Bosnia and Herzegovina: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

September 11, 2012

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.
Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  

Dear Ms. Lagarde:

1. The economy of Bosnia and Herzegovina (BiH) was hit hard by the global financial crisis. The currency board arrangement (CBA) and fiscal restraint as well as multilateral financial support including under the 2009 Stand-By Arrangement (SBA) with the IMF mitigated the adverse impact of the crisis and helped maintain macroeconomic stability and public confidence.

2. In recent months, the slow post-2009 economic recovery has stalled amid intensified stress in the euro area, which has also contributed to a loss of international reserves. Together with underlying imbalances in our domestic economy, these developments have raised concerns about macroeconomic stability and BiH’s growth prospects. In response, the Institutions of BiH, Federation and Republika Srpska governments and the Central Bank of Bosnia and Herzegovina (CBBH) have developed an economic program to safeguard macroeconomic stability and support sustainable growth over the medium term.

3. Our economic program, for which we are seeking IMF support, is designed to counter the effects of the worsening external environment and reduce domestic vulnerabilities. It provides a roadmap in a difficult economic and financial environment and should give confidence to the population, business community and investors by signaling our resolve to improve policy coordination, maintain fiscal discipline, safeguard financial sector stability, and improve the business environment.

4. Under the program, we will: (i) reduce the fiscal deficit and improve medium-term fiscal sustainability; (ii) enhance the role of the Fiscal Council in fiscal policy coordination; (iii) implement agreed fiscal reforms; (iv) improve crisis preparedness and contingency planning; and (v) promote structural reforms to enhance external competitiveness.

5. In support of these policies and based on our balance of payments needs, we request IMF support through an SBA in the amount equivalent to SDR 338.20 million (200 percent of quota) for the period September 2012 through September 2014.
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. During the period of the arrangement, we will consult in advance with the IMF on the adoption of any new measures in accordance with the IMF’s policies on such consultations. Further, we will provide the IMF with such information as it requests on policy implementation and achievement of the program objectives.

I. Macroeconomic Framework

Economic conditions have deteriorated in recent months. The global slowdown and tighter financing conditions cloud BiH’s growth outlook, with real GDP likely to stay flat this year and to grow by mere a 1 percent in 2013. With sluggish credit to the economy domestic demand will be subdued, thus limiting CPI inflation to about 2 percent during 2012−13. Despite a deceleration of imports the external current account deficit is expected to remain relatively large (7.5 percent of GDP). With limited access to private financing, external financing requirements will need to be met in large part by drawing on official resources.

II. Improving National Policy Coordination

We are committed to maintaining the Currency Board Arrangement as constituted by law (structural benchmark). The CBA remains the strongest guarantee of macroeconomic stability and enjoys broad political and public support. The CBBH is prohibited from extending credit to the government, from issuing central bank securities, and from granting credit to banks and any other private agents. Mindful of the importance to maintain public confidence in the stability of the convertible marka, we will refrain from legislative actions that would weaken, or cast doubt on, the current arrangement and the institution entrusted with its operation—the CBBH.

We are committed to preserving the integrity of the national system of indirect taxation. We will continue collecting indirect taxes at the BiH level and maintain the single account of the Indirect Taxation Authority (ITA). We will strive to ensure its continued effectiveness by working together in a constructive and timely manner to resolve any contentious issues. In particular, on August 31, 2012 we adopted a decision on the settlement of all disputed amounts through end-2011 (prior action) and we will settle them by end-2012. To reduce the size of the required settlement in the future, we will reset the allocation coefficient between entities on a quarterly basis and accelerate the verification of any disputed claims.

We will take steps to improve tax compliance. The large informal economy has been undermining tax revenue collection and placing a disproportionate burden on the formal sector, calling into question the fairness of the tax system. To improve compliance, we will strengthen cooperation among tax administrations by formalizing information exchange. As
the first step, the ITA and Entity tax administrations will sign a memorandum on cooperation and sharing of taxpayer information.

11. **The interruption in servicing foreign debt obligations experienced in early 2012 will not be repeated.** We are putting in place safeguards to avoid any risks in this respect. The Council of Ministers has approved an amendment to the law on financing of the Institutions of BiH to allow for continued servicing of foreign debt even in the absence of an adopted budget. We will have it approved by Parliament by end-2012 (structural benchmark).

12. **We will take steps to enhance statistics by removing any impediments to information sharing.** Specifically:

- We will amend the relevant ITA laws, particularly Article 52 of the “Law on Indirect Taxation Procedure” published on the Official Gazette of BiH No. 89/05 to allow the Entity statistical agencies and the Agency for Statistics of Bosnia and Herzegovina (BHAS) to access ITA’s foreign trade and VAT data.

- The Entity statistical agencies and the BHAS will strengthen data sharing and cooperation by agreeing on modalities of data exchange.

