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Bosnia and Herzegovina: Letter of Intent and Technical Memorandum of Understanding

June 16, 2009

The following item is a Letter of Intent of the government of Bosnia and Herzegovina, which describes the policies that Bosnia and Herzegovina intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Bosnia and Herzegovina, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Bosnia and Herzegovina: Letter of Intent

Sarajevo and Banja Luka, Bosnia and Herzegovina

June 16, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. The global financial and economic crisis has taken its toll on the economy of Bosnia and Herzegovina (BiH). The impact of the crisis has been aggravated by underlying imbalances in our economy, thus raising concerns about macroeconomic stability and BiH's long-term prospects. In response, the State, Federation, and Republika Srpska governments and the Central Bank of Bosnia and Herzegovina have developed a comprehensive strategy aimed at ensuring continued macroeconomic stability, and supporting our goal for sustainable growth over the medium term. In support of these policies and based on our balance of payments needs, we request that the IMF support our program through a Stand-By Arrangement (SBA) in the amount equivalent to SDR 1.01 billion (600 percent of quota) for the period July 2009 through June 2012.

2. We have discussed with IMF staff our economic program, which is outlined below. The program's objective is to safeguard the continued strength of the Currency Board Arrangement (CBA) and cushion the effects of the deteriorating external environment, while adopting policies to address fiscal imbalances and strengthen the financial sector. We expect the program to help set the stage for sustainable growth and convergence with the EU. To achieve the program's objectives, we intend to: (i) strengthen fiscal policy to reduce the government's financing needs and improve medium-term fiscal sustainability; (ii) exercise public sector wage restraint; (iii) undertake structural fiscal reforms aimed at reforming the system of transfers and strengthening public finance management; (iv) adopt a coordinated approach to ensure financial sector stability; and (v) promote other structural reforms that would safeguard competitiveness and ensure the stability of the CBA.

3. We have already taken a number of measures to deal with the impact of the crisis. The Central Bank of Bosnia and Herzegovina (CBBH) reduced reserve requirements to improve the liquidity situation in the banking sector; the deposit insurance limit was raised substantially; and our governments approved mitigating strategies and have been exercising spending restraint. We realized that the rapidly deteriorating external and financial environment could pose difficulties in the months ahead, and, thus, we have approached the IMF for support. As part of our commitments to the program, we plan to

consolidate our public finances—which in recent years saw a significant deterioration—and reorient public spending toward capital investment and to encourage private investment. To protect vulnerable groups, we are going to reform the social safety net. We are also taking measures to ensure sufficient liquidity of the banking sector and to strengthen our crisis preparedness efforts.

4. The program will be monitored through quantitative performance criteria and structural benchmarks, during quarterly reviews. Table 1 below sets out specific quarterly targets that are to be observed under the SBA for: the cumulative change in the banking system net credit to the government and sub-ceilings for the State, the Federation and the Republika Srpska governments; ceiling on new short-term external credit to the State, the Federation and the Republika Srpska governments; ceiling on issuance of new guarantees and on the assumption of enterprise debt to banks by the State, Federation and the Republika Srpska governments; ceiling on accumulation of external and domestic arrears by the State, Federation and the RS governments. Prior actions and structural benchmarks are set out in Table 2. The first review of the program will take place on or after December 10, 2009, and the second review on or after March 10, 2010. The understandings between us and the IMF staff regarding performance criteria and structural measures described in this letter are further specified in the attached Technical Memorandum of Understanding (TMU).

5. We believe that the policies described in this letter are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures as appropriate to ensure the attainment of these objectives. During the period of the arrangement, we will consult with the Fund on the adoption of any new measures and in advance of the policies contained in this letter in accordance with the IMF's policies on such consultations. Further, we will provide the Fund with such information as it requests on policy implementation and achievement of the program objectives.

