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

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BOSNIA AND HERZEGOVINA: LETTER OF INTENT

Sarajevo and Banja Luka, Bosnia and Herzegovina
March 5, 2010

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

Dear Mr. Strauss-Kahn:

1. The economy of Bosnia and Herzegovina (BiH) has been adversely affected by the global financial and economic crisis. The impact of the crisis has been aggravated by underlying imbalances in our economy, raising concerns about macroeconomic stability and BiH's long-term prospects. Economic activity has been contracting, hit by declines in exports and domestic demand. However, recent indicators suggest that the pace of the contraction is slowing and we expect a gradual improvement in 2010. The current account deficit of the balance of payments is shrinking, and external financial strains have eased. Foreign banks have broadly maintained their exposure to BiH, household deposits have resumed flowing into the banking system, and foreign exchange reserves have partly recovered.
2. Despite the challenging environment, policy implementation of the IMF-supported program has been broadly in line with our commitments (Tables 1 and 3). All quantitative performance criteria for end-September and end-December 2009 and structural benchmarks have been met albeit some with a delay. Regarding the structural benchmark for the publication on the State government's website of quarterly consolidated general government data (continuous structural benchmark), we have established a coordinating group with the task of collecting and consolidating fiscal statistics from all levels of government to ensure that we meet this benchmark on time in the future.
3. Although we were able to keep overall expenditures in check, revenue shortfalls led to a 2009 fiscal deficit outturn above the program objective, and ongoing fiscal pressures put achievement of the program's 2010 fiscal deficit objective at risk. We have thus identified corrective measures elaborated in this Letter. In view of this performance and our continued commitment to the program, we request completion of the first review under the Stand-By Arrangement.
4. The policies described in the letter of June 16, 2009 and in this Letter are adequate to achieve the objectives of our economic program, and we stand ready to take additional measures as appropriate to ensure the attainment of these objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in

this letter or adopting new measures that would deviate from the goals of the program, and provide the IMF with the necessary information for program monitoring.

I. RECENT DEVELOPMENTS

5. Since the beginning of 2009, the downturn has quickly spread across the economy and, as elsewhere in the region, the sharp drop in domestic demand has helped drive down imports substantially, while exports have declined as well, but by a lesser amount. As a result, the trade deficit is narrowing faster than initially projected, leading to a sharp contraction in the current account deficit. Inflation has declined sharply from near 10 percent in mid-2008 to zero by end-2009, partly aided by drops in food and energy prices.

6. Financial market stress has eased, reflecting an improvement in market sentiment. Nongovernment deposits have been flowing back into the banking system and central bank reserves have strengthened in large part owing to the first purchase under the SBA and the SDR allocation. Commercial banks are liquid but their reluctance to assume increased risk and the general worsening of the economic environment have brought credit growth to a halt.

7. However, because of uneven implementation of fiscal policy measures included in the program and revenue shortfalls, the general government deficit has been widening. We now estimate that the consolidated general government deficit in 2009 reached 5.3 percent of GDP compared with a deficit of 4.8 percent in 2008 and against a deficit objective of 4.7 percent under the program. Limiting the consolidated fiscal deficit to this level took substantial efforts from all governments (see below). The State budget is estimated to have recorded a surplus. In the Federation, the fiscal slippage is mainly attributed to revenue shortfalls, while overruns in current expenditure were partially compensated by cuts in capital spending. In the Republika Srpska (RS), shortfalls in indirect tax revenues have been more than offset by better than budgeted social contributions and direct taxes. However, overruns took place in the wage bill and pressures on the finances of the pension fund have been increasing.

II. THE PROGRAM

8. The main objectives of the program remain to preserve macroeconomic and financial stability, safeguard the currency board, and cushion the effects of the adverse external environment. Uneven implementation of our commitments in the fiscal area will necessitate stronger efforts in the coming months. The fiscal consolidation and public sector wage restraint will ensure stability in the short term, but also bring us back on 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. Macroeconomic Framework

9. The macroeconomic framework has retained cautious assumptions. A gradual return to positive growth is projected, with GDP gaining about 0.5 percent in 2010, aided by recovery in the euro area. Inflation is expected to pick up slightly, approaching 1½ percent by end-2010. While exports are expected to lead the recovery, imports are also projected to grow, but at a fairly modest rate. As a result, the current account deficit is expected to remain flat, but considerably below pre-crisis levels.