- We recognize the importance of the Government Finance Statistics compliant with the GFS2001 manual for both program monitoring and official statistics reporting purposes. To that end, all levels of government in BiH will continue to provide all necessary information to the CBBH required for timely compilation of a full set of GFS statistics of BiH.

### III. Maintaining Fiscal Discipline

13. The large financing gaps and the existing structural fiscal deficit make a case for fiscal adjustment. We will exercise firm control over current expenditure, while protecting transfers to the most vulnerable population groups and spending on infrastructure.

14. We will limit the 2012 general government deficit to about 3 percent of GDP. The budget for the Institutions of BiH, which was approved by the BiH Parliament in May 2012, is appropriately restrictive. The central Entity governments prepared rebalanced budgets, consistent with policy commitments in this Letter, and had those budgets adopted by Parliaments in early September (prior action). We recognize that there are downside risks to our budgets, and we stand ready to take compensatory measures, if needed.

15. On the revenue side, we will continue the step increase in excises on tobacco products as prescribed in the law. The EU’s decision to raise the minimum excises on tobacco products has enlarged the gap between BiH and the EU minimum. We will amend the current law, and raise the excises on tobacco products to the EU minimum in order to harmonize our excises with EU legislation over time.
16. On the expenditure side:

- The 2012 budget for the Institutions of BiH envisages limited new employment, mainly related to the census, local elections and strengthening the capacities of the anti-corruption agency; a 4.5 percent reduction in base wage effective May 2012, except for those employees whose wage coefficient is 1; and a 12 percent reduction in employee allowances. Total current expenditure (which includes employee compensation and spending on goods and services) will be limited to 1.5 percent below the 2011 execution. In 2013, Institutions of BiH will maintain the number of employees at the 2012 level.

- In the Federation, the central government will continue to exercise fiscal restraint and will: (i) generate savings of KM 8 million in the compensation of employees; this will be achieved by setting the base for calculation of wages and allowances to KM 315, which will be maintained throughout 2012; a moratorium on payment of allowances for work in committees and for overtime work; and through a restrictive employment policy for the remainder of the year; (ii) re-assess the effectiveness of subsidies and improve their targeting, thus saving KM 10 million; (iii) expedite the eligibility audits of beneficiaries; (iv) ensure that the budgeted allocation of the transfer to the Pension Fund will not be exceeded; this will be achieved by lowering the highest payment coefficient for pensions under favorable conditions and by stepping up the collection of overdue contribution obligations; (v) exercise strict expenditure control and put in place measures to ensure the stability of the Health Fund by adjusting the scope of the health protection program to the available funding and avoid accumulation of arrears; (vi) reduce transfers to public enterprises by KM 17 million.

- In Republika Srpska (RS), the central government will continue to exercise fiscal restraint and freeze hiring for the remainder of this year, except in education; and will generate savings in: (i) goods and services of KM 6.9 million; (ii) transfers to social institutions of KM 8 million; (iii) transfers to other levels of government of KM 1.1 million; and (vi) Health Fund (FZO) financial plan in the amount of KM 5 million. Also, we will generate savings in goods and services in municipality and city budgets of KM 5 million. Moreover, operations funded by the escrow account will be reduced by KM 35 million.

17. All governments are committed to maintaining fiscal discipline over the medium term. We therefore intend to continue consolidation in 2013, through a further reduction in the consolidated general government deficit to around 2½ percent of GDP. Fiscal efforts will continue to be concentrated on the expenditure side, which will benefit from the full-year impact of the measures undertaken this year and from the structural fiscal reforms outlined below.
IV. Advancing Public Sector Reform

18. We are committed to carry out structural fiscal reforms to make the expenditure reduction in 2012 permanent and to return public finances to a more sustainable path. We have already adopted the “Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina” for 2013–15. This Framework will provide the basis for the preparation of the budgets of the Institutions of BiH and the Entities for 2013. In addition, the role of the Advisory Group of the Fiscal Council will be enhanced with the task of coordinating all issues related to program implementation and monitoring.

Institutions of BiH

- We have amended the Law on Service in the Armed Forces of BiH, repealing the provisions that grant eligibility for early retirement of army personnel. This amendment does not compel the Entity governments to provide same or similar benefits. All the obligations under the original law through end-May 2012 have been provided for in the 2012 budget of the Institutions of BiH. Payments of these obligations will be made during 2012 once the Ministry of Defense establishes the exact amounts of the individual entitlements (structural benchmark).

Federation of BiH

- We will draft a law on retirement under favorable conditions and submit it to parliament by end-October 2012 for adoption by end-2012. This law will reform privileged pensions in a comprehensive way, including aligning the average level of these pensions with the one of contributory pensions, and limiting the payout of these pensions to available funds in the budget through the application of a rationing coefficient for all pensions under favorable conditions. Until this law comes into force, we will not grant any new or additional special retirement benefits (structural benchmark).

