IMF, the World Bank, EBRD, EIB, IFC, or bilateral co financing of lending by these institutions; and (ii) concessional loans.

II. DATA REPORTING

The Bosnia and Herzegovina authorities will report the following data to the Fund within the time limits listed below. The authorities will also provide, no later than the first week of each month, a summary of key macroeconomic policy decisions taken during the previous month. Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with a detailed explanation. The Bosnia and Herzegovina authorities will make every effort to move speedily towards sending the required data by electronic mail.

All magnitudes subject to performance criteria or indicative targets will be reported in millions of convertible marka where the corresponding target is in convertible marka, or in millions of U.S. dollars where the target is in U.S. dollars.

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

Monthly data reporting

The Bosnia and Herzegovina authorities will send to the Fund the following data no later than 3 weeks after the end of each month:

- (i) Transfer payments by Entities to the State;
- (ii) Stock of free reserves of the CBBH; the balance sheet of the CBBH;
- (iii) The commercial bank survey and monetary survey;
- (iv) Banking supervision indicators including capital adequacy ratio, loan-loss provisioning data, and bad loan information (classification);
- (v) Revenues, expenditures and financing data for all levels of government (including the State, Entities, and Cantonal (for FBiH));
- (vi) Pension funds payment data and cut-off dates for contributions collection;

- (vii) Revenues, expenditures, and financing data for the Brcko District;
- (viii) Revenues, expenditures, and financing data for the extrabudgetary funds (including health funds, unemployment funds, and (in the RS) the children's fund);
- (ix) Debt service payments by the State to creditors;
- (x) Report on privatization revenues, including revenues received and the balances held in escrow accounts;
- (xi) Monthly Statistical Data on Economic and Other Trends review published by the Federation's Office of Statistics and Monthly Statistical Review published by the Republika Srpska Institute of Statistics;
- (xii) Data sheets issued by the Republika Srpska Institute of Statistics reporting on data that are not included in their Monthly Statistical Review.

Quarterly data reporting

The Bosnia and Herzegovina authorities will send to the Fund the following quarterly data within the timeframes indicated:

- (i) State debt service projections for current year;
- (ii) Summary of government guarantees on quarterly basis;
- (iii) Summary of government loans and degree of concessionality (grant element);
- (iv) Summary of short-term loans by government on quarterly basis;
- (v) Budget execution data by individual canton;
- (vi) Report on privatization revenues, including revenues received and use of funds;
- (vii) Summary of the financial activities of the RS Goods Reserve;
- (viii) Execution of foreign-financed investment projects.

Robustness of Key Policy Recommendations to Data Deficiencies

This appendix examines how robust the main policy recommendations for the medium-term are to the key uncertainties with macroeconomic data.

There are three major uncertainties with the macro data:

- Official data on nominal GDP exclude the non-observed economy. Key gaps include: (i) unrecorded retail trade, (ii) unregistered businesses, (iii) understated value added of registered businesses, (iv) unrecorded wages of Bosnian staff of international institutions, and (v) rental services for foreign staff of international institutions. Preliminary estimates by the IMF Statistical Advisor in Bosnia suggest that of these, the largest by far is understated value added of registered businesses accounting for over half of the estimated under recording. With all factors included, the non-observed economy is estimated at about 40 percent of official GDP. This ratio appears to have been declining in recent years because of the reduction in the presence of the international community and better tax administration.
- At present, no official country-wide estimates of the Gross Domestic Fixed Investment (GDFI) are compiled for Bosnia and Herzegovina. Staff estimates have been based on data for the Federation, grossed up for the whole country. An alternative approach suggests that this may understate GDFI. In particular, if investment estimates are based on the sum of:
 - (i) estimates of capital grants, project loans, and foreign direct investment as reported in the balance of payments (assuming that most of the modest amount of FDI is greenfield);
 - (ii) purchase of capital goods by the entity governments;
 - (iii) estimates of residential construction from the national accounts; and
 - (iv) conservative estimates for other corporate investment, then the level of GDFI is higher than staff estimates.
- A comparison with data for neighboring countries suggests that estimates of private transfers in the balance of payments currently used by the staff may be low (Table 3 and Table A1). Estimates prepared by the Central Bank of Bosnia and Herzegovina are almost US\$400 million higher and would bring the relative size of the annual transfers, at US\$135 per capita, closer to the estimates used for Albania and the Federal Republic of Yugoslavia. While these inflows are currently recorded under (non-debt creating) “other capital” inflows in the staff estimates for the balance of payments, a reclassification into transfers would reduce the estimate of the current account deficit significantly.