I. Recent Economic Performance and Macroeconomic Framework for 2009–10

6. The economy of Bosnia and Herzegovina exhibited robust growth in recent years, but over time macroeconomic imbalances emerged. Benefiting from a favorable external environment, the currency board, and the effect of past reforms, real growth averaged 6 percent annually between 2003 and 2008. Fiscal consolidation in 2002–03, a successful introduction of the VAT in 2006, and the recent income tax reforms, as well as major privatization completed in Republika Srpska (RS) in 2007, helped improve the health of public finances. Moreover, the establishment of the Fiscal Council in 2008 represents an important step in advancing national fiscal policy coordination. The business climate improved, attracting large inflows of foreign capital, mainly in the form of FDI and foreign bank financing. All these achievements culminated in the signing of the Stabilization and Association Agreement (SAA) with the European Union in June 2008.

However, over time, these external inflows fuelled a domestic demand boom: bank credit growth reached 30 percent and the fiscal stance was relaxed in 2008. Reflecting mainly food and energy price shocks, inflation peaked in July 2008; wage growth accelerated; and the external balance worsened.

7. The global economic and financial crisis is now making the transition from the overheated economy appear particularly sharp. With the recession deepening in Europe, export growth stalled in late 2008 and turned negative in 2009. Credit growth has ground to a halt, effectively choking off domestic demand. As a result, imports and indirect tax revenue collections are falling; the latter are also affected by the reduction in customs tariffs as stipulated in the SAA.

8. Through our prompt action we have tried to address the impact of the crisis. The CBBH has relaxed reserve requirements in several steps, most recently in April, and the deposit insurance limit was raised from KM 7,500 to KM 20,000 in late 2008. Faced with revenue shortfalls relative to their projected amounts, our governments have been taking steps to restrain spending relative to the initial budgets. However, the rapidly deteriorating external and financial environment create substantial external and budget financing needs, thus necessitating a rapid adjustment.

9. In view of the uncertain global environment, our program's macroeconomic framework incorporates cautious assumptions. The economy has turned sharply down in recent months, and we expect the global growth slowdown and tighter external financing conditions to weight on BiH's growth outlook in the period ahead. We anticipate a drop in GDP this year of about 3 percent, and hope that the measures proposed in this program will limit the fall. A slow recovery is expected in 2010, but growth is likely to remain near zero. With credit to the economy unlikely to increase, domestic demand will fall sharply, thus contributing to a subsiding of inflationary pressures, with projected CPI inflation of about 2 percent on average during 2009−10.

10. A fast contraction in imports will contribute to a narrowing in the external current account deficit this year, thus reducing our gross external financing needs in 2009. However, there will also be a reduction in available capital inflows. We expect that foreign parent banks will maintain their exposure to their BiH subsidiaries. The remaining external financial needs can be covered by drawing on resources, mainly from the IMF, and also from the World Bank, the EU, and bilateral contributions.

II. Economic Policies

11. We recognize that a strong policy package will be required to achieve our goals. Since the overarching objective of the program is to safeguard the continued strength of the currency board and cushion the effects of the deteriorating external environment, the burden of the adjustment will fall primarily on fiscal and incomes policies. We are convinced that the fiscal consolidation and public sector wage restraint outlined below

will ensure stability in the short term, but also bring us back to the path of fiscal sustainability. Fiscal policy measures will be accompanied by measures to strengthen the financial sector and ambitious structural reforms to improve public finance management, and the competitiveness of our economy, thus providing an environment conducive to robust private sector activity.

A. The Currency Board

12. The Currency Board Arrangement has served us well over the past 12 years and its continued stability remains a key objective of our program. The CBA has ensured macroeconomic stability with low inflation, and has broad political and public support. Thus, we will continue to maintain the strict CBA now in place during the program period. Under this arrangement, the CBBH is prohibited from extending credit to the government, from issuing central bank securities, and from granting credit to banks and other private agents, through the purchase of securities. Further changes in minimum reserve requirements will be undertaken only after consultation with IMF staff. We do recognize that sizeable exchange rate depreciations in BiH's regional trading partners could nevertheless have adverse implications for the CBA's viability. Thus, we are committed to use all our tools to safeguard competitiveness, including through wage flexibility, implementation of strong macroeconomic and financial sector policies, and progress on structural reform.