- By end-2012 the government will adopt a strategy for a comprehensive pension reform.

- The government has adopted a decision on the settlement of central government debt to the Pension Fund, which will be done in equal annual payments over the next ten years beginning in 2013. This will be reflected in a law to be submitted to Parliament by end-August 2012.

- We will expedite the process of eligibility audits of war disability beneficiaries and publish results on a quarterly basis (structural benchmark), and complete the process by end-2014. In the meantime, we will explore ways to improve targeting of these benefits.
• We will establish a centralized database of all beneficiaries of social transfers, operated by the Federation Taxation Authority. This will facilitate the tracking and auditing of such benefits, yielding savings going forward. We plan to have this operational by end-2012.

• We will reach an agreement with representatives of the trade unions on the settlement of government employees’ lawsuits arising from the 2009 and 2010 cuts in wages and allowances by end-August 2012. This agreement will, inter alia, include amendments to the collective agreement to prevent lawsuits in the future.

• The government recognizes the need to amend the budget process to ensure that approved legislation is backed by sufficient financial resources and the fiscal spending will not jeopardize medium-term fiscal sustainability. To this end, we are working toward a new law that will, inter alia, include penalty clauses for undertaking commitments in excess of budget allocations. We plan to submit the draft to parliament by end-2012.

• Given the decentralized structure in Federation, expenditure control in lower levels of governments is key to safeguarding fiscal sustainability. To this end, we will aim to finalize the introduction of treasury systems at lower levels of government by end-2013, and link them to the central government treasury system. This will also improve the reporting system at all levels of governments.

• We recognize the urgency of safeguarding the financial soundness of the Health Fund. We will exercise strict expenditure control to secure its financial soundness. We have adopted a consolidation plan to ensure that the health protection program is consistent with the financial plan and that contracts with health providers are in line with the program.

**Republika Srpska**

• We will aim to reduce the wage bill as a share of GDP over the medium term by reforming public administration and maintaining a prudent wage policy. To achieve this, we will:

  ➢ As the first step, freeze the compensation of employees in 2013–14 at the 2012 level.

  ➢ Adopt a Law on Wages and Salaries of Public Service Employees (Pension and Disability Insurance Fund, Health Insurance Fund, Child Protection Fund and Employment Fund) to ensure that wages and salaries of employees in extrabudgetary funds will be at the same level in all the funds, while being aligned with wages and salaries of employees in the public administration. We plan to have the law adopted by end-2012 and to enter into force as of January 1, 2013.
Amend and supplement the Law on Wages and Salaries of Employees in the Public Administration of Republika Srpska (Official Gazette of Republika Srpska, nos. 118/07, 116/09, 1/11 and 1/12) to prescribe similar coefficients for all employed civil servants and government employees, depending on the complexity of their respective tasks. We plan to have the law adopted by end-2012 and to enter into force as of January 1, 2013.

Amend the Law on Salaries and other Allowances of Judges and Prosecutors in Republika Srpska (Official Gazette of Republika Srpska, nos. 115/05, 30/07 and 118/07) to abolish those provisions of the law related to linking the wage growth with the growth of average monthly net wage in BiH. We plan to have the law adopted by end-2012 and to enter into force as of January 1, 2013.

Introduce a centralized payroll system for employees in the public sector, in order to set up a system for recording, controlling and improved planning at the level of the public sector. It is expected that the implementation process will start in July 2013 and be fully implemented as of July 2014.

Review the operations of agencies with the objective of making savings, revisit the rationale for their existence, as well as the manner of their organization and operation in the future. Depending on the outcome of this process, we will consider merging or abolishing some agencies which have not yielded the desired results. We plan to have this process completed by end-2012.

Amend the relevant legislation to ensure that changes in the statutory income tax rates and contributions do not automatically lead to changes in the gross pay of civil servants and employees, thus eliminating the take-home pay protection.

We plan to amend the Budget System Law so as to introduce penalty clauses for undertaking commitments that exceed the level of budget allocations. The deadline to amend the law is end-2012 with the enforcement date set to January 1, 2013.

We have enacted two important laws on pension and disability insurance and war-veteran benefits. These laws separate the benefits based on past contributions from those arising from special conditions. This progress will not only improve budget transparency, but also allow the Ministry of Veteran Affairs to redouble its effort in tightening eligibility criteria and expedite audits of beneficiaries. We intend to publish the quarterly audit results (structural benchmark), and complete the review of eligibility rights by end-March 2013. Following the audits, we will explore ways to improve targeting of these benefits.