B. Fiscal Policy

10. Since the approval of the program in July 2009, we have maintained fiscal prudence. We prepared rebalanced budgets of the two Entity budgets incorporating all our commitments. Since the delay in completion of the first SBA review also delayed the second disbursement from the Fund, the Fiscal Council recommended distribution of the funds from the SDR allocations to the two Entities, which used them for budget financing (within the agreed deficit objectives).

11. The Institutions of Bosnia and Herzegovina have adopted the amendments to wage legislation, effective from July 1st, 2009, as agreed under the Letter of Intent as of June 16 2009. In addition, BiH Institutions have implemented saving measures in 2009 as instructed by the ministry of finance and treasury. These measures are estimated to have achieved a surplus of 0.1 percent of GDP in 2009.

12. The Federation exercised restraint in spending, at all levels of government and across all types of expenditures in 2009. However, given the further shortfalls in revenue collection, in particular of indirect tax revenues, the Ministry of Finance adopted a budget rebalance, which provided for further cuts of public revenues of KM 55 million.

13. In July 2009, the Federation Parliament passed a Law on Savings, providing for savings on wages, allowances, transfers and other current spending for the duration of the program on a temporary basis, and until new legislation reforming spending in these categories is designed and adopted.

14. In order to legally regulate the wage cuts for government employees and the employees of other institutions financed from the Federation budget, the government passed amendments and changes to the Law on Savings providing for changes of Articles 1 and 2 in a way to include the following provisions regarding savings on: (i) gross wages and allowances through 10 percent cuts and (ii) employees' allowances by introducing a ceiling of 1 percent of the average wage on meal allowances and lowering the vacation allowance to 50 percent of the average wage from 75 percent of the individual wage. Until the Amendments and Changes to the Law on Savings become effective, the Federation

government has passed, as a temporary measure, a decision on coefficient cuts across wage grades of all budget users.

15. Republika Srpska adopted a rebalanced budget for 2009 by December 31, 2009 which incorporated lower overall spending.

16. We will continue fiscal consolidation in 2010. To this end, we will aim at a general government deficit of 4½ percent of GDP. Our adjustment efforts will focus on controlling current expenditure, thus allowing space for spending on much-needed infrastructure. 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. We are also planning comprehensive structural fiscal reforms to return public finances to a sustainable path.

17. On the revenue side, we have already approved a Law on Excises, which will lead to a full harmonization of excises on tobacco by 2015 with those stipulated in the EU directives. On January 1, 2010, these excises increased again (with an estimated impact KM 120 million—0.5 percent of GDP).

18. In 2010, the Institutions of Bosnia and Herzegovina will continue to implement restrictive wage policy based on legislation amended in 2009. Total spending in the 2010 budget of BiH Institutions will be slightly lower in comparison to the 2009 budget. As a result of a drawdown in deposits accumulated in 2008 and 2009, to finance part of the expenditures in 2010 budget, deficit will reach 0.8 percent of GDP (KM 194 million).

19. To address the weaknesses in the current system of public wages and transfers on a lasting basis, the Federation Government has elaborated a new draft law on wages and allowances for civil servants in all levels of government and draft legislation regulating social sector. These will allow a further reduction in the wage bill and keeping social transfers at the level of the rebalanced 2009 budget. As a result, the consolidated budget deficit will go down to KM 439 million in 2010.