Table A1. Bosnia and Herzegovina: Private Transfer Receipts in Comparison with Neighboring Countries

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

	Albania		Croatia		Macedonia		FR of Yugo.		Bosnia	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Private transfers	543	510	983	1,049	454	192	1,132	1,698	172	165
Nominal GDP	3,745	4,109	18,427	19,503	3,582	3,509	8,071	12,841	4,622	4,879
Private transfers (in % of GDP)	14.5	12.4	5.3	5.4	12.7	5.5	14.0	13.2	3.7	3.4
Population (in millions)	3.1	3.2	4.4	4.7	2.0	2.0	10.6	10.6	3.8	3.8
Per capita GDP	1,197	1,305	4,207	4,185	1,764	1,720	761	1,211	1,210	1,284
Per capita transfer receipt	173	162	224	225	224	94	107	160	45	43

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

A revised medium-term adjustment scenario, reflecting the reestimates for nominal GDP, GDFI, and private transfers discussed above, is summarized in Table A2. It indicates that the key policy recommendations discussed with the authorities are robust to these sizeable revisions.

The reason for this robustness is that these revisions do not alter the two key assumptions: that aid inflows will decline sharply, and that GDFI by corporates is currently negligible.

- International aid for reconstruction has been large and will decline, and thus the required adjustment in the current account balance over the medium term remains large. This will require significant export growth if it is to be compatible with strong economic growth.
- GDFI by corporates is, currently, negligible. Though the KM value of GDFI in staff estimates may be low, the alternative approach to estimating GDFI, when combined with the alternative estimate of nominal GDP, yields a similar investment to GDP ratio as the staff estimates. And both imply negligible corporate GDFI. Thus, increased exports will thus require a significant increase in corporate GDFI, notwithstanding the adjusted estimates for GDFI and GDP.
- With capital inflows declining, the increase in investment necessary to support the envisaged strong export growth will need to be financed from domestic savings. This requires significant fiscal consolidation and increased corporate profits.
- On the alternative estimate of nominal GDP, government revenue is equivalent to 37½ percent of GDP in 2002. Nonetheless, fiscal consolidation efforts would still have to focus on expenditure restraint because further increases in taxation would compromise private sector activity and investment. Thus the medium-term path

envisaged for government expenditure under the program (in millions of KM) remains appropriate.

Table A2. Bosnia and Herzegovina: Revised Medium-Term Adjustment Scenario, 2002-2006
(In percent of adjusted GDP, unless otherwise indicated)

	2002	2003	2006
Capital and credit for reconstruction	5.5	4.3	2.1
Other capital flows	5.2	4.6	1.5
Current account balance	-10.7	-9.0	-3.6
Total investment	18.2	19.0	23.1
Domestic savings	-3.9	-0.9	9.9
<i>Of which:</i>			
Private	-3.9	-2.7	5.9
Public	0.0	1.8	3.9
Memorandum items:			
Fiscal revenue	37.6	36.5	34.3
Fiscal expenditure (millions of KM)	6,127	6,031	6,939
Fiscal balance	-2.9	-1.5	-1.1
Growth rate of real GDP (in percent)	2.5	4.2	5.4

Source: IMF staff estimates and projections.

**Statement by the IMF Staff Representative
December 20, 2002**

This statement summarizes developments and data releases since the Staff Report was issued. The information does not alter the staff appraisal.