The newly enacted law on pension and disability insurance aims to ensure long-term sustainability of the public pension system and improve its fairness. We will closely
monitor how well these two objectives are being met and stand ready to consider modifications to the system if necessary.

- We recognize the urgency of improving the financial soundness of the Health Fund (FZO). To achieve this, we intend to enhance expenditure control through intensified work of the internal audit department in the FZO and health institutions. In addition, the internal audit department will develop and strengthen financial management system and internal control procedures. Introduction of “e-health card” will enable additional savings in the FZO. The FZO will appoint new committees and improve assessments of working ability to eliminate misuse of sick leave. We will rationalize employment in the FZO. We will take steps to reduce health care treatment costs abroad. The Ministry of Health and Social Protection and the FZO will work together to optimize the scope of the health care system.

19. We understand that the unfavorable economic situation and our adjustment program could adversely affect the vulnerable groups of our population. Thus, we will ensure that public financial support for households is better targeted toward the most vulnerable groups, and that financial integrity of public pension and unemployment insurance schemes is not jeopardized.

V. Safeguarding Financial Sector Stability

20. The banking system in BiH weathered the impact of the global financial crisis well. Supported by the 2009 SBA, we swiftly responded to the crisis and adopted measures to shore up confidence in the system and ensure the health of our banking sector. We lowered bank reserve requirements to boost liquidity, established the Standing Committee for Financial Stability (SCFS) to monitor vulnerabilities and enhanced crisis preparedness, and increased deposit insurance coverage.

21. While our banking system has remained stable recently, the uncertain financial situation abroad and domestic economic vulnerabilities have created challenging conditions. Against this backdrop, nonperforming loans (NPLs) have risen substantially and now stand at 12.1 percent of total loans. Moreover, foreign parent banks have reduced their exposure to BiH over time, thus limiting the availability of long-term funding sources for our banks.

22. Therefore, we will adopt necessary measures to further strengthen our financial system as well as to enhance our crisis preparedness and institutional capacity to monitor financial stability. We will proceed gradually toward risk-based supervision and Basel II/III implementation. As the first step, we are establishing working groups to design the conduct of bottom-up stress tests for large banks to be done on a regular basis.

23. The high level of NPLs in BiH’s banks represents a key vulnerability of our financial system with important negative effects for economic activity. To tackle this vulnerability, we
will review our legal and regulatory frameworks, seeking cooperation from financial sector participants, with a view to creating an environment conducive to NPL resolution. In this respect, we will adopt Entity laws on factoring and agencies for the repurchase of claims, which would regulate the transferring of a portion of the banks' loan portfolios to a separate legal entity and tax treatment of such transactions.

24. In close collaboration with IMF staff we reviewed our crisis preparedness and contingency planning frameworks and identified a number of areas where action is required. We will strengthen the role of the SCFS in timely monitoring financial sector risks, by having regular quarterly meetings and additional ad hoc ones as necessary. Furthermore, each member of the SCFS will prepare contingency plans, including technical requirements, to be rolled into a comprehensive contingency plan for financial stability. We will strengthen the bank resolution framework by amending both banking laws by end-2012 to set the legal expiration date for provisional administration to one year with a possible six month extension (structural benchmarks).

25. We are committed to further enhancing the resilience of the system and coordination among agencies. The CBBH together with the Banking Agencies will continue to review periodically the stress test results with individual banks, and to monitor the exposure of foreign parent banks vis-à-vis BiH. In this context, coordination of the stress tests will be further formalized with the signing of the “Internal Guidelines on Stress Testing,” with a view to ensuring the credibility, objectivity, and timeliness of top-down stress tests.

26. The Banking Agencies have strengthened their cooperation with foreign home supervisors including through their participation in colleges of supervisors. We will remove remaining impediments to signing bilateral Memoranda of Understanding with Austria’s and Italy’s banking supervisors. We are amending the legal frameworks related to the treatment of confidential information in order to align them with EU requirements, and plan to have these approved by the parliaments by end-2012 (structural benchmark).

27. Public confidence in the banking system is of paramount importance to financial stability. In this context, institutional independence of the Banking Agencies will be respected. To this end, we repealed the amendments to the Federation Banking Agency Law, Articles 15 and 27, that were adopted in 2012 (prior action).

28. To strengthen the role of deposit insurance in our financial system, we are revising the law governing our Deposit Insurance Agency (DIA), including along the following lines: (i) the DIA will cover those most in need of protection by extending coverage to small- and medium-sized enterprises; (ii) all BiH banks will be members of the DIA, including those that may fall under provisional administration subsequent to the adoption of the new law; and (iii) Article 18 related to governance of the DIA will be amended to ensure compliance with international standards. We will submit the revised DIA law to the BiH Parliament by end-March 2013 (structural benchmark).
VI. Improving the Business Environment

29. BiH’s recovery will not be possible without a vigorous private sector. Improving the business environment will encourage private investment and support long-term growth and contribute to improved market sentiment. We have made some progress in streamlining procedures and creating transparency regarding business regulation, but much more remains to be done. Specifically:

- In the RS, we will implement a “one-stop-shop” registration system. This involves removing the registration of companies from the economic courts and entrepreneurs from the municipalities, simplifying and combining the steps needed, and concentrating the whole procedure at a single institution. The realization of the project requires an amendment of 21 laws, and will be concluded by end-2013.