B. Fiscal Policy

13. On account of a sharp increase in spending and weak indirect revenue performance, the fiscal stance worsened in 2008. Increases in wages and higher spending on rights-based transfers, coupled with increasing VAT refunds and lower customs revenues, resulted in a deficit of 4 percent of GDP in 2008, from a near balance in 2007. We are aware that under past spending trends and current revenue performance, the consolidated general government deficit could reach 7.8 percent of GDP in 2009. Besides difficulties in financing such a deficit, the increasing fiscal imbalances could threaten medium-term fiscal sustainability.

14. We are committed to maintaining fiscal prudence and we will make strong efforts to limit the 2009 general government deficit to 4.7 percent of GDP. Accordingly, we will prepare rebalanced budgets at the central Entity level of government, which will incorporate all our fiscal policy commitments included in this Letter, and have those budgets approved by governments and submitted to Parliaments by end-June 2009 (prior action). We expect the rebalanced budgets to be adopted by Parliaments by end-August (structural benchmark). The Council of Ministers of BiH Institutions will adopt necessary amendments to wage bill legislation and decrees by end-June 2009 (prior action). We recognize that there are several risks to our budgets, and we stand ready to take compensatory measures, if needed.

15. Our adjustment efforts will focus on controlling current expenditure, thus allowing space for spending on much-needed infrastructure. We recognize that wages in the public sector have grown very rapidly over the past few years and we are committed to wage restraint across all levels of government. Also, the Federation government recognizes the need to reduce nontargeted transfers to individuals.

16. On the revenue side, we have prepared a draft Law, harmonized with EU legislation, increasing excises on tobacco, coffee and petroleum products. The draft is now under consideration by Parliament and will become effective on July 1, 2009 (prior action), with an estimated impact of KM 162 million—0.7 percent of GDP—in 2009.

17. On the expenditure side:

- The State government has already adopted restrictive measures and will further reduce: spending on wages, meal and vacation allowances, and on good and services to achieve a total expenditure reduction of KM 40 million (0.2 percent of GDP). Similar measures will lead to expenditure savings of KM 10 million in the Brcko District.

- In the Federation**,** the government has passed a restrictive budget for 2009 and has demonstrated restraint in spending, at all levels of government and across all types of expenditures, already in the first quarter of the year. We have also prepared an Intervention Law, to be adopted by the Federation Government by end-May 2009, mandating savings on wages, allowances, transfers and other current expenditures for the duration of the program, and until new legislation reforming spending in these categories is designed and adopted. The Intervention law sets a 10 percent cut compared to the level in December 2008 of the following expenditures: wages of all budget users; transfers to civil and war invalids, and medal holders; transfers for favorable military pensions; transfers to civil victims of war; and all remaining current expenditures.

  In addition, the Law introduces a ceiling of 1 percent of the average wage on meal allowances; lowers the vacation allowance to 50 percent of the average wage from 75 percent of the individual wage; and suspends the allowances for participation in commissions, overtime work and contractual services. Moreover, savings are envisaged by the cantons, social funds and municipalities. The expected total savings amount to KM 414 million (1.7 percent of GDP) in the Federation.

- In the RS, the central government will reduce spending on: (i) employee compensation, by reducing the salaries of the highest paid civil servants by 10 percent, lowering the daily allowance for business trips, unifying the rulebook on compensations, and adopting a hiring freeze for the entire year; (ii) veteran and disability benefits, by streamlining eligibility criteria and improving targeting; and

(iii) current as well as nonproductive capital spending. The expected savings amount to KM 66 million (0.3 percent of GDP).