20. The Federation Government shall undertake, in consultation with the World Bank, comprehensive reforms of the system of rights-based benefits, with the objective of better targeting through means-testing. We intend to: (i) introduce means-testing for acquisition of social benefit rights for disabled civilians, civilian war victims, and war-disabled (from January 1, 2011), and income tests for war medal holders (from May 1, 2010); (ii) link increases in all allowances to inflation, rather than average salary increases; and (iii) pass a law to eliminate the special benefits for unemployed demobilized soldiers, effective May 1, 2010 (prior action—already met). We will reform privileged pensions (structural benchmark, end-March 2010), specifically: (i) pension rights of war disabled people and demobilized soldiers; (ii) rights to pensions under favourable conditions of military insurees of FBiH Armed Forces, civil servants and employees of the former Federal Ministry of Defence. We will consult with the IMF on any new proposed legislation in the area of rights-based benefits

and ensure that it is consistent with the goal of fiscal sustainability and the objectives of the reform of these benefits. Specifically, any reintroduction of benefits for demobilized soldiers currently under consideration will not feature cash benefits, special pensions, housing loans or subsidized provision of housing.

21. These reforms will be supported through amendments to the following existing laws:

- Law on Audit of Rights of Beneficiaries Entitled to Defence-Invalid Protection (already adopted by parliament). Audits have started on January 1, 2010 and the disqualified beneficiaries will see their benefits cut immediately. The results of the audits will be published on a quarterly basis in the government's website, along with the estimates of realized monthly savings (continuous structural benchmark).
- Amendments to the Law on Rights of War Veterans and Members of their Families.
- Amendments to the Law on Rights of War Medal and Order Holders to become effective May 1, 2010;
- Law on Social Protection Basis and Social Security Minimum; Law on Basic Rights of Individuals with Disabilities; Law on Civilian War Victims by March 31, 2010;
- Framework Law on Targeting of Cash Benefits was adopted by Parliament (prior action).
- Law on Preferential Retirement of War Insurees which would unify all the FBiH Government provisions on preferential conditions for acquisition of rights to age retirement of military insurees of FBiH Armed Forces, civil servants and employees of the former Federal Ministry of Defence (Provision I, II and III). The purpose of the amendment will be to reduce the amounts paid out for privileged pensions (by tightening eligibility criteria and bringing the average amount closer to the average amount of regular pensions) and align the total cost with the resources earmarked for this purpose. This will help safeguard the financial integrity of the public pension system, on which the most vulnerable groups of society rely for income.
- To advance the transition to a means-tested system of social benefits, we will undertake the comprehensive property and revenue census, and introduce audits of property status for all the holders of civilian and war veteran rights by January 1, 2011.

22. The Government of the Federation will establish a centralised system of registration, control, and collection of taxes and contributions. This system will help improve implementation of laws and compliance with laws and regulations. For this purpose, we have

adopted the Law on Fiscal Systems regulating record keeping and control of sales through fiscal systems.

23. The Federation Government will adopt a comprehensive Law on Wages to establish a fully harmonized, comprehensive and transparent remuneration system across all levels of government (structural benchmark, end-March 2010). All allowances and contributions will be consolidated in the base wage. This law will prescribe payment classes and coefficients for the categories of elected officials, managers, advisors, civil servants and police officers. The base will be determined by Government in consultation with the Trade Union, in accordance with the transparency principle.

24. The Federation Government recognises the need to change the budget process to ensure that adopted laws are adequately financially supported. For this purpose, we will be working toward adoption of a law on fiscal responsibility. In the meantime, amendments to the Law on the Budget have been adopted. The purpose of the amendments is to ensure that no legislation can be adopted without a full analysis of its fiscal implications and financing. This will rule out adoption of legislation for which adequate funding has not been identified.

25. The Government of Republika Srpska adopted a 2010 budget envisaging a consolidated deficit of KM 497 million (2 percent of GDP). Substantial cuts are envisaged for the wage bill: (i) a wage cut of KM 3 million compared to the 2009 budget rebalance will be carried out through amendments and changes of the RS Law on wages of government employees, Law on wages of Ministry of Interior employees, of those employed with correction institutions and court police as well as the Law on wages of those employed in education and culture or by Government decision; (ii) wage cuts to the employees in local administration units of KM 8.5 million in 2010 compared to the 2009 budget execution; (iii) wage cuts to the extra-budgetary funds employees (PIO, Health Fund, Child Protection Fund and Employment Fund) of KM 3.7 million compared to the 2009 budget execution; and (iv) wage cuts to PE"RS Roads" employees of KM 0.3 million compared to the 2009 budget execution.