- In the Federation, we will reduce the administrative burden on business, ensure efficient organization and simplify administrative procedures related to export-import operations, establish and strengthen the quality assurance system, support export growth in key areas and enhance competitiveness of the agriculture sector, as well as continue work to create more favorable environment for domestic and foreign investments. In this regard, we will follow up on the steps we have already taken in partnership with the IFC to simplify the regulatory environment and improve administrative capacity for dealing with business operations, and we will aim to fully implement the remaining IFC recommendations.

VII. Data Issues

30. We recognize the importance of improving the quality of statistics. The BHAS and the two Entity Statistics Agencies commit to reconcile the expenditure and production GDP data and publish them in a timely manner. Furthermore, all three Statistics Agencies, with assistance from the IMF regional resident TA advisor, will accelerate the development of quarterly GDP data, aiming at the first publication of the historical time series by mid-2013. In addition, we intend to make every effort to improve necessary capacity, so as to participate in the IMF’s general data dissemination system (GDDS). As the first step, we will appoint a country coordinator by end-September 2012.

31. We have made important progress in improving the quality of fiscal statistics, including a gradual introduction of the harmonized fiscal reporting template (HRT), jointly developed with IMF staff. We will continue the publication of consolidated general government fiscal data according to the HRT on a quarterly basis (structural benchmark). At the same time, we are mindful of the significant gaps in the quality of published data, due to incomplete coverage of off-budget spending and foreign-financed projects, partial implementation of accrual accounting, and long delays in reporting by lower levels of government, particularly in the Federation. To address these weaknesses,
• we will apply international accounting standards and adopt the HRT together with reporting deadlines at all levels of government and formalize the procedure for publication of consolidated reports.

• we will broaden the coverage of reporting on fiscal execution to include foreign-financed projects and off-budget spending in general government fiscal accounts.

• we will continue to improve data collection, and reconciliation of external grants and loan disbursements, and external debt service.

• the Federation Ministry of Finance will strengthen the staffing and capacity in the area of monitoring and consolidating financial reports from lower level governments and funds. The objective is to prepare consolidated reports of fiscal operations at the level of the Federation general government by end-2012.

VIII. Program Modalities and Other Issues

32. The program will be monitored through quarterly (and continuous) quantitative performance criteria, indicative targets, prior actions, structural benchmarks, quarterly reviews and consultation clauses. Quantitative performance criteria for 2012 and indicative quantitative targets for 2013 are set out in Table 1; and prior actions and structural benchmarks are set out in Table 2. The understandings between the authorities of BiH and IMF staff regarding the quantitative performance criteria and indicative targets are further discussed in the attached Technical Memorandum of Understanding (TMU).

33. IMF resources under the arrangement will be disbursed to the central bank, and credited to an account of the Institutions of BiH, earmarked for the budgets of Federation of BiH and Republika Srpska on the 2/3:1/3 split. Upon the approval of the arrangement by the IMF Executive Board, we plan to draw the whole available amount of SDR 50.73 million (30 percent of quota) to support the Entity budgets. The first review of the program is expected to take place on or after December 15, 2012.

34. We recognize the importance of completing a safeguards assessment by the first review of the SBA. In this regard, the CBBH will provide as soon as feasible the necessary documentation required for completing such an assessment and receive a safeguards mission from the IMF as necessary.
Vjekoslav Bevanda
Chair
of the Council of Ministers
Bosnia and Herzegovina

Nermin Nikšić
Prime Minister
Federation of Bosnia and Herzegovina

Aleksandar Džombić
Prime Minister
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Nikola Špirić
Minister of Finance
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Ante Krajina
Minister of Finance
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Zoran Tegeltija
Minister of Finance
Republika Srpska

Kemal Kozarić
Governor
Central Bank of Bosnia and Herzegovina
1. This Technical Memorandum of Understanding (TMU) sets out the understanding between the authorities of Bosnia and Herzegovina and the IMF mission regarding the definitions of quantitative performance criteria and indicative targets for the Stand-By Arrangement (SBA) (Tables 1) as well as data reporting requirements for program monitoring (Table 3).

I. PERFORMANCE CRITERIA AND INDICATIVE TARGET

2. In the following definitions, the end-quarter test dates apply to the last working day of each quarter.

3. The definitions of all fiscal variables contained in this TMU are based, unless otherwise specified, on the IMF’s Manual on Government Finance Statistics 2001.