RS municipalities and extra budgetary funds will also contribute to the adjustment through savings on wages, pensions and other current spending. Expenditure cuts in the municipalities will amount to KM 25 million, and in the health funds to KM 30 million (entirely on wages). In the municipalities, a wage law will be adopted. Finally, through our ongoing ambitious and comprehensive reform of the PAYG pension system, we will be able to save about KM 25 million thanks to the introduction of parametric changes redefining early retirement requirements and introducing a change in the indexation in line with the Swiss model.

18. A strict wage policy across the entire public sector is critical for fiscal consolidation to safeguard external competitiveness. Thus, we are committed to a cautious wage policy for the duration of the program. In addition, we will secure commitments from the boards of all publicly-owned enterprises to restrain spending on wages and other forms of compensation. We expect that wage restraint in the public sector will provide a strong signal for wage moderation in private sector settlements.

19. All governments are committed to maintaining fiscal discipline over the medium term. We therefore intend to continue budget consolidation in 2010, through a further reduction in the consolidated general government deficit to around 4 percent of GDP. Fiscal efforts will continue to be concentrated on the expenditure side, which will benefit from the full-year impact of the reforms undertaken this year. Specific quarterly targets for 2010 will be set at the time of the first review of the program—to be completed by December 31, 2009.

20. We are planning comprehensive structural fiscal reforms to return public finances to a sustainable path. Specifically:

- Following the establishment of the Fiscal Council last year, we intend to strengthen its operational framework. As a first step, the FC will adopt the “Global Framework of fiscal balance and policies in Bosnia and Herzegovina” (prior action) and by end-September 2009 revised macroeconomic parameters. This Framework will provide the basis for the preparation of the budgets of the State and the Entities for 2010 and will take into consideration the 2009 savings achieved under this Letter. In the context of the Fiscal Council and with the objective of a more coordinated fiscal policy across the country, we will also set up procedures for improved multi-year budgeting of the various levels of government.

- The Federation government will undertake a comprehensive reform of its rights-based benefits system, in consultation with the World Bank. We understand that making reforms of the current complex system will take time; and we intend to phase out the revision of the various laws over the next 18 months. As a first step, by end 2009, we intend to: (i) eliminate special unemployment benefits granted to demobilized soldiers by allowing the sunset clause to expire; (ii) introduce a maximum income threshold for eligibility for civilian and veterans benefits; (iii) reduce all civilian and veterans' benefits by 10 percent and eliminate indexation; and (iv) reform war veterans' pensions. These reforms will entail the revision of existing legislation, including: (i) Decree on eligibility for pension under more favorable conditions of the military insurees of the Army of FBiH; (ii) Decree on eligibility for age pension under more favorable conditions of the military insurees of the Army of FBiH; and (iii) Decree on eligibility for age pension under more favorable conditions of the members of the former Army of FBiH and civil servants and employees of the former Ministry of Defense of FBiH.

- Over the medium term, we will seek the assistance of the World Bank to undertake a comprehensive income and property census and introduce means-testing for all civilian and war-related benefits.

- The Federation government will establish a centralized system of registration, control, and collection of taxes and social contributions. This should help improve compliance.

- Our governments recognize the importance of further reforming public administration. To this end, we will launch a comprehensive review of the various functions and responsibilities, with the objective of strengthening the quality and efficiency of public administration.

- Along with the objective to provide a more efficient public administration, the Federation government will adopt a comprehensive wage law, which, among others, will aim at consolidating all allowances and bonuses into the main wage.

- The Federation government recognizes the need to amend the budget process to ensure that approved legislation is backed by sufficient financial resources. To this end, we will work towards adopting a fiscal responsibility law.

- The Federation government is determined to move ahead with the privatization of state-owned companies, and to this end, by June 2009 it will initiate the process.

21. We understand that our adjustment program may have an impact on the vulnerable groups of our population. Thus, we will reform the social safety net to ensure the protection of the poor.