26. Savings of KM 40 million will be realized on extra-budgetary funds: (i) the Pension Fund will save KM 25 million in line with the Pension System Reform Strategy and Restoration of the first mandatory insurance pillar; (ii) the Health Fund will save KM 15 million in health system costs; (iii) the deficit of the PIO Fund will be reduced by clearing the arrears of the RS budget as pursuant to the Protocol on mutual reconciliation of obligations and claims for war veterans' pension contributions (dated July 12, 2007) through escrow account payments—KM 38 million. Also savings in consolidated balance of KM 10 million are envisaged.

27. Republika Srpska has already amended and changed the Law on rights of war veterans and families of deceased soldiers and the Law on protection of the civil victims of the war as envisaged under the World Bank DPL project. The RS National Assembly also

amended and changed the Law on pension and disability insurance and the Pension System Reform Strategy will be adopted by end-March 2010 (structural benchmark).

28. The Entity governments understand that our adjustment program may have an impact on the vulnerable groups of our population. Thus, the envisaged reforms are critical to ensuring that financial public support for households is better targeted toward the most vulnerable groups of society, and that financial integrity of public pension and unemployment insurance schemes does not become jeopardized.

C. Financial Sector Policies

29. The banking system has been able to withstand the shock of the global financial crisis. However, nonperforming loans have increased from 3 percent of assets at end 2008 to 5.8 percent at end December 2009, and profitability has declined. The two banking agencies are closely monitoring banking sector developments and ensure that banks continue to have adequate capital. To this end, banks have been instructed to retain profits and build up their buffers to prevent capital depletion. The banking agencies will ensure that banks have a forward-looking capital plan that will show how any potential deterioration in capital levels will be addressed and the banking agencies and the banks will review such plans periodically, to account for changing macroeconomic environment.

30. Parent banks have also pledged to continue to support their subsidiaries in BiH and more specifically to maintain their exposure to BiH. The CBBH has received all 9 bilateral commitment letters from the parents of, mainly large, foreign-owned banks, confirming their commitments made in Vienna in June 2009 and Sarajevo in September 2009. The CBBH and the Banking Agencies are in the process of monitoring the parent banks' commitments. To help monitor the level of parent bank exposure to BiH, the parent banks have been requested to provide comprehensive data on their exposures on a regular basis. In addition, bilateral discussions with banks will be initiated to review their capital adequacy, on the basis of stress tests to be finalized by the CBBH in cooperation with the two banking agencies.

31. We continue to improve our framework for crisis preparedness and management. To this end we have established a Standing Committee for Financial Stability (SCFS), which consists of members of the Fiscal Council, the CBBH, the two banking agencies, and the Deposit Insurance Agency. A Memorandum of Understanding that establishes the formal framework of cooperation among the various parties has already been signed. We will be meeting on a regular basis to discuss and exchange information related to financial stability.

32. We are also continuing to improve our deposit insurance scheme to ensure continued confidence in our banking system. We have amended the deposit insurance regulation to enable all banks, regardless of the bank's ownership, to become a member of the deposit insurance scheme if the bank fulfills the necessary prudential criteria (structural benchmark

for end-February 2010). In addition, we have signed an agreement with EBRD on access to emergency credit.

D. Other

33. We have already made important progress in improving the quality of statistics, particularly of the government accounts with the objective of compiling data harmonized with Eurostat and the IMF's Government Statistics guidelines. Under the umbrella of the Fiscal Council, we created a coordinating group with the task of collecting and consolidating the fiscal statistics from all levels of government in BiH. We will ensure timely submission of all fiscal statistics by lower levels of government in the two Entities. We will make progress towards improving data collection and reconciliation of external grants and loan disbursements at the level of donors, state, and Entities. We will also 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 in the two Entities.