A. Floor on the Net Lending of (i) the Institutions of Bosnia and Herzegovina, (ii) Central Government of the Federation of Bosnia and Herzegovina, and (iii) Central Government of the Republika Srpska (Performance Criteria)

Definitions

4. The Institutions of Bosnia and Herzegovina is defined to comprise all spending units depending on its budget. The central government of the Federation of Bosnia and Herzegovina is defined to include all spending units depending on its budget whether these units are included or not in the treasury system. The central government of the Republika Srpska includes all spending units depending on its budget whether these units are included (entirely or partially) or not in the treasury system, and the operations funded by escrow accounts.

5. Net lending is defined as revenue minus expenditure.

Application of performance criterion

6. Program targets will be individually monitored quarterly through the respective accrual balances and measured as the cumulative change from the level existing on December 31 of the previous year.

7. For the purposes of program monitoring, compliance with the floor on the net lending will require that each of the three above-defined floors be observed independently.
**Adjustors to performance criterion**

8. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.

9. The floor on the net lending will be adjusted upward by the full amount of any shortfall in programmed disbursements of budget support loans. Program budget support disbursements are defined as external disbursements from official creditors (e.g., World Bank and European Commission) used for financing of government budget deficits.

**Reporting requirements**

10. Data on monthly execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the respective Entities and no later than five weeks after the end of each month (six weeks for end-year numbers). The Ministry of Finance of the Institutions of BiH will provide monthly data on revenue and expenditure no later than five weeks after the end of each month (six weeks for end-year numbers) and quarterly data on financing no later than six weeks after the end of each quarter.

**B. Floor on the Net Lending of the General Government of Bosnia and Herzegovina (Indicative Target)**

**Definitions**

11. *The general government of Bosnia and Herzegovina* is defined to include the Institutions of Bosnia and Herzegovina, and the general governments of Federation of Bosnia and Herzegovina Entity (Federation), Republika Srpska Entity (RS), and the District Brcko. The *Federation general government* is defined to include the central government, the cantonal governments, the municipal governments, the federal and cantonal extrabudgetary funds and the road and highways funds. The *RS general government* is defined to include the central government, the municipal governments, the extrabudgetary funds and the road and highway funds. The *District Brcko* is defined to include the central government with all spending units depending on its budget and extrabudgetary funds. Extrabudgetary funds include, but are not limited to, pension funds, health funds, unemployment funds, and children's fund. Any new budgetary or extra budgetary fund, created during the program period will also be included in the definition of the general government. The BiH authorities will inform IMF staff of the creation of any such new funds. Any fund that uses public resources not included in the definitions above will be automatically allocated either to one of the entity general governments or to the Institutions of Bosnia and Herzegovina. The BiH authorities will promptly inform IMF staff of the existence of any of such funds.
12. The net lending of the General Government of Bosnia and Herzegovina is defined as revenue minus expenditure. The floor on the net lending of the General Government of Bosnia and Herzegovina will be defined, for each test date, as the cumulative change from the level existing on December 31 of the previous year.

Adjustors to indicative target

13. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.

14. The target will be adjusted upward by the full amount of any shortfall in programmed disbursements of budget support loans. Program budget support disbursements are defined as external disbursements from official creditors (e.g., World Bank and European Commission) used for financing of general government budget deficit.

Reporting requirements

15. Data on quarterly general government execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the respective Entities and District Brcko no later than six weeks after the end of each quarter.

C. Ceiling on Contracting or Guaranteeing of New Nonconcessional Short-Term External Debt by Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criterion)

Definitions

16. **Definition of debt.** The term “debt” is defined to include all current liabilities to non-residents, 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 Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH 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.

\(^1\) (No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, Decision No. 6230-(79/140), August 3, 1979, as amended by Decision Nos. 11096-(95/100), October 25, 1995, 12274-(00/85), August 24, 2000, and 14416-(09/91), August 31, 2009, effective December 1, 2009). 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.

\(^1\) See [Debt Limits in Fund-Supported Programs—Proposed New Guidelines 6230-(79/140)](http://example.com)
18. **New nonconcessional external debt** is defined as including all external debt (as defined above) contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH during the program period that is not on concessional terms.

19. **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). For short-term loans, the average CIRRs of the proceeding six-month period (plus a margin of 0.75 percent) will be used.

20. **Short-term external debt** is defined as external debt contracted or guaranteed with an original maturity of up to and including one year.

**Application of performance criterion**

21. The zero ceiling on contracting or guaranteeing new nonconcessional short-term external debt applies to obligations of the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, and CBBH. This criterion will be measured quarterly on the basis of end-of-quarter data.