C. Financial Sector Policies

22. Our banking system is strong, but we recognize that it faces difficult and uncertain macroeconomic and global financial conditions. All banks are relatively well-capitalized, and most of them (accounting for about 95 percent of total assets) are foreign owned and have parents in the euro area. However, the worsening of global financial situation poses exceptionally uncertain prospects: with credit growth coming to a halt and higher funding costs, bank profitability is deteriorating. This necessitates coordinated action, including support of parent banks and home country authorities. To this end, following the staff-level agreement on this program, we will seek a pledge from foreign banks to maintain exposure to their BiH subsidiaries and to recapitalize those as needed over the program period. Finally, we will consult with Fund staff prior to the introduction of any new or revised prudential regulations for banks.

23. The financial sector strategy will evolve around a comprehensive framework to strengthen the financial system and improve monitoring. To this end, the Fiscal Council, the CBBH, the two banking agencies, and the Deposit Insurance Agency (DIA) will form a Standing Committee for Financial Stability (SCFS) and formalize the cooperative arrangements for financial stability, crisis preparedness and management through the signing of a Memorandum of Understanding (MoU). The CBBH and two banking agencies will produce and monitor high-frequency data; on the basis of such data, regular reports will be prepared and disseminated within the SCFS.

24. As part of our contingency planning in the case of crisis, we intend to strengthen the bank resolution framework, by: (i) preparing a contingency manual for a two-agency bank resolution strategy, (ii) making law amendments to broaden the banking supervisory agencies' discretion to appoint a temporary administrator, and (iii) ensuring irreversibility of supervisors' decisions and seniority of the DIA's claims for depositor reimbursements over the claims of general creditors.

25. To ensure continued confidence in the deposit insurance scheme, we plan to bring the coverage more closely in line with neighboring countries and prospective requirements under EU directives. We also intend to supplement the existing Deposit Insurance Fund (DIF) with access to a credit line from EBRD, expected to be approved by June 2009. The DIA will establish a principle of universal membership by abolishing the criteria regarding limits to public ownership of capital and ensuring the consistency between the DIA's membership criteria and banking licensing.

D. Other

26. We recognize the importance of improving the quality of statistics, particularly in the context of the IMF program. The State and Entity Statistics Agencies commit to further harmonize the expenditure and production GDP data and publish it in a timely

manner. Furthermore, the Statistic Agencies will develop quarterly / semiannual GDP data.

27. This program provides us an opportunity to strengthen our efforts for improving the quality of fiscal statistics, with the objective of compiling data harmonized with Eurostat and the IMF's Government Statistics guidelines. We will ensure timely submission of all fiscal statistics by lower levels of government in the two entities and improve coverage. To this end, and under the umbrella of the Fiscal Council, we will create a coordinating group with the task of collecting and consolidating the fiscal statistics from all levels of government in BiH. This group will consist of officials from the State, Federation, and RS Ministries of Finance, representatives from MAU, and of the Statistics Division of the CBBH.

28. We will broaden the coverage of reporting on fiscal execution to include foreign-financed projects and off-budget spending from escrow accounts in general government fiscal accounts (State and two entities). Also, we will improve centralized data compilation and monitoring of foreign grants for all levels of government.

29. Because of current general government data weaknesses, the program monitoring relies on changes in net general government position as reported by the central bank. It is envisaged that with improvements in fiscal data reporting the general government position would be ultimately monitored from above the line, as a difference between revenue and expenditure.

30. We recognize the importance of completing a safeguards assessment by the first review of the Stand-By Arrangement. In this regard, the CBBH will provide as soon as feasible the necessary documentation required to complete the assessment by the first review and receive a safeguards mission from the IMF as necessary. IMF resources under the arrangement, in the context of a balance of payments need, will be disbursed to the Central Bank of Bosnia and Herzegovina.