34. On the basis of the conclusions of the updated safeguard assessment of the CBBH, we are planning to: (i) revise the Audit Committee charter to include into its responsibilities an oversight of the external audit process and the requirement that at least one member of the Committee is an expert in accounting and/or audit issues; and (ii) ensure that audit procedures for FY2009 include confirmation that foreign assets are not pledged.

35. The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria, and structural benchmarks. Revised quantitative targets for 2010 are set out in Table 2; and structural benchmarks are set out in Table 3. We request that the end-March and end-June 2010 targets be established as performance criteria. The understandings between the authorities of Bosnia and Herzegovina and IMF staff regarding the quantitative performance criteria described in this memorandum are further specified in the TMU attached to this memorandum.

36. IMF resources under the arrangement will be disbursed to the Central Bank of Bosnia and Herzegovina, which acts as the fiscal agent for BiH, and credited to an account of the State. The resources will be allocated to the two Entity budgets on the customary 2/3:1/3 split.

/s/
Nikola Špirić
Chair
of the Council of Ministers
Bosnia and Herzegovina

/s/
Mustafa Mujezinović
Prime Minister
Federation of Bosnia
and Herzegovina

/s/
Milorad Dodik
Prime Minister
Republika Srpska

/s/
Dragan Vrankić
Minister of Finance
of BiH Institutions
Bosnia and Herzegovina

/s/
Vjekoslav Bevanda
Minister of Finance
Federation of Bosnia
and Herzegovina

/s/
Aleksandar Džombić
Minister of Finance
Republika Srpska

/s/
Kemal Kozarić
Governor
Central Bank of Bosnia and Herzegovina

Attachment

TECHNICAL MEMORANDUM OF UNDERSTANDING

BOSNIA AND HERZEGOVINA

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

March 5, 2010

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 1-3) as well as data reporting requirements for program monitoring (Table 5).

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. Any new budgetary and extra budgetary funds, created during the program period will also be included in the definition of the general government consistent with the definitions of the IMF *Manual on Government Finance Statistics 2001*. The BIH authorities will inform IMF staff of the creation of any such new funds.
- ***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 of the banking system to the general government*** (net bank claims on general government) is defined as all banking system 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) as defined in the Table 4 below. 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 net bank claims on 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. Table 4 shows the banking system net claims on the general government as of end-December 2009.
- The ceilings on the cumulative change in net bank claims on 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 bank claims on general government will be defined in terms of three sub-ceilings that, together with the net bank claims on the District of Brčko,¹ sum to the ceiling for the general government. These sub-ceilings will be on the cumulative change in net bank claims on 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 net bank claims on general government will require that each of these three sub-ceilings be observed independently.

Adjustors to performance criteria

- The targets on net bank claims on general government will be adjusted upward (downward)² by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants. Program budget support disbursements are defined as external disbursements from official creditors (e.g., World Bank, IMF, and European Commission) used for financing of general government budget deficits.

¹ The net bank credit to the District of Brčko is not monitored individually because of its small size.

² In the case of both positive and negative targets on net bank claims on general government, upward means resetting of the target to an arithmetically bigger number, whereas downward means resetting of the target to an arithmetically smaller number.

- The targets on net bank claims on general government will be adjusted upward (downward)³ by the amount by which reported change in float is arithmetically smaller (greater) than its targets in the fiscal program. Float is defined as accrued but unpaid purchases of goods and services, wages and salaries, pensions, social benefits, and investments that are not in arrears (as defined in the text below). The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target.

BiH: General Government Change in Float, 2009
(In millions of KM)

	2009 Dec
Change in float ((1)-(2)-(3))	180
State government	0
FBiH government	113
RS government	67
District Brcko	0
(1) Change in arrears and float	180
State government	0
FBiH government	113
RS government	67
District Brcko	0
(2) External debt service arrears	0
State government	0
FBiH government	0
RS government	0
District Brcko	0
(3) Domestic arrears	0
State government	0
FBiH government	0
RS government	0
District Brcko	0

Sources: Ministries of Finance; and IMF staff estimates.