**Reporting requirements**

22. Data on newly contracted or guaranteed nonconcessional short-term external debt will be provided by the Ministries of Finance of the Institutions of BiH and the respective Entities and by the CBBH on a quarterly basis within six weeks of the end of each quarter.

**D. Ceiling on the Accumulation of External Payments Arrears by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criterion)**

**Definitions**

23. **External payment arrears** are defined as overdue debt service arising in respect of debt obligations (as described above) incurred directly or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, and CBBH, except on debt subject to rescheduling or restructuring.

**Application of performance criterion**

24. The zero ceiling on accumulation of external payments arrears applies to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, or CBBH. This criterion will apply continuously.
25. 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.

26. Accumulation of new external payments arrears is prohibited under the program.

**Reporting requirements**

27. The Ministries of Finance of the Institutions of BiH and the respective Entities and the CBBH will inform Fund staff immediately of any accumulation of external payments arrears.

**E. Ceiling on the Accumulation of Domestic Arrears by the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska General Governments (Performance Criterion)**

**Definition**

28. The performance criterion established on the stock of domestic arrears contemplates a zero ceiling on the increase in the stock of domestic arrears compared with the stock as of December 31 of the previous year. The stock of domestic arrears is defined as the sum of payments obligations (accounts payable) past the due date stipulated by the contractual or legal payment period for each expenditure item and are nondisputed. They can arise on any expenditure item, including transfers to individuals, debt service, wages, pensions, energy payments and goods and services. Past-due payments obligations on inter-governmental transfers (i.e., transfers between Entity central governments and local governments, and extrabudgetary funds) are not included in the stock of arrears.

**Application of performance criterion**

29. The zero ceiling on accumulation of domestic arrears applies to obligations of the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska general governments. This criterion will be measured quarterly on the basis of end-of-quarter data. Thus, if at the end of any given quarter any of the three governments exceeds the zero ceiling on the change in the stock of its arrears compared with the stock of the same government’s arrears as of December 31 of the previous year, the performance criterion will be missed.

30. **Reporting requirements**: Data on domestic arrears will be transmitted on a quarterly basis by the Ministries of Finance of the Institutions of BiH and the respective Entities within five weeks of the end of each quarter.
II. OTHER DATA REPORTING REQUIREMENTS

31. The Bosnia and Herzegovina authorities will report the following data to the Fund within the time limits listed below (Table 3). In addition, the authorities will provide, no later than the fourth week of each quarter, a summary of key macroeconomic policy decisions taken during the previous quarter; a summary of regulatory changes in the area of banking and financial sector, report any amendments to the Entity and state budgets within a week after their government approval.

32. Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with necessary explanation. All data will be provided in an electronic form.

33. All magnitudes subject to performance criteria or indicative targets will be reported in millions of convertible marka.

34. 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: Quantitative Performance Criteria and Indicative Target Under the 2012–14 Stand-By Arrangement, 2012-13

(Cumulative flow since the end of the previous year; in millions of KM)

<table>
<thead>
<tr>
<th>Performance Criteria</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>End-September</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End-December</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End-March</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End-June</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End-September</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End-December</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Indicative targets</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Performance Criteria</strong></th>
<th><strong>Institutions of BiH</strong></th>
<th><strong>Federation central government</strong></th>
<th><strong>RS central government</strong></th>
<th><strong>Federation general government</strong></th>
<th><strong>RS general government</strong></th>
<th><strong>CBBH</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Floor on the net lending of 1/</td>
<td>10.7</td>
<td>38.3</td>
<td>4.0</td>
<td>60.9</td>
<td>13.9</td>
<td>-49.6</td>
</tr>
<tr>
<td>Ceiling on contracting and guaranteeing of new nonconcessional short-term external debt by</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- Institutions of BiH</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- Federation general government</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- RS general government</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ceiling on accumulation of domestic arrears by</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- Institutions of BiH</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- Federation general government</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- RS general government</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ceiling on accumulation external payment arrears by 2/</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- Institutions of BiH</td>
<td>0</td>
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<td>0</td>
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<tr>
<td>- Federation general government</td>
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<td>0</td>
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<tr>
<td>- RS general government</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>- CBBH</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Indicative target</strong></td>
<td><strong>Floor on the net lending of the general government of BiH</strong></td>
<td><strong>413.0</strong></td>
<td><strong>-237.6</strong></td>
<td><strong>-9.9</strong></td>
<td><strong>91.1</strong></td>
<td><strong>114.9</strong></td>
</tr>
</tbody>
</table>

1/ Excluding foreign financed projects as defined in TMU.
2/ Continuous.
Table 2. Bosnia and Herzegovina: Structural Conditionality