/s/	/s/	/s/
Nikola Špirić Chair of the Council of Ministers Bosnia and Herzegovina	Nedžad Branković Prime Minister Federation of Bosnia and Herzegovina	Milorad Dodik Prime Minister Republika Srpska

/s/	/s/	/s/
Dragan Vrankić Minister of Finance of BiH Institutions Bosnia and Herzegovina	Vjekoslav Bevanda Minister of Finance Federation of Bosnia and Herzegovina	Aleksandar Džombić Minister of Finance Republika Srpska

/s/

Kemal Kozarić
Governor
Central Bank of Bosnia and Herzegovina

Attachments

Attachment I. Technical Memorandum of Understanding

BOSNIA AND HERZEGOVINA

Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program

June 16, 2009

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 requirements for program monitoring.

I. DEFINITIONS

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 Cumulative Change in Net Credit from the Banking System to the General Government

Definitions:

- ***The general government*** is defined to include the governments of the State, the Republika Srpska Entity (RS), the Federation of Bosnia and Herzegovina Entity (Federation) and the District Brcko. The Federation government is defined to include the central government, the cantonal governments, the municipal governments, the extrabudgetary funds and the road fund. The RS government is defined to include the central government, the municipal governments, the extrabudgetary funds and the road fund. Extrabudgetary funds include, but are not limited to, the pension funds, health funds, unemployment funds, and children's fund in the two Entities.

- ***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.

- ***Net credit to the general government*** is defined as all claims on general government (e.g. loans, securities, bills, and other claims in both convertible marka and foreign currencies) minus general government claims on the banking system (deposits, loans and other claims, including deposits in entities' escrow accounts). For program purposes, those components of claims that are denominated in foreign currencies will be converted into convertible marka at current exchange rates.

Application of performance criteria:

- The value of banking system net credit to 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 cumulative change in net credit from the banking system to the general government will be defined, for each test date, as the cumulative change from the level existing on December 31 of the previous year.

- The ceilings on the cumulative change in net credit from the banking system to the general government will be defined in terms of three-sub-ceilings that sum to the ceiling for the general government. These sub-ceilings will be on the cumulative change in net credit from the banking system to the government of the State, the governments of the Federation of Bosnia and Herzegovina and of the Republika Srpska. For the purposes of program monitoring, compliance with the ceiling on banking system net credit to general government will require that each of these three 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 unless 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 to include: (i) gold, and other precious metal and stones; (ii) convertible foreign exchange notes; (iii) credit balances in convertible foreign exchange—including SDRs—on the books of foreign central banks or other financial institutions; (iv) liquid debt securities issued by the government and the central bank of the country on whose currency the securities are denominated; and (v) officially guaranteed forward and repurchase contracts of different types providing for future payments in convertible foreign exchange by nonresidents.

- ***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 and international financial institutions; (ii) credit balances due to foreign central banks, governments, international organizations, and foreign financial institutions; (iii) forward and repurchase contracts of different types providing for future payments in foreign exchange by the CBBH to 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.

- Foreign currency holdings will be converted into convertible marka at the exchange rates of April 30, 2009, 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.[1]

C. Ceiling on External Payment Arrears

Definitions:

- ***External payment arrears*** are defined as overdue debt service arising in respect of debt obligations incurred directly or guaranteed by the general government, except on debt subject to rescheduling or restructuring.

- ***Debt obligations*** are defined as all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (Including currency) or services, and which require the general government to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described

[1] At end-April 2009, one SDR unit was equal to 1.1283 euro, or to 1.4978 U.S. dollars.

above (including loans, suppliers' credits and leases) will be included in the definition and be subject to the ceiling. The definition of general government is as described above.

Application of performance criteria:

- The ceiling on the change in external payments arrears applies to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the State, the Federation, and the Republika Srpska. This criterion will apply continuously.