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 pay a dividend only if its initial capital and general reserves exceed 5 percent of its monetary liabilities.

Definitions

- *Net foreign exchange reserves of CBBH* are defined as the value of foreign assets less the value of foreign liabilities, including short-term liabilities denominated in convertible currencies or convertible marka.
- *Foreign assets* are defined to include: (i) any gold, other precious metal and stones held by or for the account of the Central Bank; (ii) any banknotes and coins in freely convertible foreign currency held by or for the account of the Central Bank; (iii) convertible foreign exchange notes; (iv) credit balances in convertible foreign exchange—including SDRs—on the books of foreign central banks or other financial institutions; (v) liquid debt securities issued by the government and the central bank of the country on whose currency the securities are denominated; and (vi) officially

³ In the case of both positive and negative targets on net bank claims on general government, upward means resetting of the target to an arithmetically bigger number, whereas downward means resetting of the target to an arithmetically smaller number.

- guaranteed forward and repurchase contracts of different types providing for future payments in convertible foreign exchange by nonresidents. Excluded are (i) assets in nonconvertible currencies; (ii) any assets that are pledged, collateralized, or otherwise encumbered; (iii) claims on residents; and (iv) foreign exchange claims arising from derivatives in foreign currencies vis-à-vis domestic currency.
- ***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, (b) accumulated profits of the CBBH since the beginning of its operation on August 11, 1997, (c) shares, (d) other reserves.
 - ***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.⁴

⁴ At end-April 2009, one SDR unit was equal to 1.1283 euro, or to 1.4978 U.S. dollars.

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 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 45 days as defined in BiH organic Budget law, 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 20-29 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.
- ***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 than 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.

Table 1. Bosnia and Herzegovina: Performance Criteria Under the 2009–12 Stand-By Arrangement, 2009
(In millions of KM)

	End-year stock	Cummulative flow within the calendar year				
	2008	2009				
	December	June	September	Dec		
	Actual	Actual	Program	Actual	Program	Actual
Ceiling on accumulation of net credit of the banking system to: ¹						
General government	-2,338	261	476	156	676	309
<i>of which:</i>						
State government	-412	-89	44	-69	44	-30
RS government	-1,109	285	424	398	536	523
Federation government	-737	86	15	-161	108	-191
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
Ceiling on accumulation external debt service arrears ²	...	0	0	0	0	0
Ceiling on contracting new short-term external nonconcessional debt ²	...	0	0	0	0	0
Ceiling on accumulation of domestic arrears of: ²						
State government	...	0	0	0	0	0
RS government	...	0	0	0	0	0
Federation government	...	0	0	0	0	0

¹ Cumulative within each calendar year. Equal to the sum of the three listed sub-ceilings plus the net bank credit to the District of Brčko, which is not monitored individually due to its small size.

² Continuous.

Table 2. Bosnia and Herzegovina: Performance Criteria Under the 2009–12 Stand-By Arrangement, 2010
(In millions of KM)

	Stock	Cumulative flow since the beginning of the referenced year			
	2009	2010			
	December	March	June	September	December
	Actual	Program	Program	Ind target	Ind target
Ceiling on accumulation of net credit of the banking system to: ^{1,2}					
General government	-2,029	333	580	759	845
<i>of which:</i>					
State government	-442	20	-11	75	122
RS government	-586	251	429	564	638
Federation government	-928	61	164	122	91
Ceiling on new guarantees and the assumption of enterprise debt to banks by the State, Federation and RS governments ³	...	0	0	0	0
Ceiling on accumulation external debt service arrears ³	...	0	0	0	0
Ceiling on contracting new short-term external nonconcessional debt ³	...	0	0	0	0
Ceiling on accumulation of domestic arrears of: ³					
State government	...	0	0	0	0
RS government	...	0	0	0	0
Federation government	...	0	0	0	0

¹ Equal to the sum of the three listed sub-ceilings plus the net bank credit to the District of Brčko, which is not monitored individually due to its small size.