Political Developments

Following the national elections on October 5, discussion on the formation of new administrations continue. Meanwhile, the caretaker administrations remain in place.

Fiscal Developments

At end-October, borrowing from banks by the Federation municipalities had declined below the end-September and end-December performance criteria ceilings. Bank borrowing by Cantons had also declined, by KM 8 million from end September, bringing it within KM 3 million (less than half of 0.1 percentage point of BiH GDP) of the performance criteria ceilings for September and December.

Entity transfers to the State for November have been completed on schedule.

Ahead of program commitments, the Federation reconstituted an additional KM 12 million of succession monies in December, bringing total reconstitution for the year to mid-December to KM 27 million (some 0.3 percent of BiH GDP).

Budgets for 2003 which are consistent with program commitments have been approved.

- In the Republika Sprska, the newly elected unicameral National Assembly approved a supplementary budget for 2002 on December 2. This allocated the stronger-than-budgeted revenues mainly to social transfers and to facilitate a reduction of bank borrowing by extra budgetary funds to below the end-December performance criteria ceiling. The Assembly approved the 2003 budget on December 9.
- In the Federation, no supplementary 2002 budget was necessary. The House of Representatives (first chamber) approved the 2003 budget on December 10. As the House of Peoples (second chamber) will not be formed until next year, the High Representative, Lord Ashdown, imposed on December 16 the approved 2003 budget at the formal request of the House of Representatives.
- At the State level, the House of Representatives approved the budget on December 11. The House of Peoples will not convene until next year. Leaders of political parties at the state level have committed in writing to the Managing Director to support passage of the approved budget in the upper house when the upper house is convened.

Economic Developments

Inflation and industrial production for BiH for January-October 2002 were 0.3 percent and 6 percent respectively over the same period the previous year, in line with the projections in the staff report. The outturns for the Entity budgets in October were also consistent with the staff report.

Relations with the International Monetary Fund

The authorities advised on December 17 that they had designated the Central Bank of Bosnia and Herzegovina as the fiscal agent for the Fund.

NEWS  BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/131
FOR IMMEDIATE RELEASE
December 20, 2002

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

**IMF Approves US\$16 Million Tranche to Bosnia and Herzegovina
Under Stand-By Credit**

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Bosnia and Herzegovina's economic performance under the Stand-By Arrangement for the period August 2002-November 2003. The decision enables Bosnia and Herzegovina to draw SDR 12 million (about US\$16 million) from the IMF immediately.

The Stand-By Arrangement, which was approved on August 2, 2002, totals SDR 67.6 million (about US\$91 million). So far, Bosnia and Herzegovina has drawn SDR 19.6 million (about US\$26 million).

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chair, said:

"Bosnia and Herzegovina has made significant economic progress during the current Stand-By Arrangement. Overall program implementation remains fundamentally on track, as most macroeconomic performance criteria and structural benchmarks have been observed to date. There was a case of misreporting of Entity transfers to the State that required, and obtained, a waiver from the Fund's Executive Board. It will be critical that such incidents not be repeated.

"The welcome acceleration in the pace of fiscal adjustment in 2002 reflected prudent expenditure management alongside key reforms to tax administration. Interim budgets for 2003 incorporating further fiscal discipline have been approved pending the formation of the new

administrations. Any revisions to these budgets by the new administrations should avoid increasing the consolidated deficit and spending targets.

“The currency board arrangement continues to deliver a strong and stable currency and low inflation and enjoys the confidence of markets, as reflected in the high level of international reserves. The banking system has been strengthened through privatization and the increasing application of international standards of banking regulations.

“In the context of prospective declines in reconstruction aid inflows and high unemployment, actions to increase exports will be essential. Fiscal prudence and efforts to accelerate privatization, improve the business environment, and strengthen bankruptcy procedures will form key elements of an appropriate strategy to achieve this objective. The poverty reduction strategy paper now under preparation should aim to tackle poverty on the basis of strong macroeconomic policies, and efforts are encouraged to secure as wide an ownership base for this as possible,” Mr. Sugisaki said.

###