- The limit on the change in external payments arrears also applies to the change in the stock of overdue payments on short term debt in convertible currencies with an original maturity of up to and including one year. The limit excludes reductions in connection with rescheduling of official and commercial debt and debt buy back. Accumulation of new external arrears is prohibited under the program.

D. Ceiling on Domestic Expenditure Arrears

Definition:

Expenditure arrears are defined as the difference between payment obligations due, and actual payments made. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Expenditure arrears for goods and services to suppliers are defined as obligations to suppliers, which are due but not paid for more than 30 days and are nondisputed. Arrears between the Entity central government budgets and local government, and extrabudgetary funds are not counted towards the expenditure arrears' ceiling on the general government.

Application of performance criteria:

The ceiling on accumulation of domestic payment arrears applies to obligations of the State, the Federation, and the Republika Srpska. This criterion will apply continuously.

E. Contracting or Guaranteeing of New External Debt

Governments will consult with the IMF before contracting or guaranteeing any new external debt.

Definitions:

- ***The term "debt"*** is defined to include all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the general government to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits and leases) will be included in the definition. The definition of general government is as described above.

- ***New nonconcessional external debt*** is defined as including all debt (as defined above) contracted or guaranteed by the general government or the CBBH during the program period that is not on concessional terms.

- ***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 20-19 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 proceeding six-month period (plus a margin of 0.75 percent) will be used.

- ***Short-term debt*** is defined as debt contracted or guaranteed by the general government with an original maturity of up to and including one year.

Application of performance criteria:

The ceiling on contracting new short-term external nonconcessional debt applies to obligations of the State, the Federation, and the Republika Srpska. This criterion will apply continuously.

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 that the first week of each month, a summary of key macroeconomic policy decisions taken during the previous month; a summary of regulatory changes in the area of banking and financial sector, report any revisions to monthly and annual fiscal reports as well as any amendments to the Entity and state budget and local government budgets within a week after their approval.

Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with a detailed explanation. The data will be provided in an electronic form.

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 euro where the target is in euro.

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.

Daily Data Reporting

The Bosnia and Herzegovina authorities will send to the Fund the following data no later than 14 working days after the end of each week:

(i) Deposits, by bank

(ii) Gross international reserves

(iii) CBBH foreign exchange purchases and sales

Monthly Data Reporting

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

(i) The balance sheet of the CBBH.

(ii) The commercial bank survey and monetary survey

(iii) Banking supervision financial soundness indicators, including capital adequacy ratio, loan-loss provisioning data, nonperforming loan data.

(iv) Weighted average interest rates by bank and by type of loans

(v) Net foreign exchange position, by bank

(vi) Exposure of foreign parent bank to its subsidiary(ies) in BiH (amount of deposits, loans and subordinated loans from foreign parent banks).

(vii) Data on direct bank cross-border claims on BiH corporations and households (along the lines reported by the Bank for International Settlements in its Table 9C: Consolidated Banking Statistics).

(viii) Detailed information on (a) banking sector credit to the general government (by level of government), and (b) government deposits in the banking sector (Table 1).

(ix) Revenues, expenditures and financing data for central governments (the State, and the Entity governments). Expenditures will include those financed from deposits in the escrow accounts.

(x) ITA revenues.

(xi) New external loans contracted or guaranteed by governments.

(xii) New domestic loans contracted or guaranteed by governments.

(xiii) Domestic debt payments (interest, amortization) by level of government

(xiv) Report on inflows into and outflows from escrow accounts (FBiH, RS).

(xv) Transfers to the Entity Development Banks from the Entity central governments.

Quarterly Data Reporting

The Bosnia and Herzegovina authorities will send to the Fund the following quarterly data within five weeks after the end of each quarter.

(i) Banking supervision: financial soundness indicators, quarterly

(ii) Banking supervision: commercial bank's balance sheets (by bank)

(iii) Banking supervision: commercial banks' income statement (by bank)

(iv) Revenues, expenditures and financing data for municipalities (in both entities), and cantons (in the Federation).