² The targets on banking system net claims the general government will be adjusted upward (downward) by the full amount of any shortfall (surplus) in programmed disbursements of budget support loans and grants; and will also be adjusted upward (downward) by the amount by which reported change in float is arithmetically smaller (greater) than its targets in the fiscal program. The upward adjustment is limited to 10 percent of the absolute value of the respective change-in-float target (see Technical Memorandum of Understanding on Definitions and Reporting Under the 2009–12 Economic Program).

³ Continuous.

Table 3. Bosnia and Herzegovina: Performance for the First Review under the 2009–12 Stand-By Arrangement

	Target date	Status
I. Quantitative performance criteria		
1. Ceiling on accumulation of net credit of the banking system to:	December 2009	
general government		observed
State government		observed
RS government		observed
Federation government		observed
2. Ceiling on new guarantees and assumption of enterprise debt to banks by the State, Federation and RS governments	December 2009	observed
3. Ceiling on accumulation of external payment arrears	December 2009	observed
4. Ceiling on contracting new short-term external nonconcessional debt	December 2009	observed
5. Ceiling on accumulation of domestic payment arrears	December 2009	
State government		observed
RS government		observed
Federation government		observed
II. Current Structural Benchmarks		
A. Continued adherence of the Currency Board Arrangement as constituted under the law	continuous	observed
B. Fiscal Sector		
1. Approve the rebalanced budgets by the Entity Parliaments	end-August 2009	observed
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	observed with delay
3. Submit to the Parliament a Law forbidding passing of unfunded legislation (Federation)	end-November 2009	observed with delay
4. Publish on the State government's web site quarterly consolidated general government accounts with a 5 week lag	continuous	observed partially, with delay
C. Financial Sector		
1. Form a standing committee of financial stability and sign the MoU on financial stability, crisis preparedness and crisis management	end-November 2009	observed with delay
2. The Deposit Insurance Agency to impose a principle of universal membership requirements, including for partially state-owned banks	end-February 2010	observed
III. Proposed New Conditionality		
Prior Actions		
1. Approve by State and Entity Parliaments 2010 budgets consistent with the program, including supporting legislation		met
2. Enact by Entity Parliaments framework legislation in preparation for the transition to a means-tested system of rights-based benefits (Federation, RS)		met
3. Enact law to eliminate special unemployment benefits granted to demobilized soldiers effective May 1, 2010 (Federation)		met
Structural Benchmarks		
1. Carry out eligibility audits for civil and war benefit recipients; publish results (quarterly within 4 weeks after the end of each quarter) of audits, including expected savings from disqualifications (Federation, RS)	continuous	
2. Adopt by Parliament wage legislation consistent with the 2010 fiscal policy objectives (Federation)	end-March 2010	
3. Reform privileged pensions by entity governments (Federation, RS)	end-March 2010	
4. Prepare a strategy for pension reform by entity governments (Federation, RS)	end-March 2010	

Table 4. Bosnia and Herzegovina: Net Claims of the Banking System on the General Government, as of December 31, 2009

(In millions of KM)

Position	Stock
Total net bank claims on the general government ((1) + (2))	-2,029
(1) Central bank claims on general government (net)	-398
Claims	0
State government	0
FBiH government ¹	0
RS government ²	0
District Brcko	0
Deposits	398
On-balance sheet deposits in KM ³	50
State government ⁴	48
FBiH government ¹	2
RS government ²	0
District Brcko	0
Off-balance sheet deposits in foreign currency	347
State government ⁵	347
FBiH government	0
District Brcko	0
(2) Commercial bank claims on general government (net)	-1,632
Claims	346
State government	1
FBiH government ¹	36
RS government ²	303
District Brcko	6
Deposits	1,978
State government	48
FBiH government ¹	962
RS government ^{2,6}	890
District Brcko	78

Source: CBBH.