<table>
<thead>
<tr>
<th>Actions</th>
<th>Test date</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prior Actions for Board consideration of the arrangement</strong></td>
<td></td>
</tr>
<tr>
<td>Adoption by the Federation of BiH Parliament of a revised 2012 Federation budget, incorporating agreed measures</td>
<td></td>
</tr>
<tr>
<td>Adoption by the RS Parliament of a revised 2012 RS budget, incorporating agreed measures</td>
<td></td>
</tr>
<tr>
<td>Repeal of the amendments to the Federation Banking Agency law, Articles 15 and 27, that were adopted in 2012</td>
<td></td>
</tr>
<tr>
<td>Adoption of a decision on the settlement of any disputed indirect tax amounts through end-2011</td>
<td></td>
</tr>
<tr>
<td><strong>Structural benchmarks</strong></td>
<td></td>
</tr>
<tr>
<td>Continue to adhere to the Currency Board Arrangement as constituted under the law</td>
<td>Continuous</td>
</tr>
<tr>
<td>Refrain from introducing new privileged or special rights for retirement</td>
<td>Continuous</td>
</tr>
<tr>
<td>Publish on the web site of Institutions of BiH quarterly consolidated general government accounts with a 6 week lag.</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Carry out eligibility audits for war benefit recipients; publish results (quarterly within 4 weeks after the end of each quarter) of audits (Entities)</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Pay obligations accrued through May 2012 arising from early retirement provisions under the Law on Service in the Armed Forces of BiH</td>
<td>End-December 2012</td>
</tr>
<tr>
<td>Amend the law on financing of Institutions of BiH to allow for continued servicing of foreign debt in the absence of an adopted budget</td>
<td>End-December 2012</td>
</tr>
<tr>
<td>Amend the banking law in Federation to limit provisional administration to one year with a possible six month extension</td>
<td>End-December 2012</td>
</tr>
<tr>
<td>Amend the banking law in the RS to limit provisional administration to one year with a possible six month extension</td>
<td>End-December 2012</td>
</tr>
<tr>
<td>Amend the legal frameworks related to the treatment of confidential information to align them with EU requirements</td>
<td>End-December 2012</td>
</tr>
<tr>
<td>Submit to the BiH Parliament a revised law governing the Deposit Insurance Agency along the lines specified in ¶28 of the LOI</td>
<td>End-March 2013</td>
</tr>
</tbody>
</table>
Table 3. Bosnia and Herzegovina: Data Reporting Requirements under the 2012 SBA

<table>
<thead>
<tr>
<th>Data series</th>
<th>Data frequency</th>
<th>Periodicity of data reporting</th>
<th>Timeliness of data reporting (after the end of each reporting period)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Daily data reporting</td>
<td>Daily</td>
<td>Weekly</td>
<td>Up to 14 working days, unless noted otherwise</td>
</tr>
<tr>
<td>Gross international reserves</td>
<td>CBBH foreign exchange purchases and sales</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. Monthly data reporting</td>
<td>Monthly</td>
<td>Monthly</td>
<td>Up to 4 weeks, unless noted otherwise</td>
</tr>
<tr>
<td>Financial sector</td>
<td>The balance sheet of the CBBH</td>
<td>The commercial bank survey and monetary survey</td>
<td>Weighted average interest rates by bank and by type of loans</td>
</tr>
<tr>
<td>Debt service</td>
<td>New external loans contracted or guaranteed by governments.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. Quarterly data reporting</td>
<td>Quarterly</td>
<td>Quarterly</td>
<td>Up to five weeks, unless noted otherwise</td>
</tr>
<tr>
<td>Financial sector</td>
<td>Banking supervision: financial soundness indicators</td>
<td>Banking supervision: bank-by-bank commercial banks’ summary balance sheets and income statements and prudential data on loan quality, liquidity, and exposures</td>
<td>Net exposure to BiH of foreign bank groups participating in the European Bank Coordination Initiative for BiH</td>
</tr>
<tr>
<td>Government finances</td>
<td>Financing data for the State</td>
<td>Revenues, expenditures and financing data for municipalities (in both entities), and cantons (in the Federation), and Brcko District</td>
<td>Revenues, expenditures and financing data for the road funds and highway funds in both entities</td>
</tr>
<tr>
<td>Debt service</td>
<td>External debt service projections for current year; total, by creditor, by level of government, and in original currency</td>
<td>Newly issued government guarantees on domestic loans contracted by public and private entities</td>
<td>Newly contracted government short-term external loans and degree of concessionality (grant element); total, by creditor, by purpose (project/budget support), original currency, and maturity</td>
</tr>
<tr>
<td></td>
<td>External loan and grants disbursements; by creditor, by level of government, by purpose (project/budget support) and original currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Stock of external debt for public sector, private nonbank sector, and banking sector</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>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)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1/ Up to 6 weeks for end-year data.
2/ Up to 10 weeks for end-year data.