(v) Revenues, expenditures and financing data for the Brcko District.

(vi) Revenues, expenditures and financing data for the road funds.

(vii) Revenues, expenditures and financing data for the extrabudgetary funds (pension funds, health funds, unemployment funds and (in the RS) the children's fund).

(viii) Financial statements of (a) the RS Investment and Development Bank, and (b) Federation's Development Bank.

(iv) External debt service projections for current year; total, by creditor, by level of government, and in original currency

(x) Summary of government guarantees.

(xi) Summary of government foreign loans and degree of concessionality (grant element); total, by creditor, by purpose (project/budget support) and original currency

(xii) Summary of short-term loans by government, by creditor.

(xiii) External debt service payments (interest, amortization) by level of government

(xiv) Summary of foreign loan disbursements, by creditor, by level of government, by purpose (project/budget support) and original currency

(xv) Stock of external debt for (a) public sector; (b) private nonbank sector and (c) banking sector.

(xvi) Summary of domestic loan disbursements, by creditor, and by level of government.

(xvii) Stock of domestic debt outstanding, by level of government; and projected domestic debt service payments (interest, amortization).

(xviii) Report on project and budget support grants for general government prepared by MOF BIH Unit for coordination of international economic aid. The unit will also coordinate data flow from federation, RS and local governments. The report will include information on the country of the donor, sector of support and the purpose (project/budget/BOP, etc)

Table 1. Bosnia and Herzegovina: Performance Criteria Under the 2009–10 Stand-By Arrangement 1/
(In millions of KM, unless otherwise noted)

	2009				2010	
	March	June	September	December	March	June
	Actual		Performance criteria		Indicative targets	
Ceiling on accumulation of net credit of the banking system to: 1/						
general government	-57	696	476	676	157	337
State government	-109	-24	44	44	29	59
RS government	123	376	424	536	132	336
Federation government	-58	346	15	108	-3	46
Ceiling on new guarantees and the assumption of enterprise debt to banks by the State, Federation and RS governments 2/	0	0	0	0	0	0
Ceiling on accumulation external payment arrears 2/	0	0	0	0	0	0
Ceiling on contracting new short-term external nonconcessional debt 2/	0	0	0	0	0	0
Ceiling on accumulation of domestic arrears of: 2/						
State government	0	0	0	0	0	0
RS government	0	0	0	0	0	0
Federation government	0	0	0	0	0	0

1/ Cumulative within each calendar year.
2/ Continuous.

Table 2. Bosnia and Herzegovina: Prior Actions and Structural Benchmarks, June 2009–June 2010

		Implementation date
I.	**Prior Actions for the approval of the arrangement**	
1.	Adopt rebalanced budgets by Entity governments and submit to Parliaments.	
2.	Adopt amendments to the wage bill legislation by the State Council of Ministers.	
3.	Adopt the Intervention Law in the Federation.	
4.	Adopt the excise law.	
5.	Adopt the Global Framework by the Fiscal Council	
II.	**Structural Benchmarks**	
A.	Continued adherence of the Currency Board Arrangement as constituted under the law	continuous
B.	**Fiscal Sector**	
1.	Approve the rebalanced budgets by the Entity Parliaments	end-August 2009
2.	Agree on an action plan acceptable to the World Bank and IMF staffs to reform the system of rights-based transfers (Federation)	end-November 2009
3.	Submit to the Parliament a Law forbidding passing of unfunded legislation (Federation)	end-November 2009
4.	Publish on the State government's web site quarterly consolidated general government accounts with a 5 week lag	continuous
C.	**Financial Sector**	
1.	Form the standing committee of financial stability (SCFS) and sign the MoU on financial stability, crisis preparedness and crisis management	end-November 2009
2.	The Deposit Insurance Agency to impose a principle of universal membership requirements, including for partially state-owned banks	end-February 2010