¹ Includes FBiH central government, cantons, municipalities, road fund, and social funds.² Includes RS central government, municipalities, road fund, and social funds.³ Excludes on-balance sheet accounts at CBBH used for safekeeping on behalf of State and Entity governments of the proceeds from sale of general and special SDR allocations.⁴ The deposits of the State government, as reported by CBBH, are adjusted to exclude the deposits of the Indirect Tax Administration (KM 33.65 million at end-September, 2009).⁵ Excludes the off-balance sheet account at CBBH used as a pass-through account for external debt servicing on behalf of Entity governments; and the off-balance sheet account at CBBH used for safekeeping on behalf of State and Entity governments of succession funds from the distribution of rights, obligations, assets and liabilities of the former Socialist Federal Republic of Yugoslavia among successor states.⁶ The deposits of the RS government are adjusted to exclude the deposits of investment funds managed by the RS Development Bank. Whereas the latter is not included in the definition of general government, some banks report the deposits of these investment funds as part of net bank credit to government. At end-September 2009, the amount of excluded deposits stood at KM 33.78 million.

Table 5. Bosnia and Herzegovina: Data Reporting Requirements under the 2009 SBA

Data series	Data frequency	Periodicity of data reporting	Timeliness of data reporting
I. Daily data reporting	Daily	Weekly	Up to 14 working days after the end of each week, unless noted
1 Gross international reserves			
2 CBBH foreign exchange purchases and sales			
II. Monthly data reporting	Monthly	Monthly	Up to 4 weeks after the end of each month, unless noted otherwise
1 The balance sheet of the CBBH.			
2 The commercial bank survey and monetary survey			
3 Weighted average interest rates by bank and by type of loans			
4 Banking sector credit to the general government (by level of			
5 Government deposits in the banking sector			
6 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.			
7 ITA revenues.			
8 New external loans contracted or guaranteed by governments.			
9 Report on inflows into and outflows from escrow accounts (FBiH,			
10 Transfers to the Entity Development Banks from the Entity central governments.			
III. Quarterly data reporting	Quarterly	Quarterly	Up to five weeks after the end of each quarter, unless noted
1 Banking supervision: financial soundness indicators			
2 Banking supervision: bank-by-bank commercial banks' summary balance sheets and income statements and prudential data on loan quality, liquidity, and exposures ¹			
3 Revenues, expenditures and financing data for municipalities (in both entities), and cantons (in the Federation), and Brcko District			
4 Revenues, expenditures and financing data for the road funds in both entities			
5 Revenues, expenditures and financing data for the extrabudgetary funds (pension funds, health funds, unemployment funds and (in the RS) the children's fund)			
6 Revenues, expenditures and financing data for consolidated BiH, consolidated FBiH, consolidated RS			
7 Financial statements of the RS Investment and Development Bank			
8 External debt service projections for current year; total, by creditor, by level of government, and in original currency			
9 Newly issued government guarantees on external and domestic loans contracted by public and private entities			
10 Newly contracted government external loans and degree of concessionality (grant element); total, by creditor, by purpose (project/budget support), original currency, and maturity			
11 External debt service payments (interest, amortization) by level of government			
12 External loan and grants disbursements; by creditor, by level of government, by purpose (project/budget support) and original currency			
13 Stock of external debt for public sector, private nonbank sector, and banking sector			
14 Net exposure to BiH of foreign bank groups participating in the European Bank Coordination Initiative for BiH ²			
15 Stock of domestic government debt outstanding (by level of government, type of obligation, and holder (bank and non-bank sectors)); projected domestic government debt interest and amortization payments (by level of government, type of obligation, and holder)			
16 End-period stock of outstanding arrears and float during the reference period by creditor and type of expenditure (wages, social benefits, pension, goods and services, etc.)			
17 Number of demobilized soldiers receiving unemployment benefits (by canton), and amounts paid			

¹ Up to six weeks after the end of each quarter

² Upon request within eight weeks